Policy Stance

5.45%	Inflation forecast
6.75%	Repo rate
4.75%	Reverse Repo rate
6.50%	CRR
19.50%	SLR
14.80%	Broad Money Growth
11.00%	Reserve Money Growth
15.90%	Domestic Credit Growth
11.90%	Public Sector Credit Growth
16.60%	Private Sector Credit Growth

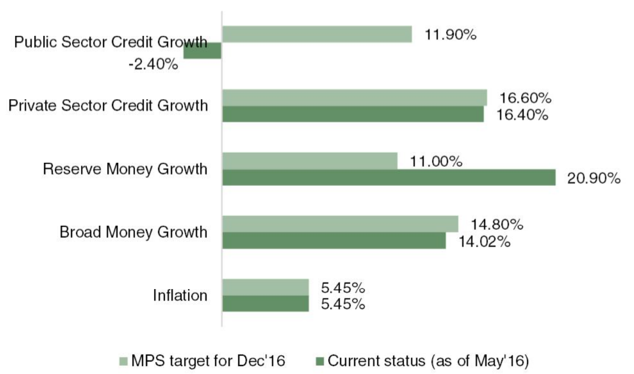
Source: Monetary policy statement July-December 2016

Policy Highlights

- The H1FY17 monetary policy forecasts 5.45% inflation in December 2016. However, incorporating external shock, inflation is expected to center around 6.0%. The target inflation in the end of FY17 is set at 5.80%.
- After keeping the policy rates static for quite a long time, both Repo and Reverse Repo rates were reduced by 50 basis points to 6.75% and 4.75% respectively in the last MPS. These rates are kept unchanged in the new MPS.
- CRR and SLR remain at existing 6.50% and 19.5% respectively.
- Bangladesh Bank (BB) projects reserve money growth of 11.0% and broad money growth of 14.8% by Dec'16 (YoY).
- The target for private and public sector credit growths are set at 16.6% and 11.9% in Dec'16 (YoY).
- BB expects 8.5% growth for both export and import in FY17, while remittance growth forecast is 2.5%.
- BB's expects FY17 real GDP growth between 7.1% and 7.3%.

The H1FY17 Monetary policy is formulated with the core objective of moderation and stabilization of CPI inflation alongside supporting output and employment growth. Monetary and financial policies continues to be supportive of inclusive, environmentally sustainable growth without any prolific change in policy stance. This new monetary policy sets very realistic targets.

Chart 1: Target vs Current Status



Source: Bangladesh Bank

Policy rates remains unchanged

After keeping policy rates fixed since February 2013, both repo and reverse repo rates had been cut by 50 basis points in the last MPS for Jan-Jun 2016, sending the repo to 6.75% and reverse repo to 4.75%. Bangladesh Bank (BB) was able to reduce the policy rates as the inflation rates have been on a declining trend which is supportive for policy easing. The aim was to put downward pressure to the other market interest rates and help to stimulate higher investments in the economy. This new MPS for Jul-Dec 2016 (H1FY17) has kept the policy rates unchanged.

Mentionable here, BB stopped lending through Repo auction since Dec'11. But the lending operation resumed again after 4 years on January 2016.

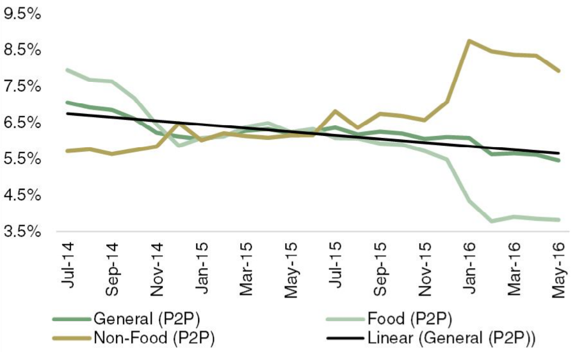
Broad and reserve money growth targets have been lowered further

BB has again lowered its targets for broad money and reserve money growth from its previous MPS targets. Reserve money growth has been estimated to be 11.0%against the current growth of 20.9%. However, 14.05 growth has been targeted for the end of FY17 (Jun'17). Broad money growth has been estimated at 14.8% for Dec'16, with 15.5% target for Jun'17. This growth rates are expected to be adequate to meet inflation and economic growth targets.

Strong growth expected in Private Sector Credit

The private sector credit growth target had also been lowered in the last MPS due to the sluggish investment climate present at that time. However, the scenario has changed since then. The economy stabilized and interest rates came down to very attractive level. As a result, private credit growth boosted and exceeded the target by a huge margin. As of May'16, the private credit growth of the country stood at 16.4%, against the Jun'16 target of 14.8%. The new MPS for H1FY17 sets private credit growth target at 16.6% for Dec'16 and 16.5% for Jun'17.

Chart 2: Inflation Rates (2005-06 Base) (%)



Source: Bangladesh Bank

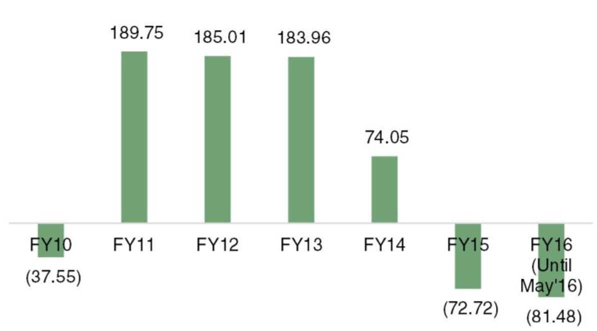
Public Sector credit growth target has been lowered

The public credit growth target has also been reduced from its previous target. The H2FY16 target for public credit growth was 18.7%, but the achieved growth was -2.4% until May'16. This MPS for H1FY17 lowers the public sector credit growth targets to 11.9% for Dec'16 and 15.9% for Jun'17. However, if the Government's last 2 fiscals' (FY15 and FY16) policy of doing nearly the entire domestic borrowing from the costly nonbank NSD instruments continue, then this reduced target will also prove to be way too optimistic.

Inflationary outlook

Twelve-month average CPI inflation in Bangladesh has shown a slowly declining trend for the last couple of years. Inflation, which was 7.28% in Jul'14, gradually fell to 5.92% in Jun'16. As of May 2016, Point to point (P2P) inflation and 12 months average inflation stood at 5.45% and 5.98%, respectively, the lowest since Sep'12. The decline in average inflation is mainly attributable to the falling food prices while non-food inflation edges up primarily because of the consumption boost in the wake of the historically highest salary hike in the public sector. As past evidence suggests, the private sector is likely to follow suit in a staggered fashion, putting an upward pressure on nonfood inflation. However, the inflation rate is now in a safe zone.

Chart 3: Govt. Borrowing from the banking system (BDT



Source: Bangladesh Bank

BB's research team forecasts Dec'16 general inflation rate of 5.45%. This forecast, however, does not incorporate other external shocks. An inflation-expectations survey conducted by Bangladesh Bank provides indication that inflation will center around 6 percent, which is quite moderate for a developing economy like Bangladesh. The Government's FY17 inflation target has been set at 5.8% which, we think, is quite realistic and achievable.

Table 1: External Balance Summary

Economic Indicator	FY12	FY13	FY14	FY15	FY16 Estimate	FY17 Target
Export Growth Rate (%)	6.0%	11.2%	11.7%	3.4%	9.7%	8.5%
Import Growth Rate (%)	2.4%	0.8%	8.9%	11.2%	6.0%	8.5%
Remittance Growth Rate (%)	10.2%	12.6%	-1.6%	7.6%	-2.5%	2.5%
Current Account Balance (in million USD)	(447)	2,388	1,406	(1,650)	2,958	1,781
Forex Reserve(in million USD)	10,364	15,315	21,508	25,021	30,176	33,041
Exchange Rate (Tk./USD)	81.80	77.80	77.60	77.67	77.80	-

Source: Bangladesh Bank

External Sector Outlook

After recording a deficit of USD 1,650 mn in FY15, the Current Account Balance (CAB) has become positive again in FY16. The estimated CAB in FY16 was a surplus of USD 2,958 mn against the H2FY16 MPS target of 960 mn. The H1FY17 MPS target for CAB in FY17 has been set at USD 1781 mn surplus. Considering the current external sector condition, this target seems achievable.

Export growth was was quite strong in FY16. Export registered 9.7% (estimated growth YoY in FY16 against only 3.4% in FY15. The central bank expects to 8.5% growth in export in FY17, which is achievable.

Import registered 11.25% growth in FY15. But import growth has slowed down in FY16 and stood at only 6.0%. The import bill has declined due to fall in oil and commodity prices in the international markets. The H1FY17 MPS import target is set at 8.5%, which seems too high at this moment.

Remittance recorded de-growth of -2.5% in FY16. Despite that, the remittance growth target for FY17 has been set at 2.5%.

Economic Growth Outlook

The GDP growth of Bangladesh was 7.05% in FY16, exceeding the 7% mark for the first time ever beating the Government's target by 5 basis points. Growth of industry sector scaled up (10.1%) in FY16 supported by excellent growth in mining and manufacturing sub-sectors while service sector, which contributes more than half to GDP, noted 6.7% growth in the last fiscal year.

While the government targets GDP growth of 7.2%, BB expects the economy to achieve a growth rate between 7.1% and 7.3% in FY17. The World Bank, on the other hand, forecasts only 6.3% GDP growth for Bangladesh in FY17 while IMF forecasts 6.9%, evidencing a remarkable difference in the projections of the two international agencies.

The central bank gives priority to providing electricity, gas, and infrastructure to businesses to ensure higher level of sustainable growth. Faster implementation of ADP will also be helpful to promote revenue and growth potentials for the country.

Implication for banking sector and the capital market

The MPS for H1FY17 does not have anything specific for the banking sector or the capital market. However, emphasis has been given on improving banking supervision and corporate governance. The government and Bangladesh Bank are working with the World Bank toward putting in place Enterprise Resource Planning (ERP) and core banking IT platforms in the state owned banks and financial institutions, introduction of pension funds for general citizenry, and crop insurance schemes.

The government has recently taken up an initiative of introducing long term pension savings schemes for general citizenry, to be supervised by a new Pension Funds Regulator. Successful introduction of such schemes will help the financial and capital markets greatly in mobilizing long term savings for long term investments.

The MPS addresses the need for streamlining processes and lowering costs in equity issuance, facilitating access of corporates to capital markets for raising finance.

Lengthening the maturity spectrum of the yield curve with issuance of new treasury bonds for 25 and 30 year tenors is being contemplated. The government is also working with Asian Development Bank to activate primary and secondary markets in corporate bonds.

As quite a few banks and financial institutions have substantial portfolios of mortgage backed housing loans, Bangladesh Bank is suggesting issuance of mortgage backed securities against these housing loan assets, which would also help corporate bond market activation. The state owned housing finance institution, HBFC, can be shored up to take up underwriting and market making in mortgage backed securities, while for securities backed by other assets, some entity like the state owned Investment Corporation of Bangladesh can take up similar underwriting and market making roles.

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LBSL Capital Market Research Department

Md. Mahfuzur Rahman — Head of Research — mrahman@lbsbd.com

Analyst	Designation	E-mail
Md. Rezwanur Rahman	Senior Research Associate	rezwanur.rahman@lbsbd.com
Salma Yeasmin Xinat	Senior Research Associate	salma@lbsbd.com
Tanay Kumar Roy	Senior Research Associate	tanay.kumar@lbsbd.com
Quazi Naureen Ahmed	Research Associate	naureen.quazi@lbsbd.com
Mahibul Karim Khan	Research Associate	mahibul.karim@lbsbd.com
Debashish Sutradhar	Trainee Research Associate	debashish.sutradhar@lbsbd.com

Institutional & Foreign Trade Department

Rehan Muhammad — Head of Business — rehan@lbsbd.com/rmuhammad1@bloomberg .net

LankaBangla Securities Limited

Research & Analysis Department
Corporate Office
A.A. Bhaban (Level-5)
23 Motijheel C/A
Dhaka-1000, Bangladesh
Phone: +880-2-9513794 (Ext-118)
Fax: +880-2-9563902