Monetary Policy

Review 2022-23

Bangladesh Bank

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Chief Economist's Unit
Bangladesh Bank
May 2023

Monetary Policy Review

2022-23

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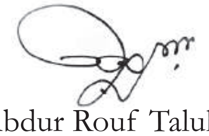
Message

The global economy has witnessed unprecedented volatility and turmoil in recent times, presenting policymakers with unexpected challenges. These challenges include recurring waves of Covid-19, persistent disruptions in supply chains, surging commodity prices, and the eruption of the Russia-Ukraine conflict. In 2022, inflation reached multi-year highs in many advanced and emerging economies, causing central banks to miss their inflation targets by significant margins. As a result, they were compelled to swiftly tighten monetary policy, particularly in the United States, which exerted immense pressure on emerging market currencies. Furthermore, certain developed economies' banking sectors have encountered severe challenges, ushering the world economy into a new phase of instability. The risk of bank failures and contagion has raised concerns about overall financial stability.

On a positive note, the economy of Bangladesh rebounded strongly from the shock of the Covid-19 pandemic, achieving real GDP growth rates of 6.94 percent and 7.10 percent in FY21 and FY22, respectively. This recovery was facilitated by effective pandemic management, increased domestic and external demand, and well-coordinated monetary and fiscal policy support. However, the economy faced multidimensional challenges stemming from global economic uncertainties and intense pressure on the balance of payments, leading to a sharp depreciation of the exchange rate. These unfavorable developments hindered growth momentum and resulted in persistently high inflation in FY23. Nevertheless, the Bureau of Statistics (BBS) has provisionally estimated a reasonably high real GDP growth rate of 6.03 percent for FY23, considering the global and domestic economic developments. The Bangladesh Bank (BB) has been actively utilizing all available options to control inflation, manage the balance of payment instabilities, and ensure affordable funding for the productive sectors.

The *Monetary Policy Review 2022-23* comprehensively evaluates macroeconomic, monetary, and financial sector concerns. Its purpose is to identify potential short and medium-term challenges within the current monetary policy stance. Additionally, the Review aims to assist policymakers in designing future monetary policy approaches by examining the impacts of past measures.

I trust that this Monetary Policy Review will prove helpful and insightful for stakeholders in understanding recent trends and emerging issues of interest. I would like to express my heartfelt appreciation to the Chief Economist and his team for presenting an informative 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

ADP	Annual Development Program
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BoP	Balance of Payment
BSEC	Bangladesh Securities and Exchange Commission
COVID	Corona Virus Disease
CPI	Consumer Price Index
CRR	Cash Reserve Requirement
CSE	Chittagong Stock Exchange
DSEX	DSE Broad Index
FY	Fiscal Year
GDP	Gross Domestic Products
IMF	International Monetary Fund
IPO	Initial Public Offering
LC	Letter of Credit
MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
NBFIs	Non-bank Financial Institutions
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Asset
NSCs	National Savings Certificates
REER	Real Effective Exchange Rate
RM	Reserve Money
RMG	Ready-made Garment
USD	United States Dollar
WEO	World Economic Outlook

Executive Summary

In the latter part of FY22, the Bangladesh economy encountered several challenges, including a rise in inflation, an expanding current account deficit, and mounting pressure on exchange rates. In this regard, the monetary policy for FY23 was formulated in June 2022 and subsequently revised in January 2023. The Bangladesh Bank adopted a cautiously accommodative approach, establishing targets of 11.5 percent growth for broad money (M2) and 14.1 percent growth for private sector credit by June 2023. This was accompanied by an increase in the repo rate, first by 25 basis points to 5.75 percent in October 2022 and later to 6.00 percent in January 2023. The reverse repo rate was also raised to 4.25 percent in January 2023.

The *Monetary Policy Review 2022-23* offers a comprehensive overview of the current macroeconomic and financial sector landscape, encompassing both domestic and global economies. It highlights the immediate and medium-term macroeconomic challenges and evaluates the effectiveness of the monetary policy concerning the objectives set by the Bangladesh Bank.

Despite central banks' policy tightening, improving supply situations, and declining global food and energy prices, global inflation decreased slower than expected. As a result, many advanced economies extended and intensified their policy-tightening efforts to bring inflation back to desired levels. Prolonged policy tightening and uncertainties arising from the war-driven geo-economic fragmentation have weakened global growth momentum and increased vulnerabilities in the financial sector. The World Economic Outlook (WEO) forecasted a deceleration in global economic growth from an estimated 3.4 percent in 2022 to 2.8 percent in 2023.

After a strong rebound from the shock of the Covid-19 pandemic with real GDP growth rates of 6.94 percent and 7.10 percent in FY21 and FY22, respectively, the Bangladesh economy faced challenges due to growing global economic uncertainties stemming from the war in Ukraine, intense pressure on the balance of payments, sharp depreciation of the exchange rate, rationing of electricity supply, and upward revision of fuel and energy prices in the domestic market. These unfavorable developments hindered growth momentum and led to persistently high inflation in FY23. While the fiscal year has not yet concluded, the Bangladesh Bureau of Statistics (BBS) provisionally estimated a lower real GDP growth rate of 6.03 percent for FY23. The industry sector experienced a more pronounced deceleration, with growth registering at 8.18 percent during this period.

Despite improvements in the supply situation and declining global commodity prices, the sharp depreciation of the exchange rate and high production and transportation costs kept domestic inflation elevated. Headline CPI inflation (point to point) reached an 11-year high of 9.52 percent in August 2022, rising from 7.56 percent in June 2022, and remained above 8 percent before reaching 9.24 percent in April 2023. The 12-month average inflation steadily increased to 8.64 percent in April 2023 from 6.15 percent in June 2022, significantly exceeding the target of 7.50 percent for FY23.

During the first nine months of FY23, the current account deficit narrowed to USD 3.64 billion compared to USD 14.3 billion during the same period in FY22. This improvement was driven mainly by a contraction in the trade deficit due to exchange rate depreciation and various policy initiatives aimed at reducing imports and increasing remittance inflows. However, the overall balance of payments deficit widened to USD 8.17 billion during this period, as the financial account shifted from a large surplus of USD 11.9 billion to an unusual deficit of USD 2.2 billion compared to the same period in FY22. To address the demand-supply gap in the foreign exchange market, the Bangladesh Bank responded by selling foreign currencies and allowing depreciation, which resulted in a rapid decline in foreign exchange reserves from USD 41.83 billion in June 2022 to USD 31.14 billion in March 2023. During this period, the Bangladeshi Taka (BDT) exchange rate against the USD depreciated by 12.5 percent, reflecting the shift towards a more flexible and market-oriented exchange rate system as outlined in the Monetary Policy Statement for H2FY23.

The growth of broad money (M2) decelerated from 9.43 percent in June 2022 to 9.13 percent in March 2023 due to a sharp decrease in net foreign assets (NFA) caused by a significant deficit in the balance of payments. Meanwhile, the net domestic assets (NDA) increased from 14.02 percent in June 2022 to 15.40 percent in March 2023, primarily driven by a surge in public sector credit growth resulting from weak revenue growth and lower borrowing from national saving certificates. However, credit growth to the private sector moderated to 12.03 percent in March 2023 from 13.66 percent in June 2022, mainly due to a slowdown in trade-related credits and weak investment demand. As a result of BB's net selling in the foreign exchange market, a sudden rise in cash withdrawals from banks by depositors, and sluggish deposit growth, the banking system experienced liquidity stress, leading to an upward trend in interest rates in the money market during this period.

Looking ahead, the growth momentum of the Bangladesh economy is expected to accelerate. However, the economy's future trajectory will depend on improving the country's balance of payments position. While the current account deficit has significantly reduced, sustained improvement in the current account balance will require increased exports and remittance inflows. Additionally, the stubbornly high inflation raises concerns about unanchored inflation expectations, which may necessitate an extended period of contractionary policy. Therefore, the Bangladesh Bank needs to proactively exercise caution and vigilance to anchor inflation expectations and limit the second-round effects of inflation.

Moreover, the increasing financial innovations, deepening and evolving financial structure, and greater integration of Bangladesh with the global economy have weakened the relationship between BB's current monetary policy instruments and objectives within the monetary targeting framework. In light of this situation, a shift towards an interest rate-focused monetary policy framework could enhance the effectiveness of BB's monetary policy.

Chapter I
Overview of Current Monetary Policy Stance and Progress

I.1 Current Monetary Policy Stance

War in Ukraine, zero-Covid policy in China, energy shortages in Europe, protectionism in the United States, and skyrocketing debt burden in developing countries are the major events that generated multi-edged challenges for the current world economies. Soaring inflation, aggressive policy rate hikes by major advanced economies, and slowing economic growth are common features almost everywhere in the world. Bangladesh is no exception, facing inflationary and exchange rate pressure through international trade channels.

In this circumstance, Bangladesh Bank's (BB) monetary and credit programs for the second-half (H2) of FY23[1] (January-June, 2023) has been designed to pursue a cautiously accommodative policy stance to contain inflationary and exchange rate pressures, support desired economic growth, ensure the necessary flow of funds to the economy's productive and employment generating activities.

Table I.1: Monetary and Credit Program for FY23

(y-o-y % change)

Item	22-Jun	22-Dec	Program for Jun-23	
	Actual	Actual[P]	Original[@]	Revised
Broad money	**9.4**	**8.4**	**12.1**	**11.5**
Net Foreign Assets*	-11.9	-22.6	-2.1	-11.9
Net Domestic Assets	17.2	18.5	16	17.9
Domestic Credit	16.2	15.1	18.2	18.5
Credit to the public sector	29.1	26.6	36	37.7
Credit to the private sector	13.7	12.8	14.1	14.1
Reserve money	-0.3	17.4	9.0	14.0
Money multiplier	4.93	4.63	5.07	4.82
NCG (Crore Taka, during the respective fiscal year)	62,540	32,249	1,06,334	1,11,608

Source: Monetary Policy Statement, January-June 2023, Bangladesh Bank.
NCG= Net credit to government from the banking system, P=Provisional
*Calculated using the constant exchange rates of end June 2022. @Announced in June 2022.

Raising the policy rates could be one of the options to combat inflation while signaling the market about BB's intention and, thereby, anchoring the inflationary expectations. Because of the vast liquidity withdrawal from the system, the liquidity condition in the money market is already tight, reflected by rising call money rates. Therefore, MPS for H2FY23 has sought various alternative options for curbing inflationary pressure. BB has emphasized raising production and employment opportunities by providing necessary funds to various productive sectors of the economy. BB's monetary policy has also sought policies for limiting imports of non-essential and luxury commodities to reduce the exchange rate pressure, protect foreign exchange reserves, and control imported inflation.

[1] FY stands for Fiscal Year spanning July to June.

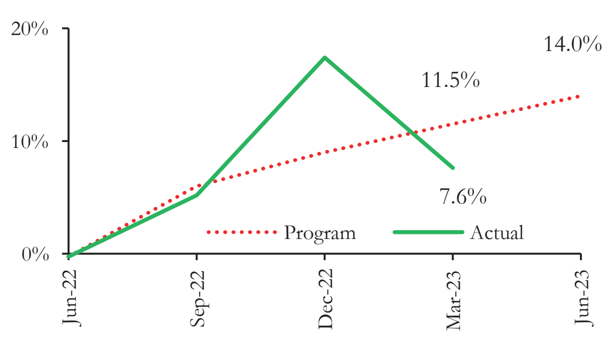
Accordingly, BB has decided to increase its policy rates by 25 basis points, the repo rate to 6.00 percent from 5.75 percent, and the reverse repo rate to 4.25 percent from 4.00 percent as a part of policy stance. BB is also taking necessary measures to gradually move towards a market-based, flexible, and unified exchange rate regime (within a 2.00 percent variation) by the end of FY23.

To determine the monetary policy objectives, stance, and monetary and credit program, BB's Monetary Policy Committee (MPC) has considered: (1) the current macroeconomic developments, including the decisions of the coordination council meeting; (2) the analyses and forecasts of the multilateral development partners, global and local think tanks, academia, past and present national-level decision makers, journalist and business bodies about the outcomes and outlooks of global and domestic economic growth, inflation, exchange rate, and interest rate movements; and (3) BB's internal exercises on understanding macroeconomic dynamics and making near-term economic projections.

1.2 Progress

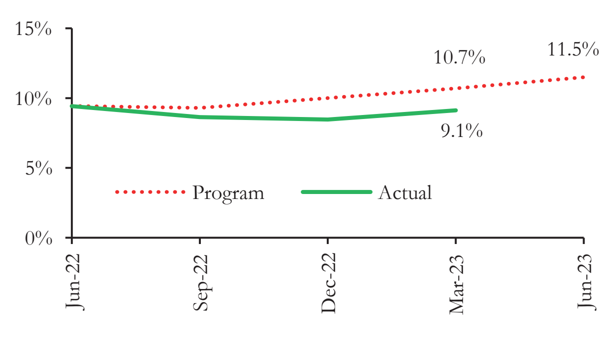
Charts I.1-I.6 display the actual growth paths of major monetary and credit aggregates against their programmed path, which is revised in H2FY23 MPS (announced in January 2023). The reserve money (RM) growth, the operating target of BB's monetary policy, moved below the programmed path during the first quarter and above the programmed path during the second quarter of FY23 due to huge liquidity support in the market to avoid the liquidity crunch. The reserve money growth declined after December 2022 and remained below the programmed line in March 2023 because of the relative strength of the negative growth of BB's net foreign assets (NFA) and the positive growth of BB's net domestic assets (Chart I.1).

Chart I.1: Reserve Money (RM) Growth



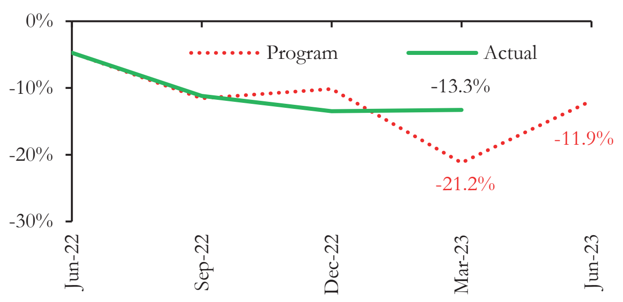
Source: Bangladesh Bank.

Chart I.2: Broad Money (M2) Growth



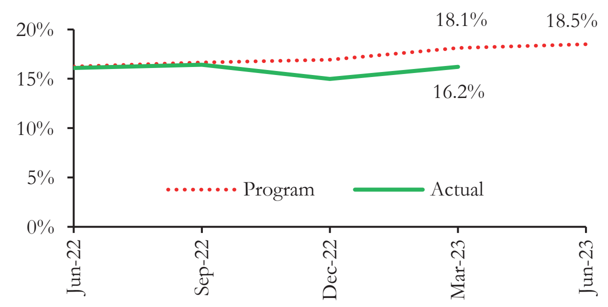
Source: Bangladesh Bank.

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



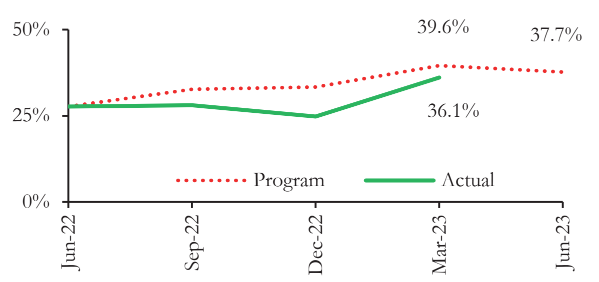
Source: Bangladesh Bank.

Chart I.4: Domestic Credit (DC) Growth



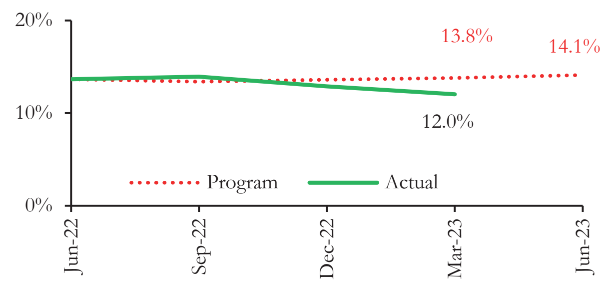
Source: Bangladesh Bank.

Chart I.5: Public Sector Credit Growth



Source: Bangladesh Bank.

Chart I.6: Private Sector Credit Growth



Source: Bangladesh Bank.

The broad money (M2) growth, the nominal anchor or intermediate target of BB's monetary policy, remained well below the programmed path during the first 9 months of FY23 (Chart I.2), dragged down by lower than expected growth in domestic credit owing to slower growth in public and private sector credit (Chart I.4 and I.5). At the same time, net foreign assets (NFA) of the banking system continued registering negative growth. The decline in NFA was broadly due to a wide deficit in the overall balance of payments (BoP)(Chart I.3). The BoP deficit is the result of a higher amount of import payments as compared to the total amount of export receipts and inward remittances, and turning of the financial account to a deficit from a large surplus.

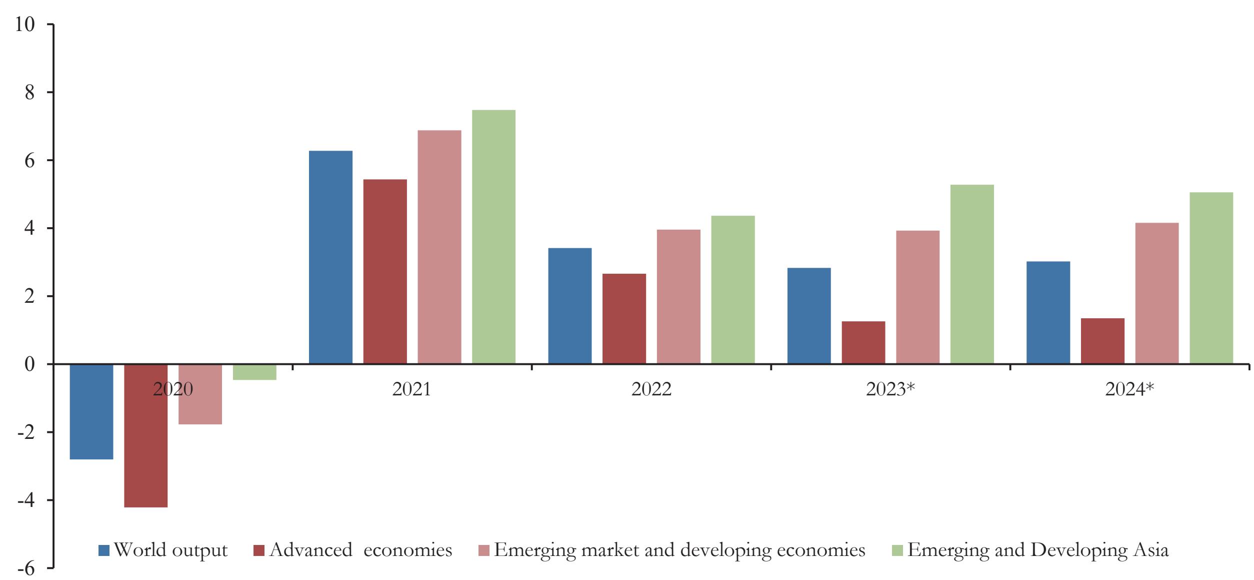
Chapter II
Development in the Global Economy

Provisional indicators in early 2023 indicated signs of stabilization in the world economy following the fall in food and energy prices, while most central banks raised their interest rates to control inflation. However, underlying pricing pressures prevailed from earlier cost shocks and tight labor markets in many economies. Moreover, despite the lower food and energy prices, many economies are facing new challenges in the financial sectors with increased uncertainty from the recent strains in the bank and non-bank financial institutions in the face of higher interest rates. The future health of the global economy relies on the successful negotiation and calibration of policy measures to bring harmony to the global supply chains.

II.1 Global Economic Growth

Global economic growth is forecasted to decelerate from an estimated growth rate of 3.4 percent in 2022 to 2.8 percent in 2023 before rising to 3.0 percent in 2024, according to the IMF's most recent release of the World Economic Outlook (WEO), April 2023. Global growth in 2023 is estimated to be 1.0 percentage points lower than the January 2022 WEO Update. This growth gap is only anticipated to close over the next two years gradually (Chart II.1).

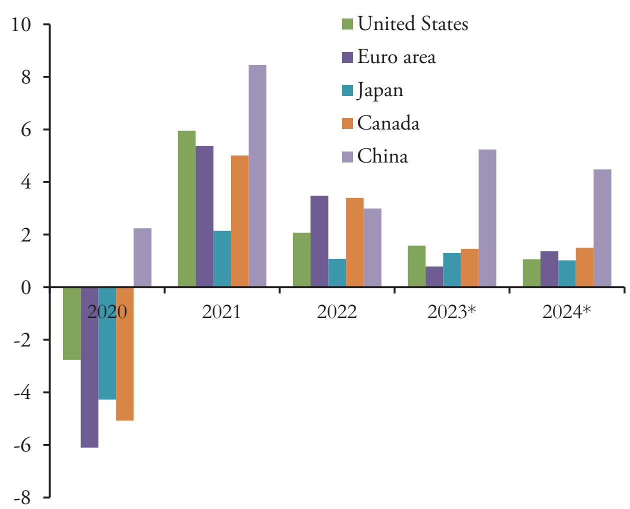
Chart II.1: Output Growth of Global and Selected Regional Economies (in percent)



* Projection.
Source: World Economic Outlook, April 2023, IMF.

In 2023, the growth of advanced economies is expected to decrease by 1.3 percent before increasing to 1.4 percent in 2024 since most advanced economies are expected to experience a growth deceleration along with rising unemployment in 2023. Meanwhile, the US and China are predicted to grow by 1.6 and 5.2 percent, respectively, in 2023, compared to the growth of 2.1 and 3.0 percent in 2022 (Chart II.2). However, the prospects observed wide regional divergences. On average, the growth of the emerging market and developing economies is projected to be 3.9 percent for 2023, which would rise to 4.2 percent in 2024. On the other hand, the growth of emerging and developing Asia is expected to be 5.3 percent in 2023, which would fall slightly to 5.1 percent in 2024. Countries in South Asia, except Sri Lanka, would maintain positive growth in 2023 and 2024, as depicted in Chart I.3, indicating a strong growth momentum. Although the growth forecast for the Indian economy has been moderated by 20 basis points to 5.9 percent for 2023, the growth is expected to rise and reach 6.3 percent in 2024. Similarly, Bangladesh's economy is predicted to grow by 5.5 percent in 2023, a 1.6 percentage-point lower than the growth rate of 7.1 percent in 2022, according to the latest release of the World Economic Outlook (Chart II.3).

Chart II.2: Economic Growth of Peer Countries: Advanced Economies (in percent)



* Projection.
Source: World Economic Outlook, April 2023, IMF.

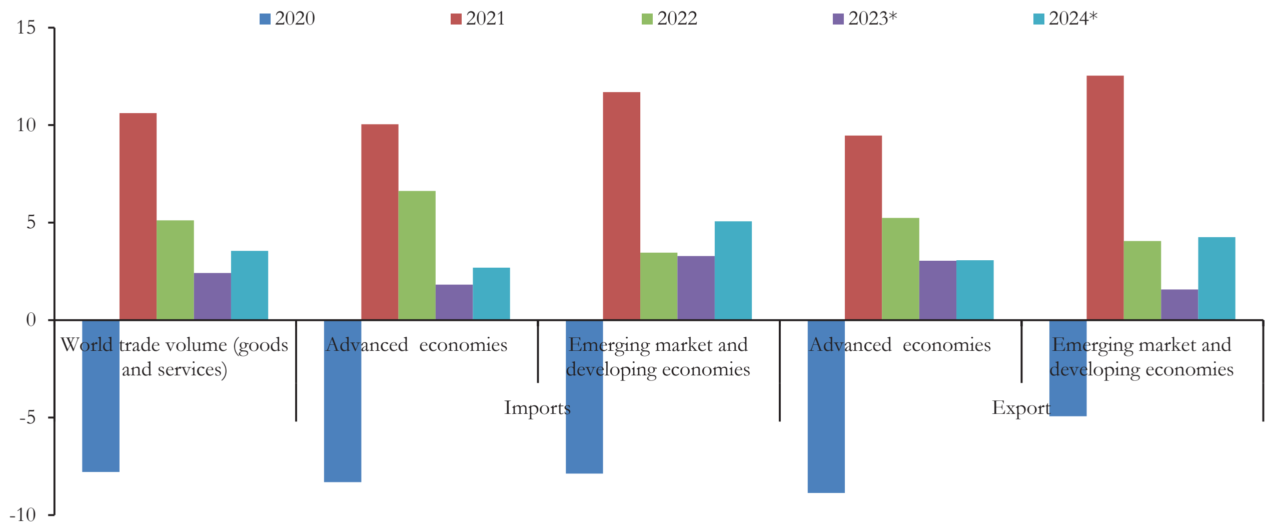
Chart II.3: Economic Growth of Peer Countries: South Asia (in percent)

* Projection.
Source: World Economic Outlook, April 2023, IMF.

II.2 Global Trade

The growth in global trade volume is projected to slow from 5.1 percent in 2022 to 2.4 percent in 2023, reflecting the slowdown in worldwide demand after two years of quick recovery from the pandemic recession and the shift in consumer spending from exported goods back to domestic services. Rising trade barriers and the lingering impacts of the US dollar's rise in 2022 are also anticipated to hurt the growth of trade in 2023 (WEO, April 2023, (Chart II.4).

Chart II.4: Global Trade, Imports, and Exports (growth, in percent)



* Projection.
Source: World Economic Outlook, April 2023, IMF.

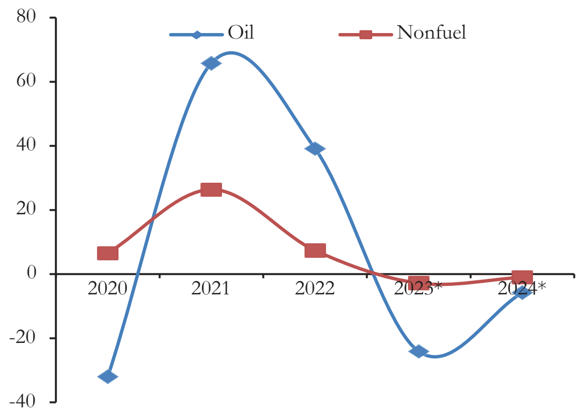
II.3 Global Inflation

Global headline (consumer price index) inflation is expected to fall from 8.7 percent in 2022 to 7.0 percent in 2023, according to the baseline projection of the IMF (WEO, April 2023), which is 0.4 percentage points higher than the projection released in January 2023. In all major country groups, disinflation is projected in 2023 due to falling fuel and nonfuel commodity prices and the cooling effects of monetary tightening on economic activity. At the same time, initial inflation discrepancies between advanced economies and emerging markets and developing nations are expected to persist. Core inflation-excluding food and energy, is anticipated to fall by only 0.2 percentage points to 6.2 percent in 2023, reflecting the stickiness of underlying inflation. Returning inflation to the targeted path is usually estimated to take until 2025.

Among the selected South Asian countries, as shown in Chart I.6, the IMF forecasted that India and Sri Lanka would be able to lower the inflation rate in 2023 in line with the trend of the advanced economies, emerging markets and developing economies. However, Bangladesh and Pakistan may experience an uptrend of inflation during 2023 until it is expected to decline from 2024 onwards.

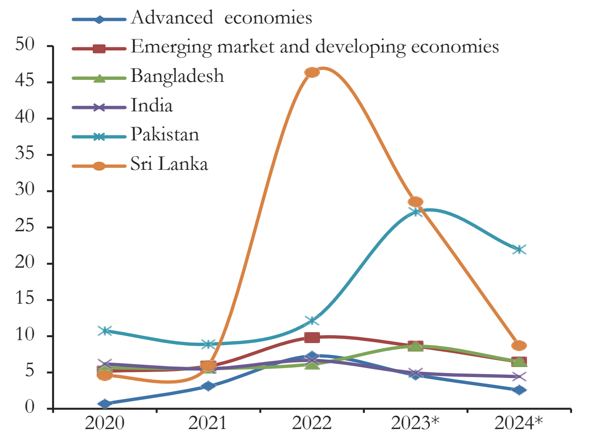
Due to the decrease in global demand, oil prices are predicted to decline by 24.1 percent in 2023 compared to the price of 2022 before progressively returning to the baseline over the projection horizon. The average oil price was USD 96.36 in 2022 a barrel, whereas the price is projected to be USD 73.13 in 2023 and USD 68.90 in 2024 a barrel. Based on futures markets, the per barrel price is projected to be USD 73.13 in 2023 and USD 68.90 in 2024. The prices of nonfuel commodities are also predicted to decline by 2.8 percent in 2023 compared to 2022 and may return to normalization by the following years (Chart II.5).

Chart II.5: Global Commodity Prices (y-o-y change, in percent)



* Projection.
Source: World Economic Outlook, April 2023, IMF.

Chart II.6: Consumer Prices: Global and Emerging Markets and Selected Peer Countries of South Asia (y-o-y change, in percent)

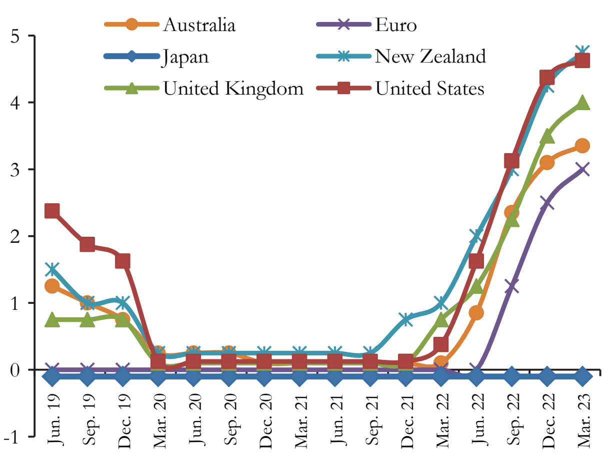


* Projection.
Source: World Economic Outlook, April 2023, IMF.

II.4 Global Financial Condition

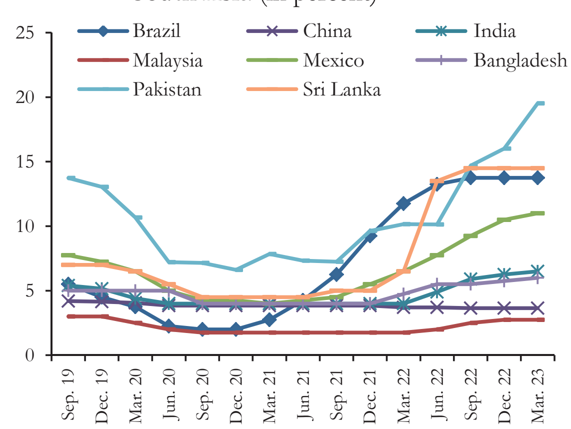
Central banks of most of the advanced economies, i.e., the Federal Reserve System, Bank of England, and European Central Bank, have started increasing policy rates from the beginning of 2022 with few exceptions, such as the Bank of Japan, which has been maintaining the policy rate (-0.1 percent) set in 2016. Consequently, a notable spike in the policy rate increase for the selected advanced economies can be observed by the end of March 2023 (Chart II.7). On the same note, central banks of emerging and developing economies and South Asia have also been increasing the policy rate since the beginning of 2022 with exception such as China where the policy rate has been declining although marginally. In the case of South Asian countries, a significant uptrend of policy rates could be observed for Pakistan and Sri Lanka, which could be aligned to the existing economic and financial turmoil of those economies, while India and Bangladesh have been maintaining a steady upward adjustment considering the global financial conditions (Chart II.8).

Chart II.7: Central Bank's policy rate of selected advanced economies (in percent)



Source: Policy Rate Statistics, Bank for International Settlements.

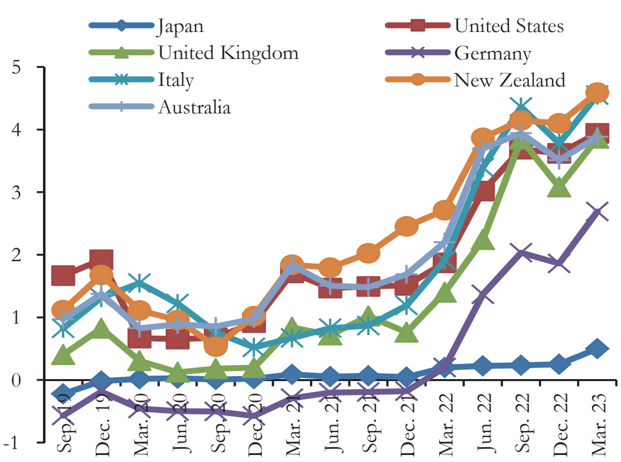
Chart II.8: Central Bank's policy rate of emerging markets and selected peer countries of South Asia (in percent)



Source: investing.com

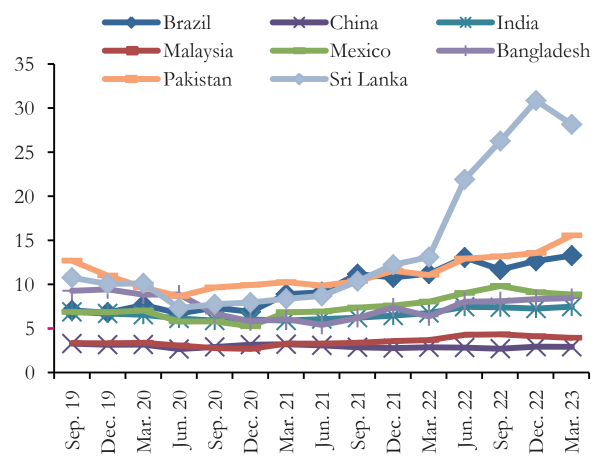
The 10-year government bond yields of most of the advanced economies went up significantly in March 2023 compared to that of March 2022 (Chart II.9). A broad-based outflow of capital from emerging market and developing economies caused dollar appreciation, worsening vulnerabilities in economies with dollar-denominated external debt. Those countries started taking measures to preserve foreign exchange reserves. In response, the emerging economies and peer countries of South Asia have also been adjusting the yields of 10-year government bonds not only to respond to the global conditions but also to protect the capital outflows (Chart II.10).

Chart II.9: 10-year Government Bond Yields of Selected Advanced Economies (in percent)



Source: investing.com

Chart II.10: 10-year Government Bond Yields of Selected Emerging Markets and Peer Countries of South Asia (in percent)



Source: investing.com

II.5 Lessons from Global Perspective for Bangladesh

Countries around the globe get influenced by the pass-through or spillover effects of the monetary policy stance of the advanced economies through different channels. However, the degree of influence over the domestic monetary policy depends much on the economic fundamentals, global financial integration, foreign exchange market intervention, capital flow regulation, and determination of macro-prudential policy measures of the domestic economy. With prudent macroeconomic management, Bangladesh successfully navigated the pandemic-induced shocks and maintained notable economic growth and development trajectory. BB has been playing a crucial role in this journey, combating the pandemic-induced economic slowdown with an accommodating and expansionary monetary policy stance. However, with the changing global scenarios and higher domestic inflationary situations, the BB shifted gear to contractionary bias and accommodating monetary policy since March 2022, including increasing the repo rate and sector-specific credit supports facilitating production and exports. Specific policy measures for CMSMEs and other employment-generating sectors have been formulated and implemented with different time horizons. As a result, the major macroeconomic and financial indicators remained resilient and continued observing healthy trends. Nevertheless, tackling domestic inflation, gaining trade competitiveness, and stabilizing financial sector prices would be the major concerns amid this global turmoil emanating from galloping inflation, terms of trade shocks, and exchange rate pressures.

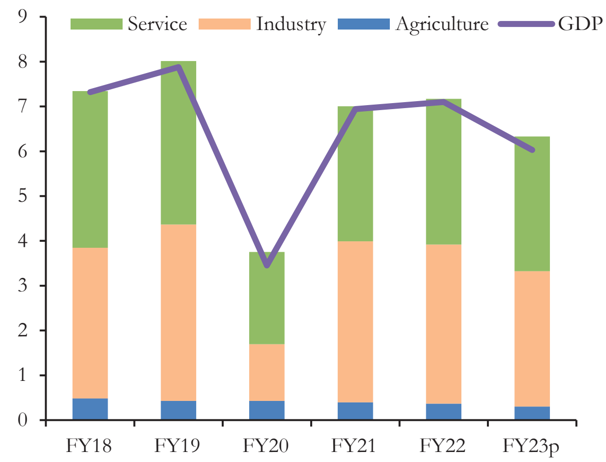
The outlook is vulnerable to downside risks. As the global economy started responding to pandemic shocks over the past two years and financial sector upheaval, the Asia and Pacific region's short-and medium-term future has to deal with global and regional headwinds to growth. Inflation anxieties and recession worries are rising, coupled with recent banking system turmoil, which could lead to a harsher and more sustained tightening of global financial conditions than expected. Due to historically high private and governmental debt, rate hikes of the central banks may have more contractionary impacts on the economies than predicted. Higher borrowing costs and poorer growth could create a systemic debt crisis in emerging and developing nations. Besides, policymakers in low-income countries need more room to balance new adverse shocks due to high debt, inflation, and financial market instability.

Chapter III
Domestic Economic Activities and Inflation

III.1 Real Sector Economic Activities

The overall growth profile of Bangladesh's economy proved resilience amidst the highly uncertain global situation. The economy had rebounded strongly from the pandemic dent with a robust real gross domestic product (GDP) growth outcome (6.94 percent in FY21 and 7.10 percent in FY22) (Chart III.1). This growth episode was backed mainly by well-recovered progress in the industry and service sectors, while the agriculture sector witnessed sustained production. The industry and service sectors, holding around 88 percent of GDP, grew by 9.86 and 6.26 percent, respectively in FY22. A solid external demand also favored buoyant economic activities in FY21 and FY22.

Chart III.1: Decomposition of Gross Value Addition
(in percent)

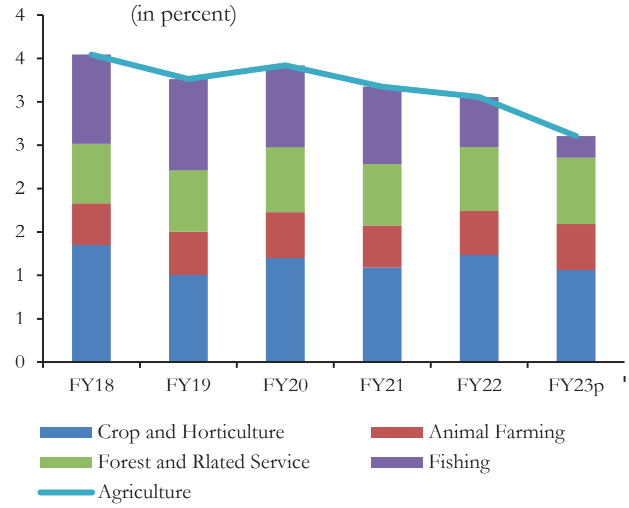


P=Provisional.
Source: Bangladesh Bureau of Statistics (BBS).

However, the recovery of Bangladesh economy from the pandemic has faced challenges in FY23, originating from growing global economic uncertainties emerged from the war in Ukraine, intense pressure on the BoP, sharp depreciation of the exchange rate, rationing of electricity supply, and upward revision of fuel and energy prices in the domestic market. Although BB has been extending various supportive policies and ensuring necessary flow of funds to the economy's productive sectors at an affordable cost to bolster economic growth, these unfavorable developments impeded the economy's growth momentum. According to the latest data from the Bangladesh Bureau of Statistics (BBS), the real GDP growth slowed to 6.03 percent in FY23 against the revised target of 6.50 percent, contributed by growth deceleration in all the three broad sectors–Industry, Service and Agriculture. The growth in the industry sector decelerated to 8.18 percent and the service sector growth moderated to 5.84 percent, whereas the agriculture sector growth declined to 2.61 percent. The sluggish government expenditure and lower ADP utilization weighed heavily on the growth outcome of FY23. Moreover, the subdued external and domestic demand in FY23 manifested in decelerated export and import growth and lower than expected remittance inflows has significantly disrupted the growth momentum.

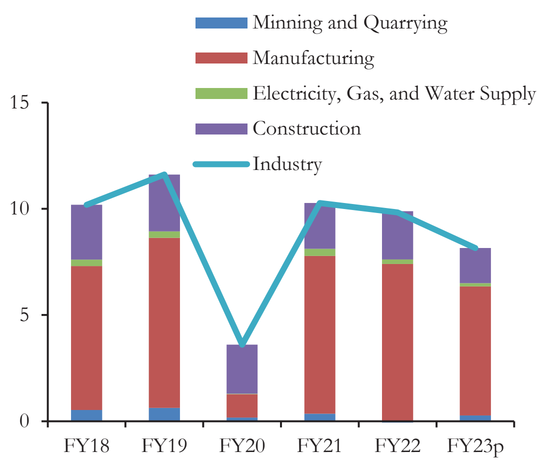
The agriculture sector maintained a lively performance during the pandemic period (in FY19 and FY20), averaging 3.34 percent growth. Subsequently, the growth momentum slowed down to 3.17 percent in FY21 and 3.05 percent in FY22 but remained resilient. In FY22, the production of rice, cereal, potato, vegetables, and onion recorded healthy growth of 4.18, 3.47, 2.61, 9.90, and 8.28 percent, respectively. However, the agriculture sector growth dropped to 2.61 percent in FY23, owing primarily to weather-related adversities and rise in input costs such as fertilizer, fuel, etc. The deceleration in agriculture growth came from lower growths in crops and horticulture and fishing, while animal farming and forest and related services exhibited increased growth (Chart III.2). A significant increase in disbursement of credit to the agriculture sector (19.53 percent, year-on-year) during July–March of FY23 together with availability of inputs and higher acreage indicates the healthier scenario of the agriculture sector in coming periods. However, this prospect might be clouded by recent heat waves and other adverse weather conditions.

Chart III.2: Growth Decomposition: Agriculture
(in percent)



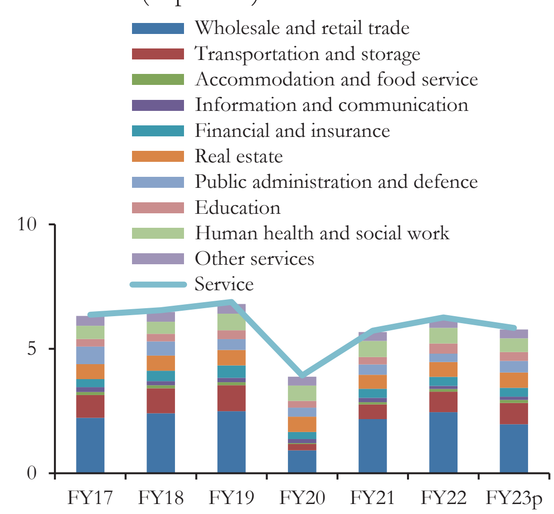
P=Provisional.
Source: Bangladesh Bureau of Statistics (BBS).

Chart III.3: Growth Decomposition: Industry
(in percent)



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

Chart III.4: Growth Decomposition: Service
(in percent)



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

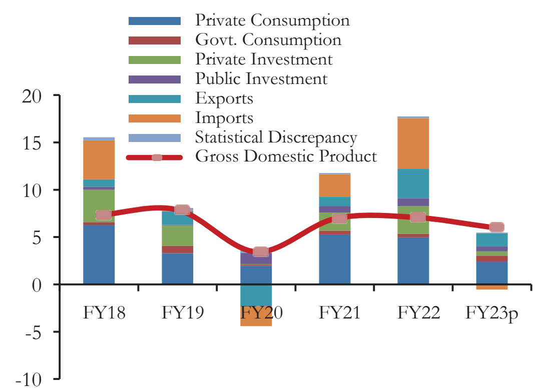
The growth performance of the industry sector was accelerated by a number of supportive policy measures, including fund allocation through stimulus packages, and various refinance schemes of BB and the government. The industry sector attained a robust growth of 9.86 percent in FY22, driven by 11.41 percent growth in the manufacturing sector. The industry sector constituted 36.92 percent of GDP in FY22, of which 24.29 percent came from manufacturing. Moreover, construction activities remained buoyant with 8.71 percent growth in FY22 which was 8.08 percent in FY21 (Chart III.3). However, the industry sector observed growth deceleration in FY23, resulted from the multifaceted catalysts, such as rationing of electricity supply, high input cost, weak export demand, and shortage of foreign currencies. The industry sector growth moderated to 8.18 percent in FY23, of which 6.07

percent growth came from the manufacturing activities. Nonetheless, the micro, small, and medium-scale manufacturing industry exhibited a strong growth of 9.73 percent in FY23 compared to 4.84 percent growth in FY22. The cottage manufacturing industry grew by 10.69 percent in FY23.

The service sector activities sustained its upward trajectory and posted a higher growth of 6.26 percent in FY22 compared to 5.73 percent growth in FY21. However, the service sector's growth slowed to 5.84 percent in FY23 owing to a substantial deceleration in wholesale and retail trade. Wholesale and retail trade grew by 6.65 percent in FY23, which was 8.46 percent in the previous year. Among other activities in the service sector, transportation and storage, accommodation and food services, financial and insurance activities, and real estate activities grew by 5.99 percent, 5.89 percent, 5.76 percent, and 3.87 percent, respectively (Chart III.4). Additionally, service sector-related activities are also reflected in several high-frequency proxy indicators, of which cargo handling through Chattogram port and credit to trade and commerce and consumer finance were crucial. During the first nine months of FY23, credit to trade and commerce and consumer finance grew by 15.67 percent and 24.70 percent, respectively, while total cargo handling growth through Chattogram port decelerated to 6.6 percent.

Domestic demand maintained a healthy growth of 7.95 percent and 8.69 percent in FY21 and FY22, respectively, favored by supportive policy initiatives. Private investment and private consumption–the key components of the domestic demand–grew in real terms by 11.82 and 7.48 percent, respectively, in FY22. However, policy measures for reducing inflation and BoP imbalances, tepid remittance inflow growth, and weak fiscal performance affected domestic demand in FY23. Domestic demand decelerated to 3.78 percent, resulting from a slump in private investment growth (1.73 percent) and private consumption growth (3.63 percent) (Chart III.5).

Chart III.5: Decomposition of Real GDP Growth from Expenditure Side (in percent)



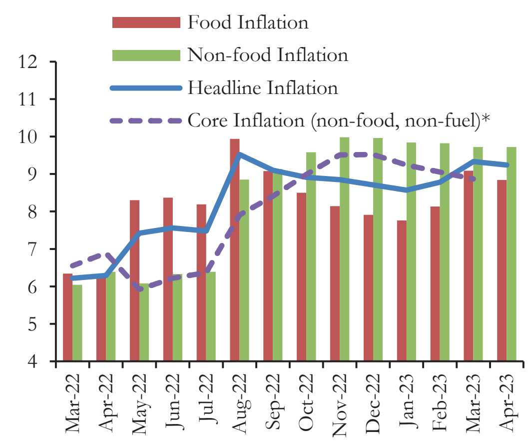
P=Provisional.
Source: Bangladesh Bureau of Statistics (BBS).

Looking ahead, the growth momentum is expected to accelerate in the period ahead by the favorable effects of improving the global supply situation, declining global commodity and energy prices, ongoing fiscal and monetary policy support, and potential improvements in export demand and remittance inflows. However, the economy's future path would crucially be conditioned upon the improvement of the country's BoP position.

III.2 Price and Inflation

Domestic headline inflation intensified and remained more than 8.0 percent during August–April of FY23. Both food and non-food inflation momentum interplayed with the headline inflation dynamics. The high domestic inflation trajectory was attributed mainly to a series of adverse supply shocks–both global and domestic–and the continuing pass-through of higher import costs. BB has taken several policy initiatives to control inflation, including tightening policy rates. In line with the policy stance as announced in MPS for FY23, the policy rate (the reprate), so far, has been increased by 75 basis points to 5.75 percent from 5.0 percent to deal with demand-side pressures, hence containing inflation. Nevertheless, the inflation scenario remained unfavorable during July–December 2022, ranging between 7.48-9.52 percent.

Chart III.6: Consumer Price Index Inflation
(point-to-point, in percent)



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

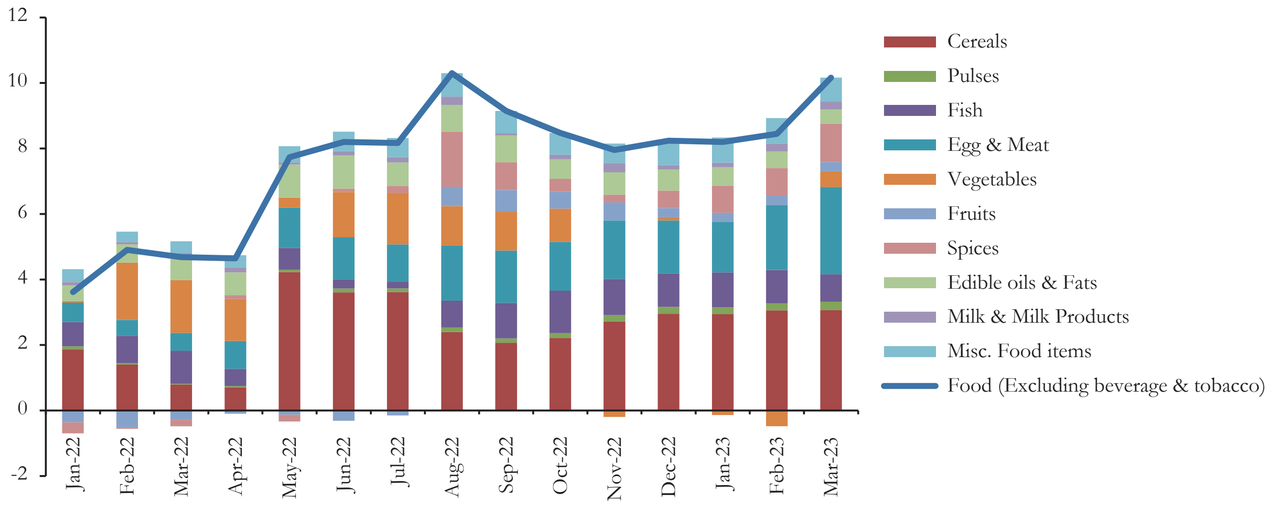
The headline inflation reached 9.52 percent in August 2022, the highest after 2011, and this acceleration came from a broad-based positive price momentum. Against this backdrop, the MPS for January–June 2023[2] was cautiously restrictive with a tightening bias to contain demand and has subsequently increased the policy rate (the repo rate) to 6.00 percent from 5.75 percent. Besides, BB also crafted quantitative tightening by selling a huge amount of dollars in the market. Therefore, headline inflation decreased slowly and reached 8.57 percent in January 2023, backed mainly by cooling food inflation, while non-food inflation remained at the pick. Food inflation came down partly due to a seasonal correction in vegetable prices. However, the recent surge in food inflation was driven mainly by higher demand from the Ramadan effect that began in the last week of March 2023 and pushed headline inflation to 9.33 percent in March and 9.24 percent in April 2023. Similarly, twelve-month average inflation has been following an upward trajectory during the first nine months of FY23 and steadily went up from 6.33 percent in July 2022 to 8.39 percent in March 2023. In addition, core inflation (CPI excluding food and fuel) had also been on the rise and reached 9.52 percent in December 2022. However, the core inflation softened during January-March 2023, although it exhibited considerable stickiness above 8.0 percent (Chart III.6).

Drivers of Food Inflation

Food inflation remained unstable during the nine months of FY23 due to sustained price pressures from cereals, pulses, and spices and a pick-up in protein-based food inflation. Meanwhile, a seasonal Ramadan effect on food inflation added momentum to food inflation in March 2023. The contribution of cereals (with a weight of 21.62 percent in overall CPI) into the CPI food basket remained the highest followed by egg and meat during the first nine months of FY23. The contribution of egg and meat inflation to overall food inflation sharply picked up to 2.67 percent in March 2023 although it had been rising more than 1.0 percentage point since May 2022. Spices contributed 1.17 percent to food inflation in March 2023. The contribution of edible oils and fats and fish prices to inflation started easing since December 2022, reflecting softening of those prices (Chart III.7).

[2]Previously MPS was published yearly. Half-yearly MPS for H2FY23 was published in January 2023.

Chart III.7: Decomposition of CPI Food Inflation (point-to-point, in percent)

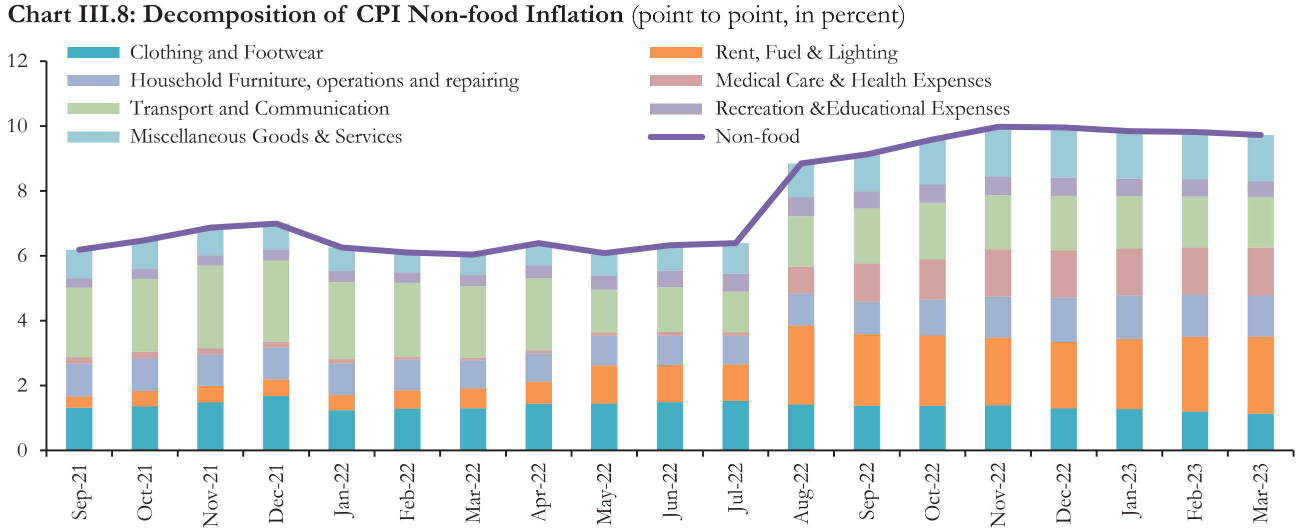


Source: BB Staff's calculation based on BBS data.

Drivers of Non-food Inflation

Non-food inflation remained persistently high over 9.0 percent on average during the nine months of FY23 mostly because of supply-side disruption and exchange rate pressure. Most of the non-food items of the CPI basket had contributed significantly to the inflation build-up. Rent, fuel and lighting was the highest contributor during the August 2022–March 2023 period on the back of subsequent fuel and electricity price hikes in the domestic market. The rise in fuel prices impacted the inflation of transport and communication expenses, contributing 1.59 percent on average from July 2022–March 2023. The contribution of medical care and health expenses to overall non-food inflation went up substantially to 1.32 percent on an average during August 2022–March 2023 after an episode of the lower contribution of 0.14 percent on an average during September 2021-July 2022 (Chart III.8).

Chart III.8: Decomposition of CPI Non-food Inflation (point to point, in percent)

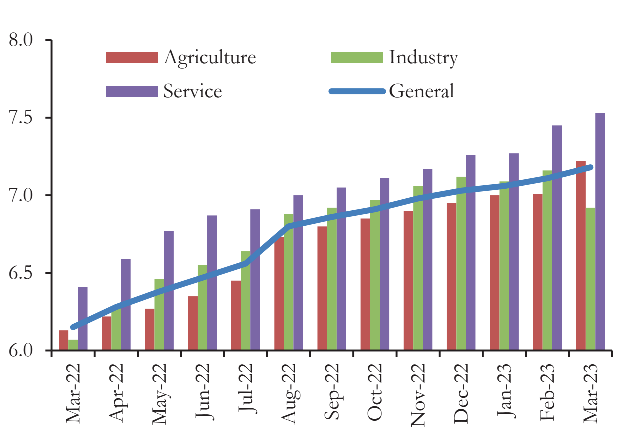


Source: BB Staff's calculation based on BBS data.

Nominal Wage Rate

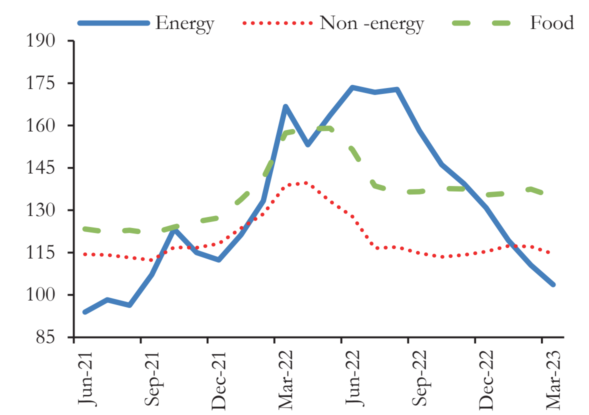
The nominal wage growth gradually increased from 6.56 percent in July 2022 to 7.18 percent in March 2023. The growth in the wage index largely reflected the recent inflation episode, although the wage growth was smaller than CPI inflation, impacting the purchasing power of the households. Wage growth in the service and agriculture sectors revealed the same pattern as the general wage growth, while the industry sector showed some volatility. Wage growth in the industry sector steadily increased till February 2023 before a short-lived fall in January 2023. In March 2023, it again fell to 6.92 percent (Chart III.9).

Chart III.9: Wage Rate Index
(percentage change: point-to-point)



Source: Bangladesh Bureau of Statistics

Chart III.10: Global Commodity Price Indices
(2010=100)

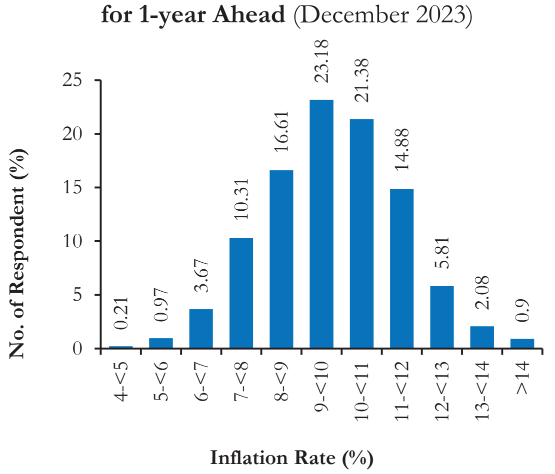


Source: Commodity Market outlook, World Bank.

Global Commodity Prices

Global commodity prices have exhibited a downward trend since the beginning of FY23. The energy prices index gradually decreased since July 2022 and decreased by 37.9 percent in March 2023 on a year-on-year basis due to a significant decline in crude oil prices. Crude oil prices eased during this period partly because of subdued global growth and milder winter in Europe. Non-energy and global food prices exhibited a declining trend during July 2022-March 2023, decreasing by 17.5 percent and 14.4 percent in March 2023, respectively, compared to the same month of the previous year (Chart III.10)

Chart III.11: Distribution of Inflation Expectations for 1-year Ahead (December 2023)



Source: Bangladesh Bank.

Inflation Expectation and Projection

According to the inflation expectation survey of BB, one year ahead (December 2023) inflation expectation is significantly higher than the targeted level of inflation (7.50 percent) for FY23 (Chart III.11). Moreover, the forward-looking inflation expectation increased in December 2022 survey compared to the previous survey. The upward development of inflation expectations might be evident in the context of the recent higher inflation trajectory. However, BB's forecasts suggested a tolerable level of CPI inflation in the period ahead, assuming normal weather conditions, a progressive normalization of supply chains, and no further exogenous shocks.

Chapter IV
Development in the External Sector

IV.1 Balance of Payment

The external sector of Bangladesh economy has started facing headwinds since H2FY22, originating from growing import payments, led by post-Covid recovery-driven strong import demand and elevated global commodity and energy prices, and receding export receipts and remittance inflows amid weak global growth recovery in the face of high inflation, prolonged monetary contraction by a majority of the advanced and emerging market economies aimed at taming inflation, and geo-economic fragmentation and payment system disruptions ensued from the war in Ukraine. Consequently, the current account deficit continued widening and peaked at USD 18.64 billion (4.0 percent of GDP) in FY22 compared with a moderate deficit of USD 4.58 billion (0.9 percent of GDP) in FY21. This surge in the current account deficit led to a deficit of USD 5.38 billion in the overall BoP in FY22 from a surplus of USD 9.27 billion in FY21.

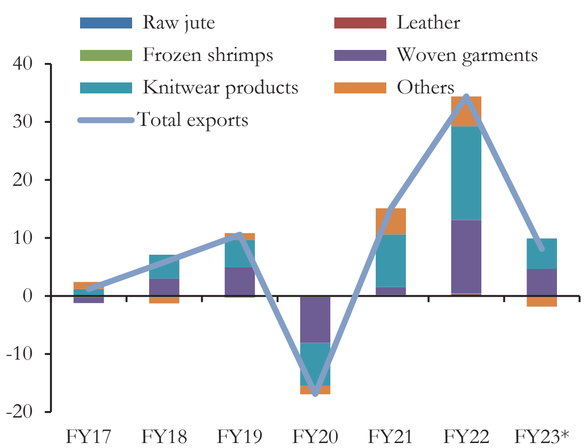
The soaring current account deficit started moderating and declined to USD 3.64 billion in the first nine months of FY23, driven by the contraction of the trade deficit with the help of exchange rate depreciation and several policy initiatives for increasing remittance inflows and containing imports. Despite a sharp contraction of the current account deficit, the overall BoP deficit widened to USD 8.17 billion in this period, as the financial account witnessed an unusual deficit. BB continued selling foreign currencies to mitigate the demand-supply gap in the foreign exchange market. At the same time, BB allowed a considerable depreciation of exchange rates, reflecting a move toward a more flexible and market-oriented exchange rate system, as stipulated in the MPS for H2FY23.

Export

Amid weak global growth momentum caused by the war-driven geo-economic fragmentation and protracted tight monetary policy to tame inflation in most of the regions, the total export of the country amounted to USD 41.7 billion, registering a moderate growth of 8.07 percent (y-o-y) in the first nine months of FY23 compared with 33.41 percent growth during the same period of FY22 (Chart IV.1).

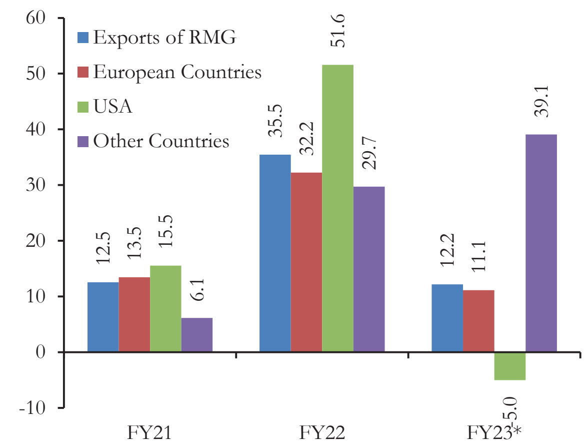
The growth of total export was overwhelmingly concentrated in the export of ready-made garments (RMG), which grew by 12.17 percent in the first nine months of FY23—significantly lower than 33.80 percent growth in the same period of FY22. During this period, the main destinations of RMG exports were European countries, where RMG exports grew by 11.1 percent, while exports to the USA declined by 5 percent (Chart IV.2). Apart from RMG, the majority of export items, such as jute and jute goods, agriculture products, engineering products, frozen fish, and chemical products registered negative growth during this period.

Chart IV.1: Decomposition of Export Growth
(in percent)



Source: BB Staff's calculation based on EPB data.
* July – March, FY23.

Chart IV.2: RMG Export Growth in Major Destinations
(in percent)

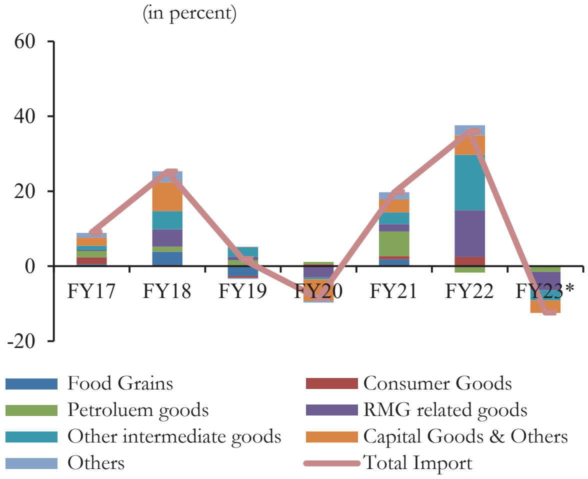


Source: Export Promotion Bureau (EPB).
* July – March, FY23.

Import

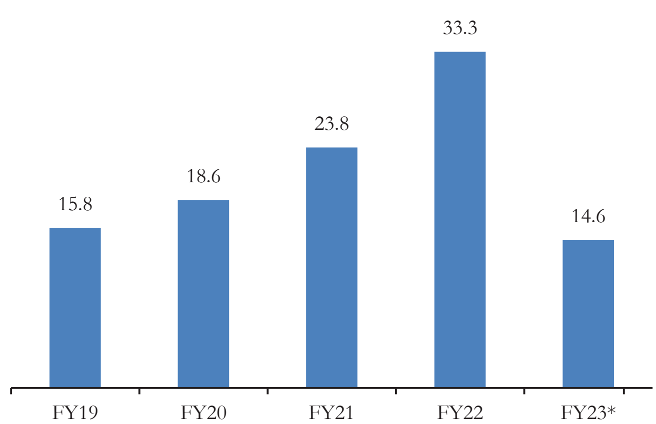
The surge in import subsided in FY23, aided by a notable depreciation of BDT, deferring low-priority foreign exchange-related purchases by the government, and several policy initiatives taken by BB (see Box IV.1 for details) for containing import demand. After a high growth of 35.95 percent in FY22, import payment declined by 12.3 percent (y-o-y) and stood at USD 53.94 billion in July-March of FY23 (Chart IV.3). This downturn in import payment helped to reduce the trade deficit to USD 14.61 billion in this period, whereas the trade deficit was USD 25.03 billion during the same period of FY22 (Chart IV.4).

Chart IV.3 : Decomposition of Import Growth
(in percent)



Source: Bangladesh Bank.
* July – March, FY23.

Chart IV.4: Trade Deficit (in billion USD)



Source: Bangladesh Bank.
* July – March, FY23.

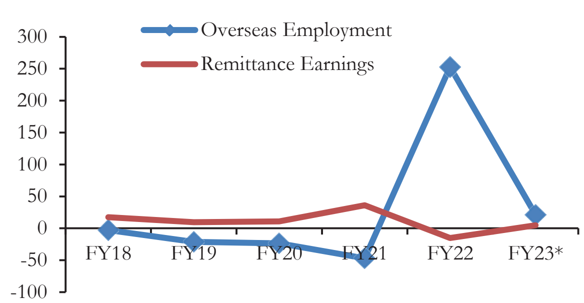
Although the slowdown of import remained broad-based, the decline was primarily driven by the import of raw materials and intermediate goods, capital machinery, and capital good. Import payments for raw materials and intermediate goods (about 60 percent of total imports) declined by 14.7 percent, capital machinery declined by 11.9 percent, consumer goods declined by 0.1 percent, and food grains declined by 4.6 percent. However, the import of raw cotton, an essential input for the textile sector, increased by 3.2 percent in this period.

Remittance

Remittance inflow grew by a moderate rate of 4.8 percent to USD 16.0 billion in July-March of FY23 after a decline in FY22 (Chart IV.5). This positive growth of remittance inflows and subsided trade deficit together resulted in a decline in current account deficit to USD 3.64 billion in the first nine months of FY23 (Chart IV.6). The current account deficit was as high as USD 14.3 billion during the same period of FY22.

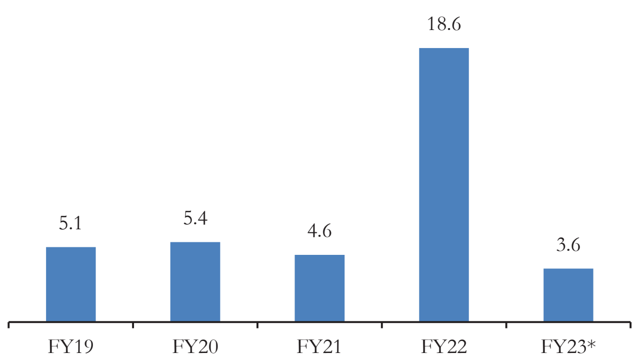
Although BB has taken several supportive policies[3] to revitalize the remittance inflows, official remittances inflows have yet to keep pace with the high growth of overseas employment in FY22 and FY23. The deceleration in remittance inflow growth originated mainly from a decline in remittance inflows from the Gulf region, which accounts for half of the total remittances and most of the overseas employment in Bangladesh. Despite strong positive growth of remittance from the UAE (74.0 percent), remittance inflows from the Gulf region declined by 0.78 percent in the first nine months of FY23, while remittance from the Euro region and the USA increased by 22.4 percent and 11.34 percent, respectively. Given the strong growth in overseas employment, the weak growth of remittance inflows through official channels could partially be attributed to returning a sizeable amount of remittance to the informal channel, as the Covid-related restrictions have already been withdrawn.

Chart IV.5: Remittance Inflow and Overseas Employment (Growth in Percent)



Source: Bangladesh Bank and Bureau of Manpower, Employment, and Training
* July – March, FY23

Chart IV.6: Current Account Deficit (in billion USD)



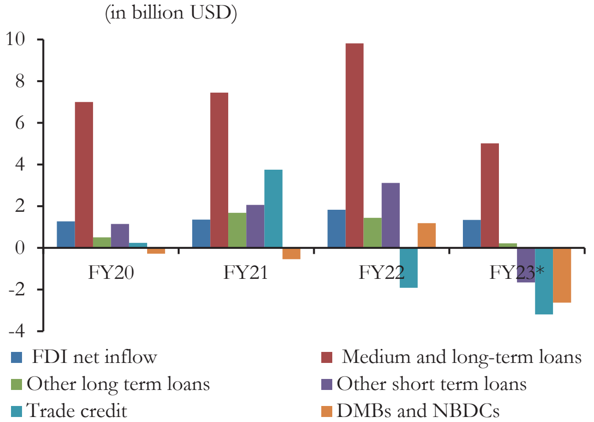
Source: Bangladesh Bank
* July – March, FY23

[3] These policy initiatives include: allowing BDT to depreciate significantly to reduce the wedge between formal and informal exchange rates, offering higher exchange rates for remittances, easing the remittance repatriation and cash incentive distribution process, waiving the money transfers fees by local banks for expatriate remitters, and allowing the mobile financial services in the remittance collection and distribution process among others.

Financial Account

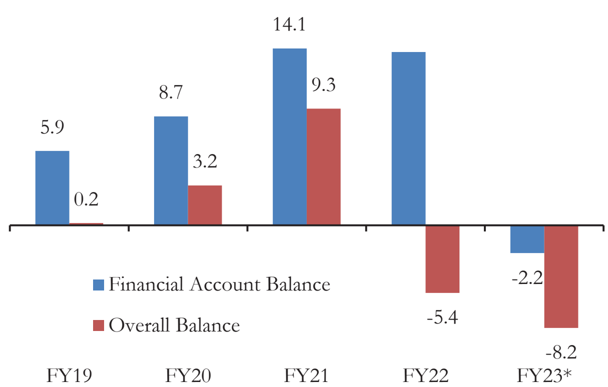
The financial account became a deficit in FY23 for the first time since FY10. This deficit was driven mainly by slow long-term private foreign loan inflows amid rising global economic uncertainties, faster repayment of short-term private foreign borrowings than receipts to avoid additional costs arising from the rising international base interest rate, a large deficit in the trade credit resulted from the delay in repatriation of some export earnings and a higher repayment for DMB's and NBDC's foreign currency liabilities (Chart IV.7). The financial account deficit reached USD 2.2 billion in July-March of FY23 in contrast to a surplus of USD 11.9 billion during the same period of FY22 (Chart IV.8). During this period, the capital account recorded a surplus of USD 287 million. Despite a sharp contraction of the current account deficit, the unusual deficit in the financial account led to a rise in the overall BoP deficit to USD 8.2 billion in July-March of FY23 compared with the deficit of USD 3.1 billion during the same period of FY22.

Chart IV.7: Major Components of Financial Account
(in billion USD)



Source: Bangladesh Bank
* July – March, FY23

Chart IV.8: Balance in the Financial Account and Overall BoP (in billion USD)



Source: Bangladesh Bank
* July – March, FY23

IV.2 Foreign Exchange Market

Intervention in the Foreign Exchange Market

To reduce the demand-supply gap in the foreign exchange market and restrain any abrupt depreciation, BB continued selling foreign currency, which resulted in the erosion of the official foreign exchange reserve (Chart IV.9 and Chart IV.10). Moreover, the turning of the financial account balance to a deficit heightened the pressure on foreign exchange reserve. During the first nine months of FY23, BB's net sales of foreign currencies amounted to USD 10.92 billion. Consequently, foreign exchange reserves plummeted to USD 31.14 billion at the end of March 2023 from USD 41.83 billion at the end of June 2022. Nonetheless, this reserve was sufficient to pay import bills for 5.3 months considering the current trend of imports. The government and BB have already taken several policy measures to reduce the pressure on the BoP and increase foreign exchange reserves (see Box IV.1).

Box IV.1: BB's Recent Policy Initiatives to Improve External Sector Performance

Selected policies to reduce outflows of foreign currencies

- BB increased margins, advance payment requirements for all LCs, and a higher margin requirement for LCs of non-essential and luxury goods. Pre-authorization for LCs over USD 3 million has also been initiated.
- In the first half of FY23, liquefied natural gas (LNG) imports from the spot market were deferred.
- Government purchases of cars, ships, and aircraft have been deferred. In addition, government investments relying heavily on imported materials have also been deferred.
- To reduce energy use, rationing of electricity supply was temporarily enforced in the first half of FY23.
- Temporary restrictions were placed on government officials' overseas travel for training and study tours incurring foreign exchange expenses.
- Personal foreign visits, including training/workshop/seminar/study tours of bank officials have been restricted until further instruction.

Selected policies to increase inflows of foreign currencies

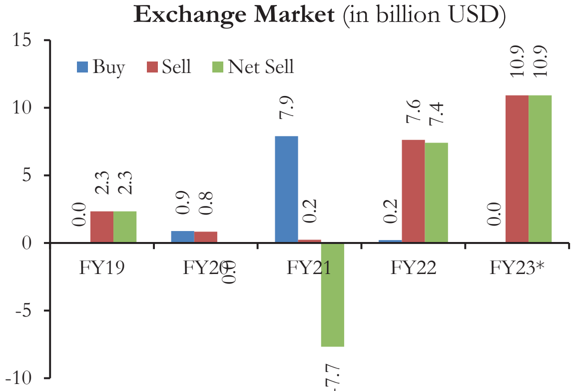
- Removal of ceiling on fund transfers through Internet banking for remittances.
- Removal of interest rate cap on non-resident foreign currency deposits.
- Removal of source discloser requirement for remittances of more than USD 5,000.
- Permission for importers to extend guarantees and the maturity of suppliers' and buyers' credit, and permission for domestic banks to borrow from offshore operations to settle certain import payments.
- Requirement for encashment of 50 percent of the balance held in exporter retention quota (ERQ) accounts has been initiated.

Selected policies to reduce volatility in the exchange rates

As of March 2023, BAFEDA instructed all authorized dealers to maintain the following BDT/USD exchange rates for transactions:

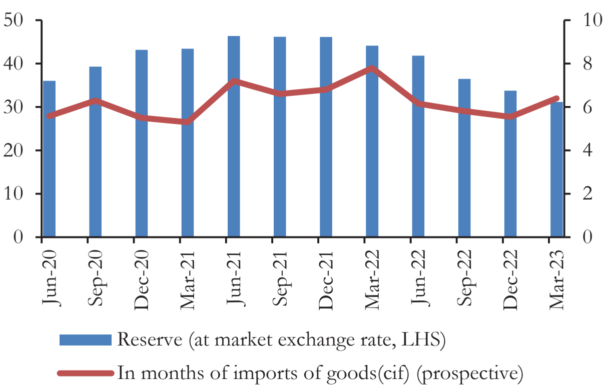
- Exporters-Banks would buy export proceeds at a predetermined rate of BDT 104 per USD.
- Remittances-Banks would purchase remittances from exchange houses and banks at a cost not exceeding BDT 107 per USD.
- Banks may charge a maximum BDT 1 spread over the 5-day weighted average buying cost of export proceeds and remittances for LCs, import bills, and outward transfers.

Chart IV.9: BB's Intervention in the Foreign Exchange Market (in billion USD)



Source: Bangladesh Bank
* July – March, FY23

Chart IV.10: International Reserve (in billion USD)



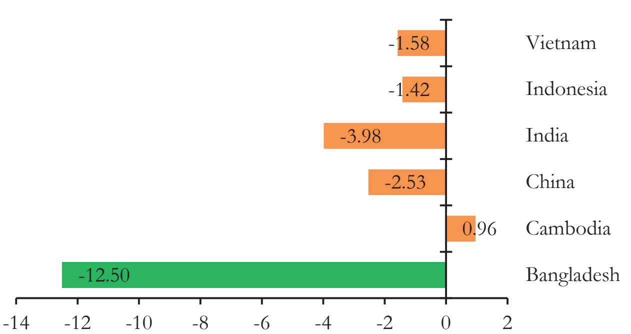
Source: Bangladesh Bank

Exchange Rate Movements

The widening deficit in the BoP, sustaining contractionary monetary policy by major advanced and emerging market economies, including the Fed and the ECB, and growing uncertainties from the war-driven geo-economic fragmentation led to a depreciation pressure on the exchange rate of BDT. To mitigate the pressure on the BoP and slow down the erosion of foreign exchange reserves, BB has allowed more flexibility in exchange rates to come into play in the market forces since late FY22. In addition, BB has introduced a multiple exchange rate regime with different exchange rates for exports, imports, remittances, and interbank transactions, and the responsibility for determining the exchange rates has been given to the Bangladesh Foreign Exchange Dealers Association (BAFEDA) and the Association of Bangladesh Bankers (ABB) since September 2022. Given the deficit in the BoP, the exchange rate for inter-bank transactions of BDT vis-à-vis USD (excluding BB's intervention rate) culminated in depreciation by 12.5 percent at the end March 2023 over the end of June 2022 (Chart IV.11), reflecting a move toward a more flexible and market-oriented exchange rate system as stipulated in the MPS for H2FY23. Moreover, BB has continued its efforts to unify foreign exchange rates. Although the currencies of many developing and emerging market economies witnessed depreciation against USD during this period, the depreciation of BDT was more pronounced than that of Bangladesh's major competitors in the export market.

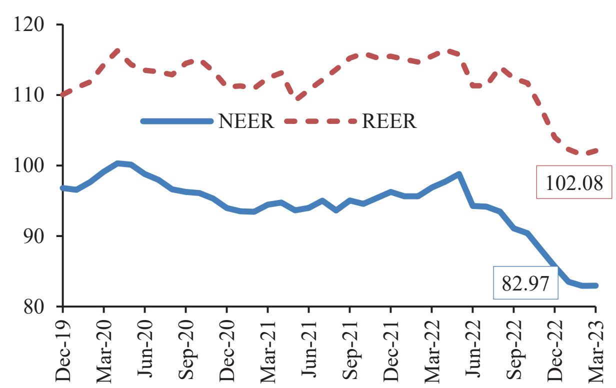
The depreciation of BDT vis-à-vis USD is also reflected in the nominal effective exchange rate (NEER) and the real effective exchange rate (REER) (Chart IV.12). The NEER and REER indices descended to 82.97 and 102.08 in March 2023 from 94.26 and 111.30 in June 2022, depreciating by 11.98 percent and 8.28 percent during this period, respectively. The falling of the REER index close to 100 implies a waning of depreciation pressure on nominal exchange rates.

Chart IV.11: Appreciation/Depreciation (+/-) of Peer Countries' Nominal Exchange Rates against USD (in Percent)



Source: Bangladesh Bank and Internatinal Financial Statistics, IMF.

Chart IV.12: Movements in NEER and REER

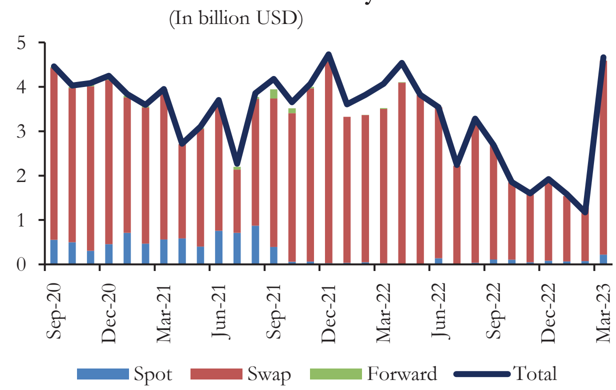


Source: Bangladesh Bank

Turnover in the Foreign Exchange Market

Transactions in Bangladesh's interbank foreign exchange market are comprised of spot, forward, and SWAP transactions. Total turnover in the foreign exchange market declined by 31.71 percent and stood at USD 4.67 billion by the end of March 2023 compared to the month of June 2022, reflecting a shortage of liquidity in the foreign exchange market (Chart IV.13). This deceleration was driven by swap transactions, which constituted 93.6 percent of the total transaction, increased by 28.5 percent by the end of March 2023 compared to June 2022. Besides, Spot transactions also observed a notable increase in this period.

Chart IV.13: Total Turnover by Instruments



Source: Bangladesh Bank

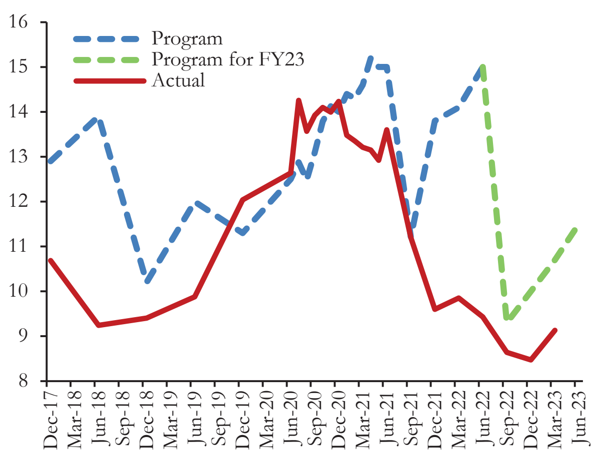
In FY23, the widening BoP deficit was due mainly to turning the financial account to a deficit from a substantial surplus in FY22, while the current account deficit subsided notably, driven mainly by a lower import payment on the back of falling global commodity and energy prices and import limiting measures. In the near term, the upcoming disbursements of foreign assistance for budget support and other development programs from development partners could provide some respite for the BoP and foreign exchange reserve pressure. At this juncture, as the space for further reduction of imports is limited, the improvement in the current account balance would depend on the pick-up in the growth of exports and remittance inflows. However, downside risks to future export growth might emerge from the growth slowdown in major export destination economies. In addition, high export concentration in terms of both export basket and export destination could also amplify the risk.

Chapter V
Development in the Money and Credit Market

V.1 Broad Money (M2)

The broad money (M2) growth decelerated gradually in the first two-quarters of FY23 before turning around in the third quarter. However, it came down to 9.13 percent in March 2023 from 9.43 percent growth at the end of FY22, triggered by both lower-than expected growth in the net domestic asset (NDA) and a sharp decrease in the net foreign asset (NFA) for the period (Chart V.1). At the end of March 2023, the growth of M2 was lower than the target of 10.70 percent for the period. Albeit remaining much below the target growth of 20.52 percent, the NDA growth increased from 14.02 percent in June 2022 to 15.40 percent in March 2023, instigated by a surge in the public sector credit growth. Although growth to private sector credit moderated to 12.03 percent in March 2023 from 13.66 percent in June 2022, a strong rebound in the public sector credit growth, which increased to 37.82 percent from 28.18 percent during this period, contributed to pulling the overall NDA growth rate. The increase in public sector credit growth emanated from the higher budget deficit financing by the Government from the banking sector for July-March, FY23 in the face of a remarkable decline in the net sales of National Saving Certificate (125.22 percent during July-March, FY23) and sluggish revenue collection.

Chart V.1: Broad Money (M2) Growth: Program vs. Actual (in percent)



Source: Bangladesh Bank.

In contrast, credit to the private sector was below its target growth of 13.80 percent for March 2023 due to lower investment demand arising from the decline in the import of capital machinery and industrial raw materials on the one hand and depressing consumer goods demand on the other. As per the sector-wise credit data, it becomes evident that credit growth to agriculture, trade & commerce, and consumers were evincing a burgeoning trend, rising by 17.90, 11.54, and 21.19 percent, respectively, by the end of March 2023. As the economic activities are picking up, private sector credit growth is expected to rebound and reach as close as the target for June 2023 of 14.10 percent by the remaining quarter of the current fiscal year.

On the other side, NFA growth remained negative because of a growing deficit in the BoP. NFA dwindled by 13.28 percent (y-o-y) at the end of March 2023 compared to a decline of 4.72 percent at the end of the previous fiscal year, against a negative 21.24 percent programmed growth for March 2023. Despite the present course of events, the NFA growth is expected to remain above the target of negative 11.90 percent growth at the end of FY23 with the help of potential improvement in the

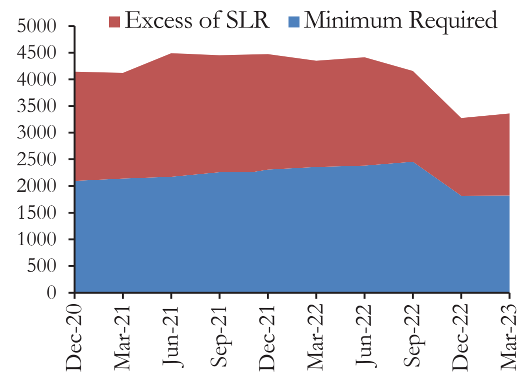
V.2 Reserve Money

The growth rate of reserve money (RM) witnessed a jump from negative 0.26 percent in June 2022 to 7.61 percent in March 2023; however, it remained below the target for both March 2023 (11.50 percent) and June 2023 (14.00 percent). This growth in RM resulted from accelerated growth in the NDA of BB in the face of a huge cash demand from the Government and DMBs. NDA of BB grew remarkably by 369.43 percent in March 2023 from 96.84 percent in June 2022., The money multiplier rose to 5.15 at the end of March 2023 from 4.92 at the end of June 2022, primarily owing to a decrease in the reserve-deposit ratio.

V.3 Liquidity

The contractionary effects of selling foreign currency by BB, a sudden rise in cash withdrawal from banks by the depositors, and sluggish deposit growth resulted in a tighter liquidity condition in the banking system. Consequently, maintained liquid assets decreased from BDT 4414 billion in June 2022 to BTD 3361 billion in March 2023, making excess liquidity (as per SLR) in the banking system decrease from BDT 2031 billion to BDT 1538 billion in the same period (Chart IV.2). Since June 2021, there has been a steady decline in liquidity in state-owned banks and private commercial banks up to December 2022, which propelled the overall liquidity of the banking system to slide. Even though the liquid assets of foreign banks have gradually increased, the relative strength of the decline in liquid assets in SOBs and PCBs has contributed to the overall drop in liquidity. Considering the situation, BB has taken up various initiatives to ameliorate the banking system's liquidity by giving continuous liquidly support through repos and introducing the Islamic Bank liquidity facility (IBLF).

Chart V.2: Liquidity (in billion BTD)

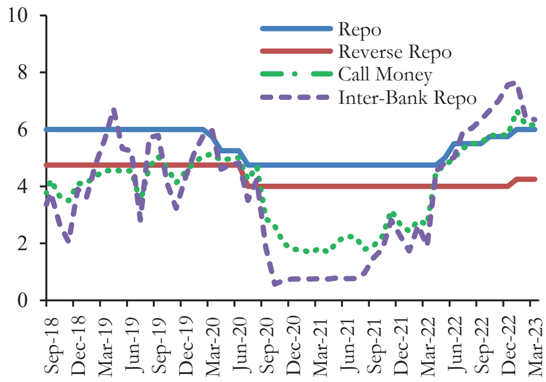


Source: Bangladesh Bank.

V.4 Interest Rates

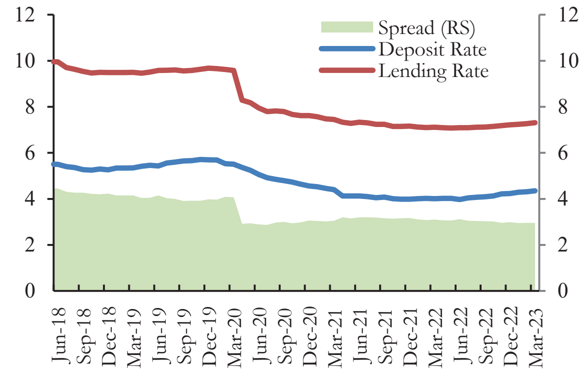
To contain the inflationary pressure, predominantly arising from pandemic related expansionary fiscal and monetary policies, global commodity prices hike, and depreciated exchange rate of BDT, BB has brought a change to its policy stance by tilting towards monetary tightening while ensuring sufficient funds for investment and employment generating activities. In that line, BB has revised the repo rate upward by 25 basis points to 5.75 percent in October 2022 before increasing again by the same amount to 6.00 percent in January 2023. Accordingly, the reverse repo rate was increased to 4.25 percent in January 2023 from the prevailing 4.00 percent. However, the cash reserve ratio (CRR) and bank rate were kept unchanged at 4.00 percent.

Chart V.3: Movements in Policy and Money Market Rates (in percent)



Source: Bangladesh Bank

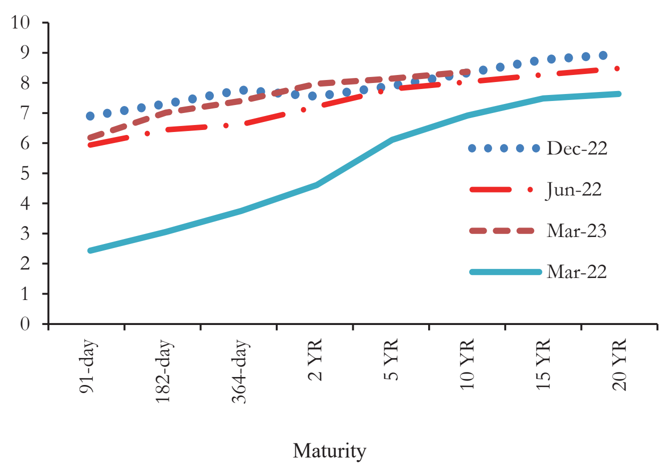
Chart V.4: Interest Rate Spread (in percent)



Source: Bangladesh Bank

Amid a downward pressure on liquidity and upward adjustment of policy rates, interest rates in the call money market and interbank repo market followed an upward trend during the same period (Chart V.3). Moreover, weighted average interest rates in the retail market continued to follow an upward trend since July 2022, reflecting the tighter liquidity situation in the banking system. Weighted average lending and deposit rates went up to 7.31 percent and 4.35 percent, consecutively, in March 2023 from 7.09 percent and 3.97 percent in June 2022, respectively. Due to the relative strength of the increase in deposit rates, the spread decreased to 2.96 percent in March 2023 as compared to 3.12 percent in June 2022, marking an improvement in the efficiency of the banking system (Chart V.4).

Chart V.5: Yields of Government Securities (in percent)



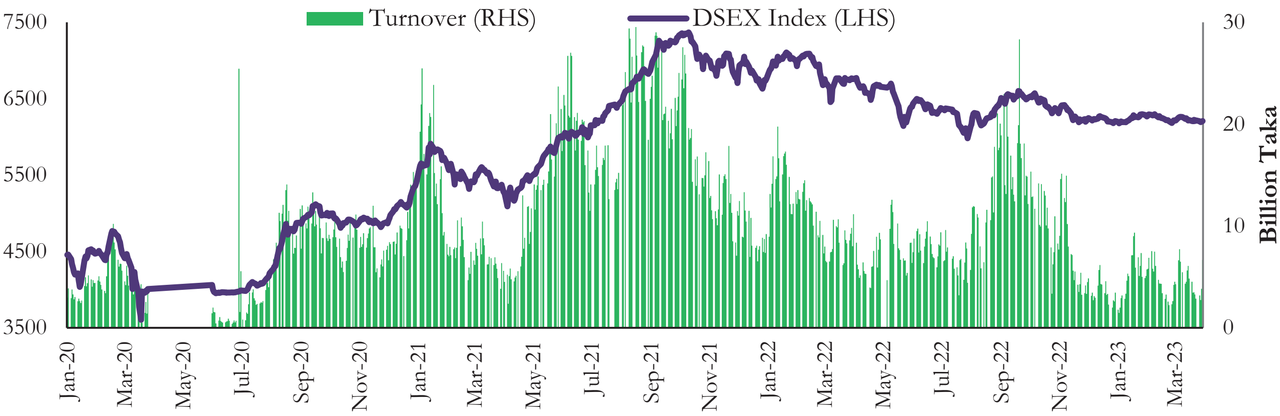
Source: Bangladesh Bank.

The tight liquidity situation has also pushed the weighted average yields on government securities for all medium- and long-term maturities upward, as reflected in the upward shift of the primary yield curve for March 2023 from June 2022. The yield on 91-day, 182-day, and 364-day Treasury bills jumped to 6.18, 7.01, and 7.40 percent in March 2023 from 5.94, 6.44, and 6.62 percent, respectively, in June 2022. Similarly, the yield on 5-year and 10-year Treasury bonds increased to 8.14 and 8.37 percent from 7.8 and 8.03 percent, respectively, during the same period. Although, in March 2023, 15-year and 20-year treasury bonds were not traded in the market, their yield rates were significantly high in February 2023 as compared to June 2022 (Chart IV.5).

Chapter VI
Development in the Capital Market

The performance of the country's capital market remained broadly subdued in FY23, despite various supportive measures taken by the Bangladesh Securities and Exchange Commission (BSEC) and BB. The capital market continued rebounding from the pandemic shock until October 2021 with the economy's recovery. Since then, the performance of the market has followed a downward trend with volatility amid some unfavorable developments in the domestic and global economy, such as falling liquidity in the banking system, substantial depreciation of the exchange rates, quick erosion of the foreign exchange reserve, tight global financial condition, slowdown of global economic growth and economic uncertainties emerged from the war in Ukraine, among others.

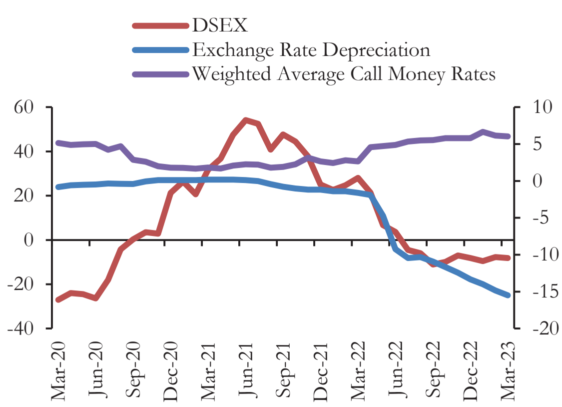
Chart VI.1: DSEX Index and Turnover



Source: Dhaka Stock Exchange.

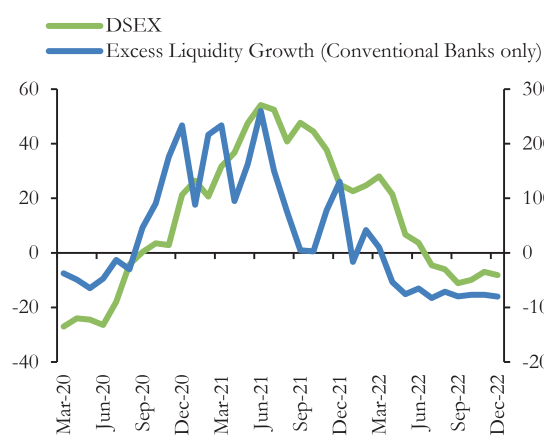
The DSE broad index, the benchmark index of the country's leading stock exchange, remained unchanged with some deviations since November 2023 amid lingering economic uncertainties emanating from the war in Ukraine, supported by various measures taken by BSEC, including the enactment of unconventional floor prices since July 2022.

Chart VI.2: DSEX, Exchange Rate Depreciation and Call Money Rate



Source: Dhaka Stock Exchange.

Chart VI.3: DESX and Excess Liquidity Growth

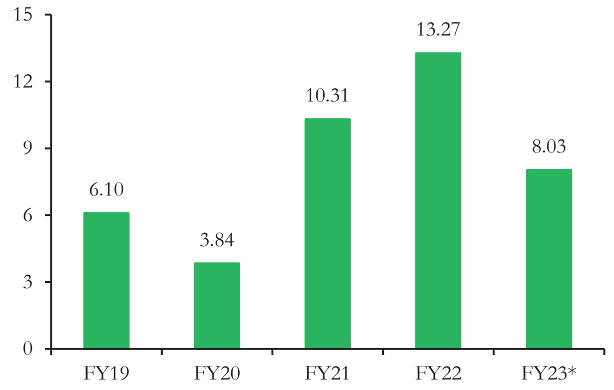


Source: Dhaka Stock Exchange.

Despite BB's adopting tightening monetary policy in line with global interest hike to tackle the adverse spillover effect of global economic slowdown, banks were discouraged from investing more in the stock market because of a liquidity crunch arising from substantial depreciation of the exchange rate (Chart VI.2). Although DSE index maintained steady pace during the last couple of months, the values of the index were much lower than that of a year ago. This index declined by 8.15 percent at the end of March 2023 compared to March 2022.

Chart VI.4: DSE Daily AverageTurnover

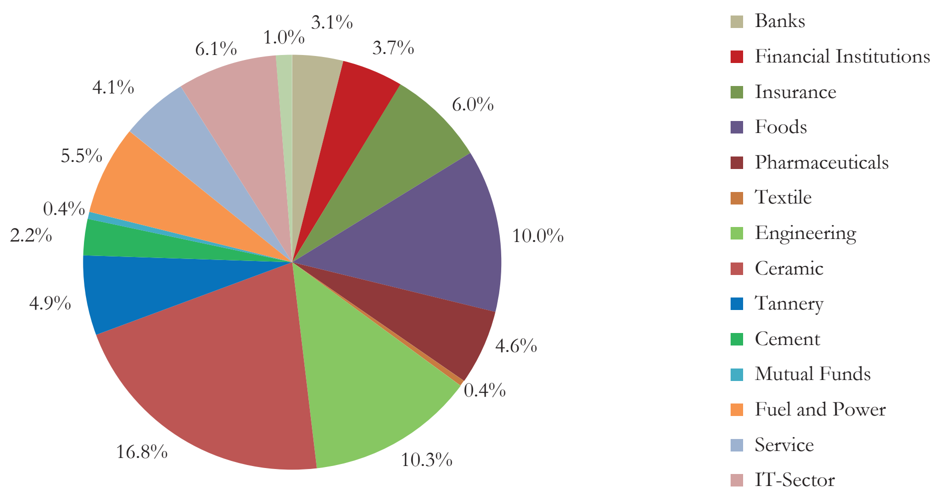
(in billion Taka)



Source: Dhaka Stock Exchange * Up to March

The daily average turnover in the DSE decreased significantly by 46.96 percent to BDT 8.03 billion in the first nine months of FY23 from BDT 15.13 billion in the first nine months of FY22, which was BDT 13.27 billion in FY22 (Chart VI.4). Low turnover volume in the first nine months of FY23 was partly caused by the floor price effect, which mirrored the sluggish capital market activity. Among all sectors, ceramics had the highest turnover share (16.8 percent) in H1FY23, whereas textiles had the lowest turnover (0.4 percent) (Chart VI.5).

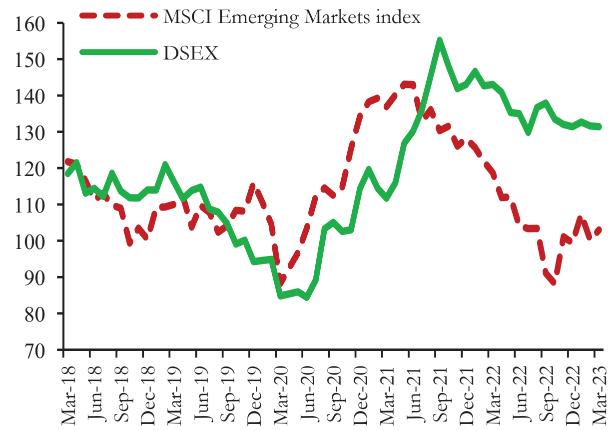
Chart VI.5: Turnover of Major Sectors in H1FY23



Source: Dhaka Stock Exchange

The DSE's market capitalization reached BDT 7623.66 billion at the end of March 2023, compared to BDT 5177.81 billion in June 2022. However, market capitalization increased to 17.1 percent of GDP in March 2023 from 13.0 percent in June 2022 due to increased shares outstanding. The stakeholders and regulatory bodies (BB, BSEC, DSE, and CDBL) have taken the necessary steps to

Chart VI.6: Synchronization of DSEX with Global Markets (Base: Jan 2015=100)



Sources: Dhaka Stock Exchange and www.msci.com

increase DSE's market capitalization by trading government securities on stock exchanges. Six firms and two perpetual bonds raised capital through initial public offerings (IPOs) in the first nine months of FY23, compare to eleven enterprises in FY22. In FY23 (up to March), BDT 7.21 billion was raised through an IPO, compared to BDT 32.58 billion in FY22. The global capital markets index (MSCI emerging market) experienced a downward trend with some volatility during the first nine months of FY23 due to a lack of investor confidence caused by concerns about rising prices and weakening economic development prospects (Chart VI.6). The worldwide financial markets were under further stress because of the Fed's tighter monetary policies. Although comovements between the MSCI emerging market and the DSE index have shown a correlation in performance over the past few years, this correlation began to detangle from the beginning of the fiscal year and continued till March 2023.

The Recent Policy Supports Towards Capital Market Developments

The BSEC took several steps to restore investors' confidence in the capital market. The minimum investment limit has been raised from BDT 2 million to BDT 3 million for an investor to be eligible to trade shares of companies listed on the SME board of the stock exchange. In addition, the BSEC has given three months to investors who are already trading shares on the SME board with a portfolio of BDT 2 million to increase their investment to BDT 3 million. To diversify investors' portfolios through risk-free investment in government securities, the BSEC started trial trading on 10 October 2022 in both Dhaka Stock Exchange and Chittagong Stock Exchange (CSE). A Memorandum of Understanding (MoU) between the BSEC and the Securities and Commodities Authority (SCA) of the United Arab Emirates was also signed to explore opportunities for dual listing, bond issue, joint subscription, and commodities exchange in both countries in order to attract more foreign investors. Through the trading platform of the CSE, BSEC has taken the initiative to launch the country's first commodity market. The Government has also taken a number of steps, including putting a lot of effort into developing, expanding, and modernizing the capital market to get big, well-known companies to list on it. The Government has already introduced two special instruments, Sukuk and Treasury bonds, which may help create a vibrant bond market. In line with the Government and BSEC, BB has also taken some notable initiatives. BB has allowed banks and financial institutions to compute their stock market exposure limit based on the purchase price of their own securities rather than their current market value. It also provided more time for banks to adjust their investment from the capital market exposure limit. BB has made some policy decisions in money market management to improve the capital market's liquidity condition. BB permits the reporting of bond investments by banks in the capital market exposure ratio, loans from state-owned banks to ICB, the choice of a perpetual bond's mandated dividend payout, etc., to promote good governance in the capital market.

Chapter VII
Near and Medium-term Outlook and Challenges

Bangladesh economy had been recovering from the Covid-19 shock since FY21, aided by better management of the pandemic situation and well-coordinated monetary and fiscal policy support. This recovery strengthened further and led to 7.1 percent real GDP growth in FY22, driven by a surge in both domestic and external demand. However, the economy started confronting headwinds, originated from elevated global commodity and energy prices, growing global economic uncertainties emerged from the war in Ukraine, intense pressure on the BoP, sharp depreciation of the exchange rate, rationing of electricity supply, and upward revision of fuel and energy prices in the domestic market. These unfavorable developments impeded growth momentum and kept inflation stubbornly high in FY23. Although the fiscal year has not yet concluded, BBS provisionally estimated a lower real GDP growth of 6.03 percent for FY23 compared to 7.10 percent growth in FY22.

Looking ahead, the growth momentum is expected to accelerate in the period ahead by the favorable effects of improving global supply situation, fiscal supports, and ongoing cautiously accommodative monetary policy ensuring sufficient low-cost credit to the productive sectors. However, the future path of the economy would crucially be conditioned upon the improvement of the country's BoP position. The financial account of the BoP, which turned into a deficit from a substantial surplus, is expected to return to its normal course in the near term with the inflow of foreign assistance in the form of budget support and development project aids. The current account deficit has already been reduced significantly, driven mainly by the slowdown of imports. Given the import dependence on raw materials, capital machinery, and fuel energy, containing imports for an extended period could impair the future growth momentum. Therefore, sustaining the improvement in the current account balance would depend on picking up exports and remittance inflow growth. However, downside export risks might emerge from the growth slowdown in major export destinations. In addition, high export concentration in terms of both export basket and export destination could amplify the risk. The inflow of remittances is expected to be stronger in the period ahead with the favor of high growth in overseas employment, depreciation of exchange rates, and supportive measures of BB.

BB's selling of foreign currency to mitigate the pressure on the exchange rate reduced foreign exchange reserves rapidly. At this juncture, the priority of building foreign exchange reserves to a comfortable level warrants more flexibility in the exchange rate. The negative growth in NFA ensued from a deficit in the BoP kept M2 growing below the target. Moreover, the intervention in the foreign exchange market led to a monetary contraction and liquidity stress in the banking system, which was partially counteracted by liquidity support to the commercial banks and lending to the government by BB. Nonetheless, the rising interest rates on deposits and in the interbank market justify lifting the interest rate cap on lending

Although improving the supply situation lessened pressure on global commodity prices, the significant depreciation of the exchange rate and high cost of production and transportation kept domestic inflation elevated. The prevailing high and persistent inflation might result in an unanchored inflation expectation, necessitating pursuing a contractionary policy for an extended period. Therefore, BB needs to be cautiously proactive and vigilant in anchoring inflation expectations and limiting the second-round effect of inflation. However, the potential instability of money demand resulted from increasing financial innovations and deepening and evolving financial structure in a growing economy. The endogeneity of money supply ensued from the greater integration of Bangladesh with the global economy has weakened the relationship between BB's current monetary policy instruments and monetary policy objectives within the monetary targeting framework. Given this situation, moving toward an interest rate-focused monetary policy framework could help enhance BB's monetary policy effectiveness.

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