



**Committee on Macroeconomic Policy, Poverty Reduction
and Inclusive Development**

24 November, 2009

Bangkok, Thailand

Keynote address by Dr. Atiur Rahman, Governor, Bangladesh Bank

Email: governor@bangla.net

**Responses to the recent global financial and economic crisis- lessons
in bolstering resilience and preventive defenses**

1. Introduction- the crisis:

1.1. I am grateful to our gracious hosts at ESCAP for this opportunity of sharing with you a Bangladesh perspective on the collective and country-level responses to the recent global financial turmoil and economic downturn, and on lessons from this in bolstering resilience and preventive defenses against future episodes of such crisis.

1.2. As we are looking for lessons from the crisis, we may begin with a brief glance at its genesis. The makings of the crisis were in the mounting global imbalances from about two decades of US external current account deficits; dollar's position as the dominant global reserve currency permitting indefinitely long spells of lax macroeconomic policies in the US. The export driven Asian growth hubs kept financing the US deficits avidly, piling up mountains of dollar denominated US debt as reserve assets. The two sides occasionally exchanged blames for the global imbalance, citing excessive profligacy of the US and excessive frugality of Asia, with little said or done about putting in place safeguards in the global monetary order against buildup of large imbalances.

1.3. The surfeit of global liquidity arising from debt fuelled spending did help growth in real global output, but this contribution to real growth was outpaced by faster growth in financial claims; with credit bubbles created by glut of cheap liquidity leading to price bubbles in asset and commodity markets. As the credit and price bubbles collapsed in advanced markets precipitating chains of corporate and household insolvencies on massive scale, the distresses spread fast to the reach the shores of our region; in lost export orders, failed businesses and lost jobs,

plummeting tourist arrivals, return of emigrant workers retrenched in host markets abroad.

2. The responses:

2.1. The global community has been quite quick in mobilizing coordinated near term responses to the fallouts from the global crisis, organizing massive rescue packages for bailing out failing institutions and markets, and massive stimulus packages to uphold economic activities and domestic demand in individual economies. The robust coordinated near term responses appear to have already averted the feared prolonged global economic downturn. Growth outcomes exceeding earlier downbeat predictions are being reported frequently, near and medium term forecasts for regional and global growth are also getting frequent upgrades. There are still lingering concerns about the robustness of recovery of some of the troubled large financial institutions, and finance ministers of the G-20 forum has held another round of consultations in early November 2009 in Scotland towards making sure that the recovery processes in the financial and real economy do not falter.

The crisis did not impact Bangladesh economy severely because of its limited, regulated openness to short term external capital flows. Despite some demand weakening in markets abroad, exports held on to double digit growth rate in FY 09, with real GDP growth slowing modestly to 5.9 percent against 6.2 percent of FY 08. GDP growth slowdown from the crisis has been much milder for Bangladesh than those suffered by larger, faster growing regional neighbors. Remittance inflows from migrant Bangladeshi workers continued on uptrend. Uncertainties associated with the global slowdown weakened new investment activities however, with decline in capital goods imports. Low outflows for imports from the growing export receipts and workers' remittance inflows kept local financial markets awash with liquidity. Bangladesh government made ample allocations in the FY 09 and FY 10 national budgets to uphold domestic demand by expanding the social safety net for the weak and vulnerable population segments, and to provide temporary support to economic sectors hurt in the global crisis. Bangladesh Bank (BB) on its part has maintained easy monetary conditions to facilitate investment activities, allowed banks to reschedule nonperforming export loans temporarily on more lenient terms, widened its foreign exchange lending window (the Export Development Fund) to banks for financing input imports of exporters, and has also launched elaborate refinance support networks for promoting bank lending to under-served sectors of productive economic activities including agriculture, SMEs, sustainability /renewable energy related projects. *Broad-based, inclusive economic growth is viewed by Bangladesh*

Bank as the way forward in strengthening domestic demand by reduction of poverty in the country.

2.2. The emergency stimulus packages for temporary upholding of domestic demand will need to be substituted by longer term policy initiatives towards continuing strengthening of domestic demand and intraregional trade. Also, progress thus far has been limited on other longer term issues including the needed reforms in financial sector regulatory and compensation regimes, accounting standards, leveraging norms and tax treatments of debt finance and equity. Serious dialogue has not even begun about putting in place safeguards in the global monetary order against buildup of large imbalances.

I hope our deliberations in this ESCAP forum can contribute usefully towards setting and pushing ahead the medium and longer term agenda in bolstering resilience to and defenses against future crisis episodes. In putting together the important elements for a comprehensive agenda, here I have freely used the contents of the Dhaka Outcome Document of the ESCAP-BB regional high level workshop held at Dhaka in July 2009.

3. Unfinished agenda for the path ahead

3.1. Upholding and strengthening domestic demand: For our Asia Pacific region, this tops the to-do list for now as well as for the longer term. The blame on the supposed excessive Asian frugality for weaker domestic demand is misplaced, the rich and the rising middle classes in our region are as attracted by good things in life as their western counterparts. The root cause behind weaker domestic demand in our region is poverty and low income of large part of the population. *Sustained inclusive economic growth with advancement opportunity open to all will be the key to strengthening of domestic demand by reducing poverty. In fostering inclusive economic growth, central banks in the region will need to be proactive in promoting financial inclusion*, with action programs for bridging the market gaps and failures in reaching out to the excluded and under-served population segments and economic sectors. Some of such central bank refinance supported programs launched by Bangladesh Bank were mentioned earlier at paragraph 2.1.

With the break up of extended family structure in the recent times, safety net support from the extended family for the weak and the vulnerable has dwindled rapidly; social safety nets must now extend fast to take its place. Sustained inclusive economic growth should provide the increased revenues needed to finance expansion of the social safety networks; but richer advanced economies, multilateral development banks and private philanthropies will have important supportive, supplementary roles to play, particularly at times of crisis and emergency.

The vast majority of workforce in developing countries like Bangladesh being employed in the informal sector, promotion of well managed pension funds will be important in underpinning consumption demand from senior citizens as they retire from working life. The pension funds will also be important financing sources for infrastructure and other longer gestation investment projects.

Strengthening domestic demand in the region in ways suggested above will address at root the oft-alleged reluctance in the region to allow currency appreciation. Increased imports for meeting stronger domestic demand will weaken currencies in the region, ironing out any earlier undervaluation.

3.2. Promoting intraregional trade and investment: Our region is often blamed by the West for consuming too little of what the regional growth hubs produce. As explained in the preceding paragraph 3.1., poverty and low purchasing power is the root cause, and lasting remedy lies in rapid poverty reduction powered by sustained inclusive economic growth.

Placement of the growing mountains of foreign exchange reserves of our region in financial markets in the West have done a disservice to the global economy, having been used there much less in supporting real output growth than in financial wizardries feeding instability with credit bubbles and speculative price bubbles. Since financial markets in our region failed to be proactive in channeling the mounting regional reserves in infrastructure and other growth supportive real sector investments in the region, stronger direction and guiding hand from intergovernmental forums like the ESCAP may be a need of this hour. An added momentum to the Asian Bond Fund initiative may merit consideration, with increased equity contributions from the huge pile of regional reserves, and broader mandate including underwriting and market making in bonds issued by existing corporates and new investment projects in the region.

Governments in the region can consider establishing individual or collective sovereign wealth funds, using part of their foreign exchange reserve resources as equity, for infrastructure and other real sector investments in the region. There is no reason why returns from such investments would be inferior to those from placements of the reserves in financial markets in the West.

In promoting intraregional exports of capital goods, setting up/ strengthening of export credit guarantee outfits by capital goods producing countries in the region may be helpful.

Short term external borrowings become hard to refinance at times of stress, flightiness of external portfolio investments also accentuate instability in crisis situations. Stability concerns would suggest that in attracting external funds for investment, countries in our region should opt more for long term rather than short

term borrowings, and likewise more for foreign direct investments rather than foreign portfolio investments.

3.3. Regulatory, supervisory reforms: (a). Procyclicality of capital requirements, and marking to market valuation of trading book assets required by international accounting standards sharply accentuated difficulties for banks and financial institutions at the height of the financial crisis. Ongoing expert level consultations in relevant global forums are expected to finalize appropriate reform recommendations in due course; but countercyclical features in varying degrees and forms already exist in regulatory regimes in individual countries. For instance in Bangladesh, a bank wishing to disburse dividend higher than twenty percent must set aside as retained earning a sum equal to the dividend in excess of twenty percent. Central banks may like to be proactive in introducing countercyclical capital buffers in forms best suited to the respective country circumstances.

(b). Reforms in executive compensation packages in ways that dissuade senior managements in banks and financial institutions from pursuing short term gains at cost to longer term institutional interests are being debated. Regulators in our region may wish not to wait for consensus from protracted global debate, immediately curbing any patently obvious impropriety or excess.

(c). In the recent global financial crisis, excessive leveraging of non financial and financial corporates sharply deepened distresses with extensive chains of insolvencies and consequent market freeze-ups. Expert level consultations on global best practice norms on leveraging are underway in the Basel forum of bank supervisors; regulatory authorities in our region may wish to be proactive in kicking off country level stakeholder consultations about leveraging norms appropriate for local circumstances. Differences in tax treatments of debt and equity require taxation reform placing debt and equity on more equal footing.

(d). In the recent global crisis episode position taking in commodity futures by globally active financial institutions including hedge funds played significant role in accentuating commodity price volatility, pushing global prices of many food and non food commodities to dizzying heights. Position taking in commodity futures by financial institutions and others that are no part of the supply chains do not facilitate price discovery and serves instead to distort and destabilize prices towards profiteering from volatility. A global consensus debarring financial institutions from position taking in commodity futures will be an important safeguard against instability. For similar reasons appropriate regulatory barriers against

speculative use of derivatives that are meant to be used as hedging tools merit consideration.

3.4. Regional cooperation and policy coordination towards bolstering stability: The Chiang Mai Initiative taken up some years back has developed a network of bilateral swap arrangements between a number of central banks in East Asia for mutual assistance in situations of stress; the Asian Clearing Union between central banks in South Asia also has a modest swap arrangement for temporary trade settlement support to members in need. These mutual support networks can be integrated and extended to cover more central banks in the region. Several trade and economic cooperation forums have sprouted in the region over the years; but unlike the evolution of the European Union, mostly as yet without significant extent of policy coordination and with no unequivocal articulation of integration towards monetary union as definitive goal or vision. It may be high time now for these regional cooperation initiatives to consider crystallizing visions and goals as fully integrated platforms for safer sailing through future global crises.

3.5. Dialogue on reforms in the global monetary order: To begin with, I would like to draw attention to the insufficient, even non-existent voice of smaller developing countries in current practices of global dialogues. Regional forums like ESCAP can usefully advocate and advance the case for the voice of the smaller countries in global dialogues, by way of participation of a suitable number of these countries nominated by rotation say, every 2-3 years.

The prevailing global monetary order has proven deficient in safeguarding global balance and stability. As mentioned in the beginning, the current global crisis originated with continually mounting global imbalances permitting global liquidity to perilously outpace real global output growth, inflating credit bubbles and price bubbles that collapsed eventually with attendant widespread distresses for all. Among various reform possibilities one option could be to tether global liquidity growth to actual or potential growth in real global output; with issues of national and regional currencies needing to be backed by a global unit of settlement (say the SDR) allocated by an apex global monetary agency (say, an appropriately reconstituted IMF) annually, proportionately with potential growth in global real output. Global dialogue on substantive reforms of the existing monetary order is yet to start off in right earnest. If this is delayed indefinitely to be forgotten as the world recovers from the current crisis, it may not be very long before another episode of global imbalances cause surging global liquidity to inflate another round of credit bubbles and price bubbles, eventually collapsing to precipitate the next global crisis.
