

Global Financial Crisis: A Comparative study of three representatives (US, India and Bangladesh) of three different worlds -developed, developing and least – developed

Nalin Bharti (Ph.D, JNU)

Assistant Professor, Humanities and Social Sciences,

Indian Institute of Technology Patna

Patliputra Colony, Patna – 800 013, India,

Phone: +91-612-2552017, Fax: +91-612-2277383

Email: nalinbharti@gmail.com, nalinbharti@iitp.ac.in

Abstract

Global financial crisis is deepening. The extent of the problems has been so severe that some of the world's largest financial institutions have collapsed. The governments of the wealthiest nations in the world have resorted to extensive bail-out and rescue packages for the remaining large banks and financial institutions. International organizations such as *IMF, World Bank, WTO, UN, ILO (2008,2009)* and experts like *Baker, Bogle and Easterly, Jean and Santos, Roach, Robert, Roubini, Smick (2009), Olivier, Yunus (2008)* has proclaimed this crisis worse than the great depression of 1930s. One way developed world is facing a challenging task of not having a proper *regulatory mechanism* to control the crisis at this critical juncture and the other way developing and least developed economies such as India and Bangladesh is directly and indirectly involved in taking strong precautionary steps to avoid and reduce the impact of such crisis. This paper presents an interesting comparison of three representatives (*US, India and Bangladesh*) of three different worlds *developed, developing and least –developed* respectively on post crisis monetary stategy.

Kew Words: Financial Crisis, Regulatory Mechanisms, Financial Transactions, Public Policy.

Introduction

There were many financial crises before but the current crisis which began in mid 2007 in United States is completely strange compare to other crisis in terms of its impact. This is the first major crisis after a true globalization of trade, telecommuication and transaction of financial assets. The extent of the problems has been so severe that some of the world's largest financial institutions have collapsed. The governments of the wealthiest nations in the world have resorted to extensive bail-out and rescue packages for the remaining large banks and financial

institutions. International organizations such as *IMF, World Bank, WTO, UN, ILO* (2008,2009) and experts like *Baker, Bogle and Easterly, Jean and Santos, Roach, Robert, Roubini, Smick* (2009), *Olivier, Yunus* (2008) has proclaimed this crisis worse than the great depression of 1930s. Crisis of an individual nation has US has made crisis after crisis.

Crisis after Crisis

The current financial crisis began in the US in summer 2007 with the so called *sub prime crisis*. But there were bubbles dependent growth model in a surprisingly large number of countries-all now bursting (Roach, 2009). This crisis is not merely the result of the U.S housing bubble's bursting or the collapse of the US's sub prime mortgage sector. The credit excesses that created this disaster were global. There were many bubbles, and they extended beyond housing in many countries to commercial real estate mortgage and loans. There were bubbles for the securitizing products that converted these loans and mortgages into complex, toxic and destructive financial instruments and there were still more bubbles for local governments borrowing, leveraged buyouts, hedge funds, commercial and industrial loans, corporate bonds, commodities, and credit -default swaps - a dangerous unregulated market wherein up to \$60 trillion of nominal protection was sold against an outstanding stock of corporate bonds of just \$ 6 trillion(Roubini, 2009).

Financial Globalization is very fast and its negative impact is even faster. In this context the 'rapid global integration and deep and complex interconnections between financial institutions, the crisis quickly moved across assets, markets, and economies. The rest is history or, more precisely, history in the making' (Blanchard, 2008). Global economy is currently falling into three major trap *liquidity trap, deflationary trap and debt deflation*. US is such a huge part of the global economy, as it shrinks, the entire global economy will go into recession. In Europe, Canada, Japan and the other advanced economies, it will be severe (Roubini, 2009).

The recent crisis, however, has sent investors scrambling to the dollar for safety, causing it to soar against most other currencies. The rising dollar, coupled with recessions in much of the rest of the world, will cause the trade deficit to rise again (Baker, 2009). Policymakers in advanced economies were adopting appropriate measures on the financial front; the financial crisis began to have a sharper and deeper impact on the real economy. Deleveraging by financial institutions has now translated into more expensive credit for households and firms, and difficulties in financing even normal business operations. And, more importantly (at least in terms of its quantitative effects), consumers and firms across the globe have lost confidence. Fears of a long and deep recession, similar

to the experience of the 1930s, have triggered worries about job security, savings, and credit. As a result, consumer spending has slumped, business investment has shrunk, and unemployment is rising rapidly (Blanchard, 2008).

The crisis has more or less captured the entire world. And this made most of the Central Banks very serious in last two years which were set up for monetary regulations. I present three case study each from developed, developing and least developed.

Monetary Policy Response to the Crisis in United States

The Federal Reserve (FR) has responded aggressively to the crisis since its emergence in the summer of 2007. Following a cut in the discount rate (the rate at which the Federal Reserve lends to depository institutions) in August of that year, the Federal Open Market Committee began to ease monetary policy in September 2007, reducing the target for the federal funds rate by 50 basis points. As indications of economic weakness proliferated, the Committee continued to respond, bringing down its target for the federal funds rate by a cumulative 325 basis points by the spring of 2008. In historical comparison, this policy response stands out as exceptionally rapid and proactive. In taking these actions, FR aimed both to cushion the direct effects of the financial turbulence on the economy and to reduce the virulence of the so-called adverse feedback loop, in which economic weakness and financial stress become mutually reinforcing (Bernanke, 2009).

In the last few months of 2008 the Federal Reserve took dramatic action on multiple fronts to avert a crisis of the global financial system, backing the acquisition of wounded investment firm Bear Stearns and increasing the flow of money to other banks squeezed for credit. The Fed in effect is offering to be a lender of last resort for 20 major Wall Street firms, a role it has previously played only for commercial banks. (Irwin and Cho, 2008). Fed Communication Released a statement that it "...is providing liquidity to facilitate the orderly functioning of financial markets [and] will provide reserves as necessary through reserve management operations to promote trading in the federal funds market at rates close to the Federal Open Market Committee's target of 5¼%" (Papadia 2008).The Federal Reserve has responded aggressively to the financial crisis since its emergence in the summer of 2007. The reduction in the target federal funds rate from 5-1/4 percent to effectively zero was an extraordinarily rapid easing in the stance of monetary policy. In addition, the Federal Reserve has implemented a number of programs designed to support the liquidity of financial institutions and foster improved conditions in financial markets. These new programs have led to a significant change to the

Federal Reserve's balance sheet. Following tools may be observed as the traditional tools of the FR :

1. The first set of tools, which are closely tied to the central bank's traditional role as the lender of last resort, involve the provision of short-term liquidity to banks and other depository institutions and other financial institutions. Because bank funding markets are global in scope, the Federal Reserve has also approved bilateral currency swap agreements with 14 foreign central banks. These swap arrangements assist these central banks in their provision of dollar liquidity to banks in their jurisdictions.
2. A second set of tools involve the provision of liquidity directly to borrowers and investors in key credit markets. The Commercial Paper Funding Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Money Market Investor Funding Facility, and the Term Asset-Backed Securities Loan Facility fall into this category. All of the programs are described in detail elsewhere on this website.
3. As a third set of instruments, the Federal Reserve has expanded its traditional tool of open market operations to support the functioning of credit markets through the purchase of longer-term securities for the Federal Reserve's portfolio. For example, on November 25, 2008, the Federal Reserve announced plans to purchase up to \$100 billion in government-sponsored enterprise (GSE) debt and up to \$500 billion in mortgage-backed securities. On March 18, the Federal Reserve announced plans to purchase up to \$300 billion of longer-term Treasury securities in addition to increasing its total purchases of GSE debt and mortgage-backed securities to up to \$200 billion and \$1.25 trillion, respectively (The Federal Reserve, 2009).

These policy actions helped to support employment and incomes during the first year of the crisis. Unfortunately, the intensification of the financial turbulence last fall led to further deterioration in the economic outlook. The FR responded by cutting the target for the federal funds rate an additional 100 basis points last October, with half of that reduction coming as part of an unprecedented coordinated interest rate cut by six major central banks on October 8. In December the Committee reduced its target further, setting a range of 0 to 25 basis points for the target federal funds rate (Bernanke , 2009).

FR predict that at some point, global economic growth would moderate, resulting in slower increases in the demand for commodities and a leveling out in their prices--as reflected, for example, in the pattern of futures market prices. As you know, commodity prices peaked during the summer and, rather than leveling out, have actually fallen dramatically with the weakening in global economic activity. As

a consequence, overall inflation has already declined significantly and appears likely to moderate further. At this point, with global economic activity weak and commodity prices at low levels, we see little risk of inflation in the near term; indeed, FR expects inflation to continue to moderate. (Bernanke ,2009). There are many positive statement by FR but before analyzing these statements it is imperative to see the Monetary policy responses in other country too.

Monetary Policy Response to the Crisis in India

The outlook for India going forward is mixed. There is clear evidence of economic activity slowing down. Real GDP growth has moderated modestly in the first and second quarters of 2008/09, and sharply in the third quarter. The services sector, which has been our prime growth engine for the last five years, is slowing, mainly in construction, transport and communication, trade, hotels and restaurants sub-sectors. For the first time in seven years, exports have declined in absolute terms for four months in a row during October 2008 - January 2009. Recent data indicate that the demand for bank credit is slackening despite comfortable liquidity in the system. Dampened demand has dented corporate margins while the uncertainty surrounding the crisis has affected business confidence. The index of industrial production has shown negative growth for two recent months and investment demand is decelerating. All these factors suggest that growth will moderate more than we had earlier thought (Subbarao, 2009a).

Like other developing country India also got the bad kick. Like other central banks of many developing country The Reserve Bank of India's policy stance can be summarised below :

1. Maintaining comfortable rupee and forex liquidity positions.
2. There are indications that pressures on mutual funds have eased and that NBFCs too are making the necessary adjustments to balance their assets and liabilities.
3. Despite the contraction in export demand, Bank will be able to manage balance of payments.
4. It is the Reserve Bank's expectation that commercial banks will take the signal from the policy rates reduction to adjust their deposit and lending rates in order to keep credit flowing to productive sectors.
5. In particular, the special refinance windows opened by the Reserve Bank for the MSME (micro, small and medium enterprises) sector, housing sector and export sector should see credit flowing to these sectors.
6. Also the SPV set up for extending assistance to NBFCs should ease the financing constraints of NBFCs.

7. The government's fiscal stimulus should be able to supplement these efforts from both supply and demand sides. (Subbarao,,2009b).

In addressing the fall out of the crisis, India has several advantages. Some of these are recent developments. Most notably, headline inflation, as measured by the wholesale price index, has fallen sharply though consumer price inflation is yet to moderate. Clearly, falling commodity prices have been the key drivers behind the disinflation; however, some contribution has also come from slowing domestic demand. The decline in inflation should revive and support consumption demand and reduce input costs for corporates. Furthermore, the decline in global crude prices and naphtha prices, if sustained, will reduce the size of subsidies to oil and fertilizer companies, opening up fiscal space for infrastructure spending. From the external sector perspective, it is projected that imports will shrink more than exports keeping the current account deficit modest (Subbarao, 2009a). Following are several structural factors that have come to India's aid:

1. First, notwithstanding the severity and multiplicity of the adverse shocks, India's financial markets have shown admirable resilience. This is in large part because India's banking system remains sound, healthy, well capitalized and prudently regulated.
2. Second, our comfortable reserve position provides confidence to overseas investors.
3. Third, since a large majority of Indians do not participate in equity and asset markets, the negative impact of the wealth loss effect that is plaguing the advanced economies should be quite muted. Consequently, consumption demand should hold up well.
4. Fourth, because of India's mandated priority sector lending, institutional credit for agriculture has remained unaffected. The farm loan waiver package implemented by the Government should further insulate the agriculture sector from the crisis.
5. Finally, over the years, India has built an extensive network of social safety-net programmes, including the flagship rural employment guarantee programme. These uniquely Indian versions of automatic stabilizers should protect the poor from the extreme impact of the global crisis (Subbarao, ,2009a).

It is true that the global crisis will dent India's growth trajectory as investments and exports slow. Clearly, there is a period of painful adjustment ahead of us. However, once the global economy begins to recover, India's turn around will be sharper and swifter, backed by our strong fundamentals and the untapped growth potential. Meanwhile, the challenge for the government and the RBI is to manage the adjustment with as little pain as possible (Subbarao,

,2009a).India's low inflation , moderate growth rate and high foreign direct investment shows the indication of faster recovery and growth.

Monetary Policy Responses to the Crisis in Bangladesh

Performance of Bangladesh in such areas as export, remittance, share market, and aid has been along historical trends during the July-December 2008 period. However, some of the early disquieting developments are starting to emerge in some sectors (banking and finance, import duties). Government of Bangladesh has set up a technical committee and The Central Bank (Bangladesh Bank) has taken some precautionary measures through its monetary policy and has set up a Task Force to review and monitor the situation(Rahman, Moazzem, Hossain ,2009)

Bangladesh Bank in its Monetary Policy Statement for July-December, 2008 has provided its policy stance envisaging possible impact of global economic meltdown on the domestic economy. These steps may be highlighted as follows:

1. *Supporting productive sectors:* Priority to unhindered flow of private sector credit to productive sectors, with agriculture, SMEs, and the rural economy being the primetargets.
2. *Private sector credit:* Growth in private sector credit would be watched carefully and if the situation warrants, necessary policy adjustments would be introduced.
3. *Soundness of banking sector and their liquidity position:* BB will continue monitoringthe liquidity situation in the banking system and adopt appropriate measures to overcome any temporary pressure on liquidity.
4. *Exchange rate:* Desired exchange rate stability would be maintained to keep the pressure of imported inflation under control. BB would routinely conduct 'surprise inspections' on banks and exchange companies relating to compliance with foreign exchange regulations as well as the anti money laundering act.
5. *Remittances:* Measures would be taken to divert increasing amount of remittances toward investment in productive sectors to ease the potential demand pressure and expand the economy's productive capacity.
6. *Import payments:* For facilitating more efficient import of essential goods, BB has made available forward hedging mechanism to importers. In this context, BB would ensure that the facility is used only for true hedging.
7. *Women entrepreneurs:* BB would continue to encourage increased flow of credit to women entrepreneurs for investment in productive sectors.
8. *Measures protecting the poor and the vulnerable Social Safety Net Programmes:* In order to provide support to the poor and

vulnerable group, a number of social safety net programmes have been implemented in the country on a regular basis. This includes among others, public food distribution system (PFDS), rural employment and road maintenance programme, and 100 Days Employment Generation Scheme. The last two programmes have been introduced under the national budget for FY2008-09.

More recently Governor Bangladesh Bank ruled out the Bangladesh Bank's prudential supervisory regulations along lines of BCBS standards, covering inter alia the following:

- i) Financial statements and disclosures in conformity with internationally accepted accounting standards;
- ii) Good corporate governance; with fit and proper tests for directors and chief executives, clear delineation of roles, responsibilities and accountabilities for directors and chief executives, prior central bank clearance for appointments, removals and compensation structures for chief executives. In the recent past, the large four state owned commercial banks have been converted into public limited companies ('corporatized'), putting them in readiness for eventual partial or total privatization.
- iii) Sound risk management practices meeting the minimum standards set in guidelines for management of core risks issued by BB, now in the process of further revision.
- iv) Limits on large exposures to single borrowers, limits and disclosure requirements on loans and other facilities to directors, members of senior management and their connected interests.
- v) Internal control and compliance units reporting to Audit Committees of boards, annual external audits besides continuous on- and off-site BB supervision.
- vi) From 2009 onwards banks are to work out their capital requirements according to Basel II capital regime, alongside continuing compliance with the current 'Basel-I minimum plus two percent' capital requirement on risk weighted assets (Rahman,2009).

However, many of these initiatives that were taken in the recent past were not directly related to the causes or consequences of the global financial crisis, and are in many instances, coincidental. Nevertheless, some of the very recent initiatives (encouraging higher remittance, banking sector practices, reserve management) appear to be inferred by concerns about possible impacts and consequences. Fiscal/monetary policy packages to stimulate domestic demand, income and employment measures taken by the Government. A high-powered technical committee has been formed in early November, 2008 to closely monitor the impact on the country's economy from the fallout of the current global financial crisis and take instant remedial measures. (Rahman, Moazzem, Hossain ,2009).

Due to these policy responses Bangladesh's economy has stood up well in the face of the surge in international food and commodity prices in the first half of 2008 and the outbreak of the global crisis since September 2008. Real GDP growth is expected to remain strong in 2008-09 (July-June) at around 6.0 per cent, benefiting from a favourable agricultural performance and the fall in food, fuel and commodity prices in the second half of the year. As a result and reinforced by a combination of supply management and monetary-fiscal policies, inflation fell on a year-on-year basis to 6.1 per cent in January 2009 from 11.4 per cent a year ago. Public finances have come under some strain with growth in tax revenues falling short of target which is being offset by reduced expenditure due to sluggish demand and lower Annual Development Plan utilisation. With the deepening global downturn affecting major export markets, Bangladesh's balance of payments has come under some pressure, aggravated by some slowing down of remittances although they continue to hold up well. Gross international reserves stood at US \$ 5.9 billion at the end of February 2009, close to three months of imports. Bangladesh has also welcomed the decisions of the G -20 to deal with the current crisis within a multilateral framework while shunning trade protectionism and competitive devaluations. Bangladesh is striving to weather the crisis with a modest stimulus package aimed at boosting domestic demand with investment in rural, agricultural and infrastructure sectors, propping up the export sectors, buttressing food and social security measures and undertaking additional employment programmes (Subbarao, 2009b).

Remittances are one of the major sources of income for Bangladesh which is currently facing problem due to this crisis. But macroeconomic indicators suggest that the impact of the crisis is less and the Bangladesh Bank is not facing any difficulty in solving the crisis.

Conclusion

Three different study of three different world: developed, developing and least developed gives many insights. Bangladesh bank is trying hard to retain the previous level of remittances. set back to services exports are the major set back for India. But the essence of the monetary policy in India and Bangladesh is quite positive because the growth rate is still near to the older level which is not true with US. Federal reserves major problem is to provide liquidity, inject capital and disposal of problematic assets. In India and Bangladesh such disposal of problematic assets are not required because central banks in these countries had not allowed such practice. Barnanke's (2009) statement that we see little risk of inflation is not appropriate when country is

striving hard to come out from deflationary traps as Roubini (2009) has pointed out. India and Bangladesh's central bank's statements are clearer and sound compare to the Federal Reserve of US may be because the crisis is more sever in US than in India and Bangladesh.

References

- Baker Dean, watch the Doller, *Foreign Policy*, Jan/Feb 2009, p .68
Bangladesh Bank's 'Monetary Policy Statement for July-December, 2008.
Bernanke S. Ben (2009), At the Stamp Lecture January 13, 2009 ,London School of Economics,London, England
Blanchard Olivier, Cracks in the System: Repairing the damaged global economy, *Finance & Development* , December 2008, pp.8-10
Bogle C John and Sullivan N. Rodhney, *Financial Analysts Journal*, Jan/Feb 2009, pp 17-24
Easterly William, The Poor Man's Burden, *Foreign Policy*, Jan/Feb 2009, pp 63-64
IMF (2009), Global Financial Stability Report Market Update, January 28, 2009
Irwin Neil and Cho David, Fed Takes Broad Action to Avert Financial Crisis, Washington Post , March 17, 2008
- Jean Pisani-Ferry and Indhira Santos , The World in Crisis, Reshaping the Global Economy, *Finance & Development* ,March 2009, pp 8-12
Papadia Francesco (2008), CGFS Papers No 31,Central bank operations in response to the financial turmoil, Report submitted by a Study Group established by the Committee on the Global Financial System chaired by Francesco Papadia of the European Central Bank, Bank for International Settlement, July 2008
Rahman Atiur, Governor, Bangladesh Bank on 08 September, 2009 in *Keynote address by Conference on Global Banking: Paradigm Shift*, Mumbai, India
Rahman Mustafizur, Moazzem Golam Khondaker, Hossain Syed Saifuddin, National Policy Responses to the Financial and Economic Crisis:The Case of Bangladesh, ILO Subregional Office for South Asia, New Delhi,.....
- Roach S. Stephen, A Lethal Shakeout, *Foreign Policy*, Jan/Feb 2009,pp 65-66
- Robert J. Shiller, Are We There Yet?, *Foreign Policy*, Jan/Feb 2009,p67
Roubini Nouriel, The Worst is yet to come, *Foreign Policy*, Jan/Feb 2009, pp 63-64
Smick. M. David, Good Luck, Barack, *Foreign Policy*, Jan/Feb 2009, pp 66-67
Subbarao Duvvuri ,India - Managing the Impact of the Global Financial Crisis, Speech delivered at the Confederation of Indian Industry's National Conference and Annual Session 2009 in New Delhi on March 26, 2009a
- Subbarao Duvvuri Statement by Dr., Governor, Reserve Bank of India on behalf of Mr. Palaniappan Chidambaram, Member, IMFC (representing the Constituency consisting of Bangladesh,Bhutan,India and Sri Lanka), Leader of the Indian Delegation to the International Monetary and Financial Committee, Washington D.C., April 25, 2009b
- Subbarao. D, at Alternate Governor at IMFC, Washington D.C,2009
The Federal Reserve,2009, Credit and Liquidity Programs and the Balance Sheet, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW, Washington, DC. 20551

Internet Sources:

http://www.federalreserve.gov/monetarypolicy/bst_crisisresponse.htm
<http://www.federalreserve.gov/newsevents/speech/bernanke20090113a.htm>

<http://www.imf.org/external/about.htm>
<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,pagePK:50004410~piPK:36602~theSitePK:29708,00.html> ssed on April 4, 2009.

<http://www.londonsummit.gov.uk/resources/en/news/15766232/communique-020409>
last asseced on April 3, 2009.

http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=413
http://www.rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=10208

<http://www.un.org/News/Press/docs/2008/gaef3228.doc.htm> last accessed on March 29, 2009.
http://www.oecd.org/document/4/0,3343,en_2649_33715_42061060_1_1_1_1,00.html
last assessed on March 28, 2009.