Part A: Economic and Financial Developments

Overview and Executive Summary

The first quarter of 2012/13 (Q1FY13) presents a mixed picture in terms of various factors associated with output growth. One indicator which has grown significantly is remittances (19.7 percent growth in Q1FY13 compared with 11.8% in Q1FY12 and an average of 10.2% in FY12) with likely positive consequences for both domestic consumption and investment. Other indicators are on par with the FY12 average e.g. private sector credit growth of 19.9 percent in Q1FY13 compared to an average of 19.7% in FY12 while ADP utilization of 12% in Q1FY12 is only slightly higher than the 11% in Q1FY12. On the other hand lower export growth (2.07 percent in Q1FY13 compared to a 6.2% average growth in FY12) and import growth (2.0% in Q1FY13 compared to a 5.2% average growth in FY12) point to a more moderate level of economic expansion.

CPI inflation (point to point) fell to 7.4 percent in Q1FY13 from 12 percent in September 2011, with average inflation at 9.69 percent in September 2012. This development reflected a slowdown in food inflation and the impact of monetary policy on non-food inflation and inflationary expectations. We expect average inflation to decline further in FY13.

The first quarter of FY13 witnessed three key developments related to monetary policy. First the sharp increase in foreign remittances during the quarter (19.7%) and higher foreign aid disbursements contributed to a sharp increase in Net Foreign Assets (27% over the quarter). While this favored a reserve build-up close to four months of import cover, it also led to some over-shooting of monetary targets. The second key development relates to the sharp decline in inter-bank rates which fell from 15 percent in June 2012 to 9.81 at end September 2012, and from a peak of 19.66 in January 2012. This confirms the ample liquidity prevailing in the banking system and as such BB is seeking to sterilize some of this liquidity to avoid a re-emergence of inflationary pressures. The third development centers around the healthy growth in private sector credit which during FY13 Q1 grew by 19.9%, against a target of 18.4%, suggesting that the credit envelope will not be a constraint towards achieving overall economic growth targets. Conversely net credit to central government is sharply lower than the same period last year.

In public finances tax collections appear to be broadly on track. NBR tax collections were 12.8 percent higher than raised in Q1FY13 and 18.6 percent of the budgeted amount for the whole of FY13. Higher revenue inflows from direct taxes (22.7 percent increase) and value added tax (15.7 percent increase) accounted mainly for the positive first quarter FY13 performance. Total government expenditure in Q1FY13 increased by 24.6 percent compared to Q1FY12. Within these outlays, ADP expenditures rose by 32 percent over Q1FY12.

Banking sector indicators present a mixed picture during Q1FY13 for a variety of reasons. The risk weighted capital asset ratio (RWCAR) for all banks improved from 10.35 in September 2011 to 10.85 in September 2012. However this latest number is lower than the June 2012 RWCAR of 11.31 due partly to higher provisioning in anticipation of the impending implementation of BBs new provisioning guidelines by some banks as well as an increase in NPLs. The Q1FY13 figure remains higher than the five year average of 10.4, though this varies across banks with state-owned and specialized banks lagging behind. The ratio of non-performing loan (NPL) to total loan for the banking sector, in both gross and net terms, increased. Gross NPL went up from 7.2%

to 8.8% between Q4FY12 and Q1FY13 with a 4% point increase among SCBs. At the same time the overall banking industry end Q1FY13 NPL figure remained lower than the last five year average of 9.3%. The return on asset (ROA) and return on equity (ROE), two important measures of bank profitability, declined in Q1FY13 compared to Q4FY12 mainly due to higher interest expenses which grew faster than interest receipts.

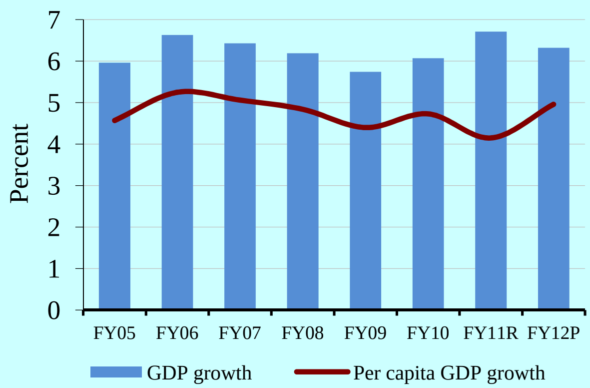
In the external sector, the current account balance (CAB) turned into a surplus of USD 140 million during Q1FY13 against a deficit of USD 10 million in Q1FY12. Remittance inflows increased by a remarkable 19.7 percent to USD 3.56 billion during Q1FY13 compared to USD 2.97 billion during Q1FY12 and more than covered the trade deficit of USD 2 billion and the deficit in other current services. The CAB surplus combined with a surplus in the capital account contributed to a overall balance of payment surplus of USD 1.1 billion in Q1FY13 against a deficit of USD 100 million in Q1FY12. As a result, gross foreign international reserves rose to USD 11.25 billion at the end of Q1FY13 compared with USD 9.88 billion in Q1FY12. The foreign exchange market remained mostly stable during this period with the Taka appreciating by 0.21 percent against the US dollar during Q1FY13.

Notwithstanding the continued global economic slowdown with likely negative impact on Bangladesh's trade and investment outlook, real economic growth in FY2013 is expected to be similar to the 6.2% average growth over the last ten years. We expect agricultural output targets to be met and that agricultural growth at 3.5-3.75% will be higher than FY12. We project that private sector credit growth will not be a constraint to achieving growth targets and assume better implementation of the Annual Development Program. Domestic demand will on one hand be fueled by higher worker remittance inflows while on the other hand it will be counter-balanced by more subdued rural consumer demand due to lower rice prices. Moreover export growth is forecasted to be lower than the 6.2% achieved in FY12 mainly in light of the Eurozone crisis. As such lower aggregate demand is likely to affect growth of the industrial sector which we are projecting at between 7.25-7.5% in FY13 compared to 9.5% in FY12. Service sector growth in FY13 is projected higher than the 6.1% growth in FY12 due to sharp increase in bank lending for key sub-sectors as well as insights from various service-sector related indicators in Q1FY13. These sectoral assumptions lead to our forecasted growth range of 6.1-6.4%. This forecast has downside risks from global and domestic sources. Global risks include a further slowdown in the EU and the possibility of the US economy not resolving its budget negotiations and suffering from the 'fiscal cliff'. Domestic risks include those related to natural disasters and any other unanticipated disruption to economic activity. Growth projections will be regularly revised based on new data.

I. Developments in the real economy

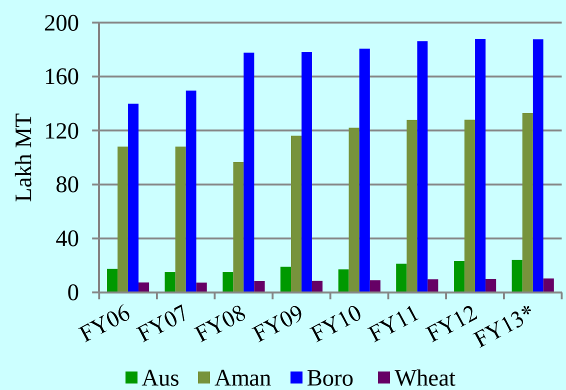
1.1 The first quarter of 2012/13 (Q1FY13) presents a mixed picture in terms of various factors associated with output growth. One indicator which has grown significantly is remittances (19.7 percent growth in Q1FY13 compared with 11.8% in Q1FY12 and an average of 10.2% in FY12) with likely positive consequences for both domestic consumption and investment. Other indicators are on par with the FY12 average e.g. private sector credit growth of 19.9 percent in Q1FY13 compared to an average of 19.7% in FY12 while ADP utilization of 12% in Q1FY12 is only slightly higher than the 11% in Q1FY12. On the other hand lower export growth (2.07 percent in Q1FY13 compared to a 6.2% average growth in FY12) and import growth (2.0% in Q1FY13 compared to a 5.2% average growth in FY12) point to a more moderate level of economic expansion.

Chart I.1: Growth of Real GDP



P=Provisional estimates of BBS

Chart 1.2: Production of Major Crops



*Target set by DAE

1.2 The total cereal food grain production target has been set at 37.6 million metric tons (MMT) for FY13 which is 1.9 percent higher than the production in FY12. The target for *Aus* production, the first crop of the fiscal year, was set at 2.41 MMT on 1.2 million hectares of land, a 3.43 percent increase from FY12. Available information indicates that *Aus* crop production met the target due to favorable weather and availability of agricultural inputs. The *Aman* production, the second largest crop and the second crop of the fiscal year, is targeted at 13.3 MMT on 5.6 million hectares of land which is 3.91 percent higher than the FY12 production. The production target for *Boro*, the largest crop, is set at 18.8 MMT on 4.8 million hectares of land which is same as the production of FY12. Wheat and maize production targets have been set at 1.04 MMT and 2.04 MMT respectively which are 4 percent and 4.62 percent higher than the actual production of FY12. Total vegetable production target is set at 12.7 MMT on 0.74 million hectares of land. This is 0.8 percent higher than the actual production of FY12. The target for potatoes is set at 8.6 MMT on 0.5 million hectares of land for FY13.

1.3 In order to contribute to the agriculture growth target, Bangladesh Bank has set a disbursement target of agricultural credit of Tk.141.3 billion for FY13 which is 7.62 percent higher than the actual disbursement of Tk.131.3 billion in FY12. During the first quarter of FY13, total agricultural credit disbursement was Tk.22.9 billion. This was 16.22 percent of the yearly target and 11.74 percent higher than the actual disbursement for the same period of FY12. Of the total agricultural credit disbursement during the first quarter of FY13, an amount of Tk.8.9 billion went to the crop sector, Tk.3.1 billion to poverty alleviation program and Tk.5.4 billion to others sectors.

Chart I.3: Quantum Index of Manufacturing Output

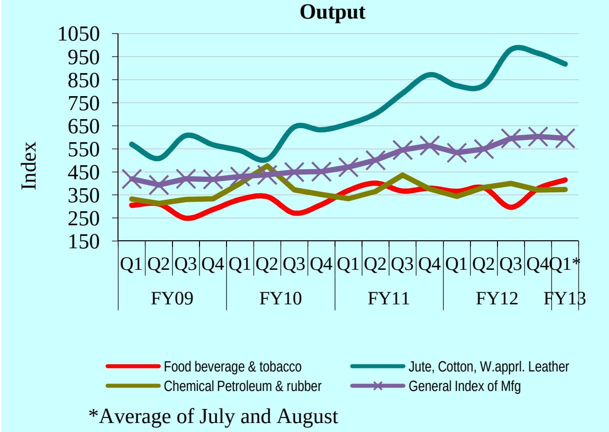
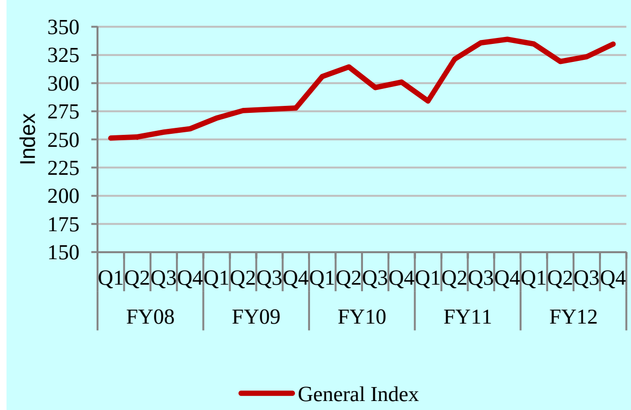


Chart 1.4: Quantum Index of Small Scale Manufacturing Industries



1.4 The Quantum General Index for industrial production (large and medium manufacturing) increased by 4.9 percent (y-o-y) during July-August of FY13 as against 13.3 percent growth in Q1FY12. The disbursement of industrial term loans grew by 30.69 percent to Tk. 97.20 billion in Q1FY13 as against the negative growth of 0.48 percent in Q1FY12. During Q1FY13, the disbursement of SME loan increased to Tk. 173.49 billion from Tk.137.77 billion in Q1FY12. This is 29.4 percent of the annual (calendar year) target and 25.93 percent higher than the actual disbursement in Q1FY12. At the end of Q1FY13, the outstanding SME loans stood at Tk. 1000.02 billion as against the amount of Tk. 931.48 billion at the end of Q4FY12.

1.6 There are a number of proxy indicators for service sector growth e.g. cargo handling, trade financing, bank advances to transport and communication sector and subscription of mobile phone. Total cargo handled (export and import) by Chittagong port grew by 9.4 percent during

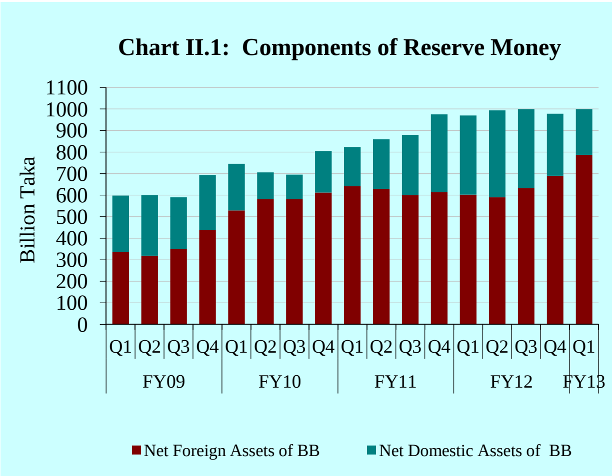
Q1 of FY13 as against negative growth of 2.37 percent in Q1 of FY12. Export cargo grew by 4.82 percent in Q1 of FY13 as against 0.02 percent growth in Q1 FY12 and import cargo increased by 10.01 percent during the quarter as against the negative growth 2.68 percent in Q1 FY12. The number of mobile phone subscribers reached 98.47 million at the end of September 2012 from 93.78 million at the end of June 2012 showing a growth of 5.0 percent growth during the quarter under report which was 5.8 percent in Q1 FY12. Bank advances on transport and communication registered an annual growth of about 84 percent in Q1FY13 as against the growth of 52.1 percent in Q1FY12. Trade financing increased by about 25.2 percent during the quarter under review as against the growth 18.6 percent growth in Q1FY12. In general, these indicators point to robust service sector growth in Q1FY13.

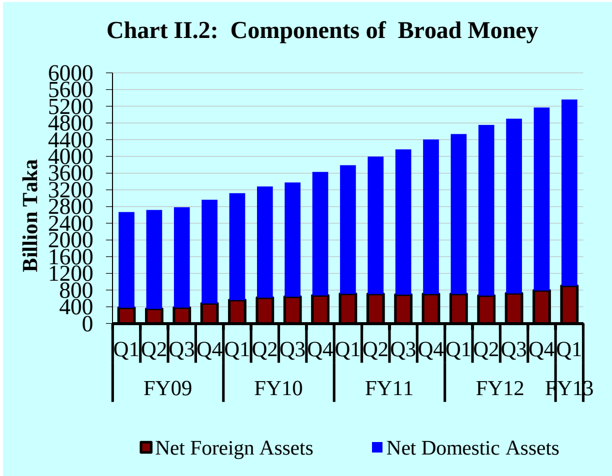
II. Money and Credit Market Development

2.1 The first quarter of FY13 witnessed three key developments related to monetary policy. First the sharp increase in foreign remittances during the quarter (19.7%) and higher foreign aid disbursements contributed to a sharp increase in Net Foreign Assets (27% over the quarter). While this favored a reserve build-up close to four months of import cover, it also led to some over-shooting of monetary targets. The second key development relates to the sharp decline in inter-banking rates which fell from around 15% in June 2012 to 9.81 during the quarter, and broadly from a peak of 19.66 in January 2012. This confirms the ample liquidity currently prevailing in the banking system and as such BB is seeking to sterilize some of this liquidity to avoid a re-emergence of inflationary pressures. The third development centers around the healthy growth in private sector credit which during FY13 Q1 grew by 19.88%, against a target of 18.4%, suggesting that the credit envelope will not be a constraint towards achieving overall economic growth targets. Conversely net credit to central government is sharply lower than the same period last year.

2.2 BB’s monetary policy for FY13 aim to contain reserve money growth to 13.8 percent, broad money growth to 16.5 percent and credit to the private sector growth to 18.0 percent (July, 2012, MPS). This monetary stance aims at containing inflation to 7.5 percent level while ensuring sufficient credit for Government’s real GDP growth target. During Q1FY13, reserve money growth stood lower at 10.44 percent compared with the programmed level of 13.0 percent. However, domestic credit growth was higher at 17.6 percent (y-o-y) compared with the 16.5

percent programmed growth for Q1FY13.Credit to the private sector increased by 19.9 percent compared with 18.4 percent programmed growth while credit to the public sector recorded a lower 9.4 percent growth compared with 9.5 percent growth programmed for Q1FY13. Policy continues to aim at of containing inflation and inflationary expectations, even though BB kept its policy rates unchanged in Q1FY13 after having adjusted rates upward in FY12.





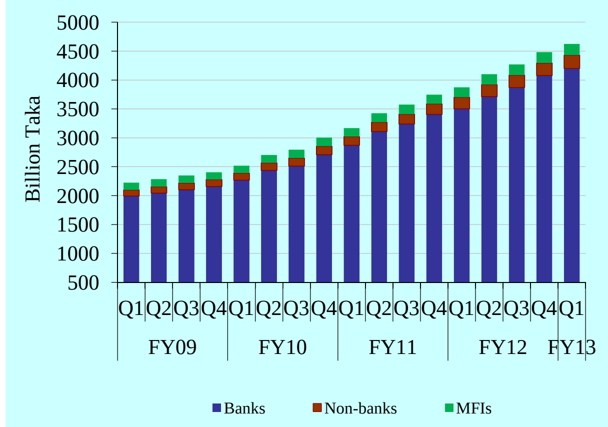
2.2 Provisional data show that M2 experienced a growth of 18.24 percent (y-o-y) and stood at Tk.5361.0 billion at end September, 2012 fueled mainly by 16.49 percent growth in NDA resulting from increased credit to the public (10.41 percent) and private sectors (19.88 percent) and 27.76 percent increased in NFA. Credit to govt. (net) slowed substantially in Q1FY13 registering a 13.93 percent growth compared with 50.37 percent growth during the same period of the preceding year. M1 increased by 6.22 percent at end September, 2012 compared to a much higher increase of 13.83 percent during the same period of the preceding year mainly due to a deceleration of growth in demand deposits and currency outside of banks.

2.3 A look at the components of M2 shows that currency, demand deposits and time deposits increased by 7.10 percent, 5.17 percent and 21.84 percent (y-o-y) respectively during Q1FY13 as compared with 14.90 percent, 13.19 percent and 21.44 percent respectively during the same period of the preceding year. The money multiplier (M2/RM) increased to 5.4 in Q1FY13 reflecting the relatively faster expansion of M2.

2.4 Reserve money (RM) grew by 10.44 percent (y-o-y) and stood at Tk. 999.5 billion in September, 2012 resulting from 30.62 percent increase in NFA of BB despite a 29.77 percent fall in NDA of BB. RM grew by 9.87 percent (y-o-y) in September 2011.

2.5 The total advances by economic purposes increased by 22.3 percent and stood at Tk. 3882.8 billion in Q1FY13 compared to an increase of 21.3 percent in Q1FY12. Bank advances to the storage sector increased by 29.2 percent in Q1FY13 while credit to the transport and communication sector increased sharply by 84.0 percent. Credit to the construction and industry sectors increased by 29.3 percent and 21.3 percent respectively in Q1FY13 and credit to the trade sector increased by 25.2 percent. The supply of credit to the agriculture sector increased by 8.1 percent at end of Q1FY13 (of which crops increased by 8.2 percent and non-crops by 6.7 percent) as compared with 19.1 percent growth in Q1FY12. Credit to the working capital financing increased by 12.5 percent in Q1FY13 as compared with 21.4 percent in the same period of the preceding year.

Chart II.3: Trends in Private Sector Credit



2.6 The disbursement of term lending by banks and NBFIs increased by 30.69 percent and stood at Tk. 97.20 billion at end Q1FY13, which was Tk.74.37 billion during the same period of the preceding year. Between Q1FY12 and Q1FY13, term lending by PCBs increased from Tk.

Chart II.4: Yield on T-Bills

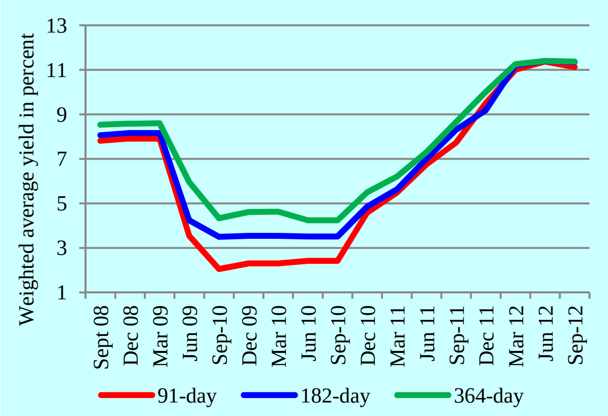
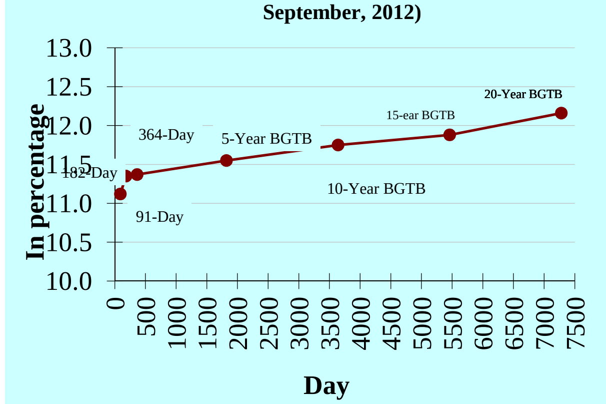


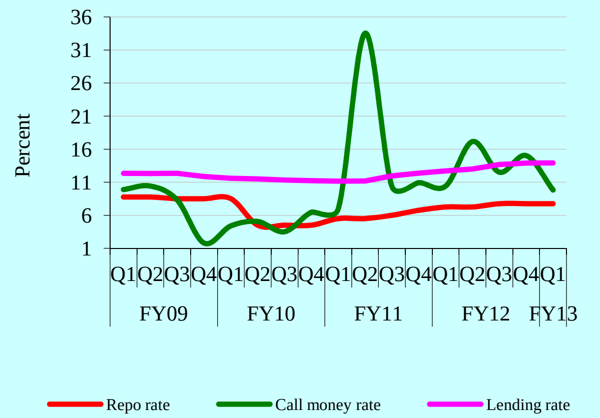
Chart II.5: Weighted average yield of accepted Government Treasury Bills & Bonds (End September, 2012)



50.88 billion to Tk.64.05 billion, SCBs term lending increased from Tk. 7.63 billion to Tk. 17.99 billion, that of FCBs increased slightly from Tk. 2.75 billion to Tk. 2.80 billion, term lending by specialized banks also increased from Tk. 3.17 billion to Tk. 3.94 billion during the same period while the term lending by NBFIs decreased from Tk.9.95 billion in Q1FY12 to Tk. 8.42 billion in Q1FY13.

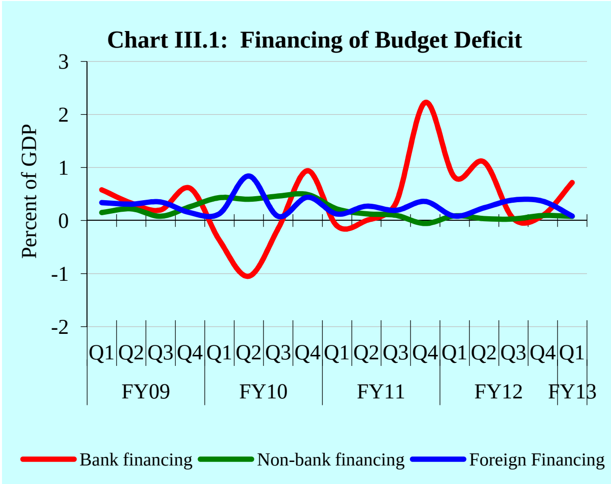
2.7 The repo and reverse repo rates were 7.75 percent and 5.75 respectively in September, 2012. These had increased by a total of 100 basis points to contain inflation and inflationary pressure emanating from various domestic and international factors in FY12. Overall yields on short term treasury bills e.g., 91-day increased to 11.12 percent in September, 2012 from 7.73 percent in September, 2011, while 182-day, 364-day treasury bills rates both were increased to 11.35 percent and 11.37 percent respectively at the end of September, 2012 from 8.30 and 8.65 percent respectively at the end of September, 2011. Long-term bond such as 5-year and 10-year increased to 11.55 and 11.75 percent respectively at the end of September, 2012 from 8.35 percent and 9.53 percent in September, 2011 (Table II.3), while the yields on 15-year, and 20-year BGTB both were also increased from 10.30 percent and 10.85 percent respectively to 11.88 and 12.16 percent in September, 2012. The call money rate came down to 9.81 percent at the end of September, 2012 which was 10.41 percent at the end of September, 2011 due to increased excess liquidity in the money market. The call money rate peaked at 19.66 percent at the beginning of Q3FY12 and its recent reduction reflects ample liquidity in the money market. The outstanding stock of NSD certificates in September, 2012 was Tk. 643.7 billion against Tk. 639.4 billion in September, 2011. This marginal increase occurred despite an increase in the yields of these instruments - the 3-Year and 5-Year NSD certificate rate were raised to 12.59 percent and 13.19 percent since Q3FY12 from 10.26 and 11.00 percent respectively at the end of September FY12.

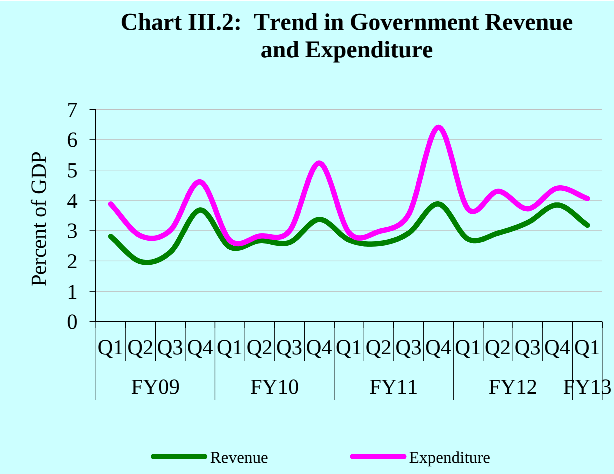
Chart II.6: Interest Rate Movements



III. Fiscal Developments

3.1 The national budget for FY13 estimated overall revenue and expenditure to be 13.4 percent and 18.4 percent of GDP respectively against 12.8 percent and 16.1 percent realized in FY12 generating a projected fiscal deficit of 5.0 percent of GDP in FY13 and an actual deficit of 3.4 percent of GDP in FY12. This expansionary fiscal stance remains in line with the government's target of achieving 7.2 percent growth in FY13 consistent with the target of attaining middle income status by 2021. In FY13, total deficit financing is set at Tk. 520.7 billion, of which Tk. 334.8 billion is projected to be financed by domestic borrowing including bank financing of Tk. 230.0 billion and non-bank financing of Tk. 104.8 billion and Tk. 185.8





billion from foreign sources including foreign grants of Tk. 60.4 billion (see Graph III.1).

3.2 The FY13 budget projects total revenue of Tk. 1396.7 billion of which NBR tax revenue is Tk. 1122.6 billion which is 18.8 percent higher from the actual level of FY12, non-NBR tax revenue is Tk. 45.7 billion which is 25.5 percent higher from the actual level of FY12 and non-tax revenue is 228.5 billion which is 23.1 percent higher from the actual level of FY12. This target of better revenue collection seems viable mainly because of continued legal, procedural and structural reforms in revenue sector. A new VAT law, electronic filing of taxes and Alternative Dispute Resolution (ADR) system introduced in the current fiscal year will play a significant role in scaling up revenue collection. Further, as a result of re-fixation of the rates of non-NBR tax and Non-Tax Revenue, revenue collection will be further accelerated. The NBR projects Tk. 404.7 billion from VAT (36.0 percent of NBR tax revenue), Tk. 353.0 billon from income tax (31.4 percent), Tk. 145.3 billion from customs duties (12.9 percent) and Tk. 219.7 billion from other sources (19.6 percent) for FY13, which are 14.1 percent, 25.0 percent, 9.4 percent and 25.9 percent respectively higher than the actual level in FY12. Preliminary estimated data indicate that NBR collected Tk. 208.9 billion during the first quarter of FY13 which is 12.8 percent higher than the corresponding level in FY12 and 18.6 percent of the annual target. The tax revenue growth was led by income tax, value added tax (VAT), other sources[1], and customs duties. During Q1 of FY13, tax revenue collected from income tax, value added tax (VAT), other sources, and customs duties increased by 22.7 percent, 15.7 percent, 4.4 percent and 1.6 percent respectively over the level in the corresponding period of FY12 (see Graph III.2).

3.3 In FY13, current expenditure and annual development program (ADP) expenditure were set at Tk. 995.0 billion (9.6 percent of GDP) and Tk. 550.0 billion (5.3 percent of GDP), which are 28.1 percent and 45.2 percent respectively higher than the actual level of FY12. Economic analysis of non-development expenditure of the FY13 budget shows that the largest allocations are likely to go to the heads of 'interest payment' (17.2 percent), 'pay and allowance' (17.0 percent), 'others, (16.6 percent), 'subsidies' (10.7 percent) and 'goods and services' (9.6 percent). The shares of development expenditure indicate that the largest allocations are likely to go to the heads of 'local government and rural development' (21.4 percent), both 'energy and power' and 'transport and communication' (16.8 percent to each), 'education and information technology, (13.1 percent), both 'agriculture sector' and 'others' (7.7 percent each) and 'health' (6.8 percent).

3.4 During the first three months of FY13, preliminary estimates of total expenditure stood at Tk. 422.5 billion (22.0 percent of target) which is 24.6 percent higher than the level of the corresponding period of FY12. The preliminary estimate of ADP expenditure stood at Tk. 63.8 billion (11.6 percent of annual ADP) which is about 32.0 percent higher than the level (Tk. 48.4 billion) of the corresponding period of FY12.

3.5 The overall budget deficit in FY13 was fixed at Tk. 520.7 billion excluding grants (5.0 percent of GDP) relative to the actual deficit of Tk. 309.0 billion (3.4 percent of GDP) in FY12. In FY13 budget, deficit financing from domestic and foreign sources is projected at Tk. 334.8 billion and Tk. 185.8 billion respectively compared to the actual level of Tk. 210.3 billion and Tk. 98.7 billion respectively in FY12. Among domestic sources, bank financing was set at Tk. 230.0 billion and non-bank financing at Tk. 104.8 billion in FY13, compared to the realized figure of Tk. 187.9 billion and Tk. 22.4 billion respectively in FY12. During the first three months of FY13, the preliminary estimate of the budget deficit stood at Tk. 91.8 billion (0.9 percent of GDP) compared to Tk. 90.5 billion (0.99 percent of GDP) in the same period of FY12. Deficit financing during the quarter under review amounted to Tk. 82.7 billion from domestic sources

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[1] Other sources include supplementary duty (local and import), excise duty, turnover tax, and travel tax.

that included bank financing of Tk. 74.7 billion and non-bank financing of Tk. 8.1 billion while the remaining amount of Tk. 9.0 billion was from foreign sources.

IV. External Sector Developments

4.1 The current account balance (CAB) turned into a surplus of USD 135 million during Q1FY13 against a deficit of USD 8 million during the same quarter of the previous fiscal year. During the quarter trade deficits increased to USD 1.98 billion against USD 1.91 billion recorded in the corresponding quarter of FY12. Workers' remittances which contributed more than 95 percent of total secondary income increased remarkably by 19.7 percent to USD 3.56 billion during Q1FY13 compared to USD 2.97 billion during Q1FY12. Based on the surplus in the CAB and capital & financial account the overall balance recorded a surplus of USD 1.11 billion during the Q1FY13 quarter against a deficit of USD 99 million in the first quarter of FY12. The foreign exchange reserve rose to USD 11.25 billion at the end of Q1FY13 against USD 9.88 billion at the end of the corresponding quarter of FY12. The foreign exchange market remained mostly stable experiencing 0.21 percent appreciation of Taka against US dollar during Q1FY13.

Chart IV.1: Trends in current account and overall balance

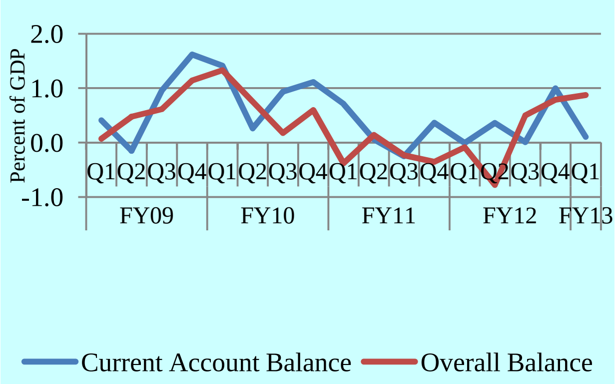
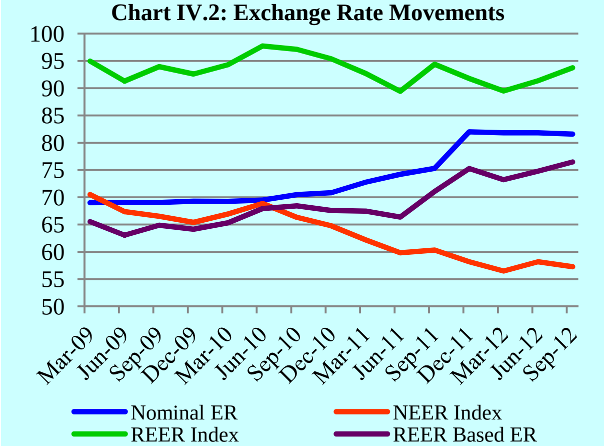
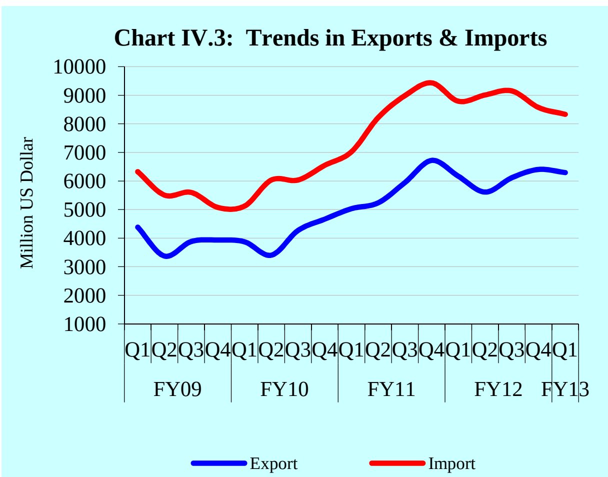


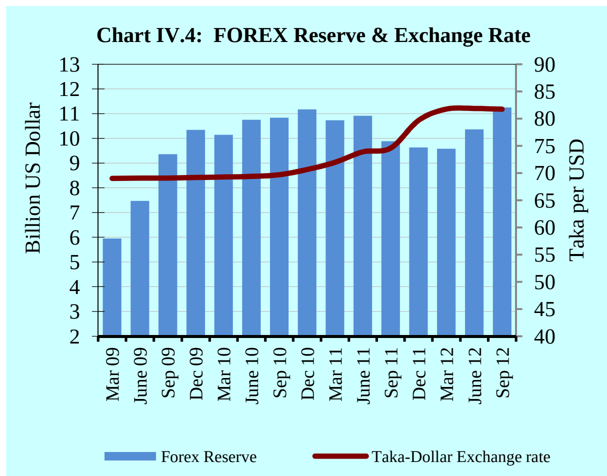
Chart IV.2: Exchange Rate Movements



4.2 The current account balance (CAB) maintained a surplus during first quarter of FY13 mainly due to a large increase in the secondary income (mainly remittances) in spite of higher deficits in the trade balance, services and primary income. The trade deficit widened from negative 1907 while the net services account witnessed a deficit of USD 928 million during Q1FY13 against a deficit of USD 763 million in the same quarter of previous fiscal. Deficits in the primary income account increased to USD 609 million compared to a deficit of USD 424 million in Q1FY12. In contrast, the surplus in the secondary income account increased to USD 3.66 billion compared to USD 3.09 billion of Q1FY12.

4.3 Capital and financial account showed a surplus of USD 1.03 billion during Q1FY13 against a surplus of USD 427 million in Q1FY12. The overall balance of payments (BOP) reached a surplus of USD 1.11 billion during Q1FY13 and the foreign exchange reserve was USD 11.25 billion at end September 2012.





4.4 The foreign exchange market remained mostly stable and experienced only 0.21 percent appreciation during Q1FY13. Bangladesh Bank continued its interventions in the domestic foreign exchange market which contributed to avoiding excessive volatility of the exchange rate. The REER based exchange rate increased to Taka 76.49 per USD at end September'12 from Taka 74.77 per USD at end June'12, suggesting a marginal loss in external trade competitiveness during Q1FY13.

4.5 Export earnings increased by only 1.7 percent to USD 6.19 billion (on adjusted fob basis and according to EPB data it was 2.1 percent) during Q1FY13 against USD 6.10 billion recorded during the corresponding quarter of FY12. The low growth in exports was mainly due to slower demand of RMG due to the financial crises in the advanced economies especially in the European Union and slower growth in USA which together account for almost 70 percent of the country's total exports. During Q1FY13 the export of jute goods (+10.4 percent), tea (+16.7 percent) and woven garments (+9.9 percent) increased while exports of raw jute (-18.9 percent), leather (-2.1 percent), knitwear products (-1.5 percent), frozen food (-66.1 percent), terry towels

(-19.2 percent) and fertilizer (-100.0 percent) recorded declines compared to the corresponding quarter of FY12 (Table IV.2).

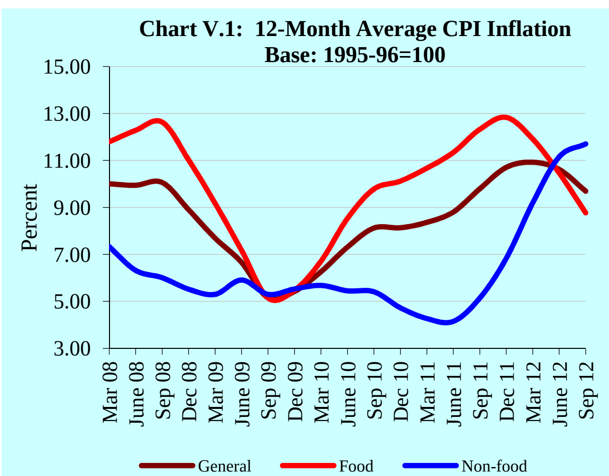
4.6 Import payments recorded 2.0 percent growth (on adjusted fob basis) to USD 8.17 billion during Q1FY13 compared to USD 8.01 billion in Q1FY12 (Table IV.3). Imports of foodgrains declined by 14.3 percent during Q1FY13 to USD 265.9 million compared to USD 310.1 million in Q1FY12 of which rice import decreased sharply by 94.4 percent (USD 10.9 million against USD 194.1 million) while imports of wheat increased by 119.8 percent (USD 255.0 million against USD 116.0 million). However, customs reported NBR data witnessed a sharper decline (68.3 percent) in foodgrains import during Q1FY13. Imports of other food items decreased by 34.4 percent to USD 501.0 million during the quarter under review compared to USD 763.3 million recorded during Q1FY12, of which the imports of milk & cream (+9.9 percent) and pulses (+55.9 percent) increased while imports of spices (-21.4 percent), edible oil (-47.6 percent) and sugar (-57.3 percent) decreased.

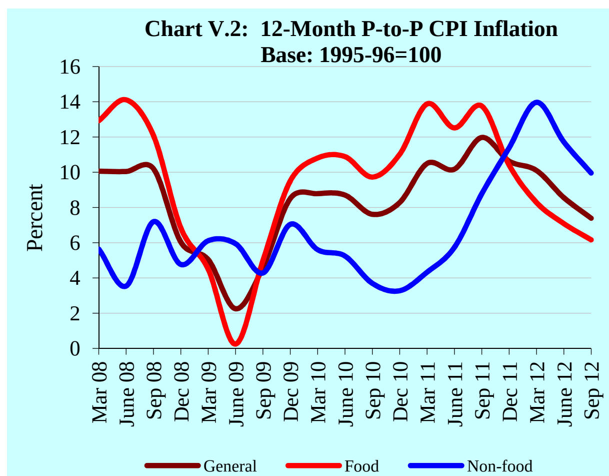
4.7 Imports of intermediate goods mainly used for manufacturing output increased by 4.9 percent during Q1FY13. Among the intermediate goods imports of crude petroleum (+13.6 percent), oil seeds (+151.0 percent), chemicals (+13.2 percent), pharmaceutical products (+15.9 percent), fertilizer (+62.3 percent), dyeing and tanning materials (+11.5 percent), plastic and rubber articles thereof (+10.3 percent), raw cotton (+15.7 percent) and staple fibre (+35.6 percent) increased while imports of clinker (-6.9 percent), POL (-5.3 percent), yarn (-17.6 percent) and textile and articles thereof (-6.5 percent) decreased. Imports of capital goods and others recorded a 12.5 percent decline in Q1FY13, of which imports of iron, steel and other base metals increased by 10.1 percent while imports of capital machinery (-23.1 percent) and other capital machineries (-15.3 percent) declined. During Q1FY13 LCs settlements for imports came down by 5.2 percent (y-o-y) to USD 8.04 billion which was USD 8.55 billion during the same period of previous fiscal.

4.8 The inflow of workers’ remittance recorded a remarkable 19.7 percent growth rising to USD 3.56 billion during Q1FY13 compared to USD 2.97 billion in Q1FY12. This higher growth was mainly due to higher manpower export during FY12 and greater access to formal banking channels. During Q1FY13 remittances from the Gulf region recorded 17.8 percent growth (Saudi Arabia, 10.9 percent, UAE, 28.3 percent, Oman, 70.4 percent and Bahrain, 56.0 percent, while remittance from Kuwait declined by 2.6 percent compared to the same quarter of previous fiscal year). Remittances from the Euro region recorded 25.5 percent growth while from the Asia-Pacific region remittances grew by 36.9 percent and 16.5% from rest of the world (including USA) during the quarter under review. The major sources of remittance during the quarter was Saudi Arabia (USD 943.2 million), followed by UAE (USD 689.8 million), USA (USD 433.9 million), Kuwait (USD 286.0 million), and UK (USD 275.7 million) (Table IV.4).

V. Price Developments

5.1 Twelve month point to point and average CPI inflation maintained its declining trend during the first quarter of FY13. While point to point food inflation fell throughout the quarter under review, non food inflation exhibited an uptick in the closing month of the quarter after declining for the previous five months. Gross rent and administered fuel and energy price were the dominant sources of current non food inflationary pressure in the country.





5.2 Both point to point and twelve month moving average CPI inflation in Bangladesh declined during Q1 of FY13 (July-September 2012). On the basis of old base year (1995-96=100), point to point overall inflation declined from 8.56 percent in June 2012 to 7.39 percent in September 2012. During this period point to point food inflation declined from 7.08 percent to 6.16 percent. However, after exhibiting a declining trend for the last five months, point to point non-food inflation rose to 9.95 percent in September 2012 from 9.59 percent in August 2012, which was 11.72 percent at the end of June 2012. It is clearly evident from Table 5.1 that the non-food component was the main driver of the current inflationary pressure. Among the non-food items gross rent, fuel and lighting were contributing more to overall inflation than their weight in CPI basket. Inflation (both food and non food) remained higher in urban areas compared to that in rural areas. The twelve month average inflation came down from 10.62 percent in June 2012 to single digit level of 9.69 percent in September in 2012 after 12 months, though it remained above the target of 7.5 percent set out in the national budget for FY13.

Bangladesh Bureau of Statistics has introduced a new base year (2005-06=100) for calculating the CPI since July 2012. On the basis of the new base year, the overall point-to-point inflation fell to 4.96 percent in September 2012 from 5.54 percent in June 2012. Point to point food inflation declined from 2.25 percent to 1.75 percent over the same period. On the other hand, non food inflation declined to 9.95 percent in August 2012 from 10.20 percent in June 2012 and then increased to 10.18 percent in September 2012.

Table-5.1

Contribution[@] of Food and Major Non-Food Items / Groups in CPI inflation(Y-o-Y)

Base Year: 1995-96=100

Months	**Food beverage & tobacco**	Clothing & Footwear	Gross rent, Fuel & Lighting	Furniture, Furnishing & Other	Medical care and Health Expenses	Transport & Communications	Recreation, Entertain-ment, Education & Cultural Services	Misc. Goods & Services	**Non-food**
Weight	**58.84**	6.85	16.87	2.67	2.84	4.17	4.13	3.63	**41.16**
Jan-12	**54.26**	11.29	19.73	2.88	1.55	5.29	0.71	4.29	**45.74**
Feb-12	**45.70**	12.96	23.74	3.56	2.00	6.11	0.87	5.06	**54.30**
Mar-12	**45.99**	12.65	23.39	3.59	2.16	5.87	0.93	5.42	**54.01**
Apr-12	**45.84**	12.47	24.02	3.39	2.16	5.86	0.91	5.36	**54.16**
May-12	**45.61**	12.49	25.45	3.41	2.03	4.96	0.96	5.08	**54.39**
Jun-12	**46.15**	12.37	26.37	3.41	2.36	3.99	1.00	4.33	**53.85**
Jul-12	**43.49**	11.91	30.33	3.36	2.61	3.61	1.02	3.66	**56.51**
Aug-12	**51.22**	8.79	26.07	3.12	2.55	3.55	0.95	3.76	**48.78**
Sep-12	**46.62**	9.96	28.39	3.60	2.72	3.49	1.14	4.07	**53.38**

$$@\ \textbf{Contribution of ith Group} = \left(\frac{\textbf{Inflation in ith group} \times \textbf{Weight of ith group in CPI basket}}{\textbf{Overall Inflation}}\right) \times 100$$

5.3 The restrained monetary policy pursued by Bangladesh Bank (BB), favorable domestic food grains production, moderate global commodity prices in the earlier months of 2012 (Chart V.3) and stable exchange rate contributed to the decline in point-to-point inflation in Bangladesh during the period under review. Satisfactory crop production in the country in last *aman* and *boro* seasons was well supported by weather conditions and adequate and timely supply of inputs and credit to the farmers. However, the benefit of these outcomes were partly offset by the successive upward adjustment of administered energy and fuel prices (petroleum oil, CNG and elasticity prices) in the domestic market whose adverse effect was felt on overall inflation during the period under review (Table-5.1). Though the upward adjustment of administered fuel and energy prices affected inflation in the near-term, it helped in reducing the medium-term inflationary pressures by containing the fiscal deficit.

To bring down inflation to its targeted path, Bangladesh Bank continued its restrained monetary policy for H1 of FY13, while ensuring adequate credit for the private sector to stimulate inclusive growth. BB's monetary policy uses repo, reverse repo, and BB bill rates as policy instruments for influencing financial and real sector prices toward the targeted path. In Q1 of FY13, BB maintained its repo and reverse repo rate at 7.75 and 5.75 percent respectively, both of which had been raised by 0.50 percentage point at the beginning of Q3 FY12.

Chart V.3: Commodity Prices in International Market

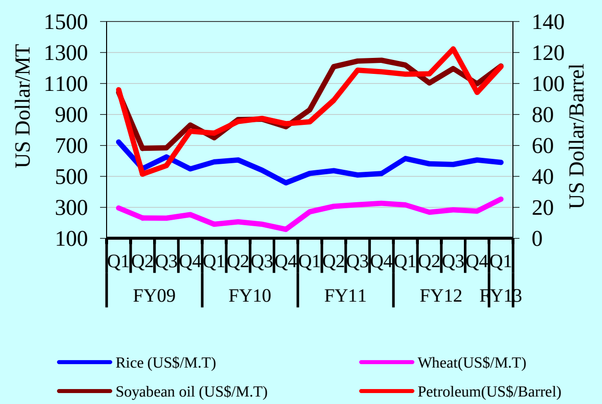
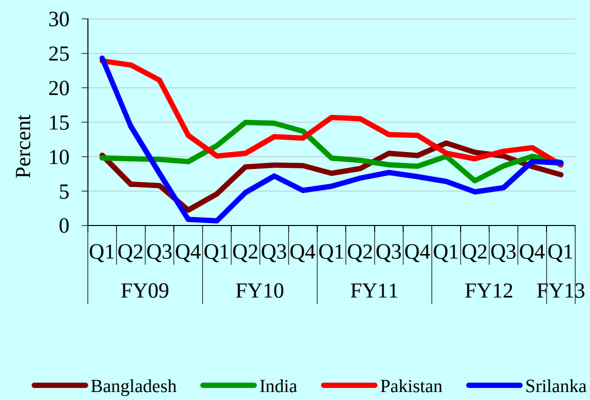


Chart V.4: Inflation in South Asia (Year on Year)



5.4 The current monetary policy stance aims to bring down non food inflation. Food inflation may ease more in the coming months in the wake of next *aman* harvest as its production is expected to be satisfactory. However, some upside risks result from international commodity prices volatility and further upward adjustment of administered energy prices in the domestic market. In contrast to earlier months, international commodity prices started to increase in Q1 of FY13 (Chart V.3). The uptick in commodity prices in recent months has been driven by crude oil and food prices. Food prices, especially of wheat and coarse cereals, increased in recent months following supply disruptions in a number of countries. Moreover, quantitative easing in advanced economies in light of the current Euro zone crisis could lead to speculative flows into the commodity markets which would create further pressure on inflation in the medium term.

5.5 Point to point CPI inflation in our neighboring South Asian countries also exhibited falling trend during the quarter under review (Chart V.4). In India, point-to-point CPI inflation (for industrial workers) declined to 9.14 percent in September 2012 from 10.05 percent in June 2012, while WPI inflation increased marginally from 7.58 percent to 7.81 percent. In Pakistan, point-to-point CPI inflation came down sharply to 8.8 percent in September 2012 from 11.30 percent in June 2012. In Sri Lanka, inflation declined marginally from 9.3 percent to 9.1 percent during this period.

VI. Banking Sector Performance

6.1 Banking sector indicators present a mixed picture during Q1FY13 for a variety of reasons. The risk weighted capital asset ratio (RWCAR) for all banks improved from 10.35 in September 2011 to 10.85 in September 2012. However this latest number is lower than the June 2012 RWCAR of 11.31 due partly to higher provisioning in anticipation of the impending implementation of BBs new provisioning guidelines by some banks as well as an increase in NPLs. This Q1FY13 figure remains higher than the five year average of 10.4, though this varies across banks with state-owned and specialized banks lagging behind. The ratio of non-performing loan (NPL) to total loan for the banking sector, in both gross and net terms, increased. Gross NPL went up from 7.2 percent to 8.8 percent between end FY12 and end Q1FY13 with a 4.0 percent point increase among SCBs. At the same time, the overall banking industry end Q1FY13 figure remained lower than the last five year average of 9.3 percent. The return on asset (ROA) and return on equity (ROE), two important measures of bank profitability, declined mainly due to higher interest expenses which grew faster than interest receipts.

6.2 The risk weighted capital asset ratio (RWCAR) for all banks decreased to 10.85 percent at the end of September 2012 from 11.31 percent at the end of June 2012. This ratio for state owned commercial banks (SCBs), private commercial banks (PCBs) and specialized banks (SBs) declined from 11.16 percent, 11.43 percent and (-) 4.34 percent at end-June 2012 to 9.74 percent, 11.27 percent and (-) 6.21 percent respectively at end-September 2012. However, for foreign commercial banks (FCBs), the ratio increased from 21.45 percent to 21.76 percent during the same period. The RWCAR, remained significantly above the regulatory requirement of 10 percent only for FCBs, while the PCB ratio was marginally higher than requirement. In SCBs this ratio fell below the 10 percent regulatory requirement (Table VI.1).

6.3 The ratio of gross NPL to total loans of the banking sector increased from 7.17 percent at the end of June 2012 to 8.75 percent at the end of September 2012. Gross NPL ratio for the state owned commercial banks (SCBs) increased substantially to 17.69 percent at end-September 2012 from 13.54 percent at end-June 2012 (Table VI.2). The ratio for the private commercial banks (PCBs), the specialized banks (SBs) and the foreign commercial banks (FCBs) also increased from 3.84 percent, 23.83 percent and 3.17 percent at end-June 2012 to 4.91 percent, 24.1 percent and 3.23 percent respectively at end-September 2012. Similarly, net NPL ratio for all banks increased from 1.71 percent at the end of June 2012 to 2.89 percent at the end of September 2012 resulting from higher provisioning required for increased gross NPL. Net NPL ratio for the SCBs increased significantly from 2.38 percent at end-June 2012 to 6.03 percent at end-September 2012 (Chart VI.1). For the PCBs and SBs the ratio also increased from 0.42 percent and 16.42 percent to 1.06 percent and 16.79 percent respectively during the same period. However, for FCBs, similar ratio declined marginally from (-) 1.33 percent to (-) 1.34 percent during the period under review (Table VI.3).

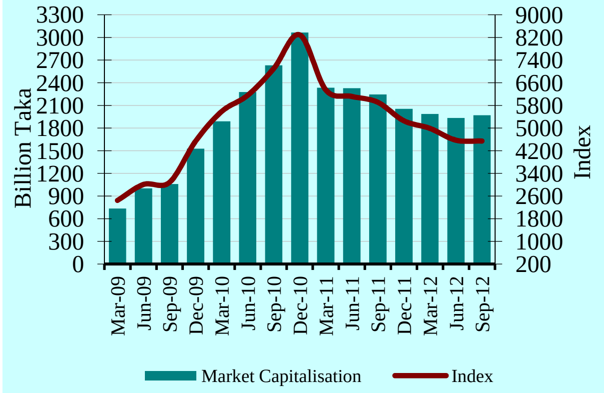
6.4 Among the profitability measures, overall return on assets (ROA) in the banking sector declined marginally from 1.54 percent at the end of December 2011 to 1.16 percent at the end of June 2012. This was primarily due to interest expenditure growing faster than interest income as well as higher loan provisioning. At end September 2012, the interest rate spread was 5.53 percentage points for all banks which was marginally lower than 5.60 points of end June 2012. The ROA for SCBs, SBs and PCBs declined from 1.34 percent, 0.03 percent and 1.59 percent at the end of December 2011 to 0.75 percent, (-) 0.04 percent and 1.19 percent respectively at the end of June 2012. However, the ROA for FCBs increased marginally from 3.24 percent to 3.78 percent during the same period. Similarly, overall return on equity (ROE) declined from 17.02 percent at the end of December 2011 to 13.49 percent at the end of June 2012 due mainly to a sharp decline in ROE for SCBs from 19.66 percent to 11.72 percent and a moderate decline for PCBs from 15.69 percent to 12.39 percent (Table VI.4).

VII. Capital Market Trends

7.1 During Q1 of FY13 the capital market was relatively stable with some volatility in day to day transactions. At the end of Q1 FY13, DSE general index was 4544.41 which was 0.62 percent lower than the end of Q4 FY12 index. During the same period, market capitalization increased by 1.98 percent (chart VII.1 and Table VII.1). Compared to last year the DSE general index and market capitalization have declined significantly - by 23.11 percent and 12.21 percent respectively during Q1 FY12 compared with Q1FY13.

7.2 The average price earnings ratio of the DSE reached 13.04 in September 2012 compared with 12.53 in June 2012. Total turnover volume in the Dhaka Stock Exchange increased by 0.9 percent from Tk. 282.88 billion to Tk. 285.45 billion over the Q4FY12. However, from Q1 FY12 it declined by 37.59 percent. The "number of listed securities" increased to 292 in September'12 from 290 in June '12. The value of "issued equity and debt" increased by 2.16 percent and (Table VII.1) two new companies were listed in the capital market during Q1 FY13.

Chart VII.1: Trend in Market Capitalisation and DSE Index



7.3 Sector-wise DSE data shows that during the Q1 of FY13 market capitalization decreased in the major sectors like banks, financial institutions, pharmaceuticals and chemical, cement, insurance and telecommunication (Table VII.2). Together these sectors contributed 60 percent of the total market capitalization. However sectors such as fuel and power gained as did other miscellaneous sectors. The relative contributions of the different sectors in total market capitalization remained almost unchanged during the last two quarters with banks contributing more than 25 percent.

VIII. Near-Term Economic Outlook

8.1 Notwithstanding the continued global economic slowdown with likely negative impact on Bangladesh's trade and investment outlook, real economic growth in FY2013 is expected to grow at a similar pace as that experienced over the last ten years. Inflation is expected to remain in single digits in FY13 assuming no major supply-side shocks and continued monetary-fiscal coordination.

Growth outcome and outlook

8.2 DAE and the Food Planning and Monitoring Unit (FPMU) have set the gross domestic agricultural production (major crops) target at 65.6 million metric ton (MMT) in FY13. This level of output is 2.2 percent higher than that experienced in FY12. Overall cereal production (accounting for two-thirds of agricultural output) will be led by higher output of *aus* and *aman* and the expanded acreage of another major crop, *boro* rice. The outlook for non-cereal crops (eg potato and vegetables) as well as non-crop items such as fisheries and poultry remains positive, and in line with historical trends, due to government incentives and stepped up agricultural credit disbursement. For instance disbursement of fisheries increased by 37% in Q1FY13 compared to a year earlier and for livestock it increased by 50%. We also assume that the effective fertilizer supply and better seed distribution seen in recent years will continue and contribute to achieving an agricultural growth rate of between 3.50 percent and 3.75 percent in FY13.

8.3 In FY13, growth in the industrial sector will continue to be driven by export-oriented manufacturing. During the July-October period of FY13 manufactured exports have increased by 3.08 percent compared to the same period of the previous year. Among other factors growth in the industry sector – mainly manufacturing and construction - would also be determined by remittances growth, intermediate inputs and capital machinery imports, access to bank credit by the private sector and BB's refinance program for the SME sector. As discussed earlier remittance growth in FY13 is on track to outpace last year's growth levels though overall rural aggregate demand is likely to be constrained by declining rice prices. Credit flows to the private sector and to SMEs specifically are also on track to support the achievement of output growth targets. As such, several indicators point to a robust overall growth outlook for the manufacturing and construction sectors. However, in light of the projected export slowdown we estimate industry growth in the range of 7.5 percent to 7.75 percent in FY13, lower than the sector's growth rate of 9.47 percent experienced in FY12 but in line with the average industry sector growth rate over the last ten years.

8.4 Since services sector activities such as trade and transport are structured around the agriculture and industry sectors of the economy, growth in services is closely related to the weighted average growth of these two sectors. At the same time credit flows to key service related sub-sectors have risen sharply in Q1FY13 (see table I.9 and details in the 'Money and Credit Developments' section). Given this we project services to grow within the 6.2-6.5 percent range in FY13, with the last ten-year average growth at 6.23 percent.

8.5 Given the sectoral growth projections and their contributions to the national income, overall GDP is projected to grow within the band of 6.09-6.36 percent in FY13. This compares favorably with a developing country average forecast of 5.3% (World Bank 2012) for 2012. This forecast has downside risks from global and domestic sources. Global risks include a further slowdown in the EU and the possibility of the US economy not resolving its budget negotiations and suffering from the 'fiscal cliff'. Domestic risks include those related to natural disasters and any other unanticipated disruption to economic activity.

Projected Real GDP Growth in FY13

Sector	GDP share in FY12 (percent)	Average growth FY03-FY12 (percent)	GDP growth FY12 (Provisional)	FY13 growth Projected range (percent)	
				Low case	High case
Agriculture	19.29	3.91	2.53	3.50	3.75
Industry	31.26	7.67	9.47	7.50	7.75
Services	49.45	6.23	6.06	6.20	6.50
GDP	100.00	6.16	6.32	6.09	6.36

Inflation outcome and outlook

8.6 After reaching a record high of 11.97 percent in September 2011, point to point CPI inflation has been declining, falling to 7.39 percent in September 2012. Falling food inflation dominated this deceleration in prices as food inflation reached 6.16 percent compared to a decline to 9.95 percent in non-food inflation.

8.7 The declining 12-month average CPI inflation trend is expected to continue in FY13 due to more subdued inflation expectations and reasonable prospects for a stable food supply. Both the point to point and average CPI inflation are expected to remain in single digits in FY13. However, the the possibility of upward adjustment of fuel prices represents a risk to the inflation outlook as does the possibility of volatility in the global commodity market and any major natural disaster.