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Expansionary Monetary Policy to Tackle the Onslaught of Covid-19

Macroeconomic Report
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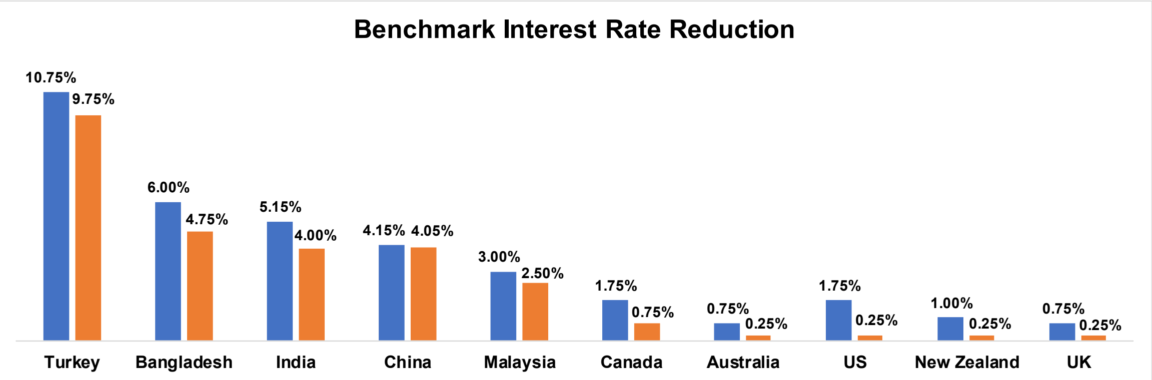
Monetary Policy Statement for FY 2020-21: Key Figures

Figures in Percentage	Targets for FY 2020	Actual in FY 2020*	Targets for Dec 2020	Targets for Jun 2021
GDP Growth Rate	8.20	5.20	8.20	8.20
Inflation	5.50	5.65	5.04-5.93	5.04-5.93
CRR	5.50	4.00	4.00	4.00
Repo Rate	6.00	5.25	4.75	4.75
Reverse Repo Rate	4.75	4.75	4.00	4.00
Bank Rate	NA	5.00	4.00	4.00
Broad Money Growth Rate	13.00	12.70	14.00	15.60
Domestic Credit Growth Rate	17.40	13.70	15.00	19.30
Private Sector Credit Growth Rate	14.80	8.60	11.50	14.80
Public Sector Credit Growth Rate	37.70	53.30	35.60	44.40

**as of Jun 2020, Source: Bangladesh Bank, MPS*

Is the MPS up to the Task of Reviving the Economy?

The monetary policy tools available for crisis situations are dwindling for central banks around the world. Cutting interest rate to near zero level (some even in negative territory) and QE (bond buying program) are losing their impact gradually.



**as of Jul'20 for Bangladesh & India, as of Mar'20 for the remaining countries*
Source: World Economic Forum, Bangladesh Bank, Business Standard

Bangladesh Bank has come out with all guns blazing. The 2020-21 MPS is expansionary and growth accommodative. Key interest rates have been slashed by a good amount. The central bank is fully aware of the fallout due to the pandemic, severe flood, lingering slowdown of the local economy, rising bad assets in the banking sector and sluggish global economy. More than BDT 1 trillion (about USD 12 billion) stimulus package has already been announced by the Government to aid the faltering economy. BB is trying to ensure availability of adequate liquidity at low cost for propping up the business climate.

Are these policy changes enough to regenerate employment and revive the economy? This would only work in this crisis when people and businesses are confident of a win against the coronavirus. Banks are supporting all types of businesses with interest deferral, moratorium and low-cost financing. No major change has been advised for banks in managing their credit risk and piling bad debt. However, this is unprecedented situation and making credit available at low cost is the best bet for any central bank in the world. BB has done the same thing; we only wait for a better control of the pandemic by our government.

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Policy Rates are Cut to Ensure Sufficient Liquidity

Results in FY 2020 & Proposed Policy

- CRR was reduced in H2 FY'20 to push money into the banking sector. CRR is kept unchanged at the reduced rate of 4%. SLR is still unchanged at 13%.
- Repo rate was reduced to 5.25% in H2 FY'20. The repo rate has been further reduced by 50 basis points to 4.75%. Reverse repo rate has been reduced by 75 basis points to 4.0%.
- Bank rate, which was unchanged for 17 years, was reduced from 5% to 4% to rationalize with the current interest rate regime.
- Call money rate ranged within 2.31%-5.21% in FY 2020 and ended at 5.02% on Jun 30, 2020.
- Excess of liquid assets (above of CRR and SLR) — a proxy for liquidity condition in the banking sector — has started at a low level in FY 2021. However, liquidity issues were solved with depleting NSC sales.

Analyst Notes

The bank sector is given the herculean task of disbursing the stimulus package of over BDT 1 trillion (~USD 12 Bn) during a distressed time. In order to entice the banks to distribute the stimulus packages and to ensure sufficient liquidity, CRR and Repo rates were cut. The rates aren't expected to be reversed to the previous points in the current fiscal year.

NSC sales declined by 76.4% in the first 11 months of FY 2020. However, as the central bank set a lending rate cap of 9% on loans, the liquidity in the banking sector is being shifted towards government securities. The high treasury yields of 5%-9% and demand for bank borrowing from the government is pushing the liquidity to public sector.

The central bank wants to ensure low cost lending in this turbulent time. Hence, the lending rate cap is not expected to be withdrawn in H1 FY'21.

Inflation Projection Ranges within 5%-6%

Results in FY 2020 & Proposed Policy

- Current 12-months average inflation stood at 5.65% as of June 2020, above the target ceiling of 5.50%.
- Central Bank projects average inflation to range within 5.04%-5.93%

Figures in Percentage	Actual Inflation	Target Inflation
1H FY2015	7.35	6.0 — 6.5
2H FY2015	6.99	NA
1H FY2016	6.40	6.50
2H FY2016	6.19	6.20
1H FY2017	5.92	6.07
2H FY2017	5.52	5.80
1H FY2018	5.44	5.80
2H FY2018	5.78	5.50
1H FY2019	5.54	5.4 — 5.8
2H FY2019	5.47	5.3 — 5.6
1H FY2020	5.59	5.50
2H FY2020	5.65	5.50
1H FY2021	NA	5.04-5.93

Source: Monetary Policy Statement, Jul 2020

Analyst Notes

The Covid-19 put an inflationary pressure on both food & non-food items, specially health care, which caused the headline inflation to be higher than the target in FY'20. As there was a bumper harvest of boro, the main paddy crop, global food price volatility isn't expected to affect the food inflation in our country. However, monsoon floods have already occurred and damaged crops. Deterioration of the situation may lead to importing crops and possibility of high food inflation. Oil price dropped during H1'20 but it's on the rise now. However, the global oil price doesn't affect the domestic fuel price significantly. Demand for credit and consumption is expected to be low in FY'21 which is expected to pull down core inflation. However, the various government stimulus packages, high demand for health care, and high broad money growth target may result in inflationary pressure. The inflation target for FY 2021 includes a broad range and thus the actual inflation is expected to meet the target.

Breakdown of Inflation	Actual Inflation (%)*	Trend
General Inflation	5.65	Stable
Food Inflation	5.52	Stable
Non — Food Inflation	5.85	Stable
Core Inflation^	5.76	Stable

**as of Jun 2020, ^excludes food, oil and commodity prices, Source: MPS*

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Private Sector Credit Growth Subdued while Public Sector Growth Remains Robust

Results in FY 2020 & Proposed Policy

- In FY 2020, broad money growth rate of 12.7% was close to the target rate of 13.0%.
- In FY 2020, private sector credit growth of 8.6% was lowest in the last decade and ended way below its target of 14.8%. Public sector credit growth came at 53.3% and far exceeded the target of 37.7%.
- Domestic credit growth — a combination of private and public sector credit growth, came below the target (13.7% against 17.4%), mostly impacted by weak private sector credit — which is ~9 times bigger than public sector credit.
- Target for private sector credit growth in H1 & H2 FY 2021 is increased from the actual level to 11.5% and 14.8% respectively. Public sector credit growth target is at 35.6% and 44.4% in H1 FY'21 & H2 FY'21 respectively. Domestic Credit growth target for the same period is at 15.0% and 19.3% respectively.
- Target for broad money growth is set at 14.0% in H1 FY'21 and 15.6% in H2 FY'21.

Analyst Notes

The private sector credit growth has been falling since H2'18 due to liquidity concern and asset quality risk. The asset quality risk has only increased over time which was further amplified during Covid-19. Moreover, demand for private loans are subdued due to the global economic slowdown. An economic recovery in 2020 can only be considered a wishful thinking. Even if the economy recovers and demand picks up, the piled up classified loans during this distressed time and the lending rate cap will ensure a continuation of cautious approach in lending from the banks. Therefore, private sector credit growth is not expected to hit double digit in FY 2021 and has high possibility of missing the target.

The public sector credit growth has been robust in FY 2020 owing to a poor tax collection. However, ADP spending is forecasted to grow only 6% in FY'21 in the budget. Moreover, Covid-19 caused a supply disruption which may continue in H1' FY21. Hence, the central bank may have set the target at a lower rate than the actual growth. If the works of mega project can be continued without much disruption, the public sector targets can be achieved in FY 2021.

The broad money target has been increased as per our expectation. In order to ensure proper disbursement of the government stimulus packages the central bank is going to inject liquidity into the money market.

Current Account Deficit is Forecasted at a Similar Level

Results in FY 2020 & Proposed Policy

	Actual in FY 2020* (USD Mn)	Targets for FY 2021 (USD Mn)	Actual YoY Growth FY 2020	Targeted YoY Growth FY 2021
Trade Balance	-17,861	-18,392	-12.8%	-3.0%
Remittance	18,205	18,751	10.9%	3.0%
Current Account Balance	-4,849	-4,876	5.0%	-0.6%
Current Account Deficit as % of GDP	-1.5%	-1.3%	NA	NA
Gross International Reserve	36,037	37,000	10.1%	2.7%

**as of Jun 2020, Source: Bangladesh Bank, MPS*

Analyst Notes

Export & Import both slowed down in H2 FY'20 due to global economic meltdown. RMG orders are expected to recover moderately after a couple of months. However, exports will still face negative growth unless global economy revives which is not expected within 2020. About 35% of the imports are for RMG export, imports are expected to be subdued as well. Therefore, the central bank's trade balance target matches our expectation.

Remittance saw a tremendous growth in FY 2020 as government declared cash incentive of 2% on remittance. The central bank's low target growth for remittance in FY 2021 seems logical as overseas employment decreased by ~74% in the first five months of 2020.

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Stability in the FX is Expected

Results in FY 2020 & Proposed Policy

- BDT depreciated by 0.5% against USD in FY'20
- The NEER stood at 98.8 and the REER stood at 112.6 in Jun'20.

Analyst Notes

The REER of BDT shows that the currency is overvalued. However, the intervention of the central bank in FX market has always propped the currency up. In the MPS, the central bank has stated that both the local and foreign exchange interbank markets are in comfortable position regarding liquidity. Moreover, a strong foreign exchange reserve of USD 36 billion will act as a guard against depreciation of BDT. Therefore, we expect currency to remain stable in FY 2021 and depreciate slightly to stay competitive in export.

Bangladesh Bank Assumes Real GDP Growth Rate of 8.20%

Results in FY 2020 & Proposed Policy

- Real GDP increased by 5.20% in FY 2020, mainly driven by high public sector investment and dragged down by a slump in demand and export during H2 FY'20.
- Bangladesh Bank projects GDP growth to be 8.20% in FY 2021 provided that both the domestic and global economy recover soon.

Analyst Notes

BB's projection of GDP growth rate for FY 2021 is much higher than multilateral lenders like IMF, WB & ADB. As the rate of infection in Bangladesh shows no sign of slowing down, a full economic recovery isn't expected soon. Global demand may pick up a little which will benefit export but still it's not expected to be sufficient to ensure such a high growth. Meeting the GDP growth target may be difficult.

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