B A N G L A D E S H

Yearly Economic & Market Roundup 2003

J a n u a r y 1 5, 2 0 0 4

Oscillating leafs of hope in air of despair, aspiring elusive leapfrogging in broken promises and squandered potential…

Balance hangs on many poles

- Good revenue collections throughout the year as various measures were afoot to enhance collection from the large untaxed part of economy, which kept domestic borrowing on leash.
- Export recovered amid an international price damp through enhanced quantum and stable growth.
- Steady growth in agriculture production, especially in Aman crop that propelled the GDP growth, and saved hard cash.
- Respectable foreign exchange reserve built piggy-backed on prudent policy prescription and increased aid flow, in spite of free floating the currency.
- Steady growth in industrial loan disbursement reduced the banks' cash glut to some extent.
- Auspicious financial sector reform, especially in banks, is in full swing to bring down the lending rates for industrial financing, reduce inefficiency from the sector and create a healthy financial infrastructure.
- Fiscal balance remained sound mainly due to low ADP implementation, and most of the politically driven locally-financed projects are getting jettisoned.
- Supportive monetary and fiscal policy taken during the year helped enhancing inflow of invisible surplus in the financial market.
- Likely achievement of mid-term macroeconomic framework of iPRSP, which will allow foreign assistance to flow in uninterruptedly.
- Import of capital machinery and raw materials have grown significantly, suggesting greater activities in industrialization and production.

Distracters stymie the march

- High inflationary pressure led by hike in petroleum fuel and utility prices and unauthorized toll collection by political and criminal quarters.
- Poor government response to menacing deterioration of law and order situation that is eating up vitals in economic and social fronts.
- Increasing perception of corruption resulted from unabated swell in social degeneration might put FDI in deep trauma in coming days.
- Growing confrontation among rival political quarters keeps plunging the country's polity into deeper fissure that eroded both image and investment opportunities as well as growth.
- Manufacturing sector failed to recover a healthy pace of growth despite a host of robust ongoing financial sector reforms throughout the year.
- A low level of foreign direct investment inflow compared to previous years, as well as in other regional economies put the industrial growth on mark-time.
- After moving at a slow yet steady pace, privatization met with sudden retrieval from its committed course as ministry hands took over SoEs from the PC.
- After a robust growth for some two years, remittances flow began to show slight slowdown.
- Despite export is highly concentrated on a few items, there was slow progress in diversification of new nontraditional items.
- Growing trade gap may push the foreign exchange reserve at stake in near future, if imports are not put on leash.
- A large number of reform measures are now afield in the banking sector to trim nonperforming assets and reign in lending rates.
- Capital market watchdog sharpens its vigilance with fresh hands and policies.
- Transitory bubbles in capital market may not help sustain the current level of public confidence built so far.

Foggy globe in *Pax Americana*

Year 2003 dawned amid an imprudent global phenomenon of *pax Americana*, with searing war rhetoric that sweltered nerves of every small nation in the world. Bangladesh, as a low-key partner in the bedlam had to come through the inevitable economic jolt only to end up as a passive sufferer in the havoc. This global turmoil coupled with domestic unrest stemmed out from the historical clash of interests between the political divide and coteries of economic spoilsports continued to marginalize the country in every aspect. However, in the latter half of the year the economy began to show resilient growth in major sectors.

Global output growth rekindles hope that economic buoyancy has been reinstated in 2003. Major economies mustered uniform monetary policies and fiscal incentives to thwart the lingering aftereffects of the early 2000 recession, equity price bubble burst, and the ease of uncertainties associated with the Iraq invasion. The September 2003 IMF WEO projections estimate a global output growth of 3.2% for 2003 against 3% of 2002.

The projections augur well for USA and Japan, but visibly worse for Euro zone, mainly because the major economies had little room to employ necessary fiscal stimuli for growth. Developing economies together are expected to grow by 5% in 2003, while the advanced economies by 1.8%. World trade growth for 2003 has been projected at 2.9%, much lower than early forecasts and also lower than the projected global output growth. Consumer price inflation continues to remain low both in advanced economies and developing countries, with deflation risk a concern for some countries with very low inflation.

Global output and trade growth rates are expected to reach 4.1% and 5.5% in 2004 respectively. Developing countries collectively are projected to attain higher output and trade growth rates than the advanced economies. Amongst the latter, a brisk growth rate increase from 2.6% to 3.9% has been projected for the US in 2004. In contrast, rather lower growth is envisaged for Japan, which now suffers from an utter deflation and structural problems. Amongst developing economies China is likely to continue to grip the average high growth rate of 7.5% in 2004. South Asia's growth rate is expected to glitter at 5.8% in 2004, up from 5.5% in 2003.

High budget and current account deficit marking recovery of the US economy are now envisaged as ominous major risks that could plunge the global growth prospects down. The recent fiasco in the Cancun world trade talks evinces growing rift among economic interests and doubt in trade growth expectations, clouding prospects for export-driven output growth. The sharp and continuous depreciation in the US dollar resulting from the high and rising US budget and current account deficit will lead to corresponding appreciation of major trade partner currencies, boosting internal demand but reducing export competitiveness of partner economies. Because of various domestic compulsions, large Asian trade partners have tried to resist a major appreciation of their currencies, even through amassing high reserves. It is now expected that stable global growth might set in if progress in the more difficult medium and longer-term structural reforms can be ensured in the coming days.

At home, compared to previous two years of the incumbent regime, the economic recovery has stepped on an elevated path during the year. Following the Iraq invasion in last March, remittances by expatriates rose to a record peak, exports recovered its early slides, imports grew in capital machinery and industrial raw materials, revenue targets for short terms achieved, tax net widened, and reforms in financial sector took new shape with faster tempo. Global polity had its impact in the region, though not starkly, and Bangladesh successfully wriggled out the game so far. However, domestic situation also showed strong linkages with kaleidoscopic development in both the middle-east and south Asian polities.

Bangladesh paves own avenue

The year was of a continued convalescence and resilience from global shocks and recovery from economic ennui for Bangladesh. The economy for first few months had to wade through recessionary doldrums, but later it regained wield over macroeconomic factors, especially revenue, exports, remittances, foreign exchange reserve and money market. Among the distracters were incessant price hike in essential consumer goods throughout the year, reduction in export prices, sharp increase in food import, hick-up in foreign direct investment head count, stagnation in privatization process, slow growth in manufacturing and industrialization, rising confrontation in home polity, aggravated law and order, unbridled corruption, and a poor perception of the country abroad that put hurdles on the development stride.

In fiscal year 2002-03 that concluded in June, the economy chalked an annual growth of 5.33%, marking recovery from previous year's 4.42%. Agriculture with about a sixth of GDP size grew by 3.59%, thanks to bumper Aman crop against 0.62% diminution last year. Manufacturing, the second highest contributing sector, yielded 15.94% of GDP, with 1.14% more growth from last fiscal.

The year's national budget for the fiscal year 2003-04 had a Tk203.0b approved annual development program (ADP), with 18.7% higher than last year's revised. However, poor implementation of ADP, only 19% in first 6 months, suggest that the government might resort to prune the size again, to a likely Tk175b, truncating lesser important projects, especially those to be funded by local resources.

This year the government opted for more external resources for development programs, while depending more on VAT and import tax for domestic revenue mobilization. Revenue growth has been estimated at 16.23% to reach Tk361.71b and at the same time nondevelopment revenue expenditure is to grow by 14.5% to hit Tk289.7b in the Tk519.8b outlay. Massive bank borrowing of Tk26.03b has been projected, up from last year's Tk15.01b, coupled with donor-committed funds to finance the deficit.

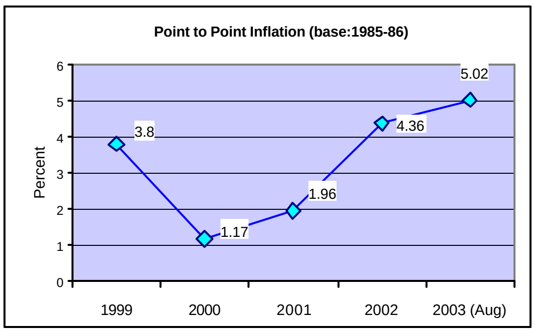
In spite of a noteworthy performance in macroeconomic stability, there remains a lot to be done in combating pervasive poverty. Every second person of the 147m population lies below poverty line, some 3.0m additional people relegate down the poverty line every year, while 50% household income go to only top 5% of populace. In 2003-04 an ADP of Tk130.0b has been approved for implementing the poverty reduction strategy in next 3 years. However, pace of implementation was not up to the mark. While Bangladesh needs to grow by over 7% to achieve millennium goals on poverty reduction, requiring investment at around 28% of GDP, investment-GDP ratio is yet to reach this level, which was about 23.21% in 2002-03. National savings did not increase much to meet the required investment volume. Savings-GDP ratio was about 23.74%, against last year's 23.44%.

Agricultural sector has bounced back from a negative 0.6% growth in previous fiscal year to 3.59% growth in 2002-03. That is expected to continue this year too. Growth of manufacturing sector was 6%, which is far below the required 15-20% for the challenging poverty alleviation target.

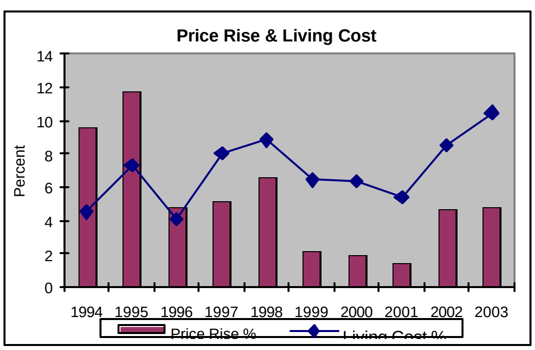
During the year Bangladesh continued with its regular creeping success in human development index, such as infant/child mortality, immunization, population growth, primary school enrollment, etc. However, erosion in law and order situation became a major setback for the government around the year. In a desperate bid a full-scale military operation was launched to leash crimes, which created controversy as the government resorted to legally indemnify the custodial deaths occurred in the operation. Other sporadic efforts could not reign in crimes, and hardcore criminals remained beyond reach of law, despite government initiatives for speedy trials by setting up special tribunals. As criminals showed increasing trend of fearlessness under small power pockets, public confidence in law enforcement ability of the state continued to erode. Donor agencies as well as the grumbling civil society voiced deep disquiet for the apparent failure to manage law and order situation, which might wield severe impact on FDI, manufacturing and exports.

Inflation deflate purses

The economy went through a recessionary phase till the first half of the year, but began to show recovery, though slow, in the latter half. Inflationary pressure on the middle income group was potently visible during the year. Prices of consumer goods shot high following an unsavory 13.75% hike in petroleum prices early in the year that lead to rise in transportation costs. The chain effect had a bite on prices of essential and food items. It also led to rise in power and water tariff, which made the inflation rate pinching deeper in the urban areas. In all indications it was a cost pull inflation, though the central bank termed it a wage pulled one, since wage had increased by 15.4% in FY2002-03 they said.



Point to point inflation has been on rise since 2000, when it was at a record low in past one decade at 1.17%. Of late, it reached at about 5.02% against last year's 4.36%. Inflationary trend persisted despite adoption of a restrictive monetary policy. Cost of living increased by 10.48% this year, compared to last year's 8.50%. Price spiral in house rent, cost of utilities and essentials made the life of general people more difficult. Despite there was a food surplus of 3.0m tons, a famine-like situation persisted in the northern region for a longer time as a large number of people remained seasonally unemployed. Political opposition alleged that the government failed to demonstrate adequate seriousness in addressing the situation.



The government wanted to form an independent market watchdog with adequate authority to regulate commodity prices following the hike. Supposed to be based on hired experiences from other developed countries the proposed body was intended to police factories and marketplaces and impose penalties for anomalies in pricing. However, no such agency has come out yet. And the long pending Consumer Protection Act to check adulteration and protect consumer rights still remains a far cry.

Revenue lush

National Board of Revenue (NBR) has collected Tk237.65m tax revenue during fiscal year 2002-03, outwitting the set target by Tk150m, with 18% overall growth compared to the previous fiscal. This accounted for 10.4% of the GDP. NBR target for 2003-04 has been set at Tk277.5b, eyeing 16.8% annual growth. Achievement of target for 2003-04 should take the percentage to about 11%, seemingly good, but still very low by global standards.

Overall revenue earning was Tk116.69b during the second half of the year having a 10.24% growth over last year's corresponding period, Tk105.85b, but narrowly missed the target.

The government tussled to fulfill election pledges to contain public expenditure, misuse of resources and corruption. But due to lack of political resolve, failure to uphold parliamentary norms, culture and practice, and breed consensus among lawmakers the bid proved inadequate, which ranked the country to top in the corruption perception index prepared by Transparency International. However, to curb misuse of resources and enhance domestic resource mobilization, the government has already set up a Revenue Reform Commission (RRC).

The RRC suggested a number of reforms including abolition of development surcharge, tax holiday, advance income tax, diplomatic bonded warehouse, pre-shipment inspection, concessionary duty rate, dispersion of duty rate, regulatory duty, documentation fee, hard currency shops, and wealth tax, etc. The NBR has already set up a central monitoring and intelligence unit to tackle pervasive tax evasion.

Despite a good quantum of revenue has been collected in 2003, domestic borrowing was also high, and debt servicing liability grew higher. In 2002-03 total domestic borrowing came down to Tk233.68b from previous year's 249.01b, marking 6.16% decline. Of this amount, bank borrowing was Tk190.61b and through savings certificates was Tk43.07b. Debt servicing liability for foreign loans is expected to rise in the coming years, as aid flow grows.

Reform pledges lubricate assistance

The government had to promise 57 reforms in 10 sectors, including governance, public administration, privatization, poverty reduction, fiscal management, etc, for securing a pledge of $2,179m foreign assistance. It received $300m as development support credit and $500m as a part of $2.2b credit under the poverty reduction growth facility during the 2002-03 from WB-IMF and disbursement of rest in next 2 years, largely upon implementation feat.

Acknowledging 'good progress' in key reform areas, the WB approved a $536m soft loan to support poverty reduction strategy, development of sound banking system, and enhancement of rural transport and telecommunication facility. IMF also approved a $490.0m loan of which $70m has already been disbursed with conditions for reforms in NCBs, SOEs, trade and exchange liberalization and improving governance

During the period from July 1996 to September 2003, the country received some $6,231.77m from the multilateral and bilateral lenders/donors and paid $1,117.08m as interest on loans. Total foreign debt liability stood at $16,276m in June 2003.

Investment slow but not steady

The overall investment scenario had a pale face in 2002, as it was a year of recovery from 2001 election hullabaloo and 9/11. Excess liquidity in banking system of over Tk100.0b at the yearend shows that the lassitude has not gone yet. If this fails to vent out for feasible investment opportunities, a likely severe inflationary pressure or a capital flight in the near future might not be averted.

Domestic investment was poor compared to past few years. There were many factors in the seemingly low investment other than usual ones of lack of depth in market, political disturbance and finance. A recent survey made by Midas and International Consulting Group estimates that some 565,000 small and medium enterprises (SMEs) have been shut down in last 5 years due to various infrastructure and government policy problems.

The Board of Investment (BoI) apprehends that lending restrictions on the NCBs, i.e. limiting lending growth to only 5% of their paid-up capital would appear as a disservice to industrialization. A NCB consortium will not be able to offer lending more than Tk497.1m for a single project, while a Tk3.0b composite textile mill, for example, would need at least Tk1,950m on a debt-equity mix of 65:35 basis. Entrepreneurs will now need a 20-bank consortium to finance a large project, which will not only be toilsome, but also utterly unrealistic, and would sure discourage large projects. Instead of acting sternly, the regulator should leave the banks to decide on their own rationale for lending projects, the entrepreneurs would be able to fix the optimum debt-equity mix.

The government tried to encourage entrepreneurs to boost their capacity through various incentives. A Tk3.0b Equity Entrepreneurship Fund (EEF) was in operation, and other funds like Matching Grant Fund (MGF), Product & Market Development (PMD), Customs Administration Modernization (CAM), Profitability Analysis & Trade Cooperation (PATC), etc, for promotion of various industries, especially agro-based, ICT and readymade garments sectors. But response was not too visible. It is alleged that PATC and PMD have failed to deliver because of some inherent faults in the project designs.

Foreign direct investment (FDI) failed to show a comfortable comeback, as Bangladesh has been continuously falling out of favor of international investors. Thanks to poor image on corporate culture, infrastructure and governance, flow of FDI could not reach a sizeable level. Compared to $360m in 2002, almost 5 times of $78m in 2001, flow in 2003 was less than $200m. The country's ranking in global FDI Index, which was 121 out of 140 countries in 1998-2000, has dipped to 125 in 1999-2001.

Annoyed foreign investors in EPZs where the largest concentration of foreign owned enterprises are located and generates substantial export earnings, went to court when the government seemingly relented to pressures from the USA in the from of threats of withdrawal of GSP facilities in the largest destination of export goods, and decided to allow trade unionism at the EPZs. Earlier TU was barred by law at the EPZs as an incentive to foreign investors. Caught in a catch 22 situation, the government could at last prevail in gaining some time, promising to first train the labor force in constructive TU activities, before annulling the existing ban.

To improve the situation, the Board of Investment (BoI) has taken some measures. It has already chalked out a medium term strategic plan to raise the volume of FDI inflow to the billion-dollar mark by 2006. BoI opened two Investment & Trade Centers (ITCs) in Dubai and Frankfurt during the year as part of a government plan to attract investment. The next ITCs will be gradually launched in New York, Kuala Lumpur, Singapore, and Hong Kong.

Recently the government has opened FDI in the readymade garments (RMG) sector, which was prohibited since 1999, to help it remain competitive in the post-MFA scenario, on the condition that the investor also sets up at least one backward linkage industry. However, no response has yet been received.

Export creep up while import bulge

The year 2002 had a record slide in exports during the past decade, which then began to recover in the third quarter in the same year. Exports started showing upward trend from March 2003 although prices faced continuous slump in the global market for nearly two years. Prices of export commodities dipped by around 15% in FY02 alone, and till February of FY03 it went down by another 10%. Reacting to the negative trend, the government revised the export target to $6,405m from the original target of $6,750m in FY2002-3.

Bangladesh earned $6,316m during the first 11 months of the year, compared to $5,562m of last year's corresponding period, marking a 13.56% rise. Export earning was $6,550m in the fiscal year 2002-03, recording a 9.39% growth over the previous year. Export target for FY03-04 has been fixed at $7,490m, which is 14.39% higher than the actual export earnings of the last fiscal year. Following is the calendar year-wise actual export earnings and import payments:

Year	Export (m$)	Import (m$)
1999	5,458	7,534
2000	6,405	8,025
2001	6,033	8,081
2002	6,066	7,710
2003 (up to Nov)	6,316	9,333

Export was, like previous years, highly concentrated, as is evidenced in the fact that one single group of commodity, i.e. apparels, account for over 76% of receipts. Other than raw jute, jute goods and handicrafts, export receipts for all other categories increased during the third quarter. However, nontraditional items such as pharmaceutical and chemical made a sharp rise of 121% and tea 93%. Current export growth remains quite fragile for next few years, as country's export competitiveness is going to be on severe test once the RMG quota is phased out in a year's time.

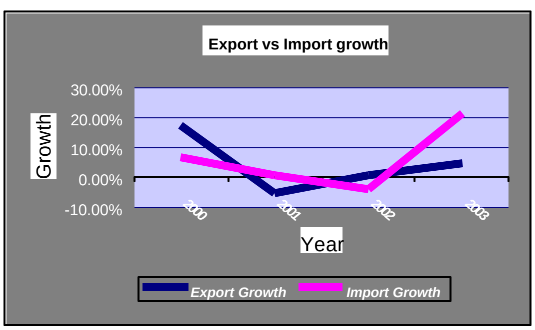
High concentration on limited products and overseas market destinations remains the single major problem for export.

Although the country usually exports a total of 109 different products, the major export earnings come from only 8, of which 75% are from RMG and knitwear products. Similarly, exports go to some 78 countries but the lion share of the earnings comes from the EU and US. The country earned $3,258.3m and $1459.3m from RMG and knitwear products respectively in the last fiscal and bagged 32.9% of its total export earning from the US and 43.4% from the EU markets.

Though the pharmaceutical sector could be a major foreign exchange earner up to 2016, taking advantage of the trade related property rights (TRIPS), decision regarding setting up industrial complex incorporating 20 top pharmaceutical companies has been kept waiting.

Despite there were some visible and hectic efforts to enhance trade and narrow the gaping deficit with some major trading partners through signing favorable trade agreements, including duty free entry to EU, Australia, Pakistan and Canada and accounts trade with Myanmar and Thailand, export base remained in the same narrow alley. Incentives were provided to ITC, light engineering, agro-processing etc. while export promotion offices at home and abroad were set up, but the impact is not likely to be visible in the short run.

Import picked up in the second half of the year despite containment during the first half. Import payment during July-September 2003 was 21.6% higher than that of in the last year's corresponding period. Capital machinery import exhibited robust increase, around 49% during the third quarter, while food grains by 71%. Earlier the government tried to contain import by imposing a strict margin on letter of credits (LCs) of all sorts of imports, but later withdrew it in line with policy of further liberalization and a precondition of International Monetary Fund (IMF) for securing funds under Poverty Reduction Growth Facility (PRGF). With relaxation of LC margin, consumer goods import in the coming days may increase further.

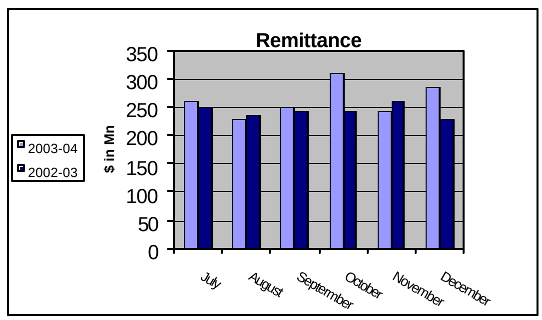


A 3-year export-import policy has been approved this year with limited safeguard for import, focusing diversification and value addition in export. The new import policy for 2004-06 envisages limited restrictions on import of CI sheet, cement, coconut oil, medicine, medical equipment, soybean and palm oil, reconditioned vehicle and electric meter for ensuring quality as well as health and environmental safety. Export policy focused heavily on strengthening RMG sector through increased value addition and diversification along with identifying new destinations.

With imports increasing at a faster rate than export, trade deficit reached at around $3,018m by November 2003. The current growth of import will continue to widen the gap. Overall balance showed a paltry surplus of $163m in September 2003, as against $229m in the same period last year.

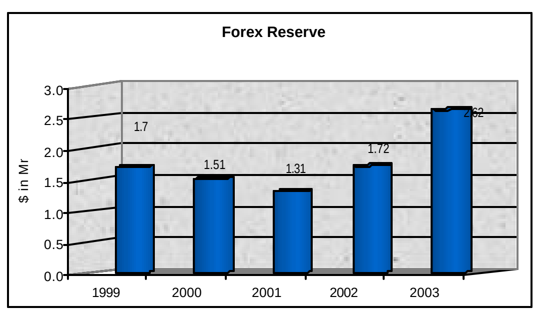
Robust remittance roars

Remittances continued to flow at a healthy rate during the year, with $3,171.5m at the end of December, compared to last year's $2,847.8m, marking a dazzling growth of 11.4%. Though the rate of inflow slowed down a little in the second half, year to year comparison shows a clear spurt over all previous years. Some 231,543 people had been added to the overseas employment in 11 months of 2003, against 198,440 in the same period last year, which contributed to healthier remittances. Nonresident Bangladeshis (NRBs) residing in Saudi Arabia topped the list, followed by US and Kuwait. NRBs residing in US have sent more money than usual fearing that their bank accounts might be frozen, after the country was listed with special INS registration. As long as the ongoing global tension over *war on terror* runs down the spine, remittances are likely to flow in at this rate, if not more. However, there is no definitive statistics of returnees from overseas jobs.



Consolidated reserve

The foreign exchange reserve experienced upward trends in recent times. The reserve was $1.55b during the first week of January 2003, which reached to $2.56b in the first week of January 2004, after making all payments to clearing agencies. After long seven years since mid-1996 the foreign exchange reserves hit the $2.0b mark during the year. The reserve plummeted to $1.05b in mid-2001, lowest in a decade, but began to rise after the ruling regime took power in late 2001.



The healthy state can be attributed by the soaring inflow of remittances following the US invasion against Afghanistan and Iraq, sizeable foreign assistance disbursement, and an astute import regime that discouraged all luxury items and even some food items to be freely channeled in, and above all, a slow yet steady growth in export.

However, after the withdrawal of LC margin import may shoot again, as recently rate of growth in import became almost double that of export. Though higher disbursement of foreign assistance and remittances may provide leverage to the reserve for the time being, growing import pressure may create significant dent in it in the medium term.

Money market minting

The local money market was somewhat vibrant during the year. Bangladesh Bank allowed all tenors of treasury bills for the repurchase agreement from March 16, 2003 and introduced Reverse Repo facility for banks with excess liquidity from May 5, 2003. A deal was first clinched between two private banks on June 11, Citibank carried out the first secondary market T-Bill transaction on August 30, marking the auspicious stride towards a structured money and bond market. Since introduction, some eight banks and an NBFI responded positively to act as primary dealer (PD) for such transactions.

During the year Bangladesh Bank slashed statutory liquidity ratio (SLR) by 4% and decreased the bank rate by 1% to 5% on November 8. Call rates remained more or less stable throughout the period, despite there were some spurts in early February due to huge cash inflow following a major religious festival. The rates again skyrocketed to 36% in June when the central bank withered liquidity from the market to contain a likely artificial turbulence in the foreign exchange rates. As the central bank provided ample fund through Repo facility, almost Tk38.0b, call rates failed to make any visible jerk till December, and remained poised within average 4% -5% band.

Taka feared no FEER

The country entered a different foreign exchange market scenario after the local currency Taka was free-floated. Yielding to a long urged demand of IMF as an essential condition for receiving loans under the Poverty Reduction Growth Facility, Bangladesh introduced free-floating exchange rate (FFER) in the current account on May 31, 2003. To keep vigilance on the ensuing situation, the central bank remained ready with necessary intervention measures in the money market. The move had been hailed by bankers, economists, currency traders and central bank experts. Despite logical apprehension, Taka remained more or less stable against US dollar during the second half of the year. Inter-bank rates moved in a narrow band of Tk58.40-58.95 between June and December, though kerb rates hovered around Tk61.00-62.50 range.

The successful float without the accompanying baggage of volatility drew kudos, since India, Sri Lanka and Egypt, which also floated currencies recently, could not escape the severe turbulences. Despite deficit in balance of payments demanding depreciation, the Taka appreciated instead. The paradox can be attributed to the fact that US dollar itself depreciated against almost all currencies, and government intervention mechanism was indeed efficient.

The currency scenario for past 6 months in the regional economies, where most have floated their currencies, was as follows (BDT was free-floated on May 30, 2003):

	USD	UKP	JY	EUR
May 30, 2003				
BDT	58.50	96.30	0.485	68.81
IRs	46.47	76.75	0.380	53.12
PRs	57.90	95.35	0.481	66.15
Dec 17, 2003				
BDT	58.50	99.00	0.545	71.00
IRs	45.54	79.79	0.420	56.08
PRs	57.45	100.34	0.525	70.77

It was reported that the commercial banks have lost around Tk6.0b in foreign exchange transactions in the past eight years, due to faulty dealing by the banks and misconception coupled with absence of standard operational guidelines. Integrated foreign trade with less competent forex dealers has made the condition worse for the NCBs. Irregular monitoring and supervision, inadequate training for dealers, absence of technology and separate front and back office dealing rooms, nontransparent accounting policy also compelled the local commercial banks to be in the back seat in this particular area of business.

No cheers for privatization

Although closure of Adamjee Jute and other loss-making state-owned enterprises (SOEs) appeared as no nonsense government measure to arrest hemorrhage of the national exchequer, however, privatization as a continuous process failed to mark any visible development during the year. A total of 94 SoEs have been listed for privatization of which 10 have been closed down during the last two years, while only three have been handed over to private hands at a price of Tk680m. Some 16 SoEs have been provided with letter of intent (LoI), to be sold at Tk1, 126m. However, handing over to private hands is now plagued by various problems. To crown it all, recently Privatization Commission (PC) has been pruned of authority, as ministries began a new trend of taking back power from the PC to liquidation the closed SoEs, while few has been returned for restarting operation with subsidy. Privatization now cuts a sorrier face than before.

Financial sector reforms high in deeds indeed

The government showed greater degree of seriousness in carrying out financial sector reforms, especially in banking, which have jolted the entire sector throughout the year. A bank reforms committee was formed last year to suggest necessary measures. Recently it recommended greater autonomy for central bank with power to formulate banking regulations along with discretion to trade foreign exchanges, declare approved foreign currency, and shifting accountability under a Parliamentary Standing Committee instead of the Finance Ministry. The tenure of the governor is reset at 4 years, and advice from central bank has been made mandatory in hiring and firing of the chiefs of the NCBs, though much of the control over NCBs still remain with the ministry. Reform plan for NCBs also envisages reducing the existing manpower of around 62,000 by half.

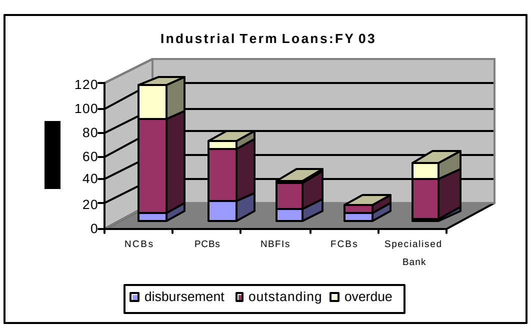
The central bank has limited the number of directors in a bank to 13, made mandatory the appointment of two directors in each bank from among the depositors and refixed tenure of a bank director to be limited within maximum 6 years in two terms and not to be reelected within the next two years. It also restricts the chairman's tenure to three years, with two-year interval for being reelected. It has suggested limiting the number of directors from the same family to one, and asked the directors to furnish information on the enterprises they have business interest in.

However, the moves faced severe resistance from bankers who argued that some proposed changes would dwarf the sector's growth and stand in violation of the fundamental rights. They fear that shortening of tenure would discourage genuine entrepreneurs, and appointment of depositor directors would be influenced by political factors, and external directors would have little accountability to the shareholders, which may create fresh problems for the industry. Some of the matters have been taken to court.

The bank reforms committee suggested ways to deal with the huge default loan dilemma, recommended that persons convicted or involved in criminal charges, forgeries, financial crimes or other irregular activities, bankruptcy, etc be barred from sitting on a bank board. Meanwhile, IMF suggested putting all lending of the NCBs on hold until the government takes firm measures for the intended reforms. Donors suggested downsizing, changing structure of the board, and putting NCBs under the regulatory authority of the central bank instead of the finance ministry.

In a facelift bid Bangladesh Bank has asked the commercial banks to write off all bad loans that are overdue for 5 years or more, and to take strong initiatives for recovery. Total amount of loans overdue for 5 years or more with banks was about Tk133.0b at the beginning of the year, of which almost half was with the NCBs. The NCBs had total non-performing loans of about Tk117.89b in June 2003.

The ongoing banking reforms have already begun to show results. Classified loans, the most crippling impediment in banking system, decreased by 4% in 9 months between Dec 2002 and Sep 2003. Total bad loan in September was Tk212.48b, reducing nonperforming loan share to 24% of all outstanding amounts. During the past 9 months banks have written off Tk38.74b of bad loans, of which Tk19.84b by NCBs and Tk7.18b by the PCBs. NCBs share 52.02% of the default loans, PCBs share 24.85% and FCBs 0.59%, while DFIs share the rest 22.54%.

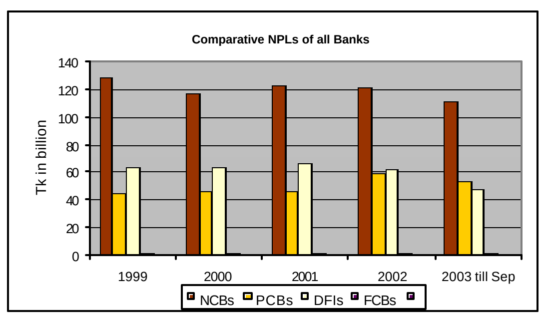


It is noted that a total Tk39.62b industrial term loan has been disbursed by the banking system during the 2002-03 fiscal year, which took the total outstanding amount to ok184.25, of which Tk51.61b remain overdue. PCBs have disbursed the highest amount during the year, though the largest outstanding amount lies with the NCBs, however, NCBs and specialized banks together share the lion's share of overdue amount, Tk42.62b or 82.58%.

Default loans, though declined significantly, still float at around Tk212.48b at the end of September 2003, by some 77,805 borrowers. Different measures have been taken to recover default loan including enactment of Money Loan Court Act 2003, setting up full time Loan Courts, introducing provisions of loan write off, rescheduling of loan, etc. But large defaulters, numbering about 325 with strong political backing, still remain unperturbed by such measures. Some 74,000 cases involving default loans worth Tk120.0b were pending with the courts as of April this year of which only Tk11.63b have been recovered through final settlement of 29,000 cases. Default loans scenario of the past 3 years was as under: (bTk)

Banks	Sep 2003	Dec 2002	Dec 2001
NCBs	110.53	121.79	122.27
Sonali	NA	52.17	54.34
Janata	NA	25.48	24.45
Rupali	NA	12.70	13.48
Agrani	NA	31.44	30.00
PCBs	52.80	54.83	45.66
FCBs	1.25	1.37	1.40
DFIs	47.90	61.61	67.76
Total	212.48	239.62	234.99

Two bills suggesting tough action against money laundering have been passed in the Parliament. The Foreign Exchange Regulation (Amendment) Bill 2003 and Money Laundering Prevention (Amendment) Bill 2003 suggested trial of money laundering offences under the recently introduced Speedy Trial Act 2002 with stringent punishments.



Quite a high cost for corruption, noncommercial operations, accumulated bad assets, and squandering bank property, etc led to Tk107 spending by NCBs to earn Tk100. An analysis till March 2003 revealed that among the four NCBs, Rupali Bank spends Tk136, Sonali Tk99.19, Janata Tk94.90 and Agrani Tk96.43 to earn every 100 Taka. During the year the banks made around Tk21.1b operating profit, of which NCBs share 15% with Tk3.2b. However, net profit might not live up to this serene picture, as most banks, especially the NCBs, suffer from inadequate provisioning.

The NCBs are already in severe capital shortfall, almost to the tune of Tk14.56b at the beginning of the year, which was Tk12.71b more than that in the previous year. NCBs will have to limit growth of loans to 5% of outstanding in 2003. The banks will not sanction any credit to a single borrower, which is more than 5% of their paid-up capital. Bangladesh Bank has initiated a move to take on defaulting directors and clean up loan portfolio of nonbanking financial institution (NBFIs) also, as nearly 16% of total disbursement by the NBFIs has become nonperforming.

Uttara, National, NCC, United Commercial, City, Pubali and the Oriental Bank were problem banks by a central bank rating, of which National, NCC and Uttara have come out. The central bank has at long last included the nonbanking financial institutions (NBFIs) in the Credit Information Bureau (CIB) list in the backdrop of increased number of defaulters with the NBFIs. The NBFIs had been asked to fulfill the new capital requirement of Tk250m within the next two years.

The Cabinet Committee on Econom ic Affairs has decided to privatize the state-run Rupali Bank as part of government plan and WB-IMF advice. The 4-member working group on NCBs along with donors hired PricewaterhouseCoopers as management agent for handling day to day operations of Agrani Bank, which is the first of its kind in the country's banking history, will take charge of the bank by March 1, 2004. AG has 872 branches with 12,000 staff and assets of US$2.18b (10% of the total banking assets).

Interest rates on chain

Despite vigorous measures to bring down lending rates by BB for past six months, not much of significance was visible till early December, when some PCBs began to reduce lending rates, usually as high as 14-16%. Banks maintain about 5-6% spread, making huge profits every year. Experts feel that as PCBs do not have huge burdens of NPL or provision deficit, they have no reason to keep up a profiteering trend.

Recently BB has offered a number of incentives to PCBs for cutting rates including allowing them to collect utility bills, keep 20% of ADP funds, 25% of government fund, and get BB refinance at 6% against agro-loans. Currently the total government deposit with NCBs is about Tk137.09b, which would channel at least Tk30.0b to the PCBs and reduce the weighted average cost of fund. Banks have already reduced lending rates by 1-2%.

Bangladesh Bank has slashed the bank rate by 1% to 5% and reduced the requirement of commercial banks to maintain funds with the central bank through treasury and approved instruments, as a major step to an expansionary monetary policy in past 13 years. The statutory liquidity reserve (SLR) has been reduced to 12% from 16%, with additional cash reserve requirement (CRR) remaining at 4%.

The step created an additional liquidity of about Tk40.0b in the money market, on top of the existing surplus of some Tk85.0b, enhancing lending capacity of commercial banks and harness the lending rates to a single digit from the current level of 12.8% on average. Interest rates on T-bills have also declined by 23% and call rate hovered around 4 5% during the last year.

Bangladesh Association of Banks (BAB) urged the central bank to fix the spread between cost of fund and lending rate to avoid unhealthy competition in the sector. To complement the demand, BB published its first monthly report on interest rates of all scheduled banks for the convenience of clients and investors. The report reveals lending rates of NCBs for agriculture sector range from 5-10%, term rates 9-10.5%, commercial rates 14.5-15% and rate on working capital, 13%. For PCBs lending rates for the agriculture sector is 9 14.5%, term lending 13-15.5%, commercial lending 11-16% and on working capital, 13%. Foreign banks maintain a range of 10.5-15% for term lending, 8.25-15% for working capital and 8.5-16% for commercial lending. Deposit rates are 4.50-7.25% in NCBs, 4.75-12% in PCBs and 5.0-10.75% in FBs.

No license for new banks or non-bank financial institution was granted during the year. However, some third generation banks went public as per statutory requirement.

Insurance reforms far fetched

Despite there were no perceptible development initiative by the government in past few years, insurance industry grew at a sizeable rate, albeit in laissez faire. In particular, introduction of new products has spurred impressive growth in the life insurance sector, but small size of the market and a number of administrative and legal impediments plague the nonlife insurance sector. As Bangladesh Insurance Association (BIA) calculates, total premium in the private life insurance sector increased to Tk8.27b in 2002 from the previous year's Tk6.43b, posting a telling 28.6% growth.

While the top 10 general insurance companies enjoy some advantages in both operation and expansion of business, some 34 down-the-echelon companies find business difficult to mobilize premium incomes to survive. While the latest position of the premium income is yet to be known, premium incomes from nonlife business was Tk4.5b and from life was Tk8.27b in 2002, around 9.87% and 28.6% higher than Tk4.10b and Tk6.43b respectively in 2001. Restrictions imposed by the Insurance Act and administrative order on the scope of business, enlistment of insurance companies with the commercial banks, payment of VAT etc have counteracted against growth of nonlife insurance business. The following table shows the insurance business scenario in past two years: (bTk)

Year	Particulars	Life	JBC	Nonlife	SBC
2002	Life fund	16.74	5.69		
	Investment	14.28	5.01	4.48	3.06
	Total assets	20.31	NA	10.32	5.66
	Total premium	8.27	1.96*	4.50	0.82*
2001	Life fund	13.30	5.35		
	Investment	11.23	4.57	3.65	3.37
	Total assets	15.86	NA	9.86	5.67
	Total premium	6.43	1.79*	4.10	0.76*

*Gross amount

Moreover, the dual role of the state-owned Sadharan Bima Corporation as reinsurer and competitor in underwriting and increasing noncompliance of marine cargo policy are also impeding growth of private general insurance business.

Total life fund of some 18 private life insurance companies accumulated to Tk20.0b at the beginning of the year, but the regulators are yet to keep track of its whereabouts, as no concerned agency knows about the investment areas or if fund management is transparent. Under the present rules the companies has to invest 30% of life fund in government securities and the rest 70% in government approved securities, including bonds and debentures. However, under the shrinking interest rates of government securities most are not interested to invest in such instruments abiding by the 30:70 rules. Interest on fixed deposits, a preferred mode, is also declining, making fixed income securities investment appear rather discouraging.

With over Tk1.0b loss in the reinsurance services, the state-owned general insurance agency SBC has decided to take action against private insurance companies for default deals. The lone reinsurer of the country also has decided to cancel its coinsurance services as their private partners have been found reluctant to pay off the claims owed to the SBC as total arrears stood at Tk400m. Despite warnings, these companies failed to clear their dues in time.

Under the current insurance laws, SBC is the lone reinsurer of the private insurance companies. SBC used to write co-insurance for stuck-up projects of the NCBs. As a state-owned general insurance company, SBC had to underwrite 51% while the rest was shouldered by any other private insurance companies. But while paying off the claims, the SBC was, in most cases, forced to pay the entire claim.

Despite there are now a hefty 59 insurance companies operating, a structured apex body could not be established yet to perform watchdog role properly, leaving enough scope to breach laws and rules. However, recently the government thought aloud of a plan to inject fresh blood to strengthen the regulatory and monitoring roles of the insurance watchdog, the Department of Insurance. Private expertise may also be outsourced for its specialized work.

Though successive government committees in the last few years have strongly suggested strengthening the capacity of the department, the Commerce Ministry never cared much to address the issue. World Bank and ADB made similar observations in their periodic reports, suggesting that DoI needs more teeth to regulate the growing sector.

Bull grumbles lately in fresh breather

The primary market had a classy performance during the year. Though some in the banking sector under statutory compulsion, 14 new issues came to the market, pouring 128.8m shares worth Tk9,682m of which 31.9% may be free floated. Most of these issues received tremendous response from the eager investors, both institutional and individual, and collected a total Tk1,711.5m in private placement and Tk13.3b in initial public offering, 9.7 times oversubscription against offer of Tk1,376.2m, revealing huge appetite for quality stocks. However, two issues were undersubscribed showing market maturity and cautious approach. The bourses have also been more careful in scrutinizing securities for listing. Dhaka Stock Exchange (DSE) refused listing of 3 securities, as the issues failed to meet the listing requirements. Although, almost all the IPOs in varying degrees got over subscribed, it is the banks, insurance and financial institutions which attracted the most interest. Nonetheless, the capital market remains shallow and skewed.

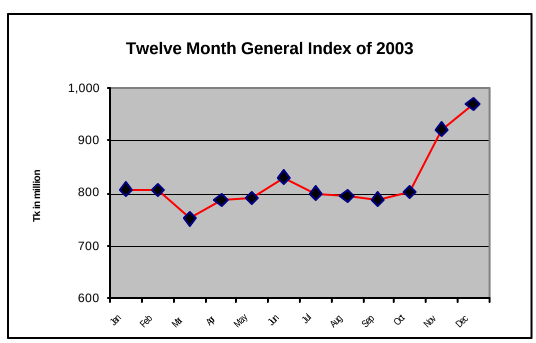
The deluge came in the second half of the year, after the Chairman of the Securities & Exchange Commission (SEC) for past three dormant years left, reportedly being denied requested extension. Among 14 new issues, 5 were banks as a part of legal compliance, while the rest 9 were from different other sectors. Banks drew more interest, as their basic financial strengths are visible and operations are under strict control of the regulatory bodies.

The heat soon percolated across the market. DSE General Index shot from 848.41 in December 30, 2002 to 967.88 in December 30, 2003 marking a 119.47 point or 14.08% growth. During the previous year the index experienced a growth of 2.27% only. Though during the year issued capital has increased by 27.9%, and 8.31% more securities were added to the market, turnover sharply plummeted by 45.4%, mainly due to ban on day trading.

The bull run hit both bourses since mid November and gathered further momentum in early December. Suspecting speculative transactions, the SEC suspended trading of 16 Z Category companies with weak fundamentals, as a surge in their share prices were evidenced. Though prices of all shares in categories B and Z experienced some corrections, in case of the blue chips the heat remained flowing underneath.

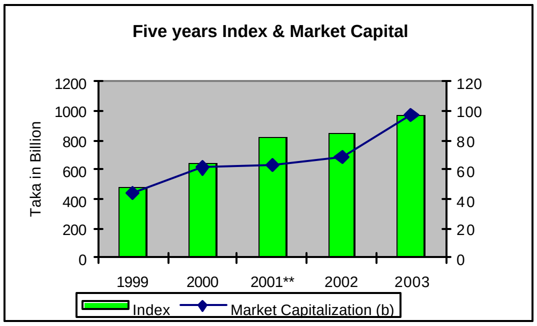
Some 56 companies out of 249 are yet to declare annual general meeting date for the year and 98 companies did not pay any dividend. At least 20 companies have negative net asset value, while 32 companies have incurred loss. Some 106 companies paid dividend at least @ 10%, compared to last year's 119. Average dividend was Tk15.03 against an average earning per share of Tk37.19.

It will be interesting to observe how the SEC succeeds in weeding out the dead stocks and restoring confidence in the capital market. However, the recent response in the primary market revealed that at least Tk13b of liquidity is looking for an opportunity of investment in dependable scripts.



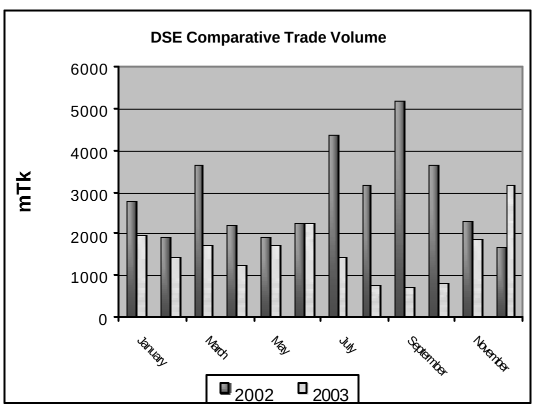
It is suspected that the lucrative initial public offerings of banks attracted a significant amount of undeclared money to the capital market that has trickled in to the secondary market it is also reckoned that a number of blue-chip securities had been undervalued for a long time and their prices went up as they started declaring good dividends.

Market capitalization at DSE on Dec 30, 2003 amounted to Tk97.44b ($1,680m), which is only 3.24% of GDP, against last year's Tk68.68b. Three major groups of listed companies, i.e. banks, pharmaceuticals & chemicals, and food & allied products together constitute about 60% of the total market capitalization, while textile sector has the largest number of listed companies at 44.



***Due to SEC instituted change in index calculation method from 22 Nov 2001, DSE index popped to 817.62 from the original 615.48 by adding extra 202 points.*

The secondary market was hibernating from the beginning of the year. DSE recorded an average turnover of Tk2,924m per month in 2002, which after reaching a high of Tk5,187m in August started to slide at a rate of 30% per month that continued till February 2003, when the market took a sharp upturn. Afterwards the rise was sporadic, and in June turnover reached over Tk2,282m only to be sloped again. In September turnover plummeted to a new nadir of Tk727m. However, after the assumption of office by a new Chairman at the SEC after a long 111 days of vacancy created by the departure of the past Chairman, the market again began to show signs of recovery in October and soon turnover shot to over Tk3,151m in December. In next few months turnover might slide a bit to stabilize, but is not likely to come below the average level of 2003 at Tk1,596m, as the recent market response suggests.



The new leadership of SEC tried to convey a clear view of commitment to the market soon after taking office on Nov 1, 2003. He withdrew the controversial weighted average index, which virtually served no practical purpose to gauge market barometer other than deception, and aired out stern measures against misdemeanors.

The central depository CDBL began mock trading practice with a number of dealers. It may be in full operation within 2004, as new scrips are brought under CDS fold. However, CDS is yet to come out with an affordable rate of charges for services that would encourage general small investors to take advantage of the final stage of automation of stock trading. Regrettably attempts to exempt the bourses from dial-up multi-metering system, which compounds the woes of stockbrokers operating under present WAN, is yet to be implemented by BTTB that could reduce operational cost of broking houses.

During the year SEC remained vigilant against all market movements. It instructed the bourses to introduce the rolling system of trade settlement instead of the netting system, effectively ending day-trading, which was used to conduit manipulation and speculation. It was welcomed by serious market operators, as it would benefit the genuine investors. SEC has also fined two companies Tk20.5m for failure to comply legal obligations. Bourses have also showed greater professionalism. DSE fined 30 listed companies for failing to submit half-yearly reports within the deadline.

Corporate failures also mark the year in the capital market. Four companies under Doel Group defaulted in dividend payments, and failed to pay principal and interest amount on listed debentures. The lingering default to institutional investors by the Beximco Group, the largest conglomerate with 11 listed companies, debentures also compounded.

The market is now likely to show greater resilience as there have been new developments across the economy. Market correction of stocks which have been undervalued for years, has already started since last November. Moreover, some fiscal measures like tax incentives to the listed companies declaring dividend, sizeable cuts in bank deposit rates and in interest rates of government saving instruments have begun to spill effect.

The government, shrugging off apathy of long 17 months, has eventually taken initiatives to discipline and vibrate the capital market. SEC has decided to sit with Bangladesh Bank every quarter to ensure greater coordination between the two regulatory bodies. A project is learnt to be underway shortly with assistance from ADB to standardize financial statements and auditing systems, ensure good governance, foster investors' confidence, and to combat accounting malpractice. Steps are now well afoot to create a bond market in the country.

However, some measures were not conducive to market development. Enhancement of tax on nonlisted companies, banking and nonbanking financial institutions, reduction of allowable technical fees and imposition of tax on dividend distribution and allowing investment of undeclared income in stock market sans question was identified as much less conducive to corporate and capital market growth; some measures were even deceptive in final impact count.

The most common malaise of the capital market, i.e. lack of liquidity, confidence, adequate supply of quality stocks and general inefficiency in regulatory regime have come under greater scrutiny during the year. Both regulators and the bourses showed greater interest in this regard. The following table shows the capital market performance at a glance:

Indicators	30-Dec-03	30-Dec-02	Change
DSE All Share Price Index	967.88	848.41	14.08%
Weighted Average Price Index	NA	822.34	NA
DSE 20 Index	1228.20	1054.89	16.43%
Market capitalization (mTk)	97,442	69,922	39.36%
Market capitalization (m$)	1,680.04	1,184.09	41.88%
No of listed securities	267	257	3.89%
No of listed companies	249	239	4.18%
No of listed mutual funds	11	10	10.00%
No of listed debentures	7	8	(12.5%)
Total issued capital (mTk)	45,083,73	35,242.49	27.92%
Total issued capital (m$)	777.31	607.63	27.92%
No of IPOs floated	14	8	75.00%
No of issues listed	10	11	(9.09%)
Cap raised through IPO (mTk)	1,376.17	450.2	205.68%
Cap raised through IPO (m$)	23.73	7.76	205.80%
Companies held AGM regularly	193	186	3.76%
Companies with min 10% div	106	119	(10.92%)

During the year some 14 companies issued initial public offer and collected Tk3,087.67m from a highly responsive market as under below: (mTk)

Company	Private placement	Public subscription	Capital injected
Keya Detergent	36.00	24.00	60.00
Khaza Mosaic	10.00	15.00	25.00
Mutual Trust Bank	125.00	375.00	500.00
ICB AMCL First MF	70.00	30.00	100.00
Agni Systems	30.00	20.00	50.00
Jago Corporation	20.00	20.00	40.00
First Lease	30.00	20.00	50.00
Standard Bank	220.00	110.00	330.00
One Bank	196.98	97.02	294.00
Bank Asia	200.00	100.00	300.00
Mercantile Bank	213.19	106.575	319.765
Daffodil Computers	45.00	30.00	75.00
JMI Bangla	30.00	20.00	50.00
Lafarge Surma	150.00	743.90	893.90
Total	**1,376.17**	**1,711.50**	**3,087.665**

The following table shows the sector-wise distribution of EPS, dividend and yield. :

Sector	Average EPS Tk	Average dividend %	Average yield %
Fuel & Power	88.23	5.83	3.16
Bank	62.68	51.94	7.33
Miscellaneous	59.31	9.71	8.52
Insurance	50.51	22.26	6.15
Engineering	49.20	19.71	5.71
Pharmaceuticals	47.36	15.03	6.52
Leather	47.15	7.75	8.24
Food & Allied	39.02	12.19	5.76
Investment	36.93	39.95	9.40
Cement	27.40	12.50	5.83
Service/Real Est	23.64	7.83	7.67
Textile	18.08	6.88	9.42
ICT	17.28	1.14	6.94
Jute	16.02	15.00	7.18
Ceramic	9.46	8.75	6.29
Market	**37.19**	**15.03**	**7.15**

Yawer Sayeed, Managing Director & CEO
Wasiq al Aazd, Head of Operations
Laila Mahmuda Shilpi, Manager, Research
Afshana Banu, Executive Officer, Research
Zakia Rashid, Executive Officer, Research

AIMS Mission & Vision Statement

Our Mission:

To be a household name in Bangladesh and be recognized as a reliable companion in the pursuit of wealth creation.

Our Goal:

To take the extra mile to meet the customer's needs through continuous innovation of suitable financial products and offering the best services.

Our Values:

To strive for achieving and maintaining the highest ethical and moral standards to earn the trust of our clients and patrons.

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