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Optimistic Growth Targets Continue
Macroeconomic Report
July 31, 2019

Bangladesh Bank (BB) published the Monetary Policy Statement (MPS) for the first half of FY20 on 31 July 2019. The inflation and GDP growth target remain in a similar range. Private sector growth target has been lowered to a more realistic level after significant deviation from target has been noted in FY 2019 while public sector credit growth target has been set very high. The policy rates will remain unchanged. BB is working with IMF SARTTAC for adopting a policy interest rate focused monetary policy regime instead of the current one which is based on Money Supply (M2) target.

Monetary Policy Statement for 1H FY2019-20: Key Figures

Figures in Percentage	Targets for FY 2019	Actual in FY 2019*	Targets for 1H FY2020
GDP Growth Rate	7.5 — 8.2	8.13	8.20
Inflation	5.3 — 5.6	5.47	5.50
Repo Rate	6.00	6.00	6.00
Reverse Repo Rate	4.75	4.75	4.75
Broad Money Growth Rate	12.00	9.88	11.30
Domestic Credit Growth Rate	15.90	12.30	14.50
Private Sector Credit Growth Rate	16.50	11.29	13.20
Public Sector Credit Growth Rate	10.90	21.10	25.20

**as of Jun 2019, Source: Bangladesh Bank, MPS*

Inflation Projection Slightly Decreases to 5.50%

Results in FY 2019 & Proposed Policy

- Current 12-months average inflation stood at 5.47% as of June 2019, below the target ceiling of 5.60%.
- Central Bank projects average inflation to be below 5.50% for Jul-Dec 2019.

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	NA	5.50

Source: Monetary Policy Statement, Jul 2019

Analyst Notes

Sor far, stable commodity prices and weak food inflation has worked in BB's favor. Global commodity prices are expected to be stable in FY 2020. But the non-food inflation is expected to be negatively impacted by domestic fuel gas price hike. The new VAT law may also have an inflationary pressure as retailers will want to pass the VAT to the consumers. Moreover, monsoon flood has already damaged crops at the beginning of FY 2020 and prolongation of such a situation can force higher food inflation. Combined with the possibility of further depreciation of BDT, the risk of missing the inflation target set by BB is high.

Breakdown of Inflation	Actual Inflation (%)*	Trend
General Inflation	5.47	Upwards
Food Inflation	5.48	Downwards
Non — Food Inflation	5.47	Upwards
Core Inflation^	5.48	Upwards

**as of Jun 2019, ^excludes food, oil and commodity prices, Source: MPS*

Bangladesh Bank Assumes Real GDP Growth Rate of 8.20%

Results in FY 2019 & Proposed Policy

- Real GDP increased by 8.13% in FY 2019, mainly driven by high public sector investment and strong domestic demand & export.
- Bangladesh Bank projects GDP growth to be 8.20% in FY 2020.

Analyst Notes

BB's projection of GDP growth rate for FY 2020 is 80 bps higher than that of World Bank. Continued high public sector credit growth and domestic demand will facilitate in attaining the GDP target. But a possibility of no-deal Brexit resulting in lower export to UK combined with a low private sector credit growth may ultimately result in a lower GDP growth rate than the projection given by BB.

Private Sector credit growth subdued while Public sector growth remains robust

Results in FY 2019 & Proposed Policy

- In FY 2019, broad money growth rate of 9.9% was below the target rate of 12.0%. This came short of the target in the previous two MPS reports as well.
- In FY 2019, private sector credit growth of 11.3% was lowest in the last 6 years and came way below its target of 16.5%. Public sector credit growth came at 21.1% (up from 13.4%) and far exceeds the target of 10.9%.
- Domestic credit growth — a combination of private and public sector credit growth, came below the target (12.3% against 15.9%), mostly impacted by weak private sector credit — which is ~7 times bigger than public sector credit.
- Target for private sector credit growth in H1 FY 2020 is increased from the actual level to 13.2%, but lower than the previous target. Public and domestic credit growth targets came at 25.2% and 14.5% respectively.
- Target for broad money growth is set at 11.3%, lower than the target for FY 2019 at 12.0%.

Analyst Notes

The liquidity condition in private banks has worsened, which is further amplified by a sharp increase in public sector borrowing crowding out private sector credit. BB has not given any explicit reason of low private sector growth, but continues to project a rather optimistic private sector credit growth (13.2% as mentioned). The central bank, however, has ushered optimism about the liquidity condition owing to the government's recent policies of tightening NSC sales to the general public.

The public sector credit growth has been robust in H2 FY 2019, owing to a strong uptick in ADP spending. In our opinion, the central bank is forecasting a very high public sector credit growth going forward. Should this happen, it will crowd out private sector credit growth but help banks earn higher treasury yield income for their investment portfolio.

The broad money target is based on the central bank's inflationary targets. The target has remained rather stable as inflation rates have not been very volatile in recent times.

Policy rates remain unchanged while liquidity condition deteriorates

Results in FY 2019 & Proposed Policy

- Central bank's policy rate (Repo 6% & Reverse-repo 4.75%), banks' CRR (5.5%) and SLR (18.5%) will remain same.
- Call money rate continued to creep up and settled at 4.6% from ~ 4.0% in H1 FY 2019.
- Excess of liquid assets (above of CRR and SLR) — a proxy for liquidity condition in the banking sector — has continued to deplete and remains low, especially for the Private Commercial Banks, while this remains strong for State Commercial Banks, although showing a slight downward trend.

Analyst Notes

Call money market has remained illiquid for sometime as this rate has remained below the repo—reverse repo rates offered by the central bank. But the call money rate is finally catching up with the rates offered by the central bank owing to tighter liquidity conditions.

The central bank has termed the slight deterioration of spread as efficiency gain and further added that lower spread can be further achieved by lower lending rates and higher deposit rates. The central bank seems to have avoided the impact of rising NPL on loan–deposit spreads.

The central bank is optimistic about liquidity condition as the need to intervene the USD FX market waned and increased compliance requirements to buy National Savings Certificate (NSC) have been introduced.

Stability in the FX is expected despite acknowledgement of an overvalued currency by the central bank

Results in FY 2019 & Proposed Policy

- Current account deficit shrunk to 1.8% of GDP in FY 2019, primarily due to ~15.0% improvement in the trade balance.
- Remittances posted ~9.6% growth in FY 2019.
- BB expects ~12.0% growth in remittance inflow and ~1.5% improvement in the trade balance in FY 2020.
- BDT exchange rate depreciated by ~0.9% in FY 2019.
- BB expects foreign exchange rate volatilities to subside.

Analyst Notes

According to BB, de-growth in import has been attributed to a slowdown in government's megaproject needs and rice imports. The central bank has increased its FY 2020 target for public sector credit growth from actual credit growth in FY 2019 and if this were to materialize, we think that there is a higher chance of increased pressure on import growth. On the positive side, export growth has strongly picked up this fiscal year and we attribute much of this to ongoing global trade conflicts.

The central bank has explicitly admitted that the currency is overvalued. On the other hand, the central bank mentioned about stability in the FX market, going forward. MPS mentioned that banks are no longer asking for BB intervention to provide US dollar.

Central Bank indicated revamp in the way it conducts monetary policy

One key highlight of this Monetary Policy Statement is that the central bank is proceeding to change its monetary policy tool from Money Supply (M2) target regime to one based on the policy interest rate. Unlike many central banks in the developed world, the primary tool Bangladesh Bank uses to conduct its monetary policy operation is the M2 target. The central bank said that it is currently working with IMF SARTTAC to adopt this change. It appears that the central bank wants to tighten its grip on monetary policy.

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