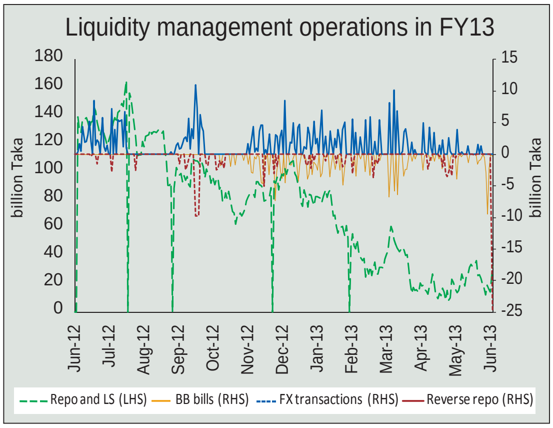
Money and Credit

Monetary Policy Stance

4.1 In FY12 the economy was faced with the challenges of rising inflation and balance of payments pressures stemming largely from a sudden surge in oil imports. In order to address these challenges BB pursued a more restrained monetary policy stance which along with other policy measures helped curb inflationary pressure and significantly strengthened foreign exchange reserves. In FY13 the economy faced a different set of challenges. Robust foreign remittance and export growth along with sluggish import growth led to a sharp growth of Net Foreign Assets (NFA) which needed to be sterilised. Moreover declining inflation and concerns over a slowdown in growth created space for a 50 basis point rate cut by BB effective from early February 2013 with the aim of influencing bank lending rates downwards. At the same time the January 2013 MPS set out a monetary programme consistent with bringing average inflation down to the targeted 7.5 percent level. This balanced monetary policy also aimed to minimize excessive volatility of the exchange rate.

Data for the second half of FY13 suggests that solid progress was made towards these key objectives. Reserve money growth and growth of net domestic assets of Bangladesh Bank remained within programme targets,

Chart 4.1



despite the aforementioned NFA surge. Broad money growth was also close to programme targets. Average inflation measured using the 1995/96' base year continued its decline and in June 2013 it reached 7.70 percent from 8.40 percent in January, though core inflation (non-food, non fuel) is on a rising trend since April 2013 reflecting aggregate demand pressures. Retail interest rates also declined during these six months with the spread between lending and deposit rates dipping below 5 percent and its trend indicating that lending rates have declined faster than deposit rates. Frequent strikes in H2 FY13 led to a slowdown in demand for domestic private sector credit though the introduction of new foreign currency borrowing facilities by BB partially compensated for this.

Changes in the domestic debt market were also made in line with the monetary objectives and liquidity conditions in the banking system. Scheduled banks investment in government securities were altered so that 60 percent of treasury bills/bonds are issued to the Primary Dealers (PDs) and rest 40 percent to the Non-PDs. This was in order to reduce the burden on PD banks and provide liquidity support to Non-PD banks (25 banks). Considering improved liquidity condition of scheduled banks, the tenure of liquidity support against devolved treasury bills/bonds was reduced from 75 days to maximum of 60 days (2 months). Moreover, in order to strengthen liquidity management, and specifically to sterilize the sudden increase in NFA growth, the 30-day Bangladesh Bank bill was introduced since November 2012. Call money rates declined to 7.17 percent in June FY13 and retail interest rates spread fell to 5.13 percent reflected easing of liquidity pressure in the banking system. BB intensified its effort for improving the transmission channels of monetary policy. Various steps were taken to strengthen secondary market of Government securities by enhancing the shorter end of yield curve, introducing on-line secondary trading of bills/bonds, and providing space to Non-PDs along with PDs in the auction of T.bills/bonds.

Considering important role of financial sector in implementation of monetary policy, measures were taken including tightening loan classification and provisioning requirements towards convergence with global best practices, strengthening and rearranging on-site and off-site supervision, requirement of on-line supervisory reporting in L/C opening and buying internal bills, self assessment report regarding internal audit and control with the signature of chief executive and counter signature of audit committee chairman of board. BB has sharpened its monitoring on improving the quality, adequacy, transparency and timeliness regarding financial and other statements of banks and financial institutions.

Table 4.1 Money and credit situation

(billion Taka)

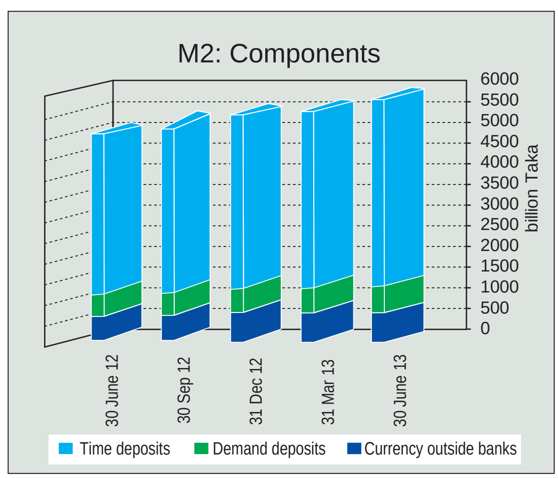
	End June 12	End June 13	
	Actual	Programme	Actual
1. Net foreign assets	742.8	898.9	1116.7
	(7.3)	(21.0)	(50.3)
2. Net domestic assets (a+b)	4425.8	5184.7	4915.2
	(19.3)	(17.1)	(11.1)
a) Domestic credit (i+ii)	5101.2	6069.8	5657.4
	(19.2)	(19.0)	(10.9)
i) Credit to public sector 1/	1022.2	1236.2	1135.9
	(17.4)	(20.9)	(11.1)
ii) Credit to private sector	4079.0	4833.6	4521.6
	(19.7)	(18.5)	(10.8)
b) Other items (net)	-675.4	-885.1	-742.2
3. Narrow money (i+ii)	1094.8		1232.9
	(6.4)		(12.6)
i) Currency outside banks	584.2		675.5
	(6.6)		(15.6)
ii) Demand deposits 2/	510.6		557.4
	(6.1)		(9.2)
4. Time deposits	4073.9		4799.0
	(20.7)		(17.8)
5. Broad money (1+2) or (3+4)	5168.7	6083.5	6031.9
	(17.4)	(17.7)	(16.7)

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



Special diagnostic examinations on State Owned Commercial Banks' activities were introduced.

4.2 The policy stance for FY13 was designed in line with the target of 7.2 percent real GDP growth in a scenario of 7.5 percent annual average CPI inflation. Accordingly broad money (M2) growth was programmed at 17.7 percent. The monetary programme vis-à-vis actual outcomes are presented in Table 4.1. Broad money (M2) grew by 16.7 percent in FY13 against targeted growth of 17.7 percent under the programme and 17.4 percent actual growth in FY12.

The growth in broad money (M2) was mainly due to the growth in net foreign assets. The growth in net foreign assets was 50.3 percent in FY13 against the targeted 21.0 percent growth under the programme due to robust growth in remittance and satisfactory export growth along with sluggish import growth. In FY13 growth of domestic credit declined to 10.9 percent against 19.0 percent growth targeted under the programme and 19.2 percent actual growth in FY12. The growth in domestic credit declined due mainly to the significant decline in private sector credit for general investor faced uncertainty ahead of the national general election along with more stringent lending practices by domestic banks. The growth in public sector credit was 11.1 percent against the targeted 20.9 percent growth under the programme and 17.4 percent growth in FY12. As a result, net domestic assets registered 11.1 percent growth against the targeted 17.1 percent growth and 19.3 percent growth in FY12.

Chart 4.3

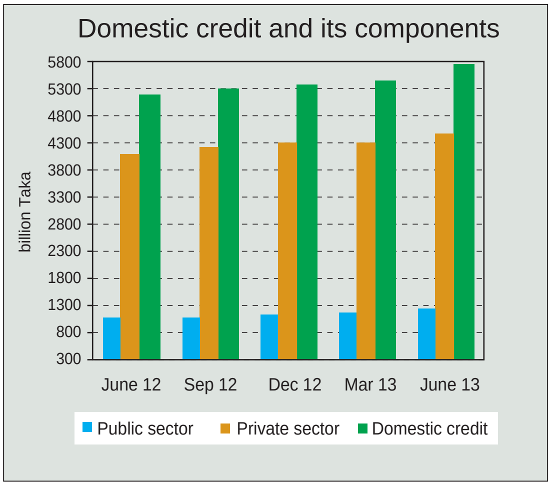
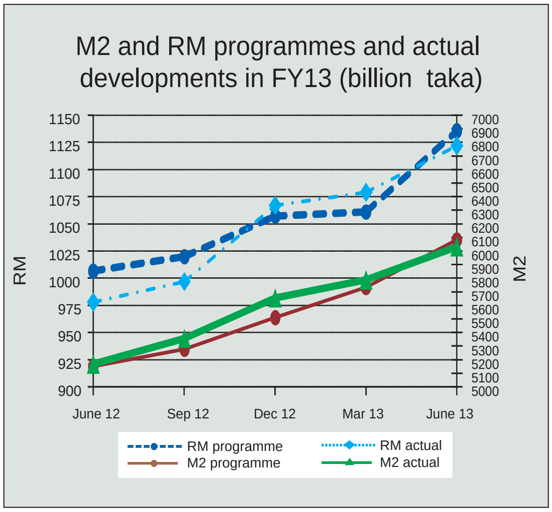


Chart 4.4



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 16.1 percent growth of RM for FY13 but the actual growth out turn was 15.0 percent. The lower than projected growth of RM during the year was due mainly to the substantially lower level of net domestic assets compared to the programme level. This in turn was mainly due to lower than expected growth of government borrowing from BB (Table 4.2).

Credit to the deposit money banks stood at Taka 62.8 billion in FY13 against the targeted amount of Taka 74.8 billion in FY13 as banks had sufficient liquidity to meet the required demand.

On the other hand, net foreign assets of BB, substantially increased by Taka. 224.4 billion and stood at Taka. 931.1 billion against the programme level (Taka 706.7 billion). Net foreign assets of BB rose sharply as BB bought USD 4.54 billion from the foreign exchange market in FY13 to avoid excessive volatility of exchange rate in the foreign exchange market.

4.5 Money multiplier increased to 5.38 in FY13 as compared to the actual number of 5.30 in FY12. Reserve-deposit ratio decreased to 0.084 in FY13 from 0.086 in FY12. Currency-deposit ratio slightly decreased to 0.126 in FY13 from 0.127 in FY12. Net changes in these two behavioral ratios led to an increase in money multiplier. This explains the growth in broad money despite the subdued growth in reserve money. Movement of domestic credit and its components in FY13 are shown at Chart 4.3.

Table 4.2 Reserve money position

(billion Taka)

	End June 12	End June 13	
	Actual	Programme	Actual
Net foreign assets[1/@]	586.4	-	948.2
Net foreign assets[2/@]	541.1	706.7	931.1
Net domestic assets[1/]	389.2	-	173.5
Net domestic assets[2/]	434.5	426.0	190.7
Domestic credit	419.4	487.4	344.2
	(4.0)	(16.2)	(-17.9)
Credit to the public sector[3/]	352.6	412.6	281.4
	(14.6)	(17.0)	(-20.2)
Credit to deposit money banks[4/]	66.8	74.8	62.8
	(-30.3)	(12.0)	-(6.0)
Other items (net)	-30.2	-61.4	-170.7
Reserve money	975.6	1132.7	1121.8
	(9.0)	(16.1)	(15.0)
Currency issued	649.0	762.2	753.7
	(7.2)	(17.5)	(16.1)
Deposits of banks with BB[5/]	326.6	370.4	368.0
	(12.6)	(13.4)	(12.7)
Money multiplier	5.30	5.37	5.38

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.
4/ Considers only loans and advances to DMBs.
5/ Excluding depository corporations.
@ Excluding foreign currency clearing accounts balance and offshore bank account.

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
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	3628.2	1.91
			(-7.73)
FY11	7967.0	4403.2	1.81
			(-5.24)
FY12	9181.4	5168.7	1.78
			(-1.66)
FY13	10380.0	6031.9	1.72
			(-3.37)

Note: Figures in parentheses indicate percentage changes.

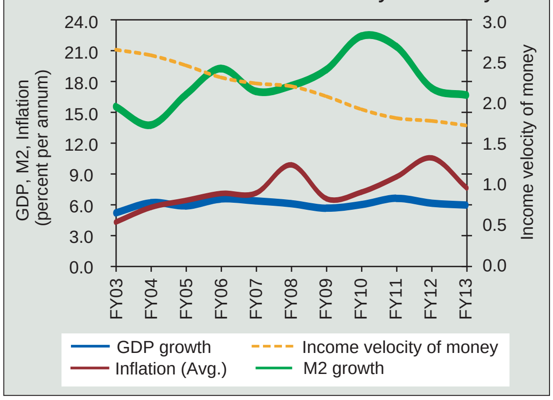
Actual development of M2 and RM against their respective programme path is shown in Chart 4.4.

Income Velocity of Money

4.6 The income velocity of money decreased to 1.72 in FY13 from 1.78 in FY12 (Table 4.3). The rate of decrease in FY13 was 3.37 percent as against 1.66 percent decline in FY12. 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 FY03-FY13 are shown in Chart 4.5.

Chart 4.5

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



Bank Credit

4.7 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY13 rose by Taka 365.58 billion or 8.88 percent to Taka 4482.15 billion as against an increase of 18.40 percent in FY12. The rise in the bank credit during FY13 was driven by the increase in advances.

Advances increased by Taka 405.1 billion or 10.45 percent in FY13, as against an increase of 18.73 percent during FY12. Bills purchased and discounted decreased by Taka 39.52 billion or 16.57 percent in FY13 as compared to the increase of 13.35 percent in FY12. This lower growth in bank bill may be attributed to decrease in import demand. The quarterly position of bank credit and its components may be seen at Table 4.4.

Table 4.4 Bank credit*-FY13 quarterly positions

(billion Taka)

Outstanding as of	Advances	Bills	Total
30 June 12	3878.05 (94.20)	238.52 (5.79)	4116.57
30 Sep 12	4020.29 (94.87)	217.44 (5.13)	4237.73
31 Dec 12	4161.80 (94.88)	224.36 (5.12)	4386.16
31 Mar 13	4191.17 (94.96)	222.46 (5.04)	4413.63
30 June 13	4283.15 (95.56)	199.0 (4.44)	4482.15

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

Bank Deposits

4.8 Bank deposits (excluding inter-bank items) increased by Taka 828.69 billion or 16.91 percent to Taka 5728.91 billion during FY13 against 19.38 percent increase in FY12. The rise in total bank deposits was shared by increase in all deposits, though mainly by time deposits. Time deposits increased by Taka 725.14 billion or 17.80 percent and stood at Taka 4799.02 billion in FY13 against growth of 20.74 percent during FY12. Demand deposits increased by Taka 46.77 billion or 9.16 percent in FY13 to Taka 557.37 billion against 6.14 percent Increase in FY12. Government deposits increased by Taka 56.78 billion or 17.98 percent to Taka 372.52 billion in FY13 against 26.70 percent increase in FY12. Piled up of time deposits indicates sluggish economic activities and lack of alternate investment opportunities. Quarterly position of bank deposits in FY13 may be seen at Table 4.5.

Credit/Deposit Ratio

4.9 The credit/deposit ratio of the scheduled banks, excluding the specialised banks was 0.78 at the end of June 2013 and was 0.84 at the end of June 2012. Declining credit to deposit ratio points to declining investor appetite for credit during an election year as well as tightening bank loan processing standards.

Scheduled Banks' Borrowing from the BB

4.10 Scheduled banks' borrowings from the Bangladesh Bank decreased by Taka 122.30 billion or 56.43 percent to Taka 94.42 billion at the end of June 2013 against 21.52 percent increase during FY12. The fall in schedule banks' borrowing from BB resulted from the ample liquidity in the money market.

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

4.11 Balances of scheduled banks with the BB increased by Taka 4.05 billion or 1.08 percent to Taka 377.41 billion at the end of June 2013 against the decrease of 2.77 percent to Taka 373.37 billion at the end of June 2012. Cash in tills of scheduled banks increased to Taka 78.19 billion as of end June 2013 against Taka 64.79 billion as of end June 2012.

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.

Table 4.5 Bank deposits*- FY13 quarterly positions

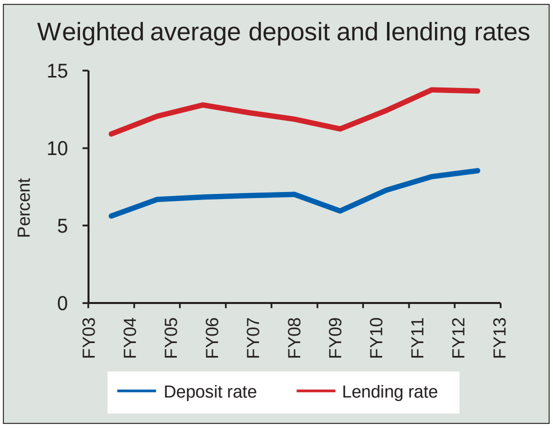
(billion Taka)

Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 12	510.60	4073.88	315.74	4900.22
30 Sep 12	495.31	4250.94	312.45	5058.70
31 Dec 12	533.86	4472.97	333.05	5339.88
31 Mar 13	519.36	4607.39	341.31	5468.06
30 June 13	557.37	4799.02	372.52	5728.91

Table: 4.6 Weighted average interest rates of scheduled banks

Items	as of end June (in %)					
	FY08	FY09	FY10	FY11	FY12	FY13
Deposit rate	7.00	7.00	6.01	7.27	8.15	8.54
Advance rate	12.30	11.90	11.31	12.42	13.75	13.67
Spread	5.30	4.90	5.30	5.15	5.60	5.13

Chart 4.6



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 banks remained unchanged at 19.0 percent of their demand and time liabilities, excluding inter bank items. The SLR for the Islamic banks remained unchanged at 11.50 percent. This rate has 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 FY13. This rate has been in effect since 6 November 2003.

Interest Rates on Deposits and Advances

4.15 Table 4.6 and Chart 4.6 contain weighted average interest rates of scheduled banks on deposits and advances along with the spread during FY08 to FY13. It is evident from the Table that weighted average interest rate on deposits was stable throughout FY08-FY09; it decreased in FY10 and reached at 6.01. Again, it started to increase since FY11 and gradually reached 8.54 in FY13. Rate of advances however moved downward during FY08 to FY10 but increased in FY11 and FY12. Further it declined to 13.67 percent in FY13. The trend of the spreads between advances and deposits rates was above 5 percent in the recent years except FY09 and in FY13 spread rate was 5.13 percent.