

BANGLADESH: SEMI-ANNUAL ECONOMIC UPDATE
April 15, 2009

SUMMARY

- **Bangladesh's economy has exhibited resilience in the face of the global economic downturn.** Despite the global recession – especially in countries to which it exports both goods and people – Bangladesh has maintained an impressive growth rate of 5.5 percent in FY09. The macroeconomic policy response remains on track.
- **However, there are indications that the global economic recession is beginning to impact the economy.** The recession in developed markets and the economic slowdown in the Middle East are beginning to threaten Bangladeshi exports and remittances.
 - **Exports:** Overall export growth has been volatile and has slowed considerably to a monthly decline of 3 percent by February 2009. Exports of Ready Made Garments (RMG), while still growing, have fallen significantly from 59 percent at the beginning of FY09 to 19 percent in February 2009. RMG export orders have declined since December 2008, and this will have a lagged impact on exports. Prices of RMG exports are being re-negotiated downwards in some cases, while in others, buyers are requesting an extension of shipment dates. Non-RMG exports have also been declining.
 - **Remittances:** Remittances have held up so far but growth rates are rapidly declining. The lackluster performance of many Gulf Cooperation Council (GCC) countries is adversely affecting work opportunities for migrants from Bangladesh and therefore, future remittances. Meanwhile, there are reports of visas to workers being cancelled and some migrants returning to Bangladesh.
- **Protecting the poor a top policy priority.** Recognizing the potential of the global crisis to affect Bangladesh's economy, the government has recently appointed a high-level Task Force to study the likely impact and possible responses to the crisis. While there is scope for fiscal maneuvering due to lower food and fuel prices, Bangladesh is resource-constrained and therefore delicate tradeoffs have to be made while designing a fiscal package. The focus should be on growth-promoting activities (infrastructure, trade, health and education) and on strengthening the social safety nets to protect the poor.

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I. Changing the External and Domestic Environment

Global economic conditions are deteriorating. The world economy has entered into a sharp downturn caused by a shock in mature financial markets. With credit markets tightening, firms scaling back production and capital spending plans, and consumers reining in spending, the global economic crisis is affecting both developed and developing economies alike. Economic forecasts are grim. According to the World Bank's Global Economic Prospects (GEP) report, global GDP is projected to contract by 1.7 percent in 2009. OECD countries are expected to contract by 3 percent this year; other high-income countries by 2 percent. While low-income countries may avoid the severe contractions of advanced economies, they will nevertheless feel the pain. GDP growth among low-income countries is expected to slow from 5.8 percent in 2008 to 2.2 percent in 2009.

Economic connectivity between developed and developing countries will impact Bangladesh. World trade in goods and services is expected to see an historic decline of 6.1 percent in 2009 according to the GEP report. Weak global demand is exacerbated by scarce trade finance, with small and medium enterprises being disproportionately affected. Meanwhile, private capital flows have halved in 2008 compared to the previous year, and foreign direct investment is expected to taper off in all regions. Remittances by overseas workers to developing countries are also expected to drop sharply by an estimated 5 percent in 2009. Primary commodity prices have fallen, with differing impacts on net commodity importers and exporters. Finally, the impact on flows of Official Development Assistance remains uncertain. For developing countries such as Bangladesh, the ability to undertake policies to protect growth and poverty reduction will depend in large part on their initial macroeconomic positions, their vulnerability to shocks, and access to concessional external aid.

In the recent past, Bangladesh's economy has experienced steady growth. The global economic crisis came at a time when Bangladesh was witnessing a period of relative economic prosperity. Bangladesh averaged a healthy growth rate of 6 percent over the last six years mainly from the industrial and services sectors (See Annex-I for details). Industrial growth averaged 8 percent per annum in the last six years despite inadequate infrastructure – particularly electricity and natural gas. Services, which grew at over 6 percent per annum in recent years, have remained robust, benefiting from continued inflow of remittances. Agriculture grew at nearly 4 percent per annum in recent years and output has varied largely because of weather-related shocks. More recently, in FY09, agricultural production is on track to set an historic productivity record. Even though growth in both industry and services are likely to slow in the last quarter of FY09, overall GDP growth in FY09 is expected to be around 5.5 percent given the outcomes already observed in agriculture, exports and remittances in the first three quarters of the current fiscal year.

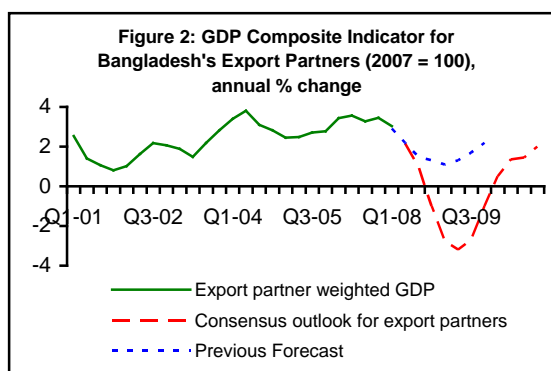
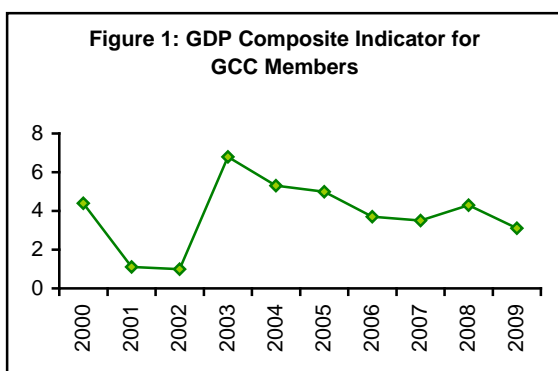
The current macroeconomic position is remains stable. The external current account has been in surplus since FY06. Continued robust growth of remittances and strong export growth helped maintain the surplus in the first seven months of FY09. The foreign exchange reserve position has continued to improve, reaching over US\$ 6 billion (2.9 months of import cover) by early April. The Bangladesh Bank (BB) has maintained the dollar exchange rate stable to guard against imported inflation pressures. Aggregate fiscal discipline and monetary prudence have been important pillars of Bangladesh's macroeconomic management. Overall the budget deficit has been maintained at less than 4 percent of GDP and domestic financing around 2 percent throughout this decade, notwithstanding continued weaknesses in revenue mobilization. This has continued into FY09. Implementation of the Annual Development Program (ADP) remains a perennial problem and this has

remained unchanged so far in FY09. Slow ADP implementation and savings from provisions made for fuel and fertilizer subsidies helped contain the budget deficit at less than 4 percent of GDP in FY09 as well, with domestic financing projected at around 1.8 percent.

II. Impact of the Global Recession on Bangladesh

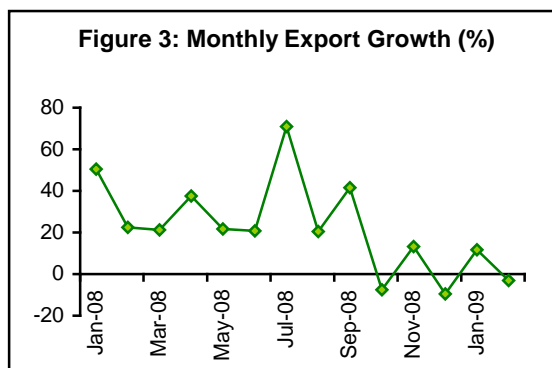
While the Bangladesh economy has largely escaped the first round effects of the global financial crisis, weak consumer spending in developed economies and the collapse in global trade are likely to have an increasingly adverse impact on Bangladesh. Policy preparedness and timely action will be required to deal with the impending impact of the global crisis. In the absence of such precautionary measures, there is a danger that the domestic economy could descend into a downward spiral of reduced export and remittance growth, leading to lower GDP growth and higher unemployment.

Second-round effects of the crisis are now being felt. While some early indicators suggest problems ahead, Bangladesh is still not in economic crisis. Exports and remittances—the two crown jewels of the Bangladesh economy—are most vulnerable to the impending global recession (Figures 1 and 2). Minimal exposure to global financial markets has staved off first-round effects of the ongoing global financial crisis. However, as the global crisis worsens, Bangladesh becomes more vulnerable to second-round effects.



(i) Impact on exports

Overall export performance. The pace of export growth slowed significantly, from 71 percent in July 2008 to 15.3 percent in February 2009, reaching US\$ 10.3 billion so far in FY09. During the first eight months of FY09, total export *volumes* rose by 13.6 percent while *prices* rose by 2.3 percent. Strong export growth for the Ready Made Garment (RMG) sector¹ occurred in knitwear (23.1 percent) and woven garments (19.3 percent), but the declining trend in non-RMG exports of leather (-33.1 percent), jute goods (-18.1 percent) and raw jute (-19.8 percent) continued. Pharmaceutical exports declined by 15.5 percent and export of frozen food items fell by 11 percent. RMG export earnings dropped 20 percent to US\$2.7 billion in Q2, down from US\$3.4 billion in Q1 of FY09. Non-RMG export earnings have fallen by 33 percent to US\$683



¹ The performance of the RMG sector is crucial because it accounts for over three-quarters of export earnings and contributes about 10 percent to GDP. It also accounts for about 40 percent of manufacturing output and employment and supports many ancillary industries.

million in Q2, down from US\$1.0 billion in Q1 of FY09. Export of most items declined in December 2008 and February 2009 (Figure 3).

Bangladesh's export markets are not doing well. Recent World Bank projections paint a grim picture for Bangladesh's export markets. Growth in export markets is likely to continue to fall sharply in 2009 – putting pressure on external balances. World Bank calculations – based on the latest Census surveys on the quarterly real GDP growth outlook – suggest that Bangladesh's export markets will contract in 2009² (Figure 2).

Despite this gloomy forecast, Bangladesh's RMG exports have held up well so far. Demand for low-end RMG products registered overall growth in the first seven months of FY09 relative to the corresponding period of FY07. But future RMG export prospects are worrisome because of declining orders. For instance, the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) reported a slowdown in export orders for woven garments since September 2008. In February, BGMEA reported a decline in export orders of 17.6 percent after recording a decline in export orders of 5.5 percent in January and 7.7 percent in December 2008. RMG export orders grew by a miniscule 0.1 percent in March 2009, compared with 22 percent growth in March 2008. BKMEA export orders have been slowing since September 2008 and growth turned negative during December-March 2009. Given the time lag between orders and shipments of about 4 months for woven garments, a slowdown in growth of exports or even a decline may become evident in Q4 of FY09. There is concern about the impact on export prices as well. Buyers are renegotiating prices and delaying orders. Rebates of 15 to 25 percent on already placed orders are being negotiated.

Meanwhile, non-RMG export demand and prices are falling. The global economic downturn is exerting significant downward pressure on both demand and price of a number of Bangladesh's non-RMG exports. Frozen shrimp, a major export item, has experienced steep decline in price from US\$5 per kg to US\$3.7 per kg. Profit margins for vegetable exporters (exporting mostly to UK) have eroded due to the sharp depreciation of the UK pound vis-à-vis the US dollar. The Jute Mills Association and Jute Spinners Association have reduced their production by 25-30 percent due to the slump in external demand for raw jute and jute goods. Anticipated retrenchment of around 50,000 workers is predicted in the jute sector by the end of 2009, if demand conditions do not improve. The emerging shipbuilding sector has also been adversely affected by the global economic downturn. According to shipbuilders, both price and demand for ships have declined recently.³

Summing up. Overall in the export arena, there are a number of worrying signs: export volatility appears to have increased with growth rates fluctuating widely; buyers are pressing for higher discounts; orders are being deferred; and the threat from competitors to Bangladesh in traditional apparel markets has become stronger.

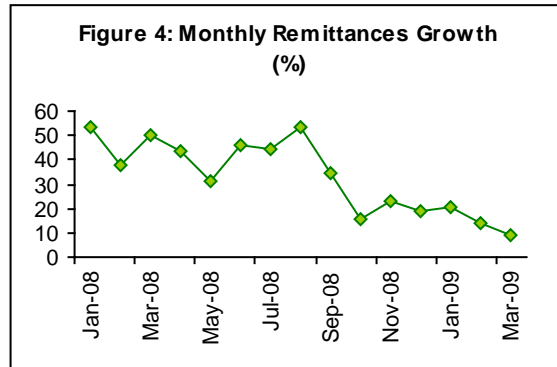
² The composite index of Bangladesh's export markets is calculated using 2007 weights from IMF Direction of Trade Statistics (DOT) statistics. The index is compiled from countries for which there are timely and comparable GDP data. It represents 89% of reported world imports from Bangladesh: United States (27.9%), Germany (14.3%), United Kingdom (11.3%), France (5.8%), Canada (4.2%), Italy, Netherlands and Spain (4%), Turkey (1.9%), Sweden (1.6%), India (1.5%), Japan (1.4%), China and Hong Kong (0.9%), Switzerland and Singapore (0.7%), Norway and Korea (0.6%), Russia (0.4%), Indonesia, Slovak Republic, Australia and Poland (0.3%), Malaysia and Taiwan (0.2%), and Brazil, Czech Republic and Thailand (0.1%).

³ The price of a ship weighing 7,500 tons has fallen from US\$10 million to US\$ 9 million in the last year.

(ii) Impact on remittances

Global remittance flows are projected to decline.

Remittances have been a key driver of economic growth and poverty reduction in Bangladesh. The impact of the global financial crisis on remittances is of critical importance. In the past, global remittance flows have been stable, or even counter-cyclical, during an economic downturn in the recipient country, and resilient in the face of a slowdown in source countries. However, the current crisis is global and the World Bank's Global Economic Outlook projects a 4.2 to 7.3 percent decline in remittance flows to South Asia in 2009. If exchange rates remain unfavorable global remittance flows are likely to experience an even greater decline.



The pace of remittance growth into Bangladesh has started to slow down. The monthly remittance growth rate slowed from 44.7 percent in July 2008 to 9 percent in March 2009; the lowest so far in this fiscal year (Figure 4). However, overall remittances in Bangladesh have held through March 2009.⁴

Remittance flows and oil prices are positively correlated. In Bangladesh there is strong evidence that remittances are positively correlated with oil prices. The sharp and sustained decline in oil prices combined with the impact of the financial crisis in the banking sector is adversely affecting the construction boom in the Middle Eastern economies. This reduced growth in demand for migrant labor in the oil-rich Arab countries, which eventually could hurt Bangladesh's remittance income. This together with immigration controls in destination countries could worsen remittance prospects.

The performance of GCC countries is particularly important. The bulk of Bangladesh's remittances, about 63 percent, come from the Middle East, which hosts over 3.6 million Bangladeshi workers. A further 29 percent come from the US, UK and Germany. Therefore, for Bangladesh, economic developments in the Gulf Cooperation Council (GCC)⁵ countries will be decisive. The Kuwaiti Foreign Minister stated on January 16 2009 that about 60 percent of development projects have either been postponed or cancelled by the GCC countries because of the global meltdown. Industry insiders anticipate that the impact of the global financial crisis on Saudi Arabia and other GCC countries will lead to further restrictions on foreign workers and visas.⁶

Remittances from other countries may decline too. The Bangladeshi think-tank Refugee and Migratory Movement Research Unit (RMMRU), estimates that Bangladesh may also face declines in remittance inflows from the UK and US. Remittances from the UK may fall significantly as most of it derives from Bangladeshis engaged in hospitality and catering activities, which are highly susceptible to economic downturns. Remittances from the US, sent mainly by small entrepreneurs and blue collar workers (e.g. taxi drivers, restaurant staff, sales staff), may also decline due to the economic downturn.

⁴ Remittance inflows increased by 24.4 percent in the first three quarters of the fiscal year as compared to the same period last year, with the level of remittance inflows reaching over \$7 billion. Record high remittance inflow in January and even higher inflow in March 2009 in the face of a growing number of people getting retrenched abroad suggests that this may be due to terminal returnees repatriating their savings.

⁵ Gulf Cooperation Council (GCC) member countries include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE.

⁶ There are some positives as well. According to RMMRU of Dhaka University, Libya has agreed to source between 0.1 to 1 million workers from Bangladesh in 2009.

Outflow of migrant workers is slowing. A record number (1.7 million) of Bangladeshi workers have left the country in the last two years. Recently there has been a marked slowdown in the outflow of migrant workers. The first nine months of FY09 (July–March) saw a 25 percent decline in migrant workers employed abroad from 537,000 compared to 720,000 during the same period last year. The outflow of Bangladeshi workers to GCC countries declined by 16 percent, from 407,000 in FY08 (Jul-Feb) to 342,000 in FY09 (July-Feb). Outflow of migrant workers to Saudi Arabia, the most important destination country, declined by 84 percent during the same period. Saudi Arabia and Kuwait, which account for nearly 40 percent of total migrant workers from Bangladesh, have virtually stopped issuing new work permits. Demand for migrant workers also weakened in the UAE, another major destination for Bangladeshi workers. This decline in outflow of migrant workers will affect future remittances to Bangladesh.

Cancelled visas and returning migrants. Singapore, home to over 170,000 Bangladeshi workers, is expected to be particularly hard hit from slowing trade with the US and Europe, layoffs have reportedly already begun. In March 2009 the Malaysian government cancelled the visas of 55,000 Bangladeshi workers. The number of returnee migrants has increased too. The Bangladesh Association of International Recruiting Agencies (BAIRA) estimates the number of returnee migrants per month increased to 300-400 compared to 150-200 previously. Most migrants return from countries like Saudi Arabia, UAE, Malaysia and Singapore.⁷ From March 1-23, 2009 more than 4,500 workers have returned home having been laid off or denied work when returning from vacations. BMET data shows that 13,540 Bangladeshi workers returned during December 2008 and February 2009 (some of these returns may be due to other reasons not linked to the downturn). Although a large number of migrants are returning home, new migration flow is still positive and the stock of existing migrants has increased from 4.7 million in February 2008 to 5.4 million in February 2009. If the migrant stock persists, it could contribute to the resilience of remittance flows in the face of the crisis.

(iii) Impact on employment

Job losses. The current labor force is estimated at around 50 million. While there is no noticeable impact of the global crisis on employment in the RMG sector, the textile and jute sectors have clearly suffered. Since most of the growth is volume-driven, employment in the RMG sector, which employs more than 3.1 million workers, has been more or less sustained. The sector is yet to witness any large scale layoff, wage cut, or benefit withdrawal. However, in the textile sector, 12 spinning mills out of 341 mills are reported to have shut down and most of the mills have reduced their operation by about 30 percent. As a result, a significant number of workers have lost their jobs as reported in the national media.⁸

⁷ Labor migration affected by economic downturn: BAIRA; *The Daily Star*, 17 March 2009

⁸ Reduction in yarn export has led most of the jute enterprises to reduce production levels by 25-30 percent and to lay off 10-20,000 workers during July-December 2008. According to the leaders of Bangladesh Jute Mills Association (BJMA) and Bangladesh Jute Spinners Association (BJSJA), the job loss may reach 50,000 by the end of FY09. Although exports of frozen food (particularly shrimp), and processed and finished leather have declined during the July-January period, so far there is no report of any factory shut down or retrenchment. The shipbuilding sector is under pressure because of reduced orders and, in some cases, deferment/cancellation of some previous orders but the impact on employment is still unclear. Large outflow of migrant workers had eased the domestic employment situation in the past.

Box 1: Outlook for Remittance Flows 2009-2011

In the light of a downward revision in the World Bank's Global Economic Outlook, revised forecasts for remittance flows to developing countries suggest a 5-8 percent decline in 2009. Low-income and middle-income countries are also expected to see a 5 percent decline in 2009 remittance inflows.

Remittance flows to South Asia surged in 2008. In contrast, in 2009, South Asia is expected to experience a sharp slow down, in part due to the high base effect of 2008. South Asia is particularly vulnerable given the importance of the GCC countries as a source of remittances. While the outlook for remittance flows from the GCC countries remains uncertain; the latest assessments for remittances from these countries project a decline of 3 percent.

The persistence of the migrant stock will contribute to the continuity of remittance flows in the face of the crisis. Sources of risk to this outlook include uncertainty about the depth and duration of the current crisis, unpredictable movements in exchange rates, and political reaction to weak job markets in destination countries which could lead to tightening of immigration controls.

Table 1: Outlook for remittance flows to developing countries, 2009-10

	2008e	Base case forecast			Low case forecast		
		2009f	2010f	2011f	2009f	2010f	2011f
Growth rate (%)							
Developing countries	8.8	5.0	2.9	6.3	8.2	0.2	3.2
East Asia and Pacific	6.6	4.2	1.9	5.6	7.5	1.3	2.1
Europe and Central Asia	5.4	-10.1	4.2	7.5	12.7	1.6	5.1
Latin America and Caribbean	0.2	4.4	2.3	5.6	7.7	1.0	2.5
Middle East and North Africa	7.6	1.4	2.9	5.6	5.2	0.9	2.1
South Asia	26.7	4.2	3.4	6.8	7.3	0.5	4.2
Sub Saharan Africa	6.3	4.4	3.5	6.7	7.9	0.0	3.5
Low-income countries	13.0	5.4	4.4	7.5	8.2	1.6	4.9
Middle-income countries	8.1	4.9	2.7	6.0	8.1	0.5	2.9

e = estimate; f=forecast. Source: See Migration and Development Brief 8 for the methodology for the estimates for 2008 and forecasts for 2009 and 2010. Base case scenario assumes that new migration flows to major destination countries would be zero; implying that the stock of existing migrants will remain unchanged. Low case scenario assumes that there is return of migrant's equivalent to one year of inflows.

Need to create more jobs. There could be a significant impact on unemployment in an economy where 2 million people enter the labor force every year if the export industries begin to layoff workers. Prior to the oil price boom in 2007-08, Bangladesh exported 250,000-300,000 workers per annum. This jumped to over 560,000 because of booming labor exports in the last half of FY07 and to over 980,000 in 2007-08. The overwhelming majority of migrant workers went to GCC countries (nearly 60 percent in 2007 and 73 percent in 2008). If oil prices remain depressed, then annual migrant labor will likely decline. In addition, if there are layoffs in the affected export sectors, particularly in the RMG sector, there would be a significant increase in unemployment. In the immediate future, the domestic economy may need to create about 2 to 2.5 million new jobs to keep the unemployment rate under control.

(iv) Impact on the banking sector

No impact so far on the banking sector. Bangladesh has made good progress in recent years in the banking sector, as reflected in the growth of credit and deposits and the reduction in non-performing loans (NPL). NPLs in the banking sector have declined to 10.79 percent in December 2008, from a high of 13 percent in December 2007. NPLs of State-owned Commercial Banks (SCBs) decreased for

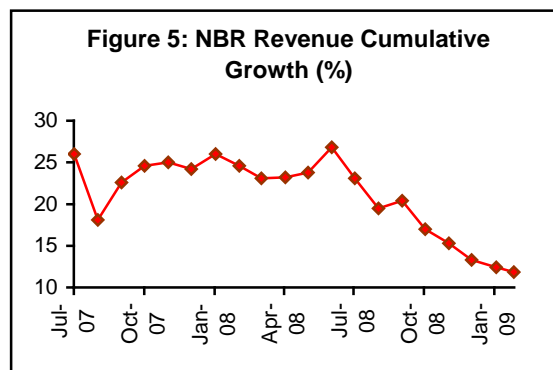
the first time last year – from 30 percent to 25 percent. Reforms and the absence of political interference are seen as possible drivers of this. NPLs of the private banks increased moderately from 4.44 percent to 5.01 percent.

Downside risks to be monitored. There are downside risks from the second round effects that include the adverse impact of a slowdown in earnings from exports and remittances on deposits as well as effects on loan servicing/repayment by firms/individuals facing financial distress. The banking sector reportedly has significant exposure to the spinning, RMG, frozen food, jute and pharmaceutical sectors which compounds the risks from the second round effects of the global slowdown.

Need for stress tests. Precautionary measures including stress tests for individual banks and review of capital adequacy will be important. There is the possibility of some stress being created in the banks because exporters are increasingly obliged to provide goods on credit. This could require making bridge financing available through banks for exporters.

(v) Impact on revenue

Import-based taxes lower. The global slowdown has posed challenges for revenue mobilization. Sharp reduction in international commodity prices due to the global downturn has reduced import values and thus import-based taxes. Growth in tax revenue has slowed from 23.1 percent in July 2008 to 11.8 percent by February (Figure 5). Growth in import-based tax has slowed from 50.8 percent in July 2008 to 8.7 percent by February.⁹



(vi) Silver linings

Some positive signs. Surprisingly, the global recession has also brought with it positive developments for Bangladesh. Sharp declines in international commodity prices—particularly oil, fertilizer and food—have eased pressure on import payments and helped reduce the quasi-fiscal deficits. Cumulative growth in import payments has declined from 35 percent in July-September 2008 to 19.4 percent in July-January 2009. Because of sharp increases in international prices and their lack of pass-through to domestic prices, quasi-fiscal losses reached 2.5 percent of GDP in FY08. This is now projected to decline to 0.6 percent of GDP.

(vii) Impact on poverty

An approximation of the poverty impact – with caveats. Household Income and Expenditure Survey (HIES) data shows that poverty incidence in Bangladesh fell from 57 percent in 1991-92 to 49 percent in 2000, and then even more rapidly to 40 percent in 2005. See World Bank (2008), Poverty Assessment for Bangladesh: Creating Opportunities and Bridging the East-West Divide. While household data for Bangladesh after 2005 is not available, the rapid economic growth between 2005 and 2008 – an average of 6.4 percent annually – suggests that the pace of poverty reduction is likely to have continued. Now, the global economic crisis poses a significant risk to continued growth. The impact of the economic downturn on poverty incidence in Bangladesh is calculated using the growth elasticity of poverty incidence that is estimated from HIES 2000 and 2005 data (World Bank, 2008). The impact should be regarded as an approximation only, with significant caveats. A more rigorous

⁹ In the first eight months of FY09, 57 percent of the target for import-based taxes has been achieved compared to 61 percent and 63 percent in the corresponding period of FY08 and FY07 respectively.

analysis using micro-simulation methods is being conducted, the results from which are likely to lead to deeper insights into the welfare and distributional impact of the crisis.

Impact on poverty – the growth elasticity approach. Growth elasticity of poverty is the parameter that estimates the percentage decrease in poverty associated with one percent increase in GDP. There are many competing methods for estimating this parameter, among which we decided to adopt a slight modification of the methodology suggested by Datt and Ravallion (1992), since it appears to best fit the historical trends in Bangladesh. According to this approach, the growth elasticity of Bangladesh is 0.64. This implies that if GDP were to grow by one percent, the next year's poverty rate will decline by 0.64 percent. The poverty impact of the global financial crisis is simulated under the benchmark growth (average annual growth rate of 6.5 percent in FY09 and 6.2 percent in FY10) and different scenarios of GDP growth projected for FY09 (5.5 percent) and FY10 (5 percent or 4 percent in high and low case scenarios respectively). The difference in the projected poverty rate of FY09 and FY10 between the benchmark and the projected growth scenarios can then be considered as the poverty impact of the global crisis.

Results. Adopting this methodology, we find the economic slowdown in FY09 and FY10 due to the global crisis is likely to increase poverty rate by 0.3 percentage point in FY10 and by 0.5-0.7 percentage point in FY11 (corresponding to the high and low case scenarios, respectively), compared to what would have been the case in absence of such a slowdown. Poverty headcount rate would have declined by about 5 percentage points between 2005 and 2010 in the benchmark case with 6.5 and 6.2 percent annual GDP growth in FY09 and FY10 respectively; instead, with the slowdown in FY09 and FY10, poverty rate would decline by 4.3-4.5 percentage points (for the low and high case scenarios, respectively) between 2005 and 2010. The projections for FY10 and FY11 also factor in the impact of the rice price shock in 2008, which is estimated to have led to an increase in poverty of around 3 percentage points for that year, compared to a scenario without the shock. This estimate has strong caveats as well, since it does not take into account: (i) behavioral changes in consumption (such as substitution between commodities) that may have occurred from 2005 to 2008, and (ii) the impact of government's assistance schemes in response to the price shock.

Important caveats. These results should be treated with caution for a number of reasons, two of which are particularly important. First, the projections do not take into account the recent decline in food and fuel prices as a result of the global economic crisis, which is likely to help the poor. Therefore, GDP decline and falling food/fuel prices due to the global economic crisis would have opposing effects on poverty. The eventual impact on poverty would depend on the relative magnitudes of these opposing trends. Second, the projections are extrapolated from historical data – an imperfect guide for the future. The projections essentially show the future path of poverty reduction if the association between growth and distribution in the recent past were to hold for the future. But if, for example, the economic slowdown were to disproportionately affect certain groups, sectors or regions (for example, the export sector in Bangladesh), the distributional impact could be such that the aggregate poverty reduction would be different from what is projected here for the same GDP growth rate.

III. Policy Responses to the Global Financial Crisis

(i) Policy Responses in Major Asian Countries

The principles underlying a sound policy response are summarized in Box 2. While the measures taken differ from country to country, the following commonalities in the chosen approaches and measures have emerged in major Asian countries:¹⁰

- They have all responded with expansionary fiscal and monetary policies once the effects of the global financial crisis were felt domestically.
- Policy responses have generally not been targeted to specific industries most affected by the global economic meltdown.
- The size of the fiscal stimulus packages range from 0.9 percent of GDP (Malaysia) to 4.1 percent (Philippines).

Fiscal policy responses have taken the form of both *revenue* and *expenditure* measures:

- Revenue measures include adjustments to both tax rates and tax base for VAT, corporate and personal income tax, import duties, capital gains and property tax.
- Expenditure measures are mostly in the form of increased spending on infrastructure (roads, transport, housing), and subsidies to businesses and low-income households.

Monetary policy responses have taken the form of both *interest rate* measures and *quantitative easing*:

- Interest rate measures include adjustments to deposit and lending rates, as well as policy (repo and reverse repo) rates.
- Quantitative easing mainly in the form of cuts in reserve requirement and statutory liquidity ratios to inject additional liquidity into the system.
- Governments have committed to, or increased, deposit guarantees.
- Governments have not interfered with existing exchange rate mechanisms in their respective countries.

(ii) Policy Responses in Bangladesh

Bangladesh's economy has exhibited resilience in the face of the global economic meltdown. The government has been proactive and has responded with measures to counter the effects of the global financial crisis on the local economy. These can be strengthened to further insulate the economy from adverse impacts.

Task Force formed to address the crisis. In March 2009 the government formed a 27 member Financial Crisis Task Force headed by the Finance Minister. The Task Force is composed of some of the country's foremost economists, top bureaucrats, as well as representatives from the private sector, civil society and political parties. The Task Force has been mandated to monitor the impacts of the global economic crisis, recommend measures to address the crisis and has a particular focus on measure to boost agricultural productivity.

¹⁰ The countries examined and the specific measures taken are listed in Annex 1 and include China, India, Indonesia, Malaysia, Philippines, South Korea, Sri Lanka and Vietnam.

Box 2: Fiscal Policies during a Crisis: Lessons from Experience

Policy makers in developing countries are grappling with two questions:

- What are the appropriate policies to support the financial sector?
- What is the best fiscal strategy to stimulate demand while avoiding an unsustainable increase in debt?

Experience has shown that fiscal policy responses are essential to counter the effects of a crisis as deep as the current one. If the crisis is prolonged, expenditure measures cushion a first round impact on demand. Policy makers in developing countries can draw on the following principles when devising an effective fiscal stimulus plan:

- The fiscal policy measures envisaged must not endanger macroeconomic stability and jeopardize the country's long-run fiscal sustainability. Otherwise the country risks increasing volatility and contributing to excessive debt accumulation, both of which will hamper future economic growth.
- The fiscal stimulus should consist as much as possible of temporary measures. These measures can be prolonged in nature, but it should be made clear from the beginning that they are not permanent.
- Policies have to strike a balance between tax cuts and spending increases. Direct spending is generally more effective than tax cuts. However, tax cuts and transfers make sense when they favor individuals and firms whose spending is constrained by lack of financing.
- The quality of spending must not be sacrificed. If the country's administrative and institutional capacity is weak, rushing into an increase in spending may lead to a massive waste of resources. Spending increases should concentrate on areas where the expenditures are either reversible or likely to increase growth in the future.

In addition to the above principles, fiscal policies should be aligned with long-term development priorities. Experience has shown that effective stimulus measures include: (1) strengthening of social safety nets, such as in-kind or cash transfers to low-income households, as these measures help protect the most vulnerable from potentially irreversible human capital losses such as in health or education; and (2) measures protecting growth – such as frontloading of existing projects and increasing maintenance spending. Governments should expand tested and well-functioning existing and pre-appraised new projects. Infrastructure spending can stimulate aggregate demand and employment in the short run, as well as contribute to growth in the long run. Drawing from past experience, measures to be avoided include: (i) new large scale entitlement programs; (ii) increase in public sector wage bill; (iii) increase in subsidies to specific industries; (iv) reduction in corporate tax rates, dividends and capital gains taxes, which are likely to have a small effect since they usually fall during a crisis; (v) increases in tariffs; and (vi) tax amnesties for companies in trouble, as this may seem as unfair industrial policy by competitors.

Steps taken so far. The following fiscal and monetary measures have so far been announced by the government:

(i) Fiscal measures

- *Austerity measures:* To increase the fiscal space, the government is planning to introduce 13 austerity measures to control public expenditure. These include policies for limiting the purchase of vehicles for ministries and reductions in discretionary spending in certain ministries and divisions.
- *Fiscal policy measures under consideration:* A series of quick steps has been recommended at the first meeting of the Financial Crisis Task Force. These include cash incentives for exporters, temporary withdrawal of renewal of license fees for captive power generation, and temporary withdrawal of VAT on exports.

(ii) Monetary and financial measures

- *Reduction in repo rate:* The Bangladesh Bank (BB) cut the repo rate in March 2009 by 25 basis points from 8.75 percent to 8.50 percent. Similarly, the central bank also lowered the reverse repo rate by 25 basis points from 6.75 percent to 6.50 percent.
- *Relaxation of SCB credit limits:* On March 17, 2009, Bangladesh Bank (BB) doubled the lending limits of the four state-owned commercial banks (SCBs) in an attempt to boost domestic investment. SCBs capacity to provide loans to a single borrower was also raised. A memorandum of understanding (MoU) between BB and SCBs -- Sonali, Janata, Agrani and Rupali banks—has raised the limit on the increase in loans and advances that can be issued in a year by these institutions from five percent to ten percent. This will likely enable the SCB's to provide loans of around Tk. 60 billion this fiscal year.
- *Rescheduling of loans:* The RMG, textiles, frozen food, leather, jute, and tea sectors have been allowed to reschedule loans.

(iii) The Way Forward - Policy Responses in Bangladesh

Refining the approach to the crisis is a challenge that involves complex trade-offs. There is a debate emphasizing the need for “bail-out” packages and immediate relief. There are also calls for a more comprehensive approach to protect and enhance economic growth, exports and employment. Delicate trade-offs need to be considered. On the one hand there is limited fiscal space for a large bailout package, coupled with the risk that revenues might decline with the slowdown in trade. However, there is some room for maneuver, because of lower oil prices that will likely save the government about 1.1 percent of GDP. This is an important opportunity that needs to be used judiciously to generate lasting impacts that support growth and employment. Possible candidates might include infrastructure; support to small and medium enterprises; micro-credit schemes; health and education; safety net programs. Stretching the deficit too far risks compromising fiscal prudence. Ideally financing of any additional deficit would come from concessional aid sources that would have a limited impact on the public debt and future interest payments.

The crisis may also present some opportunities for reform. The global financial crisis poses both a threat and an opportunity. The threat is the downside risk of a fall in earnings from exports, remittances, revenues and the health of the banking system. But it also presents the country an opportunity to initiate reforms to sustain equitable development and growth. International experience suggests that crises often create an environment for reforms. A case in point from South Asia is the balance of payments crisis of 1991 in India that saw the emergence of the modern Indian economy.

Focusing on policies that simultaneously address immediate needs and long-term goals for development. The priority has to be on reforms that address the immediate concerns of the global financial crisis while also contributing to the long term development agenda.

(i) Fiscal measures: There are some measures that Bangladesh can take to create more fiscal space. Firstly, the declining global fuel price has created savings on fuel and fertilizer subsidies. Secondly, there is some scope to strengthen tax revenue mobilization through improvements in administration and compliance. Bangladesh has the lowest tax-to-GDP ratio in South Asia, and one of the lowest in the world. Thirdly, the government could focus efforts on improving the

efficiency and composition of expenditures. The following are some specific fiscal policy options that could be considered:

- **Review of public spending:** A thorough review of public spending programs would identify priorities that have strong poverty alleviation and growth benefits. These might include rural and urban infrastructure, the power sector; spending on basic health and education; spending on programs that support small and medium enterprises including micro-credit schemes, and spending on well designed poverty alleviation programs.
- **Enhancing safety nets:** Strengthening of safety nets is one of the most effective measures to sustain aggregate demand and protect livelihoods in times of an economic downturn. Moreover, if designed appropriately, these public spending increases will be self – reversing. Existing workfare programs could be enhanced and their design fine tuned to assure even greater targeting to the poor, improved effectiveness and transparency.
- **Strengthening revenue mobilization:** There are two obvious possibilities for increasing tax revenues. Reforms that raise tax compliance would boost revenues and modernization of the property tax system would also increase the revenue potential of this asset.
- **Annual Development Program (ADP) implementation:** Implementing the already planned expenditures of the ADP is the simplest and quickest way for the government to stimulate demand and increase output. ADP implementation has often lagged behind planned allocations¹¹. Hence there is scope for expanding spending through projects that have already been sanctioned and appraised. Again the focus could be on projects with a high labor content. Addressing systemic delays in project approval and implementation would also bring durable benefits beyond the crisis.

(ii) *Measures to facilitate external trade:* The following menu of options could be considered to facilitate external trade and competitiveness.

- **Increasing the inflow of remittances:** Reducing the transactions costs of transferring funds may yield some additional flows. For instance automated check clearing and electronic fund transfer systems could expand and speed-up cash transfers. Other more long term measures could aim at attracting investments by non-resident Bangladeshis (NRBs) in Bangladesh using various saving schemes offered by the government and Banks to NRBs.
- **Promoting external competitiveness:** In the medium term, any measure that enhances the country's competitiveness will promote greater resilience to global shocks. International comparisons of cost of doing business show that Bangladesh lies at the bottom third of comparator countries. This suggests that there is scope for improving business competitiveness through measures such as improvements in electricity, transport and ports.
- **Promoting regional connectivity and trade (medium-term measure):** Bangladesh can raise its exports, investment and growth through better connectivity and trade with regional countries. The priorities are in the areas of trade logistics, regional transport, power, and water. All these are critical areas for development. Preliminary estimates suggest that Bangladesh can earn an additional \$1.0 billion or more from exports, transit charges and port fees. Supported by higher exports, investment opportunities and better connectivity of border towns to regional

¹¹ So far the government has only utilized 34 percent of total allocation in the first eight months of FY09.

growth centers, economic growth could be raised by an additional 2 percent per year. The global crisis provides a major opportunity for Bangladesh and its neighbors to rethink the economic cooperation agenda. The East Asian experience of rapid growth is a clear example of how economic cooperation can support development efforts of all partners, large or small.

(iii) *Monetary and financial measures:* Like fiscal policy responses, monetary policy responses entail both opportunities and risks. A policy of monetary easing can put excessive downward pressure on the exchange rate, and may lead to increased inflationary pressures. Hence it is crucial that monetary policy not only provides liquidity to the economy, but that it is also consistent with dampening inflationary pressures. Historical evidence from other countries has shown that maintaining exchange rate flexibility is critical to enhancing the competitiveness of the economy. In this regard it is noteworthy that none of the governments in the major Asian countries have sought to regulate exchange rates to counter the effects of the current global financial crisis. In addition to carrying forward the ongoing financial sector reforms, the following interventions deserve consideration:

- Support to the micro-finance sector; particularly micro-enterprises.
- Enhancing the Small Enterprise Fund (SEF), which provides a refinancing window in Bangladesh Bank, has been successful in financing the “missing middle” and creating jobs.
- Provision of bridge financing for exporters who are being increasingly compelled to provide goods on credit.
- Deepening and broadening the financial sector through the development of the debt/bond and equity markets in order to make long-term finance, especially infrastructure finance and housing finance, more accessible.

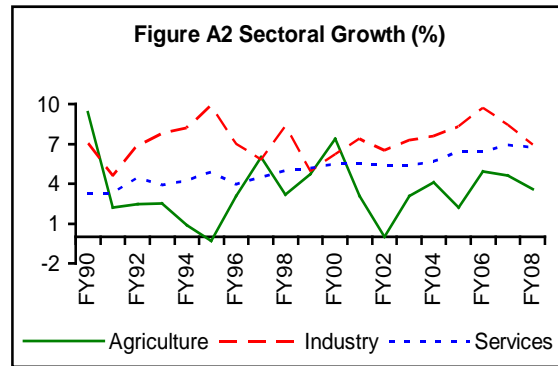
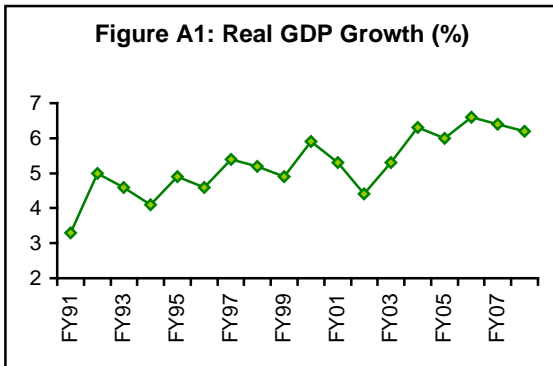
Annex I. Recent Economic Developments

A. Economic growth

Economic growth in FY09 is on track to exceed 5 plus percent, thanks to a favorable agricultural outlook and strong export and remittance growth.

Bangladesh's growth in recent years has come mostly from the industrial and services sectors, while the contribution of agriculture has fluctuated widely depending largely on the vagaries of nature and the performance of the agricultural input distribution systems (Figures A1 and A2). Agricultural production this year is on track to set an historic productivity record while industry and services are likely to slow in the last quarter of FY09 as the impact of the global economic crisis percolates through the local economy.

Agriculture: Agricultural growth in FY09 is likely to exceed 4 percent, compared with 3.5 percent last year. Following bumper harvests of *boro* (rice), wheat, and potato earlier in FY08, the agricultural production outlook continues to look bright since monsoon this year has not caused any damage. *Aus* (rice) harvest is estimated to be about 1.9 million tons compared with 1.5 million tons last year. *Aman* (rice) production is estimated to be about 13 million tons which is 36 percent higher than last year's production. Crop production this year may reach new heights if the bumper *boro* production performance of last year is repeated. *Boro* cultivation has already surpassed the target area by 1.4 percent as of end-February 2009. Animal farming and fisheries are also reported to be doing very well.



The favorable weather conditions plus other factors including supply response to higher market and government procurement prices, continued government attention to supply of inputs, credit, and extension services, prevention of Avian Flu that badly affected livestock production last year—all of these factors imply that agricultural growth in FY09 is expected to be higher than the 3.6 percent growth achieved in FY08.

Industry: Industrial growth in the country has slowed from 9.7 percent in FY06 to 6.9 percent in FY08 mainly due to lower manufacturing and construction growth. This growth slowdown is caused by lower private investment in manufacturing and declining public investment in construction.¹² These resulted from inadequate infrastructure facilities, particularly electricity and natural gas, and uncertainties surrounding the political transition. The latter has been somewhat resolved with the conclusion of national elections last December; the BDR incident has renewed caution among investors. The former remains an intractable challenge, especially in the short run. Without early remedial measures, frequent load shedding and irregular gas supply will continue to disrupt industrial production. The small- and medium-scale industries, which are the largest provider of employment

¹² Real investment in plant and machinery declined by 18 percent in FY08. Public investment declined from 5.5 percent of GDP in FY07 to 5 percent in FY08 mainly due to nonperformance of construction contracts.

outside agriculture, are most adversely affected due to energy shortfall as they can not afford to have alternative energy sources (e.g., generators).

Manufacturing growth held up well in the first quarter of FY09. In July-November of FY09, the general index of medium and large scale manufacturing increased by 10.3 percent compared to same period last fiscal year. The general index of small scale manufacturing also increased by 7.1 percent during the same period. Since then industrial activity has slowed down somewhat as exports slowed. LC opening in FY09 (Jul-Jan) for the import of capital machinery declined by 24 percent while that for the import of machinery for miscellaneous industries increased by 11.5 percent. LC opening for the import of industrial raw materials and intermediate goods grew by 5.5 percent and 44.6 percent respectively in the same period. LC opening for construction materials, however, declined by 17.5 percent in the first 7 months of FY09 compared with same period last fiscal year. A survey done by a local think-tank shows that business confidence has improved significantly (by 25.8 percent) in Q2 of FY09 compared to Q1.¹³ However, business confidence of export oriented sectors like RMG and pharmaceuticals was weaker than that of other sectors.

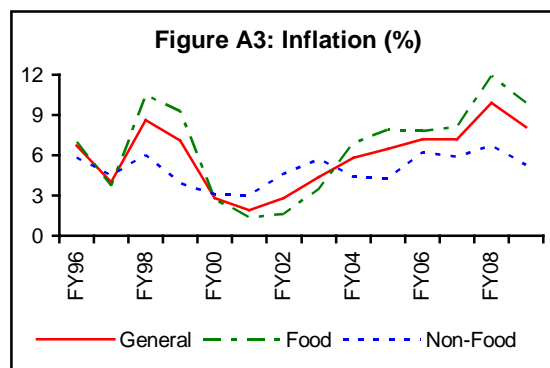
Large and immediate investments in natural gas and power are a pre-requisite for putting industrial growth back on the double-digit trajectory. Investments in improving road conditions, port operations and urban infrastructure, and services are also needed to sustain high industrial growth. In this context, the ongoing global crisis is posing new challenges as private sector financing (particularly foreign) for infrastructure projects is likely to be increasingly difficult. In light of the current global situation, a new approach to public-private partnership may be required, where significantly more public funds will be needed.

Services: Services growth has remained robust (6.7 percent in FY08) benefiting largely from continued strong inflows of remittances. With likely higher growth in agriculture in FY09, the retail and wholesale sub-sectors will also get a boost. Wholesale and retail trade, transport, telecommunications and real estate and housing—all services sub-sectors have performed well in the first quarter of FY09. Continued expansion of industry is likely to have a positive impact on services growth. A rapid growth in the mobile phone market, banking, and an increasing number of healthcare providers has also contributed to robust growth in services. Slower remittances inflows, however, may take a toll on services growth in the months ahead.

B. Inflation

Inflation has receded on account of declining international commodity prices, but demand side pressures may resurge.

Inflation in Bangladesh, particularly food inflation, was a major problem until recently. However, with the global downturn in commodity prices as well as good domestic agricultural production, this is no longer a near-term concern. Inflation increased steadily from 1.5 percent in FY01 to a nine-year high of 11.6 percent in December 2007 and remained in double digits until October 2008. Since then it has declined sharply to 5.8 percent in February 2009, reflecting largely a decrease in food inflation (Figure A3). Food price inflation has dominated the increase in overall inflation since FY03. The surge in international prices of rice and wheat (key items in the Bangladesh CPI) were major contributors to the rise in food price inflation in Bangladesh. The increase in international prices of oil, raw materials and intermediate inputs; internal



¹³ Shamunnay, Bangladesh Economic Outlook, Vol. 2, No. 2, January 2009.

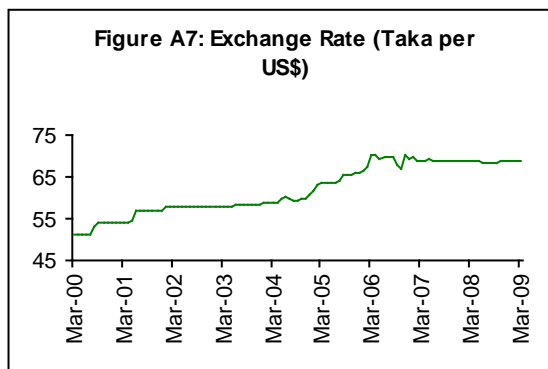
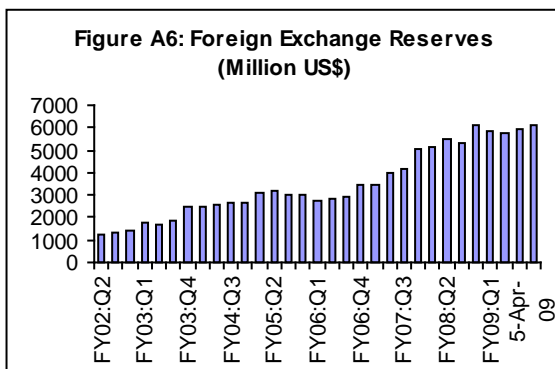
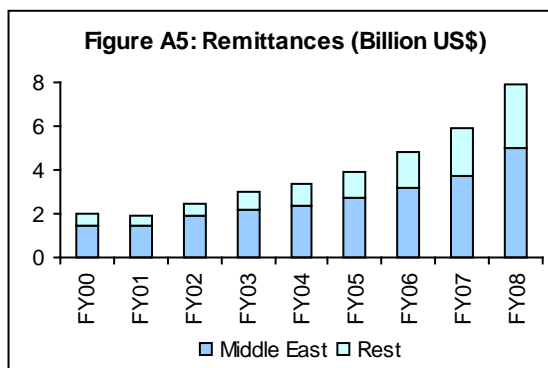
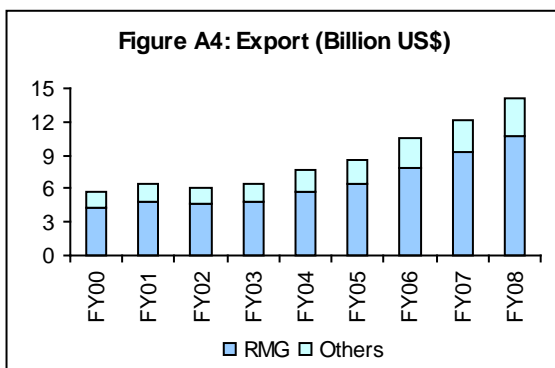
shocks such as poor crop harvests and natural disasters; and domestic supply distortions exacerbated the pressures on prices emanating from abroad. High monetary growth also contributed.

The decline in food and nonfood inflation is expected to continue in the near-term, as the global crisis deepens. However, it is possible that demand side pressures will resurge. Bangladesh Bank’s (BB) recent monetary policy statement has left the door open for monetary policy actions to counter inflationary pressures, but it maintains a bias towards accommodating credit demand, particularly to key growth driving sectors. BB, however, did send a signal of its intention to fight inflation through a small preemptive increase in daily cash reserve requirements. While inflation is not a near term threat, monetary vigilance must continue.

C. Macroeconomic management

The current macroeconomic position is stable, but policy actions will be required to deal with the emerging impact of the ongoing global crisis and to accelerate momentum on the structural policy and institutional reform agenda.

External Sector: Continued robust growth of remittances and strong export growth helped maintain sound external balances in the first seven months of FY09 (Figure A4 and A5). There was a significant deterioration in the current account balance last October when it turned from a surplus of US\$366 million in the first quarter of FY09 to a deficit of US\$280 million in the first four months of FY09 (July-Oct), reflecting a US\$646 million deficit in October 2008. This was largely due to weakening of exports and remittances in October 2008. Boosted by strong remittance growth, the current account balance recovered subsequently reaching a \$464 million surplus in July-January, FY09 compared with \$168 million surplus in July-January, FY08. The foreign exchange reserve position has continued to improve, reaching over US\$ 6 billion (2.9 months of import cover) by early April (Figure A6).



The Bangladesh Bank has maintained the dollar exchange rate stable to guard against imported inflation pressures. The weighted average nominal exchange rate against the US dollar has varied within a rather narrow band, hovering between Tk. 68.5 and slightly over Tk. 69 per \$ during the last few months (Figure A7). Bangladesh Bank continues to intervene in the interbank foreign exchange market to prevent appreciation of taka against the US dollar.¹⁴ This has not necessarily prevented the erosion of export competitiveness because the currencies of Bangladesh's competitor countries have depreciated by 5 to 8 percent since the onset of the global financial crisis.¹⁵ Moving forward, greater flexibility in the taka-dollar rate will be needed to support policy objectives and cushion the impact of falling export prices on export profit margins. Greater flexibility will also help develop the interbank market.

Fiscal Management: Aggregate fiscal discipline has been an important pillar of Bangladesh's macroeconomic management. This tradition has continued into FY09. Notwithstanding slower than projected revenue growth, overall budget balance in the first half of FY09 has been well within a sustainable level.

In recent months the growth in tax revenue has begun to slow down primarily on account of import-based taxes (Figure A7). Growth in tax revenue has slowed from 23.1 percent in July 2008 to 17 percent by October to 11.8 percent by February. Growth in import-based tax has slowed from 50.8 percent in July 2008 to 22.3 percent by October to 8.7 percent by February. During July-February 2009 domestic taxes grew by 11.8 percent, and income taxes by 19.4 percent compared to the same period last year. In order to meet the Tk. 545 billion target for FY09, revenue has to grow by 20.4 percent in the last 4 months of the fiscal year relative to the last 4 months of the previous fiscal year. Tax revenue grew by 29 percent in the last 4 months in FY08. It appears increasingly likely that revenue will fall short of the original budget target.

Current expenditures in the first half of FY09 grew by 12.7 percent relative to the first half of FY08, below the annual growth target of 19.5 percent. The FY09 budget provided Tk. 131.6 billion for subsidies out of which provision for Bangladesh Petroleum Corporation alone amounted to Tk. 61.1 billion. With the decline in international prices of oil, fertilizer and food, a significant part of this provision may not be needed despite downward adjustment in diesel and kerosene prices by Tk. 11 per litre in three steps since late October 2008. Ensuring safety net programs, particularly the new 100-Day Employment Program, are well targeted and leakages are minimized, is critical for safeguarding the quality of FY09 expenditure expansion. The recent step taken by the government to suspend the 100-Day Employment Generation Program with a view to reviewing it to minimize leakages is a step in the right direction.

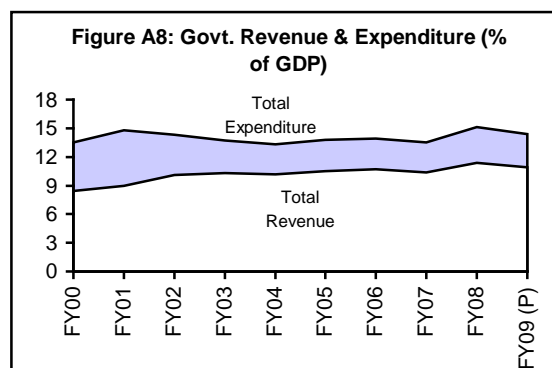
Implementation of the Annual Development Program (ADP) remains a perennial problem. Increased demand for revenue expenditures together with rising construction costs (that led contractors to forgo their original contracts) hindered ADP implementation in FY08. The usual slow rate in ADP implementation has remained unchanged so far. Only 34 percent of the total FY09 ADP allocation was spent during first seven months of FY09, compared with 30.6 percent implementation during the same period of FY08. Reaching a reasonable implementation level of about 80-85 percent by the end of the current fiscal year is likely to be a major challenge. The quality and pace of ADP spending need to be enhanced by addressing capacity constraints and improving coordination with donors as well as implementing agencies.

Slow ADP implementation and savings from provisions made for fuel and fertilizer subsidies helped contain the budget deficit in the first seven months of FY09 below levels incurred during the same

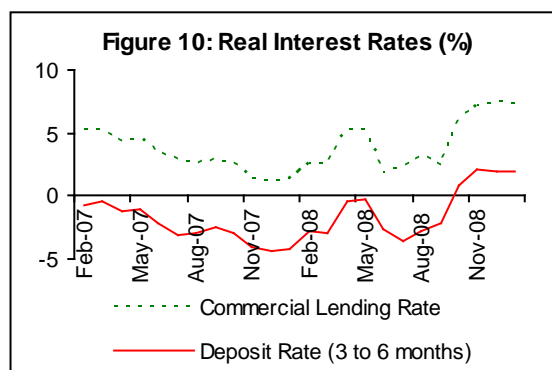
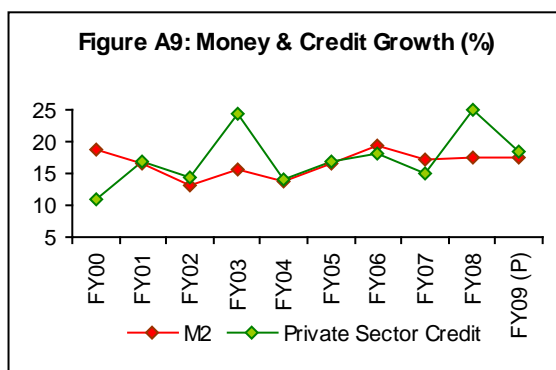
¹⁴ BB purchased about \$361.7 million from the market in the first quarter of 2009.

¹⁵ Indian Rupee depreciated by 7.9 percent, Malaysian Ringgit by 4.9 percent Cambodian Rile by 0.6 percent and Thai Baht by 5 percent.

period in FY08. Budget deficit in the first seven months amounted to Tk. 124.3 billion, compared with Tk. 146.2 billion deficit in the first seven months of FY08. Domestic financing during the same period amounted to Tk. 84.4 billion, constituting 62.5 percent of the FY09 domestic financing target. There was a Tk. 5 billion decline in Bangladesh Bank’s claim on the public sector—a continuation of decline in monetary financing of the budget deficit since FY07. Only 29.4 percent of the foreign financing target was realized in the first seven months of FY09, reflecting largely a shortfall in implementation of aided projects in the ADP. The budget deficit for the whole year is likely to be less than 4 percent of GDP (Figure A8).



Monetary Management: Monetary management has generally been sound. Bangladesh Bank maintained close vigilance of the monetary aggregates in view of the global price increases in the first half of 2008 and the consequent high levels of inflation in Bangladesh. The onset of the global economic crisis and the subsequent plummeting of international commodity prices have induced BB to revisit the monetary policy stance for the second half of FY09 to take account of the risk of an impending economic slow down in Bangladesh. Monetary growth has been rather high in recent months (Figure A9). Broad money growth through January 2009 was 19.8 percent, compared with 14.2 percent growth through January 2008. The rise in broad money growth was driven by 20.9 percent growth in private credit and 22.5 percent growth in credit to the government. Growth in private sector credit reflected growth in bank advances for trade, industry, construction and transport and communication.



BB faces the challenge of steering a monetary policy that is consistent with price stability while at the same time ensuring adequate liquidity and credit to stimulate economic activities. With a slower growth in economic activity in the first half of FY08, BB’s position to keep interest rates and market liquidity steady was appropriate. Real interest rates have increased in recent months (Figure 10). There is a widely shared concern to avoid putting the brakes on private credit growth and adopt a selectively accommodative monetary policy focusing on key sectors. However, such a policy could entrench inflationary expectations that may haunt Bangladesh when the current downward price trends in international commodity markets are reversed. Moreover, credit and liquidity conditions have not tightened to a point that can justify economy wide monetary stimulus at this stage. In fact, excess liquidity in the banking system increased from Tk. 130 billion at end-June, 2008 to Tk. 215 billion at end-February, 2009.

Annex II- Impact of the Global Financial Crisis: Policy Responses in Selected Asian Countries¹⁶

	Impact	Size	Fiscal response		Monetary response	
			Revenue measures	Expenditure measures	Interest rate / exchange rate measures	Quantitative easing measures
China	<ul style="list-style-type: none"> ▪ GDP growth projected at 8% for 2009 compared to 9% in 2008 ▪ GDP growth slowed to 6.8% in Q4 2008 from 9% in Q3 and 10.1% in Q2 ▪ An estimated 10 million migrant workers have lost their jobs due to impact of financial crisis 	2% of GDP each in 2009 and 2010	<ul style="list-style-type: none"> ▪ VAT reform to be rolled out nationwide with deductions for capital spending ▪ VAT reductions for small firms ▪ Increase in VAT refund rates for exporters 	<ul style="list-style-type: none"> ▪ Low income public housing projects ▪ Rural infrastructure - water supply and conservation ▪ Transport – railways, highways, airports ▪ Local health clinics and renovating schools in inland provinces ▪ Post earthquake reconstruction 	<ul style="list-style-type: none"> ▪ One-year benchmark deposit rate cut from 3.87% to 2.25% since October 2008 ▪ RMB¹⁷ benchmark loan rate lowered from 6.93% to 5.31% since October 2008 ▪ Benchmark deposit and loan rates for other maturities adjusted accordingly ▪ Central Bank reiterated commitment to keep the RMB stable at a reasonable and balanced level, while making the exchange rate more flexible 	<ul style="list-style-type: none"> ▪ RMB reserve requirement ratio lowered by 1% for large depository financial institutions, and by 2% for small and medium-sized depository financial institutions; it has been lowered by a further 0.5% in December 2008

	Impact	Size	Fiscal response		Monetary response	
			Revenue measures	Expenditure measures	Interest rate / exchange rate measures	Quantitative easing measures
India	<ul style="list-style-type: none"> ▪ GDP growth projected at 6.2% for 2009-10 compared to an estimated 7% in 	1.4% of GDP (excluding states and recap fund)	<ul style="list-style-type: none"> ▪ Central VAT reduced 4% across the board, except petroleum products (0.2% of GDP) ▪ Increased duty refunds for exporters 	<ul style="list-style-type: none"> ▪ State owned India Infrastructure Finance Company Ltd allowed to raise INR¹⁸400 billion (USD8 billion or 0.8% of GDP) to refinance PPP routed infrastructure 	<ul style="list-style-type: none"> ▪ Interest rate ceilings on Non Resident Indian (NRI) deposits have been raised by 	<ul style="list-style-type: none"> ▪ Cash reserve ratio (CRR) cut by 400bps from 9% to 5%, and statutory liquidity ratio cut by 100bps to 24% (total liquidity injected into system equivalent to USD60 billion) ▪ To meet the liquidity requirements of the Mutual Funds, a 14-day Term Repo Facility was provided, and banks were allowed to borrow up to 0.5% of their Net Demand and Time Liabilities (NDTLs). ▪ Liquidity Package including a re-finance facility for banks up to 1% of their NDTL for a period of 90days, and extension of

¹⁶ The matrix provides a descriptive listing of policy responses in selected Asian countries and makes no value judgment as to their impact and effectiveness.

¹⁷ Renminbi

¹⁸ Indian Rupees

<p>2008-09 and 9% in 2007-08</p> <ul style="list-style-type: none"> Exports growth rate turned negative in Oct and Nov 08 for the first time in 5 years In 2008, net capital outflow by Foreign Institutional Investors was in excess of USD10 billion 	<p>over FY09 and FY10</p>	<ul style="list-style-type: none"> Duty drawback schemes on certain items have been enhanced Measures introduced to promote exports include interest subvention on pre- and post-shipment export credit for labor intensive exports, refund of service, tax as well as setting up of export incentive schemes. Countervailing Duty Exemptions for TMT bars and structurals, and cement as well as custom duty exemption for zinc and ferro alloys have been withdrawn. Duty Entitlement Passbook (DEPB) rates restored to those prevailing prior to Nov 08 and will continue 	<p>projects</p> <ul style="list-style-type: none"> Other infrastructure, low income housing, irrigation, rural employment and social assistance of up to INR200 billion (USD3.9 billion or 0.4% of GDP) Enhanced guarantees for borrowing by SMEs States can borrow an extra 0.5% of their GDP for capital expenditures (USD6 billion) Recap fund of 0.4% of GDP if needed in next fiscal year Authorization for additional expenditure of INR. 200.00 billion (0.4% of GDP), and ensure that full utilization of funds already provided. To encourage public purchase of commercial vehicles, states given assistance for 	<p>175bps</p> <ul style="list-style-type: none"> Repo rate cut by 350bps (from 9% to 5.5%), reverse repo rate by 200bps (from 6% to 4%) Public sector banks have been advised to lower their lending rates by around 200 basis points. 	<p>liquidity support to mutual funds and Non Banking Financial Companies (NBFCs) by allowing banks to avail liquidity support up to 1.5% of their NDTL.</p> <ul style="list-style-type: none"> To ease the crunch faced by the NBFCs, liquidity support of Rs.250bn will be provided against the investment grade paper held by the NBFCs. Moreover, NBFCs focused on infrastructure to be allowed to access the external commercial borrowing (ECB) route from multilateral/bilateral agencies. Credit availability for financing the commercial vehicle segment to be ensured by giving public sector banks a line of credit for these loans. Public sector banks' credit targets have been revised upwards. Exim Bank has a line of credit from RBI of Rs. 5000 crores and will provide pre- and post-shipment credit to exporters at competitive rates. Central Bank introduced dollar swap line¹⁹ for Indian private/public banks having foreign branches or subsidiaries. <p>Sectoral Credit easing:</p> <ul style="list-style-type: none"> Progressively eased ECB norms like borrowing caps while widening the coverage of companies under infrastructure. Removed curbs on Participatory Notes that were introduced earlier. A number of liquidity packages aimed at exporters, real estate, SMEs, textiles and infrastructure have been introduced. Special market operations for Oil bonds were reinstated. Foreign Institutional Investors (FII) investment limit in corporate bonds have been hiked from \$3 billion to \$15 billion. <p>Targeted easing :</p> <ul style="list-style-type: none"> A refinance facility of INR 70 billion has been set up for Small Industries Development Bank of India (SIDBI) to support incremental lending to SMEs and current guarantee cover on loans is raised from INR 5 million to INR 10 million with a guarantee cover of 50%. This has been further extended to 85%
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¹⁹ This facility intends to provide forex liquidity to Indian private and public sector banks through forex swaps of tenors up to three months. The pricing of swaps is based on the interest rates in the domestic as well as the overseas markets using the Central Bank reference rate for the USD-INR exchange rate. The facility is available until further notice.

			till Dec 09. ▪ Excise taxes and service taxes cut.	purchase of buses while accelerated depreciation will be provided for vehicles purchased during Q4 of 2008-09.		for loans upto INR 0.5 million. ▪ INR 14 billion has been allocated to clear the backlog in Technology Upgrade Fund for textiles. ▪ To facilitate financial closure of infrastructure projects, India Infrastructure Finance Company Limited (IIFCL) has been allowed to raise INR 100 billion crores as tax free bonds. It can raise an additional INR 300 billion once funds raised in this year are effectively utilized. ▪ INR250 billion (USD4.8 billion) under the Agricultural Debt Waiver Scheme is to be made available to banks immediately.
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	Impact	Size	Fiscal response		Monetary response	
			Revenue measures	Expenditure measures	Interest rate / exchange rate measures	Quantitative easing measures
Indonesia	<ul style="list-style-type: none"> The economy is projected to grow between 4.5%-6.0% in 2009 GDP growth was 6.2% in 2008 and 6.3% in 2007 	IDR ²⁰ 73.3 trillion (USD6.1 billion), or 1.4% of GDP	<ul style="list-style-type: none"> Income tax breaks worth IDR43 trillion (USD3.6 billion), including for labor intensive export firms Waived taxes and import duties for businesses and households worth IDR13.3 trillion (USD1.1 billion) 	<ul style="list-style-type: none"> Subsidies for diesel and electricity and government spending for businesses and employment worth IDR15 trillion (USD1.3 billion), of which Infrastructure to get around IDR12.2 trillion (USD1 billion) 	<ul style="list-style-type: none"> The Central Bank, Bank Indonesia (BI), has reduced its policy rate by 1.25 percentage points from 9.5% to 8.25% BI reduced overnight interbank lending rates by trimming the rate for repo transactions from BI Rate plus 100bps to BI Rate plus 50bps 	<ul style="list-style-type: none"> BI raised the short-term deposit rate from BI Rate minus 100bps to BI rate minus 50bps

	Impact	Size	Fiscal response		Monetary response	
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Malaysia	<ul style="list-style-type: none"> Government will revise 2009 growth projection of 3.5% 	MYR ²¹ 7 billion (USD1.9 billion),	<ul style="list-style-type: none"> Reduction in Employees Provident Fund 	<ul style="list-style-type: none"> MYR1.5 billion (USD220 million) to set up an Investment Fund to attract more private investments Building MYR1.2 billion (USD176 	<ul style="list-style-type: none"> Overnight Policy Rate (OPR) reduced by 150bps from 	<ul style="list-style-type: none"> Statutory Reserve Requirement (SRR) adjusted downwards from 2% to 1% to reduce further the cost of intermediation

²⁰ Indonesian Rupiah

²¹ Malaysian Ringgits

<p>downward as figure no longer realistic</p> <ul style="list-style-type: none"> 2008 economic growth was 4.6% - lower than the government's earlier forecast of 5.0% In 2007, the economy grew by 6.3% 	<p>or 0.9% of GDP</p>	<p>contribution for 2009 and 2010 from 11% to 8%</p> <ul style="list-style-type: none"> Reductions in import duties on steel and cement for selected companies 	<p>million) worth of low- and medium-cost houses</p> <ul style="list-style-type: none"> MYR500 million (USD73 million) to upgrade police stations, army camps and quarters MYR600 million (USD88 million) to build roads, bridges and community halls in kampungs; and MYR500 million (USD73 million) to upgrade schools and hospitals 	<p>3.5% to 2.0%; ceiling and floor rates of the corridor for the OPR correspondingly reduced from 3.5% to 2.25% and 3% to 1.75% respectively</p>	<ul style="list-style-type: none"> All ringgit and foreign currency deposits fully guaranteed by the Government; guarantee extends to all domestic and locally incorporated foreign banking institutions Access to Central Bank's liquidity facility will be extended to insurance companies and takaful²² operators regulated and supervised by the Bank
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	Impact	Size	Fiscal response		Monetary response	
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Philippines	<ul style="list-style-type: none"> Government is targeting 2009 GDP growth of 3.7%-4.4% - the original forecast was set at 3.7%-4.7% In 2008 the economy grew by 4.5%, exports declined by 2.9% to 	<p>PHP²³330billion (USD6.7 billion) economic resiliency plan, or 4.1% of GDP; around PHP50 billion (USD1 billion)</p>	<ul style="list-style-type: none"> PHP40 billion (USD0.8 billion) in tax cuts, including a corporate income tax rate cut from 35% to 30%, reduction in personal income tax threshold, exemption of minimum wage earners from income tax, optional standard deduction for self-employed and professionals, and tax exemption for personal 	<ul style="list-style-type: none"> PHP160 billion (USD3.3 billion) additional expenditure in national government budget PHP100 billion (USD1.1 billion) in private-public investment in infrastructure PHP30 billion (USD0.6 billion) in additional benefits 	<ul style="list-style-type: none"> Cut Manila Reference Rate²⁴ by 2% Central Bank cut key policy rates by a total of 100bps in December and January. The overnight borrowing and lending rates stand at 5.0% and 7.0% 	<ul style="list-style-type: none"> Tripling the PHP rediscounting facility to PHP60 billion (USD1.3 billion) Extended repo operations (wider range of collateral) Opened new dollar deposit and new dollar repo facilities Relax Central Bank mark-to-market²⁵ rules for government bonds Increased deposit guarantee from PHP250,000 (USD5,210) to PHP500,000 (USD10,420) Strengthened supervisory power of the Philippine Deposit Insurance

²² Islamic insurance concept which is grounded in Islamic muamalat (banking transactions), observing the rules and regulations of Islamic law

²³ Philippines Pesos

²⁴ Weighted average interest rate announced by Central Bank, based on combined promissory notes and time deposit transactions of commercial banks

²⁵ Assigning a value to a position held in a financial instrument based on the current market price and not the future expected value

	USD49 billion	already included in budget	equity and retirement fund	from social security institutions	respectively	Corporation.
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	Impact	Size	Fiscal response		Monetary response	
			Revenue measures	Expenditure measures	Interest rate / exchange rate measures	Quantitative easing measures
South Korea	<ul style="list-style-type: none"> In 2009, growth expected at 2%, down from earlier forecast of 3.7% Current account would likely post a surplus of USD22 billion in 2009 due to reduced imports, compared with a deficit of USD4.5 billion in 2008 	KRW ²⁶ 33 trillion (USD22 billion) total package (~3% of GDP)	<ul style="list-style-type: none"> More than half the package is tax cuts including personal income tax and corporate income tax, capital gains and property tax 	<ul style="list-style-type: none"> KRW11 trillion (USD7.3 billion) of additional public expenditure in 2009 Biggest increase in spending for public infrastructure (KRW4.6 trillion = USD3.1 billion), with about 90% allocated to help regional economies The expenditure package also contains KRW3.4 trillion (USD2.3 billion) for SMEs, farmers and fishermen, KRW1.1 trillion (USD0.7 billion) for local governments, KRW1 trillion (USD0.7 billion) for low-income households, and public enterprises will expand their investments by KRW1 trillion too Investments to Export Insurance Fund increased, and upper limit of export insurance contracts raised from KRW130 to KRW170 trillion (USD113 billion) 	<ul style="list-style-type: none"> Benchmark interest rate cut by 275bps to 2.50% since October 2008 Increase of Foreign-Exchange Stabilization Fund from KRW15 to KRW20.6 trillion (USD13.7 billion) 	<ul style="list-style-type: none"> Expansion of bilateral currency swap arrangements between central banks with US, Japan and China to secure liquidity in the market Government guarantee on banks' borrowing in foreign currency totaling USD100 billion Expansion of repurchase agreements with non-bank financial institutions, securities firms and asset management companies Liquidity support of KRW19.5 trillion (USD13 billion) through open market operations, increase of aggregate credit ceiling loan, interest on reserves, and support for bond market stabilization fund

²⁶ Korean Won

	Impact	Size	Fiscal response		Monetary response	
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Sri Lanka	<ul style="list-style-type: none"> The economy is estimated to grow by 6% in 2009, while the annual inflation should fall to 9% In 2008 the economy grew by 7% while inflation was around 14.4% 		<ul style="list-style-type: none"> Fuel price cuts 	<ul style="list-style-type: none"> Export enhancing measures, including a 15% reduction in surcharge in tourism, apparel, leather and rubber industries Specific measures for tea industry including price support through minimum-price purchases, an exemption from repaying loans used to modernize factories, and increase in bank lending Stimulus package to Registered Finance Companies and Specialized Leasing Companies worth LKR²⁷ 4.25 billion (USD37 million) 	<ul style="list-style-type: none"> Repurchase rate and reverse repurchase rate have been reduced by 250 bps to 10.25% and 11.75% respectively 11 February 2009 	<ul style="list-style-type: none"> Statutory Reserve Requirement (SRR) reduced on all rupee deposit liabilities of commercial banks by 225bps to 7% Provide liquidity through commercial banks and Primary dealers by relaxing access to reverse repurchase rate for a maximum of 10 times per calendar month up from 6 times.

	Impact	Size	Fiscal response		Monetary response	
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Vietnam	<ul style="list-style-type: none"> Economy estimated to grow by 6.2% in 2009 – slightly down from the earlier projection of 6%-6.5% Economy grew by 6.2% in 2008 and 8.4% in 2007 In 2008 exports grew by 29.5%, and in 2007 by 30% In 2008 remittances inflow was USD7 billion compared to USD 6.8 billion in 2007 	USD6 billion, of which USD1 billion, or 1% of GDP, approved	<ul style="list-style-type: none"> VAT and personal income tax payment deferment 30% rebate on corporate income tax for SMEs from 2Q 08 to end-2009 Much faster reimbursement of VAT for exporters 	<ul style="list-style-type: none"> VND²⁸ 44.5 trillion (USD2.6 billion) of bond issuance for investment over next two years Credit guarantee fund and interest rate subsidies for SMEs Support to low income housing One-time cash handout to poor households Small-scale infrastructure program for poor districts Scaled up investment in large-scale infrastructure 	<ul style="list-style-type: none"> Prime interest rate cut from 14% in July 2008 to 8.5% at present 	<ul style="list-style-type: none"> Reserve requirement ratio for state-owned and foreign banks cut from 5% to 3%

²⁷ Sri Lanka Rupees

²⁸ Vietnam Dong

