Bangladesh Bank moving towards a Contractionary Monetary Policy

MPS H1'FY-24 Highlights

"In an effort to combat inflation as well as to stabilize the Forex market aligning with the IMF conditions"

GREEN DELTA DRAGON
Asset Management Company Limited

Moving Towards a Contractionary Monetary Policy Stance

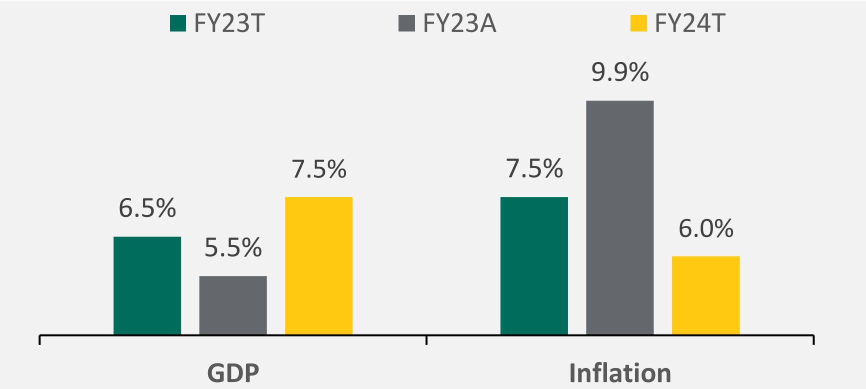
Bangladesh Bank (BB) has shifted from a monetary targeting framework to an interest rate targeting framework and moving towards a contractionary monetary policy stance.

To curb the inflation through dampening the aggregate demand in the economy while continuing the supply-side interventions, BB has adopted a contractionary monetary policy stance.

- BB has raised the policy rate (Repo Rate) by 50 bps to 6.5%, keeping a ±200 bps of Interest Rate Corridor (IRC).
- Standing Deposit Facility (SDF), previously known as reverse repo rate, has been raised by 25 bps to 4.5%.
- The era of lending rate cap has finally come to an end as BB introduced a new market-driven interest rate called SMART (Short-Term Moving Average Rate), which will be effective from July 1, 2023.
- Target of both broad and reserve growth has been reduced in a move to control money supply that will eventually cut the consumer spending.
- Domestic credit growth is projected to reach 16.9% at the end of H1'FY24 driven by the public sector credit growth while private sector credit growth will see lower growth in FY24.

To stabilize the forex market, a unified and market-driven single exchange rate will be adopted.

BB will commence to calculate and publish Gross International Reserves (GIR) in line with the sixth edition of the IMF's BPM6, complying with the IMF conditions.

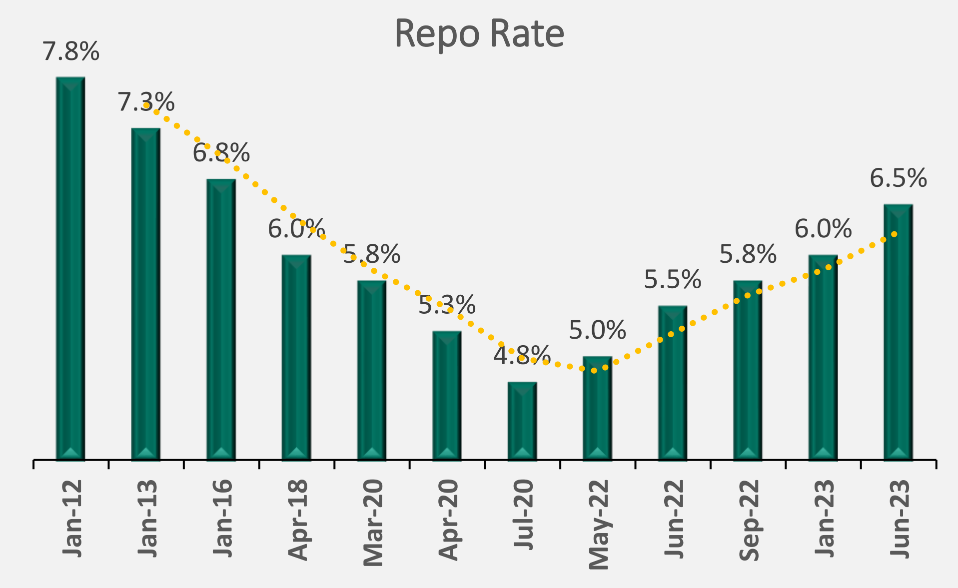


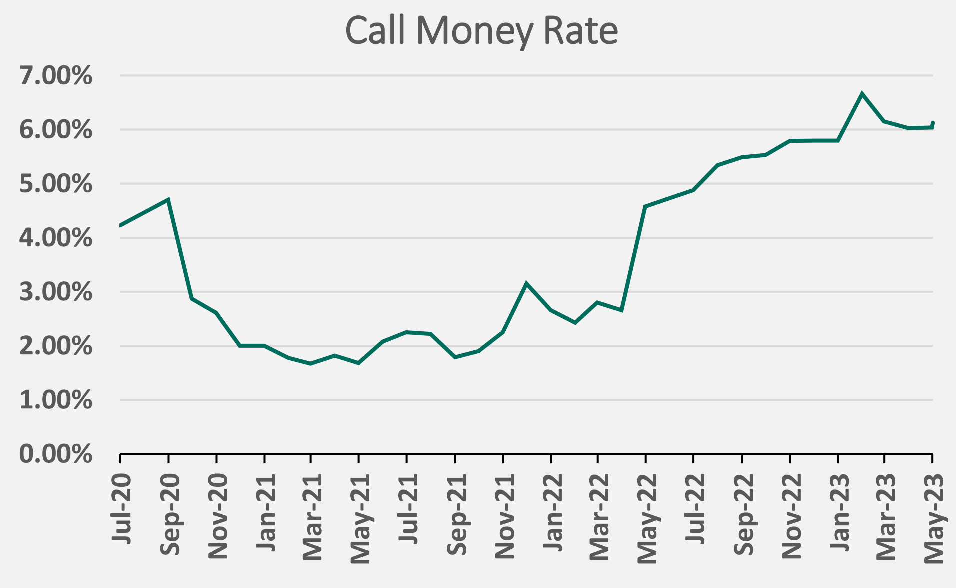
Key Changes	FY22A	H1'23A	H2'23E	H1'24P	H2'24P
Broad Money Growth	9.4%	8.5%	10.5%	9.5%	10.0%
Reserve Money Growth	-0.3%	17.4%	10.0%	0.0%	6.0%
Money Multiplier	4.9	4.6	5.0	5.1	5.1
Private Credit Growth	13.7%	12.9%	11.0%	10.9%	11.0%
Public Credit Growth	29.1%	27.6%	40.0%	43.0%	30.0%
Domestic Credit Growth	16.2%	15.1%	16.4%	16.9%	15.3%

A= Actual, E= Estimated, P= Programmed, T= Target H1= July-December, H2= January-June

Introduction of Policy Interest Rate Corridor

A symmetric Interest Rate Corridor (IRC) of ±200 bps centered on the policy rate has been introduced aiming to keep the interbank call money rate near the policy rate.





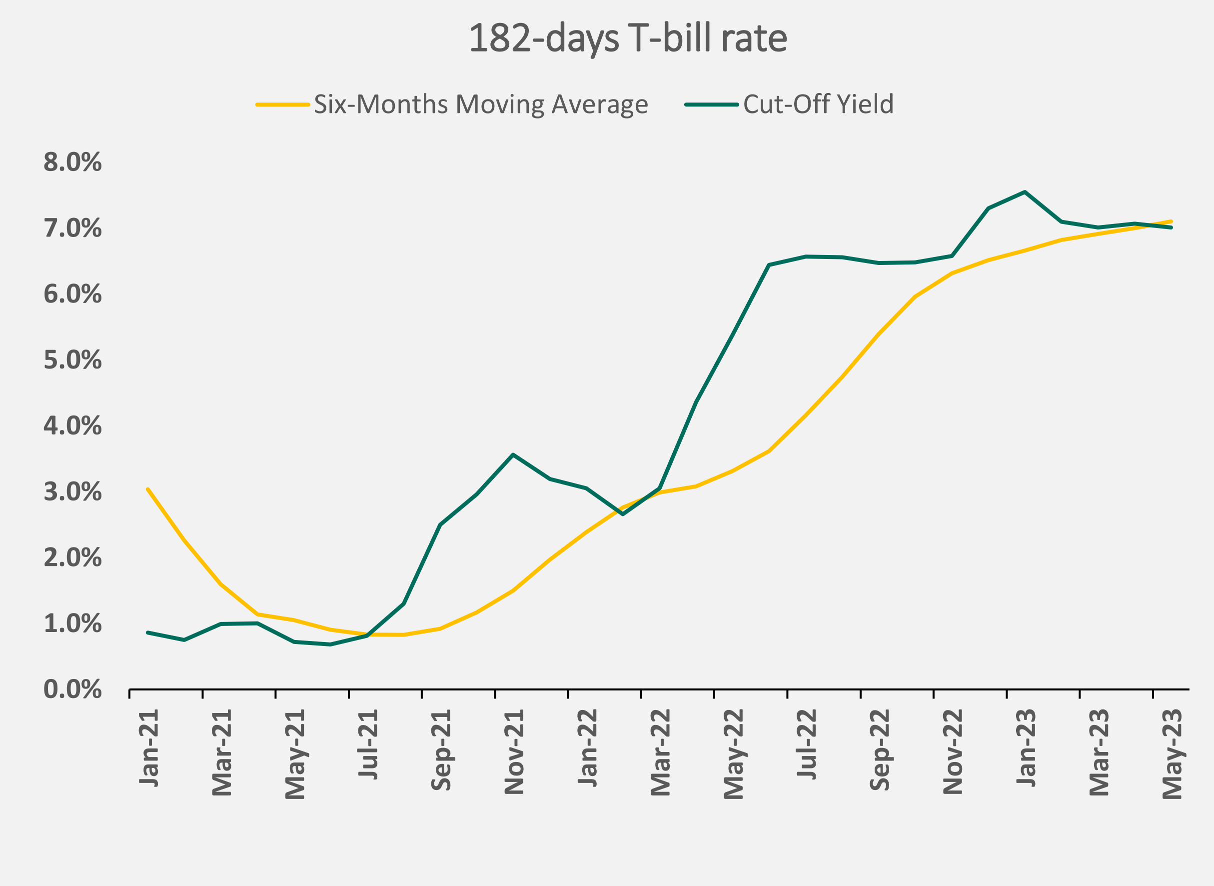
- Policy Rate (Repo Rate) has been raised by 50 bps to 6.5% with a symmetric corridor consisting of a standing lending facility (SLF) rate at 8.5% (upper limit) and a standing deposit facility (SDF) rate at 4.5% (lower limit).
- The objective of introducing the policy interest rate corridor is to ensure that the short-term interbank call money rate remains around the long-term policy rate.
- The call money rate will be at 6.5% ± 200 bps, effective from July 01, 2023.

Effectiveness of the policy rate mostly depends on the movement of market reference rate without any simulated intervention.

Source: Bangladesh Bank, GDDA Research

Introduction of Market-Based Reference Rate

Lending rate cap to be lifted and a new reference lending rate called SMART (Short-Term Moving Average Rate) will be introduced effective July 1, 2023. SMART to be based on 6-month average 182-days T-bill rate.



- ***Banks can lend at SMART + 3.0% margin.***
- NBFIs can lend at SMART + 5.0% margin.
- Additional maximum 1.0% supervision cost for CMSME and consumer loans.
- No changes in credit card interest rates.

7.3%
6-month moving-average 182-days T-bill rate in May 2023

+3.0% Margin Banks	+5.0% Margin NBFIs
10.3% **New lending rate till date**	**12.3%** **New lending rate till date**

Note: Auction of BDT 25.0 bn of 182-days T-bill will be held on June 25, 2023, hence, the lending rate may change.

Any intervention by BB on the yield curve movement of T-bills and T-bonds may hinder the establishment of market reference rate.

Source: Bangladesh Bank, GDDA Research

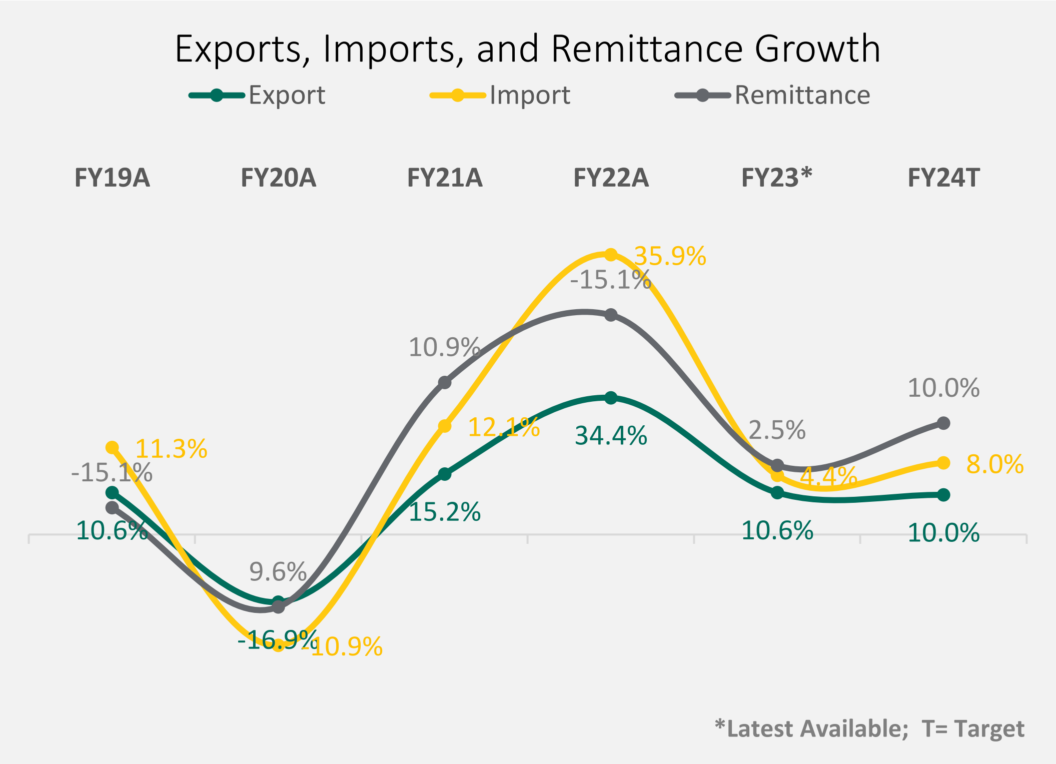
Unified Exchange Rate to Support the Forex Reserve

To stabilize the forex market, a unified and market-driven single exchange rate will be adopted and any specific rates for buying or selling foreign currencies will no longer be quoted.

- The unified market-driven exchange rate system will be effective from July 01, 2023, aligning with the international standards.
- BB will no longer quote specific rates for buying or selling foreign currencies rather will buy and sell on the prevailing interbank rate.
- BB expects that this removal will help to stabilize the forex market as well as to ease pressure on the forex reserve of the country.
- The single exchange rate will reduce the gap between the formal and informal channels, which will eventually increase the remittance.

In order to increase the inward remittance, BB's measures-

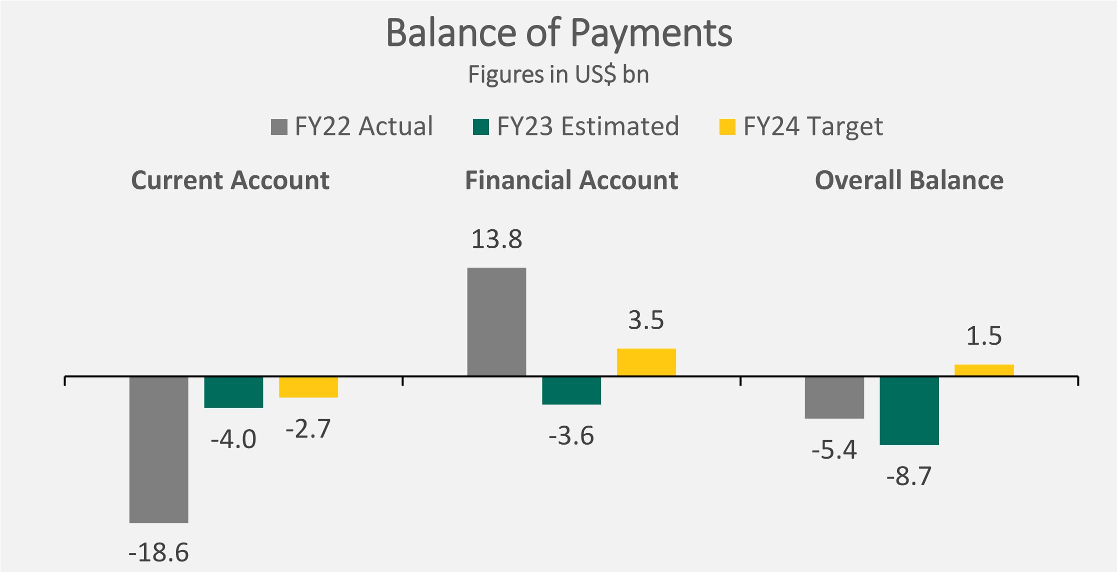
- BB relaxed the documentation requirements on remittance amounts exceeding US$ 5,000.
- Furthermore, exemption of fees for remittance, increase NFCD rate, waiver of limit on internet banking, promotion of MFS for transfer, and adopting a unified market-driven exchange rate will increase the inflow of remittance.
- Bangladeshi nationals living abroad will be able to send foreign currency/ remittance very easily and directly to their own bank accounts maintained in Bangladesh or to their nominated person's / relative's bank accounts in Bangladesh.

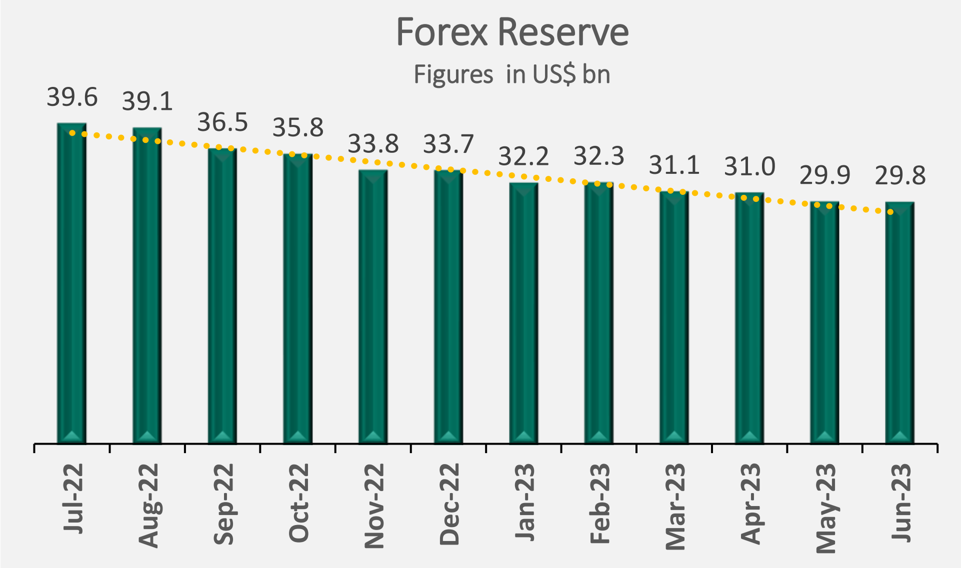


Source: Bangladesh Bank, GDDA Research

New Method of Calculating Gross Forex Reserve

Gross forex reserve will be calculated following the IMF BPM6.





- BB will start to calculate and publish Gross International Reserves (GIR) from July 2023 in line with the sixth edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6) while keeping track of current practices of calculating and reporting total foreign assets.
- However, BB has not followed the IMF's recommendation to calculate and publish the net forex reserve from this July, raising the concern about the transparency of Bangladesh's international reserve.
- The financial account experienced highest ever deficit of US$2.2 bn in the first ten months of FY23 the deficit amount may stands at US$3.6 bn at the end of FY23, which is projected to bounce back to the positive region in FY24.

Source: Bangladesh Bank, GDDA Research

Impact of the Monetary Stances

- BB unveiled the monetary policy with several new reformations that were long awaited to battle with the ongoing economic instabilities such as declining forex reserve, skyrocketing inflation, and continuous devaluation of Bangladeshi Taka.
- The adopted monetary stances are aligned with the conditions set by the IMF while approving US$ 4.7 bn of loan packages.
- Meeting the target of GDP at 7.5% and inflation at 6.0% for the FY24 seems more challenging considering the current economic scenario where P-o-P inflation is now hovering around ~10.0% as of May 2023 and GDP is estimated to stand at 5.5% in FY23.
- Private sector credit growth target set at 11.0% for the FY24 down from 14.1% target revised for the FY23 will cause a slow down in business expansion, hence, listed companies that are highly dependent on bank borrowings for capex will be affected.
- The withdrawal of interest rate ceiling will make loans costlier that will affect the high leveraged company's earnings.
- However, companies holding a huge cash reserve (cash cow) will be benefitted from this new interest rate regime as deposit rate will be increased.
- Export-oriented businesses will see a decline in their topline margin due to the introduction of single exchange rate.
- Effectiveness of the policy rate mostly depends on the movement of market reference rate and any crucial intervention by BB on the yield curve movement of T-bills and T-bonds may have an impact on the establishment of the market reference rate.

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