# Kamal puzzled by stock investors' behaviour

STAR BUSINESS REPORT

Much hue and cry is made every time the stock market falls, a sight not seen anywhere else in the world, said Finance Minister AHM Mustafa Kamal yesterday.

"Even if the index comes down to zero from 1,000 no one abuses or attacks the securities market regulator anywhere in the globe. They don't break cars or come to the streets," he told reporters after a meeting of the cabinet committee on purchase.

Kamal's comments come as the stock market crashed to a three-and-a-half-year low under his watch as the finance minister.

The finance minister's job is to strengthen the economy and to monitor whether the companies and banks are manipulating the capital market or not, he said.

He is also responsible for checking whether the companies are announcing dividends properly.

"The kind of misdeeds I have seen when I took charge as finance minister is not taking place anymore."

Awareness should be raised among retail investors about the risks related to trading and the misconceptions, he said.

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**Finance Minister AHM Mustafa Kamal talks to journalists after a meeting of the cabinet committee on purchase in Dhaka yesterday.**

The government previously tried but could not implement single-digit interest rates for deposits and lending.

"This time we will be stricter in ensuring that banks maintain the rates."

The lending rates hover between 2-3 percent worldwide, whereas it is as high as 14-15 percent in Bangladesh, which is a major barrier to boosting industrialisation in the country.

"Investment will get a boost if these rates are implemented," he said, adding that private sector credit growth has been sliding as entrepreneurs are holding off their investment plans for the single-digit interest rates to take effect.

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# ICT Division seeks Tk 50cr for Startup Bangladesh Co

MUHAMMAD ZAHIDUL ISLAM

The ICT Division has decided to write to the finance ministry and seek Tk 50 crore for Startup Bangladesh Company Ltd (SBCL) after the government gave its nod to the new company to give a boost to budding businesses.

SBCL will get the fund from the Tk 100 crore the finance minister has allocated for startups in the budget for the current fiscal year.

The cabinet gave the final nod on the memorandum of the articles of SBCL on Monday.

"The government has secured Tk 100 crore for startups but we haven't had much of time to spend all of the money. So, we are going to take Tk 50 crore from the allocation," Zunaid Ahmed Palak, state minister for ICT, told The Daily Star.

The government has targeted to bankroll 1,000 startups. As part of the plan, the ICT Division has already provided Tk 7 crore to 126 start-ups as a grant and has received another Tk 4 crore for them for the second round of funding.

"We have also selected another 115 startups for funding," Palak added.

From the expected fund, SBCL is planning to provide Tk 10 lakh initially as seed money to each of about 200 local startups.

A start-up is a young company founded by one or more entrepreneurs in order to develop a unique product or service and bring it to market. By nature, a typical startup tends to be a shoestring operation, with initial funding from the founders or their families.

Typically, banks are not comfortable with investing in digital service companies as they have no fixed assets and carry higher chances of not turning out to be economically viable ventures, officials of the proposed company said.

The government started to work with startups in 2016 and now the initiative has taken a shape.

"Our ultimate target is to develop an entrepreneurial startup culture in the country. That's why we are funding good number of companies," Palak said.

"If only a single company can hit the global market from this basket, it will be huge for the country."

So far, the Startup Bangladesh project has disbursed funds as grants to the startups but in the next phase of the funding, it will own share in the companies, ranging from 5 percent to 49 percent depending on the valuation, according to Syed Mujibul Haq, project director of the Innovation Design and Entrepreneurship Academy (iDEA) under the ICT Division.

# Back to square one

ZAHID HUSSAIN

IT'S deja vu all over again. On June 21, 2018, Bangladesh Association of Bankers (BAB), a platform of private banks' owners, agreed to cap the interest rate on deposits at 6 percent and the lending rate at 9 percent from July 1, 2018. This did not work despite significant monetary and fiscal policy support. Other than continued weakening of the financial health of the sector, not much has changed a year and a half later except that the BAB has once again announced bringing lending rates down to 9 percent with deposit rates capped at 6 from April 1, 2020. Back to square 1 after a Bangladesh Bank (BB) committee spent days to recommend capping lending rates at 9 percent for "industrial/manufacturing" sectors only while leaving other lending rates and all deposit rates free for the market to set on a commercial basis.

The headwinds that curtail the possibilities for investment and growth in Bangladesh are well known. In the banking sector, most of the headwinds are our own making. What is different this time that could make us believe that the same old wine in the same old bottle would taste better? Hard to figure except, according to BAB, there is fuller government support! This is a new known unknown because "no additional support will be required for banks for implementation of the decision", according to BAB again. What does "fuller support" mean then? You get a hint from the Finance Minister: "government will provide support to banks for a while" to tide over losses caused by the lower lending rate. Exactly half of state-owned entities deposits have to be held in private banks at 6 percent.

Whether shopping for business or housing loans, borrowers are naturally concerned about rates and terms to make sure they do not pay too much for the use of someone else's money. It is therefore no surprise to see business leaders wasting no time to welcome the move and even seek preponement of its implementation.

What is the economic case for ceilings on interest rates? Do ceilings always result in lower rates without reducing the amount of available credit? Do some borrowers tend to benefit from ceilings more than others?

The argument justifying the 9 percent cap is that high interest rates are driven by substantial risk premia on loans. Lenders calculate the risk premium based on the probability that a borrower repays the loan and the loss in case of default. It is difficult to accurately assess these parameters due to lack of information on firms or households with no or little credit history and recoverable collateral. Unable to identify a borrower's potential for repayment, banks charge an interest rate which is more attractive to the higher risk client. This feeds back into higher risk premia and lending rates. The problem is particularly acute when banks lack proper tools to price and manage risks efficiently. Moral hazard occurs when clients borrowing at this high rate make riskier investments to cover their borrowing costs. This also increases default probabilities and risk premia.

Caps on interest rates might alleviate this vicious cycle by altering the interest rates that would otherwise be charged, making them also attractive for more credit worthy borrowers and reducing the pressure to engage in high risk projects to cover the borrowing costs.

On the surface, this seems logical. However, there is more to it than meets the eye, particularly the unintended consequences which can undo in practice what appears impeccable in theory.

When a ceiling is introduced, it may have no impact on the credit market, or it may alter the way in which the cost and quantity of credit are determined. Exactly what happens depends on where the ceiling is relative to the initial market rate. When the ceiling is above the market rate of interest, it has no effect at all. When the ceiling is below the market rate of interest, as is the case in Bangladesh now, it can affect the market outcome in many different ways.

A ceiling below the market rate is binding if enforcement is perfect. When binding, the ceiling rate becomes the rate of interest charged. But it may also decrease the quantity of credit supplied. Like any other business, if a lender does not recoup its costs and earn an adequate return on its resources, it will put those resources to work elsewhere. Since the amount of credit offered at the ceiling rate will not satisfy all those who are willing to borrow at the 9 percent rate, excess demand is created, giving rise to a situation in which the reduced amount of credit must be rationed among borrowers by some means other than the ceiling rate.

Bankers may set rigid loan terms, screen borrowers more rigorously, increase non-interest fees and charges, or concentrate the impact of ceilings on certain borrowers. Imposing more stringent loan terms such as shorter maturities and higher minimum loan size reallocates credit toward those who are able to afford larger down payments or larger monthly payments. While a ceiling may reduce the explicit interest rate, it may not result in lower overall costs of borrowing even for those able to obtain loans. Several studies internationally on the effects of restrictive interest rate ceilings have established that loan terms do become less favourable to borrowers. No matter how elaborate the monitoring mechanism may be, banks have little difficulty demonstrating ceiling compliance to the regulator using creative accounting.

Basing lending decisions heavily on individual characteristics, such as borrowing history or income, without the flexibility of adding risk premiums, can ration credit away from new borrowers who might be willing to pay higher than 9 percent. Low priced credit is not useful to those who cannot meet the requirements for obtaining it. Usually, when lenders ration credit by some means other than interest rates, first-time borrowers, small borrowers, low-income and high-risk borrowers find it more difficult to obtain credit. The creditworthy borrowers, on the other hand, may obtain more credit than they would have at normal market interest rates.

The willingness to provide credit at the ceiling rate depends also on the cost of funds and the prevailing "risk-free rate" in the economy.

To reduce costs of funds we have 6 percent cap on deposit rates and to ensure fund availability to the private commercial banks (PCB) we have 50 percent government deposit requirement. Shifting government deposit from state-owned banks to the PCBs is a zero-sum game for the banking system as a whole. It does not increase the total funds available to the banking system. It is not clear how much the PCBs will benefit since the average deposit rate is below 6 percent currently as remittances have boomed and the net sales of the National Saving Certificates has declined significantly. The deposit rate ceiling does not make a difference to bankers when they are getting deposits at a lower rate any way. The 6 percent cap, if binding, may hurt depositors who have no other option but to keep their money in the bank.

Risk free lending options to bankers have become attractive recently. Between July 2018 to November 2019, risk free rates have increased by at least 3 percentage points, with rates on 5-year BGTB approaching 9 percent and 10-year BGTB above 9 percent. If the government is offering risk free lending opportunity to the bankers at close to or even above 9 percent, why would bankers be interested to lend heavily to risky borrowers at 9 percent?

Political economy consequences are important too. A combination of the presence of state-owned banks and interest rate controls can turn into a mechanism for ensuring that cheap credit flows only to specific borrowers. Unconnected and small firms may get very little benefit from the policy. As a result, the bottom tier of borrowers could lose access to credit. The sustainability of growth and inclusion may then be seriously jeopardized by lowering economic efficiency if credit worthy borrowers with no elite connection are excluded.

These practices may erode the benefits that the 9 percent cap aims to provide. Since the intended policy goal is to reduce the overall cost of credit in the economy, the solutions should be based on the causes of the "excessive" rates.

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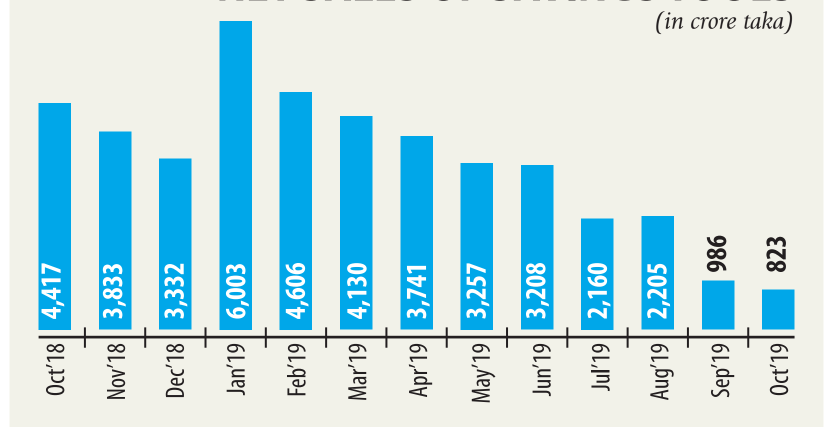
**EXISTING INTEREST RATES OF BANKS** (in%)

| | |
|---|---|
| Farm loans | 4.00-9.00 |
| Term loan to large, medium industries | 6.00-16.50 |
| Term loan to small industries | 8.00-20.50 |
| Working capital to large, medium industries | 6.75-17.00 |
| Working capital to small industries | 8.00-17.00 |
| Export credit | 6.75-7.00 |
| Trade financing | 6.75-16.00 |
| Home loans | 7.00-16.00 |
| Consumer credit | 7.99-20.00 |
| Credit to non-banks | 6.75-20.50 |

SOURCE: BANGLADESH BANK




# Oil posts biggest yearly rise since 2016

REUTERS, *New York*

OIL prices fell 1 percent on Tuesday, the last trading day of the decade, but notched the biggest annual gain in three years, supported by a thaw in the prolonged US-China trade war and ongoing supply cuts from major oil producers.

Brent gained about 23 percent in 2019 and WTI rose 34 percent, their biggest yearly gains in three years, backed by the recent breakthrough in the trade talks and output cuts pledged by the Organization of the Petroleum Exporting Countries (OPEC) and its allies.

Forecasters do not expect oil prices to move sharply in either direction next year. Brent crude is expected to hover around $63 a barrel, a Reuters poll showed on Tuesday, down modestly from current levels, as OPEC production cuts offset weaker demand.

Over the past year, increased US oil output offset the supply reductions undertaken by OPEC, led by Saudi Arabia and stemming from US sanctions on Venezuela and Iran. Lackluster demand, including in developed economies, remains a primary concern headed into 2020.

REUTERS/FILE

**Crude oil tanker Maran Cassiopeia is pictured in the waters off Tuas in Singapore.**

"Oil prices, though largely expected to trade positive, will face headwinds from subdued global growth momentum and robust US shale output levels in the first quarter (of 2020)," said Benjamin Lu, an analyst at Phillip Futures.

US crude oil production in October rose to a record of 12.66 million barrels per day (bpd) from a revised 12.48 million bpd in September, the US government said in a monthly report. The pace of growth is expected to slow in 2020.

Brent crude LCOc1 fell 67 cents, or 1 percent, to settle at $66.00 a barrel. US West Texas Intermediate (WTI) crude CLc1 fell 62 cents, or 1 percent, to settle at $61.06 a barrel.

On Tuesday, trade volumes were low with many market participants away for year-end holidays, amplifying the market's moves.

# China to cut reserve requirement for banks

AFP, *Beijing*

CHINA'S central bank announced Wednesday it was cutting the reserve requirements for banks, freeing up about $114 billion to boost lending and spur the slowing economy.

The People's Bank of China will cut the reserve requirement ratio (RRR) on January 6 by 50 basis points, it said in a statement, reducing the amount of cash banks must hold.

Lowering the RRR for banks frees up more money for lending to small businesses.

The central bank cut the requirement three times in 2019 to bolster the Chinese economy, which grew at the slowest rate in three decades last year.

State news agency Xinhua said the latest cut will "offset the impacts of cash demand" ahead of the Spring Festival in late January.

Cooling domestic demand and a bruising trade war with the United States have contributed to the economic slowdown.

Washington and Beijing last month announced a "Phase One" trade deal, de-escalating their nearly two-year trade war as President Donald Trump reduced or cancelled some tariffs while Beijing promised to adopt trade reforms and buy more US farm exports.

The partial trade agreement will be signed in the middle of January, Trump said Tuesday, announcing that he will also travel to China for continued talks.