Managing the banking sector fault lines

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REFORMS over the past two decades or so have greatly improved the quantity and quality of banking services in Bangladesh.

The urban areas are well served by a competitive banking sector with convenient access and a range of banking products, including electronic banking.

The rural areas are increasingly coming under the spread of commercial banking, supplemented by the large growth of microfinance institutions. A growing number of the unbanked rural population is being serviced through mobile financial services.

Interest rates are falling sharply and many borrowers with good track record are getting loans at single digit interest rate.

But, there is still a long way to go, especially to service the remaining large unbanked population and to meet the financing requirements of the host of micro and small enterprises that do not have access to banking sector credit.

Still, the above achievements are to be celebrated.

Policy effort should now seek to consolidate the gains and focus the banking sector agenda to achieve the country's dream of securing the upper-middle income status by 2031. How well prepared is the sector to respond to this challenge?

Unfortunately, there are signs that some deep fault lines are emerging, which, if not addressed swiftly and with resolve, could create serious difficulties and hurt the country's effort to move to the upper middle-income status.

These fault lines can broadly be grouped under two headings: the growing incidence of non-performing loans and the growing asset concentration among single borrowers.

International evidence suggests that both present high risks to the financial health and stability of the banking sector.

Indeed, the range of prudential norms underscored in the Basel rounds (Basel III now in place) is meant to guard against these and other systemic risks.

International evidence also shows the critical importance of having a highly professional and autonomous banking sector regulator, globally known as the central bank, to serve as the guardian of the banking sector health and to protect the depositors' confidence in the banking system.

The lack of autonomy of the Bangladesh Bank is the third fault line that requires careful political debate and resolution.

The amount of NPL climbed to an astounding Tk 70,400 crore ($8.8 billion) in fiscal 2016-17, which is 90 percent of Bangladesh's actual annual development spending for the year.

While traditionally the NPL phenomenon is large in public banks for well-known governance problems, the evidence of rising NPLs in private banks presents additional challenges.

In a market economy, business-cycle related downturns can cause financial difficulties for private firms that could spill over to the banking sector. But there are many corrective instruments that the BB can use to manage these shocks.

What are near-impossible to tackle are difficulties infused in private banking by political interventions including constraints on the effectiveness of BB supervision.

One of the prudential instruments for portfolio management is the selection of bank board members based on the "fit and proper" test. There is a widely shared concern in the banking professional community that the quality of the boards in many private banks is weakening.

There is a growing dominance of non-professional private bank boards, often based on family connections and the BB has very little authority in practice to correct that.

As a result, lending decisions are not always made on solid business evidence but on connections. In this case, the risk to NPLs will obviously increase.

Furthermore, there is now a proposal under active consideration to further relax the prudential norm regarding board selection by increasing the tenure of board membership and allowing as many as four members of the same family to sit on the board.

Prudential norms usually limit the banking sector's exposure to an individual and or family to a small number (usually to 10 percent) with a view to protecting the domino effect of the collapse of a business on the banking sector.

Global evidence of business collapses during an economic downturn is plenty. The most recent episode was the global financial crisis of 2008-2010 triggered by irresponsible lending and economic downturn in the US.

A large Bangladeshi business dealing with speculative commodity trading, stock market shares, or real estate transactions can easily go under, which could lead to its inability to service its bank loans. The larger the exposure of this firm, the larger the risk to the banking sector.

It is a no-brainer that the BB needs to protect the health of the banking sector against this risk by setting banking sector-wide exposure limits and closely monitoring its implementation.

Due to confidentiality, the BB does not publish the asset concentration data. But there is common talk in the banking profession that this asset concentration is growing, including through acquisition of several banks under single family ownership.

Whether or not it is true, the government and the BB would know best. If true, the BB needs to worry a lot and alert the highest level of policymaking about the associated risks and the possible reform options.

The degree of autonomy granted to a central bank is a contentious subject in most developing countries.

In advanced economies this is taken for granted and is an important indicator of good governance.

As Bangladesh aspires to attain upper middle-income status, it must also reform its institutions including the establishment of a professional and autonomous central bank.

If this principle is accepted, the government may want to re-examine the current management of the banking sector and strengthen the reach of the BB supervision to all banks along with full application of all prudential norms.

It must also refrain from any intervention in the functioning of the BB.

Bangladesh should be proud of its many achievements in the banking sector. It now needs to build on them and push ahead with banking reforms that will support the realisation of upper middle-income status by 2031.

Several deep fault lines have emerged that should be deftly managed to prevent backsliding on progress.

A combination of growing NPLs and asset concentration if unchecked can jeopardise the stability of the banking sector. Swift actions are needed to address these concerns.

The best solution is to increase the authority and autonomy of the BB to strengthen supervision of all banks (public and private) and apply the full prudential norms.

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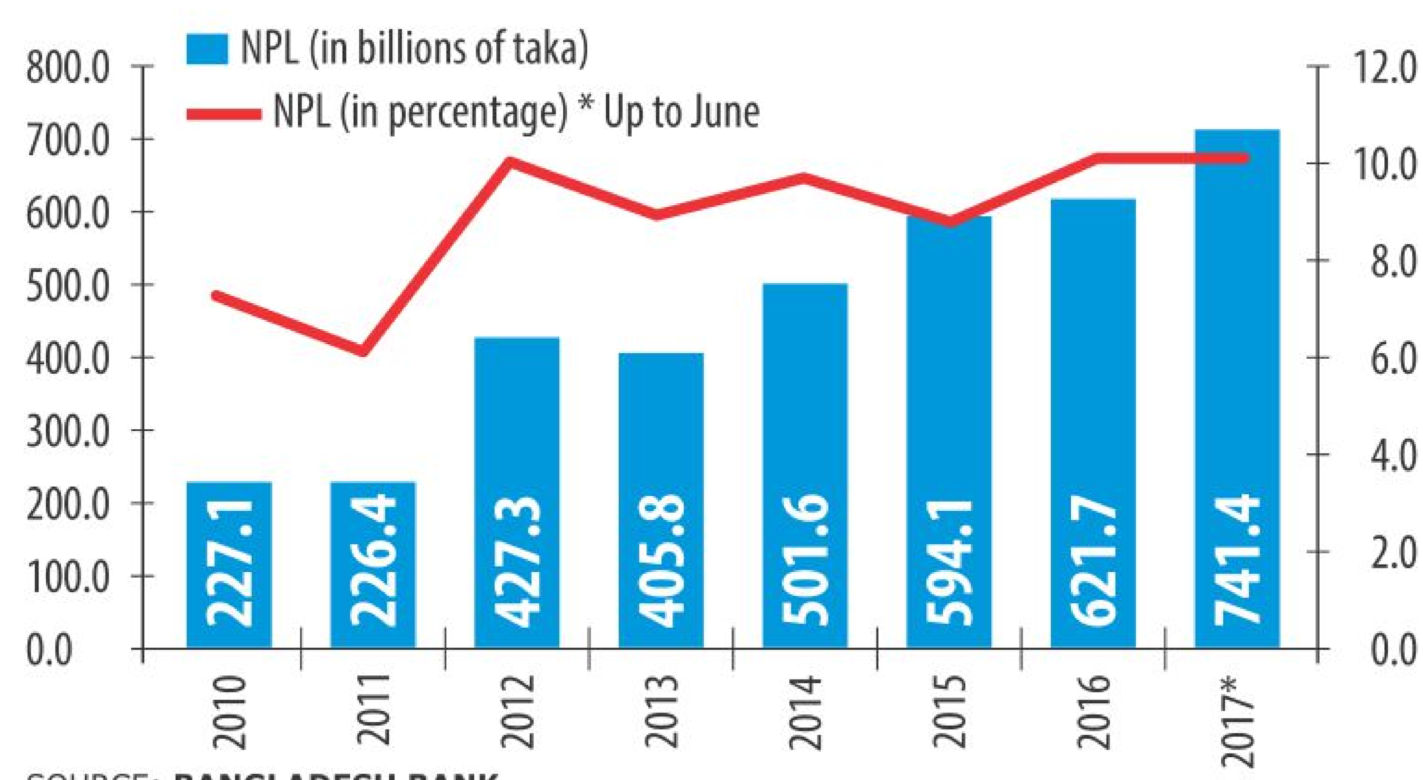
GROSS NON-PERFORMING LOANS OF BANKING SECTOR



SOURCE: BANGLADESH BANK

'Robo-taxis' hold promise, and perils, for automakers

AFP/FILE

Technicians analysed data following the trial of an autonomous self-driving vehicle in Milton Keynes, north of London.

AFP, *Paris*

IT'S November 22, 2028 and Sarah, a young mother, gives her two children a kiss goodbye before buckling them into the driverless car that will bring them to school.

Sarah doesn't have a car and has no plans to buy one. Living in a suburb, she has run the numbers and the result is clear: It's much cheaper to order a car only when she needs one.

The "robo-taxi" has also made her life easier, but only after such vehicles upended the business models which carmakers had relied on for decades.

The revolution is already underway, with every major brand racing to create autonomous electric cars and trucks that will always be just a few clicks of a smartphone away.

Fully electric cars are expected to make up 12 percent of the global market in 2025, before jumping to 34 percent in 2030 and 90 percent by 2050, analysts at Bank of America Merrill Lynch forecast last month.

The motivations are clear: Smog is becoming a serious menace in cities around the world, with China in particular demanding cleaner vehicles for its rapidly growing market.

Traffic jams are also eating up hours of commuters' time, meaning car ownership is already no longer a given for many city dwellers.

And carmakers have nimble new rivals: Apple, Google and Tesla -- which last week unveiled an all-electric semi truck -- see a chance to dominate a market that will soon depend as much on software as on engineering.

Industry chiefs aren't waiting: France's PSA is betting on car-sharing and other "services" with its Free2Move division, which it hopes will let it get back into the huge US market.

In Germany, Daimler is working with Bosch to develop self-driving electric cars that could be on the road by the early 2020s, and has already launched its own car-sharing service, Car2Go, in some two dozen cities worldwide.

Its German rival Volkswagen has created Moia, a "social movement" unit exploring e-shuttles, ride pooling and car hailing.

"Even if in the future not everyone is going to own a car, with Moia we're trying to make sure everyone will be a client of ours one way or another," VW's chief Matthias Mueller said.

Robo-taxis could generate 40 percent of auto industry profits by 2030, according to German consulting firm Roland Berger, which expects demand for private vehicles to drop 30 percent in the period.

And industry experts warn that the automakers which fail to adapt to the shift risk might not survive.

But that means investing billions in batteries, charging infrastructure and autonomous driving technologies with little prospect of seeing a payoff anytime soon.

VW announced Friday a plan to spend 34 billion euros ($40 billion) over the next five years on hybrid and electric cars and services in a bid to "reinvent" the automobile.

But for now, so-called "zero emission" vehicles remain a tough sell: Renault's Zoe range of electric cars, which is has offered since 2012, made up just 1 percent of its sales last year.

Its chief, Carlos Ghosn, is hoping that figure will reach 5 percent by 2022.

Bumper profits, government pressure to drive Asia's dividend bonanza

REUTERS

REUTERS

Dividends grew between 0.5 percent and 9 percent between 2012 and 2016.

DIVIDEND payouts by Asia's biggest companies are poised for their biggest increase in six years as profits surge and pressure grows on firms to be more generous with their shareholders.

Across Asia, dividend payouts in 2017 are expected to grow by 12 percent year-on-year, a Reuters analysis showed, marking the largest increase in payouts since 2011.

That corporate generosity, driven to some extent by improving economic growth, is only partly reflected in the share price, analysts say.

If, as consensus forecasts show, earnings growth stays strong into next year and 2019, there is plenty of room for Asian stock markets to rally beyond current multi-year highs.

"2017 is the year when earnings finally recover after five years of disappointing growth in Asia," said Frank Benzimra, head of Asia equity strategy at Societe Generale in Hong Kong.

"Accordingly, we see dividends rising, in line with earnings growth."

The numbers, compiled from Thomson Reuters earnings data, show technology companies such as Taiwan Semiconductor Corp, Samsung Electronics Co Ltd and Sony Corp are expecting record profits and higher dividends this year as the launch of new smartphones drives up demand of memory chips and image sensors.

Malaysia's CIMB Group Holdings Bhd, which announced its second best quarterly earnings in four years in the June quarter, issued an interim dividend of 1.18 billion ringgit ($281.96 million), translating to a dividend payout ratio of 51.6 percent of first-half profits.

The analysis covered 1,571 Asian companies each with a market capitalisation of at least $1 billion across 12 markets for which Thomson Reuters has available data on dividend estimates. Dividends grew between 0.5 percent and 9 percent between 2012 and 2016.

Across the region, corporate profits are climbing owing to higher commodity prices, a revival in global demand for consumer products and an improvement in bank profits as loan growth soars even as funding costs stay low.

The markets have priced in some expectations of these bumper returns but analysts expect earnings and therefore dividends growth to stay strong even in 2018 and 2019, said Benzimra.

"I don't think this is really priced into the market," he said. "If we indeed have this kind of earnings growth, that could lift the market."

MSCI's Asia ex-Japan index has risen about 30 percent this year and is at its highest since 2007.

Grace Tam, a senior market strategist at HSBC Global Asset Management based in Hong Kong, said free cash flows are higher among Asian companies and investors might find themselves surprised by future payouts.

Thomson Reuters data on the same set of companies showed their total free cash flows for 2017 are estimated at $374 billion- the highest in at least a decade.

Asian shares arguably have more room to grow than developed markets such as the United States, based on forward dividend yields, the ratio of estimated dividend payments over the next 12 months to share price.

Taiwan, Hong Kong, Singapore, Malaysia, and Thailand have forward dividend yields in excess of 3 percent, much higher than United States' 1.9 percent. Asia's average yield stood at 2.4 percent.

Yet, Asia's price-to-earnings ratios are lower, ranging from South Korea's 9.6 to China's 13.5, against the global average of 15.4.

The ability of Asian companies to pay dividends has never been in doubt, but their desire to sit on large cash piles has traditionally affected shareholder returns.

Asia's dividend payout ratio stood at 34 percent over the last 12 months, less than Europe's 45 percent and North America's 43 percent, despite Asian profit growth exceeding the other two regions.

Analysts said Asia's dividend culture is likely to change, as government pressure on companies grows.

China, where the securities regulator has vowed to penalise companies that do not pay cash dividends, is seeing rising payouts. Coal miner Shenhua Energy Co proposed a special dividend worth 50 billion yuan ($7.53 billion) earlier this year.

Japan introduced the corporate governance act in 2015, aimed at protecting shareholder rights and enriching their returns. Since its inception, more companies have started to comply with it.

Japan, as well as Hong Kong, Malaysia, Taiwan and Thailand, have introduced stewardship codes aimed at institutional investors agitating for better governance and returns on their investment.

South Korea is expected to adopt the stewardship code this year and has strong backing from new President Moon Jae-in.

Samsung last month said it would double dividends next year to 9.6 trillion won and keep them at that level until 2020, as it responds to investor pressure to share its vast cash reserves.