Part A: Economic and Financial Developments

Overview and Executive Summary

The FY13 growth momentum continued to be driven by large inflows of remittances and a rebound in export growth. At the same time a slowdown in imports related to industrial output as well as a more tentative expansion in agriculture points to a mixed picture for real output growth. Government expenditures remained steady in support of economic expansion with strong revenue collections, larger funding from external aid disbursements and consequently lower recourse to domestic bank financing. External balances showed marked improvements contributing to strong accumulation in international reserves with the taka remaining stable with an appreciating tendency.

After a declining trend in recent quarters, CPI inflation (point to point) turned somewhat higher in Q2FY13 to 7.69 percent from 7.39 percent in the previous quarter. The uptick in prices was driven by increases in the food component. However, average 12-month inflation continued to trend downwards and the full year single digit inflation target of 7.5 percent is well within reach.

In public finances, the overall budget deficit through Q1FY13 was moderately lower than for the same period last year. Revenue collections continued to register strong growth with higher income tax payments while total government expenditures continued to lag behind budgeted amounts. Lower overall deficit in Q1FY13 and larger external aid disbursements combined to reduce the need for domestic bank and nonbank financing relative to the situation in Q2FY12.

Money and credit market developments in Q2FY13 continued to be heavily influenced by large inflows of foreign remittances and higher foreign aid disbursements. Larger net foreign assets expansion fueled a larger than programmed growth in broad money. However net domestic asset growth remained well within targets while allowing continued strong growth in credit to the private sector. More liquidity at the short-end of the money market continues to reduce call money and TBills rates. But large bank holdings of domestic government debt with little secondary market transactions have resulted in longer tenure interest rates rising progressively.

Banking sector performance continued to show deterioration during Q2FY13. The risk weighted capital asset ratio (RWCAR) for all banks declined while the ratio of non-performing loan (NPL) to total loan for the banking sector, in both gross and net terms, increased. The fall in RWCAR is due in part to the implementation of tighter BB provisioning requirements. The return on asset (ROA) and return on equity (ROE), two important measures of bank profitability, declined reflecting the higher provisions but also a tightening of the interest rate spread. This worsening bank performance was mainly concentrated in state owned commercial banks and specialized banks.

In the external sector, the current account balance (CAB) in Q2FY13 continued to be in surplus reflecting the increasing inflows of remittances bolstered by continued export expansion and declining imports. With large external aid disbursements, the capital account was also in surplus resulting in accumulation of international reserves to $12.75 billion, sufficient to cover 4.4 months of

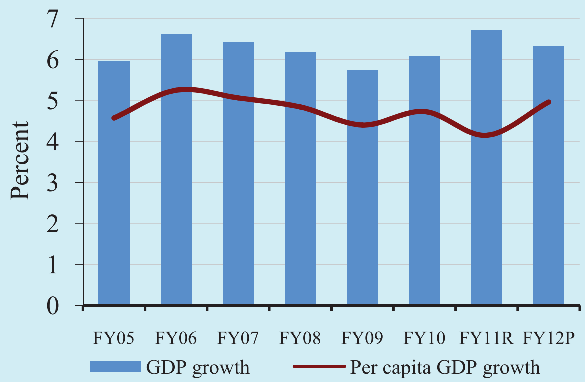
FY13 projected imports. The foreign exchange market remained mostly stable during this period with the Taka appreciating by 2.28 percent against the US dollar during Q2FY13.

Economic developments related to output growth in FY13Q2 compared to the previous quarter include a pick-up in exports while the prospects for rice output are more moderate. External and other domestic risks are not materially different compared to FY13Q1. As such our output growth forecast of between 6.1-6.4% for FY13, detailed in the last Bangladesh Bank Quarterly remains unchanged.

I. Developments in the real economy

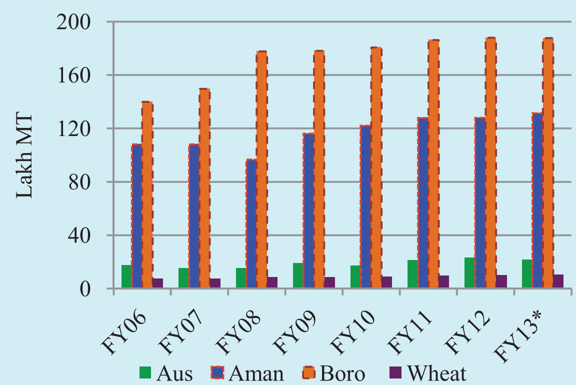
1.1 The second quarter of FY13 (October-December 2012) presents a mixed picture with regards to the drivers and indicators of output growth One indicator, which has grown strongly, is remittances (24.15 percent growth in Q2FY13 compared with 7.05 percent in Q2FY12 and an average of 10.2 percent in FY12) with likely positive consequences for both domestic demand and investment. Among other indicators, private sector credit grew at a moderate 16.1 percent at the end of Q2FY13 compared to an average of 19.7 percent in Q2FY12 while public investment measured by ADP utilization was 18.0 percent in Q2FY13, only slightly higher than the 17.0 percent in Q2FY12. Exports picked up during the quarter under review, growing by 12.43 percent, boosting the half-yearly average growth between July-December 2012 to 7.0% compared to the 6.2 percent average growth in FY12. However, imports slipped to a negative growth of 10.32 in Q2FY13 compared to a 5.2 percent average growth in FY12 driven by sharp decline in food-grain imports as well as falls in capital machinery and industrial raw material imports.

Chart I.1: Growth of Real GDP



P=Provisional estimates of BBS

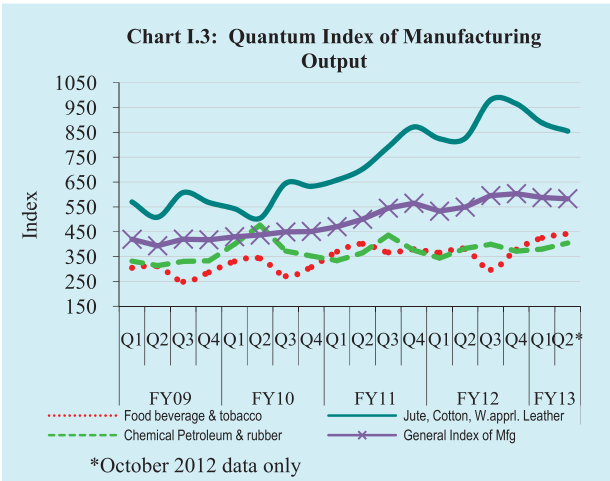
Chart 1.2: Production of Major Crops

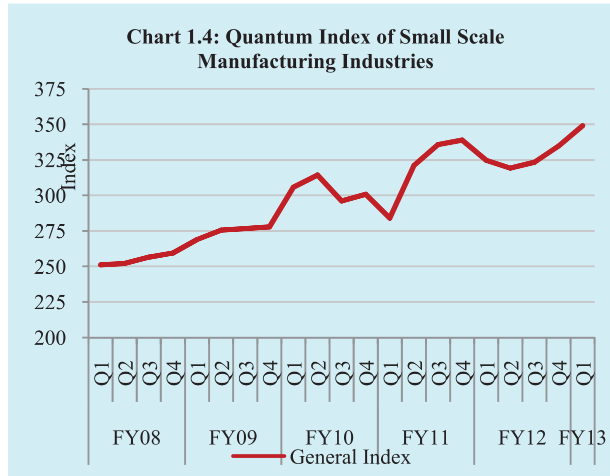


*Boro and Wheat figure represents target set by DAE

1.2 The total cereal foodgrain production target was set at 37.6 million metric tons (MMT) for FY13, which is 1.9 percent higher than the production in FY12. Specifically, the target for aus production, the first crop of the fiscal year, was set at 2.37 MMT on 1.15 million hectares of land, a 3.43 percent increase from FY12. However, available information shows that for FY13 2.16 MMT aus paddy was grown on 1.05 million hectares of land, which are slightly short of the annual targets for both production and area of cultivation. The aman production, the second largest cereal crop and the second crop of the fiscal year, was targeted at 13.3 MMT on 5.63 million hectares of land which was 3.91 percent higher than the FY12 production. Department of Agricultural Extension's estimate shows that 13.13 MMT aman paddy was grown on 5.61 million hectares land which while still 2.55 percent higher than FY12, was slightly short of the annual targets for both production and area of cultivation. The decline in area of cultivation under both aus and aman reportedly reflects the response of growers to the low price for rice. The production target for boro, the largest cereal crop, is set at 18.76 MMT on 4.78 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 4.0 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 for 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 second quarter of FY13, total agricultural credit disbursement was Tk. 41.3 billion. This represented 29.23 percent of the yearly target and 12.23 percent higher than the actual disbursement in the same period of FY12.



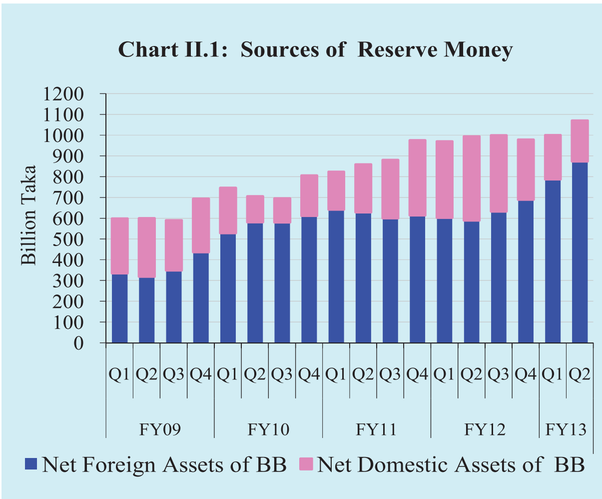


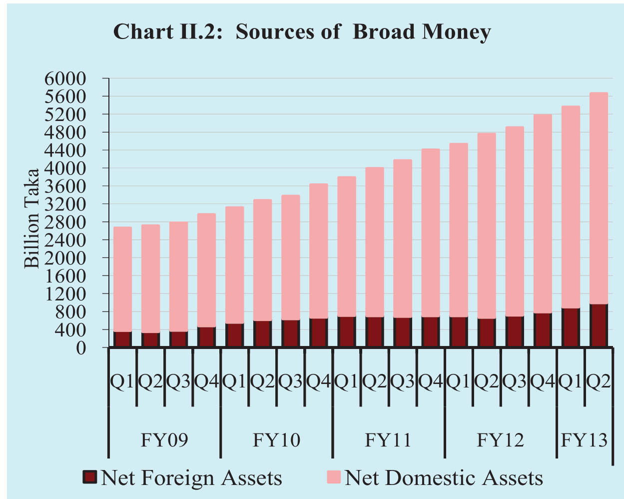
1.4 The Quantum General Index for industrial production (large and medium manufacturing) increased by 9.32 percent (y-o-y) in October of FY13 as against 9.7 percent growth in Q2FY12. This does not reflect the strong increase in loans to the sector which should contribute to higher medium term growth in the sector. Disbursement of industrial term loans grew by 24.0 percent to Tk. 122.34 billion in Q2FY13 as against 4.42 percent growth in Q2FY12. Disbursements of SME loan in Q2FY12 was 13.19 percent higher than the disbursement in Q2FY12. However outstanding SME loans barely changed as they stood at Tk. 1008.13 billion compared to Tk. 1000.02 billion in Q1FY13. On the other hand the sharp negative growth of imports – 14.3% decline in Q2FY13 compared with Q2FY12 – and specifically the decline in imports related to industrial output (see details in section IV) suggest that the pace of investment may have slowed in FY13.

1.5 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) through Chittagong port grew marginally by 0.67 percent during Q2FY13 as against negative growth of 13.01 percent in Q2FY12. Export cargo grew by 11.05 percent as against negative growth of 9.01 percent in Q2FY12. Import cargo decreased marginally by 0.58 percent during the quarter as against the negative growth of 13.46 percent in Q2FY12. Bank financing for trade related activities increased by 24.7% in Q1FY13 compared with Q1FY12 – the data for Q2FY13 is not available yet. The number of mobile phone subscribers decreased to 97.18 million at the end of December 2012 from 98.47 million at the end of September 2012 showing a negative growth of 1.31 percent during the quarter under review.

II. Money and Credit Market Developments

2.1 In the second quarter of FY13, as in the first quarter, Net Foreign Assets (NFA) of the banking system increased substantially by 48.5% (y-o-y) and 10.26% (q-o-q) which fueled a larger than programmed growth in broad money. The sharp increase in net foreign assets stemmed from continued large remittance inflows boosted by foreign aid disbursements during the quarter. This resulted in a reserve build-up reaching USD 12.75 billion in Q2FY13. The components of net domestic assets (NDA), (domestic credit, credit to the public sector and credit to the private sector) remained within the program limit of 16.1%, 8.5%, 18.3% respectively for Q2FY13.

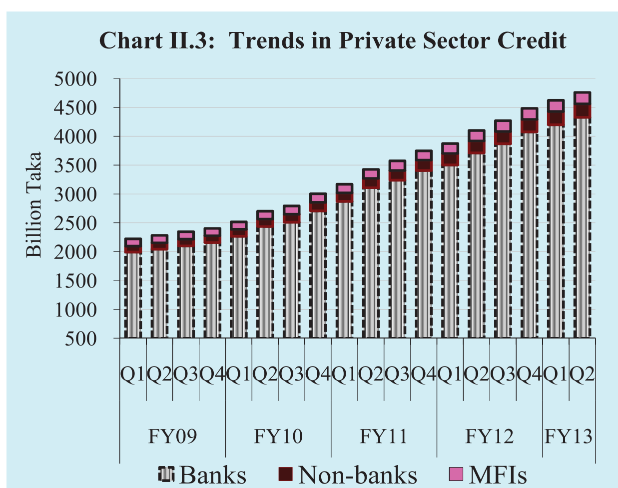




2.2 In Q2FY13, private sector credit (including banks, non-banks and micro-finance institutions) grew by 16.1 percent compared with the 19.7 percent in Q2FY12. Interest rates eased as the spread between lending and deposit rate decreased from 5.53 at end of Q1FY13 to 5.33 percent at the end of Q2FY13, with the call money rate falling to 9.34 percent at the end of December, 2012 from 17.15 percent at the end of December, 2011 reflecting relatively excess liquidity conditions in the money market.

2.3 Provisional data show that M2 experienced a growth of 19.01 percent (y-o-y) and stood at Tk.5659.1 billion at end December, 2012 fueled mainly by a 49.9% growth in NFA. On the other hand NDA growth was more moderate at 14.17 percent with growth in the credit to the public sector of 11.55 percent and private sector credit grew by 16.61 (y-o-y). M1 grew by 9.87 percent at end December, 2012 compared to 8.05 percent in December 2011 (y-o-y).

2.4 The components of M2 shows that currency, demand deposits and time deposits increased by 11.67 percent, 7.74 percent and 21.70 percent (y-o-y) respectively during Q2FY13 as compared to 9.88 percent, 5.98 percent and 22.78 percent respectively for Q2FY12. The money multiplier (M2/RM) rose to 5.3 percent in Q2FY13 an increase by 10.41 percent compared to Q2FY12 because of relatively faster expansion of M2.



2.5 RM grew by 15.61 percent (y-o-y) and stood at Tk. 1069.9 billion in December, 2012 compared with a growth of 7.73 percent in December 2011. This is attributed to the significant growth in NFA which could not be fully sterilized.

2.6 Total bank advances by economic purposes increased by 21.5 percent and stood at Tk. 3860.0 billion in Q1FY13 compared to an increase of 21.3 percent in Q1FY12. The highest share of bank advances went to the trade sector (37.59 percent) followed by the industry and working capital financing (Table I.9).

Chart II.4: Yield on T-Bills

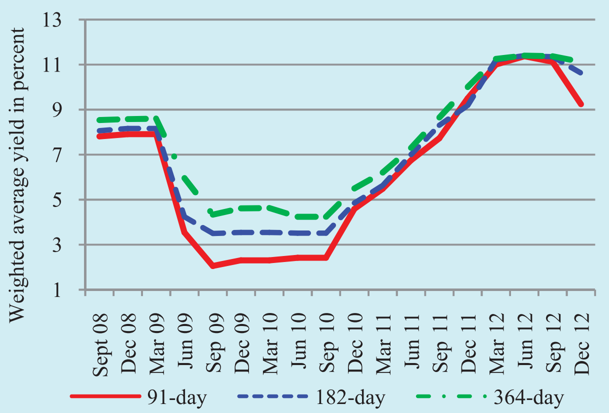
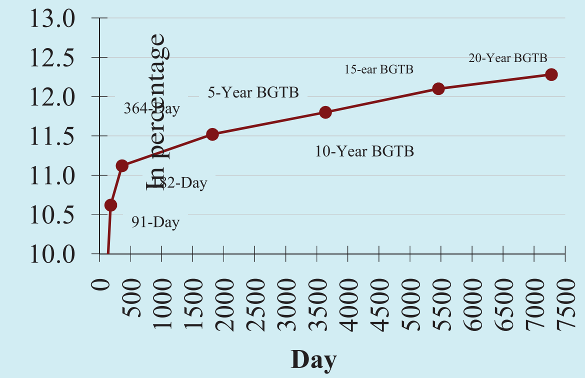


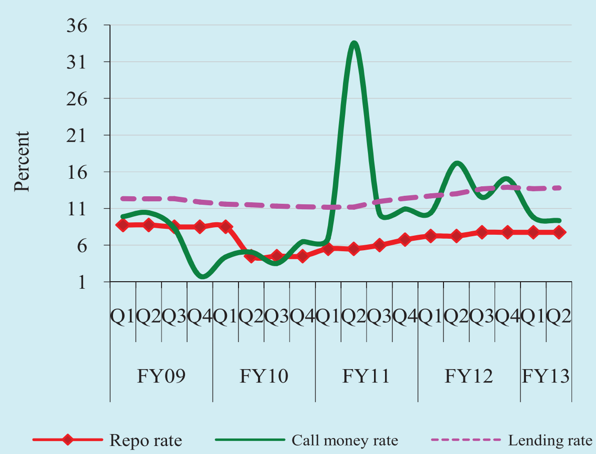
Chart II.5: Weighted average yield of accepted Government Treasury Bills & Bonds (End December, 2012)



2.7 The disbursement of term lending by banks and NBFIs increased by 30.69 percent and stood at Tk. 97.20 billion at end Q1FY13, from Tk.74.37 billion in Q1FY12. Between Q1FY12 and Q1FY13, term lending by PCBs increased from Tk. 50.88 billion to Tk. 64.05 billion, SCBs term lending increased substantially from Tk. 7.63 billion to Tk. 17.99 billion reflecting increased economic activities of SCBs while the term lending by 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 term lending by NBFIs decreased from Tk. 9.95 billion to Tk. 8.42 billion.

2.8 The BB repo and reverse repo rates remain unchanged at 7.75 percent and 5.75 respectively in December, 2012. Although overall yields on short term treasury bills e.g., 91-day decreased to 9.24 percent in December, 2012 from 9.50 percent in December, 2011, other T-bill rates e.g., 182-day, 364-day were increased to 10.62 and 11.12 percent respectively at end of December, 2012. Yields on long-term bond such as 5-year, 10-year, 15-year, 20-year BGTB also increased at the end of December (Table II.3).

Chart II.6: Interest Rate Movements



III. Fiscal Developments

3.1 Overall fiscal performance continued to show a healthy trend in Q2FY13 that emerged in Q1 FY13. Preliminary estimates show total revenue increasing by 13.1 percent whereas expenditure grew much slower at 2.0 percent during Q2FY13 as compared with Q2FY12. For the whole of H1FY13, revenue collection was 45 percent of the annual budgeted amount while expenditure ran at a lower 40 percent of the full year budgeted outlay. Accordingly, the overall budget deficit for H1FY13 amounted to 26 percent of the budgeted annual deficit or 1.67 percent of GDP relative to annual FY13 budget of 5 percent of GDP and a deficit of 2.37 percent of GDP in H1FY12. As a consequence, for Q2FY13 with disbursements of net foreign financing running at a faster pace compared to Q2FY12, the government domestic borrowing requirements remained substantially below that experienced in FY2012 and projected for FY2013, with most of this positive development reflected in lower government borrowing from the banking system. (Table III.1 and Chart III.1 and III.2).

Chart III.1: Trend in Government Revenue and Expenditure

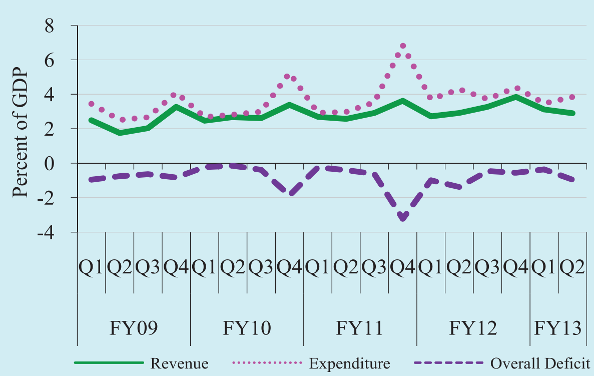
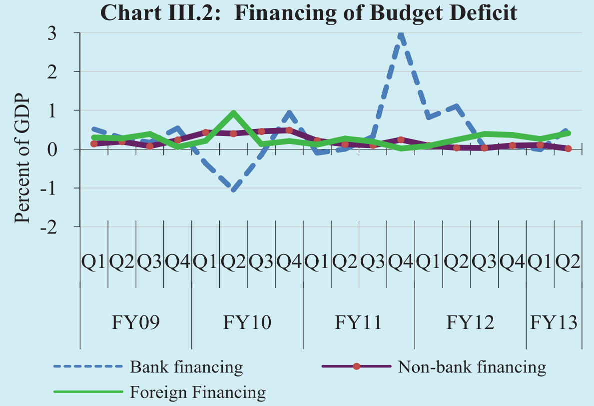


Chart III.2: Financing of Budget Deficit



3.2 Total NBR tax revenue increased by 14.5 percent to Tk. 238.4 billion in Q2FY13 from the level of Tk.208.2 billion in Q2FY12. Income tax and VAT were the leader in increased revenue during the quarter under review. For H1FY13, preliminary estimates of total revenue collection reached Tk. 626.5 billion, which is 21.5 percent higher than the level of H1FY12 and 44.9 percent of budget FY13. Of this amount, NBR tax revenue stood at Tk. 447.7 billion, which is 13.8 percent higher than in H1FY12. Better NBR revenue collections came from income tax, value added tax (VAT), custom duties and other sources increased by 27.0 percent, 15.8 percent, 1.8 percent, and 2.3 percent respectively compared to H1FY12 due mainly to higher income tax augmented by corporate bodies. In addition, non-tax revenue stood at Tk. 160.0 billion in H1FY13, which is 50.7 percent higher than the level of the same period of FY12.

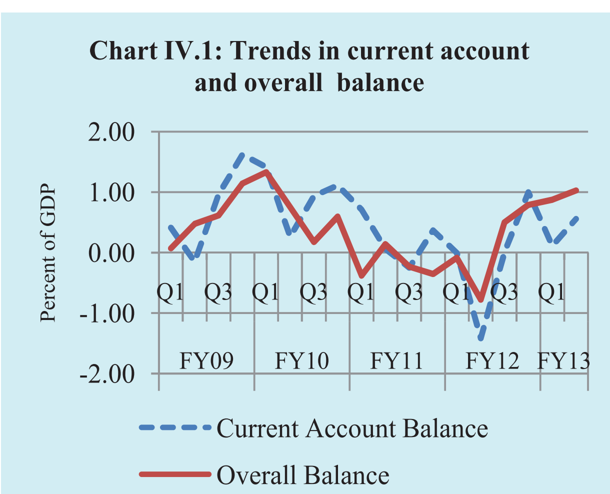
3.3 Preliminary estimates of total expenditure increased by about 2.0 percent to Tk.400.8 billion during Q2FY13 over Q2FY12. With ADP and current expenditure increasing by 27.7 percent and 17.7 percent respectively during Q2FY13 over Q2FY12, the strong moderation in total expenditure increases continued to be accounted for by a fall in the growth of the ‘other expenditures’ category which includes subsidies on petroleum and electricity. During H1FY13, total government expenditure is estimated at Tk. 762.5 billion (7.32 percent of GDP), which is 4.1 percent higher than the level of H1FY12 and 39.8 percent of FY13 budget. During this period, current expenditure rose to Tk. 445.5

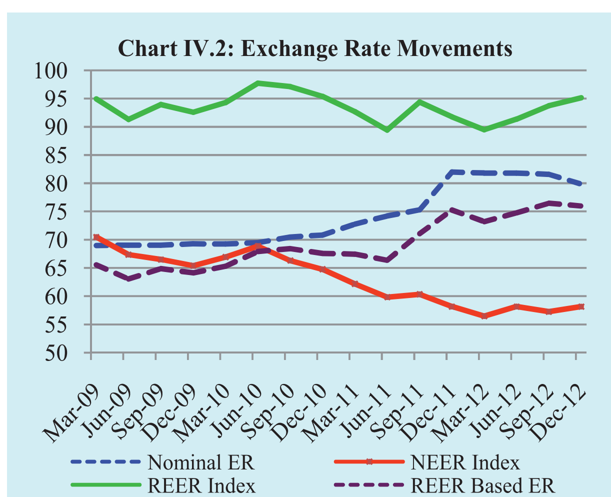
billion (4.28 percent of GDP), which is 17.8 percent higher relative to H1FY12 and represented 44.8 percent of FY13 budget. Annual development program (ADP) outlays reached Tk. 164.3 billion (1.58 percent of GDP) in H1FY13, which is 29.3 percent higher than in H1FY12 but are running behind the whole year target, as outlays were only 29.9 percent of FY13 budget. At the same time, 'other expenditure' in H1FY13 was 32.7 percent lower than in H1FY12, after reaching Tk. 152.8 billion (1.47 percent of GDP), which is 41.0 percent of the FY13 budgeted amount.

3.4 The overall fiscal deficit stood at Tk. 98.9 billion in Q2FY13, representing 1.3 percent of GDP compared with Tk. 126.3 billion or 1.4 percent of GDP in Q2FY12. Domestic financing of the deficit at Tk. 56.3 billion in Q2FY13 was much lower than the Tk. 104.3 billion registered in Q2FY12 while foreign financing at Tk. 42.6 billion was much higher than the Tk. 22.0 billion disbursed in Q2FY12. The overall fiscal deficit in the first half of FY13 amounted to Tk. 136.0 billion or 1.7 percent of GDP compared to Tk. 216.8 billion or 2.4 percent of GDP in H1FY12. Tk. 66.1 billion of the deficit in H1FY13 (Tk. 187 billion in H1FY12) was accommodated from domestic sources that included bank financing of Tk. 53.7 billion and non-bank financing of Tk. 12.4 billion, while the remaining amount of Tk. 69.9 billion (Tk. 29.8 billion in H1FY12) came from foreign sources in H1FY13.

IV. External Sector Developments

4.1 Due mainly to a substantial decline in import payments, the current account balance (CAB) turned into a surplus of USD 708 million during Q2FY13 against a deficit of USD 1.64 billion during the same quarter of the previous fiscal year. During the quarter, trade deficits declined to USD 1.69 billion less than one-half the deficit of USD 3.67 billion recorded in Q2FY12. Workers' remittances, which contributed more than 95.0 percent of total secondary income once again increased remarkably by 24.2 percent to USD 3.84 billion during Q2FY13 compared to USD 3.10 billion during Q2FY12. Based on the surplus in the CAB and capital & financial account, the overall balance recorded a surplus of USD 1.31 billion during the Q2FY13 quarter against a deficit of USD 899 million in the same quarter of FY12. The foreign exchange reserves rose to USD 12.75 billion at the end of Q2FY13 against USD 9.64 billion at the end of the same period last year. The foreign exchange market remained mostly stable even as the Taka continued its slight appreciation by 2.28 percent against US dollar during Q2FY13.





4.2 The current account balance (CAB) maintained a surplus during the second quarter of FY13 mainly due to a decline in the trade deficit while the increase in secondary income was offset by large deficits in services and primary income. The trade deficit declined to USD 1.69 billion against a deficit of USD 3.67 billion in Q2FY12 based on continued strong export growth and a further decline in imports. The net services account witnessed a deficit of USD 1.18 billion during Q2FY13 against a deficit of USD 863 million in the same quarter of previous fiscal. Deficits in the primary income account increased to USD 428 million compared to a deficit of USD 355 million in Q2FY12. In contrast, the surplus in the secondary income account increased to USD 4.00 billion compared to USD 3.25 billion of Q2FY12.

4.3 Capital and financial account showed a surplus of USD 1.17 billion during Q2FY13 against a surplus of USD 641 million in Q2FY12. The Overall balance of payments (BOP) reached a surplus of USD 1.31 billion at the end of Q2FY13 and the foreign exchange reserve stood at USD 12.75 billion at end December 2012.

4.4 The foreign exchange market remained mostly stable and experienced a 2.28 percent appreciation during Q2FY13. Bangladesh Bank has continued interventions in FY13 with net purchases of foreign currencies amounting to USD 984.0 million during Q1Y13 and an additional USD 1,069.00 million during Q2FY13 which has helped to keep exchange rate developments stable. The REER based exchange rate decreased to Taka 75.98 per USD at end December 2012 from Taka 76.49 per USD at end September 2012 while the weighted average nominal exchange rate decreased to Taka 80.53 per USD at end December 2012 from Taka 81.73 per USD at end September 2012, suggesting a marginal loss in external trade competitiveness during Q2FY13.

Chart IV.3: Trends in Exports & Imports

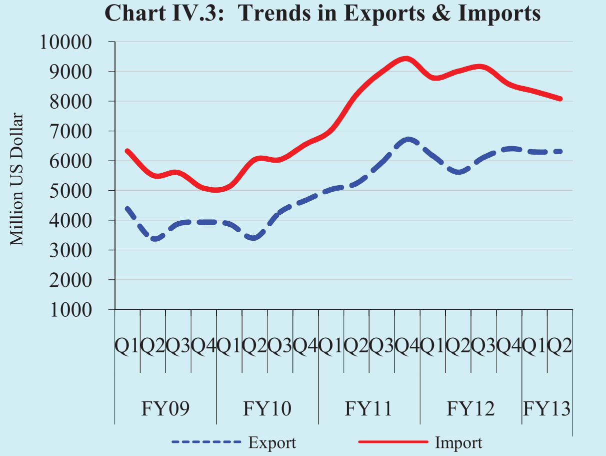
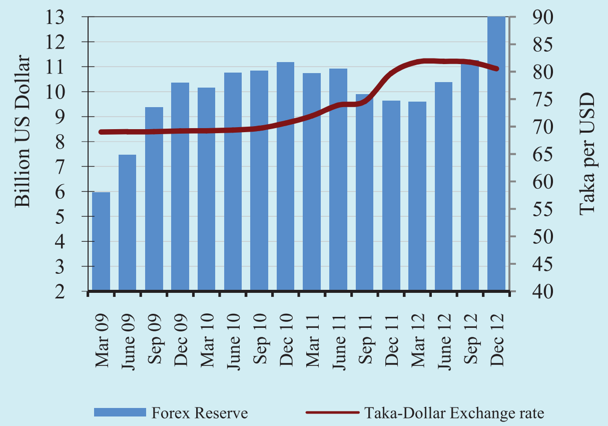


Chart IV.4: FOREX Reserve & Exchange Rate



4.5 Export earnings increased by 12.1 percent to USD 6.20 billion (on adjusted fob basis and according to EPB data it was 12.4 percent) during Q2FY13 against USD 5.53 billion recorded during the corresponding quarter of FY12. This growth was mainly due to increases in the export of raw jute (+7.8 percent), jute goods (+8.3 percent), leather (+16.9 percent), frozen food (+23.9 percent), woven garments (+13.1 percent) and knitwear products (+10.1 percent), while exports of tea (-47.5 percent) and terry towels (-7.8 percent) recorded declines compared to the corresponding quarter of FY12 (Table IV.2).

4.6 Import payments recorded a 14.3 percent decline (on adjusted fob basis) to USD 7.89 billion during Q2FY13 compared to USD 9.20 billion in Q2FY12 (Table IV.3). Reflecting the better harvest in Bangladesh, imports of food-grains declined by 28.7 percent during Q2FY13 to USD 152.9 million compared to USD 214.4 million in Q2FY12 of which rice import decreased sharply by 90.2 percent (USD 6.7 million against USD 68.0 million) and imports of wheat decreased marginally by 0.1 percent (USD 146.2 million against USD 146.4 million). Imports of other food items increased by 4.2 percent to USD 871.6 million during the quarter under review compared to USD 836.4 million recorded during Q2FY12, of which the imports of edible oil (+7.1 percent) and pulses (+82.0 percent) increased while imports of milk & cream (-17.3 percent), spices (-44.1 percent) and sugar (-2.6 percent) decreased.

4.7 Imports of intermediate goods mainly used for manufacturing output decreased by 8.1 percent during Q2FY13. Among the intermediate goods imports of crude petroleum (+40.1 percent), oil seeds (+7.5 percent), chemicals (+3.7 percent), dyeing and tanning materials (+4.9 percent), textile and articles thereof (+7.7 percent) increased while imports of clinker (-5.6 percent), POL (-11.1 percent), pharmaceutical products (-20.5 percent), fertilizer (-36.6 percent), plastic and rubber articles thereof (-8.9 percent), raw cotton (-13.2 percent), yarn (-7.2 percent) and staple fibre (-5.3 percent) decreased. Imports of capital goods and others recorded a 20.5 percent decline in Q2FY13, of which imports of iron, steel and other base metals increased by 1.3 percent while imports of capital machinery (-2.6 percent) and other capital machineries (-29.3 percent) declined. During Q2FY13 LCs settlements for imports came down by 15.8 percent (y-o-y) to USD 7.84 billion which was USD 9.31 billion during the same period of the previous fiscal quarter.

4.8 The inflow of workers' remittance recorded a remarkable 24.2 percent growth rising to USD 3.84 billion during Q2FY13 compared to USD 3.10 billion in Q2FY12. This higher growth was mainly due to higher remittance from Oman, Singapore and UAE. During Q2FY13 remittances from the Gulf region recorded 24.3 percent growth of which Saudi Arabia recorded 23.4 percent, UAE recorded 34.0 percent, Oman recorded 70.6 percent and Bahrain recorded 40.4 percent, while remittance from Qatar declined by 10.7 percent compared to Q2FY12. Remittances from the Euro region recorded only 0.2 percent growth, while remittances from the Asia Pacific region registered 41.3 percent growth and growth from rest of the world (including USA) was 27.4 percent in Q2FY13 In absolute amounts, the major sources of remittance during the quarter was Saudi Arabia (USD 1062.1 million), followed by UAE (USD 767.2 million), USA (USD 469.5 million), Kuwait (USD 312.7 million), and UK (USD 276.9 million) (Table IV.4).

V. Price Developments

5.1 Twelve month average CPI inflation maintained its declining trend during the second quarter of FY13 while point to point CPI inflation increased at the end of the second quarter of FY13. Based on current trends, the average CPI inflation is expected to reach the targeted level of 7.5 percent at the end of June 2013 resulting from prudent monetary and fiscal policies and moderating global commodity prices (Table V.2).

Table-5.1

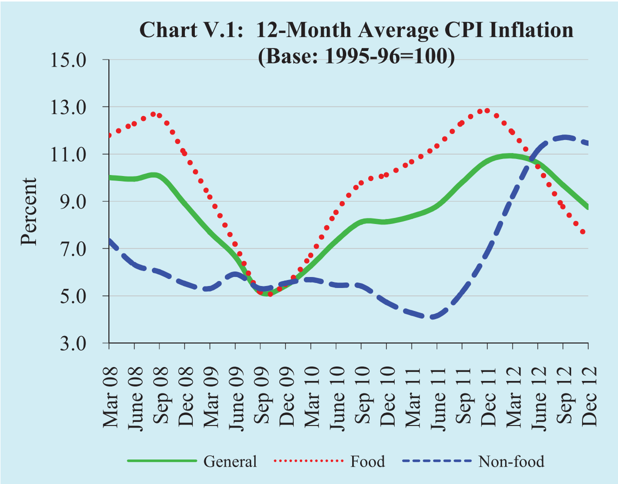
Contribution@ of Food and Major Non-Food Items / Groups in CPI inflation(Y-o-Y)

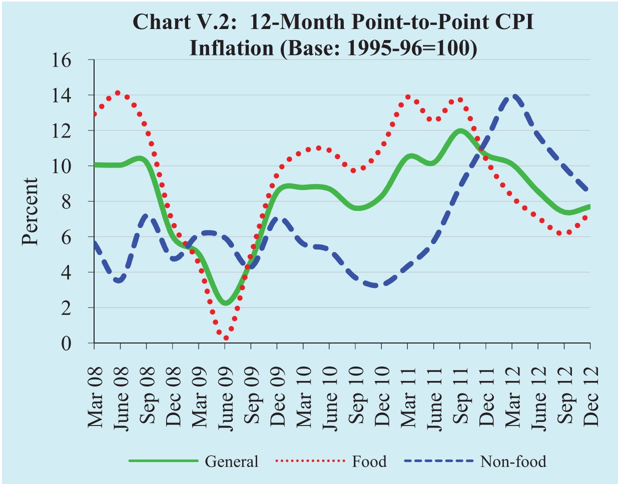
Base Year (1995-96)=100

Months	Food beverage & tobacco	Clothing & Footwear	Gross rent, Fuel & Lighting	Furniture, Furnishing & Other	Medical care and Health Expenses	Transport & Communi-cations	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	4.66	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
Oct-12	43.07	11.38	30.09	3.42	2.87	3.46	1.23	4.47	56.93
Nov-12	49.83	10.33	25.03	3.34	2.75	3.33	1.27	4.12	50.17
Dec-12	55.59	10.33	20.40	3.03	2.43	3.05	1.36	3.81	44.41

@ Contribution of ith Group=(Inflation in ith group*Weight of ith group in CPI basket/Headline inflation)*100

5.2 After exhibiting a declining trend, point to point CPI inflation increased during Q2FY13 (October-December 2012) mainly driven by food component of inflation. Using the 1995-96=100 base year, point to point overall inflation increased from 7.39 percent in September 2012 to 7.69 percent in December 2012 after touching its lowest point at 7.22 percent in October 2012. During this period point to point food inflation increased from a low of 5.57 percent in October 2012 to reach 7.33 percent in December 2012, after registering 6.16 percent in September 2012. Point to point non-food inflation





which had increased to a double digit level of 10.46 percent in October 2012 from 9.95 percent in September 2012 subsequently declined to 8.43 percent in December 2012. It is evident from Table 5.1 that the food component was became the main driver of the inflationary pressure observed in

December 2012. Among the food items, although the price of rice fell on account of a satisfactory aman production; the prices of all other food components including vegetables, meat and eggs, fish and dry fish, oil and fats, milk and milk products, beverage and tobacco increased during the period under review. Inflation (both food and non food) remained higher in urban areas compared to that in rural areas. The twelve month average inflation continued to decline over the past ten months from a peak of 10.96 percent in February 2012 to 8.74 percent in December in 2012.

Chart V.3: Commodity Prices in International Market

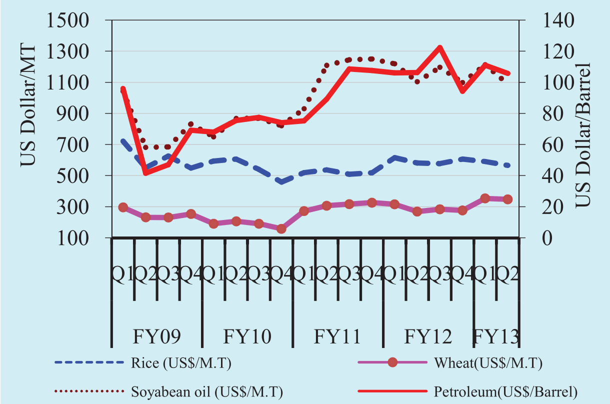
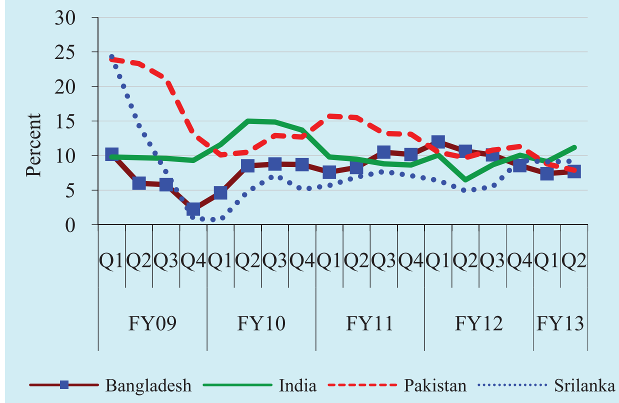


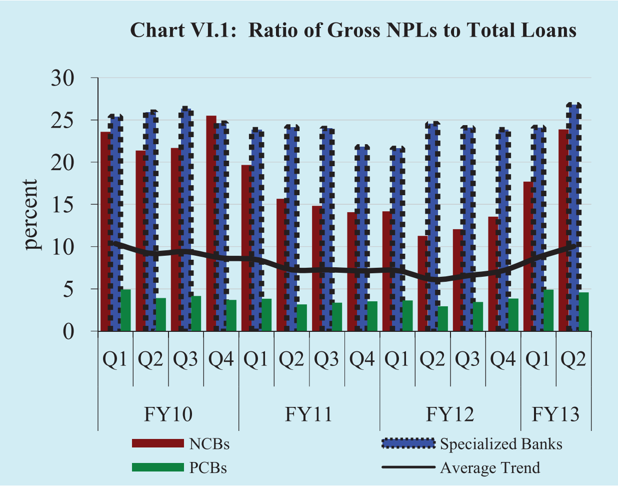
Chart V.4: Inflation in South Asia (Year on Year)

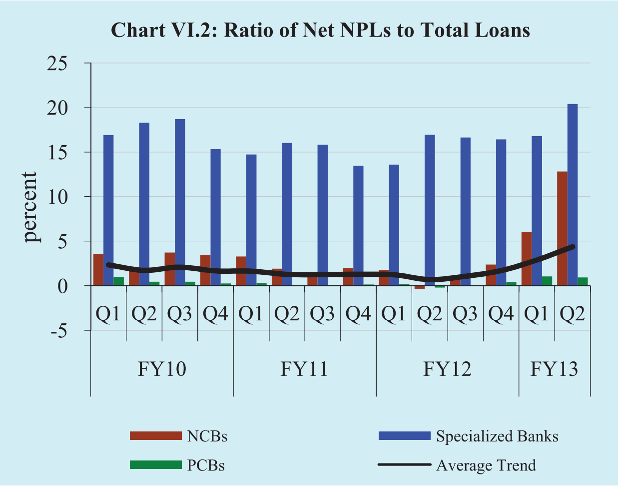


5.3 Point to point CPI inflation in our neighboring South Asian countries exhibited on balance an increasing trend except for Pakistan during the quarter under review (Chart V.4). In India, point-to-point CPI inflation (for industrial workers) increased to 11.17 percent in December 2012 from 9.14 percent in September 2012, while WPI inflation decreased from 8.07 percent to 7.18 percent. In Pakistan, point-to-point CPI inflation came down to 7.9 percent in December 2012 from 8.8 percent in September 2012. In Sri Lanka, inflation increased marginally from 9.1 percent to 9.2 percent during this period.

VI. Banking Sector Performance

6.1 Banking sector indicators for Q2FY13 raises some concerns for a variety of reasons. The risk weighted capital asset ratio (RWCAR) for all banks fell from 10.85 in September to 10.46 in December 2012 after having fallen progressively from 11.35 in December 2011. The fall in RWCAR is in part due to the implementation of BBs new provisioning guidelines, as well as an increase in NPLs for state owned commercial banks. The ratio of non-performing loan (NPL) to total loan for the banking sector, in both gross and net terms, increased sharply at the end of Q2FY13. Gross NPL went up from 8.8 percent at the end of Q1FY13 to 10.0 percent at the end of Q2FY13, with SCBs suffering a 6.2 percentage point deterioration. The overall banking industry NPL at end Q2FY13 is higher than the last five year average ratio of 9.3 percent. The return on asset (ROA) and return on equity (ROE), two important measures of bank profitability, declined due to both higher provisioning and higher interest expenses which grew faster than interest earnings.





6.2 The risk weighted capital asset ratio (RWCAR) for all banks decreased to 10.46 percent at the end of December 2012 from 10.85 percent at the end of September 2012. RWCAR dropped because the risk weighted assets (RWA) of the banking industry increased by Tk. 102.60 billion while total eligible capital decreased by Tk. 8.88 billion within the period under consideration. This ratio for state owned commercial banks (SCBs), specialized banks (SBs) and foreign commercial banks (FCBs) declined from 9.74 percent, (-) 6.21 percent and 21.76 percent at end-September 2012 to 8.13 percent and (-) 7.78 percent and 20.56 percent respectively at end-December 2012. However, for private commercial banks (PCBs) the ratio marginally increased from 11.27 percent to 11.38 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 remained below the 10 percent regulatory requirement after first breaching the requirement in Q1FY13 (Table VI.1).

6.3 The ratio of gross NPL to total loans of the banking sector increased from 8.75 percent at the end of September 2012 to 10.03 percent at the end December 2012 (Table VI.2 and Chart VI.1). Gross NPL ratio for the state owned commercial banks (SCBs) increased substantially to 23.87 percent at end-December 2012 from 17.69 percent at end-September 2012. The ratio for the specialized banks (SBs) and the foreign commercial banks (FCBs) also increased from 24.10 percent and 3.23 percent at end-September 2012 to 26.77 percent and 3.53 percent respectively at end-December 2012. However, for private commercial banks (PCBs) the ratio decreased from 4.91 percent to 4.58 percent during the same period. Similarly, net NPL ratio for all banks increased from 2.89 percent at the end of September 2012 to 4.38 percent at the end of December 2012 resulting from insufficient provisioning for increased gross NPL (Table VI.3 and Chart VI.2). Net NPL ratio for the SCBs increased significantly from 6.03 percent at end-September 2012 to 12.82 percent at end-December 2012 (Chart VI.1). For the SBs and FCBs the ratio also increased from 16.79 percent and (-) 1.34 percent to 20.40 percent and (-) 0.86 percent respectively during the same period. However, for PCBs, similar ratio declined marginally from 1.06 percent to 0.92 percent during the period under review.

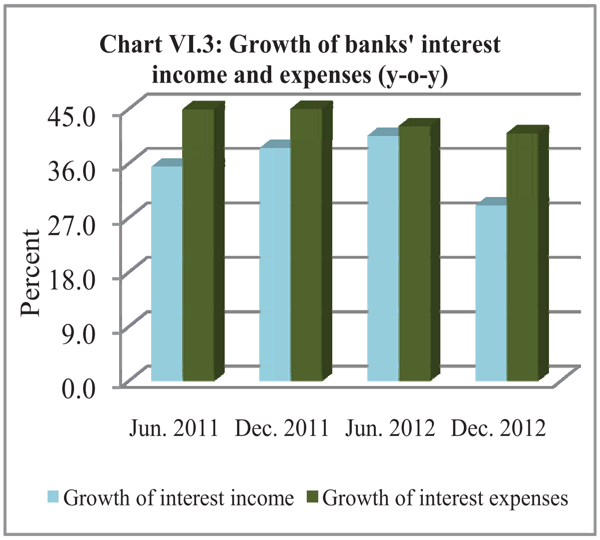


Table 6.1: Comparative position of classified loan and provisioning

(billion Taka)

Quarter	Items	SCBs	SBs	PCBs	FCBs
Q2FY12	Total classified loan	91.71	56.45	72.02	6.26
	Required provision	60.84	21.66	58.29	7.37
	Provision maintained	69.01	13.94	61.24	8.52
	Provision maintenance ratio	113.43%	64.36%	105.06%	115.60%
Q1FY13	Total classified loan	155.18	64.27	135.85	7.53
	Required provision	86.27	24.89	83.84	8.75
	Provision maintained	77.12	15.48	84.90	9.30
	Provision maintenance ratio	89.39%	62.19%	101.26%	106.29%
Q2FY13	Total classified loan	215.15	73.30	130.35	8.45
	Required provision	119.22	29.83	84.43	8.91
	Provision maintained	81.90	13.64	84.94	9.29
	Provision maintenance ratio	68.70%	45.73%	100.60%	104.26%

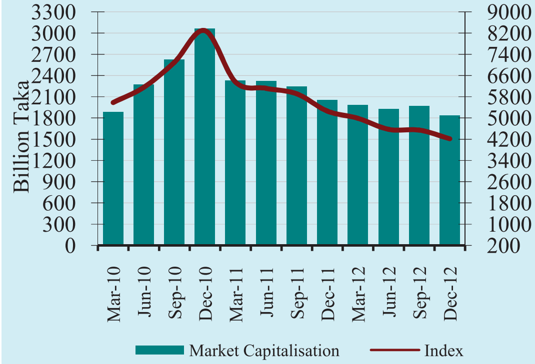
6.4 Among the profitability measures, overall return on assets (ROA) in the banking sector declined from 1.54 percent at the end of December 2011 to 0.64 percent at the end of December 2012. This was primarily due to interest expenditure growing faster than interest income (Chart VI.3) and increase in NPL as well as higher loan provisioning requirements under the new loan provisioning guidelines of BB (Table 6.1). At end December 2012, the interest rate spread was 5.33 percentage points for all banks which was lower than 5.53 percentage points of end September 2012. The performance of the SCBs also had some downward impacts on the industry outcomes as four SCBs hold about 26.1 percent in the total industry assets and 21.2 percent in the total outstanding loan. The ROA for SCBs and PCBs declined from 1.34 percent and 1.59 percent at the end of December 2011 to (-) 0.56 percent and 0.92 percent respectively at the end of December 2012. However, the ROA for FCBs and SBs increased marginally from 3.24 percent and 0.03 percent to 3.27 percent and 0.06 percent during the same period. Overall return on equity (ROE) declined significantly from 17.02 percent at the end of December 2011 to 8.20 percent at the end of December 2012 due mainly to a sharp decline in ROE for SCBs from 19.66 percent to (-) 11.87 percent and a moderate decline for PCBs and SBs from 15.69 percent and (-) 0.92 to 10.17 percent and (-) 1.06 percent (Table VI.4). However ROE of FCBs increased from 16.58 percent to 17.29 percent during the same period.

VII. Capital Market Trends

7.1 During Q2 of FY13 the capital market continued to experience downward pressure as reflected in the falling DSE index and declining market capitalization. At the end of Q2FY13, the DSE general index stood at 4219.31 which was 7.15 percent lower than Q1FY13. Over the same period, market capitalization decreased by 6.87 percent (chart VII.1 and Table VII.1). Over a 12-month period, the DSE general index and market capitalization declined significantly by 19.75 percent and 10.72 percent respectively during Q2FY13 as compared to Q2FY12.

7.2 The average price earnings ratio of the Dhaka Stock Exchange came down slightly to 12.07 in December 2012 from 13.04 in September 2012 ostensibly making the market more attractive for new investments. Notwithstanding this, total turnover volume in the DSE decreased by 29.02 percent to Tk. 202.61 billion in Q2FY13 from Tk. 285.45 billion in the first quarter of FY13. However, it increased marginally by 0.79 percent compared to the same period of last year. The 'number of listed securities' increased to 294 in December'12 from 292 in September'12. The value of 'issued equity and debt' increased by 2.02 percent (Table VII.1) and two new companies were listed in the capital market during Q2FY13. The liquidity situation in the capital market tightened as measured by the Turnover velocity ratio (TVR)[1] , which decreased to 44.14 percent in Q2 from 57.92 percent in Q1 of FY13.

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



7.3 Sector-wise, DSE data shows that during Q2 of FY13 market capitalization decreased in all sectors except for food and allied products and the telecommunication sectors (Table VII.2). The relative contributions of the different sectors in total market capitalization remained almost unchanged during the last two quarters with banks continuing to account for more than 26 percent.

7.4 With a view to enhance transparency and accountability in the two exchange houses, the capital market regulator (SEC) has installed surveillance software on December 12, 2012 aimed at better detection of any kind of violation of rules and regulation adopted by the SEC for the development of the capital market.

VIII. Near-Term Economic Outlook

8.1 Notwithstanding the continued global economic uncertainties real economic growth in FY13 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 In FY12, real output grew by 6.3 percent where the shares of agriculture, industry and service sectors were 19.3, 31.3 and 49.5 percent respectively with their respective growth of 2.53, 9.47 and 6.06 percent. As discussed earlier, both the Aus and Aman rice crops have surpassed FY12 output levels but are likely to fall short of the FY13 target levels. Agricultural output prospects hinge on the 'Boro' rice crop for which it is too early to provide any assessments. Data on the outlook for the non-rice crop and non-crop agriculture remains sketchy. One indicator – credit growth – shows that credit disbursements to fisheries and livestock in FY13Q1 increased significantly (37 and 50 percent respectively). On the whole given the shortfalls in two of the three rice crops the risks to achieving the

[1] TVR = (Turnover during the quarter/Quarter-end Market capitalization)*4

FY13 agricultural growth are greater than that forecasted in the previous issue of the Bangladesh Bank Quarterly where the forecasted agricultural growth was in 3.5-3.75 range.

The significantly higher export (12.1%) and remittance (24.0%) growth in FY12Q2 compared to that in FY12Q1 bodes well for manufacturing and construction sector growth. The key cautionary note relates to imports, and specifically the slowdown in imports related to industrial output. Moreover private sector credit growth has also slowed by about 3.5% points at the end of FY13Q2 relative to end FY13Q1. As such the industrial sector projection of around 7.50–7.75 percent remains. Services sector activities such as trade and transport are closely related to the weighted average growth in the agriculture and industry sectors of the economy. Given this data the growth forecast for FY13 remains unchanged at 6.09–6.36 (details of the growth forecast can be found in the Bangladesh Bank Quarterly Vol. X No.1).

Inflation outcome and outlook

8.3 After reaching a record high of 11.97 percent in September 2011, point to point CPI inflation has been declining through October 2012 to 7.22 percent but has since reverse course, rising to 7.69 percent in December 2012. Food inflation in particular showed an uptick during last two months of Q2FY13 rising to 7.33 percent in December 2012 reflecting successive domestic fuel and energy price hikes, which also impacted on production, processing and transportation costs. Non food inflation in contrast declined to 8.43 percent. Overall point to point inflation is likely to show further small increases but this momentum may be short-lived in the months ahead.

8.4 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 possibility of additional upward adjustment of fuel prices represents a risk to the inflation outlook as does the possibility of volatility in the global commodity market, any major natural disasters or other prolonged disruptions to economic activity.