Macro Economic Report
June 30, 2022

Monetary Policy Statement FY 2022-23

Lending Rate Ceiling Unchanged, BB Cautious Over Inflation

Monetary Policy Statement (MPS) FY 2022-23: Key Figures

Figures in Percentage	FY 2022 Review: Target vs. Actual		Targets for FY 2023	
	Targets	Actual*	6M (up to Dec'22)	12M (up to Jun'23)
GDP Growth Rate	7.20	7.25	7.50	7.50
Inflation	5.30	5.99	6.30-7.50**	6.30-7.50**
CRR	4.00	4.00	4.00	4.00
Repo Rate	4.75	5.00	5.50	5.50
Reverse Repo Rate	4.00	4.00	4.00	4.00
Bank Rate	4.00	4.00	4.00	4.00
Reserve Money Growth Rate	10.00	0.0	9.0	9.0
Broad Money Growth Rate	15.00	9.1	10.0	12.1
Domestic Credit Growth Rate	16.50	15.6	16.7	18.2
Private Sector Credit Growth Rate	14.80	13.1	13.6	14.1
Public Sector Credit Growth Rate	32.60	27.9	32.3	36.3
Net Foreign Assets Growth	10.40	-12.5	-10.7	-2.1
Net Domestic Assets Growth	16.50	16.9	16.7	16.0

**as of May 2022, Source: Bangladesh Bank, MPS*
*** Inflation expectation has been taken from BB's modeling and forecasting unit's forecast. For details, refer to chart 14, page –11 of MPS FY2022-23*

Bangladesh Bank (BB) has announced the MPS for FY 2023, aiming at economic growth while keeping the inflation in check. In contrast to the previous MPS published in a pandemic landscape, BB is going for a contractionary monetary policy by raising the policy rates. However, the lending rate ceiling has not been modified, so the effectiveness of this stance remain to be seen.

As the world was just recovering from COVID-19, the Russia-Ukraine war triggered another round of economic uncertainties, pushing the inflation to the historical high levels in many countries and impeding the economic recovery. Bangladesh is no exception to that. As such, in line with other major countries' Central Bank, BB opted for a cautionary stance by targeting tighter money supply to less productive imports, while ensuring that fund flows to the productive and employment generating sectors to ensure long term economic growth.

BB has hiked the repo rate to 5.50% from 5.00%. The increase in interest rate along with reduced liquidity in the system (USD 20.2 Bn in May 2022 vs USD 24.8 Bn in Jun 2021) is expected to increase the cost of funding, making it difficult for the banks to maintain the 9% lending rate cap. However, as per BB, the weighted average lending rate is still hovering ~7% as of May 2022, keeping room for rate increase. BB has assured to remain watchful of this and take policy actions if necessary.

Additionally, BB has also cut the target for private sector credit growth to 14.10% for FY'23 from the previous target of 14.80% for FY'22. BB has prioritized to keep the exchange rate stable by discouraging import of non-essentials as well as incentivizing import substitute sectors. We also see a notable rise in public credit growth targets, 36.3% for FY23 vs 32.60% for FY22.

This MPS marks a change in the policy landscape, as BB moves away from expansionary stances, and focuses to make a balance between continuing economic growth as well as keeping down the inflationary and exchange rate pressure.

POLICY RATES HIKED TO KEEP INFLATION IN CHECK

Results in FY 2022 & Proposed Policy

- BB has hiked the policy rate (repo rate) by 50 bps to 5.5% from 5.0% to contain the rising inflationary pressure.

- The purpose of the interest rate hike is to manage the demand side pressure as well as to ensure flow of required fund to priority and productive sector.

Analyst Notes

Eyeing the upshoot in inflation, BB has already hiked the repo rate by 25 bps to 5% in May, 2022. This is the second round of hike in a year since Jan 2012. We are expecting the policy rate to continue throughout FY23. However, we are skeptical about the effectiveness of this step as much of the inflation is caused by supply constraints where monetary tools are generally ineffective. The cost-push inflation, in most cases, is tamed by cutting down production costs rather than controlling the money supply.

INFLATIONARY PRESSURE IS EXPECTED TO CONTINUE

Results in FY 2022 & Proposed Policy

- Inflation is projected to be between 6.3% to 7.5% in FY23.
- Current 12-months average inflation stood at 5.99% as of May 2022, above the target ceiling of 5.30%.
- BB considers potential inflationary pressure from the followings to continue in the next year as well:
  - Ongoing commodity price hike partly triggered by Russia-Ukraine war.
  - Frequent lockdowns in China is expected to hike the inflation even further.
  - Upward adjustment of administered energy price might exert more on the value of money.
  - Uptick in inflation in India, one of the largest trading partner of Bangladesh, might increase the inflationary pressure.
  - Ongoing flood in the country.
  - Continuous pressure on exchange rate.
- BB has stepped in by increasing the Repo rate by 50 bps to 5.5% to contain inflation. BB has already issued a circular (MPD circular No. 02) on this. Note that the rate for reverse repo remains unchanged at 4.0% as per the circular.

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	5.59	5.50
2H FY2020	5.65	5.50
1H FY2021	5.69	5.04-5.93
2H FY2021	5.56	5.40
FY2022	5.99	5.30
FY2023		6.30-7.50*

Source: Monetary Policy Statement, Jun 2022
**Inflation expectation has been taken from BB's modeling and forecasting unit's forecast. For details, refer to chart 14, page –11 of MPS FY2022-23*

Analyst Notes

To contain inflationary pressure, BB has already increased the policy rate. Additionally, BB is planning to provide policy level support to import substitute products like refinance schemes and discourage import of luxury good by increasing LC margin. These steps are expected to provide a breather to the increasing inflation level. We expect, even with the policy support, the inflation is expected to increase in FY23, however, the degree to increase might slow down a bit.

PRESSURE ON EXCHANGE RATE MIGHT CONTINUE

Results in FY 2022 & Proposed Policy

- BDT depreciated by 9.0% against USD till 29 Jun 2022
- Real Effective Exchange Rate (REER) stood at 98.8 in Jun 2022, indicating currency has become undervalued in comparison to peers.
- Similar to the previous years, in FY22, the central bank intervened in the FX market by selling ~USD 7.3 Bn in the market.

REER is the weighted average of a country's currency in relation to an index or basket of other major currencies. The weights are determined by comparing the relative trade balance of a country's currency against that of each country in the index.

Analyst Notes

In the current FY, Bangladesh Bank retraced from its firm stance of devaluing currency slowly, to adjusting the exchange rate with the market promptly. As a result, we observed a currency deviation of 8.1% since April 2022. We are expecting that this move would narrow down the difference between official and unofficial exchange rate, encouraging the remittance workers to send money through legal channel.

The current account deficit (CAD) might not narrow down in FY23 as the export growth might slow down a bit due to the probable recessionary pressure in the USA and UK. However, import growth might tame down a bit due to the policy level interventions. As such, the CAD might continue to exert pressure on exchange rate. As per BB, FY23 would have a CAD of USD 16.5 Bn.

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Credit Growth Expected to Go Up, Mostly on Public Front, Amid a Less Liquid Landscape

Results in FY 2022 & Proposed Policy

- In FY 2022, actual growth rate of the broad money was 9.1%, lower than the target rate of 15.0%. For FY23, target for broad money growth is set at 10.0% in H1 and 12.1% in H2.
- In FY 2022, programmed growth for reserve money was 10.0%. For FY23, the target is set at 9.0%.
- In FY 2022, actual private sector credit growth was 13.1%, lower than the target of 14.8%. Public sector credit growth came at 27.9%, which was below the target of 32.5% as well.
- Domestic credit growth was in line with the target (15.6% projected against target of 17.8%), as the relaxation of COVID restrictions propelled restoration of economic activities.
- For FY 2023, target private sector credit growth in H1 & H2 is set at 13.6% and 14.1%, respectively. Public sector credit growth target is at 32.3% and 36.3% for H1 & H2 respectively. Domestic credit growth target for the same period is at 16.7% and 18.2% respectively.
- BB mopped up some excess reserves during Aug-Oct of FY'22, while also injected liquidity into the system through repo & liquidity support facilities during Feb-Jun of FY'22. In FY22, BB sold USD ~7.3 Bn in the market to offset foreign exchange pressures, which helped to reduce excess reserve from the system. Reduction in excess reserves contributed to decline in overall excess liquidity in the economy. Excess liquidity stood at BDT 1.89 Bn as of May'22, down from BDT 2.32 Bn in Jun'21.

Analyst Notes

Successful vaccination campaign contributed to reopening of the economy from Aug'21, while restoring economic activities from 2QFY22. However, the rising commodity and raw material prices affected inflation, foreign reserve and current account balance, among others. BB's action to ensure supply of foreign currencies for imports contributed to reduction in Net Foreign Assets, which in turn dragged both Reserve Money & Broad money growth rates.

Restoration of economic activities post-pandemic and pent-up demand stimulated private sector credit growth. Meanwhile, the public sector credit growth was broadly in line with programmed rate, despite the lower ADP implementation rate (11MFY22: 65.5%) and lower borrowings from NSC sales (9MFY22: 51% of the target). Higher subsidies owing to rising fuel and fertilizer prices in the global market contributed to the buoyant public sector credit demand. Inflows of foreign funds and mobilisation of idle funds from the state owned enterprises (SOEs) offset some of the demand.

Current Account Deficit is Forecasted to moderate in FY 2023

Results in FY 2022 & Proposed Policy

	Actual in FY 2022 (USD Mn)*	Targets for FY 2023 (USD Mn)	Actual YoY Growth FY 2022*	Targeted YoY Growth FY 2023
Trade Deficit	32,207	36,705	+35.4%	+14.0%
Remittance	21,309	24,505	-14.0%	+15.0%
Current Account Deficit	17,732	16,545	+287.6%	-6.7%
Current Account Deficit as % of GDP	4.2%	3.5%		
Gross International Reserve	42,000	42,500	-9.5%	+1.2%

**estimated for Jun'22, Source: Bangladesh Bank, MPS*

Analyst Notes

Both export & import remained buoyant throughout FY'22, as both global and domestic economies started recovering. Exports rose 34.1% YoY during 11MFY22, as RMGs got higher prices to compensate for rising input costs. Meanwhile, import rose 41.4% YoY during the period, on the back of pent-up demand and rising prices.

Remittance saw a slump during FY'22, as reopening of air travel shifted some inflow through the unofficial remittance channel, in addition higher base effect. As a result, remittance was down ~16.0% YoY during 11MFY22, despite the continuation of government incentives. BB's projection of 15%+ remittance growth for FY23 can be attributed to improved economic and working conditions in the source countries. BB expects despite a widening of trade deficit, a increase in remittance is expected to keep current account deficit somewhat close to FY22. BB expects a 20%+ increase in financial accounts, nearly matching the projected CA deficit and thus keeping reserves close to USD 42 Bn. While the projection seems to be represent an obtainable GDP growth picture for BD, BB recognizes certain headwinds that may jeopardize achievement, including unfavourable outcomes of the Russia-Ukraine war, the continuation of soaring global commodity & energy prices, and sustained widening current account deficits. As result, BB has taken a cautionary stance to adjust accordingly in case situations take a worrying turn.

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