Is the taka in free fall?

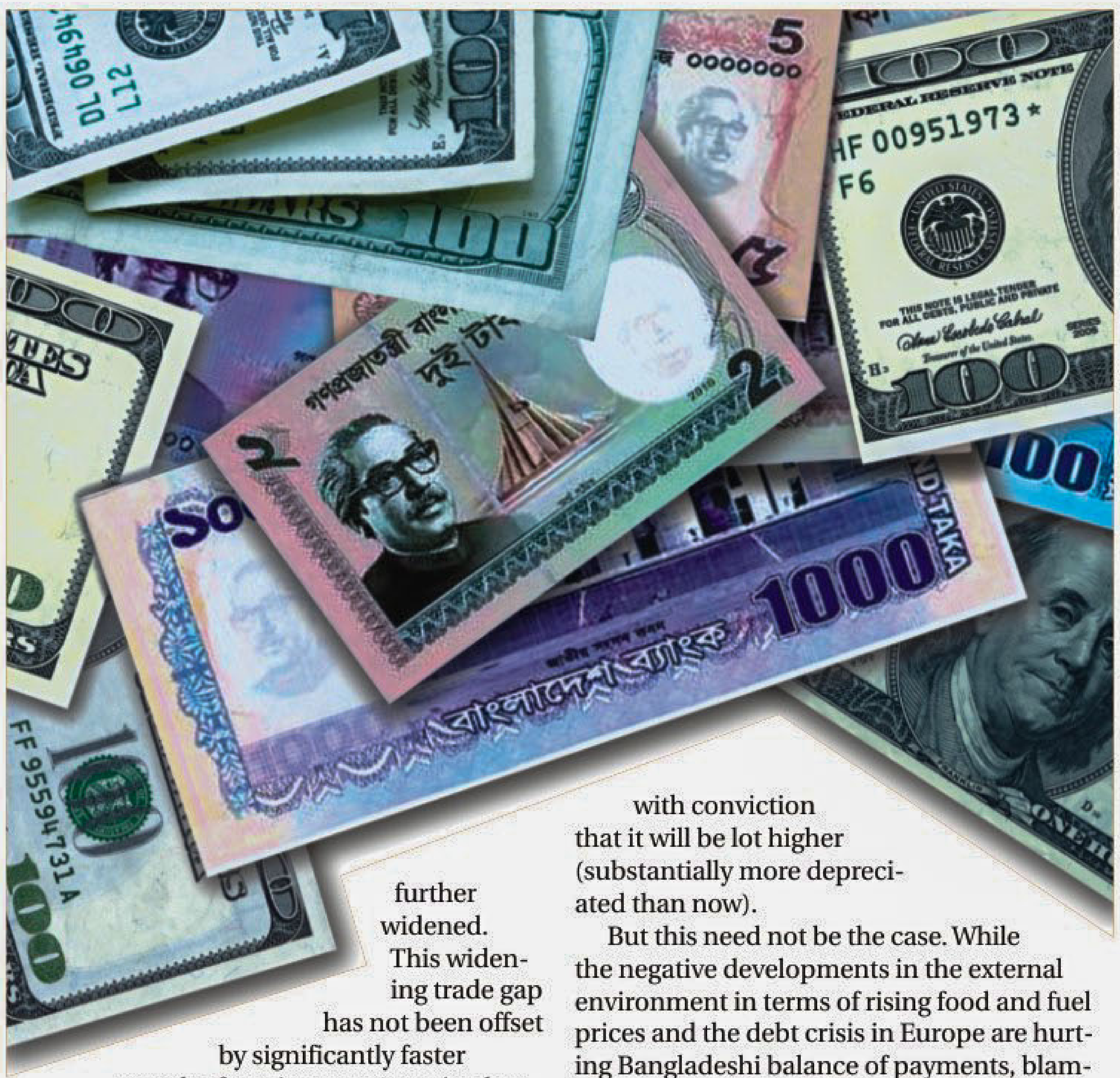
SADIQ AHMED

THE value of the Bangladesh taka in terms of the US dollar has been declining since July 2010. The fall has been steady but at a moderate pace until August 2011. The rate of decline has picked momentum since then, and especially after November 2011. Today the taka is trading at 86 per dollar in the kerb market as compared with Tk 70 in July 2010 and Tk 76 in July 2011; in the inter-bank transactions the taka is trading at 84 per US dollar as against Tk 69.4 in July 2010 and Tk 73.6 in August 2011. This amounts to a whopping 23 percent depreciation of the Bangladeshi currency in the past 18 months, which is among the fastest pace of depreciation since 1982.

This rapid rate of depreciation has alarmed the business community as well as the general public. I have received many phone calls from business circles and journalists enquiring about this development and asking the inevitable question: is the Bangladeshi currency heading for a free fall?

At the request of The Daily Star I wrote a piece "The falling Bangladeshi currency" that was published on July 22, 2011. In that article I explained the reasons why the Bangladeshi currency was depreciating and provided a number of policy responses that might arrest the decline in the value of the currency. I do not want to repeat the arguments here and would direct the readers to that article to understand the fundamentals underlying the decline of the Bangladeshi currency. The only point I will re-emphasise is that the underlying reasons for a more rapid decline in the value of the Bangladeshi currency that is happening now are still the same: the demand for foreign currency (dollar) is growing even faster now relative to the growth of supply than previously.

On the demand side, imports have grown by 22 percent in the first five months of the current fiscal year (FY2012). As compared to this, on the supply side, exports have grown by a moderate 14.6 percent in the first six months. Given that the trade deficit in Bangladesh is substantial because imports are much larger than exports, the trade gap has further widened. This widening trade gap has not been offset by significantly faster growth of remittances (growing by a modest 8 percent in the first five months) or by capital inflows (the capital account remains substantially negative). It is hardly surprising that the value of the currency is declining rapidly.



Will there be a free fall? As always, the answer is it depends on a host of factors. If the present import and export growth trends continue, if remittances do not show faster growth and if the negative capital account does not become significantly positive, the Bangladeshi currency will continue to fall. In the absence of a full-fledged quantitative model, it is not possible to put a number on what could be the likely value of the US dollar in terms of the taka by the end of the fiscal year under a status quo scenario, but I can say with conviction that it will be lot higher (substantially more depreciated than now).

But this need not be the case. While the negative developments in the external environment in terms of rising food and fuel prices and the debt crisis in Europe are hurting Bangladesh balance of payments, blaming it all on these factors is not very reasonable. On the compensating side, Bangladesh has also gained quite a bit from the changing external environment whereby cost increases in China and India have benefitted the Bangladeshi garment industry. Additionally, we know from economic history that when external factors become adverse agile governments respond by strengthening economic policies.

Indeed, there is quite a lot that the government can do to stabilise the currency. On the demand side, as I had argued in my earlier article, the excess demand for dollar is partly fuelled by rapid monetary growth and high domestic inflation. In recent months the Bangladesh Bank has tried to slow down the growth of money supply (defined as M2 or broad money) from the 22 percent rate of growth. There are signs that monetary expansion is slowing down but there is a risk that this may not be sustainable owing to fiscal policy failures. Inadequate tax reforms combined with huge energy subsidies have played havoc on the FY2012 budget. In the absence of adequate alternative financing instruments including foreign financing, the resulting budget deficit has been financed largely through borrowings from the Bangladesh Bank.

While monetary tightening effort is still evolving, the brunt of the monetary tightening so far has been placed on the private sector. The growth of private credit has slowed substantially, from 26 percent in FY2011 to 19 percent (annualised, month-on-month basis) in the first five months of FY2012, but credit to public sector has expanded dramatically, from 34 percent to 51 percent over the same period. The slowdown in the growth of private credit is also reflected in rising domestic interest rates.

But this uncoordinated policy response is neither necessary nor desirable for managing the balance of payments or for lowering inflation. It is not necessary because monetary tightening could be combined with better fiscal management to reconcile domestic and external stability targets with the growth target. It is not desirable because the crowding out effect of uncoordinated monetary tightening with lose fiscal policy could push interest rate up to an extent that might reduce the expansion of private investment and hurt economic growth.

The Bangladesh Bank and the treasury should work cohesively as a team under the leadership of the finance minister to help reduce monetary growth while also preserving the proper distribution of domestic credit between public and private sectors through a prudent fiscal management. This requires strengthening tax reforms, reducing subsidies and tapping alternative sources of budget financing.

On the supply side, actions must be taken to increase the growth of exports. Bangladesh's exports basket lacks diversification and remains heavily reliant on readymade garments (RMG). The solid performance of RMG has been a boon for Bangladesh. There are still prospects for doing better, especially as cost increases in competing countries (China, India and Vietnam) open up more markets. Bangladesh is also moving up the value chain with increasing presence in higher-end brand name RMG products. Yet, the risks of over-dependence on a single source of export are obvious from global developments including the most recent European debt crisis.

Endowed with abundant low-cost labour, Bangladesh can and should develop export competencies in other areas. The most potent way of doing this is through strategic partnerships with international investors including participation in the global vertical manufacturing chain. A range of policy reforms is needed to facilitate this including better macroeconomic management, reforms of the trade policy to lower trade protection, improving infrastructure, improving trade facilitation and strengthening regional cooperation.

Much of the actions to increase exports noted above will yield result in the medium term. In the short term, the supply of foreign exchange can be augmented by a coherent strategy for mobilising official and private foreign resources. In a number of my writings I have pointed out that Bangladesh is a rare example of a developing country that has a negative capital account balance. India, for example, has a significant current account deficit but it has a large surplus in the capital account that not only finances the deficit but also allows a buildup of foreign reserves, which helps stabilise the foreign value of the Indian rupee. The lack of a coherent foreign resource mobilisation strategy is one of the major policy failures in Bangladesh that needs to be quickly addressed to avoid a continuing slide in the value of the Bangladeshi currency while preserving the growth momentum.

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Go for capital goods industry

An NRB expert says how Bangladesh can advance in industrialisation

MD FAZLUR RAHMAN

BANGLADESH should take initiative to establish capital goods industry at least as a partner country to produce parts and components for industrialised nations, said an analyst.

Dr Ashraf Ali, a non-resident Bangladeshi scholar living in the United States, said Bangladesh will be a latecomer if it ultimately joins this party at all, as the developed world has progressed a lot.

It will be tough for Bangladesh to become a major player in the industry, he added.

"Going head-to-head is impractical in my mind. Latecomers face difficulty in industrialisation within competition-based free-market principle. But there is a win-win solution, where they will give us specification to make sure the product meets the quality and we will make parts and components for them."

"We can produce the same quality of products at low cost, which will allow the foreign companies to sell their products in a cheaper way to compete more effectively in the market," he told The Daily Star in an interview in Dhaka recently.

He was in the city to attend a symposium on capital goods industry organised by US-based Bangladesh Development Initiative (BDI).

Established in 1988, the BDI is a non-profit and non-political organisation in the USA. It is engaged in accelerating socio-economic development of Bangladesh through various campaigns such as conferences and symposia, publication of books and journals, development and submission of policy papers to Bangladesh government.

There are around 40,000 light engineering units in Bangladesh, employing around six lakh semi-skilled, skilled and technically educated and innovative entrepreneurs, according to a study by the SME Foundation.

They are producing 1,000 types of machinery, spares and accessories for automobile, railway, jute, chemical, sugar and food, agriculture, bicycle and rickshaw, pharmaceuticals, engineering and metal industries, shipbuilding, oil and gas line fittings, electrical, electronics and telecommunication sectors.

Imports of capital machinery and local manufacturing together account for Tk 20,000 crore, according to Bangladesh Engineering Industry Owners' Association.

However, Ali said if Bangladesh establishes domestic production of capital goods with research and development, it would allow creation, increased endowment and retention of highly skilled labour as well as overall welfare of the country.

"This is because capital goods industry requires complex and sophisticated technical knowledge. The practice of this technical knowledge and experience would raise individual labour productivity. The knowledge and experience gained from domestic capital goods production would have broad linkages to other economic sectors."

Ali graduated in civil (structural) engineering from Bangladesh University of Engineering and Technology (Buet) in 1979. He is a master in science in civil engineering from Rensselaer Polytechnic Institute, Troy, New York, DSc in civil engineering from Washington University, St Louis, Missouri and MBA from the University of Phoenix, US.

The father of two edited two books -- Development Issues of Bangladesh (1996) and Development Issues of Bangladesh-II (2003) -- both published by Dhaka-based University Press Ltd.

Ali, also the treasurer of BDI, said Bangladesh's capital goods or machinery manufacturing sector has a fairly large, but mostly under-utilised production capacity.

The former lecturer of Buet said, on one side Bangladesh machinery manufacturing and capital goods industry is being presented with a variety of opportunities in recent months. On the other side, this industry is being deprived of government patronage in fundamentally crucial areas.

He said Bangladesh can work as a junior partner with advanced nations and produce parts and components used in the capital goods industry of those nations.

"In recent times, Malaysia has successfully achieved economic development under the patronage of and by partnering with Japan."

According to Ali, in 2010 a number of organisations from the US, Canada and Japan are said to have contacted Bangladesh Industry Technical Assistance Centre whether they can get automotive parts produced by the machinery manufacturing factories in Dholaikhal and Valuka.

"There is no need for Bangladesh to start from scratch as the country already possesses capability."

The 56-year-old said: "Parts and components are being manufactured in many places across the country for a long time. We can see such small industries in Dolaikhal, Bogra and Jessore."

Dr Ashraf Ali

"The government and the industries need to work together to become the junior partners of those industries. We have to ensure facilities that can help make the products of the same quality"

"Their prospect is good, but they copy goods from other countries without any local research and development. From outside they look good, but in reality they are far from the quality of their foreign counterparts. As a result, these goods are not durable."

"Forget about capturing the international market, the quality is not up to par to compete even in the local market. How can we move from the current stage to connect the universities so the product is developed in a proper way? Capital goods needed very sophisticated technology."

Ali said, in Jessore light engineering factories are manufacturing the entire body of automobile and trucks and many other vehicles. They just imitate the imported products. They are producing such things without any engineering knowledge. As a result, it does not add intellectual value to the product, he added.

He said there is a huge demand in the local market. "In any country, the local market is the primary target. They can later look for serving the industries in advanced countries. We have heard that some companies from western world have already started contacting the Bangladeshi manufacturers."

Ali said: "Obviously the customers will be the industries in advanced countries."

Major motor companies in the world could be customers of the light engineering industries in Bangladesh, he said.

"If we cannot manufacture machinery, we can try to make parts and components. We need to do that in an official manner."

Ali said this is the only way for Bangladesh to become industrialised at this late stage in the game, as the country is 100 years behind them in industrialisation.

Ali thinks the country's light engineering sector is capable of ensuring quality of products as per international standard.

He said the industries should be given a separate industrial park so that they can expand their production. "In Dholaikhal, you will see that they are crammed in small places."

The financial support should go to the real producers, who are struggling to establish the light engineering industries, Ali said, adding that the finance should be given according to their needs and in time.

"They also need connection with the real academics. Through the association they should communicate with Buet for improving their quality of works."

He said the R&D has a huge role in taking the largely unorganised sector to the next level. "In the developed world, hundreds of highly educated and skilled engineers are trying hard to make and improve the quality of the products. But the people in Bangladesh are just imitating. It will have to be changed, engaging the technical universities in a proper R&D. The R&D will be triggered by what the sector needs."

He said the major global companies would be interested to work with cheap labour producing countries like Bangladesh for their own survival. "When Japan faced price competition, it engaged with Malaysia and other countries in Asia. It allowed Japan to become price competitive, destroying every competitor in the entire world."

"Now it is up to Bangladesh whether it will catch the opportunity. The government and the industries need to work together to become the junior partners of those industries. We have to ensure facilities that can help make the products of the same quality."

"If the government cannot support them they should leave the sector to grow alone."

Syed Saad Andaleeb, a former president of the BDI, said the country's small engineering industries should strive to build a strong link with technical universities to become a supplier to the local and global firms.

He said the country's technical institutions and universities hardly have research and development centres.

Andaleeb, a professor and programme chair, Marketing Sam and Irene Black School of Business, Pennsylvania State University, said Bangladesh is producing ships for global buyers, but still designs are coming from outside.

He said the industries should communicate with the universities to tell them about their needs. "Industries should also start internship programmes as students of technical and engineering universities do not have any practical knowledge until they enter the industries," said Andaleeb.

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