MONETARY POLICY STATEMENT

Fiscal Year 2020-21

Bangladesh Bank

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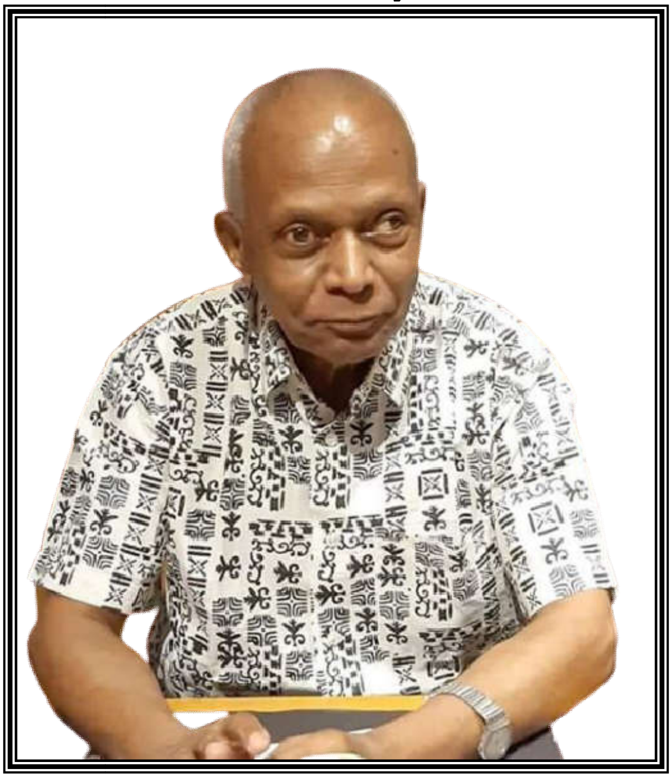
UNITY, a sculpture by Hamiduzzaman Khan
on the Bangladesh Bank premises.

A TRIBUTE

In Memory of



MAM Kazemi
(1949-2020)

It is with the deepest sense of gratitude that we dedicate this FY21 Monetary Policy Statement (MPS) to the memory of late MAM Kazemi, who was the architect of Bangladesh Bank's first ever MPS launched in January 2006. Since then, each and every MPS of Bangladesh Bank was published under his direct supervision and with his exquisite contributions until FY20.

We are extremely saddened by the recent demise of MAM Kazemi. His long cherished knowledgeable guidance, leadership and inputs of the highest quality have been badly missed while formulating the MPS of FY21. We pray for the eternal peace for his departed soul.

Monetary Policy Statement

Fiscal Year 2020-21

Bangladesh Bank

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Acronyms and Abbreviations

ADP	Annual Development Plan
ADR	Advance to Deposit Ratio
App(+)	Appreciation
ARIMA	Auto Regressive Integrated Moving Average
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BoP	Balance of Payments
BSEC	Bangladesh Securities and Exchange Commission
CMSME	Cottage, Micro, Small and Medium Enterprise
COVID	Coronavirus Disease
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DC	Domestic Credit
Dep(-)	Depreciation
DSE	Dhaka Stock Exchange
EDF	Export Development Fund
FAO	Food and Agriculture Organization
FCB	Foreign Commercial Bank
FDI	Foreign Direct Investment
FI	Financial Institution
FY	Fiscal Year
GDP	Gross Domestic Product
H1FY	First Half of the Fiscal Year
H2FY	Second Half of the Fiscal Year
IDR	Investment to Deposit Ratio
IMF	International Monetary Fund
IPO	Initial Public Offering
IT	Information Technology
LHS	Left Hand Side
M2	Broad Money
MPS	Monetary Policy Statement
nCoV	novel Coronavirus
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Asset
NPL	Non Performing Loan
NSC	National Savings Certificates
OBU	Offshore Banking Unit
PCB	Private Commercial Bank
POS	Point of Sale
REER	Real Effective Exchange Rate
RHS	Right Hand Side
RM	Reserve Money
SCB	State-owned Commercial Bank
SEZ	Special Economic Zones
SLR	Statutory Liquidity Ratio
UK	United Kingdom
USA	United States of America
USD	U.S. Dollar
WEO	World Economic Outlook
y-o-y	Year on Year

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Highlights

- The recent fallout in global output growth due to coronavirus pandemic is being recognized as the worst and unprecedented since the Great Depression of the 1930s. Like everywhere else, the Bangladesh economy too has had to bear substantial economic losses resulting in significantly lower real GDP growth for FY20 than the target as well as actual growth (8.15 percent) recorded in FY19. Annual average CPI-based general inflation stood at 5.65 percent in FY20, slightly up from the target (5.50 percent) ceiling as well as actual inflation of 5.47 percent in FY19. The annual average non-food inflation, particularly concerning to medical care and health expenses, and disruption of supply chains due to coronavirus pandemic were largely responsible for this higher inflation.
- A comparison of FY20's program versus actual developments indicates that the broad money (M2) growth (12.7 percent) remained very close to the target ceiling of 13.0 percent. The domestic credit growth fully moved together with the programmed path during the first half of FY20, though slightly plunged in the third and fourth quarters due mainly to a slower than programmed growth of private sector credit. The public sector credit growth including the growth of net credit to Government ended up higher with some volatilities while the growth in private sector credit experienced a moderating trend throughout the FY20 initially due to the banks' adherence towards quality lending which was further aggravated by the recent outbreak of coronavirus.
- The monetary policy stance and program executed in FY20 was largely successful in narrowing the current account deficit from 1.7 percent of GDP in FY19 to primarily estimated at 1.5 percent of GDP in FY20. The Government's 2 percent incentive program and BB's initiatives of easing money transfer process along with the policy of gradual depreciation of Taka against the USD played vital roles in augmenting remittance inflows (10.9 percent growth) in the country in FY20.
- BB's policy supports of reducing CRR and repo rate alongside providing enhanced repo and refinance facilities to banks with timely intervention in the foreign exchange market helped to maintain normalcy in both the Taka and USD interbank markets.
- BB's monetary policy stance and monetary programs for FY21 are essentially expansionary and accommodative for all growth support needs without impairing attainment of the targeted inflation rate subject to any such mid-course modifications as found necessary.
- Despite countrywide unprecedented lockdown during 26 March - 30 May, 2020 owing to the COVID-19 outbreak, the uninterrupted banking, and mobile financial services for all in the country have been effectively maintained by BB.
- Bangladesh Bank took a series of instant and proactive policy initiatives to minimize any possible economic losses due to the COVID-19 pandemic. BB has used its available monetary policy instruments, like, cash reserve ratio (CRR), repo facility (interest rate and tenor), refinancing facility

and other monetary condition easing initiatives to inject necessary liquidity in the market including the recent formation of a credit guarantee scheme to support cottage, micro and small enterprises that lack adequate assets to pledge for bank loans are noteworthy. All these policy measures are taken to help generate employment opportunities in agriculture, industry and services sectors so that the COVID-19 pandemic related economic losses could be recovered fast.

- As a part of BB's expansionary monetary policy stance and supporting the preparedness for additional demand for funds, this MPS is proposing a further cut in the overnight repo rate from 5.25 percent to 4.75 percent and a reduction of reverse repo rate from 4.75 percent to 4.00 percent, ensuring the availability of less costly funds for banks and rationalizing the policy rates' corridor (the gap between the repo and reverse repo rates). Moreover, the Bank Rate which remained unchanged for the last 17 years (since 2003) has also been considered to be reduced from 5.00 percent to 4.00 percent to rationalize it with the current interest rate regime. All these rates change will be in effect soon.
- There are several risk factors to the attainment of FY21 monetary policy program objectives mainly arising from the ongoing COVID-19 pandemic, seasonal floods, and international sluggish economic and volatile price situations resulting in slower than expected economic activities, formation of unexpected commodity price bubbles, and building-up of undue bad assets of banks. BB will remain fully engaged and vigilant in monitoring and taking timely actions, where necessary.

Monetary Policy Statement: Fiscal Year 2020-21

1. Foreword

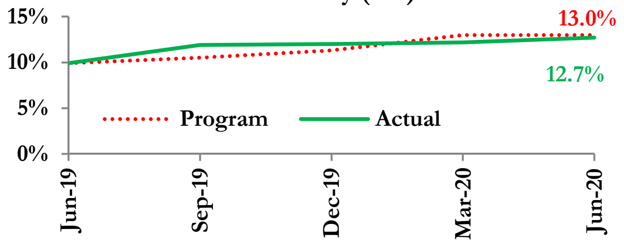
This Monetary Policy Statement (MPS) outlines Bangladesh Bank's (BB's) monetary policy stance and strategies along with monetary and credit program for FY21 (July 2020 - June 2021), considering the evolving internal and external macroeconomic and financial developments since the last MPS announced in July 2019 subject to any such mid-course modifications as found necessary. As we were unable to have any physical stakeholders' consultation meetings due to an unprecedented coronavirus pandemic situation, electronic feedbacks were requested from the senior level former and current policymakers, analysts from think-tanks, academia, and real and financial sector representatives. A good numbers of useful feedbacks via email highlighting current economic conditions and suggesting possible policy options were received which we have kept in mind while composing this MPS. We would like to thank those who have spared their valuable time in providing very pertinent comments and suggestions that help enrich the contents of this MPS.

2. Monetary Policy Outcomes in FY20

The monetary policy stance and monetary program of Bangladesh Bank for FY20 was drawn-up with the dual objectives of maintaining price stability and supporting inclusive, equitable, and environmentally sustainable economic growth. Until February of FY20, the domestic economy of Bangladesh upheld its precise path of moderating inflation and accelerating real GDP growth supported by broad-based economic activities. The emergence of novel Coronavirus (nCoV) pandemic in the late December 2019 confounds the world to an incomprehensible halt. With the confirmation of COVID-19 outbreak locally in March 2020 creates some serious impediment to the achievement of the key monetary policy objectives - keeping annual CPI average inflation within 5.50 percent and attaining real GDP growth at 8.2 percent. As result, annual average CPI-based general inflation stood at 5.65 percent in FY20, slightly up from the target as well as actual inflation of 5.47 percent in FY19. The annual average non-food inflation, particularly concerning to medical care and health expenses, and disruption of supply chains due to coronavirus pandemic were largely responsible for this higher inflation. The real GDP growth also tumbled which was primarily estimated at 5.2 percent for FY20, significantly lower than the target as well as actual growth (8.15 percent) recorded in FY19. Despite healthy growth in various subsectors of agriculture including crops, and reasonably high growth (10.9 percent) in inward remittances, the real GDP growth declined in FY20 due mainly to a sharp drop of exports owing to long and sustained worldwide lockdowns caused by the COVID-19 pandemic. The Government's 2 percent incentive program and BB's initiatives of easing money transfer process along with the policy of gradual depreciation of Taka against the USD played vital roles in augmenting remittance inflows in the country.

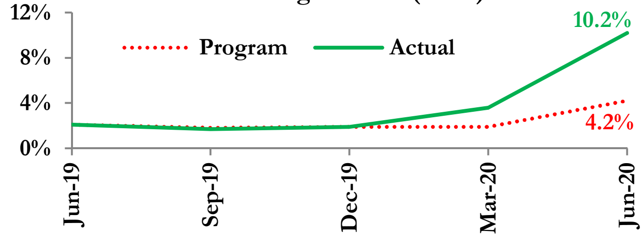
The monetary policy stance and program executed in FY20 was largely successful in narrowing the current account deficit from USD5102 million or 1.7 percent of GDP in FY19 to primarily estimated at USD4849 million or 1.5 percent of GDP in FY20. Faster-dwindling trend in imports relative to exports due mainly to shrinking internal as well as external demand excelling up the overall net foreign asset (NFA) growth of the banking system. BB's policy supports of reducing CRR and repo rate alongside providing enhanced repo and refinance facilities to banks with timely intervention in the foreign exchange market helped to maintain normalcy in both the Taka and USD interbank markets.

Chart 1: Broad Money (M2) Growth



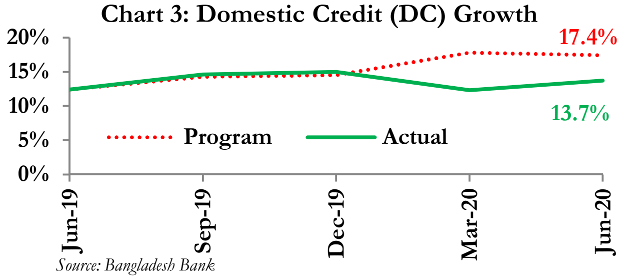
Source: Bangladesh Bank

Chart 2: Net Foreign Assets (NFA) Growth



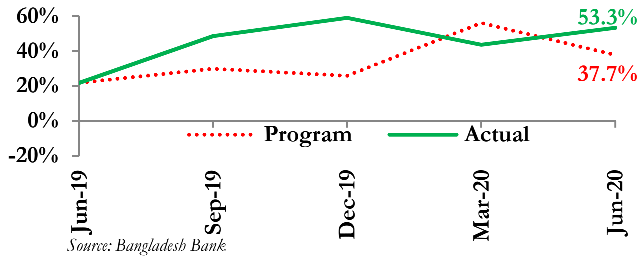
Source: Bangladesh Bank

Chart 3: Domestic Credit (DC) Growth



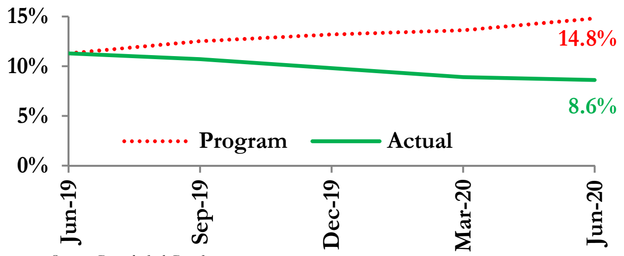
Source: Bangladesh Bank

Chart 4: Public Sector Credit Growth



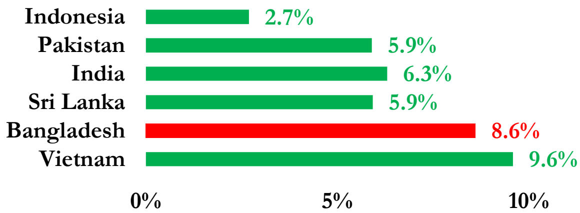
Source: Bangladesh Bank

Chart 5: Private Sector Credit Growth



Source: Bangladesh Bank

Chart 6: Cross-country Comparison of Private Sector Credit Growth



Source: Respective Central Banks' Websites, Latest Available Data

A comparison of FY20's program versus actual developments plotted in Charts 1-5 indicates that actual growth paths of major monetary aggregates were somewhat consistent with their program paths in FY20. The broad money (M2) growth (12.7 percent) remained very close to the target ceiling of 13.0 percent while the domestic credit growth fully moved together with the programmed path during the first half of FY20, though slightly plunged in the third and fourth quarters due mainly to a slower than programmed growth of private sector credit. The growth of credit to the public sector including net credit to Government, however, witnessed some degrees of volatilities staying above their programmed path until February 2020 before dropping below the programmed path in March 2020 which has finally surpassed the programmed path in June 2020. On the other hand, the growth in private sector credit experienced a moderating trend throughout whole year (FY20) initially due to the banks' adherence towards quality lending which was further aggravated by the outbreak of coronavirus. Nonetheless, Bangladesh's private sector credit growth is still higher than many other fast-growing South Asian and East Asian emerging markets and developing economies including India, Sri Lanka and Indonesia (Chart 6).

3. Overview of Global and Local Contexts of Monetary Policy Stance for FY21

3.1. Global Growth, Inflation, Interest Rate and Trade Environment

The recent fallout in global output growth due to coronavirus pandemic is being recognized as the worst and unprecedented since the Great Depression of the 1930s by many global giant institutions including the IMF. Table 1 shows the IMF's latest (June 2020) near-term projections for global economic growth as a whole and by major advanced and emerging markets and developing economies groups. The last two columns of the Table demonstrate the percentage points they have had downgraded or upgraded from their previous projections made in January 2020. Coronavirus pandemic is not only tragically costing a large number of human lives but also inflicting huge output losses in almost all the regions and countries of the world. Given the uncertainties created by COVID-19, global growth has been projected to be shrunk by 4.9 percent in 2020 which is anticipated to be recovered by a growth of 5.4 percent in 2021. It is noteworthy that the growth performance of emerging markets and developing economies anticipated to be shattered by 3.0 percent in 2020 which is anticipated to be recovered by registering a growth of 5.9 percent in 2021.

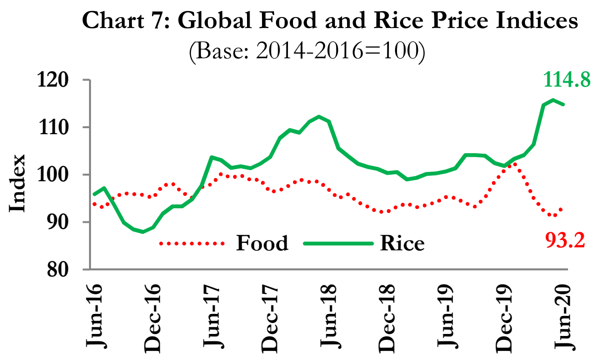
Table 1: Overview of Global Economic Growth as per June 2020 WEO Update

Region	Growth				Difference from January 2020 WEO projection	
	Actual		Projection			
	2018	2019	2020	2021	2020	2021
World	**3.6**	**2.9**	**-4.9**	**5.4**	**-8.2**	**2.0**
Advanced Economies	2.2	1.7	-8.0	4.8	-9.6	3.2
USA	2.9	2.3	-8.0	4.5	-10.0	2.8
Euro Area	1.9	1.3	–10.2	6.0	-11.5	4.6
Other Advanced Economies	2.7	1.7	–4.8	4.2	-6.7	1.8
Emerging Market and Developing Economies	4.5	3.7	–3.0	5.9	-7.4	1.3
China	6.7	6.1	1.0	8.2	-5.0	2.4
India	6.1	4.2	–4.5	6.0	-10.3	-0.5

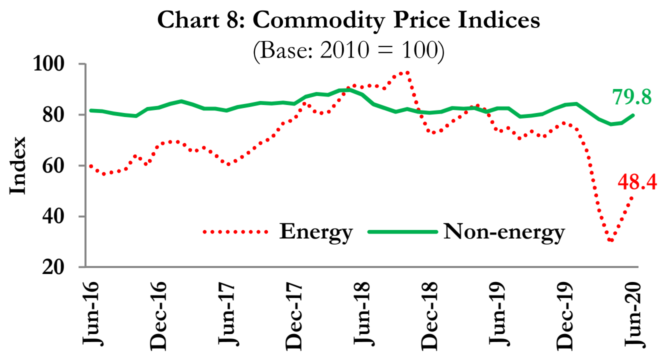
Source: International Monetary Fund

Non-food commodity such as oil price sharply dropped to a historical low during the first half of 2020 is now showing a rising trend. Despite a significant drop in global real GDP growth, headline inflation has been seen to increase in many countries due to the disruption of production and supply chains. As a result, there has been significant uncertainty regarding global inflation. The latest food and rice price indices published by the FAO show that the rice price index has sharply increased after December 2019 with a slight moderation in recent months. In contrast, the overall food price index abruptly fell to a recent low level which is now being showing a sign of amplification (Chart 7). According to the World Bank's latest update on global commodity price, both energy and non-energy commodity price indices maintained a downward trend from December 2019 with the sign of some upticks since March 2020

(Chart 8). The domestic price pressure in Bangladesh arising from the global price volatilities is expected to remain passive due to recent bumper boro (the main paddy crop) harvest along with an internal administered domestic fuel price policy in Bangladesh.

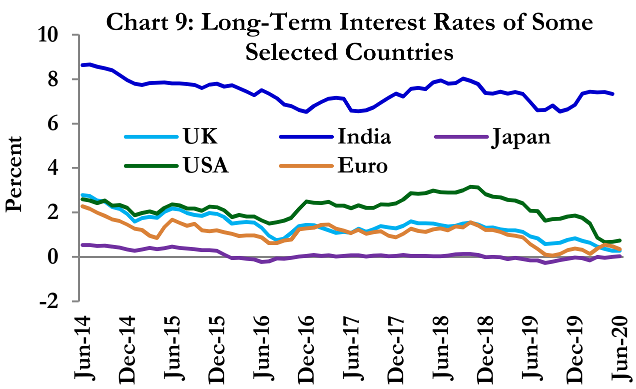


Source: Food and Agriculture Organization (FAO)

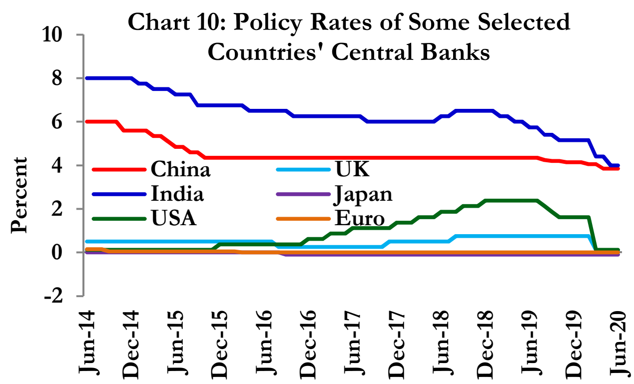


Source: World Bank

The interest rate in most of the world economies deepens down further due to ongoing coronavirus pandemic which was already in the lower bound regime for some of the advanced economies. Long-term interest rates in the USA, UK, and Eurozone remained at a very low level while it is essentially remaining at zero or even below zero level in Japan for a long time (Chart 9). However, the interest rate in India, a representative of emerging market economies, remains at a relatively higher level reflecting a very common feature of many other emerging markets and developing economies including Bangladesh. The policy interest rates are also higher in emerging market economies like India and China compared to those of advanced economies. It is noteworthy to mention that the policy interest rates in both the groups of countries have dropped significantly in recent months. The policy interest rate for India and China is hovering around 4 percent while it remains in the vicinity of zero percent for advanced economies like the USA, Japan, the UK and the Euro area (Chart 10).



Source: Organization for Economic Co-operation and Development



Source: Bank for International Settlements

Various global issues such as trade wars, Brexit, tensions in the Middle Eastern region were already daunting features in the global economy which have further aggravated by newly created coronavirus pandemic. Despite limited external exposure of the financial sector of Bangladesh economy, the current gloomy and highly uncertain global outlook may affect adversely of its exports and inward remittances in the coming months. Effective and coordinated measures are needed to uphold the present markets and to find new destinations for Bangladeshi exports as well as expats in restoring expected growth in exports and remittances in near future. With apparently no internal political tensions, implementations of recently announced hefty stimulus packages, significantly improved power and energy situation, completion of some of the mega projects, and a good number of newly created Special Economic Zones (SEZs) for the local and overseas investors would be crucial in keeping the country's overall economic situation afloat.

3.2. Domestic Growth and Inflation Outlook

Bangladesh's progression path of the government's pursuit of an ascending trajectory of sustained inclusive, equitable and environmentally benign economic growth and social development proceeded broadly on track during H1FY20 (July-December, 2019). In this period, the pace of economic activities continued its normal trend due to robust domestic demand aided by strong remittance inflows and higher government investment, while decelerated private credit growth and weak external demand suggested some moderation.

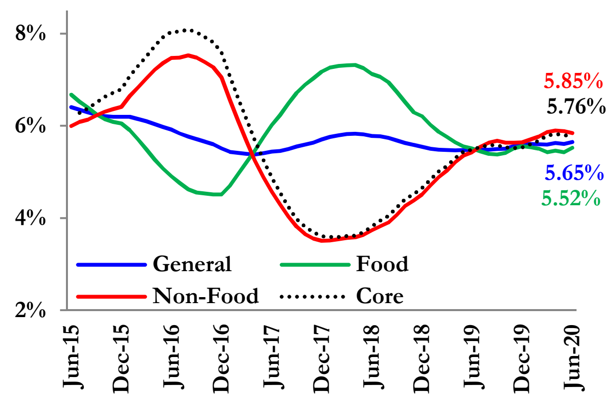
Towards the end of calendar year 2019, the dark shadows of the hitherto wholly unknown new COVID-19 pandemic began to engulf the entire global community very rapidly, causing the health and economic disruptions on an unprecedented scale. Bangladesh too came under the cloud of the new scourge with the identification of first COVID-19 patients in the country in early March 2020. Like everywhere else, Bangladesh authorities too have had to adopt abrupt drastic steps like community wide extensive spells of mandatory quarantines and lockdowns during 26 March - 30 May, 2020 to limit and contain the threat of COVID infection; bringing in its trail disruptions in domestic economic activities in substantial extents.

To overcome these adverse effects, the Bangladesh authorities had no option other than to line up massive support measures to help out affected businesses and weaker population segments facing loss of work opportunities for their livelihood. So far more than one trillion Taka of stimulus packages have been announced by Government to fight against coronavirus pandemic and to bring the economy back in track. BB is also aggressively supporting with its various policy relaxations and low cost refinances lines of credit. Although the pandemic's pace of expansion in Bangladesh has thus far remained relatively moderate and the economy has already been reopened in a limited scale since 31 May 2020, the shadow of pandemic related uncertainties is still there.

Because of the coronavirus pandemic related devastation, the Government's estimated real GDP growth for FY20 plunged to 5.20 percent from its target of 8.20 percent. The Government has set the target of real GDP growth at 8.20 percent for FY21 considering that the ongoing corona pandemic situation will improve soon and the economy will rebound strongly following a V-shaped path. Based on the pandemic related uncertainties and revised growth of FY20, BB's Research Team projects a possible scenario, instead of calculating a point estimation, of the real GDP growth for FY21. Anticipating that the ongoing pandemic situation will improve soon and the possible economic recovery at home and abroad will follow immediately aided by the successful and timely implementation of the stimulus packages taken by the Government and BB, the projected output growth scenario is found to be consistent with the Government target.

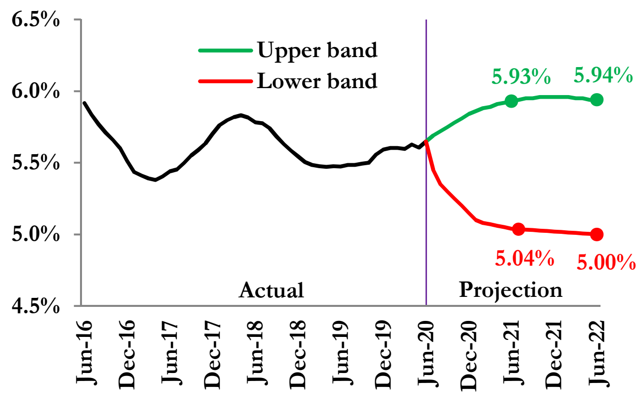
Chart 11 plots the trend of Bangladesh's general CPI (12-month average) inflation along with its components food, non-food, and core (non-food and non-energy) inflation since June 2015. Cautiously accommodative monetary and fiscal stances with inclusivity bias have helped stabilize headline (y-o-y annual average) general CPI inflation at around 5.65% marginally higher than the targeted 5.50% for FY20. The core and non-food components of general CPI inflation are seen to be moving in tandem in FY20, though the non-food inflation was slightly higher than food inflation mainly due to medical care and health expenses.

Chart 11 : Twelve Month Average CPI Inflation



Source: Bangladesh Bureau of Statistics

Chart 12: Twelve Month Average General CPI Inflation



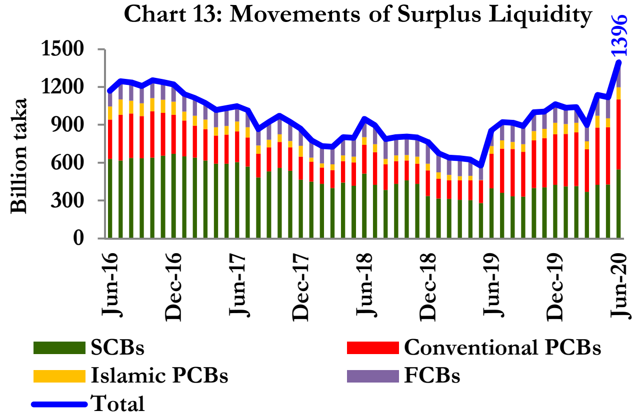
Source: Bangladesh Bureau of Statistics and Bangladesh Bank

Generally, we would not expect significant inflationary pressure under the current subdued economic situation inflicted by the COVID-19 pandemic. With a significant drop in international commodity and energy prices along with domestic bumper production of crop and non-crop agriculture will keep food inflation thereby general inflation well in check in the coming months. Based on these expectations, BB's Research Team projects the ranges of average general CPI inflation for FY21 and FY22 using four econometric techniques, namely, univariate ARIMA, univariate ARIMA with monthly dummies, VAR and model-based dynamic inflation forecast and finds a range of 5.04-5.93 percent inflation for FY21 and a range of 5.00-5.94 percent inflation for FY22 (Chart 12). BB's projections suggest a moderate and tolerable single digit average general CPI inflation both in FY21 and FY22, very much consistent with the target set in the medium-term macroeconomic framework of the Government. However, the huge liquidity injection attributable to the various stimulus packages along with BB's policy relaxation including the possibility of crop loss due to natural calamities like floods, cyclones, etc., might create undue price bubbles anytime in the future requiring continuous monitoring of domestic price developments so that the possible inflationary pressure could be contained on time.

3.3. Liquidity Situation, Interest Rates and Related Issues in Money and Credit Markets

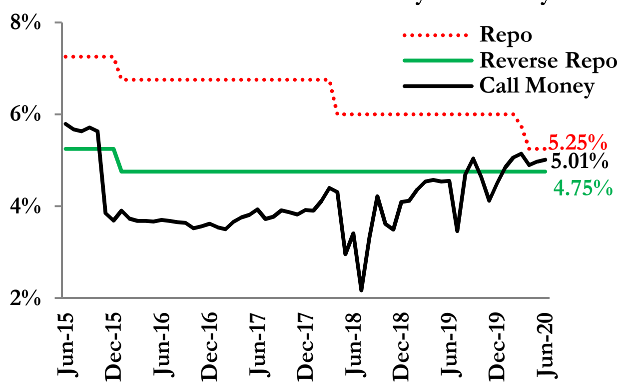
Lower than expected tax revenue generation and slow sales in the National Savings Certificate (NSC) forced the Government to switch its borrowing source from non-bank to banks to meet up its ADP related expenditure in FY20. In the backdrop of COVID-19 outbreak, BB's liquidity enhancing policy measures including reduction of CRR by 150 basis points for banks (domestic units), by 350 basis points for offshore banking units (OBU) and by 100 basis points for FIs, purchase of government securities from banks and FIs, the introduction of long-term repo facilities up to 360-day, along with the adoption of several refinance schemes helped to inject sufficient liquidity in the money market. Charts 13 and 14 depict trends of surplus liquidity (liquid assets after the maintenance of CRR and SLR) of banks and the movements of call money rate (weighted average overnight interest rates in interbank money market) along with BB's policy rates. Overall surplus liquidity of banks substantially increased in FY20 mostly supported by BB's various policy measures, though a lion share of this surplus liquidity holding by the banks remained in the form of government securities. During FY20, monthly average surplus liquidity stood at Tk. 1034.9 billion, of which monthly average surplus reserves (reserves with BB after the maintenance of CRR) was Tk. 100.4 billion.

Chart 13: Movements of Surplus Liquidity



Source: Bangladesh Bank

Chart 14: Movements of Call Money and Policy Rates

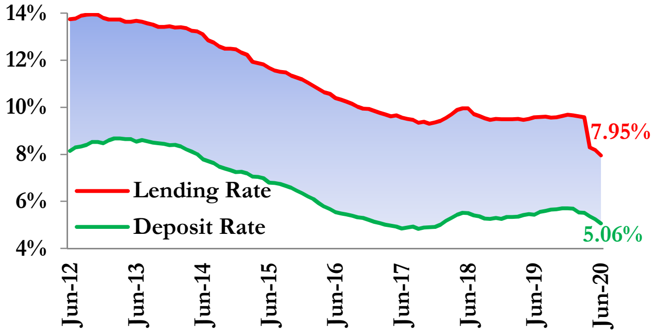


Source: Bangladesh Bank

Alongside BB's ongoing expansionary policy measures its recent drive of buying foreign currency from the market helped restoring normalcy in both the money and foreign exchange markets, stabilizing the call money rate within the corridor of the repo and reverse repo rates and keeping the Taka-USD exchange rate competitive. Moreover, with the gradual improvement of the existing pandemic situation and restoration of full normalcy in economic activities in the coming days, BB will continuously monitor the progress in money as well as foreign exchange markets and take appropriate policy measures as required.

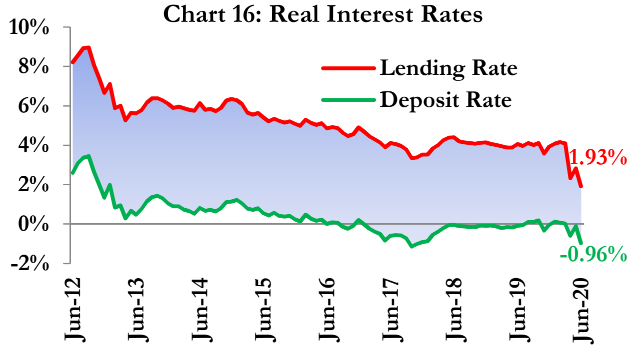
BB's efforts towards rationalization of market lending rate and enhancement of banks' intermediation efficiency through reduction of the spread between the deposit and lending rates continued in FY20. Charts 15 and 16 plot trends of weighted average lending and deposit interest rates of all scheduled banks in both nominal and real terms.

Chart 15: Nominal Interest Rates



Source: Bangladesh Bank

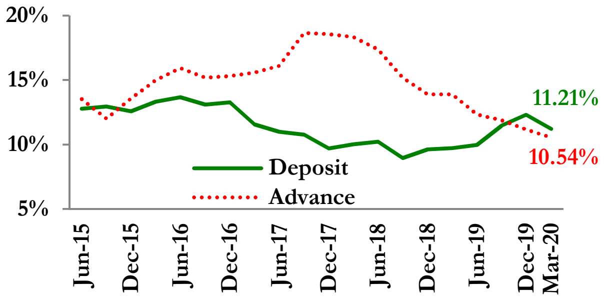
Chart 16: Real Interest Rates



Source: Bangladesh Bank

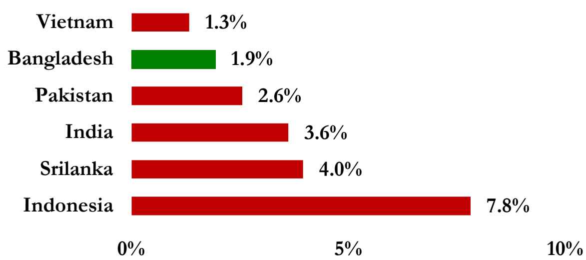
Both lending and deposit interest rates are seen to be following declining trends particularly towards the end of FY20. The gap between lending and deposit interest rates (interest rate spread) that viewed as a measure of intermediation efficiency of banks has also been markedly narrowed down since April 2020 due mainly to BB's policy direction for rationalization of interest rates/profits on banks' lending and investment, with effective from 01 April 2020. Along with the reduction in the intermediation spread, both the deposits and advances maintained their growing trends in FY20 supported by the Government's execution of discipline on the issuance of NSCs. Chart 17 and 18 plot the trends of deposit and advance growth and cross-country comparison of Bangladesh's real lending interest rate with some South and East Asian peer economies. The cross-country evidence suggests that the weighted average real lending rate remained lower in Bangladesh than in some of our regional neighbors including India (Chart 18).

Chart 17: Trends of Deposit and Advance Growth



Source: Bangladesh Bank

Chart 18: Cross-Country Real Lending Rate



Source: Respective Central Banks' Websites, Latest Available Data

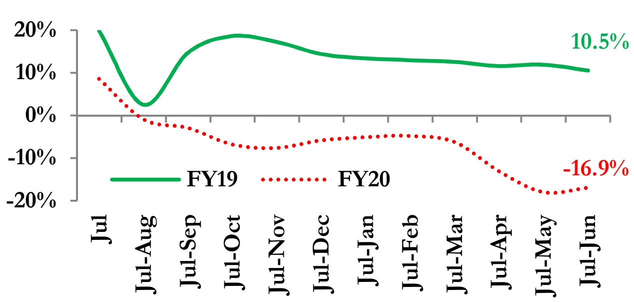
Feedbacks from selected economists, policymakers, and stakeholders have raised some concerns over the issues developed recently in the financial sector of Bangladesh. They argued that BB's policy direction for rationalizing interest rates/profits by executing 9 percent lending rate cap might seriously hamper the growth of small and medium-sized enterprises whose monitoring and management costs are relatively higher in nature. The recent reduction of intermediation spread, a marked efficiency gain of banks, will be difficult to sustain if the non-performing loan (NPL) burdens, most often cited as a basic reason behind the downward stickiness of lending interest rates, could not be contained. BB's recent policy measures of allowing banks' rescheduling of default loans by 2 percent down payments and an exemption of borrowers from rescheduling their bad loans helped significantly to improve the latest

NPL situation of banks which might deteriorate in the longer-term if the practices of transparency, accountability, and good governance are not ensured effectively.

3.4. Overview on External Sector Developments and Outlooks

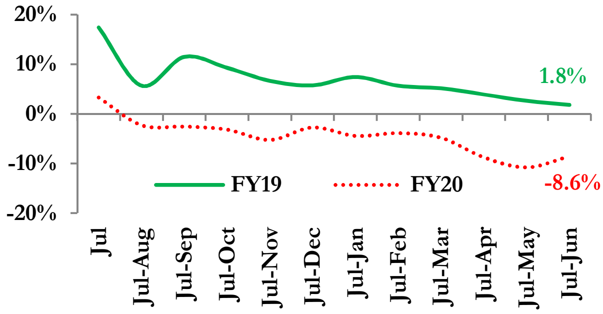
The balance of payment witnessed a surplus of USD 3655 million in FY20, contributed by a decline in current account deficit on the back of robust remittance inflows along with higher inflows of FDI coupled with somewhat healthy inflows of medium and long-term loans (Table 2). However, the deficit in trade balance widened to USD 17861 million during this period, amid a decline in exports and imports by 16.9 percent and 8.6 percent respectively owing mainly to sluggish domestic and international demand during H1FY20 which further aggravated by the worldwide outbreak of COVID-19 pandemic (Charts 19 and 20). The exchange rate remained broadly stable and competitive in FY20 aided by the timely interventions of Bangladesh Bank.

Chart 19: Cumulative Exports Growth



Source: Bangladesh Bank

Chart 20: Cumulative Imports Growth



Source: Bangladesh Bank

Looking ahead, the deficit in the current account is anticipated to slightly deteriorate with moderate receipts in financial accounts as compare to the previous year but will be sufficient enough to make a sensible BoP surplus in FY21(Table 2).

Table 2: Balance of Payments Highlights

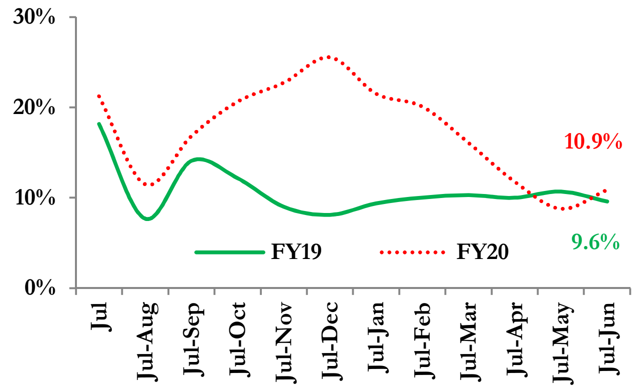
(In million USD)

Major Items	Actual			Outlook
	FY18	FY19	FY20P	FY21
Trade balance	-18178	-15835	-17861	-18392
Services	-4201	-3177	-2987	-2866
Primary income	-2641	-2993	-2776	-2957
Secondary income	15453	16903	18775	19338
of which: Workers' remittances	14982	16420	18205	18751
Current account balance	**-9567**	**-5102**	**-4849**	**-4876**
Capital accounts	331	239	256	250
Financial accounts	9145	5907	7952	6635
Errors and omissions	-766	-865	296	-759
Overall balance	**-857**	**179**	**3655**	**1250**
Memorandum item:				
Gross international reserves (GIR)	32944	32717	36037	37000
Months of imports of goods and services	6.0	6.5	6.4	6.4

Source: Bangladesh Bank. P = Provisional

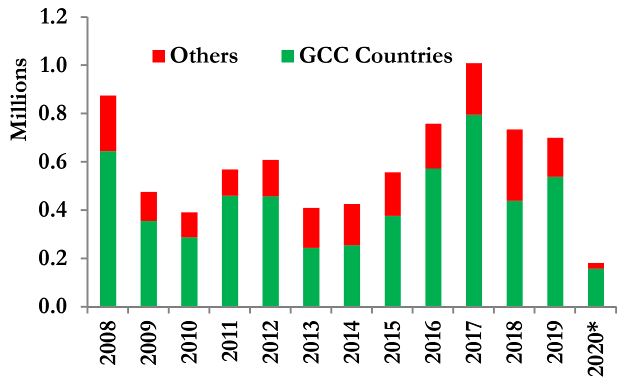
Chart 21 shows the cumulative growth path of wage earners' remittances inflows in FY19 and FY20. Despite the economic slowdown in most of the remittance source countries, Government's 2 percent cash incentive was instrumental to achieve a 10.9 percent growth of inward remittances in FY20 reasonably higher than the 9.6 percent growth recorded in FY19. However, somewhat worrisomely, available information indicates that overseas employment of the Bangladeshi workers and professionals has dropped sharply in 2020 (Chart 22) and many overseas workers have already reportedly become jobless due to worldwide breakout of COVID-19 and as such the growth of inward remittances might not be sustainable unless the ongoing pandemic situations in the host countries improve fast.

Chart 21: Cumulative Remittance Growth



Source: Bangladesh Bank

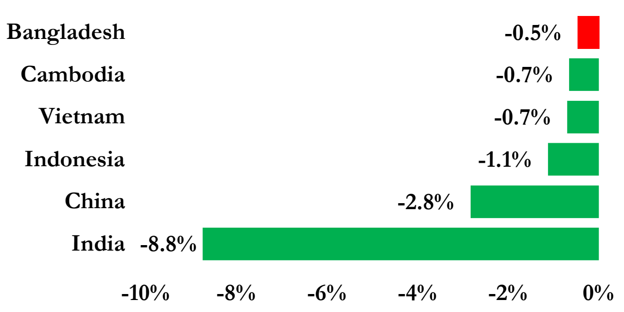
Chart 22: Overseas Employment



Source: Bureau of Manpower, Employment and Training * Up to May 2020

During the first half of FY20, the exchange rate of Taka against intervention currency USD faced a little depreciating pressure, which disappeared gradually during the second half due mainly to shrinking growth of imports and a significant amount of receipt in the financial accounts along with a good inflow of workers' remittances. However, the exchange rate of Taka against the USD depreciated by 0.5 percent in FY20 which is markedly smaller than India and China but pretty much in line with other Asian competitors like Vietnam and Cambodia (Chart 23). The movement of NEER index indicates that the exchange rate of Taka remained slightly undervalued while the REER index signals that it is largely overvalued as of end June 2020 due mainly to big price differentials with the major trading partner countries of the foreign currencies' basket (Chart 24).

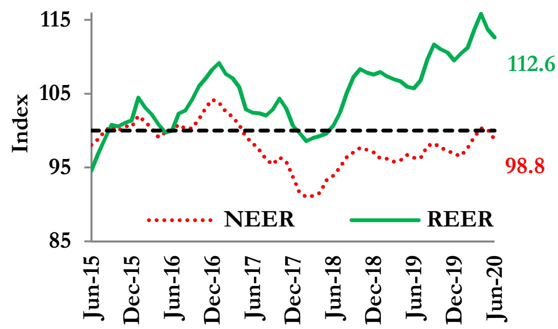
Chart 23: App(+)/Dep(-) of Domestic Currency against USD in FY20



Sources: Respective Central Banks' Websites

Chart 24: Effective Exchange Rate Indices

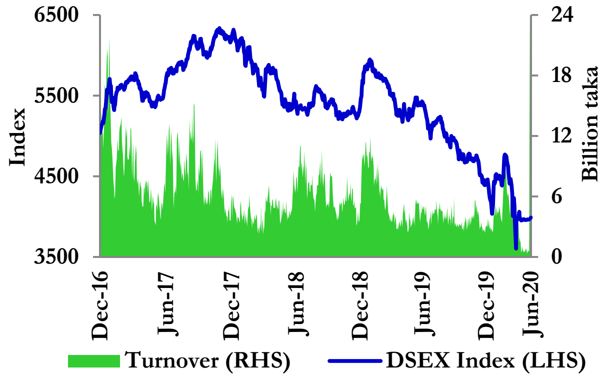
(Base: 2015-16=100)



Source: Bangladesh Bank

3.5. Capital Market Development and Prospect

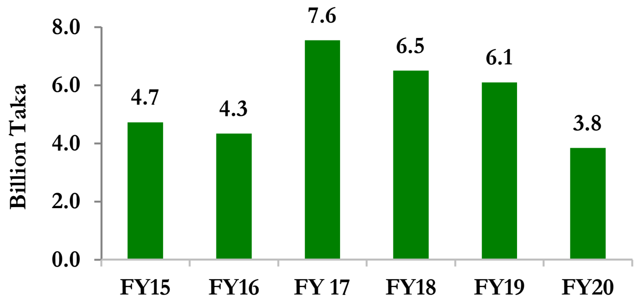
Chart 25: DSEX Index and Turnover



Source: Dhaka Stock Exchange

Despite the favorable policy support by BB and related regulatory bodies, falling prices and trade volume with much volatility continued in the capital market during H2FY20 due to investors disquiet stemmed mainly from the COVID-19 pandemic compared to the H1FY20. Consequently, the DSE broad index dropped by 26.4 percent in FY20 from the level of FY19 (Chart 25). The Daily average turnover reduced significantly to Tk. 3.8 billion in FY20 from Tk. 6.1 billion in FY19 (Chart 26). Likewise, the market capitalization of the listed equities in the two exchanges in Bangladesh also remained relatively low.

Chart 26: DSE Daily Average Turnover

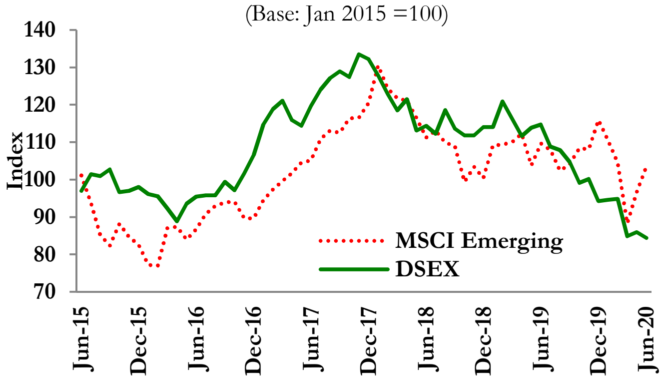


Source: Dhaka Stock Exchange

BB is always proactive in working with the capital market regulators and other stakeholders to offer supportive policy initiatives. To improve the liquidity condition in the capital market, Bangladesh Bank took several initiatives including: (i) The relaxation of capital marker investment exposure limit for banks (invest in the capital market from excess liquidity up to 25 percent of banks capital on a SOLO basis and 50 percent on a consolidated basis), (ii) The creation of a special investment fund of Tk. 2.0 billion by each bank to be invested in the stock market in addition to banks' stock market exposure limit, (iii) The initiation of a new dividend disbursement policy allowing the banks to distribute dividend up to 30 percent including 15 percent in cash subject to maintaining minimum 12.5 percent capital conservation, and (iv) The introduction of the long-term repo and other liquidity enhancing policy measures helping the banks' to ease up their maneuverability of funds. Besides, the Government has taken a series of initiatives to increase the flow of funds and institutional participation in the capital market including the investment of undisclosed money in the capital market.

Chart 27: Synchronization of DSE with Global Markets

(Base: Jan 2015 =100)



Sources: Dhaka Stock Exchange and www.msci.com

Bringing quality IPOs, ensuring good governance, upgrading information technology, and disseminating/disclosing standard industry information is the vital policy priority for capital market development in the medium to longer term. To enhance the market capitalization, listing of good fundamental companies, especially profitable state-owned and multinational companies, is required. The BSEC, Merchant banks, and Stock Exchanges may take coordinated initiatives in this regard. The synchronized movements between the global equity market and DSE were observed for the last several years due to increasing trade and financial integration and increasing global portfolio participation in DSE (Chart 27). In response to the COVID-19 pandemic outbreak, central banks across the countries adopt unprecedented easy monetary and prudential financial policies, and the global market started to recover during H2FY20. With these positive policy supports and gradual normalcy in the economic activities, it is expected that the two stock exchanges in Bangladesh are likely to rebound in the coming months.

4. Monetary Policy Stance, Monetary Program and Policy Initiatives for FY21

4.1. Monetary Policy Stance

The prime objectives of the monetary policy stance and monetary programs for FY21 are the recovery of the economy from the adversity of the COVID-19 pandemic and rehabilitation of the production capacity of the economy including the restoration of the normal livelihoods of the people along with maintaining dual goals of price stability and quality growth. The key considerations of this MPS would, therefore, be to adopt a strategy so that the adequate financing support will be available to all the priority sectors like agriculture, CMSMEs, manufacturing industries and so on with the options of necessary adjustment to match the demand of the specific sectors where essential. Based on these considerations, *BB's monetary policy stance and monetary programs for FY21 are essentially expansionary and accommodative for all growth support needs without impairing attainment of the targeted inflation containment.*

The FY21 monetary program is set based on the government targets of 8.2 percent real GDP growth and 5.4 percent average general CPI inflation ceiling declared in the national budget for FY21. BB's annual monetary programs are outlined making sure that there are enough rooms for money and credit growth to sufficiently support the targeted nominal GDP growth. Assuming a stable money demand function, the operational target of BB's monetary policy, the broad money (M2) growth is set based on the equation of exchange that accounts for the necessary adjustment in the change of the money velocity, and the target nominal GDP growth comprising the summation of target real GDP growth and inflation ceiling.

The money velocity in Bangladesh markedly fell in FY20 due to the slowdown of economic activities. BB's projection suggests that the money velocity may fall further in FY21 due to the lingering COVID-19 impact. Since the change in money velocity is negative, the M2 growth target would be larger than the nominal GDP growth target for FY21. To maintain M2 growth target, BB sets its operational target, the reserve money (RM) growth target. BB uses its monetary policy instruments like repo and reverse repo interest rates, cash reserve ratio (CRR), statutory liquidity ratio (SLR) along with its available open market operation tools to control RM growth impacting broad money growth and, thereby, influencing ultimate policy objectives in the desired direction.

4.2. Monetary Program for FY21

BB's money and credit program containing the half-yearly movements of key monetary aggregates for FY21 are illustrated in Table 3. Programmed broad money (M2) growth target has been set at 15.6 percent consistent with the targeted real GDP growth and CPI inflation ceiling, accommodating 19.3 percent domestic credit (DC) growth for FY21. In the backdrop of increased spending promises by the government, backed by the expansionary policy stance of BB in combating the COVID-19 fallout, the public, and the private sector credits are projected to annually grow by 44.4 percent and 14.8 percent respectively by end June 2021. The expected increased public sector credit growth is partly attributable to the fact of shallow non-bank borrowing options mainly due to slow sales of NSCs in the recent past, which is very likely to continue in the coming months. BB's expansionary and accommodative monetary policy stance along with the implementation of the various stimulus packages on top of base effect are likely to augment the private sector credit growth to its program level. Consistent with the forecasted BoP outcomes, the Net foreign asset (NFA) is projected to grow by 5.8 percent in FY21.

Table 3: Key items of Monetary Program

(y-o-y growth in %)

Item	Actual			Program	
	Jun-19	Dec-19	Jun-20^P	Dec-20	Jun-21
Net Foreign Assets*	2.1	1.9	10.2	12.5	5.8
Net Domestic Assets	12.3	15.1	13.4	14.4	18.3
Domestic Credit	12.4	15.0	13.7	15.0	19.3
Credit to the public sector	21.7	58.9	53.3	35.7	44.4
Credit to the private sector	11.3	9.8	8.6	11.5	14.8
Broad money	**9.9**	**12.0**	**12.7**	**14.0**	**15.6**
Reserve money	**5.3**	**6.9**	**15.7**	**15.5**	**13.5**
Money multiplier	4.97	5.17	4.84	5.11	4.93

Source: Bangladesh Bank. * At constant exchange rates of end June 2020. P = Provisional

4.3. Policy Initiatives

Despite countrywide unprecedented lockdown during 26 March - 30 May, 2020 owing to the COVID-19 outbreak, the uninterrupted banking, and mobile financial services for all in the country have been effectively ensured by BB. Bangladesh Bank took some timely and proactive policy initiatives during H2FY20 to minimize any possible liquidity stress in the local currency market emanated from nationwide lockdown in late March 2020. BB has used its available monetary policy instruments, like, cash reserve ratio (CRR), repo facility (interest rate and tenor), refinancing facility and other monetary condition easing initiatives to inject necessary liquidity in the market.

The policy initiatives that BB has already taken include : (i) the reduction of CRR from 5.5 percent to 4.0 percent for domestic banking operations, from 5.5 percent to 2.0 percent for offshore banking operations, and from 2.5 percent to 1.5 percent for financial institutions (FIs); (ii) the reduction of repo interest rate from 6.00 percent to 5.25 percent and the introduction of 360-day repo facility; (iii) the extension of ADR for conventional banks and IDR for Islami Shariah-based banks by 2 percentage points to 87 percent and 92 percent respectively, (iv) the provision of purchasing of excess government securities holdings by banks, and (v) the allocation of the total amount of Tk. 55,250 crore for different refinancing schemes (including the expansion of EDF by USD 1.5 billion or Tk. 12,750 crore) including the recent formation of a credit guarantee scheme to support cottage, micro and small enterprises that lack adequate assets to pledge for bank loans are noteworthy. All these policy measures are taken to help generate employment opportunities in agriculture, industry and services sectors so that the COVID-19 pandemic related economic losses could be recovered fast.

In the context of the foreign exchange market, BB remained always watchful to keep the Taka-Dollar exchange rate competitive, intervened by selling USD 835 million, while buying USD 877 million in different occasions during the last fiscal year. Currently, both the local currency and foreign exchange interbank markets are in comfortable conditions in terms of liquidity. The average outstanding repo amount in July 2020 (Tk. 2616.59 crore, up to 26 July) was very low compared to that of April-June, 2020 (Tk. 7015.18 crore). To prevent any appreciating pressure on the local currency, BB is currently purchasing foreign exchange from the market, indicating healthy liquidity conditions in the foreign exchange market while injecting additional liquidity in the local currency market.

As a part of BB's expansionary monetary policy stance and supporting the preparedness for additional demand for funds, this MPS is proposing a further cut in the overnight repo rate from 5.25 percent to 4.75 percent and a reduction of reverse repo rate from 4.75 percent to 4.00 percent, ensuring the availability of less costly funds for banks and rationalizing the policy rates' corridor (the gap between the repo and reverse repo rates). Moreover, the Bank Rate which remained unchanged for the last 17 years (since 2003) has also been considered to be reduced from 5.00 percent to 4.00 percent to rationalize it with the current interest rate regime. All these rates change will be in effect soon.

As mentioned in the last MPS that BB is going to adopt a policy interest rate based monetary policy regime in which changes in policy rates exert a direct impact on prices in the financial and real sectors, rather than indirectly through a monetary aggregate (broad money) as in the policy regime now in use. Given the ongoing COVID-19 crisis, the transition to the interest rate target based policy framework has been deferred for future consideration.

5. Quality Dimension of BB's Growth Support Objective

Countering the COVID-19 impact, BB instantly extended a significant number of refinancing lines of credit and subsidy measures supporting lending for productive segments and underserved economic sectors, solely with BB funds or in participation with development partners impacting own balance sheet and addressing the BB's policy rates. The overall liquidity of the financial sector is maintained bearing in mind that the private and the government sector investment requirements deploying central bank's monetary policy tools balancing the policy rates, growth potential, and inflation. Beside the prime objective of quick recovery of business and economic activities, BB also focuses on quality and inclusive growth, job creation, and environmental sustainability of the economy while maintaining moderate inflation with stability.

BB remains continuously engaged to improve countrywide IT network infrastructure for connectivity between bank accounts, mobile phone accounts, and merchant POS machines, while some mentionable progress has already achieved facing the reality. Country's significant and untapped informal economy is bringing under the umbrella of digital financial services contributing to marginal and rural employment and encouraging economic activity ensuring deposit mobilization necessitates for money multiplier momentum recovering from the COVID-19 pandemic related slowdown.

6. Potential Risk Factors and Policy Priorities

In addition to thousands of lives losses and health hazards, the economic losses of Bangladesh due to the COVID-19 outbreak are undoubtedly very intensive and widespread. To bring normalcy in the livelihood of the mass people, the countrywide lockdown, and movement restrictions have been gradually lifted since 31 May 2020 along with implementing the largest social welfare efforts in the history of Bangladesh. Although there are signs of gradual improvements in people's movement and economic activities, the uncertain length and depth of the COVID-19 pandemic in the coming days is considered to be the number one risk factor in attaining monetary program objectives of FY21. Secondly, further aggravation in the global recessionary economic condition due to lingering of coronavirus pandemic along with the volatilities in oil price and ongoing geopolitical tensions in the Middle-East might have a serious negative impact on future export earnings and wage earners' remittance inflows to Bangladesh. Thirdly, BB's expansionary and accommodative monetary policy stance along with the implementation of the various stimulus packages in the economy may intensify the unexpected inflationary pressure through creating price bubbles in near future. Fourthly, although the present NPL situation of the banking industry of Bangladesh has markedly improved largely backed by the recent rescheduling facility, may soon be disappeared due to worsening business condition on top of the capitalization of interest along with principal obligations payable in future. Finally, the natural calamities like floods, cyclones always remain as a potential risk factor for nature dependent agricultural sector of Bangladesh. Some parts of the country are already hardly hit by the seasonal floods causing huge disruptions in the livelihood of the people in the affected areas.

The present policy priory is to bring the economy back to its normal path by applying required and appropriate policy actions under the purview of BB. Notwithstanding the above risk factors, the recovery of the economy calls for a target-oriented sector-specific plan along with the availability of sufficient liquidity in the system, and the effective implementation of the plan. BB remains fully engaged in selecting the priority sectors and ensuring the required funds in the system through various policy options under its disposal. For the implementation part, the coordinated and concerted efforts by all the relevant stockholders like banks, businesses, and Government are required in addition to BB's fully engaging and vigilant role in monitoring and taking timely actions, where necessary.