

Prices and Wages

Global Inflation Scenario

3.1 The inflationary pressure for global economy has been soaring up and is underpinned mostly by the price increase in emerging and developing economies. The key structural change is rapid growth in emerging and developing economies, which has lifted and changed the pattern of commodity consumption. Along with this, supply responses have been slow with higher marginal cost of production. Stronger-than-anticipated global demand for commodities reduced inventories and caused a strong, sustained and broad-based increase in prices. However, core inflation also increased across a number of economies. Among advanced economies, core inflation remained subdued in the United States and Japan but rose moderately in the euro area. Among emerging and developing economies, inflation pressures have become increasingly broad-based, reflecting a higher share of food and fuel in consumption demand as well as accelerating demand pressure for other products.

Achievement of near double digit growth rate in 2011 by China and India also created substantial amount of extra demand for consumption by these economies. As a result, some of these emerging economies faced unprecedented inflationary pressure; in some cases it became more than 20.0 percent. Supply shortage in international market, fall in domestic production due to bad weather, increase in international oil price, higher import dependency and some other related reasons have triggered the global inflationary pressure.

Chart 3.1

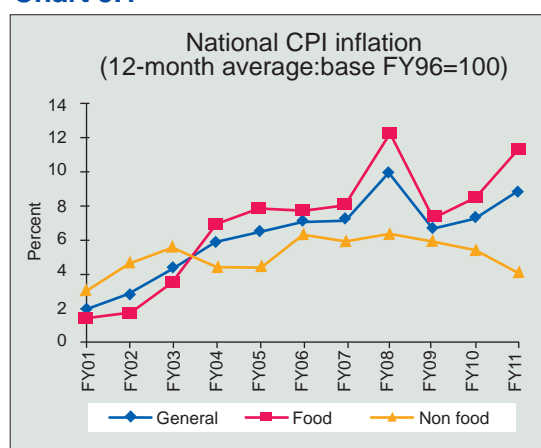


Table 3.1 Monthly Change in Inflation (%)

Months	General	Food	Non-food
Jul-10	1.52	2.15	0.36
Aug-10	1.64	2.33	0.40
Sep-10	1.38	1.86	0.41
Oct-10	0.91	1.12	0.37
Nov-10	0.09	0.02	0.20
Dec-10	0.78	1.12	0.14
Jan-11	0.72	0.84	0.57
Feb-11	0.74	0.79	0.62
Mar-11	0.69	0.89	0.24
Apr-11	0.11	0.01	0.28
May-11	0.06	-0.39	0.97
Jun-11	1.10	1.15	1.03

Consumer Prices in Bangladesh

3.2 Inflation in Bangladesh showed an upward trend in FY11. The inflationary pressures started rising from the previous fiscal year. The increasing trend in annual average inflation which started from November 2009 continued till the end of FY11 except a slight decrease in December 2010.

The rising inflation was largely because of food prices hike in the domestic markets, continuous rise in international commodity prices including food, fuel and fertilisers, growing demand caused by global economic recovery, higher-than-targeted money supply growth and Taka depreciation. The average inflation measured by 12-month average basis (Base: FY96=100) showed rising trends and stood at 8.8 percent in FY11 which was 7.3 percent in FY10 (Table 3.2, Chart 3.1). The twelve month point to point CPI inflation rose significantly to 10.2 percent in FY11 from 8.7 percent in FY10. The point to point inflation was very low in June 2009 due to base effect, began to rise from July 2009, reached at peak in February 2010. Thereafter, inflation showed mixed trend where it reached at the lowest level of 6.9 percent in October 2010 and picked up the highest level of 10.7 percent in April 2011.

Bangladesh is experiencing higher inflation mainly driven by higher food prices. The annual average food inflation showed an upward trend and point to point food inflation depicted a mixed trend in FY11. The annual average food inflation increased significantly to 11.3 percent in June 2011 which was 8.5 percent in FY10. The point to point food inflation increased to the highest level of 14.4 percent in April 2011 and then decreased to 12.5 percent in June 2011 compared to 10.9 percent in June 2010.

The average non-food inflation showed a decreasing trend during FY11 due to lower purchasing capacity of consumers on non-food items because of higher food prices. The average non-food inflation was 4.2 percent in June 2011 from 5.5 percent in June 2010. On the other hand, the point to point non-food inflation was 5.7 percent in June 2011 against 5.2 percent in June 2010 (Table 3.2, Chart 3.1). Petroleum price in the global market has moved to about USD 116 a barrel in April of

Chart 3.2

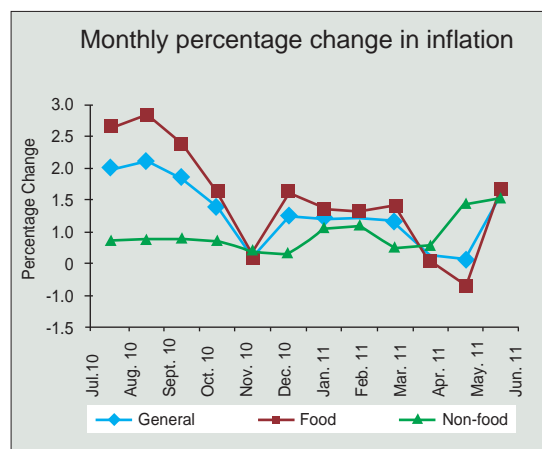


Table 3.2 Annual average CPI inflation

(Base:1995-96=100)				
Group	Weight	FY09	FY10	FY11
a. National level				
General Index	100.00	206.43 (6.66)	221.53 (7.31)	241.02 (8.80)
Food	58.84	221.64 (7.19)	240.55 (8.53)	267.83 (11.34)
Non-food	41.16	186.67 (5.91)	196.84 (5.45)	205.01 (4.15)
b. Rural				
General Index	100.00	208.46 (6.83)	223.39 (7.16)	244.38 (9.40)
Food	62.96	218.38 (7.09)	235.76 (7.96)	264.13 (12.03)
Non-food	37.04	191.59 (6.33)	202.36 (5.62)	210.81 (4.18)
c. Urban				
General Index	100.00	201.49 (6.24)	216.98 (7.69)	232.81 (7.30)
Food	48.80	229.60 (7.43)	252.21 (9.85)	276.82 (9.76)
Non-food	51.20	174.69 (4.80)	183.40 (4.99)	190.87 (4.07)

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

2011 which forced Government to do somewhat upward adjustment of the fuel price in the domestic market, resulted in small increase in the rate of non-food inflation in the last month of FY11.

Monthly percentage change in general, food and non-food inflation showed mixed trends in

FY11. Monthly change in general, food and non-food CPI recorded positive figures but only negative magnitude was in May 2011 in food CPI. Monthly food CPI which was the highest in FY11 increased by 2.33 percent in August 2010 (Chart 3.2).

3.3 Annual average CPI inflation in the rural areas surged to 9.4 percent in FY11 from 7.2 percent in FY10 (Table 3.2, Chart 3.3) due mainly to higher weight (70.9 percent) in rural CPI compared to urban CPI (29.1 percent). The food inflation increased by 12.0 percent in FY11 from 8.0 percent in FY10, while the non-food inflation decreased to 4.2 percent in FY11 from 5.6 percent in FY10.

3.4 Annual average CPI inflation in the urban areas decreased to 7.3 percent in FY11 from 7.7 percent in FY10 (Table 3.2, Chart 3.4). The food component of urban CPI gradually decreased to 9.8 percent in FY11 from the peak of 10.4 percent in September 2010 which was 9.9 percent in FY10. The non-food component also decreased to 4.1 percent in FY11 from 5.0 percent in FY10. Urban consumers experienced a lower rate of 9.8 percent food inflation in FY11, whereas the rate was 12.0 percent for the consumers in rural areas.

The food prices were relatively higher both in domestic and international markets in FY11. The resurgence in food prices in international markets due mainly to unfavourable weather condition in different parts of the world badly affected the global food production. These shocks contributed to a 2.7 percent downward revision to global grain production for 2011.

In this backdrop, Bangladesh economy was influenced by the global food supply shocks and faced higher inflationary pressure. Government adopted various measures to keep inflation at a reasonable level. Among those, agricultural credit availability; input assistance card; fertiliser and diesel subsidy have played important role for increase in

Chart 3.3

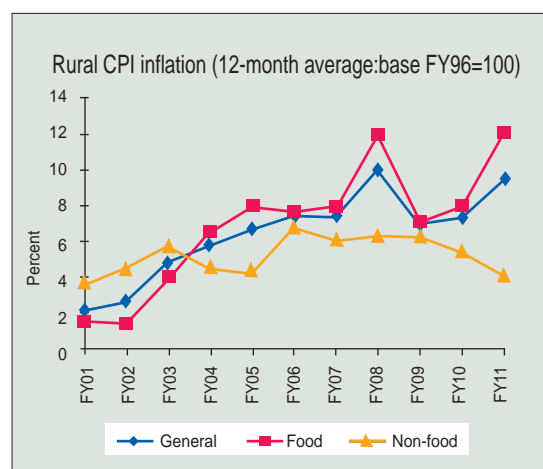


Chart 3.4

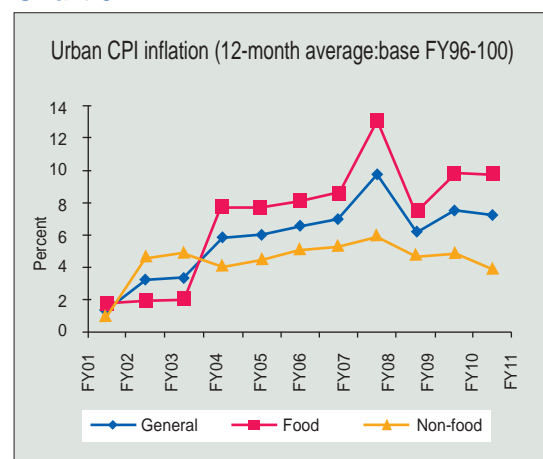


Table 3.3 Changes in international prices of major commodities

Commodity	(Percentages)				
	2007	2008	2009	2010	2011(Oct)
Petroleum	11.3	37.2	-34.1	26.4	35.5
Rice	9.5	110.7	-15.8	-11.7	4.3
Wheat	33.1	27.7	-31.5	0.1	45.0
Palm oil	72.5	20.0	-25.4	33.5	27.5
Soybean oil	45.0	41.8	-30.6	17.5	33.7
Cotton	9.0	12.8	-12.1	65.0	59.9
Sugar	-32.7	25.1	45.8	15.1	27.8

Source: International Financial Statistics, November 2011

foodgrain production during FY11. Favourable weather and lower price expectation have also contributed to the higher production to achieve the target. Production of *Aus* and *Aman* posted a growth of 7.3 percent in FY11. According to the preliminary estimation by BBS, total foodgrain production is about 4.0 percent higher than that of FY10.

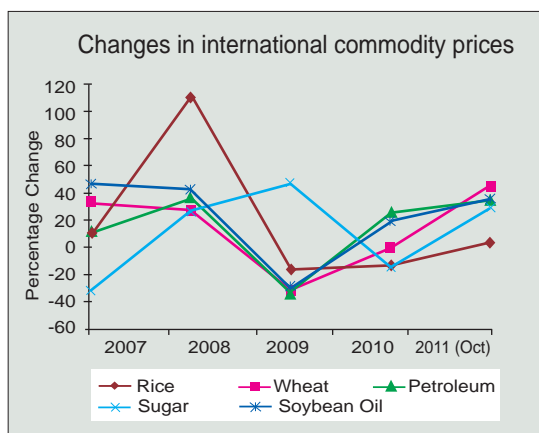
The data provided by Food Planning and Monitoring Unit show that actual production of *Boro* stood at 18.62 million metric tons in FY11 compared to the production of 18.34 million metric tons in FY10. On the other hand, *Aman* production was 12.79 million metric tons in FY11 which was 12.21 million metric tons in FY10. Total domestic food production recorded 34.50 million metric tons in FY11 against 33.21 million metric tons in FY10. According to the FAO forecast, Bangladesh will maintain a sharp fall in import of rice in the current fiscal year due to a large carryovers and abundant rice supplies.

The government provided electricity to rural areas for *Boro* production in the last season to fulfil high demand for irrigation. Other steps included open market sales of rice in Dhaka city and neighbouring districts and introduction of 'Fair Price Cards' for 2.5 million ultra poor families.

During FY11 monetary policy of Bangladesh Bank was implemented with a view to stabilise the price level and to maintain orderly conditions in the financial markets. To control inflationary pressure Bangladesh Bank increased Cash Reserve Requirements (CRR) and Statutory Liquidity Requirements (SLR) both by 50 basis points of their total liabilities which stood at 6.0 and 19.0 percent respectively with effect from 15 December 2010.

Moreover, Bangladesh Bank raised the policy interest rate on repo to 6.75 percent from 6.25

Chart 3.5



percent while reverse repo interest rate was refixed at 4.75 percent from 4.25 percent on 14 June 2011 to contain inflationary build up through discouraging credit flow to unproductive sectors including real estate and investment in stock market beyond affordable limit. The various adopted policy interventions did not work immediately like many other developing countries; it will involve some time-lag for its expected impact in Bangladesh.

3.5 International prices of food and non-food items experienced mixed trends in 2011 compared to those of the previous fiscal year. (Table 3.3, Chart 3.5).

3.6. The South Asian countries particularly SAARC countries depicted higher inflation during 2011. Among those, Nepal, Pakistan and Maldives showed higher inflation (Table 3.4, Chart 3.6).

Wage Rate Trends

3.7 The general wage rate indicated lower growth in FY11 compared to that in previous year. The growth of annual wage rate (Table 3.6, Chart 3.7) decelerated significantly to only 4.0 percent in FY11 from 10.7 percent in FY10. The rise in wage rate in the agricultural

Box 3.1**Inflation Persistence in Bangladesh**

A low to moderate-inflationary regime is a sine qua non for the pursuit of economic growth with stability. A recent Bangladesh Bank study on inflation revealed that the threshold level of inflation ranges between 6-8 percent and any rate beyond this negatively affects economic growth.

BBS data show that in September 2011 average September inflation recorded at 9.79 percent against 8.12 percent and 5.15 percent in September 2010 and 2009 respectively.

Average retail prices (open market) of selected commodities in Dhaka city

Group/sub-group	FY09	FY10	FY11	% Change (4-3)	% Change (5-4)
1	2	3	4	5	6
Rice (Best Quality) (per kg)	34.9	40.5	48.8	16.05	20.49
Rice (medium) (per kg)	33.5	38.6	45.4	15.22	17.62
Wheat (per kg)	22.6	23.4	33.4	3.54	42.74
Sugar (per kg)	40.0	42.0	64.5	5.00	53.57
Onion (per kg)	26.0	22.5	28.9	-13.46	28.44
Soybean oil (per litre)	83.2	83.0	120.3	-0.24	44.94

Source: Bangladesh Bureau of Statistics.

Given the composition of the Consumer Price Index (CPI), inflation in Bangladesh is mainly driven by food price increases both in international and domestic markets. Moreover, monetary factors like higher broad money (M2) growth (due largely to significant Government borrowing from the banking sector), the depreciation of the Taka, increase in producer and supplier prices due to fuel price increases have influenced the rising prices of commodities in Bangladesh.

Several factors contributed to increases in food and fuel prices in international markets: a) Increasing demand for commodities in emerging economies like China, India etc. in recent years; b) Increasingly channelling more staple foods and oilseeds towards bio-fuel and bio-diesel production; c) Crop failure due to bad weather including drought, wildfire and wet summers in big food producing countries; d) Recent oil price increases due to supply disruptions in the Middle East and Libya; e) Higher transport costs due to rising oil prices and f) Following the subprime crisis, investors' tendency to invest money in commodity markets due to the recent global turmoil in financial markets.

The Bangladesh economy needs to employ both short and long-term measures to cope with global commodity price increases: a) Supply side constraints have to be addressed to reduce the price differential between producer and consumer prices; b) The BB should formulate the monetary policy carefully where there is a reasonably stable linkage between interest rate, money supply and prices; c) To restrict borrowing from the banking sector the Government should take appropriate decisions on curtailing spending such as on oil subsidies; and d) Monitoring systems of commodity prices should be strengthened.

sector was the highest which increased by 6.8 percent while manufacturing sector recorded lowest growth rate of 2.4 percent in FY11. Growth rate of wages for all the sectors experienced mostly drastic fall compared to those in the last year. It is also notable that the growth in general wage rate was lower than the rate of consumer price inflation (8.80 percent) in FY11.

The indicating point was that purchasing power of the poor people has been slower due to lower wage rates against higher inflation.

Near Term Inflation Outlook

3.8 The global economic recovery is at a prolonged stage as it was anticipated. The world output growth has accelerated by 5.1 percent in 2010 from a negative growth of 0.7 percent in 2009. The remarkable growth has led by the emerging and developing economies which encouraged global demand and resulted in pressure on food supply.

Global demand for major food crops remained robust largely reflecting robust growth in emerging market economies which picked up to about 2.5 percent whereas China accounted for 70.0-80.0 percent demand growth during the past 3 years. Now China is an importer of global grain specially corn after many years of self sufficiency.

The global economy also experienced another turbulent year of high level of international food price in 2011. The FAO food price index reached a record high of 233.8 in June 2011, about 4.0 points lower than the historical high record of February 2011. While unfavourable weather is the main cause behind this unstable food market, many other causes including the catastrophe in Japan and an unprecedented wave of political

Chart 3.6

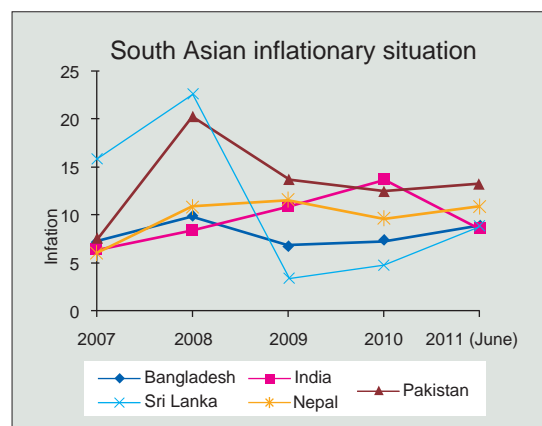


Table 3.4 Inflation in Asian countries[#]

Countries	2007	2008	2009	2010	2011(June)
SAARC Countries					
1. Bangladesh@	7.2	9.9	6.7	7.3	8.8
2. India	6.4	8.4	10.9	13.7	8.6
3. Pakistan	7.6	20.3	13.6	12.5	13.3
4. Nepal	6.1	10.9	11.6	9.6	10.9 (Apr)
5. Bhutan*	5.9	8.8	3.0	6.1	8.3
6. Sri Lanka	15.8	22.6	3.4	4.8	8.8 (May)
7. Maldives	6.8	12.0	4.5	6.1	12.3
Other Asian Countries					
8. Thailand	2.2	5.5	-0.8	3.3	4.1
9. Singapore	2.1	6.5	0.2	2.7	5.2
10. Malaysia	2.0	5.4	0.6	1.6	3.5
11. Indonesia	6.3	10.1	4.6	5.1	5.5
12. Korea	2.5	4.7	2.8	2.6	4.4
13. Myanmar	35.0	26.8	1.5	9.3	5.4

[#] IFS, November, 2011 CPI (base: 2000=100)
[@] = Source: BBS, Consumer Price Index (base:1995-96=100), figures relate to financial year (July-June)
^{*}= Monthly Statistical Bulletin August, 2011, Royal Monetary Authority of Bhutan.

unrests in North Africa and the Near East countries also triggered the food price.

Demand for biofuel feedstock has also rebounded more rapidly than expected as the US corn ethanol sector recovered from the widespread bankruptcies of 2008-09. Ethanol operating margins remain thin, but the sector has retained considerable policy support which serves to buttress ethanol crises. Higher prices of alternative feedstock particularly sugar have also supported demand for corn based ethanol. About 40.0

Table 3.5 Annual average national level CPI by consumption basket sub-groups

(Base:1995-96=100)						
Group/sub-group	Weight	FY09	FY10	FY11	% Change (4-3)	% Change (5-4)
1	2	3	4	5	6	7
General index	100.00	206.43	221.53	241.02	7.31	8.80
1. Food, beverage and tobacco	58.84	221.64	240.55	267.83	8.53	11.34
2. Non-food of which	41.16	186.67	196.84	205.01	5.45	4.15
i) Clothing & footwear	6.85	173.10	181.29	191.92	4.73	5.86
ii) Gross rent, fuel & lighting	16.87	184.46	191.49	197.92	3.81	3.36
iii) Furniture, furnishing, household equipment & operation	2.67	194.75	215.04	231.75	10.42	7.77
iv) Medical care & health expenses	2.84	189.25	199.22	203.67	5.27	2.23
v) Transport and communications	4.17	222.12	234.10	244.17	5.39	4.30
vi) Recreation, entertainment, education & cultural services	4.13	181.44	192.46	198.44	6.07	3.11
vii) Miscellaneous goods and services	3.63	188.84	208.40	218.59	10.36	4.89

Source: Bangladesh Bureau of Statistics

percent of the US corn harvest- equivalent to 14.0 percent of total global corn consumption- was used as ethanol feedstock in 2010, a 5.0 percentage point increase over the previous year.

The adequacy of production and productivity of the agricultural commodities remain a constraint due to many reasons of which high price of fertiliser is the most important. Most of the emerging and developing countries including Bangladesh have increased the fertiliser price in domestic market. In the end month of the FY11, the international price of three major fertilisers Urea, DAP and TSP showed a record increase by 112.0, 40.0 and 58.0 percent respectively compared to the respective month of FY10 (Chart 3.8). The World Bank forecast also expects an increasing trend for the year 2011, while these may ease in 2012.

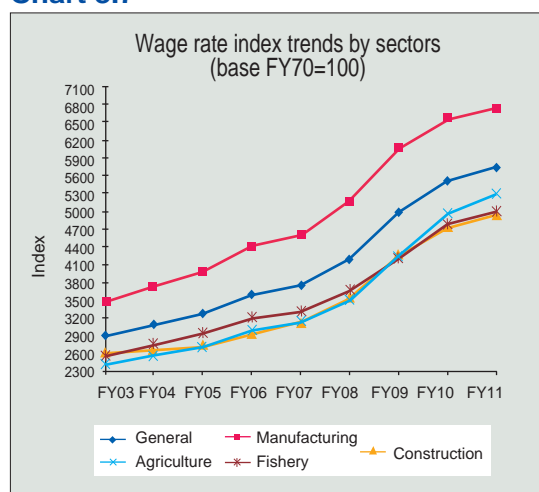
Global food output should recover quickly from recent supply shocks, with increased global acreage and more normal weather condition pointing to favourable harvest prospects in 2011. The World Bank forecast of primary commodity price index (2000=100) for 2011 estimated a 20.6 percent higher than 2010. There is a positive correlation between international oil price and the primary commodity

Table 3.6 Trends of wage rate indices

(Base: FY70=100)					
	FY07	FY08	FY09	FY10	FY11
General	3778.8	4227.4	5025.7	5561.8	5781.64
	(4.52)	(11.87)	(18.88)	(10.67)	(3.95)
Manufacturing	4635.9	5196.8	6128.36	6620.3	6778.06
	(4.30)	(12.10)	(17.93)	(8.03)	(2.38)
Construction	3134.8	3549.2	4311.3	4755.8	4983.29
	(6.32)	(13.22)	(21.47)	(10.31)	(4.78)
Agriculture	3155.7	3524.0	4273.7	4985.4	5325.63
	(4.44)	(11.67)	(21.27)	(16.65)	(6.83)
Fishery	3332.0	3686.1	4236.5	4827.5	5043.15
	(3.55)	(10.63)	(14.93)	(13.95)	(4.47)

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

Chart 3.7



price. The current market shows an upward trend for major commodities in the international market. The price for petroleum (crude) also shows a record high of USD116 in April 2011 which increased by 41.6 percent in June 2011. The price of rice (Thailand, 5.0 percent broken), wheat (US, no.1, hard red winter) and soybean oil (crude, fob) also showed a high record of 16.8, 107.0 and 54.1 percent respectively in June 2011 compared to June 2010 (Chart 3.9). However, forecast for these three major non-energy primary commodities remained very high for 2011 as well.

The global production of rice and wheat is projected to be higher in 2011 considering favourable weather and government supports. The FAO prediction shows that the rice production is estimated to increase by 1.8 percent to a new record in 2010. The early outlook by FAO also remains positive, increased by 2.6 percent in 2011. FAO forecast also reveals that the trade in rice will boost by 1.4 percent in 2011, the same level as 2007 record. Among exporters, Thailand and Viet Nam are likely to supply a substantial share due to their higher production in FY11. However, rice export by Egypt, Pakistan and the United States are likely to see a bleak picture this year compared to last year. India has recorded expected production in FY11. The Indian government also lifted the ban on non-*Basmati* rice export in July this year. According to the government notification ten lakhs metric ton rice are allowed to export from private stock. These altogether will increase the supply of rice in international market, hence may lead to a lower price.

Commodity supplies against growing demand are expected to respond to higher prices in 2011. There is spare capacity in the energy sector which could make up for production losses on account of civil war in Libya and an anticipated return to more normal weather

Chart 3.8

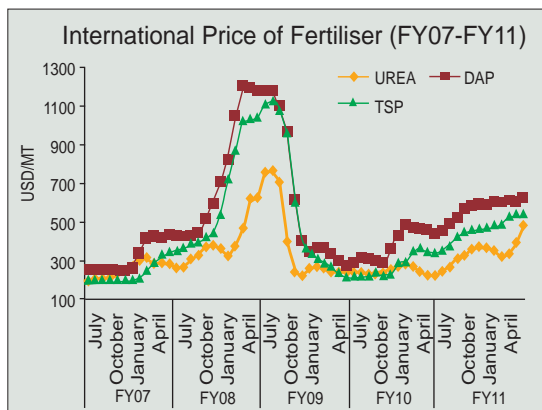


Chart 3.9

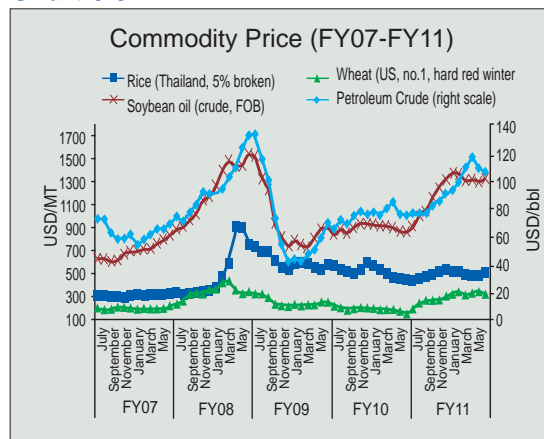


Table 3.7 Global inflationary situation

	(Percentage change)			
	2009	2010	2011*	2012*
Advanced Economies	0.1	1.6	2.6	1.4
United States	-0.3	1.6	3.0	1.2
Euro Area	0.3	1.6	2.5	1.5
Emerging and developing economies	5.2	6.1	7.5	5.9
Developing Asia	3.1	5.7	7.0	5.1
Bangladesh	5.4	8.1	10.1	7.4
India	10.9	12.0	10.6	8.6
Pakistan	20.8	11.7	13.9	14.0
Sri Lanka	3.4	5.9	8.4	6.6

Source: World Economic Outlook, IMF, September, 2011.

* Projection

condition should result in increased agricultural output. At the same time, demand growth should moderate somewhat, reflecting usual cyclical patterns. These developments are forecast to allow for more balanced growth in both supply and demand. But low inventories will take time to rebuild, and so prices are likely to remain more volatile than usual. Nonetheless, the outlook for oil markets remains quite uncertain, as perceptions of geopolitical supply risks can be volatile which may impact prices of agricultural commodities through cost push factor.

Crude oil supply is responding sluggishly to the ongoing pickup in demand, largely reflecting the policy stance of OPEC. Constraints on non-OPEC capacity and disruption of production in Libya may be resulted in increase of supply from other OPEC countries in 2011. Current OPEC spare capacity levels, estimated at about 4.5 percent of global demand, are sufficient to make up losses of supply from Libya and to meet the expected increase in demand. Moreover, if the supply response materialises, it should restrain further upward price pressure.

The outlook for food prices over the near-term and beyond will depend largely on supply developments. Over the medium term, supply should continue to rise in response to higher demand and prices.

Improving supply should ease tightness somewhat and allow prices to retreat modestly from their recent highs through 2011 but risks to the price outlook remain decisively to the upside. The most immediate risk is that the final phases of the current *La Nina* weather pattern will continue to threaten yields in the Southern Hemisphere. Other risks include persistently higher energy prices

or the imposition of international trade restrictions on food items in response to supply shocks in major food producing countries. The process of rebuilding international stocks of foods will take time and until these international buffers return to more normal levels, food prices will remain highly sensitive to shocks that tighten physical markets.

After getting a substantial decrease of inflation in 2009, inflation has started to increase, reflecting the sharp recovery of commodity prices and emerging capacity constraints. However, the inflation in advanced economies is projected to remain at low levels in 2011 as well as 2012. In advanced economies, inflation is projected at 2.6 percent in 2011, and 1.4 percent in 2012 as food and energy price hikes abate and a slight acceleration of wage amid weak labour markets. Contrary to this scenario, the inflation in emerging and developing economies has risen significantly in 2010 and 2011 but projects signs of moderating in 2012. Assuming broadly stable food and energy prices, the WEO forecasts inflation at 7.5 percent in 2011 and 5.9 percent in 2012.

In this global scenario, Bangladesh is passing through a higher inflationary situation. The projected inflation rate in the national budget for FY12 has been set at 7.5 percent, and this is lower than the FY11 rate of 8.8 percent. Attaining the level depends mainly on the food inflation, as the non-food inflation is at low level now. Prudent policy stance is required to maintain the target rate as the economy is facing few challenges. Challenges from external economy include global recession, international oil price increase and exchange rate volatility. Political stability, favourable weather condition, access to government measures for farmers are the domestic challenges to contain the targeted inflation rate.

The food inflation of both annual average and point-to-point are in double digits since December 2010 due to continuous strong domestic demand because of higher population growth and continuous economic growth which causes considerable hardship for the low income people, despite satisfactory growth in domestic output of major food crops including rice, potato and wheat. With global prices of food commodities including rice, wheat, sugar and edible oil high and volatile, the uptrend of food CPI inflation situation is much the same in other developing countries. In the open global trade regime, prices of rice and other food commodities in domestic markets in Bangladesh

are impacted by trends of global prices, even though imports constitute only a small portion of total domestic rice consumption.

In this backdrop, domestic food production should be augmented with lower production cost and emphasised on smooth local supply channel.

Attainment of the projected decline of domestic CPI inflation to 7.5 percent in FY12 will thus be subject to moderation in global commodity price trends, limiting of demand pressures from excessive liquidity expansions and stable benign domestic environment with no major supply side disruption.