Chapter-4

Money and Credit

Stance of Monetary and Credit Policies

4.1 Bangladesh Bank continued to pursue a cautious restrained monetary policy with the broader objective of maintaining price stability while supporting the highest sustainable real output growth in FY06. With a view to curbing the excess demand from inflationary expectations that originated from growth supportive policy stance followed in early FY05, policy interest rates underwent steady increase throughout FY06. Increase in Cash Reserve Requirement (CRR) and Statutory Liquidity Ratio (SLR) from 4.5 and 16.0 percent respectively to 5.0 and 18.0 percent respectively of demand and time liabilities of scheduled banks were made effective from 1 October 2005 towards slowing down the domestic credit and its components. However, despite stringent measures, higher import bill due to rising prices of petroleum has had its toll on public sector during the year. The cautious monetary stance although could not fully eliminate the excess demand generated from inflationary expectations, it protected well the external sector viability by bringing back import growth to a sustainable level, stimulating export growth and turning around the eroding net foreign assets back to growth path.

Monetary Programme was initially drawn up with projection of 6.0 percent of real GDP growth and 6.0 percent of CPI inflation for FY06. Accordingly broad money (M2) growth was targeted at 12.8 percent. In the mid course review, the projected CPI inflation was revised upward to 7.5 percent as the international oil price along with other prices were continued to increase coupled with growing dependency of the government on bank borrowing in a situation of delayed foreign assistance. Consequently the broad money growth was revised upward to 14.3 percent during the year under report.

Table 4.1 Money and credit situation

(billion Taka)

	End June, 2005	End June, 2006	
	Actual	Projection	Actual
1. Net foreign assets	186.7	203.0	220.1
	(+14.3)	(+9.2)	(+17.9)
2. Net domestic assets (a+b)	1327.4	1527.0	1586.1
	(+17.1)	(+15.0)	(+19.5)
a) Domestic credit (i+ii)	1431.3	1675.0	1732.8
	(+17.5)	(+16.9)	(+21.1)
i) Credit to public sector 1/	323.9	414.0	423.1
	(+19.3)	(+27.8)	(+30.6)
ii) Credit to private sector	1107.4	1261.0	1309.7
	(+17.0)	(+13.9)	(+18.3)
b) Other items (net)	-103.9	-148.0	-146.7
3. Narrow money (i+ii)	353.7	-	426.0
	(+16.2)		(+20.5)
i) Currency outside banks	185.2	-	228.6
	(+17.1)		(+23.5)
ii) Demand deposits 2/	168.5	-	197.4
	(+15.3)		(+17.1)
4.Time deposits	1160.4	-	1380.2
	(+16.9)		(+18.9)
5. Broad money (1+2) or (3+4)	1514.1	1730.0	1806.2
	(+16.7)	(+14.3)	(+19.3)

Figures in the parentheses indicate percentage changes.

1/ "Govt. lending fund" is treated as deposit in calculating claims on Govt. (net) and claims on other financial institutions (public) are excluded.

2/ Demand deposits of monetary authority are excluded.

4.2 The revised monetary programme vis-à-vis actual outcome is presented in Table 4.1. An analysis of the Table shows that broad money (M2) growth during FY06 was 19.3 percent, which was higher than 16.7 percent growth in FY05 and 14.3 percent growth targeted under the revised programme. The increase in broad money (M2) was due to higher than envisaged growth in both net foreign assets and net domestic assets. The growth in net foreign assets stood at 17.9 percent as against projection of 9.2 percent during FY06 due mainly to increase in export earnings following a sizeable depreciation in the Taka-Dollar exchange rate and increase in workers remittances during FY06. This increase in net foreign assets was also higher than the actual growth of 14.3 percent in FY05. Despite tight monetary policy the credit to private sector grew at 18.3 percent notably higher than projected growth of 13.9 percent reflecting acceleration of economic activities. Credit to the private sector increased by 17.0 percent in FY05. Credit to the public sector, however, increased by 30.6 percent as against the projected growth of 27.8 percent due mainly to acceleration in government expenditure to support BPC in financing high cost imported petroleum products. Overall, domestic credit growth was 21.1 percent, higher than the projection of 16.9 percent and the actual growth of 17.5 percent during FY05.

4.3 Inflation (annual average CPI inflation, base FY96=100) remained within the expectations of the monetary projections, although creeping up from 6.5 percent as of end June 2005 to 7.2 percent as of end June 2006. In order to stabilize inflationary expectations, policy initiatives were taken accordingly along with appropriate liquidity management. Movements of M2 and its components over FY06 may be seen at Chart 4.1.

Reserve Money Developments

4.4 As usual, the reserve money (RM) has been used as an operating target to modulate liquidity consistent with overall monetary projection. The weekly treasury bills and bonds auctions were used in influencing the level of RM, while repo and reverse repo auctions were used for smoothing the money market.

4.5 In line with the projected broad money growth, the revised monetary programme set a

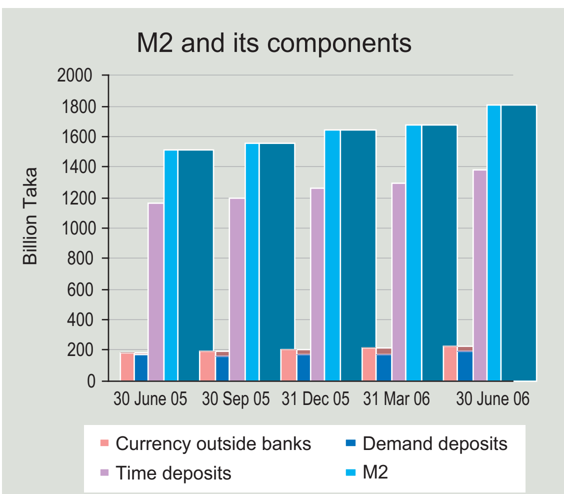
Table 4.2 Reserve money position

(billion Taka)

	End June, 2005	End June, 2006	
	Actual	Projection	Actual
1. Net international reserve [1/@]	130.7	140.0	156.7
	(+12.8)	(+7.6)	(+19.9)
Net international reserve[2/@]	135.3	135.0	141.9
		(0.0)	(+4.9)
2. Net domestic assets[1/]	143.3	178.0	182.8
	(+16.7)	(+23.6)	(+27.6)
Net domestic assets[2/]	138.7	183.0	197.6
		(+31.7)	(+42.5)
a) Domestic credit	202.6	232.0	296.0
	(+23.0)	(+14.5)	(+46.1)
i) Credit to the public sector [3/]	145.2	171.0	236.5
	(+32.1)	(+17.9)	(+62.9)
ii) Credit to deposit money banks	57.5	61.0	59.5
	(+4.8)	(+7.0)	(+3.5)
b) Other items (net)	-59.3	-49.0	-113.2
3. Reserve money (A+B) or (1+2)	274.0	318.0	339.5
	(+14.8)	(+16.1)	(+23.9)
A) Currency issued	203.3	229.0	248.9
	(+17.6)	(+12.8)	(+22.5)
B) Deposits of banks with the Bangladesh Bank [4/@]	70.7	89.0	90.6
	(+7.4)	(+27.1)	(+28.1)
4. Money multiplier (M2/RM)	5.53	5.44	5.32

Figures in the parentheses indicate percentage changes.
@ Excluding foreign currency clearing A/C balance.
1/ Calculated from monetary survey data.
2/ Calculated using programme exchange rate (end March, 2005 rates)
3/ "Govt. lending fund" is treated as deposit in calculating claims on Govt. (net) and claims on other financial institutions (public) are excluded.
4/ Excluding deposits of the other public sector.

Chart 4.1



16.1 percent growth for RM. Table 4.2 shows the actual RM growth during FY06. An analysis of the Table reveals that RM growth was much higher at 23.9 percent against the projected growth of 16.1 percent due mainly to higher growth in net domestic assets (NDA[1/]). The growth in NDA[1/] was substantially higher at 42.5 percent against the projected 31.7 percent during FY06. Huge government borrowing from the central bank contributed to such a notable growth in NDA of Bangladesh Bank. The government had to subsidize Bangladesh Petroleum Corporation in the face of higher oil price in the international market. As such Government's entire bank borrowing remained with the Bangladesh Bank. However, net international reserve (NIR[1/]) of the Bangladesh Bank increased by 4.9 percent in FY06 compared to zero growth projection for the year.

An analysis of the behavior of the liability side of the central bank balance sheet shows that a significant increase in the currency in circulation resulted in an increase in the reserve money.

4.6 Because of much higher growth in reserve money compared to broad money, money multiplier decreased to 5.32 in FY06 as compared to the actual number of 5.53 in FY05. This resulted from the rise in both currency-deposit ratio and reserve-deposit ratio. Movement of M2 and its components and domestic credit in FY06 may be seen at Charts 4.1, 4.2 respectively. Actual development of M2 and RM against their respective programme path is shown in Chart 4.3.

Income Velocity of Money

4.7 The income velocity of money declined from 2.45 of FY05 to 2.30 in FY06 (Table 4.3). The rate of decline in FY06 was 6.1 percent, as against 4.7 percent and 2.7 percent decline in FY05 and FY04 respectively. Income velocity of money is on a declining trend over the past several years indicating increased monetization and financial deepening in the economy. Movement of GDP growth, M2 growth, inflation and income velocity of money during FY95-FY06 is shown in Chart 4.4.

[1/] Calculated using programme exchange rate (end March, 2005 rates).

Chart 4.2

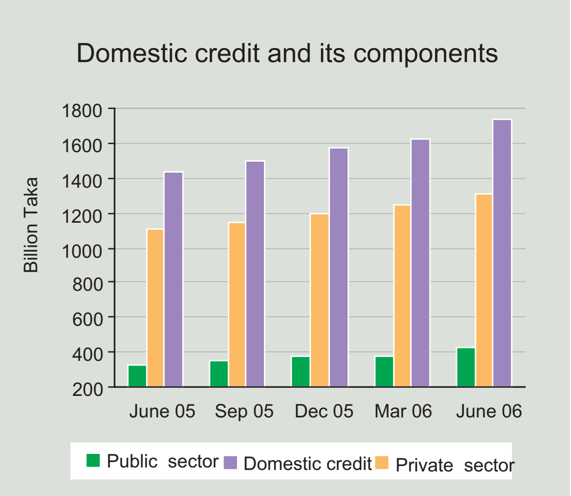


Chart 4.3

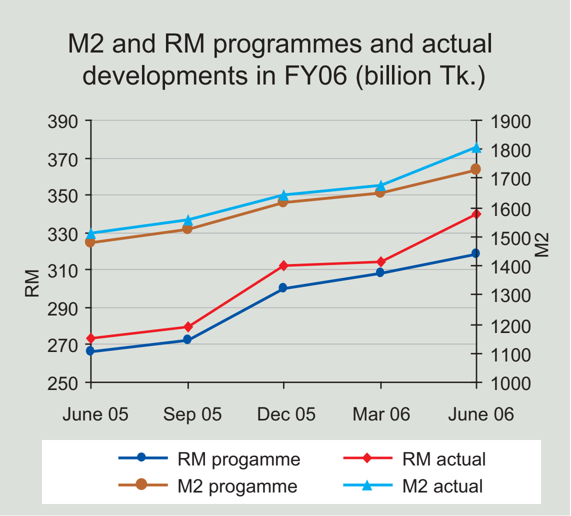
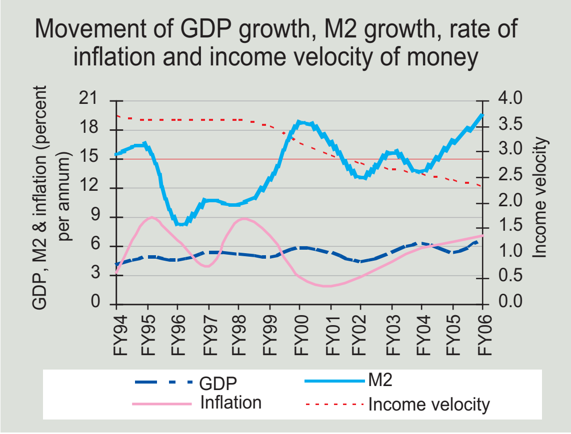


Chart 4.4



Bank Credit

4.8 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY06 rose by Taka 241.90 billion or 20.2 percent to Taka 1439.56 billion as against an increase of 17.4 percent in FY05. The rise in the bank credit during FY06 was driven by both the growth in import and inland bills and increase in advances. Bills purchased and discounted increased by Taka 60.13 billion or 72.5 percent in FY06 due mainly to higher import price of crude petroleum and petroleum products and depreciation of Taka against Dollar. Advances increased by Taka 181.77 billion or 16.3 percent, as against an increase of 17.3 percent during FY05. The quarterly position of the bank credit components may be seen at Table 4.4.

Bank Deposits

4.9 Bank deposits (excluding inter-bank items) increased by Taka 264.05 billion or 18.5 percent to Taka 1689.90 billion during FY06 against 17.5 percent increase in FY05. The rise in total bank deposits is a result of increase in all types of deposits–demand deposits, time deposits and government deposits. Time deposits increased by Taka 219.80 billion or 18.9 percent and stood at Taka 1380.22 billion in FY06 against growth of 16.9 percent during FY05. Demand deposits increased by Taka 28.90 billion or 17.2 percent in FY06 to Taka 197.40 billion against 15.3 percent increase in FY05. Government deposits grew by Taka 15.35 billion or 15.8 percent to Taka 112.28 billion in FY06, against 30.4 percent increase of FY05. Quarterly position of bank deposits in FY06 may be seen at Table 4.5.

The relatively higher growth rate of deposits may be attributed to upward revision of deposit rates.

Credit/Deposit Ratio

4.10 The credit/deposit ratio of the scheduled banks, excluding the specialized banks, increased to 0.86 in June 2006 from 0.84 as of end June 2005 reflecting higher credit demand and higher economic activities.

Table 4.3 Income velocity of money

Year	GDP at current market prices (billion Taka)	Broad money (M2) (billion Taka, end June position)	Income velocity of money (GDP/M2)
FY03	3005.8	1139.9	2.64 (-4.7)
FY04	3329.7	1297.7	2.57 (-2.7)
FY05	3707.1	1515.9	2.45 (-4.7)
FY06p	4161.6	1806.2	2.30 (-6.1)

Figures in the parentheses indicate annual percentage changes.
P= Provisional.

Table 4.4 Bank credit - FY06 quarterly positions

(billion Taka)

Outstanding as of	Advances	Bills	Total
30 June 05	1114.71 (93.1)	82.95 (6.9)	1197.66
30 Sep 05	1150.63 (92.0)	100.68 (8.0)	1251.31
31 Dec 05	1192.50 (90.4)	127.10 (9.6)	1319.60
31 Mar 06	1243.04 (90.4)	132.17 (9.6)	1375.21
30 June 06	1296.48 (90.1)	143.08 (9.9)	1439.56

Figure in parentheses indicate percentage shares.

Table 4.5 Bank deposits*- FY06 quarterly positions

(billion Taka)

Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 05	168.50	1160.42	96.93	1425.85
30 Sep 05	164.66	1198.53	94.63	1457.82
31 Dec 05	174.39	1265.77	103.80	1543.96
31 Mar 06	171.33	1289.51	105.47	1566.31
30 June 06	197.40	1380.22	112.28	1689.90

*Excluding inter bank deposits.

Scheduled Banks' Borrowing from the BB

4.11 Scheduled banks' borrowings from the Bangladesh Bank increased by Taka 14.47 billion or 25.8 percent to Taka 70.47 billion at the end of June 2006, against 4.1 percent increase of FY05. The scheduled banks borrowings from

Bangladesh Bank increased due mainly to increase in foreign currency overdraft in the face of higher oil import payments.

Balances of Scheduled Banks with the BB and their Cash in Tills

4.12 Balances of scheduled banks with the BB increased by Taka 43.92 billion or 46.9 percent to Taka 137.65 billion as of end June 2006, against the increase of Taka 6.2 billion to Taka 93.73 billion as of end June 2005. Cash in tills of scheduled banks increased to Taka 20.32 billion as of end June 2006 against Taka 18.10 billion as of end June 2005.

Cash Reserve Requirement (CRR)

4.13 The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank has been revised upward to 5.0 percent of their total demand and time liabilities from 1 October 2005, which was 4.5 percent since 1 March 2005.

Statutory Liquidity Ratio (SLR)

4.14 The Statutory Liquidity Ratio (SLR) for the scheduled banks, except banks operating under the Islamic Shariah and the specialized banks, has been revised upward in 1 October 2005 at 18.0 percent of their demand and time liabilities, excluding inter bank items. The SLR for the Islamic banks remained unchanged at 10.0 percent. The specialized banks continued to remain exempt from maintaining the SLR.

Bank Rate

4.15 The bank rate remained unchanged at 5.0 percent in FY06. This rate has been in effect since 6 November 2003.

Interest Rates on Deposits and Advances

4.16 Table 4.6 contains weighted average interest rates of scheduled banks on deposits and advances along with the spread during FY02 to FY06. It is evident from the Table that

Table 4.6 Weighted average interest rates of scheduled banks

Sector	As of end June				
	FY02	FY03	FY04	FY05	FY06
Deposit rate	6.7	6.3	5.7	5.6	6.7
Advance rate	13.2	12.8	11.0	10.9	12.1
Spread	6.5	6.5	5.3	5.3	5.4

weighted average interest rates on deposits and advances were declining during FY02-FY05. Deposit and lending rates thereafter moved upward in FY06 keeping in pace with the tightened monetary stance of BB. The spread between advance and deposit rates remained unchanged at 6.5 during the period from FY02 to FY03 before declining to 5.3 in FY04 and FY05. However, the spread between advance and deposit rates increased to 5.4 in FY06.

Operation of the Export Development Fund (EDF)

4.17 Lending in foreign currency from the Export Development Fund (EDF) for financing import of raw materials, accessories, spare parts and packing materials used in export production decreased in FY06. Total disbursement from EDF during FY06 stood at USD 172.22 million as against USD 216.37 in FY05. The major share of this credit was used for export of readymade garments.

Changes in Monetary and Credit Regulations

The major policy measures taken in monetary and credit fronts in FY06 were as follows:

- Statutory Liquidity Ratio (SLR) for the scheduled banks with the Bangladesh Bank has been adjusted upward to 18 percent from 16 percent of total demand and time liabilities including an upward revision of Cash Reserve Requirement (CRR) from 4.5 percent to 5 percent with effect from 1 October 2005. Banks are required to maintain CRR daily at the rate of 5 percent on the average on bi-weekly basis provided that the CRR would not be less than 4 percent in any day.

- In order to enhance and widen the opportunity for refinance scheme in small enterprise sector a Fund equivalent to 30 million US dollar has been created in the BB under "Small and Medium Enterprise Sector Development project" introduced by the government with the financial assistance from ADB. The refinance facility under the Fund will be extended to banks/financial institutions who are engaged in financing small enterprise sector.

- It has been decided that financial institutions can receive deposits of minimum 6-month tenure only in case of institutional deposits effective from 19 July 2005. Prior to these instruction financial institutions were not allowed to receive deposits of less than one-year tenure.

- Some amendments have been made in the policy on loan classification and provisioning. As per amendments banks will be required to make General provision @ 5 percent on the outstanding amount of loans kept in the 'Special Mention Account' (SMA) after netting off the amount of Interest Suspense and the status of the SMA loan should be reported to the Credit Information Bureau (CIB) of BB. This instruction was made effective from 31 December 2005.

- With a view to wider application of fair value accounting of Government securities and encouraging secondary trading after issuance of these securities, some changes have been made. The securities, held for the fulfillment of Statutory Liquidity Requirement by a banking company, will be treated as Held to Maturity (HTM). The gain/loss due to the revaluation will be taken to Capital Account and disclosed in the 'Statement of Changes in Capital', and Government treasury bills and bonds in excess of SLR will be treated as Held for Trading (HFT). The portion of securities in Held for Trading should be revaluated at least on weekly basis based on marking to market or at current market prices. The banking company will show the gain/loss due to this revaluation in the Profit and Loss Account of the concerned period. The weekly revaluation based on marking to market for the portion of securities Held for Trading by the banks will be compulsory from 1 February 2006.

- Financial institutions were directed to send the statement regarding classification and provisioning of their invested assets like lease, loan, housing loan and other assets on quarterly basis instead of half-yearly basis effective from 1 January 2006.

- It has been decided that loans will have to be classified into 8 (eight) categories 1. Superior (SUP), 2. Good (GD), 3. Acceptable (ACCPT) 4. Marginal/Watchlist (MG/WL), 5. Special Mention Account (SMA) 6. Substandard (SS), 7. Doubtful (DF) 8. Loss (BL) instead of the existing four categories. Guidelines containing revised classification and provisioning for consumer financing and small enterprise financing have been provided to banks for compliance.

- The rate of General Provision has been reduced from 5 percent to 2 percent on the unclassified amount for Housing Finance and Loans for Professionals to set up business under Consumer Financing Scheme.

- Policy for rescheduling of loans has been reviewed and it has been decided that the borrower whose credit facility has been rescheduled will get new loan facility subject to the fulfillment of the following conditions: i) the defaulting borrower who has availed interest waiver must settle at least 15 percent of the compromised amount (excluding the down payment on rescheduling as per present guidelines) to avail any further credit facility from any bank. In case of borrowing from other banks, the same rule will be applicable along with compulsion of submission of NOC from the rescheduled bank, ii) export borrower may be granted further credit facility (after being identified as not a willful defaulter), if required, subject to settle at least 7.5 percent of the compromised amount (excluding the down payment on rescheduling as per present guidelines) being paid, iii) prior approval of Bangladesh Bank shall have to be obtained if the loan is related to the director/ex-directors of a Bank Company, and iv) information on the loan accounts rescheduled shall be reported to the Credit Information Bureau (CIB) of Bangladesh Bank.