External Sector: Recent Trends and Challenges

Bangladesh Economic Update

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1. INTRODUCTION

The current issue of Bangladesh Economic Update attempts to understand the current status of external sector against the backdrop of declining growth in export, falling import letter of credits (LCs) for industrial raw materials, decreasing rate of growth in remittance inflow, and unsatisfactory disbursement of foreign aid.

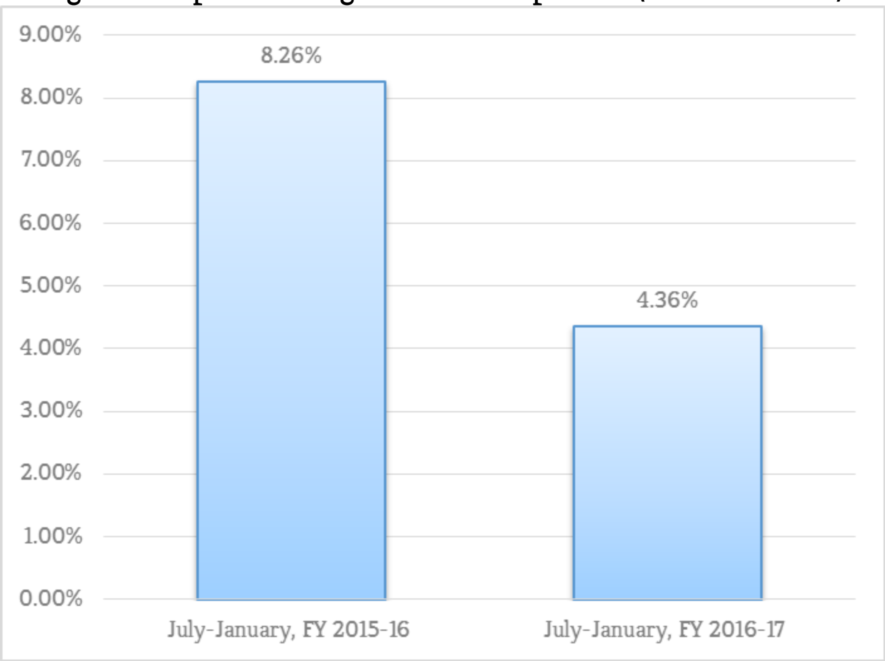
The Update reveals declining growth in two major external sector indicators – export shipment and wage earner's remittance, and consequential deficit in current account balance are likely to exert pressure on the country's balance of payment. However, overall external balance is showing positive balance because of inflow of one or two items such as financial account of the balance of payment in large amount, but decrease in remittance and increasing deficit in service and trade balance are likely to impede the growth of the economy. Inflows of remittance is declining since the last Fiscal Year (FY) mainly because of the decline in labour migration in major markets of the middleeast countries. This declinig inflow of remitance is likely to exert adverse impact on rural economy since consumption and expenditure of people living in rural areas are largely contingent upon remittance sent by their household members living aborad.

2. EXPORT EARNING

Growth in total export earnings exhibit a decline in the last seven months of FY 2016-17 compared to FY 2015-16. Percentage change in the export earning in July-January of FY 2015-16 over the preceding fiscal year was 8.26 percent, which declined to 4.36 percent in the corresponding period of the current fiscal year. However, total merchandise export during July-January 2016-17 increased by USD 0.84 billion or 4.36 percent to USD 20.11 billion compared to USD 19.27 billion during July-January 2015-16. Actual performance of merchandise export shipments during July-January 2016-17 was 4.43 percent lower than the target of USD 21.04 billion. Export earnings declined by 3.49 percent in July 2016 compared to the corresponding month of 2015. Total export shipment stood at USD 2534.31 million in July 2016 compared to USD 2625.93 million July 2015. However, total export declined by 29.46 percent in July 2016 compared to June 2016 when export earnings stood at USD 3592.97 million. Export earnings declined by 13.91 percent in September 2015 compared to the month of August 2015 and stood at USD 2.37 billion. In addition, export earnings fell by 6.98 percent in September 2015 compared to that in September 2014. However, export increased slightly by 0.83

percent in July-September 2015 compared to the corresponding period of the previous year. However, export earnings showed a negative rate of growth in the first month of FY 2014-15 which was positive in same period in previous year 2013-14 for especially decreasing export in the non-traditional markets. In July'2014 Export earnings decreases to USD 2982.74 million from USD 3024.29 in FY2013-14 million represent a decrease in growth rate to -1.37 percent from 23.99 percent that is 25.36 percentage point decrease. Moreover, export earning is increasing from FY 2010-11 to FY 2013-14. In FY 2009-10, export earnings were USD 16204.7 million. In FY 2012-13, export earnings were USD 27027 million which stand to USD 30186.6 million in FY 2013-14. The consequences of global economic recession, political crisis in North Africa and the Middle East exacerbated the situation of the import expenditure and the export earnings in Bangladesh in FY 2011-12.

Figure 1: Export earnings over recent periods (in million USD)



Source: Bangladesh Bank, 2017a

During July-January, 2016-17 exports of tea (71.32%), raw jute (38.79%), chemical products (13.80%), jute goods (9.02%), knitwear (6.03%), woven garments (2.37%) and leather (1.72%) experienced a positive growth compared to that of the same period of the previous year. On the other hand, agricultural products (20.25%), engineering and electric goods (10.78%) and frozen food (0.80%) experienced a negative growth during July-January, 2016-17 compared to the same period of the previous year. Category-wise breakdown of exports shows that two of the main export items – woven garments and knitwear – registered negative growth in the starting month of the current fiscal year. Woven garments and knitwear experienced negative growth of 4.36 percent and 4.45 percent respectively in July 2016 over July 2015. However, the export items that registered positive growth in July 2016 include raw jute, jute goods (excluding carpet), and chemical products. On the other hand, knitwear, woven garments, engine and electric goods, agricultural products, leather, tea, and frozen food experienced negative growth in July 2016 compared to the same month of the previous year.

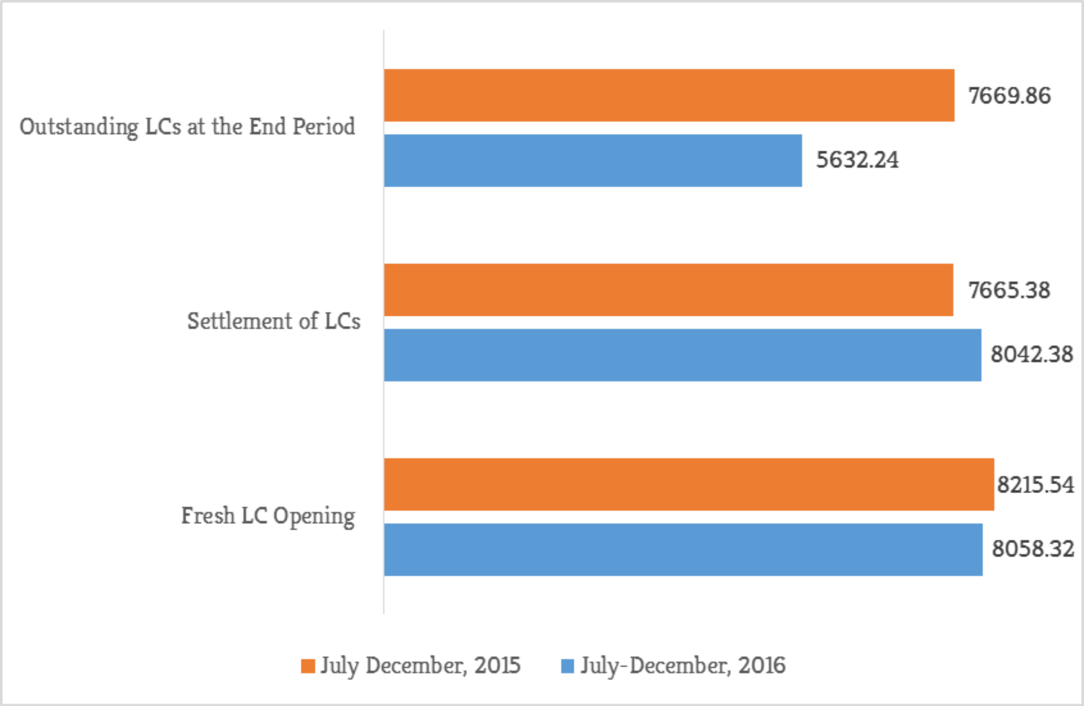
3. IMPORT PAYMENT

Fresh opening of import letter of credits (LCs) for industrial raw materials has registered a negative 1.91 percent growth during July-December of FY 2016-17 compared to the corresponding period of the preceding fiscal year. This negative growth in opening LCs for industrial raw materials implies the lack of entrepreneurship and productive capacity in the economy, which together with current challenges of unemployment and low private investment may cause the rate of growth in Gross Domestic Product (GDP) to decelerate. Custom based import during July-December, 2016 stood higher by USD 1.71 billion or 8.18 percent and stood at USD 22.61 billion against USD 20.90 billion during July-December, 2015. Settlement of import LCs during July-December, 2016 increased by 11.25 percent and stood at USD 22.59 billion against USD 20.30 billion during July-December, 2015. Fresh opening of import LCs during July-December, 2016 increased by 9.30 percent and stood at USD 23.02 billion compared to USD 21.06 billion during July-December, 2015. Landed import of customs during FY 2015-16 increased by 5.45 percent and stood at USD 42.92 billion against USD 40.70 billion during FY 2014-15. Settlement of import LCs during FY 2015-16 increased by 4.22 percent and stood at USD 40.08 billion against USD 38.46 billion during FY 2014-15. Fresh opening of import LCs during FY 2015-16 increased by 0.62 percent and stood at USD 43.34 billion compared with USD 43.07 billion during FY 2014-15. However, the total import payments during the period of July-August 2015 decreased by 2.98 percent and stood at USD 6.56 billion compared to USD 6.76 billion during the corresponding period of 2014.

The import of capital machineries declined by 30.85 percent during the period of July-August 2015 and stood at USD 416.3 million compared to USD 602 million in July-August 2014. However, import payment decreased from FY 2010-11 because of lower import of food grains, capital machinery and industrial raw materials and the continuous bumper harvest of food grain. Due to the continuous contractionary monetary policy, liquidity crisis and shortage of US dollars, imports of capital machinery and industrial raw materials massively decreased in the last two fiscal years before 2013-14. In FY 2012-13, import payments were USD 34084 million which was decreased by 4.03 percent as compared to USD 35516 million with a growth rate of 5.52 percent in the corresponding previous fiscal year but in 2013-14 import payment increases to USD 40692.92 million; an increase of 19.39 percent.

As mentioned earlier, fresh opening of import LCs during July-December, 2016 increased by 9.30 percent and stood at USD 23.02 billion compared to USD 21.06 billion during July-December, 2015. However, fresh opening of import LCs slightly increased by 0.62 percent in FY 2015-16 and stood at USD 43335.33 million compared to USD 43068.76 million in FY 2014-15. However, opening of import LCs for capital machinery and industrial raw materials assumed negative growth of 18.19 percent and 13.50 percent respectively in July 2016 over July 2015.

Figure 2: Opening and settlement of LCs for industrial raw goods (in million USD)



Source: Bangladesh Bank, 2017a

However, settlement of import letters of credits (LCs) during July-September, 2015 increased by 8.00 percent and stood at USD 6.94 billion against USD 6.43 billion in July-August, 2014. Fresh opening of import LCs during July-August, 2015 decreased by 6.83 percent and stood at USD 6.64 billion compared with USD 7.13 billion in July-August, 2014. Import payment shows a upward trail in FY 2013-14 compared to FY 2012-13 in terms of opening and settlement of LCs. However, import payment in July-June of FY 2013-14 was USD 37188.84 million which was USD 32358.52 million in July-June of FY 2012-13. Industrial raw materials, machineries for miscellaneous industries, petroleum and petroleum products, consumer goods, and intermediate goods rise both in terms of opening of fresh LCs and settlements. During July-June period of FY 2012-13 opening of fresh LCs was USD 35961.05 million but rises to 41818.56 in FY 2013-14 which implies a 16.29 percent increase.

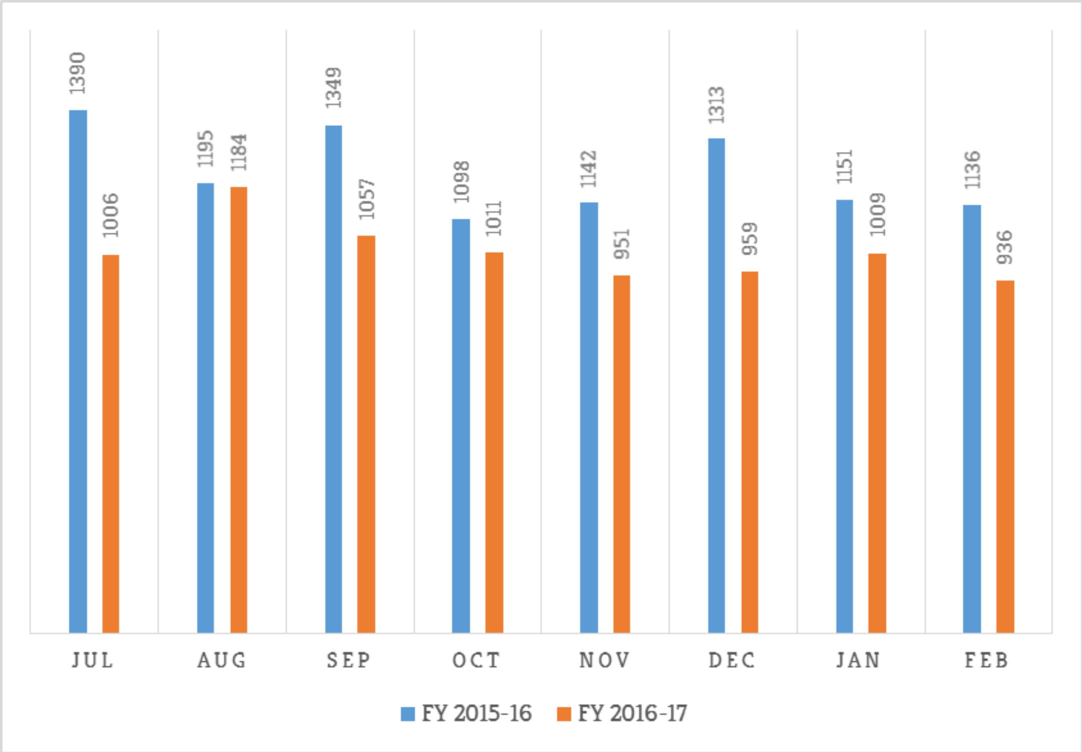
4. REMITTANCE

The inflow of remittance declined by 17 percent and amounted to USD 8112 million in July-February of FY 2016-17 compared to the corresponding period of the preceding fiscal year. On monthly basis, the remittance inflow stood at USD 936 million in February 2017 (a decline by 17.6 percent from February 2016), which is lowest in the first eight months of the current fiscal year.

Decline in the inflow of remittance is likely to pose threat to the social infrastructure of rural Bangladesh since the remittance recipient households in rural areas expend a significant portion of their income on consumption, health and education. Given the informal system for transferring money induced by large gap in rate of US Dollars in banks and curb market, it is imperative that a conducive atmosphere for higher inflow of remittance be maintained through effective regulatory measures and diplomatic negotiations

However, the inflow of remittance declined by 27.64 percent and amounted to USD 1005.43 million in July 2016 compared to the corresponding month of 2015. In addition, on month to month basis, remittance receipts fell by 31.41 percent in July 2016 over June 2016. In addition to decreasing inflows of remittance, recent incidences of restriction to overseas employment of Bangladeshi unskilled workers, i.e. Kuwait's recent ban on recruitment of Bangladeshi workers only four months after the nine-year restriction to employment of Bangladeshi unskilled workers was removed, is likely to aggravate the declining remittance growth and adversely impact the country's external balance.

Figure 3: Trends in inflows of remittance (in million USD)



Source: Bangladesh Bank, 2017a

The inflow of remittance further declined by 3.08 percent and amounted to USD 2584.58 million during the period of July-August of FY 2015-16 compared to USD 2666.84 million during the corresponding period of FY 2014-15. Noting the decline of inflow of remittance to -1.61 percent during the period of July-June of FY 2013-14 from the corresponding period of FY 2012-13, the finding is that total inflow of remittance during July-February of FY 2013-14 came down to USD 14227.84 million from USD 14461.15 million during the corresponding period of FY 2012-13.

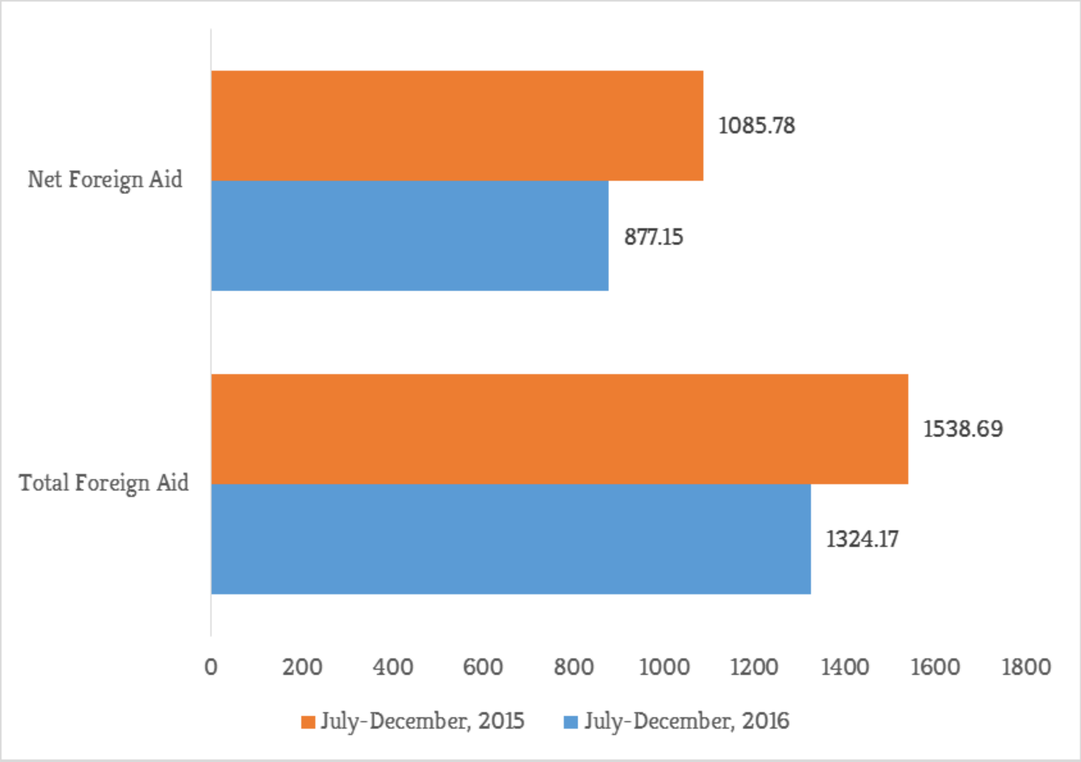
Remittance was increasing at a decreasing rate after FY 2007-08 because of the decrease in the labour migrations to the different destinations due to the global economic recessions and decline in the labour demand by the Middle East countries due to collapsing construction sector. In FY 2012-13, flow of remittance was USD 14461.15 million with a growth rate of 12.60 which was USD 12843.43 million with 10.24 percent growth rate in FY 2011-12.

5. FOREIGN AID AND FOREIGN DIRECT INVESTMENT

Both total and net receipt of foreign aid declined during July-December of FY 2016-17. The disbursement of total foreign aid decreased by 13.94 percent and stood at USD 1.32 billion in the first half of the current fiscal year compared to the corresponding period of the previous fiscal year. The net receipt of foreign aid, on the other hand, declined by 19.21 percent in July-December of FY 2016-17 over the corresponding period of FY 2015-16.

Total foreign aid disbursements during July-December, 2016 decreased by USD 0.21 billion or 13.94 percent and stood at USD 1.32 billion. After principle repayment of USD 0.45 billion, the net receipt of foreign aid stood at USD 0.88 billion during July-December, 2016 as compared to USD 1.09 billion of the same period of the previous year.

Figure 4: Trend in Disbursement of Foreign Aid (in Million USD)

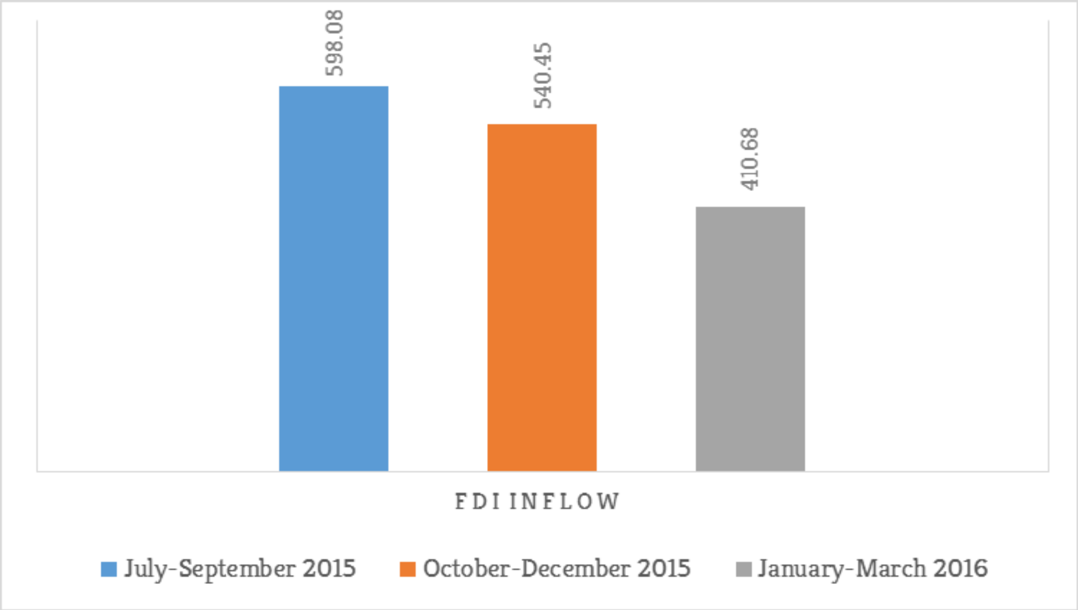


Source: Bangladesh Bank, 2017c

On quarterly basis, inflow of FDI has been gradually decreasing since July-September quarter of FY 2015-16. From USD 598.08 million in July-September of

2015, net inflow of FDI fell by 9.64% and stood at USD 540.45 million in October-December of 2015. FDI inflow further declined by 24.01 percent from October-December level and came down to USD 410.68 million in January-March of 2016.

Figure 5: Trends in inflows foreign direct investment (in million USD)



Source: Bangladesh Bank, 2017c

Both the investor and the recipient can take advantage from foreign direct investment (FDI). It allows money to go freely to whatever business has the best prospects for growth. The FDI in the country has usually observed much fluctuation. For example, inflow of FDI decreased to USD 1480.34 million in FY 2013-14 from USD 1730.63 million in FY 2012-13, although FDI inflow reached USD 1833.87 million in FY 2014-15.

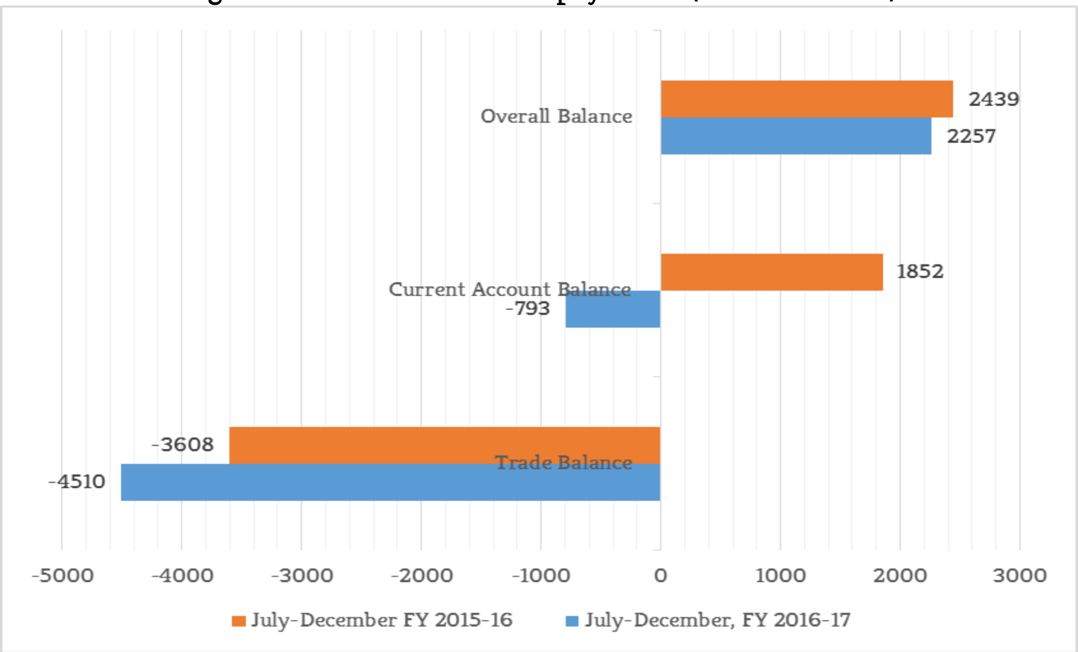
In addition, FDI decreased after FY 2005-06 from 845million to 792million in FY 2006-07, and then to 692 million in FY 2007-08.FDI increased to1086 million in FY 2008-09.After showing a negative growth rate in 2009 of -35.54 flow of FDI follow a positive growth rate of 30.4 and 24.4 percent in FY 2010 and FY 2011 respectively. Most importantly, rate of growth in FDI (net) has been seen a negative trend in FY 2013 (January-June) of -28 percent .In developing country like Bangladesh the current amount of FDI is insufficient for inclusive growth; more incentive should be given to foreign partners to increase the inflow of capital through FDI.

6. OVERALL BALANCE

With decline in inflow of remittance, rise in import payables along with shortfall in the primary income and income from the service sector, the current account balance exhibits a continuous deficit from the third month of the current fiscal year. From a surplus of USD 1852 million during July-December of FY 2015-16, the current account balance registered a deficit of USD 793 million during July-December of the current fiscal year. As a consequence, despite the surplus in financial account, surplus in overall balance decreased from USD 2439 million in the first half of FY 2015-16 to USD 2257 million in the corresponding period of FY 2016-17.

Trade balance recorded a deficit of USD 4.51 billion during July-December, 2016 as compared to the deficit of USD 3.61 billion during July-December, 2015. Current account balance continued with deficit during July-December 2016. Despite the current account deficit, financial account surplus of USD 2.70 billion contributed to an overall surplus of USD 2.26 billion in overall balances during July-December, 2016. The deficit in current account of July-December, 2016 was mainly due to the rise in import payables along with the shortfall in the primary income and income from the service sector as well as slow growth in remittance inflow.

Figure 6: State of balance of payments (in million USD)



Source: Bangladesh Bank, 2017b

Trade Balance recorded a deficit of USD 6274 million during FY 2015-16 as compared to the deficit of USD 6965 million during FY 2014-15. However, higher export earnings and an improvement in primary income and income from services contributed to a current account surplus of USD 3706 million during FY 2015-16 as compared to the surplus of USD 2875 million during FY 2014-15. Current account surplus along with a financial account surplus of USD 1610 million resulted in a surplus of USD 5036 million in overall balances during FY 2015-16 as compared to the surplus of USD 4373 million during FY 2014-15. The current account balance stood at USD 1406 million in FY 2013-14, whereas the balance became negative and stood at USD – 1645 million in FY 2014-15.

However, current account surplus soared by 35.21 percent during July-June of FY 2013-14 than that of the same period of FY 2012-13 because of the increasing rate of import payments and slower rate of remittance. Import showed a decreasing rate over the months of calendar year 2011 and 2012 which slowed the business activities although increases in FY 2013-14. However, recent monetary policy statement (MPS) estimated that this surplus might decrease in the next six months. According to MPS, surplus in overall balance of payment might reduce by the slower rate of RMG sectors and escalating in imports for growing the confidence of investors. In the meantime, imports to crude petroleum and petroleum products decreased by 22 percent due to the hamper in transportation for continuous shutdowns and blockades in the last few months. Bangladesh will have to fulfil a number of conditions to continue enjoying the trade privilege generalised system of preferences (GSP) of the European Union. Even, European GSP might be cancelled if Bangladesh government does not fulfil many of the conditions of GSP. To reduce the imbalances in balance of payment, government has set up various steps to manpower exports, upgrading skills of migrants and enhanced incentives to use formal channels to remit and invest funds (Byron, 2014). The financial account increased to USD 5150 million in FY 2014-15 from USD 2813 million in FY 2013-14 because of the increase in FDI and other investment.

7. CONCLUSIONS

Although the economy observed a comfortable current account balance, the decreasing rate of remittance and manpower exports might cause a serious hamper to the economy by reducing employment opportunities and output levels. In addition, declining industrial term loan will decrease the investment demand-induced import of capital machinery and industrial raw goods which may further aggravate the current declining growth in the manufacturing sector. After exploring the implications of unsatisfactory performances of the external sector, the Update concludes that the declining growth in GDP may persist if the indicators of external sector continue assuming current trends although the overall balance demonstrates surplus.

However, in order to address the current structural bottlenecks that impede developments in the external sector of economy, a thorough re-examination of the current trade and industrial policies is pressing. Adoption of a new policy regime aiming at expansion of productive capacities of the country that enhances utilisation of productive resources through enhanced entrepreneurial capabilities and increased production linkages may be fruitful in achieving developments in this sector, thereby fostering growth of the economy.

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