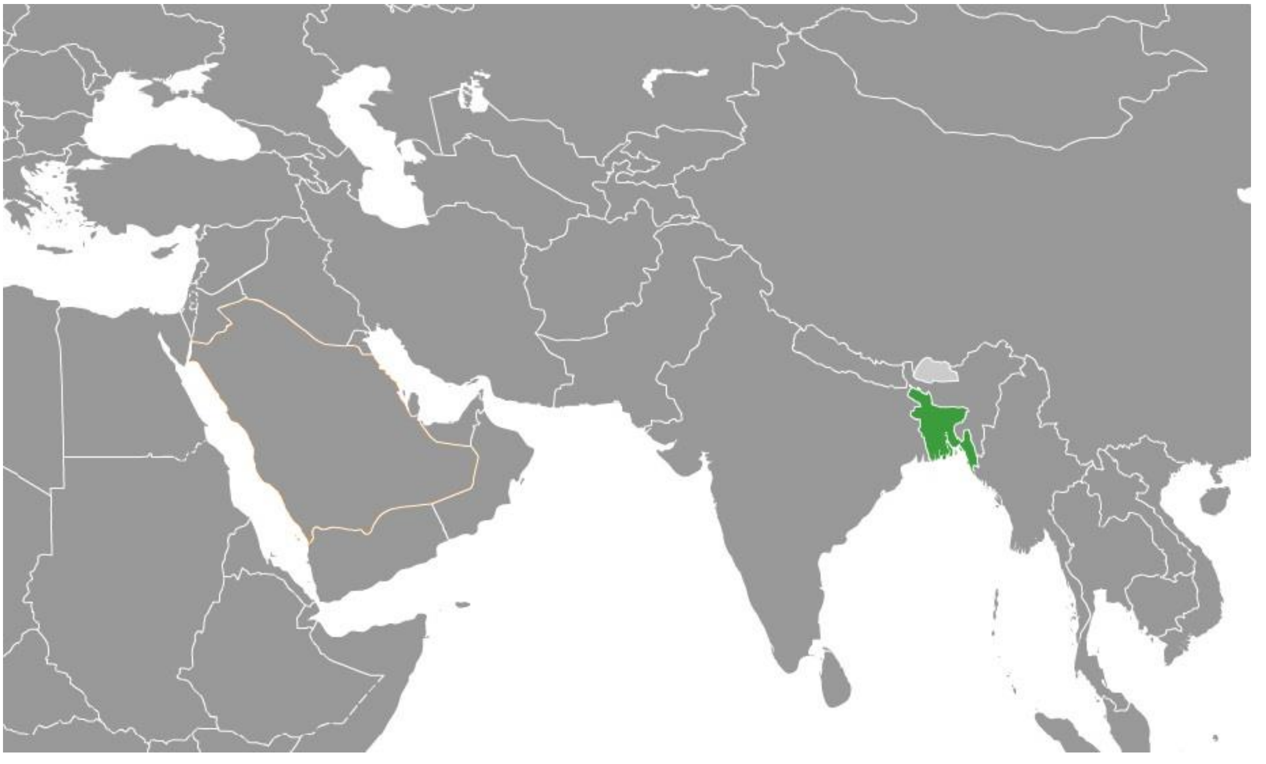


Monetary Policy Update

FY21

July 30, 2020

Policy Stance	June 2021
Inflation Projection	**5.04% - 5.93%**
Repo Rate	**4.75%**
Reverse Repo Rate	**4.00%**
Bank Rate	**4.00%**
Broad Money (M2) Growth	**15.60%**
Reserve Money (RM) Growth	**13.50%**
Domestic Credit Growth	**19.30%**
Public Sector Credit Growth	**44.40%**
Private Sector Credit Growth	**14.80%**
CRR	**4.00%**
SLR	**13.00%**

Source: Bangladesh Bank

Policy Highlights

- BB projects GDP growth of 8.20% in FY21 in line with the FY21 budget target. Driven by the pandemic driven disruptions, provisional GDP for FY20 stands at 5.20%. However, policy makers are expecting a quick V shaped recovery in FY21.
- Inflation projections are in line with FY21 budget and is expected to be contained between 5.04% to 5.93%.
- The FY21 MPS has slashed policy rates (repo and reverse repo) to 4.75% and 4.00% respectively from 5.25% and 4.75%.
- After 17 years, Bank Rate has been reduced to 4% from 5% to rationalize it with current interest rate regime.
- The CRR and SLR are kept unchanged at 4.00% and 13.00% respectively.
- Projections for Broad Money (M2) and Reserve Money (RM) growth have been set at 15.6% and 13.5% respectively, consistent with the targeted real GDP growth and CPI inflation target.
- Expecting a quick economic recovery, domestic credit growth projection has been set at 19.3% with public sector credit growth of 44.4% and private sector credit growth of 14.8%.

Key Observations

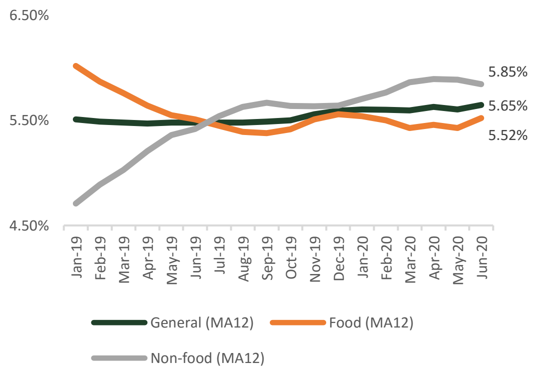
The FY21 Monetary Policy Statement (MPS) with its expansionary stance is a boon for Bangladesh capital market. The benchmark DSEX index has fallen by 22.9% since 1 January 2019 to the present, with the Bangladesh economy facing challenges from devastating economic shock from the COVID-19 pandemic, spiralling current account deficit and a deteriorating banking system. Policy makers have already started to address these issues since Mar'20 in the form of financial stimulus and policy relaxations.

In the backdrop of COVID-19 outbreak, BB's liquidity enhancing policy measures including reduction of CRR by 150 basis points for banks (domestic units), 350 basis points for offshore units (OBU) and 100 basis points for FIs, purchase of government securities form banks and FI's, the introduction of long-term repo facilities up to 360 days, along with several refinance schemes helped to inject sufficient liquidity in the money market. In addition, BB's recent drive of buying foreign currency from the market helped restore normalcy in both money market and foreign exchange market keeping the BDT/USD rate competitive. These measures resulted in monthly average surplus liquidity of BDT 1,035bn in FY20.

This MPS maintains the central banks' ongoing expansionary stance with key revisions in its repo and reverse repo rates along with a reduction in bank rate for the first time in 17 years. Policy makers are aiming to provide a life line to the economy in order to help it survive the ongoing pandemic disruptions. Expecting a quick V shaped recovery, BB projects 8.20% GDP growth in FY21 and has set its domestic credit growth target at 19.3% with public sector credit growth target of 44.4% and private sector credit growth target of 14.8%. It plans to contain inflation between 5.04% to 5.93% with Broad Money (M2) and Reserve Money (RM) growth target of 15.6% and 13.5% respectively. However, all these will primarily depend on how the pandemic plays out throughout the year.

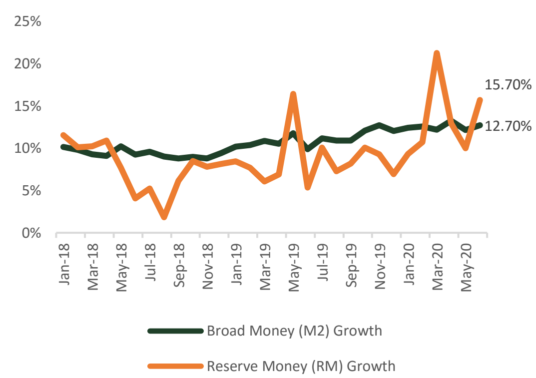
LankaBangla ASSET MANAGEMENT

Chart: Inflation



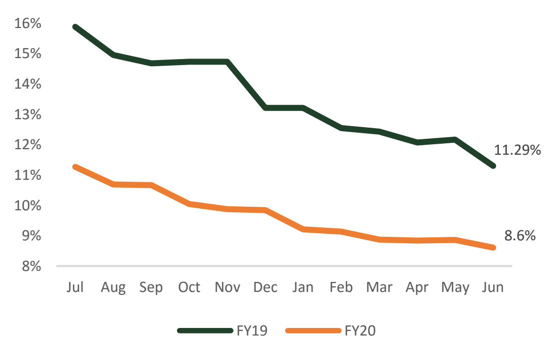
Source: Bangladesh Bank

Chart: Growth of Reserve and Broad Money



Source: Bangladesh Bank

Chart: Pvt. Sector Credit Growth (%)



Source: Bangladesh Bank

Inflation Outlook

12-month average general inflation remained within a reasonable level of 5.65% in June 2020, slightly above the central bank's target of 5.50%. Food inflation remained stable, marginally decreasing from 5.56% in December 2019 to 5.52% in June 2020, helped by adequate stocks of food grains along with a bumper harvest in early 2020. Non-food inflation, on the other hand, witnessed a rise from 5.64% in December 2019 to 5.85% in June 2020. Prospects for rising food inflation still remains given the worsening flood situation. In addition, non-food inflation is also likely to rise even further as hike in utility prices and pandemic driven disruptions may cause prices of goods and services to rise. Overall, inflation risks are tilted toward the higher side, but extensive government intervention is likely to keep inflation at within the target range of 5.04% - 5.93%.

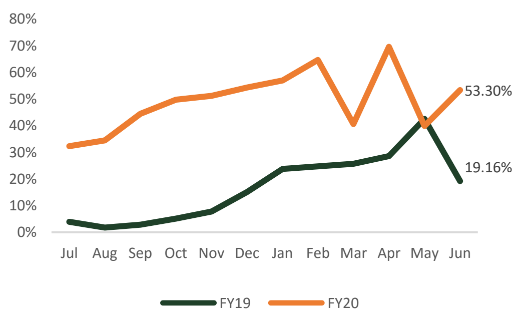
Broad Money (M2) and Reserve Money (RM) Outlook

Broad Money (M2) growth reached 12.70% in June 2020 while reserve money growth reached 15.70% in June 2020 on back of increased government borrowing. 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%. If the economy does indeed witnesses a V shaped recovery, the M2 and RM targets of FY21 are likely to be achieved.

Ambitious Private Sector Credit Growth Target

The private sector credit growth continued its downward momentum throughout FY20 falling from 11.3% in Jul'19 to 8.6% in Jun'20; missing the central bank's yearly target of 14.8% by a significant margin. Weakening credit demand and interest rate ceiling set by the central bank hampered banks ability to increase its lending activities. In addition, the pandemic driven disruptions further deteriorated both the demand for private credit and banks' ability of efficient credit disbursement. Going into FY21, the central bank has set the private sector credit growth target at 14.8% in line with GDP growth target of 8.2% as it expects increased disbursement of credit from various government stimulus packages worth BDT 1.03 trillion and a quick V shaped recovery from the pandemic shock.

Chart: Public Sector Credit Growth (%)

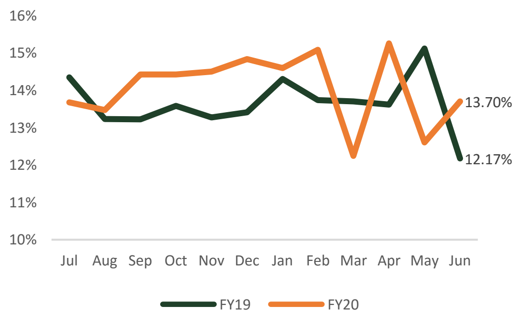


Source: Bangladesh Bank

Public Sector Credit Growth Increased

Public sector credit growth continued to grow throughout FY20 from 32.3% in Jul'19 to 53.3% in Jun'20 which overshoot the yearly target of 24.3% by a wide margin. This growth was mainly driven by government's increased spending, particularly on infrastructure projects, and fall in the sales of National Savings Certificates (NSCs) from stricter regulations and increased tax imposition. Going into FY21, the public sector growth target has been set at 44.4% which is very likely to be achieved as we expect the government to try to spend its way out of the pandemic disruptions.

Chart: Total Domestic Credit Growth (%)

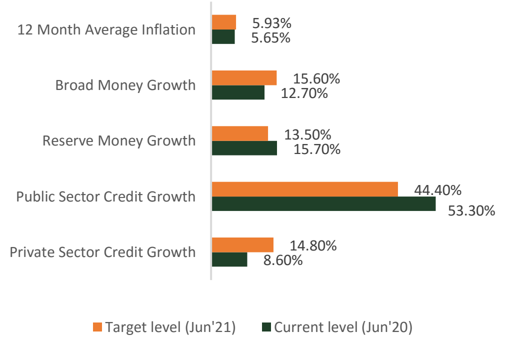


Source: Bangladesh Bank

Domestic Credit Growth Increased

Total Domestic Credit growth registered 13.70% growth in June 2020 against the MPS target of 15.90%. The current expansionary MPS has increased the target to 19.30% for FY21. This target will be achieved if growth of credit to public and private sectors proceed as programmed. Given the restrictions caused by the online management system for NSCs, the public sector credit growth target is likely to achieved. However, private sector credit growth will largely depend on how the pandemic plays out overtime.

Chart: Current Status vs June'2 Targets

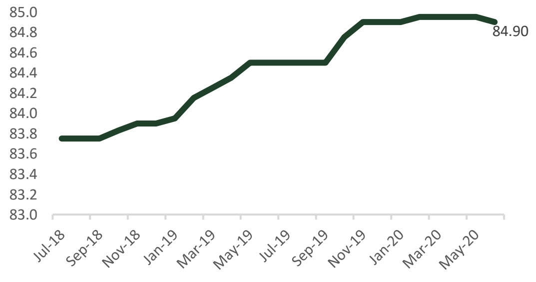


Source: Bangladesh Bank

Policy Rates Relaxed

Bangladesh Bank has introduced its expansionary MPS for FY21 through a host of policy rate cuts. Repo and reverse repo rates have been slashed to 4.75% and 4.00% respectively from existing 5.25% and 4.75%. In addition, for the first time in 17 years Bank Rate has been reduced to 4.0% from 5.0% to rationalize it with current interest rate regime. These are only the recent round of rate cuts announced; the central bank has already announced repo rate cuts twice earlier this year in order to provide stimulus to survive the ongoing pandemic disruptions. These were some of the welcomed initiatives from BB and we expect BB to take all necessary steps to ensure liquidity throughout this pandemic situation.

Chart: Exchange Rate (BDT/USD)



Source: Bangladesh Bank

Exchange Rate Outlook

BDT depreciated 0.47% in FY20 driven by persistent current account deficit. However, going into FY21 the foreign reserve has reached an all time high of USD 37.1bn in 27th July 2020 driven by greater inflow of remittance, foreign aid and lower imports. Going into the first half of FY21, we are unlikely to witness any significant depreciation of the BDT.

Table: External Sector

Economic Indicator	FY16	FY17	FY18	FY19	FY20*
Export Growth Rate	9.80%	1.70%	5.81%	9.15%	-16.90%
Import Growth Rate	6.00%	8.70%	25.23%	1.79%	-8.56%
Remittance Growth Rate	-2.50%	-14.40%	17.32%	9.60%	10.87%
Current Account Balance (USD mn)	4,382	-1,480	-9,567	-5,102	-4,849
Overall Balance (USD mn)	5,036	3,169	-857	179	3,655

* - Latest available figures

External Sector

The balance of payment witnessed a surplus of USD 3,655mn in FY20, contributed by a decline in current account deficit on the back of robust remittance inflows along with higher inflows of FDI coupled with somewhat health inflows of medium and long term loans. However, the deficit in trade balance widened to USD 17,861mn during the period, amid a decline in exports and imports by 16.9% and 8.6% respectively driven by sluggish domestic and international demand in the first half of FY20 which was further aggravated by the pandemic in the second half. Going into FY21, the current account balance is expected to deteriorate further from sluggish demand and remittance is expected to witness a slowdown as overseas employment of Bangladeshi workers have already dropped significantly due to the global recession. If the global economy does deteriorates further, the BOP may once again slide into negative territory.

Potential risks for attaining monetary policy targets

The MPS for FY21 highlighted five major risks it feels could pose a threat to the achievement of the monetary policy targets set out in the MPS. First, the uncertainty over the length and depth of COVID-19 both in Bangladesh and Global market still remain as the most important risk in the attainment of MPS targets. Second, volatility of oil price, global economic recession and geopolitical instabilities present significant challenge to export and remittance inflow. Third, Bangladesh has implemented the largest social welfare program in its history and is likely to launch more stimulus packages going forward which can create inflationary pressure beyond the BB’s target. Fourth, the worsening NPL situation of the banking industry which got a quick fix from rescheduling and interest deferral may further deteriorate from worsening business condition. Finally, natural disaster remains a key threat to the primary sector of Bangladesh.

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