Analysis of Inflation, Growth, and Money Supply of Bangladesh

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Introduction

Bangladesh is a rapidly growing economy in South Asia, with a Gross Domestic Product (GDP) growth rate of 7.3% in 2021. The country's economy is largely driven by the service sector, which accounts for over 50% of GDP, followed by the industrial sector, which has been growing rapidly in recent years. Bangladesh has a large pool of skilled and semi-skilled labor, which has helped to attract foreign investment in the country, particularly in the ready-made garment sector. The agriculture sector, though declining, still employs a significant portion of the population and provides a significant contribution to the economy. Despite strong economic growth, Bangladesh faces challenges such as poverty, income inequality, and infrastructure limitations. The government has been working to address these issues through various economic reforms and investment in infrastructure, education, and healthcare.

A major contributor to Bangladesh's economic growth is the export-oriented ready-made garment industry, which accounts for over 80% of the country's total exports. The industry has been a critical driver of employment, providing jobs to millions of workers, particularly women. The government has implemented various measures to enhance the sector's competitiveness and ensure better working conditions for the workers.

Overall, Bangladesh has a bright economic future, with the potential to become a middle-income country in the coming years. The government is continuing its efforts to address the challenges facing the country and promote sustainable economic growth.

The Bangladesh Bank, the central bank of Bangladesh, has set a target for controlling the growth of broad money (M2) at a rate of 15.5%. Additionally, it also aims to maintain inflation close to the target rate of 6%. By managing these two economic indicators, the Bangladesh Bank strives to ensure stability in the country's financial system and promote economic growth.

Analysis

This report is focused on analyzing the economic indicators of inflation, growth, and money supply in Bangladesh from 2016 to 2021. The aim is to provide a comprehensive understanding of the trends and changes in the country's economy during this period. The analysis will help evaluate the performance of Bangladesh's financial system and provide valuable insights into the state of the economy.

Fiscal Year- 2016

The monetary policy of Bangladesh Bank has been guided by two key considerations: global and domestic economic developments and monetary policy objectives.

Inflation had been gradually declining over the past couple of years, and it is projected to be 6.07 percent in June 2016 compared to 6.20 percent in December 2015.

To stimulate investment and realign market interest rates, Bangladesh Bank has decided to lower the repo rate and reverse repo rate by 50 basis points, bringing the repo rate to 6.75 percent and the reverse repo rate to 4.75 percent. The decline in inflation, particularly in food inflation, has made a case for easing the policy interest rates.

The twelve-month average Consumer Price Index (CPI) inflation in Bangladesh has shown a downward trend, falling from 7.28 percent in July 2014 to 6.19 percent in December 2015.

Studies suggest that an inflation rate of 6 percent, along with one standard deviation, is a threshold for maximizing economic growth. Bangladesh Bank has therefore decided to increase the broad money (M2) supply rate by 15.0 percent, which aligns with the output growth target, absorbs moderate inflation, and allows for the required level of monetization.

At present, Bangladesh Bank's policy interest rates (repo and reverse repo) will remain unchanged at 6.75 and 4.75 percent, respectively.

Fiscal Year 2017

The Bangladesh economy has achieved its key monetary policy targets for the fiscal year 2017. Broad money growth, as measured by M2, was recorded at 11.7 percent in May 2017, which is below the target of 15.5 percent. The economy grew by 7.24 percent in FY17, an improvement

from the previous year's 7.11 percent, due to strong domestic demand in manufacturing and growth in the agriculture and services sectors.
However, the economic slowdown in the Middle East affected remittance inflows, resulting in a 14.5 percent decline in FY17. Despite this, inflation as measured by the Consumer Price Index (CPI) gradually decreased during the fiscal year and was recorded at 5.44 percent in June 2017, below the programmed ceiling of 5.8 percent
The monetary program's three important anchors - reserve money, broad money, and domestic credit - all grew below their respective program ceilings, contributing to the favorable inflation outcome in FY17. Reserve money grew by 13.3 percent, broad money by 11.7 percent, and domestic credit by 11.3 percent in May 2017.

Fiscal year 2018

The Bangladesh economy in fiscal year 2018 (FY18) saw strong growth, driven by robust domestic and international demand. The country experienced a rise in public and private investment, as well as consumption, due to increased exports, remittances, and private credit growth. The positive global economic outlook also contributed to the growth of exports and remittances.
Despite inflationary risks, the inflation situation in FY18 remained manageable. The growth of broad money (M2), which is a significant factor in determining inflation, was 9.2 percent, below the target of 13.3 percent set by the program
The provisional estimates by the Bangladesh Bureau of Statistics show that the real GDP grew by 7.65 percent in FY18, higher than the 7.28 percent growth seen in FY17 and well above the projected 4.9 percent growth for emerging markets and developing economies in 2018. The rise in remittances, which increased by 17.3 percent in FY18 compared to a decrease of 14.5 percent in FY17, and strong private sector credit growth, contributed to the growth in consumption demand. Additionally, the growth in investment-related imports indicated a robust investment demand.
To maintain a balance between inflation and output risks, the Bangladesh Bank (BB) kept the repo rate at 6.75 percent and the reverse repo rate at 4.75 percent in the first half of FY18. The BB also prioritized supervision to improve credit quality and flow to the productive sectors.

The Bangladesh economy saw strong growth in FY18, driven by various factors such as increased exports, remittances, and private credit growth. The inflation situation remained manageable, and the BB took steps to maintain a balance between inflation and output risks, ensuring stability in the economy.

Fiscal year 2019

The monetary policy objectives of controlling inflation within a targeted ceiling and promoting real GDP growth were achieved in FY19. Inflation was 5.47 percent, below the target of 5.60 percent, and real GDP growth was strong at 8.13 percent. The sudden increase in the current account deficit in FY18 was also successfully addressed, falling from 3.2 percent of GDP to 1.7 percent of GDP in FY19

In FY19, growth in broad money, domestic credit, and private sector credit followed programmed directions but with lower trajectories. This shows a maturity in the credit market and a reduction in unproductive lending practices. Despite declining headline inflation, the core inflation component rose to 5.48 percent by June 2019, indicating persistent inflationary pressure.

In 2018, private sector banks and financial institutions experienced substantial liquidity stress, largely due to household savings being diverted to high yielding National Savings Scheme instruments. The foreign exchange market was also under stress due to high import growth. The Bangladesh Bank addressed the Taka liquidity stresses with measures such as a reduction in the Cash Reserve Requirement. The current account deficit narrowed in FY19, reducing stress in the foreign exchange market, and the government has also taken steps to reform the National Savings Scheme.

Fiscal Year 2020

The coronavirus pandemic had resulted in the worst global output decline since the Great Depression of the 1930s. Bangladesh's economy has been significantly impacted, leading to a lower real GDP growth in FY20 compared to both the target and actual growth recorded in FY19. The annual average inflation, as measured by the Consumer Price Index (CPI), stood at 5.65% in FY20, slightly above the target ceiling and actual inflation of 5.47% in FY19.

The higher inflation was primarily driven by the annual average nonfood inflation, particularly in medical care and health expenses, as well as supply chain disruptions due to the pandemic. The impact of the pandemic has been far-reaching and has had a substantial impact on the economy of Bangladesh.

The FY20 monetary policy was largely successful in narrowing the current account deficit to an estimated 1.5% of GDP, down from 1.7% in FY19. The government's 2% incentive program and BB's initiatives to ease money transfer processes, along with the policy of a gradual depreciation of the Taka against the USD, significantly contributed to the 10.9% growth of remittances in the country in FY20.

The broad money (M2) growth (12.7%) remained close to the target of 13.0% in FY20. The domestic credit growth followed the programmed path during the first half of FY20, but slightly declined in the third and fourth quarters due to a slower than expected growth of private sector credit.

Overall, the monetary policy stance and program executed in FY20 were successful in reducing the current account deficit and promoting remittance inflows in Bangladesh. The government's efforts, along with BB's initiatives, played a crucial role in achieving these results.

Fiscal Year 2021

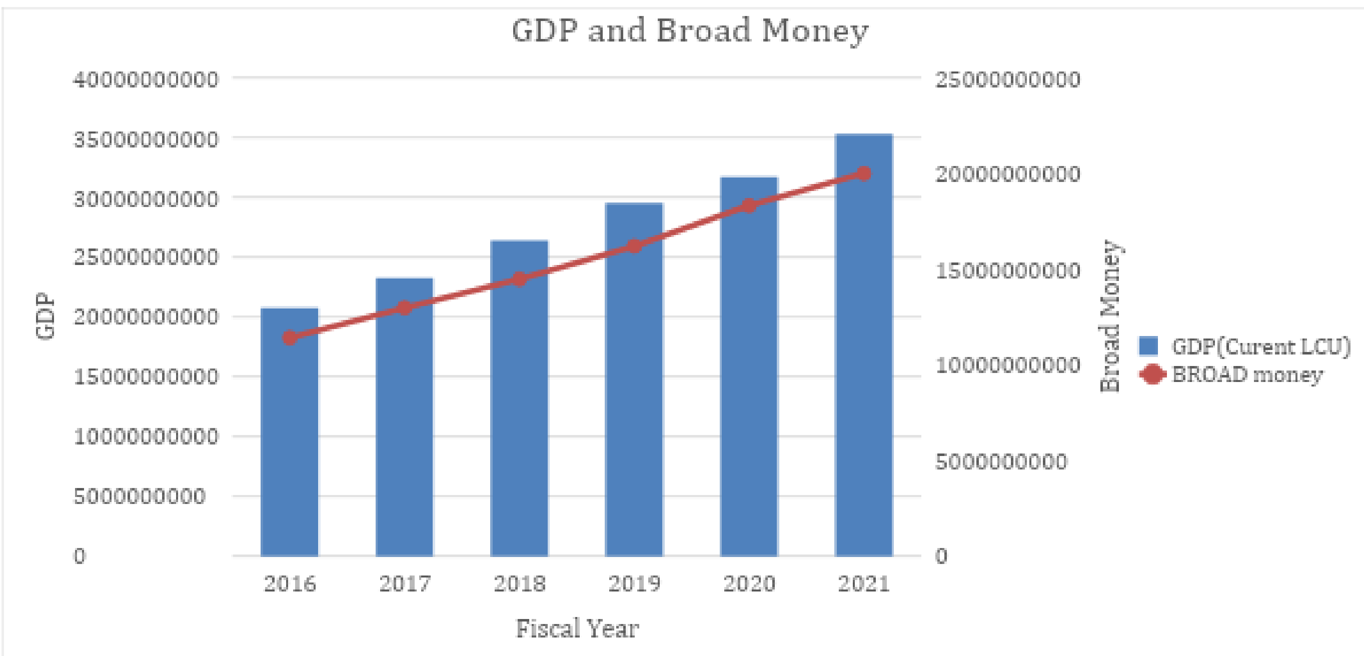
The monetary policy stance and program executed in the fiscal year 20 (FY20) in Bangladesh was effective in reducing the current account deficit from 1.7% of GDP in FY19 to an estimated 1.5% of GDP in FY20. The success was attributed to the Government's 2% incentive program and Bangladesh Bank's (BB) efforts in simplifying the money transfer process, along with the policy of gradual depreciation of Taka against the USD, which boosted remittance inflows by 10.9% in FY20.

In FY21, BB's monetary policy effectively controlled inflationary pressure despite the expansionary and accommodative monetary and fiscal policy stances and supply chain disruptions caused by COVID-19 containment measures and global price hikes. The average inflation, based on the Consumer Price Index (CPI), declined to 5.56% (against the target of 5.40% for FY21) from 5.65% in FY20.

The momentum of growth in Bangladesh continues, with an estimated growth of 6.1% in FY21, driven by rebounded exports and import growth and sustained high growth in inward remittances throughout the year, supported by prudent fiscal and monetary policy measures.
However, the money velocity in Bangladesh significantly decreased in both FY20 and FY21 due to the slowdown of economic activities and high demand for holding cash which is evident from the table below. As a result, the M2 growth target for FY22 would be larger than the nominal GDP growth target. To achieve the M2 growth target, BB sets the operational target, the reserve money (RM) growth target. BB uses various monetary policy instruments, such as repo and reverse repo interest rates, cash reserve ratio (CRR), and statutory liquidity ratio (SLR), along with open market operations to control RM growth, impacting broad money growth, and achieving its ultimate policy objectives. BB will continue to support productivity and employment-sensitive priority sectors while strengthening its monitoring to ensure loan quality and purpose.

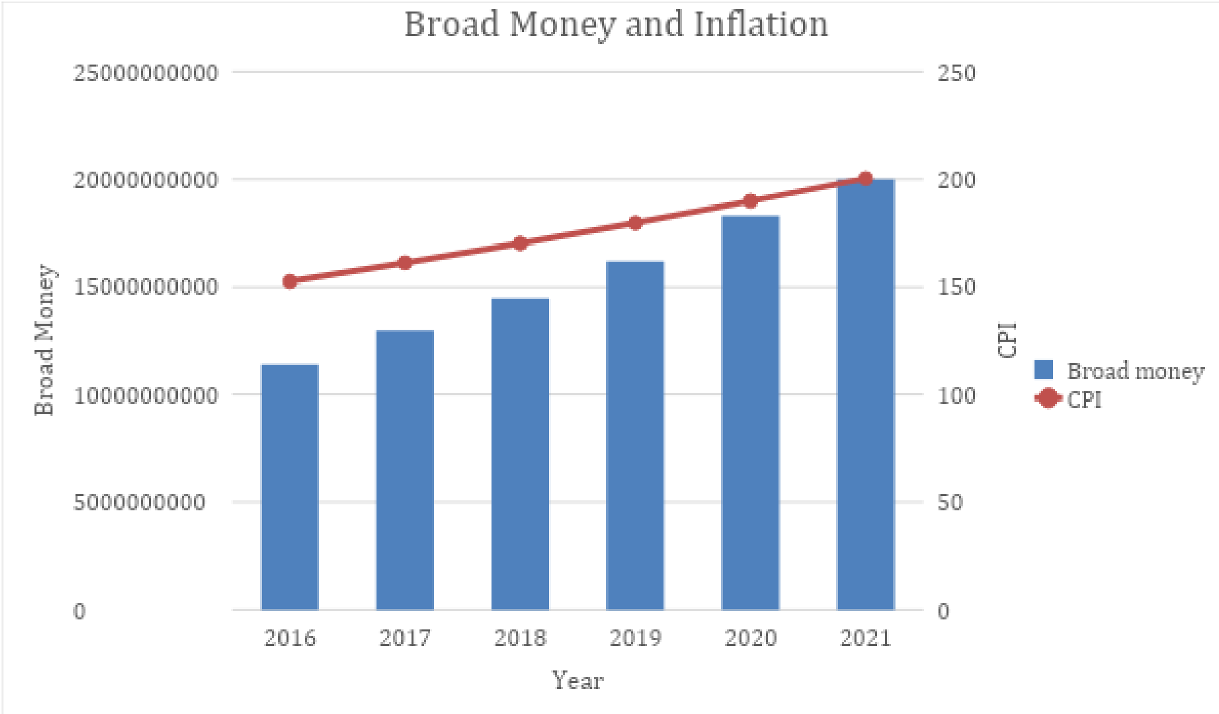
Fiscal Year	Velocity of money
2016	1.81
2017	1.79
2018	1.82
2019	1.82
2020	1.73
2021	1.76

Chart Analysis



Data Source: World Bank

The GDP and Broad money chart analysis reveals a strong positive correlation between Gross Domestic Product (GDP) and Broad Money (M2), with a correlation coefficient of 0.996057923. This highlights that as the GDP of a country grows, so does its broad money supply. The correlation coefficient of nearly 1 indicates that the two variables are closely linked and that any change in one of them will result in a corresponding change in the other. This relationship is important to consider when analyzing the economy of a country as it provides insight into the growth of the economy and the money supply.



Data Source: World Bank

The chart on Broad money and Inflation provides valuable information on the monetary policy of Bangladesh central bank. It reveals that the bank has been successfully controlling the money supply in a manner that balances inflation and economic growth. By keeping the money supply slightly lower than the inflation rate, the central bank is able to sustain a stable level of inflation that supports growth. This indicates that the bank is effectively managing the money supply and inflation to promote economic stability and drive economic development in Bangladesh.

Conclusion

In short, the economy of Bangladesh has been growing rapidly in recent years, driven by the service and industrial sectors, with a large pool of skilled and semi-skilled labor attracting foreign investment, particularly in the ready-made garment sector. The Bangladesh Bank has been working to control inflation and money supply to maintain stability in the financial system and promote growth. Over the period from 2016 to 2018, the economy achieved key monetary policy targets with growth in the manufacturing, agriculture, and service sectors. Despite some challenges, the economy has been growing with a manageable inflation rate and is projected to continue its growth trajectory in the future.

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