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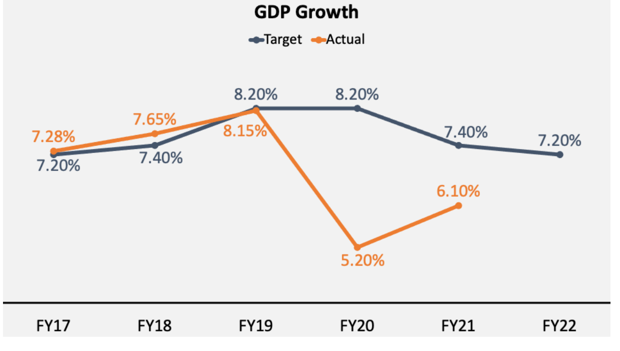
Monetary Policy Statement FY2021-22

Review by ICL Research

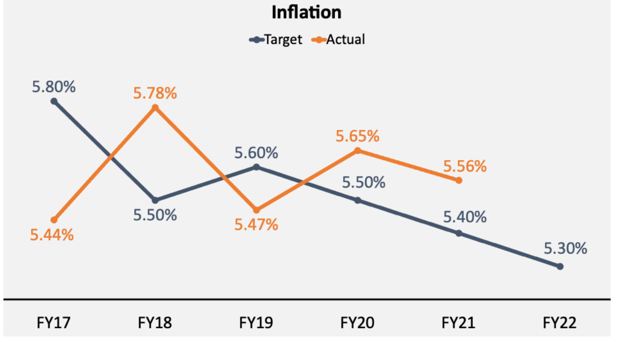
August 7, 2021

- Driven by healthy agricultural and industrial growth along with supportive policy measures, Bangladesh attained impressive GDP growth in FY21 despite the ongoing crisis brought by Covid19 pandemic.
- Due to global supply chain disruption and price hike, average inflation stood at 5.65% surpassing the target.
- Significant jump in remittance inflow and robust export earnings took foreign exchange reserve to a historical high of $46.4 billion as of June 2021.
- In FY22, BB will continue ongoing expansionary measures while maintaining caution for overall price stability.
- BB considers restoration of full normalcy in lives & livelihood as a major challenge in the current year. Sustained COVID-19 situation, global price hike, and unexpected crop loss can create pressure on price levels.



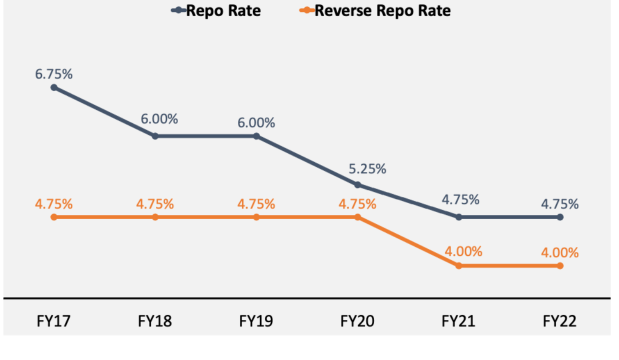
GDP Growth:

- Due to the pandemic, the government was forced to revise its projected GDP growth rate for FY21 twice. Real GDP grew by 6.1%, rate well below the projection.
- BB has designed the MPS to support the government's GDP growth target of 7.2% for FY22
- Real GDP growth projections by external sources for FY22 are: World Bank- 5.1%, ADB GDP- 7.2% IMF- 7.5%.



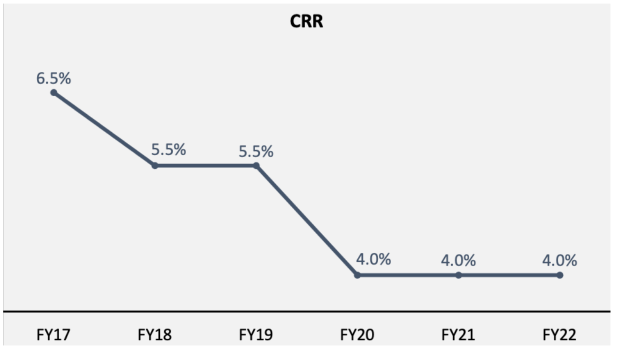
Inflation:

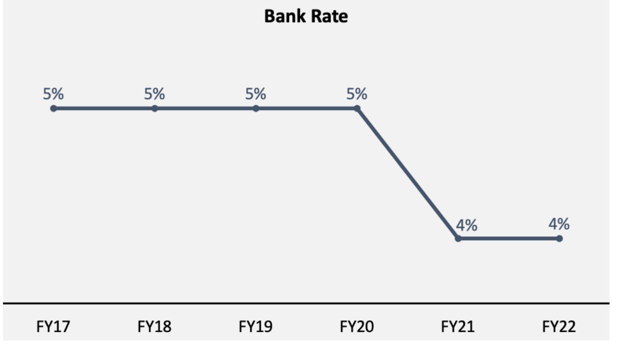
- On June 2021, 12-months average inflation was 5.56%, slightly higher than the projected 5.40%.
- In FY22 budget, inflation target is set to be 5.3%, despite prevailing global commodity price hike and excess liquidity in the banking sector.
- Due to the slow pace in consumer spending and bumper production of agricultural products, inflation is expected to remain within 5.25%-5.55% band at a high confidence level.



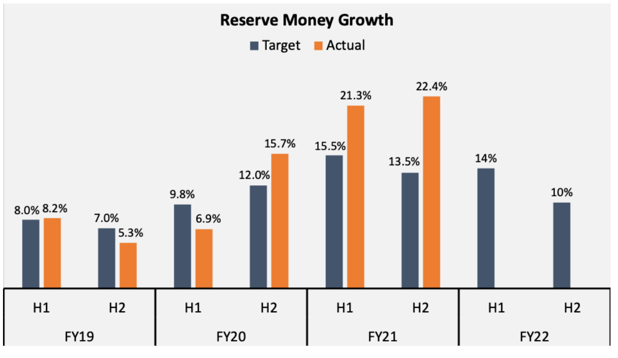
Policy rates:

- In April 2020, considering the pandemic, economic situation of the country and liquidity condition in the capital market, Bangladesh bank slashed its the policy rates (CRR by 150 bps, Repo rate by 125 bps, Reverse Repo rate by 75 bps) to supply the liquidity in the economy at a low and stable interest rate.
- BB has decided to continue with such accommodative stance to support the economy.



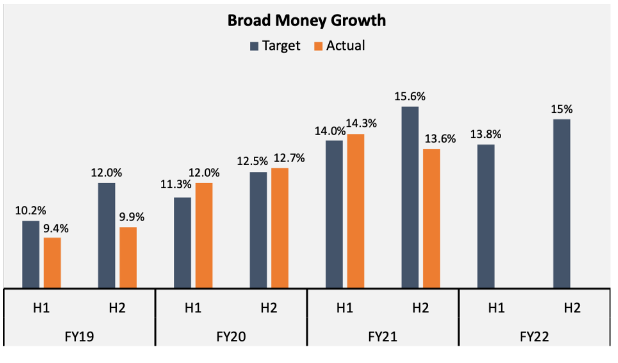


- BB will continue CRR at 4% in FY 22 following expansionary policy.
- After 17 years (since 2003), BB changed the Bank Rate from 5% to 4% in the FY21. The central has decided to continue the 4% bank rate for FY22 to maintain the liquidity.



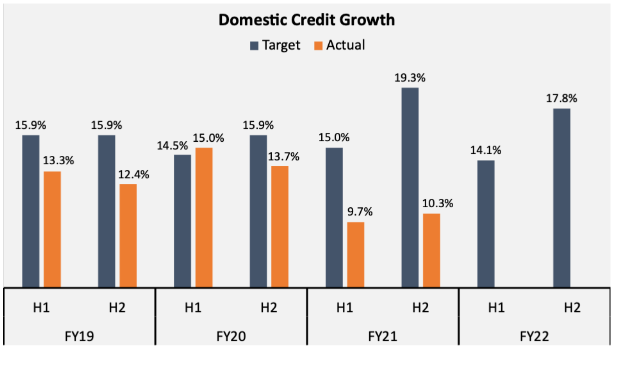
Reserve Money Growth:

Bangladesh Bank has direct control over the reserve money growth rate through the policy instruments. Increased central bank's support throughout FY21 is apparent from the fact that actual reserve money growth exceeded the target growth by large margin. However, taking the excess liquidity condition in consideration, BB lowered the reserve money growth rate target for FY22.



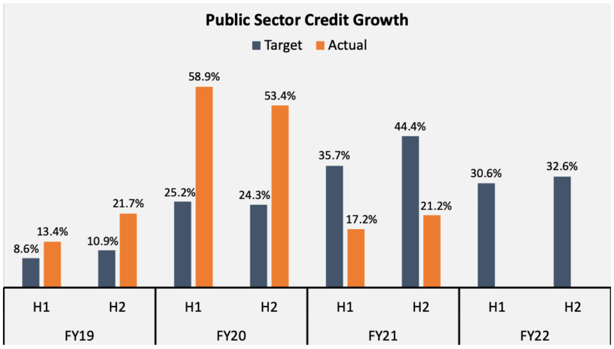
Broad Money Growth:

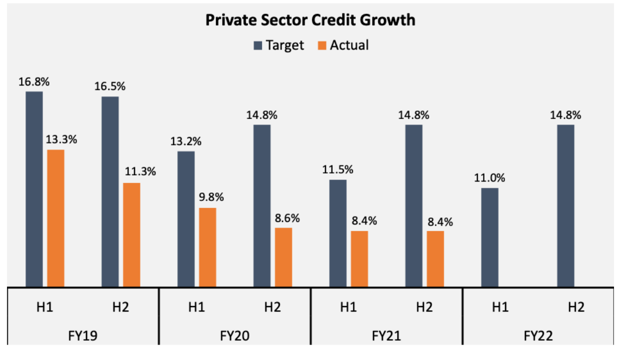
Bangladesh Bank has targeted 13.8% and 15% broad money growth in the H1 and H2 of FY22, respectively. The differences between the nominal GDP growth target and M2 growth target suggests that Bangladesh Bank is expecting further reduction in the money velocity. On the other hand, the difference between the reserve money growth target and M2 growth target indicates the expectation of the increase in the money multiplier.



Domestic Credit Growth:

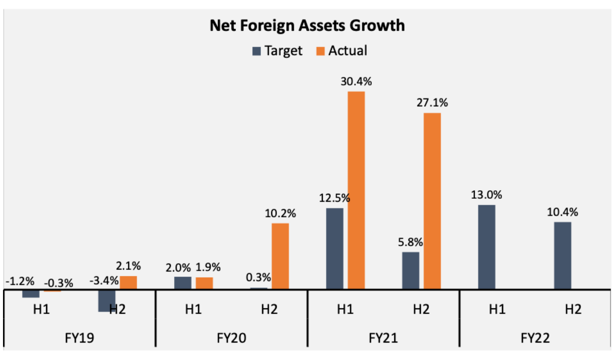
Taking the government's borrowing target as envisaged in the national budget for FY22 and the expectation of the gradual recovery of the economy, Bangladesh has targeted 14.1% domestic credit growth in H1 of FY22 and 17.8% domestic credit growth in H2 of FY22 which are respectively 4.4% and 7.5% greater than what the actual outcome was in the H1 and H2 of FY21.





Pubic and Private Sector Credit:

- In FY20, public sector credit growth was 58.9% in H1 and 53.4% in H2 greatly exceeding the target.
- For the later year FY21, BB targeted 35.7% and 44.4% growth in H1 and H2 respectively. But because of the pandemic, the credit growth was well below the target.
- Target for FY22 has been set to meet government's borrowing needs to tackle budget deficit.
- The private credit growth target for FY 2022 is almost same as was for the FY 2021. Central Bank explained the projection by showing the expectation of the pickup in the pace of the credit demand in the upcoming months after the launching of the national vaccination and health safety related programs.



Net Foreign Assets Growth:

- BoP (balance of payment) surplus was $9.3 billion in FY21 and $3.2 billion in FY20.
- This huge increase in BoP position is the result of strong remittance inflows and remarkable surplus in financial accounts.
- BB projects BoP surplus to be $5.1 billion in FY22.
- Projected net foreign asset growth is lower than the actual growth in FY21.

Opinion:

Just like the central banks of other economies around the world, both developed and emerging, BB has gone for continuation of ongoing expansionary monetary stance. Strong recovery in export and high growth in remittance have provided BB sufficient cushion and required breathing space. However, slow recovery in the business sector and resultant lower credit demand have become causes of concern. Huge liquidity has been piling up in the banking sector due to lower credit demand and massive dollar purchase by BB. This high liquidity situation may push the price levels up as global supply chain disruption and rising commodity prices may add to it. It will be challenging for BB to simultaneously support the economy and keep inflation in check.

For Capital Market:

Expansionary monetary stance usually appears to be a boon for the capital market. Due to sinking deposit rate, savers are flocking into the market. Existing liquidity situation may bring down the interest rate even lower guiding more money to the capital market. The concern could be that a number of speculative stocks might have already become exceedingly overpriced despite having little or no valid fundamentals. In that case, whether there is already a bubble in the market or not is a debatable topic. However, BB has emphasized on the point in the monetary policy statement that they may intervene in the market with open market operation anytime to mop up the excess liquidity. Apparently, it is now a matter to see, how soon they would be triggered to do it.

To sum up, how efficiently and effectively Bangladesh can run the vaccination campaign in the coming days would indicate how its fiscal and monetary policies would play out for FY22. Numerous challenges are ahead but on the external front, the country is in somewhat comfortable position and that gives some headroom to the policymakers.

IMPORTANT DISCLOSURES

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Prepared By:
RESEARCH, IMPRESS CAPITAL LIMITED
Contact: research@impresscapital.com

Impress Capital Limited
Evergreen Plaza (1st Floor), 260/B,
Tejgaon I/A, Dhaka 1208, Bangladesh.
Phone: +880 2 9830776
E-mail: info@impresscapital.com
Website: www.impresscapital.com