Why is managing banks' liquidity risks so important?

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Liquidity is the ease with which an asset can be converted into cash without affecting its market price. Liquidity risk is one of the most significant risks that banks need to manage appropriately to avoid failure. It is a sudden surge in liability withdrawals that may leave banks in a position of having to liquidate assets at a very short notice and low prices. Banks collect deposits on short-term bases and lend the money on long-term bases, which create a gap between the terms of deposits and loans. The deposits mature earlier than the loans usually do. As a result, banks have to arrange liquid assets from other sources to meet the liability withdrawals. When they fail to collect such assets, they face liquidity risk.

There are three liquidity management strategies that banks usually employ. The first is asset liquidity management or asset conversion strategy, which calls for piling up liquidity in the form of liquid assets and selling them when needed. Banks generally hold some assets that they can sell when they face such a problem. Although this strategy minimises the liquidity risk, it reduces the profitability as well, because maintaining more liquid assets generate less return.

The second strategy is borrowed liquidity or liability management strategy. This allows banks to borrow from the market to cover all of its liquidity needs. This is a risky strategy because borrowing from the market may be highly expensive during a liquidity crisis. Sometimes, borrowing may also not be possible due to the unavailability of funds.

The third is a balanced liquidity strategy, which combines the use of liquid asset holdings and borrowed liquidity to meet liquidity needs. Here, a bank not only holds some liquid assets, but also makes contracts with other banks for borrowing at the time they need money. It also takes a standing borrowing facility from peers having excess liquid assets.

Liquidity managers should follow some guidelines to avoid liquidity problems. Generally, they have to keep track of all fund-using and fund-raising departments; they must know in advance about withdrawals by the biggest credit or deposit customers. Furthermore, priorities and objectives for liquidity management should be clear. A bank, for instance, may try to manage liquidity in a way that it will never face a liquidity crisis.

VISUAL: **BIPLOB CHAKROBORTY**

Finally, liquidity needs must be evaluated continuously—daily, weekly, monthly, quarterly, and yearly.

Banks have to estimate the amount of liquidity needs, which they can do using four approaches. The first is sources and uses of funds approach, where loans and deposits are forecast for a given liquidity planning period. Here, the probable change in loans and deposits are also calculated. Then the liquidity manager estimates the bank's net liquid funds by making a comparison between the estimated changes in loans and deposits.

The second approach is the structure of funds approach, where a bank's deposits and other funds are divided into categories such as volatile, vulnerable, and stable funds. The liquidity manager sets aside liquid funds in accordance with some operational rules. A bank may keep, for instance, 85 percent of volatile funds always ready for withdrawal. This percentage is determined by previous experience and expected change in the customers' financial behaviour.

In the third approach, known as the liquidity indicator approach, a bank calculates different ratios which are compared with some benchmark to understand its liquidity position. If some ratios like cash position, liquid assets, volatile funds, core deposits and deposit composition of a bank reach the benchmark, the bank is said to have maintained the required liquidity position.

The fourth approach uses signals from the market to assess liquidity needs. Hence, liquidity managers closely monitor the signals such as public confidence, stock price behaviour, risk premiums on borrowings, loss sales of assets, and borrowings from the central bank. The public confidence in a bank will be low if it does not have top-notch liquidity management. A bank that offers high interest rates on borrowing or receives liquidity support from the central bank frequently gives a signal that its liquidity management is not effective, and the risk is high.

When a bank has a liquidity crisis, it tries to borrow from other solvent banks to pay its depositors. If the solvent banks do not extend this support, the bank's liquidity crisis aggravates, resulting in a panic among its customers. The panicked customers hurry to withdraw their deposits, which may push the bank into an acute liquidity crisis. This way, a sound bank can become insolvent, failing to meet the liquidity needs.

Global experience shows that during the 2008 financial crisis, the biggest bank failure in the US history occurred with the closure of Washington Mutual, which had $307 billion in assets. A run on deposits where its customers withdrew $16.7 billion in just two weeks was one of the reasons why this bank failed.

Dexia, a Franco-Belgian bank, had high maturity mismatch as it heavily borrowed short-term funding to make long-term loans. It expanded its balance sheet from 258 billion euros in 2000 to 651 billion euros in 2008, before collapsing after a liquidity crisis in October 2008. Then Dexia faced a second liquidity crisis in 2011 from which France, Belgium and Luxembourg rescued it to avoid bankruptcy, costing taxpayers over 18 billion euros.

Merrill Lynch was an investment bank in the US and existed independently until January 2009. Its residential mortgage loans rose to $100 billion in 2007, from $58 billion in 2005. The mortgage assets went under pressure and Merrill Lynch was forced to reduce its risk by selling assets at a loss. The bank faced a record loss of $37.9 billion in 2008, resulting in liquidity shock. Later, it was acquired by the Bank of America in January 2009.

In 2023, the US saw the failure of Citizens Bank in November, Heartland Tri-State Bank in July, First Republic Bank in May, and Signature Bank and Silicon Valley Bank in March. Before collapsing, customers of Silicon Valley Bank had withdrawn $42 billion in just 48 hours.

Banks in Bangladesh sometimes face liquidity crises from normal operational outcomes. However, several banks have been encountering liquidity problems for a long period of time, mainly because of irregularities arising from a lack of good governance. The irregularities gave birth to huge amounts of non-performing loans (NPLs) where funds remained blocked. BASIC Bank with a default rate of 63 percent, Padma Bank with 46 percent, and Bangladesh Development Bank Ltd with 42 percent found their liquidity risk management simply unrealistic. The Bangladesh Bank had to provide special support to some Islamic banks to help them overcome their liquidity problems, which originated allegedly from unlawful activities.

Without ensuring good governance in the banking sector, liquidity management strategies will not function properly in Bangladesh's banks. A standard setting must be created for suitable liquidity management practices. If not, liquidity risk can make many banks extremely vulnerable, needing them to be rescued at the expense of taxpayers' money.

Time to exploit the potential of local partners and products

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NAWSHAD AHMED

A successful political regime is expected to maintain formal and informal arrangements through which the government, private actors and non-government organisations (NGOs) cooperate to formulate and carry out key policy decisions. In a pluralistic society, power is not supposed to be concentrated on a single development actor, but should be spread between these three major actors so that a developmental balance is maintained and each can judge the performance of the others.

All three development actors have their respective circle of influence and are capable of reaching out to the household level through a variety of goods and services. While the Bangladesh government provides electricity, education and basic health directly to the people, NGOs provide micro-credit, income-generating activities and social awareness, and the private sector supplies consumer goods and services. Often the work of these development actors overlaps—e.g. the government funds micro-credit programmes and builds houses for the poor families; and NGOs are involved in education and health services, and have been running banks and industries. The private sector is also involved in social welfare activities and education sector. In fact, thousands of schools and most of the universities and medical colleges in Bangladesh are in the private sector. While this is the situation, strong cross-sectoral collaboration is warranted. The government, as the lead player, should give the impression that it considers the strength of each of the development players, but it seems people are in doubt about the government's position in this regard.

Though Bangladesh made notable progress in enhancing its productive capacity and maintained persistent high economic growth rates in the past decades, the growth rate in the current fiscal year has been projected to be below six percent. Over the last two years, high inflation rates have affected the quality of life of the middle class and lower income groups. Economic inequality has risen in the country over the last two decades. The country built up high foreign exchange reserves as a result of positive balance of payment for several years. The forex reserves averaged $24.91 billion between 2008 and 2024, reaching as high as $48.0 billion in August 2021. But the situation has deteriorated in recent years and forex reserves slipped to $18.61 billion on May 21, 2024, because of higher import payments caused by the rise in prices in the international market, slow growth of foreign remittance and the taka's depreciation against international currencies. Economists made various recommendations to increase the country's foreign currency reserves: diversify export items; increase competitiveness of Bangladeshi products in the international market; use modern technology; encourage flow of foreign remittance through the official channel; and limit foreign borrowing.

When in a crisis situation, people should limit their consumption for foreign goods and help save foreign currency as much as possible. We as a nation should move away from our over-reliance on foreign goods.

Under the circumstances, it is important to encourage all development players to invest money and energy to maximise their contributions towards the GDP growth. They should all increase investment, build human and physical capitals, use better technology, and boost employment of labour to increase production and create income that would enhance consumer spending. We have a wrong notion that only the big private sector investors invest; in fact, millions of poor households, mainly NGO members, invest a significant amount of money in agriculture, fisheries, livestock, poultry and cottage industries. Therefore, there is a need to highlight the importance of the work of all development players in boosting production to move the country towards a high growth path again.

Controlling imports of non-essential items in order to build forex reserves is a difficult task because the high-income and the upper-middle-class families have a tendency to depend on imported consumer items. In FY2022-23, the total import was $93.77 billion while total export was $57.31 billion, which created a negative trade balance of $36.46 billion. In FY2022-23, the government increased the duty and taxes on 300 non-essential (luxury) items like SUVs, high-end mobile phones and home appliances, and still the import of these items has been rising. When in a crisis situation, people should limit their consumption for foreign goods and help save foreign currency as much as possible. We as a nation should move away from our over-reliance on foreign goods. As a UN official working in other countries, I have seen that most of my international colleagues preferred to use products of their own countries, and they often went an extra mile to get those. This shows their nationalistic attitude, which should be emulated.

Bangladesh now produces quality consumer products that we should cultivate a taste for and help the country save precious foreign currencies, which should be used only for the import of industrial raw materials, production plants, petroleum, life-saving drugs and essential consumer items. The country is incapable of living on the margins of vulnerability with a foreign currency reserve of about $18.61 billion for a long time. For a population of around 17 crore, it translates to about $109 per person, which came down from $270 in 2021. India had a foreign currency reserve of $648 billion on April 12, 2024, which means it had a reserve of $450 per person. If Bangladesh exploits the productive capacity of all development players, and people switch from a tendency of buying foreign goods to buying local products, the country can secure high forex reserves again.

Government of the People's Republic of Bangladesh
Bangladesh Regional Connectivity Project 1:
National Single Window Implementation and Strengthening Customs Modernization
National Board of Revenue (NBR)
IDEB Bhaban (10th Floor), 160/A, Kakrail, Dhaka -1000, Bangladesh.

Memo No. 1(187)/Passive Infrastructure/Hardware/NSW/2024/2064 **Date: 29 May 2024**

Subject: Addendum to Bidding Document for Supply and installation of Hardware and infrastructure (network, communication, cabling, etc.) and standard software for NSW solution; other network, communication equipment, structure, hardware and cabling: Passive Infrastructure for NSW Server Room & DR. Bangladesh Regional Connectivity Project 1. Request for Bids (RFB) No. NBR-GD2A.2.

Addendum No. 4

This is for the information of all Bidders concerned that the following amendments have been made for procurement mentioned in the subject above:

Ref.	Existing entry	Amended entry
ITB 22.1	The deadline for Bid submission is: Date: May 20, 2024; Time: 14.00 hours. Date & time for bid opening May 20, 2024; Time: 14.30 hours.	The deadline for Bid submission is: Date: June 10, 2024; Time: 14.00 hours. Date & time for bid opening June 10, 2024; Time: 14.30 hours.
Addendum-3	The deadline for Bid submission is: Date: May 29, 2024; Time: 14.00 hours. Date & time for bid opening May 29, 2024; Time: 14.30 hours.	

All other terms and conditions of Bidding Document (RFB) No. NBR-GD2A.2 shall remain unchanged. This Addendum No. 4 shall be considered an integral part of the Bidding Document and shall be binding on all Bidders who have obtained or will obtain the Bidding Document from the Purchaser in accordance.

You are requested to acknowledge the receipt of this Addendum.

Faithfully yours.

29.05.2024

(Jewel Ahmed)
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GD-891