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Fathoming the crisis

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seen a slight decline in growth rates. Much of Indian industry is taking a more financially prudent stance, given the impact of the global financial meltdown. India is likely to miss the revenue and fiscal deficit targets in the current fiscal year as the government wants to spend extra money to boost the aggregate demand in the economy which has shown clear signs of slowdown.

The government has forgone 31,000 crore rupee worth of revenue through reduction in taxes and duties, on account of fiscal measures to stimulate growth and fight inflation. Indian currency has come under pressure, prompting the Reserve Bank of India to intervene in support.

Impact on Bangladesh economy

This crisis has several downside risks for the Bangladesh economy. However, the impact on the Bangladesh economy will depend on the nature, scope, severity, and duration of the crisis. Although the economy of Bangladesh has become increasingly integrated with the global economy in recent years, the country's financial sector is not as globally integrated as India's. Private foreign players are important in the banking sector; however, foreign portfolio holdings in the equity market are relatively small at only 2.6 per cent. Also, currency transfers abroad are restricted, so no question of large-scale capital flight. Therefore, the country's financial markets have yet to feel any direct impact.

The risks are likely mainly in the areas of export earning, remittances and foreign aid. Financial sector is in relatively good health, underpinned by prudent regulation and sound management due to past reforms. It is highly insulated from foreign markets and lacks sophisticated financial derivatives linked to Western capital markets. Non-performing loans are decreasing and the capital base is relatively comfortable. Foreign exchange reserves remain well managed and kept mostly in cash, US Treasury securities, accounts with central banks, and in sovereign bonds with no holding of any corporate bonds. At present they are equal to about $5.3 billion. The banking system is mostly separated from international financial markets, and does not have sophisticated financial products. These factors also apply to the financial sectors in Sri Lanka and Nepal.

The capital account remains nonconvertible with few private transactions permitted such as foreign direct investment and portfolio investment. There is a positive current account balance that reduces the risks emanating from short run fluctuations in the exchange rate and foreign reserve situation. Net inflow of FDI has remained relatively stable in recent times whereas private debt transactions are limited and strictly monitored by the central bank.

One potential threat for the banking sector however is the likely incidence of payment default by foreign buyers against export orders, especially of RMGs, in the event of their going bankrupt.

Nearly 87 per cent of Bangladesh's export are destined to markets in developed countries. Ready Made Garments (RMG) make up over 75 per cent of all exports, mostly to US and EU markets. The impact on RMG exports will therefore determine the impact on the country's overall exports. With the ongoing recession in the US and EU, it is likely that exports will be hurt. There are some moderating factors that should be considered. Since the country's RMG exports mainly cater to the low price segment of the apparel market, the current slowdown may create less impact on the country's RMG exports. With incomes falling, even some diversion of demand from the high-end garment segment to low-end may take place. But people may also compensate by not diverting to low-end and just buying far less high-end clothing.

Major purchasers of RMG products may move to take advantage of the market situation by negotiating less favourable order contracts for suppliers from LDCs. Bangladesh is the cheapest producer of RMG in the world at present. In fact, a local company has received a $10 million order that was diverted from China. There are also negotiations for orders that are being diverted from India, Turkey, Indonesia, and Cambodia. Latest data from government indicate exports from India, Turkey, Indonesia, and Cambodia. These indicate exports during Jul-Sep 2008 being up by about 42 per cent over the same period of the previous year. But a more important question would be if this trend can be sustained if recession prolongs.

Bangladesh is a net importer of essential food commodities and fuel. In recent months prices of commodities such as rice, wheat, edible oil, fuel, fertiliser, etc. have dropped significantly in the global market which favours Bangladesh. The settlement of L/Cs for consumer goods during Jul-Oct 2008 declined by 19 per cent (Source: Bangladesh Bank). On the other hand, settlement of L/Cs for capital machinery has increased by about 8.5 per cent which is a positive sign for future industrial growth and productivity. Taka has appreciated against many currencies such as the euro, Aus $, Canadian $ etc. so this makes imports from those countries cheaper. Official general inflation figures are: 7.26 per cent in October down from 10.19 per cent in September. Food inflation is 8.08 per cent, down from 12.09 per cent (these are point-to-point calculations).

Remittance receipts during July-October 2008 went up by around 36.5 per cent compared to the same period of the previous year. Most remittance to Bangladesh is from the Middle Eastern Gulf states whose financial health has not yet been severely affected by the crisis. However, the price of oil has fallen very sharply, from $147 a barrel in July to under $50 at present. If this continues, the demand for labour from Bangladesh is bound to fall as new construction projects are halted.

Bangladesh has had little flow of FDI and most of this is longer term in nature. Tighter global credit markets have raised the cost of capital in the international market and are likely to reduce FDI in developing countries. Increasing FDI flow to Bangladesh depends more on domestic factors such as improvements in infrastructure, power supply, and governance and business practices.

Most of Bangladesh's aid sources (nearly 80 per cent of the total) come from multilateral sources. Aid inflows are likely to remain unaffected in the short run although the promises of significant aid increases may not materialise. Aid during FY 2009-10 is not likely to increase as developed countries mobilise resources to tackle their domestic economic problems.

Bangladesh Bank projects growth of around 6.2 per cent for the current fiscal year. However, World Bank projects it will be in the range of 4.8-5.4 per cent. Official forecasts are based on the fact that Bangladesh has not had any major natural disasters this year which set back agricultural output earlier on. Over half of all economic activity in the country occurs in the informal sector. Accurate data regarding this sector is hard to come by. The informal sector employs a large segment of the population (particularly lower income groups) and the global financial crisis is unlikely to affect it.

It is therefore difficult to paint an accurate picture of the impact of the crisis on the economy of Bangladesh, lower income groups in particular. The newly elected government will have to actively focus on these issues.

In fine, South Asia as a whole is clearly feeling the effects of the current global financial crisis in varying degrees. Pakistan might be the most affected in the subcontinent on current reckonings. India has felt the adverse effects and is trying to tackle the slowdown with several stimulus measures.

The extent to which the crisis will hurt the economy of Bangladesh is still unclear. At present, some indicators such as exports and remittance are actually encouraging. However, that does not mean that the government can be complacent. A prolonged global recession now seems likely, and therefore, negative impacts may be inevitable. So, Bangladesh must be prepared to face this crisis, both at the macro and micro level. Policy adjustments may have to be made at any time as demanded by the depth of the crisis. Appropriate policy taskforce, in addition to the routine monitoring by technical groups will have to be functioning continuously to provide necessary guidelines to the implementers, so that no sense of complacency, and hence, inaction creeps in.

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