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# Research Proposal

Impact of the Global Financial Cycle on the GDP Growth of Bangladesh

# Introduction

The global financial cycle (GFC) refers to fluctuating financial conditions worldwide, driven by changes in international credit, capital flows, and asset prices. Characterized by booms and busts, the GFC significantly influences economic dynamics across nations, particularly in the interconnected global economy of the 21st century. For developing economies like Bangladesh, which are increasingly integrating into global financial markets, the impact of the GFC is both profound and multifaceted. (Borio, Drehmann, & Xia, 2001)

Over the past two decades, Bangladesh has maintained steady economic growth, fueled by key sectors such as garment exports, remittances, and robust domestic consumption. However, the economy remains exposed to external shocks, including those induced by global financial cycles. For example, a tightening of global financial conditions can lead to reduced capital inflows, currency depreciation, and disruptions in trade, collectively dampening GDP growth. Conversely, a favorable GFC phase, marked by low global interest rates and abundant liquidity, can stimulate economic activity by encouraging investment and trade.

Despite the relevance of the GFC, limited research has explored its direct and indirect effects on Bangladesh. While global studies have examined the GFC's influence on emerging markets, the specific transmission channels and implications for Bangladesh remain underexplored. This research aims to address this gap by analyzing the mechanisms through which the global financial cycle affects Bangladesh’s GDP growth. It will identify the key transmission channels and propose policy recommendations to bolster economic resilience. (Miranda-Agrippino & Reey, 2015)

This study tests the hypothesis that global financial conditions (independent variable) influence GDP growth in Bangladesh (dependent variable). Key control variables include exchange rate dynamics, trade volumes, and inflation, which are critical macroeconomic factors. The independent variable will be represented by a composite index of the US Federal Funds Rate, Global Credit-to-GDP Ratio, and VIX (Volatility Index). GDP growth will be measured as the annual percentage change in real GDP. (Drehman & al, 2012)

Understanding the implications of the GFC on developing economies like Bangladesh extends beyond academic relevance. It provides actionable insights for policymakers to craft strategies that insulate the economy from adverse global shocks. As globalization deepens, the dynamics of global liquidity, trade, and capital flows become increasingly vital for nations striving to maintain economic stability. Additionally, Bangladesh's experiences could offer valuable lessons for other emerging economies navigating similar vulnerabilities. (Ceratti & al., 1019)

# Research Objectives

1. To analyze the relationship between the global financial cycle and GDP growth in Bangladesh. This objective involves quantifying the degree to which changes in global financial conditions influence the trajectory of Bangladesh's economic growth. (Aldasoro & al., 2020)

2. To identify the primary transmission channels, such as capital flows, trade, and exchange rate fluctuations, through which the GFC affects Bangladesh. Understanding these channels will provide insights into how global financial conditions permeate the Bangladeshi economy. (Ceratti & al., 1019)

3. To provide actionable policy recommendations to enhance Bangladesh's economic resilience against global financial shocks. This includes strategies for macroeconomic stability, financial regulation, and institutional reforms. (Oman, 2019)

# Additional Focus Areas

- Investigating the role of regional trade agreements and partnerships in mitigating GFC impacts.

- Assessing the contribution of remittance flows in cushioning external shocks.

- Exploring sector-specific vulnerabilities, such as the ready-made garments (RMG) industry.

# Research Questions

1. What is the relationship between the global financial cycle and GDP growth in Bangladesh?

2. Which transmission channels play the most significant role in linking the GFC to Bangladesh’s economy?

3. What policy measures can strengthen Bangladesh’s economic resilience to global financial shocks?

4. How do remittances and foreign direct investment (FDI) act as buffers or amplifiers during GFC phases?

5. What role does domestic financial market development play in mitigating external vulnerabilities?

# Literature Review

The concept of financial cycles has gained traction in economic research due to its relevance in explaining the synchronization and vulnerability of economies in an interconnected world. (Borio C. , 2014) emphasizes that financial cycles—long-term fluctuations in credit, asset prices, and systemic risk—have a profound influence on macroeconomic stability. (Miranda-Agrippino & Reey, 2015) introduced the concept of the “global financial cycle,” linking it to the “dilemma, not trilemma” hypothesis, which argues that monetary policy independence is constrained by global financial conditions, irrespective of exchange rate regimes.

Studies by (Claessens, Kose, & Terrones., 2011) highlight the synchronization of business cycles driven by global liquidity conditions. These liquidity conditions affect credit availability and investment, amplifying the highs and lows of economic activity. Similarly, Mendoza (2010) discusses the adverse effects of sudden reversals in capital flows, particularly in emerging markets.

The link between the GFC and GDP growth is further supported by frameworks such as the financial accelerator model (Bernanke, Gertler, & Gilchrist, 1999)and the credit cycle dynamics explored by (Drehman & al, 2012) These studies underscore how disruptions in credit availability and asset prices influence aggregate demand, thereby shaping economic outcomes. For countries like Bangladesh, these disruptions often manifest through reduced export earnings, currency volatility, and inflationary pressures.

Bangladesh’s vulnerability to the GFC is evident in its reliance on foreign capital and trade. (Drehman & al, 2012) (Hasan & Islam, 2020)argue that financial globalization has synchronized economic activities globally, increasing susceptibility to external shocks. Empirical studies, such as Hasan and Islam (2020), highlight how exchange rate volatility negatively affects Bangladesh’s GDP growth, emphasizing the need for resilient macroeconomic policies.

# Addressing Gaps in the Literature

While substantial research exists on the impacts of the GFC on emerging markets, studies specifically addressing Bangladesh remain scarce. This proposal seeks to fill this gap by providing empirical evidence on the interplay between global financial conditions and Bangladesh’s economic performance. It also aims to integrate insights from regional and global perspectives to enrich the discourse.

# Methodology

1 Data Collection

Global Financial Indicators: US Federal Funds Rate, Global Credit-to-GDP Ratio, VIX (Volatility Index), and global trade volumes. Bangladesh Macroeconomic Data: GDP growth rate, exchange rates, capital flows (FDI and portfolio investment), trade balance, and inflation.

Data Sources: International Monetary Fund (IMF), World Bank, Bangladesh Bank, and BIS.

2 Analytical Framework

The study will employ a Structural Vector Autoregression (SVAR) model to capture the dynamic relationships between global financial cycle variables and GDP growth.

Estimation Techniques:

Impulse Response Functions (IRFs): Analyze the impact of GFC shocks on Bangladesh’s economy over time.

Variance Decomposition: Quantify the contribution of GFC variables to fluctuations in GDP growth.

3 Hypothesis

**Null Hypothesis:** The global financial cycle has no significant impact on Bangladesh’s GDP growth.

**Alternative Hypothesis**: The global financial cycle significantly influences Bangladesh’s GDP growth through multiple transmission channels.

4. Supplementary Methods

To ensure robustness, the study will also utilize:

**Panel Data Analysis:** Incorporating data from other South Asian economies for comparative insights.

**Scenario Analysis:** Simulating policy responses to hypothetical GFC shocks.

6. Expected Contributions

**1. Theoretical Contribution:** Extend the literature on global financial cycles by focusing on their impact on a developing economy with unique structural characteristics.

**2. Policy Insights:** Provide evidence-based recommendations for macroprudential policies and financial regulations to mitigate adverse effects.

**3. Practical Relevance:** Enhance the understanding of policymakers, researchers, and financial practitioners regarding the vulnerabilities and opportunities posed by the GFC.

Broader Impact:

By addressing a critical gap in the literature, this study aims to inform global discussions on financial stability and resilience, particularly for emerging markets.

7. Policy Implications

- Strengthening financial regulation to mitigate the impact of volatile capital flows.

- Enhancing foreign exchange reserve management to stabilize the currency during GFC downturns.

- Promoting economic diversification to reduce dependence on vulnerable sectors.

- Developing robust early warning systems to anticipate and respond to GFC shocks.

- Encouraging regional economic cooperation to buffer against global financial instability.

8. Ethical Considerations

This study will utilize secondary data from credible sources, ensuring compliance with ethical guidelines. No primary data collection involving human subjects is anticipated.

9. Timeline

1. Literature review and data collection: Weeks 1–3

2. Data analysis: Weeks 4–5

3. Writing and dissemination: Weeks 6–8

Milestones

- Initial draft submission: Week 7

- Final submission and presentation: Week 8

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