

## Talking monetary policy

Monday, Feb 2, 2009

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Bangladesh Bank (BB) issued its Monetary Policy Statement (MPS) on January 14. The MPS almost went unnoticed, except for the envisaged surge in credit to the public sector and a decline in the growth rate of credit to the private sector envisaged for the second half of FY 2009. Certainly it is not a careless mistake on the part of BB to program a surge in credit to the public sector to 27.25% in FY2009, compared with about 12% in FY07 and FY08. This surge is consistent with the estimated budget deficit of 5% of GDP, reflecting the expansionary stance of FY09 policy. However, it is not clear how the fiscal deficit target will be achieved with revenue growth already well below the budgetary revenue target of Tk. 545 billion and the bleak revenue outlook, with import prices declining. The decline has barely been reflected in the revenue data through November, but credit to the public sector has grown by 23% compared with 9.2% in the first half of FY08. Thinking that saving because of petroleum subsidy would offset the decline in revenue is simplistic. Not only will the revenue shortfall be larger than the saving in petroleum subsidy, there is also no reflection of the reduction in fertiliser prices on public sector borrowing. At Tk 2757 crore, this measure alone may increase public sector borrowing by 4.7 percentage points over the growth shown in the MPS. BB is not responsible for the possible worsening of the fiscal deficit, but it has the

responsibility of reflecting the potential impact of such borrowing on the monetary policy. The MPS should state the risk to the monetary program targets emanating from the fiscal side, and the cost of funding new measures. The projected decline in the growth rate of credit to the private sector in the second half of FY09 by almost 6 percentage points is also puzzling. The argument that “with no further seasonal spike in liquidity demand in the second half of FY09, broad money and domestic credit growth paths are expected to remain close to their program paths...” does not appear convincing because of two factors. First, credit expansion to the private sector in the second half of the fiscal year is usually higher than in the first half. Taking a three-year average, growth of private sector credit in the second half (21.6%) exceeds the rate of expansion in the first half (17.3%). Second, the MPS states that the rate of real economic growth would be 6.5%. Since this position rules out any slowdown in economic activity in the second half, why would credit expansion be slowing down in that period? The tightening of credit in the second half of FY09 is also difficult to reconcile with maintaining a private sector led growth strategy. Given the seasonal pattern, “appropriate active use of the repo and reverse repo tools” will lead to a tightening of credit to the private sector in the second half of FY09 if BB really wants to achieve the quantitative targets. Would it not be appropriate for BB to alert the public about the potential monetary tightening that may be needed to bring monetary expansion in line with the envisaged targets? The final untold story in the MPS relates to the priority accorded to the “expansion of relative shares of supplyside loans such as those for agriculture and SMEs, and not of non-essential demand side consumer loans.” While agreeing with this stated priority, we could not find any statement on how BB aims to

achieve this under the current market-based system. It does not require much imagination to presume that BB would probably resort to moral suasion or “arms twisting” to encourage banks to lend more to the priority sectors and contain consumer lending. Since such administrative measures have their limitations, BB may consider increasing the risk weights for consumer lending so that banks would be forced to provision for such risky lending. The economic outlook has changed in some important areas since the original monetary program was formulated in the context of the budget, perhaps more so due to the government’s announced policy priorities. BB’s new MPS should entail a corresponding shift in the stance of monetary policy and also highlight the risks factors, which may potentially undermine the stated monetary policy objectives. Spelling out the untold stories underpinning the monetary developments would have certainly enhanced both the quality and objectivity of the MPS.

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