Overseas Development Institute

Global Financial Crisis Discussion Series

Paper 1: Bangladesh

Mustafizur Rahman, Debapriya Bhattacharya, Md Ashiq Iqbal, Towfiqul Islam Khan and Tapas Kumar Paul

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Overseas Development Institute
111 Westminster Bridge Road
London SE1 7JD

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1 This study was prepared by researchers at the Centre for Policy Dialogue (CPD), House 40C, Road 11, Dhanmondi R/A, Dhaka-1209, Tel: 9141734, 9141703, 9145090; Fax: 8130951; email: info@cpd.org.bd; website: www.cpd.org.bd. This study is part of a wider research project coordinated by the Overseas Development Institute (ODI) London and supported by the UK Department for International Development (DFID) and the Dutch Ministry of Foreign Affairs, but it does not necessarily reflect their views.

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Acronyms

ADB	Asian Development Bank
ADP	Annual Development Programme
AIDS	Acquired Immunodeficiency Syndrome
ASEAN	Association of Southeast Asian Nations
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BFLLFEA	Bangladesh Finished Leather, Leather Goods and Footwear Exporters Association
BGMEA	Bangladesh Garments Manufacturers and Exporters Association
BKMEA	Bangladesh Knitwear Manufacturers and Exporters Association
BMET	Bureau of Manpower, Employment and Training
BoI	Board of Investment
BoP	Balance of Payments
BPC	Bangladesh Petroleum Corporation
BSTI	Bangladesh Standards and Testing Institution
BTA	Bangladesh Tanners Association
CCS	Cash Compensation Scheme
CIB	Credit Information Bureau
CPD	Centre for Policy Dialogue
CRR	Cash Reserve Requirement
CTG	Caretaker Government
DFI	Development Finance Institution
DSE	Dhaka Stock Exchange
EEF	Equity and Entrepreneurship Fund
EIU	Economist Intelligence Unit
EPB	Export Promotion Bureau
EPZ	Export Processing Zone
EU	European Union
FBCCI	Federation of Bangladesh Chambers of Commerce and Industry
FCB	Foreign Commercial Bank
FDI	Foreign Direct Investment
fob	Free on Board
FY	Financial Year
GDP	Gross Domestic Product
GNI	Gross National Income
ILO	International Labour Organization
IMF	International Monetary Fund
IRBD	Independent Review of Bangladesh’s Development
L/C	Letter of Credit
LDC	Least-developed Country
M2	Broad Money
MCA	Millennium Challenge Account
MCCI	Metropolitan Chamber of Commerce and Industry
MDG	Millennium Development Goal
MFD	Manufactured Products
MoF	Ministry of Finance
MoP	Muriate of Potash
MTMF	Medium Term Macroeconomic Framework
NBR	National Board of Revenue
ODA	Official Development Assistance
PCB	Private Commercial Bank
PDB	Power Development Board

PFI	Portfolio Investment
POL	Petroleum, Oil and Lubricants
PRSP	Poverty Reduction Strategy Paper
QIP	Quantum Index of Production
REER	Real Effective Exchange Rate
RMG	Readymade Garments
SCB	State-owned Commercial Bank
SLR	Statutory Liquidity Ratio
SME	Small and Medium-sized Enterprises
UAE	United Arab Emirates
UD	Utilisation Declaration
UK	United Kingdom
US	United States
USITC	US International Trade Commission
VAT	Value Added Tax
VGD	Vulnerable Group Development
VGF	Vulnerable Group Feeding
WEO	World Economic Outlook (IMF)

Abstract

The global financial crisis has already started to have a negative impact on the increasingly globalising economy of Bangladesh. The export growth rate has slowed in recent times, particularly during the October 2008 to January 2009 period – indeed, the second quarter of FY2008/09 (October-December 2008) experienced a first-time negative growth of Bangladesh's export in recent history; export of non-apparels items has seen significant deceleration in growth. Depreciation of currencies by competing countries ranging from 6% to 30% over the past one year and their stimulus packages that provide wide-ranging incentives to export-oriented sectors have led to erosion of Bangladesh's competitive strength in the global market in recent times. Remittance earnings, although robust until now, could be adversely affected in the near future: the number of job seekers leaving in January and February 2009 halved compared with the same period of 2008. Some countries (such as Malaysia) have revoked earlier job contracts and yet others have stopped issuing new visas (Saudi Arabia, United Arab Emirates – UAE).

The resultant adverse effects are likely to have negative implications for gross domestic product (GDP) growth, labour markets and consequently the attainment of poverty alleviation targets and the Millennium Development Goals (MDGs) by Bangladesh. In view of falling commodity prices, import-dependent domestic revenue mobilisation has suffered in recent months. Proxy indicators such as industrial output, import of capital machineries, letters of credit (L/Cs) opened for industrial raw materials and term loan disbursement, when taken together, allude to signs of weakening macroeconomic performance.

In view of these emerging disquieting signals, it is argued here that it will be both timely and appropriate for Bangladesh to design her own stimulus package. It is reckoned that in the context of falling commodity prices in the global market and the resultant low subsidy burden on account of fertiliser and fuel, some fiscal space will be created in this year's budget which could provide additional resources for the stimulus package. This is a time to infuse confidence and inject cash into the economy. Policymakers may consider pursuing a moderately expansionary monetary policy to stimulate domestic investment and domestic demand, providing fiscal incentives and stimuli to incentivise export-oriented sectors and injecting cash to enhance coverage and deepen entitlement under the various safety net programmes, so that Bangladesh remains on track with regard to poverty alleviation and MDG attainment. The paper argues that such measures could be time-bound in nature but fine-tuned in response to the emerging scenario. Such a stimulus package could include a sector-specific cash subsidy scheme; tariff rationalisation, particularly for industrial inputs and capital machineries; setting-up of a dedicated fund for credit disbursement at reduced rate; establishing a technology upgradation fund; compensation against export earnings; a special package for exports to new markets; and a dedicated fund for skill upgradation of migrant workers.

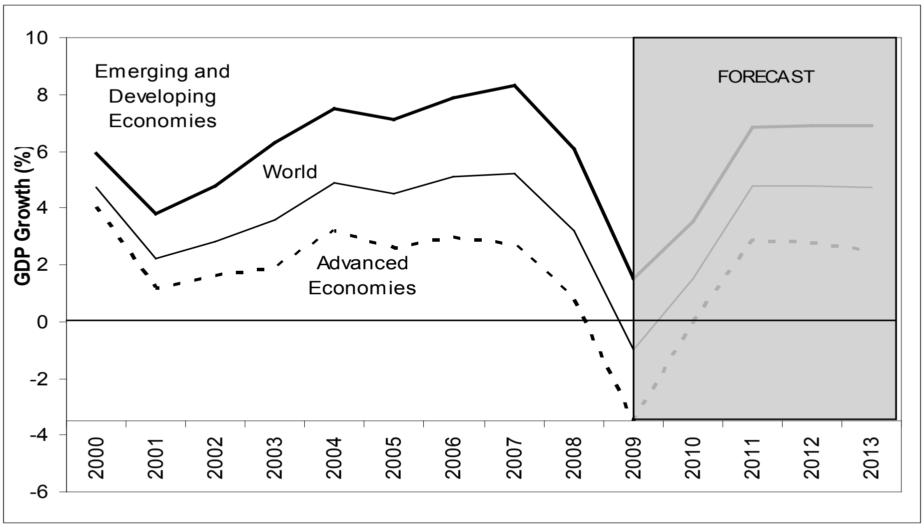
1. Introduction

1.1 Nature of the crisis

Developing countries, particularly low-income countries such as Bangladesh, in view of the adverse impacts and consequences of the ongoing global economic crisis, have been confronted with a number of critical challenges, particularly in the area of macroeconomic management. Hardly any country has been immune to a global shock of such wide and deep scale. Indeed, the scenario is still continuing to develop and unravel, requiring countries to design and adjust their strategies accordingly. All projections, from various sources, give clear indications that the global economic meltdown, which started in 2008, is likely to continue and further deepen in 2009 (Table 1). The financial crisis, which developed into liquidity and solvency crises, has afflicted the real economy and has now degenerated into an economic crisis of global scale, hurting growth, job and income to varying degrees. Countries that did not feel the impact of the first shockwave originating from the financial crisis are now being impacted adversely by the second wave (through impact on credit) and third wave (through impact on real economy). The International Monetary Fund (IMF) analysis published in March 2009 (IMF, 2009a) portrayed a bleak picture of global economic growth for 2009, with the situation improving only in the next year (-1.0 to -0.5% in 2009 and 1.5 to 2.5% in 2010).[2] Although the US and the Euro area, two major economies, registered lower but positive growth in 2008 (1.1% and 0.9%, respectively), both were likely to experience negative growth in 2009 (-2.6% and -3.2%, respectively), before they start to pick up in 2010.[3] It is to be noted that the US registered significant negative growth of -6.2% in the fourth quarter (Q4) of 2008.

Whether L, V or U shaped,[4] the downturns observed in developed countries have started progressively to affect advanced and subsequently emerging, developing and low-income economies (Figure 1). Economic growth of Middle East countries was likely to be 3.9% in 2009, about 2.2% lower compared with 2008, mainly as a consequence of lower crude oil prices, drying up of foreign capital and declining demand for the region's energy-intensive industrial and building materials (Gulf Finance House, 2009).

Figure 1: Achieved and forecast growth for the world, advanced economies and emerging and developing economies, 2000-2013 (% of GDP)



Source: Created from IMF World Economic Outlook (WEO), various issues.

2 Indeed, a recent World Bank projection maintains that the world economy will experience negative growth in 2009 for the first time since World War II.
3 Within the European Union (EU), all major economies registered a low level of growth in 2008 and were likely to face negative growth in 2009: Germany (1.7% and -0.80%), the UK (0.8% and -1.3%) and Italy (-0.2% and -0.6%).
4 A prolonged recession, a recession that reaches the bottom line soon and the economy picks up or a recession that runs for one to two years before the global economy sees an upturn.

Table 1: Growth projections for major economies, 2007-2010 (% of GDP)

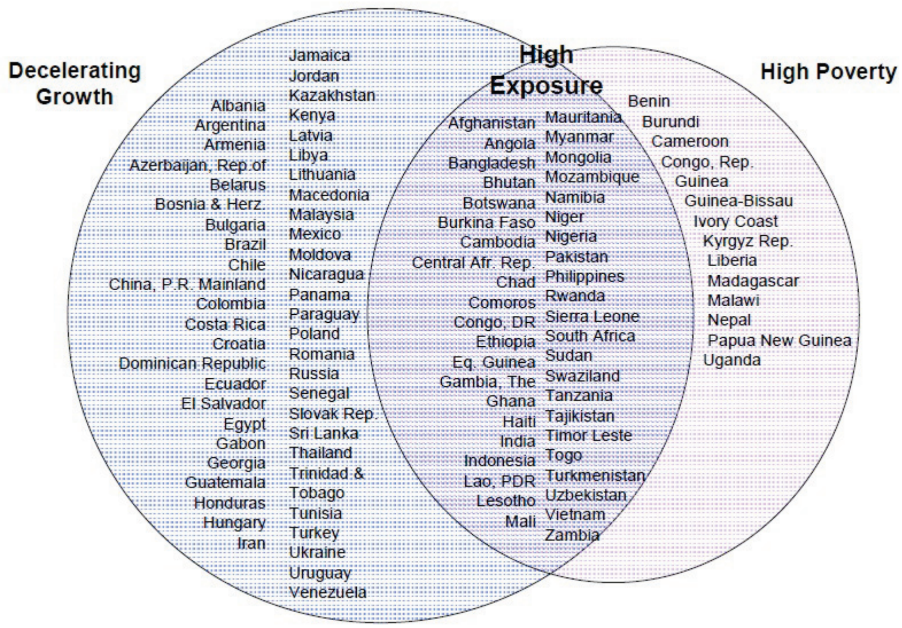
	Actual 2007	Actual 2008	January 2009 report		March 2009 analysis	
			2009	2010	2009	2010
World output	5.2	3.4	0.5	3	-1.0 to -0.5	1.5 to 2.5
US	2	1.1	-1.6	1.6	-2.6	0.2
Euro area	2.6	1	-2	0.2	-3.2	0.1
Germany	2.5	1.3	-2.5	0.1	--	--
France	2.2	0.8	-1.9	0.7	--	--
Italy	1.5	-0.6	-2.1	-0.1	--	--
UK	3	0.7	-2.8	0.2	--	--
Middle East	6.4	6.1	3.9	4.7	--	--
China	13	9	6.7	8	--	--
India	9.3	7.3	5.1	6.5	--	--

Source: IMF WEO updates (various).

According to the January report, Southeast Asian major economies were expected to experience slower economic growth in 2009 compared with that in 2008: Malaysia (from 5.8% in 2008 to 4.8% in 2009), and Singapore (3.6% to 3.5%). Economic growth in China and India was also expected to decline in 2009 (to 6.7% and 5.1%, respectively). Least-developed countries (LDCs) are likely to experience a 5.1% growth in 2009 against the 6.4% attained in 2008 (UN, 2009). Recovery was likely to start only in the second half of 2010, according to some projections; some analysts have projected that the upturn will kick off only in early 2011, much of it depending on how the stimulus packages actually work on the ground.[5]

According to a recent policy note prepared by the World Bank (2009), the global economic crisis is exposing households in virtually all developing countries to increased risk of poverty and hardship (Figure 2). Almost 40% of developing countries are highly exposed to the poverty effects of the crisis (with both declining growth rates and high poverty levels) and an additional 56% are moderately exposed (these face either decelerating growth or high poverty levels). Only less than 10% face little risk.

Figure 2: Exposed countries



Source: World Bank (2009).

5 Professor Nuriel Rubini, one of the very few who saw it all coming and who predicted an ensuing crisis back in 2006 (gaining him 'notoriety' as 'Mr Doomsday'), predicts that the recession could as well be an 'L-shaped one' (meaning a prolonged recession) instead of an 'U-shaped one' (quick recovery), depending on the efficacy of the bailout packages of developed countries to stimulate their economies.

It is to be noted that this particular report places Bangladesh in the group of countries that are highly exposed to the poverty effects of the crisis (with both declining growth rates and high poverty levels).

Some of the general features of the ongoing economic crisis can be summarised in the following manner: i) the crisis comes on the back of a sharp fall in commodity prices; ii) the crisis has evolved from financial crisis to credit contraction to crisis of confidence; iii) global financial markets continue to remain volatile; iv) global imbalances are unwinding in a disorderly fashion, heightening the risk of exchange rate volatility; v) unemployment is increasing worldwide at an alarming pace; vi) many countries have seen their fiscal position deteriorate significantly; vii) crisis-driven countries are trying to cope with the emergent situation through various fiscal monetary measures and stimulus packages. Indeed, what started as a crisis in the sub-prime housing market in the US soon took the shape of systemic failure.

1.2 The Bangladesh context

The Bangladeshi economy has become increasingly integrated with the global economy over recent years, through trade, remittance flows and, in some measure, flows of foreign direct investment (FDI) and portfolio investment (PFI). Export value addition accounts for 9% of gross domestic product (GDP), with remittances equivalent to 11% of GDP.[6] The degree of openness of the Bangladeshi economy was about 43.4% towards the end of FY2007/08,[7] with the extent of globalisation equivalent to 56.6% of GDP.[8] Net exports account for about 10% of GDP and net exports and remittances are equivalent to 20% of gross national income (GNI) (Table 2). About 85% of Bangladesh's exports[9] are destined for developed economies, and about 60% of her imports[10] are sourced from those countries. If India, China[11] and other emerging economies are taken into consideration, the extent of exposure of the Bangladeshi economy to crisis-driven developed and developing economies will be quite significant.

Table 2: Bangladesh's degree of openness and extent of globalisation, FY1980/81-FY2007/08 (US$m)

	FY1980/81	FY1990/91	FY2000/01	FY2006/07	FY2007/08
1. Export (X)	725	1718	6467	12,154	140,88
2. Import (M)	1954	3472	9335	17157	20,217
3. Remittance (R)	379	764	1882	5978	7915
4. ODA disbursed	1146	1733	1369	1565	1873
5. FDI (net)	NA	24	550	793	650
Total (1-5)	4204.0	7710.5	19,603.4	37,646.3	44,743.8
GDP (current price)	19,811.6	30,974.8	47,306.0	67,714.0	78,996.9
Degree of openness (X + M as % of GDP)	13.5	16.8	33.4	43.3	43.4
Extent of globalisation	21.2	24.9	41.4	55.6	56.6

Source: CPD IRBD database 2009.

Consequently, it is to be expected that the increasingly globalising economy of Bangladesh will not be able to avoid being affected by the global crisis, through various transmission mechanisms. However, projections with regard to Bangladesh's GDP growth tend to vary (Table 3). Bangladesh Bank (BB, 2009a) earlier reconfirmed GDP projections made in the national budget for FY2008/09 (6.5% growth), which was subsequently revised downward (6.0%). The January 2009 policy statement of the central bank (BB, 2009a) mentions a high case of 6.6% and a low case of 6.3%. The World Bank (2008) has come up with two alternate scenarios: under the best case scenario, Bangladesh's GDP will grow by

6 The share of the industrial sector in Bangladesh's GDP is about 30%, that of agriculture is 20% and that of services is 50%.
7 Share of export and import in GDP.
8 Share of all types of external flows in GDP.
9 Mainly apparels, and also frozen food, textiles, leather and footwear.
10 Capital machineries, industrial raw materials, chemicals.
11 Major imports are fabrics, agricultural products, machineries, industrial inputs.

5.4%; under the worst case scenario, GDP growth could come down to 4.8%. The Asian Development Bank (ADB), in its December 2008 issue of Quarterly Economic Outlook on Bangladesh, projected the growth rate to range between 5.5% and 6.0%.[12] It might be pointed out that most of these projections were not based on real time data.

Table 3: GDP growth projections for Bangladesh for FY2008/09 (% of GDP)

	GDP growth (%)	
BB Monetary Policy Statement	6.5 (high case 6.6%; low case 6.3%)	
IMF	5.6	
World Bank[2]	Scenario 1	Scenario 2
	5.4	4.8
Country Report, EIU[3]	5.5	
ADB[4]	Scenario 1	Scenario 2
	5.5	6.0

Sources: ADB (2008); BB (2009a); EIU (2009); IMF (2008); World Bank (2008).

Admittedly, any slowdown of the Bangladeshi economy is likely to have knock-on impact on resource mobilisation, poverty alleviation and employment creation. Downward deviations in GDP growth from what has been projected by the government for 2008/09 (6.5%) would imply that the number of people coming out of poverty will be lower for the year. Using growth elasticity of poverty (0.38, as mentioned by the second Poverty Reduction Strategy Paper – PRSP II – of Bangladesh – Planning Commission, 2008), if the IMF projection for Bangladesh materialises (GDP growth of 5.6%), about 0.49 million fewer people will come out of poverty in 2009 compared with the expected level. If the lower projection of the World Bank (4.8%) is considered, the reduction in the number of people in poverty during 2008/09 will be lower by about 0.9 million people. At the same time, a deceleration in GDP growth would mean fewer employment opportunities. Following the International Labour Organization (ILO) methodology (2002), with 6.5% growth in GDP, the projected level of employment generation during 2008/09 would be about 1.9 million. The PRSP II projected that, during 2009-2011, on average 1.8 million people would be added to the labour force. If GDP growth underperforms, as projected by the IMF, there will be 0.3 million fewer jobs on offer. If GDP growth further slows down to the World Bank's projected level of 4.8%, incremental job opportunities may squeeze by 0.5 million compared with the expected level.

It is thus imperative to examine and investigate the performance of the various transmission channels (export, import, remittance, FDI, PFI and ODA) in order to understand their likely impact on the growth prospects of the economy in 2009 and their possible social dimensions. It is to be further noted that crisis-driven countries are taking various proactive measures with the goal of addressing the adverse impact of the ongoing crisis. Accordingly, it is also important to evaluate and assess how policies of other countries, having market linkages with Bangladesh, are likely to impact on the performance of her domestic economy in general and export-oriented sectors in particular. Possible consequences for domestic resource mobilisation represent an area that merits close scrutiny.

In view of the above, it is vital to examine and analyse which policy stance Bangladesh should take in order to best accommodate the possible negative consequences of the crisis. This will likely pose formidable challenges in terms of macroeconomic management. No doubt, how far Bangladesh will be able to cope with the possible adverse impact of the crisis will hinge critically on her ability to pursue appropriate fiscal, monetary and overall macroeconomic management policies in view of the emerging situation and challenges. At the same time, these policies are also important from the perspective of realising potential opportunities that could emerge from the crisis.

It is reckoned that, with adverse implications of the global crisis for government revenues, as a consequence of falling commodity prices and slowing down of economic activities, the budgetary position of low-income countries could be significantly weakened. Potential declines in donor support and tighter financing conditionalities could impose heightened pressure on the budgets of these

12 The Bangladeshi economy achieved 6.43% real growth in FY2006/07 and 6.21% real growth in FY2007/08.

countries. Spending in support of social safety net programmes could go up and currency depreciation to enhance export competitiveness could raise debt-servicing liabilities. In the face of restrained flow of aid from developed countries in crisis and binding fiscal constraints, there will be a need for renewed emphasis on rationalising spending and increasing the efficacy of resource allocation and use. This will be required to create the fiscal space for social protection programmes, poverty alleviation efforts and Millennium Development Goal (MDG) attainment activities. Strengthened effort may be required for more domestic resource mobilisation in view of such scaled-up activities. Maintaining macroeconomic stability would be crucial. Declining inflationary pressure could help, as would flexible exchange rates that could act as shock absorbers. Particularly, the health of domestic financial institutions will need to be carefully monitored for any signs of gathering weakness and, if this is the case, it will be necessary to monitor the situation through quick proactive interventions.

In other words, the possible adverse impact of the ongoing crisis will require sound macroeconomic management on the part of economies that are particularly exposed to the global economy. Where does Bangladesh stand in view of the above? Is there any need to revisit its policies? Should this be reflected in current policies and in the context of the upcoming budget, work on which must have begun in earnest by now? These are questions that merit serious consideration.

1.3 Layout of the paper

This paper first traces the performance of the Bangladeshi economy, focusing particularly on the major transmission mechanisms of the impact of global economic crisis on the domestic economy. The paper then makes an analysis of the state of the economy (particularly relating to fiscal, monetary and real economy sectors) to assess the strengths, weaknesses and vulnerabilities of the Bangladesh economy as it faces the global crisis; this is important since it will determine policy space at the disposal of the government and its ability to act. Some suggestions have been put forward with regard to policy options that merit consideration by policymakers in view of the emergent situation.

2. Bangladesh economy and global economic crisis: Transmission channels and initial impact

2.1 Exports: Gradual slowdown in growth

With the deepening of the ongoing crisis, most countries have seen their exports go down significantly. China's declined by 17% in January 2009, those of Singapore by 44%. Compared with many other countries, Bangladesh's export performance, if the first few months of the current fiscal year are considered, has been quite remarkable – growth during first seven months of FY2008/09 (July-January) was a robust 18.2% (only 0.45% lower than the target).[13] Two major contributors, knit and woven readymade garments (RMG), maintained impressive figures, of 26.2% and 20.6% growth, respectively (these growth figures were 14.3% and 4.2%, respectively, for July-January of FY2007/08). Export of apparels, which contributes about three-fourths of export earnings, is still holding. Demand for low-end products registered overall growth in the first seven months (to a significant extent, thanks to the so-called 'Wal-Mart effect') in keeping with trend growth rates.[14] If the US market is considered, total imports by the US during the last quarter (October-December) of 2008 (which represents the most affected quarter of the year from economic shock) declined by 8.8%.[15] US imports from China and Sri Lanka increased only marginally, whereas imports from India and Cambodia experienced negative growth (over the last quarter of the previous year). However, imports from Bangladesh and Vietnam increased impressively, by 18.1% (compared with negative growth of 3.4% in the same period of 2007) and 20.1%, respectively (Table 4), mostly on account of higher imports of lower-end apparels.

Table 4: Growth in US imports, Q4 2007 and Q4 2008 (in value terms)

Country of origin	Oct-Dec 2007	Oct-Dec 2008
World total	10.1	-8.8
Africa subtotal	35.4	-18.1
Cambodia	6.7	-8.5
China	6.8	0.1
India	14.7	-3.2
Pakistan	-1.5	7.5
Sri Lanka	-11.4	0.4
Vietnam	33.9	20.1
Bangladesh	**-3.4**	**18.1**

Source: Computed from the USITC database.

If the top 14 RMG products (of which Bangladesh's exports were over US$40 million in FY2007/08, which includes eight woven items and six knit items) are considered, during Q4 of 2008 US imports from Bangladesh increased by 22.1% (Table 5) to about $618 million; exports of these items from China increased by 34.4% over the same period (when China's overall growth was only about 0.1%) (Figure 3).

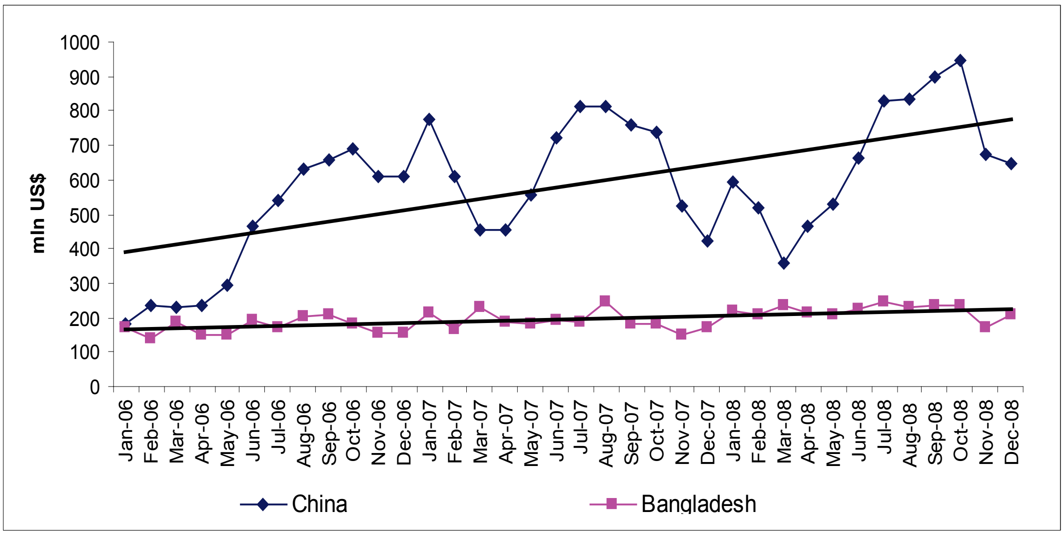
13 The Export Promotion Bureau (EPB) of Bangladesh provides annual and periodic growth targets for exports.
14 Demand for lower-end products tends to be relatively less impacted in times of economic downturn because of distributional effects of income on patterns of demand.
15 Exports to the US market constitute about 25% of the total exports of Bangladesh. Share of exports to EU markets is about 52% of the total.

Table 5: Growth in US imports of major RMG export items (>US$40 million), Q4 2007 and Q4 2008 (in value terms)

	Oct-Dec 2007	Oct-Dec 2008
Bangladesh	**2.6**	**22.1**
Cambodia	7.9	-7.3
China	**-11.5**	**34.4**
India	-6.5	-4.1
Pakistan	-1.5	-2.3
Sri Lanka	-17.8	1.8
Vietnam	74.7	10.9

Source: Computed from USITC database.

Figure 3: Imports by the US: Bangladesh's major RMG export items vis-à-vis China, 2006-2008 (US$m)



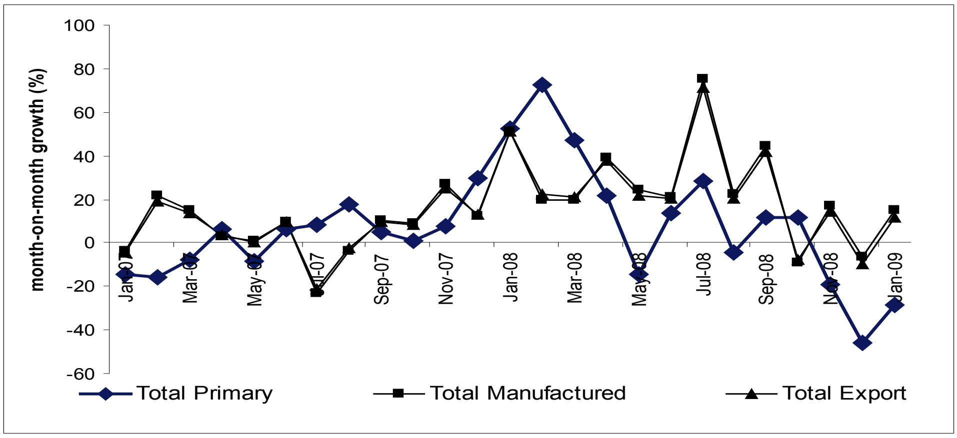
Source: Computed from USITC database.

Withdrawal of the US quota restriction on imports from China as of January 2009, combined with China's response to the global shock (e.g. raising tax rebates on certain exports along with other export incentives), could put exports of these items from Bangladesh under further increasing pressure in the coming months.[16]

While the overall exports of Bangladesh during the first seven months of FY2008/09 were impressive, some slowdown is visible when performance in recent months is considered. Monthly export data bear this out quite clearly. Growth in Q2 of FY2008/09 (October-December, 2008) was negative, -1.2% compared with Q2 of FY2007/08, for the first time in recent times.[17] Particularly for the month of December, overall export declined 10.1% compared with the December exports of the previous year. Indeed, month-on-month growth figures for exports show a gradual decline during the past few months (Figure 4). However, exports picked up once again in January 2009, by 11.9%, underwritten by growth of apparels and indicating the increasing volatility in the global market.

16 It is to be borne in mind that US imports for January-December 2008 do not include Bangladeshi exports for the month of December 2008, as the Bangladeshi exports take about a month to reach the US.
17 Export of RMG was positive (5.5%); however, growth in exports of primary products (raw jute, tea, vegetables, frozen food etc.) was negative (-21.1%) and non-RMG manufacturing products (leather, jute goods, handicrafts, chemicals etc.) was also negative (-20%). Detailed data are available in Table 6.

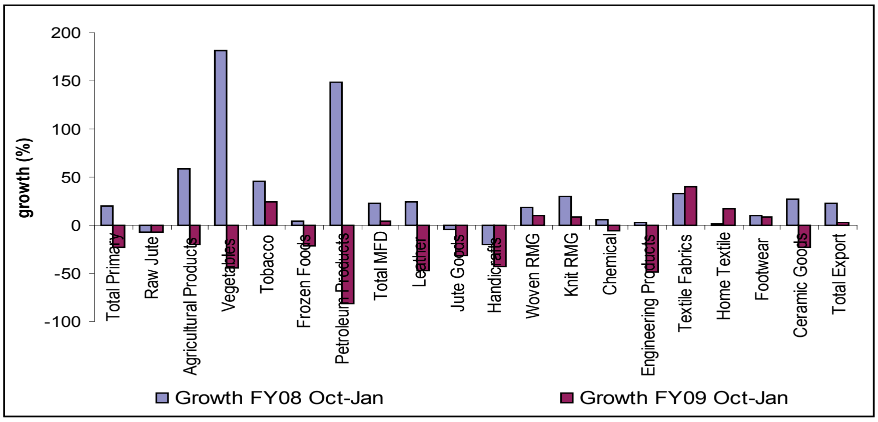
Figure 4: Gradual decline of exports in recent months, 2007-2009 month-on-month growth (%)



Source: EPB (2009).

From the October-January data of FY2008/09, it is evident that exports of Bangladesh's primary products have been relatively more affected by the global economic slowdown (Figure 5). Total exports of primary products in value terms declined significantly, by 22.9% compared with October-January exports of the previous year.[18] Exports of tea (-37.0%), agricultural products (-19.7%) and frozen foods (-21.7%) bear marks of significant slowdown. Exports of vegetables (-44.3%) and petroleum products (-81.5%) in particular declined sharply. Among the major seven primary export items, only tobacco (24.7%) managed to post positive growth in value terms.

Figure 5: Growth in major export items of Bangladesh, FY2007/08 and FY2008/09 (%)



Source: EPB (2009).

Manufactured products posted a marginal positive growth of 4.3% during this quarter, owing only to the slower but positive growth recorded by woven (10.0%) and knit (9.0%) RMG[19] (Figure 5 and Table 6 provide further product-specific performance). Apart from these two items, only textile fabrics (39.6%), home textiles (16.8%) and footwear (9.1%) recorded positive growths. All other major manufacturing items recorded significant decline in exports during October-January of FY2008/09 over the same period of FY2007/08. Particularly hard hit was the leather sector, which posted a negative growth of -47.3% during this period.

As noted above, following the disturbing developments of Q2, overall exports picked up in January, with a month-on-month increase of 11.86%, underpinned by RMG export performance. However, there are a number of disquieting signals: volatility appears to have increased; China continues to remain a

18 Primary products account for about 8% of Bangladesh's total exports. Within primary products, frozen food constitutes about 55%, raw jute about 17%, agricultural products about 12%. The major market for frozen food is the US, the major export destination for agricultural products is the UK and for raw jute the major markets are Pakistan, China and India.

19 RMG constitutes about 85% of Bangladesh's total manufactured product exports. The US, Germany, the UK and France are the major markets for RMG products.

major threat for Bangladesh in traditional apparels markets; higher discounts are being asked for by buying houses and buyers; orders are being deferred and at times cancelled; profits are being squeezed. However, this is based on anecdotal evidence, drawing on discussions with entrepreneurs. According to entrepreneurs, the January increase came against the backdrop of a substantial cut in profits and the overall growth in demand in major markets in view of early summer orders.

Table 6: Growth in major export items during Q2 FY2008/09 and January 2009 (%)

Export item	Growth (%)	
	Q2 FY2008/09 vs. Q2 FY2008/09	Jan 2009 vs. Jan 2008
Total primary	**-21.1**	**-28.4**
Total manufactured products (MFD)	**0.5**	**14.7**
Raw jute	7.4	-55.5
Tea	-28.7	-55.2
Agricultural products	-20.0	-18.0
Vegetables	-52.8	9.1
Tobacco	20.6	52.8
Frozen foods	-24.3	-14.2
Petroleum products	-79.9	-86.4
Leather	-50.2	-31.4
Jute goods	-32.0	-32.5
Handicrafts	-32.0	-61.8
Chemical	-13.9	38.1
Engineering products	-55.8	-20.4
Textile fabrics	125.3	-36.0
Home textile	-3.8	205.7
Footwear	8.9	9.4
Ceramic goods	-22.7	-26.5
Woven RMG	**6.4**	**18.7**
Knit RMG	**4.7**	**21.2**
RMG total	**5.5**	**19.9**
Non-RMG total	**-20.9**	**-16.1**
Total exports	**-1.2**	**11.9**

Source: Based on EPB monthly statistics.

It needs to be underlined here that prices offered for Bangladesh's products, particularly for apparels, have been on the decline in recent years, seriously undermining the country's terms of trade situation. As Table 6 shows, Bangladesh's terms of trade have deteriorated significantly in the recent past. If only apparels price dynamics are taken into consideration, this fact becomes quite evident. In view of this, from a medium-term perspective, there is a growing need for renewed initiatives to promote export diversification and strengthen backward linkage industries.

Table 7: Declining terms of trade, FY1999/00-FY2007/08

FY1995/96	Export price index	Import price index	Apparels price index	Terms of trade	Apparels price index/import price index 100 (terms of trade – apparels)
FY1999/00	100	100	100	100	100
FY2000/01	102	108	101	95	94
FY2001/02	105	116	85	91	73
FY2002/03	107	125	83	86	67
FY2003/04	115	130	80	89	62
FY2004/05	119	134	78	89	58
FY2005/06	121	139	74	87	53
FY2006/07	127	145	71	88	49
FY2007/08	132	150	71	88	47

Source: CPD IRBD database.

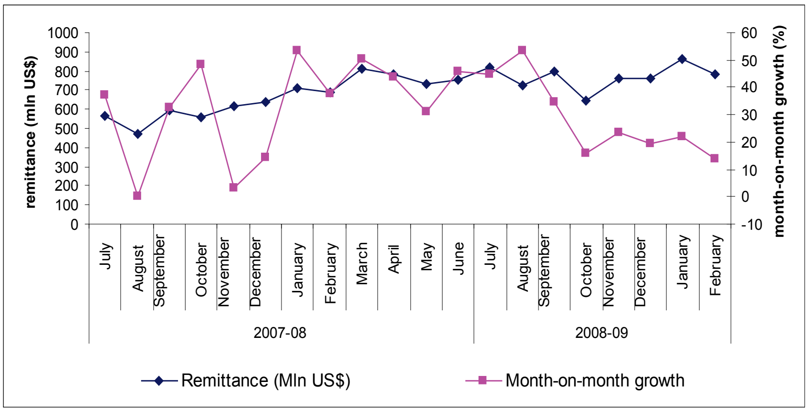
It is also to be noted that the emerging shipbuilding industry of the country, which is considered to have great potential and has received export orders of about US$500 million for about 40 vessels to be delivered by 2010, is also at present experiencing difficulties. These relate to receiving fewer orders consequent to slower growth of trade and significant falls in shipping traffic and freight incomes; some of the orders placed earlier have now been cancelled.[20]

To summarise, although export earnings for the first few months (July-January) of FY2008/09 remain high, both month-by-month performance and record of performance at disaggregated sector level allude to disquieting developments.

2.2 Remittances: Robust inflow but deceleration in number of workers leaving

Over the past two years, a record number of Bangladeshi workers (1.7 million) left the country in search of jobs abroad (the total number of migrant workers is estimated at about 6.1 million at present, over 10% of the total labour force; they are estimated to have sent about US$7.9 billion in FY2007/08, equivalent to 10% of GDP). Remittance flows play a crucial role on three counts: i) ability to pay for import payments; ii) sustaining foreign exchange reserves; and iii) household income of remitters. Remittance flow till now has been quite robust. During July-February of FY2008/09, remittance earnings increased by 27.1% compared with the corresponding period of last year. Indeed, $865.3 million was remitted in the month of January 2009, a new record; another $784.4 million was sent in February, 13.8% higher than the comparable month of FY2007/08 (Figure 6).

Figure 6: Remittance inflow, FY2007/08 and FY2008/09 (US$m)



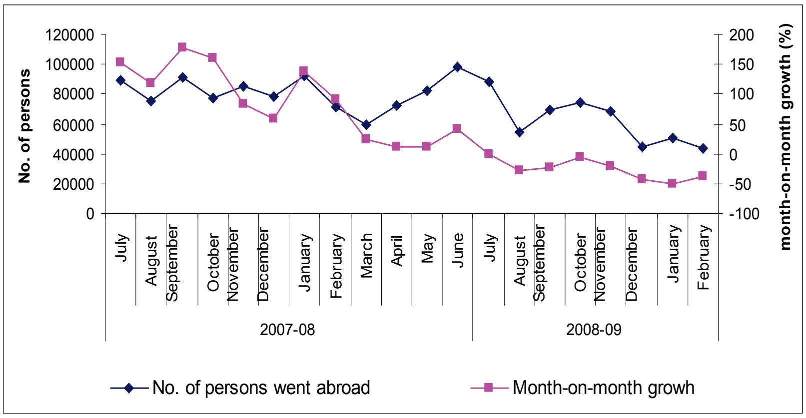
Source: BB (2009c).

However, in all likelihood, the number of workers going abroad will be significantly lower in 2009. One important impact of the crisis has been the significant slowdown in the number of people migrating in recent months. Already some of the traditional destinations, including the United Arab Emirates (UAE), Saudi Arabia, Malaysia and Singapore, have indicated caution with respect to recruitment in the face of sluggish economic growth and lower demand for construction and other services.[21] According to recent data, during July-February of FY2008/09, the number of people migrating abroad in search of jobs declined by 26.2% compared with the same period of FY2007/08.[22] In February 2009, the number of persons was only 43,856, compared with 71,716 in February 2008 (38.8% fall) (Figure 7). Saudi Arabia and Kuwait have virtually stopped issuing new work permits to Bangladeshi workers; these destinations account for 39.7% of all Bangladeshi migrant workers. The UAE, another major destination, has also shown lower demand for migrant workers, with the number of workers going to

20 Production of ships, in terms of metric tonnage, declined significantly in September 2008 (273 metric tonnes) compared with August 2008 (409 metric tonnes).
21 Malaysia has an estimated 2.2 million foreign workers. Recently, it slashed work permits for foreign workers by about 70% – in January and February 2009 on average only 250 permits were approved daily, compared with the corresponding period of 2008, when about 500-600 work permits were approved. In recent times, Malaysia has introduced more stringent vetting of foreign workers and adopted policies to encourage recruitment from its own job market.
22 In 2008, over 75% of all migrant workers went to Middle East countries, 15% to Malaysia and 6.5% to Singapore.

the UAE in February 2009 lower by 5000 compared with January 2009. Falling demand in Dubai, particularly in view of stoppage of ambitious construction works, may make the UAE picture gloomier in the near future. It is to be kept in mind that many workers leaving the country now are going against work permits issued earlier; the slowdown of issuance of new contracts and work permits could reduce the number of future migrants significantly.[23] Slowdown in growth of the US and the UK economies (accounting for 17% and 11% of remittances) could also have adverse impacts in the near future.

Figure 7: Number of persons leaving for jobs abroad, FY2007/08 and FY2008/09



Source: BB (2009c).

There is a dearth of adequate information about returnee migrants – information regarding expatriates is not maintained in a systematic manner. Returnees could include both retrenched workers and natural returnees (who would have come back anyway). Nevertheless, evidence suggests that workers in affected countries are experiencing retrenchment (though on a limited scale).[24] Some Middle East employers are not issuing new job permits. Malaysia announced retrenchment of about 45,000 workers by January 2009, of whom a substantial number appears to be migrant workers from countries such as Bangladesh. Bureau of Manpower, Employment and Training (BMET) figures (see Sohal, 2009) show that, over the past three months, 13,540 Bangladeshi workers have returned: 701 in December 2008, 4817 in January 2009 and 8022 in February 2009. Although there are indications of migrant workers losing their jobs, this is yet to be reflected in remittance figures, at least in the short term, since the number of returnees does not constitute a significant share in the total number of people still working abroad (flow as a small percentage of stock). This would perhaps be reflected in remittance statistics gradually, over the medium term. Record high remittance inflow in January 2009 in the face of growing numbers of people losing jobs abroad raises concern as to whether this is because of terminal returnees coming back with whatever savings they had. Workers are being sent back from Middle East countries such as UAE, the country with the largest Bangladeshi workforce (around 0.9 million). Countries are sending back workers on long vacations or reducing their salary owing to the slowdown of work in construction projects. An intensive diplomatic initiative will need to be undertaken to safeguard the interests of Bangladeshi workers and to ensure that Bangladesh does not miss out on any remaining opportunities.

Gloomy growth projections for major destinations for Bangladeshi migrant workers (both developed and developing) would indicate that the current downward trend in demand may continue over the near term, in 2009 and perhaps 2010. If this is the case, remittance growth could slow down in future, beyond 2010.

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23 Recently, the Malaysian government, under pressure from labour organisations, revoked the work visas of 55,000 Bangladeshi workers issued earlier. The government has banned hiring of new workers after reports that 45,000 jobs could be lost over the next few months. Of the 3 million Asian migrant workers staying legally and illegally in Malaysia, about 500,000 are Bangladeshi.
24 For example, owing to the slowdown of the Singapore economy, especially in the shipping and construction sectors, 55 Bangladeshis employed by construction sub-contractor Tunnel & Shaft have returned home after working there for seven months or fewer. They were recruited last year in anticipation of two major projects estimated to be worth US$20 million.

In the recent past, large outflows of migrant workers have eased the employment situation in Bangladesh.[25] Lower numbers of people going abroad could exacerbate the unemployment situation. This will have important implications for the domestic job market and social safety net programme-related expenditure. In view of the emergent situation, efforts should now be strengthened so that Bangladesh is able to cater to the needs of the new markets for migrant workers in the developed countries, which relate, to a large extent, to the caring sectors (nurses, medical technicians, etc.) It will also be important to negotiate with host countries, particularly in the Middle East, to allow for extension of work permits, even when Bangladeshi workers lose their jobs because their respective companies have discontinued operations. This is also an opportunity to curb and discipline the activities of unscrupulous middlemen in the 'manpower business'. Comprehensive regulation with strict guidance as regards charges/fees, guarantee of work, wages to be received by migrant workers, etc., will need to be designed and strictly enforced.

In view of the difficulties faced in the overseas job market, and also in response to needs to diversify the market, Bangladesh will require a comprehensive plan for training and skills development. A time-bound plan should be put in place so that all workers travelling abroad have an opportunity to undergo skills upgrading. In this context, the need to tap the emerging opportunities in the medi-care sector of developed countries and in Eastern European markets should merit special attention. For this to happen, public–private partnership will need to be encouraged, using appropriate incentives. A dedicated fund may be created for this. The government has made plans to make the vocational training system more market oriented through public–private partnerships. A more involved engagement with trade associations may be considered in this context.

2.3 Imports: Gradual slowdown with falling global prices

In the coming months, import payments are likely to slow down, as suggested by recent trends. During July-December of FY2008/09, total import payments posted 23.25% growth compared with the corresponding period of the last year. But this high growth was, to a significant extent (42.4% of the incremental contribution), accounted for by high growth in imports of crude and refined petroleum products and fertiliser, prices of which have now come down sharply in the international market over the recent past few months. This has resulted in a gradual slowdown in import growth, as seen from recent data. Import growth for July-November of FY2008/09 was 29.7%, which came down to 23.25% for July-December because of significantly lower growth in the month of December 2008 (Table 8). Aggregate import figures available for July-January of FY2008/09 reveal that this growth rate has further declined to 18%, indicating a further dip in imports. With lower import demand of fertiliser for the rest of the fiscal year, with plantation of Boro coming to an end soon, import payments may further slow down over the remaining few months of FY2008/09. It is also to be noted that it is increasingly production-related imports, rather than consumption-related imports, that have a larger share in the incremental import payments of Bangladesh.

25 The total number of people entering the job market of Bangladesh every year is about 1.8 million. About 8.4% is absorbed by growth in overseas employment (taking average overseas employment growth for the past 10 years). According to the last Labour Force Survey of 2005/06 (BBS, 2008a), Bangladesh has an unemployment rate of 4.2% and underemployment rate of 24.5%; share of informal sector employment was 75.3%.

Table 8: Growth in import payments, FY2007/08 and FY2008/09 (US$m)*

	Jul-Dec FY2007/08	Jul-Dec FY2008/09	Growth	Incremental contribution
Food grains	**612.9**	**394.1**	**-35.7**	**-9.8**
Rice	314.6	195.6	-37.83	-5.3
Wheat	298.3	198.5	-33.46	-4.5
Other food items	**952.6**	**853.5**	**-10.4**	**-4.4**
Consumer and intermediate goods	**4227.5**	**5831.2**	**37.93**	**71.9**
of which				
Clinker	163.1	143.8	-11.83	-0.9
Crude petroleum	*279.9*	*403.1*	*44.02*	*5.5*
Petroleum, oil and lubricants (POL)	*881.2*	*1206.1*	*36.87*	*14.6*
Fertiliser	*258*	*756.5*	*193.22*	*22.3*
Dyeing and tanning materials	98.6	145.5	47.57	2.1
Plastics and rubber articles thereof	371.8	428.9	15.36	2.6
Yarn	308.3	423.7	37.43	5.2
Textile and articles thereof	915.5	1048.1	14.48	5.9
Staple fibre	48.8	61.1	25.2	0.6
Capital goods and others	**3231.2**	**4104.7**	**27.03**	**39.1**
Iron, steel and other base metals	545.3	718	31.67	7.7
Capital machinery	752.2	760.5	1.1	0.4
Others	1933.7	2626.2	35.81	31.0
Total	**9024.2**	**11183.5**	**23.93**	**96.8**
Import by export processing zone	**575.7**	**648**	**12.56**	**3.2**
Grand total	**9599.9**	**11831.5**	**23.25**	**100.0**

Note: * Taka converted into US dollars.
Source: BB (2009c).

2.4 ODA: Decline, but perhaps not related to crisis

Aid is a soft target in any crisis. While earlier commitments could hold, new pledges in view of the growing needs in crisis-driven developing economies may not be forthcoming. Although aid's role has been on the decline over the past years, it still accounts for about half of Bangladesh's expenditure on development budget.[26] However, until now, no adverse affect is visible in this regard. The figures for July-December FY2008/09 indicate a decline of 8.0% in net foreign aid disbursement in Bangladesh, with gross disbursement falling slightly, from US$903.2 million in FY2007/08 (July-December) to $898.3 million in FY2008/09 (July-December) (Table 9). Commitment figures for FY2008/09 look promising, however, with the highest ever commitment ($1.34 billion) by the World Bank for the current fiscal year.

Table 9: Flow of foreign aid, FY2007/08 and FY2008/09 (US$m)

	Food aid	Commodity aid	Project aid	Total aid	Payment (principal)	Net foreign aid
Jul-Dec FY2007/08	54.3	0.0	848.9	903.2	273.2	630.0
Jul-Dec FY2008/09	2.4	0.0	895.9	898.3	318.6	579.6
Growth (Jul-Dec) FY2008/09	**-95.6**		**5.5**	**-0.5**	**16.6**	**-8.0**

Source: BB (2009b).

It is to be borne in mind that a major part of the aid flow in Bangladesh comes as project aid, through the Annual Development Programme (ADP) channel. Actual project aid disbursement under the ADP is subject to implementation status of different projects. Therefore, actual disbursement will depend more on Bangladesh's capacity for utilisation than being constrained by availability of aid itself.

26 Bangladesh government prepares its expenditure budget under two broad heads: Revenue budget and Development budget. Development budget constitutes about 25% of the total budget.

However, as is known, only 30% of the project aid allocation could be utilised during the first seven months of FY2008/09. Slow implementation of donor-funded ADP projects in the current fiscal year could be a reason for lower aid disbursement of aid so far this year. In view of the need to generate more local demand through enhanced economic activities, as a consequence of the crisis, it is crucial that both quality and quantity of aid disbursement and ADP implementation are significantly improved this year.

2.5 Flow of FDI: No impact so far

Flow of FDI to Bangladesh was considerably higher during July-December 2008 compared with the same period of the previous year. Net FDI increased to US$706 million during this period, which was only $285 million in the previous year (Table 10). It is to be noted here, however, that FDI inflow to Bangladesh has traditionally been rather low, even compared with her South Asian counterparts, and constitutes only about 3.4% of total investment.[27] A worrying sign, though, relates to registration of FDI in 2008. The number of units registered with the Board of Investment (BoI) in 2008 was only 13 (with a total investment proposal of $60 million), whereas in 2007 it was 75 (with a total of $327 million investment). As would be expected, the global meltdown has particularly affected the flow of portfolio investments in the capital market: the net flow was negative ($-48.0 million) during July-December of FY2008/09, implying a higher amount of withdrawal of capital by foreign investors.[28]

Table 10: FDI and PFI in Bangladesh, FY2006/07-FY2008/09 (US$m)

	FY2006/07	FY2007/08	Jul-Dec FY2007/08	Jul-Dec FY2008/09
FDI	793	650	285	706
PFI	106	48	48	-48

Source: BB (2009b).

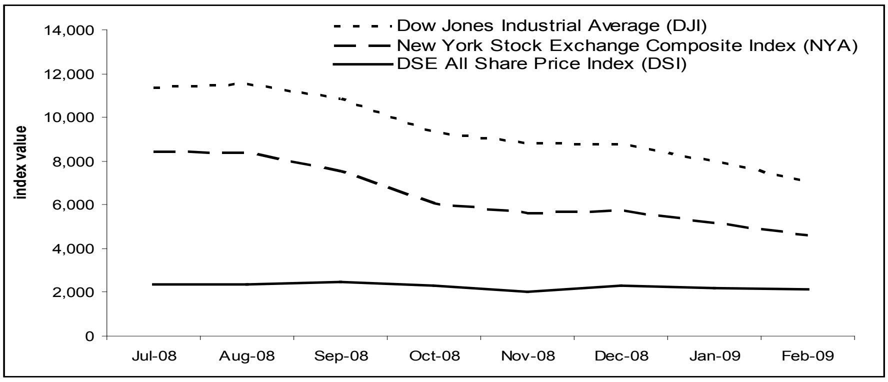
2.6 Capital market: Sluggish growth mainly for domestic reasons

A sluggish trend has been observed in the capital market for the period between July 2008 and February 2009. However, in view of the insignificant role played by foreign capital (accounting for about 2.5% of market capitalisation) in the capital market of Bangladesh, it was mainly the domestic factors rather than the negative affect of global shock that contributed directly to this trend. Movement of Dhaka Stock Exchange (DSE) indices did not correspond to the sharp downward movement of major global indices in the aftermath of the global financial meltdown (Figure 8). However, it needs to be highlighted that all the indices in the DSE experienced negative growth during the first few months of FY2008/09 (Table 11).

27 In Bangladesh, FDI primarily goes to telecommunications, energy and export processing zones (RMG, textiles, footwear, etc.)

28 Underdevelopment of the country's capital market and low exposure to global financial markets (only 2.5% market capitalisation is accounted for by PFI) may have saved Bangladesh from a large outflow of capital from her share market, with consequent adverse effects on the economy (as happened in India).

Figure 8: Movement of major world indices and DSE all share price index, July 2008-February 2009



Source: New York Stock Exchange (www.nyse.com) and DSE (www.dsebd.org).

Table 11: Movement of share price index at DSE, FY2008/09

Indices	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
DSE (All)	2369	2389.2	2498.5	2278.2	2040.2	2309.4	2196.96	2144.3
DSE (20)	2526.2	2441.5	2466.1	2351.9	2090.1	2328.7	2175.11	2085.9
DSE (Gen)	2761.1	2791.2	2966.8	2748.6	2468.9	2795.3	2649.49	2571.0
Market capitalisation (US$ billion)								
FY2008/09	13.95	14.15	15.18	14.37	14.01	15.21	14.75	14.50

Source: www.dsebd.org.

3. Bangladesh economy and global economic crisis: Macroeconomic balances and real economy

Trends in external sector aggregates imply that global economic meltdown is gradually affecting Bangladesh's performance; these adverse impacts are likely to intensify in the coming months. At the same time, policies of other countries, most importantly Bangladesh's competitors in global export markets, are having direct implications for the country's export competitiveness and also domestic sector performance. What is the state of the macroeconomic fundamentals of Bangladesh's economy against this backdrop? How feasible is the idea of a stimulus package of her own? An analysis of the current state of the Bangladesh economy will help decide which policy options and flexibilities Bangladesh actually has in view of the emerging situation and the attendant challenges. The following discussion focuses on the state of the fiscal, monetary and real sectors of the Bangladesh economy at this crucial juncture.

3.1 Fiscal balance: Strengths and weaknesses

The budget for FY2008/09 presented in June 2008 was relatively large, prepared against the backdrop of high inflation, commodity prices, import burden and subsidies. A large deficit projection of Tk30,623 crore, equivalent to 5.0% of GDP,[29] made the task of balancing the budget challenging. This higher deficit was to be met by higher revenue generation and higher financing by development partners, to be replenished by increased government borrowing from domestic sources, both banking and non-banking.

Subsequent developments had repercussions for the budget in FY2008/09, both ways: some bringing comfort and some adding to the challenges. With the onslaught of the financial crisis and the consequent decline in global demand, global commodity prices experienced a significant fall. This was true particularly for petroleum products, which were the single largest contributor to demand for subsidy in the budget. The budget 2008/09 kept Tk6106 crore for Bangladesh Petroleum Corporation (BPC) alone and also Tk540 crore as a diesel and electricity subsidy for agriculture. The over 72.8% fall in the price of petroleum on the international market has now created an opportunity for significant savings on account of budgetary allocations for fuel subsidies, in spite of the downward revision in prices. As may be recalled here, BPC made its last profit in FY1998/99, following which there was an uninterrupted string of losses over subsequent years. In the first seven months of the current fiscal year (July-January), BPC incurred a net loss of around Tk1600 crore. However, this owed to losses incurred during the first four months (July-October 2008). Thereon, BPC started to make profit: during the months of November 2008 to January 2009, BPC made a profit of Tk553 crore, in view of the falling fuel prices on the global market and in spite of the aforesaid reduction in the managed price level of fuel products.

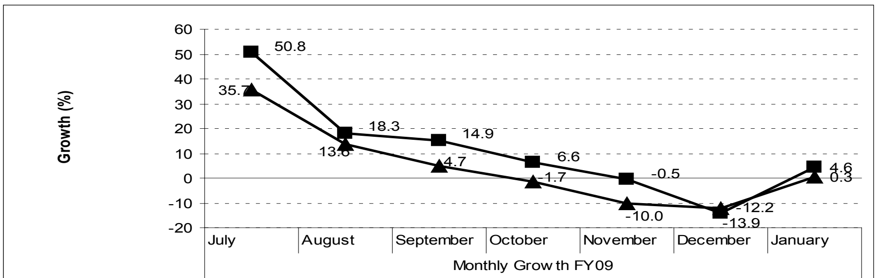
In view of the crisis and the consequent fall in demand in the near future, oil prices on the international market are likely to hover around the current level of US$40-45 per barrel during the remaining months of FY2008/09. This would allow BPC to continue to make a profit in the coming months, as it did in December and January, if prices are not revised significantly further downward. It is estimated that, at the current rate, for the entire fiscal year, the total subsidy on account of BPC is likely to be about Tk600 crore. This would be about Tk5500 crore less than the budgetary allocation for subsidy on account of BPC. At the same time, prices of various types of fertiliser on the international market have also fallen sharply (barring muriate of potash, known as MoP). This is likely to further reduce subsidy demand for FY2008/09 on account of fertiliser. Thus, a significant amount of the Tk13,641 crore subsidy kept in the FY2008/09 budget will be saved.

29 This deficit was 15% higher than the previous year.

The fall in commodity prices is reflected in the revenue expenditure account of the government.[30] This shows 12.7% growth in total revenue expenditure (not accounting for BPC, the Power Development Board (PDB) and agriculture- and export-related subsidies) during July-December of FY2008/09, against an annual growth target of 19.5%. These figures are for the first and second quarter of the fiscal year only; since then, the prices have gone down further and new contracts made at present should be able to take advantage of the falling prices. It is to be noted that implementation of the ADP (only 31% during July-January) is also indicative of the possible lower government expenditure by the end of the fiscal year. Even if the FY2007/08 performance record of ADP utilisation is attained for the current fiscal year, about Tk19,000 crore of the total Tk 25,600 crore allocated for the ADP in FY2008/09 will be utilised. This will result in approximately Tk6000 crore of reduced expenditure from the projected expenditure budget of FY2008/09. In fact, fiscal space created by the non-implementation of the ADP will be somewhat less because, based on recent trends, a part of it (around Tk2000 crore) will not be actually available (unutilised project aid will not be available to the government). However, this will still leave the government with some comfort zone.

True, the government is likely to face formidable challenges from the perspective of domestic resource mobilisation. Revenue earnings data for July-January of FY2008/09 confirm these suspicions. With the fall of imports, in value and in many instances volume terms,[31] there were adverse impacts on import duties collected during July-January of FY2008/09. These posted only a 3.4% growth in the first seven months against the annual target of 13.1% for FY2008/09. Month-on-month comparison shows that collection of import duty experienced a sharp fall in recent months (Figure 9), with only marginal improvement in the month of January 2009. Import duty and other import-related duties together constitute around 42% of total National Board of Revenue (NBR) revenue collection in Bangladesh. Thus, it is likely that revenue collection in FY2008/09 will fall short of the target by a significant margin.

Figure 9: Recent decline in import duty collection, FY2008/09 month-on-month growth (%)



	July	August	September	October	November	December	January
Import Duty	35.7	13.6	4.7	-1.7	-10.0	-12.2	0.3
Import Related Total	50.8	18.3	14.9	6.6	-0.5	-13.9	4.6

Source: NBR (2009).

However, overall growth in NBR revenue collection (12.4%) is still hovering around the target set for FY2008/09 (14.9%), owing mostly to higher than targeted income tax growth and high import stage duty collection achieved in the initial months of FY2008/09, when the international prices were way higher compared with their current level (Table 12).[32]

30 Oil prices have gone down from a peak of about US$140/barrel to $40/barrel at present. Prices of a wide range of commodities have fallen. On 24 February 2009, The Economist's commodity price dollar index had fallen by 42% compared with a year ago – the index for food was 30% down, for non-food agricultural products 45% down and for metal 60% down.
31 Imports have fallen in value terms owing to a fall in commodity prices; in some instances, imports have also fallen in volume terms because of a fall in domestic demand (e.g. cereals, because food grain production has picked up following the fall in food production in 2007/08 owing to two floods and Cyclone Sidr).
32 NBR revenue accounts for about 80% of Bangladesh's total revenue; thus, import-related duties account for about 35% of total duties in Bangladesh, a significantly high share by any measure.

Table 12: NBR revenue collection, FY2008/09 (Tk crore)

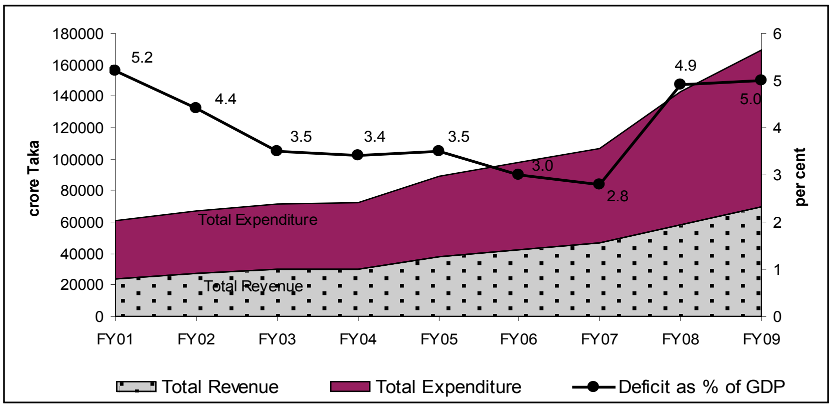
	Annual growth target FY2008/09	Growth Jan FY2008/09	Growth Jul-Jan FY2008/09	Jul-Jan FY2007/08as % of actual	Jul-Jan FY2008/09 as % of target
Import duty	13.1	0.3	3.4	43.2	39.8
Value added tax (VAT) import	12.6	8.3	15.3	41.7	42.7
Supplementary, import	20.4	8.1	26.0	49.1	54.0
Import-related total	13.5	4.6	10.6	43.1	42.4
Excise duty	17.1	-80.9	-78.4	3.9	1.5
VAT local	16.4	13.8	19.7	43.1	42.5
Supplementary, local	23.6	4.4	3.1	46.9	39.0
Turnover tax	17.2	-32.0	-14.1	42.8	53.0
Local total	19.2	5.2	12.0	44.0	40.5
Income tax	11.1	19.0	17.8	35.7	37.2
Travel tax	24.9	9.7	-5.4	53.2	40.6
Others	1566.7	100.0	14.3	550.0	9.5
Total direct tax	11.7	18.7	16.6	36.3	37.3
Grand total	14.9	7.7	12.4	41.6	40.5

Source: NBR (2009).

The other source of financing, ODA, has recently shown a downward turn, as net foreign flow of foreign aid declined by 8% during July-December of FY2008/09. However, commitments made by development partners for the rest of the fiscal year look promising. In fact, as was noted earlier, the World Bank committed the highest ever aid to Bangladesh (US$1.34 billion) in FY2008/09. Recent commitments of €50 million by the EU and $ 90 million by the World Bank for food security and safety nets, along with $440 million by Japan in power and infrastructure, will contribute to the resource envelope of the government in the current fiscal year.

Since FY2000/01, Bangladesh has been experiencing a fall in the deficit–GDP ratio; however, in FY2007/08, the ratio climbed to 4.9% from 2.8% in FY2006/07 (Figure 10). Thus, the 5% GDP equivalent deficit that was targeted for FY2008/09 was rather high compared with recent trends, although it approximated the FY2007/08 deficit.

Figure 10: Trend in budget deficit, FY2000/01-FY2008/09 (Tk crore)



Source: MoF (2008).

It is reckoned that, between the gains from the falling subsidy expenditure and the losses in the revenue account, there are likely to be some net gains in the budget for FY2008/09. As the latest available figures show, net domestic financing declined by 28.9% and net foreign financing by 8.05% during the first six months of FY2008/09. Thus, overall, deficit financing of the government decreased by 23.0% during the July-December period of FY2008/09, compared with the corresponding period of the previous fiscal year (Table 13). This is a cushion that the government is likely to continue to build on over the rest of the fiscal year.

Table 13: Growth in deficit, FY2008/09 (Tk crore)

Period	Net bank borrowing	Net non-bank borrowing	Total domestic financing	Net foreign financing	Total financing
Jul-Dec FY2007/08	9478.4	1557.28	11,035.68	4324.58	15,360.26
Jul-Dec FY2008/09	5569.3	2273.89	7843.19	3977.19	11,820.38
Growth (Jul-Dec) FY2008/09	-41.2	46.0	-28.9	-8.0	-23.0

Source: BB (2009b).

It is also to be kept in mind that the remaining months of FY2008/09 may show month-on-month decline in the expenditure account, owing to the absence of the high rehabilitation costs associated with mitigating the consequences of the natural catastrophes (two floods and Cyclone Sidr) seen in the previous year. For the same reason, flow of foreign financing may also show some decline in the coming months, as a substantial part of the aid received by Bangladesh in FY2007/08 was dedicated towards rehabilitation efforts. Subsidy expenditure for fertiliser will increase against the backdrop of the higher amount of subsidy announced by the government on fertiliser in view of the critically important Boro season.

However, as was noted, the continuing fall in fertiliser prices and its positive impact on government's subsidy expenses could result in a net gain and ease the overall fiscal situation in FY2008/09. In view of the need to undertake any additional expenditure for mitigating adverse impacts of the ongoing crisis, the government may also seek resources that were not allocated in the original budget. Tk1200 crore recovered from the anti-graft drive undertaken by the immediate past caretaker government (CTG), which is now lying with the BB, could be a possible source. This, along with the net budgetary gains, could create some fiscal space to allow the government to go for higher expenditure, without overshooting the projected deficit of 5.0% of GDP.[33] Mode of financing the deficit remains a concern. While borrowing from the banking system has the advantage of being less costly in terms of the interest payment burden, it has the disadvantage of being inflationary. Crowding-out effects on private sector credit remain a concern, although a contrary view is that, in view of the surplus liquidity in the system, this should not be a worry. On the other hand, non-bank borrowing, which is non-inflationary, involves higher interest payment obligations; availability of such borrowing could also be a problem. The government will need to decide on options and policy choices in this regard through careful consideration of the needs, priorities and possible implications for the economy.[34]

3.2 Monetary developments: Decreasing inflationary pressure and some freedom to act

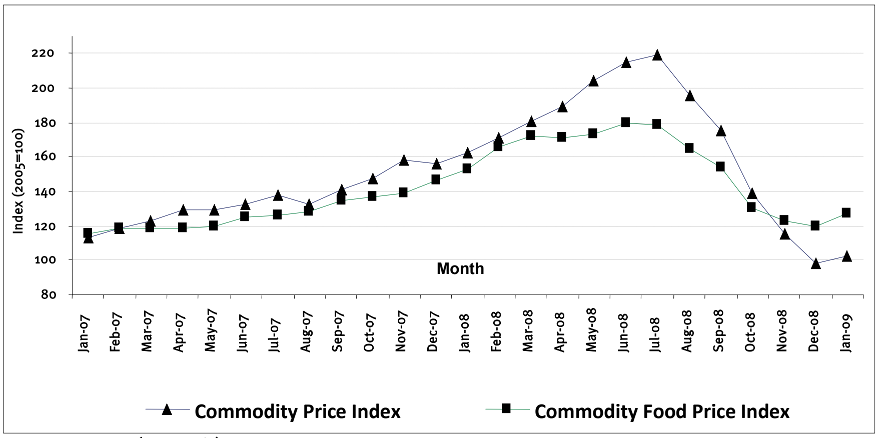
3.2.1 Trends in inflation rates

In the context of concern over rising price of commodities, particularly essential commodities, experienced in the recent past, restoring macroeconomic stability and curbing high inflation were perceived as major policy goals by policymakers. One important feature of the current economic situation is that inflationary pressure has started to ease in recent months. Inflationary pressure is expected to come down further in response to falling global commodity prices and good harvests. Significant devaluation in India, the major import source for consumer products, is also expected to have a positive impact on the general inflationary situation (Figure 11).

33 Taking into consideration that the GDP growth rate projected for FY2008/09 (6.5%) will be about 5.5-6.0%.

34 Since part of the fertiliser distributed in the first six months was purchased at higher prices, the subsidy burden during the first six months was perhaps higher. However, later purchases should have been able to take full advantage of falling prices, with subsequent positive impacts on government expenditure on account of fertiliser subsidies.

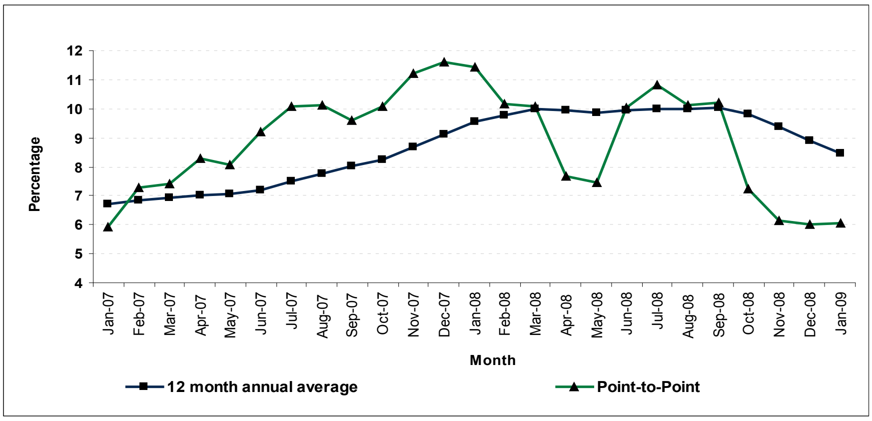
Figure 11: IMF world commodity price index, 2007-2009



Source: IMF (2009b).

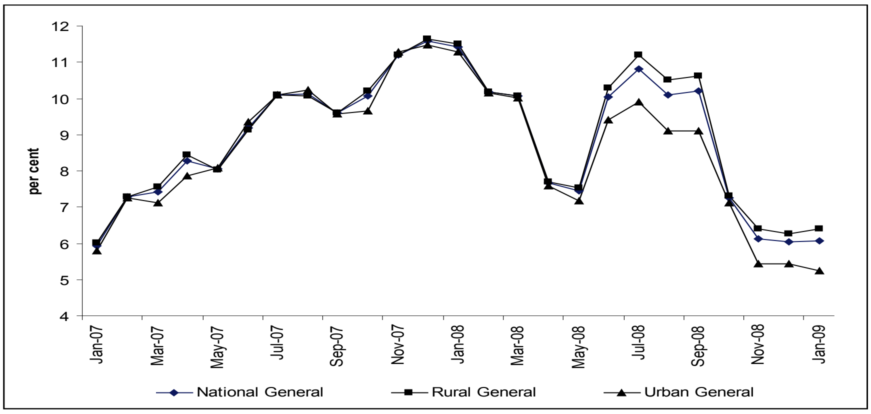
There has been some respite thanks to the declining trend of inflationary pressure during July-January FY2008/09. The annual average rate of inflation (12-month annual average commodity price index, 1995-96 = 100) decreased to 8.5% in January 2009 from 9.6% in January 2008 (Figure 12). The 12-month point-to-point inflation declined to 6.1% in January 2009 compared with 11.4% in January 2008. This deceleration in inflationary trends is visible for both food and non-food items, and for both rural and urban areas (Figure 13). This would indicate that the overall inflation rate could be below the projected rate of 9.0% for FY2008/09, mentioned in the budget for FY2008/09. Maintaining moderately high growth rates with low levels of inflation could thus be an attainable target. Given the trade-off between growth and stability, the government appears to be somewhat better placed at present for pursuing active growth financing policies.

Figure 12: Inflation rate, 2007-2009 (%)



Source: BBS (2009).

Figure 13: National, rural and urban inflation rate (P2P), 2007-2009 (%)

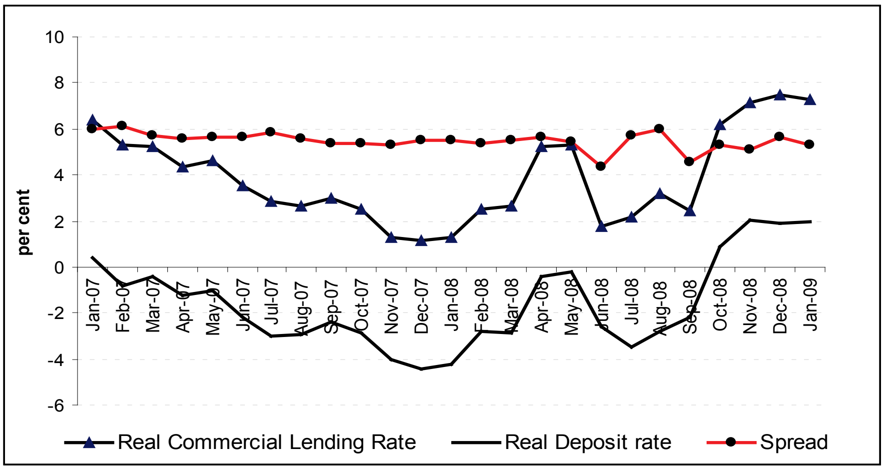


Source: BBS (2009).

3.2.2 Interest rates

As noted, the commercial lending rate is considered to be high in Bangladesh. In recent times, the rate has risen further – in January 2009 the lending rate was 13.33%, about 0.71 percentage points higher than September 2008. The real lending rate was 7.27% (Figure 14). A higher spread between lending and deposit rates has continued to be a major concern for Bangladesh's policymakers. Investors have often mentioned the high interest rate as a major disincentive from the perspective of undertaking entrepreneurial activities. Indeed, this conflict of interest has persisted for quite some time now. BB has often tried to convince the commercial banks to reduce the interest rate spread but the situation has not changed much. Indeed, in January FY2008/09 the spread was higher, at 5.33% compared with 4.58% in September FY2007/08.

Figure 14: Real interest rates and spread, 2007-2009 (%)



Source: BB (2009c).

3.2.3 Classified loan scenario

The share of non-performing loans has been in gradual decline over the past couple of years; this was particularly evident in the first half of FY2008/09 (Table 14). At the end of December 2008, the percentage share of classified loans to total outstanding loans declined to 10.8%, compared with 13.2% in the corresponding period of the previous year. The percentage share of net classified loans to total loans also decreased, to 2.8% at end-December 2008 from 5.1% at end-December 2007. The government has corporatised three large state-owned banks with the objective of improving the quality, efficiency and performance of these institutions. The loan default scenario of these banks has started to show some positive improvements in recent times. State-owned commercial banks (SCBs) were able to reverse earlier trends and to reduce the amount of classified loans (by 7.45%). These banks account for the largest share in total classified loans. However, a significant rise of the classified loan portfolio of private commercial banks (PCBs) and foreign commercial banks (FCBs) has emerged as a cause for concern. There needs to be examination of why this is happening and whether corrective measures are required. Nevertheless, overall, the data suggest some improvements in banking sector efficiency.

Table 14: Classified loan scenario, December 2007 and December 2008

Banks	As of Dec 2007 (Tk crore)	As of Dec 2008 (Tk crore)	Growth (%)
SCBs	13,791.17	12,764.15	-7.45
PCBs	4921.70	5698.60	15.79
FCBs	194.30	286.30	47.35
DFIs*	3716.90	3732.30	0.41
Total	22,5624.07	22,481.35	-0.63

Note: DFI = Development finance institution.
Source: BB (2009d).

Maintaining the good health of banks will be critical to addressing possible adverse impact of the crisis. Some of the commercial banks are having to defer settlement of credit lines in view of difficulties faced by importers who made import contracts before the slump in commodity prices. Of importance will be monitoring whether this is having adverse implications on trade financing and, if required, taking remedial measures.

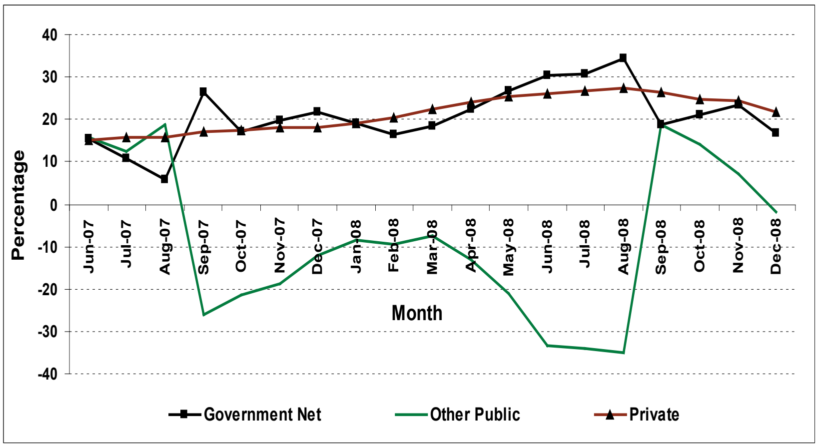
3.2.4 Money supply, credit flow and liquidity

Broad money supply (in terms of M2) has started to slow down in recent times. Outstanding M2 posted a growth of 19.83% at the end of January 2009 against a backdrop of around 16.9% growth projected in the PRSP II for FY2008/09. Growth of outstanding M2 was 23.50% in September 2008. Growth of domestic credit and its major components have also somewhat slowed down in recent times. Outstanding net domestic credit registered 19.53% growth at the end of January 2009 on a point-to-point basis over the corresponding benchmark figure of FY2007/08 (Figure 15); in September 2008, the corresponding figure was 24.58%. Such deceleration originated from lower growth of net credit to the public sector, at 15.33% at the end of January 2009; although growth in net credit to the government was 22.5%, net credit to other public sector in fact declined by 6.36% at the end of the same period.

Growth of net domestic credit to the private sector also slowed down considerably, posting a growth of 19.53%, which was 26.6% in September 2008. An increase of repo and reverse repo rates during the second quarter of FY2008/09 may have discouraged credit flow in subsequent months.[35] This move indicated some tightening of monetary policy by BB, a departure from the accommodative monetary policy of the recent past. However, in the latest half-yearly monetary policy statement (announced on 14 January 2009), the central bank indicated pursuance of a policy of monetary accommodation for achieving the GDP growth target by supporting adequate credit growth for activities that facilitate production and supply of goods and services. Subsequently, repo and reverse repo rates were re-fixed to their earlier rates (8.50% and 6.50%, respectively) on 11 March 2009. BB also indicated that it would provide refinance against lending in priority sectors (small and medium-sized enterprises (SMEs), agriculture, low cost housing, etc.) which are not appropriately served by the market. BB has also indicated that it would discourage excessive expansion of non-essential, life-style-related consumer credit and other demand-side lending.

It is, however, to be noted that the scheduled banks had excess liquidity to the tune of Tk20,275.55 crore as of end-December 2008, against Tk129,88.58 crore as of end-June 2008. The current deceleration in the growth of domestic credit provides an opportunity to once again go for monetary expansion, if required, in view of the global crisis.

Figure 15: Trends in net domestic credit, 2007-2008 (%)



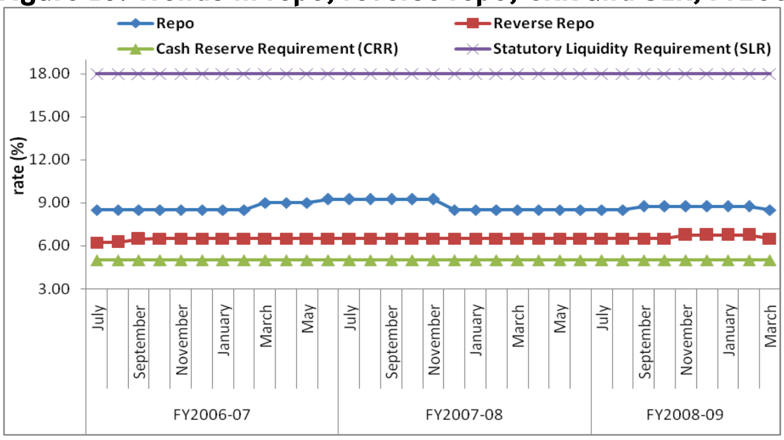
Source: BB (2009c).

35 BB raised the interest rate of repo to 8.75% on 17 September 2008 from 8.50% and then re-fixed interest rate on reverse repo at 6.75% on 19 November 2008 from 6.50%.

On 17 March 2009, the central bank increased loan disbursement limits for the four SCBs which will allow them to lend more aggressively. These banks will now be able to increase the amount of lending by 10% over the preceding year (previously the growth was limited to 5%). Additionally, the ceiling on single borrower exposure has been raised by another 5% of paid-up capital. Together with the reduced repo and reverse repo rates introduced earlier, these measures are expected to enhance credit flow to productive sectors of the economy.

As in many other countries, in recent times Bangladesh has been using indirect instruments such as repo and reverse repo as the major monetary policy instruments, as distinct from direct instruments of cash reserve requirement (CRR) and statutory liquidity ratio (SLR). These latter two ratios have tended to remain constant over the past years. A survey on monetary policy instruments in developing, emerging and developed countries has observed that in recent years a majority of countries have abandoned the use of direct instruments as vehicles of monetary policy (Buzeneca and Maino, 2007).

Figure 16: Trends in repo, reverse repo, CRR and SLR, FY2006/07-FY2008/09 (%)

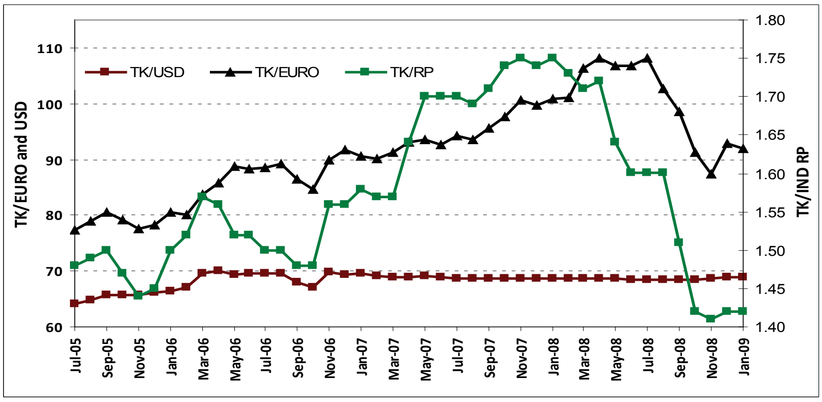


Source: BB (2009b).

3.2.5 Exchange rate

At the global level, all major currencies have become weaker against the US dollar (Figure 17). On the contrary, the taka has continued to remain stable against the dollar. Consequently, the taka has appreciated considerably against other currencies, including the euro and the Indian rupee.[36] Depreciation of both the rupee and the euro against the dollar resulted in appreciation of the taka by 21.5% and 13.4%, respectively, between February 2008 and February 2009. In view of apprehension about the weakening competitiveness of Bangladesh's exports in the global market in recent times, the idea of dual exchange rates and proactive interventions towards depreciation of the currency have been floated.

Figure 17: Movements of taka against US$, Euro and Indian rupee, 2005-2009

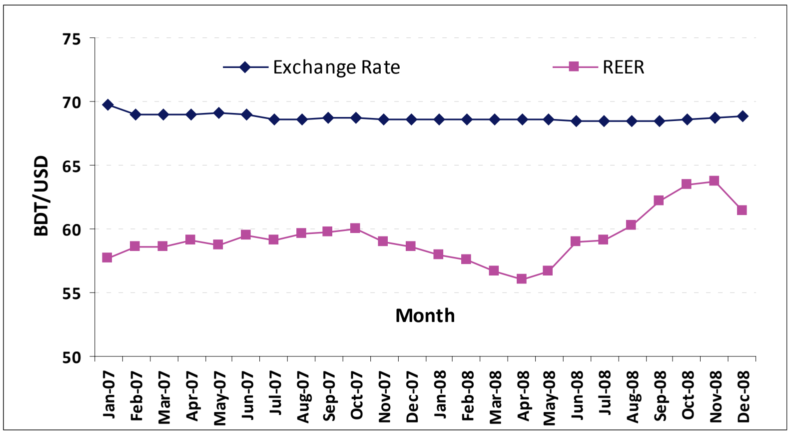


Source: BB (2009c).

36 Euro/taka and rupee/taka rates are calculated from the traded rates of US$/taka.

Movements of the real effective exchange rate (REER) (Figure 18) would not, however, support the idea of further depreciation of the taka. Indeed, in recent times, BB's policy appears to be geared towards maintaining stability of the price of the dollar against the taka. The apprehension is that policy-induced depreciation could lead to higher prices for export-oriented inputs and also imports in general, and have negative impacts on the expected decline in inflationary pressure.

Figure 18: Exchange rate and REER, 2007-2008 (taka/US$)



Source: BB (2009e).

3.3 Balance of payments: Still healthy, but concerns for near future

Over 19% growth in exports and around 30% of higher remittance flow helped Bangladesh to maintain a healthy balance of payments (BoP) situation at the end of December 2008. High growth in imports, driven by high commodity prices in the initial months of FY2008/09, however, resulted in a deteriorated trade balance compared with July-December of the previous year (Table 15). While trade balance during July-December of FY2007/08 was US$-2227.0 million, during the same period it stood at $-2974.0 million in FY2008/09. But thanks to higher remittance inflow, the current account balance maintained a surplus of $232.0 million during July-December FY2008/09, albeit lower compared with the $298.0 million surplus during the matching period of the previous year. Combined with a surplus of $213.0 million in the financial account (which was a deficit of $130.0 million in July-December FY2007/08), the overall balance experienced a higher surplus of $489.0 million in the first six months of the current fiscal year compared with $44.0 million for the corresponding period of the previous year.

Table 15: Balance of payments situation, FY2006/07-FY2008/09 (US$m)

	FY2006/07	FY2007/08	Jul-Dec FY2007/08	Jul-Dec FY2008/09
Trade balance	**-3458**	**-5541**	**-2227**	**-2974**
Exports fob*(including export processing zones – EPZ) 1/	12053	13945	6421	7708
Imports fob(including EPZ)	-15511	-19486	-8648	-10,682
Current transfers	**6554**	**8743**	**3839**	**4874**
of which, workers' remittances	5979	7915	3441	4505
Current account balance	**936**	**672**	**298**	**232**
Capital account	**490**	**576**	**338**	**130**
Capital transfers	490	576	338	130
Financial account	**762**	**-431**	**-130**	**213**
i) FDI (net)	793	650	285	706
ii) Portfolio investment	106	48	48	-48
iii) Other investment	-137	-1129	-463	-445
Errors and omissions	**-695**	**-213**	**-462**	**-86**
Overall balance	**1493**	**604**	**44**	**489**

Note: * fob = free on board.
Source: BB (2009b).

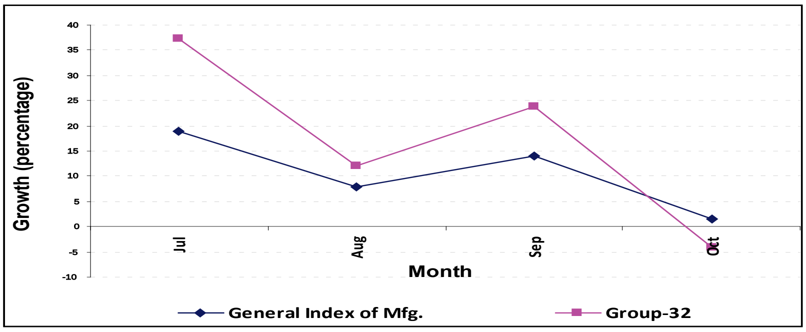
How the BoP situation will develop, and whether the trade balance and current account balance will further improve, will hinge on the extent of deceleration in import payments in view of falling global commodity prices, and the impact of the ongoing crisis on export earnings (affecting not only non-RMG but also the RMG sector) and remittance flow of Bangladesh, and also the aid situation.

3.4 Real sector: Weak investment may put medium term outlook under strain

Production of rice during Aus and Aman season of FY2008/09 was satisfactory, which helped Bangladesh keep inflationary pressure under control in recent months. Preliminary estimates of Aus production indicate a 25.7% annual growth in FY2008/09. Despite the fact that some areas were affected by flood in 2008, and there were reports of insect attacks in some pockets of production, field-level information is indicative of an overall satisfactory Aman production in FY2008/09. If potential benefits of measures initiated for the Boro season (e.g. revision of fuel and fertiliser price and subsidies and greater availability) can be realised effectively on the ground, a good Boro harvest could be expected this year, critical to ensuring food security and helping further reduction of inflation.

While good harvests in the agriculture sector could provide a cushion of comfort for the government during these troubled times, slowdown in the industrial sector is likely to become a major concern in the near term. During the first four months of FY2008/09, production estimates based on quantum index of production (QIP) of large and medium-scale manufacturing industries have recorded a moderate growth of 10.6% (Figure 19). Within the general index, Group 32, which includes major export-related industries (e.g. jute, cotton, apparels and leather, etc., with 38.16% weight), registered 17.4% growth. However, growth of this group appears to have decelerated in October 2008, with adverse implications for the performance of the manufacturing sector.

Figure 19: Growth in industrial production, FY2008/09 (%)



Source: BBS (2008b).

However, it is the growth achieved in the first three months that is still holding the growth figure up. While the first quarter (July-September) of FY2008/09 showed growth of 13.5%, the first month in the second quarter (October 2008) achieved only 1.5% month-on-month growth over October 2007 (Table 16). For most of the categories of industries, production had slowed down in October 2008 which was a rather disquieting development (Table 16). Industrial growth performance also has important implications for export sector performance and should be carefully monitored to see whether the observed slow pace of growth is connected with the global crisis.[37]

37 The slowdown in production performance of jute textile, tanning and finishing is already reflected in export performance in the subsequent months. For RMG, the production figures are difficult to relate to export performance because of high volatility in RMG exports.

Table 16: Industrial production situation, October 2008 and July-October FY2008/09

	Unit	Production	
		Growth Oct 2008 (%)	Growth Jul-Oct FY2008/09 (%)
Jute textile	mt	-14.24	-8.03
Yarn	mt	2.63	3.33
Cloth	000' metres	10.04	9.58
Garments	Tk millions	-7.32	26.78
Tanning and finishing	000' m^2	-49.39	-35.11

Source: BBS (2008b).

Proxy indicators suggest that the declining trends in the manufacturing sector could continue in the near future. Indeed, letters of credit (L/C) figures show that, during the first quarter of FY2008/09 (July-October), both opening (37.5%) and settlement (40.1%) of L/Cs for industrial raw materials did maintain high growth. However, quite disturbingly, during the second quarter (October-December) of FY2008/09, L/C opening for industrial raw materials posted a negative -12.0% growth. L/C settlement of the same, however, posted a positive growth (26.8%), owing perhaps to high growth in opening of L/Cs during the previous quarter. L/C opening for capital machineries also declined by 39.8% in the second quarter, which was already negative (-3.0%) in the first quarter. What is noteworthy in this connection is that term loan disbursement fell quite sharply during the second quarter of FY2008/09, when disbursement declined significantly by 32.1%; to compare, disbursement was 30.8% higher in the first quarter of FY2008/09 (amounting to Tk4950.93 crore) over the first quarter of FY2007/08. This significant fall in disbursement in the second quarter was accompanied by 20.3% growth in recovery during the second quarter. This resulted in a net disbursement of a mere Tk4.35 crore (against Tk2567.02 crore net disbursement in the second quarter of the previous year), a 99.8% fall!

Table 17: Proxy indicators for manufacturing outlook and their recent trends

Indicators			Quarterly growth (%)	
	Jul-Sep FY2008/09	Oct-Dec FY2008/09	Jul-Sep FY2008/09	Oct-Dec FY2008/09
Average industrial output (QIP)	419.6	352.1	13.5	1.5*
L/C opening for industrial raw material (US$m)	2740.5	1837.4	37.5	-12.0
L/C opening for capital machinery (US$m)	397.4	230.1	-3.0	-39.8
Term loan disbursement (gross) (Tk crore)	4950.9	3989.6	30.8	-32.1
Term loan disbursement (net) (Tk crore)	1072.6	4.3	-7.5	-99.8

Note: * For the month of October 2009 only.
Source: BBS (2008b); BB (2009b).

L/C opening data for the first month of the third quarter of FY2008/09 (January 2009) portray a further dismal picture. L/C opening for industrial raw materials declined by 34.6%, compared with the L/C opening figure for January 2008. For capital machineries also, opening of L/Cs declined by 39.7% in January 2009. Opening of L/Cs for capital machineries experienced negative growth for all major groups of industries during the last few months, particularly those related to export (Table 18). Such a significant decline in import of capital machineries is likely to have negative implications for investment and could emerge as a major concern in the medium term.

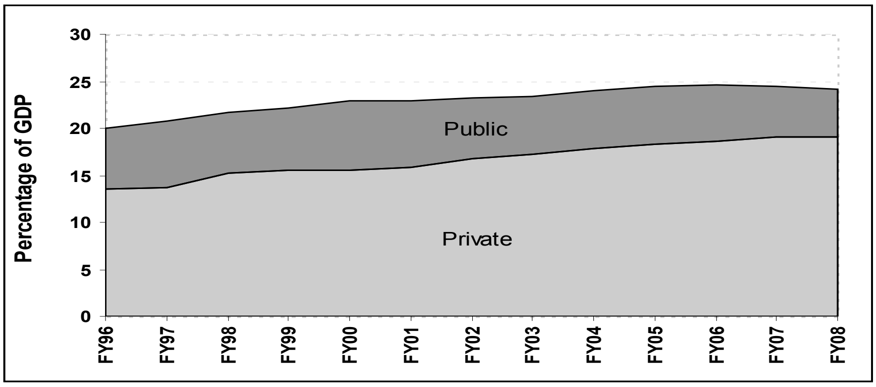
Table 18: Growth of L/C opening, FY2007/08 vs. FY2008/09 month-to-month growth (%)

Month	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Capital machinery	13.9	-39.4	26.8	-46.5	-34.9	-38.7	-39.7
Textile	-23.5	-6.8	-26.3	-59.1	-49.2	-57.6	-67.1
Jute industry	-52.0	-67.2	203.0	-53.4	253.4	-98.0	-94.8
Garment industry	71.0	-41.2	-0.9	-43.3	-9.3	-44.1	-46.6

Source: BB (2009b).

Along with the sharp deceleration of manufacturing sector growth, another emerging concern in the real sector of the economy relates to the stagnating investment scenario (Figure 20). For the second consecutive year, gross investment rate as a percent of GDP declined in FY2007/08. Following an insignificant improvement in FY2005/06, to 24.7% of GDP (from 24.5% of GDP in FY2004/05), the gross investment rate fell back to 24.5% in FY2006/07 and then to 24.2% of GDP in FY2007/08.[38]

Figure 20: Investment, FY1995/96-FY2007/08 (% of GDP)



Source: MoF (2008).

Public investment has continued to decline and scored a historic low rate of 5% of GDP in FY2007/08, lower when compared with the earlier low levels of 5.5% in FY2006/07. Low implementation of the ADP is a major reason for the slowdown in the pace of public investment, which in turn explains the fact of stagnating gross investment in recent times. Implementation of the ADP did not improve during FY2008/09 either; only 31% of the ADP could be implemented during the first seven months. Lack of availability of power has been a major problem, severely limiting growth potentials of the country. Significant public sector investment will be required to address the situation; however, the power division has managed to implement only 30% of the total ADP during July-January FY2008/09, which will adversely impact on gross domestic investment in FY2008/09. In this regard, it is worth underlining here that, as suggested by a BB analysis, public sector investment has a positive crowd-in effect for private sector investment in the Bangladesh context (Majumder, 2007).

Private investment, which covers four-fifths of total investment of the country, as a share of GDP increased marginally, from 19.0% in FY2006/07 to 19.2% in FY2007/08. However, as signs of political transition became clear, the private sector started to show renewed interest in investment. The BoI received some 1217 local investment proposals, with total investment registration amounting to Tk17,684 crore for January-October of 2008, against only 286 investment proposals with an investment registration of Tk1966 crore in the 12 months of 2007. The majority of these investment proposals (953) were made in the apparel/textile sector, of which 643 were in textile industries. However, as the aforesaid trends of proxy indicators, such as import of capital machineries, term credit and import data, would suggest, these registered investment proposals have perhaps remained mostly unrealised.

38 This was, however, lower than the medium-term macroeconomic framework (MTMF) target of the extended PRSP which was set at 24.9% in FY2007/08.

4. Bangladesh economy and global economic crisis: Implications of stimulus packages of other countries

Both advanced and emerging economies have initiated various fiscal and monetary measures in the form of bailouts and stimulus packages in view of the current economic meltdown. The objectives of such initiatives appear to be primarily fivefold: i) to restore confidence in the financial system and revamp and stabilise the financial market; ii) to stimulate domestic demand; iii) to create new job opportunities; iv) to support domestic industries; and v) to safeguard export interests. However, in today's globalised context, initiatives taken by one country are expected to have consequences for their competitor countries, through knock-on impact on consumer confidence and demand for imports, relative change in export competitiveness strength and availability of resources for aid, FDI and PFI. An evaluation of these is important from the perspective of designing Bangladesh's own stimulus package, if and when such an initiative is considered (major features of the packages declared by India, China, Vietnam and Indonesia are given in Annex 1).

A review of stimulus packages by countries mentioned above reveals some common policy stands: i) boosting domestic demand through additional investment in infrastructure and productive sectors; ii) fiscal stimuli by way of reduced duties and taxes; iii) aggressive monetary policy through rate cuts and reduced interest rates; iv) readiness to go for higher deficits to stimulate the economy; v) fiscal/financial incentives in the form of cash compensation schemes, income tax rebates, credit at reduced interest rates in support of export-oriented sectors; vi) competitive devaluation of the currency ranging from 6% to 40%.

For Bangladesh, this cross-country evidence has relevance in two ways: first, it provides an insight into the thinking of policymakers of neighbouring countries in the area of macroeconomic management against the backdrop of the ongoing crisis; second, it provides an idea about how export-competing sectors of these countries are being supported, with consequent impacts on Bangladesh's own relative competitiveness situation in the global market.

Initiatives of competing countries in the form of currency depreciation, tax rebates and duty drawbacks, lower interest rate, cash compensation schemes, availability of additional funds and other fiscal-monetary incentives are likely to undermine the competitive strength of Bangladesh's exports quite significantly in the global market. As noted earlier, for example, in the US and EU apparels markets, China, India and Vietnam are some of Bangladesh's major competitors. Stimulus packages of these countries have significantly enhanced their competitive edge vis-à-vis Bangladesh. Until now, Bangladesh's performance record has been maintained, thanks mainly to readiness of exporters to accept lower cut and make charges and profit margins. Yet another example relates to the adverse impact on backward linkage sectors, such as yarn/spinning, which have now lost a large part of their competitiveness as a consequence of stimulus-induced lower import prices of Indian yarns. It may also be recalled in this connection that, in the recent past, a number of large-scale buyers, particularly from Japan, have shown interest in sourcing apparels from Bangladesh in view of higher prices in China. The stimulus packages put in place by China have now limited Bangladesh's opportunity to avail herself of these new opportunities. In view of the above, and against the backdrop of the warning signs in the country's external sector performance, it is time for Bangladesh's policymakers to start to come up with their own stimulus package in order to support the country's export-oriented and also other sectors that have come to be affected by the crisis. Such a package is also required to help realise the emerging opportunities in the global market.

5. Bangladesh economy and global economic crisis: Policy stance, alternatives and tradeoffs

It is worth noting that BB took a number of energetic steps when the financial sector crisis first kicked off in October 2008. Central bank reserves were safeguarded through withdrawal from risky investments and transfer to reliable central bank accounts, and private sector financial institutions were immediately advised by the bank to protect their respective deposits. It helped that the capital market was exposed to foreign portfolio investment only to a limited scale (2.4% of market capitalisation) and exotic but toxic derivatives were not traded on the country's capital market. This enabled Bangladesh to avoid the consequences of the first wave of the adverse impact. However, as the analysis indicates, Bangladesh has not been immune to the second wave of impact, when financial crisis hit the real economy. The adverse impacts have started to be transmitted through various channels to the domestic economy.

The discussion above indicates that, while Bangladesh's economy has thus far been able to avoid the worst adverse consequences of the ongoing global crisis, a number of disquieting developments transmit cautionary signals and should be of concern to policymakers. Macroeconomic performance indicators relating to the first seven months of the current fiscal year do not appear to be off the recent trends. However, when month-on-month performance is put under scrutiny, one cannot fail to locate some disquieting developments. When these are considered and analysed in light of the ongoing global economic crisis, there is much reason to be concerned. Slowdown in export growth, lower number of workers leaving for jobs abroad, declining industrial growth, negative growth of import of capital machineries, slow growth of term loans, lower domestic resource mobilisation and adverse impact of policies pursued by competing countries are disquieting developments indeed. As the analysis indicates, these can to a large extent be related to the adverse consequences originating from the global economic crisis.

As noted, countries that have been adversely affected by the crisis have been taking an array of proactive measures in order to mitigate the negative fallouts and to address the challenges in the area of macroeconomic management. These countercyclical policies relate to exchange rate management, export incentives, tariff rates, credit and interest rates, domestic demand stimulation through investments in infrastructure development and policies to promote job creation.

It is reckoned that, as policymakers get on with the task of designing the budget for FY2009/10, they will weigh the policy options at their disposal to best accommodate the emergent situation. The work on the budget will begin in earnest in April, with the budget expected to be announced on 11 June 2009. It is to be mentioned here that the government has taken an initiative to bring about three million additional people, including RMG workers, under the rationing system (20kg/month of rice at a subsidised rate). The government has also declared expansion of entitlement under safety net programmes. However, the government is attributing these initiatives not as a consequence of the global financial crisis, rather as part of its programme of implementation of promises in its election manifesto.

The earlier government set up two task forces made of government officials, and on 24 March 2009 the much-awaited National Task Force, comprising 27 members, with the Minister of Finance as convenor, was announced. Its mandate is as follows:

1. To identify the **transmission channels** through which the impacts of the ongoing financial crisis will be transmitted to the Bangladesh economy, and to analyse relevant outcomes and indicators on a quarterly basis;
2. **Qualitative analysis** of economic situation and its review;
3. To **review and evaluate any depression-related model**, if these are available at various research and policy institutes. If these are not readily available, to encourage building of such models;
4. To keep the **investment growing and pursue growth-friendly policies**;

5. Avoid **excessive government spending**;
6. To **increase the pace of growth of rural and agriculture sectors** (to design employment generating recommendations for the domestic sector);
7. To continue ongoing endeavours to provide **adequate energy and undertake steps for improving physical infrastructure for electricity, gas, etc.**;
8. To remain **cautious about the exchange rate management** of the taka;
9. To remain **cautious about monetary policy and interest rate policy**;
10. To **analyse the BoP situation** (especially with regard to export earnings, remittance and foreign fund flow);
11. To **facilitate overseas employment**; and
12. To maintain **robust domestic demand**.

Some of the policy options that the government will need to weigh in relate to the areas elaborated in the following section.

Box 1: Suggestions and demand put forward by private sector organisations

Bangladesh Garments Manufacturers and Exporters Association (BGMEA)
- 10% cash incentive for RMG exporters on total export value.
- As an alternative, government could maintain a separate exchange rate for the sector and give Tk10 more against US$1, for 30% of total export value.
- Withdrawal of VAT from utility and other services (electricity, telephone, etc.) for the sector.
- Lower commercial lending rate of 7% (currently 13.3%).
- Rescheduling of three-year loans to five-year loans and seven-year loans to 10-year loans.
- Subsidised diesel for the RMG sector in view of the rising cost of power supply occurring from the use of generators owing to frequent power failure.

Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA)
- 10% cash subsidy to the knitwear industries on total export value.
- Reduction in interest rates to 10%.

Federation of Bangladesh Chambers of Commerce and Industry (FBCCI)
- A Tk6000 crore rescue package for the export sector (Tk3500 crore for garment exporters, Tk1400 crore for textile spinners and Tk 1100 crore for jute, leather, frozen food and vegetable exporters).
- Rescheduling and one-two year moratorium facility on bank loans.
- Relaxation of Credit Information Bureau (CIB) rules by BB which bars loan-defaulting companies from transacting export and import orders.

Metropolitan Chamber of Commerce and Industry (MCCI)
- A supportive monetary policy and conducive tariff regime rather than a direct cash incentive to exporters as part of the government's effort to tackle the recession. Supportive monetary policy and conducive tariff regime include reviewing and keeping the exchange rate stable and competitive, keeping the interest rate supportive to export and production, ensuring priority distribution of bank credit to agriculture, manufacturing and service sectors and limiting government's borrowing from the banking sector.
- If a cash subsidy is an absolute necessity, it is to be given after a thorough analysis by the government, only to affected businesses.
- Rescheduled term loans and creation of a contingency fund.
- Opportunity to whiten black money paying relevant taxes and 5% extra penalty tax.
- Reduced corporate tax rate and widened tax holiday facility as a tool to encourage more investments.

Bangladesh Finished Leather, Leather Goods and Footwear Exporters Association (BFLLFEA) and Bangladesh Tanners Association (BTA)
- Increase in cash subsidy to 25% on the total export value. The national budget has a provision of 15% cash subsidy to the sector.
- Credit flow at a lower interest rate of 5%.
- Waiver of interests and penalties for loans taken since 1 January 2008.
- Withdrawal of duties and VAT on inputs and machineries used by the tanneries along with abolishment of the provision of 25% tax at source for leather and leather products.
- A temporary suspension of recovery of interests on loans for two years.

5.1 Exchange rate

Exchange rate management is an important tool that policymakers have at their disposal but it involves various tradeoffs. A depreciation of the taka exchange rate will basically work in the same manner as cash incentives for exporters and remittances earners. However, it could adversely affect imports, domestic prices and inflation. While a taka depreciation could have a positive impact on export competitiveness and profits, the net impact in view of Bangladesh being a net importing country remains questionable. In the context of the recent high inflation, the need for transmitting the positive impact of falling commodity prices to consumers and constraining inflationary pressure also remains a concern. Also, depreciation will result in higher import cost of raw materials for export-oriented sectors.

As pointed out earlier, the REER appears to be below the nominal rate of the taka. Additionally, in a managed float system, the capacity to influence the exchange rate depends on various factors, including access to adequate resources to intervene in the market. Until now, Bangladesh's policy appears to have been focused mainly on maintaining stability of the dollar. Towards this, BB has intermittently been purchasing dollars from the market. Between 15 January and 11 March 2009, the bank purchased about US$269.2 million from the market, which helped restrain the taka from appreciating against the dollar. The current level of reserves ($5513.65 million on 9 March 2009) amounts to about 2.8 months of import payments, implying that there is further room to purchase US dollars from the market in order to replenish dollar reserves.

Since exchange rate manipulation is likely to have economy-wide impact, it is argued that a better policy option would be to have sector-specific intervention mechanisms in place rather than pursuing a proactive policy that induces the exchange rate to depreciate. As pointed out earlier, because of significant depreciation of currencies and other support measures put in place by many of Bangladesh's competitors, the competitive strength of Bangladesh's exports in the global market has seen significant erosion in the recent past.

5.2 Interest rate

Interest rates on lending have come under scrutiny in Bangladesh in the recent past. With high interest rates on deposits, induced by high inflation, the lending rate has also tended to remain high. As noted, notwithstanding, the spread between the lending and deposit rate is considered high and thereby discourages investment. In spite of repeated attempts by BB, not much has happened in this context. In the 1990s Bangladesh gradually shifted towards market-driven policymaking in determining the interest rate. BB routinely uses repo and reverse repo interest rates and open market operations to regulate levels of reserve money and influence growth of B2 and its components on the asset (credit) and liability (currency and deposit) sides, rather than imposing direct influence on the interest rate.

Changes in the CRR and SLR for scheduled banks are the other monetary policy tools used, albeit less often. However, the extent to which the interest rate is able to stimulate investment and economic activities in Bangladesh has been questioned. Results of an empirical study by BB suggest that investment spending at the aggregate level is non-responsive to interest rates (Ahmed and Islam, 2006). Investment spending at disaggregated level is responsive to the interest rate, to a limited scale, for the private sector investment category. A conducive business environment and overall good governance remain critically important factors; the lending rate appears to be a sufficient factor in stimulating investment. However, in view of bolstering the competitive strength of both export-oriented and domestic market-oriented activities, availability of credit at a lower interest rate remains a vital issue. Against a backdrop of high liquidity in the system, it would appear that there is scope to reduce this high spread.

5.3 Reduction in duties, taxes and bank charges

The rate of duty on capital machinery imports and spare parts was reduced from 5% to 3% in the FY2008/09 budget. In this regard, the CPD (2008) observed at the time that, given the depressed investment scenario, imports of capital machinery and spare parts may be made duty free to stimulate industrial investment. At present, export-oriented industries import capital machinery and spares on payment of 1% customs duty – the indemnity bond system was abolished and replaced with a concessionary rate of 1% in the FY2008/09 budget. The aforesaid CPD report pointed out that this has raised exporters' production costs. This concessionary rate of 1% could be revisited by the government in the upcoming budget. In the budget of FY2008/09, customs duty on basic raw materials was reduced to 7% from 10%. At the same time, duty on intermediate raw materials was reduced from 15% to 12%. In view of the current financial crisis, a number of countries have adjusted their duty levels. The government may think about further rationalisation of these rates.

In July 2008, the government relaxed import conditions to enable producers to take advantage of low-cost Indian yarn. To protect the interests of the local spinning sector, the government has now tightened rules on yarn imports, particularly from India. Imports are subject to more rigorous checks on yarn-count and chemical tests. The present move by the government in tightening the rules is expected to benefit local yarn industries. However, additionally, local spin millers are demanding a rescheduling of the loan payback time. In view of this, extension of loan settlement could be considered.

A number of fiscal measures were proposed in the budget for FY2008/09 in support of SMEs. For example, the SME sector has been given income tax relief by defining SMEs as entities with an annual turnover below Tk2.4 million. The upper limit of investment in capital machinery, in order to enjoy the cottage industry benefit (i.e. no VAT), was increased from Tk700,000 to Tk1.5 million and the turnover limit was raised from Tk2 million to Tk2.4 million. This measure is expected to help growth in the SME sector. At the same time, VAT was set to be withdrawn from the production stage for some items, including fabrics produced from artificial fibres and thread using handlooms. A tax holiday was given to agro-processing industries. In view of the crisis, many countries, such as India and Vietnam, are now putting in place new initiatives in support of small and medium domestic industries, particularly to boost domestic demand. Various industries, as noted, received support through duty cuts and access to funds at lower cost. While designing the budget for FY2009/10, the Bangladesh government may consider revisiting the existing tax and duty structure and undertake further adjustments against the backdrop of the gloomy investment outlook.

Earlier, Bangladesh's exporters and importers raised concern about high bank charges for various services offered. To mitigate the situation, BB issued a circular (September 2008) through which banks were asked to undertake certain disciplines in making service charges.[39] The government will need to strongly monitor adherence to what is stipulated by this circular.

5.4 Credit line

In the budget for FY2007/08, the government allocated an endowment fund of Tk100 crore for the SME Foundation to provide credit to SMEs through private commercial banks. Government has decided to provide more funds to the Foundation in the FY2008/09 budget; an additional amount of Tk100 crore was allocated in support of SMEs. The SME Refinancing Scheme of BB allocated Tk500 crore in FY2008/09, up from Tk300 crore in the previous year. Other than this, allocations from the Equity and Entrepreneurship Fund (EEF) in the FY2008/09 budget (Tk100 crore) have been targeted to information technology-related industries.[40] BB has also indicated that it will establish a fund, under a refinancing

39 The circular was issued on 30 September 2008, fixing charges to be imposed for a number of services were fixed.
40 In FY2007/08 EEF allocations were also targeted to agro-based industries.

scheme, in support of the country's emerging shipbuilding industry, in a bid to help it to graduate into an important export earning sector.[41]

Many of Bangladesh's competitors have come up with initiatives to establish dedicated funds that would allow access to credit line at lower cost. Policymakers could think of establishing such funds in support of export-oriented industries that are facing difficulties in view of the global crisis. Such funds could be used to ensure credit flow to crisis-hit sectors at lower interest rates, with expanded repayment periods requiring a higher number of (smaller size) instalments for repayment. The government could also consider pursuing the commercial banks to extend the repayment period of the existing loans for the sectors that are already affected.

5.5 Cash incentive

An amount worth Tk1050 crore has been kept in the budget for FY2008/09 as a cash subsidy for 13 export-oriented activities, including frozen food, products made of hogla, straw, coir and sugar cane, bicycles, processed agricultural products, RMG, jute products, leather products, potatoes, hatching eggs and one-day chicks, liquid glucose and light engineering products. In view of the need to bolster competitive strength and lower the costs of doing business, this cash compensation scheme may be furthered. Immediate steps are required to release the arrear of about Tk2.43 billion cash subsidy which was not released to the 13 sectors eligible for this support.

As detailed, Bangladesh's competitors are coming up with various initiatives to address the emerging challenges. Recently, India has announced the setting-up of a cash incentives programmes for a number of items. For example, a Rs325 crore export incentive programme has been established for apparels and leather products that are to be shipped to the US and EU markets. Exporters will receive 2% of the exported value as an incentive from April 2009.[42] India has also made an additional allocation of Rs350 crore for export incentive schemes; the exact mechanism to implement the scheme is yet to be known – this could take the form of cash incentives, tax refund for import of inputs, etc. At the same time, along with India, other countries, including China and Indonesia, are creating multibillion dollar funds mostly directed towards infrastructure development, domestic demand stipulation, tax and duty refund, support to export-oriented sectors, etc.

Table 6 provides an idea about the volatility being faced by the various export-oriented sectors. Although overall exports picked up again in January 2009 (12% growth compared with January 2008), disaggregated figures of the second quarter FY2008/09 and January 2009 testify to the fact that the global crisis has started to have an adverse impact on Bangladesh's export-oriented sectors and has subjected it to higher volatility. The government has said that it is considering the idea of expanding the existing cash subsidy scheme to an additional seven export items. These will need to be carefully selected. Forward-looking analysis will need to be undertaken towards this end, for example of the RMG sector's performance with regard to issuance of utilisation declaration (UD) certificates, important to get a preview of future export performance.[43] Evidence suggests negative growths of UDs for the months of December 2008 (-7.68%), January 2009 (-4.98%) and February 2009 (-17.5%). This is likely to have adverse consequences for the performance of the export-oriented apparels sector in future months.

As pointed out, Bangladesh has some fiscal space in FY2008/09 in view of lower budgetary expenditure pressure, particularly on subsidies. Using this cushion, the government could consider undertaking well-considered initiatives in view of the crisis. These could include economy-wide

41 BB has agreed, in principle, to create this fund, worth about TK500 crore and to be disbursed through commercial banks.
42 This facility will be provided on a temporary basis for six months.
43 UDs are certificates issued by the BGMEA and BKMEA to their member enterprises certifying the orders that they have received from apparels buyers through back-to-back L/Cs. The UDs (in volume terms) and their growth compared with earlier years provide an idea as regards trends in orders placed and hence give an indication about growth in volume in the near-term future (UDs are generally realised through exports in about two-three months).

measures, such as monetary and fiscal policies (influencing the interest rate, general fiscal rationalisation) as well as sector-specific measures (in the form of withdrawal of VAT, incentives for entry into new markets, product-specific tariff concessions, etc.) Two issues are important here: first, many such initiatives should be strictly time-bound and, second, they should be strictly monitored to ensure that they are targeted and used in an appropriate manner. Such initiatives could be in two forms: immediate measures of support and through the upcoming budget for FY2009/10. The National Task Force set up by the government is mandated to monitor the impact of the crisis on various sectors of the economy. Its work will be critical to addressing the attendant challenges. The government may like to consider the idea of a comprehensive stimulus package if, on the basis of performance of macroeconomic indicators relating to exports, imports, remittances, industrial growth and the domestic labour market, the Task Force puts forward such a suggestion to the government.[44]

Support to backward linkage industries of apparels, in the spinning sector, could bolster Bangladesh's competitive strength. Better performance of trousers compared with shirt items in recent times testifies to relative advantages that originate from domestic backward linkages (denim sector) as against imported fabrics. In view of the need to help entrepreneurs to go for upmarket products and raise productivity, the government could also consider providing incentives for research and development activities and import of capital machineries. A technology upgradation fund could be set up to provide assistance for this. Any support should also take into account the emerging opportunities for Bangladesh's export sector.

5.6 Domestic demand stimulation

In these times of trouble, stimulating domestic demand must be seen as a critical policy instrument to address the adverse consequences of the crisis. Unlike many other low-income countries, Bangladesh has a formidable and large domestic market. Private consumption accounted for 74.5% of Bangladesh's GDP in FY2007/08. While the export sector is important, export value addition constitutes only about 9.0% of GDP. Unlike many other neighbouring countries to the east, Bangladesh economy is thus critically dependant on domestic demand. Stimulating private consumption through direct government expenditure would thus be the most effective way of stimulating the economy. In view of the low level of development of the financial market, direct fiscal budgetary support to stimulate domestic economic activities, job creation and domestic demand should be seen as major policy interventions in view of addressing the adverse affects of the crisis.

The upcoming budget provides an opportunity to take concrete steps in this regard. Effective implementation of programmes such as the 100-day employment generation programme, proposed initiatives in support of 'one job one family', higher allocation for Vulnerable Group Development/Feeding (VGD/VGF) and other social protection programmes could absorb shocks arising from a slowdown in export growth, slower pace of industrial growth and lower numbers of people going abroad. The government has already mentioned plans to go for a more expanded VGD programme and the introduction of a rationing system for selected groups of workers. The upcoming budget will need to reflect the government's initiatives and contemplations in this regard. Government's initiatives to pursue large-scale infrastructure projects could also play a positive role in stimulating domestic demand and creating jobs.

44 Some members of the Task Force in its first meeting on 24 March 2009 put forward a number of suggestions: speedy release of money under the Cash Compensation Scheme (CCS); withdrawal of renewal fee on diesel generators; relaxation of rules and regulations relating to loans and loan defaults; withdrawal of VAT on export income; expansion of safety net programmes; support to modernise the Bangladesh Standards and Testing Institution (BSTI) to meet standardisation requirements. Emphasis was put by many on agriculture and rural development and infrastructure development, particularly energy. A recurring issue mentioned was that of the high interest rate on lending and ways to bring it down.

6. Concluding remarks

The third wave of adverse implications of the ongoing crisis appears to have started to hit the increasingly globally integrated economy of Bangladesh. The need to take policy initiatives in order to address the emerging challenges originates from four considerations:

1. Negative impacts affecting the economy through various transmission mechanisms;
2. Possible adverse impact of policies pursued by other countries;
3. The need to stimulate domestic demand in view of knock-on affects on production and employment situation; and
4. Taking advantage of emerging opportunities.

The upcoming budget offers an opportunity to undertake medium-term economy-wide as well as targeted initiatives in view of the above challenges. However, concrete sector-specific measures will need to be considered for immediate implementation. Three considerations could inform policy choices in this regard: first, as pointed out, the government will be able to take advantage of fiscal space in the 2008/09 budget; second, targeted measures can be put in place for a limited period, i.e. would be of a clear time-bound nature; and third, any opportunity arising from any global stimulus/initiative must be fully exploited. The analysis in this report has mentioned various possible initiatives to stimulate both production-related activities and domestic demand as instruments of possible countercyclical measures. These are related to tariff rationalisation and tariff rebates; a stimulus package for export-oriented sectors in the form of cash incentives; duty-free access for inputs; setting up a technology upgradation fund; establishing special credit lines for lending at reduced interest rates; income tax rebates; setting up of dedicated funds for returnee migrant workers; domestic demand stimulation through enhanced safety net programmes; and higher entitlements and higher investment in infrastructure programmes that create jobs and income-earning opportunities.

Along with the above, renewed efforts to improve the overall governance and business environment to raise the quality of implementation of various initiatives and programmes of the government, and greater efforts to mobilise higher domestic resources, will be needed to address the emerging challenges.

The recent G-20 meeting provided an opportunity to highlight developing country interests with respect to aid and debt cancellation. There is likely to be a renewed call for raising aid commitments to 0.7% of the GNIs of developed countries;[45] a review of the global financial architecture and the role of World Bank and IMF are also on the cards. In the last meeting of the G-20 finance ministers and central bank governors (14 March 2009), there was an appeal to ensure higher capital availability to multilateral development banks; the need for a substantial capital increase for the ADB to help the world's poorest was highlighted in this context. As a leading member of the LDC group, Bangladesh should play an active role in this debate. The attention of the international community in recent times has been focused relatively more on Africa, even though the vulnerabilities of Asia Pacific low-income countries are also being quite manifestly exposed as a result of the ongoing crisis. It needs to be emphasised in this context that any package of support should not exclude low-income countries of the Asia Pacific region. In this connection, it may be recalled that Bangladesh has not been considered for support from the Millennium Challenge Account (MCA) put in place by the US government; this could be an opportunity to explore Bangladesh's inclusion.

It needs to be recalled in the context of the current discussion that over the recent past Bangladesh had suffered a reversal of poverty reduction because of high inflation, particularly on account of high prices of essentials. Possible negative consequences of the ongoing crisis could undermine Bangladesh's efforts to reverse this reversal of poverty reduction trends. In view of this, every effort will need to be put in place so that policy initiatives are geared towards a higher pace of poverty alleviation

45 It is also to be kept in mind that the devaluation of the British pound against the dollar (by about 30%) and the euro against dollar (by about 15%) over the past one year is likely to cut the value of EU commitments.

and that attainment of the MDGs by Bangladesh continue to stay on track. Global economic crisis is likely to make both of these tasks much more challenging in 2009, and perhaps beyond.

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Annex 1: Stimulus packages of other countries

This section highlights salient features of stimulus packages announced by selected countries over the recent past.

India

In response to the global financial crisis, the Indian government has announced three rescue packages. On December 2008, India declared the first stimulus package, worth US$4.0 billion, with several fiscal measures and support for infrastructure development. The Indian government adopted an across-the-board 4% cut in central value added tax, aimed at bringing down the prices of both consumers' as well as producers' goods (cars, cement, textiles and others). Export support measures included: i) pre- and post-shipment export credit for labour intensive exports, i.e. textiles (including handlooms, carpets and handicrafts). Leather, gems and jewellery and marine products and SME sectors were provided incentives through an interest subvention of 2% up to 31 March 2009 subject to a minimum rate of interest of 7% per annum; ii) additional funds of Rs1100 crore to ensure full refund of terminal excise duty or central sales tax; iii) an additional allocation for export incentive schemes of Rs350 crore; iv) government back-up guarantee to be made available to the Export Credit Guarantee Corporation of India Ltd to the extent of Rs350 crore to enable it to provide guarantees for exports to difficult markets or products; v) exporters to be allowed a refund of service tax on foreign agent commissions of up to 10% of fob value of exports. They were also to be allowed a refund of service tax on output services while availing benefits under the Duty Drawback Scheme.

Incentives for textiles sector included: i) an additional allocation of Rs1400 crore to be made to clear the entire backlog in the Technology Upgradation Fund scheme; and ii) all items of handicrafts be included under the Vishesh Krishi & Gram Udyog Yojana (Special Agriculture and Village Industry Scheme). The package also contained full exemption from basic customs duty on industrial intermediate naphtha to give relief to the power sector and withdrawal of export duty on iron ore fines while cutting down the levy on export of iron lumps from 15% to 5%. The government declared that it would accord the highest priority to supporting the medium, small and micro enterprises sector, perceived to be critical for employment generation. To facilitate the flow of credit to this sector, the Reserve Bank of India announced a refinance facility of Rs7000 crore for the Small Industries Development Bank of India, which would be available to support incremental lending, either directly to the enterprises or indirectly via banks, non-banking financial companies and state financial corporations.

The following steps were also taken in the first stimulus package of the Indian government: i) to boost collateral free lending, the current guarantee cover under the Credit Guarantee Scheme for Micro and Small Enterprises on loans was to be extended from Rs50 lakh to Rs1 crore, with a guarantee cover of 50%; ii) a lock-in period for loans covered under the existing Credit Guarantee Scheme would be reduced from 24 to 18 months in order to encourage banks to cover more loans; iii) government would issue an advisory to central public sector enterprises and request state public sector enterprises to ensure prompt payment of bills of medium, small and micro enterprises. Easing of credit conditions was likely to help public sector undertakings to make such payments on schedule. The Reserve Bank has announced that in the near future it will put in place a refinance facility of Rs4000 crore for the National Housing Bank. As a further measure of support to the housing sector, public sector banks would announce in the immediate term a package for borrowers of home loans in two categories: up to Rs5 lakh and Rs5 lakh to Rs20 lakh.

Following the announcement of the first stimulus package, there was criticism on the grounds that not enough was done to address the liquidity crisis that had deterred banks from lending to their clients and to face the adverse impacts of global recession. In January 2009, the Indian government announced that another US$4.0 billion would be pumped into the economy over the next two years. The second stimulus package had five elements, which included a strong focus on interest rate reduction; an additional liquidity injection to productive sectors; financial aid to the export sector; a boost to the infrastructure sector; and easier access to external commercial borrowings and foreign institutional investors. The stimulus package announced an additional expenditure to the tune of Rs20,000 crore during the current year, mainly for critical rural, infrastructure and social security sectors and measures to support exports, housing, medium, small and micro enterprises and textiles. The Reserve Bank reduced the repo and the reverse repo rate and, in addition, the CRR has been reduced with a view to injecting additional liquidity into the system. The reduction in policy interest rates and the CRR is expected to further encourage banks to lower interest rates and provide additional credit, infusing more liquidity in the market.

Credit targets of public sector banks are to be raised by an increase in the provision of sectoral credits, which the government would monitor closely. Duty entitlement passbook rates were to be restored to those prior to November 2008. The Duty Entitlement Passbook Scheme would be extended till 31 December 2009, which would provide predictability and stability in the short term for future contracts. Duty drawback benefits on certain items, including knitted fabrics, bicycles, agricultural hand tools and specified categories of yarn, were being enhanced. These changes would take effect retrospectively from 1 September 2009. Exim Bank would provide pre-shipment and post-shipment credit to Indian exporters at competitive rates from a line of credit of Rs5,000 crore obtained from the Reserve Bank.

The stimulus package also included measures to boost infrastructure spending, small and medium businesses and labour-intensive export sectors such as textiles and handicrafts. Several other initiatives, including tax rebate, credit facilities and devaluation of the rupee were also being pursued. It was envisaged that in the short term these expenditure of the central government would induce budgetary expansion and may lead to a higher budget deficit. However, it was felt by Indian policymakers that these initiatives were necessary to boost domestic demand, enhance investment and create employment opportunities, and hence were justified. Furthermore, as is known, between July 2008 and February 2009, the Indian rupee depreciated by about 18.4%.

At the end of February 2009, the Indian government came up with a third stimulus package. This included a 2% cut in excise duty and service tax. Service tax was reduced to 10% from the prevailing level of 12% and excise duty was reduced by a similar magnitude for items presently subject to 10%. Tax concessions would entail a revenue sacrifice of about Rs30,000 crore for the economy or about 0.5% of GDP. The package also includes an extension of 4% across-the-board excise duty cut beyond 31 March 2009 and excise duty on bulk cement to be 8% or Rs230 per metric ton, whichever is higher.

A special package of Rs325 crore for the employment-intensive industries was unveiled on 26 February this year. The package includes incentive for leather and textile sectors, removal of import curbs on gems and jewellery, relaxation in export obligations and a 5% in duty credit for exports of handmade carpets under the Focus Product Scheme, against 3.5% that was given earlier.

China

China announced a US$586 billion stimulus package in November 2008 to be implemented over the next two years to boost domestic demand in view of sluggish global demand and significant falls in exports.[46] This package was equivalent to about 7% of China's annual GDP. In the stimulus package, four trillion yuan were to be spent on upgrading infrastructure, particularly roads, railways, airports and the power grid; raising rural incomes via land reform; and social welfare projects such as affordable housing and environmental protection. China indicated a shift to 'moderately easy' monetary policy, where lending limits on commercial banks were being lifted. The stimulus package also involved a cut in VAT. One of the stimuli to boost the economy was raising tax rebates for certain exports to help

46 The yuan appreciated marginally in the recent period, which also had some negative impacts on China's exports.

producers cope with falling profit margins as a result of slacking market demand and rising cost of production. The adjustment involves 3486 items from labour-intensive industries such as textiles, garments, toys and hi-tech and high value added sectors such as anti-AIDS drugs and tempered glass.

Vietnam

Vietnam announced a US$1 billion demand stimulus plan in December 2008, focusing mainly on the manufacturing sector and infrastructure development. The budget deficit of the country is likely to rise to 7% from the current 5% of GDP. Vietnam has initiated a programme that encourages its people to use locally made products. The government would use economic stimulus package to help small and medium-sized businesses, especially those engaged in processing agricultural products and providing jobs for workers, particularly those involved in building rural infrastructure. The government would spend significant resources to assist poorest districts to implement social welfare policies. Supportive policies involving VAT, export duties for oil and coal and import taxes on car components are being pursued. To boost the purchasing power of the poor, the package included allowances for these population groups, who were severely affected by inflation, which was as high as 19.9% in December 2008. Vietnam depreciated the dong by 4.1% between July 2008 and February 2009.

Indonesia

The Indonesian government came up with a plan to launch a fiscal stimulus package worth about US$6.1 billion (R73.3 trillion) in March 2009 in view of the ongoing global financial crisis. The government estimates that up to three million new jobs will be created in the current year. Part of the fiscal stimulus relates to tax, which was already being implemented from January 2009, when a new income tax law began to take effect. Infrastructure expenditure was raised by another R2.0 trillion. The R73.3 trillion package included taxation stimulus worth R56.3 trillion and state expenditure stimulus worth R17.0 trillion. Taxation stimulus included reduction of tariffs, government-borne VAT and import duties and incentives related to income tax. The state expenditure stimulus consisted of infrastructure expenditure worth R12.2 trillion ($1.02 billion) and direct subsidy and energy subsidy worth R4.8 trillion ($400 million). The stimulus package is expected to increase the deficit in the 2009 state budget to 2.5% of GDP from 1% of GDP. During the past eight months, the Indonesian rupiah has been depreciated by about 30% in order to boost the country's export earnings.

Others

In response to the financial crisis, Association of Southeast Asian Nations (ASEAN) finance ministers have come up with a proposal to set up a multilateral fund of US$120 billion to boost the regional economy. Japan, China and South Korea have also joined the scheme; the agreement with regard to the fund will be finalised in May this year.

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