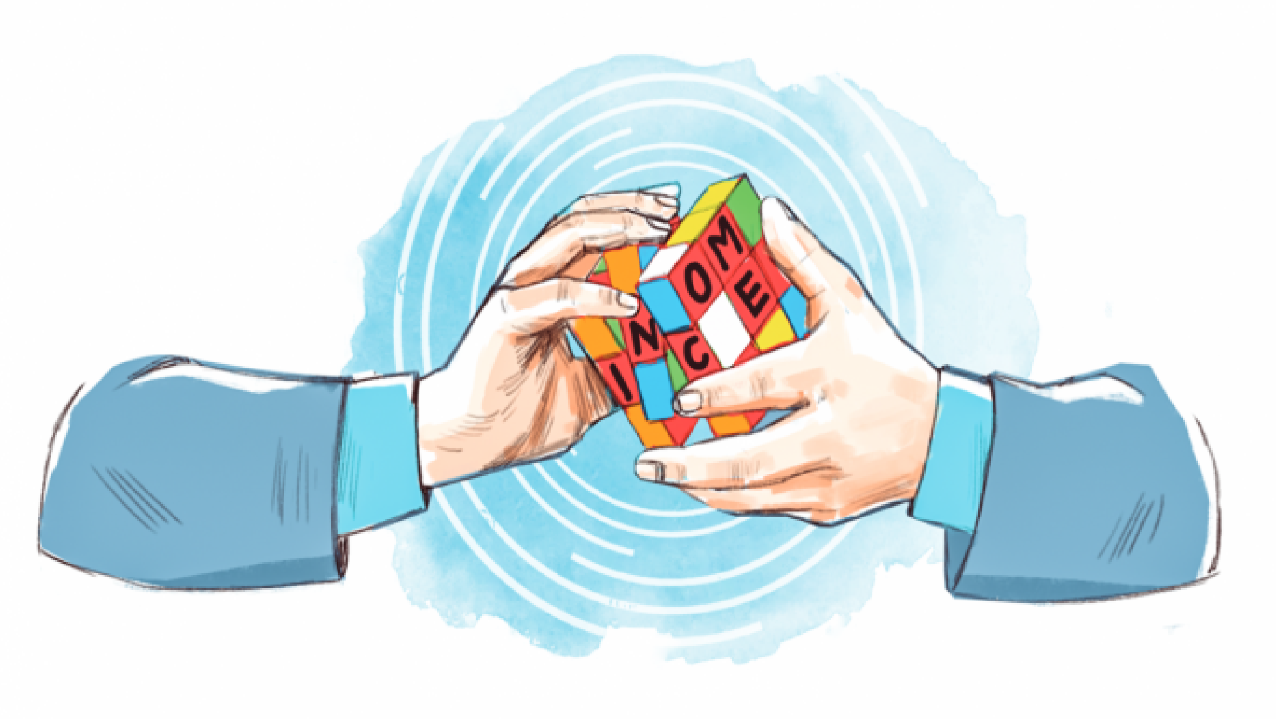

Twin shocks call for stronger domestic policy response

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By *Dr. Ahsan H. Mansur*

For Bangladesh, the main problems are internal in nature, which did not happen overnight. This is a result of our systemic failure to address the problems, and even now we are not properly addressing them

The year 2022 has been a tumultuous time for all nations, and coping with the global economic shocks has been difficult. The global economy was not prepared for the twin shocks. We were already accustomed to Covid-19, but the post-covid supply disruptions caused by lack of workers and shortage of ocean-going vessels were not anticipated.

Ships lined up at the Los Angeles Port, but very few workers were there for unloading those ships. All major international airports including Heathrow airport experienced severe shortage of security personnel and airlines could not increase the number of flights as rapidly as the air travels surged due to shortage of pilots and flight attendants and maintenance crew. There were severe shortages of workers in the service sectors. Opening up of businesses did not bring workers back.

In the US, millions of jobs are still open, but people are not returning to work. Many, rather, are taking early retirement. This was unanticipated. We had assumed when covid would go away, supply would increase. That did not happen so. Demand went up, but supply did not due to supply chain disruptions at every stage, which spiked prices.

Then came the Ukraine war, which led to a second round of price shocks.

But both shocks are now unwinding. For example, in case of Russian oil, everyone assumed oil exports from Russia would come to a halt, oil prices would reach $200 per barrel, but Russia is selling its oil. What happened is that sourcing and destinations changed. The crude they previously sent straight to the EU is now being sent to India and China. This reorientation took some time, but that is almost complete. Both Russian and Ukrainian wheat and corn are now reaching all destinations under special arrangements.

It is a reset. Economies, companies, and corporations are readjusting to the reorientation regarding oil, wheat, cooking oil. The economy is adjusting to political realities. I believe that in 2023, if current trends persist, there will be a return to normalcy on the supply side. Except for climate change induced effects which are yet unanticipated and that can have another round of havoc.

China is realising that the zero-covid policy won’t work; people’s life and economy cannot be stopped any more. Supply situation is going to improve. I am cautiously optimistic about the global commodity price situation in 2023 unless something new happens.

So then where does the problem lie? The global economy is returning to normalcy. Since demand and prices have increased, supply will increase too. People are losing money from their pockets, so they have to come back to work. The external shock is being overcome.

The problem is that the value Bangladesh currency has fallen by 25%. In the short term, our internal problems, which have been in the making for 12 or 15 years, have accentuated. This did not happen overnight. This is our systemic failure in addressing our internal problems and even now we are not addressing them in any significant way.

One of our biggest problems is the poor tax-to-GDP ratio (below 8% of GDP), which will decline further in the current fiscal year. The government is saying they are working on it, but we don't think it will work. That is not the reform we want to see. The government is blindsighted in this regard. It seems listening to NBR officials, not the ones who are actually suffering. This leads us toward a severe debt burden.

Foreign debt has already tripled in recent years. This was not supposed to happen. We will be in trouble if this increase continues at this pace. We have survived so far because Bangladesh has had a very strong macroeconomic foundation built over several decades. We do not want to reduce development or social expenditure either, so we have to boost resource mobilisation. Since the pace of government borrowing should come down, tax revenue has to be increased.

The second biggest problem is the dollar crisis. First we need to understand why it has happened. Remittance, export or import? Import had gone up in FY22 at an unsustainable pace, but that has been addressed to a degree through import compression. At the same time the levels of imports have to be at levels commensurate with the size of the economy and its growing needs. We have to increase exports too. Positively, we are doing that due to the depreciated exchange rate, while lockdowns and supply disruptions in China and Vietnam are pushing buyers towards Bangladesh.

Concern remains regarding remittance. Remittances increased in FY21 because of the 2.5% incentive is a complete misinterpretation. That's not why it went up. It increased because normal capital flight did not occur during the Covid-19 lockdowns as people could not go abroad or travel for education, treatment, etc. So about $8 to $10 billion was saved. Where did these savings go? Money changers could not get this fund since nobody was travelling to Bangladesh. So the whole amount came through the formal channel and ended up in Bangladesh Bank in the form of reserve buildup. And that's why we got $24 billion remittance in FY21 in the midst of Covid-19.

Remittance flow right now is back to its normal range. Incentive is still there, so why has it gone down? It has gone down from $2 billion per month to $1.5 billion. It should have gone up in the post covid period as we are sending much more workers abroad. In 2022 (January-December), more than 1.1 million workers went abroad. But we are still not getting enough remittance.

People are going to the Middle East, which is booming. Despite that, remittance is decreasing from there. Saudi Arabia used to be our number one remittance source. But the US has topped the list because from the US people are sending through the banking channel and there are no “Hundi Walas” in the US markets.

The EU economy is near recession. But our RMG will still do well in exports because strong demand in ports will benefit from the substitution of Chinese apparel products.

Gas prices fell down recently, but the main reason is warm weather in Europe and North America. Stock of gas in Germany and other European countries have reached record levels. They were preparing for a cold winter but that did not happen so far. Ships were moving around the EU to offload their energy stocks. So they reduced prices and Bangladesh also bought a few shipments from them. These are opportunities that appear and disappear.

In the midst of scarcity, there is plenty opportunities in the gas sector too in 2023. But for gas, the demand and supply situation may turn bad again until more permanent new LNG supplies from North America start flowing to Europe.

Inflation has gone up. But it has been neglected by our central bank in contrast to other global central banks. We did not take any effective anti-inflationary measures. The authorities are counting on the positive supply response in rice and other winter crops or vegetables. The government is hopeful, and there is merit in that, as the Aman rice crop recorded a bumper harvest, while meat, egg, fish supplies are also going up, the inflation rate may come down in the near term through the winter months. But there are issues with the level of inflation in the longer term.

Our balance of payments situation is passing through a difficult period. Bangladesh Bank’s foreign exchange reserves are declining steadily despite serious import compression.

Bangladesh Bank is selling its reserves and that has contributed to loss of domestic taka liquidity. Liquidity is tight in the market. The Financial account of the BOP has turned negative compared with $13.7 billion surplus in FY22 and $14 billion surplus in FY21.

This huge outflow of funds from Bangladesh economy is a major source of our payments and reserve problem. To reverse this outflow in 2023, we ultimately need to get rid of the 9% lending rate cap and also unify the exchange rate in the interbank foreign exchange market. Already the central bank is showing flexibility in some areas. Broadening it will result in better money management.

The dollar crisis is still persisting. Central bank should not fix the exchange rate and interest rates like before. The exchange rate of dollar vis-à-vis taka has to be based on the market. There are lots of pressures in the foreign exchange market: there is a huge amount of LCs (quantity still unknown) which have matured and cannot be settled due to dollar shortage; there is a huge pent up demand for imports and LCs cannot be opened leading to large drops in the volumes of imports of industrial inputs, basic food supplies, capital machineries etc.; the short-term debt of the private sector ($11 billion) cannot be paid and should be rolled over creating pressures in the market; and unless the financial account of the BoP turns positive it would be difficult to restore balance in the foreign exchange market.

Under these circumstances, the foreign exchange shortage is not expected to disappear soon and may last at least for five to six months, or even longer. We hope the authorities will adopt proper monetary and fiscal policies to stabilise the economy from the demand side, and encourage reflow of capital from the international capital market (through the financial account) by providing support to the Taka through higher interest rates.

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