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Policy Analysis Unit
Research Department, Bangladesh Bank

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On the Communication Policy of the Bangladesh Bank

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On the Communication Policy of the Bangladesh Bank

Executive Summary

- *The newly emerging paradigm on central bank communication suggests that regular release of timely and high quality macroeconomic assessment by the central bank affords greater policy effectiveness by inducing appropriate response on the part of economic actors, and thus leads to more predictable macroeconomic outcomes. Against this backdrop, the communication strategy that the central bank actually follows is of utmost significance.*
- *It is argued below that the communication strategy facing a developing country central bank consist of four primary elements. The first is the transparency of communication. In this regard, the emergence of consensus in the central bank's economic outlook would be crucial. BB senior management is fully cognizant of the virtues of transparency.*
- *The next element is the ability to conduct best practice research and policy analysis at the central bank itself. Short of this, mere transparency will not earn the Bank any credibility at the hand of the market participants and independent analysts at home and abroad. This therefore puts an enormous stress on the central bank to modernize its analytical and research capabilities, and participate in the only game in town. As elaborated below BB has undertaken a major new initiative in this regard.*
- *Thirdly, the central bank ought to be able to pursue the policy measures as dictated by its considered assessment of the evolving economic outlook without political interference. This may be trying at times, but constitutes an integral part of the new regime of transparency and credibility. It would be embarrassing for the central bank to declare a certain necessary policy stance, but then refrain from following through with the necessary policy directives. This will be seen as total surrender of credibility, and hence the central bank must have the necessary degree of autonomy in its policy domain.*
- *The final element is the physical facilities for dissemination of the message and the analysis that go with it. Here again BB is in a strong position with the new information technology initiative currently underway, which is a comprehensive package encompassing hardware, software infrastructures as well as the augmentation of human capital.*
- *Overall therefore the Bangladesh Bank is well poised to turn the corner on all these aspects of a viable communication strategy befitting a modern central bank.*

On the Communication Policy of the Bangladesh Bank¹

1. Introduction: Transparency and Credibility

The current thinking on the subject of the central bank communication policy centres squarely on the *transparency* with which the bank conveys its beliefs on the evolving pattern of macroeconomic fundamentals affecting the country, and hence, on the likely course of its immediate and future policy moves. There is now a body of nascent but fairly detailed empirical studies that purports to demonstrate that such transparency helps improve the eventual effectiveness of policy.

In its pristine form the above view has recently been articulated by Ben Bernanke while on the Board of Governors of the US Federal Reserve System (FRS).² While the principal monetary tool of the FRS is merely the federal funds rate (FFR), i.e., the interest rate at which commercial banks lend each other reserves for short periods (typically overnight), Bernanke argues convincingly that FRS has succeeded in communicating well its views of future short-term rates. The prediction of successive short rates, *if by and large accurate*, eventually allows the private sector to gauge the longer term interest rates, which essentially guide private investment decisions as well as household asset behaviour (including investment in housing stock and other durables). On the supply side, the FRS outlook and policy intentions also influence the pricing of fixed-income securities and other assets (both real and financial), especially those transacted in the leasing market. This is precisely the mechanism by which the essential monetary policy goal of containing inflation within its target band via adjustment of short-term interest rates, the dominant practice in much of the industrialised world (especially Australia, Canada, the Euro zone, New Zealand, UK and the US), influences the macro economy.

Bernanke synthesises the current wisdom that greater transparency and openness of communication makes monetary policy, especially as interpreted above, more effective in at least *three* distinct ways. First, and rather obviously, clear communication helps to increase the short-term predictability of central bank's rate decisions, which reduces risk and volatility in financial markets and allows for smoother adjustment of the economy to rate changes. Second, in the long run, communicating the central bank's objectives and policy strategies can help to anchor the public's long-term expectations of inflation. "Public confidence that inflation will remain low in the long run has numerous benefits. Notably, if people feel sure that inflation will remain well controlled, they will be more restrained in their wage-setting and pricing behaviour, which ...makes it easier for the Federal Reserve to confirm their expectations by keeping inflation low" (Bernanke, 2004, p1). Such a firm belief in low future inflation on the part of the private sector agents provides an additional dividend in that it allows

¹ This document was edited by the Resident Economic Advisor on the basis of notes arising out of extensive consultations with Governor Dr. Salehuddin Ahmed, Deputy Governor M. A. M. Kazemi, Dr. Shahabuddin M. Hossain, and Mr. K. M. Jamshed uz Zaman. PAU members, notably, Md. Akhtaruzzaman, Md. Habibur Rahman, Sayera Younus, Md. Kabir Ahmed, Md. Shahiduzzaman and Moinul Islam Chowdhury participated in group discussions within PAU on its contents and scope.

² See Bernanke (2004).

the central bank additional short-term flexibility to respond to economic shocks that affect output and employment.

The third and final channel is one that allows communication itself to enhance the effectiveness and precision of monetary policy. Bernanke argues, “to the extent that central bank talk provides useful guidance to markets about the likely future path of short-term interest rates, policymakers will exert greater influence over the longer-term interest rates that most matter for spending decisions. At the same time, expanding the information available to financial-market participants improves the efficiency and accuracy of asset pricing” (2004, p2).

The Bernanke argument essentially renders communication itself a major tool of monetary policy. Or to quote Paul Jenkins, the Senior Deputy Governor of the Bank of Canada, “monetary policy is most effective when it is effectively communicated” (2004, p1). Jenkins elaborates how effective communication can also help central banks to be more accountable: we must not only communicate our policy objective and our progress in meeting that objective, but also the challenges that arise in the economic environment and the factors that we take into account in making decisions (p.2). The challenges on the latter front are more daunting for the developing country banks than their industrial counterparts. Given the delay in obtaining data and related official estimates, the Central Bank’s assumptions of the prevailing macro environment and the prediction of its immediate evolution may on occasion be off the mark. The Central Bank therefore has to be prudent in alerting the public that the outlook is uncertain and that the future path of policy variables remains contingent on future developments in the economy. “In other words, the outlook is conditional - conditional on assumptions, such as an assumption about the world price of oil, and on views and analysis based on circumstances at a given point in time” (Jenkins, 2004, p4). Hence though difficult, the goal is to be as clear as possible. Hence central bank communication is as much art as science.

By now the vision of Central Bank communication developed above has gained wide currency. Many central banks have articulated very similar positions on the multiple gains from an open and transparent communication regime. A recent Sri Lankan document states, “An open and coherent communication strategy ...enhances the effectiveness of monetary policy. A clear communication policy also helps to reduce risks and volatility in financial markets... will also be helpful in enhancing the reputation and prestige of central banks.” (Sri Lanka, 2005)

While reviewing the writings of the most creative minds in central banking is most useful, and indeed necessary, one has to keep in mind the institutional context of central bankers in a developmental setting. Of the above cited three channels through which communication may influence the macro economy, the third will have limited applicability in contexts such as Bangladesh where the level of monetization in the economy is relatively low, and where, due to the virtual absence of a market in private sector bonds or even for secondary trading of government securities, the behavioural response to interest rate changes are limited. But the first two channels remain most relevant. It is interesting to note that the Monetary Policy Committee (MPC) of the Bank of England has recently argued that public’s long-term expectations of *low inflation* has taken hold so much so that British consumer price index (CPI) inflation over the past two quarters or so has remained muted (hovering around the target of 2 percent) in spite of significant pressures in the labour market in the face of near or even slight over-capacity utilisation in the industrial sector. “..The move to inflation

targeting in 1992 appears to have established confidence that the policy framework would keep inflation close to target and so has stabilized inflation expectations ...People expect monetary policy to offset the impact of changes in demand on inflation, and they set wages and prices accordingly” (Bank of England, 2005, p27). While the quote itself refers only to policy change, namely the switch to inflation targeting, it is evident that the consequence the MPC is citing eloquently speaks of the virtues of successful communication.

2. Policy Articulation: A Prerequisite of Successful Communication

It is evident that unless the central bank’s policy regime (encompassing both goals and instruments) is precise enough, communication will be difficult even though actions speak louder than the printed words. In other words, while by its consistent and repeated actions in the exercise of policy, a central bank can communicate its intentions well and thereby gain public confidence, but lacking a clear statement as to its mission, there will always exist scope for confusion. To quote the Sri Lankan central bank, “a clearly defined mandate, and properly identified targets and goals are crucial in a communication strategy. Therefore, defining the core objectives would help in developing a clear and credible communication strategy.” (2005, p5).

Historically the Central Bank mandate in Bangladesh has been of a broad nature. The original Bangladesh Bank Order of 1972 that provided the founding charter cited (a) price, (b) exchange rate and (c) economic growth and high level of employment among the major goals.³ Indeed all three of these elements had been among the core objectives of most central banks of that epoch. The practice of monetary policy in Bangladesh has also evolved along these guidelines without further discussion as to the mutual ranking of the goals. The amended Order of 2003 is even broader requiring the Bangladesh Bank (BB), among other, to “formulate” its monetary policy, and to formulate a foreign exchange “intervention policy”.⁴ The newer piece of legislation, literally interpreted, allowed an even greater freedom to the central bank in terms of the monetary policy formulation, but hints at a pro-active stance regarding the foreign exchange market. However with the floating of the currency on May 31, 2003, the market is expected to bring about any necessary adjustments in the exchange rate in view of market fundamentals, the Central Bank is left with the residual responsibility to smoothen the *short-term volatility* in the exchange rate. It is interesting to note that the inclusion of the analysis of monetary and fiscal policy interaction as a major responsibility of the central bank in the 2003 amendment puts a new stress on research.

³ The original 1972 Order stated the broad objectives of the Bank: (a) to regulate the issue of the currency and the keeping of reserves; (b) to manage the monetary and credit system of Bangladesh with a view to stabilizing domestic monetary value; (c) to preserve the par value of the Bangladesh Taka; (d) to promote and maintain a high level of production, employment and real income in Bangladesh; and (e) to foster growth and development of the country's productive resources for the national interest.

⁴ The 2003 Order mandates the central bank (a) to formulate and implement monetary policy; (b) to formulate and implement intervention policies in the foreign exchange market; (c) to give advice to the Government on the interaction of monetary policy with fiscal and exchange rate policy, on the impact of various policy measures on the economy and to propose legislative measures it considers necessary or appropriate to attain its objectives and perform its functions; (d) to hold and manage the official foreign reserves of Bangladesh; (e) to promote, regulate and ensure a secure and efficient payment system, including the issue of bank notes; (f) to regulate and supervise banking companies and financial institutions.

Recent monetary policy stance has indeed targeted price and exchange rate stability. Nevertheless, it is necessary that the monetary policy framework (both in terms of the precise goals, the instruments, and the analytic channels of transmission) be articulated for greater clarity and transparency benefiting both the policy makers as well as the stakeholders. Indeed as this document is being crafted, there is parallel work in progress at the Bank on the preparation of a *Monetary Policy Strategy* document (Bangladesh Bank, 2005), which lays down the underlying monetary policy framework of the Bangladesh central bank.

The brief review of policy noted above illustrates however the complexity facing a central banker in a developmental setting as in Bangladesh with its industrial counterparts. Most developing countries have to deal with multiple goals, but typically without access to a commensurately potent set of policy instruments. However, one need not stretch the gap too far between the authorities whose principal mandate is to target inflation (with the policy tool at disposal being the control over the short-term interest rates) vis-à-vis the developing country counterparts. As we all know all central banks take, and quite appropriately, any disorderly behaviour in the foreign exchange market or other symptoms of macro disequilibria affecting the economy (or that of its major trading partners) most seriously. Very recently, distinguished scholar and a former central banker himself, Princeton's Alan Blinder has gone on to argue that it will make sense to augment the FRS mandate by including (a) the promotion of price stability, (b) ensuring full employment, (c) supporting global economic and financial stability (so long as the latter may be targeted without prejudicing the first two goals).⁵ Evidently the relevance of the last element of the proposed mandate arises only in the context of a major economy, and most developing countries do not generally have to worry about that (except possibly China). Hence an expansion of the mandate as recommended for the FRS would bring it on a level field with the typical developing country central banks. Even then the conduct and the modalities will vary greatly as we explore more fully below. Consequently, from hereon, the discussion will primarily focus on the communication issues as particularly relevant to developing country settings.

3. Communicating with Multiple Stakeholders and on Multiple Goals

Routine dissemination of basically ex-post information served purpose in the days of an administratively dictated financial regime. This has changed altogether with the development of new indirect instruments of monetary control (e.g., *repo* and *reverse repo* auctions) which has facilitated the process of transition to market based interest rates and exchange rates. Consequently market participants, including all public and private stakeholders, are now keenly interested in the *ex-ante* forecast of the macroeconomic outlook as perceived by the central bank. Given this backdrop, there appears to be a near consensus that a developing country central bank needs to communicate on multiple areas.⁶ These include (a) the monetary policy strategy, (b) the supervision, regulation and financial stability, (c), financial market development, communication (d) with the Government, and, (e) with the Parliament.

⁵ See the presentation by Alan Blinder and Ricardo Reis (2005) at the Jackson Hole Symposium in honour of the outgoing Chairman of the US Federal Reserve, Alan Greenspan.

⁶ See Patel (2004) for a related discussion.

(a) Monetary Policy Strategy

Like many central banks, Bangladesh Bank (BB) attempts to achieve maximum sustainable output growth by focussing on the price stability through the use of monetary policy, and thus monetary policy communication must assume the cornerstone of the overall communication policy. The modalities of monetary policy practice however differ among central banks both depending on their mandate and the particular institutional context. For example, much of the industrial world believes that by merely influencing the target overnight rate, the central bank can achieve a rate of monetary expansion compatible with low inflation, which is the ultimate policy goal. And, this is so in spite of considerable uncertainty about the duration of the transmission lags between the rate changes and the price level.

The Bangladesh Bank, like many developing country central banks, has adopted the monetary programming approach to inflation control, which requires close monitoring of the growth of reserve money (RM), *the operating target*. While the money supply can be influenced by the banking system as well as by the treasury operation of the Ministry of Finance (MOF), the most important determinant happens to be RM, which is under the direct control of the central bank. While the underlying inflation model (e.g., the old quantity equation) relates the price level changes to the growth of broad money, targeting RM does allow control over broad money (say M2), *the intermediate target*, via the money multiplier. BB programs the required limit of expansion of M2 based on estimates of GDP growth, target CPI and changes in the income velocity of money. The monetary program is then broken down to weekly (and even daily) targets to facilitate regular monitoring of liquidity in the financial system through open market operations. However, the success of this strategy squarely depends on the accuracy of output and inflation forecasts built into the target money stock growth. While sophisticated models have been around estimating the role of money stock as predicting the future GDP developments (especially in the industrial country contexts), the transmission mechanism between money supply and prices remain tenuous in the case of developing economies.

In the case of BB, as suggested above, direct control of liquidity on a day-to-day basis is achieved via the *repo*, *reverse-repo* and the weekly treasury bill auctions, which would in turn have an impact on the inter-bank call money rate for overnight transactions. Over and above directly adjusting the excess liquidity in the banking system, BB also re-sets the repo and reverse-repo rates on a daily basis. This is as much directed at curbing inflationary pressures as to enforcing financial discipline by allowing the banking system to re-evaluate its asset portfolio.

Among other monetary policy tools, BB monitors the cash reserve requirement (CRR) and the statutory liquidity ratio (SLR), which also affords control over the rate of monetary growth as well as serving the prudential requirements. However the traditional bank rate has lost much of its force in the present context since the borrowing-deposit rate structure appears not well integrated with the structure of short-term rates such as the bank rate or the repo/reverse repo rates.⁷

⁷ In earlier years the commercial banks were heavily dependent on the rediscount window of BB, the only source of borrowing at the time of liquidity shortages. Over the years, however, BB has encouraged activation of an inter-bank call money market, and discouraged borrowing by the commercial banks from BB through the discount window.

The brief overview of the process of monitoring the broad money stock at Bangladesh Bank outlined the multiplicity of tools at disposal: (1) repo, reverse-repo, and T-bill auctions, (2) influence over the call money rate, (3) setting of cash reserve ratio and statutory liquidity requirements, and (4) setting of the bank rate. This is in contrast to the primacy of only one rate, the overnight target rate, as practiced in most of the industrial world. A thorough analytical research based on adequate data (over a sufficient length of time) is needed in order to both better understand the various transmission processes, and, to better identify the relative efficacy of the tools of monetary policy intervention.

Communication on monetary policy will require careful articulation of the outlook for inflation (highlighting the risks and vulnerabilities). Well thought out announcements can only be offered following thorough periodic analysis of the underlying developments in the macro economy as would be available in the proposed bi-annual *Monetary Policy Review* of the Bangladesh Bank. It may be noted that the empirical research cited above on the enhanced effectiveness of monetary policy in the industrial countries, especially USA, was based exclusively on the announcements that follow each of the federal funds rate decisions made by the federal open market committee (FOMC).⁸ Over and above a formal periodic statement as suggested above, it would be useful to have all the monetary policy terms explained, and their purpose and presumed effectiveness elaborated in simple language for public awareness and dissemination via the web and through press releases (as appropriate).

Exchange Rate Policy: Stability of the national currency has been a traditional element of BB monetary policy. However, as already observed, under the floating rate regime the market forces are expected to adjust the equilibrium level of the currency in light of economic fundamentals in an autonomous fashion. Nevertheless BB remains vigilant lest short term events, speculative or otherwise, prove destabilising or unsustainable. This may involve the occasional buy and sell of foreign currencies as appropriate. However the capacity to engage in such interventions is constrained by BB's foreign exchange reserve accumulation policy. Besides occasional interventions, the Bangladesh Bank also has in its toolkit the indirect instruments that can exert an influence on the par value of the currency. These relate to the control over liquidity primarily via open market operations as described above.

Over the longer run, the primary exchange rate issue has to do with the real value of the exchange rate, namely the *real effective exchange rate* (REER), which measures the competitiveness of the nation's exports. In particular it would be remiss of the central bank not to keep an eye on the relative values of REER of the domestic currency vis-à-vis that of its trading partners. The nominal exchange rate changes may not fully and instantaneously adjust to the differential purchasing power of different currencies even in a flexible regime. Fortunately, however, the inflation adjusted par value of the national currency has held up well against its competitors and the pattern has been stable, even depreciating a little during the past two-to-three years. To illustrate, the REER index of the currency stood at nearly 100 in early 2003 (indicating no over-or-under valuation); it has fallen to 90 in the current quarter, which represents a 10-percent depreciation rendering national exports more competitive. In the event of a persistent misalignment that is not being corrected by the market, the instruments at the disposal of BB are same as noted above.

⁸ In Box-1, two samples of central bank policy announcements are presented, one each from the Bank of England and the US Federal Reserve System.

BB therefore has to articulate its concerns and views on the evolving pattern of both the anticipated temporary discrepancies in the demand for and supply of foreign currency as well as on the pattern of REER. Brief statements on these accounts may be released to the media and the public in regular intervals, and of course, at other times should events so warrant. Anticipation of events is likely to make the eventual fluctuations more orderly as time and the risks actually unfold, and thereby render the Central Bank policies more effective.

In this section time and again we have stressed the importance of periodic release of major statements on the evolving pattern of macroeconomic fundamentals and their likely consequences on prices and the exchange rate. Since the entire focus of central bank communication is to add *an element of predictability* in the events that are likely to unfold (which therefore serves as a rationale for the various decisions and directives that the bank administers), it is most desirable to have a set (pre-announced) timetable for the release of such information. The latter in turn would generally require some meeting of minds at precisely the same intervals. It would thus be ideal for BB to institute a high-level Policy Review Committee (PRC) to take stock of events, and issue the statement.⁹ This is essentially how monetary policy is practiced in the successful central banks around the world (especially in the industrial countries), but the trend is catching on elsewhere. Indeed there has been a significant development in this direction in the South Asian region.¹⁰

(b) Supervision, Regulation and Financial Stability: Given the history of the nationalized commercial banks (NCBs) dominating the industry since the early years of independence, Bangladesh embarked in developing a financial system on a weak institutional base. Stories of many scams and crises in a regime of directed credit filled the media reporting on the subject for decades. All this changed when the Financial Sector Reform Program (FSRP) was launched in 1990. The principal reform goals were to (a) develop financial institutions into sound, efficient and competitive entities, (b) develop financial instruments that meet the need of savers, investors, and entrepreneurs, both large and small, (c) render financial markets transparent and cost effective by strengthening prudential regulations and supervision, (d) develop financial infrastructure (including legal and judicial processes), and, (e) allow financial regulatory agencies greater autonomy in discharging their duties and responsibilities. Full utilisation of the information technology is imperative in attaining many of these goals.

As regards the first objective, much progress has been made in the last decade or so by the establishment of private commercial banks (both of domestic and foreign origin) and the accompanying measures of financial deregulation. Private banks are the main pillars of the financial system today, and NCBs are also scheduled to be gradually (if at

⁹ The PRC should be chaired by the Governor, and consist of Deputy Governors in charge of macroeconomic management, the chief economist (or equivalent), and selected executive directors. It would also be helpful for the committee to invite external testimony from professional economists as well as industry spokespersons as part of its informational base, but the latter need not serve as regular members of PRC.

¹⁰ In March 2003, the Sri Lankan central bank commenced reviewing the monetary policy stance on a monthly basis and issuing press releases on the monetary policy stance, with explanatory notes providing more information to the market on monetary and other economic developments. It also publishes an advance calendar of monetary policy reviews giving the dates on which the monetary policy is reviewed. In addition, the overall monetary policy framework and monetary policy targets are posted on the Bank's website (www.centralbanklanka.org).

a slower pace than initially anticipated) privatized. The share of industry assets held by NCBs has fallen from 54 in 1998 to 39.6 percent by June 2005. Loss making NCB branches are being closed down gradually; indeed a total of 161 NCB branches have so far been closed as of June '05. Roles of board and management functions have been clarified and redefined.

New arrangements for capital adequacy ratio (CAR) have been introduced since 1996, which was set at 8 percent of the risk-weighted asset (RWA) base of the bank or BDT 200 million (100 million in case of foreign entities), whichever is higher. These figures have since been revised and scheduled banks are currently required to a maintain CAR of 9 percent or BDT 1 billion, whichever is higher. The next step would be to gradually implement the terms of Basel Accord II expeditiously.

Table 1: Gross NPL Ratios by Type of Banks

	1999	2000	2001	2002	2003	2004	2005 Q ₁	2005 Q ₂
NCBs	45.62	38.56	37.02	33.73	29.03	25.30	26.00	24.37
PCBs	27.09	22.01	16.98	16.65	12.43	8.53	8.77	7.76
FBs	3.80	3.38	3.33	2.61	2.68	1.50	1.83	1.54
SBs	65.02	62.56	61.80	56.19	47.41	42.86	41.13	35.20
Total	41.11	34.92	31.49	28.10	22.13	17.63	17.53	15.79

Note: First note the additional acronyms of bank types: Private Commercial Banks (PCBs), Foreign Banks (FBs), and Specialized Banks (SBs). The NPL data is obtained from Bangladesh Bank documents, the Annual Report and BB Quarterly.

There is evidence that the health of the banking system has improved markedly over the past decade reflecting the fruits of reforms that have been taken over the years. The gross non-performing loan (NPL) ratio has fallen dramatically over the last six years as seen from Table 1, though both the NCBs and SBs have a long way to go.

The liberalisation of the interest rate policy whereby commercial banks are free to set their own deposit and lending rates has also been a major step forward. The central bank has also evolved in its adoption of prudential norms and guidance on both accounting standards, audit regimes, and in overall risk management. Management support has been provided to several NCBs and a revamped audit regime to evaluate the quality of the asset quality of all four NCBs has been under way for some time. A new system of classification of loans and provisioning consistent with international norms were gradually phased in as part of financial sector reforms measures.

All banks have been asked to disclose transparent and adequate data in their financial statements consistent with the International Accounting Standard (IAS). In addition, recently measures such as reduction of the single borrower exposure limit, increase in the capital and reserves, reduction in the dependency on call money market have been instituted for all financial institutions.¹¹ In pursuant of reduced dependence on the call money market and to avoid long term asset-liability mismatch, financial institutions have been advised to utilize alternative long-term sources, such as the credit line, mortgage based securitization, and asset securitization. A maximum of 15 percent of

¹¹ Effective October 2005, it has been decided to reduce the single borrower exposure limit from 50 to 35 percent. The total outstanding financing facilities by a bank to any single person or enterprise or organisation of a group shall not at any point of time exceed 35 percent of the bank's total capital subject to the condition that maximum funded facilities do not exceed 15 percent of the bank's total capital.

their total net assets can be accessed in the call money market with effect from July 1, 2005.

In the legal area, Money Laundering Act of 2002, Money Loan Court Act of 2003, and the 2003 Amendment of BB order of 1972 (allowing greater autonomy to the Central Bank) have been among the major milestones. Additional measures have been adopted in July 2005 in keeping with the *Guidance Notes on Money Laundering*.

Nevertheless, speculation, fraud and poor decisions continue to plague the financial system today. The key to the early detection of lapses can be made effective through supervision of individual banks and routine review of suspicious transactions in individual accounts. Recently BB was quick to spot a stock scam (related to the IPO issue) by a new private bank and took appropriate measures. In all such contexts, solid cooperation between the central bank and the Securities and Exchange Commission (SEC), the authority with oversight responsibility of the securities market in Bangladesh, has been of great help. Indeed BB and SEC should make further progress in institutionalizing the modalities of cooperation to ward off future malfeasance and monitor the orderly functioning of both credit as well as stock markets. The areas of common interests are expected to widen considerably once secondary trading in government securities as well as trading in private debt take place in the near future.

The principal communication challenge here is to make the banking system comprehend in no uncertain terms the zero tolerance where public trust, and the theft or otherwise misuse of shareholder or depositor wealth is compromised. Similar warning in case of non-compliance with BB directives and rules on norms must apply. Violators ought to be identified and the punishment and deterrence structure clearly released to the public in order to restore public's confidence in the financial system and of the central bank's authority and competence in this regard.

(c) Financial Market Development: Developing country Central Banks have an important role in the promotion of financial market development in view of growing demand for financial intermediation, among other, in industry, trade and commerce, and the housing market. The latter markets are mainly served by Non-Bank Financial Institutions (NBFI) such as investment, finance and leasing companies. Presently they number 28 and are regulated by the Financial Institutions Act of 1993. Recently these institutions have also been brought under the purview of the Anti Money Laundering Department of BB. The NBFIs have also been asked to implement effective risk management system in the core risk areas of credit, asset and liability, and internal control and compliance by the end of FY06. In view of the growing role of this industry, compliance with these and further guidelines will require careful monitoring, and the outcome of such reviews should be communicated to the stakeholders for greater transparency.

The Bangladesh Bank has a major role to play in the expansion of the *micro-finance industry* and the development of the financing facilities for the small and medium-scale enterprise (SME) sector in support of the growth and poverty reduction objectives enshrined in the Medium Term Macroeconomic Framework incorporated in the National Strategy for Accelerated Poverty Reduction (GOB, 2005). The size of the credit disbursed by microfinance institutions (MFIs) now rivals that of the formal sector lending in many respects; in FY05 total disbursement by Grameen Bank and three other large NGO-MFIs amounted to BDT 95.3 billion, which was about double the total formal sector credit to agriculture (55.4 billion), and was in excess of the total of industrial term lending by scheduled banks and NBFI combined (of 91.1 billion). Given

that this industry is poised for further growth, its effective supervision and monitoring has assumed greater importance. MFIs have been operating without effective regulation till now. In anticipation, the Micro Finance Research and Reference Unit has recently been set up at BB, and a Steering Committee (chaired by the Governor of the Bangladesh Bank) has been looking into the formulation of a uniform guideline and legal framework for the regulation of microfinance in Bangladesh. It is expected that a comprehensive legal statute will come into force shortly.

SME Development: Bangladesh Bank categorises an industrial unit/business enterprise with fixed assets of less than BDT 10 million as an SME. This sector is presumed underdeveloped primarily due to inadequate finance. There is evidence (both domestic and international) that SMEs have unexploited potential in furthering industrial expansion and employment vis-à-vis larger enterprises for reasons such as the former's advantageous infrastructure costs, lower job creation costs, and their primarily rural origin. The rural location allows these units to establish greater links with the agro-processing industry, a fast growing sector. The issue of easier access to funds on fair terms for SMEs therefore assumes great significance.

In recent years BB has undertaken several measures to encourage SME lending. These have generally taken the form of refinance facilities some of which have earmarked allocations for specific segment of the market, e.g., the agro-processing industry. The refinance activity has received further boost with the creation of SME Sector Development Project whereby a special refinance fund of about \$30 million has been set up by BB in July 2005 with the assistance of the Asian Development Bank (ADB). BB has also been active in revising the prudential guidelines designed for SME lending by scheduled banks. Future innovations in SME finance would appear to be an important area of transparent communication by the Central Bank.

Financial Reporting: This is another area of close interest in the development of the financial system. In recent years BB have adopted the International Financial Reporting Standards (IFRS) as well as the General Data Dissemination Standards (GDDS) proposed by the International Monetary Fund (IMF). Bangladesh Bureau of Statistics (BBS) and BB have been coordinating the GDDS project, and BB staff has received special training sessions jointly arranged by BB, BBS and IMF. Since 2003, BB has been in compliance with these requirements.

(d) Government and BB: The issue of communication between the Government and the Central Bank assumes a major focus in a developmental context. Lacking outright independence, coordination between the Ministry of Finance (MOF) and the Central Bank is required on significant issues. Hence a clear understanding must exist on the sharing of areas for all types of public communication. Logic would require the Minister defer all enquiries related to the financial system, the foreign exchange market, and the practice of monetary policy to the Governor. If events so warrant they may both speak, either in a joint press conference or otherwise; this must be done with prior, if tacit, agreement as to the scope of such an exercise. *What is of utmost importance is that both the Minister and the Governor must be perceived by all concerned to have delivered the same message.* Otherwise, any anomaly would jeopardise the effectiveness of policies. Privately they may exchange views, and need not necessarily agree on all issues either of perception of the context or of the suitability of a policy response, but these should only be resolved away from the public eye.

(e) Bank and the Parliament: In an ideal environment, the Governor should be appointed by the Parliament and as a consequence be answerable to it. However in most South Asian countries such a degree of independence is not enjoyed by any Governor. However, it is a time-honoured practice in many countries for the Governor to address the Parliament (once or twice a year) on the state of the economy, whereupon members may also question the Governor on various issues. Indeed there is a provision for the BB Governor to address the Parliament on the state of the economy, but regrettably this has not been practiced yet. One may also observe that so long as the Bangladesh Parliament does not function fully (given the typical absence of the opposition), instituting of this practice will be one of form only. However, the Parliamentary Standing Committee on Finance and the Committee on Public Accounts take up various issues related to the Bangladesh Bank and requests the Governor to provide information, and indeed sometimes requests the Governor to personally appear before the committees for an exchange of views on various matters relating to banking, finance and the national economy.

4. The Central Bank as a Centre of Excellence in Policy Research

The foregoing discussion amply demonstrates that the primary function of the central bank is to analyse the evolving economy and to take necessary *ex-ante* policy actions.¹² However rigorous analysis cannot be carried out in a vacuum. It must pioneer to carry out relevant policy research, suitably in collaboration with universities, major think tanks, independent consultants and the like. However the benefit of such joint research cannot be fully harnessed unless the bank also has an in-house research department that pursues excellence in policy analysis. It must acquire the capacity to prepare its own evaluation and forecasts relating to the macro economy, and to communicate that to the wider public (i.e., both the lay as well as the professional public).

Recently, Bangladesh Bank and the World Bank Institute (WBI) have initiated a joint project, 'Partnership for Excellence in Research and Policy Analysis at Bangladesh Bank' which aims to upgrade the capacity for research and policy analysis at BB. As part of this program in July 2005, BB has created a new Policy Analysis Unit (PAU) within the Research Department that will conduct quality research and policy analysis. Once recruitment is completed, PAU will consist of 25 professionals headed by a Resident Economic Advisor (REA), reporting directly to the Governor. The Unit in collaboration with WBI will devise an on-going training program in modern macroeconomic analysis and forecasting methodologies for its members. PAU is mandated to publish the *Monetary Policy Review* and the *Financial Sector Review*, each semi-annually. In addition the group will hold seminars and workshops, publish Policy Notes and Working Papers on timely topics on a regular basis. All these documentation and related data will be made available on the world-wide web. It is anticipated that the group will soon establish itself as the premier research unit on the Bangladesh Macro Economy in the country.

At the end of the project phase, PAU will become a part and parcel of the Research Department of BB, thus enshrining the continuation of research excellence in the central bank of the country. Indeed the above initiative is part of a broader goal of an

¹² Note the 2003 amendment of the Bank Order (part c) requires the bank to provide an analysis of the interaction of monetary, fiscal and exchange rate policies, and of their impact on the economy, and to rationalise the suggested policy measures. None of these tasks may be accomplished without extensive and high quality research.

overall make over of the Bangladesh central bank fashioned as the Central Bank Strengthening Project (CBSP). The latter consists of the following components:

- I. Strengthening the Legal Framework
 - (a) Legal Counsels
 - (b) Anti Money Laundering and Countering Financing of Terrorism
- II. Reorganization and Modernization of Bangladesh Bank
 - (a) Functional Reorganization
 - (b) Automation of BB, i.e., Information System Development.
 - (c) Human Resource Development
- III. Capacity Building
 - (a) Strengthening of the Research Department (cited above)
 - (b) Strengthening Prudential Regulation and Supervision
 - (c) Strengthening Accounting and Auditing.

5. The Process and the Means of Communication at BB

(a) Present Position¹³

Consultations: Consultative meetings with stakeholders (e.g., banks and financial institutions, forums representing commerce and industry, other regulatory authorities, self-regulatory and professional bodies) about major new policy changes constitute the main plank of the communications approach of BB. Consultations are held regularly with the Association of Bankers especially prior to regulatory and/or policy changes. Similarly, BB also organizes meeting with the Bangladesh Lease and Finance Companies Association (BLFCA). Regular meetings are held with primary dealers in government securities and foreign exchange dealers. Bangladesh Bank regularly arranges meetings with the press, particularly with Economic Reporters Forum (ERF) to share policy changes and to explain reforms. A training program was organized recently to train the members of ERF at the bank's in-house Training Academy (BBTA).

Publications: Bangladesh Bank brings out a number of research and statistical publications including the Annual Report, the Quarterly Report, and a Monthly Report that are intended to inform policy makers, market participants and general public. Research, IT, Monetary Policy and Statistics Departments jointly prepare these reports, with support from Public Relations and Publications Department. The latter department helps handling media briefings and liaison, and issuance of press releases.

BB's websites (www.bangladesh-bank.org and www.bangladeshbank.org.bd) now serve as important communication platforms, allowing continuous instant access to information on roles, responsibilities and policy approaches of the central bank. The websites contain circulars issued by the BB, economic indicators and other reports and publications.

Internal Communication: Regular consultation meetings at various levels are held in order to facilitate communication laterally across departments and vertically across hierarchies. Once a week the Deputy Governors (at present three) meet in the Governor's chamber to discuss important policy and operational matters. At the next level, an Executive Management Team comprising Governor, Deputy Governors and

¹³ This section is has been edited by the REA based on a brief prepared by the Bangladesh Bank Governor's Secretariat.

Executive Directors meets fortnightly. The Executive Directors hold weekly meetings with senior supervisors of departments under their guidance, and the departments hold monthly internal consultation meetings. Quarterly/half yearly consultative meetings chaired by the Governor are also held with heads of departments and offices.

(b) Challenges Posed by Market/Institutional Reforms and BB's Communication Strategy

There are several areas where the current practices need a major overhaul. These are perceived as follows.

Communication with Market Participants at Home and Abroad: As outlined above, correct, consistent and forward looking assessment of the underlying economic conditions and the corresponding stance of central bank's expected future policy is now important for influencing financial market behaviour thereby inducing policy effectiveness. In Bangladesh, it may require a modest period of time in order to get the broader public accustomed to the new central bank communication regime, and thus to create the desired awareness and confidence; however, the process should be launched soon. Indeed the process will experience a total make over with the strengthening of the research capability via the creation of the Policy Analysis Unit as mentioned above, as well as via the advanced information technology changes underway at the bank. More on the latter program is detailed below.

Communication with the Commercial Banks and Other Financial Institutions in the Supervision and Regulatory Contexts: Management changes under the reform projects for the BB and the nationalized commercial banks have added further urgency to the strengthening of the communication approaches and practices. Unintentional misinformation from ignorance, as well as intentional misinformation by various quarters apprehensive of redundancies can obstruct smooth progress of the change processes. Information dissemination about the change processes need to be skilfully designed to effectively counter misinformation and to generate support and enthusiasm. The IT platform will also enhance the quality and timeliness of financial reporting by banks and financial institutions to the central bank. Consultations with stakeholders prior to major policy changes are now being held as a regular practice.

Internal Communication for Effective Functioning of the Central Bank: Bangladesh Bank is currently in the process of implementation of USD 46 million Central Bank Strengthening Project (CBSP) cited above. The project incorporates, among other, a new information technology initiative, which is a comprehensive package encompassing hardware, software infrastructures as well as the augmentation of human capital.¹⁴

¹⁴ A major share of the funds would be used for automation of Bangladesh Bank in areas like Core Banking & Treasury, Enterprise Resources Planning (ERP), Data Warehouse for online analytical support, automation of clearing house using MICR technology, and the bank-wide intranet. Apart from this the branch offices and head office of Bangladesh Bank would be linked together via communication network using either fibre optic cables/VSAT or Digital Data network infrastructure developed by the government-owned BTTB (public telecom network). The integration of the various activities would optimize the business process, foster administrative efficiency and ensure ease of management. The IT initiative is being sequentially phased in seven packages. These are as follows. Package-1: Network, Network Management, Backup Management, Office Automation, Intranet, Electric System, Data Centre, Disaster Recovery System, Air Conditioner, Fire Control System (Fire Extinguisher), Data Migration, Experts' Assistance, Furniture, Training and Post-installation Maintenance Support. Package-2: Standard Hardware, Software, Training and Post-installation Maintenance Support. Package-3: Banking Software, Related Hardware, Training and Post-installation Maintenance Support. Package-4: Systems Integration,

A proposed intranet at BB will be operated over the proposed network on an enterprise wide basis. This would enable BB employees to communicate easily through simplified distribution of regulation, policies, newsletters, circulars, instructions, notices, publications, virtual libraries, manuals, guidelines, handbooks and special reports thus raising the overall productivity and efficiency of employees. The intranet is likely to help in information dissemination, distribution and management to significantly improve internal communication at BB.

Complementary Reform in Human Resource Policy: Effective implementation of the new communications strategy will require large scale upgrading of skill base of BB's staff and reorientation towards new communications set-up. Accordingly, top management personnel in the BB have meanwhile undergone sensitization exposures in workshops conducted by external communication consultants, and concerned officials working in the area of communications have received training exposures within and outside the country.

The recruitment and training program of BB will also be reoriented towards the new communications strategy befitting for a modern central bank. BB currently has an active training program for its staff and those of the commercial banks through its own outfit, known as the Bangladesh Bank Training Academy (BBTA). Senior BB officials (especially those with advanced degrees from abroad) regularly participate by giving lectures in their fields of expertise to the trainees. As part of the IT reforms, all the professional staff will be provided with a computer terminal linked to the system and necessary training for effective communication.

Improvements have been brought about in the Bank's periodical reports and reviews, internal house magazine and the website; these now contain more analysis, forecast/projection than before, and clearer exposition of the Bank's intentions and objectives.

Communicating Bad News: Often the policy alternatives facing a Central Bank are inherently difficult. For example, since the summer of 2005 world oil price has remained exceptionally high. With the phasing out of MFA related textiles quotas, many countries including Bangladesh face greater uncertainty, and the possibility of export earnings for FY06 falling below the projected level cannot be ruled out. The consequent impact on the terms of trade, foreign exchange reserves, the exchange rate, and the ensuing inflationary pressures require careful analysis and communication to the public. The rationale for following a tightened monetary policy stance can be difficult to communicate given the public's expectations. In the particular context of Bangladesh, there is also the related problem of adjusting the administered domestic fuel prices, a volatile topic especially depending on the electoral cycle as well as the economic cycle. The negative effects of the energy price increase are all too obvious to the public. Central bankers' task is difficult. On the one hand, they have to explain to the Finance and Planning officials in the Government of the need to take prudent fiscal measures in consonant with the prevailing monetary policy stance; then on the other hand, they also have to convince the general public of the appropriateness of these policies. Failing to address both parties adequately risks the confounding of the real

Training and Post-installation Maintenance Support. Package-5: CIB online, Training and Post-installation Maintenance Support. Package-6: Resource Management (ERP), Related Hardware, Training and Post-installation Maintenance Support. Package-7: Enterprise Data Warehouse (EDW), Related Hardware, Training and Post-installation Maintenance Support.

issues often in the hands of uninformed press and media, and worse, harmful speculation by market players trying to make mischief. In time of such crises, the central bank communication policy is put to a real test! Nevertheless only a regime of transparent communication can instil public confidence in national institutions.

6. Conclusion

The newly accepted paradigm on central bank communication suggests that regular release of timely and high quality macroeconomic assessment by the central bank affords greater policy effectiveness by inducing appropriate response on the part of all economic actors, and thus leads to more predictable macroeconomic outcomes. Against this backdrop, the strategy that the central bank actually follows is of utmost significance. As elaborated above, we see the communication strategy to consist of *four* primary elements. The first element is the *transparency* of communication. BB senior management is fully cognizant of the virtues of transparency.

The next major element in the strategy is the ability to conduct *best practice research and policy analysis* at the central bank itself. Short of this, mere transparency will not earn the bank any *credibility* at the hand of the market participants and independent analysts at home and abroad. This therefore puts an enormous stress on the central bank to modernize its analytical and research capabilities, and participate in the only game in town. It is anticipated that BB's forthcoming series of analytical reports (the bi-annual Monetary Policy Review and Financial Sector Review, and the more frequent series of Policy Notes and Working Papers), which will all be uploaded on the web, will fill a major vacuum.

Thirdly, the Central Bank ought to be able to pursue the policy measures as dictated by its considered assessment of the evolving economic outlook without political interference. This may be trying at times, but a measure of independence constitutes an integral part of the new regime of transparency and credibility. It would be embarrassing for the central bank to declare a certain necessary policy stance, but then refrain from following through with the necessary policy directives. This will be seen as total surrender of credibility, and hence the central bank must have the necessary degree of autonomy in its policy domain. Indeed Central Bank autonomy is a prerequisite of its success in steering monetary policy.

The final element is the physical facilities for *dissemination of the messages and the analysis* that go with it. Here again BB is in a strong position with the new information technology initiative currently underway, which is a comprehensive package encompassing hardware, software infrastructures as well as the augmentation of human capital. Bangladesh Bank therefore appears well poised to soon turn the corner on all aspects of a viable communication strategy befitting a modern central bank.

Box 1: A Sample of Central Bank Release of Periodic Policy Statements

1. Bank of England press notice of 4 August 2005

Bank of England reduces interest rates by 0.25 percentage points to 4.5 percent: The Monetary Policy Committee today voted to reduce the Bank's repo rate by 0.25 percentage points to 4.5 percent.

In the first half of the year, output growth in the United Kingdom was subdued. Household spending and business investment growth have slowed. Although there are some signs of a pickup in consumer spending, downside risks remain in the near term. Looking further ahead, however, the rise in equity prices and the recent fall in the exchange rate should boost activity.

CPI inflation was 2.0 percent in June. Higher oil prices may raise inflation further in the short term. But, in the Committee's view, the slackening in the pressure of demand on supply capacity should lead to some moderation in inflation. Against that background, the Committee judged that a decrease of 0.25 percentage points in the repo rate to 4.5 percent was necessary to keep CPI inflation on track to meet the 2 percent target in the medium term.

The Committee's latest inflation and output projections will appear in the *Inflation Report* to be published on Wednesday 10 August.

The minutes of the meeting will be published at 9.30 am on Wednesday 17 August.

2. US Federal Reserve System

Press Release of August 9, 2005

The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 3-1/2 percent.

The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. Aggregate spending, despite high energy prices, appears to have strengthened since late winter, and labour market conditions continue to improve gradually. Core inflation has been relatively low in recent months and longer-term inflation expectations remain well contained, but pressures on inflation have stayed elevated.

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Voting for the FOMC monetary policy action were: Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Susan S. Bies; Roger W. Ferguson, Jr.; Richard W. Fisher; Donald L. Kohn; Michael H. Moskow; Mark W. Olson; Anthony M. Santomero; and Gary H. Stern.

In a related action, the Board of Governors unanimously approved a 25-basis-point increase in the discount rate to 4-1/2 percent. In taking this action, the Board approved the requests submitted by the Boards of Directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco.

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