Some thoughts on Bangladesh Bank’s next monetary policy statement

Wednesday, Jul 29, 2020

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12:00 AM, July 24, 2020 / LAST MODIFIED: 02:51 AM, July 24, 2020

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The next monetary policy statement (MPS) of the Bangladesh Bank (BB) will be announced at a time when the economy is in a deep recession, unemployment is high, millions of people and households have become poor overnight, and the infection level is still on the rise.

Economic activity has resumed but seriously handicapped by very low domestic and foreign demand and there is no end in sight for the flattening of the infection curve.

People (jobless workers) and entrepreneurs look to the government for help in pulling them out of the gut.

Various countries have undertaken massive fiscal and monetary interventions to pull their economies out of this devastating situation.

We also must acknowledge that as long as the elephant is in the room, i.e., coronavirus caseload is on the rise, private sector investment will not come back.

Businesses will not be able to operate with full capacity and economic activities will be limited to a sub-optimal level — well below the 2019 level in real terms (except for agriculture).

Fundamentally, what I would like to underscore is that the BB should not expect that the economy will be rebounding strongly, like after pushing a reset button beginning on July 1.

The central bank should not lose its credibility by projecting that economy will be growing at 8.2 per cent in real terms.

No country in the world can achieve this lofty goal in 2020 amid a pandemic.

At the same time, the MPS must clearly state that the BB would be following an expansionary monetary policy (MP) — by expanding its balance sheet — and accommodate the genuine credit needs of the economy in support of economic recovery.

HOW THE MONETARY POLICY SHOULD RESPOND TO THE CURRENT PANDEMIC SITUATION

The huge logjam created by any crisis of this proportion must be cleared with enough injection of liquidity for the wheels of the economy to start turning again.

How much liquidity will be needed will be extremely difficult to predict.

However, the BB should err on the side of injecting a little too much instead of injecting too little under current circumstances.

Close monitoring of the liquidity situation of banks, large enterprises and SMEs will be important in this regard.

In particular, the BB should look at how much credit has been extended to enterprises, including and excluding the unrealised interest accrual that has been capitalised into the outstanding loans by the banks.

The capitalisation of accrued interest will continue to grow fast as borrowers would not be able to service their debt properly and will continue to be protected by the BB regulations without impairment of their loan quality.

How much additional financing has gone to the enterprises of different types should be looked at continuously.

WHAT SHOULD BE THE APPROPRIATE MIX BETWEEN MONETARY AND FISCAL POLICIES IN THE CURRENT BANGLADESH CONTEXT

The policy response to the pandemic has been asymmetric in terms of the mix between fiscal and monetary policies.

While the BB is going to inject liquidity to the tune of Tk 74,000 crore, budget support for creating domestic demand and support for workers’ jobs and livelihood have remained modest.

Total budget subsidy embedded within the economic stimulus package was estimated to be only about Tk 3,000 crore and possibly another Tk 2,000 crore out of the interest held in the suspense account.

Unfortunately, the budget does not have domestic resources to provide a significant amount of income or livelihood support without making the already announced deficit even larger.

In my view, this is not a normal year and there was no reason for the fiscal deficit to be limited to 6 per cent of GDP.

It could certainly go up to 8-9 per cent for one year to boost up domestic demand and provide employment and livelihood support.

SHOULD WE BE CONCERNED ABOUT INFLATIONARY PRESSURE UNDER CURRENT CIRCUMSTANCES?

Generally, we would not expect significant inflationary pressure under the current deflationary situation.

Thus, non-food inflation is expected to decelerate in the coming months as house rent, wage costs and THE cost of many services are expected to decline or at best remain unchanged.

In contrast, food inflation as always will continue to be supply-driven and the government has to remain vigilant about accurate production and supply situation.

Rice price has increased in recent months contributing to the spike in food inflation last month.

There is no reason for the current boro paddy price to be at or above Tk 1,100 per maund in various districts even before the flood.

This is an indication of a potentially tight supply situation that may also get aggravated by the loss of entire Aus crop due to the ongoing flood.

The high paddy price, like in 2017/18, may give us a nasty surprise.

The government should go easy on domestic procurement and encourage the private sector to import 1-2 million tonnes of rice from India in the next 1-2 months through reduction of customs duty.

We want farmers to get fair prices, which should be about Tk 900-1,000 per maund of paddy.

On other supplies like fish, poultry, beef, fruits and vegetables, the issue is an efficient transport system and restoration of marketing chains amid the expanding coronavirus caseload.

The bottom line is that, if the government can keep rice price stable and lower than what it is now and help improve domestic transportation and marketing bottlenecks, there should be no upsurge in inflationary pressure.

WHAT SHOULD BE THE STANCE ON THE EXCHANGE RATE AND RESERVE MANAGEMENT?

On the exchange rate, the government has for long been following the policy of maintaining the nominal exchange rate virtually unchanged against the dollar. This did not help the export sectors including garment.

The government had to provide various budgetary incentives to partially compensate for this loss of competitiveness. The sooner we get out of this convoluted arrangement, the better it is for the budget and the export sector.

Recently, with the influx of remittance and a sharp decline in imports due to collapsed domestic economic activity, there has been an excess supply of dollar in the interbank market. This is not an unusual phenomenon.

India is also experiencing a surge in reserve build-up due to a collapse in domestic demand

and negative growth (-5 per cent to -9 per cent).

I fear that the Bangladesh economy is also going through a contraction (negative growth) though official data is not reflecting that.

India has massively built up foreign exchange reserves as their trade deficit has declined to a historic low. We are seeing a similar picture in Bangladesh.

The BB should take this opportunity to build up reserves at a fast pace — perhaps and if possible — by one billion dollars per month until the economy comes out of the guts.

India is accumulating at the rate of $12-15 billion a month. The consequent injection of liquidity would help increase deposit growth in the banking system and help expand credit to both the private and public sectors.

As regards the prime minister's desire to use dollars for financing development budget, as you know very well, the budget does not need dollar — it needs taka to finance its projects and other operations.

The government can borrow from the banking system, including also from the BB (which will amount to the creation of high-powered money) in taka to finance its development programme.

If it needs to import anything it can open letters of credit in taka and the BB and banks can provide the necessary foreign exchange.

The government budget does not have any use for foreign currency — what it needs is taka. The government must make efforts to increase the National Board of Revenue's collection by undertaking forceful and correct reforms — not bad reforms by listening to the vested groups.

The BB can, however, propose to establish a Sovereign Infrastructure Fund by diverting $5 billion or so to promote public-private partnership investment in major infrastructure projects.

The finance ministry and the BB worked out such a scheme in 2017, but for some unknown reasons, despite cabinet approval, it did not see the light of the day.

That proposal may be presented to the PM for reconsideration to promote $40-$50 billion worth of PPP infrastructure investment in the country.

WHAT IS THE OUTLOOK FOR RESERVE BUILD UP AND WHAT IS ITS IMPLICATIONS FOR LIQUIDITY MANAGEMENT AND DOMESTIC INFLATION?

In my view, Bangladesh has an opportunity to build up reserves, if possible, up to $0.5-$1.0 billion per month for the next six months.

This process of accumulation will inject an additional Tk 30,000-50,000 crore liquidity to the economy.

That would be a large amount and together with the planned refinancing facility will go a long way towards alleviating the liquidity problem and deposit growth of the banking system.

My personal feeling is that inflows of remittance will nose dive after a few months once the transfer of savings by the returning workers is completed.

Many workers in Saudi Arabia and other Gulf countries are without jobs and are sending their savings.

Nobody has gone outside Bangladesh as workers after February and the outlook for the coming months is quite grim.

So we have to protect our reserves for the days when domestic demand will pick up and imports will get back to its normal growth path.

Remittances may not be available in abundant quantities at that time.

I do not believe that liquidity expansion through reserve build-up will fuel inflation under current circumstances.

There will be no need for mopping up operations through the issuance of BB bills.

WHAT WOULD BE THE STRATEGY FOR GROWING OUT OF THE HUGE UNDERLYING BUILD-UP OF DEFAULT LOANS?

The default loan situation of banks will certainly get much worse once proper reporting is resumed.

At present, banks are capitalising the unpaid interest obligations, thereby artificially fuelling domestic credit expansion to the private sector in the reported data.

The banks’ default loans are certainly going to increase by at least Tk 60,000 crore or more by the end of the year.

Banks should be heavily provisioning against such an outcome and the BB should encourage and mandate the banks in going toward that approach.

The BB should not ease its macro-prudential conditions like credit reserve ratio, loans-deposit ratio and so on any further.

The central bank should prepare a contingency plan for merger, acquisition and liquidation of weak banks. It should have a strategy for dealing with massive delinquency of banks and non-bank financial institutions.

I do not support the public sector asset management company in a country like Bangladesh with serious governance problems.

This will simply allow private and public sector banks and financial institutions to dump their bad assets to this institution at inflated recoverable asset values and the government and citizens will be carrying the liabilities of the bad assets forever.

Instead, the BB should urge the finance ministry to create a regulatory framework for establishing private sector asset management companies and the financial institutions should deal with the private asset management companies without any risk/liability to the public sector.

WHAT NEEDS TO BE DONE BY THE REGULATOR REGARDING SME LENDING?

SME sector needs special attention in every country. In Bangladesh, we made SME lending virtually impossible due to the 9 per cent cap on the lending rate, with a de facto 6 per cent cost of fund.

The 3 per cent spread is not at all attractive enough for banks to lend to the SME sector, give the risks associated with such lending and the high cost of administration in managing such portfolios.

The BB has finally agreed to reduce the partial risk guarantee for SME loans at a fee of 0.5 per cent (from the originally proposed 2 per cent). This is welcome.

I believe, in this moment of crisis, more should be done to promote SME lending.

Either the BB can allow the lending cap for SMEs to be increased to 12-13 per cent or provide subsidy to the financial institutions for SME sector lending in the amount of 3-4 per cent per annum. The subsidy could come from the finance ministry or the BB itself.

Similar issues exist with regards to cottage and micro enterprise (CME) lending through microcredit institutions.

The BB should look into the problems seriously if it wants the credit to be disbursed to the CME sector expeditiously.

STIMULUS PACKAGE AND ITS CLOSE MONITORING

I welcome the initiative by the BB to put pressure on the banks to disburse most of the stimulus package related loans to affected companies within August.

While this timeframe is indicative, the BB should put in place a monitoring cell with representatives from the finance ministry, banks and the relevant sectors.

The committee should meet with sector representatives and banks every week to monitor the flow of loans based on daily reporting by banks in prescribed formats.

A progress report should be prepared by the monitoring cell and disseminate that to the stakeholders along with media every two weeks.

The progress report should review the performance of each bank by sector (SME, agriculture, large industries etc.) and also identify the impediments, if any, based on stakeholders' consultations or inputs.

The monitoring cell should also help identify whether the allocated funds are adequate for the demands of the sectors and make recommendations in this regard.

The sectoral allocations announced should be seen as starting points and the endpoints should be determined based on sectoral demands and the state of recovery of the economy and the sector.

AUTOMATION OF BB AND THE BANKING SECTOR

Finally, I would request the BB to take the opportunity of the pandemic to move fast towards paperless banking transactions and operations.

All submissions to the BB should be mandated to be done electronically and the authorities should prepare the BB infrastructure and staff accordingly.

There is no reason for banks to submit bundles of papers to the BB regularly.

The BB should set a target for making all banking-related transactions in the paperless form within three years and force all banks and the central bank staff to undertake necessary preparations in that regard.

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