Chapter Five

Path Ahead: Constraints and Policy Responses

Introduction

5.1 This chapter encompasses the discussion of the potential challenges to the implementation of the 2015-2017 MTBF (Medium Term Budget Framework) and the accompanying annual budgets. In a broader perspective, world economy is strengthening. Higher growth in advanced economies will translate into higher export growth for developing and emerging economies which in turn would boost GDP growth in these economies. Combined GDP growth in the US, Euro area and Japan is expected to almost double to 1.9 percent in 2014 from 1 percent in 2013 (ADB, 2014). IMF projected 3.6 percent world economic growth in 2014 and 3.9 percent in 2015. In advanced economies growth is expected to increase to 2.25 percent in 2014-15 where the USA is expecting a 2.75 percent growth. In emerging market and developing economies growth is projected at 4.7 percent in 2013, 5.0 percent in 2014 and 5.25 percent in 2015 (IMF, 2014). In this backdrop, the main challenges for the Bangladesh economy would be how to adjust to the differential behaviours and shocks in the external economy as well as internal investment and consumption scenario.

5.2 Bangladesh is maintaining more than 6 percent growth for the last four years and government policies are formulated to ensure higher growth in the long-run. Maintaining higher growth in future under uncertainty is one of the major challenges for the Bangladesh economy. Uncertainty disturbs saving and investment behaviour. For a smoothly growing investment climate in the medium-term, Bangladesh needs to surmount power and energy shortage, infrastructure bottlenecks, unadjusted fuel and non-fuel commodity prices compared to international market prices, uncertainty in remittance growth, inflationary pressure, underutilization of the ADP, increased bank borrowing by the government and mounting subsidy. All the challenges mentioned above may not be appropriate at this point of time (i.e. not a challenge in short-term) but could be very much important in medium-term. Apart from these, there are also some social challenges such as attaining MDGs (Millennium Development Goals), realization of population dividend, raising quality of human capital etc. The challenges discussed below are not statements of what will happen, but what might happen in view of the prevailing global and domestic economic environment and government responses towards them. Government's staunch and prudent macroeconomic management and timely policy interventions/responses will certainly help tackle these challenges and facilitate achievement of the medium term economic objectives.

5.3 While addressing these constraints with appropriate government policy responses, we may make some assumptions. Firstly, after the recent national polls, consumer and investor confidence are improving. Secondly, January 2014 monetary policy statement places emphasis on containing inflation within 7.0 percent while at the same time maintaining steady credit flows to private sector. Thirdly, electricity and fuel prices will be raised to lower subsidy that will eventually lower bank borrowing. Fourthly, food grain and oil prices will remain stable in the international market. Finally, there would be no major natural disaster affecting the economy.

Supply Side Constraints and Policy Responses

Power Sector

5.4 Power sector is the most important sector to ensure supply driven growth. The country was chronically suffering from an acute power shortage since independence due to limited generation capacity that struggles to meet the ever increasing demand for power. With prudent policy of the government, at present the shortage is not acute but not yet completely mitigated. Government has given importance equally on power generation, transmission and distribution. At present the country has an installed capacity of 10,341 MW electricity of which highest actual generation is 7,356MW in 2013-14. 5,060MW of additional electricity has been added to the national grid from January 2009 to March 2014. To meet the growing demand, by December 2014 additional 1249MW electricity will be added to the national grid. The ambitious increase in power generation planned over the medium term, if realized, will help solve the problem of power shortage.

5.5 According to the Government's long-term plan on power sector i.e. Power System Master Plan (PSMP) 2010, the estimated demand for power will be 19,000MWby 2021 and 34,000MW by 2030. Government has taken initiatives to set up coal, nuclear, renewable energy and solar based power plants. An agreement has been signed between Bangladesh and India to establish a coal based power plant in Rampal, Khulna with a total capacity of 1320MW. Government has taken steps to raise the installed capacity of 19,000MW by 2017. From January 2009 to March 2014, 1012 circuit km. of transmission line and 40000 km of distribution line have been built.

5.6 Although the medium to long-term power generation plan seems encouraging, implementation of it might be challenging for many reasons. Construction of new power plants and maintenance of old ones will require enormous amounts of capital investment and strengthened implementation and supervision capability of Power Division. High capital investment might create higher budget deficit if the implementation process is not well planned. Again continuous supply of power is necessary for industry and agriculture to achieve 8.0 percent real GDP growth by FY17 as projected in the MTMF. A faster transition to larger gas based and coal based power plants would be critically important for avoiding the fiscal and BOP pressures without burdening the private sector with excessively high electricity tariff rates. If the coal and gas based power plants are established, cost of electricity generation will reduce significantly which will help flourish the private sector. With this objective, the National Coal Policy needs to be finalized as early as possible.

Energy Sector

5.7 Natural gas is the largest source of primary energy for power generation. Currently, the power sector consumes about 41 percent of total natural gas produced. Natural gas is also used for captive power (17 percent), industry (17 percent), fertilizer (8 percent), CNG (5 percent), household (11 percent) and others (1 percent). In January 2014, daily 2,332 million cubic feet (cft) of gas was being extracted from 19 gas fields. With steady upward movement in economic growth, demand for energy is mounting. From January 2009, with the relentless efforts of the government, additional daily production of gas increased by 588 million cft that has been accrued to national grid. For attaining a huge breakthrough in the gas sector, different steps have been taken to strengthen the state owned company BAPEX by providing it with modern equipment and imparting improved training to its officials. It is estimated that by 2015-16 demand for gas will increase to 3800 million cft per day. Government has taken initiative to meet the demand mostly from domestic sources. Under medium term plan, 765 million cft of additional gas will be supplied to the national grid by 2015-16.

5.8 Ensuring energy security is an avowed objective of the government. Along with exploration, production and processing, the government has taken initiative to increase the storage capacity of liquid petroleum products. Current storage capacity has been raised to 10.54 lac metric tons from 8.94 lac metric tons in 2009 i.e. during the tenure of the present government. Due to limited supply of natural gas, the power sector will have to depend heavily on liquid fuels. The import of petroleum and petroleum products (considering the opening of fresh LCs) in the first eight months of FY14 is 3,116.42 million US$ which is higher compared to corresponding period of FY13 (2,711.19 million US$). Demand for petroleum products by industry, agriculture and communication sectors is expected to increase keeping with the projected world GDP growth. Meeting the growing demand for both natural gas and fossil fuels remains a challenge in the medium term. Besides, finalization of the coal policy and, its effective implementation is deemed to be a big challenge for the energy sector.

5.9 Petroleum products are important source of energy supply. It is important to see the future trends of petroleum demand in international market. Table 5.1 shows that over the years oil demand will decrease in developed countries and increase in developing countries. By 2035, OECD or developed countries will need 40.4 million barrels per day (mb/d) while developing countries will need 62.1 mb/d. With the resumption of higher growth in the world economy, especially in the developing world, demand for oil will gradually rise over medium-run entailing a gradual increase in oil price too.

Table 5.1:World Oil Demand Outlook (mb/d)

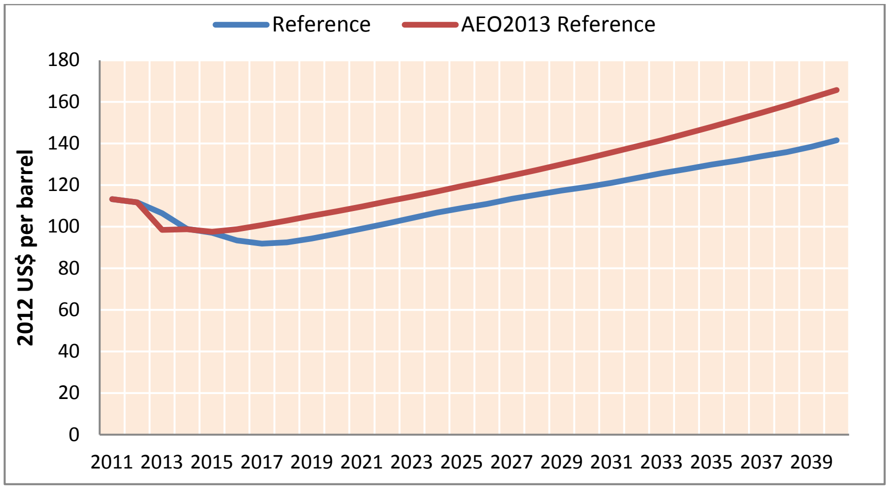
	2012	2015	2020	2025	2030	2035
OECD	46.0	45.2	44.2	43.1	41.8	40.4
Developing countries	37.8	41.1	46.6	51.8	57.0	62.1
Eurasia	5.0	5.3	5.5	5.7	5.8	6.0
World	88.9	91.6	96.3	100.7	104.6	108.5

Source: World Oil Outlook 2013

5.10 In the short-run, there is no sign of an oil price rise in 2014. Crude oil prices have downside trend with the average selling price near US$98.9 a barrel in 2014. Annual Energy Outlook 20141 described two distinct oil price scenarios including a price scenario linked to 2013 forecast and the other one linked to 2014 forecast as shown in the Figure 5.1.

[1]US Energy Information Administration, US Department of Energy.

Figure 5.1: Annual Average Spot Price for Brent Crude Oil Up to 2040



Source: Annual Energy Outlook 2014with Projections to 2040

5.11 Figure 5.1 shows that if the reference case 2014 prevails then the Brent crude oil price will decline gradually to US$ 91.84 per barrel in 2017 and afterwards will increase over the remainder of the period to US$ 141 per barrel in 2040. For Bangladesh economy with increased demand for oil, the high prices will put significant pressure on the balance of payments, accelerate inflation and require increased budgetary subsidy.

5.12 To keep the budget deficit within affordable levels, there is limited scope for increasing allocations for price subsidies both in power and energy sectors. Therefore, continuation of the gradual adjustments of power tariff and fuel prices will be required. Fiscal adjustments may also be necessary. Energy and Mineral Resources Division has short, medium and long-term plans to cope with any oil price shocks.

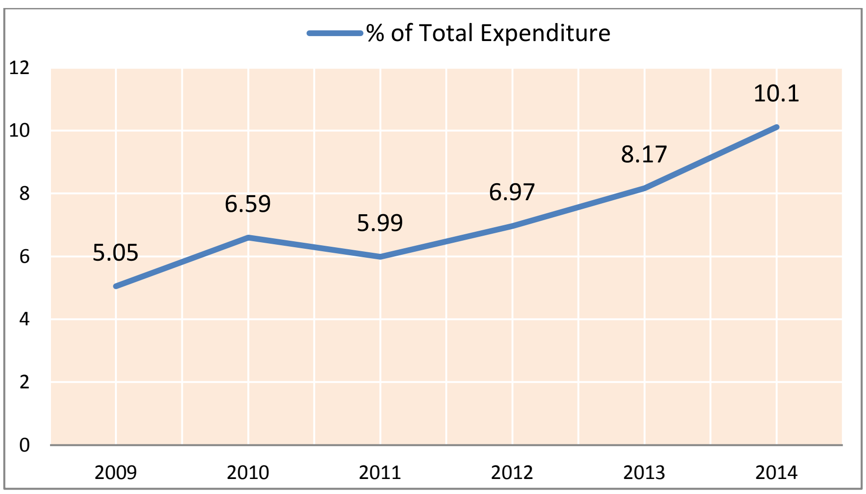
Infrastructure

5.13 Infrastructure plays a key role in removing supply side constraints. Government is spending money on building physical infrastructure. In transport and communication sector (consists of six[2] ministries) share of actual expenditure[3] is increasing as percentage of total budget (See Figure 5.2). Government has taken long-term plans for the development of infrastructure.

Policy Responses

- Government has approved Integrated Multi Modal Transport Policy (IMTP) on 26/08/2013
- Priority has been placed on constructing Padma Bridge to connect the capital with the south western part of Bangladesh

Figure 5.2: Transport & Communication Expense (% of Expenditure)



Source: Annual Energy Outlook 2014with Projections to 2040

- A Strategic Transport Plan (STP) has been formulated to modernize the transport system of Dhaka city. MRT (Mass Rapid Transport) will be implemented under this plan.
- There are plans to convert all nationwide important roads into four lanes from existing two lanes

[2] Ministries include Ministry of Railway, Roads Division, Bridges Division, Ministry of Shipping, Ministry of Post and Telecommunications, Ministry of Civil Aviation and Tourism.

[3] Total actual expenditure excluding loans and advances, food accounts operation and Non-ADP employment generation program. FY14 figure is budget expenditure not actual.

- Government has scaled up investment in new rail network around the country with a view to creating a low-cost improved transportation system for people and for goods trade
- A First Track Project Monitoring Committee headed by the honourable Prime Minister has been established to supervise implementation of six mega projects (Padma Multipurpose Bridge Project, Rampal Coal Based Electricity Generation Project, Ruppur Atomic Energy Project, Dhaka Metro Rail Project, LNG Floating Storage and Regasification Project and the Project to Establish a Deep Sea Port).

Production

5.14 In FY13 GDP growth slowed to 6.01 percent from 6.52 percent in FY12. According to broad category of sectors, agricultural growth decreased to 2.46 percent in FY13 from 3.01 percent in the previous year. One of the reasons is the lower crops and horticulture growth that dropped to 0.59percent in FY13 from 1.75 percent in FY12. In FY13, because of the manufacturing sector growth at 10.31 percent, industry sector growth was 9.64 percent - slightly higher than previous year. In FY13 service sector growth slowed to 5.51 percent from 6.58 percent in the previous year (BBS, 2014).

5.15 In FY14 due to frequent strikes before the election, industry sector growth is expected to be slightly lower (8.39 versus 9.64) compared to last year. The quantum index of medium and large scale manufacturing industries reveals that during July-December FY14 growth is 9.14 percent which is slightly lower than the FY13 growth which was 10.76 percent (Bangladesh Bank(1),2014). Recent BBS estimates show that manufacturing and agriculture sector growth are respectively 8.39 percent and3.35 percent in FY14. According to recent BBS projection, total Aman (rice) production of FY14 has been estimated at 13.02 million metric tons as compared to 12.9 million metric tons in FY13 which is 0.98 percent higher than that of last year. Total Boro (rice) production of FY14 has been estimated at 18.9 million metric tons as compared to 18.8 million metric tons in FY13 which is 0.73 percent higher than that of last year. There are no imminent risks or challenges on production side although the economy confronted frequent strikes.

Population Dividend

5.16 The population dividend or demographic dividend can be defined as the potential economic benefit offered by changes in the age structure of population during the demographic transition when proportion of working-age population (15-59 age groups) is higher than dependent population. Bangladesh is experiencing this demographic transition. This is high time to spend on human capital development or skills development. Parallel to that investment on physical capital is also necessary. During this time if government spends more on education and health that will have high return in future. Government is aware of this population dividend and is allocating bulk amount in the budget on health, education and skills development for complete realization of the dividend. To this end, a program titled' Skills for Employment Investment Program' has been taken up by the government to create skills linked massive employment.

Demand Side Constraints and Policy Responses

Remittance Flow

5.17 Remittance has been one of the major drivers of recent impressive growth performance. It has fostered economic growth by providing support to the BOP, spurring entrepreneurial activity and stimulating consumption, savings and investment. Bangladesh is one of the largest recipients of workers' remittances in the world. Bangladesh Bank data show that the growth of inflow of remittances in the first 10 months of the fiscal year is negative. Until April 2014 remittance growth is negative (-4.78) but negative growth is gradually decreasing which could be positive by the end of the fiscal year. One of the reasons cited for these decreasing trends is the appreciation of domestic currency against the US$. However, resumption of manpower exports to KSA, Libya and Iraq, regularization of illegal migrant Bangladeshi workers in Malaysia and KSA, increasing number of female workers going abroad (Hong Kong, Lebanon and other Middle Eastern countries) – all these together will contribute to increased inflow of remittances. Until December 2013 overseas employment stands at 24.51 lakh. From January 2009 to December 2013 additional overseas jobs created is more than 10 lakh.

5.18 Earnings from remittances will tend to be volatile because workers are mostly unskilled/semi-skilled and get laid off quickly when economic activity slows down in the host countries. A critical challenge will be to enhance the skill level of the migrant workforce, expand the existing markets and penetrate into new markets to reduce dependency on any specific region.

Policy Responses

5.19 The Government has undertaken various measures to increase the flow of remittances by:

- Adopting steps to reduce migration cost by sending workers through G2G system and digitizing the migration management system
- Easing the process of delivery of inward remittance
- Ensuring overall welfare of the expatriate workers and their families and protecting their rights through diplomatic channels
- Legalization of illegal workers in Malaysia and KSA
- Providing loans and other services through *Probashi Kallyan Bank* since 2010
- Providing assistance and support to repatriated migrant workers

- ❖ Negotiating with competent and relevant bodies so that displaced migrants could again be sent for overseas employment
- ❖ Activating NSDC (National Skill Development Council) to create semi-skilled and skilled workforce with a view to implement NSDP (National Skills Development Plan)
- ❖ An 1.6 billion US$ worth of 10 year long program has been taken up titled 'Skills for Employment Investment Program' to improve skills of the existing and new labour force so that they can find overseas employment not as unskilled Bangladeshi rather as skilled workforce. The program will help to increase the growth of remittance flows.

Export Diversification

5.20 Export earnings during July-April period of FY14 is US$ 24.65 billion. The growth of export earnings was 10.14 percent during July-April FY13 and the growth during July-April FY14 is 13.18 percent - a little higher. The bulk of export earnings come from the RMG sector which is growing at healthy rate and until January 2014 export growth is positive. Furthermore, leather, frozen food, chemical products etc. experienced positive growth. In contrast, some items such as raw jute, jute goods (excluding carpet), agricultural products and engineering and electrical goods experienced negative growth. Since a significant part of Bangladesh's export is destined to the EU, any slowdown or contraction in the European economies may slow overall exports to the EU in the next fiscal year. However, export to India is rising following the duty-free access granted by India to Bangladeshi products, including RMG.

5.21 Our export base is narrow, being heavily dependent on the RMG sector(woven garments and knit wear) accounting for more than80 percent of total export earnings (in US$). This sector is in trouble now-a-days because of two inexplicable disasters that happened in last fiscal year. Intensive discussion is going on between government and stakeholders regarding improving workers' safety standards in garment industries of Bangladesh and some actions have already been taken on maintaining the standard so that there is no downward trend of exports in future. Broadening the export base has been a challenge for the economy. The rise in export earnings in unconventional items indicates the potential for export diversification. Efforts to explore markets for unconventional export items like light engineering and plastic goods, ocean going vessels and pharmaceutical products may contribute to export earnings from traditional products.

Import

5.22 Import (c & f) payments in FY13 were 4.36 percent lower than in FY12. Import payment during July-March FY14 is 17.48 percent higher compared to the corresponding period of the previous year. In FY13 during July-March import payment was 25.34 billion US$ while in FY14 it is 29.77 billion US$. Settlement of import LCs increased by 14.12 percent during July-March FY14 compared to the same period of the previous year. Fresh opening of import LCs during July-March FY13 is 11.46 percent higher than the corresponding period of the previous year. Positive growth of import indicates that risks related to appreciation will be lowered.

Government Sector Constraints and Policy Responses

Revenue Income

5.23 Acceleration of growth rate from 6.18 percent in FY13 to 8.0 percent in FY17 will require a substantial increase in the rate of private as well as public investment. A large component of increased public investments will be financed from domestic resources including the additional revenues estimated at more than 1.0 percent of GDP to be mobilized by FY17 as projected in the Medium Term Macroeconomic Framework (MTMF).

5.24 Revenue performance in FY13 has been impressive. The growth is attributable to the reform initiatives and actions discussed earlier in Chapter 04. Actual Revenue-GDP ratio was 12.3 percent in FY13 showing higher realization of budget estimates (13.4 percent). Although, Bangladesh's revenue–GDP ratio of 12.3 percent is similar to some of the neighboring South Asian countries, this ratio should be increased by efficient management. In the revised budget of FY14 Revenue-GDP ratio is estimated to be 13.3 percent of GDP which was 14.1 percent in the Budget estimate.

5.25 Sustainability of the on-going tax reforms is important not only for revenue mobilization but also for fiscal stability. The tax base and the tax net need to be further expanded to enhance revenue. If the revenue targets are not achieved, the Government will have to make adjustments to expenditure outlays or increase borrowing which may undermine fiscal balance, growth, poverty alleviation efforts, and crowing out of private investment.

5.26 Bangladesh needs huge investment in infrastructure for a better investment climate. Raising tax revenue is the best way so that budget deficit can be kept unchanged. Bangladesh's tax effort is only 10.4 percent of GDP in FY13 which is much lower compared to Developed countries. In this regard, Government has taken a wide range of initiatives by simplifying tax laws and procedures, improving logistic and automation, and reducing scope for evasion with the introduction of improved enforcement technique.

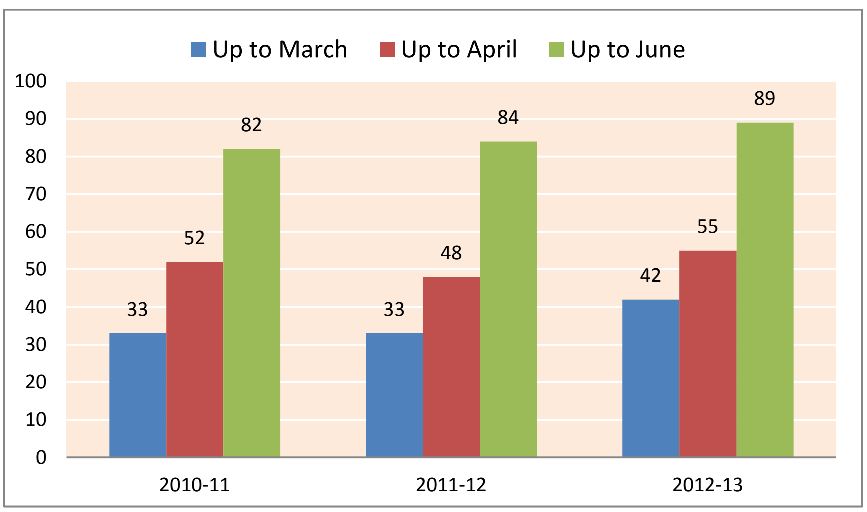
Deficit Financing

5.27 Fiscal deficit can be financed by mobilizing resources from three sources - foreign aid, borrowing from the financial institutions and borrowing from other private saving sources. Deficit financing creates risks for maintaining macroeconomic stability and avoiding crowding out of private sector credit. This is primarily due to underutilization of foreign resources and gradual increment of subsidies in the budget. So far, deficit target has always been kept below five percent of GDP. If this principle is followed strictly then budget deficit will not be a challenge over the medium run.

Foreign Financing

5.28 Utilization of foreign assistance at a rate significantly less than the target has compelled the government to resort to bank borrowing which in turn could lead to private sector crowding out and inflation. Foreign aid utilization in Bangladesh has been increasing over the past few years. A picture of upward trend at the end of last three fiscal year scan be seen from Figure 5.3. It shows that project aid utilization has an increasing trend of 82 to 89 percent during FY11 to FY14.

Figure 5.3: Project Aid Utilization Trend from FY11 to FY13



Source: IMED, Ministry of Planning

Policy Responses

5.29

- ECNEC meeting is held every week to accelerate project implementation as well as foreign aid utilization.
- IMED has enhanced its inspection activities.
- Frequent change of Project Director has been stopped.
- ERD, in consultation with the development partners, is devising ways for quicker disbursement of aid in the pipelines.
- Measures have been taken to enhance the capabilities of the Ministries/Divisions on project implementation.

Domestic Financing

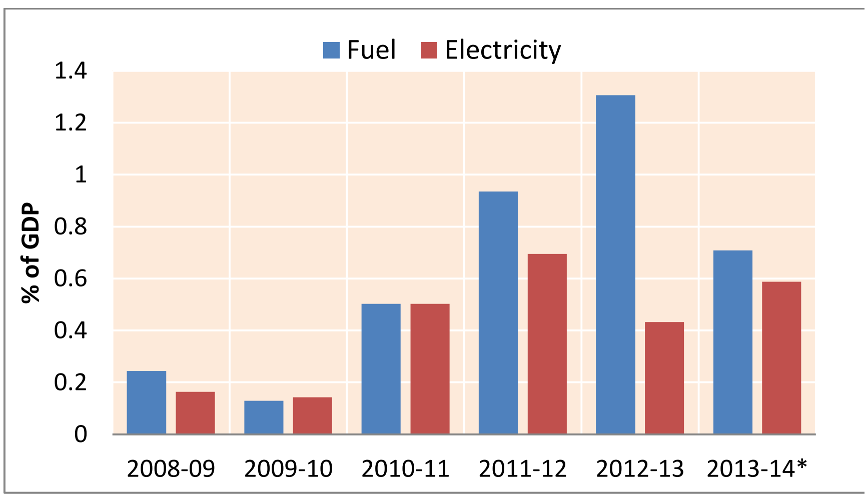
5.30 Because of the low Tax-GDP ratio (11.9 percent in FY14), resorting to deficit financing from both foreign and domestic sources is a standard feature of Bangladesh's fiscal management. In FY13, actual budget deficit was 4.4 percent of GDP of which 3.1 percent of GDP was financed from domestic sources. During FY14 to FY17 domestic financing has been projected to hover around 3.1 percent of GDP in MTMF.

5.31 Over the years, due to prudent macro-fiscal policy, Bangladesh has been able to sustain deficit financing within affordable levels. However, a rising trend in fuel and fertilizer prices in the international market in medium term may require higher price subsidies that may put further pressure on budgetary resources in the medium term. If aid utilization remains lower than planned, these factors may lead to higher than projected domestic financing. However, the government remains vigilant and is considering measures to keep domestic financing at projected level. Besides, the national savings certificates have been made attractive by increasing the rates of interest.

Demand for Cash Loans/Incentives

5.32 Demand for cash loans/incentives from different ministries/ divisions is increasing. It puts pressure on fiscal balance and creates distortion in macro-economic management. The provision for subsidies on fuel and electricity in FY14 revised budget is Tk. 13,450 crore which is 1.3 percent of GDP. Figure 5.4 shows the ratio of cash loans to GDP in electricity and fuel that shows little lower cash loans payment in FY14. Figure 5.5 shows the fertilizer incentives from FY09 to FY14.

Figure 5.4: Trends of Major Cash Loans as Percentage of GDP (FY09 to FY13)



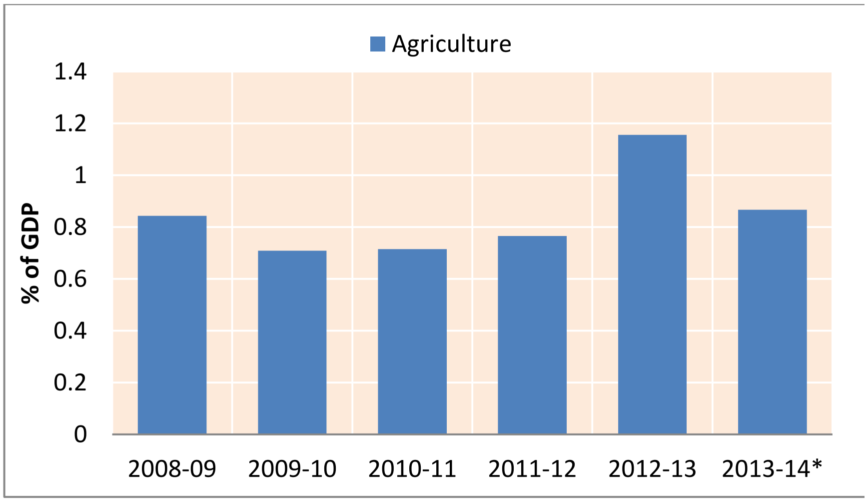
Source: Finance Division, Ministry of Finance; Note* means provisional, others are actual

Policy Responses

5.33

- Cash loans/incentives on fuel and electricity will gradually be eased by price adjustments
- Distribution of fertilizer incentives gradually will be more targeted so that marginal and small farmers get maximum benefit

Figure 5.5: Trend of Agriculture Incentives as Percentage of GDP (FY09 to FY13)

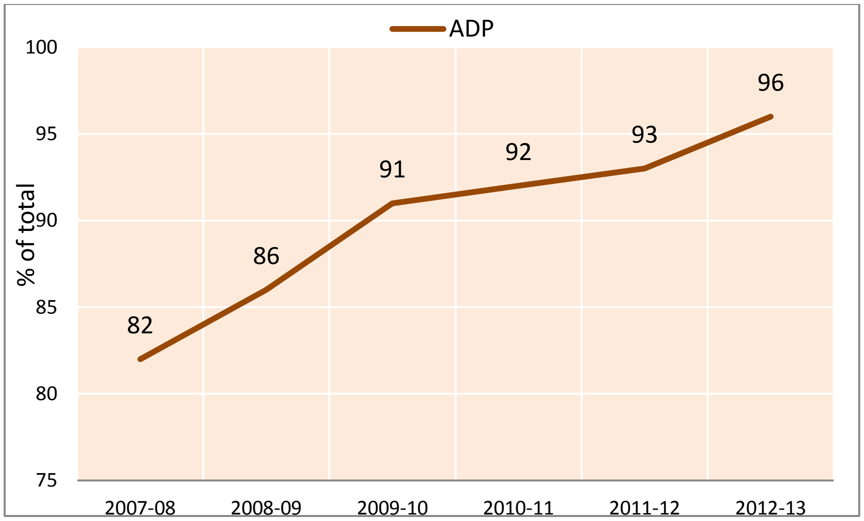


Source: Finance Division, Ministry of Finance; Note * means provisional, others are actual

Implementation of Annual Development Program

5.34 Full utilization of resources allocated for Annual Development Program (ADP) is crucial for maintaining momentum of economic development. Historical trend of ADP fund utilization as shown in the figure 5.6 below, still falls short of targets but is improving satisfactorily. Implementing a larger ADP maintaining the quality and timeliness of spending will remain as a major challenge for the government in the coming years. On the positive side, the figure also depicts that ADP utilization capacity has registered a rising trend in the recent years due to various measures taken by the government. The measures or policy responses for enhancing capacity utilization of ADP allocation introduced recently will continue to further improve the utilization.

Figure 5.6: ADP Utilization Trend from FY08 to FY12



Source: IMED, Ministry of Planning

Policy Responses

5.35 In order to ensure quality of spending and better ADP implementation, all ministries/divisions have been brought under MTBF - a more integrated budgeting system. Some of the major steps taken for improved budget management are noted below:

Planning Process Reform

- Simplification of project preparation, approval, implementation process
- Delegation of authorities and responsibilities for budget setting to Ministries/Divisions
- Adequate screening with feasibility studies mandatory for technically complex and high cost projects
- Project appraisal includes reviewing of procurement plan
- Introduction of Robust Result Based Monitoring and Evaluation system

- Introduction of Electronic Government Procurement (eGP)
- Introduction of online Procurement Performance Monitoring System
- Preparation of rules on production and publication of statistics on the basis of Statistics Act, 2013 is going on

Reform towards Enhancing Public Sector Transparency

- MTBF rolled out in all ministries
- Deepening and strengthening the quality of the MTBF across the Government
- Annual Audit Report of C&AG published
- Quarterly Report on Revenue, Expenditure and Macroeconomic situation along with budget implementation status is presented to the Parliament
- Establishment of Information Commission.

Monetary and Financial Sector Constraints and Policy Responses

Balance of Payments and Foreign Exchange Reserve

5.36 During July-February period the growth in exports and imports in Bangladesh is better in FY14 compared to the same period of FY13. Current account balance is in surplus (2.02 billion $US) during July-February FY14. The merchandise trade account balance during July-February of FY14 recorded a deficit of 3.6 billion US$ as compared to that of 4.6 billion US$ in the same period of FY13. Trade balance has improved during the first eight months of FY14. In addition, FDI has increased slightly in the first eight months of the current fiscal year compared to the corresponding period of last fiscal year (1,148 and 1,107 million $US). Up to February 2013, overall balance of the Balance of Payments is 3,329 million US$ which was 3,506 million US$ during the corresponding period of last year (Bangladesh Bank, 2014). So far BOP is in a favourable position because of higher remittance inflows.

5.37 The foreign exchange reserve in FY13 (June 30, 2013) was US$ 15.31 billion. On March 31, 2014, the foreign exchange reserve stood at US$ 20.1 billion. The gross foreign exchange reserve without ACU liability is equivalent to of 6.13[4] months' import payments. A major policy challenge in medium-run will be to maintain foreign exchange reserves at their current level because any unexpected international shocks particularly in fuel and oil prices could increase pressure and that may lower credit worthiness and may have a negative impact on Bangladesh's sovereign credit rating and inward foreign investment. However, steps taken by the Government to increase in remittance inflows and FDI flows would help improve further both the balance of payments and the foreign exchange reserve position.

Monetary Sector

5.38 A review of recent Monetary Policy Statement (January-June 2014) shows that Bangladesh Bank prepared its monetary stance considering the situation of the first half of fiscal year (July-December 2013).It is a monetary policy to contain pressures on inflation and external sector, while ensuring adequate private sector credit to stimulate inclusive growth. In the first half of the fiscal year, solid progress was made towards the key goals. Present half-yearly monetary policy (January-June) stance of Bangladesh Bank has one major objective - keep average inflation within 7.0 percent which is challenging. Bangladesh Bank kept unchanged the half yearly (January-June) broad money growth target at 17.0 percent. The Bank also has kept unchanged private sector credit growth envelope of 16.5 percent in June 2014. At the same time Bangladesh Bank remains committed to reduce inflation, avoid any asset price bubble and encourage banks to lend only to creditworthy clients for productive purposes not for speculative purposes. The 'balanced' monetary policy will also aim to minimize excessive volatility of exchange rate.

[4] Average import payments were calculated by averaging import payments from March 2013 to February 2014. Then months were calculated as the ratio of foreign exchange reserve to average import payments. Foreign exchange reserve was taken from the Bangladesh Bank publication 'Major Economic Indicators'/April, 2014.

Inflation

5.39 One of the major policy objectives of the Government is to sustain and strengthen growth momentum without fuelling inflationary pressures or jeopardising macroeconomic and financial stability. The CPI inflation targeted in FY13 was 7.5 percent. The rate of inflation as per latest BBS information is currently single digit. According to the BBS April'14 report, the CPI inflation calculated on a point-to-point basis is 7.46 percent considering the base year 2005-06. For food items on a point to point basis inflation is 8.95 percent and for non-food items inflation is 5.23 percent. General CPI Inflation in March FY14 is higher than target delineated in the MTMF and monetary policy statement of Bangladesh (7 percent). Inflation projected for FY15 is 6.0 percent and for FY16 is 5.8 percent in the MTMF. Containing inflation at the projected levels will be a major challenge, given the present inflation scenario.

5.40 CPI inflation gradually increased from 2009 to 2012, later on decreased gradually. Due to high inflation Bangladesh Bank took some measures that helped to reduce inflation such as (i) limiting domestic credit growth to levels consistent with the FY13 single digit CPI inflation target (ii) ensuring that productive growth-conducive activities are not hampered by access to credit and (iii) preserving external sector stability including building reserves to more comfortable levels.

Policy Responses

5.41 Pre-emptive management of inflation through a coherent policy mix of monetary and fiscal interventions is a primary policy priority of the government. Bangladesh Bank (BB), through its management of monetary policy, plays an important role in this respect. In its 2nd half yearly Monetary Policy Statement (MPS) for January to June, 2014 Bangladesh Bank has announced a monetary policy to limit credit expansion in line with domestic activity and the inflation target. Monetary policy helped so far to contain inflation. Bangladesh Bank needs to continue the same to keep the inflation within target.

5.42 From supply side perspective and with a view to minimizing the effect on inflation, government has been pursuing the following important programs to keep inflation within target:

- Maintaining uninterrupted supply and distribution system for essential commodities
- Emphasizing market monitoring by taking into consideration the difference between import price and domestic market price, and also the difference between production cost and market price
- Building up of a satisfactory stock of food grains for OMS
- Issuing Agricultural Input Distribution Cards to farmers
- Continued supports to farmers through loans and subsidies
- Open market sales of food stuff
- Introducing fair price cards for the ultra-poor
- Widening of social safety net and special allowances programs for targeted groups
- Controlling unproductive expenditure and keeping fiscal deficit within affordable limit in order to restrict too much expansion of public sector credit.

Bank and Financial Institution

5.43 Bank and financial institutions, at present, are facing a more stable environment. Government has already taken up appropriate steps to ensure governance at allstate-owned commercial banks.

Policy Responses

5.44
- A memorandum of understanding has been signed between Bangladesh Bank and state-owned commercial banks. State-owned banks need to improve their performance by adopting stronger risk management and control. Bangladesh Bank will have the authority to fix up ceilings on credit growth for each bank based on its financial soundness.

- In 2013, Bank Company Act, 1991 was amended to strengthen the supervisory role of Bangladesh Bank as well as the legal framework of these banking companies.

Capital Market

5.45 Long-term financing opportunities for business and industries are met by capital market. It is a way of mobilizing savings to investment. Primary security market directly provides financing to business and industries and secondary market keeps continuation of price discovery and liquidity generation for the investor keeping the whole system active. The capital market can be an effective source for mobilizing financial resources. After the massive market correction in 2011, the capital market is now more stable due to a number of appropriate steps taken by the government. Confidence of the investors has been restored to a great extent but restoring full confidence of the small investors still remains a challenge. After reviewing the recommendations of the Capital Market Enquiry Report 2011 on early 2011 volatility, the government has restructured the Bangladesh Securities and Exchange Commission. Strong supervision of private commercial banks by Bangladesh Bank to stop credit (term and SME loans) diversion to the capital market and reducing exposure of commercial banks to the capital market to improve liquidity management have contributed to stabilize the capital market.

Policy Responses

5.46 Law and Rules Reform

- The Exchanges Demutualization Act 2013 has been enacted
- Securities and Exchange Commission Act 1993 and Securities and Exchange Ordinance 1969 have been amended in 2012 . Under section 25B sub-section (1) of the Securities and Exchange Ordinance 1969 government has formed Special Tribunal

- Amendment proposal of the Banking Company Act, 1991 is on progress
- Securities and Exchange Commission (Private Placement of Debt Securities) Rules 2012 has been gazetted
- Bangladesh Securities and Exchange Commission (Research Analysis) Rules, 2013 has been formulated
- The book building process has been reformed under the Securities and Exchange Commission (Public Issue) Rules, 2006
- Amendment of the Securities and Exchange Commission (Right Issue) Rules, 2006 has been gazetted.

Other Reforms

- For identifying artifice and irregularities in the share market, a Surveillance Software of international standard has been introduced in BSEC
- BSEC has approved formation of the Bangladesh Fund targeting an amount of 5000 crore taka on 29 November, 2012. Up to 31 March, 2014 net asset value at cost price is 1763.78 crore taka
- To improve the accounting and accounting disclosure of listed companies a Financial Reporting Act (FRA) will be formulated
- A committee has been formed by BSEC to submit a preliminary report on establishing a derivative market
- A committee has been formed by BSEC to submit a preliminary report to establish a commodity exchange market
- New share price indces have been introduced in DSE and CSE for removing anomalies of indices
- Entrepreneurs and directors of the listed companies must hold 30 percent shares of the paid up capital and each director must hold at least 2 percent share.

5.47 The economy of Bangladesh has so far been resilient to both internal and external shocks due to prudent fiscal policy and efficient macroeconomic management. Even in the face of global economic crisis, the economy of Bangladesh achieved more than 6 percent (6.18 percent) real GDP growth in FY13. Let us sum up positive forces in the economy. In the government sector revenue earnings in FY13 have grown at a satisfactory rate, implementation of ADP recorded 96 percent in FY13, project aid utilization touched 89 percent in FY13 and the government could contain the budget deficit below 5 percent of GDP. Among the demand side forces, export and import growth rates are positive during July-March FY14 compared to corresponding period of previous year. Supply side forces are also encouraging in the medium-term if all the plans of the government are implemented regarding power and energy sector as well as the infrastructure. Monetary policy is designed to keep inflation within target. Current account balance has remained in surplus and the level of gross foreign exchange reserves are hovering around 20-22 billion US$ on end March, 2014 which is enough to cover 6.13 months' import payment. Inflation rate in April, 2014 is 7.46 percent - much lower than April, 2013 (8.37 percent).

5.48 Previous paragraph delineates an optimistic picture of the economy. Nevertheless, there are some challenges for the economy in short and medium run that need to be mentioned. In short-term the economy may have to face political instability. Furthermore, there remains some concern over the negative growth of remittance flows up to February FY14. Another point to ponder is the mobilization of domestic resources. In the budget estimate of FY14, revenue-GDP ratio was estimated to be 14.1 percent of GDP. But in the revised budget revenue-GDP ratio has been lowered to 13.2 percent of GDP.

5.49 In the medium and long-term, there are some risks and uncertainties but there is nothing to be pessimistic. Export and import growth is likely to be satisfactorily positive that could create positive effect on growth in the medium term. If negative remittance growth continues it may reduce aggregate demand that in turn might adversely affect GDP, consumption and investment. Monetary policy should be handled with caution as during January-April 2014, point-to-point inflation is hovering around 7.4-7.5 percent although target of latest MPS is 7.0 percent. In medium-term power and energy shortages will mostly be removed if projects are implemented as planned. The Government is well aware of the main concerns such as inflation, pressure on the balance of payments, power and energy shortage and underutilization of the ADP. The government has already adopted comprehensive, appropriate and timely policies and strategies to face the challenges to the projected high revenue growth, removing infrastructure bottlenecks, increasing remittance growth, containing inflation, limiting domestic borrowing of the public sector at a tolerable level, strengthening ADP utilization capacity and increasing disbursement of concessional loans from development partners. These measures and the government's firm commitment should help overcome the challenges and take Bangladesh to a higher growth trajectory in the medium term.