

Bangladesh's Monetary Policy 2010



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*Luncheon Meeting of
Embassy of the Federal Republic of Germany*

13 April, 2010
Dhaka

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Introduction

- Monetary policy, both in developed and developing economies, seeks to maintain price stability accompanied by sustained output growth in the face of internal and external shocks faced from time to time.
- For developing economies like Bangladesh with significant underemployment/under exploitation of production factors, supporting higher output growth is an overriding priority.
- Monetary policy of Bangladesh Bank (BB) therefore aims at maintaining price stability while permitting monetary expansion needed to support output growth at sustained high rate.

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Evolution of Monetary Policy Formulation in Bangladesh

- In the 1970s and 1980s, monetary policy in Bangladesh was conducted with full direct control over the interest rates and exchange rates and also on the volumes and directions of credit flows.
- The situation began to change in the 1990s with the abolition of directed lending and gradual liberalization of interest rates. The regime of flexible exchange rate started from 2003.
- From then on, interest rate and exchange rates are largely market driven with occasional central bank interventions to maintain stability and to address consumer protection concerns.

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Objectives of Monetary Policy in Bangladesh

- Maintaining domestic price stability, external sector viability;
- Supporting inclusive, broad-based economic growth.

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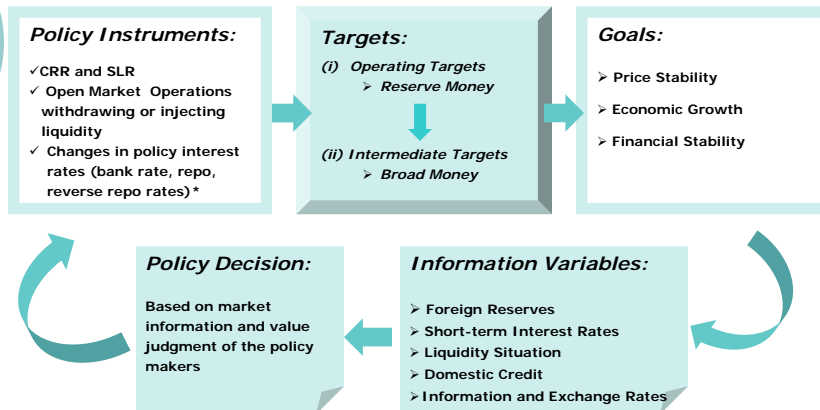


Formulation of Monetary Policy: Current Practices in BB

- Since 2006, BB has been announcing half-yearly Monetary Policy Statements (MPS) to anchor inflation expectations of economic agents and the general public.
- For the first time, drafting of the Monetary Policy Statement for H2 FY10 was preceded by extensive stakeholder consultations from the grassroots level up to the level of experienced professionals including past Finance Ministers /Advisers / Governors, think tanks and trade bodies.

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Monetary Policy Framework in Bangladesh



* In addition to policy interest rate changes from monetary policy perspective, interventions on specific lending rates occur sporadically to rectify aberrant trends like excessive intermediation spread.

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Policy Approaches and Tools

- BB mainly uses monetary targeting to influence CPI, drawing up monetary programs each financial year with target growth path for broad money (M2) that accommodates monetary expansion commensurate with the projected real GDP growth, inflation, and the likely change in income velocity of money.
- Reserve Money (RM) growth path is the operating target used by BB to influence the M2 growth path (the intermediate target), for this in turn to influence CPI, the final target.
- Changes in key policy interest rates (repo, reverse repo rates), Cash Reserve Requirement (CRR) and Statutory Liquidity Ratio (SLR) are also employed as necessary, in support of the monetary programs.

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Near Term Growth Outcome & Outlook

- Domestic demand remains robust, well supported by growing workers' remittance inflows and budgetary stimulus outlays including higher social safety net spending.
- After a slower first quarter, manufacturing output and investment activities accelerated from Q2 FY 10.
- During July-March 2009-10, opening of import LCs grew by around 22%.
- Following 10.3% y-o-y growth in FY 09, exports weakened in FY 10 (4.7% y-o-y decline during July-January 2010) due to weak growth recovery in markets abroad.

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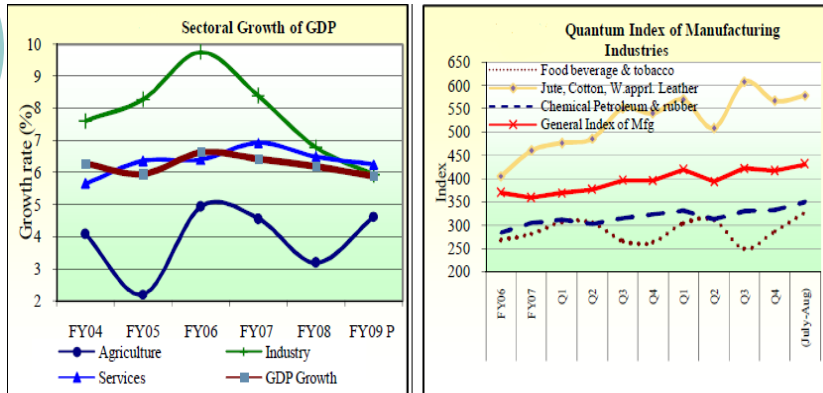


Near Term Growth Outcome..(Cont'd)

- The agriculture sector output activities are responding robustly to market price incentives and support measures provided by the GoB and BB.
- During July-February FY 10, the growth of agricultural credit disbursement was recorded at 21% against 7.2% during the same period of FY 09 .
- Output activities in the service sector are correspondingly vibrant; Capital market activities remain buoyant.
- BB's monetary program for FY 10 is designed to accommodate 6% real GDP growth.

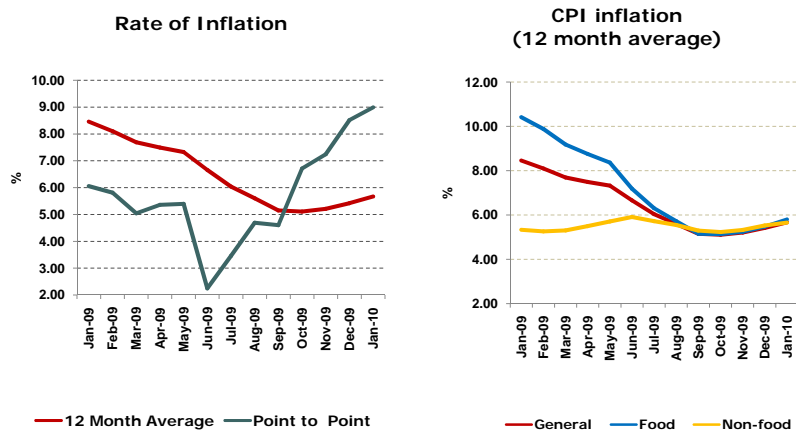
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Growth Outlook



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Near Term Inflation Outcome & Outlook



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Near Term Inflation Outlook..(Cont'd)

- Point-to-point and 12-month average CPI inflation in Bangladesh were both on declining trend in FY 09 from Q2 onward, driven by decline in global commodity and fuel prices and bumper domestic output of the boro rice crop.
- In FY 10 CPI inflation has been edging upward slowly, driven mainly by rising import prices of commodities.
- The 12-month average CPI inflation is projected to be at or under 6.5% at end June 2010.

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Fiscal Developments

- Revenue receipts in H1 FY 10 registered 16.8% growth over the same period of previous year with high growth in income tax offsetting the low growth in custom duty receipts.
- The 28.2% utilization of ADP of the annual allocation of Taka 305.0 billion during H1 FY10 was better than the 23.0% utilization during the same period of FY 09.
- High net sales of NSD instruments and substantial budget support from ADB drove down bank borrowing for deficit financing into negative; leaving greater room for expansion of credit to the private sector.

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Developments in External Sector

- Export shipments declined in FY 10 due to weak demand recovery in markets abroad with 4.7% y-o-y decline during July-January 2010.
- There are indications of incipient recovery in export growth; Order books of exporters in the apparel sector are reportedly full with shipments to new destinations in East Asia beginning to offset demand weakness in traditional markets.
- Opening of LCs for imports of inputs by the apparel sector are on increasing trend. Opening of LCs for inputs of capital goods have lately on rising trend, indicating restoration in new investment momentum.

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Developments in Money and Credit

- Slow off-take of bank credit from deposits and soaring workers' remittance inflows led banks to leave large excess balances in their Taka and foreign currency accounts with the BB in H1 FY 10, causing high growth in reserve money.
- The liquidity surge in H1 FY 10 has declined in H2 FY 10, with pick up in imports and with BB's active use of reverse repo tool.

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Monetary Policy Stance: Jan-Jun 2010

- The latest issue of BB's half yearly Monetary Policy Statement (MPS) outlines the monetary policy stance to be followed in H2 FY10.
- The MPS for H2 FY10 stresses on support for sustained high broad-based economic growth in the unfolding internal and external context, while containing inflation within tolerable moderate levels.
- BB will continue a supportive monetary stance until fuller restoration of investment confidence in the domestic economy and with firmer demand recovery in the export markets recovering from the global recession.

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Broadening Financial Inclusion

- Monetary policies of BB seek to support enhancement not only in quantum but also in quality of growth measured in terms of inclusiveness and environmental sustainability.
- Therefore, BB has recently embarked on campaign-like thrust on broadening financial inclusion, and has launched several refinance support lines for increased lending to sectors like:
 - agriculture, SMEs, effluent/waste disposal, solar/biogas/other renewable energy projects.

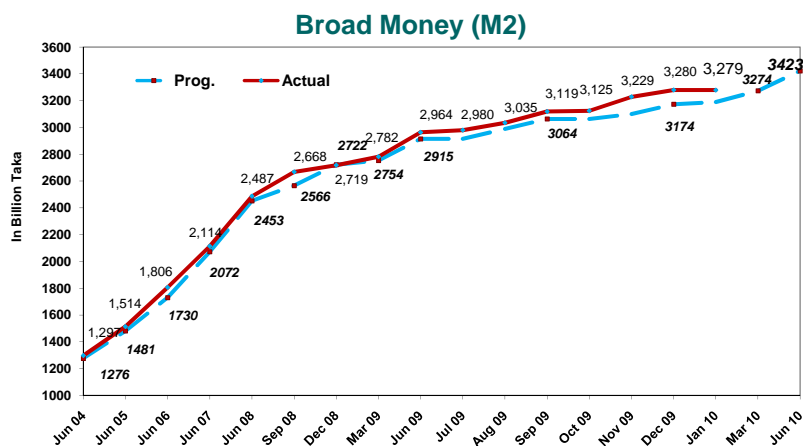
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Broadening Financial Inclusion..(Cont'd)

- The Agricultural Credit Program announced by BB for FY 10 enjoins all banks to engage in lending for a comprehensive range of on- and off-farm rural economic activities.
- A first ever Taka 5.00 billion refinancing line against loans to landless sharecroppers.
- Bank accounts for farmers at only Taka 10.
- Motivating banks and financial institutions to expand lending to under-served sectors both as business case and as CSR obligation.

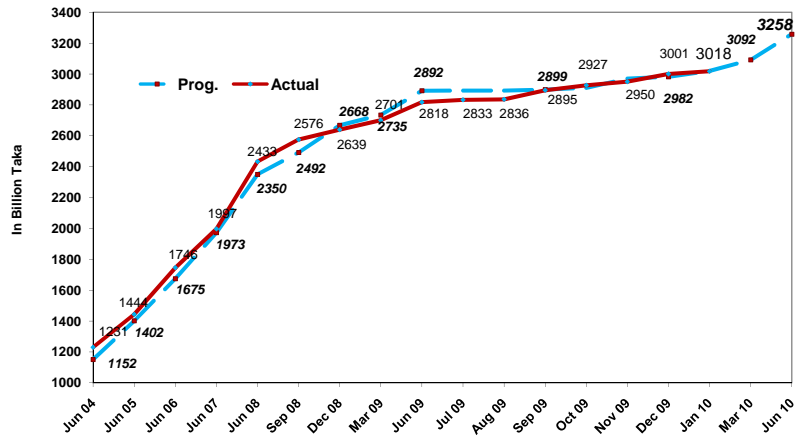
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In FY 10, Actual Growth Paths of Monetary Aggregates Remain Close to Their Programmed Paths



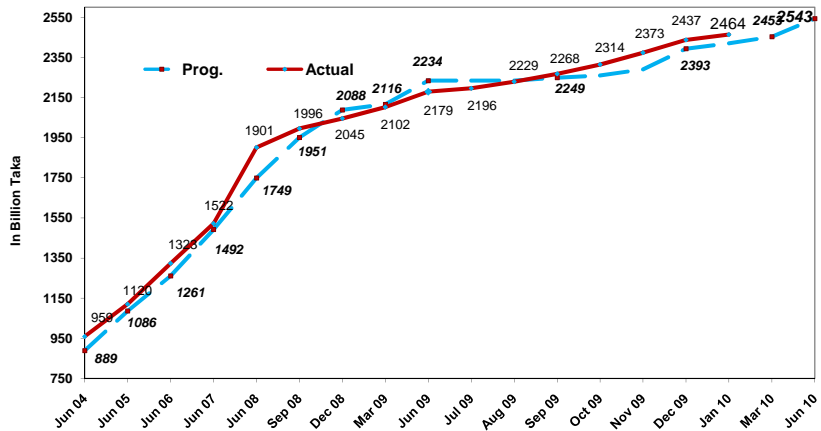
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Domestic Credit



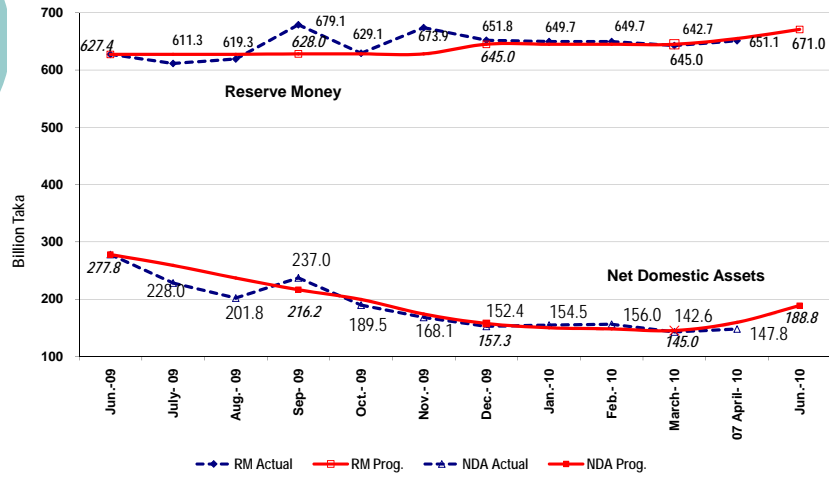
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Credit to Private Sector



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Reserve Money and Net Domestic Assets



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Sovereign Rating: Stable Outlook for Bangladesh

- Sovereign rating for the first time by two international rating agencies- *Standard and Poor's (S&P)* and *Moody's* regarded Bangladesh as a reliable destination for international creditors and investors.
- In the global financial arena, the BB- and Ba3 sovereign credit ratings by S&P and Moody's respectively, ranked Bangladesh only behind India in South Asia.

Country	S&P	Moody's
India	BBB-	Baa3
Bangladesh	BB-	Ba3
Pakistan	B-	B3
Sri Lanka	B	NR
Indonesia	BB	Ba2
Thailand	BBB+	Baa1
Vietnam	BB	Ba3
Malaysia	A-	A3
Cambodia	B+	B2

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Sovereign Rating: Major Observations

- Resilience of Bangladesh economy to domestic and external shocks with stable economic growth over the past decade.
- Macroeconomic and price stability underpinned by prudent economic management.
- Strong and resilient RMG sector and robust inflow of workers' remittances maintaining external sector viability.
- Domestic demand underpinned by strong remittances, MFI activities and social safety net payments.
- Narrow revenue and export base seen as ratings constraints.

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Concluding Remarks

- Supportive monetary condition will be maintained in FY 10 to help the recovery of exports and new investment activities get firmer traction.
- Successful spurring of growth will keep inflationary pressures in check by maintaining benign situation on the supply side.
- Efficient and expeditious ADP implementation will create conditions crowding in private sector investments, facilitated by congenial monetary regime.
- BB has taken recent steps to deepen and broaden secondary trading in treasury securities to eliminate settlement risks.

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Concluding Remarks..(Cont'd)

- BB has introduced mandatory Basel II based capital requirements for banks from 2010 to enhance banks' capacity of handling intermediating large financial flows.
- Steps have also been taken to develop and strengthen risk assessment capacities including forward looking stress testing in the banks as well as in BB supervision departments.
- In conclusion, BB stands ready to respond promptly with appropriate modification in monetary stance required by any exigency in unfolding developments in the domestic and external scene.

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Many thanks

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