Monetary Policy Statement (MPS) FY 2019-20

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Policy Stances

Inflation Projection	5.5%	▼
Repo Rate	6.0%	⬍
Reverse Repo	4.75%	⬍
M2 Growth	11.3% H1 12.5% H2	▲
RM Growth	9.8% H1 12.0% H2	▲
Domestic Credit Growth	14.5% H1 15.9% H2	⬍
Public Sector Credit Growth	25.2% H1 24.3% H2	▲
Private Sector Credit Growth	13.2% H1 14.8% H2	▼

Changes Observed...

- Once in a year announcement of MPS
- Interest-based Monetary Policy from now on; Technical assistance from IMF and SARTTAC in this regard
- Despite lower private sector credit growth, higher economic growth target
- Lower Inflation projection whereas inflation may rise due to the flood impact, geopolitical tension, trade war, and rising fuel prices
- Nothing significant for the moribund capital market

Highlights of MPS

We understand from the policy stances of FY 2019-20 that it is aiming to inject money into the economy suffering from a liquidity crunch with a cautious outlook, along with complacent targets despite the concern of global slowdown. The central bank has termed it **'Cautiously Accommodative'.**

The central bank has expressed its satisfaction on its non-intervention in the market correction. The slow and steady depreciation of taka with go-slow import policy, the boost in Foreign Direct Investment (FDI) and remittance, and Net Foreign Assets (NFA) growth recovery have improved the current account balance. The BB is optimistic about even greater economic growth, as slow and declining growth of domestic credit still managed to achieve higher economic growth in the outgoing fiscal year.

The diversion of bank deposits of mass people to the NSC has lessened the loanable funds' amount. Unscrupulous and unproductive lending practices among some in the banking sector during the higher credit disbursement period has resulted in a big chunk of default loans.

This inflation focused MPS, however, notifies about potential inflation overshooting, as core inflation and non-food inflation are on the rise. The flood may force to go for rice import along with the multilayer VAT, and the tariff on fuels can shoot the prices of commodities.

Confusion erupts over the emphasis on single-digit interest rate scheme, in the NPL burdened financial sector whereas private banks are already failing to compete in deposit attraction because of higher NSC rate. However, the new regulation on NSC purchase may lessen the decreasing trend of loanable funds in private banks. However, increasing government borrowing from banks will have an impact on that. The expectation to beef up capital market was not reflected in this MPS.

MONETARY AFFAIRS

Liquidity squeeze in the overall financial system is narrowing the Interest Rate Spread (IRS). Resultant lower money velocity implying lowering investment activity. NSC sales at an average interest rate of 11.76% have eroded the capability of banks to attract deposits at a rate of 6%-7%. Furthermore, the increase of government borrowing from banks for implementing the Annual Development Plan (ADP) has a crowding-out effect on private sector credit.

This inflation focused monetary policy of FY2020 may give in to the liquidity pressure, the higher yield of treasury securities, and the falling investment paradigm with a higher lending rate. The inflation will shoot up, if fuel price rises, and import spikes up due to flood. The regulatory assistance is required to rationalize the NSC interest rate regime for the greater good of the financial system.

Broad Money (M2) and Reserve Money (RM)

- Broad Money growth of 9.88% and Reserve Money growth of 5% at June 2018-19.
- Seemingly contractionary FY 2019-20 M2 growth target, lower than Nominal GDP growth.
- Lower M2 growth being influenced by the low supply of Reserve Money

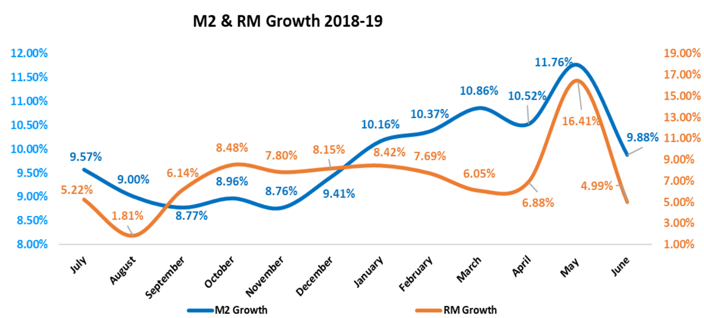

Figure 1: M2 & M3 Growth 2018-19 (Source: Bangladesh Bank Statistics)

Credit Growth

In FY 2019,

- Private Sector Credit growth of 11.3% lesser than the target of 16.5% and Domestic Credit growth registering 12.3% against 15.9%

Factors behind the lower growth:
Crowding-out effect on the private sector due to government's excessive borrowing from banks and through NSC

It sounds paradoxical how taming inflation has become an obvious high priority at the cost of suppressing private sector credit growth while aiming at a higher economic growth.

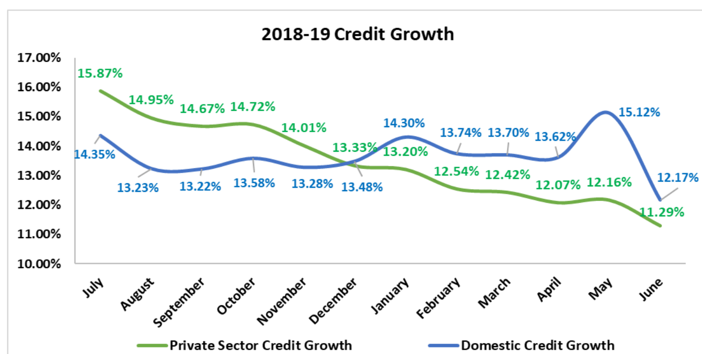

Figure 2: Credit Growth 2018-19 (Source: Bangladesh Bank Statistics)

Inflation

- 12-months average inflation of 5.47% as of June 2019, below the target ceiling of 5.60%
- Subdued CPI inflation across most advanced and emerging market economies during 2018-19
- Moderate oil prices on an average in 2019

In FY 2020, higher inflation expectations are because of-

- Rising non-food inflation to 5.71% in June 2019
- 32.8% new tariff hike on gas usage
- Multi-tiered VAT and AIT on steel, cement sector
- Spiking rice and agricultural commodity import after the flood impact triggers

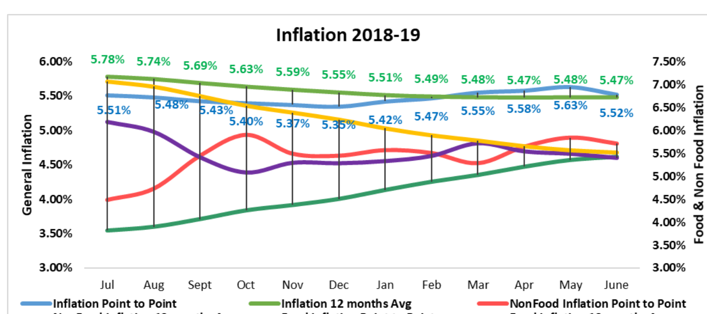

Figure 3: Inflation (Food and Non-Food)2018-19 (Source: Bangladesh Bank Statistics)

EXTERNAL SECTOR

The export figure heightened and registered almost double growth in 2019 on a cumulative basis due to the depreciation of BDT against USD. Moreover, the government also disburses 2-4% of export incentives on garments export, which accounts the most in export figure. Import figures fell due to the significant fall in capital machinery import because of low private sector credit growth, and there was the availability of enough agricultural commodities to shed import.
The remittance though started with slower pace, sped up after currency depreciation, cash incentives disbursement during holy festivals. Remitting money through illegal channels slowed the pace, in spite of the increased base of working people in the overseas. Significant growth of 67.94% in FDI has also geared the current account balance upward in the outgoing fiscal year.

Export

- Export growth of 10.55% in 2019 compared to 5.81% growth in 2018
- Higher export from 84% garments shipment overseas riding the benefits of China-US trade war

But the matter of concerns lie in-
- After signing FTA with EU, Vietnam will gain further market share from Bangladesh
- Failing to capture the relocation of factories in Bangladesh
- Increased dependency over RMG export & non-diversification of export basket
- Cutting prices by global buyers

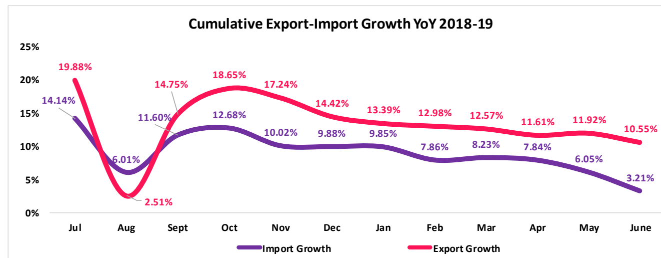

Figure 4: Export-Import Statistics monthly (Source: Bangladesh Bank)

Import

- Import growth of 6.05% in the respective 11 months of 2019
- Higher import of construction material mainly for public sector infrastructure development
- Increasing fuel imports of 16.08%

Matter of concern pops up on the upcoming flood impact due to severe damage in crops where food import will be required.

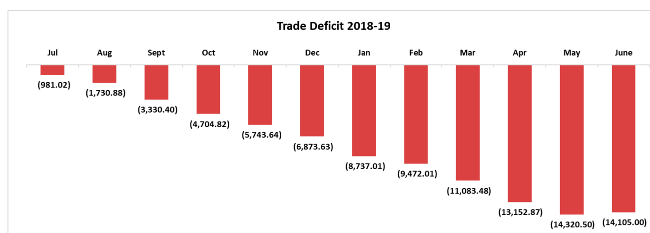

Figure 5: Trade Deficit 2018-19 (Source: Bangladesh Bank)

Remittance

Remittances growth of 9.6% from YoY mainly driven by:
- Depreciation of BDT against USD
- Easing restrictions of MFS money transfers

Eventually, it is helping the financial system through record level inflow from expatriates. The most surprising fact in the MPS announcement event was that there was no data of remittance outflow in store of BB, which somehow makes the net remittance data questionable.

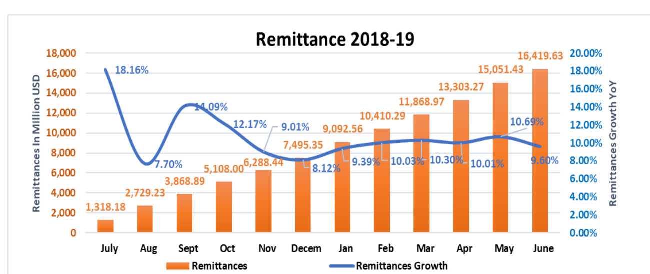

Figure 6: Remittance Statistics 2018-19 (Source: Bangladesh Bank)

FY2019-20 Monetary Policy Update

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INTEREST RATE AND EXCHANGE RATE REGIME

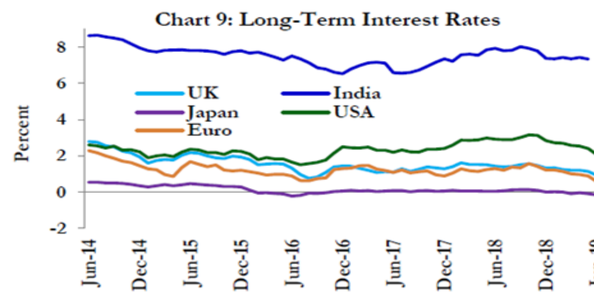
The interest rate in most of the developed & developing countries was cut to keep the possibility of growth alive. However, MPS didn't reflect such rate cut.

Most of the countries are devaluing their currencies, and BDT is also following the same to encourage export.

The FOREX reserve was volatile, and registered negative growth due to huge sales of USD to banks for increasing import payments at a higher exchange rate. In line with the advanced and emerging countries, Bangladesh Bank decides to introduce interest-based monetary policy, and IMF and SARTTAC will help BB for ongoing preparatory works.

International Interest Rate Regime

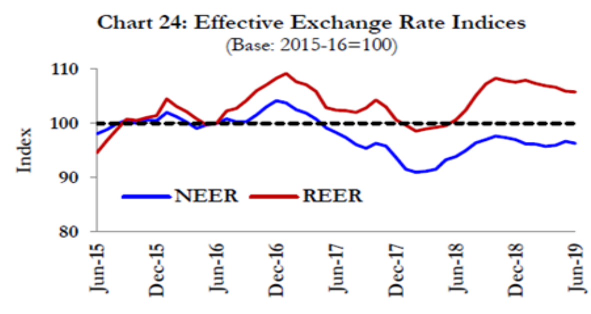
US Fed, along with other advanced and emerging economies proceed with rate cuts in the wake of economic slowdown and thus seek 'Quantitative Injection'.



Source: Organization for Economic Co-operation and Development

Exchange Rate Reactions

Exchange rate of Taka against USD was relatively stable by the end of the fiscal year and depreciated only 0.92% on June 2019 YoY. As of now, both Taka and USD interbank market are at ease with no requirement of intervention from BB.



Source: Bangladesh Bank

Foreign Exchange Reserve

Foreign exchange reserve has seen negative growth throughout FY 2019 because of the sudden spike in selling US dollars due to import payments. However, the pressure has now ceased due to slower growth in import and high growth of remittance. The current Forex reserve can make import payments worth of 7 months.

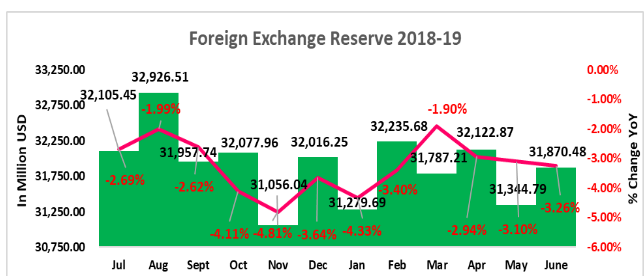


Figure 7: Foreign Exchange Reserve 2018-19 (Source: BB statistics)

CONCLUDING REMARKS

It seems that the liquidity crunch has been eased a bit due to the favorable current account balance relieving pressure on the exchange rate. The stringent measures for squeezing NSC sales may not be enough to ease the liquidity crunch. We expect the NSC rate to be revised down in this respect. On the other hand, increasing government borrowing may further crowd-out private sector credit. The current economic condition has led many to opine that inflation may shoot up from the current projection. The focus of limiting price movement and inflation with lower credit to private investment can cause economic growth to falter. Externalities like US-China trade war and geopolitical tension may come as shocks soon. Overall, the step for announcing interest-based monetary policy is commendable. Accordingly, we will see the policy rates working actively in the financial sector.