

Bangladesh's Monetary Policy in Pursuit of Inclusive Growth



Dr. Atiur Rahman
Governor, Bangladesh Bank
Email: governor@bb.org.bd

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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 also supporting growth pursuits with adequate monetary accommodation for all productive economic activities.

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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.

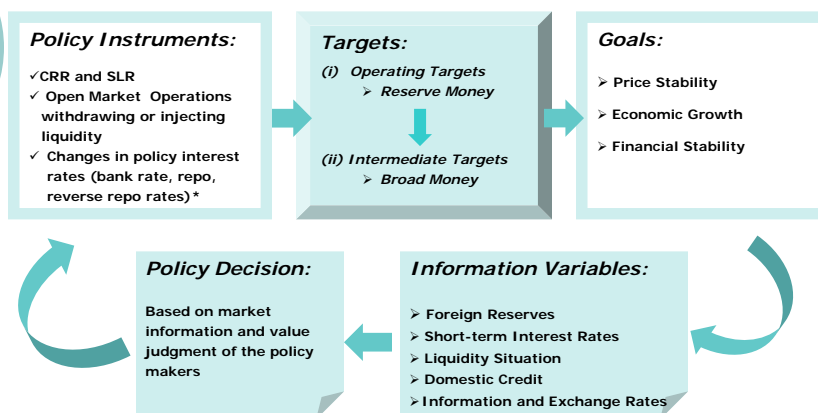
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Formulation of Monetary Policy: Current Practices in BB

- Since 2006, BB has been announcing half-yearly Monetary Policy Statements (MPS) to anchor inflation expectations of economic agents and the general public.
- Drafting of monetary policy is preceded by broad-based stakeholder consultations; post announcement feedback are also lately being obtained with BB participating in discussion sessions outside BB.

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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

- Besides price based tools (policy interest rates, repo, reverse repo), monetary aggregate based tools (changes in CRR, SLR) are also used by BB, like in other developing economies maintaining restriction on capital account.

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Growth Outcome & Outlook

- Growth performance in the agriculture sector was robust in FY 10, with favorable climatic conditions and strong support from the government and BB ensuring timely access to adequate inputs and financing.
- According to the provisional estimates:
 - 4.39% growth in agriculture sector output in FY 10 against preceding year's 4.60%.
 - 6.42% growth in industry sector output in FY 10 against 6.46% in FY 09.
 - 6.59% growth in service sector output in FY10 against preceding year's 6.32%.
- Government's provisional estimate for overall FY 10 GDP growth is 6.09%, against preceding year's 5.88%.

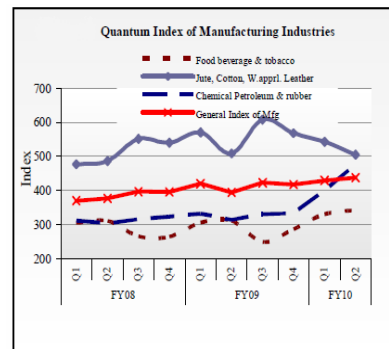
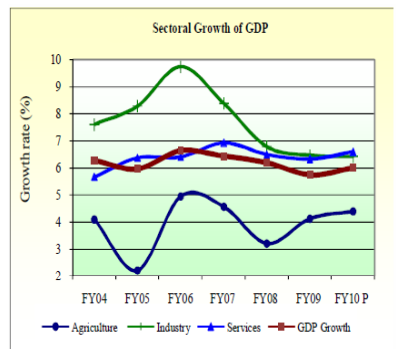
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Growth Outcome & Outlook..(Cont'd)

- Domestic demand remained robust in FY 10, well supported by growing workers' remittance inflows and budgetary stimulus outlays including higher social safety net spending.
- In FY 10, the growth of agricultural credit disbursement was recorded at 19.7% against 8.2% in FY 09 .
- Output activities in the service sector were correspondingly vibrant; Capital market activities remained buoyant.
- BB's monetary program for FY 11 is designed to accommodate 6.7% real GDP growth outlined in the government's budget .

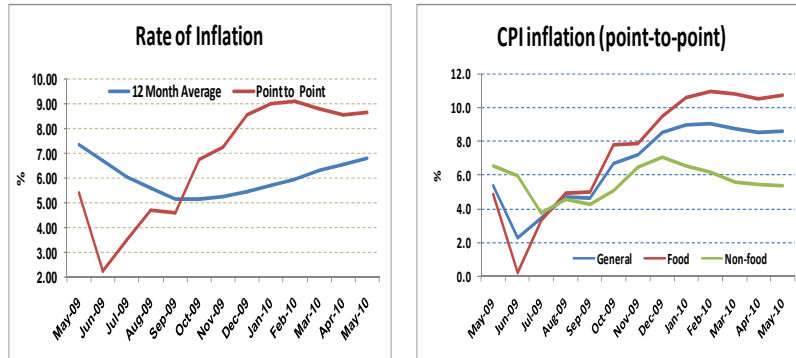
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Growth Outlook



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Trends in CPI Inflation



Point to point CPI inflation are on slow up creep; the 12 month average CPI inflation crept up to 6.78% in May 2010, exceeding the earlier projected 6.50% level for end FY 10.

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Inflation Outlook

- The rising trend in global prices of food and non food commodities seen in the beginning of 2010 abated by May 2010.
- Given the deflation fears in some of the advanced economies, consumer price inflation projections in IMF's July WEO update have been lowered for advanced economies to 1.4% and 1.3% for 2010 and 2011, from April projections of 1.5% and 1.4%.
- In view of projected quicker pace of economic growth, inflation projections for the emerging and developing economies have been raised to 6.3% and 5.0% for 2010 and 2011, from previous projections of 6.2% and 4.7%.

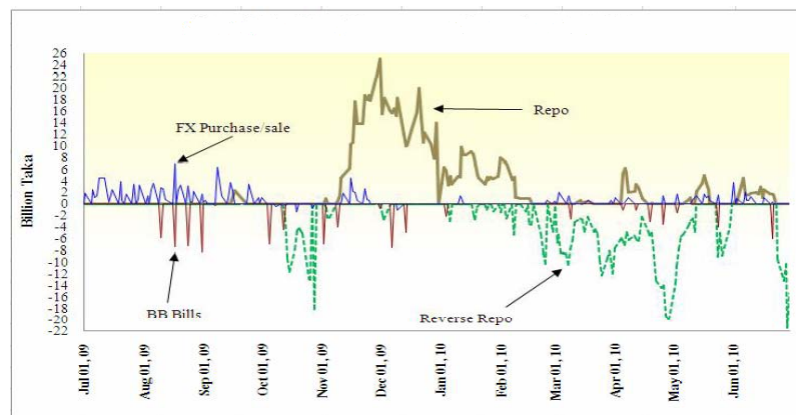
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Inflation Outlook..(Cont'd)

- Given these moderate projections for global inflation, influences from external prices on consumer price trends in Bangladesh in FY 11 are likely to remain subdued.
- 12-month average domestic inflation crept to 6.78% in May 2010, exceeding the 6.50% ceiling targeted for FY10.
- The average CPI inflation will continue up creep for some months before starting decline in line with trend in point to point CPI inflation.
- The 12-month average CPI inflation in Bangladesh is projected to remain moderate in FY 11, within 6.5%.

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Liquidity Management Operations in FY 10



Liquidity in the domestic market came down to near normal levels by Q2 with pick up in private sector credit and in opening of LCs for import of capital goods.

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Fiscal Outlook

- Government's FY 11 budget targets 19.6% increase in public expenditure to Tk. 1321.7 billion, including 34.4% increase in development expenditure to Tk 427.7 billion.
- Seen against the reported high attainments respectively of 25.5% and 47.2% increase in FY 10, both expenditure targets for FY 11 look attainable.
- Revenue receipts are targeted to grow by 16.8% in FY 11, again looking quite attainable seen against the 25.7% growth reported for FY 10.
- Budget deficits of 4.5% and 5.0% of GDP are estimated for FY10 and FY11; eventual actual outcomes are likelier to be around the trend level of under 4.0% of GDP.

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Developments in External Sector

- Annualized import and export growth in FY 10 were 5.5% and 4.1% respectively.
- However, these low figures mask the steady year round improvement from negative growth in initial months.
- In FY 2009-10 opening and settlement of import LCs grew by around 32.0% and 7.0% respectively.
- After steady narrowing throughout first ten months of FY 10, trade deficit widened in May 2010 with high import payments.
- Current account surpluses grew throughout FY 10 with rising inflows from expatriate workers.

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Developments in External Sector..(Cont'd)

- Both imports and exports are projected to grow at double digit rates in FY 11, with workers' remittance inflows settling down around lower double digit trend level.
- Capital inflows as FDI and ODA are expected to increase substantially as government's initiative for attracting external equity and loan/grant inflows in infrastructure investments start bearing fruit.
- BB's main objectives for the external sector will be the maintaining of flexibility and competitiveness of exchange rate of Taka, curbing of tendencies for instability and excessive volatility, and consolidating external sector viability with gradual further buildup in the foreign exchange reserve cushion.

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Developments in Money and Credit

- Credit to private sector has grown strongly in FY 10, to 24.2% y-o-y by June 2010 with no clear evidence of correspondingly strong pick up in output activities.
- With import growth a mere 5.47%, overall growth of domestic credit was contained at 17.9%, due to government's negative bank borrowing.
- To keep inflationary pressures in check by restraining expansion of the monetary base, BB raised CRR and SLR for scheduled banks by one half percentage point from mid May 2010.

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Monetary Policy Stance: Jul-Dec 2010

- The latest issue of BB's half yearly Monetary Policy Statement (MPS) outlines the monetary policy stance to be followed in H1 FY 11.
- Monetary policies in FY 11 will be maintained on a growth supportive stance to help promote faster inclusive economic growth, with due vigil against inflationary pressures.
- Monetary program for FY 11 has been chalked up accordingly, based on real GDP target and inflation ceiling mentioned in the FY 11 national budgets.

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Broadening Financial Inclusion

- BB's financial inclusion initiatives will continue strong support for adequate lending for agriculture, SMEs, renewable energy and other productive sectors.
- The Agricultural Credit Program announced by BB for FY 11 enjoins all banks to engage in lending for a comprehensive range of on- and off-farm rural economic activities.
- A total target of Taka 240.0 billion SME credit has been set by the banks and financial institutions for the first time in 2010 considering SME development as a high policy priority.

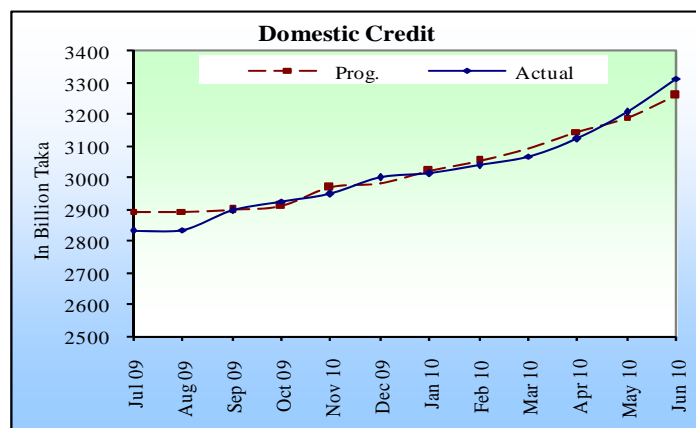
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Broadening Financial Inclusion..(Cont'd)

- A first ever Taka 5.00 billion refinancing line against loans to landless sharecroppers.
- Bank accounts for farmers at only Taka 10; Up to July 2010, around 8.9 million farmers' accounts have been opened. These accounts will be used to disburse government input subsidies to the farmers.
- Bank accounts for unemployed people and special banking services for physically disabled people have been initiated.
- Motivating banks and financial institutions to expand lending to under-served sectors both as business case and as CSR obligation.

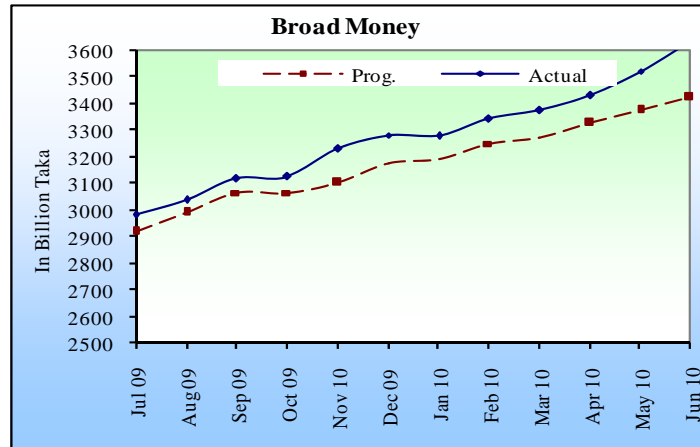
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In FY 10, Actual Growth Paths of Monetary Aggregates Remained Close to their Programmed Paths



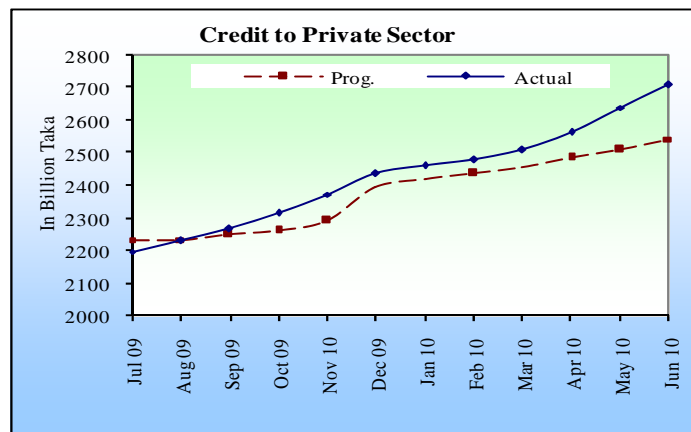
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Broad Money



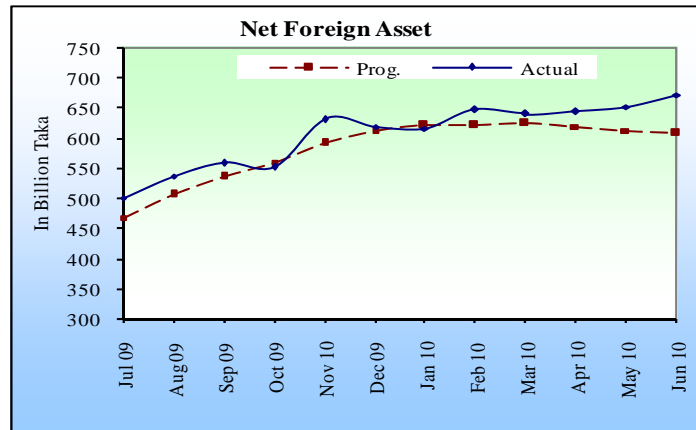
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Credit to Private Sector



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Net Foreign Asset



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Monetary Aggregates

Monetary aggregates (y-o-y growth in percent)							
	FY 09	Sep-09	Dec-09	Mar-10	May-10	Jun-10	Jun-11
							(Prog.)
1. Net Foreign Assets	27.2	49.7	78.7	70.0	51.3	41.3	4.2
2. Net Domestic Assets	17.8	11.6	12.2	13.7	17.9	18.8	17.6
Domestic credit	15.9	12.4	13.7	13.6	16.1	17.9	17.9
Credit to the public Sector (incl. Govt.)	20.3	8.2	-5.1	-6.9	-5.9	-5.2	25.3
Credit to the private Sector	14.6	13.7	19.2	19.5	22.3	24.2	16.0
3. Broad money	19.2	16.9	20.7	21.3	22.9	22.4	15.2
4. Reserve money	31.9	24.3	18.7	19.6	25.2	18.1	13.0

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Concluding Remarks

- The monetary stance for FY 11 is designed to render meaningful support to government's policies and programs aimed at placing the economy in firmer traction on path of faster inclusive growth and poverty reduction; while also maintaining monetary and price stability.
- 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.

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Concluding Remarks..(Cont'd)

- 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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