

Conducting monetary policy by suasion

In an environment of global financial pandemic, an increase in loan default is prudent for banks to be a little risk averse. Besides, the inflation risk is not unfounded. Bangladesh Bureau of Statistics reported an increase in inflation rate in April to 5.36% after it was declining since January.

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ON April 19, Bangladesh Bank (BB) asked the commercial banks to set a lending rate ceiling in five specific areas to a maximum 13%, to lessen the adverse effects of global recession. On May 27, BB has advised the non-bank financial institutions (NBFIs) to double their capital by the end of this calendar year, from Tk.250 million to Tk.500 million, in order to remain sound. Governor Atiur Rahman asked the NBFIs not to depend mostly on bank loans and call money market, to meet their liquidity shortfall, and advised them to issue alternative financial instruments, like zero coupon bonds and asset-backed securities, to drum up funds. These suasions seem like a tradition in terms of monetary policy in Bangladesh. In a meeting in February 2008, former BB Governor Salehuddin Ahmed asked bankers to reduce interest rate spreads (IRS) from an average of 6.98% to around

5%. Then Finance Adviser, Mirza Azizul Islam, warned the banks not to do whatever they like in the name of free market economy. Joining the choir at the time, Chief Adviser Fakhruddin Ahmed instructed the BB to find a way to reduce the IRS to 4-5%. The bankers agreed that the lending rate was high and a lower rate is achievable through cost-cuttings, accompanied by a tax reduction of 1% from 2% on general provision. The snapshot of data in the table indicate that neither monetary policy nor moral suasion have succeeded in having any desired effects on the lending rate. Paradoxically, inflation and interest rates moved in opposite direction instead of moving the same way. The credit for lower inflation in recent months may be ascribed more to global price deflation than to BB's monetary policy. Also the little decline in the IRS, taking place recently, is attributable primarily to an increase in the deposit rate. It seems prima facie that the authority has been resorting to coercing banks to

Time period	Inflation rate (%)	Lending rate (%)	Deposit rate (%)	Rate spread (%)
Sept 06--May 08	6.77--10.00	12.41--12.92	6.76--6.99	5.43 - 6.14
Oct 08 -- May 09	5.04--7.27	13.24--13.51	8.04 --8.16	5.09 - 5.71

Data source: BB Website. Data for missing months were unavailable.



Banks are reluctant to lower their lending rates.

cut lending rates, since monetary policy appeared to be ineffective in doing the job. One would then wonder why the lending rate is so sticky downward. In his May 25 piece, "Some thoughts on

the upcoming budget," Mirza Islam recommended that the tax rates on financial institutions be reduced, provided they reduce both the lending rate and the prevailing IRS while keeping the deposit

rate unchanged. He is asking banks to guarantee an interest rate floor of around 8%, while lowering the lending rates. This is what banks want, and is a good recommendation, but it doesn't work even in a "less than" market economy like Bangladesh. This can be graphically visualised from the demand and supply framework of the credit market. A 1% tax cut will shift the upward sloping credit supply curve to the right. If the credit demand is perfectly elastic (horizontal), there will be no change in the lending rate. A full effect of the tax cut will be reflected in the lending rate if the credit demand is perfectly inelastic (vertical). In reality, the credit demand curve follows neither of these extreme cases -- it should have a normal downward sloping curve. In that case, the equilibrium lending rate will fall but by less than the full percentage of the tax cut -- the magnitude will depend on the relative slopes of the demand and supply curves. Therefore, some downward adjustment of the deposit rate must be accommodated to achieve a lower lending rate. Banks are reluctant to lower their lending rates for many different reasons such as loan default risk, inflation risk and so on. The BB statistics on bank lending from January to March showed a 5% increase in defaulted loans compared to December last year. In an environment of global financial pandemic, an increase in loan default is

prudent for banks to be a little risk averse. Besides, the inflation risk is not unfounded. Bangladesh Bureau of Statistics reported an increase in inflation rate in April to 5.36% after it was declining since January. If banks have alternative default risk free investment opportunities, such as treasury bonds with guaranteed hefty returns, why should they be interested in lowering their lending rates? Banks also lend funds to microcredit NGOs and earn over 14% returns, which are also nearly default free. Recently, I met a microcredit credit NGO chief who told me that her NGO borrows funds from banks at 14% interest rate and lend those at 12.5% to small borrowers. Borrowing at a higher rate and then lending at lower rate is made possible because the NGO's effective lending rate reaches up to or over 23% -- mostly from fees from early loan repayment and other fees. Grameen bank charges simple interest at an annual rate of 20% compared to compound interest of 13-16% charged at commercial banks. In Grameen, principal is repaid first and interest is repaid only after the principal is paid off, making an effective interest rate of 10-12%. Since moral suasion is not working in lowering the lending rate, BB has no choice but to make its policy instruments do the job. Dr. Abdullah A. Dewan, founder of politconomy.com, is a Professor of Economics at Eastern Michigan University.

Aila after Sidr

While both poor men and women in the coast have a common legacy of poverty and insecurity, the poor woman is poorer than the poorest man.

AUDITY FALGUNI

THE Bay of Bengal, a northern and extended arm of the Indian Ocean and covering about 510,000 square kms is probably the "rebellious daughter" of the ocean who often turns too angry and smashes the lives of thousands along its huge coastlines particularly in the months of May and October each year. Actually, the coast of Bangladesh is known as a zone of multiple vulnerabilities. It is prone to severe natural disasters, such as cyclones, storm surges, and floods. The death toll from Cyclone Aila rose to 121; 800 wounded and at least 58,450 domestic animals killed (*The Daily Star* report -- May 27, 2009). The report quoting the disaster management ministry informs that at least 30 lakh people in 352 unions and 62 upazilas in 14 districts have been affected by the cyclone. Thankfully the level of damage was far less than Sidr in November last year. Approximately 3,447 deaths were blamed on the storm according to governmental sources. Agencies like Save the Children or Red Crescent Society claimed the number of deaths to be within 5,000 to 10,000 in Sidr. A total of two million people had to take recourse in the emergency

shelters. About a quarter of the world heritage site Sundarbans (the tropical mangrove forest) was damaged and it would take 40 years to recover itself from the catastrophe. Sidr was the strongest cyclone to hit Bangladesh since the cyclone of 1991. Records of the last 200 years show that at least 70 major cyclones have hit the coastal belt region of our country. Some examples of severe tropical cyclones are the Barisal cyclone of 1584, the Bakerganj cyclone of 1876, the May 1985 Urir Char cyclone, the November 1970 cyclone and the Great cyclone of 1991. The November 12, 1970 cyclone hit the coastal districts severely, particularly those in the southwest. The official death figure was 1,70,000, but unofficial estimates were as high as 500,000. An area of about 8,100 km was affected. 400,000 houses, 3,500 schools and 20,000 fishing boats were destroyed and half a million tons of food grains were lost. The Great Cyclone of 29 April, 1991 caused an estimated 140,000 deaths, over 85% of them in just 5 upazilas, but more than 10 million people in 102 upazilas in Chittagong, Noakhali and Cox's bazaar were affected (1). The total population in the coastal zone amounts to 35.08 million, male population being 17.9 million and female

Period	Occurrences of major cyclones
1795-1845	3
1846-1896	3
1897-1947	13
1848-1998	51
Total	70

Sources: BBS, 1993 and BBS, 2002 d. 17.1 million (BBS, 2003) living in 6.8 million households in 19 districts comprising of 147 upazilas in the coastal zone of Bangladesh. The total number of coastal population increased from only 8.1 million a century earlier. Agricultural laborer, small farmer, fishermen and urban poor make up 70% of the 6.85 million households in coast and the coastal population is projected to grow to about 41.8 million in 2015 and 57.9 million in 2050. The extent of poverty is relatively high compared with the remaining part of Bangladesh: 52% are poor and 24% are extreme poor. Of the coastal population, 49.1 percent are female and 41% of the total population is below 15 years of age. Of 6.8 million households in the coastal area, the number of female headed households stand at about 3.4 million, higher than the national average of 2.37 (BBS, 2003) millions. While both poor men and women in the coast have a common legacy of poverty and insecurity, the poor woman is poorer than the poorest man. Rate of severe malnutrition among girl children in comparison to the boy children is also higher than the national average.

The state of reproductive health among coastal women is worse than elsewhere in Bangladesh. Violence against women is a common phenomenon in the coastal area including domestic violence, rape and sexual abuse, trafficking and acid threats. Frequent sea cyclones-tornados-floods often make millions of coastal people homeless and women become the worst victim of the natural disasters. Relief and rescue workers recorded lots of incidents during the last Sidr whereupon women in the marooned areas have been raped, allured to be trafficked or get engaged in prostitution for food, safe drinking water or shelter. If we turn our glance to the indigenous people living in coastal regions of the country, we would note that relief and rescue operations particularly at government level reaches the indigenous people last. This contributor herself recorded allegations from religious and ethnic minorities from the Sidr devastated areas on 2007 that relief reaches them very rare. In the coastal areas, Bengalees are the dominant ethnic community, comprising more than 99% of the population. According to the 1991 census, there are 0.2 million people belonging to the minority ethnic communities living in the coastal zones including the Rakhaines, Pundra-Khatris, Munda and Mahatos. The Rakhaines are the largest indigenous community in the coastal region particularly in the Kolapara upazila of the Patuakhali district, Sadar and Amtali upazila of Barguna district and Ukhiya and

Teknaf thanas of the Cox's Bazar district. The Rakhaines had undergone severe damages during last Sidr with little relief and rescue supports and in the aftermath of AILA there does not seem to be any exceptional either. Although there are a total number of 92 relevant laws regarding disaster management and well-being of the coastal regions of Bangladesh, it is yet to be decided that a separate "coastal zone regulations" would be relevant to enact in Bangladesh as has been done in some other countries. The Program Development Office for Integrated Coastal Zone Management Plan (PDO-ICZMP) has recently prepared a "Compendium on the Laws Relating to and/or

having Bearing on Coastal Areas" (PDO-ICZMP, 2004: Where Land Meets the Sea, page 233), it is yet to be approved at government policy level. Recurring natural disasters along the coast-lines of Bangladesh warns the nation to adopt a frame-work of policy guidelines relating to techniques of disaster management and economic rehabilitation programs focusing on poor, women and indigenous people in the coastal area unanimously. 1- Where Land Meets the Sea: A Profile of the Coastal Zone of Bangladesh, edited by M.Rafiqul Islam, UPL July 2004 (pg 78-79).



Relief and rescue efforts reach the minorities at the very end.

New government in Nepal: Will it help end political instability?

All parties involved in the political landscape in Nepal must demonstrate prudence and sagacity so that democracy is not disturbed, and a country which has witnessed so much of mayhem and lawlessness must not revert to the same phase.

ZAGLUL AHMED CHOWDHURY

A new government headed by moderate communist leader Madhav Kumar Nepal has taken over the reins in Nepal, ending the three week vacuum caused by the resignation of Prime Minister Pushpa Kumar Dahal -- better known as "Prachanda" (fierce one). The new prime minister has assured his countrymen that he will spare no effort to bring back the stability that has been eluding their new-found democracy. But doubts persist whether the new government will really be able to give the nation a stable government since Prachanda and his hard line Communist Party (Maoist) are bent upon creating problems for the new administration which replaced theirs in the midst of raging controversy on certain issues that have divided the nation. As Madhav Kumar Nepal, the 56-year-old veteran of the Communist Party (Marxist-Leninist) took oath from president Ram Baran Yadav, the Maoists, who form the largest single political group in the constituent assembly, vowed to continue their agitation till the "irregular act" committed by the president himself

when he overruled the sacking of the army chief by Prime Minister Prachanda, was rectified. It is not long ago that the picturesque Himalayan country came out of a long spell of violence and instability centring on the existence of the monarchy that ruled Nepal for 240 years. Established political parties like the Nepali Congress and the Communist Party (Marxist-Leninist), of which the new minister is a senior leader, in collusion with the then underground Maoist outfit, ousted King Gyanendra from effective power. The subsequent elections for a constituent assembly to draft a new constitution saw a stunning victory for the ultra-left, which came out from the hideouts and joined conventional politics. They won 240 of the 601 seats in the house. Although they fell short of absolute majority they finally formed a government led by Prachanda with the support of others, including Madhav Kumar's party. But the tenure of the government has unfortunately been cut short because of differences among the coalition partners on the issue of dismissal of the army chief by the prime minister and the vetoing of this decision by the president.

Earlier, immediately after the assembly elections, all parties worked together to abolish the throne and turn Nepal into a secular republic in place of a Hindu kingdom. But the same political parties squabbled, and eventually the government had to resign when some allies like the Communist Party of Madhav Kumar left the coalition, while the Nepal Congress was already in the opposition. As the heart of the crisis is the sacking of the army chief for, what the government said, his failure to abide by government instructions on the inclusion of about 19,000 former guerrilla Maoists in the armed forces. While Prachanda's government was obviously keen to take them into the army, other parties, including the allies in the cabinet, were somewhat unwilling because they feared that Prachanda's strength would increase once they were in the army. President Ram Baran Yadav, who won the largely ceremonial presidency as the nominee of the Nepali Congress and supported by most others barring the Maoists, was expected to take a position contrary to the prime minister on the issue of dismissal of the army chief. Consequently, the development that emerged has not come as a surprise since political opponents of Prachanda were waiting to avenge their defeat in the polls, and they have certainly seized the opportunity. It is also believed that India is also opposed to the sacking of the army chief. The Maoists also obliquely blamed New



When will there be stability in Nepal?

Delhi for the crisis without directly mentioning India -- a charge that New Delhi evidently gave no importance to. Controversy erupted as two diametrically opposite views emerged on whether the president could overrule the decision of the prime minister and the cabinet. Prachanda says it is totally unconstitutional while his critics assert that the president is the supreme commander of the armed forces and that all the coalition partners of the government were not party to the decision. In any case, this debate continues in Nepal for the simple reason that the variance in views was not

totally unexpected. Prachanda's party is out of power in the new government while Prime Minister Madhav Kumar Nepal says he will continue his efforts to bring the Maoist into the new administration. There is little likelihood that the Maoists will join the new government unless their conditions are met -- which are in a way quite difficult to fulfill. They want president Yadav to "apologise" or rescind the decision on the sacking of the army chief, whose removal is also a key demand of the radical leftists. It will be the height of folly to expect

that such demands will be met by a government which has come to power with differing views on these crucial issues. At the same time, any government having the support of 22 parties but devoid of the largest single group in the house can hardly be expected to provide a stable government. When the Maoists have vowed to keep the pot boiling, it be will be unrealistic to expect stability in Nepal. But the Maoists themselves should also be mindful of the fact that they should not be responsible for taking the country back once again towards violence and anarchy. One good thing is that they have stressed on democratic agitation, and this is a positive move from the former dreaded radicals. However, all parties involved in the political landscape in Nepal must demonstrate prudence and sagacity so that democracy is not disturbed, and a country which has witnessed so much of mayhem and lawlessness must not revert to the same phase since it badly needs political and economic stability. Zaglul Ahmed Chowdhury is a senior journalist and analyst of international affairs. In yesterday's Point Counterpoint we inadvertently dropped the photo and illustration credits. The photo with "Surviving the Great Recession" is by Qudus Alam/ DrikNews. The photo with "Running the Numbers" is by Noor Alam/ DrikNews. The illustration with "Nurul Islam: Searching for Truth" is by Arif. We regret the error.