Monetary

Policy Review

2023-24

Bangladesh Bank

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Chief Economist's Unit
Bangladesh Bank
July 2024

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Message

The global economy has been facing significant volatility since 2020, starting with the Covid-19 pandemic at first and then the Russia-Ukraine war-related challenges. Recent political unrest in the Middle East, in addition to the prolongation of the war, has exacerbated the instability. Bangladesh economy was not immune to the impact of global issues, though it performed fairly well a couple of years after the Covid-19 recovery. However, since 2023, the economy feels the pressures of persistently high inflation and exchange rate depreciation, particularly through geopolitical tension and trade uncertainties.

Despite the challenges, provisional estimates from Bangladesh Bureau of Statistics (BBS) indicate that Bangladesh's gross domestic product (GDP) grew by 5.82 percent in FY24, up from 5.78 percent in FY23, reflecting a modest improvement in the country's economic performance. To mitigate inflationary pressure and restore the stability of the exchange rate, Bangladesh Bank (BB) upheld a hawkish approach to monetary policy throughout 2023 and continued the contractionary stance for H2FY24. BB has been diligently employing various available measures and instruments to effectively manage inflation, stabilize the balance of payments, and foster stability in the exchange rate. Bangladesh Bank recently introduced crawling peg system for buying and selling foreign currencies to bring more flexibility to the foreign exchange market. Bangladesh Bank scrapped the SMART formula in order to make fully market-based interest rates in the banking system. Besides, BB has taken substantial reform and regulatory actions in the financial sector, aiming at reducing non-performing loans, enhancing corporate governance, and fostering financial deepening.

The Monetary Policy Review (MPR) 2023-24 is an all-encompassing analysis of the prevailing macroeconomic, monetary, and financial sector circumstances. The primary objective is to proactively identify potential near- and medium- term challenges within the existing monetary policy stance. In addition, the MPR is intended to serve as a valuable resource for policymakers in shaping future monetary policy strategies by examining the impacts of prior measures.

I strongly believe that this MPR will prove to be of immense value to stakeholders in comprehending the latest trends and emerging issues of interest. I would like to express my heartfelt appreciation to the Chief Economist's Unit for delivering a comprehensive review. I also thank all supporting departments for their valuable contributions to this Review.

Abdur Rouf Talukder
Governor

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List of Abbreviations

ABB	Association of Bankers, Bangladesh
ADR	Advance-deposit Ratio
BAFEDA	Bangladesh Foreign Exchange Dealer's Association
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BCC	Bangladesh Computer Council
BDT	Bangladeshi Taka
BFIU	Bangladesh Financial Intelligence Unit
BoP	Balance of Payment
BSEC	Bangladesh Securities and Exchange Commission
CAB	Current Account Balance
CMSME	Cottage, Micro, Small and Medium Enterprise
COVID	Corona Virus Disease
CPI	Consumer Price Index
CPMR	Crawling Peg Mid-rate
CRAR	Capital to Risk-weighted Asset Ratio
CRR	Cash Reserve Requirement
DBU	Domestic Banking Units
DSE	Dhaka Stock Exchange
DSEX	DSE Broad Index
EMDE	Emerging Market and Developing Economy
EPB	Export Processing Bureau
ERQ	Exporters' Retention Quota
FDI	Foreign Direct Investment
FY	Fiscal Year
GDP	Gross Domestic Products
IDRA	Insurance Development Regulatory Authority
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPO	Initial Public Offering
IRC	Interest Rate Corridor
LC	Letter of Credit
M2	Broad Money
MFS	Mobile Financial Service
MoU	Memorandum of Understandings
MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
NBFIs	Non-bank Financial Institutions
NBR	National Board of Revenue
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Asset
NPA	Non-Performing Asset
NPLs	Non Performing Loans
NRBs	Non Resident Bangladeshis
NSCs	National Savings Certificates
OBOs	Offshore Banking Operations
PCA	Prompted Corrective Action
PPI	Producers price Index
RBS	Risk-Based Supervision
REER	Real Effective Exchange Rate
RFCD	Resident Foreign Currency Deposit
RM	Reserve Money
RMG	Ready-made Garment
ROA	Return on Asset
ROE	Return on Equity
SCBs	State-owned Commercial Banks
SDF	Standing Deposit Facility
SLF	Standing Lending Facility
SMART	Six-Months Moving Average Rate of Treasury bills
SME	Small and Medium Enterprise
USD	United States Dollar
UK	United Kingdom
WEO	World Economic Outlook
Y-o-Y	Year on Year

Executive Summary

Economic activities in Bangladesh demonstrated resilience in FY23, with notable growth of 5.78 percent amid continued geopolitical tensions and trade uncertainties. The activities continued in the first quarter of FY24, with 6.07 percent growth bolstered by robust performances in the industry and service sectors, notwithstanding slower growth in the agriculture sector. However, in the second quarter of FY24, growth moderated to 3.78 percent mostly as a result of deceleration of growth in the industry sector. Despite continued policy tightening and ongoing geopolitical instability, global economic growth was surprisingly robust, at 3.1 percent for both 2023 and 2024. The aggressive policy rate hikes by the major central banks resulted in a faster-than-expected decline in inflation, with a smaller-than-expected toll on employment and economic activity. Although FY24 is still ongoing, the Bangladesh Bureau of Statistics (BBS) has released provisional estimate of GDP, indicating that real GDP grew by 5.82 percent, slightly surpassing the 5.78 percent growth recorded in FY23. However, the BBS has not yet released individual GDP estimates for the third and fourth quarters of FY24.

The headline CPI inflation followed an upward trend in FY23, echoing trends in many other parts of the world. Despite continued policy rate hikes, inflation stayed significantly higher for most of the period in 2023. In April 2024, the headline (p-t-p) inflation slightly decreased to 9.74 percent from 9.81 percent in March 2024. Over the past year, fluctuations in fuel, food, and energy prices have mostly influenced the overall headline inflation, with food and fuel costs largely mirroring global commodity price trends.

Bangladesh's economy has experienced the most volatile episodes in the external sector in recent years. At the beginning of FY22, the crisis started to emerge with depreciating pressure on the exchange rate resulting from the expanding current account deficits of the balance of payments (BoP). BB responded by implementing various policy measures, such as discouraging unnecessary imports, selling foreign currencies, and allowing depreciation. BB sold a net of foreign currencies USD 7.62 and 9.02 billion in FY22 and FY23, respectively, thereby reducing the gross official foreign exchange reserve substantially from USD 41.83 billion in June 2022 to USD 31.2 billion in June 2023. The exchange rate depreciated by 9.25 and 13.76 percent in FY22 and FY23, respectively. Consequently, in July-April of FY24, the current account deficit witnessed an improvement owing to a narrowing trade deficit and remittance. However, the financial account maintained surplus, but it decreased during July-April FY24 as compared to the same period of previous year. During July-April of FY24, BB sold a net of USD 9.27 billion. Accordingly, the gross official foreign exchange reserve decreased further to USD 25.37 billion at the end of April 2024. During July-April of FY24, the exchange rate experienced a depreciation of 1.96 percent, reflecting an easing of depreciation pressure in the foreign exchange market. In May 2024, BB implemented a crawling peg system for foreign currency transactions as an interim measure before transitioning to a fully flexible market-based exchange rate system. In the new arrangement, a crawling peg mid-rate (CPMR) is set at Taka 117.0 per USD. BB will keep monitoring the new system and make adjustments to its parameters as needed.

BB made a remarkable transition in its monetary policy approach from a monetary aggregate targeting framework to an interest rate corridor (IRC) system in the monetary policy statement (MPS) of the first half of FY24, which commenced on 1 July 2023. The monetary policy framework anticipates the interbank call money rate to closely align with the policy (repo) rate, forming a symmetric corridor with an upper bound known as the standing lending facility (SLF) and a lower bound known as the standing deposit facility (SDF). In addition, BB removed the previous cap on lending interest rates and introduced a more market-oriented reference lending rate for commercial banks.

The MPS for H1FY24 announced the repo rate to be 6.50 percent, 50 basis points higher than the previous repo rate, indicating a tight monetary policy stance to contain inflationary pressure. The corridor width was set at a range of ±200 basis points from the policy rate. Later, BB increased the policy rate twice, on 5 October 2023 and 27 November 2023, by 75 basis points and 50 basis points, respectively, to curb the escalating inflationary pressure. The reference lending rate was linked with the six months moving average rate of Treasury bills named SMART, with an added margin of up to 3.00 percent for bank lending. Later, this margin subsequently increased by 75 basis points in two stages. During July-December 2023, the interbank call money rate followed an upward trend, moving closely with the policy (repo) rate but remaining within the corridor set by BB without any significant fluctuation.

In the monetary policy statement (MPS) for H2FY24, BB again raised the policy rate by 25 basis points to 8.00 percent with a view to arresting inflation. Moreover, BB narrowed the corridor to ±150 basis points from the policy rate to allow more precise and efficient liquidity management. Moreover, as the SMART continued increasing, the margin on SMART was revised downward twice, first to 3.50 percent and then to 3.00 percent. On 8 may 2024, the monetary policy committee (MPC) decided in their third meeting to raise the policy rate further by 50 basis points to 8.50 percent. In addition, to move towards market-based lending interest rate determination, MPC also decided to abandon the use of SMART.

In the money market, average yields of government securities for all short, medium, and long-term maturities increased in March 2024, reflecting the transmission of tightened monetary policy. The broad money (M2) growth decelerated to 8.9 percent in March 2024, compared to 10.48 percent growth in June 2023, and it remained below the projection of 9.5 percent for March 2024. Similarly, the growth of reserve money (RM) declined to 3.2 percent in March 2024 compared to the growth of 10.48 percent in June 2023 and was higher than the projection of 1.5 percent for March 2024.

Looking ahead, in the proposed national budget for FY25, the growth target was set at 6.75 percent, taking into account the current challenges of the macroeconomic environment. Growth prospects for FY25 remain strong, portraying a picture of resilience, adaptability, and sustained expansion. However, this growth prospect will be contingent upon the enhancement of the country's external sector resilience. Moreover, the ongoing high inflation may require additional monetary tightening for an extended period.

Chapter I: Monetary Policy Stance

I.1 Review of Monetary Policy Stance in 2023

During 2023, the global economy grappled with turbulent challenges emanating from the shock of the COVID-19 pandemic, the Russia-Ukraine conflict, and the implementation of tight monetary policies aimed at curbing high inflation. Correspondingly, Bangladesh's economy encountered obstacles in 2023, such as persistent high inflation, mounting exchange rate pressure, the depletion of foreign exchange reserve and liquidity stress in the banking sector. In efforts to mitigate inflationary pressure and restore the stability of the exchange rate, Bangladesh Bank (BB) upholds a hawkish approach to monetary policy throughout 2023, issuing two Monetary Policy Statements in January and June.

Monetary Policy Stance and Outcomes (January–June 2023)

The monetary policy stance and money and credit programs for H2FY23 were cautiously accommodative to contain inflationary and exchange rate pressures, and support desired economic growth by ensuring the necessary flow of funds to the economy's productive and employment-generating activities. To contain inflationary pressures, the repo rate was raised by 25 basis points, increasing from 5.75 percent to 6.00 percent, while the reverse repo rate was adjusted from 4.00 percent to 4.25 percent. Besides, to mitigate exchange rate pressures, BB took initiatives to transition from multiple exchange rates system towards a unified and market-oriented regime for all international transactions, bringing stability to the BDT-USD exchange rate. Consequently, the money and credit program set for H2FY23 was aligned with the revised target of 6.50 percent real GDP growth while keeping inflation within a ceiling of 7.50 percent. The monetary and credit programs and their actual developments in H2FY23 are as shown in Table 1.

Table 1: Monetary and Credit Development for H2FY23.

(y-o-y % change)

Item	Dec-22	Jun-23	
	Actual	Actual	Programs
Broad money	**8.5**	**10.5**	**11.5**
Net Foreign Assets*	-25.0	-23.4	-11.9
Net Domestic Assets	21.6	21.3	17.9
Domestic Credit	15.4	15.3	18.5
Credit to the public sector	27.6	35.8	37.7
Credit to the private sector	12.9	10.6	14.1
Reserve money	**17.4**	**10.5**	**14.0**
Money multiplier	4.63	4.93	4.82

Source: Bangladesh Bank. Note: *Calculated using the constant exchange rates of end June 2022.

Though monetary and credit aggregates remained on the program path during H2FY23 as seen in Table 1, the inflation rate soared above the ceiling of 7.50 percent mainly because of supply-side factors. Broad money (M2), the nominal anchor or intermediate target of BB's monetary policy, increased by 10.5 percent, which was slightly lower than the program path during H2FY23, due to the lower net foreign assets (NFA) of the banking system. The NFA of the banking system witnessed a decline of 23.4 percent in June 2023, in contrast to the negative program growth of 11.9 percent set for June 2023. The substantial deficit in the overall balance of payments (BoP), stemming from both a sizable current account deficit and significant repayments of trade credit, contributed to the strong negative growth of NFA during this period. The growth of reserve money (RM), the operating target of BB's monetary policy, remained well below the program path during H2FY23 due to a significant decrease in BB's net foreign assets (NFA). On the other hand, the growth of BB's NDA was positive, surpassing the program set for June 2023 because of enormous liquidity support by BB to both conventional and Shariah-based Islamic banks, as well as the devolement of government securities to BB in response to liquidity pressure in the money market. The negative growth of BB's NFA was counter balanced by the higher positive growth of BB's net domestic assets (NDA), resulting in a 10.5 percent increase in RM in June 2023, compared to the programmed path of 14.0 percent for June 2023.

The public sector credit growth increased 35.8 percent (YoY) in June 2023, against the program set for 37.7 percent growth in June 2023. The higher growth of public sector credit during this period could be attributed to various factors, including the negative net sale of national savings certificates (NSCs), reduced net deficit financing from foreign sources, and elevated costs associated with implementing government mega projects amidst increased global commodity prices. The private sector credit growth recorded an increase of 10.6 percent in June 2023, well below the program path of 14.1 percent. Lower credit demand from private sector investors due to uncertainty in the global and domestic economy, liquidity stress in the banking sector, and pursuance of contractionary monetary policy might have been the reasons behind lower than program growth in private sector credit during H2FY23.

The Consumer Price Index (CPI) based point-to-point inflation rate reached 9.74 percent in June 2023, compared to 7.56 percent in June 2022. Moreover, the CPI-based average headline inflation stood at 9.02 percent in June 2023, surpassing the government's revised target ceiling of 7.50 percent set for June 2023. Several factors have contributed to the elevated domestic commodity prices and inflation. These include higher prices of imported items in the global market, a larger depreciation of the Bangladesh Taka (BDT), upward adjustments in fuel and energy prices, and the lack of a competitive environment in the market.

The exchange rate of BDT/USD faced depreciated pressure throughout the H2FY23, which emanated from excess demand for foreign exchange and an appreciation of the USD in the global market. In response to the depreciation pressure, BB allowed the BDT to depreciate significantly and supplied a huge amount of foreign exchanges to the market from its international reserves during this period. During FY23, BB sold (net) around USD 13.4 billion, while BDT depreciated by more than 13.8 percent against USD. Considering the potential inflationary impact of depreciation on the economy, BB followed the strategy of gradual depreciation of the Taka. Furthermore, BB responded positively to allowing different exchange rates for exports, imports, and remittances, as indicated by BAFEDA and ABB.

Monetary Policy Stance and Outcomes (July - December 2023)

BB pursued a contractionary monetary policy stance for H1FY24 and shifted towards a structural change within its monetary policy framework. BB's monetary policy was transitioned to an interest rate targeting framework from a monetary targeting one. Within the framework of interest rate targeting, the target policy interest rate was set at 6.50 percent, accompanied by a ±200 basis point symmetric corridor consisting of a standing lending facility (SLF) rate at 8.50 percent and a standing deposit facility (SDF) rate at 4.50 percent. Within this new framework, the interbank call money rate would closely align with the policy rate, ensuring stability. Under the contractionary monetary policy stance, the policy rate (repo rate) was increased by 50 basis points from 6.00 percent to 6.50 percent, while the SDF rate, previously known as the reverse repo rate, was adjusted upward by 25 basis points from 4.25 percent to 4.50 percent. Besides, the monetary policy stance for H1FY24 introduced a market-driven reference lending rate for all types of bank loans, which is known as the 'SMART' (Six-month Moving Average Rate of Treasury bill) and used as the reference lending rate, replacing the previously imposed lending rate cap to enhance competitiveness in the banking sector and foster a favorable lending environment for businesses and individuals.

The aim of MPS for the H1FY24 was to bring down inflation within a ceiling of 6.0 percent, aligning with the government's target declared in the national budget. The monetary and credit projections and their actual development in H1FY24 are shown in Table 2.

Table 2: Monetary and Credit Development for H1FY24.

(y-o-y % change)

Item	Jun-23	Dec-23	
	Actual	Actual	Projection
Broad money	**10.5**	**8.6**	**9.5**
Net Foreign Assets*	-23.4	-21.8	-16.8
Net Domestic Assets	21.3	16.0	15.9
Domestic Credit	15.3	11.6	15.9
Credit to the public sector	35.8	17.9	37.9
Credit to the private sector	10.6	10.1	10.9
Reserve money	**10.5**	**-2.0**	**0.0**
Money multiplier	4.93	5.13	5.07

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

The broad money (M2), an indicative indicator of monetary policy, grew by 8.6 percent at the end of December 2023, which was lower than the projection set for December 2023. This subdued growth of M2 was dragged down by lower net foreign assets (NFA) of the banking system during H1FY24.

NFA experienced a decline of 21.8 percent in December 2023 compared to the projected 16.8 percent decline. This decline was attributable to a deficit in the overall balance of payments (BoP). The Reserve Money (RM) another indicative indicator of monetary policy had decreased by 2.0 percent (year-over-year) by the end of December 2023. Nonetheless, the growth of reserve money (RM) fell short of the anticipated trend in H1FY24 due to the negative growth of Bangladesh Bank's Net Foreign Assets (NFA), which experienced substantial declines resulting from significant foreign currency sales to banks to address excess demand for USD.

In December 2023, private sector credit increased 10.1 percent, slightly lower than the projected growth of 10.9 percent by December 2023. The modest growth in private sector credit could be attributed to lower credit demand from private sector investors due to the pursuit of a contractionary monetary policy induced by higher borrowing costs, ongoing uncertainty in the global and domestic economy, and liquidity stress in the banking sector. Likewise, public sector credit increased by 17.9 percent in December 2023, notably below the anticipated growth of 37.9 percent for the same period. The noticeable decline in public sector credit growth within the banking system was due to the government's selective spending on priority projects as part of austerity measures. Domestic credit growth fell short of the projected trajectory for December of FY24, mainly due to slow private-sector credit growth combined with reduced expansion in public-sector credit.

There have been remarkable changes within the money market due to the transition of BB's monetary policy framework from monetary targeting to interest rate targeting. The weighted average call money rate surged to 8.84 percent by December 2023, up from 6.06 percent in June 2023. Similarly, the interbank average repo rate climbed to 8.06 percent by December 2023, compared to 6.16 percent in June 2023.

Based on the Consumer Price Index (CPI) data, the point-to-point inflation rate reached 9.41 percent in December 2023, compared to 9.74 percent in June 2023. However, the CPI-based average headline inflation rose to 9.48 percent in December 2023 from 9.02 percent in June 2023, primarily due to higher inflation rates in the most recent months being considered in this count. Furthermore, average core inflation (excluding food and fuel) stood at 7.72 percent in December 2023, compared to 8.53 percent in June 2023. Several factors, such as supply chain disturbances caused by the COVID-19 pandemic and the Russia-Ukraine conflict, significant depreciation of BDT/USD owing to deficit in the overall balance of payments, were responsible for persistently high inflation. Moreover, the second-round effect of upward energy price adjustment and imperfections in the commodity market are also contributing factors to high inflation during H1FY24.

The exchange rate of Bangladesh Taka (BDT) against the US Dollar (USD) in FY23 experienced a depreciation of 13.8 percent. Moreover, during July-December 2023, the BDT experienced an additional depreciation of 1.49 percent against the USD, reaching Tk. 110.00/USD at the end of December 2023 from Tk. 108.36/USD at the end of June 2023. To mitigate disruptive fluctuations in the foreign exchange market, Bangladesh Bank (BB) allowed market forces to determine the exchange rate. Simultaneously, BB intervened in the foreign exchange market through net sales. During July-December 2023, BB's net sale of foreign currency amounted to USD 5.69 billion

I.2 Current Monetary Policy Stance (H2FY24) and Progress (January –June, 2024)

BB adopted a contractionary monetary policy stance for H2FY24. Considering global and domestic macroeconomic developments, as well as existing challenges, the BB opted to maintain its current policy stance. Maintaining a tight monetary policy stance throughout the latter half of FY24 seems prudent to manage inflation and stabilize inflation expectations while ensuring sufficient funding to support growth in the productive sectors of the economy. To continue tightening monetary policy, the policy rate was increased by 25 basis points to 8.00 percent from 7.75 percent. Additionally, to refine liquidity management, the Standing Lending Facility (SLF) rate was reduced by 25 basis points to 9.50 percent from 9.75 percent, and the Standing Deposit Facility (SDF) rate was increased by 75 basis points to 6.50 percent from 5.75 percent, reducing the policy rate corridor from ± 200 basis points to ± 150 basis points. The money and credit projections for H2FY24 are shown in Table 3.

Table 3: Monetary and Credit Projections for H2FY24

(YoY % change)

Item	Jun-23	Sep-23	Dec-23	Mar-24		Jun-24	
	Actual	Actual	Actual	Projection	Actual	Prior Projection@	Revised Projection
Broad money	**10.5**	**9.0**	**8.6**	**9.5**	**8.9**	**10.0**	**9.7**
Net Foreign Assets*	-23.4	-23.7	-21.8	-9.8	-22.2	4.7	-2.4
Net Domestic Assets	21.3	17.9	16.0	13.8	15.8	11.1	12.2
Domestic Credit	15.3	12.7	11.6	14.0	12.1	15.4	13.9
Credit to the public sector	35.8	25.9	17.9	30.0	18.6	31.0	27.8
Credit to the private sector	10.6	9.7	10.1	10.0	10.5	11.0	10.0
Reserve money	**10.5**	**1.2**	**-2.0**	**1.5**	**3.3**	**6.0**	**-1.0**
Money multiplier	4.93	5.46	5.13	**5.56**	5.44	5.11	5.46

Source: Bangladesh Bank.

Note: *Calculated using the estimated constant exchange rates of end June 2023. @ Announced in June 2023.

The monetary and credit projections for FY24, as depicted in Table 3, align with the revised Gross Domestic Product (GDP) growth target of 6.5 percent and an average inflation ceiling based on the Consumer Price Index (CPI) of 7.5 percent. These projections also consider anticipated shifts in the velocity of money. The growth of broad money is set at 9.7 percent. The growth of public sector credit is set at 27.8 percent, reflecting the government's selective expenditure on priority projects as part of its austerity policy measures. Private sector credit growth is projected at 10.0 percent. Considering these growth rates in both the public and private sectors, domestic credit growth is projected to grow by 13.9 percent by the end of June 2024. The Net Foreign Assets (NFA) of the banking system is projected to decrease by 2.4 percent for FY24. The projection of NFA are based on the underlying assumption of a modest overall balance of payments (BoP) deficit, despite the anticipated moderate growth in exports and remittances, alongside a decrease in imports.

The exchange rate of Bangladesh Taka (BDT) against the US dollar (USD has experienced huge depreciation pressure since mid-2022. To mitigate abrupt fluctuations in the exchange rate, BB is actively considering to adopt a 'crawling peg' system, which would be linked to a basket of currencies and operate within a specified band corridor. Implementing crawling peg arrangement in exchange rate management is expected to notably decrease market volatility and bolster stability in the foreign exchange market.

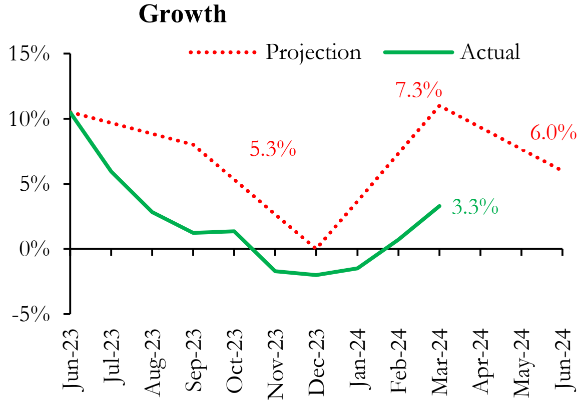
Progress

Based on the available Consumer Price Index (CPI) data, the point-to-point inflation rate stood at 9.74 percent in April 2024 which was same level in June 2023. Moreover, the CPI-based average headline inflation rose to 9.73 percent in April 2024 from 9.02 percent in June 2023. Furthermore, core inflation (excluding food and fuel), an important indicator closely linked to monetary policy, continued to show a declining tendency, averaging 7.36 percent in April 2024 compared to 8.53 percent in June 2023.

BB has transitioned towards an interest rate targeting framework and introduced a competitive reference interest rate in July 2023. As a result, all types of interest rates in the money market have firmed up since July 2023, which is reflected in the higher call money rate and customer deposit and lending interest rates of banks. The weighted average call money rate rose from 6.06 percent in June 2023 to 8.81 percent in April 2024. Moreover, the inter-bank repo rate soared 8.17 percent in April 2024 from 6.16 percent in June 2023.

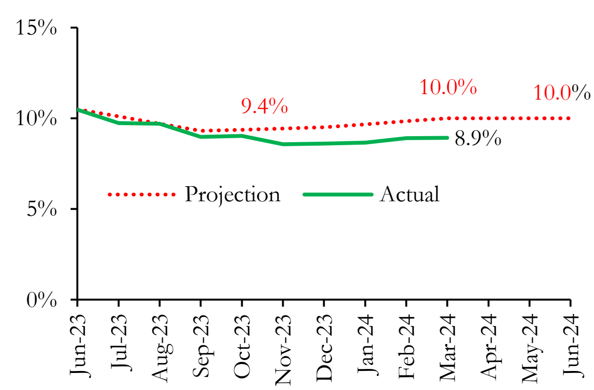
Charts I.1-I.6 exhibit the actual growth paths of major monetary and credit aggregates up to February 2024 compared to the projection set for H2FY24.

Chart I.1: Reserve Money (RM) Growth



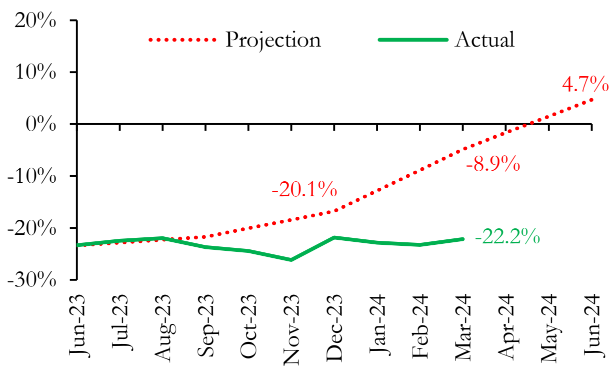
Source: Bangladesh Bank.

Chart I.2: Broad Money (M2) Growth



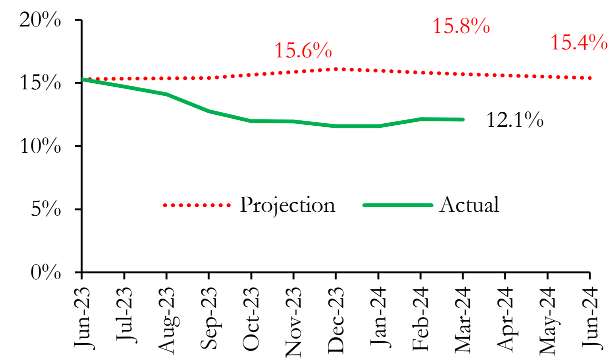
Source: Bangladesh Bank.

Chart I.3: Net Foreign Assets (NFA) Growth



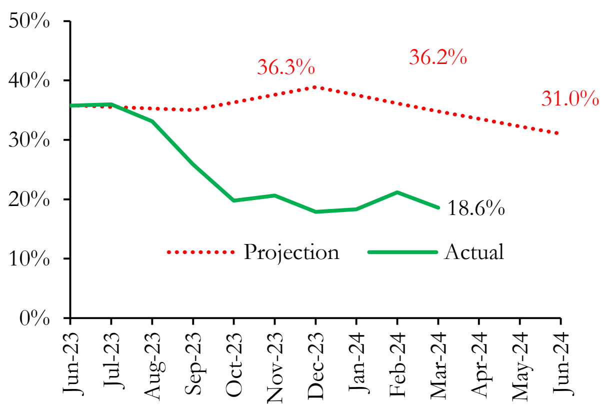
Source: Bangladesh Bank.

Chart I.4: Domestic Credit Growth



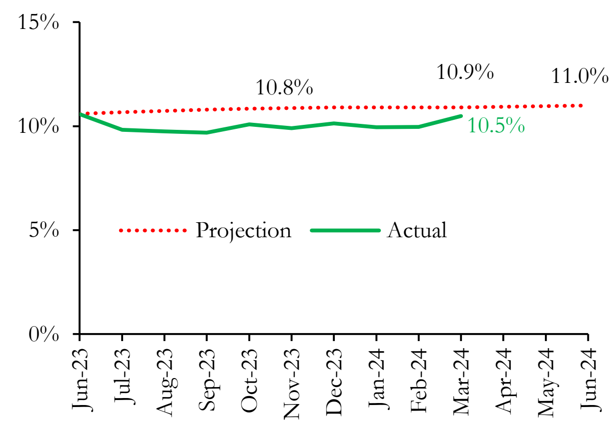
Source: Bangladesh Bank.

Chart I.5: Public Sector Credit Growth



Source: Bangladesh Bank.

Chart I.6: Private Sector Credit Growth



Source: Bangladesh Bank.

Regarding the monetary landscape, broad money (M2), a key indicator monitored by monetary policy, grew by 8.9 percent (Chart I.2) by the end of March 2024. Among the components of M2, the Net Foreign Assets (NFA) decreased by 22.2 percent (Chart I.3) at the end of March 2024 while Net Domestic Assets (NDA) increased by 15.8 percent. In March 2024, private sector credit expanded by 10.5 percent (Chart I.6). Similarly, public sector credit grew 18.6 percent in March 2024 (Chart I.5). Domestic credit movements grew by 12.1 percent in March of FY24 (Chart I.4). The Reserve Money (RM) experienced an increase of 3.3 percent (Chart I.1) (year-over-year) by the end of March 2024 due to the higher growth of Bangladesh Bank's Net Domestic Assets (NDA).

In order to bring more flexibility in the foreign exchange market, Bangladesh Bank has introduced crawling peg system for buying and selling of foreign currencies on 8 May 2024. Under the new system, Crawling Peg Mid-Rate (CPMR) was set at Taka 117.00 per USD. The crawling peg system will be an interim arrangement before moving to a fully flexible market based system in the near future.

Chapter II: Global Economy and Bangladesh's Perspective

The world economy has proved remarkably resilient in the face of challenges posed by the Covid-19 pandemic and the Russia-Ukraine war, defying concerns of stagflation and economic recession. The combination of favorable demand and supply side developments, coupled with aggressive monetary tightening by many central banks, has effectively anchored inflation in most regions, with a smaller-than-expected toll on employment and economic activity. Looking ahead, although there is potential for stronger global growth than expected, downside risks to the growth remain plausible, on the possibility of further commodity price spirals amid geopolitical and weather shocks.

II.1 Global Economic Growth

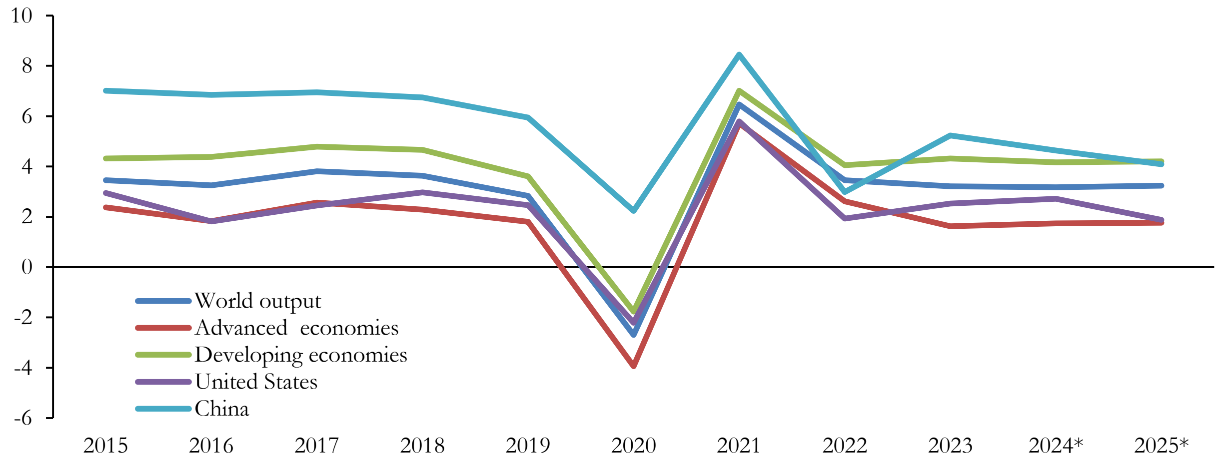
Global economic growth, estimated at 3.2 percent in 2023, is projected to grow at the same rate in 2024 and 2025, according to the IMF's most recent release of the World Economic Outlook (WEO, April 2024). Favorable demand and supply side developments have bolstered the growth prospects, resulting in steady growth in income and employment generation in major economies. Greater performances from the United States, as well as several large emerging market and middle-income economies that benefitted from increased private consumption-driven aggregate demand, contributed to this growth trajectory (Chart II.1). However, the projected growth forecasts fall short of the historical (2000-19) average of 3.8 percent, reflecting escalating global interest rates, tightening fiscal supports, as well as low productivity growth.

GDP growth for advanced economies is expected to slow from 2.6 percent in 2022 to 1.6 percent in 2023, amid stronger-than-expected US momentum but weaker-than-expected growth in the euro area. The US and Japan are estimated to grow from their low rates of 1.9 percent and 1.0 percent in 2022 to 2.5 percent and 1.9 percent in 2023, respectively. However, the Euro area, the United Kingdom, and Canada are anticipated to exhibit notably weaker performances in 2023.

The growth rate for advanced economies is projected to rise to 1.7 percent in 2024 and 1.8 percent in 2025. This trajectory includes a recovery in the Euro area from its sluggish growth in 2023 and a pick-up in growth rate in the US for 2024. Specifically, the growth rates for the Euro area are anticipated to rise from an estimated 0.4 percent in 2023 to 0.8 percent in 2024, and 1.5 percent in 2025, underpinned by robust household consumption and price stability. Meanwhile, the US economy, which grew at 2.5 percent in 2023, driven mostly by the lag effects of monetary and fiscal policy tightening coupled with sluggish aggregate demand, is projected to rise to 2.7 percent in 2024 and then slow to 1.9 percent in 2025.

The growth rate in emerging market and developing economies is forecasted to experience a slight decrease from 4.3 percent in 2023 to 4.2 percent both in 2024 and 2025. The Chinese economy is projected to demonstrate resilient growth, estimated at 5.2 percent in 2023, declining to 4.6 percent in 2024 and further decreasing to 4.1 percent in 2025 (Chart II.1).

Chart II.1: Output growth of global and selected regional economies (in percent)

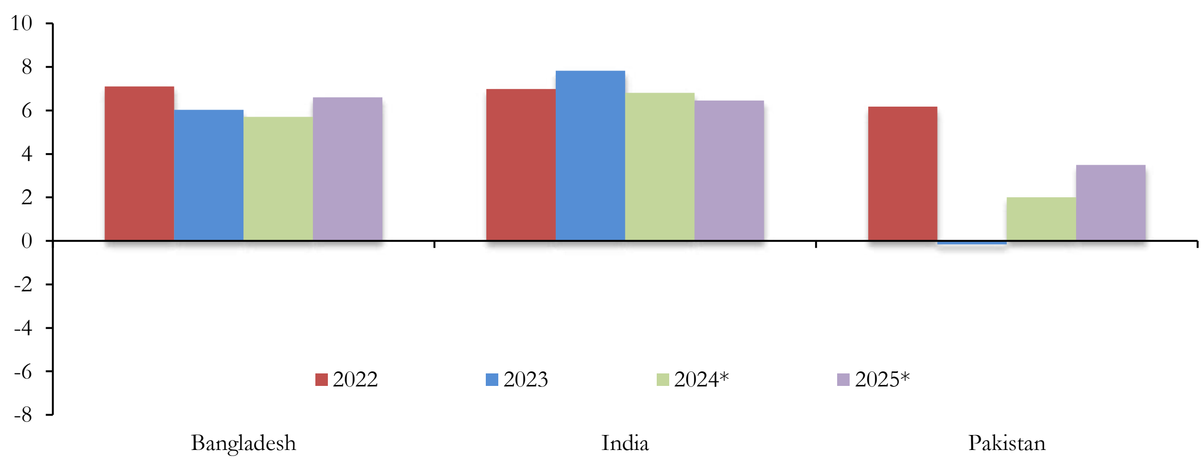


* Projection.

Source: World Economic Outlook, April 2024, IMF.

In the South Asia region, India and Bangladesh are expected to maintain GDP growth rates surpassing 6.0 percent in 2023, indicating resilience in domestic demand. However, the growth estimate for Pakistan is less promising. Furthermore, growth projections for India and Bangladesh indicate continued resilience, with expected rates of 6.8 percent and 5.7 percent, respectively, in 2024 (World Economic Outlook, April 2024) (Chart II.2).

Chart II.2: Economic growth of peer countries in South Asia (in percent)



* Projection.

Source: World Economic Outlook, April 2024, IMF.

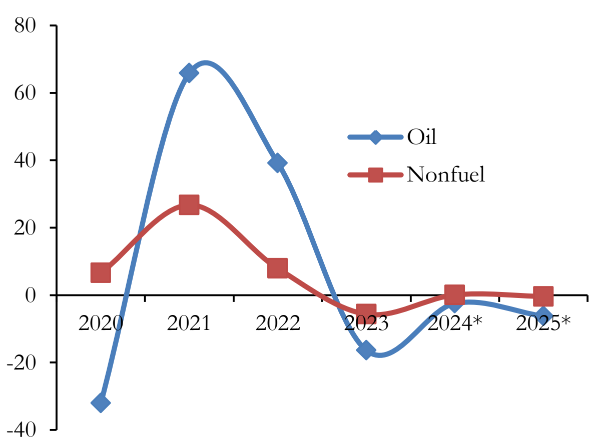
II.2 Global Inflation

Global headline inflation, which surged significantly in the beginning of 2022, began softening in the third quarter of that year and gradually declined to 6.8 percent in 2023 from 8.7 percent in 2022, albeit with some fluctuations. The faster-than-expected decline in inflation is largely attributed to developments in supply-side issues, coupled with the implementation of hawkish monetary policies in most countries, both advanced economies and emerging market and developing economies alike.

The deceleration momentum is expected to continue for advanced economies, with a projected decrease from the estimated 4.6 percent in 2023 to 2.6 percent in 2024, followed by a further decline to 2.0 percent in 2025, according to the baseline projection of the IMF (WEO, April 2024). However, inflation is expected to rise for emerging market and developing economies in the near term and remain above 8.0 percent in 2024. Nonetheless, ongoing policy rate hikes combined with persistent declines in oil and energy prices are expected to reduce inflation to 6.2 percent in 2025 for emerging market and developing economies. The IMF's forecasts for South Asian countries indicated that Bangladesh is expected to experience inflation remaining above 9 percent in 2023, which will, eventually, cool down to 6.1 percent in 2025. As for India, it would experience a decline in inflation rates in 2024, and this trend is expected to continue through 2025 (Chart II.4).

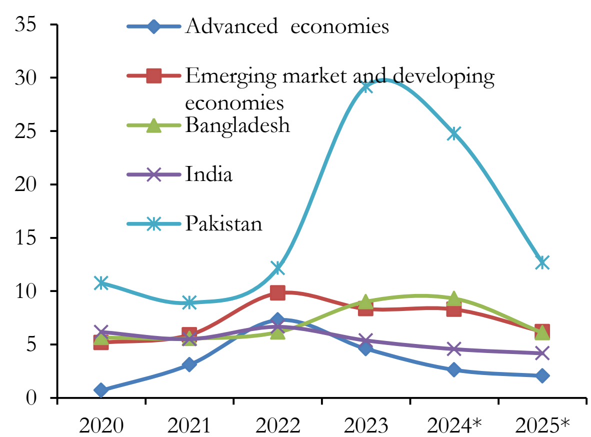
The annual average oil price is predicted to further decline by 2.5 percent in 2024 after the decline of about 16.4 percent in 2023. This downward trend is expected to continue, with the price projected to decrease by 6.3 percent in 2025. The average oil price was assumed to be USD 80.59 per barrel in 2023 and projected to be USD 78.61 per barrel in 2024 and USD 73.68 per barrel in 2025. Additionally, the prices of nonfuel commodities are also predicted to decrease by 0.1 percent in 2024 compared to 2023, followed by a further decline of 0.4 percent in 2025 (Chart II.3).

Chart II.3: Global commodity prices (y-o-y % change)



* Projection.
Source: World Economic Outlook, April 2024, IMF.

Chart II.4: Consumer prices (y-o-y % change)



* Projection.
Source: World Economic Outlook April 2024, IMF.

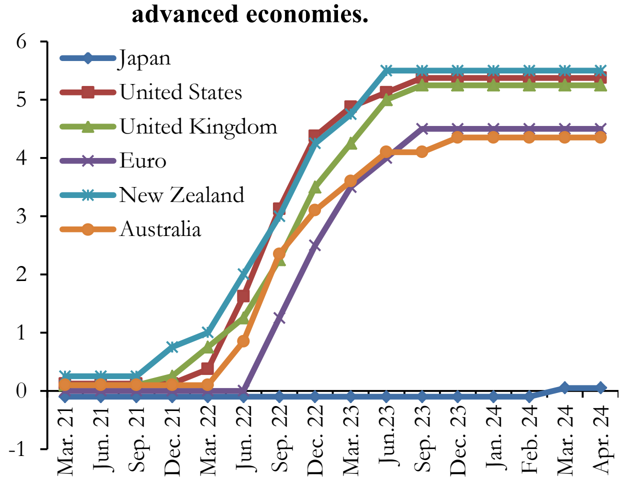
II.3 Global Financial Condition

The global monetary policy stance remained largely restrictive in 2023, with the exception of the Bank of Japan, which maintained its policy rate at -0.1 percent, set in 2016, until February 2024. The Bank of Japan then increased the policy rate to 0.05 percent in March 2024. The Federal Reserve and most central banks in other advanced economies maintained higher interest rates due to the potential upside risk of inflation, keeping these rates steady until April 2024. However, recent indications of easing inflation in advanced economies suggest that major economies may soon consider initiating a less restrictive policy stance in the near future (Chart II.5).

Central banks in most emerging market and developing economies also increased their policy rates beginning in 2022 and continued with this stance throughout 2023, except China and Brazil, which experienced a gradual decline in policy rates during 2023. Brazil's policy rate showed a broadly downward trend in 2023 and continued to decline steadily until April 2024. China also marginally softened its policy rates in 2023, and this trend continued steadily until April 2024.

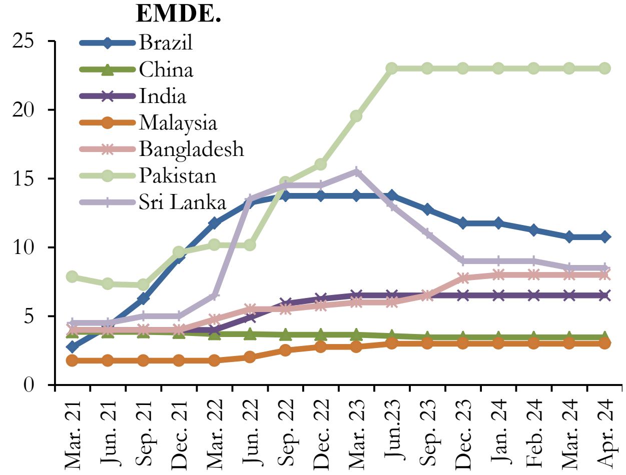
In the South Asia region, Pakistan, India, and Bangladesh maintained a steady upward adjustment in policy rates to control inflation and anchor inflation expectations in 2024, which is likely to continue in the near term. Conversely, Sri Lanka lowered its policy rates considering its domestic financial conditions in 2023, and this trend continued steadily until April 2024 (Chart II.6).

Chart II.5: Central bank's policy rate of selected advanced economies.



Source: Bank for International Settlements.

Chart II.6: Central bank's policy rate of selected EMDE.

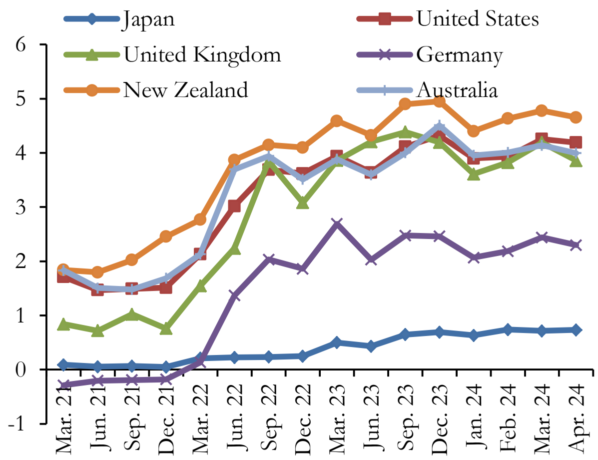


Source: Bank for International Settlements.
Notes: EMDE- emerging market and developing economies.

The 10-year government bond yields of most advanced countries experienced a generally upward trend until September 2023, driven by increases in policy rates aimed at containing inflationary pressures. However, while many advanced economies maintained policy rates at higher levels to ease inflationary pressure, some downward adjustments in yield rates have been observed since October 2023, which continued until April 2024 (Chart II.7).

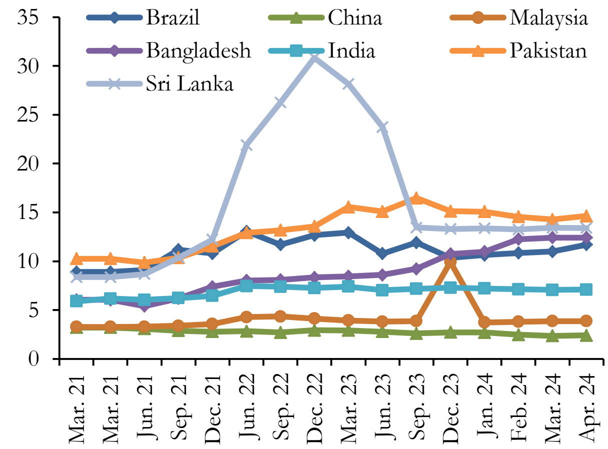
In response to the tight global financial conditions and the associated increase in yield rates, many countries in emerging markets and developing economies, including those in South Asia, have experienced higher yields on 10-year government bonds. Bangladesh has observed an upward trend in its yield curves, not only in response to global conditions but also to mitigate capital outflows. On the other hand, Sri Lanka has consistently decreased the yields on its 10-year government bonds from December 2022 to December 2023, and continued this trend until April 2024 with an easing monetary policy stance (Chart II.8).

Chart II.7: 10-year government bond yields of selected advanced economies.



Source: investing.com

Chart II.8: 10-year government bond yields of selected EMDE.



Source: investing.com, EMDE- emerging market and developing economies.

II.4 Global Outlook and Challenges

Although the growth trajectory has shown buoyancy in some advanced economies and emerging market and developing economies, there has been uneven growth across regions in 2023. Notably, the United States and China have outperformed expectations, while the euro zone has lagged. Global growth exceeded expectations, aided by favorable inflation conditions that saw a faster decline than previously estimated. The outlook suggests that inflation will continue to fall faster with a pass-through effect of declining energy prices. The faster disinflation raises the possibility of easing financial conditions and the implementation of looser fiscal policies in various countries. However, price pressures remain dominant in some of the countries, and uncertainties lurk, particularly with geopolitical tensions in the Red Sea. This conflict could potentially induce a supply shock, reversing the global inflation trend. Amid these concerns, central banks around the world may exercise caution in not reducing policy rates prematurely or prolonging adjustment, thus avoiding the risk of overshooting their targets. It will be necessary to take prudent measures considering the forthcoming global developments.

Apart from the potential risks, Bangladesh stands to benefit from a confluence of favorable global economic factors, including a positive global growth outlook, low inflation or disinflation in major advanced economies, low prevailing oil prices, and improved demand in advanced economies. With a positive global growth outlook, Bangladesh's export-oriented industries are poised to benefit from rising consumer demand for goods and services. The low inflation or disinflation in major advanced economies translates to lower input costs for Bangladeshi manufacturers, enhancing their competitiveness in the global market. Furthermore, the prevailing low oil prices offer a significant advantage for Bangladesh by reducing import bills and easing pressure on the country's current account balance and overall balance of payments (BOP). An improvement in BOP, which would minimize exchange rate pressure, could further enhance Bangladesh's economic prospects, leading to even more favorable conditions for growth and stability. Lastly, better demand in advanced economies presents an opportunity for Bangladesh to expand its export markets and diversify its export basket further.

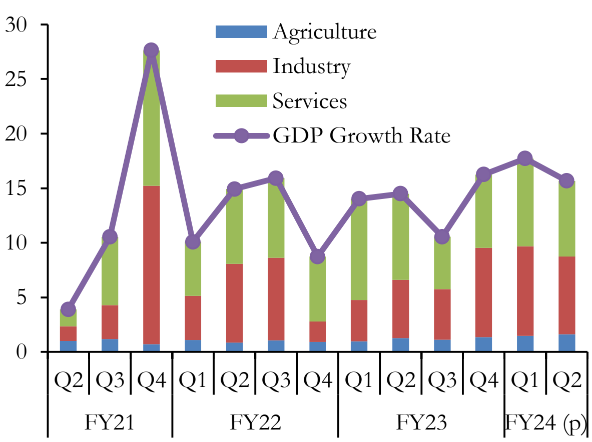
Chapter III: Overview of Domestic Economy

III.1 Economic Activities and Inflation

Real Sector Economic Activities

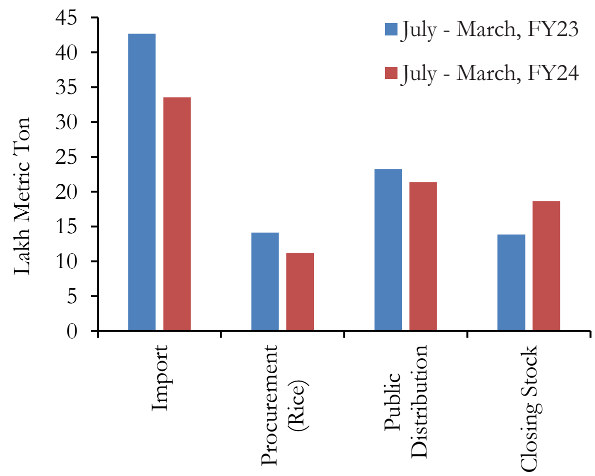
Bangladesh's economy has demonstrated remarkable resilience, registering significant growth amid persistent geopolitical tensions and trade uncertainties. GDP exhibited robust expansion in FY24, underpinned by strong performances across the agriculture, industrial, and service sectors. Despite various adversities, Bangladesh recorded commendable GDP growth rates of 5.78 and 5.82 (provisional) percent in FY23 and FY24 respectively, underscoring the intrinsic strength of its economic framework. This sustained momentum is attributable to the implementation of prudent and appropriate policy measures, which have effectively mitigated external and internal shocks. The continuation of these prudent policy measures is projected to facilitate the achievement of a GDP growth target of 6.75 percent in FY25. By maintaining a focus on strategic economic diversification, bolstering human capital development, and investing in critical infrastructure, Bangladesh aims to sustain its growth trajectory, mitigate external vulnerabilities, and enhance overall economic resilience.

Chart III.1: Gross Domestic Product
(Sectoral growth in percent)



P=provisional.
Source: Bangladesh Bureau of Statistics (BBS).

Chart III.2: Domestic Food Situation
(in lac metric ton)



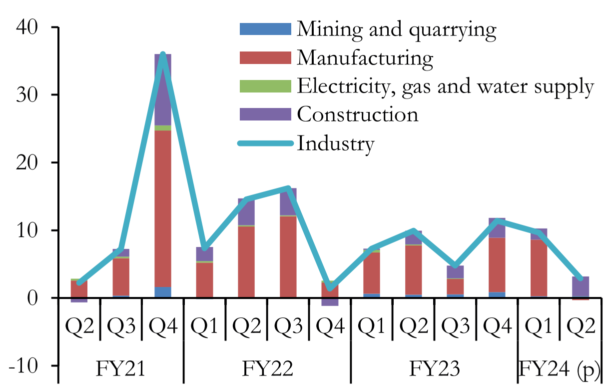
Source: Financial Management Information System, Directorate General of Food.

The agriculture sector continued its steady growth during the first half of FY23, benefiting from favorable weather conditions, advanced crop management techniques, better market prices, a timely supply of inputs, and financial support. However, in the first quarter of FY24, the agriculture output growth experienced some moderation, reflecting primarily a rise in fertilizer, fuel, and labor costs. However, agriculture output growth improved in the second quarter of FY24 (Chart III.1).

To uphold the pace in the agriculture sector, BB's monetary policy stance for July–December FY24 further strengthened agriculture and rural credit programs by expanding the agricultural credit disbursement target. Consequently, the disbursement of credit to the agriculture sector has experienced a significant increase. Specifically, about 76.19 percent of the target for agricultural credit disbursement has been achieved in the first three quarters of FY24. The increased financial support and expanded cultivation areas bode well for the sector's growth and sustainability.

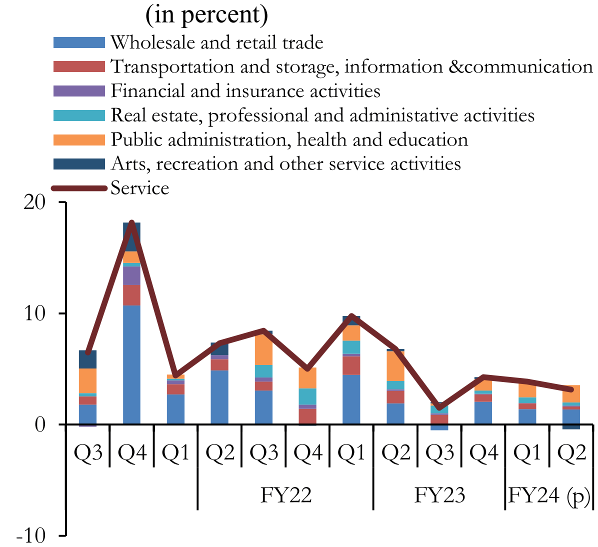
The higher production target for FY24 suggests a positive impact on production levels for the rest of the fiscal year. Total food grain imports reached 42.66 lac metric tons, with procurement and public food distribution totaling 14.15 and 23.25 lac metric tons during the first three quarters of FY24, respectively. However, the closing stock increased and became 18.61 lac metric tons in Q3FY24 compared to 13.84 lac metric ton in Q3FY23 (Chart III.2).

Chart III.3: Contribution to Industry Sector
(in percent)



P=provisional.
Source: BB staff's calculation based on BBS data.

Chart III.4: Contribution to Service Sector
(in percent)



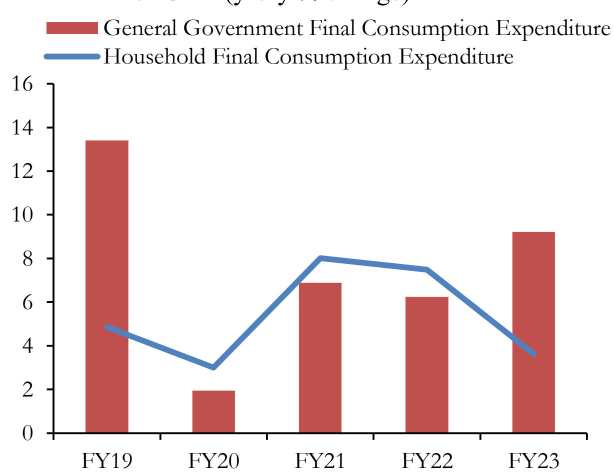
P=provisional.
Source: BB staff's calculation based on BBS data.

The industrial sector exhibited a significant resurgence, registering a growth rate of 11.41 percent in Q4 FY23 and 9.67 percent in Q1FY24, underscoring robust quarter-on-quarter expansion within the manufacturing domain. However, a precipitous decline in the manufacturing sub-sector marked contraction in the sector's growth in Q2FY24. The contraction in both domestic and external consumption because of high inflation, import restrictions amid the US dollar crisis, and the recent gas and electricity shortages have significantly impeded growth in the manufacturing sector. Additionally, construction subsector registered steady growth and mining subsector declined significantly in growth form during Q4FY23 to first two quarters of FY24, while electricity contributed marginally. Looking at the monthly industrial production index, the momentum in the manufacturing sector slowed down during July–December of FY24, registering a growth rate of 3.86 percent. Nonetheless, amid a tight monetary policy stance, BB's precedence to ascertain adequate credit flow to the economy's productive sectors was further rolled up in July–December H1FY24 MPS. Accordingly, in the first quarter of FY24, the disbursement of industrial loans, term loans, and working capital financing increased by 12.51 percent, 12.97 percent, and 12.05 percent, respectively.

To foster the advancement of cottage, micro, small and medium enterprises (CMSMEs), identified as a priority sector, BB continued its refinance and pre-finance facilities to banks. Consequently, CMSMEs secured an 8.06 percent increase in loan disbursement in FY23. Within the manufacturing sector, small and medium enterprises (SMEs) and cottage-scale manufacturing industries recorded growth rates of 3.80 percent and 5.98 percent, respectively, during July–December FY24. Meanwhile, large-scale manufacturing witnessed a growth rate of 3.24 percent during July–December FY24.

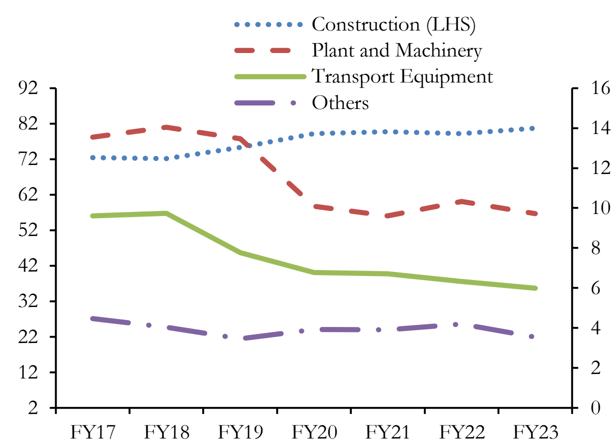
The service sector activities increased sharply from 1.47 percent and 4.33 percent in Q3FY23 and Q4FY23, respectively remained almost stable in first two quarter of FY24 with a slightly downward trend (3.73 percent and 3.06 percent respectively). Wholesale and retail trade, financial and insurance activities, public administration, and real estate, professional and administrative activities played a pivotal role in sustaining positive momentum for overall service sector growth (Chart III.4). As service sector data for the rest of the period of H2FY24 has not been published yet, several high-frequency proxy variables, such as comparatively lower growth in credit flows to trade and commerce (6.51 percent) and consumer finances (8.95 percent), credit to transport (0.80 percent) during the first half of FY24, reflecting the moderation in the service sector.

Chart III.5: Composition of Expenditure Categories of GDP (y-o-y % change)



Note: FY23 provisional data.
Source: National Accounts Statistics, BBS.

Chart III.6: Contributions to Gross Fixed Capital Formation (in percent)



Note: FY23 provisional data.
Source: National Accounts Statistics, BBS.

Domestic demand decelerated in FY23 after maintaining substantial growth in the previous two consecutive years, led by a decrease in household final consumption expenditure growth, reflecting the current monetary tightening. Conversely, government final consumption expenditure showed an uptick in FY23 on the back of expenditure on hefty megaprojects (Chart III.5).

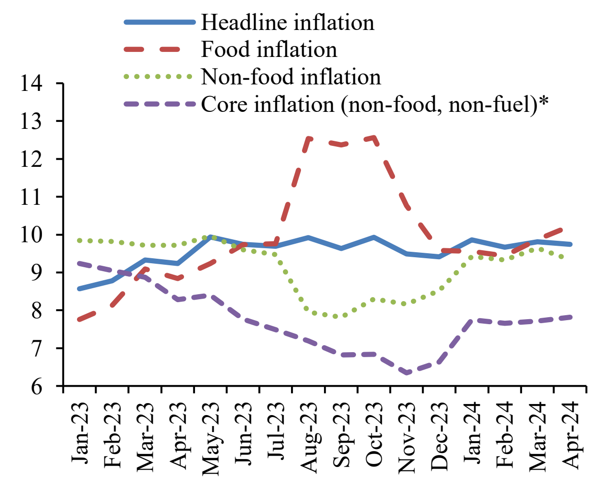
Among the components of gross fixed capital formation, about 80.76 percent of the total investment is recorded for construction in FY23, which is higher than the previous year. The increase in the level of investment in construction reflected the demand for real estate and the pace of industrialization. The data for credit disbursement to the construction sector (10.82 percent) in H1FY24 also suggested expansion in this sector. On the other hand, 9.72 percent of investment went to the plant and machinery suggested for modernizing textile machinery, agriculture equipment, and expanding technological infrastructure. Meanwhile, 5.99 percent of the investment was allocated to transport equipment during FY23 (Chart III.6).

The diverse growth across sectors and the consistent performance in subsequent quarters bode well for the country's economic outlook, portraying a picture of resilience, adaptability, and sustained expansion. Moreover, early indicators from H1FY24 suggest that the momentum continues, with sustained agricultural production, impressive manufacturing activities, and steady growth in the service sector.

Inflation

Bangladesh has been grappling with consistently elevated inflation recently, echoing trends seen in many countries. The Consumer Price Index (CPI) headline inflation has persisted above 9.0 percent since 2023, peaking at 9.93 percent year-on-year in October 2023. The lag effect of marked global commodity price hikes, partly exacerbated by the weaker exchange rate of BDT against USD, has prolonged the persistently high inflation. Inflationary pressures have also broadened within the core basket, reflecting spillover and second-round effects as well as the pass-through of costs associated with electricity generation. Despite decreasing trend of global commodity price of that time, Bangladesh's economy couldn't benefit due to the significant domestic currency depreciation, which subsequently raised import prices, thereby contributing to inflationary pressures.

Chart III.7: Point-to-Point CPI Inflation (in percent)



Source: Bangladesh Bureau of Statistics (BBS).
*Calculated by Research Department, BB using BBS data.

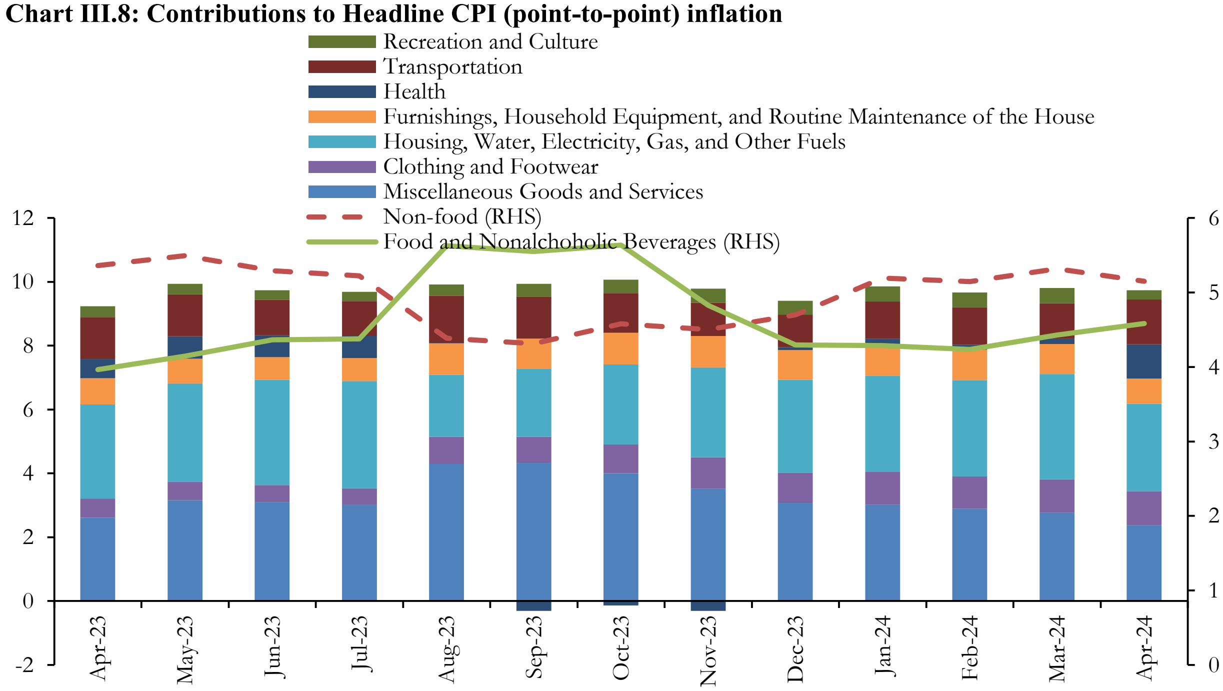
In light of this, BB prioritized keeping inflation under control, as announced in the July–December FY24 MPS, adopting a tight monetary policy stance. The policy rate was raised from 6.50 percent to 7.25 percent in October 2023, which was re-fixed by raising 50 basis points to 7.75 percent in

November 2023. However, despite a 125-basis point hike in the policy rate, for most of the period, inflation stayed significantly higher. But in the latter two months of H1FY24, headline inflation began to decline, and in December 2023, it reached 9.41 percent, driven primarily by a decline in food inflation and contained core inflation. Nonetheless, headline inflation surged again to 9.86 percent in the initial month of H2 FY24, driven by an uptick in non-food inflation. By March 2024, headline inflation had marginally declined to 9.81 percent. Over the past year, fluctuations in fuel, food, and energy prices have been the predominant drivers of headline inflation, with food and fuel costs largely mirroring global commodity price trends.

Additionally, BB has implemented steps to stabilize the external sector and, hence, halt excessive inflation, including stepping up its surveillance of the foreign exchange market, quantitatively tightening by supplying dollars, and letting the BDT gradually depreciate by the state of the market.

BB continued to monitor indications of persistent inflationary pressures and resilience in the economy closely as a whole and stretched its tightening stance in the MPS announced for the second half of FY24 by raising the policy rate subsequently to 8.50 percent. Nonetheless, monetary policy would need to be restrictive for sufficiently long to return inflation to around the 7.5 percent target sustainably in the medium term, and further tightening would be required if there were evidence of more persistent inflationary pressures.

Chart III.8: Contributions to Headline CPI (point-to-point) inflation

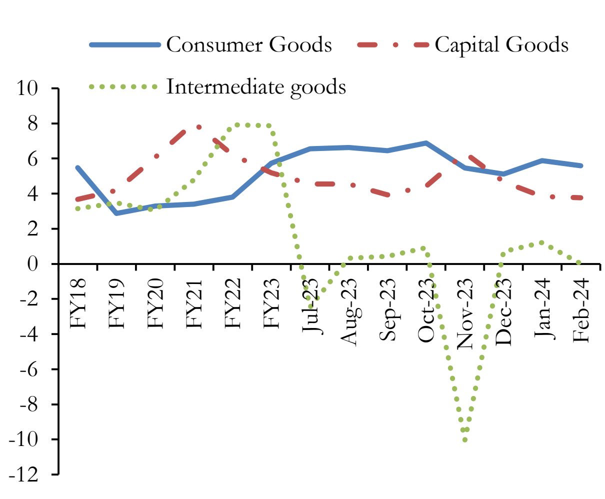


Source: BB staff's calculation based on BBS data.

Drivers of Food and Non-food Inflation

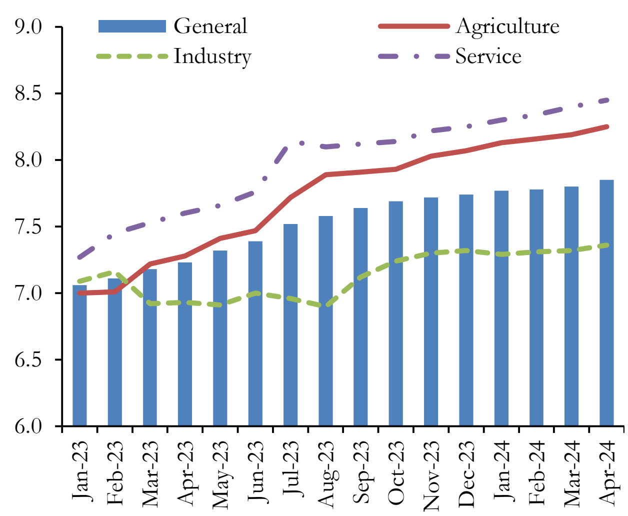
Over the past ten months, from July through April FY24, food inflation underpinned much of the dynamics, while non-food inflation gradually gained influence over time. Food inflation slightly declined but rose again to double-digit growth, reaching 10.22 percent in April FY24. This resurgence followed a period of double-digit growth from August to November FY24, partly attributed to the Ramadan and Eid-ul-Fitr celebrations. Conversely, non-food inflation eased from 9.60 percent in June 2023 to 7.82 percent in September 2023 before rising again to 9.42 percent in January 2024. However, non-food inflation decreased to 9.34 percent in April 2024 from 9.64 percent in March 2024. Among the components of non-food inflation, the highest rate was recorded in the health sector at 13.69 percent. This was followed by 11.34 percent in furnishings, household equipment, and routine maintenance of the house, 10.65 percent in recreation and culture, 9.55 percent in clothing and footwear, 8.23 percent in transportation, and 9.90 percent in housing, water, electricity, gas, and other fuels in April 2024. Furthermore, urban inflation on a point-to-point basis was 9.46 percent, whereas rural inflation was higher at 9.92 percent in April 2024.

Chart III.9: Producer Price Index (y-o-y % change)



Source: BB staff's calculation based on BBS data.

Chart III.10: Wage Rate Index (y-o-y % change)



Source: Bangladesh Bureau of Statistics (BBS).

Producers' Price Index

The Producers Price Index (PPI) of consumer goods, capital goods, and intermediate goods registered higher growth of 5.74 percent, 5.19 percent, and 7.87 percent, respectively, in FY23 compared to the previous year, suggesting underlying inflationary pressures, increased production costs, and pressures on profit margins for businesses. This growth spurt continued for consumer and capital goods in the first quarter of FY24, albeit due to producers' price inflation in intermediate goods. In October FY24, the Producer Price Index (PPI) for consumer goods surged by 6.88

percent, indicating a notable increase in production costs for food, clothing, electronics, and household goods. This uptick in costs potentially had repercussions on the retail prices of consumer goods, signaling a substantial impact on consumer spending habits and overall inflationary pressures. After that, PPI for consumer goods slightly decreased and in February FY24 it became 5.59 percent. Meanwhile, the PPI for capital goods recorded 3.76 percent inflation in February FY24, lower than the July 2023 figure of 4.55 percent, signaling heightened investment activity and growing demand for productive assets by businesses, which could be interpreted as a positive sign for economic expansion and growth. Conversely, the PPI inflation for intermediate goods experienced a deceleration in February FY24 (0.01 percent), from 1.21 percent in January 2024 (Chart III.9). This sluggish growth hinted at challenges within the production process, likely attributed to higher transportation costs, elevated energy prices, and disruptions in the supply chain.

Nominal Wage Rate

The nominal wage rate climbed progressively from 7.39 percent in June 2023 to 7.7 percent in December 2023. In April 2024, it was 7.85 percent. Despite being less than CPI inflation, the pay index increase significantly represented the current inflationary wave, affecting households' purchasing power. In line with the overall wage growth pattern, wages in all three subsectors—agriculture, industry, and services—showed a consistent upward trend, rising from 8.07 percent, 7.32 percent, and 8.25 percent in December 2023 to 8.25 percent, 7.36 percent, and 8.45 percent in April 2024, respectively (Chart III.10).

III.2 External Sector

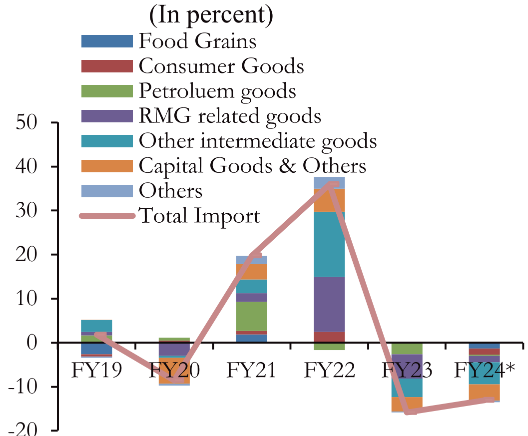
Balance of Payment

Bangladesh's external sector has experienced vulnerabilities since the second half of FY22, marked by increased pressure on the balance of payments (BoP) amid significant depletion of foreign exchange reserves and noticeable currency depreciation. These vulnerabilities have been exacerbated by heightened global economic uncertainty originating from ongoing geopolitical tensions. However, a positive development was observed in the deficit of current account balance (CAB) during July- April of FY24, reflecting a significantly lower trade deficit and increased remittance inflows compared to July-April of FY23. The CAB had a deficit of USD 5.7 billion during July-April of FY24 which was a deficit of USD 10.2 billion during the same period of the previous year. The financial account reported a surplus of USD 2.2 billion during July-April of FY24, contributing significantly to improvement in the overall balance of payment (BoP) deficit as compared to the same period of the previous year. The deficit in the overall BoP decreased to USD 5.6 billion during July-April of FY24 compared to a wider deficit of USD 8.8 billion during the same period in FY23.

Country's total exports stood at USD 33.7 billion, registering a negative growth of 6.8 percent during July-April of FY24 compared to USD 36.1 billion in the same period of FY23. The lion's share (88.1 percent) of total export was concentrated in the export of ready-made garments (RMG), which also declined by 6.7 percent during July-April of FY24.

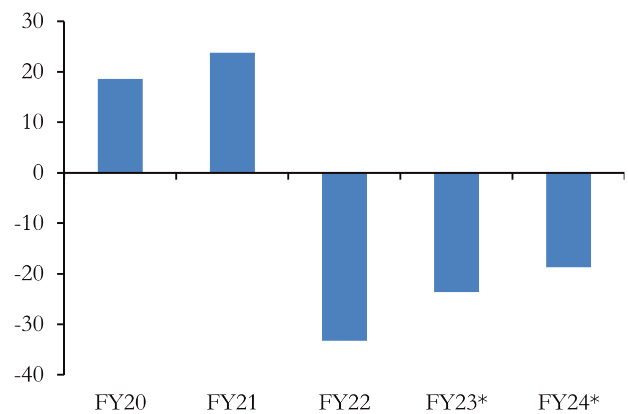
Country's import payment declined by 12.3 percent and registered USD 52.4 billion during July-April of FY24. This significant fall in import payments spread out all categories of import items during July-April of FY24 (Chart III.11), supported by several BB's policy measures implemented to contain import demand. A notable downward in import payments reduced the trade deficit remarkably to USD 18.7 billion during July-April of FY24 from USD 23.6 billion during the same period of FY23 (Chart III.12).

Chart III.11: Decomposition of Import Growth (In percent)



Source: Bangladesh Bank.
*July-April, FY24.

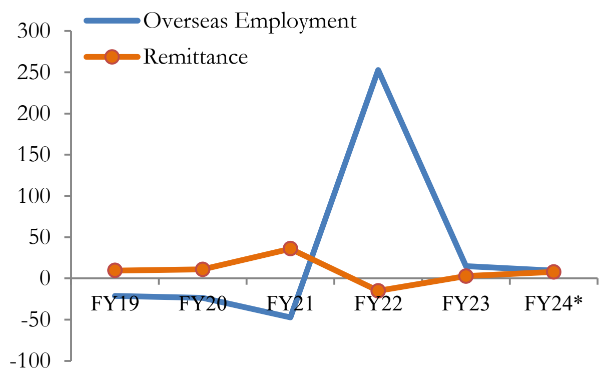
Chart III.12: Trade Deficit (in billion USD)



Source: Bangladesh Bank.
* July – April of the Financial Year.

Remittance inflows registered at USD 19.1 billion, growing by 7.9 percent during July-April of FY24, while the growth rate was 2.75 percent in FY23 (Chart III.13). The highest amount of remittance was received mainly from the Gulf region, which accounts for about half (48.8 percent) of the total remittances. During July-April, FY24, remittances from Saudi Arabia decreased by 28.8 percent. The UAE, the Euro region, Malaysia, and the UK contributed significantly to maintain the improved growth in country's remittance inflows. On the other hand, remittance from the USA declined by 25.3 percent during the same period of FY24 (Chart III.14). However, to enhance the workers' remittances with the high growth of overseas employment, the government and the BB have taken several multifaceted policies like dual incentive scheme, the double limit for remittances to individual mobile financial service (MFS) account, expanded remittance channels, streamlined the banking regulation, fair pricing for remittances, the 'PROBASH' pension scheme for expatriate Bangladeshis etc.

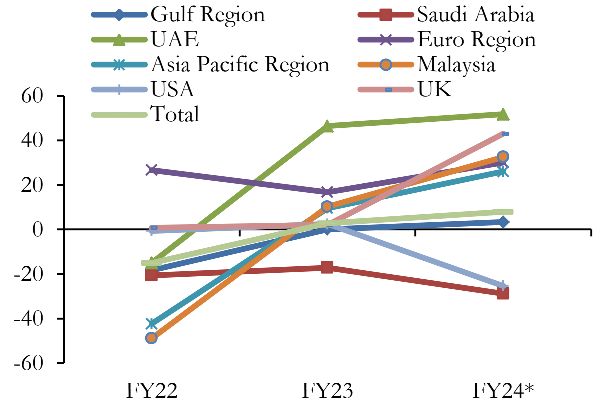
Chart III.13: Remittance Inflow and Overseas Employment (growth in percent)



Source: Bangladesh Bank and Bureau of Manpower, Employment, and Training

* July – April, FY24

Chart III.14: Region/Country-wise Growth of Remittance Inflows (in percent)

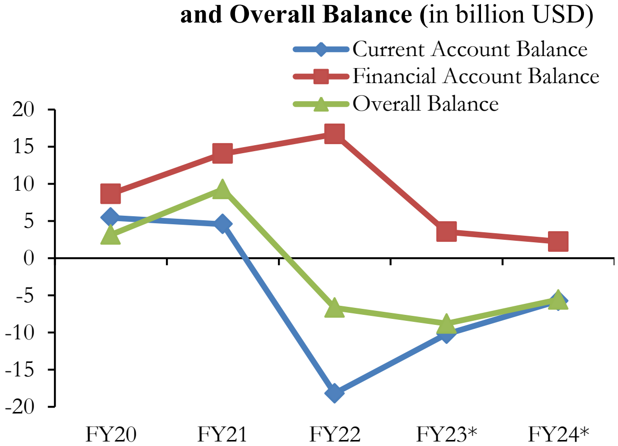


Source: Bangladesh Bank.

* July – April, FY24.

The current account balance registered a deficit of USD 5.7 billion during July-April of FY24, which experienced a deficit of USD 10.2 billion during same period of FY23. On the other hand, the financial account surplus reduced to USD 2.2 billion during July-April of FY24 compared to a surplus of USD 3.5 billion during the same period of FY23 (Chart III.15). The moderation of the financial account surplus in July-April of FY24 was due to decrease in portfolio investment and other investment amid rising global interest rates and economic uncertainties (Chart III.16). Despite the deficit in the current account balance, a notable surplus of the financial account contributed to mitigate the overall BoP deficit to USD 5.6 billion in July-April of FY24 compared with the enormous deficit of USD 8.8 billion during the same period of FY23.

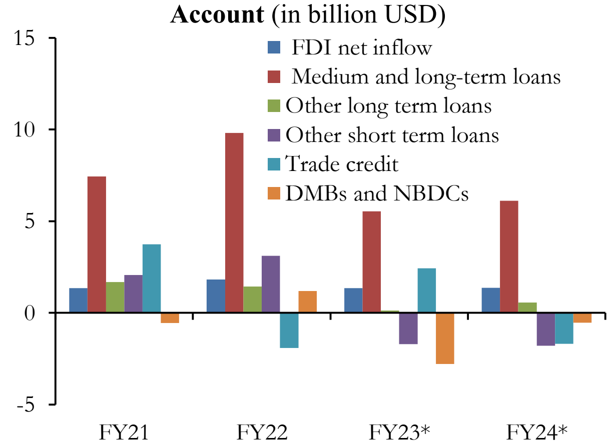
Chart III.15: Current Account, Financial Account and Overall Balance (in billion USD)



Source: Bangladesh Bank.

* July – April of the Financial Year.

Chart III.16: Major Components of Financial Account (in billion USD)



Source: Bangladesh Bank.

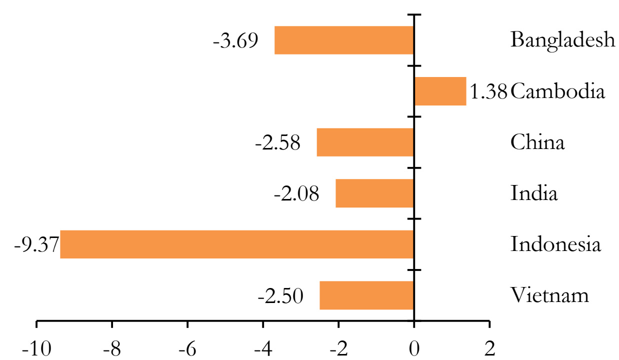
* July – April of the Financial Year.

Exchange Rate and Foreign Exchange Market

Exchange Rate Movements

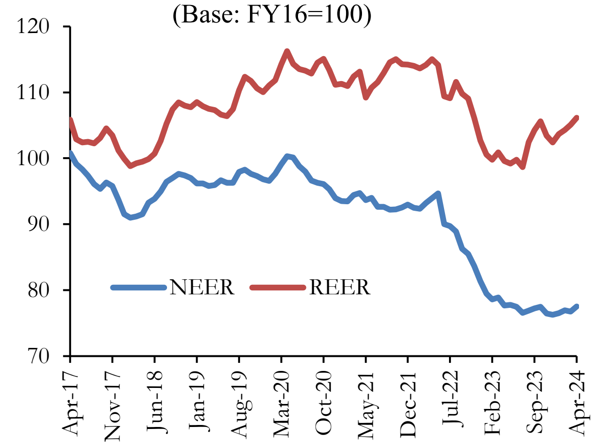
The significant deficit in country's BoP, the persistence of contractionary monetary policies in major advanced and emerging market economies, and increasing uncertainties arising from war-induced geo-economic fragmentation and geopolitical tensions have exerted depreciation pressure on the exchange rate of BDT against USD. To alleviate BoP pressure, address the depletion of foreign exchange reserves, and make the exchange rate more market oriented, BB recently introduced crawling peg system, setting crawling peg mid-rate (CPMR) at Taka 117.00 per USD on 8 May 2024. The BDT's exchange rate against USD for inter-bank transactions depreciated by 3.7 percent at the end of April 2024 compared to the end of April 2023 (Chart III.17).

Chart III.17: Appreciation/ Depreciation (+/-) of Peer Countries' Nominal Exchange Rate against USD at end April 2024 (in percent)



Source: Central banks of the respective countries.

Chart III.18: Movements in NEER and REER
(Base: FY16=100)



Source: Bangladesh Bank.

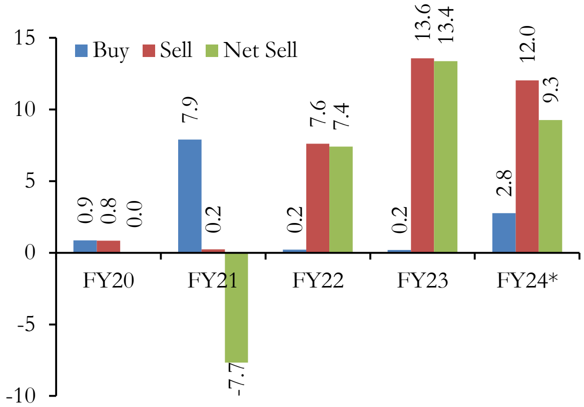
The depreciation of the BDT against the USD was also evident in the nominal effective exchange rate (NEER), which declined by 0.2 percent at the end of April 2024 compared to April 2023. Although, the real effective exchange rate (REER) indices depicted some appreciation (6.6 percent) of BDT against USD at the end of April 2024 (Chart III.18), due to higher price level in the domestic economy compared to the partner countries' economy. The nominal exchange rates of peer countries except Cambodia also experienced some depreciation at the end of April 2024 compared to April 2023. The decrease in the REER index approaching 100 suggests reducing the pressure for nominal exchange rate depreciation.

Foreign Exchange Market

BB continued selling foreign currency to address the demand-supply gap in the foreign exchange market and prevent sudden depreciation, which led to reduce the official foreign exchange reserves. BB's net sales of foreign currencies during July-April FY24 totaled USD 9.3 billion. Consequently, the foreign exchange reserve decreased from USD 31.20 billion at the end of June 2023 to USD

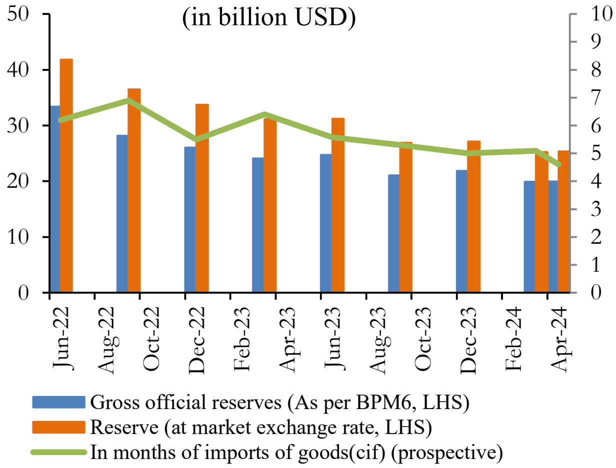
25.37 billion at the end of April 2024. Despite this decline, the reserve remained sufficient to cover import bills for 4.6 months, based on prevailing import trends (Chart III.19 and Chart III.20).

Chart III.19: BB's Intervention in the Foreign Exchange Market (in billion USD)



* July – April, FY24.
Source: Bangladesh Bank.

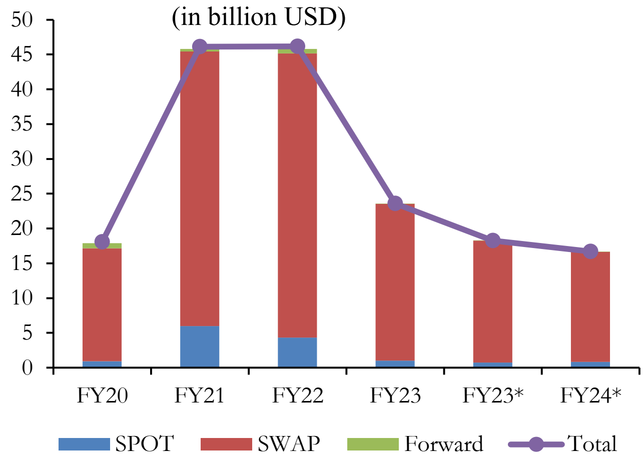
Chart III.20: International Reserve
(in billion USD)



Source: Bangladesh Bank.

Bangladesh's interbank foreign exchange market transactions consist of spot, forward, and swap transactions. Total turnover in the foreign exchange market stood at USD 23.6 billion in FY23, indicating a sharp fall of 48.9 percent compared to the overall turnover in FY22. In July–March of FY24, the total foreign exchange turnover declined by 8.7 percent and registered at USD 16.7 billion compared to USD 18.3 billion in the same period of FY23, reflecting a shortage of liquidity in the foreign exchange market (Chart III.21). The main component for this deceleration was swap transactions, which constituted 94.8 percent of the total transaction, and decreased by 9.6 percent in July-March, FY24 compared to the swap transactions in July-March, FY23. However, spot transactions increased by 9.7 percent in this period, accounting for only 4.9 percent of the total turnover.

Chart III.21: Total Turnover by Instruments
(in billion USD)



Source: Bangladesh Bank; *July - March of FY23 and FY24.

The deficit in the balance of payment significantly eased in FY24, supported by improvements in the current account balance deficit and a surplus in the financial account. Adopting several policy initiatives by the government and Bangladesh Bank for promoting exports and remittances, strong FDI inflows, and improvement in the trade balance may stabilize the exchange rates of BDT in the coming months. Moreover, the tightening of global financial conditions may trigger broad-based capital outflows, affect the cross-border portfolio, lower foreign direct investment flows, and increase borrowing costs and debt hardship.

III.3 Money and Credit Market

Interest Rates Development

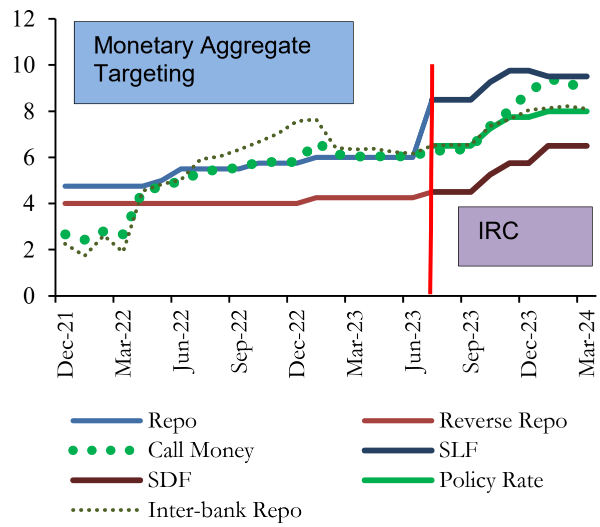
Bangladesh Bank made a remarkable transition in its monetary policy approach from a monetary aggregate targeting framework to an interest rate corridor (IRC) system commenced on 1 July 2023, announced in its Monetary Policy Statement (MPS) for July-December, 2023. The corridor is bounded by an upper limit known as the standing lending facility (SLF) rate and a lower limit known as the standing deposit facility (SDF) rate. Within a symmetric corridor between the two rates, BB announced the policy (repo) rate as mid rate, influencing the interbank call money rate so that the call money rate can move closely with the repo rate.

The monetary policy stance for the first half of FY24 (July-December, 2023) continued tightening by raising the repo rate by 50 basis points to 6.50 percent to contain the inflationary pressure while ensuring adequate funding for the productive sectors. The SLF and SDF rates were fixed at 8.50 percent and 4.50 percent, respectively, with the corridor at ±200 basis points of the policy rate. Besides, BB removed the previous cap on the lending interest rate and introduced a more market-oriented reference lending rate for commercial banks. The reference lending rate was the six-month moving average rate of the Treasury bill (SMART) plus a margin of up to 3.00 percent for banks.

Later, BB decided to tighten the monetary policy further to contain inflationary pressure and revised the policy rate upward by 75 basis points to 7.25 percent on 5 October 2023. Similarly, the SLF and SDF rates also were revised upward by 75 basis points to 9.25 percent and 5.25 percent, respectively. The reference lending rate was also increased and fixed at SMART plus a margin of up to 3.50 percent for banks. On 27 November 2023, BB again tightened the monetary policy by revising the policy (repo) rate upward by 50 basis points to 7.75 percent. Likewise, the SLF and SDF rates were increased by 50 basis points to 9.75 percent and 5.75 percent, respectively. The reference lending rate was also increased and fixed at SMART plus a margin of up to 3.75 percent for banks.

In Monetary Policy Statement (MPS) for January-June 2024, BB again increased policy (repo) rate by 25 basis points to 8.00 percent from 7.75 percent, effective from January 21, 2024. However at the same time, to refine the liquidity management, the standing lending facility (SLF) rate was lowered by 25 basis points to 9.50 percent, while the standing deposit facility rate (SDF) was raised by 75 basis points to 6.50 percent, thereby narrowing down the corridor from ±200 basis points to ±150 basis points. On the other hand, the reference lending rate was lowered twice and fixed at SMART plus a margin of up to 3.50 percent for banks from March 1, 2024 and then a margin of up to 3.0 percent for banks from April 1, 2024. To anchor inflation expectations at the desired level, the policy rate has been increased by 50 basis points to 8.50 percent from 8.00 percent on 8 May 2024. Additionally, the Standing Lending Facility (SLF) rate increased by 50 basis points to 10.00 percent from 9.50 percent, and the Standing Deposit Facility (SDF) rate increased by 50 basis points to 7.00 percent from 6.50 percent. Moreover, to move towards a market based interest rate, the existing reference rate SMART for determining the lending rates of banks/NBFIs was abolished. Banks and NBFIs can set the interest rates based on the interaction of demand and supply in the market as well as the banker customer relationship.

Chart III.22: Movements in Policy rate and Money market Rates (in percent)



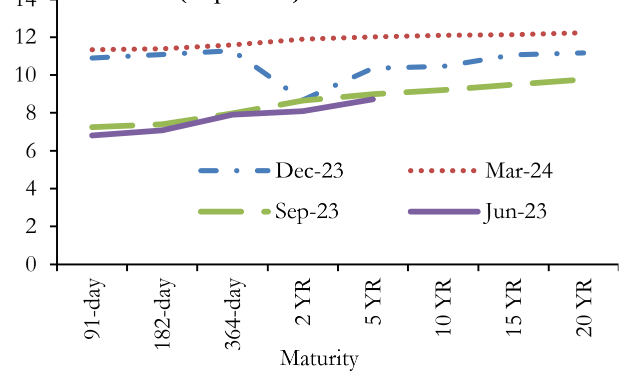
Source: Bangladesh Bank.

Amid the upward adjustments of policy rates, the interbank call money market rate and the interbank repo market rate followed an upward trend and moved closely with the policy (repo) rate. Nonetheless, It remained within the corridor set by BB without any significant fluctuation during July 2023 - March 2024 (Chart III.22).

In the money market, average yields of government securities for all short, medium, and long-term maturities increased in March 2024, reflecting the transmission of tightened monetary policy. The yields on 91-day, 182-day, and 364-day treasury bills rose to 11.33, 11.38, and 11.59 percent in March 2024 from 6.80, 7.07, and 7.9 percent in June 2023, respectively. Correspondingly, the yields on 2-year and 5-year treasury bonds increased to 11.90 and 12.02 percent in March 2024 from 8.09 to 8.71 percent in June 2023, respectively. Similarly, among the other instruments, 10-year, 15-year and 20-year treasury bonds were traded at higher rates of 12.09, 12.14 and 12.24 percent in March 2024, respectively (Chart III.23).

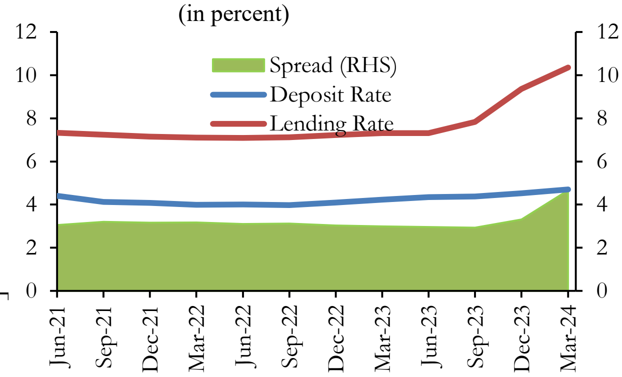
The reference rate for lending, the six-month moving average rate of Treasury bills (SMART), gradually increased from 7.10 percent in June 2023 to 10.55 percent in March 2024. Consequently, weighted average interest rates in the retail market continued to follow an upward trend during the period under review, reflecting the tighter situation in the banking system. Weighted average deposit and lending rates rose to 5.17 percent and 10.36 percent in March 2024 from 4.38 percent and 7.31 percent in June 2023, respectively. The interest rate spread increased to 5.19 percent in March 2024 from 2.93 percent in June 2023, reflecting the relatively substantial increase in the lending rate compared to the rise in the deposit rate (Chart III.24).

Chart III.23: Yields of Government Securities
(in percent)



Source: Bangladesh Bank.

Chart III.24: Interest Rate on Deposits and Lending
(in percent)

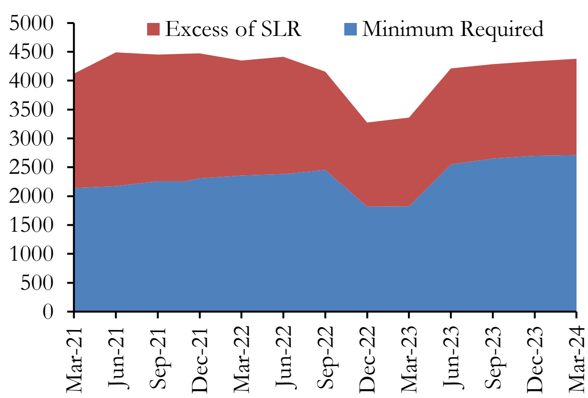


Source: Bangladesh Bank.

Liquidity

The liquidity in the banking system remained mostly sufficient during July 2023- March 2024 on the back of rebounding growth in total deposits (8.85 percent in March 2024) encouraged by higher deposit rate and BB's liquidity support. Liquid assets in the banking system stood at BDT 4378.79 billion in March 2024, which was BDT 4212.3 billion in June 2023. The excess liquidity, estimated as the difference between the maintained liquidity and minimum required liquidity, increased to BDT 1668.26 billion in March 2024 from 1662.7 billion in June 2023 (Chart III.25).

Chart III.25: Liquidity (In billion BDT)



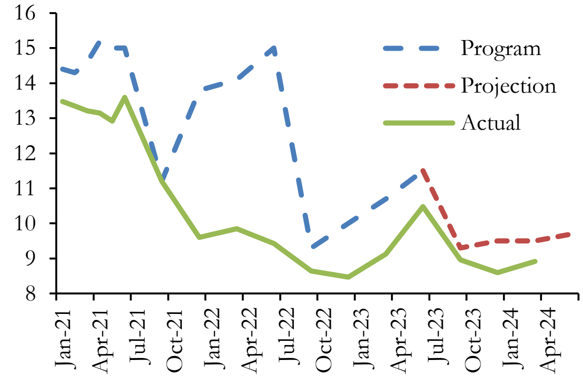
Source: Bangladesh Bank.

Broad Money (M2)

BB's new monetary policy framework abandoned targeting the growth of reserve money (RM) and broad money (M2). However, it remains crucial to align their projections with the policy interest rate target towards achieving the key objectives of monetary policy. In the January –June 2024 monetary policy statement, BB projected broad money (M2) growth to be at 9.5 percent in March 2024. Against this projection, the actual growth of the broad money (M2) stood at 8.92 percent, indicating a tight monetary condition in the market. This lower growth resulted from a higher-than-projected net foreign asset (NFA) decline. However, growth in the net domestic asset (NDA) was higher relative to the projection (Chart III.26).

NFA growth remained negative because of deficit in the overall balance of payment (BoP). NFA dwindled by 16.1 percent at the end of March 2024 against the projection of -9.8 percent growth for March 2024. Public sector credit growth experienced a deceleration from 35.8 percent in June 2023 to 18.6 percent against the projection of 30.0 percent for March 2024. The decrease in public sector credit growth was supported by satisfactory growth in NBR tax revenue collection, and the lower financing demand emanated from the continuation of austerity measures taken by the government that started in the last fiscal year.

Chart III.26: Broad Money (M2) Growth (%):
Prjection Vs. Actual



Source: Bangladesh Bank.

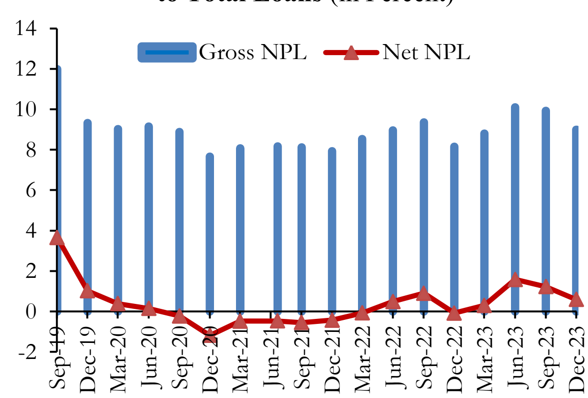
Reserve Money (RM)

The growth rate of reserve money (RM) witnessed a fall from 10.49 percent in June 2023 to 3.2 percent in March 2024. However, this growth was higher than the projection of -0.8 percent for March 2024. This fall in RM can be attributed to the 19.5 percent deceleration of the NFA of BB. In contrast, the NDA of BB experienced a remarkable growth of 104.3 percent during the same period and this growth was sufficient to offset the fall of NFA to help RM achieve positive growth.

Banking Sector Performance

The overall performance of the banking system exhibited a mixed trend during July–December 2023, reflecting a marginal decline in the ratio of non-performing loans (NPLs) to total loans, an improvement in the deposit growth along with a moderation in the advance growth, a constant shortfall of provision maintenance with some improvement and a fall in excess liquidity within the banking sector. The ratio of non-performing loans to total loans declined from 10.11 percent in June 2023 to 9.00 percent in December 2023, with the help of a notable improvement of NPLs in state-owned commercial banks (SCBs) (Chart III.27). Nonetheless, the failure of some banks to maintain required provisions against their NPLs created a remarkable shortfall in provisions maintained in the banking system. However, the shortfall declined from BDT -214.6 billion in

Chart III.27: Ratio of Gross NPLs and Net NPL to Total Loans (in Percent)



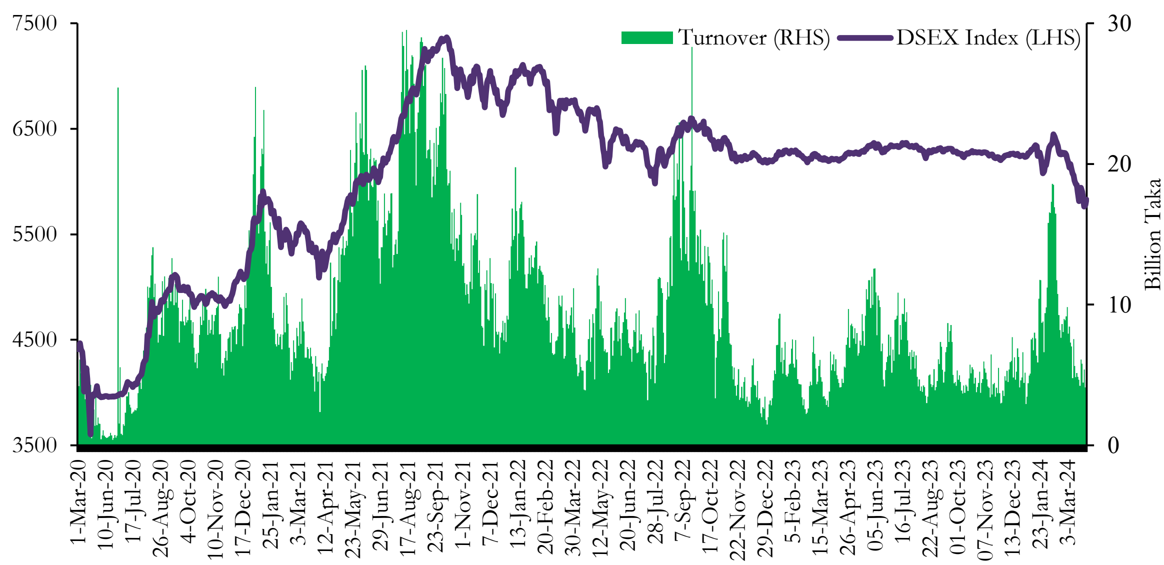
Source: Bangladesh Bank.

June 2023 to BDT -192.6 billion in December 2023. The deposit growth surged to 8.85 percent in March 2024, up from 7.69 percent in June 2023, mainly influenced by the competitive deposit interest rate offered by the commercial banks after the removal of the interest rate cap by Bangladesh bank. Similarly, the growth in bank advances declined to 9.20 percent in March 2024 from 11.34 percent in June 2023, partly influenced by the higher lending rates. Accordingly, the banking sector's overall advance-deposit ratio (ADR) increased to 80.98 percent in March 2024 from 78.51 percent in June 2023. The banking industry's capital to risk-weighted asset ratio (CRAR) decreased to 11.08 percent in September 2023 from 11.19 percent in June 2023. However, the total industry CRAR remained above the minimum requirement of 10 percent. The banking industry's profitability witnessed some improvement at the end of December 2023 compared to the end of June 2023, which was reflected by an increase in both return on assets (ROA) and return on equity (ROE). During the same period, both ROA and ROE increased from 0.43 and 7.88 percent to 0.59 and 10.55 percent, respectively.

III.4 Capital Market

The capital market indicators exhibited a mixed performance during July 2023–March 2024, reflected in the marginal growth of price indices and market capitalization along with reduced average turnover and the price-earnings ratio. Some unfavorable developments both in the domestic and global economy, including tight liquidity in the banking system, depreciating pressure of the exchange rates, tightening of the global financial condition, and instability that emerged from the global geopolitical tension, contributed to the mixed performance of the capital market.

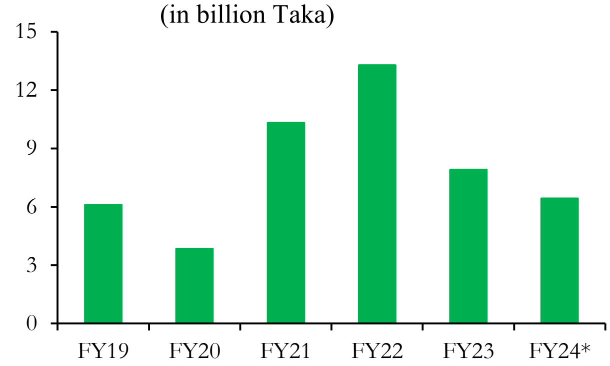
Chart III.28: DSEX Index and Turnover



Source: Dhaka Stock Exchange.

Although BB adopted a tight monetary policy stance to restrain rising domestic inflation, BB's policy stance allowed banks to keep their investments unimpeded in the stock market to ensure the robust performance of the capital market. The benchmark index of the country's leading stock exchange, the DSE broad index (DSEX), experienced sharp fall(6.07 percent, y-o-y) at the end of March 2024. (Chart III.28). Similarly, the DSE-30 index continued to decelerate and declined by 8.38 percent (y-o-y) at the end of March 2024.

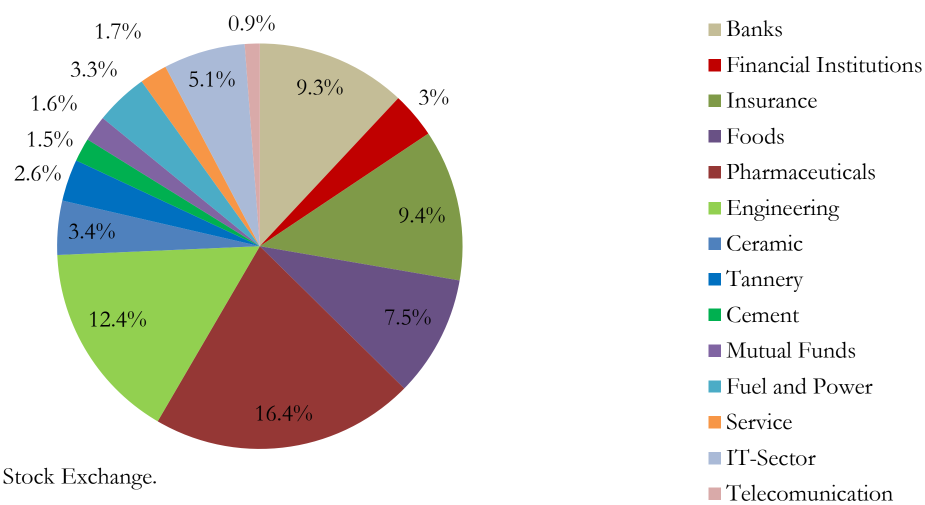
Chart III.29: DSE Daily Average Turnover
(in billion Taka)



Source: Dhaka Stock Exchange. *July - March, FY24.

The daily average turnover in the Dhaka Stock Exchange (DSE) decreased significantly by 40.35 percent to BDT 7.92 billion in FY23 from BDT 13.27 billion in FY22, which was BDT 10.31 billion in FY21 (Chart III.29). During July 2023-March 2024, the daily average turnover decreased further to BDT 6.42 billion. Among all sectors, pharmaceuticals had the highest turnover share (16.4 percent) in March 2024, whereas telecommunication had the lowest turnover (0.9 percent) (Chart III.30).

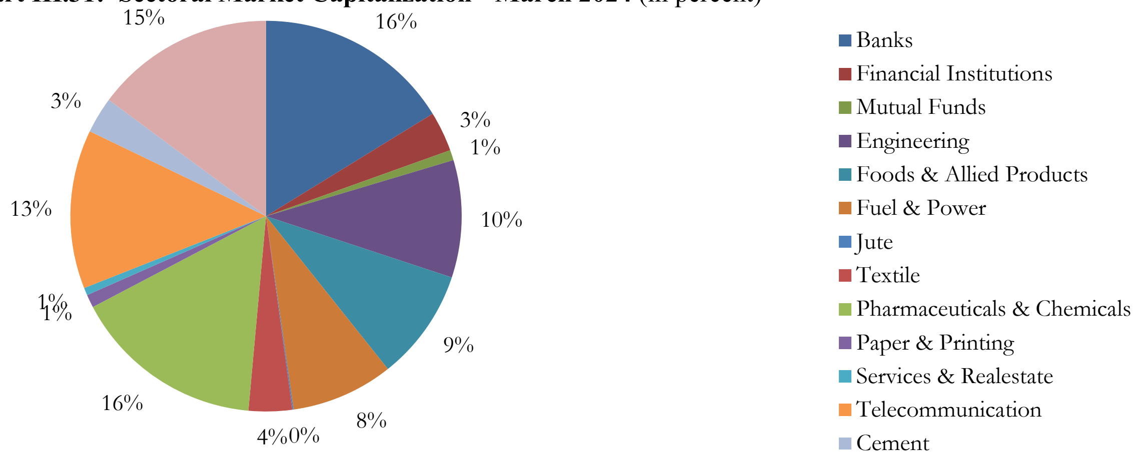
Chart III.30: Turnover of Major Sectors in March 2024



Source: Dhaka Stock Exchange.

DSE's total market capitalization fell by 10.3 percent (y-o-y) in March 2024 and stood at BDT 6833.0 billion compared to BDT 7623.7 billion in March 2023. However, compared to June 2023, market capitalization decreased by 11.4 percent in March 2024. Among all sectors, banks had the highest share of market capitalization (16.22%) in March 2024, while Jute had the lowest share (only 0.10 percent) in March 2024 (Chart III.31). Eight companies raised capital through initial public offerings (IPOs) in 2023, compared to nine in 2022.

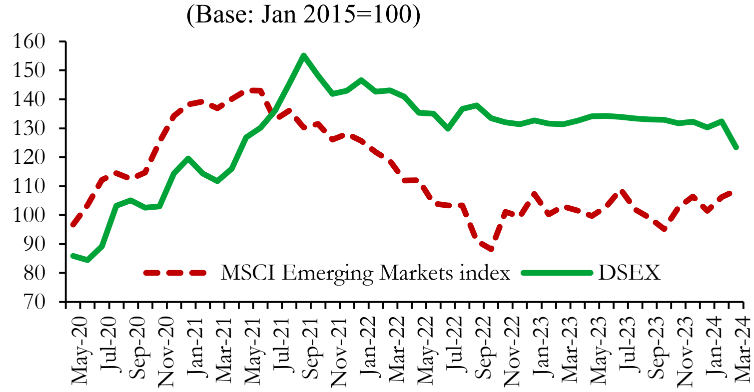
Chart III.31: Sectoral Market Capitalization - March 2024 (in percent)



Sources: Dhaka Stock Exchange.

In 2023, BDT 28.84 billion was raised through an IPO, compared to BDT 18.51 billion in 2022. Morgan Stanly Capital International (MSCI) index for emerging market which reflects global capital markets index experienced an upward trend with some volatility during March 2023-March 2024, reflecting improvement in economic prospects (Chart III.32).

Chart III.32: Synchronization of DSEX with Global Markets
(Base: Jan 2015=100)



Sources: Dhaka Stock Exchange and www.msci.com

Chapter IV: Policy Review and Forward Looking Guidance

IV.1 Exchange Rate Stability and Foreign Exchange Reserve

Bangladesh Bank (BB) has proactively implemented a range of measures to stabilize the exchange rate of the Bangladeshi Taka (BDT) in response to its recent depreciating pressure. These measures include encouraging foreign currency inflows, allowing the BDT to depreciate BDT, selling foreign currency from international reserves, and introducing crawling peg exchange rate system for spot purchases and sales of US dollars. Overall, BB has focused on improving the balance of payment position to support exchange rate stability as well as increase foreign exchange reserves.

The BB allowed a notable depreciation of over 3.69 percent (y-o-y) of the Bangladeshi Taka (BDT) against the US dollar at the end of April 2024. This depreciation, however, is seen as a competitive adjustment, in line with market rates, supported by assessments based on the Real Effective Exchange Rate (REER) Index. In order to bring more flexibility in the foreign exchange market, Bangladesh Bank decided to introduce crawling peg system for buying and selling of foreign currencies. Under the new system, Crawling Peg Mid-Rate (CPMR) is set at Taka 117.00 per USD on 8 May 2024. BB will keep the new regime in review and will adjust the parameters of the regime as needed. The crawling peg system will be an interim arrangement before moving to a fully flexible market based system in the near future. The implementation of this system is expected to reduce the foreign exchange market volatility and stabilize the exchange rate.BB has decreased the limits of the Exporter Retention Quota (ERQ) and reduced net open positions. BB has promoted Domestic Banking Units (DBUs) to borrow from Offshore Banking Operations (OBOs) without limits to settle certain import payments. Furthermore, banks are not required to maintain Cash Reserve Ratio (CRR) with BB for OBOs. These initiatives have enhanced the inflow of foreign currency and eased the depreciation pressure. To contain the demand for foreign currency, BB has raised interest rates on Export Development Fund (EDF) loans from 4.00 to 4.50 percent. Imposing restrictions on overseas travel for government officials has also helped save foreign exchange reserves to some extent.

The initiatives undertaken by BB to encourage the influx of foreign currency into formal channels involve permitting markup on foreign currency term deposits and expanding the range of Resident Foreign Currency Deposit (RFCD) accounts. Policies such as reducing retention limits on foreign currency for exporters and intensifying scrutiny on import prices are geared towards optimizing the utilization of foreign currency and regulating trade-related transactions. Moreover, BB's unwavering commitment to upholding market discipline is demonstrated through its directives to apply current exchange rates, establish limits on forward premiums, and take effective measures against illicit money changers.

While accomplishing a surplus in the financial account, challenges persist in the current account balance, prompting BB to address deficits and boost export growth. To bolster foreign currency reserves and attract foreign investment, the Parliament enacted the Offshore Banking Act 2024 on March 14. This Act allows only scheduled banks to obtain licenses from BB for offshore banking operations, with specific guidelines set by BB. Furthermore, non-resident Bangladeshis, individuals of Bangladeshi origin, foreign nationals, companies, foreign firms, and foreign institutional investors are permitted to open offshore bank accounts to invest in Bangladesh.

BB's proactive and comprehensive strategy for managing exchange rate stability and foreign exchange reserves is evident. Despite decreased reserves from USD 41.80 billion at the end of June 2022 to USD 25.23 billion at the end of March 2024, the current level still signifies a strong reserve position, providing coverage for 4 (four) months of import payments. The country's robust reserve position and prudent policy measures establish a foundation for sustained economic growth, instilling confidence among investors and lenders. The shift towards a unified exchange rate regime underscores a commitment to market-based principles, fostering stability in the foreign exchange market. Ongoing vigilance and adaptability to evolving economic conditions will be crucial for maintaining accomplishments in exchange rate stability and foreign exchange reserve management.

IV.2 Controlling Inflation

In the face of persistently high inflation, BB has implemented a series of monetary policy measures to control inflation and maintain a stable economic environment. The monetary policy stance in H1FY24 and H2FY24 was tight on upholding a hawkish approach to contain growing inflationary pressures. BB has implemented and proactively addressed the challenges posed by both demand-side stress and supply-side bottlenecks through various innovative and strategic measures. These measures included increasing the policy rate (repo rate) in several phases and conducting substantial sales of US dollars for quantitative tightening while continuing pre-financing and refinancing schemes for critical sectors like agriculture and CMSMEs. Also, BB continued import-limiting policies for non-essential commodities, increased monitoring to prevent invoicing irregularities, and worked towards a unified and market-driven single exchange rate to ease the exchange rate as well as inflationary pressures.

Moreover, BB adopted an interest rate targeting framework in July 2023, introducing an Interest Rate Corridor (IRC) to replace the reliance on reserve money. This shift aimed to enhance the precision of monetary policy signals and better manage inflation. Other than a continuation of policy rate increases and quantitative tightening strategies, BB's forward-looking measures in H1FY24 and H2FY24 included removing remaining lending restrictions and eliminating deposit rate floors, aiming at controlling inflation, ensuring efficient credit allocation, and supporting a favorable lending environment. To facilitate the transition towards a market-based interest rate, the existing reference rate SMART, which is used to determine the lending rates of banks/NBFIs, was abolished. Consequently, banks and NBFIs will be able to set interest rates based on the interaction of demand and supply in the market as well as the banker-customer relationship. Furthermore, BB's decision to stop lending to the government aimed at containing inflation by reducing high-powered money injections into the market.

IV.3 Stabilizing Financial Sector

The financial sector in Bangladesh has undergone significant reforms and regulatory changes to ensure stability, transparency, and good governance. The BB has been at the forefront of these initiatives, implementing measures to address non-performing loans (NPLs), strengthen corporate governance, and promote financial deepening. BB's key measures for stabilizing financial sectors are given below:

NPL Resolution and Regulatory Framework:

The government's proactive approach to addressing NPLs is evident through the issued of the Bank Company Act, 1991 (Amendment). The proposed amendments, embodied in the Bank Company (Amendment) Act 2023, empower the BB to identify and take punitive actions against willful loan defaulters. The act's provisions underscore a commitment to instilling discipline in the banking sector by restricting families' influence on bank boards. The noteworthy changes to the structure of the Board of Directors are listed below.

- The number of directors on the board of directors shall be a maximum of 20 persons, out of which the number of independent directors shall be three persons. If the number of directors on the board is less than 20, the number of independent directors shall be 2.
- At most, three members of a single family can hold the directorship of any bank company at the same time.
- No more than one representative director can be appointed on behalf of any alliance or company on the board of directors.
- A person cannot serve as a director of a bank company for more than 12 consecutive years.
- After the term ends, the person can only be a director of the bank company again after three years have passed.

The following criteria must be met for an individual to be eligible for the position of director in a bank company:

- The individual has not been convicted of any criminal offense or involved in any forgery, financial crime, or other illegal activity;
- No adverse comments were observed in any civil or criminal court case against the individual; the individual has not been convicted of any violation of rules, regulations, policies, or rules of any financial regulator;
- The individual was not associated with any company/establishment whose registration/ license has been cancelled or the establishment has been wound up;
- The individual is not in default for loans received from any bank or financial institution in their name or the name of a related institution;
- The individual has never been declared bankrupt by a court;
- Any person who has been listed as a willful defaulter by a bank or financial institution established under the Finance Companies Act, 2023 will be unequivocally ineligible to become a director of any bank until five years have elapsed from the date of an exemption from the listing.

As part of the bank's credit risk management, it is necessary to classify non-performing credit accounts as bad loans and make provisions against them at a fixed rate to ensure financial stability. However, including long unrecovered debt accounts tends to cause unnecessary inflation in a bank's balance sheet. Banks can use internationally recognized loan write-off methods to clean up their balance sheets by removing non-performing assets (NPA). It should be noted that necessary provisions must be kept against the amount written off. Even after a write-off, the bank can use legitimate methods to get back the loan amount since the loan account did not close permanently during the loan write-off process. Given the current situation, BB has taken proactive measures to ensure that all scheduled banks adhere to the roadmap announced for the country's banking sector. These measures are aligned with international best practices and emphasize the importance of effective initiatives to write-off and recover the loan. The most significant measures are given below:

- The credit accounts that are classified as bad and harmful for consecutive 2 (two) years can go for the write-off method.
- A separate unit called "Credit Write-off Recovery Unit" (in the case of Islamic Shariah-based banks, "Investments Write-off Recovery Unit") should be formed at the head office under the direct supervision of the Managing Director or Chief Executive Officer of the bank.
- The performance of the banks' managing director or chief executive officer on this issue will be considered for reappointment.
- An amount equal to 5% of the recovered amount against the written-off loan will be distributed to the officials involved in the recovery process as an incentive. A maximum of 10 percent of the distributable amount will be received by the Managing Director/Chief

Executive Officer of the bank. The Head of the Recovery Unit will receive the remaining amount along with other officers of the Unit. Henceforth, the branch/department officials directly related to the branch/department from which the written-off loan will be recovered will also be entitled to incentives at the same proportional rate as the unit officers.

In addition, the introduction of the Risk-Based Supervision (RBS) framework by 2025 is a strategic move by BB, aligning with international best practices. Monitoring mechanisms, such as Memorandums of Understanding (MoUs) with banks and the Prompted Corrective Action (PCA) framework, set customized targets to reduce NPLs, maintain capital adequacy, and enhance corporate governance. Under the PCA framework, stronger banks can merge with or acquire weaker banks.

Corporate Governance Enhancements:

The Bank Company (Amendment) Act of 2023 signifies a pivotal shift in corporate governance. Empowering BB to remove boards of directors involved in harmful activities demonstrates a commitment to accountability. Reducing the maximum number of directors from the same family and introducing the Finance Companies Act, 2023 for non-bank financial institutions further fortify governance structures.

The Prompt Corrective Action (PCA) framework, introduced in December 2023, is a proactive tool for regulatory intervention. With parameters like capital adequacy and corporate governance, the PCA framework enables timely corrective actions, preventing systemic issues from escalating.

Amalgamation and Prompt Corrective Action (PCA) Framework:

BB introduced detailed guidelines for bank amalgamation on March 04, 2024. Additionally, the PCA framework, introduced in December 2023, categorizes banks based on their NPLs and Capital-to-Risk (Weighted) Assets Ratio (CRAR). This categorization, based on 2024 audited financial reports, will come into effect in May 2025. In the event that a bank does not show improvement under Prompt Corrective Action (PCA), it may necessitate BB to consider initiating bank mergers.

Financial Deepening and Sustainable Finance:

BB's focus on financial deepening and raising the M2/GDP ratio is complemented by initiatives such as financial inclusion, digitization, and encouragement of long-term financing beyond the banking sector. The introduction of bank assurance in December 2023, leveraging commercial banks to increase insurance penetration, is a notable step. The BB's modernization of sustainable finance policies aligns with global trends, considering environmental factors and gender aspects. Rating banks based on sustainability components fosters transparency and encourages responsible financial practices.

Transparency and Regulatory Compliance:

The BB's insistence on third-party evaluation firms for collateral appraisal enhances transparency in the banking sector. The alignment with International Financial Reporting Standards (IFRS) and the regular publication of comprehensive data on rescheduled loans contribute to a transparent and credible reporting framework. The BB's initiative to disclose rescheduled loans alongside NPLs in the annual financial stability report contributes to a more accurate portrayal of distressed assets.

The BB's unwavering commitment to fair and ethical lending practices is exemplified by its diligent legal compliance initiatives. These initiatives include thoroughly reviewing charge documents and obtaining borrower signatures, ensuring the lending process is transparent and equitable for all parties involved.

IV.4 Boosting the Remittance Inflows

In Bangladesh's economy, inward remittances are crucial in fortifying the current account balance, accumulating net international reserves, and boosting rural development. This analytical review delves into the various policy measures undertaken by the government and Bangladesh Bank (BB) to enhance remittance inflows, ensuring a favorable environment for remitters and contributing to overall economic growth and development.

1. Policy Measures to Encourage Remittances:

a) Incentives and Documentation Relaxation: Providing a 2.50 percent cash incentive for beneficiaries of wage earners' remittances, coupled with eliminating documentation requirements for amounts exceeding USD 5,000, showcases a commitment to simplifying processes and encouraging remitters to use official channels.

b) Combatting Hundi Activities: Efforts to cease hundi-related activities through mobile financial services and address missed invoicing highlight a proactive stance in curbing unofficial channels. This ongoing process aligns with global anti-money laundering initiatives.

c) Facilitating Fund Transfers: Removing limits on fund transfers through Internet banking for remittances, increasing non-resident foreign currency deposit rates, and eliminating documentation requirements for wage earners' remittances contribute to a more accessible and attractive environment for remitters.

d) Exemption of Fees and Market-Driven Exchange Rates: The exemption of fees for sending remittances through banks and exchange houses, coupled with offering the highest exchange rates, reflects a commitment to make official channels more appealing. Adopting a market-driven exchange rate reduces the gap between formal and informal rates, incentivizing remittances through banking channels.

2. Expanding Remittance Channels:

a) Passport as an Investment Document: Allowing non-resident Bangladeshis (NRBs) to use passports as documents to invest in wage earners' bonds provides an additional avenue for investment, demonstrating flexibility in facilitating financial transactions.

b) Mobile Financial Service Providers: Enabling mobile financial service providers to transfer remittances using web-based mobile apps simplifies the process for remitters, allowing direct transfers to beneficiaries' accounts or wallets.

c) International Cooperation and Celebrations: Celebrating the 'International Day of Family Remittances' and international cooperation with foreign embassies reflect a collaborative approach to promoting remittances through official channels.

3. Regulatory and Enforcement Measures:

a) Law Enforcement and Anti-Hundi Activities: Collaboration between the Bangladesh Financial Intelligence Unit (BFIU) and law enforcement agencies to identify individuals engaged in Hundi activities underscores a commitment to curbing unofficial channels and enforcing regulatory compliance.

b) Pension Scheme for Expatriates: Introducing the 'PROBASH' particular pension scheme under the universal pension scheme is a unique initiative to attract inward remittances by offering additional benefits to expatriate Bangladeshis.

The policy measures undertaken by the government and Bangladesh Bank showcase a comprehensive and proactive approach to harnessing the potential of inward remittances. The multifaceted strategies, ranging from financial incentives and documentation relaxation to embracing digital channels and international collaboration, collectively create a conducive environment for remitters. These initiatives enhance the country's foreign exchange reserves and are pivotal in supporting sustained economic growth and development, particularly in rural areas. The commitment to continuous improvement and facilitation suggests a positive trajectory for Bangladesh in leveraging remittances as a powerful economic booster.

Chapter V: Near and Medium-term Outlook and Challenges

The economic outlook remains positive based on the sound prospects of robust performances in the key economic sectors. The provisional estimates of BBS indicate that the real GDP grew by 5.82 percent in FY24, supported by proactive measures undertaken by the government and the BB. Bangladesh's export industries may benefit from rising global demand for goods and services in light of the optimistic global growth outlook and the low inflation or disinflation in major advanced economies. In addition, the potential reduction in fuel oil prices could ease strain on the balance of payments, thus bolstering the stability of the exchange rate.

However, it is crucial to contemplate the potential ramifications of continuing the ongoing conflict between Russia and Ukraine, as it could have a detrimental impact on the global economy and the economy of Bangladesh. The continuing turmoil in the Middle East could affect the Bangladesh economy as well. These conflicts could potentially induce supply shocks, which could reverse the global disinflation trend and lead to generate domestic inflationary pressure. To mitigate inflationary pressure and restore the stability of the exchange rate, BB continued a vigilant approach by monitoring signs of persistent inflationary pressure, recognizing the necessity of maintaining a more restrictive monetary policy stance to bring inflation back to an accepted level.

BB has embarked on historic initiatives to improve financial sector stability by reducing NPLs to a certain level and promoting good governance within the banking industry by 2026. A roadmap encompassing critical action measures for banks and financial institutions is prepared for implementation to ensure discipline, governance, and credibility in the financial sector. These endeavors are anticipated to contribute to economic stability, foster sustainable growth, and enhance the country's financial health.

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