



Conference on: **Strengthening Remittance Flows and Impact: Policies, Practice, Prospects**

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Macroeconomic policy challenges of large remittance inflows

1. For some years now, remittance inflows from migrant workers abroad have been playing a major role in underpinning external sector viability of balance of payments of Bangladesh. Rising steadily, annual inflows have grown nearly four-fold between FY 02 and FY 09 (from USD 2.5 billion in FY 02 to USD 9.7 billion in FY 09); during this period ODA inflows net of amortization have stagnated around an average of about USD 1.0 billion annually. Contrary to apprehensions, workers' remittance inflows to Bangladesh grew buoyantly during the global financial turmoil (by 32.4 and 22.4 percent respectively in FY 08 and FY 09). Bangladeshi migrant workers largely in low-skilled jobs did not suffer as extensive job losses in host markets abroad as initially feared, and much of the increased inflows during this period are presumably transfers of their savings from the turmoil ridden unstable financial markets in host countries to the safety and familiarity of stable environment prevailing in financial markets in Bangladesh.

2. The growing remittance inflows have been highly beneficial for Bangladesh in upholding domestic demand in the recessionary global environment, in enhancing availability of borrowing resources for both the government and the private sector, and in augmenting foreign exchange reserve cushion for coping with the uncertainties of the fragile, unstable external environment.

3. Rising labor migration and the attendant high remittance inflows are not altogether unmixed blessings however, they pose some challenges in macroeconomic management that require careful handling. The main challenges and the approaches adopted in Bangladesh in addressing them are enumerated briefly below.

a) The high remittance inflows have created a liquidity overhang in the domestic financial markets; with only partial immediate use of the inflows in productive investment activities in the backdrop of the recessionary global environment (weakness in new investment activities and capital goods imports seen in FY 09 is yet to show a significant turnaround). The excess liquidity has tended to spill into speculative outlays in real estate and other asset markets, creating bubble like asset price pressures. Extensive recourse to sterilization of the excess liquidity with issues of treasury/central bank securities, besides being costly, is problematic in the current situation in that it risks dampening further the already weak investment initiatives by way of hike in market interest rates.

In the immediate term, fiscal policies of the Government of Bangladesh (GOB) have provided various incentive measures to stimulate real sector investments, including specific supports to sectors affected by the global downturn, public-private partnership initiatives in infrastructure investments and support for microfinance self-employment initiatives. Treasury bonds in Taka and USD targeted at non-resident Bangladeshis including migrant workers are absorbing part of the remittance inflows in financing fiscal deficit. Bangladesh Bank (BB) has, besides taking limited recourse to mopping up excess liquidity with auctions of 30 day BB Bills, adopted various financial sector policy measures supporting and promoting lending to under-served productive real sectors including agriculture, SMEs, renewable energy and environmental protection. Also, BB has allowed banks larger open exchange positions to permit wider engagement in lending in foreign exchange from their domestic branches and offshore banking units, simultaneously intensifying oversight on their exchange risk management processes.

Over the longer term, strengthening the capacity of domestic financial markets for handling and absorbing large inflows will require deepening of secondary markets in treasury and corporate securities, creating new secondary markets in asset-backed securities, supporting growth of new capital market institutions like venture capital and private equity institutions. Deepening of the local inter bank foreign exchange market will require adequate availability of hedging tools covering exchange risks of Taka vis-à-vis major convertible currencies, which in turn will require some degree of openness of the Taka money market to non-resident institutional investors. Besides maintaining oversight on solvency, liquidity, asset quality and risk management in the financial sector, BB and the GOB will appropriately phase in regulatory and market development reforms in these directions gradually, as stability and external sector viability consolidates and strengthens further.

b) The high inflows of workers' remittances into the as yet relatively small and shallow local inter bank foreign exchange market has created appreciation pressure on exchange rate of Taka, adversely impacting the remittance recipients (families of migrant workers), and exporters already hurt by demand weakness in external markets in recession. As immediate measures to preserve export competitiveness and reasonable incentive for migrant workers sending the remittances, BB has been active in buying up USD funds from the inter bank market to maintain exchange rate of Taka on a slight undervaluation bias.

The build up in BB's foreign exchange reserves (USD 9.3 billion as of 24 Sept 2009, against a past low of USD 1.3 billion as of 30 June 2001) resulting from regular purchases in the inter bank market has heightened balance sheet risk for BB from appreciation of Taka, entailing higher losses in Taka valuation of the higher reserve balances in foreign exchange. Effectively addressing the challenges associated with appreciation of Taka will require some easing of capital account restrictions on placement/investment of funds abroad by Bangladesh residents, to be considered over the medium term as external sector viability strengthens sufficiently.

c) Domestic shortage of skilled manpower, and Dutch disease in remittance beneficiaries typically associated with high manpower exports and high remittance inflows have not emerged as major concerns for Bangladesh. Current demographics of Bangladesh and the country's institutions for general, professional and technical education are providing steady streams of new unskilled and skilled entrants into the labor market well in excess of local requirement; leaving ample room for manpower export without causing domestic shortage. Reports of sample surveys/studies conducted at different times by various domestic and external initiatives about utilization patterns of workers'

remittance inflows indicate that while a major part of remittance inflows go into consumption expenses, a substantial part (around 40 percent) is utilized for acquisition of capital assets and/or for financing migration and costs of job acquisition abroad for other family members/relations of the remitting migrant workers.

4. To sum up, GOB and BB are responding flexibly and creatively in a coordinated way to challenges for macroeconomic policies posed by high inflows of migrant workers' remittances; using these as opportunities for phasing in appropriate regulatory and market development reforms towards bringing about greater breadth, depth and inclusiveness of the financial sector in Bangladesh.
