Interest rate challenge amid exchange rate dilemma

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There is widespread allegation from the business community that bank interest rates and charges in Bangladesh are too high. They also feel that the current weakness in the domestic economy is in part attributable to high interest rates which have adversely impacted investment and domestic economic activity.

This is an important national policy issue and will require careful review of many related aspects of the Bangladesh economy before making an informed policy decision in this regard. We all would like to see the lending rates to come down, but it must not be engineered by administrative interventions and has to be market-based and sustainable.

LIBERALISATION OF FOREIGN CURRENCY DENOMINATED BORROWING BY THE PRIVATE SECTOR: After a long period of virtual prohibition on borrowing from international market by the domestic private sector, BB in recent years has started to shift its policy. Until 2008, the domestic private sector, barring some special cases/circumstances, were not allowed to borrow from foreign sources, even though foreign borrowings could be made at lower lending rates than those charged by the domestic banks and other financial institutions.

Following an improvement in the foreign exchange reserve position of BB, the government decided to liberalise such borrowing in the year 2008 primarily for the import of capital goods of new projects and modernisation of existing projects, and for sectors defined in the country's industrial policy.

In the past six years, BB has allowed private firms to borrow $5.56 billion from foreign sources at lower interest rates of around 5.0%-6.0%. In its monetary policy for July-December FY15, BB has set the private sector indicative credit growth at 16.5 per cent for the second half of the year, with 2.5 percentage points of that coming from foreign borrowing.

Borrowing in foreign currency is not something new for a country like Bangladesh. In fact most countries in the region including India, China, Viet Nam and others have much more liberalised approach to foreign borrowing by the domestic private sector. Despite the shock experienced at the time of Asian Economic Crisis of 1990s, most East Asian countries have come back to liberalized foreign borrowing to enable the private sector to get financing at competitive interest rates.

For Bangladesh the journey has just started and hence a number of issues are being raised about its appropriateness, timing, sustainability etc.

The total loan approved for the private sector in Bangladesh has been increasing consistently from 2009 onwards. The amount of total approved loans increased from $0.412 million in 2009, to $1.55 billion in 2013, which was an increase of 277%. From 2011 onwards, the approval process for loans has increased significantly which indicates that BB is actively trying to open up foreign financing sources for the private sector.

A sectoral classification of the foreign loan portfolio of the private sector from 2009-2014 shows that the sector that received the highest amount was the telecommunication/ internet service provider (ISP) sector which accounted for 42.6% of the total. The second and third highest loan amounts was received by the Power and RMG/related products sector, which accounted for 18.6% and 12.5% of the cumulative loans for the period, respectively.

The highest recipient of foreign loans, the telecommunication/ISP sector, is exposed to relatively low risk due to most of them being parented by large international conglomerates. In comparison, most of the power sector and RMG sector projects are owned domestically.

A survey report of BB states that these loans were mostly been used for importing foreign capital machineries, expansion of existing projects and establishing new ones. The survey pointed to three major potential/actual difficulties in external borrowing:

l Exchange rate fluctuations: Companies which are not export oriented do not earn in foreign currency. Hence unfavourable exchange rate fluctuations lead to losses in local currency when servicing their foreign currency denominated loans.

l Borrowing from off-shore banking unit: One company which borrowed from the off-shore banking unit of a local bank, faced significant losses as the bank was unable to continue foreign exchange financing and switched to higher cost local financing.

l Lengthy procedures for loan approval: The loan application and approval process takes considerable time, which acts as a hindrance for some companies which require financing urgently.