Restoring stability in the balance of payments

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The underlying causes of the BOP crisis are long-standing and deep-rooted

Bangladesh has been facing a severe downturn in the balance of payments (BOP) since FY2021-22. While commendable progress has been made to reverse the downward trend, there is still a way to go. The objective of this essay is to explain the recent developments in the BOP, assess the robustness of the adjustment process, and suggest policy options for moving forward.

The underlying causes of the BOP crisis are long-standing and deep-rooted. The immediate triggers were a series of external shocks relating to COVID19, the global inflation of 2021-22, and the Russia-Ukraine War starting on February 24, 2022. These external shocks lowered global GDP growth and trade, and raised global commodity prices, inflation rates and interest rates. Their adverse effects on Bangladesh's BoP were magnified by poor macroeconomic management, reflected in a fixed exchange rate, a fixed and artificially low interest rate, large fiscal deficits fueled by the COVID-19 response, and excessive use of bank credit to finance these deficits.

In the event, Bangladesh export earnings fell, cost of imports surged, the volume of trade financing fell, and its cost increased. The net outcome was a huge surge in the current account deficit, reaching a record $18.2 billion in FY22. This large increase in the current deficit put pressure on the reserves (Table 1).

RECENT DEVELOPMENTS IN THE BOP AND THE ADJUSTMENT PROCESS

USD Billion	FY2022	FY2023	FY2024	FY2025
Exports (GNFS)	57.8	50.3	47.1	50.7
Imports (GNFS)	95.0	80.8	73.7	76.5
Remittances	21.0	21.6	23.9	30.3
Other Net Investment Income	(-) 2.0	(-)2.7	(-) 3.9	(-) 4.6
Current Account Balance	(-) 18.2	(-) 11.6	(-) 6.6	0.1
Capital Account Balance	(-) 6.7	(-) 8.2	(-) 4.3	3.4
Extraordinary BoP Financing		2.3	3.2	5.0
Foreign Reserves (IMF Method)	35.8	24.8	21.7	26.7
Real GDP Growth Rate (%)	7.1	5.8	4.2	4.0
Interest Rate (weighted average lending rate) (%)	7.1	7.3	11.5	12.1
Nominal Exchange Rate (TK/USD) (end of period)	93.5	108.8	118.0	122.8
REER Index (FY2022=100)	100.0	91.2	91.0	92.5
Nominal GDP (USD Billion)	460	452	450	462
Nominal GDP (BD Taka billion)	39717	44908	50027	55528

Source: Bangladesh Bank and the Bangladesh Bureau of Statistics

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The government was initially slow to respond to this crisis and chose to take the hit on the reserves. The rapid rundown of reserves made it obvious that this was not a sustainable policy response. Consequently, Bangladesh entered into a 3-year IMF adjustment program starting in January 2023. Policy corrections started since then but most progress was made between May 2024 and June 2025. In a series of steps, the interest rates were deregulated, the exchange rate was unified and made market based, fiscal deficits were lowered, mostly through cutbacks in public development spending, and bank financing of fiscal deficits was curtailed.

The BOP response to these policies is illustrated in Table 1. Export earnings are recovering, remittance income has surged, and imports have fallen sharply. The current account deficit fell substantially showing a small surplus in FY25. The exchange rate has stabilized at a realistic level consistent with market behavior, reserve drawdown has been reversed, and Bangladesh secured a significant surplus in the balance of payments in FY25, allowing a modest buildup of reserves.

This is a substantial turnaround in the BOP, and the authorities ought to be commended. Yet, there is no room for complacency. The most important policy question is how robust is the BoP and is this progress sustainable?

To answer these questions, it is important to examine the nature of the BoP adjustment process. Looking at Table 1, two features stand out. First, export earnings in FY25 are still some $7 billion lower than in FY22. But remarkably, this decline has been more than compensated by the acceleration in remittance earnings, which were $9 billion higher in FY25 as compared with FY22. Secondly, and most significantly, imports fell by $19.5 billion between FY22 and FY25. This decline almost entirely explains the improvement in the current account deficit of $18.3 billion between FY22 and FY25.

The reduction in imports was initially pushed through quantitative restrictions. While they were relaxed in recent months, a combination of interest rate hike, the depreciation of the real effective exchange rate (REER) and the sharp slide in the GDP growth rate worked together to bring about the reduction in imports.

The slide in the GDP growth rate falling to 4% in FY25 raises doubts about the robustness and sustainability of the current BoP situation. The slide in the GDP growth is mostly explained by the weakening of the underlying investment climate reflected in deterioration in the law and order situation, political uncertainties related to the upcoming national elections, energy constraints, cutback in ADP spending, high cost of trade logistics, anti-export bias of trade policy, and the skills constraints. Post national elections, it is likely that the investment climate will improve and there will be a recovery of economic growth. There is no doubt that a recovery of economic growth will be associated with a sharp increase in imports.

Research done by PRI shows that over the medium to long-term, the income elasticity of import is around a value of 1 for Bangladesh. This is consistent with similar econometric results for India, Sri Lanka, Pakistan, Indonesia and Vietnam. So, it is almost guaranteed that a recovery of GDP growth over the medium term will require sufficient BoP space for imports to grow along the long-term trend.

Illustrative medium-term projections for FY25-FY30 that allow GDP growth to recover to 7% by FY30, with inflation falling to 5% by FY30 and REER maintained constant, will require imports to grow by an average of 10.8% per year between FY25-FY30. Allowing for a sustainable level of current account deficit of around 1% of GDP per year, total foreign exchange earnings from exports and remittances will need to grow by an average 10.1% per year in order to maintain BoP stability.

What are the policy implications for this sustained BoP management strategy that reconciles GDP growth with BoP stability? In addition to pursuing all the policies needed to lower inflation to 5%, the most fundamental challenge is to diversify exports. The recent unprecedented surge in remittances is largely explained by the diversion of remittance transactions from the hundi market to the official channels. So, the growth of remittances will likely stabilize at the long-term trend of 5-6% per year. Therefore, exports will need to grow by double digits to finance the imports associated with a recovery of the GDP growth momentum.

RMG will continue to play a dominant role, but double digit export growth will not be possible without export diversification. PRI research shows that export diversification requires reforms in a number of critical areas. One fundamental policy requirement is to maintain a flexible exchange rate management with no scope for any appreciation of the REER. A fixed nominal rate and a sharply appreciating REER was a fatal flaw in exchange rate management between FY11 and FY23 that hurt exports and has cost Bangladesh's BoP heavily. This must be avoided at all costs.

A second critical reform is to eliminate the anti-export bias of trade policy. PRI research has provided empirical evidence how the anti-export bias of trade policy has hurt the expansion of non-RMG exports. The recent correction of the exchange rate mismanagement is a welcome policy move that is already benefitting exports and remittances, but this must be augmented by a correction of trade protection that is hurting non-RMG exports.

Other policies include addressing the investment climate issues relating to energy, trade logistics, infrastructure and skills that support both domestic and foreign private investment. Additionally, entering into free trade agreements, participation in the global value chain, export-focused FDI and investment in R&D are necessary to expand the non-RMG export base.

Policies are also needed to sustain the progress in the capital account. As illustrated in Table 1, the surplus in the capital account balance in FY25 is explained mostly by the inflow of extraordinary BoP financing from the IMF and other multilateral partners. This was necessary and is a smart policy move. But obviously this is a short term policy move. These inflows have helped build confidence in the exchange system, but continued improvement in the reserve situation will not only require deft management of the current account as explained above but also access to sustained sources of BoP financing. Multilateral MLT will remain important. But debt servicing, especially amortization, is catching up as access to subsidized MLT financing dries out and only commercial financing is available. Here the fundamental need is to have sustained FDI inflows and smooth access to trade credits at reasonable cost. Strengthening of Bangladesh investment climate and creditworthiness will help improve access to FDI and other sources of private capital inflows.