

# Money matters and the economy

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**A**MPLE discussions regarding money supply and its significance in the economy have taken place recently. Why is it so important? Any country's prime objective is to attain a high economic growth and overall macroeconomic stability. Control of money supply and interest rate is executed through monetary policy which helps attain the prime objectives.

So how does the alteration in monetary policy affect the economy? In a developing country like Bangladesh, the level of investment is crucial for attaining higher economic growth. If Bangladesh is to attain the middle-income status by 2021, it is imperative that it increases its investment to GDP ratio. However, in recent years, total investment hovered within a narrow band of 25 percent of GDP. Countries with the middle-income status have investment to GDP proportions ranging from 35 percent to 40 percent. This can depict how far behind Bangladesh is in the race to attain higher growth and how vital it is to increase investment levels.

Now this is where a prime importance of monetary policy comes in. As investors are concerned with the cost of borrowing money from banks, i.e., interest rates, Bangladesh Bank alters broad money growth rates to modify interest rates. If the investment climate is favourable, the central bank may pump in more money into the economy to accommodate the rise in demand for credit, which in turn can lower interest rates and increase investments. Conversely, if the BB wants to tame a high rate of inflation, it will reduce money supply from the economy. One can naturally infer that increasing money supply and lowering interest rates (quantitative easing) may be ideal in order to promote investment in Bangladesh. However, this may not be true.

It has persistently been argued that one of the main reasons for lower levels of investment is the recent



'contractionary' monetary policy pursued by the BB. Past statistics, however, portray a different scenario. Broad money growth rates in fiscal 2010 and 2011 have been 22.4 percent and 21.3 percent respectively, which were higher than the targets set. Private sector credit in those years grew by 24.2 percent and 25.8 percent, whereas its previous ten-year average was 15.7 percent.

Since the private sector was taking loans at an astounding level, one can indisputably expect a rise in investments by the private sector. On the contrary, private sector investment remained practically unchanged. So where were the loans taken by the private sector all stashed? The formation of the stockmarket bubble and its burst in recent years can be attributable to this. Prices of real estates and lands swelled and inflation surged and

reached double digits. The repercussions of these were immense: people lost their hard earned money and savings when the stock bubble burst; high prices of real estates and land made these assets out of reach for many people and adjoined to further income inequality. High inflation acted as a tax on income and peoples' real income fell. Needless to say, investments in these sectors hardly act as a catalyst for economic growth. Now why were not there any growth-augmenting investments by the private sector? This may be because there are several barriers that discourage people from investing such as a lack of energy, political instability and a deficiency in infrastructure.

The BB in its recent monetary policy opted for tightening the broad money growth rate to reduce inflation from 7.7 percent to 7 percent.

Private sector credit target has been cut to 15.5 percent from 18.5 percent. Some say that the BB should have gone for quantitative easing and lowered interest rates which could have revived investment. However, the private sector credit growth has been plummeting since July 2012. Is it unlikely that the private sector will undertake investments in the face of intense political turmoil? An argument can be placed saying that private sector credit growths were much higher than current 11.4 percent in previous election years, so why not go for quantitative easing to generate investment?

However, in the past, the length of political turbulence could be predicted as elections were held on time. Since the end of the previous BNP regime and takeover by the caretaker government, there has been perplexity about how long the

political chaos will last. Contrary to previous, this time the investors cannot predict how long the slump in economic activity will persist and thereby cannot calculate the depth of their risks.

There are certain anomalies in the conduct of monetary policy as well. Firstly, in recent years, the BB could not adhere to the targets it set for broad money growth as it was always higher than the targets. In May 2013, the rate was 18.1 percent against a target of 17.5 percent. The BB mostly does this by buying off dollars from banks and thus pumps the taka back into the system. Dollars are bought to keep the taka from appreciating since an undervalued currency augments to export competitiveness. This dilutes the efficacy of monetary policy and entails risk of high inflation and asset bubbles. This also makes imports expensive and can discourage investors from buying imported machinery.

The second problem lies in the occasional lack of harmony between the monetary and fiscal policies. For instance, in fiscal 2012, government borrowing from the banking system surged mainly due to a rise in subsidy payments. This was a time when monetary policy started to contract. As a result of high borrowing by the government, private sector was 'crowded out' during that time. One way by which the fiscal gap could have been bridged is by the issuance of sovereign bonds (bonds issued by national governments in foreign currencies). However, these bonds will not surface until the arrival of the next government.

Prudent application of monetary policy is highly necessary for Bangladesh as it cannot only spur investment but also help attain the objectives required for economic growth.

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## Singapore to double capacity of Changi Airport

AFP, Singapore

Singapore will build a new terminal that will double the capacity of Changi Airport in a bid to retain its edge as a regional aviation hub, Prime Minister Lee Hsien Loong said on Sunday.

Construction work will begin soon and will be completed in 12 to 15 years, Lee announced in his annual policy speech.

"T5 (Terminal 5) sounds like a terminal, but it is actually a whole airport by itself, as big as today's Changi Airport," said Lee.

He did not reveal the cost of the new facility, but said it would include a third runway that would double the capacity of Changi, which handled 51.2 million passengers last year.

Changi Airport, named the world's best by Britain-based consultancy Skytrax this year, currently has three terminals with a total capacity of 66 million passengers a year.

In February it started to demolish its terminal for budget airlines to replace it with a larger facility.

The new facility, Terminal 4, will have the capacity to handle 16 million passengers a year when it opens in 2017.

In his speech late Sunday, Lee said there was growing competition from other major international airports in Southeast Asia.

He noted that Malaysia's Kuala Lumpur International Airport and Thailand's Suvarnabhumi Airport are planning to expand.

"The question is do we want to stay this vibrant hub of Southeast Asia, or do we want to let somebody take over our position, our business and our jobs?" Lee said.

Passenger traffic at Changi totalled 51.2 million last year, the first time in the airport's 31-year history that the number of people passing through crossed 50 million.

## Rare blue diamond to be auctioned in Hong Kong

AFP, Hong Kong

A rare round blue diamond will go under the hammer in Hong Kong in October, with auctioneers hoping the sale will fetch a record-breaking \$19 million despite fears over the slowing Chinese economy.

Auction house Sotheby's expect the 7.59-carat fancy vivid blue diamond, which is about the size of a shirt button, to set a new record for price-per-carat.

Quek Chin Yeow, Sotheby Asia's deputy chairman, said Hong Kong was the natural venue to sell the gem, known as "The Premier Blue", with collectors expected to fly in from all over the world.

"While there is a slowdown (in Chinese economy), the number of top-level collectors are still there," he told AFP.

"We have been selling very well in Hong Kong." Hong Kong has become a centre for jewellery auctions thanks to growing wealth in China and other parts of the region, as well as the region's increasing taste for art.

But there are fears for the future of the Chinese economy, the world's second largest, where growth fell to 7.8 percent in 2012 -- its slowest pace in 13 years.

Blue diamonds seldom hit the market and have been coveted by royals and celebrities for centuries, while a round cut is rarely used in coloured stones because of the high wastage.

The most famous example of a blue diamond is the "Hope Diamond", which was bought by King Louis XIV of France in the 17th Century.

## INDIAN ECONOMY

# Focus should be inflation, not just halting rupee's fall



REUTERS

A jeweller poses with silver plates in the form of rupee notes at a showroom in New Delhi. India's benchmark 10-year bond yield rose to its highest since the pre-Lehman crisis on Monday as the rupee fell to a record low.

DH PAI PANANDIKER

**I**NDIAN stocks have been battered over the past few sessions. The market condition is not unexpected, thanks to over-action by policymakers and over-reaction by stock investors.

The apparent anxiety on the part of the government was that even if the fall of the rupee was inevitable, left entirely to the market, speculative activity would push the economy into a crisis. Presumably, the rupee at 60 to the dollar was the benchmark for intervention.

Concerted action started with the Reserve Bank of India (RBI) raising short rates through marginal standing facility and mopping up cash through the liquidity adjustment facility on July 17, although Governor Duvvuri Subbarao had maintained that the central bank's objective was to reduce exchange rate volatility and not its level. The assumption was probably that the rupee was over-valued and had to find its reasonable level.

Not content with the impact of these initiatives, the RBI announced on

Aug. 8 that it would auction 220 billion rupees of government cash management bills [6] every Monday, in a kind of reverse quantitative easing.

Anticipating the central bank's moves, foreign institutional investors had already pulled out \$4 billion from investment in debt. The banking system was left dry.

The government complemented the RBI with its own initiatives. It declared its intention to restrict non-essential imports and raised duty on gold to 10 percent. Not that this would stop imports. Gold will be imported through illegal routes and also boost the hawala business.

But that's not the real issue. What triggered the Sensex freefall is the reversal of reforms. Indian companies now cannot invest more than 100 percent of their net worth overseas without RBI approval and remittances by individuals were brought down to \$75,000 from \$200,000 per financial year. That created fears that government policy has changed direction from reforms to controls.

Was all that necessary? Not really, if the government had addressed a single issue—inflation. No country

can maintain a stable currency with high inflation over a long period. The rupee cannot always be propped up by FII and external commercial borrowing inflows. Already, nearly half of the foreign exchange reserves with the RBI are from FII investment.

Inflation should have been the policy target. It eroded the value of the rupee and at 45 to the dollar, the rupee became highly over-valued. Allowing for inflation in India and inflation in the United States in the past five years, 62-63 rupees per dollar would be the real exchange rate. The market, so far, has not exaggerated the fall of the rupee.

Apparently, the government was anxious to take the rupee back to a higher level and introduced measures which, to an extent, negated the steps that had led to the India growth story. The market feared the worst and the bears took full advantage. The damage has been done and it will take time to undo it.

The writer undertakes research on current macroeconomic issues of interest, mainly to industry, as president of RPG Foundation, a private think tank in India.

## India's rupee tumbles as World Bank says gloom overplayed

AFP, Mumbai

**I**NDIA'S currency plunged to a new low and shares tumbled another two percent on Monday even as the World Bank's chief economist said the country's economic problems were "overplayed".

Kaushik Basu said India was not in danger of a full-blown economic crisis, despite mounting fears about Asia's third largest economy, which is struggling with a gaping current account deficit that has helped push the rupee to record lows.

"Growth may not have bottomed out. We have further to go (down), but the situation is not as bad as is being captured by the mood and captured in the headlines," Basu told an audience in New Delhi.

Basu, who was an adviser in the Indian finance ministry until September, said the situation was different from 1991 when India had to seek a bailout from the International Monetary Fund in what was considered a national humiliation.

"India is nowhere near the 1991 crisis. The gloom is being overplayed," he added.

The partially convertible rupee, now Asia's worst-performing major currency this year, fell to 62.70 to the dollar, past its previous low of 62.03 on August 16,

weaken further on concerns that a series of central bank measures over the past three months would not help it.

At Monday's new low, the rupee has fallen over 14 percent against the dollar this year, outstripping the yen in its tumble.

Investors awaited fresh measures from the Reserve Bank of India (RBI) and the government to aid the rupee on Monday, but there was no intervention by early afternoon.

"The market is so panicked that 63 is a possibility," said Param Sarma, chief executive with consultancy firm NSP Forex, referring to the rupee's level.

Sarma said he expected the RBI to intervene in the forex markets to prop up the currency, but it would not help much.

"There is no respite for the rupee," he said.

Last Wednesday, in the latest of a series of measures to prop up the currency, the RBI spooked investors when it tightened controls on the amount of money Indian firms and individuals can send abroad.

The move has been criticised as a disturbing throwback to the days before India unleashed its economic liberalisation drive in the early 1990s, when Indians' access to foreign exchange was strictly limited.

In the past few weeks policymakers



Kaushik Basu

on concerns about the slowing economy.

Indian shares, which fell nearly four percent on Friday, plunged another 2.11 percent or 392.86 points to 18,205.32 points in afternoon trade.

Nervousness rose over the currency as foreign investors pulled out cash.

Yields on benchmark 10-year government bonds jumped to over 9 percent -- their highest since November 2011 -- with a higher rate indicating a lack of willingness to invest in the paper.

Dealers said they feared the rupee could

have raised short-term interest rates, announced plans to let state firms raise foreign funds abroad, and curbed gold imports in a bid to narrow the deficit and stabilise the rupee.

Emerging-market currencies have been hit by the prospect that the United States will roll back massive stimulus measures. These have been responsible for huge inflows of foreign investment into developing countries.

India relies on foreign capital to fund its current account deficit.