ADB

BANGLADESH

Quarterly Economic Update

June 2010

Asian Development Bank

CONTENTS

NOTES

(i) The fiscal year (FY) of the government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2010 ends on 30 June 2010.

(ii) In this report, "$" refers to US dollars, and "Tk" refers to Bangladesh taka.

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MACROECONOMIC DEVELOPMENTS

Highlights

- GDP growth in FY2010 is preliminarily estimated at 6%.
- Agriculture sector benefited from broad-based policy support and grew briskly.
- Industry sector growth was held back by severe power and energy shortages.
- Managing inflation is emerging as a major macroeconomic challenge.
- Tax reforms need to be accelerated to boost domestic resource mobilization.
- Capacity in line agencies needs to be enhanced for efficient implementation of the public investment program.
- Bangladesh's growth prospect would depend on large and quick investments in power, energy and transport infrastructure.

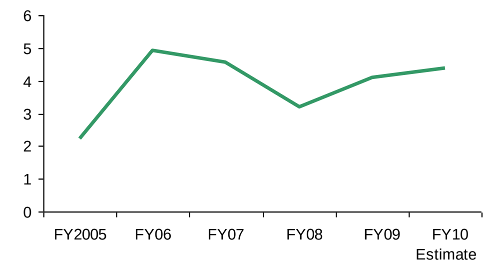
Sector Performance and Economic Growth

1. The lagged effects of the global economic recession reduced growth of the country's two major growth drivers—exports and remittance inflows. Nevertheless, the Bangladesh economy attained a 6.0% GDP growth in FY2010 (according to the Ministry of Finance sources). This was the result of buoyant domestic demand, underpinned by an expansionary fiscal policy, and rapid credit growth. Production of aman (monsoon crop) showed healthy growth. The government continued broad-based policy support to strengthen the incentive regime in agriculture. The industry sector performed well, although its growth potential is held back by acute shortages of power, gas, and other basic infrastructure. The services sector performance also improved.

2. The country's stable macroeconomic environment, supported by well-coordinated monetary, fiscal, and

exchange rate policies was a major factor in managing the effects of the global economic recession. The FY2011 budget affirms the government's strong commitment to maintain macroeconomic stability and accelerate institutional and policy reforms to attain higher growth essential for reducing poverty (paras. 54–72). The government needs to take decisive actions to mitigate growing power and gas shortages. Investment in key strategic sectors, especially power, ports, and communication needs to be scaled up. With the global recovery slowly picking up, the country's subdued investment climate is expected to improve. An important measure will be operationalizing public–private partnerships (PPPs) to boost domestic and foreign investment in strategic infrastructure. At the same time, delivery of basic services, especially the provision of social infrastructure, needs to be improved to advance living standards in rural and semi-urban areas. The capacity of line agencies should be enhanced to ensure timely implementation of development programs.

Figure 1. Agriculture growth

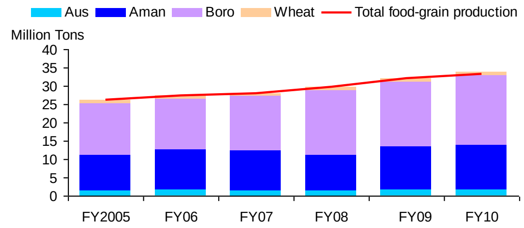


Agriculture

3. The agriculture sector grew by 4.4% in FY2010, up from 4.1% in FY2009 (Figure 1). The higher growth was aided by continued policy support from the government, including subsidy on input prices, supply and distribution of key inputs, higher procurement prices for outputs, access to credit, and better delivery of extension services. Growth in the sector was broad based with sustained growth in poultry, livestock, fisheries, and forestry. To meet food demand of the growing population, productivity in these subsectors, which is significantly low compared with other Asian developing countries, needs to be raised. Given the slow process in raising productivity, sustaining high growth in agriculture will require continued government support to expand irrigation facilities and increase cropping intensity.

4. Production of staple food grains, i.e., rice and wheat, is estimated to grow from 32.2 million tons in FY2009 to 33.9 million tons in FY2010, up 5.3% (Figure 2). Other crops are also expected to do well because of growing commercialization of agriculture and a publicity campaign undertaken by the government and nongovernment organizations for encouraging crop diversification. The farmers are showing interest in high-value crops because of higher risk and low returns in traditional agriculture. Bangladesh has a high potential for exporting high-value crops. Their production needs to be supported as a means of increasing agriculture's

Figure 2. Food-grain production



contribution to GDP and for diversifying the country's exports.

5. Production of aus (summer crop) was lower at 1.7 million tons in FY2010 from 1.9 million tons in FY2009, down by 10.5% because of the decreased planting area caused by the drought. The area under aman cultivation rose by 3.6% (5.7 million hectares) in FY2010 from 5.5 million hectares in FY2009. Production of aman was up by 5.2%, from 11.6 million tons in FY2009 to 12.2 million tons in FY2010. The production target for boro (winter crop) in FY2010 is set at 19 million tons, up by 6.7% from the actual production of 17.8 million tons in FY2009. Wheat production is targeted to rise from 0.9 million tons in FY2009 to 1.0 million tons in FY2010, up by 11.1%. In FY2011, agriculture growth is expected to moderate to 4.1%, close to the sector's historical average growth because of the higher base following the strong growth in the past several years.

6. To attain the goal of self-sufficiency in food production by 2012, the FY2011 budget affirms the government's top priority to sustain broad-based higher growth in the agriculture sector. The budget emphasized an integrated development strategy for agriculture, encompassing the rural nonfarm sector, rural development including rural infrastructure, rural electrification, rural housing, use of land and water resources, and development of rural small and medium-sized enterprises (SMEs). The government plans to keep fertilizer prices within the reach of farmers. It has initiated a program to distribute organic, green, and biofertilizers to 9.7 million families in the country to popularize the use of natural fertilizers in kitchen farming for raising agricultural production.

7. The government has distributed agro-input assistance cards to 18.2 million farmer families, and Tk7.5 billion to 9.2 million boro farmers to help them purchase diesel in the FY2010 boro season. Under the program for supplying high-yielding variety seeds to farmers, FY2011 targets are fixed to distribute 118,450 tons of seeds through Bangladesh Agricultural Development Corporation and 84,838 tons through the Department of Agricultural Extension. Actions are also under way to increase seed storage capacity from 40,000 tons to 100,000 tons. The government adopted schemes to grow hybrid paddy on 1.2 million hectares, and salinity resistant Bri-47 on 50.0% of the salinity-affected 1.0 million hectares of land.

8. The government has taken steps to produce crops suitable for particular kinds of land with the help of a soil survey that facilitates analysis of soil quality, identification of land resources, and assessment of land fertility. Under this program, the government has distributed guidelines on the use of land, soil, and fertilizer; and ensured transfer of technology on land management in hilly and salinity-affected areas. The government plans to expand irrigation facilities in the southern part of Bangladesh by utilizing surface water, mitigating water-logging problems in the southwest, increasing the area of cultivable land, and facilitating multicrop production by draining water from *haor* areas. Expanding agricultural credit and removing institutional bottlenecks are the government's major priorities in agricultural development. In FY2011, the government plans to distribute Tk120.0 billion as agricultural loans. To raise productivity, the government plans to operationalize the newly created Agricultural Research Fund during FY2011.

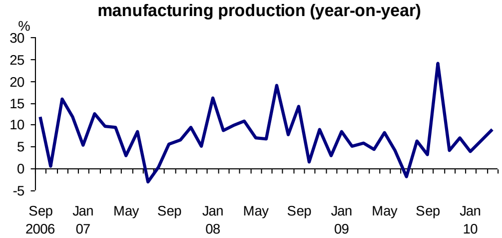
9. To ensure fair prices for agricultural produces, the government has taken steps to organize farmer marketing groups and farmer clubs throughout the country, and develop 128 *upazila* agromarkets and 30 district agrobazaars to facilitate marketing of agricultural produces. Moreover, infrastructure provision is planned for wholesale markets in 15 districts and 60 growers' markets in another 16 districts of the northern region. The government also has an initiative to introduce an agriculture insurance scheme to provide small and medium-sized farmers with crop price support in the event of crop failure due to natural disasters.

Industry

10. The industry sector performed well despite adverse impacts of the global economic recession on the country's export-oriented industries although industry growth moderated to 6.4% in FY2010 from 6.5% in FY2009. Production in domestic market-oriented industries expanded to offset the lower value-added in export industries. In addition, robust growth of mining and quarrying, and continued expansion of construction and housing, especially in the second half of the fiscal year, helped the sector to attain healthy growth. Directives from Bangladesh Bank (central bank) to promote credit financing facilities to SMEs contributed to the maintenance of satisfactory industrial growth.

11. The general index for medium- and large-scale manufacturing rose by 6.5% during July–March FY2010 (Figure 3). The major industrial category—jute, cotton, wearing apparel, and leather—posted a rise of 0.4% from the corresponding period of FY2009. Chemicals, petroleum, and rubber production rose by 28.0%; food, beverages, and tobacco by 9.2%; fabricated metal products by 7.4%; nonmetallic products by 2.3%; paper and paper products by 2.0%; and wood products including furniture by 4.6%. Production of basic metals was down by 44.8%.

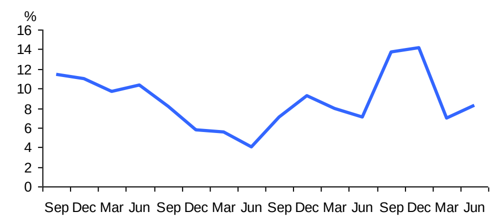
Figure 3. Growth of medium- and large-scale manufacturing production (year-on-year)



12. The general index for small-scale manufacturing rose by 10.7% in FY2010 (Figure 4). Food, beverages, and tobacco increased by 38.3%. Production of other industrial categories also increased: leather and apparel up 4.3%; metal products and machinery up 4.2%; chemicals, rubber, and plastic up 0.8%; basic metal industries up 1.4%; nonmetallic products up 5.0%; and paper, printing, and publishing up 4.6%. However, production of wood and wood products fell by 0.4% and other manufacturing industries were down by 19.9%.

13. The FY2011 budget attached high priority to attaining Vision 2021, which aims to increase the contribution of the industry sector to GDP to 40.0% and attain labor absorption of 25.0% by 2021. To that end, the government drafted the Industrial Policy 2010, which provides policies and strategies for industrialization. The government gives priority to developing agrobased and labor intensive industries. The sectors receiving priority are agroprocessing, readymade garments and knitwear, shipbuilding and shipping, light engineering, pharmaceuticals, jute and leather goods, and furniture. Under the proposed Industrial Policy, export-oriented industries, identified as a thrust sector, will receive special incentives and support from a risk fund. Priority will be given to foreign direct investment and investment by nonresident Bangladeshis in installing renewable energy-based power stations. In addition, incentives will be given for establishing institutions such as the Bangladesh Standard and Testing Institute in the private sector to test the quality of goods produced.

Figure 4. Growth of small-scale manufacturing production



14. The government is implementing several projects to induce agglomeration and competitiveness in the industry sector. To promote labor intensive and environment-friendly industrialization, the land development work for the installation of a 81.0 hectares leather industrial city along the *Dhaleshwari* riverside of *Savar-Keranigonj upazila* has been completed. Establishment of a central effluent

treatment plant and construction of a dumping yard is underway. A pharmaceutical industrial park is being built to facilitate growth of factories for production of pharmaceutical raw materials with job facilities for 25,000 people. The government plans to establish another fertilizer factory with a production capacity of 577,000 tons to increase the production of urea fertilizer in the country. To revive the jute sector, an allocation of Tk10.9 billion in the form of cash and bank guarantees has been made to jute mills under the Bangladesh Jute Mills Corporation. An additional 10.0% cash incentive has been given to support the export of jute goods and a refinancing fund of Tk5.0 billion was created to help public jute mills overcome likely liquidity shortage.

15. To promote tourism, Bangladesh *Parjatan* Board Act 2010 was enacted to facilitate development, operation, and promotion of the industry. The Bangladesh Conservation and Preservation of Tourism Areas and Exclusive Tourist Zone Ordinance, 2010 was promulgated with goals of identifying and preserving potential areas for tourism, declaring exclusive tourist zones, attracting domestic and foreign investments in these areas, and preventing erection of unplanned structures and related operations in the reserved areas. The government intends to continue with development programs to improve tourism facilities in different parts of Bangladesh. In addition, development and modernization of SMEs are major priorities of the government's strategic plan for industrialization.

16. Industry performance will improve in FY2011; growth is projected at 7.5% because of strong domestic demand and higher production by SMEs and agrobased industries, and the expected pickup in production for export. However, attaining this target depends on the government's capacity to mitigate prevailing electricity and gas shortages. The government attached priority to eliminating the growing shortages, through large investments in power generation and transmission and distribution. Its purchase of rental power and better demand management is expected to alleviate the power shortage—a major constraint to industrial production.

17. The government has increased efforts to mitigate gas shortages. It is attaching priority to gas exploration, and is seeking ways to diversify fuel use by importing liquefied natural gas and coal for power generation. In addition, the government resorted to gas rationing to augment energy supply for electricity production. It prepared a medium-term roadmap to raise power

generation capacity to 9,426 megawatts (MW) by 2015, largely focusing on PPPs. Bangladesh signed memoranda of understanding with India for purchasing electricity and setting up coal-fired joint venture power plants in Chittagong and Khulna. The government is also encouraging investment in alternative sources of energy. Reaping benefits from these measures will take time because of the long gestation period in electricity production. In the meantime, the government is considering purchasing electricity from India and Nepal. To mitigate the energy shortages, the government also needs to finalize the coal policy.

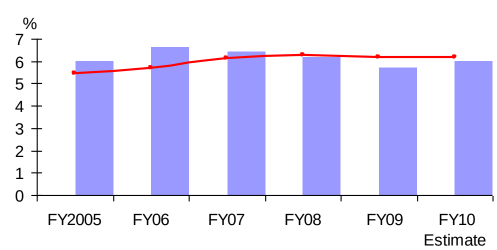
Services

18. Services sector growth depends largely on growth of agriculture and industry. The services sector grew by 6.6% in FY2010 (6.3% in FY2009), supported by the recovery of transport services and strong performance of wholesale and retail trade, and other services. Better performance in agriculture and domestic market-oriented industries contributed to the higher growth. Telecommunications and communication performed well, along with the pickup in the financial sector, public administration, education, health and social services and wholesale and retail trade. In FY2011, higher industry growth will improve growth prospects for the service sector, pushing growth up slightly to 6.7%. The increase in trade and transport activity with the revival of import and export trade will support services growth.

Economic Growth

19. The Ministry of Finance estimated GDP growth in FY2010 preliminary at 6.0% compared with 5.7% in FY2009 (Figure 5). In view of the sharp decline in the growth in exports and remittances—the two traditional growth drivers—this better than expected performance is mainly attributed to strong domestic demand underpinned by rapid growth in private credit and rise in public sector wages.

Figure 5. GDP growth



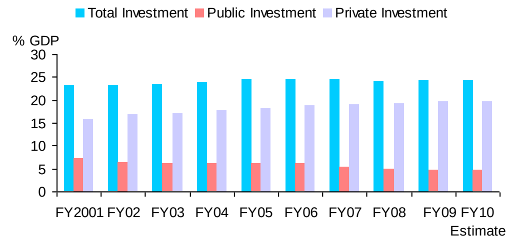
20. Bangladesh's growth potential is held back by growing shortages of power and energy, in addition to the weak investment climate. Inadequate power and gas supply is affecting production in existing industries, while new investments are postponed.

21. GDP growth in FY2011 is projected at 6.3%. While the slow global recovery will prevent export and remittance growth from returning to their precrisis levels, strong domestic demand supported by accommodative fiscal and

monetary policy is expected to offset the slow pickup in external demand. With limited scope for rebalancing in favor of domestic consumption, Bangladesh should continue to explore the potential for increasing exports as the major source of growth, including by diversifying by product and destination while maintaining conducive measures to support domestic consumption.

22. The investment to GDP ratio was 24.4% in FY2010, unchanged from FY2009 (Figure 6). Private investment rose slightly from 19.7% of GDP in FY2009 to 19.8% in FY2010, while the public investment–GDP ratio declined from 4.7% in FY2009 to 4.6% in FY2010. Trends reveal a number of anomalies in the country's investment profile. First, the amount of investment is low compared with what is required to support higher growth. Second, the investment–GDP ratio exhibits a stagnating trend confined to the 24.2% to 24.5% range. Third, complementary public investment is falling. Fourth, the contribution of foreign direct investment is negligible in total investment. Fifth, the spread between the national savings–GDP ratio and the investment–GDP ratio is about 5 percentage points, which implies Bangladesh lacks an efficient financial system and appropriate incentive regime to channel savings to productive investment. It also implies that investment is not constrained by lack of liquidity; it is likely to be held back because of a poor investment climate and institutional bottlenecks.

Figure 6: Investment

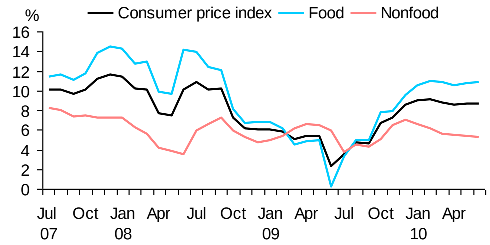


23. Bangladesh's business environment needs to be improved. The country's global ranking for the World Bank's ease of doing business index has fallen to 119 in 2010 from 110 in 2009. Its ranking for starting a business dropped to 98 in 2010 from 90 in 2009. The cost to start a business rose significantly to 36.2% of per capita income in 2010 from 25.7% in 2009. The ranking for dealing with construction permits is 118 out of 183, down from 114 in 2009; and for closing a business, the ranking is 108 out of 183, down from rank 106 in 2009. According to the 2010 index of economic freedom (Heritage Foundation), Bangladesh's economy is the 137th freest in the world. The overall freedom to start, operate, and close a business is limited by Bangladesh's regulatory environment. Starting a business takes an average of 44 days (73 days in 2009), compared with the world average of 35 days. Obtaining a business license however requires less than the world average of 18 procedures. The country ranks 59.4 on the business freedom index in 2010 compared with 62.9 in 2009 (2010 index of economic freedom).

Inflation

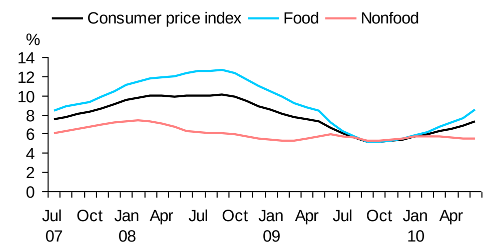
24. Managing inflation is emerging as a major challenge. After falling in the previous year, inflation rose in FY2010, reaching 9.1% year-on-year in February 2010 from 2.3% in June 2009. While it moderated slightly during March and April, it started rising again from May 2010 (Figure 7). Food and nonfood inflation followed the same pattern. Annual average inflation edged up to 7.3% from 6.7% in FY2009 (Figure 8). With the relatively stable global commodity prices, inflationary pressures intensified primarily because of the rapid money supply and private credit growth. As monetary policy affects output and prices with long and variable lags, the effects of the past high money and credit growth could be felt over the next several months.

Figure 7. Inflation, point-to-point



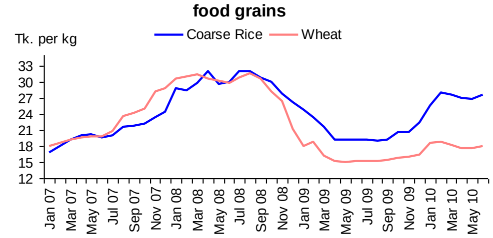
25. The price of the main staple food, rice (coarse), reached Tk28.0/kilogram (kg) in February 2010, a 16-month high, from Tk19.2/kg in July 2009 and thereafter declined until May 2010 (Tk26.8/kg) and again edged up to Tk27.5/kg in June 2010. The price of wheat rose from Tk15.2/kg in July 2009 to Tk18/kg in June 2010 (Figure 9). According to Trading Corporation of Bangladesh (TCB), the price of rice (coarse) ranged from Tk30/kg to Tk33/kg in mid-August 2010, while the price of wheat rose from Tk27/kg to Tk28/kg. Food inflation rose from 3.3% in July 2009 to 10.9% in June 2010, while nonfood inflation rose from 3.7% in July 2009 to 5.2% in June 2010.

Figure 8. Inflation, 12-month moving average



26. Bangladesh Bank is vigilant in its quest to curb inflationary pressures mainly through reducing liquidity by adjusting policy rates and open market operations. In August 2010, it raised the repo rate from 4.5% to 5.5% and the reverse repo rate from 2.5% to 3.5%. Earlier in May, it raised the cash reserve requirement by 50 basis points to 5.5%. To keep the effects of inflation on the population in check, the government intervened in the retail market through open market sales of rice and took several measures, including intensively monitoring the market (by the commerce ministry), enhancing the supply and distribution of commodities, revitalizing TCB and using it to intervene in the market, and procuring rice to build up stock.

Figure 9. Domestic open market retail prices of food grains

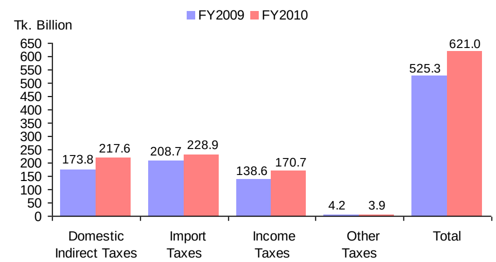


Fiscal Management

27. Fiscal policy continued to remain focused on maintaining macroeconomic stability and promoting pro-poor growth, while ensuring food security and encouraging social inclusion. The strategic thrusts of the fiscal policy as envisioned in the national strategy for poverty reduction (National Strategy for Accelerated Poverty Reduction II, FY2009–FY2011) are increasing revenue, reordering public expenditure to more productive and social sectors, and improving efficiency of public expenditure. The FY2011 budget, which is anchored on the medium-term budgetary framework, emphasizes maintaining the fiscal deficit within sustainable limits and noninflationary financing of the deficit, while encouraging private investment.

28. Despite the global recession, the country's tax–GDP ratio rose from 8.6% in FY2009 to 9.3% in FY2010. Revenue collection under the National Board of Revenue (NBR) rose by 18.2% in FY2010 (Figure 10). Import-based taxes grew by 9.7%: customs duty by only 1.5%, value-added tax (VAT) by 11.9%, and supplementary duty by 33.7%. Revenue from domestic indirect taxes grew robustly by 25.2%: VAT by 26.0%, supplementary duty by 23.0%, and excise duty by 45.8%. Income tax collection rose by 23.2%.

Figure 10. Revenue collection by National Board of Revenue



29. Raising the revenue–GDP ratio to the level of other South Asian countries is a major challenge. Low revenue severely restricts the government's ability to provide public goods and services. It also limits the fiscal resources available to finance development activities, especially building critical infrastructure to maximize pro-poor growth and poverty reduction. To ensure a major boost in revenue, the tax base needs to be expanded and the tax laws and procedures streamlined. The government's initiatives in overhauling the VAT and income tax laws are steps in the right direction.

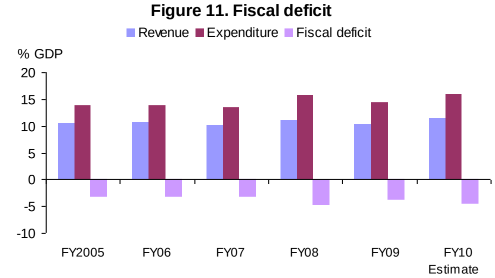
30. The FY2011 budget seeks to build on the good revenue outturn in FY2010. The government initiated rationalization of the tax system with a focus on minimizing exemptions and distortions. The government seeks to review the possibility of reducing dependence on custom duties. Following stakeholder consultations, NBR formed a task force to make recommendations on tariff rationalization. A core committee has been formed to suggest administrative reforms and increase efficiency at NBR. To prevent tax evasion, NBR is taking initiatives to

strengthen monitoring and auditing activities. Full automation of the tax assessment system at Chittagong and Dhaka customs houses is now complete. Initiatives are underway to bring changes to the current preshipment inspection system to reduce cost burden and to introduce modern physical verification methods. To monitor preshipment inspection of imported goods, a proposal to set up customs offices in 10 important Bangladesh missions abroad is now in progress. Efforts to bring different customs houses under the ASYCUDA++ system will continue.

31. The government is attaching priority to increasing utilization of the Annual Development Program (ADP) allocation. ADP utilization is expected to rise from 4.1% of GDP in FY2010 to 4.9% in FY2011. To increase ADP utilization, the government is implementing a number of institutional reforms, including ensuring discipline in planning; undertaking projects on the basis of the implementation capacity of line ministries and divisions; setting priorities among projects; undertaking advanced procurement planning for ensuring smooth project implementation; ensuring matching funds for foreign-aided projects, and intensively monitoring implementation progress; introducing a management information system; rationalizing number of projects, and expanding implementation capacity of large ministries such as education, communication, and local government; and establishing separate budget wings in ministries and divisions.

32. A task force was formed to monitor ADP implementation of 10 major ministries and divisions. In addition, progress of implementation of the largest 50 foreign-aided projects is under review. The government has revived the Statistics Division to strengthen the foundation of planning and public policy and make them more information-based.

Figure 11. Fiscal deficit



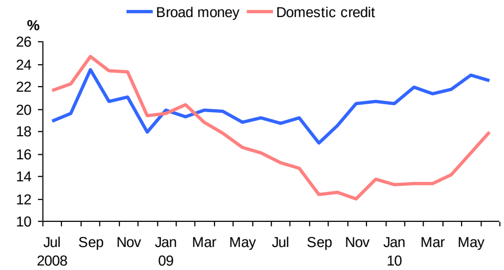
33. Because of the government's expansionary fiscal stance, the fiscal deficit is estimated to have risen from 3.9% of GDP in FY2009 to 4.5% in FY2010 (Figure 11). However, the debt-GDP ratio declined from 41.0% in FY2009 to 37.4% in FY2010.

Monetary and Financial Developments

34. In July, Bangladesh Bank announced its monetary policy statement (MPS) for July–December 2010. Bangladesh Bank seeks to maintain its growth-supportive

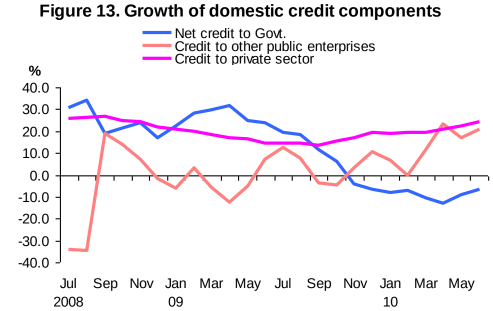
stance, while remaining vigilant against inflationary pressures. The central bank will strengthen its efforts to intensify financial inclusion by encouraging higher flows of resources to agriculture, SMEs, and agrobased industries. The MPS aims at higher (6.7%) growth in FY2011 along with limiting the inflation rate within 6.5%. It supports the export sector and investment in prioritized sectors. To check inflation, the MPS seeks to reduce excess liquidity in the banking system and sterilize the effects of the accumulated buildup in foreign exchange reserves. In addition, it aims to channel credit for productive investment.

Figure 12. Growth of broad money and domestic credit



35. Money supply (M2) grew by 22.4% year-on-year in June 2010, up from 19.2% in June 2009 (Figure 12). The growth exceeded the annual target of 18.8%. Despite monetary tightening by raising the policy rates, credit to the private sector maintained a healthy flow (24.2% year-on-year in June 2010) because of the credit expansion for working capital and for retail consumers. Net credit to the government declined by 6.5% as the higher revenue growth reduced the need for borrowing, while credit to other public sector rose by 20.8% year-on-year in June 2010 (Figure 13).

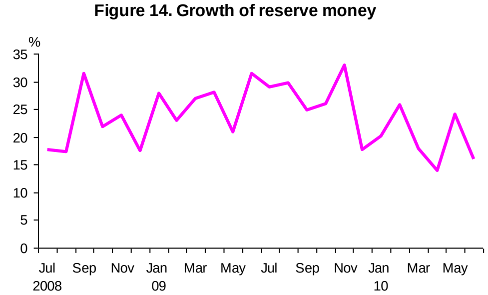
Figure 13. Growth of domestic credit components



36. The MPS projects that year-on-year growth in M2 will slow to 15.2% in June 2011, because of effective monitoring and control over unproductive and speculative use of credit. Private sector credit growth will decline to 16.0% during the same period. The MPS expresses the hope that the anticipated pickup in imports and slowdown in remittance growth will eliminate the overhang of taka liquidity, putting downward pressure on prices. Bangladesh Bank will also be ready to limit any rise in demand-side pressures, and change policy rates.

37. Reserve money rose 16.0% year-on-year in June 2010 (Figure 14) because of a sharp rise in net foreign assets (41.5%). The continued growth in the inflow of remittances, and decline in import payments are the main reasons behind the rise in net foreign assets. Net domestic assets fell sharply (26.1%) in June 2010. The reserve money multiplier rose slightly to 4.5 year-on-year in June 2010 from 4.3 in June 2009.

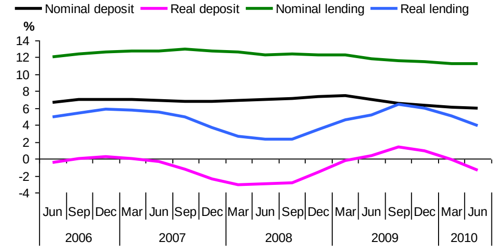
Figure 14. Growth of reserve money



38. Interest rates on treasury bills (T-bills) declined because of excess liquidity in the banking system. The weighted average yield on 91-day T-bills declined from 3.5% in June 2009 to 2.4% in June 2010. The yields on 182-day T-bills dropped from 8.2% in March 2009 to 3.5% in June 2010. After dropping to less than 1.0% in the first

quarter of FY2010 because of the large accumulation of excess liquidity in the banking system, the interbank call money rate rose to 6.5% in June 2010 because of a pickup in private sector credit demand, including import demand together with Bangladesh Bank's intention to reduce excess liquidity.

Figure 15. Nominal and real interest rates



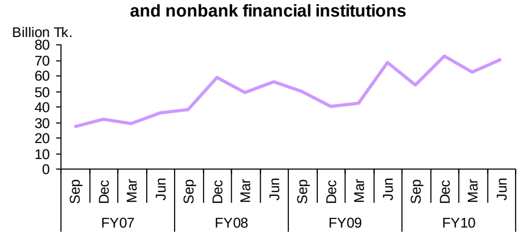
39. Excess liquidity in the scheduled banks, despite recent moderation, remains large. It stood slightly lower at Tk345.0 billion at the end of June 2010 down from Tk347.6 billion at the end of June 2009. In FY2010, Bangladesh Bank purchased $2.2 billion in foreign exchange from the commercial banks to stabilize the foreign exchange market; it had purchased $1.5 billion in FY2009. As a balancing measure, the central bank started selling government securities directly to commercial banks to absorb excess liquidity.

40. The weighted average lending rate declined slightly to 11.2% in June 2010 from 11.9% in June 2009; the weighted average deposit rate declined to 6.0% from 7.0% in the same period, implying a negative real deposit rate (Figure 15). The high interest rate spread reflects inefficiency in the banking system.

41. Disbursement of industrial term loans stood higher at Tk70.5 billion during the fourth quarter of FY2010 compared with Tk62.1 billion in the third quarter of 2010 (Figure 16). Large-scale industries accounted for about 70% of the total fund, followed by medium-scale industries (22%). The government prioritized the expansion of SME finance. Total SME loans rose from Tk45.0 billion at the end of March 2009 to Tk52.6 billion at the end of March 2010, up by 17.0%.

42. The ratio of gross nonperforming loans (NPLs) to total loans of the banking system dropped from 10.4% at the end of September 2009 to 9.2% by 31 December 2009. The gross NPL ratio for state-owned commercial banks fell from 23.6% at the end of September 2009 to 21.4% at the end of December 2009. The gross NPL for private commercial banks declined from 4.9% to 3.9% from the end of September 2009 to 31 December 2009, and for foreign commercial banks from 2.6% to 2.3% during the same period. The specialized banks had a higher gross NPL ratio, which rose slightly from 25.4% to 25.9% during the same period. The net NPL ratios for all banks declined from 2.3% at the end of September 2009 to 1.7% by 31 December 2009. The net NPL for state-owned commercial banks declined sharply to 1.9% at the end of December 2009 from 3.6% at the end of September 2009.

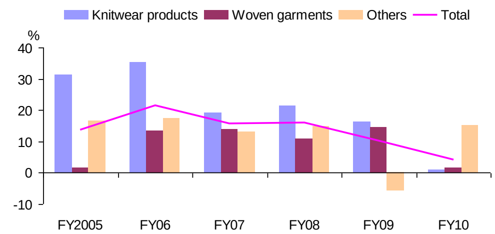
Figure 16. Disbursement of term loans by banks and nonbank financial institutions



Balance of Payments

43. Export earnings declined up to the third quarter of the fiscal year, although the rate of decline gradually slowed as the year progressed—from 11.7% in the first 3 months, to 6.2% after 6 months, to 0.8% after 9 months. Eventually, exports posted a growth of 4.2% for the full year (Figure 17). Ready-made garments, accounting for over three-fourths of the total export basket, grew by only 1.2% in FY2010. Subdued external demand evidenced by weak retail sales and continued price cuts in the United States and Europe combined with severe power outages and frequent labor unrest account for the poor performance. Earnings from other products such as frozen foods, tea, and chemicals declined because of weak demand and shrinkage in profit margins. On the other hand, exports of leather (27.5%), raw jute (32.5%), jute goods (100.6%), and engineering products (71.6%) rose briskly. Exports of primary products declined by 4.8%, because of a fall in export price, while manufacturing exports grew by 4.5% during FY2010. The year-on-year export growth picked up strongly since March 2010 (18.8%) and rose to 20.5% in June 2010.

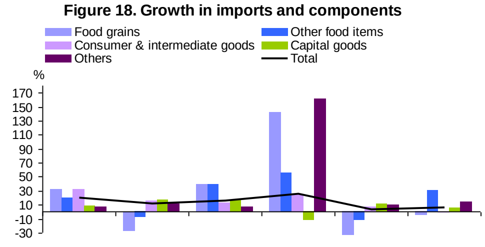
Figure 17. Growth in exports and components



44. The volume index of overall exports rose by 5.0% in FY2010, while the price index declined by 0.9%. For primary commodities, the price index declined by 4.9%, while the volume index grew slightly by 0.1%. For manufactured products, the price index declined by 0.6%, and the volume index rose by 5.2%.

45. In FY2010, imports grew by 5.4% (Figure 18). Food grain import declined by 5.2%. Import of rice dropped sharply by 68.5% because of a good domestic harvest, although import of wheat grew by 18.4%. The import value of consumer and intermediate goods fell by 1.0% reflecting lower international prices. Import of crude petroleum, fertilizer, yarn, and textiles declined; while pharmaceutical products, and dyeing and tanning materials recorded moderate growth. Import of capital machinery rose by 12.3%.

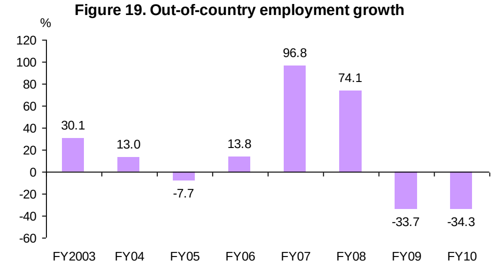
Figure 18. Growth in imports and components



46. The total value of import letters of credit (L/Cs) opening rose by 31.4% in FY2010. L/Cs for imports of food grains rose by 41.7%, other consumer goods by 73.4%, intermediate goods by 4.9%, industrial raw materials by 17.6%, petroleum by 26.9%, and capital machinery by 55.4%.

47. Remittance inflows grew by 13.4% in FY2010, down from 22.4% in FY2009. Remittance earnings continued to moderate during the second half of the fiscal year. The number of people leaving Bangladesh for overseas jobs declined by 34.3% in FY2010 (Figure 19). Remittance is still growing despite drop in overseas jobs because of the large outflow of migrant workers in FY2007 and FY2008. In FY2010, the United Arab Emirates (UAE) was the major destination for Bangladeshi workers (237,423) with a growth rate of 55.6%. The construction boom in the UAE, especially in Dubai, is attracting a large number of Bangladeshi workers. The second largest destination was Singapore (38,762 workers), followed by Oman (35,863), Libya (25,618), Bahrain (21,605), Lebanon (14,349), Kingdom of Saudi Arabia (10,582), and Qatar (10,334).

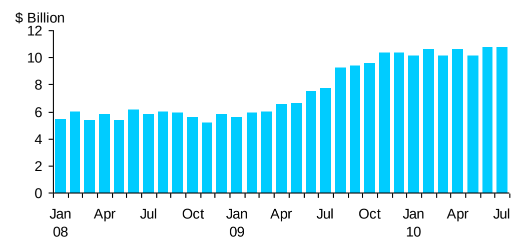
Figure 19. Out-of-country employment growth



48. Net foreign direct investment inflows to Bangladesh in FY2010 were $636.0 million, down by 33.8% from $961.0 million in FY2009, because of the global recession. Domestic power and gas shortages and unavailability of suitable land for projects were also factors. In FY2010, net portfolio investment showed an outflow of $117.0 million compared with $159.0 million in FY2009. In FY2010, net foreign assistance stood higher at $1.5 billion compared with $1.0 billion in FY2009.

49. In FY2010, trade deficit widened by 9.4%, from $4.7 billion in FY2009 to $5.2 billion because of lower export growth relative to import payments. Remittance inflows offset the deficits in trade, services, and income payments, resulting in a current account surplus of $3.7 billion, up from $2.4 billion in FY2009. The surplus in the capital account fell slightly from $451.0 million in FY2009 to $442.0 million in FY2010 with a decline in capital transfers, while the deficit in the financial account dropped from $825.0 million in FY2009 to $755.0 million in FY2010 because of lower net outflows of portfolio and other investment, despite a fall in foreign direct investment. The overall balance recorded a surplus, an increase of 39.2%, from $2.1 billion in FY2009 to $2.9 billion in FY2010.

Figure 20. Gross foreign exchange reserves

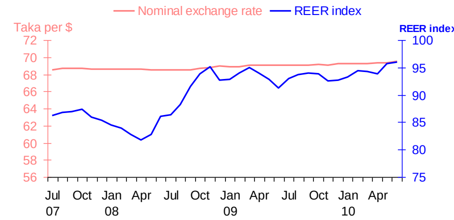


50. At the end of July 2010, gross foreign exchange reserves of Bangladesh Bank reached $10.7 billion, up by 38.9% from a year earlier (Figure 20). Despite slower growth in exports and remittances, the higher foreign exchange reserves were made possible because of lower import payments and higher inflow of foreign assistance.

Exchange Rate

51. The nominal exchange rate (taka/dollar) remained stable in FY2010, with a modest depreciation of 0.6%. The movement of the exchange rate was confined within a range from Tk69.1:$1 to Tk69.5:$1 (Figure 21), benefiting from the healthy and stable foreign exchange reserve position. Bangladesh Bank's large purchase of foreign exchange from the interbank market prevented the taka from appreciating. Because of higher relative domestic inflation, the real effective exchange rate appreciated by about 5.2% year-on-year in June 2010.

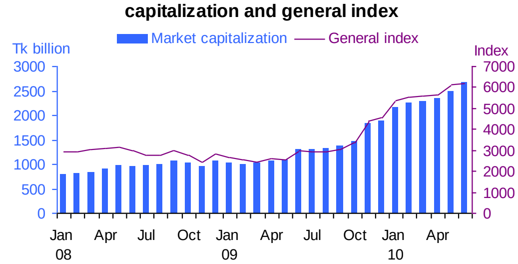
Figure 21: Nominal exchange rate (taka-dollar) and real effective exchange rate (REER) index



Capital Market

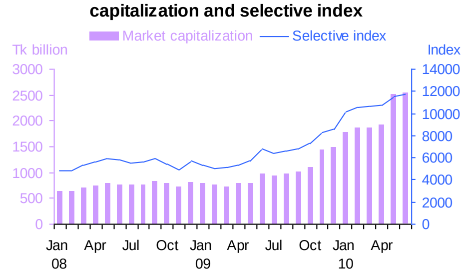
52. The Dhaka Stock Exchange general index rose steeply in FY2010 (Figure 22). The listing of Grameenphone on the stock exchange and the significant involvement of institutional participants and retail investors in daily transactions pushed the index up by 105.8% year-on-year in June 2010. The market price–earnings ratio rose from 18.4 in June 2009 to 24.1 in June 2010 suggesting that a part of private credit growth is fuelling speculation. The low return on bank deposits is encouraging the diversion of savings to the stock market. Market capitalization rose by 103.5% during FY2010 reaching $38.6 billion in June 2010 (about 38.7% of GDP), reflecting the listing of many companies (20 companies have listed since July 2009). To limit the exposure of banks and financial institutions to the stock market, Bangladesh Bank allowed banks to invest only up to 10% of their liabilities, while financial institutions could invest up to 25% of their paid-up capital and reserves in the stock market.

Figure 22. Dhaka Stock Exchange: Market capitalization and general index



53. The Chittagong Stock Exchange selective categories index mostly followed the trend of the Dhaka Stock Exchange index, rising steadily from 6,772.2 in June FY2009 to 11,694.4 in June FY2010. Market capitalization also rose from Tk961.7 billion in June FY2009 to Tk2,534.4 billion in June FY2010, up by 163.5% (Figure 23). However, the total number of listed securities declined from 246 in June FY2009 to 232 in June FY2010.

Figure 23. Chittagong Stock Exchange: Market capitalization and selective index



Overview

54. On 10 June 2010, the finance minister unveiled a Tk1.3 trillion national budget for FY2011 aimed at boosting economic growth, aided by higher spending on power and gas, and encouraging private investment. The macroeconomic framework for the budget is aligned with the revised National Strategy for Accelerated Poverty Reduction II (FY2009–FY2011) and the government's Vision 2021. The budget projects GDP growth for FY2011 at 6.7% (Figure 24) to be achieved by crowding in private sector investment through ADP implementation; expediting private investment by increasing the supply of credit to the private sector and through PPPs; and increasing the competitiveness of the external sector by maintaining a stable exchange rate. The budget expects that inflation will be contained within a tolerable limit of 6.5% (Figure 25). It also projects that GDP growth will pick up to 8% by FY2014. To achieve this, the budget plans to increase (i) revenue collection by 0.5% of GDP each year, (ii) ADP allocation from the current 4.1% to 6.0% of GDP, and (iii) investment from 24.4% to 32.0% of GDP by FY2014.

Figure 24. GDP growth outlook

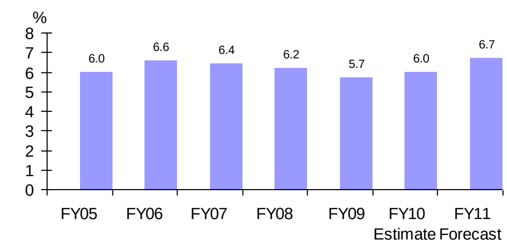
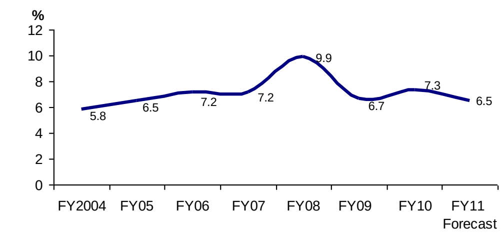


Figure 25: Inflation outlook



Budget Structure

55. In FY2011, total revenue income is projected at Tk928.5 billion, which is 11.9% of GDP and 16.8% higher than in the revised FY2010 budget (Figures 26 and 27). Total expenditure is estimated at Tk1321.7 billion, which is 16.9% of GDP and 19.6% higher than in the revised FY2010 budget (Figures 28 and 29). In FY2011, Tk936.7 billion (12% of GDP) is allocated for the nondevelopment budget and Tk385 billion (4.9% of GDP) for the ADP. The overall budget deficit will be 5% of GDP (Figure 30). Up to Tk156.4 billion (2% of GDP) of the deficit will be financed from external sources and Tk236.8 billion (3% of GDP) from domestic sources. Domestic financing includes Tk156.8 billion (2% of GDP) from banking sources and Tk80.0 billion (1% of GDP) from nonbanking sources, the major portion of which will come from national savings certificates (Table 1).

Figure 26: Annual growth in revenue

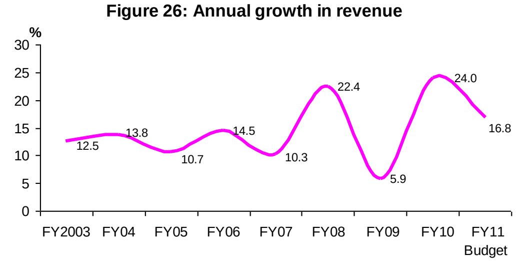


Figure 27: Revenue-GDP ratio

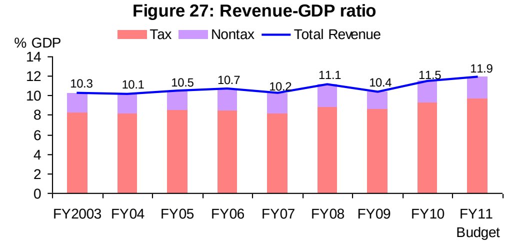


Table 1: Budget at a Glance

(Tk billion)

Item	FY2011 (A)	FY2010 Revised (B)	Change in A over B	A as % of GDP
Total Revenue	928.5	794.8	16.8	11.9
Tax Revenue	760.4	639.6	18.9	9.7
Nontax Revenue	168.1	155.3	8.2	2.2
Total Expenditure	1321.7	1105.2	19.6	16.9
Current Expenditure	767.6	699.2	9.8	9.8
Annual Development Program	385.0	285.0	35.1	4.9
Other Development Expenditure (net)	169.1	121.1	39.7	2.2
Fiscal Deficit	-393.2	-310.4	26.7	-5.0
Financing of Deficit	393.2	310.4	26.7	5.0
External Resources (net)	156.4	137.1	14.1	2.0
Foreign Grants	48.1	37.4	28.5	0.6
Foreign Loans	108.3	99.7	8.6	1.4
Domestic Resources	236.8	173.3	36.7	3.0
Domestic Bank Borrowing	156.8	86.6	81.0	2.0
Domestic Nonbank Borrowing	80.0	86.6	-7.7	1.0

Source: FY2011 national budget documents, Government of Bangladesh.

Budget Priorities

56. The budget pledged to continue the core subsidy provided in the existing stimulus packages until the export sector stabilizes. It allocated Tk20 billion for fiscal stimulus to prioritized sectors affected by the global economic recession. The budget provided Tk30 billion of fresh funds for PPP projects in FY2011, sought to introduce a simpler PPP project approval process, and set up a separate office to deal with PPPs. The budget also reallocated Tk16 billion from the previous year's allocation (to PPP projects) to the Bangladesh Infrastructure Finance Fund (BIFF) to supplement any likely shortfall in infrastructure development and maintenance. To realize its Vision 2021, the government is formulating its sixth 5-year plan. In addition, the budget highlighted the need to formulate a perspective plan, prepare a more gender sensitive budget, unify the nondevelopment and development budgets, and formulate district budgets over the medium term.

Figure 28: Annual growth in expenditure

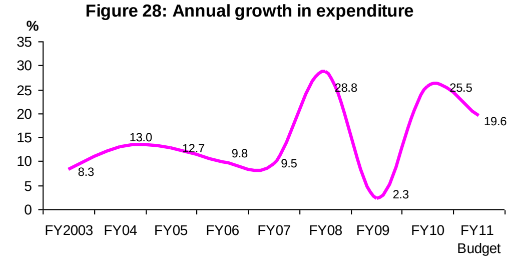
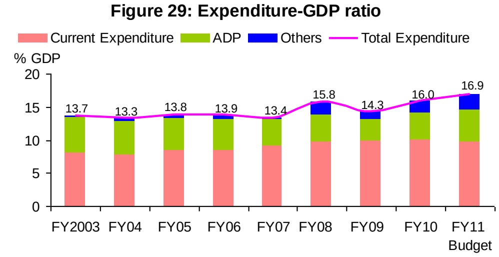


Figure 29: Expenditure-GDP ratio

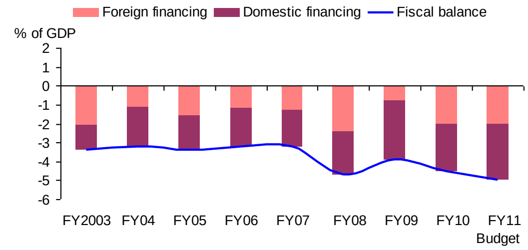


Revenue Measures

57. Total tax revenue is expected to rise by 18.9% (9.7% of GDP), while nontax revenue is expected to grow by 8.2%. Among the major tax items, income tax is

targeted to grow by 26.8%, VAT by 18.9%, import duty by 4.4%, excise duty by 5.4%, and supplementary duty by 22.7%.

Figure 30: Fiscal balance and financing



Tax Measures

Income Tax

58. The government announced that an additional 500,000 taxpayers will be brought under income tax coverage by June 2011. To augment revenue, the budget introduced a web-based tax calculator, tax card, spot assessment of small taxpayers, and e-linkage between taxpayer identification number management and the national identity card project's database. The budget made use of taxpayer identification numbers mandatory for connection of gas and electricity for commercial purposes. Provision has been made for purchase of bonds under BIFF at a tax rate of 10% up to 2012.

59. The budget introduced a tax holiday for industries engaged in manufacturing solar panels and energy saving bulbs. It introduced a tax rebate for any assistance made to schools and colleges in improving computer and English education.

60. The budget declared that automation of income tax offices in Dhaka will be completed by 2011. The government will upgrade the post of director general of the Central Intelligence Cell with a view to intensifying the prevention of tax evasion. It will establish a large taxpayers unit in Chittagong by FY2012.

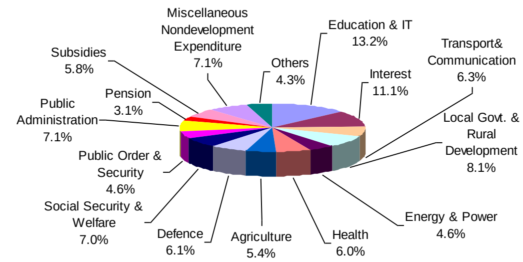
Value-Added Tax

61. The budget introduced several measures related to the VAT, including amendments to the VAT Act 1991; VAT exemption for a number of local industries; withdrawal of VAT exemption from a number of products; creation of seven new service codes; exclusion of cottage industry facilities from a number of goods; amendment of the provision for VAT deduction at source at the import stage for commercial importers; withdrawal of truncated base value from some services, and revision of truncated base value for selected goods and services; withdrawal of VAT from manufacturers of energy-saving lamps and their raw materials for 5 years; and continuation of VAT exemption for waste paper at the import stage up to June 2011.

Import Duty

62. The key budget measures related to import duty are (i) continuing with the four-slab customs duty structure; (ii) zero duty on commodities like rice, wheat, onion, pulse and edible oil, seeds, fertilizer, medicine, and cotton; (iii) lower duties on milk powder; (iv) specific rate of duty on raw sugar and refined sugar; (v) 10% export duty on unmanufactured tobacco; (vi) benefits of duty-tax exemptions for power and gas; (vii) issuance of a notification to help transshipment and transit activities; and (viii) revision of the First Schedule to the Customs Act, 1969 by bringing changes to 677 harmonized codes including elimination of 328 codes.

Figure 31: Sectoral shares in public expenditure in FY2011



Expenditure Allocation

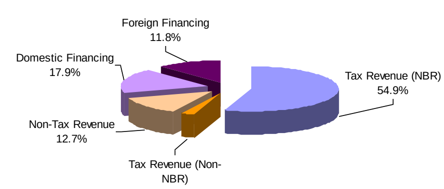
63. The budget classified the ministries and divisions under three major categories depending on their allocation of business: social infrastructure, physical infrastructure, and general service sector. In the budget, 33.3% of total outlay is allocated to social infrastructure, 30.4% to physical infrastructure, and 21.1% to the general service sector. The remaining 15.1% will be spent for interest payment and net lending.

64. The ADP for FY2011 allocated 21.2% of resources to the agriculture sector (agriculture, rural development, rural institutions, and water resources), 15.8% to power and gas, 15% to communication (roads, railway, bridges, river transport, civil aviation, and telecommunications), and 24.2% to human resources (education, health, science, and technology).

Priority Sectors

65. **Power and gas.** Identifying power as the top priority, the FY2011 budget reiterated the government's plans to resolve the prevailing load-shedding problems within the next 2 years. The Roadmap for Development of Power and Energy Sector report outlines an action plan to address the ongoing crisis. Under direct procurement, the government has concluded contracts for installing 1,107 MW diesel-fired and furnace oil-based power plants. The government has taken steps to ensure production of 9,426

Figure 32: Sources of financing public expenditure in FY2011



MW power by 2015. To strengthen transmission and distribution of power in the next 3 years, the budget pledged to add 837 km of power grid lines, 17 substations, and more than 15,000 km of distribution lines.

66. The budget also pledged to take appropriate measures for generating environment-friendly power from renewable energy sources. The Renewable Energy Policy was prepared with the goal of using renewable energy sources for producing 5% of total power generation by 2015 and 10% by 2020. Efforts are underway to ensure effective demand management. For the energy sector, some of the immediate tasks include finalizing coal policy, expediting import of liquefied natural gas, floating oil and gas block bidding and encouraging renewable energy generation.

67. **Education.** The budget raised the education sector allocation by 13.5% over the FY2010 revised budget. The government is supporting projects such as the school feeding program; stipends for primary education; and installation of teaching centers at *char*, *haor*, tea garden and remote areas. Construction of 40,000 additional classrooms and inclusion of preprimary education in government schools are priority measures. The government will continue giving stipends involving Tk40.4 billion for primary education from its own resources until 2013. The stipend coverage was recently increased to 7.8 million students. The government will also set up 1,500 primary schools.

68. **Agriculture.** The budget gives priority to increasing agricultural productivity by diversifying agricultural products aided by intensified agricultural research. In addition, the government is proposing a wide range of government assistance for agriculture (paras. 6–9).

69. **Communication.** The budget allocation for communication is Tk7.5 billion, an increase of 26.6%. The government is formulating an integrated multimodal transport policy. To reduce the growing traffic congestion in Dhaka, the budget includes steps to erect a 32 km long elevated expressway from Uttara to Jatrabari.

70. The budget reiterated that Bangladesh Railway will become a state-owned corporate entity, and be integrated with the Trans-Asian Railway network. In addition, a 20-year railway master plan to solve railway problems is now at the final stage of formulation. A master plan for construction of an underground railway system is also

being prepared.

71. The budget emphasized the need to improve the inland water transportation system and develop river ports. It announced that an integrated dredging program to develop river ports will be undertaken, and there are plans to increase the capacity of Chittagong port and the efficiency of Mongla port. In addition, 12 land ports will be constructed on a build-operate-transfer basis.

72. **Social safety net programs.** The budget supports all ongoing social safety net programs with a total allocation of Tk195 billion, which is 14.8% of the development and nondevelopment expenditure and 2.5% of GDP. The government has taken steps to develop a database on the beneficiaries of social safety net programs to ensure better utilization. It is also considering pension and insurance schemes for the welfare of disadvantaged and low-income groups.