Trade, Climate Change and Development Monitor

Monthly E-Newsletter of South Asia Watch on Trade, Economics and Environment (SAWTEE)

Volume 16, Issue 04, May 2019

CONTENTS

OPINION IN LEAD

Transmission of policy rate cuts during an accommodative monetary policy stance

Monetary policy for the fiscal year 2019-20 is due in the next few weeks. Among the policy instruments in stimulating economic activity, the scope of monetary policy spans well beyond, say, inflation targeting although, in recent decades, there has been a distinct overemphasis on inflation targeting.

In recent months, the issue that has attracted the attention of policymakers and sparked debates is that of widening spread in financial institutions. The widening—from 5.4 per cent in 2017-18 to 5.8 per cent in

2018-19—has occurred despite rate cuts. While there are several explanations into the rising spread, a visible adverse outcome has been the poor transmission of policy rate cuts (also termed an accommodative monetary policy stance, where interest rates are reduced to inject liquidity and stimulate investment). In this brief article, we discuss the concept of transmission during an accommodative monetary policy stance and why there may be stickiness. The article highlights some Nepal-specific observations on which, notwithstanding the significance of the issue, not much has been studied.

In June 2018, the monetary policy adopted an accommodative stance and reduced both–the Cash Reserve Ratio (CRR) requirements and the Bank Rate–the former by whopping two percentage points. Such stance by the monetary authority is aimed at freeing up loanable funds with the banks, stimulating aggregate demand and spurring private investment and this is to be achieved via interest rate reduction in the financial institutions. However, it appears that there has been almost no transmission of interest rate cuts into the financial system. Despite the rate cuts, the average spread in the third quarter of FY18-19 is almost identical to one in June 2018. The stickiness, while not unusual for a host of reasons, reduces the effectiveness of monetary policy in shaping economic activity.

Interest rates may be sticky and transmission only partial because the incremental additions in deposits and lending may not match and lending may outpace deposit mobilization. The transmission also depends on the liquidity in the system (or whether more resources can be mobilized). Lending rate cuts are supposed to be followed by softening of deposit rates (with some lag), but, such softening may be difficult. The banks may be reluctant to cut deposit rates fearing withdrawal or exit of depositors. For instance, institutional depositors often form a large part of the overall deposit base and may be sensitive to small movements in deposit rates. Moreover, retail depositors, for instance, may be relying heavily on deposit interest as social security. An important dimension in the transmission is liquidity. Banks in Nepal have high credit to deposit ratios which implies further reluctance on cutting deposit rates because funds mobilized as deposits, much of them, have already been lent. A minuscule portion of free resources means, on average, that lending rates may remain sticky.

Despite its significance, there is not much of Nepal-specific evidence on transmission dynamics; for instance, the proportion of policy rate cuts passed on to borrowers–retail or firms–or the time taken in transmission. The existing knowledge, mostly conjectures at best, confide perhaps correctly that financial institutions pass on interest rate hikes almost immediately while policy rate cuts are either not passed on at all or are transferred a minuscule proportion. The proposition here is that financial institutions invariably capture much of value. Although incentives (for instance, profit maximization goals), information asymmetries, exploitative business practices, and poor regulatory capabilities certainly affect transmission, there are several other aspects to it.

Amid this backdrop, it needs to be understood that rate cuts induced by the monetary policy are only one component in growth-enhancing interventions. Even if there is a quick and significant transmission, policy rate cuts, on their own, are only a partial fix in stimulating economic activity. Experts, citing India's case, argue that policy rate cuts, even if transmission occurs credibly and in a reasonable time, are only a cyclical demand management tool and not a credible long-term aggregate demand and private investment stimulating tool. The argument here is an accommodative stance are not a substitute to structural reforms–for instance, land use (how land is used; assigning property rights to those who can provide the highest returns) and productive capabilities–although such position has a role to play.

Indeed, the transmission is not just an issue of policy relevance in Nepal. In the region, in countries like India, transmission appears to take at least four to six months while the same is only partial. In response to the low transmission rates, the Reserve Bank of India, India's central bank, has touted linking interest rates with marginal cost-based lending. In Nepal's case, we do not seem to have any benchmark concerning transmission–duration or the proportion of benefits (rate cuts) passed on.

It remains to be seen whether the issue of transmission will capture the attention of the central bank here and if the monetary authorities will pursue the issue as a research agenda to arrive at a credible picture on the issue. Not least because even though attempts have been made to cut interest rates, the same have not been passed on to consumers and firms. Consider this: spread in Nepal is in the range of around six per cent which is nearly double of those in countries like Bangladesh and Sri Lanka.

This piece is contributed by Mr. Avinash Chandra Gupta, Research Officer, SAWTEE.

REPORT

China, India retreat from investing in coal energy

Although the global coal power fleet has continued to grow, global investment in coal-fired power declined by nearly three per cent to its lowest level since 2004, mainly due to lower spending in China and India.

Renewables-based power investment edged down by one per cent, as net additions to capacity were flat and costs fell in some technologies, but spending was also supported by plants under development, according to World Energy Investment Report 2019 published by the International Energy Agency (IEA).

The report shows that in 2018 global energy investment remained relatively stable at over US$1.8 trillion following three years of decline. Higher spending in upstream oil and gas and coal supply was offset by lower spending in fossil-fuel based generation and renewable power. Solar Photovoltaic (PV) investment fell by around four per cent, while investment in wind energy remained flat. The dip in solar PV investment was largely due to policy changes in China, where the government is seeking to promote more cost-effective and system-friendly investment. Besides China, renewables spending in the rest of the world grew by almost five per cent. In India, solar PV spending exceeded that for coal power for the first time, supported by government auctions. In the United States, solar PV and wind investment rose almost 15 per cent, supported by corporate procurement. Nuclear power investment edged up as new grid connected plants in 2018 grew threefold, 80 per cent of them in China.

After rising to a decade high in 2012, gas-fired power spending slowed, notably in the Middle East and North Africa (MENA) region and in the United States, where a large pipeline of projects has been realized in recent years. Gas power spending in Europe remained near its lowest level this century.

China remained the largest market for energy investment in 2018, but its lead narrowed. While spending is increasingly driven by low-carbon electricity supply and networks, total investment declined by seven per cent over the past three years due to lower spend on new coal-fired plants, down over 60 per cent, outweighing relatively high investment in renewable power and nuclear.

The report cautions that the amount of investment in energy is not sufficient to meet future energy needs. Low-income countries are in need of greater investment in energy, yet high-income countries, with just over 15 per cent of the global population, accounted for over 40 per cent of energy investment in 2018. Lower-middle and low-income countries accounted for less than 15 per cent of energy investment in 2018 despite containing well over 40 per cent of the world's population. In recent years, the fastest investment growth within this group has come from India with rising power sector spending, while spending in sub-Saharan Africa has declined, mostly due to less investment in fuel supply.

Looking ahead, the report states, the largest investment needs remain concentrated in currently high- and upper-middle income countries and regions, in part reflecting continued investment to replace and upgrade aging assets. However, to meet sustainable development goals, overall spending needs to grow from today's levels and to rebalance towards the fast-growing needs of lower-middle and low-income countries, says the report.

The report also sheds light on the stable share of low-carbon in total energy investment, which stayed at near 35 per cent. At the same time, investment in electricity grids–an enabler for clean energy transitions–has decreased modestly in the past two years. Thus, to meet long-term sustainability goals, even with changing costs, low-carbon investment would need to grow two-and-a-half times by 2030, with its share rising to 65 per cent. Although the needs in networks are comparatively less, the regulated nature of grids points to a need for sustained policy commitment for appropriate levels of investments that supports growing shares of variable renewables.

This piece is excerpted from International Energy Association's latest report 'World Energy Investment 2019'.

NEWS

Tatopani Customs re-opened for Nepal-China trade

The Tatopani Customs at Nepal-China border in Sindhupalchok opened on 28 May after being closed following the devastating earthquake on 25 April 2015. Four Nepali containers entered China via the newly opened customs point.

Chinese authority has opened one of the main land trade routes of Nepal-China trade by providing entry passes to ten loaders and containers. The trade point is set to open officially from 29 May after the Chinese Ambassador to Nepal Hou Yanqi on behalf of the Chinese government hands over Miteri Bridge, Kodari Highway and the Tatopani dry port to Nepali authority.

The Chinese side is reported to have consented on allowing import of 182 types of goods. These involve wooden log, edibles, woolen carpet and handicrafts, among others. Nepal can import wool, footwear, electric goods and readymade garments, among others.

Before the devastating earthquake, more than 15,000 tourists and 1,500 vehicles including loaded containers used to pass through the Nepal-China border.

The infrastructure works on the Nepali side is also in progress to facilitate trade via the Tatopani customs. The inland container depot in Tatopani, being constructed by China Railway Construction Group Company, is nearly complete. The company has also constructed Baseri-Liping road segment while the Nepali authority has constructed Bahrabise-Baseri road.

Source:http://kathmandupost.ekantipur.com/news/2019-05-29/nepal-china-trade-set-to-surge-with-tatopani-customs-re-opening.html, 29-05-2019.

China leads with 75 per cent share in Pakistan's total foreign loans

Pakistan, for the first time, fully disclosed the debt taken from China which stood at US$6.5 billion for the current fiscal year alone, equal to three-fourths of the US$8.6 billion worth of total loans that Islamabad received in the past 10 months.

Under pressure from the International Monetary Fund (IMF), the Pakistani government has disclosed every type of loan that Islamabad has received from its strategic ally, China.

Foreign loan disbursements during July-April of the current financial year showed loans for the Karachi Nuclear Power Plants, known as K2 and K3, and China SAFE deposits as part of federal debt obligations. Earlier, the US$2 billion worth of China SAFE deposits, which Islamabad had received in July 2018, were shown on the books of the State Bank of Pakistan. SAFE is an acronym for the State Administration of Foreign Exchange managed by the Chinese central bank.

Pakistan also received US$3 billion from Saudi Arabia and US$2 billion from the United Arab Emirates but these loans were not disclosed along with Chinese SAFE deposits.

The full disclosure of Chinese loans was one of the sticking points between the government and the IMF during staff-level negotiations for a US$6 billion bailout package. It now seems Prime Minister Imran Khan has accepted the IMF's terms on Chinese loans.

The United States wants to ring-fence IMF money in order to stop Pakistan from using such funds for repaying Chinese loans.

Source: https://tribune.com.pk/story/1978533/2-pakistan-discloses-borrowing-china/, 23.05.2019.

Bangladesh enforces 65-day fishing ban in Bay of Bengal

Mr. Ashraf Ali Khan Khasru, State Minister for Fisheries and Livestock, asked the authorities concerned to strictly enforce the 65-day ban on fishing in the exclusive economic zone (EEZ) in the Bay of Bengal.

He issued the directive, aimed at boosting Bangladesh's marine fish stock, during an interaction held at the Chittagong Circuit House.

Stating that marine resources are not unlimited, the state minister said: "These resources will deplete one day if we do not use them sustainably. We should let fish grow and breed. Otherwise, we will have to suffer in the future."

State Minister Mr. Ashraf further said that people should keep in mind that the ban period of 65 days is during the breeding season of marine fish to ensure safe breeding and conservation of fish and shrimp.

Meanwhile, several hundred fishermen of Chittagong, carrying festoons, placards and banners, staged a demonstration at the Circuit House premises against the decision of the 65-day ban on catching fish from the Bay of Bengal.

Earlier, on 20 May 2015, the Fisheries and Livestock Ministry issued a gazette notification prohibiting fishing in the bay between 20 May and 23 July, every year, to ensure breeding of fish.

Later, a writ petition was filed with the High Court challenging the legality of the ban. However, on 15 May 2017, the High Court upheld the government order.

Source:https://www.dhakatribune.com/bangladesh/event/2019/05/16/fisheries-ministry-for-enforcing-65-day-fishing-ban-in-bay-of-bengal, 16.05.2019.

Electronic cargo tracking system for Nepal-bound freight

The containerised rail cargo carrying third-country imports of Nepal through the Indian ports of Kolkata and Vizag will no longer require clearance by Indian Customs authorities as both ports have introduced the electronic cargo tracking system (ECTS).

The ECTS is an electronic seal that, unless tampered with, ensures free movement of the container through the international border.

The system has already been introduced at Vizag port in line with a project undertaken by the Asian Development Bank (ADB) and was introduced by Kolkata port a few months ago.

The electronic cargo system at Kolkata now does away with Indian Customs' check of Nepal's third-country imports. Nepal had for long been resisting checks by Indian Customs of its third-country imports, while the Customs authorities had defended the move, citing the prospect of diversion of cargo.

With rail movement of containers easing up, Kolkata port authorities are planning to introduce ECTS for road movement of containers, in phases. While Vizag doesn't have any road cargo for Nepal, a large section of the third-country container imports through Kolkata take the road.

Meanwhile, the transition to ECTS has resulted in a shift of cargo from Kolkata port to Vizag. According to sources in the Container Corporation of India (Concor), till two months ago, 70 per cent of the Nepal-bound container cargo was through Kolkata port.

Source:https://www.thehindubusinessline.com/economy/logistics/electronic-cargo-tracking-system-at-kolkata-port-does-away-with-customs-check-for-nepal-bound-freight/article27060973.ece, 07.05.2019.

Bangladesh's GDP growth puzzling

The recent economic growth of Bangladesh is dubbed as "puzzling" as the country's GDP growth mismatched with the data and various indicators of the economy, according to South Asian Network on Economic Modeling (SANEM), a non-profit research organisation.

Claiming that export and remittance are the primary drivers for economic growth, SANEM said that economic growth rates in recent years do not match with the fluctuations in the export and remittance flow.

SANEM, citing Bangladesh Bureau of Statistics (BBS) and other dataset, said private consumption was estimated to grow by 11.41 per cent in fiscal year 2017-18 compared to growth of 7.43 per cent in the previous year, despite decline in remittance and export income.

The second concern is that we see high manufacturing growth despite low export growth and slow private investment, pointed out Dr. Selim Raihan, SANEM's Executive Director, who is also Professor of Economics at University of Dhaka.

The research organization came up with the observation two weeks after the Centre for Policy Dialogue (CPD), private think tank, questioned the current year's growth estimate of 8.13 percent, citing incoherency in various indicators of the economy.

SANEM also questioned high manufacturing growth rate at 13.4 percent in fiscal year 2017-18, although export growth was 5.81 per cent in that year when the private investment growth was also slow.

Source: https://www.thedailystar.net/business/bangladesh-gdp-growth-rate-puzzling-south-asian-network-on-economic-modeling-1741114, 09.05.2019.

Sustainable Development Fee on regional tourists recommended in Bhutan

A recently released fourth pay commission report of Bhutan has recommended the government to introduce sustainable development fee (SDF) on regional tourists from India, Bangladesh and the Maldives.

The report recommended introducing a SDF of US$8 per head for regional tourists visiting Bhutan. This was recommended as part of the revenue enhancement measures.

As per the report, introducing the SDF on regional tourists would earn an US$6.25 million annually. Bhutan has been receiving increasing number of regional tourists. In 2017, around 170,000 regional tourists have visited Bhutan, which has increased to 202,290 in 2018.

The pay commission report also recommended the government to look into the possibility of enhancing the SDF of US$65 currently levied on international tourists, as it has remained unchanged for the last 40 years or more.

Source: http://www.xinhuanet.com/english/2019-05/07/c_138040535.htm, 07.05.2019.

CALL FOR PAPERS

Twelfth South Asia Economic Summit

For the 12th South Asia Economic Summit (SAES), organizers invite papers from the region on the topic of Shaping South Asia's Future in the Fourth Industrial Revolution (4IR).
Deadline: 30 June 2019
Contacts: Prabir De (prabirde@ris.org.in) and Janaka Wijayasiri (janaka@ips.lk)
For information: http://www.ips.lk/wp-content/uploads/2019/03/SAES-XII-Call-for-papers.pdf

Fourth South Asia Economic Network Conference 2019

South Asia Network on Economic Modelling and the World Bank invite papers addressing one of the following (or related) questions: how is subnational finance affecting local service delivery in South Asia?; how successful are decentralization efforts in South Asia in improving service delivery?; what is the effect of fiscal decentralization on the efficiency of public services? Which conditions make decentralization efforts more successful?; how can the measurement and reporting of subnational expenditure and subnational revenue in South Asia be strengthened?
Deadline of submission: 15 July 2019
Contacts: Rucheta Singh (rsingh33@worldbank.org) and Selim Raihan (sanem.conference@gmail.com)
For more information: http://sanemnet.org/4th-south-asia-economic-network-conference/

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