

# Monetary Policy Review

2025-26



Bangladesh Bank

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Monetary Policy Review is published on a yearly basis. Electronic version of this document is available at [www.bb.org.bd](http://www.bb.org.bd). Bangladesh Bank welcomes suggestions and comments from readers, which may be forwarded to [mabdul.wahab@bb.org.bd](mailto:mabdul.wahab@bb.org.bd) or [gm.ceu@bb.org.bd](mailto:gm.ceu@bb.org.bd)

Chief Economist's Unit

Bangladesh Bank

June 2026

# Monetary Policy Review

2025-26



Chief Economist's Unit

**Bangladesh Bank**

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## Message

The Bangladesh economy demonstrated resilient signs of recovery in FY26, overcoming a few domestic structural challenges alongside dual global headwinds—escalating geopolitical tensions and underpinning reciprocal tariff measures. The country’s real GDP growth rebounded to 4.14 percent (provisional) in FY26, up from 3.49 percent in the previous fiscal year. This moderate revival was largely supported by stronger performance in the agriculture and service sectors even as industry sector recorded moderate growth. Despite this positive growth momentum, domestic inflationary pressures remained elevated, with point-to-point CPI inflation stood at 9.42 percent in May 2026, up from 8.48 percent in June 2025. To curb persistent inflation, stabilize the foreign exchange market, and preserve the resilience of the external sector, Bangladesh Bank (BB) maintained its contractionary monetary policy stance—keeping policy rate at 10.00 percent throughout January 2025 to June 2026.

However, the downside risk—an unprecedented subdued private-sector credit growth that has constrained industrial growth momentum and slowed vital employment generation. On the external front, recent conflicts in the Middle East have injected severe uncertainty into global commodity and energy markets, raising the risk of supply disruptions and price hikes. Despite this penetrating global volatility, the country’s external sector has demonstrated remarkable resilience. Remittance inflows recorded strong growth in the current fiscal year, supporting foreign exchange reserves, stabilizing external balances, and strengthening domestic demand. The combined measures undertaken by fiscal and monetary authority have played an important role in strengthening Bangladesh's macroeconomic stability.

The new elected government has undertaken a series of comprehensive measures to boost the private-sector economic activities. Alongside, BB has launched a Tk. 60,000 crore Private Sector Development, Employment Creation, and Economic Recovery Program to support productive economic activities and job creation. This facility is designed to channel surplus liquidity toward productive and employment-intensive sectors through concessional financing arrangements, without creating additional inflationary pressures.

Looking ahead, the economic outlook for Bangladesh is projected to expand significantly, driven by the successful implementation of ongoing initiatives and structural institutional reform programs undertaken by the present government, and well-coordinated monetary and fiscal measures. This positive momentum is further supported by anticipated improvements in global supply chains as Middle-East geopolitical tensions may ease. Consequently, these dynamics are expected to accelerate employment generation and strengthen revenue collection, driving real GDP growth to a target of 6.5 percent in FY27, while successfully cooling headline inflation down to the target at 7.5 percent.

This *Monetary Policy Review 2025-26* assesses recent macroeconomic developments and evaluates the implementation and outcomes of monetary policy during the year. It highlights the key risks, challenges, and policy trade-off associated with restoring price stability while supporting economic recovery. We hope this Review will serve as a useful reference for policymakers, researchers, market participants, and the wider public.

I would like to express my sincere appreciation to the Chief Economist's Unit (CEU) for preparing this Review and to all concerned departments of Bangladesh Bank for their valuable contributions.

Md Mostaqur Rahman FCMA  
Governor

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## List of Abbreviations

ADB	Asian Development Bank	FCB	Foreign Commercial Bank
ADO	Asian Development Outlook	FDI	Foreign Direct Investment
ADP	Annual Development Programme	FSSP	Financial Sector Support Project
ADR	Advance Deposit Ratio	FPMU	Food Planning and Monitoring Unit
ADs	Authorised Dealers	FY	Fiscal Year
AI	Artificial Intelligence	GCC	Gulf Cooperation Council
AQR	Asset Quality Review	GDP	Gross Domestic Product
BB	Bangladesh Bank	GFCF	Gross Fixed Capital Formation
BBS	Bangladesh Bureau of Statistics	GoB	Government of Bangladesh
B2C	Business-to-Consumer	IFRS	International Financial Reporting Standards
BDT	Bangladesh Taka	IMF	International Monetary Fund
BIS	Bank for International Settlements	IRC	Interest Rate Corridor
BoP	Balance of Payments	IFS	International Financial Statistics
BPM6	Balance of Payments and International Investment Position Manual 6	LC	Letter Of Credit
BRICS	Brazil, Russia, India, China and South Africa	LHS	Left Hand Side
BRRF	Bank Restructuring and Resolution Fund	LNG	Liquefied Natural Gas
BSEC	Bangladesh Securities and Exchange Commission	LPG	Liquefied Petroleum Gas
CAB	Current Account Balance	IT	Information Technology
CIB	Credit Information Bureau	M2	Broad Money
CIF	Cost, Insurance, and Freight	MCCI	Metropolitan Chamber of Commercial Industry
CMSME	Cottage, Micro, Small and Medium Enterprise	MLT	Medium to Long Term
COVID	Corona Virus Disease	NBR	National Board of Revenue
CPI	Consumer Price Index	NDA	Net Domestic Assets
CRAR	Capital to Risk-weighted Asset Ratio	NEER	Nominal Effective Exchange Rate
DSE	Dhaka Stock Exchange	NFA	Net Foreign Asset
DSEX	DSE Broad Index	NPL	Non-performing Loan
EEU	European Economic Union	OCA	Optimum Currency Areas
EDF	Export Development Fund	OMO	Open Market Operation
EMDEs	Emerging Market and Developing Economies	PCB	Private Commercial Bank
EPZ	Export Processing Zone	PMI	Purchasing Managers' Index
		P-t-P	Point to Point
		QR	Quick Response

RM	Reserve Money	SLF	Standing Lending Facility
RMG	Readymade Garments	SLR	Statutory Liquidity Ratio
ROA	Return on Assets	SMA	Special Mention Account
ROE	Return on Equity	SME	Small and Medium Enterprise
RR	Reference Exchange Rate	T-bills	Treasury Bills
RBS	Risk Based Supervision	TCB	Trading Corporation of Bangladesh
REER	Real Effective Exchange Rate	UAE	United Arab Emirates
RHS	Right Hand Side	US	United States
SAARC	South Asian Association for Regional Cooperation	USA	United States of America
SAFTA	South Asian Free Trade Area	USD	United States Dollar
SB	Specialised Bank	UK	United Kingdom
SCB	State-owned Commercial Bank	WEO	World Economic Outlook
SDF	Standing Deposit Facility	WRI	Wage Rate Index
SIPMM	Singapore Institute of Purchasing and Materials Management	WTO	World Trade Organization
		Y-o-Y	Year on Year

## Executive Summary

In 2025, the global economy performed resiliently than projected, despite concerns about U.S. tariff measures and geopolitical tensions. This rebound was primarily driven by robust global demand, buoyant global trade, effective fiscal support in major economies, and increased investment in technology and artificial intelligence (AI). However, short-term global risks remain due to the ongoing Middle East conflict. While global inflation eased in 2025, it is expected to rise in 2026 for both advanced and emerging market economies, mainly due to disruptions in energy supply, higher commodity prices, and renewed pressures on exchange rates and increasing transportation cost. In response, many economies maintained accommodative or cautious monetary policies through April 2026 to balance slowing growth and clouded inflationary pressure.

Bangladesh, a small, limited open and commodity-importing country, remains vulnerable to external shocks. Higher global energy and food prices are likely to pose continue pressuring on domestic inflation, import payments, and the external balance. Additionally, slower growth in key trading partners may reduce export demand.

In 2025, Bangladesh Bank (BB) maintained a tight monetary policy stance to address inflation, stabilise expectations, and support macroeconomic stability, keeping the policy rate at 10.0 percent level. As a result, headline point-to-point inflation dropped to 8.49 percent in December 2025, down from 10.89 percent a year earlier, remaining well above BB's 7.0 percent ceiling. To curb elevated inflationary pressures, BB extended its restrictive policy stance through January-June 2026 period. This review compares the policy stance to a model-based estimate of the natural rate of interest and finds that the current real policy rate is close to its natural level.

The country's economic activity rebounded in FY26, with real GDP growth rising to 4.14 percent from 3.49 percent in FY25. Sectoral performance was mixed: the service sector remained resilient, agriculture sector showed steady growth, and industry sector experienced a notable slowdown. However, inflationary pressure remained a significant challenge for the Bangladesh economy. Headline consumer price index (CPI) inflation rose to 9.42 percent in May 2026 from 8.48 percent in June 2025. Point-to-point core inflation showed mixed trends but moderated to 8.50 percent in May 2026, as compared to 8.95 percent in June 2025, supported by favorable base effects and the lagged impacts of monetary tightening. This small gap between headline and core inflation indicates broad-based inflationary pressures. The scenario underscores the need to maintain a contractionary stance to anchor inflation expectations and ensure price stability.

Record-high remittance inflows, increased trade credit, and moderate import growth kept Bangladesh's external sector resilient in FY26. A substantial rise in workers' remittances more

than offset the widening trade deficit of USD 22.21 billion in July-April FY26, despite a decline in export, thereby the current account deficit narrowing to USD 1.07 billion. The capital and financial accounts also improved, contributing to overall balance of payments surplus. The exchange rate (BDT against per USD) remained broadly stable, supported by BB's structural reforms to the exchange rate framework. Gross foreign exchange reserve rose significantly to USD 35.10 billion at the end of April 2026, providing a buffer against external shocks. Overall, Bangladesh's external sector outlook is cautiously optimistic, supported mainly by resilient remittances and trade credit inflows.

The banking sector's performance was mixed. Liquidity situation improved, recovering from the severe downturn after the post-uprising period. However, other indicators remained weak. Non-performing loans (NPLs) raised sharply, both in volume and as a share of total loans, leading to higher bad-debt provisions and reduced profitability. The gross NPL ratio stood at 32.26 percent at the end of March 2026, up from 24.13 percent a year earlier. Additional vulnerabilities persist, especially mounting pressure on capital adequacy ratios, which could undermine the sector's resilience. These trends highlight the need for robust policy interventions and comprehensive reforms to ensure long-term stability in the banking system.

Going forward, BB's continued tight monetary policy, which keeps the real policy rate positive and near its natural rate, along with improving supply conditions, should further ease inflation in the near term. While growth prospects remain limited by weak private investment, slower export momentum, and external pressures from Middle East tensions and global trade frictions. However, government social protection measures, support for productive sectors, and the Tk. 600 billion BB's stimulus package are expected to boost domestic consumption, private investment, and exports.

### I.1 Monetary Policy Stance in 2025

#### I.1.1 Monetary Policy Stance for January–June, 2025

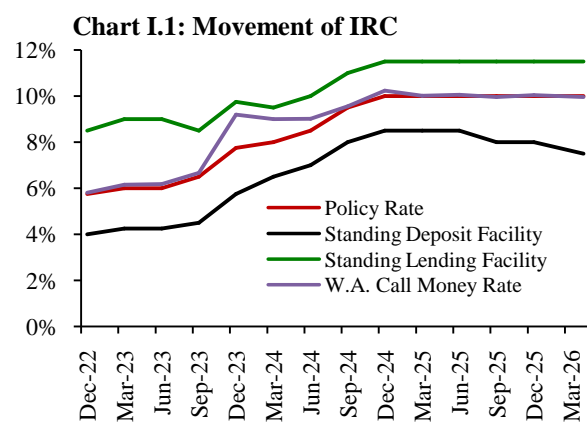
The world economy demonstrated remarkable resilience in 2023 and 2024, despite implementing the tightening monetary policies across the globe aiming to curb inflationary pressure. Consequently, global inflation continued its downward trajectory toward central bank targets in 2024. On the domestic front, during the period, the Bangladesh economy faced significant macroeconomic challenges characterised by persistently high inflation, decelerating GDP growth, exchange rate volatility, stagnant private investment, rising public debt, and alarmingly high levels of non-performing loans. In response these challenges, Bangladesh Bank (BB) maintained a tight monetary policy stance for January–June, 2025 to curb inflation, anchor inflation expectations, and maintain macroeconomic stability. Accordingly, BB kept the policy rate (repo rate) unchanged at 10.0 percent, with the Standing Lending Facility (SLF) and the Standing Deposit Facility (SDF) rates at 11.5 percent and 8.5 percent respectively, with a symmetric policy corridor of  $\pm 150$  basis points. Besides, BB introduced a flexible exchange rate system in May 2025 to enhance flexibility and stability within the foreign exchange market. Prudent exchange rate management under this new system was anticipated to bolster remittance inflows, enhance foreign exchange reserve, and stimulate export activity.

#### I.1.2 Monetary Policy Outcomes during January-June, 2025

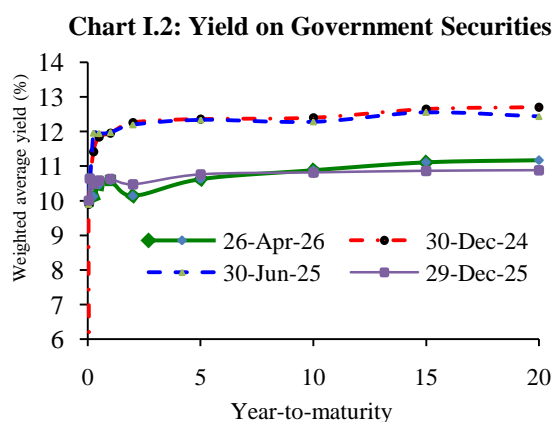
The stubbornly high inflation in Bangladesh showed signs of easing during January–June 2025. Headline (p-t-p) inflation was at 11.66 percent in July 2024 and then steadily declined to 8.48 percent in June 2025. Food inflation dropped sharply to 7.39 percent in June 2025 from 10.42 percent in June 2024, while non-food inflation increased slightly to 9.37 percent in June 2025 from 9.15 percent in June 2024. Headline inflation gradually eased in response to the coordinated demand and supply-side measures adopted by the government and BB. Exchange rate stability was achieved due to a substantial improvement in the Balance of Payments (BoP), which contained the pass-through effect of imported inflation.

Amid tight liquidity conditions in the banking system during FY25, significant developments were observed in the money market, driven by the implementation of a contractionary monetary policy stance and the streamlining of Open Market Operations (OMOs). The weighted average

call money rate in the interbank market rose to 10.14 percent in June 2025 from 9.08 percent in June 2024, remaining within the Interest Rate Corridor (IRC) (Chart I.1). Similarly, the interbank



Source: Monetary Policy Department & Debt Management Department, Bangladesh Bank.



Source: Monetary Policy Department, Bangladesh Bank.

repo rate increased to 10.37 percent in June 2025, up from 8.56 percent in June 2024. In contrast, the government securities yield curve at end-June 2025 moves below that at end-June 2024 (Chart I.2). The downward shift reflects lower yields on Treasury bills and Treasury bonds, due to the increased investment demand from banks, non-bank financial institutions, and individual investors.

**Table I.1: Developments of Monetary Aggregates**

(Y-o-Y Growth, in %)

Item	Jun-24	Dec-24	Jun-25		Deviation from Projection (in percentage point)
	Actual	Actual	Actual	Projection	
<b>Broad money (M2)</b>	<b>7.7</b>	<b>7.6</b>	<b>7.0</b>	<b>8.4</b>	<b>-1.4</b>
Net Foreign Assets	-17.4	-15.7	4.5	7.7	-3.2
Net Domestic Assets	13.5	11.9	7.4	8.5	-1.1
Domestic Credit	10.0	9.4	8.0	12.0	-4.0
Credit to the public sector	10.5	18.1	13.5	19.8	-6.3
Credit to the private sector	9.8	7.3	6.5	9.8	-3.3
<b>Reserve money (RM)</b>	<b>7.9</b>	<b>7.3</b>	<b>-0.1</b>	<b>1.0</b>	<b>-1.1</b>
Money multiplier	4.92	5.15	5.27	5.28	-0.01

Source: MPD, Bangladesh Bank.

Broad money (M2), an information variable of monetary policy, witnessed a year-on-year growth of 7.0 percent in June 2025 against the projected growth of 8.4 percent for June 2025. Broad money recorded lower growth compared to the projected growth path due to lower growth in net foreign assets (NFA). The lower growth in NFA was mainly attributed to the repayment of short-term loans, trade credit (net), and increased payments of Medium and Long Term (MLT)

amortisation. Reserve Money (RM), another information variable of monetary policy, experienced negative growth of 0.1 percent in June 2025 against the projected growth of 1.0 percent. The negative growth of RM was attributed to the negative growth of the Net Domestic Asset (NDA) of BB. The negative growth of NDA was mainly driven by the Government's net repayment of Tk. 63,997.0 crore to BB. The positive growth of NFA of BB partially offset the negative growth of Bangladesh Bank's NDA. Private sector credit grew by 6.5 percent in June 2025, marking a historic low and falling well below the projection. The slowdown reflected weak credit demand from borrowers, alongside persistent liquidity tightness in the banking sector.

### **I.1.3 Monetary Policy Stance for July–December, 2025**

Global economic growth was expected to weaken due to increased trade tensions and heightened policy uncertainty. Concurrently, global inflation was anticipated to ease as a result of weakening demand and declining hydrocarbon prices. Furthermore, world commodity prices were expected to decline in 2025 and 2026. On the domestic front, Bangladesh's economy was facing macroeconomic challenges, including persistent inflation, political uncertainties associated with the national election in February 2026, slowing GDP growth, subdued private investment, and consistently high levels of non-performing loans. Considering the global and domestic phenomena, BB decided to continue the tight monetary policy stance during July–December, 2025 to contain inflationary pressure and anchor inflation expectations. Accordingly, the policy rate was kept unchanged at 10.0 percent, while the Standing Lending Facility (SLF) rate remained at 11.5 percent and the Standing Deposit Facility (SDF) rate at 8.0 percent. Moreover, in order to improve adjustments to external imbalances, easing foreign exchange market pressures, and preserving foreign reserves, BB continued flexible exchange rate regime during July-December, 2025.

### **I.1.4 Monetary Policy Outcomes during July–December, 2025**

The stubbornly high inflation in Bangladesh had witnessed a continued disinflation in 2025. Headline point-to-point inflation declined to 8.49 percent in December 2025 from 10.89 percent in December 2024, reflecting progress in controlling price growth. Food inflation dropped to 7.71 percent in December 2025 from 12.92 percent in December 2024. Non-food inflation also decreased to 9.13 percent at the end of December 2025 from 9.26 percent at the end of December 2024. To combat inflation, BB's tight monetary policy approach helped in anchoring inflation expectations. On the supply side, rationalising import duties, removing Letter of Credit (LC)

margin requirements for key imports, and enhancing commodity stock monitoring helped for easing food price pressures.

Liquidity conditions in the banking sector improved during July–December, 2025, supported primarily by a recovery in deposit growth and BB’s net purchase of USD 3.14 billion from the foreign exchange market. Besides, targeted liquidity support to a few banks facing acute operational liquidity pressures improved system-wide liquidity stress. Higher deposit rates also encouraged stronger deposit mobilisation, further improving liquidity buffers. In parallel, BB’s timely efforts to streamline Open Market Operations (OMOs) contributed to a more orderly and active money market during July–December, 2025, with interest rates remaining broadly stable within the Interest Rate Corridor (IRC). Reflecting the improved liquidity environment, the weighted average call money rate eased slightly to 9.99 percent in December 2025 from 10.14 percent in June 2025 (Chart I.1). Similarly, the interbank repo rate declined to 10.14 percent at end-December 2025 from 10.37 percent at end June 2025. A notable positive development was the downward shift of the government securities yield curve at end December 2025 compared with end June 2025 (Chart I.2). This movement reflected lower yields on Treasury bills and Treasury bonds, driven by stronger investment demand from banks, non-bank financial institutions, and individual investors, consistent with improved liquidity conditions. The exchange rate of Taka (BDT) vis-à-vis USD remained broadly stable during July-December, 2025 due to market-oriented exchange rate regime, and a favorable development in the BoP.

**Table I.2: Developments of Monetary Aggregates**

(Y-o-Y Growth in %)

Item	Jun-25	Dec-25		Deviation from Projection (in percentage point)
	Actual	Actual	Projection	
<b>Broad money (M2)</b>	<b>7.0</b>	<b>9.6</b>	<b>7.8</b>	<b>1.8</b>
Net Foreign Assets (NFA)	4.3	26.8	28.3	-1.5
Net Domestic Assets (NDA)	7.4	7.0	4.8	2.2
Domestic Credit	8.1	11.0	10.0	1.0
Credit to the public sector	13.6	28.9	20.4	8.5
Credit to the private sector	6.5	6.1	7.2	-1.1
<b>Reserve money (RM)</b>	<b>-0.1</b>	<b>9.2</b>	<b>5.0</b>	<b>4.2</b>
Money multiplier	5.27	5.16	5.28	-0.12

Source: MPD, Bangladesh Bank.

Broad money (M2), an information variable of monetary policy, witnessed a year-on-year growth of 9.6 percent in December 2025 against the projected growth of 7.8 percent for December 2025. The actual M2 growth was higher than the projection due to higher growth in NDA. Reserve Money (RM), another information variable of monetary policy, experienced a positive growth of 9.2 percent (year-on-year) by the end of December 2025 while it was projected at 5.0 percent for the period. The actual growth of RM was significantly higher than

the projection due to the strong growth in net foreign assets (NFA) of BB. The positive growth of NFA of RM was primarily driven by BB's purchase of USD 3.14 billion from the domestic foreign exchange market during July–December, 2025.

Credit growth in the private and public sectors, an indicator of the national investment landscape, exhibited mixed trends during July–December 2025. Private sector credit grew by 6.1 percent, significantly lower than the projected growth rate of 7.2 percent for December 2025. This lower growth was attributed to several factors, including reduced credit demand from borrowers amid ongoing uncertainties ahead of the national election scheduled for February 2026, the implementation of a contractionary monetary policy that led to higher borrowing costs, and a tight liquidity situation within the banking sector. In contrast, public sector credit experienced robust growth of 28.9 percent in December 2025, well above the projected growth rate of 20.4 percent. This substantial increase was attributed to higher credit demand from the government to meet its spending needs as revenue collection had fallen significantly compared to the target. Overall, domestic credit growth exceeded the projected trajectory for December 2025, primarily driven by the strong growth in public sector credit alongside lower expansion in private sector credit.

## **I.2 Current Monetary Policy Stance and Progress**

### **I.2.1 Monetary Policy Stance for January-June, 2026**

The global economy demonstrated notable resilience in 2025 despite trade barriers and geopolitical conflicts. However, global growth was projected to decelerate and global inflation was expected to decrease in 2026. Major economies' central banks were anticipated to lower their policy interest rates, as inflation expectations remained firmly anchored. Additionally, a decline in global commodity and energy prices was forecasted for 2026 amid sluggish global growth prospects. Domestically, GDP growth remained subdued and inflation also remained persistently above BB's 7.0 percent target, despite exchange rate stability and favorable global commodity price developments. The persistently high inflation reflecting entrenched structural rigidities rather than purely monetary factors. To address these intricate economic landscapes, Bangladesh Bank (BB) continued the tight monetary policy for January-June, 2026. Accordingly, BB maintained the policy rate at 10.0 percent and continued its tight stance in H2FY26. The Standing Lending Facility (SLF) rate was held at 11.5 percent. However, BB decided to reduce the Standing Deposit Facility (SDF) rate from 8.0 percent to 7.5 percent to accelerate interbank money market activities, consolidate liquidity management, and increase credit flow to the private sector. Additionally, to entrench a market-based exchange-rate framework, BB allowed greater exchange-rate flexibility during January-June, 2026. BB also decided to step into the

foreign exchange market to curb volatility in the exchange rate and ensure greater stability in the foreign exchange market.

### **I.2.2 Progress**

While headline inflation, along with its food and non-food components, has fallen to single digits, it has remained persistently high for an extended period. According to the latest available data, headline inflation reached to 9.42 percent in May 2026 from 8.48 percent in June 2025. Similarly, food inflation rose to 9.06 percent in May 2026 from 7.39 percent in June 2025, and non-food inflation increased to 9.71 percent in May 2026 from 9.37 percent in June 2025. Although inflation is showing signs of subsiding, it remains elevated and uneven. Despite various measures undertaken by the Government and the BB, inflation has not been contained within the targeted level of 7.0 percent by the end of June 2026.

High inflation was primarily a consequence of several domestic and global factors. Domestically, contributing elements include a lack of competitive market structure, a weak distribution system, inefficient market management, and supply chain disruptions. Globally, rising geopolitical tensions and volatile oil prices increased import costs, further fueling inflation. The combined impact of these domestic and global factors ultimately pushed Bangladesh's inflation upward in May 2026.

According to available data, the weighted average call money rate decreased slightly and stood at 9.95 percent at the end of April 2026 from 9.99 percent at the end of December 2025. Similarly, the inter-bank repo rate also declined to 10.03 percent at the end of April 2026, from 10.14 percent at the end of December 2025. The deposit rate stood at 6.24 percent at the end of April 2026 while it was 6.34 percent at the end of December 2025. The lending rate stood at 11.96 percent at the end of April 2026 while it was 12.03 percent at the end of December 2025. It is noticeable that the yield curve at the end of April 2026 shifted lower compared to the end of December 2025, implying lower interest rates and an easing of the liquidity situation. All types of interest rates decreased as liquidity conditions in the money market improved significantly.

Table I.3 presents the actual development and projections of monetary aggregates for FY26. Broad money recorded 11.4 percent growth at the end of April 2026 against the projection of 11.5 percent for June 2026. The slower growth of broad money, compared to the projected growth, is primarily due to the lower growth in net domestic assets (NDA). Private sector credit growth stood historic low level at 4.7 percent for April 2026 against the projection of 8.5 percent at the end of June 2026. This significantly lower growth of private

**Table I.3: Development and Projection of Monetary Aggregates**

(Y-o-Y Growth in %)

Items	Jun-25	Dec-25	Apr-26	Jun-26	Deviation from Projection (in percentage point)
	Actual			Projection	
1	2	3	4	5	6= (4-5)
<b>Broad Money (M2)</b>	<b>7.0</b>	<b>9.6</b>	<b>11.4</b>	<b>11.5</b>	<b>-0.1</b>
Net Foreign Assets (NFA)	4.3	26.8	29.9	22.0	7.9
Net Domestic Assets (NDA)	7.4	7.0	8.6	9.7	-1.1
Domestic Credit	8.1	11.0	9.7	11.5	-1.8
Credit to Public Sector	13.6	28.9	26.9	21.6	5.3
Credit to Private Sector	6.5	6.1	4.7	8.5	-3.8
<b>Reserve money (RM)</b>	<b>-0.1</b>	<b>9.23</b>	<b>14.4</b>	<b>8.0</b>	<b>6.4</b>
Money multiplier	5.27	5.16	5.38	5.44	-0.06

Source: MPD, Bangladesh Bank.

sector credit was due to lower credit demand from big corporations, banks invested their excess fund in T-Bills and T-Bonds rather credit disbursement, slowing investment, and mounting uncertainty in the economy. These conditions were further reinforced by the continued contractionary monetary policy along with the uneven liquidity situation within the banking sector. Reserve Money (RM) experienced 14.4 percent growth at the end of April 2026 against the projection of 8.0 percent at the end of June 2026. The higher growth in RM mainly attributed due to the higher growth in NFA of BB.

The improvement in the BoP has effectively diminished pressure on the exchange rate. The nominal exchange rate of the BDT against the USD has been stable since January 2025. The BDT-USD reference rate depreciated by 0.11 percent in FY26 (Up to 11 June 2026), following a stabilisation in exchange rate.

**BOX 1: Assessing Monetary Policy Stance Using Estimated Natural Rate of Interest<sup>#</sup>**

The short-term real interest rate consistent with stable inflation and output at its long-term potential is known as the natural rate of interest, or  $r^*$ . Although  $r^*$  is unobservable and varies over time, it provides a valuable benchmark for assessing monetary policy. Policy is considered expansionary when the real policy rate is below  $r^*$ , and contractionary when it is above. Bangladesh Bank's transition to an interest rate-based monetary policy framework underscores the need for a reliable estimate of  $r^*$ . This analysis estimates Bangladesh's natural rate of interest using the state-space model developed by Laubach and Williams (2003).

## The $r^*$ Model

The  $r^*$  model that this box estimates is the Lewis and Vazquez-Grande (2019) version of the model described in Laubach and Williams (2003). The model is semi-structural, featuring six equations including the dynamic investment-saving (IS) and a Phillips curve relationship drawn on the New Keynesian framework.

$$\tilde{y}_t = a_1 \tilde{y}_{t-1} + a_2 \tilde{y}_{t-2} + \frac{a_r}{2} (\tilde{r}_{t-1} + \tilde{r}_{t-2}) + \sigma_1 \varepsilon_{1,t} \quad (1)$$

$$\pi_t = b_1 \pi_{t-1} + (1 - b_1) \sum_{i=2}^4 \frac{\pi_{t-i}}{3} + b_y \tilde{y}_{t-1} + \sigma_2 \varepsilon_{2,t} \quad (2)$$

$$r_t^* = g_t + z_t \quad (3)$$

$$z_t = \rho_z z_{t-1} + \sigma_3 \varepsilon_{3,t} \quad (4)$$

$$y_t^* = y_{t-1}^* + g_{t-1} + \sigma_4 \varepsilon_{4,t} \quad (5)$$

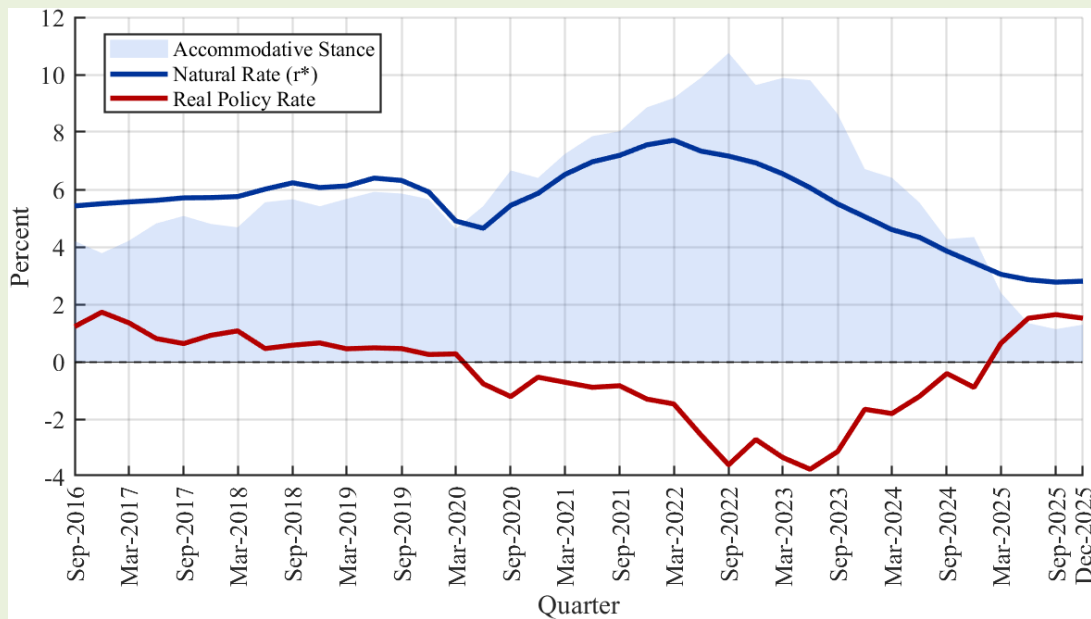
$$g_t = \mu_g (1 - \rho_g) + \rho_g g_{t-1} + \sigma_5 \varepsilon_{5,t} \quad (6)$$

Where,  $y$  is log-real gross domestic product (GDP),  $y^*$  is log-potential GDP, and  $\tilde{y} \equiv y - y^*$  is the output gap. Similarly,  $\tilde{r} \equiv r - r^*$ , with  $r$  and  $r^*$  being the ex-ante real short-term interest rate and the smoothed estimate of the natural rate of interest, respectively. Equation (3) represents the law of motion for the natural rate of interest, driven by the shocks to the trend growth of the potential output ( $g_t$ ) and non-growth components ( $z_t$ ) such as rate of time preference. The remaining three equations show the evolution of  $z_t$ ,  $g_t$ , and  $y_t^*$ , with each following an autoregressive process. The model is estimated in the Bayesian fashion, following Lewis and Vazquez-Grande (2019). This analysis uses following variables: quarterly real GDP from the BBS, point-to-point CPI-based quarterly inflation, the four-quarter moving average of inflation in period  $t$  as a proxy for inflation expectations and the weighted average call money rate as the short-term interest rate. The effective estimation sample spans from 2016 Q3 to 2025 Q4.

## Natural Rate of Interest and Monetary Policy Stance

Figure B.1 displays the median path of the smoothed estimates of the natural rate of interest. For comparison, it also shows the evolution of the real policy rate — calculated as the difference between the repo rate and inflation — over time.

**Figure B.1: Natural Rate vs. Real Policy Rate and Policy Stance**



Source: Author's estimation

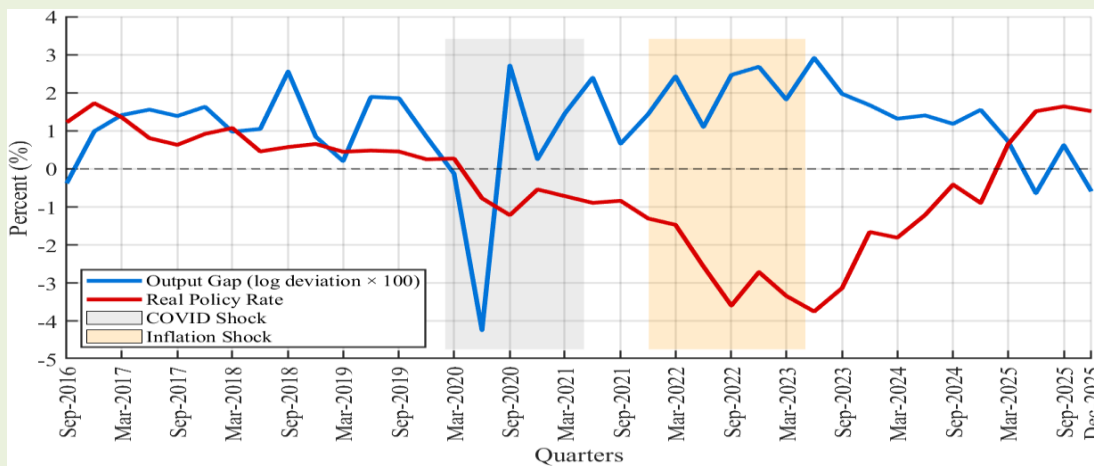
As shown by the blue solid line in Figure B.1,  $r^*$  remained stable until September 2019, just before COVID-19 began. The onset of the pandemic led to a decline in  $r^*$ , as the crisis weakened potential output growth, to which  $r^*$  is tied according to Equation 3 of the model. The  $r^*$  then increased gradually, reaching a peak of 7.71 percent in March 2022, before falling to 2.8 percent by December 2025. The real policy rate, shown by the red solid line, remained below  $r^*$  throughout the sample period. This near-zero real policy rate reflects the nominal policy rate staying close to the inflation rate. The ex-ante real policy rate has consistently been below the smoothed estimate of  $r^*$ , indicating an expansionary stance that has gradually moderated with ongoing monetary tightening. The blue shaded area shows the extent of accommodative policy during the study period. Figure B.1 shows that the real policy rate never exceeded the natural rate of interest during the sample period, implying that the monetary policy stance was never restrictive by our measure.

### Estimates of the Output Gap

Bayesian estimation of the semi-structural model provides a smoothed estimate of potential output. Figure B.2 shows the estimated output gap and real policy rate. The output gap was generally positive until the pre-COVID period, peaking just before the pandemic. During the early phase of COVID-19, the gap fell sharply into negative territory as actual output dropped below potential. The gap returned to pre-pandemic levels as lockdown measures eased. The analysis also examined the inflation shock episode, attributing it mainly to the Russia-Ukraine war, which raised global commodity and energy prices between January 2022 and June 2023. During this period, actual output remained above potential output. Toward the end of the sample, however, the output gap turned negative—apparently following the post-July 2024 mass uprising—and subsequently hovered around zero. Evidence from Figures B.1 and B.2 suggests that policy

accommodation since COVID-19 has coincided with sustained upward pressure on economic activity. Overall, the results show a clear relationship between the output gap and the real policy rate.

**Figure B.2: Output Gap and Real Policy Rate Dynamics**



Source: Author's estimation

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- Laubach, T., and Williams, J. C. (2003). Measuring the natural rate of interest. *Review of Economics and Statistics*, 85(4), 1063-1070.
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#The box is prepared by Dr. Saidul Islam, Joint Director of Chief Economist's Unit (CEU). The Author is grateful to Dr. Salim Al Mamun, Director (Research) for his valuable comments. The views expressed in the box is author's own and do not reflect those of Bangladesh Bank.

## Chapter II: Global Economy and Bangladesh's Perspective

*In 2025, the global economy remained resilient aided by technology-driven investment particularly in AI, coupled with accommodative financial conditions, supportive and synchronised monetary and fiscal policy measures across major economies. Despite the twin headwinds of reciprocal tariff measures and heightened geopolitical tensions, after the outbreak of the recent Middle East conflict—the US-Israel war on Iran has downside risks to the global outlook through disruptions of supply chains, higher energy and non-energy commodity prices, and rising inflation expectations. The magnitude impact of the war on the global economy is expected to depend on the duration and intensity of the conflict. The economics like energy and other necessary commodities importing countries may likely to face greater vulnerabilities in future.*

### II.1 Global Economic Growth and Outlook

According to the IMF's *World Economic Outlook* (April 2026), world output growth in 2025 was 3.4 percent, significantly higher than the 2.8 percent projected in the April 2025 outlook. The stronger than expected rebound has reflected robust aggregate demand, continued resilience in global trade through supply chain adjustments, effectiveness of fiscal support in major economies, and strong technology specifically AI-related investment. Besides, the effective tariff burden was lower than initially assumed, while firms adapted through trade diversion and market diversification. However, following the outbreak of the Middle East conflict in late February this year, the global economic growth has been projected downward by multilateral agencies for 2026. The IMF, in its April 2026 Economic outlook, forecasted the world economic growth at 3.1 percent for 2026, downgraded by 0.2 percentage points from the earlier January projections. The downgraded Global Economic outlook is underpinned by expected weakening external demand, escalating geopolitical uncertainty and surging commodity prices stemming directly from the ongoing conflict in the Middle East. The IMF kept the projected growth at 3.2 percent in 2027.

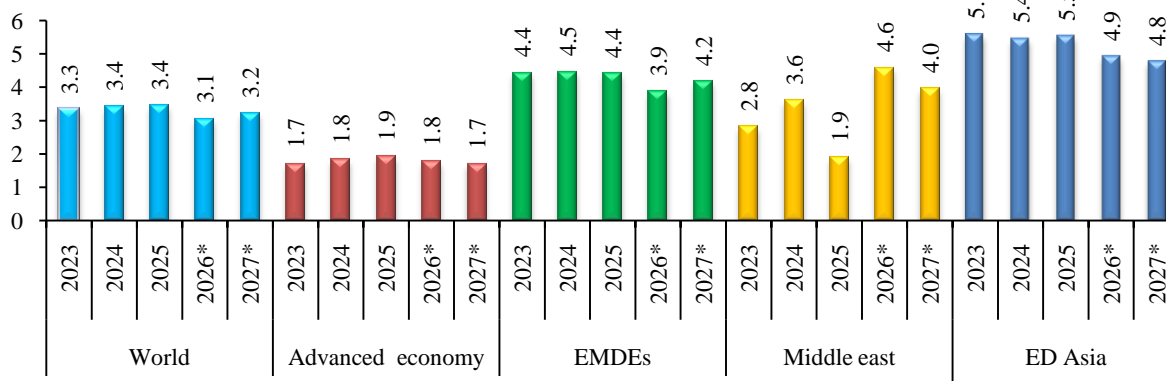
Growth in advanced economies was 1.9 percent in 2025, is projected to slow at 1.8 percent for 2026 and 1.7 percent for 2027 (Chart II.1). Economic Growth in US, the EURO area, the United Kingdom, Canada, and across other advanced economies is expected to weaken in 2026, with the slowdown expected to persist in 2027.

Emerging Market and Developing economies (EMDEs) are expected to face greater challenges from the Middle East conflict through higher energy dependence, weaker financial flows, and disruptions to remittance inflows and trade. Growth in EMDEs was 4.4 percent in 2025 and is projected to decelerate to 3.9 percent for 2026. The latest revised forecast for 2026 is a

downgrade adjustment of IMF's January projections. However, EMDEs economic growth rebound is anticipated at 4.2 percent for 2027, with expectation of normalisation of supply chains and stabilization of global energy market (Chart II.1).

In China, growth is projected to decelerate to 4.4 percent in 2026, down from the 5.0 percent growth rate recorded in 2025. The downward trajectory is expected to persist in 2027 and is forecasted to slow to 4.0 percent (Chart II.2). The economic growth contraction in China is driven by significant headwinds-higher reciprocal tariffs imposed across major trading partners, a stagnant property market and weak domestic consumption. Unlike China's economic trajectory, India's economic growth is projected to remain stable at 6.5 percent for both 2026 and 2027, despite recorded 7.6 percent growth rate in 2025. In contrast, Russia is expected to maintain a steady growth rate around 1.0 percent and supported by an expansion in BRICS-related trade and technology-based exports.

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



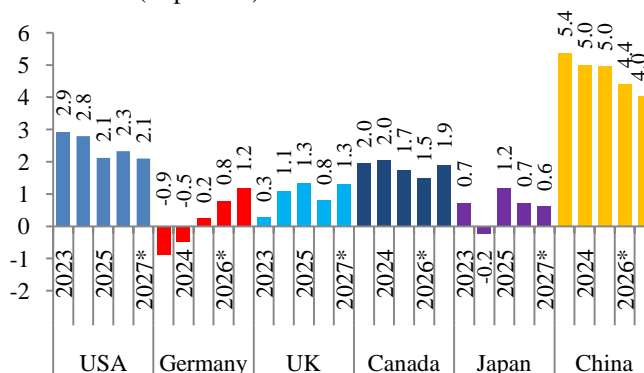
\*Projection

Source: World Economic Outlook, April 2026, IMF.

In Bangladesh, growth remained subdued in 2025 due to domestic political transition and elevated macroeconomic pressures. However, the IMF projects a gradual recovery in the growth to 4.7 percent in 2026 before moderating slightly to 4.3 percent in 2027. By contrast, the growth outlook for Sri Lanka remains less favorable, whereas Pakistan is projected to experience steady improvement, with growth forecast at 3.6 percent in 2026 and 3.5 percent in 2027 (Chart II.3).

In brief, the global economic outlook is expected to weaken in 2026 due to the adverse effects of the Middle East conflict. In the medium to long term, the negative impacts of geopolitical tensions are expected to be partly offset by technology-driven productivity gains, as well as improvements in global supply chains and trade flows.

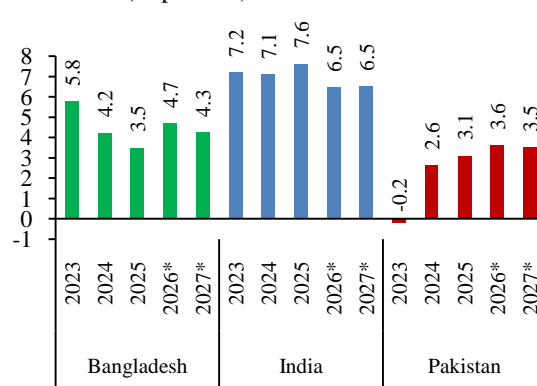
**Chart II.2: Output Growth of China and Advance Economies (in percent)**



\*Projection

Source: World Economic Outlook April 2026, IMF.

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



\*Projection

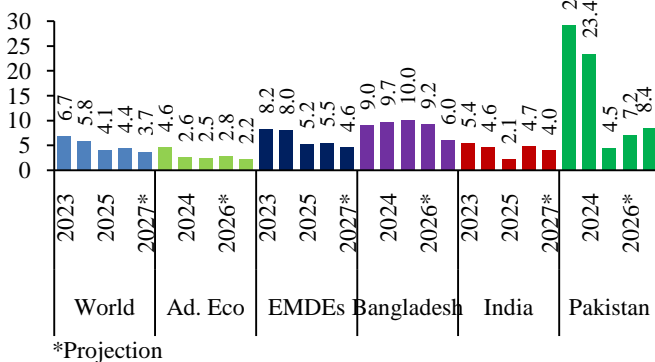
Source: World Economic Outlook April 2026, IMF

## II.2 Global Inflation

Global inflation moderated significantly to 4.1 percent in 2025 following sharp increases in previous years. However, according to the IMF’s *World Economic Outlook* (April 2026), global inflation is projected to rise to 4.4 percent in 2026, representing a 0.6 percentage points upward revision from January 2026 forecasts. This near-term acceleration is driven by persistent geopolitical shocks and energy supply disruptions that continue to pressure commodity prices and second phase pressures on exchange rates and transportation costs. However, the medium-term outlook points to a renewed easing cycle, with global inflation projected to decline to 3.7 percent in 2027, as global supply chain stabilise and tight monetary policy take full effect (Chart II.4).

In advanced economies, inflation was 2.5 percent in 2025 that is projected to increase to 2.8 percent in 2026, then moderate to 2.2 percent in 2027 (Chart II.4). In the United States, inflation was 2.7 percent in 2025 and is expected to rise to 3.2 percent in 2026, mainly due to tariff-related import pressures and higher consumer costs that is remaining above the Federal Reserve’s target rate. Similarly, inflation in the Euro area is projected to rise to 2.6 percent in 2026, up from 2.1 percent in 2025, reflecting higher energy prices and supply disruptions linked to geopolitical tensions. In contrast, inflation in Japan is expected to decline gradually to 2.2 percent in 2026 and 2.3 percent in 2027, from 3.2 percent in 2025 supported partly by the abolition of the gasoline tax and easing energy costs.

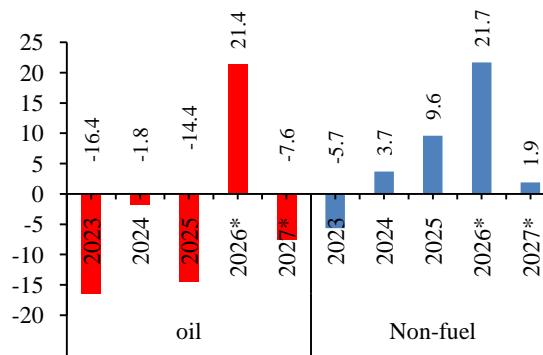
**Chart II.4: Inflation Rate in Major Economies**  
(in percent)



\*Projection

Source: World Economic Outlook April 2026, IMF

**Chart II.5: Changes (y-o-y) of Global Commodity Prices**  
(in percent)



\*Projection

Source: World Economic Outlook April 2026, IMF

Similar to advanced economies, inflation in EMDEs is projected to increase from 5.2 percent in 2025 to 5.5 percent in 2026, then moderate to 4.6 percent in 2027. The temporary rise in inflation mainly reflects higher global energy and commodity prices, supply-chain disruptions, exchange rate pressures, and increased transportation and fertilizer costs associated with geopolitical tensions. In India, inflation is expected to increase to 4.7 percent in 2026 before moderating to 4.0 percent in 2027, mainly reflecting higher food and commodity prices and indirect tax adjustments.

The annual average oil price is projected to increase by 21.4 percent in 2026, driven by disruptions in oil production, tighter supply conditions, and heightened uncertainty in the global energy market stemming from the Middle East conflicts. However, assuming that the conflict remains temporary and supply conditions gradually normalise oil prices are projected to decline by around 7.6 percent in 2027 (Chart II.5).

Natural gas prices are projected to experience a larger increase than oil prices due to technical difficulties in restarting production and limited reserve capacity. In addition, higher energy prices are likely to spill over into broader commodity markets through increased fertilizer prices, higher transportation costs, and disruptions in key shipping routes. As a result, non-fuel commodity prices are projected to increase substantially, rising by 21.7 percent in 2026.

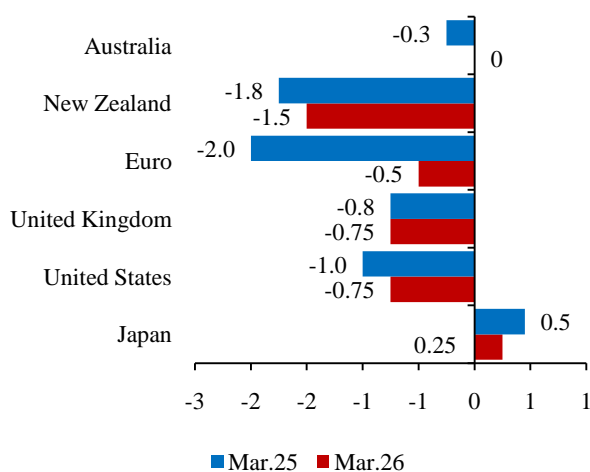
### II.3 Global Monetary Policy Stance

The escalation of geopolitical conflicts in the Middle East has significantly increased global energy and non-energy commodity prices, particularly affecting commodity-importing economies and raising inflation expectations for 2026. Moreover, U.S. tariff-related trade tensions, together with the prolonged Russia–Ukraine war, have further weighed on global

output and trade prospects. Under such circumstances, an aggressive monetary tightening stance could further weaken consumer and business confidence, dampen investment activity, and intensify downside risks to economic growth. Consequently, many advanced economies adopted a relatively accommodative or cautious monetary policy stance through April 2026.

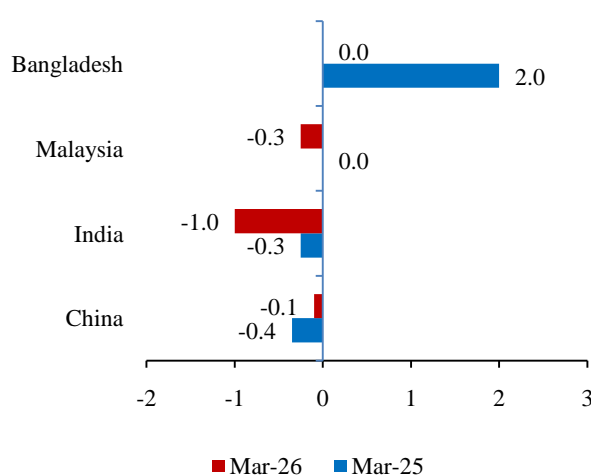
For example, the United States reduced its policy rate by 25 basis points in the last quarter of 2025 and remained unchanged thereafter, with further easing expected by 2027. In contrast, Japan’s policy rate is projected to gradually normalise toward its estimated neutral rate. In the United Kingdom, weaker growth prospects are expected to support a modest reduction in the policy rate during 2026. Meanwhile, the euro area maintained a stable policy rate of 2.0 percent during both the last quarter of 2025 and the first quarter of 2026 (Chart II.6). However, according to the latest IMF outlook, the policy rate in the euro area is projected to increase by 50 basis points over the course of 2026.

**Chart II.6: Change in Central Bank's Policy Rate of Selected Advanced Economies** (in percentage points)



Source: Bank for International Settlements.

**Chart II.7: Change in Central Bank's Policy Rate in Emerging Asia** (in percentage points)



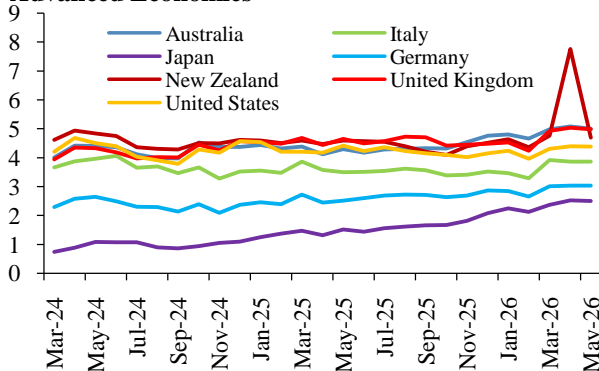
Source: Bank for International Settlements.

Amid the dual challenges moderating growth and persistent inflation, alongside an increasingly uncertain global trade environment, most EMDEs have maintained unchanged policy rates since the late 2025. Between March 2025 and March 2026, China reduced its policy rate by 10 basis points to 3.0 percent, while Malaysia lowered its policy rate by 25 basis points during the same period. Similarly, India cut its policy rate by 25 basis points to 5.25 percent. In contrast, Bangladesh Bank has maintained its policy rate unchanged at 10.0 percent, reflecting its continued focus on containing inflation and anchoring inflation expectations. Therefore, monetary policy stances across EMDEs remain divergent.

Despite monetary easing in several economies, long-term government bond yields in most advanced economies have continued to rise amid trade policy uncertainty and elevated inflation expectations. This upward trend, which began in mid-2025, is expected to persist through 2026 (Chart II.8).

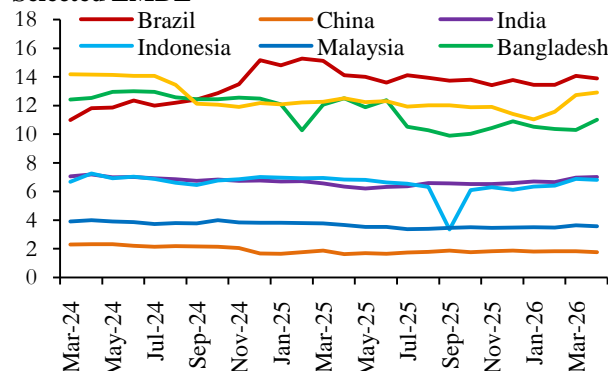
In contrast, 10-year government bond yields in emerging and developing countries have shown mixed movements. Between April 2025 and April 2026, yields declined in Brazil (14.1 percent to 13.8 percent), Malaysia (3.6 percent to 3.5 percent), Bangladesh (12.5 percent to 11.0 percent), and Sri Lanka (11.8 percent to 11.1 percent) (Chart II.9). Conversely, yields increased in China, India, and Pakistan, while remaining broadly stable in Indonesia.

**Chart II.8: 10-year Government Bond Yields of Advanced Economies**



Source: investing.com

**Chart II.9: 10-year Government Bond Yields of Selected EMDE**



Source: investing.com

## II.4 Global Outlook and Challenges of Bangladesh Economy

The near-term global economic outlook remains challenging, primarily owing to the risk of supply-chain disruptions and heightened energy price volatility stemming from a potential blockage of the Strait of Hormuz amid escalating geopolitical tension in Middle East. Hence, global economic growth is projected to grow slow in 2026. At the same time, higher energy and commodity prices are expected to generate inflationary pressures, is forecasted at higher level compared to the rate of 2025, and is expected that inflation may ease in 2027 as supply conditions normalise. However, downside risks remain elevated, particularly if geopolitical conflicts intensify or commodity price shocks persist for longer than expected.

As a small, limited open and commodity-importing economy, Bangladesh remains vulnerable to these external developments. Higher global energy and food prices may continue to exert pressure on domestic inflation, import payments, and the current account balance, while slower growth in major trading partners could weigh on export demand. However, sustained political

stability, following the 2026 national parliamentary election, ongoing structural reform in financial sector, and a gradual recovery in private investment and domestic demand are expected to support economic growth. Furthermore, easing global financial conditions and a recovery in global trade could provide additional support to exports and remittance inflows.

Navigating these challenges, Bangladesh economy requires the continued implementation of prudent monetary and fiscal policies, maintaining exchange rate stability, strengthening foreign exchange reserve buffers, and accelerates institutional structural reform initiatives to enhance economic resilience and sustainable growth. Continued efforts to improve the business environment, diversify exports, generate employment, and enhance the financial sector's resilience will help Bangladesh mitigate external shocks. Consequently, these measures will sustain a stronger, more inclusive economic recovery over the medium term.

## Chapter III: Overview of Domestic Economy

### III.1 Economic Growth and Inflation

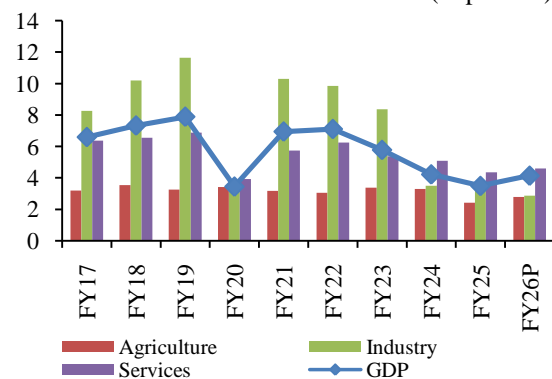
Bangladesh economy showed signs of recovery in FY26, despite persistent domestic structural constraints, heightened global geopolitical tensions and the adverse effects of reciprocal tariff measures. The country's real GDP growth rose to 4.14 percent in FY26 from 3.49 percent in FY25, driven mainly by the expansion of agriculture and service sectors. However, inflationary pressures remained persistent throughout the year. In response, BB maintained a tight monetary policy stance aimed at restoring price stability and safeguarding macroeconomic stability. At the same time, fiscal policy measures were implemented in a coordinated manner to contain inflationary pressures while supporting economic growth and employment.

#### Real Sector: Economic Output Growth

According to the latest provisional data from the Bangladesh Bureau of Statistics (BBS) in FY26, Bangladesh's GDP (real) growth transitioned to an acceleration trajectory, reversing a deceleration trend experienced over the last three consecutive fiscal years (Chart III.I). The growth rate rebounded to 4.14 percent in FY26, up from 3.49 percent in FY25. This growth momentum was primarily propelled by the resilience of the service sector (accounted for around 52 percent share of total GDP), which remained the dominant growth engine by accelerating to 4.59 percent in FY26 from 4.35 percent in FY25. Furthermore, a steady recovery in the agriculture sector (accounted for around 11 percent share of total GDP) bolstered by improved seasonal yields of crops registered a growth of 2.78 percent in FY26, outperforming the 2.42 percent expansion in the previous fiscal year.

Conversely, the industrial sector (accounted for around 37 percent share of total GDP) experienced a notable slowdown, decelerating from 3.71 percent in FY25 to 2.86 percent in FY26. This cooling in industrial output was largely triggered by a reduction in exports and weakened domestic demand, compounded by persistent inflationary pressures throughout the fiscal year. Despite the industrial bottleneck, the broader economic recovery highlights a stable “soft landing” layout, positioning Bangladesh on a sustainable trajectory toward macroeconomic stability as it enters the next fiscal cycle.

Chart III.1 Real GDP Growth Rate (in percent)

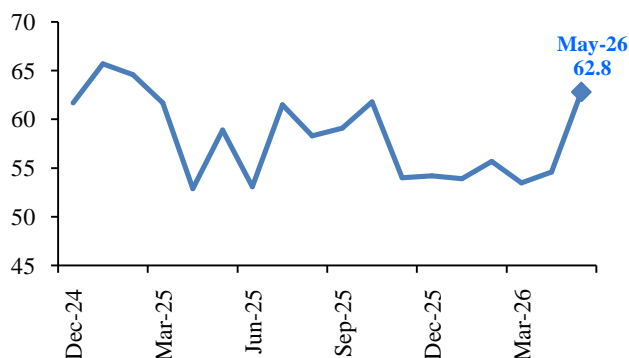


Source: Bangladesh Bureau of Statistics  
P= Provisional

## The Purchasing Managers' Index<sup>1</sup>

The Purchasing Managers' Index (PMI) closely mirrored the real sector's underlying operational performance. In May 2026, the PMI registered at 62.8 points, maintaining its position above the neutral 50.0 points threshold and signaling sustained expansion of Bangladesh economy (Chart III.2). The expansionary momentum reflected stronger aggregate economic activity, partly supported by seasonal demand associated with the Eid festive period.

Chart: III.2 Purchasing Managers' Index

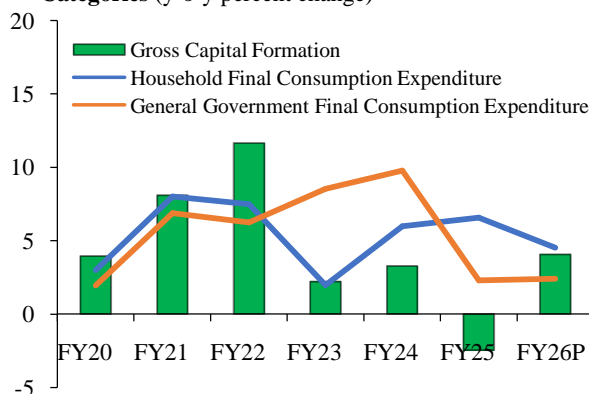


Note: PMI > 50 suggests expansion threshold and vice versa.  
Source: Metropolitan Chamber of Commerce & Industry, Dhaka

## Consumption and Investment

The growth in household final consumption expenditure declined to 4.52 percent in FY26 from 6.57 percent registered in FY25, reflecting the weakened demand from households due mainly to weakened purchasing power for persistence high inflation. In contrast, growth in gross capital formation rebounded to 4.07 percent in FY26, following a contraction of 2.45 percent in FY25 indicating a gradual recovery in investment activity (Chart III.3). Similarly, government expenditure increased marginally to 2.40 percent in FY26 from 2.29 percent in FY25, consistent with fiscal efforts to support macroeconomic stability while complementing the prevailing contractionary monetary stance.

Chart III.3: GDP by Composition of Expenditure Categories (y-o-y percent change)



Source: Bangladesh Bureau of Statistics.

Note: P= Provisional

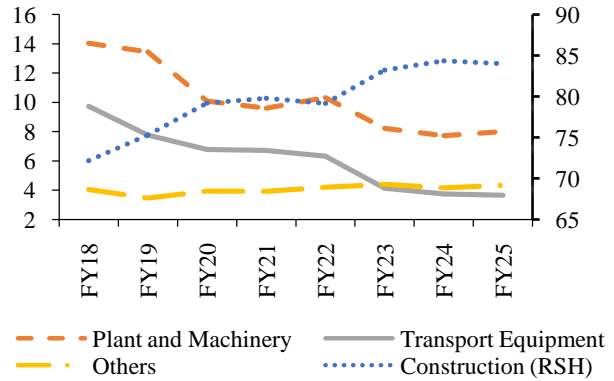
Similarly, government expenditure increased marginally to 2.40 percent in FY26 from 2.29 percent in FY25, consistent with fiscal efforts to support macroeconomic stability while complementing the prevailing contractionary monetary stance.

The structural composition of Gross Fixed Capital Formation (GFCF) indicates a growing concentration in construction-oriented investment in FY25. The share of construction investment expanded significantly to 84.0 percent of total GFCF in FY25 from 79.2 percent in FY22 (Chart III.4). In contrast, allocations in plant and machinery, and transport equipment—key components

<sup>1</sup> The Purchasing Managers' Index (PMI) is a forward looking economic indicator that helps understand the direction of an economy. The Bangladesh PMI was developed in 2024 by Metropolitan Chamber of Commerce and Industry (MCCI) and Policy Exchange Bangladesh, in cooperation with the Singapore Institute of Purchasing & Materials Management (SIPMM) and supported by UK International Development.

for enhancing productive efficiency and industrial capacity—fell sharply to 8.0 percent and 3.66 percent, respectively over the same period. This deepening capital asymmetry toward long-gestation real estate and infrastructure, coupled with subdued investment in factory-level productive assets, threatens to constrain medium-term industrial scaling and total factor productivity enhancement. The evolving capital trajectory demonstrates that private sector confidence in manufacturing expansion remains subdued, despite persistent fiscal incentives and regulatory accommodations tailored for the real sector.

**Chart III.4: Contribution to Gross Fixed Capital Formation (in percent)**

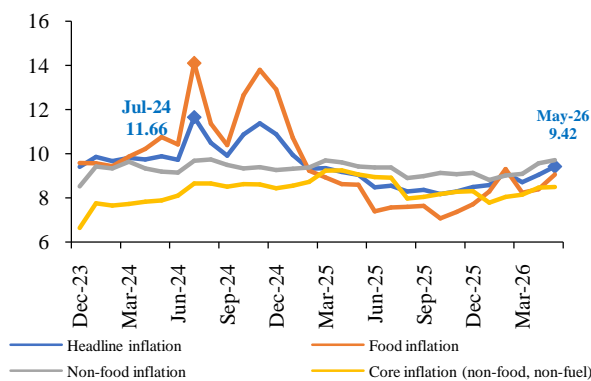


Source: Bangladesh Bureau of Statistics.

### Price and Inflation

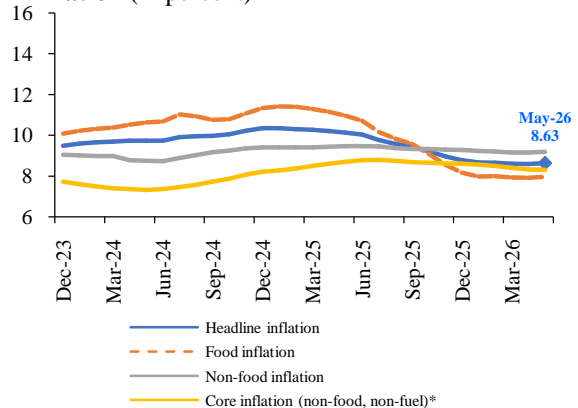
Inflationary pressure remained a major headwind for the Bangladesh economy. Over a long-term horizon—more than three years, the economy has been grappling with persistent inflationary pressures, with point-to-point CPI based headline inflation consistently hovering above 9 percent. This structural inflationary trend initially manifested in early of FY23, largely fueled by global supply chain disruption and commodity price shocks stemming from Russia-Ukraine conflict and subsequent sanction imposed on Russia by USA and alliances.

**Chart III.5: Point to Point CPI Inflation (in percent)**



Source: Bangladesh Bureau of Statistics.

**Chart III.6: Twelve Month Average CPI Inflation (in percent)**



Source: Bangladesh Bureau of Statistics.

Headline inflation climbed to a historic peak at 11.66 percent in July 2024 from 7.56 percent in June 2022. Subsequently, a disinflationary trend was observed, and the headline inflation declined to 8.71 in March 2026. This moderation was primarily attributable to the tight monetary policy stance maintained by Bangladesh Bank, which helped contain underlying inflationary

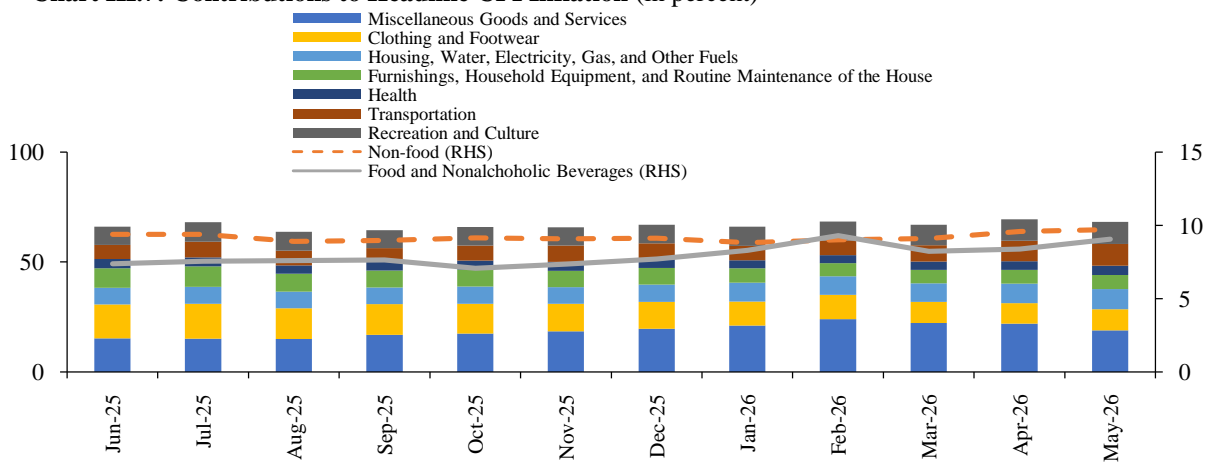
pressures. However, headline inflation further elevated to 9.42 percent in May 2026. The increase of headline inflation was mainly driven by food inflation, which rose to 9.06 percent in May 2026 from 7.39 percent in June 2025, a broadly upward trend after easing to 7.71 percent in December 2025. Non-food inflation also remained persistently elevated at 9.71 percent in May 2026, up from 9.37 percent in June 2025, and 9.15 percent in June 2024 (Chart III.5). In contrast, based on 12-month average CPI, the headline inflation declined to 8.63 percent in May 2026 from 10.03 percent in June 2025, with corresponding declines in both food and non-food inflation (Chart III.6).

Core inflation (non-food and non-fuel) remained elevated throughout FY26 despite tight monetary conditions (Chart III.5). Point-to-point core inflation exhibited a mixed trend during the year and moderated to 8.50 percent in May 2026, supported by favorable base effects and the lagged transmission of monetary tightening. However, the relatively narrow gap between headline and core inflation indicates that price pressures remain broadly embedded across the economy, underscoring the importance of maintaining a prudent monetary policy stance to anchor inflation expectations and support a sustained return to price stability.

### Major Drivers of Inflation

A disaggregated analysis of inflation reveals that price pressures remained broad-based across both food and non-food categories during FY26. Food and non-alcoholic beverages inflation stood at 9.06 percent in May 2026, driven mainly by higher prices of meat, fish, milk, cheese, and eggs. At the same time, non-food inflation remained elevated, reflecting sustained increases across several major components of the CPI basket. Transportation inflation rose sharply to 9.86 percent in May 2026 from 6.43 percent in June 2025, largely due to higher fuel prices. Similarly, inflation in housing, water, electricity, gas, and other fuels increased to 9.26 percent from 7.56

**Chart III.7: Contributions to Headline CPI Inflation (in percent)**

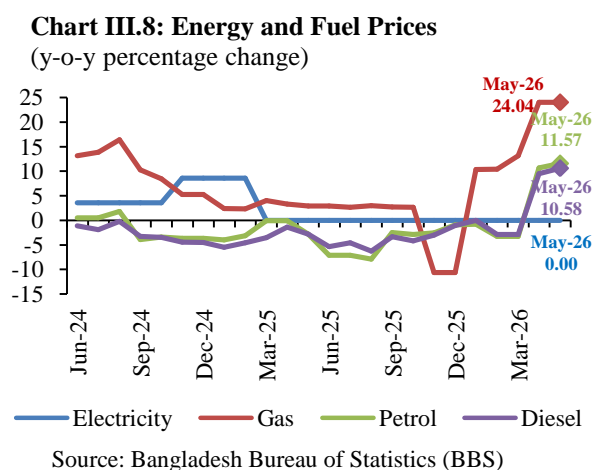


Source: BB staffs' estimates from BBS data.

percent over the same period (Chart III.7). Inflation for miscellaneous goods and services accelerated markedly to 18.93 percent in May 2026 from 15.25 percent in June 2025, while clothing and footwear inflation decreased to 9.56 percent from 15.40 percent over the same period. Overall, the persistence of elevated inflation across key non-food categories indicates continued underlying price pressures and highlights the need for sustained monetary vigilance.

### Energy and Fuel Prices

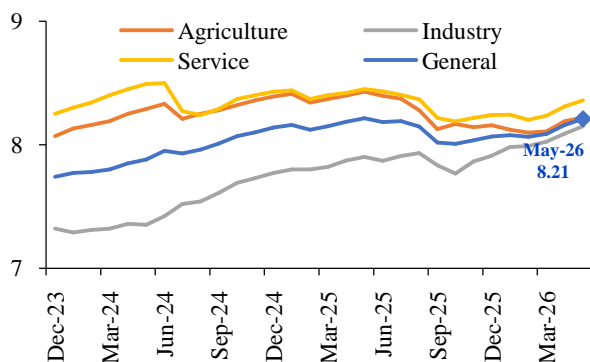
Electricity prices remained stable at same level from May 2025 to May 2026 (Chart III.8). In contrast, gas, petrol, and diesel prices rose sharply in March–May 2026, driven by reductions in energy subsidies amid global supply disruptions linked to the Middle East conflicts. The resulting increase in administered energy prices is expected to exert significant cost-push pressures on headline CPI inflation through direct fuel costs and second-round effects on transportation and production. Nevertheless, the prevailing tight monetary stance is strategically positioned to contain broader pass-through of these supply-side shocks and prevent their transmission into generalised core inflation.



### Wage Rate

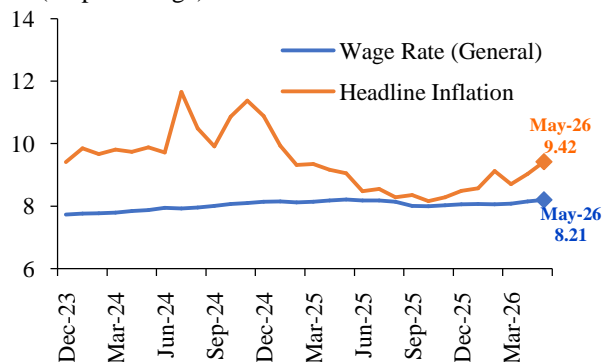
The Wage Rate calculated based on Wage Rate Index (WRI), experienced a modest upward trajectory; the overall wage rate marginally increased to 8.21 percent in May 2026 from 8.18 percent in June 2025. In the industry sector wage rate increased from 7.87 percent in June 2025 to 8.15 percent in May 2026. While in agriculture sector wage rate declined to 8.22 percent in May 2026 from 8.40 percent in June 2025 along with the services sector wage rate decreased to 8.36 percent in May 2026 from 8.43 percent in June 2025 (Chart III.9). However, nominal wage rate remained below the headline inflation over the period, reflecting depletion of consumer real purchasing power (Chart III.10).

**Chart III.9: Wage Rate (in percentage)**



Source: Bangladesh Bureau of Statistics.

**Chart III.10: Wage Rate and Inflation Dynamics (in percentage)**

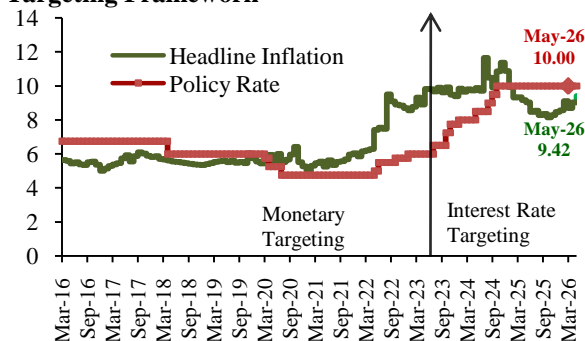


Source: Bangladesh Bureau of Statistics

### Policy Implication on Inflation

In July 2023, Bangladesh Bank shifted its monetary policy framework from monetary targeting to an interest rate targeting regime, replacing reserve money growth with the policy rate as the primary policy anchor and signaling tool. Following the transition, the central bank gradually increased the policy rate to 10.0 percent in October 2024 (Chart III.11) and keeping it unchanged up to the current period, also maintaining a tight monetary stance through FY26 to contain inflationary pressures and anchor inflation expectations. To balance inflation control with the need to sustain economic growth, BB complemented its restrictive monetary policy stance with targeted refinancing facilities for priority productive sectors, including agriculture and cottage, micro, small, and medium enterprises (CMSMEs), while seeking to minimize adverse effects on real economic activity.

**Chart III.11: Inflation under Interest Rate Targeting Framework**



Source: Bangladesh Bank, Bangladesh Bureau of Statistics  
 Note: Prior July, 2023, Policy rate was named as Repo Rate

### Outlook of Economic Growth and Inflation

BB pursued a tight monetary policy stance aiming to contain persistently high inflation, while the disinflation process remains uneven owing to supply-side constraints and economic structural bottlenecks along with heightened geopolitical tensions. This divergence highlights the limitations of monetary tightening, underscoring the need for supply-side measures and effective market interventions.

However, Bangladesh's economic outlook for FY27 is expected to improve gradually, supported by a combination of prudent macroeconomic policies, targeted government interventions, and improving external sector dynamics. The government's continued emphasis on social protection and productive sector support through initiatives such as the Family Card, Farmer Card, and other targeted assistance programs is expected to bolster domestic demand and safeguard vulnerable households. In addition, BB's Tk. 600 billion stimulus package announced in May 2026 is likely to provide much-needed support to industrial production, export-oriented industries, and employment generation. The expected recovery in private sector activity, coupled with resilient remittance inflows and a gradual normalisation of import and supply conditions, should contribute to a moderate acceleration in economic growth over the medium term.

Inflation is projected to follow a gradual downward trajectory, supported by the continued tight monetary policy stance of BB, improved supply chain conditions, and enhanced coordination between monetary and fiscal policies. The moderation of global commodity prices, easing exchange rate pressures, and targeted government measures to improve market supply are expected to further mitigate inflationary pressures. However, the disinflation process may remain uneven due to persistent structural bottlenecks, weather-related risks, and uncertainties in global energy and commodity markets. Moreover, heightened geopolitical tensions in the Middle East, disruptions to global trade routes, and domestic supply-side challenges continue to pose downside risks to both in economic growth and inflation prospects. Against this backdrop, maintaining prudent macroeconomic management and accelerating structural reforms will remain essential to sustaining growth momentum while steering inflation toward a more stable and desirable range with the government target—GDP growth rate at 6.5 percent and inflation at 7.5 percent for FY27.

### **III.2 External Sector**

*Amidst elevated global trade-related policy uncertainty and heightened geopolitical tensions, Bangladesh's external sector remained resilient in FY26, supported by strong remittance and trade credit inflows, moderate import growth, and thus achieved a significant improvement in the balance of payments position. During FY26 (July-April), remittance inflows sustained a strong trajectory, recording 19.5 percent growth and providing a crucial buffer for the current account. On the contrary, export receipts registered a marginal decline (y-o-y) of 1.5 percent during the first ten months of FY26, weighed down by subdued performance in knitwear and woven readymade garment (RMG) categories. However, engineering products surged 26.1 percent, indicating a gradual diversification of the export base. At the same time, import demand rose 6.2 percent, largely driven by food grains. Reflecting these developments, the overall*

*balance of payments (BoP) shifted to a surplus position in FY26 (July- April) from a deficit in the corresponding period of the previous year, underpinned by a marked improvement in the financial account, and thereby strengthening the country’s external position. Although developments in the external sector have eased pressure on the BoP and contributed to greater exchange rate stability, the sector continues to face significant structural challenges. In particular, the widening trade deficit highlights underlying vulnerabilities and underscores the need for an improved business environment, stronger export competitiveness, and higher investment to ensure sustainable external sector resilience over the longer term.*

### **Balance of Payments (BoP)**

The trade deficit increased to USD 22.21 billion in July–April of FY26 from USD 18.23 billion in the corresponding period of FY25, a deterioration of USD 3.98 billion. This was driven by the combination of declining export receipts (negative 1.5 percent) and rising import payments (6.2 percent). The widening trade gap underscores the structural vulnerability of Bangladesh's merchandise account (Table III.1). Despite the wider trade deficit, the deficit of current account balance (CAB) narrowed substantially to USD 1.07 billion in July–April of FY26 from USD 1.64 billion in the same period of FY25, representing an improvement of USD 0.56 billion. This improvement was primarily attributable to the strong increase in workers' remittance inflows (19.5 percent), which served as the primary offset to the enlarged trade deficit (Table III.1 and Chart III.12).

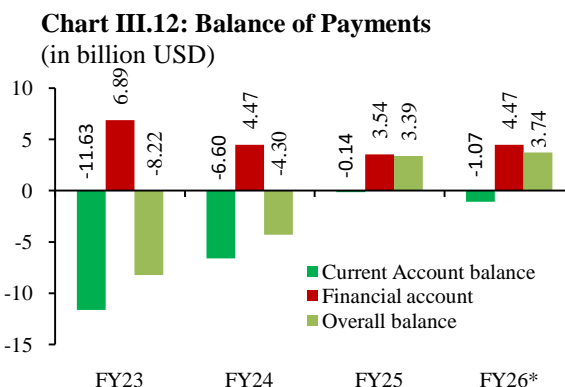
**Table III.1: Key Components of Balance of Payments (In billion USD)**

<b>Items</b>	<b>FY25 (July-April)</b>	<b>FY26 (July-April)</b>	<b>Change</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4=(3-2)</b>
<b>Trade balance</b>	<b>-18.23</b>	<b>-22.21</b>	<b>-4.0</b>
Export f.o.b.(including EPZ)	36.57	36.02	-0.5
Readymade garments	32.64	32.01	-0.6
Import f.o.b. (including EPZ)	54.8	58.23	3.4
Workers’ remittances inflows	24.54	29.33	4.8
<b>Current Account Balance</b>	<b>-1.64</b>	<b>-1.07</b>	<b>0.6</b>
<b>Capital account</b>	<b>0.29</b>	<b>0.33</b>	<b>0.0</b>
<b>Financial account</b>	<b>1.13</b>	<b>4.47</b>	<b>3.3</b>
Trade Credit (net)	-1.47	3.57	5.0
Foreign direct investment (net)	1.43	1.14	-0.3
<b>Overall Balance</b>	<b>-0.66</b>	<b>3.74</b>	<b>4.4</b>

Source: Statistics Department, Bangladesh Bank.

The capital account balance improved to USD 0.33 billion in July-April of FY26 up from USD 0.29 billion in the same period of FY25.

The financial account balance recorded a surplus of USD 4.47 billion in July–April of FY26, a significant increase from USD 1.13 billion in the same period of FY25. The key driver of this surplus was trade credit, which swung from a net outflow of USD 1.47 billion in July-April of FY25 to a net inflow of USD 3.57 billion during the same period of FY26. This represents significant utilization of supplier credits and external borrowings to finance import transactions.



Source: Statistics Department of Bangladesh Bank.  
\* Up to April 2026

FDI inflows moderated to USD 1.14 billion in July-April FY26 from USD 1.43 billion at the same period of previous fiscal year, a decline of 20.3 per cent, reflecting continued investor caution.

However, the overall balance of payments recorded a surplus of USD 3.74 billion in July–April of FY26, compared with a deficit of USD 0.66 billion in the corresponding period of FY25 (Table III.1 and Chart III.12). This outcome has contributed to a meaningful accretion of foreign exchange reserves and has broadly stabilized the exchange rate environment

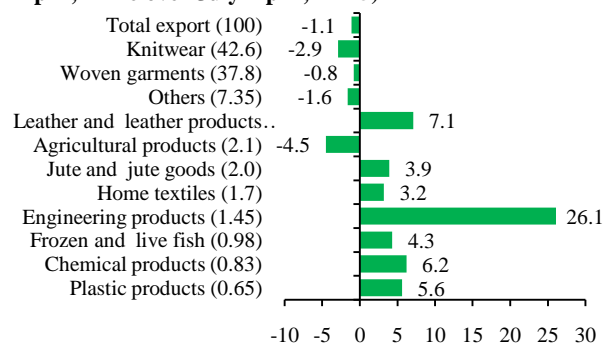
## Merchandise Trade

Despite weaker global demand due to the reciprocal tariff policies and accelerated global geopolitical tension, Bangladesh’s merchandise exports and imports (in value) experienced challenges in FY26.

Total merchandise export receipts amounted to USD 39.79 billion during July–April of FY26, down 1.1 percent from USD 40.22 billion in the same period of FY25. This marks a reversal from the robust growth of 9.8 percent in July–April of FY25 (Table III.2). The decline in export earnings during July–April FY26 was mainly due to weaker demand in major export destinations, particularly Europe and North America.

The category-wise export data for July- April FY26 reveals a tale of two sectors (knitwear and woven garments) (Chart III.13). Bangladesh’s RMG-dominated export basket where the share of knitwear (42.6 percent) and woven garments (37.8 percent) together account for roughly 80 percent of total export receipts registered declines of 0.8 percent and 2.9 percent respectively. The weakness in these two major export categories was sufficient to outweigh gains in other sectors, resulting in an overall contraction of 1.1 percent in total export earnings during the period. Among non-RMG categories, engineering product posted the most impressive growth at 26.1 percent, albeit from a small based of 1.45 percent share, representing the clearest signal of export diversification gaining traction. Leather and leather products (7.1 percent), chemical products (6.2 percent), plastic products (5.6 percent), home textiles (3.2 percent), and jute and jute goods (3.9 percent) all record modest growth in FY26 (July-April), reflecting broad-based strength across smaller export lines (Chart III.13).

**Chart III.13: Category-wise export growth (July-April, FY26 over July-April, FY25)**



Note: Figure in the parentheses indicate the share of total export  
Source: NBR, Statistics Department of Bangladesh Bank

**Table III.2: Exports, Imports and Remittance Inflows**

Particulars	FY23	FY24	FY25	FY25 (July- April)	FY26 (July- April)
In value (billion USD)					
Export	46.49	44.47	48.30	40.21	39.79
Import (cif)	75.06	66.72	68.35	58.17	61.61
Remittance	21.61	23.91	30.32	24.53	29.32
Growth in percent (y-o-y)					
Export	-10.7	-4.3	8.6	9.8	-1.1
Import	-15.8	-11.1	2.4	5.4	5.9
Remittance	2.8	10.7	26.8	28.3	19.5

Source: National Board of Revenue (NBR), Statistics Department of Bangladesh Bank

Import payments (cif) reached to USD 61.61 billion during July–April of FY26, up 5.9 percent from USD 58.17 billion in the same period of FY25 (Table III.2). This scenario reflects gradual normalisation of import demand, following a period of contraction in earlier years and a subsequent recovery in the most recent year.

Category-wise customs-based import data for July-April FY26 reflects a broadly prudent demand structure, with imports of productive inputs recovering while discretionary and consumer imports remained relatively restrained. Among the major import categories (Chart III.14), intermediate goods, which dominate the import basket with a 62.2 percent share, grew 8.81 percent during this period. This increase reflects stronger demand for industrial inputs to support domestic manufacturing and export-oriented industries.

Capital goods (13.8 percent share) rose a modest 6.07 percent suggesting cautious but positive private investment activity in industrial capacity, consistent with a gradually improving business environment. Food grains (4.0 percent share) recorded the sharpest growth of 27.68 percent, a development that points to heightened government vigilance on food security buffers amid global commodity price volatility and domestic supply uncertainties.

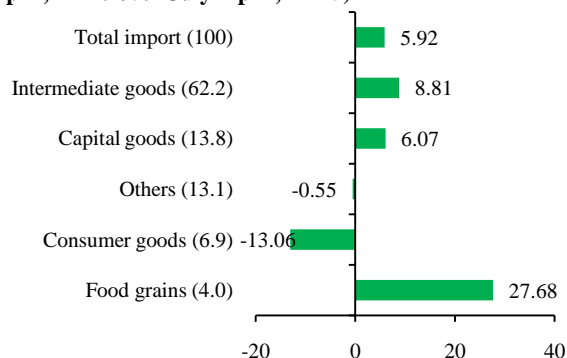
### Remittance Inflows

Workers' remittance inflows aggregated USD 29.32 billion during July–April of FY26, registering robust growth of 19.5 percent from USD 24,536.7 million in the corresponding period of FY25 (Table III.2).

The country-wise remittance data for July-April of FY26 reveals a broadly positive but notably heterogeneous picture across major remittance source markets, with aggregate remittance inflows showing strong performance (Chart III.15).

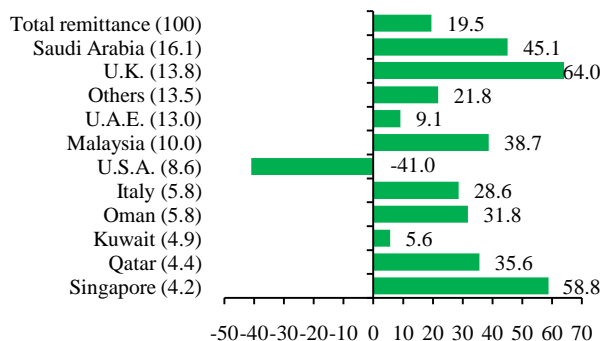
Among the Gulf Cooperation Council (GCC) markets, Saudi Arabia with a 16.1 percent share of total remittance inflows, recorded strong growth of 45.1 percent and remained the largest source country by share in FY26. This likely reflects a combination of increased Bangladeshi worker deployments in the Kingdom. Remittance from Qatar (4.4 percent share) grew 35.6 percent, a recovery that is somewhat surprising given the anticipated

**Chart III.14: Category-wise import (c&f) growth (July-April, FY26 over July-April, FY25)**



Note: Figure in the parantheses indicate the share of total import  
Source: NBR, Compiled by Statistics Department, Bangladesh Bank

**Chart III.15: Country-wise Remittance growth (July-April, FY26 over July-April, FY25)**



Source: Statistics Department of Bangladesh Bank  
Note: Figure in the parantheses indicate the share of total remittance

normalisation. The UAE (13.0 percent share), despite being the second largest source country, posted only 9.1 percent growth, relatively modest compared with its GCC peers, warranting monitoring of workforce trends in that market.

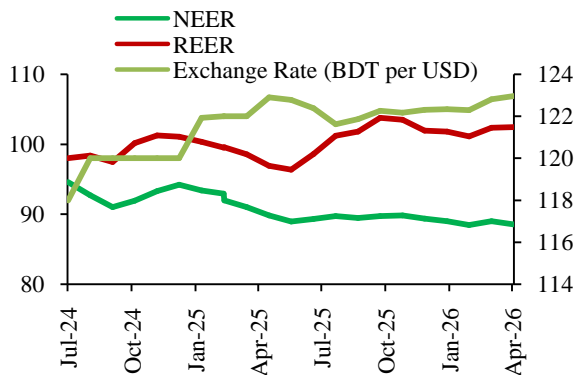
Outside the GCC, the most striking development is the United Kingdom (13.8 percent share), which recorded significant growth of 64.0 percent in July-April of FY26, the highest rate among all source countries, elevating it to the position of the single fastest-growing remittance corridor in absolute growth terms. This likely reflects both a larger diaspora base actively remitting through the formal channels and the compounding effect of favourable sterling-to-taka exchange rate differentials. Italy (5.8 percent share) grew 28.6 per cent, reflecting formalisation and deepening of remittance flows from the Bangladeshi community in Southern Europe.

The most significant outlier and the one most demanding of analytical scrutiny, is the United States (8.6 percent share), which contracted sharply by 41.0 per cent, the only source country to record a negative growth rate in FY26. This is a notable reversal, particularly given that the USA is one of Bangladesh's most important remittance sources. The contraction may reflect reclassification of transfer flows, a shift toward investment remittances recorded under capital account transactions, or data measurement issues, rather than a genuine decline in diaspora transfers.

### Exchange Rate Movements

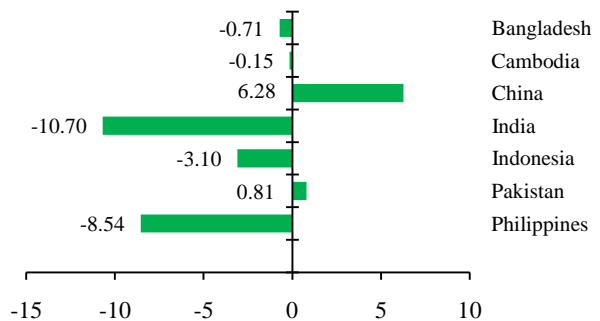
The Bangladeshi Taka (BDT) demonstrated a broadly stable trajectory against the US Dollar (USD) during July-April of FY26. This stability is attributable, in large part, to the structural reforms undertaken by BB in the management of the exchange rate framework.

**Chart III.16: NEER and REER Indices and Exchange rate**



Source: Monetary Policy Department, Bangladesh Bank.

**Chart III.17 : Peer Countries' Local Currency Appreciation/ Depreciation (+/-) against US dollar: April 2026 over April 2025.**



Source: Central Banks of the Respective Countries.

As of end April 2026, the exchange rate stood at BDT 122.87 per USD, reflecting a depreciation of 0.71 percent from the end April 2025 level. Since late 2024, the nominal exchange rate, as implied by the REER, has shown convergence, signaling improved alignment with fundamentals. The Real Effective Exchange Rate (REER), which measures the BDT's value against a basket of other currencies adjusted for inflation, and the Nominal Effective Exchange Rate (NEER), which reflects the unadjusted value against the same basket, both shifted over the period (Chart III.16). A cross-country comparison indicates that, with the exception of China and Pakistan, the currencies of most peer economies also depreciated nominally by end-April 2026, albeit at a more moderate pace (Chart III.17).

### Foreign Exchange Market

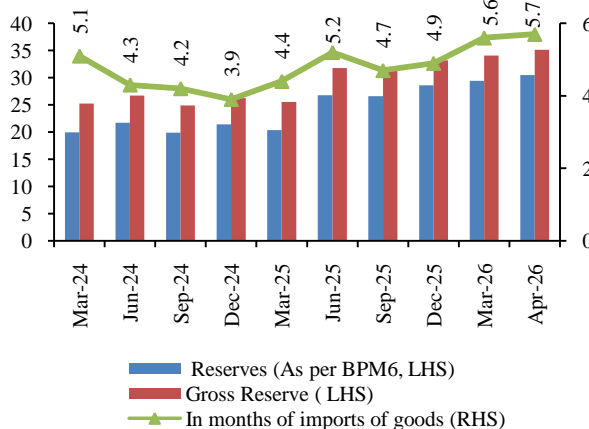
Bangladesh's gross foreign exchange reserves strengthened significantly during the review period, rising to USD 35.10 billion at the end of April 2026 from USD 27.43 billion at the end of April 2025. This improvement reflects the combined impact of robust remittance inflows, the overall BoP surplus, and strategic foreign exchange management by BB. During July-April of FY26, BB did not sell of foreign currencies rather buy USD 5.7 billion in the interbank market, reflecting measured intervention to smooth undue exchange rate volatility while allowing market forces to guide the rate (Chart III.18 and Chart III.19).

**Chart III.18: BB's Intervention in the Foreign Exchange Market** (in billion USD)



Source: FRTMD, Bangladesh Bank. \* Up to April 2026

**Chart III.19: International Reserves** (in billion USD)



Source: FRTMD, Bangladesh Bank

Total turnover in Bangladesh's interbank foreign exchange market increased marginally to USD 24.4 billion during July–April of FY26, from USD 23.6 billion in the corresponding period of FY25. This uptick reflects the rebound in external sector activity and improved liquidity conditions. A notable structural shift was observed in the composition of market transactions. The share of swap transactions declined sharply to 65.5 percent from 84.4 percent in the prior

year period, while the share of spot transactions rose to 34.4 percent from 15.5 percent. This shift towards spot transactions indicates greater availability of foreign exchange for immediate settlement and improved market liquidity, broadly consistent with the move towards greater exchange rate flexibility. The share of forward transactions remained small, declining marginally to 0.1 percent from 0.2 percent (Chart III.20).

**Chart III.20: Total Turnover by Instruments**  
(in billion USD)



\* Up to April 2026  
Source: FRTMD, Bangladesh Bank.

### External Sector Outlook

Bangladesh’s external sector outlook is cautiously optimistic, underpinned primarily by resilient workers’ remittances, which are expected to continue supporting the current account and potentially narrow down the trade deficit by enhancing export growth maintains trajectory. While subdued external demand may weigh on export performance, the growing contribution of non-RMG sectors is expected to support export diversification, which could be further accelerated by targeted policy support. Import growth is likely to be driven mainly by intermediate and capital goods, reflecting continued economic activity. The overall balance of payments is likely to remain in surplus, supported by remittances and trade credit inflows, though the decline in FDI represents a medium-term vulnerability that requires structural reforms to restore investor confidence. Overall, while cyclical stability is evident, the key policy challenge remains converting it into structural resilience through export diversification, strengthening formal remittance channels, reviving FDI, and prudent import management to ensure the external sector provides a durable foundation for Bangladesh’s broader macroeconomic objectives.

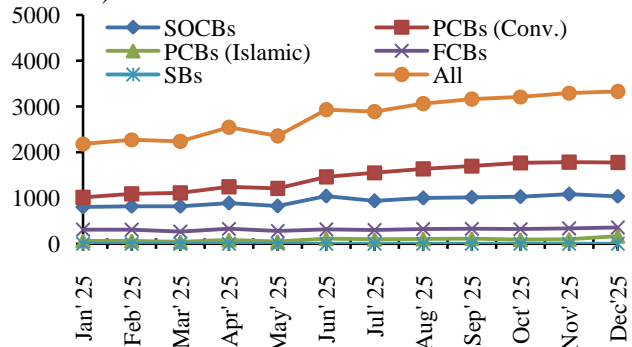
### III.3 Banking Sector Performance

The performance of Bangladesh’s banking sector has recently undergone a complex evolution, characterized by partial liquidity recovery amidst a challenging macroeconomic and post-crisis landscape. While certain liquidity metrics have exhibited discernible improvement, these gains remain uneven and have been offset by persistent structural fragilities. Notably, elevated levels of non-performing loans and mounting pressures on capital adequacy have continued to undermine sectoral profitability and resilience. Such dynamics underscore the imperative for robust policy interventions and comprehensive reforms to ensure enduring stability within the banking system.

#### Liquidity

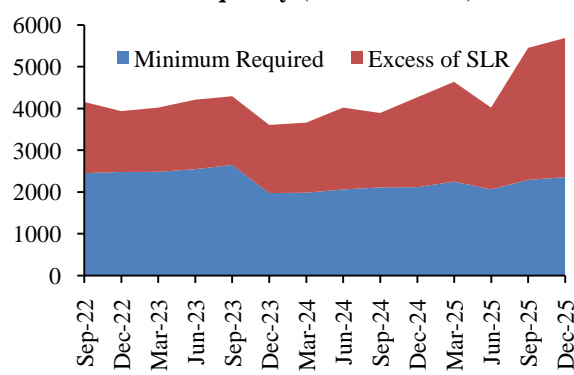
The total amount of liquidity in excess of SLR in the banking industry grew from BDT 2183.85 billion in January 2025 to BDT 3329.44 billion in December of the same year (Chart III.21). Across different ownership structures, most bank groups display strikingly similar liquidity patterns, though a few notable exceptions stand out. The amount of liquidity in excess of SLR in state-owned commercial banks (SOCBs) and conventional private commercial banks (PCBs Conv.) rose from BDT 805.07 billion and BDT 1010.02 billion in January 2025 to BDT 1036.90 billion and BDT 1774.07 billion in December 2025, respectively (Chart III.21). Barring minor anomalies, the trend of excess liquidity within the banking sector has exhibited an unequivocal and persistent escalation since September 2024. By December 2025, aggregate excess liquidity within the banking system surged markedly, substantiated by an impressive 54.84 percent (y-o-y) augmentation in total surplus liquidity (Chart III.22). This pronounced liquidity accretion was precipitated by Bangladesh Bank’s expeditious market interventions, sustained implementation of contractionary monetary policy, and a diminution in private sector credit attributable to the proliferation of non-performing loans.

**Chart III.21: Liquidity in Excess of SLR (in billion BDT)**



Source: SDAD, Bangladesh Bank

**Chart III.22: Liquidity (in billion BDT)**

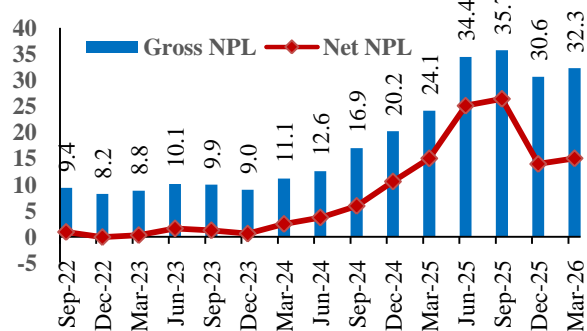


Source: SDAD, Bangladesh Bank

## Asset Quality

The ratio of gross non-performing loans (NPL) to total loan increased significantly from March 2025 to March 2026, indicating heightened risk in the banking sector. After rising from 24.13 percent in March 2025 to a record high of 35.73 percent in September 2025, the NPL ratio to total outstanding loans fell to 32.26 percent in March 2026 (Chart III.23). Politically directed lending, stricter classification policies aligned with international standards, economic stress on borrowers and structural weakness in banking governance were the main causes of the deteriorating NPL position. On the other hand, the banking industry experienced a slight increase in the ratio of net non-performing loans to total loans, rising from 15.00 percent at the end of March 2025 to 15.01 percent by March 2026. However, at the end of September 2025, the net NPL ratio jumped to 26.40 percent (Chart III.23). The recent decline in net NPL compared to September 2025 could be attributable to a sizable increase in provisions maintained, coupled with a rise in the interest suspense account balance.

**Chart III.23: Ratio of Gross NPL and Net NPL to Total Loans (in percent)**

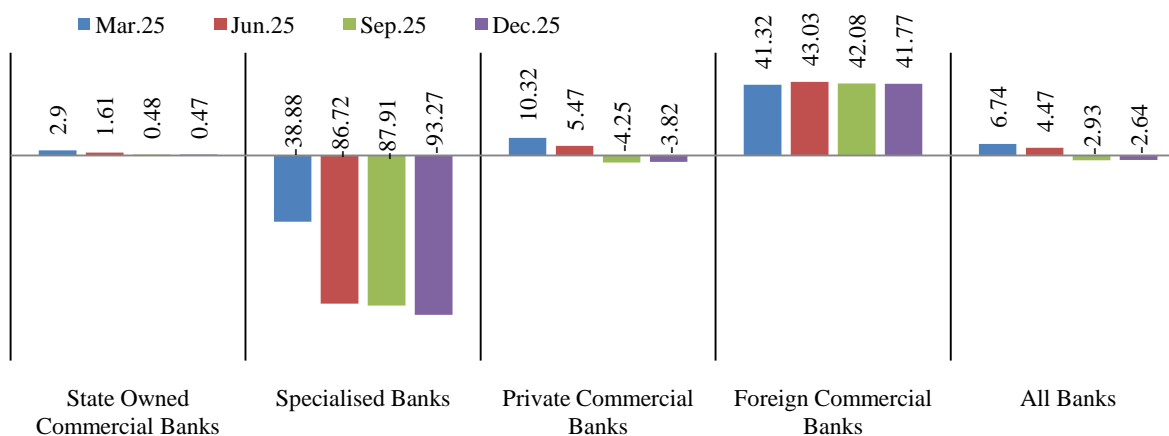


Source: BRPD-1, Bangladesh Bank

## Capital Adequacy

The banking system's overall capital to risk-weighted assets ratio (CRAR) dropped well below the Basel III minimum of 10 percent in December 2025. In December 2025, the banking system's overall CRAR was -2.64 percent, down from 6.74 percent at the end of March 2025. While the CRAR for FCBs (foreign commercial banks) increased slightly from 41.32 percent at the end of March 2025 to 41.77 percent at the end of December 2025, the CRAR for SCBs, SBs, and PCBs (private commercial banks) fell precipitously to 0.47 percent, -93.27 percent, and -3.82 percent at the end of December 2025, respectively (Chart III.24). The sharp deterioration in CRAR in domestic commercial banks signals severe capital inadequacy and heightened financial vulnerability.

**Chart III.24: Capital to Risk Weighted Assets Ratio (CRAR) (in percent)**



Source: SDAD, Bangladesh Bank.

## Profitability

Return on equity (ROE) and return on assets (ROA) declined in September 2025 compared to March 2025, indicating reduced profitability in the banking sector. Overall ROA and ROE decreased from -0.18 percent and -3.99 percent in March 2025 to -0.54 percent and -15.10 percent in September 2025, respectively (Table III.3). The observed decline in profitability indicators is linked to elevated loan loss provisions amid a rise in non-performing loans.

**Table III.3: Profitability Ratios by Types of Banks (in percent)**

Type of Banks	Return on Assets (ROA)*			Return on Equity (ROE)*		
	2025			2025		
	March	June	Sep	March	June	Sep
State Owned Commercial Banks	-0.51	-0.55	-0.53	-18.80	-22.94	-20.76
Specialised Banks	-2.59	-11.96	-3.64	-10.23	-27.49	-8.19
Private Commercial Banks	-0.30	-0.55	-0.74	-6.11	-13.28	-18.13
Foreign Commercial Banks	4.07	4.06	3.72	18.02	17.34	15.89
<b>All Banks</b>	<b>-0.18</b>	<b>-0.58</b>	<b>-0.54</b>	<b>-3.99</b>	<b>-16.11</b>	<b>-15.10</b>

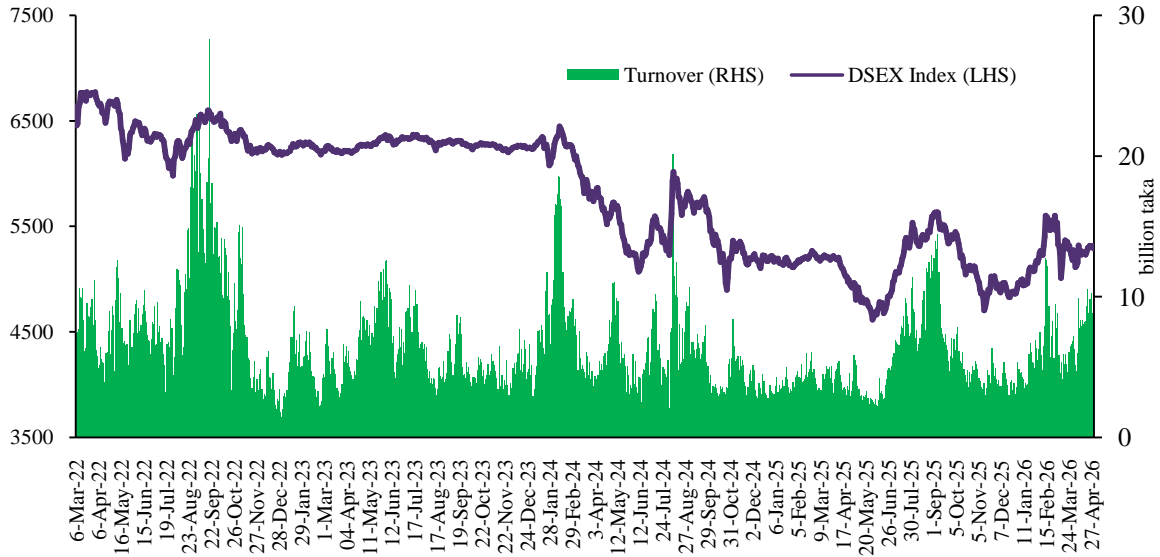
Source: \*All are annualized. SDAD, Bangladesh Bank.

## III.4 Capital Market

Between July 2025 and April 2026, Bangladesh's capital market performed comparatively well, as seen by rising price indices, market capitalisation, and average turnover. Despite a number of negative developments in the domestic and international economies, such as ongoing monetary tightening, declining investor sentiment, political unpredictability, and instability brought on by

global geopolitical tensions, particularly the war in Iran, the capital market has somewhat recovered.

**Chart III.25: DSEX Index and Turnover**



Source: Dhaka Stock Exchange

The DSEX index reached 5286.87 at the end of April 2026 from 4917.92 at the end of April 2025, the turnover jumped to BDT 8.64 billion at the end of April 2026 from BDT 3.27 billion at the end of April 2025, and the total market capitalisation increased from BDT 6565.69 billion at the end of April 2025 to BDT 6851.19 billion at the end of April 2026, despite Bangladesh's capital market facing a number of difficulties, such as a lack of liquidity, a lack of investor confidence, and a lack of transparency (Chart III.25).

## Chapter IV: Policy Review and Forward Looking Guidance

*Bangladesh Bank (BB) has adopted significant monetary and regulatory policy measures to address persistent inflationary pressures, maintain external sector stability, and strengthen banking sector resilience amid intricate global and domestic challenges. These initiatives evince the country's unwavering dedication to the structural recalibration of its financial infrastructure, meticulously contextualised to endogenous realities, harmonised with international standards towards enhancing macroeconomic stability in response to evolving challenges.*

### IV.1 Persistent Inflationary Pressures and Coordinated Policy Measures

Despite maintaining the policy rate at 10 percent to contain inflationary pressures, inflation has remained above the comfort threshold for a prolonged period. One of the key factors behind the persistence of inflation is the pronounced downward stickiness in the prices of essential commodities. In Bangladesh, prices tend to rise almost immediately in response to global price surges or domestic supply shocks, such as adverse weather conditions. However, these prices seldom return to previous levels once these pressures subside. This persistent price rigidity has also impeded the anchoring of inflation expectations. In its policy appraisal, Bangladesh Bank undertook surveys in two phases for five pivotal commodities to elucidate latent supply chain inefficiencies. Results indicated pronounced downward price rigidity, especially in staple agricultural commodities prevalent in Bangladesh.

To address the additional pressure of cost-push inflation resulting from the recent conflicts in the Middle East and rising global energy and LNG prices, both the Government and BB have undertaken several proactive measures to contain inflation. Measures include adjusting import duties, removing LC margin requirements for selected essential imports, permitting credit facilities for LPG imports, maintaining stable exchange rates, issuing farmer cards to support stable production, and improving commodity stock monitoring to reduce food price pressures. In addition, authorities have expanded Trading Corporation of Bangladesh (TCB) operations and introduced family cards for low-income groups, intensifying efforts to curb hoarding and illegal market activities to reduce supply constraints and enhance market efficiency.

Prospectively, BB is likely to maintain its contractionary monetary policy stance until inflation shows clear moderation. These coordinated policy measures are expected to help anchor inflation expectations and support a more favourable near-term inflation outlook.

## IV.2 Exchange Rate Stability and Foreign Exchange Reserve Developments

Despite the recent Middle East conflict and subdued global demand, Bangladesh's external sector demonstrated significant improvement, driven by increased remittance inflows, improved balance of payments (BoP) conditions, and ongoing exchange rate reforms. Following the adoption of a more flexible exchange rate regime in May 2025, the foreign exchange market has remained largely stable, with the taka exhibiting only moderate fluctuations against the US dollar. BB has continued to publish a daily reference rate and has allowed authorized dealers to negotiate rates independently, thereby improving market efficiency and transparency.

To contain excessive volatility and maintain orderly market conditions, BB intervened selectively in the foreign exchange market through dollar purchase auctions and liquidity management operations. Despite lower export earnings, foreign exchange reserves gradually improved during the review period, supported by robust remittance inflows and prudent demand management policies, which helped ease pressure on the foreign exchange market and strengthen reserve accumulation.

Additionally, to promote export diversification, the Bank approved payments against discount claims for exports of ships, frozen shrimp, fish, and jute goods, and removed the certification requirement for betel leaf exports. Incentives and cash assistance were extended to synthetic footwear and bags made from synthetic materials and fabrics, and the BDT 2,000 crore ship building refinance scheme was resumed. Furthermore, BB allowed exports below USD 1,000 through Business-to-Consumer (B2C) e-commerce platforms without requiring an EXP form to support export growth and integrate small, micro, and cottage industries into global markets. Moreover, BB has introduced subsidies for subcontracting factories alongside original exporters of ready-made garments and knitwear to boost export earnings. On November 12, 2025, BB instructed banks to provide subsidies to subcontracting factories at the same rate applicable to original exporters.

Since portfolio investment remains historically low in Bangladesh, BB also instructed banks to sanction loans against treasury bonds to encourage portfolio investment. It is worth mentioning that Bangladesh incurs significant foreign exchange payments for freight services under trade in services. Therefore, expanding the shipbuilding industry could help reduce these substantial foreign exchange outflows while also increasing inward service income.

Looking ahead, Bangladesh Bank is expected to continue its market-based exchange rate management framework and maintain prudent external sector policies to preserve exchange rate stability and strengthen foreign exchange reserve buffers amid global uncertainties. Continued

emphasis on export diversification, remittance growth, shipbuilding sectors, and greater integration into global digital trade platforms are anticipated to support sustainable reserve accumulation and improve resilience in the external sector. Furthermore, ongoing policy support for service exports and portfolio investment is expected to enhance foreign exchange inflows and contribute to long-term macroeconomic stability.

### **IV.3 Advancing Prudential Regulations and Non-Performing Loan Resolution**

After a sharp rise in classified loan ratios in June 2025, attributable to corrective actions aligned with international standards, subsequent regulatory enhancements and recovery initiatives by Bangladesh Bank (BB) facilitated a gradual decline. This improvement underscores the effectiveness of reforms aimed at improving credit discipline and resolving NPLs. However, persistent NPLs continue to exert stress on the sector, necessitating ongoing corrective interventions by BB.

During the review period, BB permitted the write-off of non-performing loans with limited recovery prospects to better reflect banks' financial positions and harmonise with international norms. The Bank also revised its policy for distressed borrowers, enabling special rescheduling of classified loans for up to ten years, including a grace period of up to two years, subject to the bank-client relationship and repayment capacity.

To strengthen external debt monitoring and risk assessment, BB mandated that all private-sector foreign loans be reported to the Credit Information Bureau (CIB). In addition, special policy support facilities for affected borrowers were extended until June 2026, allowing eligible businesses to restructure and reschedule loans under revised conditions. These measures were intended to support viable businesses facing temporary financial stress while preventing a sudden deterioration in banks' asset quality.

In December 2025, revised instructions on loan classification and provisioning for scheduled banks were issued to reinforce credit risk management and ensure adequate provisioning. Furthermore, sector-specific regulatory relaxations were introduced to support credit flows to productive sectors, particularly agriculture and Cottage, Micro and Small Enterprises (CMSMEs). Banks were instructed to maintain lower provisioning requirements for standard and Special Mention Account (SMA) loans in these sectors until December 2026 to facilitate credit expansion and employment generation. Additionally, Bangladesh Bank commenced preparations for IFRS 9's Expected Credit Loss framework, shifting to a forward-looking risk assessment to enhance resilience and transparency, and early risk recognition within the banking system. The

forthcoming Bank Resolution Act 2026 and Deposit Protection Act 2026 are anticipated to reinforce financial discipline and mitigate NPLs.

Going forward, Bangladesh Bank will continue strengthening the NPL resolution framework through enhanced regulatory oversight, risk-based provisioning under IFRS 9, and implementation of banking sector reforms to ensure financial stability, transparency, and improved asset quality.

#### **IV.4. Key Reforms in Bank Regulation and Resolution**

##### **IV.4.1 Bank Restructuring and Resolution Mechanisms**

The banking sector in Bangladesh is currently undergoing a significant transformation. The National Parliament of Bangladesh enacted the Bank Resolution Act 2026 on 10 April 2026, replacing the earlier Bank Resolution Ordinance 2025 with a few amendments. This enactment represents an important step toward strengthening the resilience and stability of Bangladesh's banking sector. The Act provides BB with a formal legal framework to intervene in financially distressed banks in a timely and orderly manner through measures such as restructuring, acquisition, recapitalization, and resolution. The Act aims to reduce systemic risk, safeguard depositors, minimize the need for repeated taxpayer-funded bailouts, and enhance market discipline by enabling early corrective actions against weak banks and supervisory efficacy. It is also designed to restore confidence, strengthen governance, and ensure financial stability, all of which are essential for effective monetary policy and sustainable growth. Meanwhile, Bangladesh Bank has established a dedicated Bank Resolution Department to implement the Act.

Prior to the promulgation of the Bank Resolution Ordinance 2025 (later enacted as the Bank Resolution Act 2026), BB issued the Special Regulations of Bangladesh Bank for Asset Quality Reviews (AQRs) in 2024 to ensure consistency, transparency, and comparability across banks in the bank resolution process. Under the AQR framework, BB appointed international consulting firms to conduct AQRs of distressed banks and prepare comprehensive resolution plans based on the findings. The Board of BB subsequently approved a resolution framework for five Shariah-based banks, leading to their merger into a newly established state-owned entity, *Sammilito Islami Bank PLC*, which was enlisted as a scheduled bank on 1 December 2025. The newly scheduled bank has an initial authorized capital of Tk. 40,000 crore and a paid-up capital of Tk. 35,000 crore, including a government equity injection of BDT 20,000 crore. The government plans to gradually divest its ownership stake over the next three to five years, allowing strategic private investors to assume control at an appropriate stage.

To support the overall resolution process, the National Parliament of Bangladesh enacted the Deposit Insurance Act 2026 on 10 April 2026, replacing the earlier Deposit Insurance Ordinance 2025. Under this Act, a Deposit Protection Fund will be established, and in the event of the resolution of any member institution, the Fund will primarily be used to pay protected deposits to depositors. One of the major features of the Act is the increase in the deposit protection coverage limit from Tk. 1 lakh to Tk. 2 lakh, which is expected to provide greater security to small depositors and reduce the risk of panic withdrawals during periods of financial stress. The upper limit will be revised by the Government through a gazette notification, based on the recommendation of the Trustee Board of the Fund, at intervals of every three years. In addition, BB has finalized the Bank Restructuring and Resolution Fund (BRRF) framework to provide a dedicated financing backstop for future resolutions.

#### **IV.4.2. Enhancing Supervision through Risk Assessment**

BB is implementing Risk-Based Supervision (RBS) to strengthen banking oversight and align with global standards. The risk-based approach replaces traditional compliance-based supervision with a forward-looking, risk-focused approach that emphasizes underlying risks and the quality of the bank's risk management practices. RBS enables supervisors to exercise qualitative judgment and tailor supervisory actions to each bank's specific risk profile. The primary objective of RBS is to enhance the effectiveness, stability, and efficiency of banking supervision by reinforcing portfolio-based oversight and improving coordination between on-site and off-site supervision.

Further improvements to the risk based framework are ongoing. These include finalizing the Supervisory Manual and all needed guidelines with expert feedback. A single point data collection platform for all supervisory departments is also being developed under the World Bank's FSSP Two project. With technical help from the World Bank, a Supervisory Intervention Guideline is currently being prepared. This guideline will provide an integrated framework for banking supervision, enforcement, and resolution activities. A forensic supervisory department will also be created. The staff in this department will receive proper training to carry out forensic audits and inspections of banks when needed.

#### **IV.4.3. Efforts to Trace and Repatriate Illicit Assets**

Bangladesh has enhanced its asset recovery efforts by restructuring the Inter Agency Task Force on Stolen Asset Recovery and Management, led by the Bangladesh Bank Governor and coordinated by the Bangladesh Financial Intelligence Unit (BFIU). The task force identifies, investigates, recovers, repatriates, and manages illegally expatriated assets, coordinating

domestically and internationally to address legal and practical barriers. Eleven priority money laundering cases are under investigation by Joint Investigation Teams, with assets traced and attached both locally and abroad, aided by Mutual Legal Assistance Requests. The government is engaging international law firms, collaborating with global recovery bodies, and pursuing Mutual Legal Assistance Treaties. Civil and criminal actions are being pursued, particularly for assets linked to non-performing loans, while legal reforms and high-level oversight continue.

Looking ahead, Bangladesh Bank is expected to continue strengthening the bank resolution and supervisory framework through the full implementation of risk-based supervision, enhanced forensic oversight, and operationalisation of newly enacted bank resolution mechanisms. Ongoing reforms in asset recovery, governance, and prudential regulation are anticipated to improve banking sector resilience, restore market confidence, and support long-term financial stability. The disbursement of dividends is contingent upon adherence to capital adequacy and loan loss provisioning requirements, while the declaration of staff bonuses is strictly proscribed in the absence of making profits established under proper accounting standards.

#### **IV.5. The Shift to an Integrated Digital Payment Ecosystem**

To further incentivize the proliferation of Bangla QR, an interoperable QR code-based payment system, BB has promulgated a directive mandating that all payments executed via Bangla QR be instantaneously credited to merchants' accounts, effective from December 2025. Furthermore, the Ministry of Local Government has decreed that all city corporations and municipalities shall require retail enterprises to implement Bangla QR facilities as a prerequisite for the issuance or renewal of trade licenses. In pursuit of geographically targeted cashless initiatives, BB is collaborating with the Tourism Police, local authorities, and banks to institutionalize cashless and digital payments for hotels and merchants within the Cox's Bazar tourism precinct, thereby advancing secure, transparent, and digital transactions in principal tourism nodes. Simultaneously, BB is orchestrating the development of a unified payment interface designed to interlink all relevant players in the payment ecosystem and facilitate instantaneous fund transfers. Additionally, a Memorandum of Understanding has been signed with the Gates Foundation to support the rollout of the Instant Interoperable Payment System by June 2027, affording technical expertise and ensuring alignment with international best practices.

## Chapter V: Near and Medium-term Outlook and Challenges

Bangladesh economy is facing challenges in reviving its growth momentum while containing inflationary pressures. Following the successful and widely anticipated peaceful democratic transfer of power, the economy faces a significant external supply shock stemming from the ongoing conflicts in the Middle East. The disruption has created supply bottlenecks in fuel and liquefied natural gas (LNG), both of which are strategic commodities for the economy.

Inflationary pressures are expected to persist in medium term through September 2026 in response to the escalation in global oil prices and subsequent adjustments to administered domestic fuel and LPG prices, assuming the conflict in the Middle East will not be significantly prolonged, global supplies will gradually normalise, and the absence of any new exogenous shocks. Bangladesh Bank and the Government are working in close coordination to contain these pressures and bring inflation around 7.5 percent in June 2027. In the meantime, to mitigate the adverse effects of elevated inflation on low-income households, the Government will continue its subsidized truck-sale operations through the Trading Corporation of Bangladesh (TCB) and further expand the distribution of family cards and other targeted social assistance programs for vulnerable groups, and rationalize non-essential spending. Moreover, BB will maintain a tight monetary policy stance to reinforce its commitment to anchoring inflation expectations, containing demand-side pressures, and safeguarding overall macroeconomic and financial stability.

Regarding economic growth, it is expected to experience a gradual recovery, primarily supported by favorable agricultural production, and improving private sector confidence. According to the Asian Development Bank's (ADB) Asian Development Outlook (ADO), April 2026, Bangladesh's GDP growth is projected to remain around 4.0 percent in FY2026, which is still below the desired level. In this context, BB and the Government have undertaken a range of policy measures to stimulate economic activity and strengthen growth prospects. These include enhanced financing support for the agriculture and SME sectors, the continuation of the Export Development Fund (EDF) to promote export-oriented production, and initiatives to facilitate the reopening and rehabilitation of financially distressed industrial units. Together with ongoing structural reforms and improvements in the business environment, these measures are expected to support a stronger growth trajectory and help to raise GDP growth to around of 6.5 percent in FY2027.

However, the realisation of these inflation and growth objectives will depend on the economy's resilience to external shocks, including geopolitical tensions and commodity price fluctuations,

as well as the effective management of domestic challenges such as supply-chain constraints, weather related risks, energy market pressures, fiscal discipline, and the timely implementation of structural and financial sector reforms.

## Note

# Should Bangladesh Join a Currency Union in South Asia?

Akhand Akhtar Hossain<sup>2</sup>

## Introduction

The idea of countries with similar economic structures adopting a common currency became popular in the late 1990s. This idea came about following the successful introduction of the Euro in 1999 for most members of the European Economic Union. The theoretical basis of the formation of a currency union is Mundell's *Optimum Currency Areas* (OCA) (Mundell, 1961, 2003, McKinnon, 1963). The OCA comprises of some sovereign nations in one or more regions which are integrated in both the product and factors markets and affected by common economic shocks. Members of a currency union, like the European Economic Union, discard individual currencies and adopt a common currency to achieve economic-and political integration.

Over the past two decades, some political leaders in India have argued for the establishment of a currency union in South Asia. However, not many citizens outside India have taken this idea seriously. Aside from currency union, India does not show much enthusiasm for economic and political integration among South Asian countries. After the SAARC<sup>3</sup> meeting of the heads of government in Islamabad in 2004, where the SAFTA<sup>4</sup> agreement was signed, and some Indian politicians started arguing for the establishment of a currency union in South Asia. This followed former Indian Prime Minister Vajpayee's vision statement where he urged South Asian nations to put aside mistrust and dispel unwarranted suspicion to work for the integration of South Asian economies facing the challenges of globalisation. This positive sentiment was carried forward to the 11th SAARC summit in Kathmandu, Nepal in 2002. During this summit, a vision statement was adopted for the purposes of setting up the South Asian Economic Union in 2020, with the possibility of establishing a monetary union with a common currency (Gauchan and Sarin, 2018). Not much has changed since then.

Since the idea of a currency union in South Asia continues to flare up and down, this note argues that Bangladesh should avoid joining any monetary arrangement that undermines its ability to conduct independent monetary policy for price stability. This argument is developed here and analysed from a broader perspective.

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<sup>3</sup> SAARC represents the South Asian Association for Regional Cooperation.

<sup>4</sup> SAFTA represents the South Asian Free Trade Area.

## Review of the Literature

The issue of establishing a currency union in South Asia can be debated through the following areas: (1) the extent of trade integration among South Asian countries; (2) the extent of factor mobility among South Asian countries; (3) the nature of economic structures and the patterns of shocks to South Asian economies, and (4) the extent to which wages and prices are flexible within a country (Hassan, 2001; Maskay, 2001, 2003; Gauchan and Sarin, 2018).

Accordingly, several studies have investigated the feasibility of a currency union in South Asia. For example, Maskay (2003) has examined the appropriateness of a currency union based on economic characteristics in South Asian countries. His analysis suggests that South Asian countries are the least integrated and unsuitable candidates for the establishment of a currency union. Gauchan and Sarin (2018) have also reviewed the issues and argued for monetary cooperation but not for establishing a currency union in South Asia. They have stated that:

The increased number of positive correlations of output growth, inflation, exchange rates movement and supply shocks in the last two and half decades compared to earlier studies suggest that there is macroeconomic convergence among the countries. This underpins the basis for moving towards greater monetary cooperation in South Asia in spite of the fact that it is not feasible to pursue a goal of a monetary union with single currency immediately. (p.598)

In the extant literature on currency union, there is a view that even when economic characteristics do not justify the formation of a currency union, if there is political will, the countries involved can change economic structures such that economic conditions needed for the establishment of a currency union are met *ex post*. This raises the question of whether there have been any concerted efforts in South Asia over the past few decades to integrate product and factor markets. The answer is no, and the prevailing condition is unlikely to change in the near future. South Asian countries as a matter of historical legacy have developed economic and political institutions un conducive to economic cooperation and integration.

While an argument could be made that the removal of tariff and non-tariff barriers to trade in goods and services would expand intra-industry trade in South Asian countries, such trade is unlikely to be large unless these countries dismantle the existing tariff and non-tariff barriers to trade in goods and services. This is a big ask and not a realistic one within the existing economic and political configurations.

Under the present global trading arrangements, smaller economies remain in an advantageous position with respect to the import of high-quality capital and intermediate goods from advanced countries. Such imports are growth promoting as they raise productive capacity and economic

efficiency. Since exports and imports are mutually dependent as high-quality imports lead to high-quality exports. The main benefit of economic openness is that technological progress is transmitted through foreign trade in goods, services and assets. The formation of currency union undermines this channel of raising economic efficiency and growth.

Under a currency union with the option of forming an economic union, the smaller economies of South Asia would have to shift their sourcing of capital and intermediate goods from many advanced countries to India for example. Since the quality of capital and intermediate goods of India is lower than those of advanced countries, any trade diversion from advanced countries to India would invariably lower the quality of products destined for consumption or exportation or both. Smaller South Asian countries would therefore lose from trade diversions to larger economies, such as India.

Nevertheless, in the absence of a currency union, there would still have some potential for intra-industry trade in South Asian countries. This is because these countries with similar technological base and level of development can produce differentiated products and then export and import among themselves simultaneously. Although traditional theories suggest that foreign trade emerges from the principle of comparative advantage, recent trade theories suggest the possibility of intra-industry trade among countries with similar endowments and comparative advantage in products that they can export and import simultaneously.

Unfortunately, the volume of intra-industry trade would not increase much until the mercantilist outlook of certain, if not all, South Asian countries changes. The present state of the bilateral trade between Bangladesh and India can be used as an example. As a small country, Bangladesh has the potential to produce and export many labour-intensive, differentiated products that India produces and consumes. However, Bangladesh has maintained huge trade deficits with India over several decades. The major obstacles of Bangladesh's exports trade to India are tariff and non-tariff barriers. This indicates that the difficulties in the removal of tariffs and non-tariffs are obstacles to the expansion of regional trade than any transaction costs of trade arising from the use of international currency. Bangladeshi businesses are aware of the difficulties in exporting goods to India due to tariff and non-tariff barriers.

Finally, although goodwill among leaders in South Asia may create opportunities for institutionalising initiatives for economic integration, the political and economic aspirations of South Asian countries remain fundamentally different. As a historical legacy, South Asian countries are guarding their national independence and remain unwilling to surrender policy autonomy to the bureaucracy of any institution operating within a currency union that could be dominated by one or two larger countries such as India and Pakistan. Furthermore, although India, by virtue of economic size and resources, expects to be the natural leader in South Asia,

this situation is unacceptable to other regional countries. The moribund state of the SAARC is an example of political non-cooperation among South Asian countries and there are other issues as well. For example, there is not much scope for large-scale labour mobility among countries in South Asia. Each country in this region guards its borders zealously and remains suspicious of citizens from other countries. Similarly, capital mobility among these countries is seen with suspicion and these countries consider it harmful to domestic industrial development. There is also fear that if capital moves from the poorer regions to the relatively developed areas, they can cause uneven economic growth and adverse distributions of income and wealth. Therefore, in summing up, the idea of economic integration among South Asian economies is unlikely to make any progress in the near future as all South Asian countries are bound by their own traditions, languages, religions and cultures. Cooperation among them is desirable but not inevitable. Since the idea of economic and political integration remains politically sensitive, not much is expected under the present economic and political configurations.

## **Conclusion**

This note has defined the concept of currency union and has reviewed the possibility of establishing a currency union among South Asian countries. In general, when some individual countries integrate product and factor markets and experience common shocks, they can benefit from establishing a currency union. The presumption is that the loss of monetary policy under a currency union would be smaller than the benefits they could gain from the reduction of transaction costs in trade of goods and services. An increase in the mobility of both labour and capital and any technological progress within the region is expected to raise productivity and hence economic growth. However, this is unlikely in the case of South Asia. This note has highlighted key issues in labour and capital mobility that would influence the success of a currency union in South Asia. Mundell (1961) made the point that unless factors of production (labour and capital) move freely between regions, any shifts in demand facing one region relative to another would lead to unemployment if the nominal exchange rate is not made flexible. Here follows the policy implication of the issues reviewed above for Bangladesh.

The formation of a currency union in South Asian countries would create a constraint on monetary policy for an emerging market economy such as Bangladesh. As one of the major economies in South Asia, Bangladesh should retain monetary policy independence for price stability under a flexible exchange-rate system. Since the early 1990s, Bangladesh has integrated with the global trading system. Bangladesh's economy has therefore become exposed to external shocks. In an open economy, exchange rates act as a shock absorber and hence can be deployed for macroeconomic adjustment to external shocks. As wages and prices are generally rigid, the exchange rates are considered more effective in adjusting aggregate demand in response to

external shocks. For a country like Bangladesh, fiscal policy is equally important as an instrument of demand management and economic stabilisation. More significantly, fiscal policy supports monetary policy and raises its credibility and effectiveness in sustaining price stability. Overall, despite different trade-offs and uncertainties, fiscal, monetary and exchange rate policies, individually and jointly, remain useful in managing both internal and external balances. Below additional comments are made on the desirability of an independent monetary policy for Bangladesh from a longer-term context.

Bangladesh's economy has steadily grown since the mid-1980s when it became deregulated and opened to foreign trade and investment. To conduct independent monetary policy, the exchange rate became flexible. Bangladesh Bank (Bangladesh's central bank) has also enhanced technical capacity to formulate a rules-based monetary policy for price stability. Finally, under IMF-World Bank surveillance, the formulation of fiscal policy has improved and become disciplined although there is scope for institutionalising a rules-based fiscal policy needed for making fiscal policy compatible with the stance of monetary policy. Therefore, it is possible to say that if Bangladesh can avoid major economic and political crises, it has the potential to become an advanced middle-income country within the next two decades. To consolidate its economic standing, Bangladesh needs to formulate and sustain disciplined monetary, fiscal and exchange rate policies and avoid inflation and debt problems.<sup>5</sup> While it is true that monetary policy cannot be used to promote long-term economic growth, the availability of monetary policy as the instrument of monetary policy gives confidence to policy-makers that they can deploy monetary policy for demand management as and when needed. In contrast, the main benefit that a currency union provides to a small country is the reduction of trade costs, including any costs that originate from transactions in foreign currency. It seems that Bangladesh would do better if it avoids joining in any monetary arrangement in South Asia that would restrict its monetary policy independence.

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Alesina and Barro (2000) show that the type of country with the strongest incentive to give up its own currency is a small country with a history of high inflation that is close (in a variety of different ways) to a large and monetarily stable country. Bangladesh does not have incentives to discard its currency, especially when the average rate of inflation in this country has remained at a low, moderate level and therefore not much can be gained from anchoring its currency to a low inflation country such as the United States.

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