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BANGLADESH

Quarterly Economic Update

December 2008

Asian Development Bank

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The Quarterly Economic Update (QEU) is prepared by the Economics Unit of the Bangladesh Resident Mission, Asian Development Bank (ADB). The views expressed in the QEU are those of the authors and do not necessarily reflect the views of the ADB or its member governments. The QEU is published in March, June, September and December.

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(i) The fiscal year (FY) of the Government ends on 30 June.
(ii) In this report, “$” refers to US dollars and "Tk" refers to Bangladesh taka.

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MACROECONOMIC DEVELOPMENTS

Highlights

- Gross domestic product (GDP) growth is estimated to range from 5.5% to 6.0% in FY2009.
- The global financial crisis and a longer than expected recession affected growth outlook.
- Exports show signs of slowing with decreasing global demand.
- Remittance growth is slowing.
- Foreign exchange reserves will remain at a safe level because of slower growth in imports.
- Revenue collection is likely to post major shortfall.
- Inflationary pressures continue to ease.

Sector Performance and Economic Growth

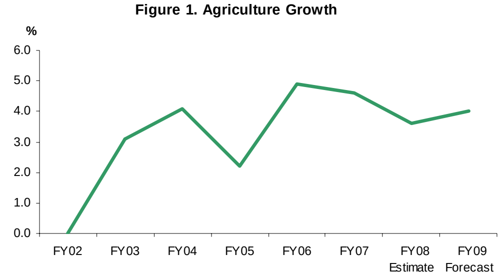
1. The global financial crisis is yet to significantly affect Bangladesh. However, pressures from the global slowdown are building up with signs of moderation in growth. Economic performance in the first quarter of FY2009 held up reasonably well with steady progress in domestic economic activity and satisfactory growth in exports and remittances. Growth in readymade garment production, together with improved business confidence and recovery in housing and construction, stimulated industrial activity. Services, especially wholesale and retail trade, and transport and telecommunications, also performed well. In the second quarter ending December 2008, both exports and remittances slowed, implying deceleration in industry and services growth. The agriculture sector nonetheless looked poised for robust growth, aided by favorable weather conditions and proactive policy support from the Government. Before the onset of the global financial crisis, the 6.5% growth target for FY2009 appeared attainable. With the financial crisis in the advanced economies still unfolding and recession appearing to last longer than earlier anticipated, a growth rate of 5.5%–6.0% seems more likely in FY2009. In addition to dealing with the impacts of the global recession, the newly elected Government will need to improve the investment climate, upgrade infrastructure, and accelerate economic reforms to achieve higher economic growth,

create jobs, and sustain progress in poverty reduction over the longer term.

Agriculture

2. In the first half of FY2009, climatic conditions remained favorable and government support to boost agriculture growth was strong. As a result, the agriculture sector is expected to attain the target growth rate of 4.0%, up from actual growth of 3.6% in FY2008 (Figure 1). Production of rice and wheat for FY2009 is targeted at 34.3 million tons (rice, 33.3 million tons, and wheat, 1 million tons), a 15.1% rise from actual production in FY2008. Good harvests of *aman* (monsoon) rice, maize, wheat, and potatoes in FY2009 are being reported. The outlook is also favorable for the upcoming *boro* (dry season) rice crop because of good weather conditions together with strong government support to ensure availability of key agricultural inputs. The prospects for output of various noncrop subsectors appear bright. The fisheries subsector has performed well because of growing domestic demand.

Figure 1. Agriculture Growth



3. A total of 1.1 million hectares was cultivated for the *aus* (summer) crop, up 15.9% from FY2008. Production of aus is recorded at 1.9 million tons, up 25.8% from the previous year. The yield rate rose by 8.0%. With total cultivable land for aman at 5.8 million hectares, the production target is 13.0 million tons in FY2009, a 34.0% rise over actual production in FY2008. The target for total rice production in FY2009 is 33.3 million tons, up 15.2% from the actual production of 28.9 million tons in FY2008. Total cultivable land for wheat is targeted at 0.4 million hectares, while the production target is 1.0 million tons in FY2009, a 19.0% rise over actual production in FY2008.

4. The caretaker Government made commendable efforts to support broad-based agriculture growth to attain food security. The newly elected Government has already affirmed its strong commitment to robust growth in the sector.

5. The Awami League's election manifesto contains strong policy messages for developing the country's agriculture sector. The manifesto pledges to ensure "food for all" and to make Bangladesh self-sufficient in food by 2013. The manifesto stresses that agricultural input subsidies will be enhanced and availability of inputs to farmers ensured. Agricultural lending will be increased and procedures simplified. Incentives will be provided to develop rural warehousing, and ensure remunerative

prices so that farmers increase production. The manifesto also announces that efforts will be made to attain self-sufficiency in the production of fish, milk, eggs, livestock, and salt in addition to staple crops. It pledges to make efforts to encourage exports of surplus products and promises loans for sharecroppers, employment facilities for farm laborers, and establishment of a rural rationing system.

6. For medium- and long-term measures, the manifesto outlines actions to address the challenges of globalization by encouraging commercial agriculture, use of genetic engineering methods, and development of the nonagriculture sector. To increase agricultural production, the manifesto emphasizes modernization of agriculture, innovation of technology, and expansion of agricultural research facilities. Land records will be computerized and a land reform commission formed to ensure higher production and social justice in the distribution of land and water bodies.

7. Signaling its intention to provide strong support to the agriculture sector, the new Government announced major cuts in the prices of non-urea fertilizers (Box). The Government expects that lower fertilizer prices and higher irrigation subsidies will encourage crop production. However, production is also dependent on the supply of electricity in rural areas to run irrigation pumps. Currently, the Government can meet only one fifth of total electricity demand for irrigation. Availability of irrigation water is essential to reap the full benefits of the fertilizer subsidy in stimulating production. In addition, inefficiency in allocating the fertilizer subsidy must be minimized, and degradation of the resource base from overuse contained. Care also needs to be taken to ensure that the incentive regime, which heavily favors rice cultivation, does not impair crop diversification.

Box: Fertilizer Price Cuts and Extent of Subsidies

On 14 January 2009, the newly elected Government slashed prices of non-urea fertilizers by almost half: at the farmgate, the price of triple super phosphate (TSP) was cut to Tk40/kilogram (kg) from Tk75–Tk80/kg, the price of murate of potash (MOP) to Tk35/kg from Tk65–Tk75/kg, and the price of di-ammonium phosphate (DAP) to Tk45/kg from Tk80–Tk85/kg. The price of urea fertilizer (already subsidized) was unchanged at Tk12/kg. In the world market, fertilizer prices, except MOP, have declined substantially, with oil prices easing. Using the world market price and adjusting for transport costs and trading margins, the estimated economic farmgate prices are Tk33/kg for urea, Tk95/kg for TSP, Tk91/kg for MOP, and Tk55/kg for DAP.

The new fertilizer prices thus contain substantial subsidies even against the lower world market prices. Bangladesh imported fertilizers and built up current stocks when world market prices were much higher, on average about Tk90/kg for TSP, Tk81/kg for MOP, and Tk100/kg for DAP. The Government fixed farmgate prices at around 55% of these average prices, and estimated the total implicit subsidy to utilize the existing stock of non-urea fertilizers at Tk27 billion (0.4% of GDP and 2.7% of total expenditure), out of which Tk15 billion (0.2% of GDP) is needed for estimated fertilizer demand in FY2009. Of the Tk27 billion, Tk15 billion will be given to the state-owned Bangladesh Agriculture Development Corporation and Bangladesh Chemical Industries Corporation. The remaining Tk12 billion will be passed on to private sector importers. The Government also reduced the prices of diesel and kerosene by Tk2 per liter to Tk44 a liter. The current import cost of both diesel and kerosene is Tk35, which allows for some savings on the budgetary allocations for fuel subsidies.

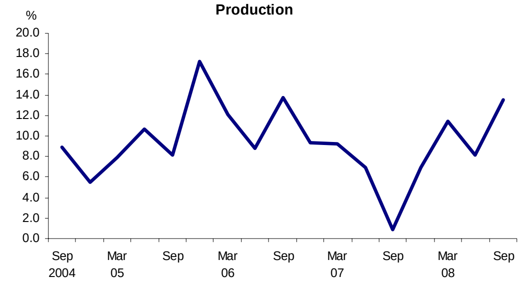
8. To sustain agriculture growth, Bangladesh needs to enhance its disaster risk management capacity. Floods, cyclones, and other manifestations of climate change affect the country's agriculture sector. Higher temperatures and changing rainfall patterns, along with increased flooding and rising salinity in the coastal belt and more frequent droughts in the northwest, are likely to affect crop production. The International Panel for Climate Change estimates that by 2050, rice production in Bangladesh could decline by 8% and that of wheat by 32% against a base year of 1990.[1] The production of wheat, and high-yielding varieties of aus and boro might no longer be economically viable. Because of the effects of climate change, use of inputs like fertilizers, pesticide, and irrigation may rise substantially, resulting in higher production costs. Climate change may also advance or delay flowering and fruiting, and prompt early arrival of insect pests, which would affect production and yields. The reduced crop production will adversely affect food security and human well-being. Climate change could lead to loss of fishing grounds and coastal inland fisheries, changes in species composition, major losses of freshwater culture fisheries, and adverse impacts on coastal shrimp culture. Like human beings, livestock and poultry may suffer due to more frequent natural disasters and higher temperatures. In changing climate scenarios, fodder production may decrease, and disease and mortality rates may rise, threatening the viability of the livestock subsector.

[1] Government of Bangladesh. 2008. *Bangladesh Climate Change Strategy and Action Plan*. Available: www.moef.gov.bd/moef.pdf.

Industry

9. Industrial activity was aided by robust export growth of 42.4% in the first quarter of FY2009 led by readymade garment, along with improved business confidence and recovery in housing and construction. However, industrial production slowed in the second quarter as exports declined (–1.2%). Falling prices of construction materials and a rise in demand for real estate because of the growth in bank credit and higher remittances helped to revive construction, providing a boost to activity.

Figure 2. Growth of Medium and Large Scale Manufacturing Production

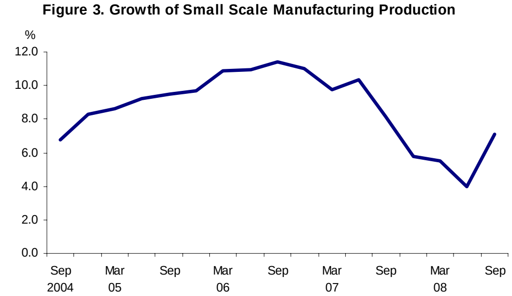


10. The general index of industrial production (medium- and large-scale manufacturing) increased to 419.6 during the first quarter of FY2009, recording a 13.5% rise over the first quarter of FY2008 (Figure 2). Items recording growth were jute, cotton, apparel and leather (23.9% over the same period in the preceding year); basic metal products (16.4%); nonmetallic products (11.2%); wood products including furniture (5.8%); fabricated metal products (6.3%); chemicals, petroleum, and rubber (6.5%); and paper and paper products (3.2%). On the other hand, food, beverages, and tobacco decreased by 0.9%.

11. The general index for small-scale manufacturing industry rose by 7.1% to 269.0 during July–September FY2009 over the same quarter of the previous fiscal year (Figure 3). Indices recording growth were textiles; leather and apparel (4.9%); basic metal products (13.9%); nonmetallic products (0.9%); wood products including furniture (9.3%); metal products and machinery (2.5%); chemicals, plastic, and rubber (1.2%); paper, printing, and publishing (11.2%); and food, beverages, and tobacco (5.6%).

12. The country's export-oriented industry sector is set to face challenges in the period ahead because of a drop in consumer spending and lower prices. Readymade garment, which constitutes the bulk of the industrial value added is likely to be adversely affected. Similarly, shrimp, fish, and leather exports are expected to decline due to contraction of demand in global markets. Industrial growth is expected to be in the range of 6.6%-7.2% in FY2009 compared with 6.9% in FY2008 with production for export likely to slowdown. Deceleration in remittance growth will dampen domestic demand for household goods.

Figure 3. Growth of Small Scale Manufacturing Production



13. The new Government announced its strong commitment to infuse dynamism in the country's industry sector. The new industrial policy, currently being formulated, is expected to outline government strategies to

promote large, and small- and medium-scale enterprises. The election manifesto outlines the priority areas for increasing growth and competitiveness of the industry sector, and pledges to introduce short-, medium-, and long-term plans to accelerate sector growth. The key measures pertaining to industrial development include efficient management, increased listings in the stock market, maintenance of law and order, elimination of corruption and administrative difficulties, avoidance of political influence, creation of an investment-friendly environment and a competitive market system, adoption of innovative technology, and provision of infrastructure facilities to attract entrepreneurs and expand the domestic market.

14. The manifesto also maintains that a one-stop facility will be made effective by simplifying legal and procedural formalities to encourage investment. It plans to take measures to protect indigenous industries; develop the information technology industry; strengthen the readymade garment and textile subsectors; and expand the food processing, pharmaceuticals, leather, chemical products, toy, jewelry, and furniture industries. It commits to take special initiatives for alternative uses of jute and to make the industry viable. Small industries, including handicrafts and agroprocessing, would be encouraged and given support in the expansion of markets at home and abroad. Expansion of the tourism sector, higher labor exports, and investment of remittances in productive sectors will be ensured. Special incentives will be given to weavers, blacksmiths, and clay potters. The weaving industry will be given protection and silk, *benarasi,* and *jamdani* villages set up.

15. To promote the industry sector, the prevailing shortages in power and gas supplies need to be addressed urgently. Unless early remedial measures are adopted, frequent power cuts and irregular supplies will hamper domestic production and affect medium-term growth prospects. The lack of gas supplies will also constrain power generation and new investment in manufacturing activities. Large and quick investments in gas and power are essential to ensure their availability. As the expected foreign direct investment flows in power and gas, which the country urgently needs, are unlikely to materialize in the near term because of the global economic slowdown, the Government must mobilize its own resources and tap development assistance for investing in these sectors.

16. The election manifesto pledges to formulate a comprehensive long-term policy on electricity and energy generation. For strategic policy tools, the Government pledges to ensure the economic use of oil, gas, coal, hydropower, wind power, and solar energy. Large and small power generation stations, coal extraction, and oil and gas exploration will be given priority. Under a 3-year program, quick implementation of ongoing and planned power generation stations; import of electricity from neighboring countries; urgent preparation of 100/150 megawatt gas turbine projects; and the reactivation of the past 10, 20, and 30 megawatt power stations will be undertaken. A schedule for repair, maintenance, and overhauling or salvaging of old power stations will be made to increase and stabilize power production. The manifesto states that supply of gas and LPG (liquefied petroleum gas) will be improved, and the Rooppur Nuclear Power Project implemented. The manifesto pledges that power production will be raised to 5,000 megawatts by 2011 and to 7,000 megawatts by 2013.

17. For energy, the manifesto assigns priority to exploration and exploitation of new oil and gas fields. Arrangements will be made to supply gas in the north and western regions of the country. Supply of gas and LPG will be significantly increased, and coal policy will be formulated to safeguard the national interest. Special initiatives will be taken to ensure economic use of the coal available and to develop coal-based power plants. Priority will be given to the exploration and exploitation of new coal fields and other mineral resources.

Services

18. Services, especially wholesale and retail trade and transport and telecommunications, performed well in the first quarter of FY2009. Rapid growth in the mobile phone market and growing numbers of health-care service providers are contributing to robust sector growth. The satisfactory performance of agriculture and industry also contributed to healthy services sector growth. In the second quarter, higher demand for services during the parliamentary elections boosted retail trade in rural and urban areas. Profit margins of private sector banks remain quite healthy, and are likely to have a positive impact on growth of financial services. However, the global financial crisis will also eventually have an adverse impact on the services sector, because of effects on industry, particularly related to exports and compression of domestic demand in general. Services growth will slow to the range 5.8%-6.2%, down from 6.7% in FY2008, due to slower activity in the

export sector and a slower growth in consumption spending induced by lower incomes and remittance inflows.

Economic Growth

19. Before the onset of the global financial crisis, a 6.5% growth target for FY2009 appeared attainable. With the financial crisis in the advanced economies still unfolding and recession likely to be longer than earlier anticipated, a growth rate in the range of 5.5%–6.0% now seems more likely, with the balance of risk being on the lower side of the range (Figure 4). The drop in consumer spending in importing countries, because of income losses and looming economic uncertainties, will have moderating effects on demand for textiles (76% of Bangladesh's exports), and more pronounced impacts on high-end products such as frozen foods and leather products, which together make up the bulk of Bangladesh's exports. A slowdown in remittance flows will also affect growth by reducing domestic consumption and investment demand.

20. To sustain higher economic growth for creating jobs and eradicating poverty, Bangladesh needs to substantially increase investment, which has been declining (as a percent of GDP) in recent years. To enhance the economy's productive capacity, public investment must be raised by accelerating implementation of the annual development program (ADP) (in recent years, no more than 80% of the annual program has been implemented). The Government must also pay attention to improving institutional capacities in its various agencies for implementing reforms and strengthening development administration.

Inflation

21. Inflation moved steadily downward as the second quarter of FY2009 unfolded, sliding from 10.2% year-on-year in September to 7.3% in October and then further to 6.0% in December (Figures 5 and 6). The rapid decline in international commodity prices (Figure 7) and improved domestic food supplies are the main factors pushing inflation lower. The decline in food inflation (6.8% in December 2008 from 12.1% in September) was steeper than that for nonfood inflation (4.8% in December from 7.2% in September). The cuts in the domestic administered price of oil in October and December 2008, after a rise in July, also helped ease price pressures.

Figure 4. Contributions to GDP (supply)

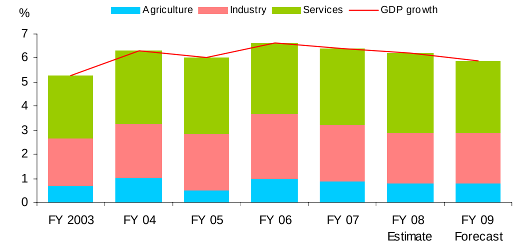


Figure 5. Inflation, Point-to-Point (Base Year: FY1996)

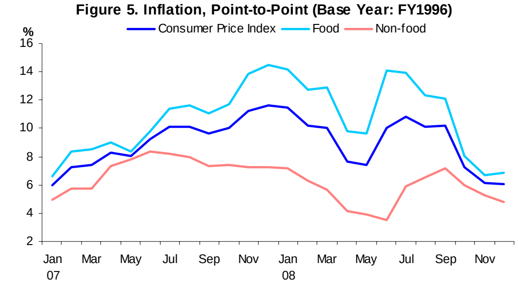


Figure 6. Inflation, 12-Month Moving Average (Base Year: FY1996)

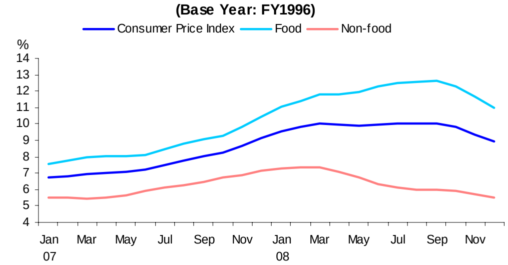
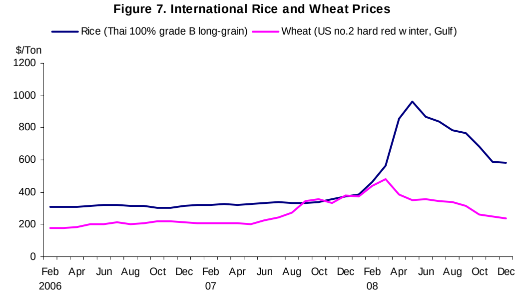


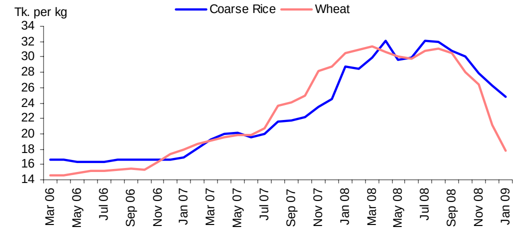
Figure 7. International Rice and Wheat Prices



Source: FAO

22.	The inflation projection for this fiscal year is based on the considerable fall in international commodity and raw materials prices, which is likely to continue to relieve pressures on prices. The good domestic crop harvests and the consequent boost to food supplies, the effects of raising policy rates by the central bank for restraining credit in the second quarter of FY2009, and the January 2009 reduction in domestic fuel and fertilizer prices will also help to ease inflation. Especially, good aus harvest and favorable outlook on aman, boro and wheat production, aided by favorable weather condition and strong policy support by the Government are likely to curb food crop prices in the coming months (Figure 8). Inflation is projected at about 7.0% for the year as a whole, down from 9.9% in FY2008.

Figure 8. Domestic Open Market Retail Prices of Food Grains



Fiscal Management

23.	Growth in government revenues is decelerating, falling from 20.5% during the first quarter, to 13.2% during the first half of FY2009, over the corresponding periods of FY2008 (Figure 9). Slower private sector activity, as the impacts of the global economic slowdown take hold, could further affect revenue collection. Import-based revenues will be affected by cuts in customs duties in the FY2009 budget and the erosion in import values resulting from declines in international commodity prices. Although the Government transferred a portion of the benefits of lower international petroleum prices to consumers through successive cuts in domestic prices, the sharp decline in international prices (Figure 10) also allowed the Government to reduce petroleum subsidies and more recently earn a small profit. The cut in non-urea fertilizer prices by about 50% in January 2009 will raise the budgetary cost of fertilizer subsidies, but unless there is a major revenue shortfall, the fiscal strain is likely to be minimal due to the savings on petroleum subsidies, and lower spending on food subsidies compared with the budget targets. The lower operation and maintenance costs for the Power Development Board and Petrobangla because of the fall in prices of parts and spares will allow them to contain their losses and reduce budgetary subsidies. The Public Resources and Budget Management Ordinance, enacted in 2008, setting a cap on domestic borrowing by the Government, will also help to control public spending.

Figure 9. Revenue Collection by NBR (July-December)

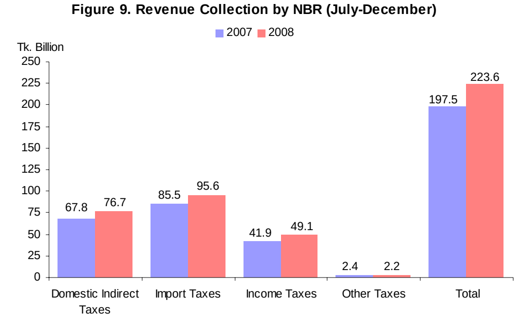
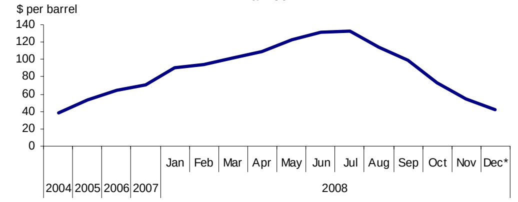


Figure 10. Average Spot Crude Oil Price in International Market



Source: IFS online database, IMF	* Provisional

24.	Import-based taxes during the first half of FY2009 rose by 11.9%, with customs duties growing by only 4.1%, value-added taxes (VAT) by 16.9%, and supplementary duties by 29.4%. The growth rate of customs duties moderated due to the reduction of and exemption from tariffs, and fall in global commodity prices.

25. Domestic indirect taxes grew by 13.1% during the first half of FY2009. Domestic VAT (20.5%) recorded robust growth, while supplementary duties rose only modestly (3.0%) and turnover taxes declined (–15.5%). To improve VAT collections, the Government needs to build on the reform measures initiated by the caretaker Government. Institutional reforms are necessary for audits, registration procedures, and tax legislation. Revenue governance should be improved to enhance the efficiency and productivity of the tax system.

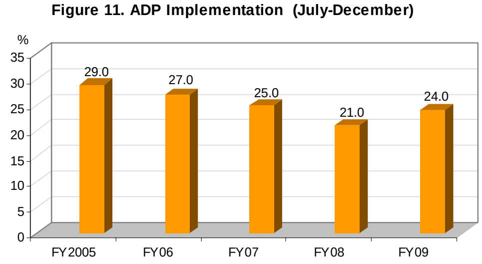
26. Income tax collections grew by 17.2% during the first half of FY2009. However, ongoing and planned tax-reform efforts, including streamlining the universal self-assessment system, expanding the number of taxpayers, increasing the intensity of supervision and monitoring, and implementing concerted drives against tax evasion are likely to raise income tax collections in the remainder of the fiscal year. Nevertheless, Bangladesh has the lowest direct tax (mainly income tax) effort among comparator South Asian countries because of the narrow tax base, which is further eroded by exemptions and evasion.

27. The Government is expected to strengthen reform measures, including expanding taxpayer registration, modernizing the National Board of Revenue (NBR) along functional lines, and streamlining audit functions to improve tax performance. The Government needs to review existing tax exemptions, exclusions, and fiscal incentives to expand the tax base and raise tax collections. The tax administration should be revamped to make it more results-focused with updated and simplified administrative systems.

28. A major challenge for the Government is to raise the ADP utilization rate. During past years, ADP implementation has been seriously impaired by weak institutional capacity and delays in project formulation (Figure 11). Both the quantity and quality of the ADP need to be enhanced by addressing capacity constraints and improving interagency and aid coordination, so that infrastructure provision can support increased private investment and help address the country's development needs.

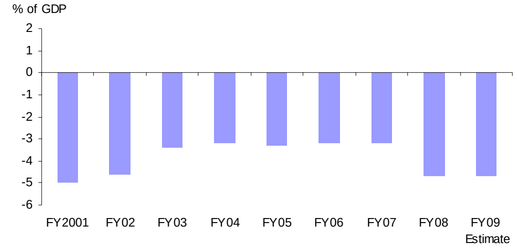
29. Total deficit financing of the Government during July–December FY2009 amounted to Tk118.2 billion, compared with Tk153.6 billion during the same period of

Figure 11. ADP Implementation (July-December)



the previous year. Of this deficit, net foreign financing stood lower at Tk39.8 billion, against Tk43.2 billion in the previous year. Total domestic financing stood markedly lower at Tk78.4 billion, against Tk110.4 billion in the previous year. Outstanding domestic debt increased by Tk124.4 billion or 13.9% to Tk1019.4 billion, against Tk895.1 billion in the previous year. Despite the recent rise in fertilizer subsidies, the budget deficit is expected to be around 4.7%, within the budgeted 4.9% (Figure 12).

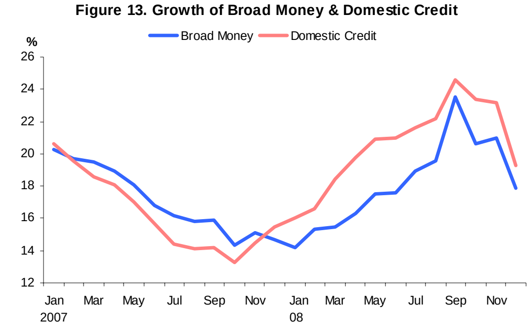
Figure 12. Fiscal Balance



Monetary and Financial Developments

30. Broad money growth reached 17.9% year-on-year in December 2008, up from 14.7% in December 2007 (Figure 13). This was caused by high growth in domestic credit (19.3%), while growth of net foreign assets (3.7%) moderated. Reserve money rose by 17.6% year-on-year in December 2008, up from 11.4% in December 2007 because of the sharp rise in net domestic assets (32.0%) of Bangladesh Bank. The rise in net domestic assets was driven by high growth of credit to the private sectors. The reserve money multiplier at end of December 2008 remained at the same level (4.5), as at end of December 2007. The outstanding stock of government treasury bills, bonds, and national savings directorate certificates stood at Tk478.6 billion at the end of December 2008, up from Tk444.3 billion in December 2007.

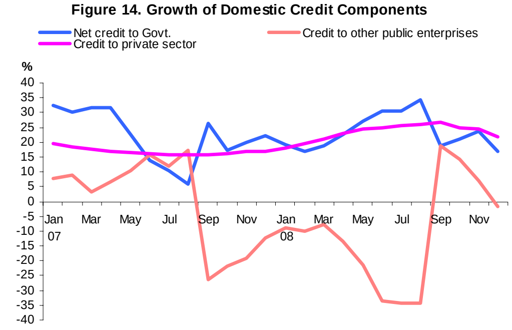
Figure 13. Growth of Broad Money & Domestic Credit



31. Private sector credit grew rapidly at 21.8% year-on-year in December 2008 compared with 16.8% in December 2007 (Figure 14). This was due to expansion of credit and advances by private commercial banks for trade, industry, and consumer credit. But net credit to Government grew by 16.7% year-on-year in December 2008 down from the growth of 22.1% in December 2007. Credit to the rest of the public sector declined by 1.7% compared with a decline of 12.4% in the previous year.

32. Bangladesh Bank maintained an accommodating monetary policy stance with little adjustment in policy rates to support growth and contain inflation within tolerable levels. It also conducted regular auctions of its 91-day and 182-day treasury bills, with yields rising moderately to contain inflation and maintain currency stability by reducing excess liquidity. The auction of shorter duration, 28-day treasury bills remained suspended during the first half of FY2009. While the reverse repo rates (1–2 day tenure) rose for the first time in 2 years and stood at 6.75% between September and December 2008, repo rates (1–2 day tenure) for identical tenures were unchanged at 8.8% in December 2008. Call money rates declined from 9.9% in

Figure 14. Growth of Domestic Credit Components



September 2008 to 7.6% in October and November. However, in December, the rate rapidly rose to 10.4%, the highest since March 2008 because of the pressures on liquidity ahead of the national parliamentary elections and the *Eid* festival (Figure 15).

33. Bangladesh Bank introduced the BASEL II capital adequacy assessment for banks in January 2009 as part of its efforts to encourage banks to systematically evaluate material risks to their capital bases. Bangladesh Bank has initiated steps to operationalize the core risk management guidelines to prevent gross risk management failures and introduce mandatory safe limits of debt equity ratios in bank lending to projects and curb excessive leveraging. The gross nonperforming loan (NPL) ratio for all banks declined to 12.3% at the end of September 2008 from 14% at the end of September 2007 (Figure 16). However, NPLs of the state-owned commercial banks rose from 26.9% to 29.3% during the period. The NPL ratio of specialized banks declined from 31.8% to 26.2% during the same period, contributing significantly to the lowering of overall NPLs. The performance of state-owned commercial banks with negative capital and high NPL ratios remains weak. Better recovery of NPLs, greater balance in liquidity management, and greater attention to maintaining credit quality is needed to improve the banks' financial position.

34. Bank advances show significant growth for trade, industry, construction, and transport and communication as total bank advances to the private sector rose by 27.1% in the first quarter of FY2009 over the corresponding period of FY2008 (Figure 17). Although Bangladesh Bank instructed banks to raise the share of advances to agriculture, they actually declined to 6.8% in the first quarter of FY2009 from 7.5% in the corresponding quarter of FY2008, as advances from private and foreign banks did not materialize. Disbursement of industrial term lending by all banks and nonbank financial institutions rose by 30.8% in the first quarter of FY2009 over the corresponding period of FY2008. Tk93.8 billion is programmed for disbursement as fresh agricultural credit in FY2009; Tk51.1 billion of this was disbursed in the first seven months of the year, a growth of 12.3%.

35. Weighted average lending rates continued to fall and stood at 12.4% at the end of September 2008. However, weighted average deposit rates rose to 7.2% in September 2008, and are expected to turn positive in real terms as inflation continues to ease. The interest rate spread narrowed from 6.2% in September 2007 to 5.2% in September 2008, indicating banks' efforts to lower the

Figure 15. Selected Interest Rates

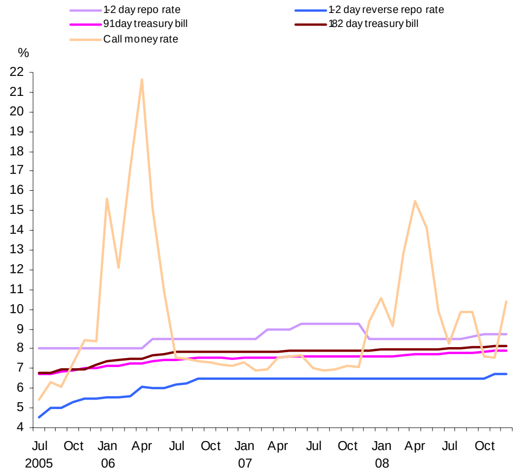


Figure 16. Gross Nonperforming Loan Ratios by Type of Bank

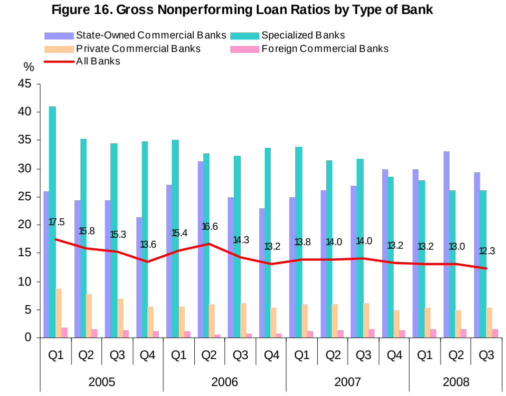
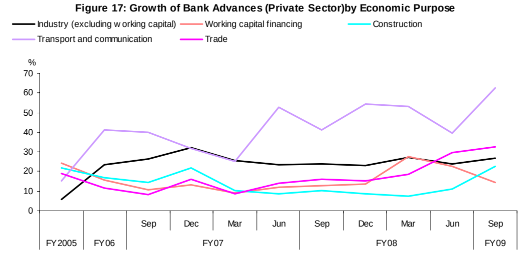
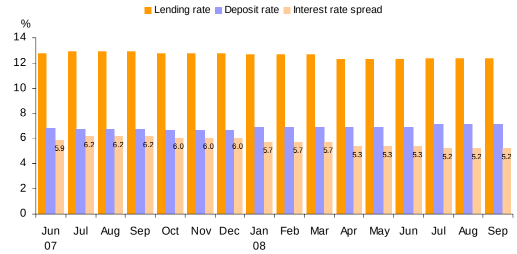


Figure 17: Growth of Bank Advances (Private Sector)by Economic Purpose



spread under Bangladesh Bank guidance and mobilize savings to meet rising credit demand (Figure 18).

Figure 18. Lending and Deposit Rates

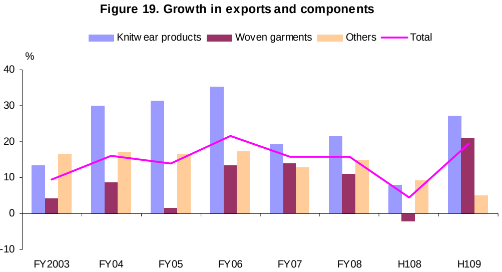


36. In mid-January 2009, Bangladesh Bank announced the monetary policy statement for January–June FY2009 envisaging no change from the July 2008 monetary policy stance. With unchanged policy, Bangladesh Bank will continue to support the flow of credit to increase production of goods and services, and provide refinancing against lending in employment-intensive sectors such as agriculture and small- and medium-sized enterprises, which are underserved by the market. The year-on-year growth in broad money (17.9%) in December 2008 is in line with its end-June 2009 annual program target of 17.5%. While the year-on-year growth in private sector credit in December 2008 is 21.8%, the adjustments in the repo and reverse repo rates are expected to guide credit growth back toward the program target of 18.5%. The inflation projection of 8.5% for FY2009 appears to be on the high-side considering the pace at which price pressures are easing. Finally, the monetary policy statement does not anticipate the need for any major monetary or fiscal stimulus, as domestic credit and liquidity conditions remain easy.

Balance of Payments

37. Though export performance was robust (42.4% growth) in the first quarter of FY2009, exports declined by 1.2% in the second quarter. On a cumulative basis however, export growth in the first half of FY2009 was still robust at 19.4%, as against 4.4% in the same period of FY2008 (Figure 19). Export growth is driven mainly by readymade garments. Among the exported items, woven garments rose by 21.0% and knitwear by 27.1%. In the face of the global slowdown, the robust growth is partly due to Bangladesh being a low-end producer and rising volumes of readymade garment exports to new markets such as Brazil and Mexico, following exporters' efforts to diversify markets. While the volume indexes of primary commodity exports declined by 31.0% and manufactured products rose by 18.9%, their price indexes rose by 25.9% and 2.6%, respectively. The decline in the growth in the volume index to 15.4% through December 2008 from 22.0% in November 2008 indicates a sharp slowing of production activities in the export sector.

Figure 19. Growth in exports and components



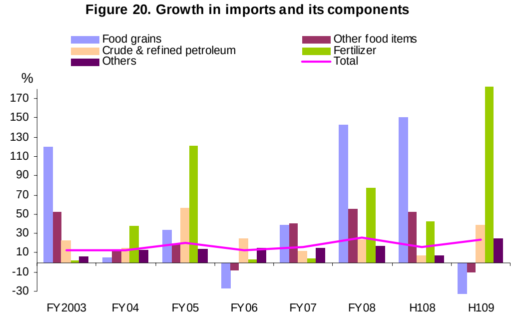
38. The merchandise export target is $16.3 billion for FY2009, 15.5% higher than actual exports in FY2008. However, in the first half of FY2009, export earnings were $7.8 billion, 1.3% lower than the first half target. With this

trend, which is likely to continue, Bangladesh may not attain the targeted export growth of 15.5% in FY2009. Jute goods and leather are unlikely to attain their annual targets. Exports of leather items declined by 31.9% in the first half due to lower demand for finished leather and leather goods in destinations such as Italy, Japan, and Republic of Korea. The Bangladesh leather industry has also been affected by the high import cost of inputs used in the processing of finished leather and lack of skilled workers in the industry. The Government may need to review the high import duties and VAT imposed on essential imported inputs used in the leather industry as a step to reduce production costs. In addition, the Government should support initiatives to develop expertise in producing quality leather items as part of diversifying the industry. The export of engineering products has dropped sharply in recent months due to declining demand in Europe.

39. Preventing a sharp decline in export earnings in the coming months will be a major challenge. With an abundance of cheap labor, and a financial system largely unaffected by the global financial crisis, Bangladesh could still attract foreign investors wanting to shift their existing textile sector investments from other Asian countries. As overall export earnings largely depend on the performance of readymade garment, the authorities should encourage the sector to search for newer export destinations and broaden product categories, while taking advantage of the country's cheap labor.

40. During the first half of FY2009, imports rose by 23.2% over the same period of FY2008 (Figure 20). Import payments of food items declined (–35.7%), mainly due to the lower international food prices compared with prices in the corresponding period of FY2008. Within the consumer and intermediate goods category, crude and refined petroleum, chemicals, fertilizer, yarn and raw cotton recorded robust growth. Higher import growth was recorded for iron, steel, and other base metals and capital machinery. The total value of letters of credit (L/Cs) opened during the first half of FY2009 showed low growth of 4.2% over the corresponding period of the previous year. This is due to the fall in international oil and commodity prices and caution exercised by importers in opening any new L/Cs in the face of falling prices in the international market. L/Cs declined by 56% for imports of food grains and by 21.8% for other consumer goods, in the first half of FY2009 because of higher domestic food-grain production and adequate stocks of food and consumer items, while those for intermediate goods (58.8%) and

Figure 20. Growth in imports and its components



petroleum products (16.3%) rose considerably. Opening of L/Cs for capital machinery fell by 20.7%, indicating further stagnation in investment in the near future.

41. Because of the fall in international oil and commodity prices, the import bill is expected to be manageable in FY2009. Import trade finance may however be affected, as liquidity shortages may create difficulties for international negotiating banks to support import activities. Declines in import values (the tax-base at the import stage) because of the fall in commodity prices (if not offset by a rise in import volumes) would also imply loss of revenue, which could in turn affect essential public spending.

42. Total remittance receipts during July–January FY2009 rose by 29.4% over the same period of the preceding fiscal year (Figure 21). But the growth in remittance earnings is slowing as the year progresses. About 65% of the remittances sent by overseas workers were from the Middle East and about 27% from the United States and Europe. Efforts to increase remittances continue as the Government is trying to encourage more workers to go to countries with new opportunities, such as Jordan, Libya and Qatar. Bangladesh Bank is urging commercial banks to increase remittance flows by providing better customer service. To monitor and supervise the overall inflows of remittances, Bangladesh Bank has formed a high level committee and given permission to three private commercial banks to set up exchange houses in Malaysia and the United Kingdom.

43. The annual growth (5.1%) in the number of workers leaving Bangladesh for overseas jobs slowed sharply in 2008, compared with growth of 118.2% in 2007 (Figure 22). Among the major destinations for overseas employment, new jobs for Bangladeshi workers in Saudi Arabia fell by 35.3% in 2008. Kuwait has reduced hiring of Bangladeshi workers since late 2006 following an allegation of malpractice in recruitment. In 2008, new jobs for Bangladeshi workers in Kuwait fell by 92.4%, and in Bahrain by 19.8%. New job opportunities for Bangladeshi workers also declined in 2008 in Malaysia (down 51.8%) and Brunei (decreasing by 11.1%) because of the economic slowdown. The global recession is also badly affecting jobs for Bangladeshi workers in Europe; in 2008 new jobs for Bangladeshi workers fell by 36.7% in Italy and 2.1% in the United Kingdom. Job opportunities however grew by 202.6% in Oman, 85.2% in United Arab Emirates, 68.9% in Qatar, and 47.6% in Singapore.

Figure 21. Workers' Remittances

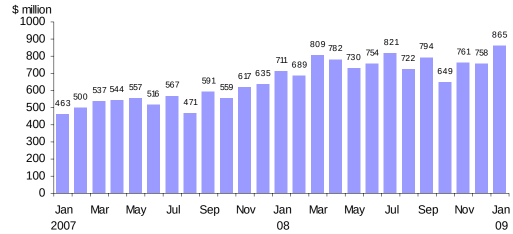
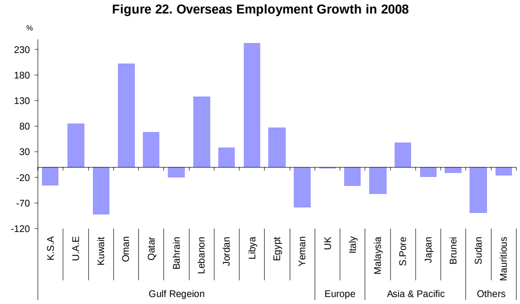
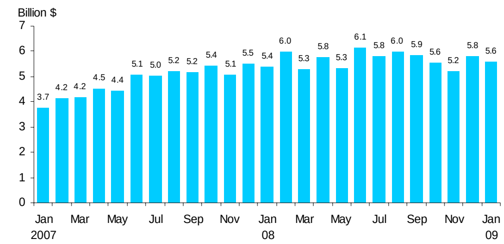


Figure 22. Overseas Employment Growth in 2008



44. Net foreign direct investment (FDI) inflows to Bangladesh in July–December 2008 totaled $706 million, a 147.7% growth over the same period of 2007. However, the fall in FDI proposals by foreign investors in 2008 as registered by the Board of Investment is of concern. In 2008, the Board of Investment registered only $60 million in FDI proposals covering 13 projects. The expected FDI flows in the energy sector are unlikely to materialize in the near term as investors will be cautious about any large investment. Postponement of FDI in the energy sector will be seriously detrimental to growth prospects in view of the prevailing power and gas shortages. Net foreign assistance stood at $579.6 million during July–December 2008, a decline of 8.0% over the corresponding period of 2007.

Figure 23. Gross Foreign Exchange Reserves



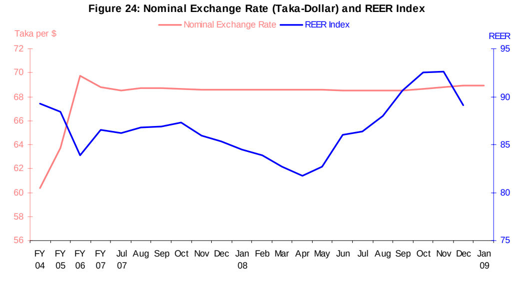
45. The trade deficit edged up to $2.9 billion in the first half of FY2009, up from the $2.2 billion deficit in the corresponding period of FY2008. Despite robust growth (30.9%) in remittances during this period, higher deficits in trade and service payments reduced the current account surplus to $232 million from a surplus of $298 million in the same period of FY2008. Reflecting the higher surplus in the financial and capital accounts, the overall balance showed a larger surplus of $489 million in July–December 2008 against a surplus of $44 million in the previous year.

46. Gross foreign exchange reserves of Bangladesh Bank fell to $5.6 billion (equivalent to about 3.0 months of imports) at the end of January 2009, from $6.1 billion at the end of June 2008 (Figure 23). However, this was higher than the $5.4 billion at the end of January 2008. In spite of the deceleration in the growth in foreign exchange earnings from exports and remittances, the current account balance will likely post a tiny surplus for the year as a whole due to the moderating import bill caused by falling commodity prices.

Exchange Rate

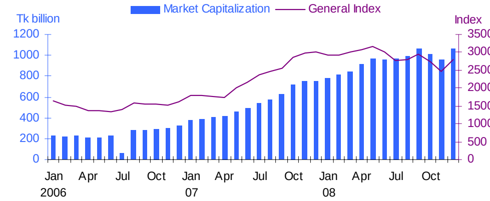
47. The weighted average nominal exchange rate of the taka remained stable against US dollar between Tk68.5—Tk68.9 during the second quarter of FY2009, indicating a still healthy foreign exchange position (Figure 24). Bangladesh Bank continues to intervene in the interbank foreign exchange market to prevent the taka from appreciating. From 15 January up to 22 February, the central bank purchased $151 million from four commercial banks as part of its market intervention. Moreover, private banks reported to the central bank that they have more foreign currency in stock due to a slowing demand for

Figure 24: Nominal Exchange Rate (Taka-Dollar) and REER Index



import L/Cs opening, which more recently has created opportunities for Bangladesh Bank to increase reserves. The real effective exchange rate (REER) index appreciated by 3.6% during the first half FY2009, implying erosion in export competitiveness in the international market.

Figure 25. Dhaka Stock Exchange: Market Capitalization and General Index

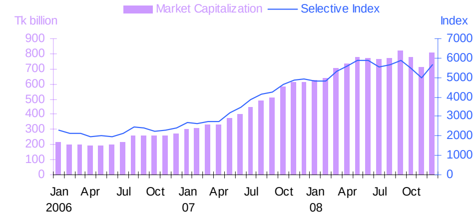


Capital Market

48. The major stock market indicators showed a downward trend in the second quarter of FY2009. The Dhaka Stock Exchange (DSE) general index reached 2,468.9 points at the end of November 2008, the lowest since August 2007, also lower by 10.2% than October 2008 (Figure 25). Market expectations became volatile ahead of the national elections, the Hajj, and the year-end book closure of financial institutions. However, the DSE index bounced back in December to 2,795.3 points, a rise of 13.2% from November. DSE market capitalization reached Tk1,059 billion by year end, rising by 4.6% from October 2008. Similarly, the Chittagong Stock Exchange (CSE) selective categories index declined to 4,957.6 in November 2008 from 5,463.0 in October 2008, a drop of 9.3% (Figure 26). However, the CSE selective categories rose to 5,680.6 in December, a rise of 14.6% from November. The market capitalization of CSE rose by 4.4% between October and December 2008. The volatility of transactions in the stock markets is a concern for investors and companies. Liquidity declined significantly and money has revolved around a narrow group of stocks. Fragile sentiment, inactive institutional participation, falling purchasing capacity of small investors, and weak surveillance are the major reasons for higher volatility in the market.

49. Two listed state-owned enterprises, namely, Zeal Bangla Sugar Mills Limited and Shaympur Sugar Mills Limited, offloaded 49% of their shares in the stock market on 30 December 2008 and 12 January 2009, respectively. Currently, 80.3% of Zeal Bangla Sugar Mills Limited shares and 57.1% of Shaympur Sugar Mills Limited shares are traded. On 18 November, Shinepukur Ceramics Limited, one of the country's largest ceramic companies, issued shares under the direct listing regulations.

Figure 26. Chittagong Stock Exchange: Market Capitalization and Selective Index



THE ROLE OF MIGRATION AND REMITTANCES IN BANGLADESH'S DEVELOPMENT[2]

50. International labor migration and workers' remittances play major roles in Bangladesh's economic development by reducing unemployment, increasing national income, and augmenting foreign exchange reserves. The employment function of migration—relieving pressure of underemployment and unemployment—is important in view of the country's large pool of surplus labor, while remittances fill the critical gap resulting from the shortage of foreign exchange due to limited FDI and the still narrow export base. Recognizing the role of migration as an instrument for transferring skills, raising productive efficiency, and stimulating domestic investment, international labor migration and remittances are assigned high priority in the country's development strategy.

Trends and Profile of International Labor Migration

51. Bangladesh has two main types of migrants. The first includes immigrants and permanent residents to industrialized countries—a process that began in the 1950s with the United Kingdom and has gained momentum in recent years with the increase in the size of the Bangladeshi diaspora in other countries. This group includes many who have acquired foreign citizenship and many who are professionals and semiprofessionals. The second type of migrant includes short-term migrants to the Middle East and Southeast Asian countries—a process that began in the wake of the 1973 oil price hike and the emergence of Middle East countries as affluent economies. These migrants, who usually return after completing their contracts, are mainly nonprofessionals. Information on each group is limited as no records are available on their movement.

52. According to government estimates, the current stock of migrants from Bangladesh exceeds 5 million, or about 3% of the population. In recent years, the annual outflow of migrants fluctuated between 200,000 and 300,000, a trend that exhibited a sharp increase in 2007 when it exceeded 830,000, largely because of a spurt in demand from Malaysia. The principal destinations of migrant workers are the oil-exporting Middle East countries such as Saudi Arabia, Kuwait, United Arab Emirates, Bahrain, and Oman. About 80% of all migrants are located in oil-exporting countries, and a large component, or about 45%, are based in Saudi Arabia. Other major destinations among the Middle East countries are United Arab Emirates with 17% of the migrants and Kuwait with 9%. Given this distribution of migrants, the total flow of remittances is critically dependent on oil prices and the state of these economies. Other major destinations outside of the Middle East include Singapore, accounting for 6%, and Malaysia with 3%. Recently, some western European countries such as Italy are becoming attractive destinations for Bangladeshi migrant workers.

53. The Government classifies migrants into four skill categories: professional, skilled, semiskilled, and unskilled. Between 1990 and 2006, about 4% of migrants were professional, 31% skilled, and the remaining two thirds unskilled or semiskilled. Little systematic information is available on the demographics or the educational attainments of migrants. Casual empiricism—as well as studies from other countries—suggests that most migrants are young (from 15 to 35 years of age) at least when they made their first trip as an overseas worker.

[2] This chapter is based on the study "Improving Institutional Arrangements for Enhancing Manpower Export and Remittance Inflow" prepared by M. G. Quibria and Syed Ashraf Ali in May 2008 under Asian Development Bank technical assistance (4044-BAN): Efficiency Enhancement of Fiscal Management II.

Given that the vast majority are unskilled and semiskilled, most likely have limited education, often not exceeding primary or secondary education.

54. In contrast to the global trend of increasing female migration, Bangladesh has seen limited numbers of female migrants. During 1997–2007, the 62,000 female migrants comprised less than 1% of the total flow of more than 3.5 million migrants. Of these female migrants, the majority were destined for the Middle East—with Saudi Arabia and United Arab Emirates accounting for about 30%—while the remainder were destined for other parts of the world, such as Malaysia (8%). Even if the number of actual female migrants is much larger than recorded officially, the outflow was relatively small, due to social constraints and legal restrictions.

Trends and Regional Pattern of Remittance Inflow

55. In tandem with the flow of migration since 1976, the size of workers' remittances has shown sustained increase. From a nascent base in 1976, Bangladesh maintained a robust growth in remittances through the formal channel in recent years. Remittances have accelerated—from $2.1 billion in FY2001 to $7.9 billion in FY2008, an average growth of 17% per annum. Remittances as a percentage of GDP continuously increased, reaching 10% in FY2008 compared with only 1.4% in FY1980.

56. The country's remittance inflow is disproportionately dependent on middle-eastern countries. Saudi Arabia is the most important source of remittances. Its share in 2008 was 29.4% of the aggregate remittances received in Bangladesh. The United States, which received a large inflow of migrants in recent years, accounts for the second largest source with a remittance of $1,380 million during FY2008, or nearly 14.3% of the total. Nevertheless, some diversification of external markets for labor has been taking place recently.

57. In addition to remittances sent through official channels, a significant proportion of remittances continue to be sent through unofficial channels. However the proportion seems to be declining. The principal reasons for the robust growth of remittances are as follows: first, an increase in the size of the migrant population and a rise in average wages; second, a shift of remittance flows from informal to formal channels. The latter effect is the outcome of several factors—including the convergence between the curb market and official exchange rates; improved international connectivity and greater access to remittance technology leading to falling remittance costs; and finally greater scrutiny of informal remittances. In the formal sector, the major instruments used by Bangladeshi migrants for transferring remittances are the traditional ones: bank drafts, telegraphic transfers, cashier's checks, and international money orders. More sophisticated card-based remittance instruments such as automatic teller machines or debit cards, stored-value cards, and credit cards are not available to remittance-receivers in Bangladesh because of the lack of harmonization of cross-border payment systems, lack of availability of card-processing machines, and lack of financial sophistication on the part of the remitters and their beneficiaries.

Development Impacts of Migration and Remittance Inflow

58. Economic development and migration have a close relationship. The World Bank concludes that remittances appear to have a positive impact on the development and welfare of

migrant-sending countries.[3] Rapoport and Docquier, in an extensive and widely cited review of current economic literature on remittances, reach similar conclusions.[4]

59. The importance of remittances to the Bangladesh economy can be gauged by comparing them to other macroeconomic indicators of the economy. In FY2008, remittances were equivalent to 56.1% of total export earnings, could finance 36.6% of total imports, were almost nine times the FDI flows to the country, and were more than three-and-a-half times the total foreign aid received. At this stage of economic development, remittances play a critical role as a source of external finance. Overseas employment also contributes significantly to the economic development of Bangladesh by reducing unemployment.

60. In Bangladesh, the greater inflow of remittances helped to sustain macroeconomic stability by improving the country's current account position, foreign currency reserves, and external debt servicing capability. The country needs significant foreign exchange resources to import capital machinery, raw materials, and consumer goods, and to service external debt. In FY2008, the ratio of imports to GDP was 27.4% and exports to GDP 17.9%, resulting in trade deficits. But because of the strong inflow of remittances, the current account balance showed a surplus of 0.9% of GDP in FY2008. In FY2008, remittance flows were about 142.8% of the trade deficit and 56.8% of merchandise exports. Despite heightened external pressures, continued buoyancy in remittances translated into a reasonably robust foreign currency reserves of $6.1 billion at the end of FY2008. Robust remittance flows helped reduce the debt service ratio to 3.2% in FY2008 from as high as 6.6% in FY2001. It has enabled the country to maintain balance of payment surpluses for more than 5 years in a row, despite trade imbalances and stagnant FDI inflows.

Addressing Problems of Labor Migration

61. Measures need to be taken to ensure that migrant workers receive fair treatment from recruiting agencies in terms of wages and service conditions. Difficulties faced by migrants at different stages of the migration process, from securing passports, visas, and tickets; to completing airport formalities; to returning from abroad after the completion of a contract must be minimized. Migrants need to be properly briefed prior to their departure abroad so that they can better cope with culture shocks that they experience at their places of employment. The quality and quantity of welfare services provided by the Government to the migrant workers need to be enhanced. When overseas workers encounter job-related difficulties abroad, they need assistance from government departments. In addition, the Government needs to do more to provide training opportunities for migrants so that they can obtain more remunerative employment.

Removing Barriers to Remittance Inflows

62. Although the remittance transfer process has improved, remaining barriers to efficient transmission need to be removed to promote the use of official channels. They include:

(i) access in originating countries: better access to the Bangladeshi network of banks and exchange houses needs to be provided in certain areas in the Middle

[3] World Bank. 2006. *International Migration, Remittances, and the Brain Drain,* edited by Çaglar Özden and Maurice Schiff. Washington, DC: The World Bank; New York: Palgrave Macmillan.

[4] Rapoport, Hillel, and Frédéric Docquier. 2005. The Economics of Migrants' Remittances, IZA Discussion Paper No. 1531. Bonn, Germany: Institute for the Study of Labor. Available: http://repec.iza.org/RePEc/Discussionpaper/dp1531.pdf.

East and in new migrant destinations such as Greece, Italy, Republic of Korea or Spain;

(ii) infrastructure and technology challenges: widespread use of new technology must replace manual processing of remittances to prevent delay in transmission and disbursement of funds;

(iii) educational issues: financial literacy needs to be enhanced to help remitters explore the formal channel; information material in the form of booklets, brochures, and leaflets needs to be made available to Bangladeshi migrants, and briefing arrangements need to be introduced by banks, the post office, or money transfer operators about remittance methods and investment options;

(iv) governance: governance for remittances handled by commercial banks and the post office needs to be improved to eliminate fraud and delays in remittances by streamlining the administrative mechanisms to address such issues; and

(v) access in receiving country: more branches of commercial banks, particularly private banks, need to be opened in remote areas in Bangladesh. Cooperation between private banks and state-owned commercial banks needs to be enhanced to efficiently handle remittances.

Concluding Observations

63. The Government of Bangladesh views the export of human resources and remittances as important elements of its strategy to accelerate economic development in the country. As the current flow of migrants consists predominantly of unskilled and semiskilled categories, one plausible way to increase remittances, besides increasing the quantity of migrants, is by improving the skills mix. While enhancing labor export and remittances is important, this objective should be pursued in a manner that ensures the welfare of workers—that is, protecting and ensuring the human rights and dignity of workers, and safeguarding them from unnecessary harassment both at home and abroad. The Government can play an important role in this process by regulating the recruitment industry, ensuring the transparency of the migration process, and providing helpful support to vulnerable and in-distress migrants both at home and abroad. It can also play an important role internationally by negotiating with labor-receiving countries to develop a set of minimum labor standards for migrant workers that includes minimum wages, working and living conditions, medical facilities, and other benefits.

64. Increasing migrants' remittances through formal channels requires decreasing remittance fees, improving speed of delivery, and reducing the various transactions costs. This requires, among others, strengthening banking arrangements for remittances; improving access to modern technology for processing and transmitting remittances; creating a legal framework that is conducive to use of formal channels; and improving financial literacy for remitting money and for saving and investing.

65. The growth of migration is expected to continue as the demand for labor in developed and advanced developing countries is unlikely to decline, although a temporary deceleration is likely due to the ongoing global economic slowdown (paras. 42–43). This scenario presents major opportunities for Bangladesh to increase migration and boost remittance earnings. As other labor-abundant countries are also naturally aspiring to avail of greater opportunities for human resource exports with supportive policies, Bangladesh is expected to face stiffer competition in its endeavor to promote migration. Bangladesh needs to adopt and implement suitable policies for human resource development, activate its relevant agencies in proactively pursuing overseas employment opportunities, and efficiently manage migrant flows. For migration and the remittance flows to contribute to economic development, sound macroeconomic and sector policies must be ensured and institutional capacities in the various government departments upgraded.

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Asian Development Bank
Bangladesh Resident Mission
Plot E-31, Sher-e-Bangla Nagar
Dhaka 1207, Bangladesh
www.adb.org/BRM
Publication Stock No. 010401

Printed in Bangladesh