Monetary policy dilemma of Bangladesh Bank

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As the covid-19 pandemic unfolded, central banks across the globe responded with a dramatic easing of monetary policy to provide liquidity support for the faltering economic activities.

Bangladesh Bank's (BBs) policy response was also similar, but measured in terms of scope and extent in line with the unfolding domestic economic conditions. The injection of liquidity, as part of the government's bank-led economic stimulus package, has been sizable and considered absolutely essential to avoid any liquidity crunch in the economy.

In the event, due to the ongoing surge in the officially measured inflow of workers' remittances and the decline in import payments associated with economic slowdown, the external current account of the balance of payments (BOP) recorded large surpluses and foreign exchange reserves of BB increased by more than $11 billion to more than $43 billion by end-December.

The strengthening of the BOP through the reserve buildup is a welcome development, although it is to a large extent an outcome of weak domestic demand and economic activity.

The implementation of the stimulus package led to injection of high-powered money into the economy in the form of BB's liquidity support (potentially up to Tk 60,000 crore). The inflows forced BB to intervene in the foreign exchange market to keep the exchange rate of the dollar against taka stable by preventing a significant appreciation of the taka in the interbank foreign exchange market.

The interventions in the interbank foreign exchange market and the counterparts of the large pandemic-induced foreign assistance to the government (about $2 billion) injected huge amounts of liquidity into the banking system.

The amount of high-powered money injected into the banking system through the reserve buildup has been in the range of Tk 80,000-90,000 crore. The combined liquidity injection into the banking system from these two sources alone already amounted to about Tk 1.4-1.5 lakh crore.

This rapid liquidity injections have been happening at a time when the growth in private sector credit demand has decelerated to 8.2 per cent, the lowest level in the last one decade or more. Large corporates with strong financial standings are also borrowing from abroad at much cheaper rates and restructuring their liabilities by substituting domestic debt with foreign currency denominated debt at much cheaper interest rates.

Combined with the massive slowdown in credit to the private sector, the liquidity injection has contributed to a significant liquidity overhang. For most banks the advances to deposits ratios have come down well below the regulatory limit of BB.

The result is a collapse in the interest rate structure with deposit rates coming significantly below the inflation rate. The lending rates have also come down to levels not seen in several decades.

For good corporates, the current domestic borrowing rates are ranging between 5 per cent-7 per cent, well below the 9 per cent lending cap imposed by the government.

Against this background, BB's monetary policy committee will soon be reviewing the stance of monetary policy and make necessary adjustments for the coming months.

The implementation of the stimulus packages led to injection of high-powered money into the economy in the form of BB's liquidity support

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The Bangladesh Bank head office is seen in the capital's Motijheel area. The policy dilemma is likely to intensify in the coming months, complicating the central bank's monetary policy management.

In this context, BB needs to understand: (i) what are "real sources" of the ongoing surge in workers' remittances; (ii) the state of the real economy preferably based on surveys of key economic sectors; (iii) possible implications of the excess liquidity for domestic consumer price index (CPI) and its spillover effects on the asset price inflation; and (iv) the outlook for the remittance inflows and domestic private sector credit demand in the coming months and their implications on the excess liquidity in the money market. The remainder of this paper focuses on these issues in order to draw some policy implications for the consideration of BB authorities.

UNDERSTANDING 'REAL SOURCES' OF REMITTANCE INFLOWS

Officially recorded inflows classified under workers remittances have increased by more than 40 per cent in the first half of FY21. This has happened at a time when the number of workers going abroad has declined by almost 75 per cent.

New workers going out of Bangladesh for work abroad has stopped after February 2020 and has not reopened as of now.

At the same time, because of the collapse in petroleum prices and the pandemic induced recession, most oil exporting gulf countries and some others have sent back 300,000-400,000 workers from those countries.

Income levels of workers in the gulf countries and in other parts of the world also might have declined, and there is no reason to expect that their income have gone up enabling them to send significantly more money to their families. There are other reasons like expatriates sending more money to their relatives adversely impacted by the pandemic (such as loss of jobs or illness) and to mitigate the impact of the flood and long rainy season on farm and nonfarm rural income.

Another factor which might have contributed to the surge was that hundreds of thousands of repatriating workers were sending their hard-earned savings prior to their return. Each of these factors might have played some role but none can explain the continued increase in inflows well after the return of workers and the end of the floods. Thus we need to look for other plausible factors such as: (i) expatriates are sending their financial savings to Bangladesh due to virtually zero returns on financial assets in many host countries; and (ii) people switching to more formal channel due to technological interventions like instant cash transfers through mobile financial service networks and attracted by the 2 per cent cash incentive provided by the government.

Both of these factors are sustainable over the next few years contributing to continued strong inflows, given the expected continuation of easy monetary policy in the industrial world.

STATE OF THE REAL ECONOMY AND OUTLOOK

All available economic indicators are pointing to continued weakness in the domestic economic activity. In addition to subdued credit demand, demand for imports have declined and remains significantly below the 2019 level.

The stock price index already increased by more than 50 per cent in the midst of the pandemic and further upward moves leading to another price bubble cannot be ruled out if the excess liquidity remains high

Tax collection remains very weak with the projected revenue shortfall of about Tk 80,000 crore in FY21. In particular, the growth in domestic VAT, which is directly linked with domestic economic activity increased by only 2 per cent in the first half of FY21, pointing to a decline in real terms.

Exports, which recovered somewhat during July and August, have once again declined due to the fall in orders from the EU and the USA as a result of the second coronavirus pandemic wave in the Western hemisphere. Overall, the growth outlook for FY21 is likely to be worse than in FY20.

POSSIBLE IMPLICATIONS OF EXCESS LIQUIDITY

Excess liquidity in the money market is generally manifested in commodity price and asset price inflation. Global liquidity expansion has already contributed to global commodity price inflation in the midst of economic recession.

Prices of food grains like rice (reaching 7-year high), wheat, corn and soybean are much higher than last year; same with construction materials and hydrocarbon products; industrial inputs like cotton increased significantly (28 per cent); and prices of construction materials like steel (32 per cent) have also increased sharply due to supply bottlenecks or shocks.

Commodity prices and industrial and construction raw materials in Bangladesh (such as edible oil, wheat, cotton, yarn, steel, etc.) are also rising significantly with rice prices at record high levels. Thus food inflation will remain high, although due to subdued wages and diminished capacity to spend for a large part of the population resulting from increased poverty and joblessness, non-food inflation will continue to remain moderate.

In this setting, the excess liquidity is likely to end up in asset price inflation, as recorded in most industrial countries and in India. In the USA and India stock prices are at already record high levels. In Bangladesh, the stock price index already increased by more than 50 per cent in the midst of the pandemic and further upward moves leading to another price bubble cannot be ruled out if the excess liquidity remains high.

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GLOBAL BUSINESS

India proposes law to ban cryptocurrencies, create official digital currency

Reuters, Mumbai

India plans to introduce a law to ban private cryptocurrencies such as bitcoin and put in place a framework for an official digital currency to be issued by the central bank, according to a legislative agenda listed by the government.

The law will "create a facilitative framework for creation of the official digital currency to be issued by the Reserve Bank of India (RBI)," said the agenda, published on the lower house website on Friday.

The legislation, listed for debate in the current parliamentary session, seeks "to prohibit all private cryptocurrencies in India, however, it allows for certain exceptions to promote the underlying technology of cryptocurrency and its uses," the agenda said.

In mid-2019, an Indian government panel recommended banning all private cryptocurrencies, with a jail term of up to 10 years and heavy fines for anyone dealing in digital currencies.

REUTERS/FILE

A representation of virtual currency Bitcoin and small toy figures placed on a computer motherboard in this illustration.

The panel has, however, asked the government to consider the launch of an official government-backed digital currency in India, to function like bank notes, through the Reserve Bank of India.

The RBI had in April 2018 ordered financial institutions to break off all ties with individuals or businesses dealing in virtual currency such as bitcoin within three months.

However, in March 2020, India's Supreme Court allowed banks to handle cryptocurrency transactions from exchanges and traders, overturning a central bank ban had that dealt the thriving industry a major blow.

Governments around the world have been looking into ways to regulate cryptocurrencies but no major economy has taken the drastic step of placing a blanket ban on owning them, even though concern has been raised about the misuse of consumer data and its possible impact on the financial system.

China exported more than 220b masks in 2020: govt

AFP, Beijing

China exported more than 220 billion face masks last year, the commerce ministry said Friday, the equivalent of nearly 40 per person outside China as demand for protective gear skyrocketed during the coronavirus pandemic.

Shifting billions of dollars' worth of the coverings has become an important driver of China's exports after Covid-19 virtually halted economic activity in the earlier part of 2020 and ravaged growth.

On Friday, vice-minister for commerce Qian Keming told reporters that in addition to masks, China exported 2.3 billion pieces of protective gear and one billion test kits last year, "making an important contribution to the global fight against the epidemic".

The mask shipments alone were worth 340 billion yuan ($52.6 billion), a customs official said earlier this month. "(The volume) is equivalent to providing nearly 40 masks to each person in the world outside China," said customs spokesman Li Kuiwen.

China, where Covid-19 first emerged in late 2019, was also the first country to bounce back after imposing strict lockdowns and virus control measures. It is expected to be the only major world economy to clock positive 2020 growth.

But on Friday, commerce ministry official Chu Shijia added that China still faced a "severe and complex" environment in foreign trade and investment this year.

People wearing face masks walk down a street following the coronavirus outbreak in Shanghai, China.

REUTERS/FILE

German economy posts minimal growth as virus bites

AFP, Berlin

The German economy, Europe's largest, posted just 0.1 per cent growth in the fourth quarter last year as new coronavirus restrictions choked off activity, official figures showed Friday.

The Destatis statistics office said a sharp rebound of 8.5 per cent in the third quarter "was braked by the restrictions imposed (to curb) a second wave of the virus at the end of the year".

Compared with fourth quarter of 2019, the German economy contracted 3.9 per cent.

For full-year 2020, the Germany economy shrank 5.0 per cent, in line with estimates published earlier this month.

Meanwhile the Federal Labour Agency reported a stable unemployment rate for January of 6.0 per cent despite the new measures imposed the previous month to slow the spread of coronavirus.

The country closed restaurants, hotels, culture and leisure centres in November, followed by schools and non-essential shops in December. The measures have since been extended until mid-February.

Analysts said the outlook remained uncertain. "The resilience shown in the fourth quarter is not going to last," said Andrew Kenningham, chief economist at Capital Economics.

According to the DIW Institute, German output in the first quarter this year could shrink 3.0 per cent.

But there is some hope that the rollout of vaccination programmes will begin to limit the pandemic damage later in the year. "We could see a clear rebound in the second half of the year if enough people get vaccinated," said Fritzi Koehler-Geib, chief economist with KFW bank.

Earlier this week, the German government cut its 2021 growth forecast sharply, to 3.0 percent from 4.4 percent given the persistence of the health crisis which likely means the economy will not return to pre-pandemic levels until mid-2022.