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Is Bangladesh Economy on the Wrong Foot?

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Abstract

The Bangladesh economy that expanded during the great recession of 2008-09, seems to be losing its momentum, which is reflected in the turmoil in its stock markets, rising inflation and mounting supply side constraints with regard to energy and infrastructure, among other factors. While the 'search for yield' phenomenon owing to real negative interest rate led the irrational exuberance, notably in the stock market, there is a regulatory failure in the economy. Moreover, the actions of the Awami League government's economic policymakers have been less than adequate in recognising the economy's existing and implied demand owing to changes in demographic settings, inter alia. The paper discusses these issues at some length and suggests that the government should prioritise the economic agendas rather than the political ones in order to minimise the gap between potential and actual economic output.

The stock markets in Bangladesh are in turmoil, commodity prices are skyrocketing, remittance flows have decelerated, supply-side constraints such as energy and power show no signs of abating, and the deficit in infrastructure continues to mount. The growing pressure on the country's balance of payment propelled the government to sign a billion dollar loan deal with the International Monetary Fund lately. More importantly, while most emerging markets are booming following the great recession of 2008-09, the Bangladesh economy that was resilient during the global crisis seems to be losing its momentum.

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What has gone wrong? Let us begin with the ongoing crisis in the country's stock market. The volatilities in the equity markets are a common phenomenon all over the world. However, what separate the Bangladesh stock markets from the rest is the unusual trends of equity indices that cannot be explained merely by market fundamentals.[2] A heightened state of speculative fervour that former Federal Reserve Chairman Alan Greenspan termed 'irrational exuberance'[3] has been present in the market but the role of the regulators poses a huge question mark.

In the laissez-faire system, the stock market is perhaps one of the few areas where market principles do not work as prudently as described in textbooks. As the renowned stock investor Warren Buffet famously observed, 'Had the market been efficient, I would have been a bum in the street with a bowl in my hand!' How the unchecked financial greed led to the collapse of the global financial system that was eventually transmitted to the real economy in 2008-09 is not a distant memory. While the Government has some legitimate excuses to overcome the fundamental problems in the equity markets, such as the limited supply of new shares, it cannot avert the regulatory failure.

The next critical issue is the inflationary pressure in the economy. It is true that the concerned ministries and the central bank of Bangladesh (in pursuit of its financial inclusion goal) have placed high priority on agricultural growth. In pursuing the goal, they are fairly successful. But the prices of staple and some other agricultural commodities are rising in the midst of a bumper crop. But what explains this puzzle?

Not much research has been conducted on this issue, but one can search for answers in some anecdotes. In the absence of an updated demographic survey, there could be an underestimation of the country's estimated population that perhaps misled the food production target. But what is less discussed is the degree of monetisation of the economy, which has been on the rise due to the phenomenal rise in remittances, and the steady growth of the industrial sector, led by apparel, in the past decade. This is a sign of progress. But there is a mismatch in income distribution that is making a large number of consumers (notably, urban low-wage earners and the fixed income group) worse off in terms of their purchasing power. At the same time, the size of the middle class has increased in line with the country's

[2] The stock price index at the Dhaka Stock Exchange (DSE), referred to as the DSE General Index (DGEN), increased 75 per cent in the span of eight months (the index rose from 4,923 on 3 January 2010 to 8,599 on 29 November 2010) before it witnessed a sharp decline in January-February 2011 (the index values were 6,323 on 20 January 2011 and 6,719 on 6 February 2010). In recent weeks, prices showed extreme volatilities with the index fluctuating more than 500 points in the span of 24 hours. In some instances, investors have protested on the streets in response to the sharp fall in stock prices; this led to the increase of the stock index, *Bloomberg*, www.bloomberg.com/apps/quote?ticker=DHAKA:IND. Accessed on 27 January 2011 and 7 February 2011.

[3] 'The Challenge of Central Banking in a Democratic Society', remarks by Chairman Alan Greenspan at the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research, Washington D.C. (5 December 1996).

steady economic growth. Moreover, the extreme poor's entitlement to food has increased, which is reflected in the rapid decline in abject poverty.

Farmers get subsidised inputs and have access to easy credit but their produce needs to be marked up 8 to 10 per cent of annual inflation to keep their real income growth unhurt.

Nevertheless, despite marked success in agriculture, Bangladesh remains an import-dependent economy for many essential commodities, notably wheat, edible oil and crude oil, and the ongoing price hikes of these commodities in the international markets have worsened the food inflation in the domestic market. The depreciation of the US (United States) dollar is also pushing up commodity prices owing to the inverse relations between the two variables. Moreover, the higher than projected monetary expansion has apparently also exacerbated the inflationary pressure. These are the facts already captured by numbers. However, the actual inflation in the economy might be higher than the official figures.[4]

Further, the issue of food inflation has huge political ramifications. The Awami League promised voters during the 2009 general elections that rice prices be kept affordable as much as a quarter of the current market prices. While the food prices are following the northbound trend, the government's popularity is more southbound.

Having said this, there are fundamental issues, such as poor infrastructure and distortions in the economy (licensing, consortium, tariff rates, etc.) that made goods and services expensive. The incumbent's delivery of these provisions has been less than adequate.

Economists measure the distance between two places based on economic and not Euclidean distance (which is the ordinary distance between two points). The distance between Dhaka and Gazipur, for instance, is merely 26km. It should take less than an hour to commute between these two places but the travel time is on average two hours. Higher economic distance costs growth and fuel inflation. Apart from reducing the power of middlemen in the commodity businesses, it is the government's responsibility to cut down transport costs by providing adequate infrastructure. The state of infrastructure in Bangladesh is one of the worst in Asia.[5]

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4 Bangladesh's GDP is growing at 6.0 to 6.5 per cent and inflation in the economy is hovering around 8 to 9 per cent. The broad money (M2) growth has been 22 per cent. If one plugs the data in the equation of exchange [money growth (m) + velocity growth (v) = price growth (p) + output growth (g)] on which the Quantity Theory of Money is built, it seems that the real inflation in the economy is over 12 per cent. For details see, 'Inflation and BB's Policy Independence', *Daily Sun* (6 January 2011), www.daily-sun.com/?view=details&archiev=yes&arch_date=06-02-2011&type=daily_sun_news&pub_no=120&cat_id=2&menu_id=5&news_type_id=1&index=0. Accessed on 6 January 2011.

5 According to the World Economic Forum, Bangladesh ranks 107th out of 139 countries in the 2010-11 global competitiveness ranking. However, in terms of quality of infrastructure, which is one of the key determinants of competitiveness, the country is placed 133th on the list. For details, see 'Infrastructure for a Seamless

Then there is a severe crisis of power and gas. While the government should be credited for adding a few hundred megawatts of electricity to the national grid, it is also to be graded poorly for failing to recognise the difference between the perceived and implied demands for energy. The power sector is projecting (and producing) electricity based on the prevailing demand, but one must foresee the implied demand in the economy where many industries and buildings are not built and household appliances are not bought due to the chronic shortage of power. So, the disguised demand is much higher than the perceived demand for energy. As a result, unless the government revises the power production target upward recognising the implied demand, the power crisis is likely to persist.

There is also a failure in the production and exploration of natural gas where, like electricity, the implied demand is much higher than the existing demand. A large number of Bangladeshi households do not have access to electricity and gas. All in all, the delivery of energy and infrastructure are far lower than even the current demand in the economy.

That said, the current government, particularly officials who are involved in economic policymaking, have failed to foresee some key changes both at home and abroad. While a steady flow of remittances, better performance in agriculture and the rise of the apparel industry increased the monetisation of the economy, a favourable demographic change has been one of the key driving forces in this regard. The working age group has become increasingly dominant in the age structure of Bangladesh's population. The country's dependency ratio (non-working age to working age group) has declined from 92 in 1975 to 53 in 2010.[6] A nation's demographic window generally opens when the dependency ratio (non-working to working age population) goes below 50. More people in the working age group and a lower dependency ratio mean higher savings and investable surplus.

It is no accident that Bangladesh's gross domestic savings is now 38 per cent of its GDP. The higher working age population and soaring savings partly, if not largely, explain why so much money is chasing too few shares in the stock market and why thousands of youth are considering (though mistakenly) equity trading as a profession, not to mention that land prices in Dhaka in some cases are higher than those in New York.[7] The job creation rate in the economy is falling behind the growth of the working age population. The lower absorption rate of Bangladeshi workers in the overseas labour markets in recent years has exacerbated the problem.

Asia', Asian Development Bank and Asian Development Bank Institute, www.adbi.org/book/2009/09/15/3322.infrastructure.seamless.asia/. Accessed on 25 January 2011.

6 'The World Population Prospects 2008', Department of Economic and Social Affairs, United Nations.

7 'Shelter for the Poor', *Dhaka: Improving Living Conditions for Urban Poor*, Chapter 3, p.37-38, The World Bank, www.worldbank.org.bd/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/BANGLADESHEXTN/0,,contentMDK:21384826~pagePK:141137~piPK:141127~theSitePK:295760,00.html.

There is another important change as far as the economy's demand side is concerned. Bangladesh's stride in the social sector is ahead of its economic development. So, the mismatch between the demand and supply sides keep distorting the equilibrium in the economy.

The disequilibrium in different sectors of the economy can also be explained by the 'search for yield' phenomenon. The irrational exuberance in the stock market, for instance, is heightened by the negative real interest rate in the economy owing to falling interest rates on savings and high inflation. Money is becoming more and more debased. Bangladesh Bank's monetary policy, including its exchange rate management, should have addressed the issue more prudently. Of course, the central bank alone cannot address many structural problems in the economy, including the growing mismatch between savings and investment.[8]

Policymakers have also paid less attention to global and regional changes that would have enormously benefited the Bangladesh economy if seized properly. China, which has been known to be a low-cost and low-end manufacturer for decades, has shifted its stance in recent years by transforming the economic structure vertical-focusing on high-end manufacturing and services.[9] This is largely because of the growing labour shortages (thus, higher labour cost) in its coastal areas. Such a shift has led to hollowing out much low-end manufacturing from China and investors have been seriously considering Bangladesh, among other countries, as an alternate location for some of their plants. Bangladesh should have seized the opportunity entirely, thereby generating thousands of jobs. While some impact of China's shift is visible in the apparel sector, though marginally, this could easily have tapped a number of low-end manufacturing units. The flow of foreign direct investment in Bangladesh remains one of the lowest in South Asia.

If politics is a strong function of economics, then the election results in the recent municipal polls are perhaps the outcome of the less-than-expected economic performance of the incumbent Awami League government. The Bangladesh Nationalist Party that conceded a huge defeat in the 2008 general elections has come back strongly in the local elections. Moreover, the opinion polls show that the popularity of the Awami League government is on the decline. A relevant lesson for the incumbent government in this regard is that many analysts believe that politics in India, Bangladesh's next-door neighbour, has already recognised that the delivery of economic output is the key to defeating the anti-incumbency factor in the elections. In the 2009 elections, the Congress Party of India, and more recently,

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[8] While the gross savings in Bangladesh is nearly 36-38 per cent of its GDP (gross domestic product), the economy invests only 24-25 per cent.

[9] For details see, Islam, M. Shahidul, 'Window of Opportunity for South Asia', *Roubini Global Economics* (12 July 2010).

the Chief Minister of Bihar, Nitish Kumar, beat the anti-incumbency factor by taking economic development as a core agenda.

To sum up, the economic management of the Awami League government in the past two years has been rather poor. Its failure to deliver basic infrastructure and its less than adequate effort in addressing other supply-side constraints, reflected in investment drought, are costing the country's growth and fuelling inflation. The 'search for yield' phenomenon owing to negative real interest rates is increasing instability in the economy.

It seems that the government prioritised its political agendas than the economic ones. It is time for the government to reverse the course by bringing the economic plans to the fore. Further, policies should be formulated foreseeing the emerging local and global trends so that the gap between the potential and actual economic output is minimised as much as possible. Economic policymakers should act prudently in line with perhaps the suggestions made earlier.

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