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Currency Devaluation and its impact on Bangladesh

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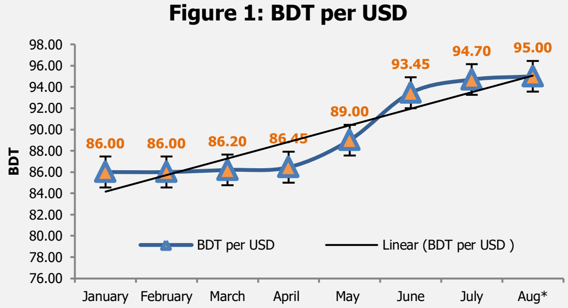
Bangladesh is maintaining a floating exchange-rate regime where the currency rate is set by the foreign exchange market based on supply and demand relative to other currencies. Due to recent past uncalled events like the Covid-19 pandemic and the Russia-Ukraine war, the world is experiencing shockwaves and it is facing the resulting impact on its economies and the USD currency appreciation against major currencies in the world created pressure on the exchange rate of Bangladesh along with other countries. Ensuing from the abrupt shocking events, the market uncertainty, and economic obstruction is disrupting the global markets with soaring prices of oil, metals, grains, etc. The international market is experiencing unique price pressure from uncalled events and expansionary policies in the global economy. Being a developing country, Bangladesh is also wrestling with the current turn of events in both international and domestic markets affected by increased commodity prices, shooting import payments, and dollar shortage.

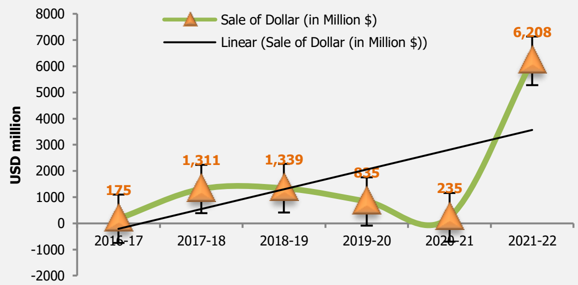
The world could not release a sigh of relief after the pandemic just when the invasion by Russia in Ukraine affected the global supply chain with a dollar crunch and rising inflation rate. This dollar crunch had a significant impact on the economy of Bangladesh. Over the last four months (May-August, 2022), the currency rate of Bangladesh followed an increasing trend which started at a slower pace in the first three months after the political turmoil heated up (Figure 1). There had been fluctuations in the sale of dollars by Bangladesh Bank over the last six years and the sale increased significantly in FY2022 (Figure 2). Currently, the currency rate is at BDT 95 as on August 25, 2022, as per data by Bangladesh Bank (Figure 1). The dollar price in the open market also jumped to BDT 120 in the second week of August according to industry insiders which increased by around 26% (The Financial Express, 2022).

Figure 1: BDT per USD



Source: Bangladesh Bank (2022)

Figure 2: Sale of Dollar (in Million USD)



Source: Bangladesh Bank (2022)

Usually, the central bank intervenes to stabilize the foreign exchange market by injecting greenbacks. However, the currency market has become unstable with the rising demand for greenbacks. Not only the Bangladeshi Taka but also the currencies of the world's top economies like the UK & Germany, including the neighboring countries like India, Pakistan, Sri Lanka, and Afghanistan, have also lost their value against the US dollar. For example, within the last year, the GBP in the UK and the EUR from various European countries have lost 14.29% and 15.7%, respectively, against the US dollar. This resulted when the US Federal Reserve System raised the short-term interest rate by 0.75% on May 4, 2022, to reduce the dollar supply and encourage people to save money (Business Inspection BD, 2022).

A gap was created due to higher imports compared to export, which widened the current account balance in FY2022. As observed by the data from Bangladesh bank the gap inflated during FY2022 compared to previous years' current account deficit. Along with Bangladesh's trade deficit of USD 27.56 billion, remittances declined by 18% in FY2022 (Business Inspection BD, 2022). As a result, the country's foreign exchange market has come under pressure. The remittance flows also declined to illustrate additional pressure on the economy.

Governments and central banks control the factors that influence currency value. Currency devaluation can occur when the foreign exchange value of one currency drops against the exchange value of other currencies. In this case, the dollar rate appreciated against most major currencies which is one of the main reasons for currency devaluation in Bangladesh (Ross, 2021).

Bangladesh's foreign exchange market has been facing a shortage of the US dollar over the last couple of months mainly due to soaring import payments and lower-than-expected remittance inflow. The expatriate remittance inflow fell by 15.95% year-on-year to USD 19.19 billion and the foreign exchange reserves decreased to USD 42.11 billion on June 01, 2022, from USD 46.15 billion on December 31, 2021 (Uddin, 2022). This decreased remittance and higher imports in the country further aggravated the currency depreciation in Bangladesh.

This dollar crunch further increased as Bangladesh Bank adopted step by step policy to stabilize the dollar shortage situation. Bangladesh Bank released about USD 6.21 billion of its reserves through commercial banks as liquidity support for settling import-payment obligations in their FY 2021-22 and thus the foreign reserve has been reduced to about USD 42 billion. The step-by-step policy aims to reduce the adverse reaction in the import-export trade and it compelled the BB to depreciate the local currency eight times in FY2022 to keep control of the foreign exchange market (Uddin, 2022).

Moreover, the productive capacity of an economy and the size of its money supply also influence currency depreciation. As the supply of money grows faster than productivity, it represents more units of currency with less exchange value and inflation is produced (Ross, 2021). According to the monetary policy statement in Bangladesh 2022 (Bangladesh Bank, 2022), Bangladesh follows an expansionary policy and had been formulated assuming a 7.20% GDP growth and 5.30% inflation rate. In FY2022-23, the broad money growth is projected to rise to 12.1 percent from 9.1 percent in FY2021- 22 as per the monetary policy statement in Bangladesh. However, Bangladesh Bank will follow a cautious policy attitude with its monetary and credit programs in 2023.

Trade deficit of increasing by 53% in FY2022

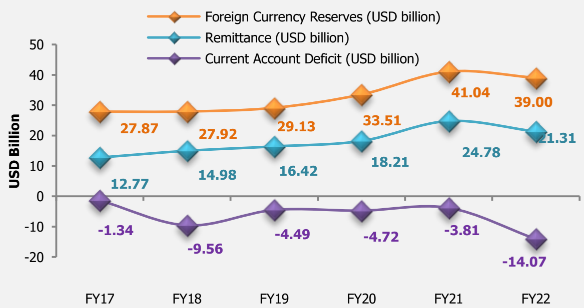
Remittance fell by 15.95%

Foreogn currency reserve decreased to USD 42.11 billiob in 2022

Inflation rate increased to 7.40% in FY2022

BDT against USD standing at BDT 95 in August 2022

Figure 3: Reserve, Remittance & Current Account Dificit



Source: Bangladesh Bank (2022)

The recent currency devaluation in Bangladesh already affected the balance of payment of the nation as the import payments took pace while export did not grow as much. Moreover, the devaluation in currency is contractionary to the economy's long-run negative effect on economic growth & productivity. The consequences include a reduction in real income as the price of commodities increases leading to worsened terms of trade, rising inflation rate, transfer of income from the private sector to the government sector, income spending declines with the rise in saving, and lower investments leading to slow down of the economy (Ojuolape et al., 2015).

The depreciation will bring further add inflation, affecting the poor due to the increase in commodity prices. Thus, the government should take appropriate measures to handle this crisis to avoid long run impact. Policy recommendations should include both monetary and fiscal measures to support the economy. Policy measures have to be adopted to encourage export, increase expatriate remittance flow and investments by creating an investment-friendly business environment, and increase subsidies for export-oriented industries.

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About ECRL

Emerging Credit Rating Limited (hereinafter referred to as ECRL) began its journey in the year 2009 with the motive to deliver credible superior & quality credit rating opinion in various industry segments around Bangladesh. ECRL obtained credit rating license from Bangladesh Securities and Exchange Commission (BSEC) in June 2010 as per Credit Rating Companies Rules 1996 and also received Bangladesh Bank Recognition as an External Credit Assessment Institutions (ECAI) in October 2010 to do the rating of Banks, Financial Institutions and their borrowers and also from Insurance Development & Regulatory Authority (IDRA) in 2015 to do the rating of Insurance Companies & affiliated with Malaysian Rating Corporation Berhard.

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