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THE GLOBAL ECONOMIC CRISIS: IMPLICATIONS FOR BANGLADESH

Abstract

The current global economic meltdown that is originated from the financial crisis in the US has now spread worldwide through a number of transmission channels. Bangladesh was virtually immune from the global financial crisis as our financial market is least integrated with the rest of the world. However, as thê economy of Bangladesh has proceeded a long way in terms of globalization, any development in the world economy has important implications for the real side of the economy. The paper makes an attempt to analyze the implications of the global crisis for Bangladesh. As more than ninety per cent of Bangladesh's export is directed to the developed countries, recession in the developed world has negative implications for the country's export. Export from Bangladesh has already started to decelerate and export of most of the items excluding RMG started to decline. Number of persons left for overseas employment started to decline significantly and remittances inflow started to decelerate. Global recession had also implications for government revenue collection, particularly from trade related taxes as import is showing a very slow performance. The crisis would have some indirect impact on a few other areas of the economy as well. However, there is some development in the world market that has some offsetting affect of the crisis on the overall macroeconomic balance of the country, including inflation. Although the economy of Bangladesh is not hurt that much yet, it could be hurt more severely in the days to come if the global recession prolongs. Hence, appropriate policies to mitigate the negative impact of the crisis deserve serious consideration.

1. INTRODUCTION

The global financial crisis that spread rapidly since September 2008 led to a severe economic downturn. The crisis originated in the US has spread to other countries around the globe through different channels. The recent downturn of the world economy that is yet to be fully exposed provides a signal of an ever bigger recession after the great depression. While no one can clearly foresee how deep the recession would be or how long it will last, there is no doubt that the

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world economy is undergoing a very fragile stage. Projections made by different organizations, while vary in terms of numerical figures, indicate that global meltdown that started at the end of 2008 will further deepen in 2009. The world output is going to experience a contraction, a phenomenon that never happened after the great depression (Table 1).

Many of the low income countries (LICs) had a lagged effect of the crisis compared to the rest of the world. However, eventually they may be severely hurt by the crisis given their exposure to the global economy, low resilience capability, and limited scope of counter cyclical policies in these countries. International Monetary Fund (IMF) and the World Bank have already projected that developing countries and low income countries would suffer a huge reduction in growth rates due to global economic crisis.[1] Reduced growth rate has serious negative implications for poverty reduction. According to a recent policy note of the World Bank, the global recession may expose households to increasing risk of poverty and hardship in almost all the developing countries, and forty three developing countries may be highly exposed to the poverty effect of the crisis (World Bank, 2009). Similarly, IMF report opines that twenty-six LICs appear particularly vulnerable to the unfolding global economic crisis (IMF, March 2009).

Bangladesh is a low income country that is highly exposed to the globalization process. Hence, recent economic crisis is expected to have significant impact on the economy of Bangladesh. There is a possibility of decelerating growth. According to the World Bank policy note mentioned above, Bangladesh is heavily exposed to poverty effect of the crisis as growth would be decelerating on the facet of an existing high poverty incidence. However, the economy of Bangladesh has been insulated from the first wave of the crisis as the financial sector of Bangladesh is least integrated with the global financial market. On the top of this, some developments in the global commodity market might have offset part of the negative impact of the crisis. There are also some positive factors that may safeguard the economy in the early phases of the crisis. Hence, there is a quarter who believes that the effect of the global crisis on Bangladesh might not be that severe. Given this context, present paper wants to make an attempt to examine the implications of global economic crisis for Bangladesh based on economic analysis and supplemented by early signals.

The paper is divided into seven sections. While the ongoing Introduction is section 1 of the paper, Section 2 makes a brief exposition of the genesis, spread and policy response of the crisis. Section 3 discusses how Bangladesh could be affected by the global economic crisis. Section 4 analyzes the affect of global recession on external sector of Bangladesh. Some possible further round and indirect effect of the crisis are introduced in Section 5. Section 6 discusses the

[1] Latest IMF projection about growth of different region is given in table (2)

likely impact of the crisis on the overall macroeconomic balance of the country. Section 7 concludes with the proposition of some policy responses.

2. GENESIS, SPREAD AND POLICY RESPONSE OF THE CRISIS

Genesis of the crisis lies in the inherent weakness of the financial market of the US due to under pricing of newly developed securities at the beginning of the new millennium. Failure of sub-prime mortgage market resulted in bank and insurance failure that ultimately resulted in credit crunch. Sub-prime mortgage default led to spill over effects around the world (Europe and emerging economies) *via* an elaborate network of derivatives and turned it into a global financial crisis.

Box 1: Sub-prime mortgage Failure and the US Financial Crisis

As a response to recession at the beginning of the new millennium, Fed took a low interest policy and encouraged the housing sector. Sub-prime mortgages in the housing market emerged under the auspices of general growth of credit default swap, a new financial instrument involving risky customers. However, banks were able to transfer credit risk to third party through the process of securitization, such as mortgage backed securities (MDS). Consequently, there was a reckless growth of sub-prime mortgage which in turn reduced yield on risky mortgage that actually could not properly account for default risk (Murphy 2008). Arbitrage drove the yields on all bonds & loans down that resulted in expansion in consumer credit. There was a bubble in the housing price. Initially, premium rate of the sub-prime mortgages was low and the issuer of the instrument was happy with the service charge etc. However, with gradual rise in interest rate, mortgage premium increased under the adjustable rate mortgages making repayment of premium quite difficult. Thus, the unsuitability of credit default swap and sub-prime mortgages got exposed. Bubble in the housing price bust resulting in further default in mortgage payment and foreclosures. This resulted in Bank and insurance failure and credit crunch. Thus, the crisis in the US Financial market developed. Sub-prime mortgage default led to spill over effects around the world. As many of the banks and financial institutions in Europe and some emerging countries held securities based on US sub-prime mortgages, they also faced financial hardship, as their balance sheets were heavily affected by the reduced value of these toxic assets.

The financial crisis that was initially confined mostly in the developed world has now spread worldwide and from the financial world to the real economy through a number of transmission mechanism. The first round impact on the real economy is transmitted from the financial sector through the credit crunch channel. Direct exposure to toxic assets that came out of securitization led to some localized bank failures, which in turn affected inter bank credit. Consequently, credit to the real economy squeezed. Limited availability of credit for working capital, trade finance and viable investment would definitely mark a negative impact on the real sector of the economy. Secondly, on the top of credit crunch, crisis got its own dynamics through the confidence channel. Consumers and investors became cautious about spending decision leading to lower output, employment and prices, which in turn had further effect on confidence among the consumers and investors. This phenomenon can be called the vicious circle of depression. Third, the crisis is spreading worldwide through international linkage as the world is now highly globalized. The globalization channel works through foreign trade of goods and service, capital transfer, exchange rate and commodity price making the crisis as of global magnitude. The manifestation of the crisis includes insolvency of financial institutions, depressed demand, volatile stock market, high incidence of unemployment, decline in world trade and low or negative growth of GDP etc.

Low income countries (LICs) did not feel much of the first round impact as the financial market of these countries are least integrated with that of the rest of the world. LICs are affected mostly through the globalization channel. Low income countries export goods to both the developing and the developed world. However, many of the LICs have a heavier dependence on the developed countries for their export market. Hence, recession in the developed world would have adverse impact on the export from the low income countries. Reduction in commodity price may either reinforce or mitigate the adverse affect of the global recession. Those countries which are heavily dependent on export of primary products or oil are likely to be hurt by the reduced price. However, importers of commodities may be better off by the reduced commodity prices. Exchange rates of many countries became volatile since the spread of the financial crisis, which has also important implications for many low income countries.

Many LICs depend heavily on remittances as a source of external finance. Remittances are also important for supplementing local job opportunities, providing income to the poor, and contributing economic growth. Worldwide job loss and repressed demand for development work due to recession have negative implications for remittances inflow to the LICs. IMF estimates a stagnating inflow of remittances in the second half of 2008 and projects a shrinking flow of global remittances in 2009. Global recession also has implications for FDI flows. According to a recent UNCTAD report, FDI flows could decline by 20 per cent in 2008, and a further decline in FDI flows can be expected in the current year (UNCTAD 2009). The impact of global recession may be transmitted to FDI flows through several channels. First, global economic and financial crisis would imply a reduced access to financial resources to invest due to a decline in corporate profits and lower availability and higher cost of finance. Second, there is a decline in propensity to invest due to gloomy prospect out of deep recession worldwide. The impact of both factors is compounded by a very high level of risk perception, which induces the TNCs to curtail cost and investment program in order to become more resilient to any further deterioration in the business environment. Global recession also has implications for availability of foreign aid. There will be political pressure from the citizens of donor countries to limit spending of tax payers' money for the good of other countries rather than to spend it for own bailout measures. However, multilateral donor agencies like

IMF or the World Bank may feel urge to come out with enhanced financial assistance to support the rescue packages in the LICs.[2]

To address the financial and economic crisis and to mitigate the possibility of severe economic downturn, countries around the world have adopted unprecedented measures that include both rescue measures to financial sector and stimulus package to boost up the economy.[3] Early interventions were made by the developed countries and a few developing countries to stabilize the financial market and to restore credit liquidity. Some of the steps, in this regard, include capital injection to the financial institutions, induced mergers, explicit government guarantee to retail deposits and other liabilities, reducing bank leverage through government purchase of distressed assets etc. Bailout measures to financial sectors have been supported by monetary easing and other actions of the central bank including series of internationally coordinated interest rate cut. Despite these efforts, the global economic activity continued to decline. As interest rate already reached a very low level (and near zero in some cases), further scope of monetary policy was quite limited. Governments, thus, turned their attention to fiscal rescue package. Although composition of rescue packages varied considerably across countries, almost all of them can be grouped in three areas: increase in spending in public goods and services, fiscal stimulus aiming at the consumers (i.e., income tax cut, cash transfers etc), and fiscal stimulus to firms (corporate tax cut, cash incentive etc). Several countries have also announced explicit goals of job creation and protecting workers' interest. Some of the fiscal stimulus packages have indirect negative impact on international trade because of the associated nationalistic spirit in these. Many countries also announced direct measures to restrict import and to enhance export competitiveness.

3. BANGLADESH AND THE GLOBAL ECONOMIC CRISIS

Bangladesh is a country that is least integrated with the rest of the world in terms of financial market. Market capitalization ratio is quite low and there is no direct float of foreign shares of stock in the stock exchanges. Capital account is virtually closed and there is very little scope of private capital transfer. Hence, the financial sector and the economy of Bangladesh remained virtually immune from the initial impact of the global financial crisis. However, Bangladesh is heavily exposed to the global economic crisis through the globalization channel. The crisis has started to put mark on the economy of Bangladesh through this channel.

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[2] IMF already started to implement enhanced support in a few countries.

[3] ILO (2009), WTO (2009) provide detail discussion of the rescue packages across different countries.

In the early years, the economy of Bangladesh was much less integrated with the world economy, although it was heavily dependent on foreign aid. However, since it started to implement trade liberalization and other economic reform programs during late-1980s, the economy came to be influenced by the process of globalization (table 3). While trade intensity was less than 15 per cent in the early 1980s, the ratio has, by now, gone up to around 45 per cent. Remittances inflow also started to pick up with the wave of globalization, particularly since the late 1990s. Remittances now stand at more than 10 per cent of GDP. With economic reform, Bangladesh also adopted a very liberal FDI policy. While FDI was virtually non-existent before 1990s, it started to grow in the 1990s with ups and downs and it is approaching a billion dollar mark this year. On the other hand, despite a decline in the importance of foreign aid, the Government of Bangladesh still depends on it to a large extent to finance budget deficit. Thus, Bangladesh is highly exposed to the global economic crisis through the globalization channel.

While there might be some initial impact on the economy through the globalization channel that will be reflected on the international trade of goods and service, and the balance of external sector, it has other implications for overall macroeconomic balance. For example, a decline in import value will have an impact on tax revenue collection affecting overall fiscal balance. In addition, there will be second round of impact of the global crisis on the economy of Bangladesh through the transmission channel and this may further continue. There could be many indirect impact of the crisis as well that would be visible eventually. However, severity of the further round of impact would depend on the exact magnitude and duration of the global crisis as well as policy response of the government.

Stimulus package announced by other countries to face the recession has also implications for Bangladesh. If the rescue measures in the developed world succeeds to boost up depressed demand, or at least help prevent consumer demand to fall further, it will also help to protect our export. On the other hand, direct and indirect protectionist measures taken by the rest of the world may bring negative news to our export. Measures taken by our major competitors in the export market to support their own export will hurt our competitiveness in the global market.

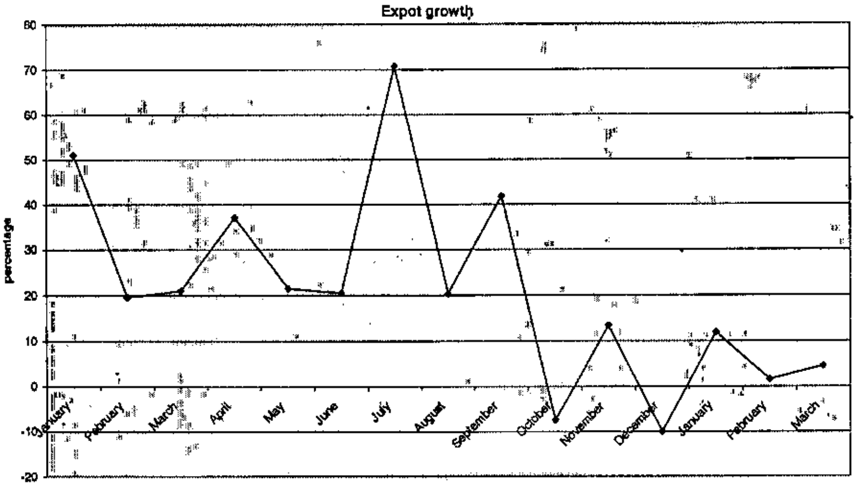
4. RECESSION AND EXTERNAL SECTOR OF BANGLADESH

4.1 Export of Goods

More than ninety per cent of Bangladesh's export is targeted to the US, the EU and other developed countries. Depressed demand in these countries has negative implications for the prospects of our export. Our export is less diversified both in terms of export items and also in terms of destination that makes it more sensitive to any relevant shock.

Empirical evidences apparently show that our export is not that affected in terms of early impact of the crisis. Export increased by 14.51 per cent up to March 2009 compared to the first nine month of the previous fiscal year. However, month-wise comparison shows that global recession started to mark some impact on our export. Export growth has slowed down in the recent months (figure 1), giving some signal that export performance may be hurt further in the near future if the global recession persists a while. Item-wise breakdown of export earnings show that the export of many items, such as jute, jute goods, leather, frozen food and many other primary products is in serious decline. On the other hand, high growth is maintained so far in case of RMG and related products (table 4).

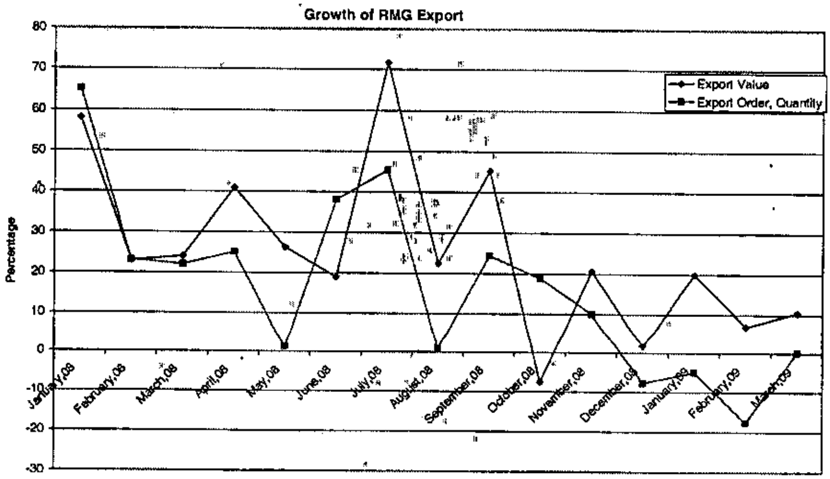
Figure 1: Growth of Monthly Export (year on year: 2008-09)



Data Source: EPB

As more than three-fourths of our export depends on RMG, export performance in near future will heavily depend on impact of global recession on this sector. In terms of product variety of RMG, Bangladesh concentrates mostly on the lower end products. In terms of market destination, more than 30 per cent of RMG is exported to the US and about 60 per cent is to the EU countries. What could be the probable impact of the global economic crisis on the demand for low value apparel on the part of the US and the EU? There could be both income and substitution effect in this regard. Reduced demand for apparel in the retail market may reduce demand for our RMG export. However, income elasticity of the lower end product may not be that high. On the other hand, people may switch to buy cheaper products due to reduction in income that may increase the demand for low value RMG product. The recent Wal-Mart phenomenon is supportive to the later[4]. Net result on our RMG export depends on relative strength of income and substitution effect. Retailers may also look for cheaper source of supply more seriously. Empirical evidences show that RMG sector has been able to maintain a respectable growth. The question is, whether in future, such growth performance can be maintained or not. EPB periodic reports on export show that, the apparent success in RMG export is mostly due to excessive high growth in the first few months of the current fiscal year. Growth rate has already slowed down in the last few months (figure 2). According to a recent Report on RMG, retail sales of apparel have declining trend in most of the major chain stores. Moreover, Bangladesh is now exposed to an intense competition from China as the restriction on export growth from China to US and EU markets under the WTO safeguard clause already expired. Despite all these, Bangladesh had been able to maintain a positive growth of RMG export, thanks to vibrant entrepreneur class and cheap labour that could establish Bangladesh as a low cost supplier of apparel. However, UD based export order data show that growth in export order reduced sharply in the recent months. Growth in export order became negative for three consecutive months from December 2008 to February 2009 (Figure 2). Growth in export order in March was virtually zero. This may provide a signal of further slowdown of growth in RMG export. However, we may not see a drastic fall in export in near future as long as Bangladesh can maintain its identity as one of the low cost suppliers of RMG.

Figure 2: Growth of RMG Export and UD Based Export Order (year on year) in the recent months.



Data Source: BGMEA

Apart from RMG, most of the major export items marked significant negative growth in the recent months, although not the entire decline in export is

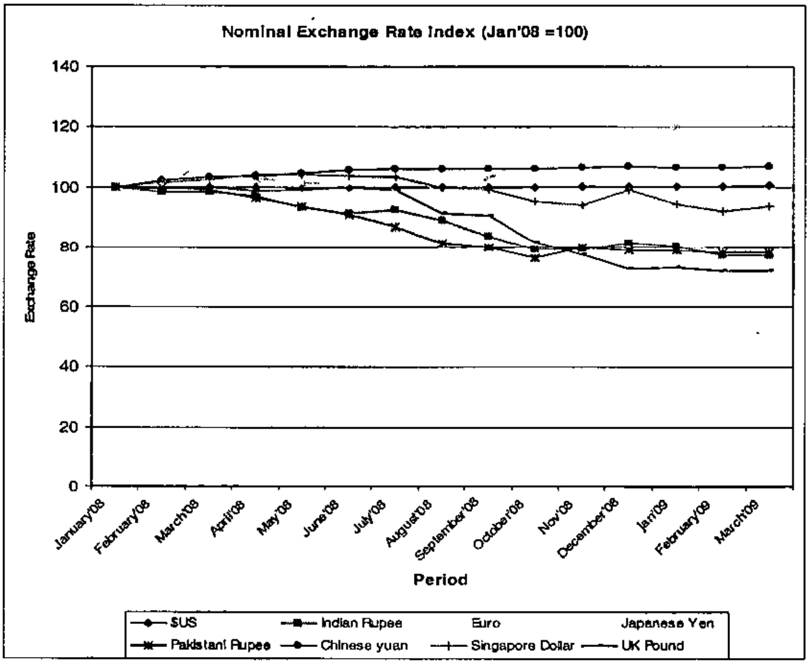
[4] Wal-Mart, that is a chain store selling cheaper consumer items reported to increase its sale of apparel items in the recent months.

related to global recession. Consequently, share of RMG in total export exceeded 79 per cent of total export in January-March 2009. Export of primary products is hurt both in terms of price and volume. However, many of the non-traditional manufactured products experienced respectable growth. For example, while leather export has declined, export of footwear and handbag increased. Export performance of RMG and some manufactured product is a clear indication that Bangladesh has a competitive edge in labour intensive manufactured export.

4.2 Exchange Rate and Commodity Prices

Since the global exposure of the financial crisis, exchange rate of most of the countries with floating exchange regime experienced depreciation of their currencies against US Dollar. Capital flight due to financial crisis and the expected decline in export might have resulted in such dynamics of exchange rate. In this regard, government policy toward competitive devaluation is another factor. On the other hand, Bangladesh had been able to maintain a fairly stable exchange rate against US dollar with its managed float regime mostly due to a stable foreign exchange reserve and healthy balance of payment situation. Consequently, our currency appreciated against most of our major trading partners and export competitors. Impact of such exchange rate movement is mixed. Bangladeshi export would be less competitive in their export market, particularly in comparison to many of our export competitors. On the other hand, price of imported items in local currency will be lower making essential commodities and industrial raw material relatively cheaper.

Figure 3: Nominal Exchange Rate Index of Taka with Other Currencies



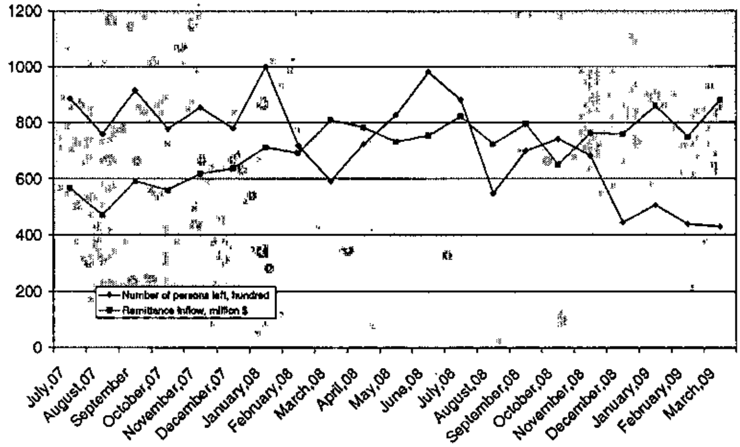
Data Source: Bangladesh Bank

Since 2006, the world experienced a massive increase in commodity price. Increasing trend in commodity price took a shape of bubble, which busted right before the outbreak of the financial crisis. Global recession might have a reinforcing effect on declining commodity price. Low income countries those are heavily dependent on commodity export are vulnerable to this price shock. Bangladesh is least hurt by the commodity price decline as it is not much dependent on commodity export. Rather, Bangladesh is benefited from lower price of imported commodities. Consequently, terms of trade of Bangladesh is expected to improve.

4.3 Remittances

Bangladesh experienced a massive growth of remittances in the recent years. Remittances stood at US$8 billion in the FY2007-08. While about 65 per cent of remittances come from the Middle East, most of the rest comes from the UK, the US and other developed countries. Very lately, some developing countries, such as Malaysia, South Korea and Singapore have been added to the list of destination of Bangladeshi workers. Current global economic crisis may hurt our remittances directly and indirectly. Firstly, Bangladeshi workers may face job loss due to repressed demand and job cut in the developed world as migrant workers are hurt first in such crises. In the face of nationalistic sentiment of the crisis-prone countries and the reduced demand for labour, recruitment of new workers will also be severely affected. These will have direct impact on our remittances. The countries of the Middle East are basically oil exporting countries. After the unusual growth of oil price increase in 2007 and 2008, oil price started to fall right before the global financial crisis. The crisis could contribute to further decline in oil price in the subsequent months. Current petroleum price is lower than the trend price of it. Even the trend line is drawn excluding recent boom in petroleum price. Such a low price of petroleum would severely affect our overseas employment in the Middle East, particularly because of a slum in construction work. However, the countries have also accumulated huge reserves due to high oil price in the last years, and the impact will be less severe if that accumulated money is used for development works in these countries.

Figure 4: Recent trends in person left for overseas job and Remittances Inflow



Data Source: Bangladesh Bank, Manpower Export Bureau

It is evident that remittances in the recent months are still growing, although growth rate has declined. On the other hand, number of persons left abroad for overseas employment dropped remarkably in the recent moths (figure 4). Number of persons left abroad in the two quarters of the crisis period has declined by 22.6 per cent (October-December) and 40.5 per cent (January-March) compared to that in the previous year. However, rate of returnees is still much lower than the number of persons left for abroad. Hence, total number of people working abroad is still on the rise, but at a decelerating rate. Consequently, remittances is still growing but at a declining rate. In the near future, remittances growth may decelerate further, or even it may start to decline if number of people left for abroad declines further and there is a downward pressure on the wages.

In the recent past, there were some negative developments impinging on our image in a few countries that hurt manpower export to those countries and elsewhere. Despite this, Bangladesh was able to maintain a steady growth in overseas employment. This has been achieved basically through diversification of the destination. The process is still on as market is expanding in Lybia, South Korea and Few other countries. Malaysia cancelled employment contract of fifty five thousand Bangladeshi workers due to factors not related to global recession, which will also reverse soon. Efforts at further diversification of the job market abroad may offset some of the losses in overseas employment due to recession.

4.4 Foreign Direct Investment and Foreign Aid

As we mentioned earlier, recession may have impact on the global FDI flow and it has already started to decline. However, interestingly enough, FDI has gone up in the first eight months of the current fiscal year (table 5). This is an indication that FDI base is quite narrow in Bangladesh and it is subject to fluctuation due to many idiosyncratic factors. Profitability of transnational companies (TNCs) is still high in Bangladesh, and it would not be hurt that much by a modest deceleration in growth due to global recession. Disbursement of foreign aid has slightly declined in the first eight months of the current fiscal year. However, major donors are still committed to maintain their assistance to us. If the implementation of ADP gets momentum with the assumption of the political government, aid disbursement may enhance in the coming days.

5. PROBABLE IMPACT ON SECTORAL LEVEL

First round impact on the economy through the transmission channel may trigger further impact on the economy at sectoral and sub-sectoral levels. A formal analysis of the next round of impacts may require scenario analysis in terms of economic modelling which is beyond the scope of the paper. However, a cursory discussion on further impact of the crisis is made here based on the probable linkage of transmission channels with various parts of the economy.

A significant decline in the number of persons left abroad for overseas employment is visible for the last few months. Given the fact that increasing number of new people are entering the labour force everyday, decline in new overseas employment will obviously deteriorate already existing high incidence of unemployment, particularly in the rural areas. This has also negative implications for rural poverty. Reduction in overseas employment also means slow business for travel agencies, recruitment agencies and airlines operating to some routes. A bulk of the remittances is spent on real estate, education in private sector etc. These sectors may also be affected if growth rate of remittances slows down further.

Many of the export sectors experienced negative growth and that has implications for employment. For example, labour demand in jute mills, shrimp cultivation, hatchery will go down that may give rise to job loss. Similarly, if the RMG sector growth slows down further, it will reduce absorption of woman. All these have implications for increasing unemployment, particularly female unemployment. With slowdown in RMG sector, linkage industries may also suffer. There has been huge investment in the backward linkage industries in the recent past. If these industries suffer, it would result in default in bank loan repayment. Yarn manufactures are now already in trouble with a huge pile-up of unsold products. Indian yarn became further cheaper with appreciation of Taka against Indian Rupee. It is now quite difficult for our yarn producers to compete with imported yarn.

Our financial sector was virtually insulated from the first round of impact of the global crisis. However, the banking sector is likely to be affected indirectly. Sluggish performance of external trade will reduce bank services. Decline in the number of workers leaving for overseas employment and slow growth of remittances inflow would also mean lower businesses for the banks. Reduced profitability or increased loss of the export oriented industries may increase bank default. As investment is discouraged, particularly in the export oriented and linkage industries, there will be negative impact on credit demand. Banks are already holding excess liquidity. On the top of this, reduction in interest rate would have negative impact on bank business if it fails to attract more productive investment and if cost of fund can not be reduced proportionately. Price of bank shares has already shown some downturn in the local stock exchange.

Overall decline in profitability in export oriented and linkage industries may have adverse impact on the other sectors through negative income effect. Real estate and housing sector is the most likely victim. However, exact magnitude of such second round and further rounds of changes are quite uncertain. It would depend on severity of the crisis, policy response of the government and many other factors.

6. GLOBAL RECESSION AND MACROECONOMIC BALANCE OF BANGLADESH

Global economic crisis has implications for the overall macroeconomic balance of Bangladesh. The crisis not only affects the external sector balance through globalization channel, it may also affect fiscal balance and monetary development of the country through direct and indirect route and through the policy responses.

6.1 Balance of Payment

Thanks to impressive growth of export and remittances inflow, the balance of payment (BOP) situation of Bangladesh has been quite good since last few years. BOP would be affected by the recession to the extent it can affect export, import, remittances and capital flows. Table (5) shows the latest position of the BOP account along with the same in the recent past. Although the export growth has slowed down in the recent months, cumulative export growth is still quite satisfactory. On the other hand, import growth has slowed down in the recent months due to decline in commodity price and in import of few commodities. During the July-February period of the FY2009, export growth was 15.0 per cent while import growth was 15.5 per cent for the same period of the previous fiscal year. Despite the slow down of remittances growth in the recent months, overall growth rate of remittances in July-February period was 27per cent. Consequently current account balance (CAB) has improved significantly during this period compared to the previous year. On the financial account, FDI showed remarkable increase during this time period. However, this increase in FDI has been mostly offset by the deterioration in investment in other sectors, such as net trade credit (that includes suppliers' credit) and capital transfer.[5] Similarly, foreign aid

[5] Increase in overseas credit repayment and other capital transfer abroad in the recent years is a concern for good economic reason.

disbursement marked a slight decline. Overall balance of payment is still better compared to that in the last fiscal year. Foreign exchange reserve is still steady which can afford almost three month's import.

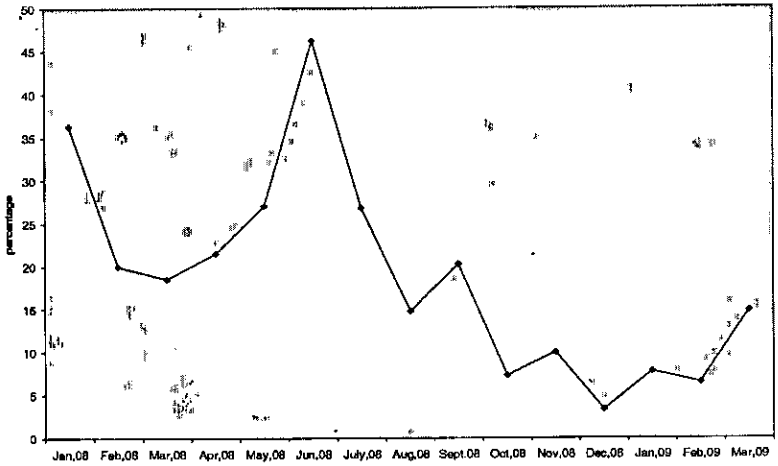
Although BOP and its components look quite healthy up to February this year, future development regarding the BOP is uncertain. If remittances growth decelerate further and export growth reaches a gloomy picture (as indicated in the previous section) it will hurt BOP. On the other hand, further slowdown of import growth would help BOP. As we know, declining growth of import is achieved mostly through reduction in commodity price. However, declining trend in commodity price has already reached to an asymptotic level. Price of many commodities, such as petroleum and a few food items already started to show some reverse trends. Hence, there is not much scope for further reduction in import growth unless there is drastic fall in import volume. FDI that has marked significant increase in the first eight months of this fiscal year also faces uncertainty in the days to come as the global FDI is supposed to shrink due to economic recession as explained before. All these will influence the future BOP situation in the country.

6.2 Fiscal Balance

Current global economic crisis has implications for both the revenue collection of the government and the public expenditure. Despite drastic trade liberalization, Bangladesh is still heavily dependent on import for tax revenue. More than 40 per cent of tax revenue is collected through custom duty, supplementary duty on import, and VAT on imported item. A deceleration of import growth has negative implications for taxes on import. Similarly, reduction in profit in different sectors and overall slowdown of GDP growth may have adverse impact on the growth of income tax.

The growth of tax revenue collected by NBR has slowed down significantly in recent months (Figure 5). Despite this, there is still 12.41 per cent increase in revenue collection in the first nine months of the current fiscal year compared to the same period of the pervious year (Table 6). Given an average inflation rate of 8 per cent and a GDP growth rate of around 6 per cent, this revenue is not satisfactory. Even, this performance has been possible due to huge growth in revenue in the first quarter. During the second quarter of FY2009, custom duty fell compared to the same period of the previous year. This was partly offset by high growth of supplementary duty, but still trade related tax shown a negative growth of 2.55 per cent in October-December. In the subsequent quarter, import related tax achieved a low but positive growth. Despite this poor performance of the import related tax revenue in the crisis period, it registered 8.35 per cent growth in the July-March period, thanks to initial ballooning of import and associated revenue collection. Income tax growth in the first nine months is lower than that of the previous year. But the growth rate is a respectable one and it got a momentum in the third quarter.

Figure 5: Month-wise Growth of NBR tax Revenue (year-on-year)



Data Source: NBR

On the expenditure side, the government so far had been in relatively relaxed situation. Lower implementation of ADP, reduction in subsidy due to fall in petroleum and other commodity prices, decelerating inflationary trend etc. contributed to relatively low pressure on public expenditure. Consequently, overall budget deficit has been contained within a level lower than the previous fiscal year. During the July–February period of the current fiscal year, government's deficit financing was Tk.14297.63 crore[6] against Tk.14368.93 crore in the same period of the previous fiscal year. Given an expected 14 per cent growth in nominal GDP, deficit financing as a percentage of GDP would be lower than before. If the declared bailout package of Tk.3400 crore is properly implemented, it may add to the deficit in the last quarter of the fiscal year, but still overall deficit would not be large. In the next fiscal year, government expenditure is expected to increase for several reasons: a high rate of implementation of ADP under the political government, implementation of election pledges and the bigger size of ADP, expected expansion in the stimulus package to face recession etc. Hence, the budget deficit may increase if the slow revenue growth trend of the recent months continues along with enhanced public expenditure. However, as budget deficit as a percentage of GDP is now less than 4 per cent, there is fiscal space to accommodate further deficit financing if we set 5 per cent of GDP as the reasonable limit of budget deficit.

6.2 Money Supply, Inflation and Investment:

Investment in real sector is the pre-condition for sustained growth. Gross Investment GDP ratio has stagnated around 24 per cent of GDP in the recent years. Global recession may affect new investment, particularly in the export

[6] Crore = ten million

oriented and linkage industries. During the first nine months of the current fiscal year, settlement of letter of credit (LC) remained similar to that in the previous period. However, there is a significant decline in new L/C opening. Facts on LC signals that although industrial investment is not affected much yet, there might be decline in industrial investment which in turn may reduce overall gross investment in the days to come.

Inflation rate has also come down in the recent months primarily due to the commodity price decline in the world market. Broad money growth also started to slow down. However, if the increased budget deficit in the coming days is financed by borrowing from the central bank, money supply may increase at higher rate. This may raise inflationary pressure again unless the money raised out of deficit financing is spent on productive use.

7. CONCLUSION

Bangladesh economy remained virtually immune from the global financial crisis as our financial market is least integrated with the rest of the world. However, as the economy of Bangladesh is integrated with the rest of the world, global economic crisis has already started to have its impact on Bangladesh. Our external sector performance is clearly affected in the recent months by the wave of global recession. Some other sectors are also likely to be adversely affected in indirect way as the impact of the crisis unfolds further. However, the extent of the impact of the global crisis on the economy of Bangladesh is not that severe yet. Overall macroeconomic balance is also hurt little by the global meltdown, as there are some mitigating factors. In fact, Bangladesh is one of those countries that have done reasonably well amid global economic crisis. However, although the economy is hurt only modestly so far, there are signals that the situation may be worse in the days to come. As other countries came out with policy response to tackle the global recession, Bangladesh should also take measures to mitigate the adverse impact of the global recession.

Our neighbouring countries and our export competitors have taken countercyclical fiscal, monetary, and financial policy measures to fight global recession and stimulate the economy. The objective of stimulus packages are manifold, such as to stabilize financial market, stimulate domestic demand, support domestic industries, protect and enhance export interests, and create job opportunities. Stimulus package of Bangladesh should have similar objectives. However, exact policy measures should be framed in the context of specific reality of Bangladesh. In addition to protecting domestic industries or supporting export sector, policy package in Bangladesh should aim at creating new jobs, maintaining price stability, providing better environment for investment and ensuring social safety net. Policies must maintain social justice and help poverty reduction directly or indirectly. Recently, the Government has declared an interim stimulus package. A bigger and more detailed package is expected to come in the upcoming budget. Instead of any detail policy suggestions, the paper here will highlight some broad guidelines and outline some possible policy implications.

Many countries declared a policy of monetary easing and lowering interest rate. Business bodies in Bangladesh also unanimously demanded interest rate cut to reduce their cost of business. In fact, Bangladesh is a country where not only interest rate is quite high but also there is high spread between lending and deposit rates. Accordingly, Bangladesh Bank has already initiated some modest steps to reduce interest rate. Commercial Bank's credit growth has slowed down and they have now huge excess liquidity. This provides some room to cut lending rate that may have impact on credit expansion. Reduction in inflation rate in the recent months also provides scope for reducing both the lending rate and the deposit rate maintaining real interest rate unaffected.

Bangladesh has proceeded a long way towards trade liberalization. Reducing anti-export bias helps ensure better efficiency of resource allocation. However, many of our competing countries have already taken some protectionist measures and export stimulating policies. To support our domestic industries and to maintain our competitiveness, we may also take some safeguard measures for our local industries and to provide some stimulus to export on temporary basis. Tariff structure should be revised further to encourage import of capital machineries and to reduce cost of imported raw materials. Local industries may be given stimulus also through restructuring corporate income tax.

Bangladesh has to compete in the global market with a poor infrastructure that ultimately increases cost of doing business. We need to go a long way for infrastructure development. Infrastructure development is a long-term issue, and it is not an immediate policy response to the crisis. However, selective steps in this regard may be taken as a short-term response to the crisis. For example, immediate steps to ensure gas pressure and fix the problematic power stations may help reduce power crisis in the industrial sector. Construction of new roads and highways or maintenance of the existing ones may help create employment opportunity for the poor.

As we have seen before, our export competitiveness is hurt by depreciation of currencies of our major trading partners. Hence, the need for devaluation of our currency was raised mostly by the export oriented and export related sectors. However, devaluation of currency will increase domestic price of imported goods. Capital machineries, industrial raw materials, and consumer goods will be more expensive and it will affect both producers and consumers. In a (managed) floating exchange rate regime, the central bank has also limited capacity to drastically change the exchange rate. Existing foreign exchange reserve of Bangladesh is able to support less than three months of export. The central bank may buy foreign currency further to increase reserves that will increase price of foreign currency and devaluate our currency to some extent. However, this step will increase money supply fuelling inflation.

Cash incentive came up as a financial measure to support the export related sectors that have important fiscal implications. In the past, the scheme was not that effective to achieve its desired goal and it also raised question of equity. However, if other policy supports can not reach some of the affected sector, cash incentive may become a need for those. For example, if devaluation is not possible, cash incentive may be enhanced to yarn producers or some severely affected export industries so as to compensate for the loss out of competitive devaluation of other countries. Cash incentive should be allowed only after thorough analysis by the government and only on temporary basis.

The government should also take measures for employment creation. There should be enhanced allocation for training, credit and other measures for job creation, particularly in the rural areas. Measures may be taken to encourage SMEs designed to generate employment opportunities. Social safety net programs should be enhanced too as the poverty reduction pace may slow down with decelerating growth. All these will require additional money in the coming budget. However, as discussed above, there is some fiscal space for deficit financing making it easier to have adequate allocation for stimulus package. The government should also further stimulate tax collection efforts so that it can raise revenue without imposing new taxes.

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Table 1: Projection of World Output Contraction (Percentage)

	2007	2008	2009	2010
IMF	5.2	3.2	-1.3	1.9
Word Bank	3.8	1.9	-1.7	2.3
OECD	2.9	2.2	-2.7	1.2
Deutsche Bank			-0.8	

Source: IMF, World Bank, OECD and Deutsche Bank.

Table 2: IMF Projection of Growth of Different Region (Percentage)

	ESTIMATE		PROJECTION	
	2007	2008	2009	2010
World Output	5.2	3.2	-1.3	1.9
Advanced Economies	2.9	0.9	-3.8	0.0
US	2.0	1.1	-2.8	0.0
UK	3.0	0.7	-4.1	-0.4
EURO Area	2.7	0.9	-4.2	-0.4
Emerging Market and Developing Economies	8.3	6.1	1.6	4.0
CIS countries	8.6	5.5	-5.1	1.2
Newly Industrialized Asian Economy	5.7	1.5	-5.6	0.8
Developing Asia	10.6	7.7	4.8	6.1
China	13.0	9.0	6.5	7.5
India	9.3	7.3	4.5	5.6

Source: IMF, April 2009.

Table 3: Extent of Globalization of the Bangladesh Economy (Percentage of GDP)

	FY 1980-81	FY 1990-91	FY 1995-96	FY 2000-01	FY 2005-06	FY 2006-07	FY 2007-08
Export	3.7	5.5	9.5	13.7	12.0	18.1	17.8
Import	9.9	11.2	16.9	19.9	16.8	25.6	25.6
Remittances	1.9	2.5	3.0	4.0	7.8	8.9	10.0
ODA Disbursement	5.8	5.6	3.5	2.9	2.5	2.3	2.4
FDI (net)				1.2	1.1	1.2	0.8

Source: Various Issues of Bangladesh Economic Review and Economic Trend.

Table 4: Relative Share and Growth of Major Export Items in the Recent Period

	July-January 2008-09			October-December 2008	**January 2009**
	Value	Percentage Share	Year-on-Year Growth	Year-on-Year Growth	**Year-on-Year Growth**
Raw Jute	80.33	0.88	-15.17	7.4	**-55.5**
Jute Gods	151.44	1.66	-20.24	-32	**-32.5**
Tea	10.01	0.11	-10.06	-28.7	**-55.2**
Frozen Food	309.81	3.39	-5.54	-24.3	**-14.2**
Leather	115.95	1.27	-31.82	-50.2	**-31.4**
Woven Garments	3389.99	37.13	20.59	6.4	**18.7**
Knit Garments	3803.57	41.66	26.17	4.7	**21.2**
Chemical Products	189.33	2.07	84.24		
Agricultural Goods	52.05	0.57	-8.41	-20	**-18**
Engineering and Electrical Goods	96.44	1.06	-20.65		
Others	932.13	10.20	12.68		
Primary	549.28	6.02	-8.46	-21.1	**-28.4**
Manufactured	8581.81	93.98	20.40	0.5	**14.7**
Total	**9131.05**	**100**	**18.16**	**-1.2**	**11.9**

Source: Constructed from EPB data.

Table 5: Balance of Payment Situation in Recent Time (Million US $)

	Fiscal Year 2006-07	Fiscal Year 2007-08	July-February 2007-08	July-February 2008-09
Trade Balance	**-3458**	**-5541**	**-3087**	**-3560**
Exports f.o.b.(including EPZ)	12053	13945	8973	10399
Imports f.o.b (including EPZ)	-15511	-19486	-12060	-13959
Services	**-1255**	**-1525**	**-1116**	**-1214**
Receipts	1484	1879	1023	1161
Payments	-2739	-3404	-2139	-2375
Income	**-905**	**-1005**	**-715**	**-893**
Receipts	244	221	128	81
Payments	-1149	-1226	-843	-974
Of which: Official Interest Payment	-212	-234	-154	-152
Current transfers	**6554**	**8743**	**5217**	**6483**
Official Transfers	97	127	80	55
Private Transfers	6457	8616	5137	6428
Of Which: Workers' Remittances	5979	7915	4841	6148
Current Account Balance	***936***	***672***	***299***	***816***
Capital Account	**490**	**576**	**347**	**228**
Capital Transfers	490	576	347	228
Financial Account	**762**	**-431**	**-151**	**-101**
i) Foreign Direct Investment (net)*	793	650	446	851
Ii) Portfolio Investment	106	48	70	-76
Iii) Other Investment	-137	-1129	-667	-876
MLT Loans 2/	1037	1338	774	860
MLT Amortization Payments	-525	-580	-362	-411
Other Long-Term Loans (net)	-24	-3	28	-50
Other Short-Term Loans (net)	493	-160	-75	-98
Other Capital	-535	-581	-309	-450
Trade Credit (net)	-481	-1010	-733	-991
DMBs and NBDCs	-102	-133	10	264
Assets	-86	-146	-11	111
Liabilities	-16	13	21	153
Errors and omissions	**-695**	**-213**	**-185**	**-170**
Overall balance	***1493***	***604***	***310***	***773***
Reserve assets	**-1493**	**-604**	**-310**	**-773**
Bangladesh Bank	-1493	-604	-310	-773
Assets	-1593	-1072	-691	-584
Liabilities	100	468	381	-189

Source: Monthly Economic Update, April 2009, Bangladesh Bank.

Table 6: Growth in Tax Revenue (year-on-year, Percentage)

	July-March, 2009	July-March, 2008	July-September, 2009	October-December, 2009	January-March, 2009
Custom duty	1.55	8.26	16.45	-7.42	-3.00
Value Added Tax (import)	12.10	25.37	37.91	-2.39	4.24
Supplementary Duty (import)	25.60	40.99	39.97	19.90	18.17
Import Related Total	8.35	17.64	27.66	-2.55	2.10
Excise Duty	9.93	16.27	-92.35	-27.27	12.65
Value Added Tax (local)	18.79	20.47	26.74	15.66	15.22
Supplementary Duty (local)	2.29	26.27	8.24	-2.08	1.78
Turnover Tax	-10.06	-21.32	-19.83	0.97	-10.08
Total Tax on Local Production	12.08	22.64	18.73	8.39	9.99
Income Tax	21.13	35.66	12.20	22.10	27.07
Other Tax and Duty	-13.34	50.44	-28.70	20.05	-9.94
Total Tax	12.21	23.21	20.60	6.77	10.25

Source: Constructed from NBR data.

Table 7: Budget Financing (in crore taka)

Fiscal Year	Net borrowing from the Banking System	Net non-bank borrowing	Total domestic Financing	Net Foreign Financing	Total Financing	Total fincing as a % of GDP
2001-02	2487.1	4711.47	7198.57	5782.82	12981.39	4.75
2002-03	-1103.1	4795.22	3692.12	6560.78	10252.9	3.41
2003-04	1246.2	4598.94	5845.14	3597.3	9442.44	2.84
2004-05	3106.6	2907.56	6014.16	6236.68	12250.84	3.3
2005-06	5667.8	2758.9	8426.7	7236.8	15663.5	3.77
2006-07	4937.2	4373.53	9310.73	7591.15	16901.88	3.58
2007-08	11622	4008.68	15630.68	5021.6	20652.28	3.81
July-February, 08-09	6425.6	2843.89	9269.49	5028.14	14297.63	-
July-February, 07-08	6197.7	2518.22	8715.92	5653.01	14368.93	-

Source: Bangladesh Bank, Monthly Economic Update, April 2009.

Table 8: LC Opening and Settlement for Capital Machinery (in million US $)

	July-March 2008-09		July-March 2007-08		Changes during July-March2008-09 over July-March 2007-08	
	Fresh LC opening	Settlement of LC	Fresh LC opening	Settlement of LC	Fresh LC opening	Settlement of LC
Textile Machinery	201.26	305.68	398.6	280.55	-197.34	25.12
Leather / tannery	1.05	0.88	2.48	2.28	-1.43	-1.39
Jute Industry	2.62	3.96	4.14	2.81	-1.52	1.14
Garment Industry	233.10	274.15	305.14	270.89	-72.04	3.65
Pharmaceutical Industry	16.60	18.85	20.21	14.83	-3.61	4.02
Packing Industry	8.96	6.74	7.28	6.67	1.68	0.07
Other Industry	412.63	489.97	541.86	473.06	-129.22	16.90
Total	876.22	1100.22	1279.71	1052.10	-403.50	49.12