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BANGLADESH
Quarterly
Economic
Update

March 2009

Asian Development Bank

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Asian Development Bank
March 2009

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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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NOTES

- (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

- Macroeconomic management remains prudent.
- The Bangladesh economy has begun to be affected by the second-round effects of the global economic crisis, which could reduce the country's near-term growth prospects.
- Despite slowing growth, Bangladesh will perform better than most other Asian countries.
- The agriculture sector is poised for robust growth.
- Moderation in international and domestic demand will curb industry sector growth.
- Service sector growth will slow due to moderating industry growth and remittance inflows.
- The Government unveiled a stimulus package to combat the effects of the global economic crisis.
- Inflation has eased—the result of decreased global commodity prices and improved domestic food supplies.
- Fiscal revenue will fall short of the target, but the overall deficit will remain well within the budgeted amount.
- Exports are decelerating, but year-to-date growth remains positive.
- Robust remittance earnings provide a cushion for the external balance.
- Foreign reserves continue to grow and remain comfortable.

Sector Performance and Economic Growth

1. The Bangladesh economy managed to avoid the first-round shocks of the global financial meltdown due to the low integration of the country's financial sector with the global financial system. As the global financial crisis transformed into a global recession, the economy began to be affected by the global economic slowdown. Moderation

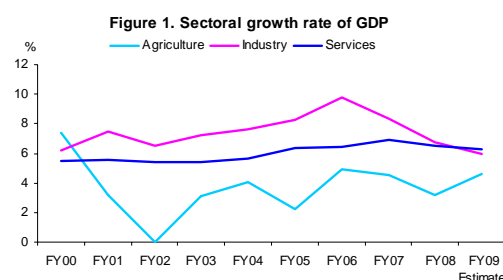
in the growth of exports and remittances has impacted the country's real sector, undermining near-term economic growth prospects. Although the agriculture sector, underpinned by favorable weather conditions and the Government's strong policy support, is poised for robust growth in FY2009, industry and services are likely to slow, primarily due to weaker demand. Since readymade garments (RMG) and knitwear together account for 40% of industrial value added, the slowdown in RMG and knitwear exports will affect growth in the industry sector. The services sector will moderate due to the slowdown in industrial activities and trade, and weaker private consumption due to the slowdown in remittance inflows. The country's macroeconomic management remains prudent in the face of the global slowdown. While the Government on 19 April 2009 announced a Tk34.2 billion stimulus package (Table below) to boost domestic production and raise business confidence, continued macroeconomic prudence is vital to limit the effects of the economic slowdown. At the same time, public investment in infrastructure should be increased and well-targeted safety net programs implemented. Reforms need to be continued to augment the country's competitiveness and improve the investment climate.

(Tk. in billion)

Sectors	Current Allocation	Additional Allocation	Total
a. Subsidy			
Export	10.5	4.5	15.0
Agriculture	42.9	15.0	57.9
Power	6.0	6.0	12.0
b. Agricultural credit (Re-capitalization)	10.0	5.0	15.0
c. Social Security (Food)	42.0	3.7	45.7
TOTAL	111.4	34.2	145.6

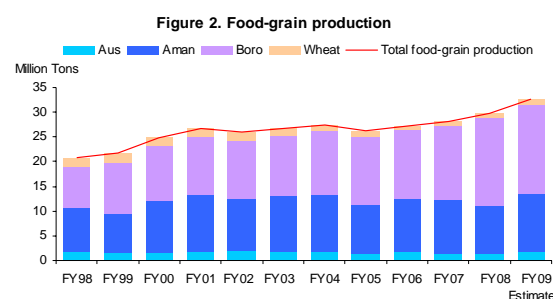
Agriculture

2. The newly elected Government attaches top priority to developing agriculture to enhance food security through raising domestic food production and support pro-poor growth. According to Bangladesh Bureau of Statistics (BBS) estimates, agriculture will post growth of 4.6% in FY2009 (Figure 1). Actual production of rice and wheat may be close to the target despite insufficient precipitation in February and March 2009. Good harvests of *aman* (monsoon) rice, maize, wheat, and potatoes in FY2009 are likely to materialize. The outlook for the *boro* rice (dry



season crop) is optimistic. The Government sought to ensure timely availability of agricultural inputs to farmers. In January 2009, the Government cut non-urea-fertilizer prices by almost 50%, reduced prices of diesel and kerosene by Tk2 per liter, supplied more electricity to rural areas for irrigation, and made changes to improve the fertilizer delivery system. The Government also took measures to provide credit to farmers and expedite delivery of extension services. Bangladesh Bank set minimum farm credit levels for all banks. The poultry and fishery subsectors are expected to perform well. They recently experienced modest improvements in productivity and competitiveness; although these remain significantly lower than in neighboring countries.

3. Rice production is targeted to increase by 15.2% in FY2009 to 33.3 million tons, up from actual production of 28.9 million tons in FY2008. In FY2009, the *aus* (summer) rice crop was cultivated on 1.1 million hectares, up 15.9% from FY2008. Aided by favorable weather conditions together with strong government support, actual *aus* production rose by 25.8% over FY2008. The yield rate increased by 8.0%. In FY2009, *aman* was cultivated on 5.5 million hectares, with actual production of 11.6 million tons, a 20.2% increase over actual production in FY2008 (Figure 2). Total cultivable land for *boro* is targeted at 12 million hectares, up 2.0% over FY2008. The production target for *boro* is 18.0 million tons compared with 17.8 million tons in FY2008. Crop production may attain a new peak if a bumper *boro* crop is attained. Total cultivable land for wheat is set at 0.4 million hectares, with a production target of 1 million tons in FY2009, an 18.5% rise over actual production in FY2008.



4. Because of higher domestic production and a drastic fall in food-grain prices in international markets, the import of food grains fell from 3.2 million tons during July–April FY2008 to 2.6 million tons during July–April FY2009, an 18.7% decline. Procurement of food grains by the Government rose from 0.3 million tons in July–April FY2008 to 0.8 million tons during July–April FY2009. Government distribution of food grains rose by 29.8%, from 1.2 million tons in July–April FY2008 to 1.5 million tons during the same period this fiscal year. Food stocks at the end of April 2009 rose to 1.0 million tons from 0.4 million tons at the end of April 2008, a 124.1% increase. These actions support the Government's commitment to enhance food security.

5. The Government wants to ensure timely delivery of key inputs by subsidizing input prices and improving the

input delivery system. At the same time, it is keen to provide fair output prices to farmers. Use of quality agricultural inputs such as seeds, fertilizers, pesticides, farm equipment, and irrigation is critical to promote diversification and increase productivity. Despite significant improvement, agricultural inputs continue to experience problems, such as, poor quality, and high prices, which are more acute in remote rural areas. Lack of accessible markets and collusion by traders pose significant constraints in both agricultural input and output trade. Marketing margins remain high relative to the services provided. Lack of market information and infrastructure, the reported existence of syndicates, and collection of illegal tolls aggravate the situation. The impact of input price policy and subsidies on profitability and competitiveness needs to be examined, and options explored for reform. Input price subsidies often bypass the neediest farmers, while benefits disproportionately accrue to the largest and richest farmers. Moreover, subsidies distort the neutrality of the incentive regime and undermine crop diversification. Better targeting of subsidies will free up resources for agricultural research and extension, which are essential to increase long-term productivity.

6. Cultivable land in Bangladesh is rapidly depleting. With the country's population growing at 1.3% per year, demographic pressures and increased urbanization have caused a decline in the cultivated area. Therefore enhancing growth in crop production on a sustainable basis is important. The most pressing problem is thus the current state of stagnating yields and declining productivity in a range of food and nonfood crops. As cropping intensity has approached its limit (about 182%), growth will need to come from intensification of cereal production, diversification into high-value crops and noncrop activities, and value addition in agroprocessing. This will require reform of the agricultural research and extension systems, and financial and other regulations. Attention needs to be given to harnessing the potential for higher crop production in the south-west region through providing irrigation and supporting crop diversification. Land administration and security issues also need to be addressed.

7. The need for crop diversification in Bangladesh's agriculture sector is well founded. Currently, with rice occupying almost 80% of the cropped area, followed by wheat at approximately 4% and jute at about 3%, less than 13% of the cropped area is devoted to other crops. Crop production must be urgently reoriented to nonrice crops such as maize, pulses, oilseeds, potatoes, and other vegetables; as well as poultry and livestock. Several

factors underpin the need for crop diversification. First, the diet of the average Bangladeshi is critically deficient in proteins, vitamins, and minerals due in part to a lack of diversity in food availability. Second, diversification will enable farmers to allocate productive resources optimally and maximize incomes. Third, overdependence on rice production throughout the year is detrimental to soil fertility. It also makes the crops easily susceptible to pest attacks. Crop diversification can help maintain a better soil health for long-term sustainability. Fourth, a good proportion of current food imports could be substituted through domestic production. For example, wheat has gradually become part of the rural diet. It requires less irrigation than rice, making it cheaper to produce and less damaging to the environment. However, the climate limits the scope for increasing wheat yields significantly. Fifth, with the considerable decline in jute production, diversification is essential for agriculture to break into the export market. Potatoes, vegetables, fruits, onions, and spices are all easily produced in Bangladesh. However, storage and transport infrastructure has not been adequate to prompt large-scale adoption of these crops. Farmers have been discouraged by the high price risks associated with the marketing of these crops. Moreover, extension of on-farm water management technology for nonrice crops has been inadequate and there is a lack of need-based extension services.

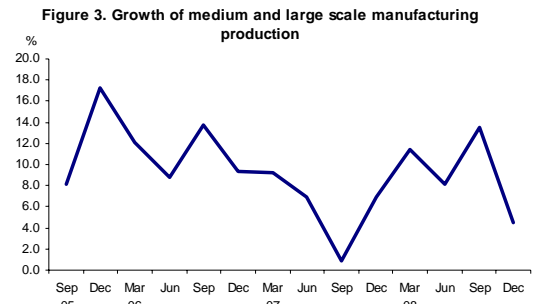
8. In the Government's stimulus package (para. 1), the measures for the agriculture sector were (i) increasing the subsidy to the sector from Tk42.9 billion (0.7% of gross domestic product [GDP]) to Tk57.9 billion (0.9% of GDP); (ii) increasing allocations for the recapitalization of state-owned agricultural banks from Tk10.0 billion to Tk15.0 billion; and (iii) increasing spending on the food safety net from Tk42.0 billion to Tk45.7 billion. In addition, on 20 April, Bangladesh Bank asked financial institutions to reset lending rates for the poultry subsector at the rate applicable to agriculture credit instead of commercial credit, and to reschedule classified loans outstanding with farmers without any down payment to rehabilitate the bird-flu affected poultry subsector.

Industry and Services

Industry

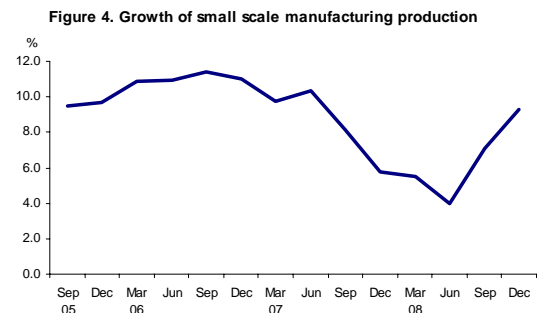
9. The country's industry sector is beginning to feel the effects of the global economic slowdown. Growth in RMG and knitwear production has started to slow. The acute power shortages at the onset of the dry season have

also decreased industry sector growth prospects. The gains in business confidence with the peaceful transition to the newly elected Government have been at least partly offset by the negative impact of the global economic slowdown. Export-oriented industries have been directly affected by falling export demand, while domestic market-based industries are affected by lower consumption demand caused by slower remittance inflows. The slowdown in industrial activity is also evident in the fall in industrial term loans from Tk49.5 billion during July–September FY2009 to Tk39.9 billion during October–December FY2009. During the first 9 months of the current fiscal year, letters of credit (L/Cs) opened for the import of capital machinery declined by 31.5%, although import of machinery for miscellaneous industries increased by 15.1%. L/Cs opened for the import of industrial raw materials declined by 0.5%, while those for intermediate goods rose by 24.8% during the same period. L/Cs opened for construction materials declined by 1.5% compared with the same period of FY2008. These developments will affect industrial growth in FY2009. BBS estimates that industry sector growth will fall to 5.9% in FY2009 from 6.8% in FY2008 (Figure 1).



10. Measured by the quantum indices, output of medium- and large-scale manufacturing during the first 7 months of FY2009 rose 8.9% over the same period of FY2008 (Figure 3). This increase is much lower than the increase of 13.5% during the first quarter of FY2009. Indices recording an increase during July–January of FY2009 are basic metal products (16.7%); jute, cotton, apparel, and leather (13.9%); nonmetallic products (14.4%); fabricated metal products (6.2%); chemical, petroleum, and rubber (4.4%); paper and paper products (3.6%); wood products including furniture (2.0%); and food, beverages, and tobacco (0.4%).

11. The general index of small-scale manufacturing rose by 8.2% during the first half of FY2009 (Figure 4). The performance of various industries was basic metal products (16.4%); textiles, leather, and apparel (5.4%); nonmetallic and mineral products (0.1%); metal products, machinery (4%); chemical, rubber, and plastics (1.9%); paper, printing, and publishing (8.5%); wood and wood products (11.4%); and food, beverages, and tobacco (6.6%).



12. As a crisis response measure, Bangladesh Bank recently instructed commercial banks to reschedule their outstanding loans without down payment for the RMG, textile, leather, jute, and frozen food industries. It also

instructed commercial banks to set a ceiling of 13% on the lending rate for these industries. The same lending rate ceiling has been fixed for agriculture, large-scale industries, small and medium-sized enterprises (SMEs), housing, and trading. However, public sector enterprises will not receive this opportunity. A significant part of the Government's recently announced stimulus package is intended to support export-oriented strategic industries. Under the stimulus package, Bangladesh Bank will take measures for export-oriented industrial units, which are affected by the global economic crisis, to enable them to better access financing opportunities.

13. SMEs bear a disproportionate share of the adverse impacts of the global economic slowdown; they account for about 40% of manufacturing output, 80% of industrial employment, and 25% of the total labor force. Protecting SMEs from the global crisis is important because of the vital role they play in fostering industrialization and pro-poor growth. SMEs, being generally labor intensive, can play a vital role in promoting industrialization, based on production linkages among the key sectors and geographic regions. The promotion of SMEs can significantly help to empower women. Many SMEs are clustered in certain key industries, such as textiles and garments, which account for about 75% of total exports. SMEs have been growing in rural areas, where most of the poor live, providing livelihood and employment opportunities in food production, agroprocessing, and nonfarm rural economic activities. However, they have not yet attained their full potential due to various bottlenecks. The main constraints include (i) lack of adequate medium- to long-term credit; (ii) limited access to market opportunities, technology, expertise, and information, relative to larger enterprises; (iii) inefficient and limited outreach of government services; (iv) weak managerial capacity among SME entrepreneurs; (v) structural bottlenecks, especially lack of infrastructure, power, and communication; and (vi) lack of an appropriate institutional framework. Bangladesh Bank recently instructed commercial banks to increase lending to SMEs.

Services

14. After the robust performance of the first two quarters of the fiscal year, the services sector is also being affected by the global economic slowdown. Slower export growth and a fall in import volume have adversely affected transport and communications. Retail and wholesale services are affected by the drop in consumption demand caused by the moderated remittance inflows. The slowdown in industrial activity has adversely affected

service sector growth. As a result, according to BBS estimates, service sector growth will fall to 6.3% in FY2009 compared with 6.5% in FY2008 (Figure 1).

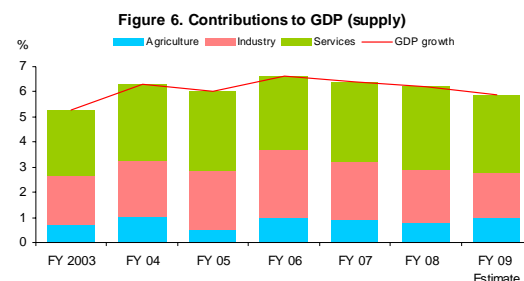
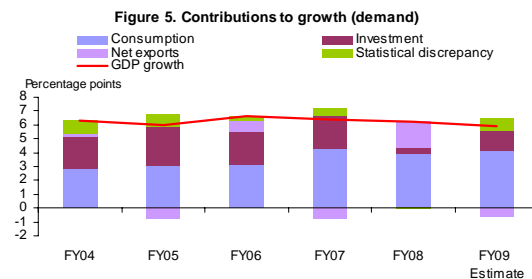
Economic Growth

15. The prospects for attaining the originally projected GDP growth of 6.5% in FY2009 waned as the fiscal year progressed. The economy held up quite well in the first quarter of FY2009, supported by the rise in consumption demand and renewed private investment activity. With the moderation in export and remittance inflows, aggregate demand has started to slow, decreasing growth prospects. Slowing private consumption and investment activity is expected to exert downward pressure on GDP growth. As a result, BBS now estimates GDP growth in the current fiscal year to fall slightly to 5.9% from 6.2% in FY2008 (Figures 5 and 6). Nonetheless, Bangladesh will perform much better than most other Asian countries.

16. A major weakness of the Bangladesh economy is prolonged low investment. Private investment increased marginally from 19.3% of GDP in FY2008 to 19.6% in FY2009. During the term of the caretaker government, investment uncertainties resulted from the anticorruption drives, which induced investors to adopt a wait and see attitude. Bangladesh Bank attempted to stimulate private investment by channeling credit to the private sector. Nevertheless, Bangladesh needs to address weak infrastructure, including acute power shortages, transportation bottlenecks, inadequate and inefficient port facilities, high startup costs of business, and slow institutional reforms, which are the major obstacles to investment, including foreign direct investment (FDI).

17. Public investment has steadily declined from 6.2% of GDP in FY2005 to 4.6% in FY2009. This is primarily due to poor performance of the annual development program (ADP), which is seriously constrained by the weak implementation capacity of government line agencies. Public investment in infrastructure, power, energy, and other public goods is critical for attracting private investment.

18. The Government's stimulus package seeks to pay attention to boosting investment in agriculture and rural development, energy, industry, and physical infrastructure. Measures to support investment include (i) recapitalization of specialized banks; (ii) special efforts to invigorate schemes supervised by Bangladesh Bank, such as (a) the Tk4.0 billion Investment Promotion and Financing Facilities



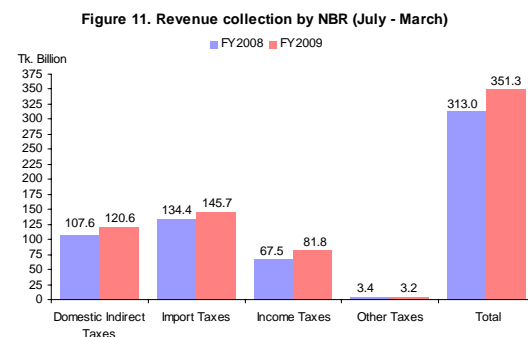
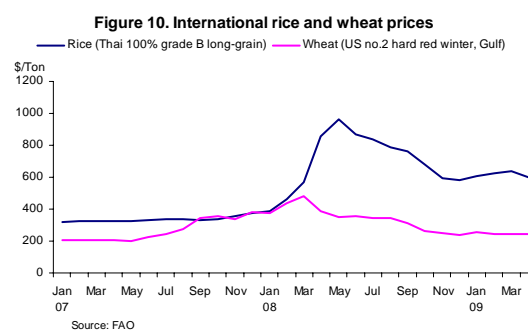
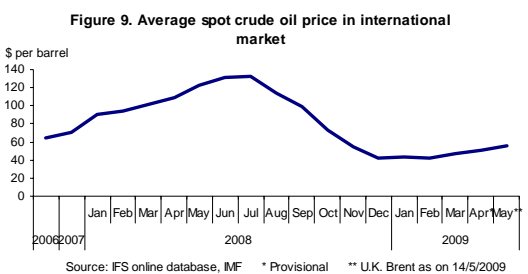
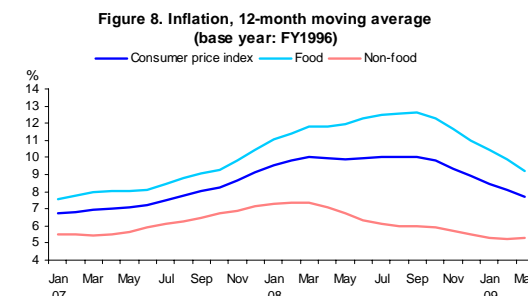
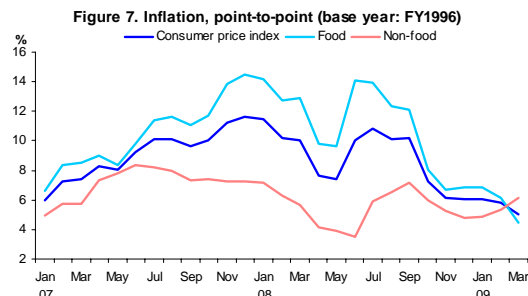
(b) the Tk6.0 billion Small and Medium Enterprises Fund, which was increased by Tk1.0 billion, (c) the Tk5.0 billion Housing Fund, which was increased by Tk2.0 billion, (d) the Tk3.0 billion Equity Fund, (e) the Tk1.0 billion Agriculture Fund, (f) the Tk2.0 billion Information Technology Fund (an additional Tk1.0 billion will be added in the next budget), and (g) the transfer of the agriculture and information technology funds to the Investment Corporation of Bangladesh; (iii) provision of equity participation funds from Tk5.0 million to Tk100.0 million from the Equity and Entrepreneur Fund for production and processing of fodder and for poultry firms; (iv) development of an effective council to immediately implement the steps taken for ailing industries, including 270 garment factories; and (v) an extensive campaign by the Ministry of Expatriate Welfare and Overseas Employment and Bangladesh Bank to encourage investment in the US Dollar Bond, US Dollar Investment Bond, and Wage Earners Development Bond.

Inflation

19. Inflation has dropped steadily during FY2009, reaching 5.0% year-on-year in March 2009, from 10.8% in July 2008 (Figures 7 and 8). Despite the accommodative monetary policy followed by Bangladesh Bank, inflation has decelerated due to the sharp decline in international oil and food-grain prices (Figures 9 and 10), and improvements in domestic food supply. The decline in food price inflation to 4.5% in March 2009 from 13.9% in July 2008 accounts for the decline in overall inflation, as the nonfood price index remained essentially unchanged (6.1% in March 2009 versus 5.9% in July 2008). The attention paid by the Government to better food management (including imports, domestic procurement, and distribution) also helped to contain inflation. The Government, through its election manifesto, sent a clear message that its top priority is to curb commodity prices; this also helped reduce inflationary expectations.

Fiscal Management

20. Government revenue has slowed significantly since the onset of the global financial crisis. Growth decelerated from 20.5% in the first quarter of FY2009 to 12.2% in the first 9 months of FY2009, over the corresponding periods of FY2008 (Figure 11). The total revenue target for FY2009 (Tk545 billion) will not likely be attained. The sharp fall in import prices have markedly affected collection of import-based taxes, which account for more than 40% of all tax collections. The growth of revenue from import-based



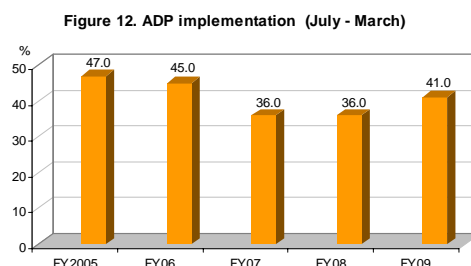
taxes fell from 27.7% in the first quarter of FY2009 to 8.4% during the first 9 months of the fiscal year. Collection of domestic taxes also slowed with a decline in private sector activity as people adopt a more cautious approach to spending and banks become more conservative in lending.

21. With regard to import-based taxes, receipts from customs duty increased only 1.6% during the first 9 months of FY2009. Revenue from value-added tax (VAT) at the import stage rose 12.1% during July–March compared with 37.9% during the first quarter of FY2009. A similar scenario is evident for domestic taxes. Revenue receipts from domestic indirect taxes increased 12.1% during this period of the current fiscal year, compared with 18.7% during the first quarter. The growth rate of domestic VAT moderated to 18.8% during the first 9 months of FY2009 from 26.7% in the first quarter. Supplementary duties from domestic sources rose by only 2.5% during the first 9 months of FY2009, down from 8.2% during the first quarter. Income tax receipts recorded slightly higher growth at 12.1% during the first 9 months of the current fiscal year, compared with 11.6% during the first quarter.

22. In its April 2009 stimulus package, the Government initiated a fiscal reform program to significantly improve the country's low tax ratio. Measures include (i) undertaking publicity campaigns to induce voluntary tax registration and compliance; (ii) forming special tribunals for speedy resolution of income tax, customs duty, and VAT-related cases; (iii) automating tax and tariff administration more fully; (iv) ensuring timely deposits through regular monitoring of taxes and tariffs collected at the source; (v) reducing tax and tariff exemptions; (vi) ensuring corporate responsibility by reconsidering tax relief for the corporate tax; (vii) making special efforts to reduce the inherent weaknesses of VAT administration; (viii) separating tax administration from policy making; (ix) updating the income tax, VAT, and customs acts; (x) increasing human resources in National Board of Revenue and the departments under it; (xi) expanding the tax administration structure up to the *upazila* (sub-district) level, with the objective of providing local tax services; (xii) introducing one-stop services to taxpayers; (xiii) expanding the tax base and strengthening tax collection; (xiv) implementing a system for installment payments; and (xv) simplifying tax returns and tax payment procedure, and introducing online payment of taxes.

23. Current expenditures during the first 7 months of FY2009 rose 15.1% over the same period of FY2008. This is well below the budget target of 19.5%. The major

expenditure accounts are interest (19.8%), followed by education (17.7%), general public services (14.6%), agriculture (11.5%), defense (8.8%), and public order and safety (8.6%). ADP utilization remains dismal with only 41% of the total FY2009 allocation spent during the first 9 months of FY2009 (Figure 12). In view of the under performance, the Government in its revision exercise in April 2009 reduced the ADP by 10%. In the context of the global economic crisis, aggregate demand must be enhanced and ADP implementation sped up. In particular, ADP projects should be reprioritized with added emphasis on those that enhance long-term growth prospects. Projects with higher linkage effects should receive priority. Bangladesh needs to improve ADP utilization by addressing capacity constraints and improving institutional coordination among concerned agencies.



24. In announcing the stimulus package, the finance minister outlined immediate measures to be undertaken to enhance ADP implementation. These include instructing the Planning Commission and Implementation, Monitoring, and Evaluation Division to take administrative actions for implementing the ADP, and the 10 ministries responsible for 90% of the ADP to advance procurement planning for proper implementation. To avoid delays and complications in the project approval process, an initiative was started to examine the whole process and to implement the new measures from the beginning of the coming fiscal year. In addition, a review to determine whether the procurement process is a hurdle to ADP implementation is already under way. Further, relevant ministries have been instructed for regular monitoring and evaluation of ADP implementation progress. However, further institutional reforms are needed to address capacity constraints for ADP implementation and improve ADP quality.

25. The fiscal deficit during July–February of FY2009 was Tk143.0 billion, slightly lower than Tk143.7 billion in the corresponding period of the previous fiscal year. Domestic financing remains dominant with Tk92.7 billion, or 54.5% of the FY2009 domestic financing target. Only 37.0% of the foreign financing target was realized, implying deterioration in aid absorption, indicating a shortfall in implementation of foreign-aided projects in the ADP. During the first 8 months of FY2009, the budget deficit at 2.3% of GDP remains well below the budget target.

Monetary and Financial Developments

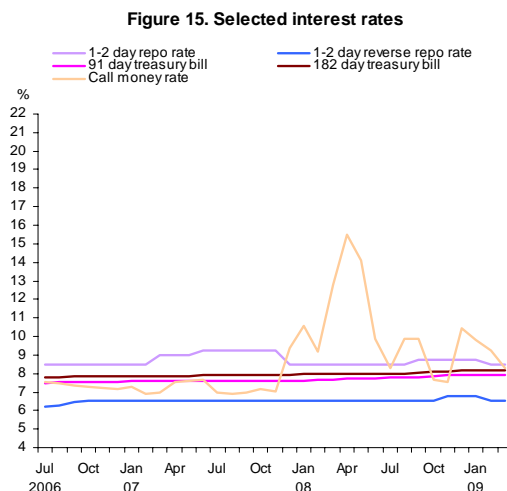
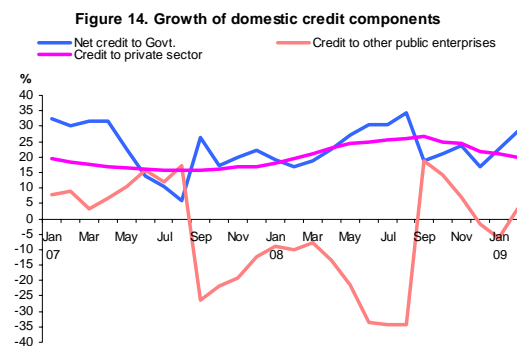
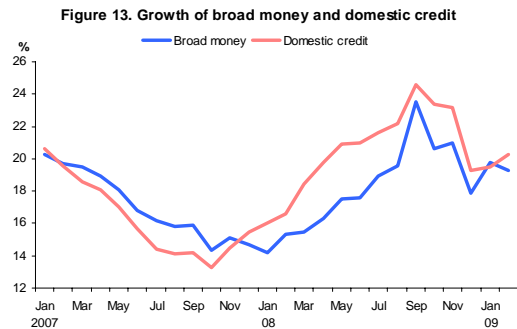
26. Bangladesh Bank continued to pursue an accommodative monetary policy aimed at steady flows of

credit to the economy's productive sectors, while avoiding stoking inflationary pressures. On a year-on-year basis, in September 2008, broad money growth reached 23.5% with private sector credit growth of 26.6%. However, since October 2008, responding to Bangladesh Bank's attempted monetary tightening (repo rate in September 2008 and reverse repo rate in November 2008 were raised by 25 basis points each), growth of broad money (20.6%) and private sector credit (24.7%) started to abate, slowing to 19.3% and 19.8%, respectively, in February 2009. However, the rates were higher than the growth rates of 15.3% and 19.4% in February 2008. This expansion in broad money was driven by high growth in domestic credit (20.3%), while growth in net foreign assets (3.3%) moderated despite large purchases of foreign exchange by Bangladesh Bank. On the other hand, the relatively high growth in private sector credit was due to the expansion of credit and advances by private commercial banks for trade, industry, and consumer credit. Net credit to Government grew 28.1% year-on-year in February 2009 because of lower growth in revenue earnings compared with growth of 16.7% in the previous year (Figures 13 and 14).

27. Reserve money grew rapidly by 22.9% year-on-year in February 2009, up from 9.4% in February 2008, caused by a sharp rise in net domestic assets (up 51.8%) due to increased government borrowing from Bangladesh Bank. The reserve money multiplier declined marginally to 4.7 at the end of February 2009 from 4.9 at the end of February 2008. The outstanding stock of government treasury bills (T-bills), bonds, and national savings directorate certificates stood at Tk481.8 billion at the end of February 2009, up from Tk451.7 billion the previous year.

28. Bangladesh Bank continues to adjust its policy rates and conducts regular auctions of its 182-day and 364-day T-bills, with yields declining moderately to achieve the twin goals of supporting growth while containing inflation within tolerable levels, although the auction of shorter duration 28-day (since July 2008) T-bills remains suspended. To sustain growth and mitigate the impact of the global economic recession, in March 2009 Bangladesh Bank cut its interest rates on repos (1–2 day tenure) and reverse repos by 25 basis points (Figure 15). While repo rates fell for the first time since September 2008 to 8.5% from 8.8%, reverse repo rates also fell to 6.5% from 6.8%.

29. Responding to the lower repo and reverse repo rates, interest rates on T-bills declined, indicating excess liquidity in the banking system. The weighted average yield on 91-day T-bills declined from 7.9% in December 2008 to



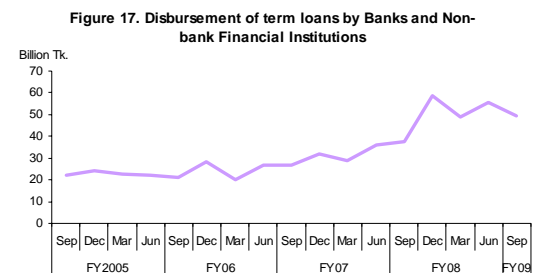
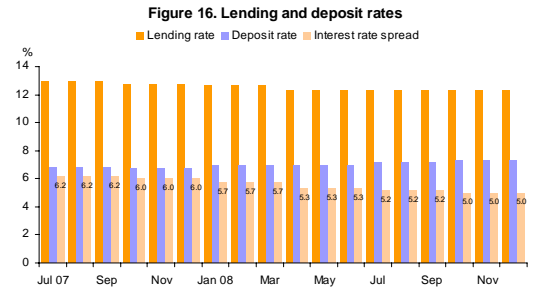
5.0% in April 2009, and yields on 182-day T-bills declined from 8.2% in December 2008 to 7.5% in April 2009. The yields on 364-day T-bills also dropped from 8.6% in December 2008 to 8.3% in April 2009. The yield on 5-year Bangladesh Government Treasury Bonds fell to 9.9% in April from 10.6% in March 2009.

30. Interbank call money rates declined in recent months, from 10.4% in December 2008 to 9.8% in January 2009 and to 8.3% in March 2009. The rate reached a record low of 2.1% in April, indicating excess liquidity in the banking system, partly due to the reluctance of Bangladesh Bank to withdraw cash from the market. The purchase of foreign exchange by Bangladesh Bank from commercial banks injected fresh liquidity into the market.

31. Weighted average lending rates continued to fall, reaching 12.3% at the end of December 2008. However, weighted average deposit rates rose to 7.3% in December 2008 from 7.2% in September; they are expected to turn positive in real terms as inflation continues to decelerate. The interest rate spread narrowed from 6.0% in December 2007 to 5.0% in December 2008 (Figure 16), indicating banks' efforts to lower the spread under Bangladesh Bank guidance and mobilize savings to meet rising credit demand through lower interest rates. In the wake of the low inflation outlook and the ongoing global recession, Bangladesh Bank issued a directive on 19 April to reset the lending rate ceiling of commercial banks at 13% to support agriculture, large and medium-sized industries, housing, and trade financing. In a subsequent directive on 5 May, Bangladesh Bank set a ceiling of 12% for financing imports L/Cs of eight essential food items: edible oil (crude and refined), chick-peas, lentils, beans, onions, spices, dates, and fruits to keeping prices of essentials at reasonable levels during the forthcoming Ramadan.

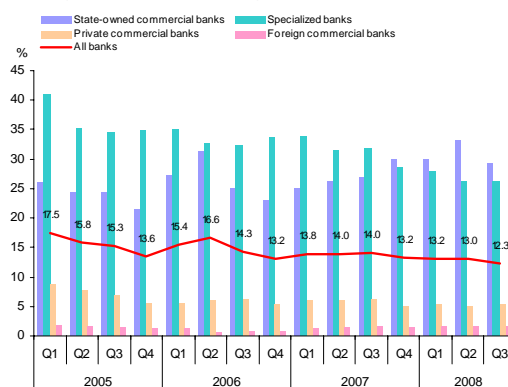
32. The disbursement of industrial term loans in the first half of FY2009 declined by 7.5% over the first half of FY2008 (Figure 17). However, banks are complying with Bangladesh Bank's instruction to raise the share of advances to agriculture. About Tk93.8 billion is programmed for disbursement as fresh agricultural credit in FY2009, of which Tk69.1 billion (73.7% of total target) has already been disbursed through the third quarter, a growth of 9.4%. The banking system also has increased its focus on loans to SMEs, which stood at Tk434.4 billion at the end of December 2008, up 42.0% over December 2007.

33. After introducing the BASEL-II capital adequacy requirement for banks in January 2009, Bangladesh Bank



decided to form a committee to implement the BASEL-II standard in nonbank financial institutions (NBFIs). Such an initiative would ensure that NBFIs follow core risk management and corporate governance guidelines. Bangladesh Bank also issued a guideline allowing NBFIs to borrow foreign currency from international sources, which they can onlend only to manufacturers and for infrastructure (except housing). The initiative aims to help NBFIs reduce the cost of funds and enable them to provide loans at lower interest rates. The high nonperforming loan ratio of the state-owned commercial banks (SCBs) (29.3% in September 2008) is a matter of concern (Figure 18). However, in 2008, the four SCBs recovered about 87.8% of their default loans (Tk10.8 billion of Tk12.3 billion). Based on this development, Bangladesh Bank relaxed the ceiling of single borrower exposure limits (from an average of 5.0% to 10% of paid-up capital) for four SCBs to meet the growing demand for corporate loans, and permitted them to raise annual credit growth to 10% from the existing 5.0%.

Figure 18. Gross nonperforming loan ratios by type of bank

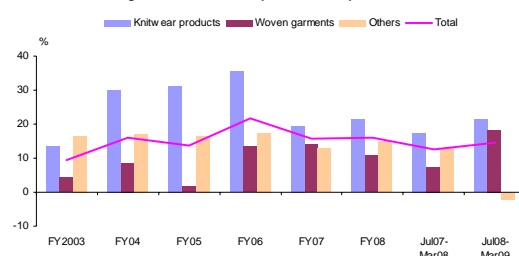


34. Given the increasing demand for housing loans, Bangladesh Bank increased its refinancing fund for its low-interest-bearing facility to Tk5.0 billion from the existing Tk3.0 billion.

Balance of Payments

35. Growth of export earnings has been decelerating steadily as FY2009 unfolds, falling from 42.4% during the first quarter, to 19.4% during the first half, and to 14.5% during the first 9 months of FY2009 (Figure 19), indicating erosion of demand for Bangladesh's export products. Among the main categories, exports of primary products declined 14.7%, while exports of manufactured products rose 16.9%. During July–March of FY2009, exports of woven garments rose 18.4% and knitwear 21.4%, declining from 21.0% and 27.1%, respectively, during July–December of FY2009. Growth in the overall export volume index declined to 14.3% through March 2009 from 15.4% in December 2008 and 34.7% in September 2008. For primary commodity exports, the volume index declined by 9.8% and the price index by 4.9%, while for manufactured products, they declined by 16.4% and 0.5%.

Figure 19. Growth in exports and components



36. The merchandise export target for FY2009 is set at \$16.3 billion, which implies annual growth of 15.5%. By the third quarter of FY2009, export earnings were \$11.6 billion, 1.5% lower than the target for the period, indicating a likely shortfall compared with the target, mainly due to the declining growth trend of RMG export earnings. Although

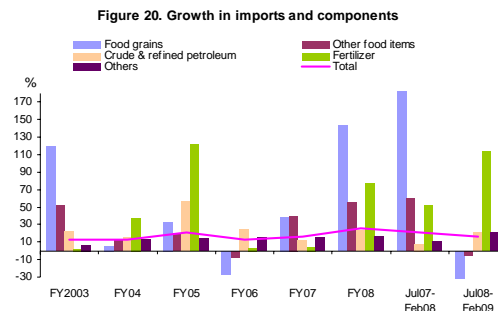
growth of RMG exports is still robust, the rate is declining sharply—from 44.6% in the first quarter of FY2009 to 24.2% in the first half and to 19.9% in July–March. Falling retail sales in developed economies such as the United States are slowing garment export orders and translating into shrinking profit margins for Bangladeshi exporters through price reductions.

37. The export of primary products will likely fail to attain annual targets in FY2009 as export earnings from primary products were 29.0% lower than the target during July–March of FY2009. Exports of raw jute, jute goods, and leather are also declining sharply and are unlikely to attain their annual targets. Export earnings from raw jute declined by 19.6% and from jute goods by 18.0% in July–March of FY2009. The Government, in the April 2009 stimulus package, raised the cash subsidy for export of jute goods from 7.5% to 10.0% for April–June FY2009. Exports of leather items also declined by 34.6% until the third quarter, due to lower demand for finished leather and leather goods in the international market. The 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 April, the Government raised the cash subsidy for the export of leather and leather products from 15.0% to 17.5% for the current fiscal year. Export earnings from frozen foods declined by 13.0% in July–March of FY2009, justifying enhancement of the cash subsidy for export of frozen shrimp and other fishes from 7.5% to 10.0%.

38. With the advantage of lower labor costs and a shift to automated production systems, Bangladeshi RMG exporters could still compete for their major export items in the world market and expand export earnings with the support from the Government. In addition to the financial stimulus announced by the Government in April 2009, Bangladesh Bank relaxed rules allowing a loan rescheduling facility without any down payment for 6 months for five export-oriented sectors: frozen foods, jute, leather, textiles (including spinning), and RMG, which are at risk of defaulting on loan repayments because of the global economic recession. The size of the Export Development Fund was increased to \$150 million from \$100 million, and the single borrower limit enhanced to \$1.5 million from \$1.0 million. The scope of export credit at concessional rates (7.0%) will be expanded to all export items.

39. Import payments during the first 8 months of FY2009 rose by 16.3% over the same period of FY2008

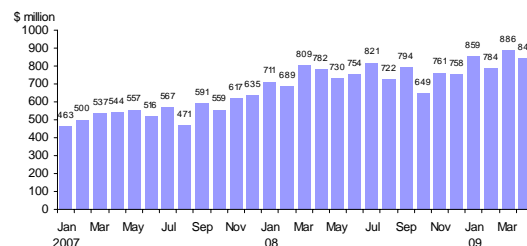
(Figure 20). Import payments for food items fell dramatically (minus 40.2%), mainly due to lower international food and fuel prices and good domestic harvests of agricultural commodities. However, import payments for consumer and intermediate goods showed robust growth of 23.8% during this period, led by high imports of fuel, chemicals, fertilizer, yarn, and raw cotton. The decline (minus 12.4%) in capital machinery imports remains a concern for the country's investment outlook.



40. The total value of L/Cs opened through the third quarter of FY2009 declined by 6.1% from the corresponding period of FY2008, due to a fall in commodity prices and caution exercised by importers in opening any new L/Cs given falling prices in the international market. The L/Cs for imports of consumer goods declined by 43.8% through the third quarter of FY2009 because of higher domestic food-grain production and adequate stocks of food and consumer items. Those for intermediate goods (24.8%) rose considerably. L/C opening for capital machinery fell by 31.5%, indicating a near-term decline in investment. The cancellation rate of L/Cs for import also escalated in recent months. This is due to the emergence of a large number of unviable projects that were previously thought feasible, impacts of the ongoing global recession, and failure to supply commodities on time.

41. According to the Outlook for Remittance Flows 2008–2010 of the World Bank, Bangladesh ranks among the top 10 recipients of remittances for developing countries in 2008. Remittance inflows continue to exhibit robust growth in FY2009, with an expansion of 22.7% during July–April of FY2009 over the same period of the preceding fiscal year (Figure 21). However, the monthly growth rates of remittance inflows have been decelerating as FY2009 progresses, falling from 34.5% in September 2008 to 19.3% in December 2008, and to 9.7% in April 2009. This is due to the adverse impact of the current global crisis on advanced economies as well as the Middle East, and consequently, a slower outflow of workers to those countries. International employment therefore continues to fall in FY2009, declining by 29.3% in the first 10 months over the corresponding period of FY2008. The trend has been more pronounced in recent months as international employment declined by 42.9% in the first 4 months of 2009 over the corresponding period of 2008.

Figure 21. Workers' Remittances



42. Efforts to raise remittances continue as the Government encourages more workers to go to countries with job opportunities hitherto not fully explored. For example, Libya has opened up to foreign workers again

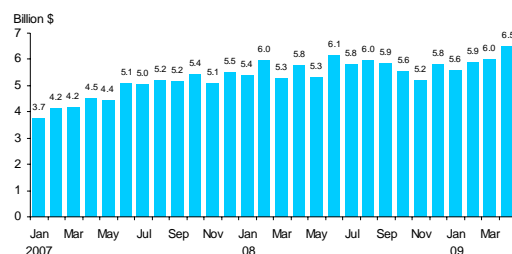
after a lengthy closure that could provide opportunities for Bangladesh's low-skilled workers to find employment in construction and the oil and gas sectors. Bangladesh Bank has taken steps to increase the flow of remittances through official channels such as commercial banks by providing better customer service. It is also exploring how nongovernment organizations and mobile phone companies could be used to increase remittance transfers. The Government offers special facilities to nonresident Bangladeshis who send \$5,000 and more per annum. The Government is also planning to start an expatriate bank with provisions to provide loans to labor migrants.

43. In spite of the global economic slowdown, net FDI inflows in July-February of FY2009 were \$851 million, an increase of 90.8% over the same period of FY2008. The FDI inflows in the first 8 months in FY2009 are 30.9% (\$201 million) higher than total FDI inflows in FY2008. Some investors from Asia, including the People's Republic of China, are relocating their production units to Bangladesh due to its abundant cheap labor. Bangladesh may attract more FDI if the power situation can be improved and an investment-friendly environment created. During July-February FY2009, foreign aid remained sizeable at \$1.1 billion, only 3.6% lower than the amount received during the same period of FY2008, despite the slow ADP implementation. However, net foreign assistance (total aid less principal payment) stood at \$732.0 million in July-February of FY2009, a decline of 11.1% from the corresponding period of FY2008.

44. The trade deficit widened to \$3.6 billion in the first 8 months of FY2009, up from \$3.1 billion in the corresponding period of FY2008 due to slower growth of export earnings compared with import payments. Despite the higher deficits in trade, services, and income payments, robust growth (27.0%) in remittances during this period led to a large current account surplus of \$816 million, up by \$299 million over the same period in FY2008. As a result, the overall balance of payments showed a surplus of \$773 million in July-February of FY2009 against a surplus of \$310 million in FY2008. A surplus of \$127 million in the capital and financial account also contributed. However, the deficit in trade credits edged up to \$991 million during July-February of FY2009, from a \$733 million deficit in FY2008, due to higher excess of shipments over actual receipts from exports as some buyers of Bangladeshi products were unable to make timely payments.

45. Gross foreign exchange reserves stood at \$6.5 billion at the end of April 2009, up from \$6.1 billion at the end of June 2008 (Figure 22). The still robust growth of remittance inflows and the continued disbursement of foreign aid contributed to the higher foreign exchange reserves, among other factors, and underpinned a healthy balance of payments situation, allowing Bangladesh Bank to continue buying foreign currency from the market.

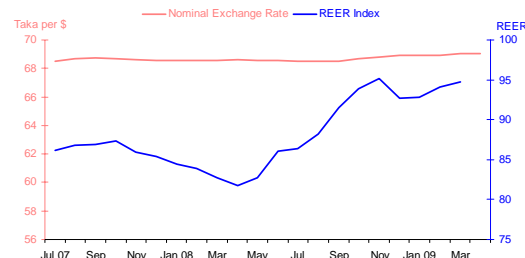
Figure 22. Gross foreign exchange reserves



Exchange Rate

46. The weighted average nominal exchange rate (taka/dollar) remained mostly stable at Tk68.9–Tk69.0:\$1 during the third quarter of FY2009 (Figure 23), reflecting the healthy foreign reserve position. Bangladesh Bank continues to intervene in the interbank foreign exchange market, purchasing about \$1.0 billion from the commercial banks during 15 January–17 May to keep the market stable. This is due to the increased accumulation of foreign exchange in commercial banks because of falling trends in opening of import L/Cs. Moreover, Bangladesh Bank has been buying foreign currency from commercial banks to help them comply with the net open position rules on holding foreign exchange. During July–March of FY2009, the nominal effective exchange rate index appreciated by 9.9% and real effective exchange rate index by 9.7%, implying modest erosion in export competitiveness.

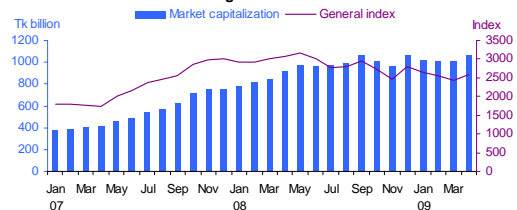
Figure 23: Nominal exchange rate (Taka-Dollar) and REER index



Capital Market

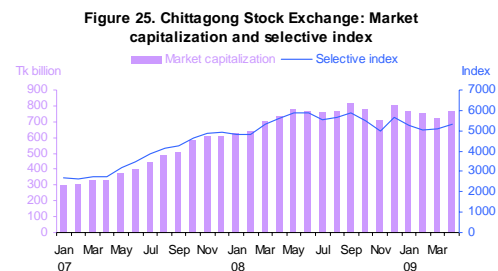
47. The major stock market indicators continued to show a volatile trend through the third quarter of FY2009. After bouncing back in December 2008 from a 13-month low in November 2008, the Dhaka Stock Exchange (DSE) general index fell again in January 2009. The DSE general index reached 2,446.9 points at the end of March 2009, near a 20-month low, before climbing back to 2,591.4 points in April 2009, still 15.7% below April 2008 (Figure 24). DSE market capitalization reached Tk1,062.4 billion by the end of April 2009, up by 0.3% from December 2008. The low growth of market capitalization is due to the underperformance of bank stocks, about 28.0% of total market capitalization, which declined by 16.0% from October 2008.

Figure 24. Dhaka Stock Exchange: Market capitalization and general Index



48. Similarly, the Chittagong Stock Exchange (CSE) selective categories index declined sharply in January 2009 (7.0%) after a rise in December 2008 (14.6%) from the previous month. However, the CSE selective categories index increased by 0.9% reaching 5,102.8 in March 2009, an almost 13-month low, before climbing by

4.8% to 5,347.9 in April 2009 (Figure 25). The market capitalization of the CSE dropped by 4.3% between December 2008 and April 2009. Moreover, outflows in portfolio investment reached \$76 million during July–February of FY2009, compared with \$70 million inflows during the same period of FY2008, raising concerns about the prospects for foreign investment in the capital market. Four new companies were listed in the capital market during January–May 2009.



49. The Securities and Exchange Commission (SEC) is introducing new sets of measures to increase the flow of funds into the capital market. The measures include enhancing the margin–loan ratio provided by brokers to clients, increasing the capacity of financial institutions to provide loans to brokers, and issuing more licenses to merchant banks. SEC issued merchant banking licenses to four commercial banks to increase liquidity flows in the capital market. The four banks are two SCBs—Sonali Bank Limited and Agrani Bank Limited—and two private commercial banks—Southeast Bank Limited and Standard Bank Limited. With these four new banks, a total of 33 merchant banks are listed in the stock market. SEC also amended a rule specifying that merchant banks must build up five additional portfolios every year besides managing their own portfolios in order to net more clients and improve funds flow to the market.

50. To attract big issues to the stock market, SEC approved rules for a book-building system for initial public offer (IPO) pricing of companies that either offer at least a 10% share of their paid-up capital or shares valued above Tk300 million. Under this new system, the price of an IPO share will be determined through automated bidding to be participated in by different financial institutions, then the share will be opened for IPO participation at the given rate. The system expects to attract national and multinational companies, which want competitive pricing of their IPOs. The launch of mutual funds of six leasing companies worth Tk1,300 million is also being processed, subject to SEC approval. The companies are Phoenix Finance and Investment Ltd, International Leasing Financial Services, Union Capital, Uttara Finance, People's Leasing and Financial Services Ltd, and Islamic Finance and Investment Ltd.

51. The volatility of transactions in the stock markets remains a concern for overall capital market development. Liquidity declined sharply and a few companies captured large shares of total market capitalization. To boost the stock market, higher investment must be elicited from institutional investors, especially financial institutions with adequate liquidity; strong surveillance must be ongoing; and investor confidence built through proactive measures of the regulatory authority.

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ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two thirds of the world's poor. Around 903 million people in the region live on \$1.25 or less a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.