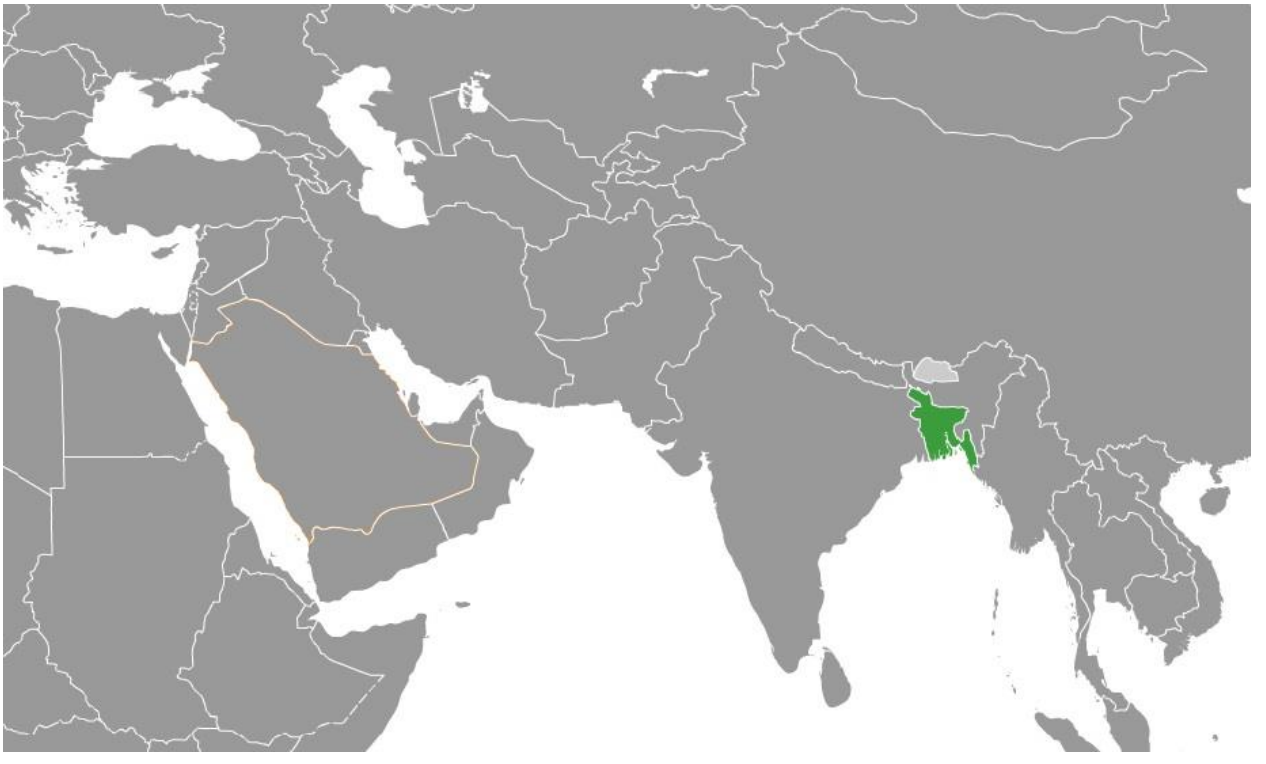

Monetary Policy Update
H1 FY20

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Policy Stance	June 2020
Inflation Projection	**5.50%**
Repo Rate	**6.0%**
Reverse Repo Rate	**4.75%**
Broad Money (M2) Growth	**12.5%**
Reserve Money (RM) Growth	**12.0%**
Domestic Credit Growth	**15.90%**
Public Sector Credit Growth	**24.30%**
Private Sector Credit Growth	**14.80%**
CRR	**5.50%**
SLR	**18.50%**

Source: Bangladesh Bank

Policy Highlights

- BB projects GDP growth of 8.20% in FY20 in line with the FY20 budget target. Provisional GDP for FY19 stands at 8.13% against target of 7.80%.
- Inflation projections have been retained in line with the FY20 budget at 5.50% from previous level of 5.40%-5.60%.
- The H1FY20 MPS keeps repo and reverse repo rates unchanged at 6.0% and 4.75% respectively.
- The CRR and SLR are kept unchanged at 5.50% and 18.50% respectively.
- Projections for Broad Money (M2) and Reserve Money (RM) growth have been increased from 12.0% to 12.50% and from 7.0% to 12.0% respectively. The negative effects of the current account deficit on domestic liquidity conditions in FY18 has largely dissipated due to higher exports and remittances amid decline in import growth in FY19.
- Domestic credit growth projection has been kept unchanged at 15.90%. Public sector credit growth projection has been raised from 10.90% to 24.30% while private sector credit growth has seen a slight reduction from 16.50% to 14.80%
- BB is moving towards interest rate-based monetary policy regime from the current monetary aggregate-based regime

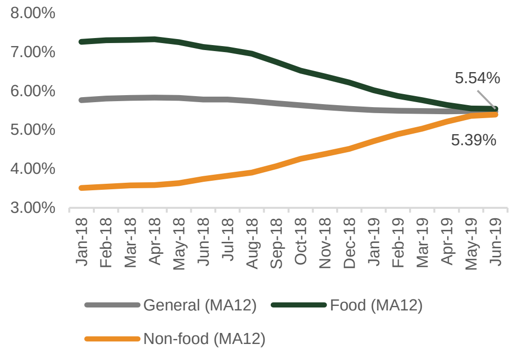
Key Observations

The H1FY20 Monetary Policy Statement (MPS) comes at a critical time for the Bangladesh capital market. The benchmark DSEX index has fallen by 18% since 1 January 2018 to the present, with the Bangladesh economy facing challenges from a spiralling current account deficit and consequent liquidity pressure and depreciating exchange rate. Those factors are slowly dissipating at present, and the H1FY20 monetary policy statement will have a critical effect on influencing the future trend of the capital market and deciding whether the recovery in economic indicators will lead to a turnaround in the capital market in the next few months.

The Bangladesh economy maintained its growth momentum in the first half of 2019, with the Bangladesh Bureau of Statistics (BBS) estimating provisional GDP growth of 8.13% for FY19 against the FY19 budget target of 7.80%. Inflation was successfully brought down from 5.78% at the end of Jun-18 to 5.47% at the end of Jun-19, below the previous MPS ceiling of 5.60%. Remittance inflow picked up, with 9.60% growth in FY19. Exports registered growth of 10.55% in FY19 while import growth reduced to 2.61%. As a result of these favourable external sector developments, the current account deficit was brought down to USD 5,175 million in FY19 (1.71% of GDP) compared to USD 9,780 million (3.20% of GDP) in FY18.

This MPS maintains a cautious but accommodative approach to address inflationary risks while supporting growth. Inflationary risks include rise in prices due to introduction of VAT and hike in domestic fuel prices. The broad money and reserve money growth targets have been revised upward slightly to support growth and ease the liquidity situation, while total domestic credit growth target has remained unchanged. The private sector credit growth target has been reduced keeping in mind the need to restrain over-exuberant lending by financial institutions amid a rise in non-performing loans in the financial sector while the public sector credit growth target of 24.30% reflects the smaller base of public sector credit compared to private sector credit and the government's bank borrowing targets for FY20. With the pressure on the current account balance largely contained

Chart: Inflation

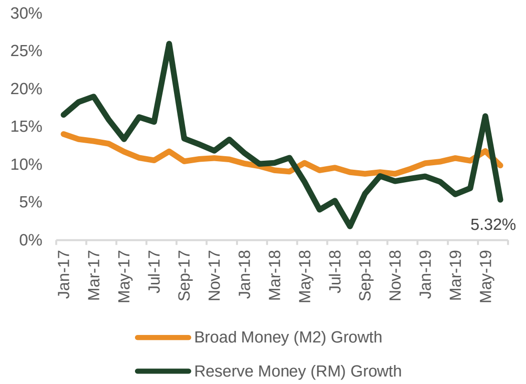


Source: Bangladesh Bank

Inflation Outlook

12-month average general inflation remained subdued at 5.47% in June 2019, squarely within central bank target range of 5.30%-5.60%. Food inflation decreased from 6.21% in December 2018 to 5.54% in June 2019, helped by adequate stocks of food grains along with a bumper harvest in early 2019. Non-food inflation, on the other hand, witnessed a rise from 4.51% in December 2018 to 5.39% in June 2019. Prospects for food inflation remain muted in the short term due to adequate stocks of food grains amid healthy harvests, but non-food inflation is likely to rise even further as hike in gas prices and introduction of VAT cause prices of goods and services to rise. Overall, inflation risks are tilted toward the higher side in coming months, but extensive government intervention is likely to keep inflation at around the 5.50% level.

Chart: Growth of Reserve and Broad Money

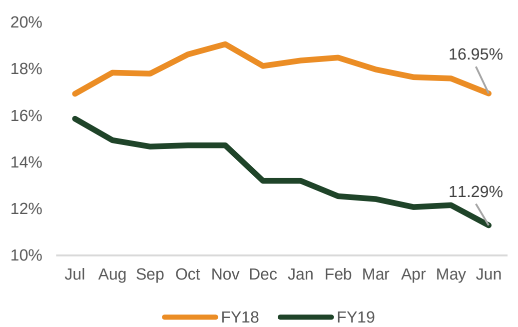


Source: Bangladesh Bank

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

Broad Money (M2) growth reached 9.88% in June 2019 while reserve money growth reached 5.32% in June 2019 on back of increased government borrowing. Interest rates increased gradually in the first six months of 2019. Net Foreign Assets (NFA) growth recovered to 2.2 % in June 2019 due to improvement in external sector performance in FY19. Net Domestic Asset (NDA) growth stood at 12.3% in June 2019, due to domestic credit growth of 12.3%. NFA growth recovery to positive territory is a welcome sign that the economic pressures faced in 2018 may finally have started to reverse course.

Chart: Pvt. Sector Credit Growth (%)

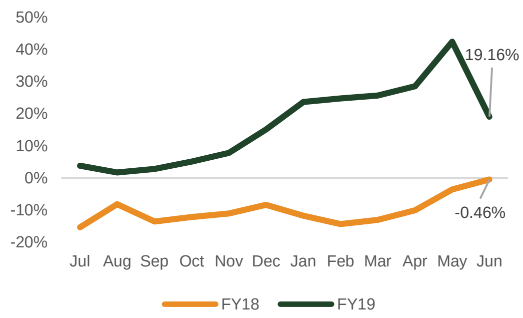


Source: Bangladesh Bank

Private Sector Credit Growth Target Reduced

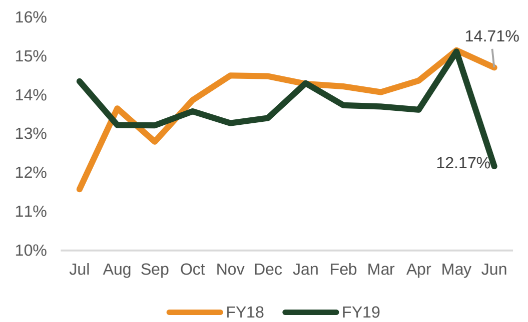
Private sector investment started to pick up in FY18, driving private sector credit growth to a record 16.94% in FY18, exceeding the central bank target of 16.90%. The central bank subsequently reduced the Advance-to-Deposit ratio (ADR) of banks in order to restrain the private sector credit growth. This led to private sector credit growth coming down to 13.20% in December 2018, well below the central bank target of 16.80%. Private sector credit growth continued to decline due to tight liquidity conditions, coming down to 11.29% in June 2019. The central bank judged the lowered private sector credit growth amid high GDP growth as a positive sign that low-quality lending has been successfully restrained from previous high levels. Under that rationale, the private sector credit growth target has been set at 14.80% for June 2020.

Chart: Public Sector Credit Growth (%)



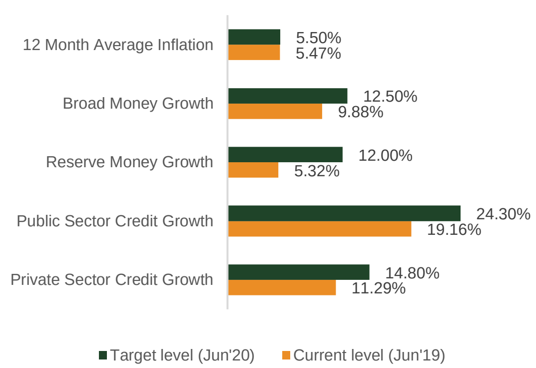
Source: Bangladesh Bank

Chart: Total Domestic Credit Growth (%)



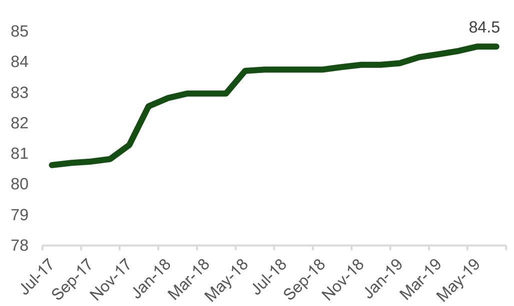
Source: Bangladesh Bank

Chart: Current Status vs June'20 Targets



Source: Bangladesh Bank

Chart: Exchange Rate (BDT/USD)



Source: Bangladesh Bank

Public Sector Credit Growth increased

Public sector credit growth saw sharp rise since April 2018, to stand at 19.16% in May 2019. 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.

Domestic Credit Growth target unchanged

Total Domestic Credit growth registered 12.17% growth in June 2019 against the MPS target of 15.80%. The current MPS has slightly increased the target to 15.90%. This target will be achieved if growth of credit to public and private sectors proceed as programmed. Given the additional restrictions caused by the online management system for NSCs, greater public sector credit growth is likely to lead to the target being achieved.

Policy Rates unchanged

Bangladesh Bank cut the Cash Reserve Ratio (CRR) from 6.5% to 5.5% with effect from 15 April 2018. At the same time, repo rate was cut from 6.75% to 6.0%. These measures were taken in order to address the liquidity crunch caused by the earlier reduction of the Advance-Deposit Ratio (ADR) from 85% to 83.5%. The current MPS keeps those rates unchanged. The moves of restricting the ADR and lowering of CRR and repo rates moved monetary policy in opposite directions. Bangladesh Bank is likely to keep interest rates and liquidity situation under monitoring and intervene with interest rate instruments for overall demand management as needed.

Exchange Rate Outlook

BDT depreciated 0.72% in the first six months of 2019, from 83.9 per USD in December 2018 to 84.50 in June 2019. The depreciation was due to the persistent current account deficit, which reached USD 5.18 bn in May 2019. Given the turnaround in external sector performance and reduction in current account deficit, the exchange rate is likely to remain at the 84.50 level for the foreseeable future, or to experience a slight depreciation if the current account comes under pressure again.

Table: External Sector					
Indicator	FY15	FY16	FY17	FY18	FY19*
Export Growth Rate	3.40%	9.80%	1.70%	5.81%	10.55%
Import Growth Rate	0.20%	6.00%	8.70%	25.23%	2.61%
Remittance Growth Rate	7.70%	-2.50%	-14.40%	17.32%	9.60%
Current Account Balance (USD mn)	2,875	4,382	-1,480	-9,780	-5,175

* - Latest available figures, Source: Bangladesh Bank

External Sector

The current account deficit was USD 9,780 million in FY18, caused by high import growth of 25.23% due to import of capital machinery to complete the government's ongoing megaprojects and high food grain imports to replace the rice harvests lost during widespread floods in early 2018. In contrast, lack of those factors recurring enabled the import growth to be brought down to 2.61% in FY19. As a result, the current account deficit was successfully brought down to USD 5,175 million in the first 11 months of FY19. Export growth picked up appreciably to 10.55% due to the twin effects of depreciation of BDT and increased exports to the US due to the ongoing trade war between the US and China. Remittances bounced back in FY19 due to greater number of workers going abroad combined with depreciation of the official exchange rate causing greater share of remittances to be sent through official channels.

In contrast to the current account balance, the financial account registered a positive balance of USD 4,847 million in the first 11 months of FY19, reflecting increased foreign investment in the country. Net FDI inflows grew 34.05% YoY to reach USD 2,067 million while medium and long-term loans (MLT) grew 13.54% YoY to reach USD 4,975 million. The capital account registered a surplus of USD 217 million, for an overall balance of payments (BoP) deficit of USD 682 million, a reduction of 30% from the overall balance deficit recorded in the same period of FY18.

Bangladesh Bank moving toward interest-rate monetary policy regime

The BB has started preparatory work in order to move towards an interest rate based monetary policy regime rather than one based on control of monetary aggregates. In an interest rate based monetary policy regime, changes in the policy rate of the central bank exert direct impact on prices in the financial and real sectors, rather than indirectly through monetary aggregate as in the current monetary policy regime. Interest rate based monetary policy regimes are extensively used in middle- and high-income countries. Properly implemented, the new regime is expected to quicken and heighten efficiency in transmission of intentions of monetary policies. The BB is being assisted in this regard by IMF South Asia Regional Training and Technical Assistance Center (IMF SARTTAC).

Potential risks for attaining monetary policy targets

The MPS for H1FY20 highlighted a particular set of risks it feels could pose a threat to the achievement of the monetary policy targets set out in the MPS. The recent upward revision of domestic gas prices, while alleviating the pressure of gas subsidies on the national budget, also increased the risk of inflation. Monsoon floods have already led to some limited crop losses at present. If the floods are prolonged or recur in the future, it could lead to significant losses of rice harvests, which would directly contribute to a upward spike in inflation. The ongoing trade war between the US and China has proved to be a boon for Bangladeshi exports as well as inward foreign direct investment, but if the trade was is resolved through an agreement between the US and China these gains would be threatened.

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