State of the Bangladesh Economy in FY2007-08 (*Second Interim)*

Paper 67

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The present paper titled **State of the Bangladesh Economy in FY2007-08: Second Interim** has been prepared under the CPD programme on *IRBD*. As a part of this programme CPD undertakes in-depth examination of various developments in the Bangladesh Economy, tracks movements of major macroeconomic variables, carries out analysis of national budget and studies the impact of various policies at macro and sectoral level. The outputs of the programme have been made available to all stakeholder groups including the government and policymakers, entrepreneurs and business leaders, and trade and development partners.

The paper has been prepared by the CPD IRBD Team 2008.

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The CPD-IRBD team alone remains responsible for the analyses and interpretations presented in this report.

CONTENTS

LIST OF TABLES, FIGURES AND BOXES

Tables

Figures

<u>Boxes</u>

ACRONYMS

ADP	Annual Development Programme
AfT	Aid for Trade
BB	Bangladesh Bank
BCIC	Bangladesh Chemical Industries Corporation
BEPZA	Bangladesh Export Processing Zones Authority
BGTB	Bangladesh Government Treasury Bond
BMET	Bureau of Manpower, Employment and Training
BPC	Bangladesh Petroleum Corporation
BPDB	Bangladesh Power Development Board
BRAC	Bangladesh Rural Advancement Committee
CPI	Consumer Price Index
CSE	Chittagong Stock Exchange
CTG	Caretaker Government
DAE	Department of Agricultural Extension
DAP	Di-Ammonium Phosphate
DF-QF	Duty Free-Quota Free
DSE	Dhaka Stock Exchange
EP	Essential Priority
EPZs	Export Processing Zones
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FFE	Food for Education
FFW	Food for Works
FM	Flour Mill
FPC	Fair Price Card
FY	Fiscal Year
GDP	Gross Domestic Product
GNI	Gross National Income
IDB	Islamic Development Bank
IFIs	International Financial Institutes
IMF	International Monetary Fund
IMO	International Maritime Organisation
IPOs	Initial Public Offerings
KAFCO	Karnaphuli Fertiliser Co.
LCs	Letter of Credits
LDC	Least Developed Countries
LEI	Large Employee Industries
MoA	Ministry of Agriculture
MoP	Muriate of Potash
MPS	Monetary Policy Statement
NCBs	Nationalised Commercial Banks
NPDA	New Partnership for Development Act
NSD	National Savings Directorate
OMS	Open Market Sale
OP	Other Priority
PDB	Power Development Board
PFDS	Public Foodgrain Distribution System
PKSF	Palli Karma-Sahayak Foundation
RMG	Readymade Garments
RRI	Real Rate of Interest
TR	Test Relief
TSP	Triple Super Phosphate
US	United States
US$	United States Dollar
VGD	Vulnerable Group Development
VGF	Vulnerable Group Feeding
WTO	World Trade Organisation

1. INTRODUCTION

Macroeconomic Situation at the Beginning of FY2008

Fiscal year 2008 started its journey in the backdrop of the moderately high growth rate of 6.51 per cent achieved in FY2007. Experience of FY2007 was unique in the history of Bangladesh in the sense that it saw three consecutive governments and declaration of a state of emergency. The new caretaker governments (CTG's) first six months coincided with the second half of FY2007. Despite the challenging scenario, political turmoil and disruption in the economy in the early months of FY2007 (particularly in November-December, 2006) and the uncertainties afflicting the economy during the period following the takeover by the current CTG in January 2007, FY2007 saw a number of positive developments. These included moderately high growth of manufacturing industries (10.01 per cent), robust performance of the export sector (15.69 per cent growth), revitalized capital market (121 per cent growth in DSE market-capitalisation) and high growth of remittance flow (24.5 per cent). However, some disturbing signs were already discernible as FY2007 was drawing to a close: a deteriorating trade balance, weak implementation of public investment programmes, stagnating food grains production and a fall in agricultural credit disbursement. Creeping inflation throughout the year, particularly, rising prices of cereals and fuel originating from increasing world prices of cereals and oil, was already emerging as causes for concern. The wide ranging anti-corruption drive added to uncertainties affecting investment environment with consequent negative implications for domestic and foreign investment.

Major Distinctive Features of FY2008

One distinctive feature of FY2008 is that the CTG is expected to be in charge of macroeconomic management for the duration of the full fiscal year. However, this was not the only departure from a normal year. Firstly, three consecutive natural disasters, two floods and cyclone *Sidr*, inflicted severe burden on the macroeconomic management in FY2008. The damage to the economy was estimated to be of $1.8 billion and a lot of attention had to be paid for rehabilitation and reconstruction related activities. Secondly, the creeping inflation observed in FY2007 gathered momentum as the year proceeded, driven by rising food and fuel prices in the international market and also domestic supply-side constraints. Thirdly, global economic slowdown, particularly the downturn in the US economy, generated negative consequences for the increasingly globally integrated economy of Bangladesh. Exports particularly to the US and terms of trade suffered as a result (Box 1.1 provides an elaborated discussion on the issue).

Macroeconomic performance during FY2008 was marked by lower level of ADP implementation underpinned by cost escalation of project and weak implementation capacity of the government machinery, higher public expenditure owing to the flood and cyclone rehabilitation related efforts, rising demand for subsidy in the wake of higher import prices, and pressure on balance of payment arising from higher trade deficit driven by higher import expenditure particularly for food and fuel imports and relatively low pace of export growth. Frequent power shortages, high cost of construction raw materials and inputs, uncertainties afflicting investment in both industry and real estate in the context of the ongoing anti-graft drive, had adverse impact on investment environment. FY2008 also saw larger than anticipated budget deficit on account of high levels of subsidy arising from higher import prices of food, fuel and fertiliser and wider coverage under safety-net programmes.

Towards the end of the first half of the fiscal year, the economy had started to show signs of rebound as business confidence was gradually restored. Investment scenario changed for the better, with export oriented industries gearing up the pace, higher demand for investment credit, high import of raw materials and intermediate inputs and robust capital market performance. It is hoped that institutional reforms particularly formation of Regulatory Reform Commission and the Better Business Forum will impact positively on the performance of the economy, on revenue earnings, and improve business climate. The economy also experienced a number of positive developments driven by phenomenal growth in earnings from income tax, substantial growth of export earnings and remittance flow, and growing foreign exchange reserves.

Notwithstanding the upturn seen in the recent past, the cumulative impact of the global and domestic challenges facing the economy resulted in a downward revision of the growth projection of about 1 per cent, to about 6 per cent, from the earlier envisaged 7 per cent GDP growth target set for FY2008.

The cumulative impact of high inflation and significant income erosion is being most severely felt particularly by low income groups of people in the country. According to CPD estimates, even when the increase in cumulative GNI is considered (between 2005 and 2008), given the price hike (particularly taking into consideration the weighted inflationary impact of price of rice), an additional 8.5 per cent people have fallen below the poverty line in recent times because of high inflation (taking Household Income and Expenditure Survey data for 2005 as reference point). This would mean that as high as an additional 2.5 million household could have fallen below the poverty line in terms of real income. However, it needs to be kept in mind that a large proportion of these households have received support from government's various safety net programmes, coverage of which was substantially increased in the recent past. This support would have enabled such households to address their immediate nutritional needs, to some extent. However, the fact remains that the prevailing high rate of inflation is having severe negative consequences for life and livelihoods of a large segment of the population in Bangladesh, particularly those belonging to low income groups.

As FY2008 draws to an end, and the CTG prepares to present the budget for FY2008-09, the challenge will be to contain the inflation, ensure food security, mobilise resources for the rising budget deficit and create a supportive environment for investment through appropriate policy support and energy security.

The present occasional paper provides an analysis of the performance of major macroeconomic indicators of Bangladesh during the first three quarters of FY2007-08. The paper examines the performance of both monetary and the real sectors. In doing so, the analysis deals not only with the dynamics and trends of performance of major relevant correlates but also flags emerging challenges in each of the areas. The present report is expected to provide a reference point for the performance of the economy prior to the placement of the upcoming budget for FY2008-09.

BOX 1.1: GLOBAL TRENDS AND THEIR IMPLICATIONS

Global economic developments in 2008 had important implications for macroeconomic performance of Bangladesh in FY2008. The increasingly globally integrated economy of Bangladesh suffered the consequences of some of the negative trends experienced by the global economy in 2008. As is known, about 56 per cent of Bangladesh economy is at present connected with the global economy through export and import of goods and services, and aid and investment. Slower growth projections for major export destinations of Bangladesh, particularly the stagflation in the US (following the sub-prime mortgage market crisis) and also the Eurozone countries, and the high global inflationary trends, have had an adverse impact on the performance of Bangladesh economy in FY2008. Growth projections for the US economy for 2008 was a low 0.5 per cent (down from 2.2 per cent in 2007); for the EU the corresponding figure was 1.8 per cent (3.1 per cent in 2007) and for Japan this was 1.4 per cent (2.1 per cent in 2007). Growth rates were also revised downward for China and India, two major import sources of Bangladesh. Indeed IMF has reduced its 2008 global growth projections from 4.1 per cent to 3.7 per cent; world trade growth is expected to come down to 4.5 per cent in 2008. High commodity prices, particularly of critically important import items of Bangladesh including food, fuel and fertiliser, raised the import burden significantly. Prices of these increased in the range of 100-200 per cent in the span of one year between April 2007 and April 2008.

Sluggish growth in developed countries is also likely to have dampening effect on FDI and portfolio investment flow to Bangladesh and adverse implications for flow of foreign aid. Sluggish US growth, and consequently lower consumer demand, led to a deceleration in demand for Bangladeshi exports – in the first nine months of FY2008 export to US had come down by 10 per cent; however, export to EU registered quite robust growth. One effect of the sluggish global demand had been increasing price squeeze in the international market for Bangladesh's major exports, including apparels. Higher commodity prices in global market, and declining export prices of Bangladeshi commodities has led to deteriorating terms of trade and higher trade deficit in the first three quarters of FY2008. A weakened dollar also had negative impact for Bangladesh's forex reserves (denominated, to a significant extent, in dollar terms), and for import from Eurozone and other countries. Slower growth of major economies could also dampen initiatives such as *aid for trade*, and also undermine the prospects of LDC-friendly initiatives in the WTO in the form of *DF-QF market access*, and the *NPDA2007* initiative in US (providing zero-tariff access to LDC products). On the other hand, rising fuel prices have significantly enhanced export earnings of oil-exporting economies which are attracting increasing number of migrant workers, leading to higher remittance flow from countries such as Bangladesh.

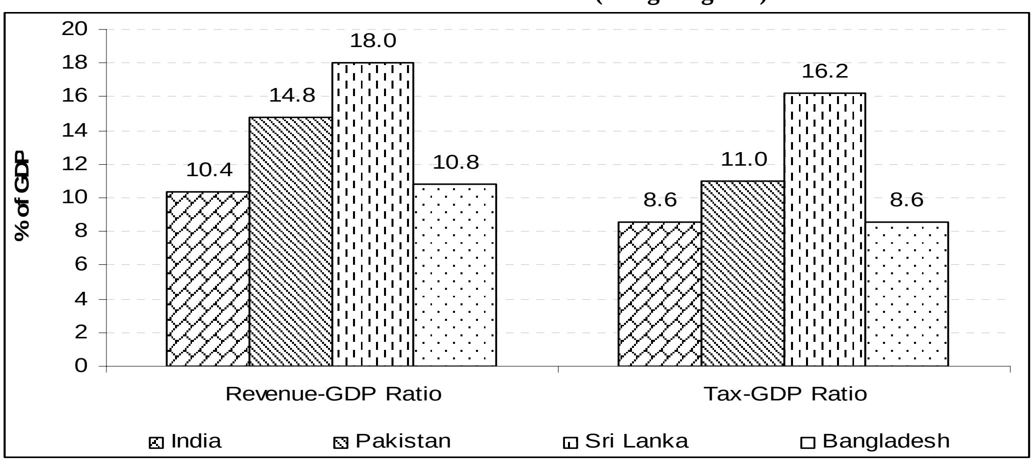
The experience of FY2008 indicates the need for a close monitoring of the developments in the global economy and the necessity of pursuing appropriate strategies in view of both the emerging challenges and the attendant opportunities for Bangladesh.

2. PUBLIC FINANCE

2.1. Revenue Receipts

In the backdrop of a 10.1 per cent revenue growth achieved in FY2007, an ambitious growth target of 22.3 per cent was set in the budget of FY2008 over the actual receipts of FY2007. Even if this was received, revenue-GDP ratio of Bangladesh would have reached to 10.8 per cent, which does not compare favourably to that of her neighbours including Pakistan (14.8 per cent) and Sri Lanka (18.0 per cent), albeit a bit higher than that of India (10.4 per cent). However, composition of revenue receipts in FY2007, particularly on account of tax revenue, helped some shift towards direct tax. Share of income tax within the total tax revenue receipts improved to 22.7 per cent from 18.8 per cent in FY2006. Direct tax is generally recognised to be progressive, while indirect tax has the propensity to be regressive. The budget for FY2008 however projected a slower movement towards this positive shift; share of income tax was to raise by 0.9 per cent to 23.6 per cent in the total tax revenue receipts.

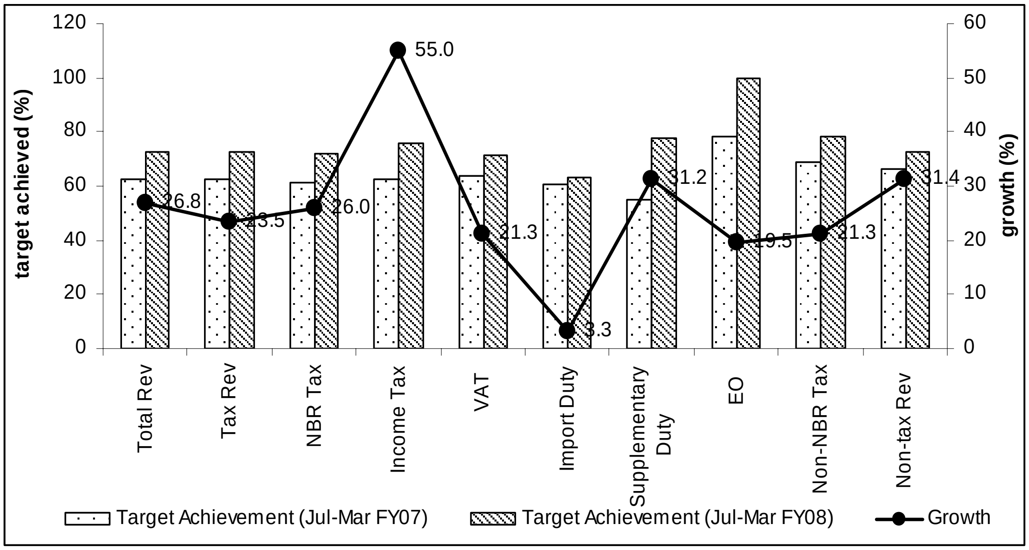
FIGURE 2.1: TAX AND REVENUE TO GDP RATIO AND TAX STRUCTURE OF SOUTH ASIAN COUNTRIES FY2008 (Budget figures)



Source: CPD IRBD Database.

Anticipated high growth in expenditure in FY2008 necessitated a robust effort aimed at higher resource mobilisation. Data available for July-March period of FY2008 from the finance division reveals encouraging achievements in this regard. Total revenue receipts amounted to Tk. 41,557.0 crore, registering 26.8 per cent rise over the corresponding figure of FY2007, indicating higher than targeted growth. This was the first time this has happened in recent years. Most of the additional revenue was contributed by the tax revenue component, particularly by the NBR. NBR contributed 74.3 per cent of the total additional revenue during the period over the same in FY2007 with 26.0 per cent growth. Non-NBR tax component increased by 21.3 per cent. Total tax and non-tax components registered 23.5 per cent and 31.4 per cent growth respectively. Total revenue collection during the first nine months of the current fiscal amounted to 72.5 per cent of the annual revenue target which was 62.4 per cent during the matching period of FY2007. Since there is always a drive for fulfilling targets during the last quarter, it is possible that the target set for the entire year will be achieved by end-June 2008.

FIGURE 2.2: REVENUE COLLECTION SCENARIO DURING JULY-MARCH OF FY2007 & FY2008



Source: CPD IRBD Database.

NBR growth in FY2008 was mostly driven by higher income tax collection, achieving 55.0 per cent increase during the period under concern, a record rise, in the backdrop of 20.5 per cent increase in tax return submission during FY2008 over FY2007. Total number of tax returns submitted in FY2008 was 6,45,617 which was 5,35,994 in FY2007. NBR drive to widen tax net has yielded good results in this regard, bringing 65,000 new taxpayers within the tax coverage through the country-wide survey. Total number of TIN holders is now 2.2 million and expected to reach to 2.5 million in the current fiscal from 2 million in FY2007. Provision of declaring undisclosed money provided during July to October period also contributed to the high income tax growth. A total of 42,459 persons availed of the opportunity. Tk. 5,213 crore was declared under this scheme from which Tk. 802 crore (9.7 per cent of the total income tax collection) was contributed to the public exchequer. High growth in income tax during the first nine months of FY2008 took income tax to total tax revenue ratio higher at 24.8 per cent.

VAT also posted respectable growth of 21.3 per cent in the first nine months of FY2008. If the first eight months (July-February) are considered, with companies and top state-run enterprises under the Large Tax Payers Unit (LTU) contributed 63.4 per cent of the total VAT collection; contribution of the LTU posted a rise of 22.7 per cent (totalling Tk. 6,348 crore).

31.2 per cent growth has been achieved in supplementary duty collection during July-March period of FY2008. What is to be particularly noted is that customs duty receipts posted a slower rise (3.3 per cent) compared to other components of NBR tax. Though import payments rose substantially during the recent months, owing to higher international prices, this declining income was mainly due to reduction or withdrawal of duties on import of food items and critical inputs for industrial sector, which was undertaken to keep imported food prices low and stimulate investment.

Latest NBR revenue figures from the Bangladesh Bank indicate a slower growth of 23.2 per cent for July-April period of FY2008, with income tax growth of 35.7 per cent. The two estimates of the BB and the finance division however does not compare since finance division uses CGA data system that to some extent varies from the NBR data used by the BB.

We note a discrepancy between NBR data (quoted by the Bangladesh Bank) and the Finance Division data based on the report from CGA. Whilst the NBR data may include revenue in the pipeline for a particular period, the CGA data reports actual receipt by the exchequer. This could lead to some discrepancy as the Finance Division rightly points out in its reports. However, the data sources should match when the final estimates are made. We have observed that the revised NBR revenue earnings in FY2007 was Tk. 36,172 crore, according to the Finance Division, whilst Bangladesh Bank reported this to be Tk. 37,174 crore (higher by 1,002 crore). For FY2006 these figures were respectively Tk. 32,438 crore and Tk. 33,987 crore, indicating a difference of almost 5 per cent. This anomaly needs to be explained in a more transparent manner.

While the growth so far has been impressive, much remains to be done during the rest of the fiscal. July-April figures for NBR revenue earnings indicate that around 20 per cent of the targeted revenue collection will need to be realized over the remaining two months. Attainment of the annual target is important in view of the higher than planned expenditure requirement in FY2008. Renewed emphasis needs to be placed on improving import duty collection. It needs to be kept in mind that the anti corruption drive of the government might have been a major driving factor behind the impressive growth in income tax collection – which was likely to be a “one time” phenomenon. If the income tax worth Tk. 802 crore (collected as a result of legalising untaxed income) is deducted from the actual income tax collection of July-April, growth of income tax collection would come down to only 21.6 per cent (the target is to achieve 25.7 per cent growth over the actual collection of FY2007). Consequently, higher expenditure targets for the next fiscal year based on growth over current year’s income and revenue collection may not be feasible.

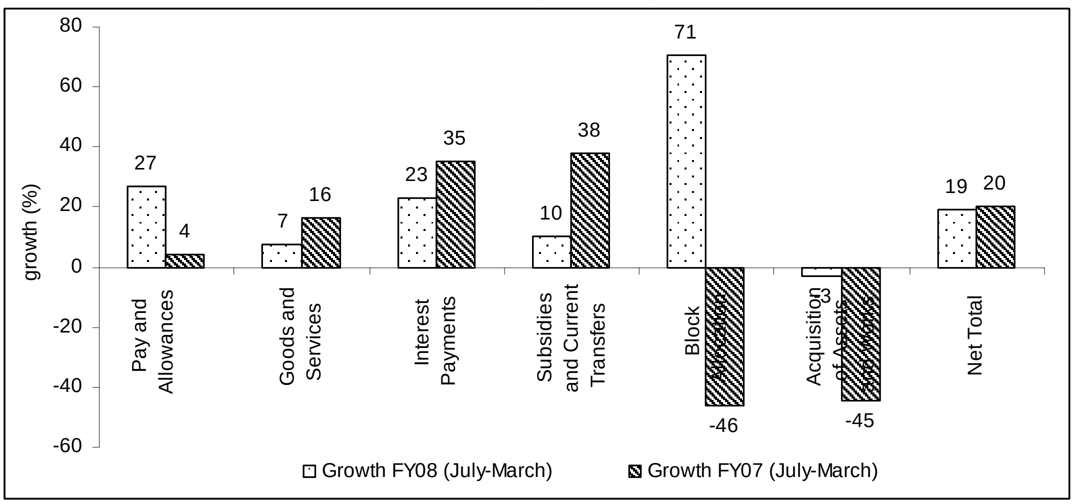
2.2. Revenue Expenditure

The expenditure budget for FY2008 was facing pressure on a number of fronts. Increasing fuel price in the international market required fuel subsidy to grow by a significant margin. Larger food subsidy also became a necessity in the backdrop of the spiralling price hike of food items leading to more extensive OMS activities to provide safety net for the poor. Higher import of food grains by the government was necessary due to the crop damage due to the consecutive floods and the cyclone, and larger distribution of food through VGF and other safety nets. At the same time, world wide food crisis and associated food price hike in the world market made food import more expensive. Fertiliser subsidy was also expected to overshoot the target owing to higher import price. On top of it, financing the post flood/cyclone rehabilitation efforts added to significant expenditure burden on the government.

Latest available figure on revenue expenditure[1] by economic classification from the finance division shows 20.3 per cent higher revenue expenditure during the July-March period of FY2008 over the corresponding figure of the previous year. Expenditure during this period was 64.4 per cent of the total annual target, which was 64.6 per cent of the original budget during the same period of FY2007, in the backdrop of a 23.8 per cent higher revenue budget in FY2008 compared to the original budget of FY2007. Among the major three heads that accounts for 88.2 per cent in the total actual revenue expenditure, "subsidies and transfers" and "interest payments" registered high growths during the first nine months of FY2008 with 37.8 per cent and 35.2 per cent growth respectively. "Salary and allowances" on the other hand posted a rise of only 4.0 per cent during the period under concern.

FY2008 faced demand from a number of unexpected, and at the same time, unusual areas. The pattern of expenditure during FY2008 could thus create some confusion with regard to government accounts, particularly due to the spending requirements originating from floods and the cyclone. To facilitate assessment of regular revenue expenditure, an "unexpected liabilities" account could be added to the economic classification of revenue expenditure with appropriate subheads. This will make it possible to separate out the unusual or unexpected expenditures from regular expenditures.

FIGURE 2.3: GROWTH OF REVENUE EXPENDITURE BY ECONOMIC CLASSIFICATION FY07 & FY08 (JUL-MAR)



Source: CPD IRBD Database.

Revenue expenditure data for July-March period shows substantial rise in subsidies by 192.0 per cent. Budget for FY2008 kept around Tk. 6,000 crore as subsidies. However, the actual subsidy demand for the year could cross Tk. 16,000 crore. The government might not be able to meet the entire demand from the current budget and may have to transfer a part of it to the next year.

[1] Augmented revenue expenditure including acquisition of assets and works. Recoveries, which is less than 3 per cent, is not deducted here. Excluding the acquisition of assets and works, revenue expenditure targets for FY2007 and FY2008 were Tk 39,536 crores and Tk 48,429 crores. Deduction of recoveries was not accounted for in the available information on actual revenue expenditure during July-February period collected from finance division.

When the national budget for FY2008 was prepared, crude petroleum and diesel were selling at US$67 and US$85 per barrel at the international market. These prices have gone up to US$130 and US$169 per barrel recently. With unchanged local prices, these entailed that in the ultimate analysis the government is absorbing the difference. Around Tk. 55 subsidy has to be given for each litre of diesel and kerosene. Octane is also subsidised at present (by Tk. 13/litre), the price of which was set somewhat higher than the import price (allowing a small margin of profit) at the time of the last adjustment of fuel prices in April 2007.

Agricultural subsidy is also expected to rise significantly with around 200 per cent growth in fertiliser price in the international market. Tk. 2,250 crore was kept in the budget for FY2008 for the agriculture ministry, while the actual demand for the fiscal year is now anticipated to be around 4,200 crore. According to the figures provided by the agriculture ministry, total fertiliser subsidy requirement for FY2008 was around Tk. 3,600 crore, with subsidy amount of Tk. 25.7/kg (import price of Tk. 31/kg and selling price of Tk. 5.3/kg) for imported, and Tk. 2.4/kg (production cost of Tk. 7.2/kg and selling cost of Tk. 4.8/kg) for domestically produced Urea.

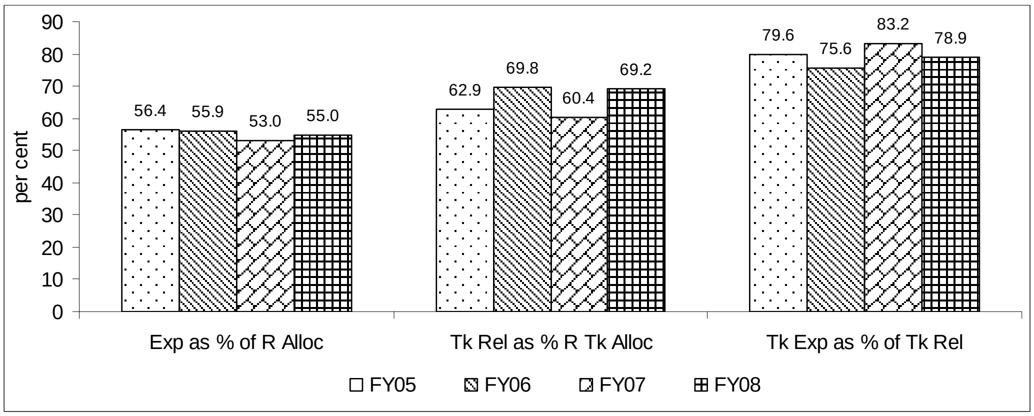
With the added expenditure demand, it is likely that the total revenue expenditure will overshoot the target by around Tk. 10,000 crore, if not more in FY2008. While the current subsidy level is already becoming a major source of deficit, maintaining the existing level of fuel price may become even more untenable in the next fiscal year.

Any fuel price adjustment will need to be carried out carefully. The subsidy for diesel, kerosene, octane and petrol will need to be crafted keeping in view (a) international market price, (b) needs of crop and production sector, (c) purchasing power and (d) equity consideration. Diesel, used for irrigation in agriculture, will need to be subsidised to a significant level for reasons of food security. A mechanism for transfer of the subsidy (a variety of which was put in practice this year) will need to be designed if the general price level of diesel is adjusted to reflect market prices. It may be mentioned here that Petrol and Diesel are selling in Kolkata (May 2008) at prices higher by almost 28 per cent and 50 per cent respectively, compared to the Bangladesh prices.

2.3. Annual Development Programme (ADP)

The financial year 2007-08 began with an expectation of a better ADP implementation compared to the last fiscal year. The actual performance in the course of the year however remains more or less same compared to the poor performance of the recent past. In fact, ADP implementation during FY2008 depicts the same frustrating picture seen in FY2007, a year which experienced lowest ADP implementation in recent years. Expenditure record of ADP indicates that only 46.7 per cent (Tk. 12,367 crore) of the total fiscal allocation (Tk. 26,500 crore) or 55.0 per cent of the revised allocation (Tk. 22,500 crore) was spent during the first ten months of FY2008. To compare, ADP implementation during July-April of FY2007 was 44.0 per cent of the original allocation (53.0 per cent of revised allocation). Low expenditure of the current fiscal also needs to be seen from the perspective of higher expenditure requirement of the government on account of revenue expenditure and disaster management linked to floods and *Sidr*. Nonetheless, this will have developmental consequences, particularly in terms of infrastructure building and employment creation. Another factor behind the slow pace of ADP implementation this time has been the rising cost of inputs which undermined the cost estimations of earlier contracts and led to slowdown of development works by many contractors who asked for review of cost estimation. Risk aversion and fear psychosis may also have played a role this year. As data bears out, taka released during the July-April period was 69 per cent of the revised taka allocation, which was 60 per cent during the matching period of FY2007. However, only 78.9 per cent of the released amount was spent, compared to 83.2 per cent of FY2007. Utilisation of project aid was also at low levels. Only 50.7 per cent of the allocated project aid financed by the development partners has been utilised during July-April period (55.5 per cent of the revised PA allocation), which was 52.4 per cent during the corresponding period of FY2007 (57.6 per cent of the revised PA allocation).

FIGURE 2.4: PERFORMANCE OF ADP DURING JULY-APRIL (FY2005 TO FY2008)

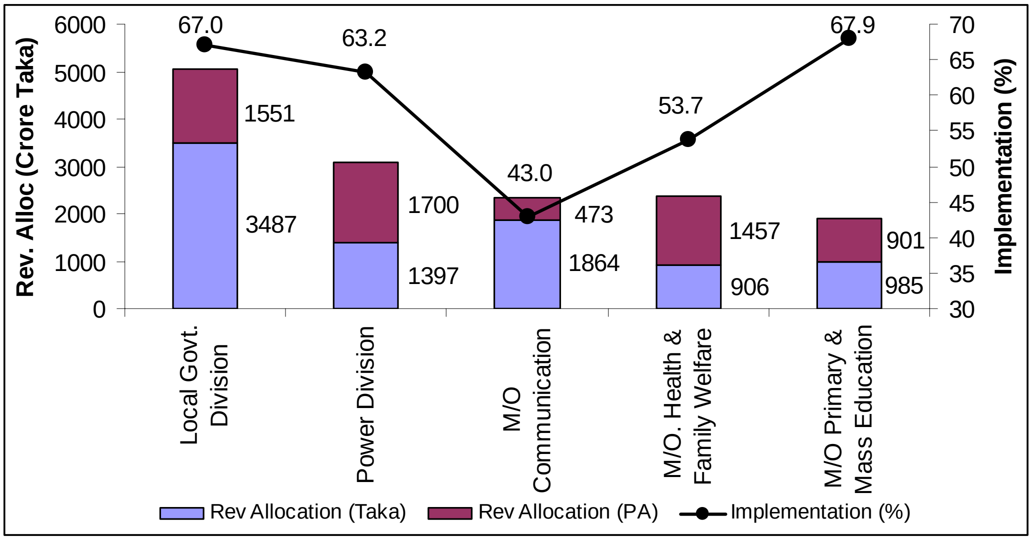


Source: CPD IRBD Database.

Among the five ministries/divisions which received the highest allocation in the original ADP accounting for 56.9 per cent of the total original ADP allocation (65.4 per cent of the RADP), the M/O Communication and the M/O. Health & Family Welfare were the least spending, with only 43.0 per cent and 53.7 per cent expenditures of their respective revised allocations during the first ten months of FY2008. Power Division was given priority in the formulation of ADP for the current fiscal, taking into cognisance the deteriorating power situation, and its associated impact on producers and consumers. However, implementation did not match the aspirations and power situation actually worsened during the course of the year. Although July-April figures for the Power Division indicates 63.2 per cent implementation, the figure looks impressive only due to the large downward revision in the allocation (reduction of Tk 680 crore or 18 per cent) in the RADP, possibly taking cue from poor utilisation status of the previous months. If the original allocation is considered, implementation of the Power Division stands at only 51 per cent (which was as low as 32 per cent during July-March period). M/O Primary & Mass Education and Local Govt. Division (including block allocation and Cash for Work) fared better, spending 67.9 per cent and 67.0 per cent of their respective revised allocations.

One usual phenomenon in case of ADP implementation in the past has been the rushed disbursement which tends to be carried out during the last few months of the fiscal year. Such rushed disbursement often ignores the quality of implementation of the project which in turn results in poor quality of the project outcomes and higher expenditure on rehabilitation and maintenance in subsequent years. It appears that this year is not going to be any exception in this regard. It is interesting to note that implementation (in terms of utilisation of the revised allocation) increased from 42.1 per cent (during July-March) to 55.0 per cent (July-April) which would indicate an additional 13 per cent utilisation of allocation in just one month (April)!

FIGURE 2.5: ALLOCATION AND EXPENDITURE OF THE TOP 5 MINISTRIES DURING JULY-APRIL, FY2008



Source: CPD IRBD Database.

Among the 14 ministries which have developed their own budget under the MTBF, only 5 were able to use above the average spending of all ministries i.e. 55.0 per cent of revised allocation. Indeed, average expenditure of these 14 ministries was 54.0 per cent. The initial idea that MTBF ministries would be able to register better implementation record did not materialise on the ground.

Monthly ADP implementation status provided by the IMED (Implementation Monitoring and Evaluation Division) is however based on financial statements. This report does not provide any insights about actual physical achievements which could reflect the progress in terms of financial disbursements. To strengthen project monitoring in terms of quality and with financial accountability, IMED should include some detailed information on physical progress as well in its reports.

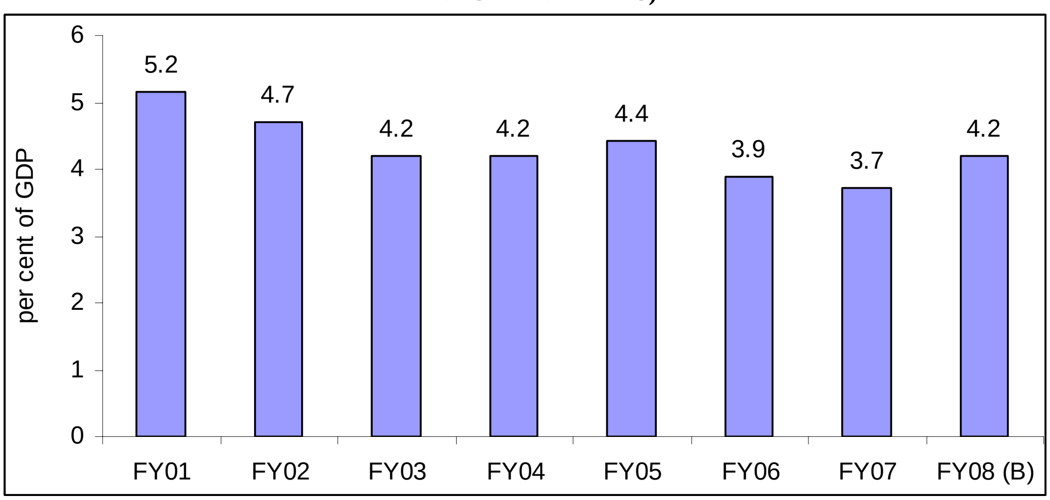
In view of the unlikelihood of meeting the ADP target, the government has already lowered its ambition and has revised the target at Tk. 22,500 crore. However, the actual implementation is more likely to remain lower than Tk. 19,000 crore, as was the case in FY2007. The revised ADP targets stipulate that 63 per cent of the total expenditure is to be financed from domestic resources and 37 per cent from foreign resources, while in the original ADP the domestic-foreign financing ratio was set at 60:40. Additional Tk. 174 crore has been given as special block allocation in the revised ADP over the original allocation. As for sectoral allocations, largest cuts were made from Transport (Tk. 752.63 crore), Education and Religious Affairs (Tk. 721.33 crore) and Power (Tk. 644.14 crore) sectors. It is to be noted that these sectors, particularly Power and Education, were given priority in the original ADP of FY2008 with largest increase over the revised ADP of FY2007.

Rather than reducing the size of ADP in the next fiscal year, given the increasing needs of the country, thrust should be put on raising the efficiency of implementation of ADP which would enable handling of larger ADP. Quality of projects needs to be the ultimate guiding principle for inclusion in the ADP. Higher employment generating projects should get the priority. Special emphasis needs to be given to the power sector, in the face of the existing power crisis, and its critical importance for the economy.

2.4. Budget Deficit and Financing

Excluding grants and BPC liabilities, national budget for FY2008 projected Tk. 22,313 crore or 28 per cent gap between the anticipated revenue earnings and total expenditure. This deficit was to be 4.2 per cent of the GDP. Including the Tk. 7,523 crore BPC liabilities, which has been subsumed by the two state owned banks (Sonali Bank: 66%, Janata Bank: 44%) as bonds, total deficit was estimated to be 5.6 per cent of the GDP in FY2008. Compared to the average deficit of 4.1 per cent during the last five years, the targeted deficit for FY2008 was already set at a high level. But as the latest figures of revenue earnings and public expenditure figures reveal, actual deficit will almost certainly be higher. According to the recent figures, total deficit during July-February period of the current fiscal was of Tk. 16,678.6 crore against the deficit of Tk. 7,479.5 crore faced over the matching period of FY2007. This indicates a substantial growth in deficit by 123.0 per cent for the first eight months.

FIGURE 2.6: BUDGET DEFICIT AS % OF GDP (EXCLUDING GRANTS AND BPC LIABILITIES)



Source: CPD IRBD Database.
** Budget figure for FY2008 (excluding BPC liabilities)*

In financing the deficit, government had to heavily rely on the banking sector; availability of credit from non-bank financing was low probably owing to the anticorruption drive that resulted in a fall in the sale of NSD certificates and also a shift towards the equity market. Non-bank borrowing by the government to finance the deficit actually declined by quite a large margin of (-) 36.9 per cent, taking its share to only 11.4 per cent within the total domestic financing of Tk. 13,898.0 crore. As a result, government had to draw on the banking sources which experienced a high growth of 133.8 per cent during July-February period, amounting to Tk. 12,305.7 crore. 88.5 per cent of the total domestic financing has been made from the banking sector.

TABLE 2.1: GROWTH IN DEFICIT AND SOURCES OF FINANCING DURING JULY-FEBRUARY OF FY2007 AND FY2008

Crore Taka

	FY2007		FY2008		Growth FY2008 (Jul-Feb)
	Budget	Actual (July-Feb)	Budget	Actual (July-Feb)	
Net Foreign financing	**8364.4**	**-326.8**	**10560.2**	**2780.6**	**--**
Grant	2508.0	247.2	4255.0	418.1	69.1
Loan	9618.0	1927.5	10403.0	5094.1	164.3
Amortisation	*3761.6*	*2501.5*	*4097.8*	*2731.6*	9.2
Domestic Financing	**8896.8**	**7806.3**	**11808.8**	**13898.0**	**78.0**
Non-Bank Borrowing	3400.0	2509.0	4500.0	1582.2	-36.9
Bank Borrowing	5434.0	5262.9	7253.0	12305.7	133.8
Sale of Assets	62.8	34.4	55.8	10.1	-70.6
Deficit as % of GDP (excluding grants and BPC liabilities)	**3.7**		**4.2**		

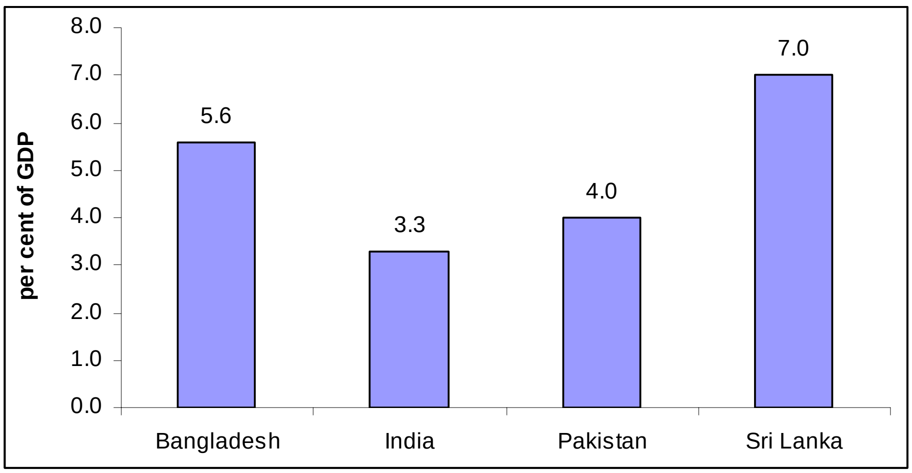
Source: CPD IRBD Database.

Along with the high share of domestic financing of 83.3 per cent in total financing, foreign financing (before amortisation) also shows significant growth of 153.5 per cent during the July-February period of FY2008, totalling Tk. 5,512.2 crore. In net terms (after amortisation), foreign financing during the period amounted to Tk. 2,780.6 crore (Tk. 418.1 crore in grants and Tk. 5,094.1 crore in loans with amortisation of Tk. 2,731.6 crore). Whatever aid was received, of this half went for foreign debt servicing. In fact, since FY2003, payment made on amortisation always exceeded amount of aid received as loan. Net foreign financing during the July-February period of FY2007 was negative since amortisation exceeded the combined amount of loans and grants by Tk. 326.8 crore. Encouraging growth in foreign financing in FY2008 still leaves about Tk. 7,779.40 crore (in net terms) to be mobilised to cover the projected foreign assistance requirement of Tk. 10,560 crore (net), about US$ 1.5 bln, made in the budget. However, the actual gap between realized and projected foreign financing requirement would be higher, since aid received only for natural disasters constitutes a significant portion of the total foreign aid disbursement during July-February period. Total foreign aid disbursement, not accounting for payment of principle and interest, amounted to US$ 1127.4 mln, indicating 122 per cent higher inflow compared to the corresponding figure of FY2007 (US$ 506.8 mln).

Although the amount of deficit is significant, actual deficit could have been substantially higher if the ADP implementation would have been better. However, with plans to go for record high stock of food grain, government have planned to procure 1.5 million tonnes of rice during the current boro season, an additional amount of Tk. 4,200 crore (0.8 per cent of the targeted GDP of FY2008) would be required. It thus appears that total deficit might exceed 5 per cent of GDP at the end of the fiscal year, even if the initial BPC liability is excluded from the accounts.

The *one time* nature of the current growth in revenue earnings and the apprehension of further growth in fuel and food prices in the international market might compel the government to go for an even higher budget deficit for the next fiscal year. Given the special circumstances, both domestic and global, it may not be totally unjustified to accept a higher deficit in the next fiscal year. However a sustained high deficit for a long period may create a vicious circle of borrowing to meet deficit and higher revenue expenditure through debt servicing liabilities emanating from deficits. Indian experience could be a good lesson in this regard. Although in recent years annual deficit of India has come down to below 5 per cent of GDP, continuing with deficit over 6 per cent of GDP throughout the 90's and early years of the current decade has resulted in setting aside over 25 per cent of the total budget for interest payments on domestic and foreign borrowings. Bangladesh now spends around 13 per cent of her expenditure budget on interest payments. But the percentage is on the rise and could become a major concern in the coming years.

FIGURE 2.7: BUDGET DEFICIT AS % OF GDP IN SOUTH ASIAN COUNTRIES (BUDGETARY TARGETS OF FY2008)



Source: CPD IRBD Database.

3. MONETARY SECTOR

The monetary sector is posed with the challenge of following a monetary policy which can ensure poverty alleviation and accelerate economic development. These objectives can only be achieved through sustainable output growth by channelling adequate resources in the productive sectors of the economy. A prudent monetary policy can play a vital role in resource allocation through the banking and financial framework of the country. The Bangladesh Bank (BB) has been pursuing a monetary policy in a transparent way through its Monetary Policy Statement (MPS) since January 2006. The BB has announced its MPS of January - June 2008 which aims to 'support the highest sustainable output growth along with maintaining price stability' (Monetary Policy Statement, Bangladesh Bank, January 2008). To this end the BB has resisted the suggestion of the International Monetary Fund (IMF) to raise interest rate and follow a contractionary monetary policy and has been pursuing an accommodative policy in view of domestic and global economic developments. As evidence shows, *money supply went up* between July-March period by 19.2 per cent in FY 2006, 19.8 per cent in FY 2007 and 15.5 per cent this year (Figure 2.2). However, there is no denying that the BB will need to perform a very careful balancing act in view of the need to control inflation and the need to stimulate investment at a time of sluggish growth. *It is important that the BB continues to follow an independent monetary policy keeping in view of the larger interest of the economy.*

The challenge before Bangladesh Bank's monetary policy is *how to strike a balance between high inflation and interest rate*. The long term interest rates have either declined or remained the same over the years. For example, interest rates on 5 year and 10 year Bangladesh Government Treasury Bond (BGTB) have declined while the interest rate on National Savings Directorate (NSD) certificates remained same in March 2008 compared to December 2007 (Table 2.1). This implies that the real rate of interest (RRI) has declined in the face of high inflation. This has been a disincentive to the depositors who are currently shifting towards the capital market instead of saving in NSD certificates. As a matter of fact, net sale of NSD certificates during July-February 2008 was 40.23 per cent lower compared to July-February 2007 while total sale was 6.97 per cent less during the same period (Table 2.2).

On the other hand, both Demand Deposit (DD) and Time Deposit (TD) have increased in the FY2008. A comparison between March 2008 and March 2007 shows that DD has increased by 19.71 per cent and TD has increased by 15.62 per cent during this period. The increase in TD implies that even with high inflation rate the opportunity cost of holding money in these instruments is still attractive.

The RRI has been declining on all deposits. For example, the RRI in March 2008 was only 0.60 per cent on 5 year BGTB, 1.72 per cent on 10 year BGTB, 1.50 per cent on 3 year NSD certificate and 2.0 per cent on 5 year NSD certificate. Such low interest rate has made these savings instruments such as NSD less attractive and led private savers to move towards other forms of investment such as capital market. The heated capital market during FY2008 is the reflection of such moves. Table 2.1 shows the weighted average interest rates and real interest rates of various savings instruments.

TABLE 3.1: WEIGHTED AVERAGE INTEREST RATE OF GOVERNMENT LONG TERM T-BILL/BONDS AND INFLATION

	BGTB		NSD		Inflation Rate (12 month average)	Real Rate of Interest on			
Period	**5-Year**	**10-Year**	**3 Year**	**5-Year**		**5-Year BGTB**	**10-Year BGTB**	**3-Year NSD**	**5-Year NSD**
June 2004	8.00	10.00	10.50	11.00	5.83	2.17	4.17	4.67	5.17
June 2005	8.75	9.93	10.00	10.50	6.49	2.26	3.44	3.51	4.01
June 2006	10.60	12.09	10.00	12.00	7.16	3.44	4.93	2.84	4.84
June 2007		12.14	11.50	12.00	7.20		4.94	4.30	4.80
December 2007	10.65	11.73	11.50	12.00	9.11	1.54	2.62	2.39	2.89
March 2008	10.60	11.72	11.50	12.00	10.00	0.60	1.72	1.50	2.00

Source: Monetary Policy Department, Bangladesh Bank.

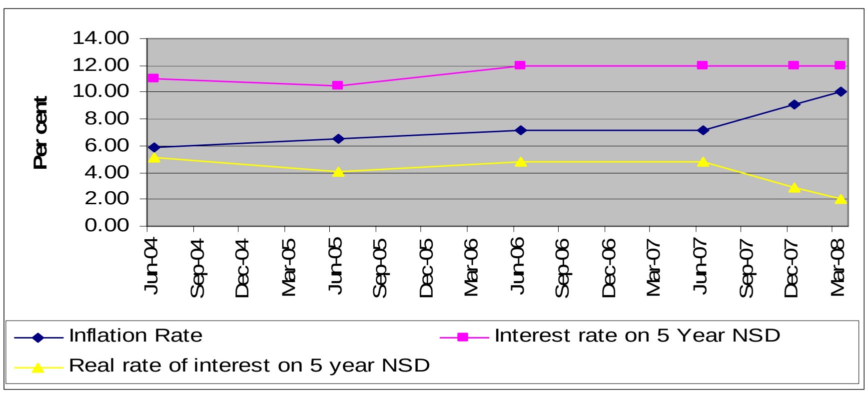
TABLE 3.2: SALE AND REPAYMENT OF NSDS

(In Crore Tk)

Period	Sale	Repayment	Net Sale	Outstanding at the end period
July Feb' 2006-07	9932.29	7369.88	2562.41	42026.67
July Feb' 2007-08	9240.01	7709.65	1530.36	45169.54

Source: Bangladesh Bank.

FIGURE 3.1: REAL RATE OF INTEREST



Source: Bangladesh Bank.

The following sub sections provide a brief overview of the trends of some of the major variables in the monetary sector.

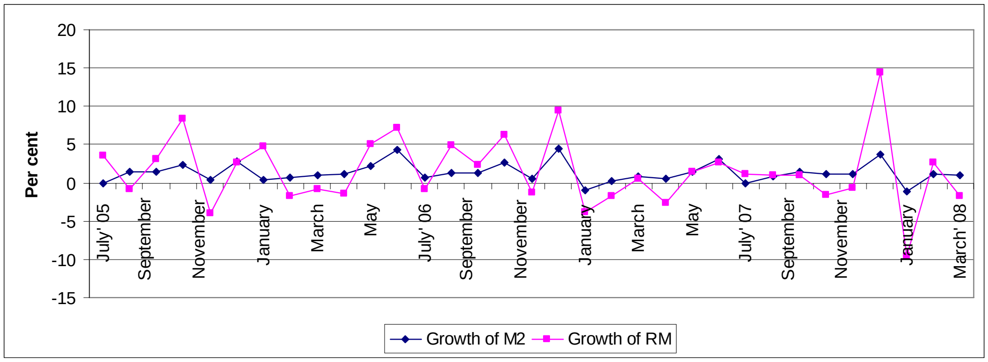
3.1. Money Supply, Reserve Money and Liquidity

Broad Money Supply (M2) has posted a rise of 15.47 per cent as of end March 2007-08 compared to March 2006-07 (Figure 2.2). This growth has been due to growth in the domestic credit by 18.36 per cent during March 2007 and March 2008. Net Foreign Assets (NFA) continues to increase due to increased remittances. NFA increased by 25.63 per cent during March 2007 and March 2008. Net Domestic Assets (NDA) has also posted an increase by 13.89 per cent during March 2007 and March 2008.

The increase in *Reserve Money (RM)* was lower during July-February 2007-08 compared to the same period in 2006-07. The RM has observed a growth of only 7.28 per cent (Tk. 3245.80 crore) during July-February 2007-08 compared to15.46 per cent (Tk. 5854.60 crore) during July-February 2006-07. However, RM registered a rise of

6.87 per cent as of end March 2007-08 compared to March 2006-07. The money multiplier (M2/RM) increased to 4.96 at the end of March 2008 compared to 4.59 in March 2007.

FIGURE 3.2: MONTHLY TREND OF MONEY SUPPLY AND RESERVE MONEY



Source: Bangladesh Bank.

Excess liquidity of the scheduled banks was lower at Tk. 13488.51 crore as of end February 2008, against Tk. 14279.42 crore as of end June 2007. This is reflected in attempts to the deposit collection drive by some commercial banks through offering competitive interests rates on long term deposits. Banks are borrowing from the call money market at a high interest rate for their day to day operations.

In order to ease the liquidity crisis the government has also started to inject money in the economy. The government had earlier withdrawn an amount of Tk. 5000 crore in FY2008 from the banking sector through primary dealers (by way of sale of treasury bills to nationalized banks and a few commercial banks) for government's use and to control inflation by reducing money supply in the market. However, this has raised the call money rate, which sometimes reaches as high a level as 20 per cent. The government is now trying to keep the call money rate around 8 to 8.5 per cent and has recently injected Tk. 1000 crore to this end.

However, the liability to be carried out by the state owned banks as against the loss of Tk 7523 by the Bangladesh Petroleum Corporation (BPC) has had an impact on the excess liquidity situation. Though the government took the liability, it did not provide banks with cash. Instead, they were given bonds, which the banks cannot use for statutory liquidity ratio (SLR) requirement. As a result, although the balance sheets of the banks show the liabilities, actually there is no cash flow against them. *Hence the excess liquidity figure may be overstated.*

A number of *reasons* may be identified behind decline in excess liquidity. *First,* private sector credit has increased (Section 2.2). *Second*, the government had earlier withdrawn an amount of Tk. 5000 crore in FY2008 from the banking sector through primary dealers (by way of sale of treasury bills to nationalized banks and a few commercial banks) for government's use and to control inflation by reducing money supply in the market. However, this has raised the call money rate, sometimes as high as 20 per cent. The government is now trying to keep the call money rate around 8 to 8.5 per cent and has injected Tk. 1000 crore recently to this end. *Third,* due to anti-corruption drive black money is out of the banking system. *Fourth,* due to high inflation rate and high commodity prices the middle income group is using their savings to cope with high cost of living. *Fifth*, because of anti-corruption drive and low interest rate on deposits both large and small depositors have invested in the capital market which is reflected through 107.11 per cent increase of market capitalisation during March 2007 and 2008 The increase was 57.98 per cent during March 2006 and 2007 (more on capital market in Section 2.3.4).

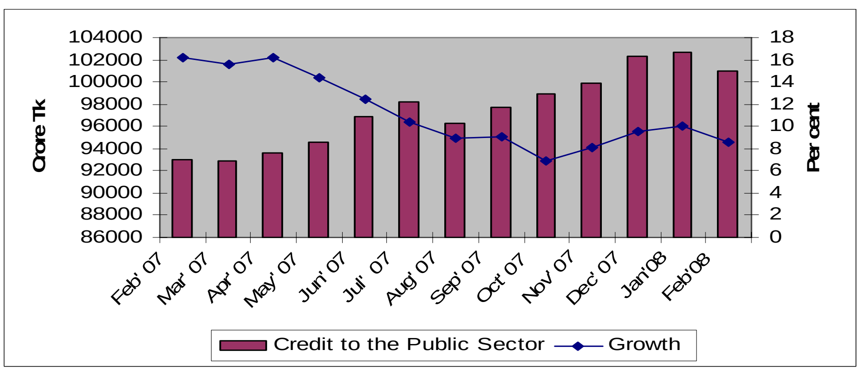
3.2. Domestic Credit

Total domestic credit increased by 11.26 per cent (Tk. 23003.70 crore) during July-February 2007-08 against the increase of 9.58 per cent (Tk. 17036.20 crore) during July-February 2006-07. The rise in domestic credit is due to the rise of private sector credit by 13.92 per cent (Tk. 20985.50 crore) and public sector credit by 3.77 per cent (Tk. 2018.20 crore). If compared between March 2008 and March 2007, domestic credit showed an increase of 18.56 per cent during this period. Domestic credit to the public sector experienced an increase of 8.59 per cent during February 2007 and February 2008. On the other hand, credit to other public sectors declined by 9.3 per cent during the same period.

Government Sector Borrowing

Government borrowing accounts for 86.23 per cent of the total public sector credit. This has posted an increase of 12.12 per cent during February 2007 and February 2008. Outstanding borrowing of the government through NSD certificates as of end February 2008 stood at Tk. 45484.5 crore, recording an increase of Tk. 3457.8 crore or 8.23 per cent against Tk. 42026.7 crore as of end February 2007. Figure 2.3 shows the volume and growth of government sector borrowing month by month.

FIGURE 3.3: GOVERNMENT SECTOR BORROWING



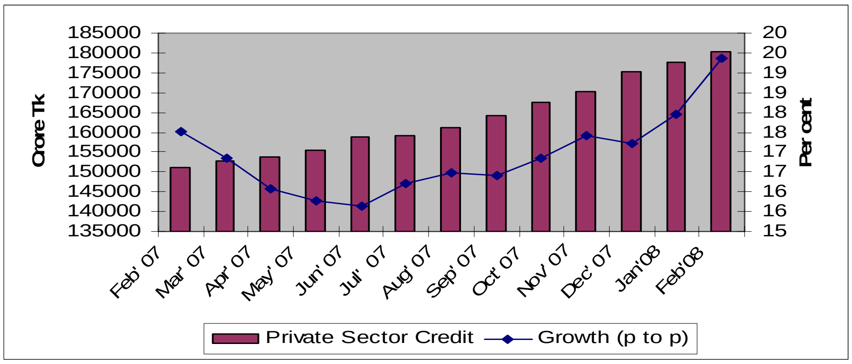
Source: Bangladesh Bank Economic Trends.

Private Sector Borrowing

Though in the beginning of the FY2007-08 there was a decline in private investment, partly due to uncertainty and fear created in view of the changed governance framework and anti-corruption drive pursued by the interim government the situation started to improve gradually which is reflected through renewed activities in the economy. Expansion of private sector credit has experienced a strong growth during July-February 2008 is evidence to this dynamism. At the end of February 2008, total outstanding domestic credit to the private sector posted an increase of 19.38 per cent over February 2007. During July-February 2008 this growth was 13.92 per cent compared to 9.70 per cent during July-February 2007. Within the total credit to the private sector, 92.27 per cent came from the banking sector while the rest came from the Non-Bank Depository Corporations (NBDCs). During January-March 2008 the growth of credit to the private sector increased to 18.1 per cent compared to 16.5 per cent during January-March 2007.

A significant share of credit disbursement has been for trade (34.13 per cent of total disbursement), industrial sector (21.19 per cent) and working capital financing (17.1 per cent). During July-February 2007 the share of disbursement was 33.44 per cent, 20.8 per cent and 17.84 per cent for trade, industrial sector and working capital financing respectively. Figure 2.4 presents the trend of private sector credit month by month during February 2007 and February 2008.

FIGURE 3.4: PRIVATE SECTOR BORROWING



Source: Bangladesh Bank Economic Trends.

3.3. Industrial Loan

Industrial term loan during January-March 2008 recorded a significant 68.69 per cent growth in total disbursement compared to the corresponding period of FY2007. Overall recovery of the term loan also posted a significant growth of 61.07 per cent during the reported period (Table 2.3).

Disbursement of industrial term loans during July-March 2008 was 66.1 per cent higher than that of July-March 2007. The high disbursement can be related to higher investment which can also be observed through growth in industrial credit and working capital financing through the private sector. During July-March growth in credit to industrial sector has increased by 23.46 per cent compared to 23.36 per cent during July-June 2007. The increase in working capital financing during July-March 2008 was 14.29 per cent compared to 9.02 per cent growth during July-March 2007.

Recovery of industrial term loans during July-March 2008 was 66.12 per cent against 73.29 per cent during July-March 2007 implying that overdue loan as percentage of total outstanding has increased.

Overdue industrial term loans at the end of March 2008 stood higher at Tk. 6279.54 crore compared to Tk. 3087.88 crore at the end of March 2007. *Overdue as percentage of outstanding industrial term* loans increased to 16.23 per cent at the end of March 2008 compared to 13.01 per cent at the end of March 2007.

TABLE 3.3: INDUSTRIAL CREDIT

(In Crore Tk)

Period	2007-08		2006-07	
	Disbursement	Recovery	Disbursement	Recovery
July-September	3784.76	2625.19	2660.34	1740.93
October-December	5878.47	3311.45	3204.46	2393.95
January-March	4911.08	3700.03	2911.39	2297.1

Source: Agricultural Credit & Special Programme Department, Bangladesh Bank.

3.4. Loan Default Scenario

Total classified loan as on March 2008 was Tk. 23838.28 crore. Total classified loan increased by 12.32 per cent as on March 2008 compared to the corresponding period of the previous year. Except for the Development Finance Institutions (DFIs) no banks made any progress in reducing classified loans. The increase in classified loan was 17.12 per cent for the State owned Commercial Banks (SCBs), 96.03 per cent for Foreign Banks (FBs) and 19.05 per cent for Private Commercial Bank (PCBs). However, the DFIs made an impressive progress in reducing the total classified loan recording negative growth rate of (-) 11.90 per cent as on March 2008 from the corresponding time of the previous year (Table 2.4).

The negative performance in loan recovery is partly due to the anti-corruption drive which put several businessmen behind the bar and led many to flee from the country. Since the corporate governance of most of the companies in Bangladesh is weak with heavy dependency on one person business has been experiencing a down turn due to this cleansing operation. Many of these companies are not being able to do the loan servicing. Also due to the fear factor among the businessmen there was very limited investment during the beginning of the FY2008 leading to weak performance of their business which in turn could have an impact on the loan default scenario.

TABLE 3.4: CLASSIFIED LOAN

(In Crore Tk)

Bank Type	As on March' 07	As on March' 08	Growth in 08 compared to FY 07
SCBs	12134.81	14212.56	17.12
PCBs	4826.86	5746.16	19.05
FBs	115.80	227.00	96.03
DFIs	4145.80	3652.56	-11.90
Total	**21223.27**	**23838.28**	**12.32**

Source: Banking Regulation and Policy Department, Bangladesh Bank.

3.5. Agricultural Credit

In a bid to increase agricultural production a lot of emphasis was given on agricultural credit during FY2007 which was reflected in increased disbursement of agricultural credit by the Nationalised Commercial Banks (NCBs), Specialised Banks, Bangladesh Rural Development Board (BRDB) and Bangladesh Samabya Bank Limited (BSBL) during July-April 2008 (Tk. 4811.84 crore) compared to July-April 2007 (Tk. 4294.93 crore). The disbursement is 12.04 per cent higher in FY2008 than FY2007 for the period July-April (Table 2.5). The increased disbursement is also due to the directive of the BB to the private commercial banks to increase disbursement of agricultural credit in view of the production loss due to flood and cyclone in 2008.

TABLE 3.5: AGRICULTURAL CREDIT POSITION

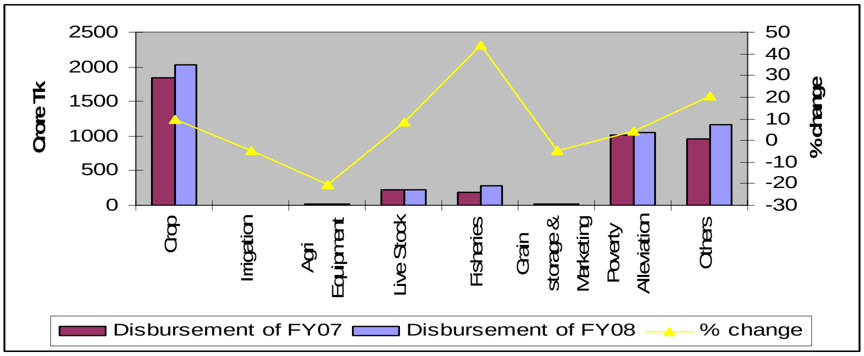
	FY2006-07 (July to April)		*FY2007-08 (July to April)*	
Section	*Disbursement*	*Recovery*	*Disbursement*	*Recovery*
Crop	1845.77	1599.95	2023.99	1467.96
Irrigation	7.38	50.64	7.04	57.69
Agri Equipment	25.42	23.09	20.31	10.71
Live Stock	216.59	258.08	234.73	174.92
Fisheries	189.59	85.03	273.52	75.00
Grain storage & Marketing	26.03	28.08	24.79	43.29
Poverty Alleviation	1017.90	877.39	1061.06	920.35
Others	966.25	864.87	1166.40	762.71
Total	**4294.93**	**3787.13**	**4811.84**	**3512.63**

Source: Agricultural Credit & Special Programme Department, Bangladesh Bank.

However, recovery of agricultural credit during July-April 2008 was 73.0 per cent compared to 88.18 per cent during July-April 2006-07. On the other hand overdue as percentage of total outstanding during July-March was 36.0 per cent compared to 45.5 per cent during July-March 2007. Credit to the crop sector received the highest allocation (28.5 per cent of total disbursement) followed by poverty alleviation (9.05 per cent) and irrigation (8.5 per cent). Figure 2.5 shows the change in disbursement during FY2007 and FY 2008.

Private banks are lending to the agriculture sector in two ways. *First,* following the model of the Indian ICICI Bank's *Para Banking* (which has in fact been developed on the basis of the Grameen Bank model blended with the Indian reality), a number of private banks have come to an agreement with some large non-government organizations (NGOs) such as BRAC, ASA and TMSS to disburse agri-loan through them. They are now finding out that agriculture credit can also be profitable. Such arrangements have been made in view of the fact that these NGOs have infrastructural and institutional set up in the rural areas, and it is not always financially viable for the banks to establish a new set up in the remote areas. *Second,* under a tripartite arrangement among the government, private banks and NGOs credits are being disbursed for the agriculture sector. Currently, a pilot project is being implemented through two private banks – Eastern Bank Ltd and BASIC Bank. The Asian Development Bank (ADB) has provided a fund of USD 42 million to the Ministry of Finance (MoF) for this. The government has disbursed USD 36 million to these two private banks at 3.5 percent interest rate. The private banks are lending these funds to the aforesaid three NGOs at 7 percent interest rate.

FIGURE 3.5: AGRICULTURAL CREDIT POSITION FY2007 & FY2008 (JULY TO APRIL)

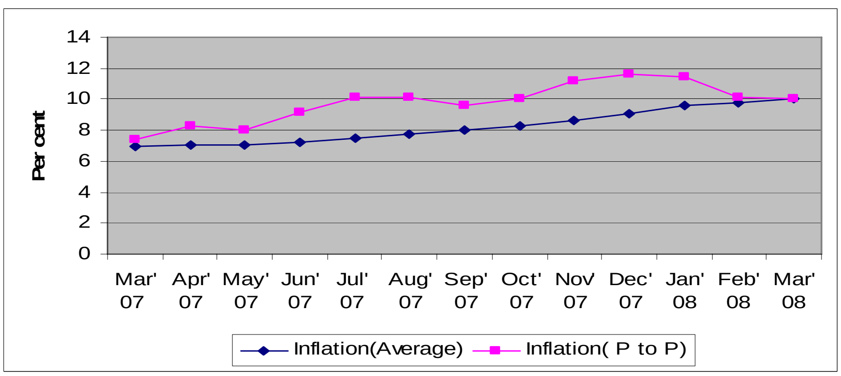


Source: Bangladesh Bank Agricultural Credit & Special Programme Department.

3.6. Consumer Price Inflation

National CPI: The annual average rate of inflation (12-month annual average CPI, 1995-96 = 100) increased to 10.00 per cent in March 2008 from 6.94 per cent in March 2007. High inflation is basically due to higher domestic food prices as food comprises about 59 per cent of total CPI. Global commodity price hike also contributed to the uptrend of inflation in the country (Figure 2.6).

FIGURE 3.6: CPI INFLATION

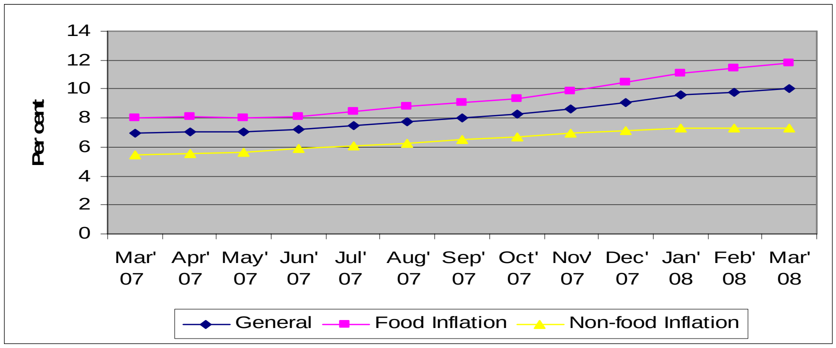


Source: Bangladesh Bureau of Statistics.

Urban and Rural Inflation: Both rural and urban consumers have been feeling the heat of high prices equally. The point to point inflation rate in rural areas in March 2008 was 10.08 per cent with food price inflation rate of 12.54 per cent and non-food price inflation rate of 5.60 per cent. The point to point inflation rate in urban areas in March 2008 was 10.02 per cent with food price inflation rate of 13.81 per cent and non-food price inflation rate of 5.70 per cent.

Food and Non-food Inflation: At the end of March 2008, food and non-food inflation rates on a point to point basis were 12.92 per cent and 5.63 per cent respectively. Food inflation rate on the basis of 12 month average increased from 8.00 per cent in March 2007 to 11.79 per cent in March 2008. Non-food inflation rate increased from 5.42 per cent to 7.33 per cent during the same period (Figure 2.7).

FIGURE 3.7: GENERAL, FOOD AND NON-FOOD INFLATION (12 MONTH AVERAGE)



Source: Bangladesh Bank Quarterly (January to March).

Global Price Scenario: Prices of most commodities, especially those of wheat, rice, edible oil, and crude oil have increased at an unprecedented rate. The price of rice increased by 50 per cent while wheat prices doubled by February 2008 from their respective levels in February 2007. Prices of rice from Thailand (5 per cent parboiled) jumped to US$ 855 per metric tonne in April 2008 from US$ 324 per metric tonne in April 2007. On the other hand, price of Vietnamese rice (5 per cent broken) shot up to US$ 725 per metric tonne in April 2008 from US$ 303 per metric tonne in April 2007. Crude oil price touched US$ 131 per barrel on 29 May 2008 from only US$ 63.92 per barrel on 18 May 2007. Similar trend was observed in case of wheat and soybean oil (Table 2.6).

TABLE 3.6: GLOBAL PRICE OF SOME IMPORTANT COMMODITIES

Period	**Rice US$/metric tonne**	
	Thailand 5 % broken Parboiled	Vietnam 5 % Broken
April 2007	324	303
April 2008	855	725
	Crude oil US$/barrel	
18 May 2007	63.92	
29 May 2008	131	
	Wheat US$/ metric tonne	
March 2007	199.1	
February 2008	425.0	
	Soybean oil US$/ metric tonne	
March 2007	679.5	
February 2008	1307.7	

Source: Bangladesh Bank; www.eia.doe.gov; www.ers.usda.gov, www.bbc.com.

Regional Inflation: South Asian countries have had similar experience with inflation during the recent past. The point to point inflation was 7.9 per cent in India and 28.1 per cent in Sri Lanka in March 2008 compared to 6.7 per cent and 19.5 per cent in India and Sri Lanka respectively in March 2007. In Pakistan inflation rate was 11.3 per cent in February 2008. Table 2.7 shows a comparison of inflation rates in December 2006, December 2007 and March 2008.

TABLE 3.7: REGIONAL COMPARISON OF INFLATION (POINT TO POINT)

Period	*Bangladesh*	*India*	*Pakistan*	*Sri Lanka*
December' 06	6.1	6.6	8.9	19.3
December' 07	11.59	5.9	8.8	16.4
March' 08	10.06	7.9	11.3 (February)	28.1

Source: Bangladesh Bank.

Income Erosion due to Inflationary Pressure: Recent inflationary pressure has had an adverse impact on the consumers through reduction of their purchasing power and income erosion. High inflation, particularly high food inflation, has particularly affected the poor and people in the fixed income group. *A CPD estimate shows that those below the poverty level of income experienced an income erosion of 36.7 per cent during January 2007 to March 2008.* This section of the population spends 45.6 per cent of their income on rice alone. Given the increase of rice price by 66.9 per cent during January 2007 and March 2008 income erosion due only to price hike of rice was about 30.5 per cent. For the remaining 54.4 per cent expenditure, income erosion would be to the tune of 6.2 per cent if only the overall inflation rate is considered. Indeed, most of the workers in the manufacturing and other sectors whose income level is very low are experiencing considerable income erosion. If wages of the lower income groups are adjusted against this inflationary trend, real wage would be much lower. For example, monthly wages of the workers in grades 5, 6 and 7 in the ready made garments (RMG) sector have been fixed at Tk 2046, Tk 1851 and Tk 1662.5 respectively at the time of the last minimum wage review. Taking into account an average income erosion of 36.7 percent the real wages come down to Tk 1295, Tk 1172 and Tk 1052 for workers belonging to the respective grades per month.

The CPD estimates also show that even when the increase in cumulative Gross National Income (GNI) is considered (between 2005 and 2008), given the price hike (particularly taking into consideration of the weighted inflationary impact of price of rice), an additional 8.5 per cent people have fallen below the poverty line in recent times because of high inflation (taking Household Income and Expenditure Survey data for 2005 as reference point). *This would mean that as high as an additional 2.5 million households could have fallen below the poverty line in terms of real income.* Government's Public Food Distribution System (PFDS) and other safety net programes, covering about 10 million people have helped to mitigate the food deprivation of people below the hard core poverty line

3.7. Interest Rate

Interest rate has been an issue of content among the business and banking community for quite sometime in view of high spread between lending and borrowing rates. The BB has recently directed the major commercial banks to reduce the interest rate spread and reduce their lending rates. There has been an agreement recently to fix the highest lending rate at 14.0 per cent. However, the business community is still pursuing for a higher cut in the lending rate. On the other hand private banks feel that given the high cost of funds and high risks of lending in Bangladesh any further reduction in the lending rate is not feasible. Moreover, a lower lending rate calls for a lower deposit rate which will discourage savers to keep money in the bank and thus create liquidity crisis. This, in turn, will have an impact on the overall economy.

Ensuring better returns on deposits would be one way to address the liquidity crisis and improve the situation. The lending rate (calculated on a quarterly basis) of scheduled banks was 12.75 per cent in December 2007 as compared to 12.60 per cent in December 2006. Their deposit rate (also calculated on a quarterly basis) also stood lower at 6.77 per cent in December 2007 as compared to 6.99 per cent in December 2006 (Table 2.8 and Figure 2.8).

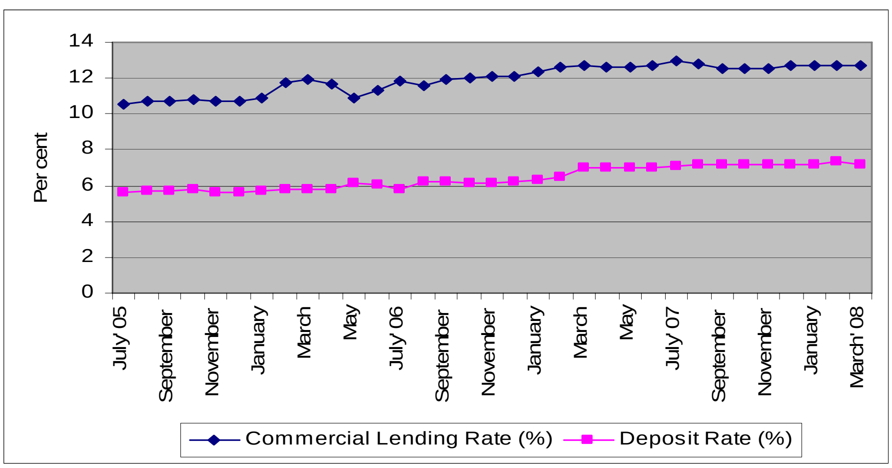
In recent times the spread between banks' *lending and deposit rates* in Bangladesh has come under scrutiny. A study by the BB pointed out that the spread is relatively high in Bangladesh because of inefficiencies, market segmentation and lack of competition (Bangladesh Bank, Policy Analysis Unit, May 2008). The BB has recently directed the major commercial banks to reduce the interest rate spread and reduce the lending rates. There has been an agreement recently to fix the highest lending rate at 14.0 per cent. However, the business community is still pursuing for a higher cut in the lending rate. On the other hand, private banks feel that given the high cost of funds and high risks of lending in Bangladesh any further reduction in the lending rate was not feasible. Moreover, a lower lending rate could consequently lead to a lower deposit rate which could discourage depositors from keeping their savings with the banking system and which could lead to liquidity shortage in the banking sector. If the BB pushes banks to lower their lending rates devoid of any self-clearing market mechanism this could have damaging consequences. *If the real rate of interest continues to decrease people might become more aggressive to hedge inflation by investing in real estate or capital market which could create bubble in the respective markets.*

TABLE 3.8: WEIGHTED AVERAGE OF INTEREST RATES

Period	Lending Rate	Deposit Rate	Call Money Rate
December 2004	10.83	5.56	7.62
December 2005	11.25	5.90	8.40
December 2006	12.60	6.99	7.16
December 2007	12.75	6.77	9.37
April 2008			18.85
May 2008			20.00

Source: Bangladesh Bank and Communication with Private Banks.

FIGURE 3.8: MONTHLY TREND OF LENDING AND DEPOSIT RATES



Source: Bangladesh Bank.

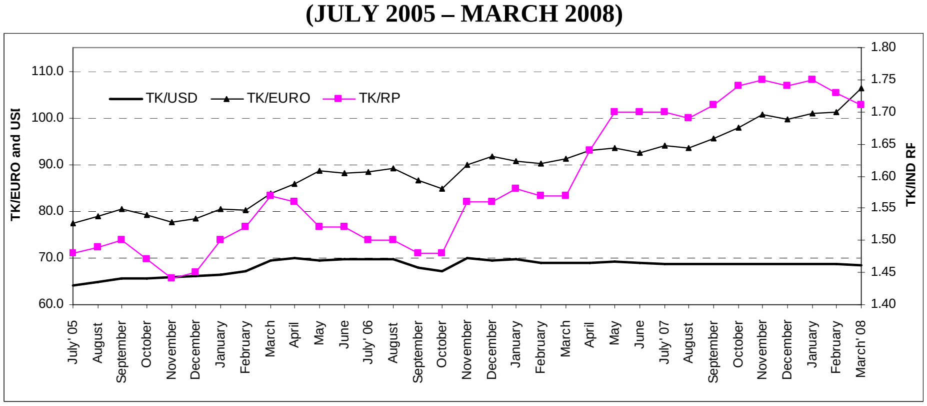
3.8. Exchange Rate Situation

The introduction of floating exchange rate in 2003 has been useful in containing fluctuations of Taka against foreign currencies, particularly the US dollar. Taka has appreciated slightly by 0.33 per cent during March 2007 and March 2008. At the end of March 2008 Taka per US$ decreased to Tk. 68.58 from Tk. 68.81 at the end of

March 2007. However, depreciation of the Taka against Euro continues. Taka depreciated against Euro by 17.87 per cent in March 2008 compared to March 2007

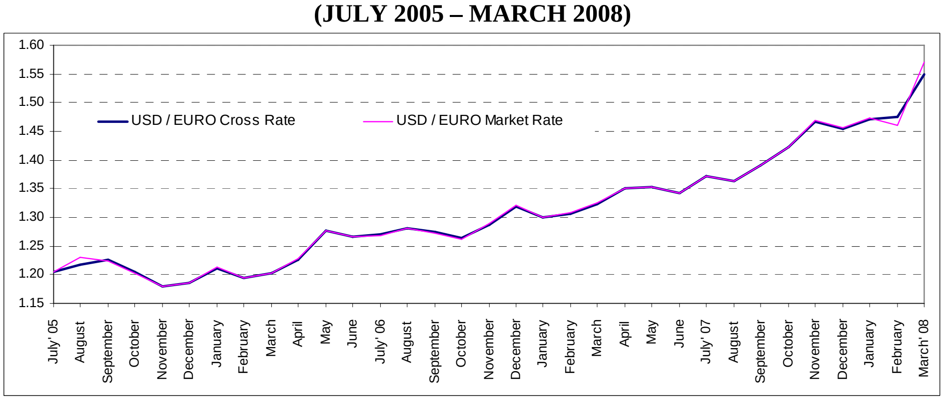
Notwithstanding high inflation rate, *Bangladesh Taka (BDT) has remained strong against the US Dollar (USD) in view of the relatively high levels of forex reserves underpinned by unprecedented growth in remittance flows*. At the end of March 2008 BDT per USD declined to Tk.68.58 from Tk.68.81 at the end of March 2007 (Figure 10). The weakening of the USD at the global level is also likely to keep BDT/USD exchange rate stable. In FY2008 the BB has injected about US$ 500 million in the foreign exchange market to keep BDT from depreciating further. A stable exchange rate against the USD has been helpful in not allowing import prices to rise further. In Bangladesh there is no EURO/BDT market and EURO/BDT rate is calculated from the traded rates of USD/BDT. Against EURO, BDT depreciated as EURO appreciated significantly against USD, and USD remained stable against BDT. Given the increase in volume of trade between Bangladesh and India the exchange rate of BDT with Indian Rupee (INR) is becoming important too. Depreciation of BDT against INR in recent years has helped Bangladeshi exporters. Figures 2.9, 2.10 and 2.11 present monthly movements of BDT against USD, EURO and INR during July 2005 and March 2008.

FIGURE 3.9: MOVEMENTS TO TK AGAINST USD, EURO AND INDIAN RUPEE (JULY 2005 – MARCH 2008)



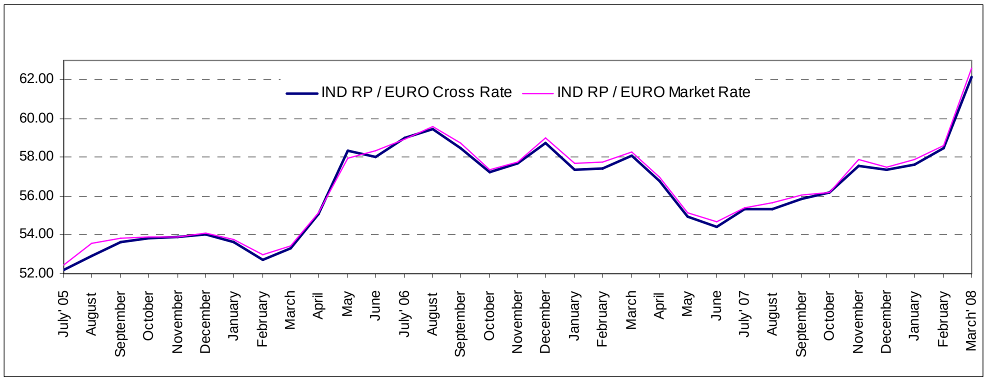
Source: Bangladesh Bank.

FIGURE 3.10: USD/EURO CROSS RATE AND MARKET RATE (JULY 2005 – MARCH 2008)



Source: Bangladesh Bank.

FIGURE 3.11: INDIAN RUPEE/EURO CROSS RATE AND MARKET RATE (JULY 2005 – MARCH 2008)



Source: Bangladesh Bank.

4. REAL SECTOR

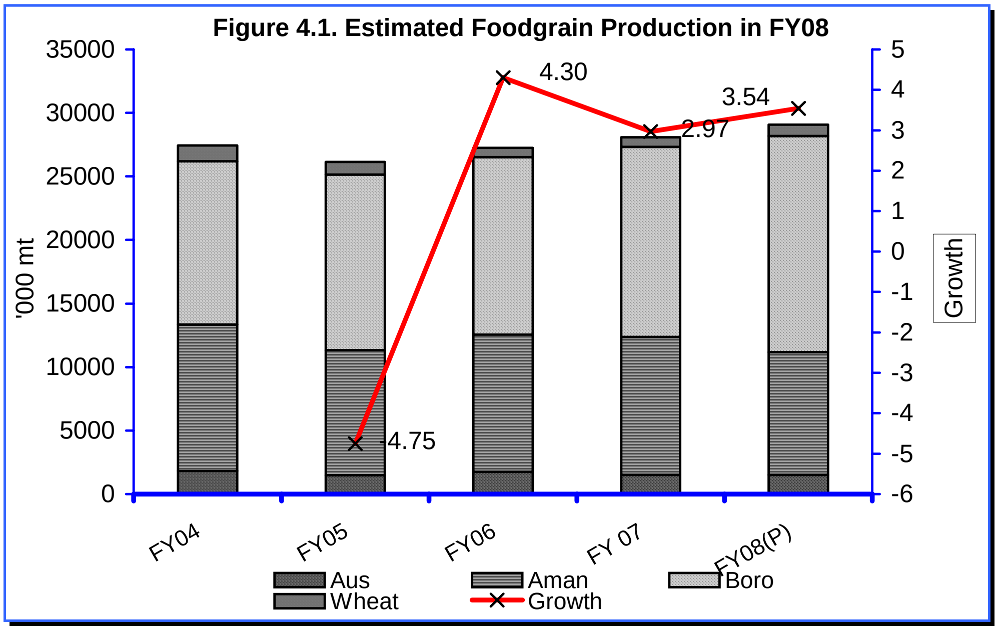
4.1. Agriculture

***Production of Foodgrains**:* According to the final estimates of the Bangladesh Bureau of Statistics (BBS), total foodgrains (rice and wheat) production in FY2007 was 28.07 million metric tonnes (mmt) (Aus: 1.51 mmt, Aman: 10.86 mmt, Boro: 14.97 mmt and wheat: 0.74 mmt) which was 2.97 per cent higher than previous year (FY06). However, it was 14.6 percent less than the foodgrain production target (32.87 mmt in FY2007). Total production of foodgrains in FY2007 increased due to increase in rice production. Wheat production has been on a gradual decline since 1999.

Department of Agricultural Extension (DAE), initially set the operational target for foodgrains production in FY2008 at 33.05 million mt (Aus 2.22 mmt, Aman 13.05 mmt, Boro 16.95 mmt and wheat 0.84 mmt) which was 15.04 per cent higher than actual production in FY2007. After the floods and *Sidr*, DAE planned for a massive agricultural rehabilitation programme and revised its target for Boro rice production. As per the revised target, DAE planned to produce 17.50 mmt of Boro rice from 4.50 million ha of land comprising of 1.25 million ha Hybrid rice, 3.125 million ha of HYV rice and 0.125 million ha of local Boro rice in FY2007/08. It is pertinent to recall that both Aus and Aman rice was affected by two consecutive floods in 2007 and super cyclone *Sidr* has also destroyed standing Aman crops. According to the estimate of CPD and BRAC, about two million metric tons of rice was lost due to flood and *Sidr*.

According to the BBS, Aus and Aman production in FY2008 was 1.51 mmt and 9.66 mmt, respectively. Farmers are currently harvesting Boro rice which will continue until the end of June. According to the estimates of the Centre for Environmental and Geographic Information Services (CEGIS), total area under Boro rice in the current season was 4.53 million ha. Boro rice cultivation is relatively more concentrated in Sunamganj, Kishoreganj, Mymensingh, Dinajpur, Comilla, Naogaon and Bogra districts. Seven districts (Dinajpur, Sunamganj, Mymensingh, Noagaon, Bogra, Comilla, Netrakona) accounts for about 32 percent of the total Boro rice area in this season and each of them has an area which is more than 1.5 lakh ha. Another eight districts (Kishoreganj, Jessore, Rangpur, Tangail, Sirajganj, Gaibandha, Habiganj, Brahamanbaria) have a share of about 22 percent of total Boro rice area of the country and each of these districts has a cultivated area of between 1 lakh ha and 1.5 lakh ha cultivated under Boro rice.

We had made an attempt to estimate distribution of area under differents cultivars in the current Boro season. According to our estimates, share of HYVs, Hybrids and Local varieties are 85 percent, 12 percent and 3 percent, respectively. Important local varieties cultivated are Kali Boro, Jagli and Binni. Popular HYV rice varieties were BR28, BR29. These two varieties covered approximately 60 percent of area under HYV. BR 14 (Gazi) has grown in about 4 percent of total HYV area. Rest of the area under HYV is covered by other varieties. Among the Hybrids, most popular variety was Heera (32 per cent of all hybrids), followed by BRAC hybrids (Aloran, Jagoron and Shakti covering 22 per cent of all hybrids), Sonar Bangla (9 per cent of all hybrids), hybrids marketed by ACI (9 per cent of all hybrids), Aftab (7 per cent of all hybrids), Lal Teer (marketed by East-West Seed Company: 7 per cent of all hybrids) and others (14 per cent). Thus, our estimates indicate that area under all Hybrids in this Boro season may be about 0.6 million ha. As regards likely production of Boro rice, this may be in the range of 17.0 mmt, according to our estimates. Wheat production is estimated at about 0.90 mmt. Thus, total production of foodgrains in FY2008 may be in the range of 29.07 mmt (Figure 3.1). In other words, total production of foodgrains in FY2008 is likely to be 3.5 percent higher than that of last fiscal year.



Source: Bangladesh Bureau of Statistics (BBS), CPD estimates.

Considering the good production of Boro rice the pertinent question is whether the price of rice will experience a down turn in the coming days? Our understanding is that rice price would be reduced only insignificantly and is likely to remain high.

Food and Agriculture Organization (FAO) in its latest Food Outlook report (May 2008) also predicted similar trends for global price of rice. According to the FAO forecast, this year's (2008) cereal production (about 2192 million tons including rice in milled terms) will increase by 3.8 per cent compared to the last year. The Report added that rice production is expected to hit a new record of some 670 million tonnes worldwide, a global increase of 2.3 per cent. Production in Asia is expected to increase and large increase is forecasted in Bangladesh, China, the Philippines, Thailand and Vietnam. The FAO Food Outlook report also added that global rice prices may fall to some extent but will still remain at high levels.

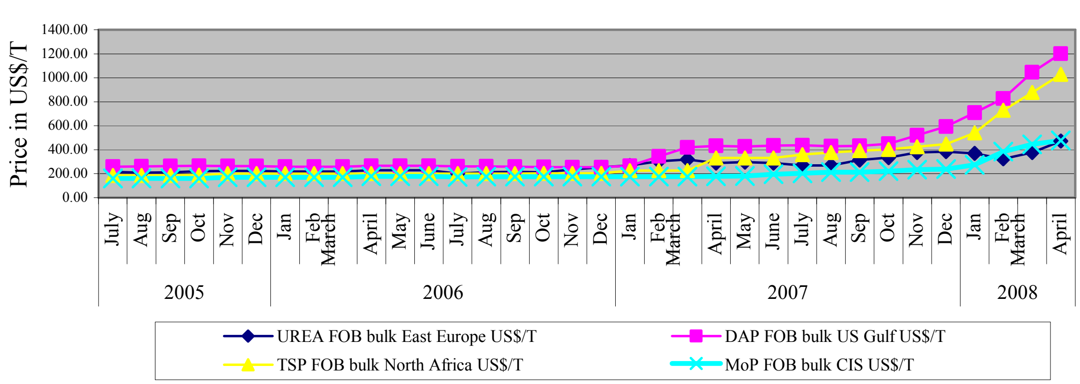
Potato production was good but production of jute was poor than last year. According to the BBS, potato production in FY2008 was 6.65 million metric tons which is 28.7 per cent higher than that of FY2007. On the other hand, jute production in FY2008 was 4.62 million bales which is 0.28 percent lower than that of FY2007. Lower production of jute was mainly due to flood damage. Production situation of winter vegetables were good. Currently, farmers are harvesting summer vegetables. Production situation of summer vegetables is also good.

Input supply and subsidy for the crop sector: Input supply situation was relatively good in the current Boro season, compared to the last year. Total consumption of electricity by irrigation pumps during July-March of FY2008 was 75.84 mkwh which was 17.9 percent higher than that of FY2007 (comparable months). Electricity consumption by irrigation pumps during the Boro season (November-March) of FY2008 was 72.99 mkhwh which was 24.6 percent higher than that of FY2007 (comparable months). As is known, subsidy on account of irrigation may reach upto Tk. 75 crore in FY2008.

Total supply of fertiliser was less than required. There was a gap between actual requirement to attain high yield goal and amount of total fertiliser distributed but concerned agencies were able to distribute the available fertiliser in an effective manner. National Budget FY2007/08 allocated Tk. 1500 crore as subsidy for fertiliser and Tk. 750 crore as subsidy for diesel. Fertiliser used by farmers in Bangladesh is obtained from two sources: domestic and international. The Ministry of Agriculture (MoA) estimated demand for urea fertiliser in FY2007/08 as 28.18 lakh metric tons, TSP 4.76 lakh metric tons, DAP 2.50 lakh metric tons and MoP 4.00 lakh metric tons. The MoA planned that total demand for Urea would be met through 15.00 lakh metric tons from production of BCIC factories, 4.50 lakh metric tons from KAFCO and 9.00 lakh metric tons from international import. According to the MoA report (October 2007), per kg production cost of urea in Bangladesh was Tk. 7.20 which was sold at Tk. 4.80 and subsidy for per kg urea from domestic sources was thus equivalent to Tk. 2.40. On the other hand, import cost of per kg urea was estimated as Tk. 31.00 which was sold at Tk. 5.30 and thus government had to subsidise Tk. 25.70 for each kg fertiliser imported from abroad. According to the aforesaid report amount of total subsidy for fertiliser was estimated at Tk. 3606 crore (urea: Tk. 3120 crore and TSP, DAP and MoP: Tk. 486 crore). As is happened, price of fertiliser in the international market continued to rise and, consequently, actual subsidy on account of fertiliser had to be substantially increased.

Between June 2007 (Budget announcement) and April 2008, price of all types of fertilizer has risen consistently increased in the international market (Figure 3.2). Price of urea increased from US$ 289.00 per metric ton in June'07 to US$ 471.30 in April'08. During this period, per metric ton price of TSP has increased from US$ 331.00 to US$ 1029.00, and that of DAP increased from US$434.50 to US$ 1201.00; price of MoP has increased from US$ 196.90 to US$ 477.60.

Figure 4.2. International Price of Fertiliser (Urea, DAP, TSP & MoP): July 2005 to April 2008



Source: Commodity market review, World Bank.

Available information suggests that total subsidy for fertiliser and other activities under the ministry of agriculture could be about Tk. 3740 crore (Tk. 3408.5 crore for fertiliser, Tk. 75.0 crore for electricity for irrigation and Tk. 250 crore for diesel for irrigation and Tk. 6.5 crore for sugarcane). During the July-February of FY2008, actual amount spent was Tk. 1900 crore.

High and rising prices of fertiliser and diesel in the international market have implications also for the next Budget. Given the global situation of export restrictions on foodgrains, particularly on rice, Bangladesh's only option appears to be to produce more foodgrains. To do so, estimated fertiliser requirement in Bangladesh in FY2009 is likely to be 35.2 lakh metric tons of Urea, 5.9 lakh metric tons of TSP, 5.0 lakh metric tons of MoP and 3.2 lakh metric tons of DAP. Bangladesh will need to estimate and allocate the subsidy on fertiliser accordingly. If the government can not find the required resources to provide adequate subsidy to supply the required amount of fertiliser, it will be forced to increase the administered price of fertiliser so that subsidy provided on per kg fertiliser will be reduced but total and timely availability of fertiliser will be assured.

Food Aid and Commercial Import: Imports of foodgrains to Bangladesh are sustained from two sources: food aid and commercial imports. The latter comes through both government and private channels. During July-May of FY2008, total import of foodgrains (food aid and commercial imports) was 3380 thousand mt out of which 239 thousand mt was food aid, 254 thousand mt as commercial import by public sector, and 2887 thousand mt was imported by the private sector import (Table 3.1). It may be noted that private sector import of total foodgrains during the comparable months of FY2007 was 2049 thousand mt. Private sector import of rice in FY2008 was 1681 thousand mt against 627 thousand mt. On the other hand, wheat import by private sector during July-May of FY2008 was 1208 thousand mt against 1421 thousand mt for comparable months of FY2007. Total import of foodgrains and rice during July-May of FY2008 were respectively 52.0 and 208.0 per cent higher than that of comparable months in FY2007. After two consecutive floods, when it was clear that there was substantial production loss and price was increasing in the domestic market, private sector started to import large quantities of rice. Import would have been much higher if there was no restriction of export of rice and other foodgrains by various countries. Even though import of foodgrain in FY2008 was much higher (11.6 lakh mt more) than that of last year (FY2007), it failed to meet the gap in view of requirement and production loss caused by flood and Sidr (20 lakh mt), leading to price volatility in the market.

TABLE 4.1: FOOD IMPORT IN FY2008

(in '000 metric tons)

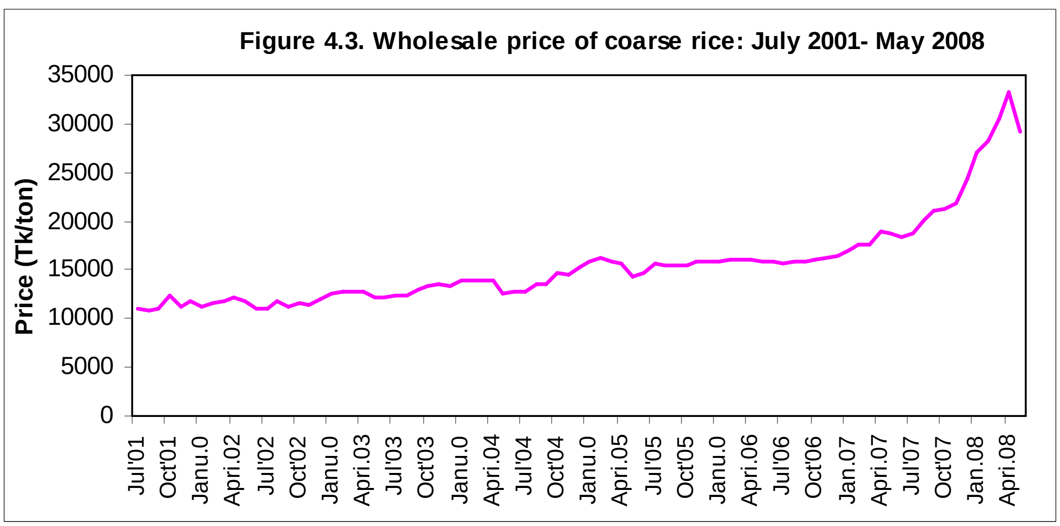
Category of Imports	FY2007 (July-May)			FY2008 (July-May)		
	Rice	Wheat	Total Foodgrains	Rice	Wheat	Total Foodgrains
Food Aid	25	66	91	73	166	239
Public Commercial Import	0	85	85	254	0	254
Private Import	627	1421	2049	1681	1206	2887
Total	652	1572	2224	2008	1372	3380

Source: Food Planning and Monitoring Unit (FPMU), Ministry of Food and Disaster Management

Rice Price: In the beginning of FY2008 (i.e. July 2007) the wholesale price of coarse rice in Bangladesh was Tk. 18,700 per mt which gradually increased to Tk. 29,000 per mt in early January 2008 and reached record high levels in April (Tk. 33,196) and then declined to Tk. 29,141 in May 2008 after harvest of boro rice (See Figure 3.3). Domestic prices (both for wholesale and retail) of coarse and medium rice (Figure 3.4 to Figure 3.5) increased exponentially during the last one year. It becomes evident from price analysis that domestic price of rice has increased sharply with the announcement of minimum export price by India. This was true for both the retail and wholesale market. It may be recalled here that India first fixed minimum export price of non-basmati rice at US$ 425 per metric ton on October 25, 2007. Subsequently, India announced US$ 505 per mt on December 27, 2007 and US$ 650 per mt on March 19, 2008. Finally, India announced minimum export price US$ 1000 per mt for non-basmati rice and US$ 1200 per mt for basmati rice on March 28, 2008. Finally, on April 1, 2008 India banned export of non-basmati rice.

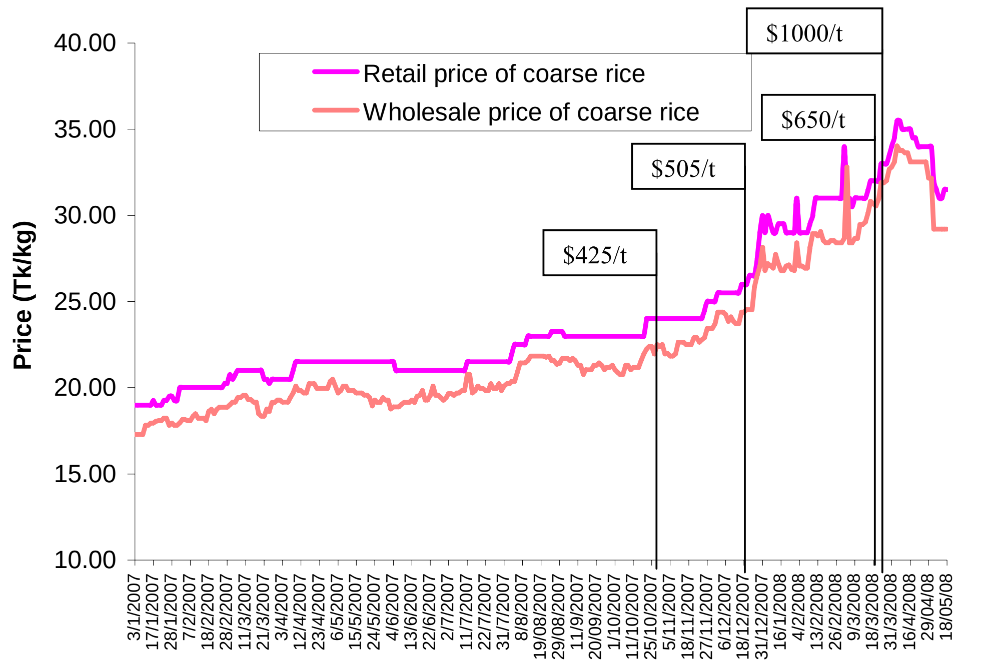
It is possible that minimum export price fixed by the government of India also had an effect on the global rice price (Figure 3.6). Policies taken by India had to some extent, influenced those of other countries such as Vietnam, Cambodia, and Egypt who were persuaded to rethink their export strategy. At some point in time these countries had also imposed temporary ban on export of rice.

In 1998 and 2004, following floods, Bangladesh was able to import huge quantities of rice and wheat from international market to offset the production loss caused by flood. Due to restrictions imposed on rice exports by major exporters, import of rice was a problem in the current fiscal year of FY2007/08. However, it is evident from Figure 3.7 that private sector of Bangladesh has responded well to the domestic and international prices and polices to bridge the gap between demand and supply in Bangladesh.



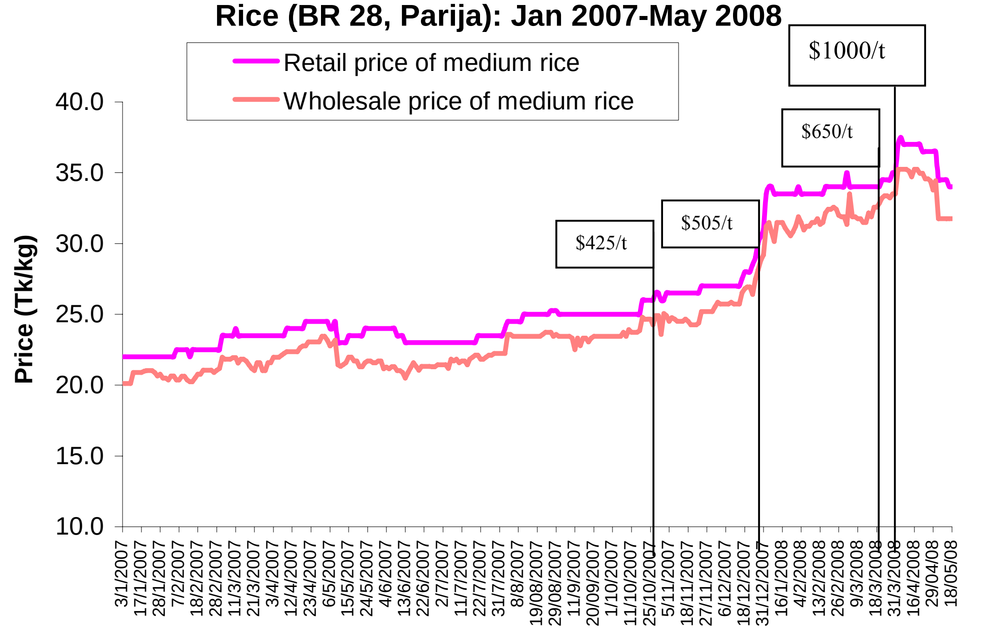
Source: Food Planning and Monitoring Unit (FPMU)

Figure 4.4. Retail and Wholesale Price of the Coarse Rice (BR 8, BR 11, Swarna): Jan 2007-May 2008



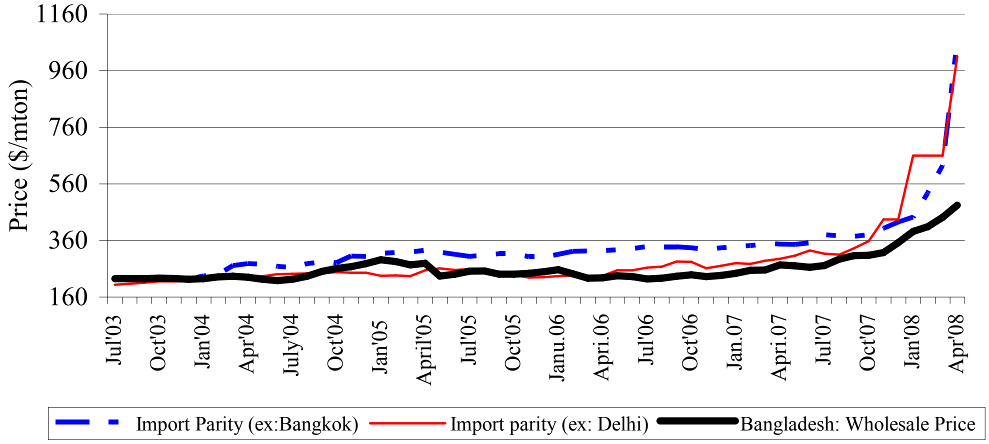
Source: Directorate of Agricultural Marketing (DAM).

Figure 4.5. Retail and Wholesale Price of the Medium Rice (BR 28, Parija): Jan 2007-May 2008



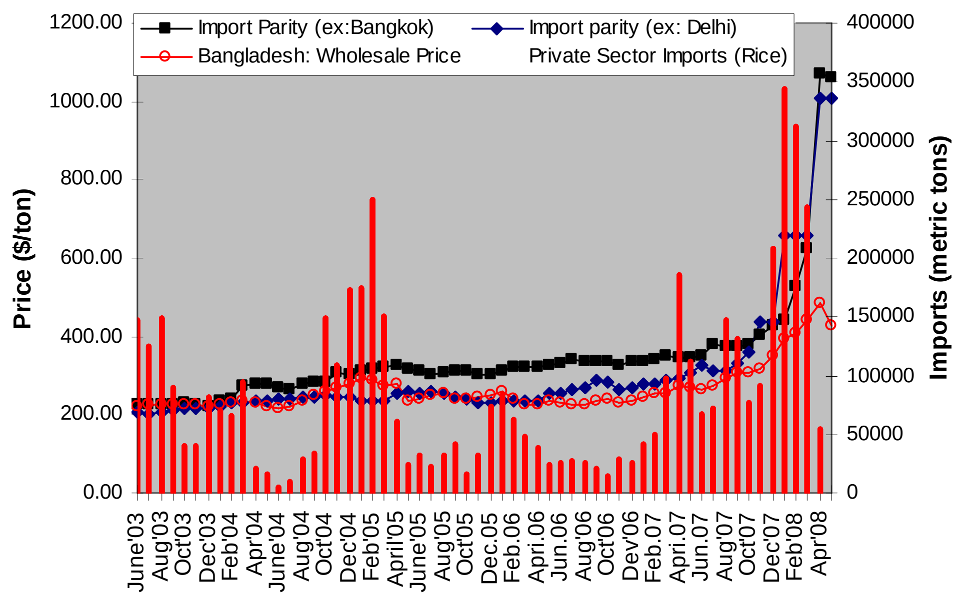
Source: Directorate of Agricultural Marketing (DAM).

Figure 4.6. Comparison of Domestic Prices of Rice with Import Parity Price: July 2003-May 2008



Source: Source: Food Planning and Monitoring Unit (FPMU), Bangladesh; USDA; and Price Monitoring Cell, Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

Figure 4.7: . Rice Prices and Quantity of Private Rice Imports in Bangladesh, June 2003- May 2008



Source: Food Planning and Monitoring Unit (FPMU), Bangladesh; USDA; and Price Monitoring Cell, Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

We must be cautious about the future production and prices of foodgrains in Bangladesh and total global production. There are a number of medium and long term factors which will have an impact on future food production, to varying extent. *First,* the *conflict between food and fuel* will increase with high demand for fuels by the rich countries and also the big emerging economies, such as India and China. The distribution of land for agriculture and land for fuels will be a major factor contributing to limited food production. *Second,* the ongoing Doha Round

Negotiations of the World Trade Organisation (WTO) on agriculture will have an impact on net food importing countries. The objective of agriculture negotiation in the WTO is to withdraw domestic support given by the USA and the European Union. This will imply that net food importing countries such as Bangladesh will have to buy food at a higher price from the global market. *Third,* the impact of climate change will be felt more frequently and severely by low lying poor countries such as Bangladesh. Frequent flood, cyclones and other extreme weather are early indications of this danger. This will not only destroy production, but also reduce the fertility of land and change the cropping pattern. *Fourth,* every year 90 million people are being added to the global population leading to increased demand for food.

Livestock Production: Livestock producers were severely affected by flood and *Sidr* in 2007. According to the Department of Livestock Services, two consecutive floods had affected 2,794 livestock farms and 5,412 poultry farms of 228 upazilas under 39 districts. Floods have also damaged about 148 thousand tons of livestock and poultry feed. Total loss to the livestock and poultry sector by floods in 2007 was Tk. 64.36 crore. On the other hand, *Sidr* led to the death of 108 thousand cattle, buffalo, sheep and goats and 2.57 million poultry birds. *Sidr* has destroyed more than six thousand livestock and poultry farms. Estimated loss of livestock sector, affected by *Sidr* is Tk. 132.26 crore.

As part of rehabilitation measures for livestock and poultry farms affected by flood and *Sidr*, government and other organisations have taken following measures: (i) A medical team of 4 members are working in each upazila and providing medical services and continuing vaccination programme; (ii) A high ranked medical team of 4 members are supervising local activities in each division; (iii) 47 metric tons of livestock feed was distributed in 7 districts; (iv) Up to second week of May 2008, more than 200 thousand of livestock and about 2010 thousand poultry have been vaccinated; medical service was provided to about 195 thousand livestock and 803 thousand poultry; and (v) Bangladesh Army, BRAC, and other NGOs distributed 1665 cows, 882 oxen, 2581 calves, 13115 goats and 6564 chickens in 27 upazilas of Barisal and 2 upazilas of Khulna districts. In addition, Tk. 17.94 lakh were distributed to reconstruct the damaged firms in these areas.

Poultry production in many areas has faced bird flu (avian influenza). According to the Department of Livestock Services, bird flu was found in 219 poultry farms (Commercial: 177 and family: 42) under 110 upazilas and 13 Metro Thanas of 47 districts. Culling was done in 425 poultry farms (Commercial: 383 and Family: 42) where 1.433 miilion birds were culled and 1.553 milion pieces of eggs were destroyed by the concerned authority. Government distributed Tk. 11 crore 20 lakh to compensate for the affected firm owners. Each firm owner received Tk. 95 per domestic chiken, Tk. 90 per layer, Tk. 60 per broiler and Tk. 3 per egg as compensation. Concerned agencies of the government had taken prompt actions such as active disease surveillance, culling of birds in affected farms, limiting human movement in affected farms and disinfecting the affected farms which are crucial to containing the situation. However, the threat is not yet over. According to news published in the Newspaper (Prothom-Alo, 23 May 2008), a human boy was affected by bird flu in Bangladesh. We thus need to remain vigilant about the spread of bird flu. To this end, effective implementation and continuation of the two projects on prevention of bird flu and development of poultry sector would be required. A budget of Tk. 400 million was allocated in the National Budget FY2007-08 for this and this resource needs to be appropriately allocated in the next budget.

Fisheries Production: Fisheries sub-sector was also badly affected by floods and *Sidr*. According to the Department of Fisheries (DoF), two consecutive floods affected more than two lakh ponds and *dighies* in 259 upazilas under 39 districts. Total loss of fish production was 33.56 thosand metric tons which was worth of Tk. 196.49 crore. The government allocated Tk. 41 crore for rehabilitation of the fisheries sub-sector. During the flood, concerned agencies suspended planned disbursement and release of fingerlings (worth Tk. 3.03 crore) were suspended during the floods. Following the flood these agencies distributed 1.2 crore fingerlings in the flood affected areas.

Sidr hit the coastal belt at a time when it was off-season for Bagda. However, loss to the fish farmers, who invested in ponds with prawn (galda) and various types of fresh water fish, were substantial. Fish farmers made fairly good investment, often financed by micro-credit. The ponds were flooded and the fish escaped to creeks and canals. The water in the ponds has been contaminated with fallen leaves and twigs and has become unfit for fish culture in the immediate future. According to the DoF, 11 districts (Khulna, Satkhira, Bagerhat, Barisal, Jhalokati, Pirojpur, Bhola, Barguna, Patuakhali, Gopalgonj and Munshigonj) were severely affected by *Sidr*. More than 139 thousand ponds and *dighies* were affected by *Sidr* which together covered an area of about 44 thousand acres. As a result about 799 metric tons of shrimp, 5.7 thousand metric tons of fish, and 205 lakhs fingerlings were damaged. It is to be noted that fish farming is no longer a business of the rich people only. To sustain the growth in fisheries sub-sector a massive rehabilitation programme would be required in FY09. Small farmers would require both technical (reclamation of damaged fish pond, fish fry) and financial support in the form of loan.

4.2. Industrial Sector

Production of Large, Medium and Small Industries: Manufacturing sector, particularly large and medium scale industries, has registered a modest rise of 6.4 per cent during the first three quarters compared to the matched period of FY2007 (Table 3.2). After a sluggish growth in the first quarter (0.6 per cent), production picked up in second (9.2 per cent) and third quarters (9.8 per cent). However, the performance of the manufacturing sector was substantially below the level of growth achieved in the recent past in FY2006 (16.3 per cent) (Figure 3.8). It appears from the data that business confidence is gradually improving following a number of initiatives of the government towards better business environment. These included relaxation/withdrawal of several stringent measures taken earlier for monitoring business practices, formation of better business forum headed by the Chief Advisor, establishment of Regulatory Reforms Commission etc. According to CPD's Executive Opinion Survey 2008 which was conducted during February-April, 2008, about 60 per cent of leading business executives perceived that government drives against improper business activities including corruption in 2007 had negatively affected business environment (Table 3.3). On the contrary, various institutional reform measures pursued by the government in FY2008 were perceived by business executives to have improved business environment (80 per cent).

TABLE 4.2: GROWTH OF QIP OF MANUFACTURING SECTORS BETWEEN 2007 AND 2008

	Q1-Q3 (Jul.-Mar.)
General index of Mfg new	6.4
Food, beverage & tobacco	4.5
Jute, cotton & apparel, leather	7.4
Wood product including furniture	14.8
Paper & paper product	12.7
Chemical, petroleum & rubber	1.4
Nonmetallic product	3.5
Basic metal product	9.1
Fabricated Metal product	7.5

Source: BBS and Bangladesh Bank

Figure 4.8: Growth of QIP of Large and Medium Industries

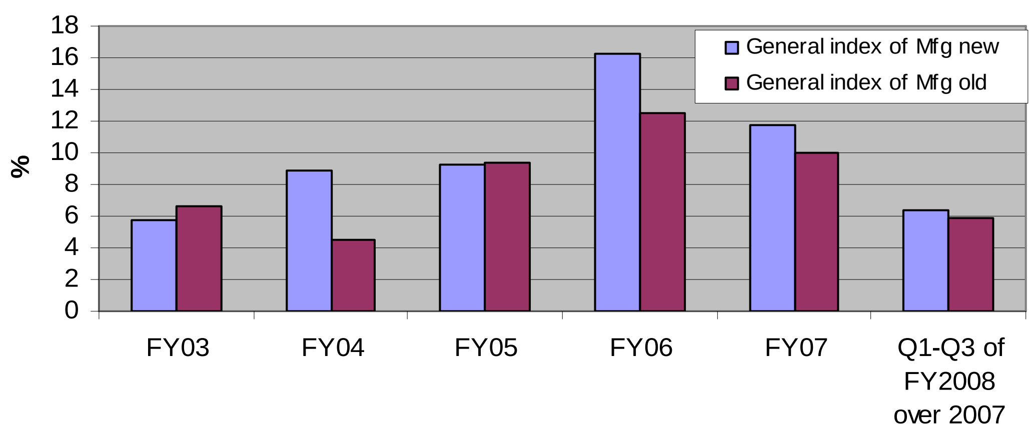


TABLE 4.3: CPD EXECUTIVE OPINION SURVEY 2008

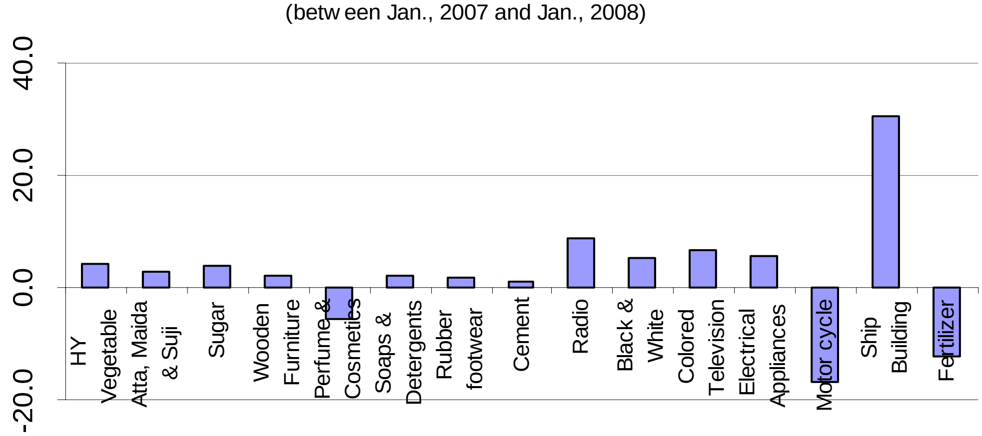
		Frequency	Valid Per cent
Entrepreneurs' Perception on Recent policy/Institutional Reforms of the government: Whether these reforms would help to develop business environment of the country?	Disagree	8	9.8
	Indifferent	8	9.8
	Agree	66	80.4
	All	82	100
Entrepreneurs' Perception on Government's drive against improper business activities including corruption in 2007: Whether such measures had	Negative impact on business environment	49	59.1
	Indifferent	15	18.1
	Positive impact on business environment	19	22.8
	All	83	100

Source: CPD Executive Opinion Survey, 2008.

Major manufacturing sectors, such as apparels, food, beverage, tobacco, basic metals, except chemical products have achieved relatively moderate level of growth during this period. Apparel sector, which accounts for two-thirds of the overall weight of the manufacturing sector, has attained a growth of 7.4 per cent in the Q1-Q3 period; more importantly, sectoral growth was 11.8 per cent in the third quarter of FY2008 compared to that in FY2007, after a negative growth in first quarter of FY2008 (-0.4 per cent) and a significant rise in the second quarter (11.4 per cent). Contrary to the usual trend, production of various processed food products such as soyabean oil, flour etc., which in recent months suffered from inflationary pressure, is driven by higher price of imported raw materials (Figure 3.9).

These sectors registered low levels of growth in recent months (3-4 per cent higher in January, 2008 *vis a vis* 2007). Production of other consumer goods, which largely targeted the domestic market, such as furniture, soaps and detergents, perfume and cosmetics, rubber and footwear have also registered slower growth rates. Indeed with the fall in purchasing power due to high inflation, demand for consumer goods was expected to suffer which is clearly reflected in the figures.

Figure 4.9: Growth of Production of Various Manufacturing Products (between Jan., 2007 and Jan., 2008)



Source: BBS.

It is interesting to note that not withstanding the rising demand for fertiliser in the domestic market, production of fertilizer was only 45 per cent in July-January, 2008 period (892,531 mt) compared to the amount of production during the whole year of FY2007 (1,982,292 mt); more importantly, production of fertiliser in the month of January, 2008 was 12.4 per cent lower compared to January, 2007. One of the major reasons for the low level of fertilizer production was the decline in the supply of gas to fertilizer plants (24 per cent of total gas supply in FY2003, 17.4 per cent in FY2007 and 14 per cent till February, FY2008). In view of recent changes in the regulations of the International Maritime Organisation (IMO) as regards structure of ships, opportunities for emergence of Bangladesh as a major small scale ship building industry has increased quite considerably. Entrepreneurs are taking initiatives to develop the export-oriented ship building industry in the country which needs to be complemented through policy support. During July-January, 2008 production was 2081 mt, which was 3705 mt for FY2007; indeed production in January, 2008 was 30.7 per cent higher compared to January 2007. Telecom companies including mobile and PSTN have performed well during July-April period of FY2008. Total number of subscribers of mobile telephone companies was 32.4 million in July, 2007 which increased to 38.9 million in April, 2008, including a rise of 13 per cent in the number of subscribers. In case of PSTN, total number of subscribers increased from 1.19 million in December, 2007 to 1.26 million in April, 2008 a rise of 5.8 per cent within five months.

Production of small scale industries, on the other hand, rose at a relatively slow pace compared to that in large and medium industries (Table 3.4). During the second quarter of FY2008, rate of growth of small scale industries was 5.7 per cent (comparable figure for large and medium industries was 9.2 per cent). Small scale industries grew at a similar pace with large and medium enterprises in case of manufacturing textile, apparel and leather products, and grew at a higher rate in case of chemicals, rubber and plastic, non metallic and mineral products, metal products and machinery etc. However, they posted lower (or negative) growth in case of food and beverage, wood products, paper and printing. A slow growth of the manufacturing sector, particularly the small scale enterprises, during first and second quarters of FY2008, was to a large extent caused by uncertainties originating from institutional reform measures, inadequate infrastructure facilities particularly lack of adequate electricity supply, high inflation and high interest rate for borrowing from banks.

TABLE 4.4: COMPARISON OF QIPS BETWEEN LARGE, MEDIUM AND SMALL INDUSTRIES (SECOND QUARTER OF 2007 AND 2008)

	Large Industries	Small Industries
Manufacturing industry (new)	9.2	5.7
Manufacturing industry (old)	7.2	
Food, beverage, and tobacco	1.9	-0.9
Textile, apparel and leather	11.4	10.1
Wood and wood product	18.2	10.0
Paper printing and publishing	15.5	1.2
Chemicals, rubbers & plastic	0.9	2.3
Non-metallic, mineral product	3.7	8.4
Basic metal industry	9.1	4.9
Metal product & machinery	6.3	11.3
Other manufacturing industry		-3.6

Source: BBS.

Industrial Term Loan, Bank Advances and Opening and Settlement of LCs: Investment in the manufacturing sector, as measured by such proxy indicators as industrial term loan, bank advances to industrial enterprises, opening and settlement of LCs etc., showed some positive results during July-March period of FY2008 compared to that of the previous year. According to Table 3.5, disbursement of industrial term loan during July-March, 2008 was 66 per cent higher (total disbursement was Tk. 14,574.3 crore) compared to that in the previous year; additionally, recovery of term loan during the same period was also better (51 per cent). Net disbursement of industrial term loan as measured by disbursement after deducting recovery of loan, was Tk. 4,868 crore which was Tk. 2,523 crore (108 per cent) higher compared to the same period of the previous year. The highest amount of net disbursement (Tk. 2,567 crore) took place during the second quarter of FY2008. Advances by private sector banks, which comprise short and long term loans including term loan and working capital financing to manufacturing and service sectors have increased by a considerable amount. According to Table 3.6, net disbursement of loans in a form other than working capital, has increased by 24 per cent; while in terms of working capital it has increased by 52 per cent. In case of service related industries, such as trade and miscellaneous industries, net disbursement has increased by 52 per cent and 146 per cent respectively, while it has decreased in the case of construction (72 per cent), transport and communication (23 per cent), and storage (57 per cent) etc. A low level of disbursement in certain sectors indicates low investment response of entrepreneurs of those sectors, which may also be related to increasing amount of overdue loans that in turn, discouraged financial institutions to provide credit to those sectors. It is also of some concern to note that overdue loans, in case of industrial term loans, have grown by 3 per cent in January-March, FY2008 compared to the same period of the previous year (16 per cent as against 13 per cent) (Figure 3.10).

TABLE 4.5: INDUSTRIAL TERM LOAN (CRORE TK.)

Month	2006-07			2007-08		
	Disbursement (a)	Recovery (b)	Net (a-b)	Disbursement (a)	Recovery (b)	Net (a-b)
July-September	2660.3	1740.9	919.4	3784.8 (42.3%)	2625.2 (50.8%)	1159.6 (26.1%)
October-December	3204.5	2394.0	810.5	5878.5 (83.4%)	3311.5 (38.3%)	2567.0 (216.7%)
January-March	2911.4	2297.1	614.3	4911.1 (68.7%)	3770.0 (64.1%)	1141.1 (85.8%)
July-March	**8776.2**	**6432.0**	**2344.2**	**14574.3 (66.1%)**	**9706.7 (50.9%)**	**4867.6 (107.6%)**

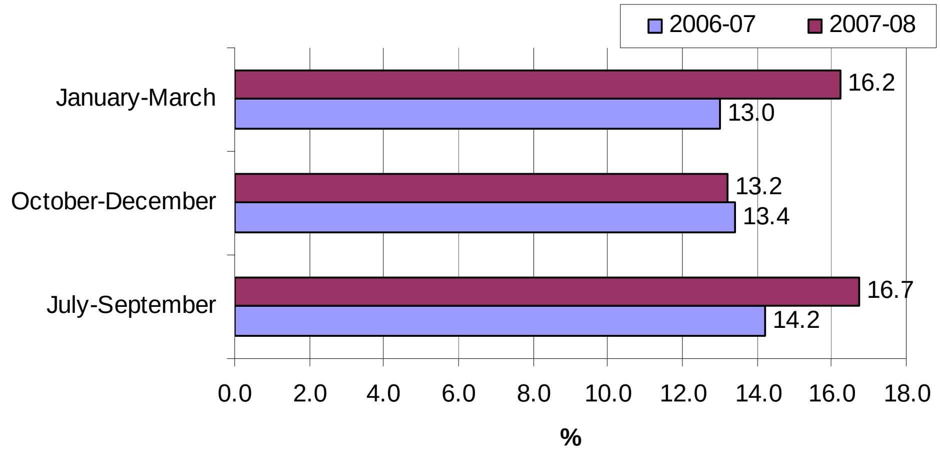
Source: Bangladesh Bank.

TABLE 4.6: NET DISBURSEMENT OF CAPITAL BY BANKS DURING JULY-MARCH, 2007 AND 2008

	Net Disbursement of Capital (crore Tk.)		
	July-March, 2007	July-March, 2008	Change
Industry (other than working capital)	3600	4470	24.2
Working capital financing	1380	2100	52.2
Construction	1190	330	-72.3
Transport and Communication	310	240	-22.6
Storage	-140	-60	-57.1
Trade	4870	7300	49.9
Miscellaneous	1210	2980	146.3
Total (including agriculture)	***13140***	***18570***	***41.3***

Source: Author's estimate based on data collected from the Bangladesh Bank.

Figure 4.10: Overdue as percentage of outstanding



Bank advances for small scale enterprises under 'EEF' programme, a good initiative in itself, could not meet the growing demand of eligible businesses to the required extent.. According to Bangladesh Bank, a total of Tk. 469.8 crore has been disbursed till April, 2008 in 215 agro-based and 34 IT related projects (Table 3.7). Major projects included fish hatchery (93), shrimp hatchery (50), software development (32) and poultry and fish feed projects (18). However, the EEF covered only about 38.1 per cent of the total cost of the projects, and this coverage needs to be expanded to provide adequate support to the eligible business activities. Thus so far, 82 projects have received full financial support, 145 projects received partial support, while 22 projects are yet to claim for support. In case of IT sector, instead of concentrating only on software development, the coverage of the EEF support should be extended to call centre projects as well in view of their increasing presence. There is hardly any window of support for new, innovative and risky small scale projects from financial institutions. Taking this into consideration, Bangladesh Bank should facilitate support in the form of venture capital to small scale investors.

TABLE 4.7: DISBURSEMENT STATUS OF EEF IN AGRO-BASED AND IT INDUSTRY (UP TO 30 APRIL, 2008)

(Crore Tk.)

	Agro-based				IT industry				Total (EEF)			
Project Status	No.	Total project cost	Sanction amount	Disbursed amount	No.	Total project cost	Sanction amount	Disbursed amount	No.	Total project cost	Sanction amount	Disbursed amount
Fully Disbursed	69	660.0	198.5	198.5	13	76.2	26.8	26.8	82	736.2	225.2	225.2
Partly Disbursed	126	720.2	323.8	227.2	19	64.7	30.1	17.3	145	784.9	353.9	244.4
Projects not yet claimed for disbursement	20	112.2	43.5		2	3.8	1.7		22	116.0	45.2	
Total	215	1492.4	565.8	425.7	34	144.7	58.6	44.1	249	1637.1	624.3	

Source: EEF unit, Bangladesh Bank.

A major factor constraining business activities in recent years has been the high rate of interest both in case of term loan and working capital. According to the perception of leading business executives captured through CPD's Executive Opinion Survey in February-April, 2008, as many as 93.2 per cent of business executives mentioned that high rate of interest was a problem leading to cost escalation; while 36 per cent business executives mentioned cost escalation to be as 'high'(Table 3.8). In 2007, the comparable figures were 91 per cent and 32 per cent respectively. Besides, 52 per cent of business executives in FY2008 thought that the prevailing level of inflation has increased cost of production at a 'high' level, when the corresponding figure for 2007 was only 19 per cent. This indicates severity of inflation as a problem which was having negative impact on businesses in FY2008.

TABLE 4.8: CPD EXECUTIVE OPINION SURVEY, 2008

	July 2006-June 2007				July 2007-Jan 2008			
	High	Medium	Low	No	High	Medium	Low	No
Did existing lending rate increase cost of production?	31.9	36.1	23.6	8.3	35.6	35.6	21.9	6.8
Did existing level of inflation increase cost of production?	19.4	56.9	15.3	8.3	52.0	36.0	6.7	5.3

Source: CPD Executive Opinion Survey, 2008.

Recently, banks have decided to lower the lending rate of term loan and working capital, and fixed this at the maximum of 14 per cent. A total of 23 banks have decided to reduce their rates of lending from a maximum of 16 per cent to 14 per cent level (Table 3.9). In case of term loan, a good number of banks have decided to cut lending rate by about 1-2 per cent, while in case of working capital financing 11 banks have reduced lending rate by less than 0.5 per cent. Reduction of interest rate on term loan and working capital was expected to reduce entrepreneur's cost of borrowing from the banking sector.

TABLE 4.9: NUMBER OF BANKS HAVING LENDING RATE HIGHER THAN 14 PER CENT

Range	Term Loan to Large & medium scale Industry (no.)	Term Loan to small industry (no.)	Working Capital to Industry (no.)
$14 < r^* \leq 14.5$	6	6	11
$14.5 < r \leq 14.75$	5	2	2
$14.75 < r \leq 15$	4	3	5
$15 < r \leq 16$	7	7	5
Total	22	18	23

* r denotes the rate of interest

Source: Author's Estimate.

Import of raw materials and capital machineries

Opening and settlement of LCs for importing intermediate goods and industrial raw materials could be used as proxy for investments in existing operation. Imports of intermediate goods and raw materials have increased by about 11.5 per cent during

July-April FY2008 compared to the same period of the previous year.However, import of capital machineries has decreased by 8.5 per cent during the same period. Import of intermediate goods, industrial raw materials, and capital machineries is likely to increase in the fourth quarter as is indicated by the growth of LCs opened in recent months (July-March, FY2008). Growth of LCs opening for industrial raw materials and capital machineries were 40per cent and 15 percent respectively during July-April of FY2008 (Table 3.10) . Imports of industrial raw materials such as edible oil, textile fabrics, pharmaceutical raw materials, raw cotton yarn etc. is likely to increase substantially (40 per cent). In line with this, settlement of LCs for these have increased by 28 per cent.. From this, one could infer that entrepreneurs are investing through working capital.

TABLE 4.10: CHANGES IN FRESH OPENING AND SETTLEMENT OF LCs DURING JULY-APRIL PERIOD OF 2007 AND 2008

	Fresh LCs opening	Settlement of LCs
Industrial raw materials	*40*	*27.9*
Edible oil & oil seeds	69.7	76.3
Textile fabrics (B/B & others)	17.5	4.4
Pharmaceutical raw materials	58.3	22.2
Raw cotton	43.5	43.1
Cotton yarn	46.6	20.5
Synthetic yarn	46.5	21.3
Chemicals & chemical products	61.8	43.8
Capital machinery	*14.9*	*-9.8*
Textile machinery	33.3	-23.8
Leather / tannery	-1.3	50.1
Jute industry	-1.75	-27.9
Garment industry	19.9	1.7
Pharmaceutical industry	15.3	-22.5
Plastic Industry	80.7	-61.6
Packing industry	-20.8	43

Source: Bangladesh Bank.

On the other hand, opening and settlement of LCs for importing capital machineries and other machineries could be used as proxy for investment in new projects or extension of existing projects etc. Imports of capital machineries such as textile, garment, and pharmaceutical machinery have increased during July-April, 2008 to varying degrees (Table 3.10). However import of capital machinery (in terms of LC opening) has declined in case of some industries such as leather, jute and packing industry etc. Although import of capital machineries posted negative growth of -7.2 per cent during July-September, 2007, indicating a slow down in new investments, the rise in LC openings in the following periods of FY2008 compared to the same period of the FY2007 signals a positive upturn in recent months.In terms of settlement of LCs for capital machineries, the proportionate share was 9.8 per cent lower in the current fiscal year compared to the previous year. Import of machineries of other industries has also increased. Thus, it appears that not all industries are responding at the same level when asked about setting up of new projects, possibly considering different levels of growth prospects and cost involved.

FDI in Bangladesh: County's overall FDI trends in the first eight months show signs of stagnation**.** During July-February, 2008 period foreign investment including portfolio investment amounted to US$561 million, which was 3.6 per cent lower compared to the previous year (Table 3.12). On its own, inflow of portfolio investment has increased in recent months; as a result overall flow of FDI has increased by 15.4 per cent in January-December, 2007 compared to that of the previous year. Investment in EPZs has substantially increased (100 per cent) during July-April, 2008 compared to that in the whole year of FY2007 (Table 3.13). Simultaneously, a large amount of outward transfers of FDI-related income has taken place during these comparable periods which has consequently reduced effective flow of FDI in the country to a significant level (Table 3.14). During 2007 outward transfers in the form of profit, dividend, royalties, license fees, and most importantly income of power, oil and gas companies amounted to be US$705 million and this was US$466 million in 2006. Thus, effective inflow of FDI, after deduction transfers from FDI inflow, amounted to only US$245 million in 2007 and US$358 million in 2006. A substantial amount of transfers in the form of income, especially by oil, gas, and power companies against their investment is taking place, which amounted to US$507 million in 2007 (corresponding figure for 2006 was US$318 million). Reinvestment should be encouraged although this is highly related to a conducive business environment. Prompt decision will also need to be taken with respect to major investment proposals including the TATA's.

TABLE 4.11: INFLOW OF FDI

(Million. US$)

Items	2005 (Jan.-Dec.)	2006 (Jan.-Dec.)	2007 (Jan.-Dec.)	% change in 2007 over 2008	FY2007 (Jul.-Feb.)	FY2008 (Jul.-Feb.)	Change between Jul-Feb., 2007 and 2008
Foreign direct investment (net)	734.4	792.5	749.3	-5.5	540	491	-9.1
Portfolio investment	110.8	30.9	201.1	550.8	42	70	66.7
Total FDI	***845.3***	***823.4***	***950.4***	***15.4***	***582***	***561***	***-3.6***

Source: Bangladesh Bank.

TABLE 4.12: INVESTMENT IN EPZ

(Million. US$)

EPZ	FY2007		FY2008
	Total	Total (up to April)	Total (up to April)
Chittagong	32.6	25.8	105.5
Dhaka	87.5	80.8	101.1
Adamjee	7.7	7.0	30.3
Karnaphully	1.9	0.3	16.4
Comilla	21.0	18.3	8.7
Mongla	0.4	0.1	2.0
Ishwardi			1.4
Uttara	1.2	0.2	0.1
All	152.4	132.5	265.6 (100.4%)

Source: Bangladesh Export Processing Zone Authority, BEPZA.

TABLE 4.13: NET INFLOW OF FDI

(Million. US$)

	2006 Jan-Dec	2007 Jan-Dec	% change in 2008 over 2007
FDI Inflow	823.4	950.4	15.4
Transfer of FDI related Income	465.7	705.4	51.5
Royalties and license fee	4.8	7.7	61.8
Profit and Dividends	143.2	190.9	33.3
Earnings of Oil, Gas and Power companies	317.7	506.8	59.5
Net FDI Inflow	357.7	245	-31.5

Source: Bangladesh Bank.

It needs to be noted that registration of FDI in 2007 has declined substantially (-78.7 per cent) compared to the previous year (Table 3.15). A total of US$318 million worth of investment projects was registered in 2007, which was only one third of the total FDI flow in that period. Manufacturing and textiles sectors received substantial amount of new investment proposals, while in all other sectors including power, gas, services, telecommunications, agriculture and food there was a substantial reduction in terms of investment proposals. Out of the US$318 million worth investment proposals submitted by 141 companies, only 17 projects with an investment of $38.4 million was actually realized (which was only 12 per cent of the total proposed investment in 2007). BEPZA, on the other hand, has received substantially high investment proposals (US$943 mil.) during July-May, 2008 compared to that in FY2007 (Table 3.16). A large rise in the inflow of FDI and registration of new FDIs with EPZs is partly because of new investment opportunities created at two recently opened EPZs, namely Adamjee and Karnafuly EPZs. This year, some investment proposals targeted new industries such as terry towel, metal products, chemical and fertiliser, furniture, sports goods, tent, services etc., which is important in view of diversification of production and export base of the manufacturing sector of the country.

TABLE 4.14: FDI REGISTERED AT BOI IN 2006 AND 2007

(Million. US$)

Sector	2006	2007	% Change
Agriculture & Food	8.6	3.1	-63.3
Manufacturing	62.7	113.8	81.5
Power Gas Petroleum	17.9	17.0	-5.1
Service	45.9	5.8	-87.3
Textile & Wearing	128.9	169.1	31.2
Telecommunication	1116.1	0.3	-100.0
Transport, Storage & Comm.	115.6	8.7	-92.5
Total	1495.6	317.8	-78.7

Source: BOI.

TABLE 4.15: PROPOSED INVESTMENT IN EPZS

(Million. US$)

Sector	Proposed Investment in EPZs	
	FY2008 (up to 21 May)	FY2007
Textile	133	9
Terry towel	7	0
Metal Products	10	0
Electronics & electrical goods	5	0.1
Garments	73	211
Plastic goods	41	12
Footwear & leather goods	68	7
Knitting & other textile dept.	14	43
Agro products	6	1
Garment accessories	110	21
Power Industry	163	64
Chemical & Fertilizer	14	0
Furniture	173	0
Sports goods	3	0
Service Oriented Industries	59	0
Tent	49	0
Miscellaneous	15	3
Total	943	370

Source: BEPZA.

Capital Market: Buoyancy in the capital market was notable since the early months of FY2008. This was sustained over the subsequent period, despite the sluggish trends both in industrial growth and long term investments in early months. During July, 2007 market capitalisation of DSE was US$7.9 billion, which surged in the following months and reached US$12.5 billion in April, 2008; the corresponding figures for FY2007 were US$3.4 billion and US$5.7 billion respectively (Figure 3.11). Market capitalization of CSE was US$10.7 billion (64.6% higher) in April, 2008 compared to that in July, 2007. Similar trend is observed in case of all share price index, general index and top 20 index in DSE (Figure 3.12). According to financial analysts, country's capital market received a large amount of capital since the early months of FY2008. New and small scale investors are once again showing interest and it seems that some transfer of funds has taken place from the banking sector to capital market; which could be a result of strict monitoring of bank transactions leading to a transfer of savings to the capital market. This is corroborated by the fact that outstanding stock of total deposits including demand and time deposits has decreased in July-February, 2008 (Tk. 15199.7 crore) compared to the corresponding period of the previous year (Tk. 15252.4 crore) (Table 3.17). Bullish capital market has attracted small investors in the later part of FY2008 also because of the incentive in the form of capital gains tax waiver for investment into the market. Low levels of real return from bank deposits, at a period of high inflation is also a likely reason. One will need to closely monitor how the capital market makes necessary adjustments in the coming months in view of the relatively slow pace of growth of the industrial sector. It is important to note that till February, 2008, US$70 million portfolio investment has entered into the capital market, which was 67 per cent higher compared to the corresponding period of the previous year. A large inflow of portfolio investment was possibly because of high return in short term transaction in the country's capital market as also because of poor return on investment in weak stock markets in some of the developed countries.

Figure 4.11: **Market Capitalization of DSE**

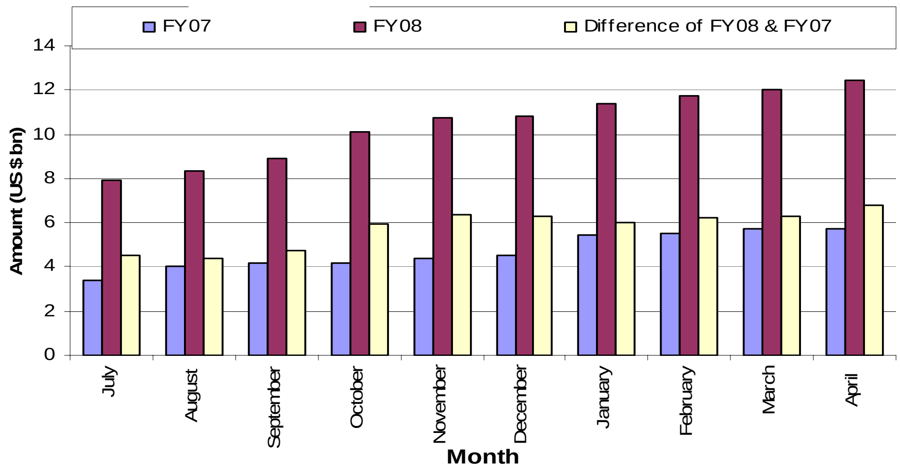
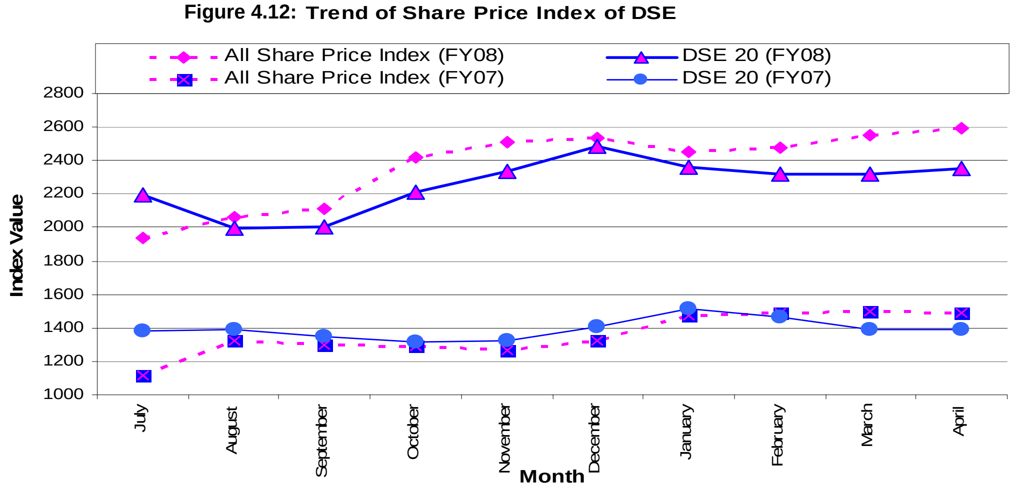


TABLE 4.16: CHANGES IN BANK DEPOSITS DURING 2007 AND 2008

	Outstanding stock			Changes in outstanding stock			
	June, 2006	June, 2007	Feb, 2008	July-Feb, 2007-08	Feb, 2008 over Feb, 2007	July-Feb, 2006-07	Feb, 2007 over Feb, 2006
	1	2	3	5	6	7	8
Deposits	158294.00	185342.40	200542.10	15199.70 (+8.20)	26995.70 (+15.56)	15252.40 (+9.64)	28378.60 (+19.55)
Demand deposits	20272.10	24006.10	24946.70	940.60 (+3.92)	3899.20 (+18.53)	775.40 (+3.82)	3687.70 (+21.24)
Time deposits	138021.90	161336.30	175595.40	14259.10 (+8.84)	23096.50 (+15.15)	14477.00 (+10.49)	24690.90 (+19.32)

Source: Bangladesh Bank.
Note: 6 and 8 indicates percentage changes over end-June of previous fiscal year; 5 and 7 indicates percentages over the corresponding period of the preceding year

Figure 4.12: **Trend of Share Price Index of DSE**



Movement of the various share prices in the DSE (also in CSE) reveals that prices of all types of shares have increased including 'Z' category shares in FY2008. Indeed prices of blue chips have increased at a relatively slower pace compared to all share price index and general index (which includes 'Z' category shares) (Figure 3.12). A large number of small investors are possibly unaware of, or do not care about performance and future plan of the enlisted companies. Many such investors are buying shares at high prices in anticipation of further rise in prices; consequently their exposure to risk appears to be quite high.

New IPOs in the capital market till 21 May, 2008 was only 9 and only a few number of IPOs operated in the previous year as well (12) (Table 3.18). All new IPOs are related to financial sector including banks, insurance, mutual funds etc. Entrepreneurs in the manufacturing and service sector appear to be less interested to mobilise equity from the capital market; rather they appear to prefer substantial debt financing through banks and other financial institutions. Substantial oversubscriptions (though reduced by 48 per cent in the current fiscal year) indicate that a large number of investors are ready to invest in the capital market, if more good IPOs come to the market. The government has given tax incentive to companies (to the tune of 10 per cent of company tax) to encourage them to participate in the share market. Government's initiative to attract large companies to the capital market including the telecom companies is yet to give results (the Grameen Phone is expected to offload a certain percentage of its share, 5-10 per cent, in the coming months). Offloading a number of public limited companies, a decision taken by the government previously, is also yet to take place. Offloading shares of large companies in the capital market is likely to attract more local and foreign portfolio investment in the country.

Figure 4.13: Difference of Indices in DSE for FY08 and FY07 (upto April)

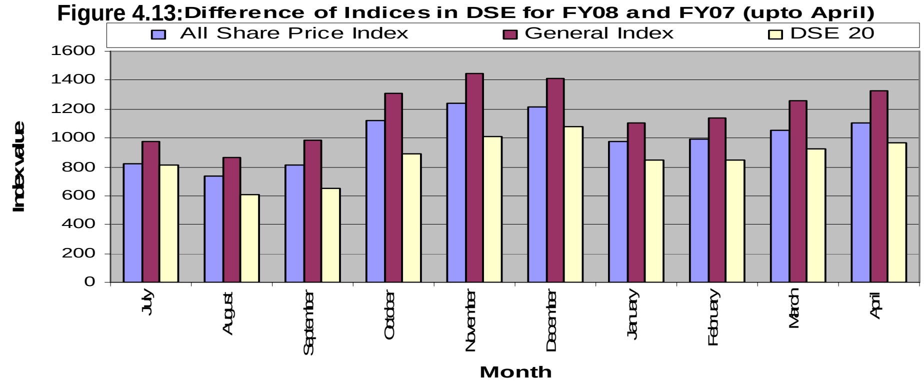


TABLE 4.17: IPO'S FLOATED IN THE DSEs DURING 2007 AND 2008

	FY2007	FY2008 (up to 21May)	per cent change
No. of IPO's	12	9	-25
Total Issued Shares	149705920	28073270	-81.25
Sponsors' Portion (Share)	94598125	15800220	-83.30
Public Offer (Share)	55107795	12273050	-77.73
Public offer as percentage of total Issued Shares	36.81	43.72	18.76
Total Paid up Capital (after IPO) (in Tk)	7154943862	5517327000	-22.89
Total Paid up Capital (after IPO) (in Tk)	7154943862	5517327000	-22.89
Total over-subscription (Tk)	26249633100	21405568250	-18.45
Over-subscription as per cent of total public offer	734.30	378.44	-48.46

Source: Calculated based on information collected from the DSE website.
Note: For FY2008 over-subscription includes eight IPO's

Power Sector: Distribution and Generation: Inadequate power supply has been a major bottleneck that has severely constrained investment and business activities in Bangladesh. New industries and economic activities are not coming up because of absence of power supply; the existing ones suffer from frequent outages, leading to damage of equipments, production disruption and cost escalation originating from more costly alternative sources. A large gap (734 MW in May, 2008) exists between demand for power generation and distribution, though generation has somewhat increased in recent months (Figure 25 and Table 3.19). During April, 2008 on average total power generated was 3639 MW, which was 8.7 per cent higher compared to the same period of the previous year; since January, 2008 production has increased by more than 10 per cent, but this still lags significantly behind the demand for electricity. According to Table 3.20, load shedding in recent months has increased - from 720 MW in February, 2008 to 907 MW in April, 2008, and 1049 MW in May, 2008 because of a number of plants not being in operation. According to the BPDB, the highest number of power plants in operation was 90 in February, 2008, while the lowest number of power plants in operation was 78 in April, 2008. Because of frequent power outages, industries and businesses are becoming increasingly dependent on captive power in order to ensure uninterrupted power supply to factories and business premises.

According to BPDB major reasons for the generation shortfall are repair and maintenance works of plants and forced stoppage, and very recently due to shortages of gas. Power generation has been hampered in recent months due to shortages of gas to the tune of 939 MW in February, 2008, 728 MW in March, 2008 and 720 MW in April, 2008. One of the main reasons for lack of gas supply in public sector power plants is because of shortage of gas supply by gas companies for having large amount of arrears. Petrobangla MIS report shows that government has arrears of Tk. 260 crore up to February, 2008, whereas non-government companies have arrears of Tk. 86 crore (Table 3.21). These arrears of the power companies are related to the huge amount of unpaid bills of various government and non-government organisations and system loss etc. The government needs to take appropriate measures to ensure payment of gas companies by recovering arrears of public companies which is due to the BPDB, in order that power generation is not hampered.

Figure 4.14: : **Demand-Supply Gap of Electricity**

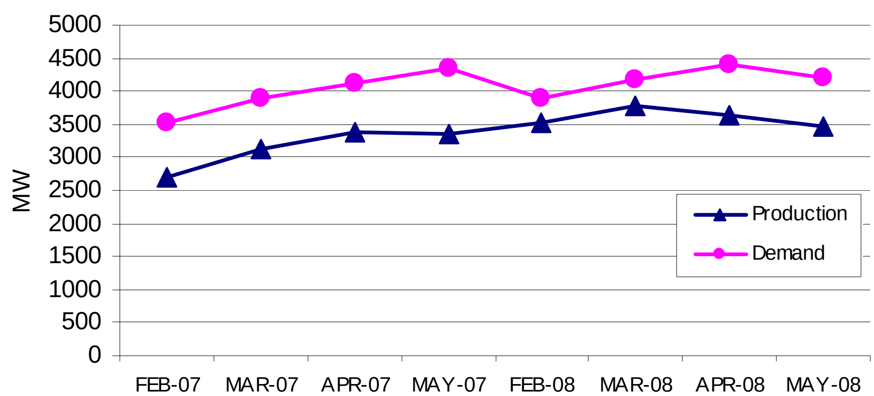


TABLE 4.18: POWER USE DURING 2007 AND 2008

	FY2007 (Mkwh)	FY 08 (Mkwh)	Point to point Change (%)
July	1966.76	1993.88	1.4
August	1976.74	2040.22	3.2
September	1731.47	2052.18	18.5
October	1745.59	1884.87	8.0
November	1592.29	1638.83	2.9
December	1565.55	1547.14	-1.2
January	1542.29	1721.24	11.6
February	1460.32	1728.03	18.3
March	1800.93	2039.02	13.2

Source: BPDB, MIS Report.

TABLE 4.19: OPERATION, GENERATION AND LOAD SHEDDING SITUATION OF POWER PLANTS DURING 2007 AND 2008

		Feb. 2007	Feb. 2008	Mar. 2007	Mar. 2008	Apr. 2007	Apr. 2008	May 2007	May 2008
Plants in Operation	Highest	75	90	77	82	81	84	82	83
	Lowest	69	79	68	75	72	78	76	76
Generation	Highest	2888.6	3826	3588	3935.1	3717.8	3847.3	3557.1	3773.6
	Lowest	2455.7	3025	2500.1	3537.8	2679.9	3491.8	3205.1	3271.7
Load Shedding	Highest	931	720	1144	835	1062	907	1118	1049
	Lowest	478	110	80	000	000	310	408.00	0
Generation shortfall due to gas shortage (MW)	Highest		939		728		720		710
	Lowest		300		447		400		389

Source: BPDB, MIS Report.

TABLE 4.20: ARREARS OF POWER GENERATION COMPANIES TO GAS COMPANIES (UP TO FEB, 2008) (MILLION TAKA)

Power Generation Companies	Titas	Bakhrabad	Jalalabad	Western Zone	Sylhet	BGFCL	RPGCL	Barapukuria	Total
Government	2054.16	210.1	191.5	148.53	0	0	0	0	2604.29
Non Government	781.1	0	0	80.21	0	0	0	0	861.31
Total	2835.26	210.1	191.5	228.74	0	0	0	0	3465.6

Source: Petrobangla MIS Report.

To generate the required amount of electricity in the country, government should take immediate steps to construct several large and small scale power plants in the country. According to BPDB, a total of 30 power plants are to be set up in the country by 2012, of which 17 power plants are now under construction phase which are expected to be commissioned by 2009 and another 13 power plants are under processing which are planned to be commissioned by 2010 to 2012. If all these power plants are constructed in time, a maximum of 4445 MW additional power supply could be added to the national grid. A total of 12 power plants with a production capacity of 694 MW is planned to be built during 2008. However, only one has been established as of now and others are still under construction. Out of this, 11 power plants will be constructed on rental terms for 3 years to 15 years. Since most of these constructed or proposed power plants is planned to use gas as raw materials, supply of the required gas in power plants is critical. According to an estimate of generation of electricity in a large scale combined cycle power plant, a total of 0.16-0.19 mmscf gas is required for generation of 1 MW of electricity. Taking this into account, an amount of 711.2-844.55 mmscf gas will be required for generating 4445 MW of electricity. It will be a challenge for petrobangla to supply the required quantity of gas to the power plants from its limited reserves for a prolonged period of time, unless it explores new sources of gas in the country. Government should take necessary measures to set up coal-based power plants by using the coal reserve of the country. The first step towards this would be to take a decision with regard to the National Coal Policy, which is now in the process of review by the CTG.

Gas Production: Gas production has somewhat decelerated over time – its growth rate was 7.6 per cent in 2006, which fell to 6.7 per cent in 2007 (Table 3.22).During 2008 gas production was 11008 mmcf till February, FY2008, which was 61.1 per cent of the target set for FY2008 (18025 mmcf).Under the existing rate of production (1393.4 mmcf in February, 2008 from 73 wells out of 93 wells) it would be difficult to achieve the target level of production, though it may cross the production mark of the previous year. In 2008, production is projected to decline by 30.9 per cent and reach the lowest level in six years (11007.85 mmcf), mainly because of substantial fall in the generation of gas by Petrobangla (39 per cent).However, although use of gas in industrial and business activities is increasing (29.2 percent of total gas consumption for industry and captive power till February, FY2008 against 26.1 per cent in FY2007 and 16.9 per cent in FY2003), more gas will be required to meet the growing demand of these economic activities (Table3.23) . Due to shortage of gas, government has delimited/controlled the supply of gas to various economic activities, especially in industrial units particularly, yarn and textile manufacturing units in the evening hours. Appropriate initiatives will have to be taken to put in place additional power for meeting the increasing demand of the consumers and entrepreneurs. As is known, gas supply to industrial units in Chittagong has been rationed in recent times.

TABLE 4.21: GAS PRODUCTION IN DIFFERENT YEARS (MMCF)

Year	Petrobangla	IOC	Total	Growth rate
2002-03	9449.125	2476.721	11925.85	
2003-04	9715.113	3106.01	12821.12	7.51
2004-05	10086.48	3696.907	13783.39	6.98
2005-06	10116.56	4804.286	14920.85	7.62
2006-07	10148.45	5771.65	15920.1	6.69
2007-08	6155.987	4851.867	11007.85	-30.86 (predicted)

Source: MIS Report, Petrobangla.

According to energy experts, current gas reserves, estimated to be 8.0 trillion cubic feet (tcf), will not be able to meet the demand of the country after 2015; about 24 tcf gas will be required to meet the energy demand up to 2025, with an estimated investment of US$8 billion in the energy sector. Petrobangla floated international tender on February 15, 2008 to lease out 28 offshore gas blocks, divided into two categories-shallow blocks and deepwater blocks. The price of gas was proposed to be US$180 per metric ton while it was US$120 in the first round of bidding and US$140 in the 2nd round. According to the offer, per-unit gas (1000 cubic feet) will cost US$4.50, which is similar to the price offered by Myanmar and India in their recent block bidding ($4.5 to $5 per 1000 cubic feet).

TABLE 4.22: SHARE OF DIFFERENT SECTORS IN TOTAL GAS CONSUMPTION (%)

Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-2008 (up to Feb)
Power	46.5	46.6	46.3	45.3	41.2	39.7
Fertilizer	23.9	21.7	20.6	17.9	17.4	14.1
Captive Power	6.5	7.5	8.3	9.9	11.7	13.5
Industry	10.4	10.8	11.3	12.8	14.4	15.7
Commercial	1.1	1.1	1.1	1.1	1.1	1.1
Brickfield	0.1	0.5	0	0	0	0
Tea-garden	0.2	0.2	0.2	0.2	0.1	0.2
CNG	0	0.5	0.8	1.4	2.2	3.6
Household	11.2	11.5	11.5	11.5	11.8	11.9

As reported in the newspaper, a UK-based consulting firm has recently mentioned that 12 out of 28 gas blocks offered under the latest offshore bidding round have been wholly or partly licensed by neighboring countries. One shallow water block and eleven deepwater blocks have been wholly or partly licensed by India and Myanmar. It is reported that of the 12 blocks, India has already licensed five of the Bangladesh offshore gas blocks, while Myanmar licensed seven blocks in the prospective Bay of Bengal zone. Taking into cognisance the possible disputes with Myanmar and India, the President has recently formed a committee to discuss these issues with neighboring countries. This issue ought to be given priority by Bangladesh's policymakers in view of the critical importance of gas for energy security, FDI inflow, domestic consumption and economic development of the country..

Petroleum Subsidy: Government has been providing huge amount of subsidy to the Bangladesh Petroleum Corporation (BPC), over a long period of time, because administered prices of various types of fuels were consistently lower than the global prices. In April 2007, prices of petroleum products were increased from Tk. 33.00 to Tk. 40.00 for per litre of Kerosene and Diesel, from Tk. 56.00 to Tk. 65.00 for per litre of Petroleum, and from Tk. 58.00 to Tk. 67.00 for per litre of Octane, to adjust to global prices. In the Budget FY2007/08, the government had taken the liabilities of BPC worth Tk. 7523 crore which was financed through the issuance of Bonds. It was expected that it would suffice to smooth functioning of BPC and probably without further subsidy.

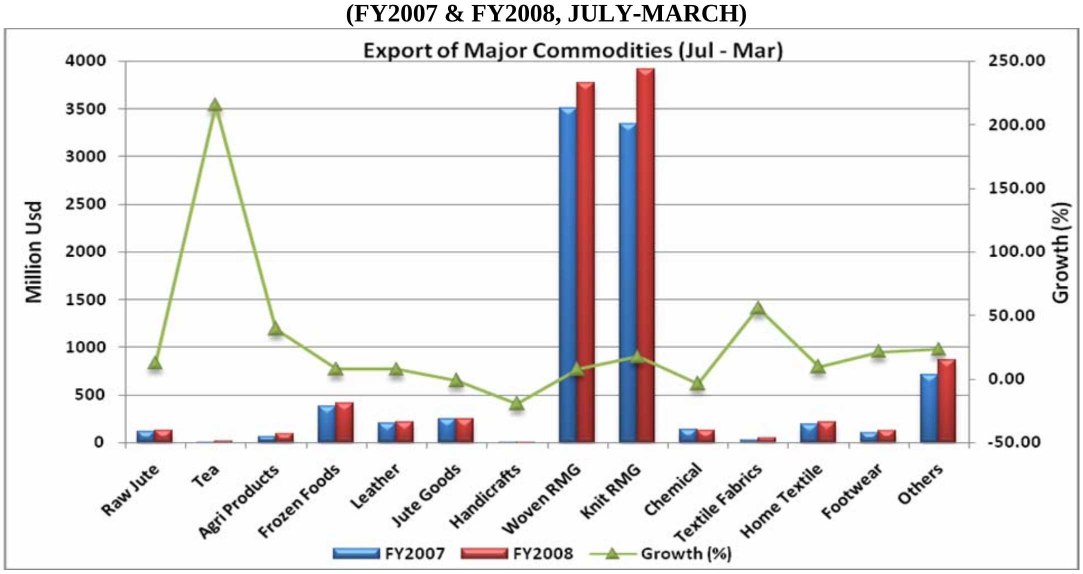
International price of crude and refined petroleum products has increased substantially since the last adjustment. Between June 2007 (Budget announcement) and May 2008, per unit price of crude oil had increased from US$65.37 per barrel to US$126.57 per barrel (93.6 per cent increase). Price of crude oil in May 2008 (US$126.57 per barrel) is about 2.9 times of that in May 2005 (US$43.67). This sky-rocketing price of fuel also had an adverse impact on the subsidy for fuel. Current (Last week of May 2008) price of refined products are as follows: diesel and kerosene: Tk. 97.40 per litre, octane: Tk. 80.35 per litre, jet fuel: Tk. 97.57 per litre. On the other hand, per litre administered price of diesel and kerosene is Tk. 40.00, octane Tk. 67.00, and jet fuel Tk. 72.00. Thus, subsidy provided to per litre of diesel and kerosene is Tk. 57.40, octane Tk. 13.35 and jet fuel Tk. 25.57. As a consequence, the government is being required to pay a significant amount of subsidy. Given the severe burden on the exchequer, this may not be a suitable option for the government and it may have to go for some readjustment. However, if and when it does so, it will need to design a mechanism so that both food safety and equity concern are upheld.

5. BANGLADESH'S EXTERNAL SECTOR IN FY2008

5.1. Export Sector's Performance

Bangladesh's total export earnings during the first three quarters (July-March) of FY2008 stood at USD 10159.78 million, registering a double-digit growth of 12.68 per cent over the same period of FY2007. The sector was able to recover from the debacle suffered in the first quarter of FY2008 when export earnings registered a negative growth of (-) 5.39 per cent. The growth rate posted during this period is also impressive because it comes in the backdrop of high growth rates of 24.65 per cent and 15.60 per cent attained over the previous two fiscal years. However, if the target for FY2008 (USD 14.5 billion) is to be attained, the average exports growth during the last quarter has to be to the tune of 38.35 per cent over the corresponding period of FY2007. It appears to be difficult to achieve such high growth rates, although this year's growth is likely to match last year's which was 15.6 per cent, and could reach about $14.0 billion by the end of FY2008.

FIGURE 5.1: EXPORT OF MAJOR COMMODITIES (FY2007 & FY2008, JULY-MARCH)



Source: CPD Trade Database, 2008.

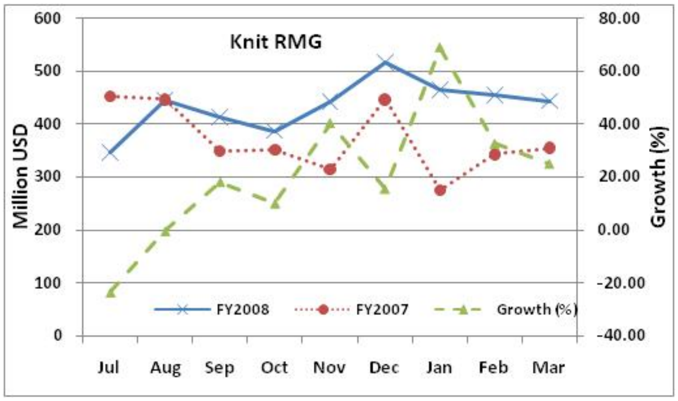
Bangladesh's foremost export item, *readymade garments*, posted a high growth of 12.33 per cent during the first nine months of FY2008. RMG's contribution stood at 75.63 per cent of Bangladesh's total export earnings. Bangladesh earned USD 7.68 billion from export of apparels in this period, compared to the USD 6.84 billion earned over the corresponding period of FY2007. During the period under review, an additional amount of USD 843.21 million was earned by the sector compared to FY2007, major share in this originating from the increasing export of knit-RMG (amounting to USD 577.65 million or 68.51 per cent). A decomposition of the RMG export indicates robust growth for both woven-RMG (7.58 per cent) and knit-RMG (17.32 per cent). Thanks to the consistently high growth rates of knitwear in recent years, share of this sub-sector in the total RMG export now exceeds that of the woven-wear. Since domestic value retention of knitwear (55-60 per cent) was substantially higher than woven wear (25-30 per cent when fabric is imported, and about 60 per cent when fabric is locally sourced), this structural shift within the RMG must be viewed as a commendable achievement. Indeed estimates of net export carried out by the CPD illustrates that during the first three quarters of FY2008, value retention in knit-RMG was about USD 2150. 0 million compared to USD 1270.0 million for the woven-RMG (or about 1.7 times more). RMG's performance must be seen as an indication of the sector's inherent strength in the context of the quota-derestricted regime of the increasingly competitive post-MFA global market. The quota imposed on the Chinese export of apparels by both the USA (2003) and the EU (2005) has worked in favor of Bangladesh. Of the other major items of export, textile fabrics (55.6 per cent), footwear (21.29 per cent), frozen food (7.25 per cent) and leather (7.28 per cent) demonstrated high growth rates. On the other hand, earnings from Bangladesh's traditional export items such as jute goods and handicrafts, continued to slide and experience negative growth (-1.40 per cent and -19.77 per cent respectively) over the first three quarters of FY2008.

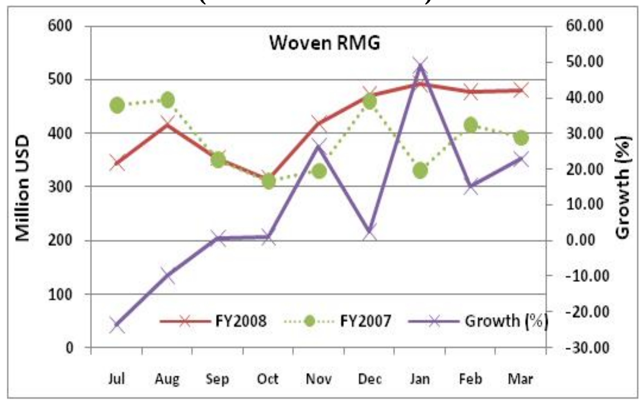
Month-by-month export earnings during July-March of 2008 exceeded that of the corresponding period of FY2007 for all months (except July and August 2007, which is evident from Figure-4.2). There was some cause for concerns when export dipped during these two months, posting negative growth rates of (-) 21.08 per cent and (-) 2.32 per cent respectively (in large measure caused by domestic political uncertainties following takeover of the CTG in January 2007 and labor unrest during May, which resulted in low export orders from major buyers). Export earnings in July 2007 and August 2007 declined by (-) 23.61 per cent and (-) 9.71 for woven wear and (-) 23.45 per cent and (-) 0.41 per cent for knitwear respectively. During the following nine months, export of both knitwear and woven-wear had gradually picked up, which resulted in high growth rates for the overall RMG exports in the first nine months of FY2008 (Figure-4.3).

FIGURE 5.2: MONTHLY TRENDS IN EXPORT (FY2007 VS. FY2008)

Source: CPD Trade Database, 2008.

FIGURE 5.3: MONTHLY TRENDS IN RMG EXPORT (FY2007 VS. FY2008)





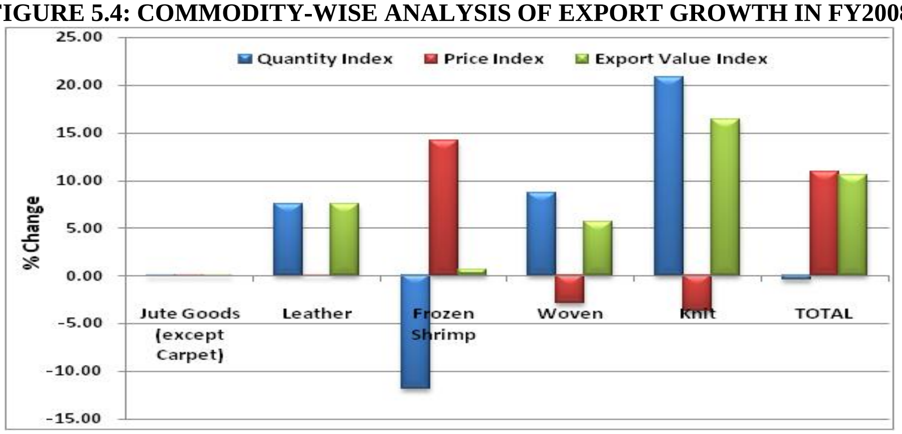
Source: CPD Trade Database, 2008.

In terms of markets for Bangladesh's export, there was no marked deviation from the traditional destinations. The EU (25) continued to be the major destination, accounting for USD 3.5 billion (first six months of FY2008) – exports to the EU rose by nearly 6.29 per cent, (which meant an additional earning of USD 205.27 million). Indeed, CPD analysis of data for the first nine months of FY2008 shows that export earnings from six of the major European countries (Germany, UK, France, Italy, Belgium and Netherlands) posted a significant growth of 16.22 per cent (or an increase of USD 625.45 million over the corresponding period of FY2007, of which the share of RMG was 91.46 per cent). Performance in the US market was discouraging, however, with exports decreasing by (-) 7.49 per cent (to USD 1661.78 million), perhaps because of depressed demand following the recent economic downturn. A steady taka-dollar exchange rate could also have contributed to this. In the first 9 months of FY2008, Bangladesh was able to register an increase in export of only USD 7.57 million to the USA. While export earnings from RMG rose by 1.16 per cent (or increase of USD 26.81 million), total export growth was only 0.29 per cent, which indicated declining export earnings from other sectors (barring RMG). With the sanctions on China to be withdrawn in January 2009, this should be a cause of concern for Bangladesh. Phase-out of quota on 21 categories of apparels from China (which accounted for about 70 per cent of Bangladesh's export to USA in 2006) is likely to put Bangladesh's export of apparels to US under more competitive pressure in 2009.

It is a matter of interest to note that export to India has been on the rise in recent years. In FY2003 export to India was USD 84.08 million which increased to USD 241.96 million in FY2006 and USD 289.42 million in FY2007. Exports during the first six months of FY2008, matched those of the same period of FY2007 registered a growth of only 0.9 per cent. It is important to identify the new products of export to India (ceramic, cement, melamine) and build on this. It is a good sign that the zero-duty offer by India for 8 million prices of garments export from Bangladesh (worth about USD 30-35 millions export) has now been operationalized. Bangladeshi exporters should make every effort to realize this offer on the ground. A comprehensive strategy is required to take advantage of the bringing forward to the time line for duty-free access under SAFTA and curtailing of the negative list. Although intra-developing country trade is on the rise globally, Bangladesh is yet to take advantage of the expanding markets in developing and emerging markets.

Product and market diversification along with the increase of local value addition, continue to remain major obstacles facing Bangladesh's export sector. Export growth, whilst impressive, have continued to be driven in large measure in terms of volume growth rather than rise in prices. A decomposition evaluation of growth dynamics reveals that the rise in export (12.43 per cent) was accounted for by rise in volume (13.93 per cent), whilst average prices experienced a fall of (-) 1.5 per cent. This also needs to be considered in relation to the considerable deterioration of Bangladesh's terms of trade (TOT) experienced in recent years. As is evident from Table 4.1, if export prices of FY2000 are taken as the base year, TOT declines significantly to 85.6 by FY2007. A CPD analysis of export prices and import prices of selected major essential items vividly illustrates the deteriorating TOT (Table 4.2). While in 2006, to import a barrel of crude petroleum Bangladesh had to export 2.34 dozens of RMG, in 2008 it increased to 4.46 dozen. Similarly, to import one ton of rice, in 2006 Bangladesh had to export 0.52 tons of jute goods; now in 2008, to import the same amount of rice Bangladesh has to export 1.71 tons of jute goods.

FIGURE 5.4: COMMODITY-WISE ANALYSIS OF EXPORT GROWTH IN FY2008



Source: CPD Trade Database, 2008

TABLE 5.1: DETERIORATING TERMS OF TRADE

(Base: FY2000 = 100)

	Export Price Index	Import Price Index	Terms of Trade
FY2000	100.00	100.00	100.00
FY2001	102.40	107.53	95.23
FY2002	104.82	115.61	90.66
FY2003	107.44	124.57	86.25
FY2004	115.07	129.62	88.77
FY2005	118.82	134.21	88.53
FY2006	121.18	139.50	86.87
FY2007	124.21	145.14	85.58

Source: CPD Trade Database, 2008.

TABLE 5.2: FALLING PURCHASING POWER OF EXPORTS

	dozens of RMG		Rise (in times)	Tons of Jute Goods		Rise (in times)
	2006	**2008**		**2006**	**2008**	
1 barrel of Oil (Fuel)	2.34	4.47	1.9	0.11	0.21	1.9
1 ton of rice	10.97	37.24	3.4	0.52	1.71	3.3
1 ton of wheat	6.23	16.76	2.7	0.30	0.77	2.6
1 Metric Ton Soya bean Oil	21.19	51.93	2.5	1.00	2.38	2.4
1 Metric Ton Whole Milk Powder	77.87	156.39	2.0	3.69	7.18	1.9

Source: CPD Trade Database, 2008.

RMG (2006) (Yearly Average)	28.25	USD/Doz	**Jute (2006) (Yearly Average)**	596.55	USD/Ton
RMG (2008) (Feb)	26.86	USD/Doz	**Jute (2008) (Feb)**	584.99	USD/Ton

Bangladesh's narrow export base is one of the reasons for the sector's vulnerability in the global market. There is a need for both intra-RMG and extra-RMG diversification. Special attention aught to be given to stimulate new non-traditional exports such as home textile, light engineering and ship-building. The prospects of ship building industry calls for special mention. Bangladesh has started to gain a foothold in this lucrative market with the first export having been made in May, 2008. A number of Bangladeshi companies have received orders for small-scale ships (of less than 10 thousand dwt). Bangladesh has the maritime tradition and skilled manpower and entrepreneurial expertise to emergence as a major player in the global market for smaller vessels. The sector will need support in such areas as (a) bonded warehouse facilities, (b) availability of bank guarantee, (c) duty rebate for import of capital machineries, (d) special zoning policy to facilitate setting up of shipyards. The global market is worth USD 800 billion and if Bangladesh is able to capture a mere share of 1 per cent, it will be worth USD 8 billion!

BOX 5.1: EXPORT DIVERSIFICATION: EMERGENCE OF SHIP BUILDING AS AN EOI

Bangladeshi shipbuilders have been in the export business since the year 2000 when they started to build and export fishing vessels. Recently, in May 2008, Ananda Shipyard exported the first seagoing vessel from Bangladesh (HS8901.90.10, 2900 DWT to Denmark worth USD 6.2 million) and also received orders for building another 19 ships worth about USD 209 million to be delivered by 2012. Two other private sector shipyards have also signed similar export contracts with a total contract value of about USD 137 million. All this is indeed encouraging.

Ships are of various types: tankers, bulk carriers and containers which make up by far the largest portion of the fleet and a significant part of the output of the shipbuilding industry. Bangladesh's comparative advantage lies with the third type of ship, where the tonnage ranged between 2,000 to 10,000 dwt (cargo vessels for the transport of both people and goods). Current markets of the global small shipbuilding industry is worth about USD 76 billion (HS Chapter 89; data analyzed at the CPD on HS6 digit level based on the dataset collected from Trade Map). The category of ship that Bangladesh is exporting (8901.90) has a market of about $44.0 billion Bangladesh has the potential to capture a significant share of the market and eventually become a major destination for companies seeking construction of small ocean-going vessels. It is to be noted that traditional shipbuilding countries such as South Korea and China are now focusing on building of large ships. Even, relatively new ship building countries such as Vietnam is becoming less interested to build small ships weighing up to 2,500 dead weight tons. As a result, a new window of export opportunities is opening up for Bangladesh. Bangladesh has a strong maritime tradition with skilled manpower and a history of building small scale ocean and river going vessels. Indeed USD 3.57 million worth of ship related products including life boats, fishing boats, scraps, etc was exported by Bangladesh to Netherlands, Maldives, India, etc during July-March of FY2008. Apart from the cargo vessel, Bangladesh could also gradually make inroads into export market for cruise ships, excursion boats, dredgers, floating or submersible drilling or production platforms, warships, lifeboats and hospital ships through sealing up (above 10,000 dwt).

With regard to the growth of supply and demand for container shipping, it is to be noted that for the first time in 2006 since 2001, the growth of fleet again outstripped the growth of containerized trade. For 2007, it was estimated that that world container carrying capacity grew at an annual rate of 13.4 per cent, which was 2.4 per cent higher than the estimated growth in demand. In September 2007, the order book of containerships stood at 6.2 million TEUs, representing 60 per cent of the existing fleet.

In view of the emerging opportunities, there is a need to provide strategic support to this industry, which has been declared as a thrust sector, through fiscal, banking and infrastructure development support.

The ongoing negotiations in the WTO also pose formidable challenges for Bangladesh. In recent months, Bangladesh has been lobbying the US for an LDC-friendly design of the DF-QF (97 per cent) list. Besides, the NPDA 2007 (New Partnership for Development Act of 2007), which has been tabled in the US Congress, is also being debated at present. These issues ought to get priority attention of policy makers. In view of ongoing WTO negotiations on SPS, TBT, environmental issues, Bangladesh (and also other LDCs) is likely to be confronted with new challenges in terms of complying with the various standards. Agricultural exports (SPS-TBT), knitwear (affluent facilities) and other sectors will need to considerably strengthen their compliance strength in view of the likely demands stemming from the current round of trade negotiations. Bangladesh's export policies and incentive structure will need to be geared towards addressing these attendant issues. Bangladesh will need to jointly fight with other LDCs for getting market access in Mode-4 under GATS negotiations, which is being discussed as part of the WTO's Doha Work Programme. It is also important that Bangladesh receives her due share under the proposed Aid for Trade initiative of the WTO to strengthen her trade related supply-side capacities.

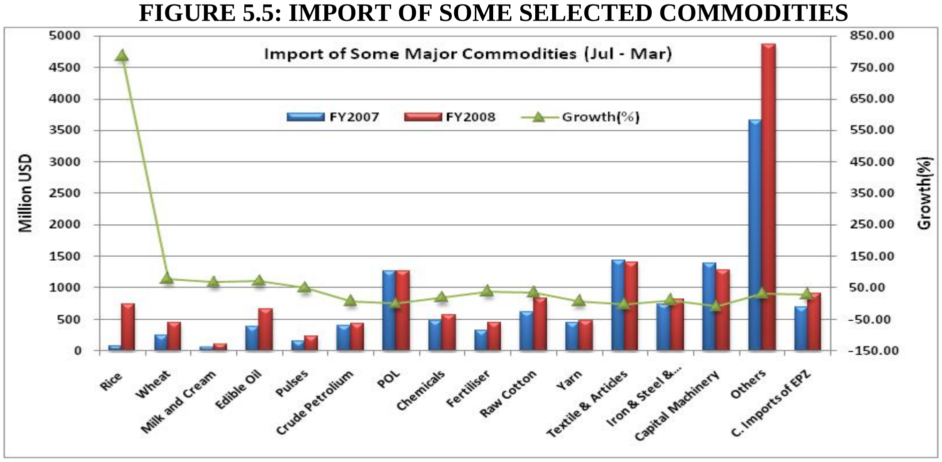
Appropriate proposals will need to be developed to claim Bangladesh's stake in the proposed funds. Bangladesh should make every effort to get a fair share of the financial support envisaged under the proposed aid for trade (AfT) of the WTO.

5.2. Key Features of the Import Sector

Total imports to Bangladesh during July-March FY2008 amounted to USD 15503.60 million, registering a growth of 25.09 per cent compared to the corresponding period of FY2007. Imports to the EPZs also registered a positive growth of 29.65 per cent. Import share of textiles and articles recorded the highest share, around 9.05 per cent of total import. The second highest import share (in value terms) was of capital machineries, accounting for about 8.23 per cent of total import. Imports of foodgrains posted a staggering growth of 254.73 per cent (7.72 per cent of total import), with rice registering a staggering increase of 8.8 times and wheat 1.8 times. The huge rise in imports of foodgrains, particularly rice and wheat, was necessary to address the shortage caused by the two consecutive floods and cyclone *Sidr*.

Import growth was high to moderate for all major non-food items excluding textile & articles and capital machineries, which posted negative growth rates of (-) 2.26 per cent and (-) 8.18 per cent respectively. Import growth of crude petroleum was high at 7.45 per cent, fuelled by the rise in global oil prices. By the third week of May 2008, crude oil price/barrel has already hit USD 132. Import of POL, however, posted a negative growth of (-) 0.08 per cent. The bill for this was to the tune of USD 1266.30 million in the first nine months. High import growth of intermediate inputs, such as raw cotton (34.91 per cent) would indicate backward linkage and yarn (6.98 per cent) and iron, steel and other base metals, also posted significant increase (11.40 per cent). (Figure 4.5)

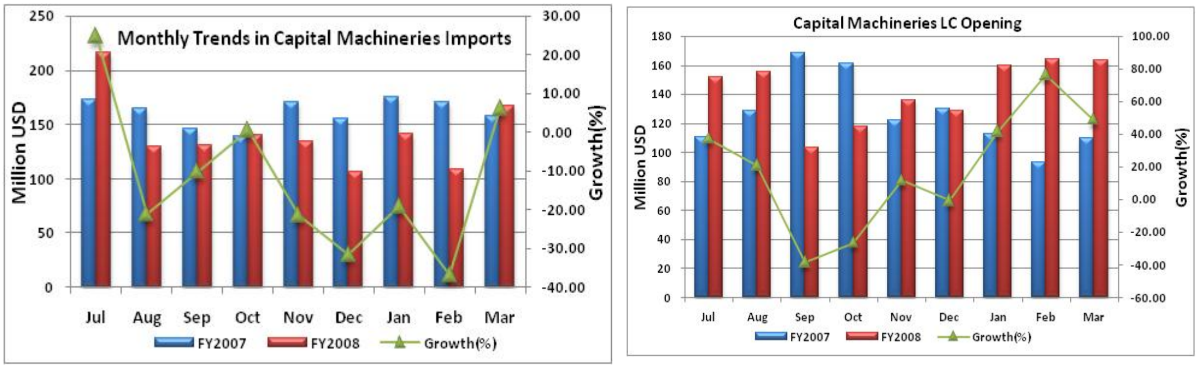
FIGURE 5.5: IMPORT OF SOME SELECTED COMMODITIES



Source: CPD Trade Database, 2008.

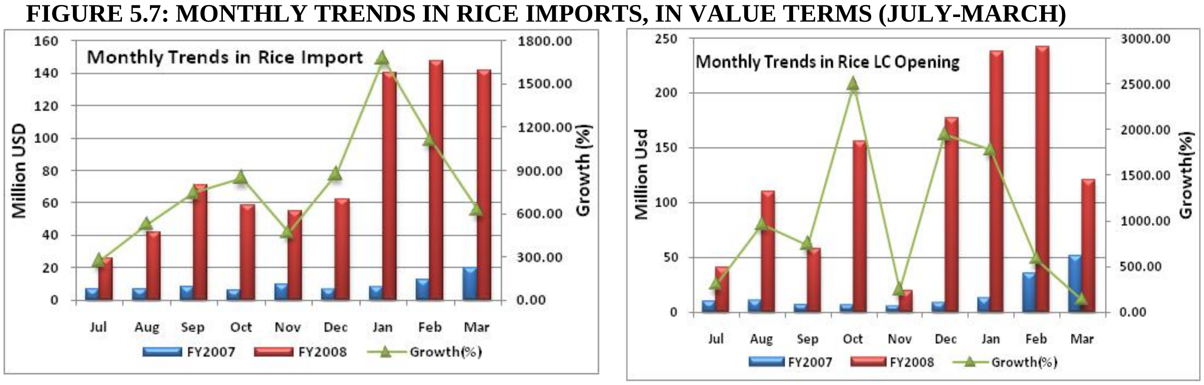
As mentioned earlier, import of capital machineries fell by 8.18 per cent during the first nine months of FY2008 compared to the matched period of FY2007. Except for the month of July and March (growth of 24.90 per cent and 6.23 per cent respectively), in all the other months (compared on a monthly basis with the earlier fiscal), import of capital machineries maintained a declining trend. Interestingly, opening of L/C in case of capital machineries for the first 9 months of FY2008 showed a positive trend of 12.58 per cent, whereas settlement of L/C for capital machineries revealed a negative growth of (-) 8.76 per cent when compared against the same period of FY2007 (Figure 4.6). The fact of declining import of capital machineries is disturbing since this was likely to have negative implications for investment. However, double-digit growth of L/C openings for capital machineries transmits positive signals as to future demand with subsequent positive impact on investment.

FIGURE 5.6: MONTHLY TRENDS IN CAPITAL MACHINERIES IMPORTS (JULY-MARCH)



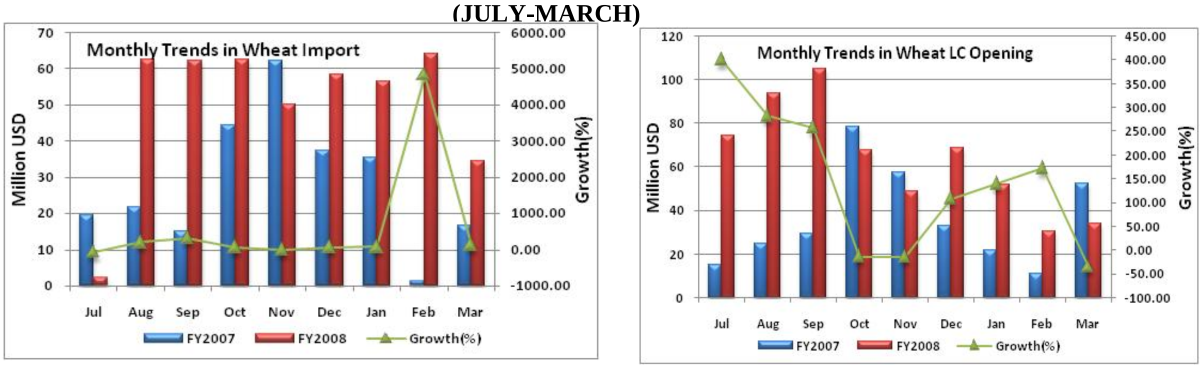
Source: CPD Trade Database, 2008.

FIGURE 5.7: MONTHLY TRENDS IN RICE IMPORTS, IN VALUE TERMS (JULY-MARCH)



Source: CPD Trade Database, 2008.

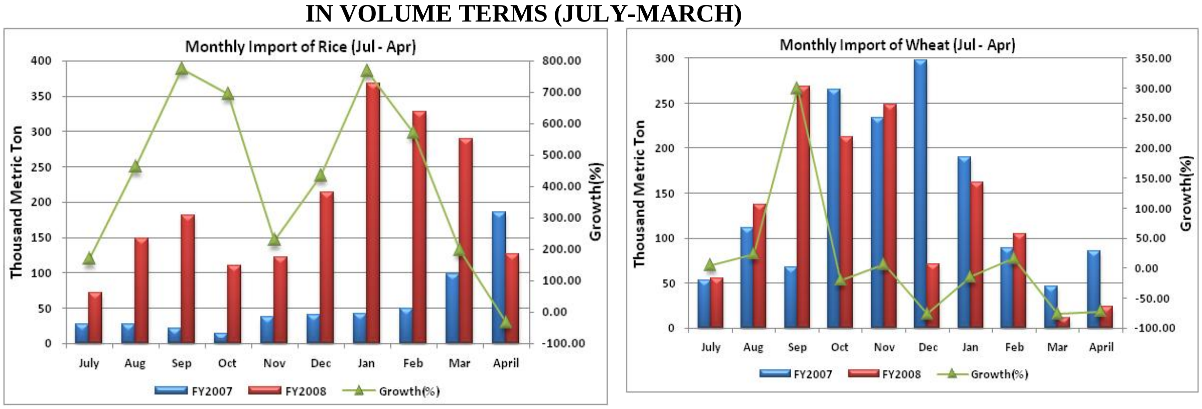
FIGURE 5.8: MONTHLY TRENDS IN WHEAT IMPORTS, IN VALUE TERMS (JULY-MARCH)



Source: CPD Trade Database, 2008.

In view of the crop losses caused by two successive floods and cyclone *Sidr*, high import of rice was expected to be a salient feature of FY2008. Import of rice rose by about 8.8 times in FY2008 compared to the same period of FY2007 (Jul – Mar). Import of rice rose from USD 84.1 million to USD 743.8 million. Monthly import trends of rice and wheat presented in Figures 4.7 and 4.8 indicate this high growth. Import of rice in FY2008 picked up from the very beginning of the fiscal year (July 2007) and continued to be on the rise till March 2008 – not only in value terms, but also in volume terms. During the first 10 months of FY2008 (July-April), import of rice was 1957.70 thousand metric tons, 263.35 per cent higher than the corresponding period of the previous fiscal (Figure 4.9). Relatively higher growth rate in value terms indicate the effect of rising prices of rice in the international market. Whereas, on average, import price of rice was USD 238.67/ton during the first 9 months of FY2007, it stood at USD 353.55/ton in the first 9 months of FY2008 (an increase of 48.13 per cent in unit price). The price rise of rice was due to the unprecedented increase in global rice price over the preceding one year, combined with the export ban on rice by major rice producing countries. Bangladesh imported rice at a cost of USD 224 per ton in July 2007 whereas she had to pay USD 488 in March 2008, a rise of 2.2 times (118 per cent rise). More availability of rice in the global market has now become an issue.

FIGURE 5.9: MONTHLY TRENDS IN RICE AND WHEAT IMPORTS, IN VOLUME TERMS (JULY-MARCH)



Source: Analysis from Information collected from Food Directorate, Ministry of Food and Disaster Management.

Thailand, world's largest rice exporter, has been recently quoting export price of rice well beyond USD 1000 per ton. Vietnam, the world's second largest rice exporter, experienced a downturn in her domestic production which resulted in low availability of rice for export. The Chinese government, following the removal of VAT export rebate on rice (coupled with some other agricultural products in December 2007), introduced 5 per cent export duties on rice beginning from 2008. India initially imposed a ban on rice export; later on the government withdrew the restriction while increasing the minimum export price (MEP) of rice to USD 400, USD 500, USD 650 and finally USD 1000 per ton, at which point excepting basmati export of all rice was banned.

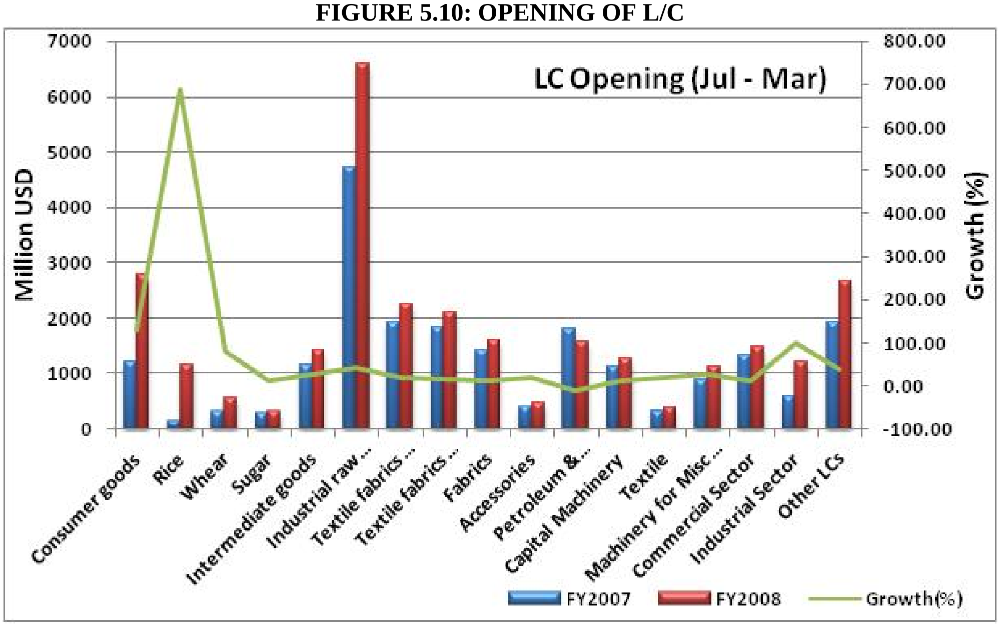
Increasing global population, increasing demand in India and China, soaring demand for bio-fuels and animal feed, and unfavorable weather conditions are major reasons which contributed to the sudden hike in rice prices. Use of corn for ethanol and biofuels started to became economically viable once fuel prices went beyond USD 80-90 per barrel. The tension between fuel and food, factory and farm is likely to be a feature in the global scenario with major implications for net food importing countries such as Bangladesh.

5.3. L/C Opening and Settlement

L/Cs opened during July-April of FY2008 were worth USD 19.89 billion, which was 38.07 per cent higher compared to L/Cs opened during the corresponding months of FY2007. To compare, L/Cs settled in this period amounted to USD 16.49 billion which was 24.19 per cent higher than the matched period of FY2007. Indeed, as Figure 4.10 indicates, for July-March period of FY2008. Excluding Petroleum and Petroleum Products (-12.26 per cent), L/Cs opened for all other commodities registered high positive growth rates ranging from 12-25 per cent. For some items including capital machinery, there way a decline in terms of L/C settlement (- 8.76 per cent). Settlement of L/C for textile also suffered a serious setback, registering a negative growth of (-) 24.86 per cent.

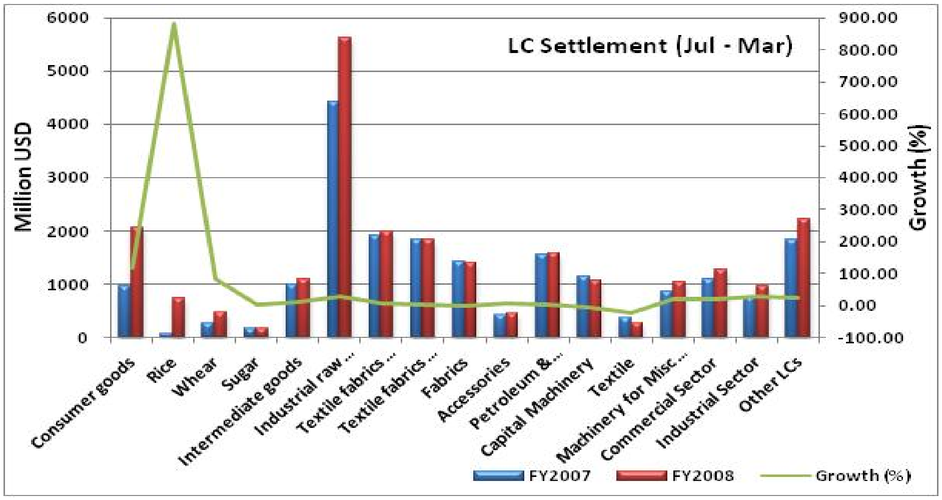
On the other hand, L/C opening for consumer goods has been exceptionally high (128.89 per cent), driven by import of cereals, particularly rice, and also wheat, soyabean, vegetable oil etc. As Figures 4.10 and 4.11 bear out, following comparatively lower levels of L/Cs opened for rice in the months of July and November, the number of import L/Cs opened in other months demonstrated quite high growth (with overall July-March FY2008 growth of 615.81 per cent). In case of wheat, the trend in L/C opening was somewhat inconsistent, with higher amounts of L/Cs between July – September 2007, lower in October – November period, and again picking up during January – March FY2008 and declining by (-) 35.46 per cent in April. Overall, import L/Cs for wheat during July-April increased by 77.84 per cent.

FIGURE 5.10: OPENING OF L/C



Source: CPD Trade Database, 2008.

FIGURE 5.11: SETTLEMENT OF L/C

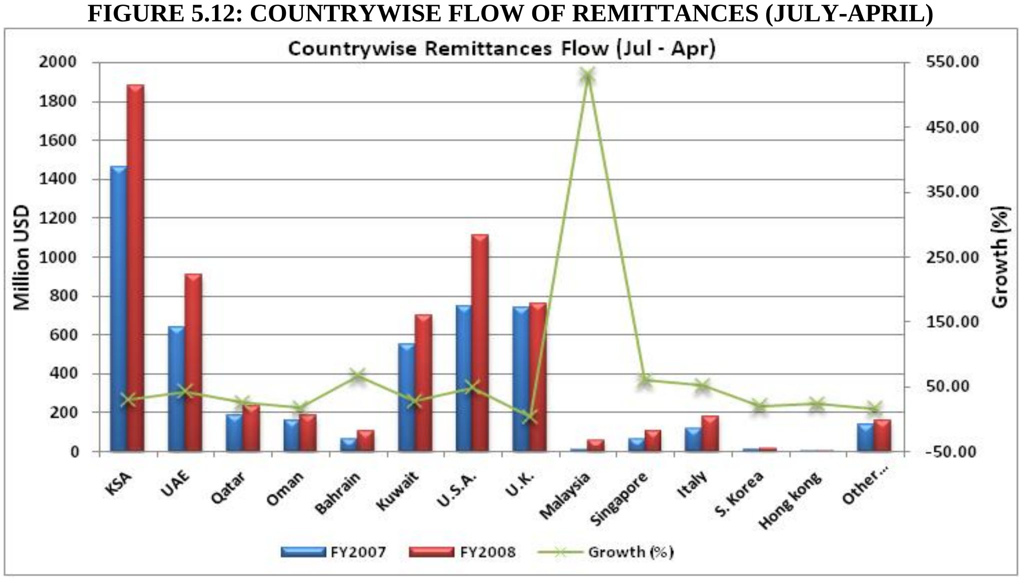


Source: CPD Trade Database, 2008.

5.4. Remittance Flow

In recent years, remittance flow has demonstrated phenomenal growth. From under two billion dollars in 2000 (USD 1.95 billion), remittance rose to USD 5.98 billion in 2007. During the first ten months, earnings from remittance was USD 6.43 billion which was about USD 1.53 billion more than the corresponding period of FY2007 (31.11 per cent growth). Indeed, the CPD estimates for comparable period (July-April, FY2008) indicate that remittance earnings was equivalent to more than half of Bangladesh's gross export (55.60 per cent), and approximated that of net export (99.93 per cent). Remittance flow is expected to reach close to USD 8.0 billion by end-June, 2008.

FIGURE 5.12: COUNTRYWISE FLOW OF REMITTANCES (JULY-APRIL)



Source: CPD Trade Database, 2008.

From Figure 4.12 we see that, Saudi Arabia continued to rank as the major source, accounting for 29.30 per cent of all remittance (FY2008), recording a growth of 28.85 per cent compared to the Jul-Apr period of FY2007. Of the other major sources, growth rates of remittance from UAE (42.52 per cent), Kuwait (26.87 per cent) and USA (48.54 per cent) have been quite high. Significant growth of remittance earnings has been observed from countries such as Malaysia. During the Jul – Apr period of FY2007 remittance earnings from Malaysia was only USD 9.72 million, which increased to USD 61.35 million, posting an impressive growth of 531.17 per cent. Though in terms of aggregate remittance earnings this value does not hold much significance considering the earnings from KSA, UAE, USA and Kuwait, it has important policy implications. Contracts signed in FY2007 with the UAE, Malaysia and South Korea has contributed importantly to the growth in remittances. Recent market opening in Oman also created a favorable environment for Bangladesh in terms of boosting her manpower export. In very recent times, skilled Bangladeshi textile workers have been invited to work in Russia –around 60 workers are expected to leave Bangladesh within the next few months with more to follow in the ensuing months. During 2007 some 832 thousand workers went abroad. By the end of 2007, a total of 5,390,854 Bangladeshis have gone overseas as migrant workers (from 1976 till 2007). Among them, the number of professional workers was 166,413 (3.09 per cent), skilled 1,614,762 (29.95 per cent), semi-skilled 859,054 (15.94 per cent) and unskilled 2,750,625 (51.02 per cent). In the first 3 months of 2008, a record 223,000 workers have gone abroad. Although the skill composition of workers leaving for overseas employment has shown some positive change in the past years (favoring skilled labor as against un-skilled and semi-skilled), percentage of skilled workers in the total migrant labor force of Bangladesh has, however, come down in the recent past. Bangladesh is expected to send around 900 thousand workers abroad this year (2008). A total of more than 352 thousand workers has already received permission to go abroad (till May 20), which is 56 per cent more than the comparable period of last year.

There is an urgent need to design a comprehensive policy with a view to make Bangladesh capable of taking advantage of the rising demand for workers in the global labour market. More effort needs to be taken to train up more workers who will be expected to travel abroad for work related purposes. Bangladesh should also be well-prepared to take advantage of market opportunities in Mode4, particularly in health and caring services. These opportunities are based to open in the coming years, either as a result of multilateral negotiations under WTO-GATS, or through bilateral initiatives.

5.5. Balance of Payments

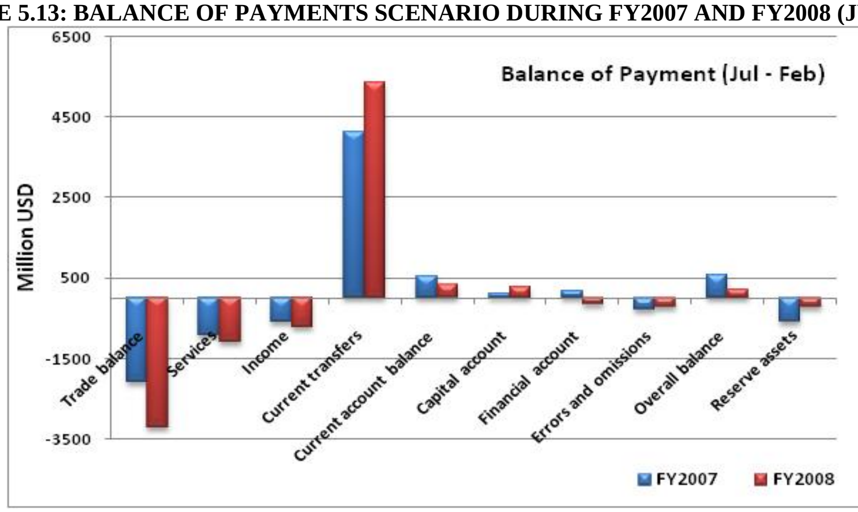
Trade balance recorded a high deficit of USD 3206 million during July-February FY2008 (USD 5343.82 million in the first nine months), compared to that of USD 2066 million during the corresponding period of FY2007. Services also posted a higher negative balance (-) USD 1095 million during July-February FY 08 against (-) USD 913 million during July-February FY 07. Despite larger deficit in the trade balance current account balance recorded a surplus of USD 328 million during July-February, FY2008 against the surplus of USD 558 million during July-February, FY2007.

BOX 5.2: EXPLORING NEW MARKETS FOR MANPOWER EXPORT

CPD study shows that in order to stabilize the size of the working population in the European Union (EU-15), an annual net gain of some 550,000 foreign workers and professionals would be necessary upto 2010 and a further 1.6 million per annum between 2010 and 2050, totaling a net inflow of 68 million people between 2003 and 2050. This is the likely scenario that would emerge because of ageing, low fertility rate and limited manpower. This will create new export opportunities for developing countries such as Bangladesh. CPD study further highlighted that the potential benefit from exporting 2 lakhs professionals from Bangladesh would be USD 11.57 billion, and an increase of 2 lakhs unskilled workers would bring an additional USD 3.5 billion to the county.

Overall trade balances for the first eight months (July-February) of FY08 indicate some deterioration, although remittances have eased the situation. Export earnings and import payments during July-February of FY2007 were USD 7954 million USD (-) 10020 million respectively. Although export earnings increased to USD 8854 million, import payments have outstripped this totaling about USD (-) 12060 million during July-February of FY2008 (indeed trade balance deteriorated further during the first nine months of FY2008 and reached USD 5.3 billion; export earnings and import payments were USD 10159.78 million and USD (-) 15503.60 million respectively for this period). However, this large deficit in the trade balance was offset by the surplus in the current transfers (mainly private transfers in the form of worker's remittances which recorded USD 4841 million in the July-February period; by the end of April 2008, earnings from remittances hit a record mark of USD 6431 million). On the financial account side, BoP experienced a net deficit of USD 162 million during the first eight months, against a surplus of USD 180 million during the same period of FY2007. The overall balance also showed a modest surplus of USD 222 million during July- February, FY2008 against the surplus of USD 577 million during July-February, FY2007 due to surplus in both the capital and current accounts of USD 286 million and USD 328 million respectively. Overall, the current account balance for July-February period fell from USD 558 million in FY 07 to USD 328 million in FY 08, whereas capital account balance increased from USD 118 million in FY 07 to USD 286 million in FY 08.

FIGURE 5.13: BALANCE OF PAYMENTS SCENARIO DURING FY2007 AND FY2008 (JUL-FEB)



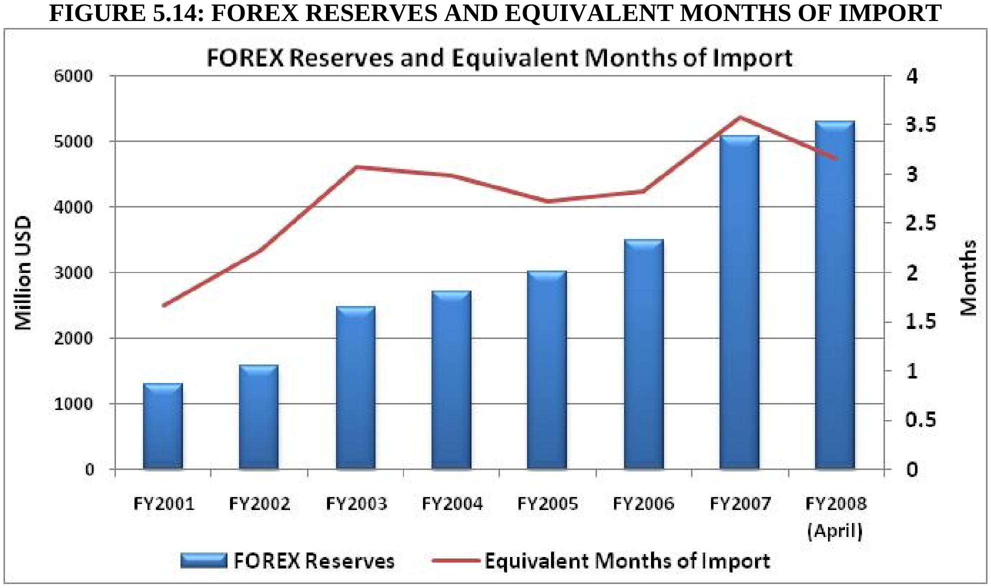
Source: CPD Trade Database, 2008.

As observed earlier, balance of current transfer responded positively to robust remittance flow, which increased by 27 per cent (from USD 3824 million in July-February of FY2007 to USD 4841 million during July-February of FY2008), somewhat compensating for the negative trends in balances on account of trade and services. Although remittance is expected to continue with its high flow in the coming months, anticipated higher import payments combined with modest exports is likely to create further pressure on the BoP position in the near future. Recently, government has decided to borrow USD 220 million as emergency support from the IMF to which would help avert unexpected pressure on the balance of payment shortfall.

5.6. Foreign Exchange Reserves

In the backdrop of high export and remittance earnings, the foreign exchange (FX) reserves stood at USD 5671 million at the end of April 2008 (following two ACU, payment of USD 462.3 million made in mid-November 2007 and USD 733.17 million on 6th March, 2008), which is equivalent to about 3.3 months of import payment. This was 24.9 per cent more than the comparable figure of FY2007. The current level of reserves was higher than the year-end reserves of FY2007 (USD 5077.24 million). After the ACU payment of USD 684 million made on 5 May 2008, forex reserves came down to the tune of US$ 5.33 billion (as of May 29, 2008), or equivalent to 3.1 months of import at the end of May 2008. If the current higher flow of remittance is sustained in the next month, reserves could reach about 6.0 billion by the end of FY2008. Whilst comfortable, given the pressure from the import side in the wake of the economy pick-up of recent months, the reserve position will need to be carefully monitored.

FIGURE 5.14: FOREX RESERVES AND EQUIVALENT MONTHS OF IMPORT



Source: CPD Trade Database, 2008.

Bangladesh has been pursuing floating exchange rate regime since 2003. However, the Bangladesh Bank has in all practicality been implementing a managed float policy. In the early part of FY2008 Bangladesh Bank has intervened in the forex market directly to keep the taka appreciated against dollar, by injecting (selling about) USD 500 million. This was perhaps done to contain the effect of imported inflation.

Taka has been quite steady against dollar (at about 68.00 Tk./USD) in recent times. The Bangladesh Bank has also stopped intervening in the forex market in the past few months. The challenge for the Bangladesh Bank will be to ensure that the exchange rate of Taka against major currencies is kept at a level that provides incentive to exports but at the same time acts as a cushion against imported inflation. Whilst under a floating exchange regime the market should take care of the exchange rate, some type of market monitoring, and selective intervention may be required on the part of the Bangladesh Bank given the volatility of the external sector observed in recent times. The other issue is the currency composition of the Bangladesh's reserves. Given the depreciation of the dollar against all foreign currencies, particularly Euro, and given that a large part of Bangladesh's import is from Euro-denominated area, it appears that keeping a higher share of reserves in Euro would serve Bangladesh's interest better. It is interesting to note the rise of Euro as a hard-currency for foreign exchange reserve – from 2000 to 2006, the share of US dollar official holdings of foreign exchange worldwide declined from 71 per cent to nearly 65 per cent, while during the same period, the share of Euro official holding of foreign exchange increased from 18 per cent to almost 26 per cent. The Deutsche Bank Research group predicts that the euro share of global foreign exchange reserves will rise to 30- 40 per cent by 2010. In recent years, both Russia and China have opted for basket of currencies rather than pegging those to US Dollars. In view of the increasing world-wide rapid use of Euro as an anchor currency, the Bangladesh Bank may have to rethink about the composition of her forex reserves. The composition of reserves at present more or less reflects the business carried out in major currencies. However, given the persistent fall in the value of dollar, there may be a need to have a forward looking strategy with regards to forex composition.

5.7. Foreign Aid

Flow of foreign aid during July-February period of FY2008 increased significantly compared to the inflow during the corresponding period of FY2007. Total aid inflow stood at USD 1127.41 million, more than twice the amount received during July-February of FY2007 (122.0 per cent growth). With payment (principle) also registering a modest growth (11.2 per cent growth), net foreign aid inflow 765.0 million USD registered a significant increase of 322.0 per cent! During these first eight months of FY2008, USD 54.32 million arrived as food aid (provided by the WFP) following two consecutive floods in September and the cyclone-*Sidr* in December, 2007 against absence of any inflow on account of food aid during the matching period of FY2007.

Total aid disbursement during July-February, FY2008 was higher at USD 1127.41 million, compared to USD 506.76 million during July-February, FY2007. Net receipts of foreign aid during July-February, FY2008 also stood notably higher at USD 765.35 million, against USD181.38 million during July-February, FY2007.

Total foreign aid disbursement during July-March, FY2008 was USD 1291.808 million, while in FY2007 total disbursement was USD 1630.575 million for the entire year. Foreign aid commitment in FY 08 (up to May, 08) was USD 2187.61 million, which was closer to the committed foreign aid during the FY 07 (USD 2256.128 million). Apart from the food aid disbursed for the cyclone-*Sidr*, a sum of USD 634.00 million was committed in view of the natural disasters. A large part of that aid commitment intended for the cyclone-*Sidr* was made by the WB (USD 325 million) of which USD 100 million has already been disbursed (in January, 2008) as a budgetary support under the WB DSC IV-Supplemental Financing II. The fate of the remaining USD 225 million is still uncertain. It is to be noted that, the government has chalked out a 15-year plan designed by the joint Damage Loss and Needs Assessment mission, made up of 11 donors including the World Bank. These donors have pledged to release USD 1.5 billion in 2008-12, another USD 1.4 billion in 2013-17 and a further USD 1.1 billion in 2008-22 towards strengthening the country's preparedness for natural disasters.

6. SOCIAL SECTOR AND SOCIAL SAFETY NET

6.1. Health

During July to February of FY2008, Ministry of Health and Family Planning has utilised a total of Tk. 2268, only 41.5 percent of the total allocation, compared to 39.0 percent utilisation in the comparable months of the previous fiscal year (Table 5.1). Revenue expenditure during July-Feb of FY2008 was 55 percent against 64.2 percent in FY2007. On the other hand, utilisation of development budget in FY2008 (July-February) was 26.6 percent against that of 13.4 percent in comparable months of FY2007.

TABLE 6.1: EXPENDITURE FOR HEALTH AND FAMILY PLANNING IN FY2008

(*in Crore Tk*)

Item	Budget FY2008	Actual Expenditure		Actual Expenditure in FY2007 (July – February) as % of Budget FY2007	Actual expenditure in FY2008 (July-February) as percent of Budget FY2008
		FY2007 (July – February)	FY2008 (July – February)		
Revenue Expenditure	2863.2	1547.5	1573.5	64.2	55.0
Development Expenditure	2606.3	317.5	694.4	13.4	26.6
Total	5469.5	1865	2267.9	39.0	41.5

Source: Ministry of Finance.

Health, Nutrition and Population Sector Programme (HNPSP) is the largest programme of the health sector, which was initiated in 2004. The HNPSP emphasises reducing malnutrition, mortality, and fertility, promoting healthy life styles, and reducing risk factors to human health from environmental, economic and social and behavioural causes. It also focuses on vulnerable and the elderly people. In FY2008 (July-April), total utilisation of the budget was only 52 per cent which is very low considering the size of the programme (Table 5.2). Available data suggests that infant mortality rate, mortality of children under five years, and total fertility rate had declined between 2004/05 and 2007/08 (Table 5.3). To reduce maternal mortality, ensure safe motherhood, and better health and nutrition of hardcore poor mothers as well as safe birth and sound upbringing of infants, the government has initiated a pilot programme in FY2008 titled "Maternity Allowance for the Poor Lactating Mothers". Budget of FY2008 had allocated a total of Tk. 17 crore. Until April'08, Tk. 16.2 crore has been distributed to the expecting mothers. A total 450 thousand mothers of 3 thousand unions are getting allowance under this programme.

TABLE 6.2: PLANNED, BUDGETED AND ACTUAL EXPENDITURE OF THE HNPSP

(*in Crore Taka*)

Item	**2005/06**	**2006/07**	**2007/08 (July – April)**
Revised Programme Implementation Plan (RPIP)	3173.0	3047.3	3234.1
Budget	1693.9	2119.5	2361.6
Expenditure	1453.4	1402.1	1235.8
Utilisation of budget	86%	66%	52%

Source: Bangladesh Health, Nutrition and Population Sector Programme (HNPSP): Mid Term Review (2008), and Ministry of Health and Family Welfare.

TABLE 6.3: BASIC INDICATORS OF THE HEALTH STATUS

Indicator	Baseline Condition in 2004/05	Target in 2007/08	Condition in 2007/08
Infant Mortality Rate (IMR)	65	45	52
Under Five Mortality Rate (UFMR)	88	64	65
Maternal Mortality Ratio (MMR)	320	264	n.a
% U5 underweight (6-59 ms)	47.5	42	46
% U5 severely underweight	12.8	<5%	11.8
% U5 severely stunted (24-59 ms)	16.1	n.a	16.1
Total Fertility Rate (TFR)	3.0	2.6	2.7
Contraceptive Prevalence Rate (modern methods)	15	29.5	18.2

Source: Bangladesh Health, Nutrition and Population Sector Programme (HNPSP): Mid Term Review (2008).

6.2. Education

Education is the main vehicle for human resources development. Long-term development of a country depends to a large extent on the level of its human capital. Total allocation for education (revenue and development) was Tk. 12,369 crore (Table 5.4). During July-February of FY2008, actual expenditure for education was Tk. 6,522 crore which is 52.7 percent of the Budget of FY2008, against 53.6 percent during comparable months of FY2007. During this period, actual expenditure of the revenue budget was 62.7 percent, compared to 68.9 percent in the comparable months in FY2007. On the other hand, spending under development budget in FY2008 (July-February) was 29.5 percent, against 25.2 percent in the comparable months of FY2007.

TABLE 6.4: BUDGET (REVENUE AND DEVELOPMENT) AND ACTUAL EXPENDITURE IN EDUCATION IN FY2008

(in Crore Taka)

	Sub-sector	Budget FY2008	Actual expenditure in		Expenditure in FY2007 (July - Feb as % of Budget FY2007	Expenditure in FY2008 (July – Feb) as % of Budget FY2008
			FY2007 (July – Feb)	FY2008 (July – Feb)		
Revenue Expenditure	Education Sector	8659.1	4971.6	5426.5	68.9	62.7
	Ministry of Primary and Mass Education	3371.1	1856.0	1985.6	75.4	58.9
	Ministry of Education	5172.6	3060.3	3379.1	65.7	65.3
Development Expenditure	Education Sector	3710.2	978.0	1095.8	25.2	29.5
	Ministry of Primary and Mass Education	2279.9	641.1	791.0	28.4	34.7
	Ministry of Education	1315.9	325	277.1	21.3	21.1
Total		12369.3	5949.6	6522.3	53.6	52.7

Source: Ministry of Finance.

Female Stipend Programmes: Government has four ongoing stipend programmes for female students at the secondary and one programme at the higher secondary level. These are: Female Secondary Stipend Project phase 2 (FSSP2), Female Secondary School Assistance Project phase 2 (FSSAP2), Secondary Education Sector

Development Project (SESDP), and Higher Secondary Female Stipend Project 3rd Phase (HSFSP3). One has to fulfil three conditions to receive stipend under these programmes. The recipient has to obtain at least 45 percent marks in the final examination, at least 75 percent attendance in class and must be unmarried. During July-April of FY2008, total expenditure was about Tk. 183 crore which is 53.3 percent of revised allocation (RADP) in FY2008 (Table 5.5). During July-April FY2008, 28.07 lakh female students received stipend and Tk. 134.65 crore was spent, which is 56.20 percent of allocation under RADP.

TABLE 6.5: FEMALE STIPEND PROGRAMMES IN BANGLADESH

(in Crore Tk)

Project Name	Project Period	Covered Upazila	Allocation for FY2008		Expenditure in FY2008 (July- April)		Expenditure in FY2008 (July-Apr) as % of RADP		Stipend recipient (End 2007)
			ADP	RADP	Total	Stipend	Total	Stipend	(in lakh)
FSSP2	July 2005 - December, 2008	302	183.43	123.00	58.84	55.00	47.84	50.00	13.2
FSSAP2	July 2001 – June 2008	119	33.00	65.00	16.64	0.00	25.60	0.00	8.0
SESDP	January 2007 – June 2013	53	110.00	83.13	39.40	14.00	47.40	46.67	2.6
HSFSP3	July 2005 - June 2008.	All over the country	70.24	72.00	68.16	65.65	94.67	98.87	4.27
ALL PROJECTS			396.67	343.13	183.04	134.65	53.34	56.20	28.07

Note: FSSP2- Female Secondary Stipend Project phase 2; **FSSAP2-** Female Secondary School Assistance Project phase 2; SESDP- Secondary Education Sector Development Project; **HSFSP3-** Higher Secondary Female Stipend Project 3rd Phase
Source: Directorate of Secondary and Higher Education.

Primary Education: Three programmes for primary children are currently in operation. These are: (i) Primary Education Development Project (Phase-II), (ii) Primary Education Stipend Project (Phase I), (iii) Reaching Out of School Children. Primary Education Development Programme (PEDP) is the largest programme under the Ministry of Primary and Mass Education. This project aims at increasing enrolment, and improving school infrastructure. The “Innovation Grants” programme under PEDP Phase II was initiated in FY2008 to finance some innovative education project targeted for special community or to the special type of children who have little or no access to take education under traditional education system. On the other hand, Reaching out of School Programme (ROSC) has three broad objectives: (i) improving access to primary education for the disadvantaged Out-of-School children; (ii) improving quality of education in the ROSC learning centres and Shishu Kallayan Primary Education, and (iii) building capacity of related institutions. Under these three projects, a total of Tk. 570.94 crore was allocated in the ADP of FY2008, which was reduced to Tk. 478.44 crore in the RADP (Table 5.6). During July-April of FY2008, actual expenditure of the primary education stipend project was about 75 percent of the allocation under RADP while it was 66.4 percent of the allocated amount under the innovation programme. Data for the RSOC project was available up to December 2007 and only 5.2 percent of the RADP was used until that time.

TABLE 6.6: PRIMARY EDUCATION STIPEND PROGRAMMES IN BANGLADESH

(in Crore Tk)

Project Name	Project Period	Covered Upazila/ project	Allocation for FY2008		Expenditure in FY2008 (July- April)		Expenditure in FY2008 (July-Apr) as % of RADP		Stipend recipient (End 2007) (in lakh)
			ADP	RADP	Total	Stipend	Total	Stipend	
Primary Education Stipend Project (Phase I)	July 2002 to June 2008	477 Upazila	468.00	468.00	349.47	334.62	74.67	74.87	48.15
Innovation Grants under Primary Education Development Project (Phase-II)	Pilot programme starting from July 2007	10 Project	1.40	1.40	0.93	n.a.	66.43	n.a.	n.a
Reaching Out of School Children (RSOC)	July 2004 to June 2010	60 upazila	101.54	9.04	0.47 (until Dec'07)	n.a. (until Dec'07)	5.22 (until Dec'07)	n.a.	n.a
ALL PROJECTS			570.94	478.44					

Source: Directorate of Primary Education.

6.3. Social Safety Net

Towards targeted social empowerment, social safety net, poverty reduction, and employment generation (including micro credit support scheme) programmes, total allocation in the budget for FY2008 was Tk. 3893 crores. It was targeted that 20 lakh people would be directly benefited through these programmes. These programmes are administered by different ministries, departments and organisations and a large group of Non Government Organisations (NGOs) are also involved in the implementation of some of the schemes. Programmes under the social safety net include old-age allowance; allowances programme to the widowed, deserted and destitute women; capitation grant for public and private orphanage; honorarium programme for insolvent freedom fighters; programme for the assistance to the fully retarded; fund for mitigating risk due to natural disaster; fund for rehabilitation of the acid burnt women and the physically handicapped; seasonal unemployment reduction fund; development fund for the readymade garments workers; maternity allowance for the poor lactating mother; VGD, VGF, Test Relief (TR) and Gratuitous Relief (GR).

An allowance of Tk. 220 per person is provided to the beneficiaries of the old-age allowance; allowances programme to the widowed, deserted and destitute women under widow and destitute women for the allowance programmes. Tk. 300 per month is provided to the beneficiaries of the 'Maternity allowance for the poor lactating mother' programme. Tk. 600 per month is provided to the public and private orphanage for each orphan. The programme for the assistance to the fully retarded provides a monthly allowance of Tk. 200 for diasabled studying in the primary level, Tk. 300 for secondary level, Tk. 400 for higher secondary level and Tk. 600 for university level. Tk. 600 is provided as honorarium for insolvent freedom fighters, on a monthly basis. Under the Vulnerable Group Development (VGD) programme women are receiving 30 kg of rice or wheat or 25 kg atta for one year.

During FY2008 (July-April), 100 percent of the target for the full fiscal year was achieved in case of allowances programme to the widowed, deserted and destitute women; Maternity allowance for the poor lactating mother and Capitation Grant for public orphanage (Table 5.7). More than 99 percent of the target was achieved in case of Capitation Grant for private orphanage. In case of honorarium programme for insolvent freedom fighters, about 93 percent of the target beneficiaries were covered, but only 40 percent of the total budget allocation was spent during July-April of FY2008. About 88 percent of the target beneficiaries received benefit from the programme for the Assistance to the Fully Retarded but total spending was about 66 percent of the budget allocation. Under the fund for rehabilitation of the acid burnt women and the physically handicapped 83 percent of the targeted beneficiaries received support but total spending was only 48 percent of the budget allocation. Under the VGD programme, 2.60 lakh metric tons of rice has already been distributed to 7.5 lakh women.

TABLE 6.7: UTILISATION OF FUNDS ALLOCATED FOR SOCIAL SAFETY NET PROGRAMMES

(CroreTaka)

Programmes	**FY2008 (B)**	**Target number of beneficiaries**	**Achievement in FY2008 (July-Apr)**			**Achievement in FY2008 (July-Apr) as % of target**	
		(thousand)	Disbursed	Distributed	Number of Beneficiaries (Thousand)	Distribution with respect to FY2008 (B)	Beneficiary
Old-age allowance	448.80	1700	336.60	331.17	1672	73.79	98.39
Allowances programme to the widowed, deserted and destitute women	198.00	750	198.00	198.00	750	100.00	100.00
Capitation Grant for Public orphanage	14.94	10	14.94	14.94	10	100.00	100.00
Capitation Grant for Private orphanage	30.74	42.7	30.78	30.58	42.5	99.48	99.48
Honorarium programme for insolvent freedom fighters	99.50	100	36.00	33.40	93	39.57	92.78
Programme for the Assistance to the Fully retarded	52.80	200	39.60	34.65	175	65.63	87.50
Fund for Mitigating risk due to natural disaster	35.00	n.a.	20.00.	n.a.	n.a.	57.14	n.a.
Fund for rehabilitation of the acid burnt women and the physically handicapped	10.00	6	4.84	4.84	5	48.40	83.24
Seasonal unemployment Reduction Fund	50.00	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Development fund for the readymade garments workers	20.00	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Maternity allowance for the poor lactating mother	17.00	450	17.00	17.00	450	100.00	100.00

Source: Budget Documents.

Programmes under the Ministry of Food and Disaster Management: The government mainly distributes rice and wheat under the *Public Food grain Distribution System* (PFDS) through monetized and non-monetized (targeted) channels. Monetized distribution is the sale of rice and wheat through Essential Priority (EP), Other Priority (OP), Large Employee Industries (LEI), Flour Mill (FM), Open Market Sale (OMS), and Fair Price Card (FPC). Non-monetized (targeted) channels include targeted safety net programmes such as Food for Works (FFW), Test Relief (TR), Gratuitous Relief (GR), Vulnerable Group Development (VGD), Vulnerable Group Feeding (VGF), Food for Education (FFE) and other relief channels.

During 1 July- 22 May of FY2007/08, amount of food grains distributed under various PFDS channels was about 14.34 lakh metric tons against 13.02 lakh metric tons distributed during the comparable period of the previous year (Table 5.8). In other words, during the first 11 months of the current fiscal year total distribution under PFDS was 10 percent higher than that of last year. Distribution through non-priced channel (9.53 lakh metric tons) was 51 percent higher than last year. On the other hand, distribution under priced channel was 4.81 lakh metric tons which was 28 percent lower than comparable period of the previous fiscal year. It is pertinent to mention here that allocation for food subsidy in FY2008 Budget was Tk. 786 crore. Till the first week of May 2008, actual expenditure on food subsidy was Tk. 651 crore.

In view of high global food prices in the coming years, government will need to continue distribution under PFDS and expand the social safety net programmes in the next fiscal year (FY2008/09). The government may have to go for an increased distribution under PFDS in 2008-09 to the tune of 3.0 million tons of rice and wheat. This would require a foodgrain rolling stock of about 12-15 lakh tons. Government does have the physical facility to maintain this stock. Procurement will have to be made mainly in the Boro and Aman seasons with distribution being made throughout the year, with greater allocation during October-November and March-April period. Social Safety Net Programme needs to be designed in such a way that hard core poor families are adequately covered. To this end, an *independent monitoring mechanism* needs to be put in place to ensure that the VGF and VGD beneficiaries are appropriately targeted, and that those in needs are not overlooked. Regular feedbacks from this oversight exercise will enable the government to closely calibrate the programme to mitigate distress promptly and effectively, and also to avoid wastage and rent seeking in the distribution process.

Effective operation of PFDS requires procurement from both domestic and international sources. Ministry of Food has declared its procurement target of Boro rice as 1.2 million metric tons of rice and 0.3 million metric tons of paddy and set procurement price of Tk. 18 for per kg paddy and Tk. 28 for per kg rice. As of May 27, 2008 actual procurement was about 20 thousand metric tons of paddy and 191 thousand metric tons of rice. Mechanisms to promote procurement of foodgrains need to be explored so that farmers receive better price. Public stock of foodgains currently stands at about 583 thousand metric tons. If the government is able to materialise its plan for food procurement from domestic sources and is able to realise import of 500 thousand metric tons from India, it would be within the *comfort zone* in terms of operating its safety net programmes adequately and appropriately. Given that food security originates both from cyclical and transitory factors; both of these aspects will have to be kept in mind while designing food security strategy for FY2009.

TABLE 6.8: SECTOR WISE PUBLIC DISTRIBUTION OF FOOD GRAINS

(*in Thousand metric tons*)

	1st July 2006-24 May 2007			1st July 2007-22 May 2008		
	Rice	Wheat	Total	Rice	Wheat	Total
Priced Channel						
EP	136.94	95.43	232.37	116.17	71.89	188.06
OP	9.63	6.64	16.26	12.25	5.39	17.65
LE	3.43	8.78	12.21	5.88	4.42	10.30
OMS	408.01	0.00	408.01	265.01	0.00	265.01
Others	0.00	0.03	0.03	0.01	0.00	0.01
Sub total	**558.00**	**110.89**	**668.89**	**399.32**	**81.70**	**481.02**
Non Priced Channel						
FFW	79.15	2.26	81.41	77.61	45.67	123.28
TR	114.30	0.00	114.30	65.55	10.37	75.92
VGF	230.07	0.00	230.07	187.36	0.00	187.36
VGF (Aid)	0.00	0.00	0.00	205.32	2.84	208.16
VGD	84.89	38.72	123.61	181.49	55.47	236.96
GR	25.57	0.00	25.57	36.40	0.00	36.40
Others	43.87	14.14	58.00	63.78	21.05	84.82
Sub total	**577.85**	**55.11**	**632.96**	**817.50**	**135.39**	**952.89**
Total	**1135.85**	**166.00**	**1301.85**	**1216.82**	**217.09**	**1433.91**

Source: Source: Food Planning and Monitoring Unit (FPMU), Ministry of Food and Disaster Management.

7. CONCLUDING REMARKS AND OUTLOOK FOR FY2009

In the budget speech delivered in June 2007 the Finance Advisor mentioned that his main tasks in FY2007-08 were to maintain macroeconomic stability, control inflation, create jobs and ensure equitable growth. As the analyses presented in this report bear out, the economy has experienced formidable challenges in the current fiscal year in each of these areas. Inflation has gone up further in FY2007-08 with consequent erosion of purchasing power of the average citizens, fall in real wages and salaries, and with more people falling below the poverty line. The CTG has tried to tackle the issue of food security through energetic policies to enhance food production, by widening the coverage of safety net programmes, and through open market sales at controlled prices. The post-*Sidr* relief and rehabilitation efforts of the CTG have also been impressive. However, prices of essential items are still at high levels and inflation remains a major concern. These are having an adverse effect not only on consumers, but also on the producing sectors and the economy as whole. Whilst initiatives such as *Better Business Forum* and setting up of *Regulatory Reforms Commission* do have the potential to contribute to establishing better business climate and good corporate governance, prevailing uncertainties at a time of energetic anti-corruption drive and state of emergency did have an adverse impact on investment climate which led to a slowdown of the GDP growth rate. However, one good sign is that investment appears to have been picking up in the third quarter of FY2008 as manifested by import structure, disbursement of industrial term loan and performance of export-oriented sectors.

It is perhaps to be accepted that many of the major challenges which inhibited the economic performance in FY2008 are likely to be continued in FY2009. The budget for FY2009 will need to have adequate measures to address those concerns so that the growth rates projected in the PRS-II, of 7 per cent, could be achieved. The challenge in the forthcoming fiscal year will also be that elections will have to be held by the end of 2008 and a major part of the planned activities will be implemented by the newly elected government.

Inflation control and investment promotion appear to be the two major challenges as the economy approaches the new fiscal year. Latest figures indicate that the spiraling prices have stabilised to some extent in April-May period with inflation rates coming down, albeit only insignificantly. A bumper boro crop of about 17.0 million tons has ensured that the crop losses of about 2.0 million tons would be largely offset and total foodgrains availability will be at levels similar to those of FY2007. This is likely to have positive impact on food prices and inflation, although significant reductions are unlikely. According to FAO projections, global production and supply of foodgrains in 2008 is likely to increase in view of better weather conditions; however, high foodgrains prices will perhaps persist. In view of this, all out effort to increase domestic foodgrains production will need to be given the highest priority in FY2009. Timely availability of fertiliser, electricity, diesel and hybrid and good quality seeds will have to receive urgent attention.

Although gas prices have been rationalised, adjusting the currently highly subsidised fuel and fertiliser prices will be a challenge. Experience of FY2008 indicates that some adjustment of the subsidy on fertiliser, in view of the growing subsidy burden in the context of rising global prices of fertiliser and higher domestic market prices of rice, may have to be considered. In this connection, timely and adequate supply of fertiliser should be ensured during the upcoming aus and aman crops. Some readjustment of petrol, diesel and octane may also be needed in FY2009. Mechanisms will have to be designed so that marginal farmers and low income people get the necessary transfers to offset the adverse incidence of any such price adjustments. Support given to farmers this year to adjust to diesel prices could serve as a reference point in this context. Since food availability in the global market itself could become a concern, the compelling need of ensuring food security ought to be given precedence whilst making any adjustment in the subsidy policy.

A major challenge in FY2009 will be to address the growing fiscal deficit which is likely to cross 5 per cent in FY2008. The government has gone for high borrowings from domestic sources (which was 1.8 times higher than that of the preceding fiscal, and primarily from the banking sector). At a time of global inflationary pressure and the need for higher levels of public expenditure, high fiscal deficit of 5-6 per cent of GDP will perhaps need to be tolerated. However, in view of future expenditure burden (on account of higher domestic debt-burden), the deficit will have to be carefully managed. Although ADP implementation rate has been sluggish in FY2008 (unlikely to exceed 65-70 per cent of the revised ADP in FY2008) it will not be advisable to go for any drastic reduction in the size of the ADP in FY2009 given the high developmental demands in the economy. The ADP for FY2009 will possibly need to be of the same size as the original ADP for FY2008. A renewed emphasis will have to be put on ensuring ADP implementation, both in terms of quantity and quality. Creation of employment opportunities in the economy is also closely associated with ADP implementation. CTG's plan to go for a substantive *employment guarantee scheme* is a welcome initiative; however, there should be appropriate institutional mechanisms in place to implement such a large-scale scheme successfully.

Cost of doing business in Bangladesh has seen substantial rise in FY2008. With continuing inflation at near double digit level this is expected to remain so in FY2009. Positive signals in terms of business confidence, evident in the latter half of FY2008, will need to be supported with concrete policies. The agreement to fix the highest lending rates for term and working loans at 14 per cent is to be appreciated in this context. However, the demand by the private sector to borrow from international market will also need to be given careful examination. In view of its critical importance for investment, ensuring the required amount of power must be seen as one of the most urgent tasks.

The accommodating monetary policy pursued by the central bank in view of the inflationary pressure appears to have been the right policy under the circumstances. A contractionary monetary policy through higher interest rates could have further dampened investment stimulus at a time when investment was sluggish. However, the envisaged dearness allowance and some of the other budgetary measures are likely to increase money supply in the economy with consequent inflationary pressure. In view of this, FY2009 must see a renewed effort to stimulate production and also productivity. Expenditure on R&D will need to be radically enhanced; and import policy for FY2009 should facilitate import and adoption of new technologies that augment process, product and quality upgradation.

FY2009 is likely to see continuing pressure on balance of trade and balance of current account because of higher burden of import which is likely to approximate about 20 billion in FY2008 and will perhaps be higher in the next fiscal. Efforts will need to be strengthened towards both intra-RMG and extra-RMG diversification. Arresting the continuing downward sliding of terms of trade ought to be given attention. Special package of support will need to be designed for emerging sectors with high promise including home textile, high value RMG and shipbuilding. It appears that high remittance earnings will continue to be a major factor in ensuring positive balance in the current account. Indications are there that the recently seen high demand for migrant workers is likely to continue in 2008 and 2009. Strategies will need to be put in place to take the fullest advantage of the global job market openings.

The ongoing WTO negotiations in Geneva are at a crucial juncture at this point. Ensuring LDC interests in the negotiations on agriculture, non-agricultural market access (NAMA), services and other areas of interest to Bangladesh, is important since these are likely to have critical implications for Bangladesh's short, medium and long term economic interests. This is important also in view of the high possibility of a deal being struck in the next few months with regard to the *Doha Round agenda*.

It was mentioned at the outset that FY2009 will be a threshold year for Bangladesh. It is hoped that the *road map* for transition to democratic governance will be implemented in 2008 and a conducive environment for investment and economic activities will prevail, so that the country is able to focus its attention on the manifold challenges that remain to be addressed, only some of which have been mentioned in the above sections.