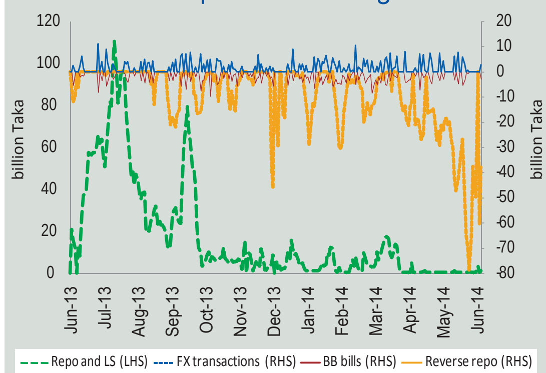
Money and Credit

Stance of Monetary and Credit Policy

4.1 Bangladesh Bank pursued prudent monetary policy stances in FY14 against the backdrop of a sharp growth of net foreign assets and surging inflation in FY13. Growth and investment friendly monetary policy was undertaken during the year aiming at keeping average inflation down to 7 percent along with stimulating investment by providing sufficient credit in the productive sectors. More emphasis was given on BB's financial inclusion initiatives, especially on agriculture and SME sectors. The policy rates remained unchanged in the year in view of risks of the inflationary pressures. Macro-prudential policies and other incentives were used to support economic growth. The FY14 monetary programme was consistent to bring down the non-food point-to-point inflation falling from 7.76 percent in June 2013 to 5.45 percent in June 2014. It contributed to bring down average inflation to 7.35 percent at the end of FY14 which was slightly higher than the 7.0 percent target initially set for the year. Retail interest rates of both deposit and lending declined in FY14 where the latter declined less than the former. As a result, the interest rate spread stood at 5.31 percent at the end of FY14. The increased liquidity in the banking system for significant surge in net foreign assets needed to be sterilised via reverse repo operation with consequent costs to be incurred by BB. BB raised the CRR (Cash Reserve Ratio) by 50 basis points to 6.5 percent with effect from 24 June 2014 in order to tame persistent inflationary pressures.

Chart 4.1 Liquidity management operations during FY14



In FY14 reserve money growth (15.4 percent) which is single-most critical anchor of monetary programme and monetary policy stance remained within the programme target (16.2 percent). However, net domestic assets stood significantly lower (Taka 57.7 billion) against the programme level of Taka 266.0 billion. Broad money growth (16.1 percent) was less than the programme target (17.0 percent) due to both lower public and private sector credits growth during the year. Growth of public sector credit registered substantial decline (8.8 percent) against the target growth (22.9 percent) in FY14 mainly due to significantly lower government borrowing from the banking system than projected in both original and revised FY14 budget. This lower government borrowing was related to a sharp rise in revenue from the sales of National Savings Certificates.

Private sector credit growth ceiling was set at 16.5 percent in FY14 which is consistent with the target GDP growth and higher than the average private credit growth rate of emerging Asian Economies. However , private sector credit growth from local sources registered a 12.3 percent growth in FY14 as investors have been a bit conscious and followed a go slow strategy in the backdrop of political uncertainty, stringent lending practices by banks following scams in few banks and BB's facilitation of private sector trade credit from abroad which led to some switching to lower cost overseas financing.

Target for net foreign assets growth was adjusted upward from the earlier 8.4 percent to 9.9 percent due to sharp rise in net foreign assets, while target for net domestic assets growth cut down to 18.6 percent from earlier 19.0 percent. BB's active involvement in the interbank money and foreign exchange market helped in maintaining suf ficient liquidity and stability in the exchange rate and bring down the call money rate to 6.23 percent at the end of June 2014 from 7.17 percent a year ago.

4.2 BB announced various growth and investment friendly incentives in credit and financial policies with the aim of influencing investors and enhancing banks' lending activities in the backdrop of unstable political situation prevailed in the first half of FY14. Among these, the more remarkable ones are: relaxation in loan rescheduling; increase of export development fund from USD 1.2 billion to USD 1.5 billion; reduction of EDF loan interest rate and inclusion of leather and ceramics sectors under EDF . Access to finance has also been broadened with more emphasis on the SME sector . About 14 million' 10 taka accounts' were opened by the end of June 2014 compared to 13.2 million at the end of June 2013. BB has also set up a 2

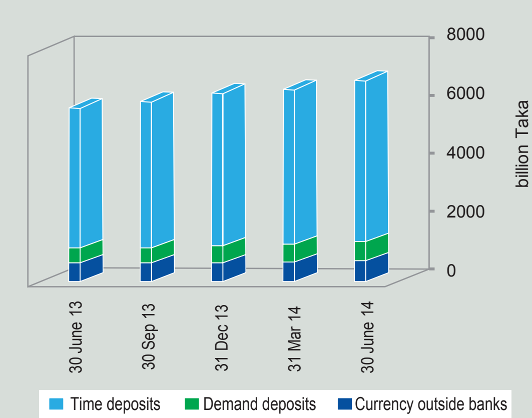
Table 4.1 Money and credit situation

(billion Taka)

	End June 13	End June 14	
	Actual	Programme	Actual
1. Net foreign assets	1120.7	1232.2	1552.9
	(50.1)	(9.9)	(38.6)
2. Net domestic assets (a+b)	4911.2	5825.2	5449.4
	(11.1)	(18.6)	(11.0)
a) Domestic credit (i+ii)	5657.4	6663.5	6311.7
	(10.9)	(17.8)	(11.6)
i) Credit to public sector 1/	1135.9	1395.9	1235.3
	(11.1)	(22.9)	(8.8)
ii) Credit to private sector	4521.6	5267.6	5076.4
	(10.8)	(16.5)	(12.3)
b) Other items (net)	-746.2	-838.3	-862.3
3. Narrow money (i+ii)	1232.9		1412.5
	(12.6)		(14.6)
i) Currency outside banks	675.5		769.1
	(15.6)		(13.8)
ii) Demand deposits 2/	557.4		643.4
	(9.2)		(15.4)
4.Time deposits	4799.0		5589.8
	(17.8)		(16.5)
5. Broad money (1+2)or(3+4)	6031.9	7057.3	7002.3
	(16.7)	(17.0)	(16.1)

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 M2 components



billion taka refinancing facility via micro finance institutions to provide small loans to those low-income rural households who have opened a '10 Taka' account. Efforts were taken to strengthen socially responsible banking which included greater emphasis on 'green banking' and enhanced corporate social responsibility. Rapid expansion of mobile banking arrangement has helped banks to provide better and more services to the client cost-effectively. A fund of Taka 1.0 billion was formed by BB with the assistance of JICA for financing to reconstruct the risky building of garment sectors. With a view to attracting foreign investment, BB has relaxed restrictions on foreign investor borrowing from the local market and their access to working capital financing from their parent company.

Bangladesh Bank took measures to strengthen monetary transmission channels for more effective implementation of monetary policy. Strengthening secondary market activities for public and private credit was one of the main focuses of FY14 monetary policy. Supervisory role and capacity of Bangladesh Bank were strengthened to establish good governance including strong internal control of banks in general. Bangladesh Bank has escalated supervision in order to strengthen regulation, modernise services, deepen accountability and promote transparent and good corporate governance in banks and financial institutions. Expansion of inclusive financial service resulted in lowering liquidity risk as well as default loan risk by broadening deposit and investment base of banks and financial institutions.

The enhanced authority was given to BB over the appointment and dismissal of senior

Chart 4.3 Domestic credit and its components

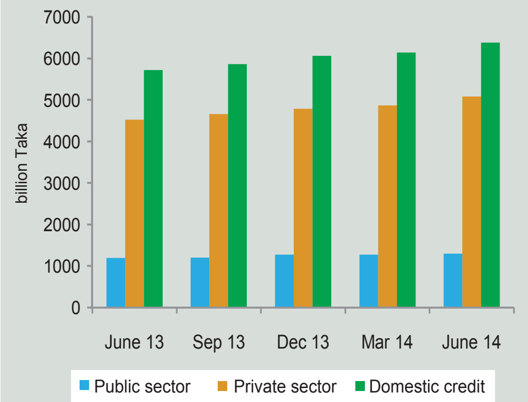
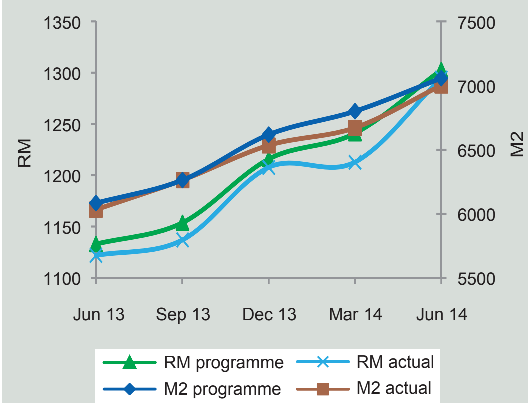


Chart 4.4 Programmes and actual developments of M2 and RM in FY14 (billion Taka)



management in SCBs. Stringent financial improvement plan was set up with the four SCBs and BASIC Banks which included different ceilings on loan growth. Debt markets became more functional with several recent auctions of Govt. T. bills & bonds over-subscribed and a sharp fall in devolvement from 34 percent in FY13 to 15.25 percent in FY14. To this end, modern online based information technology was introduced. Setting ceilings on loan growth of the bank concerned, prior approval of Bangladesh Bank for large loan and loan in excess of single borrower exposure and regular submission of statement on of f-balance sheet items to Bangladesh Bank were made mandatory under the MoU with board of directors regarding management of SCBs and specialised banks including BASIC Bank. Visible progress on implementing automation benchmarks in the SCBs was made a pre-condition for sanctioning the release of additional recapitalisation funds.

Financial sector stability is a necessity for economic development of the country . Bangladesh Bank is very much concern regarding this.

The monetary policy stance aimed at maintaining country's external sector stability . In FY14 double digit export growth of 12.0 percent with import growth of 8.9 (due to lower base effect) percent narrowed the trade deficit (Appendix-3, Table-XV).

Foreign exchange reserve reached to USD 21.5 billion in FY14, which was suf ficient to cover about 7 months of import payment. Avoiding excessive exchange rate volatility remains a key objective of BB. The nominal value of Taka against USD barely changed in FY14 while real exchange rate data indicated a marginal impact on export competitiveness.

However, BB's interventions in the foreign exchange market have protected exporters by slowing the appreciation of Taka. BB bought USD 5.15 billion from foreign exchange market in FY14.

4.3 The policy stance for FY14 was designed in line with the target of 7.2 percent real GDP growth in a scenario of 7.0 percent annual average CPI inflation. Accordingly broad money (M2) growth was programmed at 17.0 percent. Broad Money (M2) grew by 16.1 percent in FY14 against this targeted growth and 16.7 percent actual growth in FY13. The monetary programme vis-à-vis actual outcomes are presented in Table 4.1.

Table 4.2 Reserve money position

(billion Taka)

	End June 13	End June 14	
	Actual	Programme	Actual
Net foreign assets 1/@	948.2	-	1400.2
Net foreign assets 2/@	935.1	1036.9	1352.5
Net domestic assets 1/	173.5	-	-105.3
Net domestic assets2/	186.7	266.0	-57.7
Domestic credit	344.2	304.2	156.9
	(-17.9)	(-11.6)	(-54.4)
Credit to the public sector 3/	281.4	240.4	102.3
	(-20.2)	(-14.6)	(-63.7)
Credit to deposit money banks 4/	62.8	63.8	54.6
	(-6.0)	(1.6)	(-13.1)
Other items (net)	-157.5	-38.2	-214.6
Reserve money	1121.8	1302.9	1294.8
	(15.0)	(16.2)	(15.4)
Currency issued	753.7	892.8	854.9
	(16.1)	(18.5)	(13.4)
Deposits of banks with BB 5/	368.0	410.1	440.0
	(12.7)	(11.4)	(19.5)
Money multiplier	5.38	5.42	5.41

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 foreign currency clearing account balance and non-bank deposits.
@ Excluding foreign currency clearing account balance and offshore bank account.

Table 4.3 Income velocity of money

(billion Taka)

Year	GDP at current market prices (base:FY06)	Broad Money (M2) (end June position)	Income velocity of money
FY08	6286.82	2486.9	2.53 (-2.69)
FY09	7050.72	2963.6	2.38 (-5.93)
FY10	7975.39	3628.2	2.20 (-7.56)
FY11	9158.29	4403.2	2.08 (-5.45)
FY12	10552.04	5171.10	2.04 (-1.92)
FY13	11989.23	6031.9	1.99 (-2.45)
FY14	13509.20	7001.8	1.93 (-3.02)

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

The growth of broad money (M2) declined due mainly to the lower growth of net foreign assets and public sector credit in FY14. Credit to the public sector declined due to higher non-bank borrowing of the government through sale of national saving certificates which was Taka 117.07 billion in FY14 compared with Taka 7.73 billion in FY13. The growth in public sector credit stood at 8.8 percent against the target 22.9 percent growth under the programme in FY14 and 11.1 percent actual growth in FY13. Credit to the private sector recorded 12.3 percent growth against the target growth of 16.5 percent in FY14 but it remained marginally higher than the actual growth of 10.8 percent in FY13. As a result, net domestic assets registered a 11.0 percent growth in FY14 compared with the target growth of 18.6 percent for the same year and 11.1 percent growth in FY13. On the other hand, the growth in net foreign assets stood at 38.6 percent in FY14 against the target growth of 9.9 percent under the programme and the actual growth of 50.1 percent in FY13. Higher growth in NFA then the target is the outcome of robust export growth along with moderate import growth.

Trends of broad money and its components are shown in Chart 4.2.

Reserve Money Developments

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

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

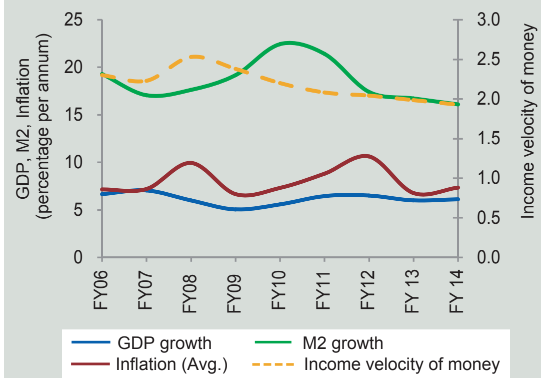


Table 4.4 Bank credit*-FY14 quarterly positions

(billion Taka)

Outstanding as of	Advances	Bills	Total
30 June 13	4283.15 (95.56)	199.01 (4.44)	4482.16
30 Sep 13	4422.62 (95.70)	198.64 (4.30)	4621.26
31 Dec 13	4567.99 (95.94)	193.53 (4.06)	4761.51
31 Mar 14	4663.81 (96.17)	185.68 (3.83)	4849.49
30 June 14	4854.00 (96.17)	193.49 (3.83)	5047.49

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

4.5 In line with the projected broad money growth, the monetary programme set a 16.2 percent growth of RM for FY14 but the actual growth was 15.4 percent mainly due to substantially lower level of net domestic assets of BB compared to the program level. Net domestic assets stood negative at Taka 57.7 billion against the programme level of Taka 266.0 billion. Domestic credit of BB registered negative 54.4 percent growth associated with its components; public sector credit recorded negative by 63.7 percent growth compared to negative 14.6 percent growth targeted under the program due to lower than expected growth of government borrowing from BB. In FY13 public sector borrowing from BB was negative (20.2 percent). Credit to the deposit money banks stood at Taka 54.6 billion in FY14 against the targeted amount of 63.8 billion as banks had sufficient liquidity to meet the required demand.

On the other hand, net foreign assets of BB, however, substantially increased by Taka 417.4 billion and stood at Taka 1352.5 billion against the programme level of Taka 1036.9 billion. Net foreign assets of BB rose sharply as BB bought USD 5.15 billion from the foreign exchange market in FY14 to maintain external competitiveness of Taka against the USD.

4.6 Money multiplier increased to 5.41 in FY14 from to 5.38 in FY13. Reserve-deposit ratio increased to 0.085 from 0.084, while currency-deposit decreased to 0.123 from 0.126 over the same period. Net changes in reserve-deposit ratio and currency-deposit ratio led to an increase in money multiplier . Both money multiplier and reserve money growth explain the growth in broad money . Movement of domestic credit and its components in FY14 are shown at Chart 4.3.

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

Income Velocity of Money

4.7 The income velocity of money decreased to 1.93 in FY14 from 1.99 in FY13 (Table 4.3). The rate of decrease in FY14 was 3.02 percent as against 2.45 percent decline in FY13. Income velocity of money was on a declining trend over the past several years indicating increased monetisatio and financial deepening in the economy. Growth of GDP, M2, inflation and income velocity of money during FY06-FY14 are shown in Chart 4.5.

Table 4.5 Bank deposits*- FY14 quarterly positions

(billion Taka)

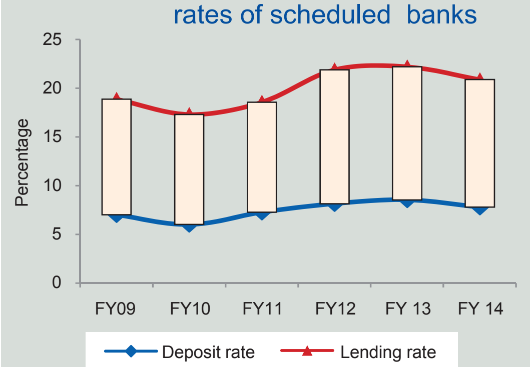
Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 13	557.37	4799.02	372.52	5728.91
30 Sep 13	539.45	5032.87	348.71	5921.03
31 Dec 13	553.65	5253.32	394.14	6201.11
31 Mar 14	602.19	5341.95	386.19	6330.33
30 June 14	643.44	5589.32	392.18	6624.94

*Excluding inter bank and restricted deposits.

Table: 4.6 Weighted average interest rates of scheduled banks

Items	as of end June (in %)					
	FY09	FY10	FY11	FY12	FY13	FY14
Deposit rate	7.01	6.01	7.27	8.15	8.54	7.79
Lending rate	11.87	11.31	12.42	13.75	13.67	13.10
Spread	4.86	5.30	5.15	5.60	5.13	5.31

Chart 4.6 Weighted average interest rates of scheduled banks



Bank Credit

4.8 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY14 increased by Taka 565.33 billion or 12.61 percent to Taka 5047.49 billion compared to an increase of 8.88 percent in FY13. The rise in bank credit during FY14 was driven by increase in advances.

Advances increased by Taka 570.85 billion or 13.33 percent in FY14, as against an increase of 10.45 percent during FY13. Bills purchased and discounted decreased by Taka 5.52 billion or 2.77 percent in FY14 as compared with the increase of 16.57 percent in FY13. The quarterly position of bank credit and its components are given at Table 4.4.

Bank Deposits

4.9 Bank deposits (excluding inter-bank items) increased by Taka 896.03 billion or 15.64 percent to Taka 6624.94 billion during FY14 compared to 16.91 percent increase in FY13. he rise in total bank deposits was contributed by time deposits and government deposits. Time deposits increased by Taka 790.30 billion or 16.47 percent and stood at Taka 5589.32 billion in FY14 compared to the growth of 17.80 percent during FY13. Government deposits increased by Taka 19.66 billion or 5.28 percent to Taka 392.18 billion in FY14 compared to 17.98 percent increase in FY13. On the other hand, demand deposits increased by Taka 86.07 billion or 15.44 percent in FY14 to Taka 643.44 billion against 9.16 percent increase in FY13. Quarterly position of bank deposits in FY14 may be seen at Table 4.5.

Credit/Deposit Ratio

4.10 The credit/deposit ratio of the scheduled banks, excluding the specialised banks was 0.79 at the end of June 2014 compared to 0.78 at the end of June 2013. Increasing credit to deposit ratio indicates higher credit growth than deposit growth.

Scheduled Banks' Borrowing from Bangladesh Bank

4.11 Scheduled banks' borrowings from the Bangladesh Bank decreased by Taka 39.15 billion or 41.46 percent to Taka 55.27 billion at the end of June 2014 compared to the decrease by 56.76 percent to Taka 94.42 billion at the end of June 2013. The fall in scheduled banks' borrowing from BB is indicative of adequate liquidity in the money market.

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

4.12 Balances of scheduled banks with the BB increased by Taka 71.95 billion or 19.55 percent to Taka 439.98 billion at the end of June 2014 compared to the increase by 12.68 percent to Taka 368.03 billion at the end of June 2013. Cash in tills of scheduled banks increased by Taka 7.58 billion or 9.69 percent to Taka 85.77 billion at the end of June 2014 compared to the increase by 20.68 percent to Taka 78.19 billion as of end June 2013.

Cash Reserve Requirement (CRR)

4.13 The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank has been increased by 50 basis points to 6.50 percent of their total demand and time

Box 4.1

Price stability and financial stability: Bangladesh perspective

The question whether there is a trade-of f between monetary and financial stability has been one of the most interesting areas of research for central banking for many years. According to conventional wisdom, monetary policy aimed at maintaining price stability would lessen both the incidence and the severity of financial instability . The argument was that price stability obviates the information problems for both borrowers and lenders and ensures financial stability through ef ficient allocation of resources. A monetary policy that maintains price stability , thus, also would promote financial stability. Following this wisdom, a number of countries have set explicit targets for inflation and mandated control of inflation as the paramount objective of monetary policy over the past decade. Critics argue that such a narrow focus sometimes fails to protect the stability of the financial system. The recent financial crisis proves that financial stability can be endangered even if there is price stability. Thus, the crisis has revitalised the question whether monetary policy should only have a single objective of price stability or not.

The financial instability af fects monetary transmission mechanism by impairing the bank lending channel. Such impairment makes the central banks more inclined to pay attention to financial stability in their monetary strategy . Since the recent global financial crisis, central banks became more interested to address the problem of financial instability . Along these lines, the role of macro-prudential policy and monetary policy in achieving and maintaining macroeconomic and financial stability became a high priority in the agenda of policymakers.

Mainstream monetary policy approaches of developed economies seek to impact real sector primarily by influencing financing costs and occasionally by influencing liquidity volumes. Recurring cycles of financial instability and prevalence of financial exclusion show this mainstream monetary policy approach to be sub-optimal for both sustained growth and stability . In the presence of liquidity surfeits and policy laxity, markets tend to siphon of f financing away from SMEs towards speculative profit seeking that creates price bubble in commodity and asset markets and impairs financial stability. In this backdrop, Bangladesh Bank (BB), has decided to deliberately imparting some directional bias in monetary and financial policies towards supporting inclusive, sustainable growth. BB has chosen a socially responsible inclusive financing orientation as the mainstream approach for the financial sector in Bangladesh.

In the financial sector of Bangladesh, inclusive financing is bolstering financial stability by widening and diversifying the asset and deposit bases of lending institutions, reducing their credit and liquidity risk exposures. The diverse small-sized financing in the inclusive initiatives constitute a new asset base, entailing lower aggregate credit risk than from large loan exposures to a few large borrowers. At the same time, the new client base of numerous small borrowers constitute a substantial base of new deposits that are more stable than large deposits from a small number of big depositors-enhancing financial sector stability . Inclusive financing shielded small farms and businesses inBangladesh from any credit crunch in the last global financial crisis. BB's inclusive financing promotion exists within its monetary growth programme, designed to maintain price and macro-financial stability. All banks and financial institution have enthusiastically engaged themselves in nationwide financial inclusion initiatives. Financial support from these initiatives has boosted agriculture and SMEs, generating both domestic output and demand to compensate for external demand weakness from the slowdown in developed economies. Sustainability supportive policies of BB have successfully enthused banks and financial institutions into spawning new initiatives of reaching out with financial services supporting productive initiatives in underserved communities and sectors, using cost-effective mobile phone/smart card and other off branch service delivery channels enabled by a BB-led massive upgrading of the financial sector IT infrastructure.

BB's role as monetary policy authority, well integrated with macro-prudential regulation and micro-prudential supervision. Macro-prudential measures, inter alia sharpening quantitative risk focus, specifying quality specification on required capital, stress testing of banks for identifying their vulnerabilities, contingency planning for handling crisis situations, and introducing liquidity requirement specifications in the new Basel III capital regime steers country's financial system away from recurrent instability. The institutional arrangement in the financial sector was already in place for inter-regulatory co-ordination to monitor financial stability. So, BB's approach to financial stability has been proactive and preventive rather than reactive. BB considers price level stability and financial stability are very much compatible, not competing goals for monetary policy.

Mainstreaming of this approach in monetary policy garnered good outcomes in regard to upholding of price and macro financial stability. The financial sector of Bangladesh remained unscathed and resilient during the global financial crisis and subsequent global growth slowdown, actively supporting the domestic sectors and supplementing the government's fiscal efforts to uphold domestic demand.

liabilities with effect from 24 June 2014. It may be noted that banks are required to maintain CRR at the rate of 6.50 percent on average on bi-weekly basis provided that the CRR would not be less than 6.00 percent in any day.

Statutory Liquidity Ratio (SLR)

4.14 According to the amendment of subsection (2) under section 33 of Bank Company Act, 1991, it is decided that banks should maintain statutory liquidity ratio separately. For the conventional banks, the statutory liquid assets inside Bangladesh which also includes excess reserves with Bangladesh Bank, shall not be less than 13.0 percent of their total demand and time liabilities, and for the shariah based Islamic banks, this rate shall not be less than 5.5 percent. This has been in effect from 1 February 2014.

4.15 The bank rate remained unchanged at 5.0 percent in FY14. This rate has been effective from 6 November 2003.

Interest Rates on Deposits and Lending

4.16 Table 4.6 presents the weighted average interest rates of scheduled banks on deposits and lending along with the spread during FY09 to FY14. It is evident from the table that the weighted average interest rates on deposits and lending showed mixed trends during FY09-FY14. The weighted average interest rate on lending declined to 13.10 percent in FY14 from 13.67 percent in FY13 though policy rates remained unchanged as a result of fall in demand for credit and continued moral persuasion by BB. The weighted average deposit interest rate came down to 7.79 percent in FY14 compared to 8.54 percent in FY13. The large excess liquidity in the banking system contributed to lower the deposit rate. The trends of the spreads between lending and deposits rates were above 5 percent from FY10 to FY14. The spread stood at 5.31 percent in FY14 compared with 5.13 percent in the preceding year.