Bangladesh Bank continues the Contractionary Monetary Policy

MPS H2’FY-24 Highlights

“In an effort to combat inflation as well as to stabilize the Forex market”

Continuing the Tightening Monetary Policy Stance

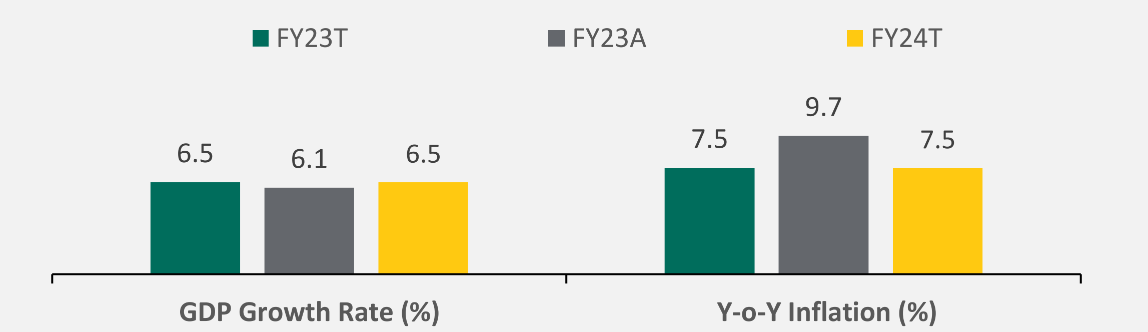
Bangladesh Bank (BB) maintained its hawkish stance through tightening monetary controls to rein in inflation while ensuring sufficient liquidity to nurture growth sectors. Additionally, the central bank emphasized the need to manage the Balance of Payments (BoP) account and foreign exchange reserve levels.

To combat the stubborn inflation through managing the aggregate demand in the economy, BB has maintained its hawkish monetary policy stance. This management will be complemented by taking strategic supply side interventions.

The policy rate (Repo Rate) has been increased by 25 bps to 8.0% while the policy rate corridor has been reduced from ± 200 bps to ± 150 bps. To stabilize the forex market, BB is also contemplating the adoption of a crawling peg system linked to a selected basket of currencies which will operate within a defined band corridor.

Key revisions in projections:

- In a move to control money supply that is expected to cut the consumer spending, target of both Broad Money (M2) and Reserve Money (RM) growth for Jun'24 has been reduced from the previous projection in H1FY24 MPS. The revised projection for M2 growth is 9.7% while the projection for RM growth is negative 1.0% for Jun'24.
- Domestic credit growth for the FY24 has been revised down to 13.9% mainly driven by a substantial cut in the public sector credit growth target as part of government's fiscal austerity measures.
- As the targets for GDP Growth and Inflation rates for FY-23 has not been met, BB revised its FY24 targets to match those initially set for FY23.

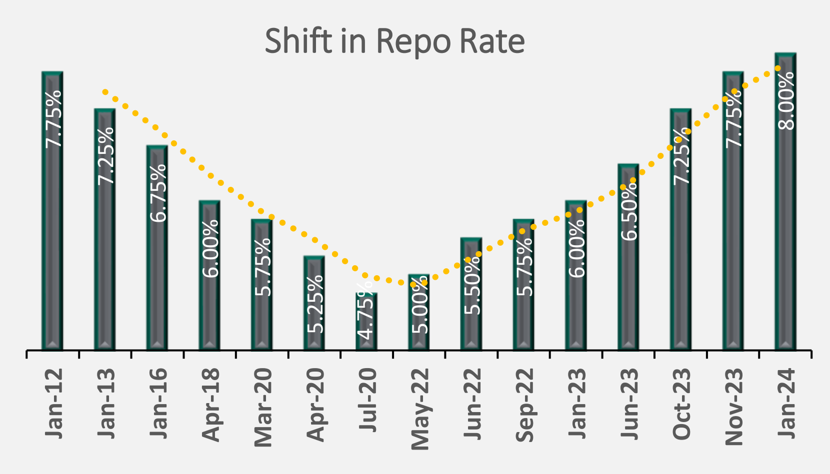


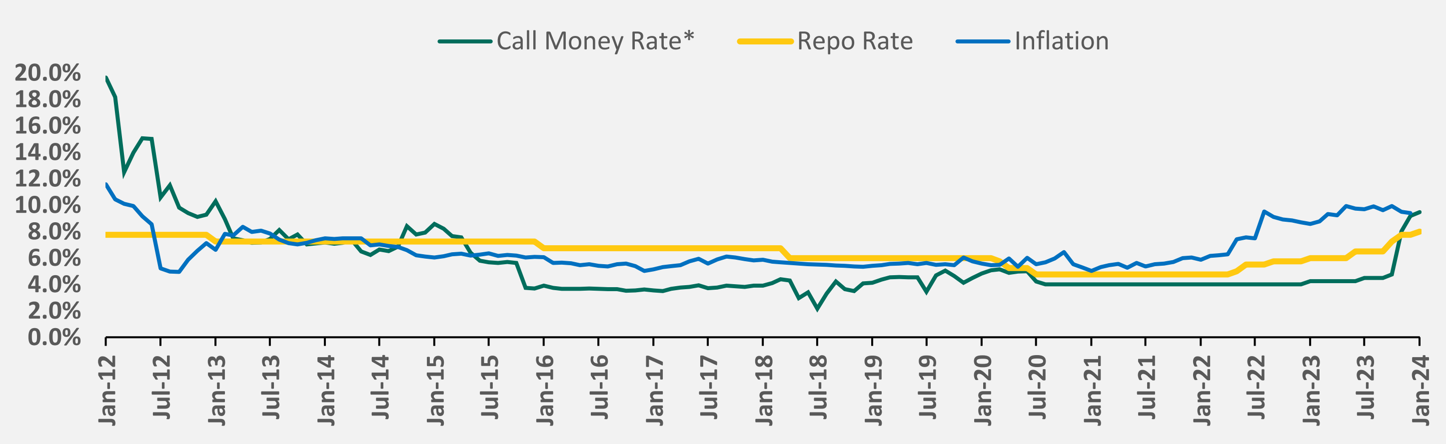
Key Changes (Y-o-Y % Change)	FY23A	H1'24T	H1'24P	H2'24T (Initial)	H2'24T (Revised)
Broad Money	10.5	9.5	8.8	10.0	10.0
Net Foreign Assets	-23.4	-16.8	-21.8	4.7	-2.4
Net Domestic Assets	21.3	15.9	16.2	11.1	12.2
Domestic Credit	15.3	15.9	11.7	15.3	15.4
Private Credit	10.6	10.9	10.2	11.0	11.0
Public Credit	35.8	37.9	18.0	30.0	31.0
Reserve Money	10.5	0.0	-2.0	6.0	6.0
Money Multiplier	4.93	5.07	5.14	5.11	5.46

A= Actual, P= Provisional, T= Target, H1= July-December, H2= January-June

Decades High Policy Rate at 8.00%

Policy Rate (Repo Rate) increased by 25 bps to 8.00% from 7.75%. The Standing Lending Facility (SLF) rate reduced by 25 bps to 9.50% from 9.75% and the Standing Deposit Facility (SDF) increased by 75 bps to 6.50% from 5.75%. The policy rate corridor is therefore, reduced from ±200 bps to ±150 bps.





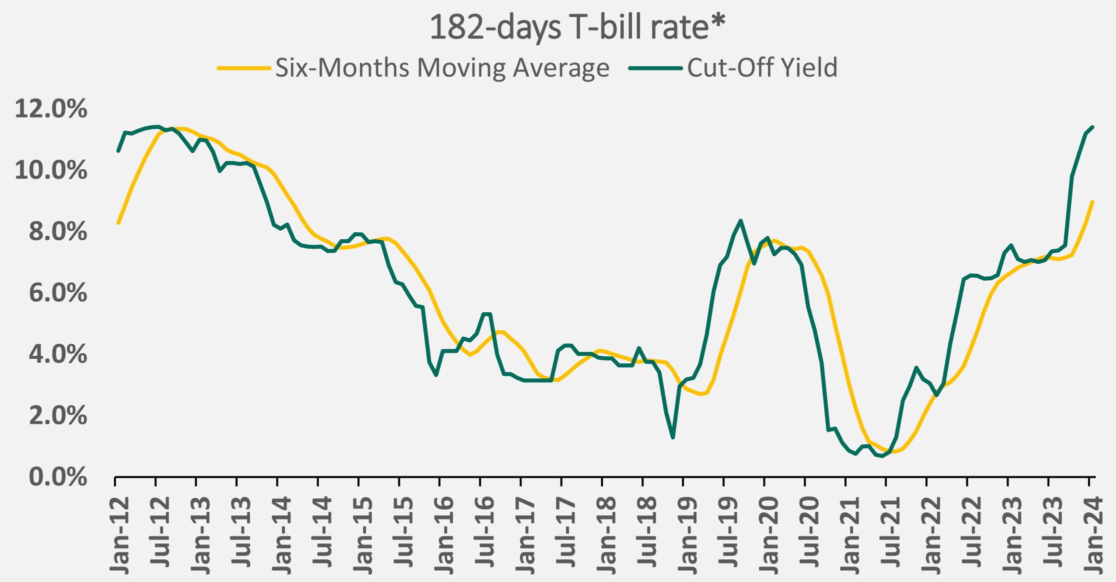
** Jan-24 rate is of 18-Jan'24*

- In the last MPS for H1FY24, BB introduced four major reforms: Introduction of a policy rate corridor, establishment of a market-based reference interest rate (SMART rate), introduction of a unified market driven exchange rate, and calculation of gross forex reserves as per IMF BPM6.
- BB hiked the policy rate three times by 150 bps from 6.5% to 8.0% since then.
- However, general inflation has reached double digit levels in H1FY24 while the call money rate has shot up from 6.2% to 8.1% during the same period. The elevated figures are reminiscent of the situation the country faced back in 2012.

Source: Bangladesh Bank, GDDA Research

Lending Rate in Banking System to go above 13.0%

With the policy rate revised upwards, treasury yields are also expected to rise and thereby increasing the reference SMART rate.



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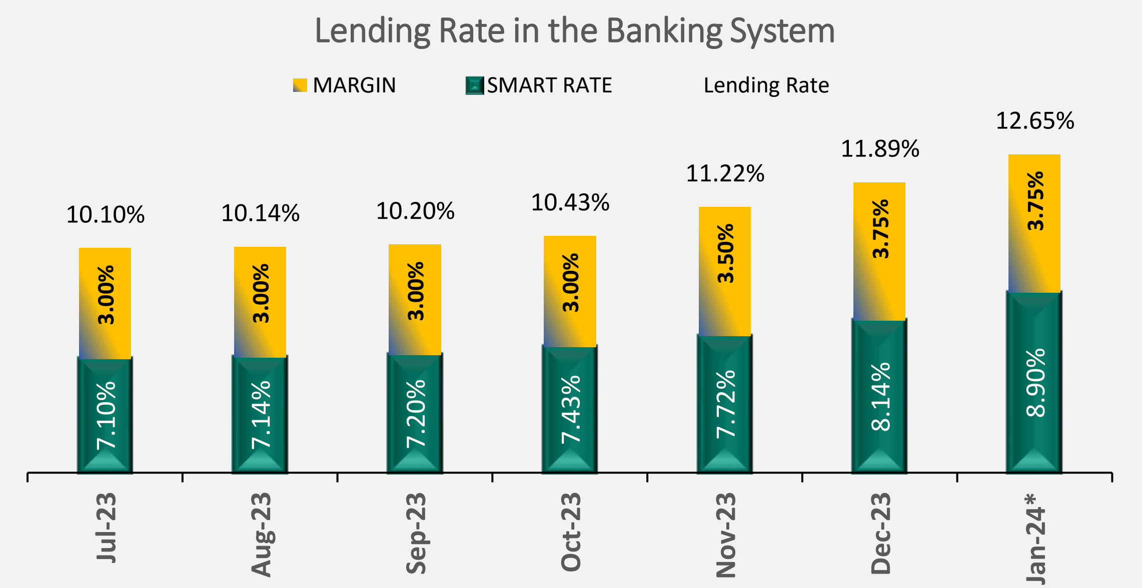

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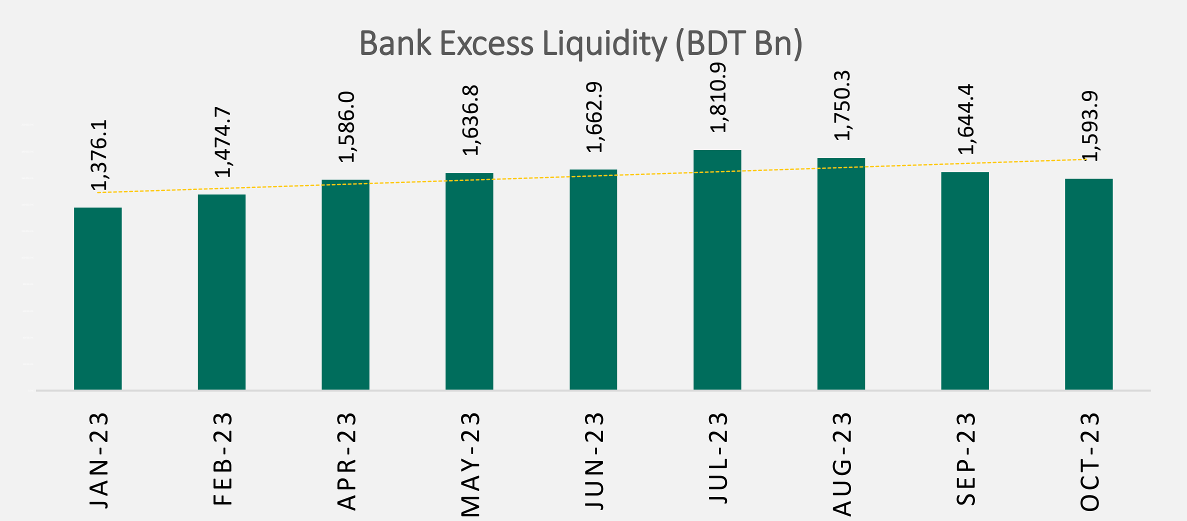
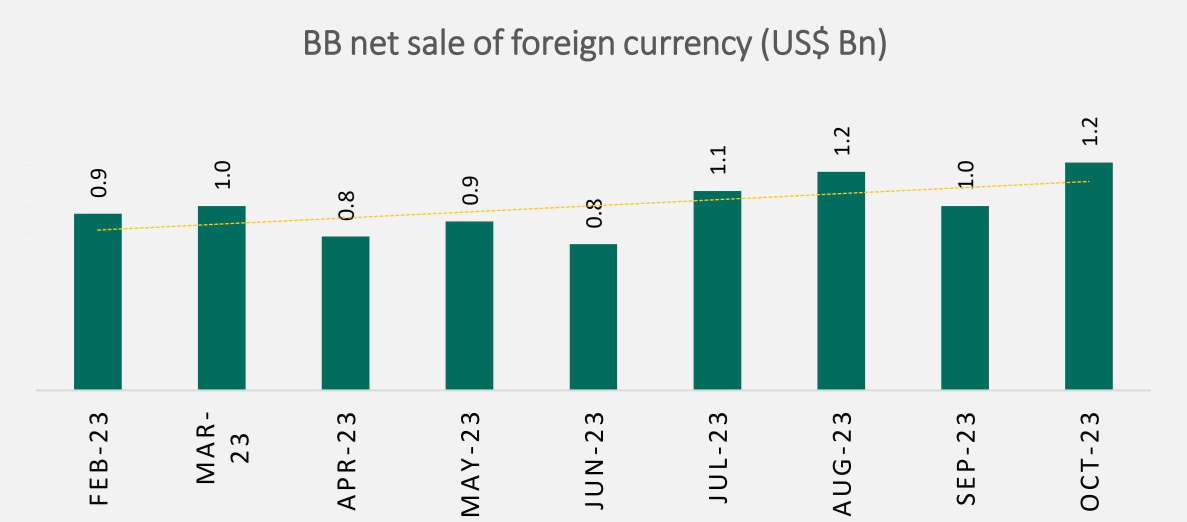
- After introducing the SMART rate in the MPS of H1FY24, BB hiked the margin spread by 75 bps during the last six months to 3.75% for the banks and 50 bps to 5.5% for the NBFIs.
- When BB raised the repo rate to 7.25% in early Oct'23, the 182-days T-bill yield jumped by 190 bps. With the repo rate at decades high, we expect the yield to increase as well.
- The cut-off yield of 182-days T-bills stands at 11.4% as of 15-Jan'24, and the six months moving average rate (reference rate) may go up to up to 10.0% within the next two months.
- Thus, the lending rate in the Banks can hover around 13.0% to 14.0% (for NBFIs 14.5%-16.0%) for the next six months without any further upward revision of margin spread.

Source: Bangladesh Bank, GDDA Research

But solving the bank excess liquidity situation will remain an issue

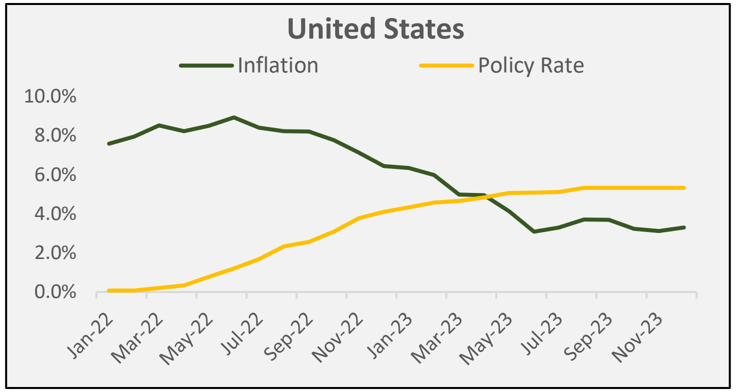


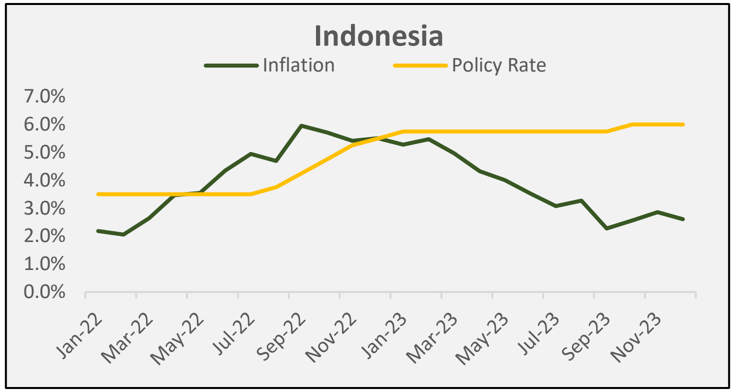


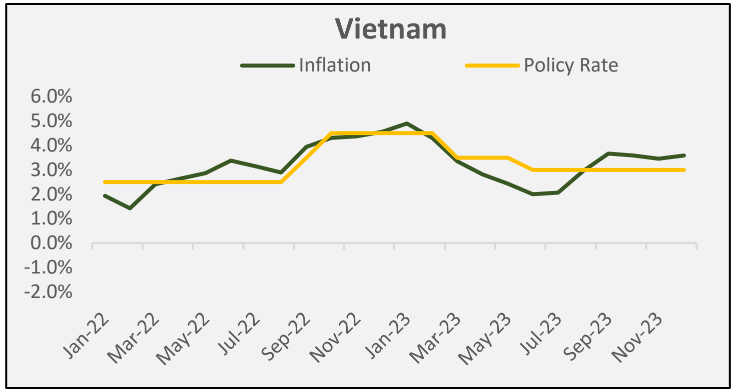
Source: Bangladesh Bank, GDDA Research

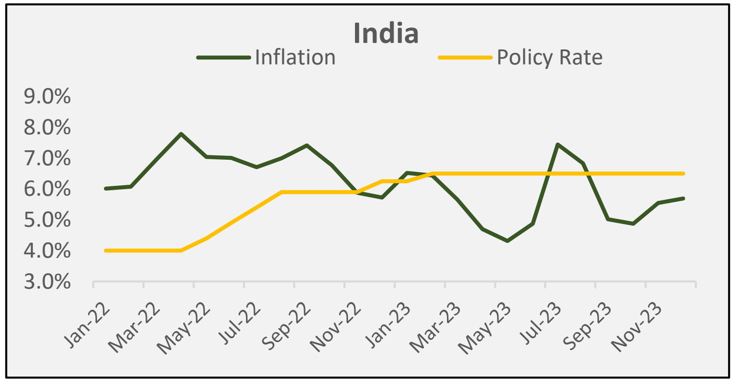
- The rising interest rate will further discourage businesses from borrowing and thereby reduce private sector credit growth. The government is taking austerity measures and hence public credit growth will also remain subdued. Hence, bank lending growth is expected to be in low range.
- However, rising yield curve will allow banks to offer higher rates for deposits and we expect an increased inflow for bank deposits in H2FY2024. BB has also stopped devolvement after Aug'23. Therefore, bank liquidity situation can slightly improve.
- Declining foreign exchange reserve, along with rising NPL, is threatening bank excess liquidity situation. To support the decline, BB has sold US$ 5.69 bn in H1FY024.
- The decline in bank excess liquidity is reflected in the increase in the weighted call money average rate, which has increased from 6.2% in Jun'23 to 8.1% in Oct'23.
- Although the repo rate has been increased to reflect the growing excess liquidity shortage problem, reducing the SLF rate under this situation led us to believe that this action will trigger further repo rate rises in H2FY2024.

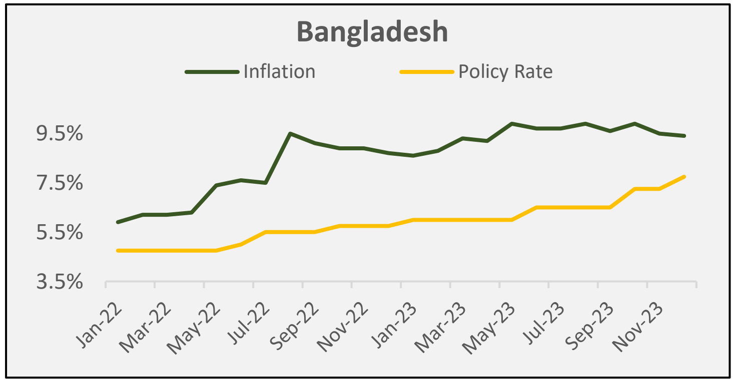
Aggressive policy rate hikes in peer countries led to reduced inflation









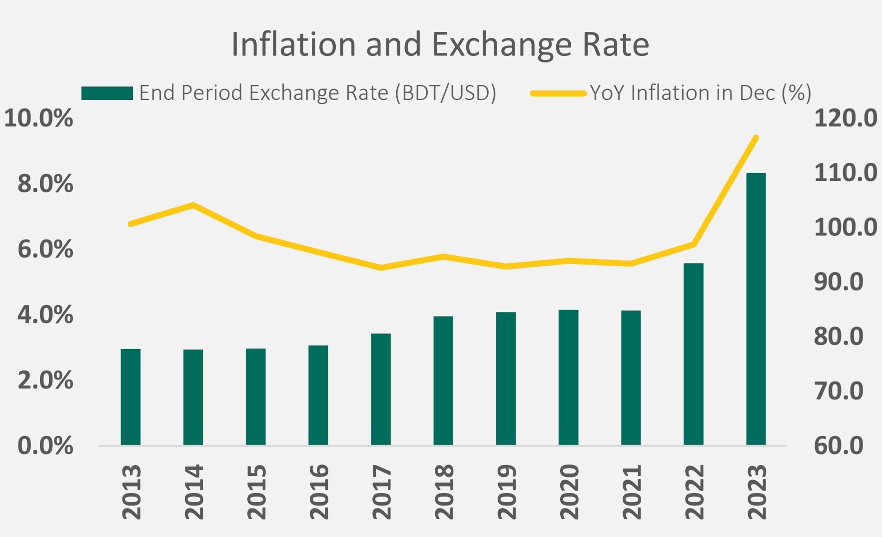


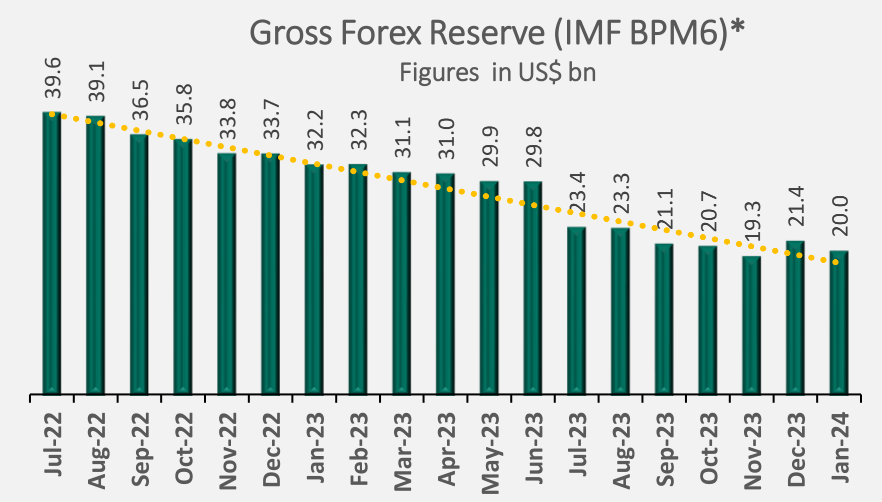
- After the US Federal Reserve initiated rate hikes in 2022, several central banks in peer Asian countries swiftly followed suit within approximately six months. Notably, these countries implemented substantial rate increases, some even reaching as high as 200 basis points. The consequence of these measures became evident as inflation rates experienced a discernible decline.
- In contrast, Bangladesh adopted a more measured approach to rate adjustments (Policy Rate increased by ~200 bps from 2022 to present), resulting in a less pronounced impact on inflation. Anticipating the need for continued efforts to align with the Bangladesh Bank's inflation target, we anticipate the probability of additional rate hikes during the first half of the fiscal year 2024.
- However, it is essential to acknowledge potential challenges posed by external factors such as the El-Nino phenomenon and the ongoing Red Sea crisis, which may impede the effectiveness of monetary policy in curbing inflationary pressures.

Source: Bangladesh Bank, Respective countries' central bank and statistical authorities, GDDA Research

BB is contemplating the adoption of a Crawling Peg Regime

- While the BB initially contemplated transitioning to a market-based exchange rate in the previous MPS, it instituted an exchange rate to be declared by the Bangladesh Foreign Exchange Dealers' Association (BAFEDA) and Association of Bankers, Bangladesh (ABB) in Sep'23.
- The current stance opts for the implementation of a crawling peg. In a crawling peg regime, the currency is fixed to other currency(s) as determined by the central bank but allowed to move within a specific rate. BB aims to set a competitive equilibrium exchange rate at the midpoint of this band to establish a stable benchmark while allowing flexibility to intervene when necessary.
- This shift aims to meet the current need of policymakers to manage inflation levels. However, the central bank will move towards a fully flexible market-based exchange rate system in the future.
- Managing the exchange rate will be important to control inflation. As the graphical representation on the right illustrates, the role of BDT devaluation has been influential in driving inflation rates since 2013. A recent study published by the International Monetary Fund (IMF) further reinforces this correlation, attributing half of the current record-high inflation rates to Taka devaluation.
- The new regime is quite like the managed float regime maintained by BB from 2003 till 2022. But with a calculation, the new regime will be more formula based.
- The REER index reached approximately 104, primarily due to higher inflation rates in Bangladesh compared to its trade partners which is indicating BDT is slightly overvalued. Therefore, if the new regime is established, the rate of Taka depreciation will be less than what was experienced back in 2022.
- It's crucial to acknowledge that while the crawling peg has the potential to prevent further depreciation, its continuous management within the specified band may impact BB's foreign exchange reserve levels. Bangladesh's gross reserve levels (as per IMF BPM6) stood at US$ 21.4 bn at end of Dec'23, down from US$ 24.7 bn in Jan'23.

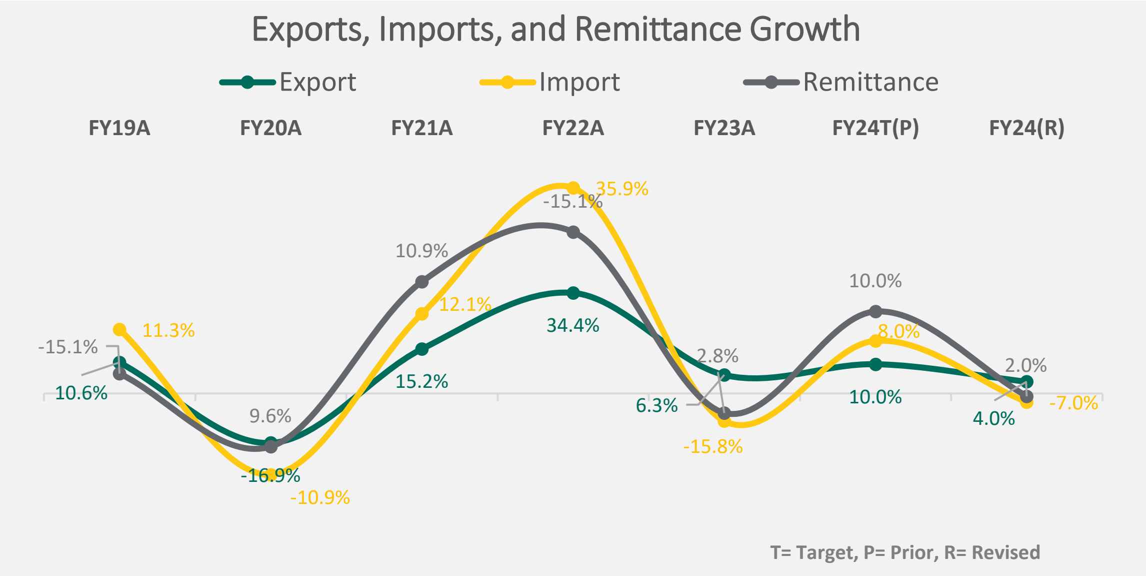


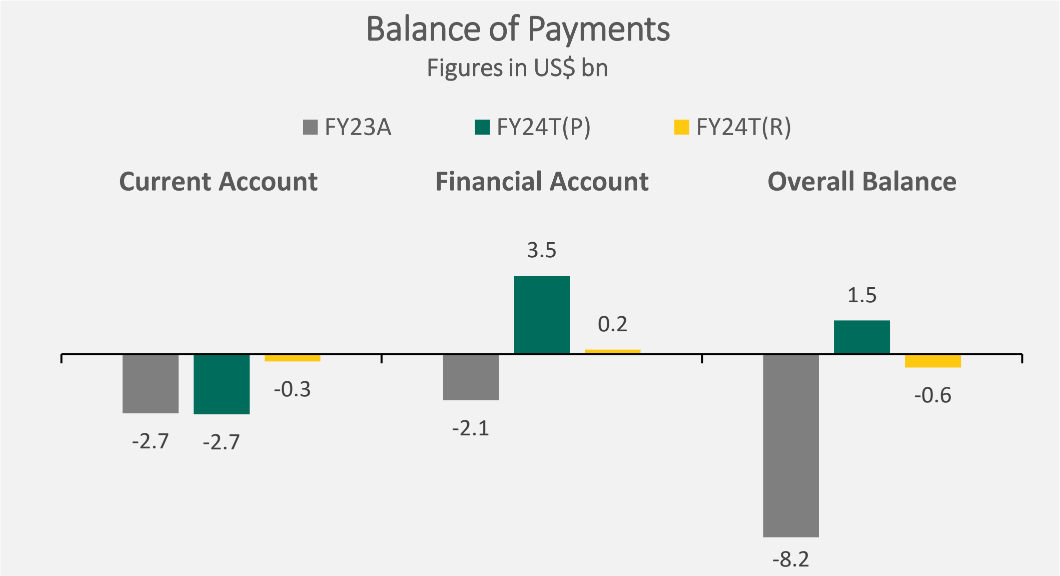


** Jan-24 figure is of 17-Jan'24*

Source: Bangladesh Bank, GDDA Research

Commentary: Managing BoP account will be essential to meet MPS's goal





- The financial account experienced highest ever deficit of US$3.9bn in the first four months of FY24 the financial account is projected to stand at US$0.2 bn surplus at the end of FY24.
- Although the current account is now at a surplus balance of US$ 579.0 mn, it is expected to end the fiscal year in a deficit balance of US$ 0.2bn mainly because of the reduced growth in the export and remittance.
- Due to the financial account deficit, reserve levels experienced a decline. As a result, the BDT experienced a devaluation, which led to inflation reaching record high levels.
- Therefore, it will be crucial to return to a financial account surplus this year to improve forex level, allow the proposed crawling peg regime to work smoothly, and bring inflation to target levels.
- Bangladesh is implementing a comprehensive strategy to boost remittances in the coming months such as Dual Incentive Scheme, increased MFS limits, expanded channels through PSPs, 'PROBASH' Pension Scheme, and tax remission for IT freelancers.

Source: Bangladesh Bank, GDDA Research

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