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Single-Digit Interest Rate and Future of Bangladesh Economy: A Brief Analysis

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Abstract

Investment plays a vital role in employment. Interest rate is the main factor that determines the investment. The government of Bangladesh has implemented a single-digit interest rate to increase investment and employment. As of July 1, 2018, the government allowance has reduced the bank interest rate to a single digit. We evaluate statistics data from 2011 to 2020 and find that investment and employment do not vary much before and after the single-digit is established. We see a slight increase in investment after setting single digits, but no change in employment.

Along with the reduction of interest rate investment climate have to be improved. Investment climate includes technological improvement, stimulus package, cost of doing business, property rights law, and good governance after implementing reduced single-digit interest rate investment. It may be for the worldwide pandemic.

Keywords *Interest rate · Single-digit interest rate · Bangladesh economy*

1. Introduction

Bangladesh is a developing country that intends to become a middle-income country by 2021; growth must be accelerated in all areas of the economy. The Central Bank plays a vital role in realising this objective by providing an effective policy promoting growth-generating economic activity while maintaining price and exchange rate stability.

One of the essential tools in the modern banking system is interest on deposits and loans. We know that interest rate dramatically impacts the economy.

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If the interest rate is higher, the investment is low because the investors are reluctant to take loans at the higher interest rate. As a result, a “single-digit interest rate” is desperately needed to revitalise our economy. Even though it has been nearly two years since the government established a single-digit interest rate, only state-owned banks adhere to the law, while others refuse to do so.

Bangladesh’s average GDP growth rate has been about 6% for several years, lower than many other developing countries. Bangladesh’s GDP growth rate in 2020–21 is only 5.4 per cent, which is lower than the previous year’s rate. During the COVID-19 period in Bangladesh, over 2.26 million individuals lost their jobs, with the World Bank reporting that 68% of persons working in urban areas lost their jobs. As a result, the poverty rate quickly increased.

As a result of the present condition of the economy of Bangladesh, to create economic growth, there needs to be an increase in investment in every sector. So, single-digit interest rates play a vital role in increasing investment rates. However, interest rates have been rising in recent months, and the authorities have been unable to bring them down, which is a barrier to economic development. Investment is critical for substantial and long-term economic growth in every economy.

To attain the required level of economic growth, policymakers frequently use investment-stimulating measures. To meet their investment desire, most investors borrow money from financial organisations. The interest rate on money borrowed from financial institutions for investment purposes is quite sensitive. Several research points to the interest rate as one of the most important factors influencing the investment. Bangladeshi investors are likewise concerned about the interest rate when making investment decisions.

Many bank authorities say that bringing down the interest rate from double-digit to single-digit is not possible in a short period at 6% and 9%, and respectively, the government set the highest deposit and advance rates. However, if this is done, it will have a negative impact on investors, particularly those at the grassroots.

Finding a good sector to invest in will be challenging for them. Bangladesh’s capital market is highly volatile, and investors have lost faith in it.

Because of insecurity, many investors are also hesitant to invest in non-banking financial firms. Investors’ first choice used to be government savings certificates. However, because the government has enforced some additional procedures, investing in savings has become relatively complex. It should be clear to the people because the country’s people are directly and indirectly clients of the Banks, and everybody is affected by the higher interest rate. To know the problems, we must first understand the interest and its determination.

People who come to the bank to deposit their money expect to get a benefit, profit, or interest throughout the deposit period. People who borrow money from a bank, on the other hand, pay interest, profit, or cost for the money borrowed for a particular period. We all know that banks borrow money from depositors at a specific interest rate and then lend it to borrowers at a greater rate than they receive.

People who deposit money in the bank anticipate getting a benefit, profit, or interest throughout the deposit period. People who borrow money from a bank, on the other hand, must pay interest, profit, or cost for the money they borrow for a set period. We all know that banks borrow money from depositors at a fixed rate and then lend it to borrowers at a higher rate. The decision also involves two other crucial stakeholders: depositors and banks. These stakeholders are primarily responsible for the implementation issues. The depositors will undoubtedly be dissatisfied with the change because their savings will now yield lower returns.

Banks lend to the demand side and accept deposits from the supply side. Banks can lend at a lower rate if they take deposits at a lower rate. The lending rate is calculated by adding the spread to the deposit interest rate. The deposit rate of interest governs the lending rate, and it is one of the critical concerns of businesspeople to reduce the loan rate to a single digit. However, this is only achievable if the deposit rate falls into the single digits. As a result, it is evident that the interest rate on deposits in Bangladesh is currently high, and the borrowing rate is similarly high. Let us investigate the many factors behind Bangladesh's high deposit interest rate.

We can observe that the interest rate on the government's savings certificate differs from the interest rate on bank deposits. The government borrows money from citizens to fund development projects by issuing high-interest savings certificates that pay more than a bank's deposit rate. As a result, depositors prefer to buy savings certificates since they provide the best return. The banking sector in Bangladesh is overly competitive. In comparison to the economy, there are far too many banks. Over 60 banks are operating in the market. All banks are striving hard to attract market deposits. The demand for money exceeds the supply of money. It also resulted in a rise in the interest rate on deposits.

2. Literature and Inferences

Rahman & Hoque (2019) analysed that most loans, particularly in consumer credit, construction, transportation, trade, and green and SME financing, have rates well above 9%, while the weighted average deposit rate in the banking industry is far below 6%. As a result, it is reasonable to conclude that the depositor surpluses generated due to lower deposit rates are primarily divided among banks and borrowers in the form of bigger spreads or, in some situations, lower lending rates. When setting interest rates, most banks in the country consider the cost of funds, peer banks' rates, and market rates, market competition and demand and supply of loanable funds, regulatory compliance, operating costs, assets-liabilities condition, credit risk, BB's monetary policy stance, money market situation, economic outlook and inflation movement, borrower's financial strength, NPL position, and so on. Furthermore, the advance to deposit ratio, spread, and the yield on government securities, among other things, have a considerable impact on the deposit rate. They estimated that the range for loans is 6.2 to 13.0 per cent, which means that a bank with a low cost of funds, low operating cost, low capital charge, and low-risk factors could set a lending rate as low as 6.2 per cent, while a bank with a high cost of fund, high operating cost, high capital charge, and high-risk factors would not be able to set a lending rate lower than 13.0 per cent.

Sarker (2021) reported that Bangladesh's government had announced a single-digit interest rate. Initially, most banks were reluctant to adopt a single-digit interest rate. However, most banks have now cut down deposit and lending rates to a level even far below the 6-9 per cent benchmark. The Bangladesh Bank has recently recognised the plight of specific depositors caused by declining interest on deposits and instructed the banks not to set deposit interest below the inflation rate.

Jonaed (2020) analysed that the lending rate is one of the main determinants of private investment, contributing to gross domestic product (GDP). Private investment in Bangladesh's GDP was 23.4 per cent in the 2018-19 fiscal year and is projected to be 24.2 per cent by 2019-20. Borrowers will be happy if the government can carry out the decision. Low lending rates lower the cost of doing business, encouraging more significant private investment. Growth in private investment would improve GDP and create more jobs, a key government goal. The majority of the implementation issues come from depositors and banks. As a result of the lending rate cut, demand for the loanable fund will significantly increase. The situation may lead to a significant gap between the demand and supply of loanable funds. This mismatch will intensify the liquidity crisis of banks, keeping pressure for increasing the rates. Some banks may face higher challenges in such a situation.

Mowla (2018) reported that the depositors are unwilling to deposit their money as it cuts down the interest rate. As a result, the bank faces a liquidity crisis. Because many depositors are withdrawing their money and investing in other sectors such as saving certificates. In the banking sector, the deposit rate has been falling. According to central bank data, depositors withdrew roughly a thousand crore taka between December 2017 and March 2018. The total deposit in December of the previous year was Tk 9,26,179 crore. The total amount was Tk 9,25,279 crore at the end of March. However, investors and business people were pleased with the decision because they believed that a lower interest rate would increase investment in all sectors of the economy.

Haq (2021) finds out that, due to high inflation, the single-digit interest rate primarily impacted poor and senior depositors, as most of them rely on the interest rate. A retired person with no other source of income gets about 3% of his bank savings on average, while the inflation rate consistently fluctuates around 6%.

Essentially, the retiree is left with no income at all to survive. Since August of this year, the banking industry has been struck by crises. Depositors earn negligible, and perhaps negative, returns on investment as the real interest rate for deposits falls below the inflation rate. There are countries with interest rates even lower than 1%. It may appear normal in a welfare state when a social safety net protects the people. Unfortunately, such a system does not exist in Bangladesh.

Figure 1: Interest Rate

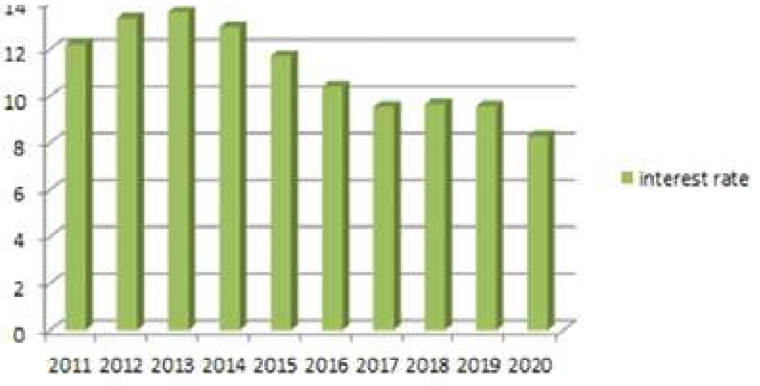
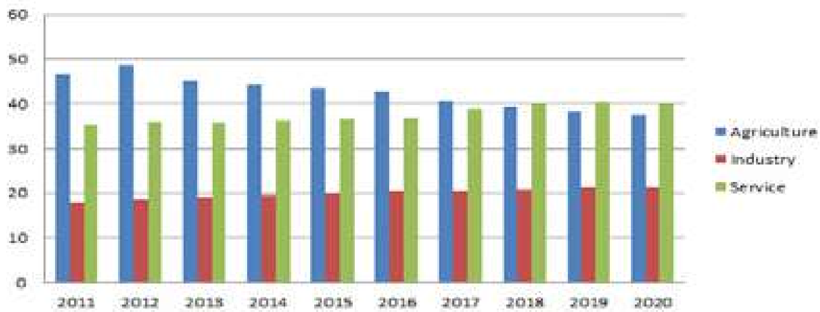


Figure 2: Investment

Figure 3: Employment Rate



In 2016, the interest rate was 10.41%, the investment rate was 28.887%, and the employment rate in agriculture, industry, and the service sector was 42.66 per cent, 20.46 per cent, and 36.87 per cent, respectively. In 2017, the interest rate was 9.54 per cent, the investment rate was 29.653 per cent, and the employment rate in agriculture, industry, and the service sector was 40.60 per cent, 20.42 per cent, and 38.98 per cent, respectively.

As of July 1, 2018, the government allowance has reduced the bank interest rate to a single digit. In this scenario, the government charged a 9% interest rate on loans and a 6% interest rate on deposits. We can see the difference between the economic environment before and after the single-digit interest rate was established. According to statistics, the interest rate for 2018 is 9.65 per cent. This year's investment rate is 30.51 per cent higher than the previous year. However, employment rates in the agriculture, industrial, and service sectors remain unchanged from the last year, at 39.39 per cent, 20.84 per cent, and 39.77 per cent, respectively. The interest rate for the year 2019 is 9.56 per cent. Investment rises from 30.510 per cent to 31.370 per cent, but employment rates remain unchanged at 38.30 per cent, 21.32 per cent, and 40.38 per cent in agriculture, industry, and services. The interest rate in 2020 will be 8.30 per cent. In the agriculture and service sectors, the investment rate is 30.468 per cent, and the employment rate is 37.6 per cent, 21.40 per cent, and 39.80 per cent.

We evaluate statistics data from 2011 to 2020 and find that investment and employment do not vary much before and after the single digit is established. We see a slight increase in investment after setting single digits but no change in employment.

3. Conclusion

Bangladesh Bank announced that it would establish a single-digit interest rate system to reduce interest rates to 6% for deposits; otherwise, a single-digit interest rate procedure would be impossible. The single-digit interest rate procedure becomes nearly impossible if they do not collect deposits at low-interest rates.

However, according to the only announcement from Bangladesh Bank, people will not agree to deposit at a 6% interest rate because the government does not have control over private wealth.

According to government reports, the current inflation rate is close to 6%, but this is not the case; the actual interest rate is higher than 6%. In this situation, people are not interested in keeping their money at a low-interest rate because it is a litmus test. How do they provide loans if they do not collect money? In an open market economic system, market demand determines market supply. Others have no option but to pressurise.

The first condition for establishing a single-digit interest rate is a decreased cost of funds. However, it is possible. According to a government report, the current cost of funds in a government bank is 8.25 per cent. The cost of funding for a private bank is higher than that of a government bank. As a result, if the private bank wishes to reduce its operating costs, it will be unable to do so. One factor that can significantly lower interest rates or establish single-digit interest rates is defaulted loans.

If the government can take appropriate steps to collect defaulted loans, it will benefit from providing loans because it increases bank liquid money.

It is undeniably true that establishing a single-digit interest rate in a developing country such as Bangladesh is critical. However, taking proper steps to remove all variables responsible for establishing single-digit interest rates can play a significant role in the development of economic growth. When interest rates are low, entrepreneurs are more likely to invest in various sectors, particularly small and medium-sized businesses. When investment increases, it aids in the establishment of multiple types of mills, factories, industries, and business institutions. It improves working conditions and reduces unemployment. Increased employment leads to increased savings, which leads to an increase in per capita income. As a result, single-digit interest rates play a direct role in national growth and economic development. Although establishing single-digit interest is critical, it will open up a world of opportunities for our country if the government can.

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