Abdicating Accountability:
The Monetary Policy Statement of July-December 2013

Bangladesh Economic Update
July 2013

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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 July-December of FY 2013-14.

The recent spat of political agitation has started from February 2013 while the economy has started deceleration of growth since FY 2011-12.

The Update examines the role of the successive MPSs on the decline of the rate of growth in economy for the last two consecutive years and the BB assertions that the recent political agitation has created negative impacts on the rate of growth. The recent spat of political agitation has started from February 2013 while the economy has started deceleration of growth since FY 2011-12. The rate of growth declined from 6.71 percent in FY 2010-11 to 6.23 percent in FY 2011-12 and to 6.03 percent in FY 2012-13, 0.20 percentage points lower than the decadal average rate of 6.23 percent.

The current MPS, like its previous versions, is pursuant to a three-year reform programme of the International Monetary Fund (IMF). The government signed a Memorandum of Economic and Financial Policies (MEFP) with the IMF, embodying nothing but orthodox contractionary monetary and fiscal policy instruments.

The current MPS has been taken by the Bangladesh Bank (BB) when the economy of Bangladesh is facing with major challenges such as declined rate of growth of gross domestic product (GDP), slump in investment, negative growth of import in intermediate goods, industrial raw materials and capital machineries, non-achievement of targeted growth in export, high interest rate spread, huge subsidy in quick rental power plant, higher government borrowing and lesser private sector credit etc.

2. KEY MACROECONOMIC CHANGES IN THE CURRENT MPS

The current MPS is announced at a time when the economy of Bangladesh is facing major challenges accompanied with lower rate of investment as well as lower economic growth. The BB could not manage to come up with policy measures those would increase investment and growth. Moreover, the adopted target of rate of growth on private sector credit, broad money, reserve money and net domestic assets in the current MPS are lower than those of the previous one which might lead to further contraction to the economy. The current MSP is the continuation of the previous MPS and the incorporation of IMF recommendations. The four major feature of the MPS are as follows:

- The target of private sector credit in the current MPS is set at 15.5 percent by December 2013 that is 3.0 percentage points less than the target (18.5 percent) of previous monetary policy statement.
- The targeted rate of growth on broad money in current MPS (17.2 percent) is 0.5 percentage point lower than that of the target (17.7 percent) of the last MPS.
- Current target of the rate of growth on reserve money is 15.5 percent that was 16.1 percent in previous MPS which means that the current target is 0.6 percentage point lower than that of the previous one.
- The rate of growth of net domestic assets in current MPS is 1.6 percentage point lower than that of the MPS announced for January-June of FY 2012-13. Current target is set at 16.8 percent by December 2013 which was 18.4 percent in previous MPS.

3. APPRAISAL OF PAST MPS: INSTRUMENTS, TARGETS AND ACHIEVEMENTS

The rate of growth in GDP was 6.03 percent (estimated by Bangladesh Bureau of Statistics) against the target of 7.0 percent in FY 2012-13.

The apparent divergence between the key targets and outcomes seems to occur with unfailing regularity raising the issue of credibility and realism in the target setting. The rate of growth in GDP was 6.03 percent (estimated by Bangladesh Bureau of Statistics) against the target of 7.0 percent in FY 2012-13. This similar difference prevailed for the domestic credit, credit to private sector, external sector-especially on import and export as well as other indicators. The proposed mechanisms in the last policy statement have already been restraining the rate of growth in GDP, the target of further lowering may induce shrinkage.

Table 1: Targets and Achievements of MPS (July -December, 2013)

Indicators	Targets	Actual
Rate of Inflation	The MPS and budget aimed to keep the average inflation down to 7.0 percent.	Average rate of inflation reached at 7.70 percent in July 2013
Credit to the Private Sector	The private sector credit to grow by 15.5 percent in December 2013.	The rate of growth on credit to private sector declined to 8.89 percent in July-May 2012-13 from targeted 18.5 of previous MPS.
Government Borrowing	Maintain the budgetary target of FY 2013-14.	Government borrowing from banking system increased to Tk. 248 billion in FY 2012-13.
Rate of Interest Spreads	Limited rate of interest spreads for the banking sector	Rate of Interest spreads to 5.13 percent at July 2013. Interest rate spread of weighted average rate of interest on deposits and advances in foreign and private bank is 8.59 and 5.34 respectively in July 2013.
Broad Money	Set the rate of growth on broad money at 17.2 percent by December 2013	The rate of growth of broad money was 14.46 in July-May 2012-13* against the target (last MPS) of 17.7 percent.
Reserve Money	Set at 15.5 percent by December 2013	The reserve money rose by 14.25 percent up to July to May 2013* against the target (last MPS) of 16.1 percent.
Net Domestic Assets	Target set at 16.8 percent by December 2013.	The net domestic assets increased by 8.69 percent till July-April, 2013* against the target of 18.4 percent in previous MPS.
Net Foreign Assets	Target is 19.3 percent in Current MPS	The net foreign assets target was achieved 51.2 percent in may 2013 and set at 14 percent in the last MPS.
Call Money Rates	Declined call money rate	The weighted average call money rate was 7.56 percent in 16 July,2013
External Sector Stability	The MPS stance assumed that export might increase to 11.0 percent, import might attain at 9.0 percent, remittance might increase to 11.0 percent and	Export has increased by 10.67 percent in July-May FY 2012-13 from the same period of the preceding year, but some export items has (say frozen food and raw jute)been seen as negative growth. Remittance has increased by 13.85 percent and 21.89 percent from July to May, FY 2012-13 compared to same preceding period of FY 2011-12 respectively. Current account balance is USD 2004 million in FY 2012-13.
Rate of Exchange	Market based rate of exchange while seeking to avoid excessive foreign exchange rate volatility.	Bangladesh Bank has been purchasing a huge amount of dollar to stablise the exchange rate. In FY 2012-13 (up to March), BB has purchased USD 5114 million, from mere USD 157 million in FY 2011-12 and USD 316.50 million in FY 2010-11.

Source: Unnayan Onneshan, 2013. *Abdicating Accountability: The Monetary Policy Statement of July - December 2013*

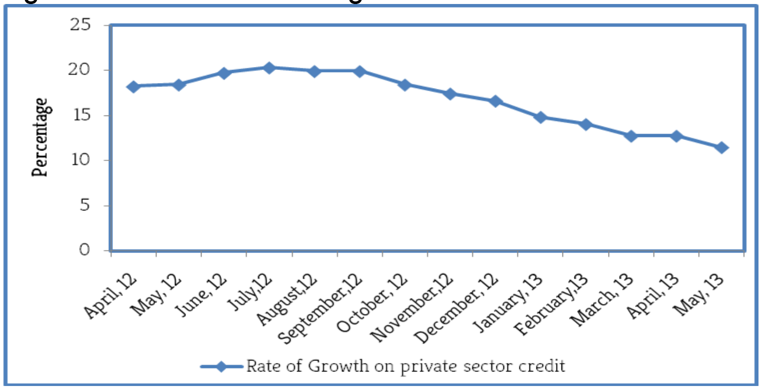
a) Private Sector Credit

One of the major threats to the Bangladesh economy is that the supply of private sector credit is following a declining trend that in turn is contracting the investment scenario. High bank interest rate is mainly liable for create an unfriendly business situation in the country that radically restrained the credit flow to the private sector in FY 2012-13.

In May of FY 2012-13, the growth of private sector credit declined to 11.4 percent from 14.8 in January of FY 2012-13 percent against the target of 18.5 percent.

In May of FY 2012-13, the growth of private sector credit declined to 11.4 percent from 14.8 in January of FY 2012-13 percent against the target of 18.5 percent. The growth of private sector credit has witnessed a nose dive from August of FY 2012-13 owing to consecutive contractionary monetary taken by Bangladesh Bank. The targeted growth of private sector credit in the recently announced MPS is set at 15.5 percent that is 3.0 percentage point lower that of the preceding MPS.

Figure 1: Private sector credit growth



Source: Bangladesh Bank, 2013

The proposed mechanisms as a sequel to the past MPSs, which have already been restraining the rate of growth in private sector through high rate of interest may further dampen the investment by increasing the cost of capital, as the banks are already advancing at higher rates and continue to contract national output.

b) Rate of Interest

The policy application of IMF results in high rate of interest which adversely affects the level of investment as well.

The spread on lending rate has been recorded at 5.13 percentage point in May 2013 whereas the rate of interest on depositor and lender was 8.54 and 13.67 percent respectively.

The spread on lending rate has been recorded at 5.13 percentage point in June 2013 whereas the rate of interest on depositor and lender was 8.54 and 13.67 percent respectively. It is noticeable that the spread on rate of interest of foreign banks is higher and there is a chance of capital flight which sometime affects the profit of sate owned commercial banks (Table 2).

Table 2: Monthly weighted average rate of interest on deposits and advances (on June, 2013)

Name of Bank	Weighted Average Deposits	Weighted Average Advances	Spread
State owned Banks	7.61	11.27	3.66
Specialized Banks	9.8	12.86	3.06
Foreign Banks	5.4	13.99	8.59
Private Banks	9.1	14.44	5.34
All Banks	8.54	13.67	5.13

Source: Statistics Department, Bangladesh Bank, 2013

The rate of weighted interest on advances of all banks was 13.67 percent in June 2013.

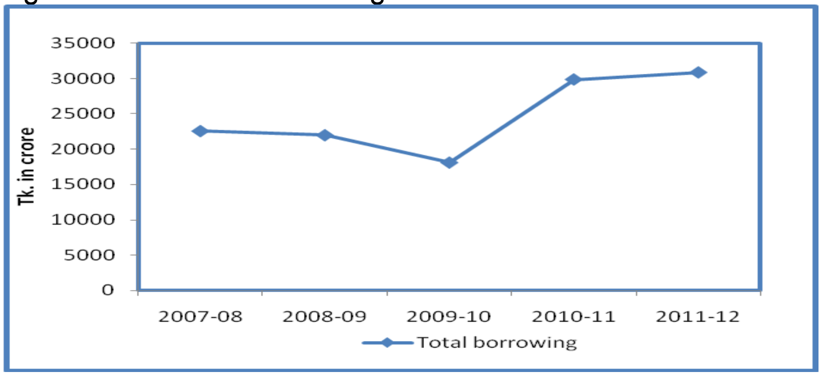
The rate of weighted interest on advances of all banks was 13.67 percent in June 2013 whereas this rate was much higher in the private banks and foreign bank as 14.44 percent and 13.99 percent respectively in the same period. Due to a higher rate of interest on bank lending, business are facing difficulties as well as exerting adverse impact on the investment sector.

c) Government Borrowing

Government borrowing from banking system increased to Tk. 24800 crore in FY 2012-13.

Government borrowing from schedule banks has been increasing after FY 2009-10. Government borrowing from banking system increased to Tk. 24800 crore in FY 2012-13. Government borrowing increased to Tk. 30864.8 crore in FY 2011-12 from Tk. 29867.47 crore in FY 2010-11.

Figure 2: Government borrowing



Source: Monthly Economic Trends, June 2013, Department of Statistics, Bangladesh Bank

Excessive borrowing from banking sectors indicates a sharp crowding out effect, which may dampen the private investments and increase inflation.

In FY 2012-13 (up to March), BB has purchased USD 5114 million from foreign market while the amount was only USD 157 million in FY 2011-12 and USD 316.50 million in FY 2010-11.

d) Exchange Rate

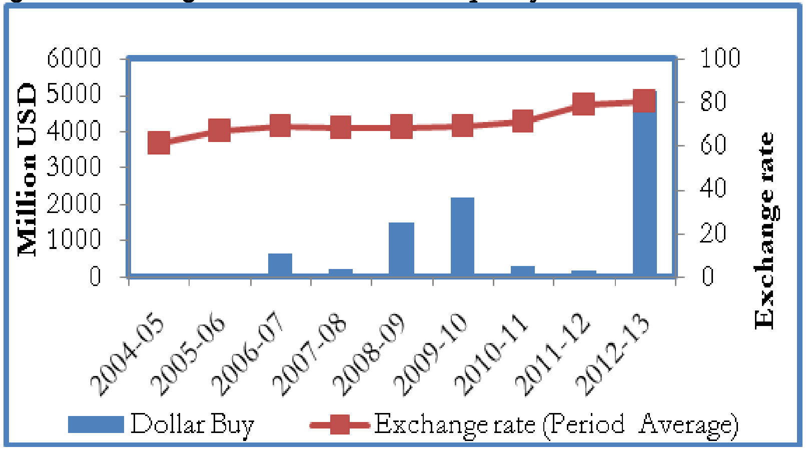
Bangladesh Bank has been purchasing a huge amount of dollar to stablise the exchange rate particularly to halt appreciation. In FY 2012-13 (up to March), BB has purchased USD 5114 million from foreign market while the amount was only USD 157 million in FY 2011-12 and USD 316.50 million in FY 2010-11. In 30July 2013, the exchange rate was Tk. 77.75 per USD which was Tk. 81.70 per USD in the same period of the previous fiscal year.

After November 2012, the value of Taka has appreciated. In December, January, February and March of FY 2012-13; the rates of appreciation were 2.09 percent, 0.78 percent, 0.46 percent and 0.82 percent respectively.

In 30July 2013, the exchange rate was Tk. 77.75 per USD which was Tk. 81.70 per USD in the same period of the previous fiscal year.

The reserve accumulation is needed mainly either to discourage the competitiveness of exports or to increase the competitiveness of imports. Excessive liquid dollar asset that is purchased from international market and increment of short and medium term loan have increased the foreign exchange reserve. This is also occurred due to a decline in imports and increase in remittances. These scenarios finally indicate a sagging in domestic demand or ineffective domestic demand management.

Figure 3: Exchange rate movement and liquidity of dollar



Source: Bangladesh Bank, 2013.

** Data available up to March, 2013.*

Foreign exchange reserve has reached its peak at USD 15000 million in June 2013.

Foreign exchange reserve of USD 15000 million is more or less residuals considering the sluggishness in some macroeconomic components. More international reserves do not necessarily mean better, and a large stockpile should not be mistakenly seen as a sign of healthy economic dispensation. Capital inflows could cause the real exchange rate to appreciate, affecting macroeconomic performance in a way not consistent or compatible with domestic policy objectives, such as sustainable economic growth with price stability.

Considering the export scenario, the overvaluation of exchange rate reduces the export earnings. In addition; the import sector has failed to take the advantage from such exchange rate due to lower credit availability to the private sector. Moreover, the foreign exchange reserve could meet up the import payment for almost five months. More international reserve does not suggest a balanced scenario of the economy, rather this indicate the poor aggregate demand and lower implementation status which includes risk and cost of the economy. In a nutshell, the reserve has not been able to create multiplier effects on the country's economy.

Threat of Dutch Disease in Bangladesh Economy

'Dutch Disease' occurs in any country when export competitiveness of a country is influenced as a result of appreciation of its domestic currency due to huge foreign currency inflow. Huge reserve associated with stockpile of recently purchased US dollars have infused the domestic currency to appreciate which might decline the volume of export in fear of losing profit. Moreover, foreign exchange reserve cannot create multiplier effect.

In Bangladesh, insufficient demand for dollar is caused by fall of imports. Bangladesh Bank might not ignore the risk of the 'Dutch Disease'. There is no alternative to increase investment particularly in the private sector by increasing supply of private sector credit.

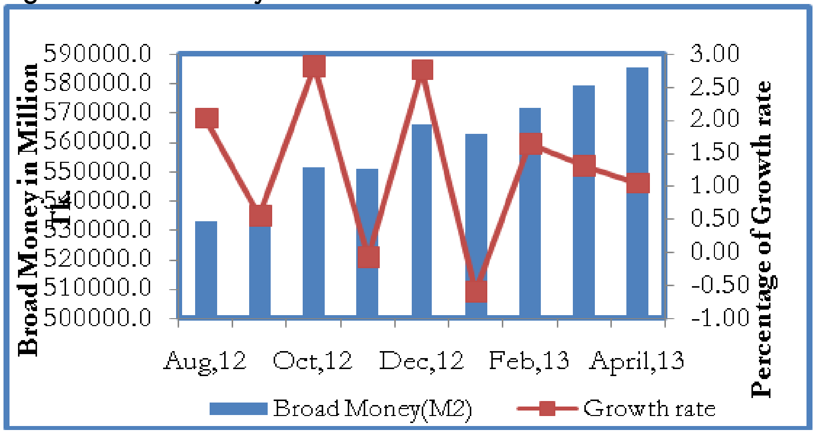
e) Broad Money

Aggregate money supply is positively related to economic growth and development. However, the upward adjustment in different monetary aggregates and the gap between money supply and economic growth still exits. Therefore, the monetary authorities should adopt prudent policies to increase the flow of credit to the productive sector of the economy.

The rate of growth in broad money was 13.15 percent in July-April 2013 against the target of 17.7 percent in the last MPS.

Though the actual flow (up to May, 2013) of broad money is far below the target of last monetary policy, BB has set a further lower target in the current monetary policy. The rate of growth in broad money was 13.15 percent in July-April 2013 against the target of 17.7 percent in the last MPS. The current target of the rate of growth on broad money is 17.2 percent by December 2013.

Figure 4: Broad money



Source: Statistics Department, Bangladesh Bank, 2013

Broad money has recorded an increase of Tk. 68007.30 crore or 13.15 percent during July to April 2013 against the increase of Tk.53287.20 crore or 12.10 percent at the end of April 2012.

Broad money has recorded an increase of Tk. 68007.30 crore or 13.15 percent during July to April 2013 against the increase of Tk.53287.20 crore or 12.10 percent at the end of April 2012. Of the sources of broad money, net domestic assets (NDA) rose by Tk. 57683.20 crore or 13.78 percent and net foreign assets (NFA) increased by Tk.33626.50 crore or 44.76 percent. Increases in NFA create availability of the reserve. For this, there is a stockpile of idle money in the reserve volt.

To see the relationship between gross domestic products (GDP) and money supply, the Ordinary Least Square (O.L.S) is used here. OLS result shows a positive relationship between (GDP) and money supply. By inference, as money supply falls, GDP decreases and the coefficient is statistically significant. With R^2 of 0.44 percent, 44 percent of the variation in GDP is accounted for by money supply. However, the F-test of 15.581 percent has been found to be significant at 1 percent level of significance, which indicates that the overall equations and the parameters estimates are significant and the regression line performs well.

Table 3: O.L.S. Result on money supply and economic growth

Variable	Estimated Co-efficient	Standard Error	t-test
Constant	2.958	.640	4.621
Broad Money Supply	0.160	.040	3.947

R^2 = 0.438
Adjusted R2 = 0.410
*F-test = 15.581**
** indicates significance at 1 percent level.*

f) Domestic Credit

In July-April 2012-13, growth of domestic credit was 5.73 percentage points lower than the corresponding period.

The domestic credit is one of the components of net domestic assets of Bangladesh Bank. The rate of growth of domestic credits is decreasing day by day due to the contraction of credits in the private sectors. In July-April 2012-13, growth of domestic credit was 5.73 percentage points lower than the corresponding period. Growth of private sector credit has also slowed down in recent times mainly because of deceleration in import growth.

In the second half of FY 2012-13, the domestic credit was targeted to keep at 17.7 percent which was 19.1 percent during the same period of FY 2011-12, The rate of growth in broad money was 13.15 percent during July to December, 2012-13.

g) Industrial Term Loan (Disbursement and Recovery)

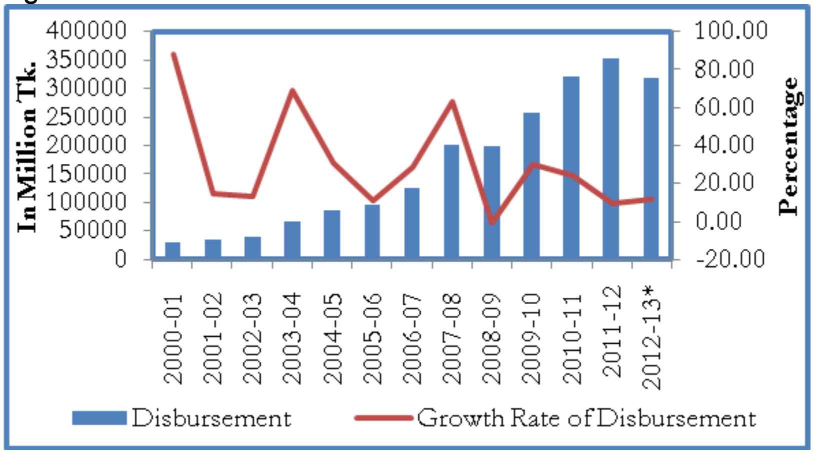
The rate of growth in the industrial term loan has been experiencing a decreasing trend since FY 2010-11 because of contractionary monetary policy. Loan is one of the most important components of capital formation especially for developing country like Bangladesh. In the context of the country, loan allocation in industrial sector is not so satisfactory.

In the third quarter of FY 2012-13, the disbursement of loan in industrial sector was Tk. 10061.24 crore which was Tk. 2172.26 crore less than that of second quarter.

In the third quarter of FY 2012-13, the disbursement of loan in industrial sector was Tk. 10061.24 crore which was Tk. 2172.26 crore less than that of second quarter. The disbursement of loan in industrial sector was Tk. 352781 million in FY 2011-12. In FY 2011-12, the rate of growth in industrial term loan was 9.68 percent, which were 24.30 percent and 29.56 percent in FY 2010-11 and FY 2009-10 respectively. The average rate of growth on industrial loan was 37.55 percent from FY 2000-01 to FY 2005-06 whereas this rate was only 25.61 percent from FY 2006-07 to FY 2011-12.

The average rate of recovery of industrial term loan was 87.08 percent during the period of FY 2000-01 to FY 2005-06 whereas it was only 76.54 percent from FY 2006-07 to FY 2011-12, indicating a worse rate of recovery on industrial term loan.

Figure 5: Industrial term loans



Source: Bangladesh Bank, 2013

The share of SME loan in total loan declined to 21.02 percent in March 2013 from 21.80 percent in March 2012.

The share of SME loan in total loan has traditionally been lower. The share of SME loan in total loan declined to 21.02 percent in March 2013 from 21.80 percent in March 2012. The industrial loan is facing multiple problems. The rate of growth of SME loan is lower while recovery of industrial term loan is decreasing. The share of SME loan in state owned banks and private bank is decreasing whereas this share in foreign banks is always maintaining a lower rate.

h) Reserve Money

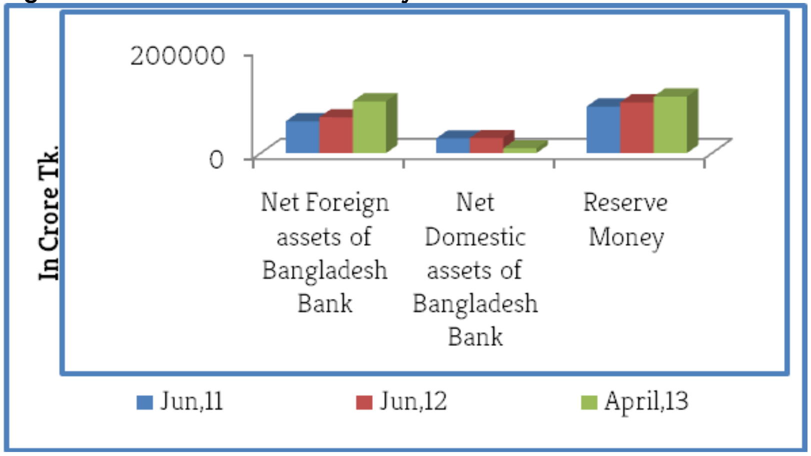
In the monetary policy statement of July, 2013 central bank targeted the rate of growth in reserve money at 15.5 percent whereas during July-April of FY 2012-13 the rate of growth of reserve money was 11.37 percent.

The Reserve Money (RM) consists of currency with the public cash in tills and balances of scheduled banks as well as other financial institutions with the central bank. Rate of growth on reserve money is decreasing mainly due to the decrease in net domestic assets of the central bank. In the monetary policy statement of July, 2013 central bank targeted the rate of growth in reserve money at 15.5 percent whereas during July-April of FY 2012-13 the rate of growth of reserve money was 11.37 percent.

In FY 2012-13, during July-April, net foreign asset of Bangladesh bank increased by 44.87 percent than that of June 2012.

There has been a mismatch between the growth of net domestic asset and the foreign asset while the growth of net domestic asset is decreasing and the foreign asset is increasing at a very high rate. In FY 2012-13, during July-April, net foreign asset of Bangladesh bank increased by 44.87 percent than that of June 2012. On the other hand, net domestic asset decreased by 68.61 percent than that of the same period of the previous fiscal year.

Figure 6: Sources of reserve money



Source: Monthly Economic Trends, June 2013, Department of Statistics, Bangladesh Bank

Reserve money multiplier was 5.37 at the end of April 2013.

In July-April 2012-13, there has been a negative growth in net domestic assets and a positive growth in net foreign assets of BB compared to the same period of the last fiscal. Reserve money multiplier was 5.37 at the end of April 2013.

4. ASSESSMENT OF RISK MANAGEMENT, SURVEILLANCE ON FINANCIAL SECTOR

In calendar year 2012, ROA and ROE decreased by 0.9 percentage point and 9 percentage point respectively than those of 2011.

The state of Return on Asset (ROA), Return on Equity (ROE) and Non-Performing Loan (NPL), which are used to measure the earning, and profitability of a bank indicates the lack of presence of prudential surveillance on the financial sector. In calendar year 2012, ROA and ROE decreased by 0.9 percentage point and 9 percentage point respectively than those of 2011. Moreover, overall net NPLs increased to 4.38 percent in 2012 than that of 0.70 percent in 2011.

4.1. Return on Assets (ROA)

Return on Assets (ROA) indicates the productivity of the assets i.e. how much income is earned from per unit of assets.

According to Basel-II accord, ROA should be more than 1 percent. Profit for a particular period is compared with the value of its assets for that particular period which shows how effectively the company is using its assets.

Table 4: Return on Assets (ROA) by different types of banks (percentage)

Types of Banks	2006	2007	2008	2009	2010	2011	2012
SCBs	00	0.0	0.7	0.96	1.11	1.34	-0.56
DFIs	-0.15	-0.27	-0.6	-0.37	0.19	0.03	0.06
PCBs	1.07	1.28	1.37	1.55	2.14	1.59	0.92
FCBs	3.34	3.1	2.94	3.18	2.87	3.24	3.27
Total	0.79	0.89	1.16	1.37	1.78	1.54	0.64

Source: Bangladesh Bank, Annual Report, 2013

State owned commercial banks (SCBs) have achieved nearly zero percent of ROA over the period of 2006 to 2012 (Table 4). The scenario is much worst in case of Development Financial Institutions (DFIs) while most of the time ROA was less than 1 percent in 2010 to 2012. Insignificant profit during this period has occurred due to the ratio of ROA scenario in SCBs and DFIs. The position of foreign commercial banks (FCBs) was stable over the period.

4.2 Return on Equity (ROE)

Return on Equity (ROE) is another important measure of earning and profitability, which indicates net income after tax to total equity. The amount of profit generation for the equity shareholders is found from the ratio. Higher value of ROE is an indication of high productivity of equity.

Table 5: Return on Equity (ROE) by different types of banks (percent)

Types of Banks	2006	2007	2008	2009	2010	2011	2012
SCBs	0.0	0.0	22.52	26.15	18.43	19.66	-11.87
DFIs	-2.0	-3.40	-6.94	-171.68	-3.17	-0.92	-1.06
PCBs	15.19	16.65	16.37	20.95	20.94	15.69	10.17
FCBs	21.53	20.44	17.75	22.38	16.99	16.58	17.29
Total	14.13	13.78	15.60	21.72	20.97	17.02	8.20

Source: Bangladesh Bank, 2013

In 2010, the position of state owned commercial banks (SCBs) was the lowest among the banks and ROE of state owned commercial banks was -11.87 percent (Table 5). The negative value means huge loss in the business of SCBs. Private commercial banks (PCBs) obtained 10.17 percent in 2012. On the other hand, foreign commercial banks (FCBs) hold a consistent level of ROE, which was 17.29 percent in 2012. DFIs were also in a worse situation in 2010 probably due to huge provision shortfall and net loss in that year. Overall ROE in banking sector was 17.02 percent in 2011, which reduced to 8.20 percent in 2012. Reduction of ROE ratio in banking sector indicates that shareholder profits are declining day by day.

4.3 Non-Performing Loans (NPLS) by Different Types of Banks

Non-Performing Loans (NPLs) is an indicator which captures quality of loan portfolio. The ratio of the net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense) are given here (Table 6).

Table 6: The ratio of net NPLs to total loans by different types of banks

Types of Banks	2006	2007	2008	2009	2010	2011	2012
SCBs	14.45	12.92	5.92	1.92	1.90	0.34	12.82
DFIs	23.62	18.96	16.96	18.3	16.0	16.95	20.4
PCBs	1.80	1.37	0.85	0.45	-0.02	0.20	0.92
FCBs	-2.57	-1.93	-2.04	-2.31	-1.71	-1.81	-0.86
Total	7.13	5.13	2.79	1.73	1.28	0.70	4.38

Source: Bangladesh Bank, 2013

Net Non-Performing Loans to total loans are higher in state owned commercial banks (SCBs) and development financial institutions (DFIs). In 2011, net-NPLs were 0.34 and 16.95 percent in state owned commercial banks (SCBs) and development financial institutions (DFIs) respectively whereas in 2012, the percentages stood too high as 12.82 and 20.4 respectively. Overall net NPLs was 0.70 percent in 2011 which increased to 4.38 percent in 2012. NPLs increasing mean the increasing of risk on investment.

5. EFFICACY OF PROPOSED MEASURES

The policy-induced macroeconomic challenges loom large. The lack of farsightedness and creativity in policy making has exposed Bangladesh economy in recent times to several risks, which have substantially altered the favourable conditions prevailing in the economy and in the society. The economy has been witnessing the arrested growth rate of the gross domestic product (GDP) at six percent and the rate of investment at 24 – 26 percent of GDP over the years, with decelerating rate of growth of last two fiscal years, from 6.71 percent in FY 2010-11 to 6.23 percent in FY 2011-12 and to 6.03 percent in FY 2012-13, 0.20 percentage points lower than the decadal average rate of 6.23 percent.

5.1 Savings–Investment

The high rate of interest, an outcome of contractionary monetary policy is contributing to lower investment. Again, the incremental capital output ratio (ICOR) that measures investment required to increase GDP has deteriorated in the past few years. For example, the government would require investment rate to rise at 32.0 percent of GDP for achievement of 7.2 percent GDP growth rate in FY 2013-14, if the ICOR remains same of the outgoing year. Alternatively, the productivity of investment has to enhance to reduce ICOR to 3.72, if the investment rate remains to the level of FY 2012-13.

Savings-investment gap might increase to 5.14 percent, 5.47 percent and 5.81 percent of the nominal GDP in FY 2012-13, FY 2013-14 and FY 2014-15 respectively.

Moreover, if the existing policies remain unchanged, the savings-investment gap might increase sharply and might continue to increase in the upcoming fiscal years. This gap might increase to 5.14 percent, 5.47 percent and 5.81 percent of the nominal GDP in FY 2012-13, FY 2013-14 and FY 2014-15 respectively. Savings-investment gap however, should be reduced to foster the growth prospect.

5.2 Implications on Productive Sector

In January - March of 2012-13, the quantum index stands at only 192 points.

Recently, quantum index have slided down due to lower industrial production. Industrial production of the country is almost stagnant. In the first eight months of the last fiscal year (July – February of 2012-13), the quantum index stood at 191.32 points. In January - March of 2012-13, the quantum index stands at only 192 points. In this regard, the production growth can be considered as insignificant. This calculation is based on new base year of 2005-06. To identify the reasons of lower industrial production, the performance of the following sectors should be examined:

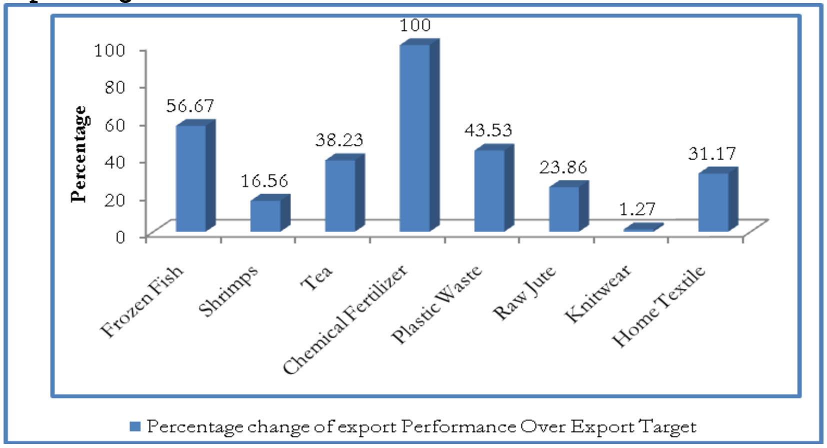
Export performance was Tk. 24301.9 crore and Tk. 27018.26 crore respectively during July-June of FY 2011-12 and FY 2012-13 against the target of Tk. 26500 crore and Tk. 28000 crore.

5.2.1 Export

In spite of slightly increasing rate of growth of export, the target fell still short at the end of the consecutive two fiscal years. Export performance was Tk. 24301.9 crore and Tk. 27018.26 crore respectively during July-June of FY 2011-12 and FY 2012-13 against the target of Tk. 26500 crore and Tk. 28000 crore. The rate of growth of export was 8.29 percent and 3.51 percent in FY 2011-12 and FY 2012-13 respectively.

At the end of June 2013, the actual achievement of frozen fish, shrimps, tea, chemical fertiliser, plastic waste, raw jute, knitwear and home textile have been found lower by 56.67 percent, 16.56 percent, 38.23 percent, 100 percent, 43.53 percent, 23.86 percent, 1.27 percent and 31.17 percent respectively than those of the targets. Moreover, the achievement was USD 1047 crore against the target of the export of knitwear of USD 1061 crore in FY 2011-12 which suggest that the achievement was 1.5 percent lower than that of the target.

Figure 7: Gap of percentage change on export performance over the export target of FY 2012-13



Source: Export Promotion Bureau (EPB), 2013

Restriction of Generalised System of Preference (GSP) facility by USA has emerged as a great concern.

5.2.2 Import

Import of capital machinery and industrial raw material (the main elements of industrialisation) has showed a decreasing trend as a result of contractionary monetary policy hampering industrial production as well as exportable commodities. During July to May of FY 2012-13, the cumulated rate of growth in

During July to May of FY 2012-13, the cumulated rate of growth in letters of credit (LCs) opening and settlement was -1.53 percent and -9.09 percent respectively.

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The settlement of LCs for industrial raw materials and capital machinery has crashed down to USD 12004.44 million and USD 1956.99 million during July to May of FY 2012-13 from USD 12387.13 million and USD 2281.64 million, decreased by 3.09 percent and 14.23 percent respectively than those of the corresponding period of the previous fiscal year. Import payments during July-April 2012-13 stood lower by 5.63 percent at USD 28172.40 million against the amount of the same period of the previous fiscal.

Table 7: Summarized import payments statistics

Items	2011-12R (July-May)	2012-13P (July-May)	Percentage Changes
Petroleum products	4327.13	3934.88	-9.06
Capital machinery	2281.64	1956.99	-14.23
Industrial Raw Material	12387.13	12004.44	-9.06
Others	12597.53	11003.88	-12.65

Source: Bangladesh Bank, Economic data, Balance of Payments, 2013

In FY 2011-12, the import of Bangladesh Export Processing Zones (BEPZ) has decreased (USD 2114 million) for the first time within 10 years.

In FY 2011-12, the import of Bangladesh Export Processing Zones (BEPZ) has decreased for the first time within 10 years. In FY 2011-12, the import of EPZ areas was USD 2114 million which was USD 26 million less than that of FY 2010-11. The rate of growth of import in EPZ was 51.34 percent and 8.60 percent respectively in FY 2010-11 and FY 2009-10. Moreover, in 3rd quarter of FY 2012-13, the imports of textiles and textile articles have decreased by Tk. 310 million than that of 4th quarter of the last fiscal year. In FY 2012-13, import of cotton, (all types) cotton yarn/thread and cotton fabrics have decreased by USD 235.8 million than that of FY 2010-11.

5.2.3 Liquidity Position of the Scheduled Banks

At the end of May 2013, total liquid assets of the schedule banks stood at Tk. 165494.60 crore while these assets were Tk. 125444.21 crore at the end of June 2012.

At present, the amount of idle money in banking sector is about Tk. 70644 crore. At the end of May 2013, total liquid assets of the schedule banks stood at Tk. 165494.60 crore while these assets were Tk. 125444.21 crore at the end of June 2012. Foreign exchange reserve is on the rise as import is following a downward trend and investment demand is declining due to higher interest rate. Moreover, people are not interested to invest in capital market due to lack of confidence or down fall of market and keep their money in the bank.

Excess liquidity of the banks rose by 57 percent and recorded at Tk. 71,660 crore on 30 May 2013.

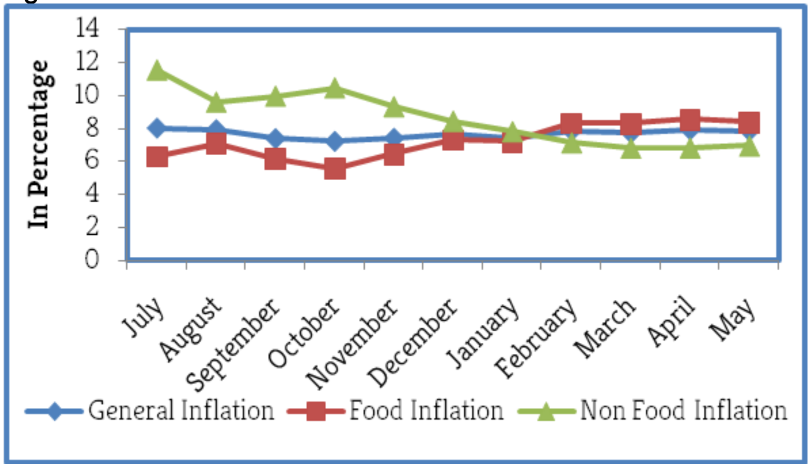
The ultimate outcome is a stockpile of idle money in banking sector. This excess liquidity becomes a burden for the banks as they failed to invest the capital properly. Excess liquidity of the banks rose by 57 percent and recorded at Tk. 71,660 crore on 30 May 2013. Poor appraisal and weak internal supervision are also the root causes that ultimately resulted in idle money, a negative indicator of banking sector.

6. INFLATION

The overall inflation is still very high and was 8.05 percent (point to point basis considering new base year) in June 2013 against 7.98 percent in May 2013.

Bangladesh Bank adopted the contractionary monetary policy with the pretext of reducing the inflation. The overall inflation is still very high and was 8.05 percent (point to point basis considering new base year) in June 2013 against 7.98 percent in May 2013. Considering 1995-96 as the base year, the overall inflation was 7.97 percent in June and 7.86 percent in May 2013.

Figure 8: General, food and non-food inflation



Source: Bangladesh Bureau of Statistics, 2013

During FY 2010-11, the food inflation rose at its peak (11.34 percent) while non-food inflation was quite lower (4.15 percent). The scenario changed in FY 2011-12 where the food inflation decreased slightly at 10.47 percent. On the other hand, non-food inflation increased significantly at 11.15 percent (base year, FY 1995-96).

7. CONCLUSION

Bangladesh has been currently facing four major challenges in the monetary sector and the MPS falls short of addressing those. First, the country has been experiencing a high inflation rate even after the adoption of a contractionary monetary policy, which although has declined in recent time. Second, the contractionary monetary policy, on the other hand, has reduced the credit demand of the private sector, which was 13.62 percent in July-March of FY 2011-12 and 6.98 percent in the corresponding period of FY 2012-13. Third, policies have failed to lower interest rate spread and promote financial inclusion as private sector banks have not played its part. Fourth, it is urgent to come out from the circle of the arrested growth rate of the gross domestic product (GDP) at six percent and the rate of investment at 24 – 26 percent of GDP over the years.

It is undeniable that the government and BB have been following the suggestions of the IMF in the budget as well as in the monetary policy. The fiscal management is facing the key question whether public spending in general and fiscal deficit in particular have been able to create multiplier effects in the economy. The deficit has arisen because of financing consumption as opposed to paying for infrastructure, which would have not only augmented investment demand but also avoided crowding out of private investment. The policies have not been targeted towards removal of supply-side constraints, which could have improved investment demand. On the other hand, bank borrowing has financed a sizeable fiscal deficit and crowded the private sector out.

This has also led to debt payment emerging as a major expenditure and lessened fiscal space. Interest payment has risen from Tk. 23,630 crore in FY 2008-09 to Tk. 38,627 crore in FY 2012-13, representing an increase of 38.83 percent. In addition, the regressive nature of the tax structure, limited tax net, avoidance and evasion of taxes and the politically motivated allocation and slow implementation of ADP remain major drawbacks to the mobilisation and use of resources. The National Board of Revenue has fallen short of achieving the revenue collection target for the first time in FY 2012-13 since FY 2009-10.

The monetary policy of Bangladesh has also been going through a self-conflicting way. The budget remains expansionary to placate the ruling party stalwarts in an election year while the central bank has adopted contractionary monetary policy. The contraction continues due to adherence to the IMF policies.

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