

Terms of trade gains: Silver lining amidst dark clouds

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By *Dr. Zaidi Sattar*

In this climate of doom and gloom, the twin global shocks of output and trade have produced some unexpected windfall gains for all segments of the Bangladesh economy – producers, consumers, and the government. This gain comes from the collapse of global commodity prices. The World Bank’s Commodity Market Review for low and middle income countries shows that, compared to July 2008, energy prices tumbled more than 50 per cent as of February 2009, while non-energy commodity prices declined by over 33 per cent. On average, commodity prices in March 2009 were 17 per cent below their levels for the year 2008. For Bangladesh, that translates into substantial savings on its import bill.

Table 1. Terms of Trade Gains from Global Commodity Price shocks

Estimation of Terms of Trade Gain in FY09

Average reduction in import prices (FY09 over FY08)	-16.8%
Savings in import bill	\$3.7 billion
Increase in export receipts (due to price increase)	\$0.283 billion
Total gain	\$4.0 billion
As % of GDP	4.5%

To be sure, the contraction of global demand which sent commodity prices on a downward spiral, has also contributed to a reduction in Bangladesh’s trade deficit – the excess of dollar value of imports over exports. A significant deceleration of imports can be observed since January, largely due to the fall in import prices, and exacerbated by some weakness in the manufacturing sector. A close review of the export data reveals that export prices, particularly of ready made garments (RMG), have held steady, though export growth has slowed. Consequently, the trade deficit is expected to shrink by about \$1.7 billion or 2.0 per cent of fiscal year (FY) 09 gross domestic product (GDP).

On a relative scale, we find that prices of imports into Bangladesh lost more ground than those of exports, resulting in a favorable terms of trade shock. In the jargon of international trade, terms of trade or TOT is the relative prices of a country's export to import. For an economy, a favourable terms of trade shock works like a positive income effect, enabling the economy to afford import and consumption of more goods and services. Alternatively, this results in a savings in the import bill.

For Bangladesh, the estimated terms of trade gain of \$4.0 billion in FY09 (Table 1) or roughly 4.5% of estimated GDP for the current fiscal year will help cushion some of the trade related shocks that the economy is facing or will face in the coming months.

These terms of trade gains will not be limited to the improvement in the balance trade deficit, but will be showing up in (a) increases in the current account surplus, (b) accumulation of foreign exchange reserves, (c) a lower budgetary deficit, and (d) budgetary savings that will create more fiscal space for additional public spending that might be warranted by deteriorating market conditions emanating from the global recession.

Thanks to continuing growth of remittances coupled with strong export performance, the current account of the balance of payments has been in surplus for the past four years – even in FY08, despite the huge negative terms of trade shock equivalent to 8.0 per cent of GDP. This year, though exports and remittances have slowed lately, all indications are that they will end the year with a minimum of 12 per cent and 20 per cent year-on-year growth. Together with the terms of trade gains, it is no surprise that the current account has been increasing rapidly, and is expected to reach \$1.1 billion by year end, which is equivalent to 1.5 per cent of GDP, thus creating some space for any expansionary policy. Though, in a floating exchange rate regime, this should have resulted in the appreciation of the exchange rate, we are aware of the intervention by Bangladesh Bank (buying US dollars) in the foreign exchange market, in order to prevent the appreciation; and that is leading to the accumulation of reserves, which could hit \$7.0 billion by year end if current trend persists.

Table 2. Fiscal Implications of Terms of Trade Gain

Items	% change in price	Import payments (US \$million)	Change in import payments(US \$ million)
Rice	20.3	574	116.4
Wheat	-27.2	534.5	-145.7
Petroleum products	-32.3	2886.9	-932.7
Fertilizer	-9.1	1217.3	-111.1
Savings from import payments			-1073.2
(% of GDP)			1.2

Source : Budget Documents , Bangladesh Bank, World Bank Commodity Markets Review.

Gains from improvements in Bangladesh's terms of trade also have significant budgetary implications. Data in Table 2 shows budgetary savings of over \$1.0 billion, which is nearly 8 per cent of budgetary outlay of \$14.3 billion or 1.2 per cent of GDP, as import payments on public procurement of food, fertilizer and petroleum declined. To that extent, the need for subsidies on these commodity accounts will also be lower. It looks like the budget deficit for the current fiscal year, originally estimated at 5.0 per cent of GDP, will be limited to a comfortable level of 3.9 per cent of GDP, thereby also curbing the requirement of domestic financing.

To sum up, by default more than by design, there seems to be some fiscal space in the budget for accommodating a modest stimulus package within the realms of macroeconomic sustainability. In the absence of any fundamental reform of tax laws and administration, revenue effort appears behind comparator countries and will remain so for the short-term at least.

Although revenue mobilization has shown no signs of improvement (except for FY08 due to the vigorous anti-corruption drive by the caretaker government or (CTG), significant shortfalls in ADP implementation year after year has left the fiscal deficit in the comfortable zone of 3.0-4.0 per cent of GDP for the past five years, where the sustainable deficit is estimated to be around 5.0 per cent. Add the terms of trade gain of roughly 1.0 per cent of GDP this year. That would create fiscal space of at least 2.0 per cent of GDP for a proper fiscal stimulus,

should that be needed. That might be the silver lining policymakers were looking for.

(Dr. Zaidi Sattar is Chairman, Policy Research Institute (PRI) of Bangladesh. Research support for this write-up was provided by PRI's Rubaiya Zaman. The writer can be reached at zaidisattar@gmail.com)