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Cover Photograph
UNITY, a sculpture by Hamiduzzaman Khan on the Bangladesh Bank premises.
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Highlights

- GDP growth momentum in FY18 was underpinned by strong domestic and external demand, as reflected in buoyant public and private investment, and consumption, driven by higher exports, remittances, and private credit growth. A broad-based pickup in global growth provided a favorable external backdrop for exports and remittances.

- Import growth, however, increased sharply, reflecting a confluence of domestic and external factors: capital goods and infrastructure-related imports, higher commodity and oil prices, a sharp one-off increase in food imports after the floods last year, which widened current account deficit and tightened liquidity conditions.

- GDP growth at 7.65 percent outperformed the target of 7.4 percent and average inflation at 5.78 percent slightly underperformed, relative to the goal of remaining within 5.5 percent, reflecting weather-related shocks amid rising global inflation.

- Inflationary risk concerns remained largely under control in FY18 since broad money (M2), the key determinant of inflation, grew by 9.2 percent, well below the program target of 13.3 percent. Private credit growth, despite recent moderation, remained strong at 16.95 percent in June 2018, slightly above the FY18 program target, but domestic credit (DC) growth reached 14.6 percent, below the program target of 15.8 percent.

- BB's policy measures since the last MPS - a reduction in CRR by 1 percentage point and repo rate by 75 basis points - along with the increased deposits by public agencies in private banks helped moderate the liquidity tightening from the negative NFA growth. These measures aided banks' initiatives to moderate interest rate spikes in the near term. That said, medium-term interest rate and foreign exchange flexibilities remain important pre-conditions for market development, higher investment, and employment-focused growth for achieving the Sustainable Development Goals (SDGs) by 2030.

- Balancing the inflation and output risks, amid improving liquidity conditions and moderating food inflation while inflation expectations are elevated and global market conditions tighter, BB has decided to maintain the policy rates at their current levels, with repo and reverse repo rates at 6.0 and 4.75 percent, respectively. The FY19 monetary program sets growth ceilings of private credit, domestic credit and broad money at 16.8, 15.9, and 12.0 percent, respectively, adequate to support growth while maintaining price stability.

- Furthermore, BB will continue to resort to intensive and intrusive supervision in ensuring that credit flows reach the priority sectors (agriculture, manufacturing, SMEs) that can create more and better jobs while protecting the environment. A move toward a market rate-linked National Savings Certificates (NSCs) pricing mechanism, reduction in NPLs, and nudge to the corporates for increasing their reliance on capital market financing remain important pre-requisites for improving monetary transmission mechanism, financial efficiency and stability, and developing the capital markets.
Monetary Policy Statement

The First Half of the Fiscal Year 2019: July-December 2018

This Monetary Policy Statement (MPS) presents Bangladesh Bank’s (BB) monetary policy outcome for the fiscal year 2018 (FY18) and the monetary policy stance for H1 FY19. As in the past, the FY19 monetary program and the monetary stance for H1 FY19 have been formulated by taking into account the actual outcome for FY18, domestic and external developments, and feedback from stakeholder consultations with academics and policy analysts, current and former policymakers, the BB Board of Directors, and real and financial sector representatives.

Monetary Policy Performance for H2 FY18

Economic growth momentum in FY18 was underpinned by strong domestic and external demand, as reflected in buoyant public and private investment, and consumption, driven by higher exports, remittances, and private credit growth relative to FY17. A broad-based pickup in global growth in the first half (H1) of FY18 provided a favorable external backdrop for exports and remittances. Import growth in FY18, however, reached a recent high of over 25.0 percent, reflecting a confluence of domestic and external factors: infrastructure-related imports, higher commodity and oil prices, a sharp increase in food imports after the floods last year, resulting in a current account deficit of around 3 percent of GDP. The widened current account deficit led to a reversal of the liquidity injections due to a decline in net foreign assets (NFA) at (-)4.3 percent in June 2018, well below the initial FY18 target of 5.4 percent, accompanied by exchange rate depreciation, and sales of foreign exchange reserves. To moderate the tightening of liquidity conditions, BB subsequently adopted a package of measures, including the reduction of Cash Reserve Ratio (CRR) by 1 percentage point and the repo rate by 75 basis points to 6 percent, while lengthening the available repo tenures to 7, 14, and 28 days. Together, these measures subsequently eased the liquidity crunch, with the interbank call money rates now at around 2.0 percent. In line with the robust economic activity, private credit growth, despite recent moderation, remained strong at 16.95 percent in June 2018, slightly above the FY18 program target of 16.8 percent but domestic credit growth reached 14.6, well within the program target of 15.8 percent, an outcome that partly reflects the negative growth of government borrowing from the banking system, which afforded additional space for private sector credit growth while remaining within the broader monetary program parameters. Inflationary risk concerns remained largely under control since broad money (M2) growth for FY18, the key determinant of inflation, came at 9.2 percent, well below the nominal growth of GDP and the program target of 13.3 percent. With closer surveillance on adherence to the Asset Liability Management and Forex Risk Management guidelines, over-exuberant credit growth in some of the banks is showing signs of moderation.

In terms of the output and price objectives, strong domestic and external demand, with support from robust private sector credit growth, helped the economy to grow by 7.65 percent in FY18, over-performing the Government’s growth target of 7.4 percent. Higher global commodity prices and weather-related shocks raised food inflation to above 7 percent in June 2018. Overall CPI inflation (12-month-average) was at 5.78 percent, slightly above the target of 5.5 percent, but less than the pick-up in inflation in advanced and emerging market economies by 0.4-0.5 percent during the same period.
Monetary Policy Stance for H1 FY19

To help the Government’s inclusive and sustainable growth agenda, BB’s monetary and financial sector policies are designed to foster price stability while supporting growth that can create more and better jobs in environmentally sustainable production activities. Given Bangladesh’s relatively high level of national savings compared to the peer economies and the need for improving the volume, maturity, and efficiency of investment financing, it is important that monetary and financial sector policies also advance the Government's medium- and long-term market development agenda. Monetary program for FY19 is aimed at providing adequate amount of quality credit to support the Government’s growth and inflation targets, while promoting financial and external stability amid the shifting global and domestic risk considerations.

In light of the domestic and global inflation outlook and considering the evolving domestic inflation and output risks, repo and reverse repo rates will be maintained at 6.0 and 4.75 percent, respectively for H1FY19. The FY19 monetary program targets domestic credit (DC) and broad money (M2) growth ceilings at 15.9 and 12.0, respectively, sufficient to accommodate real GDP growth of up to 7.8 percent and average annual CPI inflation of up to 5.8 percent. Public sector bank borrowing, projected to grow by 8.5 percent, well above the FY18 outturn of (-)2.5 percent, is expected to leave adequate space for private sector credit to grow within the FY19 target ceiling of 16.8 percent. BB's continued focus on banks' adherence to the ALM and Foreign Risk Management guidelines along with the intensive and intrusive surveillance of credit quality is expected to support both financial and external stability in FY19 and further moderate over-exuberant lending by a few banks and align their credit growth with deposit growth. As the impacts of one-off factors (e.g., flood-related food imports) on imports taper off and with projected solid remittance and export performance in FY19, current account deficit is expected to moderate. In this context, the projected improvement in overall balance of payments will contribute to a reserve money growth of 7.0 percent in FY19, gradually improving domestic liquidity.

The challenge of monetary transmission mechanism, especially in developing economies with various market frictions, stems from how any changes in the short-term policy rates controlled by the central banks transmit to the medium- and long-term rates faced by the borrowers in the banking system and in the bond market. As experienced by other emerging economies during their middle-income phase, improving monetary transmission mechanism goes hand in hand with increasing interest and foreign exchange rate flexibility, which are also preconditions for the market development needed to increase the quality and quantity of investment financing that can improve Bangladesh’s competitiveness in the years ahead. Any sustained and market-based reduction in nominal interest rate can come only through a durable reduction in inflation and an improvement in the efficiency of financial intermediation (e.g., lower NPLs). Furthermore, higher risk-free rates of NSCs pose additional challenges for financial deepening and efficiency. Introducing a market rate-linked pricing of the NSC is therefore important for monetary policy implementation. The recent attempt by the banks to moderate interest rate overshooting, aided by the policy measures to increase liquidity and BB’s various refinancing windows, has important long-term implications for the role of interest rate in overall demand management, for financial deepening, market development (e.g., corporate bond) and the financial inclusion agenda. BB will be ready to intervene with interest rate instruments for overall demand management as needed.
Global Growth and Inflation Outlook

Global growth is expected to reach 3.9 percent in 2018 and 2019, supported by investment recovery in advanced economies, continued strong growth in emerging Asia, an upswing in emerging Europe and signs of recovery in several commodity exporters (World Economic Outlook Update, July 2018). Advanced economies are projected to grow at 2.4 percent in 2018 and 2.2 percent in 2019. For both the years, this aggregate forecast is considerably stronger than expected a year ago, but there are growing signs that the growth momentum is softening and becoming uneven and risks to the outlook is rising. Growth projections have been revised down for the euro area, Japan, and the United Kingdom, reflecting negative surprises to activity in early 2018. US growth, which has been boosted by the recent fiscal stimulus, is projected to moderate in the medium term. In the emerging markets, growth is now more uneven than expected, driven by rising oil prices, higher yields in the United States, dollar appreciation, increasing trade tensions, and market pressures on the currencies of some economies with weaker fundamentals, with the net effect on individual economies varying with the strength of the cross-winds they are facing and idiosyncratic domestic factors. In Asia, growth in China is projected to moderate from 6.9 percent in 2017 to 6.6 percent in 2018 and 6.4 percent in 2019, as regulatory tightening of the financial sector takes hold and external demand softens. India’s growth rate is expected to rise from 6.7 percent in 2017 to 7.3 percent in 2018 and 7.5 percent in 2019, as the headwind from the currency exchange initiative and the introduction of the goods and services tax fade. Oil exporters in the Middle East have benefited from the improved outlook for oil prices, with growth projected to strengthen from 2.2 percent in 2017 to 3.5 percent in 2018 and further to 3.9 percent in 2019, supporting the outlook of remittance inflows to Bangladesh. To summarize, during FY19, overall global growth outlook is expected to provide favorable tailwinds for Bangladesh’s economy but external risks have increased significantly.

Global commodity prices have increased in 2018, supported by both demand and supply factors. A broad-based global recovery lifted demand for commodity, while some commodities faced supply constraints. According to the April 2018 World Bank commodity market outlook, energy prices are forecasted to rise by 19 percent in 2018, led by oil and natural gas prices (around 23 percent). Strong oil demand and production cuts in the OPEC and non-OPEC producers, rising geopolitical concerns have bolstered oil prices. Non-energy commodity prices are projected to rise by 3.6 percent and agricultural prices by 2.3 percent, largely due to supply shocks in the United States. According to the latest available

Table: Overview of the World Economic Outlook

<table>
<thead>
<tr>
<th>GDP at constant prices</th>
<th>Percentage Change</th>
<th>Difference from April 2018 WEO Projection</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>3.2</td>
<td>3.7</td>
</tr>
<tr>
<td>Advanced Economies</td>
<td>1.7</td>
<td>2.4</td>
</tr>
<tr>
<td>USA</td>
<td>1.5</td>
<td>2.3</td>
</tr>
<tr>
<td>Euro Area</td>
<td>1.8</td>
<td>2.4</td>
</tr>
<tr>
<td>Other Advanced Economies</td>
<td>2.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Emerging Market and Developing Economies</td>
<td>4.4</td>
<td>4.7</td>
</tr>
<tr>
<td>China</td>
<td>6.7</td>
<td>6.9</td>
</tr>
<tr>
<td>India</td>
<td>7.1</td>
<td>6.7</td>
</tr>
</tbody>
</table>

Source: World Economic Outlook Update (July 2018), International Monetary Fund.

Chart: Commodity Price Index

Food and Agriculture Report published by FAO, international rice prices steadily increased since 2017, creating additional pressure on Bangladesh's current account.

Furthermore, financial conditions in the advanced economies have tightened with higher inflation and strong job creation in the US, reflected in the increase in the Federal Funds rate by 25 basis points in June. Markets are increasingly pricing in two additional rate hikes in 2018 and three in 2019—a steeper schedule than previously expected. US short-term risk free rates increased significantly since 2017, up by over 150 basis points, flattening the US yield curve (Chart). Recent bouts of global financial market volatility highlight the markets’ reassessment of fundamentals and risks. A sudden deterioration of risk appetite could trigger disruptive global portfolio adjustments, worsen the reversal of capital flows from emerging markets, and lead to further US dollar appreciation. Higher expected US rates are likely to continue generating additional pressures on interest and exchange rates in the emerging markets, including Bangladesh. Looking ahead, tightening global financial conditions are expected to create pressures on the interest and exchange rates in FY19, increasing the upside risks to inflation.

**Domestic Growth and Inflation Outlook**

According to the provisional estimates by Bangladesh Bureau of Statistics (BBS), real gross domestic product (GDP) grew by 7.65 percent in FY18, up from 7.28 percent in FY17, well above the projected 4.9 percent GDP growth for emerging market and developing economies in 2018. A surge in remittance inflows, 17.3 percent in FY18 up from (-)14.5 percent in FY17, along with strong private sector credit growth boosted consumption demand. At the same time, higher growth in investment-related imports reflected robust investment demand. Export growth also maintained its momentum during this period. On the supply side, the growth impulse largely came from the industry and the service sectors. The agriculture sector activities also remained solid, supported by benign weather conditions, higher crop price, and timely supply of inputs and finance.
Industry benefitted from robust growth in manufacturing and construction. Aided by a

rebound in export due to stronger-than-expected growth in the US and Euro area, manufacturing sector grew by 13.2 percent in FY18, up from 11 percent a year ago. A pick-up in the implementation of government’s mega projects raised construction sub-sector growth to 10.1 percent. As reported by the BBS, investment as a percent of GDP rose by around 1 percentage point to 31.5 of GDP in FY18. Based on the sector-wise growth trends and econometric estimates, BB projects GDP growth to range from 7.5-7.7 percent in FY19, assuming a continuation of domestic political calm and no further escalation of global trade-related conflicts. That said, BB will update its forecasts on a regular basis during the course of the year and accordingly monetary program to accommodate any significant changes.

Average inflation edged up during most of FY18 before peaking at 5.83 percent in April and then moderating to 5.78 percent in June, slightly above the target of 5.5 percent and broadly tracking the food inflation dynamics driven by flood-related domestic shocks and higher global commodity prices. As anticipated in the previous MPS, average food inflation reached 7.3 percent in April 2018, up from 6.0 percent in June 2017, before moderating to 7.1 percent in June 2018, aided by imports and better harvests. Lower non-food inflation (3.7 percent in June 2018) provided some offsets to overall inflation but has registered an uptick since their recent lows (3.50 percent in December 2017), likely reflecting some spillover from higher commodity prices and exchange rate depreciation. Core inflation, which excludes food, oil, and other volatile commodity prices, remains moderate at 3.8, despite its gradual increase since February 2018 (3.6 percent). Although the second-round effects from food inflation

<table>
<thead>
<tr>
<th>Sectors</th>
<th>FY-16</th>
<th>FY-17</th>
<th>FY-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Agriculture</td>
<td>2.79</td>
<td>2.97</td>
<td>3.06</td>
</tr>
<tr>
<td>2. Industry of which Manufacturing</td>
<td>11.09</td>
<td>10.22</td>
<td>11.99</td>
</tr>
<tr>
<td>of which Construction</td>
<td>8.56</td>
<td>8.77</td>
<td>11.18</td>
</tr>
<tr>
<td>3. Service</td>
<td>6.25</td>
<td>6.69</td>
<td>6.33</td>
</tr>
</tbody>
</table>

GDP at constant market price 7.11 7.28 7.65

Table: Sectoral Growth Rate of GDP at Constant Prices (Growth rate in %)

Source: Bangladesh Bureau of Statistics, P = Provisional

Chart: Projection of GDP Growth for FY2019-FY2023

![Graph showing projected GDP growth for FY2019-FY2023](source)

Chart: Twelve Month Average Inflation

![Graph showing twelve month average inflation](source)

Chart: Distribution of Inflation Expectation*

![Graph showing distribution of inflation expectation](source)

* One year ahead general inflation
exchange rates movements are on the upside. BB’s inflation expectation survey also confirms the upside risks, since around 70 percent of the respondents expect one-year-ahead average inflation to be above 6 percent, highlighting the need for continued oversight in the management of monetary aggregates. BB projections show average inflation to be around 5.4-5.8 percent in December 2018, assuming no large domestic or external shocks.

**Money Supply and Credit Growth**

Almost all monetary aggregates in FY18 stayed close to or even below the monetary program path. Broad money, domestic credit, and credit to private sector growth in June 2018 stood at 9.2, 14.6, and 16.95 percent, respectively, against their targeted ceilings of 13.3, 15.8, and 16.8 percent. Negative growth in net foreign assets of (-)4.3 percent reflected the decline in NFA due to the sharp increase in current account deficits from high import growth. The stronger-than-expected decrease in overall BoP and decline in NFAs caused significant tightening of domestic liquidity conditions.

Despite a stronger-than-expected growth in private sector credit, domestic credit growth remained below the targeted ceiling (15.8 percent), as credit to the public sector declined by (-)2.5 percent in FY18, since the Government's
bank loans were paid off with proceeds from the larger-than-planned sales of National Savings Certificates (NSCs).

By balancing the inflation and output risks, BB kept repo rate at 6.75 percent and reverse repo rate at 4.75 percent in the first half of FY18 and prioritized supervision to improve credit quality and flows to the productive sectors. Furthermore, in order to reduce liquidity and foreign exchange risks and foster financial stability, banks were alerted to tighten their compliance with the BB's ALM and Foreign Exchange Risk Management guidelines. These measures put banks on a course to avoid excessive credit growth and align their credit growth with deposit mobilization; the average ADR peaked in April 2018 at 77.3 percent, before moderating to 76.7 percent in June 2018. Indications are that excessive credit growth by individual banks is also moderating.

In terms of the sectoral composition, credit to industry, transport, and construction sectors grew by 25, 26, and 18 percent, respectively, reflecting a pick-up in investment demand; consumer credit registered a modest growth of 4.1 percent (Chart). Based on a cross-country comparison, private sector credit growth in Bangladesh, one of the higher ones among the peer economies, remain sufficient to support the country's investment and growth targets (Chart).

Strong private sector credit growth, at around 17.0 percent, above the deposit growth of 10.3 percent, accompanied by liquidity withdrawals from the negative growth in NFAs and competition among the banks for deposit mobilization, given the high risk-free NSC rates, increased liquidity pressures in H2 FY18. As liquidity conditions tightened, reserve money growth fell to 4.0 percent and broad money growth to 9.2 percent in June 2018, well below the monetary program targets. BB reduced Cash Reserve Ratio (CRR) by 1 percentage point and repo rates by 75 basis points to 6 percent and increased available repo tenors to 7, 14, 28 days. This led to subsequent improvements in liquidity conditions, as indicated by excess reserves as measured by the banks' deposit with BB in percent of reserve money and also reflected in the interbank interest rates (now around 2 percent) (Chart).

During FY18, as in recent years, given the high interest rates of NSCs available on tap, the more-
than-planned sales of NSCs created excess funds that were used to pay off the lower-cost bank borrowing and the market-based T-bills and T-bonds, complicating market development. A move toward a market rate-linked NSC pricing mechanism is an important pre-requisite for improving monetary transmission mechanism and developing bond market to facilitate longer-term investment financing.

To support investment and growth while keeping a lid on inflationary pressures in FY19, domestic credit growth is programmed to increase by 15.9.

The table below summarizes the key monetary aggregates outcome and projections for FY18 and FY19.

<table>
<thead>
<tr>
<th>Item</th>
<th>Actual</th>
<th>Program</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Jun-17</td>
<td>Jun-18</td>
</tr>
<tr>
<td>Net Foreign Assets</td>
<td>11.5</td>
<td>-4.3</td>
</tr>
<tr>
<td>Net Domestic Assets</td>
<td>10.6</td>
<td>14.3</td>
</tr>
<tr>
<td>Domestic Credit</td>
<td>11.2</td>
<td>14.6</td>
</tr>
<tr>
<td>Credit to the public sector</td>
<td>-13.0</td>
<td>-2.5</td>
</tr>
<tr>
<td>Credit to the private sector</td>
<td>15.7</td>
<td>17.0</td>
</tr>
<tr>
<td>Broad money</td>
<td>10.9</td>
<td>9.2</td>
</tr>
<tr>
<td>Reserve money</td>
<td>16.3</td>
<td>4.0</td>
</tr>
</tbody>
</table>

**Policy Interest Rates**

During FY18, BBs’ policy measures resulted in a largely stable interest rate in the call money market, ranging between 2.0-4.5 percent. During the initial months of H2 FY18, with rising liquidity demand from high credit growth, and as reserve and broad money growth came down, pressures on call money rate increased. However, subsequent policy measures reversed the tightening trends in liquidity (Chart).

Improving liquidity conditions are also evidenced by the ratio of excess of SLR assets to Total Demand and Time Liabilities (TDTL), often referred to as "excess liquidity," which continued to moderate through December 2017 reaching 8.8 percent, but has since gradually increased to 9.2 percent in June 2018 (Chart).

Reflecting rising credit demand amid shifting liquidity conditions, the weighted average deposit interest rate spread (Chart),

![Chart: Deposit with BB in Excess of CRR](chart)

![Chart: Liquidity as a % of TDTL](chart)

![Chart: Call Money and Policy Rates](chart)

![Chart: Interest Rate Spread](chart)
and lending rates rose to 5.51 percent and 9.96 percent at the end of May 2018 from 4.84 percent and 9.56 percent, respectively, at the end of June 2017. The gap between deposit and NSC rates increased upward pressures on the deposit rates as liquidity conditions tightened from negative NFA growth and the divergence between credit and deposit growth. Faster increase in deposit rates tighten spread by 27 basis points in FY18.

Banks, subjected to BB's intensive and intrusive inspection and risk-based supervision, need to further improve their internal risk management and the capacity to evaluate and monitor loan projects. Increased information sharing can also help reduce concentration risks in the portfolio of individual banks and the banking system. The elevated levels of NPLs, which edged up to 10.8 percent in March 2018, increase spread and lending rates, and reduce profitability. As observed in other emerging markets, elevated NPLs reduce the effectiveness of the monetary policy and weaken the impact of any change of the policy rates on the lending rates faced by the borrowers. That said, given Bangladesh's high GDP growth, the real lending rates, defined as the nominal lending rate adjusted for inflation, remain sufficiently accommodative for investment and growth, relative to other high growth economies in South Asia (e.g., India) or South East Asia (Chart). During Bangladesh's middle income transitions, lowering inflation and NPLs, and increasing banks' operational efficiency can help banks to sustainability reduce their lending rates, while improving their profitability and financial stability.

Balancing inflation and output risks, in spite of improving liquidity conditions and moderating food inflation, BB has decided to keep policy rates unchanged at their current levels due to elevated inflation expectation, exchange rate pressures, and rising global interest rates. As in the previous policy cycles, economic and financial variables are monitored on a continuous basis and policy rates can be adjusted promptly as and when conditions warrant. The decision to maintain the policy rates at the current levels has also taken into consideration that reserve money (RM) and broad money (M2) growths in FY18 have been significantly lower than the monetary program path.
External Sector Developments and Outlook

Table: Balance of Payments Highlights

<table>
<thead>
<tr>
<th>Major Items</th>
<th>Actual 2016-17</th>
<th>Estimate 2017-18</th>
<th>Outlook 2018-19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade balance</td>
<td>-9,472</td>
<td>-18,372</td>
<td>-22,196</td>
</tr>
<tr>
<td>Services</td>
<td>-3,284</td>
<td>-4,214</td>
<td>-3,977</td>
</tr>
<tr>
<td>Primary income</td>
<td>-2,007</td>
<td>-2,204</td>
<td>-2,401</td>
</tr>
<tr>
<td>Secondary income</td>
<td>13,283</td>
<td>15,608</td>
<td>18,417</td>
</tr>
<tr>
<td>of which: Workers' remittances</td>
<td>12,591</td>
<td>14,769</td>
<td>17,428</td>
</tr>
<tr>
<td>CURRENT ACCOUNT BALANCE</td>
<td>-1,480</td>
<td>-9,182</td>
<td>-10,158</td>
</tr>
<tr>
<td>Capital account</td>
<td>314</td>
<td>301</td>
<td>350</td>
</tr>
<tr>
<td>Financial account</td>
<td>4,126</td>
<td>8,190</td>
<td>10,187</td>
</tr>
<tr>
<td>Errors and omissions</td>
<td>209</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>OVERALL BALANCE</td>
<td>3,169</td>
<td>-691</td>
<td>379</td>
</tr>
</tbody>
</table>

Source: Bangladesh Bank, EPB and the Ministry of Finance.

External sector developments in FY18 have been dominated by import dynamics. Current account deficit widened to 3.3 percent of GDP, due to higher trade deficit, despite a strong and broad-based rebound in remittances growth (17.3 percent) and a pick-up in overall export growth to around 6.0 percent, up from 1.7 percent a year ago. The sharp increase in import growth reflects higher demand for investment goods and food imports due to the flood-related weather shocks. Of the 14 percentage points (ppts) rise in import growth (up from 11 percent in FY17 to over 25 percent in FY18), capital goods, construction materials, export-related intermediate goods and food imports account for 80 percent of the increase. Overall BoP balance declined to (-)0.3 percent of GDP, leading to a decline in NFAs.

According to BB projections for FY19, remittance inflows and export growth are expected to continue their recent performance, driven by global output growth and stronger economic activities in the Middle East from higher oil prices. The measures taken by the Government and the Bangladesh Bank for reducing the cost of remittance transfer and curbing the role of unauthorized intermediaries in transferring remittances will continue to support inflows through the official channels.

As the effects of one-off factors taper off, import growth is expected to moderate in FY19, aided by better harvests and progress in some of the mega projects. BB projects export growth at around 8.0 percent, remittance growth at around 16 percent and import growth at 12.0 percent in FY19, resulting in a current account deficit of around 3 percent of GDP, reflecting excess of investment over savings and largely financed by FDIs and long-term borrowing.
Foreign Exchange Rates and Reserves

Reflecting the reversal of current account balance from their surpluses in recent years, exchange rate depreciated by around 4 percent in FY18, a moderate level relative to some of the peer economies (Chart). However, foreign exchange reserves stood at USD 32.9 billion at the end of June 2018; reserve coverage of imports decreased but remains broadly adequate at around 5 months (Chart).

In line with the market forces, Bangladesh Bank increased foreign exchange flexibility to moderate any external imbalances from high import growth and shifting global conditions but from time to time supported the market to avoid excessive volatilities. Looking ahead, as import growth and current account deficit moderate, increased foreign exchange rate flexibility will continue to play its part in managing external stability and accelerating market development. Continued strengthening of commercial banks' capacity to ensure that both over-invoicing of imports and under-invoicing of exports are minimized will help further deepen foreign exchange market and contribute to external stability.

Capital Market

The Dhaka Stock Exchange Broad (DSEX) index witnessed some price fluctuations in H2 FY18, in the aftermath of a strong performance in the first half of the fiscal year. Given Bangladesh's growing trade and financial integration and the increased participation of global portfolio
investors in DSE, the price and market turnover closely tracked the movements in the global markets (Chart). Daily average turnover declined from the peak level in 2017, reflecting both global and domestic liquidity conditions (Chart).

Looking ahead, improving liquidity conditions are expected to support financial stability, which is important for the capital market development agenda. In this context, the recent strategic investment by the Chinese Consortium-Shenzhen Stock Exchange and Shanghai Stock Exchange as strategic partners is expected to improve capacity and accelerate the development of capital markets. Furthermore, BB remains supportive of the much-needed shift of the non-financial corporates' long-term financing sources, away from the banking system and toward the stock and bond markets. For a balanced growth of the financial system, bond market needs to play a far greater role in upgrading Bangladesh's investment and growth trajectory.

Monetary Policy Implementation Risks and Challenges

As in many developing economies, monetary policy implementation faces various market frictions and shocks, and structural constraints, at home and abroad. Among the medium-term structural factors, degree of bank competition and the maturity of the financial markets (e.g., bond market) determine how any monetary policy actions affect lending rates and change aggregate demand.

Bangladesh Bank has pursued various initiatives to support the country's growth aspirations and supported market development agenda that can help better finance long-term investment. BB's continued focus on SMEs, agriculture, and green initiatives, including the $350 million Long Term Financing Facility and the $200 million Green Transformation Fund (GTF), reflect that vision. Given Bangladesh's young labor force, more and better jobs will need support from both the engines of growth - a vibrant manufacturing-led export sector and output activities to meet domestic demand that can create jobs in all three sectors - agriculture, services, and industry.

In terms of the market development agenda, deepening the bond markets remains a priority for a more efficient monetary transmission mechanism. In this context, market rate-linked pricing of NSCs accompanied by a two-way interest rate flexibility and the nudge to the corporates to shift their long-term financing to the capital markets will be needed. To make the banking channel more efficient, reducing corporate leverage, concentration risks, and NPLs remain important pre-requisites, which need to be accompanied by a timely and efficient debt resolution mechanism.

In terms of the risks, during FY18, growth outlook, assuming a relatively calm domestic political environment, faces downside risks from any significant ratcheting up of global trade-related conflicts and associated slowdowns. Inflationary risks stem from persisting domestic inflation expectations, exchange rate pass-through...
effects from higher global commodity prices, tighter global financial conditions, and higher current account deficits. Banks' increased vigilance in monitoring that credit flows finance capital goods that enhance the potential growth of the economy will benefit from a closer coordination among the BB, NBR, and Ministry of Commerce. Furthermore, developing capital markets to attract foreign portfolio investment and increasing equity financing - domestic and external - of mega projects would further improve external stability.