Bangladesh Economic Update

Monetary Policy: Evidence Based?

January 2013

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Economic Policy Unit
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1. INTRODUCTION

This Update investigates into effectiveness of the prescribed policy instruments in attainment of three core objectives of the current MPS in light of past experiences.

The current issue of the Bangladesh Economic Update focuses on the recently announced six-monthly Monetary Policy Statement (MPS) by the Bangladesh Bank for the second half of the current fiscal year of 2012-2013. This Update investigates into effectiveness of the prescribed policy instruments in attainment of three core objectives of the current MPS in light of past experiences. The assigned objectives of the central bank are: (i) limiting the domestic credit growth to levels consistent with the FY 2012-13 single digit CPI inflation target (ii) ensuring that productive growth-conducive activities are not hampered by access to credit and (iii) preserving external sector stability including building reserves to more comfortable levels.

The central bank has dubbed the current half-yearly MPS as 'balanced' monetary policy. This is for the fourth time in a row the Bangladesh Bank has been pursuing contractionary monetary policy, though the central bank has variously styled those (e.g. 'restrained,' 'balanced' etc.).

This is for the fourth time in a row the Bangladesh Bank has been pursuing contractionary monetary policy, though the central bank has variously styled those (e.g. 'restrained,' 'balanced' etc.).

The contractionary monetary policy has been taken by the Bangladesh Bank when the economy of Bangladesh is confronted with major challenges such as declined rate of growth of gross domestic product (GDP), slump in investment, negative growth of import of intermediate goods, industrial raw materials and capital machineries, non-achievement of targeted growth in export, depreciation of Taka, continuation of inflationary pressure, and faux-pas in fiscal management, particularly arising out of rental power plants, management of subsidies, disbursement of foreign aid. The credit to the private sector has shrunk and is less than even the lowered target of the central bank for the first time in the last four years while the credit to the government has remained at a higher level and the payment for principal and interest has emerged as the largest head in the revenue budget.

The current Update has three tasks. *First*, it investigates into relevance of proposed measures in the context of the current

The Update examines the robustness of claim of relative reduction in average inflation owing to the past monetary policy stance and provides reasons for such moderate decline of inflationary pressure though the level has still remained at a higher level

macroeconomic setting and feasibility of achievements of three core objectives, namely, maintenance of economic growth, reduction in inflationary pressure and stability of external sector. *Second,* it examines the robustness of claim of relative reduction in average inflation owing to the past monetary policy stance and provides reasons for such moderate decline of inflationary pressure, though the level has still remained at a higher level. *Finally,* the Update scrutinises whether such policymaking is evidence-based. This is further corroborated by conducting an econometric analysis of two aspects: (a) the nature of the relationship, if one exists and (b) the direction of causality, between growth and inflation in Bangladesh.

2. MONETARY POLICY STANCES

2.1 Key Changes in Current MPS

The apparent divergence between the key targets and outcomes seems to occur with unfailing regularity raising the issue of credibility and realism in the target setting.

The recently announced MPS has kept most of targets of the previous one. There are only three changes:

- Reduction of all repo rates - short for repurchase agreement or the key rate of interest at which central bank lends to the commercial banks - by 50 basis points;
- Revision of central bank's monetary programme with a broad money growth target of 17.7 percent in June 2013 compared to the previous target of 16.5 percent; and
- Revised private sector credit envelope of 18.5 percent in June 2013 compared to the previous programme target of 18 percent.

2.2 Targets and Achievements of MPS (July-December, 2012)

The apparent divergence between the key targets and outcomes seems to occur with unfailing regularity raising the issue of credibility and realism in the target setting. The rate of inflation in the first half of FY 2012-13 was 8.74 against the target of 7.5 percent. This similar difference prevailed for the domestic credit, credit to private sector. The same scenario has been seen in the targets and achievements in external sector, especially on import and export.

Table 1: Targets and Achievements of MPS (July -December, 2012)

Indicators	Focus / Target	Achievement
Rate of Inflation	The MPS aimed to keep the rate of inflation at 7.5 percent, the same as the budgetary statement.	Average rate of inflation was 8.74 in December 2012
Broad Money	Set the rate of growth on broad money at 16 percent by December 2012	The rate of growth on broad money was 18.6 in November 2012 against the target of 16.2
Reserve Money	Set at 1059 billion Taka	The reserve money has increased due to increased net foreign assets, though the targeted net domestic asset has not been achieved. The net foreign asset jumped by 53.4 percent in December 2012 against the target of 17 percent
Credit to the Private Sector	The private sector credit to grow by 18.3 percent in December 2012.	The rate of growth on credit declined to 17.4 percent in December 2012 from 20.2 percent in July 2012. Even the actual is lesser by almost one percent than the already reduced rate
Government Borrowing	Restrain on government borrowing	Net credit to the government has been moving upwards since September 2012
Call Money Rates	Declined call money rate	The weighted average call money rate in the inter-bank market remains 9.35 percent in December, 2012
Rate of Interest Spreads	Limited rate of interest spreads for the banking sector	Rate of Interest spreads to 5.33 percent at December 2012
External Sector Stability	The MPS stance assumed that export might increase to 8.0 percent, import might attain at 8.0 percent, remittance might increase to 12.00 percent and Current Account Surplus might reach to 620 Million USD.	Export has increased by 7.01 percent from July to December over the corresponding period of the preceding year, but has fallen short of the target. Certain items have witnessed declined growth of exports. Import has decreased by 6.87 percent from July to November over the corresponding period of the preceding year. Remittance has increased by 9.18 percent and 21.89 percent from July to December, 2012 over January to June, 2012 and July to December, 2011 respectively. Current Account Surplus has increased by 43 Million USD from July to November.
Rate of Exchange	Market based rate of exchange while seeking to avoid excessive foreign exchange volatility.	During the last six months of the current fiscal year, the average rate of exchange was Tk. 81.39, Tk. 5.49 more than that of the same time of the previous fiscal year.

The historical track record pauses skepticism about the achievement of the current MPS as well.

2.3 Broad Money[1]

The underlying assumption is that the growth of the monetary aggregates such as M2 has a direct impact on the domestic price levels. M2 is the main instrument with which central bank tries to control the price level of the country.

The central bank has adopted tight monetary policy for controlling the money supply. As a result, the incremental rate of broad money is following a downward trend

The central bank has adopted tight monetary policy for controlling the money supply. As a result, the incremental rate of broad money is following a downward trend. In November 2012, the supply of M2 was Tk. 5507.51 billion whereas it was Tk. 4645.22 billion in November 2011. In July-November 2012 of FY13, broad money grew by Tk. 336.419 billion or 6.51 percent against the increase of Tk. 416.126 billion or 8.75 percent at January-June in FY 2011-12.

Net domestic assets increased by Tk. 541.796 billion or 13.47 percent in November 2012 than that of November 2011. It, however, increased by Tk. 180.3 billion or 4.11 percent in July-November, 2012 than that of June, 2012. On the other hand, net foreign assets increased by Tk. 320.499 billion (51.35 percent) in November, 2012 than that of November, 2011 and it increased by Tk. 156.1 billion (19.79 percent) in July-November, 2012 than that of June, 2012.

Table 2: Particulars of Broad Money

	Outstanding Stock (In billion Tk.)			Rate of Growth	
	Nov'11	June '12	Nov'12	July'12-Nov'12	Nov'11-Nov'12
Net foreign Assets of Banking System	624.19	788.60	944.69	19.79	51.35
Net Domestic Assets of Banking System	4021.03	4382.49	4562.82	4.11	13.47
Broad Money	4645.22	5171.10	5507.51	6.51	18.56

Source: Monthly Economic Trends, January 2013, Statistics Department, Bangladesh Bank

[1] Broad money is a measure of the money supply that includes more than just physical money such as currency and coins (also termed narrow money). It generally includes demand deposits at commercial banks, and any monies held in easily accessible accounts.

2.4 Reserve Money[2]

In November 2012, reserve money recorded an increase of Tk. 83.517 billion, which is 8.54 percent more than that of June, 2012. This is due to decrease in import and increased inflow of remittance.

In the monetary policy statement of July, 2012 central bank targeted the rate of growth in reserve money by 14.5 percent. There has been a mismatch between the growth of net domestic asset and the foreign asset while the former decreased and the latter increased at a very high rate. In November 2012, reserve money recorded an increase of Tk. 83.517 billion, which is 8.54 percent more than that of June, 2012. This is due to decrease in import and increased inflow of remittance.

Table 3: Sources of Reserve Money

	Outstanding Stock (In billion Tk.)			Rate of Growth	
	Nov'11	June '12	Nov'12	July'12-Nov'12	Nov'11-Nov'12
Net Foreign Assets	549.138	689.717	837.358	21.41	52.49
Net Domestic Assets	380.17	288.31	224.186	-22.24	-41.03
Reserve money	929.308	978.027	1061.544	8.54	14.23

Source: Monthly Economic Trends, January 2013, Department of Statistics, Bangladesh Bank

Due to consecutive tight monetary policy, the growth of domestic credit has been restrained

In FY 2012-13, during July-November, Net Foreign Asset of Bangladesh bank increased by Tk. 147.641 billion or 21.41 percent than that of June, 2012. On the other hand, Net Domestic Asset decreased by Tk. 155.984 billion (41.03 percent) in November, 2012 than that of November, 2011 and it decreased by Tk. 64.124 billion (22.24 percent) in July-November, 2012 than that of June, 2012.

2.5 Domestic Credit

Due to consecutive tight monetary policy, the growth of domestic credit has been restrained. The rate of increase in domestic credit has been kept at lower rate by keeping the rate of growth of credit to the private sector at a lower rate. The private sector has the high share in domestic credit. As a result,

[2] The reserve money is the operating target in the annual monetary programme. It consists of currency with the public cash in tills and balances of scheduled banks as well as other financial institutions related to Bangladesh Bank.

private investment decreased and consequentially GDP would contract.

In November 2012, domestic credit was Tk. 5430.594 billion whereas it was Tk. 4724.887 billion in November 2011. In July-November 2012, domestic credit increased by Tk. 248.451 billion or 4.79 percent than that of June, 2012.

Private sector credit increased by only Tk. 169.161 billion or 4.15 percent in July-November, 2012 than that of June, whereas it increased by Tk. 629.791 billion or 17.41 percent in November 2012 than that of November 2011

Private sector credit increased by only Tk. 169.161 billion or 4.15 percent in July-November, 2012 than that of June, whereas it increased by Tk. 629.791 billion or 17.41 percent in November 2012 than that of November 2011. On the other hand, public sector credit increased by Tk. 75.916 billion or 6.86 percent in November, 2012 than that of November, 2011 and it increased by Tk. 79.29 billion (7.19 percent) in July-November, 2012 than that of June, 2012.

Table 4: Components of Domestic Credit

	Outstanding Stock (In billion Tk.)			**Rate of Growth**	
	Nov'11	June '12	Nov'12	July'12-Nov'12	Nov'11-Nov'12
Domestic credit	4724.89	5182.14	5430.59	4.79	14.94
Public Sector	1106.50	1103.13	1182.42	7.19	6.86
Private Sector	3618.39	4079.02	4248.18	4.15	17.41

Source: Monthly Economic Trends, January 2013, Department of Statistics, Bangladesh Bank

The rate of growth on lending rate of interest increases more than that of the rate of deposit albeit with a higher gap between these two rates of interest

The MPS has revised private sector credit envelope to 18.5 percent in June 2013 compared to the previous programme target of 18 percent, an upward target by 0.5 percent. Although the central bank put a reduced target of 18.3 in December 2012, the actual flow stood at 17.4, almost a one percent below the target. It is reasonable to be skeptic that such minor adjustment could accelerate the required level of flow to spur investment in the remaining five months of the current fiscal year and attain the government's targeted rate of growth in GDP.

2.6. Rate of Interest

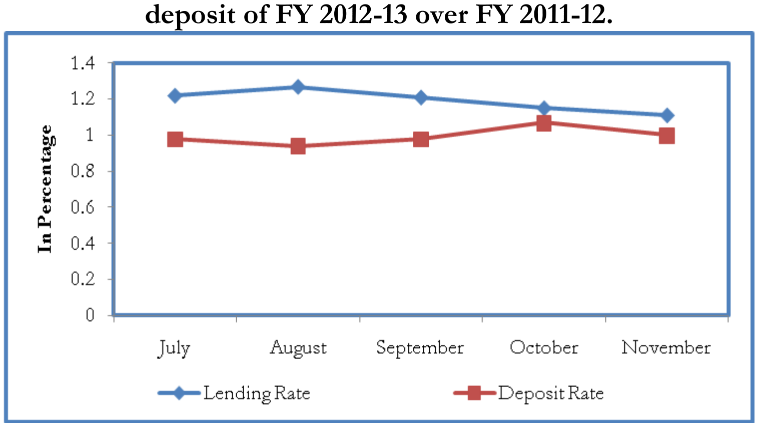
The rate of growth on lending rate of interest increases more than that of the rate of deposit albeit with a higher gap between these two rates of interest. Already private sector investment has squeezed due to the higher rate of interest. On the other hand, after adjusting inflation, real rate of interest, even if it lower down to zero or negative, depositors continue to supply loanable funds to banks, making banks profiting out of this situation.

The spread on lending and rate of deposit expanded to 5.41 percent in November, 2012 from 5.23 percent of November, 2011

The spread on lending and rate of deposit expanded to 5.41 percent in November, 2012 from 5.23 percent of November, 2011. In July, August, September, October and November of FY 2012-13, the rate of growth in lending rate of interest recorded an increase by 1.22 percent, 1.27 percent, 1.21 percent, 1.15 percent and 1.11 percent respectively than those of the same time of the previous fiscal year.

The rate of growth on deposit, however, has increased by only 0.98 percent in July, 0.94 percent in August, 0.98 percent in September, 1.07 percent in October and 1.00 percent in November of FY 2012-13 over the same time of FY 2011-12. To implement the contractionary monetary policy, Bangladesh Bank has increased the rate of growth on rate of lending by 0.33 percent in August, 0.23 percent in September and 0.11 percent in November of FY 2012-13 over the same time of the previous fiscal year.

Figure 1: Monthly Gap in the rate of interest on lending and deposit of FY 2012-13 over FY 2011-12.



Source: Monthly Economic Indicator, Economic Data, 2012

The current MPS reduces the policy rate by 50 basis point, implying that the cost of investible fund would go down and consequentially much needed investment would go up to accelerate the GDP.

The current MPS reduces the policy rate by 50 basis point, implying that the cost of investible fund would go down and consequentially much needed investment would go up to accelerate the GDP. Given the characteristics of the financial market, particularly of the commercial banks, the lagged effect and the availability of five months in this fiscal year, such move may ease the credit availability at a lower price, but would not pull the investment to the required level for the attainment of the targeted growth in GDP.

3. EXTERNAL BALANCE

External balance as well as current account balance shows a surplus due to lower import of intermediate goods, industrial raw materials and capital machinery. On the other hand, remittance is increasing over the years.

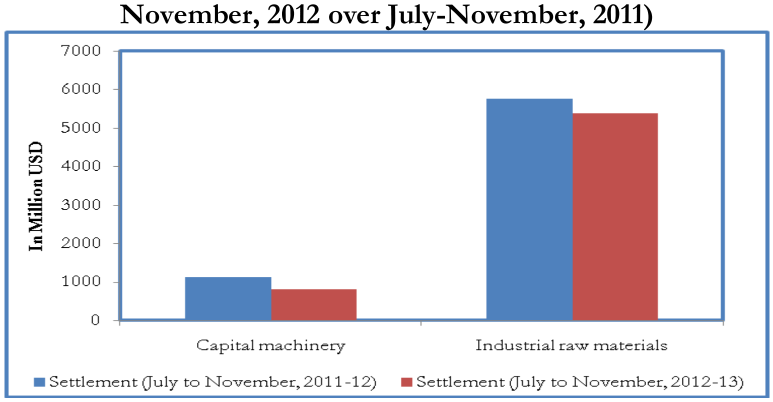
External balance as well as current account balance shows a surplus due to lower import of intermediate goods, industrial raw materials and capital machinery. On the other hand, remittance is increasing over the years. As a result of which, the current account balance ended up in the surplus by USD 43 million during July-November 2012. The current account balance was in the deficit by USD 1.35 billion in the same period of July-November 2011. In July-November, imports fell by 4.31 percent. In the month of November itself, imports fell by 5.25 percent. On the other hand, exports increased by 3.96 percent during that period. Trade deficit in the first five months of FY 2012-13 narrowed by 22 percent due to falling imports. The decline in import of intermediate goods, industrial raw materials and capital machineries suggests adverse implications on the growth prospects of the economy while the failure in meeting export targets also pause a challenge in attainment of the target in terms of growth in GDP.

3.1 Import

Import of intermediate goods, industrial raw materials and capital machineries are decreasing which reduces production.

Import of intermediate goods, industrial raw materials and capital machineries are decreasing which reduces production. Capital machinery imports and industrial raw materials fell by 28 percent and 6.31 percent respectively during July-November of the current fiscal year, considering the settlement statistics in Bangladesh.

Figure 2: Scenario of Letter of Credit (L/C) Settlement (July-November, 2012 over July-November, 2011)



Source: Foreign Exchange Policy Department, Bangladesh Bank, 2012

Though the rate of growth in export is slightly increasing, it is still short of the target.

Fresh LCs opening of intermediate goods, industrial raw materials and capital machinery decreased by USD 9.9 million, USD 417.4 and USD 13.21 million respectively in July-October, 2012 over July-October, 2011. Settlement of intermediate goods, industrial raw materials and capital machinery decreased by USD 50.27 million, USD 202.79 million and USD 252.61 million respectively in the reporting time. For this reason, at the end of the period, the outstanding LCs of settlement in intermediate goods, industrial raw materials and capital machinery reduced by USD 17.7 million, USD 1017.9 million and USD 58.68 million than that of July-October, 2011.

3.2 Export

In the month of November 2012, most of the export showed a downward trend. Though the rate of growth in export is slightly increasing, it is still short of the target. In the month of November 2012, total export earning was USD 1765 million against a target of USD 1990 million with a shortfall of 11.35 percent. There was a downward trend in the export of some commodities during the last quarter of FY 2011-2012. During this period, EU member countries emerged as the largest buyers of Bangladeshi goods and their combined imports totaled at Tk.206897 million (or 53.2 percent of the country's total exports).Total exports to EU countries during the corresponding period of the previous year were, however, Tk. 212402.00 million (or 55.6 percent of total exports). Similarly, exports to North American Free Trade Agreement (NAFTA), OIC (Organization of Islamic Countries) and other European countries reduced by USD 72.73, USD 36.18

In the month of October 2012, export earnings from tea, fish & shrimp, readymade garments (including knit wear and hosiery), fertiliser, and others (including EPZ) decreased by Tk. 10 million, Tk. 2210 million, Tk. 11640 million, Tk. 1290 million and Tk. 3400 million respectively than the corresponding figures of October 2011.

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Table 5: Monthly Scenario of Export Earning

	FY 2012-13 (July to Nov)	FY 2011-12 (July to Nov)	Percentage Changes of FY 2012-13 over FY 2011-12
Raw jute & Jute goods	369.82	379.28	-2.49
Readymade garments	6255.15	6930.72	-9.75
Frozen food	157.14	254.63	-38.29
Leather	128.91	130.22	-1.01
Others	883.45	942.58	-6.27
Export by EPZ enterprises	883.45	1427.08	-0.99

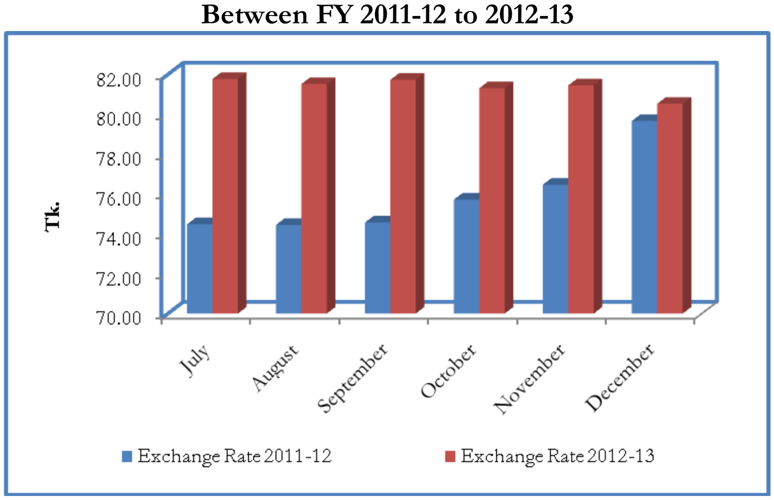
Source: Export Receipt, Balance of Payment, Economic Data, Bangladesh Bank, 2012

During the last six months of the current fiscal year, the average exchange rate was Tk. 81.39, Tk. 5.49 more than that of the same time of the previous fiscal year

3.3 Depreciation of Taka

The depreciation of Taka against USD increases the import bills (measured in Taka) further which induces the trade deficit. During the last six months of the current fiscal year, the average exchange rate was Tk. 81.39, Tk. 5.49 more than that of the same time of the previous fiscal year. . In December, 2012 the exchange rate was Tk. 80.53 which was Tk. 81.45 and Tk. 81.31 respectively in the month of October and November, 2012.. Simultaneously, depreciation of Taka against USD was 0.54 percent, 0.08 percent and -0.01 percent in the month of October, September and August of FY 2012-13 respectively.

Figure 3: Monthly Comparison in The Rate of Exchange Between FY 2011-12 to 2012-13



Source: Bangladesh Bank, Monthly Publication, 2012

4. INVESTMENT

Implementation of the current monetary policy might face some major macroeconomic challenges by the way not allowing the investment to increase at desired level

Implementation of the current monetary policy might face some major macroeconomic challenges by the way not allowing the investment to increase at desired level. This is owing to high rate of interest despite the reduction of the repo rate by 50 basis point. The rate at which the private sector credit has grown and the fall in import have an import bearing on investment. Moreover, the increasing savings-investments gap may hinder attainment of the desired level of growth in FY 2012-13. The high rate of interest, an outcome of contractionary monetary policy, is contributing to the mounting savings-investment gap.

According to Unnayan Onneshan report if the existing policies remained unchanged, the savings-investment gap might increase sharply and will continue to increase in the upcoming fiscal year.

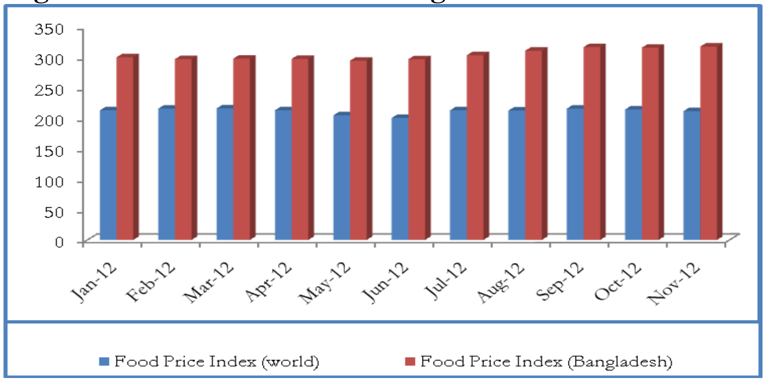
According to Unnayan Onneshan report[3], if the existing policies remained unchanged, the savings-investment gap might increase sharply and will continue to increase in the upcoming fiscal year. This gap might be 5.14, 5.47 and 5.81 percent of the nominal GDP in FY 2012-13, FY 2013-14 and FY 2014-15 respectively. According to the MTMF projections, there will be no gap between savings and investment by 2014-2015. It is estimated that, at that time, savings and investment each will be 29.6 percent of the current GDP. The adopted policy, however, does not support this target. The linear regression based on corresponding growth-investment data shows that, according to MTMF 13-16, USD 2460 billion investments would be required to achieve 7.2 percent economic growth. This figure was USD 2327 billion in FY 2011-12.

5. THE CAUSES OF MODERATION OF INFLATION IN BANGLADESH

The observed moderation of inflation from a peak of 10.96 percent in February to 8.74 percent in December 2012, though still high, cannot by any means, be attributed to contractionary monetary policy. This decline has largely been due to lower food price inflation from a peak of 10.47 percent in June to 7.43 percent in December 2012. On the other hand, non-food inflation has increased from 11.15 percent in June to 11.45 percent in December, 2012.

3 http://www.unnayan.org/reports/meu/dec_12/MEU_DEC_12.pdf

Figure 4: Food Price Index of Bangladesh and the World



Source: Food and Agriculture Organization (FAO)

The non-food inflation was lower over the years but started to increase in the last fiscal year due to hikes in electricity and fuel price. Point-to-point food inflation has declined mainly due to bumper harvest of food grain and decline in international prices.

The economy of Bangladesh is mainly import based and the country has undergone massive unilateral trade liberalization at the behest of International Monetary Fund (IMF) and World Bank

The economy of Bangladesh is mainly import based and the country has undergone massive unilateral trade liberalization at the behest of International Monetary Fund (IMF) and World Bank. This has resulted into international price becoming domestic price. Thus, the domestic prices depend on the movement of the world prices. In the last year, all world price index showed a downward movement and thus, also resulting in the falling rate of inflation in Bangladesh. Furthermore, the stability in domestic food production due to lesser random shock has helped in lowering the rate of inflation.

In November 2013, food price index of Bangladesh and the world were respectively 317.53 and 211.68. They were 300.29 and 212.92 respectively in July, 2012 which were 6.55 and 12.50 more than those of the previous months. In October, 2012, food price index of Bangladesh and world reduced by 0.85 and 1.32 than those of the previous months.

The international food price index has gone down. The main reason for the fall in December is the continuous build-up of palm oil due to bumper production in Southeast Asia coincided with a protracted weakness of import demand

The international food price index has gone down. The main reason for the fall in December is the continuous build-up of palm oil due to bumper production in Southeast Asia coincided with a protracted weakness of import demand. The decline in the index would have been even stronger without the prospect of both a tight global supply and demand situation for soybean oil during the next two to three months and lower than anticipated availabilities of sunflower-seed oil. For 2012, as a whole, the index averaged 225 compared to 252 in 2011.

In December 2012, FAO Food Price Index [4] averaged 209, down 2 points (1.1 percent) from November and the lowest since June 2012, when the Index stood at 200.

6. RELATIONSHIP OF GROWTH IN GDP AND INFLATION

The nexus between inflation and economic growth have drawn extensive attention and generated considerable amount of controversy regarding the nature of their relationship as well as the direction of causality. A recent study of Unnayan Onneshan (UO) attempts to find out the empirical validity of inflation targeting approach, adopted by the most of the central banks since 1990s, conducting an analysis of two aspects to this debate: (a) the nature of the relationship, if one exists and (b) the direction of causality. Through this study, an empirical assessment for Bangladesh has been acquired through the co-integration and Vector Error Correction Model (VECM), Granger Causality test and multiple regression analysis. No statistically significant relationship has been found and inflation does not reduces growth in GDP in the short run, though a statistically significant positive relationship exists between the two variables in the long-run.

A recent study of Unnayan Onneshan (UO) attempts to find out the empirical validity of inflation targeting approach, adopted by the most of the central banks since 1990s, conducting an analysis of two aspects to this debate:

The Granger Causality Tests suggest that there is independence in the relationship between growth in GDP and the rate of inflation. Independence is suggested as the sets of growth in GDP and inflation coefficients are not statistically significant in both regressions.

The results of multiple linear regression model analyses the growth in GDP, used as a dependent variable and the model fits the data quite well (R- square and Adjusted R-square both are high).The coefficient of inflation, however, is highly insignificant; meaning that rate of inflation cannot explain the growth in GDP in the short run. On the other hand, the multiple regression model analyses the rate of inflation, used as the dependent variable where the explanatory variables fail to explain the dependency and all the coefficients including growth in GDP are highly statistically insignificant.

[4] The FAO Food Price Index is a measure of the monthly change in international prices of a basket of food commodities. It consists of the average of five commodity group price indices (representing 55 quotations), weighted with the average export shares of each of the groups for 2002-2004.

The R-square and adjusted R-square are very low, indicating the low variation of dependency of inflation on selected explanatory variables.

The results of the empirical analysis have major policy implications. Firstly, excessive emphasis on reduction in inflation through raising the rate of interest to lessen the supply of money may negatively affect the rate of growth.

The results of the empirical analysis have major policy implications. *First,* excessive emphasis on reduction in inflation through raising the rate of interest to lessen the supply of money may negatively affect the rate of growth. This is supposedly happening in case of Bangladesh as the contractionary monetary policy has been put instead of reducing inflation, which in turn has contracted the rate of economic growth. *Second*, the level of price is important. That means, the sources of information are important. Most of the developing countries are prone to supply shocks due to their high dependency on agriculture and imported energy. *Finally,* the evidence suggests that emphasis in the short run has to be concentrated on understanding the level of price, the sources of inflation and its relationship with other complementary policies affecting growth and employment, as opposed to concentrate on inflation targeting approach.

7. CONCLUSIONS

The historical track record of the successive MPS suggests that the contractionary monetary policy in Bangladesh has restrained the productive growth-conducive activities by way of hindering access to credit to the private sector and declining the import of raw materials, intermediate goods and capital machinery

The historical track record of the successive MPS suggests that the contractionary monetary policy in Bangladesh has restrained the productive growth-conducive activities by way of hindering access to credit to the private sector and declining the import of raw materials, intermediate goods and capital machinery. This has further compromised the achievement of targeted growth against the backdrop of slump in investment and declined rate of growth in GDP.

As regards reduction in inflationary pressure, the moderate decline is attributed to drop in food inflation owing to lessening the international prices and higher domestic agricultural production in contrast to inflation declining due to contraction in money supply through squeezing of credit and imports. The non-food inflation still remains high. The claim of relative reduction in average inflation owing to the past monetary policy stance does not come with evidence and remains ideological and prescriptive. In effect, this monetary policy has been pursued to satisfy the conditions articulated in the Memorandum of Economic and Financial Policies (MEFP) under the three reform programmes agreed with the IMF. The evidence suggests that emphasis has to be concentrated on understanding the sources of inflation and its relationship with other complementary fiscal policies affecting growth and employment.

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