Monetary Policy Review

2024-25

Bangladesh Bank

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Chief Economist's Unit
Bangladesh Bank
July 2025

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Message

Bangladesh's economy is currently navigating a challenging macroeconomic environment marked by moderately high inflation, external pressures, and underlying vulnerabilities in the financial sector. The current interim government has been striving to maintain macroeconomic stability despite starting its journey in an uncertain economic environment. Although FY25's economic growth was slower at 3.97 percent, recent months have seen a drop in inflation rates. Notwithstanding persistent global uncertainties stemming from trade tensions and geopolitical conflict, a rebound is anticipated in FY26, supported by ongoing structural and strategic economic reforms.

The Bangladesh Bank (BB) has taken coordinated measures to control inflation, stabilise the foreign exchange market, and reform the banking sector. Inflation dropped to 8.48 percent in June 2025, the lowest since February 2023, mainly due to BB's tight monetary policy. With positive global commodity trends and ongoing policy support, BB is optimistic about a further decline in inflation. To address long-standing structural weaknesses, restore financial stability, strengthen governance, and enhance the sector's resilience, the Banking Sector Reform Taskforce was established by BB on September 11, 2024. Additionally, BB transitioned from a crawling peg to a flexible exchange rate system, effective as of May 14, 2025. This transition marks a significant milestone in modernising the country's economic policy. The initiative is expected to enhance the performance of the external sector and bolster the competitiveness of Bangladeshi exports by accurately reflecting prevailing market dynamics, increasing the attractiveness of foreign investment, and facilitating the accumulation of foreign reserves. It is noteworthy to highlight that the substantial increase in remittance inflows observed during FY25 can be attributed to a series of thoughtful reforms such as the implementation of a unified and market-aligned exchange rate, measures to curb informal transfers, the expansion of remittance channels, and the introduction of the 'Probash' pension scheme for expatriates.

The Monetary Policy Review (MPR) 2025 is a comprehensive analysis of the prevailing macroeconomic, monetary, and financial sector conditions. The primary objective of this Review is to proactively discern potential near and medium-term challenges within the existing monetary policy stance, accompanied by a rigorous assessment of the efficacy of our policy interventions. This Review is intended to enhance transparency and informed public discourse while also offering valuable insights to policymakers, researchers, and market participants. Additionally, this MPR aims to serve as an indispensable resource for policymakers in formulating future monetary policy strategies by scrutinising the impacts of prior measures.

I believe that this MPR will serve as an essential resource for stakeholders to understand current trends and emerging salient issues. It is my great pleasure to warmly thank the Chief Economist's Unit for their diligent efforts in preparing this detailed and insightful Review. I also extend my sincere thanks to all supporting departments for their valuable contributions to this Review. In 2025, we will work together to implement the changes we have initiated, leading to a more innovative, agile, and transparent Bangladesh Bank.

Dr. Ahsan H. Mansur
Governor

Contents

List of Abbreviations

ALS	Assured Liquidity Support
ADP	Annual Development Programme
ADR	Advance-Deposit Ratio
ADs	Authorised Dealers
AR	Assured Repo
ASEAN	Association of South East Asian Nations
AQR	Asset Quality Review
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BFIU	Bangladesh Financial Intelligence Unit
BMPI	Building Material Price Index
BoP	Balance of Payments
BRO	Bank Resolution Ordinance
BRRF	Bank Restructuring and Resolution Fund
BRRU	Bank Restructuring and Resolution Unit
BSEC	Bangladesh Securities and Exchange Commission
BSR-TF	Banking Sector Reform Task Force
CAB	Current Account Balance
CEPAs	Comprehensive Economic Partnership Agreements
CMSME	Cottage, Micro, Small and Medium Enterprises
COVID	Corona Virus Disease
CPI	Consumer Price Index
CPMR	Crawling Peg Mid Rate
CRAR	Capital to Risk-weighted Asset Ratio
CRR	Cash Reserve Requirement
DSE	Dhaka Stock Exchange
DSEX	DSE Broad Index
EMDEs	Emerging Market and Developing Economies
EPZ	Export Processing Zone
FCBs	Foreign Commercial Banks
FCDO	Foreign, Commonwealth & Development Office
FDI	Foreign Direct Investment
FPMU	Food Planning and Monitoring Unit
FTA	Free Trade Agreement
FY	Fiscal Year
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GoB	Government of Bangladesh
HRI	House Rent Index
ICB	Investment Corporation of Bangladesh
IMF	International Monetary Fund
IRC	Interest Rate Corridor
IS	Investment-Savings
LDC	Least Developed Country
IDLF	Intra-Day Liquidity Facility
IFS	International Financial Statistics
LNG	Liquefied Natural Gas
IT	Information Technology
M2	Broad Money
MCCI	Metropolitan Chamber of Commerce and Industry
MCR	Minimum Capital Requirement
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets
NPLs	Non Performing Loans
OMOs	Open Market Operations
PCB	Private Commercial Banks
PMI	Purchasing Managers' Index
PPI	Producers Price Index
PTAs	Preferential Trade Agreements
REER	Real Effective Exchange Rate
RM	Reserve Money
RMG	Ready-Made Garments
RMP	Reserve Maintenance Period
ROA	Return on Assets
ROE	Return on Equity
SBs	Specialised Banks
SCBs	State-owned Commercial Banks
SDF	Standing Deposit Facility
SIPMM	Singapore Institute of Purchasing and Materials Management
SLR	Statutory Liquidity Ratio
SLF	Standing Lending Facility
SMART	Six months Moving Average Rate of Treasury Bills
SME	Small and Medium Enterprises
USD	United States Dollar
UK	United Kingdom
WEO	World Economic Outlook
WRI	Wage Rate Index
WTO	World Trade Organisation
Y-o-Y	Year on Year

Executive Summary

In 2024, the global economy started to exhibit early signs of recovery following several years of exacerbated shocks and disruptions. The reduction in inflation, along with a cut in the policy rate in major economies, has made the short-term economic outlook optimistic. However, this outlook was overshadowed by rising trade tensions, especially after the US imposed broad tariffs on major trading partners. The new US trade policies have reintroduced uncertainty into the international economic environment. Consequently, there is growing concern that these events may jeopardise the fragile recovery and impede the prospects for global growth in the near future. According to the IMF's World Economic Outlook (WEO), April 2025, global economic growth is projected to decline from an estimated 3.3 percent in 2024 to 2.8 percent in 2025.

At the beginning of FY25, the Bangladesh economy encountered significant economic disruptions across all three major sectors– agriculture, industry, and services – following the student-people uprising in July and August 2024. Moreover, when the new interim government began its journey with greater commitments toward economic reforms, the country experienced output losses due to several rounds of floods in many districts from August to October 2024. As a result, economic activities slowed down, with a provisional GDP growth rate of 3.97 percent for FY25, which is lower than the 4.22 percent recorded in FY24.

Despite the government and BB had taken several tightening policy measures to control inflation, the inflation remained elevated for an extended period and reached a record peak of 11.66 percent in July 2024. The reasons explaining the upward trend in inflation include- an accommodative monetary policy since 2020, marked by delayed and inadequate interest rate adjustments, a sharp depreciation of the Bangladesh Taka, domestic energy price adjustments, and disruptions caused by the floods in 2024. Prioritising inflation control, BB continued to pursue a tighter monetary policy stance during the first half of FY25 (July-December 2025). During this period, BB raised the policy interest rate three times, each time by 50 basis points, raising it to 10.00 percent from 8.50 percent. Considering the persistently high inflation, BB opted to maintain its tight monetary policy stance for the second half of FY25 (January-June 2025) and kept the policy rate unchanged at 10.0 percent. Maintaining a tight monetary policy stance throughout the latter half of FY25 seems prudent to control inflation and anchor inflation expectations. The headline inflation stood at 8.48 percent in June 2025 down from 9.05 percent in May, which marks the lowest inflation rate since February 2023.

During July-May of FY25, the external sector of Bangladesh demonstrated resilience supported by robust export performance, a sharp rise in the inflow of workers' remittances, a stable exchange rate, and an improvement in the balance of payments position reflecting the economy's improved capacity to absorb adverse global macro-financial shocks, reinforcing overall macroeconomic and financial stability. During July-May of FY25, the current account deficit narrowed to USD 0.43 billion compared to USD 6.12 billion during the same period in FY24. This improvement was driven mainly by a sharp rise in workers' remittance inflows by 28.7 percent. The overall balance of payments deficit declined to 1.15 billion during this period, compared to 5.89 billion during the same period in FY24. Between July 2024 and June 2025, the Bangladeshi Taka (BDT) exchange rate against the USD depreciated by 3.94 percent, reflecting the stability of the exchange rate under a market-oriented exchange rate system.

Looking ahead, the analyses of this report indicate that the real policy rate has been positive since January 2025, which is expected to significantly contain the inflationary pressure in FY26, and the rate is expected to come down to 6.50 percent by FY26. Once the inflationary pressure subsides, domestic demand is anticipated to be boosted, and the GDP growth rate is expected to achieve the 5.50 percent target for FY26, supported by ongoing structural and strategic economic reforms. However, although Bangladesh's external sector has shown a strong performance in recent months in FY25, potential uncertainties stemming from global trade tensions and geopolitical conflicts remain a concern for this sector.

Chapter I: Monetary Policy Stance

I.1 Review of Monetary Policy Stance in 2024

Monetary Policy Stance for January –June 2024

In 2023, the global economy experienced subdued growth, which was attributed to tight monetary policies implemented in response to persistent inflationary pressures. Similarly, Bangladesh's economy was grappling with significant macroeconomic headwinds, including heightened inflation, diminishing foreign exchange reserves, and exchange rate volatility, which were exacerbated by a burgeoning balance of payments deficit, tight liquidity situation, and persistently high levels of non-performing loans during July-December'23. To address these intricate economic landscapes, Bangladesh Bank (BB) continued to adopt a tight monetary policy for H2FY24 to curb inflation, anchor inflation expectations, and maintain macroeconomic stability. Accordingly, BB raised the policy interest rate by a cumulative 75 basis points during H2FY24, and narrowed the policy interest rate corridor to ±150 basis points. In addition, BB discontinued the devolvement of T-bills and T-bonds, considering the multiplier effect of high-powered money on inflation. Moreover, the SMART- based interest rate cap was scrapped, allowing the market to determine the interest rates. Furthermore, BB introduced a crawling peg exchange rate system to manage abrupt fluctuations in the exchange rate and mitigate inflationary pressure stemming from exchange rate pass-through to inflation.

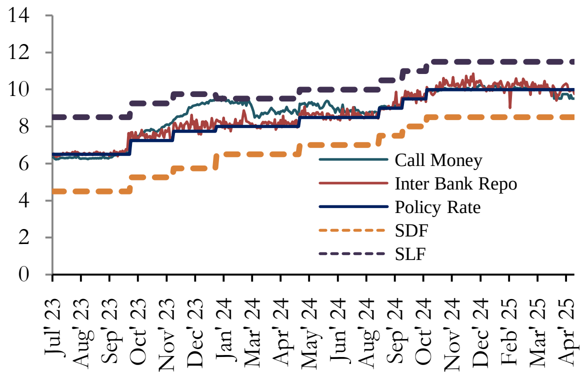
Monetary Policy Outcomes (January –June 2024)

Despite various fiscal and monetary policy measures, inflation remained above 9.0 percent during H2FY24. The point-to-point inflation rate decreased to 9.72 percent in June 2024 from 9.74 percent in June 2023. However, the CPI-based average headline inflation increased to 9.73 percent in June 2024, up from 9.02 percent in June 2023. During this period, food inflation played a more significant role than non-food inflation in contributing to headline inflation. Furthermore, core inflation (excluding food and fuel) also declined, averaging 7.36 percent in June 2024 compared to 8.53 percent in June 2023. This inflationary episode was initially triggered by significant depreciation of the BDT against the USD, disruptions in the domestic supply chain due to market distortions, and high inflation expectations. Over time, inflation became more entrenched due to second-round effects from domestic fuel and energy price adjustments.

There were significant changes in the money market stemming from BB's shift in its monetary policy framework—from monetary targeting to interest rate targeting. As a result, both short-term and long-term interest rates increased markedly during H2FY24. Regarding short-term rates, the weighted average call money rate rose to 9.08 percent by June 2024, up from 6.06 percent in June 2023 (Chart I.1). Similarly, the interbank average repo rate climbed to 8.56 percent from 6.16

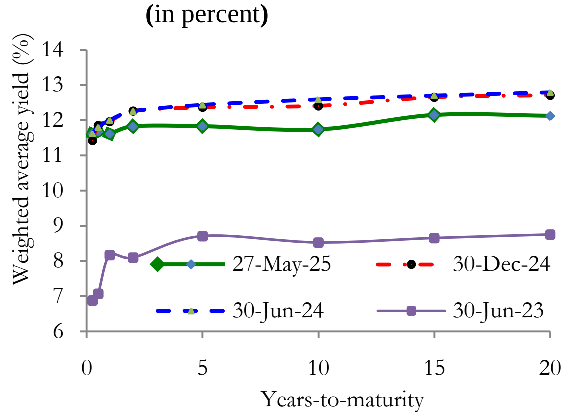
percent over the same period. The interbank call money rate, which is the operating target of monetary policy, was effectively contained within the Interest Rate Corridor (IRC) (Chart I.1).

Chart I.1: Movements of IRC and Call Money Rate (in percent)



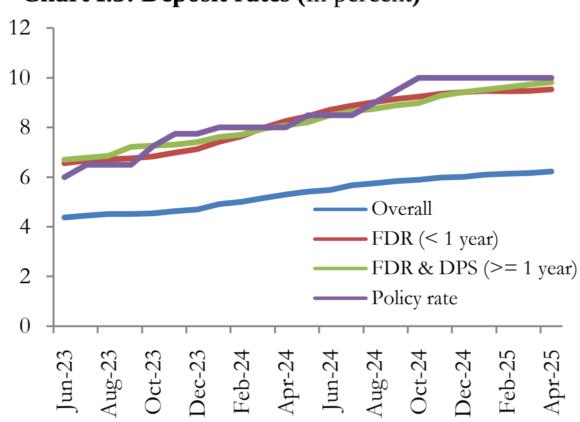
Source: Bangladesh Bank.

Chart I.2: Yields on Government Securities (in percent)



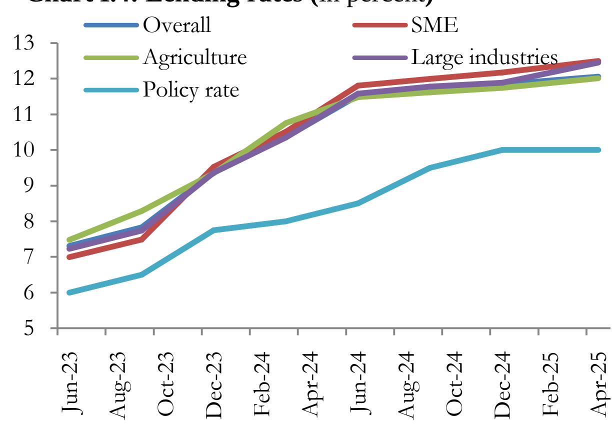
Source: Bangladesh Bank.

Chart I.3: Deposit rates (in percent)



Source: Bangladesh Bank.

Chart I.4: Lending rates (in percent)



Source: Bangladesh Bank.

It may be noted that high short-term interest rates significantly impacted lending and deposit rates for various financial transactions. Consequently, lending and deposit rates also rose notably during H2FY24. The lending rate for the large industry sector rose from 7.23 percent in June 2023 to 11.58 percent in June 2024. Lending rates for the SME and agriculture sectors also experienced notable increases, climbing from 6.99 percent and 7.48 percent, respectively, in June 2023 to 11.80 percent and 11.48 percent by June 2024 (Chart I.4). Deposit rates for tenures of less than one year and more than one year also increased and reached 8.72 percent and 8.50 percent, respectively, at the end of June 2024, from 6.56 percent and 6.71 percent in June 2023 (Chart I.3). At the same time, the yield curve displayed a significant upward shift (Chart I.2), reflecting a broad-based increase in interest rates due to tight liquidity in the money market and the implementation of a tight monetary policy by the BB.

However, remarkable change in the short-term as well as long-term interest rates during H2FY24 were driven by several key factors, including the removal of the SMART lending rate cap, a cumulative 75 basis point increase in the policy interest rate as part of the contractionary monetary stance, and a narrowing of the interest rate corridor from ±200 basis points to ±150 basis points.

Table I.1 presents the actual monetary aggregates and their projections for H2FY24. Regarding the monetary landscape, broad money (M2), an indicative target of monetary policy, experienced a year-on-year growth of 7.7 percent in June 2024, falling short of the projected 9.7 percent growth for June 2024, linked to a decline in the net foreign assets (NFA) of the banking system. Reserve Money (RM), another key information variable of monetary policy, increased by 7.9 percent year-on-year by the end of June 2024, exceeding the projected trajectory for H2FY24. This increase was due to the positive growth in net domestic assets (NDA). This higher positive growth in NDA was caused by huge liquidity support provided by BB to some liquidity deficit banks.

Table I.1: Developments of Monetary Aggregates

(Y-o-Y Growth %)

Item	Jun-23	Dec-23	Jun-24	
	Actual	Actual	Projection.	Actual
Broad money	**10.5**	**8.6**	**9.7**	**7.7**
Net Foreign Assets*	-23.4	-21.8	-2.4	-17.1
Net Domestic Assets	21.3	16.0	12.1	12.8
Domestic Credit	15.3	11.6	13.9	10.0
Credit to the public sector	35.8	17.9	27.8	10.5
Credit to the private sector	10.6	10.1	10.0	9.8
Reserve money	**10.5**	**-2.0**	**-1.0**	**7.9**
Money multiplier	4.93	5.13	5.46	4.92

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

During the second half of FY24, private sector credit expanded by 9.8 percent by the end of June 2024, closely aligning with the projected growth rate of 10.0 percent for June 2024, despite facing higher borrowing costs due to the implementation of contractionary monetary policy. In contrast, public sector credit grew by 10.5 percent in June 2024, significantly below the projected growth rate of 27.8 percent for June 2024. This subdued growth in public sector credit indicated reduced demand from the government, which had been selectively allocating funds to priority projects as part of austerity measures. Overall, domestic credit dynamics in FY24 remained below projections, largely driven by robust growth in private sector credit and moderated expansion in public sector credit.

In FY24, the deficit in the balance of payments (BoP) exerted significant pressure on the exchange rate. To restore external balance and stabilise the foreign exchange market, BB initially responded by allowing greater flexibility in the exchange rate, accompanied by net selling interventions in the foreign exchange market. At the same time, BB adopted a crawling peg exchange rate system as an interim measure before transitioning to a more flexible exchange rate regime. As a result of the policy initiatives undertaken by BB, the exchange rate of the BDT against the USD stood at 118.0 at the end of June 2024, and the nominal exchange rate of BDT/USD depreciated by 8.17 percent during FY24.

Monetary Policy Stance for July- December 2024

During H1FY25, Bangladesh Bank (BB) pursued a contractionary monetary policy stance to manage persistent inflationary pressures, ease external sector imbalances, and ensure exchange rate stability. Despite a global trend of easing inflation and policy rate cuts in major economies during 2024, domestic inflation remained above 9.0 percent in H2FY24, which prompted BB to maintain a tight monetary policy stance. To anchor inflation expectations at the desired level, BB raised the policy rate by 150 basis points during H1FY25. Additionally, BB decided not to intervene in the foreign exchange market, as it exhibited reasonable stability and transactions were occurring within the predefined bands.

Monetary Policy Outcomes (July- December 2024)

Prioritising inflation control, BB implemented a tight monetary policy stance during H1FY25 to curb persistently high inflation and manage inflation expectations effectively. Despite the GoB and BB had taken several fiscal and monetary policy tightening measures to contain inflation, the rate stubbornly stayed above 9.0 percent for an extended period of time. The point-to-point inflation rate increased to 10.89 percent in December 2024 compared to 9.72 percent in June 2024. Meanwhile, average headline inflation rose to 10.34 percent in December 2024 from 9.73 percent in June 2024. Among the components contributing to headline inflation, the prominence of food inflation outweighed non-food inflation during the period under review. Additionally, core inflation (excluding food and fuel), an important indicator closely linked to monetary policy, continued to show a rising trend and reached 10.29 percent in December 2024 compared to 8.10 percent in June 2024.

Several factors contributing to this sustained inflation include an excessively accommodative monetary policy since 2020, marked by delayed and inadequate rate adjustments (please see Chart I.5 for real policy rate of Bangladesh), a sharp depreciation of the Bangladesh Taka, which has led to inflationary pass-through effects, energy price adjustments, and disruptions caused by the twin floods in August and September 2024.

During H1FY25, the local money market experienced significant improvement in interest rates, primarily due to the implementation of a contractionary monetary policy and tight liquidity conditions. Consequently, the weighted average call money rate increased to 10.07 percent by December 2024, up from 9.08 percent in June 2024. Similarly, the interbank average repo rate rose to 10.36 percent by December 2024, compared to 8.56 percent in June 2024. The interbank call money rate remained within the Interest Rate Corridor (IRC). Following the policy rate hike, the short-term interest rates saw substantial increase, leading to notable rises in the lending and deposit rates across various financial transactions in H1FY25.

Table I.2: Developments of Monetary Aggregates

(Y-o-Y Growth %)

Item	Actual		Projection
	Jun-24	Dec-24	Dec-24
Broad money	**7.7**	**7.6**	**8.2**
Net Foreign Assets*	-17.1	-15.7	2.3
Net Domestic Assets	13.5	11.9	9.3
Domestic Credit	10.0	9.4	10.7
Credit to the public sector	10.5	18.1	14.2
Credit to the private sector	9.8	7.3	9.8
Reserve money	**7.9**	**7.3**	**2.0**
Money multiplier	4.92	5.15	5.45

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

Specifically, the weighted average nominal lending rate grew from 11.52 percent in June 2024 to 11.84 percent in December 2024. Likewise, the weighted average nominal deposit rate increased from 5.49 percent in June 2024 to 6.01 percent in December 2024. Notably, the yield on government securities at the end of December 2024 was lower than at the end of June 2024, indicating an easing of liquidity conditions in the money market.

Table I.2 represented the actual monetary aggregates and their projections for H1FY25. With respect to monetary developments, broad money (M2), an information variable of monetary policy, witnessed a year-on-year growth of 7.6 percent in December 2024 against the projected growth of 8.2 percent for December 2024. The broad money recorded a lower growth compared with the projected growth path due to the negative growth in NFA. Reserve Money (RM), another indicative target of monetary policy, experienced a robust growth of 7.3 percent (y-o-y) by the end of December 2024. The growth of RM exceeded the projected trajectory set in December 2024 due to the strong growth in BB's net domestic assets (NDA). The positive growth of NDA is mainly driven by BB's significant liquidity support to some banks for their daily liquidity needs.

Exchange rate pressures, which had intensified in FY24, eased in H1FY25 due to an improved BoP position. BB adopted a more flexible exchange rate policy, which enhanced exchange rate stability, improved market confidence, and contributed to a more sustainable foreign exchange market outlook. The nominal exchange rate of the Bangladeshi Taka (BDT) depreciated modestly by 1.7 percent in H1FY25, reaching 120 per USD, compared to 8.2 percent depreciation in FY24.

I.2 Current Monetary Policy Stance and Progress

Monetary Policy Stance for January-June 2025

BB opted to maintain a tight monetary policy stance for H2FY25 by considering the domestic macroeconomic challenges such as persistently high inflation, decelerating GDP growth, exchange rate volatility, stagnant private investment, rising public debt, and alarmingly high levels of non-performing loans. Although inflation has moderated in recent months, it remains above the target range, justifying BB's decision to continue its tight monetary stance for H2FY25. Accordingly, the policy repo rate has been maintained at 10.0 percent, while the Standing Lending Facility (SLF) and Standing Deposit Facility (SDF) rates remained unchanged at 11.5 percent and 8.5 percent, respectively. Maintaining a tight monetary policy stance throughout the latter half of FY25 seems prudent to control inflation and anchor inflation expectations.

Progress

Regarding price developments, headline inflation and its components— food and non-food inflation have demonstrated a gradual easing after remaining persistently high for an extended period. Based on the latest available data, the headline inflation reached to 8.48 percent in June 2025, compared to 9.72 percent in June 2024. Moreover, food inflation declined to 7.39 percent in June 2025, compared to 10.42 percent in June 2024. Furthermore, non-food inflation reached 9.37 percent in June 2025, compared to 9.15 percent in June 2024. The observed decline in headline inflation was primarily a consequence of several demand-side and supply side measures taken by the GoB and BB. These measures including BB's tight policy measures, effort to stabilise exchange rate, reduced tariffs on some necessary food items by the GoB, facilitating the steady supply of monsoon vegetables, and declining global commodity prices.

As per available data, the weighted average call money rate remained unchanged at 10.1 percent at the end of May 2025, the same as in December 2024. Similarly, inter-bank repo rate also remained at 10.4 at the end of May 2025, the same as in December 2024. The deposit rate stood at 6.2 percent at the end of April 2025 compared to 6.0 percent at the end of December 2024. The lending rate stood at 12.1 at the end of April 2025 compared to 11.8 at the end of December 2024. It is noticeable that the yield curve at the end of May 2025 shifted lower compared to end of December 2024, implying lower interest rate and easing of the liquidity situation.

Table I.3 presents the actual development and projections of monetary aggregates for FY25. Broad money growth recorded 7.7 percent at the end of April 2025 compared to a projection of 8.4 percent at the end of June 2025. The slower growth of broad money compared to the projected growth is primarily due to the lower growth in net foreign assets (NFA). Private sector credit growth stood at 7.5 percent at the end of April 2025 compared to a projection of 9.8 percent at the end of June 2025. The ongoing deceleration of private sector credit is not the result of policy rate hikes but rather a combination of several other factors. These factors include energy price adjustments, disruptions caused by the twin floods, and declining investor confidence in the absence of an elected government. The public sector stood at 10.0 percent also remains below the projected path, mainly due to austerity measures taken by the government and slower-than-expected ADP implementation.

Table I.3: Development and Projection of Monetary Aggregates

(Y-o-Y growth in %)

Items	Actual			Projection
	Jun-24	Dec-24	Apr-25	Jun-25
Broad Money (M_2)	7.7	7.6	7.7	8.4
Net Foreign Assets#	-17.4	-15.7	1.4	7.7
Net Domestic Assets#	13.5	11.9	8.8	8.5
Domestic Credit	10.0	9.4	8.1	12.0
Credit to Public Sector	10.5	18.1	10.0	19.8
Credit to Private Sector	9.8	7.2	7.5	9.8

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

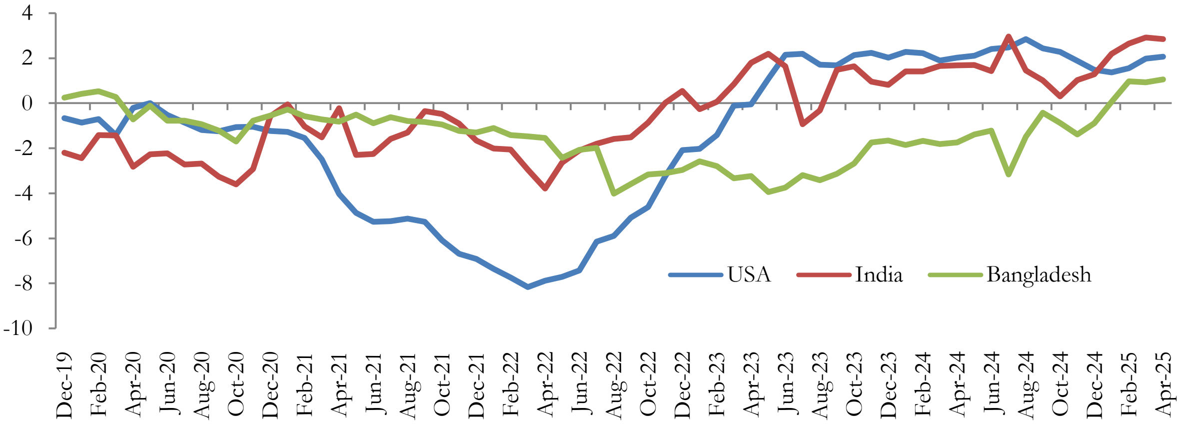
The improvement in the BoP has effectively diminished pressure on the exchange rate. The nominal exchange rate of the BDT against the USD has been stable since January 2025. The BDT depreciated by 4.0 percent in FY25 (Up to 29 May 2025), following a substantial depreciation of 8.2 percent in FY24.

Is Monetary Policy in a Tight Spot?

Bangladesh economy experienced persistent high inflation for a longer period of time. Globally, pursuing a tight monetary policy is recognised as a way to deal with high inflation. Accordingly, BB adopted a contractionary monetary policy stance since May 2022, significantly increasing the policy rate by a total of 525 basis points and avoiding new high-powered money issuance for government spending to curb persistently high inflation. Although BB significantly increased the policy rate, is monetary policy actually tight, or does it remain loose?

Prior to the COVID-19 pandemic, all three countries maintained relatively loose monetary policies, as evidenced by real policy rates—adjusted for inflation—that hovered near zero. In response to the pandemic, central banks further reduced policy rates, while governments introduced fiscal stimulus packages to cushion the economic shock across various sectors. This combination of global supply chain disruptions, expansionary monetary policy, and large-scale fiscal support led to a surge in inflation, which peaked in June 2022.

Chart I.5: Real Policy Rates (in percent)



Source: Bank for International Settlements and respective Central Bank.

To combat this elevated inflation, the central banks of the United States and India implemented timely policy rate hikes, resulting in real policy rates turning positive within a year, supported by a significant decline in inflation. Since then, both countries have maintained positive real policy rates for approximately two years and have successfully reached their inflation targets. In contrast, Bangladesh's monetary policy has been characterised by delays and inadequate adjustments, keeping its real policy rate in negative territory for an extended period, lasting until January 2025 (Chart I.5). This observation can also be complemented by presenting an estimate of natural rate of interest while comparing it with real policy rate (Box 1 estimates the natural rate of interest and output gap applying semi-structural model).

From the discussion above, it is evident that, unlike the swift and decisive actions taken by the United States, India, and many other advanced and emerging economies—which promptly raised policy rates and completed their tightening cycles within a year—Bangladesh responded more slowly. Although Bangladesh's real policy rate is now positive, it remains below the levels observed in the United States and India, indicating that the country is not currently in a tight spot compared to them. However, if the recently achieved positive real policy rate can be sustained for another two years—as was the case in the United States and India—Bangladesh is expected to achieve its medium-term inflation target of 5 percent.

BOX 1: Measuring the Natural Rate of Interest and the Output Gap#

This box presents an estimate of the natural rate of interest, henceforth r^*, for Bangladesh, based on the well-known semi-structural approach. Introduced in 1898 by Knut Wicksell, the natural interest rate remains at the core of modern macroeconomics. It refers to the short-term real interest rate consistent with output converging to its long-term potential and stable inflation. BB has adopted an interest rate-based monetary policy framework, so a reasonable estimate of r* would serve as one of the benchmarks for evaluating the effectiveness of the stance of monetary policy. The monetary policy is considered "expansionary" if the actual short-term real interest rate is below the r^*, and "contractionary" if it exceeds the r^*.

This box also attempts to estimate the output gap, derived from the difference between actual and estimated potential output, applying the Bayesian estimation method of a semi-structural model. The estimated output gap helps to observe its relationship with the real interest rate gap, which is an important input for policymakers to understand the path of economic performance.

Economic theory implies that the natural rate of interest is time-varying in response to factors such as structural changes related to economic activity and prices. Therefore, rendering comparisons between the real policy rate and the unconditional mean or long-run average of r^* is problematic. However, this time variability would not be an issue if one could observe r^* accurately and in real time. Since r^* is directly unobservable, it needs to be inferred from the data. Researchers often estimate the level of r^* by making assumptions about its composition. For instance, Laubach and Williams (2003), and Lewis and Vazquez-Grande (2019) modeled two processes: shocks to aggregate supply and shocks to aggregate demand, driving the r^*.

This exercise adopts the Lewis and Vazquez-Grande (2019) model of r^* for Bangladesh, further built on Laubach and Williams (2003) to estimate filtered and smoothed estimates of r^*.

The r^* Model

The estimated model is semi-structural, featuring a dynamic investment-saving (IS) and a Phillips curve relationship drawn within the New Keynesian framework. It models how the output gap and inflation evolve in response to deviations of the real interest rate from its natural level. The model includes the following six equations.

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

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

$$r_t^* = g_t + z_t \tag{3}$$

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

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

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

where y is log-real gross domestic product (GDP), y^* is log-potential GDP, and output gap, $\tilde{y} \equiv y - y^*$. 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, y_t^*, and g_t, with each following an autoregressive process.

Data and Estimation

The model uses transformed quarterly data on real GDP from the BBS; quarterly inflation, calculated from consumer price index from the International Financial Statistics (IFS); the four-quarter moving average of inflation in period t as a proxy for inflation expectations, following Holston, Laubach, and Williams (2017) and the repo rate as the short-term interest rate. The estimation sample spans 2004:Q2 to 2024:Q2.

The model equations can be cast into the following state space form (transition equation (eq. 7) and observation equation (eq. 8)) using the standard formulation:

$$s_t = As_{t-1} + Bu_t + Cw_t \tag{7}$$

$$x_t = Ds_t + Fu_t + Gw_t \tag{8}$$

with $s_{t=}[y_t^*, y_{t-1}^*, y_{t-2}^*, g_{t-1}, g_{t-2}, z_{t-1}, z_{t-2}]'$, $x_t = [y_t, \pi_t]'$, $w_t = [\varepsilon_{1,t}, \varepsilon_{2,t}, \varepsilon_{3,t-1}, \varepsilon_{4,t}, \varepsilon_{5,t-1}]'$, and $u_t = \left[1, y_{t-1}, y_{t-2}, r_{t-1}, r_{t-2}, \pi_{t-1}, \sum_{i=2}^{4} \frac{\pi_{t-i}}{3}\right]'$ referring to the vectors of unobserved variables, observed variables, shocks, and other regressors, respectively.

The model estimates the parameters using the Bayesian approach, as in Lewis and Vazquez-Grande (2019). This approach involves specifying priors, constructing a likelihood function from the linear-Gaussian filter output, and finally generating draws from the posterior distributions of the parameters with the Random-Walk Metropolis-Hastings Algorithm, with each draw representing a sample of the unobserved variables. In what follows, the median estimates of two unobserved variables: r^* and y^* are briefly discussed.

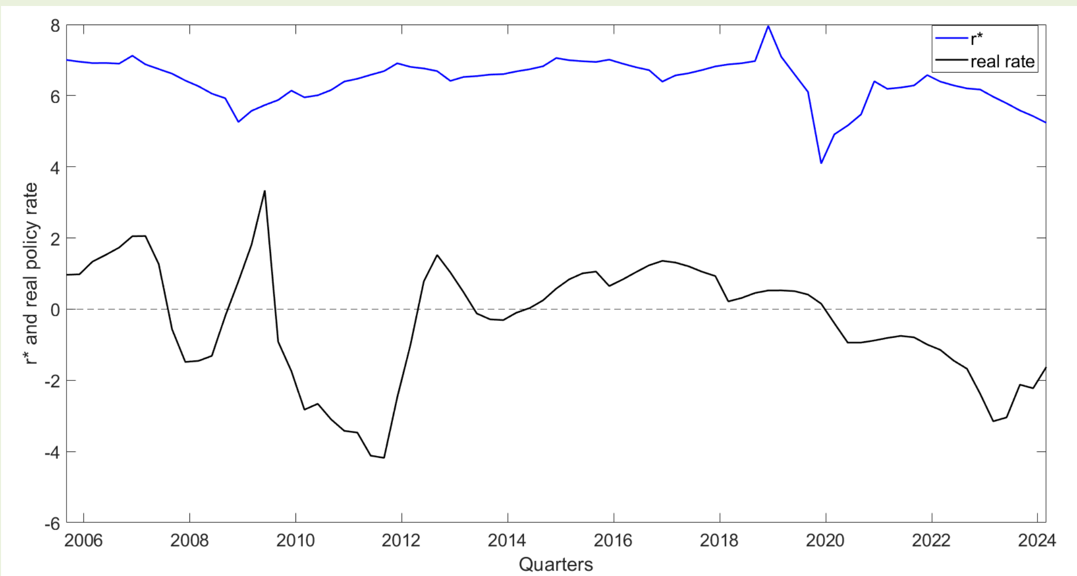
Estimates of the Natural Interest Rate and Monetary Policy Stance

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

The r^* reflects conditions that make the output gap zero with stable inflation, and it can be time-varying. A sensible estimate of the r^* represents a long-run real rate "anchor" for monetary policy, often modeled as the intercept term in the monetary policy feedback rules such as Taylor's Rule. Importantly, it abstracts from short-run price and output fluctuations.

The r^*, indicated by the blue line in Chart B.1, declines steadily from 7.00 percent in September 2005 to 5.24 percent in March 2024 with occasional swings. The rate reached 7.96 percent in December 2018 and then plunged to its lowest level in the subsequent quarters. The results indicate that both the trend growth of the potential output and the non-growth components of the r^* drive its paths. The real policy rate, shown by the black line, remains below the natural rate of interest over the sample period. The low real policy rate reflects the nominal policy rate staying close to the inflation rate throughout the period under study. The gap between the ex ante real policy rate and the smoothed estimate of r^* indicates that the monetary policy remains expansionary throughout the sample period, leaving room for further tightening.

Chart B.1: Natural Interest Rate and Real Policy Rate

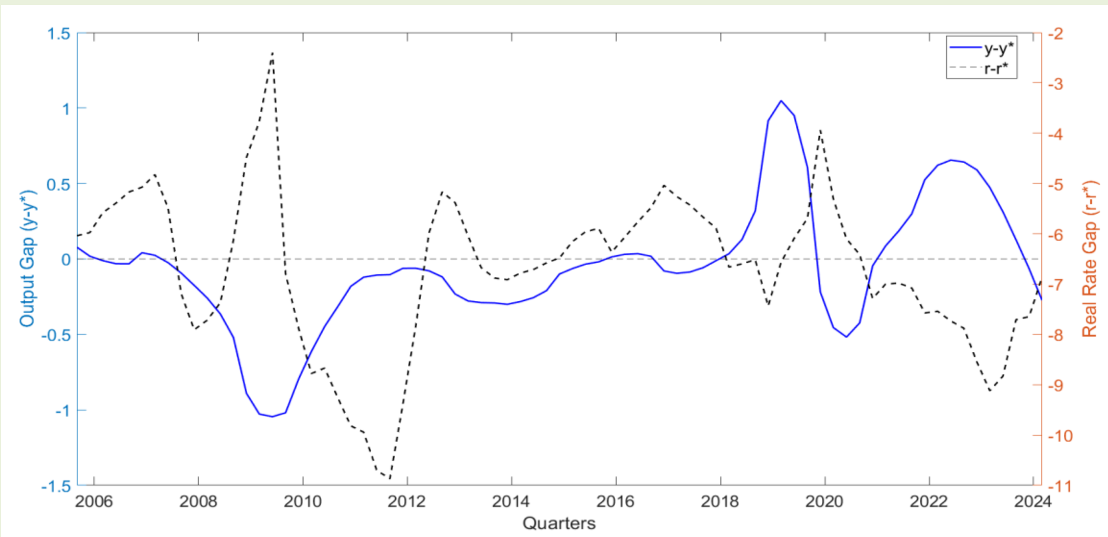


Estimates of the Output Gap

The Bayesian estimation of the semi-structural model provides a smoothed estimate of potential output. Chart B.2 presents the output gap, defined as the difference between actual output and the median smoothed estimates of the potential output. This chart also includes a series for the real rate gap — measured as the difference between the ex ante real policy rate and the smoothed estimate of natural rate of interest — on the secondary Y-axis.

The smoothed estimate indicates that the output gap was generally negative until the pre-COVID period, with actual output staying about 1 percent below potential output following the global financial crisis of 2008-09. The output gap peaked in the quarters leading up to COVID-19, when actual output exceeded potential output by 1 percent. However, during the COVID crisis, this gap decreased significantly. Towards the end of the sample period, the output gap exhibited a hump-shaped behaviour, reflecting vibrant economic activity influenced by pent-up demand during the post-pandemic period, particularly until 2023. Overall, the output gap estimates suggest that the economy operated below its potential throughout the sample period. On a different note, unsurprising and model-consistent paths of the output and real rate gaps are observed. The estimated output gap tends to decline following periods when the real rate gap is positive. Conversely, when the real rate gap is negative, the output gap tends to rise. This inverse relationship clearly indicates that the contractionary policy, reflected as the positive real rate gap, leads to a fall in actual output below its potential counterpart. The opposite holds when the policy is expansionary.

Chart B.2: Output Gap and Real Rate Gap



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Lewis, K. F., and Vazquez-Grande, F. (2019). Measuring the natural rate of interest: A note on transitory shocks. Journal of Applied Econometrics, 34(3), 425-436.

[#]The box is prepared by Dr. Saidul Islam, Joint Director of Chief Economist's Unit (CEU). The Author is grateful to Shohel Ahammed, Additional Director and Raju Ahmed, Joint Director of CEU for their valuable comments. The views expressed in the box was author's own and do not reflect those of Bangladesh Bank.

Chapter II: Global Economy and Bangladesh's Perspective

The global economy began to show early signs of recovery in 2024 after several years of compounded shocks and disruptions. Easing inflation and a shift toward more accommodative monetary policies in major economies contributed to a cautiously optimistic short-term outlook. However, this nascent momentum was soon overshadowed by rising trade tensions, particularly following the United States' introduction of sweeping tariffs on key trading partners. The new US trade policies have raised the risk of a significant reconfiguration of global trade flows and reintroduced volatility into the international economic environment. As a result, there is growing concern that these developments could derail the fragile recovery and dampen global growth prospects in the near term.

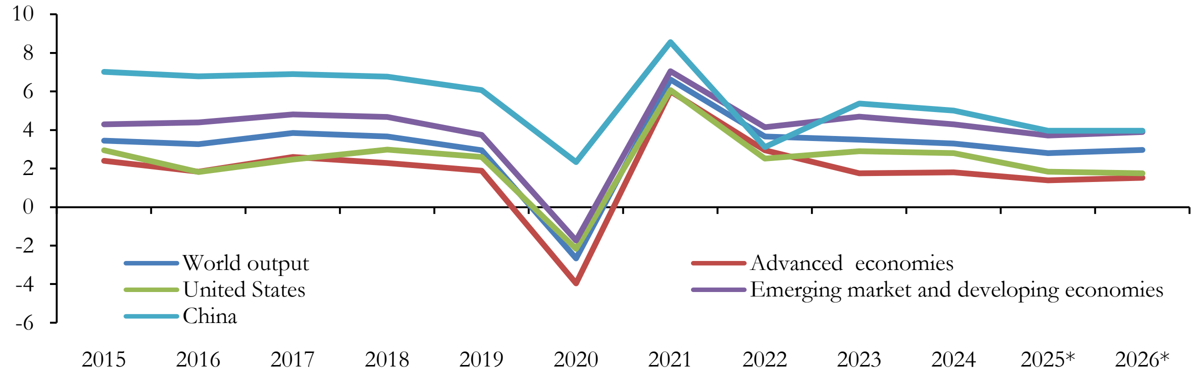
II.1 Global Economic Growth

According to the IMF's World Economic Outlook released in April 2025, global growth was relatively stable, estimating 3.3 percent in 2024. However, the landscape has changed in 2025, following the recent imposition of new U.S. trade policies and retaliatory actions by trading partners. In light of these developments, the IMF has revised its forecasts downward, projecting global growth rates at 2.8 percent in 2025 and 3.0 percent in 2026.

Growth in advanced economies is estimated at 1.8 percent in 2024, with a projected decline to 1.4 percent in 2025 before a modest rise to 1.5 percent in 2026 (Chart II.1). This broad-based weakening reflects increased global uncertainty and the negative impact of escalating trade barriers. A major contributor to this slowdown is the lower projected growth rates in the United States, where newly enacted tariffs are anticipated to trigger a notable decline in domestic demand. Consequently, the U.S. growth rate has been revised downward to 1.8 percent for 2025, before being estimated at 2.8 percent for 2024. The euro area is also expected to lose momentum, with growth projected to 0.8 percent in 2025.

Emerging markets and developing economies (EMDEs), which have maintained growth rates above 4.0 percent since 2022, are estimated to grow by 4.3 percent in 2024. However, growth is projected to decline to 3.7 percent in 2025 before edging up slightly to 3.9 percent in 2026. The anticipated downturn in EMDEs is largely driven by expected headwinds in major economies such as China, Russia, and Mexico. China is projected to experience a notable slowdown, with growth declining from 5.0 percent in 2024 to 4.0 percent in both 2025 and 2026, primarily reflecting the adverse impact of escalating trade tensions. Russia's economic growth is expected to fall sharply, from 4.1 percent in 2024 to 1.5 percent in 2025, driven by weakening private consumption and investment alongside slower wage growth. Meanwhile, Mexico may face negative growth in 2025, driven by the ongoing imposition of import tariffs and rising geopolitical uncertainty.

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

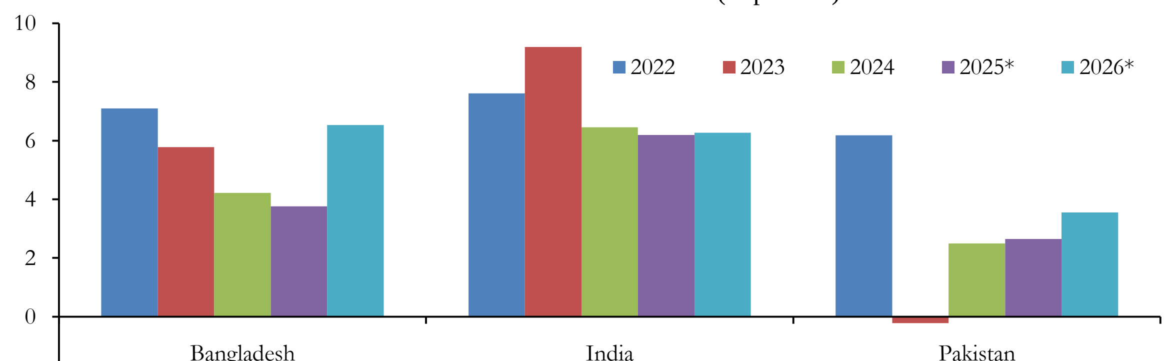


* Projection.
Source: World Economic Outlook April 2025, IMF.

In South Asia, India is projected to maintain stable growth, with rates of 6.2 percent in 2025 and 6.3 percent in 2026, slightly lower than the 6.5 percent observed in 2024 (Chart II.2). In the case of Bangladesh, the IMF forecasts a modest decline in growth from 4.2 percent in 2024 to 3.8 percent in 2025. Meanwhile, Pakistan is projected to experience steady improvement, with growth reaching 3.55 percent by 2026.

Overall, the global growth outlook is tilted to the downside, with headwinds visible across all major economies, primarily due to newly emerging trade tensions originating from the United States. Although these subdued performances are expected in the medium term, any potential rebound in growth depends on how swiftly and effectively global trade activities can stabilise.

Chart II.2: Economic Growth of Peer Countries in South Asia (in percent)



* Projection.
Source: World Economic Outlook April 2025, IMF.

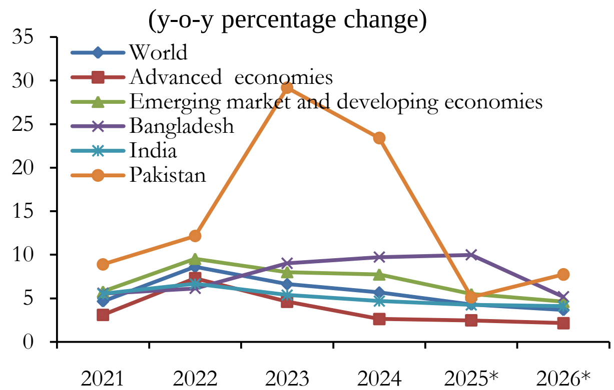
II.2 Global Inflation

Global headline inflation continued to ease throughout 2024, supported by declining energy and food prices, improved supply chain conditions, and the delayed impact of earlier monetary tightening from most of the central banks. According to the IMF's World Economic Outlook (April

2025), global inflation stood at 5.7 percent in 2024 and is projected to decline to 4.3 percent in 2025 and further to 3.6 percent in 2026.

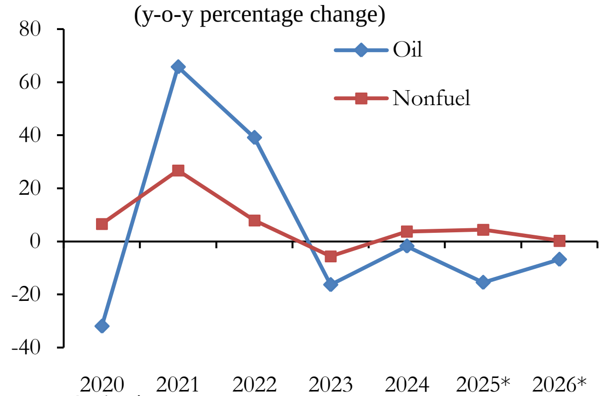
In advanced economies, year-on-year inflation fell to 2.6 percent in 2024, below target thresholds, driven primarily by lower fuel prices and stabilizing food costs. Inflation of these economies is expected to decline further, reaching 2.5 percent in 2025 and 2.2 percent in 2026. In the United States, inflation is estimated at 3.0 percent in 2024, projected to remain stable in 2025 before easing to 2.5 percent in 2026 (Chart II.3).

Chart II.3: Consumer Prices



* Projection.
Source: World Economic Outlook April 2025, IMF.

Chart II.4: Glabal Commodity Prices



* Projection.
Source: World Economic Outlook April 2025, IMF.

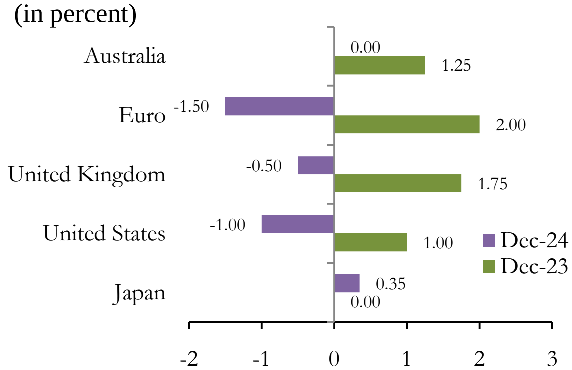
The inflation outlook in EMDEs is also improving significantly. After peaking at 9.5 percent in 2022, the inflation gradually declined to 7.7 percent in 2024. This downward trend is expected to continue, with projections of 5.5 percent in 2025 and 4.6 percent in 2026. In China, inflation remained low at 0.2 percent both in 2023 and 2024 and is forecasted to decline further to 0.0 percent in 2025 before edging up slightly to 0.6 percent in 2026. The lower inflation outlook for the Chinese economy is attributed to its effective management of the exchange rate through a controlled regime. In India, inflation is expected to ease slightly to 4.24 percent in 2025 and 4.10 percent in 2026, down from the recorded 4.67 percent in 2024. For Bangladesh, a notable transition from high to moderate inflation is anticipated. The inflation rate, recorded at 9.73 percent in 2024, is projected to increase marginally to 9.98 percent in 2025 before declining significantly to 5.18 percent in 2026. It is expected that a stable exchange rate, supported by a market-based exchange rate regime and a prudent monetary policy stance, will enable Bangladesh to maintain a moderate inflation by 2026 (Chart II.3).

Oil prices, which experienced a significant decline in 2023, fell modestly by 1.8 percent in 2024, reflecting robust global oil supply and weakening demand. The IMF projects a further sharp decline of 15.5 percent in 2025, with the annual average oil price estimated at USD 66.9 per barrel. This downward trend is expected to continue into 2026, with prices forecasted to drop to USD 62.4 per barrel as global geopolitical tensions are anticipated to suppress oil demand. In contrast, non-fuel prices are projected to increase by 4.4 percent in 2025, up from 3.7 percent in 2024, before easing slightly by 0.2 percent in 2026 (Chart II.4).

II.3 Global Financial Condition

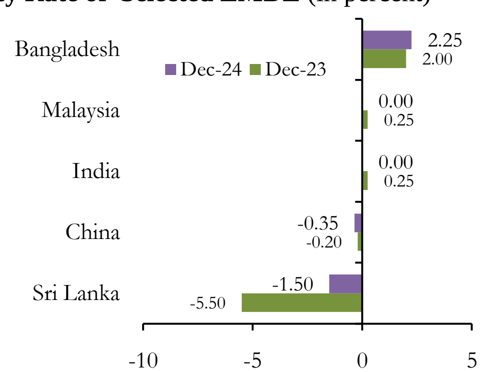
Following the expansionary fiscal policies implemented in response to COVID-19 and the geopolitical tensions between Russia and Ukraine, global monetary policy has largely been restrictive over the past few years, aimed at anchoring inflation. These measures proved effective, as many economies succeeded in bringing inflation under control—and in some cases, even reducing it below target levels. With inflationary pressures easing and growth momentum weakening, the focus has now shifted toward supporting domestic demand. As a result, most advanced economies began easing policy rates in 2024 to help sustain economic recovery and bring output closer to pre-pandemic levels. For example, the United States reduced its policy rate by a total of 100 basis points over several occasions in the last quarter of 2024 to 4.375 percent and then maintained it at that level. Similarly, the United Kingdom lowered its policy rate by 50 basis points in 2024, followed by an additional 25 basis points cut in February 2025. The Euro Area implemented a more aggressive approach, cutting rates by 150 basis points in 2024 and a further 75 basis points in 2025 (up to April). A notable exception is Japan, which maintained a zero percent policy rate from 2021 to 2023, but began tightening in 2024 with a cumulative increase of 35 basis points, followed by an additional 25 basis point hike in January 2025 (Chart II.5). According to the latest outlook from the International Monetary Fund (IMF), most central banks in advanced economies are expected to pursue further monetary easing. This is primarily in response to anticipated weakened demand stemming from tariff increases and heightened global economic uncertainty. However, central banks are expected to remain vigilant about inflation expectations and upside risks in the near term.

Chart II.5: Annual Change in Central Bank's Policy Rate of Selected Advanced Economies (in percent)



Source: Bank for International Settlements.

Chart II.6: Annual Change in Central Bank's Policy Rate of Selected EMDE (in percent)

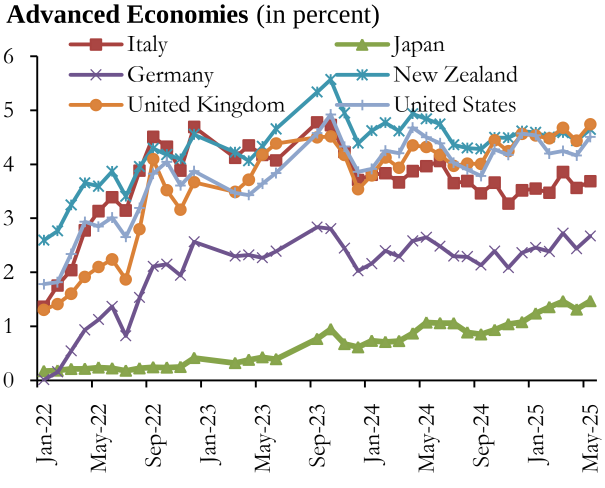


Source: Bank for International Settlements and Central Bank of Sri Lanka.

In emerging markets and developing economies (EMDEs), the monetary policy stance in 2024 was mixed but generally showed an easing trend, which is expected to continue. For example, China further lowered its policy rate by 35 basis points in 2024, compared to a 20 basis point reduction in 2023. This monetary easing is justified by persistently weak domestic demand, a soft labour market, and global trade uncertainty that could dampen future growth. The central banks of India and Malaysia kept their policy rates unchanged throughout 2024, although in April, India adopted an accommodative stance by reducing its rate by 25 basis points to 6.0 percent. Sri Lanka, which had already shifted to a softer policy stance in 2023, continued on an expansionary path in 2024 by reducing its policy rate by an additional 150 basis points. Bangladesh, on the other hand, has continued to maintain a tight monetary policy stance to manage inflation. In 2024 alone, it raised its policy rate by 2.25 percentage points, following a 2.00 percentage point hike in 2023 (Chart II.6). Moreover, other EMDE countries such as Indonesia, Mexico, the Philippines, Turkey, South Africa, Pakistan, and South Korea have adopted accommodative policy stances in 2024 to support domestic demand and buffer against external shocks. Looking ahead, although policy rates in EMDEs are projected to ease further, central banks must proceed cautiously. Continued focus on inflation trends and exchange rate dynamics will be essential, with policy stances adjusted accordingly to ensure macroeconomic stability.

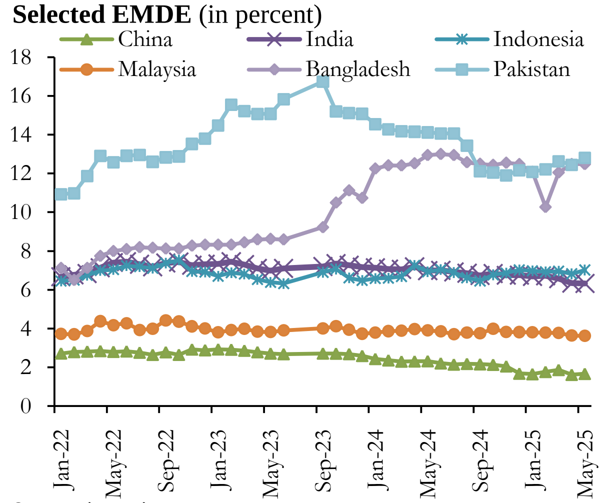
The 10-year government bond yields in most advanced countries exhibited a generally upward trend initially driven by tightening monetary policy (Chart II.7). This upward trajectory has persisted through April 2025, even though the monetary policy cycle has begun to reverse with rate cuts in several economies. The continued elevation in long-term government bond yields is partly attributed to a heightened risk premium, reflecting growing uncertainty stemming from recent trade policy shocks.

Chart II.7: 10-year Government Bond Yields of Advanced Economies (in percent)



Source: investing.com

Chart II.8: 10-year Government Bond Yields of Selected EMDE (in percent)



Source: investing.com

In contrast, most emerging markets and developing economies, including those in South Asia, have experienced relatively stable or declining 10-year government bond yields during the same period. As of April 2025, the 10-year government bond yields stood at 1.62 percent in China, 6.35 percent in India, 12.49 percent in Bangladesh, and 14.16 percent in Pakistan. In comparison, the corresponding yields in April 2024 were 2.31 percent, 7.20 percent, 12.41 percent, and 12.45 percent, respectively (Chart II.8).

II.4 Global Outlook and Challenges

The global economic outlook for 2025 and 2026 suggests a gradual slowdown in both advanced and emerging market economies. This deceleration is primarily driven by heightened policy uncertainty arising from escalating trade tensions, particularly between the United States and its major trading partners. These tensions have disrupted global trade flows, eroded investor confidence, and contributed to economic imbalances across many countries. The weakening growth trajectories of the U.S. and China—two of the world's largest economies—are expected to have significant spillover effects globally.

On the inflation front, global price pressures eased considerably in 2024, supported by declining energy and food prices, improved supply chain dynamics, and the delayed impact of earlier monetary tightening. However, inflation has yet to return to pre-pandemic levels and remains vulnerable to renewed pressures, especially in light of the recent announcements on trade tariffs. Nevertheless, global inflation is projected to decline gradually, driven by softening demand, easing supply-side constraints, and narrowing corporate profit margins. Advanced economies are likely to maintain accommodative policy rates to offset supply shocks, while emerging markets may pursue varied monetary responses depending on their exposure to currency volatility and capital outflows, particularly in the face of a stronger U.S. dollar.

As a globally connected economy, Bangladesh is not immune to these global headwinds. In line with broader international trends, Bangladesh's near-term growth forecast has been revised slightly downward, reflecting both external risks and domestic challenges. One pressing concern is the recent escalation in U.S. trade tariffs. While the U.S. has granted Bangladesh a 90-day pause before implementing the proposed hikes, the long-term implications remain unclear.

Despite this uncertainty, Bangladesh retains several comparative advantages. Its proposed import tariffs remain among the lowest in the region, and its role as a low-cost manufacturing hub continues to underpin competitiveness—especially in the Ready-Made Garments (RMG) sector. As RMG exports to the U.S.—Bangladesh's largest export destination—are generally inelastic to price, the sector is expected to remain resilient despite temporary disruptions. Although protectionist sentiment and uncertainty among U.S. buyers may lead to a short-term dip in export volumes, a recovery is anticipated as confidence stabilises. The recent transition to a market-based exchange rate regime is also expected to enhance export competitiveness by making Bangladeshi products more attractive for foreign buyers.

Meanwhile, Bangladesh's inflation outlook shows encouraging signs. According to the IMF's recent projections, inflation is expected to moderate significantly—from a high of 9.73 percent in 2024 to 5.18 percent by 2026. This transition will be supported by the adoption of a flexible exchange rate regime, prudent monetary policy, and targeted policy measures to manage domestic demand.

While Bangladesh faces short-term challenges stemming from global economic uncertainty and shifting trade dynamics, its medium-term outlook remains positive. Continued policy reforms, export diversification, and strong macroeconomic management will be essential for navigating external shocks and restoring a sustainable growth path.

Chapter III: Overview of Domestic Economy

III.1 Economic Activities and Inflation

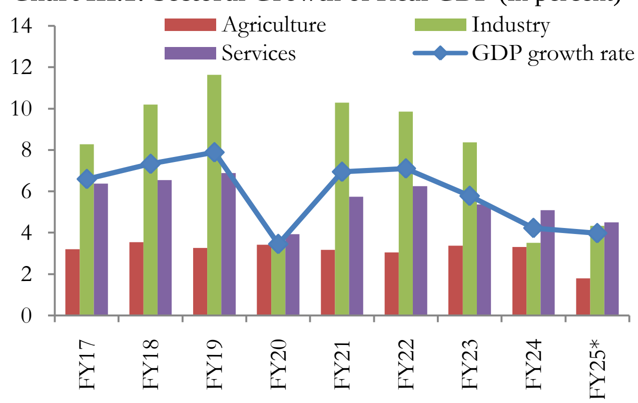
Real Sector Economic Activities

Bangladesh economy experienced sluggishness, with a provisional GDP growth rate of 3.97 percent for FY25, lower than the 4.22 percent recorded in FY24. This slowdown was primarily due to flood-affected losses in agricultural output, which were partly offset by improvement in industrial production, backed by sustained performance in the external sector. Looking ahead, Bangladesh's economy is transitioning into a phase of stabilisation and recovery amid ongoing structural and strategic economic reforms under the current interim government. On the expectation of inflation easing, domestic demand is anticipated to be boosted in FY26 and beyond. Hence, the government projected that the GDP growth rate would accelerate to 5.5 percent in FY26. However, the upcoming uncertainties stemming from global trade tensions remain a concern given Bangladesh economy's increasing dependence on the performance of the external sector.

Sectoral Performance: Agriculture, Industry, and Service

The real GDP in the agriculture sector was affected by badly damaged *Aus, Aman,* and other seasonal crops, and grew by only 1.79 percent in FY25, which disrupted the overall economic performance. However, significant rise in *Boro* rice and *maize* harvests in early 2025 is expected to recover some losses, meeting the government's targets this year. In FY25, the industry and service sectors, which accounted for 37.44 and 51.62 percent of the GDP, respectively, maintained robust growth rates of 4.34 and 4.51 percent. Despite persistent macroeconomic challenges, the industry sector performed better than the previous year.

Chart III.1: Sectoral Growth of Real GDP (in percent)



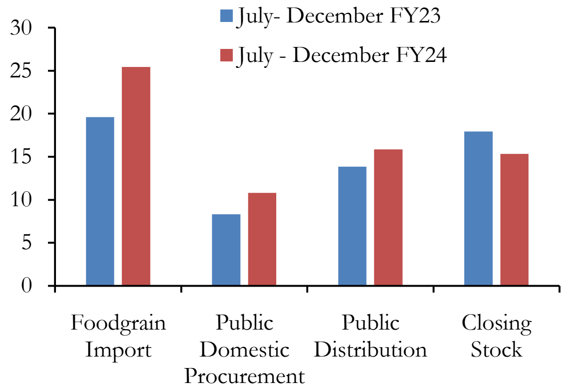
* = provisional
Source: Bangladesh Bureau of Statistics (BBS).

The general index of large-scale manufacturing industrial production grew by 6.1 percent in July-January of FY25, significantly up from 0.99 percent in the same period of FY24. Activities in the textiles and pharmaceuticals sectors in the large-scale manufacturing were the main contributors to the improved industrial output. Industrial term loan growth moderated to 24.53 percent during July-December of FY25 compared to 43.24 percent for the same period of the previous fiscal year, reflecting cautious investment sentiment. In the services sector, activities have rebounded; however, consumer demand remains constrained by high inflation and rising borrowing costs (Chart III.1).

Domestic Food Situation

The domestic food supply situation in FY25 has shown signs of stabilisation, supported by a 3.98 percent year-on-year increase in food grain production in FY24, accompanied by a production target of 442.2 lakh metric tons for FY25. However, the first nine months of FY25 saw a reduction in public procurement alongside a drop of one lakh metric tons in public food grain stock, reflecting weakened buffer capacity as compared to the same period of FY24 (Chart III.2). On the other hand, the food grain imports rose significantly by 7.51 lakh metric tons during July–March FY25 to cushion the flood-affected supply bottlenecks (Chart III.2).

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

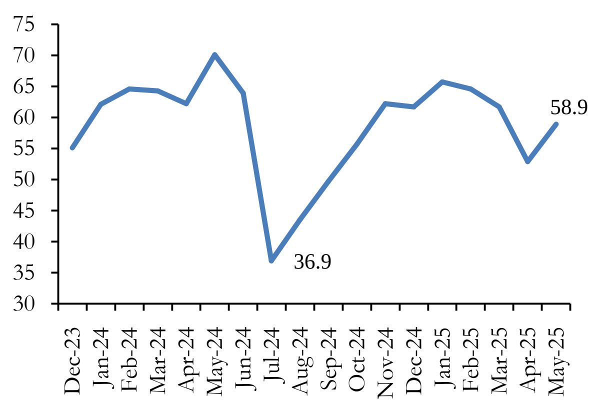


Source: Food Planning and Monitoring Unit (FPMU), Ministry of Food.

The Purchasing Managers' Index[1]

This real sector trajectory is mirrored in the trends of the Purchasing Managers' Index (PMI), a high-frequency indicator of business sentiment and industrial activity. The latest reading for May 2025 at 58.9 suggests that overall economic activities grew at a faster rate, driven by the buoyancy of export-led manufacturing and uptake in agriculture and its supply chain ahead of the Eid festival. (Chart III.3).

Chart III.3: Purchasing Managers' Index



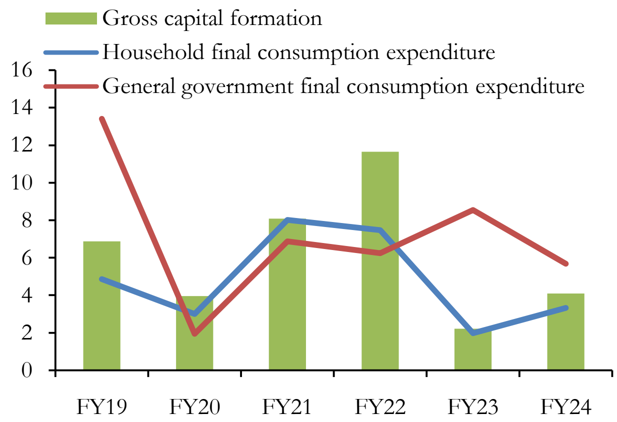
Note: PMI > 50 suggests expansion thresold and vise versa.
Source: Metropolitan Chamber of Commerce & Industry, Dhaka

Consumption and Investment

Household final consumption expenditure slowed to 4.77 percent in FY25 compared to a rebounding (5.99 percent) in FY24, reflecting subdued demand in the economy. Gross capital formation also declined to 1.76 percent in FY25 after a significant increase (3.27 percent) in FY24, reflecting cautious investor sentiment amid a high interest rate environment (Chart III.4). Besides, government expenditure reduced significantly in FY25 as compared to the previous post-pandemic years, reflecting austerity measures. These trends reflect the alignment of government policies with tightened monetary policy, which prioritises anchoring inflation expectations.

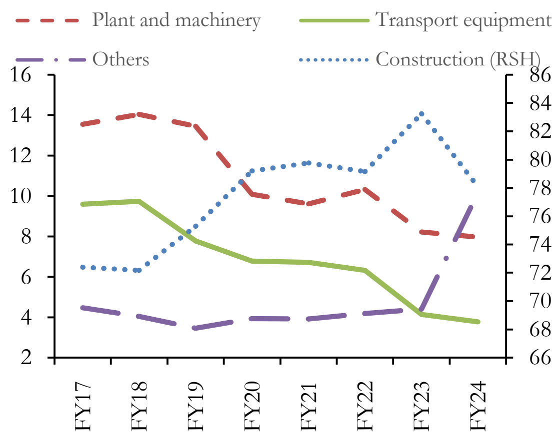
[1] The Purchasing Managers' Index (PMI) is a forward looking economic indicator that helps understand the direction of an economy. The Bangladesh PMI was developed in 2024 by Metropolitan Chamber of Commerce and Industry (MCCI) and Policy Exchange Bangladesh, in cooperation with the Singapore Institute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

Chart III.4: Composition of Expenditure Categories of GDP (y-o-y percentage change)



Source: Bangladesh Bureau of Statistics (BBS).

Chart III.5: Contribution to Gross Fixed Capital Formation (in percent)



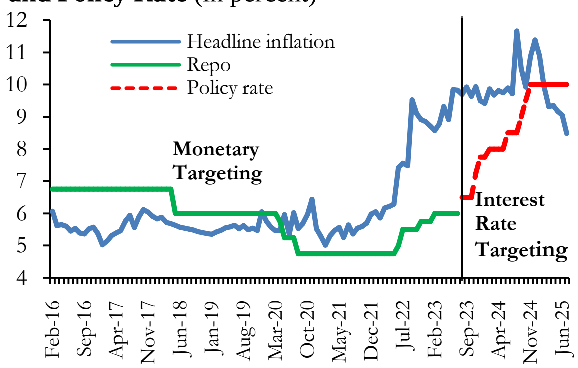
Source: Bangladesh Bureau of Statistics (BBS).

The composition of Gross Fixed Capital Formation (GFCF) reveals a structural tilt toward construction-related investment, which accounted for over 78 percent in FY24—up from 72 percent in FY17. On the other hand, the shares of plant and machinery and transport equipment have steadily declined over the years, reaching 7.96 percent and 3.78 percent in FY24, respectively (Chart III.5). This shift underscores a growing focus on infrastructure and real estate over capacity-building investments in manufacturing and logistics. As a result, the industrial sector may face constraints in scaling up output, dampening medium-term growth prospects. The real sector's uneven recovery—characterised by cautious private investment despite fiscal support—reflects this pattern of composition.

Inflation Development

BB formally transitioned from a monetary targeting regime to an interest rate targeting framework in July 2023, marking a structural shift in its monetary policy operations. Under the new framework, the policy rate, introduced as the central signaling instrument, replaced reserve money growth as the anchor for monetary condition. This shift was complemented by the removal of the long-standing 9.0 percent interest rate cap, significantly enhancing monetary transmission through the interest rate channel.

Chart III.6: Movements of Headline Inflation and Policy Rate (in percent)



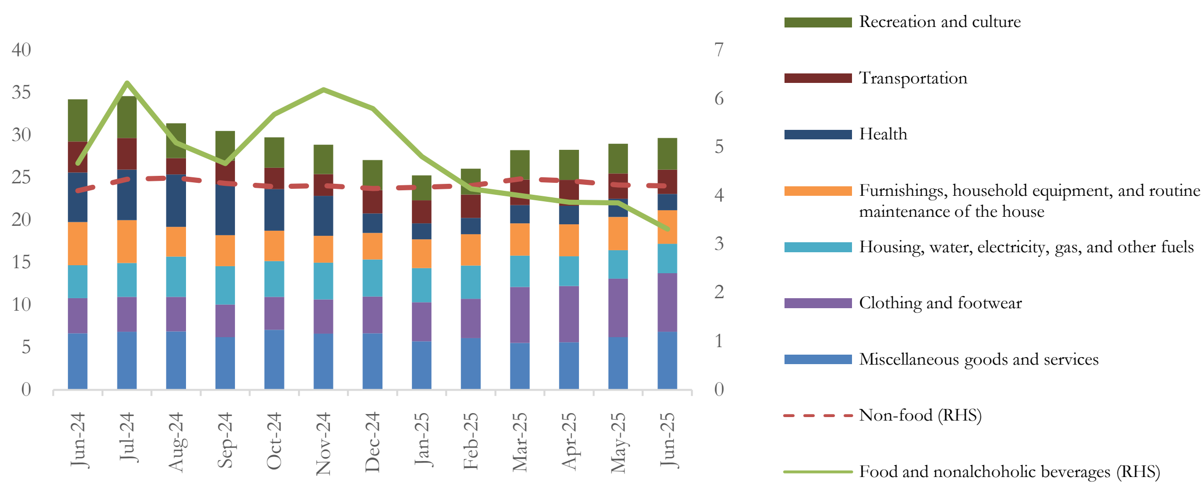
Note: Interest rate cap has been introduced in April, 2020 and removed in July, 2023.
Source: Bangladesh Bank and Bangladesh Bureau of Statistics.

The shift to an interest rate targeting regime has strengthened BB's ability to combat inflation and enhance the effectiveness of monetary policy. Following the regime shift, BB continued to raise the policy rate from 6.5 percent in July 2023 to 10 percent by October 2024. BB's latest aggressive policy tightening during FY25 helped anchor inflation expectations, contributing to a gradual decline in inflation to 8.48 percent by June 2025 (Chart III.6). The removal of the rate cap restored transmission, evident in sharply higher interbank rates and tighter liquidity, curbing demand-side pressures. BB's balanced approach—combining contractionary measures with targeted credit support for agriculture, CMSMEs, and exporters—helped buffer growth, demonstrating the regime's flexibility.

Inflation Trends and Drivers

Headline CPI inflation peaked at 11.7 percent in July 2024 (highest since 2011), driven by volatile food prices, before easing to 8.48 percent by June 2025 amid moderating global commodity prices and slower FX pass-through. Inflation has eased, primarily due to a decline in food inflation. The reduction in food prices is largely attributed to improved crop yields, supported by favorable weather conditions. This decrease stemmed largely from a successful *boro* rice harvest. Furthermore, a stable exchange rate and the adoption of contractionary monetary policy have reinforced the overall moderation in inflation.

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



Source: BB staffs' estimates from BBS data

Contribution of food inflation to CPI headline inflation dominated early FY25 (peaking at 6.32 percent in July 2024) but decelerated to 3.31 percent by June 2025 due to improved supply, while non-food inflation contribution remained stable (4.1-4.3 percent), reflecting persistent core pressures. The health inflation contribution declined sharply from 6.15 percent in August 2024 to 1.90 percent in June 2025, while housing inflation contribution remained consistent. Transportation fluctuated in line with the fuel prices (Chart III.7). Despite food-driven moderation, broad-based non-food rigidity underscores lingering core inflation risks, necessitating sustained monetary vigilance.

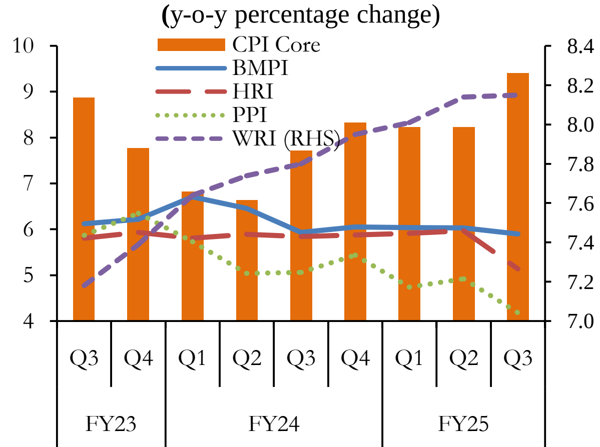
Cost-side Drivers

The key cost-side inflation drivers– Building Material Price Index (BMPI), House Rent Index (HRI), Producer Price Index (PPI), and Wage Rate Index (WRI) – reveal mixed trends in terms of policy responsiveness. The divergence among these indicators underscores the asymmetric transmission of monetary policy. While price-based costs (PPI, BMPI, HRI) are softening, wage pressures remain resilient, limiting the pace of disinflation (Chart III.8). This may require a prolonged tight policy stance, complemented by fiscal resilient, labour market productivity improvements, and targeted supply-side measures.

Core inflation

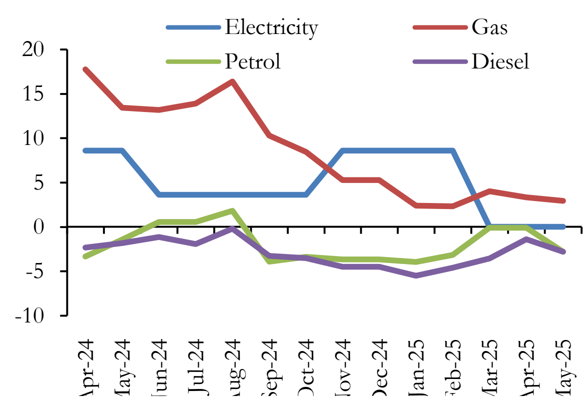
Point-to-point core inflation gradually increased throughout FY24 to FY25 and reached 11.07 percent by April 2025 (Chart III.8). This rise reflects persistent demand-side pressures (services, wages, etc.) and potential structural inflation. The significant divergence between headline CPI and core inflation poses a risk of policy misalignment. Aggressive rate hikes could stifle growth, given PPI's decline and headline CPI's late-2024 moderation. However, in June 2025 the core inflation went down to 8.95 percent.

Chart III.8: Cost-side inflation drivers
(y-o-y percentage change)



Source: Bangladesh Bureau of Statistics (BBS).

Chart III.9: Energy and Fuel Prices
(y-o-y percentage change)



Source: Bangladesh Bureau of Statistics (BBS).

Energy and Fuel Prices

Electricity and gas prices demonstrated a steady upward trend, with gas showing a more pronounced increase (Chart III.9). Electricity prices rose in two distinct steps and have remained elevated since early 2024. Petrol and diesel prices, though historically higher, showed relative stability. The trends in administered energy prices reveal critical cost-push pressures on headline CPI, particularly through direct fuel costs and second-round effects on transportation and production. The phased changes (April 2024 to April 2025) suggest moderated pass-through to non-fuel categories, but sustained energy price hikes risk anchoring higher inflation expectations, necessitating monetary vigilance to prevent broader price spirals.

Assessing the Outlook: Growth and Price

The economy faces a prolonged tightrope walk between entrenched inflation and faltering growth momentum. Although the headline inflation moderated, food inflation remains high. This underscores that tight monetary policy alone cannot fully address price pressures, particularly in the food sector. Thus, BB's restrictive stance must be reinforced through coordinated supply-side measures and targeted market interventions to stabilise food prices and safeguard vulnerable populations.

Although the transition to an interest rate targeting regime is enhancing monetary transmission, structural rigidities continue to complicate the path toward achieving the 9.0 percent inflation target by end-FY25. Escalating utility expenses are eroding margins in agriculture and industry, which might curb future investment and production.

In this context, BB must adopt a cautious yet flexible policy approach—remaining focused on core inflation while closely monitoring real sector dynamics. Besides, both monetary and fiscal policy must jointly incentivize productivity-enhancing investment (e.g. machinery, transport) through targeted credit support, tax incentives, and investor confidence-building measures. This shift is crucial for enhancing productivity, diversifying the industrial base, and sustaining the growth momentum. Clear communication, data-driven calibration, and policy coherence will be essential to anchor expectations, preserve monetary policy credibility, and support a measured recovery.

III.2 External Sector

Amid global economic uncertainties, Bangladesh's external sector has demonstrated resilience supported by robust export performance, a stable exchange rate, and an improvement in the balance of payments position. As a result, the economy's capacity to absorb adverse global macro-financial shocks has improved, reinforcing overall macroeconomic and financial stability.

Balance of Payments

The deficit of current account balance (CAB), narrowed to USD 0.43 billion in July-May of FY25, significantly down from USD 6.12 billion during the same of the previous year, driven by stronger export earnings and substantial remittances inflows. The trade deficit shrank slightly to USD 19.38 billion in July-May of FY25, down from USD 20.22 billion in the same period of FY24. However, the robust export earnings were partially offset by in the rise in imports in the July-May of FY25. The financial account also recorded a surplus of USD 0.27 billion during the first eleven months of FY25, further easing external sector pressure and contributing to an improved overall BoP (Table III.1).

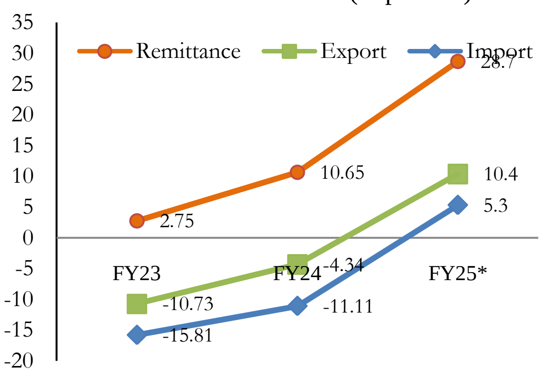
Table III.1: Balance of Payments (in million USD)

Items	July-May, FY24R	July-May, FY25
Trade balance	-20224	-19380
Export f.o.b.(including EPZ)	37343	40868
Import f.o.b. (including EPZ)	57567	60248
Workers' remittances inflows	21374	27506
Current account balance	-6116	-432
Capital account	359	320
Financial account	2074	266
Foreign direct investment (net)	1351	1583
Overall balance	-5885	-1149

R=Revised.
Source: Bangladesh Bank.

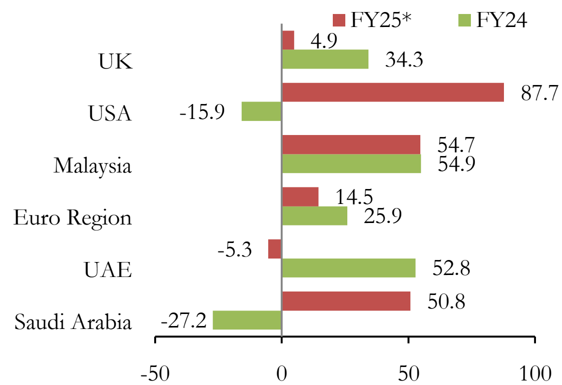
Chart III.10 exhibits that exports increased significantly by 10.4 percent (y-o-y), reaching USD 44.95 billion in July-May of FY25. The ready-made garments (RMG) continued to dominating share in the export basket, accounting for USD 36.55 billion, an increase of 10.6 percent compared to the preceding year. With easing of pressure on balance of payments, BB gradually relaxed import restrictions. Therefore, imports grew by 5.3 percent of USD 63.96 billion during July-May of FY25. This increase was primarily driven by higher import payment for intermediate goods, which shared

Chart III.10 Growth of Export, Import and Remittance Inflows (in percent)



*July-May
Source: Bangladesh Bank.

Chart III.11: Country-wise Growth of Remittance Inflows (in percent)



*July-April
Source: Bangladesh Bank.

around 61 percent of total imports and grew by 5.9 percent during July-May of FY25. Moreover, foreign remittance inflows registered a substantial rise of 28.7 percent (y-o-y) during July-May of FY25, reaching USD 27.51 billion. This notable increase reflects the greater use of formal channels under a more competitive exchange rate environment.

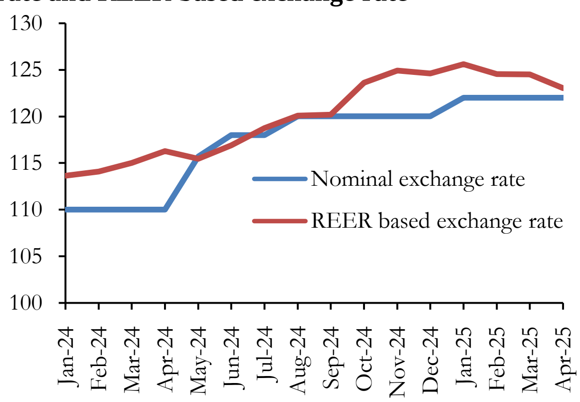
Country-wise analysis shows that the highest volume of remittances amounting USD 10.95 billion (around 45 percent of total) came from the Gulf region. The UAE remained the largest sender within the region with USD 3.49 billion though it experienced a decline of 5.34 percent during July-April of FY25. In contrast, the USA suppressed the UAE, sending the highest remittance amount at USD 4.27 billion (Chart III.11). Besides, other major contributor countries were Saudi Arabia, Malaysia, the Euro region, Oman, Kuwait, Singapore, Bahrain, and the UK. The Government and BB have implemented a range of strategic reforms, including the adoption of a unified and market-aligned exchange rate, measures to curb informal transfer, the relaxation of banking regulations, the expansion of remittance channels, and the introduction of the 'Probash' pension scheme for expatriates. Furthermore, the Eid-ul-Fitr festival in March 2025 contributed to a notable seasonal increase in remittance inflows.

Exchange Rate and Foreign Exchange Market

Exchange Rate Movements

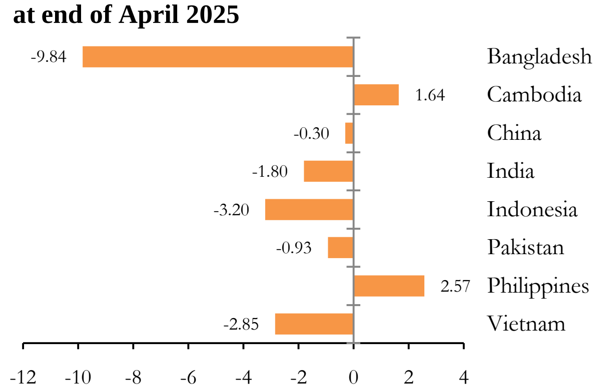
The exchange rate of the Bangladeshi Taka (BDT) against the US Dollar (USD) showed signs of stability with moderate depreciation during July-April of FY25. In May 2024, BB introduced a crawling peg exchange rate, adjusting the Bangladeshi Taka (BDT) against the US Dollar (USD) to market-clearing levels and in line with the underlying Real Effective Exchange Rate (REER). The central rate was adjusted twice since August 2024. In December 2024, BB allowed authorised dealers to trade currencies at negotiable rates. BB has also begun publishing a Foreign Exchange Market Spot Reference Exchange Rate (RR) since January 2025 twice a day and intends to develop an auction-based intervention strategy.

Chart III.12: Movements in Nominal Exchange rate and REER based exchange rate



Source: Bangladesh Bank.

Chart III.13: Peer Countries' Currency Appreciation/ Depreciation (+/-) against US dollar at end of April 2025



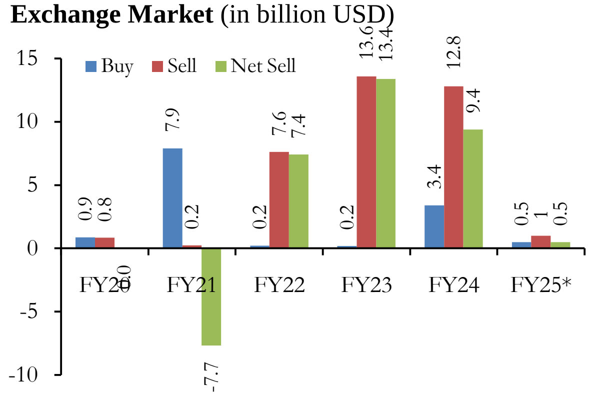
Source: Central Banks of the respective countries.

Chart III.12 demonstrates that the nominal exchange rate and REER based exchange rate are being closer to each other since December 2024. At the end of April 2025, the exchange rate of the BDT stood at 122.00 BDT per USD, marking a depreciation of 9.84 percent compared to April 2024 (Chart III.13). It may be noted that the indices of the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) also depreciated by 10.82 percent and 4.60 percent, respectively, over the same periods. A comparison with peer countries shows that, except Cambodia and Philippines, most of the countries' nominal exchange rate depreciated by the end of April 2025, though at a slower pace (Chart III.13).

Foreign Exchange Market

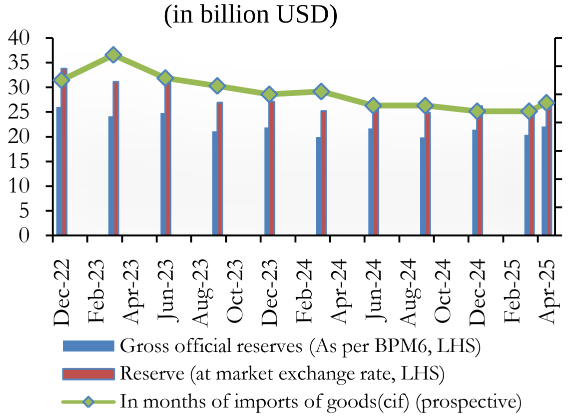
BB has been able to restrain net foreign currencies sales to USD 0.5 billion during July-April FY25. As a result, the foreign exchange reserve recorded a slight increase, reaching USD 27.43 billion at the end of April 2025, which is sufficient to cover approximately 4.7 months import payments (Chart III.14 and Chart III.15).

Chart III.14: BB's Intervention in the Foreign Exchange Market (in billion USD)



Source: Bangladesh Bank.
* July – April.

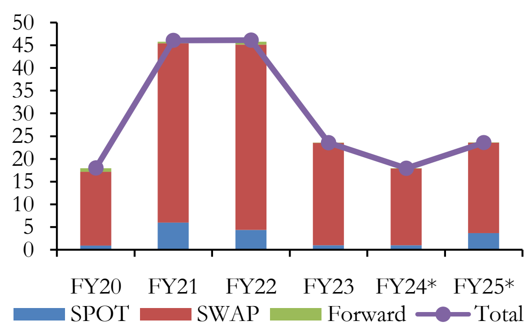
Chart III.15: International Reserve (in billion USD)



Source: Bangladesh Bank.

Bangladesh's interbank foreign exchange market turnover, encompassing spot, forward, and swap transactions, rose significantly to USD 23.6 billion during July-April FY25, up from USD 17.94 billion in the same period in the previous fiscal year. The surge in turnover across all types of market transactions reflects rebound in external sectors and improve liquidity conditions, and enhanced interbank foreign exchange market dynamics. While swap transactions continued to dominate the market, their share declined to 84.3 percent during July-April FY25 down from 94.6 percent at the same period of the previous fiscal year. Conversely, the share of spot transaction increased sharply to 15.5 percent compared to 5 percent over the years under review. Forward transactions also registered a growth, albeit maintaining a relatively small market share (Chart III.16).

Chart III.16: Total Turnover by Instruments (in billion USD)



Source: Bangladesh Bank.
*July - April of FY24 and FY25.

Bangladesh's economic outlook for FY25 appears optimistic, along with a stabilised balance of payments, driven by improvements in both the current and financial accounts. The narrowing trade deficit, increased higher remittance inflows, and foreign assistance are the key contributing factors. However, risks persist, including declining FDI, potential U.S. tariffs (a more detailed illustration of the potential impact of US tariffs on the Bangladesh economy is described in Box 2), and global protectionism sentiment. Additionally, the ongoing Israel-Iran conflict and potential escalation may drive up fuel prices and heighten global uncertainty. Moreover, structural challenges, such as overreliance on the RMG sector and limited export diversification, persist. To ensure long-term stability and growth, Bangladesh must focus on diversifying export items and trade partners, attracting FDI, and pursuing trade agreements like Free Trade Agreements (FTAs) and Comprehensive Economic Partnership Agreements (CEPAs), alongside broader structural reforms.

Box 2: The Potential Impact of US Tariff on Bangladesh Economy##

Rising global trade tensions, driven by sharp US tariff hikes and the ongoing US-China trade conflict, have increased uncertainty. The International Monetary Fund (IMF) states that these tariffs pose a substantial risk to the global outlook amid already sluggish conditions[2]. The WTO predicts that new US tariffs will cause global merchandise trade to shrink by about 1% in 2025[3], due to an 80% drop in US-China trade. These uncertainties concern present potential threats of long-term economic disruption, reduced investment, and a slower global recovery.

For Bangladesh, the imposition of reciprocal tariffs presents both significant challenges and potential opportunities. Although the country faces a 37 percent levy, the impact is somewhat cushioned, as major competitors like China, Vietnam and Cambodia face higher tariffs are expected to be affected more severely. The US, a key market for Bangladesh's ready-made garments, could emerge as a more attractive sourcing destination, potentially helping Bangladesh gain market share. Though the proposed US reciprocal tariffs pose certain risks, competitive labour costs and the growing manufacturing capacity of Bangladesh position it to benefit from shifting global supply chains and trade realignments. This uncertainty could also encourage Bangladesh to diversify exports and explore new markets, driving structural changes that enhance external sector resilience and growth. However, the global slowdown could weigh on Bangladesh's overall trade, especially the export of RMG. This will likely strain the external balance and dampen domestic economic activities.

As trade retaliation intensifies, US companies will seek countries with low and favourable tariff regimes for investment and establishment of manufacturing facilities. In this context, Bangladesh could emerge as an attractive destination for foreign direct investment (FDI) due to its large manufacturing base, competitive labour costs, and favourable tariff regime. To grab these opportunities, Bangladesh should focus on improving its business climate, upgrading infrastructure and ports, and adopting investor-friendly policies—such as ensuring hassle-free business operations and smooth fund repatriation. Additionally, other potential investors, including those from China, may shift their investments to Bangladesh to take advantage of the favorable tax regime and low production costs, which could help further offset some of the negative impacts of trade protectionism.

The imposition of tariffs—although suspended for 90 days until 9 July 2025—served as a wake-up call for Bangladesh. In response, the country intensified strategic trade negotiations with the US and initiated diplomatic efforts aimed at easing tensions by offering to increase imports of key US goods such as cotton, wheat, soybeans, and LNG, as well as providing duty-free access for selected American products. Bangladesh also pledged to reduce tariffs on US goods and is currently negotiating a Free Trade

[2] Statement by IMF Managing Director Kristalina Georgieva, April 3, 2025.

[3] Statement from Dr. Ngozi Okonjo-Iweala, Director-General of the WTO, April 3, 2025.

Agreement (FTA) with the US, which could lead to favourable trade concessions and strengthen bilateral economic ties in the future.

Despite potential short-term gains from US tariffs, the overall outlook for Bangladesh remains cautious. The proposed 37 percent US tariff on Bangladeshi goods, though currently delayed, has already hurt buyer and investor confidence, creating uncertainty that threatens the country's key manufacturing sector, RMG. As Bangladesh approaches graduation from LDC status and navigates global protectionism, it remains vulnerable to trade policy shifts. To mitigate the probable shock, Bangladesh has already launched various measures including, preferential trade agreements (PTAs), free trade agreements (FTAs) and comprehensive economic partnership agreements (CEPAs) with diverse spectrum of prospective countries such as Japan, China, the UAE, Thailand, Indonesia, and Singapore. Additionally, joining regional economic blocs such as ASEAN will help diversify market access and strengthen trade resilience.

Table B.2: Probable impact of US tariff on Bangladesh's economy

Factors	Economic activities	Inflation	Remarks
Export competitiveness	+ / -	=	US demand for export from Bangladesh strengthens or weakens depending on the US's other trade partners' policies, but it has largely no impact on inflation.
Exchange rate	+ / -	- /+	Most of BD's trade partners have closer trade transactions with the US. Hence, their exchange rate movement will affect the value of Taka.
Resourcing destination	+	-	BD can gain through resourcing from competitors, and an improved business environment may lead to an influx of FDI in the country.
Increased global demand of low-end products	+	-	BD exports mainly low-end products to the US.
Global economic downturn	-	-	Slower global growth may dampen the growth prospects of the BD economy as well as inflation.

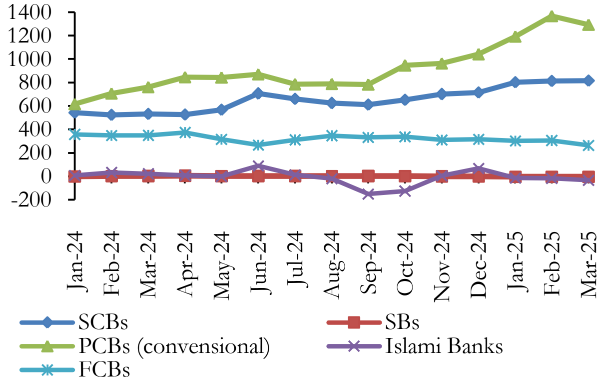
Bangladesh may experience limited trade losses from US tariffs, as many competitors are similarly affected. To strengthen its resilience, Bangladesh should diversify its exports beyond ready-made garments into sectors such as agro-processing, information technology (IT), and pharmaceuticals. It should also actively pursue Free Trade Agreements—especially with the US—and explore new markets and regional blocs like ASEAN. In addition, Bangladesh should initiate key domestic reforms including lowering import tariffs, improving infrastructure, reducing bureaucratic complexity, promoting labour-intensive industries with technology, and global standards compliance. The US tariff imposition underscores the urgency of rethinking Bangladesh's trade strategy, focusing on export diversification, industrial development, and deeper international integration – especially after LDC graduation. However, it is expected that Bangladesh remains competitive due to its demographic dividend, skilled labour force, strong manufacturing capacity, strategic location, and proximity to major global markets.

##The box is prepared by Shampa Chakraborty, Additional Director and Dr. Md. Rubel Islam, Joint Director of Chief Economist's Unit. The Author is grateful to Dr. Md. Salim Al Mamun, Director (Research) of Chief Economist's Unit for his valuable comments. The views expressed in the box are authors' own and do not reflect those of Bangladesh Bank.

III.3 Banking Sector Performance

Bangladesh's banking sector is experiencing its most challenging period ever. Some banks encountered severe liquidity problems and even faced difficulties making payments to their customers. Moreover, non-performing loans (NPLs) in the banking sector have been rising rapidly. BB remained vigilant to protect depositors' money and provided liquidity support to weak banks to ensure the stability of the banking sector.

Chart III.17: Liquidity Position of the Scheduled Banks (in billion BDT)

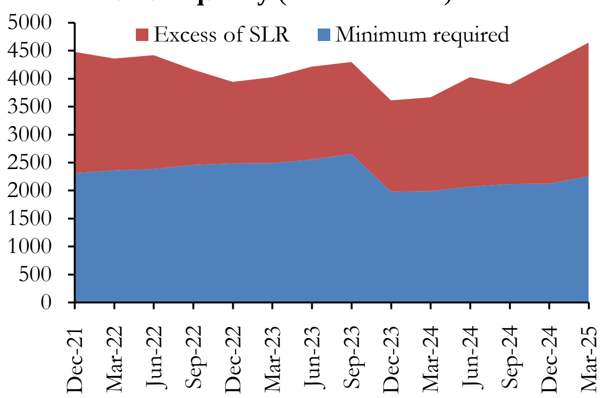


Source: Bangladesh Bank.

Liquidity

In August 2024, some banks, mostly Islamic shariah based banks, failed to maintain the required reserves (CRR and SLR) with BB as reflected in the shortfall of liquidity of those banks (Chart III.17). BB continued its liquidity support to those banks and ensured depositors about the safety of their deposits. Some banks have started to recover, while some others are still facing liquidity shortages resulting from the weakening of the customers' confidence. However, the aggregate liquidity in the banking system experienced a notable increase in March 2025, reflected in robust growth in total excess liquidity, increasing by 42.45 percent (y-o-y) (Chart III.18). This increase in total liquidity was partly because of BB's timely market intervention, like granting unrestricted access to the Standing Lending Facility (SLF), facilitating full allotment of repo facilities for banks and financial institutions, and providing special liquidity support to weak banks.

Chart III.18: Liquidity (in billion BDT)



Source: Bangladesh Bank.

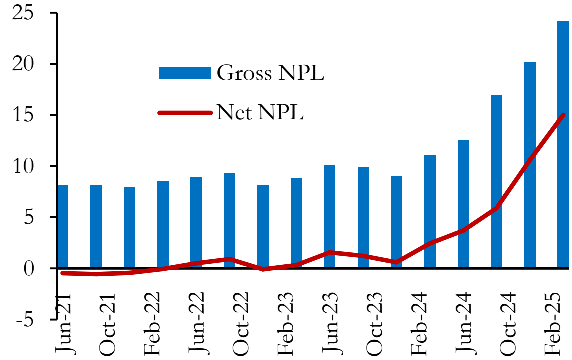
During April 2025, the deposit growth stood at 8.21 percent, decline from 9.25 percent in June 2024. Moreover, the growth in bank advances declined to 8.22 percent in March 2025 from 10.69 percent in June 2024, partly due to higher lending rates. However, the banking sector's overall advance-deposit ratio (ADR) slightly increased to 80.33 percent in March 2025 from 80.20 percent in June 2024.

Asset Quality

The ratio of gross non-performing loans to total loans (NPLs) witnessed a sharp rise during March 2024 to March 2025. The NPL ratio to total outstanding loans reached a record high of 24.13

percent in March 2025, up from 11.11 percent in March 2024 (Chart III.19). The worsening NPL situation was primarily driven by the non-renewal of some existing loans and non-repayment of rescheduled loans. This trend was further exacerbated by the revised overdue-status counting system, which took effect on 30 September 2024, reducing the threshold for fixed-term loans from 6 months to 3 months, contributing to the increase in classified loans.

Chart III.19: Ratio of Gross NPLs and Net NPL to Total Loans (in percent)



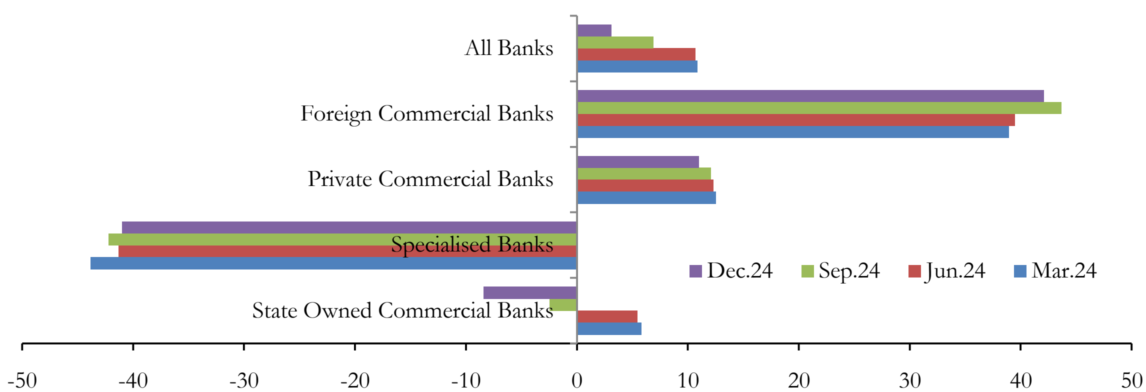
Source: Bangladesh Bank.

Additionally, the ratio of net NPLs to total loans in the banking sector increased significantly, reaching 15.00 percent at the end of March 2025, up from 2.44 percent at the end of March 2024 (Chart III.19).

Capital Adequacy

Capital adequacy focuses on the overall position of bank's capital and the protection of the depositors and other creditors from potential losses that a bank might incur. Under Basel-III, banks in Bangladesh are instructed to maintain the minimum capital requirement (MCR) at 10.0 percent of the risk-weighted assets.

Chart III.20: Capital to Risk Weighted Assets Ratio (CRAR) (in percent)



Source: Bangladesh Bank

In December 2024, the overall capital to Risk weighted Assets Ratio (CRAR) of the banking system fell significantly below the Basel III minimum requirement. This decline was mainly driven by state-owned commercial banks (SCBs). The overall CRAR for the banking system reached 3.08 percent in December 2024, compared to 10.85 percent at the end of March 2024. The CRAR for SCBs dropped sharply to - 8.42 percent at the end of December 2024, down from 5.80 percent at the end of March 2024 (Chart III.20).

Profitability

The Banking industry's profitability improved in December 2024 compared to March 2024, as reflected by a rise in both return on assets (ROA) and return on equity (ROE). The overall ROA and ROE increased to 0.43 percent and 8.7 percent in December 2024 from 0.23 percent and 4.32 percent in March 2024, respectively (Table III.2).

Table III.2: Profitability Ratios by Types of Banks (in percent)

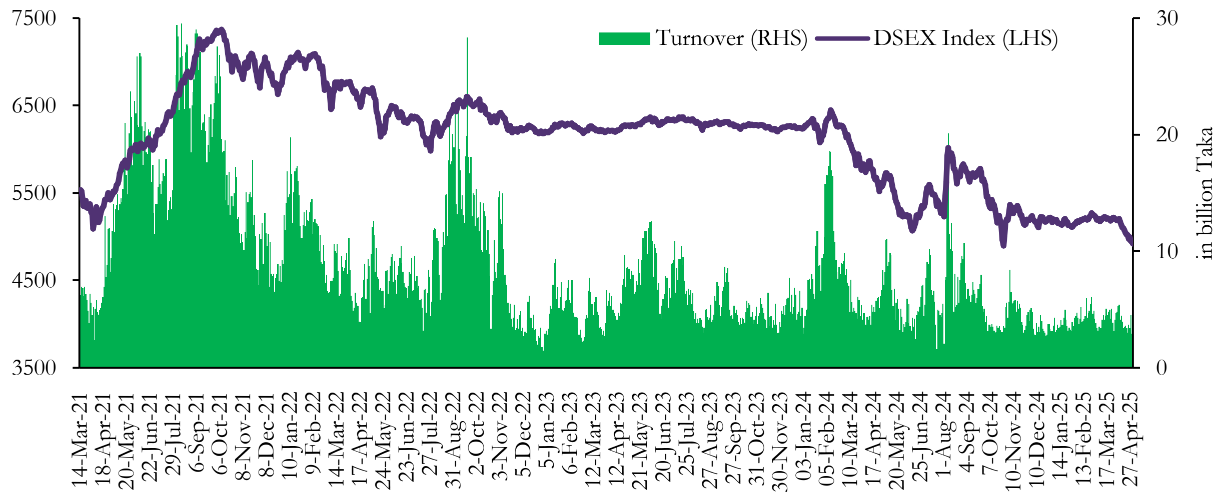
Type of Banks	Return on Assets (ROA)*				Return on Equity (ROE)*			
	2024				2024			
	March	June	Sep.	Dec.	March	June	Sep.	Dec.
State Owned Commercial Banks	-0.65	-0.37	-0.25	-0.37	-19.10	-11.40	-7.21	-12.20
Specialised Banks	-3.12	-2.54	-3.31	-2.35	-11.49	-10.08	-12.84	-9.17
Private Commercial Banks	0.34	0.48	0.39	0.51	5.9	8.75	7.22	9.43
Foreign Commercial Banks	3.92	4.08	4.56	4.30	19.87	19.33	21.09	19.09
All Banks	**0.23**	**0.4**	**0.38**	**0.43**	**4.32**	**7.85**	**7.42**	**8.7**

Source: Bangladesh Bank. *All are annualised except the quarter of December.

III.4 Capital Market

The capital markets of Bangladesh demonstrated a dismal performance during July-April 2025, reflected in the slump in the price indices and market capitalization along with the reduced average turnover and the price-earnings ratio (Chart III.21). A number of adverse events in the domestic and global economy, including hawkish monetary policy, deterioration in investor sentiment and corporate profitability, political uncertainty, and instability brought on by the world's geopolitical tensions, all contributed to the capital market's poor performance.

Chart III.21: DSEX Index and Turnover



Source: Dhaka Stock Exchange

Although the capital markets of Bangladesh are facing various challenges, including liquidity crunch, lack of investor confidence, and lack of transparency, the recent interim government has taken multiple initiatives to reform the capital markets, including reorganising key institutions like the Bangladesh Securities and Exchange Commission (BSEC), Dhaka Stock Exchange and Chittagong Stock Exchange, reducing the capital gains, creating a task force for market improvement and providing a sovereign guarantee to the Investment Corporation of Bangladesh (ICB) etc.

Chapter IV: Policy Review and Forward Looking Guidance

Bangladesh is undergoing a structural transformation in economic changes, marked by significant policy and reform measures across various sectors aimed at ensuring long-term stability and growth. BB has implemented coordinated approaches to manage inflation, stabilise the foreign exchange market, and reform the banking sector. These endeavors epitomise the nation's unwavering commitment to modernising its financial infrastructure, aligning with global standards, and fortifying economic resilience in the face of evolving challenges.

IV.1 Inflation Control Measures

BB has made significant progress in reducing inflationary pressures, with headline inflation falling to 8.48 percent in June 2025—down from 9.05 percent in May. This marks the lowest inflation rate since February 2023, driven by a moderation in both food and non-food inflation, which stood at 7.39 percent and 9.37 percent, respectively. This recent easing in inflation has been underpinned by BB's continued adherence to improved monetary policy framework. The current policy rate of 10 percent has helped anchor inflation expectations and promote overall macroeconomic stability.

As part of its tightening strategy, BB has discontinued the devolvement facility for the government—a move aimed at limiting the inflationary impact of high-powered money creation. However, the growing demand for money has intensified stress in some weak banks. In response, BB has extended temporary liquidity support to struggling banks while simultaneously absorbing excess liquidity through the issuance of BB bills to mitigate long-term financial risks.

Looking ahead, BB expects inflation to decline further in the coming months. This outlook is supported by recent policy actions, continued exchange rate stability, easing global commodity prices, and an anticipated boost in agricultural output—particularly from the *Boro* rice harvest. BB remains committed to closely monitoring inflation dynamics and stands ready to adjust interest rates and liquidity operations as needed.

IV.2 Foreign Exchange Rate Flexibility

Bangladesh's transition to a flexible exchange rate system marks a significant milestone in modernising the country's economic policy. This shift aligns the country's economic strategy with global financial standards, allowing the market to play a more prominent role in determining the value of the taka. The move is expected to improve the competitiveness of Bangladeshi exports by reflecting true market conditions and augmenting the allure of foreign investments, ultimately supporting industrial growth.

To manage the risks associated with exchange rate volatility, BB has established a USD 500 million fund to mitigate unusual fluctuations in currency movements when necessary. The success of this flexible exchange rate policy will hinge on precise communication, prompt measures, and continuous monitoring of domestic and global economic trends. A policy issue remains how the capital account of Bangladesh could be liberalised better to integrate Bangladesh's economy with global capital markets. Through greater transparency and a more market-driven exchange rate system, Bangladesh economy aims to integrate more effectively with the global economy and foster sustainable economic growth.

IV.3 Banking Sector Reform

The banking sector in Bangladesh is currently undergoing a significant transformation, spearheaded by the Banking Sector Reform Taskforce (BSR-TF), established by Bangladesh Bank on September 11, 2024. This initiative is a response to long-standing structural weaknesses and aims to restore financial stability, strengthen governance, and enhance the sector's resilience to any shocks. The BSR-TF has laid a strong foundation by formalising its legal framework and establishing key governance bodies, including Implementation, Project Management, and Steering Committees. A core component of the reform is the Asset Quality Review (AQR), launched in collaboration with international firms, KPMG and Ernst & Young. These reviews are being conducted under the newly issued Special Regulations for AQR (2024), ensuring uniformity and transparency in the evaluation of asset quality.

In parallel, BB formed strategic partnerships to bolster reform efforts, notably signing a Memorandum of Understanding with the UK's Foreign, Commonwealth & Development Office (FCDO), which has appointed Deloitte LLP as a technical adviser. A dedicated Special Inspection Team has also been deployed to carry out root-cause analyses in underperforming banks. Institutional capacity is being enhanced through the creation of the Bank Restructuring and Resolution Unit (BRRU), which will oversee policy execution and coordinate the rollout of a comprehensive Bank Resolution Ordinance (BRO) 2025, recently published in the official gazette. The BRO will legally empower BB to apply a broad resolution toolkit—including bridge banks, bail-ins, asset transfers, and temporary public ownership—enabling prompt and structured responses to failing any financial institutions.

Forward-looking guidance suggests that while near-term stress is expected—particularly a rise in non-performing loans due to stricter loan classification standards—the sector is poised for medium-term improvement. The reforms are designed to improve transparency, governance, and capital adequacy, ultimately leading to a more disciplined and resilient financial system. In alignment with these objectives, a Bank Restructuring and Resolution Fund (BRRF) has been established with an initial disbursement of BDT 100 million to support distressed banks. Additionally, regulatory manuals like the Resolution Handbook and an Enforcement Manual are under development to guide future interventions.

Bangladesh’s banking sector reform agenda represents a comprehensive and forward-thinking approach, aligning with global best practices and embedding robust regulatory and institutional frameworks. The ongoing reforms will pave the way for sustainable growth and foster greater public confidence in the sector's future. By addressing inflation through a disciplined monetary policy, moving towards a flexible exchange rate system, and embarking on comprehensive banking sector reforms, the country is positioning itself for stronger integration with the global economy. These strategic moves aim to build a more competitive, transparent, and resilient economy, ensuring long-term growth and financial stability.

Chapter V: Near and Medium-term Outlook and Challenges

Bangladesh's economy is currently going through some key macroeconomic challenges, including high inflation, external pressures, and underlying vulnerabilities in the financial sector. The primary objective of the central bank's monetary policy is to bring the inflation rate down to a more tolerable level. BB continued to adopt a contractionary monetary policy stance for bringing down the inflation below 9.00 percent by the end of FY25, while facilitating economic recovery. There are signs of moderation of inflation rates in recent months. BB is likely to continue the tightened monetary policy stance for some periods in H1FY26. With prudent strategies, it is expected that the inflation rate will come down to 6.50 percent, while achieving a growth rate of 5.50 percent in FY26. Policymakers are also concerned about the demand- and supply-side determinants of inflation. To this end, supportive fiscal policy measures are required to be coordinated with monetary policy to stabilise the macroeconomic environment and achieve the inflation target for FY26.

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Policy Notes

Policy Note 01

Modernisation of Monetary Policy Framework: Bangladesh Bank's Measures [4]

Modernisation of Monetary Policy Framework

In the process of monetary policy formulation, Bangladesh Bank (BB) has been relying on the monetary targeting approach since its independence, to achieve the ultimate goal of price stability along with financial stability and supporting growth. The possibility of achieving success in maintaining price stability under the monetary targeting framework became very difficult, mainly due to changes like the money demand function resulting from financial innovation, the digital payment system, and the integration of Bangladesh's economy with the global economy. As Bangladesh's economy is strongly growing and equally integrating with the worldwide economy, the financial market has been developing and becoming more complex. In this context, a forward-looking strategy and an interest rate targeting monetary policy would be more effective for ensuring macroeconomic stability and promoting financial development. Therefore, BB adopted the interest rate targeting monetary policy framework to have an efficient monetary transmission mechanism to support the monetary policy objective of price stability and economic growth trajectory from July 2023 onward.

Policy Measures taken by BB under Modernisation of Monetary Policy

1) Policy initiatives for operationalisation of Interest Rate Corridor (IRC)

i) On 1st July, 2023 BB introduced a Interest Rate Corridor (IRC) where overnight Repo rate replaced by Policy rate and re-fixed at 6.50%. The upper limit of this IRC is named as "Standing Lending Facility (SLF)" and replaced Special Repo rate which was re-fixed at 8.50%. Moreover, the lower limit of IRC named as "Standing Deposit Facility (SDF)" and replaced the Reverse Repo rate which also re-fixed at 4.50%.

ii) On October 5th, 2023 BB re-fixed its IRC by increasing all the rates by 75% basis points. After the increase Policy rate, SLF and SDF stand at 7.25%, 9.25% and 5.25% respectively.

iii) On November 26th, 2023 BB re-fixed its IRC by increasing all the rates by 50 basis points. After the increase Policy rate, SLF and SDF stand at 7.75%, 9.75% and 5.75% respectively.

iv) On January 17, 2024, Bangladesh Bank (BB) re-fixed its Interest Rate Corridor (IRC) by increasing the policy rate by 25 basis points, from 7.75% to 8.00%. At the same time, the band width of the IRC was narrowed from ±200 basis points to ±150 basis points by Reducing SLF

[4] This note has been prepared by Dr. Md. Omor Faruq, Additional Director, Monetary Policy Department, Mr. Mahmud Salahuddin Naser, Director, Monetary Policy Department and Dr. Md. Ezazul Islam, Executive Director of the Bangladesh Bank. Views expressed in this note are authors' own and do not necessarily reflect that those of the Bangladesh Bank.

rate by 25 basis points from 9.75% to 9.50%, and increasing SDF rate by 75 basis points from 5.75% to 6.50%.

v) On May 8th, 2024 to tame down the uprising inflation, BB re-fixed its IRC by increasing all the rates by 50 basis points. After the increase Policy rate, SLF and SDF stand at 8.50%, 10.00% and 7.00% respectively.

vi) On August 25th, 2024, following the Monetary Policy Committee's decision to continue raising the policy rate until inflation reaches the desired level, BB increased all IRC rates by another 50 basis points. After the increase Policy rate, SLF and SDF stand at 9.00%, 10.50% and 7.50% respectively.

vii) On September 24th, 2024, BB further re-fixed its IRC by increasing all rates by 50 basis points. After the increase Policy rate, SLF and SDF stand at 9.50%, 11.00% and 8.00% respectively.

viii) On October 22nd, 2024, BB re-fixed its IRC once again, raising all rates by 50 basis points. After the increase Policy rate, SLF and SDF stand at 10.00%, 11.50% and 8.50% respectively.

ix) Finally, on March 4th, 2025, to provide liquidity flexibility and financial support to all scheduled banks (including Islamic banks), BB reduced the daily Cash Reserve Requirement (CRR) by 50 basis points, from 3.50% to 3.00%, while keeping the bi-weekly average CRR unchanged at 4.00%.

2) Policy initiatives for streamlining Open Market Operations (OMOs)

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

ii) Since July 2024, BB introduced Central Bank Repo auctions twice a week, on Mondays and Wednesdays (or the next working day in case of a holiday), replacing the previous practice of daily auctions, while the Standing Lending Facility (SLF) and Standing Deposit Facility (SDF) remained available daily at prevailing rates.

iii) To enhance the effectiveness of monetary policy transmission within the framework of the Interest Rate Corridor (IRC) of monetary policy of BB, the following structural reforms in Open Market Operations (OMOs) has been implemented:

- Starting from 1st November 2024, the practice of conducting repo auctions twice a week has been replaced with a single weekly auction (7 days, 14 days, and 28 days) held once a week, on Tuesdays. If Tuesday is a holiday, the auction will be rescheduled to the next working day.

- The Reserve Maintenance Period (RMP) for Cash Reserve Requirement (CRR) has been aligned with a one-week maintenance cycle to synchronize with OMO operations. To eliminate liquidity crunch on RMP it has been decided to introduce fine tuning overnight OMOs.
- It was assured that the SLF and SDF available on a daily basis to support liquidity management in line with the IRC framework.

iv) To sterilise the additional liquidity injected through Lender of Last Resort to ailing banks, BB introduced 90-day and 180-day BB Bill operations along with existing 7-day, 14-day, and 30-day BB Bills from November 2024.

v) To enhance the monetary policy framework and strengthen liquidity management, the daily minimum Cash Reserve Ratio (CRR) has been reduced from 3.5% to 3.0%, effective March 5, 2025. The bi-weekly average CRR requirement remains unchanged at 4.0.

vi) To eliminate the interest rate differential in term repos, it has been decided to conduct all term repo auctions at the policy repo rate. This decision has been implemented from 09th March 2025.

vii) To further enhance the efficiency of the interbank money market and strengthen liquidity management, it has been decided to discontinue all repo operations except the 7-days and overnight tenors. In this regard, the 28-day repo facility has been discontinued with effective from April 10, 2025, and the 14-day repo facility will be phased out from July 2025.

Forward-looking OMOs Streamlining

- Assured Liquidity Support (ALS) facility is proposed to be discontinued effective June 2025.
- Intra-Day Liquidity Facility (IDLF) will be introduced shortly to support smooth settlement of OMOs.
- Assured Repo (AR) operations against special-purpose treasury bonds, as well as capital market repo operations, are planned to be phased out in the near future.

3) **Policy Initiatives to stabilise the foreign exchange market**

i) Bangladesh adopted fixed exchange rate regime since its independence and continued until 30 May, 2003 with occasional adjustment to maintain export competitiveness.

ii) Effective from 31 May, 2003 Bangladesh floated its exchange rate and followed a market based exchange rate for Taka. Under this arrangement, exchange rate was determined on the basis of *demand and supply of the respective currencies.*

iii) For avoiding unusual volatility in the exchange rate Bangladesh Bank may purchase and sell US Dollar as and when it deems necessary to maintain stability in the foreign exchange market.

iv) Up until April 2022, the Bangladesh Taka (BDT) maintained a stable rate of 86.45 BDT/USD, reflecting Bangladesh Bank's active intervention.

v) During the height of the pandemic, BB frequently sold foreign currency to stabilise the Taka. Over FY22, FY23, and FY24, BB's net sales of foreign currency totaled USD 7.4 billion, USD 13.4 billion, and USD 9.4 billion, respectively, showing increased intervention to support the currency. However, this intervention contributed to a depletion of foreign reserves, prompting Bangladesh to adopt a gradual depreciation strategy.

vi) Recognizing the un-sustainability of an overvalued BDT, BB allowed gradual depreciation, which amounted to 9.3 percent in FY22, 11.84 percent in FY23, and 10.14 percent in FY24.

vii) In order to bring more flexibility in the foreign exchange market, BB implemented a crawling peg system on 8 May 2024. This interim arrangement was anchored to a currency basket with a mid-rate aligned with the Real Effective Exchange Rate (REER) Index. Under this system, the Crawling Peg Mid Rate (CPMR) was set at Tk. 117.00 per US dollar and allowed market participants to trade around this mid-rate.

viii) Following the introduction of the Crawling Peg Exchange Rate System, Bangladesh Bank implemented a ±1 Taka band around the Crawling Peg Mid-Rate (CPMR) (BDT 117/USD), effective from May 9, 2024. It allowed interbank foreign exchange transactions within a defined range, facilitating a gradual market adjustment to the new regime.

ix) Following the initial implementation of a ±1 Taka band around the Crawling Peg Mid-Rate (CPMR) (BDT 117/USD) on May 9, 2024, BB further widened the band to ±2.5%, effective from August 19, 2024. The widening of the band was aimed at enhancing the efficiency of the foreign exchange market, reducing distortions, and supporting the transition to a more market-oriented exchange rate regime.

x) On December 30, 2024, the Governor of Bangladesh Bank announced an upward revision of the Crawling Peg Mid-Rate (CPMR) from BDT 117/USD to BDT 119/USD, effective January 1, 2025. The band of ±2.5% around the CPMR was remained unchanged.

xi) In order to enhance market-driven foreign exchange operations, BB allowed authorised dealers (ADs) to freely negotiate foreign exchange rates with customers and other dealers, ensuring greater flexibility in currency transactions since December 31, 2024

xii) BB started to publish a daily reference benchmark exchange rate from January 12, 2025, which was calculated as the weighted average of freely quoted exchange rates from market transactions.

xiii) On 9 February 2025, BB decided that spot exchange rates may vary from transaction to transaction in a business day, subject to movement within the prescribed band of the crawling peg mid rate, as guided by BB from time to time.

To bring wider flexibility in exchange rate management, it has been decided to repeal the previous circular in which it was instructed that Authorised Dealers (ADs) may apply a maximum of 1 Taka as spread between buying and selling foreign currencies as well as to maintain uniformity irrespective of the size for all buying and selling transactions of a business day. Accordingly, FE Circular No. 38 dated 31 December 2024 was made operational which allowed ADs to purchase and sell foreign currencies from/to their customers and other dealers at freely negotiated rates.

Policy Note 02

Why Electricity Consumption Data is an incomplete Proxy for Economic Activity[5]

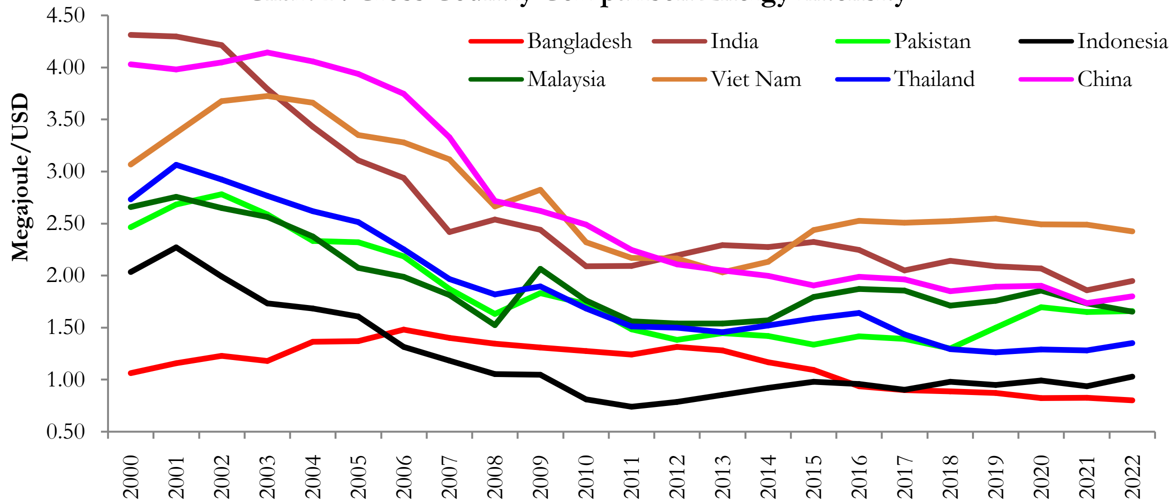
Bangladesh Bureau of Statistics (BBS) is compiling and publishing national accounts since 1972. According to the BBS, nominal GDP stood at $459 billion in FY24. Recently, Citibank Capital, a subsidiary of City Bank PLC, published a report titled "Macroeconomic Outlook 2025: Bangladesh", in which they estimated nominal GDP at $300 billion for FY24, using electricity production data published by the Bangladesh Power Development Board (BPDB). By comparing nominal GDP data from a few regional countries for FY24, the report suggested that nominal GDP of Bangladesh was overestimated by around 35 percent in FY24. Some of the media outlets in Bangladesh also published reports based on the claim made by Citibank Capital.

01. The BBS compiles GDP based on the concepts, definitions, classifications, and methodology outlined in the best practice document "*System of National Accounts, 2008 (2008 SNA)*". The SNA is the internationally agreed standard set of recommendations on how to compile measures of economic activity in accordance with strict accounting conventions based on economic principles. It has been produced and is released under the auspices of the United Nations, the European Commission, the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), and the World Bank (WB) Group. The IMF and WB regularly provide technical assistance to the BBS to improve the GDP compilation process. Furthermore, an Advisory Committee, or technical committee, headed by renowned economist Prof. Dr. Wahiduddin Mahmud, was established to review the methodological appropriateness of the GDP compilation. The committee oversaw and contributed to the effective compilation of the new GDP series, with 2015-16 as the base year without interference from the interim government.
02. The BBS has been rebasing GDP approximately once a decade since 1972 to capture structural changes in economic activities, consumption patterns, savings behaviour, and relative price changes. The size of GDP increased with the rebasing, due to the inclusion of new and emerging sectors of the Bangladesh's economy in the GDP compilation process. The BBS has rebased GDP four times, with base years 1984-85, 1995-96, 2005-06 and 2015-16 resulted in volume increases of 4.96%, 27.73%, 15.21%, and 19.79% respectively.
03. Chart 1 displays historical data on energy consumption per unit of output, commonly referred to as energy intensity, for various countries. The chart demonstrates that, with a few exceptions, Bangladesh has maintained the lowest energy intensity level among these countries. Lower

[5] This note has been prepared by Dr. Md. Ezazul Islam, Executive Director, Mr. Mahmud Salah Uddin Naser, Director, Dr. Md. Omor Faruq, Additional Director and Mr. Ahsan Ullah, Joint Director of Monetary Policy Department of the Bangladesh Bank. Views expressed in this note are authors' own and do not necessarily reflect that those of the Bangladesh Bank.

energy intensity may suggest that the Bangladesh's economy is labour-intensive, as sectors such as agriculture, textiles, and services typically use less energy than a more industrialised or manufacturing-based economy

Chart 1 : Cross Country Comparison Energy Intensity



Source: World Bank for GDP (current US$) and International Energy Agency for Total Electricity Production

04. The ratio of energy use to GDP is not an ideal indicator of energy efficiency or technological development. The ratio depends much on the structure of the economy as on the energy intensities of sectors or activities and changes in the ratio over time are influenced almost as much by change in the structure of the economy as by the changes in the structure of the economy as by the changes in the sectoral energy intensities. Estimating Bangladesh GDP based only on electricity consumption data may lead to inaccurate estimates of nominal GDP for several reasons such as exclusion of non-electricity using sectors, change in the source of electricity production, improvement in labour productivity, or growth in sectors with low energy consumption. Additionally, when calculating measurements for different countries using GDP, it is preferable to use GDP based on Purchasing Power Parity (PPP) rather than nominal GDP. PPP-based GDP is calculated by dividing nominal GDP by the PPP exchange rate. The latter reflects the purchasing power of the national currency relative to that of the US dollar in the USA. The International Energy Agency (IEA) also uses GDP based on PPP to compile energy intensity data.

05. While calculating Bangladesh's GDP, many sub-sectors that do not using electricity for production. Additionally, while various mechanical tools are utilised in agriculture, fishing, and other service sectors, many of these tools do not operate on electricity. As a result, estimating GDP solely based on electricity production data could yield inaccurate nominal GDP figures.

In conclusion, while electricity production data can offer some insight into economic activity, relying solely on it for estimating GDP is likely to overlook significant factors and result in a skewed or inaccurate estimate of nominal GDP.

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