Monetary Policy Statement

July-December 2024

Bangladesh Bank

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Acronyms and Abbreviations

Act.	Actual
ALS	Assured Liquidity Support
AMC	Asset Management Company
App	Appreciation
AD	Authorised Dealer
ADR	Alternative Dispute Resolution
AR	Assured Repo
ALS	Assured Liquidity Support
AMC	Asset Management Company
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladesh Taka
BoP	Balance of Payments
BPM6	Balance of Payments and International Investment Position Manual – Sixth Edition
BSEC	Bangladesh Securities and Exchange Commission
CAB	Current Account Balance
CEO	Chief Executive Officer
CMSF	Capital Market Stabilization Fund
CMSMEs	Cottage, Micro, Small and Medium Enterprises
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DBU	Domestic Banking Units
Dep	Depreciation
ECB	European Central Bank
E-Money	Electronic Money
FY	Fiscal Year
Fed	Federal Reserve
FMI	Financial Market Infrastructure
FoB	Free on Board
GDP	Gross Domestic Product
H1	First Half
H2	Second Half
HFT	Held for Trading
IBLF	Islamic Banks Liquidity Facility
IMF	International Monetary Fund
IRC	Interest Rate Corridor
LC	Letter of Credit
L.H.S	Left Hand Side
LSR	Liquidity Support against claims of Remittance

M2	Broad Money
MD	Managing Director
MFS	Mobile Financial Service
MLS	Mudarabah Liquidity Support
MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
NBFIs	Non-Bank Financial Institutions
NEER	Nominal Effective Exchange Rate
NDA	Net Domestic Asset
NFA	Net Foreign Asset
NFCD	Non-Resident Foreign Currency Deposit
NPL	Non-Performing Loan
NRB	Non-Resident Bangladeshis
NSCs	National Savings Certificates
OBOs	Offshore Banking Operations
OMO	Open Market Operation
PCA	Prompt Corrective Action
PCBs	Private Commercial Banks
Proj.	Projection
QR	Quick Response
RBS	Risk-Based Supervision
Repo	Repurchase agreement
REER	Real Effective Exchange Rate
REIT	Real Estate Investment Trust
RFCD	Resident Foreign Currency Deposit
R.H.S	Right Hand Side
RM	Reserve Money
RMG	Ready-Made Garments
SDF	Standing Deposit Facility
SLF	Standing Lending Facility
SLR	Statutory Liquidity Ratio
SLS	Special Liquidity Support
SMART	Six-months Moving Average Rate of Treasury bills
SOCBs	State-Owned Commercial Banks
T-bills	Treasury Bills
T-bonds	Treasury Bonds
UK	United Kingdom
US	United States
USA	United States of America
USD	US Dollar
Y-o-Y	Year over Year

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Executive Summary

This MPS assessed the current macroeconomic situation, challenges, and outlook from domestic and global perspectives. The global economic outlook for 2024 and 2025 is optimistic, with major economies avoiding severe downturns and reducing inflation without increasing unemployment. Headline CPI inflation is expected to align with central bank targets, barring significant shocks in food and energy prices. However, geopolitical tensions and potential supply chain disruptions remain concerns. As global inflation continues to fall, many central banks are anticipated to lower policy rates this year.

Domestically, the current trends in inflation, monetary aggregates, liquidity, interest rates, foreign exchange reserves, and exchange rate developments were reviewed following three major recent policy decisions: the introduction of a crawling peg system with a market-driven mid-rate, the removal of the interest rate cap under SMART, and the increase in policy rates. The MPC noted that Bangladesh's economy has begun to rebound. While the upward trend in inflation has moderated recently, it remains stubbornly high. The crawling peg system has stabilized the exchange rate and contributed to building foreign exchange reserves. Amid tight liquidity conditions, all interest rates—including those in the money market, deposits, lending, and yields on Treasury bills and bonds—have increased substantially, indicating effective policy transmission. Most monetary aggregates have followed the projected paths. After careful review, the MPC concluded that the current monetary policy tightening stance should be maintained until inflation reaches a tolerable level.

Inflation control remains a top priority for Bangladesh Bank (BB). BB has maintained a contractionary monetary policy for over a year, significantly increasing the policy rate and avoiding new high-powered money issuance for government spending. The government supports these efforts by reducing tariffs on selected commodities, expanding social protection schemes like Open Market Sales (OMS), and introducing the Family Card. BB has also instructed banks to maintain minimum cash margins on import L/Cs for essential, high-demand products. Despite some moderation, CPI inflation remained above 9 percent throughout H2FY24. However, coordinated policy initiatives and global commodity price temperance are expected to continue reducing CPI inflation in the coming months. BB aims to bring down inflation around 6.5 percent at the end of FY25.

> *For the first half of FY25, BB will maintain a cautiously tight monetary policy stance, keeping the policy (Repo) rate at 8.50 percent, the SDF rate at 7.0 percent, and the SLF rate at 10.0 percent unchanged. Additionally, BB will continue quantitative tightening by streamlining Open Market Operations, ceasing currency swaps among banks and BB, and refraining from creating new money for government spending. However, BB remains prepared to take necessary policy actions if required.*

Since mid-2022, the Taka-Dollar exchange rates have faced depreciation pressures due to external sector challenges. In response, BB has allowed market forces to have greater influence over the exchange rate, simplifying the framework and enhancing transparency. To further stabilize the exchange rate and move towards a more flexible system, BB introduced a crawling peg system on 8 May 2024. This system links the Taka's value to a currency basket aligned with the Real Effective Exchange Rate (REER) Index, reducing market volatility and narrowing the gap between formal and informal market exchange rates. Additionally, recent foreign exchange policy liberalization initiatives, such as the RFCD, NFCD, and Offshore Banking Act 2024, are expected to bolster foreign exchange inflows, alleviate exchange rate pressure, and support rebuilding foreign exchange reserves.

As the Forex market is showing reasonable stability and transactions are taking place within predefined bands, BB decides to keep the crawling peg mid-rate unchanged at Tk. 117.00 per USD. BB will also enhance import liberalization by removing LC margin requirements for all products except luxury goods like cars, fruits, flowers, cosmetics, and similar items, with margins determined based on bank-customer relationships. The crawling peg system is a transitional measure towards a fully flexible, market-based exchange rate system, aiming to stabilize exchange rate movements while preparing for broader market liberalization.

Bangladesh faces several immediate macroeconomic issues that threaten its economic stability and growth. These challenges arise from domestic and international factors, creating a complex policy environment. Persistently high inflation erodes purchasing power and real incomes, exacerbating income inequalities. Geopolitical tensions, such as the Russia-Ukraine conflict and unrest in the Middle East, disrupt global supply chains and drive up prices for essential commodities like food and energy. BB has adopted a contractionary monetary policy to manage inflation, but balancing this with economic growth remains delicate. BB will continue providing comprehensive credit support to agriculture and CMSMEs as part of its supply-side intervention policy to enhance production and support employment generation.

The Taka has depreciated significantly due to external sector challenges and high import bills, increasing import costs and risking imported inflation. BB has implemented a crawling peg system to stabilize the exchange rate, which has shown initial success but requires continuous monitoring. Potential policy rate cuts by major central banks, like the ECB and US Fed, could provide some relief. Interventions to stabilize the Taka have depleted foreign exchange reserves, crucial for economic stability and investor confidence. Remittances from exports and wage earners are vital sources of foreign exchange. Recent policy liberalizations, such as the RFCD, NFCD, and Offshore Banking Act 2024, aim to boost forex inflows and rebuild reserves.

The global economic outlook is positive, but uncertainties persist due to ongoing geopolitical tensions. Policy rate cuts in advanced economies could affect reverse capital flows and exchange rates. Fluctuations in global commodity prices, especially for food and energy, pose risks due to Bangladesh's import dependence. High Non-Performing Loans (NPLs) undermine financial stability and limit credit availability for productive investments. BB is implementing measures to reduce NPLs and improve governance within banks, emphasizing transparency, governance, and operational efficiency.

Bangladesh's near-term macroeconomic challenges include inflation, exchange rate volatility, fiscal constraints, and financial sector stability. Addressing these issues requires a multifaceted approach involving prudent monetary policy, effective fiscal management, and structural reforms. By navigating these challenges carefully, Bangladesh can sustain economic growth and enhance resilience against external shocks.

Monetary Policy Statement: H1FY25

1. Foreword

The primary goals of Bangladesh Bank's (BB) monetary policy are to maintain low and stable inflation, support sustained economic growth, and preserve the financial stability of the Bangladesh economy. The announcement of this semi-annual Monetary Policy Statement (MPS) outlines BB's monetary policy approach for the first half of FY25, coinciding with a period marked by persistent high domestic inflation and some instability in the foreign exchange market. The current monetary policy approach includes several significant reform measures aimed at addressing ongoing economic challenges. These reforms encompass the modernization of the monetary policy framework, which involves adopting more market-oriented tools and techniques for policy implementation. Additionally, the deregulation of interest rate and exchange rate regimes is intended to enhance market efficiency and flexibility, allowing for a more responsive and adaptive monetary policy.

These efforts require effective coordination with fiscal authorities and other relevant entities. The policy formulation process considers the actual economic outcomes of the second half of FY24, as well as comprehensive macroeconomic conditions and forecasts for both the global and domestic economies. This holistic approach ensures the monetary policy is well-aligned with the broader economic context. Furthermore, the policy formulation process incorporates detailed monetary and credit projections, which provide a quantitative foundation for the policy stance. Feedback, suggestions, and guidelines from a diverse range of stakeholders, including financial institutions, industry experts, and economic analysts, are also considered. These contributions are instrumental in refining the monetary policy stance and framing the monetary and credit projections for the first half of FY25.

2. Monetary Policy Outcomes in H2FY24

Bangladesh Bank (BB) implemented several initiatives during the second half of FY24 to contain sustained high inflation. These initiatives included policy interest rate hikes amounting to 200 basis points during FY24 (a cumulative increase of 350 basis points since the start of the tightening cycle in May 2022). Additionally, the policy interest rate corridor was narrowed from ±200 basis points to ±150 basis points, and the practice of devolvement of T-bills and T-bonds on BB was discontinued, considering the multiplier effect of high-powered money on inflation. The SMART-based interest rate capping was scrapped to allow the market to play its due role in determining interest rates. Consequently, the weighted average call money rate rose to 9.08 percent by June 2024 from 6.06 percent in June 2023. Similarly, the interbank average repo rate increased to 8.56 percent by June 2024, up from 6.16 percent in June 2023. Furthermore, lending and deposit rates for various financial transactions notably increased in H2FY24, while the interbank call money rate was effectively contained within the Interest Rate Corridor (IRC).

Moreover, consumer credit, a critical indicator of internal demand, saw slower growth of 12.52 percent year-over-year (YoY) in March 2024, compared to a 21.19 percent increase in the same month of the previous year. BB's regular foreign currency sales acted as an automatic quantitative tightening mechanism in the money market, significantly absorbing liquidity. The heighten of interest rates across the spectrum led to a softening of money supply and private sector credit growth between January and June 2024. As part of its supply-side intervention to support growth-enhancing activities, BB provided comprehensive support through refinancing and pre-financing lines, ensuring liberal access to low-cost credit for agriculture and rural non-farm sectors, CMSMEs (Cottage, Micro, Small, and Medium Enterprises), import substitution, and export-oriented industries.

During the second half of FY24, Bangladesh Bank (BB) implemented several measures to enhance foreign exchange supply and reduce demand to contain exchange rate pressure. These measures included:

i) **Liberalizing NRB Investment Procedures**: Simplifying and easing the process for Non-Resident Bangladeshis (NRBs) to invest in the country.

ii) **Increasing Interest Rates on Foreign Bonds**: To attract more investment, the interest rates for US Dollar Premium Bonds and US Dollar Investment Bonds should be raised.

iii) **Restricting Fund Transfers**: Abolishing the fund transfer facility from domestic banking units to offshore banking units.

iv) **Allowing BDT Depreciation**: Allowing the BDT exchange rate against the USD to depreciate significantly in line with the Real Effective Exchange Rate (REER) Index.

v) **Exempting CRR for OBUs**: Exempting banks from maintaining the Cash Reserve Ratio (CRR) with BB for their Offshore Banking Units (OBUs).

vi) **Permitting Fund Allocation by OBOs**: Permitting Offshore Banking Operations (OBOs) to allocate funds to their Domestic Banking Units (DBUs) without restrictions.

vii) **Facilitating Foreign Currency Accounts**: Facilitating the operations of Private Foreign Currency accounts and Non-Resident Foreign Currency Deposit (NFCD) accounts.

viii) **Allowing Private Foreign Currency Accounts**: Authorized Dealer (AD) branches of respective banks to open Private Foreign Currency accounts and NFCD accounts in any approved foreign currency.

ix) **Implementing a Crawling Peg Exchange Rate System**: Introducing a crawling peg exchange rate system to manage abrupt fluctuations in the exchange rate and mitigate inflationary pressure stemming from exchange rate pass-through to inflation.

Furthermore, to enhance the country's foreign exchange reserves and attract foreign investment, the Offshore Banking Act 2024 was enacted to provide a more robust framework for offshore banking activities. These comprehensive measures aimed to stabilize the exchange rate and maintain economic stability amidst challenging global and domestic economic conditions.

Analyzing the external sector reveals that export (fob) earnings, a crucial indicator of external demand, declined by 5.9 percent year-on-year (y-o-y) as per revised data for July-May of FY24. This reduction is mainly due to decreased demand from export destination countries facing high inflation and financial tightening. Meanwhile, customs-based imports (fob), a vital measure of internal demand, dropped significantly by 12.6 percent y-o-y in the same period. This decline in imports can be attributed to efforts to discourage the import of non-essential and luxury goods, enhanced monitoring mechanisms by Bangladesh Bank (BB) to ensure justified prices for opening Letters of Credit (LCs) and a notable depreciation of the Bangladesh Taka. These factors collectively contributed to the observed negative import growth. These export earnings and import payment trends highlight the broader economic challenges and adjustments within the external sector, influenced by both global economic conditions and domestic policy measures.

During the July-May period of FY24, recent revisions to export data resulted in notable shifts in the balances of the current and financial accounts. The current account recorded a deficit of USD 5.98 billion, down from USD 12.02 billion last year, while the financial account showed a surplus of USD 2.08 billion, lower than the USD 5.52 billion surplus from the previous year. However, the overall balance remained unchanged at a deficit of USD 5.88 billion for July-May FY24, a notable improvement from USD 8.80 billion in the same period last year.

Despite various fiscal and monetary policy measures to contain inflation, it remained persistently above 9.0 percent for an extended period. Based on Consumer Price Index (CPI) data, the point-to-point inflation rate marginally decreased to 9.72 percent in June 2024 from 9.74 percent in June 2023. However, the CPI-based average headline inflation increased to 9.73 percent in June 2024, up from 9.02 percent in June 2023. During this period, food inflation played a more significant role than non-food inflation in contributing to headline inflation. Furthermore, core inflation (excluding food and fuel) also declined, averaging 7.36 percent in June 2024 compared to 8.53 percent in June 2023. This inflationary episode was initially triggered by high inflation expectations, significant depreciation of the BDT against the USD, and disruptions in the domestic supply chain due to some non-economic factors. Over time, inflation became more entrenched due to second-round effects from domestic fuel and energy price adjustments.

Regarding the monetary landscape, Broad Money (M2), an indicative target of monetary policy, experienced a year-on-year growth of 8.2 percent in June 2024, falling short of the projected 9.7 percent growth for June 2024. This subdued growth in M2 is primarily attributed to a decline in the net foreign assets (NFA) of the banking system during H2FY24. Specifically, the NFA declined by 17.0 percent in June 2024, a much sharper drop than the projected negative growth of 2.4 percent for June 2024. This significant decline in NFA was driven by a substantial deficit in the overall balance of payments (BoP).

Reserve Money (RM), another key information variable of monetary policy, increased by 7.9 percent year-on-year by the end of June 2024, slightly exceeding the projected trajectory for H2FY24. This increase was due to the positive growth in net domestic assets (NDA), which partially offset the substantial negative growth in Bangladesh Bank's NFA. The negative growth in BB's NFA was primarily due to significant foreign currency sales to banks to meet the high demand for USD. In summary, most monetary and credit aggregates followed the expected trajectory during H2FY24. Table 1 and Charts 1-6 illustrate the actual growth paths of key monetary and credit aggregates compared to the projections announced in January 2024 for H2FY24.

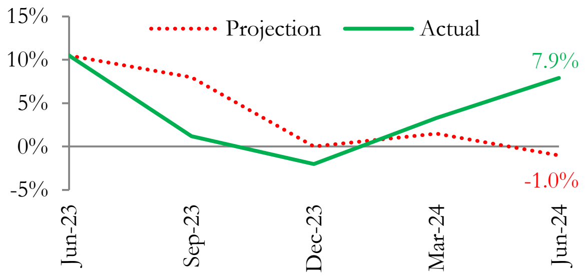
Table 1: Developments of Monetary Aggregates

(YoY % change)

Item	Jun-23	Dec-23	Jun-24	
	Act.	Act.	Proj.	Act.[P]
Broad money	**10.5**	**8.6**	**9.7**	**8.2**
Net Foreign Assets*	-23.4	-21.8	-2.4	-17.0
Net Domestic Assets	21.3	16.0	12.1	13.3
Domestic Credit	15.3	11.6	13.9	10.5
Credit to the public sector	35.8	17.9	27.8	12.8
Credit to the private sector	10.6	10.1	10.0	9.8
Reserve money	**10.5**	**-2.0**	**-1.0**	**7.9**
Money multiplier	4.93	5.13	5.46	4.94

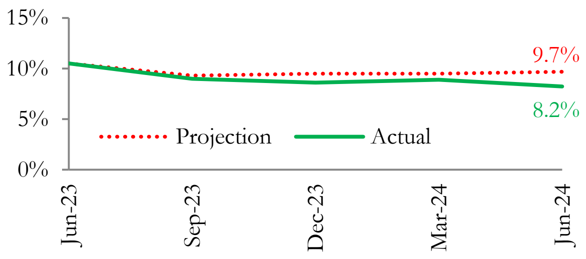
Source: Bangladesh Bank. Note:. *Calculated using the constant exchange rates of end June 2023, P = Provisional.

Chart 1: Reserve Money (RM) Growth



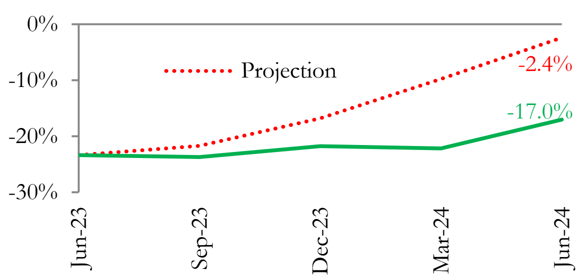
Source: Bangladesh Bank.

Chart 2: Broad Money (M2) Growth



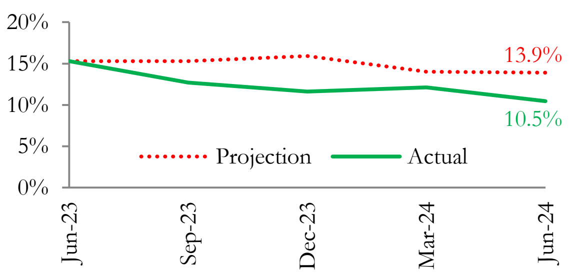
Source: Bangladesh Bank.

Chart 3: Net Foreign Assets (NFA) Growth



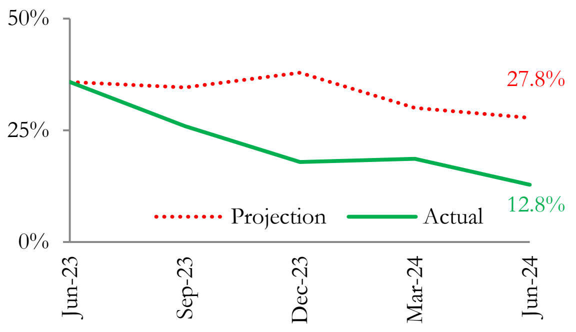
Source: Bangladesh Bank.

Chart 4: Domestic Credit Growth



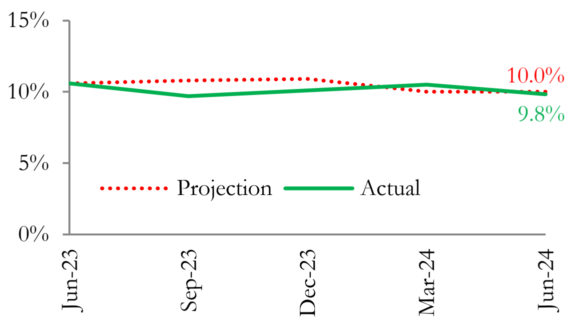
Source: Bangladesh Bank.

Chart 5: Public Sector Credit Growth



Source: Bangladesh Bank.

Chart 6: Private Sector Credit Growth



Source: Bangladesh Bank.

During the second half of FY24, the credit growth in both private and public sectors, which reflects the national investment landscape, showed divergent trends. Private sector credit expanded by 9.8 percent by the end of June 2024, closely aligning with the projected growth rate of 10.0 percent for June 2024 (Chart 6), despite facing higher borrowing costs due to implementation of contractionary monetary policy as well as tight liquidity conditions. In contrast, public sector credit grew by 12.8 percent in June 2024, significantly below the projected growth rate of 27.8 percent for June 2024 (Chart 5). This subdued growth in public sector credit indicates reduced demand from the government, which has been selectively allocating funds to priority projects as part of austerity measures. Overall, domestic credit dynamics in FY24 remained below projections, largely driven by robust growth in private sector credit and moderated expansion in public sector credit (Chart 4).

According to the latest data, the Government's net credit from the banking system in FY24 amounted to Tk. 94,281.8 crore, which is 71.2 percent of the bank borrowing target of Tk. 1,32,395 crore. During this period, the Government borrowed a net amount of Tk. 1,00,738.5 crore from scheduled banks, while it made a net repayment of Tk. 6,456.7 crore to Bangladesh Bank (BB). With BB ceasing devolvement, the Government's net credit now predominantly relies on scheduled banks. At the end of June 2023, the outstanding amount of the devolved facility stood at Tk. 133,895.85 crore, with around Tk. 52,000 crore already adjusted since the discontinuation of devolvement, indicating that no new money was created by BB to finance government spending.

From July to May of FY24, the outstanding value of National Savings Certificates (NSCs) fell by Tk. -17,743 crore, a significant decline compared to the Tk. 3,029 crore decrease was recorded during the same period in FY23. This drop indicates that repayments outpaced sales, suggesting that some NSCs were redeemed through alternative sources. Meanwhile, net foreign financing totaled Tk. 57,133 crore during July-May of FY24, up from Tk. 53,294crore in the same period of the previous fiscal year.

3. Global and Local Contexts of Monetary Policy for H1FY25

3.1 Global Context: Growth, Inflation and Trade Environment

According to the IMF's recent World Economic Outlook (April 2024), global GDP growth, which was 3.2 percent in 2023, is projected to remain unchanged at 3.2 percent in both 2024 and 2025. This growth rate is still below the historical average, reflecting critical factors such as high borrowing costs, withdrawal of fiscal support, weak productivity growth, the Russia-Ukraine war, and increasing geopolitical and geo-economic fragmentation. For advanced economies, GDP growth is expected to rise slightly from 1.6 percent in 2023 to 1.7 percent in 2024 and 1.8 percent in 2025, driven by strong growth momentum in the United States and weaker-than-expected expansion in the euro area.

Emerging markets and developing economies are projected to experience a slight slowdown, with growth decreasing from 4.3 percent in 2023 to 4.2 percent in both 2024 and 2025, primarily due to China's ongoing property sector crisis. However, in South Asia, Bangladesh and India are expected to maintain robust GDP growth rates exceeding 6.0 percent in 2025, as indicated in Table 2.

Table 2: Overview of Global Economic Growth

(YoY % change)

Region	Growth			
	Actual		Projection	
	2022	2023	2024	2025
World	**3.5**	**3.2**	**3.2**	**3.2**
Advanced Economies	2.6	1.6	1.7	1.8
USA	1.9	2.5	2.7	1.9
Euro Area	3.4	0.4	0.8	1.5
Other Advanced Economies	2.6	1.8	2.0	2.4
Emerging Market and Developing Economies	4.1	4.3	4.2	4.2
China	3.0	5.2	4.6	4.1
Indonesia	5.3	5.0	5.0	5.1
Vietnam	8.1	5.0	5.8	6.5
South Asia				
Bangladesh	7.1	6.0	5.7	6.6
India	7.0	7.8	6.8	6.5
Pakistan	6.2	-0.2	2.0	3.5

Source: World Economic Outlook, April 2024, International Monetary Fund.

The Asia and Pacific region showed strong resilience in 2023, contributing nearly two-thirds of global growth. This robust performance overcame several significant challenges, such as potential spillovers from China's property market correction, weak external conditions, and persistently high monetary policy rates. Although export demand in the region was generally sluggish in 2023, there is now greater optimism for export growth, primarily due to increased US import demand.

Inflation in Asia and the Pacific has eased and remains lower than in the rest of the world. This is attributed to appropriate monetary tightening, temporary price controls, and subsidies that have reduced commodity price pressures. Inflation is expected to align with central bank targets by the end of 2024 in most countries in the region. According to the Regional Economic Outlook for Asia and the Pacific (April 2024), growth in the region is projected to be 4.5 percent in 2024, down from 5.0 percent in 2023. This growth rate is expected to further ease to 4.3 percent in 2025.

Table 3: Global Inflation

(in percent)

Region	Actual		Projection	
	2022	2023	2024	2025
World	8.7	6.8	5.9	4.5
Advanced Economies	7.3	4.6	2.6	2.0
Emerging Market and Developing Economies	9.8	8.3	8.3	6.2

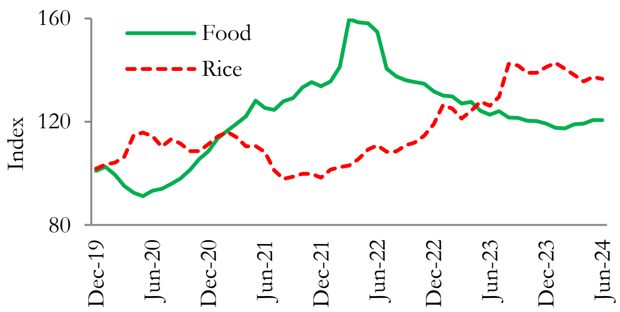
Source: World Economic Outlook, April 2024, International Monetary Fund.

Global headline inflation decreased from 8.7 percent in 2022 to 6.8 percent in 2023, primarily due to declining fuel and energy prices and monetary tightening in both advanced and emerging market economies. Projections indicate that headline inflation will further decline from 6.8 percent in 2023 to 5.9 percent in 2024 and 4.5 percent in 2025, as shown in Table 3.

Advanced economies are expected to see inflation drop from 4.6 percent in 2023 to 2.6 percent in 2024, driven by lower commodity prices and the effects of monetary policy tightening. In contrast, emerging market and developing economies are projected to maintain a relatively higher inflation rate of 8.3 percent in 2024, expected to decline to 6.2 percent in 2025. The more noticeable pace of disinflation in advanced economies reflects their robust monetary policy frameworks, effective communications, and lower susceptibility to shocks in commodity prices and exchange rates.

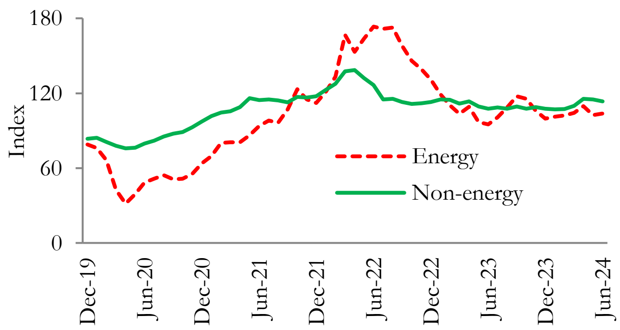
The IMF forecasts that inflation will likely exceed targets in most countries in 2024 but is expected to approach these targets by 2025 as global commodity prices and oil prices decrease. Regarding price indices, the global food price index has shown a consistent decline since July 2022, except for the rice price index, which rose from early 2022 until January 2024. The rice price index remained stable, with some fluctuations during February-June 2024 (Chart 7). The energy price index has been on a downward trend with occasional volatility in recent months, while the price index for non-energy commodities exhibited relative stability until June 2024 (Chart 8).

Chart 7: Global Food and Rice Price Indices
(Base: 2014-2016=100)



Source: Food and Agriculture Organisation.

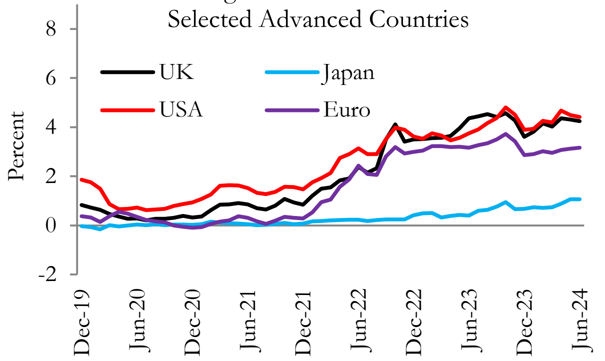
Chart 8: Commodity Price Indices
(Base: 2010=100)



Source: World Bank

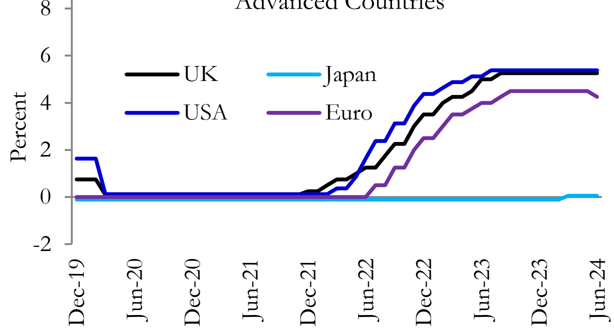
Following the pandemic, long-term interest rates have steadily risen in most advanced countries. This upward trend peaked in October 2023, reflecting central banks' proactive measures to tighten policies in response to persistent inflationary pressures (Chart 9). The Bank of Japan notably raised the upper limit of the 10-year Japanese government bond yield from 0.5 percent to above 1 percent, enabling unlimited purchases to support sustained monetary easing. The UK and Eurozone have raised policy rates from early 2022 through August 2023 to counter mounting inflationary pressures. The US followed suit, increasing its policy rate until July 2023 before pausing due to slowing inflation rates (Chart 10). However, with inflation remaining above target this year, the prospects for policy rate cuts in the US and UK have diminished. In contrast, long-term interest rates and policy rates in peer countries such as India, Pakistan, and Sri Lanka have remained mostly unchanged in recent periods (Charts 11 and 12).

Chart 9: Long-Term Interest Rates of Some Selected Advanced Countries



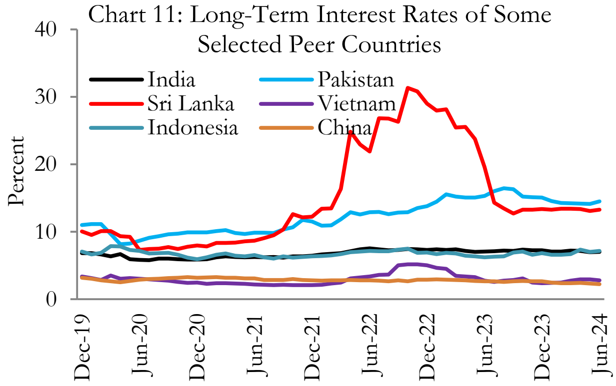
Source: Organization for Economic Co-operation and Development

Chart 10: Policy Rates of Some Selected Advanced Countries



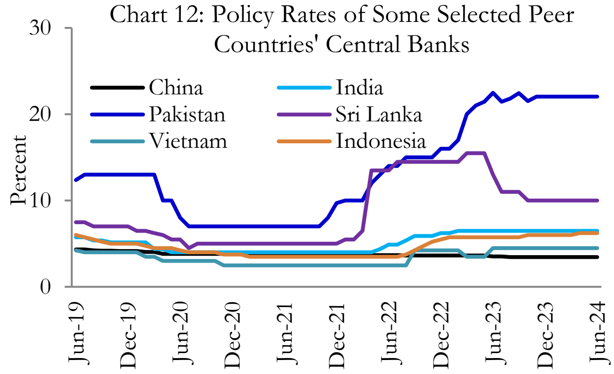
Source: Bank for International Settlements

Chart 11: Long-Term Interest Rates of Some Selected Peer Countries



Source: Organization for Economic Co-operation and Development

Chart 12: Policy Rates of Some Selected Peer Countries' Central Banks



Source: Bank for International Settlements

3.2 Local Context

3.2.1 Growth and Inflation

Bangladesh's economy has demonstrated notable resilience and strong growth in the post-pandemic era, with real GDP expanding by 6.94 percent in FY21 and 7.10 percent in FY22. The recovery was driven by significant progress in the industrial and service sectors, supported by robust domestic and international demand. However, growth moderated to 5.78 percent in FY23, influenced by persistent high inflation, substantial depreciation of the Bangladesh Taka (BDT), and challenges stemming from the Russia-Ukraine conflict, global uncertainty, and adverse conditions such as slower-than-expected growth and rising inflation in key trade partners and remittance sources. Despite these challenges, growth saw a modest rebound to 5.82 percent in FY24, as per provisional estimates from the Bangladesh Bureau of Statistics (BBS).

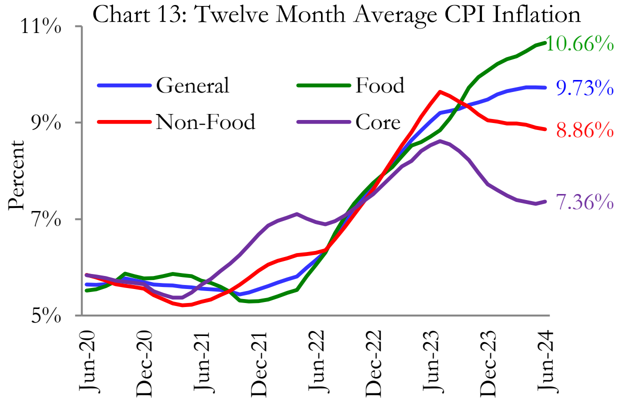
The service and agricultural sectors are expected to maintain steady growth throughout FY25, promising solid economic support. Historically, the industrial sector is one of the key contributors to domestic output and is anticipated to drive growth in the coming fiscal year. Agriculture will also play a significant role, boosted by favorable weather conditions and successful harvests. A more stable and market-oriented exchange rate environment could benefit the external sector, highlighted by a recent surge in workers' remittances and expectations of increased exports.

Looking ahead to FY25, Bangladesh's economy shows positive signs with strong industrial growth, stable service and agriculture sectors, and rising private demand. Remittance inflows and steady growth in Ready-Made Garments (RMG) exports are expected to contribute positively. The export sector, especially RMG, is set to benefit from higher global demand, while moderating global prices may benefit the import sector. The Government's proactive efforts to promote agricultural and industrial production, along with infrastructure projects, are likely to create further growth opportunities. Combined, these factors bolster the country's growth outlook. Forecasts indicate that the economy aims to regain momentum, targeting a robust growth rate of around 6.75 percent for FY25, as outlined in the national budget and supported by assessments from domestic and international agencies, including the Bangladesh Bank (BB).

While global prices have moderated due to improved supply conditions and stable food and energy prices (as shown in Chart 7 and Chart 8), Bangladesh's market has not fully adjusted. This is primarily due to rigid domestic prices, market imperfections due to lack of competition, supply-side disruptions due to non-economic factors, increases in fuel and energy costs, and significant depreciation of the local currency, countering potential benefits from lower global prices.

The CPI-based inflation surged notably in the first quarter of FY23 due to significant rises in fuel and energy prices alongside global inflationary trends. Chart 13 illustrates the 12-month average headline inflation trend covering food and non-food components since June 2020. From November 2021 onwards, there has been a consistent upward trend in the 12-month average CPI inflation. By the end of FY23, average headline inflation rose to 9.02

Chart 13: Twelve Month Average CPI Inflation



Source: Bangladesh Bureau of Statistics (BBS) percent and has remained above 9.0 percent since June 2023, reaching 9.73 percent in June 2024. Meanwhile, the 12-month average core inflation shows signs of moderation, reaching a peak of 8.62 percent in July 2023 and 7.36 percent in June 2024.

Global inflationary pressures and subsequent tightening of monetary policies worldwide drove this initial inflation surge. Internal factors such as inflexible price adjustments and persistent domestic currency depreciation also contributed. The inflationary pressures and significant price increases were observed in essential goods during FY23 and FY24. Considering the top priority of controlling inflation, the Bangladesh Bank continued its successive monetary tightening, adopting a market-based interest rate framework while ceasing the money printing through devolvement to support government spending.

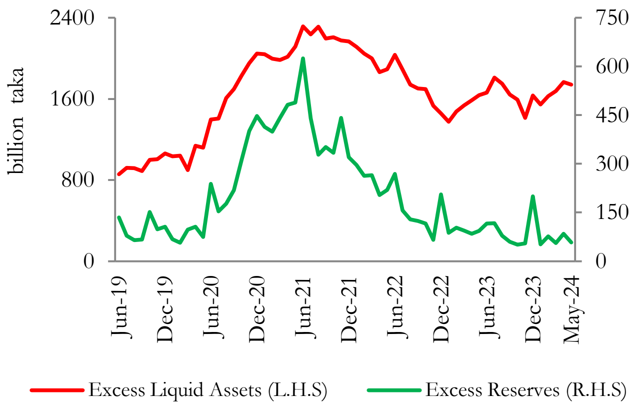
An anticipated improvement in the supply-side dynamics, supported by various supply-side interventions, is projected to lead to a decline in the inflation rate, stabilizing it at a manageable level in the coming months. Furthermore, the tightening measures implemented by BB, and relatively higher base of the CPI will bring to moderation effect on inflation. Despite these efforts, achieving the target of 6.5 percent inflation by the end of FY25 remains challenging.

3.2.2 Liquidity and Interest Rate

Bangladesh's banking sector has experienced a tight liquidity scenario since June 2021 due to substantial UDS sales by BB that absorbed a significant amount of local currency. Subsequently, implementing contractionary monetary policy to combat inflationary pressure further exerted the tight liquidity situation in the banking sector. Besides, the slower growth in deposits compared to the rapid expansion of lending, sluggish loan recovery leading to the persistent burden of non-performing loans (NPLs), increased cash holding by the public, and the government borrowing from commercial banks have also contributed to the tightening liquidity situation. Meanwhile, the liquidity situation has improved since February 2024, owing to various initiatives taken by BB. These are (i) BB reduced net sale of foreign currency in the foreign exchange market during January-June 2024 compared to July-December 2023 (ii) BB facilitated the full allotment of repo facilities to commercial banks and non-bank financial institutions based on their demand (iii) the arrangement of Dollar-Taka SWAP with commercial banks to inject liquidity in the domestic market. The movement of the liquidity scenario is depicted in Chart 14.

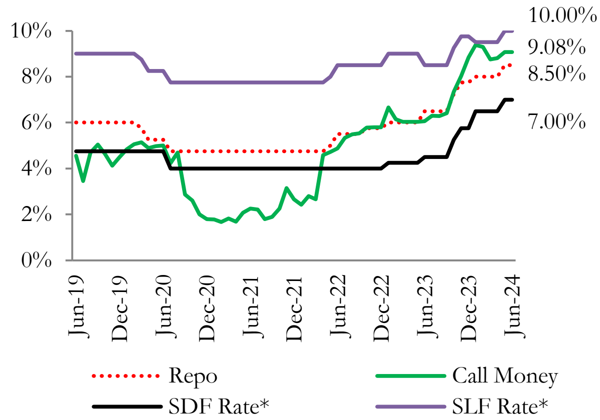
BB's contractionary monetary policy-driven tight liquidity situation in the money market has led to a gradual increase in interest rates in the money market. The weighted average call money rate experienced a significant increase, rising from 6.06 percent in June 2023 to 9.08 percent by June 2024 (Chart 15). Furthermore, the interbank repo rate also increased from 6.16 percent in June 2023 to 8.56 percent in June 2024. The movement seen in the call money rate is in line with BB's implementation of an interest rate corridor as part of its modernization of monetary policy.

Chart 14: Movement of Excess Liquid Assets



Source: Bangladesh Bank

Chart 15: Movement of Call Money and Policy Rates



Source: Bangladesh Bank, * Before 01July 2023, SDF was Reverse Repo and SLF was Special Repo .

In order to maintain stability in the financial market, BB has diligently been engaged in providing liquidity support in the local currency market through various instruments, including Repo facilities, Assured Repo (AR), Assured Liquidity Support (ALS), Liquidity Support against claims of Remittance (LSR) and Standing Lending Facilities (SLF) for conventional banks and non-bank financial institutions. BB has also continued its support for Shariah-based Islamic banks through Mudarabah Liquidity Support (MLS), Islamic Banks Liquidity Facility (IBLF), and Special Liquidity Support (SLS).

Furthermore, BB is also actively providing refinancing and pre-financing facilities specifically designed to support the growth of important sectors such as agriculture and CMSMEs (Cottage, Micro, Small, and Medium Enterprises). These strategic measures have a dual focus: ensuring enough liquidity while promoting employment opportunities & stimulating output-generating activities. The liquidity situation in the banking system has slightly improved due to several initiatives taken by BB, as explained earlier. Available data show that total excess liquidity in the banking system reached Tk. 1,74,248 crore by the end of May 2024 from Tk. 1,66,288 crore in June 2023.

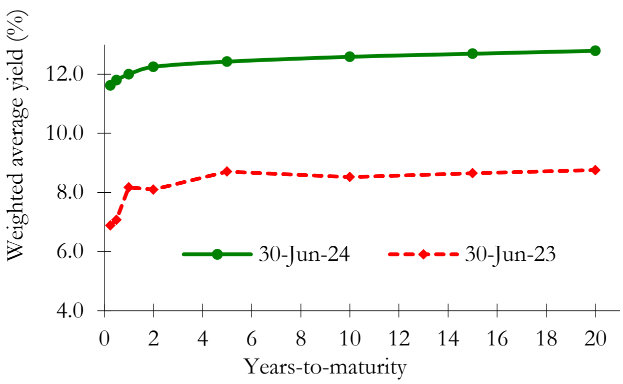
Table 4: Interest Rate Structure of the Banking Sector (%)

Category	FY22 (Jun-22)	FY23 (Jun-23)	FY24 (May-24)
Advance Rate			
Large Industries	6.92	7.23	11.35
SME	7.05	6.99	11.46
Agricultural Credit	7.26	7.48	11.31
Deposit rate			
Less than One year (FDR)	5.52	6.56	8.46
1 to 3 year (FDR)	5.76	6.71	8.12
3 year and above (FDR & DPS)	7.58	7.62	8.34

Source: Statistics Department, Bangladesh Bank

Given the current liquidity constraints in the local currency market, interest rates across various financial products have increased noticeably, notably in weighted average nominal lending and deposit rates and interest rates on short—and long-term government securities (as illustrated in Table 4 and Chart 16).

Chart 16: Yields on Government Securities



Source: Bangladesh Bank

According to the latest data, the weighted average lending rate for the large industry sector rose from 7.23 percent in June 2023 to 11.35 percent in May 2024. Lending rates for the SME and agriculture sectors also increased significantly, from 6.99 percent and 7.48 percent in June 2023 to 11.46 percent and 11.31 percent, respectively, by May 2024. Similarly, deposit rates for terms of less than one year and above three years were 8.46 percent and 8.34 percent, respectively, at the end of May 2024, up from 6.56 percent and 7.62 percent in June 2023.

Considering the dynamics of the money market and the smooth transmission of monetary policy, BB abolished the reference lending rate SMART to move towards a market-based interest rate. Now, Banks can set their interest rates based on demand and supply in the market along with the banker-customer relationship. Moreover, BB has already introduced a repo auction twice a week and provides a full allotment of funds demanded by the banks/NBFIs at the policy rate for streamlining OMOs from July 2024. Looking ahead, BB's ongoing efforts to control inflation through various policy measures, such as implementing a contractionary monetary policy and transitioning to a market-based interest rate, are expected to significantly impact real interest rates as well.

3.2.3 Overview of External Sector Developments and Outlook

Elevated global commodity prices, the spillover effects of tight monetary policies in the USA and other advanced economies, and geopolitical conflicts in the Middle East and Europe have collectively stressed Bangladesh's external sector. However, the pressure on the external position eased somewhat in the latter part of H2FY24. This relief was due to policy responses, including continued monetary and fiscal tightening, realignment of the exchange rate marked by significant depreciation, and shifting to a crawling peg exchange rate arrangement.

These developments were reflected in improving the balance of payments (BoP), increasing interbank foreign exchange transaction turnover, and recovering foreign exchange reserves by the end of FY24. According to the latest BoP statistics, the overall BoP deficit moderated in July 2023-May 2024, with the current account balance (CAB) deficit significantly reducing closer to its usual trend. However, the surplus in the financial account slightly declined during this period. The CAB deficit narrowed to USD 5.98 billion in July 2023-May 2024, down from USD 12.02 billion during the same period of the previous fiscal year (Chart 17). This improvement resulted from a sharper contraction in imports than exports and a pickup in remittances inflows due to Eid festivals and the realignment of the exchange rate.

Chart 17: Balance of Payment

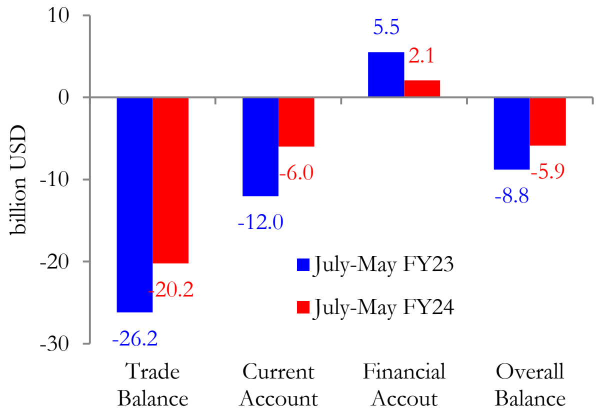
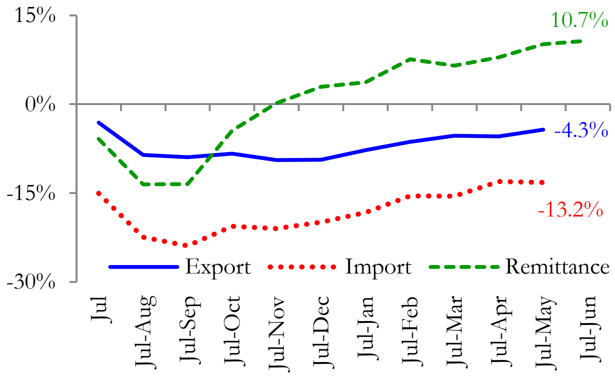


Chart 18: Cumulative Growth of Export, Import, and Remittance Inflow in FY24



High inflation in advanced economies, the war-induced economic slowdown in Europe, and surging shipping costs due to the Red Sea conflict dampened Bangladesh's exports in FY24. According to revised export data, total exports declined by 4.28 percent year-on-year to USD 40.73 billion in July 2023-May 2024, down from USD 42.55 billion in the first eleven months of FY23 (Chart 18). The export sector was heavily reliant on ready-made garments (RMG), which declined by 5.2 percent in this period. Imports continued to slow amid notable currency depreciation, several import compression measures, higher borrowing costs due to tight monetary policy, fiscal contraction, and strict monitoring of import over invoicing. However, the pace of import deceleration eased somewhat in FY24. Total imports decreased by 13.19 percent year-on-year in the July 2023-May 2024 period, slightly less than the 14.15 percent dip in the corresponding period of FY23. The downturn in imports was primarily concentrated in raw materials and capital machinery.

Supported by several policy measures and significant exchange rate realignment, the inflow of workers' remittances recovered strongly in recent months, particularly ahead of the Eid festivals. Remittance inflows grew notably by 10.66 percent in FY24 (Chart 18), providing respite for the balance of payments (BoP). Despite a historically healthy surplus, the financial account saw a decline, dwindling to USD 2.08 billion in the first eleven months of FY24 from USD 5.52 billion in the same period of FY23. This downtrend was driven largely by a reversal of net trade credit to a deficit due to delayed repatriation of export receipts and higher repayment of short-term private external borrowings amidst high global borrowing costs and economic uncertainties. Despite the deterioration of the financial account surplus, the narrowing current account deficit resulted in an overall BoP improvement. The overall BoP deficit was reduced to USD 5.88 billion in July 2023-May 2024 from a high of USD 8.80 billion in the corresponding period of FY23 (Chart 17).

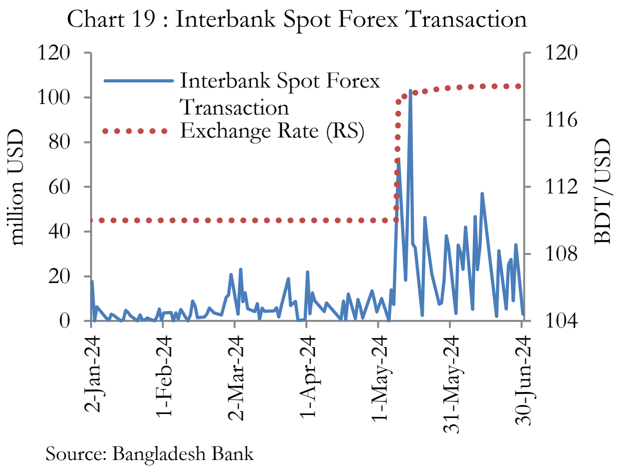
Looking ahead, the overall BoP position is expected to stabilize with ongoing monetary and fiscal contraction and exchange rate realignment. The current account balance (CAB) may continue to improve with recovering remittance inflows and further reduction of the trade deficit following exchange rate adjustments. The financial account is also likely to regain momentum with a reversal of trade credit due to the potential acceleration of export proceeds repatriation induced by necessary exchange rate corrections and a rise in foreign assistance inflows in the form of budget support and development project aids.

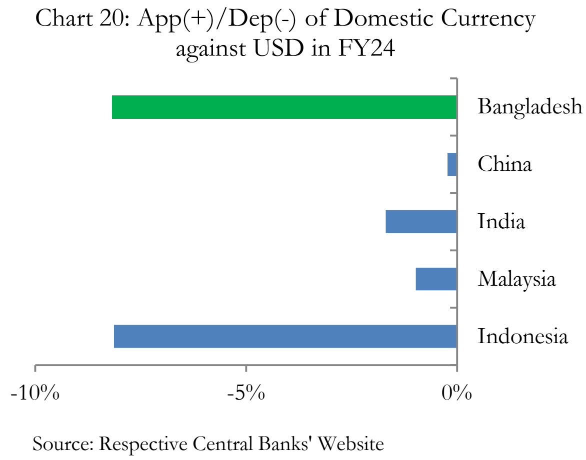
However, this outlook is fraught with uncertainties and risks tilted to the downside. Increasing repayments of the Government's foreign debt may pose additional pressure on the BoP in the future. Moreover, elevated geopolitical risks stemming from conflicts in the Middle East and Europe could hamper export demand and increase global food and energy prices, adversely affecting Bangladesh's BoP.

3.2.4. Movements of Exchange Rate and Foreign Exchange Reserve

The balance of payments (BoP) deficit exerted significant pressure on the exchange rate in FY24. Bangladesh Bank (BB) initially responded by allowing more flexibility in the exchange rate while intervening in the foreign exchange market through net sales to restore external balance and stabilize the foreign exchange market. Despite a notable 15.05 percent depreciation of the BDT against the USD from July 2022 to December 2023, liquidity mismatches in the interbank foreign exchange market and the BoP deficit persisted. This demand-supply gap in the foreign exchange market compelled BB to sell a net total of USD 9.42 billion in FY24, resulting in a decline in foreign exchange reserves. Consequently, BB's foreign exchange reserves as per BPM6 tapered from USD 24.75 billion at the end of FY23 to USD 21.78 billion at the end of FY24.

The ongoing large BoP deficit and reserve depletion necessitated greater exchange rate flexibility to clear the market. Accordingly, on 8 May 2024, BB realigned the exchange rate closer to the market-clearing level at 117 BDT/USD, allowing 5.98 percent depreciation from 110 BDT/USD, culminating in a total 8.17 percent depreciation in FY24. Simultaneously, BB adopted a crawling peg exchange rate system as an interim measure before transitioning to a fully flexible exchange rate system. The crawling peg system generally provides exchange rate stability with flexibility within a band to manage short-term shocks, helps mitigate exchange rate risks and inflation expectations, and cushions against foreign exchange reserve depletion. The introduction of this new regime led to increase in liquidity in the foreign exchange market, reflected in the turnover of interbank foreign exchange transactions (Chart 19), thereby restoring reasonable stability in the foreign exchange market.





Although the nominal exchange rate of BDT/USD depreciated by 8.17 percent in FY24, the nominal effective exchange rate (NEER) experienced a milder depreciation of 5.24 percent. This discrepancy resulted from the lesser depreciation of some major currencies in the currency basket against USD during this period. Chart 20 presents a cross-country comparison of exchange rate appreciation/depreciation of domestic currencies against the USD. The nominal depreciation effectively offset the inflation differential between Bangladesh and its major trade partners, keeping the real effective exchange rate (REER) index slightly below 100 in June 2024. This indicates that the Taka-Dollar exchange rates remained moderately undervalued, with no significant appreciation or depreciation pressure on the nominal exchange rate.

3.2.5 Capital and Bond Market

The Government's ongoing mega projects and public-private partnership investments in strategic sectors like energy, power, and transportation highlight the need for a well-developed capital market. In collaboration with BB and other regulatory authorities, the Bangladesh Securities and Exchange Commission (BSEC) is committed to developing the country's capital and bond markets.

In the secondary market, 241 government treasury bonds were actively traded until May 2024, marking a significant step in bond market development. BB introduced the Financial Market Infrastructure (FMI) system on 2 June 2024 to further enhance the secondary market for government securities. This system aims to improve monetary policy transmission by offering more efficient liquidity and buy-sell options for primary dealers alongside repo, standing liquidity, and standing deposit facilities.

The Government of Bangladesh has raised Tk. 18,000 crore through three investment sukuk in recent years, BB plans to issue a fourth Ijara sukuk with a five-year duration and a nominal value of Tk. 1000 crore. This Sukuk can be used by banks and NBFIs as part of their statutory liquidity reserve (SLR), allowing Islamic banks to contribute actively to monetary management.

A new yield curve for treasury bonds has been introduced to facilitate a dynamic secondary market. It incorporates market-oriented valuations based on actual transactions and daily two-way price quotes from primary dealers. Banks are now required to use secondary market yields for the mark-to-market revaluation of treasury bonds held for trading (HFT), while treasury bills will still rely on primary market yields.

The BSEC has prepared the Real Estate Investment Trust (REIT) Fund Rules 2024, opening up new investment opportunities in the real estate sector through the capital market. To address economic challenges, BB allows banks and NBFIs to calculate their capital market exposure based on investment cost rather than market prices, enhancing their investment capacity. Additionally, the BSEC extended the time limit for provisioning against unrealized losses for stock brokerage and merchant banks' client portfolios until 31 January 2025. To support liquidity in the stock market, the Capital Market Stabilization Fund (CMSF) has partnered with a domestic private bank to provide BDT 100 crore in loans to intermediaries such as stock brokers, stock dealers, merchant banks, and asset management companies at a competitive interest rate of 8.25 percent.

4. Forward-Looking Policy Initiatives

4.1 Upholding Good Governance

The financial sector in Bangladesh is poised for a significant transformation aimed at enhancing and strengthening good governance. Recent legislative amendments and BB's strategic initiatives reflect a comprehensive approach to ensuring robust financial governance. The enactment of the Bank Company (Amendment) Act 2023 and the Finance Company Act 2023 are pivotal steps towards integrating good governance within the financial sector. These acts provide a robust framework for financial institutions' operational and governance standards, delineating clear roles and responsibilities for board members, independent directors, and CEOs to instill discipline and accountability.

BB's guidelines on the formation and responsibilities of boards of directors set a high standard for governance in banks and financial institutions. By specifying qualifications, requiring a minimum number of independent directors, and imposing restrictions on familial and representative directors, BB ensures that boards are composed of competent, experienced, and impartial individuals. The introduction of age and experience requirements for directors further guarantees that only seasoned professionals with proven track records will oversee the strategic direction of financial institutions.

The focus on independent directors is a significant move towards safeguarding depositor interests and ensuring unbiased oversight of bank operations. BB's guidelines clearly define independent directors' qualifications, responsibilities, and remuneration, ensuring their effectiveness and independence. This fosters an environment where independent directors can contribute significantly to financial institutions' sound governance and operational integrity.

The guidelines for appointing and reappointing MDs and CEOs are designed to attract and retain top-tier leadership talent. By setting clear eligibility criteria, age limits, and approval processes, BB ensures that financial institutions' leadership is capable and accountable. Establishing a dedicated committee for evaluating MDs and CEOs underscores BB's commitment to maintaining high standards in executive leadership.

BB's strategic measures and regulatory enhancements signal a strong commitment to upholding good governance within Bangladesh’s financial sector. By fostering a culture of accountability, professionalism, and risk management, these initiatives will help build a more resilient and trustworthy financial system. As these reforms take effect, they are expected to enhance depositor confidence, attract investment, and contribute to sustainable economic growth.

4.2 Risk Management and Recovery Plans

BB's proactive approach to risk management is evident in its phased implementation of risk-based supervision (RBS) by 2025, incorporating a meticulously structured pilot program and expert-reviewed guidance notes. This strategic initiative aims to enhance the accuracy, credibility, and consistency of risk assessments using qualitative indicators, thereby fortifying the stability and resilience of Bangladesh's financial sector.

Having completed the first phase of its pilot program, which involved assessing three banks, BB's team has developed 16 draft guidance notes. These notes are pivotal in evaluating various components of a customized risk matrix aligned with international standards. Supervisors at BB will utilize these approved guidance notes to assess 20 banks selected for the second phase of the pilot program. Expert input will further refine these guidance notes before final approval by BB's competent authority. Since 24 February 2022, BB has actively guided the development of recovery plans to equip banks in handling severe stress events affecting their financial and operational stability. These plans empower banks to respond promptly and effectively to potential shocks, ensuring proactive management of stress situations.

Furthermore, BB has established the prompt corrective action (PCA) framework, effective from 31 March 2025, as a pivotal tool for early detection and rectification of banking issues. Monitoring key indicators such as capital adequacy, liquidity, non-performing loans (NPLs), and governance standards enables BB to intervene swiftly to mitigate risks. The framework's provision for mergers and amalgamations as corrective measures ensures the strengthening of weaker institutions. BB has introduced guidelines for bank-company amalgamation in support of these efforts, encompassing mutually agreed/negotiated and compulsory amalgamation policies. These initiatives aim to bolster the nation's financial services by enhancing the operational efficiency of banks, thereby fostering a resilient financial sector that delivers enhanced service to the public.

4.3 Roadmap to Managing Non-Performing Loans (NPLs)

BB is dedicated to addressing the challenge of non-performing loans (NPLs) to stabilize the banking sector and bolster economic resilience. By 2026, BB aims to reduce NPL ratios for state-owned commercial banks (SOCBs) by 10% and private commercial banks (PCBs) by 5%, targeting an overall gross NPL ratio of 8%. This strategy includes legislative reforms, rigorous identification of willful defaulters, revised loan write-off policies, and enhanced recovery processes.

The Bank Company (Amendment) Act 2023 signifies a stringent approach towards willful defaulters, defining clear penalties and establishing 'willful defaulter identification units' within banks for systematic identification. Revised loan write-off policies, effective from 18 February 2024, streamline operations while maintaining full provisions for 'bad and loss' loans up to Tk. 5 lakh without court cases. Enhanced recovery efforts through dedicated units and incentives will drive proactive loan recovery. Aligning with global standards, BB reduced the grace period for overdue fixed-term loans from six to three months, effective 30 September 2024. Starting 31 March 2025, any unpaid installment will be considered past due immediately after its due date, promoting credit discipline.

BB’s introduction of Alternative Dispute Resolution (ADR) guidelines prioritizes mediation over lengthy legal processes for swifter settlements. The upcoming private asset management company (AMC) will manage non-performing assets, improving bank balance sheets and overall sector health. This comprehensive strategy, backed by continuous monitoring and transparent reporting, aims to enhance asset quality, revenue, profits, and liquidity. BB’s proactive measures ensure a resilient financial system, fostering sustained economic growth and stability.

4.4 Enhancing Financial Inclusion and Cashless Society

In alignment with the Government's 'Smart Bangladesh Vision,' BB aims to make 75% of all transactions cashless by 2027 through the 'Cashless Bangladesh' program. This initiative underscores BB's commitment to leveraging technology to enhance financial inclusion and economic stability. Over the past decade, agent banking and mobile financial services (MFS) have significantly expanded access to formal financial services for micro-entrepreneurs and the unbanked population in Bangladesh.

Innovations such as QR code transactions, digital banks, the interoperable transaction platform (Binimoy), and TakaPay are poised to revolutionize the financial landscape by making cashless transactions more affordable and convenient. BB has drafted the 'E-Money Regulations' and prepared user guidelines for 'Bangla QR,' both pending approval to support these advancements. The draft 'Escrow' model, also awaiting approval, aims to promote online e-commerce payments and enhance customer protection. These regulatory measures will ensure digital financial transactions' safety, security, and efficiency, fostering the growth of cashless services.

4.5 Towards Market-oriented Exchange Rate and Build-up of Foreign Exchange Reserves

Given the challenges in the external sector, the Taka-Dollar exchange rates have faced sustained depreciation pressure since mid-2022. In response, BB adopted a gradual approach, allowing market forces to have a greater influence on the exchange rate. This strategy eliminated the complexities associated with multiple exchange rates for exports, imports, and remittances, promoting transparency and efficiency.

BB implemented a crawling peg system on 8 May 2024 to transition towards a free-floating exchange rate system. This interim arrangement is anchored to a currency basket with a mid-rate aligned with the Real Effective Exchange Rate (REER) Index. Allowing market participants to trade around this mid-rate introduces greater flexibility in exchange rate determination while minimizing excessive fluctuations. BB plans to continuously review and adjust the parameters of this regime as needed, paving the way for a fully flexible, market-based system in the near future.

BB has taken adequate measures to bolster foreign currency inflows and stabilize the exchange rate, including securing foreign funds from development partners. Establishing a coherent foreign exchange intervention strategy is crucial for modernizing the monetary and exchange rate policy framework. This strategy enhances BB's operational efficiency and ensures the smooth functioning of the foreign exchange market. The primary objective is to align exchange rate developments with the crawling peg exchange rate arrangement, thereby maintaining stability and predictability.

BB has drafted a comprehensive foreign exchange intervention strategy to support the effective functioning of the newly introduced crawling peg exchange rate regime. BB aims to create a resilient and adaptive foreign exchange market capable of withstanding external shocks by facilitating smoother transitions and maintaining stability. This strategic approach mitigates short-term volatility and lays the foundation for sustainable long-term economic growth and stability. The theoretical underpinning of this approach lies in the balance between market-determined exchange rates and managed interventions. The crawling peg system provides a structured path toward flexibility, offering stability while allowing gradual adjustments based on market conditions.

4.6 Streamlining Open Market Operation

BB has adopted an interest rate targeting framework, replacing the monetary targeting framework for formulating and implementing monetary policy since July 2023. This shift enables BB to engage more effectively in the money market through various open market operations (OMOs) instruments. To enhance the functionality and efficiency of OMOs under the new monetary policy framework, BB has undertaken several initiatives:

i) Since August 2023, BB has provided unrestricted access to the Standing Deposit Facility (SDF) and Standing Lending Facility (SLF) along with the full allotment of the repo facility for all banks and non-bank financial institutions based on their demand.

ii) In July 2024, BB introduced a repo auction twice a week, replacing the daily repo auction. This change encourages commercial banks to improve their liquidity management capacity and fosters a more active and vibrant money market.

Looking ahead, BB intends to conduct the main OMOs once a week to align the 7-day OMOs with the bi-weekly reserve maintenance period. Additionally, BB plans to introduce overnight OMOs for fine-tuning toward the end of the reserve maintenance period as needed. These measures will help streamline the implementation of monetary policy with efficient liquidity management to foster an active money market.

5. Monetary Policy Stance and Monetary & Credit Projections for H1FY25

5.1 Monetary Policy Stance

The global economic outlook for 2024 and 2025 appears positive, as major economies have managed to avoid a severe downturn and have successfully reduced inflation without increasing unemployment. In the absence of further significant shocks to food and energy prices, headline CPI inflation is projected to return to levels aligned with central bank targets in most major economies in the coming months. However, the geopolitical situation remains fragile, with new fears of supply chain disruptions. As global inflation is projected to continue falling, central banks in many economies are expected to begin lowering policy rates this year.

Domestically, recent trends in inflation, monetary aggregates, liquidity, interest rates, foreign exchange reserves, and exchange rates were reviewed following three major policy changes: introducing a crawling peg system, removing the interest rate cap under SMART, and increasing policy rates. The MPS noted that Bangladesh's economy is rebounding, with inflation moderating but still high. The crawling peg system has stabilized the exchange rate and helped build foreign exchange reserves. Amid tight liquidity, all interest rates have increased significantly, indicating effective policy transmission. Most monetary aggregates have followed projected paths. The Monetary Policy Committee (MPC) concluded that the current monetary policy tightening should continue until inflation reaches a comfortable level. BB will also continue providing comprehensive credit support to agriculture and CMSMEs as part of its supply-side intervention policy to enhance production and support employment generation.

Bangladesh Bank places utmost priority on controlling inflation, which has been persistently high for some time. To manage continued inflationary pressure, in addition to supply-side interventions, BB has pursued a contractionary monetary policy stance for over a year. The policy rate has been significantly increased, with no new high-powered money issued by BB to finance government spending. In line with BB’s policy initiatives, the Government has also taken several measures to control inflation, particularly food inflation, including reducing tariff rates for selected commodities, broadening social protection schemes such as Open Market Sales (OMS), and introducing the Family Card. Moreover, to stabilize the prices of essential high-demand products (edible oil, chickpeas, pulses, peas, onions, spices, sugar, and dates) and ensure adequate supply, BB has instructed authorized dealer branches of banks to maintain the cash margin rate on import LC at the minimum level based on the bank-customer relationship.

Although recent CPI inflation has moderated, it remained above 9.0 percent throughout H2FY24. With the coordinated and concerted policy initiatives mentioned above, CPI inflation is expected to continue declining in the coming months amid global commodity price temperance. In light of these complex realities, BB is announcing its half-yearly monetary policy stance through this Monetary Policy Statement (MPS) for H1FY25. The policies align with the Government's budgetary target of reducing inflation to around 6.5 percent by the end of FY25, which is consistent with BB's internal forecasts.

By closely monitoring prices and other domestic and international macroeconomic developments, BB has decided to maintain its cautiously tight monetary policy stance for the first half of FY25. BB's Monetary Policy Committee (MPC) has resolved to keep the policy (Repo) rate unchanged at 8.50 percent, with the SDF rate at 7.0 percent and the SLF rate at 10.0 percent. Additionally, BB will continue its quantitative tightening bias by streamlining Open Market Operations, ceasing currency swaps among banks and BB, and refraining from creating new money to finance government spending. However, BB remains ready to take any necessary policy actions should the situation demand it.

Since mid-2022, the Taka-Dollar exchange rates have experienced sustained depreciation pressures driven by challenges in the external sector. In response, Bangladesh Bank (BB) has taken a gradual approach, allowing market forces to exert greater influence over the exchange rate. This strategy aimed to simplify the exchange rate framework by eliminating multiple rates for exports, imports, and remittances, enhancing transparency and efficiency in currency transactions.

To further stabilize the exchange rate and move towards a more flexible system, BB introduced a crawling peg system on 8 May 2024. This interim arrangement links Taka's value to a currency basket, with a mid-rate aligned with the Real Effective Exchange Rate (REER) Index, reflecting market equilibrium. Implementing this system has notably reduced foreign exchange market volatility and narrowed the gap between formal and informal market exchange rates to a reasonable level. Additionally, recent liberalization initiatives in Bangladesh's foreign exchange policy, such as the RFCD, NFCD, and Offshore Banking Act 2024, are expected to bolster foreign exchange inflows. These measures aim to alleviate pressure on the exchange rate and support rebuilding foreign exchange reserves, contributing to overall stability in the currency market.

As the Forex market is showing reasonable stability and transactions are taking place within predefined bands, BB decides to keep the crawling peg mid-rate unchanged at Tk. 117.00 per USD. BB will also enhance import liberalization by removing LC margin requirements for all products except luxury goods like cars, fruits, flowers, cosmetics, and similar items, with margins determined based on bank-customer relationships. The crawling peg *system is a transitional measure towards a fully flexible, market-based exchange rate system, aiming to stabilize exchange rate movements while preparing for broader market liberalization.*

5.2 Monetary and Credit Projections for H1FY25

Table 5 shows the half-yearly movements of major monetary and credit aggregates, along with their projection set for FY25. BB adopted an interest rate targeting framework in July 2023, where monetary aggregates such as broad and reserve money are indicative monetary policy targets. Although monetary and credit projections do not get explicit focus in this framework, aligning the interest rate target to uphold price stability, ensure financial stability, and foster desired economic growth is essential.

Table 5: Monetary and Credit Projections for FY25

(YoY % change)

Item	Jun-23 Act.	Dec-23 Act.	Jun-24 Act.^{P}	Dec-24 Proj.	Jun-25 Proj.
Broad money	**10.5**	**8.6**	**8.2**	**8.2**	**8.4**
Net Foreign Assets*	-23.4	-21.8	-17.0	2.3	17.8
Net Domestic Assets	23.0	17.0	14.1	9.3	6.8
Domestic Credit	15.3	11.6	10.5	10.7	11.6
Credit to the public sector	35.8	17.9	12.8	14.2	17.8
Credit to the private sector	10.6	10.1	9.8	9.8	9.8
Reserve money	**10.5**	**-2.0**	**7.9**	**2.0**	**1.0**
Money multiplier	4.93	5.13	4.94	5.45	5.30

Source: Bangladesh Bank. Note: *Calculated using the constant exchange rates of end June 2024, P=Provisional

Moreover, under this framework, BB controls reserve money and broad money by adjusting the policy rate and managing liquidity through cash reserve ratio (CRR), statutory liquidity ratio (SLR), open market operation (repo operation, SLF, SDF, BB bill), assured liquidity support, special liquidity support, advance-deposit ratio, refinance/pre-finance facilities, Mudarabah liquidity support (MLS), and Islamic bank liquidity facility (IBLF).

The growth projection of broad money for FY25 is set at 8.4 percent, considering the nominal GDP growth target of 10.9 percent, along with the positive change in the velocity of money. Public sector credit growth is projected to be 17.8 percent, considering lower credit demand from the Government, as the Government has been selectively spending on priority projects in the process of austerity policy measures. Moreover, the Government's FY25 budgetary target is to borrow Tk. 1,37,500 crore from the banking system is also duly considered in projecting the public sector credit growth limit. Private sector credit is projected to grow 9.8 percent, considering the contractionary nature of the monetary policy to contain persistent high inflation while confirming the BB's supply interventions to support necessary credit flows to productive and employment-generating sectors through refinance and pre-finance schemes.

Considering the moderate growth in the public sector and private sector, domestic credit growth is projected to be 11.6 percent for FY25. The net foreign assets (NFA) projection of the banking system is expected to show a positive growth of 17.8 percent in FY25. The projection of positive growth of NFA is based on the anticipation of surplus in the overall balance of payment while predicting moderate growth in exports and imports and substantial growth in remittances. Moreover, the supply of foreign funds from the development partners is also considered for the projection of positive growth in NFA. The projection of Reserve Money (RM) growth is set at positive growth of 1.0 percent, considering the economic realities and the stable movement of the money multiplier, which is influenced by currency deposit and reserve deposit ratios.

6. Near-term Macroeconomic Issues and Challenges

Bangladesh faces several near-term macroeconomic issues and challenges that could impact its economic stability and growth prospects. These challenges stem from both domestic and international factors, creating a complex environment for policymakers. Inflation and exchange rate pressures have been major challenges over the past two years. The ongoing unrest in the Middle East and the Russia-Ukraine conflict could impact energy and commodity prices, affecting the domestic economy through import and exchange rate channels. The following are the major macroeconomic challenges for Bangladesh economy:

Bangladesh has been experiencing persistent inflationary pressures, with recent CPI inflation rates remaining above 9 percent. High inflation erodes purchasing power, reduces real incomes, and can lead to an increase in income and consumption inequalities. Global supply chain disruptions, exacerbated by geopolitical tensions such as the Russia-Ukraine conflict and Middle Eastern unrest, have led to higher prices for essential commodities, including food and energy. Bangladesh Bank has been implementing a contractionary monetary policy to manage inflation, but balancing inflation control with economic growth remains a delicate task.

The Taka has been under pressure from external sector difficulties and high import bills, leading to a significant depreciation. This volatility not only increases import costs but also risks imported inflation. In response, Bangladesh Bank (BB) implemented a crawling peg system to stabilize the exchange rate. While this approach has shown initial success, ongoing monitoring and adjustments are crucial to sustain stability. Moreover, potential policy rate cuts by major central banks such as the ECB and the US Fed could offer some relief from these exchange rate pressures.

Frequent interventions in the foreign exchange market to stabilize the Taka have led to a depletion of foreign exchange reserves. Maintaining adequate reserves is crucial for economic stability and investor confidence. Remittances from exports and wage earners are significant sources of foreign exchange for Bangladesh, and ensuring a steady flow of remittances from these sources is essential for maintaining and building reserve levels. The recent foreign exchange policy liberalization initiatives like RFCD, NFCD, and Offshore Banking Act 2024 will provide necessary inflows of forex to reduce the pressure on the exchange rate and help rebuild the foreign exchange reserves.

The global economic outlook is positive, but uncertainties persist due to ongoing geopolitical tensions threatening economic stability. Policy rate cuts in advanced economies could influence reverse capital flows and exchange rates. Fluctuations in global commodity prices, especially for food and energy, pose a significant risk to Bangladesh's economy due to its dependence on imports.

High levels of Non-Performing Loans (NPLs) in the banking sector undermine financial stability and limit credit availability for productive investments. BB is taking measures to reduce NPLs and improve bank governance. Implementing reforms to enhance transparency, governance, and operational efficiency in the banking sector is crucial for financial stability and growth.

Bangladesh faces many near-term macroeconomic challenges, from inflationary pressures and exchange rate volatility to fiscal constraints and financial sector stability. Addressing these challenges requires a multifaceted approach, including prudent monetary policy, effective fiscal management, and structural reforms. By navigating these issues carefully, Bangladesh can sustain its economic growth trajectory and enhance resilience against external shocks.

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