Monetary Policy Statement

July-December 2023

Bangladesh Bank

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Acronyms and Abbreviations

ABB	Association of Bankers, Bangladesh
ALS	Assured Liquidity Support
App	Appreciation
BAFEDA	Bangladesh Foreign Exchange Dealer's Association
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladesh Taka
BoP	Balance of Payments
BPM6	Balance of Payments and International Investment Position Manual, 6th. edition
BSEC	Bangladesh Securities and Exchange Commission
CBOE	Chicago Board Options Exchange
CMSME	Cottage, Micro, Small and Medium Enterprise
COVID	Coronavirus Disease
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DBU	Domestic Banking Unit
Dep	Depreciation
DSE	Dhaka Stock Exchange
DSEX	Dhaka Stock Exchange Broad Index
EDF	Export Development Fund
EFPF	Export Facilitation Pre-finance Fund
ERQ	Export Retention Quota
FY	Fiscal Year
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GIR	Gross International Reserves
H1	First Half
H2	Second Half
IBLF	Islamic Banks Liquidity Facility
IDTP	Interoperable Digital Transaction Platform
IMF	International Monetary Fund
IRC	Interest Rate Corridor
IT	Information Technology
LC	Letter of Credit
M2	Broad Money
MI	Market Infrastructure
MLS	Mudarabah Liquidity Support
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
MPD	Monetary Policy Department
MPS	Monetary Policy Statement
NBFI	Non-Bank Financial Institution
NDA	Net Domestic Asset
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Asset
NFCD	Non-resident Foreign Currency Deposit
NPL	Non-Performing Loan
NRB	Non-Resident Bangladeshis
NSC	National Savings Certificates
OBU	Offshore Banking Unit
PIN	Personal Identification Number
PoP	Period over Period
PoS	Point of Sale
QR	Quick Response
RBS	Risk-Based Supervision
REER	Real Effective Exchange Rate
RM	Reserve Money
SDF	Standing Deposit Facility
SLF	Standing Lending Facility
SLR	Statutory Liquidity Ratio
SMART	Six-months Moving Average Rate of Treasury bills
TB	Treasury Bills
UAE	United Arab Emirates
UK	United Kingdom
USA	United States of America
USD	US Dollar
WEO	World Economic Outlook
WHO	World Health Organization
y-o-y	Year on Year

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Executive Summary

The global economy has undergone significant challenges over the past three and a half years, including the impact of the COVID-19 pandemic that began in December 2019, followed by the Russia-Ukraine conflict that started in February 2022. Central banks worldwide have implemented various policy measures to overcome these challenges, initially through easy monetary policies such as low policy rates and quantitative easing and later transitioning to tight monetary policies through policy rate hikes tailored to the prevailing economic conditions. Encouragingly, the COVID situation has shown significant improvement, leading to the formal declaration by the World Health Organization (WHO) that the COVID-19 pandemic has ended in 2023. Similarly, the effects of the Russia-Ukraine war have started to diminish in recent times, with commodity prices displaying signs of gradual moderation since April 2022.

In parallel with the global economy, Bangladesh has also faced multiple challenges, including high inflationary and exchange rate pressures, as well as substantial erosion of foreign exchange reserves. The country's financial sector has also been burdened by a high non-performing loan (NPL). To address these challenges, Bangladesh Bank (BB) has undertaken several policy initiatives focused on controlling inflation, improving the current account balance, managing exchange rate instability and keeping adequate foreign exchange reserves, stabilizing the financial sector, and strengthening the capital market. However, rising inflation and sustained exchange rate pressures continue to pose significant challenges for Bangladesh economy.

Containing inflation will be the first and foremost objective of this MPS. The strategy will be to reduce the aggregate demand in the economy while continuing the supply-side interventions. Recognizing the importance of containing inflation and ensuring the flow of funds to productive sectors, including agriculture, CMSMEs, large industries, import-substituting sectors, and services, this Monetary Policy Statement (MPS) emphasizes the urgent need for a stable and favorable business environment. To achieve these objectives in the first half of the fiscal year 2023-24 (H1FY24), BB will adopt a **contractionary monetary policy** stance accompanied by specific policy initiatives.

Firstly, BB will transition from a monetary targeting to an interest rate targeting framework. The target policy interest rate, set at 6.50 percent, will be accompanied by a ±200 basis points symmetric corridor consisting of a standing lending facility (SLF) rate at 8.50 percent and a standing deposit facility (SDF) rate at 4.50 percent. Under this new framework, the interbank call money rate will closely align with the policy rate, ensuring stability.

Conforming to the tight monetary policy stance, BB decides to increase the policy rates. The policy rate, repo rate is adjusted upward by 50 basis points from 6.00 percent to 6.50 percent, while the SDF rate, previously known as reverse repo rate is adjusted upward by 25 basis points from 4.25 percent to 4.50 percent effective from 1 July 2023. This measure aims to raise the cost of borrowing, which is expected to have a limiting impact on CPI inflation.

Secondly, BB intends to introduce a market-driven reference lending rate for all types of bank loans, replacing the previously imposed lending rate cap. This move aims to enhance competitiveness in the banking sector and foster a favorable lending environment for businesses and individuals. The reference lending rate, known as the 'SMART' (six-month moving average rate of Treasury bill), will be announced monthly through the BB website, with a margin applied for banks and non-bank financial institutions (NBFIs). In practice, SMART plus a margin of up to 3.00 percent will be applicable for banks, and SMART plus a margin of up to 5.00 percent will be applicable for NBFIs. However, the lending activities for CMSMEs and consumer loans may be subject to an additional fee of up to 1.00 percent to cover supervision costs and there will be no changes in the interest rates applicable to credit card loans.

Thirdly, BB will adopt a unified and market-driven single exchange rate regime, allowing the exchange rate between BDT and USD or any other foreign currency to be determined by market forces. BB will no longer quote specific rates for buying or selling foreign exchanges, promoting stability in the foreign exchange market.

Lastly, BB will calculate and publish gross international reserves (GIR) in line with the sixth edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6) while keeping track of current practices of calculating and reporting total foreign assets.

The achievement of the monetary policy objectives for FY24 largely depends on various factors, including the effectiveness of the new policy initiatives, exchange rate stability, a surplus in the financial account, and a pause in the policy rate hike race among major economies. Given the favorable developments of these factors, BB aims to tackle inflation and exchange rate pressures while fostering a stable and resilient macroeconomic environment. However, with appropriate policy supports from Bangladesh Bank and the Government of Bangladesh, amid a pandemic-free environment and normalized conditions of Russia-Ukraine war-related disruptions, Bangladesh's macroeconomic outlook is expected to remain stable in the near future.

Monetary Policy Statement: H1FY24

1. Foreword

In its capacity as a customary and fundamental operation of Bangladesh Bank (BB), this Monetary Policy Statement (MPS) for the first half of FY2023-24 (H1FY24) is hereby proclaimed and published. This statement accentuates the aims and disposition of monetary policy alongside the annual monetary and credit projections for FY24. The objectives of monetary policy, in accordance with the Bangladesh Bank Order (BBO) of 1972, lay particular emphasis on upholding the stability of the internal and external par value of the Bangladeshi Taka (BDT). This entails addressing domestic inflation and preserving the BDT exchange rate vis-à-vis major trading partner currencies, while concurrently ensuring the financial sector's stability to foster sustained economic growth. Accordingly, the stance of the monetary policy, and the monetary and credit projections are devised based on comprehensive macroeconomic assessments and prospects, both domestically and internationally. Notably, BB is on the verge of implementing a transformative alteration to the forthcoming monetary policy framework by incorporating the short-term interest rate, specifically the interbank call money rate, as the operating target of monetary policy, supplanting the current practice of focusing on reserve money.

In order to establish the monetary policy objectives and stance, draw up the monetary and credit projections, and effectuate the structural change within the monetary policy framework, BB orchestrates in-person consultations with a diverse array of esteemed macroeconomic experts. These experts encompass former and current policymakers, economic analysts from think tanks and academic institutions, and esteemed leaders from the financial and business sectors. BB also conducts meetings with its executives and learned members of the BB's Board of Directors. The opinions, suggestions, and guidance proffered by these experts are accorded the utmost importance and due consideration during the formulation of this Monetary Policy Statement (MPS). The invaluable feedback elucidates the prevailing macroeconomic conditions. It unveils potential policy options, which is a pivotal tool in comprehending the requisite and fitting policy stance, ultimately informing the delineation of the monetary and credit projections for FY24. A concise evaluation of the preceding monetary policy stance has been meticulously conducted, while simultaneously scrutinizing all pertinent background information and rationale, thereby enabling the determination of the stance and formulation of the monetary and credit projections for this FY24 monetary policy statement.

2. Monetary Policy Outcomes in H2FY23

The monetary policy for H2FY23, announced in January 2023, can be viewed as an extension of the monetary policy adopted for FY23 in June 2022. However, certain adjustments were made to the monetary policy stance and the annual monetary and credit programs. The primary objectives underlying the formulation of the H2FY23 monetary policy were as follows: (i) Mitigating the inflationary pressure arising primarily from the disruptions in the supply chain resulting from the Russia-Ukraine conflict; (ii) Addressing the exchange rate pressure stemming from a substantial trade deficit along with a deficit in the financial account, which is used to be surplus; (iii) Ensuring stability within the financial sector, which had been considerably disrupted by a high level of non-performing loans; (iv) Supporting economic growth by promoting investment and fostering activities that generate employment opportunities. The H2FY23 monetary policy was devised to achieve the revised target of 6.50 percent real GDP growth while keeping inflation within a ceiling of 7.50 percent. Additionally, efforts were made to transition the multiple exchange rates towards a unified and market-oriented regime amid growing inflationary and exchange rate pressures.

In the backdrop of growing inflationary pressure, the repo rate was raised by 25 basis points, increasing from 5.75 percent to 6.00 percent, while the reverse repo rate was adjusted from 4.00 percent to 4.25 percent. These rates hike effectively conveyed BB's intentions to the market, anchoring inflationary expectations. Besides, BB's substantial foreign currency sales appeared to be an automatic quantitative tightening measure for the money market. Recognizing that the inflationary pressures primarily originated from disruptions in the supply chain, BB placed increased emphasis on containing demand along with bolstering domestic production. To this end, BB continued its support for production enhancement initiatives, including refinancing/pre-financing lines dedicated to agriculture, CMSMEs (Cottage, Micro, Small, and Medium Enterprises), import substitutes, and export-oriented industries. Additionally, BB provided substantial refinance facilities to help the implementation of the government's ongoing stimulus packages, which aimed to mitigate the impacts of the COVID-19 pandemic. During H2FY23, BB further strengthened agricultural and rural credit programs by expanding the target of agricultural credit disbursement.

In response to mounting exchange rate pressure, various policy initiatives were taken to incentivize foreign currency inflows while containing foreign exchange outflows. BB allowed the Bangladesh Taka (BDT) to depreciate by more than 13 percent while reinforcing the volume and value of exports and imports monitoring to address over and under invoice induced trade-based money laundering. Besides, BB had to inject USD 12.62 billion (net sales) during July-May of FY23 to ease the exchange rate pressure. BB established the Export Facilitation Pre-finance Fund (EFPF) to facilitate export-oriented industries, amounting to Tk. 10,000 crore at a 4.00 percent subsidized interest rate. Conversely, BB tightened the foreign currency loan limit and increased the Export Development Fund (EDF) interest rate to ensure proper utilization of foreign currencies. BB's key policy initiatives related to exchange rate and foreign exchange reserves management can be found in section 4.1.

In its efforts to mitigate the high NPL ratio, BB has bolstered its oversight of banks and large borrowers. Furthermore, BB has taken a proactive role in amending the existing Bank Company Act of 1991, aiming to address the challenges associated with the high NPL problem. BB has maintained its provision of repo and liquidity support facilities to ease liquidity conditions. In recognition of the specific needs of Shariah-based Islamic banks, BB has introduced Mudarabah Liquidity Support (MLS) options spanning 7 days, 14 days, and 28 days, as well as a dedicated 14-day Islamic Banks Liquidity Facility (IBLF). These initiatives have been implemented to ensure prudent liquidity management and promote long-term financial stability for Shariah-based Islamic banks.

As a result of the H2FY23 monetary policy measures and government actions, exports, a key indicator of external demand, have grown by 7.11 percent (Period over Period, PoP) during the July-May of FY23, which was 34.09 percent in the same period of last year. The slower export growth can be attributed to a higher base in the corresponding period and the prevailing global economic turmoil and uncertainties.

On the other hand, customs-based imports, a crucial indicator of internal demand, have declined by 14.44 percent (PoP) during the July-April of FY23 against the significant rise of 41.40 percent following the consolidation of recovery from corona pandemic fallout during the same period of the previous fiscal year. Furthermore, consumer credit, another important indicator of internal demand, has witnessed a growth of 21.19 percent (Year over Year, YoY) in March 2023, slightly higher than the 19.88 percent increase recorded in the same month of the previous year.

The private sector credit growth and the implementation of various government mega projects, which reflect the national investment landscape, have remained fairly well in H2FY23. Private sector credit growth reached 11.10 percent (YoY) in May 2023, compared to 12.94 percent in the same month of the previous year. Additionally, the output of medium and large-scale manufacturing, a significant component of Gross Domestic Product (GDP), has increased by 8.88 percent (PoP) during the July-January period of FY23. According to the provisional estimate from the Bangladesh Bureau of Statistics (BBS), the real GDP growth for FY23 is expected to be 6.03 percent, which falls short of the government's revised target of 6.50 percent. Notably, the real GDP growth in FY22 was 7.10 percent.

In H2FY23, domestic commodity prices have experienced a significant increase compared to the corresponding period of the previous fiscal year. According to available Consumer Price Index (CPI) data, the point-to-point inflation rate reached 9.94 percent in May 2023, compared to 7.42 percent in May 2022. Moreover, the CPI-based average headline inflation stood at 8.84 percent in May 2023, surpassing the government's revised target ceiling of 7.50 percent set for June 2023.

Several factors have contributed to the elevated domestic commodity prices and inflation. These include higher prices of imported items in the global market and a larger depreciation of the Bangladesh Taka (BDT) in FY23 to maintain external competitiveness. The upward adjustments in fuel and energy prices have also significantly contributed to the inflationary pressure. All these factors have collectively contributed to the overall increase in domestic commodity prices. The lack of a competitive environment, along with market syndication, could have also contributed to the current CPI inflation. Within the components of headline inflation, non-food inflation has experienced a greater rise compared to food inflation. This can be attributed to higher price in particular categories such as recreation and culture, furnishings and household equipment, housing, water, electricity, gas, and other fuels. Section 4.3 outlines BB's initiatives to control inflation, demonstrating its commitment to maintaining price stability within the economy.

Although the monetary and credit aggregates, typically controlled by BB to achieve monetary policy objectives, have remained on the programmed path until May 2023, the inflation rate has soared primarily due to the aforementioned supply-side factors. Among these aggregates, broad money growth, an indicator of demand-influencing factors, has remained below the programmed path until May 2023, indicating its limited influence on the current commodity price surge. Table 1 and Charts 1-6 visually represent the actual growth trajectories of major monetary and credit aggregates compared to their programmed growth for FY23, as set and announced in January 2023.

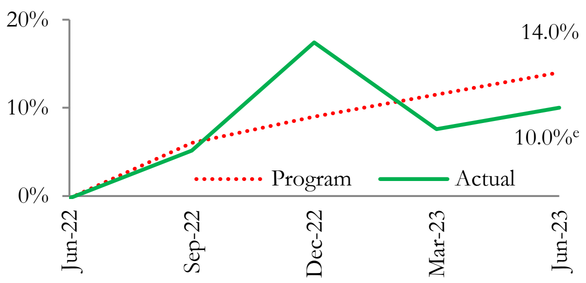
Table 1: Developments of Monetary Aggregates

(YoY % change)

Item	Jun-22 Act.	Dec-22 Act.	May-23 Prov.	Jun-23 Est.	Jun-23 Prog.@
Broad money	**9.4**	**8.5**	**9.5**	**10.5**	**11.5**
Net Foreign Assets*	-11.9	-23.3	-26.2	-25.7	-11.9
Net Domestic Assets	17.2	18.9	19.8	20.4	17.9
Domestic Credit	16.2	15.4	16.7	16.4	18.5
Credit to the public sector	29.1	27.6	43.3	40.0	37.7
Credit to the private sector	13.7	12.9	11.1	11.0	14.1
Reserve money	**-0.3**	**17.4**	**5.3**	**10.0**	**14.0**
Money multiplier	4.93	4.63	5.23	4.95	4.82
NCG (Crore Taka, during the respective fiscal year)	62,540	12,452	78,140	1,15,425	1,11,608#

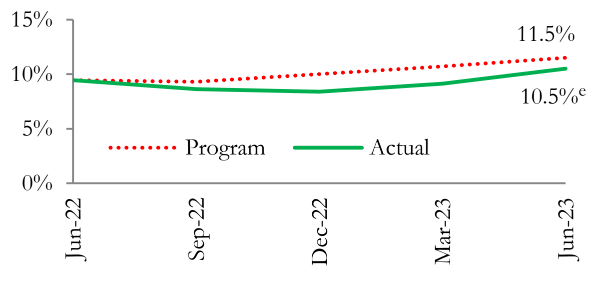
Source: Bangladesh Bank. Note: NCG = Net credit to the government from the banking system. *Calculated using the constant exchange rates of end June 2022. # Target set for FY23. @Announced in January 2023.

Chart 1: Reserve Money (RM) Growth



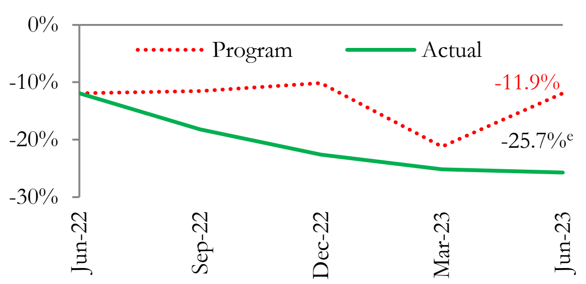
Source: Bangladesh Bank. e= estimate

Chart 2: Broad Money (M2) Growth



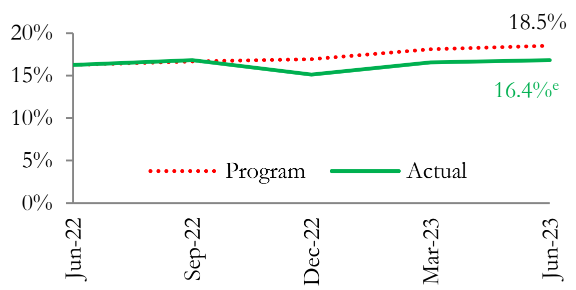
Source: Bangladesh Bank. e= estimate

Chart 3: Net Foreign Assets (NFA) Growth



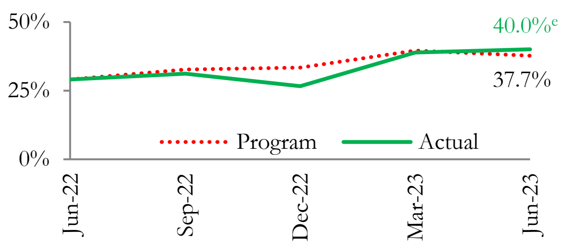
Source: Bangladesh Bank. e= estimate

Chart 4: Domestic Credit Growth



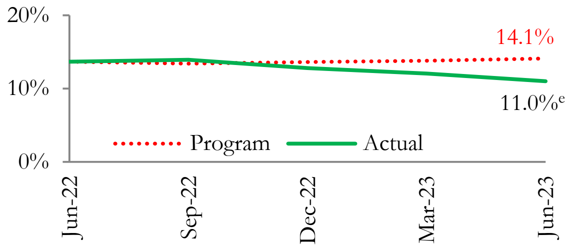
Source: Bangladesh Bank. e= estimate

Chart 5: Public Sector Credit Growth



Source: Bangladesh Bank. e= estimate

Chart 6: Private Sector Credit Growth



Source: Bangladesh Bank. e= estimate

According to Chart 1, the growth of reserve money (RM), which serves as the operating target of BB's monetary policy, deviated from the programmed path in different quarters of FY23. In the first and third quarters, this deviation was primarily due to a substantial decrease in BB's net foreign assets (NFA), which was partially offset by the positive growth of BB's net domestic assets (NDA). However, in the second quarter of FY23, reserve money growth exceeded the programmed path, largely driven by BB's significant liquidity support, particularly to Shariah-based Islamic banks, which further strengthened the positive growth of BB's NDA. It is worth noting that the negative growth of BB's NFA was driven by the substantial sale of foreign currency to banks in response to robust import demands. On the other hand, the positive growth of BB's NDA was influenced by BB's extensive liquidity support to both conventional and Shariah-based Islamic banks, as well as the transfer of government securities to BB in response to liquidity pressure in the money market.

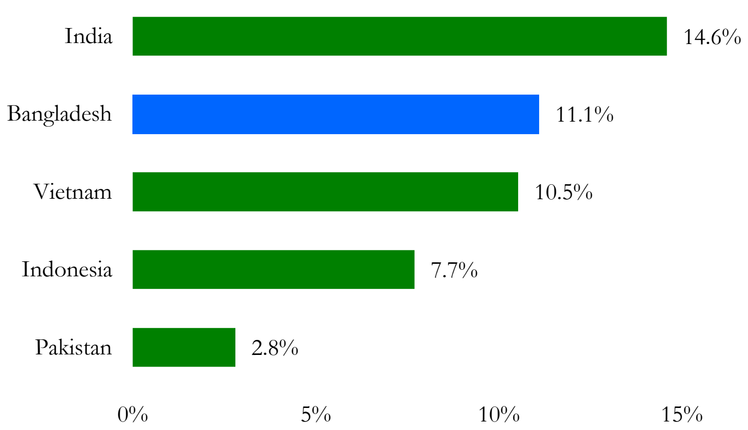
In terms of broad money (M2) growth, which serves as the nominal anchor or intermediate target of BB's monetary policy, it remained well below the programmed path until May 2023, primarily due to the drag from lower net foreign assets (NFA) of the banking system, as depicted in Chart 2. The NFA of the banking system experienced a YoY decline of 26.17 percent in May 2023, compared to the negative programmed growth of 11.90 percent set for June 2023, as shown in Chart 3. The significant deficit in the overall balance of payments (BoP), resulting from a large current account deficit and substantial trade credit repayments, contributed to the strong negative growth of NFA during the review period.

The domestic credit experienced stronger growth, primarily driven by the robust expansion of public sector credit, amid some deviations from the programmed path until May 2023. The public sector, specifically the government, borrowed Tk. 78,140 crore (67.70 percent of the yearly target) from the banking system during July- May of FY23 as against the revised yearly target of Tk. 1,15,425 crore. As a result, public sector credit growth reached 43.32 percent (YoY) in May 2023, compared with 27.66 percent in May 2022. The positive growth of public sector credit during the period under review can be attributed to the negative net sale of national savings certificates (NSCs) and lower net deficit financing from foreign sources. Additionally, the increased costs of implementing government mega projects amidst higher global commodity prices also contributed to the substantial growth of public sector credit from the banking system.

The net sale of NSCs recorded a negative value of Tk. 3,580 crore during July-April of FY23, in contrast to a positive net sale of Tk. 17,519 crore during the same period of FY22, and fell short of the government's revised target of net NSCs sales of Tk. 20,000 crore set for FY23. Similarly, net foreign financing amounted to Tk. 44,454 crore during July-April of FY23, compared to Tk. 54,895 crore during the corresponding period of the previous fiscal year.

Private sector credit exhibited a slower growth of 11.10 percent (YoY) in May 2023, following its growth rate of 12.94 percent in May 2022. This growth was mainly driven by higher domestic and international commodity prices, as well as significant depreciation of the Bangladesh Taka (BDT) against the US dollar (USD). The rebound of economic activities following the recovery from the COVID-19 pandemic also played a crucial role in the growth of private sector credit, given the lower demand for import financing. However, private sector credit growth remained well below the programmed growth target of 14.10 percent set for June 2023 (Chart 6). Nevertheless, Bangladesh's private sector credit growth, a reflection of private investment at the national level, performed fairly well compared to many other emerging and developing Asian economies (Chart 7).

Chart 7: Cross-country Comparison of Private Sector Credit Growth*



Source: Respective Central Banks' Websites.
* Bangladesh and India's data up to May 2023. Indonesia and Pakistan's data up to April 23. Vietnam's data up to March 23.

3. Global and Local Contexts of Monetary Policy for H1FY24

3.1 Global Context: Growth, Inflation and Trade Environment

According to the IMF's latest World Economic Outlook in April 2023, global GDP is projected to decline to 2.8 percent in 2023 compared to 3.4 percent in 2022. However, there is expected to be a recovery with a growth rate of 3.0 percent in 2024. The GDP growth rate of advanced economies is projected to decline to 1.3 percent in 2023 from 2.7 percent in 2022, with a marginal increase to 1.4 percent in 2024. Developing and emerging economies are expected to experience a slight slowdown in 2023 at 3.9 percent, followed by a rebound to 4.2 percent in 2024. In South Asia, excluding Pakistan and Sri Lanka, countries are expected to maintain GDP growth rates above 5 percent in 2023 and 2024. Bangladesh is anticipated to have the highest growth rate of 6.5 percent among the selected South Asian countries in 2024.

Table 2: Overview of Global Economic Growth as of April 2023 WEO

(YoY % change)

Region	Growth				Difference from October 2022 WEO Projection	
	Actual		Projection			
	2021	2022	2023	2024	2023	2024
World	**6.3**	**3.4**	**2.8**	**3.0**	**-0.1**	**-0.2**
Advanced Economies	5.4	2.7	1.3	1.4	0.2	-0.2
USA	5.9	2.1	1.6	1.1	0.6	-0.1
Euro Area	5.4	3.5	0.8	1.4	0.3	-0.4
Other Advanced Economies	5.4	2.6	1.8	2.2	-0.5	-0.4
Emerging Market and Developing Economies	6.9	4.0	3.9	4.2	0.2	-0.1
China	8.5	3.0	5.2	4.5	0.8	0.0
India	9.1	6.8	5.9	6.3	-0.2	-0.5
Bangladesh	6.9	7.1	5.5	6.5	-0.5	0.0
Pakistan	5.7	6.0	0.5	3.5	-3.0	-0.7
Sri Lanka	3.3	-8.7	-3.1	1.5	-0.9	0.0
Indonesia	3.7	5.3	5.0	5.1	0.0	-0.3
Vietnam	2.6	8.0	5.8	6.9	-0.4	-0.3

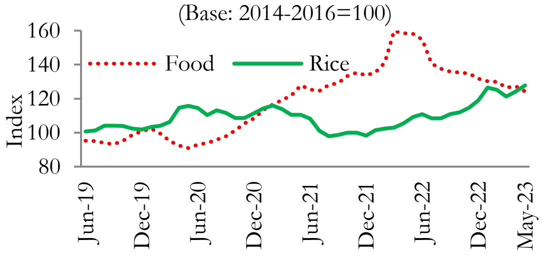
Source: World Economic Outlook, April 2023, International Monetary Fund.

The Asia-Pacific region, contributing to 70 percent of global growth, has demonstrated considerable resilience and vibrancy. This is primarily attributed to the renewed impetus generated by China's reopening and increased external demand. Projections indicate that economic growth in Asia and the Pacific is expected to climb to 4.6 percent in 2023, surpassing the 3.8 percent growth recorded in 2022 according to Regional Economic Outlook, Asia and Pacific, May 2023.

Global headline inflation has been slowly declining since mid-2022, mainly due to falling fuel and energy prices. However, the projected rates for 2023 indicate that inflation remains higher than previous forecasts. Advanced economies are expected to experience lower inflation, from 7.3 percent in 2022 to 4.7 percent in 2023, driven by dropping commodity prices and the effects of monetary tightening. On the other hand, emerging market and developing economies may continue to experience higher inflation rates, reaching 8.6 percent in 2023. The IMF predicts that inflation will likely exceed targets in most countries in 2024, but the rate is expected to approach targets in 2025 as global commodity prices trend lowers and oil prices decline.

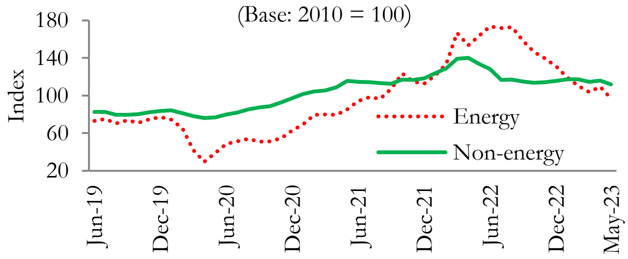
The global food price index has been steadily decreasing since July 2022, except for the rice price index, which has been rising since the beginning of 2022 and continued with some fluctuations until May 2023 (Charts 8). Similarly, the energy price index has generally been on a downward trajectory, though the price index of non-energy commodities experienced an almost stable trend until May 2023 (Chart 9).

Chart 8: Global Food and Rice Price Indices
(Base: 2014-2016=100)



Source: Food and Agriculture Organization

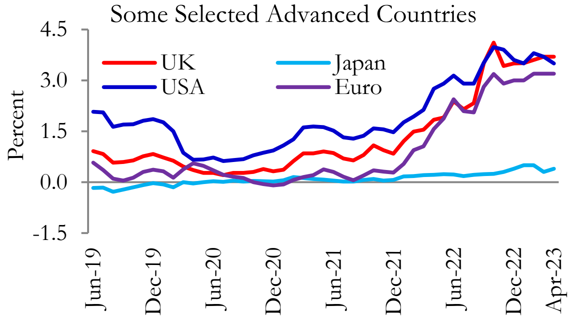
Chart 9: Commodity Price Indices
(Base: 2010 = 100)



Source: World Bank

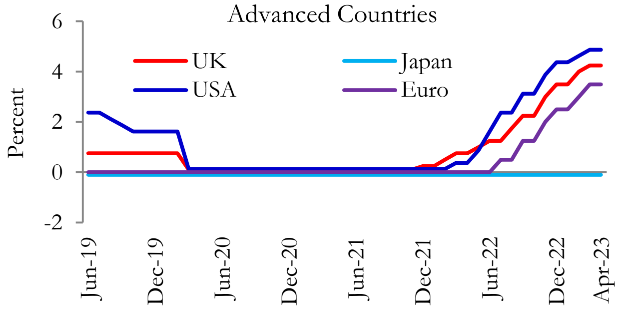
In the aftermath of the pandemic, long-term interest rates have been on an upward trajectory in most of the major developed and developing countries. These rates peaked in October 2022 and have since then fluctuated (Charts 10 and 12). The rises in interest rates, along with the subsequent fluctuations, reflect investor concerns about persistent inflation, despite central banks tightening their policy rates. Japan has continued implementing a zero interest rate policy, maintaining short-term interest rates at or near zero to address deflation and stimulate economic recovery. In contrast, countries such as the US, UK, and Eurozone have raised their policy rates since the beginning of 2022 in response to cooling inflationary pressures (Chart 11). Among the peer countries of Bangladesh, including India, China, and Indonesia, there is a mixed trend, with elevated policy interest rates being maintained, while Vietnam recently experienced a slight decrease, while Pakistan and Sri Lanka have significantly increased their policy rates to address challenging domestic economic conditions (Chart 13).

Chart 10: Long-Term Interest Rates of Some Selected Advanced Countries



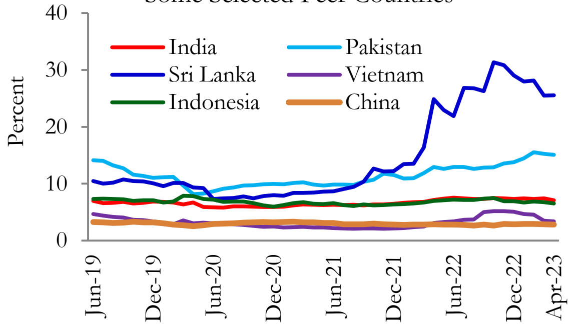
Source: Organization for Economic Co-operation and Development

Chart 11: Policy Rates of Some Selected Advanced Countries



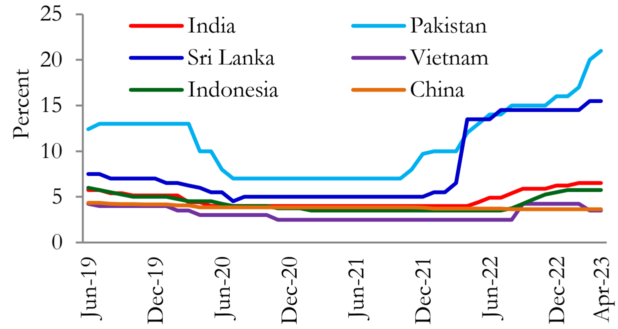
Source: Bank for International Settlements

Chart 12: Long-Term Interest Rates of Some Selected Peer Countries



Source: Organization for Economic Co-operation and Developmen and investing.com

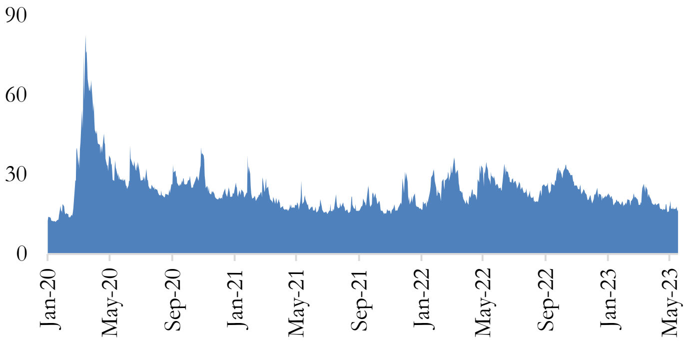
Chart 13: Policy Rates of Some Selected Peer Countries' Central Banks



Source: Bank for International Settlements and Central Banks.

After experiencing a rapid recovery from the recession caused by the pandemic, global trade volume is projected to decline from 5.1 percent in 2022 to 2.4 percent in 2023. This decline can be attributed to increasing trade barriers and the lingering effects of the appreciation of the US dollar in 2022. These factors have led to higher costs of traded products for many economies, particularly due to the dominant USD. Consequently, trade growth in 2023 is expected to be lower than the average of 4.9 percent seen during the two decades prior to the pandemic (2000-2019). Additionally, global current account balances, which rose sharply in 2022, are anticipated to shrink gradually in 2023 due to declining commodity prices.

Chart 14: CBOE Volatility Index



Source: CBOE Exchange

The CBOE Volatility Index is a widely used measure of market volatility, indicating investors' concerns. Financial markets globally have experienced a period of turbulence but are now showing signs of stabilization (chart-14). With the recent trend of decreasing volatility and the US Federal Reserve signaling a pause in interest rate hikes due to banking sector turmoil, emerging and developing countries like Bangladesh may expect reduced uncertainties in their domestic financial markets. However, the short- and medium-term outlook remains highly uncertain as the global economy adjusts to the shocks of 2020-2022 and recent volatility in the financial sector. Downside risks include concerns about recession, inflation, and exchange rate volatility. Managing public debt, raising interest rates, and implementing targeted protection for the vulnerable can help combat inflation. It is crucial to monitor areas of vulnerability, such as high corporate and household debt, market risks, and corporate credit exposure, to maintain financial sector stability.

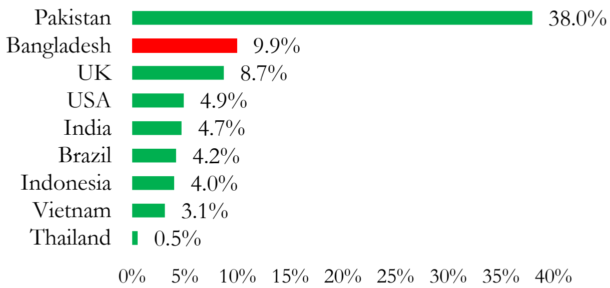
3.2 Local Context

3.2.1 Growth and Inflation

Albeit the initial slowdown caused by the COVID-19 pandemic, the economy of Bangladesh has demonstrated impressive growth over the past two fiscal years, witnessing a real GDP growth of 6.94 percent in FY21 and 7.10 percent in FY22. The economy has shown strong resilience, fueled by internal demand, and has made a swift recovery from the challenges posed by the pandemic. This recovery has been supported by robust growth in the industrial and service sectors, while output from the agriculture sector remained strong during the post-COVID-19 period. Looking ahead to FY23, the agriculture sector is expected to contribute significantly, benefiting from favorable weather conditions and a successful harvest of major crops. Despite facing contemporary threats and geopolitical uncertainties, the economy is expected to maintain a solid growth rate of 6.03 percent (as per BBS provisional estimates) in FY23. The targets for FY24's real GDP growth and CPI inflation are set at 7.50 percent and 6.00 percent, respectively.

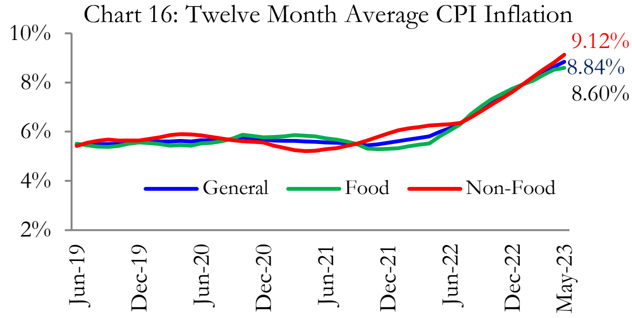
Despite the moderation of commodity prices following the war in Eastern Europe and improvements in supply chain functioning, the high inflation in major economies and global uncertainty with slower growth prospects are expected to challenge the economic recovery of Bangladesh in the first half of FY24. Achieving the growth target of 7.50 percent in FY24 may become challenging. However, the resilient domestic demand, the ready-made garment export sector's strong performance, and favorable external developments are expected to support Bangladesh's higher growth. The BB's model-based GDP growth forecasts for FY24 further reinforce this expectation.

Chart 15: Cross-country Comparison of Point to Point Inflation*



Source: Respective Central Banks' Websites.
* Up to April 2023 for India, Brazil, and USA, and May 2023 for others.

Chart 16: Twelve Month Average CPI Inflation



Note: CPI and its components are calculated by MPD, BB following the methodology adopted by Bangladesh Bureau of Statistics (BBS) while introducing the new base (2021-22) for May 2023

The elevated level of inflation across the globe has declined due to the easing of supply side conditions, and lower food and energy prices. The adjustments have not been reflected equally in Bangladesh's economy mainly due to the domestic price rigidity, lack of adequate market competition and large depreciation of domestic currency, offsetting the potential benefits of lower global prices (Chart 15).

CPI-based inflation in Bangladesh has been rising, especially after the subsequentially upward adjustment of fuel and energy prices during the first quarter of FY23. Chart 16 shows the 12-month average headline inflation trend along with its components, food and non-food inflation, since June 2019. From October 2021 onwards, there has been a gradual increase in 12-month average CPI inflation, with 6.15 percent at end of FY22. Throughout FY23, average inflation continued to rise, reaching 8.84 percent in May 2023. This inflation can be attributed to higher food and non-food prices, driven by elevated global commodity prices, supply shocks, increased transport costs due to fuel and energy price adjustments, and domestic currency depreciation. Although cost-push factors mainly drive inflation in Bangladesh, BB is prioritizing measures to contain inflationary pressure by implementing tighter policies and strengthening interventions on the supply side as envisioned in the national budget for FY24.

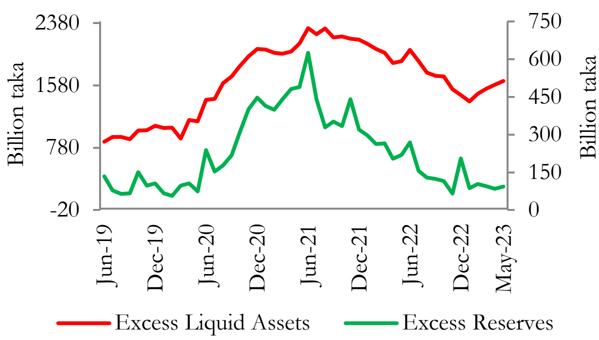
The rigid nature of internal price adjustment, combined with a significant depreciation of the domestic currency, could impede the downward adjustment of domestic inflation, despite the recent decline in international market prices. Consequently, uncertainties may persist in the inflation outlook during the first half of FY24. The inflationary pressure experienced in FY23 may also contribute to elevated inflation expectations throughout FY24. The recent surge in land and construction material prices has impacted an increase in asset prices, exacerbating inflation risk. The ongoing war in Eastern Europe, coupled with higher-than-target inflation levels in trading partner countries and the looming threat of global financial sector turmoil, make it challenging to reduce inflation to a moderate level. However, due to the policy initiatives of the BB, the exchange rate is gradually approaching an optimal level, a unified and single rate. As a result, the downward pressure on the Bangladesh Taka (BDT) is expected to ease, which would assist in containing inflation in FY24. Considering all these factors, achieving the target of 6.00 percent inflation in FY24 may prove to be challenging, as it appears to be relatively higher, as projected by BB's Modeling and Forecasting Unit.

3.2.2 Liquidity and Interest Rate

Bangladesh's banking system's liquidity landscape has been gradually tightening since the end of June 2021, evidenced by the declining levels of excess cash reserves and liquid assets (Chart 17). The heightened demand for bank credit as economic activities rebounded after the post-COVID period intensified liquidity pressures. The increased credit requirements to fuel economic growth have strained the availability of liquid resources within the banking system. The surge in local cash demand can be attributed to the escalation of commodity prices in the domestic market. This surge has been largely influenced by the corresponding price hikes in the international market, compounded by a substantial depreciation of the Bangladesh Taka. These factors have necessitated greater liquidity to meet the rising cash needs. Banks have experienced an elevated demand for foreign currency, primarily fulfilled through purchases from the central bank (BB). This heightened demand stems from much wider than expected balance of payments deficits.

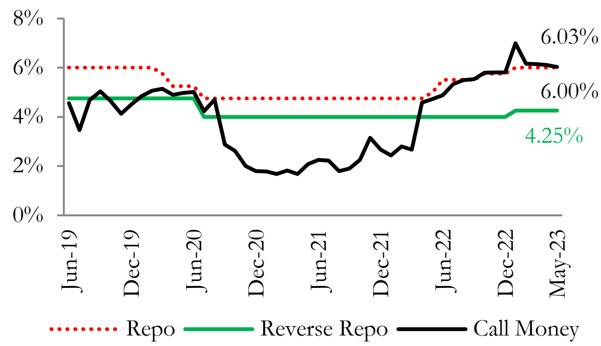
Consequently, there has been an automatic absorption of local currency due to the sale of huge volume of forex by BB, exerting further pressure on liquidity. The slower growth of deposits in banks, along with the sustained burden of NPLs, has also contributed to the tightening liquidity situation. The tight liquidity situation has resulted in a notable increase in the interbank call money rate during H2FY23. On average, the call money rate stood at 6.03 percent in May 2023, slightly surpassing the repo rate (Chart 18).

Chart 17: Movement of Excess Liquid Assets



Source: Bangladesh Bank

Chart 18: Movement of Call Money and Policy Rates



Source: Bangladesh Bank

In order to maintain stability in the liquidity situation, the Bangladesh Bank (BB) has taken various initiatives, which include:

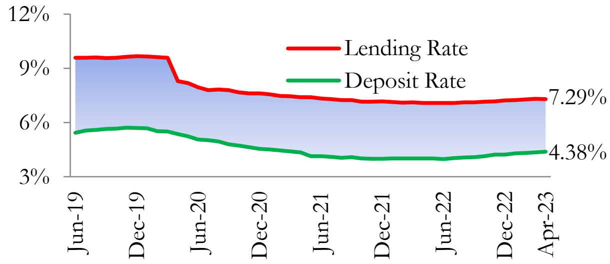
Continued Liquidity Support: BB has consistently provided liquidity support to the banking system by offering repo facilities, assured liquidity support (ALS), and special repo facilities to conventional banks and non-bank financial institutions[1]. Additionally, BB has introduced and implemented the Mudarabah Liquidity Support (MLS) and Islamic Banks Liquidity Facility (IBLF) specifically for Shariah-based Islamic banks.

[1] The outstanding balance of BB's liquidity support to the banks and NBFIs stood at Tk. 20,113 crore at the end of May 2023.

Sector-Specific Refinance Facilities: To promote the development of priority sectors such as agriculture and CMSMEs (Cottage, Micro, Small, and Medium Enterprises), BB has offered refinance and pre-finance facilities to banks. These measures aim to enhance liquidity in sectors crucial for economic growth.

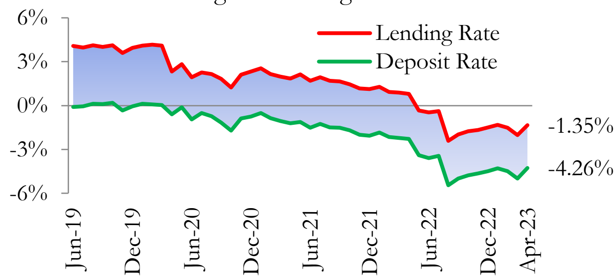
Despite these initiatives, the liquidity condition of banks, particularly Shariah-based Islamic banks, has remained critical. Available data show a significant decline in banks' excess reserves, amounting to Tk. 9,373 crore by the end of May 2023 compared to Tk. 26,876 crore in June 2022. Similarly, the total liquid assets of banks reached Tk. 1,63,682 crore by the end of May 2023, down from Tk. 2,03,435 crore in June 2022.

Chart 19: Weighted Average Nominal Interest Rates



Source: Bangladesh Bank

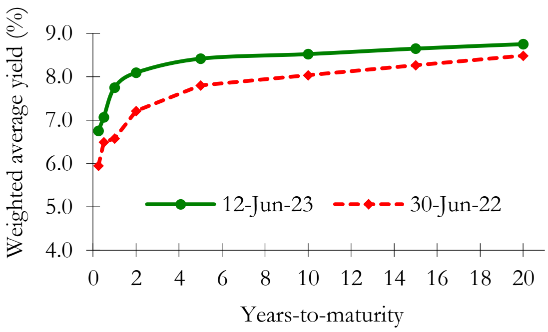
Chart 20: Weighted Average Real Interest Rates



Source: Bangladesh Bank

As the liquidity situation in the local currency market tightened, there was an upward movement in the weighted average nominal lending and deposit rates, as well as the interest rates (yield) on both short and long-term government securities. This trend can be observed in Chart 19 and Chart 21. Specifically, the weighted average nominal lending rate experienced an increase, rising from 7.09 percent in June 2022 to 7.29 percent in April 2023. Similarly, the weighted average nominal deposit rate also saw an upward shift, reaching 4.38 percent in April 2023 compared to 3.97 percent in June 2022.

Chart 21: Yields on Government Securities



Source: Bangladesh Bank

The interest rate spread, representing the difference between the lending and deposit rates, recorded broadly a declining trend in FY23 and stood at 2.91 percent in April 2023, while it was 3.12 percent in June 2022. The government securities-related yield curve on 12 June 2023 was higher than that of end June 2022[2]. The real lending and deposit rates, which had been in negative territory for an extended period, exhibited a declining trend during H2FY23, largely influenced by the upward trend in the inflation rate (as shown in Chart 20). Specifically, the real lending rate decreased from negative 0.47 percent in June 2022 to negative 1.35 percent in April 2023. Similarly, the real deposit rate decreased from negative 3.59 percent in June 2022 to negative 4.26 percent in April 2023.

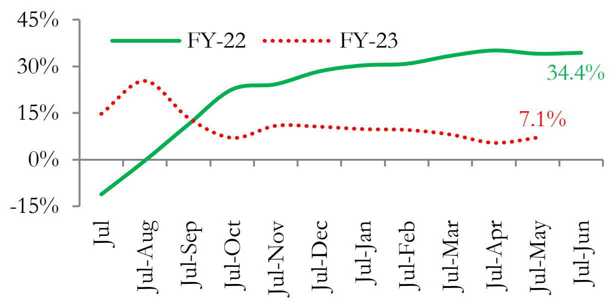
[2] The yield curve shows the interest rates (yields) on government securities for a particular day against their maturities of 91-day, 182-day, 364-day, 2-year, 5-year, 10-year, 15-year and 20-year.

Negative real interest rates on both lending and deposits pose challenges to the development of the banking sector. To address this, BB has taken measures to control inflation while promoting market-oriented interest rates. These actions include the removal of restrictions on deposit rates, the relaxation of the interest rate cap for consumer credit up to 300 basis points to 12.00 percent, and the removal of caps on credit card loans. As a result, both the deposits and credit to the private sector have witnessed steady growth. Looking ahead, BB's move of switching from monetary targeting to interest rate targeting, along with the introduction of market-based competitive reference interest rates for lending activities, may help mitigate the issue of negative real interest rates and bring required flexibility in the policy transmission mechanism.

3.2.3 External Sector

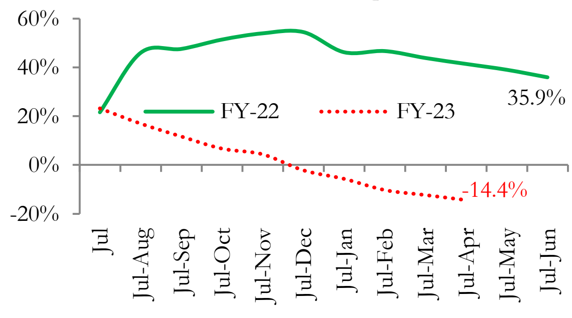
The spillover effect of the Russia-Ukraine war, global uncertainties, tightening monetary policies, and rising geopolitical tensions are significantly impacting Bangladesh and many other countries. The external sector of Bangladesh's economy is facing challenges due to the depreciation of the exchange rate and the depletion of foreign exchange reserves. These challenges arise from an expanded deficit in the overall balance of payments due to the current global economic uncertainties.

Chart 22: Cumulative Exports Growth



Source: Export Promotion Bureau

Chart 23: Cumulative Imports Growth

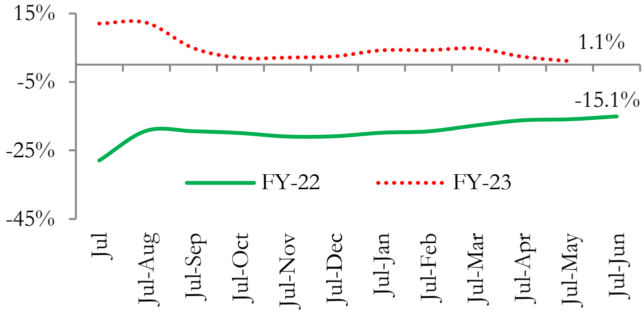


Source: National Board of Revenue

The export growth stood at 7.11 percent during July-May of FY23, while it was 34.09 percent during the same period of the last fiscal year (Chart 22). Among the components of exports, knitwear and woven garments were the driving factors for the total export growth, having 84.37 percent share in total exports and 10.67 percent growth during July-May of FY23. Moreover, plastic products' export growth contributed significantly to the total export growth.

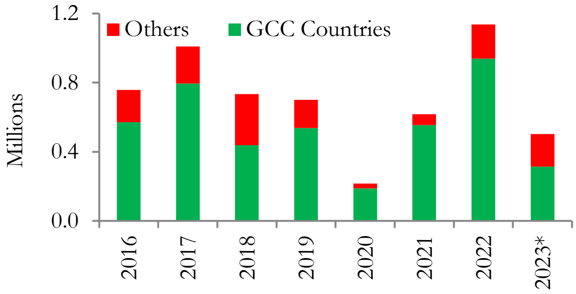
With appropriate policy interventions, the import dropped by 14.44 percent during July-April of FY23 against a staggering 41.40 percent growth during the same period of last fiscal year (Chart 23). This negative growth of imports might be attributed to last year's abrupt swell-up base on the back of unprecedented price hikes of importable items along with a number of initiatives taken by BB and the government since April 2022. Close monitoring of LC opening with fair price monitoring by BB for containing trade-based money laundering along with sharp depreciation of Bangladesh Taka might have contributed to negative growth in imports during this period.

Chart 24: Cumulative Remittance Growth



Source: Bangladesh Bank

Chart 25: Overseas Employment



Source: Bureau of Manpower, Employment and Training.
* Up to May 2023.

The decline in imports and moderate growth in exports and remittances significantly improved the trade balance and narrowed down the current account deficit during July-April of FY23. The inward remittances increased by 1.13 percent to USD 19.4 billion during July-May 2023, while it was USD 19.2 billion with negative growth of 15.95 percent during the same period of the last year (Chart 24). As per available data, the current account deficit narrowed to USD 3.8 billion during July-April of FY23 compared to USD 15.5 billion during the same period of the previous fiscal year. However, improvement in the current account balance could not ease pressure on the overall balance of payment because of the deficit in the financial account. The deficit in the financial account emerged from the repayment of short-term loans, a sharp contraction in trade credit and medium & long-term loans during the period of FY23. Due to the deficit in both the current and financial accounts, the country's overall balance of payment witnessed a deficit of USD 8.8 billion during July-April of FY23 compared with a deficit of USD 5.3 billion during the corresponding period of the previous fiscal year.

Looking ahead, the current account deficit is expected to be around USD 4 billion at the end of FY23, considering export of USD 52.7 billion, imports of USD 70.1 billion and remittance inflows of USD 21.5 billion, respectively. Moreover, the deficit in the overall balance of payments appears to be widened further to USD 8.7 billion at the end of FY23, underpinning the higher repayment of short-term loans and trade credit.

Table 3: Balance of Payments Highlights

(Million USD)

Major Items	FY21 Act.	FY22 Act.	FY23 Est.	FY24 Outlook
Trade balance	-23,778	-33,250	-17,429	-17,769
Services	-3,020	-3,955	-3,936	-4,124
Primary income	-3,172	-3,152	-4,825	-5,181
Secondary income	25,395	21,718	22,152	24,368
of which: workers' remittances	24,778	21,032	21,453	23,598
Current account balance	**-4,575**	**-18,639**	**-4,037**	**-2,706**
Capital accounts	458	181	380	400
Financial accounts	14,067	13,775	-3,580	3,500
Errors and omissions	-676	-697	-1,499	306
Overall balance	**9,274**	**-5,380**	**-8,736**	**1,500**
Memorandum items:				
Exports growth (adjusted as per BPM6, percent)	14.9	33.4	7.0	10.0
Imports growth (percent)	19.7	35.9	-15.0	8.0
Remittances growth (percent)	36.1	-15.1	2.0	10.0
Gross international reserves (GIR)	46,391	41,827	30,000	31,500

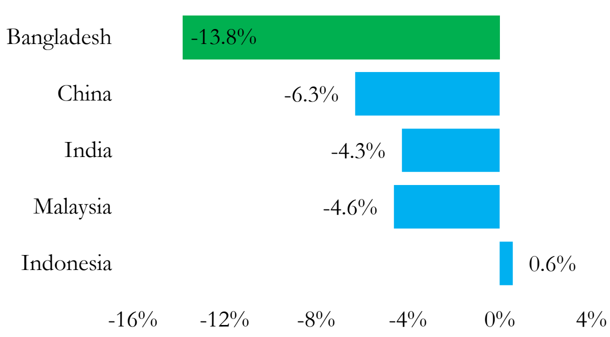
Source: Bangladesh Bank.

The current account deficit is anticipated to stay USD 2.7 billion at the end of FY24. However, the increased overseas employment of wage-earner remitters in FY22; (Chart 25) amid improved economic and working conditions in the source countries is expected to help the inward remittances grow by 10.0 percent in FY24. Considering improved short-term prospects of the world economy, exports and imports will grow by 10.0 percent and 8.0 percent, respectively, in FY24. As a result, the overall balance of payment in FY24 is projected to be at a surplus level, well supported by a befitting performance of the financial account (Table 3).

The surge in the overall balance of payment deficit has led to further depreciating pressure on the exchange rate of BDT and depletion of foreign exchange reserves up to the third quarter of FY23. The BDT has depreciated continuously since the last quarter of FY22 due to excess demand for foreign exchange along with an appreciation of the USD in the global market. To mitigate the depreciating pressure, BB sold (net) around USD 13 billion in FY23 (up to 12 June 2023). BB was following a strategy of gradual depreciation of the Taka, considering the potential inflationary impact of such depreciation on the economy. As of 12 June 2023, BB's foreign exchange reserves stood at USD 29.9 billion compared with USD 41.9 billion at the end of June 2022, while BDT was depreciated by more than 13 percent during the period of FY23.

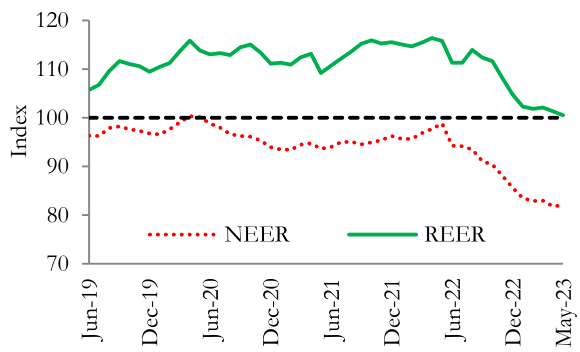
Charts 26 and 27 illustrate that the BDT has experienced a notable depreciation compared to other Asian developing countries. The NEER index reflects this depreciation, while the REER index indicates that the current market exchange rate in Bangladesh adequately represents the currency's value, indicating no immediate requirement for any substantial depreciation of the BDT. Section 4.1 briefly describes BB's initiatives to manage exchange rates.

Chart 26: App(+)/Dep(-) of Domestic Currency against USD during 01 Jul 22 - 12 Jun 23



Sources: Respective Central Banks' Websites.

Chart 27: Effective Exchange Rate Indices (Base: 2015-16=100)

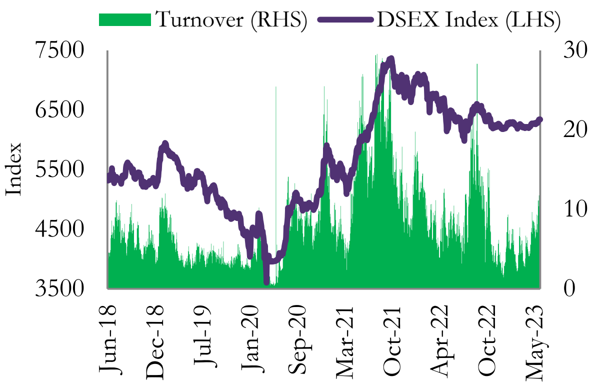


Source: Bangladesh Bank

3.2.4 Capital Market

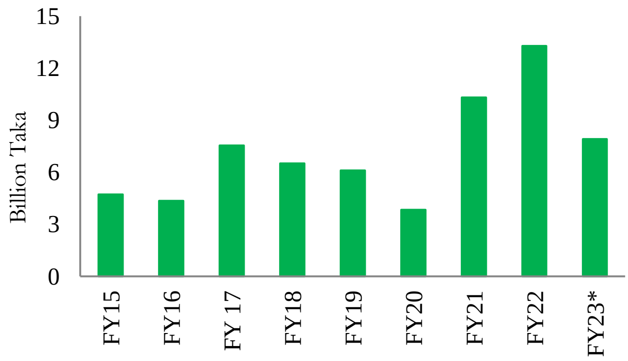
The capital market of Bangladesh experienced marked fluctuations during the second half of FY23 (until May 2023), primarily influenced by economic challenges such as high inflation, pressure on the exchange rate and foreign exchange reserves.

Chart 28: DSEX Index and Turnover



Source: Dhaka Stock Exchange

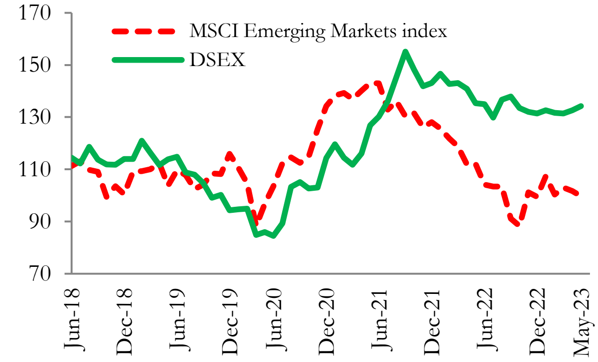
Chart 29: DSE Daily AverageTurnover



Source: Dhaka Stock Exchange * Up to May 2023

The DSEX, which represents the benchmark index of the stock market, experienced a modest rise of 2.1 percent and reached 6,339.74 points at the end of May 2023 from 6,206.81 points at the end of December 2022. However, the DSEX index, compared to May 2022, saw a decline of 0.8 percent by the end of May 2023 (Chart 28). Besides, the daily average turnover, a crucial indicator of capital market liquidity, experienced a notable decline of 40.40 percent to BDT 791 crore at the end of May 2023 from BDT 1,327 crore at the end of June 2022 (Chart 29). The decreased turnover volume in H2FY23 is attributed to investors' cautious approach. Notably, the IT sector accounted for the highest turnover share at 16.5 percent in April 2023 among all sectors. The DSE market capitalization reached BDT 7,73,719 crore at the end of May 2023, slightly increasing from BDT 7,60,937 crore at the end of December 2022. Recent policy initiatives in strengthening the capital market are briefly discussed in section 4.6.

Chart 30: Synchronization of DSE with Global Markets (Base: Jan 2015=100)



Sources: Dhaka Stock Exchange and www.msci.com

4. Recent Policy Initiatives on Important Economic Issues

4.1 Managing Exchange Rate and Foreign Exchange Reserves

In response to recent exchange rate pressure on the BDT, BB pursued various measures for exchange rate stability. Initiatives were taken to improve the current account balance by incentivizing foreign currency inflows and containing foreign exchange outflows. Besides, BB has allowed the BDT to depreciate significantly along with supplying a huge amount of foreign exchanges to the market from its international reserves to mitigate the growing pressure on the exchange rate. The BDT was depreciated by more than 13 percent during the first 11 months of FY23, while more than 12 billion USD were sold during the period.

To increase the supply of foreign currency, the bank's exports retention quota (ERQ) and net open position have been reduced, while borrowing from OBU is allowed by DBU. BB has made a requirement to encash 50 percent of the balance held in exporter retention quota (ERQ) accounts. To reduce the demand for foreign currency, BB increased annual interest on EDF loans from 4.00 to 4.50 percent for manufacturer-exporters. Moreover, BB has allowed importers to extend guarantees and the maturity of suppliers' and buyers' credit, and domestic banks to borrow from offshore operations to settle certain import payments.

In line with the government's austerity measures, BB increased overall LC margins and advance payment requirements for non-essential and luxury goods imports. Pre-authorization for LCs over USD 3 million has also been required to prevent over and under invoicing related trade-based money laundering Temporary restrictions were placed on government officials' overseas travel for training and study tours. Personal foreign visit, including training, workshop, seminar, and study tour of bank officials, has been restricted.

In order to boost foreign currency inflows, BB has implemented measures to ease fund transfers through Internet banking for remittances, removing previous ceiling on such truncations. Additionally the cap on the interest rate for deposits made in non-resident foreign currencies has been eliminated, making it more attractive. To further incentivize non-resident foreign currency deposit (NFCD), BB has raised NFCD rate. Simplifying the process for wage earners' remittances, the documentation requirement has been eliminated, allowing for seamless transfer of any amount. Furthermore, the need for a declaration on Form-C has been abolished for inward remittances up to USD 20,000 or its equivalent.

Exchange Rate: Amid the considerable shortage of US dollars as experienced in early September 2022, BB has responded positively to allowing different exchange rates for exports, imports, and remittances, as indicated by BAFEDA and ABB, with an intention to unify them later. With BB's initiatives, the initial gaps among the rates have significantly reduced, and, by now, they are staying within the 2.0 percentage points variation mark. A competitive and market-based floating, flexible and unified exchange rate regime is expected to be established for all international transactions within the third quarter of 2023. The market-determined unified exchange rate is expected to gradually close the gap between formal and informal markets and help improve external balance and international reserves, ensuring exchange rate stability.

The current exchange rate of the Bangladeshi Taka (BDT) against the USD remains closely aligned with the market rate, supported by assessments based on the Real Effective Exchange Rate (REER) Index and internal research. The latest available data show that the exchange rate is around 108 BDT per USD. Over the first eleven months of FY23, the BDT has depreciated by more than 13 percent, surpassing the depreciation observed in Bangladesh's major trade competitors, including India. With the BDT at 108 per USD, the current exchange rate seems to be highly competitive compared to peer countries, particularly when considering India, and suggests no need for major depreciation at this time.

Foreign Exchange Reserves: International reserves are very important for a country like Bangladesh for several compelling reasons. They shield against economic shocks and are crucial in maintaining stability within the country's economy. During financial crises, external imbalances, or sudden capital outflows, these reserves act as a cushion, preventing severe disruptions in the financial system. Bangladesh heavily relies on imports to meet its domestic consumption and fuel industrial production. International reserves are the lifeline that enables the country to pay for these imports, guaranteeing a continuous supply of essential goods, raw materials, and capital goods.

Maintaining a solid reserve position fosters confidence among foreign investors and lenders. It serves as a clear signal that Bangladesh can fulfill its external obligations, such as servicing external debt and repaying loans. This confidence is required to attract foreign direct investment, promote economic growth, and grant access to international financial markets. In Bangladesh, the stability of the local currency, the BDT, is paramount for domestic and external trade. International reserves are effectively utilized to manage the exchange rate, preventing excessive depreciation or appreciation of the currency. This stability is crucial as it safeguards trade competitiveness and ensures the purchasing power of citizens remains intact, fostering economic well-being.

A country gains greater flexibility in conducting its monetary policy by holding international reserves. With adequate reserves at its disposal, the central bank can effectively intervene in the foreign exchange market and skillfully manage the money supply. This allows the central bank to regulate inflation, interest rates, and overall economic stability without being excessively dependent on external factors, providing a sense of control over the country's economic destiny.

Reflecting on the recent instabilities in the external sector, the utilization of foreign exchange reserves has played a pivotal role. These reserves have been instrumental in managing significant downward pressure on the exchange rate, ensuring uninterrupted imports of essential commodities such as food, fuel, and fertilizers and meeting all foreign obligations in a timely manner. As of 12 June 2023, the foreign exchange reserves of Bangladesh Bank, including the Export Development Fund (EDF) and other foreign assets, amounted to USD 29.9 billion as compared with USD 41.8 billion recorded at the end of June 2022. The erosion of the foreign exchange reserves is mainly due to BB's continuous support to counteract foreign exchange market instabilities that arose from the remarkable deficits in BoP's current and financial accounts. However, the current level of international reserves is still equivalent to approximately 5 months of imports. This exceeds the standard benchmark of 3 months of import coverage, indicating the country's relatively strong reserve position.

Looking ahead, it is anticipated that by the end of June 2023, the international reserve position of Bangladesh will increase to approximately USD 30 billion. This projected growth further strengthens the country's capacity to withstand external shocks and meet its financial obligations promptly. By maintaining a substantial reserve position, Bangladesh Bank has navigated challenging external circumstances and upheld its economic stability. The prudent management of foreign exchange reserves continues to serve as a safeguard, protecting the country from potential vulnerabilities and providing a solid foundation for sustained economic growth.

4.2 Augmenting the Remittance Inflows

The inward remittance plays a vital role in driving the Bangladesh economy, significantly contributing to the development of rural areas. It is critical to strengthen the current account balance and build net international reserves. Despite global uncertainties, such as the Russia-Ukraine war, the inflow of remittances remains noteworthy. To increase the inflow of inward remittances, the government and the Bangladesh Bank have implemented various policy measures, including the following noteworthy initiatives:

a) Beneficiaries of wage earner remitters receive a 2.50 percent cash incentive on top of the market-determined exchange rate for any amount of remittance inflow. The documentation requirement for amounts exceeding USD 5,000 has been eliminated.

b) Measures have been taken to cease hundi-related activities by utilizing mobile financial services and addressing misinvoicing. This process is ongoing and will continue in the future.

c) The Bangladesh Bank has removed the limit on fund transfers through Internet banking for remittances, as well as the cap on interest rates for deposits in non-resident foreign currencies. The non-resident foreign currency deposit (NFCD) rate has been increased to attract more NFCD. The documentation requirement for wage earners' remittances of any amount has been eliminated. Additionally, the requirement of a declaration on Form-C has been waived for inward remittances up to USD 20,000 or its equivalent.

d) All fees associated with sending remittances through Bangladeshi banks and exchange houses have been exempted, and the highest BDT exchange rate is offered for inward remittances.

e) Non-resident Bangladeshis (NRBs) can now use their passports as a document to invest in wage earners' bonds instead of the National ID.

f) Mobile Financial Service providers can transfer remittances using web-based mobile apps, allowing remitters to send their remittances directly to beneficiaries' accounts or wallets from their mobile phones without visiting exchange houses or banks.

g) Local banks are no longer required to obtain prior permission from the Bangladesh Bank to establish drawing arrangements with foreign exchange houses.

h) A market-driven exchange rate has been adopted to reduce the gap between formal and informal exchange rates, attracting more remittances through banking channels.

i) BFIU and other law enforcing agencies are working to identify people who are engaged with Hundi activities to curb the unofficial channels.

These initiatives reflect a proactive approach to harnessing the potential of inward remittances for the country's economic growth and development. By facilitating a favorable environment for remittances, Bangladesh Bank aims to further capitalize on this vital source of income and contribute to the well-being of its people and the nation as a whole.

4.3 Controlling Inflation

The monetary policy stance for H2FY23 was initially adopted as cautiously accommodative, which de facto appeared to be tight, aiming at containing growing inflationary pressures. As of end May 2023, the point to point rate of inflation stood at 9.94 percent (12-month average at 8.84 percent) as compared with 7.42 percent (12-month average at 5.99 percent) in the same period of last year, which is mainly due to supply-chain disruptions generated through external channels.

Persistent high inflation can have various detrimental effects on the economy. It reduces the purchasing power of money, disproportionately affecting the fixed-income earning and poorer segment of the population, creates uncertainty, distorts price signals, exacerbates income inequality, undermines confidence, contributes to financial instability, affects international competitiveness, and can lead to a wage-price spiral. Given these implications, controlling inflation and maintaining a stable economic environment is the highest priority for Bangladesh Bank (BB).

BB has taken measures to address both demand-side stress and supply-side bottlenecks in order to control inflation. The central bank has increased its policy rate, the repo rate, from 5.00 percent to 6.00 percent in different phases of FY23. Additionally, BB has conducted substantial sales of US dollars in the market, facilitating automatic quantitative tightening. Furthermore, BB has implemented effective supply-side interventions and undertaken various steps to stimulate employment and investment opportunities while ensuring a sufficient flow of funds to productive sectors. The central bank has introduced pre-financing and refinancing schemes for agriculture, CMSMEs (Cottage, Micro, Small, and Medium Enterprises), and import-substituting industries.

To minimize exchange rate pressure, which in turn will ease the inflationary pressure, BB has continued its import-limiting policies for luxurious and non-essential commodities. Moreover, BB has increased monitoring to prevent over and under-invoicing, along with implementing other measures to reduce exchange rate pressure. These efforts collectively aim to help control inflationary pressures and maintain price stability within the economy. Recognizing the importance of maintaining inflation within acceptable levels, the current MPS will bolster the implementation of the following policy measures.

Increase Policy Rate: As part of its tight monetary policy stance, Bangladesh Bank decided to increase the policy rate. The policy rate, the repo rate, is adjusted upward by 50 basis points (bps) from 6.00 percent to 6.50 percent, while the standing deposit facility rate, proxied by the reverse repo rate, is adjusted upward by 25 bps from 4.25 percent to 4.50 percent under the new policy framework. This measure aims to raise the cost of borrowing, limiting consumer price index (CPI) inflation.

Remove Lending Rate Cap: By raising the policy rate, the central bank aims to elevate the borrowing costs for financial institutions, which will subsequently influence interest rates across the economy. This adjustment will make it more expensive for businesses and individuals to access funds for investments and consumption. In line with this policy rate increase, Bangladesh Bank has also decided to eliminate the existing interest rate cap on commercial banks and non-bank financial institutions (NBFIs) lending. The lending rate cap will be replaced by a competitive and market-driven reference rate, supplemented by a margin. This shift intends to curtail excessive monetary expansion, thereby aiding inflation control. Removing the interest rate cap will allow for more efficient transmission of the policy rate and promote a market-based lending environment that aligns with the central bank's objective of managing inflationary pressures.

Ensure Market-Based Exchange Rate: BB is actively engaged in efforts to transition from having different exchange rates for exports, imports, and remittances. The central bank is committed to implementing a unified and market-driven single exchange rate considering prevailing market conditions. Introducing a single exchange rate system for exports, imports, and remittances will be an automatic stabilizer against any external imbalances. By aligning the exchange rates with market forces, the central bank aims to mitigate the external sector related volatility and fluctuations. This measure ensures stability and promotes a favorable business environment for trade and foreign exchange transactions.

The move towards a unified and market-driven single exchange rate regime reflects BB's commitment to enhancing transparency, efficiency, and competitiveness in the foreign exchange market. It will help eliminate distortions caused by multiple exchange rates and promote a level playing field for businesses involved in international trade. Furthermore, a unified exchange rate system can enhance the effectiveness of monetary policy by providing more precise signals and facilitating the smooth functioning of the economy.

Quantitative Tightening: To address the intensifying exchange rate pressure and mitigate the risk of a steep depreciation of the Bangladeshi Taka (BDT), BB had to inject around USD 13 billion (net) into the market during 1 July – 12 June of FY23. This substantial injection of foreign currency was accompanied by the withdrawal of an equivalent amount of local currency, resulting in a tight liquidity environment within the money market. This strategic move effectively helped control the potential buildup of inflationary pressure from the demand side.

4.4 Stabilizing Financial Sector

Reducing Non-Performing Loans (NPL) and assuring good corporate governance in the banking industry through strengthening supervision and monitoring guidelines are crucial for a stable financial system. BB and the government of Bangladesh have formed a committee to review the existing Bank Company Act 1991, where effective resolutions on NPL have been proposed. The committee's recommendations have been sent to the Financial Institution Division of the Ministry of Finance. Following the due processes, the Cabinet Division has already approved the draft Bank Company (Amendment) Act 2023, which is under the process of approval in the parliament. This Bank Company (Amendment) Act 2023 will be useful to identify and take appropriate punitive actions against willful loan defaulters and reduce families' influences on bank boards. Work on updating the Finance Company Act is also in progress. Besides, BB has drafted Bankruptcy Act, Money Loan Court Act, and Negotiable Instrument Act, and respective ministries are examining them. Introduction of such legislative guidelines and its proper enactment would strengthen banking sector discipline and corporate governance.

BB introduced a new monitoring mechanism at the beginning of FY23 to provide a fresh look at the country's banking sector to assess the overall condition of state-owned commercial banks under a Memorandum of Understanding (MoU). Moreover, BB has already made MoU with eight domestic private commercial banks, targeting to reduce the NPL at a certain level, address banks' performance-related issues, and improve good governance. Banks are given customized annual targets concerning the maintenance of capital adequacy, reduction of non-performing loans and shortfall in provisions for loan losses, balanced expansion of credit and maintenance of liquidity, enhancement of corporate governance and risk management practices, etc., in the MoUs. BB regularly monitors the achievement of objectives, compliance with conditions, and implementation progress as stipulated in the MoUs. Fixing the single borrower exposure limit, restriction of loan purchasing, and appointing an observer/coordinator to mitigate the banking sector risks are other measures stipulated in the MoUs.

To ensure good governance in the Non-Bank Financial Institutions (NBFIs), BB recently published a circular letter instructing the NBFIs to allow up to one representative director from their sponsoring companies on the board of directors. It also prohibits appointing any director from the associated company of a company that already has a nominated director in a NBFI, and no director is eligible to be appointed as a representative on the board on behalf of any other director.

Moreover, BB has taken the initiative to assess distressed assets in the banking sector to identify potential banking system risks while preventing a systemic collapse. BB plans to disclose rescheduled loans alongside the NPLs of banks in the annual financial stability report, portraying more accurately the actual situation of distressed assets. To improve supervisory capabilities and foster the growth of a financial sector supervision framework in line with international best practices, BB has begun adopting the Risk-Based Supervision (RBS) framework. The BB has aimed to implement RBS throughout the country's banking sector by 2025.

The BB has undertaken several initiatives to promote financial deepening and strengthen the financial system. These initiatives include promoting financial inclusion, digitizing the banking industry, and encouraging using bonds and stocks for long-term financing rather than relying solely on the banking sector. One of BB's key objectives is to enhance financial deepening by increasing the ratio of M2 (broad money supply) to GDP. This ratio serves as a measure of the depth and efficiency of the financial system. BB aims to achieve a M2/GDP ratio comparable to peer countries, indicating a well-developed and robust financial sector.

4.5 Enhancing Financial Inclusion and Cashless Society

Bangladesh has made significant progress toward achieving financial inclusion, with a particular focus on promoting a cashless society. One of the key drivers of this progress has been the expansion of mobile financial services in the country. Mobile financial services such as bKash, Nagad, and Rocket have become increasingly popular, allowing individuals to send and receive money, pay bills, and purchase goods and services using their mobile phones. This has made banking services more accessible to a broader range of people, particularly those who live in rural areas where traditional banking services may not be available.

BB has taken several initiatives to popularize digital transactions and 'Cashless Bangladesh'. Recently, Bangladesh Bank launched the 'Cashless Bangladesh Smart Bangladesh' campaign on 18 January 2023 intending to integrate small-scale merchants into an affordable payment system. As part of this initiative, BB offers charge-free transactions through the 'Bangla QR' code to micro merchant for gearing up the cashless Bangladesh program. BB has also instructed all banks and financial institutions to incorporate the 'Bangla QR' code payment system into their proprietary QR codes. Additionally, Bangladesh Bank has lifted the daily transaction limit associated with using the 'Bangla QR' code. Ten banks, three mobile financial services, and three international payment gateways have participated actively in the 'Bangla QR' initiative, which reflects a significant step towards a more inclusive and convenient digital payment landscape. BB has targeted seventy five percent of digital transactions within 2027 to complete 'Cashless Bangladesh' initiatives following the government's 'Smart Bangladesh Vision.'

BB has taken steps to expand the possibilities of contactless payments, aiming at accelerating touch-and-go transactions and driving the country towards a cashless economy. To enhance the usability and effectiveness of the payment system, BB has introduced new measures that ease transactions through near-field communication-enabled contactless cards. With these changes, users will no longer need to physically insert their cards into point-of-sale (PoS) terminals or provide their PINs for transactions up to BDT 5,000. This development in contactless payments technology is expected to improve the user experience while mitigating fraud risks significantly.

BB has implemented measures to facilitate the opening of 'Individual Retail Accounts' with minimal documentation for labor-dependent micro and floating entrepreneurs, small traders, marginal product sellers, and service providers. An escrow system has been introduced for online purchases, allowing advance payment transactions to ensure consumer protection and orderliness in the e-commerce market. Furthermore, on 13 November 2022, the Interoperable Digital Transactions Platform (IDTP) called 'Binimay' was officially launched. This platform serves as a transaction bridge between various payment system partners, providing customers access to multiple digital payment services through a single application processing interface. BB established the Regulatory FinTech Facilitation Office in August 2020, recognizing the increasing demand for digital innovation and technological excellence in financial services.

Moreover, BB has implemented various initiatives to promote financial literacy and inclusion, mainly targeting the population hitherto excluded from formal financial services. As part of these efforts, a dedicated financial literacy website was launched in December 2022 to provide publicly accessible resources and information on financial literacy and inclusion. Recognizing the significance of early financial education, measures have been taken to incorporate a chapter on Financial Literacy in the national school curriculum. Incorporating financial literacy education into the educational system aims to equip the younger generation with essential knowledge and skills to make informed financial decisions. BB aims to empower individuals and enhance their understanding of financial matters through these multifaceted initiatives, ultimately fostering greater financial inclusion and a more financially literate smart society.

4.6 Strengthening Capital Market

A well-developed capital market is essential for the long-term investment and economic development of the country. But the public and private investments in Bangladesh largely depend on banks' finance due to the absence of a well-developed capital market. Usually, the banks rely on short-term deposits for long-term financing, which creates a maturity mismatch in the financial system and puts pressure on liquidity management. A developed capital market, especially the bond market, can meet the huge financing requirements for infrastructure development and industrialization and contribute to the banking system's stability. Besides, investors can reduce business costs and improve operational efficiency by borrowing from the bond market at competitive rates.

Moreover, the government can finance a significant portion of its budget deficit from the bond market at a lower cost. But the capital market, particularly the bond market, is not well developed yet. Against this backdrop, several initiatives have been taken in recent years to develop the capital market and promote investment opportunities in the country.

BB has tried to ensure enough liquidity in the capital market in the wake of some economic challenges. In this context, BB allowed the banks to maintain a general provision of 1.0 percent instead of 2.0

percent on classified amounts for loans to brokerage houses, merchant banks and stock dealers. BB also instructed non-bank financial institutions (NBFIs) to explore opportunities to mobilize funds by issuing bonds rather than relying heavily on banks. BB has issued a directive allowing all banks and financial institutions to facilitate trading Sukuk Bonds in the secondary market, which is now active well.

The government has made significant modifications in issuing and re-issuing Bangladesh government treasury bonds to improve a secondary market for government securities. The modifications include the introduction of BB's Market Infrastructure (MI) module platform, which is used to settle the transactions of government securities, including their listing and trading. BB has released guidelines regarding using the MI module platform to manage secondary trading better. Accordingly, government securities are now transacted in the secondary market through BB's MI module platform.

The amendment of the Banking Companies Act 1991, which waits in parliament for approval, can contribute to the development of the capital market by providing regulatory oversight, enabling banks to engage in capital market activities, setting capital adequacy requirements, implementing investor protection measures, and fostering collaboration with other regulatory bodies. These provisions collectively create a conducive environment for the growth and development of the capital market in Bangladesh.

To enhance the overall market growth, BSEC has emphasized the involvement of institutional investors in the capital market and taken several policy measures in this regard. One significant measure is the extension of investment limits for mutual funds, excluding special funds like pension funds. In this context, BSEC has raised the minimum investment threshold level from 60 percent to 80 percent for institutional investors. Looking ahead, the BB, BSEC and other related government authorities' coordinated efforts are required to promote a strong and vibrant capital market in Bangladesh.

5. New Policy Initiatives

5.1 Policy Interest Rate Corridor

Bangladesh has undergone a remarkable transformation, transitioning from being one of the world's poorest nations at its inception to becoming one of the fastest-growing economies today. The nation's GDP per capita has soared to USD 2,657 (according to the BBS provisional estimate for FY23), a significant leap from less than USD 100 in 1971. Over the past two decades, Bangladesh has achieved enticing GDP growth and maintained low to moderate inflation levels. The country attained lower-middle-income status in 2015 and is currently on the path to graduating from its least developed country status by 2026. Ambitiously, Bangladesh aims to reach an upper-middle-income status by 2031 and ultimately ascend to high-income status by 2041.

Bangladesh Bank, the central bank of Bangladesh, has historically employed a monetary targeting framework as its preferred approach to monetary policy. Given the evolving socioeconomic landscape, the current monetary policy framework, which relies heavily on monetary aggregates, appears to be losing effectiveness. In light of the evolving and complex nature of the financial system, it is high time to adopt a new interest rate targeting policy framework, replacing the current practice of monetary targeting framework. This shift is warranted due to several compelling reasons:

Firstly, an interest rate targeting framework provides greater flexibility in responding to economic fluctuations and changes in market conditions. Unlike a rigid monetary targeting approach focusing solely on controlling monetary aggregates, interest rate targeting allows policymakers to adjust interest rates in response to evolving economic circumstances. This flexibility enables them to manage inflation better, stabilize financial markets, and promote sustainable economic growth. Secondly, interest rate targeting can enhance the effectiveness of monetary policy transmission mechanisms. Central banks can directly influence interest rates by influencing borrowing costs, investment decisions, and consumer spending. This impact on the cost of credit and overall financial conditions enables the central bank to manage inflationary pressures and stimulate economic activity more quickly and effectively.

Moreover, the shift towards interest rate targeting aligns with international best practices in monetary policy. Many central banks around the world have adopted interest rate targeting frameworks, recognizing their effectiveness in achieving macroeconomic stability and promoting sustainable economic growth. Lastly, as the economy of Bangladesh continues to evolve and diversify, a more flexible and adaptable monetary policy framework becomes increasingly important. Interest rate targeting allows for a nuanced approach that can accommodate the changing dynamics of the economy, including the development of new financial instruments, evolving market structures, and integration into global financial markets.

In this effort, the central bank will be able to effectively manage liquidity by targeting overnight lending rates in the interbank market. This strategic action plays a crucial role in determining interest rates for different durations. Recognizing the significance of this approach, BB is going to adopt an interest rate targeting framework starting from this MPS. This progressive approach aims to establish a smart and efficient mechanism to help achieve important goals, such as controlling inflation, maintaining financial stability, and promoting economic growth.

Under this transformative framework, Bangladesh Bank intends to introduce a policy interest rate corridor for its forthcoming monetary policy, effective from 1 July 2023. This corridor, replacing the conventional reliance on reserve money, signifies a notable departure from previous practices. It reflects BB's commitment to embracing modern methodologies that optimize the impact and effectiveness of its monetary policy instruments.

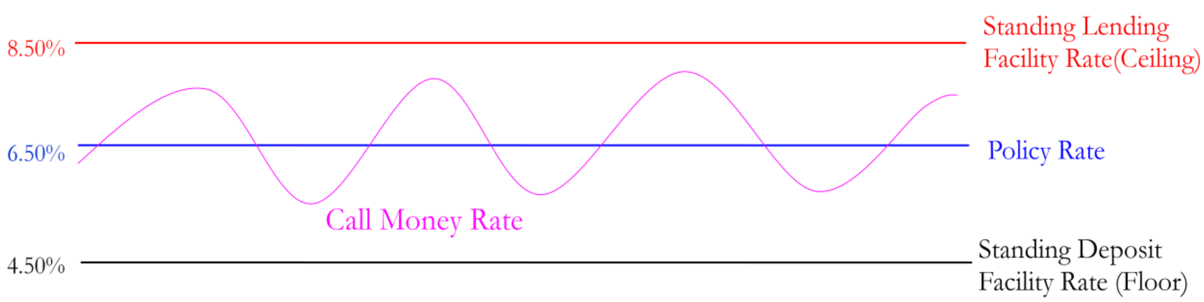
Figure 1 clearly and concisely depicts the new monetary policy framework. At its core, this framework revolves around the policy interest rate of Bangladesh Bank, precisely the repo rate. This rate is a primary driver of short-term interest rates, such as the interbank call money rate. The framework focuses on the policy interest rate as the primary target, recognizing its importance in impacting economic outcomes. The changes in short-term interest rates tend to have a positive correlation with long-term interest rates, which in turn impact various aspects of the real sector, including commodity prices. The new policy framework considers key macroeconomic indicators to achieve the overarching goals of monetary policy, including price stability, financial sector stability, and GDP growth. These indicators include inflation forecasts, GDP forecasts, as well as the dynamics of money and credit. Looking at these factors, policymakers gain valuable insights that help guide their decision-making and shape the desired economic trajectory.

Figure 1. New Monetary Policy Framework

Instruments	Operating target	Information variable	Primary monetary policy objective
• Policy rates • Open market operations • Reserve requirement • Bank rate	• Inter bank call money rate as a counterpart of short-term interest rate	• Inflation forecasts • GDP forecasts • Money and credit situation	• Price stability • Financial stability • Economic growth

In accordance with the new monetary policy framework, BB consults relevant literature, along with an assessment of current macroeconomic conditions and informed judgment, to determine the policy rate, the repo rate for the first half of FY24. The objective is to maintain the interbank call money rate in close proximity to the policy rate. Consistent with global practices, the BB implements a symmetric Interest Rate Corridor (IRC) centered on the policy rate (repo rate) of 6.50 percent. This IRC ensures that the short-term interbank call money rate remains around the policy rate, as depicted in Figure 2.

Figure 2. Interest Rate Corridor



The upper limit of the Interest Rate Corridor (IRC), the standing lending facility (SLF) rate, is fixed at 8.50 percent, 200 basis points higher than the policy interest rate. Conversely, the lower limit of the IRC, known as the standing deposit facility (SDF) rate, is set at 4.50 percent, 200 basis points below the policy interest rate. This means that banks and non-bank financial institutions (NBFIs) can borrow from the BB at interest rates ranging from 6.50 to 8.50 percent, depending on the tenor or other specific criteria determined by the BB. On the other hand, these institutions can deposit surplus cash with BB at an interest of 4.50 percent.

In the revised framework, the policy rate replaces the overnight repo rate, the ceiling of the SLF replaces the special repo rate, and the floor of the SDF replaces the reverse repo rate, which was previously employed by the BB. This adjustment ensures that the interbank call money rate, particularly the weighted average rate, fluctuates within the designated interest rate corridor. It's important to note that the IRC set for the first half of FY24 may be modified by BB's Monetary Policy Committee (MPC) at any time and any level, as deemed necessary.

5.2 Reference Interest Rate for Lending

Before the outbreak of COVID-19, Bangladesh was already experiencing some signs of economic slowdown. However, as the pandemic struck and its impact on the global economy became evident, the situation worsened significantly. To counteract these challenges, the government and BB implemented a series of measures to revitalize the economy. One of the strategies employed was the introduction of a lending interest rate cap. This policy aimed to stimulate investment, employment, and overall output within the country. The lending interest rates cap was introduced to reduce borrowing costs for businesses and individuals, making investing in and expanding their operations more affordable.

Additionally, during COVID-19, a substantial amount of liquidity was injected into the economy. This involved providing financial support and assistance to various sectors that were severely affected by the pandemic. It was aimed to ensure the continued functioning of businesses and industries, preventing widespread job losses. This measure played a crucial role in keeping the economy afloat during the challenging times. The combined efforts of implementing an interest rate cap and injecting liquidity helped alleviate the economic slowdown caused by COVID-19. These measures provided the necessary support and incentives for businesses to continue investing, promoting employment opportunities. By maintaining liquidity, the BB ensured that critical sectors remained operational and active, thus preventing any major disruptions in economic activity. As a result, Bangladesh was one of the few countries that experienced positive economic growth in FY20, followed by a sharp recovery path.

In the post-COVID period, however, as the economy of Bangladesh was experiencing a full recovery, another geopolitical conflict arose with the Russia-Ukraine war, severely disrupting the global supply chain and resulting in sharp increases in commodity prices worldwide. This had a significant impact on Bangladesh's economy, creating substantial external sector pressures in two ways: first, by exerting tremendous downward pressure on the exchange rate, and second, by fueling consumer price inflation. The BB strategically decided to remove deposit rate restrictions to address this challenging situation. Additionally, the interest rate restrictions on consumer credit were substantially relaxed in the last MPS. This step was taken to gain control over the situation and alleviate the pressures caused by the depreciation of the exchange rate and rising consumer prices.

Building upon these measures, the BB plans to further remove remaining restrictions on banks' lending and investment activities by introducing a market-driven reference rate. Under this new framework, banks will be able to operate their lending activities based on this market-driven reference rate, which will be determined by prevailing market conditions. Banks will have the flexibility to add a margin to this reference rate. Introducing this market-driven reference rate, along with the previously mentioned policy rate corridor, will create a more dynamic and market-oriented financial ecosystem. Banks will be able to adjust their lending rates in response to market fluctuations, allowing for a more efficient credit allocation. This move aims to enhance the banking sector's competitiveness and promote a favorable lending environment for businesses and individuals.

To determine the reference lending rate, BB relies on the yields of 182-Day Treasury Bills (TBs) offered by participating financial institutions/individuals through primary dealers. The BB carefully examines these rates to establish a benchmark for lending activities, providing transparency and stability in the financial sector. The yields represent competitive and market-driven outcomes that carefully take into account the cost of funds. They serve as significant indicators of interest rates prevailing in the market. The process of determining the reference lending rate involves the following steps. First, the BB calculates the weighted average yield of the 182-Day TBs on a weekly basis. Next, the BB calculates the simple average of the four weeks' weighted average yields of the 182-Day TBs on a monthly basis. Then, the BB computes the moving average of the yields of the 182-Day TBs over the past six months. This moving average provides a more comprehensive view of interest rate movements, smoothing out short-term fluctuations and capturing longer-term trends. It helps establish a stable and reliable reference rate for lending purposes. The reference lending rate, known as the "SMART" (Six months moving average rate of Treasury bill), will be announced on the first working day of each month through the BB website. This will allow market participants, businesses, and individuals to access the up-to-date reference rate for their lending activities.

Now, this MPS intends to announce that:

> *Effective from 1 July 2023, lending activities for all purposes will be conducted at SMART plus a margin of up to 3.00 percent for banks and SMART plus a margin of up to 5.00 percent for non-bank financial institutions (NBFIs), and the existing lending rate caps will be removed. However, lending activities for CMSMEs and consumer loans may be subject to an additional fee of up to 1.00 percent to cover supervision costs. It is important to note that there will be no changes in the interest rates applicable to credit card loans.*

5.3 Exchange Rate Unification

As stated in the preamble of the Bangladesh Bank Order, 1972 (amended up to 2003), one of the main objectives of the Bangladesh Bank (BB) is to maintain a competitive external par value of the Bangladesh Taka (BDT) in the best national interest, fostering the growth and development of the country's productive resources. In line with this objective, BB recognizes the importance of using available market information to ensure the stability of BDT's par value against the currencies of major trading partners, just as it seeks to maintain price stability.

To assess the movement of the BDT exchange rate in nominal and real terms, BB calculates daily and monthly indices for the nominal effective exchange rate (NEER) and real effective exchange rate (REER). These calculations allow BB to evaluate the fluctuations in the exchange rate and make informed decisions to maintain a suitable balance that benefits all stakeholders. Any depreciation in the exchange rate tends to benefit exporters and remitters while discouraging the importers, necessitating a delicate equilibrium in the exchange rate that serves the interests of all parties involved.

Historically, after transitioning from a fixed to a floating (managed) exchange rate regime in May 2003, the movement of the BDT exchange rate remained largely stable for a considerable period. However, like many other developed and developing countries, the BDT exchange rate has been facing significant instability since April 2022. This pressure is mainly attributed to higher global commodity prices along with unprecedented interest rate hikes in major developed countries, especially in the USA, to curb higher inflation.

Consequently, the BDT exchange rate against the US dollar has experienced a significant depreciation. In response, the Bangladesh Foreign Exchange Dealer Association (BAFEDA) and the Association of Bankers, Bangladesh (ABB) have responded with varying exchange rates for remittances, exports, and imports since early September 2023. However, BB has been diligently working towards implementing a unified exchange rate strategy for all these transactions, considering market conditions. The aim is to establish consistency and coherence in the exchange rates for exports, imports, and remittances.

As per the latest information, the BAFEDA and ABB have announced the exchange rates for export proceeds and inward remittances set at BDT 107.0 and BDT 108.5 per USD, respectively. The exchange rate for imports is determined on the basis of the weighted average rates for exports and remittances, plus a margin up to Taka 1.0. BB's exchange rate for buying/selling foreign currency has been increased to BDT 106.0 per USD. However, starting from 1 July 2023, BB will not sell any forex at a discounted rate. After that, if BB needs to sell or buy any foreign exchange to or from the market, it will follow the prevailing interbank market rates.

It is noted that BB has been calculating the nominal effective exchange rate (NEER) index, which indicates a nominal depreciation/appreciation of BDT against the basket of major trading partners' currencies[3] stood at 82.02 (Chart 27) as of end May 2023 against 94.26 as of end June 20222. NEER index lies far below 100 owing to a sharp depreciation of Bangladesh Taka compared to trading partners' currencies. BB also measures the real effective exchange rate (REER) index, which indicates a real depreciation/appreciation of BDT against the basket of major trading partners' currencies that provisionally stood at 100.56 as of end May 2023 against 111.30 as of end June 2022 (Chart 27). The close proximity of the REER index to 100 and BB's internal research indicate that the current

[3] The basket consists of 15 currencies, including the euro.

BDT/USD exchange rate, which lies around 108, is mostly market condition reflexive, requiring no major depreciation of BDT at this moment.

By implementing this unified and market-driven single exchange rate regime, BB seeks to address the challenges posed by external factors and promote stability in the exchange rate. This approach considers market conditions and aligns with the goals of fostering economic growth, facilitating trade, and attracting remittances. It provides greater transparency and efficiency in foreign exchange transactions, benefiting businesses, individuals, and the economy.

5.4 Calculation of GIR as per BPM6

Gross international reserves (GIR) play a vital role in ensuring the stability and resilience of a country's economy. GIR refers to the total foreign exchange reserves a country's central bank or monetary authority holds, including foreign currencies, SDR, and gold. These reserves serve several important purposes and have significant implications for the overall economic well-being of a nation. Having reserves equivalent to 3 months of import payments is generally considered healthy for a country's external financial position. It provides a buffer against potential shocks in the economy, such as sudden changes in exchange rates or a decline in export earnings. The reserves act as a safety net, ensuring the country can meet its external payment obligations even in challenging times.

BB is the sole authority to hold and manage the country's GIR, as it has been doing this job since its inception in 1972. It is important to mention that BB will compile and publish GIR as per the sixth edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6) starting from 1 July 2023. However, BB will also keep track of current practices of calculating and reporting gross foreign assets by adding EDF and other foreign assets with GIR.

6. Monetary Policy Stance and Monetary & Credit Projections for FY24

6.1 Monetary Policy Stance

The global economy has been grappling with various challenges, including enduring high inflationary and exchange rate pressures, historically high policy interest rates in many economies, and geopolitical tensions arising from the Russia-Ukraine conflict. Despite being one of the fastest-growing economies in the region, Bangladesh has not been immune to these pressures. Persistent inflationary pressures, elevated volatility in global financial conditions, and an economic slowdown among major advanced trading partners have all impacted Bangladesh's inflation, growth, exchange rate, and foreign currency reserves.

To formulate its monetary policy stance and credit policies for FY24, the Bangladesh Bank (BB) conducts a comprehensive analysis of global and domestic macroeconomic developments and their near-term outlooks. This analysis incorporates insights and forecasts from multilateral development partners, think tanks, and academia, providing valuable information on global growth, inflation, and interest rate movements. BB also closely examines the performance and near-term forecasts of the real sector, money market, foreign exchange market, and capital market within the domestic economy to better understand the current economic dynamics and outlook.

In addition to these analytical assessments, BB takes into account the feedback, opinions, suggestions, and guidelines received from experts during the monetary policy consultation meetings. Furthermore, BB aligns its policies with the government's target of achieving 7.50 percent GDP growth and keeping inflation within the ceiling of 6.00 percent for FY24.

The global price level for most commodities has declined since June 2022, possibly driven by the hawkish monetary policy stance adopted by many developed and developing countries, which involved aggressive policy interest rate hikes. However, the global price level still remains considerably high compared to pre-COVID levels, and there is a genuine concern about a potential global economic slowdown in the near future. Domestically, prices have been ascending since April 2022, primarily due to global commodity price hikes, upward adjustments in fuel and electricity prices, and significant depreciation of the Bangladesh Taka.

To address the external sector pressures, BB has intensified its monitoring in the foreign exchange market and taken measures to support the market by supplying ample liquidity while allowing the BDT to gradually depreciate in line with prevailing market conditions. These measures have resulted in a significant reduction in import payments, while export earnings and remittances from wage earners have continued to grow, leading to a noteworthy improvement in the current account balance. However, a deficit in the financial account, attributed to a substantial drop in net trade credit and the net foreign liability of Bangladesh's commercial banks, has resulted in an overall balance deficit, exerting continued pressure on exchange rate of the BDT. Nevertheless, BB's appropriate policy interventions have helped stabilize the BDT's exchange rate against the USD, reducing the spread among exchange rates for exports, imports, and remittances. The current exchange rate of the BDT against the USD remains close to the market rate, as supported by the Real Effective Exchange Rate (REER) Index and in-house study-based calculations, not warranting any major depreciation of BDT at this moment.

As of May 2023, the growth of the broad money supply has remained moderate (9.49 percent YoY) compared to the revised programmed growth target of 11.50 percent set for June 2023. Moreover, market liquidity conditions have been relatively tight, mainly due to BB's automatic quantitative tightening due to selling foreign currencies to banks by BB. As a result, the interbank call money rate has often remained above the repo rate.

> *In light of the above circumstances, this MPS strongly emphasizes the urgent need of containing inflation while ensuring the necessary flow of funds to various productive sectors, including agriculture, CMSMEs, large industries, import substituting sectors, and services. BB will also remain vigilant to contain exchange rate instability to promote a favorable business environment for trade and foreign exchange transactions.*

BB will adopt an interest rate targeting framework to achieve these objectives in place of the previously practiced monetary targeting framework. The target policy interest rate, the repo rate, has been upward adjusted to set at 6.50 percent, accompanied by a ± 200 bps symmetric corridor consisting of special repo rate replaced by standing lending facility (SLF) rate at 8.50 percent and reverse repo rate replaced by standing deposit facility (SDF) rate at 4.50 percent for FY24. It's important to note that BB will closely monitor the key monetary and credit developments in the economy as important information variables. The subsequent passage elucidates BB's monetary policy stance for H1FY24 as endorsed in this MPS:

BB will adopt a tight monetary policy stance for H1FY24, aiming to keep the inter-bank call money rate close to the policy interest rate of 6.50 percent, accompanied by a ± 200 bps symmetric corridors consisting of a standing lending facility rate at 8.50 percent and a standing deposit facility rate at 4.50 percent. This approach provides utmost priority to contain inflation to the desired level while ensuring the necessary flow of funds to productive and employment-generating sectors to support the target economic growth rate of 7.50 percent set for FY24.

Conforming to the tight monetary policy stance, BB decides to increase the policy rates. The policy rate, repo rate, will be adjusted upward by 50 basis points from 6.00 percent to 6.50 percent, while the SDF rate, previously known as reverse repo rate will be adjusted upward by 25 basis points from 4.25 percent to 4.50 percent effective from 1 July 2023. This measure aims to raise the cost of borrowing, which is expected to have a limiting impact on CPI inflation.

6.2 Monetary and Credit Projections

Although BB's monetary policy no longer explicitly sets targets for broad money and reserve money growth, it remains crucial to establish their projections in alignment with the policy interest rate target. This approach is vital for achieving the key objectives of monetary policy, such as upholding price stability, ensuring the stability of the financial sector, and promoting the desired level of economic growth and employment generation.

In recent years, Bangladesh has experienced an upward trend in money velocity, driven by increased internal and external demand, resulting in robust economic activities. The government's support through infrastructure development and BB's provision of necessary funds to productive sectors, along with the easing of the COVID-19 pandemic, have contributed to the growth in internal and external demand. This positive trend in money velocity is expected to continue in FY24. Consequently, the ceiling for M2 growth is set below the nominal GDP growth target for FY24, considering the anticipated positive change in money velocity. BB projects the growth for reserve money (RM) in accordance with economic realities and the stable movement of the money multiplier, which is influenced by currency-deposit and reserve-deposit ratios.

Under the new monetary policy framework, the control of reserve money and broad money growth will be achieved by setting the target for the policy interest rate and managing market liquidity through an interest rate corridor. This approach aims to keep the interbank call money rate close to the policy rate, i.e., within the policy rate corridor, to be specific. Additionally, existing monetary policy instruments such as open market operations involving the sale and purchase of government securities and foreign currencies, cash reserve ratio (CRR), statutory liquidity ratio (SLR), advance/investment-deposit ratio, refinance/pre-finance facilities, Mudarabah liquidity support (MLS), and Islamic bank liquidity facility (IBLF), will be utilized to adjust liquidity levels, thereby influencing the growth of reserve money and broad money. Changes in reserve money and broad money will provide valuable insights into their likely impact on inflation and economic activities.

Table 4: Monetary and Credit Projections for FY24

(YoY % change)

Item	Jun-22 Act.	Dec-22 Act.	Jun-23 Est.	Dec-23 Proj.	Jun-24 Proj.
Broad money	**9.4**	**8.5**	**10.5**	**9.5**	**10.0**
Net Foreign Assets*	-13.5	-25.0	-26.2	-20.3	4.9
Net Domestic Assets	19.7	21.8	22.4	16.8	11.0
Domestic Credit	16.2	15.1	16.4	16.9	15.3
Credit to the public sector	29.1	27.6	40.0	43.0	30.0
Credit to the private sector	13.7	12.9	11.0	10.9	11.0
Reserve money	**-0.3**	**17.4**	**10.0**	**0.0**	**6.0**
Money multiplier	4.93	4.63	4.95	5.07	5.14

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

Table 4 presents the half-yearly movements of broad money, its major components, and reserve money, along with the projections set for FY24. The growth projection for broad money in June 2024 is set at 10.0 percent, in line with the target for nominal GDP growth along with a projection of an adjustment to account for the expected change in money velocity. Considering the government's budgetary borrowing target, the public sector credit growth is projected to reach 30.0 percent by June 2024.

In contrast, the private sector credit growth is projected at 11.0 percent, reflecting BB's supply-side interventions to support necessary investment and employment-generating activities to achieve the targeted GDP growth of 7.5 percent. Considering the expansion of both public and private sector credit, the domestic credit growth is projected at 15.3 percent for FY24.

The projection for net foreign assets growth of the banking system in FY24 is expected to be positive, with a rise of 4.9 percent. This reflects the anticipation of an overall balance of payments surplus, with the predicted improvement in export earnings and inflows of remittances, and financial account, amid significant moderation in import payments.

7. Near-term Macroeconomic Issues and Challenges

The world has experienced a profound upheaval due to the COVID-19 pandemic that has lasted for over three years since December 2019, resulting in unprecedented disruptions to lives, livelihoods, and economies. However, there has been significant progress in containing the global pandemic situation, leading to the World Health Organization (WHO) officially declaring an end to the COVID-19 pandemic in 2023. Additionally, the economic effects of the Russia-Ukraine war, which began in February 2022, have started to subside as commodity and energy prices have been declining in 2023. The world has adapted to the "new normal" as the price effects of the war have largely passed. With a pandemic-free environment and stabilized conditions from the Russia-Ukraine war, Bangladesh's macroeconomic outlook appears to be stable in the near term, poised to regain its high growth trajectory by 2024.

However, despite these positive developments, rising inflation and exchange rate pressures remain critical challenges that we continue to face. The Bangladesh Bank (BB) has placed the highest priority on containing inflation while vigilantly managing exchange rates and other macroeconomic instabilities. To address these challenges, BB has implemented the following policy initiatives:

- Adopting a new monetary policy framework that shifts from monetary targeting to interest rate targeting.
- Taking the decision to increase the policy rate that subsequently raises the cost of funds for borrowers.
- Removing the lending rate cap and replacing it with a competitive and market-based reference rate along with a margin.
- Moving towards a market-driven unified and single exchange rate regime to ensure stability in the foreign exchange markets, improve the balance of payment conditions, and protect foreign exchange reserves.

However, containing inflation effectively, our top priority now, depends on various factors. These include the effectiveness of the new policy initiatives mentioned above, maintaining exchange rate stability alongside a surplus financial account, and a pause in the policy rate hike race among the US Federal Reserve, European Central Bank, and other major economies. Given the conducive developments of these factors, BB aims to tackle inflation and exchange rate pressures while fostering a stable and resilient macroeconomic environment.

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