Part A: Economic and Financial Development

Overview and Executive Summary

In several respects FY12 was a 'year of two halves'. The first half (H1FY12) witnessed significant balance of payments pressures due to high global oil prices and low aid disbursements, forcing significant depreciation of the Taka and some foreign reserve depletion. Government's borrowing from the banking sector also rose sharply during this period and inflation rose to double-digits levels. In the second half of the fiscal year (H2FY12) external pressures eased due to monetary tightening, lower import demand and pro-active steps to secure alternative sources of external financing. Government borrowing from the banking sector in H2FY12 was also more conservative and by end June 2012 it amounted to around Taka 187.9 billion, well short of the revised budget figure of Taka 291.15 billion. The more restrained monetary stance, adequate domestic foodgrain output and moderate global commodity prices contributed to point-to-point inflation falling to single digits. The Taka/US dollar exchange rate stabilized and external reserves rose to 10.36 billion USD in June 2012 from 9.4 billion USD in January 2012.

In 2012, global growth is expected to be 2.5 percent while the average for developing countries is projected at 5.3 percent. In this uncertain global context the provisional estimate of 6.3 percent GDP growth for Bangladesh in FY12 is impressive, though lower than the FY12 Budget target of 7 percent. The lower growth figure is primarily due to significantly slower agricultural growth, although this may be revised upwards once the final rice output figure is included. Industrial growth in FY12 was higher than FY11 suggesting that the relatively more restrained monetary stance in FY12 had little or no adverse impact on overall growth. This is also supported by the fact that capital machinery and industrial raw material imports registered double-digit growth between June and May FY12 even though overall import growth slowed to 5.2 percent.

The last several months of FY12 have seen moderating inflation pressures as point-to-point inflation has declined from a peak of 11.97 percent in September to 8.56 percent in June. This decline has largely been due to lower food price inflation though of late non-food inflation has also declined, from a peak of 13.96 percent in March to 11.72 percent in June 2012. While these recent trends are positive, average annual inflation remains 10.6 percent and it is important to bring inflation down further to meet the 7.5 percent target set out in the FY13 Budget. As such containing inflation will remain a core focus of the monetary program.

Monetary targets for FY12 are on track establishing the credibility of the stance taken in the previous Monetary Policy Statement. In June 2012, broad money growth (M2), on a year-on-year basis, was an estimated 17.4 percent and growth of Net Domestic Assets was 18.5 percent, compared to the targets set in the January MPS at 17 percent and 21.9 percent respectively. This stance was achieved through active liquidity management, raising repo rates by 100 basis points in FY12, lifting all but two rate caps and tightening consumer credit through administrative measures. Private sector credit growth was a healthy 19.7 percent in June 2012, higher than the 'emerging Asia' regional average of 15 percent. Analysis of the outstanding loans to the private sector indicates an increasing share of SME loans and a virtually unchanged share of industrial term loans in total outstanding credit. In addition inflow of foreign private loans, mostly of longer term tenor, was also nearly one billion US dollars in FY12.

I. Developments in the Real Economy

1.1 The economic activities which paced up during Q3 continued in Q4 of FY12, reflecting through higher flow of agricultural, SME and industrial credit, higher volume of trade and inflow of remittances and improved growth of revenues backed by satisfactory level of ADP utilization and increased production of electricity. Despite the weak global recovery and lingering debt crisis in Euro zone, the level of economic activities during the quarter under review was well supported by prudent monetary and fiscal policies.

1.2 In H1 of FY12, Bangladesh economy faced BoP pressure due to high global oil prices and low aid disbursement, experiencing significant depreciation of Taka along with some foreign reserve depletion. In H2 FY12, external pressures eased due to monetary tightening, lower import demand and pro-active steps to secure alternative sources of external financing (MPS, H1 FY13). In the wake of lower growth of world economy and a gloomy prospect of debt crisis in Euro zone, the achieving of 6.3 percent economic growth in FY12 was quite impressive despite relatively lower agriculture sector growth. Agricultural growth slowed from 5.13 percent in FY11 to 2.53 percent in FY12 due mainly to the base effect of two successive years of record growth. Industry sector had the strongest growth gained from 8.20 percent in FY11 to 9.47 percent in FY12, supported by faster growth of small-scale industries which increased from 5.84 percent in FY11 to an estimated 7.18 percent in FY12. Service sector output growth slightly edged down to 6.06 percent in FY12 from 6.22 percent growth in FY11. Of the various factors of slower service sector growth huge deceleration of external sector activities related services including substantial decline in import related services as well as export related services is one of the prominent factors.

Chart I.1: Growth of Real GDP

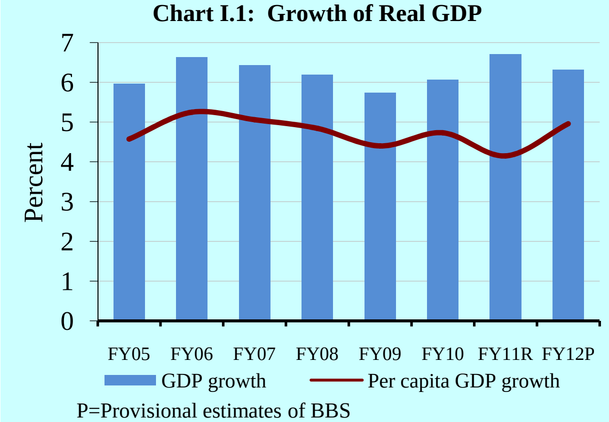
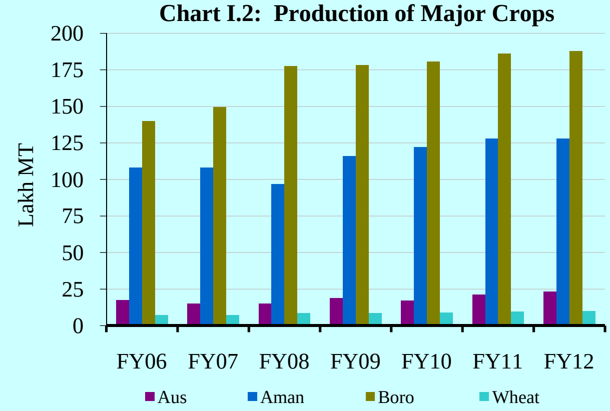


Chart I.2: Production of Major Crops



1.3 The agriculture sector growth was driven by crops and horticulture sub sector which constitutes about 60 percent of overall agricultural activities. *Aus* production, the first crop harvested in Q1, increased from 2.13 mmt in FY11 to 2.33 mmt in FY12. *Aman* production, the second crop harvested in Q2, augmented to 12.8 mmt in FY12 from 12.7 mmt. *Boro* production, the major rice crop harvested in Q3 and Q4 recorded to 18.8 mmt, which was 0.88 percent higher than the actual production of FY11. Maize production increased sharply to 2.0 mmt in FY12, up 25.0 percent from actual production of FY11. Different categories of vegetables witnessed an impressive growth of 12.4 percent higher than the actual production of FY11 to 12.6 mmt in FY12. As a result, total cereal production increased to 36.9 mmt in FY12 from the actual production of 36.1 mmt in FY11. Fishing and 'forest and related services' sub-sectors recorded a growth of 5.38 percent and 4.48 percent respectively in FY12 as against the growth of 5.25 percent and 3.90 percent in FY11. Favourable weather condition, electricity and diesel subsidy, and availability of agricultural inputs like fertilizer, pesticide, and un-interrupted power supply in rural area in boro season contributed higher food production in FY12.

1.4 During Q4 of FY12, banks disbursed Tk. 39.4 billion as agricultural credit which was 30.1 percent higher than the amount disbursed in the same quarter of FY11. Of the total agricultural credit disbursement during the quarter under review, an amount of Tk. 13.2 billion went to crop sector, Tk. 4.8 billion in livestock sector, Tk. 4.2 billion in poverty alleviation program and Tk. 11.9 billion in others sector. Total loan recovery stood at Tk. 34.8 billion during Q4FY12 as against the recovery of Tk. 31.2 billion in the same quarter of the previous fiscal year.

1.5 During FY12, total agricultural credit disbursement stood at Tk. 131.23 billion which was 7.8 percent higher than the actual disbursement of Tk. 121.8 billion in FY11 and 95.16 percent of yearly target of Tk. 138.00 billion. Out of this disbursement, an amount of Tk. 53.6 billion had been disbursed to crop sector which was 22.7 percent higher than the actual disbursement in FY11. In FY12, BRAC disbursed an amount of Tk. 2.46 billion agricultural credit to sharecropper as against disbursement of Tk. 1.91 billion in FY11 under refinance scheme of Bangladesh Bank which was a noteworthy development for financial inclusion pursued by the BB.

1.6 The buoyant activities of the overall industry sector during Q3 FY12 continued in Q4 FY12, reflecting in higher value of manufacturing production index. Quantum index of manufacturing output (large and medium manufacturing), increased by 4.3 percent in Q4 FY12 over the level of Q4 FY11. The 'Jute, Cotton, RMG & Leather' subsector, the highest weighted sector, grew by 10.4 percent during Q4 FY12 over the level of the same quarter of previous fiscal year. The 'fabricated metal product', 'paper and paper product', and 'non-metalic products' subsector increased by 16.4 percent, 5.7 percent and 10.1 percent respectively during Q4 FY12 over Q4 FY11. 'Food beverage and tobacco', 'Chemical petroleum and rubber' and 'Basic metal products' subsector on the other hand declined by 5.3 percent, 7.7 percent and 16.9 percent respectively during Q4 FY12 over Q4 FY11.

Chart I.3: Quantum Index of Manufacturing Output

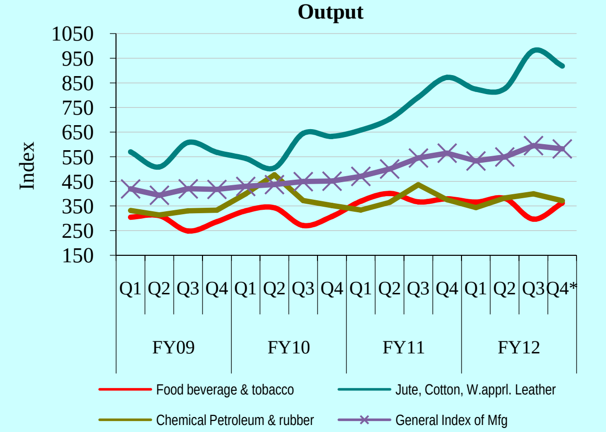
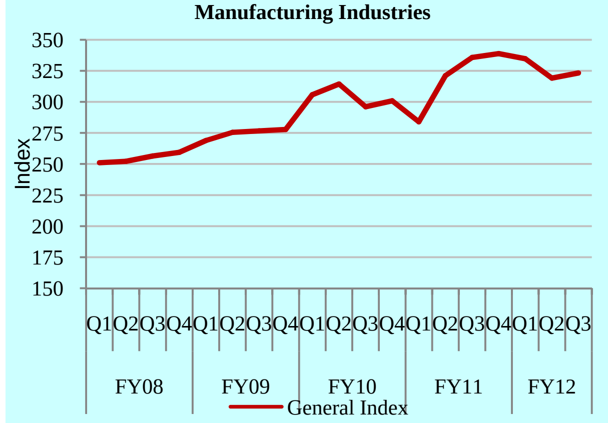


Chart 1.4: Quantum Index of Small Scale Manufacturing Industries



1.7 The overall industry sector, comprise of mining and quarrying, manufacturing, electricity, gas, water supply, and construction sub sectors, grew by 9.47 percent in FY12 as compared to 8.20 percent in FY11. The growth was broad based across subsectors. Manufacturing sub-sector grew by 9.76 percent in FY12 compared to 9.45 percent growth in FY11 due to more value added growth by small scale industry. Small scale industries increased by 7.18 percent in FY12 as compared to 5.84 in FY11 while large scale industries decelerated to 10.78 percent growth in FY 12 from 10.94 percent in FY11. Construction sector increased from 6.51 percent in FY11 to 8.51 percent in FY12. Power, Gas and water supply subsector witness a impressive growth of 14.11 percent in FY12 from 6.63 percent in FY11.

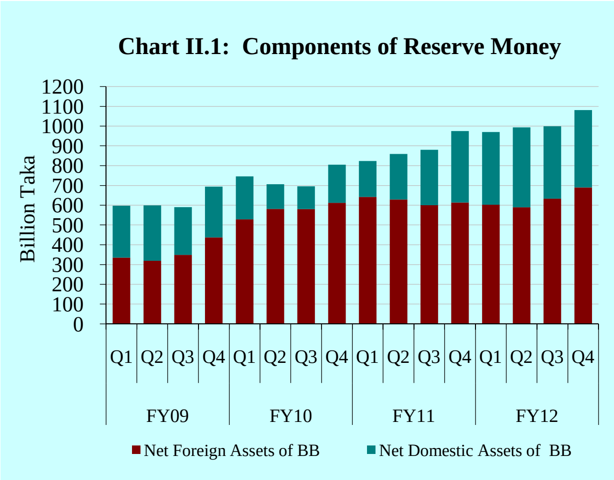
1.8 The disbursement of industrial term loan by Banks and NBFIs grew by 33.13 percent during Q4 of FY12 over the same period of previous fiscal year. During FY12, the disbursement of industrial term loan by Banks and NBFIs increased by 9.68 percent over the same period of FY11. Banks and NBFIs disbursed total Tk.179.75 billion SME loan to different sectors during Q4FY12 which was 28.76 percent higher over the same period of FY11. This is 30.46 percent of annual target of Tk.590.13 billion for 2012. Outstanding position of SME loans increased to Tk.931.48 billion at end June 2012 from Tk. 886.70 billion at end March 2012.

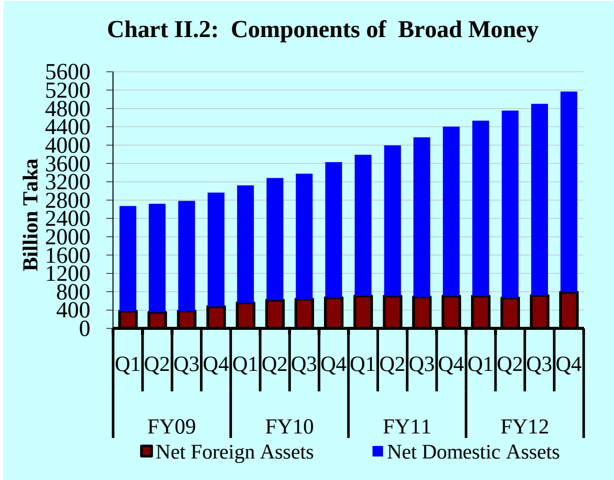
1.9 Service sector activities showed a mixed trend during Q4 FY12 reflected in many indirect indicators viz. cargo handling, trade financing and increased mobile phone user. Data on cargo handling by Chittagong port shows that about 8.2 million ton imports and 1.2 million ton exports had been handled during Q4 of FY12. The mobile phone subscriber reached 93.788 million at the end June 2012 from 89.46 million at the end March 2012.

1.10 Overall service sector, contribute about 49.5 percent share to GDP, decelerated marginally to 6.06 percent growth in FY12 as against 6.22 percent growth in FY11, due to marginally lower growth registered in wholesale and retail trade subsector which contributed about 29 percent share to service sector. This sub-sector registered a growth of 5.88 percent in FY12 as against 6.31 percent growth in FY11. Transport storage and communication (6.58 percent), hotel and restaurant (7.6 percent), 'real estate, renting and business activity' (4.05 percent), and 'community, social and personal services' (4.76 percent) recorded marginally higher growth than the previous fiscal year. While some of the other sub-sectors viz. financial intermediations (9.52 percent), public administration and defense (6.07 percent), education (8.61 percent), health and social works (7.94 percent) recorded marginally lower growth than the previous fiscal year.

II. Money and Credit Market Development

2.1 Domestic credit growth in FY12 remained close to programmed level with decline in government's bank borrowing making room for somewhat higher than programmed growth in credit to private sector. BB's monetary policy aimed to contain reserve money growth to 12.2 percent, broad money growth to 17.0 percent and credit to the private sector growth to 16.0 percent by June 2012 (January, 2012, MPS). Accordingly, quarterly growth of monetary aggregates (M1, M2), reserve money (RM) slowed during the last quarter of FY12. Reserve money growth stood lower at 10.86 percent compared with programmed level of 12.2 percent.





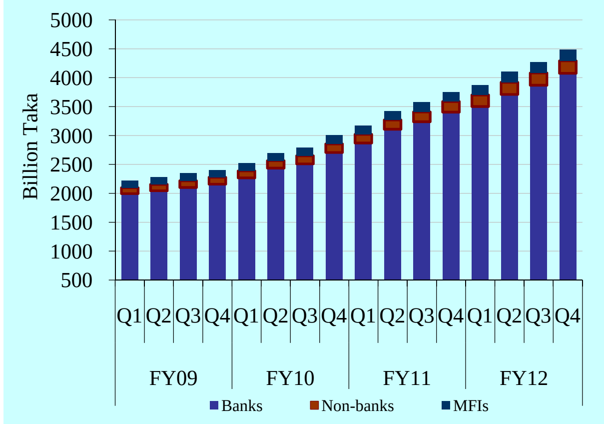
However, domestic credit growth increased slightly by 19.5 percent (Y-o-Y) compared with 19.1 percent programmed growth for Q4FY12, credit to the private sector increased by 19.7 percent compared with 16.0 percent programmed growth while credit to the public sector recorded a lower 18.9 percent growth compared with 31.0 percent growth programmed for Q4FY12. The total private sector credit by banks, non-bank and microfinance institutions grew by 13.9 percent (y-o-y) in Q4 FY12 as against 24.7 percent recorded in the same period of the preceding year. In view of containing inflation and inflationary expectations, BB kept its policy rates unchanged that were adjusted upward earlier.

2.2 Provisional data show that M2 experienced a growth of 17.4 percent (y-o-y) and stood at Tk.5171.1 billion at end June, 2012 fueled mainly by 18.5 percent growth in NDA resulting from increased credit to the public and private sectors together with 11.7 percent NFA. Credit to govt. (net) slowed substantially in Q4FY12 compared with other quarters in FY12. The growth of M1 increased by 6.4 percent at end June, 2012 which increased by 17.2 percent during the same period of the preceding year mainly due to moderate increase in demand deposits and currency outside banks.

2.3 A look at the components of M2 shows that currency, demand deposits and time deposits increased by 6.61 percent, 6.21 percent and 20.74 percent (y-o-y) respectively during Q4FY12 as compared with 18.71 percent, 15.48 percent and 22.68 percent respectively during the same period of the preceding year. The money multiplier (M2/RM) increased by 6.67 in Q4FY12. The increase of multiplier was influenced by relatively faster expansion of M2 than that of RM.

2.4 The RM grew by 10.9 percent (y-o-y) and stood at Tk. 1080.9 billion in June, 2012 which experienced about 21.1 percent (y-o-y) growth during the same period of the preceding year. The growth in NDA and NFA was 8.3 and 12.4 percent respectively in June 2012. During Q1, Q2 and Q3 of FY12, the NDA grew significantly which is mainly resulting from a substantial increase in claims on banks and also claims on the public sectors.

Chart II.3: Trends in Private Sector Credit



2.5 The total advances by economic purposes increased by 21.6 percent and stood at Tk. 3760.8 billion in Q4FY12 which increased by 25.0 percent during the same period of the preceding year. An analysis of trends of the bank advances to private sector showed that bank advances to the storage sector increased by 72.4 percent in Q4FY12, which actually decreased by 9.0 percent during the same period of the preceding year. Credit to the transport and communication sector increased significantly by 57.3 percent compared with 43.5 percent during the same period preceding year. Credit to the construction and industry sectors increased by 31.3 percent and 20.1 percent respectively in Q4FY12 which increased by 33.0 percent and 29.6 percent during the same period of the preceding year. Credit to the trade sector increased by 19.3 percent in Q4FY12, which increased by 26.0 percent during the same period of the preceding year. The supply of credit to the agriculture sector increased by 7.8 percent at end of FY12 (of

Chart II.4: Yield on T-Bills

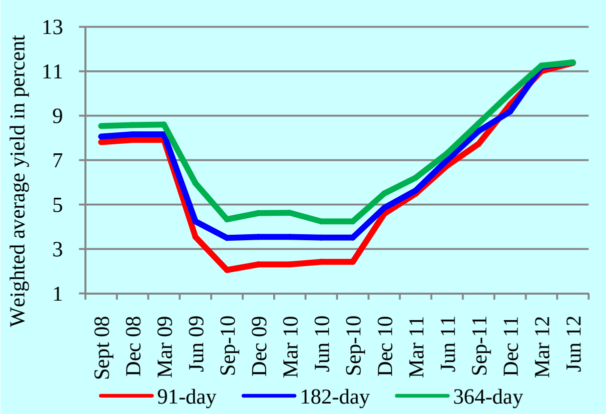
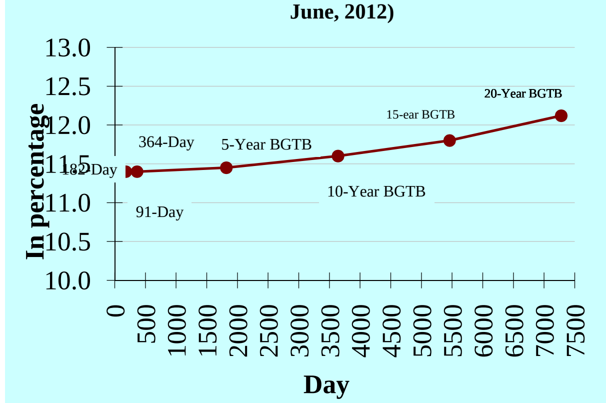


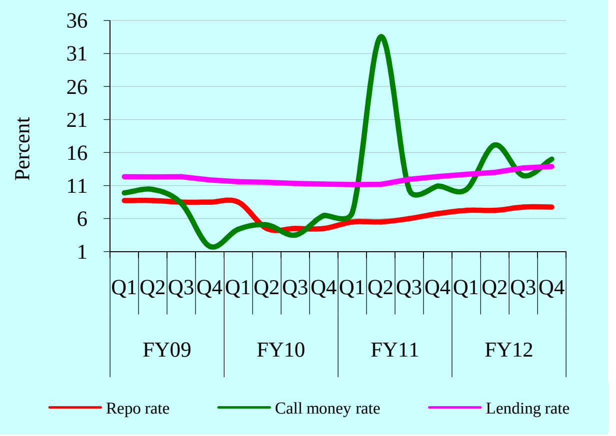
Chart II.5: Weighted average yield of accepted Government Treasury Bills & Bonds (End June, 2012)



which crops increased by 9.3 percent and others declined by 8.2 percent). Credit to the working capital financing increased by 11.5 percent in Q4FY12 as compared with 20.6 percent in the same period of the preceding year.

2.6 The disbursement of term lending by banks and NBFIs increased by 33.1 percent and stood at Tk. 102.2 billion at end Q4FY12, which was Tk. 76.8 billion during the same period of the preceding year. Between Q4FY11 and Q4FY12, term lending by PCBs increased from Tk. 47.5 billion to Tk. 61.8 billion, SCBs term lending increased from Tk. 14.3 billion to Tk. 20.8 billion. Term lending by FCBs increased from Tk. 3.5 billion to Tk. 4.5 billion, and by NBFIs increased from Tk. 8.9 billion in Q4FY11 to Tk. 10.7 billion in Q4FY12. Term lending by specialized banks also increased substantially from Tk. 2.6 billion in Q4FY11 to Tk. 4.5 billion in Q4FY12.

Chart II.6: Interest Rate Movements



2.7 The repo and reverse repo rates were 7.75 percent and 5.75 respectively in June, 2012 which increased by a total of 325 basis points to contain inflation and inflationary pressure emanating from various domestic and international factors in FY12. Overall yields on short term treasury bills e.g., 91-day increased to 11.37 percent in June, 2012 from 6.75 percent in June, 2011, while 182-day, 364-day treasury bills rates both were increased to 11.40 percent at end of June, 2012 from 7.00 and 7.30 percent respectively at the end of June, 2011. Long-term bond such as 5-year and 10-year increased to 11.45 and 11.60 percent at the end of June, 2012 from 8.26 percent and 9.45 percent in June, 2011 (Table II.3), while the yields on 15-year, and 20-year BGTB both were also increased from 9.35 percent and 9.65 percent respectively to 11.80 and 12.12 percent in June, 2012. The call money rate was 15.02 percent at the end of June, 2012 which was 10.93 percent at the end of June, 2011 due to increased credit demand in the private sector. The outstanding stock of NSD certificates in June, 2012 stood at Tk. 639.2 billion against Tk. 634.4 billion in June, 2011 due to increased in the 3-Year and 5-Year NSD certificate rate to 12.59 percent and 13.19 percent since Q3FY12 from 10.00 and 10.50 percent at the end of June FY11.

III. Fiscal Developments

3.1 Overall fiscal activities remained mostly in line with the revised yearly targets set in FY12. Provisional data show that total expenditure as a percent of GDP marginally increased to 16.36 in FY12 from 16.29 in FY11, while total revenue (both tax and non-tax sources) as a percent of GDP rose to 12.98 in FY12 from 11.81 in FY11. As a result, overall fiscal deficits as a percent of GDP stood at 3.38 in FY12 compared with 3.79 percent in FY11.

3.2 Based on quarter-to-quarter data, total revenue increased by 30.8 percent to Tk. 373.3 billion during Q4FY12 over the corresponding quarter of FY11. In FY12, total revenue increased by 27.7 percent to Tk. 1187.8 billion as compared to Tk. 929.9 billion in FY11. During FY12, revenue collection from income tax, custom duties, value added tax (VAT) and other sources increased by 28.6, 23.5, 21.4 and 22.0 percent respectively over FY11 while revenue from non-tax sources increased by 53.9 percent over the level of FY11. Total revenue as percentage of GDP in FY12 stood at 12.98 as against 12.56 in revised budget of FY12 (Table III.1).

Chart III.1: Trend in Government Revenue and Expenditure

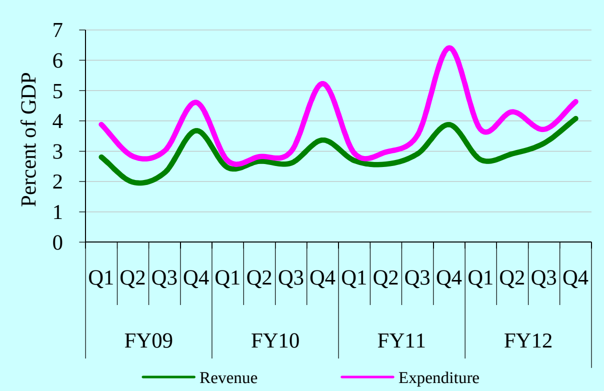
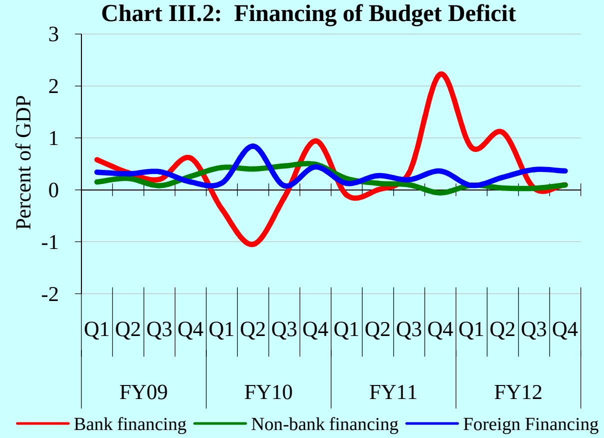


Chart III.2: Financing of Budget Deficit



3.3 Total expenditure, comprising of current and ADP expenditure, as percentage of GDP, stood at 16.36 in FY12 as against 17.62 in revised budget for FY12. Estimated data show that current expenditure increased slightly by 0.3 percent in FY12 over FY11. In FY12, ADP expenditure increased by 13.8 percent to Tk. 378.7 billion from Tk. 332.8 billion in FY11. The rate of ADP implementation stood at 92.2 percent of the targeted amount of Tk. 410.8 billion in the FY12 revised budget.

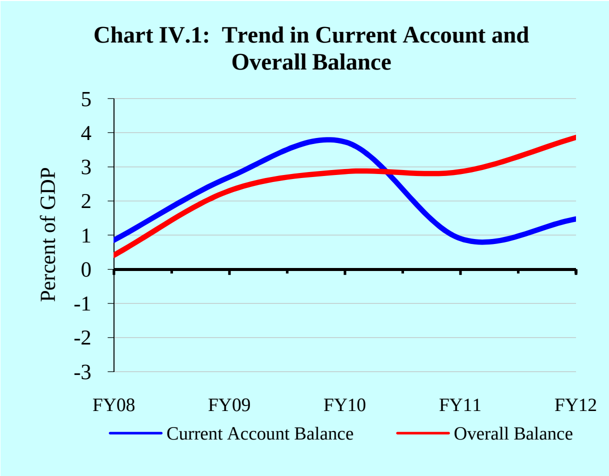
3.4 The provisional estimate indicate that overall budget deficit stood at 3.38 percent of GDP in FY12 as against the revised target of 5.06 percent in FY12 and actual level of 3.79 percent in

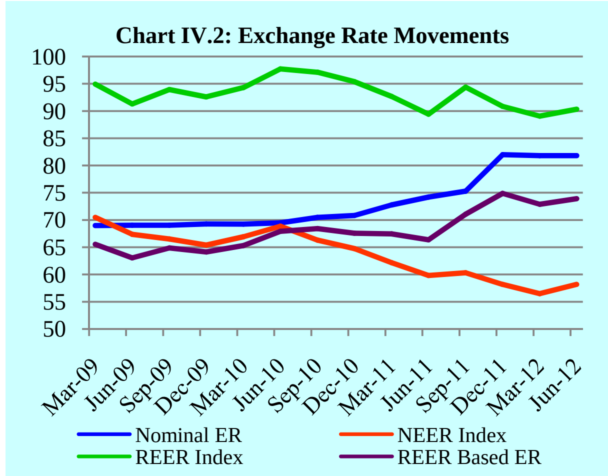
FY11. The deficit was accommodated by both domestic and external financing. The overall domestic financing in FY12 decreased to Tk. 210.3 billion from its peak of Tk. 305.9 billion in FY11. Among the domestic sources, net borrowing from the banking sector was higher and stood at Tk. 187.9 billion due mainly to sharp decline in the sale of NSD certificates. The financing from non-bank sources (through NSD) decreased by 58.4 percent to Tk. 22.4 billion in FY12 over the level of Tk. 53.8 billion in FY11. The amount of foreign financing increased by 110.5 percent to Tk. 98.7 billion in FY12 from the amount of Tk. 46.9 billion in FY11 (Table III.1).

IV. External Sector Developments

4.1 The current account balance (CAB) maintained a surplus of USD 1.25 billion during Q4FY12 and a surplus of USD 1.70 billion during FY12. During the quarter trade deficits declined by 30.1 percent to USD 1.34 billion against USD 1.92 billion recorded in the corresponding quarter of previous fiscal year due to larger decline in import payments than that of export earnings. Export earnings declined by 4.1 percent while import payments declined by 10.0 percent during Q4FY12. Workers' remittances which contributed more than 95.0 percent of total secondary income increased by 9.0 percent to USD 3.31 billion during Q4FY12 and recorded 10.2 percent growth to 12.84 billion during FY12. In spite of deficits in the overall balance of payments during the first two consecutive quarters (USD 0.10 billion and USD 0.90 billion), surpluses in the third (USD 0.58 billion) and fourth (USD 0.91 billion) quarters offsets the deficits turning the overall balance of payments to a surplus of USD 0.49 billion during FY12 leading foreign reserve position of BB to USD 10.36 billion at end June 2012. The foreign exchange market remained mostly stable experiencing only 0.02 percent depreciation of Taka against US dollar during Q4FY12.

4.2 The current account balance (CAB) recorded a huge surplus of USD 1.25 billion during the fourth quarter of FY12 (April-June FY12) against a surplus of USD 0.04 billion during the previous quarter and USD 0.30 billion during the same quarter of FY11 due to higher surplus in secondary income and narrowed down deficit in the trade balance. The CAB showed deficits of USD 0.03 billion in the first quarter of FY12 while during the rest quarters of FY12 it maintained surplus generating a larger surplus of USD 1.70 billion during FY12. The net services account witnessed a deficit of USD 0.58 billion during Q4FY12 against a deficit of USD 0.57 billion in the same quarter of previous fiscal. Deficits in primary income account decreased to USD 0.32



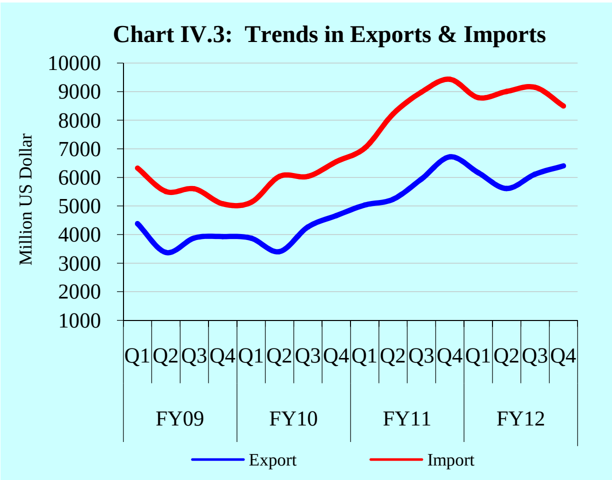


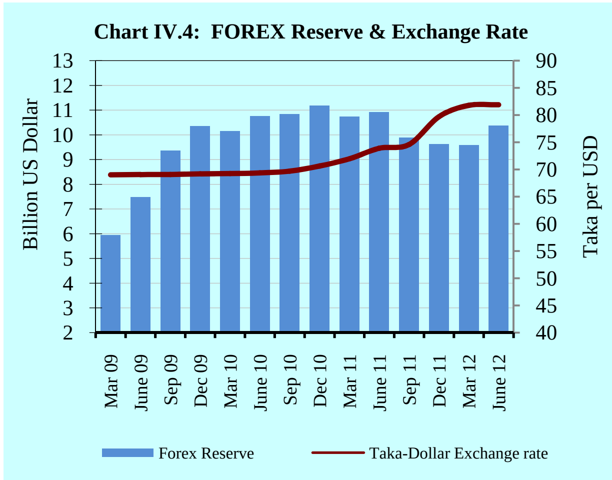
billion during the quarter under review compared to a deficit of USD 0.41 billion in Q4FY11. During Q4FY12, surplus in the secondary income account widened to USD 3.48 billion compared to USD 3.20 billion of Q4FY11. Workers' remittances, contributed more than 95.0 percent to total secondary income stood at USD 3.31 billion in Q4FY12 compared to USD 3.04 billion in Q4FY11.

4.3 Capital and financial account showed a surplus of USD 0.34 billion during Q4FY12 against a surplus of USD 0.02 billion in Q4FY11 while during the first three quarters of FY12 it was in deficit. The Overall balance of payments (BOP) maintained a surplus of USD 0.91 billion during Q4FY12 against a deficit of USD 0.13 billion during the same period of FY11. Surplus in the balance of payments in the third (USD 0.58 billion) and fourth (USD 0.91 billion) quarters offsets the deficits in the overall balance of payments during the first two consecutive quarters (USD 0.10 billion and USD 0.90 billion) turning the overall balance of payments to a surplus of USD 0.49 billion during FY12 against the deficits of USD 0.66 billion during FY11 and thus the foreign exchange reserve stood at USD 10.36 billion at end June 2012.

4.4 The foreign exchange market remained mostly stable and experienced only a marginal 0.02 percent depreciation during Q4FY12. After experiencing a strong depreciation pressure in January 2012, the Taka-Dollar exchange rate started to moderate since February 2012. At the end of June'12 the exchange rate came down to 81.87 per USD with an appreciation bias. Bangladesh Bank continued its interventions in the domestic foreign exchange market by net purchasing of foreign currencies of USD 138.0 million during Q4Y12 instead of net sale of USD 126 million during Q3FY12 which contributed to keep exchange rate of Taka in the stable position at the end of FY12. The REER based exchange rate increased to Taka 73.93 per USD at end June'12 from

Taka 72.88 per USD at end March'12, indicating increased external trade competitiveness during Q4FY12 as the nominal exchange rate of Taka against USD remained in the same level of Q3FY12.





4.5 Export earnings declined by 4.1 percent to USD 6.31 billion (on adjusted fob basis) during Q4FY12 against USD 6.58 billion recorded during the corresponding quarter of FY11. Despite decline in the 4th quarter, export earnings registered a 6.2 percent growth in FY12. During Q4FY12 the export of leather (+6.7 percent), tea (+1.1 percent), jute goods (+0.4 percent), woven garments (+1.0 percent) and terry towels (2.6 percent) increased while exports of raw jute (-24.3 percent), frozen food (-22.1 percent), knitwear products (-13.4 percent) and fertilizer (-100.0 percent) recorded decline compared to corresponding quarter of FY11 (Table IV.2).

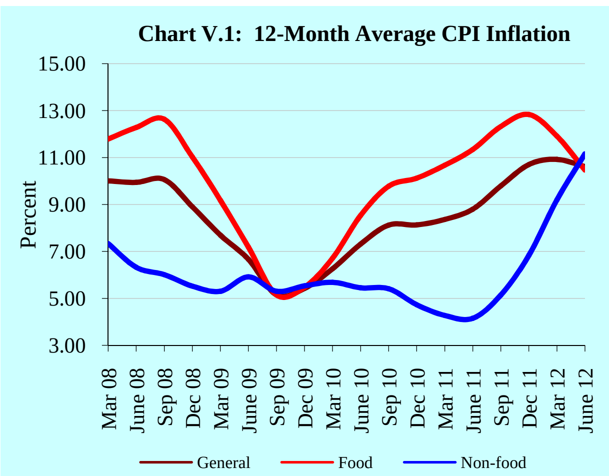
4.6 Import payments recorded 10.0 percent decline (on adjusted fob basis) to USD 7.65 billion during Q4FY12 compared to USD 8.50 billion imports recorded during corresponding quarter of FY11 (Table IV.3). Import of food-grains declined sharply by 66.4 percent during Q4FY12 to USD 204.9 million compared to USD 609.9 million recorded during Q4FY11 of which rice import decreased by 98.1 percent (USD 5.2 million against USD 268.4 million) and imports of wheat decreased by 41.5 percent (USD 199.7 million against USD 341.5 million). On the other hand, imports of other food items increased by 13.2 percent during the quarter under review, of which the imports of milk & cream, spices, oil seeds edible oil sugar and pulses increased by 8.1, 2.8, 106.9, 10.3, 1.7 and 20.7 percent respectively.

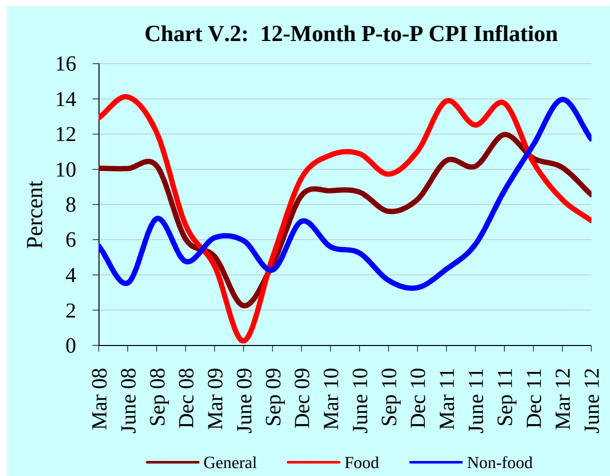
4.7 Imports of intermediate goods mainly used for manufacturing output decreased by 6.5 percent during Q4FY12. Among the intermediate goods imports of dyeing and tanning materials (+30.9 percent), raw cotton (+25.2 percent) and staple fibre (+161.1 percent) increased while imports of clinker (-6.2 percent), crude petroleum (-39.5 percent), POL (-3.8 percent), chemicals (-6.6 percent), pharmaceutical products (-25.8 percent), fertilizer (-44.7 percent), plastic and rubber articles thereof (-2.5 percent), yarn (-40.6 percent) and textile and articles thereof (-1.4 percent) decreased. Imports of capital goods and others recorded 10.0 percent decline in Q4FY12, of which imports of iron, steel and other base metals increased by 1.3 percent while imports of capital machinery (-31.5 percent) and other capital machineries (-5.3 percent) declined. During Q4FY12 LCs settlements for imports came down by 6.4 percent (y-o-y) to USD 8.04 billion which was USD 8.59 billion during the same period of previous fiscal. In spite of some decline in the current quarter, LCs settlements increased by 9.0 percent during FY12 to USD 34.81 billion compared to USD 31.95 billion during FY11.

4.8 The inflow of workers' remittance recorded USD 3.31 billion during Q4FY12 compared to USD 3.04 billion in Q4FY11. This slower growth was attributable due mainly to slower growth of remittances from Saudi Arabia (+8.0 percent), Qatar (+5.7 percent), Euro region (+3.6 percent) and a decline from rest of the world (except Gulf region, Euro region and Asia Pacific region). Overall, the inflow of workers' remittance increased by 10.2 percent to USD 12.84 billion during FY12 compared to USD 11.65 billion in FY11. During Q4FY12 remittances from Gulf region recorded 13.0 percent growth of which UAE recorded 17.4 percent and Oman recorded 59.3 percent and Bahrain recorded 68.1 percent, while remittance from Kuwait remained in the same level of same quarter of previous fiscal year. Remittances from the Asia pacific region recorded 29.6 percent growth while from rest of the world (including USA) it declined by 9.3 percent during the quarter under review. The major sources of remittance during the quarter was Saudi Arabia (USD 967.6 million) as usual, followed by UAE (USD 628.7 million), USA (USD 380.3 million), Kuwait (USD 296.4 million), and UK (USD 222.7 million) (Table IV.4).

V. Price Developments

5.1 After exhibiting an upward trend during FY11 and first half of FY12, point to point CPI inflation started to decline since February 2012 reaching to a 18-month low of 8.56 percent at the end of June 2012, due mainly to sharp decline in food inflation. As a result, 12-month average CPI inflation started to decline since March 2012 recording at 10.6 percent in June 2012, slightly above the projected target of single digit inflation. Given the continuation of tight monetary policy, the 12-month average CPI inflation is expected to soften further. However, the near term inflation outlook is conditioned by a number of factors that might emerge from upward adjustment of energy prices and any natural disruption in the crop production along with any instability in the global commodity market.





5.2 Before softening in June 2012, point to point overall CPI inflation edged up to 11.97 percent in September 2011, the highest spike since 1998, from 10.17 percent in June 2011. But during the last quarter of FY12, it climbed down significantly to single digit level of 8.56 percent in June 2012 from 10.10 percent in March 2012. It is obvious that decelerating trend in prices of food component was the driver of recent declining inflation. After rising up to 13.75 percent in September 2011, food inflation started to decline due to good domestic crop production and declining food prices in world market; it came down significantly to 7.08 percent in June 2012 which was 8.28 percent at the end of previous quarter. On the other hand, exhibiting fresh surge non-food inflation started to rise continuously since the beginning of FY12; it climbed up to 13.96 percent at a faster pace in March 2012 before easing to 11.72 percent in June 2012. In terms of contribution to overall inflation, the share of non-food inflation picked up sharply since

October 2011 and became the dominant source of inflation since February 2012 (Table-5.1). Food inflation was more acute in urban areas whereas non food inflation was more pronounced in rural areas. Continuing its upward surge for a long period, 12-month average CPI inflation climbed steadily to 10.96 percent in February 2012 and started to decline thereafter at a slower pace and reached to 10.62 percent in June 2012.

Table-5.1

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

Base Year (1995-96)=100

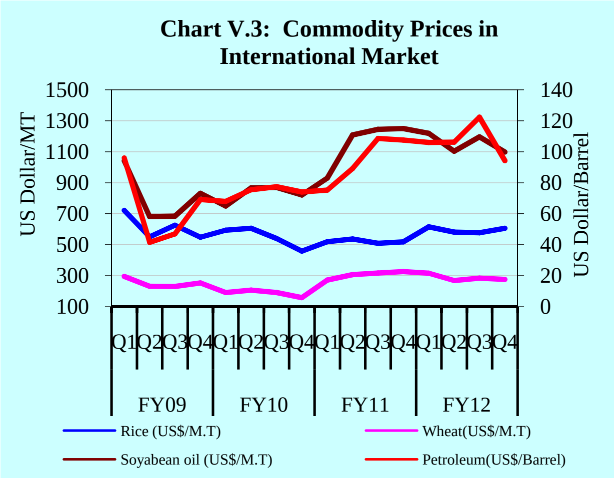
Months	**Food beverage & tobacco**	Clothing & Footwear	Gross rent, Fuel & Lighting	Furniture, Furnishing & Other	Medical care and Health Expenses	Transport & Communications	Recreation, Entertainment, Education & Cultural Services	Misc. Goods & Services	**Non-food**
Weight	**58.84**	6.85	16.87	2.67	2.84	4.17	4.13	3.63	**41.16**
Jan-11	**81.43**	4.43	5.78	2.51	0.56	1.55	1.64	2.11	**18.57**
Feb-11	**81.70**	4.42	5.78	2.23	0.66	1.73	1.46	2.03	**18.30**
Mar-11	**82.03**	4.34	5.96	2.11	0.66	1.79	1.09	2.03	**17.97**
Apr-11	**83.77**	4.31	4.55	2.13	0.63	1.75	0.80	2.06	**16.23**
May-11	**79.88**	5.38	4.73	2.43	0.93	3.11	0.77	2.77	**20.12**
Jun-11	**76.15**	6.20	5.32	2.52	0.97	4.29	0.81	3.74	**23.85**
Jul-11	**75.27**	7.26	4.66	2.49	0.97	4.41	0.77	4.19	**24.73**
Aug-11	**67.77**	10.90	7.90	2.61	1.05	4.53	0.85	4.39	**32.23**
Sep-11	**69.52**	9.68	8.09	2.33	1.04	4.50	0.80	4.04	**30.48**
Oct-11	**67.28**	10.36	8.46	2.60	1.12	5.18	0.85	4.16	**32.72**
Nov-11	**63.89**	10.91	11.35	2.45	1.11	5.18	0.88	4.22	**36.11**
Dec-11	**56.84**	12.23	15.03	2.87	1.44	5.78	1.01	4.79	**43.16**
Jan-12	**54.26**	11.29	19.73	2.88	1.55	5.29	0.71	4.29	**45.74**
Feb-12	**45.70**	12.96	23.74	3.56	2.00	6.11	0.87	5.06	**54.30**
Mar-12	**45.99**	12.65	23.39	3.59	2.16	5.87	0.93	5.42	**54.01**
Apr-12	**45.84**	12.47	24.02	3.39	2.16	5.86	0.91	5.36	**54.16**
May-12	**45.61**	12.49	25.45	3.41	2.03	4.96	0.96	5.08	**54.39**
Jun-12	**46.15**	12.37	26.37	3.41	2.36	3.99	1.00	4.33	**53.85**

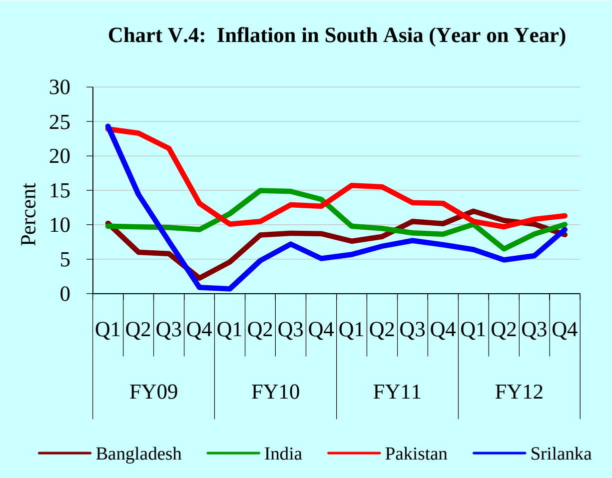
@ Contribution of ith Group=(Inflation in ith group*Weight of ith group in CPI basket/Headline inflation)*100

5.3 Favourable crop production in the country, declining food and non food commodity prices in the international market and cautious restrained monetary policy pursued by Bangladesh Bank (BB) were the main causes of decelerating inflation during the period under review. Satisfactory crop production was achieved in the country in last *aman* and *boro* seasons well supported by benign weather condition and adequate input and credit supply to the farmers.

International prices of most commodities also weakened during Q4 of FY12. However, the benefit from lower global commodity prices to Bangladesh was partly offset by upward adjustment of oil price. Though global crude oil prices have declined since March 2012, successive upward adjustment of administered energy prices (petroleum oil, CNG and elasticity prices) in domestic market was contributing to overall inflation highly during the period under review (Table-5.1). To bring inflation down to its targeted path, Bangladesh Bank continued restrained monetary policy for FY12, while ensuring adequate private sector credit to stimulate inclusive growth. It may be mentioned that BB's monetary policy uses repo, reverse repo, and BB bill rates as policy instruments for influencing financial and real sector prices toward the targeted path of inflation.

5.4 Given the pursuance of restrained monetary policy, it may expect that non food inflation will also ease down to a comfortable position in the following months. But the attainment of the level of inflation in line with the target path in coming months will be conditioned by the magnitude of further exchange rate depreciation and upward adjustment of administered energy prices, satisfactory domestic crop production and stable food and non-food price in the global market.



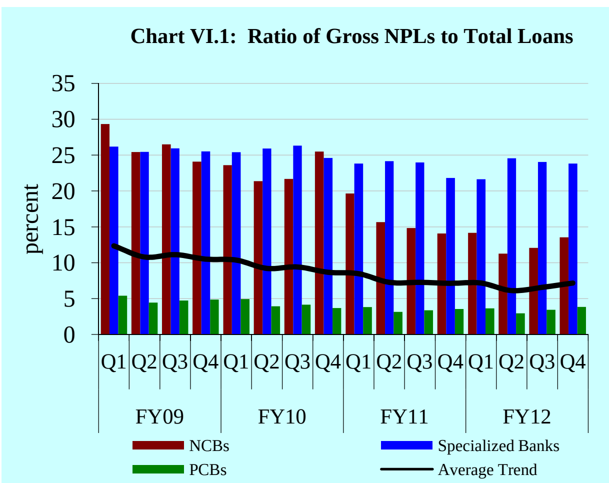


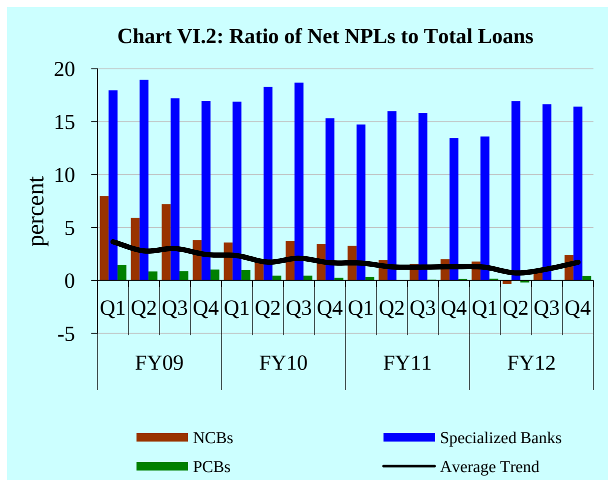
5.5 CPI inflation in our neighbouring countries was exhibiting rising trend during the quarter under review. In spite of continual monetary contraction in India, point-to-point CPI inflation increased to 10.05 percent in June 2012 from 8.65 percent in March 2012, while WPI inflation decreased to 7.25 percent in June 2012 from 7.69 percent in March 2012. In Pakistan, point-to-point CPI inflation went up to 11.30 percent in June 2012 from 10.80 percent in March 2012. In

Sri Lanka, inflation increased sharply to 9.3 percent in June 2012 from 5.5 percent in March 2012.

VI. Banking Sector Performance Trend

6.1 Major indicators describing banking sector performance showed mixed trends during the period under review. Risk weighted capital asset ratio (RWCAR) for all banks remained fixed while the ratio of non-performing loan (NPL) to total loan for the banking sector, in both gross and net terms, increased. The return on asset (ROA) and return on equity (ROE), two important measures of bank profitability, declined while the interest rate spread (IRS) for all banks increased during the period.





6.2 The RWCAR for all banks remained unchanged at 11.31 percent during end-June 2012 as compared to end-March 2012. This ratio for state owned commercial banks (SCBs) and private commercial banks (PCBs) declined marginally from 11.48 percent and 11.49 percent at end-March 2012 to 11.16 percent and 11.43 percent respectively at end-June 2012. However, for specialized banks (SBs) and foreign commercial banks (FCBs), the ratio increased from (-) 4.43 percent and 20.87 percent to (-) 4.34 percent and 21.45 percent respectively during the same period. The RWCAR, however, remained significantly above the regulatory requirement of 10 percent only for FCBs and marginally higher for PCBs and SCBs (Table VI.1).

6.3 The ratio of gross NPL to total loans of the banking sector increased from 6.57 percent at end-March 2012 to 7.17 percent at end-June 2012. Gross NPL ratio for the state owned commercial banks (SCBs) increased to 13.54 percent at end-June 2012 from 12.06 percent at end-March 2012 (Chart VI.1). For the private commercial banks (PCBs) the ratio also increased from 3.44 percent to 3.84 percent, while for the specialized banks (SBs) and the foreign commercial banks (FCBs), the ratio declined from 24.05 percent to 23.83 percent and 3.2 percent to 3.17 percent respectively during the same period. On the other hand, net NPL ratio for all banks increased marginally from 1.07 percent at end-March 2012 to 1.71 percent at end-June 2012. Net NPL ratio for the SCBs increased from 0.78 percent at end-March 2012 to 2.38 percent at 13.5 percent at end-June 2012 (Chart VI.1). For the PCBs and FBs the ratio also increased from 0.03 percent and (-) 1.46 percent to 0.42 percent and (-) 1.33 percent respectively during the same period. However, for SBs, similar ratio declined marginally from 16.64 percent to 16.42 percent (Table VI.3 and Chart VI.2).

6.4 Among the profitability measures, overall return on assets (ROA) in the banking sector declined marginally from 1.54 percent at end-December 2011 to 1.16 percent at end-June 2012. The ROA for SCBs, SBs and PCBs declined from 1.34 percent, 0.03 percent and 1.59 percent at end-December 2011 to 0.75 percent, (-) 0.04 percent and 1.19 percent respectively at end-June 2012. However, the ROA for FCBs increased marginally from 3.24 percent to 3.78 percent during the same period. On the other hand, overall return on equity (ROE) declined from 17.02 percent at end-December 2011 to 13.49 percent at end-June 2012 due mainly to a sharp decline in ROE for SCBs from 19.66 percent to 11.72 percent and a moderate decline for PCBs from 15.69 percent to 12.39 percent although ROE for FCBs and SBs increased from 16.58 percent and (-) 0.92 percent to 19.43 percent and 1.39 percent respectively during the same period (Table VI.4).

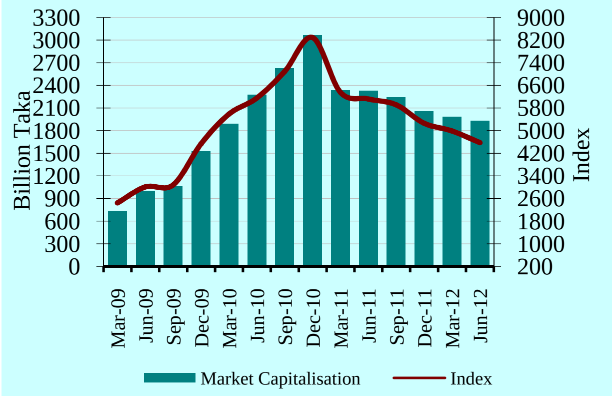
6.5 Excess liquidity in the scheduled banks increased to Tk. 446.23 billion at end-June 2012 from Tk. 386.65 billion at end-March 2012. At end-June 2012, excess liquidity held by SCBs, PCBs, SBs and FCBs are Tk. 157.23 billion, Tk. 191.56 billion, Tk. 10.08 billion and Tk. 45.39 billion respectively.

6.5 At end June 2012, the interest rate spread (IRS) stood at 5.79 percentage points for all banks marginally higher than 5.60 points of end March 2012. Both the deposit and lending interest rates increased from 8.07 percent and 13.67 percent at end-March 2012 to 8.10 percent and 13.89 percent respectively at end-June 2012. However, IRS for FCBs decreased from 9.21 percent to 8.82 percent during the period under review while for SCBs, SBs, and PCBs it increased from 4.84 percent, 2.55 percent and 5.59 percent to 5.14 percent, 2.94 percent and 6.03 percent respectively during the same period (Table II.3).

VII. Capital Market Development

7.1 The government has taken various steps of which tax rebate and rationalizations of margin loans regulation are prominent that played positive role in influencing investors to increase investment in the capital market. It improved the overall performances of the capital market. Nonetheless, the performance of capital market in terms of DSE general index and market capitalization remained subdued as of June 2012 due mainly to lack of confidence of the small and retail investors. At the end of Q4 FY12, DSE general index and market capitalization decreased by 8.36 percent and 2.72 percent respectively over the previous quarter. On year-on-year basis, however, the DSE general index and market capitalization decreased by 25.25 percent and 16.59 percent respectively.

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



7.2 Despite decreases in DSE index and market capitalization, the liquidity situation in the capital market improved in terms of increased turnover during the current quarter. The volume of total turnover increased to Tk. 282.88 billion as compared with Tk. 230.14 billion in previous quarter recording a strong growth of 22.92 percent. The number of listed securities has increased to 290 in June'12 from 283 in March'12. The value of issued equity and debt has also increased by 9.98 percent during the quarter under review (Table VII.1).

7.3 Sector-wise DSE data shows that during the Q4FY12 market capitalization declined in all sectors except cement and telecommunications. The domination of banks, power, pharmaceuticals and telecommunications in total market capitalization with significant contribution from cement industries continued in the current quarter. The share market capitalization of banking sector stood at 26.50 percent in Q4 FY12 against 28.79 percent in Q3 FY12.

7.4 The overall price earnings ratio of the market came down to 12.53 in June 2012 from historical high of 29.16 in December’ 2010 creating an attractive investment environment in the capital market of Bangladesh. In view of improving the overall performances to bring back confidence of small and retail investors in the capital market, increased participation of institutional and foreign investors are required.

VIII. Near and Medium-term Outlook

8.1 The recent performances of world’s economies remained mostly subdued due to multiple rounds of economic and financial crises in the recent past. European growth has slowed sharply and many economies in the region are now in or close to recession. In the Middle East and North Africa (MENA), unrest has spread, further depressing the outlook for the region even as some economies rebuild after earlier conflicts. In other regions, however, developments have been sort of positive. The United States has seen a spate of encouraging economic news, with growth increasing and unemployment falling. Asia has weathered the global slowdown well and looks headed for a soft landing (WEO, April 2012).

8.2 The economic activities in Bangladesh remained broad based recording a real GDP growth of 6.32 percent underpinned by a significant contribution from industry and manufacturing sector in FY12. Despite recurrent crises in the global arena, the Bangladesh economy shows its resiliencies by maintaining more than six percent real GDP growth in recent years. The CPI inflation, on the other hand, has been declining since February 2012 reaching to an 18-month low of 8.56 percent (p-t-p basis) at the end of June 2012, due mainly to sharp decline in food inflation. Given the continuation of tight monetary policy, the CPI inflation is expected to soften further.

8.3 The near-term outlook of the Bangladesh economy remained broadly positive. The GDP growth target has been set at 7.2 percent, while the target for CPI inflation has been set at 7.5 percent for FY13. In view of the economy’s past growth performance, the GDP growth target is not unrealistic. For achieving the targeted growth, the near term policy thrust requires sustenance of recent economic activities and strengthened support to lead the economy to higher growth. In particular, in view of recent developments in the food market, it would be important to put emphasis within the near term policy agenda on ensuring a good aman harvest in the coming season along with rapid expansion of SMEs and non-farm activities. The near term inflation outlook is, however, conditioned by a number of factors that might emerge from upward adjustment of energy prices and any natural disruption in the crop production along with any instability in the global commodity market.

8.4 Satisfactory growth in productivity is crucial to ensuring the positive near-term economic outlook which has been suffering from continuing power shortages, other infrastructure bottlenecks, and socio-political events. It would be important to strengthen the infrastructure and other support services and ensure congenial business climate especially prior to the general election in early 2014. Failure to ensure this would widen the gap between rising aggregate demand and domestic production creating new challenge for economic management with consequent adverse impact on production and growth.

8.5 The possibility of unexpected events including floods and other socio-political instability could substantially change the outlook. Thus it would be important to take precautions against any unexpected natural calamities along with ensuring timely supply of inputs to the farmers and take measures to minimize domestic vulnerabilities and risks.

8.6 In the backdrop of weak global growth outlook, a downturn in the demand for Bangladesh’s exports especially of RMG exports may come into effect. Bangladesh needs to remain alert regarding its competitiveness of exports especially in price-sensitive RMGs. It would also be important to ensure enough flexibility to absorb the shocks and adapt to any disruption emanating from external economic shocks. For meeting such challenges, the policies need to build solid macroeconomic fundamentals supported by prudent monetary, fiscal, and exchange rate policies.