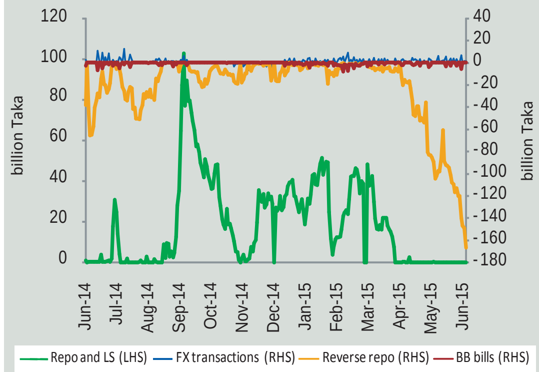
Money and Credit

Stance of Monetary and Credit Policy

4.1 Bangladesh Bank pursued a cautious yet growth friendly monetary policy stance for FY15. The objective of the monetary policy was to attain the target growth as well as to maintain price and macroeconomic stability. Bangladesh Bank took the domestic economic development and global economic outlook into consideration while setting the monetary growth targets. Bangladesh Bank engaged the country's financial sector in promotion of inclusive and environmentally sustainable financing of economic activities. The objective of bringing down 12-month average CPI inflation to 6.5 percent attained in May 2015, further edging down to 6.4 percent in June 2015. However, point-to-point headline CPI inflation stood at 6.25 percent in June 2015. GDP growth registered 6.51 percent in FY15, which was substantially higher than 6.06 percent growth in FY14, and within the range of 6.5,-6.8 percent of BB's projections; although lower than the initial target mentioned in FY15 national budget. Sustained GDP growth for several years at rates well above the global output growth rates enabled Bangladesh to cross two important milestones in FY15. The first one is the graduation to the status of lower middle income country from the low income country group, and the second one is the improvement in OECD Export credit eligibility ranking to group 5, one notch below India but ahead of all other South Asian neighbours.

Chart 4.1 Liquidity Management Operations during FY15



Bangladesh achieved Ba3 (Moody's) and BB- (Standard and Poor's) with stable outlook for the 6th consecutive years. Stable real GDP growth and strong external balances helped Bangladesh to achieve BB- rating with stable outlook from Fitch Ratings for the first time. Besides these new attainments, consolidation of macroeconomic stability, foreign exchange reserve growth and poverty decline maintained pace in FY15, setting the stage for transition to a higher growth trajectory.

4.2 Bangladesh Bank's monetary and financial policies provide proactive policy support for financing of all types of productive activities. The export sector is accessing low cost foreign exchange financing from BB's USD 2.0 billion Export Development Fund (EDF). Single borrower limit for garments accessories exporters has been enhanced from USD 1 million to USD 2 million as well as import of raw cotton and other fibre from USD

10 million to USD 15 million under the facility of EDF loan. Besides deferred import payments under buyer's credit for terms not exceeding six months has been enhanced from USD 500,000 to USD 1,000,000. As an investment incentive, foreign investors has been allowed to source term loans from local banks and access working capital as an interest free loan from their parent company. Non exporter manufacturing undertakings are also being allowed access to low cost long and short term external financing for import of capital equipment and production inputs. Banks and financial institutions are drawing on low cost refinance windows of BB against their financing of MSME output initiatives and environmentally benign green projects. The World Bank supported Investment Promotion & Financing Facility (IPFF) window of BB is providing low cost refinance against long term infrastructure sector lending.

In order to refinance Islamic banks and financial institutions against financing to agro-processing industries, small entrepreneurs and renewable energy and environment friendly initiatives an "Islamic Refinance Fund Account" has been opened at Bangladesh Bank. With a view to manage liquidity of Islamic banks, according to profit sharing ratio 3-month Islamic Investment Bond and 6-month Islamic Investment Bond has been issued since 1 January 2015.

In order to enhance the effectiveness of the financial markets as transmission channels for monetary policy, Bangladesh Bank's supervisory oversight on credit disbursement and loan recovery disciplines in banks and financial institutions has been strengthened

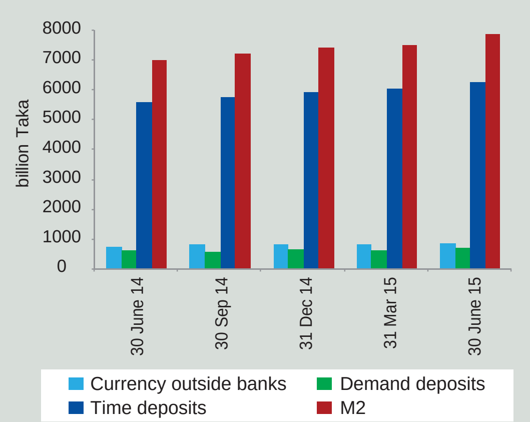
Table 4.1 Money and credit situation

(billion Taka)

	End June 14	End June 15	
	Actual	Programme	Actual
1. Net foreign assets	1552.9	1608.8	1874.3
	(38.6)	(3.6)	(20.7)
2. Net domestic assets (a+b)	5449.4	6548.9	5997.0
	(11.0)	(20.2)	(10.0)
a) Domestic credit (i+ii)	6311.7	7410.7	6950.3
	(11.6)	(17.4)	(10.1)
i) Credit to public sector[1/]	1235.3	1547.5	1204.3
	(8.8)	(25.3)	-(2.5)
ii) Credit to private sector	5076.4	5863.2	5746.0
	(12.3)	(15.5)	(13.2)
b) Other items (net)	-862.3	-861.8	-953.4
3. Narrow money (i+ii)	1412.5		1603.2
	(14.6)		(13.5)
i) Currency outside banks	769.1		879.4
	(13.8)		(14.3)
ii) Demand deposits[2/]	643.4		723.8
	(15.4)		(12.5)
4. Time deposits	5589.8		6268.0
	(16.5)		(12.1)
5. Broad money (1+2)or(3+4)	7002.3	8157.7	7871.2
	(16.1)	(16.5)	(12.4)

Figures in the parentheses indicate y-o-y percentage changes.
[1/] "Govt. lending fund" is treated as deposit in calculating claims on Govt. (net).
[2/] Demand deposits of monetary authority are excluded.

Chart 4.2 Components of broad money (M2)



with particular emphasis on risk management, internal audit and internal controls, accountability and transparency.

Deposit and lending interest rates of banks and financial institutions have been coming down in line with the decline in CPI inflation; spreads between weighted average deposit and lending interest rates of banks and financial institutions have also come down below five percentage points. Competitive lending interest rate setting behaviour has not yet been fostered well in the local financial market. Bangladesh Bank has resorted to setting ceilings on lending interest rates in two priority areas, viz., pre-shipment export credit and agricultural credit. In the context of general declining trend in interest rates, Bangladesh Bank has revised the lending rate ceiling for agriculture downward from 13 to 11 percent. Bangladesh Bank has continued to pursue ways of fostering of competitive price setting, rate setting attitudes and practices in financial markets.

The monetary policy stance has also aimed at preserving country's external sector competitiveness. In FY15, export growth slowed down to 3.39 percent for a number of domestic and external factors including weak demand in the European Union. Import recovered from sluggish growth of the past couple of years for pick up due mainly to imports of capital machinery and production inputs. Remittance maintained moderate growth of 7.65 percent. Thus, current account balance of BOP turned from surplus to deficit. The overall balance remained a surplus of USD 4.37 billion in FY15 less than USD 5.48 billion in FY14.

Bangladesh Banks' foreign exchange reserves reached at a new height of USD 25.02 billion in June 2015. Bangladesh Bank bought USD 3.76 billion from the foreign exchange market during FY15 to protect external competitiveness of Taka by easing appreciation pressure. This policy stance helped maintain stability in the exchange rate for the last two years.

Chart 4.3 Domestic credit and its components

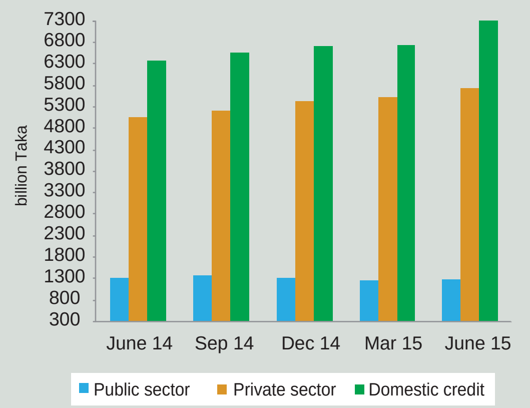
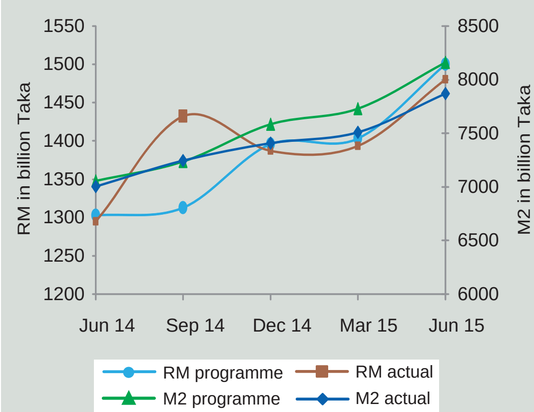


Chart 4.4 Programmes and actual developments of M2 and RM in FY15



Bangladesh Bank's initiatives for strengthening financial inclusion and diversification and environmentally sustainable financing continued in FY15 to extend outreach of financial services into remaining pockets of exclusion in underserved areas and people. As such, initiatives have been taken to bring third gender entrepreneurs, under privileged entrepreneurs, physically challenged people and all tribal including Rakhain community under SME network in order to reaching out financial inclusion benefit to the marginalised entrepreneurs. Policy has been taken to train at least 3 women under every branch area of all banks and non banks institutions those did not avail any loan from bank or non bank institutions. Moreover, at least one trained woman under every branch area shall be provided loan in cottage, micro or small industry sectors. Mobile phone financial services grew with 28.64 million registered customer in June 2015. 15.32 million "no-fril accounts" were opened by the end of June 2015. Bangladesh Bank has also set up a Taka 2 billion refinancing facility via micro finance institutions to provide small loans to the lower income rural households those who set up '10 taka' accounts.

Bangladesh Bank's attention in support of capital market stability also continued in FY15. Bangladesh Bank has the statutory responsibility of enforcing bank for compliance of the legal limits on their capital market exposures. Further, Bangladesh Bank has continued liquidity support for capital market transactions in volumes permissible within Bangladesh Bank monetary programmes. It played an instrumental role in structuring the refinancing programme supporting capital market activities and continued to play supportive role in capital market development to the feasible within laws and regulations.

4.3 Broad Money (M2) grew by 12.4 percent in FY15 against 16.5 percent targeted growth under the programme and 16.1 percent actual growth in FY14. The monetary programme vis-à-vis actual outcomes are presented in Table 4.1.

The lower growth in domestic credit in the banking system contributed to slow down the growth in broad money (M2) in FY15. Domestic credit growth from banking system slowed down to 10.1 percent against the targeted growth of 17.4 percent for FY15 and the actual 11.6 percent growth in FY14.

Table 4.2 Reserve money position

(billion Taka)

	End June 14	End June 15	
	Actual	Programme	Actual
Net foreign assets[1/@]	1400.2	-	1695.1
Net foreign assets[2/@]	1352.5	1400.2	1677.1
Net domestic assets[1/]	-105.3	-	-215.2
Net domestic assets[2/]	-57.7	99.9	-197.2
Domestic credit	156.9	186.9	143.6
	(-54.4)	(19.1)	(-8.4)
Credit to the public sector[3/]	102.3	132.3	95.4
	(-63.7)	(29.3)	(-6.7)
Credit to deposit money banks[4/]	54.6	54.6	48.2
	(-13.1)	(0.0)	(-11.6)
Other items (net)	-214.6	-87.0	-340.8
Reserve money	1294.8	1500.1	1479.9
	(15.4)	(15.8)	(14.3)
Currency issued	854.9	992.6	981.5
	(13.4)	(16.1)	(14.8)
Deposits of banks with BB[5/]	440.0	507.5	498.4
	(19.5)	(15.3)	(13.3)
Money multiplier	5.41	5.44	5.32

[@] Excluding foreign currency clearing account balance and offshore bank account.
[1/] Calculated from monetary survey using end of period exchange rates.
[2/] Calculated using constant exchange rates of end June 2011.
[3/] Govt. lending fund is treated as deposit in calculating net credit to Govt
[4/] Considers only loans and advances to DMBs.
[5/] Excluding foreign currency clearing account balance and non-bank deposits.
Note : Figures in the parentheses indicate y-o-y percentage changes.

Table 4.3 Income velocity of money

(billion Taka)

Year	GDP at current market prices	Broad Money (M2) (end June position)	Income velocity of money
FY09	7050.72	2964.99	2.38 (-5.93)
FY10	7975.39	3630.31	2.20 (-7.56)
FY11	9158.29	4405.20	2.08 (-5.45)
FY12	10552.04	5171.10	2.04 (-1.92)
FY13	11989.23	6035.06	1.99 (-2.45)
FY14	13436.74	7006.24	1.93 (-3.02)
FY15	15136.00	7871.2	1.92 (-0.52)

Note: Figures in parentheses indicate percentage changes over previous fiscal year.

Domestic credit growth declined due to lower investment demand by the private sector for a number of reasons. Credit to the public sector declined significantly due mainly to higher net sale of saving certificates by government and slower implementation of ADP. The growth in public sector credit stood negative at 2.5 percent against the targeted 25.3 percent growth under the programme in FY15 and 8.8 percent actual growth in FY14. However, private sector credit growth increased in FY15 compared to previous year but remained lower against the targeted level. The growth in private sector credit stood at 13.2 percent in FY15 against the targeted growth of 15.5 percent and the actual growth of 12.3 percent in FY14. As a result, net domestic assets registered 10.0 percent growth in FY15 compared to the targeted growth of 20.2 percent for FY15 and 11.0 percent actual growth in FY14.

On the other hand, growth in net foreign assets (NFA) stood at 20.7 percent against the targeted 3.6 percent growth for FY15. Though net foreign assets increased against the targeted level, but it was lower than 38.6 percent actual growth in FY14. However, in the pace of moderate remittance growth (7.65 percent) in the external sector, growth in net foreign assets (NFA) declined owing to weak export growth and strong demand in imports of capital machinery and production inputs which eventually caused the trade account deficit in FY15. Trends of broad money and its components are shown in chart 4.2.

Reserve Money Developments

4.4 Reserve money (RM) has been used as an operating target to modulate liquidity consistent with the overall monetary projection. The weekly auctions of Govt. treasury bills and bonds are usually influenced the level of RM, while repo and reverse repo operations are applied for smoothening the money market.

4.5 In line with the projected broad money growth, the monetary programme set at 15.8 percent growth of RM for FY15 but the actual growth was 14.3 percent. The lower than projected growth of RM during the year was due mainly to the substantially lower level of

Chart 4.5 Movement of GDP growth, M2 growth, rate of inflation and income velocity of money

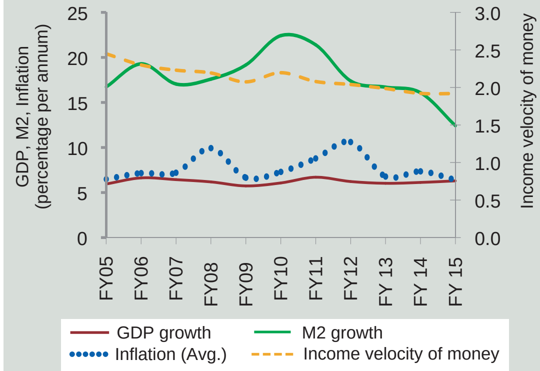


Table 4.4 Bank Credit*- FY15 quarterly positions

(billion Taka)

Outstanding as of	Advances	Bills	Total
30 June 14	4854.00 (96.17)	193.49 (3.83)	5047.49
30 Sep 14	5020.61 (95.44)	185.27 (3.56)	5205.88
31 Dec 14	5273.56 (96.76)	176.86 (3.24)	5450.42
31 Mar 15	5335.72 (96.55)	190.79 (3.45)	5526.51
30 June15	5528.69 (96.50)	200.30 (3.50)	5728.98

Figure in parentheses indicate percentage shares of total bank credit.
* Excluding foreign bills and inter bank credit.

net domestic assets of BB compared to the programme level. Net domestic assets stood negative at Taka 197.2 billion against the programme level of Taka 99.9 billion. Domestic credit of BB registered negative 8.4 percent growth associated with its components; public sector credit recorded negative 6.7 percent growth compared to 29.3 percent growth targeted under the programme due to lower than expected growth of government borrowing from banking system. Government borrowing from banking system declined due mainly to substantial increase in non-bank borrowing from net sale of NSD certificates during FY15. Credit to the deposit money banks stood at Taka 48.2 billion in FY15 against the targeted amount of Taka 54.6 billion as banks had sufficient liquidity to meet the required demand. On the other hand, net foreign assets of BB, however, substantially increased by Taka 324.6 billion and stood at Taka 1677.1 billion against the actual level of Taka 1352.5 billion in FY14 (Table 4.2).

4.6 Money multiplier decreased to 5.32 in FY15 as compared to 5.41 in FY14. Reserve-deposit ratio increased to 0.085 in FY15 from 0.084 in FY14 and currency-deposit ratio also increased to 0.1258 in FY15 as compared to 0.1233 in FY14. Net changes of both reserve-deposit ratio and currency-deposit ratio led to decrease in money multiplier. Both money multiplier and reserve money growth explain the growth in broad money. Movement of domestic credit and its components in FY15 are shown in Chart 4.3.

Actual development of M2 and RM against their respective programme path is shown in Chart 4.4.

Table 4.5 Bank deposits*- FY15 quarterly positions

(billion Taka)

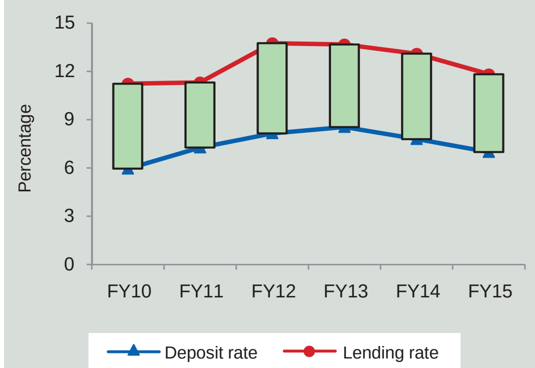
Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 14	643.44	5589.78	392.18	6625.40
30 Sep 14	620.25	5752.39	387.26	6759.90
31 Dec 14	656.36	5932.16	456.97	7045.49
31 Mar 15	642.02	6045.65	446.85	7134.52
30 June 15	723.84	6268.00	471.17	7463.01

*Excluding inter bank and restricted deposits.

Table: 4.6 weighted average interest rates of scheduled banks

Items	as of end June (in %)					
	FY10	FY11	FY12	FY13	FY14	FY15
Deposit rate	5.96	7.27	8.15	8.54	7.79	6.80
Lending rate	11.23	12.42	13.75	13.67	13.10	11.67
Spread	5.27	5.15	5.60	5.13	5.31	4.87

Chart 4.6 Weighted average interest rates of scheduled banks



Income Velocity of Money

4.7 The income velocity of money decreased by 0.52 percent to 1.92 in FY15 from 1.93 in FY14 (Table 4.3). It was declined by 3.02 percent in FY14. Income velocity of money was on a declining trend over the past several years indicating increased speed of transactions as a result of among other factors, rapid commercial bank branch expansion and financial inclusion drives in the financial system. Movement of GDP growth, M2 growth, inflation and income velocity of money during FY05-FY15 are shown in Chart 4.5.

Bank Credit

4.8 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY15 rose by Taka 681.49 billion or 13.50 percent to Taka 5728.98 billion as against an increase of 12.61 percent in FY14. The rise in the bank credit during FY15 was driven by both the increase in bills and advances.

Advances increased by Taka 674.69 billion or 13.90 percent in FY15 as against an increase of 13.33 percent during FY14. Bills purchased and discounted increased by Taka 6.81 billion or 3.52 percent in FY15 as compared to the decrease of 2.77 percent in FY14. The quarterly position of bank credit and its components is presented at Table 4.4.

Bank Deposits

4.9 Bank deposits (excluding inter-bank items) increased by Taka 837.61 billion or 12.64 percent to Taka 7463.01 billion during FY15 against 15.65 percent increase in FY14. The rise in total bank deposits was contributed by all kinds of deposits. Time deposits increased by Taka 678.22 billion or 12.13 percent and stood at Taka 6268.00 billion in FY15 against growth of 16.48 percent during FY14. Demand deposits increased by Taka 80.4 billion or 12.50 percent in FY15 to Taka 723.84 billion against 15.44 percent decrease in FY14. Government deposits increased by Taka 78.99 billion or 20.14 percent to Taka 471.17 billion in FY15 against 5.28 percent increase in FY14. Quarterly position of bank deposits in FY15 is presented at Table 4.5.

Credit/Deposit Ratio

4.10 The credit/deposit ratio of the scheduled banks, excluding the specialised banks was 0.77 at the end of June 2015. It was 0.76 at the end of June 2014. Increasing credit to deposit ratio in FY15 indicates credit growth is higher than the deposit growth.

Scheduled Banks' Borrowing from Bangladesh Bank

4.11 Scheduled banks' borrowings from the Bangladesh Bank decreased by Taka 7.03 billion or 12.72 percent to Taka 48.24 billion at the end of June 2015 against the decrease of 41.46 percent at the end of June 2014.

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

4.12 Balances of scheduled banks with the BB increased by Taka 58.41 billion or 13.28 percent to Taka 498.39 billion at the end of June 2015 compared to the increase by 19.55 percent to Taka 439.98 billion at the end of June 2014. Cash in tills of scheduled banks increased by Taka 16.36 billion or 19.08 percent to Taka 102.13 billion at the end of June 2015 against the increase of 9.69 percent to Taka 85.77 billion as of end of June 2014.

Cash Reserve Requirement (CRR)

4.13 The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank remained unchanged at 6.50 percent of their total demand and time liabilities for implementing the objectives of Monetary Policy. It may be noted that banks are required to maintain CRR at the rate of 6.50 percent on average on bi-weekly basis provided that the CRR would not be less than 6.00 percent in any day with effect from 24 June 2014.

Statutory Liquidity Ratio (SLR)

4.14 According to the amendment of subsection (2) under section 33 of Bank Company Act, 1991, banks should have maintained statutory liquidity ratio separately as follows, (a) for the conventional banks, the statutory liquid assets inside Bangladesh which also includes excess reserves with Bangladesh Bank shall not be less than 13.0 percent of their total demand and time liabilities, and (b) for the shariah based Islami banks, this rate shall not be less than 5.5 percent. This has been effective from 1 February, 2014.

Bank Rate

4.15 The bank rate remained unchanged at 5.0 percent in FY15. This rate has been in effect from 6 November 2003.

Interest Rates on Deposits and Lending

4.16 The weighted average interest rates on deposits increased during FY10-FY13 (Table 4.6) and then started decreasing from FY14 and reached at 6.80 percent in FY15. Similarly, the weighted average interest rates on lending increased during the period of FY10 to FY12 and started declining thereafter and reached at 11.67 percent in FY15. Though policy rates remained unchanged, lending rates declined due to lower cost of funds for banks, lower demand for credit as well as increasing competition from overseas lenders whose lending rates are in single digit. The spreads between lending rates and deposit rates were above 5 percent from FY10 to FY14 which decreased to 4.87 percent in FY15 from 5.31 percent in FY14.