Money and Credit

Stance of Monetary and Credit Policy

4.1 Monetary policy stance for FY17 was to achieve price stability alongside supporting sustainable output and employment growth. Bangladesh Bank (BB) made efforts to nudge the financial system toward addressing long-term sustainability concerns, by supporting an inclusive, employment generating, and environmentally sustainable growth. It is assumed that sustainable finance can help foster social cohesion and long-term macroeconomic stability, which are critical for a rapidly growing, manufacturing-led economy, with a relatively large, young population and with exposure to weather. Accordingly, BB pursued monetary and credit policies and programs to intensively engaging the financial sectors for fostering socially responsible financing in inclusive and eco-friendly green initiatives.

Monetary Policy Performance

4.2 Buoyant domestic demand driven economic activity in agriculture, manufacturing and service sectors, strong private sector credit growth supported by increasing import and consumption, momentum in public sector investment along with the macroeconomic and political stability throughout the year contributed GDP growth to outperform at 7.28 percent from the targeted 7.20 percent set by the government. On the other hand, annual average CPI inflation dipped down to 5.4 percent at the end of June 17, remained below the targeted level of 5.8 percent owing to eased in non-food inflation, aided by subdued global commodity prices and declining government's borrowing from the banking system. In the backdrop of moderate inflation outlook and ample liquidity condition in the banking system Bangladesh Bank kept policy rates (repo and reverse repo rates) unchanged at 6.75 and 4.75 percent respectively in FY17.

Table 4.1 Monetary and Credit Programme and Component of Broad Money

Particulars	End June 2016	End June 2017	
	Actual	Programme	Actual
1. Net foreign assets	2319.3	2552.5	2586.6
	(+22.8)	(+10.1)	(+11.5)
2. Net domestic assets (a+b)	6838.5	8024.4	7567.5
	(+14.3)	(+17.3)	(+10.7)
a) Domestic Credit (i+ii)	7954.0	9260.9	8842.4
	(+14.4)	(+16.4)	(+11.2)
i) Credit to the public sector[1]	1243.9	1443.6	1081.8
	(+3.3)	(+16.1)	(-13.0)
ii) Credit to private sector	6710.1	7817.3	7760.6
	(+16.8)	(+16.5)	(+15.7)
b) Other items (net)	-1115.5	-1236.5	-1274.8
3. Narrow money (i+ii)	2118.3		2394.2
	(+32.1)		(+13.0)
i) Currency outside banks	1220.7		1375.3
	(+38.8)		(+12.7)
ii) Demand deposits[2]	897.6		1018.9
	(+24.0)		(+13.5)
4. Time Deposits	7039.5		7760.0
	(+12.3)		(+10.2)
5. Broad money (1+2) or (3+4)	9157.8	10577.0	10154.1
	(+16.3)	(+15.5)	(+10.9)

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 with monetary authority are excluded.
Source: Monetary Policy Department, Bangladesh Bank.

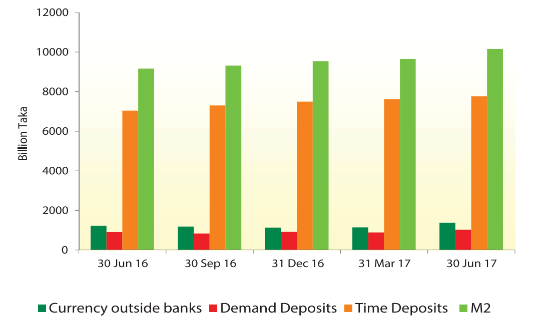
4.3 Monetary aggregates remained broadly in line with their programmed levels indicating attainment of key objectives of monetary and credit programme and policies for FY17. Broad money (M2) and domestic credit two important anchors of monetary programme grew by 10.9 and 11.2 percent respectively in FY17 remained well below the programme ceilings. Lower growth of net domestic asset (NDA) due mainly to a declining trend of net credit to the government from the banking system contributed to remain broad money below the targeted level. Throughout the FY17 Government's non-bank domestic borrowing in the costly route of high yield national saving certificates (NSCs) was non-inflationary, though afflicting banks with exuberant liquidity position. However, government's non-bank borrowing through issuing of NSCs created an extra-space for the private sector and as such private sector credit grew robustly at 15.7 percent remaining within the targeted ceiling of 16.5 percent in FY17 which was sufficient to support inclusive growth and employment generation.

4.4 Current account turned surplus to deficit in FY17 stemming from widened trade deficit and a negative growth in inward workers' remittances which weakened the value of domestic currency by depreciating around three percent against the US dollar (USD), the intervening currency. This depreciation of BDT helped to improve export competitiveness, after a prolonged appreciation pressure. In spite of having deficit in current account balance, foreign exchange reserve marked USD 33.49 billion at the end of June 2017 emanated from a remarkable surplus in financial account balance. The comfortable amount of foreign exchange reserve has bolstered the confidence of foreign investors on the strength and stability of the growing Bangladesh economy.

Money and Credit Situation

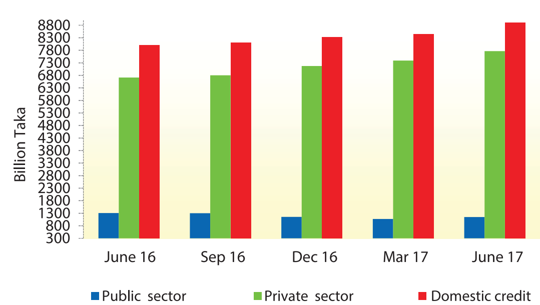
4.5 Following the growth supportive stance in monetary policy, broad money (M2) growth was programmed at 15.5 percent where growth in net foreign assets (NFA) and net domestic assets (NDA) were projected at 10.1 percent and 17.3 percent respectively in FY17 whereas

Chart 4.1 Movements of the Components of Broad Money (M2)



Source: Monetary Policy Department, Bangladesh Bank.

Chart 4.2 Movements of Domestic Credit and its Components



Source: Monetary Policy Department, Bangladesh Bank.

M2 actually grew by 10.9 percent due mainly to subdued growth in NDA. It may be noted that NDA grew at 10.7 percent against the targeted growth of 17.3 percent in FY17 due to a negative growth in credit to the public sector including Government sector. Instead of borrowing from the banking system, Government made repayment of its previous loans to the banking system owing to surge in earnings from soaring revenue income and unusually high receipts from net sale of national saving certificates contributed to negative growth of net credit to Government sector. Growth of credit to the public sector enterprises was also restrained and as such overall credit to public sector credit including Government declined by 13.0 percent at the end of June 2017 against the targeted increase of 16.1 percent and an actual growth of 3.3 percent in FY16. On the other hand, private sector credit grew by 15.7 percent at the end of June 2017 against the targeted growth ceiling of 16.5 percent supported by a buoyant domestic demand driven activities in agriculture, manufacturing and service sector. As a result, domestic credit grew by 11.2 percent against the targeted level of 16.4 percent in FY17 and actual 14.4 percent growth in FY16. Notwithstanding a declining trend in inward remittances and widening of trade gap, NFA grew by 11.5 percent in FY17 against the targeted growth rate of 10.1 percent and the actual growth of 22.8 percent in FY16. Moderate growth in broad money and overall domestic credit helped the economy to attain benign inflation outcome in FY17. The monetary programme vis-à-vis actual outcome and development of the components of broad money are presented in Table 4.1 and Chart 4.1 respectively. Movement of domestic credit and its components are also shown in Chart 4.2.

Reserve Money developments

4.6 Bangladesh Bank uses reserve money (RM) as an operating target to modulate liquidity consistent with the overall monetary projection. The weekly auctions of Bangladesh Bank's own instruments; i.e., various maturity of BB bills along with Government's treasury bills and bonds were used to influence the level of RM, while repo and reverse repo operations were applied for smoothing the money market.

4.7 In line with the projected broad money growth, monetary program set 14.0 percent growth of RM for FY17 while actual growth stood at 16.3 percent. It may be noted that RM grew by 30.1 percent in FY16. Lower growth in RM as compared to the previous year emerges from a subdued growth in net foreign assets (NFA) and a huge amount of repayment of previous loans of Government to the Bangladesh Bank. However, NFA of Bangladesh Bank increased by BDT 244.4 billion to BDT 2350.0 billion in FY17 against the programmed increase of BDT 225.4 billion. Domestic credit of BB associated with its components decreased by BDT 62.7

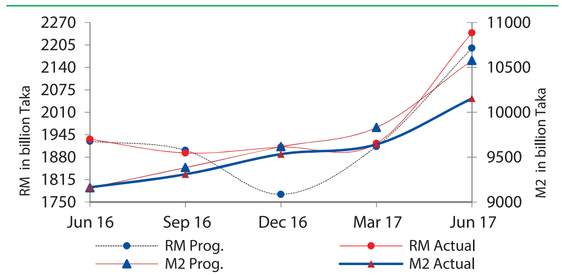
Table 4.2 Actual and Programmed Growth of Reserve Money and its Components

(Billion BDT)

Particulars	End June 2016	End June 2017	
	Actual	Programme	Actual
Net foreign assets[1/@]	2117.7	-	2430.4
Net foreign assets[2/@]	2105.6	2331.0	2350.0
Net domestic assets[1/]	-191.7	-	-190.4
Net domestic assets[2/]	-179.6	-135.4	-110.0
Domestic Credit	231.4	241.4	168.7
	(+61.1)	(+4.3)	(-27.1)
Credit to the public sector[3/]	187.7	197.7	125.7
	(+96.7)	(+5.3)	(-33.0)
Credit to deposit money banks[4/]	43.8	43.8	43.0
	(-9.3)	(+0.0)	(-1.7)
Other items (net)	-411.0	-376.8	-278.8
Reserve money	1926.0	2195.7	2240.0
	(+30.1)	(+14.0)	(+16.3)
Currency issued	1323.1	1552.2	1512.7
	(+34.8)	(+17.3)	(+14.3)
Deposits of banks with BB[5/]	603.0	643.5	727.3
	(+21.0)	(+6.7)	(+20.6)
Money multiplier	4.75	4.82	4.53

Note: Figures in the parentheses indicate y-o-y percentage changes.
@ Excluding foreign currency clearing account balance and offshore bank account.
1/ Calculated from monetary survey data using end-period exchange rates.
2/ Calculated using constant exchange rates of end June 2015.
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.
Source: Monetary Policy Department, Bangladesh Bank.

Chart 4.3 Programmes and Actual Developments of M2 and RM in FY17



Source: Monetary Policy Department, Bangladesh Bank.

billion or (-) 27.1 percent against the targeted increase of BDT 10.0 billion or 4.3 percent originated mainly from negative credit growth in the public sector. BB's credit to the deposit money banks also marginally declined by 0.8 billion to BDT 43.0 billion in FY17 against the targeted amount of BDT 43.8 billion. However, in spite of declining domestic credit, liabilities in other items (net) reduced by BDT 132.2 billion due to making payments for previously held maturity-based BB bills which contributed to decline liabilities in net domestic assets (NDA) of BB amounting to BDT 69.6 billion and contributed to increase RM alongside the growth of NFA. Actual and programmed growth of RM during FY17 can be seen in Table 4.2. Actual developments of M2 and RM against their respective programmed levels can also be seen in Chart 4.3.

4.8 Money multiplier decreased to 4.53 in FY17 as compared to 4.75 in FY16. Reserve-deposit ratio increased to 0.098 in FY17 from 0.089 in FY16 and currency-deposit ratio also increased to 0.157 in FY17 as compared to 0.154 in FY16. Increase in both reserve-deposit ratio and currency-deposit ratio stemming from increase in cash holding by the people as well as banks' reserves relative to deposits led to decrease the money multiplier.

Income Velocity of Money

4.9 The income velocity of money (GDP/money supply) increased to 1.94 in FY17 from 1.89 in FY16 (Table 4.3). The rate of increase in FY17 was 2.65 percent as against a decrease of 1.56 percent in FY16. This means the growth of nominal income was faster than the growth of M2 in FY17 due mainly to a historically high growth of sales in national savings certificates (NSCs) which is not considered as component of M2[1]. The recent stock market vibrancy might have also contributed to a slow growth in M2 as some of the depositors might have withdrawn their bank deposits for investing stocks having good return especially when weighted average real interest rate on deposits remained negative in FY17. Alternatively, income velocity of money might have increased after a continued declining trend since FY11 which reflects the availability and the use of money substitutes, low demand for money as well as greater

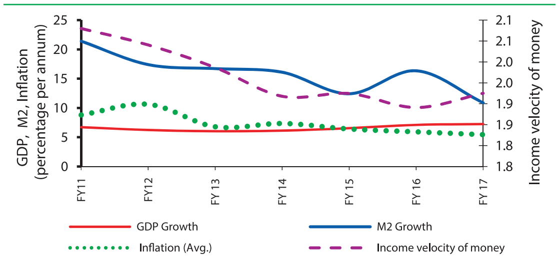
Table 4.3 GDP, Broad Money (M2) and Income Velocity of Money

(Billion BDT)

Year	GDP at current market prices	Broad Money (M2)	Income velocity of money
FY11	9158.29	4405.20	2.08 (-5.45)
FY12	10552.04	5171.09	2.04 (-1.92)
FY13	11989.23	6035.05	1.99 (-2.45)
FY 14	13436.74	7006.24	1.92 (-3.52)
FY 15	15158.02	7876.14	1.92 (0.00)
FY 16	17328.64	9163.78	1.89 (-1.56)
FY 17	19758.15	10160.76	1.94 (2.65)

Note: Figures in parentheses indicate percentage changes over previous fiscal year. Source: Monetary Policy Department, Bangladesh Bank.

Chart 4.4 Movement of GDP growth, M2 growth, rate of inflation and income velocity of money



Source: Monetary Policy Department, Bangladesh Bank.

1 NSCs are considered as component of M3.

economic activities using money substitutes due to financial development, financial innovation and technological up-gradation. Movement of GDP growth, M2 growth, inflation and income velocity of money during FY011-FY17 are shown in Chart 4.4.

Bank Credit

4.10 Outstanding bank credit (excluding foreign bills and inter-bank items) during FY17 rose by BDT 1055.95 billion or 15.84 percent to BDT 7723.40 billion against an increase of 16.16 percent in FY16. The rise in the bank credit during FY17 was driven by both advances and bills. Advances increased by BDT 1007.00 billion or 15.67 percent in FY17 against an increase of 16.14 percent in FY16. Bills purchased and discounted increased by BDT 48.95 billion or 20.35 percent in FY17 as compared to the increase of 16.62 percent in FY16. The quarterly position of bank credit and its components are given at Table 4.4.

Bank Deposits

4.11 Bank deposits increased by BDT 929.53 billion or 10.94 percent to BDT 9425.34 billion during FY17 against 13.84 percent increase in FY16. The rise in total bank deposits was shared by all kinds of deposits. Demand deposits increased by BDT 121.26 billion or 13.51 percent to BDT 1018.85 billion in FY17 against 24.00 percent increase in FY16. Time deposits increased by BDT 720.51 billion or 10.24 percent to BDT 7759.98 billion in FY17 as compared to the increase of 12.31 percent in FY16. Government deposits increased by BDT 87.76 billion or 15.71 percent to BDT 646.51 billion in FY17 against 18.59 percent increase in FY16. Quarterly position of bank deposits in FY17 may be seen at Table 4.5.

Table 4.4 Bank Credit -FY17 quarterly positions

(Billion BDT)

Outstanding as of	Advances	Bills	Total Credit
30 June 16	6426.95 (96.39)	240.50 (3.61)	6667.45
30 Sep 16	6512.96 (96.50)	236.52 (3.50)	6749.48
31 Dec 16	6886.49 (96.60)	242.43 (3.40)	7128.92
31 Mar 17	7075.89 (96.31)	271.22 (3.69)	7347.11
30 June17	7433.95 (96.25)	289.45 (3.75)	7723.40

Figure in parentheses indicate percentage shares of total bank credit
Source: Monetary Policy Department, Bangladesh Bank.

Table 4.5 Bank Deposits*-FY17 quarterly positions

(Billion BDT)

Balances as of	Demand deposits	Time deposits	Govt. deposits	Total deposits
30 June 16	897.59	7039.47	558.75	8495.81
30 Sep 16	826.20	7301.35	527.56	8655.11
31 Dec 16	906.61	7496.08	591.53	8994.22
31 Mar 17	878.59	7622.14	559.92	9060.65
30 June 17	1018.85	7759.98	646.51	9425.34

*Excluding inter bank and restricted deposits.
Source: Monetary Policy Department, Bangladesh Bank.

Credit/Deposit Ratio

4.12 The credit/deposit ratio of the scheduled banks, excluding the specialized banks was 0.82 at the end of June 2017 which was 0.78 at the end of June 2016. Increasing credit to deposit ratio indicates credit growth is higher than the deposit growth reflecting strong domestic demand driven economic activities as well as investment.

Scheduled banks' borrowing from Bangladesh Bank

4.13 Scheduled banks' borrowings from the Bangladesh Bank decreased by BDT 60.06 billion or 32.66 percent to BDT 243.94 billion at the end of June 2017 against the increase of 249.51 percent at the end of June 2016. It may be noted that scheduled banks' borrowings from

BB showed higher growth in FY16 as scheduled banks' borrowing from BB uder the Export Development Fund (EDF) has been started to shown under this head since January 2016.

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

4.14 Balances of scheduled banks with Bangladesh Bank increased by BDT 124.34 billion or 20.62 percent to BDT 727.34 billion at the end of June 2017 against the increase of 20.99 percent at the end of June 2016. Cash in tills of scheduled banks increased by BDT 35.02 billion or 34.23 percent to BDT 137.33 billion at the end of June 2017 against the increase of 0.17 percent as of end June 2016.

Cash Reserve Requirement (CRR)

4.15 The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank remained unchanged at 6.50 percent of their total demand and time liabilities in FY17. 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 with effective from June 24, 2014 which continued in FY17.

Statutory Liquidity Ratio (SLR)

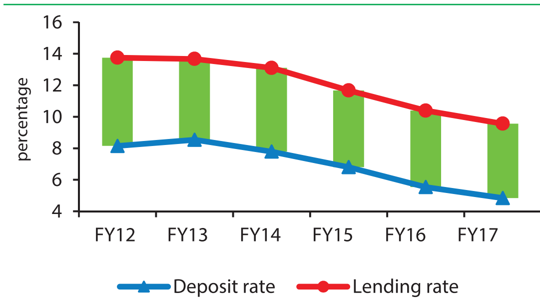
4.16 According to the amendment of sub section (2) under section 33 of the Bank Company Act, 1991, it is decided that banks should have maintained SLR separately, (a) for the conventional banks (excluding the three specialized banks- BDBL,RAKUB & BKB) the statutory liquid assets inside Bangladesh, which also includes excess reserves with Bangladesh Bank, shall not be less than 13.0 percent of their total demand and time liabilities,

Table 4.6 Trends of Weighted Average Interest Rates of Scheduled Banks

Items	as of end June (percent)					
	FY12	FY13	FY14	FY15	FY16	FY17
Deposit rate	8.15	8.54	7.79	6.80	5.54	4.84
Lending rate	13.75	13.67	13.10	11.67	10.39	9.56
Spread	5.60	5.13	5.31	4.87	4.85	4.72

Source: Monetary Policy Department, Bangladesh Bank.

Chart 4.5 Trends of weighted Average Interest Rates of Scheduled Banks



Source: Monetary Policy Department, Bangladesh Bank.

Table 4.7 Liquidity Indicators-FY17

(percent)

As on	ADR	Call money rate	Repo	LCR	NSFR
30 Jun 16	75.65	3.70	6.75	171.98	108.66
30 Sep 16	75.25	3.64	6.75	198.94	110.86
31 Dec 16	76.57	3.62	6.75	197.58	109.30
31 Mar 17	78.10	3.66	6.75	191.42	110.59
30 June17	78.87	3.93	6.75	178.45	110.22

Source: Monetary Policy Department and Department of Off-site Supervision, Bangladesh Bank.

and (b) for the shariah based Islami banks and branches of conventional banks operated on Islamic Shariah, this rate shall not be less than 5.5 percent. This became effective on February 01, 2014 and is remained unchanged in FY17.

Bank Rate

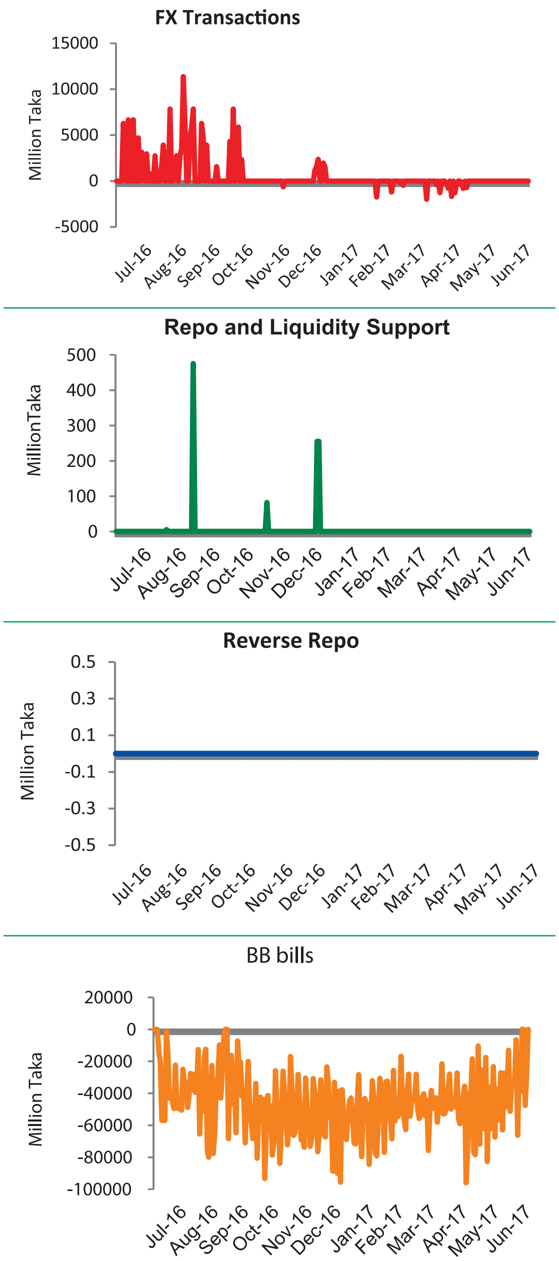
4.17 The bank rate remained unchanged at 5.0 percent in FY17 which became effective on November 6, 2003.

Interest Rates on Deposits and lending

4.18 The weighted average interest rates on deposits gradually declined from a pick of 8.54 percent in FY13 to 4.84 percent in

FY17. Similarly, following the downward trend weighted average interest rates on lending rate also gradually declined to 9.56 percent in FY17 from a pick of 13.75 percent in FY12. Favorable inflation performance, ample liquidity, access of foreign financing facilities at lower interest rate coupled with stringent loan practices by Bangladesh Bank contributed to decline in weighted average interest rates both on deposits and lending. The intermediation spreads between lending and deposit rates were above 5 percent up to FY14. Despite substantial decline of the lending and deposit rates, the intermediation spread gradually narrowed merely to 4.72 percent in FY17. Downward stickiness of the interest rate spread reflects provisioning costs on high non performing loan levels in banks with weak lending discipline, and aversion to competitive rate setting by more efficient banks with low non-performing loan levels. BB has directed the commercial banks to focus on attaining efficiency in credit disbursement and loan recovery, drive to recover default loan, increasing competition among the banks in order to reduce the interest rate spread, these would help banks to reduce interest rate on lending. Besides, Bangladesh Bank's supervisory oversight is strongly dissuading further squeezing of interest rates on bank deposits, and incipient signs of slow upward creep have emerged. Table 4.6 and Chart 4.5 contain weighted average interest rates of scheduled banks on deposits and lending along with the spread during FY12 to FY17.

Chart 4.6 Liquidity Management Operations during FY17



Source: Monetary Policy Department, Bangladesh Bank.

Liquidity Management framework

4.19 The liquidity situation is assessed mainly by the advance-deposit ratio (ADR) and call money rate (Table 4.7). It is observed that during FY17, ADR demonstrate increasing trend while call maney rate was stable at a low level. This is an encouraging sign for the Bangladesh economy. This indicates that most of the banks did not face any liquidity pressure during the reporting period. The call money rate continued to stable, indicating prevalence of no liquidity stress in the banking system. The newly introduced liquidity indicators[2] also demonstrate that all banks were well positioned to absorb any liquidity shock. Banking sector maintained LCRs[3] much above the minimum regulatory requirement of 100 percent throughout FY17. During this period, all banks were also able to maintain the minimum regulatory requirement of NSFR[4] (Table 4.7). In general, liquidity situation of the banking industry continued to indicate a position of excess liquidity in FY17. This excess liquidity was moped up and sterilized with the cautious use of Bangladesh Bank Bills which contributed stable weighted average interest rate in the call money market as well as exchange rate and real GDP growth rate. Besides, BB prudently used various open market operation tools such as repo, special repo, and liquidity support facility in FY17 to maintain instant liquidity requirements of banks. Government Treasury bills and bonds were also issued for the purpose of debt management and liquidity management operations. However, policy rates remained unchanged in FY17 considering the downward trend of inflation, subdued global inflation outlook as well as the ample liquidity position of the banking system. Liquidity management operations during FY17 are graphically shown in Chart 4.6.

2 Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NFSR) introduced in CY15.

3 LCR is defined as -Stock of high quality liquid assets /Total net cash outflows over the next 30 calendar days ≥ 100 percent.

4 The NSFR is defined as the amount of available stable funding relative to the amount of required stable funding. This ratio should be equal to at least 100 percent on an on-going basis. “Available stable funding” is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year.