Monetary Policy Statement

Fiscal Year 2022-23

Bangladesh Bank

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

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Fiscal Year 2022-23

Bangladesh Bank

www.bb.org.bd

Acronyms and Abbreviations

App	Appreciation
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BCA	Bank Company Act
BDT	Bangladesh Taka
BO	Beneficiary Owners
BoP	Balance of Payments
BSEC	Bangladesh Securities and Exchange Commission
CAB	Current Account Balance
CLIW	Composite Leading Indicators of the World
CMSE	Cottage, Micro and Small Enterprise
CMSME	Cottage, Micro, Small and Medium Enterprise
COVID	Coronavirus Disease
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DC	Domestic Credit
Dep	Depreciation
DFIM	Department of Financial Institutions & Markets
DSE	Dhaka Stock Exchange
DSMEX	DSE Small and Medium Enterprises Index
EDF	Export Development Fund
EMV	Europay, MasterCard, and Visa
EU	European Union
FY	Fiscal Year
GCC	Gulf Cooperation Council
G2P	Government to Private
GDP	Gross Domestic Product
H1	First Half
H2	Second Half
ICB	Investment Corporation of Bangladesh
IMF	International Monetary Fund
LC	Letter of Credit
LDC	Least Developed Countries
M2	Broad Money
MPS	Monetary Policy Statement
MSCI	Morgan Stanley Capital International
NBFI	Non-Bank Financial Institution
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Asset
OMS	Open Market Sales
QR	Quick Response
REER	Real Effective Exchange Rate
RM	Reserve Money
RRL	Real Rate of Lending
RTGS	Real Time Gross Settlement
SLR	Statutory Liquidity Ratio
SME	Small and Medium-sized Enterprises
SoE	State-owned Enterprise
SWIFT	Society for Worldwide Interbank Financial Telecommunications
UAE	United Arab Emirates
UK	United Kingdom
USA	United States of America
USD	U.S. Dollar
VAT	Value Added Tax
WEO	World Economic Outlook
WTO	World Trade Organization
y-o-y	Year on Year
ZIRP	Zero Interest-Rate Policy
4IR	4th Industrial Revolution

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Highlights

- A broad-based economic recovery of Bangladesh has already taken place towards its pre-COVID growth trajectory, as reflected by the BBS estimation of real GDP growth of 7.25 percent for FY22.
- Like many other economies, the pass-through of surging global energy and commodity prices resulted in higher inflation in Bangladesh.
- The CPI-based average inflation stood at 5.99 percent in May 2022 and is unlikely to be contained within the target ceiling of 5.30 percent ending June 2022.
- The monetary policy stance and monetary program outlined for FY22 were intended to maintain necessary liquidity into the banking system accompanied by a lower market interest rate regime, meeting the private and public sector demand.
- BB has taken necessary policy measures, including open market operations, issuing BB bills, and tightening policy rates to manage money market liquidity conditions.
- The external sector faced some headwinds in FY22, as reflected in the widened current account deficit resulting from a higher trade deficit and relatively moderate inflow of remittances. The overall balance of payments (BoP) witnessed a deficit of USD 3.7 billion during July-April of FY22, exerting some depreciating pressures on the exchange rate.
- BB intervened in the foreign exchange market by selling a substantial amount of foreign currency to support exchange rate stability and maintain the external competitiveness of the Bangladesh Taka (BDT) in FY22.
- *BB's monetary and credit programs for FY23 will pursue a cautious policy stance with a tightening bias to contain inflation and exchange rate pressures while supporting the economic recovery process, ensuring the necessary flow of funds to the economy's productive and employment generating activities for long-term economic growth.*
- BB has decided to increase its policy rate (the repo rate) by 50 basis points to 5.50 percent from 5.00 percent to deal with the demand side pressures along with ensuring the required flow of funds to the priority and productive sectors to promote supply-side activities.
- BB's monetary policy also seeks to promote import-substituting economic activities and dissuade imports of luxury goods, fruits, non-cereal foods, canned and processed foods, etc., to reduce exchange rate depreciating pressure, protect foreign exchange reserves, and control inflation.
    - ✓ In this respect, BB will introduce a new refinance line of credit for import-substituting products to minimize import dependency and save valuable foreign exchange reserves.
    - ✓ The LC margins for luxury goods, fruits, non-cereal foods, canned and processed foods, etc., will be increased comprehensively to discourage their imports.
- BB will continue its support to implement the government’s ongoing stimulus packages alongside BB’s refinance schemes in the face of new adversities, including the Russia-Ukraine war in addition to the COVID-19 pandemic.
- Given the shallow trade linkage of Bangladesh with Russia and Ukraine, the direct adverse impact of the war is expected to be limited. The climate and environment-related vulnerabilities, like the recent sudden floods in the North and Northeastern part of the country, could have some headwinds on the country's overall price stability and growth prospect.

Monetary Policy Statement: Fiscal Year 2022-23

1. Foreword

Bangladesh Bank (BB), the central bank of Bangladesh, has been carrying out its principal task of formulating and implementing the monetary policy to manage the monetary and credit system of the country with a view to stabilizing domestic monetary value and maintaining a competitive external par value of Taka towards fostering growth and development of country's productive resources in the best national interest. BB formulates its monetary policy stance and designs monetary and credit programs based on macroeconomic updates and outlooks at home and abroad, subject to any mid-course revision if necessary.

Organizing face-to-face consultation meetings were not possible due to the COVID-19 pandemic-related restrictions for the last two years. With the improvement of the pandemic situation, in-person consultation meetings with different macroeconomic experts, including former and sitting policymakers, economic analysts from think tanks, academia, and leaders from financial and business sectors were arranged. Opinions, suggestions, and guidelines from the experts present were taken into account with due importance while formulating this fiscal year's MPS.

The feedbacks, articulating current economic conditions and possible policy options, were instrumental in comprehending the required policy stance and framing the monetary and credit programs for FY23 MPS. Besides, the valuable inputs from all the learned Members of the Board of Directors of BB were also acknowledged. A concise evaluation of the last monetary policy stance has been made. All essential background information and rationale have been assessed before taking any stance or policy/program for FY23 MPS.

2. Monetary Policy Outcomes in FY22

The monetary policy for FY22 was designed to support the continuing efforts for economic recovery from COVID-19 pandemic-induced adversities and maintain appropriate cautions for overall price and financial stability. Therefore, the monetary policy stance in FY22 was necessarily expansionary and accommodative like that of FY21. The monetary and credit programs for FY22 were designed with the assumption of a 7.20 percent real GDP growth and a 5.30 percent general inflation ceiling, as declared in the national budget. Some of the critical policy measures were: allowing low cash reserve and high loan disbursement ratio, keeping a low level of various policy interest rates, purchasing government securities from banks' holdings, continuing different low-cost refinance lines and moratorium facilities and extending the time for realizing the export receipts and import payments, and offering credit guarantee facility for CMSMEs. In addition, BB supported the implementation of most of the Government's stimulus packages to safeguard and revive the economic activities against the COVID-19 pandemic-related disruptions.

In the backdrop of global commodity price hikes resulting from the COVID-19 pandemic-driven supply disruptions amid the ongoing Russia-Ukraine war, an orderly exit from the extraordinary expansionary policy stance was necessary. Despite lower than programmed monetary growth, Bangladesh has been facing growing inflationary and exchange rate depreciating pressure since the second half of FY22, mainly due to the spillover effect of the unexpectedly higher global inflation rate along with widening current account deficits. Following the exercises of peer countries, BB absorbed some liquidity by issuing BB bills and selling foreign currency to the banks to stabilize the foreign exchange market as a part of its preventive measures.

With the support of these policy measures alongside the withdrawal of COVID-related restrictions, a solid and broad-based economic recovery was evident in FY22, reflected through various macroeconomic and financial indicators. During this period, complete normalcy in almost all the economic activities in agriculture, manufacturing, and service sectors was restored, propelled by increased internal and external demand. As per available data, the external demand, which is reflected mainly by export receipts, increased by 34.09 percent during July-May of FY22 compared with an increase of 13.64 percent during the same period of the previous fiscal year. Similarly, the internal demand partly reflected by import payments increased by 39.01 percent during July-May of FY22 as against an increase of 17.31 percent in the previous year. The growth of consumer credit, another critical indicator of internal demand, also appeared to be strong (20.07 percent) as of March 2022.

The private and public sector investment activities, partly reflected through the robust private sector credit growth and implementation of various mega projects, remained buoyant in FY22. The private sector credit increased by 12.94 percent (y-o-y) at the end of May 2022 as against an increase of 7.55 percent in the corresponding period of the previous fiscal year. The large and medium-scale manufacturing output registered 17.05 percent growth during the first 8 months (July-February) of FY22, while it grew by 4.15 percent during the corresponding period of the previous fiscal year. As per the Bangladesh Bureau of Statistics estimate, the real GDP will be growing by 7.25 percent in FY22, exceeding the FY21's actual growth of 6.94 percent.

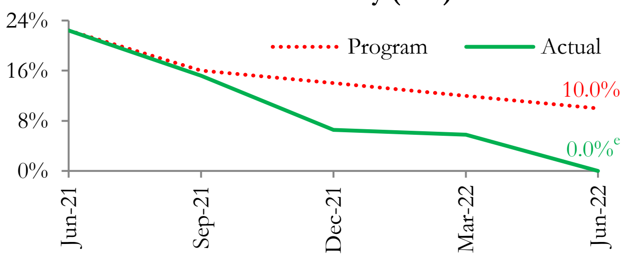
The prices of essentials in the global market went up significantly, mainly due to COVID-induced supply chain disruptions amid the expansionary fiscal and monetary measures of the pandemic period, compounded further by the Russia-Ukraine war. With the improvement of the COVID-19 pandemic scenario, the aggregate demand responded faster than the aggregate supply shooting both the energy and non-energy commodity prices up across the globe. The CPI-based twelve-month average inflation in Bangladesh rose to 5.99 percent in May 2022, surpassing the target ceiling of 5.30 percent set for June 2022, which was 5.56 percent in June 2021. Among the components, the prices of food items like edible oil, vegetables, eggs and meat, and the prices of non-food items like transportation and communication, household furniture, clothing, and footwear were mainly responsible for the rising general inflation in FY22.

The FY22 monetary policy stance and monetary and credit programs were intended to ensure necessary liquidity in the local and foreign currency markets, continuing the economic recovery momentum, stabilizing the interest rate and exchange rate movements, and containing inflation. BB's timely intervention assured a comfortable liquidity condition in the money market during FY22, sufficiently meeting the private and public demand. As part of BB's routine activities, some excess reserves were mopped up by issuing BB bills during August-November of FY22. BB also injected required cash through repo and liquidity support facilities during February-June of FY22, considering the market demand for money. On the other hand, BB intervened in the local foreign exchange market by selling a substantial amount of foreign currency to support exchange rate stability and maintain the external competitiveness of the Bangladesh Taka (BDT) in FY22.

In the backdrop of recent commodity price hikes in the international markets, the import payments witnessed a strong increase, driven by post-COVID economic recovery-related enhanced domestic demand. The export growth in FY22 was also significantly higher due to the continuation of policy supports like the enhancement of the export development fund (EDF) and working capital loans for the export-oriented industries. However, the inflows of inward remittances were moderate in FY22 compared to FY21. The higher outflows of migrant workers with increased cash incentives (from 2.0 percent to 2.5 percent) and related policy relaxation amid the recent steep depreciation of BDT are expected to play critical roles in attracting more inflows remittances in the days to come.

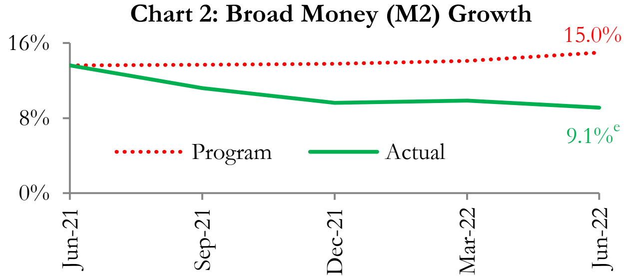
Because of the relatively higher import growth than that of export receipts and remittances, the current account deficit widened to USD 15.3 billion (3.3 percent of nominal GDP) during July-April of FY22 compared with USD 1.7 billion (0.4 percent of nominal GDP) deficit during the corresponding period of the previous year. The overall balance of payments (BoP) also witnessed a deficit of USD 3.7 billion (partly compensated by the financial account surplus) during July-April of FY22 against a surplus of USD 7.5 billion during the corresponding period of the previous fiscal year. The BoP deficit strongly drew down the banking system's net foreign assets and lowered the BB's foreign exchange reserves position to USD 41.9 billion (as of 28 June 2022) against USD 46.4 billion at the end of June 2021.

Chart 1: Reserve Money (RM) Growth



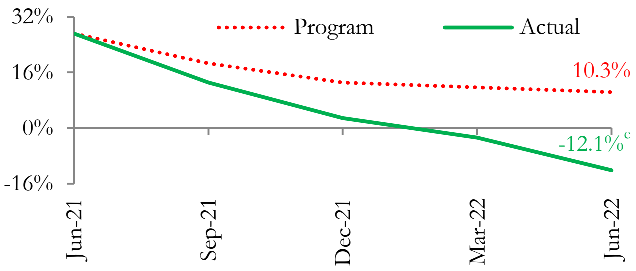
Source: Bangladesh Bank. e = estimated

Chart 2: Broad Money (M2) Growth



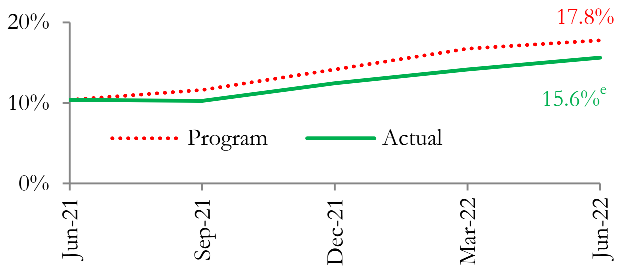
Source: Bangladesh Bank. e = estimated

Chart 3: Net Foreign Assets (NFA) Growth



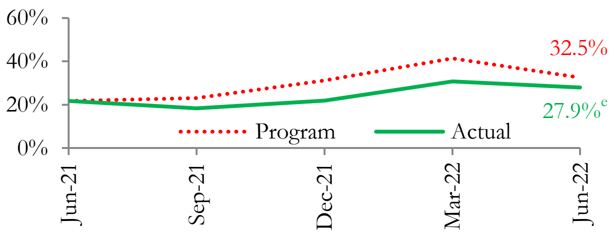
Source: Bangladesh Bank. e = estimated

Chart 4: Domestic Credit (DC) Growth



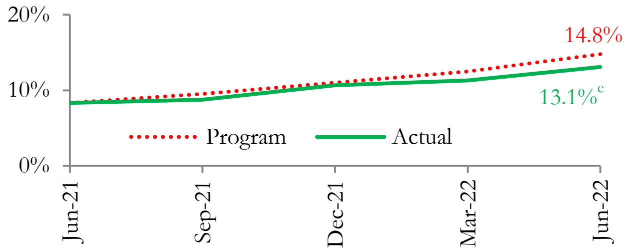
Source: Bangladesh Bank. e = estimated

Chart 5: Public Sector Credit Growth



Source: Bangladesh Bank. e = estimated

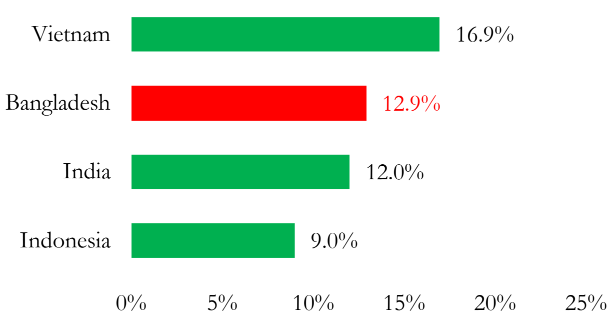
Chart 6: Private Sector Credit Growth



Source: Bangladesh Bank. e = estimated

Charts 1-6 display the actual growth paths of major monetary and credit aggregates against their programmed paths set for FY22. Reserve money growth, the operating target of BB's monetary policy, moved below the programmed path mainly due to a significant depletion of BB's net foreign assets resulting from the net sale of foreign currency to the banks, induced by very strong import demands (Chart 1). Broad money (M2) growth, the nominal anchor or intermediate target of BB's monetary policy, remained well below the programmed path during FY22, dragged by lower net foreign assets in the banking system (Chart 2). The movement of domestic credit, however, remained pretty much in line with the programmed path in FY22, well supported by the private sector credit growth (Chart 4). The faster recovery of economic activities owing to the relaxation of COVID-related restrictions appears to have contributed to the upward trend of the private sector credit growth in FY22 (Chart 6). However, the public sector credit growth was slightly lower than the target, mainly due to solid inflows of funds from foreign sources (Chart 5) and mobilization of idle money from various state owned enterprises' (SOEs) bank accounts. It is mentionable that the private sector credit growth, which presumably reflects the private investment at the national level, increased by a large extent in Bangladesh compared to many other Asian developing countries (Chart 7).

Chart 7: Cross-country Comparison of Private Sector Credit Growth (latest available data)*



Source: Respective Central Banks' Websites.
* Data available upto May 22 for Bangladesh, India, upto Apr 22 Indonesia, and upto Mar 22 for Vietnam.

3. Overview of Global and Local Contexts of Monetary Policy Stance for FY23

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

The ongoing Russia-Ukraine war, humanitarian crisis, and subsequent sanctions on Russia weakened global economic recovery prospects. While the global economy had not yet fully recovered to the pre-pandemic levels, the path to weak recovery noticeably diverged between advanced and emerging market and developing economies as many of the latter group of economies experienced limited policy space and slower vaccination pace. According to IMF's latest World Economic Outlook, April 2022, global growth will be 3.6 percent both in 2022 and 2023, 0.8 and 0.2 percentage points lower than those in the January 2022 forecasts, respectively (Table 1). The last two columns of Table 1 demonstrate the extent to which growth projections have been downgraded (in percentage points) for 2022 and 2023, reflecting worsened growth prospects for all major economies.

Table 1: Overview of Global Economic Growth as per April 2022 WEO

(y-o-y % change)

Region	Growth				Difference from January 2022 WEO Projection	
	Actual		Projection			
	2020	2021	2022	2023	2022	2023
World	**-3.1**	**6.1**	**3.6**	**3.6**	**-0.8**	**-0.2**
Advanced Economies	-4.5	5.2	3.3	2.4	-0.6	-0.2
USA	-3.4	5.7	3.7	2.3	-0.3	-0.3
Euro Area	-6.4	5.3	2.8	2.3	-1.1	-0.2
Other Advanced Economies	-1.8	5.0	3.1	3.0	-0.5	+0.1
Emerging Market and Developing Economies	-2.0	6.8	3.8	4.4	-1.0	-0.3
China	2.2	8.1	4.4	5.1	-0.4	-0.1
India	-6.6	8.9	8.2	6.9	-0.8	-0.2

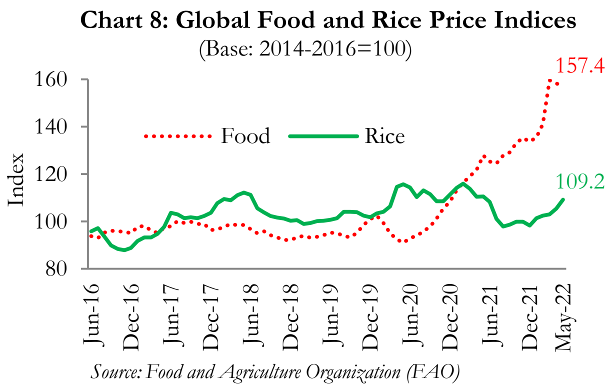
Source: International Monetary Fund.

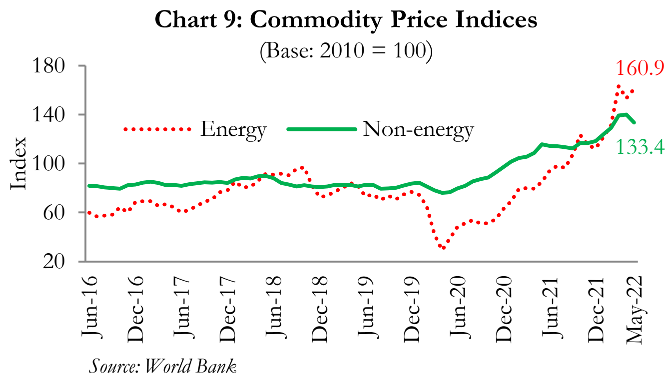
The war has propagated wide economic shocks, primarily through commodity markets, trade, and financial linkages. Since Russia (together with Ukraine) is a crucial provider of oil, gas, and metals, as well as wheat, corn, and fertilizers, the current and predicted decrease in the supply of these commodities has already pushed up prices, hurting low-income people around the world. Sanctions and banning Russia from the international payment network, SWIFT, by the Western countries also disturbed the world supply chains. Moreover, soaring shipping costs, mainly because of elevated freight demand during the recovery period, added inflationary pressure to imported commodities. New bottlenecks in global supply chains emerged due to restrictions on some manufacturing areas in China following their zero COVID policy, further intensifying the existing price pressure.

Hence, global headline inflation is expected to remain elevated for longer than the period predicted in the previous forecasts of the IMF. For 2022, inflation is projected at 5.7 percent for the advanced economies and 8.7 percent for the emerging and developing economies, 1.8 and 2.8 percentage points higher than the forecasts made in the January 2022 World Economic Outlook. With reasonably well-anchored expectations in the medium term, the inflation in 2023 is projected to be 2.5 percent for the advanced economy group and 6.5 percent for emerging market and developing economies (0.4 and 1.8

percentage points higher than the January 2022 forecast). However, these inflation projections are subjected to high uncertainty related to many challenges, such as the continuation of the Russia-Ukraine war for an extended period, a renewed wave of the pandemic, increased prices of commodities and inputs, and tight labor markets.

Bangladesh economy is also facing adverse consequences of hiking global food and fuel prices through the import channels. The trends of international food and non-food commodity price indices, as shown in Charts 8 and 9, illustrate that the price surge in the recent months has already been passed through domestic prices in Bangladesh, mirrored in the sharp rise of import payments, particularly since the second quarter of FY22. If this situation continues in the upcoming months, persistent depreciation pressures on the Bangladesh Taka will continue to push up domestic inflation further. However, the upward trend in global energy prices might remain unresponsive to domestic inflation due to administered prices in the country.

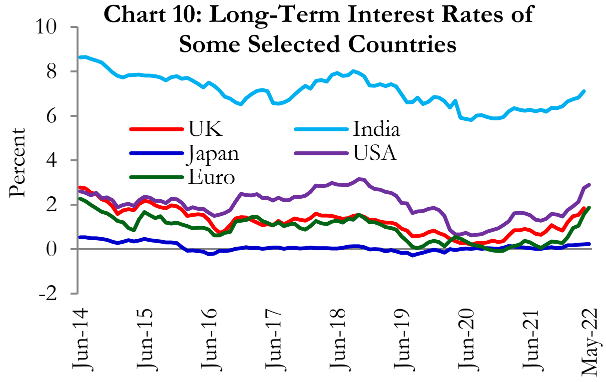




The trends of long-term interest rates in terms of the yields of government bonds maturing in ten years have been increasing in most of the major developed and developing countries since June 2020 and approached their pre-pandemic levels in May 2022 (Chart 10). The recent uptrend of long-term yields reflects investors' expectations of significantly high inflation for an extended period and tighter monetary policies ahead.

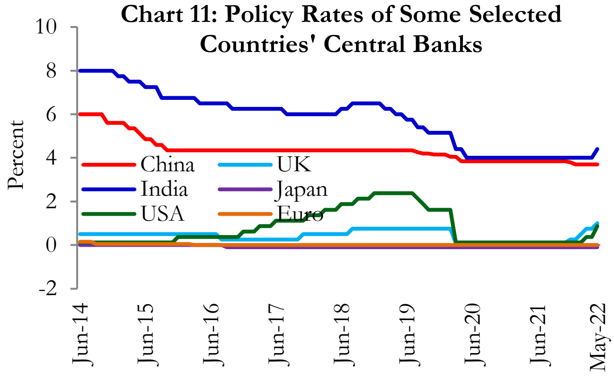
Major economies like the USA, India, UK and the Euro area raised their policy interest rates recently in a bid to tackle soaring inflation. Japan continued to employ a zero interest rate policy (ZIRP), setting its short-term interest rate at or close to zero to combat deflation and promote economic recovery (Chart 11). Despite the recent increase, most countries' policy rates remained well below the pre-COVID levels. It is worth mentioning that the interest rates (both long-term interest and policy rates) in China and India remained relatively higher than those in the advanced economies, mainly because of their inflation differentials, a common feature in many other emerging markets and developing economies, including Bangladesh. The continuation of rising trends of long-term interest rates in advanced economies may create some pressures on interest and exchange rates in the emerging market and developing economies.

Chart 10: Long-Term Interest Rates of Some Selected Countries



Source: Organization for Economic Co-operation and Development

Chart 11: Policy Rates of Some Selected Countries' Central Banks



Source: Bank for International Settlements

World merchandise trade rebounded unexpectedly in 2021, reflecting resumptions of operations and business activities as the intensity of the COVID-19 pandemic weakened and containment measures broadly eased. The value of merchandise trade grew by 26 percent to USD 22.4 trillion, whereas the value of commercial services trade also increased by 15 percent to USD 5.7 trillion in 2021[1]. However, the WTO projects that world trade growth will slow down to 3.0 percent in 2022 and 3.4 percent in 2023, considering the impact of the Russia-Ukraine war on trade along with a potential food crisis caused by supply chain disruptions. The conflict will also hamper services trade, particularly in the transport sector. Moreover, renewed lockdowns in China to prevent the spread of COVID-19 may also generate disruptions in the seaborne trade channel.

With the re-opening of major export destinations like the EU and the USA, exports from Bangladesh surpassed the pre-pandemic levels. However, the slashed growth forecasts and any possible economic recession in the advanced economies, particularly in regards to the Euro Area and the USA, are concerns for Bangladesh economy as they are the top export destinations of Bangladesh's exports as well as important sources of remittances. Besides, global commodity and energy price hikes arising from the Russia-Ukraine war mounted pressures on the trade balance, foreign exchange reserves, and exchange rate during FY22. Bangladesh Bank is judiciously taking necessary measures to maintain exchange rate stability and sustain foreign exchange reserves cushioning the economy against the possible external shocks.

3.2. Domestic Growth and Inflation Outlook

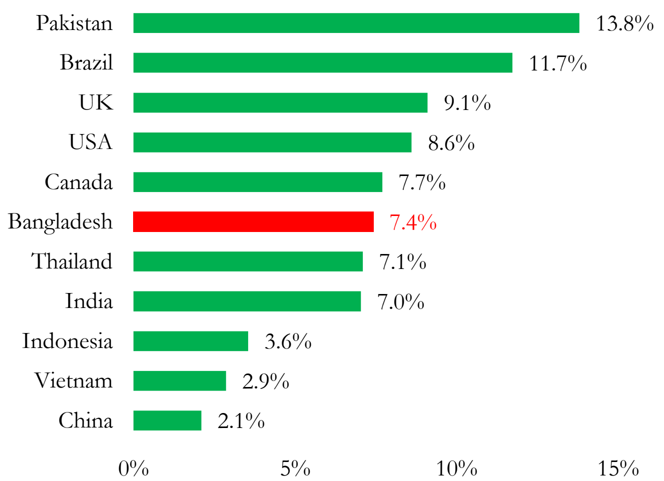
A broad-based recovery of Bangladesh economy appeared to have continued in FY22, as confirmed by the BBS estimated real GDP growth of 7.25 percent for FY22. The exuberance of economic activities was concentrated mainly in the industry sector, with 10.44 percent growth supported by the improved COVID-19 situation and pent-up demand. In addition to expansionary and accommodative monetary and fiscal policies during the pandemic, the manufacturing sector benefited from the recent surge in domestic and foreign demand. As reflected by 6.31 percent growth in FY22, a pick-up in activities in the services sector helped maintain the robust growth momentum. The healthy growth performance of the

[1] World Trade Organization, Press release, 12 April 2022.

local industries and higher external demand benefitted the buoyant activities in the services sector. After registering higher growth rates during the last two fiscal years in the pandemic period, the BBS estimated a lower growth of 2.20 percent for the agriculture sector in FY22 as it experienced slower crop and horticulture production. Overall, a robust external demand, reflected in 34.09 percent growth in exports in the first eleven months of FY22, and a buoyant domestic demand manifested by 39.01 percent growth in imports in the first eleven months of FY22 also depicted robust growth performance from the expenditure side during this period.

It may be noted that the government's 28 stimulus packages worth BDT 2.0 trillion, approximately 5.68 percent of FY21's current price GDP, for mitigating the adversities of the outbreak of COVID-19 on Bangladesh economy have facilitated faster economic recovery. BB has been pivotal in implementing the various stimulus packages through a range of complementary and supportive policy measures by injecting working capital loans and extending various refinance facilities for agriculture, CMSMEs, large industries, export-oriented industries, and the services sector. BB has taken the responsibility of implementing the government's ten major stimulus packages amounting to nearly BDT 1.7 trillion for covering the COVID-19 related disruptions.

Chart 12: Cross-country Comparison of Point to Point Inflation
(latest available data)*



Source: Respective Central Banks' Websites.
* Data available upto May 22

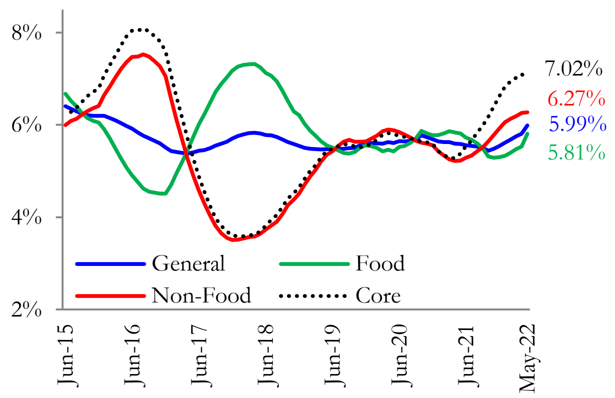
Notwithstanding the substantially diminished intensities of the COVID-19 pandemic, the Bangladesh economy's recovery process is likely to face some direct and indirect adversities due to the Russia-Ukraine war. The war has heightened the potential losses of export demand on the one hand, and the war-induced surge in the commodity prices has led to higher import costs and trade deficits, putting pressure on inflation and exchange rates on the other hand. So far, the Bangladesh economy has shown strong resilience against COVID-19 shocks and recovered the growth rate quickly in FY21 and FY22. Bangladesh has ranked 5th out of 121 countries in the Nikkei Covid-19 Recovery Index (as of 30 April 2022), while the country secured the top position among the South Asian countries. Considering the economic impact of the Padma Bridge 7.50 percent real GDP growth target seems consistent with the BB's model-based GDP growth forecasts for FY23[2].

[2] A series of output gaps from FY82 to FY22 has been calculated for estimating the model-based GDP forecast for FY23. Output-gap is a function of Composite Leading Indicators of the World (CLIW) and Real Rate of Lending (RRL), while GDP growth at a constant price is considered a function of output-gap and growth of potential GDP.

Lingering supply shocks and surging global energy and commodity prices have resulted in higher inflation in many economies, including Bangladesh's (Chart 12). The CPI-based average inflation in Bangladesh continued to rise throughout FY22 and stood at 5.99 percent in May 2022. The inflation was attributed to a significant increase in both food and non-food prices mainly because of the pass-through of elevated global commodity prices in the face of supply shocks, higher shipping costs, and the knock-on effect of an upward adjustment of fuel (diesel and kerosene) price in the domestic market. Bangladesh Bank has taken several measures to combat inflation, including issuing BB bills and tightening policy rates.

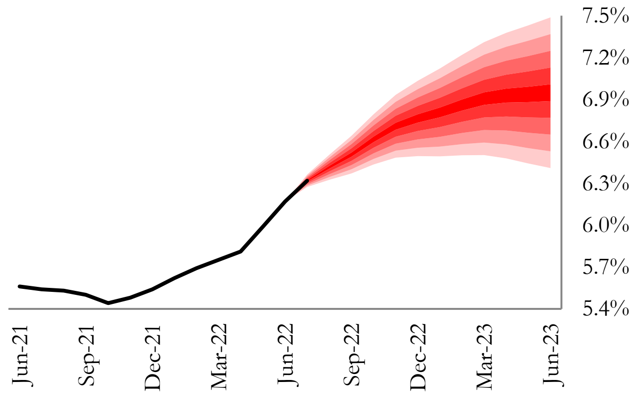
Chart 13 plots the CPI-based 12-month average general or headline inflation trend along with its broad components – food, non-food, and core (non-food and non-energy) inflation since June 2015. The 12-month average CPI inflation moderated at a slow pace up to October 2021 and then continued to pick up and reached 5.99 percent in May 2022 – higher than the target ceiling of 5.30 percent for FY22. Both the core and non-food components of average inflation are seen to be gradually increasing. It is expected that price pressure will continue for some time, and the inflation rate will likely surpass the target ceiling for FY22.

Chart 13: Twelve Month Average CPI Inflation



Source: Bangladesh Bureau of Statistics (BBS)

Chart 14: Projection of Average General CPI Inflation



Source: BB's Research Team Projection Based on BBS Data

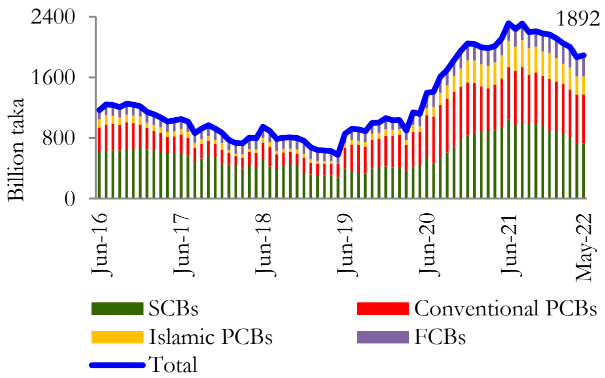
The inflation outlook might confront some uncertainties in FY23 because of increasing price pressures from supply-demand imbalances in the pace of rising demand, the unfavorable prognosis of the Russia-Ukraine war, and elevated global commodity prices. In addition, a sharp increase in inflation in India, being one of the largest trading partners, might pose upward risks to the inflation outlook of Bangladesh. Again, frequent lockdowns in China's manufacturing hubs could cause supply bottlenecks, worsening the inflation forecast as China is one of the country's largest trading partners. Moreover, upward adjustments of administered energy prices have created some pressures on the non-food commodity prices partly due to increased production and transportation costs in the domestic economy. Besides, inflation expectations might heighten owing to the rising fuel and edible oil price hike. The lagged pass-through to broader inflation from higher food and oil prices for import items could exert further pressure on domestic inflation. Additional risks might evolve from the external sector as the domestic currency is under depreciating pressure.

Moreover, the recent uptick in the asset price index, especially the real estate price index, may further exacerbate the upside risk of inflation. The current global commodity price hikes amid unfolding geopolitical conflicts may exert inflationary pressures in the coming days, making it challenging to maintain the target rate of inflation. BB's Modeling and Forecasting Unit's forecast (Chart 14) and inflation expectation survey also show that a higher inflation trajectory will continue in FY23.

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

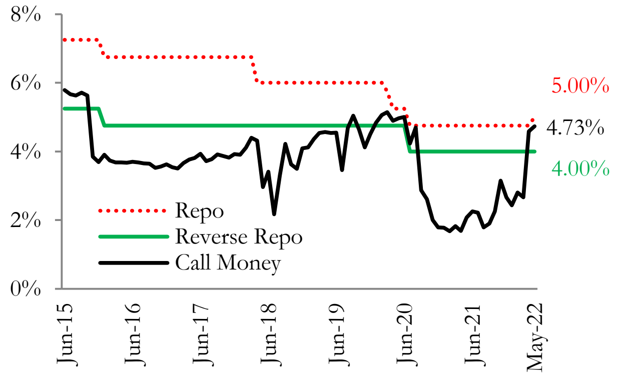
The liquidity situation of the banking system, usually measured by banks' excess reserves over CRR in a narrow sense and banks' excess liquid assets (banks' liquid assets after the maintenance of CRR and SLR) in a broad sense, was very much affluent at the beginning of FY22 due to the implementation of several easy fiscal and monetary policy measures since the last quarter of FY20 (Chart 15). However, the excess reserves and liquid assets gradually diminished over the months with the start of the recovery from COVID-19 and the revival of pent-up economic activities, pushing up demand for domestic credit. Following rising demand for local currency for regular economic activities and foreign currency for growing import payments partly settled by buying foreign exchange/greenback from BB in exchange for BDT, excess reserves contracted significantly in recent months. Thus, the liquidity situation became tidy for many banks, some of which have recently been facing increased liquidity pressure due to uneven distribution.

Chart 15: Movement of Excess Liquid Assets



Source: Bangladesh Bank

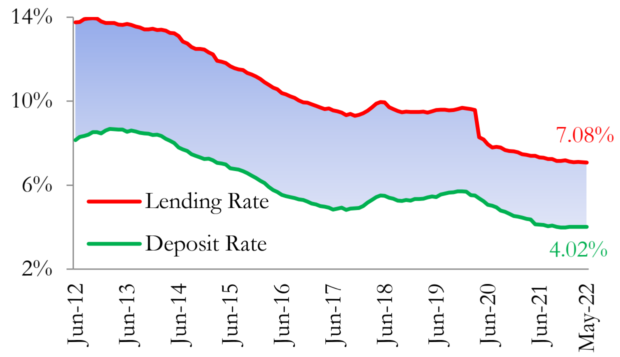
Chart 16: Movement of Call Money and Policy Rates



Source: Bangladesh Bank

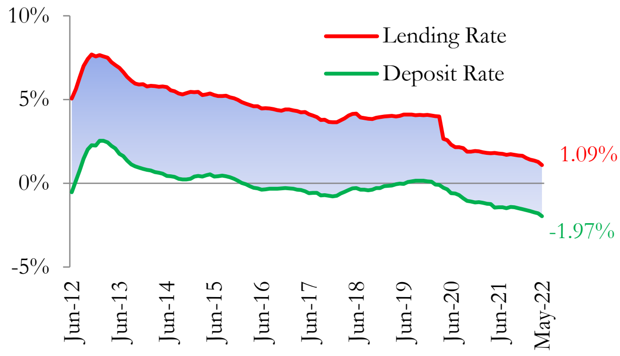
The latest available data show that the excess liquid assets declined from Tk. 2315 billion in June 2021 to Tk. 1892 billion in May 2022, mainly because of the reduction of excess reserves from Tk. 625 billion to Tk. 220 billion. Therefore, the excess government securities held by banks did not fall to the extent of excess reserves. Besides, having no other alternative opportunities for investment, Islamic banks hold a lion part of excess reserves. As a result, some conventional domestic banks fall under some liquidity stresses reflected through the recent upsurge of the interbank call money rate (Chart 16). The interbank call money rate increased to 4.73 percent in May 2022 from 2.25 percent in June 2021.

Chart 17: Weighted Average Nominal Interest Rates



Source: Bangladesh Bank

Chart 18: Weighted Average Real Interest Rates

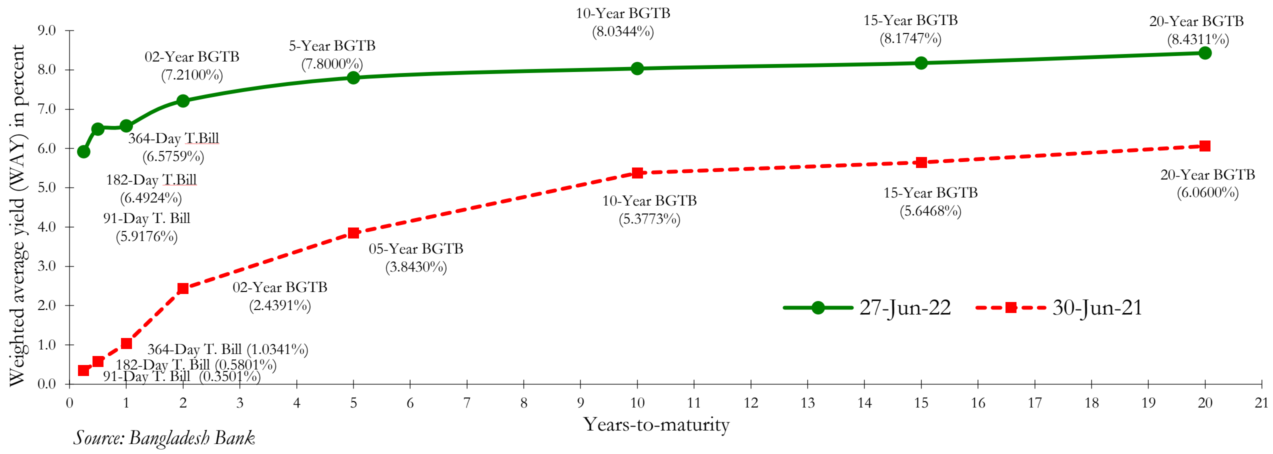


Source: Bangladesh Bank

Though the short-run interest rate increased over the months, declining trends were noticed in the weighted average lending and deposit rates until May 2022, both in nominal and real terms (Charts 17 and 18). This might be a temporary phenomenon, as the situation could reverse soon with the recent policy rate increase amid tight liquidity conditions. Available data show that the weighted average nominal lending rate came down to 7.08 percent in May 2022 from 7.33 percent in June 2021. Similarly, the nominal deposit rate declined to 4.02 percent in May 2022 from 4.13 percent in June 2021. The interest rate spread (the difference between the lending rate and deposit rate) also dropped to 3.06 percent in May 2022 from 3.20 percent in June 2021, indicating an improvement in the banking sector's efficiency.

The real deposit rate has been in the negative territory for some time, hurting the depositors to some extent (Chart 18). The negative real deposit rate discourages depositors, adversely impacting the deposit growth, as noticed recently. However, considering the depositors' interest, BB imposed a floor on the nominal deposit rate, which is not less than the average of the last 3-months inflation rate, effective from August 2021. Inflation was on an uptrend, crossing the 7.00 percent mark on point to point basis in May 2022. With the apprehension of further rising inflation, recently, BB tightened its policy rate (the repo rate) by 25 basis points to 5.0 percent from 4.75 percent. The recent yield curve also shows that the yields across all short-term and long-term bills and bonds increased significantly (Chart 19), reflecting some degree of liquidity pressure in the money market.

Chart 19: Yields on Government Securities



Source: Bangladesh Bank

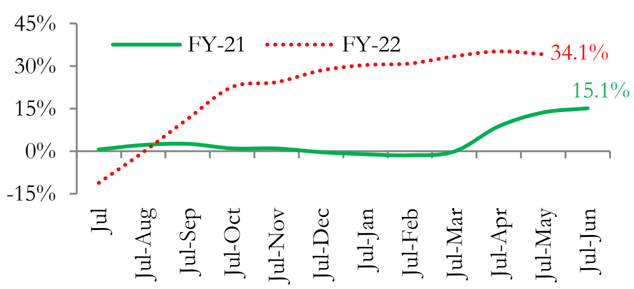
Tight liquidity conditions, a broad-based increase of yields to maturities, including higher policy rates, and rising inflation make the cost of funds higher, creating some upside pressures on the lending rate.

3.4. Overview of External Sector Developments and Outlooks

The improvement of the coronavirus situation due to multifaceted containment measures, rapid innovations of protective vaccines, and broad-based implementation of inoculation programs accompanied by the expansionary and supportive policy measures generated a solid economic recovery driven demand at home and abroad. The external sector activities of Bangladesh also witnessed a significant momentum in FY22. As per available data, both the exports and imports growths were robust during July-May of FY22 and stood at 34.09 and 39.01 percent, respectively (Charts 20 and 21).

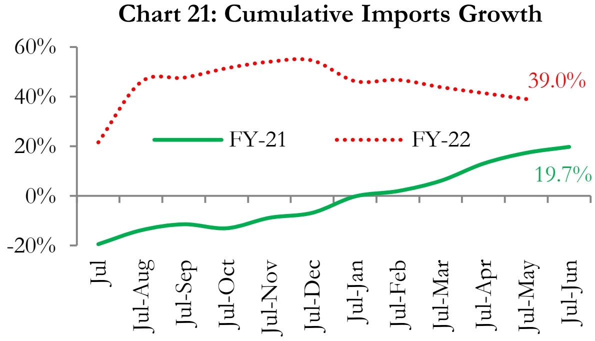
Readymade garments contributing around 82 percent of total export earnings growing by 34.87 percent, helped maintain the robust growth of overall exports of the country. In addition, the share of exports of home textile, engineering, and leather & leather products were very significant in the total exports. On the other hand, amid extraordinary global commodity price hikes, the import growth of industrial raw materials, including raw cotton, yarn, textiles articles, pharmaceutical inputs, fertilizer, plastic & rubber articles; iron, steel & other base metals, and capital machinery predominantly made the overall import growth robust.

Chart 20: Cumulative Exports Growth



Source: Export Promotion Bureau

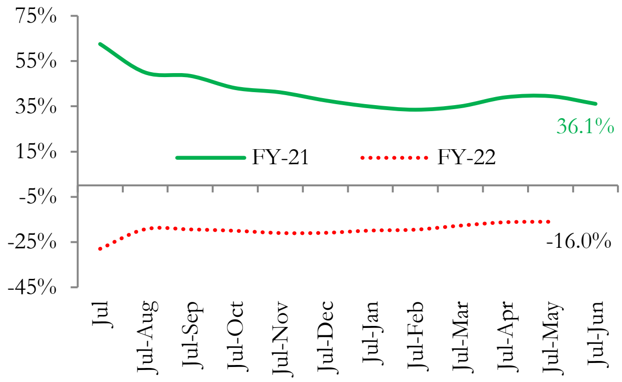
Chart 21: Cumulative Imports Growth



Source: National Board of Revenue

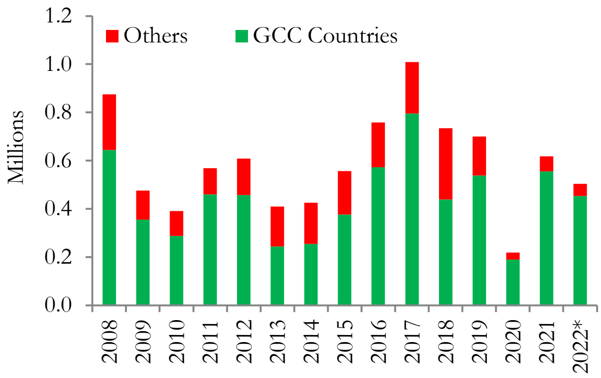
Higher volume and growth of imports than those of exports led to a vast trade deficit during July-May of FY22. The inward remittances, one of the vital factors for the stability of the current account balance, registered a negative growth mainly due to the COVID-19 pandemic-related job losses, dislocations and the reduction of expatriates' working days in different countries, uses of the informal channels to some extent and, above all, due to the base effect of the last year's massive inflows (Chart 22 and 23).

Chart 22: Cumulative Remittance Growth



Source: Bangladesh Bank

Chart 23: Overseas Employment



Source: Bureau of Manpower, Employment and Training. * Up to May 2022

Due to the widening of the trade deficit amid relatively moderate inflows of inward remittances, the current account deficit expanded to USD 15.3 billion (3.3 percent of GDP) during July-April of FY22. In comparison, it was USD 1.7 billion (0.4 percent of GDP) during the corresponding period of the previous fiscal year. Despite relatively improved financial account balance, the overall balance of payments (BoP) has witnessed a deficit of USD 3.7 billion during July-April of FY22 (offsetting by some USD 12.0 billion surplus in the financial account) compared to a surplus of USD 7.5 billion during the corresponding period of the previous fiscal year.

Table 2: Balance of Payments Highlights

(In million USD)

Major Items	Actual Outcome			Outlook
	FY20	FY21	FY22e	FY23
Trade balance	-18569	-23778	-33207	-36705
Services	-2578	-3002	-3455	-2142
Primary income	-3070	-3172	-2894	-2796
Secondary income	18782	25377	21824	25098
of which: workers' remittances	18205	24778	21309	24505
Current account balance	**-5435**	**-4575**	**-17732**	**-16546**
Capital accounts	256	221	275	380
Financial accounts	8654	13093	13131	16016
Errors and omissions	-306	535	-474	0
Overall balance	**3169**	**9274**	**-4800**	**-150**
Memorandum items:				
Export growth (adjusted as per BPM6, percent)	-18.9	14.9	32.0	13.0
Import growth (percent)	-8.6	19.7	35.0	12.0
Remittance growth (percent)	10.9	36.1	-14.0	15.0
Gross international reserves (GIR)	36037	46391	42000	42500
Months of import coverage by GIR	6.1	5.9	4.7	4.6

Source: Bangladesh Bank. e = estimate.

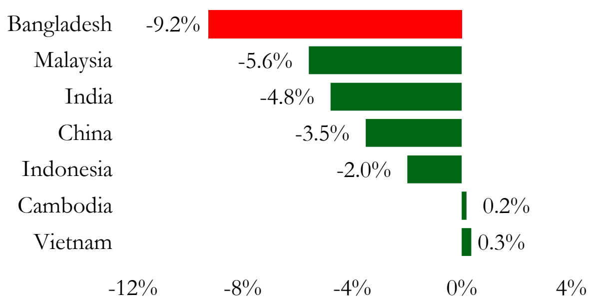
Based on the latest trend of available data, it is anticipated that the current account deficit might remain in the negative territory by around USD 16.5 billion at the end of FY23. However, the increased outflow of wage earner remitters amid improved economic and working conditions in the source countries on top of the base effect is expected to help the inward remittances grow by 15.0 percent in FY23. The exports and imports growth will also be moderated by the higher base effect, reaching 13.0 and 12.0 percent growth in FY23, respectively. As a result, the overall balance (BoP) in FY23 is anticipated to be at a moderate deficit level, well supported by a befitting performance of the financial account (Table 2).

3.5. Movements of Exchange Rate and Foreign Exchange Reserves

The commodity prices in the international markets have been soaring due to the post-COVID economic recovery-induced demand surge amid supply chain disruptions since the end of 2021. The Russia-Ukraine war has aggravated the situation, pushing the global commodity prices and international transportation costs unusually high. Bangladesh is no exception, facing mounting exchange rates and inflationary pressure during the second half of FY22.

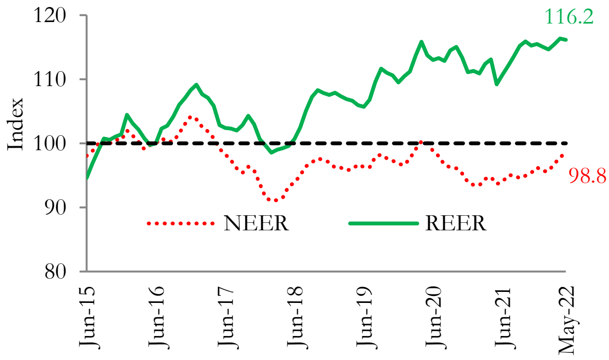
The growing CAB deficit exerted an intense depreciating pressure with some volatility on the BDT-USD exchange rate. To mitigate the depreciating pressure and exchange rate volatility, BB intervened in the local foreign exchange market throughout the year to ensure a market-aligned competitive rate. As per available data, BB sold around USD 7.3 billion (net) during FY22 (up to 28 June), while it bought USD 7.7 billion (net) during the last year. As of 28 June 2022, BB's foreign exchange reserves stood at USD 41.9 billion compared with USD 46.4 billion at the end of June 2021.

Chart 24: App(+)/Dep(-) of Domestic Currency against USD in FY22*



Sources: Respective Central Banks' Websites. *From 30 June, 2021

Chart 25: Effective Exchange Rate Indices
(Base: 2015-16=100)



Source: Bangladesh Bank

Chart 24 shows a cross-country scenario of exchange rate appreciation (+)/depreciation (-) of domestic currency against USD. It indicates that BDT depreciated more than the currencies of many other Asian developing countries, including Malaysia, India, China, and Indonesia. In contrast, the currencies of some other Asian countries, including Cambodia and Vietnam, enjoyed appreciation against the USD during FY22. The nominal effective exchange rate index (NEER index) indicates a nominal depreciation of BDT against the basket of major trading partners' currencies[3], as it lies below 100 until the end of

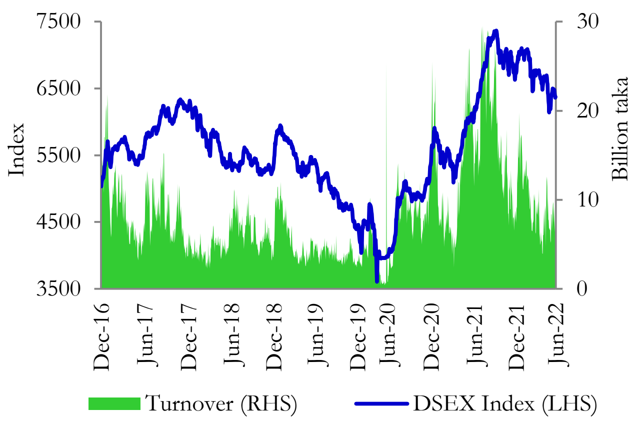
[3] The basket consists of 15 currencies, including the euro.

May 2022 (Chart 25). The real effective exchange rate index indicates a real appreciation of BDT against the basket of major trading partners' currencies, as it is much higher than 100, mainly due to the wide price differentials between Bangladesh and the major trading partners, mainly developed and emerging market economies. Based on the latest available data, BB's projection suggests that the current depreciating pressure on the BDT-USD exchange rate will stabilize in the upcoming months.

3.6 Capital Market Developments and Prospects

With the COVID-19 pandemic-related expansionary policy initiatives, the stock markets across the globe have been experiencing bullish trends until the recent hawkish policy announcements of major advanced economies, including the USA. The capital market in Bangladesh also showed robust performances during the first half (H1) of FY22, evidenced by improved growth in the price indices, buoyant turnover, expansion in market capitalization, and issued capital. The strong performances were partly aided by the easy monetary policy, which supported liquidity in the capital market during the same period. During the second half (H2) of FY22, however, the capital market indices experienced a declining trend with some fluctuations. In the backdrop of recent rising inflation and exchange rate volatilities, the market players and investors became cautious. They remained on the side-line as the profit-taking spree continued.

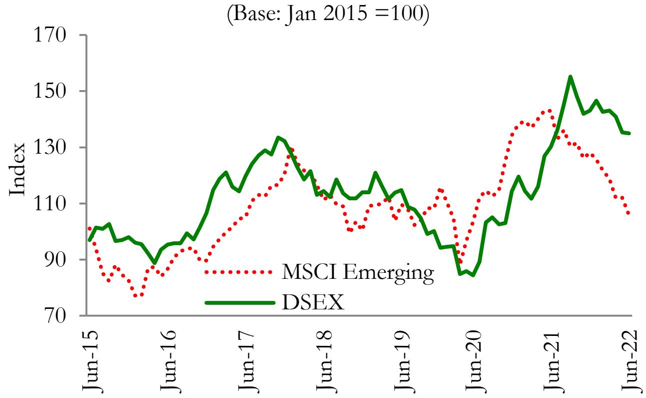
Chart 26: DSEX Index and Turnover



Source: Dhaka Stock Exchange

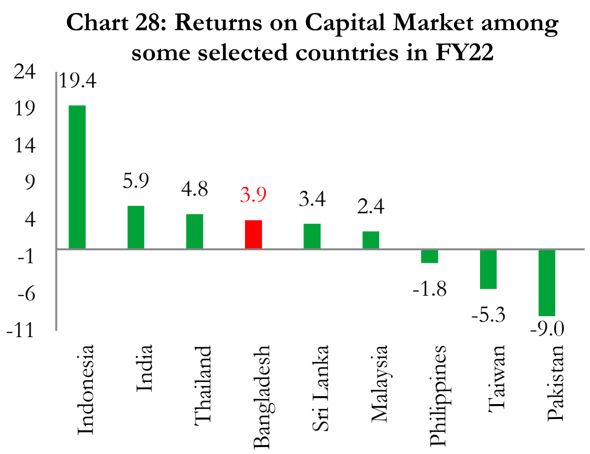
Chart 27: Synchronization of DSE with Global Markets

(Base: Jan 2015 =100)



Sources: Dhaka Stock Exchange and www.msci.com

The global capital markets index (MSCI emerging market) witnessed a similar pattern with a solid rising trajectory during FY21 followed by a declining trend since June 2021 caused by lingering fears of rising prices and slowing economic growth prospects originating from the Russia-Ukraine war (Chart 27). Recent lockdowns in China owing to their zero COVID policy and the possibility of tighter US monetary policy have induced additional pressure on the global capital markets. While the global markets, as observed by MSCI, seem to have started correcting themselves during June-December 2021, the DSE index of Bangladesh increased significantly. Bangladesh's capital market scored the fourth highest market returns in June 2021-May 2022 among some selected peer countries (Chart 28).



Sources: Dhaka Stock exchange and www.investing.com

Bangladesh Securities and Exchange Commission (BSEC) took many initiatives to restore the investors' confidence in the capital market. The banks were allowed to invest in the private green Sukuk bonds from the capital market special fund amounting to BDT 2 billion. The BSEC organized several road shows in developed countries such as USA, UK, Switzerland, and UAE to attract foreign investors. Moreover, BSEC has revised margin loan rules for category-changing stocks, reduced the lower limit of the circuit breaker, raised the investment ceiling for institutional investors, and allowed the Investment Corporation of Bangladesh (ICB) to use the one billion Taka capital market stabilization fund. The BSEC also successfully launched a separate platform, DSMEX, for the SME market, which helped small companies grow without any interest payment in their early stages.

The government has also taken several initiatives to increase the flow of funds and institutional participation in the capital market. The government has already decided to introduce a universal pension system in the next fiscal year, which is expected to improve the liquidity condition of the capital market. However, further improvement of liquidity conditions in the capital market will highly depend on expanding its investors' base and creating more institutional arrangements, promoting and activating corporate bonds, and enhancing surveillance activities of the BSEC for preserving investors' interests and confidence.

Funding long-term investment projects through the capital market is crucial for sustainability, an overriding goal for many corporations and institutions. Funding long-term projects through banks might cause significant financial instability due to maturity mismatches. A well-developed and stable capital market with solid investors' confidence is required to support long-term investment projects efficiently. In this respect, the capital market in Bangladesh is in a nascent state and will have to go a long way. BB, in coordination with other regulatory bodies, including the government, always favors a growing, well-developed, and stable capital market. Keeping the distinct objectives of money and the capital markets in mind, BB continues its policy support for the overall development of the economy's assets market. BB extends many policy supports to the capital market through the commercial banks and NBFIs from time to time.

Notable initiatives, but not limited to, taken by BB for stimulating the capital market during the times of need are: policy for adjustment of the overinvested amount made by the banks without reducing their portfolios for compliance with the Bank Company Act (BCA) 1991; policy for portfolio based provision against diminishing value of investment instead of netting off individual instrument's gain and loss;

special provisioning policy for investment in mutual funds; special regulatory forbearance and accounting treatment for investment up to Taka 2.0 billion for each bank in the capital market; special liquidity supports for the capital market; separate policy for investment in non-listed shares and securities, etc. for the commercial banks. To improve the liquidity condition of the capital market, BB recently specified the criteria for NBFIs shares, debentures, corporate bonds, mutual fund units, loans, and fees to be considered as stock market investments (DFIM Circular No. 03: 15 February 2022). To increase investment quality and reduce portfolio risks, investors can now transact government securities such as treasury bills and bonds through their BO accounts. This may be considered a significant step towards creating a vibrant bond market and increasing the market capital to a large extent. BB remains committed to the growth of the capital market to ensure the much-needed transition of long-term financing sources away from the banking system to the capital market, supporting the country's long-term development objectives.

4. Monetary Policy Stance, Monetary and Credit Programs and Possible Policy Options for FY23

4.1. Monetary Policy Stance

The world economy is undergoing various challenges due to the COVID-19 pandemic and the Russia-Ukraine conflict. As a result of the pandemic and associated expansionary policies, international markets are experiencing unprecedented price pressure. The Russia-Ukraine war has aggravated the situation, rapidly increasing commodity prices and international transportation costs because of elevated freight demand during the recovery period. Bangladesh is no exception, facing mounting inflationary and exchange rate pressure through the international trade channel. At this juncture, BB is announcing its monetary policy stance through this Monetary Policy Statement (MPS) for FY23 amid sudden nasty floods in the country's North and Northeastern regions.

BB examines the current macroeconomic condition, including the money market, foreign exchange market, capital market prices, and real sector developments, along with their near-term outlook before resorting to its monetary policy stance and credit policies for FY23. It is observed that Bangladesh economy remains buoyant with predominant price and exchange rate pressures in FY22. Available data show that the 12-month average CPI inflation rate reached 5.99 percent in May 2022, while food and non-food inflation rates were 5.81 percent and 6.27 percent, respectively. The exchange rate has depreciated by around 9 percent till 29 June 2022 over the end of June 2021, creating further pressure on domestic commodity prices.

BB's forthcoming monetary policy rightly emphasizes containing inflationary pressure while supporting investment and employment-generating activities. The monetary policy for FY23 intends to discourage unproductive financial flows to tame the demand side pressures without circumventing the required flow of funds to the productive sectors easing supply-side conditions and supporting the country's long-term growth aspirations. The BB's monetary and credit programs for FY23 are designed to ensure adequate money and credit flows to support 7.50 percent real GDP growth while keeping inflation within the desired level.

Therefore, BB's monetary and credit programs for FY23 will pursue a cautious policy stance with a tightening bias to contain inflation and exchange rate pressures while supporting the economic recovery process, ensuring the necessary flow of funds to the economy's productive and employment generating activities for long-term economic growth.

As per the current framework, BB's monetary policy is formulated using reserve money (RM) and broad money (M2) as operating and intermediate targets, respectively, to achieve the ultimate goals of price stability and output growth. The broad money (M2) growth is set based on the equation of exchange that accounts for the necessary adjustment in the change of income velocity of money (money velocity) and the target of nominal GDP growth comprising the summation of targeted real GDP growth and inflation ceiling.

The money velocity in Bangladesh upturned in FY22 after a fall in two consecutive fiscal years - FY20 and FY21. Given the rising trend of internal and external demand, money velocity will continue to rise in FY23, well supported by the opening of Padma Bridge connectivity. Since the change in money velocity is positive, the M2 growth ceiling would be smaller than the nominal GDP growth target for FY23. To maintain the M2 growth ceiling, BB sets the reserve money (RM) growth target considering a stable movement of the money multiplier. BB will employ existing monetary policy instruments like the repo and reverse repo rates, cash reserve ratio, statutory liquidity ratio, and advance/investment deposit ratio to control the movement of reserve money, if necessary. BB will also leverage its available open market operation tools like the sale/purchase of government securities and foreign currencies, issuing BB bills, and expanding refinance facilities to keep the RM growth within the target. By controlling RM growth, BB will try to keep the M2 growth within the programmed path to achieve the ultimate goal of price stability and economic growth. BB will ensure the quality and quantity of credit for productive economic activities to achieve the target GDP growth.

As we continue moving through the fourth industrial revolution (4IR), with the evolving financial products and derivatives, advancing information technology, and digitization amid changing macroeconomic landscape, using the current monetary targeting framework may not be appropriate. Bangladesh is set for LDC graduation in FY26, requiring an economic status befitting modern monetary policy framework. Accordingly, BB has already taken an initiative to modernize its monetary policy framework to a flexible interest rate targeting with the IMF's technical assistance. It was withheld in FY20 due to the unprecedented COVID-19 pandemic. As the economy returns to its normal growth trajectory, the new policy framework may be adopted subject to necessary capacity development in the Bank.

4.2. Monetary and Credit Programs

The half-yearly movements of key monetary and credit aggregates, along with their programs set for FY23, are shown in Table 3. The broad money growth ceiling is set at 12.1 percent, consistent with the real GDP growth target and CPI-based average inflation ceiling, allowing some adjustment for the expected change in the money velocity. Considering the necessary outlays for ongoing mega projects and the COVID-19 related stimulus packages of the government, the public sector credit growth ceiling is set at 36.3 percent for FY23. The government's budgetary target of borrowing Tk.1,063 billion from the banking system is duly considered in measuring the public sector credit growth limit. The private sector credit growth target, on the other hand, is set at 14.1 percent for FY23, a bit higher than the actual growth in FY22 and lower than the last year's ceiling of 14.8 percent, commensurate with some tightening bias while supporting investment, employment and growth as well. Based on the public and private sector credit expansion, the domestic credit growth is set at 18.2 percent in FY23.

Table 3: Key Monetary and Credit Aggregates

(y-o-y growth in %)

Item	Actual			Program	
	Jun-21	Dec-21	Jun-22^e	Dec-22	Jun-23
Net Foreign Assets*	27.7	2.8	-12.5	-10.7	-2.1
Net Domestic Assets	9.3	12.0	16.9	16.7	16.0
Domestic Credit	10.4	12.4	15.6	16.7	18.2
Credit to the public sector@	21.7	21.9	27.9	32.3	36.3
Credit to the private sector	8.3	10.7	13.1	13.6	14.1
Broad money	**13.6**	**9.6**	**9.1**	**10.0**	**12.1**
Reserve money	**22.4**	**6.5**	**0.0**	**9.0**	**9.0**
Money multiplier	4.49	5.01	4.90	5.06	5.04

*Source: Bangladesh Bank.**Calculated using the constant exchange rates of 27 June 2022. e = estimate. @ amount of net credit to government in FY21 and FY22 were Tk. 420 billion and Tk. 600 billion (estimate) respectively, and for FY23, it is assumed to be Tk. 1063 billion as per the national budget.

The target of the net foreign assets growth of the banking system for FY23 is set to be in the negative territory (-2.1 percent) as the overall BoP position is expected to remain deficit despite predicted improved inflows of inward remittances. The current skyrocketing import and export growths are expected to be moderated significantly due to the base effect and cooling down of internal and external demand in the backdrop of possible economic recession in the advanced economies.

4.3. Possible Policy Options

The overall liquidity condition in the money market has gradually become tighter in recent months with the improving pandemic situation and the revival of pent-up economic activities. The interbank call money rate movement is on the rising side partly due to the recent upward revision of the policy rate (repo rate). Notwithstanding the tight liquidity situation, the economy is facing strapping inflation and exchange rate pressure mainly due to commodity price hikes in the global market. The ongoing inflationary pressure is of cost-push in nature, leaving a narrow room for the demand side to deal with the situation. In this circumstance, there is a need for calibrated monetary policy measures by addressing both the demand side and supply factors to keep inflation expectations anchored and restrain escalating price and exchange rate pressures. In this regard, BB is considering the following policy options for FY23:

1. BB has decided to increase its policy rate (the repo rate) by 50 basis points to 5.50 percent from 5.00 percent to manage the demand side pressures. Besides, BB's employment, investment, and output augmenting policy initiatives through ensuring the required flow of funds to the priority sectors, such as agriculture, CMSMEs, manufacturing, services, etc., will be continued to promote supply-side activities.
2. BB's monetary policy also seeks to promote import-substituting economic activities and dissuade imports of luxury goods, fruits, non-cereal foods, canned and processed foods, etc., to reduce exchange rate depreciating pressure, protect foreign exchange reserves, and control inflation.
    - ✓ *In this respect, BB will introduce a new refinance line of credit for import-substituting products to minimize import dependency and save valuable foreign exchange reserves.*
    - ✓ *The LC margins for luxury goods, fruits, non-cereal foods, canned and processed foods, etc., items will be increased comprehensively to discourage their imports.*

BB will continue its support for implementing the government's ongoing stimulus packages alongside its refinancing schemes to face the COVID-19 adversities. In this context, BB may consider adopting the following policy options for enhancing new investment and employment-generating opportunities:

- Continuation of ongoing refinance policy focusing on micro, small and labor-intensive medium enterprises.
- Creation of a new line of startup funds supporting import-substituting initiatives, particularly the industrial raw materials like raw cotton, yarn, textile articles, fertilizer, etc.
- Initiation of new low-cost refinance schemes to enhance the production of local essential food items like wheat, maize, soybean, mustered, onion, etc.
- Expansion of the credit guarantee scheme to expedite CMSMEs financing, particularly towards the light engineering, leather & leather products, agro-based industry like fresh juice & vegetables, cooked & semi-cooked food items, canned juice, dairy & poultry, livestock, and fisheries.
- Instruction to the banks and non-bank financial institutions to open technology-driven sub-branch in the remote and rural areas to create quality jobs and strengthen financial inclusion.
- Under the current tight money market condition with the increased cost of funds amid higher inflationary and exchange rate pressures, keeping the lending rate cap fixed at 9.0 % might pose a challenge in the near future as it will narrow down the interest rate spread to some extent. However, with the rapid development of financial technology, the improved efficiency of banking operations would contribute to scaling down the banks' operating costs. At present (as

of May 2022), the weighted average lending rates for all banks stood at 7.08%, meaning that the 9.0 % lending cap still has enough space for usual lending activities. Nonetheless, BB will remain watchful of this lending cap issue and take policy actions if necessary.

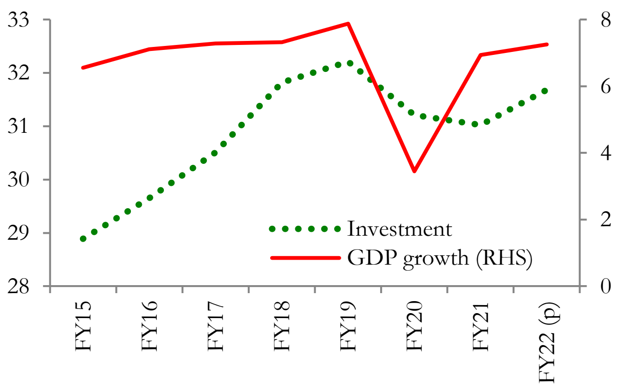
- Moreover, the government is cautious about keeping inflation at a tolerable level by taking steps such as reducing import tax on necessary items and providing essential daily goods at low costs, especially for the low-income group all over the country, through open market sales (OMS).

5. Policy Supports toward Investment and Employment Creation

Bangladesh Bank has been playing a pivotal role with various supportive financial sector policies, backing the government's stimulus packages to counteract the pandemic-induced economic disruptions. BB emphasized ensuring enough loanable funds at low costs for banks and NBFIs to recover the economy from the pandemic-related economic adversities. A total of 28 stimulus packages amounting to about BDT 2.0 trillion (of which BB is implementing 10 stimulus packages amounting to nearly BDT 1.7 trillion) have supported the affected businesses to continue their activities, contributing to investment and employment.

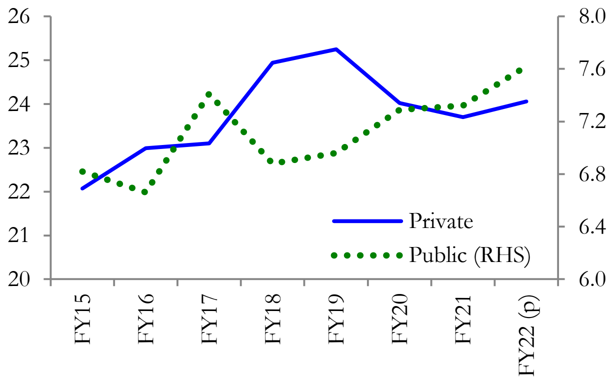
Chart 29 shows that investment as a percent of GDP increased gradually from 28.81 percent in FY15 to 32.21 percent in FY19. Following the COVID-19 period, the investment-GDP ratio decreased slightly to 31.31 percent in FY20 and 31.02 percent in FY21. As the economy revived from the pandemic severity, the ratio rebounded, reaching closer to the pre-pandemic level at 31.68 percent in FY22.

Chart 29: Investment (% of GDP) and GDP Growth



Source: Bangladesh Bureau of Statistics. p = provisional

Chart 30: Private and Public Investment (% of GDP)



Source: Bangladesh Bureau of Statistics. p = provisional

Chart 30 shows that public investment as a percent of GDP had an increasing trend in recent years, including the COVID-19 periods, reflecting mainly the implementation of the government's mega projects. On the other hand, private investment as a percent of GDP declined in the last two years of the COVID-19 period though it started to recover in FY22. The implementation of the government's ongoing mega projects, including the recent opening of the Padma Bridge, is expected to boost private investment and employment, beefing up the country’s GDP.

BB continued to extend several liquidity enhancement measures in FY22 to recover the investment momentum amid recurrent waves of the pandemic. Softened loan classification rules, allowing loan rescheduling and one-time exit facility, especially for the agriculture loans, and lowering the interest rates on agriculture and rural credit were among the key measures contributing to investment recovery and employment generation. BB's policies equally focused on retention and creation of new employment, supporting jobless people who suddenly lost their jobs during the pandemic period in the last two years. BB directly helped 3.8 million laborers and staff, including 53 percent of women workers in the export-oriented sectors, through special salary packages.

BB set BDT 283.91 billion credit target for the agriculture sector under the Agricultural and Rural Credit Policy and Program for FY22. BB introduced a refinance scheme directly benefitting about 318,848 farmers as of May 2022. BB also introduced several revolving refinance schemes, prioritizing investment in the CMSMEs and agriculture sectors. A total of 161,250 CMSMEs enterprises benefitted from these refinance schemes implemented in two phases until May 2022. Similarly, Export Development Fund (EDF) and refinance schemes for low-income professionals, pre-shipment credit, and the tourism sector have benefitted millions of employees in large industry and service sectors. After completing the first phase of stimulus packages, BB enhanced the allocation of some special packages related to large, small and medium sector businesses to support the uncovered borrowers under the first phase.

BB established various types of refinancing schemes aligned with the government-declared stimulus packages. The key refinance schemes and their progress status as of the end May 2022 are briefly listed below:

- A refinance scheme of BDT 150 billion was allocated to provide working capital loan/investment facilities for the affected large industry and service sectors. A total of 4562 industries received the loans, and the implementation rate based on the received loan demand from banks was 93.35 percent;
- A revolving refinances scheme of BDT 100 billion was introduced to provide loans for the affected CMSMEs sector entrepreneurs, with 64.00 percent implementation of the project;
- A refinance scheme of BDT 80 billion was provided as working capital for the agriculture sector, where 81.89 percent of the first phase scheme was distributed to 185,336 farmers/agriculture farms;
- A revolving refinance fund of BDT 50 billion was provided as a pre-shipment credit facility to export-oriented industries, with an implementation rate of 14.37 percent;
- A refinance scheme of BDT 30 billion for low-income professionals, farmers, and marginal/small business owners registered 97.20 percent implementation based on the demand received from banks;

- A refinancing scheme worth BDT 5 billion was devised to pay salaries-allowances to tourism sector workers in hotels, motels, and theme parks;
- A new Export Development Fund (EDF) of USD 3.5 billion for local exporters recorded 99.57 percent implementation; and
- A refinance scheme of BDT 5 billion for returnee expats who lost their jobs due to the COVID-19 pandemic and other reasons was introduced to engage them in income-generating activities.

Besides, three refinance schemes, amounting to BDT 14 billion, BDT 15 billion, and BDT 1 billion, were provided to agro-based product processing industries in the rural areas, small enterprises, and new entrepreneurs in the CMSEs. A refinance scheme of BDT 5 billion for startup funds was introduced to promote new entrepreneurs and encourage self-employment opportunities. BB provided necessary support to the government for opening new accounts for the targeted customers. It also enhanced the effectiveness of various payment platforms, smoothening the implementation of government social safety net programs.

A refinance scheme of BDT 10 billion was devised for technology development and up-gradation, expanding financial inclusion. BB introduced EMV compliant new QR standard named 'Bangla QR' and a new and easy 'Personal Retail Account' for on boarding micro and nano merchants with minimum document requirements. Besides, BB has continued its other policy supports for the financial sector, such as affordable and reliable financial services, especially digital payments and credit, raising awareness of financial education and financial inclusion, especially for women. The RTGS channel was introduced for all government VAT and Tax payments at the time of import to ensure easy, online, and transparent revenue collection. BB provided support to bring nearly 90 percent of all G2P transactions into the digital format.

The vibrancy in the online purchase and payment activities continued even after the COVID-19 related restrictions were withdrawn. It is also observed that digital purchase practices expose the consumers to certain risks, such as not receiving goods even after the advance payments. BB introduced escrow arrangements for online purchases from marketplaces against advance payments to mitigate such risks. The initiative restored discipline in the E-commerce market.

6. Near-term Macroeconomic Challenges

Looking ahead, solid economic growth momentum is expected to continue hinging upon ongoing growth supportive fiscal and monetary policies, with growing internal and external demand, improving COVID-19 situation, and rising business confidence. However, headwinds to this growth and inflation outlook could emerge from a number of factors, such as the unfavorable outcomes of the Russia-Ukraine war, the continuation of soaring global commodity and energy prices, and sustained widening current account deficits with the depreciation pressure on exchange rate.

Since Russia and Ukraine are critical suppliers of several commodities, such as wheat, maize, sunflower oil, corn, fertilizers, and rare earth minerals, including oil, gas, and metals, supply disruptions in these commodities may escalate their prices in the global markets. Given the escalated global commodity prices, the government's fuel and fertilizer subsidies will increase substantially, creating pressure on fiscal management. The pass-through of soaring global commodity prices and the exchange rate depreciation could impair domestic price stability through import channels. Apart from containing inflation at tolerable levels, keeping import payments manageable and maintaining stability in the foreign exchange markets would be a critical challenge for the economy.

Given the shallow trade linkage of Bangladesh with Russia and Ukraine, the direct adverse impact of the war is expected to be limited. However, if the war lingers and propagates in neighboring European countries, which happen to be the major destinations of Bangladesh's exports and sources of remittance, the effects of the war could be non-trivial. In addition, the climate and environment-related vulnerabilities, like the recent sudden floods in the North and Northeastern part of the country, could have some headwinds on the country's overall price stability and growth prospect.

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