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Macro Economic Report
July 18, 2024

Monetary Policy Statement H1'FY24-25

More Tightening Amid Heightening Concerns

Monetary Policy Statement (MPS) H1'FY2024-25: Key Figures

Figures in Percentage	FY23	FY H1'24 Review (Jul'23 to Dec'23)		FY H2'24 Review (Jan'24 to Jun'24)		FY H1'25 (Jul'24 to Dec'24)	FY H2'25 (Jan'25 to Jun'25)
	Actual	Target	Actual	Target	Actual	Target	Target
GDP Growth Rate	5.78	n/a	n/a	6.50	5.82 P	n/a	6.75
Inflation	9.02	n/a	9.48	7.50	9.73	n/a	6.50
CRR	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Policy Rate (Repo Rate)	6.00	6.50	7.75	8.00	8.50	8.50	n/a
SDF (Reverse Repo Rate)	4.25	4.50	5.75	6.50	7.00	7.00	n/a
Bank Rate	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Reserve Money Growth Rate	10.50	0.00	-2.00	-1.00	7.90 P	2.00	1.00
Broad Money Growth Rate	10.50	9.50	8.60	9.70	8.20 P	8.20	8.40
Domestic Credit Growth Rate	15.30	15.90	11.60	13.90	10.50 P	10.70	11.60
Private Sector Credit Growth Rate	10.60	10.90	10.10	10.00	9.80 P	9.80	9.80
Public Sector Credit Growth Rate	35.80	37.90	17.90	27.80	12.80 P	14.20	17.80
Net Foreign Assets Growth	-23.40	-16.80	-21.80	-2.40	-17.00 P	2.30	17.80
Net Domestic Assets Growth	21.30	15.90	16.00	12.20	14.10 P	9.30	6.80

Source: Bangladesh Bank, MPS
Note: Inflation is based on a12-month average. Source Chart: 16, MPS H2'FY24
FY23 GDP growth rate from IMF; FY24 growth rate taken from MPS
P denotes provisional estimate; A denotes latest figure as of now

Bangladesh Bank (BB) has announced the MPS for H1'FY 2025, further enhancing contractionary stance to tackle economic challenges. In this MPS, BB has kept the current policy rate (8.50%), Interest Rate Corridor (± 150 bps), and the crawling peg mid-point (BDT 117.0) unchanged. The inflation target has been revised downward to 6.50%, while broad money and credit growth targets have been kept in line with the FY24 provisional outcome. BB anticipates favourable results from the recently liberalized FX policy initiatives, resulting in more inflows from FDI & remittances, which would aid stabilization of exchange rate and further FX reserve buildup. Alongside, a number of policy initiatives are outlined to improve overall financials system, some of which would be rolling out within H1FY25.

Policy Rate and Interest Rate Corridor Unchanged

Downward Revision in Inflation Target

Crawling Peg Mid Rate Unchanged

FX Policy Liberalization Initiatives

Upholding Vigilence through Hawkish Approach

Since January 2024, BB has maintained its contractionary monetary policy stance and introduced three key reforms: introduced crawling peg for exchange rate, liberalized Foreign Exchange (FX) policies (Offshore Banking, RFCD, and NFCD), and reverted to market-driven interest rate mechanism (abandoning the SMART). However, BB's H2'FY24 achievement in key "money supply" objectives were overshadowed by persistent inflation. In local front, broad money supply (M2) and private sector credit growth rates moderated, while BB's continued foreign currency sales resulted in an uptick in reserve money (M0) growth. On top, BB emerged as the key liquidity supplier in the money market amidst the tightening measures which includes absorbing liquidity from the system.

From a holistic view, In H1'FY25 MPS, it appears BB is putting FX liquidity as primary target, while still depending on its policy tools to cool off inflation by tightening both price and quantum of money. BB is moving ahead with more constrictions in the policy framework, keeping policy rate and other tools at present elevated levels, lowering Open market Operation (OMO) activity and proceeding with a number of policy initiatives. It expects the tightened stance to aid inflation cooling, amid anticipations of a global macro improvement. Also, we observe BB's strong optimism on FX situation improvement, largely betting on FDI & remittance improvement from more liberal policies. Meanwhile, BB's reform agendas were well in line with meeting IMF requirements for continuing the supports.

However, considering the lack of integration amid policy rate and other components of the monetary policy, we are sceptical as to the achievement of the targets. Rather, as inflation is largely cost push, we expect further slowdown to economy, particularly considering crowding out effect still lingering through H1FY25.

Click here to access
H1'FY25 MPS

We expect another high inflation scenario ahead with interest rates staying largely at present elevated levels amid weaker credit growth. In our view, BB's optimism on FX scenario improvement is ambitious, and if import liberation is implemented, we may rather observe continuation of tight FX situation ahead. However, on FX reserve front, we expect BB to meet IMF's targets, considering the expected supports from DFIs ahead.

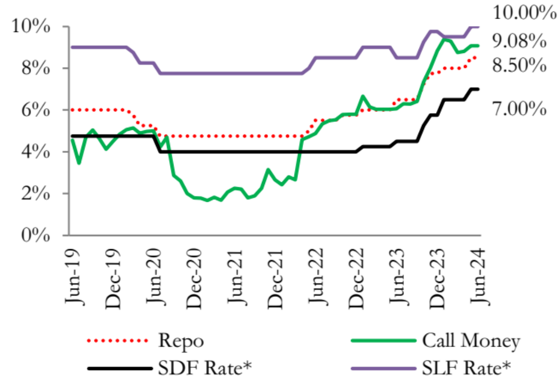
POLICY RATE: KEEP SAME, SIGNALING EASING

Corridor Set within 7%-10%, Policy Rate Unchanged: The policy (Repo) rate remains at 8.50%, unchanged from previous settings on May 08, 2024. BB aims to provide stability in the financial system while addressing inflationary pressures. Standing Deposit Facility (SDF) has been kept at 7% to encourage more deposit with BB and improving liquidity in the banking system. Whereas the 10% Standing Lending Facility (SLF) is aimed to offer predictable cost for managing short term liquidity needs by banks.

- Steadiness in IRC is intended to numb volatility in the rate environment, having the twin goal of setting inflationary expectations and offer a predictable environment for financial planning.
- Wider corridor (3%) is intended to allow more participatory actions in the interbank market, allowing better liquidity transmission among the banks.

Open Market Operations (OMO) Get Streamlined: BB is continuing quantitative tightening by streamlining Open Market Operations (OMOs). It already has reduced repo auction to twice a week from daily auctions since July 2024. This is expected to be made once a week going ahead, alongside an overnight OMO for adjusting end of reserve maintenance period as needed.

Chart 15: Movement of Call Money and Policy Rates



Source: Bangladesh Bank, * Before 01July 2023, SDF was Reverse Repo and SLF was Special Repo .

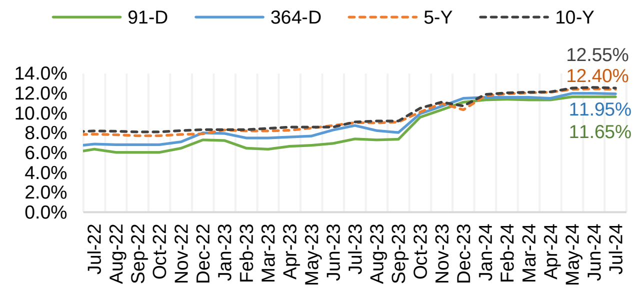
Analyst Comment:

- The decision to keep the policy (Repo) rate at 8.50%, along with stable SDF and SLF rates, reflects BB's commitment to a cautious tight monetary policy stance.
- By providing a predictable interest rate environment, this strategy is likely to enhance market stability and investor confidence.

INTEREST RATE ENVIRONMENT: SMART OUT, MARKET IS IN THE PLAY

SMART + Margin Abolished: The SMART (Six-months moving average rate of Treasury bill) anchored lending rate was removed in early May which was previously implemented in July 2023.

Cut-off Yields of T-Bills & T-Bonds



Source: BB

Implementation Market Based Interest Rate: Per the new policy, BB would allow the interest rates to reflect market dynamics and demand-supply functions. Hence, the scheduled banks are to set interest rates by themselves.

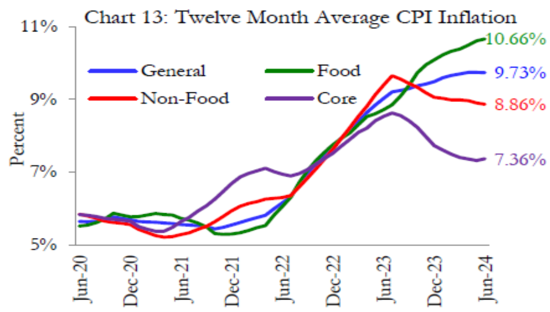
Analyst Comment:

- Market driven rates allow banks to finally price assets according to risk. The unchanged policy rate allows a temporary pause in rate hike, limiting default scopes further to some extent.
- However, high-rate environment is expected to dampen credit growth by hurting both investment and consumption demand.
- While higher rates encourage more deposit flow into the system, having treasury rates substantially above the prevailing deposit rates are going to offset the potentials.

INFLATION: PRESSURES PERSIST DESPITE MONETARY POLICY INTERVENTIONS

6.5% Is a Challenging Target: In line with FY25 Budget, the Bangladesh Bank has set a 6.5% inflation goal for June 2025. However, this appears less likely considering the 12-month average inflation is currently at a 12-year high of 9.73% (as of June 2024).

We have seen the past efforts to curb inflation remain largely ineffective, and relying on the same set of tools, effectively halving inflation by 12M appears an ambitious target. In our opinion, while increased rates, ceased currency swaps with banks and a pause in money printing for GoB spending may aid inflationary slowdown, import expansive ambitions and GoB hunger for finance may derail this from the target, alongside the risk of further external shocks.



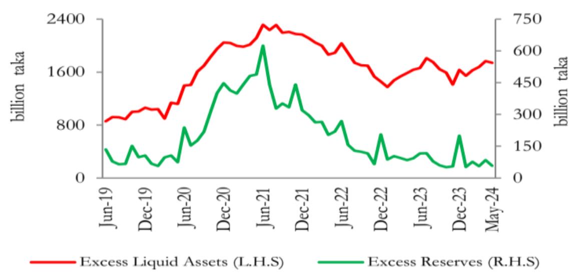
Source: Bangladesh Bureau of Statistics (BBS)

Analyst Comments: The cost push nature of domestic inflation, coupled with factors like rigid pricing, market inefficiencies, and a depreciating currency keeps us skeptical as to BB's target. While continuation of contractionary stance may soften inflationary pressures a bit, we believe additional positive developments would be needed for a meaningful decline in inflation within FY25.

LIQUIDITY: CHALLENGES TO REMAIN

Liquidity Stays Tight: Liquidity situation has improved since February 2024 due to the central bank's initiatives, including reducing USD sales, increasing repo allotments, and implementing dollar-taka swaps. However, BB is planning to cease SWAPS as an inflation combating step, while stopping money printing to cater GoB need. This may prompt public credit to surge from the banking sector, bringing liquidity pressures back. Under current macroeconomic situation, we do not foresee substantial changes to liquidity scenario. However, the revived interbank market would aid to reduce volatility a bit.

Chart 14: Movement of Excess Liquid Assets



Source: Bangladesh Bank

Broad Money is Again Off Targets: Broad Money (M2) growth registered at 8.2% YoY in H2FY24, falling short of the projected 9.7%. This shortfall was primarily driven by a significant decline in net foreign assets (NFA), contracting by 17.0% YoY, surpassing the projected 2.4% contraction. Tight liquidity prompted the call money rate (9.08% on Jun 2024) to surpass the repo rate.

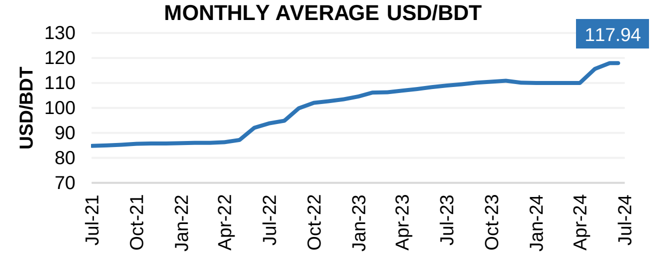
BB has maintained its liquidity support facilities to ease liquidity pressures, with steps including -

- Continued offering of repo facilities, assured liquidity support (ALS), and special repo facilities to conventional banks and NBFIs.
- Continued Mudarabah Liquidity Support (MLS) and Islamic Banks Liquidity Facility (IBLF) specifically for Shariah-based Islamic banks.
- Offered refinance and pre-finance facilities to banks for agriculture and CMSMEs sectors, aiming to enhance liquidity in pivotal sectors crucial for economic growth.

EXCHANGE RATE: CRAWLING AHEAD?

The Crawling Peg Era Is On: BB adopted a crawling peg exchange rate system as an interim measure before transitioning to a fully flexible exchange rate system on May 08, 2024**.** At initiation**,** BB decided to keep the crawling peg mid-rate at BDT 117.0 per USD, allowing in a 5.98% depreciation from 110 BDT/USD, resulting in a total 8.17% depreciation in FY24. The exchange rate has largely remained unchanged so far, with BB continuing BDT 117 as midpoint for H1FY25.

MONTHLY AVERAGE USD/BDT



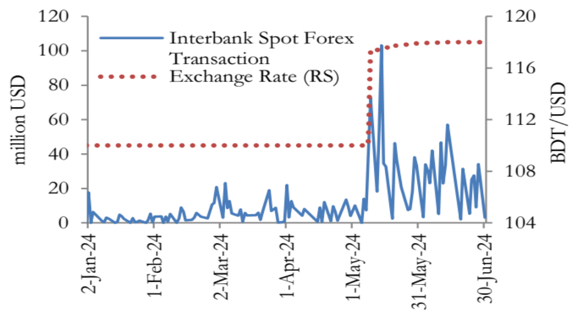
Source: BB

BB Is Still In Charge: Within FY24, BB sold around USD 9.42 Bn (net), and we expect BB to continue stepping into FX market occasionally ahead. Besides, BB enhanced import liberalization by eliminating LC margin requirements for all products except luxury goods, with margins determined by bank-customer relationships. As such, we believe BB would still retain fair amount of control in the crawling peg system.

Data Error Throws BDT Off-track: Beginning July FY25, information of a substantial USD 10 Bn over reported exports and possible multiyear errors in national export statistics have caused concerns on overall macro situation, and as such we are observing some volatility in BDT very recently. [1]

Analyst Comment:

Since crawling peg involves BB authority on setting midpoint, we are concerned that BB may stay sticky on protecting BDT's value, and thus affect overall efficacy of the policy as similar happened within 2021-2022. In such a case, this approach risks market distortions and potential overreliance on central bank interventions, which could strain foreign reserves.



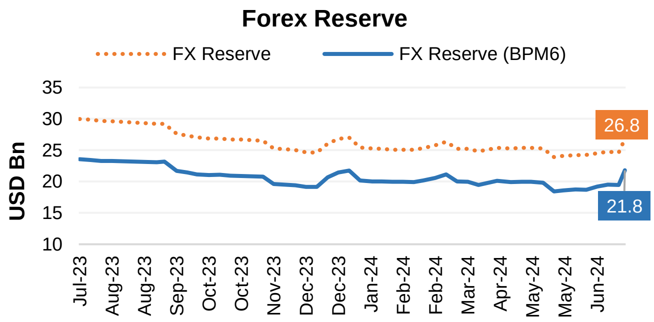
Source: Bangladesh Bank

[1] https://www.tbsnews.net/economy/how-10b-export-data-error-throws-economic-assessment-891201

FX RESERVE: A VAGUE PLAN TO BUILD UP RESERVE

BB Optimistic of FX Liberalization Policies

- Following budget supports from multilateral financiers (MFIs) and IMF instalment in Jun'24, Bangladesh successfully managed to meet the Jun'24 Net International Reserve (NIR) criteria. The FX Reserve (BPM6) stood at USD 21.8 Bn in FY24, covering ~4.1 months of import.
- Within H2FY24, BB initiated several liberalization initiatives in FX policies, notably allowing banks to open FX deposit accounts (RFCD, NFCD), and introduced further liberalization in the Offshore Banking Act 2024.



Source: BB

- BB expects a more stabilized BoP situation ahead, as it expects a better exchange rate scenario with improving trade situation, remittance & FDI growth, and MFI supports.
- While BB did not provide the projected FX reserve for Dec'24 or Jun'24, the regulator projects a 17.8% YoY growth in Net Foreign Assets (NFA) by Jun'24.

Analyst Comments:

- For FY24, mobilization of budget supports from MFIs shored up the FX reserve. However, BB is yet to provide concrete plan to bolster FX reserve for FY25.
- We are anticipating trade situation to stay weak over export degrowth and potential uptick in imports from liberalized LC margins. Remittance may not experience as strong inflow as BB is expecting.
- GoB debt servicing would create a sizable demand for USD, which could limit BB's capacity to supply USD on demand.
- For Jun'25, IMF's revised condition requires Bangladesh to keep net international reserve (NIR) of USD 19.5 Bn.

BROAD MONEY TARGETS AND CREDIT SCENARIO

Broad Money Growth Missed Target

In H2FY24, broad money growth (+8.2% YoY) came short of the projection, however modest. The subdued growth in M2 was driven by a substantial de-growth in NFA (-17.0% YoY), understandably attributed to the restated BoP situation. Additionally, the reserve money growth took a slight uptick (+7.9% YoY) as Net domestic Asset (NDA) growth partially countered the substantial negative NFA growth.

Going forward, broad money growth is kept at 8.2% for Dec'24, while the reserve money growth is projected to be at 2.0%. The NFA is projected to grow at 2.3% by Dec'24 & a significant 17.8% growth by Jun'25, anticipating on moderate export growth and aids from development partners.

Domestic Credit Scene Tightened

On the Domestic credit scene, actual public credit growth was 12.8% against projected 27.8%, explained by the selective credit demand for GoB. On the other hand, private credit growth (+9.8% YoY) remained in line with BB expectations on the face of increasing borrowing cost. Collectively, domestic credit grew 10.5% in Jun'24.

In FY25, BB projects private credit growth to remain at 9.8% anticipating dampening demand on the face of increasing lending rates. Considering the budgetary target of borrowing BDT 1.37 Tn from the banking system, the public sector credit demand is projected to grow with slight uptick at 14.2% by Dec'24 & 17.8% by Jun'25. Considering both, domestic credit projected to grow at 10.7% & 11.6% by Dec'24 & Jun'25 respectively.

Analyst Comment:

- With available funds flowing to cater GoB borrowings, the overall interest rate may remain at current level.
- Import liberalization would create additional credit demand from the private sectors, which could further strain the liquidity of the banks, and might create upward pressure on the lending rates.

BALANCE OF PAYMENTS

Diverging from the previous trend, BB refrained from providing forecast on the external sector in this H1'FY25 MPS. Following the recent revision of export data, BB reported the Current Account (CA) deficit at USD 5.98 Bn in 11MFY24 (11MFY23: USD 12.02 Bn), while Financial Account (FA) showed a surplus of USD 2.08 Bn ((11MFY23: USD 5.52 Bn surplus). Subsequently, the overall BoP balance stood at USD 5.88 Bn deficit during 11MFY24, an improvement compared to USD 8.80 Bn deficit during the previous year.

BB projects the overall BoP position would stabilize following exchange rate realignment and implementation of ongoing contractionary monetary and fiscal policies. BB's projection hinges on better remittance inflows, FX rate-driven trade deficit reduction, improved repatriation of export proceeds, and a rise in foreign assistance inflows. However, BB also acknowledges that - 1) the repayment pressure on FA coming from the GoB's foreign debt and 2) elevated geopolitical risks could hamper export demand and increase global food and energy prices.

Figures in USD Mn

	Actual FY22	Actual FY23	Outlook FY24	Actual 11MFY23	Actual 11MFY24
Trade Deficit	33,250	20,901	10,197	20,200 *	26,200 *
Remittance	21,032	21,611	22,043	21,611^	23,915 ^
Current Account Deficit	18,196	2,665	332	12,020 *	5,980 *
Current Account Deficit as % of GDP	4.0%	0.6%	0.1%	0.2%	0.1%
Financial & Capital Accounts Balance	17,301	-1,603	350	5,520 **	2,080 **
Gross International Reserve (GIR)	41,827	31,203	29,000	31,203 ^	26,815 ^

Source: Bangladesh Bank and MPS H2'FY24
** denotes figures revised for the export data mismatches*
*** denotes Financial Account balance only, excludes Capital Account figures.*
^ denotes FY-end figures
Note: GDP figures taken from IMF

OTHER UPCOMING CHANGES TO THE SYSTEM

Policy Driven Governance Improvement Effort: BB cites a number of initiatives to improve the governance level of the overall financial system, a much highlighted topic over last few years. Key steps include:

- Upgrading the legal framework: The enactment of the Bank Company (Amendment) Act 2023 and the Finance Company Act 2023 will add to better governance initiatives.
- Broader guidelines on Board of Directors, Independent Directors, MD and CEO qualification, roles and bringing the process under BB's watch would help for improving governance a bit.

Systematic Risk Management:

- BB is to deploy RBS (Risk Based Supervision) by 2025, part of which is anticipated within FY25. Phase I of the project is already complete with 3 banks, and BB plans to add 20 more banks under Phase II. Once live, this is expected to raise stress management capabilities within the sector.
- The Prompt Corrective Action (PCA) framework will be effective from 31 March 2025, as a pivotal tool for early detection and rectification of banking issues. This framework would have guideline for mergers & amalgamations.

NPL Management:

By 2026, BB aims to reduce NPL ratios for state-owned commercial banks (SOCBs) by 10% and private commercial banks (PCBs) by 5%, targeting an overall gross NPL ratio of 8%. This ambitious goal is planned to be executed via phase-wise legislative tightening, revising loan write off policies, introducing ADR channels for faster dispute resolution and finally an upcoming private AMC to mop up & manage non-performing assets. The notable plans include:

- Effective 30 September 2024, reducing the grace period for overdue fixed-term loans from six to three months.
- Starting 31 March 2025, any unpaid installment will be considered past due immediately after its due date.

Financial Inclusion & Cashless Society:

E-money regulations and Bangla QR user guidelines are underway, while the draft “escrow model” is supposed to add better security to e-transactions.

Exchange Rate and Reserve Management:

Relying on interventive approach under crawling peg mechanism, BB aims to add further stability in FX rates. The targeted anchor of BDT 117 is to be reviewed periodically to align with market situation.

- The big bet on reserve improvement is stemming from a lower volatility in BDT pricing post crawling peg introduction, and liberalization initiatives in foreign exchange policy.
- BB will keep crawling peg midpoint at BDT 117.0 per USD. In addition, it plans to remove hard margin requirements, and add margin requirements based on bank-client relationship to aid import growth.

Open market operation (OMO) streamlining:

- Repo auctions has been lowered to twice a week from daily auctions, since July 2024. This is expected to be made once a week going ahead, alongside an overnight OMO for adjusting end of reserve maintenance period as needed.

As highlighted in our previous MPS updates, a number of these updates are stemming from ongoing IMF engagement and associated terms. We expect a number of these actions are to be actualized to meet IMF loan milestones, however, considering the depth of issues across the current financial system, implementing a number of these would face delays amid prevailing challenges.

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