AT Capital Research

Monetary Policy Update

FY21

July 30, 2020

Policy Stance	June 2021
Inflation Projection	*5.04%-5.93%*
Repo Rate	*4.75%*
Reverse Repo Rate	*4%*
Broad Money (M2) Growth	*15.6%*
Reserve Money (RM) Growth	*13.5%*
Domestic Credit Growth	*19.3%*
Public Sector Credit Growth	*44.4%*
Private Sector Credit Growth	*14.8%*
CRR	*4%*
SLR	*17%*

Source: Bangladesh Bank

Policy Highlights

- BB believes a V-shape recovery from the COVID-19 scenario and expects a real GDP growth of 8.2% for FY21 aligned with the government set target.
- Inflation projections have been retained at level of 5.04%-5.93%.
- As a part of BB's expansionary monetary policy stance and supporting the preparedness for the additional demand for the funds, MPS is proposing a further cut in the overnight repo rate from 5.25% to 4.75% and a reduction of reverse repo rate from 4.75% to 4%, ensuring the availability of less costly funds for banks and rationalising the policy rate's corridor.
- Moreover, the bank rate which is remained unchanged for last 17 years (since 2003) has also been considered to be reduced from 5% to 4%
- Projections for Broad Money (M2) has been increased from 12.7% to 15.6% whereas Reserve Money (RM) growth reduced from 15.7.0% to 13.5%.
- Domestic credit growth projection has been targeted at 19.3%. Public sector credit growth projection has been reduced from 53.3% to 44.4% while private sector credit growth projection has seen a rise from 8.6% to 14.8% for FY21.

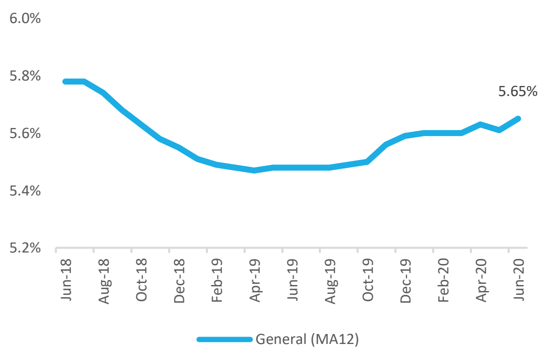
Key Observations

The FY21 Monetary Policy Statement (MPS) comes at a time of an unprecedented fall in global output due to the worldwide COVID-19 pandemic, the likes of which has not been seen since the Great Depression in the 1930s. The benchmark DSEX index fell 19% YTD in March 2020 due to the pandemic before BSEC introduced a floor price which stemmed the fall. The panic has dissipated to some extent in July 2020, with the benchmark DSEX index rising 5% from its level when the price floor was introduced at the end of March.

The Bangladesh economy maintained its growth momentum in FY19, recording GDP growth of 8.15%. This momentum continued up to February 2020, before the Covid pandemic reached Bangladesh and the government was forced to initiate a total lockdown to contain the virus. Inflation breached the 5.50% target set by the FY20 MPS, reaching 5.65% in June 2020. Remittance inflow picked up noticeably in FY20, with 10.85% growth YoY. Due to the pandemic, exports registered decline of 16.9% in FY20 while imports declined by 8.6%. As a result, the current account deficit came down to USD 4,849 million in FY20 (1.5% of GDP) compared to USD 5,102 million (1.71% of GDP) in FY19.

This MPS maintains an expansionary stance aimed at minimizing the economic fallout from the COVID-19 pandemic. To prepare for additional demand for funds, the repo rate has been cut from 5.25% to 4.75% and the reverse repo rate has been cut from 4.75% to 4.00%. The bank rate has been cut for the first time in 17 years, from 5% to 4%. The broad money growth target has been revised upward to support lending and to ease the liquidity situation, while total domestic credit growth target has been increased to stimulate recovery from the pandemic. The private sector credit growth target has been increased in order to get the private sector back on its feet while the public sector credit growth target has been trimmed slightly to reduce risk of crowding out of private sector borrowing.

Chart: General Inflation (12m Avg.)



Source: Bangladesh Bank

Inflation Outlook

12-month average general inflation reached at around 5.65% marginally higher than the targeted 5.50% for FY20. The annual average no-food inflation, particularly concerning to medical care and health expenses, and disruption of supply chains due to coronavirus pandemic were largely responsible for this higher inflation. In current subdued economic situation, significant inflationary pressure is not expected. With a significant drop in international commodity and energy price along with domestic bumper production of crop and no-crop agriculture will keep food inflation thereby general inflation well check in coming months.

Broad Money (M2) and Reserve Money (RM) Outlook

Broad Money (M2) growth reached 12.7% in June 2020 while reserve money growth reached 15.7% in June 2020 on back of increased government borrowing. Interest rates decreased gradually in the first six months of 2020. Net Foreign Assets (NFA) growth recovered to 10.2 % in June 2020 due to improvement in external sector performance in FY20. Net Domestic Asset (NDA) growth stood at 13.4% in June 2020, due to domestic credit growth of 13.7%. NFA is projected to grow by 5.8% in FY21.

Key Items of Monetary Program (y-o-y growth in %)

Item	Actual			Program	
	Jun-19	Dec-19	June-20P	Dec-20	June-21
Net Foreign Assets*	2.1	1.9	10.2	12.5	5.8
Net Domestic Assets	12.3	15.1	13.4	14.4	18.3
Domestic Credit	12.4	15.0	13.7	15.0	19.3
Credit to the public sector	21.7	58.9	53.3	35.6	44.4
Credit to the private sector	11.3	9.8	8.6	11.5	14.8
Broad Money	9.9	12.0	12.7	14.0	15.6
Reserve Money	5.3	6.9	15.7	15.5	13.5
Money Multiplier	5.0	5.2	4.8	5.1	4.9

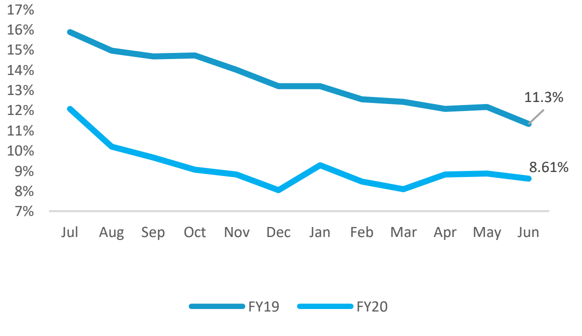
*At constant exchange rates of end June 2020; P=Provisional

Source: Bangladesh Bank

Private Sector Credit Growth Reduced

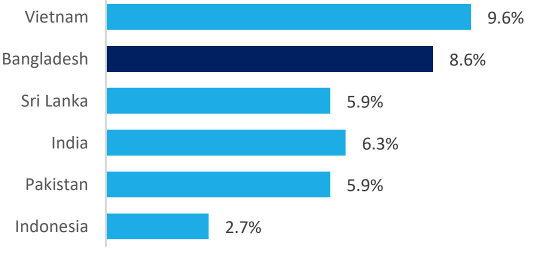
The growth in private sector credit experienced a moderating trend throughout the whole year (FY20) initially due to the banks' adherence towards quality lending which was further aggravated by the outbreak of coronavirus. Nonetheless, Bangladesh private sector credit growth is still higher than many other fast growing South Asian and East Asian emerging markets and developing economies including India, Sri Lanka and Indonesia.

Chart: Pvt. Sector Credit Growth (%)



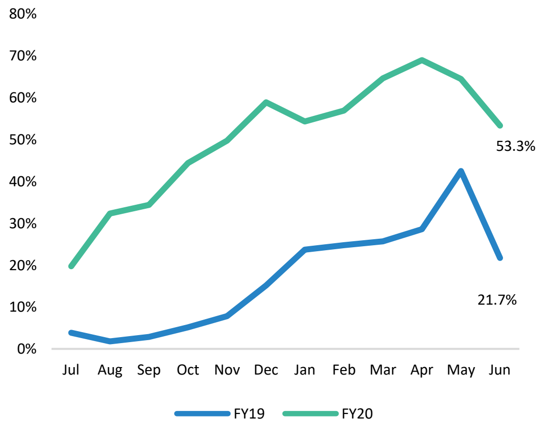
Source: Bangladesh Bank

Chart: Cross-country Comparison of Private Sector Credit Growth



Source: Bangladesh Bank

Chart: Public Sector Credit Growth (%)

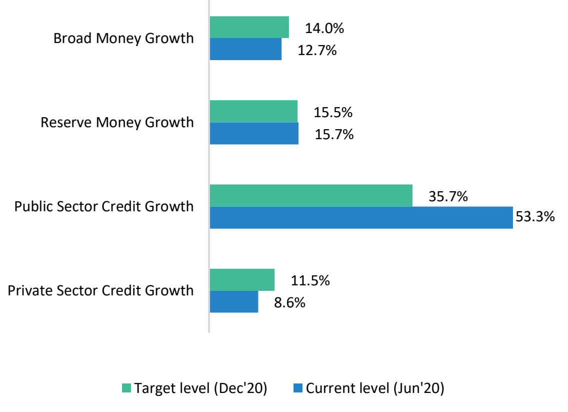


Source: Bangladesh Bank

Public Sector Credit Growth saw a sharp rise

Public sector credit growth saw sharp rise in initial months till May'20 to stand 64.5% but in Jun'20 growth has fallen to 53.3%. Such high growth is apparent due to covid pandemic pressure. Public sector credit growth had been backsliding since FY15 due to the government's reliance on National Savings Certificates (NSCs) instead of bank borrowing to finance its operations. NSC instruments offer a guaranteed fixed interest rate which is higher than rates available for deposits in banks and financial institutions. However, the government has introduced online management system for NSC sales to cut down on individuals or corporations buying more than the maximum ceiling. This led the government to sharply increase its borrowing from the banking system since the end of 2018. This growth in public sector credit growth is set to continue as the government borrows additional money in order to finance its infrastructure projects.

Chart: Current Status vs Dec'20 Targets



Source: Bangladesh Bank

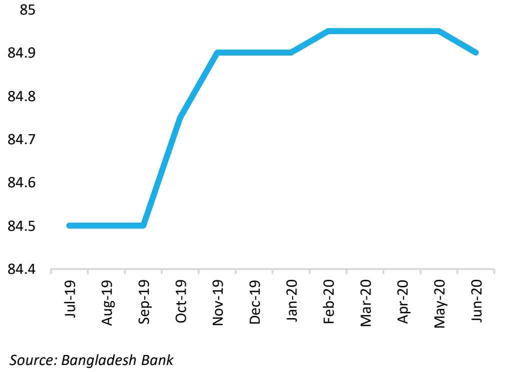
Domestic Credit Growth target Increased

Total Domestic Credit growth registered 13.7% growth in June 2020. The domestic credit growth fully moved together with the programmed path during the first half of FY20, though slightly plunged in the third and fourth quarters due mainly to a slower than programmed growth of private sector credit.

Policy Rates Changed

Bangladesh Bank cut the Cash Reserve Ratio (CRR) from 5% to 4% with effect from 15 April 2020. At the same time, repo rate was cut from 5.75% to 5.25%. These measures were taken in order to address the liquidity crunch for Covid situation. The current MPS is proposing a further cut in the overnight repo rate from 5.25% to 4.75% and a reduction of reverse repo rate from 4.75% to 4%, ensuring the availability of less costly funds for banks and rationalizing the policy rates' corridor (the gap between the rep and reverse repo). Moreover, the Bank Rate which remained unchanged for the last 17 years (since 2003) has also been considered to be reduced from 5% to 4% to rationalize it with current interest rate regime.

Chart: Exchange Rate (BDT/USD)



Source: Bangladesh Bank

Exchange Rate Outlook

During the first half of FY20, the exchange rate of Taka against intervention currency USD faced a little depreciating pressure, which disappeared gradually during the second half due mainly to shrinking growth of imports and significant amount of receipt in the financial accounts along with a good inflow of workers' remittances. However, the exchange rate of Taka against the USD depreciated by 0.5% in FY20.

Contact Us:

AT Capital Research

Celebration Point (5th Floor)
Plot 3, Road 113/A, Gulshan 2,
Dhaka 1212

Find us on the Web:

www.at-capital.com

AT Capital Research Team

Md. Nafeez Al Tarik CFA, FRM
+880 170 852 2652
nafeez.tarik@at-capital.com

Shohana Ahmed
+880 171 742 8657
shohana.ahmed@at-capital.com

Saad Niamatullah
+880 155 638 5402
saad.niamatullah@at-capital.com

Tofayel Ahamed
+880 170 707 3589
tofayel.ahamed@at-capital.com