Part A: Economic and Financial Developments

Overview and Executive Summary

In the second quarter of FY14, economic activities across all sectors and especially the dominant services sector were generally dampened due to political instability prevailing at the time. Moreover, negative 8.87 percent growth of remittance inflow compared to the same period of previous fiscal year is also likely to have adverse effects on consumption and investment demand. Among other indicators, ADP utilization experienced a slow growth of 10.39 percent compared to the same period of previous fiscal year while private sector credit growth was only 10.6 percent. A number of proxy indicators (trade financing, bank advances to transport and communication sectors, and number of mobile phone subscribers) suggest sluggish expansion of service sector activities in Q2FY14. On a brighter note, exports registered a satisfactory growth of 11.88 percent in Q2FY14 compared to Q2FY13 which has driven manufacturing growth.

Point-to-point CPI inflation followed an upward trajectory during Q2FY14 due to rising food inflation, which was primarily driven by higher rice prices at the retail level. Food inflation reached 9.0% in December 2013. In contrast, point-to-point non-food inflation exhibited a consistently declining trend since November 2012 and reached 4.88 percent in December 2013, partly due to the slowdown in economic activity. Rising food inflation thereby drove up average CPI inflation to 7.53 percent in December 2013.

Bangladesh experienced a positive current account balance (CAB) of USD 1.11 billion in Q2FY14, about USD 258 million higher than that of the same period last year. A rise in export earnings largely contributed to this growth making up for the negative growth in remittances. Foreign exchange reserves continued to expand – increasing to USD 18.08 billion at the end of Q2FY14 compared to USD 12.75 billion at the end of Q2FY13. The foreign exchange market remained reasonably stable as the exchange rate stayed at Tk. 77.75 per USD. This is partly due to Bangladesh Bank's intervention in the foreign exchange market, with a net purchase of USD 1.29 billion worth of foreign currencies, designed to preserve Bangladesh's export competitiveness

Preliminary estimates show that domestic revenue increased by 5.3 percent during Q2FY14, whereas total expenditure grew by 13.3 percent from the second quarter of FY13. The overall budget deficit for H1FY14 was 1.31 percent of GDP, which is very similar to the deficit of 1.32 percent of GDP in H1FY13. Domestic financing of the second quarter deficit, Tk. 86.3 billion, exceeded foreign financing, Tk. 51.2 billion. Of the domestic financing sources, financing from *the banking sector increased to Tk. 54.4 billion from the (-) Tk.4.8 billion in Q1FY14, and financing from non-banking sector also increased to Tk. 31.9 billion from Tk.18.3 billion in Q1FY14. The growth in non-banking sector domestic financing in H1FY14, primarily through the sale of National Savings Certificates, is a key difference with H1FY13*

Broad money (M2) growth decelerated from 19.0 percent in December 2012 to 15.6 percent (y-o-y) in December 2013. This was a result of slower growth in net foreign assets as well as domestic credit. Growth in private sector credit slowed to 10.6 percent in December 2013 from 16.6 percent in the earlier year. Reserve money growth declined from 15.6 percent in December 2012 to 13.3 percent (y-o-y) in December 2013.

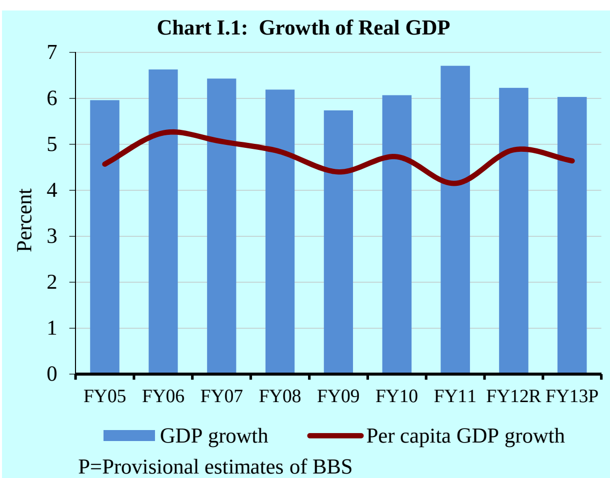
Banking sector indicators for Q2FY14 show a more optimistic outlook compared to the previous quarter in light of the relaxation of the loan rescheduling policy in December 2013, which was done to provide temporary relief to viable businesses due to the nationwide disruptions. The ratio of non-performing loans (NPL) to total loan for the banking sector, in both gross and net terms, decreased at the end of Q2FY14 compared with that of end Q1FY14. Gross NPL fell from 12.8 percent at the end of Q1FY14 to 8.9 percent at the end of Q2FY14. During the same period, the capital adequacy ratio (CAR) increased to 11.5 percent from 9.1 percent in Q1FY14. Among the profitability measures, return on asset (ROA) in the banking sector improved from 0.6 percent at the end of December 2012 to 0.9 percent at the end of December 2013, primarily due to an increase in non-interest income of the sector and the small provision deduction requirement for bad debt by the SCBs. Return on equity (ROE) of the banking industry improved too, from 8.2 percent in late December 2012 to 10.8 percent at the end of December 2013.

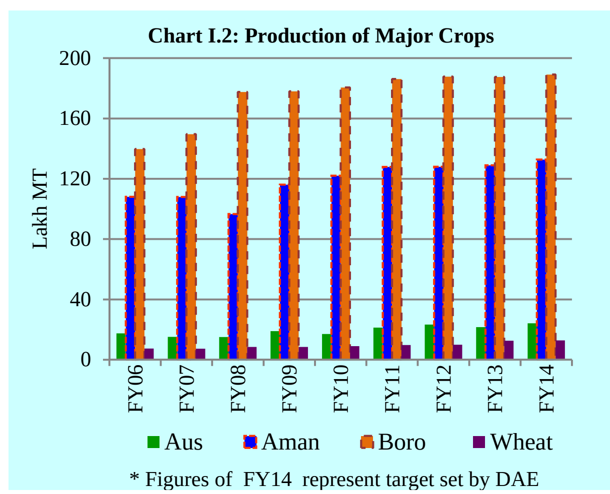
Bangladesh Bank's current forecast for output growth in FY14 range between 5.8 percent and 6.1 percent. Bangladesh Bank will update its forecasts on a regular basis during the course of the year and the monetary program will also be flexible in accommodating any significant change in these forecasts.

I. Developments in the Real Economy

1.1 In the second quarter of FY14, economic activities across all sectors and especially the dominant services sector were generally dampened due to political instability prevailing at the time. Moreover, negative (-) 8.87 percent growth of remittance inflow compared to the same period of previous fiscal year is also likely to have adverse effects on consumption and investment demand. Among other indicators, ADP utilization experienced a slow growth of 10.39 percent compared to the same period of previous fiscal year. However, export registered a satisfactory growth of 11.88 percent in Q2FY14 compared to Q2FY13, which was the driving force of manufacturing growth.

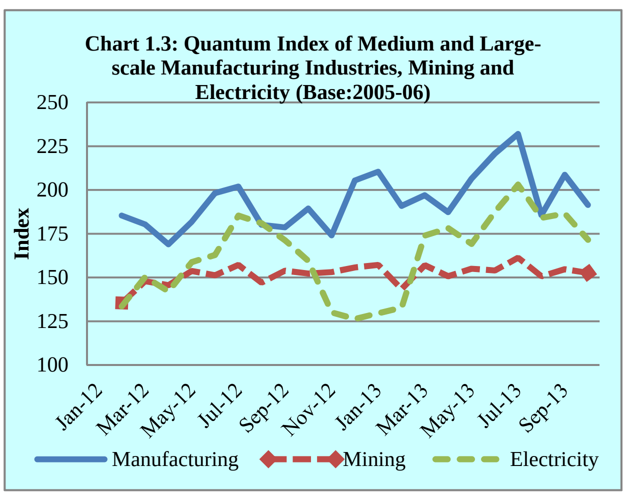
1.2 In Q2FY14 the *aman* crop, harvested in the second quarter, is expected to meet its annual production target of 13.28 mmt, as acreage was higher than target. This follows slightly lower than target *aus* rice output in Q1FY14 where 2.41 mmt *aus* was produced, lower than the annual target of 2.43 mmt. Though data on actual production is yet to be made available, preliminary information from the Department of Agricultural Extension (DAE) shows that transplanted *aman* crop, potato and wheat have grown on 3.5, 10.0 and 7.9 percent more land respectively than targeted. Higher acreage of wheat suggests that wheat production will surpass its target of 1.28 mmt significantly in the absence of major weather related disruptions. Potato output also registered a bumper production but the disruptions in Q2FY14 led to low market prices and farmers suffering a loss on this crop.

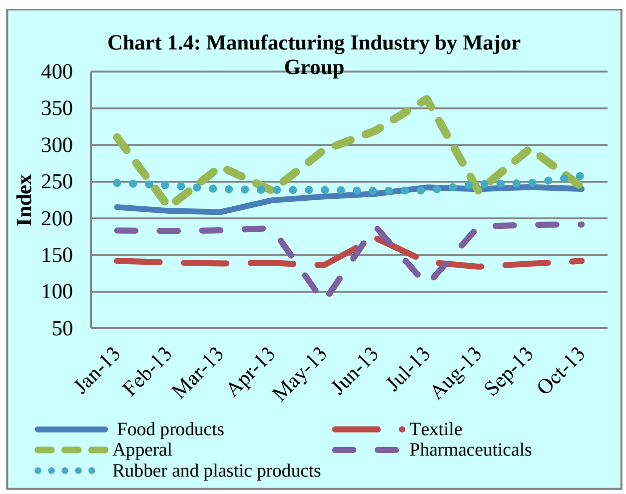




1.3 On the basis of 2005-06 base year data, large and medium scale manufacturing industries grew by 9.03 percent in July-October 2013 compared to the same period last year, while this growth was subdued at 1.04 percent in October 2013 (Chart-1.3). Apart from industrial output, moderate growth of credit to the construction sector (10.87 percent) in the Q2FY14 along with low growth of cement production (2.66 percent) in the first month of Q2FY14 reflects subdued growth of the construction sector during the quarter.

1.4 Though service sector data is available only on an annual basis, a number of proxy indicators (such as trade financing, bank advances to transport and communication sector, and number of mobile phone subscribers, etc.) reflect sluggish expansion of service sector activities in the country during the second quarter of FY14. Following the same trend of the first quarter of current fiscal year, bank advances (outstanding) to trade and commerce sector registered a low growth of 11.58 percent in Q2FY14 (table 1.9 in appendix), while bank advances to the transport and communication sectors experienced negative growth of (-) 6.63 percent compared to the same period of previous fiscal year. These low/negative growth rates of bank advances to various service related sectors may be a reflection of moderate expansion of trade and transport related services, which were badly affected by frequent nationwide shutdowns. Presumably, tourism and hotel and restaurant business faced sluggish demand during the quarter under review, as intensity of national strikes was relatively high during this quarter which includes the first two months (November and December) of the peak tourism period in Bangladesh. Apart from these, the number of mobile phone subscribers increased to 113.78 million at the end of Q2FY14 from 110.68 million at end of Q1FY14, showing a subdued 2.80 percent growth.





1.5 BB's current forecast is that output growth will pick up in H2FY14 and this will partly make up for the losses faced in H1FY14 – overall BB's current forecast for FY14 ranges from 5.8%-6.1%. This is based on various modeling exercises conducted in-house at BB as well as professional judgment based on the trajectory of key economic indicators. . BB will update its forecasts on a regular basis during the course of the year and the monetary program will also be flexible in accommodating any significant change in these forecasts.

II. Money and Credit Market Development

2.1 Broad money (M2) growth slowed to 15.6 percent (y-o-y) in December, 2013 from 19.0 percent in December 2012, and remained lower than the programmed growth of 17.0 percent for the period. The lower M2 growth resulted from slower growth in net foreign assets (35.2 percent compared with 48.7 percent in December 2012) as well as domestic credit (10.8 percent compared with 14.3 percent in December 2012). On account of weaker credit demand from the private sector, domestic credit growth remained lower than the programmed growth of 15.3 percent. The growth in private sector credit slowed to 10.6 percent in December 2013 from 16.6 percent a year earlier. However, growth in credit to the public sector increased to 11.6 percent (y-o-y) in Q2FY14 compared to 6.3 percent in Q2FY13. Growth in net foreign assets declined to 35.2 percent in December 2013 from 48.7 percent in December 2012 due mainly to lower inflows of remittance.

2.2 Reserve money growth slowed to 13.3 percent (y-o-y) in December 2013 from 15.6 percent in December 2012 due to sharp decline in growth of net domestic assets of BB (down by 111.3 percent compared with 41.7 percent decline in December 2012). The decline in NDA of BB was attributable to the large decline in lending to the public sector and to the deposit money banks. The growth of NFA (41.2 percent) in December 2013 was mainly due to purchase of foreign currency to avoid a significant loss of external competitiveness eg. USD 2353 million was purchased by BB in the first half of FY14.

Chart II.1: Sources of Reserve Money

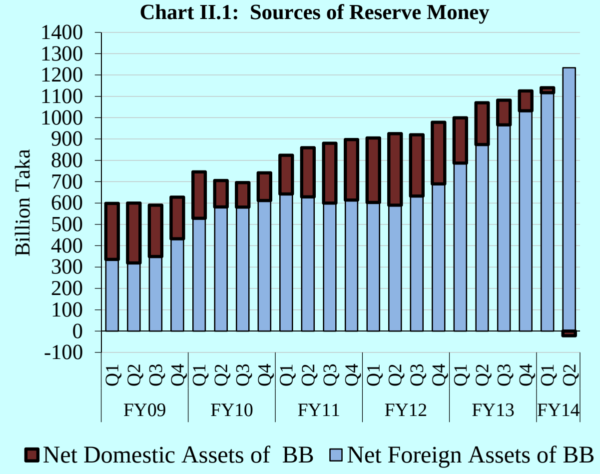
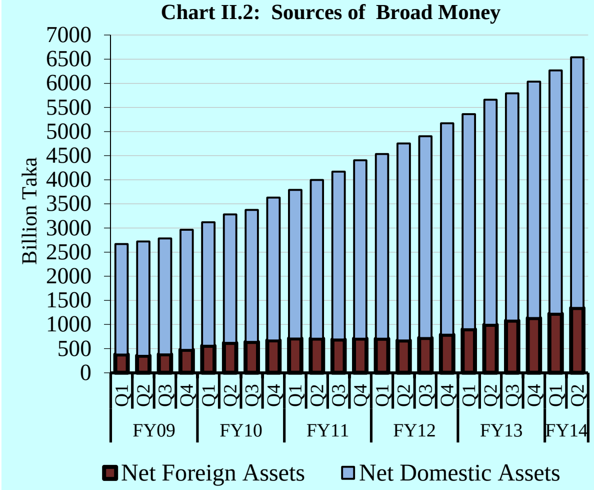


Chart II.2: Sources of Broad Money



2.3 A look at the components of M2 shows that growth of currency increased to 12.2 percent during Q2FY14 from 11.7 percent in Q2FY13. But the growth in demand deposits and time deposits slowed to 3.9 percent and 17.4 percent (y-o-y) respectively during Q2FY14 compared with the growth of 7.7 percent and 21.7 percent respectively during Q2FY13. This could partly be due to an increase in demand for National Savings Certificates (NSC) as the yield differential between banks fixed deposits and NSC instruments widened over the past few months.

2.4 In Q2FY14, a slightly broader definition of private sector credit which includes micro-finance institutions (in addition to banks and non-banks) grew by 12.0 percent compared with 16.2 percent in Q2FY13. Bank advances to the transport and communication sector had negative growth of 6.6 percent in Q2FY14, which is the most recent period for which data is available. Credit to the construction, industry and trade sectors stood at 10.9 percent, 3.8 percent and 11.6 percent respectively in Q2FY14. In the agriculture sector the supply of credit increased by 27.3 percent at end of Q2FY14 (of which crops increased by 27.8 percent and others by 21.0 percent). Credit for working capital financing increased by 38.1 percent in Q2FY14 compared with 13.6 percent in Q1FY14.The highest share of bank advances went to the trade sector (37.8 percent) followed by the industry (34.3percent) and term loan (17.5) (Table I.9).

Chart II.3: Trends in Private Sector Credit

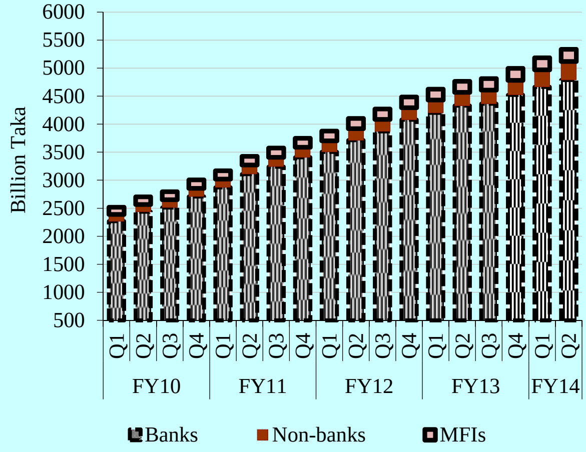


Chart II.4: Yield on T-Bills

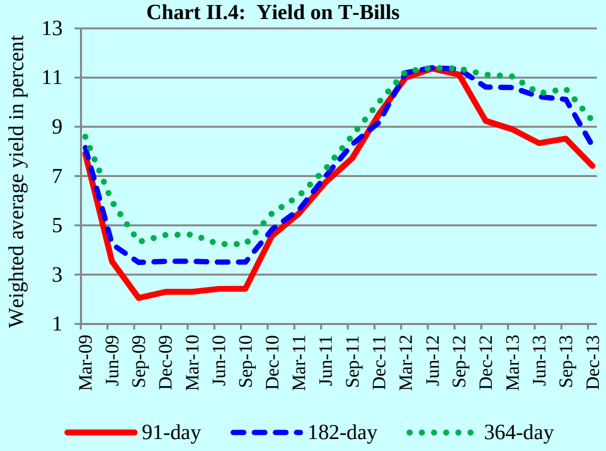
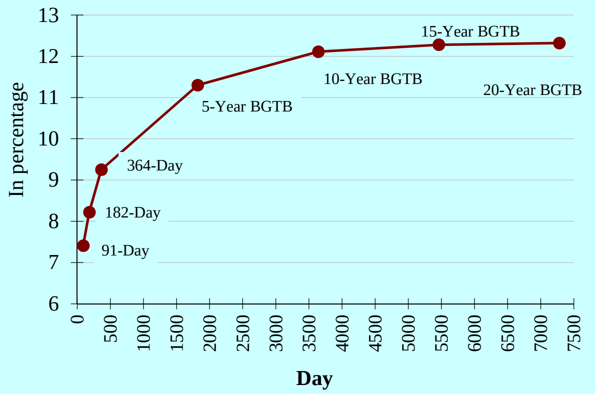


Chart II.5: Weighted average yield of accepted Government Treasury Bills & Bonds (End December, 2013)



2.5 The BB repo and reverse repo rates remain unchanged at 7.25 and 5.25 percent respectively in December, 2013. The weighted average call money rate which was relatively volatile at the beginning of FY12 is now hovering around the middle of the policy interest rate corridor (Chart II.6). The call money rate came down to 7.11 percent at the end of December, 2013 which was 9.34 percent at the end of December, 2012 reflecting more liquidity in the money market. Government security rates also fell, except for long term bond yields. The rate of 30-day Bangladesh Bank bills decreased to 7.1 percent in December 2013 from 8.9 percent in December 2012. Overall yields on short term treasury bills e.g., 91-day decreased to 7.41 percent in December, 2013 from 9.24 percent in December, 2012 and 182-day, 364-day treasury bills rates were decreased to 8.22 and 9.25 percent respectively at end of December, 2013 from 10.62 and 11.12 percent respectively at the end of December, 2012. Yields on long-term bond such as 5-year and 10-year BGTB also decreased to 11.30 and 12.11 percent at the end of December, 2013 from 11.52 and 11.80 percent in December, 2012 (Table II.3), while the yields on 15-year, and 20-year BGTB both increased from 12.10 and 12.28 percent respectively to 12.28 and 12.32 percent in December, 2013. The spread between lending and deposit rates decreased from 5.3 percent at end of Q2FY13 to 5.1 percent at the end of Q2FY14.

Chart II. 6: Policy Rates & Call Money Rate

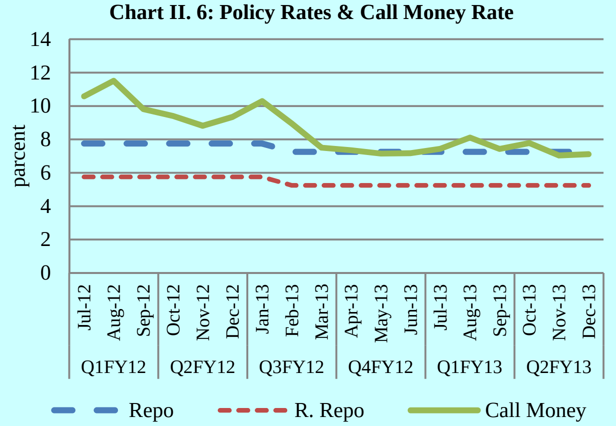
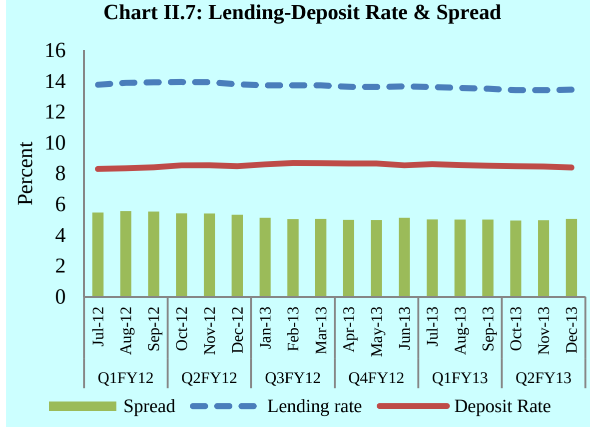
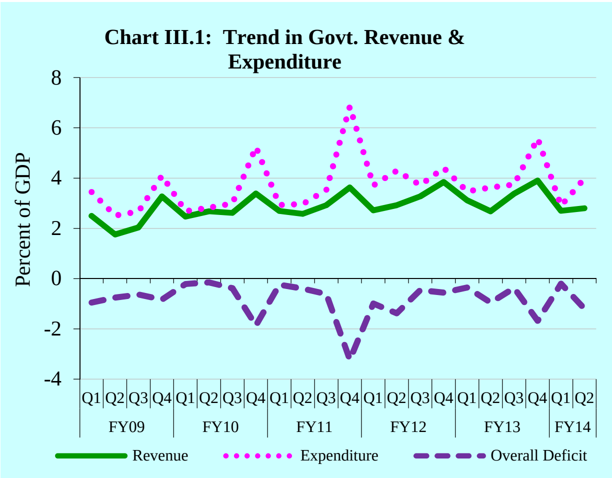


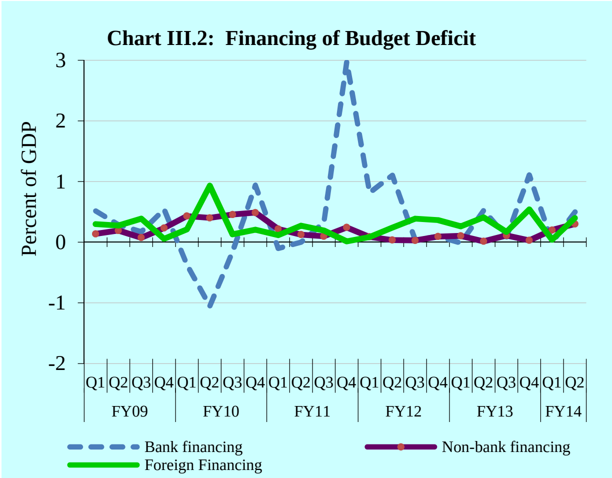
Chart II.7: Lending-Deposit Rate & Spread



III. Fiscal Developments

3.1 Preliminary estimates show that total revenue increased by 5.3 percent whereas total expenditure grew by 13.3 percent during Q2FY14 compared with Q2FY13. During H1FY14 revenue collection was 39.3 percent, while expenditure ran at 36.5 percent of the full year budgeted outlay respectively. Accordingly, the overall budget deficit for H1FY14 amounted to 28.3 percent of the annual budgeted deficit or 1.31 percent of GDP very similar to the deficit of 1.32 percent of GDP in H1FY13. Domestic financing and disbursements of net foreign financing grew faster compared to Q2FY13 (Table III.1 and Chart III.1 & III.2).





3.2 During Q2FY14, total NBR revenue increased by 6.4 percent to Tk. 254.8 billion (18.7 percent of the annual target of FY14) from Q2FY13. Revenue collection from income tax, value added tax (VAT), and other sources grew by 10.5 percent, 4.6 percent, and 10.0 percent respectively during the quarter under review. Revenue from custom duties, on the other hand, decreased by 3.0 percent during Q2FY14 due to a decline in imports payment, which was affected by the nationwide shutdown during the quarter. The overall NBR tax revenue collection in H1FY14 reached Tk. 503.4 billion (37.0 percent of the target of FY14), which is 11.9 percent higher than the level of H1FY13.

3.3 During the Q2 FY14, a preliminary estimate of total expenditure was Tk. 471.1 billion (21.2 percent of annual target), which was 13.3 percent higher, in nominal terms, than that of Q2FY13. The current expenditure grew by 22.0 percent to Tk. 300.1 billion in Q2FY14 and ADP expenditure grew by 10.4 percent to Tk. 110.9 billion (16.8 percent of annual ADP) compared to Q2FY13.

3.4 During H1FY14, total government expenditure is estimated at Tk.813.1 billion (36.5 percent of FY14 target or 6.8 percent of GDP), which is 19.4 percent higher in nominal terms than the level of H1FY13. During this period current expenditure grew to Tk. 477.3 billion (42.1

percent of FY14 budgeted amount or 4.0 percent of GDP), which is 10.1 percent higher in nominal terms relative to H1FY13. The Annual Development Program (ADP) outlays reached Tk.180.9 billion (27.5 percent of FY14 budget or 1.5 percent of GDP), which is 10.1 percent higher than it was in H1FY13, but running behind the whole year target, as outlays were only 27.5 percent of FY14 budget.

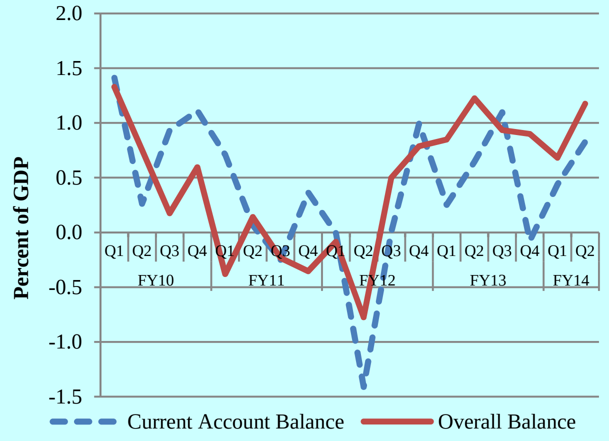
3.5 The overall fiscal deficit stood at Tk. 137.6 billion during Q2FY14, representing 1.2 percent of GDP compared with Tk.98.9 billion or 0.95 percent of GDP in Q2FY13. Domestic financing of the deficit at Tk.86.3 billion in Q2FY14 was much higher than the Tk. 56.3 billion registered in Q2FY13. Foreign financing of deficit at Tk. 51.2 billion in Q2FY14 was also higher than the Tk.42.6 billion disbursed in Q2FY13. Of the domestic financing sources, financing from the banking sector increased to Tk. 54.4 billion from the (-) Tk.4.8 billion in Q1FY14, and financing from non-banking sector also increased to Tk. 31.9 billion from Tk.18.3 billion in Q1FY14.

3.6 The overall fiscal deficit in the first half of FY14 amounted to Tk. 155.6 billion, or 1.3 percent of GDP, compared to Tk.136.7 billion, also 1.3 percent of GDP, in H1FY13. A look at the sources of financing the deficit shows that Tk. 99.7 billion in H1FY14 (Tk. 64.9 billion in H1FY13) was accommodated from domestic sources that included bank financing of Tk. 49.6 billion and non-bank financing of Tk. 50.2 billion, while the remaining amount of Tk. 55.9 billion (Tk. 71.8 billion in H1FY13) came from foreign sources in H1FY14. The growth in non-banking sector domestic financing in H1FY14, primarily through the sale of National Savings Certificates, is a key difference with the same period in FY13. The share of non-banking sector domestic financing in total budget financing was 32.3% in H1FY14 compared with 9.1% in H1FY13.

IV. External Sector Developments

4.1. Balance of payments position in Q2FY14 remained reasonably comfortable driven largely by a positive current account balance (CAB) of USD 1.11 billion, about USD 258 million higher than Q2FY13. Faster growth in export earnings coupled with slower growth in import payments contributed to this development. The overall balance was in surplus to the amount of USD 1.57 billion during the quarter. Foreign exchange reserve accumulation continued its upward trend, increasing to USD 18.08 billion at the end of Q2FY14 compared with USD 12.75 billion at the end of the same quarter last year.

Chart IV.1: Trends in CAB & overall balance



4.2 The combined capital & financial account recorded a lower surplus of USD 264 million during Q2FY14 compared with a surplus of USD 1246 million in the corresponding quarter of the previous fiscal year. While the capital account surplus of USD 100 million was similar to last year (USD 108 million in Q2FY13) the financial account recorded a surplus of USD 164 million which is significantly lower than the surplus of USD 1138 million in Q2FY13 mainly because of a decline in net trade credit (Table IV.1).

4.3 Preliminary data show that total foreign aid, comprising of loans and grants, disbursed by the multilateral and bilateral donors, was USD 886.6 million during Q2FY14 compared with USD 785.7 million during the same period of FY13. Out of the total foreign aid, USD 778.7 million was disbursed as MLT loan and USD 107.9 million as grants during the quarter, compared with USD 669.2 million as MLT loan and USD 116.5 million as grants during Q2FY13. During the quarter, Bangladesh made an amortization payment of USD 189.3 million of which USD 156.8 million was paid as principal and USD 32.5 million as interest. As a result, Bangladesh received net foreign loans and grants of USD 729.8 million during Q2FY14, significantly higher than the 556.5 million during the same quarter of the previous fiscal year (Table IV.8).

Chart IV.2: Exchange Rate Movements

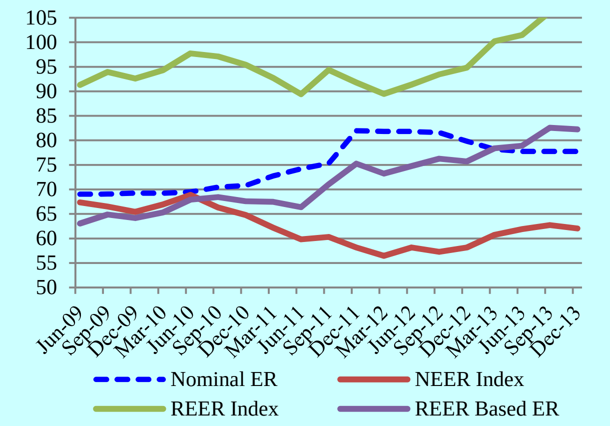
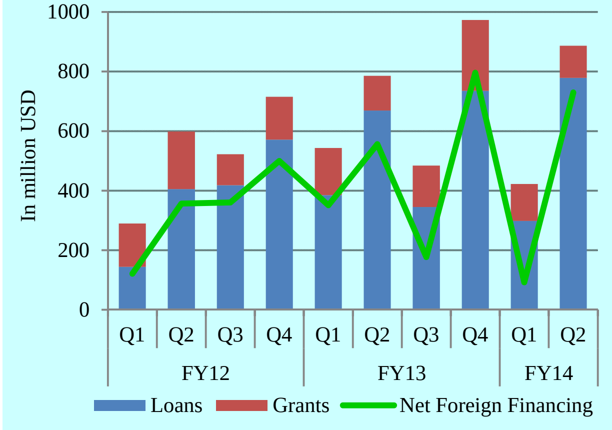
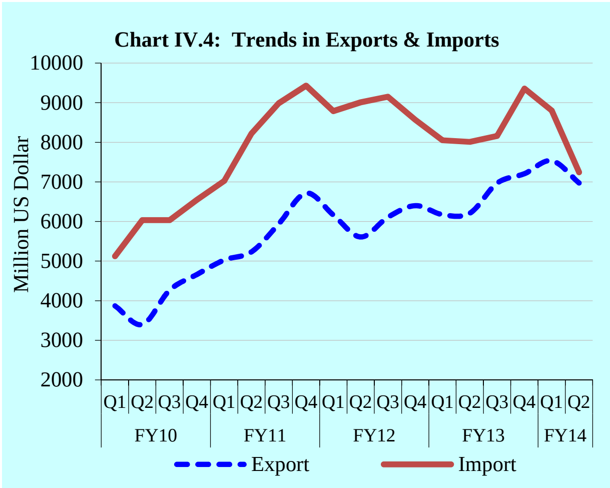


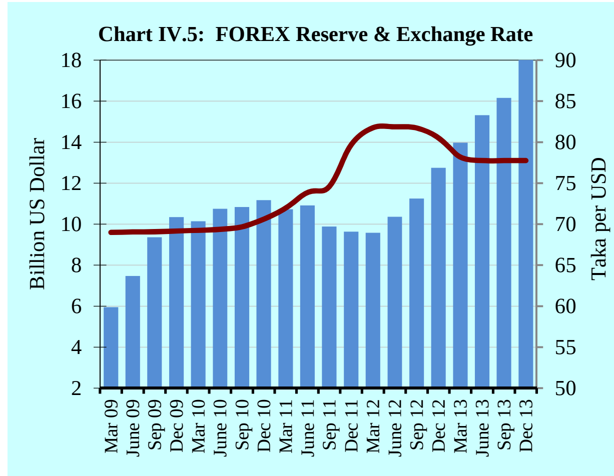
Chart IV.3: Trends in Foreign Aid Inflow



4.4 The foreign exchange market remained mostly stable as the exchange rate stayed at Tk. 77.75 per USD during Q2FY14 despite higher export earnings and lower import payments. As a short run measure of smoothening volatility in the exchange rate, Bangladesh Bank continued its intervention in the domestic foreign exchange market with a net purchase of foreign currencies amounting to USD 1.29 billion during Q2FY14. REER based exchange rate decreased over the same period from Tk. 82.55 per USD at the end of September 2013 to Tk. 82.24 per USD at the end of December 2013.

4.5 According to the Export Promotion Bureau (EPB), export earnings increased by 11.88 percent to USD 7.06 billion during Q2FY14 compared with USD 6.31 billion during the corresponding quarter of FY13. The growth in export was mainly RMG sector-driven, as the sector constituted 81.2 percent of the total export earnings. In Q2FY14, RMG export grew by 15.7 percent with earnings from European countries growing at 18.6 percent while growth from the US market was at 8.4 percent. Export to several “non-traditional destinations” gained momentum in Q2FY14. RMG related export increased in Turkey (+128.5 percent), India (+73.2 percent), Republic of Korea (+64.7 percent), Russian Federation (+62.9 percent) and China (+51.6 percent). Among other major export items, earnings from leather, and frozen shrimps & fish increased by 31.5 percent and 29.0 percent respectively. On the other hand, export earnings from raw jute, and jute goods declined by 47.2 percent and 5.3 percent respectively (Table IV.2 and IV.5).





4.6 Import payments (using banking sector data) increased by 10.7 percent to USD 8.99 billion during Q2FY14 compared to USD 8.12 billion in Q2FY13 (Table IV.3). Imports of food-grains rose by 76.7 percent during Q2FY14 to USD 270.2 million compared to USD 152.9 million in Q2FY13. This was driven by higher wheat imports which increased by 53.6 percent to USD 224.6 million during Q2FY14 compared with USD 146.2 million during Q2FY13. Rice imports also increased by USD 45.6 million during Q2FY14 compared with USD 6.7 million during Q2FY13. Imports of other food items decreased by 2.4 percent to USD 850.4 million during the quarter under review, compared to USD 871.6 million recorded during Q2FY13. Among the other food items, the import of sugar (-11.3 percent), and edible oil (-9.8 percent) decreased while spices (+71.3 percent), pulses (+5.2 percent), and milk & cream (+87.3) increased (Table IV.3).

4.7 Imports of intermediate and consumer goods increased by 13.8 percent (y-o-y) to USD 4.52 billion during Q2FY14. Among the intermediate goods, imports of POL (+15.5 percent), textile and articles thereof (+5.8 percent), raw cotton (+15.6 percent), plastic and rubber articles thereof (+28.7 percent), crude petroleum (+38.6 percent), and fertilizer (+1.4 percent) increased while imports of pharmaceutical products (-16.3 percent), and yarn (-4.1 percent) decreased. Imports of capital goods recorded a growth of 6.7 percent in Q2FY14 over Q2FY13 and specifically imports of iron, steel and other base metals recorded a 25.7 percent growth

4.8 During Q2FY14, the opening of import LCs increased by 10.83 percent to USD 9.21 billion, of which consumer goods (+27.30 percent), petroleum and petroleum products (+4.74 percent), capital machinery (+101.60 percent), industrial raw materials (+1.56 percent), machinery for miscellaneous industries (+0.41 percent) increased while intermediate goods (-8.40 percent) decreased (Table IV.9).

4.9 The overall inflow of workers' remittances recorded a negative growth of 8.87 percent during Q2FY14 to USD 3.50 billion, compared to USD 3.84 billion in Q2FY13. This was mainly due to a 16.67 percent decline in remittances from the Gulf region specifically from Saudi Arabia (-27.6 percent), UAE (-13.7 percent), Qatar (-16.3 percent), and Kuwait (-10.49 percent). Only the inflow of remittances from Oman (+6.20 percent), and Bahrain (+27.19 percent) recorded positive growth. Remittance inflow from the Euro region (-21.1 percent) and the Asia Pacific region (-3.5 percent) also fell. On the other hand, remittance inflow from the rest of the world including the USA registered 20.15 percent growth. In absolute amounts, the major sources of remittance during the quarter was Saudi Arabia (USD 768.7 million), followed by UAE (USD 662.0 million), USA (USD 577.0 million), Kuwait (USD 279.9 million), and Malaysia (USD 269.3 million) (Table IV.4).

However, overseas jobs for Bangladeshi workers increased by 7.9 percent in Q2FY14 as a total of 100,664 Bangladeshi emigrated compared with 93,314 in the corresponding period of FY13. The rise in number of overseas employment was the result of substantial improvement in the number of overseas jobs in markets such as Qatar (14,686 in Q2FY14 against 9,460 in Q2FY13), UAE (4,527 in Q2FY14 against 1,124 in Q2FY13), Iraq (3,998 in Q2FY14 against 49 in Q2FY13), and Malaysia (1,956 in Q2FY14 against 238 in Q2FY13). On the other hand, overseas employment in Saudi Arabia (1135 in Q2FY14 against 5468 in Q2FY13), Oman (31671 in Q2FY14 against 37,976 in Q2FY13), and Singapore (13,773 in Q2FY14 against 14,950 in Q2FY13) continued its downward trend.

V. Price Developments

5.1 Point-to-point inflation experienced an upward trend during Q2FY14 due to continuous rise in food inflation. After dropping to 1.8% in September 2012 from a peak of 14.9% in September 2011, food inflation rose back to 8.7% in April 2013. Food inflation began moderating from July, reaching 7.9% in September 2013, but started rising in October, reaching 9.0% in December 2013. The observed high domestic prices may be attributed to supply-side disruptions, triggered by national strikes, as well as rising food inflation in India.

Department of Agricultural Marketing (DAM) data shows that the average wholesale price of coarse rice rose by 31% from December 2012 to the end of December 2013, and its retail price increased by 29% during this period. On the other hand, in the international market, the price of Thai parboiled rice (5% broken) declined by 21% at the end of December 2013.

In contrast, point-to-point non-food inflation showed a consistently declining trend since November 2012 and reached 4.88 percent in December 2013 possibly due to a slowdown in economic activity, as reflected by the sluggish growth in the private sector credit. However, rising food inflation pushed up average inflation to 7.53 percent in December 2013. Following the same trend as the national level, an upward trend of food inflation and a declining trend in non-food inflation were also observed in both the rural and urban areas. As the charts below show urban inflation is more acute than rural inflation. In December 2013, point to point inflation in urban areas was 7.58% (food was 9.89% and non-food 5.13%) while in rural areas point to point inflation was 7.22% (food was 8.63% and non-food 4.69%).

Table 5.2: Contribution @ of Food and Major Non-Food Items / Groups in CPI inflation(Point to Point) Base Year 2005-06: 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	Misc. Goods & Services	**Non-food**
Weight	56.18	6.84	14.88	4.73	3.47	5.8	4.28	3.82	**43.82**
Jun-12	**24.36**	15.59	27.95	9.67	2.59	10.06	3.56	6.23	**75.64**
Jul-12	**22.30**	14.70	32.18	9.60	2.87	8.26	4.05	6.05	**77.70**
Aug-12	**23.74**	13.58	29.57	10.29	3.79	7.44	4.98	6.59	**76.26**
Sep-12	**18.12**	14.90	31.76	11.32	3.44	6.68	6.03	7.74	**81.88**
Oct-12	**22.28**	13.97	29.06	10.59	2.97	6.67	6.31	8.16	**77.72**
Nov-12	**32.24**	12.19	24.62	9.73	2.68	5.91	5.78	6.84	**67.76**
Dec-12	**40.56**	11.46	18.96	9.09	2.44	5.64	5.60	6.25	**59.44**
Jan-13	**41.75**	12.43	15.29	7.54	2.72	6.84	6.83	6.60	**58.25**
Feb-13	**53.38**	10.22	11.63	6.14	1.82	5.49	5.92	5.41	**46.62**
Mar-13	**54.75**	10.05	11.75	5.65	1.61	5.31	5.67	5.20	**45.25**
Apr-13	**58.73**	9.39	10.41	5.31	1.52	5.01	4.79	4.84	**41.27**
May-13	**57.65**	9.58	10.76	5.39	1.59	5.39	4.73	4.91	**42.35**
Jun-13	**58.07**	9.55	10.71	5.28	1.48	5.44	4.62	4.85	**41.93**
Jul-13	**58.92**	10.57	8.69	5.26	1.38	5.62	4.54	5.01	**41.08**
Aug-13	**62.38**	7.93	9.95	4.98	0.95	4.86	4.67	4.27	**37.62**
Sep-13	**63.54**	8.01	8.45	5.00	0.86	5.40	4.18	4.55	**36.46**
Oct-13	**68.48**	7.16	8.14	3.83	1.13	4.20	3.60	3.46	**31.52**
Nov-13	**68.63**	7.43	8.29	3.64	1.21	4.29	3.40	3.11	**31.37**
Dec-13	**70.59**	6.94	8.06	3.25	1.22	3.96	3.07	2.90	**29.41**

$$@\text{Contribution of ith Group} = \left(\frac{\text{Inflation in ith group} * \text{Weight of ith group in CPI basket}}{\text{Headline inflation}}\right) \times 100$$

Table 5.2 reveals that until January 2013, the main contributor of point-to-point CPI inflation was non-food inflation. After that, the scenario reversed and food inflation became an increasingly dominant contributor of point-to-point CPI inflation.

Chart V.2: 12 - Month Point-to-point CPI inflation(Base:2005-06=100)

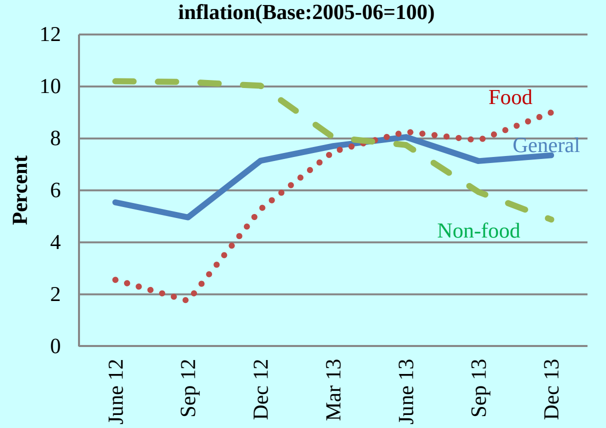


Chart V.1:12-Month Average CPI Inflation (Base:2005-06=100)

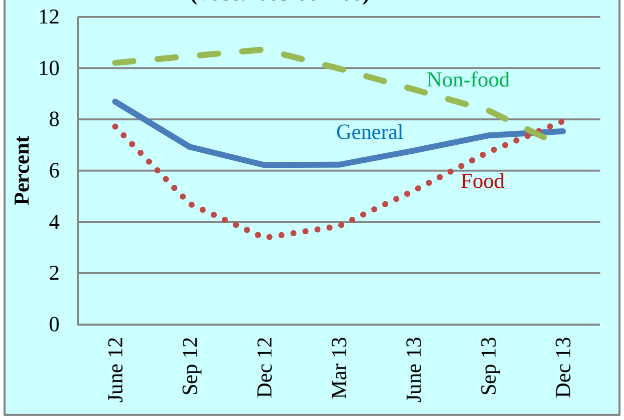


Chart V.3 : 12 Month Point-to-point CPI inflation for Rural (Base:2005-06=100)

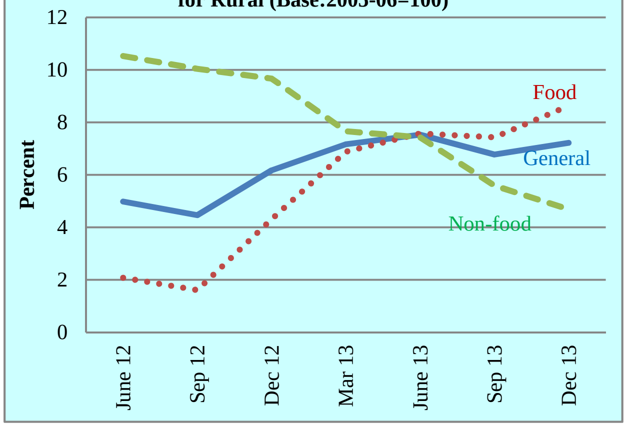


Chart V.4: 12 Month Average CPI inflation for Rural (Base:2005-06=100)

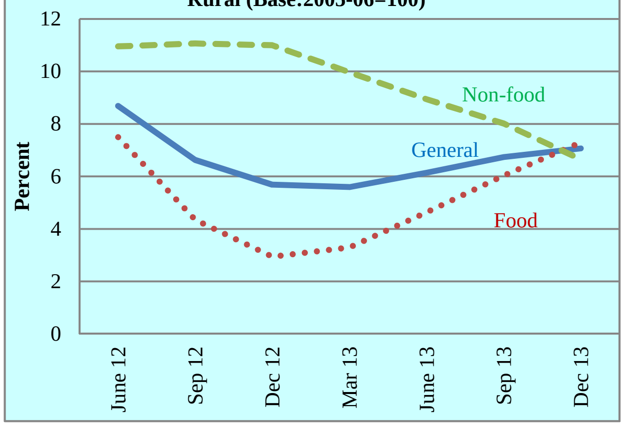


Chart V.5 : 12 Month Point-to-point CPI inflation for Urban (Base:2005-06=100)

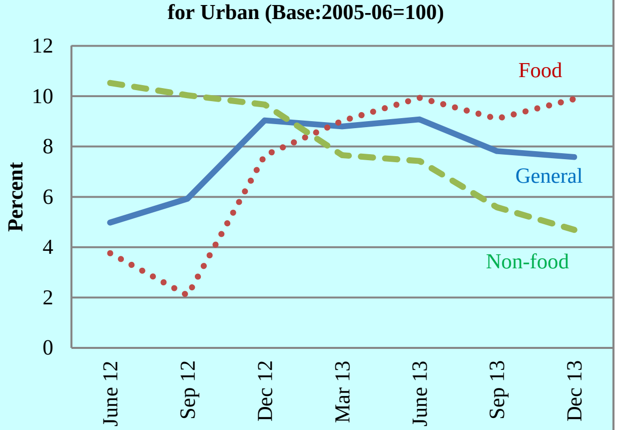
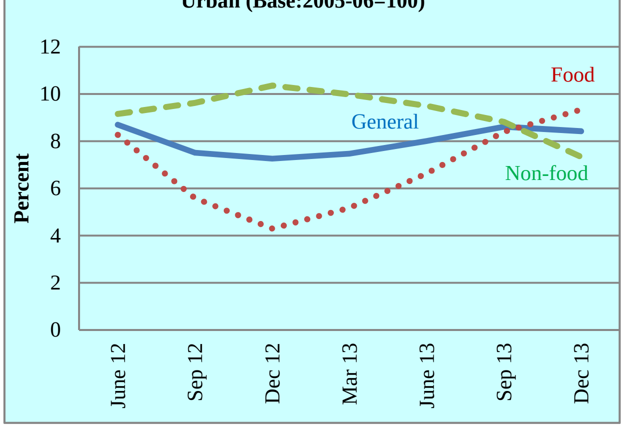
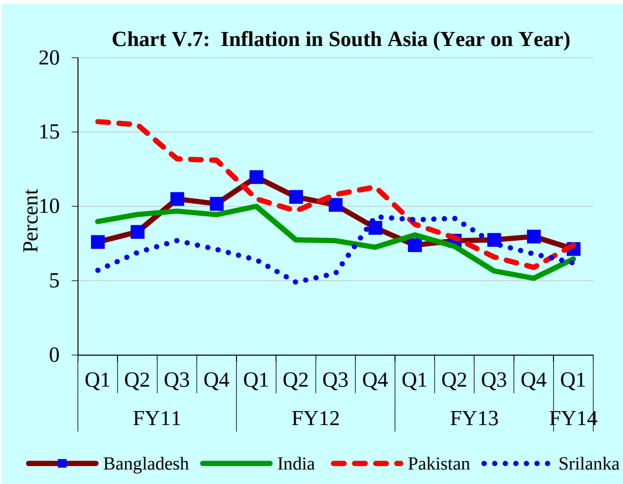


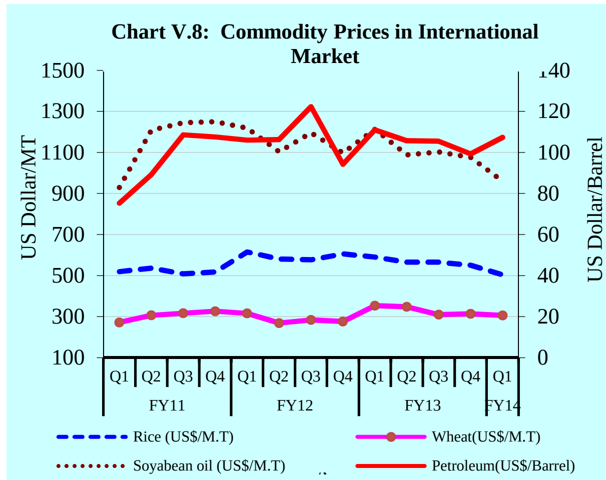
Chart V.6: 12 Month Average CPI inflation for Urban (Base:2005-06=100)



5.2 The point-to-point CPI inflation in our neighboring South Asian countries exhibits a mixed trend during the quarter under review. In India, after moving upward from 9.8% in September to 10.2% in October and 11.2% in November, point-to-point CPI inflation moved down to 9.87

percent in December 2013. On the other hand, Indian headline WPI inflation declined to 6.16 percent at the end of December 2013 compared to 7.05 percent in September 2013. In Pakistan, point-to-point CPI inflation edged up to 9.2 percent in December 2013 from 7.4 percent at the end of September 2013, whereas in Sri Lanka, inflation decreased to 4.7 percent in December 2013 from 6.8 percent in September 2013.



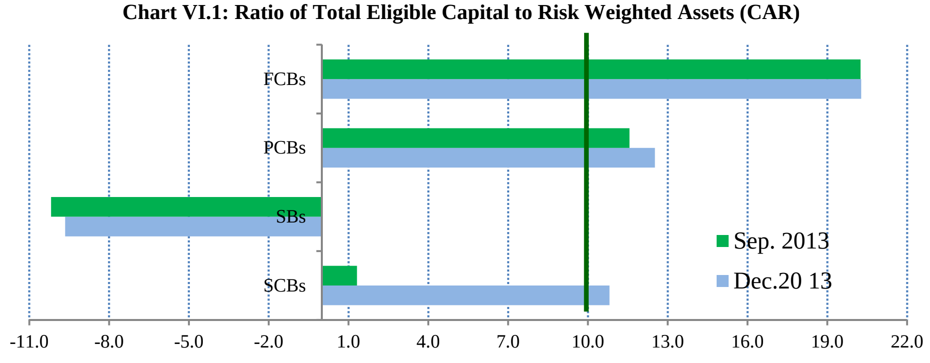


VI. Banking Sector Performance

6.1 Banking sector indicators for Q2FY14 showed an improvement compared to Q2FY13 as well as Q1FY14 due mainly to relaxation of loan rescheduling policy in December 2013 due to the business disruptions caused by nationwide strikes at the time. Gross non-performing loans (NPL) fell from 12.8 percent at the end of Q1FY14 to 8.3 percent at the end of Q2FY14. The ratio of net NPL of the sector has also decreased from 5.0 percent at the end of September 2013 to 2.0 percent at the end of December 2013 due partly to the new loan-rescheduling rules and decreased shortfall in actual provision maintained by the banks. During Q2FY14, the capital adequacy ratio (CAR) increased to 11.5 percent from 9.1 percent in Q1FY14. Among the profitability measures, return on asset (ROA) in the banking sector improved from 0.6 percent at the end of December 2012 to 0.9 percent at the end of December 2013 primarily due to increase in non-interest income of the sector (especially from investments in Government securities) and small provision deduction requirement for bad debt by the SCBs. Return on equity (ROE) of the banking industry also increased to 10.8 percent at the end of December 2013 from 8.20 percent at the end of December 2012.

6.2 During Q2FY14, the industry capital adequacy ratio (CAR) increased to 11.5 percent from 9.1 percent in Q1FY14 – a minimum of 10% is the regulatory requirement. One of the reasons for this improvement is the better capital position of SCBs and PCBs. The CAR for SCBs and PCBs increased to 10.8 percent and 12.5 percent at the end of December 2013 from 1.3 percent and 11.6 percent respectively at the end of September 2013. The CAR of FCBs remained virtually unchanged at 20.3 percent at end-December 2013 (Chart VI.1). During Q2FY14, CAR for specialized banks (SBs) slightly improved to (-) 9.7 percent from (-) 10.2 percent in Q1FY14.

Chart VI.1: Ratio of Total Eligible Capital to Risk Weighted Assets (CAR)



6.3 The ratio of gross NPL to total loans of the banking sector had been increasing since Q3FY12 before it fell by about 4.0 percentage points from 12.8 percent at the end of September

2013 to 8.9 percent at the end of December 2013 (Table VI.2 and Chart VI.2). There was overall improvement as the ratios for SCBs, SBs, PCBs and FCBs decreased to 19.8 percent, 26.8 percent, 4.5 percent and 5.5 percent respectively at end-December 2013 from 28.8 percent, 29.4 percent, 7.3 percent and 6.0 percent respectively at end-September 2013.

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

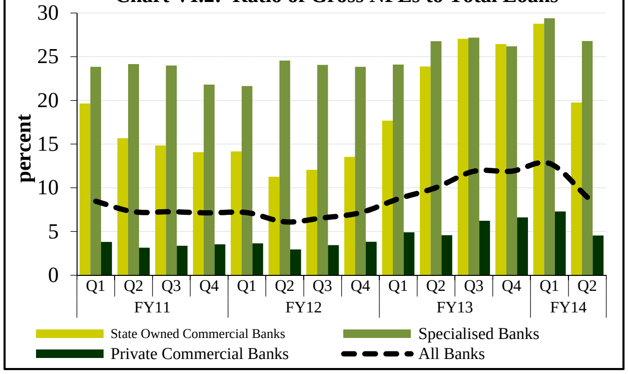
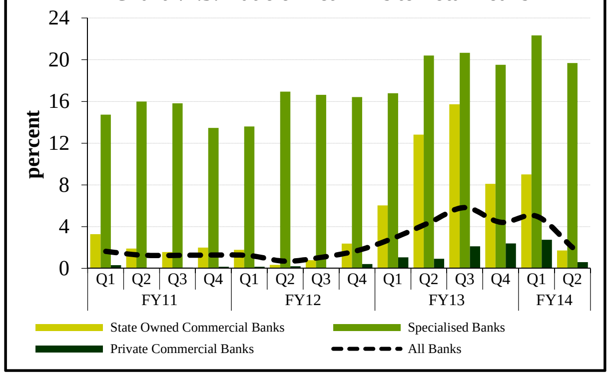


Chart VI.3: Ratio of Net NPLs to Total Loans



Similarly, the net NPL ratio for all banks decreased from 5.0 percent at the end of September 2013 to 2.0 percent at the end of December 2013 partly due to the decrease of gross NPL as well as decreased shortfall in actual provision maintained by banks (Table VI.3, Chart VI.3 and Table 6.1). Provision shortfall of the sector as a whole decreased sharply from Tk. 32.8 billion at the end of September 2013 to Tk. 2.6 billion at the end of December 2013. In Q2FY14 gross NPL ratio for SCBs fell by 9.0 percentage points and this group of banks also maintained a provision surplus of Tk. 14.5 billion. As a result, net NPL ratios for SCBs decreased from 9.0 percent at the end of September 2013 to 1.7 percent at the end of December 2013. Net NPL ratios of SBs, PCBs and FCBs have also decreased from 22.3 percent, 2.8 percent and 1.7 percent respectively to 19.7 percent, 0.6 percent and -0.4 percent respectively during the period.

Table 6.1: Comparative Position of Classified Loan and Provision Maintained

(billion Taka)

Quarter	Items	SCBs	SBs	PCBs	FCBs	All Banks
Q4 FY13	Total classified loan	238.5	77.6	196.1	10.9	523.1
	Required provision	149.7	34.8	104.9	9.6	299.0
	Provision maintained	145.7	15.4	103.8	9.5	274.4
	Excess(+)/shortfall(-)	-3.9	-19.4	-1.1	-0.2	-24.6
Q1 FY14	Total classified loan	241.7	87.8	223.1	14.5	567.1
	Required provision	151.4	39.2	117.6	12.1	320.3
	Provision maintained	146.7	17.4	114.3	9.1	287.5
	Excess(+)/shortfall(-)	-4.7	-21.8	-3.3	-3.0	-32.8
Q2 FY14	Total classified loan	166.1	83.6	143.2	13.0	405.9
	Required provision	107.8	38.2	94.8	11.6	252.4
	Provision maintained	122.3	17.4	97.8	12.3	249.8
	Excess(+)/shortfall(-)	14.5	-20.8	3.0	0.7	-2.6

6.4 Return on assets (ROA) improved from 0.64 percent at the end of December 2012 to 0.90 percent at the end of December 2013. This was primarily due to an approximately 18.0 percent increase in non-interest income (especially from investments in Government securities) and small provision deduction requirement for bad debt by SCBs (Table 6.2) in 2013. In 2013, SCBs required provision for bad debt was only Tk. 5.9 billion, compared with Tk. 46.6 billion for 2012 in light of the loan rescheduling discussed above.

Table 6.2: Profitability Position of Banks

(In Billion Taka)

Bank Groups	Net Intt. Income	Total Non Interest Income	Operating Income	Non-Intt. Exp (Operating Exp.)	NIBPT	Bad Debt Prov.	Tax Prov.	NIAPT	Total Assets	Return on Assets (ROA)	Capital/ Equity (AdjustedTotal Capital)	Return on Equity (ROE)
1	2	3	4=2+3	5	6=4-5	7	8	9=6-7-8	10	11	12	13
Dec-13												
SCBs	-5.4	65.1	59.7	33.1	26.7	5.9	8.3	12.5	2108.5	0.6%	143.3	8.7%
SBs	3.8	5.9	9.6	8.0	1.6	2.3	0.9	-1.6	454.8	-0.4%	5.2	-35.0%
PCBs	118.2	124.2	242.5	114.4	128.1	34.0	46.9	47.2	4948.2	1.0%	440.9	10.7%
FCBs	15.7	24.6	40.3	10.6	29.7	3.9	11.3	14.5	488.7	3.0%	82.4	17.6%
All Banks	132.3	219.8	352.1	166.0	186.1	46.1	67.4	72.5	8000.2	0.9%	671.7	10.8%
Dec-12												
SCBs	14.9	56.2	71.1	28.6	42.6	46.3	6.5	-10.2	1831.9	-0.6%	86.0	-11.9%
SBs	4.7	4.3	9.0	6.7	2.2	0.7	1.3	0.2	385.4	0.1%	-20.5	-1.1%
PCBs	114.7	107.2	221.8	97.7	124.1	37.0	47.0	40.2	4371.5	0.9%	395.3	10.2%
FCBs	19.6	18.7	38.3	10.0	28.3	2.5	11.4	14.4	441.8	3.3%	83.6	17.3%
All Banks	153.8	186.4	340.2	142.9	197.3	86.4	66.2	44.7	7030.7	0.6%	544.3	8.2%

NIBPT= Net Income Before Provision & Tax /Operating Profit

NIAPT= Net Income After Provision & Tax

The ROA for SCBs and PCBs improved from (-) 0.6 percent and 0.9 percent at the end of December 2012 to 0.6 percent and 1.0 percent respectively at the end of December 2013. However, the ratio for FCBs and SBs declined from 3.3 percent and 0.01 percent to 3.0 percent and (-) 0.4 percent during the same period. Return on equity (ROE) of the banking industry increased to 10.8 percent at the end of December 2013 from 8.2 percent at the end of December 2012. The ROE for SCBs increased to 8.7 percent at the end December 2013 from (-) 11.9 percent at the end of December 2012 mainly due to the positive net income and small bad debt provision deduction for the year 2013. This ratio for PCBs and FCBs slightly improved from 10.2 percent and 17.3 percent to 10.7 percent and 17.6 percent respectively during this period (Table 6.2 and VI.4). However, ROE for SBs decreased from (-) 1.1 percent to (-) 35.0 percent during the same period[1].

[1] This is a simple arithmetic outcome of SBs' negative net income and adjusted capital during this period (Table 6.2). Total capital of SBs increased to Tk.5.2 billion December, 2013 from (-) Tk.20.5 billion in December 2012 after adjustment while the bank group made net loss of Tk.1.6 billion compare to Tk. 0.2 billion net profit during the same period.

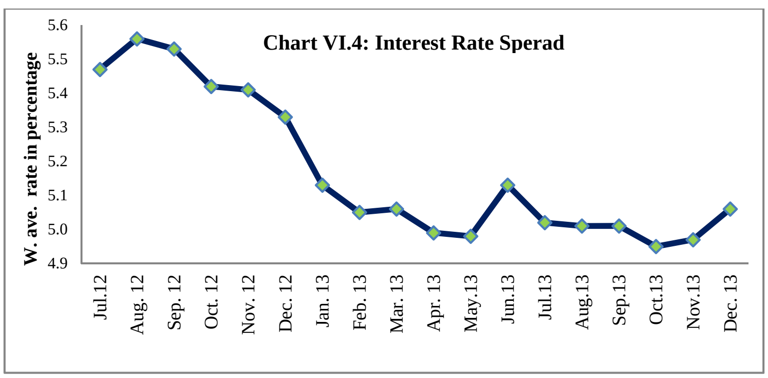
Table 6.3: Deposit and Advance Position of Scheduled Banks (end of the month)

Bank groups	Year-on year growth of deposit (excluding interbank)		Year-on year growth of advances (excluding interbank)		Advance Deposit Ratio (ADR)	
	Dec. 13	Sep. 13	Dec. 13	Sep. 13	Dec. 13	Sep. 13
SCBs	18.7%	18.1%	-4.8%	-3.2%	56.1%	58.3%
SBs	31.7%	28.5%	15.0%	15.1%	76.7%	79.4%
PCBs	14.8%	15.8%	11.1%	10.6%	76.7%	77.0%
FCBs	9.5%	8.1%	0.4%	4.3%	64.6%	65.8%
All	16.2%	16.5%	7.1%	7.4%	70.7%	71.7%

Table 6.4: Liquidity Position of the Scheduled Banks (Tk. in billion)

	As of end June, 2013[R]			As of end December, 2013[P]		
	Total Liquid asset	Required liquidity (SLR)	Liquidity: excess(+) /shortfall(-)	Total Liquid asset	Required liquidity (SLR)	Liquidity: excess(+) /shortfall(-)
SCBs	534.7	264.3	270.3	702.2	290.2	412.1
SBs	50.8	30.7	20.1	52.0	35.9	16.1
PCBs (other than Islamic)	795.2	475.4	319.8	856.2	511.0	345.2
Private Banks (Islamic)	218.4	113.0	105.4	214.2	121.6	92.7
FCBs	142.7	64.0	78.8	157.8	66.8	91.0
All	1741.7	947.3	794.4	1982.5	1025.4	957.0

6.5 At the end of Q2FY14, the growth rate (year-on- year) of deposits remained higher than that of advances. As a result, advance-deposit ratio (ADR) remained far below the approved ceiling as well as its average value for the last eight years. The growth rate of deposit decreased marginally from 16.5 percent at the end-September 2013 to 16.2 percent at end-December 2013. On the other hand, the growth of advances continued its declining trend of FY13 and it came down from 7.4 percent at the end of Q1FY14 to 7.1 percent at the end of Q2FY14. The advance - deposit ratio (ADR) decreased to 70.7 percent at the end December 2013 from 71.7 percent at the end of previous quarter (Table 6.3). Accordingly, the liquidity position of all bank groups except SBs and Islamic Banks improved at the end of December 2013 compared to that in June 2013, leading to a further easing of money market conditions (Table 6.4).

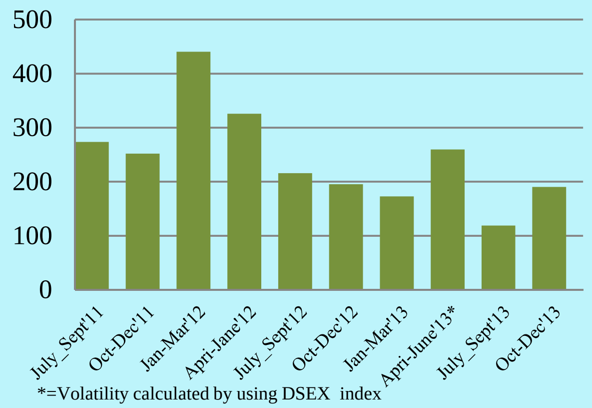


6.6 Monthly interest rate spread for all banks, measured as the difference between monthly weighted average rate of advances and deposit, came down to 4.95 percent in October 2013 from 5.01 percent in September 2013 but rose again to 5.06 percent by the end of Q2FY14 (Chart VI.4). In Q2FY14, due to low investment demand and easing money market conditions banks were forced to cut both deposit and lending rates. However, bank wise data show that most banks reduced their weighted average deposit rates more than their weighted average lending rates which caused the increase in spread. Monthly weighted average call money rate rose from 7.43 percent in September 2013 to 7.78 percent in October 2013 and then it decreased to 7.11 percent in December 2013.

VII. Capital Market Development

7.1 At the end of Q2FY14, DSE broad (DSEX[2]) index and DSE 30 index were 4266.55 and 1466.25, which are respectively 8.4 percent and 1.8 percent higher than Q1FY14's indices. Over the same period, market capitalization increased by 5.8 percent (Chart VII.1 and Table VII.1). The DSEX index increased by 4.3 percent while, DSE 30 index declined by 0.5 percent in Q2FY14 as compared to end January 2013 which was the starting date of DSEX index and DSE 30 index. On the other hand, the DSE Market capitalization increased by 13.7 percent during Q2FY14 as compared to Q2FY13. The volatility in DSEX index, measured by standard deviation, significantly increased to 190.3 during Q2FY14 compared to 118.8 in Q1FY14.

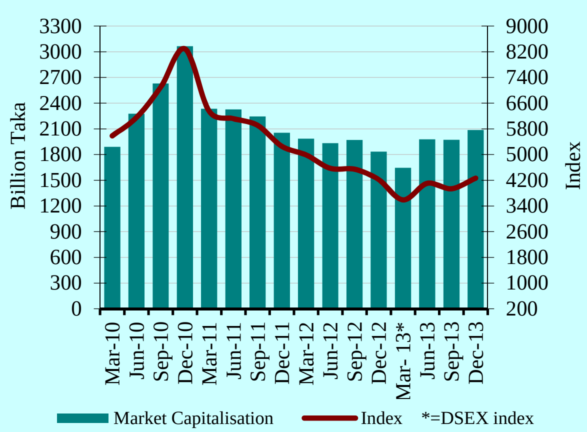
Chart VII.2: Recent Volatility in DSE



*=Volatility calculated by using DSEX index

7.2 The average price earnings ratio of the DSE increased to 14.9 in December 2013 compared to 14.6 in late September 2013. Total turnover value in the Dhaka Stock Exchange decreased significantly by 22.0 percent from Tk. 327.9 billion in Q1FY14 to Tk. 255.9 billion in Q2FY14, while total turnover value during Q2FY14 increased notably by 26.3 percent relative to the same period last year. The liquidity situation in the capital market tightened, as measured by Turnover Velocity Ratio (TVR)[3], which decreased to 48.1 percent in Q2FY14 from 66.5 percent in Q1FY14. The value of "issued equity and debt" increased by 1.9 percent (Table VII.1) and two new companies were listed in the capital market during Q2FY14.

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



7.3 The sector-wise DSE data shows that during Q2FY14 market capitalization decreased in non-bank financial institutions, food and allied products, fuel and power, jute industries, cement industries, and corporate bonds (Table VII.2). All together these sectors contributed 30.7 percent of the total market capitalization. The contribution of the banking sector, however, increased to 20.3 percent at the

[2] DSE general index discontinued from 1st August 2013.
[3] TVR = (Turnover during the quarter/Quarter-end Market capitalization)*4

end of Q2FY14 from 18.2 percent in the previous quarter. The relative contributions of all other sectors in total market capitalization remained almost unchanged during the last two quarters.

7.4 During Q2FY14 the new investment on share purchases by foreign and non-resident Bangladeshi investors increased to Tk.7.2 billion from TK. 6.5 billion in the previous quarter. At the same time, total share sales by foreign and non-resident Bangladeshi investors decreased to Tk.1.5 billion from TK.2.6 billion in the previous quarter. As a result, net investment of foreign and non-resident Bangladeshi during Q2FY14 increased to Tk.5.7 billion from TK.4.3 billion in the previous quarter. However, foreign exchange turnover still has a limited contribution in total turnover of DSE. During Q2FY14, total turnover due to foreign investors increased to 3.4 percent of total turnover from 2.8 percent in the previous quarter.

7.5 Cross country data shows that the price earnings ratio of Bangladesh capital market is comparatively lower than that of some South and East Asian countries, while dividend yield of the Bangladesh capital market is the highest (Table 7.1).

Table 7.1: Comparison among Regional Capital Markets-December 2013

Country	Price Earnings ratio	Dividend Yield
Bangladesh	14.91	3.67
India	17.78	1.45
Sri Lanka	15.92	2.93
Thailand	13.00	3.10
Malaysia	16.00	2.90
Taiwan	17.00	2.90
Hong Kong	15.00	2.50
China	10.00	3.00
Singapore	13.00	3.20

Source: Monthly Review, Dhaka Stock Exchange