External Sector, Inflation and Standard of Living

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 high import-induced inflationary pressure, hike in oil price, and falling growth in export amid little or no possibility of revival of the generalized system of preference (GSP) facility, resulting in monumental deficit in current account. The Update reveals that cost-push induced by recent rise in import of consumer goods results in price hike in commodity market on the one hand and further upset the balance of payment on the other.

The Update further analyses how declining growth in major external sector indicators and consequential deficit in current account balance are likely to exert pressure on the country's balance of payment. However, overall external balance was showing positive balance in recent past 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.

Monumental increase in import payment together with low export growth amid no possibility of revival of the generalized system of preferences (GSP) has caused enormous current account deficit, which is highest in the last decade. Moreover, recent hike in oil price and high import of consumer goods are likely to result in an upsurge of food inflation adversely affecting standard of living of the low-income people.

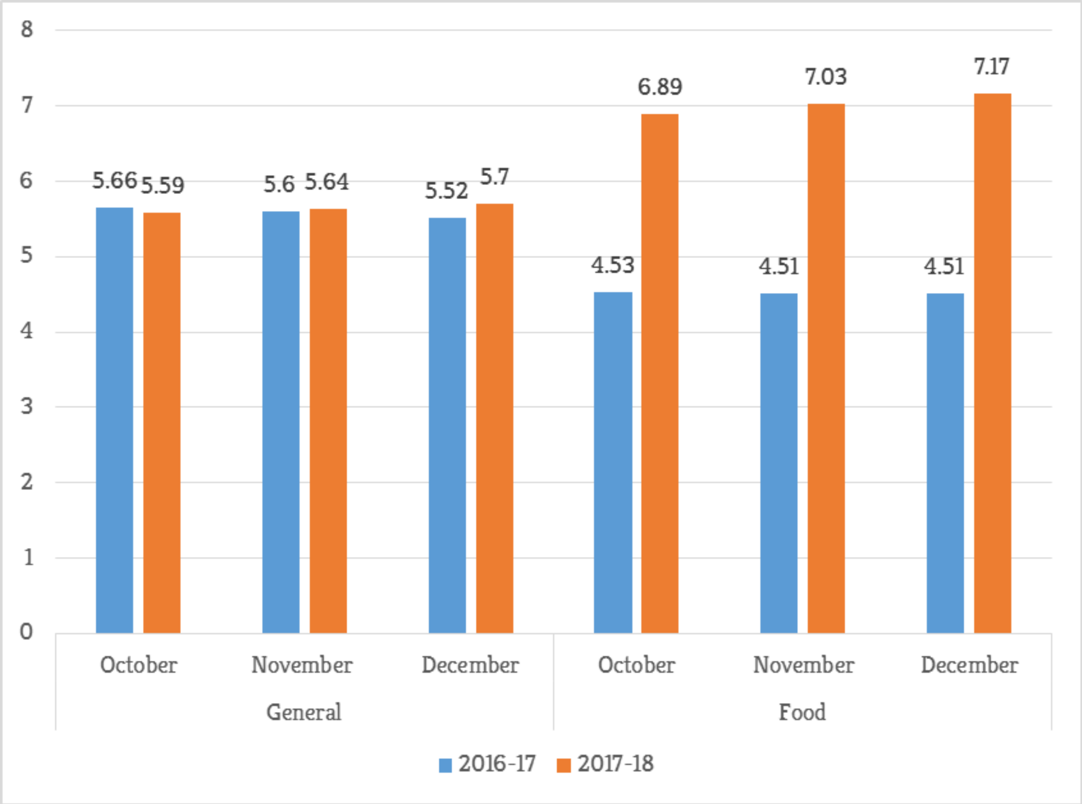
It is recommended that the country expand productive capacities that enhance utilization of available resources through efficient entrepreneurial capabilities and increased production linkages. In addition, adoption of measures to stabilize price in the short run and strategies to foster employment augmenting growth in the long run are necessary.

2. IMPORT OF CONSUMER GOODS AND INFLATIONARY PRESSURE

As regards the monumental increase in Letter of Credits (LCs) for the consumer goods and consequential price hike in recent time, it is found that during the period of July-December 2017, fresh opening and settlement of LCs increased by 56.35 percent and 60.47 percent respectively compared to the July-December 2016.

As a consequence, twelve-month average food and general inflation stood at 7.17 percent and 5.70 percent respectively in December 2017 compared to 4.51 percent and 5.52 percent in December 2016. On point-to-point basis, food and general inflation increased from 5.38 percent and 5.03 percent in December 2016 to 7.13 percent and 5.83 percent respectively in December 2017.

Figure 1: Rate of inflation at national level on point-to-point basis



Source: Bangladesh Bank, 2018a

3. EXPORT EARNINGS

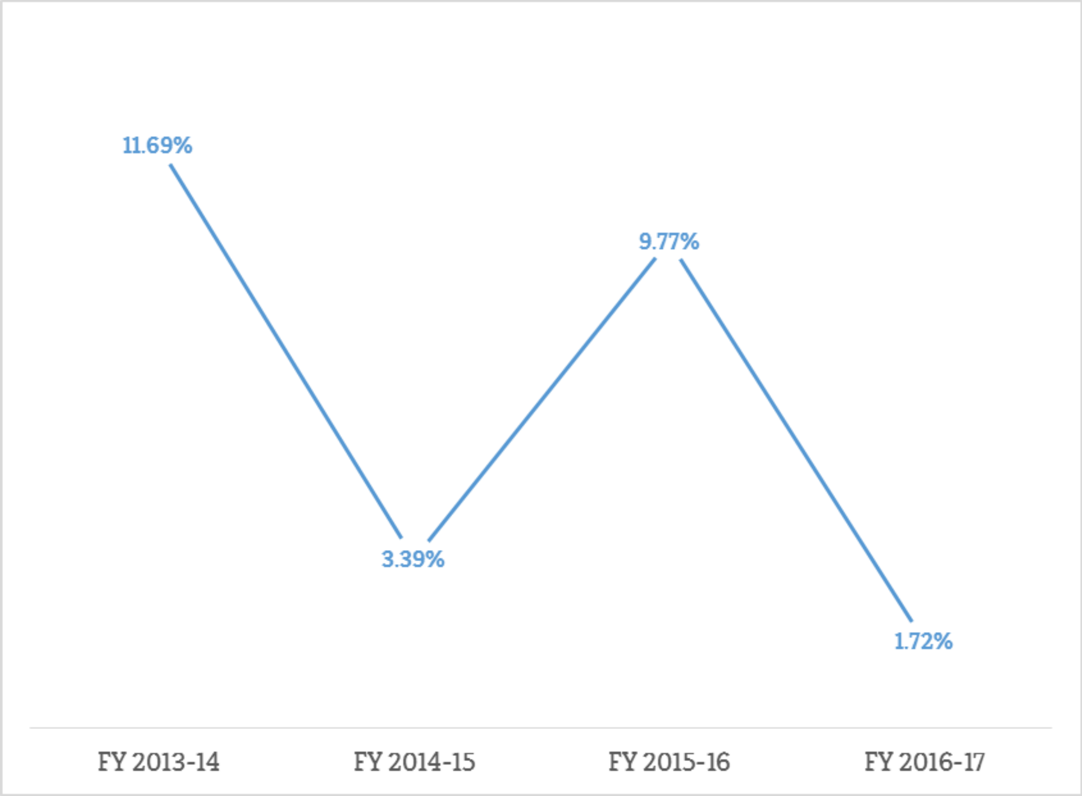
Compared to the target of export earnings of USD 21373 million for July-January 2017-18, the actual earnings fell short by USD 48.13 million, signalling the failure in achieving export target at the end of the fiscal year. In addition, a declining trend in cumulative export growth has been observed since the beginning of the current fiscal year, posing challenges to external balance.

Since the suspension of generalized system of preferences (GSP) facility for Bangladesh in June 2013 by the US, which is the country's single largest export destination, export growth considerably declined from 11.69 percent in FY 2013-14 to 3.39 percent in FY 2014-15. Despite the increase to 9.77 percent in FY 2015-16, export growth plunged to 1.72 percent in FY 2016-17. Failure to restore the GSP facility may further hinder the country's export.

With increasing export concentration of readymade garments (RMG), growth in total export earnings exhibit a significant decline by 8.67 percent in September 2017 compared to August 2017. Total export stood at 2.03 USD in the month of September which is, in fact, lower than the first two months of the current fiscal year. In view of the target of export earnings of 2.78 billion for September 2017, the actual earnings fell short by 26.72 percent, signalling the continuation of failure in mobilizing revenue at the end of the fiscal year. In addition, non-diversification of export markets and lack of export competitive products may pose serious challenge to the performance of external sector.

However, growth in total export earnings exhibit a significant decline by 8.08 percentage points in FY 2016-17 compared to FY 2015-16. Rate of growth in export earning stood at 9.77 percent in FY 2015-16, whereas at the end of June 2017, export growth declined to 1.69 percent for the last fiscal year resulting in a shortfall in the year's target (USD 37000 million) by USD 2165 million. Merchandise export in June 2017 decreased by USD 0.024 billion or 0.80 percent to USD 3.04 billion from USD 3.07 billion in May 2017 according to EPB data, that was 16.52 percent lower than the target of 3.65 billion for the said month. 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.

Figure 2: Export growth in recent years



Source: Bangladesh Bank, 2018a

As shown by category-wise breakdown of exports, during FY 2016-17, exports of tea (144.26%), engineering products (including electric goods) (35.05%), chemical products (13.21%), jute goods (6.45%) and knitwear (3.01%) experienced a positive growth compared to that of the same period of the previous fiscal year. On the other hand, frozen & live fish (1.74%), raw jute (3.08%), woven garments (2.35%), leather (16.30%), and agricultural products (27.41%) experienced a negative growth during FY, 2016-17 compared to the same period of the previous year.

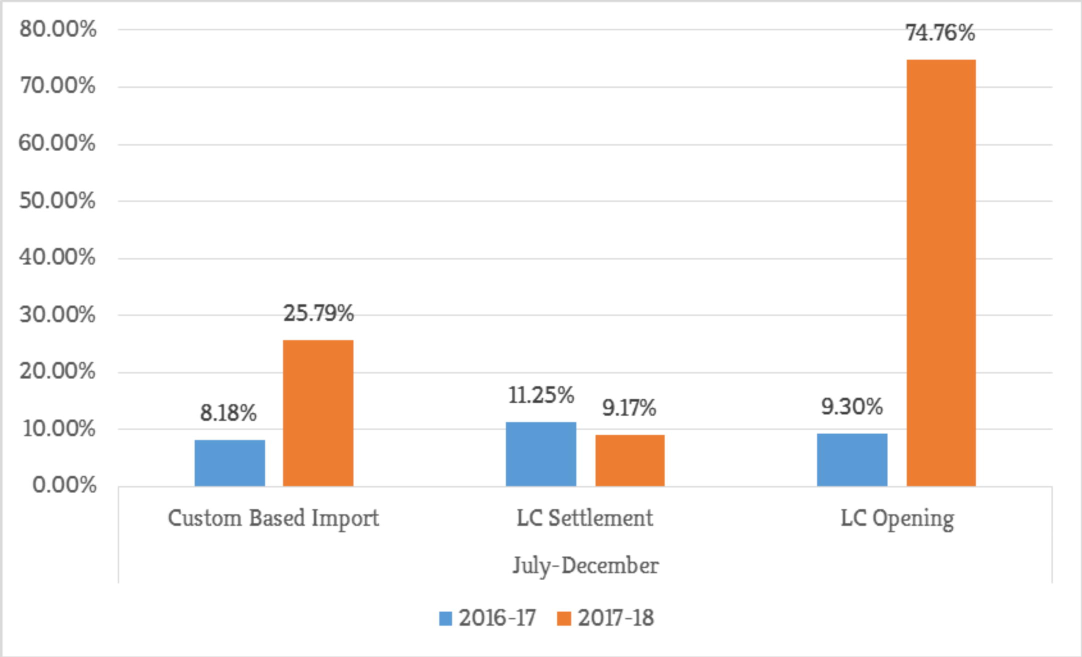
4. OVERALL IMPORT PAYMENT

As put forth by Bangladesh Bank (2018a), Custom based import during July-December 2017 stood higher by USD 5.83 billion or 25.79 percent and stood at USD 28.44 billion against USD 22.61 billion during July- December, 2016. Settlement of import LCs during July-December 2017 increased by 9.17 percent and stood at USD 24.66 billion against USD 22.59 billion during July-December, 2016. Fresh opening of import LCs during July-December, 2017 increased by 74.76 percent and stood at USD 40.23 billion compared to USD 23.02 billion during July-December, 2016.

Sector-wise analysis suggests that fresh opening of import letter of credits (LCs) for industrial raw materials has registered a growth of 15.12 percent during July-December of FY 2017-18 compared to the corresponding period of FY 2016-17. This growth in opening of LCs for industrial raw materials cannot be capitalized on until the lack of entrepreneurship and productive capacity in the economy are dealt with in order to rise to the challenges of unemployment and low private investment.

Bangladesh Bank (2018b) further states that data on projection of opening of import LCs and probable liabilities against back to back LCs sent by the authorised dealer banks are USD 12.58 billion and USD 3.44 billion respectively during February'18-April'18. The mentioned liability is 10.33 percent of foreign exchange reserves as on February 25, 2018.

Figure 3: Rate of growth in custom based imports, opening and settlement of LCs



Source: Bangladesh Bank, 2018a

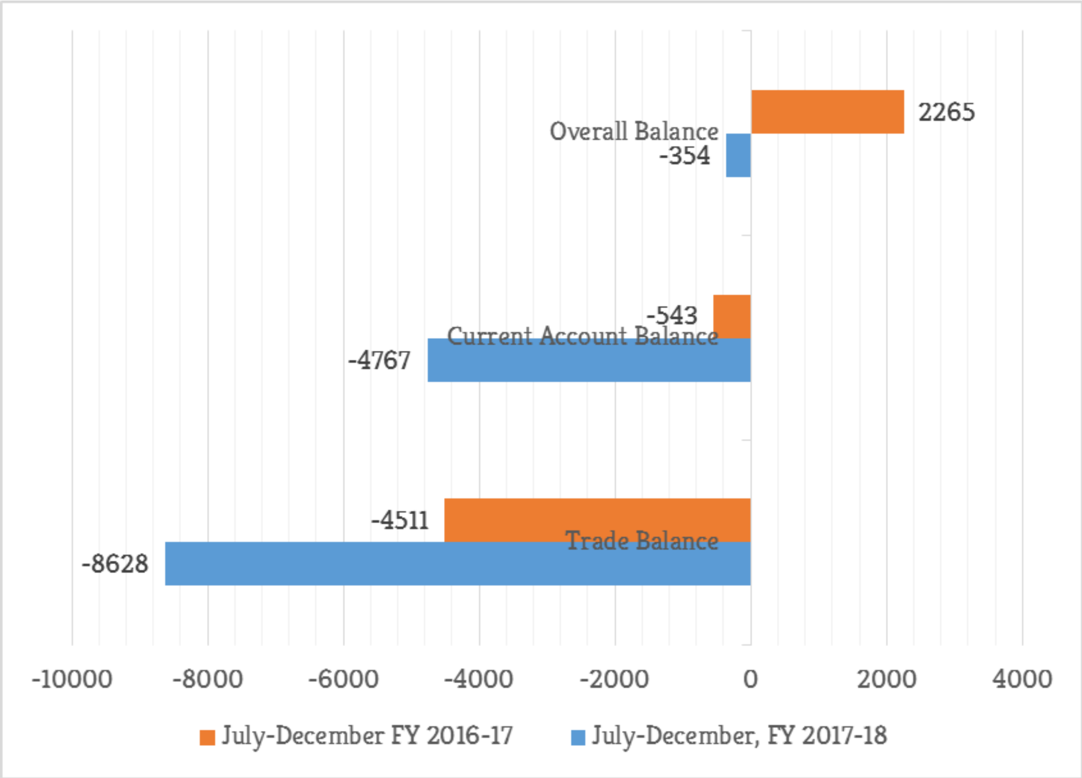
5. OVERALL BALANCE

It is important to note that with rise in import payables along with shortfall in the primary income and income from the service sector, the current account balance exhibits a deficit of USD 4767 million during July-December of 2017 compared to a deficit of only USD 543 million during the corresponding period of 2016. As a consequence, the total balance of payment undergoes a deficit of USD 354 million in July-December of FY 2017-18 compared to a surplus of USD 2265 million in July-December of FY 2016-17.

The current account balance exhibits a monumental deficit of USD 1480 million during FY 2016-17 compared to a surplus of USD 4262 million during the same period of the previous fiscal year. As a consequence, the total balance of payment declined to USD 3169 million in FY 2016-17 compared to USD 5036 million in the FY 2015-16. It is worth noting that trade balance recorded a deficit of USD 9.5

billion during FY 2016-17 compared to the deficit of USD 6.5 billion during the previous year. Despite the current account deficit, financial account surplus of USD 4.5 billion contributed to an overall surplus in the balance of payment during FY 2016-17.

Figure 5: State of balance of payments (in million USD)



Source: Bangladesh Bank, 2018a

6. 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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