Debt mountain meets population cliff

MIKE DOLAN, Reuters

Hopes the world economy can grow itself out of the mountain of debt being accumulated during this year's pandemic shock may have failed to factor in the uncomfortable prospect of a peaking population within the next 50 years.

The sweeping Covid-19 pandemic, related lockdowns and resulting historic recessions have forced governments and companies around the world to borrow to bridge the gap, and left central banks with little choice but to keep debt servicing levels affordable.

The International Monetary Fund in June estimated public debt as a share of gross domestic product in advanced economies on aggregate will now shoot to record highs above 130 per cent this year and next, topping levels seen shortly after World War Two.

Even by the end of the first quarter of 2020, the pandemic-related scramble for credit had pushed total government, corporate and household debt more than 10 percentage points higher to a record 331 per cent of GDP, or some $258 trillion, according to data published by the Institute of International Finance. The figure for so-called "mature markets" is as high as 392 per cent.

The IIF also points out that due to Covid-19-related lockdowns corporate debt has soared, with $4.6 trillion of bonds sold in the second quarter alone compared with quarterly averages last year of $2.8 trillion.

With the United States Treasury conducting record sized 10- and 30-year bond auctions this week alone, no one's in any doubt there is a lot of debt piling up.

The U.S. Congressional Budget Office in May updated its long-range forecasts for government debt held by the public and reckoned that at $116 trillion by 2050, the public debt ratio was set to more double to 180 per cent by then.

Deutsche Bank meanwhile notes that the "central scenario" of Britain's official fiscal watchdog shows a 2070 government debt/GDP ratio of 418 per cent. During the austerity drive just five years ago, that same 2070 forecast was just 87 per cent.

"It's almost inconceivable that we'll reach that point, so something will likely have to give," said Deutsche strategist Jim Reid, opining on options from cutbacks to age-related pension and healthcare costs, to higher taxes, faster inflation, central bank bond buying or even - whisper it - default.

"Economic growth could bail us out but this will be tough given demographics."

Those long-run debt projections just collided with some equally alarming population statistics.

A new academic study of global fertility rates and their long-term demographic implications published in Britain's The Lancet magazine last month showed the global population is now set to peak at 9.7 billion around 2064 before falling by more than 9 per cent by the end of the century.

While that may be a relief for the environment, it has seismic economic growth and public debt implications.

Populations in some 23 of the 195 countries in the study - including Japan, Spain, Portugal, Thailand and Ukraine - are expected to halve by the end of the century and China could see a drop of 48 per cent. Another 33 countries are seen declining by between 25 per cent and 50 per cent. Both China and India should expect to see their numbers peak before 2050.

Add in ageing in countries forecast to see 25 per cent population declines and the ratio of those over 80 to those under 15 is expected to balloon to 1.5 from just 0.16 now.

"These population shifts have economic and fiscal consequences that will be extremely challenging," the study said. "All other things being equal, the decline in the numbers of working-aged adults alone will reduce GDP growth rates."

Of course, relative changes between countries are crucial.

Flattered by immigration, the population of the United States is expected to grow until mid-century followed by a moderate decline of less than 10 per cent of the peak by 2100. In terms of GDP rankings, that would see China rise to the top by 2035 but be superseded once more by the United States in 2098.

For the United States at least, where some argue a mini-youth boom is already underway, the near-term debt situation is workable as long as the Federal Reserve keeps the cost down.

"The math is not that challenging," said Barings strategist Christopher Smart, adding that if net borrowing costs can be capped at 1.5 per cent, then just 1.5 per cent GDP growth and 2 per cent inflation could see the debt ratio shrink by 2 per cent a year.

More worrying, he said, is the long-term willingness to pay.

And if that becomes a concern in the biggest economy in the world with a relatively manageable debt scenario, not to mention the ability to print the world's dominant reserve currency, then there is an even bigger headache elsewhere.

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REUTERS/FILE

Commuters wearing protective face masks are seen a day after the government announced the lifting of the state of emergency by the Covid-19 in large parts of the country including Fukuoka, southern Japan.

Commodity traders face rising finance costs as big banks pull out

REUTERS, London

Commodity trade financing by the world's banks is drying up at a rate not seen in more than 20 years, leaving small and medium sized firms most exposed, banking and trading sources said.

Banks are retrenching after the coronavirus crisis led to defaults by some trading houses, intermediaries in the global movement of oil, metals and agricultural goods which link producers and end-users, and also exposed a series of frauds.

This week Dutch bank ABN Amro, one of the biggest commodity trade financiers, quit the business after it was among the banks worst hit by the $3.8 billion default of Hin Leong, one of Asia's biggest oil traders.

"These things are cyclical, but now the pendulum is at an extreme not seen since the late 1990s," John MacNamara of consultancy Carshalton Commodities said.

About 80% of global trade is intermediated by trade finance, which covers the loans, most commonly in the shape of a letter of credit (LC), that are crucial for the movement of goods from wheat to gasoline and reduce payment risk for counterparties when cargoes change hands.

Credit facilities allow merchants to juggle multiple transactions, but with competition between banks set to fall, credit costs will rise for trading houses, which are typically highly leveraged and rely on trade finance.

Big banks seeking to reduce trade finance exposure are likely to favour lending to the well established large independent merchants such as Vitol and Trafigura.

Meanwhile, smaller players will likely see their options limited and their credit costs rise as they are forced to turn to second tier banks.

"Banks exiting will create a massive black hole for small traders and will increasingly put the oil market into the pockets of majors," a senior oil industry source said.

Trading and banking sources say others may follow ABN and that some banks have already frozen existing credit lines, letters of credit and new business.

Major traders have been big users of revolving credit facilities (RCFs), where a consortium of banks allow a company to repeatedly borrow up to an agreed upon maximum threshold.

However, banks dislike these loans as they are not only cheap for the borrower but also unsecured, with short maturities of usually no more than a year which must be renewed.

"ABN was not an individual failure but a market failure," MacNamara said, adding that traders had been pushing for cheap, unsecured RCFs at a time when commodity finance does not fit the forward-looking balance sheet modelling regulators require.

Outsourcing had also eroded the experience of back and middle office staff at banks which are key in making checks in less transparent emerging markets, he said.

While traders said losing a credit line would not be felt now, with many boosted by record quarters so far this year due to extreme oil price volatility, the pain will come later when commodity prices recover and credit line usage rises.

Trade houses only tend to use 50-75% of their bank credit lines, leaving a cushion in case commodity prices spike.

"The RCF pool will become smaller and costs will go up. Already we saw a Covid-19 premium in the latest round," a senior banker in natural resources said.

RCFs have short maturities, usually no more than year, and must be renewed. As a result of the coronavirus crisis, banks have asked for higher rates of interest.

StanChart executes Bangladesh's first-ever blockchain LC transaction

FROM PAGE B4

"If you want to name the top five advantage of this, they are paperless, real-time, low-cost, faster and error-free," said Naser Ezaz Bijoy, CEO of Standard Chartered Bangladesh.

Although it has been done locally, Standard Chartered would soon expand the service for cross-border exports and imports, he said.

For that, everything will be paperless except for some regulatory processes of the Bangladesh Bank and customs formalities.

Contour improves data transparency, removes administration costs and reduces friction in global trade, all leading to an overall increase in efficiency and reduction in costs for all parties, Standard Chartered Bangladesh said in a press release.

As one of the founding members of Contour, the multinational bank benefits from the network, which simplifies the LC process, delivering shorter settlement times, instant discrepancy resolution and simplified sanctions screening.

"We are very excited to offer our clients improved speed and reduced risks of settlement offered by platforms such as Contour," Bijoy added.

The global trade lacks a solution that drives out inefficiencies, improves data transparency and enables interoperability between all trade participants, said Carl Wegner, CEO of Contour.

The long-established elements of trade finance don't have sufficient integration, causing friction and unnecessary administration. These inevitably cause significant barriers for global trade growth, adding complexity, increasing cost and delaying the process for both banks and corporates, he added.

"The Contour network can overcome these issues, providing a consistent and reliable infrastructure for global trade to flourish, especially in countries like Bangladesh that count on LCs for a significant part of their trade volumes."

The recent transaction with Viyellatex serves to prove that a solution is out there and readily available for adoption, Wegner added. This is not the only blockchain-based transaction that British lender has in store for its clients.

Standard Chartered is also rolling out a blockchain-based service for expatriate Bangladeshis in Malaysia, the fifth-highest source of remittance for the country, enabling them to send money home on a real-time basis.

"The service will be launched soon and we have partnered with a local MFS provider and a Malaysian company," Bijoy said.

As per the arrangement, remitters will be able to send in their hard-earned money in real-time by opening a mobile wallet with Malaysian fintech firm Valyou, a subsidiary of Telenor Group.

The amount from Valyou would then be wired through Standard Chartered's operations in Malaysia and Bangladesh. Once in Bangladesh, bKash would distribute the funds, ending the chain of cross-border transaction that harnesses the power of technology.

This means migrant workers in Malaysia would be able to settle their cross-boundary transactions in real-time with just a few clicks on their mobile phone, in an arrangement not seen before in Bangladesh. Corda, the blockchain platform, would facilitate the transaction.

The platform, which was designed to bring transparency and trust to interactions while maintaining privacy and security, ensures data is shared only with the parties that need to know.

Little progress in recovering the Tk 18,253cr lost in financial scams in recent years

FROM PAGE B1

Khasru says the lender has now turned a corner. It has already recovered a good amount of funds from the defaulters.

"But it is too tough to realise the existing defaulted loans as the money was given out by grossly breaching the banking norms," he said.

In January 2017, with the view to stemming the corruption, the Bangladesh Bank even imposed an embargo on disbursing fresh loans.

"The central bank will permit us within this month to disburse fresh loans, a sign that the bank is now in a good shape," Khasru said.

Another sensational financial scam that rattled the entire country involves Jubok (Jubo Karmasangsthan Society), an MLM company that started in 1994 by providing micro-credit to its members and went on to set up more than 20 business outfits.

The organisation -- which spread its tentacles to telecommunications, housing and real estate development, tourism, health, ceramics, seafood, IT, nursery, agro-biotech industry and capital management by 2006 -- owes a staggering Tk 2,588 crore to its clients, according to probe reports.

And the clients may never see their money back as the government does not think it is worthwhile to pursue the issue.

A six-member probe body that was formed in January 2010 led by former BB Governor Mohammad Farashuddin recommended the government to constitute a permanent commission to return the money to the depositors.

Subsequently in 2011, the government formed another commission led by former Joint Secretary Rafiqul Islam to find ways to return the swindled funds.

In August 2014, the government formed a seven-member inter-ministerial committee to review the recommendations of the previous two commissions.

The committee, which handed in its report to the commerce ministry in December 2014, too called for a permanent commission. That commission has not been formed yet.

In September 2016, an inter-ministerial meeting took place at the finance ministry, where it was learnt that the government never pursued the issue with much seriousness.

"It's a dead issue," the then Finance Minister AMA Muhith told reporters after the meeting. "There's no scope to do anything about it afresh."

And the government has been silent on the matter since.

Another MLM was operating at the same time as Jubok and indulging in the same form of duplicity. That MLM was called Destiny Group and between 1998 and 2012 it made off with Tk 4,118 crore of clients' money.

The clients are yet to get back any fund.

Destiny Group MD Rafiqul Amin and Destiny Multipurpose Cooperative Society Chairman Mohammad Hossain have long been facing cases of fund embezzlement and money laundering.

The alleged persons also laundered money worth Tk 96 crore abroad.

In 2012, the ACC filed two separate cases against 53 involved people with the Destiny scam. But the cases are still pending and the ACC claimed it has yet to complete the process of the testimony of the lawsuits.

AB Bank puts Aman Feed's factory and land on sale for failure to pay loans

FROM PAGE B4

The company offered a 13 per cent cash dividend in 2019, down from 20 per cent cash and 10 per cent stock dividend announced in the previous year.

As on 30 June, sponsors held 63.26 per cent shares of the company while general public 24.24 per cent and institutional investors the rest, according to the Dhaka Stock Exchange.

"As both AB Bank and Aman Feed are listed companies, we will see if they are doing everything as per the securities rules. We will take steps if they do anything wrong," said Mohammad Rezaul Karim, BSEC spokesperson and executive director (current charge).

Stocks of Aman Feed closed at Tk 29.5 on the DSE on Thursday, up 3.5 per cent from the previous day.

Two-thirds new poor received cash support

FROM PAGE B4

A board under the PMO should be formed to manage the database and update it regularly so that it could be used in the future if required, he said.

The board would manage the country's SSNP, said the researcher.

The Bangladesh Bureau of Statistics is preparing a database of ultra-poor people. The people who are already on the list of the SSNPs would also be included in the list.

One of the obstacles that stood in the way of distributing the support was that not all potential beneficiaries have had NID cards.

The Election Commission is already working to give NID to all citizens in the country.

Distributing the cash support among the affected people through the government to person system within a short time was a major challenge, the finance ministry letter said.

Although the target to support 50 lakh affected families could not be reached, identifying the real recipients through multi-stage scrutiny, distributing the funds among them within the shortest possible time and executing the whole process without any controversy is an achievement of the government, it said.

The recent nationwide closure of all economic activities has doubled extreme poverty in Bangladesh, raising the number of the ultra-poor from 10.5 per cent of the population to 20.5 per cent as of June, the planning commission said.

As a result, the incidence of poverty increased from 20.5 per cent to 29.4 per cent as a considerable number of people lost their income due to the coronavirus fallout.

Due to the income shock emanating from the pandemic, 77.2 per cent of the vulnerable non-poor fell below the poverty line, according to a study of the Power and Participation Research Centre and the Brac Institute for Governance and Development.

About 13 per cent of the people have become unemployed in the country due to the pandemic, a survey of the Bangladesh Institute of Development Studies showed.

As per findings, 19.23 per cent of participants with income less than Tk 5,000 reported that their income was reduced by 75 per cent.

Another sign of economic rebound: sales of commercial vehicles

FROM PAGE B1

Business improved much in June and July compared with April and May, said Hafizur Rahman Khan, chairman of Runner Group, distributor of Eicher branded trucks.

"This was beyond our expectation," he said, adding that it will take time to return to the pre-pandemic level. In the first six months of the year, a total of 4,372 units of pickups and 2,229 units of trucks were registered in the country, according to the Bangladesh Road Transport Authority.

Cheap rawhides have nothing to do with high prices of leather goods

FROM PAGE B4

The official's views were echoed by Abu Eusuf, a professor of economics in the Department of Development Studies of the University of Dhaka.

The price of leather is very minimal in the whole production and marketing cycle of leather shoes, said Eusuf.

However, bank interest rates and the cost of availing finance, accessories, marketing, establishments, showrooms, labour and others are very high, causing prices of leather shoes to go very high, he said.

A shoe manufacturer always raises the price of a pair of shoes by Tk 1,200 to Tk 1,500 from the actual production cost to survive. As a result, the sales price of a pair of shoes stays fixed between Tk 4,000 and Tk 4,500 in the local markets.

Eusuf also blames the presence of synthetic shoes for prices of leather shoes being high.

The prices of rawhides remained low for the past two years mainly because tanners could not go into full production in the STIE and incurred significant losses while shifting from Hazaribagh to the STIE, he said.

The tanners are also suffering from a lack of financing from the banking sector, said Eusuf who has conducted research for long on the rawhide and leather industries in Bangladesh.

Many tanners and merchants have already turned bankrupt for failing to make good business from rawhide and leather products, the professor also said.

Bangladesh Competition Commission (BCC) is preparing to collect information from local markets to see whether any particular company, group or syndicate have been cheating customers to make hefty profits from sale of rawhide and leather goods, said its chairperson, Md Mofizul Islam.

Primarily, if any manufacturer can produce even 10 pairs of shoes from a piece of rawhide and sells each pair for Tk 4,500, the total value stands at Tk 45,000, he said.

If the production costs and other costs are fixed at Tk 3,000 per pair of shoes, the profit is Tk 1,500 from a pair of shoes in the domestic market.

But the price of a piece of rawhide now in Bangladesh is not even Tk 500, he said.

"We will start collecting information soon from the market. If the BCC finds anybody responsible for abnormal price hikes of shoes and leather goods, we will serve notices to them."

"The BCC will also find out whether any syndicate or vested quarter is involved in turning prices of rawhides abnormally low in the country," Mofizul Islam also told The Daily Star over the phone.

The high cost of production and high bank interest rates are resulting in the abnormally high prices of leather shoes in the country, said Mohiuddin Ahmed Mahin, president of the Bangladesh Finished Leather, Leather Goods and Footwear Exporters Association.

Manufacturers do raise prices by an extra Tk 1,200 to Tk 1,500 from the actual production cost of a pair of shoes, which ultimately leads to store prices ranging from Tk 4,000 and Tk 4,500, he said.

"Around 2.50 to 3 square feet of leather is required to make a pair of shoes but another 100 kinds of items are also needed," Mahin said. Of those, only thread is available in the local markets and most of the others are imported, he added.

Moreover, the average rawhide sourced from Dhaka is of 25 square feet while 20 square feet outside but the sizes shrink significantly after tanning in factories.

In summer the quality of rawhides deteriorates a lot and the quantity of available leather is significantly reduced. As a result, leather prices go up, he said.

So at the end of the day, the manufacturers fix high prices of shoes because of high gas and electricity bills, salaries and other costs, added Mahin.

Of the cost incurred for making a leather shoe, 30 per cent is for leather and the remaining 70 per cent for accessories, said Md Shaheen Ahmed, president of Bangladesh Tanners Association.

The accessories are pricier than the leather for which the prices of shoes are high in the local markets, he added.

High prices of shoes result form high costs of production, bank interest rates and raw materials like chemicals and salt, said Saiful Islam, president of the Leathergoods and Footwear Manufacturers and Exporters Association of Bangladesh.

Although the prices of rawhides are low in the local markets, that of tanned leather is not. For instance, a square foot of tanned leather was sold between $1.70 and $2.50 over the past two years despite a reduction in rawhide prices, he said.