Market crash and the role of Bangladesh Bank

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Should the central bank play some role in bursting asset bubbles? This is a contentious issue that has been discussed for a long time.

Some argue in favor of the view that central banks should burst bubbles. But, in their view, monetary policy should respond to asset bubbles in a cautious and moderate manner in order to avoid economic distortions. Some others argue against the role of central bank in bursting bubbles. They say bubbles generally arise out of some combination of irrational exuberance, jumps forward in technology and financial deregulation, for which the connection between monetary conditions and the rise of bubbles is tenuous.

However, the central bank is at the centre point in this debate. The recent crash in the stock market in Bangladesh is also associated with some policies of the central bank. The aim of this article is to analyse the following two aspects: (i) whether the monetary policy response was appropriate to the rise and the recent collapse of the bubble, and (ii) whether the behaviour of financial institutions was optimal to the policy response.

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Commercial banks have been involved heavily in the stock market business in the last few years. Allowing merchant banking has exaggerated the situation. They became the key player in the stock market. Undoubtedly, any policies to control banks' exposure to the stock market could have significant impact on the capital market. Monetary easing during last two or more years (money supply was more than 22 percent during the period) could have helped stock market remain buoyant during these days.

Perhaps, Bangladesh Bank (BB) was not much aware about banks' exposure to the stock market. Because, surprisingly, banks profit from share business seemed to be negligible according to their income statement or balance sheet although there is a wide perception that banks are making handsome profits from investing in shares and debentures. Proper data on their exposure to the capital market remained unknown, which I think is a failure from the part of the central bank as a supervisory agency.

Moreover, almost all policies to minimise the exposure of banks were taken in the second-half of 2010, when the stock index had reached an alarming level. For example, the situation worsened when it was made mandatory for all banks to maintain their investment in the stock market equivalent to 10 percent of their total deposit and to comply by December, 2010, when in reality, the ratio was much higher than this level.

Police stand guard the Dhaka Stock Exchange building in Motijheel during street protest for a market-fall. STAR

Increasing the cash reserve ratio (CRR) was a double debacle for the banks. Naturally, big players had to sell huge volumes of shares due to liquidity constraints, which caused share prices to decline. This also casts doubt on the reported amount of excess liquidity in the banking sector in BB's published reports. Withdrawal of banks' large investments from the stock market appears to be the main reason for the recent crash in the capital market in Bangladesh.

Now the question is, whether BB had any good reason to stop banks from substantially investing in the share market this time? There might have been a few reasons behind the decisions, such as (i) to contain inflation, (ii) to channel more credit to the real sector, and (iii) to protect the interest of the bank depositors by limiting them from risky investments.

If BB did so to control the supply of money due to rising inflation trends, I would rather say that the issue was not analysed properly. The money that was running behind stocks had some multiplier effect in accumulating more stocks. Thus, it appears not to contribute to inflation to that extent, as it was not channelled directly to food prices or other non-food prices -- that are the main components of inflation.

Whether investing in the capital market crowds out private investment in the real sector is also not clear -- perhaps this is also not a very strong reason. Credit given by the merchant banks seems to be negligible compared to market capitalisation or even to daily transactions. The third one might be reasonable, but this does not require any hard measure like the one that has been undertaken.

Soft landing (measures) was expected to reduce banks' investment in the capital market to 10 percent of total deposits. Commercial banks should have been given more time for gradual adjustments. In addition, the CRR was not raised at an appropriate time.

From these viewpoints, BB's policy does not strongly justify their action against banks' investment in the stock market.

This reminds us of the Bank of Japan's (BoJ) policy in bursting a bubble in the early 1990s, which caused prolonged economic recession and one of the biggest banking crises. Although the action of BoJ was to burst the real-estate asset price bubble, it had caused a crash in the Japanese stock market also.

The main efforts to stop the bubble included monetary tightening, new regulation on administering real asset prices and adoption of the Basel Accord of capital adequacy requirements in 1989. After the bubble burst in early 1990, a decade of the crisis starts with the first failure in 1992 (as many as 180 banks up to 2003 failed according to the statistics by Deposit Insurance Corporation, Japan).

As a result, the bank assumed a huge burden of non-performing loans, deflation and recession. The then monetary policy of BoJ is still criticised. If the monetary policy (ultra-easing interest policy) is supposed to contribute to the creation of the bubble, was it appropriate to stop the bubble within a short period of time, especially when banks made collateral-based investments in the real-estate sector?

Some have argued that the asset price bubble and monetary policies at that time in Japan were mainly responsible for the crisis. The lessons that can be learned from the Japanese experience that central bank's role to burst bubbles must depend on the degree of efficiency of the financial sector and the speed to burst the bubble must be based on the overall economic situation.

It is now important for Bangladesh to investigatethe degree of involvement of commercial banks in the stock market before and during the crash as well as synchronisation of BB's policies. The worry is that BB is sceptical about their role, which is clear from statements of the governor as well as posting of news items in their web. Without being sceptical about their role, BB should try to analyse their policies and formulate a long-term policy framework for banks involvement in the capital market by taking lessons from other similar cases and analysing the overall economic situation.

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Pakistan woos the West

AFP, *Islamabad*

Daring denims and micro miniskirts are not typical on Pakistan catwalks, but at the capital's first ever fashion week, designers have turned to risque Western styles to lure foreign buyers back.

With the national economy hit by crippling debts and a torrid political scene, fashion industry insiders hope the modern designs can capitalise on the country's long-standing reputation as a global textile capital.

Islambad's glitterati, a niche group of fashion-forward entrepreneurs in the largely poor nation, held a four-day design showcase to encourage international business -- scared off by the threat of Taliban bombs -- to return.

"One reason for doing this is to bring the buying power of the world back to Pakistan," said organiser Tariq Amin, the country's best known stylist.

"Because of the current situation and the political situation, it's difficult for them (buyers) to want to come to Lahore and Karachi, so Islamabad... the embassies are here, there's a lot more security."

Security was indeed tight at Islamabad's luxury Serena Hotel, as models picked from the streets of Pakistan's main cities sashayed down the runway, showcasing the country's talent for colourful ornate and sheer fabrics.

Edgy and bold off-the-shoulder cuts hit the runway alongside more familiar long floating dresses, less likely to offend sensibilities in the devout Muslim nation.

Pakistani designer Nilofer Shahid (2R) greets the audience on Monday as part of her show on the last day of Islamabad Fashion Week in Islamabad that aims to promote Pakistan's textile industry. AFP

Designers hope that by slashing hemlines they can maximise foreign profits.

"You can't sell shalwar kameez in the West," said Amin, referring to the plain cotton tunic most commonly worn by men in Pakistan.

Pakistan's textile and clothing industry brings in 60 percent of the country's export revenues, according to official data, making it critical to reviving economic fortunes, made worse by devastating floods last year.

While other Pakistani cities such as Karachi are used to holding fashion shows, Islamabad is new to the scene. A total of 32 designers put on catwalk shows from Thursday to Sunday.

But the audience was largely Pakistani, with few foreign buyers seen milling around outside the hotel's large conference hall where new and more established designers staged their shows.

One buyer, Iranian Soheil Mazinani, of fashion house Asmaneh, said the event's success would be judged by future business, not by its popularity this time around.

Likening the show now to a "baby", Mazinani said: "I think after one or two years it can grow and you will see a lot of buyers."

But he admitted he would not be making any purchases on this trip, and that the Western styles would be equally out of place on the streets of Iran.

"We are just getting familiar with the different designers and manufacturers," he said, adding: "Ladies can wear them for celebrations, in parties or private events -- underground."

Fashion is a key engine for growth for countries such as Pakistan, said Paco De Jaimes, founder of the not-for-profit World Fashion Association, which aims to foster poor nations' participation in the lucrative fashion business.

"(Fashion is) one of the main sectors (in Pakistan) and this helps very much countries to recover their economies," said De Jaimes.

"People don't realise how fashion industries contribute to the eradication of poverty, to social integration, to empowerment of women," he said.

"Any kind of initiative that can promote that foreign step is always good."

Zohra Khokhar, a 25-year-old designer who works with her mother for their label Deeba & Zoe, said they came to Pakistan from Scotland six years ago to capitalise on the availability of good materials.

"You can do everything here from start to finish, from the dyeing of the material to the finishing of the beads and everything," she said.

But breaking into the market is now harder than ever because of global inflation pushing up manufacturing costs, she added.

"What people need to understand is that Pakistan's not as cheap as they think. All over the world prices have gone up... so materials are dearer, labour's dearer, you can't expect to get a massive profit out of it."

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