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 4

5. External Sector

The behaviour of the external sector in the early months of FY04 is best revealed by the trends in import and export, remittances flow, foreign aid disbursement and the balance of payment situation.

5.1 Import

The latest evidence suggests that imports have picked up in the early months of FY04. Actual import payments during July-October 2003 were 21.2 percent higher than that of FY03. During the comparable period in FY03, import payments in fact declined by (-)0.4 percent.

In the backdrop of only 4.5 percent growth in FY03, capital machinery import has exhibited a robust increase during the first quarter (July-October) of FY04. Fresh opening of letters of credit (LCs) for capital machinery increased by about 49 percent. This growth captures $33.4 million worth of import for a PDB power plant in Tongi and $12.9 million worth of import for a glass factory financed by Janata Bank. Machinery import for miscellaneous industries also recorded a growth as LCs opened on account of this increase by more than 8.5 percent. LCs opened for industrial raw materials increased by 27.0 percent.

However, it needs to be pointed out that imports of consumers' goods (other than foodgrains) also depict a high import trend as LC openings for those goods increased by 26.25 percent. With the relaxation of LC margin requirements, it may be safely assumed that the import of consumers' goods in the coming days will increase further.

On the other hand, during July-September 2003, import of foodgrains by the private sector was 996 thousand metric tons which was 71 percent higher than that of the preceding year. It may be mentioned that government for the first time since FY00, has undertaken commercial import of wheat amounting to 29 thousand metric tons during July-September 2003.

In fine, the import growth rate is currently more than twice that of export. Amount of L/Cs opened upto October of FY04 was worth $3.71 billion compared to $3.05 billion over the corresponding period of the preceding year, posting a robust growth of 21.8 percent. Interestingly, growth of L/Cs opened for production related imports such as industrial raw materials and capital machineries was 28.3 percent and 56.4 percent respectively. L/C settlement figures during this period also shows a 28.3 percent growth. If the trends in L/C openings are any clue, the current high growth of imports are likely to sustain in coming months (upto October 2003).

Whilst higher disbursement of foreign aid and remittances flows may provide some cushion for the time being, there is every possibility that this import surge may create fresh pressure on our foreign exchange reserves in the subsequent months of FY04. It is also expected that the exchange rate in a floating regime would absorb much ot this pressure.

5.2 Exports

Exports grew at 9.4 percent in FY03. During the first quarter (July-September) of FY04 growth in exports has been sustained at 9.94 percent. One needs to be reminded of the fact that this growth was achieved through a more than 12.6 percent increase in export volume in the face of about 2.7 percent decline in the export price index.

If we consider that export prices declined by 14.8% in FY02, to rise by 2.3% in FY03 only to fall by 2.4% in the early months of FY04 as stated above, it will not be difficult to appreciate the level of erosion in the overall export prices in recent years. As a matter of fact, analysis carried out at CPD shows that average price levels for Bangladesh's exports is yet to reach the 1996 price level.

It goes without saying that such an extensive method of export expansion is not sustainable over the medium term. This is particularly true when one single group of commodities, namely clothing, accounts for more than 76 percent of the export receipts. As is well known, the export competitiveness of Bangladesh will be put to severe test once the RMG quota is phased out in another year's time, on January 1, 2005.

Other than jute goods and handicrafts, export receipts for all other categories of items increased during the first quarter of FY04. This remains particularly true for such non-traditional items such as pharmaceutical and chemical (121 percent) as well as for a less traditional item such as tea (93 percent). These are may be some of the initial signs of export diversification.

Notwithstanding such growth, the export target for July-September 2003, period was missed by about 19 percent. These figures suggest that the recent close to double digit export growth remains below expectation.

5.3 Remittance

In recent years importance of flow of remittance has been on the rise. In FY03 flow of remittance was equivalent to about 85% of net export earnings of the country. Remittance flows for the first time crossed the threshold level of $3.0 billion in FY03, when it was $3061.9 million or 22.4% higher than FY02. During the period July-November, 2003 Bangladesh received about $1285 million as foreign remittances recording 4.33 percent point to point growth. However this growth performance looks very pale compared to what was achieved in FY03.

In fact the slowdown in the volume of foreign exchanges sent by migrant workers may appear as the first revealed signs of exhaustion of growth. The recent erratic remittance flow (when it registered a negative 6.9 percent growth in November 2003) will take sometime to settle down. It is reckoned that the post 9/11 global situation along with government's steps to improve the efficiency of the formal channel of transfer played an important role in accelerating remittance growth in Bangladesh.

Sustaining a buoyant flow of foreign remittances will be one of the most challenging tasks for the Bangladesh economy in the coming months. This will be a further challenge if the growth in the number of persons going abroad falls-it was only 3.7 percent in September 2003. Will Bangladesh be able to protect its saving grace or it has run out of its outstanding stock and now has to depend on current flow only?

5.4 Foreign Aid

In FY03 foreign aid committed to Bangladesh amounted to about $2179 million, whilst actual disbursement was in the region of $1577 million. After a secular decline in the volume of foreign aid disbursement since FY99, a growth of more than 26 percent was recorded in FY03 compared to the preceding year.

The latest figures available for FY04 indicate a modest commitment level of $136.6 million upto November 2003. Drawing on the pipeline, the disbursement till October 2003 amounted to $209.2 million.

The recent increase in foreign aid inflows to Bangladesh largely owes to the *Development Support Credit* (DSC) contracted with the World Bank. Under the DSC $300 million was disbursed in one go to Bangladesh as it promised to implement a time bound Structural Policy Reform Matrix.

On the other hand, the IMF also agreed to give Bangladesh SDR 347 million (about $490) as a loan *Poverty Reduction and Growth Facility* (PRGF), of which SDR $49.5 mln ($70 million) has been disbursed as first tranche. The second tranche will be available once Bangladesh services a number of commitments in the area of budgetary and financial sector reforms.

In comparison to many other low income countries the foreign debt scenario of Bangladesh remains manageable. The country's DSL on account of foreign loans amounted to only 6.3 percent of its total foreign exchange earnings during FY03.

The major problem for Bangladesh originates in its weak capacity to utilise the already committed foreign aid. Thus, the aid pipeline amounts to more than $6.2 billion (as of June 2003). At the same time, most of the foreign assistance disbursed in the recent past had been in the form of loans implying a growth in DSL in the near future.

5.5 Balance of Payment

With imports growing at a faster rate than that of exports, the trade balance recorded a larger deficit during July-September 2003. The current account balance registered a smaller surplus due to lower level of current transfers including foreign remittances coupled with larger trade deficit. Consequently, the overall balance showed a smaller surplus of $163 million as against $229 million in the matching period of FY03.

The slight weakening of the BOP during the early months in FY04 may not raise immediate concern, however this will definitely be an issue to be monitored closely in the coming months. It is expected that, if the current trends of the relevant variables continue, the BOP may come under increased pressure, particularly in view of the robust growth of the amount of L/C opening.

5.6 Foreign Exchange Reserve

Foreign exchange reserve of Bangladesh stood at $2438 million at the end November 2003. This amount was about 61.5 percent higher than that of in November 2002.

The current level of forex reserve, propped up by foreign loans provides a cushion for the growing import demand. However, if a draw-down on the forex reserve sets in, one may have to once again resort to monetary policy instruments to contain the import growth.

6. Concluding Remarks

It is evident from the foregoing review that most of the key variables influencing macro-economic performance that the project FY04 has started off in a relatively strong footing. Revenue collection is on target, export growth is stable and agricultural production is steady. Positive movements are taking place in case of import growth, industrial loan disbursement, and financial sector reform. However, these reassuring trends are somewhat depressed by marginal growth in the manufacturing sector, low level of FDI inflow, net outflow of agricultural credit, transitory bubbles in the capital market, paralysis in the privatisation process, slowdown in remittance flow, and, last but not the least, the perceptible price hike of essential commodities.

One observes that, the fiscal balance remains sound mainly by default (largely due to low ADP implementation), and the balance of payment situation is subjected to some pressure because of the increasing trade gap and the expected pressure of input payments in the coming months.

The four critical factors for successful implementation of the National Budget FY04 mentioned in CPD's in June 2003 Budget Review may be recalled in this connection.

(i) Implementation of ADP still remains the most vulnerable aspect of this year's economic programme from the point of view of both quantity and quality. Particular attention will need to be given to the recommendations of the *Public Expenditure Review Committee.*

(ii) Export recovery is getting stronger and there are signs of diversification in new non-traditional exports. In view of the impending phase-out of MFA this needs to be strengthened.

(iii) Private investment in the manufacturing sector has gathered momentum, particularly in the backward linkage industries of the RMG (i.e. yarn and fabric production). Other import-competing and potential export-oriented industries such as pharmaceuticals is showing sustained growth.

(iv) A successful supportive monetary and fiscal policy has generated enhanced inflow of investible surplus in the market. However, price index is showing crawling upward trend. With the emerging pressure on the BOP, the floating regime will have to effectively adjust the exchange rate, and some monetary control may became necessary.

Thus, it seems from our review that, other than the ADP and inflation, almost all other major target indicators of the *Mid-Term Macro-economic Framework* of the I-PRSP will be achieved. Accordingly, the economy is poised to record a 5.5 per cent or above growth in FY04. However, it is well known that a 5.5% growth will result in a little above 3.5% per capita income growth, which although being impressive in the global context, may not be good enough for alleviating the situation of more than 40 percent of the population living below the poverty line. This is important particularly in the context of aggravating income disparity in the economy.

Curiously, one finds that the system is flushed with excess liquidity on the lookout for viable business opportunities a baseline estimate would put the figure at least to the tune of Tk. 10,000 crores (almost $2 billion) at any point in time. These numbers of course do not include the savings of the lower income groups which remain underutilised due to lack of investment opportunities or appropriate financial instruments to productively use such savings. One wonders what would happen with this excess liquidity if investment does not pick up further growth in conspicuous consumption or flight of capital?

As the government crosses the critical mid-point of its tenure it is expected that the accumulated momentum will provide a 'big push' in the second part of FY2004 averting the setting-in of the oft-seen mid-term inertia.

What is holding back the country from a big push? Is it a mid-term inertia? Successive surveys carried out by CPD (and other institutions such as the World Bank-BEI and Japanese Commerce and Industry Association in Dhaka) to assess the business environment have revealed that it is the non-economic factors relating to governance, viz. high corruption, and weak law and order situation, which are creating serious disincentives for investment. Entrepreneurs no longer complain so much about unpredictability of policy, but emphasise poor services of the public institutions. These are the factors which can largely explain the mismatch between the strong macroeconomic fundamentals of Bangladesh and inadequate confidence of the investors.

Admittedly, the trigger to alleviating such a situation lies more within the domain of politics, rather in economics. Will the underlying political economy of Bangladesh continue to arrest its development prospects and to perpetuate poverty and inequality? The final outcomes of Bangladesh's economic performance in FY04 may partly provide answer to these questions.

(CONCLUDED)

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