

Where is Bangladesh Bank in the inflation debate?

FAISAL SALAHUDDIN

WHY is inflation at a 9-year high and increasing? Policymakers and citizens need to get the answer right as effective policy responses can come only after appropriate diagnosis.

This article argues that higher money supply has contributed to rising inflation and that a sustained decline in inflation would therefore need monetary policy action by the Bangladesh Bank.

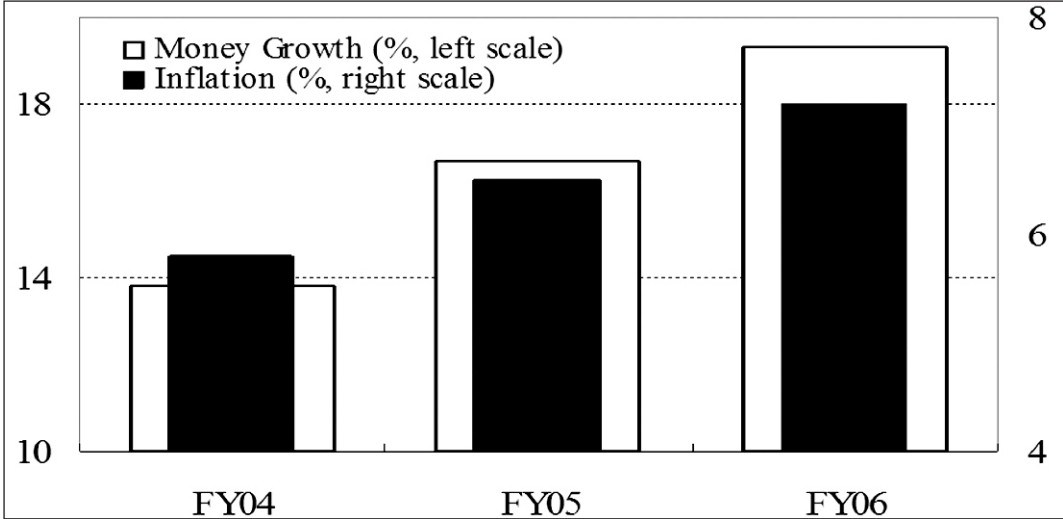
Inflation debate

Debates on inflation in Bangladesh have mostly been populist. Our policymakers and analysts have identified two sets of villains. The first set includes structural factors: (i) hoarders and syndicates; (ii) middle-men in the supply chain; and (iii) poor business confidence.

The second set includes supply shocks -- both international (rising global food and oil prices) and domestic (higher transportation costs and energy prices). Temptation is strong to explain inflation with only supply shocks -- implying that as the supply bottlenecks improve, inflation will go away.

Not surprisingly, policy measures so far have also been either populist: "four whole-sale markets in the four corners of the city" and "dal-bhat program for the poor" or too long-term to be immediately meaningful: "research to improve agricultural productivity" (budget speech, 2007-08). These measures -- while useful to limit the

It is high time that the BB properly diagnose the causes of our national fever (inflation) and be ready to firmly apply its medicine (monetary policy). The sooner it acts, the less bitter its medicine would taste. Wishing like an ostrich that inflation would simply vanish as supply shocks dissipate or that supply response through structural measures will bring it down may only worsen inflation expectation down the road. It's time for the Bangladesh Bank to take charge and redefine the inflation debate. We are waiting.



impact on the poor households -- will not succeed in containing inflation and may eventually risk bringing down the popularity of any government instead of inflation.

Inflation ultimately is a monetary phenomenon -- when higher level of money chases few goods. Any meaningful debate cannot exclude the role of money in inflation.

Surprisingly, missing from our national inflation debate has been the role of monetary policy and how the Bangladesh Bank (BB)

should/could be made responsible and held accountable for controlling inflation.

Unfortunately, even the BB has chimed in with the populist debate and frequently pointed more emphatically to the structural and supply factors -- almost never to its own monetary policy.

Show me the money

Popular argument is that recent inflation has primarily been driven

by structural villains --implying money supply has little to do with it. Of course, some of the structural and supply-side factors may have raised prices. But is it the real or major part of the story? Let's look at the big picture.

Inflation steadily went up from 2.8 percent in 2002, to 4.4 percent in 2003, to 5.8 percent in 2004, and to 6.5 percent in 2005. It exceeded 7 percent in 2006. Clearly prices -- of both food and non-food -- have been rising for a while.

Recent temporary factors alone, either structural or supply shocks, cannot explain this rising trend. Definitely, forces other than structural or temporary supply shocks are at play. What happened to money supply -- the ultimate inflation generator?

Money supply for some years now has been rising at a rapid rate (over 50 percent in total during last 3 years) due to both external (higher exports and increasing remittance) and domestic (government borrowing from the central banks and strong private sector credit growth) factors. Real interest rates (bank rate or 28-day T-bill rate minus inflation) have recently turned negative, suggesting loose monetary policy.

Compared to nominal output, money supply has clearly grown faster. In other words, the amount of money chasing a unit of output has been on the rise year after year. As theory suggests, so have the prices. And hence inflation.

It is puzzling that not many commentators are talking about monetary policy or money supply yet.

Some may retort that money supply can grow fast without creating inflation due to financial deepening -- people's higher willingness to hold more money. This argument lazily bypasses the responsibility of monetary policy in controlling inflation and the costs of not doing so.

In fact, contrary to this popular belief, money supply (M2) growth and inflation in Bangladesh have

been closely related in recent years (see graph): the higher the money supply, the higher the inflation.

Ignoring monetary causes of inflation can be very costly. Many Latin American countries with populist policies learned it the hard way: once high inflation expectation gets entrenched, controlling it becomes exponentially difficult. People then ask higher salaries which in turn raise prices again -- creating a vicious cycle.

Zimbabwe -- with inflation at over 1,000 percent in 2006 -- is now feeling the pain of earlier monetary policy inaction and populist policies. The US in the 1970s tried wage-price controls to reduce inflation and predictably failed. Inflation came down only when the Federal Reserve Bank under Paul Volcker in the 1980s tightened monetary policy.

Timely AND appropriate response is of essence -- un/mistreated cold may lead to pneumonia.

Asleep at the wheel?

Unfortunately, the BB, despite its past achievements like banking sector reform, has not provided the policy leadership on inflation expected from modern and independent central banks.

The BB should take the central stage in this debate by providing proper analysis and actions needed for containing inflation. People should know that inflation ultimately is a monetary phenomenon and that it takes some time (12-18 months depending on monetary transmission) and may involve

hard choices (higher interest rate/lower government deficit and borrowing) to reduce inflation. Forward-looking monetary policy, like a large oil tanker which takes time to turn, needs to target inflation 12-18 months ahead, based on forward-looking indicators, to deliver it.

Like a financial shepherd, the BB should guide the country to anchor inflation expectation by publicly announcing its inflation target and needed monetary policy instruments.

Fortunately, the BB does not need to start from scratch; it can learn from others' experience. After a decade of over 10 percent inflation, New Zealand successfully reduced inflation by making its target (now under 2 percent) explicit in 1988 and acting accordingly. New Zealand then, somewhat similar to Bangladesh today, lacked sophisticated financial system, a good inflation forecasting ability, or even a robust measure of inflation.

In our own neighbourhood, India and Pakistan are also moving in that direction. The Reserve Bank of India in May 2007 just reduced its medium-term inflation limit to 4.0-4.5 percent to anchor inflation expectation. The State Bank of Pakistan (SBP) is increasingly embracing the role of monetary policy to reach its targeted inflation. Let's not fall behind.

Wanted

The current BB mandate (1972 and 2003 BB Order) is too broad --

covering price, exchange rate, economic growth, and high employment. If the BB tries to achieve so many objectives and promises to deliver everything high growth, low inflation, strong but competitive currency by targeting all of them -- it will surely end up delivering none.

The BB needs to: (i) prioritise its mandate of price stability; (ii) ask for independence with regard to management of monetary policy; and (iii) build its credibility. To be effective, it needs to act independently from the government (or politicians running the government) so that interest rate and exchange rate decisions are depoliticised. It should ask for operational independence for inflation targeting and start acting as the primary champion to target inflation.

It is high time that the BB properly diagnose the causes of our national fever (inflation) and be ready to firmly apply its medicine (monetary policy). The sooner it acts, the less bitter its medicine would taste. Wishing like an ostrich that inflation would simply vanish as supply shocks dissipate or that supply response through structural measures will bring it down may only worsen inflation expectation down the road.

It's time for the Bangladesh Bank to take charge and redefine the inflation debate. We are waiting.

Faisal Salahuddin is an actuary and economist.

Travel advisory for Italy

But you can console yourself with the fact that the Italian birth rate is negative now and in a century or so, Bangladeshis will probably outnumber Italians. Then as long as the Indian cricket team continues to lose to Bangladesh and if my experience is any indication, there will be free potato chips, prosciutto and Sambuca for Indians. Joi Bangla!

RAJAN GANDHI

ALL Indians planning to visit Italy this summer would be well advised to take a crash course in Bengali. That's right, Bengali. Most Italians speak a smattering of English anyway, and Bangladeshis have taken over most of the Italian services sector.

In Genoa, I introduced myself in Bengali at an Internet Caf  as a Gujarati Indian from Gurgaon whose family had settled down in Bhowanipur, Kolkata. Out of the rafters, cubicles and side doors poured a full dozen Bangladeshis dying to converse with me, inquiring about the World Cup, the weather in Dum Dum where they had left behind residual families and where, they swore, one could find the best Natun Gurer Sandesh in the world. Disappointed that I wasn't entirely familiar with the back streets of Dhaka and Chittagong, they nevertheless escorted me to a Bangladeshi

store nearby where I was given a favourable rate for my dollars, a discount on a bottle of cheap Tuscan wine and a free bag of chips.

It's perfectly obvious why Bangladeshis congregate in Genoa. It has Europe's largest aquarium and no good Bengali, whether from East or West, can be persuaded to stray too far from his fish.

Florence was a bit of a disappointment in that respect. The streets were full of North Africans, culturally deprived since they knew nought of Bengali, Rabindrasangeet, and the green fields of Sonar Bangla. Rosalind, my Italian guide to the Uffizi spoke the Queen's English in the most plummy Brit accent, reminiscent of the drawing rooms of some of the more refined families of Calcutta (no Kolkata, old chap, that's for the plebs). I met the odd Pakistani or two, but, sadly, Bangals and Bangladeshis were missing.

In Rome, one was back in familiar territory. My wife's friends had

arranged my stay at a pension run by nuns of the Loreto order, (get him to a nunnery, she'd said, since I was travelling alone) some of whom asked whether I was familiar with the Loretos of Calcutta and Darjeeling, thus renewing the Bengali connection. But it was the trattoria across the road that drove home the importance of the Bengali language.

My waiter, seeing in me an obvious South Asian proclivity, addressed me in English in an unmistakable Bengali accent. I politely inquired -- in Bengali -- whether he was Bangladeshi and when he acknowledged his Chittagong roots, I shook his hand and congratulated him. Perplexed, he asked why. I told him that not only had Bangladesh thrashed the Indian cricket team but they had gone on to beat South Africa as well.

That was it -- nothing more needed to be said. All activity in the trattoria came to a grinding halt. A huge cheer went up and to the astonishment of the other patrons,

all the waiters did that little sprinting-on-the-spot jig that we saw the Bangladesh cricket team performing at the cricket World Cup matches. A small queue formed to shake my hand and console me briefly in Bengali, making me feel worse than a Mohun Bagan fan when defeated by East Bengal. My order of pasta arrived garnished with slivers of white truffle and my all-vegetable pizza had the aubergines replaced with the finest prosciutto. At the end of the meal, a small cup of espresso miraculously appeared accompanied by a glass of Sambuca into which two small coffee beans had been delicately dropped. I was billed only for the pizza and the tip was refused. Long live Indo-Bangladeshi solidarity! And I wish the Indian cricket team which recently visited Bangladesh had read this before the games started.

It's little things like this which helped me forget the less pleasant side of Italy. Whilst the countryside is beautiful, the monuments magnificent and Italians a very lovable people, they're a bit too much like us Indians. Taxi meters are often tampered with, pickpockets abound, and begging on the streets is not unusual. Racial profiling by the Italian police is probably the worst in Europe: at the Vatican, of all places and with

over a lakh of visitors, an Indian family with two small boys was singled out and asked for identity papers. At Genoa airport, I only escaped being questioned by the police because in front of me was an equally swarthy man, but he had a moustache. At Rome, I was the only passenger on my flight to be asked to place my shoes on an explosives detecting machine. The BBC now tells me that in Milano, they've launched a campaign against the Chinese and their red paper lanterns.

It's a bit more than disconcerting because the police all carry pistols or sub-machine guns and they don't look as if they know how to use them.

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Rajan Gandhi is a freelance contributor to The Daily Star.

Another example of ignorance

Any disaster related to some natural processes, whether it is building or bridge collapse, gas or oil-well explosion, mine disaster, road or railway track subsidence, or river bank erosion, needs geological evaluation.

AFTAB ALAM KHAN

WHEN the Spectra building at Savar collapsed it was said that it was due to structural failure because of construction flaws and material manipulation. When the Phoenix building at Tejgaon collapsed on February 25, 2006, it was said that the failure was due to faulty design.

When many other buildings in various parts of Dhaka city tilted and sank, it was again construction flaws and material manipulation that were blamed. When a six storied building collapsed at Jatrabari, no official statement was given about the reason of failure. However, we geologists look for

Phoenix building is located at the edge of an incised channel, Mahakhali khal!

There are many more incised channels situated within Dhaka metropolis. Begunbari and Kalayanpur khals are in the process of being incised. Dholai khal, Diabari khal, Narinda khal, Motijhel khal, Jatrabari khal, and Pathapath khal have already been incised.

Incised channels are avenues for continuous seepage of sub-surface water, and can make such a site highly susceptible to liquefaction. Not only earthquake vibration, but also constant, gentle, ambient vibration can generate potential local liquefaction pockets at the construction sites. Underground scouring is one of



reasons that are not apparent to non-geologists.

The reason for the collapse of the Spectra building, according to structural engineers, was a defect in the construction of one of the major columns. But, unfortunately, no attention was given to the incised channel located just below the collapsed building! Neither was any attention given to the enormous withdrawal of groundwater from very shallow depths, nor to the vibrations produced by the heavy machinery installed in the building. Similarly, the reason for the Phoenix building collapse at Tejgaon has not been looked at from a geological point of view.

It is really unfortunate that none of the non-geologists ever directed his line of thinking towards geological causes and effects, as the

the common processes that can create underground cavities slowly and, eventually, the cavities get enlarged with time. The ambient vibrations and enlarged cavities can remove soil from the base of the building located at that site, causing the building to collapse.

A six storied building at Dayaganj sweeper colony has very recently collapsed. This building is a long rectangular one, having a length of about 200 feet and width of only about 20 feet. Every structural engineer will opine that this type of building is of the worst type.

Had it been constructed on very firm ground, the building might have lasted longer. However, the worst thing is the site of the building. The entire building is aligned in a north-south direction. There is a long, narrow, parallel depression behind

by testing soil samples. It needs geological sub-surface imaging.

Any disaster related to some natural processes, whether it is building or bridge collapse, gas or oil-well explosion, mine disaster, road or railway track subsidence, or river bank erosion, needs geological evaluation. Non-geologists can perform these tasks only if they are educated from a geological perspective. If the need for geological evaluation continues to be ignored, the ultimate outcome will continue to be failure.

Aftab Alam Khan is a freelance contributor to The Daily Star.

Aid with less baggage

There will be plenty of testing grounds this year, as the United States, UK and other nations roll out numerous cash-aid trials around the world. Only a few months ago, the British Red Cross successfully delivered £1.6 billion to Indonesians displaced by last year's earthquake in Yogyakarta. In a few weeks, Save the Children will begin doling out cash to victims in Mozambique. As in Malawi, the simple swipe of a card will, it's hoped, bring relief.

SILVIA SPRING

THE last thing you'd probably expect to see a Malawian drought victim do is whip out her ATM card and pull cash out of a machine. But that's exactly how some aid recipients in this beleaguered African nation now receive their monthly entitlements. As part of a relief experiment, the British government is handing out £750,000 of aid in the form of cash rather than food.

Instead of standing in line for hours waiting for a sack of rice, Malawians simply swipe a card in one of several special mobile ATM machines located in pick-up trucks, then use local currency to buy food, medicines, fertiliser or even pay for housing or school fees for their children. "Often, people affected by disasters are the ones who know best what they need," says Chris Leather, an adviser for Oxfam, the nonprofit group carrying out the program.

It's a novel development idea that's catching on around the

world. Until recently, most of the world's relief aid came in the form of material goods like food, water, blankets, medicines or building materials, delivered by international staff that parachute into disaster areas, or local NGOs funded by rich donors.

But in recent years, as the non-profit world has increasingly come under fire for inefficiency, mismanagement and even corruption, there have been a push for new strategies. Cash aid, which has been delivered to about 100,000 aid recipients in countries like Bangladesh, Pakistan, and Ethiopia via pilot programs, is one of them.

The idea behind cash aid is to cut the cost of aid delivery, reduce opportunities for corruption and theft of goods, and empower aid recipients by giving them more control over their own well being.

So far, cash-aid programs represent only about 10 per cent of the \$3.2 billion yearly international food-aid spending. But experts expect the figures to rise sharply this year, as the US government (the world's single largest aid

donor) has thrown its support behind the strategy, following an April report showing that 65 per cent of the country's \$2 billion food-aid budget is eaten up by red tape and logistical costs.

Cash aid, which is typically delivered via ATMs with special biometric scanners or in local banks, offers several key advantages. First, cash programs cost about half as much to run as traditional emergency-aid programs -- that's a huge savings considering the multi-millions of dollars spent on food relief delivery each year.

Second, cash is more discreetly doled out, a big advantage in war-torn areas where humanitarian workers don't want to attract attention (aid distribution can turn violent: a British humanitarian taskforce saw its first attempt to hand out food and water in Basra in 2003 end in gunfire).

Unlike food aid, cash won't create unfair competition for local farmers. Development experts say it also helps to foster dignity among victims of war or disaster, giving them choices as well as introduc-

ing them to formal banking systems that they might access in the future.

But the idea isn't a silver bullet. For starters, like any sudden resource transfer, cash can distort local markets, triggering inflation in key goods, as was the case for housing supplies in post-tsunami Sri Lanka.

Critics also say there's a broader possibility for corruption, since cash (unlike a sack of maize or a bar of soap) appeals to those at all levels of the economic food chain. As a result, cash aid projects are pioneering innovative ways of registering recipients -- the Red Cross and UNHCR both employ retinal scanners to identify recipients.

When cash is distributed via banks, agencies make sure to work with big national or international institutions with strong regulatory frameworks. Proponents of cash aid also counter that most corruption in materials and food-delivery programs happen during procurement, storage and transport, none of which applies to cash transfers.

Also, cash-aid programs are relatively easy to audit, particularly when carried out electronically, so that the date and location of each handover of cash is tracked.

Still, it's clear that cash-aid programs need to be structured carefully. For starters, early trials show that like other forms of aid, cash aid works better when it's handed out to women -- young men, for example, are more likely

to spend the money on beer and cigarettes, whereas mothers will put the aid on essentials for their families.

Likewise, cash works best in places with functioning markets, where recipients can still buy what they need locally at reasonable prices, and where cash can actually be delivered securely.

"If you are in a village that's completely cut off by flooding, and there's absolutely no food left, then what you need is someone to turn up with blankets, bottled water and shelter materials in a helicopter," says Paul Harvey, a research fellow at the British government's Overseas Development Institute. "Someone turning up with \$100 wouldn't be too helpful."

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