On Liquidity Crisis and Feasible Remedy

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Md. Monirul Islam and Asif Hossain

Amidst Bangladesh's entrance into the status of lower middle income country from a least developed one, abruptly this smoothly-run economy was hit by a grim liquidity crisis a couple of months back, which has provoked not a little concern.

If the background of the crisis is analyzed, the immediate reasons become apparent. Firstly, credit growth significantly climbed to 19.06 percent in November 2017 from 15.66 percent in June 2017 causing excessive demand for loans. BB data shows that between January and December 2017, banks received a total deposit of around Tk 85,000 crore, of which around 72, 000 crore was loanable, given the former Advance-Deposit Ratio or ADR rate of 85 percent .

However, banks disbursed around Tk 1,25,000 crore, meaning that an extra 74 percent of the loanable fund was distributed to serve the extra demand. It is no surprise that liquidity crisis followed afterwards. Meanwhile, to cease more money to enter the economy, BB reduced ADR from 85 percent to 83.5 percent which made banks run hungrily after collecting deposits to stay within the newly set ceiling.

To attract deposits, high deposit interest rates were offered at the price of higher costs of banks. Resultantly, lending interest rates rocketed from about 8-9 percent to around 10-12 percent by January 2018 creating troubles for both investors and consumers.

Now, to bring down the double-digit interest rate, the central bank and the government have taken three policies: a. keeping ADR at 85 percent until December 2018, b. decreasing the Cash Reserve Ratio (CRR) by 1 percent and c. transferring 50 percent deposit of public banks to private banks.

All these policies may bring about temporal solution for the liquidity crisis; but not the permanent solution. Indeed, from the macroeconomic perspective, before making appropriate policy intervention, identifying the root of the problems is imperative.

As of experts, in the local context, liquidity crisis has taken place due to various raison d'être. Firstly, the banks are plagued by huge frauds as different phony organizations/persons bagged huge sums in fake loans.

Some flagship identities in business with long questionable reputes have fraudulently schemed to get new loans in the name of repaying old loans that they then grabbed as well devoid of paying a dime.

We see a spiraling of default loan increased to 10.67 percent in September last year against 9.23 percent a year before. In the next step, many of the frauds siphoned off capital abroad. So, the banks' liquidity management went haywire. As their receivables could not be realized on time, in a way, it led to a deposit crisis in banks.

Besides, although banks of the country just two months ago declared the FDR rates more than 10 percent from 4 percent offered to the clients for the last two years, this announcement of banks has not borne expected fruit in depositing more money due to lack of confidence of clients on the banking sector.

So, money/cash remains idle in its kind. Reportedly, deposit growth declined to about 11 percent in October last year from 13.13 percent in December 2016. It is also notable that people are investing their money in other alternatives, e.g., stock markets in place of depositing money in banks resulting in the dearth of money supply in banks for loans.

Apart from the domestic reasons, the banking sector is also being gripped by other international factors as well -- the increasing commodity price is very noteworthy. By now, oil price has been mounting steadily and is about to reach $65 a barrel in the global market.

As the pressure on dollar has increased, its value has become pricier following the simple economic thumb rule. It indicates that importers now necessitate having more cash to purchase dollar for the same volume of goods.

At the same time, as current account deficit has surpassed $6.17 billion, stress has increased on reserves to keep the Balance of Payments (BoP) in tandem. Also, due to a noticeable fall in Net Foreign Assets, base money of Bangladesh Bank (BB) has eroded to an extent.

As a result, banks as major sources of money are facing tremendous pressure to supply more money to pay for importables. Besides, the mega projects have also been putting in more pressure on dollar as their import components are massive.

Data available shows that capital goods especially machinery imports have increased by about 37 percent. Sugar, rice, wheat and cotton imports have also risen to a significant extent. All these are responsible for the current liquidity crisis in the banks of the country.

Along with the current initiatives adopted, BB can help banks to recuperate the Non Performing Loans (NPL). Point to be noted that the current figure of NPL was Tk. 80,397 crore on September 2017, which is 10.67 percent of total loan outstanding. This figure would be 17 percent if the rescheduled loan is added.

Furthermore, since sourcing funds by issuing bonds is a common phenomenon in banks in different countries, local banks can open a new wing to source funds through issuing bonds which will cut reliance on deposits. To materialize this, it necessitates developing bond and capital markets which in turn will stabilize the financial market to some degree.

In addition, large loan scams are evidently the consequence of collusions between a few deceitful businessmen and some board members with management officials deviating from ethical norms and values.

Therefore, BB should tighten their vigilance over the all-out banking operation to ensure greater health of the banking sector in the long run. Indeed, we must rely on a stringent monetary policy and cautious fiscal policy for a feasible solution.

Besides, Bangladesh may implement the Basel Accord set out by Basel Committee on Banking Supervision (BCBS) in Switzerland in 2010 to reserve the Liquidity Coverage Ratio (LCR) of 120 percent -140 percent for tackling further liquidity shock.

In fact, collective and cautious initiatives will help banks and financial institutions bring unutilised money into the capital market, supplying much-needed lubricants to our economy.

Md. Monirul Islam: Assistant Professor, Bangladesh Institute of Governance and Management (BIGM), affiliated with University of Dhaka.

Asif Hossain: Assistant Director (Research Wing), Bangladesh Institute of Governance and Management (BIGM)

Editor : Iqbal Sobhan Chowdhury
Phone: +9586651-58, email: info@observerbd.com