Prices and Wages

Global Inflation Scenario

3.1 Many advanced economies experienced limited decline in inflationary situation in the second half of FY10. Core inflation in the euro area has already dropped under 1 percent, down from below 2 percent at the peak in 2008. The drop in core inflation in the United States from 2008 to 2010 was about 1 percent due to more credible inflation control, intensified losses in productive capacity and downward wage and price rigidities while it appears to have moved sideways in the United Kingdom. In Japan, inflation dynamics significantly went down to negative level from very low level of core inflation. However, in Japan, the financial conditions have tightened and deflation remains a threat due to appreciation of the Yen and declining equity prices.

Before and after the crisis, the strong cyclical position of key emerging economies has enchained the decline in inflationary pressure at the global level. Recovering demand especially in Asia encouraged to boost up commodity prices which explains why excess capacity in commodity production and excess inventories for many commodities markets are both lower than usual for this stage of the global cycle.

Inflation in many emerging economies has been higher than in the advanced economies. Many of Latin American, Middle Eastern and CIS economies showed slowed but relatively high inflation whereas it rose strongly in India, dropped sharply in Russia. Inflation in China decreased for a while which is now rising again.

Chart 3.1

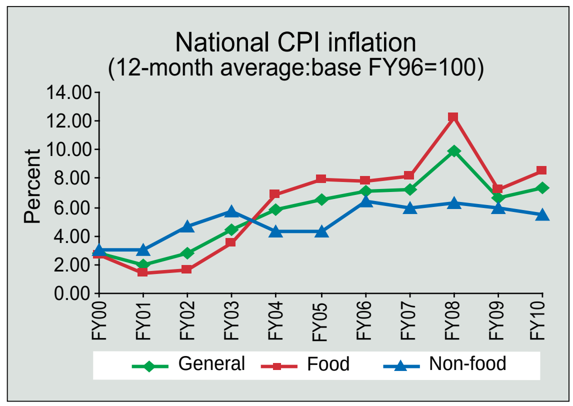
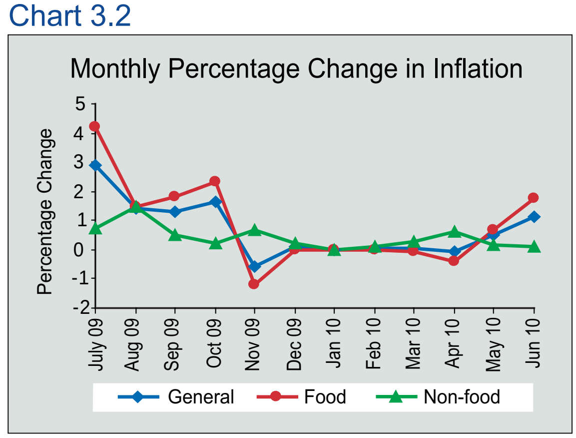


Chart 3.2



Consumer Prices in Bangladesh

3.2 Inflation in Bangladesh has been steadily rising in FY10. The easing of inflationary pressures bottomed out in October 2009 which started softening from previous year. The declining trend in average inflation which started from October 2008 ended in October 2009 and then began to rise in November 2009. This rising trend in inflation was largely because of food prices hike in the domestic markets, incessant rise in international commodity prices including food, fuel and fertilisers due to growing demand caused by global economic recovery, excess liquidity in the internal banking system and higher-than-targeted money supply growth. The average inflation measured by 12-month average basis (Base: FY96=100) showed rising trends and stood at 7.3 percent in FY10, which was 6.7 percent in FY09 (Table 3.1, Chart 3.1). The twelve month point to point CPI inflation rose significantly to 8.7 percent in FY10 from 2.3 percent in FY09. The point to point inflation started to decrease in October 2008 and reached the lowest level in June 2009 and then began to rise in July 2009, reached in peak in February 2010.

The annual average inflation followed upward trend whereas point to point inflation showed slightly mixed trend in FY10.

Inflation in Bangladesh is largely driven by food prices. The annual average and point to point food inflation depicted mainly upward trends in FY10. The annual average food inflation surged to 8.5 percent in June 2010 which was 5.1 percent in October 2009 against 7.2 percent in FY09. The point to point food inflation increased significantly to 10.9 percent in FY10 compared to only 0.3 percent in FY09. The average non-food inflation followed mixed trend during FY10 which was 5.5 percent in June 2010 from 5.9 percent in June 2009. On the other hand, the point to point non-food inflation also experienced mixed trend which was 5.2 percent in June 2010 against 5.9 percent in June 2009 (Table 3.1, Chart 3.1).

Monthly percentage change in general inflation showed mainly downward trends till November 2009 and then started to rise. Monthly change in general CPI recorded positive figures except negative magnitude in November and April in FY10. Monthly CPI increased by 2.9 percent in July 2009 which was the highest in FY10. Monthly food and non-food Inflation depicted mixed trends (Chart 3.2).

Table 3.1 Annual average CPI inflation (base:1995-96=100)

Group	Weight	FY08	FY09	FY10
a. National level				
General Index	100.00	193.54	206.43	221.53
		(9.94)	(6.66)	(7.31)
Food	58.84	206.78	221.64	240.55
		(12.28)	(7.19)	(8.53)
Non-food	41.16	176.26	186.67	196.84
		(6.32)	(5.91)	(5.45)
b. Rural				
General Index	100.00	195.14	208.46	223.39
		(9.99)	(6.83)	(7.16)
Food	62.96	203.93	218.38	235.76
		(11.95)	(7.09)	(7.96)
Non-food	37.04	180.19	191.59	202.36
		(6.41)	(6.33)	(5.62)
c. Urban				
General Index	100.00	189.65	201.49	216.98
		(9.80)	(6.24)	(7.69)
Food	48.80	213.73	229.60	252.21
		(13.07)	(7.43)	(9.85)
Non-food	51.20	166.69	174.69	183.40
		(6.06)	(4.80)	(4.99)

Source : Bangladesh Bureau of Statistics.
Figures in parentheses represent annual inflation.

The food prices were relatively higher in domestic and international markets in FY10. Prices in the international markets have been soaring mainly because of a crop failure in Australia following an invasion of locusts and a wet summer in Canada. Wheat price already reached a two year high as concerned about a ban on grain exports due to drought in Russia and rotting stock of grain in India. Moreover, there was strong evidence that speculation and wild rumor have distorted prices on the commodity markets which has driven up prices. Rice (coarse) price in the domestic markets stood at Taka 38.6 per kg. or 15.2 percent higher in June 2010 from Taka 33.5 per kg. in June 2009 (BBS).

The Government and Bangladesh Bank adopted some measures to supply timely and adequately agricultural inputs like fertilisers, seeds, pesticides and fuel. The authority planned to provide electricity to rural areas for B*oro* production in the last season by saving electricity from load-shedding in the urban areas but overall supply was not adequate to fulfill high demand for irrigation.

The data provided by Food Planning and Monitoring Unit show that actual production of B*oro* stood at 18.34 million metric tons in FY10 compared to the production of 17.80 million metric tons in FY09. On the other hand, *Aman* production was 12.20 million metric tons in FY10 which was 11.60 million metric tons in FY09. Total domestic food production recorded 33.21 million metric tons in FY10 against 32.15 million metric tons in FY09.

The Government imposed a ban on rice export in early December 2009. Moreover, the Government provided *'Krishi Card'* to 18.2 million farmers for supply inputs like fertilisers, agricultural loans and subsidies on diesel.

Other steps included open market sales of rice in Dhaka city and neighbouring districts for few months in early 2010 and introduced *'Fair Price Cards'* for 2.5 million ultrapoor families.

Though petroleum price in the global market has moved over USD 80 a barrel recently, it kept transport cost unaffected in the domestic market due to administered price, resulted in lower non-food inflation.

Bangladesh Bank raised the rates on Cash Reserve Ratio and Statutory Liquidity Ratio from 5.0 percent to 5.5 percent to enchain inflationary pressure and also raised interest rates on Government securities, particularly bonds and started auction of 30-Day Bangladesh Bank Bills as a measure to mop up excess liquidity. Moreover, Bangladesh Bank advised all the commercial banks to cap interest rates at 12.0 percent on import items like edible oil, lentils, pulses, onions, spices and sugar etc. to ensure adequate supply in comparatively lower prices and to keep prices under control.

Chart 3.3

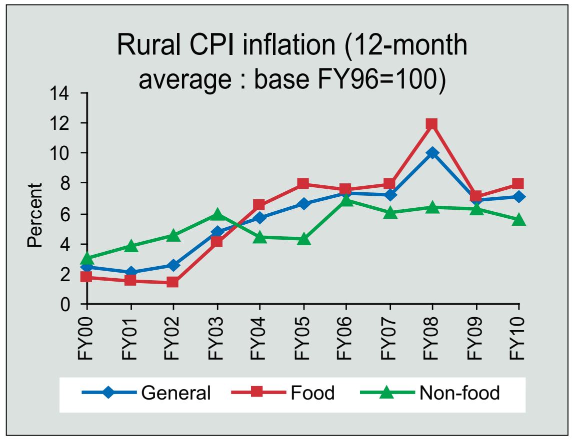


Chart 3.4

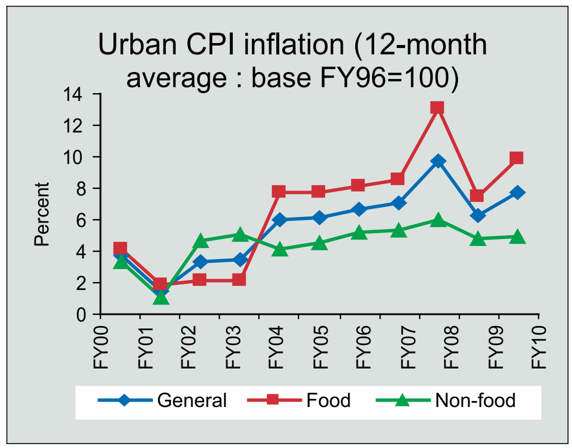


Table 3.2 Changes in international prices of major commodities (percentages)

Commodity	2006	2007	2008	2009	2010 (August)
Petroleum	24.8	11.4	37.1	-34.1	23.1
Rice	5.5	9.5	110.6	-15.8	-12.6
Wheat	25.8	33.1	27.7	-31.5	-12.6
Palm oil	13.4	72.5	20.0	-25.4	21.7
Soybean oil	11.2	45.0	41.8	-30.6	8.0
Cotton	5.2	9.0	12.8	-12.0	36.9
Sugar	46.5	-32.4	25.0	45.6	8.2

Source : International Financial Statistics, IMF October, 2010

3.3 Rural CPI carries higher weight (70.89 percent) in general CPI compared to urban CPI (29.11 percent). Annual average CPI inflation in the rural areas surged to 7.2 percent in FY10 from 6.8 percent in FY09 (Table 3.1, Chart 3.3). The component of food prices increased to 8.0 percent in FY10 from 7.1 percent in FY09, while the non-food component decreased slightly to 5.6 percent in FY10 from 6.3 percent in FY09.

3.4 Annual average CPI inflation in the urban areas rose to 7.7 percent in FY10 from 6.2 percent in FY09 (Table 3.1, Chart 3.4). The food component of urban CPI gradually increased to 9.9 percent in FY10 from 7.4 percent in FY09. The non-food component also increased to 5.0 percent in FY10 from 4.8 percent in FY09. Urban consumers experienced a higher rate of 9.9 percent food inflation in FY10, whereas the rate was 8.0 percent for the consumers in rural areas.

3.5 International prices of food and non-food items experienced mixed trends in FY10 compared to those of the previous fiscal year. Though prices of rice and wheat both decreased by 12.6 percent, but petroleum, palm oil and cotton recorded significant increase of 23.1 percent, 21.7 percent and 36.9 percent respectively upto August in 2010 (Table 3.2, Chart 3.5).

3.6. The South Asian countries particularly SAARC countries depicted higher inflation during FY10. Among those, India, Nepal and Pakistan showed double digit inflation. India topped the list among those having 13.7 percent inflation in May 2010 and Malaysia was the lowest having only 1.7 percent inflation in June 2010 (Table 3.3, Chart 3.6).

Table 3.3 Inflation in Major Asian Countries#

	2006	2007	2008	2009	2010 (June)
1. Bangladesh@	7.2	7.2	9.9	6.7	7.3
2. India	5.8	6.4	8.4	10.9	13.7
3. Pakistan	7.9	7.6	20.3	13.6	12.7
4. Nepal	7.6	6.1	10.9	11.6	10.0
5. Bhutan	5.0	5.2	8.3	4.4	-
6. Sri Lanka	10.0	15.8	22.6	3.4	4.8
7. Maldives	2.7	6.8	12.0	4.5	6.1
Other Asian Countries					
8. Thailand	4.6	2.2	5.5	-0.8	3.3
9. Singapore	1.0	2.1	6.5	0.2	2.7
10. Malaysia	3.6	2.0	5.4	0.6	1.7
11. Indonesia	13.1	6.3	10.1	4.6	5.0
12. Korea	2.2	2.5	4.7	2.8	2.6
13.Myanmer	20.0	35.0	26.8	1.5	6.6(Feb)

IFS, October, 2010 CPI (Base: 2000=100)
@= Source: BBS, Consumer Price Index (base:1995-96=100), figures relate to financial year (July-June)

Chart 3.5

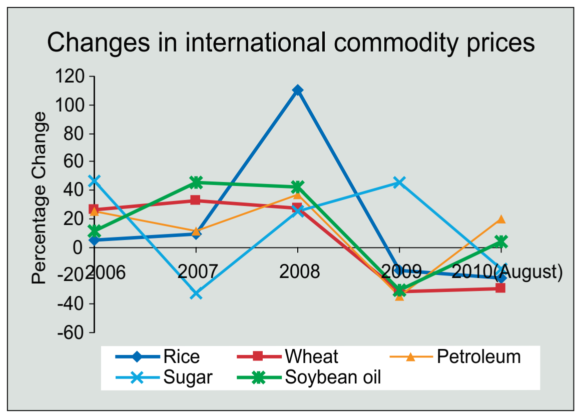


Chart 3.6

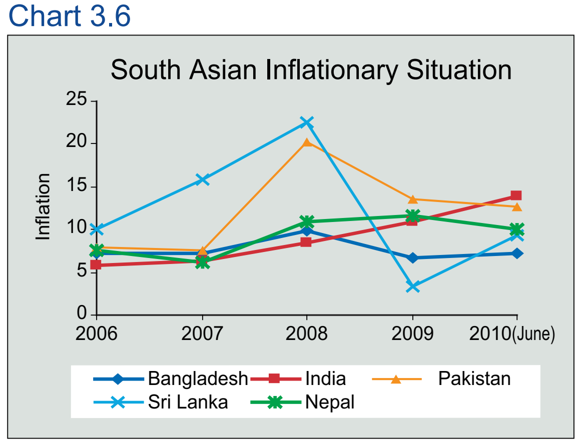


Table 3.4 : Annual average national level CPI by consumption basket sub-groups (base:1995-96=100)

Group/sub-group	Weight	FY08	FY09	FY10	% Change (4-3)	% Change (5-4)
1	2	3	4	5	6	7
General index	**100.00**	**193.54**	**206.43**	**221.53**	**6.66**	**7.31**
1. Food, beverage and tobacco	**58.84**	**206.78**	**221.64**	**240.55**	**7.19**	**8.53**
2. Non-food of which	**41.16**	**176.26**	**186.67**	**196.84**	**5.91**	**5.45**
i) Clothing & footwear	6.85	164.53	173.10	181.29	5.21	4.73
ii) Gross rent, fuel & lighting	16.87	174.70	184.46	191.49	5.59	3.81
iii) Furniture, furnishing, household equipment & operation	2.67	178.48	194.75	215.04	9.12	10.42
iv) Medical care & health expenses	2.84	185.67	189.25	199.22	1.93	5.27
v) Transport and communications	4.17	211.01	222.12	234.10	5.27	5.39
vi) Recreation, entertainment, education & cultural services	4.13	174.86	181.44	192.46	3.76	6.07
vii) Miscellaneous goods and services	3.63	166.69	188.84	208.40	13.29	10.36

Source : Bangladesh Bureau of Statistics

Wage Rate Trends

3.7 The general wage rate indicated lower growth in FY10 compared to that in previous year but still the rates were high. The growth of annual wage rate (Table 3.5, Chart 3.7) declined significantly to 10.7 percent in FY10 from 18.9 percent in FY09. The wage rate in the agricultural sector was the highest which increased by 16.7 percent, whereas manufacturing sector recorded lowest growth rate of 8.0 percent in FY10. Wage rates for all the sectors experienced mostly drastic fall compared to those in the last year. But it is notable that the growth in general wage rate was higher than the rate of consumer price Inflation (7.31 percent) in FY10.

The indicating point was that growth on income levels of the poor people has been slower due to lower wage rates.

Near Term Inflation Outlook

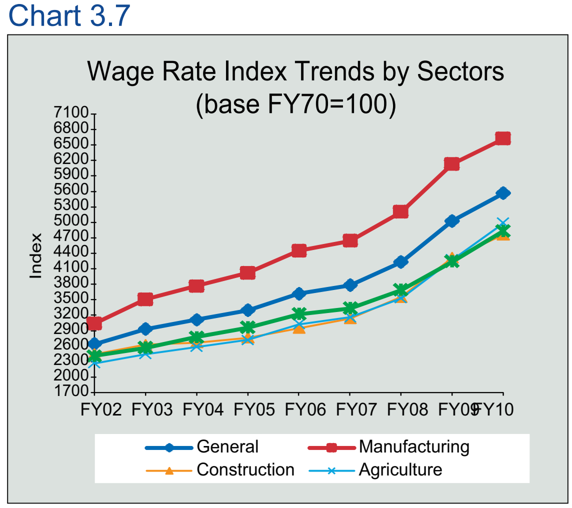
3.8 The global commodity prices dropped during the remainder of the second quarter, after rising through early May 2010, following increased financial market volatility on concerns about vulnerable euro area

Table 3.5 Trends of wage rate indices (base: FY70=100)

	FY06	FY07	FY08	FY09	FY10
General	3615.4	3778.8	4227.4	5025.7	5561.8
	(9.79)	(4.52)	(11.87)	(18.88)	(10.67)
Manufacturing	4444.6	4635.9	5196.8	6128.4	6620.3
	(10.70)	(4.30)	(12.10)	(17.93)	(8.03)
Construction	2948.5	3134.8	3549.2	4311.3	4755.8
	(6.90)	(6.32)	(13.22)	(21.47)	(10.31)
Agriculture	3021.5	3155.7	3524.0	4273.7	4985.4
	(11.12)	(4.44)	(11.67)	(21.27)	(16.65)
Fishery	3217.7	3332.0	3686.1	4236.5	4827.5
	(8.81)	(3.55)	(10.63)	(14.93)	(13.95)

Figures in parentheses are annual percentage changes.
Source: Bangladesh Bureau of Statistics.

Chart 3.7



economies. Prices recovered much of their second- quarter losses, but only the prices of food commodities, beverages and agricultural commodities increased beyond early May peaks. The overperformance of the latter largely reflects downgraded harvest expectations due to poor weather conditions. The downgrading was large for wheat, because of drought conditions and wildfires in Russia and some other major exporters, and wheat prices surged in July and August in 2010. In August the overall IMF commodity price index was about 6 percent above its December 2009 level.

The global commodity price fluctuations normalised after increasing sharply with world economic situation improving through 2009, during the current Great Recession. However, a number of causative factors help explain why commodity prices have recovered rapidly and extensively. The important factors were- a) the stronger-than-expected global recovery; b) the increasingly important role of emerging and developing economies in global commodity markets. In particular, the pace of recovery was far quicker than expected in emerging Asian economies where consumption of commodities has increased rapidly in recent years. c) Smaller increases in excess inventories relative to average stock-use ratio i.e the commodity market equivalent of inventory-to-sales ratios for many commodities and d) Investment inflows into commodity-related assets increased sharply during 2009, reflecting the continued relative attractiveness of this asset class.

Food prices have recovered modestly from the trough in December 2008 although they have generally fallen by less than prices of other commodities during the current Great Recession. Food prices have started this year by broadly declining. The IMF food price index has dropped by 5 percent since the end of 2009. Global food supply has played major role for price development across most food and beverage commodities.

The recent increase in food supply for major crops continue a trend of rising production which shows to be a response to higher demand and higher real prices. Higher consumption of food in emerging economies, growing demand for crops as biofuels and the possible impact of increasing financialisation on demand for inventories have all been identified as contributing factors to a potentially permanent increase in demand. Food supply has increased significantly due to rising yields but in recent years farmers have also expanded harvested acreage after a long period of decline. Food supply prospects over the medium term will largely depend on yield improvement which will be influenced by changes in climate, pests and diseases, land quality, the costs of inputs like fertilisers, research and development spending. With higher possible global demand, food commodity markets may remain relatively tight and that, in absence of continued unanticipated increases in supply, the risk to real food prices remains tilted toward the upside.

Oil prices have largely remained range-bound since mid-2009, fluctuating between US$70 to US$80 a barrel with exception of trading above the range in early April. On annual basis, as per estimation of International Energy Agency, global oil demand dropped by 1.3 million barrel or 1.5 percent decline a day (mbd) in 2009. The sharper decline was the result of strong demand contraction in OECD (Organisation for Economic Cooperation and Development) economies. In contrast, consumption in emerging and developing economies soared by 1.8 percent. Higher production by both

Organisation of Petroleum Exporting Countries (OPEC) and non- OPEC suppliers contributed to improve the condition. On the price side, the adjustment was reflected in a decline in the spread between futures and spot prices, whereas on the physical market, it was reflected in a decline in excess inventories (inventories above 5-year average level).

The near-term outlook for oil prices depends on the interaction between upward pressure from demand increases as global growth accelerates in 2010 and the supply response. In fact, recent oil prices have been hovering over US$ 80 a barrel which has largely reflected expectation of accelerating global economic growth and strong oil demand. This is why, upward price pressure should remain moderate for some time, barring any significant change to the medium-term outlook. Looking to the medium term, the oil price outlook depends on prospects for maintaining sustainable demand-supply balances.

Global commodity price prospects in the near-term depend on the timing and strength of the global recovery. Upward price pressures emanating from strengthening of demand, will continue as global growth accelerates. However, such pressures will likely be moderated by high spare capacity and supply responses to the price rebound. In addition, normalisation of policy interest rates will likely raise the cost of inventory holdings, which will reduce the incentive to hold inventories. For commodity markets, the policy normalisation in emerging economies- where output gaps have been closing faster than in advanced economies-will be particularly relevant. These economies have been the main contributors to incremental demand for stock-holding purposes.

Information from commodity option and futures prices suggests that investors and hedgers anticipate future price increases to be gradual and that they still see little probability of another commodity price spike, notwithstanding the recent uptick in prices. Nevertheless, some upside price risks remain, particularly, if the global recovery continues to be more buoyant. Other risk factors include heightened geopolitical tensions, major supply disruptions, abrupt increases in desired inventory stocks, and an unexpected depreciation of the U.S. dollar.

Table 3.6 Global Inflationary Situation

(Percentage change)

	2008	2009	2010*	2011*
Advanced economies	3.4	0.1	1.4	1.3
Emerging and developing economies	9.2	5.2	6.2	5.2
Emerging Asia	7.5	3.1	6.1	4.2
Bangladesh	8.9	5.4	8.5	6.9
India	8.3	10.9	13.2	6.7
Pakistan	12.0	20.8	11.5	13.5
Sri Lanka	22.6	3.4	6.5	8.0

Source: WEO, October, 2010, IMF
* Projection

Commodity prices in medium term are projected to remain high because demand is expected to grow again rapidly as the global recovery takes hold. The tension between rapid demand and sluggish capacity growth is therefore likely to reemerge once the global recovery matures into a sustained expansion, thereby keeping prices at elevated levels by historical standards.

The rise in futures contract prices traded on the major markets also follows a United Nation's Report in June 2010 that warned the food prices could rise as much as 40 percent over the coming years, amid increasing demand from emerging markets and for biofuel production.

The World Development Movement revealed Reports pointing to a long term upward trend in prices and the recent weather-related farming crisis had proved fertile ground for speculators who bet on rising prices.

Average CPI inflation in the advanced economies has been experiencing lower inflation rate while emerging and developing economies have been depicting moderate rate of inflation (Table-3.6).

The global economy has been facing commodity price hike due mainly to growing demand. This is why, inflation in emerging and developing countries including emerging Asia has been brewing up again. Though Pakistan already achieved a great success in 2010 to enchain inflation, Sri Lanka recorded higher inflation in 2010 as against that in 2009 while India topped the list (13.2 percent) in the Asian region (Table 3.6).

Bangladesh has been depicting rising inflation rates in the recent months. Sustained rise in Indian headline inflation rate during FY10 has contributed to price hike in Bangladesh due to huge cross-border trade of foods and other essential commodities. To curb inflationary pressure, the authority has taken some measures including adoption of growth-supporting monetary and financial policies.

The upward trend in food prices in the international markets, higher than targeted money supply growth, liquidity overhung etc. in the domestic economy would encourage inflation in the near future. With following upward trend, the average rate of inflation already stood at 8.12 percent in September 2010, while it was 5.1 in October 2009 and 6.7 percent in June 2010. In this backdrop, Bangladesh economy will likely to experience upward pressure in inflationary situation, probably during the late of Q2 of FY11 when the rate will start easing with expected supply of Aman in the domestic economy.