Macro Economic Report
June 18, 2023

Monetary Policy Statement H1'FY23-24

A "SMART" Forward With Contractionary Stance

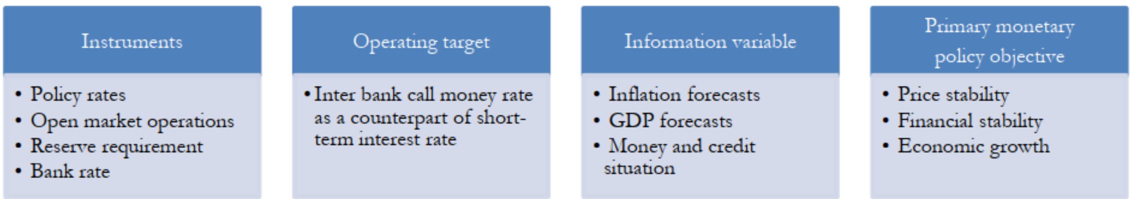
Monetary Policy Statement (MPS) H1'FY2023-24: Key Figures

Figures in Percentage	FY22 Actual	FY H1'23 Review		Targets for FY H2'23 6M (up to Jun'23)			Target for H1'FY24 (up to Dec'23)	Target for H2'FY24 (up to Jun'24)
		Targets	Actual	Target	Revised	Estimated	Target	Target
GDP Growth Rate	7.25	n/a	n/a	7.50	6.50	6.03 [P]	n/a	7.50
Inflation	6.15	n/a	7.70	6.30-7.50	7.50	8.84 [A]	n/a	
CRR	4.00	4.00	4.00	4.00	4.00	4.00	4.00	
Repo Rate	5.50	5.50	5.75	5.50	6.00	6.00	6.50	
Reverse Repo Rate *	4.00	4.00	4.00	4.00	4.25	4.25	4.50	
Bank Rate	4.00	4.00	4.00	4.00	4.00	4.00	4.00	
Reserve Money Growth Rate	-0.30	9.00	17.40	9.00	14.00	10.00 [E]	0.00	6.00
Broad Money Growth Rate	9.40	10.00	8.40	12.10	11.50	10.50 [E]	9.50	10.00
Domestic Credit Growth Rate	16.20	16.90	15.10	18.20	18.50	16.40 [E]	16.9	15.3
Private Sector Credit Growth Rate	13.70	13.60	12.80	14.10	14.10	11.00 [E]	10.9	11.0
Public Sector Credit Growth Rate	29.10	33.30	26.60	36.00	37.70	40.00 [E]	43.0	30.0
Net Foreign Assets Growth	-11.90	-10.10	-22.60	-2.10	-11.90	-26.20 [E]	-20.3	4.9
Net Domestic Assets Growth	17.20	16.60	18.50	16.00	17.90	22.40 [E]	16.8	11.0

Source: Bangladesh Bank, MPS
Note: Inflation is based on 12-month average. Source Chart: 16, MPS H1'FY24
** Reverse Repo would now be referred as Standing Deposit Facility (SDF)*
E represents estimated figures from BB; P denotes provisional estimate; A denotes latest figure as of now

Bangladesh Bank (BB) has announced the MPS for H1'FY 2024, continuing contractionary stance with some new approach in tackling its objectives. In this MPS, BB replaces existing lending rate cap with a targeting mechanism dubbed SMART, applying average 6M T-Bill rate as benchmark with varied corridor for Banks & NBFIs. In addition, it moves to a market based unified exchange rate, while contain inflation and exchange rate pressures with continuation of prevailing demand moderating approaches.

Figure 1. New Monetary Policy Framework



While BB is justifying the pivoting stances to meet economic objectives, we note that these are closely aligned to IMF requirements and hence is part of a bigger acceptance of IMF terms by GoB. The introduction of Interest rate corridor, SMART based variable limits for lending rates, market driven exchange rates and IMF guideline aligned reserve reporting all fall in line with the context of obtaining IMF support. As economic situation requires additional support to protect foreign exchange reserves, this is a necessary move to right direction by BB. However, as inflation is largely cost push, BB's contractionary stance risks slowing the economy at a time when businesses are already suffering from weak demand and rising costs.

After more than 3 years (since Apr'20), BB finally moves away from interest rate cap, by introducing a rate corridor system named SMART. The declared mechanism uses average of 6M T-bills as a benchmark rate and allows 3% and 5% margin for Banks and NBFI, respectively. Consumer and CMSME loans would be subject to an additional 1.00% on top to cover supervision costs. In addition, the heightened policy rates are expected to push up borrowing costs for FIs, thus affecting credit demand.

BB announces moving to a market driven unified exchange rate, expected to be reached by H1'FY24. It also would be publishing FX reserve information as per IMF policy (BPM6) going ahead. Meanwhile, broad money and credit growth targets have been lowered, in line with the contractionary stance.

We expect repricing benefits to show up in the financial sector stocks as the lending rate cap has been removed. In our assessment, SME focused financial institutions would be the better beneficiaries of the newly introduced system.

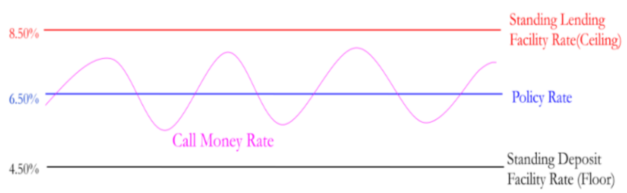
Click here to access H1'FY24 MPS

POLICY RATES: A STRUCTURAL SHIFT TO INTEREST RATE TARGETING

Policy Interest Rate Corridor: Starting FY24, BB would be shifting to a new "Interest Rate Targeting Approach" from its existing "Monetary Targeting" in its policy framework. The new structure would –

- Involve a policy interest rate of 6.50% and a symmetric Interest Rate Corridor (IRC) of 200 bps effective from July 01, 2023
- The Policy rate replaces overnight repo rate
- In IRC, the standing Deposit rate (SDR) will be the rate for FIs to deposit to BB, while for borrowing, rates would be between Policy rate and Standing Lending Facility (SLF), based on tenor and other criteria
- IRC set for the first half of FY24 may be modified by BB's Monetary Policy Committee (MPC) at any time and any level, as deemed necessary

Figure 2. Interest Rate Corridor



Policy Rate Hike Continues: In the 2HFY23 MPS, BB raised Repo rates to 6.00% from 5.75%, and Reverse Repo rate to 4.25% from previous 4.00%. In the latest MPS (for 1HFY24), BB increases Repo rate by 50 bps to 6.50%, and Standing Deposit Facility (SDF) rate (proxied by the reverse repo rate) is raised 25 bps to 4.50%.

Implications For Banks: SDF mechanism provides more control over liquidity management for banks, while receive compensation for parking surplus cash. Liquidity-strapped banks would face further increase in borrowing cost, stemming from policy rate hike.

For BB: BB can seamlessly absorb liquidity from the system without posting collaterals. Lending funds at prescribed band (6.50%-8.50%) ensures BB can lend liquidity-strapped banks without affecting the call-money market. BB would provide liquidity support by utilising existing surplus funds from the banks and NBFIs, instead of allocating additional money. BB gets added flexibility as it can Modify the IRC at any point of time to keep market at targeted path

Analyst Comment: The latest hike would put upward pressure on the call money and interbank repo rates, which had been shadowing the current repo rate (6.0%) in recent weeks.

INTEREST RATE ENVIRONMENT: REPLACING LENDING RATE CAP WITH MULTI LEVEL FLOATING LIMITS

Lending Rate Cap Removed: The lending rate limit will be lifted on July 1, 2023, and would be supplanted with a market-driven reference rate, complemented by a margin rate for loans.

Implementation of SMART + margin: The new reference for lending rate benchmark, SMART(Six-months moving average rate of Treasury bill) would be used from FY24 for setting maximum lending rates. The new lending rate ceilings would be:

- Banks: SMART + 300 bps
- NBFI: SMART + 500 bps

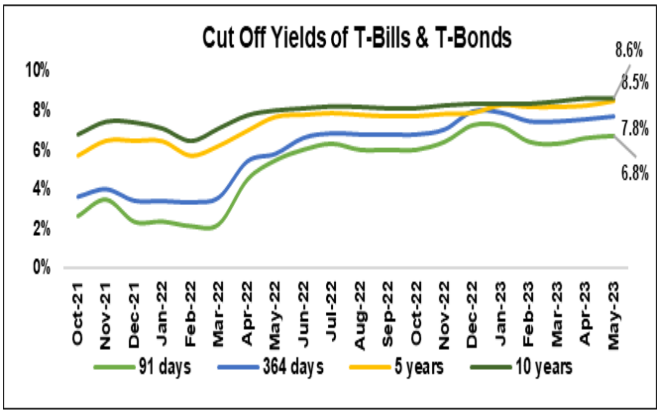
In addition, CMSME and consumer loans will have an additional 100 bps margin for supervision costs on top. Credit card rates will remain unchanged.

Real Rates Remain Negative: BB observes that average real deposit rates have been negative since June 2020. Since June 2022, the real lending rate has also been negative, primarily due to elevated inflation. In April 2023, the real deposit and lending rates are -4.26% and -1.35%, respectively. (Chart 20, MPS H1'24)

Analyst Comment: As per BB, SMART estimate as of now is 7.12%, giving the following limits to -

Corporate loans:

1. Bank: maximum 10.12%
2. NBFI: maximum 12.12%



CMSME & Consumer Loans:

1. Bank: maximum 11.12%
2. NBFI: maximum 13.12%

We expect repricing benefit to all Fis as lending rate moves upward. In addition, SME focused Fis like BRACBANK, IDLC would have stronger upside as the new policy kicks in.

Meanwhile, Consumer Loans may face some slowdown as the limit shrinks for Banks, but would be more palatable for NBFIs to expand onto.

INFLATION: INTERVENTIONS CONTINUE, IMPACT UNCLEAR

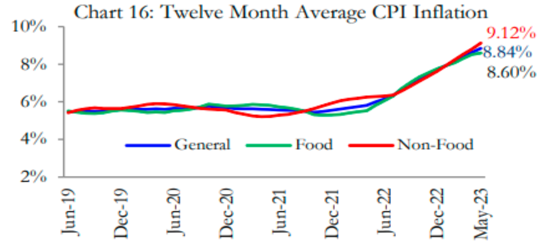
6.0% Seems Hard to Reach: The inflation target has been set at 6.0% in FY24 national budget. However, BB considers achieving this target to be challenging, as BB's Modeling and Forecasting Unit projects relatively higher inflation. Currently, 12-month average inflation stands at 8.84% (as of May'23).

BB Interventions to Continue: BB will continue the initiatives that have been taken to address both demand-side stress and supply-side bottlenecks to manage inflation, including-

- Raising Repo rates
- Supply-side intervention by ensuring fund flow to productive sectors
- Trade Finance policy changes to curb demand growth

Analyst Comments: Although BB is targeting to lower inflation with its contractionary stance, we are skeptical as to the effectiveness since a large part of the inflation is cost-push. However, as global commodity prices are entering some stability, and BDT exchange rate is showing less volatility, some slowdown in inflation is expected later.

Chart 16: Twelve Month Average CPI Inflation



Source: Bangladesh Bank

LIQUIDITY: YET UNDER CHALLENGES

Liquidity Stays Tight Despite Efforts: During Q2 of FY'23, BB provided significant liquidity support, particularly to Shariah-based Islamic banks, enhancing its net domestic assets. Despite such support, liquidity situation remains critical, as-

- Excess reserves have returned to pre-pandemic level, dropping ~65% in May'23 from Jun'22.
- Excess liquid assets also fell ~20% during the same period

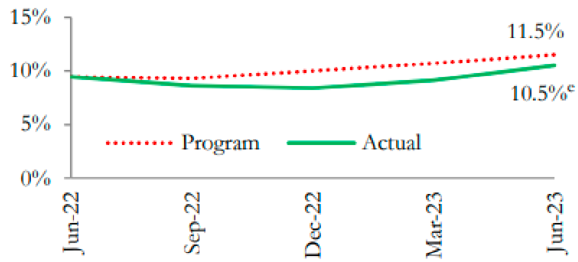
Slower growth in deposits, sustained high NPL, huge sales of dollar from reserve, and surge in local cash demand due to higher commodity prices worked as the primary catalysts behind liquidity stretch.

Broad Money is Off Targets: Broad money (M2) growth remained well below the programmed path until May 2023, primarily due to lower net foreign assets of the banking system. Tight liquidity prompted the call money rate (6.03% in May'23) to surpass the repo rate.

BB has maintained its provision of repo and 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.
- Introduced and implemented the 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 sectors crucial for economic growth

Chart 2: Broad Money (M2) Growth

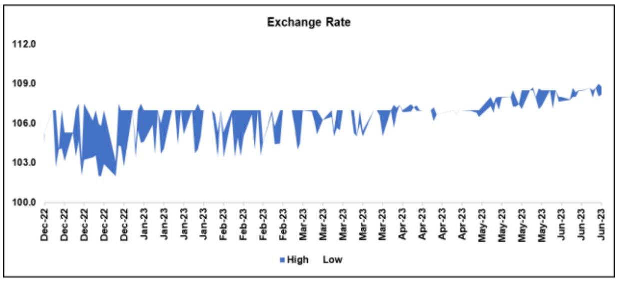


Source: Bangladesh Bank. e= estimate

EXCHANGE RATE

BB is Moving to Market Based Exchange Rate: BB is focusing to move toward a market driven uniform exchange rate within H1'FY24. In FY23, addressing the increased demand for foreign exchange, Bangladesh Bank (BB) sold around USD 13 Bn. Nevertheless, after a 13% slide during FY23, USD:BDT currently hovers at 108.50. However, the volatility is decreasing over time, and BB is expecting exchange rate to become more stable Within H1 2023.

No More Cheap USD for Banks: Starting July 01, 2023, Bangladesh Bank (BB) would discontinue selling USD at discounted rate. It will trade at prevailing interbank rates for FX transactions.



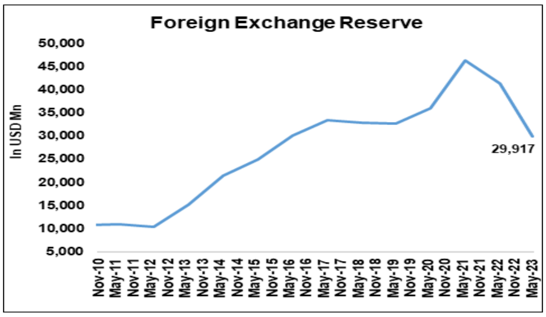
Analyst Comment: Our analysis suggests BDT is indeed getting more stable over the period. Considering REER index, BB expects no major depreciation ahead.

FX RESERVE

Going Ahead With IMF's Reserve Estimate Guides: Starting July 01, 2023, BB will publish Gross Foreign Assets using IMF's latest guidelines (BPM6). However, BB will also keep track of current practices of calculating and reporting gross foreign assets by adding EDF and other foreign assets with Gross International Reserve (GIR).

As of June 14, 2023, the foreign exchange reserves of Bangladesh Bank, including the Export Development Fund (EDF) and other foreign assets, amounted to USD 29.8 Bn. With IMF guideline FX reserve stood at USD 21.8 Bn.

Analyst Comment: IMF has required USD 30 Bn to be maintained by Bangladesh as part of its financing conditions. However, using IMFs approach, Bangladesh's reserve would be close to USD 22 Bn (removing EDF and other elements which doesn't fit IMF guideline). While BB is hopeful to reach the target, we believe foreign exchange reserves would stay below the IMF target. However, considering Bangladesh ticks most other IMF requirements, and still economically better compared to other countries requiring IMF support, we expect this shortfall should not be a road blocker for Bangladesh in getting IMF support on time.



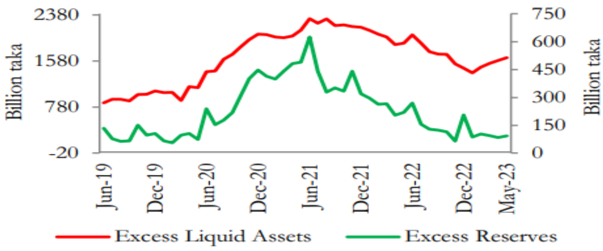
BROAD MONEY TARGETS AND CREDIT SCENARIO

FY23 Was Slow: In FY23, all growth targets were below projection. Broad money was 10.5%, lower than the target rate of 11.5%. Actual growth for reserve money was 10.0%, 400 bps lower than the programmed. Actual private sector credit growth was 11.0%, lower than the programmed of 14.1%. Public sector credit growth came at 40.0%, which was above the program of 37.7%.

Domestic credit experienced a strong growth in FY23 of 16.4%, in line with the target, primarily driven by the robust expansion of public sector credit.

FY24 Targets Are Lower: For FY24, target for broad money growth is projected at 10.0%, 150 bps lower than earlier. the projected rate of reserve money growth is 6.0%, 800 bps lower than earlier. For FY24, projected private sector credit growth is set at 11.0% and public sector credit growth projected at 30.0%. Both contributing the domestic credit growth target for the same period at 15.3%.

Chart 17: Movement of Excess Liquid Assets



Source: Bangladesh Bank

Analyst Comment: The Government's budgetary target of borrowing BDT 1.3 Tn from the banking system in FY24. As BB adopts a contractionary monetary policy to contain inflation, credit growth will slow over rising rates. However, as excess liquidity is reaching a low level, BB may need to resort to money printing should liquidity situation turns more difficult. This may pose a risk of further fuelling inflation and/or lowering BDT value.

CURRENT ACCOUNT DEFICIT

BB expects FY23 trade deficit to reach around USD 4 Bn, considering exports of USD 52.7 Bn, imports of USD 70.1 Bn and remittance inflows of USD 21.5 Bn at the end of FY23. Moreover, the deficit in the overall balance of payments appears to have widened further to USD 8.7 billion at the end of FY23, underpinning the higher repayment of short-term loans.

It is projected that the current account deficit will remain at USD 2.7 Bn by the end of FY24. However, the increased number of wage-earner remitters working overseas, due to improved economic and working conditions in their home countries, is expected to contribute to a 10.0% growth in inward remittances during FY24. Considering the improved short-term prospects of the world economy, exports and imports will grow by 10.0% and 8.0%, respectively, in FY24. As a result, the overall balance of payment in FY24 is projected to be at a surplus level, well supported by a befitting performance of the financial account.

While the projection seems to represent an obtainable GDP growth picture, BB recognizes certain headwinds that may jeopardize achievement, including: 1) prolonged & intensified Russia-Ukraine war 2) the spree of interest rate hikes by US Fed. Against such significant external issues, BB is confident about the economy's resilience to weather the current condition.

(All Figures in USD Mn)

	Actual FY22	Revised FY23	Estimated FY23	Outlook FY24	YoY Growth Est (FY23)	YoY Growth Outlook (FY24)
Trade Deficit	33,250	20,901	17,429	17,769	-47.6%	2.0%
Remittance	21,032	21,873	21,453	23,598	2.0%	10.0%
Current Account Deficit	18,639	6,818	4,037	2,706	-78.3%	-33.0%
Current Account Deficit as % of GDP	4.1%	1.4%	1.0%	0.6%		
Financial Account Balance	13,775	2,800	-3,580	3,500	-126.0%	-197.8%
Gross International Reserve	41,827	36,500	30,000	31,500	-28.3%	5.0%

Source: Bangladesh Bank MPS
Note: FY23 current account deficit (% of GDP) is extrapolated from figures provided in MPS, FY22 figure taken from IMF
YoY Growth (Est FY23) → Est. FY23 vs Actual FY22; YoY Growth (Outlook FY24) → Outlook FY24 vs Est. FY23

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