Inflation and not so SMART interest rates

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SMART refers to the Six-Month Moving Average Rate of Treasury Bill, the instrument Bangladesh Bank (BB) uses to make interest rates flexible within bounds. Unfortunately, it is not working as it has reduced neither inflation nor foreign exchange shortages.

But let us start with some good news on the economy. In January, remittance inflow was $2.1 billion, a marked increase, while export earnings amounted to $5.7 billion. Robust inflow of medium- and long-term loans (including from the IMF) led to an infusion of over $2.5 billion to gross reserves over the past two months. The current account deficit was drastically reduced to a small surplus, though with steep costs, while revenue collection increased by 14.74 percent in January.

That said, the economy's immediate challenges remain concerning. Moreover, a key element of the government's response, its monetary policy, has not been able to stabilise the balance of payments and foreign exchange markets. Plus, the failure to tame inflation not only imposes a steep tax on the poor and the middle class, it also erodes economic competitiveness.

The challenges come from three directions. First, the balance of payments pressures and the dollar shortage continue due to the unanticipated emergence of financial account deficits. While Bangladesh has traditionally maintained a healthy surplus (inflow of funds) for its financial account—$15.5 billion in FY2022—it saw a deficit of $2.1 billion in FY2023. In the first six months of the current fiscal year, this deficit widened to nearly $5.4 billion, that is, about $7.5 billion less than the $2.1 billion surplus the IMF's programme projects for June 2024. This has happened mainly because foreign short-term lending and trade credit have dried up. The widening of the deficit also signals foreign banks' lack of confidence in Bangladesh's economy.

Second, although the trade deficit has declined sharply, this has resulted from cutting imports of intermediate goods, capital goods, and raw materials down by 20-25 percent in the first half of the current fiscal year. The reduction in imports has not been made to happen through exchange rate adjustment, but through the rationing of foreign exchange. Banks, not prices, have determined in an ad hoc manner who will receive credit and foreign currency.

Third, inflation rates have increased from six percent two years ago to 9.86 percent by the end of January 2024. Inflation has spiked in Bangladesh since 2022 for two reasons. First, international energy prices roughly doubled and edible oil prices markedly increased in 2022. Second, the 30 percent depreciation of the exchange rate for the US dollar over the past two years meant that taka import prices continued to rise even when dollar prices fell.

In recent months, international prices of LNG and oil have fallen between 40-70 percent. Also, according to Bangladesh Bank's Monetary Policy Statement (January-June 2024), depreciation tapered off to only 1.49 percent in July-December 2023. As such, external factors could not be driving the ongoing inflation.

So, what is causing inflation to worsen? Much is said about the role of syndicates and intermediaries in this regard. There is, however, little evidence about the active role of syndicates in fixing prices. Economics suggests that this is difficult to do unless a small, tightly knit group has highly centralised control over the supply of specific items such as edible oil. Still, the government should be vigilant indeed. However, blaming minor traders and stockkeepers for higher prices would be a travesty, not to mention economically risky. These small players play a vital role in the supply chain by bringing the harvest and supplies from the farms or factories to consumers. If their activities and supplies are disrupted through "police action" or vigilantism, we may see higher inflation.

FILE VISUAL: REHNUMA PROSHOON

The main culprit behind rising inflation is a tepid and conflicted monetary policy that has kept demand for goods and services high on one side and their supply low on the other. It has kept supply low by rationing artificially low-priced foreign currency which has suppressed imports of vital raw materials, intermediate, and capital goods.

It has kept demand high because despite increasing the main policy interest rate (that is, the repo rate at which banks borrow from BB) six times, the increases have been too little, too late. Thus, although inflation rose sharply in 2022, the central bank waited until June 2023 to remove the market cap on interest rates, which was also somewhat deceptive. Commercial banks' lending rates are still capped by its so-called SMART instrument which ties market interest rates to the past six-month average rate of treasury bills: the rate at which the government borrows, which has been kept artificially low by stopping bidding when the interest rate became high.

For these reasons, the main policy interest rate has been negative in real terms—less than inflation rates—since 2021, encouraging commercial banks to borrow and finance higher demand, discouraging savings, and raising the advance-deposit ratios. Thus, credit to commercial banks increased by nearly four times over FY2023, and even last November was nearly three times what it was a year ago.

The second problem is with money supply. On one hand, money supply growth, especially credit growth in the private sector, has been limited—likely negative in real terms—over the past year. On the other hand, the central bank has been indulging in the most inflationary of activities: financing government deficits. Since this lending requires new money—referred to as "printing money"—it is inherently inflationary. Bangladesh Bank nearly tripled its lending to the government to nearly Tk 98,000 crore in the 2022-23 fiscal year. While the government has repaid some of this money over the previous six months, the stock of lending to the government as of last December was over twice what it was in June 2022.

Overall, the sharp rise in borrowing by commercial banks and by the government has meant that the velocity of money—how fast money changes hands—has markedly increased alongside a decrease in output or GDP growth. That is the only way to understand why inflation is creeping up despite low money supply growth.

So, what now? There are good reasons to be cautious and well prepared in the face of a floating exchange rate. One does not want to cause exchange rate overshooting and an inflation-depreciation spiral. But the exchange rate has to be floated, even if as a crawling peg at first. And caution should not turn into paralysis that increases uncertainty and erodes confidence.

Firstly, to dampen demand, the repo rate—the central bank's policy interest rate—has to be increased to make it positive in real terms. Also, commercial banks' lending rates have to be made market-based. If Bangladesh Bank insists on keeping rates in a corridor anchored to the SMART, it must stop interfering with the bidding and let treasury bill rates increase where demand meets supply. BB must signal its determination to fight inflation. Otherwise, inflationary expectations could run away, making the problem vastly more acute.

Second, to reduce the monetary overhang, Bangladesh Bank needs to continue to recover its government loan; let the government borrow from the market to repay this loan and finance its deficits. This will also help to set interest rates appropriately. It may be that the fiscal deficit and government spending must be squeezed more, but in a prioritised manner. Not, for example, by pressing down the woefully under-budgeted expenditures on repairs and maintenance, which already saw only four percent of its budget being spent in the first three months. These measures will cause pain, much as vaccine shots cause pain.

Third, along with implementing the measures above, the government needs to implement its plans to introduce a crawling exchange rate system that allows the exchange rate to float, albeit in a managed manner initially. There is no other option to stabilise the external account. However, and this is critical, the only way to make a crawling peg effective will be to liberalise interest rates.

Finally, when the banking sector is already under stress in this time of uncertainty, it is essential to make a strong start on reforming the financial sector. As the central bank's recent Financial Stability Assessment Report stated, non-performing loans (NPLs) comprised nearly half the assets of five banks. Overall, NPLs amounted to Tk 156,000 crore in June last year, or over three percent of GDP. When loans are correctly classified, the situation will reveal itself to be far worse.

It will be difficult to finance Bangladesh's long-term growth without cleaning out the balance sheet of our financial sector. Left ignored, systemic risks may cause significant adverse shocks to the economy in the near term. On the other hand, thinking positively, banking reforms, as in the 1980s and 1990s, can pave the way to sustained future growth.

Why the lack of data on how climate change affects public health?

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After decades of unwavering collaboration among government bodies, non-governmental organisations, and development partners, Bangladesh stands out among low- and middle-income countries (LMICs) for its improved health outcomes, especially in maternal and child health. Bangladesh's current maternal mortality rate is 123 per 100,000 live births, significantly lower than the LMICs' average of 232. Our under-five mortality rate is also commendable at 31 per 1,000 live births. These successes are thanks to the expansion of maternal healthcare, increased use of modern contraception, and lower fertility rates. But despite these strides, Bangladesh falls short of Sustainable Development Goal targets set for 2030, just six years away. Slower progress in maternal and child health indicators, coupled with stagnation in contraception use, present challenges. To address them, Bangladesh must prioritise all potential impediments to maternal and child health.

Of these, climate change and its adverse effects on maternal and child health have gained significant attention recently. The discussions have been intensified by the increasing frequency and severity of heatwaves, droughts, floods, and cyclones, with projections that these challenges will escalate in the years ahead. However, it is crucial to note that these discussions often lack a solid foundation in extensive data for Bangladesh. Available data mainly relies on small-scale surveys or localised evidence, insufficient for shaping national-level policies and programmes to address these developing issues. Adding to the complexity is the fact that different parts of the country experience varying weathers and climate events. For example, while Sylhet and Sunamganj faced serious floods in 2023, Rangpur Division experienced a severe drought. Consequently, bridging these data gaps is increasingly urgent. Failing to do so may hinder the development of effective policies, potentially slowing down progress in improving maternal and child health in the country.

The primary challenge in bridging these data gaps is the scarcity of longitudinal surveys, with only a few sources available. One notable example is the Chakaria Health and Demographic Surveillance System established by the International Centre for Diarrheal Disease Research, Bangladesh (icddr,b) on the south-eastern coast of the Bay of Bengal. However, these sources often represent specific regional experiences rather than providing a comprehensive national perspective.

VISUAL: SALMAN SAKIB SHAHRYAR

Meanwhile, government data concerning weather and climate events are highly fragmented, reported by various independent organisations. For instance, the Bangladesh Meteorological Department records a wide range of data related to weather, climate, and hydrology through its countrywide network. Similarly, the Department of Public Health Engineering reports data on water salinity. However, the challenge lies in consolidating these disparate sources to create a comprehensive picture, especially when obtaining long-term observations is crucial to categorise these events as climate-related rather than just weather-related. Furthermore, the government records data on healthcare services access and diseases through DHIS 2, a system which has limitations, including the absence of unique patient IDs, the lack of a standardised transfer mechanism, limited coverage of government healthcare facilities, and the exclusion of private healthcare facilities. These challenges hinder establishing connections between climate-related events and health facility-level data.

The situation is further complicated by Bangladesh's heavy reliance on surveys such as the Bangladesh Demography and Health Survey or the Multiple Indicator Cluster Survey. The nature of these surveys make them ill-equipped to present data on weather and climate events or record environmental indicators. Moreover, exploring climate change effects often necessitates long-term observations, which are not feasible to do for those in charge of carrying out these commonly utilised surveys. Additionally, surveys conducted by development partners to investigate the impacts of adverse climate and weather events are usually not publicly accessible because they primarily focus on observing the impact of climate change/natural disasters on their development interventions. Consequently, the true extent of the effects of adverse weather and climate events remains largely unknown.

Despite these challenges, there's a prevailing tendency to attribute common issues to climate-induced factors, influenced by the global focus on climate change and its adverse consequences. For example, migrants from climate-vulnerable areas are often labelled as climate-induced migrants, without considering the broader reasons behind their migration. In reality, such migrations may be motivated by people seeking an improved quality of life (a trend boosted by advancements in transportation and communication), urban job opportunities, and declining agricultural profitability. Consequently, many of these migrations are intentional rather than directly caused by climate change. Unfortunately, existing surveys, including those conducted by individual researchers, often fail to make this distinction. This failure to differentiate can lead to inaccurate estimations of subsequent effects, such as early marriage and limited access to maternal healthcare services, both closely linked to maternal and child health outcomes in Bangladesh. The key distinction is that climate-induced migration is often unintentional, significantly differing from intentional migration, and their subsequent consequences may not be comparable, despite both leading to migration.

Moreover, available surveys often struggle to distinguish between climate events and weather events, despite the common practice of categorising all such events as climate change-related. For example, Bangladesh has historically faced large-scale storms and cyclones—like those in 1991, 2007, and 2009—leading to significant migration of people from affected areas to major urban and divisional cities. These events are, in fact, adverse weather events rather than strictly climate-related, despite the prevailing tendency to label them as such. Additionally, there's often ambiguity in defining recent natural hazards, like the floods in Bandarban or in Sunamganj, regarding whether they resulted from adverse climate events or human-made hazards linked to unplanned development. Similarly, river erosion, in many cases, is worsened by human activities, including riverbank encroachment and alterations to the river's course. We must exercise caution, because mislabelling any human-made hazard as an adverse climate event may inadvertently contribute to these issues in the future rather than mitigating them, posing significant health concerns.

Climate change is undeniably a pressing concern in Bangladesh, causing adverse health impacts, particularly on maternal and child health. Thoroughly investigating these effects is crucial, and requires specialised surveys that encompass a range of weather, climate, and environmental indicators. The government should take the lead in this endeavour by collaborating with both national and international organisations which have experience in conducting relevant surveys.