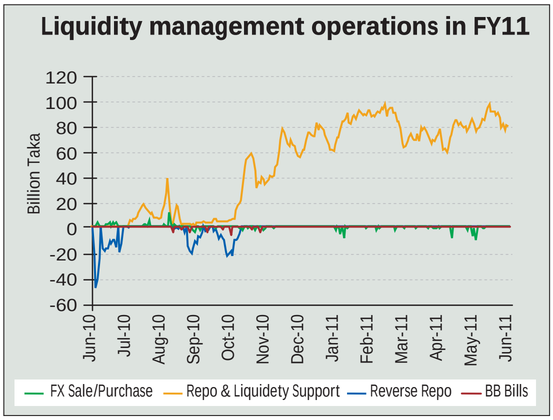
Money and Credit

Stance of Monetary and Credit policy

4.1 Output and investment activities in the economy paced up substantially in FY11 particularly in the second half as power supply shortages started easing after a couple of years in post global crisis relative slowdown with a real GDP growth of 6.66 percent (very close to initial projection of 6.70 percent) spurred by robust exports and imports growth above forty percent, far exceeding the initial projections of 9.7 and 17.5 percent respectively, with attendant high demand for trade financing. Monetary policy stance in FY11 remained accommodative for productive economic activities with growth supportive financial inclusion promotion measures in credit policies; while also firmly discouraging diversion and undue expansion of bank credit for wasteful unproductive uses, to stem buildup of inflationary pressures.

Broadly as foreseen in the Monetary Policy Statements for FY11, pickup in output and investment activities escalated demand pressure in domestic Taka and foreign exchange markets rather sharply in FY11, from both public and private sectors; while slowdown in workers' remittance inflows, widening trade deficit from strong import growth, and declining capital account inflows built up substantial stress on liquidity in Taka and foreign exchange markets. In this situation, while pursuing FY11 monetary programme objectives with 50 basis point CRR enhancement once and repo, reverse repo interest hikes totaling 225 basis points in four steps; BB had also to inject Taka

Chart 4.1



repo funds virtually on a daily basis, particularly in H2 FY11, so that liquidity crunch does not bring markets to grinding halt. This unavoidable necessity meant reserve money growth path hovering quite often above the FY11 programme levels. The pressure on exchange rate of Taka was eased partly by BB's USD sales (totaling net USD 962 million) from reserves, to limit inflationary consequences of excessive Taka depreciation. With this partial easing, Taka depreciated against USD by 6.3 percent in FY11, which however was helpful for the recovery in flagging workers' remittance inflows.

Lending interest rate caps imposed earlier in the backdrop of global slowdown being no longer tenable in the changed context of high and rising demand; phase out of these caps was initiated in March 2011, starting with loans other than industrial term loans and loans for export, agriculture and essential imports. The increased interest rate flexibility facilitated deposit mobilisation and restoration of balanced advance deposit ratios in banks. Market liquidity in both Taka and foreign exchange improved significantly by Q4 FY11. Government's borrowings from the banking system originate in BB's books, which are subsequently offloaded to banks in T-bill/bond auctions. This is why Reserve Money spikes steeply every June as government departments and offices rush for full drawal of their annual budgetary allocations, often depositing the funds drawn in accounts with scheduled banks. When market liquidity swells from such end FY spurt in reserve money growth, BB steps in to mop up excess liquidity and restore normal liquidity conditions. This June, Reserve Money growth did not slacken market liquidity by much, interbank call money rates remained firm and BB had to continue to provide substantial day to day repo funds to keep the market stable. Sterilisation operations to pull the released reserve money back are infeasible in tight market conditions needing liquidity support rather than squeeze. BB's market operations seek to maintain the extent of liquidity tightness consistent with announced monetary policy stance, not to mop up the exact volume of Reserve Money growth in excess of programme level. The need for attempting the later is not obvious; the process of financial deepening in developing economies like Bangladesh takes in some extent of monetary expansion beyond the level indicated by the monetary program identity equating monetary growth and nominal output growth. Chart 4.1 plots BB's liquidity management operations during FY11.

4.2 The intended impact of BB's monetary policy actions on monetary expansion showed up distinctly in Q4 FY11, with growth of domestic credit easing to 28.40 percent in June 2011 after peaking off at 29.18 percent in April. Domestic credit growth at rates well over 25.0 percent year over year prevailing in FY11 clearly was out of line with the modest 13.42 percent nominal GDP growth of the economy estimated by BBS, even assuming that some output from FY11 investments will show up later rather than in the same year. In FY11 the modest pool of predominantly short term domestic savings was strained heavily by spurt in longer term credit demand for new private and public sector capital investments, much of which are normally expected to be financed with term borrowing and/or equity from external sources. This kind of demand pressure on domestic credit must ease if excessive Taka depreciation, balance of payment adversities, and liquidity difficulties of lenders from asset liability maturity mismatch are to be avoided. The monetary programme vis-à-vis actual outcome is presented in Table 4.1.

Remittance inflows from workers abroad that more than made up for trade deficits in recent years decelerated in FY11 faster than expected, remaining near zero or even negative

Table 4.1 Money and credit situation

(billion Taka)

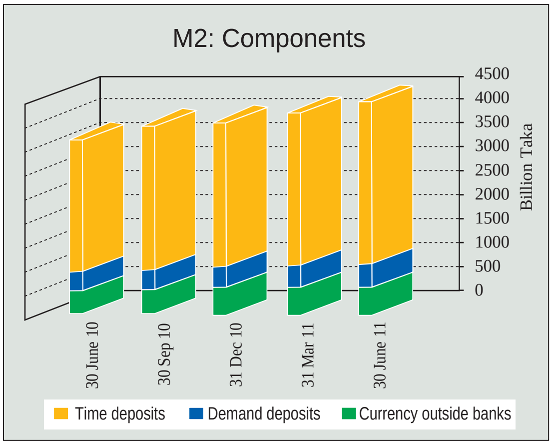
	End June 2010	End June 2011	
	Actual	Programme	Actual
1. Net foreign assets	670.7	660.4	706.2
	(41.3)	(-1.5)	(5.3)
2. Net domestic assets (a+b)	2957.5	3548.3	3697.0
	(18.8)	(20.0)	(25.0)
a) Domestic credit (i+ii)	3313.3	3936.9	4254.4
	(17.6)	(18.8)	(28.4)
i) Credit to public sector[1/]	605.7	782.5	847.3
	(-5.2)	(29.2)	(39.9)
ii) Credit to private sector	2707.6	3154.4	3407.1
	(24.2)	(16.5)	(25.8)
b) Other items (net)	-355.8	-388.6	-557.4
3. Narrow money (i+ii)	877.8		1029.0
	(32.4)		(17.2)
i) Currency outside banks	461.6		548.0
	(28.0)		(18.7)
ii) Demand deposits[2/]	416.2		481.1
	(37.7)		(15.6)
4 . Time deposits	2750.4		3374.2
	(19.5)		(22.7)
5. Broad money (1+2) or (3+4)	3628.2	4208.7	4403.2
	(22.4)	(16.0)	(21.4)

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.

in early months but recovering later to modest 6.03 percent annual growth for FY11 against initial projection of 17.6 percent. The consequent depletion in current account surplus created depreciation pressure on Taka, in reversal of preceding year's trend. This was compounded further by weakness in net capital account inflows, due to sharp decline in government's net external borrowings and to the private sector's tendency of leaning heavily on domestic savings for financing investments rather than at least partly accessing foreign debt or equity for this purpose. Increasing drawal of term loans for investment projects from the modest domestic pool of predominantly short term deposits worsened asset liability maturity mismatches and associated liquidity difficulties in the lending banks. Government borrowing from the banking system, mostly in long dated bonds, escalated sharply in FY11 due to sharp decline in foreign financing and non bank domestic (NSD) financing. Secondary market in longer dated treasury bonds still being very limited, banks and non bank financial institutions holding primary dealership in treasury bonds faced additional liquidity constraints with the increasing volumes of these bonds in their holdings. Movements of M2 and its components over FY11 may be seen at Chart 4.2.

4.3 The uptrend in CPI inflation from the global slowdown induced low of FY09 continued in FY11, but less steeply so than in FY10. While point to point CPI inflation increased in FY10 by as much as

Chart 4.2



6.45 percentage points from the FY09 low of 2.25 percent, the increase in FY11 was 1.47 percentage points, to 10.17 percent. The annual average (headline) CPI inflation rose to 8.80 percent by the end of FY11, well above the 8.00 percent level projected in the revised FY11 national budget, mainly due to high and volatile food and non-food commodity prices in global markets. The annual average non-food CPI inflation (which can be considered as 'core' inflation, as officially set fuel prices in Bangladesh are not volatile) remained low and declining however, down to 4.15 percent at close of FY11 from 5.45 percent at the opening.

Reserve Money Developments

4.4 Reserve money (RM) is used by BB as operating target to regulate liquidity consistent with overall monetary projection. Auctions of Bangladesh Bank bills and daily reverse repo operations are employed for regulating RM level and smoothing the money market. Table 4.2 plots reserve money position during FY11.

4.5 In line with the projected broad money growth, the monetary programme set a 15.0 percent growth of RM for FY11 against which it grew by 21.0 percent. The larger than projected growth of RM during the year was contributed by the substantially higher growth in net domestic assets by 87.0 percent over the last year's exceptionally lower amount (193.5 billion Taka). Domestic credit recorded higher 60.0 percent growth associated with its components credit to public sector by 58.8 percent than 18.1 percent targeted growth under the programme due to higher Government borrowing from BB by ways and means and overdraft for day to day expenditure management. Credit to deposit money banks also grew by 63.9 percent for huge repo and overdraft facilities provided by BB as banks were in tight liquidity constraint for high credit demand by the Government and private sector. Large amount of foreign currency loans due to higher demand for import financing also impacted to increase reserve money. Growth of net international reserve, however, was negative due to net sale of foreign exchange by Bangladesh Bank for maintaining stability in the foreign exchange market.

4.6 Money multiplier increased marginally to 4.91 in FY11 compared to the actual number of 4.89 in FY10. Reserve-deposit ratio increased to 0.111 in FY11 from 0.100 of FY10 level. On the other hand, currency-deposit ratio decreased to 0.142 in FY11 from FY10 level of 0.144. Consequence of changes in both these ratios has been reflected in the growth in money multiplier. Movement of domestic credit and its components in FY11 may be seen at Chart 4.3. Actual development of M2 and RM against their respective programme path is shown in Chart 4.4.

Table 4.2 Reserve Money Position

(billion Taka)

	End June 2010	End June 2011	
	Actual	Programme	Actual
1. Net International Reserve[1/@]	547.8	529.1	535.4
	(49.9)	(-3.4)	(-2.3)
Net International Reserve[2/@]	557.3	536.6	467.5
2. Net domestic assets[1/]	193.5	323.3	361.8
	(-26.1)	(67.1)	(87.0)
Net domestic assets[2/]	183.9	315.9	429.7
a) Domestic Credit	252.2	293.2	403.5
	(-24.1)	(16.3)	(60.0)
i) Credit to the public sector[3/]	193.7	228.7	307.6
	(-28.5)	(18.1)	(58.8)
ii) Credit to deposit money banks[4/]	58.5	64.5	95.9
	(-4.1)	(10.3)	(63.9)
b) Other items (net)	-58.7	30.1	-41.6
3. Reserve money (i+ii) or (1+2)	741.3	852.5	897.2
	(18.1)	(15.0)	(21.0)
i) Currency issued	504.7	634.1	605.3
	(27.9)	(25.6)	(19.9)
ii) Deposits of banks with BB[5/@]	236.6	218.4	292.0
	(1.6)	(-7.7)	(23.4)
4. Money Multiplier (M2/RM)	4.89	4.94	4.91

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 '10 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/ Considers only "loans and advances" to DMBs.
5/ Excluding deposits of the other public sector.

Table 4.3 Income velocity of money

(billion Taka)

Year	GDP at current market prices (billion Taka)	Broad Money (M2) (billion Taka, end June Position)	Income velocity of money (GDP/M_2)
FY06	4157.3	1806.2	2.30
			(-6.12)
FY07	4724.8	2114.4	2.23
			(-3.04)
FY08	5458.2	2486.9	2.19
			(-1.79)
FY09	6148.0	2963.6	2.07
			(-5.48)
FY10	6943.2[R]	3628.2	1.91
			(-7.73)
FY11	7875.0[P]	4403.2	1.79
			(-6.28)

Figures in the parentheses indicate percentage changes.
R=Revised.
P=Provisional.

Income Velocity of Money

4.7 The income velocity of money decreased from 1.91 in FY10 to 1.79 in FY11 (Table 4.3). The rate of decline in FY11 was 6.28 percent, as against 7.73, 5.48 and 1.79 percent decline in FY10, FY09 and FY08 respectively. Income velocity of money was on a declining trend over the past several years indicating increased monetisation and financial deepening in the economy. Movement of GDP growth, M2 growth, inflation and income velocity of money during FY00-FY11 are shown in Chart 4.5.

Bank Credit

4.8 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY11 rose by Taka 694.26 billion or 24.95 percent to Taka 3476.76 billion as against an increase of 23.16 percent in FY10. The rise in the bank credit during FY11 was driven by increase in both advances and bills purchased and discounted.

Advances increased by Taka 624.52 billion or 23.64 percent in FY11, against an increase of 23.32 percent during FY10. Bills purchased and discounted increased by Taka 69.74 billion or 49.57 percent in FY11 compared to the increase of 20.09 percent in FY10. This higher growth in bank bill and advances may be attributed to increase in import of capital goods and business activities. The quarterly position of bank credit and its components may be seen at Table 4.4.

Bank Deposits

4.9 Bank deposits (excluding inter-bank items) increased by Taka 735.99 billion or

Chart 4.3

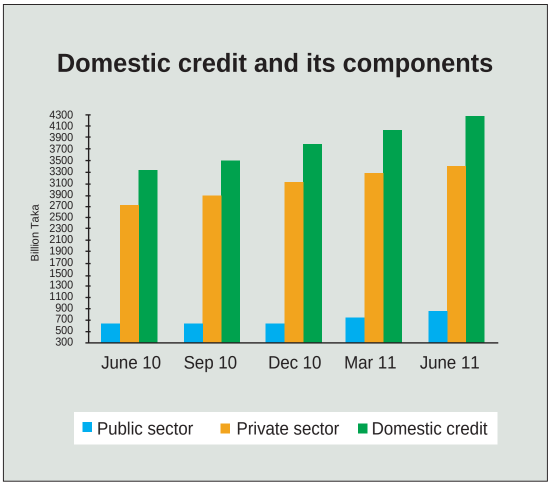


Chart 4.4

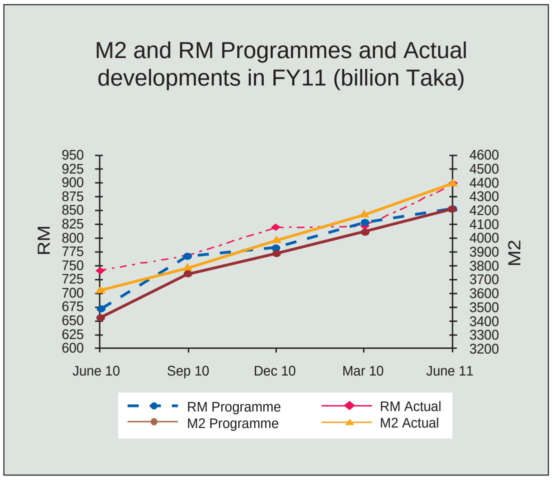
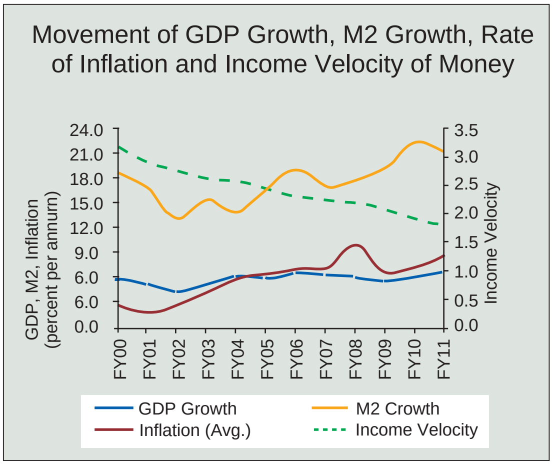


Chart 4.5



21.85 percent to Taka 4104.45 billion during FY11 against 20.90 percent increase in FY10. The rise in total bank deposits was shared by increase in demand deposits, time deposits and Government deposits. Time deposits increased by Taka 623.76 billion or 22.68 percent and stood at Taka 3374.19 billion in FY11 against 19.55 percent growth during FY10. Demand deposits increased by Taka 64.84 billion or 15.58 percent in FY11 to Taka 481.06 billion against 37.65 percent increase in FY10. Government deposits increased by Taka 47.39 billion or 23.48 percent to Taka 249.20 billion in FY11 against 10.20 percent increase in FY10. The quarterly position of bank deposits in FY11 may be seen at Table 4.5.

Credit/Deposit Ratio

4.10 The credit/deposit ratio of the scheduled banks, excluding the specialised banks was 0.85 at the end of June 2011 and was 0.83 at the end of June 2010.

Scheduled Banks' Borrowing from the BB

4.11 Scheduled banks' borrowings from the Bangladesh Bank increased by Taka 119.81 billion or 204.7 percent to Taka 178.33 billion at end of June 2011 against 3.61 percent decline during FY10. The rise in schedule banks' borrowing from BB might be due to inadequate liquidity in the money market.

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

4.12 Balances of scheduled banks with the BB increased by Taka 75.2 billion or 24.35 percent to Taka 384.02 billion at the end of June 2011 against the increase of 7.3 percent to Taka 308.8 billion at end June 2010. Cash in tills of scheduled banks increased to Taka 57.32 billion as of June 2011 against Taka 43.08 billion as of end June 2010.

Cash Reserve Requirement (CRR)

4.13 The Cash Reserve Requirement (CRR) for the scheduled banks with the

Table 4.4 Bank Credit* - FY11 quarterly positions

(billion Taka)

Outstanding as of	Advances	Bills	Total
30 June 2010	2641.82	140.68	2782.50
	(94.94)	(5.06)	
30 Sep 2010	2774.38	157.00	2931.38
	(94.64)	(5.36)	
31 Dec 2010	3019.07	177.85	3196.92
	(94.44)	(5.56)	
31 Mar 2011	3121.31	198.35	3319.66
	(94.02)	(5.98)	
30 June 2011	3266.34	210.42	3476.76
	(93.95)	(6.05)	

Figures in parentheses indicate percentage shares.
* Excluding foreign bills and inter-bank credit.

Table 4.5 Bank deposits* - FY11 quarterly positions

(billion Taka)

Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 2010	416.22	2750.43	201.81	3368.46
30 Sep 2010	418.33	2872.88	204.06	3495.27
31 Dec 2010	467.78	2993.60	222.27	3683.65
31 Mar 2011	480.07	3169.28	218.44	3867.79
30 June 2011	481.06	3374.19	249.20	4104.45

*Excluding inter-bank and restricted deposits.

Bangladesh Bank has been fixed at 6.00 percent of their total demand and time liabilities with effect from 15 December 2010. It may be noted that banks are required to maintain CRR at the rate of 6.00 percent on average on bi-weekly basis provided that the CRR would not be less than 5.50 percent in any day with effect from 15 December 2010.

Statutory Liquidity Ratio (SLR)

4.14 The Statutory Liquidity Ratio (SLR) for the scheduled banks, except banks operating under the Islamic Shariah and the specialised banks, has been re-fixed at 19.00 percent of their demand and time liabilities excluding inter-bank items with effect from 15 December 2010. The SLR for the Islamic banks re-fixed at 11.50 percent with effect from 15 December 2010. The specialised banks continued to remain exempt from maintaining the SLR.

Bank Rate

4.15 The bank rate remained unchanged at 5.0 percent in FY11. 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 FY07 to FY11. It is evident from the Table 4.6 that weighted average interest rate on deposits was increasing throughout FY07-FY08; it decreased in FY10 and then increased to 7.27 percent in FY11. Rate of advance, however, moved downward during FY07 to FY10 but increased from FY10 to FY11. The rate increased to 12.42 percent in FY11. The trend of the spread between advance and deposit rates was mixed throughout FY07 to FY11.

Table: 4.6 weighted average interest rates of scheduled banks

Items	as of end June (in %)				
	FY07	FY08	FY09	FY10	FY11[P]
Deposit rate	6.90	7.00	7.00	6.01	7.27
Advance rate	12.80	12.30	11.90	11.31	12.42
Spread	5.90	5.30	4.90	5.30	5.15

P=Provisional

Measures taken regarding Money and Credit Policy during FY11

1) A fund worth of USD 95.00 million comprising USD 76.00 million with the financial assistance of ADB and USD 19.00 million from Bangladesh Government under the "SME Development Project" taken by the Bangladesh Government (Bangladesh Bank) has been formed under "Small and Medium Enterprise Financing Scheme" with a view to generating employment and increasing domestic demand by providing financial support to emerging small and medium enterprises.

2) With a view to empowering women BB is providing other special facilities along with refinance facility under SME refinance scheme to ensure more institutional credit facility for women entrepreneurs of small industries in simple terms and conditions. Group-wise SME loan disbursement arrangement has been introduced to make credit easier for women entrepreneurs. Lower limit of loan for a single woman entrepreneur has been

set at Taka 50,000. However, provision has been introduced for women entrepreneurs requiring loan less than Taka 50,000 in such a way that they can apply for SME loan by forming a group for equivalent amount of Taka 50,000 or more.

3) BB has been providing refinance facility with a view to invest in solar panel, bio-gas and effluent treatment plant sector as an alternative measure to meet power and fuel crisis. In this connection, directives have been given to the commercial banks to strengthen loan activities faster with simple terms and conditions at maximum 10.0 percent interest rate and to introduce their own scheme to install solar panel in residential/commercial/industry and buildings used for other purposes. In this case, banks can take facility, if necessary, under the existing refinance scheme of BB.

4) With a view to facilitating export trade of the country, the size of EDF has been enhanced to USD 400 million from existing USD 300 million. Besides, EDF loans to a single manufacturer-exporter up to USD 1.5 million will be charged interest @ six-month LIBOR +1 percent per annum. But, for EDF loans in excess of USD 1.5 million (from the same AD or from up to two other AD banks), the interest rate will be as before, i.e. six-month LIBOR +2.5 percent per annum.

5) To ensure adequate supply of essential commodities and to keep the price of these commodities at tolerable level, interest rate on import financing of edible oil (crude & refined), beans, pulses, onion, spices, fruits and sugar has been re-fixed at maximum 12.0 percent.

6) Banks were advised to start school-banking in order to broaden financial inclusion and to motivate student to generate savings by rendering them knowledge about modern banking and technologies.

7) The repo and reverse repo rates have been adjusted upward by four steps totalling 2.25 percentage points from 4.5 and 2.5 percent to 6.75 and 4.75 percent respectively.

8) Decision has been taken to provide export subsidy against advance payment through TT along with same facility provided against export bill negotiation/ collections for the export of jute products produced by jute mills.

9) To encourage export trade of the country export subsidy/cash incentives provided by the Government like previous years on net fob value of the selected commodities (textile, handmade products, agro-product, potato, bicycle, crushed bone, hatching egg and day old chicks, light engineering, liquid glucose, frozen shrimp and other fishes, leather products, pet bottle-flex and ship building) shipped during 1 July 2010 to 30 June 2011 at the rates ranges from 5-20 percent was remained in force in FY11. Moreover, credit facility was provided at a concessional interest rate of 4.0 percent for salt cultivation in the coastal areas of the country.

10) Cash Reserve Requirement has been revised upward to 6.0 percent bi-weekly basis instead of 5.5 percent of the total demand and time liabilities of scheduled banks and minimum 5.5 percent on daily basis instead of 5.0 percent from 15 December 2010.

11) Statutory Liquidity Reserve (SLR) including Cash Reserve Requirement (CRR) maintained by all scheduled banks with Bangladesh Bank has been revised upward to 19.00 percent of their total demand and time liabilities from 18.00 percent and SLR for Islami shariah based banks and the Islami banking branches/ windows of all conventional banks has been re-fixed at 11.5 percent of their total demand and time liabilities from 15 December 2010.

12) BB has rationalised the charges of some services to ensure the interest of depositors/investors/customers and advised all scheduled banks to display the complete schedule of charge (including interest rate) in suitable visible places in their branches and Head Offices for the information of their customers and upload the same in their respective websites for the convenience of the customers.