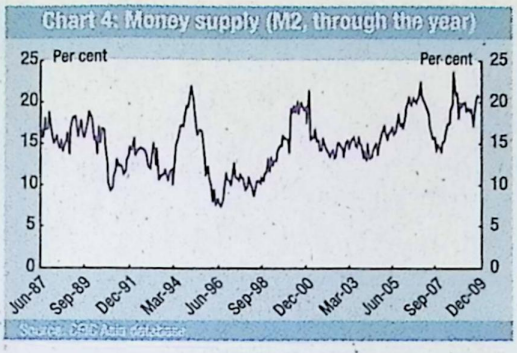


goods market as well as the asset market. Indeed, non-food inflation has jumped to 6.5 per cent in the year to January, compared with a rate of 3.7 per cent six months earlier.

The problem is compounded by two additional factors. First, the 2009 budget's provision to "recycle black money" released a large amount of cash into the economy that went into the stock market. Second, merchant banks and merchant banking divisions of non-bank financial institutions have become among the most active members of DSE.

If excess liquidity is the problem, then is a tightening in monetary condition -- through a modest appreciation of taka or more direct measures -- the only solution?

Not necessarily, at least as far as the asset market is concerned. The underlying problem in the Bangladeshi asset market might be that there are not enough instruments for people with savings to invest in. Perhaps, instead of borrowing overseas in foreign currency to fund infrastructure projects like the Padma bridge, the government could issue infrastructure bonds. And given high borrowing rates faced by businesses, perhaps the time is right for a corporate bond market in Bangladesh.

The lack of instruments to invest in ultimately points to a deeper problem Bangladesh faces: a relatively low invest-to-GDP ratio. Private investment accounts for less than 20 per cent of Bangladesh's GDP. It is difficult to envisage sustained 7-8 per cent economic growth unless investment rises relative to GDP. Rahman and Yusuf (2009) argue that infrastructure bottleneck and regulatory burden are the binding constraints on investment and economic growth in Bangladesh. Until these supply-side constraints are addressed, any rise in savings (such as through a remittance boom) is likely to drive up goods and asset inflation instead of adding to the economy's productive capacity.

And finally, there are socio-cultural factors that have caused asset bubbles and financial crises around the world over the past eight centuries. As a bitter investor or one such bubble is alleged to have said: More money has been lost because of four words than at the point of a gun. Those words are: This time is different.

Whether it is in tulip during 17th century Holland, American houses a few years ago, or the DSE, such bubbles seldom end well, particularly if the investors run up debts to fund their investment. The data are not available to judge whether the retail investors being hurt by the market correction are highly leveraged or not. And social scientists are only beginning to appreciate the herd mentality that drives these manic episodes that end in panics. Perhaps it is unrealistic to expect our policymakers to grapple with socio-cultural issues that bedevil authorities in advanced capitalist economies. But we can definitely aim for better regulatory, monetary, and supply-side policies.

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1. The data used in this piece are as of March 24, 2010.
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8. Reinhert CM and Rogoff K, This Time is Different: Eight Centuries of Financial Folly, Princeton University Press, 2009.

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