Budget FY19: Macroeconomic Setting, Lessons from FY18 Budget Execution, and Implementation Challenges

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The Presentation will Cover:

- Global and Domestic Macroeconomic Settings against which the Budget has been formulated.

- Macroeconomic performance of the domestic economy in FY18.

- The highlights from FY18 Budget Implementation and Lessons for FY19.

- Discussion on the Major Objectives and Challenges for FY19 Budget Along Following Lines:
  - Growth and investment objectives against recent performance and domestic political-economic context.
  - Attainability of the ambitious revenue target.
  - Annual Development Program (ADP) and its implementation challenges.
  - Developments in social sector spending and what it entails.
  - Fiscal deficit and its financing, and money and foreign exchange market considerations.

The Global Background Against Which The Budget Has Been Formulated

- Global economic expansion remains reasonably strong, despite a projected weakening of performance of the advanced economies, due to due to stronger growth performance of emerging and developing economies.
- Growth in world trade volume will peak in 2018 (5.1%), but expected to decelerate due to the prospective trade war among the major trading partners.

Overview of the World Economic Outlook Projections								
	2012	2013	2014	2015	2016	2017	2018	2019
IMF								
GDP at constant prices (% change)								
World	3.4	3.4	3.4	3.5	3.1	3.8	3.9	3.9
Advanced Economics	1.2	1.4	1.8	2.4	1.7	2.3	2.5	2.2
Euro Zone	-0.8	-0.5	0.9	1.5	1.7	2.3	2.4	2
Emerging and Developing Economics	5.2	5.0	4.6	4.3	4.1	4.8	4.9	5.1
Developing Asia	6.8	7.0	6.8	6.6	6.4	6.5	6.5	6.6
World Trade Volume (goods and services)	2.8	3.5	3.4	3.7	2.2	4.9	5.1	4.7
Commodity Prices (USD) (% change)								
Oil	1.0	-0.9	-7.5	39.6	15.7	23.3	18	-6.5
Nonfuel (Commodity Non-Fuel Price Index)	-3.3	-1.5	-6.2	28.4	-1.9	6.8	5.6	0.5

Source: IMF World Economic Outlook

- The surging oil prices since 2017 will imply terms-of-trade loss for oil importing countries including Bangladesh. While WEO is projecting a modest decline in oil prices in 2019, the market is very volatile and will depend on various supply side shocks and developments in demand in the emerging economies.

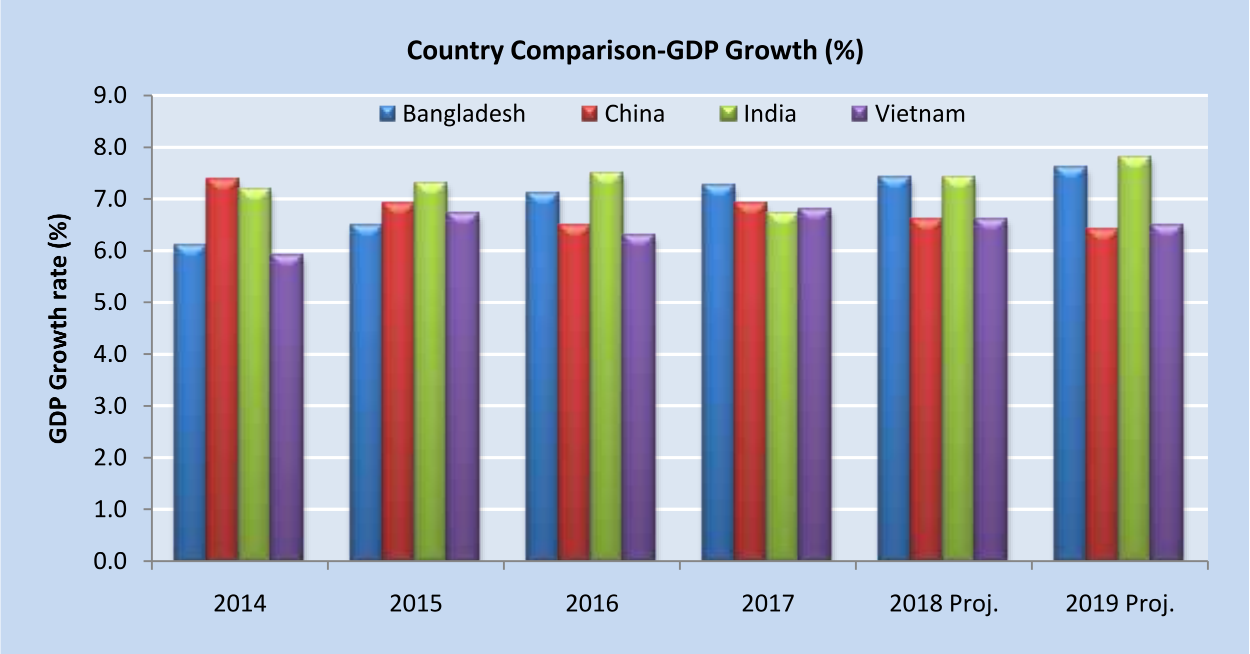
Macroeconomic Performance in FY18

- Real GDP growth rate in FY18 is officially estimated to be 7.65%, exceeding the target (7.4%) specified under the FY18 budget and the 7th Plan, despite reservations from many quarters.
- Sustainability of growth still remains an important issue because: (i) business confidence remains relatively low, as reflected particularly in the lackluster private sector investment in relation to GDP; (ii) FDI has reportedly declined in FY18 compared with the preceding year; (iii) faltering export performance, particularly for the non-RMG sector; and (iv) the emergence of two macroeconomic economic tensions: liquidity crunch in the banking system; and growing imbalance in the balance of payments.

- Inflation is has stabilized and coming down in recent months due to a bumper boro rice crop. The two main risk factors for inflationary pressures are: (i) retent and prospective devaluation of Taka against the US dollar—it has already depreciated by 5% and further depreciation is likely; and (ii) the terms-of-trade loss due to the rebound in petroleum prices in the world market resulting from supply disruptions, sustained increase in demand for petroleum products in emerging economies like China and India, and supply restrictions imposed by the OPEC members and Russia.

- Strong private sector credit demand during most of FY18, and the growing loan loss provisioning and banking scams have undermined banking sector performance in terms of profitability and outlook.

Relative Growth Performance: Where We Stand



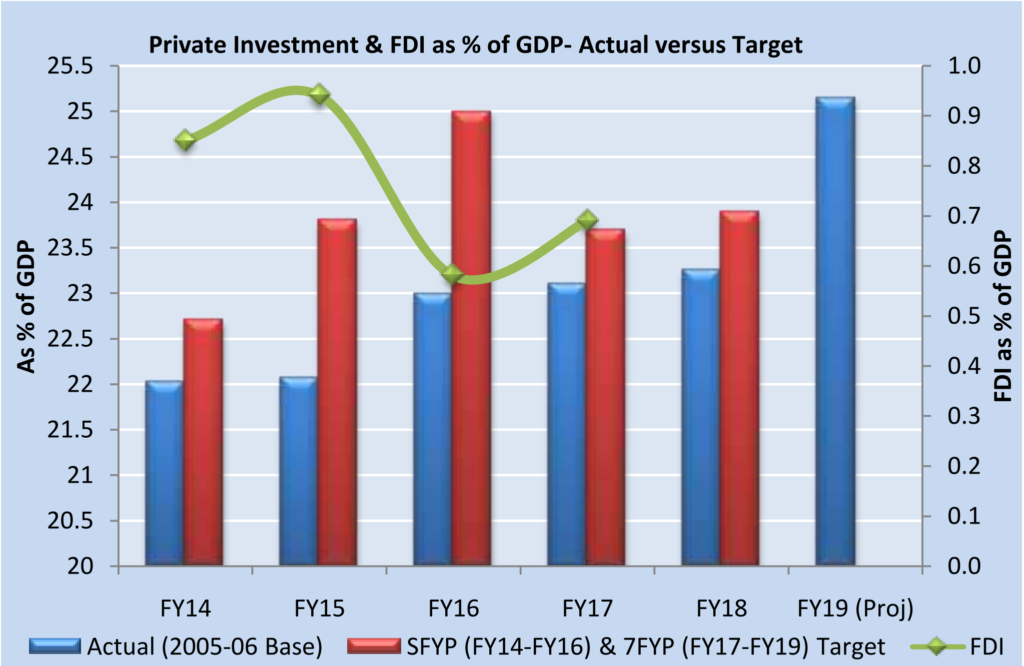
Source: IMF

- Bangladesh has growth momentum. Economic growth has been satisfactory when compared with high performing comparator countries like Vietnam, India and China, despite serious internal challenges.

- It is also noteworthy that Bangladesh has demonstrated a remarkable degree of stability in its growth performance, while all other comparator countries have experienced significant volatilities. India and China (the other best performers), along with Vietnam are the high performing Asian countries–-experienced higher degree of volatility compared with Bangladesh.

Private Investment in FY18 was Disappointing

- The shortfall in private investment/GDP ratio gives rise to the concern about sustainability of the 7% plus growth rate in the coming years. Private investment has remained virtually stagnant at 23% of GDP, with foreign direct investment (FDI) accounting for less than 1% of GDP, both being well short of their 7th FYP targets.



Source: BBS and 7FYP/SFYP Documents

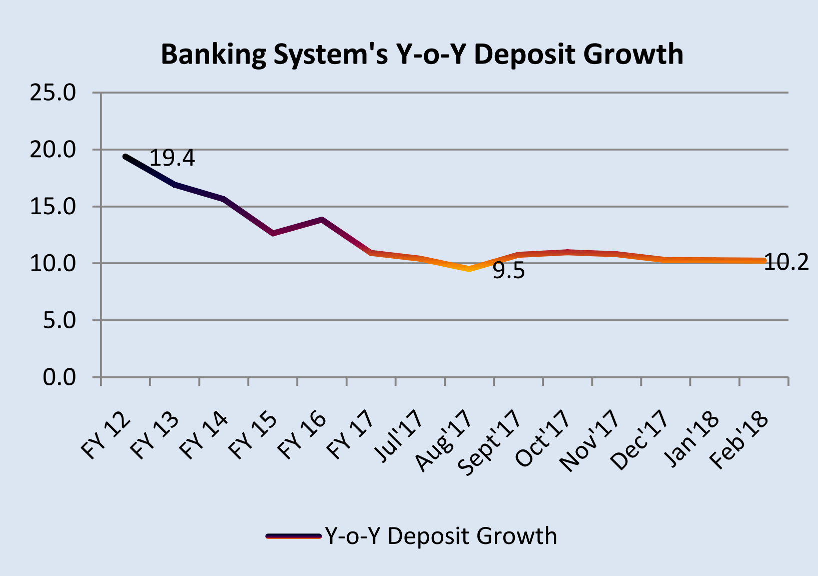
- Sustaining 7-8% real GDP growth over a long period as envisaged under the 7th Plan and Perspective Plan 2041 draft will require massive efforts in attracting private investment of foreign and domestic origins.
- In FY19, based on 7th Plan, Bangladesh will require private investment to reach 25% of GDP including 1.8% of GDP from FDI, which are unlikely to be achieved given past performance in these areas.

Addressing Private Investment Issue in FY19 Budget

- The emphasis given in the FY19 budget on boosting private investment by addressing the infrastructure gap is appropriate. These include:
  - Higher allocations for the transport and power sectors in the ADP, with emphasis on Mega-projects like Padma Bridge, Dhaka Metro Rail, Padma Rail Bridge, Materbari Deep Sea Port and Power Hub, Ruppur Nuclear Power Project, Upgradation of major highways to 4 and 6 lanes, and upgrading of railways;
  - Floating LNG Terminal facilities to supply gas with imported LNG and providing budgetary support in this regard;
  - Approved establishment of 76 Special Economic Zones (SEZs) including private SEZs and also dedicating some of the SEZs for countries like Japan, India and China;
- These are all good initiatives. However, speedy implementation will be the main challenge given the weak administrative capacity and lack of active political support. For example: the one-stop facility of BIDA is still not operational and no public sector SEZ is in operation 8 years after the enactment of SEZ Act. It will be more effective to pour resources and focus the limited implementation capacity to complete the first 5 SEZs rather than expanding the number of SEZs.

Liquidity Problem of the Domestic Commercial Banks

- There are three factors or developments which contributed to the current liquidity crisis in the banking system and the consequent upward surge in the interest rate structure.
- **The first factor** is a sharp decline in the growth of deposits in the banking system which declined from 19.4% in FY12 to the lowest point of 9.5% in September 2017, and thereafter remained at around 10% rate. Certainly, a deposit growth rate of 10% cannot sustain private sector growth rates of 16%-18%, which is needed for the economy to grow at more than 7% per annum.



- **The second factor** is the high non-performing loans of the banking system which severely restricts the amount of new loanable funds and undermines the revolving nature of banks' pool of loanable funds. It is widely believed that the actual amount of non-performing loan would be more than twice this published figure.
- **The last but still important factor** is the sale of dollars by Bangladesh Bank in the interbank foreign exchange market. For every dollar Bangladesh Bank sells, it also withdraws liquidity from the banking system by about Tk. 83. By selling $2.3 billion in the interbank market at least Tk. 190 billion worth of liquidity has been withdrawn from the banking system.

Balance of Payments Developments are Discomforting

- Bangladesh has become a permanent current account deficit country since Fy17. This is a **NEW NORMAL** given the strong trend in foreign-financed mega projects.
- The external current account deficit has crossed $8.5 billion in the 10 months of FY18 and likely to exceed $10 billion by the end of the fiscal year.
- This deficit in the current account is being largely funded by official bilateral and multilateral borrowing, as also reflected in the higher foreign financing of the budget deficit.

(US $ million)

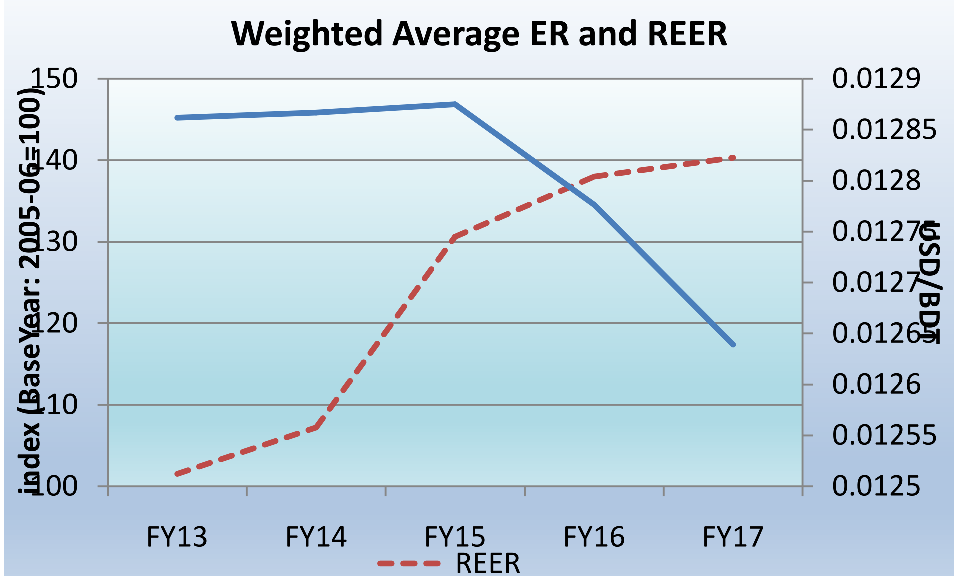
	FY14	FY15	FY16	FY17	July - March, 2017 - 18	FY 18 (Full year projection)
Trade balance	-6794	-6965	-6460	-9472	-13202	-19457
Merchandise export f.o.b. (inc. EPZ)	29777	30697	33441	34019	27098	36393
Ready made garments	24492	25491	28094	28150	22834	30712
Merchandise import f.o.b.(inc. EPZ)	36571	37662	39901	43491	40300	55850
Services (net)	-4099	-3186	-2708	-3284	-3336	-4486
Income (net)	-2635	-2869	-1915	-2007	-1609	-2137
Current transfers	14934	15895	15345	13283	11061	15268
CURRENT ACCOUNT BALANCE	1406	2875	4262	-1480	-7086	-10812
OVERALL BALANCE	5483	4373	5036	3169	-1101	-2000

***Source**: Bangladesh Bank*

- Due to the sharp increase in import payments and the moderate decline in foreign reserves, the reserve coverage of imports will be declining to less than six months of coverage for prospective imports.

Exchange Rate Management has Problems

- Compared with an one-step major or significant devaluation of Taka, the current approach does not address the root cause of the problem with full force and thus the imbalances persist;
- Since a major correction in the exchange rate of Taka is perceived to be overdue, give the appreciation of the REER by 40%, the exchange market continues to remain unsettled and many exporters are delaying repatriation of export proceeds and under-invoice exports.
- Importers are rushing to banks to open LCs and lock the exchange rate with a view to avoid the costs associated with a significant depreciation in the near future.



Source: *Bangladesh Bank, Ministry of Finance*

- Foreign investors tend to cash out of their portfolio investments in Bangladesh and wait in the sidelines to come back to the market after a major step devaluation, which is also depressing the stock price index.
- The essential question is: Should Bangladesh Bank prolong the pain of BOP adjustment over a long time and perhaps until after the elections? Or should it bite the bullet now and go for a major one-step devaluation of the currency to restore BOP equilibrium?
- Certainly, the first approach, which it is currently following, is costly for the economy and for Bangladesh Bank and also entails higher risk of an uncontrolled exchange market in months just before the national elections.

FY18 Budget Implementation

Fiscal Outturn for FY18 and FY19 Budget

❑Fiscal management in FY18 has been plagued by a significant shortfall in revenue. NBR tax revenue growth has slowed down to less than 13% in first 10 months of FY18, compared with 19% in the corresponding period preceding year.

❑ The performance in the first 10 months of the year indicates that NBR revenue increased to Tk. 1.6 trillion up to April 2018, which was only about 65% of the budget target. Reaching the substantially lower revised target will require collection of Tk. 435 billion per month in the final two months of the year, compared with Tk. 160 billion monthly collection rate recorded so far in Fy18. Even the revised target of Tk. 2.25 trillion will require monthly collection rate of Tk. 320 billion.

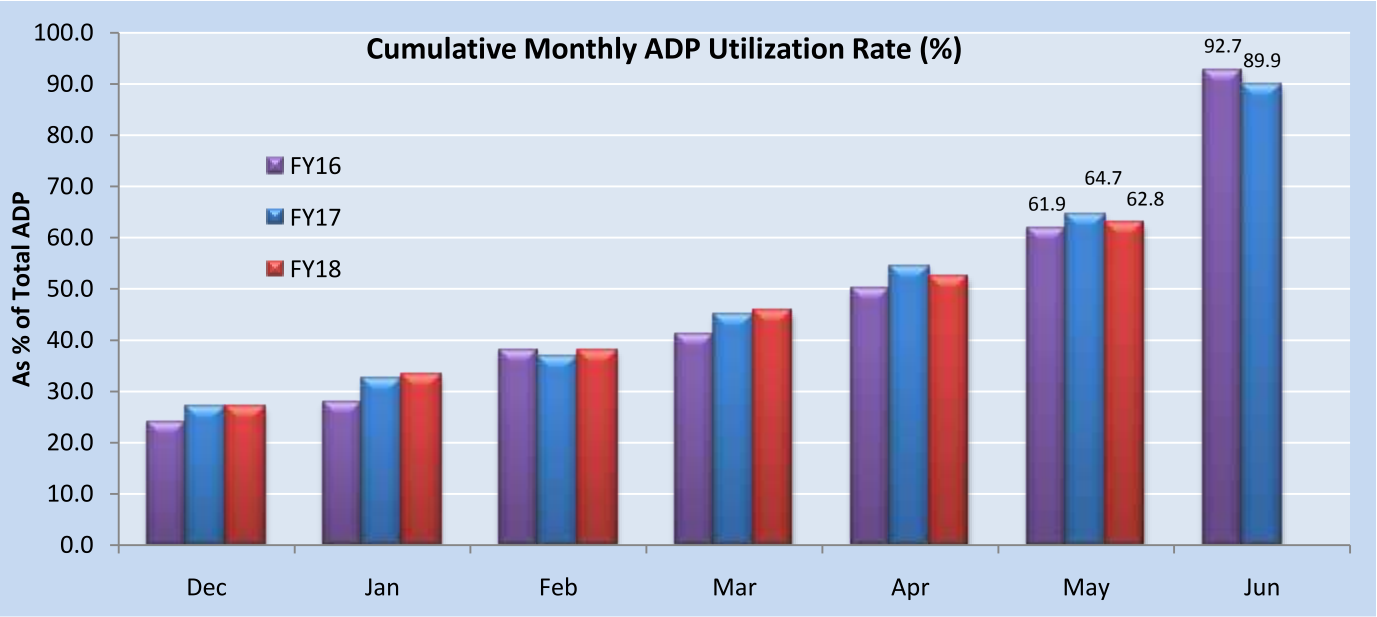
Fiscal Outturn (BDT in billions)

	FY15	FY16	FY17	FY18 (B)	FY18 (RB)	FY19B
Total Revenue	1460	1730	2012	2880	2595	3393
NBR Tax	1240	1462	1716	2482	2250	2962
Other Revenue	220	267	296	398	345	431
Total Expenditure	2044	2384	2695	4003	3715	4646
Current Expenditure	1295	1568	1758	2340	2106	2824
Of Which						
Subsidies and Incentives			69	195	173	332
Pensions and Gratuities			155	229	137	260
ADP Expenditure	604	794	841	1533	1484	1730
Equity			72	119	21	246
Overall Balance (excl. grants)	-584	-655	-683	-1123	-1120	-1253
(% of GDP)	-4	-4	-4	-5	-5	-5
Financing (net)	561	636	676	1068	1076	1212
External Financing	49	129	116	464	416	500
Domestic	512	507	560	604	660	712
of which bank	5	106	-84	282	199	420

Source: Ministry of Finance, Budget Documents

❑As in the past, the budget deficit will most likely remain at or less than 5% of GDP, given that the government's ADP implementation will be about 90% of the revised ADP.

ADP Implementation Rate in FY16-18



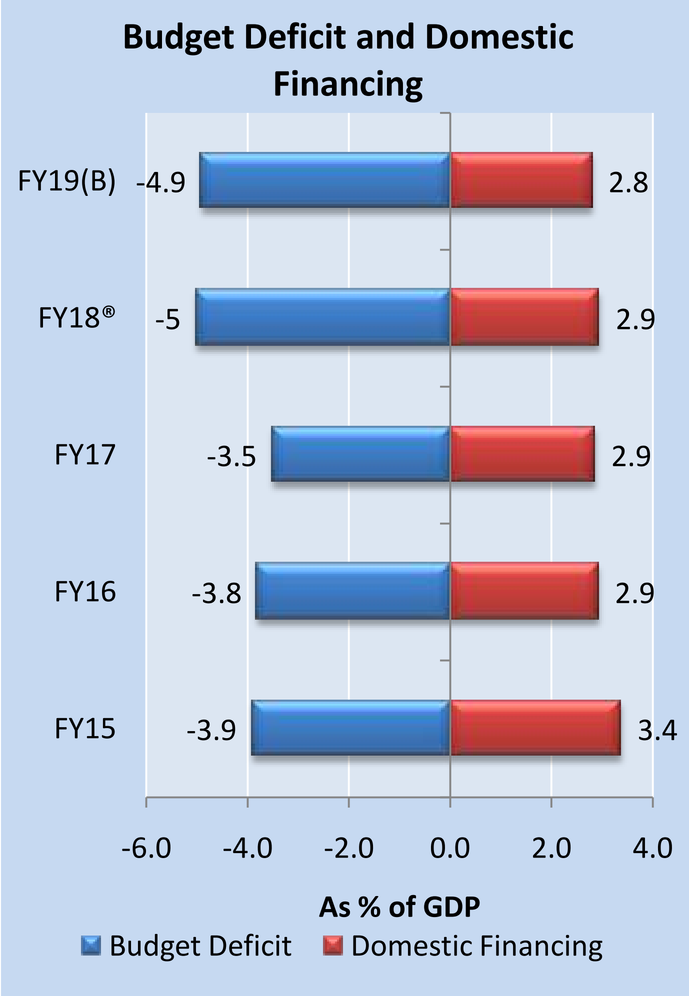
Source: IMED, Bangladesh

- ADP Utilization rate till April was slower at 52.4% (compared to 54.6% last year). This is a disappointment since a lot of mega projects are being implemented and there was an expectation that with these mega projects the utilization rate would tend to improve.

- ADP has been revised down to BDT 1.48 trillion from BDT 1.53 trillion in the original budget. The performance so far provides a cautioned outlook for the last two months and hints at one of the lowest ADP utilization rate in recent years by not exceeding 90% of the Revised ADP.

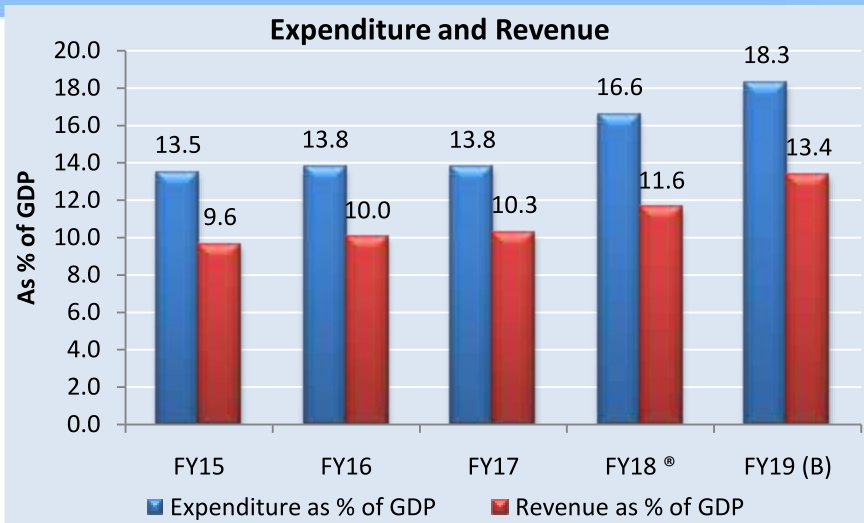
Budget Deficit Remains Stable but Dependence on High Cost Domestic Borrowing Remains

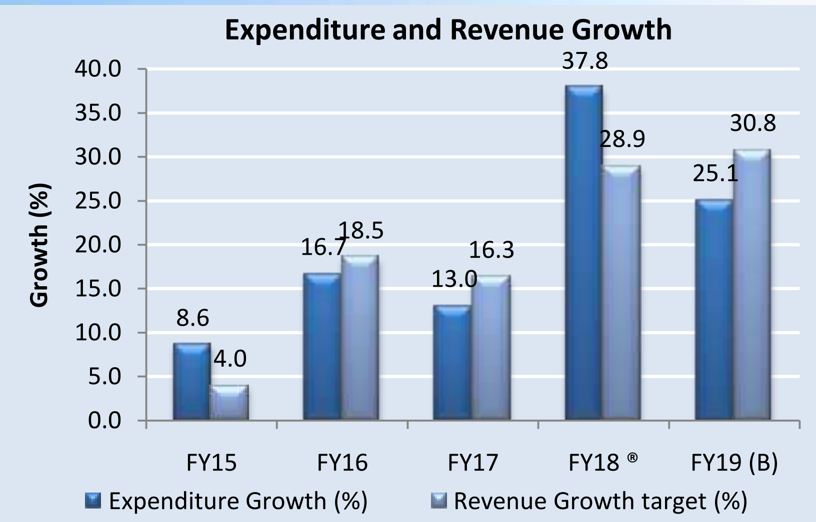
- The government will probably manage to keep the fiscal deficit at about 5% of GDP or less in FY18, given its solid track record of expenditure control and lower ADP utilization.
- However, the control was possible only through cutting of expenditure, depending on the evolving revenue situation.
- For financing the deficit, the government has appropriately leaned heavily on foreign sources (2.1% of GDP), which at US$5.5 billion is a record. At 2.9% of GDP in FY18, domestic financing would remain high and most of it came from high-interest nonbank sources.
- The decline in bank deposit growth due to diversion of funds to NSD certificates has reduced banking system's deposit growth to about 10% level from normal growth rates of 17-18%.



Source: Ministry of Finance

Execution of Budget in Compared to Expenditure and Revenue Targets





Source: Ministry of Finance

- The two panels indicate the stark reality and failures in budget execution in Bangladesh. The first three years in both panels reflect the actual performance, and the last two columns represent the unrealistic targets under the revised budget for FY18 and the proposed budget for FY19.
- Despite ambitious targets established in every budget, revenue /GDP ratio still hovers around 10%, and tax/GDP ratio at about 9% , which is lowest among all possible comparator countries.
- We should also take note that revenue growth has faltered year after year, and went down to as low as 4% in FY15, due to election related disturbances which impacted economic activity. In FY18, July-April NBR revenue growth has been less than 13%, compared with almost 19% in the preceding year.
- Overall conclusion is that revenue and expenditure growth in FY18 and FY19 will remain at levels recorded during FY16 and FY17, given that there is no major reform initiative on the revenue front in the budget.

Sectoral Expenditure Pattern- Social Infrastructure

- Social Infrastructure spending and allocation in FY18 RB and FY19 budget in terms GDP is projected to increase, but in the event actual outturns will probably be close to 4% of GDP like in recent years. The relative decline in FY19 budgetary allocation for social infrastructure is also a matter of concern.

- The decline in the level of spending on education (1.9% of GDP) and the continued very low level of public health spending (0.7% of GDP) in FY19 budget are matters of concern.

- It is noteworthy that the increase in education spending in FY16 and FY17 was primarily attributable to the very large increase in salaries of public sector supported school teachers/employees. So far we do not observe any visible improvement in quality of public sector education through this salary increase.

Sectoral Expenditure-Social Infrastructure

	FY15	FY16	FY17	FY18 RB	FY19 (B)
As % of Total Expenditure					
Social Infrastructure	26.7	30.6	28.8	29.0	27.3
Of which					
Education	13.4	15.9	14.4	11.2	10.2
Health	5.0	5.3	5.1	4.1	3.9
Food and Social Security	2.6	3.4	2.6	2.9	3.0
As % of GDP					
Social Infrastructure	3.6	4.2	4.0	4.8	5.0
Of which					
Education	1.8	2.2	2.0	1.9	1.9
Health	0.7	0.7	0.7	0.7	0.7
Food and Social Security	0.3	0.5	0.4	0.5	0.5

Sectoral Expenditure Pattern- Physical Infrastructure

- Total allocation for physical Infrastructure in terms of GDP has increased markedly in both FY18 RB and in the proposed budget for FY19.

- Greater emphasis has been given to communication infrastructure, reflecting the ongoing and prospective implementation of many large transportation projects.

- Greater emphasis has also been given to agriculture and rural development, largely to improve rural infrastructure before the elections.

- Allocation for the power and energy sector in relation to GDP is significantly higher indicating continued focus on this sector. Although much of the investment in power generation is being done by the private sector, allocations for transmission and distribution will remain in focus.

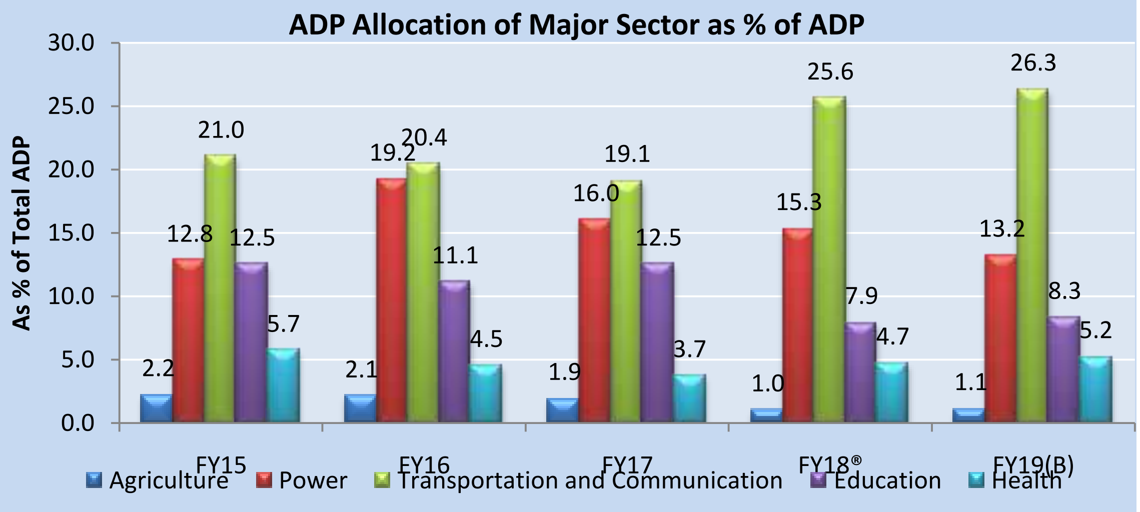
- The sharp increase in General Service is possibly due to the expected rise in the pay scale of government employees. After all, this is an election year!

Sectoral Expenditure-Physical Infrastructure

	FY15	FY16	FY17	FY18 ®	FY19 (B)
As % of Total Expenditure					
Physical Infrastructure	31.2	33.8	28.4	34.0	31.0
Of which					
Agricultural and Rural Development	16.4	15.3	12.9	13.7	12.7
Power and Energy	4.9	7.1	5.4	6.5	5.4
Communication Infrastructure	8.6	8.9	7.7	12.2	11.4
General Service	18.8	20.4	26.9	22.5	25.3
ADP	26.9	33.3	31.2	39.9	37.2
PPP Subsidy and Liability	2.0	1.5	0.9	2.4	4.8
As % of GDP					
Physical Infrastructure	3.9	4.6	3.9	5.6	5.7
Of which					
Agricultural and Rural Development	2.2	2.1	1.8	2.3	2.3
Power and Energy	0.3	0.9	0.7	1.1	1.0
Communication Infrastructure	1.1	1.3	1.1	2.0	2.1
General Service	2.6	2.8	3.7	3.7	4.6
ADP	4.0	4.6	4.3	6.6	6.8
PPP Subsidy and Liability	0.3	0.2	0.1	0.4	0.9

Source: Budget Documents, Ministry of Finance

Sectoral ADP Allocation



Source: Budget Documents, Ministry of Finance

- ❑ Sectoral allocation pattern of the ADP for FY19 indicates a further increase in allocation for the transport and communication sector owing to many mega projects currently under implementation.

- ❑ The emphasis on transportation is appropriate and consistent with the government's political commitment to improve physical infrastructure in the transport sector to reduce cost of doing business and promote private investment.

- ❑ The reduction in allocation for electricity is not a matter of concern since much of the new capacity expansion for electricity generation will be done by the private sector under long-term power purchase agreements.

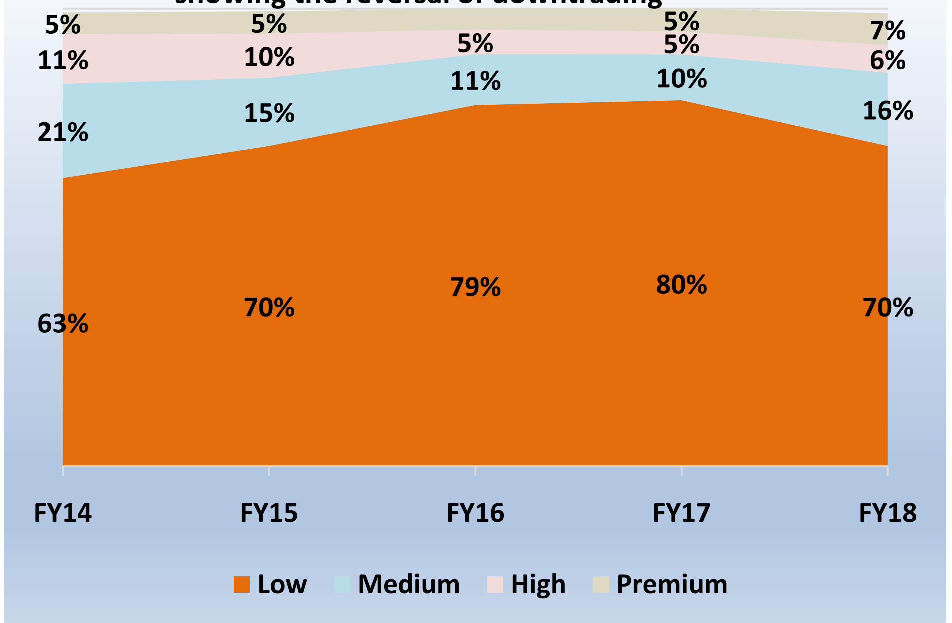
A Glance at the Tobacco Sector

- The pricing and the taxation of the tobacco sector has largely improved in FY18, and the trend of increasing revenue and arresting/reversing downtrading has taken its course.
- Cigarettes, which comprises more than 90% of the total tobacco revenue, saw the noticeable structural adjustment in the low segment.
- Intervention was made in the low segment where the price has been increased by nearly 20% (from Tk. 27 to Tk. 32+).
- Meanwhile, tax on the low segment has been increased by 3 percentage points (from 68% to 71%). This is a noticeable change in achieving an uniform taxation structure for tobacco sector.
- Due to political economy reasons, the biri sector has seen no major intervention in this election year budget
- Only price of the filter biris which are only 5% of all biri sales, saw a positive change of 25% increase. The revenue impact of this will be negligible.

Fiscal Year 2017-18					
Segment	Price(Tk/10s Pack)	Supplementary Duty	VAT (%)	Health Surcharge (%)	Total Tax Levied
High	70+	65	15	1	81
Medium	45+	63	15	1	79
Low	27	52	15	1	68

Fiscal Year 2018-19					
Segment	Price(Tk/10s Pack)	Supplementary Duty	VAT (%)	Health Surcharge (%)	Total Tax Levied
Premium	70+	65	15	1	81
High	45+	65	15	1	81
Low	32+	55	15	1	71

Yearly segment composition of cigarettes showing the reversal of downtrading



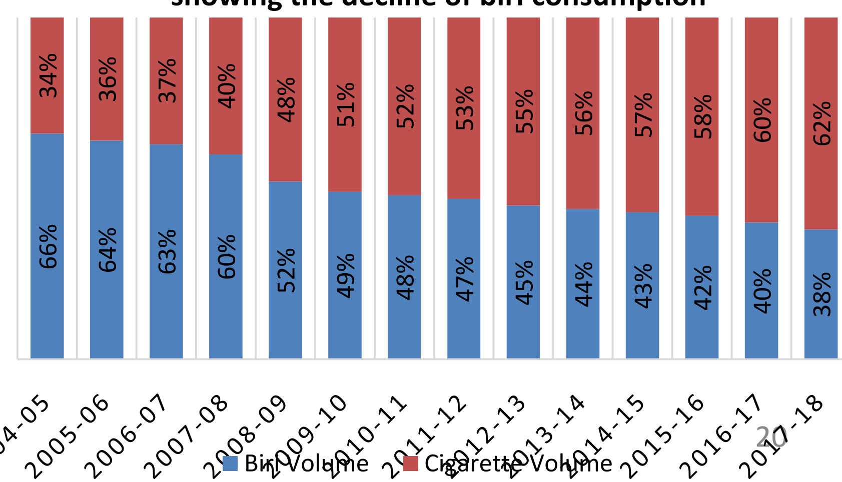
Future Trends in Tobacco Sector

- PRI estimates show that the intervention in the low segment cigarettes will increase government's tobacco revenue by some 18%, which is more than the previous years.
- Reversal of downward trading has accelerated and will accelerate further.
- If the government maintains the policy of increasing prices and taxes on the lower segment, then a uniform tax system of the tobacco sector can be reached in 2–3 years.
- If the government is really serious about accelerating the "sunset" for biri industry, the price of biri should be minimum TK. 1 per stick from current Tk. 0.5.
- This year's non-intervention in the biri sector is very discouraging as it will not help in reducing the share of biri consumption. The tax on biri has to be increased from current 45% to at least 60%. This should be done immediately after elections.
- An integrated tobacco (cigarette and biri) pricing and taxation policy will ensure fair contribution to revenue from all segments of tobacco products and help reduce smoking.
- The tobacco tax measures adopted in the budget will generate revenue growth of nearly 20%. The government can earn a total revenue of Tk. 28,300 from the tobacco industry alone in FY19.

Revenue Projection from Tobacco Products

	2017-18	2018-19
Revenue (Tk. crore)		
Cigarette	22,300	26,286
Biri	1,500	2000
Total Revenue	23,800	28,286
Growth (Tk. crore)		
Cigarette	3,000	3,986
Biri	960	500
Total	3,960	4,486
Growth (%)		
Cigarette	15.4%	17.9%
Biri	178.0%	33.3%
Total	20.0%	18.8%

Share of cigarettes and biris over the years showing the decline of biri consumption



Is Bangladesh Budget Process Consultative and Transparent?

- It must be acknowledged that Bangladesh government has conducted an extensive consultation process—covering most stakeholders--before finalizing the FY17 budget. The consultations are done by the Hon. Minister of Finance and also separately by the NBR on tax policy issues. While welcoming this consultative process, we also need to underscore that the process needs to be broadened to local levels by MPs and there are other important transparency issues that need to be addressed by the government in the greater public interest. Bangladesh's score in terms of OPEN BUDGET INDEX is the lowest in South Asia.

- While the budget is publicly available and breaks down expenditures and revenues, financial allocations to and earnings from state-owned enterprises are included only in the aggregate.

- Budgetary allocations to individual local government institutions (LGIs) are not shown separately and actual transfers to LGIs are done in ad hoc manner, often on political grounds disregarding the socially/economically desirable pattern of allocations.

- The supreme audit institution has not produced and made publicly available verifications of the government's annual financial statements within a reasonable period of time. The long (5-year) delay after the completion of the budget is not acceptable by any reasonable standard.

- Information on the defense budget includes only in the aggregate and it is widely believed that the aggregate figure does not necessarily cover all related spending. For transparency and economic analysis purpose, much more information should be provided in the budget. For example, India's defense budget explicitly lists details regarding allocation for capital expenditure, revenue expenditure, export credit for defense purposes and India's outstanding external debt from defense separately.

- Local level inputs in the budget process is virtually absent.

Summary of Changes in Tariffs and Protection

- Practically no change in nominal protection. Increase and decrease in CD and SD cancel out.

Average Nominal Protection rates (NPR)

Import categories	FY2018	FY2019
Basic Raw Materials	13.38	13.27
Intermediate Goods	15.16	15.13
Capital Goods	10.85	10.88
Final Consumer Goods	45.98	46.30
Total	26.55	26.64

Changes in Protection Components

Protection components	FY2018	FY2019
CD+RD	14.72	14.80
SD	10.19	10.21
VAT	1.64	1.64
NPR	26.55	26.64

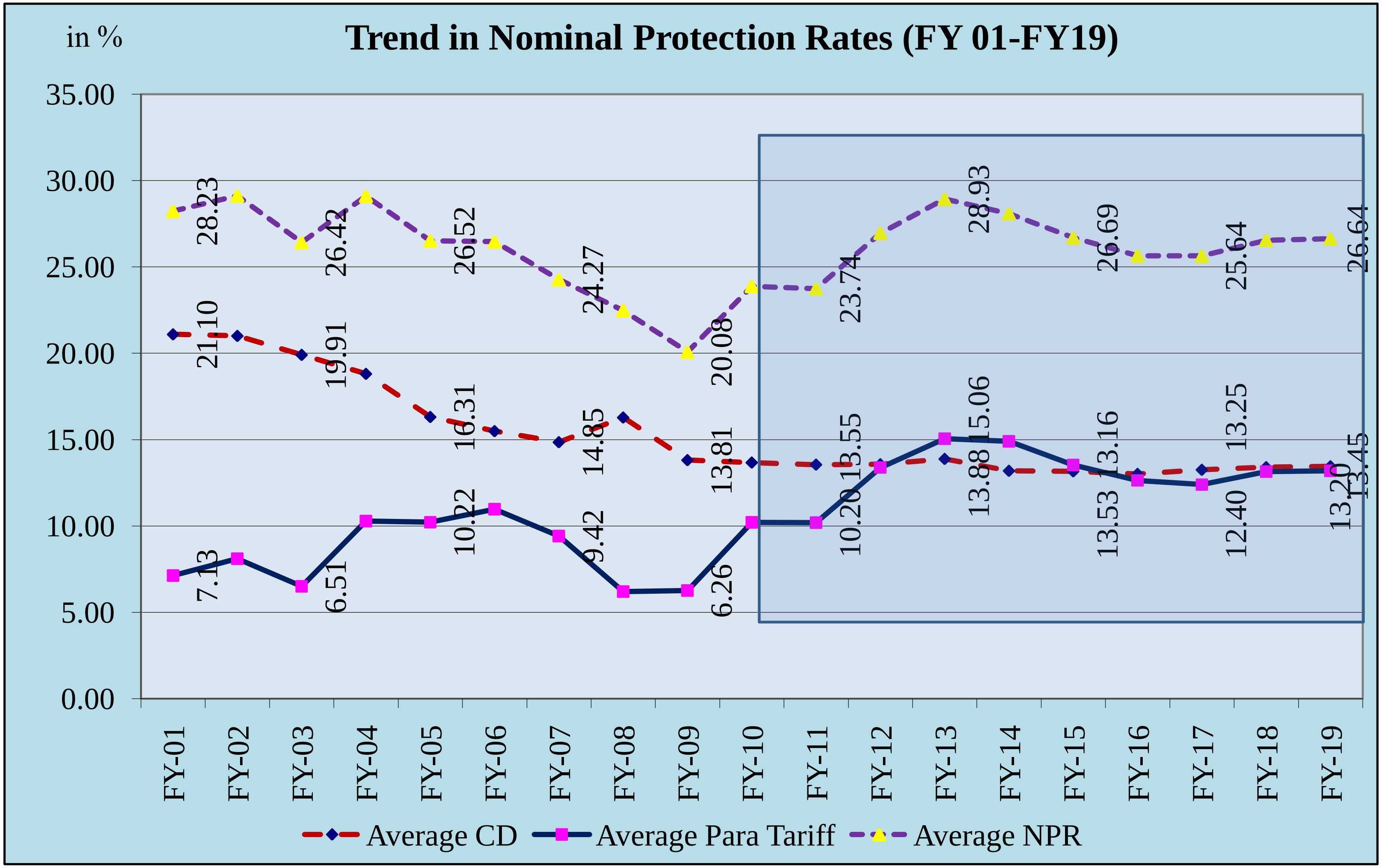
Source: NBR Budget documents and PRI Staff estimation

Tariff Structure and Trend for FY01-19

- Nominal Protection through para-tariffs almost equal to protection through custom duty in FY19 proposed budget
- Deeper cuts in para-tariffs needed until 2020

Tariff (%)	FY-01	FY-05	FY-10	FY-15	FY-18	FY-19
Avg. CDR	21.10	16.31	13.67	13.16	13.40	13.45
Avg. Para Tariff	7.13	10.21	10.21	13.53	13.15	13.19
Avg. Nominal Protection	28.23	26.52	23.88	26.69	26.55	26.64
Avg. Tariff Incidence	51.80	47.40	43.39	50.62	51.49	53.46
Top NPR*	59.00	60.00	79.00	108.00	85.60	85.60
(*) excludes tariffs on cars, alcoholic beverages, and cigarettes						

Protection Through Para tariffs about equal to Protection Through Customs Duty in FY19

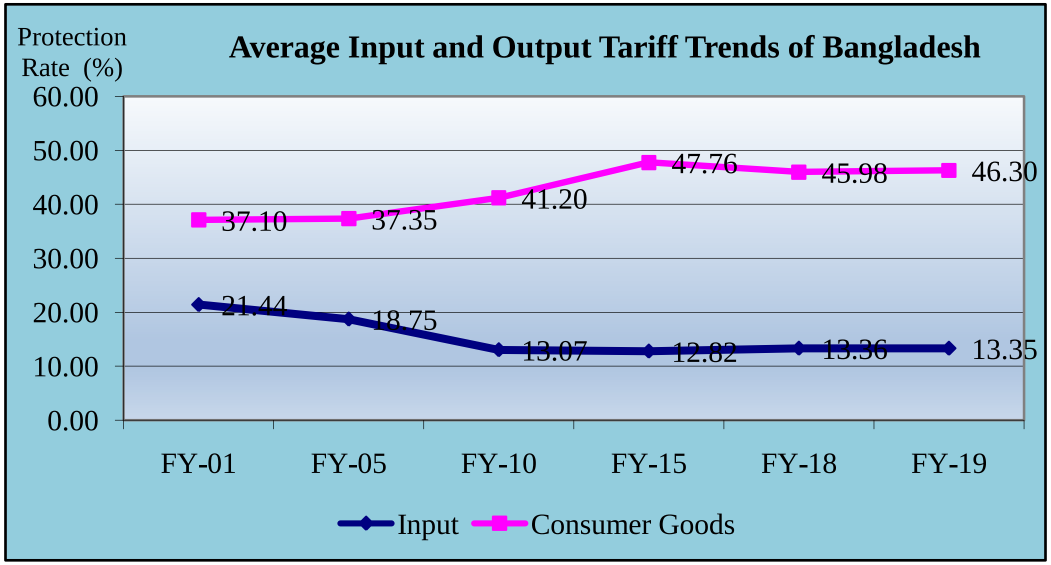


Tariff Escalation too steep

- ❑Bangladesh Tariff Escalation is unique. Higher tariff escalation signals higher effective protection.

- ❑ Average tariff on Outputs (Final Consumer Goods) rise, while those on inputs fall, raising effective protection over time.

- ❑All comparators have much lower tariff escalation ratios.



	Year	Tariff Escalation Ratio
Bangladesh	2001	1.73
	2019	3.47
Vietnam	2001	2.90
	2016	2.74
India	2000	1.22
	2016	1.28
Malaysia	2000	2.37
	2014	2.04
Thailand	2000	1.71
	2015	2.35

Concluding Remarks

- In the overall macroeconomic context, as in the past, the budget aims to moderately expand the size of the government, while maintaining macroeconomic stability.
- The growth rate of 7.8% will be challenging unless private sector investment rebounds strongly. The prevailing calm in political environment together with the number of ongoing public investment in mega projects may help support growth.
- However, initiatives such as establishment of SEZs (under public and private initiatives), and attracting Japanese, Chinese, and Indian investors to their respective SEZs are yet to materialize and not likely to help much in increasing private domestic investment and FDI inflows in FY19.
- Attaining the revenue target will be virtually impossible. The discretionary measures like taxation of cigarettes, increasing VAT withholding at the import stage to 5%, and increasing withholding income tax on RMG exporters (if sustained) on both direct and indirect tax fronts will have revenue potential. But not enough to even get closer to the revenue target.
- Given the dismal tax performance year after year, the government must focus on reform of the tax laws and modernization of tax administration immediately after the general election.
- The budget would need to be implemented carefully so that it does not crowd out private sector credit through the targeted high level of domestic borrowing by the public sector (bank and nonbank). As economic activity including investment picks up, credit demand from the private sector could easily expand by more than 20%, accentuating tensions in the money market undermining economic growth.

Concluding Remarks

- Given the tight money market situation, the government should certainly make further efforts to mobilize external financing by accelerating the utilization of foreign aid pipeline or issuing sovereign bond in the international capital market. Liberalizing private foreign borrowing would also help ease pressures In the money market.
- Easing the money market tension and reduction of the interest rate structure of the banking system will require concerted efforts in the following areas: (i) reduction of the NSD interest rate structure significantly and link it to the market interest rate structure; (ii) enforcement of contracts to reduce the volume of bad loans held by banks;

- The continued weaknesses in the financial sector due to major governance problem in public owned banks and the growing loan losses across the banking system needs to be addressed forcefully with strong political backing. Allocation of additional large sums for capitalizing the state-owned banks without significant efforts to improving governance is certainly questionable and send wrong signals.

Concluding Remarks

- The reduction in corporate tax rate only for the financial sector appears at odd with the state of governance in the sector and gives rise to the perception that the public money (tax reduction) is being used for rewarding the continued mismanagement of the sector. There should be a condition that only those banks which will reduce their average lending rate to below 10% should be eligible to receive the tax break.

- The current state of high protection appears inconsistent with a dynamic export-oriented economy growing at 7%+, which is all set to graduate out of LDC status in a few years and aspires to become an Upper Middle Income Country by FY31. It is high time for lowering protection and making it time-bound.

THANK YOU