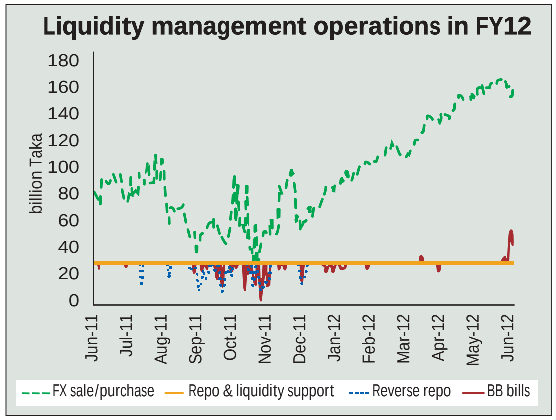
Money and Credit

Monetary Policy Stance

4.1 Bangladesh Bank set out its Monetary Policy Stance for FY12 against the backdrop of unfolding global recovery from recession and the new tension of a debt crisis in the Euro area as well as the challenges of surging inflation and balance of payment pressure in the domestic economy. In order to address these challenges BB's monetary policy stance was more restrained than that adopted in recent years. Inflation remained elevated and volatile in the H1 of FY12 due to a number of factors including the lagged effects of high domestic credit in FY11, global commodity (including oil and food) prices volatility, exchange rate depreciation and upward adjustments in energy and petroleum prices. However, the more restrained monetary policy stance, adequate domestic foodgrain supply and subsequent moderation in global commodity prices contributed in reducing the point to point inflation to a single digit level by the end of H2 of FY12. Nevertheless, the twelve month average consumer price index remained at a double digit (10.62 percent) level albeit on a declining trend.

The monetary targets for FY12 stayed on track and thus established the credibility of the stance. In FY12, broad money and net domestic assets grew by 17.4 and 18.1 percent against the target of 17.0 and 21.9 percent respectively. This outcome was achieved through active liquidity management

Chart 4.1



by raising the repo and reverse repo rates by 100 basis points, lifting all interest rates except for two rate caps and tightening consumer credit through administrative measures. Private sector credit grew by a healthy 19.7 percent against the 16.0 percent target under the programme. It was higher than the 'emerging Asia' regional average of 15.0 percent and was adequate to meet the output growth target. Analysis of loans to the private sector indicates an increasing share of SME loans and a virtually unchanged share of industrial term loans in total outstanding credit which were consistent with the policies pursued by BB.

In the first half of FY12 lower foreign aid inflows, higher subsidy payments and low levels of non-bank borrowings led to rapid growth of government borrowing from the banking sector including BB. Government borrowing from the banking sector exceeded the yearly budgetary target of Taka 189.57

billion and peaked at 213.21 billion in December 2011. In the second half of FY12 government borrowing from the banking system declined as foreign financing increased substantially and interest rates on savings instruments were raised. At the end of FY12 government borrowing from the banking sector stood at Taka 166.00 billion, well below the revised budget target of Taka 291.15 billion. Though credit growth to the public sector was above the programmed path in H1 of FY12 it was consistently below the programmed path in H2 of FY12. Thus, there was sufficient room for private sector credit growth of 19.7 percent.

BB conducted its liquidity management operation with the objectives of bringing down inflation to a tolerable level as well as attaining inclusive growth. In FY12 BB's policies of raising policy rates ensured the maintenance of positive real interest rates while easing the liquidity condition of the banks through the monetary policy transmission channels. Several additional measures were taken including 1) simplifying the liquidity support mechanism provided to primary dealer banks in the government debt market; 2) changing the Mark to Market basis for revaluation of government securities; 3) granting liquidity support on the full face value of Treasury bills and bonds after allowance for maintaining a 15.0 and 5.0 percent margin respectively; and 4) increasing the share of securities classified as Held to Maturity from 50.0 percent to 85.0 percent of SLR for primary dealers on a temporary basis to improve the liquidity condition of banks. In addition, an inter-bank fund market was introduced for Islamic shariah based banks and financial institutions and Islamic banking

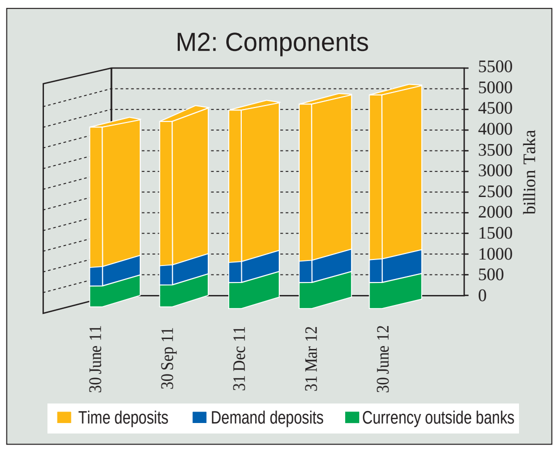
Table 4.1 Money and credit situation

(billion Taka)

	End June 11	End June 12	
	Actual	Programme	Actual
1. Net foreign assets	695.3R	633.5	788.2
	(6.2)	(-8.9)	(13.4)
2. Net domestic assets (a+b)	3707.9R	4518.2	4380.5
	(24.7)	(21.9)	(18.1)
a) Domestic credit (i+ii)	4302.2	5124.6	5130.6
	(28.2)	(19.1)	(19.3)
i) Credit to public sector 1/	895.1	1172.3	1051.6
	(38.3)	(31.0)	(17.5)
ii) Credit to private sector	3407.1	3952.3	4079.0
	(25.8)	(16.0)	(19.7)
b) Other items (net)	-594.3	-606.4	-750.1
3. Narrow money (i+ii)	1029.0		1094.8
	(17.2)		(6.4)
i) Currency outside banks	548.0		584.2
	(18.7)		(6.6)
ii) Demand deposits 2/	481.1		510.6
	(15.6)		(6.1)
4. Time deposits	3374.2		4073.9
	(22.7)		(20.7)
5. Broad money (1+2) or (3+4)	4403.2	5151.7	5168.7
	(21.4)	(17.0)	(17.4)

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

Chart 4.2



branches/windows of conventional banks with a view to strengthening liquidity management of those banks.

In the H1 of FY12 the external sector faced a challenging environment. The current account deficit widened as import growth outpaced export growth. The negative current account balance was compounded by low foreign aid inflows putting pressure on the BOP. This led to some depletion in foreign exchange reserves and exchange rate depreciation. Taka's value fell by 12.19 percent vis-à-vis the US dollar from 74.1450 at end June 2011 to 84.4400 in January 2012. This depreciation was a market led adjustment reflecting Bangladesh's weak BOP position as well as the need for the nominal exchange rate to adjust to maintain export competitiveness given the global slowdown. In the H2 of FY12 BOP pressures eased to some extent due to the restrained monetary policy stance, a slowdown in import demand and access to a greater range of foreign financing. As remittance inflow and foreign financing increased, a new equilibrium for the Taka-Dollar exchange rate was established in early 2012 and since then the exchange rate has remained relatively stable. At the end of June 2012 the Taka had depreciated by 9.4 percent from its level at the end of June 2011 and the Taka-US Dollar exchange rate stood at 81.8708. Foreign exchange market liquidity improved to the extent that all the foreign exchange overdrafts given by the central bank to the commercial banks, amounting to around USD 500 million at the end of 2011, were repaid by June 2012. Foreign exchange reserve increased to USD 10.36 billion by end June 2012 from USD 9.39 billion in January 2012 and compared with USD 10.91 billion at end June 2011.

4.2 The monetary policy stance for FY12 was designed to achieve the targets of a 7.0 percent real GDP growth and a 7.5 percent annual average CPI inflation. Accordingly, broad money (M2) growth was programmed at 17.0 percent. The monetary programme vis-à-vis actual outcomes are presented in Table 4.1.

Chart 4.3

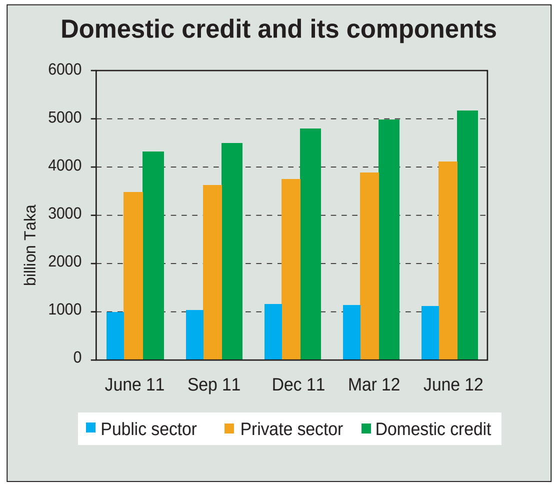
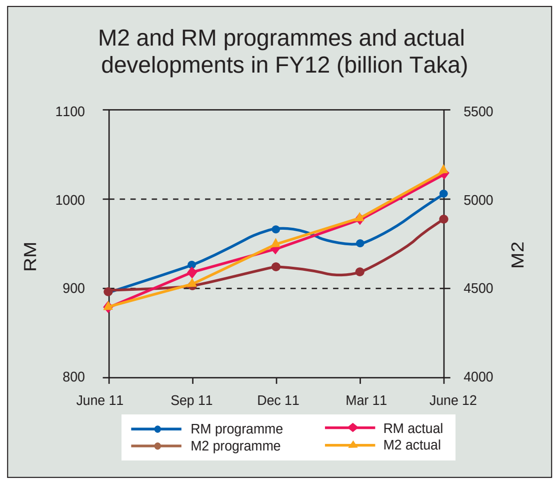


Chart 4.4



Broad money (M2) grew by 17.4 percent in FY12 slightly higher than the target under the programme but lower than the 21.4 percent growth experienced in FY11.

The growth in broad money (M2) came from increases in both net domestic assets and net foreign assets. The growth in domestic credit stood at 19.3 percent in FY12 against 19.1 percent under the programme due to the growth in private sector credit. Growth of private sector credit moderated to 19.7 percent against 25.8 percent growth achieved in FY11 due to the restrained monetary policy stance. However, it was higher than the targeted 16.0 percent under the programme and was made possible by lower government borrowing from the banking system, which declined sharply in the H2 of FY12. For all of FY12 credit to the public sector (including government) from the banking system recorded 17.5 percent growth against the targeted 31.0 percent under the programme. The growth in NFA stood at 13.4 percent against the negative 8.9 percent growth target under the programme for FY12. The slowdown in import demand, buoyant remittance inflows eased the current account balance. The access to a greater range of foreign financing inflows led to a positive growth in NFA. Trends of broad money and its components are shown at chart 4.2.

Reserve Money Developments

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

4.4. In line with the projected broad money growth, the monetary programme set a 12.2 percent growth of RM for FY12 but the actual growth out turn was 9.0 percent in FY12. The lower than projected growth of RM during the year was mainly due to the substantially lower level of net domestic assets compared to the programme level. Domestic credit registered a low 4.0 percent growth. Credit to the public sector grew by 14.6 percent against the target of 44.5 percent under the programme with lower than expected government borrowing

Table 4.2 Reserve money position

(billion Taka)

	End June 11	End June 12	
	Actual	Programme	Actual
Net foreign assets[1/@]	525.3	-	586.8
Net foreign assets[2/@]	523.1	461.6	541.1
Net domestic assets[1/]	371.9	-	391.2
Net domestic assets[2/]	374.1	545.1	437.4
Domestic credit	403.5	536.5	419.4
	(60.0)	(33.0)	(4.0)
Credit to the public sector[3/]	307.6	444.5	352.6
	(58.8)	(44.5)	(14.6)
Credit to deposit money banks[4/]	95.9	92.0	66.8
	(63.9)	(-4.1)	(-30.3)
Other items (net)	-32.0	8.6	-28.3
Reserve money	897.2	1006.7	978.0
	(21.0)	(12.2)	(9.0)
Currency issued	605.3	692.8	649.0
	(19.9)	(14.5)	(7.2)
Deposits of banks with BB[5/]	292.0	313.9	329.0
	(23.4)	(7.5)	(12.7)
Money multiplier	4.91	5.12	5.29

Figures in the parentheses indicate y-o-y percentage changes.
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., credit to other non-bank financial institutions (public) are excluded.
4/ Considers only loans and advances to DMBs.
5/ Excluding foreign currency clearing accounts balance and deposits of the other public sector.
@ Excluding foreign currency clearing accounts balance and offshore bank account.

from BB. Government borrowing, the dominant source of reserve money growth, was sharply lower due to reduced government expenditure and increased inflows from foreign sources. Credit to the deposit money banks declined by 30.3 percent against a targeted decrease of 4.1 percent under the programme due mainly to the lower demand for foreign currency loans from BB.

Net foreign assets of BB, increased by Taka 79.5 billion to Taka 541.1 billion as against a programmed fall in reserves on the strength of a robust growth of remittances and higher than envisaged inflows of foreign aid and foreign investments.

4.5 The Money multiplier increased to 5.29 in FY12 compared to 4.91 in FY11. The two ratios of the money multiplier - the currency-deposit ratio and the reserve-deposit ratio declined to 0.127 and 0.086 respectively in FY12 from 0.142 and 0.091 in FY11. The decline in these two behavioural ratios led to an increase in the money multiplier. This explains the higher growth in board money despite the subdued growth in reserve money. Movements of domestic credit and its components in FY12 are shown in Chart 4.3. Actual development of M2 and RM against their respective programme path is shown in Chart 4.4.

Income Velocity of Money

4.6 The income velocity of money decreased to 1.77 in FY12 from 1.81 in FY11 (Table 4.3). The rate of decline in FY12 was 2.21 percent against 5.23 percent in FY11. Income velocity of money has been on a declining trend over the past several years indicating increased monetisation and financial deepening in the economy. Movements in GDP growth, M2 growth, inflation and income velocity of money during FY02-FY12 are shown in Chart 4.5.

Bank Credit

4.7 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY12 rose by Taka 658.54 billion or 18.94 percent to Taka 4135.3 billion. The rate of growth was 24.95 percent in FY11. The rise in bank credit in FY12 was driven by the increase in both advances and bills purchased and discounted.

Advances increased by Taka 630.44 billion or 19.30 percent, against an increase of 23.63 percent in FY11. Bills purchased and discounted increased by Taka 28.1 billion or 13.35 percent in FY12, compared to 49.57 percent in FY11. The lower growth of advances and bills relative to FY11 is partly explained by the restraint stance for credit flow to the unproductive and consumer sectors. The quarterly position of bank credit and its components is presented at Table 4.4.

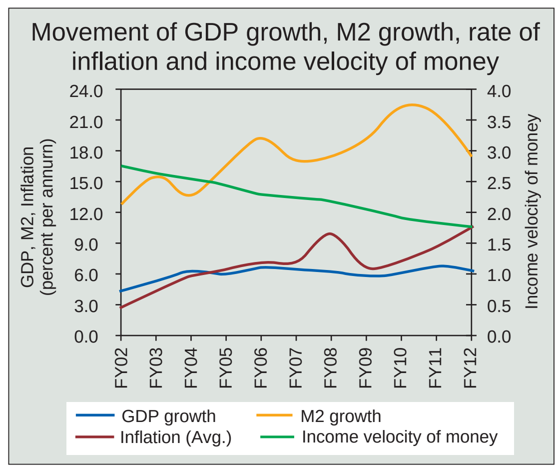
Table 4.3 Income velocity of money

(billion Taka)

Year	GDP at current market prices	Broad money (M2) (end June position)	Income velocity of money (GDP/M2)
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 (-1.91)
FY10	6943.2	3628.2	1.91 (-7.73)
FY11	7967.0[R]	4403.2	1.81 (-5.23)
FY12	9148.0[P]	5168.7	1.77 (-2.21)

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

Chart 4.5



Bank Deposits

4.8 Bank deposits (excluding inter-bank items) increased by Taka 796.02 billion or 19.39 percent to Taka 4900.47 billion in FY12 against the 21.85 percent increase in FY11. The rise in total bank deposits was observed in all deposits. Time deposits increased by Taka 699.69 billion or 20.74 percent and stood at Taka 4073.88 billion in FY12 against the growth of 22.68 percent in FY11. Demand deposits increased by Taka 29.54 billion or 6.14 percent in FY12 to Taka 510.60 billion against a decrease of 15.58 percent in FY11. The tighter monetary policy led to a substitution from demand deposits to time deposits by increasing interest rates on deposits and lifting the cap on interest rates. Government deposits increased by Taka 66.54 billion or 26.70 percent to Taka 315.74 billion in FY12 against 23.48 percent increase in FY11. The quarterly position of bank deposits in FY12 is presented at Table 4.5.

Credit/Deposit Ratio

4.9 The credit/deposit ratio of the scheduled banks, excluding the specialised banks was 0.84 at the end of June 2012 which was also the same as at the end of June 2011.

Scheduled Banks' Borrowing from the BB

4.10 Scheduled banks' borrowings from the Bangladesh Bank increased by Taka 38.38 billion or 21.52 percent to Taka 216.71 billion at the end of June 2012 against the 204.74 percent increase in FY11. The lower access to foreign currency loans by scheduled banks resulted in their lower borrowings from BB.

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

4.11 Balances of scheduled banks with the BB decreased by Taka 10.66 billion or 2.77 percent to Taka 373.36 billion at the end of June 2012 against the increase of 27.81 percent to Taka 384.02 billion at the end of June 2011. Cash in tills of scheduled banks increased to Taka 64.79 billion as of end June 2012 against Taka 57.32 billion as of end June 2011.

Cash Reserve Requirement (CRR)

4.12 The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank remained unchanged at 6.00 percent of their total demand and time liabilities. This rate has been in effect since 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)

4.13 The Statutory Liquidity Ratio (SLR) for the scheduled banks, except banks operating under the Islamic Shariah and the specialised

Table 4.4 Bank credit*-FY12: quarterly positions

(billion Taka)

Outstanding as of	Advances	Bills	Total
30 June 11	3266.34 (93.95)	210.42 (6.05)	3476.76
30 Sep 11	3355.93 (94.13)	209.18 (5.87)	3565.11
31 Dec 11	3567.43 (93.99)	228.18 (6.01)	3795.61
31 Mar 12	3699.21 (94.07)	233.03 (5.93)	3932.24
30 June 12	3896.76 (94.23)	238.52 (5.77)	4135.3

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

Table 4.5 Bank deposits*- FY12: quarterly positions

(billion Taka)

Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 11	481.06	3374.19	249.20	4104.45
30 Sep 11	470.50	3488.93	245.00	4204.43
31 Dec 11	495.24	3675.41	267.84	4438.49
31 Mar 12	483.36	3837.65	270.34	4591.35
30 June 12	510.60	4073.88	315.74	4900.47

*Excluding inter-bank and restricted deposits.

banks remained unchanged at 19.00 percent of their demand and time liabilities, excluding inter bank items. The SLR for the Islamic banks remained unchanged at 11.50 percent. These rates have been in effect since 15 December 2010. The specialised banks continued to remain exempt from maintaining the SLR.

Bank rate

4.14 The bank rate remained unchanged at 5.0 percent in FY12. This rate has been in effect since 6 November 2003.

Interest Rates on Deposits and Advances

4.15 Table 4.6 contains weighted average interest rates of scheduled banks on deposits and advances along with the spread during FY07 to FY12. It is evident from the Table that weighted average interest rates on deposits had increased to 7.0 percent in FY08 and remained stable in FY09. Thereafter, the interest rates on deposits declined to 6.01 percent in FY10 but started to increase again in FY11 and continued rising in FY12. On the other hand, the interest rates on advances had declined throughout the period FY07 to FY10. But they started to increase in FY11 and this continued in FY12 in response to the policy changes by BB. The trend of the spread between advances and deposits rates was mixed throughout the period of FY07 to FY12. With the withdrawal of the lending cap Bangladesh Bank strengthened its supervision and instructed banks to limit spread below 5.0 percent. As a result, from the second half of FY12 spreads were in declining trends for all banks.

Table: 4.6 Weighted average interest rates of scheduled banks

Items	as of end June (in %)					
	FY07	FY08	FY09	FY10	FY11	FY12
Deposit rate	6.90	7.00	7.00	6.01	7.27	8.15
Advance rate	12.80	12.30	11.90	11.31	12.42	13.75
Spread	5.90	5.30	4.90	5.30	5.15	5.60

Policies taken in FY12 Regarding Money and Credit

1) To reduce credit growth to unproductive sectors the loan margin ratio was fixed at 70:30 for fresh consumer loans for house finance and at 30:70 for all other consumer loans including motor car loans.

2) Bangladesh Bank increased repo and reverse repo rates by 50 basis points to 5.25 and 7.25 percent from 4.75 and 6.75 percent respectively, with effect from 5 September 2011. These rates were again increased by 50 basis points to 5.75 and 7.75 percent respectively, on 8 January 2012.

3) In order to strengthen liquidity of the banks, limit of holding HTM securities for Primary Dealers was increased from 50.0 percent to 85.0 percent of SLR for the concerned month.

4) Uniform accounting procedure for repo transactions was introduced in order to simplify the liquidity support operation to the primary dealer banks of Goverment securities. Instead of outright buy/sell of securities the procedure will treat such operations as collateralised repo transaction following compliance with some rules. BB will apply a 15.0 percent and 5.0 percent margin on the face value of T-bill/T bond, respectively, under this operation for liquidity support. The securities provided as collateral will be encumbered and thus shall not be eligible to meet the SLR or collateral for any other purposes.

5) In order to rationalise the rate of interest on lending and deposits, the cap on lending

interest rates in all sectors other than pre-shipment export credit and agriculture credit were withdrawn. Moreover, banks were advised to behave rationally in applying the freedom in determining interest rates and were also asked to limit the difference between the weighted average lending and deposit rates or intermediation spread within lower single digits in different sectors other than high risk consumer credit (including credit card) and SME loans.

6) Islami Inter Bank Fund Market (IIFM) was introduced in order to strengthen liquidity management of Islami shariah based Banks and FIs including Islami banking branches of conventional banks. In the Islami Inter-bank Fund Market (IIFM), Islami shariah based banks and FIs including Islami branches of conventional banks, may handover excess funds to the Islami Bond Fund (IBF) on a daily basis. IBF will act as a custodian. According to the Profit Sharing Ratio (PSR) fixed by IBF, funding will be provided to the borrower subject to availability.

7) In order to clarify share holding and capital market exposure of banks a circular was issued with instructions that capital provided by a bank to its subsidiary company established for merchant banking and brokerage activities will be excluded in calculating its capital market exposure. In addition, long term equity investment in a company will not be included in accounting capital market exposure of the banks.

8) Banks were advised to allow the opening of bank accounts by depositing Taka 100 against documentation showing the existence of a life insurance policy up to Taka 1,50,000 with a view to granting small life insurance policy holders access to the banking sector to broaden financial inclusion.

9) To provide banking services to ill served segments of the population in the rural areas relative to those in urban areas, the ratio of urban to rural branches was increased to 1:1.

10) To encourage export trade of the country export subsidy/cash incentive was continued in FY12. To facilitate the leather industry, cash incentive against the export of leather goods rose from 12.5 percent to 15.0 percent in FY12. Export subsidy was provided against advance export proceeds for shipping export through advance payments/TT. Export subsidy was also provided against export proceeds through negotiation/collection along with TT to facilitate frozen shrimp and other products in the fishing sector and to assist diversification to new export products or the expansion to new export markets. Textile mills were provided a 5.0 percent special cash incentive in addition to the existing cash incentive/ stimulus facility.

11) In order to expand bank branches in rural areas for providing banking services to the ill served population segments in the rural areas, it was decided to extend applications for refinance of credits to cottage and micro enterprises under the guidelines of 'Bangladesh Bank Fund' refinance scheme. The existing refinance programme for small enterprises of women entrepreneurs at the rate of 10.0 percent (bank rate+5.0 percent) will be applicable for cottage and micro enterprises. In case of fund shortages credits to manufacturing and service sectors will get the priority. All entrepreneurs, except women, will get 100.0 percent refinance facility against disbursed loan only in manufacturing and service sector under cottage, micro and small enterprises subject to adequacy of fund. In case of cottage industry the limit of refinance was enhanced from Taka 10,000 to Taka 5,00,000 and for micro industry it was

increased from Taka 20,000 to Taka 10,00,000. For small enterprises it remained unchanged from Taka 50,000 to a maximum of Taka 50,00,000.

12) Banks were allowed to disburse credit to the "Fish Cultivation in Cage" programme as a sub-sector of fish resources under the agricultural/rural credit policy and programme for FY12.

13) With a view to provide solar power to the electricity deprived rural areas by establishing solar home systems, interest rate will be charged by reducing balance system at the maximum rate of 12.0 percent at the beneficiary client level.

14) With a view to generate more and wider usage of bio-gas in rural areas it was decided that under the programme of consolidated cattle rearing and bio-gas production, using company/institutions as agent/intermediary, interest rate at beneficiary client level could be charged/realised at the rate of conventional bank rate+maximum 6.0 percent and no service charges could be applied.

15) Banks were advised to provide credit to bee keepers in those areas where honey is produced/has the potential to be produced.

16) Non-authorised dealer bank branches and non-bank financial institutions were permitted to provide term loans in Taka to foreign owned/controlled firm/company only in association with authorised dealer bank branches subject to compliance of instructions stipulated in the Guidelines of Foreign Exchange Transaction-2009.

17) In order to attain desired economic growth by increasing credit flow to the productive sector and reducing unproductive and consumer credit, the decision was taken to limit the growth of consumer credit not to be more than the average growth of total bank credit.

18) New loan classification and rescheduling as well as provisioning guidelines for the banks were issued in order to strengthen the capital base of the banks. This would ease the liquidity conditions of the banks and enhance their ability to provide more credit.