Money and Credit

Stance of Monetary and Credit Policies

4.1 Bangladesh economy showed signs of resilience and successfully faced twin natural disasters and worsened inflation situation with its pro-growth monetary policy stance persuaded in FY08. But again in FY09, economy had to face shocks like slow down in world output and trade. Economy is in a critical moment now with unfolding impact of the financial crisis. The new challenge now is of shielding the economy from the global financial turmoil with the macroeconomic fundamental and stability of the economy while rekindling growth to protect the poor who bear the brunt in difficult times.

In the context of the severity of the impact of the crisis on the real economy of countries around the world, the growth outcome reflects the resilience of Bangladesh economy. Even then, Bangladesh economy has experienced some loss of growth momentum with major drivers of the growth witnessing moderation. However, robust agricultural sector output and strong domestic demand, supported by continued strong inflow of worker's remittances, helped sustain domestic economic activity.

The current year saw some disciplined implementation of macroeconomic policies complemented by prudent monetary policy and improvement in fiscal discipline. BB had to, therefore, strike a fine balance between maintaining the impulses of growth and reining in inflation. BB's monetary policy stance, therefore, was to accord priority to credit support for creation and expansion of output capacity rather for stoking of demand pressure. BB continued to support credit growth for activities facilitating of goods and services, providing refinance against lending in income and employment generating priority sectors (agriculture, SME, low cost housing etc.) underserved by the market; while discouraging excessive expansion of non-essential credit and similar other demand-side lending. To ensure supply of bank credit to the productive and supply augmenting uses, BB made engagement in agriculture lending mandatory for all banks including private and foreign banks. BB continued its effort to narrow down spread between lending and borrowing interest rates by improving management efficiency and asset quality; enabling lowering of interest rates on loans for productive purpose while also maintaining real positive interest rates on bank savings. Measures were also initiated to maintain asset quality of the banking system at a time of rapid credit growth.

During the course of the fiscal year, double digit inflation rates and high domestic credit growth in Q1 FY09 prompted BB’s precautionary 25 basis point hike in repo and reverse repo interest rates respectively in September and November 2008. Subsequently these hikes were reversed in March 2009 as domestic inflation abated with good domestic food grain output and lower import prices of major commodities and credit growth eased down, with the global recession weakening export demand and related output activities. Increase in workers’ remittance inflows and

Box 4.1

Monetary Policy Framework of the Bangladesh Bank

Monetary policy framework refers to a logical and sequential set of actions that a central bank has to design to conduct monetary policy. The central bank wants to achieve certain goals but cannot directly influence the goals. It has a set of tools at its disposal that can affect the goals indirectly after long and variable lags. So, if central bank waits to see the effect of the tools on the goals it will be too late to make any correction to the policy. That is why it aims at some variables that lie between tools and goals, which it can influence and monitor very shortly. Thus a central bank decides on the strategy for conducting monetary policy. The variables that the central bank addresses can be classified as instruments, targets and goals. If the framework is expressed in a flow chart instruments (i.e. tools) and goals are on the two ends and targets are in between. The targets are further classified as operational target and intermediate target. The central bank also keeps an eye on some information variables to make any policy decision.

The objective of monetary policy of Bangladesh Bank is to maintain price stability towards achieving highest sustainable output growth; as such inflation and output growth are the basic policy targets. BB uses the reserve money (operational target) programme to target a growth path for broad money (intermediate target) consistent with the targeted rate of GDP growth and inflation. Annual monetary programme is continually monitored and adjusted in light of unfolding events. The actual developments are also monitored to keep in line with the programme. In this pursuit monetary policy instruments presently being used by BB are: a) open market operation through repo, reverse repo and 30-day and 90 day Bangladesh Bank bills; b) variation in reserve ratios; c) secondary trading; d) discount rate; and e) moral suasion. Through open market operation BB targets available liquidity flow in the market, routinely mop-up excess liquidity and inject it as appropriate. Auctions of repo and reverse repo generally held on daily basis while that of BB bills are held on weekly basis. Variation in reserve ratios (i.e. CRR and SLR) which are primarily used to influence the quantity of credit available in the banking system are used infrequently. BB conducts secondary trading as and when necessary.

Tracking the monetary programme and its components on a regular basis allows BB to monitor the growth rates of currency in circulation and demand deposits as early indicators of inflationary bias. Similarly, growth of domestic credit against the programme target and rate of deposit mobilization indicate prevalence of excess demand induced by inflationary expectation. Apart from these slope of yield-curve, exchange rate, asset prices etc. are also monitored by the BB to assess the inflationary expectation in the economy. Such a regular scrutiny allows BB to follow up with corrective measures as appropriate with a timely manner.

slower outflows for imports resulted in swelling BOP current account surplus. The consequent appreciation pressure on Taka was checked by BB with continuous foreign exchange purchases from the local market, to protect export competitiveness and to maintain incentive for inflows from workers abroad. In consonance with its monetary policy stance of shoring up domestic demand BB kept credit conditions easy for borrowers, refraining from reverse repo operations particularly in Q4 FY09, leaving the Taka liquidity from its foreign exchange purchases unsterilized. Yields on treasury securities and interest rates on bank deposits declined promptly in the market awash with liquidity, but with no corresponding decline in lending interest rates. BB had to address this situation with mandatory rather than advisory instructions to banks about the levels of lending interest rates particularly for the priority economic sectors.

4.2 The initial policy stance for FY08 was designed around a 6.5 percent real GDP growth in a scenario of 9.0 percent annual average CPI inflation. Attainment of the initial projected growth seemed realistic possibility but in a more downbeat scenario of significant slowdown in global GDP, FY 09 real GDP growth was expected to be above or around 6.0 percent with annual average CPI decline to around 8.5 percent by the end of FY09, as lower prices of fuel oil and other imports were expected to gradually pass on to local consumers. Accordingly broad money (M2) growth was programmed at 17.2 percent. The monetary programme vis-à-vis actual outcome is presented in Table 4.1.

It is revealed from the table that broad money (M2) growth during FY09 was 19.2 percent, which was higher than 17.6 percent growth in FY08 and 17.2 percent growth targeted under the programme for the year. The accelerated growth in broad money (M2) was mainly due to higher growth in net foreign assets (NFA). The growth in NFA stood at 27.2 percent, notably higher than the programme of 9.6 percent in FY09 and 15.2 percent growth in FY08. Healthy inflows from workers' remittances and export vis-à-vis import resulted in swelling surpluses in current account balance of BOP that led to record growth in NFA. The growth in NDA stood at 17.8 percent as against programmed 18.5 percent during FY09 consequent by a drop of growth in private sector credit due to slackened investment activities in the recessionary situation. However, credit to public sector grew at 20.3, lower than programmed growth of 23.9 percent mainly due to downside revision of ADP and better revenue collection. Overall, domestic credit growth was 15.9 percent, lower than the projection of 18.9 percent and the actual growth of 21.8 percent during FY08.

4.3 Inflationary pressure in the economy originated from burst in global commodity price of FY08 continued in Q1 FY09 but easing thereafter with good domestic harvest bringing down food grain prices and with falling import prices of fuel oil and other commodities. Inflation (annual average CPI inflation base FY96=100) went up to 10.06 percent in September 2008 from 9.94 percent in June 2008, the 12 month average inflation gradually came down to 6.66 percent in June 2009 which is lower than the estimated 7.0 percent for the period. Movements of M2 and its components over FY09 may be seen at Chart 4.1.

Reserve Money Developments

4.4 During FY09, the reserve money (RM) has been used as an operating target to modulate liquidity consistent with overall monetary projection. The weekly auctions of Bangladesh Bank Bills were used in influencing the level of RM, while repo and reverse repo auctions were used for smoothing the money market.

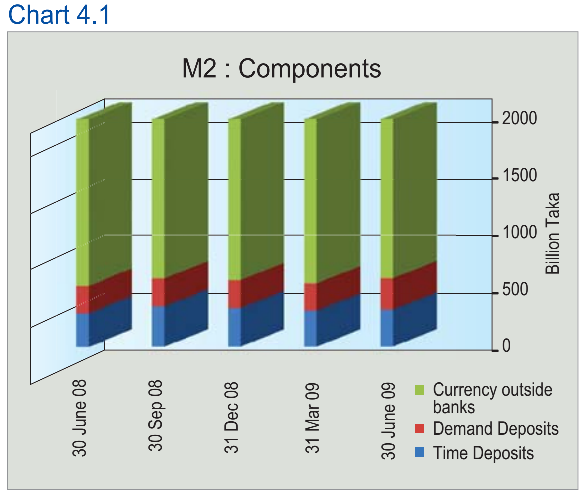
Table 4.1 Money and credit situation

(billion Taka)

	End June 08	End June 09	
	Actual	Programme	Actual
1. Net foreign assets	373.2 R	409.1	474.6
	(+15.2)	(+9.6)	(+27.2)
2. Net domestic assets (a+b)	2113.7	2505.2	2489.0
	(+18.1)	(+18.5)	(+17.8)
a) Domestic credit (i+ii)	2432.6R	2892.3	2818.1
	(+21.8)	(+18.9)	(+15.9)
i) Credit to public sector [1/]	531.2R	658.2	638.9
	(+11.7)	(+23.9)	(+20.3)
ii) Credit to private sector	1901.4	2234.1	2179.3
	(+24.9)	(+17.5)	(+14.6)
b) Other items (net)	-318.9	-386.8	-329.2
3. Narrow money (i+ii)	592.1R	-	662.9
	(+18.2)		(+12.0)
i) Currency outside banks	326.9	-	360.5
	(+22.7)		(+10.3)
ii) Demand deposits [2/]	265.2R	-	302.4
	(+13.0)		(+14.0)
4.Time deposits	1894.8R	-	2300.7
	(+17.4)		(+21.4)
5. Broad money (1+2)or(3+4)	2486.9	2914.6	2963.6
	(+17.6)	(+17.2)	(+19.2)

Figures in the parentheses indicate percentage changes.
1/ "Govt. lending fund" is treated as deposit in calculating claims on Govt. (net) and claims on other financial institutions (public) are excluded.
2/ Demand deposits of monetary authority are excluded.
R=Revised.
Note : Discrepancies may arise after decimal point due to rounding figure.

Chart 4.1



4.5 In line with the projected broad money growth, the monetary programme set a 16.0 percent growth of RM for FY09 against which it grew by 31.9 percent. The larger than projected growth of RM during the year was contributed by the substantially higher growth in net international reserve. Net flow of foreign exchange swelled particularly in the second half of FY09 with lower outflow of import and other settlements compared to inflows of workers' remittances and export receipts. To protect competitiveness of Taka, which was under appreciating pressure throughout FY09, BB purchased a total of USD 1385.7 (net) from the market and let foreign exchange reserve soared to record level of USD 7.47 billion at the end of June 2009.

An analysis of the behaviour of the liability side of the central bank balance sheet shows that a significant increase in DMB's reserve (local currency balance) with BB mainly resulted in a remarkable increase in reserve money. To keep domestic credit condition easy in a recessionary global environment BB refrained from reverse repo operations in Q4 of FY09 leaving unsterilized the Taka liquidity from its regular purchase of USD from the local market. The resulted surge in DMB's reserve raised reserve money to such a high level.

4.6 Because of higher growth in reserve money compared to broad money, money multiplier decreased to 4.72 in FY09 as compared to the actual number of 5.23 in FY08. This outcome is mainly because of rise in reserve-deposit ratio to 0.10 from 0.07 of FY08 level. Currency-deposit ratio, on the other hand, decreased to 0.14 from FY08 level of 0.15 and kept money multiplier from further falling. Consequence of change in both these ratio have been reflected in the fall in money multiplier. Movement of domestic credit and its components in FY09 may be seen at Charts 4.2. Actual development of M2 and RM against their respective programme path is shown in Chart 4.3.

Table 4.2 Reserve Money position

(billion Taka)

	End June 08	End June 09	
	Actual [R]	Programme	Actual
1.Net International Reserve 1/@	275.5	303.9	365.5
	(+14.4)	(+10.3)	(+32.7)
Net International Reserve2/@	272.7	309.0	385.2
2.Net domestic assets1/	200.0	247.7	261.9
	(+30.4)	(+23.8)	(+30.9)
Net domestic assets2/	202.9	242.7	242.2
a) Domestic Credit	312.7	371.7	332.1
	(+4.5)	(+18.9)	(+6.2)
i) Credit to the public sector 3/	245.9	298.9	271.1
	(+1.6)	(+21.6)	(+10.2)
ii) Credit to deposit money banks 4/	66.8	72.8	61.0
	(+16.5)	(+9.0)	(-8.7)
b) Other items (net)	-112.7	-124.0	-70.2
3. Reserve money (i+ii) or (1+2)	475.6	551.6	627.4
	(+20.6)	(+16.0)	(+31.9)
i) Currency issued	356.5	413.2	394.5
	(+23.8)	(+15.9)	(+10.7)
ii) Deposits of banks with the Bangladesh Bank 5/@	119.1	138.4	233.0
	(+12.0)	(+16.3)	(+95.6)
4. Money Multiplier (M2/RM)	5.23	5.28	4.72

Figures in the parentheses indicate percentage changes.
@ Excluding foreign currency clearing A/C balance.
1/ Calculated from monetary survey data.
2/ Calculated using program exchange rate (end March, 08 rates)
3/ "Govt. lending fund" is treated as deposit in calculating claims on Govt. (net) and claims on other financial institutions (public) are excluded.
4/ Considers only "loans and advances" to DMBs.
5/ Excluding deposits of the other public sector.
R=Revised.

Table 4.3 Income velocity of money

(billion Taka)

Year	GDP at current market prices (billion Taka)	Broad money (M2) (billion Taka, end June Position)	Income velocity of money (GDP/M2)
FY06	4157.3	1806.2	2.30
			(-6.12)
FY07	4724.8	2114.4	2.23
			(-3.04)
FY08[R]	5458.2	2486.9	2.19
			(-1.79)
FY09	6149.4[P]	2963.6	2.07
			(-5.48)

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

Income Velocity of Money

4.7 The income velocity of money decreased from 2.19 in FY08 to 2.07 in FY09 (Table 4.3). The rate of decline in FY09 was 5.48 percent, as against a 1.79 percent, 3.04 percent and 6.12 percent decline in FY08, FY07 and FY06 respectively. Income velocity of money was on a declining trend over the past several years indicating increased monetization and financial deepening in the economy. Movement of GDP growth, M2 growth, inflation and income velocity of money during FY98-FY09 are shown in Chart 4.4.

Bank Credit

4.8 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY09 rose by Taka 292.94 billion or 14.9 percent to Taka 2259.34 billion as against an increase of 19.1 percent in FY08. The rise in the bank credit during FY09 was driven by the increase in advances.

Advances increased by Taka 311.05 billion or 17.0 percent, as against an increase of 23.2 percent during FY08. Bills purchased and discounted declined by Taka 18.1 billion or 13.4 percent in FY09 as compared to a decreased 17.9 percent in FY08. This lower growth in bank advances may be attributed to decline in import and slow export growth linking to sluggish business activities in the face of global financial crisis. The quarterly position of bank credit and its components may be seen at Table 4.4.

Bank Deposits

4.9 Bank deposits (excluding inter-bank items) increased by Taka 469.42 billion or 20.3 percent to Taka 2786.22 billion during FY09 against 17.6 percent increase in FY08. The rise in total bank deposits was shared by increase in demand deposits, time deposits and government deposits. Time deposits increased by Taka 405.92 billion or 21.4 percent and

Chart 4.2

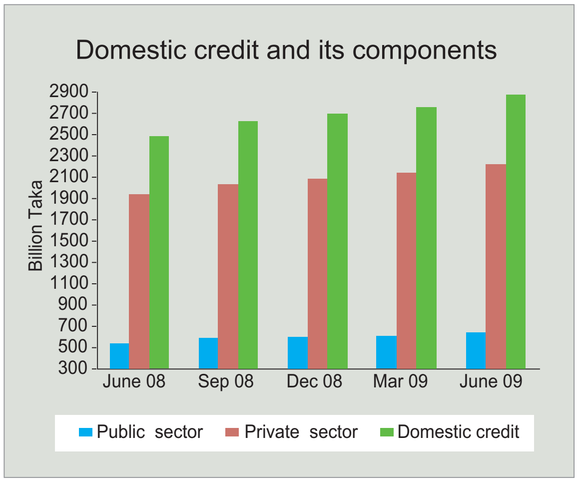


Chart 4.3

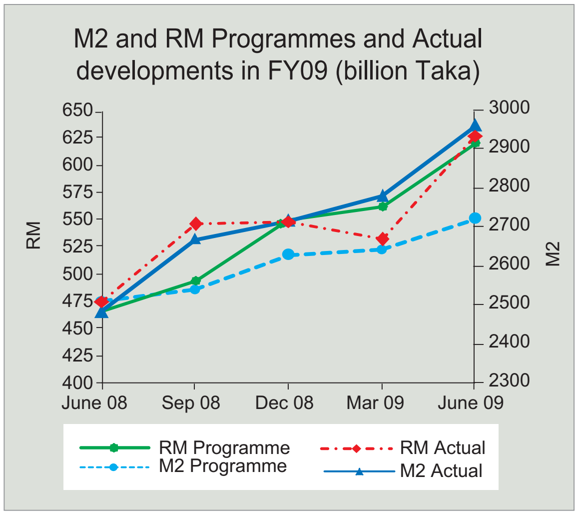


Table 4.4 Bank Credit*-FY09 quarterly positions

(billion Taka)

Outstanding as of	Advances	Bills	Total
30 June 08	1831.14 (93.1)	135.26 (6.9)	1966.40
30 Sep 08	1939.49 (92.9)	147.14 (7.1)	2086.63
31 Dec 08	1995.30 (93.2)	145.00 (6.8)	2140.30
31 Mar 09	2079.09 (94.8)	115.07 (5.2)	2194.16
30 June 09	2142.19 (94.8)	117.15 (5.2)	2259.34

Figure in parentheses indicate percentage shares

* Excluding foreign bills and inter bank credit.

stood at Taka 2300.73 billion in FY09 against growth of 17.1 percent during FY08. Demand deposits increased by Taka 37.18 billion or 14.0 percent in FY09 to Taka 302.36 billion against 15.3 percent increase in FY08. Government deposits increased by Taka 26.32 billion or 16.8 percent to Taka 183.13 billion in FY09 against 29.0 percent increase of FY08. Quarterly position of bank deposits in FY09 may be seen at Table 4.5.

Table 4.5 Bank deposits*- FY09 quarterly positions

(billion Taka)

Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 08	265.18	1894.81	156.81	2316.80
30 Sep 08	271.09	2005.86	146.31	2423.26
31 Dec 08	270.48	2072.66	163.43	2506.57
31 Mar 09	263.78	2167.48	171.46	2602.72
30 June 09	302.36	2300.73	183.13	2786.22

*Excluding interbank and restricted deposits.

Credit/Deposit Ratio

4.10 The credit/deposit ratio of the scheduled banks, excluding the specialized banks was 0.81 at the end of June 09 and was 0.85 at end of June 2008.

Scheduled Banks' borrowing from the BB

4.11 Scheduled banks' borrowings from the Bangladesh Bank decreased by Taka 5.82 billion or 8.71 percent to Taka 61.02 billion at the end of June 2009, against 9.49 percent declined during FY08.

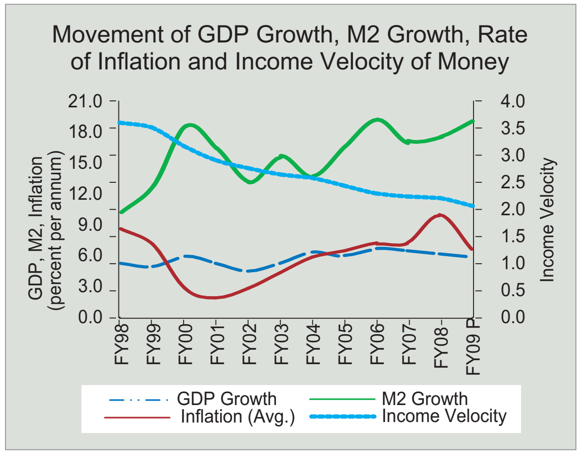
Balances of Scheduled Banks with the BB and their Cash in Tills

4.12 Balances of scheduled banks with the BB increased by Taka 120.61 billion or 72.17 percent to Taka 287.73 billion at the end June 2009, against the increase of 9.46 percent to Taka 167.12 billion at the end of June 2008. Cash in tills of scheduled banks also increased to Taka 33.99 billion as of June 2009 against Taka 29.59 billion as of end June 2008.

Cash Reserve Requirement (CRR)

4.13 The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank remained same at 5.0 percent of their total demand and time liabilities since 1 October 2005. It may be noted that banks are required to maintain CRR daily at the rate of 5.0 percent on average on bi-weekly basis provided that the CRR would not be less than 4.5 percent in any day with effect from 1 March 2009.

Chart 4.4



Statutory Liquidity Ratio (SLR)

4.14 The Statutory Liquidity Ratio (SLR) for the scheduled banks, except banks operating under the Islamic Shariah and the specialized banks remained same at 18.0 percent of their demand and time liabilities, excluding inter bank items since 1 October 2005. The SLR for the Islamic banks remained unchanged at 10.0 percent. The specialized banks continued to remain exempt from maintaining the SLR.

Bank rate

4.15 The bank rate remained unchanged at 5.0 percent in FY09. This rate has been in effect since 6 November 2003.

Interest Rates on Deposits and Advances

4.16 Table 4.6 contains weighted average interest rates of scheduled banks on deposits and advances along with the spread during FY05 to FY09. It is evident from the Table that weighted average interest rate on deposits was increasing throughout FY05-08 and reached 7.0 percent in FY08. However, amidst fluctuation it remained unchanged in FY 09. Rate of advance however moved upward during FY05 to FY07 but declined again in FY08 and continued to fall in FY09 reflecting monetary policy stance of BB in lowering of interest rates on loans. The spread between advance and deposit rates was increasing throughout FY05 to FY07, and then declined in two successive years reflecting BB's earnest and continuous effort to narrow it down.

Operation of the Export Development Fund (EDF)

4.17 Lending in foreign currency from the revolving Export Development Fund (EDF), that provides refinance facilities through commercial banks to exporters for financing import of raw materials, accessories, spare parts and packing materials under L/C and export contract increased in FY09. Total disbursement from EDF during FY09 stood at USD 287.32 million as against USD 215.97 million in FY08. The outstanding balances as on 30 June 2009 stood at USD 93.45 million. The rate of interest against borrowing from the fund is LIBOR+1% out of that LIBOR part is for EDF and rest 1% for concerned AD banks. With a view to keeping the existing pace of evolving and expanding trend of the export oriented industries in the country ceiling for the single borrower credit has been increased to USD 2.0 million from USD 1.5 million in case of import of raw materials for the production of existing export goods on-site basis with effect of July 2009.

Changes in Monetary and Credit Regulations

The major policy measures taken in monetary and credit fronts in FY09 were as follows :

Table 4.6 weighted average interest rates of scheduled banks

	As of end June (in %)				
	FY 05	FY 06	FY 07	FY 08	FY 09
Deposit rate	5.6	6.7	6.9	7.0	7.0
Advance rate	10.9	12.1	12.8	12.3	11.9
Spread	5.3	5.4	5.9	5.3	4.9

- In order to ensure food security by enhancing agricultural production through increasing disbursement of agricultural loans/ advances, BB made engagement in agriculture lending mandatory for all banks including private and foreign banks and advise banks to fix a portion of total loan portfolio for agricultural credit at the beginning of each fiscal year. Credit should be disbursed following 'area approach' by giving importance on the cultivation of crops based on region and type of crops and banks that do not have branch in the rural area or number of branch is not adequate, will disburse agricultural credit through NGO-linkages;
- For effective agricultural credit operation, that is, to make agricultural credit easier and hassle-free to the farmers and to ensure continuous flow of agricultural credit at the farmer level, BB introduces a "Revolving Crop Credit Limit System (RCCLS)" of 3 (three) years tenure. After realization of previous loan (principal and interest accrued thereon), the farmer will get further loan/renewal without re-documentation. Credit limit, mortgage and interest rate etc. for the loan will be determined by bank itself;
- With a view to simplifying agricultural credit disbursement system in favour of share-croppers and considering their important contribution to agricultural development and to the national economy, share-croppers are made eligible for availing agricultural credit;

- To comply with the international best practices and to make the bank's capital more risk-sensitive as well as to build the banking industry more shock absorbent and stable, a revised regulatory capital framework 'Risk Based Capital Adequacy for Banks' in line with Basel II has been devised and sent to the banks for implementation from January 2009;
- In pursuance of the objectives of monetary policy, all scheduled banks of Bangladesh Bank have been required to maintain the amount of Cash Reserve Requirement (CRR) at the rate of 5% of their total demand and time liabilities effective from 1 October 2005. Banks are also required to maintain the CRR at the rate of 5% daily on bi-weekly average basis subject to the condition that the rate of CRR should not be less than 4% in any day. After Review of the present situation of the monetary policy, it has been decided that the CRR will remain unchanged at the rate of 5%, with the condition that the rate of CRR should not be less than 4.5% in any day. This instruction has come into effect from 1 March 2009;
- The National Payment System Council (NPSC) has been reorganized to support the development of sound and efficient payment, clearing and settlement systems in Bangladesh and to serve as a forum for cooperation in domestic and international payment matters. The Payment Systems Division (PSD) of Bangladesh Bank will provide secretarial and research services to the Council. Accordingly, BB has approved Bangladesh Payment and Settlement Systems Regulations, 2009;
- It has been observed that, desired loan are not being provided to women entrepreneurs under Small and Medium Entrepreneurs (SME) in spite of 15% of SME fund allocated for woman entrepreneurs. Now, banks and non bank financial institutions are advised to provide at least 10% of total SME loan to women entrepreneurs. If any bank/financial institution fail to provide at least 10% of total applied fund for refinance to women entrepreneurs no refinance facility will be provided to the concerned bank/non bank financial institution;
- Rescheduling without mandatory down payment of default loans has been allowed up to 30 September 2009 on the banker-customer relationship for the affected export oriented industries especially frozen food, leather and leather products, jute and jute goods, textiles (including spinning) and RMG industry;
- The rate of interest on loan financing in the agriculture, term and working capital loan to large and medium scale industries, housing loan and trade financing has been lowered and fixed to a maximum at 13 percent in the backdrop of existing inflation rate and prevailing global economic condition;
- With a view to ensuring adequate supply of essential commodities and keeping the price of these commodities within a reasonable limit in the ensuing month of Ramadan, the rate of interest on import financing edible oil (crude and refined) chick-peas, lentils, beans, onions, spices, dates, fruits and sugar have been fixed at a maximum of 12 percent. Moreover, in case of import of the mentioned commodities, banks are also advised to fix reasonable charges/fees/ commissions.
- Under stimulus package formulated for facing the impact of global economic recession, rates of export subsidies/cash incentives have been revised for the following products shipped during 1 April to 30 June 2009

Products	Present rates	Revised rates
Jute products	7.5%	10%
Leather products	15%	17.5%
Frozen shrimps and other fishes	10%	12.5%

- During FY08 agriculture sub-sector like poultry and Shrimp were affected by the attack of Avian Influenza and tornado "Aila" respectively. With a view to lessening losses of the affected farmers and rehabilitating them, banks were allowed to re-schedule their overdue/classified loans by relaxing terms and conditions of down payment on the basis of banker customer relationship. Moreover, as a sub-sector of agriculture, interest rate of agriculture was made applicable for credit disbursed in poultry sector instead of interest rate for commercial loan.