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ORIGINAL ARTICLE

TURBULENCE IN DISGUISE IN THE BANKING SECTOR CREATE PANIC WITHDRAWAL OF MONEY IN BANGLADESH

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Abstract
Bankers may find it difficult to get deposits from households as a result of financial market turmoil. Negative returns on bank assets cause creditors to worry about financial stability, causing them to exaggerate the possibility of a bank failure in the future and withdraw money from banks in a panic. This article provides a simplified alternative for building beliefs about panic withdrawal. By lowering asset prices and raising the cost of bank borrowing, banks' balance sheet positions deteriorated, which caused worries for the depositors, who became panicked. This article discusses potential bank panic scenarios in Bangladesh due to several internal causes that vary countercyclically. Although the major issue confronting the banks was not illiquidity but rather insolvency due to a high percentage of nonperforming loans, bank supervisory authorities may respond to this panic situation by offering liquidity support, government policy intervention, ensuring good governance, limiting the number of withdrawals, and so on.

Keywords
Bank Panic, Public Confidence, Good Governance, Liquidity Crisis, Non-Performing Loan

JEL Classification
G21, G32, H12, G18.

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1. INTRODUCTION

Customer deposits are the source of a bank's financial stability. The two main services that banks provide depositors are financial incentives for deposits and secure storage of deposited cash. Banks use these deposits to produce cash. It offers loans to borrowers, who subsequently repay the money at a fixed interest rate, affecting GDP growth (Mosharrafa, 2015a). Banks make profit from the transactions in-between these two types of transactions. Any financial institution's poor performance affects people's interactions. Profit-driven motivations, self-interested resistance from support executives, an under qualified workforce, and unfavorable competition have all bred problems that are putting the financial sector in a precarious position.

Bangladesh is the fastest-growing economy in the Asia-Pacific region. In an effort to become a middle-income country, the country is swiftly changing its social, economic, and technological landscape. Its notable GDP growth rate for the fiscal year 2021–2022 was 7.2%. An emerging economy like Bangladesh is expected to have high private sector credit growth, high investments, a booming stock market, and a dynamic financial system in light of all of the aforementioned elements; nevertheless, the financial system has been on a downward trend. Unsustainable and coercive development initiatives as well as client onboarding without proper appraisal have made the non-performing loan (NPL) situation worse. A multitude of demand and supply side issues have led to a liquidity shortage in the financial sector. High levels of NPLs have also been a result of banking system governance problems, which have undermined public confidence in the sector. When the public finds that banks frequently engage in unethical behavior and scams, they become alarmed and begin to lose faith in them. Losing confidence can have a variety of effects, such as moving the funds to another country or selecting other non-banking ways to save. Large-scale bank frauds have been commonplace in Bangladesh since 2012. It all started with the confession of the Hallmark Group's Tk 3,547 crore loan fraud with the state-run Sonali Bank.

Regaining "public trust" in the banking industry is critical in the post-pandemic period of global turmoil in order to avoid future economic issues. A sound banking system is thought to require strong public confidence. There is an alarming level of mistrust in the banking sector. Several reasons contributed to the liquidity crunch, in addition to the rising trend of NPLs.

The likelihood of a run is growing, putting pressure on deposit spreads and asset prices and weakening banks' financial conditions. The financial accelerator is increased as a result. Additionally, when the likelihood of a run increases, bank deposits begin to leave, dropping by about 12% and contributing to the development of a slow run (Gertler et al., 2016).

This article is also closely related to other recommendations for preventing runs, including deposit insurance (Diamond & Dybvig 1983), suspending convertibility (Wallace 1988), raising equity capital for banks (Gangopadhyay & Singh 2000), and state-contingent deposit payments with priority-of-claims provisions (DeNicolo, 1996). We concentrate on Bangladesh's banking system's public confidence crisis and panic withdrawal of money, which create a liquidity crunch. This article also offers some ideas that interested parties should consider in order to improve the situation.

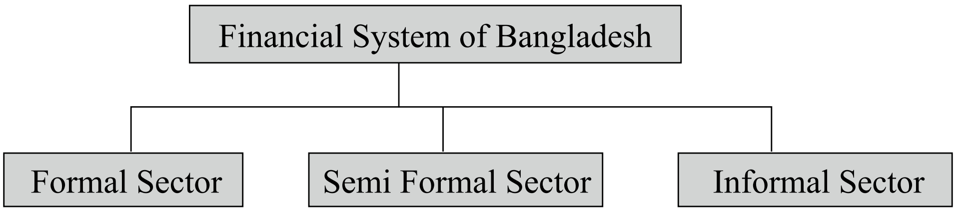
2. LITERATURE REVIEW

Banking panic refers to events in which the bank fails or declines when there is disorder or confusion in the financial market (Calomiris & Gorton, 1991). It occurs when people withdraw cash from banks or when bank debts are claimed to be converted to cash. Usually, the bank debt is comprised of liabilities that circulate as a medium of exchange- bank notes and demand deposits. When a bank a liquidity crisis, many of its clients believe that the bank may cease to work in near future and that is why they withdraw money, resulting in a bank run which is indeed a constant threat to financial systems (Graeve & Karas, 2014). As a bank run progress, there may be a positive feedback mechanism. The more is the cash withdrawal, the default increases resulting in further withdrawals. The result of a bank run may disturb the stability of the bank due to a shortage in liquidity, and the bank may face sudden bankruptcy (Diamond, 2007).

3. THE STRUCTURE AND RECENT ADVANCEMENTS OF BANGLADESH'S FINANCIAL SECTOR

Bangladesh's financial system is divided into three main sectors: the formal sector, the semi-formal sector, and the informal sector. Each and every regulated financial institution is a part of the formal sector. The semi-formal sector consists of organizations that are governed by other regulations but are not governed by the Central Bank. Private intermediaries operating in the informal sector are totally unregulated. The financial system of the state is depicted in the following diagram as its basic framework:

Figure 1
Financial System



Source: Bangladesh Bank

There are 31 financial institutions, 61 scheduled banks, and 5 non-scheduled banks in Bangladesh's financial economy (Bangladesh Bank). The proactive and progressive strategy of Bangladesh Bank has led to the adoption of numerous automation initiatives within the banking sector in Bangladesh. Some of these initiatives are:

- Bangladesh introduced the Market Infrastructure (MI) Module for automated auction and trading of government securities.
- Providing automated Credit Information Bureau (CIB) service for prospective and existing borrowers.
- Introduced L/C Monitoring System
- The department of off-site supervision must receive weekly statements of position from all scheduled banks on every Thursday, by online submission within three working days.
- E-returns service has been introduced.
- An online export monitoring system is introduced.
- Started to work Bangladesh automated clearing house (BACH) arrangement.
- Electronic Fund Transfer (EFT) has been introduced
- Initiation of mobile banking services.
- Inauguration of internet trading both in DSE & CSE
- The online report submission tools are used by micro finance institutions to submit their reports to the regulatory body.
- Basel-III has been introduced since January 2015, and capital ratios will be fully implemented as of January 2019.
- Circulated. Policy Guidelines on Green Banking
- Recommendations for conducting stress tests for FIs and banks in a variety of challenging circumstances.

- Several policy measures to promote financial inclusion have been undertaken.
- Building up a separate risk management unit has been requested by the banks.
- Banks have been instructed to create separate subsidiaries for capital market operations.
- Banks are instructed to participate in Corporate Social Responsibility (CSR).
- Guidelines for insurance providers, money changers, and postal remittances have previously been disseminated.
- Public Issue Rules, 2006 and Mutual Fund Rules, 2001 have both been revised by the SEC.
- Merchant banks and mutual funds are authorised by the SEC to boost the participation of institutional investors.
- Insurance Act 2010 was formulated in a better shape.

In addition, a number of attempts have been made to prevent the industry's malpractices involving insurance commissions, agents, premiums, etc., as well as corporate governance issues.

4. THE SHORTCOMINGS IN THE BANKING SECTOR OF BANGLADESH

Recurrent instances of identical loan scams show that Bangladeshi banks, both publicly and privately held, have not learned from their mistakes. They failed to take meaningful steps to prevent such incidents from occurring in the future. These have had a significant negative impact on public trust in the banking sector. Prospective borrowers are now less likely to borrow money from banks. Borrowers are clearly moving away from institutional loan sources in favor of other non-institutional ones. Regaining "public trust" in the financial industry is essential in the aftermath of the epidemic and within the current climate of political upheaval on a worldwide platform in order to prevent future economic problems.

Banking adoption is still quite low. According to the World Bank, 47% of Bangladesh's adult population did not have a bank account in 2021, with 8% of adults alleging religious objections. Insurance and takaful penetration rates were both relatively low at 0.5% in 2021 (Natoor & Shawki, 2022).

The banking sector has been impacted by poor governance in a number of ways. Non-performing loans (NPLs) and/or financing facilities have been noted as the primary problem hurting Bangladesh's banking industry The abundance of banks exacerbated the situation. There are already too many competitors, which has tarnished the market's image. The human resource pool has not been able to keep up with the demand for skilled and experienced bankers to fill the new seats as the industry has experienced exponential growth. The majority of the more recent banks and NBFIs are therefore having difficulties. Such an occurrence has seriously harmed the bank, which is the main output producer of the financial system. Various organizations exist in the country. There are certain institutions in the country that provide high-quality training in banking-related issues, but sadly there aren't many of them. The Bangladesh Bank initiated single-digit borrowing and lending rates back in April 2020. Due to low rate of deposit, people might go for the stock market or invest elsewhere rather than keep their money idle in the bank which may create a problem in terms of collecting deposits. The illness in the banking sector is once again evident as a result of a variety of circumstances, including the central bank's "cautious policy stance with a tightening tendency," significant economic inflation, and the imprudent choice to cap the lending and borrowing rates of the banking sector. All of them have significantly reduced the liquidity of the banking system, particularly for the newcomers. The adverse effect of the lending and borrowing rate restrictions is that far safer government instruments, including Treasury Bills and Bonds, now pay higher interest rates than the highest deposit rate any bank in the nation can provide. Along with the NPL, the lending-deposit rate cap has also severely decreased the banking system's profitability, which is negatively harming the state of the industry as a whole (Mosharrafa & Islam, 2021).

5. FACING CHALLENGES IN THE BANKING ARENA

The banking sector in Bangladesh is currently having some difficulties. Inflation and an unstable foreign exchange rate in the post-Covid-19 period became a significant problem in this sector as a result of internal mismanagement. These factors have led to a significant trade deficit. The impact on the country's foreign exchange reserves will be lessened if the Bangladeshi government refrains from importing luxury products at this time. Introduce some margins in the case of LC opening to meet the situation. To alleviate the situation, provide money straight from the reserves of the central bank. Import restrictions on essential goods like food, infant food, fertilizer, gasoline, and electricity are eased. Discourage the importation of goods that are not urgently needed right now.

The banking industry, a crucial component of a nation's monetary and fiscal structure, is still suffering the effects of the Covid-19 pandemic. By implementing certain monetary and fiscal policies, Bangladesh Bank and the government have taken steps to stabilize the economy, especially the banking sector, in order to maintain robust growth in the years to come.

According to the World Bank, 61% of Bangladesh's population lived in rural areas in 2021, placing the Islamic finance sector at a hurdle due to the lack of Islamic banks' branch and digital banking networks there (Natoor & Shawki, 2022). A lack of sukuk investment options, Islamic derivatives, or hedging instruments, low awareness of Islamic products, a lack of standardization, insufficient use of fintech, a lack of incentives for sukuk issuers, and a human capital pool with insufficient skills all contribute to the underdevelopment of the regulatory framework for Islamic finance.

6. HOW RUMOR SPARKED PANIC AND BANK RUN IN BANGLADESH

A bank run occurs when many customers withdraw all their money simultaneously from their deposit accounts with a banking institution for fear that the institution is, or might become, insolvent. A self-fulfilling prophesy occurs when a public outcry against a bank culminates in a bank run that ultimately causes the bank to fail. There is a chance of default when more clients withdraw their money, which will lead to more withdrawals until the bank runs out of money. When several banks are involved, an uncontrolled bank run might result in bankruptcy and a general panic in the economy that could cause a recession. When depositors electronically remove huge sums of money from the bank without physically going inside, this is known as a silent bank run. Silent bank runs resemble regular bank runs; however, instead of physically taking cash out of the bank, funds are transferred using ACH transfers, wire transfers, and other techniques.

When the Bangladesh Bank governor quit on 15 March, 2016 and two deputy governors were abruptly fired in response to harsh criticism of the central bank's handling of the $101 million cybercrime, confusion and panic ensued. Around midnight on February 5, hackers used malware to penetrate the Bangladesh Bank system and steal the funds.

As of 2018, Tk. 22,501 crore was the total amount of money lost as a result of significant fraud, irregularities, and heists in the banking industry (USD 2.68 billion) (Khatun, 2018). Scams have increased as a result of stringent rules and political influence inside the banking sector, which has reduced public trust in banks and lowered the quantity of deposits. Due to their failure to honor payments and other responsibilities, the Chinese government has placed five regional private banks on a blacklist (Islam, 2019). A decrease in confidence has also been seen in the interbank money market. The majority of banks are hesitant to offer credit to organizations with questionable financial standing. Bangladesh ranks second in South Asia for illegal money outflows, according to Global Financial Integrity (GFI). According to the Swiss National Bank's 2017 annual report, Bangladeshis kept about USD 481 million in Swiss banks. It is obviously concerning to see so significant capital flight impacting the nation's cash reserves.

There are 61 commercial banks, over 40 NBFIs, and over 60 insurance companies in Bangladesh. In South Asia, Bangladesh had the highest concentration of commercial bank branches in 2016, with

75 branches per 1000 square kilometers of land (Khatun, 2018). Despite these numbers, only 47% of the population has access to financial services through the banking industry. Only 25% of them have full-service banking accounts. Due to their concentration in urban areas, commercial banks underutilize a substantial portion of the money circulating in remote areas. To address this issue and determine how banks are making the necessary profit to remain in business, mobile financial services (MFS) and agent banking operations, particularly for rural communities, are now being developed (Ferdous et al., 2015). There is a US dollar demand-supply gap as a consequence of high import costs and low export revenues. Due to growing dollar exchange rates versus taka, the foreign currency market has been unstable. Since the devaluation of the local currency, local banks were compelled to use funds from their reserves to settle letters of credit (L/Cs), which put pressure on the banks' total liquidity. In the interbank market, the nominal taka-US dollar exchange rate fell by 3.9%, but the Real Effective Exchange Rate (REER) increased by 2.7%.

7. RATIONAL FOR THE IMPADED ASSET QUALITY GROWTH OF THE BANKING SECTOR

The private sector in Bangladesh significantly relies on commercial banks to raise internal savings and to lend money to firms and investors due to the country's underdeveloped capital market. However, a high number of NPLs place a significant burden on the banking sector. The increased percentage of NPL is a sign that banks' asset recovery rates are deteriorating. This has had a detrimental effect on the economy's money supply and liquidity. Poor governance at the corporate and governmental levels is the primary cause of the rising NPL trend (Mosharrafa, 2015b).

The largest numbers of defaulted loans were rescheduled by Islami Bank Bangladesh, totaling Tk 4,814 crore, or 21% of all loans rescheduled in 2018. About 200 special approvals were granted by the central bank in violation of its own rules. Banks have been extending the rescheduling facility for years, but little improvement in the amount of NPL could be seen. Loans of Tk 12,350 crore were rescheduled in 2014, and over the following four years, the amount expanded by 87.94% (Uddin, 2019). The borrowers' cash flow should be taken into consideration when rescheduling. The reason for the increase in rescheduled loans may be due to inadequate due diligence, persuaded lending, fraud, and carelessness in adhering to risk management procedures.

8. BANGLADESH BANK INITIATIVES TO MINIMIZE PANIC WITHDRAWAL OF MONEY FROM BANKS

The Russia-Ukraine conflict, a broken supply chain, and a balance of payments deficit have all contributed to Bangladesh's current difficult situation. To prepare for an upcoming global recession and doom, it must find a balance between carefully watching the situation as it is while enhancing business flow and sustainability at the same time. Rumors about a catastrophic liquidity crisis in our banking system have been circulating on social media platforms, frightening users, especially depositors who contribute the majority of the banking system's funding sources. In fact, the people of Bangladesh shouldn't panic since the central bank of the nation has issued a statement denying any liquidity crisis in the banking sector and informing everyone that there is plenty of liquidity—Tk1.70 trillion worth, to be exact excess liquidity. The efforts made by Bangladesh Bank recently to control the flow of imports, including enabling 50% of ERQ (Export Retention Quota) accounts, moving money from the Offshore Banking Unit to the Digital Banking Unit, and lowering the NOP (Net Open Position) restriction from 20% of regulatory capital to 15% (Iftekhar, 2022). In the foreign exchange market, these actions have undoubtedly contributed to a portion of the required liquidity.

The banking industry will work with other stakeholders to advance the Fintech movement and the rebranding of "made in Bangladesh." The authority of the banking sector must strike a balance in the face of the impending global recession and doom by carefully monitoring the existing situation and promoting business flow and sustainability.

The Bangladesh Bank warned banks that failing to pay import bills on time might result in the loss of their authorization to operate authorized dealer (AD) branches, which specialize in foreign exchange trading (Star Business Report, 2022). Additionally, the responsible bankers will be punished for the banks' refusal to pay import payments. Due to the ongoing global economic downturn, certain banks are currently having trouble collecting export revenues from foreign buyers who haven't made their payments on time. The dollar scarcity in banks has gotten worse since some exporters have either cancelled or delayed their export orders. As the cost of various items has climbed on the global market, the central bank is selling more dollars to government banks to cover the nation's import expenses. The Bangladesh Bank's dollar sales have increased partly as a result of efforts to accommodate domestic demand in light of the general situation worldwide.

On November 10, 2022, BB sold $107 million to a number of government banks, according to sources at Bangladesh Bank. The amount was $68 million and $131 million, respectively, on the 9th and 8th of November 2022. After selling dollars on November 10th, 2022, the reserve balance of the central bank was $34.25 billion. LC (letter of credit) openings for importing consumer goods and petroleum increased by 4.56% and 50.99%, respectively, in the first three months of the fiscal year 2022 compared to the same period the previous year. (TBS Report, 2022). In the period from July to September of FY23, the opening of LCs decreased by 8.57% for imports of capital goods, intermediate goods, and industrial raw materials. Moreover, because to greater import payments made earlier in the year, LC settlements jumped by 31.56% to $22.4 billion. The entire value of imports from July through September of this year was $19.34 billion, rising from $17.32 billion at the same time last year. The central bank must sell dollars in order to import essentials into the country (Economy Desk, 2022). However, if there is a greater outflow of dollars than there is an inflow of dollars, the amount of reserves will decrease. To increase remittances, the central bank needs to take immediate action. Dollar prices ought to be tied to market prices in order to stop transactions in hundi.

In FY21, because of low imports and significant remittance inflows during the epidemic, the Bangladesh Bank purchased almost $8 billion from banks. Bangladesh received remittances totaling more than $4 billion in the first two months of FY22. However, after the uniform dollar rate in September, the remittance flow sputtered. In October, 2022, the nation got $1.52 billion in remittances, the least amount in the previous eight months. According to the Export Promotion Bureau, exporters brought $4.35 billion in October, 2022, which is a 7.85% decrease from the same month last year (EPB).

The Governor of Bangladesh Bank (BB) has said that there will be no foreign exchange crisis from January 2023, as the country's exports and remittances have become surplus compared to imports (Economy Desk, 2022). Governor said a BB investigation found that the country's unusual import volume rose over $8 billion since the beginning of this year. Bangladesh Bank identified cases of under and over-invoicing of imported and exported items came to its notice during specials audit (Tribune Desk, 2022).

9. NECESSARY ACTIONS TO BE TAKEN IN THE BANKING INDUSTRY

Since Bangladesh's independence, there have been persistent default loans in the banking industry. The issue persisted through 2011 despite some progress made in the 1990s and in 2001 or 2002. Massive scale fraud involving default loans was revealed as a result of governance shortcomings and a lack of discipline in the banking sector. According to government estimates, the sum of our defaulted loans is over Tk 130,000 crore, but the IMF estimates it to be almost over Tk 300,000 crore. (Mansur, 2022). An unpaid loan obtained more than 20 years ago does not count as a default loan due to political pressure. The crisis then only became worse. Over Tk 200,000 crore in loans were provided by the government as part of an incentive program during the Covid-19 outbreak. Yet the beneficiaries of loans have showed reluctance to repay the money they received as "incentives". In order to overcome the culture of defaulted loans and the liquidity issue, the government must maintain effective governance, shed its social responsibility or propensity to yield to political pressure, and begin properly enforcing the law. To get rid of corrupt decision-makers, the government needs to take over the weaker banks.

The banking industry as a whole is in a miserable condition. The return on investment is dropping. Banks are being exploited as an instrument of economic oppression, with the true investors being denied the rewards while the directors share the funds among themselves. To ensure effectiveness, the regulatory authority previously argued that the presence of so many banks would eventually promote financial inclusion with respect to the issuing of additional banking licenses. To save the economy from further complications, stakeholders may consider a variety of measures, some of which could be as follows:

- To keep an eye on prospective problems, a robust intelligence unit may be established and made operational in every bank. It is best to steer clear of any political reasons that can compromise loan scrutiny and standard criteria.
- Banks may also implement a policy for advertising that would inform the public of the advantages of banking. Banks that have experienced scams should inform the public of the steps they have taken and the results so far.
- The recent financial hoax and panic withdrawals have opened everyone's eyes in the banking industry, including politicians. A thorough investigation and the punishment of those responsible are pertinent for enhancing bank oversight and governance.
- A Commission for the Financial Sector can be established to absorb shocks brought on by financial and economic stress, enhance risk management and governance, and strengthen bank transparency and disclosures by adhering to Basel III regulations.
- It would be prudent to stop issuing licenses to new banks. Due to the size of the economy and the saturation of the banking industry, further banks are not necessary.
- As financial inclusion is essential for an economy's expansion, access to financial services in rural markets needs to be widened.
- For Islamic banks formation of Shariah Advisory Council as directed by the Bangladesh Securities and Exchange Commission in August 2022 need to work properly to support standardization and sukuk insurance.
- The policy on green bond financing for banks and financial institutions, including Islamic securities, released by the Bangladesh Bank in September 2022, needs to be implemented skillfully.
- In order to ensure sound governance and make informed judgments, former banking experts should be recruited as representative directors on the boards.
- Limit the number of withdrawals any customer is permitted to make or suspend all withdrawals as a means of calming the fear. In order to grow its cash on hand, the bank may also get more money from other banks or the central bank.
- A bank may artificially slow down the procedure when it faces the possibility of running out of money as a result of a bank run. The bank is temporarily closed by the government during a recession to stop customers from withdrawing all of their funds.
- The bank may borrow money from other banks or the central bank if its cash reserves are insufficient to cover the volume of cash withdrawals.

10. CONCLUSION

Bangladesh is currently at a pivotal point in its history as it is close to becoming a middle-income country. In order to successfully direct the economy toward a better position, the economy must be updated, and that will not be possible without the presence of a robust and sustainable financial system. Alternative means of finance, such as private equity companies, venture capitalists, angel investors, crowd funding, etc., have not expanded as much as they should have to offset the banking sector's lack of liquidity in Bangladesh.

One significant fraud in the banking institution ought to have raised the red flag. The issue needs to be handled right away with the utmost care. A dedicated banking authority will result in positive changes by addressing the anomalies. With the correct policy proposals and implementation guidelines in place, the banking sector will be able to overcome its problems and grow into a powerful support system for the economy. Banks may avoid a run situation by issuing liquid demand deposits and time deposits with low liquidation value. Making prompt actions is necessary right now to solve this condition in the banking sector in Bangladesh. The right steps and policies can help to minimize the threats to our financial system.

The financial sector needs to be greatly strengthened if goals, such as becoming a middle-income country are to be achieved. Banks in Bangladesh will need to come up with new ways to operate because of tighter international regulations, increased volatility in the global economy, and a lack of resources. To ensure compliance and the efficient operation of banks, more money and qualified human resources will be required in the near future.

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