

## BB's monetary policy dilemma

Under the dismaying budgetary imbalances, prevailing high interest rate scenarios, domestic and global inflationary specter, one naturally wonders how the BB is opting for an aggressively expansionary monetary policy. This is a million dollar riddle that I wasn't trained to unlock.

ABDULLAH A. DEWAN

FIRST of all, my congratulations to Dr. Atiur Rahman for being the first academic and research oriented economist to become the governor of Bangladesh Bank (BB). I wish him success with the country's monetary policy.

Monetary policy is about changing the money supply to influence interest rates, which in turn affects output and prices. The interest rates that we observe everyday as savers, borrowers, and lenders are all nominal interest rates (NIR). Typically, high NIR is associated with low inflation and low NIR is associated with high inflation. At low NIR, people tend to borrow more and spend more and thus drive up the prices. If rates are high, cost of borrowing is high, hence less borrowing and less spending -- causing prices to fall.

A rising inflation erodes the purchasing power of money. In order to compensate for this loss, investors are paid interest that is either equivalent to or higher than the inflation rate (INFR). In developed economies, interest rates on savings normally equal that of the INFR.

In the US, the return that lenders have required over and above the INFR has swung between 1.5% and 6%, and has averaged about 3% over the past several decades. For instance, if inflation is 3% and the lenders expect a return of 3%, one would expect a 30-year bond to yield 6%. If inflation increases to 5% while the lenders expected profit remains at 3%, a 30-year bond would be expected to yield 8%. Additionally, tax provisions and some profit for the risk for lending must also be added to the lending rate.

When inflation moves up or down, the central bank adjusts the benchmark interest rate -- known as the call money rate (CMR), an interest rate at which banks borrow reserves overnight from each other -- to influence the NIR that affects the economy's savings, credit flow, and growth. The central bank achieves these changes through conducting repos (purchases of govt. bonds, increasing bank reserves to banks) and reverse repos (sales of govt. bonds, decreasing banks

Table: Interest rate, inflation and money growth						
Time period	Deposit rate (real gain)	Lending rate (real gain)	Rate spread	Call money rate (%)	Inflation rate (%)	M-2 growth (%)
08-Oct	8.14 (0.88)	13.42 (6.16)	5.28	7.65	7.26	20.63
08-Nov	8.15 (2.03)	13.24 (7.12)	5.09	7.61	6.12	21.02
08-Dec	7.90 (1.87)	13.51 (7.48)	5.61	10.27	6.03	17.88
09-Jan	8.00 (1.94)	13.33 (7.27)	5.33	9.76	6.06	19.83
09-Feb	8.16 (2.35)	13.47 (7.66)	5.31	9.23	5.81	19.3
09-Mar	7.91 (2.87)	13.62 (8.58)	5.71	8.31	5.04	—
Average	8.04 (1.99)	13.43 (7.38)	5.39	8.81	6.05	19.73

Source: Bangladesh Bank. All data are expressed in percent (%). Real gain in parenthesis is calculated by subtracting the inflation rate.

reserve) and, in the process, manipulating the real interest rate (RIR) and inflation over time.

The monetarist model of the quantity theory of money suggests that once the government begins spending the stock of money increases, causing the INFR to rise. In order to slowdown borrowing, and hence spending, by businesses and consumers, the monetary authority raises the NIR by decreasing the money supply. This money-inflation dynamics cause the real interest rate (RIR = NIR - INFR) to move in the opposite direction to both NIR and INFR.

In this relationship, RIR reflects the inflation adjusted return for lenders and depositors. If the price level rises more than the nominal cash holdings, ceteris paribus, the real value of this particular holding will decrease. The same applies

equally to RIR. However, RIR is not an observable variable -- it must be estimated.

Now let's see how all these relate to interest rate and inflation in the Bangladesh economy.

Referring to the table, lenders are making 7.38% on average in real terms, while the depositors' average real return is only 1.99%. These real gains aren't too high across national boundaries. The interest spread is marginally higher than those in the US. Most monetary economists will blame banks much less for higher lending rates than BB's benchmark rate (call money rate) and the inflation rate.

In a recent meeting of the finance ministry's coordination council, it was revealed that GDP growth in the current FY is expected to be 5.9%, while next year's growth rate has been revised downwards

to 5.5% from an earlier projection of 6%. Interestingly, BB's report card claimed the state of the economy as being strong. Despite earlier inflationary spirals, BB espoused for an expansion of credit flow through expanding the money supply at 24% from its recent growth rate of 17.5%.

BB has been aggressively persuading banks to narrow the interest rate spread between lending rate and deposit rate in the range of 4% 5%. It seems, BB is close to achieving that goal (see table). But BB's recent push to banks for lowering the lending rate from the average rate of 13.43% to 10% would mean that their real gain will decrease from 7.80% to 3.95%, assuming that the average deposit rate of 8.04% and average INFR of 6.05% remain unchanged. Lowering the lending rate to 10% and still maintaining decent real return would force the deposit rate downward, since lowering inflation seems a far flung proposition given BB's expansionary monetary policy stance and then some.

Another channel -- in addition to the announced easy monetary policy -- through which inflation will threaten is the revelation of this year's revenue shortfall, forcing the Treasury to increase a 34% borrowing from banks for the next FY. Finance ministry sources indicated a deficit financing of about Tk 36,000 crore in the next FY to be financed partly from foreign sources and savings instruments and the rest from bank borrowing.

Finally, the bailout spending driven global inflationary spiral, which is waiting to sprout, may mess up inflationary scenario to its worse. Fiscal conservatives are raising signs everywhere.

Although the US Federal Reserve is infusing \$1 trillion worth of liquidity in the banking system to ease credit flow, the inflation rate here is well below 1% and the FFR (call money rate) is at a "zero bound" (0.0-0.25%) compared to the corresponding rates of 6.05% and 8.8% in Bangladesh.

The Fed is also positioning to avert a deflationary trend. With its FFR at zero bound, the Fed has huge leeway to fight inflationary pressure by successively raising the interest rate -- but success is not guaranteed. On the other hand, any rate hike by the BB to deter inflationary spiral is like to throw the economy into a deep credit crunch and a deep recession, or might have to live with double digit inflation down the line.

Under the dismaying budgetary imbalances, prevailing high interest rate scenarios, domestic and global inflationary specter, one naturally wonders how the BB is opting for an aggressively expansionary monetary policy. This is a million dollar riddle that I wasn't trained to unlock.

(Thanks to Drs. Habibur Rahman and Sayera Yunus of BB, my former students at EMU, for providing the necessary data.)

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## Lessons for our politicians

If you have done a good job and have faith in the people, you don't need either a caretaker government or an implanted Election Commission to deliver you victory. The people will do it for you.

SYED MUNIR KHAN

THE clean sweep by Congress in the Indian elections has confirmed political pundits and astrologers alike. The prediction was for a tight race between Congress led NDA and BJP led UPA, with smaller parties expected to play a pivotal role in coalition formation. Words of horse-trading and backstage negotiations were already ripe in the air, with prediction for either a hung parliament or political instability caused by loose alliance among divergent forces. The unexpected win of Congress has important implications for regional politics, and lessons for our politicians.

Respected for his impeccably clean record, this technocrat cum politician steered the country well during regional political instability and global economic recession. A decent and sober man, he refused to ride on the bullet proof BMW and rather rode on the historic Indian Ambassador, symbolising the Nehru era doctrine of economic self-reliance.

He is a great combination of competency and credibility as well as humility and modesty. Hence, no matter how hard BJP tried to portray him as a "weak prime minister," voters were smart enough to know better.

Lesson for our politicians? Do your job competently and honestly and people will not be dissuaded from rewarding you.

Congress President Sonia Gandhi, while leading party from the front, was all through respectful to Manmohan Singh. She never left in doubt as to who would be the PM if Congress won the elections, even when her son was in the limelight during the campaigns. As results started surfacing and she was questioned whether Rahul would be in the cabinet, like a sensible mother she

replied: "It's up to the prime minister." Most importantly, she meant what she said.

She let her son rise through the ranks on his own merit, and not because of political lineage only. Like a wise mother, she let her son grow but not at the expense of breaking party norms. Her personality, grace, and authenticity struck a chord with voters, who respected her more than they may have loved her.

Lesson for our great mothers? Opportunity to scions because of lineage may be acceptable, but undue privileges and impunity are not. Let the sons prove themselves first in a fair and acceptable manner before putting any claim on power.

Rahul has demonstrated his potential as a politician more through his actions, as opposed to favours and party positions. He went from door to door, campaign to campaign, appearing in almost 300 public meetings. Aware of the growing discomfort of the younger generation with a dynastic system of political leadership, he was candid in his confession of his inborn advantage of being a Gandhi, but equally vocal in his support for a system based on meritocracy.

This Harvard graduate caught sea-sick politicians like Advani and Narendra Modi off-guard with his wits as well as guts. Most importantly, he has been very patient in his journey and left no stone unturned to prove his eligibility and not accessibility to the top.

Even before the elections, he showed his penchant to reach common people by spending time with the poor and underprivileged, and repeatedly refused party or cabinet positions.

Lesson for our privileged sons? Insulate yourself from power and privilege and integrate with the common and ordinary to prove your eligibility.



Emulate their example.

BJP Leader L.K. Advani has risen to the occasion by losing no time in accepting

defeat gracefully and congratulating both Manmohan Singh and Sonia Gandhi. Already, thoughts have crept in as to who would lead BJP in the future as Advani has intimated his desire to step down.

To quote BJP party spokesperson

Arun Jaitley: "BJP accepts peoples' mandate with full respect." Their soul searching has already begun as the party comes to terms with the unexpected defeat and analyses reasons that have led to this failure.

Lesson for politicians? Understand the reasons for the defeat and don't blame everybody else for your own failure.

Indian politicians did not need a "caretaker government" or "army-backed caretaker government" for having fair elections, and could accept defeat without using words like "vote thieves" or "subtle rigging."

Question to our politicians. When will you ever grow up? The lesson? If you have done a good job and have faith in the people, you don't need either a caretaker government or an implanted Election Commission to deliver you victory. The people will do it for you.

Many opine that Indian democracy is 60 years old and firmly embedded into an institutional system evolved over decades. Some even use the fifteen years of Bangladeshi democracy as a justification for the largely dysfunctional and confrontational democracy we have, whose seeds are planted in the dislike and distrust between the two ladies, unbridled sycophancy of the corrupt and debauched, and unchecked power of the head of the government and party.

If the attitude and acts of our politicians don't change, no matter how many fifteen years and 1/1s we have, we will continue to be in the same quagmire -- i.e. a nation that loves democracy but suffers most because of it.

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## A nonchalant administrator

SABER REZA KARIM

Alauddin, a CSP Officer of 1952 batch, was a calm personality who sailed through his life in tempestuous circumstances without ever being cowed by unjust pressures or requests. His innate strength of character emanated from a built-in unperturbed attitude to support the right decisions even during crisis.

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His room at the Civil Service Academy was a centre for discussions on Ezra Pound's Cantos or Emile Zola's writings. He always put forward his point of view in a succinct manner with a smile. After about 18 more months of training as magistrate in Chittagong Division, he studied in the Brasenose College in the Oxford University. Alauddin was posted in East Pakistan.

As Additional Commissioner, Chittagong Division, Alauddin studied in depth the disenchantment of the hill tribes at the paltry compensation for the land acquired by the government for building the Kaptai Dam. Moreover, corrupt officers often delayed or denied compensation to

the tribesmen. Alauddin, who was on a visit to Dhaka, spoke strongly of the adverse reaction of the hill tribes and felt that the tribes might even rise in revolt.

By the time Alauddin's forecast of troubles in Chittagong Hill Tracts became a reality, he had returned to Dhaka from another tour of duty and found that Alauddin was Commissioner, Dhaka Division. The discontent among the people of East Pakistan was spreading among all sections of the society.

The colonial style exploitation of the wealth of East Pakistan gave rise to the 6 points demand, which was adopted by Sheikh Mujib as his political agenda. We used to discuss the possible repercussions as round tables and negotiations broke down. Alauddin opined in private that the possibility of a military clampdown could not be ruled out. This forecast of Alauddin also turned out to be correct.

Alauddin was summoned by the military authorities to depose as a witness to testify to the alleged complicity of Sheikh Mujib in channeling the grievances of East Pakistan citizens against the government of Pakistan. Alauddin stood his ground and refused to do the bidding of the Pakistani leaders.

Alauddin had a unique way of empathising with victims of injustice in those cataclysmic times. He would do it in his quiet manner. The military junta decided to punish senior bureaucrats of East Pakistan on trumped-up corruption

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charges for assisting and advising the political leaders of East Pakistan at that time, 303 senior officers were dismissed from service and many of them were from East Pakistan. Alauddin would visit the houses of many of the victims and stay with them for hours. He was a soft-spoken person and spoke very little. But his presence was equivalent to a thousand words.

I met Alauddin for the last time in Colombo, where he was representative of Unicef. I contacted him from my hotel but he insisted that I should stay with him. He mentioned his plan of writing books on various tribes he knew and those he would like to visit in future.

His bearer-cum-cook was full of praise for his boss. He told me of the numerous cases of assistance rendered by Alauddin to the poor and sick. He ended by saying: "No one goes back from this house without some assistance."

Alauddin was a man of integrity, living within his means and shunning pomp and power. He served the people in their just causes and was a sincere friend to his colleagues, but demonstrated indomitable courage in withstanding the undue pressures of a power hungry cabal.

Alauddin breathed his last at a hospital in Lahore, but his benevolent personality will always be remembered by those who came in touch with him.

## Last of the triumphant trio

RAVINDRA KUMAR

THE Indian navy will long lament that post-retirement commercial and personal associations prevented the mantle of greatness draping itself upon the shoulders of Admiral S. M. Nanda, who died on May 11. His service record was impeccable and

inspiring. As naval chief in 1970-73 he was at the helm in December 1971 and, along with Sam Manekshaw and P.C. Lal, scripted the most decisive campaign in Indian military history -- which gave birth to an independent nation.

Such was the glittering force of Mankeshaw's personality that in public perception 1971 was a one-man show -- not that Sam did not relish that -- but students of military history and science will confirm that it was a three-pronged effort. Even if not always scoring

top marks in what is now termed "jointsmanship," Lal and Nanda led the Indian navy with flair and distinction.

In Nanda's passing away the last of that triumphant trio has hauled down his flag.

The navy will remember Katari, Soman and Chatterjee as the chiefs

who consolidated the transition from a British-oriented to an Indian service. They were the lovable pioneers, and they laid down the keel of the ethos and standards by which the navy charted its course.

Nanda brought high professionalism to the chief's office. Maybe he was lucky in that the opportunity came his way. For, in 1965, the navy was deliberately excluded from the war strategy; not so six years later when Indira Gandhi and Jagjivan Ram exhibited the political will to bring all of India's military assets to bear. The rest, as they say, is history. And for the navy it was inscribed in golden letters on both flanks of the sub-continent peninsular.

For sheer innovative "cheek" what could match the Nanda-crafted plan to use the bigger warships to tow the small yet lethal missile-boats to within striking distance of Karachi, and then letting them race in to sting both the port installations and pride of the Pakistani navy, the people at large. In military terms the damage was severe, in psychological terms it proved devastating.

Less dramatic, but probably contributing more to the overall campaign, was the watertight blockade of