

State of Bangladesh economy in 2003-04: First interim report

The first interim report (July-December 2003) on 'State of the Bangladesh Economy in the Fiscal Year 2003-2004' has been prepared by the Centre for Policy Dialogue (CPD) under its programme titled Independent Review of Bangladesh's Development (IRBD).

Part 2

3. Monetary Aggregates, Credit Expansion and Inflation

In response to recessionary business conditions and the deceleration of private investment, the government is currently pursuing an accommodative monetary policy through a number of measures: reduction in bank rate, reduction in interest rates on government bonds, and reduction of Statutory Liquidity Requirement (SLR).

Financial sector reforms is also being pursued through strengthening of the oversight functions of the central bank, improving the corporate governance of the private commercial banks through higher transparency and accountability, contracting out of management of a number of nationalised commercial banks (NCBs), amending legal framework for loan recovery, improving prudential guidelines and their enforcement.

It is well recognised that currently an inefficient financial sector in Bangladesh is imposing a heavy structural constraint on the investment situation in Bangladesh. How far these financial sector reform measures may actually stimulate investment without addressing the other structural constraints to investment (e.g. underdeveloped infrastructure) remains to be seen.

3.1 Domestic Credit Expansion

As of October 2003, overall domestic credit expansion rate (on point to point basis) was 10.13 percent. In October 2002, the comparable figure was 10.49 percent. Relatively moderate aggregate growth in the domestic credit flow during the first four government months of the FY04 is due to the negative balance (-7.03 percent) in case of

government borrowing and relatively low growth (3.93 percent) in case of "other public bodies".

What needs to be noted is that domestic credit recorded a net increase of 3.54 percent (Taka 3681.90 crores) during July-October 2003 compared to 2.93 percent (Taka 2780.70 crores) during the matching period in the earlier year. This increase is largely attributable to higher inflow to the private sector (Taka 3499.60 crores or 4.51 percent increase). On a point to point basis, credit growth in the private sector, as of October 2003, was 15.76 percent. These positive developments in monetary expansion resulted in the growth of the private sector's share in total domestic credit flow to 75.35 percent, which is the highest share recorded in recent years.

It needs to be pointed out that the central bank's measures relating to reduction of Bank Rate and SLR came in November, 2003, and thus, could not be responsible for the relatively higher disbursement of term loans during July-September 2003. Moreover, whatever decline in interest rate has taken place, it did not take place in the second half of FY03 and this was the period when most of the investment decisions took place resulting in disbursement in the first quarter of FY04. Whatsoever, it is now to be seen to what extent the declining trend of interest rate accelerates the investment flow in the coming months.

It seems that after an early pick-up till September 2003, some restraint was imposed on monetary growth in October 2003. It is not immediately apparent whether this is the result of a conscious constraint imposed by the central bank in the face of the rising price level or it is a reflection of poor response from effective investment demand. This may well reflect the monthly trend projected under the Bangladesh Bank's monetary programme.

It may be pointed out that excess liquidity of the scheduled banks, as of end November 2003, stood at Tk. 7204 crores. Out of the total amount Tk. 7204 crores, Tk. 2118 crores (29.4 per cent) are in

foreign currency clearing account which is readily not available for local lending. In addition, excess liquidity in the Islamic Banks is about Tk. 1,000 crores (13.9 per cent). If these two amounts are excluded, effective excess liquidity is about Tk. 4,086 crores which is less than 4 per cent of an average daily balance of Tk. 110,520 crores. However, it will be enlightening to take a closer look at the composition of this amount to assess the extent of effective liquidity.

It is to be seen whether the commercial banks will be able to avoid "moral hazard" and avoid financing bad projects.

3.2 Government Borrowing

Following the reduction of the interest rates on the National Saving Deposit (NSD) certificates, the growth of their sales gradually declined from the peak of 15.08 percent in July 2003 to (-) 5.23 percent in October 2003. The average growth in this period was 2.8 percent the total amount purchased being more than Tk. 3520 crores. The total outstanding to the government on account of borrowing from the public at the end of October 2003 amounted to Tk. 31312 crores (16.6 percent growth over the four month period).

It is evident that the fall in yield rate has partly dampened the demand for NSD, although every month, till date, on average Tk. 800 crores worth of NSD continue to be purchased by the public. In sum that net government borrowing during July-October 2003 declined by 5.8 percent, notwithstanding a 9.8 percent net increase in non-bank borrowing. The debate on the implications of the so-called high interest rates paid by NSD certificates for lowering interest rates in the commercial banks is worth pursuing, but possibly on a different occasion.

3.3 Agricultural Credit

Between July and October 2003, a total amount of Tk. 729.53 crores were disbursed as agriculture credit, recording an increase in disbursement by 5.7 percent.

However, due to higher recovery (Tk. 850.60 crores), the sector experienced a net outflow of Tk. 121.1 crores during these four months. The only comforting fact seems to be that there had been a larger outflow in FY03 during the comparable period. More importantly, it seems that the agriculture sector is yet to benefit from the current moderately expansionary policy.

Currently (October 2003), the share of overdue loans as a percentage of total outstanding loans stood at more than 63 percent. Collection of overdue loans should be seen as a healthy initiative, leading to better loan disciplines. However, if the recovery rate increases in the backdrop of such a modest growth in fresh loans, the agricultural credit delivery system will emerge as the main conduit of transfer of resources from the rural to the urban areas. Although, refinance facility from the Bangladesh Bank is available to the scheduled and specialised delivery of agriculture credit, it appears that the banks are not so enthusiastic about giving credit to the farmers.

It therefore needs to be explained to what extent the financial sector reforms have failed to address the importance of channelling credit to the poorer sections of society and may even be responsible for slowing down credit flows to the rural areas.

3.4 Industrial Loan

In the backdrop of the slowdown in growth of industrial term loans in the recent years (since FY01), the disbursement record for July-September 2003 is quite impressive Tk. 1423 crores, i.e. more than 106 percent growth. The net flow to the sector is Tk. 482.5 crores which compares favourably with the outflow of (-)Tk. 206.1 crores during the comparable period in FY03. The sharp growth can be partially explained by the growth of import of capital machinery. However, the question remains whether the settlement of L/C for capital machinery imports took place after the disbursement of the loan.

It needs to be recalled that the share of overdue as a share of

outstanding industrial term loans declined from 32.8 percent in September 2002 to 28.7 percent in September 2003. This decline took place largely due to write-off decisions by the commercial banks. NCBs have written-off Tk. 1984 crores, which is 2.73 per cent of NCBs classified loans. Five specialised bank have written off Tk. 779 crore of bad loans, reducing their default loans by 8 percent; private commercial banks and foreign banks have written-off Tk. 1079 crore and Tk. 125 crore respectively.

As a whole, the reduction of classified loans occurred as a result of window-dressing, which is a normal practice, but not due to improvement in recovery. It should be kept in mind that the policy of debt rescheduling, practised by successive regimes in Bangladesh, has contributed to a serious moral hazard problem in the banking system which may actually have contributed to the perpetuation of the default culture in Bangladesh.

3.5 Price and Wage Inflation

The latest available figures from the BBS show that the national inflation rate (base year 1995/96, in September 2003) was 4.71 percent moving average. On a point to point basis the rate was about 5.58 percent. It may be recalled that the inflation rate (moving average) was 2.79 percent and 4.38 percent in June 2002 and June 2003 respectively.

Although we do not have official statistics on the consumer price index (CPI) for more recent months, market information on prices of essential commodities suggests that the inflation rate has further increased during October and November 2003 (Ramadan months). The inflation rate (moving average) for non-food prices has been higher (5.1 percent) than for food prices (4.4 percent). However, very surprisingly one finds that both food and non-food price increase had been higher in the rural areas than in the urban areas. Thus, it is evident that the recent price hike will hit the poor more (those who spend relatively more

on food), particularly those living in the rural areas. The higher inflation in rural area also indicate the emergence of structural shift of rural economy with increasing monetization and growth of non-farm sectors.

It needs to be seen how the food price index behaves once *Aman* crop is harvested. But the need to monitor the inflation closely in the coming months, particularly when the government is pursuing a moderately expansionary policy. A larger portion of rural population is dependent on agricultural labour.

This concern for price inflation becomes quite serious when we consider the recent trend in wage inflation. The wage index grew by more than 11 percent throughout FY03, and during the period July-September 2003 this has remained above 8 percent. It goes without saying that such wage inflation is often driven by the wage goods price inflation, which in turn erodes export competitiveness of the economy. On the other hand, increase in real wage (around 5.3 per cent) may be an expression higher of labour demand and growth in productivity. Thus, it needs further examination to explain a growth in real wage during a period in a country with one-third of its workforce unemployed or underemployed when it has experienced a large retrenchment of manufacturing labour (more than 51,000) through closing of the SOEs.

In assessing inflationary trends in the economy we need to recognise that very little research evidence is at hand to explain the dynamics of price inflation in Bangladesh to enable us to differentiate between the contribution of monetary and structural factors. The sudden escalation of price levels during Ramadan which appeared to be at variance with supply and demand trends for certain key items of consumption suggests that the structural components of price and wage inflation and their institutional foundations merits investigation if appropriate policy responses are to be designed to cope with the problem.

Bush sees economy getting stronger

AFP, Washington

US President George W Bush said Friday he was "really optimistic" about US growth and built on unexpectedly anemic job creation in December to call for passage of his economic agenda.

Speaking to women small business owners after the US government reported that the economy created just 1,000 jobs in December, Bush declared: "That's not good enough."

"But nevertheless, it is a positive sign that the economy is getting better," said Bush. "I'm really optimistic about the future of our nation's economy. This economy is strong and it is getting stronger."

The president cited encourag-

ing manufacturing orders, productivity figures, and "strong" home construction data, concluding that "all the signs in our economy are very strong."

The US president, who has been ramping up his 2004 re-election bid, credited the tax cuts he pushed through Congress for promoting growth and said lawmakers "must make every part of the tax package permanent."

His comments came after the US Labor Department reported that the US economy generated just 1,000 jobs in December. The report was a shock to economists, who projected average job growth of 148,000 in the month to signal an end to the so-called jobless recovery in the United States.

CURRENCY

Following is yesterday's forex trading statement by Standard Chartered Bank

Sell	BC	Currency	Buy		
			TT Clean	OD Sight Doc	OD Transfer
59.1500	59.2000	USD	58.2550	58.0839	58.0144
76.9187	76.9837	EUR	73.8906	73.6735	73.5654
110.3029	110.3962	GBP	106.8363	106.5723	106.4448
46.7640	46.8035	AUD	44.5418	44.4109	44.3578
0.5612	0.5617	JPY	0.5414	0.5388	0.5392
48.8803	48.9216	CHF	47.2811	47.1422	47.0858
8.3181	8.3261	SEK	7.8027	7.7798	7.7705
46.9258	46.9655	CAD	45.4230	45.2896	46.2354
7.6291	7.6356	HKD	7.4946	7.4726	7.4637
36.1361	36.1648	SGD	34.2374	34.1369	34.0960
16.2353	16.2490	AED	15.7327	15.6865	15.6677
15.8993	15.9127	SAR	15.4114	15.3661	15.3477
10.8335	10.6425	DKK	9.6153	9.5870	9.5755

Exchange rates of some currencies against US dollar

Indian rupee	Pak rupee	Lankan rupee	Thai bath	Nor kroner	NZ dollar	Malaysian ringgit
45.43	57.215	97.73	38.985	6.7372	0.7319	3.80

ReadyCash Raffle Draw Winners

The latest ReadyCash Raffle draw was held at ReadyCash Bangladesh office at Dhanmondi in Dhaka on Saturday, says a press release.

Prizes	Name of Winners	Card No
China Junction Chinese Free Lunch for two	Md. Mohiuddin Ahmed	504798000050499
Meal in the Box Free Lunch for Two	Mrs. Fatema Yusuf	5047980010027393
Kena Kata free Gift Box	Md. Abu Jafor	5047980010027394
White Castle free Lunch Package	Md. Rezaul Islam	504798000050503
Liton's Snacks free Meal Box	Md. Nasir-Uz-Zahan	504798000050523
Patna Cloth Store free Gift Box	A Sattar Siddiqui	504798000050509

Winner can collect their prizes from the Executive, Promotion of ReadyCash within 30 days of this news circulation by producing their ReadyCash card transaction vouchers. ReadyCash encourages its cardholders to read The Daily Star and the Daily Prothom Alo on every Sunday or call our Customer Service at : 8123850, 8130497, and 8125294-7.

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