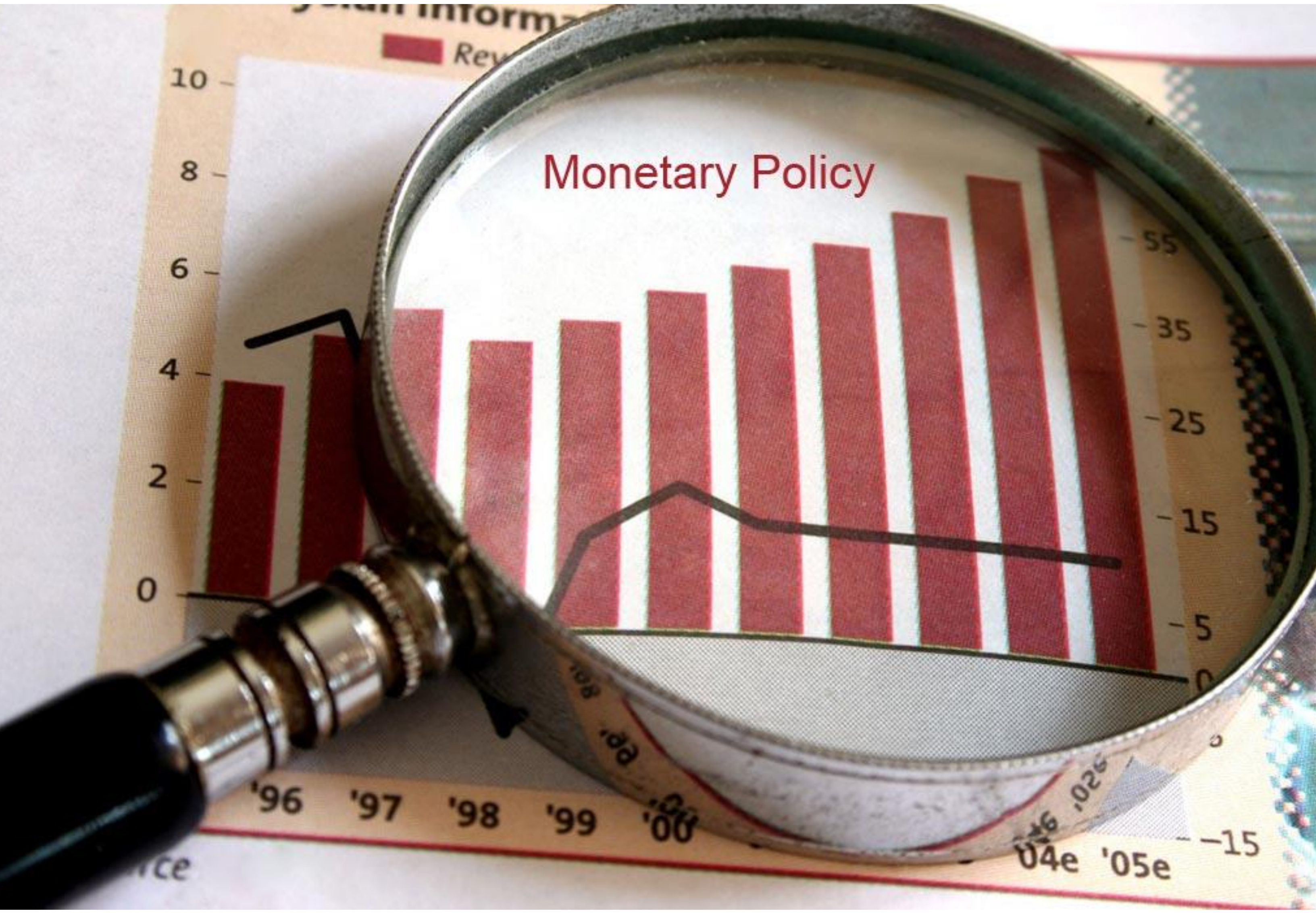
Bangladesh Economic Update

Myopic views of Monetary Policy Statement

January 2012



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Unnayan Onneshan
The Innovators
centre for research and action on development

Bangladesh Economic Update
Volume 3, No. 1, January 2012

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1. INTRODUCTION

The current issue of the Bangladesh Economic Update focuses on the recently announced six-monthly Monetary Policy Statement (MPS) for the period of January-June of 2012.

The report suggests that the proposed instruments in recent policy statement such as hikes of repo rates may dampen investment by increasing the cost of capital, as the banks will keep borrowing at higher rates. This implies that there will be associated risk factors in terms of targeting the productive sector for further investment. And at the same time, the central bank's expectation of reduction of pressure on liquidity may not be materialised as high inflationary pressure may crowd out the attempt to increase the savings rate.

This analysis also shows that the MPS's envisaged instruments may not rein in inflation because of the inadequate diagnosis of the causes of continuous increase in prices. The inflation has occurred for two reasons, namely, domestic prices are increasingly knotted to international prices due to the liberalisation of trade and administered prices are adjusted to global prices; and low level of emphasis on public distribution system has encouraged jacking up in prices.

Contrary to what has been prescribed in the MPS, harmonization of monetary policies with fiscal measures is needed to address this externally induced inflation, with the expansion of domestic productive capacities.

Furthermore, the dampening of investment and unabated rise in the price would hurt different sections of society differently. Any failure to contain inflation is to bound increase inequality as the latter has been showing an upward trend for some time.

2. STATE OF RECENT MONETARY MEASURES

Bangladesh Bank, through monetary policy, regulates the supply of money, interest rate, exchange rate; and maintains reasonable

Recently announced monetary policy would be more contractionary as it aims to curb spending in both public and private sectors in order to rein in inflation.

price level. It regulates the cost and availability of domestic credits to the priority sector. Recently, Bangladesh Bank has declared its six-monthly Monetary Policy Statement (MPS) and adopted contractionary monetary policies aiming to bring down inflation to a single digit from existing double digit level through discouraging credit flow to unproductive sectors and to achieve targeted growth of GDP by easing pressure on foreign exchange reserve.

Decline in foreign exchange reserve along with increase in domestic credit and import payment might hold back the targets of the recently announced monetary policy.

It seems that recently announced monetary policy would be more contractionary as it aims to curb spending in both public and private sectors in order to rein in inflation. Decline in foreign exchange reserve along with increase in domestic credit and import payment might hold back the targets of the recently announced monetary policy.

In order to meet up the objectives of the MPS, both REPO and Reverse REPO are used. Due to the increase in the world price of food and oil, the pressure of inflation is increasing in Bangladesh. There has been increased pressure of demand both in domestic taka and foreign exchange markets. While workers' remittance inflows slow down and trade deficit increases due to import growth; reduction in capital account inflows creates the stress on taka and foreign exchange markets. In this situation, Bangladesh Bank has enhanced the REPO 100 basis point than that of 50 basis point announced in the last MPS.

Under the business as usual scenario, it is evident that the targets set in the Monetary Policy Statement (January-June of 2012) may left far behind than the actual.

Table 1: Monetary Policy Statements (Target & Actual)

	FY 2010-11		FY 2011-12		
			H1		H2
	Target	**Actual**	**Target**	**Actual**	**Target**
Domestic Credit	17.9	28.4	20.0	25.7	19.1
Credit to public sector	25.3	39.9	28.1	62.0	31.0
Credit to private sector	16.0	25.8	18.0	18.0	16.0
Broad money	15.2	21.4	18.5	17.4	17.0
Reserve money	13.0	21.0	16	15.5	12.2
Inflation (12 Month Moving Avg.)	6.5	8.85	7.5	10.7	9.0

Source: Monetary Policy Statement, Bangladesh Bank, 2012

Yet the central bank has not been able to maintain its target. The apparent divergence between key targets and outcomes seems to occur with unfailing regularity raising the issue of credibility and realism in target setting. Target set by previous MPS' could not reign in. The inflation rate in FY 2011 was 8.85 against the target of 6.5 percent. Board money increased by 5.8 percent than that of the target of 15.2 percent and same difference prevailed for domestic credit, credit to public and private sector. Under the business as usual scenario, it is evident that the targets set in the Monetary Policy Statement (January-June of 2012) may left far behind than the actual.

3. BROAD MONEY

Broad money consists of currency plus demand deposits, travelers' checks, other checkable deposits, retail money markets, mutual fund balances, saving deposits and small time deposits. It is the intermediate targets in the monetary policy. The underlying assumption is that the growth of the monetary aggregates such as M2 has a direct impact on the domestic price levels. By controlling M2, the central bank tries to control the price level. At July-December in FY 2011-12, broad money increased by Tk. 349.77 billion or 7.94 percent against the increase of Tk. 362.48 billion or 9.98 percent in FY 2010-11.

In December 2011, the supply of M2 is Tk. 4754.97 billion whereas it was Tk. 4648.24 billion in November 2011.

In December 2011, the supply of M2 is Tk. 4754.97 billion whereas it was Tk. 4648.24 billion in November 2011. Of the components of broad money, currency in circulation has increased by 6.11 percent and demand deposit is increased by 3.12 percent while time deposits witnessed an increase of 8.93 percent in July-December, 2011 than that of July-December, 2010.

Net Domestic Assets of Bangladesh Bank Tk. 4086.25billion in December, 2011 which is increased by Tk. 62.2 billion or 1.54 percent than that of November, 2011. This is Tk. 1126.67 billion or 38.04 percent higher than that of June, 2010.

Table 2: Broad Money Movements

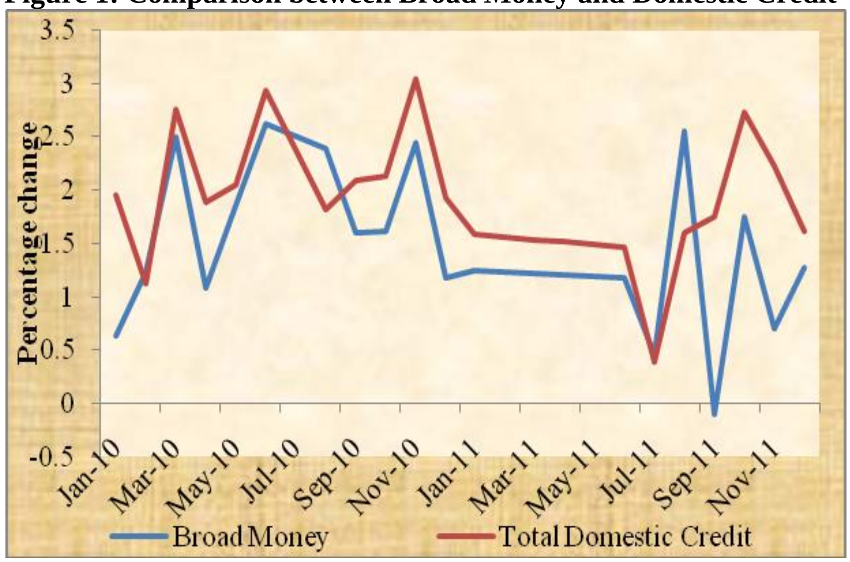
	Jun,09	Jun,10	Jun,11	Oct,11	Nov,11	Dec,11
Net Foreign assets of Bangladesh Bank	474.59	670.74	706.2	693.63	624.19	668.72
Net Domestic assets of Bangladesh Bank	2490.40	2959.58	3698.99	3919.41	4024.05	4086.25
Broad Money	2964.99	3630.31	4405.19	4613.04	4648.24	4754.96
a. Currency outside Banks	360.49	461.57	547.95	594.73	595.69	581.45
b. Deposits	2604.51	3168.74	3857.25	4018.31	4062.55	4173.51
Demand deposits	303.78	418.31	483.06	485.45	458.24	498.11
Time deposits	2300.73	2750.43	3374.19	3532.87	3604.31	3675.41
Domestic Credit	2885.52	3402.13	4335.26	4621.88	4724.95	4815.39

Source: Statistical Department, Bangladesh Bank; Bangladesh Bureau of Statistics, 2012

Domestic credit has increased by Tk. 480.13 billion or 11.08 percent during July-December in FY 2011-12 whereas it was increased by Tk. 421.49 billion in the same period of FY 2010-11.

Domestic credits are increasing day by day due to the expansion of the credits of the private sectors. Domestic credit has increased by Tk. 480.13 billion or 11.08 percent during July-December in FY 2011-12 whereas it was increased by Tk. 421.49 billion in the same period of FY 2010-11. Domestic Credit growth in December, 2011 is Tk. 991.76 billion or 25.94 percent higher than that of November, 2010. The Bangladesh Bank emphasizes on the sufficient credit availability for agriculture, small and medium enterprises, renewable energy and other productive sectors.

Figure 1: Comparison between Broad Money and Domestic Credit



Source: Bangladesh Bank, 2012

Domestic Credits in Public sectors increased more than the private sectors credit.

Domestic Credit in private sector increased by Tk. 305.30 billion or 8.96 percent in July-December, 2011 while domestic credit in public sector increased by Tk. 174.83 billion or 18.84 percent.

It as well discourages the banks to lend credits to the unproductive sectors and unnecessary consumer loans as gorgeous marriage ceremony, travel to foreign countries and consumer credits by using credit cards etc. The components of domestic credits are increasing such as private sector credit recorded an increase of Tk. 658.77 billion or 24.33 percent in FY 2010-11 whereas it was Tk. 461.11 billion in FY 2009-10. Domestic Credits in Public sectors increased more than the private sectors credit. Domestic Credit in private sector increased by Tk. 305.30 billion or 8.96 percent in July-December, 2011 while domestic credit in public sector increased by Tk. 174.83 billion or 18.84 percent.

The Government (net) sector credit also rose by Tk. 175.60 billion or 23.91 percent during July-December, 2011 while it was decreased by Tk. 19.33 billion or 3.55 percent in July-December, 2010.

4. RESERVE MONEY

In FY 2010-11, during July-December, net foreign asset of Bangladesh bank have decreased by Tk. 24.15 billion or 3.39 percent less than that of the same period of the previous fiscal year.

The Reserve Money (RM) is the operating target in the annual monetary programme. The RM consists of currency with the public cash in tills and balances of scheduled banks and other financial institutions with Bangladesh Bank. In FY 2010-11, during July-December, net foreign asset of Bangladesh bank have increased by Tk. 17.21 billion or 2.81 percent than that of the same period of the previous fiscal year. But in FY 2011-12 (July-December), it decreased by Tk. 24.15 billion or 3.39 percent than that of the same period of the previous fiscal year. The reason behind this decrease is the increased payment and slow rate of remittance inflows.

Table 3: Movements of Reserve Money

	Jun,08	Jun,09	Jun,10	Jun,11	Jul,11	Nov,11	Dec,11
Sources of Reserve Money	527.90	693.90	805.10	975.01	969.10	991.58	993.74
Net Foreign assets of Bangladesh Bank	328.36	432.45	612.05	613.89	621.45	549.14	589.73
Net Domestic assets of Bangladesh Bank	199.54	261.45	193.05	361.12	347.66	442.45	404.01
Reserve Money	527.90	693.90	805.10	975.01	969.10	991.58	993.74
a. Currency Issued	356.49	394.49	504.65	605.27	614.38	643.03	638.53
b. Deposits held with BB	171.41	299.41	300.45	369.74	354.72	348.56	355.21
Reserve Money Multiplier	4.1	4.27	4.51	4.52	4.56	4.69	4.78

Source: Statistics Department, Bangladesh Bank, 2012

The increase in reserve money occurred mainly due to the increase in net domestic assets of Bangladesh Bank which is Tk. 17.42 billion or 75.83 percent more in FY 2011-12 than that of the previous fiscal year.

In December 2011, reserve money recorded an increase of Tk. 134.71 billion and that is 15.68 percent more than that of December 2010. The increase in reserve money occurred mainly due to the increase in net domestic assets of Bangladesh Bank which is Tk. 17.42 billion or 75.83 percent more in FY 2011-12 than that of the previous fiscal year. The reserve multiplier in June 2010 was 4.51 and 4.52 in June 2011, and it increases up to 4.78 during December 2011.

5. LIQUIDITY RATIO

Central Bank regulates the liquidity position in the economy by the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). Increase of excessive investments in the unproductive sectors such as consumer products and luxurious goods, real estate, and the capital markets etc. creates the stress on liquidity. In this situation, central bank has already taken several steps to contain credit growth. One of steps is the increase in REPO rate and the last Monetary Policy Statement raises the repo rates by 100 basis points for the second half of FY 2011-12.

Monetary Policy Statement raises the repo rates by 100 basis points for the second half of FY 2011-12.

5.1 Repo and Reverse Repo

Increase of excessive investments in the unproductive sectors such as consumer products and luxurious goods, real estate, and the capital markets etc. creates the stress on liquidity. In this situation, central bank is supplying liquidity help by REPO. Repo rate (1-3 Day tenure) and reverse repo rate (1-3 Day tenure) increased by 50 basis point at 7.75 percent and 5.75 percent in 8 January, 2012 whereas it was 7.25 percent and 5.25 percent respectively in 5 January, 2012. The weighted average call money rate in the inter-bank money market increased to 19.67 percent in January, 2011 as compared to 17.15 percent in December, 2011.

Repo rate (1-3 Day tenure) and reverse repo rate (1-3 Day tenure) increased by 50 basis point at 7.75 percent and 5.75 percent in 8 January, 2012.

Due to excess liquidity in the banking system during the last quarter of FY2008-09 and the first quarter of FY2009-10, the Bangladesh Bank resumed reverse repo auction since October 2009. Eventually, the rate on repo (1-2 Day tenure) plunged into 4.5 percent in November, 2009 from 8.5 percent in September, 2009 and remained unchanged at 4.5 percent up to June, 2010. On the other hand, the rate on reverse repo (1-2 Day tenure) declined to 2.5 percent in October, 2009 from 6.5 percent in March, 2009 and also remained unchanged at 2.5 percent up to June 2010. For the high rate of inflation Bangladesh Bank increase its repo and reserve repo rates by 25 basis point and goes up to 6.25 and 4.25 percent in 27 April, 2011.In November 2011, reserve money growth and broad money rate have gone to a satisfactory level through open market operation and raising the repo rate by 100 basis points for the second half of FY 2011-12.

5.2 Cash Reserve Ratio

The reserve requirement (or cash reserve ratio) is a central bank regulation that sets the minimum reserves each commercial bank must hold (rather than lend out) of customer deposits and notes. It is normally in the form of cash stored physically in a bank vault (vault cash) or deposits made with a central bank. The reserve ratio is sometimes used as a tool in the monetary policy, influencing the country's borrowing and interest rates by changing the amount of loans available. Central banks rarely alter the reserve requirements because it would cause immediate liquidity problems for banks with low excess reserves; they generally prefer to use open market operations (buying and selling government-issued bonds) to implement their monetary policy. CLR and SLR has been determined respectively 6 percent and 19 percent in the Monetary Policy of December 2010. But in the recent monetary policy, CRR and SLR have not been determined specifically.

CLR and SLR has been determined respectively 6 percent and 19 percent in the Monetary Policy of December 2010. But in the recent monetary policy, CRR and SLR have not been determined specifically.

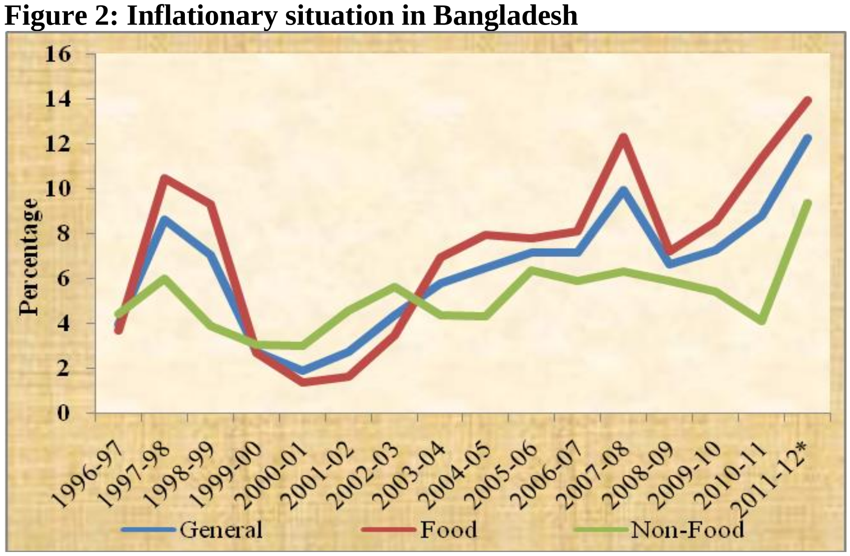
As of June 2011, the total liquid assets of the schedule banks were Tk. 1005.64 billion. By the end of December 2011, this went up by Tk. 1141.71 billion. Currently, the amount of required liquidity SLR is BDT 738.68 billion. The excess liquidity of the schedule banks decreased by Tk. 43.50 billion in June 2011 than that of June 2010 that means it decreased by 28.49 percent in 2011. Banks hold cash in tills and the excess cash reserves with the BB (which is around 10 percent of total liquidity) to meet immediate cash withdrawal needs of customers.

Currently, the amount of required liquidity SLR is BDT 738.68 billion.

6. INFLATION

Bangladesh Bank has adopted contractionary monetary policy for the reduction of high inflation. The stated objective of the Bangladesh Bank is to maintain the inflation rate, low unemployment rate and economic growth.

Figure 2: Inflationary situation in Bangladesh



Source: Statistic Department, Bangladesh Bank, 2012

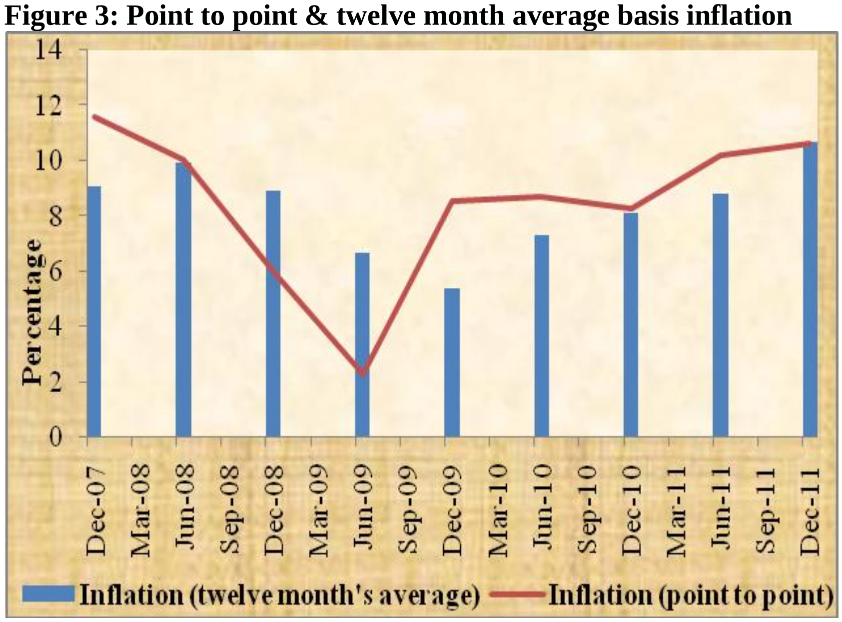
In FY 2011-12, the general inflation rate might be 12.27 percent.

The persuasion of prescribed mechanisms to contain inflationary pressures in subsequent MPS has not borne results. In FY 2008-09 Inflation rate was 6.66 percent whereas in FY 2009-10 it was 7.31 percent and 8.8 percent in FY 2010-11 that is well above the targeted level of 8.00 percent. Under business as usual scenario in FY 2011-12, the general inflation rate might be 12.27 percent.

The government projected inflation to be 7.5 percent in the current fiscal year but if this inflationary situation holds further, this projection will remain in the oblivion.

General inflation in December 2011 was 10.63 percent. In the urban areas, food inflation was 12.03 percent in FY 2010-11 than that of 9.85 percent in FY 2009-10. In the rural areas general inflation was 7.3 percent in FY2010-11 that was 7.16 percent in FY 2009-10. Changes in inflation rate in FY 2009-10 was 9.76 percent where as it was 20.38 percent in 2010-11. Percentage of change in food inflation was 18.64 percent in 2009-10 but it was 32.94 percent in FY 2010-11. The government projected inflation to be 7.5 percent in the current fiscal year but if this inflationary situation holds further, this projection will remain in the oblivion.

Figure 3: Point to point & twelve month average basis inflation



Source: Selected indicators, Bangladesh Bank, 2012

The government data shows that point to point inflation was lowest in June, 2009 as 2.25 percent. However, this is following an upward trend which was 11.58 percent in November, 10.63 percent in December, 2011. But, on the twelve month average basis, the inflation rate recorded as the highest level of 10.71 percent in December 2011 compared to 8.13 percent in December 2010.

6.1 Impacts of inflation

Inflation was the most shattering phenomenon in FY 2010-11. It has a direct impact on unemployment, the output and income levels. Increase in the global food and oil prices often leads to higher domestic retail prices due to increase in cost of production and overall prices. It mainly upsurges the level of poverty and inequality.

According to the textbook Phillips law, increases in inflation rate may reduce the unemployment rate in the economy. But such was not the case in FY 2010-11 where inflation rate increased to 8.80 percent from 8.68 percent in FY 2009-10 whereas the unemployment rate also increased from 4.9 percent in FY 2009-10 to 5.2 percent in FY 2010-11. Though unemployment rate increases, the output level has also reduced and it affects the fixed income earners. Inflation reduces the value of money and people's purchasing power.

Inflation not only worsens poverty but also exacerbates inequality in the economy such as the wealthy persons find their assets more valuable and the condition of the poor deteriorates further.

Inflation does not only worsen poverty but can also exacerbate inequality in the economy such as the wealthy persons find their assets more valuable and the condition of the poor deteriorates further. As the food inflation rises, the poorer are compelled to spend more on it that reduces the consumption in basic needs such as health, education. As real income falls due to the increased price level, conditions of the middle-income families become vulnerable.

7. POSSIBLE EFFECTS OF MONETARY POLICY

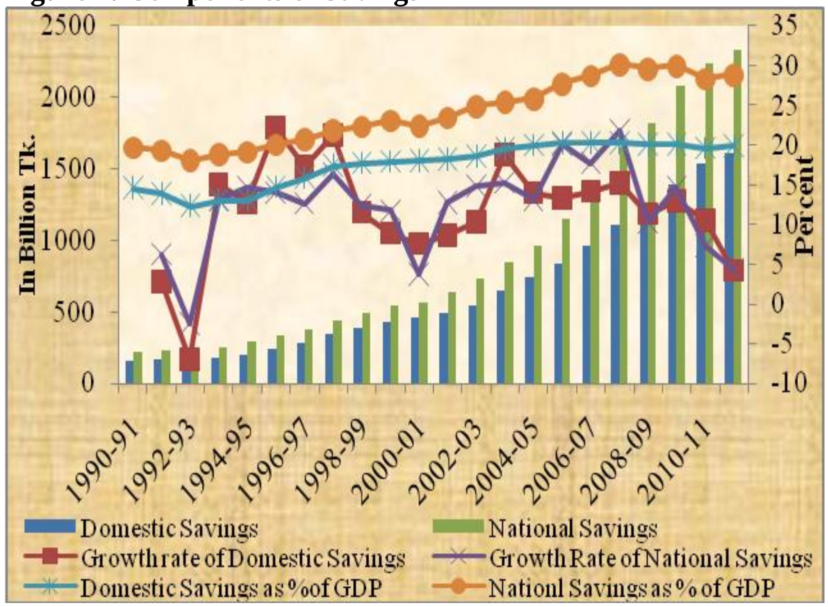
7.1 Impact on Savings

For the increased food consumption in FY 2010-11, domestic savings as percentage of GDP falls to 19.6 percent whereas it was 20.1 percent in FY 2009-10.

National saving also falls as the remittance inflow decreases in this fiscal year, which was 28.4 as percent of GDP.

Bangladesh Bank has taken the contractionary policy by increasing REPO and REVERSE REPO, which increases the interest rates. The lending rate of scheduled banks was higher at 12.83 percent in November, 2011 as compared to 12.80 percent in October, 2011 and the deposit rate of scheduled banks was 7.53 percent in November, 2011 which is higher than that of October, 2011 as 7.46 percent. For the increased food consumption in FY 2010-11, domestic savings as percentage of GDP falls. It is 19.6 percent in FY 2010-11 whereas it was 20.1 percent in FY 2009-10. National saving also falls as the remittance inflow decreases in this fiscal year, which was 28.4 as percent of GDP. Saving rate should have increased with the rise of interest rate. However, in FY 2010-11 this does not happen for the reason of high food inflation as high as11.34 percent. However, the rate of inflation rises, interest rate on deposit is still low compared to the lending interest rate and saving rate does not increase as a result.

Figure 4: Components of Savings



Source: National Accounts wings, Bangladesh Bureau of Statistics (BBS), 2012

In FY 2010-11 the growth rate of domestic savings declined by 2.4 percent and the growth rate of national savings declined by 7.3 percent compared to FY 2009-10.

In FY 2011-12, the domestic savings might be Tk. 1608.6 billion and national savings might be Tk. 2332.7 billion.

In FY 2010-11 the growth rate of domestic savings declined by 2.4 percent and the growth rate of national savings declined by 7.3 percent compared to FY 2009-10. According to the UO projection, under the business as usual scenario, in FY 2011-12 the domestic savings might be Tk. 1608.6 billion and national savings might be Tk. 2332.7 billion. That will lead to lower growth rate of both savings whereas in FY 2011-12 the growth rate of domestic savings might decline by 6.3 percent and growth rate of national savings might decline by 3 percent.

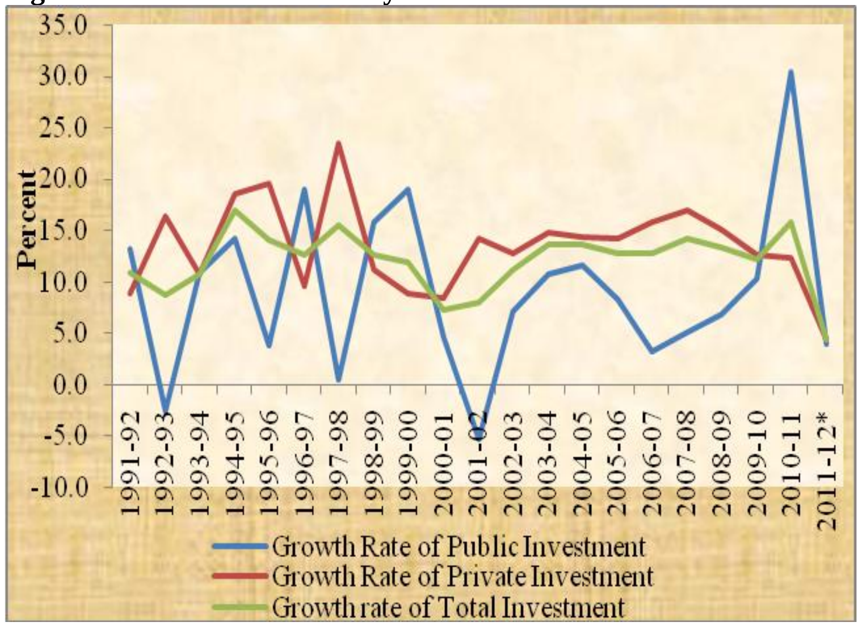
7.2 Impact on Investment

Investment is interrelated with the levels of inflation and interest rate. Increase in interest rate may pose an adverse effect on investment. In 2006 lending interest rate was 11.06 with an investment ratio in GDP was 24.5 percent. The lending interest rate rose from 12.63 in 2008 to 12.83 in November, 2011. However, in the last monetary policy statement, all the lending caps are lifted.

The investment trend is found to have declined but the investment ratio in GDP rises by 24.7 percent in FY 2010-11.

The investment trend is found to have declined but the investment ratio in GDP rises by 24.7 percent in FY 2010-11. In FY 2009-10 private investments was Tk. 1346.9 billion whereas it is 1532.1 billion in 2010-11.

Figure 5: Investment over the years



Source: Bangladesh Bank, Bangladesh Bureau of Statistics, 2012

In FY 2010-11, the public investment was Tk. 415.8 billion that was an increase by 30.4 percent and private investment was Tk. 1532.1 billion that was decrease by 12.4 percent than that of previous fiscal year.

In FY 2010-11, the public investment was Tk. 415.8 billion that was an increase by 30.4 percent and private investment was Tk. 1532.1 billion that was decrease by 12.4 percent than that of previous fiscal year. However, the total growth rate of investment increased to 15.8 percent from 12.2 percent in FY 2009-10.Under the business as usual scenario, the growth rate of public investment and private investment in FY 2011-12 might decrease.

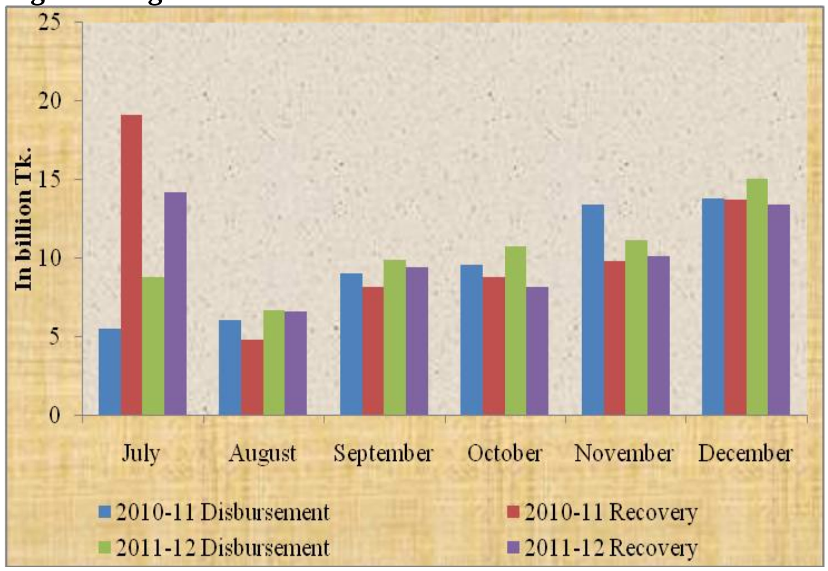
7.3 Agriculture

Bangladesh is a developing country depending mainly on its agriculture sectors to maintain the food supply in the economy. In order to ensure increase in agricultural output, poverty reduction and food security government has allocated Tk. 125.16 billion in the budget of FY 2011-12.

Disbursement of agricultural credit during July-December, 2011 is BDT 57.30 billion which was 7.19 percent lower than that of FY 2010-11.

Disbursement of agricultural credit during July-December, 2011 is BDT 57.30 billion which was 7.19 percent lower than that of FY 2010-11. Recovery of agricultural credit is BDT 64.32 billion during July-December, 2011-12 which was 3.89 percent higher than that of FY 2010-11. However, disbursement of agricultural credit during FY 2010-11 stood higher at Tk. 121.84 billion against Tk. 111.17 billion of FY 2009-10. In 2010-11, recovery of agricultural credit is BDT 121.49 billion which is 20.13 percent higher than that of FY 2009-10.

Figure 6: Agricultural disbursement over the months



Source: Selected indicators, Bangladesh Bank, 2012

The target of monetary policy is to boost up supporting funds for agriculture sector.

The target of monetary policy is to boost up supporting funds for agriculture sector. However, in this table the growth rate of agriculture and forestry in FY 2010-11 decreased to 4.82 percent whereas it was 5.56 percent in FY 2009-10. Besides of these, the share in GDP of agriculture sector in FY 2010-11 decreased to 19.95 percent from 20.3 percent in FY 2009-10. As business as usual scenario shows that agriculture growth rate and share of GDP might decrease in the next fiscal years.

Table 4: Components of agriculture sectors

	Sectorial/sub-sectorial growth rate					Sectorial/sub-sectorial share in GDP				
	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
Agriculture and forestry	4.69	2.93	4.10	5.56	4.82	16.64	16.18	15.91	15.81	15.52
Crop and horticulture	4.43	2.67	4.02	6.13	5.04	12.00	11.64	11.43	11.42	11.24
Animal farming	5.49	2.44	3.48	3.38	3.54	2.88	2.79	2.73	2.65	2.57
Forest and related service	5.24	5.47	5.69	5.23	5.35	1.76	1.75	1.75	1.73	1.71
Fishing	4.07	4.18	4.16	4.15	5.44	4.73	4.65	4.58	4.49	4.43

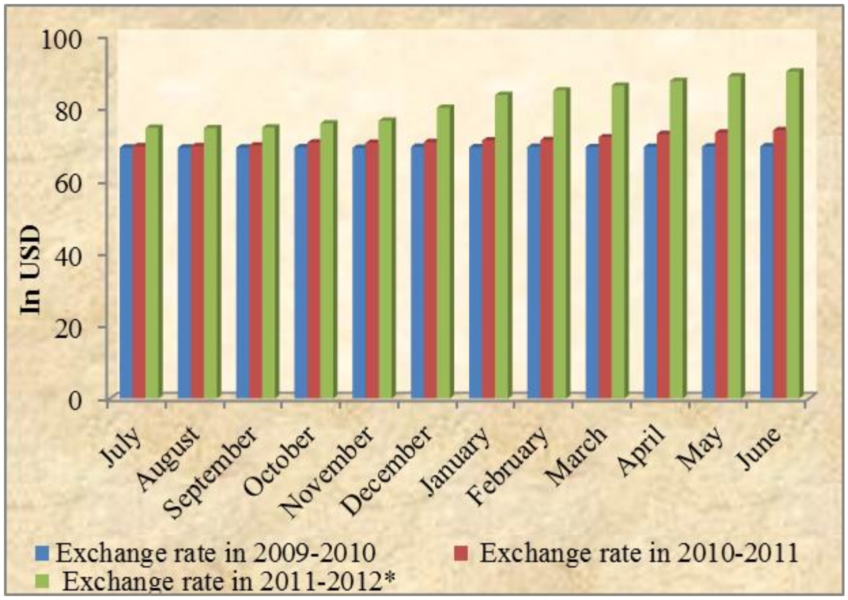
Source: Bangladesh Bureau of Statistics (BBS), 2011

7.4 Effect on Exchange Rate

In FY 2008-09 and FY 2009-10 the exchange rate of taka against dollar remained steady due to sufficient supply of foreign reserve such as USD 10750 million in FY 2009-10 and USD 7471 million in FY 2008-09. But in the recent FY 2011-12 and in current months, the overall increase in commodity and food prices has increased the cost of import, while the flows of remittance have relatively declined. As a result Bangladeshi Taka against dollars has depreciated. The exchange rate against the US dollar has dropped and the USD stands at 1:84.50 against taka in 8 February 2012.

The exchange rate against the US dollar has dropped and the USD stands at 1:84.50 against taka in 8 February 2012.

Figure 7: Exchange rate fluctuation over the months of 2009-10 to 2011-12



Source: Bangladesh Bank, 2012

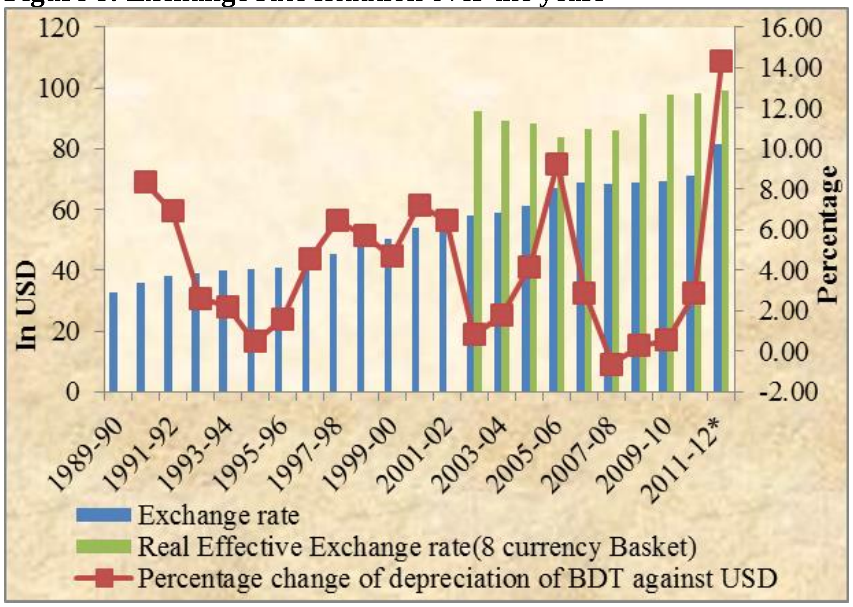
The real effective exchange rate in FY 2010-11 has depreciated to 97.78 from 94.18. This depreciation may have caused increase in export and decrease in volumes of import. In recent months, the nominal exchange rate is 83.55 in January 2012 whereas it was 71.04 in January, 2011 and 69.17 in January 2010.If the current trend continues the exchange rate might 90.03 in June, 2012 that might be 16.15 and 20.58 percentage point more than the FY 2010-11 and 2011-12 respectively. Over the years, with faster speed in recent months, Bangladeshi currency has depreciated against the USD, despite otherwise is observed for the USD in other currencies. The real effective exchange rate (8 currency basket) in FY 2008-09 was 91.30 but in FY 2011-12 it might 99.11. Percentage change of depreciation of BDT against USD in FY 2011-12 might be 14.34 percent which might be the highest depreciation in the history of Bangladesh whereas the percentage change of depreciation of BDT against USD in FY 2010-11 was only 2.87 percent. In FY 2007-08 the value of BDT

In recent months, the nominal exchange rate is 83.55 in January 2012 whereas it was 71.04 in January, 2011 and 69.17 in January 2010.

The real effective exchange rate (8 currency basket) in FY 2008-09 was 91.30 but in FY 2011-12 it might 99.11.

against USD was 68.60 and the real effective exchange rate was 86.02 and the percentage change of appreciation of BDT against USD was 0.62.

Figure 8: Exchange rate situation over the years



Source: Bangladesh Bureau of Statistics, Statistics Department, Bangladesh Bank, 2012

Export rose in FY 2010-11 to USD 22,928.2 million which was USD 16236 million in FY 2009-10. However, import rose to USD 11010.2 million.

Export may reach in FY 2011-12 at USD 25,038.73 million which was USD 22,928.2 million in FY 2010-11. However, import may rise at a higher speed and may stand at USD 11312.8 million.

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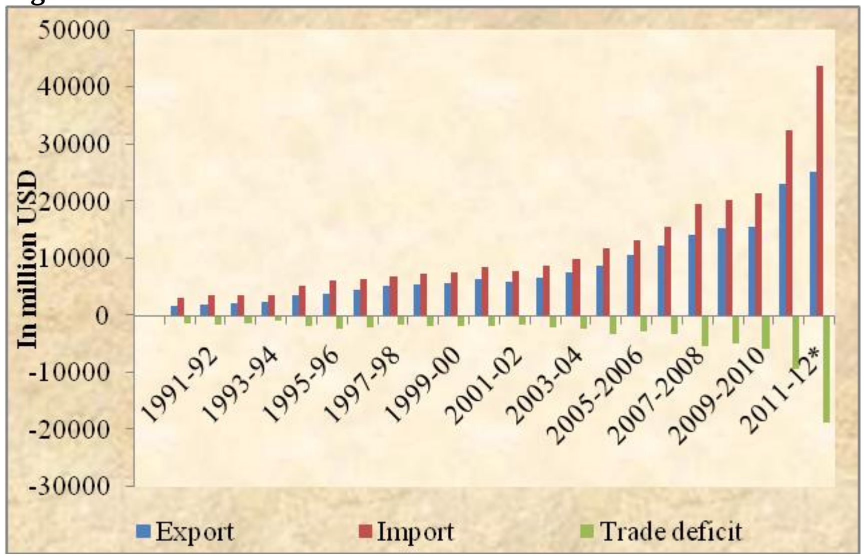
The export and import payments are increasing over the years, causing a continuous trade deficit and imbalance in balance of payment.

Figure 9: Trade Balance

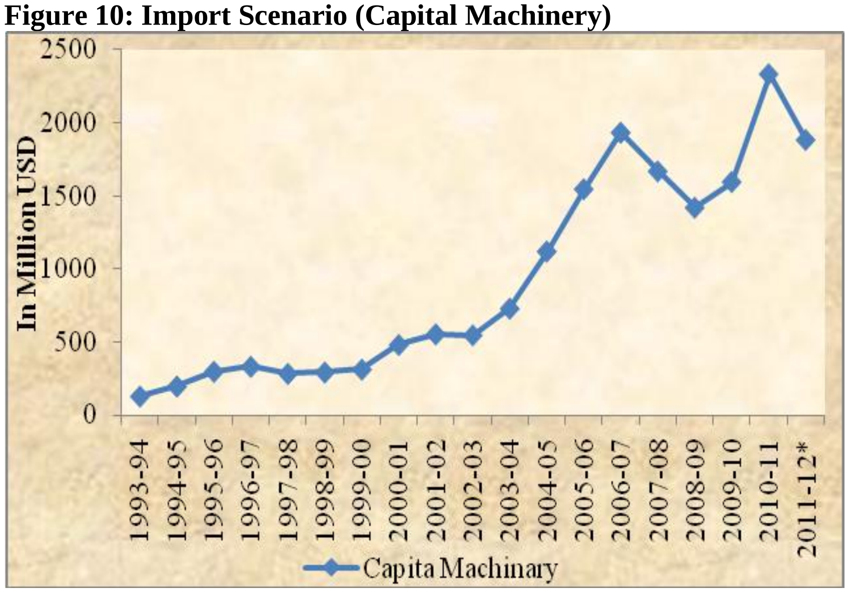


Source: Bangladesh Bureau of Statistics, Statistics Department, Bangladesh Bank, Export Promotion Bureau, 2012

7.5 Import

The principal imports of Bangladesh are food grain, intermediate raw materials, capital goods, machineries, petroleum products, fuel and lubricants, chemicals etc. Now-a-days the relative shares of different categories in total imports are changing whereas food import payments are higher which may have spillover effects on the domestic prices of commodities. As a result inflation may go upward. Again, increases in oil prices and the political instability of different countries have increased total import bills.

Figure 10: Import Scenario (Capital Machinery)



Source: Bangladesh Bureau of Statistics, 2012

Import payment as percentage of GDP is higher than the contribution of export as percentage of GDP, causing the deficit in the balance of payment. A number of national and internal factors are responsible for this situation. The service accounts also show the deficit situation. But increased deficit in B.O.P, higher amount of debt repayment and payment to IMF, foreign exchange reserves are bound to shrink.

7.6 Foreign Exchange Reserve

In January 2012, foreign exchange reserve has reached at USD 9386.46 million which was USD 10381.7 million in January, 2011.

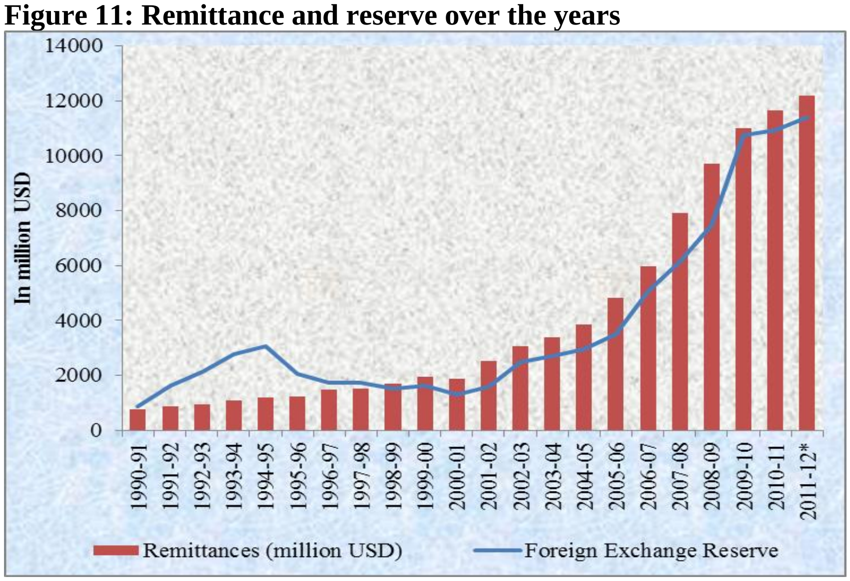
Continuation of the monthly data shows that reserve might reach at USD 8675.86 million by the end of this fiscal year.

The existing reserve is only USD 386.46 million over than that of the total cost of the import bill for the next three months.

Bangladesh Bank data shows that the reserve reached the highest amount in December 2010 to USD 11174.4 million. Reserve decreased during the period of May 2011 and July 2011 because of higher inflation and increased import bills. In FY 2010-11, reserve was USD 10911.6 million which was 1.51 percent higher than that of FY 2009-10. In January 2012, foreign exchange reserve has reached at USD 9386.46 million which was USD 10381.7 million in January, 2011. This indicates that reserve in January 2012 is USD 995.24 million or 9.59 percent lower than that of January 2011. Continuation of the monthly data shows that reserve might reach at USD 8675.86 million by the end of this fiscal year.

Moreover, a general concept is that it is required to have a total of three months import bills as reserve which is USD 9000 million but International Monetary Fund (IMF) suggests that reserve of four months import bills is a prerequisite. The existing reserve is only USD 386.46 million over than that of the total cost of the import bill for the next three months.

Figure 11: Remittance and reserve over the years



Source: Finance Division, Ministry of Finance; Accounts & Budgeting Department and Bangladesh Bank, 2012

Remittances are increasing at a decreasing rate since FY 2008-09. Yearly incremental growth rate of remittance in FY 2010-11 and FY 2011-12 is 6 and 4.4 percent respectively.

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7.7 Employment Level

The estimated population of Bangladesh is 16 crore in 2011. According to the Labor Force Survey-2010, the total labour force is 5.76 crore of the total population. In addition, 5.41 crore among the labor force are employed. This indicates that a huge population of 0.26 crore is unemployed. In the calendar year 2006, the unemployment rate was 4.30 percent while it reduced to 4 percent in 2010. A total of 0.67 crore labour forces got employed between calendar year 2006 and 2010. The participation rate for women is significantly lower than those of men. Decrease in money supply increases the interest rates in the economy. As a result firms find it less profitable for further investments and the level of employment also goes down.

7.8 Inequality

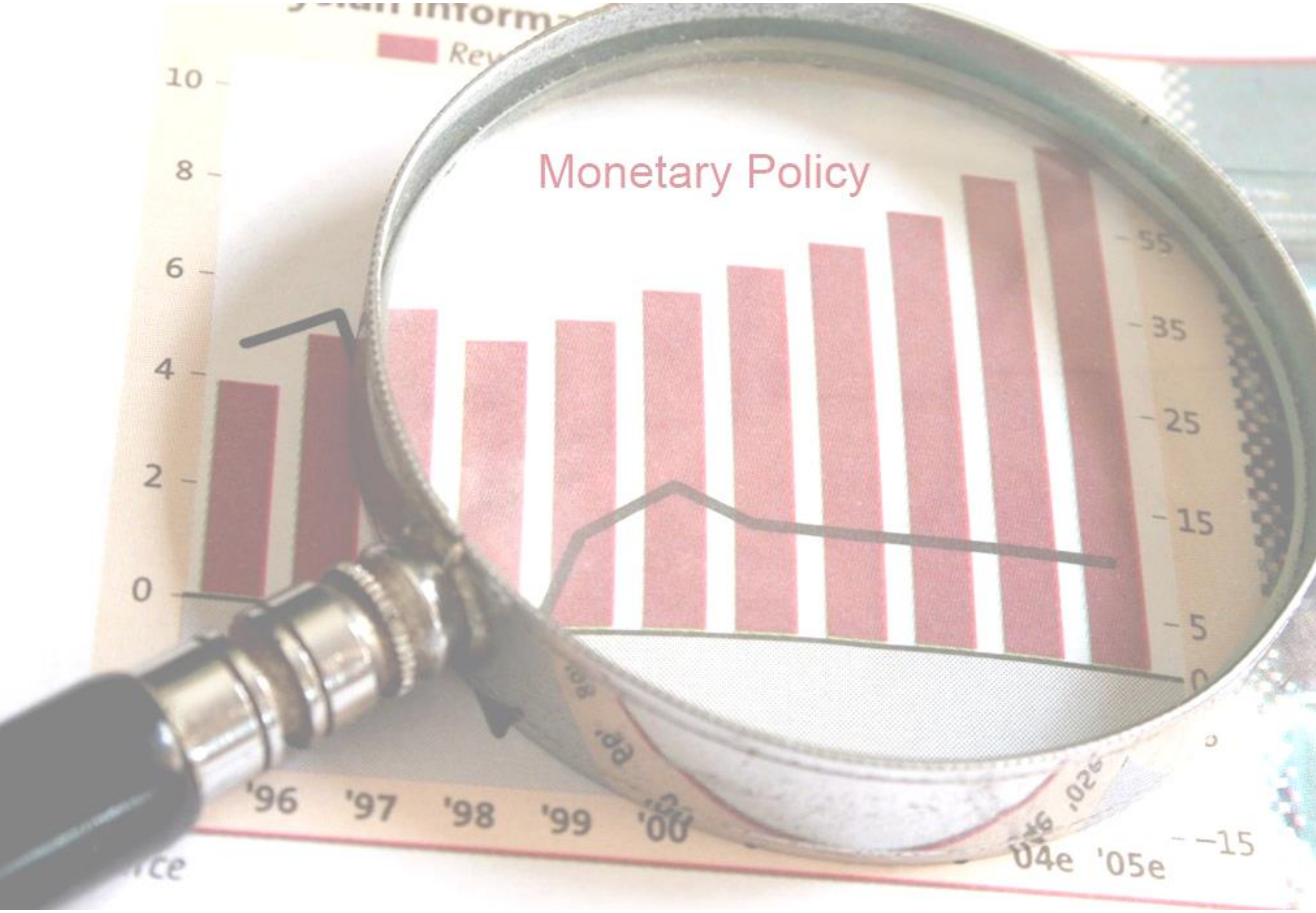
There exists a positive relationship between inflation and poverty. As inflation, especially food inflation increases, the people have to spend more money on the consumption food thus has to cut off spending money on other necessities like education and health. People with fixed income have to suffer a lot and becomes the victim of inequality and a portion of marginalised people goes under the poverty line.

8. CONCLUDING REMARKS

The recently announced monetary policy statement reveals the revision of government's wish list without having a realistic check. The main challenges of the time are to curb the inflation and to keep the growth momentum of the economy. On the basis of this growth-inflation dynamics, it is apparent that the current monetary policy stance should focus on the following areas with a clear medium term goals:

- A balanced approach is required to ensure the controls on public spending and refocus on the investment in the productive sector. For instance, huge subsidies on energy sector must not turn in to high inflation, in order to maintain price stability to keep within the remit of people.

- In order to shift the balance of aggregate demand from public to private; and from consumption to capital formation, the policy stance related to public borrowing, real positive interest rate, widening the transmission channels are welcome. However, along with this, a clear road map is required on how systematically these instruments will be monitored with a view to keeping the inflation at an acceptable rate and to easing the liquidity situations.



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