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research@bracepl.com

No Major Change in the Monetary Policy for Jan—Jun 2019

Macroeconomic Report
January 30, 2019

Bangladesh Bank (BB) published the Monetary Policy Statement (MPS) for the second half of FY19 on 30 January 2018. The inflation and growth targets remain in a similar range, indicating policy continuation without any surprise in this MPS. The repo and reverse repo rates will remain unchanged at 6.0% and 4.75% respectively for Jan-Jun 2019.

Monetary Policy Statement for Jan-Jun 2019: Key Figures

	Targets Set in Jul 2018 (%)	Actual in H1FY19*	Targets Set in Jan 2019 (%)
GDP Growth Rate	7.5 — 7.7	NA	7.5 — 8.2
Inflation	5.4 — 5.8	5.54	5.3 — 5.6
Repo Rate	6.00	6.00	6.00
Reverse Repo Rate	4.75	4.75	4.75
Broad Money Growth Rate (M2)	10.20	9.40	12.00
Domestic Credit Growth Rate	15.90	13.30	15.90
Private Sector Credit Growth Rate	16.80	13.30	16.50
Public Sector Credit Growth Rate	8.60	13.30	10.90

**as of December 2018, Source: Bangladesh Bank*

Inflation Projection Slightly Decreases to 5.3% — 5.6%

Results in FY 2018 & Proposed Policy

- Current 12-months average inflation stood at 5.54% as of December 2018, in the target range of 5.4% - 5.8%.
- Central Bank projects average inflation to be 5.3% - 5.6% in June 2019.

	Actual Inflation (%)	Target Inflation (%)
2H2014	7.53	6.0 — 6.5
1H2015	7.35	6.0 — 6.5
2H2015	6.99	NA
1H2016	6.40	6.50
2H2016	6.19	6.20
1H2017	5.92	6.07
2H2017	5.52	5.80
1H2018	5.44	5.80
2H2018	5.78	5.50
1H2019	5.54	5.4 — 5.8
2H2019	NA	5.3 — 5.6

Source: Monetary Policy Statement, Jan 2019

Analyst Notes

12 month-average inflation continued its declining trend and within the targets, driven by falling food inflation, resulting in lower inflation target from the previous monetary policy report. BB, however, emphasized on edging core inflation on which it has greater control. We also did not see anything about inflationary risks pertaining to an expected gas price hike by the government and the implication of currency depreciation. More than 70% respondents participating in the BB Inflation expectation survey anticipated above 6.0% inflation. As such, we think that there is a high probability of the central bank missing out its inflation target. Any major external or domestic shock will further our conviction.

Breakdown of Inflation (12-Month Average)	Actual Inflation (%)*	Trend
General Inflation	5.54	Downwards
Food Inflation	6.21	Downwards
Non — Food Inflation	4.51	Upwards
Core Inflation^	4.50	Upwards

**as of Dec 2018, ^excludes food, oil and commodity prices, Source: MPS*

Bangladesh Bank Assumes GDP Growth Rate between 7.5% — 8.2%

Results in FY 2018 & Proposed Policy

- Real GDP increased by 7.65% in FY 2018, mainly driven by strong remittance inflows and domestic consumption.
- Bangladesh Bank projects GDP growth to be 7.5% — 8.2% in FY19.

Analyst Notes

GDP growth rate expectation for FY 2019 is much higher than the range of 6.5% — 7.0% forecast by World Bank. If the country misses June-19 credit growth target like it did for the target of Dec-18 due to rising borrowing cost, achieving the expected GDP growth of 7.5% or above will be a big challenge.

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Private Sector Credit Growth Target is 16.5%

Results in H1FY19 & Proposed Policy

- In H1FY19, Broad money growth rate of 9.4% was below the target rate of 10.2%.
- In H1FY19, private sector credit growth rate of 13.3% was well below the target rate of 16.8%. However, credit to the public sector growth at 13.3% was stronger than the target rate of 8.6%.
- Target broad money growth rate, domestic credit growth rate, and private sector credit growth rate is set at 12.0%, 15.9%, and 16.5% respectively for H2FY19.

Sectoral Growth of Private Sector Credit	Growth Rate (%)*	Trend
Construction	20.20	Upwards
Industry	17.30	Downwards
Consumer Finance	7.50	Downwards

**as of Sep 2018 (provisional), Source: MPS*

Analyst Notes

Bangladesh Bank's directive of strict implementation and reduction of the AD ratio by 1.5%, the run-up to the National Election and restriction on market interest rate flexibility were the key reasons for missing out on the Private Sector growth target. Although two headwinds mentioned above have cleared out, AD ratio deadline is appearing in March 2019. As of September 2018, AD ratio for private banks stood at 84.4%, above the 83.5% required by BB directive. Without an extension of the AD ratio deadline further down the year, we believe Private Sector credit growth, although expected to pick up in Q1'2019, will still miss out from the target set at 16.5%.

Domestic Credit Growth has recently been supported by an uptick in Public sector borrowing growth. Assuming no change in AD ratio policy, we envision an increase in Domestic Credit growth from December 2018 level, but still short of the target set at 15.9%.

No Major Change in the Policy Rates

Results in FY 2018 & Proposed Policy

- Call money rate ranged between 2.2% to 4.2% in H1FY19.
- Lending rate declined to 9.49% in H1FY19.
- Deposit Rate increased to 5.26% H1FY19.
- Faster increase in deposit rates tightened the spread by 22 bps in H1FY19.
- Non-performing loans (NPL) edged up to 11.5% in September 2018, 70 bps higher the NPL at 10.8% in March 2018.
- Repo rate and reverse repo rate remained at 6.0% and 4.75% respectively for H2FY19.

Analyst Notes

While liquidity conditions improved from July 2018, two factors are distorting the country's interest rate environment and causing the uptick in interest rates. One is the continuous sales of National Savings Certificate to offset the fiscal deficit. The rate on NSCs at ~11.0% is much higher than deposit rates of private commercial banks. NSC sales reached 83% of annual target in just five months of FY 2019, equivalent to more than USD 2.6 billion in household savings that could have eased the liquidity scenario in the private commercial banks. BB addresses the issue of high NSC rates in the MPS but says that clearer instruction will come in H2FY19, the next MPS.

The second issue is the high NPL ratio. NPLs at around 11.5% in September 2018 contributed to 100 bps narrowing in the interest spread, according to the MPS. While BB discusses instilling strict lending and recovery discipline, the central bank does not give any specific directions regarding this issue.

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Pressure Easing off from Current Account

Results in H1FY19 & Proposed Policy

- Current account deficit moderated in H1FY19, primarily due to lower import growth (5.7% YoY till Dec 2018) and strong export and remittance growth.
- Exports registered a growth of 14.4% in H1FY19, driven by 15.7% growth in RMG sector.
- Remittances posted 8.1% growth in H1FY19.
- BB expects ~11.0% growth in remittance inflow and ~14.0% growth in exports, and import growth to moderate to ~7.5.0% in FY 2019.
- BB expects current account deficit to moderate below 2% of GDP in FY19, which was 3.6% in FY18
- BDT exchange rate depreciated by ~0.2% and REER appreciated by ~6.0% in H1FY19.
- BB sold over USD 1.1 billion during H1FY19, and another USD 0.9 billion in January 2019.

FY-19 Forecast	Forecast set in Jul-18 (%)	Actual in H1FY19	Forecast set in Jan-19 (%)
Import Growth	12.0%	5.7%	7.5%
Export Growth	8.0%	14.4%	14.0%
Remittance Growth	16.0%	8.1%	11.0%

Source: Monetary Policy Statement, Jan 2019

Analyst Notes

Tapering of one-off factors (e.g. USD ~4.0 billion of rice import in FY 2018) and favorable commodity prices resulted in the moderation of import growth in H1FY19. The base effect following the sharp increase of import in FY 2018 also played a role in the reported import growth. Over-invoicing of import to illegitimately siphon away money from the country could also have been a major issue in the pre-election period, and we expect such trends to subside in the post-election period. As these one -off events are unlikely to materialize again in FY 2019, we expect import growth to moderate in FY 2019.

The moderation in import growth and the robust export growth can help BDT to remain stable in H2FY19. As of Jan 23, 2019, foreign exchange reserve stood at USD 31.1 billion, equivalent to around 5 months of import payments. However, BB sold another ~USD 0.9 billion in the first 23 days of January 2019 alone to keep the BDT exchange rate stable. Such strategy cannot be continued for a longer term as the FX reserve is limited. Furthermore, as BB buys BDT in exchange of USD, liquidity evaporates from the money market in Bangladesh, pushing the interest rates higher. While BB addresses that increased FX flexibility will be supportive in managing external stability, BB does not describe any clear strategy regarding this issue.

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BRAC EPL Stock Brokerage Limited

Research

Ayaz Mahmud, CFA	Deputy Head of Research	ayaz.mahmud@bracepl.com	01708 805 221
Md. Sakib Chowdhury	Research Analyst	sakib.chowdhury@bracepl.com	01709 641 247
S. M. Samiuzzaman	Research Analyst	sm.samiuzzaman@bracepl.com	01708 805 224
Sadman Sakib	Research Associate	sadman.sakib@bracepl.com	01730 727 939
Ahmed Zaki Khan	Research Associate	zaki.khan@bracepl.com	01708 805 211
Md. Rafiqul Islam	Research Associate	mrafiqulislam@bracepl.com	01708 805 229

International Trade and Sales

Ahsanur Rahman Bappi	Head of International Trade & Sales	bappi@bracepl.com	01730 357 991

BRAC EPL Research
www.bracepl.com

Symphony, Plot No.: S.E.(F) – 9(3rd Floor), Road No.: 142
Gulshan Avenue, Dhaka – 1212
Phone: + (880)-2-9852446-50
Fax: + (880)-2-9852451-52
E-Mail: research@bracepl.com