Monetary Policy Statement

January-June 2023

Bangladesh Bank

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Acronyms and Abbreviations

ABB	Association of Bankers, Bangladesh
App	Appreciation
BAFEDA	Bangladesh Foreign Exchange Dealer's Association
BB	Bangladesh Bank
BBADCF	Bangladesh Bank Agricultural Development Common Fund
BBS	Bangladesh Bureau of Statistics
BDT	Bangladesh Taka
BoP	Balance of Payments
BSEC	Bangladesh Securities and Exchange Commission
CAD	Current Account Deficit
CBOE	Chicago Board Options Exchange
CDBL	Central Depository Bangladesh Limited
CLIW	Composite Leading Indicators of the World
CMSME	Cottage, Micro, Small and Medium Enterprise
Covid	Coronavirus Disease
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DBU	Domestic Banking Unit
DC	Domestic Credit
Dep	Depreciation
DSE	Dhaka Stock Exchange
EDF	Export Development Fund
ERQ	Export Retention Quota
ETF	Exchange-Traded fund
Fed	Federal Reserve
FY	Fiscal Year
G2P	Government to Private
GDP	Gross Domestic Product
GIR	Gross International Reserves
H1	First Half
H2	Second Half
IBLF	Islamic Banks Liquidity Facility
ICB	Investment Corporation of Bangladesh
ICRR	Internal Credit Risk Rating
IMF	International Monetary Fund
IPO	Initial Public Offering
LC	Letter of Credit
LDC	Least Developed Countries
M2	Broad Money
MFS	Mobile Financial Services
MoU	Memorandum of Understanding
MPS	Monetary Policy Statement
MRT	Metro Rail Transit
MSCI	Morgan Stanley Capital International
NBFI	Non-Bank Financial Institution
NDA	Net Domestic Asset
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Asset
NFCD	Non-resident Foreign Currency Deposit
NGDP	Nominal Gross Domestic Product
NOP	Net Open Position
NPL	Non-Performing Loan
OBU	Offshore Banking Unit
PSO	Payment Systems Operator
PSP	Payment Service Providers
REER	Real Effective Exchange Rate
RM	Reserve Money
RRL	Real Rate of Lending
SLR	Statutory Liquidity Ratio
SME	Small and Medium Enterprises
UK	United Kingdom
USA	United States of America
USD	US Dollar
WEO	World Economic Outlook
WTO	World Trade Organization
y-o-y	Year on Year
ZIRP	Zero Interest-Rate Policy
4IR	4th Industrial Revolution

Table of Contents

Executive Summary………………………………………………………………… 1

1. Foreword………………………………………………………………………… 3

2. Monetary Policy Outcomes in H1FY23………………………………………… 3

3. Overview of Global and Local Contexts of Monetary Policy Stance for H2FY23………… 7

3.1. Global Growth, Inflation, Interest Rate, and Trade Environment………………… 7

3.2. Domestic Growth and Inflation Outlook ………………………………………… 10

3.3. Liquidity Situation, Interest Rates and Related Issues in Money and Credit Markets………… 12

3.4. Overview of External Sector Developments and Outlooks………………………… 14

3.5. Movements of Exchange Rate and Foreign Exchange Reserves………………… 16

3.6. Capital Market Developments and Prospects…………………………………… 18

4. Recent Policy Interventions……………………………………………………… 19

4.1. Exchange Rate Stability………………………………………………………… 20

4.2. Inflation Control…………………………………………………………………… 20

4.3. Financial Sector Stability………………………………………………………… 21

4.4. Financial Inclusion and Cashless Society………………………………………… 22

4.5 Strengthening Capital Market…………………………………………………… 22

5. Monetary Policy Stance, and Monetary and Credit Programs for H2FY23………………… 23

5.1 Monetary Policy Stance…………………………………………………………… 23

5.2. Monetary and Credit Programs…………………………………………………… 26

6. Near-term Macroeconomic Challenges…………………………………………… 26

Executive Summary

The world economy has been facing a complex situation owing to the war in Ukraine, zero-Covid policy in China, energy shortages in Europe, protectionism in the United States, and skyrocketing debt burden in developing countries. The new wave of Covid-19 in North-East Asia, particularly in China, Japan, South Korea, Taiwan, and Russia, is also a great concern for the world economy. Bangladesh is no exception, facing inflationary, liquidity, and exchange rate pressures during the last few months, mainly due to external shocks. The high NPL ratio and the issue of good governance in banks and NBFIs are also matter of concern for the financial stability of the economy. To overcome these challenges, BB has already taken a series of policy initiatives, which include raising the policy interest rate amid quantitative tightening through the selling of a huge amount of dollars in the market; continuing the repo and liquidity support facilities for banks and NBFIs, and extending the refinance facilities to neutralize the tight liquidity condition; discouraging imports of luxury and non-essential commodities; enhancing the facilities to improve the export receipts and inward remittances; and engaging with concerned commercial banks and NBFIs to deal with NPLs and good governance issues. At this juncture, BB is announcing its half-yearly monetary policy for the second half of FY23 (H2FY23).

To determine the monetary policy objectives, stance, and monetary and credit program, BB has considered: (1) the current macroeconomic developments, including the decisions of the last coordination council meeting revising the target of 6.50 percent GDP growth and 7.50 percent headline inflation ceiling for FY23; (2) the analyses and forecasts of the multilateral development partners, global and local think tanks, academia, past and present national-level decision makers, journalist and business bodies about the outcomes and outlooks of global and domestic economic growth, inflation, exchange rate, and interest rate movements; and (3) BB's internal exercises on understanding macroeconomic dynamics and making near-term economic projections.

The domestic price level is likely to ease in the near future due to the recent declining global price level trend in almost all commodities, weathered by better yields of Aman and Boro paddies in the next two seasons. The exchange rate pressure is expected to be normalized within the next few months, supported by the necessary policy measures taken by Government and BB to curb the excessive import demand while enhancing the export receipts and inward remittances.

> *In this circumstance, BB's monetary and credit programs for H2FY23 will pursue a cautiously accommodative policy stance to contain inflationary and exchange rate pressures, support desired economic growth, ensuring the necessary flow of funds to the economy's productive and employment generating activities.*

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

Accordingly, BB has decided to increase its policy rates by 25 basis points, the repo rate to 6.00 percent from 5.75 percent, and the reverse repo rate to 4.25 percent from 4.00 percent as a part of its current policy stance.

Considering the current market conditions, the lending rate cap for consumers' credit has been relaxed to vary up to 3.00 percentage points, along with the complete removal of the deposit floor rate. There is no cap for credit card loans. In the presence of a suitable economic condition, the removal of the remaining lending rate cap will be considered. These relaxations on the lending rate cap and the complete removal of the deposit floor rate may help grow the overall deposit rate.

Bangladesh Bank is taking necessary measures to gradually move towards a market-based, flexible, and unified exchange rate regime (within a 2.00 percent variation) by the end of this fiscal year.

The near-term economic outlook seems quite stable, critically depending on three external issues: (i) the length and intensity of the Russia-Ukraine war, (ii) the spree of interest hikes by the Fed, and (iii) the re-emergence of the Covid-19 situation and its severity in China. Improvements in these challenges will expedite Bangladesh's future economic gains. However, in case of any adverse consequences of the above external issues, the Bangladesh economy has enough resilience to remain insulated in its current condition.

Monetary Policy Statement: H2FY23

1. Foreword

Bangladesh Bank (BB), the central bank of Bangladesh, has been carrying out its principal task of formulating and implementing its monetary policy to manage the monetary and credit system of the country with a view to stabilizing domestic monetary value and maintaining a competitive external par value of Taka towards fostering growth and development of the country's productive resources. BB designs its monetary policy stance, and monetary and credit programs based on macroeconomic updates and outlooks at home and abroad. BB has decided to announce its monetary policy on a half-yearly basis from the second half of FY23 (H2FY23), which was also a regular practice of BB during January 2006–June 2019. In this context, as before, BB has arranged several in-person monetary policy consultation meetings with different macroeconomic experts, including former and sitting policymakers, economic analysts from think tanks, academia, and leaders from financial and business sectors. Opinions, suggestions, and guidelines from the experts have been taken into account with due importance during the formulation of this MPS. The feedback, articulating current economic conditions and possible policy options, has worked as instrumental in comprehending the required policy stance and framing the monetary and credit programs for H2FY23. Besides, the valuable inputs from all the learned Members of the Board of Directors of BB have also played a significant role in formulating this monetary policy statement. A concise evaluation of the last monetary policy stance has been made, and all essential background information and rationale have been assessed before taking the stance and formulating the monetary and credit program for H2FY23 monetary policy statement.

2. Monetary Policy Outcomes in H1FY23

The monetary policy for FY23 was formulated in June 2022 to contain the inflationary pressure mainly owing to pandemic associated expansionary fiscal and monetary policies amid Russia-Ukraine war induced supply-side disruptions while supporting the investment and employment generating activities in the country. The last monetary and credit programs were designed in line with the targeted real GDP growth and CPI inflation as outlined in the national budget for FY23.

The FY23 monetary policy intends to discourage unproductive financial flows to tame the demand-side pressures without circumventing the required flow of funds to the productive sectors easing supply-side conditions and supporting the country's long-term growth aspirations. Thus, the monetary and credit programs for FY23 pursue a cautious policy stance with a tightening bias to contain inflation and exchange rate pressures while supporting the economic recovery process.

To achieve monetary policy objectives, BB has taken several policy measures during July-December 2022 (the first half of FY23, H1FY23). Some of the critically important measures are: increasing the repo rate amid automatic quantitative tightening through selling a huge amount of foreign currencies to banks;

relaxing the lending rate cap for consumer loans, including credit cards, and removing specific floor for the deposit rate; providing all sorts of production enhancing supports in terms of refinancing/pre-financing lines for agriculture, CMSMEs, import substitutes, and export-oriented industries; and continuing the support by providing enough refinance facilities to implement the Government's ongoing stimulus package.

In response to the evolving exchange rate pressure, BB has taken a series of additional policy measures during H1FY23, which include, among others, allowing Bangladesh Taka (BDT) to depreciate to an extent of around 11.28 percent; selling a significant amount of foreign currencies (around USD 7.8 billion) to banks; discouraging imports of luxury and non-essential commodities by enhancing the requirements of LC margins; restricting all sorts of foreign tours by officials in banks, NBFIs including BB; instructing the banks to reduce their operational expenses; easing the remittance repatriation and cash incentive distribution process; allowing the mobile financial services in remittance collection and distribution process; waiving the money transfer fees by local banks for expatriate remitters; strengthening the BB's monitoring on foreign exchange dealings by banks and money changers; reducing the export retention quota (ERQ) and banks' net open position (NOP); enhancing the interest rate on non-resident foreign currency deposits; and enhancing the interest rate on loans from export development fund.

As per available data, the external demand, which is reflected mainly by export receipts, increased by 10.58 percent during July-December 2022 compared with an increase of 28.41 percent during the same period of the last year. Similarly, the internal demand partly reflected by import payments decreased by 2.20 percent during July-December 2022 as against an increase of 54.47 percent during the same period of the last year. Consumer credit growth, another critical indicator of internal demand, increased by 26.70 percent in September 2022, while it grew by 22.90 percent during the same period of the last year.

The private and public sector investment activities, partly reflected through the private sector credit growth and the implementation of various government mega projects, remained buoyant in H1FY23. The private sector credit increased by 12.76 percent (y-o-y) in December 2022 against an increase of 10.68 percent in the same period of the last year. The medium and large-scale manufacturing output registered 7.42 percent growth during July-September 2022 compared to 9.13 percent during the corresponding period of the last year.

The domestic commodity prices substantially increased in H1FY23 as compared to the same period of the last year. The CPI-based point-to-point headline inflation reached 8.71 percent in December 2022, while it was 7.56 percent in June 2022. The CPI-based average headline inflation, on the other hand, reached 7.70 percent in December 2022 as compared to 6.15 percent in June 2022. Among the components of headline inflation, non-food inflation elevated more relative to food inflation, mainly due to a substantial upward revision of domestically administered fuel prices. However, the CPI-based point-to-point headline inflation has been showing a declining trend during the last 5 months (August-December), supported by a declining trend in food inflation, though core (non-food & non-fuel) inflation is still increasing, reaching 7.52 percent on average in December 2022. It is reported that domestic food production, particularly aman paddy and vegetable items, has significantly increased over the months, influencing food inflation to decline. It is noteworthy that the inflationary pressure during H1FY23 was mainly driven by supply-side factors emanating from global commodity price hikes.

On the monetary front, the broad money growth, an indicator of the demand influencing factor, was lower than the programmed growth set for H1FY23. In addition, the banks' excess reserves[1] were very limited in most cases, along with a shortfall in some cases, particularly in the Islamic Shariah-based banks.

Table 1: Developments of Monetary Aggregates

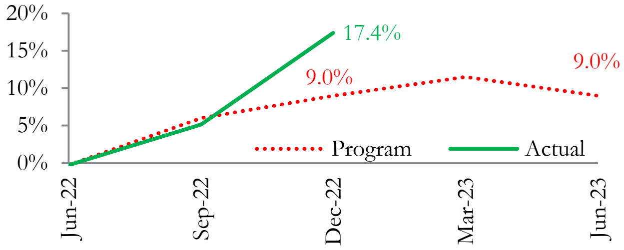
(y-o-y % change)

Item	Jun-21	Jun-22	Dec-22	
	Actual	Actual	Actual[P]	Program@
Broad money	**13.6**	**9.4**	**8.4**	**10.0**
Net Foreign Assets*	27.7	-11.9	-22.6	-10.1
Net Domestic Assets	9.2	17.2	18.5	16.6
Domestic Credit	10.4	16.2	15.1	16.9
Credit to the public sector	21.7	29.1	26.6	33.3
Credit to the private sector	8.3	13.7	12.8	13.6
Reserve money	**22.4**	**-0.3**	**17.4**	**9.0**
Money multiplier	4.49	4.93	4.63	5.06
NCG (Crore Taka, during the respective fiscal year)	42,040	62,540	32,249	1,06,334#

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

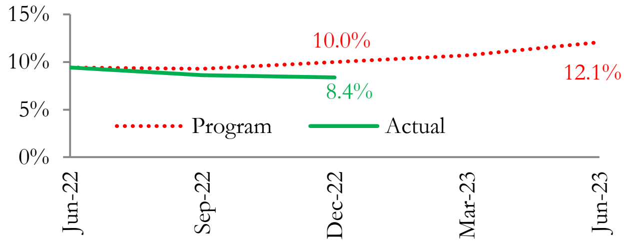
Table 1 and Charts 1-6 display the actual growth paths of major monetary and credit aggregates against their programmed paths set for FY23 (announced in June 2022). The reserve money (RM) growth, the operating target of BB's monetary policy, moved below the programmed path during the first quarter and above the programmed path during the second quarter of FY23 due to the relative strength of the negative growth of BB's net foreign assets (NFA) and the positive growth of BB's net domestic assets (NDA) (Chart 1). During that period (H1FY23), the BB's NFA growth was significantly negative due to huge net sale of foreign currency to the banks, induced by very strong import demands. On the other hand, the BB's NDA growth was also very strong due to BB's huge liquidity support to the banks and the devolvement of Government securities to BB.

Chart 1: Reserve Money (RM) Growth



Source: Bangladesh Bank.

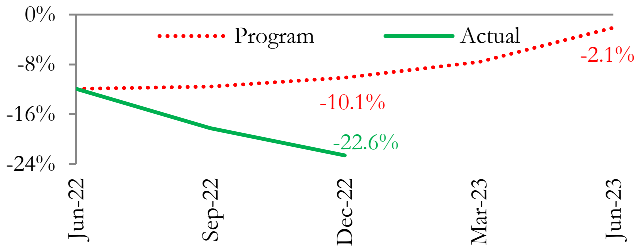
Chart 2: Broad Money (M2) Growth



Source: Bangladesh Bank.

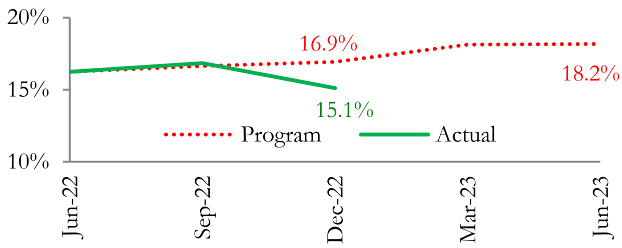
[1] Banks' excess reserve equals total cash reserve minus required reserve (as per CRR) with BB.

Chart 3: Net Foreign Assets (NFA) Growth



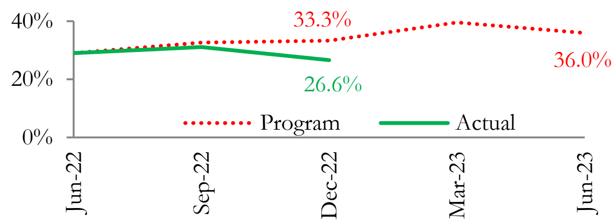
Source: Bangladesh Bank.

Chart 4: Domestic Credit (DC) Growth



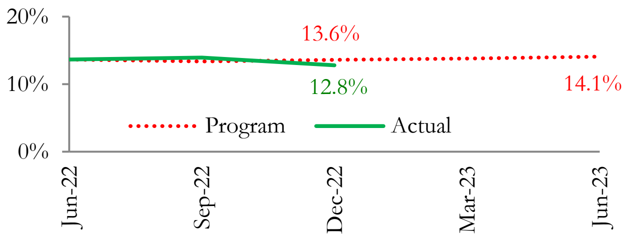
Source: Bangladesh Bank.

Chart 5: Public Sector Credit Growth



Source: Bangladesh Bank.

Chart 6: Private Sector Credit Growth

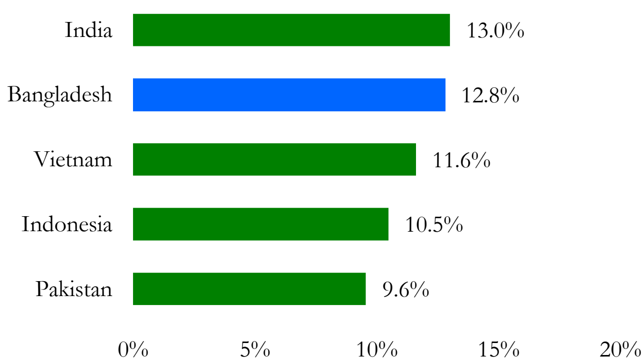


Source: Bangladesh Bank.

The broad money (M2) growth, the nominal anchor or intermediate target of BB's monetary policy, remained well below the programmed path during H1FY23, dragged down by lower net foreign assets (NFA) of the banking system (Chart 2). The NFA dropped by 22.59 percent in December 2022 against the negative programmed growth of 10.14 percent, broadly due to a wide deficit in the overall balance of payments (BoP). The BoP deficit was on account of a higher amount of import payments as compared to the total amount of export receipts and inward remittances, and a significant repayment of trade credit (Chart 3).

However, the movement of domestic credit remained in line with the programmed path in FY23, owing to a strong private sector credit growth accompanied by steady growth in public sector credit (Chart 4). Driven by the increased commodity prices and steep exchange rate depreciation, the private sector credit increased strongly by 12.76 percent in December 2022 against both the actual growth of 10.68 percent in December 2021 and the programmed growth of 13.60 percent set for December 2022 (Chart 6). Similarly, the public sector credit growth increased by 26.65 percent in December 2022 against both the actual growth of 21.94 percent in December 2021 and the programmed growth of 33.34 percent set for December 2022 (Chart 5).

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



Source: Respective Central Banks' Websites.
* Data as of Dec 2022.

The private sector credit growth has been strong during H1FY23 due to the reversion of momentum in economic activities after overcoming the impact of the corona, with the increase in commodity prices in the global market in the presence of a substantial depreciation of BDT against USD. Similarly, the increased global prices have raised the cost of implementing the Government's mega projects. The relatively lower amount of government borrowings from non-bank (sale of national savings certificate) and foreign sources have significantly increased the amount of public sector credit provided by the banking system. It is mentionable that the private sector credit growth, which presumably reflects the private investment at the national level, increased reasonably well in Bangladesh compared to many other emerging and developing Asian economies (Chart 7).

3. Overview of Global and Local Contexts of Monetary Policy Stance for H2FY23

3.1 Global Growth, Inflation, Interest Rate, and Trade Environment

Global economic growth prospects are confronting several headwinds mainly due to the Russia-Ukraine war, multi-decade record high inflation in many economies, interest rate increases in most regions, and lingering Covid-19 effects in some parts of the world, particularly in China. Normalization of policies by withdrawing Covid-related stimulus and adjusting the central bank's policy parameters towards price stability objective is cooling domestic demand with a dampening impact on economic growth. According to IMF's latest World Economic Outlook, October 2022, global growth will be 3.20 percent in 2022 and 2.70 percent in 2023, 0.40 and 0.90 percentage points lower than those in the April 2022 forecasts, respectively (Table 2). It also sees a real possibility of a recession, at least in one-third of the world economies. The last two columns of Table 2 demonstrate the extent to which growth projections have been downgraded (in percentage points) for 2022 and 2023, reflecting worsened growth prospects for all major economies.

Table 2: Overview of Global Economic Growth as per October 2022 WEO

(y-o-y % change)

Region	Growth				Difference from April 2022 WEO Projection	
	Actual		Projection			
	2020	2021	2022	2023	2022	2023
World	**-3.1**	**6.0**	**3.2**	**2.7**	**-0.4**	**-0.9**
Advanced Economies	-4.5	5.2	2.4	1.1	-0.9	-1.3
USA	-3.4	5.7	1.6	1.0	-2.1	-1.3
Euro Area	-6.3	5.2	3.1	0.5	0.3	-1.8
Other Advanced Economies	-1.8	5.3	2.8	2.3	-0.3	-0.7
Emerging Market and Developing Economies	-2.0	6.6	3.7	3.7	-0.1	-0.7
China	2.2	8.1	3.2	4.4	-1.2	-0.7
India	-6.6	8.7	6.8	6.1	-1.4	-0.8

Source: International Monetary Fund.

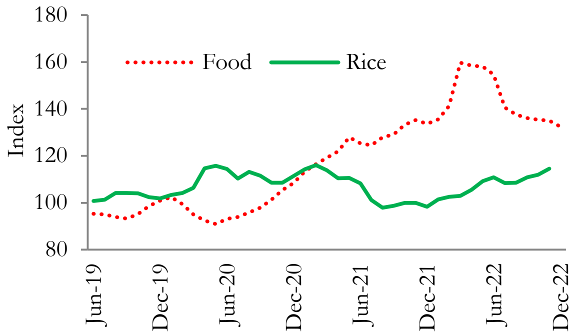
The nominal policy rates in advanced, emerging market, and developing economies have risen above pre-pandemic levels. However, with rising inflation, real interest rates have yet to return to pre-pandemic levels. Tightening financial conditions across most regions have resulted in a substantial real appreciation of the US dollar (October 2022 Global Financial Stability Report). This has also increased yield spreads –

the difference between the US dollar- and other currency-denominated government bond yields – for debt-burdened lower- and middle-income economies.

Inflation has increased worldwide more persistently than anticipated since 2021. It accelerated in 2022 in advanced economies to its highest level since 1982. For 2022, inflation is projected at 7.20 percent for the advanced economies and 9.90 percent for the emerging and developing economies, 1.50 and 1.20 percentage points higher than the forecasts made in April 2022 World Economic Outlook, respectively. With reasonably well-anchored expectations in the medium-term, the inflation in 2023 is projected to be 4.40 percent for the advanced economy group and 8.10 percent for emerging market and developing economies (1.90 and 1.60 percentage points higher than the April 2022 forecasts). Though inflation affected most countries worldwide, it disproportionately impacted lower-income groups in developing economies.

Chart 8: Global Food and Rice Price Indices

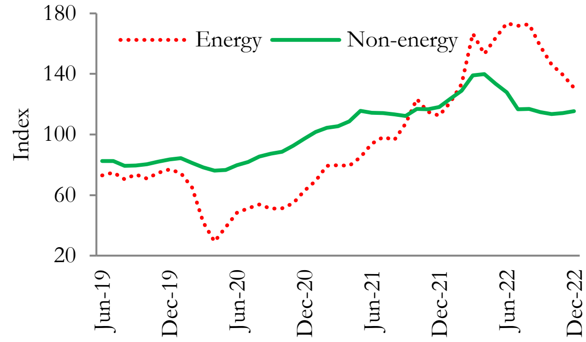
(Base: 2014-2016=100)



Source: Food and Agriculture Organization (FAO)

Chart 9: Commodity Price Indices

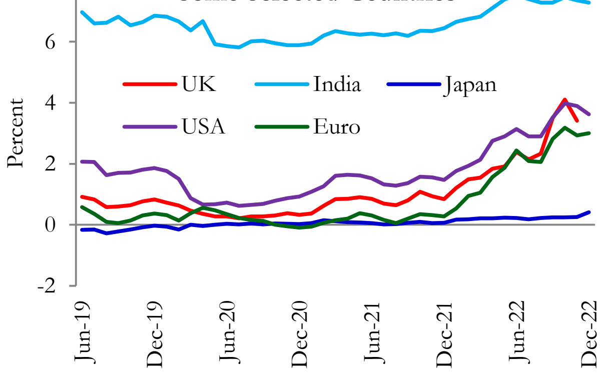
(Base: 2010 = 100)



Source: World Bank

Containing inflationary pressures becomes a critical challenge worldwide as the monetary authority could miscalculate the normalization policy toward lowering inflation. The policy paths of the world's largest economies could continue to diverge, resulting in further appreciation of the US dollar and worsening the cross-border trade balance. Persistent energy and food price shocks could extend the duration of an inflationary regime.

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



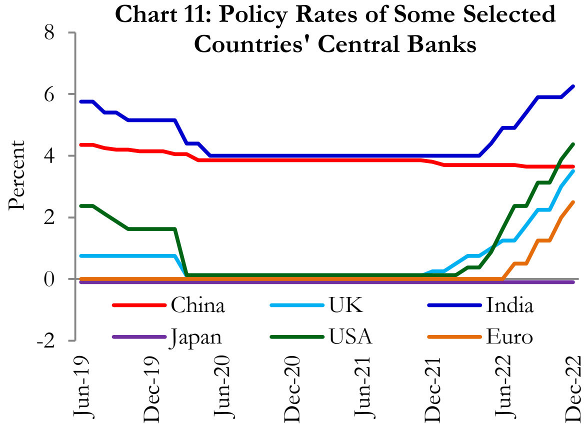
Source: Organization for Economic Co-operation and Development

Due to supply chain disruptions and subsequent commodity price hikes, Bangladesh economy has been adversely affected. The uptrend in global price indices moderated somewhat in December 2022 compared to June 2022, as shown in Charts 8 and 9. If this continues in the upcoming months, the depreciation pressure on the Bangladeshi Taka will ease up to push down the domestic inflationary pressure. However, the downward trend in global energy prices might remain unresponsive to domestic inflation mainly because of administered energy prices in the country. In this regard, the periodic fuel price adjustment in line with the global price is essential.

The increasing trends in long-term interest rates in terms of the yields of government bonds maturing in ten years in most of the major developed and developing countries continue to surpass their pre-pandemic levels in December 2022 (Chart 10). The recent uptrend of long-term yields reflects investors' expectations of significantly high inflation for an extended period and tighter monetary policies ahead.

Major economies like the USA, India, the UK and the Euro area raised their policy interest rates recently in a bid to tackle soaring inflation. However, Japan continued to employ a zero interest-rate policy (ZIRP), setting long-term interest rates around zero and short-term rates at minus 0.1% (Chart 11). It is worth mentioning that the interest rates (both long-term interest and policy rates) in India remained relatively higher than those in the advanced economies, mainly because of their inflation differentials, a common feature in many other emerging markets and developing economies, including Bangladesh. The continuation of rising trends of long-term interest rates in advanced economies may create some pressures on interest and exchange rates in the emerging market and developing economies.

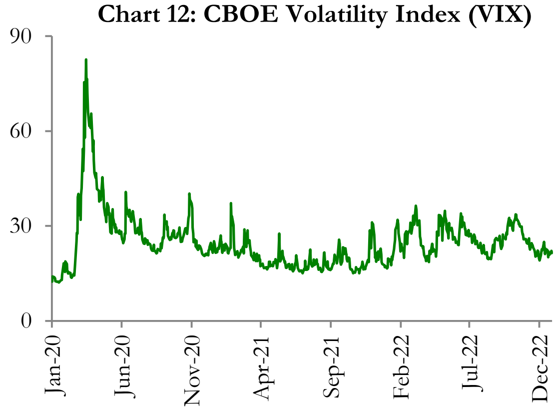
Chart 11: Policy Rates of Some Selected Countries' Central Banks



Source: Bank for International Settlements

Global financial markets broadly remained volatile in 2022, as observed by the daily closing values of the CBOE Volatility Index. Indices were 31.62 in September 2022 and 21.44 in December 2022, which were higher than that of the pre-pandemic 10 years period average (2011-19: 16.2). Since US inflation was less than anticipated in July and early August 2022, the volatility of the world financial markets moderated somewhat during that time. However, volatility started to surge again as the uncertainties started mounting over the pace of tightening of the US Federal Reserve in the second quarter of 2022. Subsequently, when the Fed issued the third 75 basis point increase and signaled at a much higher terminal rate, the index reached a 3-month high. Volatile commodity prices and worries about a slowdown in global growth also weighed on financial market uncertainties.

Chart 12: CBOE Volatility Index (VIX)



Source: Chicago Board Options Exchange

The IMF projects that world trade volume is estimated to grow at 4.30 percent in 2022 but will slow down to 2.50 percent in 2023, considering the impact of the Russia-Ukraine war on trade along with a potential food crisis caused by supply chain disruptions. The conflict will also hamper services trade, particularly in the transport sector. Moreover, renewed lockdowns in China to prevent the spread of Covid-19 may also generate disruptions in the seaborne trade channel.

On the external front, the slashed growth forecasts and any possible economic recession in the advanced economies, particularly in regards to the Euro Area and the USA, are concerns for Bangladesh economy as they are the top export destinations of Bangladesh's exports as well as important sources of remittances. Besides, global commodity and energy price hikes arising from the Russia-Ukraine war mounted pressures on the trade balance, foreign exchange reserves, and exchange rate during the first half of FY23. Bangladesh Bank has taken necessary measures to contain import demand for non-essential items to maintain exchange rate stability while sustaining adequate foreign exchange reserves for the economy.

3.2 Domestic Growth and Inflation Outlook

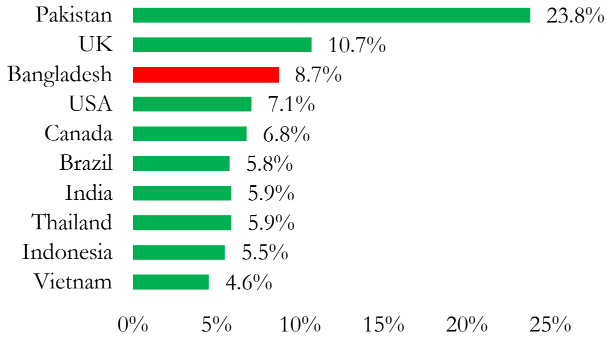
Bangladesh economy witnessed impressive growth performances during the previous two consecutive fiscal years, reflected by 6.94 percent and 7.25 percent real GDP growth rates in FY21 and FY22 respectively. The Bangladesh economy has shown strong resilience against the Covid-19 shocks and rebounded sharply, supported by higher growth in industrial and service sectors resulting from improved Covid-19 situation and robust internal and external demand. The growth rate of the agriculture sector is expected to rebound in FY23 due to favorable weather conditions aided by both the fiscal and monetary authorities' supportive policy measures.

Overall, 10.58 percent growth in exports in the first half of FY23 met the strategic target set for the period, and negative import growth of 2.20 percent during July-December 2022 has been the outcome of BB's recent policy initiatives - such as promoting import-substituting economic activities and dissuading imports of luxury goods, fruits, non-cereal foods, canned and processed foods, etc., on top of depreciation pressures of local currency.

The Government declared 28 stimulus packages worth Tk. 1,91,919 crore, approximately 5.43 percent of FY21's NGDP, for mitigating the adversities of the outbreak of Covid-19 on Bangladesh economy, which have facilitated faster economic recovery and higher real GDP growth in FY22. BB has been assigned to implement the lion's share of these stimulus packages through a series of complementary and supportive policy measures by injecting working capital loans and extending various refinance facilities for agriculture, CMSMEs, large industries, export-oriented industries, and the service sector. BB has been responsible for implementing ten major stimulus packages including Tk. 1,89,000 crore for 9 packages and USD 3.5 billion for extended EDF package for supporting the economic recovery from the adversities of the Covid-19 pandemic - of which implementation of four packages have been concluded.

The economic recovery from the Covid-19 pandemic continues to face challenges due to the ongoing Russia-Ukraine war. The war has aggravated the supply-side conditions, dropped global growth prospects, and fueled inflation. This phenomenon is likely to play some observable adversities towards the economic recovery of Bangladesh and add up uncertainties for the second half of FY23. The war has escalated the risk of losing export growth on the one hand, and the war-induced surge in commodity and energy prices has led to higher import costs and trade deficits, putting further pressure on exchange rates and inflation, on the other. Although the Government has deferred several non-urgent and low-priority projects to avoid possible adverse effects, some high-priority projects are still under implementation. In this backdrop, considering the global outlook and internal situations, the real GDP growth target has been revised down to 6.50 percent, which seems consistent with the BB's model-based GDP growth forecasts for FY23[2].

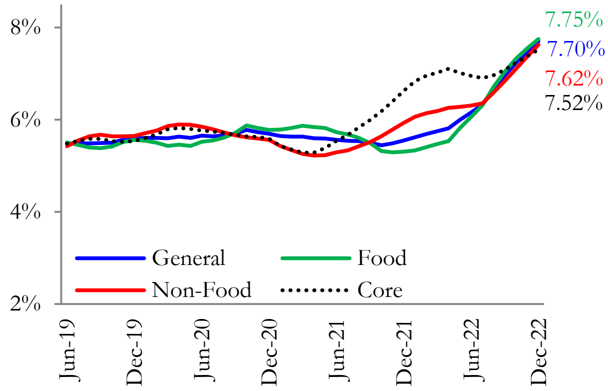
Chart 13: Cross-country Comparison of Point to Point Inflation*



Source: Respective Central Banks' Websites.
* Up to December 2022 for Bangladesh, Brazil, Indonesia, Thailand and Vietnam, and November 2022 for others.

Most economies, including Bangladesh, have been facing high inflationary pressures emerging from the persistent supply disruptions and rising global energy and commodity prices since the Covid-19 pandemic (Chart 13). CPI-based inflation in Bangladesh went up, especially after the subsequentially upward adjustment of fuel prices in the recent months of FY23. Chart 14 plots the CPI-based 12-month average headline inflation trend along with its broad components – food, non-food, and core (non-food and non-energy) inflation since June 2019. A slow pace of 12-month average CPI inflation was observed up to October 2021, which started to pick up thereafter. FY22 ended with headline inflation of 6.15 percent - well above the target inflation of 5.30 percent. The CPI-based average inflation continued its rising trend in H1FY23 and stood at 7.70 percent in December 2022. The inflation was attributed to a significant increase in food and non-food prices mainly because of the pass-through effect of elevated global commodity prices in the face of supply shocks, higher shipping costs, and domestic currency depreciation. BB has been watchful in mitigating inflationary pressure by tightening policy measures and strengthening supply-side interventions.

Chart 14: Twelve Month Average CPI Inflation



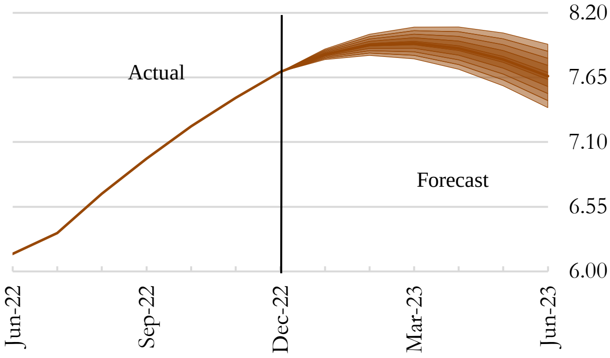
Source: Bangladesh Bureau of Statistics (BBS)

[2] A series of output gaps from FY82 to FY22 has been calculated for estimating the model-based GDP forecast for FY23. Output-gap is a function of Composite Leading Indicators of the World (CLIW) and Real Rate of Lending (RRL), while GDP growth at a constant price is considered a function of output-gap and growth of potential GDP.

The inflation outlook might continue to confront some uncertainties in the second half of FY23 because of increasing price pressures emanating from the strained supply chain, pessimistic progress regarding a peaceful resolution of the Russia-Ukraine war, and elevated global commodity prices. Among the vital trading partners of Bangladesh, inflation has started to ease up in India. However, lingering waves of Covid-19 and growing geopolitical tensions threaten to disrupt economic activities in China that could cause supply bottlenecks, worsening the inflation forecast as China is Bangladesh's another major trading partner. The sustained inflationary pressure might also be translated into higher inflation expectations. The lagged behavior of internal price adjustment, notwithstanding the price drop in the international market, could lead to further pressure on domestic inflation.

Moreover, the recent swelling in construction material prices brought about a higher asset price, which may further aggravate inflation risk. The persistent high global commodity prices amid uncertainty regarding the war in Eastern Europe, along with higher than the target level of inflation in most of the trading partner countries, would make it strenuous to bring down the inflation to a moderate level. Taking all these under consideration, the last coordination council's meeting rightly updated the target inflation for Bangladesh to 7.50 percent from 5.60 percent for FY23. BB's Modeling and Forecasting Unit's forecast also confirms a similar inflation outcome for FY23 (Chart 15).

Chart 15: Projection of Average General CPI Inflation

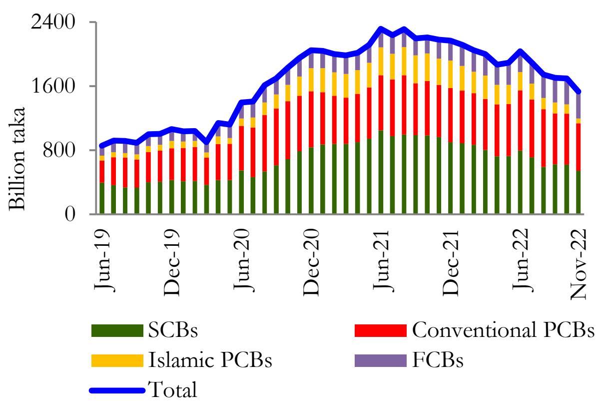


Source: BB's Research Team Projection Based on BBS Data

3.3 Liquidity Situation, Interest Rates and Related Issues in Money and Credit Markets

The liquidity situation of the banking system is usually measured by banks' excess cash reserves in a narrow sense and banks' excess liquid assets[3] in a broad sense, exhibits a declining trend during H1FY23 for several reasons. Some of them are the continuous rise in demand after the visible improvement of corona impacts, the increase in credit flow to public and private sectors, the excessive higher import costs due to very high commodity prices, and the significant depreciation of local currency (Chart 16). BB has taken various initiatives, including continuous liquidity supports to

Chart 16: Movement of Excess Liquid Assets

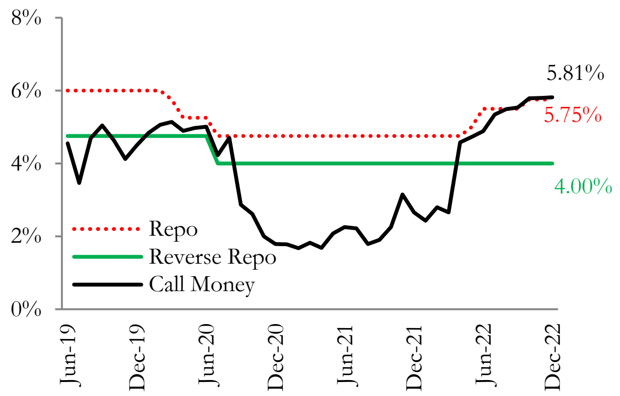


Source: Bangladesh Bank

[3] Banks' excess liquid asset is equal to the total liquid asset minus the required liquid asset (as per SLR). Total liquid asset consists of excess cash reserve, government securities holding by banks and banks' foreign currency reserve with BB.

the conventional banks through repo and assured liquidity support facility and the introduction of an Islamic bank liquidity facility (IBLF). Nonetheless, some banks, particularly Shariah-based Islamic banks, have been facing liquidity pressure during the last couple of months. As a result, the banks' total excess reserves and excess liquid assets declined from Tk. 26,876 crore and Tk. 2,03,435 crore at the end of June 2022 to Tk. 6,591 crore and Tk. 1,53,177 crore at the end of November 2022, respectively. The sale of foreign currencies to meet higher import demand than those of export earnings and inward remittances has resulted in a large volume of local currency withdrawal, significantly contributing to the declining trend of excess cash reserves/liquidity.

Chart 17: Movement of Call Money and Policy Rates

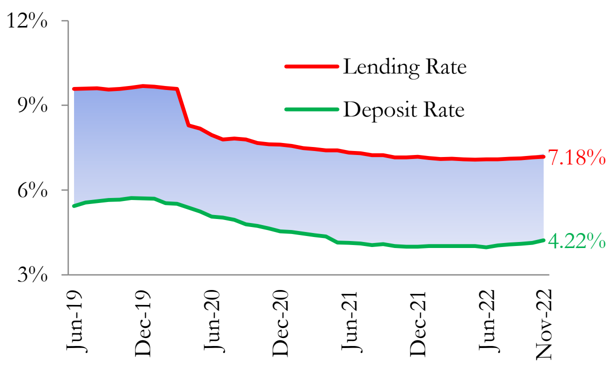


Source: Bangladesh Bank

As a result, the interbank call money rate significantly increased during H1FY23 crossing the upper bound of the interest rate corridor, i.e., the repo rate, in recent days (Chart 17). Thus, the interbank call money rate increased to 5.81 percent at the end of December 2022 from 4.42 percent at the end of June 2022.

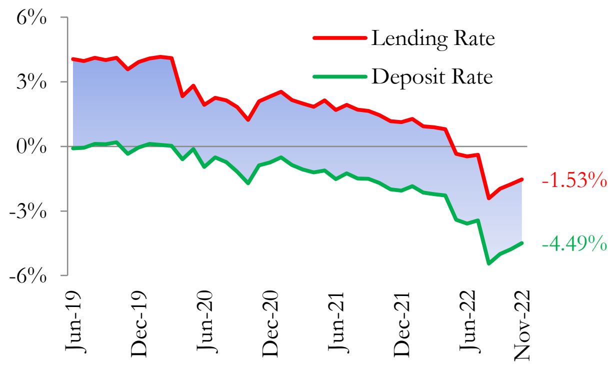
In line with the short-term interest rate, the weighted average lending and deposit rate also moved upward during H1FY23, both in nominal and real terms (Charts 18 and 19). The weighted average nominal lending rate increased to 7.18 percent in November 2022 from 7.09 percent in June 2022. Similarly, the weighted average nominal deposit rate increased to 4.22 percent in November 2022 from 3.97 percent in June 2022. Thus, the interest rate spread (the difference between the lending rate and deposit rate) slightly dropped to 2.96 percent in November 2022 from 3.12 percent in June 2022, indicating an improvement in the banking sector's efficiency.

Chart 18: Weighted Average Nominal Interest Rates



Source: Bangladesh Bank

Chart 19: Weighted Average Real Interest Rates



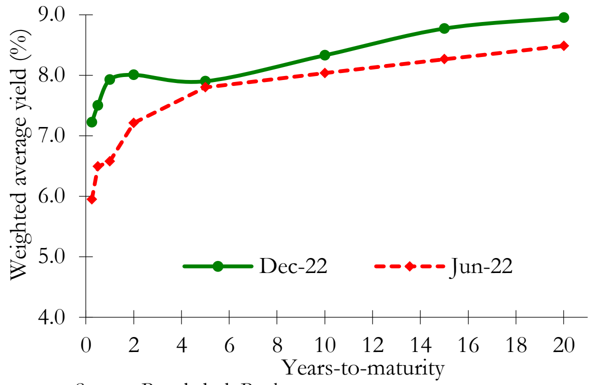
Source: Bangladesh Bank

The real lending and deposit rates remained in the negative territory until November 2022 due to a higher rate of inflation (Chart 19). A higher inflationary environment, to some extent, contributed to lower deposit growth during H1FY23. The deposit growth stood at 6.68 percent in November 2022 compared to 8.90 percent in June 2022.

Following the liquidity tightening situation in the local currency market, the yield on both short and long-term government securities increased over the months. Thus, the weighted average yield curve in December 2022 placed above the yield curve in June 2022 (Chart 20). Tight liquidity conditions, a broad-based increase of yields to maturities, higher policy rates, and rising inflation make the funds costlier, creating some upside pressures on the lending rate.

Considering the current market conditions, the lending rate cap for consumers' credit has been relaxed to vary up to 3.00 percentage points, along with the complete removal of the deposit floor rate. There is no cap for credit card loans. In the presence of a suitable economic condition, the removal of the remaining lending rate cap will be considered. These relaxations on the lending rate cap and the complete removal of the deposit floor rate may help grow the overall deposit rate.

Chart 20: Yields on Government Securities

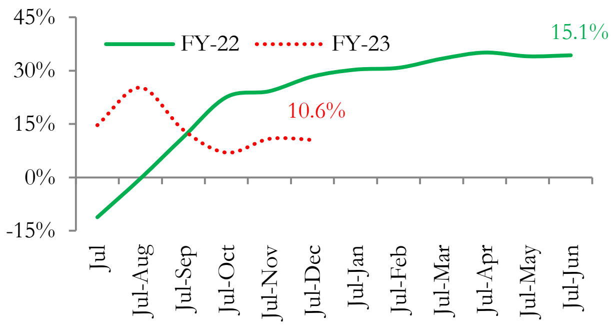


Source: Bangladesh Bank

3.4 Overview of External Sector Developments and Outlooks

The growth momentum of exports and imports, which peaked in FY22 after the recovery from corona pandemic, substantially slowed down in H1FY23 due to the reduction of both internal and external demand resulting mainly from commodity price hikes in the global market and related corrective measures, i.e., the contractionary and conservative policy measures taken by many developed and developing countries including Bangladesh to curb inflationary as well as exchange rate pressures. The Russia-Ukraine war, which imposed reciprocal sanctions on different countries, played a vital role in creating inflationary and exchange rate pressures and the possibility of economic recession in the world economy. Above all, some developed countries' central banks, especially the US Federal Reserve System, adopted hawkish-type contractionary monetary policy, aggressively raising the policy rates. Consequently, the USD moves towards investment in US securities and respective currencies face depreciating pressure.

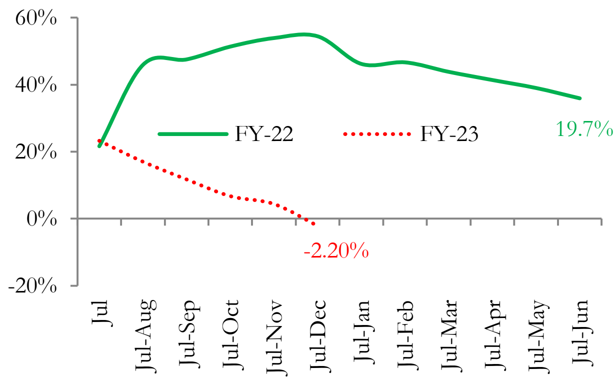
Chart 21: Cumulative Exports Growth



Source: Export Promotion Bureau

One of the important external sector variables in Bangladesh, the cumulative export growth stood at 10.58 percent during July-December 2022, while it was 28.41 percent during the same period of the last year (Chart 21). Among the components of exports, knitwear and woven garments were the main driving factors for the total export growth, having 84.20 percent share in total exports and 15.56 percent growth during July-December 2022. In addition, the shares as well as the growth of exports of leather & leather products and plastic products were also significant in the total exports growth.

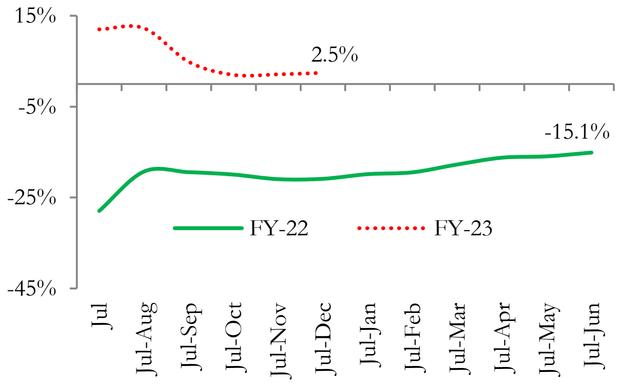
Chart 22: Cumulative Imports Growth



Source: National Board of Revenue

The import witnessed negative growth of 2.20 percent during July-December 2022, while it was 54.47 percent positive during the same period of the last year (Chart 22). This negative growth of imports might be the outcome of several initiatives taken by Bangladesh Bank and the Government since April 2022 to restrain the depletion of foreign exchange reserves. However, though the import growth was negative against the positive export growth, total imports (USD 41.2 billion) was much higher than total exports (USD 27.3 billion) during July-December 2022. Among the components, the import growth of edible oil, raw cotton, fertilizer, iron and steel, and capital machinery contributed more to total import growth during July-December 2022.

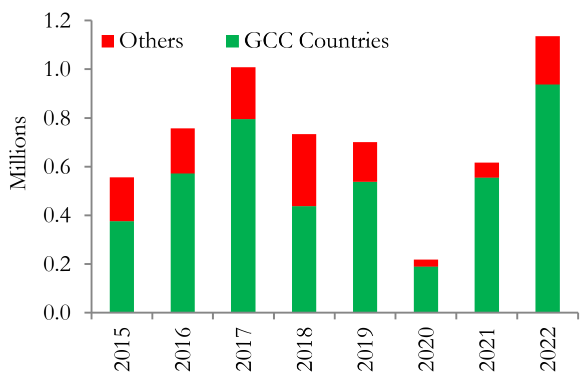
Chart 23: Cumulative Remittance Growth



Source: Bangladesh Bank

A higher volume of imports than exports led to a large trade deficit during July-November 2022. The inward remittances, one of the vital factors for the stability of the current account balance, offset the trade deficit to a greater extent during the period under review. Nonetheless, the current account registered a huge deficit during July-November 2022 owing to a substantial deficit in the service account, as the shipping charges largely increased on the back of fuel oil price hike. The inward remittances increased by 2.48 percent to USD 10.5 billion during July-December 2022, while it was USD 10.2 billion with negative growth of 20.90 percent during the same period of the last year (Chart 23). BB has taken some measures to uplift the volume of inward remittances to a desired level. These include, among others allowing BDT to depreciate significantly to reduce the exchange rate differential, easing the remittance repatriation and cash incentive distribution process, waiving the money transfers fees by local banks for expatriate

Chart 24: Overseas Employment



Source: Bureau of Manpower, Employment and Training.

remitters, and allowing the mobile financial services in the remittance collection and distribution process. With the support of these policy measures along with record-high overseas employment in 2022, the inward remittances growth is expected to improve soon (Chart 24).

Due to the widening of the deficits in trade and service accounts amid moderate inflows of remittances, the current account deficit expanded to USD 5.7 billion (1.20 percent of FY23 projected NGDP) during July - November 2022, while it was USD 6.2 billion (1.30 percent of FY22 NGDP) during the same period of the last year. Likewise, the financial account also remained in the deficit territory due to a huge trade credit (net) account shortage, which widened the overall deficit to USD 6.4 billion during July-November 2022 (Table 3).

Table 3: Balance of Payments Highlights

(In million USD)

Major Items	Actual Outcome			Outlook
	FY21	FY22	Jul-Nov, 2022	FY23[R]
Trade balance	-23,778	-33,250	-11,794	-20,901
Services	-3,020	-3,955	-1,733	-4,847
Primary income	-3,172	-3,152	-1,213	-3,440
Secondary income	25,395	21,718	9,070	22,370
of which: workers' remittances	24,778	21,032	8,793	21,873
Current account balance	**-4,575**	**-18,639**	**-5,670**	**-6,818**
Capital accounts	458	181	96	225
Financial accounts	14,067	13,775	-157	2,800
Errors and omissions	-676	-697	-653	-1,284
Overall balance	**9,274**	**-5,380**	**-6,384**	**-5,077**
Memorandum items:				
Exports growth (adjusted as per BPM6, percent)	14.9	33.4	10.9	10.0
Imports growth (percent)	19.7	35.9	4.4	-9.0
Remittances growth (percent)	36.1	-15.1	2.1	4.0
Gross international reserves (GIR)	46,391	41,827	33,789	36,500

Source: Bangladesh Bank. R = Revised.

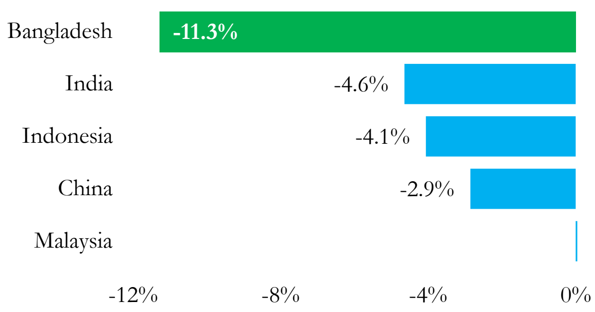
The current account deficit may stay around USD 6.8 billion at the end of FY23. However, the increased overseas employment of wage earner remitters amid improved economic and working conditions in the source countries is expected to help the inward remittances grow by 4.00 percent in FY23. The export and import growth will also be moderated by the higher base effect, growing by 10.00 percent and declining by 9.00 percent respectively in FY23. As a result, the overall balance of payment (BoP) in FY23 is anticipated to be at a moderate deficit level, well supported by a befitting performance of the financial account (Table 2).

3.5 Movements of Exchange Rate and Foreign Exchange Reserves

The world economy is facing challenges and uncertainties on various fronts, such as record-high inflation, tightening financial conditions in most regions, the Russia-Ukraine war, and post-pandemic supply chain disruptions. The repercussions of all of these are prevailing in the rest of the world, including Bangladesh. Bangladesh economy faced a huge current account deficit since the last quarter of FY22, which continued in the first quarter of FY23, emanating from unprecedented high import payments and subdued inward remittances. The surge in the current account deficit has led to considerable depreciating pressure on the BDT-USD exchange rate. BB responded with considerable foreign exchange support and allowed a greater extent of exchange rate depreciation in tandem.

Bangladesh Taka depreciated sharply during the first half of FY23 reflecting excess demand for foreign exchange along with an appreciation of the USD in the global market. To mitigate the depreciating pressure and bring current account deficits to a comfortable level, BB extended necessary policy measures, including net sales of USD 7.8 billion during H1FY23 to meet the excess demand for the greenback, imports barriers for unnecessary and luxury items, reduction of ERQ, reduction of cash foreign currency holdings by money changers, reduction of NOP limit, interest rate hike on borrowing from EDF, import monitoring and restrictions on foreign travels. Moreover, to bring stability to the exchange rate, BB has let the ABB and BAFEDA to determine the exchange rate based on the market demand and supply conditions, effective from 12 September 2022. As of end December 2022, BB's foreign exchange reserves stood at USD 33.8 billion compared with USD 41.8 billion at the end of June 2022.

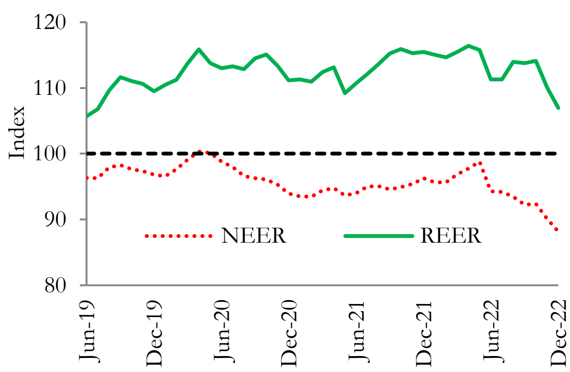
Chart 25: App(+)/Dep(-) of Domestic Currency against USD during Jul-Dec 2022



Sources: Respective Central Banks' Websites.

Chart 25 shows a cross-country scenario of exchange rate appreciation/depreciation of the domestic currency against USD (up to December 2022). It indicates that BDT depreciated more than the currencies of many other Asian developing countries, including Malaysia, India, China, and Indonesia. The nominal effective exchange rate (NEER) index indicates a nominal depreciation of the BDT against the basket of major trading partners' currencies[4], as it lies below 100 until the end of December 2022 (Chart 26). The real effective exchange rate (REER) index indicates a real appreciation of BDT against the basket of major trading partners' currencies, as it is higher than 100, mainly due to the wide price differentials between Bangladesh and the major trading partners, mainly developed and emerging market economies. Considering necessary measures taken by BB, it is expected that the exchange rate will move toward a unified rate (within a 2.00 percent variation) within this fiscal year and a flexible exchange rate system for all international transactions bringing stability to the BDT-USD exchange rate.

Chart 26: Effective Exchange Rate Indices
(Base: 2015-16=100)



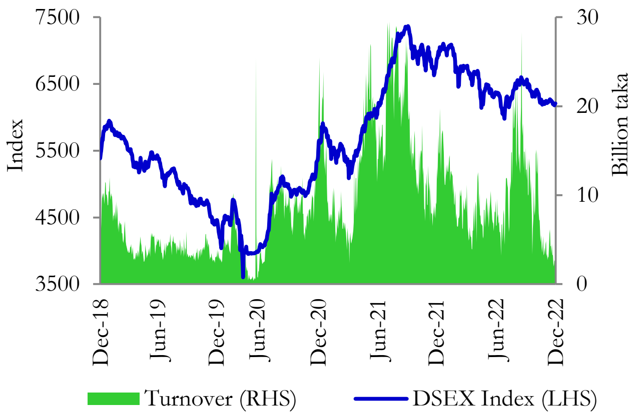
Source: Bangladesh Bank

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

3.6 Capital Market Developments and Prospects

The capital market in the country remained somewhat quiet during H1FY23 despite the favorable policies backed by BSEC and BB. The current adverse macroeconomic situation in the domestic and global economies partly led to the subdued capital market performance. During H1FY23, the trends for all significant capital indices were downward, albeit there was some variation.

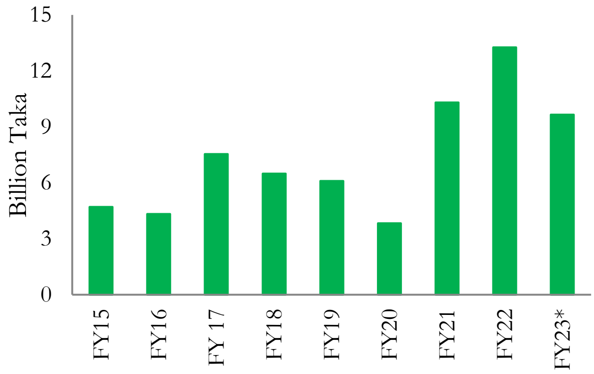
Chart 27: DSEX Index and Turnover



Source: Dhaka Stock Exchange

A vital stock market indicator, the DSE broad index reached 6,206.8 points in December 2022, down from 6,376.9 in end June 2022, which fell by 2.67 percent during that period. The DSEX index also declined by 8.14 percent at end December 2022 as compared to that of end December 2021.

Chart 28: DSE Daily AverageTurnover

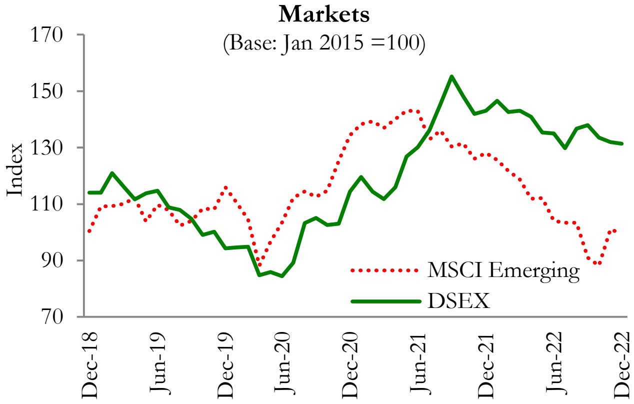


Source: Dhaka Stock Exchange * Up to December 2022

As an essential measure of capital market liquidity, the daily average turnover decreased significantly by 43.52 percent to Tk. 970 crore in the first half of FY23 from Tk. 1,710 crore in the first half of FY22 and Tk. 1,330 crore in FY22. Low turnover volume in H1FY23 reflected subdued capital market activity compared to H1FY22. Among all sectors, ceramics had the highest turnover share at 16.80 percent in H1FY23.

Chart 29: Synchronization of DSE with Global Markets

(Base: Jan 2015 =100)



Sources: Dhaka Stock Exchange and www.msci.com

The DSE market capitalization reached Tk. 7,60,937 crore at the end of December 2022, compared to Tk. 5,17,781 crore at the end of June 2022. However, market capitalization rose from 13.00 percent of NGDP in June 2022 to 17.10 percent of NGDP in December 2022. The stakeholders and regulatory bodies (BB, BSEC, DSE, and CDBL) take the necessary steps to increase DSE's market capitalization by trading government securities on stock exchanges. Three firms and two perpetual bonds raised capital through initial public offerings (IPOs) in the first half of FY23 compared to eleven enterprises in FY22. In H1FY23, Tk. 630 crore was raised through an IPO, compared to Tk. 3,258 crore in FY22.

A lack of investors' confidence stemming from worries about rising prices and weakening economic development prospects led to a downward pattern with some volatility in the global capital markets index (MSCI emerging market) during H1FY23, followed by a dropping trend since June 2021 (Chart 29). A more significant strain was evident in international financial markets due to a stricter monetary policy adopted by the United States. Although the MSCI emerging market and the DSE have shown correlated performance over the past few years, this correlation began to detangle in H1FY23, reflecting uncertainty in the global financial markets.

4. Recent Policy Interventions

The ongoing Russia-Ukraine crisis, along with the adverse impact of the Covid-19 pandemic, is continued to have worldwide spillover effects on commodity and financial market prices, trade flows, and exchange rates. Global supply chain disruptions and most advanced economies' particularly the US Fed's aggressive Hawkish policy stances, create huge global uncertainties. The overrun effects of all these on a country like Bangladesh are huge, creating multidimensional challenges, i.e., mounting inflationary and exchange rate pressures due to high imports prices and subsequent balance of payments adversities. The market situation warrants a significant depreciation of BDT along with continuous sales of forex to the domestic market, putting added pressure on the forex reserve position. Keeping all these in mind, BB has taken multipronged initiatives to navigate the situation by containing growing demand and improving supply conditions with appropriate policy interventions.

To overcome these challenges, BB has taken a series of policy initiatives, including edging up the policy interest rate to mitigate the demand-side pressure; continuing the repo and liquidity support facilities for banks and NBFIs to normalize the extensive liquidity stress; extending the refinance facilities to enhance the domestic production along with import substitute goods; imposing restriction on imports of luxury and non-essential commodities; enhancing the facilities to improve the exports receipts and inward remittances, and signing the memorandum of understanding (MoU) with concerned commercial banks to deal with NPLs and good governance in Banks and NBFIs. In this circumstance, there is a need for calibrated monetary policy measures addressing both the demand-side and supply-side factors to ensure the price (both inflation and exchange rate) and financial sector stability without compromising the desired objectives of economic growth and employment generation.

Climate change remains a major concern in Bangladesh. BB will continue to support sustainable finance to encourage innovations in green manufacturing toward a sustainable green economy and clean growth in line with its much acclaimed Sustainable Finance Policy. Given that BB has recently introduced a Tk. 5,000 crore refinance fund titled "Green Transformation Fund" focused on facilitating exports and productive industrial sector to ensure a climate-friendly environment, green economy, and sustainable growth in Bangladesh.

Some of the recent policy measures addressing the key macroeconomic issues are highlighted below.

4.1 Exchange Rate Stability

Addressing the increased demand for foreign exchange, BB sold around USD 7.6 billion during FY22 and USD 12.9 billion during CY2022. The situation was the opposite in FY21; given the huge foreign exchange inflows, BB had to buy around USD 8.0 billion from the market to neutralize the then appreciating pressure of the Bangladeshi Taka. Consistent with the market condition, the BDT was allowed to depreciate significantly by more than 20 percent, encouraging exports and inward remittances while discouraging imports. As a result, the magnitude of the current account deficit (CAD), a critical source of exchange rate pressure, could be maintained well below 2.00 percent of GDP. Bangladesh Bank is gradually moving towards a market-based, flexible, and unified exchange rate regime (within a 2.00 percent variation) by the end of this fiscal year.

With a view to preventing trade-based money siphoning, BB has beefed up its monitoring to track imports LCs before making the final payments. Issuance of LCs of USD 3.0 million and above is subject to pre-inspection.

Monitoring of foreign exchange dealings by banks and money changers was strengthened. Banks' exports retention quota (ERQ) and net open position (NOP) have been reduced, while borrowing from OBU is allowed by DBU. The non-resident Foreign Currency Deposit (NFCD) rate has been increased to attract more NFCD. Moreover, according to the Government's guidelines, all sorts of foreign tours by officials in banks, and NBFIs, including Bangladesh Bank, are restricted. At the same time, instruction was given to reduce their operational expenses by taking necessary austerity measures.

To encourage more wage earners' remittances, BB has issued a circular not requiring any documents to remit foreign exchange of any amount. Money transfer fees by local banks for the expatriate remitters have been waived, while MFSs are allowed to collect and distribute wage earners' remittances in a cost and time effective manner. BB also removed the requirement of prior approval to make any drawing arrangement with any foreign money exchange to facilitate inward remittances to Bangladesh.

4.2 Inflation Control

BB's last monetary policy stance was cautiously restrictive with a tightening bias to arrest growing demand while keeping the employment and investment augmenting activities uninterrupted. To this end, the repo rate was increased to 5.75 percent in September 2022 from 5.50 percent in June 2022 amid automatic quantitative tightening through selling a huge amount of dollar in the market, as mentioned earlier. Since the current domestic inflationary situation is mainly due to cost-push emanating from supply chain disruptions, appropriate supply-side interventions were necessary to generate employment and investment augmenting opportunities.

Employment and investment enhancing activities require a sufficient flow of funds to the productive sectors. Money supply, i.e., broad money (M2), is the main driving factor to boost investment through making bank credit. But the M2-GDP ratio in Bangladesh is meager (around 38 percent in November 2022) compared to our peer countries, including India, Vietnam and Cambodia. Though the current private sector credit growth looks strong in recent period (12.76 percent in December 2022), it is significantly influenced by global commodity price hikes and exchange rate depreciation, as evidenced in a recent study by BB. To keep the supply-side interventions going, BB has intended to continue the implementation of previously announced stimulus packages along with introducing additional production augmenting and import substituting initiatives.

BB introduced various pre/re-finance schemes of more than Tk. 50,000 crore, prioritizing investment in agriculture, CMSMEs and import substituting industries allowing them to avail term loans and working capital loans at easier terms and conditions. BB also provided a credit guarantee facility against all CMSMEs term loans. BB also formed Bangladesh Bank Agricultural Development Common Fund (BBADCF) in December 2022 to accelerate agricultural farm production. It would help the private banks to speed up their farm loan disbursements to enhance the country's food production for food security. It is worthwhile mentioning that BB has set a target for the country's agricultural credit disbursement at Tk. 30,911 crore for FY23.

4.3 Financial Sector Stability

Managing reasonably low non-performing loans (NPLs) and maintaining standard good governance practices are critical for maintaining financial sector stability. The prevailing NPLs and good governance practices in the financial sector of Bangladesh are not at the desired level. To ensure long-term financial sector stability, the current scenarios of NPLs and good governance practices must improve. Bangladesh Bank has been espousing various legal and regulatory measures conforming to the international best practices to contain NPL and establish standard good governance practices. Relevant regulatory frameworks, for instance, Bank Companies Act, 1991; Financial Institutions Act, 1993; Money Loan Court Act, 2003; Negotiable Instrument Act, 1881; and Public Demand Recovery Act, 1908 – have been scrutinized and are in the process of an update to reflect the present scenario of the financial market. Multifaceted macro prudential policies such as Risk Management Guidelines, Risk Based Capital Adequacy, and Guidelines on Internal Credit Risk Rating (ICRR) have proven to be vital instruments to manage NPLs, which have been amended/updated from time to time, ensuring the global standards.

The banks and NBFIs have been advised to improve their financial health by strengthening their recovery drive. Stress has been given to establish 'Special Monitoring Cells' for continuous review and oversight of big loans ensuring that these legal and regulatory reforms translate into an efficient corporate governance framework as part of a comprehensive NPL resolution mechanism. BB is closely working with 8 private and 4 State-owned commercial banks by signing the MoUs to address their NPL related issues. Necessary regulatory measures have been taken concerning appointing Directors of

NBFIs. BB recently introduced the Islamic Banks Liquidity Facility (IBLF) to resolve the liquidity pressure in Islamic banks.

4.4 Financial Inclusion and Cashless Society

Bangladesh Bank has made a significant effort to develop a modern digital payment system over the last decade. Digitization of the banking sector, popularization of mobile financial services (MFS) and agent banking, the rise of online-based banking services, the introduction of payment systems operator (PSO) and payment service providers (PSP), and full interoperability of the financial sector specifically the introduction of interoperable digital transaction platform "Binimoy" are some of the critical initiatives to impact the onboarding and transaction behaviors of end users.

However, as expected by the central bank, these accounts have yet to spark the broad adoption of the whole spectrum of financial products and services. Against this backdrop, the banking sector is considering a new wave of technological innovation, digital banking, in ways that could lead to a deeper level of financial inclusion, moving towards a cashless society and thereby economic activities would be augmented.

Country-wide spread mobile network, availability of electricity, new financial technologies, transformative business models, and the Government's eagerness to digitize G2P payments act as the catalyst to enable better access to financial services. The same infrastructure has encouraged Bangladesh Bank to introduce end-to-end electronic processing of banking activities or transactions, known as "digital banking." It will accommodate different segments of the population so that the unbanked will be banked, the banked will get faster access to finance at low cost, and customers will receive better access to finance.

Low-income segment and many short-term (1-15 days) borrowers are still dependent on the informal sector. Institutionalizing these services through digital banks, effective regulations, and a resilient and robust technological background will help stabilize the financial sector, bringing people's trust to the formal banking sector. An easily accessible, low-cost real time digital banking system will also help create an environment conducive to financial inclusion.

4.5 Strengthening Capital Market

To fulfill the long-term investment needs of Bangladesh in the post-LDC era, strengthening the capital market, deepening enabling policy and regulatory reforms, coordinating among the financial regulators, and improving the incentive structure for encouraging private investment in the capital markets are necessary. Banks dependent long-run investments are not befitting and could create the risks of financial sector instability through maturity mismatch. In this regard, BB is entirely on board as it formed a capital market special fund in 2020 amounting to Tk. 200 crore to invest in listed securities, listed fixed income securities and mutual funds, which can be used to invest in solar energy, hydroelectricity, and biomass production through private green Sukuk bonds. Scheduled banks have been allowed to invest both on a solo and consolidated basis in the capital market from their excess liquidity, with an upper limit of 25 percent of the bank's capital on a solo basis and 50 percent on a consolidated basis. BB has allowed banks and financial institutions to compute their stock market exposure limit based on the purchase price of the securities they own rather than their current market value. It also provided more time for banks to adjust their investment from the capital market exposure limit.

BSEC, in collaboration with BB, has also taken several measures, including a particular emphasis on developing, expanding, and modernizing the capital market to attract significant and well-reputed companies to be listed in the market, which has helped to increase the flow of funds in the capital market. Secondary trading of government treasury bonds and bills started in October 2022, which would help create a vibrant bond market with general investors' participation in treasury bonds and bills.

Looking ahead, financial diversification is critical rather than a bank-centric financial system to avoid any mismatch between short and long-term financing and to support macroeconomic and financial resilience. To this end, the development of bond markets – Government and corporate – effectuate the monetary transmission channel more functional through changes in short-term policy rates and financial policy measures to onward longer-term rates. BB continued to instruct the banks to encourage their large corporate clients to tap into the capital markets for long-term financing and investments. BB's recent policy supports are expected to improve the liquidity conditions in the capital markets, making a vibrant capital market in the near future.

5. Monetary Policy Stance, and Monetary and Credit Programs for H2FY23

5.1 Monetary Policy Stance

War in Ukraine, zero-Covid policy in China, energy shortages in Europe, protectionism in the United States, and skyrocketing debt burden in developing countries are the major events that generated multi-edged challenges for the current world economies. In addition, the new wave of Covid-19 in Northeast Asia, particularly in China, Japan, South Korea, Taiwan, and Russia, has been a great concern for the world economies. Soaring inflation, aggressive policy rate hikes by major advanced economies, and slowing economic growth are common features almost everywhere in the world. Bangladesh is no exception, facing inflationary and exchange rate pressure through the international trade channels. At this juncture, BB is announcing its half-yearly monetary policy stance through this Monetary Policy Statement (MPS) for H2FY23.

BB examines the latest global and domestic macroeconomic developments along with their near-term outlook before setting the monetary policy stance and credit policies for H2FY23. In this context, BB observes keenly the analyses and forecasts of multilateral development partners, local and global think tanks, and academia to understand the outcome and outlook of global growth, inflation, and interest rate movements. Secondly, BB rigorously examines the movement of the domestic money market, foreign exchange market, capital market, real sector developments, and their near-term forecasts to understand current economic dynamics and near-term outlook. Thirdly, BB gives due importance to the feedback, opinions, suggestions, and guidelines received from the experts who attended the MPS consultation meetings. Fourthly, BB takes into account the decision of the recent coordination council meeting regarding the revised target of 6.50 percent GDP growth and 7.50 percent inflation ceiling set for FY23.

It is observed that the movement of the global price level in terms of almost all commodities (both energy and non-energy) slightly declined over the last couple of months due mainly to a possible economic downturn. As a result, the pressure of imported inflation on the domestic price level will likely ease in the coming days. The domestic price level may also be moderated due to expected better yields in the next two seasons of Aman and Boro paddies. Exchange rate pressure may be normalized within the next few months, supported by the necessary policy measures taken by the Government and BB to curb the excessive import demand while enhancing the exports receipts and inward remittances.

Raising the policy rates could be one of the options to combat inflation while signaling the market about BB's intention and, thereby, anchoring the inflationary expectations. Because of automatic quantitative tightening due to BB's substantial foreign exchange sales, the liquidity condition in the money market is already very tight, reflected through sharply rising call money rates. Therefore, this MPS seeks alternative options for curbing the inflationary pressure, which emphasizes the enhancement of raising production and employment opportunities by providing the required flow of funds to various productive sectors of the economy. Besides, the current domestic inflationary pressure is more of a supply-side issue rather than a demand-side phenomenon. BB will remain watchful regarding any unexpected monetary growth so that the demand-side factor does not exacerbate the existing inflationary pressure. It is observed that the current broad money growth, the intermediate target, is moderate (8.39 percent in December 2022) as compared to the revised programmed growth set for FY23 (11.50 percent in June 2023). There is enough room to allow the M2 to grow during H2FY23, commensurate with the revised real GDP growth (6.50 percent) and inflation ceiling (7.50 percent) targets set for FY23.

To reduce the existing exchange rate pressure and improve the BoP condition, BB intends to make the exchange rate more market-oriented such that the current multiple exchange rates will converge to a unified exchange rate (within a 2.00 percent variation) by the end of FY23. Moreover, BB strengthens its monitoring of both the volume and value of exports and imports to prevent trade-based money laundering. To reduce the current high NPL ratio, BB strengthens the monitoring not only of the banks but also of the large borrowers.

> *In this circumstance, BB's monetary and credit programs for H2FY23 will pursue a cautiously accommodative policy stance to contain inflationary and exchange rate pressures, support desired economic growth, ensuring the necessary flow of funds to the economy's productive and employment generating activities.*

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

> *Accordingly, BB has decided to increase its policy rates by 25 basis points, the repo rate to 6.00 percent from 5.75 percent, and the reverse repo rate to 4.25 percent from 4.00 percent as a part of its current policy stance.*

As per the existing framework, BB's monetary policy is formulated considering reserve money (RM) as operating and broad money (M2) as intermediate targets to achieve the ultimate goals of price and financial sector stability along with supporting higher GDP growth and employment generation. The broad money (M2) growth is set based on the equation of exchange that accounts for the necessary adjustment in the change of income velocity of money (money velocity) and the target of nominal GDP growth comprising the summation of targeted real GDP growth and inflation ceiling.

The money velocity in Bangladesh upturned in FY22 after a fall in the previous two consecutive fiscal years - FY20 and FY21. Given the rising trend of internal and external demand, it is expected that money velocity will continue to increase in FY23, well supported by the infrastructure developments, particularly the opening of Padma Bridge and Dhaka metro rail transit (MRT). Since the change in money velocity is positive, the M2 growth ceiling would be smaller than the nominal GDP growth target for FY23. To maintain the M2 growth ceiling, BB sets the reserve money (RM) growth target considering economic reality with a stable movement of the money multiplier. BB will employ existing monetary policy instruments like the repo and reverse repo rates, cash reserve ratio, statutory liquidity ratio, and advance/investment deposit ratio to control the movement of reserve money as and when necessary. BB will also leverage its available open market operation tools like the sale/purchase of government securities and foreign currencies, issuing BB bills, and expanding refinance facilities to keep the RM growth within the target. By controlling RM growth, BB will try to keep the M2 growth within the programmed path to achieve the ultimate goal of price stability and economic growth. BB will ensure the quality and quantity of credit for productive economic activities to achieve the target GDP growth.

With the evolving fourth industrial revolution (4IR), financial products and derivatives, advancing information technology and digitization amid changing macroeconomic landscape, using the current monetary targeting framework may not be appropriate. Bangladesh is set for LDC graduation in FY26, requiring an economic status befitting the modern monetary policy framework. Accordingly, BB has been working on required capacity developments to modernize its monetary policy framework in the near future.

5.2 Monetary and Credit Programs

The half-yearly movements of major monetary and credit aggregates, along with their programs set for FY23, are shown in Table 4. The reserve money, the operating target, is set to grow by 14.00 percent while the broad money growth ceiling, the intermediate target, is set at 11.50 percent, consistent with the real GDP growth target and CPI-based average inflation ceiling, allowing some adjustment for the expected change in the money velocity. Considering the necessary outlays for ongoing mega projects and the Covid-19 related stimulus packages of the Government, the public sector credit growth ceiling is set at 37.70 percent for FY23. The Government's budgetary revised target of borrowing Tk.1,11,608 crore from the banking system is duly considered in measuring the public sector credit growth limit. On the other hand, the private sector credit growth target is 14.10 percent for FY23, commensurate with BB's supply-side interventions to support required investment and employment generation for targeted GDP growth. Based on the public and private sector credit expansion, the domestic credit growth is set at 18.50 percent for FY23.

Table 4: Monetary and Credit Programs for FY23

(y-o-y % change)

Item	Jun-22	Dec-22	Program for Jun-23	
	Actual	Actual[P]	Original@	Revised
Broad money	**9.4**	**8.4**	**12.1**	**11.5**
Net Foreign Assets*	-11.9	-22.6	-2.1	-11.9
Net Domestic Assets	17.2	18.5	16.0	17.9
Domestic Credit	16.2	15.1	18.2	18.5
Credit to the public sector	29.1	26.6	36.0	37.7
Credit to the private sector	13.7	12.8	14.1	14.1
Reserve money	-0.3	17.4	9.0	14.0
Money multiplier	4.93	4.63	5.07	4.82
NCG (Crore Taka, during the respective fiscal year)	62,540	32,249	1,06,334	1,11,608

Source: Bangladesh Bank. Note: NCG = Net credit to Government from the banking system. . P=Provisional
*Calculated using the constant exchange rates of end June 2022. @Announced in June 2022.

The target of the net foreign assets growth of the banking system for FY23 is set to be in the negative territory by 11.90 percent as the overall BoP position is expected to remain in a deficit despite predicted improved inflows of inward remittances. The import and export growth rates are expected to be moderated significantly due to the base effect and cooling down of internal and external demand in the backdrop of possible economic recession in the advanced economies.

6. Near-term Macroeconomic Challenges

The economy of Bangladesh has been facing many challenges both from the global and domestic front since 2020, starting with the devastating Covid-19 pandemic followed by the Russia-Ukraine crisis creating intense inflationary and exchange rate pressures. Despite all these challenges, the economy of Bangladesh performs reasonably well due to time-befitting, appropriate, and supportive monetary and fiscal policies. The near-term economic outlook seems quite favorable, but it critically depends on three external issues: (i) the length and intensity of the Russia-Ukraine war, (ii) the spree of interest hikes by the Fed, and (iii) re-emergence of the Covid-19 situation and its severity in China. Improvements in these challenges will expedite Bangladesh's future economic gains. However, in case of any adverse consequences of the above external issues, the Bangladesh economy has enough resilience to remain insulated in its current condition.