Monetary policy, exchange rate and taming inflation

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The Monetary Policy Statement (MPS) for the second half of fiscal 2011 is focusing on a continuous watch towards locating and neutralising likely inflationary pressures from the growth-supportive monetary and credit policies.

The policy has taken a stance to extend credit to agriculture, small and medium enterprises (SME), rural economy, housing loans, shipbuilding, and rural energy. This stance is backed by the reasoning that the domestic economy is operating below capacity and expansionary policy in the targeted sector would help to bring in short term stability and to realise long term growth prospects.

While we welcome that, the common people seem to be confused about some of the Bangladesh Bank (BB) stances. The dollar rate has gone up significantly, making import apparently much costlier than before and at times, there are serious issues coming up with regard to timely settlement of import liabilities due to foreign currency (FCY) liquidity shortage in the market. The central bank in the recent past was supporting essential commodity imports, especially in the state sector by supplying FCY liquidity to them. Lately, they expressed their shyness in continuing that and instead, they are allowing a few commercial banks to overdraw their FCY accounts held with the central bank.

However, this is creating serious disconnect in managing banks' asset and liabilities, especially in a fluctuating market, and banks are being forced to get into a tussle with their esteemed clients. Besides, common people on the streets cannot reconcile high dollar prices with a higher FX reserve. Their confusion heightens when they see imported items getting dearer, creating serious disengagement with the government's election pledges.

Appreciation of the taka is easier said than done. If the value of the dollar depreciates against the taka, it would take its toll on the export sector, that is, the lifeline of the economy. There could also be cuts in employment in all export-oriented sectors

Indicator	2005	2006	2007	2008	2009	2010	2011
Inflation Rate (P to P) %							
-National	7.35	7.54	9.20	10.04	2.25	8.70	8.28 (Dec)
-Food	8.73	8.81	9.82	14.10	0.25	10.88	11.01 (Dec)
-Non-Food	5.32	5.73	8.34	3.54	5.94	5.24	3.27 (Dec)
Exchange Rate (Tk/USD)	61.45	67.16	69.06	68.61	68.80	69.18	71.18 (15 Feb'11)
Export (in millions/USD)	8,654.5	10,526.2	12,177.9	14,110.80	15,565.19	16,204.65	12,184.19 (Jul to Jan)

Source: Bangladesh Bank and Bangladesh Bureau of Statistics.

A study by BB in the past suggested a nominal US dollar over-valuation against the taka when compared to nominal effective exchange rate (NEER) and real effective exchange rate (REER). The monetary policy therefore emphasised stability of the exchange rate to maintain external competitiveness. However, with almost 6 percent depreciation of taka against dollar, now that gap has narrowed a lot, if not gone.

There are impending debates among economists (usually banks or bankers do not dare to criticise the central bank in emerging countries like Bangladesh), whether BB should try to dampen the dollar rate to support price reductions of imported essentials. Their argument in favour of an appreciated taka is emanating from an emerging debate of export being increasingly becoming insensitive to the exchange rate, rather more dependent on labor wages, productivity and an efficient supply chain.

The world has been experiencing an episode of inflation in commodity and fuel prices for quite some time and now it is only following one way traffic of going up, while the domestic inflationary pressure is reportedly making the life of the poor, low-, and middle-income people somehow miserable.

Had the Bangladesh currency been appreciated in terms of its intervention currency, that is, the US dollar, the costs of all imports, including essential commodities, would have gone down to some extent. That would have been considered otherwise a welcome development. In that event, the government could be in a better position to blunt the edge of all public criticisms for its failure to rein in soaring prices. The consumers could also see some sort of relief. However, policy planners as well as 'inflation targeting group' with the partner agencies feel, monetary management tools in their entirety cannot control the price rise. Rather, governments need to come up with fiscal measures (including safety net or targeted subsidy) to help the marginalised groups, without denting the growth driving sectors.

They also feel that appreciation of the taka is easier said than done. If the value of the US dollar depreciates against the taka, it would take its toll on the export sector, that is, the lifeline of the economy. There could also be cuts in employment in all export-oriented sectors. A strong taka will also have the potential of affecting the flow of inward remittance by the non-resident Bangladeshis through official channels and thereby, put further pressure on our widening balance of payment.

The government reported to have initiated a dialogue in reference to taking a balance of payment support fund of $1 billion from International Monetary Fund (IMF), which they have done at various intervals in the past, especially with a heated external sector, crop loss due to natural calamities or international food price surge.

Bangladesh had its first sovereign credit rating by Standard & Poor's as well as Moody's in the recent past and the rating came out to be quite good vis-à-vis peer countries. Analysts felt it was the best time for us to go into international markets to raise some money through sovereign bonds, like similar countries. That would have helped us support growth financing or at least try Bangladesh's ability to raise money from global markets and avoid at-times undesirable and conditional IMF support.

Take it or leave it, the Bangladesh economy has become more integrated with the world over last one and half decade. Thus, it is hard to insulate commodities prices in the domestic market from global influences. What is more important is that there is no guarantee that traders would be selling goods at prices lower than existing levels, in spite of the benefits to be accrued from a possible appreciation of the taka.

So, upward adjustment of the taka against the US dollar remains a dilemma for the central bank. However, the government and the central bank need to use whatever tools they have, under their control, to tame soaring inflation without compromising on growth.

There needs to be a good balance between monetary and fiscal policy execution. While the fiscal policy would be targeted at equitable distribution and adequate safety nets for the marginalised, the monetary policy would focus on price stability.

Unless we bring transparency in goal setting for fiscal and monetary policies, they would remain ineffective in our endeavor to fight international economic uncertainties and spikes in the domestic economy.

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THE FUTURE OF FOOD

Crisis prevention

What is causing food prices to soar and what can be done about it?

THE ECONOMIST

Around the world, the food system is in crisis. Prices have rocketed; they are now higher in real terms than at any time since 1984. They could rise further still if drought lays waste to China's wheat harvest, as is feared. Food has played some role (how large is hard to tell) in the uprisings in the Middle East. High prices are adding millions to the number who go to bed hungry each night. This is the second price spike in less than four years. Companies are sounding the alarm and the G20 grouping of the world's largest economies has put "food security" top of its 2011 to-do list.

This attention is welcome. But today's spike is only part of a broader set of worries. As countries focus on food, they need to distinguish between three classes of problem: structural, temporary and irrelevant. Unfortunately, policymakers have so far paid too much attention to the last of these and not enough to the first.

The main reasons for high prices are temporary: drought in Russia and Argentina; floods in Canada and Pakistan; export bans by countries determined to maintain their own supplies, whatever the cost to others; panic buying by importers spooked into restocking their grain reserves. Influences outside agriculture make matters worse: a weaker dollar makes restocking cheaper in local currencies; and dearer oil pushes up the cost of inputs (it takes vast amounts of energy to make nitrogen fertiliser, so fertiliser prices track oil prices).

Some people mistakenly blame yet another factor: speculation. True, increased financial trading might make prices more volatile, though the evidence is weak. But trading cannot drive prices up in the long term since for every buy, there is a sell. That has not stopped Nicolas Sarkozy, the current head of the G20, from trying to persuade the world's premier economic club to crack down on evil speculators.

AFP

Cambodian children eat ice cream at a village on the outskirts of Siem Reap, 300 kilometres northwest of Phnom Penh. Rising food prices have pushed about 44 million people into poverty in developing countries since last June, the World Bank warned.

At the moment big structural shifts, such as the growth of China and India, are influencing prices less than one might think. The two Asian giants are demanding more food (and more types of food), but so far their own farmers have largely satisfied that, so they have not needed to trade much (though that would change dramatically if China were to import wheat this year).

Over coming decades, though, such fundamental factors will matter more. A good guess is that food production will have to rise by 70 percent by 2050 to keep pace with population growth, the explosion of developing countries' megacities and the changes in diet that wealth and urbanisation bring. Big increases will be harder to achieve than in the past because there is little unfarmed land to bring into production, no more water and, in some places, little to be gained by heaping on more fertiliser. Climate change may well exacerbate these problems. For the first time since the 1960s the yields of the world's most important crops, wheat and rice, are rising more slowly than the global population (see special report). The world cannot feed today's 7 billion people properly. How on earth can it feed the expected 9 billion in 2050?

The starting point may sound paradoxical: high prices. If 9 billion people are to be fed in 2050, countries that produce a miserable one tonne per hectare will have to produce two; the vast amount of food wasted on poor countries' farms -- a third or more of the total -- must be saved; and plant breeders will have to reverse the long decline in yield growth. All these things require higher returns to farmers, which will attract higher investment. Without these, there will not just be a billion hungry people (the equivalent of India) but 2 billion extra (two Indias) in 2050. Somehow, returns to farmers must rise without inflicting untold misery on the poor.

LET THEM EAT RESEARCH

It can be done. Targeting help to the poorest is part of the solution. Conditional cash-transfer programmes, such as Mexico's Oportunidades and Brazil's Bolsa Família (in which the mother gets a small stipend on condition her children attend school and get a health check-up), can work well: 70 percent of the Bolsa payments go on food.

As for boosting farm output, it will come as no surprise that this newspaper believes that a big part of the answer is removing trade barriers and cutting subsidies. Lowering tariff walls round rich countries would increase poor farmers' exports. An agreement to limit trade bans might make exporters think twice before disrupting world markets. Countries should scrap targets for biofuels which favour an expensive, environmentally damaging business that needlessly distorts food markets. America's ethanol subsidy is a particularly egregious offender. Even opening up retailing to foreigners can help: companies such as Wal-Mart are good at getting food onto supermarket shelves rather than leaving it to rot in the fields.

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Although governments can help a lot by getting out of the way in what has been a woefully distorted market, in one respect they need to do more, by reversing the decline in public spending on agricultural research. Unlike other farm subsidies, basic research works. The Green Revolution began with public research. So did Brazil's recent farming successes. Western countries have not learned the lesson. They have complacently cut back on the work done in universities and international institutions. It was a huge mistake. Basic farm research helps the whole world -- and is a bargain. One billion dollars would provide many billions of benefits in terms of people fed and food riots forestalled.

Rich countries should therefore properly finance the "CG system", a network of government-backed institutes, carrying out research into rice, wheat, maize and livestock. And the emerging giants should chip in, too. China, India, Brazil and Russia complain that they do not get the respect they deserve. Here is a chance for them to earn it by helping underwrite a global public good. They should contribute to the CG system (as Mexico, to its credit, is doing) and make their national research available more widely. Few things matter to human happiness more than the yields of staple crops.