Part A: Economic and Financial Developments

Overview and executive summary

1. *As Q4, FY 09 drew to a close in June 09, policy makers and analysts were on the whole pleased about real GDP clocking 5.9 percent annual growth (against 6.2 percent of FY 08) and exports retaining double digits annual growth in the recessionary global environment. Although domestic demand held up well, decline in capital goods imports meant weakness in new investment activities in FY 09, not altogether unexpected given the export demand weakness and other uncertainties associated with the global downturn. Low outflows for imports from the buoyant workers' remittance and export receipt inflows kept domestic financial markets awash with Taka and USD liquidity in Q4 FY 09. The downswing in Consumer Price Index (CPI) inflation continuing from Q2 FY09 reached a low of 2.25 percent (point to point) in June 09. Amid uncertainty about the pace of global recovery from downturn, the Government of Bangladesh (GOB) opted to continue measures supporting domestic demand and the affected export sectors, announcing fresh stimulus outlays in the FY 10 national budget. Bangladesh Bank's (BB's) Monetary Policy Statement for H1 FY 10 announced continuation of easy monetary conditions to facilitate investment activities; with exhortations for banks to channel the surfeit of liquidity into productive investments including agricultural and SME lending rather than into asset price speculation and consumer credit for wasteful ostentation.*

2. *End Q1 FY10 (i.e., Sept 09) data on many of the economic indicators are yet to be at hand. Available import LC data for July-Sept 09 and export data for July-Aug 09 indicate no significant upturn or slackening in economic activities in Q1 FY 10 relative to Q4 FY 09, but by September 09 signs started emerging that output activities will pace up from Q2 FY 10 onwards, including inter alia the onset of decline in Taka and USD liquidity overhang. Excess reserves of banks with the BB started to decline gradually, and the inter-bank call money rates turned around from the near zero lows. By the end of September 2009 banks ceased daily queuing up for selling foreign exchange receipts to BB, now occasionally buying from BB instead. The USD 2.8 billion exports in July-August 09 were 3.3 percent lower than in the same months previous year, but were 12.4 percent higher than exports in first two months of the preceding quarter. The high 42.4 percent y-o-y export growth in Q1 FY 09 meant a very high base for Q1 FY 10 exports to match or outgrow in a recessionary global environment. From Q2 FY 10 onwards y-o-y export growth can be expected to rise fast from the likely near zero level of Q1, helped by lower base numbers and by the continuing gains in global demand recovery.*

3. *In agriculture, following the strong 4.6 percent FY 09 annual output growth the overall outlook for aman rice output appears to be good, the somewhat delayed onset of*

monsoon largely compensated by subsequent more frequent spells of autumn rainfall easing the need for irrigated water. With no major flooding or other climatic debacle and with resolute guiding hands of the Ministry of Agriculture and BB for timely availability of necessary inputs and credit, outlook for other food and non-food crops also appears favorable.

4. *After bottoming out at 2.25 percent in June 2009, point to point CPI inflation edged up to 3.46 and 4.69 percent respectively in July and August 2009, with both food and non-food prices registering increase. Global and regional price trends indicate that point to point CPI inflation in Bangladesh is likely to edge upward rather than downward in the coming months. The 12 month average CPI inflation, at 6.04 and 5.6 percent respectively in July and August 2009, may however continue in decline for a few more months (with earlier higher inflation months falling out in the averaging) before edging up; and looks likely to remain within the 6.5 percent ceiling for FY 10 stipulated in BB's Monetary Policy Statement for H1 FY 10.*

5. *From early August 2009 BB resumed its auction of 30-day BB bills to mop up some of the excess liquidity that was sloshing around in the market, forcing inter-bank call money rates down to near zero levels. Subsequently, BB's reverse repo operations also resumed in October 2009 with the rate realigned to 2.5 percent from the previous high of 6.5 percent.*

6. *The prevailing easy monetary conditions with adequate market liquidity appear appropriate and necessary in keeping the economy on course for the targeted six percent real GDP growth in FY 10. Government's negative net new borrowing from the banking system in Q1 FY 10 did not evidence strong ADP implementation activity, which needs to pace up, particularly in infrastructure projects, to help private sector activities gain momentum in fulfilling the GDP growth aspirations.*

7. *While inflation risks are to be kept on close watch, current conditions do not call for any drastic tightening step that may impede the incipient recovery of new investment activities. BB's close continuous monitoring of sectoral flows of credit remains important however, in seeing to it that the available liquidity is channeled by banks towards fully meeting the credit needs of productive economic sectors rather than towards creating speculative asset price bubbles or towards trapping households into spirals of consumer debt for wasteful ostentations. The high emphasis placed by GOB and BB on promoting agricultural and SME activities is expected to lead to more broad-based, more inclusive growth processes; with correspondingly faster reduction of poverty.*

I. Developments in the Real Economy

1.1 Activities in the real economy maintained momentum in FY09 despite the global economic slowdown as economic activities responded promptly to the robust domestic demand throughout the period. Real GDP grew at the rate of 5.9 percent in FY09 which is not far below the 6.2 percent FY08 growth. Though industry sector adversely suffered the pass through effects of the global crisis through trade and financial channels, agriculture sector sustained its growth momentum mainly due to favorable weather condition and stable political environment and sustained supportive policies including incentive packages and institutional measures of the government. All sub-sectors of service sector also performed progressively with few exceptions.

1.2 The agriculture sector in current fiscal, FY10 expected to grow at respectable rate since favorable weather condition has remained and credit disbursement in this sector has increased significantly (Tk. 19.12 billion) during the first quarter (Q1, FY10), a 27.7 percent higher than the amount disbursed over the same period of FY09; successful implementation of rest of the targeted amount (out of total Tk. 115.1 billion) will contribute effectively in achieving robust agricultural growth in FY10. Appropriate steps from Ministry of Agriculture and BB for timely delivery of necessary inputs and credit will create favorable condition for brighter outlook for agricultural sector output including food and non-food crops in FY10. Domestic demand is gradually improving with mild increase of price level to 3.46 and 4.69 percent in July and August, FY10 from 2.25 percent in June FY09. However, the main challenge is boosting industrial growth which will predominantly depend on recovery of external demand in the global market. Service sector development is partly conditional on industrial growth. Given the positive developments in the global economic activities in 2009, growth rates have been revised to higher digits in major industrial countries including some Asian giants like India and China. Thus with the boost up of global demand, external sector growth of the country will gear up and helps to boost both industrial and service sector growth.

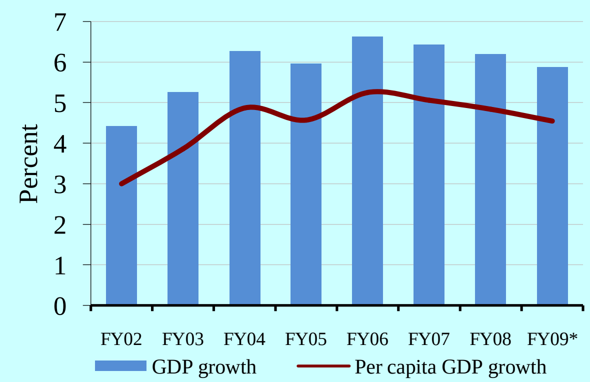
1.3 Agriculture sector recorded a significantly higher growth rate (provisional, 4.6 percent) in FY09 as compared to 3.2 percent actual of last fiscal year. Out of two agriculture sub-sectors, agriculture and forestry sub-sector has registered relatively higher growth (4.8 percent) than fishing sub-sector growth (4.1 percent) in FY09. Despite the high FY09 agricultural growth rate, the share of agriculture sector in GDP has maintained regular trend of decline to 20.6 percent in FY09 from 20.8 percent in FY08.

1.4 Trends of major crops production are reported in Table I.4. Like previous trend, the five major crops namely, aman, boro, potato, vegetables and sugar continue to contribute more than 80 percent of total crop production. Production of potato and vegetables, the two non-cereal crops has been attaining fast growth trends in recent few years though it recorded relatively lower growth rate in FY09. Maize is another fast growing crop; its target level is fixed at 11.37 metric tons in FY09.

1.5 Bangladesh is gradually moving to attain self-sufficiency in rice production which contributes about 70 percent of food requirement of the country. Food self–sufficiency is seriously hampered in the past years by lower production of rice due to natural calamities like cyclones and floods. In FY09, aus and aman have attained higher growth rates over last year and actual production reached to 1.9 and 11.6 million metric tons respectively in FY09 which was 1.5 and 9.7 million metric tons respectively in FY08. The FY10 outlook for aman rice production appears to be good as the somewhat delayed monsoon rainfall was largely compensated by more frequent spells of autumn rainfall easing the need for irrigated water. The production target of boro in FY09 (18.0 million metric ton) may likely be achieved due to the favorable weather condition with absence of any serious natural calamities.

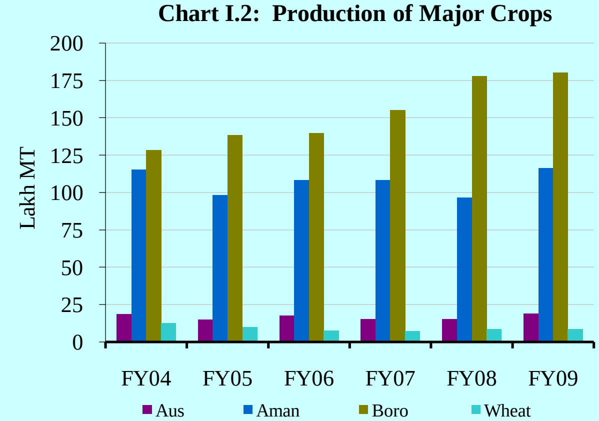
1.6 Production of wheat (0.9 million tons) recorded modest growth in FY09, up 1.2 percent over FY08 and potato recorded modest decline from 6.5 million tons in FY08 to 5.9 million tons in FY09 due to some unfavorable weather conditions and lack of adequate storage facilities. To sustain food security, government adopted some supportive policies such as higher target for public food procurement, food distribution, and to set higher procurement price and also, to maintain higher level of food stocks. The procurement target for FY10 is set at 1.6 million tons; 0.7 million tons up from 0.9 million tons in FY09. These may ensure price incentive, create higher market demand and encourage farmers to move for higher production and also, it helps in ensuring food security during possible disaster and safeguarding government against sudden price upsurge and supply shortages in international market.

Chart I.1: Growth of Real GDP



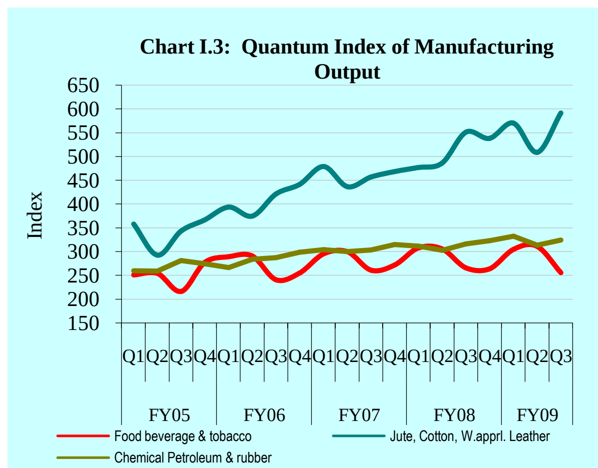
* Provosional estimates of BBS

Chart I.2: Production of Major Crops



1.7 In the backdrop of relatively lower growth (8.2 percent) in agricultural credit disbursement in FY09 as compared to around 21.0 percent average annual agricultural credit growth over the last six years (FY03-FY08), the BB has set a disbursement target of 115.1 billion agricultural credit for FY10; a targeted growth rate of 24.0 percent in FY10 over actual disbursement in FY09. Over the first quarter, Q1 FY10 Tk.19.12 billion agricultural credit has been disbursed which is 27.7 percent higher than the amount disbursed over the same period of FY09 and it represents a 16.6 percent of total disbursement target of agricultural credit in FY10. Disbursement of credit to sectors like crop, irrigation, agricultural equipment and fisheries have significantly increased with a considerable improvement in loan recovery and overdue position. Government has increased the level of subsidies for fertilizer and power used for irrigation and initiated fair price for farmers in case of government procurement to facilitate agricultural production in FY10.

1.8 A recent projection of World Bank study indicates that by 2020 Bangladesh will create substantial additional demand for vegetables, spices, fruits, eggs, meat and dairy products due to changing pattern of food demand by new generation people with rising urbanization, higher per capita income and overall economic growth. However, BB introduced subsidized interest rate (only 2.0) to stimulate cultivation of essential consumption crops like maize, oilseeds, pulses and spices present domestic production level of which is much lower than domestic requirement. The government also, gives special attention towards diversification of agricultural products containing higher food values like poultry, fisheries and vegetable production.



1.9 Industry sector output grew by 5.9 percent in FY09 which was much lower than the 6.8 percent growth of FY08. The slowdown in industrial growth mainly resulted from export decline for most of the items other than apparels and textiles. However share of industry as GDP remained stable at around 30 percent in FY09 as it was in FY08 despite the fall in industry sector's growth rate. Sub-sectoral breakup of industry sector growth shows that manufacturing sector, the largest sub-sector and dominant part of overall industrial growth, experienced a decline in growth rate since FY07 and stood at 5.9 percent in FY09 which was 7.2 percent in FY08. Fall in manufacturing sector growth during FY08 and FY09 was caused by the declining activities in apparel manufacturing due to deceleration in export growth fuelled by the chain effects of demand weaknesses in North America and Europe, the main export destinations of Bangladesh, following the global financial crisis.

1.10 In the coming few months of FY10 the growth of industry sector may decelerate further as both the import of capital machinery and disbursement of industrial term loan declined at a high rate in FY09 compared to FY08 and the declining trend is continuing in the current fiscal, FY10; a significant decline of import of 16.63 percent in July FY10 over July FY09 and a consistently declining trend of export which recorded a decline of 3.29 percent during the July-August of FY10 over the preceding year. Also, growth of overall private sector credit has slowed down with sharp fall in fresh investment initiatives lag effect of which would likely be felt during first quarter of FY10. However, the investment climate may be improving gradually fuelled by the global growth recovery with signs of recovery in the economic activities of US and Euro area countries. Furthermore, government has announced its first financial stimulus package to boost the priority sectors of the economy with special supports for industrial sector (including export oriented industries) and BB has taken measures like lowering policy interest rates, relaxing conditions for borrowing by banks from BB, widening the range of financial assets admissible as collaterals etc. to maintain adequate liquidity and credit flow to markets. Excess reserves of banks with BB started to decline gradually, and inter-bank call money rates turned up from near zero in Q4, FY09. However, its positive impact will facilitate to create favorable investment climate and boost industrial activities subsequently in rest of the three quarters in FY10.

1.11 According to the provisional estimates of BBS, the service sector registered 6.3 percent growth in FY09 which was marginally lower than the 6.5 percent growth in FY08. Sub-sectors of service sector maintained their shares as percentage of GDP with continued addition of new capacities in them. However growth of two major subsectors, wholesale and retail trade and transport, storage and communication experienced a decline mainly due to sluggishness in the industrial sector growth. Growth of services regarding financial intermediation has also declined slightly in FY09 due to slow growth in monetary intermediation by banks and insurances during the period with a chain effect of slowdown in growth of imports and exports in FY09 compared to FY08.

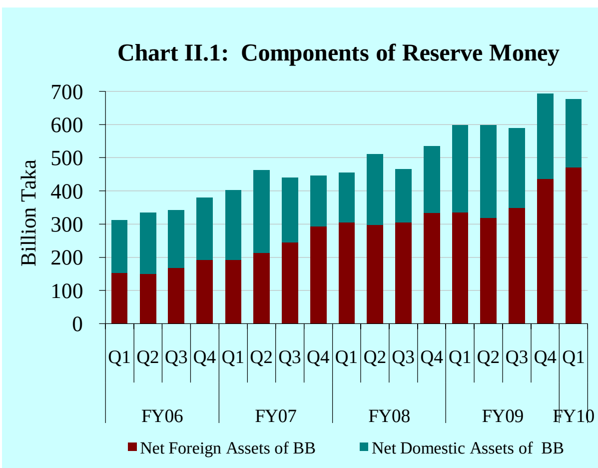
1.12 Growth of real economy activities in FY10 will depend on the sustenance of domestic demand; at the same time speed of global recovery from the ongoing economic slowdown which may boost external demand and rebound the export growth of all items including apparels and textiles. To bolster domestic demand both BB and the government have introduced a number of important initiatives. The target growth for private sector credit was fixed by 16.7 percent in FY10 with other facilities like relaxation of down payment requirements in rescheduling of bank loans to sectors hurt by the global slowdown, continuation of available refinance lines to support higher lending to priority economic sectors including agriculture and SMEs etc. With the higher target of agricultural loan (115.1billion Taka for FY10, about 25.0 percent higher over the realized disbursement in FY09), another 5.0 billion Taka loan disbursement target is set for sharecropper which will be given as a collateral free loan. To support government's financial need for its budgetary expenses including development expenditure BB has compatibly programmed to increase its target of net government sector credit by about 3.4 percentage point for FY10 (29.6 percent) compared to 26.2 percent in FY09.

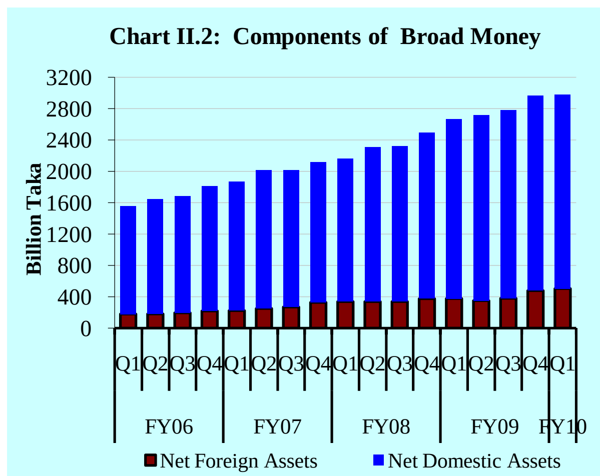
1.13 The growing power and energy shortages and underdeveloped infrastructure remain as major constraints to country’s industrial activities as well as its sectoral growth potential. In this regard the government has taken steps to attract local and foreign investors with private-public partnership approach to encourage them to invest in power and energy sector in Bangladesh. Those measures may create prospective environment for higher growth in FY10.

II. Money and Credit Market Developments

2.1 During FY09 and Q1 FY10, different monetary and credit market indicators showed steady performance in line with the Bangladesh Bank's (BB's) Monetary Policy Stance (MPS) adopted for H1 FY10. BB's monetary policy stance for July-December 2009 (announced in July, 2009) gave emphasis on continuation of easy monetary conditions to facilitate investment activities with the objective of supporting sustained high output growth while maintaining reasonable price stability; Besides regulating monetary aggregates BB's policy actions paid particular attention to sectoral flows of credit, addressing market gaps and failures in financial services to agriculture, SME and other priority economic sectors rather than to asset price speculation and consumer credit for wasteful ostentation.

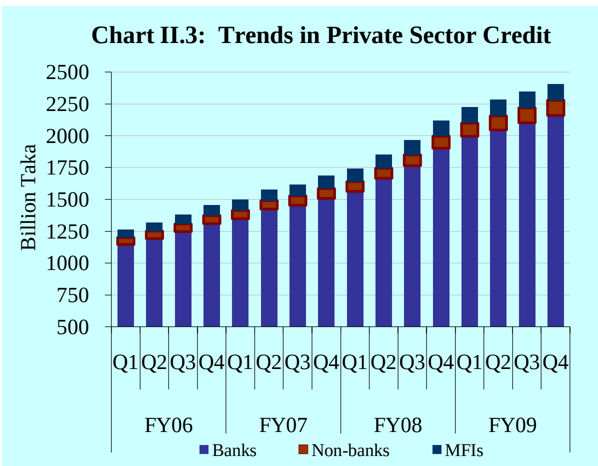
2.2 Total private sector credit by DMBs grew by 14.26 percent (y-o-y) in August, 2009 which grew by 26.14 percent during the same period of the preceding year and by 15.47 percent in FY09. Agricultural credit disbursement during Q1 FY10 increased substantially by 27.7 percent over the amount disbursed during the same period of FY09. On y-o-y basis, total credit growth to private sector from banks, non-banks and microfinance institutions increased to Tk. 2159.1 billion, Tk.119.2 billion and Tk. 127.0 billion respectively at the end of FY09 from Tk. 1901.4 billion, Tk.94.7 billion and Tk.121.5 billion at the end of FY08 reflecting increased economic activity during the period under review.

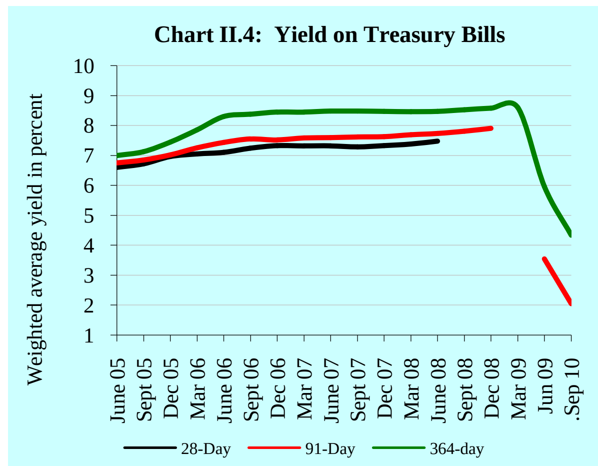




2.3 Provisional estimate shows that M2 experienced a growth of 19.13 percent (y-o-y) in August, 2009 fueled by 59.35 percent growth in NFA and 12.36 percent growth in NDA. M2 grew by 19.59 percent during the same period of the preceding year. The rise in NDA was driven by growth of public sector credit by 16.22 percent, of which credit to the Govt. sector increased by 18.39 percent in August, 2009. Private sector credit also increased by 14.26 percent (y-o-y basis) in August 2009 compared with 26.14 percent growth during the same period of the preceding year. Broad money (M2) recorded a growth of 18.94 (y-o-y basis) percent in FY09 up from 17.86 percent during the same period of the preceding year. This higher growth was caused mainly by increased growth of net foreign assets (NFA) and net domestic assets (NDA) by 27.37 percent and 17.44 percent respectively during FY09 which grew by 14.41 percent and 18.49 percent during the same period of the preceding year. The growth of M1 increased by 12.23 percent (y-o-y) in August, 2009 which increased by 16.04 percent during the same period of the preceding year.

2.4 An analysis of the components of M2 shows that currency, demand deposits and time deposits increased by 11.85 percent, 12.74 percent and 21.19 percent respectively in August, 2009 which grew by 19.20 percent and 12.16 percent and 20.69 percent respectively during the same period of the preceding year following lower inflation expectations and attractive interest rate offered by banks on term deposits. The money multiplier (M2/RM) increased to 4.43 in August 2009 from 4.27 in June 2009.





2.5 The RM grew by 29.71 percent (y-o-y) and stood at Tk. 685.30 billion in August 2009 which experienced 17.31 percent (y-o-y) growth during the same period of the preceding year. This occurred due to significant growth in NFA by 71.17 percent despite significant decline in the growth rate of NDA by 34.59 percent in August 2009[1]. The decline in NDA of BB mainly driven by a decline in BB's claims on DMBs by 15.99 percent, other public by 10.96 percent and claims on Government by 1.17 percent. The RM grew by 30.26 percent in FY09, which experienced a 20.88 percent (y-o-y) growth in FY08.

2.6 In June 2009, total advances by economic purposes increased by 3.37 percent and stood at Tk. 2090.48 billion. Bank advance by economic purposes shows that credit for trade increased by 35.42 percent, industry by 21.59 percent, working capital financing by 17.06 percent, miscellaneous purposes by 10.44 percent, construction by 6.88 percent, and agriculture by 6.58 percent, transport and communication by 1.71 percent in June FY09 (Table I.8).

[1] NFA refer to foreign exchange reserves in BB.

2.7 During Q4 FY09, the disbursement of term lending by banks and NBFIs increased by 21.85 percent and stood at Tk. 67.96 billion which was Tk.55.78 billion in Q4 FY08. Between Q4 FY08 and Q4 FY09, term lending by SCBs increased from Tk. 2.10 billion to Tk. 3.17 billion and that of PCBs increased from Tk.38.63 billion to Tk.48.12 billion, while term lending by FCBs increased from Tk. 7.51 billion to Tk. 8.12 billion. Term lending by NBFIs also increased from Tk.6.72 billion to Tk. 7.12 billion during Q4 FY08 and Q4 FY09.

Chart II.5: Weighted average yield of accepted Government Treasury Bills & Bonds (End March, 2009)

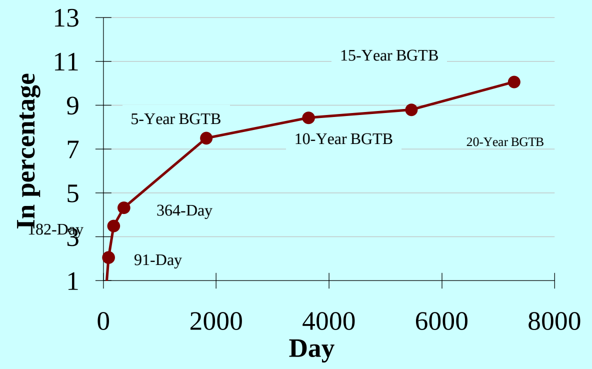
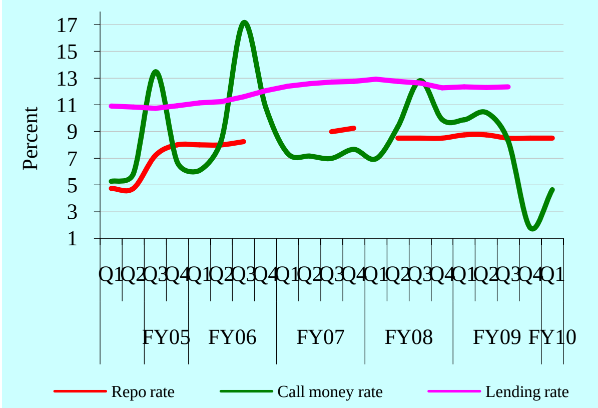


Chart II.6: Interest Rate Movements



2.8 In the backdrop of domestic lower inflation and global recessionary situation the rate on repo and reverse repo reduced by 25 basis point to 8.50 percent and 6.50 percent from 8.75 percent and 6.75 respectively on March 11, 2009 to ease the credit condition in the money market which reduced further significantly on October 12, 2009 and stood at 4.5 and 2.5 respectively in order to increase economic activity following lower credit demand and excess liquidity in the money market during two consecutive quarters, Q4 FY09 and Q1 FY10.

2.9 Overall, yields on short term treasury bills (e.g., 91-day, 182-day, 364-day) decreased to 2.14, 3.51 and 4.57 percent at the end of October, 2009 from 3.54, 4.24 and 5.96 percent respectively at the end of Q4 FY09 following lower actual inflation and inflation expectations. The yields on long-term bonds such as 5-year, 10-year, 15-year and 20-year BGTB also declined (Table II.3). Outstanding stock of government treasury bills including NSD certificates increased and stood at Tk.974.4 billion at the end of Q1 FY10 which was Tk. 789.6 billion during the same period of the preceding year. From early August 2009 BB resumed its auction of 30-day BB bills to mop up some of the excess liquidity that was sloshing around in the market, forcing inter -bank call money rates down to near zero levels. The call money rate increased to 2.82 percent in October 2009 from 1.79 percent at the end of FY09.

III. Fiscal Developments

3.1 The FY10 national budget projects overall revenue and expenditure 11.6 percent and 16.5 percent of GDP respectively as against 11.2 percent and 14.8 percent realized in FY 09. Overall fiscal deficit excluding grants is projected at 5.0 percent of GDP in FY 10 as against 4.0 percent in FY 09. In FY 10, total deficit financing is set at Tk. 343.6 billion, of which Tk. 205.55 billion is projected to be financed by domestic borrowing including bank financing of Tk.167.55 billion and non-bank financing of Tk. 38.0 billion and Taka 86.73 billion from foreign sources.

3.2 The FY 10 budget projects total NBR tax revenue of Tk. 639.6 billion, which is 16.1 percent higher from the actual level of FY09. The NBR projects of Taka 227.95 billion from VAT, Taka 165.60 billon from income tax , taka 104.30 billion from custom duty and taka 112.2 billion from other sources for FY10, which are 13.3 percent, 19.5 percent , 11.8 percent and 22.2 percent respectively higher than the actual level of FY 09. As against this target, NBR collected Tk. 133.2 billion during the first quarter of FY 10 which is 11.2 percent higher than the level of corresponding period of FY09. The tax revenue growth was led by income tax, value added tax (VAT), and other sources.[2] During Q1 of FY10, tax revenue collected from income tax, VAT, and other sources, increased by 28.7 percent, 15.7 percent, and 3.1 percent respectively over actual level of corresponding period of FY09. However, revenue earning from custom duty declined by 1.6 percent during the first quarter of FY10 over the same period of FY09 due mainly to fall in import volume and partly to fall of prices of imported commodities.

Chart III.1: Trend in Government Revenue and Expenditure

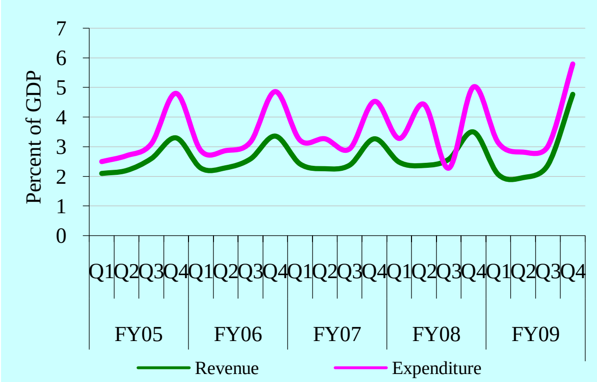
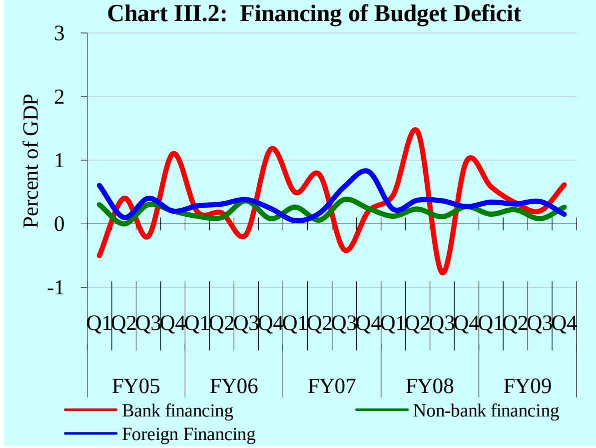


Chart III.2: Financing of Budget Deficit



3.3 In FY10, current expenditure and annual development program (ADP) expenditure set at Tk. 772.4 billion (11.25 percent of GDP) and Tk. 305.0 billion (4.44 percent of GDP), which are 15.0 percent and 54.9 percent respectively higher than the actual level of FY09. The budget FY 10 shows that the largest allocations of current expenditure are likely to go to the heads of pay and allowance (32.7 percent), subsidies and current transfer (20.3 percent) and interest payment

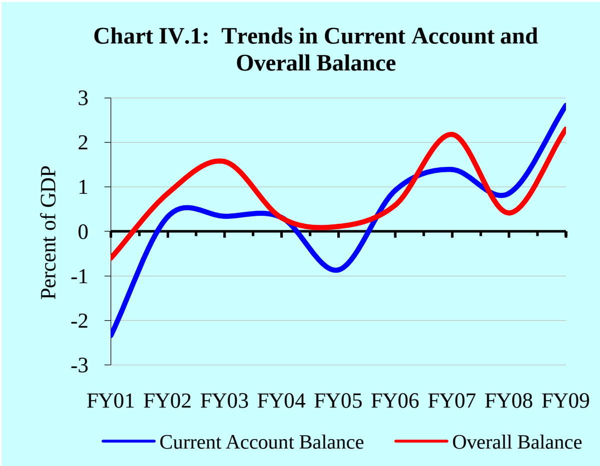
[2] Other sources include supplementary duty (local and import), excise duty, turnover tax, and travel tax.

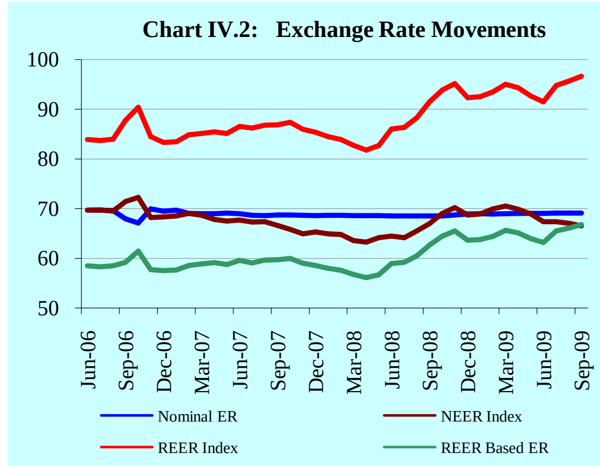
(20.3 percent). The shares of development expenditure indicate that the largest allocations are likely to go to the heads of local government and rural development (22.6 percent), energy and power (13.5 percent), education and information technology (13.0 percent), transport and communication (15.2 percent), health (9.7 percent) and agriculture (7.5 percent). During the first two months of FY10, total ADP expenditure stood at Tk.13.47 billion (4 percent of total ADP) as against Tk. 10.68 billion during the same period of FY09. ADP implementation activities need to pace up, particularly in infrastructure projects, to help private sector activities gain momentum in fulfilling the GDP growth aspirations. Preliminary estimates indicate that current expenditure stood at Tk. 126.0 billion during the first two months of FY 10 as against TK. 161.0 billion in Q1 of FY 09.

3.4 The overall budget deficit in FY10 was fixed at Tk. 343.58 billion excluding grants (5.0 percent of GDP) as against of Tk. 249.60 billion (4.0 percent of GDP) in FY 09. In FY10 budget, deficit financing from domestic and foreign sources was projected at Tk. 205.55 billion and Tk.86.73 billion respectively as against the actual level of Tk. 149.2 billion and Tk.70.4 billion respectively in FY09. Among domestic sources, bank financing was fixed at Tk. 167.55 billion and non-bank financing at Tk.38.00 billion in FY10, as against the realized figure of Tk. 105.2 billion and Tk. 44.1 billion respectively in FY09. The projected large amount of domestic bank borrowing in FY10 budget will not affect the private sector borrowing needs due mainly to the current large liquidity overhang in the market. Besides, actual bank borrowing always remained lower than the initial projections resulting in no real crowding out of private sector borrowing needs. During the first two months of FY10, net government borrowing from banking system stood at Tk. (-) 40.6 billion as against Tk. (-) 5.4 billion during the same period of FY09.

IV. External Sector Developments

4.1 Current account balance (CAB) recorded a healthy USD 0.61 billion surplus in July'09 which was USD 0.26 billion in July'08 and USD 2.54 billion during FY09. In spite of deficits in services and income account, this surplus (in July'09) in CAB was mainly attributable to the slower decline in exports (-7.1 percent on adjusted fob basis) compared to sharp decline in imports (-16.9 percent) resulted a narrowed down in the trade deficits and sustained growth in inflow of workers' remittances (reflected in current transfer). Trade deficit narrowed to USD 0.11 billion in July'09 compared to USD 0.32 billion deficits in July'08. Net balance of services account in July'09 stood at a deficit of USD 0.15 billion compared to a deficit of USD 0.18 billion in July'08. During the first month of FY10, the income account recorded a deficit of USD 0.05 billion which was USD 0.09 billion during the corresponding month of FY08 while the current transfer experienced a surplus of USD 0.93 billion during the month and recorded 8.9 percent growth over the same month of previous fiscal year. Workers' remittances constitute more than 95 percent of current transfer recorded a 7.8 percent growth and stood at USD 0.89 billion during July'09 from USD 0.82 billion of July'08. Overall the balance of payment showed a surplus of USD 0.69 billion in the first month of FY10 against a surplus of USD 0.22 billion in the first month of FY09 and thus the foreign exchange reserve rose to USD 7.74 billion at the end of July'09.





4.2 The USD 2.8 billion exports in July-August 09 were 3.3 percent lower than in the same periods of previous year, but were 12.4 percent higher than exports in first two months of the preceding quarter. The high 42.4 percent y-o-y export growth in Q1 FY 09 meant a very high base for Q1 FY 10 exports to match or outgrow in a recessionary global environment. From Q2 FY 10 onwards y-o-y export growth can be expected to rise fast from the likely near zero level of Q1, helped by lower base numbers and by the continuing gains in global demand recovery. The current quarter's decline in exports attributed mainly due to decline in exports of chemical products (-37.15%), woven garments (-2.06%), knitwear products (-0.48%), frozen shrimp and fish (-32.96%), tea (-82.88%), leather (-22.33%) and some other commodities during July-August '09.

4.3 According to the Export Promotion Bureau (EPB), several export commodities such as jute goods, electronics, terry towel, other primary commodities and some other manufacturing goods recorded higher growth during July-August '09 over the same period of last fiscal year. On the other hand, exports of woven garments, knitwear products, home textile, textile fabrics, raw jute, tea, frozen foods, leather, chemical products, foot wear, handicrafts, ceramic products, petroleum bi-products and agricultural products recorded decline over the previous year (Table IV.6).

4.4 The foreign exchange market remained stable during Q1 FY10 and Taka remained same against US dollar compared to the end of FY09. Taka remained under sustained appreciation pressure since the beginning FY09 and continued up to Q1 FY10; with slower demand of foreign exchange for imports and other purposes from the inflows of export proceeds and workers' remittances. BB acted to keep exchange rate of Taka broadly stable and to preserve external competitiveness with continuous purchase of USD funds from the local interbank market. Weighted average interbank exchange rate at the end of Q1 FY10 remained at end FY09's rate of Taka 69.06 per USD which was Taka 68.03 per USD at the end of Q3 FY09. On the other hand, the REER based exchange rate against trade weighted basket of currencies stood at Tk. 66.75 at the end of Q1 FY10, which was Tk. 63.19 at the end of FY09 and Taka 59.15 at the end of FY08. Since the nominal exchange rate remained same but REER based exchange rate against trade weighted basket of currencies appreciated, Taka lost some of its export competitiveness during Q1 FY10.

Chart IV.3: Trends in Exports & Imports

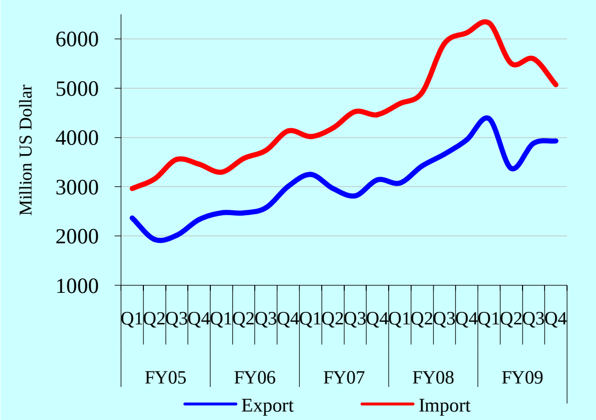
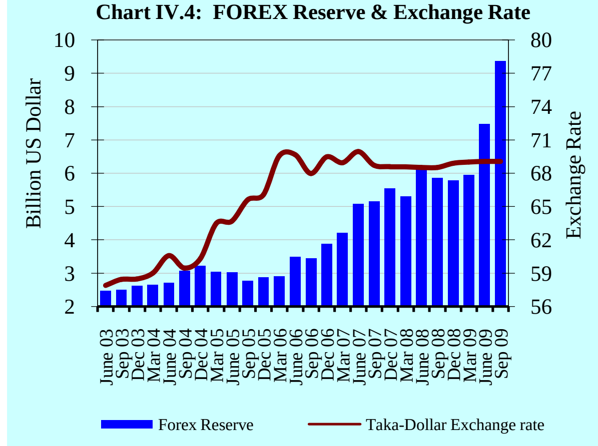


Chart IV.4: FOREX Reserve & Exchange Rate



4.5 Import payments (provisional, f.o.b.) decreased by 16.9 percent to USD 1.56 billion during the first month of Q1 FY10 compared to USD 1.87 billion in the same month of previous fiscal while import payments recorded a slower 4.2 percent growth during FY09 (Table IV.1). Food grains import declined by 49.4 percent during the month which recorded a 37.4 percent decline in FY09. This declining trend was attributable mainly due to good domestic harvest of food grains and of lower global prices. During the period, import of rice, milk & cream and sugar declined by 95.0 percent, 47.8 percent and 61.5 percent respectively while imports of wheat, spices, oil seeds, edible oil and all sorts of pulses increased by 74.0 percent, 44.8 percent, 733.3 percent 8.4 percent and 102.1 percent respectively due to its sustained demand and lower domestic production. Import of intermediate goods used for further processing in manufacturing sector also decreased by 26.2 percent during July'09 which recorded a 23.5 percent decline during Q4 FY09. During July'09 period, imports of clinker, crude petroleum, POL, chemicals, pharmaceutical products, fertilizer, dyeing and tanning materials, plastic and rubber articles thereof, raw cotton, yarn and textile and articles thereof declined by 52.7 percent, 100.0 percent, 5.3 percent, 17.3 percent, 7.0 percent, 86.0 percent, 9.8 percent, 26.8 percent, 13.5 percent, 21.4 percent and 7.2 percent respectively while import of staple fibre recorded only 3.2 percent growth over the corresponding period of FY09. Imports of capital goods and other capital machineries registered a 25.8 percent decline during July'09, also recorded 7.5 percent decline during Q4 FY09. Decline in imports of capital machineries and industrial raw materials indicate sluggishness in investment in manufacturing sector. Available import LC data for July-Sept '09 indicate no significant upturn or slackening in economic activities in Q1 FY 10 relative to Q4 FY 09, but by September 09 signs started emerging that output activities will pace up from Q2 FY 10 onwards, including inter alia the onset of decline in Taka and USD liquidity overhang.

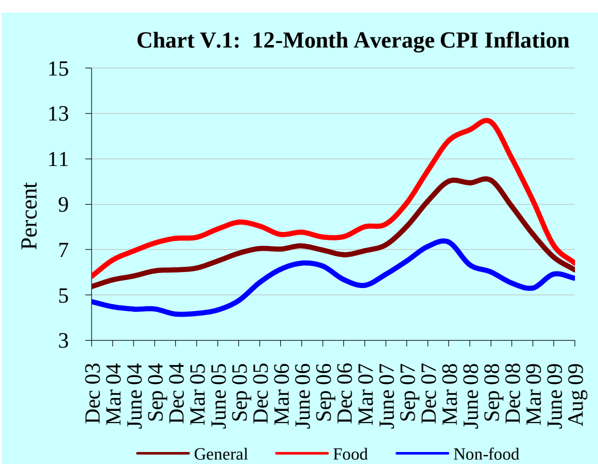
4.6 The inflow of workers' remittances, constitute more than 95 percent of current transfer, registered a strong 15.9 percent growth (USD 2.7 billion) during Q1 FY10 which recorded a 22.4 percent growth (USD 9.7 billion) during FY09. During July-August'09, the largest source of remittance was Saudi Arabia (USD 558.55 million) followed by UAE (USD 312.26 million) and USA (USD 248.94 million).

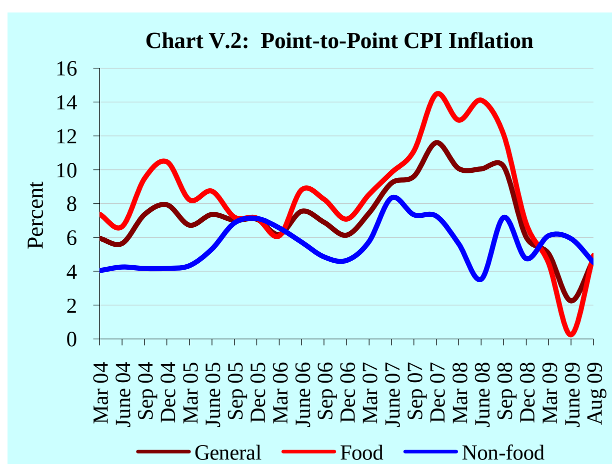
4.7 Sustained growth in inflows from export of goods and services including manpower remains important for external sector viability, the importance will heighten further over the medium term as energy import needs escalate with gradual depletion of local natural gas reserves and need for imports of added capital machineries to boost the industry sector growth. Looking for new markets in fast growing economies in Asia and South America may yield results in additional export growth. Sustaining the healthy growth in workers' remittance inflows will require similar quest of new opportunities.

V. Price Developments

5.1 The trend of decline in point to point (p-t-p) CPI inflation started from Q2FY09 continued till Q4FY09 bottoming out at 2.25 percent in June09; helped by favourable supply situation in domestic output of food grains and stable administered prices of fuel oil. CPI Inflation (p-t-p) has edged up in Q1FY10 rising to 3.46 percent and 4.69 percent respectively in July and August 2009, with both food and non-food prices registering increase.

5.2 Basically, food inflation pushes the general inflation rate to a higher level in Q1FY10. Despite good domestic output of rice crop, recent surge in domestic prices of essential commodities: rice, sugar, edible oil, pulses, onion, garlic and vegetables is the reason for higher inflation in Q1FY10. Besides, increase in domestic price of energy (natural gas) from August09 contributed to the increase in non-food inflation, which reached 4.54 percent in August09 compared to 3.74 percent in July09. On the other hand, 12-month average CPI inflation keeps declining since Q2FY09 (9.80 percent, as of October08) till Q1FY10 as reached at 5.6 percent in August09. It may however continue to decline for a few more months (with earlier higher inflation months falling out in the averaging) before edging up.





5.3 The upturn in inflation may continue in the coming months mainly because of the increasing trend in international prices of petroleum, rice, sugar and other commodities; liquidity overhang in the domestic financial market may also add to inflationary risk if used by banks in excessive expansion of consumer credit.

Chart V.3: Commodity Prices in International Market

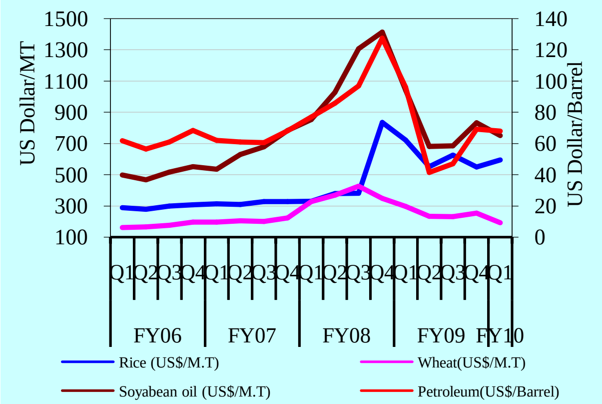
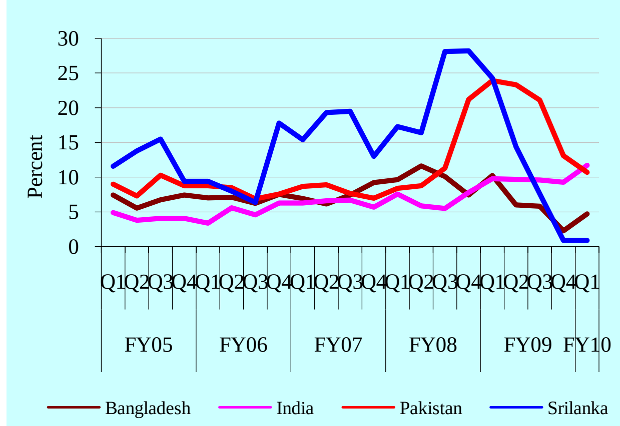


Chart V.4: Inflation in South Asia (Year on Year)



5.4 As in Bangladesh, CPI inflation in neighboring countries shows an upward trend since Q4FY09. In July09, Indian CPI inflation (point to point) has significantly increased to 11.89 percent compared to 9.29 percent in the quarter end Q4FY09 in June09, which was 8.0 percent in the end of Q3FY09. CPI inflation in Sri Lanka has slightly increased to 1.1 percent in July09 compared to 0.9 percent in the previous month of June09. On the other hand, CPI inflation in Pakistan keeps declining to 10.7 percent in August 09 compared to 13.1 percent in the end of Q4FY09 in June09.

VI. Banking Sector Performance Trend

6.1 Major indicators unfolding banking sector performance showed mixed trends during the period under review. Risk weighted capital asset ratio (RWCAR) for all banks increased while the ratio of non-performing loan (NPL) to total loan for the banking sector, in both gross and net terms, decreased. On the other hand ROA and ROE, two important measures of bank profitability increased. The interest rate spread (IRS) for all banks also increased during the period. Total deposit and advances, both were increased during the period under review. The country's banking sector remained shielded from the global financial turmoil mainly due to the low level of global integration and the sectors relatively good performance in terms of asset management and profitability underpinned by prudential regulation and sound management resulting from BB's timely policy guidance. It would however be important to continue effective supervision by BB for further improvement of the country's banking sector.

6.2 There was a significant increase in RWCAR for all banks to 11.7 percent in June 2009 from 10.0 percent in December 2008 reflecting positive changes in the asset position from 6.9 percent to 9.1 percent for state owned commercial banks (SCBs); from 11.4 percent to 12.0 percent for private commercial banks (PCBs); from 23.8 percent to 28.3 percent for foreign commercial banks (FCBs); and from (-) 5.3 percent to 0.2 percent for specialized banks (SBs). It may be mentioned that the SBs showed negative RWCAR during both halves of 2008 which turned positive in June 2009 due mainly to a payment of Tk. 500 crore by the government to Rajshahi Krishi Unnaan Bank (RAKUB) during Q4FY09. The RWCAR, however, remained significantly above the regulatory requirement of 10 percent only for FCBs and marginally higher for PCBs (Table VI.1).[3] In view of the growing share of PCBs in the overall banking activities, it would be prudent to encourage the PCBs to further augment their capital ratios to acquire higher capacity to successfully weather any episode of systemic shocks in the banking sector.

6.3 The ratio of gross NPL to total loans of the banking sector decreased from 11.1 percent during end Q3FY09 to 10.5 percent in end Q4FY09. During the period, gross NPL ratio for SCBs decreased from 26.5 percent to 24.1 percent which contributed significantly in decreasing the overall ratio. The ratios for the PCBs and FCBs increased marginally to 4.9 percent and 2.4 percent respectively during end Q4 FY09 from 4.7 percent and 1.9 percent respectively at the end of Q3FY09 (Chart VI.1). For the SBs, similar ratio decreased from 25.9 percent to 25.5 percent during the period (Table VI.2).

Chart VI.1: Ratio of Gross NPLs to Total Loans

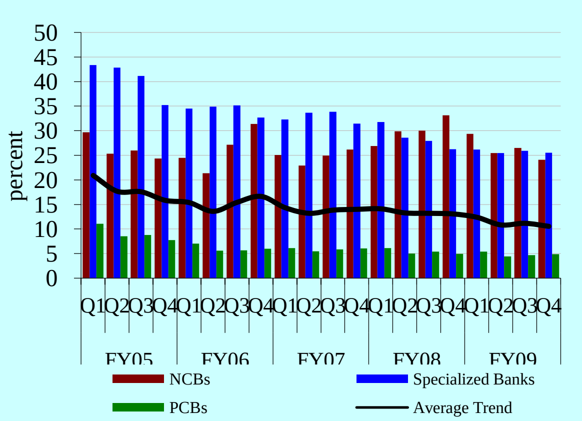
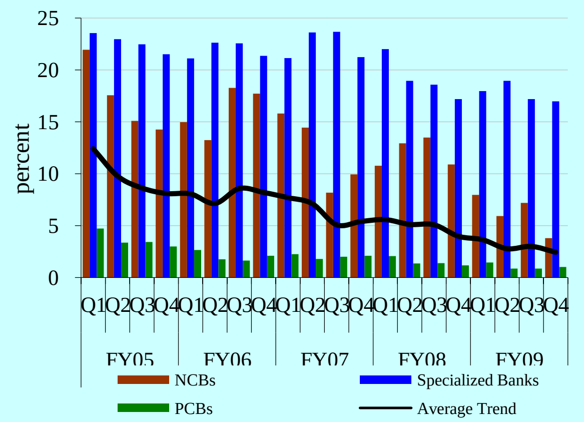


Chart VI.2: Ratio of Net NPLs to Total Loans



6.4 On the other hand, the net NPL ratio for all banks decreased from 3.0 percent in Q3FY09 to 2.5 percent in Q4FY09 contributed by sharp decline in the ratio of SCBs from 7.2 percent to 3.8 percent. Similarly, during the period the ratio decreased marginally from 17.2 percent to 17.0 percent for SBs and from (-) 2.4 percent to (-) 1.8 percent for FCBs while the same increased marginally from 0.9 percent to 1.0 percent for PCBs (Table VI.3 and Chart VI.2).

6.5 Among the profitability measures, overall ROA increased from 1.2 percent to 1.4 percent during June 2009 compared with December 2008. The FCBs and SCBs were the main contributors as ROA increased from 2.9 percent to 3.6 percent for FCBs and from 0.7 percent to

[3] As per Bangladesh Bank requirements, the banks are required to maintain capital to risk-weighted asset ratio of 10 percent at the minimum with core capital not less than 5 percent.

1.0 percent for SCBs. For SBs, ROA increased from (-) 0.6 percent to (-) 0.04 percent.[4] On the other hand, overall ROE during the period increased from 15.6 percent to 18.2 percent due mainly to a sharp rise in ROE for SCBs from 22.5 percent to 27.6 percent; moderate rise for FCBs and PCBs from 17.8 percent to 21.0 percent and 16.4 percent to 18.3 percent respectively while the same for SBs increased significantly from (-) 6.9 percent to (-) 0.3 percent. In the case of ROE, SCBs emerged as the front runner in June 2009 compared with other bank categories (Table VI.4).

6.6 During end Q4FY09, the interest rate spread (IRS) stood at 4.86 percentage points for all banks marginally higher than 4.81 points in end Q3FY09. During Q4FY09, both deposit and lending interest rates decreased from 7.52 percent and 12.33 percent in Q3FY09 to 7.01 percent and 11.87 percent respectively. However, IRS decreased from 9.48 to 9.14 percentage points for FCBs and from 3.63 to 3.40 percentage points for SCBs while the same increased from 4.58 to 4.81 percentage points for PCBs; and marginally from 2.99 to 3.01 percentage points for SBs (Table II.3).

6.7 However, recent data (Q4FY09) show that commercial banks were offering weighted average interest rates ranging from 4.96 to 8.26 percent on savings deposits, while the same for all advances were in the range of 8.47 percent to 14.10 percent. To address the downward stickiness of lending interest rates in the market now awash with liquidity and also as a measure mitigating the adverse impacts from global economic slowdown on domestic investment activities, BB prescribed interest rate ceiling of 13 percent per annum on bank lending for most purposes other than consumer credit and loans to small enterprises. To maintain momentum of economic activities BB is continuing refinance lines against bank loans to priority economic sectors like agriculture, SMEs, low cost housing etc. To help sectors affected by export decline, BB has allowed relaxation of conditions for loan rescheduling (waver of down payment requirements), provisionally up to September 30, 2009.

6.8 In April '09 BB prescribed mandatory interest rate ceilings on customer lending by banks in five areas; viz, agriculture, term and working capital loans to large and medium scale industries, housing and trade financing. BB also directed banks to limit lending interest rate on import financing for nine essential food items to 12 percent per annum. To maintain congenial credit conditions for economic activities, BB acted to limit the cost of funds for NBFIs (who depend mainly on secondary banking rather than retail deposits as fund source), prescribing 13 percent interest rate ceilings on credit lines of banks to the NBFIs.

6.9 At the end of Q4FY09, total deposit (excluding inter-bank) of the banking sector stood at Tk. 2, 793.9 billion which was 7.7 percent higher than Tk. 2,594.9 billion in end Q3 FY09. Similarly, total advances (excluding inter-bank) increased by 3.4 percent from Tk. 2022.4 billion to Tk. 2090.5 billion over the same period. During Q4FY09, among different bank categories,

[4] The SCBs reported zero figures for both ROA and ROE for 2007 set administratively despite huge provision shortfall. However, the figures became positive in 2008 and have been continuing the trends for both ROA and ROE following signing of MoU and issuing of shares in favor of the government.

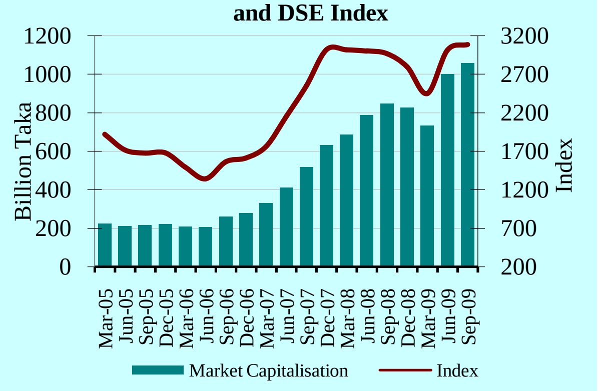
SCBs recorded the highest deposit growth of 9.4 percent over Q3FY09 which was 8.4 percent for SBs; 8.1 percent for PCBs and (-) 2.5 percent for FCBs. In the case of advances, PCBs recorded 4.8 percent growth during Q4FY09 over the Q3FY09 level compared with 3.9 percent growth for SBs; 0.3 percent for SCBs and FCBs.

6.10 With a view to preserving and bolstering domestic financial sector stability, BB has been strengthening supervisory oversight on capital adequacy, liquidity, solvency, corporate governance and risk management in banks and financial institutions; broadly in line with the best practice standards set by the Basel Committee for effective Bank Supervision (BCBS). From January 2009 banks are needed to work out effective steps to ensure their capital requirements in terms of the Basel II capital regime, initially in parallel with the earlier 'Basel-I minimum plus two percent' requirement on risk weighted assets. Overall capital requirements under the Basel II regime are not expected to be much larger than those under the current regime, however, the main benefit from Basel II capital regime will be in developing the awareness in banks about the precise quantitative risks and its management (credit risks, market risks, operational risks) associated with each of their various business lines (the Basel-I regime allocated capital solely for credit risks). However, with these various efforts by BB, most of the indicators describing banking sector performance recorded gradual improvement so far during the recent past. Therefore, as the regulator of the banking and financial sectors, it will be prudent for BB to continue effective supervision for further improvement of the country's banking sector.

VII. Capital Market Developments

7.1 After the poor performance of preceding consecutive three quarters of FY09, the country's capital market experienced robust performance during Q4 FY09 and Q1 FY10 with healthy growth recorded in all the indicators. During Q4 FY09, and Q1 FY10 DSE general index increased by 23.0 percent and 2.5 percent respectively. At the end of Q4 FY09 and Q1 FY10 market capitalization of DSE increased by 36.4 percent and 5.6 percent respectively (chart VII.1 and Table VII.1). During FY09 DSE general index and market capitalization increased by 0.3 percent and 26.9 percent respectively. Year- on- year position DSE general index and market capitalization increased by 4.0 percent and 25.0 percent respectively in the 1st quarter of FY10.

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



7.2 The liquidity situation in the capital market improved significantly during Q4 FY09 and also Q1FY10 against the previous quarters. The volume of total turnover increased to Tk. 346.3 in Q4 FY09 billion as compared with Tk. 217.8 billion in previous quarter recording healthy growth by 59.0 percent. The volume of total turnover increased to Tk. 491.45 in Q1 FY10 billion as compared with Tk. 346.3 billion in previous quarter recording healthy growth by 41.9 percent. On a year-on-year basis, the increased turnover still shows robust growth of 65.5 percent and 178.9 percent during two quarters under review. However the “number of listed securities” was 306 in March’09 increased marginally to 308 in June’09 and 310 in Sepember'09, while the total value of “issued equity and debt” increased by 10.2 percent and 4.0 percent respectively during two quarters under review (Table VII.1). There were five new companies listed in the capital market during period under review and one company delisted from DSE due to amalgamation with another parent company.

7.3 Sector-wise DSE data shows that during the Q4 FY09 market capitalization increase everywhere except Jute industry. During the Q1 FY10 market capitalization increase everywhere except banking sector. The domination of banks, power and pharmaceuticals in total market capitalization with significant contribution from cement industries is continued up to end of September’09. At the end of FY09 and Q1 FY10 share of banking (including NBFI’s) sector to total market capitalization declined to 38.6 percent and 34.2 against 52.8 percent in FY08.

7.4 Despite the robust performance in the capital market, a major weakness of the market is inability to reflect company fundamentals adequately along with danger of insider trading practice in manipulating market prices. Along with measures to address these weaknesses, it would be important to reduce volatility in the market which has shown increasing trend in recent times.

VIII. Near-term Economic Outlook

8.1 Despite relatively slower international trade (exports and imports) and lower investment activities due mainly to global economic crisis, the overall macroeconomic outcome in terms of real output growth and inflation remained positive. Export earnings and import demand slowed down, particularly in the last two quarters of FY09 and first quarter of FY10 with exports of most items other than apparels and textiles registering decline along with the declining trends in the imports of most of the food items and capital machineries. Although the country's year-on-year based overall earnings from merchandise export recorded a fall of 3.29 percent during the first two months (July-August) of FY10, but were 12.4 percent higher than exports in first two months of the preceding quarter. From Q2 FY 10 onwards y-o-y export growth can be expected to rise fast from the likely near zero level of Q1, helped by lower base numbers and by the continuing gains in global demand recovery. Import growth, on the other hand, slowed down to single digit levels in the last fiscal ending June 2009. Propelled by substantial decline in imports of food grains, consumer & intermediate goods and capital goods including capital machineries overall import payments dropped significantly by 16.6 percent in July of FY10 over July FY09.

8.2 Sustained robust growth in workers' remittances with moderated growth in imports mainly contributed to have a record surplus in the CAB in FY09. Net foreign equity inflows remained positive in FY09, with the FDI inflows far exceeding FPI outflows. Low outflows for imports and other needs from the inflows of workers' remittances and export proceeds resulted in liquidity overhang in the domestic market, bringing down call money interest rates, deposit interest rates and yield rates on treasury bills/bonds. However, excess reserves of banks with the BB started to decline gradually, and the inter-bank call money rates turned around from the near zero lows. By the end of September 2009 banks ceased daily queuing up for selling foreign exchange receipts to BB, now occasionally buying from BB instead.

Growth outcome and outlook

8.3 Bangladesh economy has sustained growth momentum in FY09 amid global downturn with 5.9 percent real GDP growth, not far below the 6.2 percent FY08 growth. Agriculture sector output grew by 4.6 percent in FY09 against 3.2 percent of FY08, with fishery the only sub-sector with lower (4.0 percent) growth than in the preceding fiscal year (4.2 percent), the weakness resulting from decline in shrimp exports in FY09. The 5.9 percent industry sector growth in FY09 was significantly lower than the 6.8 percent growth of FY08, the weakness resulting from export decline for most items other than apparels and textiles. The 6.3 percent service sector growth in FY09 was marginally lower than the 6.5 percent growth of FY08.

8.4 FY10 growth prospects for Bangladesh economy will depend significantly on rebound of export growth, this in turn dependent on the pace of global recovery from the ongoing slowdown. The high emphasis placed by GOB and BB on promoting agricultural and SME activities is expected to lead to more broad-based, more inclusive growth processes; with correspondingly faster reduction of poverty. The government's revised FY09 budget provided support for export sectors hurt by global slowdown; the FY10 national budget continues the support measures and includes stimulus package including extended social safety net to shore up domestic demand. Bangladesh Bank allowed relaxed downpayment requirements in rescheduling of bank loans to sectors hurt by the global slowdown, and kept available refinance lines to support lending to priority economic sectors including agriculture and SMEs. With these support measures to cope with the effects from the global slowdown, Bangladesh economy is conservatively projected to grow by 5.5-6.0 percent in FY10; higher growth may be possible if global economy recovers faster, kicking off faster rebound in investments.

Inflation outcome and outlook

8.5 Following the global financial crisis and economic recession thereafter caused the collapse of global commodity price bubble in late 2008 leading consumer price inflation in Bangladesh to decline from Q2 FY09. However, in the beginning of 2009, prices of petroleum and some food items registered substantial increase in the international market. In the domestic scene, the p-t-p CPI inflation was in the declining trend since September 2008 (10.19 percent) to March 2009 (5.04 percent) before registering some moderate increases in April and May 2009. After bottoming out at 2.25 percent in June 2009, point to point CPI inflation edged up to 3.46 and 4.69 percent respectively in July and August 2009, with both food and non-food prices registering increase. Global and regional price trends indicate that point to point CPI inflation in Bangladesh is likely to edge upward rather than downward in the coming months. The 12 month average CPI inflation, at 6.04 and 5.6 percent respectively in July and August 2009, may however continue in decline for a few more months (with earlier higher inflation months falling out in the averaging) before edging up; and looks likely to remain within the 6.5 percent ceiling for FY 10 stipulated in BB's Monetary Policy Statement for H1 FY 10.

Challenges ahead

8.6 Despite the recent signs of recovery in the developed countries from their worst economic crisis since World War-II (WWII), the volume as well as the value of international trade, imports in particular witnessed a significant reduction in recent months and expected to take back its momentum as the process of full swing recovery of international and domestic demand is underway. In the backdrop of substantial drop in the growth of import payments and robust remittances growth in the beginning of FY10 along with weak investment activities contributed significantly to build-up a huge liquidity overhang in the money market. Significant inflationary pressure in coming months may not be ruled out unless this huge liquidity overhang is utilized in productive and supply augmenting economic activities as mentioned above. Although the process of mopping up excess liquidity from the money market is already in place that needs to be expedited with care so that the liquidity condition in the money market remains healthy.

8.7 The major challenge for the external sector of Bangladesh economy is to breakdown the trend of continued decline in the exports of RMG including some traditional items like jute, jute goods, handicrafts, electronics, frozen food, leather and ceramic products and also some primary commodities and engineering products. By enhancing productivity and efficiency along with diversifying the products and finding new markets could be a way to revive the export growth of these items.

8.8 The fiscal sector had to withstand significant pressure during FY10 due to rising cost of subsidies and other current expenditures resulting from various stimulus packages and expected salary hike of government sector employees to be effective from July 2009. In this regard, tax collection efforts need to be strengthened especially because slowdown in earnings from customs duty due to falling value and volume of imports emanating from improved domestic supply condition and declining commodity prices in the international market. Given the indication of sluggish trend in government spending, the full implementation of ADP (Tk. 305 billion) as targeted in the budget of FY10 is also a challenge, which needs to pace up, particularly in infrastructure projects, to help private sector activities gain momentum in fulfilling the GDP growth aspirations.

8.9 Since increased economic growth is essential to achieve the poverty reduction and overall social development objectives as stated in the recent budget broad based increase in the productivity and efficiency across various sectors of the economy would be the key element in achieving the positive near term outlook and moving to higher growth path. In this respect, some critical issues need priority action including inadequate energy supply especially electricity and gas shortages, transport bottlenecks, inefficiencies in agricultural input distribution including credit and marketing networks, and other infrastructure deficiencies.