BIISS JOURNAL, VOL. 44, NO. 3, JULY 2023: 227-249
DOI: https://www.doi.org/10.56888/BIISSj2023v44n3a1
ISSN: 1010-9536 (Print)

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MANAGING THE SPILLOVER EFFECTS OF GLOBAL ECONOMIC SLOWDOWN IN BANGLADESH

Abstract

The cumulative effects of the COVID-19 and Russia-Ukraine War led the world economy to a significant slowdown. It has remarkably disrupted the global supply chains, which primarily caused high inflation across the world, and led to sharp nominal depreciation, especially in developing economies and rapid reduction of foreign exchange reserves. Developed countries introduced tight monetary policies in order to reduce high inflation, which was followed by most developing and emerging economies. The global forecasts reveal that the growth rate of world real GDP would be significantly lower in 2023 than that of the preceding year along with high exposure to financial risks that would make recovery difficult in the near term. Bangladesh's economy has been suffering from negative spillover effects of the global economic slowdown that include prolonged high inflation, decelerated growth of real GDP, rapid decline of foreign currency reserve, and significant decline in imports of intermediate and capital goods. In order to address these outcomes, the present paper suggests, inter alia, promoting economic growth through expansionary fiscal policy and a supportive monetary policy for promoting agricultural and manufacturing sectors; increasing domestic resource mobilisation; strengthening oversight and supervision of banks; continuing regulatory import duty on non-essential goods; increasing the stock of foreign exchange reserve; and enhancing finance on climate resilience.

Keywords: Recession; Foreign Currency Reserve; Inflation; Monetary Policy; Policy Rate; Russia-Ukraine War

1. Introduction

The global economy has been undergoing incredible pressure because of the back-to-back effects of the COVID-19 pandemic and the Ukraine conflict. According to the forecast of the Bretton Woods Institutions—World Bank[1] and International Monetary Fund (IMF)[2]—the world economy would witness the worst slowdown in 2023 leading to

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1 "Global Economic Prospects - January 2023," World Bank, 2023.

2 "World Economic Outlook: Countering the Cost-of-Living Crisis-October 2022," IMF, 2022.

recession, which would continue for a few subsequent years. The World Bank projected that the world economy would experience a sharp, prolonged slowdown, with economic growth of only 1.7 per cent in 2023, which was expected to be 3 per cent in the preceding year. Growth of per-capita income would be slower than it was during the 2010s in all the regions of the world. By the end of 2024, the levels of Gross Domestic Product (GDP) in Developing and Emerging Economies (DEEs, excluding China) would be nearly 6 per cent lower than the projected growth in early 2020. The slowdown in DEEs would be accompanied by high inflation, currency depreciation and under-investment in human capital (health, education and nutrition) and private businesses. It is anticipated that the effects would be devastating on the poorest economies. Restoration from the dual effects of the pandemic and the Ukraine conflict would be difficult in poverty-stricken and least-developed regions. Currently, about 20 per cent of DEEs is effectively locked out of global debt markets, which was only about 6.7 per cent in 2019. The situation would be worsened in the near future because of the prolonged global crisis. The spillovers of ongoing weakness in global economic hubs, viz. the United States (US), European Union (EU), and China are expected to deepen across DEEs in the medium term. The combined effects of slow growth, financial tightening, and heavy indebtedness would deteriorate investment and lead to corporate defaults. Higher inflation, financial stress, deepened fragilities in important economies and rising geo political tensions could bring in recession in the global economy.[3]

According to the IMF, the world economy would face similar stresses because of Ukraine War, high inflation, and the slowdown in the Chinese economy. However, according to its forecast, the global growth would be slightly higher (2.7 per cent in 2023) than that of the World Bank though it is lower than that of 2022 (3.2 per cent). It cautioned that more than one-third of the world economy would squeeze in 2023 including the US, EU and China. The worst event would be the "feeling" of a recession for many people around the world in 2023.[4] However, in the revised projection, another IMF report[5] mentioned that the global economic growth would be slightly higher than its preceding projection (2.9 per cent) in 2023 but the growth of the advanced economies, the US and the EU would remain very low (1.2, 1.4 and 0.7 per cent, respectively). It does not expect a global recession in 2023 per se, but it mentions that a restrictive monetary policy stance to curb inflation could lead developed economies into a recession.

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[3] World Bank, *Global Economic Prospects - January 2023.*

[4] IMF, *World Economic Outlook: Countering the Cost-of-Living Crisis - October 2022.*

[5] "World Economic Outlook Update: Inflation Peaking amid Low Growth - January 2023," IMF, 2023.

The United Nations (UN) Annual Report on World Economic Situation and Prospects 2023[6] apprehended that many developed and developing countries would face risks of recession in 2023 in the continuum of the current global economic slowdown. It observes that the current global economic crisis due to deepened effects of the pandemic and the Ukraine War exacerbated the crisis through disruption in food and energy markets, leading to high inflation and increased global cost of living, erosion of real incomes, and creation of new poverty. Capital outflow, sharp currency depreciations and rapid depletion of foreign exchange reserves, increasing pressures on the balance of payment, and worsening debt sustainability risks in developing and least developed countries are protracting the global economic crisis and blurring the prospects of global economic growth in the near term. According to its projection, the global output growth would merely be 1.9 per cent in 2023 from 3 per cent in 2022. It would slightly increase to 2.7 per cent in 2024. The world economy would remain highly uncertain because of the persistence of numerous economic, financial, geopolitical and environmental risks.

In all projections, South Asia has been identified as one of the most vulnerable regions in terms of the fallout of global economic slowdown and possible recession. The economic crises of Sri Lanka and Pakistan are cited as examples of the worst consequences of the cumulative effects of the pandemic and the Russia-Ukraine War.[7] The region is a great victim of financial stress and negative global spillovers stemming from advanced economies. The economic growth in the region is expected to decline in 2023 with varied rates by individual countries, while there would be increased inflationary pressure, reduced investment and fiscal space, and heightened pressure on the balance of payment among other adverse impacts. Bangladesh is also at risk of decelerated growth and other negative impacts of the global economic "slowdown"[8]. However, academic literature on the impact of the ongoing global economic slowdown on the Bangladesh economy and policy implications is currently absent.

Given this backdrop, the objectives of the present paper are to comprehend the key characteristics of the ongoing downturns and uncertainties of the world economy and the possibility of converting into a recession in the near term; analyse the ways through which the possible recession may affect the Bangladesh economy, and suggest the imperatives for the government to address the ongoing and forthcoming challenges stemming from the ongoing global economic slowdown. In order to

6 "World Economic Situation and Prospects," United Nations, 2023.

7 "Pakistan's inflation has become as high as 30 per cent as of April 2023," Monetary Policy Statement: July-December, Bangladesh Bank, 2023.

8 In an interview with the author, Michael Ferrantino, lead economist of the World Bank Headquarters, identified the ongoing economic state of the world as 'slowdown' rather than recession or depression.

achieve the objectives, the research questions are: (a) What are the salient features of the ongoing global economic slowdown, potential length and their manifestations in terms of major economic indicators? (b) How would this slowdown impact the Bangladesh economy? and (c) How can the Government of Bangladesh effectively counter the adverse effects of the slowdown through prudent policies and measures? The paper is based on data published in the literature and databases, and discussion with the relevant officials and experts.

The present paper aims to contribute to the literature and government policies in three major areas. First, it provides a detailed account of the ongoing global economic crisis and its possible transformation into a recession. Second, it presents the key characteristics of the likely impacts of the possible global recession on the Bangladesh economy, which is new in the literature. Third, it suggests a set of policy recommendations for the Government of Bangladesh to effectively counter the likely fallout in Bangladesh by formulating robust ex-ante strategies.

The rest of the paper has been organised as follows. Section 2 discusses the key characteristics of the ongoing global economic slowdown. Section 3 analyses the impacts of the global economic stresses on the Bangladesh economy and the response of the country through fiscal, monetary and external sector instruments. Section 4 suggests a set of policy recommendations for the Government of Bangladesh to counter the negative spillover effects of global economic shocks and slowdowns. Finally, Section 5 ends with the concluding remarks.

2. Salient Features of Global Economic Downturn

2.1 *Supply Chain Disruptions, Inflation and Labour Market*

The global economy is currently undergoing a highly uncertain period with the combined effects of the adverse shocks of the COVID-19 pandemic and the Russia-Ukraine War. It is triggered mainly by decreased demand, persistent disruptions in the supply chain and high inflation. In order to arrest the high inflationary pressure, the central banks of the advanced economies and most of the developing nations continued to tighten monetary instruments. The leading monetary instrument has been used to increase the policy interest rate[9] and reduce the demand for money. In turn, it had a

[9] A policy rate is a reference rate set by the central bank. There are three policy rates, viz. (i) refinancing rate at which commercial banks can borrow money from the central bank, (ii) the deposit rate of return, i.e., the rate of return on reserves of the banks with the central bank, and (iii) marginal lending rate at which banks can refinance themselves with the central bank. Policy rates are considered to be a powerful tool and are widely used for controlling inflation by advanced economies. An increase in policy rates decreases the growth rate of the money supply to reduce inflationary pressure. However, it increases the cost of credit which discourages investment.

generally negative impact on aggregate demand. However, since the inflation has been driven mostly by cost escalation (mainly increased price of the material inputs due to currency depreciation, increased transport cost and disruptions in the supply chain of food and energy), the increase in the policy rates did not bring expected results of arresting inflation, especially in the advanced countries and DEEs. The broad food and energy prices decreased outside the EU area[10], but since inflation remain high in the EU, decreased demand for other imported good resulted in lower export earning of the countries that are dependent on the Eurozone for their exports (Table 1).

Table 1: Consumer Price Inflation (Per cent year-to-year)[11]

	Actual			Estimate	Projection				
	2020	2021	2022	2023	2024	2025	2026	2027	2028
World	3.25	4.70	8.73	6.97	4.87	3.91	3.61	3.53	3.47
USA	1.25	4.68	7.99	4.52	2.32	2.10	2.00	2.01	2.09
Euro area	0.25	2.59	8.38	5.32	2.93	2.19	1.98	1.88	1.87
Japan	-0.03	-0.24	2.50	2.73	2.19	1.58	1.51	1.51	1.51
China	2.49	0.85	1.88	1.99	2.19	2.20	2.20	2.20	2.20
India	6.18	5.51	6.67	4.95	4.43	4.09	4.09	4.00	4.00
Advanced economies	0.68	3.10	7.27	4.66	2.58	2.07	1.94	1.91	1.94
Emerging markets and developing economies	5.18	5.87	9.81	8.63	6.46	5.16	4.72	4.57	4.44
Bangladesh	6.02	5.64	7.56	8.10	5.58	5.41	5.43	5.42	5.43

Table 1 shows that inflation would remain high at the global level but would decline from about 8.7 per cent in 2022 to 7 per cent in 2023. However, nearly 76 per cent of economies would witness lower inflation in 2023. A high gap in inflationary pressure would exist between advanced and developing economies. Advanced economies would experience a rapidly declining and moderate inflation in 2023 compared to high inflation in the preceding year, while it would remain high in 2023 for emerging market and developing economies but would start to become moderate in the subsequent years. However, core inflation (excluding food and energy prices) is expected to decline globally much more gradually in 2023 perhaps because of price stickiness.

[10] IMF, *World Economic Outlook: Countering the Cost-of-Living Crisis—October 2022.*

[11] IMF, *World Economic Outlook: Countering the Cost-of-Living Crisis—October 2022.*

The Russia-Ukraine war for more than a year created shocks in commodity and energy prices, and caused disruptions in trade, leading to a considerable reorientation and adjustment of macroeconomic and trade policies across economies even though the world economy demonstrated emerging signs of stabilising in early-2023. The labour market in the advanced economies remained unusually stable and strong including that of the US with a low unemployment rate.[12] In Bangladesh, the unemployment rate came down from 4.3 per cent in the fourth quarter of 2016-17 to 3.2 per cent in the fourth quarter of 2022.[13] It was perhaps because of the autonomous resilience of the labour force through the expansion of e-commerce and f-commerce, and the generation of temporary employment during COVID-19.[14]

2.2 *Monetary Tightening and Stresses on the Financial Sector*

Continued adverse shocks to both global supply chains and the supply of major commodities are considered to be important drivers of global inflation. Monetary policy tightening in the US led to an appreciation of the US dollar as investors found it more beneficial to keep the US dollar inside the US than the rest of the world which underwent significant volatility and uncertainties. It caused considerable spillovers given the role of the US dollar as the primary currency for global trade and finance—a strong dollar increased prices in local currencies and resulted in persistent inflation across the world. As global banking and capital markets use the US dollar as the funding currency, its high appreciation led to higher strains on the balance sheets of many institutions that caused stringent global credit conditions and reduced flexibility in the financial sector.[15]

The financial institutions that continued financing with low nominal interest rates (especially those used to finance startups) faced particular stress to cope with the fast pace of rises in the policy rate. One example of such consequence is the failure of Silicon Valley Bank (SVB), the 16th largest bank in the US, which created a short-term domino effect that resulted in the failure of the Signature Bank, which was the 19th largest bank in the US. It created cross-border domino effects as well, leading to the vulnerability of banks located in Japan and Switzerland. A few banks in Bangladesh

12 IMF, World Economic Outlook: Countering the Cost-of-Living Crisis - October 2022.

13 *"Quarterly Labour Force Survey 2022 Bangladesh: Provisional Report,"* Bangladesh Bureau of Statistics (BBS), Bangladesh Planning Commission, Ministry of Planning, Government of Bangladesh, 2023.

14 Discussion with Aziza Rahman, Director of Improving Labour Market Information System (ILMIS), BBS; and Mohammad Abdur Razzaque, Chairman, RAPID, Dhaka.

15 Boris Hofmann, Aaron Mehrotra, and Damiano Sandri, "Global Exchange Rate Adjustments: Drivers, Impacts and Policy Implications," *BIS Bulletin No. 62*, Bank of International Settlement, November 1, 2022, https://www.bis.org/publ/bisbull62.htm.

also faced a liquidity crisis because of the withdrawal of deposits following rumours of possible bank failures. Bangladesh Bank adopted immediate measures to address this issue by immediately issuing a circular against such rumors and standing beside those banks by providing short-term loans. Non-bank financial institutions across the world have been under tremendous pressure because of lingering pressure on economic activities because of inflation and increased policy rate.

2.3 *Shrinkage in Economic Growth*

The growth rate of real GDP has decreased sharply at the global level and in major economies in 2022 compared to the preceding year, which created an economic slowdown. At the global level, as shown in Table 2, it decreased from 6.28 to 3.42 per cent, while it decreased notably in the USA, Euro area, Japan, China and India. According to the estimate of IMF (April 2023), it would again decline in 2023 at the global level and for major economies except China. Such back-to-back decline in real GDP growth in two years characterises a prolonged economic slowdown, which may turn out to be a recession in the subsequent years. However, high inflation in 2022 at the global level, USA, Euro area and many other economies across the world is estimated to decrease in 2023. It indicates that the economic slowdown would dampen aggregate demand for at least another round.

Table 2: Growth of Real GDP (per cent)[16]

	Actual			Estimate	Projection				
	2020	2021	2022	2023	2024	2025	2026	2027	2028
World	-2.81	6.28	3.42	2.83	3.02	3.16	3.16	3.07	3.05
USA	-2.77	5.95	2.07	1.58	1.06	1.76	2.05	2.12	2.12
Euro area	-5.58	5.57	3.68	0.75	1.58	2.15	1.99	1.78	1.72
Japan	-4.28	2.15	1.08	1.30	1.02	0.59	0.49	0.39	0.41
China	2.24	8.45	2.99	5.24	4.48	4.08	3.96	3.62	3.48
India	-5.83	9.05	6.83	5.89	6.33	6.21	6.07	6.00	6.04
Advanced economies	-4.21	5.44	2.66	1.26	1.35	1.83	1.86	1.78	1.76
Emerging markets and developing economies	-1.77	6.88	3.96	3.93	4.16	4.04	4.01	3.89	3.86
Bangladesh	3.45	6.94	7.10	5.50	6.50	7.10	7.30	7.40	7.00

16 Data compilation from IMF (2023b) database.

Figure 1: A Comparison of Global GDP Growth (per cent)[17]

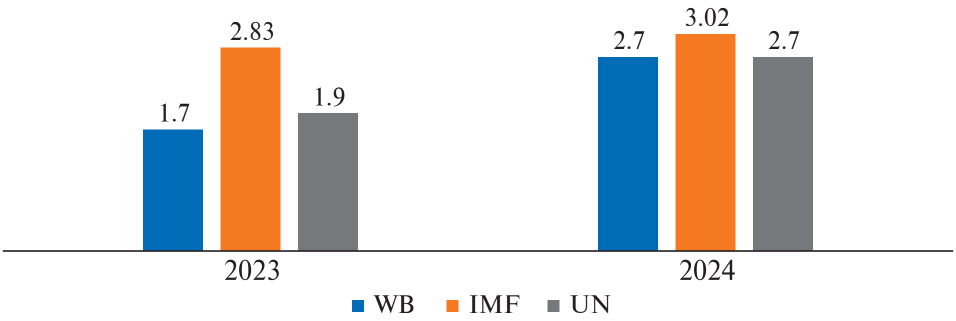


Figure 1 depicts a comparison of global GDP growth based on data from the World Bank, the UN and the IMF for the years 2023 and 2024. It would slightly increase in the year 2024 according to all the projections. However, it would not be adequate to recover from the slowdown. According to the latest IMF data of April 2023, the growth of GDP would decline by more than half in advanced economies in 2023, from 2.66 to only 1.26 per cent. It would slightly rise to 1.35 per cent in 2024 while continuing to remain at less than 2 per cent till 2028. Nearly 90 per cent of advanced economies would explain a decline in growth of real GDP in 2023. Higher unemployment would be the immediate outcome of such a sharp decline in the growth rate. Conversely, GDP growth would remain nearly 4 per cent with minor fluctuations in emerging market and developing economies even though the growth rate would vary widely across countries. The growth rate of the low-income developing countries would grow sharply at the average rate of 5.1 per cent over 2023-24. Overall, a decrease in the level of world output would be a result of tightened financial conditions. However, despite divergence in growth rates by country income group, countries would continue to be affected through trade spillovers, currency depreciation, downward pressure on foreign exchange reserves and global commodity prices.

The economy of China is expected to grow at a higher pace in 2023 than that of the preceding year with continued low inflation compared to other major countries. The Chinese government responded to the economy after the restrictions of COVID-19 with a range of measures and incentives, such as additional monetary easing, tax relief for firms, and resumption of high-frequency production activities and normal operation in the tourism sector. It would create a positive impact on production and global supply chains of industrial products including raw materials

[17] Based on data of World Bank (2023), UN (2023) and IMF (2023b), op cit.

and intermediate goods. China is the destination of about a quarter of exports from Asian countries and 5-10 per cent of other countries, which would create positive spillover effects across the world.[18]

2.4 *Foreign Currency Reserve, External Balance and Indebtedness*

The global economic slowdown has been manifested by the decreased stock of foreign exchange reserves across countries. The total foreign currency reserve at the world level has decreased by about US$1 trillion between the fourth quarter of 2021 and 2022 (Table 3).[19] Reserve in all reserve currencies declined over this period. It was an outcome of the declining reserve of all countries because of decreased global net export and a lower inflow of foreign remittance. The combined effect of increasing interest rates and depreciating currencies of developing and emerging economies was observed in increased the cost of refinancing debt for both public and private sectors.[20] High levels of debt, and considerable budget and current account deficits made these economies increasingly vulnerable to financial stress and complications related to the balance of payments in the presence of further capital outflows.[21]

Table 3: Global Official Foreign Exchange Reserve by Currency (billion US$)[22]

	Q4 2021	Q4 2022
Total	12,919.38	11,962.89
Claims in US$	7,085.01	6,471.28
Claims in Euro	2,481.34	2,270.36
Claims in other currencies	2,483.25	2,347.33
Unallocated reserves	869.78	873.92

The cumulative effect of COVID-19 and the Russia-Ukraine War has created high indebtedness across countries. It occurred because of monetary policy tightening especially by major advanced economies, which resulted in sharp increases in the cost

[18] Krishna Srinivasan, Thomas Helbling and Shanaka Peiris, "Asia's Easing Economic Headwinds Make Way for Stronger Recovery," *IMF Blog*, February 20, 2023, https://www.imf.org/en/Blogs/Articles/2023/02/20/asias-easing-economic-headwinds-make-way-for-stronger-recovery.

[19] IMF database, 2023, updated on 15 May 2023, https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4.

[20] Maurice Obstfeld and Haonan Zhou, "The Global Dollar Cycle," *Brookings Papers on Economic Activity*, BPEA Conference Drafts, Washington, DC., 2022.

[21] Jasper Hoek, Steve Kamin, Emre Yoldas "Are Higher U.S. Interest Rates Always Bad News for Emerging Markets?" *Journal of International Economics* 137 (2022): 103-585.

[22] IMF (2023).

of borrowing. Large budgetary support measures, especially to finance social protection schemes and decreased revenue of the governments, created a large budget deficit. The governments resorted to central banks, commercial banks and foreign aid. It has raised concerns about the debt sustainability of some economies, especially for the ones that have been suffering from low revenue-GDP ratios and foreign currency reserves.

A rapid recovery from the turmoil in 2022 is uncertain given the ongoing the global financial tightening with increased interest rates. Restoring price stability would take a long time, while the prospects for growth would require a decade or so if the Russia-Ukraine War continues. Moreover, the global economic slowdown would result in a global trade slowdown as the growth in the volume of world trade would experience a decline from 5.1 to 2.4 per cent in 2022 and 2023, respectively. It would happen because of the high appreciation of the US dollar in 2022 that made traded products costlier, consider austerity measures that include discouraging the import of non-essential goods and services, and rapidly declining foreign exchange reserves across economies. It would also decrease trade-related employment and financial activities. Global current and capital account balances would narrow gradually over the medium term because of a decline in commodity prices. Nevertheless, the trade growth in the medium term would be lower than that of the pre-pandemic rate.

Overall, given the persistence of increased debt burden and existing weak growth, a further adverse shock through higher inflation, fiscal-monetary tightening or financial strains is likely to drive the world economy into recession.[23]

3. Impacts on the Bangladesh Economy and Policy Response

Even though the cumulative impacts of COVID-19 and the Russia-Ukraine War can be observed in all sectors of the economy of Bangladesh, the major effects include decelerated growth of real GDP, prolonged high inflation, sharp depreciation of Taka against the US dollar, declining foreign exchange reserve, and declined share of private investment to GDP. It also impacted imports, especially intermediate goods and capital machinery. An exogenous effect was a substantial decline in foreign aid inflow and equity capital in Foreign Direct Investment (FDI).

3.1 *Growth and Inflation*

The economy demonstrated impressive growth in FY2021-22 (7.1 per cent). Subsequently, the estimated growth of real GDP shows a sharp decline in

[23] World Bank (2023), op cit.

the fiscal year 2022-23[24] when the first round of global economic slowdown has been observed. According to the most recent estimate of IMF (April 2023), the growth rate of real GDP was 5.5 per cent while the estimate of Bangladesh Bureau of Statistics (BBS) was 6.03 per cent. It was the second lowest in a decade, i.e., since fiscal year 2013-14 while the lowest rate was in 2019-20 during the first wave of COVID-19. On the other hand, consumer price inflation became record high (see, Figure 2) (on an average of 9.01 per cent from July 2022 to June 2023). The causes of high inflation are: (a) high import costs due to the sharp depreciation of the Taka, (b) price hike of food and essential products in source countries, (c) high transport costs because of the sharp upward revision of energy prices, and (d) increased domestic cost of production.

According to the World Bank (2023), the real economic growth of Bangladesh would experience a downturn in the short run (5.2 and 6.2 per cent in FY2022-23 and 2023-24, respectively), while according to IMF (2022), the corresponding figures are 6 and 6.9 per cent in 2023 and 2024, respectively. According to IMF (2023b), the projected growth figures for the corresponding years are even lower than the year 2022—merely 5.5 and 6.5 per cent, respectively. As per the UN (2023) Report, the real economic growth of Bangladesh would be 6 and 5.9 per cent, respectively. The estimated growth rate of BBS for FY2022-23, as reported in Table 4, is close to the projections of the IMF (2022) and the UN (2023). The projected growth figures are lower than that of FY2021-22.

Table 4: Medium-term Macroeconomic Indicators (fiscal year)[25]

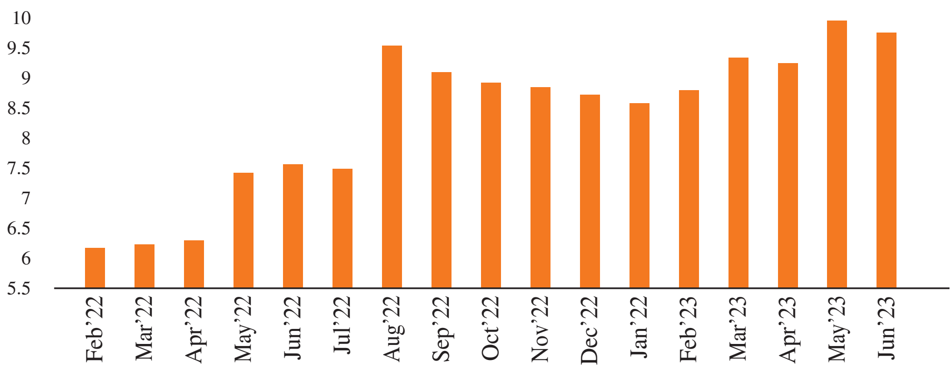
	Actual			Estimate	Projection		
	2020	2021	2022	2023	2024	2025	2026
Real GDP growth (%)	3.45	6.94	7.10	6.03	7.50	7.80	8.00
CPI Inflation (%)	5.65	5.56	6.15	7.50	6.00	5.50	5.40
Investment (% GDP)	31.3	31.0	32.0	27.8	33.8	35.1	36.0
Private	24.02	23.7	24.5	21.8	27.4	28.8	29.4
Public	7.30	7.30	7.50	6.0	6.3	6.3	6.6
Export, fob (% change)	-17.1	12.4	33.4	10.0	12.0	14.0	14.0
Import, fob (% change)	-8.6	19.7	35.9	-9.0	8.0	12.0	12.0
Forex reserve in terms of months of import	7.2	7.8	5.3	4.5	4.3	4.4	4.7

24 "Wage Earners Remittance," Bangladesh Bank, updated on July 2, 2023, http://bbs.portal.gov.bd/sites/default/files/files/bbs.portal.gov.bd/page/057b0f3b_a9e8_4fde_b3a6_6daec3853586/2023-05-16-10-44-dbee2f57222c72fc4695eeec11f317b0.pdf; and "Remittance inflow hits record high in June," Kaler Kantho, Dhaka, https://www.kalerkantho.com/english/online/business/2023/07/03/54463.

25 "Bangladesh Economic Review 2023," Finance Division, Ministry of Finance, Government of Bangladesh, 2023.

The semi-annual monetary policy declared in January 2023 mentions that the targeted growth rate of real GDP has been revised down to 6.5 per cent. It has adopted a set of monetary instruments to counter the challenges of the global economic crisis, which includes expansion of domestic credit for promoting productive and employment-generating activities, increase in policy interest rate from 5.75 to 6 per cent to mitigate inflationary pressure, the possibility of relaxations of the lending rate cap and the complete removal of the deposit floor rate to bring dynamism in the financial sector.[26]

Figure 2: Consumer Price Index (CPI) Inflation Per cent[27]



3.2 *External Trade and Remittance Inflow*

Like many other developing countries and Least Developed Countries (LDCs), the balance of payment of the country is undergoing tremendous pressure in Bangladesh. It can be revealed from the rapidly declining foreign exchange reserve of Bangladesh since February 2022 (Figure 3). It is mainly because of the sharp depreciation of the Taka against the US dollar, the crisis in the foreign exchange market despite considerable open market operation by Bangladesh Bank, restrictions in opening letters of credit (L/C), and the introduction of regulatory duty on non-essential products as a part of the government's selective austerity measures. The country experienced rapidly declining foreign exchange reserves since the onset of the Russia-Ukraine War.

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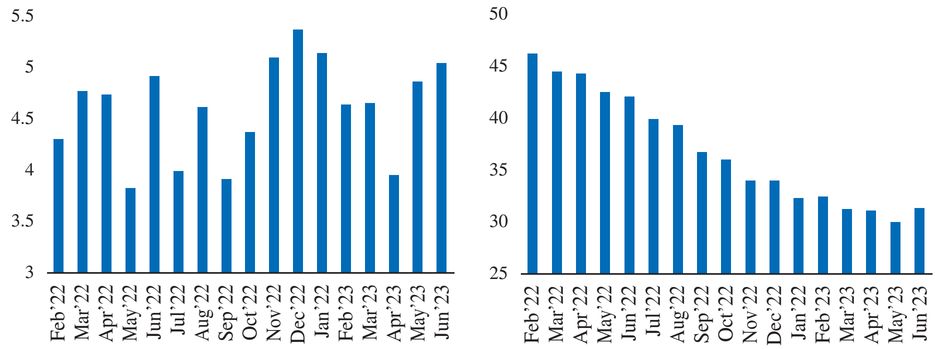
26 "Monetary Policy Statement: January-June 2023," Bangladesh Bank, 2023.

27 "Consumer Price Index (CPI), Inflation Rate and Wage Rate Index (WRI) in Bangladesh," Bangladesh Bureau of Statistics, http://bbs.portal.gov.bd/sites/default/files/files/bbs.portal.gov.bd/page/9ead9eb1_91ac_4998_a1a3_a5caf4ddc4c6/2023-07-03-09-10-ca3442c86946c228fc8c0af89e51ffb8.pdf.

Figure 3: Merchandised Exports by Month[28] (Left) and Foreign Exchange Reserve (right)[29] (billion US$)



Export performance was impressive during the period of slowdown, while the imports experienced a decline. In FY2021-22 there remained nearly US$61 billion of export of goods and services and it recorded in merchandised export from November 2022 to January 2023, nonetheless, monthly export earning remained below US$5 billion from February to May 2023, and again it crossed US$5 billion in June 2023. The energy price increase and its shortage disrupted industrial activities including the production of steel, cement and fertiliser in the fiscal year 2022-23. According to the Finance Division[30], both consumption and investment growth slowed down in this period, which occurred during the ongoing global economic slowdown because of growing inflation and uncertainty. Due to high import costs emanating from the sharp depreciation of the Taka against the US dollar and the increased price of necessary food, energy and industrial goods, and discouraging non-essential goods, import of almost all goods experience negative growth in the first ten months of FY2022-23 compared to FY 2021-22, and most notably of capital goods (-18.84 per cent) followed by intermediate goods (-17.65 per cent) (see, Table 5).

[28] "Export Data," Export Promotion Bureau of Bangladesh, updated on July 11, 2023, https://epb.gov.bd/site/view/epb_export_data/-.

[29] "Selected Indicators," Bangladesh Bank, updated on July 11, 2023, https://www.bb.org.bd//pub/weekly/selectedindi/06_july_2023.pdf

[30] Finance Division, "*Bangladesh Economic Review 2023*."

Table 5: Import Payment by Category of Products (US$ million) [31]

	July-April FY2022-23	July-April FY2021-22	% change (FY23 over FY22)
Food grains	2,203.2	2,307.5	-4.52
Consumer goods	4,921.9	4,830.0	1.90
Intermediate goods	37,481.2	45,512.2	-17.65
Capital goods	11,275.7	13,892.4	-18.84
(Capital machinery)	(4,005.1)	(4,644.0)	(-13.76)
Others	7,618.3	7,678.1	-0.78
Total	**63,500.3**	**74,220.2**	**-14.44**

Production of manufacturing items decreased because of declined imports of the later categories of imported goods as both domestic and global demand declined. The global demand for imported goods is likely to decline further as the rest of the year 2023 is going to be a period of global economic slowdown. Therefore, exports of Bangladesh would also experience a slowdown in the coming months.[32] Decreased merchandised imports, however, helped narrow the trade gap in the fiscal year 2022-23. In the first ten months, it was -US$27.695 billion in the fiscal year 2021-22, which decreased to -US$15.731 billion in the corresponding period of the fiscal year 2022-23 (Table 5).[33]

The remittance inflow remained fluctuating for more than a year (see, Figure 4). Even though the government has introduced incentives on remittance, the inflow through formal channels remains low. According to recent news reports, it is perhaps due to the strong presence of the informal channel, popularly known as 'hundi'[34] that allegedly offers a higher exchange rate than the official rate and hassle-free transaction. Since there is a lack of awareness among the remittance senders about the adverse effects of informal flow, it has been a popular credit transaction method nowadays.[35]

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[31] "Major Economic Indicators: Monthly Update—May 2023," Bangladesh Bank, 2023.

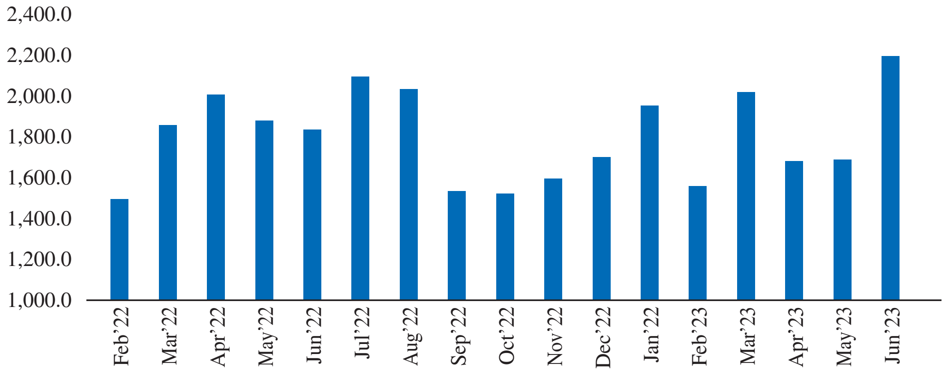
[32] Opined by Mohammad Hatem, Executive President of Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA), during a conversation with the author.

[33] Bangladesh Bank, "*Major Economic Indicators: Monthly Update—May 2023*."

[34] "Remittance drops in May due to hundi," The Business Standard, June 1, 2023. https://www.tbsnews.net/economy/remittance-drops-may-due-hundi-642286.

[35] Md Mizanur Rahman and Brenda S.A. Yeoh, "The Social Organization of Hundi: Channeling migrant remittances from East and South-east Asia to Bangladesh," *Asian Population Studies* 4, no. 1 (2008): 5-29, https://doi.org/10.1080/17441730801963490.

Figure 4: Remittance Inflow (million US$)[36]



3.3 *Financing Budget*

The government's tax revenue decreased because of the global slowdown. Besides, import tariffs, relevant value-added tax (VAT) and supplementary duty related to imports also decreased compared to the target. Reduced imports of intermediate and capital goods led to a decrease in domestic production, which again led to a decrease in domestic taxes compared to the target. While till March FY2022 the growth rate of tax revenue of the National Board of Revenue (NBR) was 15.27 per cent, the corresponding figure for FY2023 was merely 7.15 per cent.[37] It created pressure on budget financing—the government had to resort to domestic borrowing predominantly from Bangladesh Bank and commercial banks that increased cumulative public borrowing.

3.4 *Inflow of Aid and FDI*

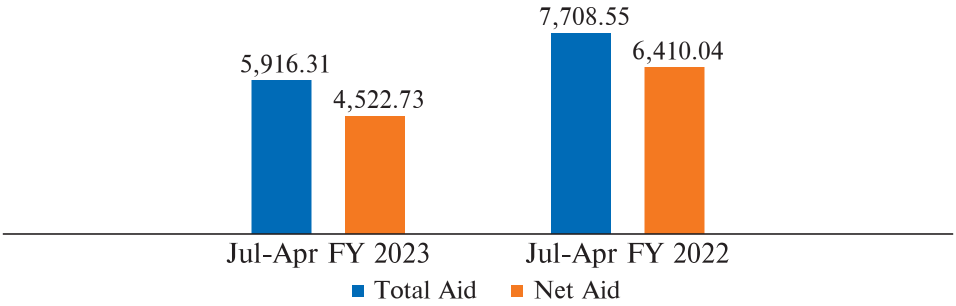
In addition to export earnings and foreign remittance, foreign aid is a source of foreign currency reserve for the country. During the global economic slowdown, the country received a lower amount of aid than that of the recovery period, which can be observed from the aid inflow during the first ten months of FY2022 and 2023 (Figure 5). Total foreign aid was lesser by US$1.792 billion or 23.25 per cent during

[36] "Selected Indicators," Bangladesh Bank, updated on July 11, 2023, https://www.bb.org.bd/en/index.php/publication/publictn/5/27

[37] Mohammad Abdur Razzaque opined that the nominal growth rate of NBR taxes of FY2023 was due to substantial currency depreciation that led to increased cost of imports in local currency, and increased cost of domestic production and services. It implies that in the absence of abnormally increased import costs, the growth tax revenue would have been negative.

July-April of FY23, while the net receipt of foreign aid (after repayment of principal with interest) was also lower by 29.44 per cent during the same period. This shortfall of aid led to greater pressure on the government to take credit from domestic sources. Foreign currency reserves could be increased if the aid inflow was consistent with the target of FY2022-23.

Figure 5: Inflow of Foreign Aid (US$ million)[38]



The sudden spur in commodity prices and global policy tightening created considerable pressure on the macro economy and the post-pandemic recovery in the country. Bangladesh requested the IMF and World Bank support to undertake policy reforms and lessen downward pressure on external balance following a rapid decline in foreign exchange reserves.[39] The government resorted to the credit of IMF to ease pressure on the current account, support budget implementation and finance for climate resilience, which the Board of IMF approved on 31 January 2023. A loan agreement of US$2.25 billion was signed with the World Bank during Prime Minister Sheikh Hasina's visit to World Bank headquarters in May 2023.[40] Another loan agreement of US$858 million was signed on 07 June 2023 for the projects on enhancing climate-resilient agricultural growth, food security, and improving road safety.[41] However, from US$45.947 billion in February 2022[42] the gross foreign exchange reserve has come down to US$29.87 billion

[38] Bangladesh Bank, "*Major Economic Indicators: Monthly Update—May 2023.*"

[39] "Bangladesh Development Update—April 2023," World Bank Office Dhaka, World Bank, 2023.

[40] "Bangladesh, World Bank ink $2.25b loan deal for 5 projects," *The Business Standard*, May 2, 2023, https://www.tbsnews.net/economy/bangladesh-world-bank-sign-225-billion-loan-agreement-5-projects-624898.

[41] "Bangladesh Receives $858 Million World Bank Financing to Improve Climate Resilient Agriculture Growth and Road Safety," The World Bank, updated June 7, 2023, https://www.worldbank.org/en/news/press-release/2023/06/07/bangladesh-receives-858-million-world-bank-financing-to-improve-climate-resilient-agriculture-growth-and-road-safety.

[42] "Foreign Exchange Reserve," Bangladesh Bank, updated on June 10, 2023, https://www.bb.org.bd/en/index.php/econdata/intreserve.

as of the end of May 2023[43] even after receiving the first installment of loan from the IMF and World Bank. The inflow of foreign remittances played a major role in the foreign currency reserves.

Table 5: Trend of Net FDI Inflow (US$ million)[44]

	2020	2021	2022
Net FDI inflow	2563.58	2,895.56	3,479.95
of which			
Equity capital	842.29	1,138.70	1,022.63
Reinvested earnings	1,566.12	1,562.27	2,514.97
Intra-company loans	155.17	194.59	-57.65

FDI is another source of foreign currency inflow, which helps increase the stock of reserve currency. The net FDI inflow in 2022 was higher than that of the preceding year. However, equity capital is the main component in the net FDI[45], which was lower in 2022 than that of 2021 (Table 5). Thus, even though FDI played an important role in the Bangladesh economy through technology diffusion, knowledge spillover, efficiency gains by local firms and greater access to the global market[46], it did not play a significant role in boosting the stock of reserve currency.

4. Policy Recommendations

Based on the above analysis, this section suggests a set of policy recommendations to overcome the ongoing challenges of the global economic slowdown in Bangladesh. The recommendations are mainly focused on the fiscal and monetary instruments, which need to be tailored to address the shocks and finance the productive sectors and invest in human development and climate resilience.

43 AKM Zamir Uddin, "IMF releases $476.27 million as first loan instalment for Bangladesh," *The Daily Star*, accessed on February 3, 2023, https://www.thedailystar.net/business/news/imf-releases-47627-million-first-loan-instalment-bangladesh-3237316.

44 "Foreign Direct Investment and External Debt: July-December, 2022," Bangladesh Bank, 2022.

45 Reinvested earnings on FDI include the net operating surplus of the FDI enterprise plus net property incomes or current transfers.

46 Laura Alfaro, Areendam Chanda, Sebnem Kalemli-Ozcan, Selin Sayek, "FDI and economic growth: the role of local financial markets," *Journal of International Economics* 64, no. 1 (October 2004): 89-112, https://doi.org/10.1016/S0022-1996(03)00081-3.

4.1 *Promote Policies Towards Accelerating Economic Growth*

Economic growth should be accelerated through the combination and convergence of fiscal and monetary policy and it is the topmost priority of the government nowadays. Expansionary fiscal policy is one of the major instruments to boost aggregate demand, encourage private investment through developing public infrastructure and utilities, introduce large transfer and workfare schemes under social protection, and provide subsidies to critical sectors and areas, such as agriculture and food, renewable energy, and education and healthcare among others. While the proposed budget for the fiscal year 2023-24 is such an apt attempt at fiscal expansion, it should be supported by a matching monetary policy, which would be primarily expansionary or at least accommodative in nature. However, achieving revenue targets and realisation of foreign aid would be important preconditions to properly implement the budget.

4.2 *Strength of Domestic Revenue Mobilisation*

Government revenue, especially tax revenue as the share of GDP, is expected to remain low until at least 2024 due to the absence of automation of tax collection including the full installation of the electronic fiscal device (EFD) to collect VAT. Because of selective austerity and continued discouraging import of non-essential goods, the import-related taxes would not increase substantially. In the fiscal year 2022-23, the revised tax-GDP ratio is merely 8.47 per cent, while for the fiscal year 2023-24, the ratio has been set as 8.99 per cent. Both rates are well below the South Asian average of 2018.[47] With such a weak state of domestic revenue mobilisation, it is difficult to implement the budget keeping the deficit at a tolerable limit. Therefore, broadening tax bases and curbing revenue leakages should be a priority to avoid excessive dependence on the banking sector for financing the budget. The proposed income tax law should be implemented to broaden the scope of transition from over-reliance on regressive indirect tax towards progressive direct tax.

4.3 *Avoid Excessive Monetary Tightening*

Curbing inflationary pressure is one of the most important targets of monetary policy along with accelerating economic growth. Central banks across the

[47] According to the World Bank, the tax-to-GDP ratio of Bangladesh was 7.7 per cent, which was the lowest in South Asia in 2018, and the average tax revenue was 11.7 per cent of South Asia's GDP in that year, https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?end=2018&locations=8S&start=1974.

world have taken the excessive monetary tightening policy by increasing policy rates. Bangladesh Bank began monetary tightening during the second quarter of 2022, which was later than most advanced economies.[48] The core objective of the monetary tightening was to reduce the supply of narrow money for discouraging consumption (because of the higher deposit interest rate that encourages future consumption) and at the same time reduce investment (due to the higher cost of capital through higher lending interest rate). This kind of monetary policy will not help reduce inflation as a high lending rate will only keep the price level up because of high production costs. Price hikes will require an increase in wage rate to clear the market, which would give rise to new unemployment and further inflationary pressure because of the higher cost of production (the 'wage-price spiral'). On the other hand, a higher price level will result in decreased aggregate demand, which would lead to a decrease in aggregate supply and subsequent reduction of demand for labour. Thus, a continued and excessive monetary contraction would produce a counterproductive outcome and protract the period of slowdown.

4.4 *Pursue Flexible Financial Conditions*

The semi-annual monetary policy declared in June 2023 seems to be contractionary ("tight")[49] in nature, which aims to increase lending and deposit interest rates, increase the policy rate further (from 6 to 6.5 per cent) to increase the cost of production and business of the private sector, and reduce credit growth to private sector (from 12.9 per cent in December 2022 to 10.9 per cent in December 2023). However, Bangladesh Bank should pursue a flexible monetary approach to boost private investment with selected expansion particularly targeting agricultural and manufacturing sectors and increasing the low-cost supply of food and other necessary goods in the domestic market.[50] It can create soft refinancing schemes and special funds to promote outputs for the domestic market with multiple targets: contain inflation, create new jobs, strengthen supply chains and accelerate economic growth. Since increased food production is likely to stabilise the food market and generate most of the employment in rural areas, supplying low-cost credit to agriculture would generate a positive impetus to the domestic market. At the same time, low-cost and soft loans for micro, cottage, small and medium enterprises (MCSMEs) would encourage them to invest more in the production of mainly raw materials and intermediate goods for the large industries besides producing final goods. The

48 United Nations, "World Economic Situation and Prospects."

49 Bangladesh Bank, 23.

50 Discussion with Mustafizur Rahman, Distinguished Fellow, Centre for Policy Dialogue, Dhaka; Mostafa Abid Khan, former Member, Bangladesh Trade and Tariff Commission; and Mohammad Abdur Razzaque.

MCSMEs are exposed to negative shocks of price escalation of inputs and a slower pace of economic growth in the country.[51] Many of these enterprises are dependent on microfinance institutions (MFIs) for credit, which is relatively costlier than bank loans. These enterprises have been suffering from price. Lack of access to credit for micro and small enterprises is a constraint on private sector growth in the LDCs and emerging economies.[52] As MCSMEs are more labour-intensive than their large counterparts, it will help generate additional employment in the formal sector and increase domestic supply especially, through backward linkage. Therefore, a flexible and selective expansionary monetary policy would help increase domestic supply and employment and decrease inflation. At the same time, convergence between fiscal and monetary targets is imperative to achieve the target of economic growth and macroeconomic stabilisation.

In this aspect, Bangladesh Bank needs to adjust domestic monetary conditions considering the effects of monetary tightening and domestic spillovers of higher policy rates of developed countries. Such a continued calibration would help it devise a flexible monetary policy to cope with the adverse effects emanating from the global level.[53] It is imperative to introduce flexible financial conditions to reduce the pressure of currency depreciation, financial volatility and pave the way to avoid the negative impact of global economic downturns. In addition, it is important to communicate such a monetary policy among a wide range of stakeholders, especially among manufacturing communities and traders. Both banks and non-bank financial institutions should have an adequate buffer to absorb substantial shocks and risks.

4.5 *Improve the Efficiency of Banks*

Oversight and supervision of banks should be strengthened. The banking sector has become increasingly vulnerable because of the cumulative effects of COVID-19 and the ongoing economic stresses emanating from a global slowdown.

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[51] Discussion with Qazi Kholiquzzaman Ahmad, Chairman, Palli Karma-Sahayak Foundation (PKSF), Dhaka. He opined that the Bangladesh economy was relatively safe during the global recession of 2007 and 2008 because of smaller size of economy and lesser integration with the global economy. However, the economy has become vulnerable to ongoing global shocks because of its relatively large size and global integration.

[52] "*Global Economic Prospects*," World Bank, 2022.

[53] Maurice Obstfeld, "Emerging-Market and Developing Economies Need Support Amid Rising Interest Rates," *Peterson Institute for International Economics*, October 6, 2022, https://www.piie.com/blogs/realtime-economics/emerging-market-and-developing-economies-need-support-amid-rising-interest, accessed on June 10, 2023; and Guénette, Justin Damien, M. Ayhan Kose, and Naotaka Sugawara, "Is a Global Recession Imminent?" EFI Policy Note 4, World Bank, 2022.

The non-performing loan has increased, while the concentration of credit to large groups of businesses has increased that intensified risks. Their capacity for shock absorption has decreased. However, global financial sector regulations introduced after the global financial crisis contributed to the resilience of banks during the COVID-19 pandemic, which should be strengthened further. Additional efforts are needed by Bangladesh Bank to overcome deficiencies in the supervisory oversight of banks, including in the prudential framework for exposures to risks and shocks with macro-prudent policies. More steps should be taken to reduce non-performing loans and increase the efficiency of the banking sector, which would capable them to absorb increased pressure. In addition, risk monitoring should be strengthened in periods of high uncertainty, market volatility, intensified inflationary pressure, and commitment to IMF towards market-based borrowing and lending interest rates as well as move towards a unified foreign exchange rate. It would help monitor risk across critical industries and sectors, and address vulnerabilities rapidly towards restoring confidence and stability in the financial sector.

4.6 *Continue Selective Austerity in Imports*

Regulatory import duty on non-essential goods should be continued. In addition, the provision of a 100 per cent margin on the letter of credit (L/C) for importing luxury goods should be retained. The government has set the priority of opening L/Cs on import in four areas: food, inputs for export-oriented industries, power and energy, and pharmaceutical products. The use of foreign exchange reserves should continue to receive priority in these sectors at least during the period of global slowdown when the country undergoes a crunch in the foreign exchange reserve.

4.7 *Boost Foreign Currency Reserve*

Increasing the stock of foreign exchange reserves should remain an important priority. It should be pursued through a combination of increasing exports of goods and services, inward FDI, increasing inflow of foreign remittance through formal channels, and preventing informal large capital outflow that takes place through mis-invoicing, fraudulent means of L/C opening and other forms of money laundering. Diversifying destinations can be an effective means of increasing exports in the short run, which would require establishing connections with new buyers in South America (primarily targeting Brazil, Argentina, Peru and Chile), the Middle East, Southeast and East Asia, Central Asia, South Africa, and Oceania.[54] Producing raw materials and intermediate goods as import substitutes for export-oriented industries would help save foreign currency and increase profit margin. FDI should be attracted to such production. A new export strategy should be formulated by the exporters to demonstrate the excellence of the idea in expanding business during the crisis.[55]

4.8 *Foster Climate Resilience*

Climate resilience should be enhanced through public and private investment. Bangladesh is widely known for its investment in climate change adaptation especially targeting the population who are the most vulnerable because of extreme weather and slow-onset climate events. The nature of the occurrence of climate-induced events over the last three years and a half are characterised by recurrent cyclones in coastal areas; massive floods in north and northeastern areas; continued drought in south, southwest, west and northwest regions; and prolonged heat waves with reduced annual rainfall. While these events have non-trivial negative impacts in terms of damage and loss[56], food shortage could be avoided because of the continued bumper harvest during this period. The loan packages of multilateral institutions such as the IMF and World Bank have components of climate resilience. The Government of Bangladesh also invests in programmes to enhance climate resilience. While investing in the most vulnerable population is important, the government should emphasise investing more in renewable energy, which would decrease import dependence on fossil fuel during the period of straining foreign exchange reserves due to global economic slowdown and at the same time reduce carbon footprint. The rapid expansion of solar irrigation plants is a low-hanging climate-smart solution that would reduce over-dependence on imported fossil fuel and at the same time generate electricity to supply to the national grid.

5. Conclusion

The present paper is an attempt to analyse the nature of the ongoing global economic slowdown, its impact on the Bangladesh economy, and suggest policy recommendations. It reveals that the cumulative impact of COVID-19 and the

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[54] Opined by Faiyaz Murshid Kazi, Director General (West Europe and EU), Ministry of Foreign Affairs, Government of Bangladesh during a discussion with the author.

[55] Fazlee Shamim Ehsan, Vice President, BKMEA, during a discussion with the author opined that it is easy to expand overseas market and increased export during normalcy. However, some businesspeople are good at doing business during crisis and uncertainties. These entrepreneurs need to be identified and promoted to devise a viable export strategy during the period of global slowdown.

[56] "*Global Economic Prospects*," World Bank, 2022.

prolonged Russia-Ukraine War have led the world economy to a significant slowdown, which may result in a global economic recession. The war has significantly disrupted the global supply chains of food, energy and industrial inputs, triggered inflation across the world, capital outflow, sharp currency depreciations and rapid reduction of foreign exchange reserves and deterioration of debt sustainability risks. In order to arrest inflationary pressure, developed countries tightened monetary policy mainly through increasing policy interest rates. A similar strategy was followed by most developing and emerging economies across the world. It primarily aimed to reduce money supply towards reducing aggregate demand, which in turn led to a reduction of growth of the real GDP. The global forecasts reveal that the growth rate of world real GDP would be significantly lower in 2023 than that of the preceding year, which would continue in the near term. Excessive and prolonged monetary tightening to reduce inflation and exposure to financial risks during the ongoing period of uncertainty would exacerbate the real economy thereby making rapid recovery difficult.

The Bangladesh economy has been undergoing significant stresses and risks that include prolonged high inflation, rapid decline of foreign currency reserve, and substantial decline in imports of industrial inputs that include intermediate and capital goods. These adverse effects led to a slowdown of the growth of real GDP as reflected in the estimates of the Government of Bangladesh, World Bank, IMF and the UN. In order to address these outcomes, the paper suggests a set of policy recommendations that include, inter alia, promoting economic growth through expansionary fiscal policy and a supportive monetary policy; pursuing a flexible monetary policy with selected expansion particularly targeting agricultural and manufacturing sectors; increasing domestic resource mobilisation through automation; strengthening oversight and supervision of banks to avoid further risks and shocks; continuing regulatory import duty on non-essential goods, increasing the stock of foreign exchange reserve through increasing export earnings, remittance inflow through the formal channel, foreign aid and FDI; and increasing finance on climate resilience. The present paper is broad-based in nature, which covers the nominal and real sectors of Bangladesh. Future studies should focus on sector-specific analysis and policy lessons to overcome the negative spillovers of global economic shocks and slowdowns.