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Flash note: Updated Macroeconomic Outlook for 2H'2024

Reaching a Stable Pulse with Essential Reforms

Bangladesh has undergone a significant political shift, following large-scale protests that resulted in the resignation of the then Prime Minister and the dissolution of parliament. As an interim government has been formed under the leadership of Nobel Laureate Dr. Muhammad Yunus, the nation faces both significant challenges and potential opportunities.

Key leadership roles have been extensively shaken up since the interim administration took over. Dr. Salehuddin Ahmed, the new Finance Advisor, has vowed for financial sector reforms, transparent reporting, and strict inflation control by addressing market inefficiencies like extortion and syndication. With Dr. Ahsan H. Mansur as the new Bangladesh Bank Governor, there's a clear shift toward a more proactive monetary policy. The sharp rally in the Dhaka Stock Exchange following the regime change reflects early investor optimism for meaningful economic reforms, renewed investor confidence, and a broader recovery of economic stability.

Key Macroeconomic Policy Changes Expected under the Interim Government:

- Prioritizing Price Stability over Growth
- Increased Transparency in Economic Reporting
- Controlled Development Expenditure
- Banking Sector Overhaul

Highlights of the Changes to Our Macroeconomic Outlook from July Considering the New Reality:

- **We expect a 150-200bps drop in inflation by Dec-24E** due to further tightening and a higher base effect from August. Inflation spiked to a 12-year high of 11.7% in July, primarily due to improved transparency in economic reporting and supply chain disruptions. The magnitude of expected easing in inflation is unchanged from our earlier forecast, but the decline will be from a higher level. However, early tightening measures could result in a sharper reduction in inflation.
- **Our Interest Rate (1-year T-bill) target is unchanged** at 12.5%-13.5% for Dec-24E as the central bank is expected to maintain a tightening stance. However, **we expect a sharper hike in the policy rate**, a 100-150bps hike by Dec-24E, revised from our earlier expectation of 25-50bps, considering the new governor's immediate priority of taming inflation over economic growth.
- **Our view on the exchange rate is unchanged** at the BDT stabilizing by 120-125 by Dec-24E due to the continued monetary tightening and a shrinking current account deficit. Reduced imports and stable remittances will mitigate the adverse effects of any slowdown in export growth.
- **We have lowered our GDP growth expectation to 3.5%-4.0% for FY25E**, reflecting anticipated sharper monetary tightening, reduced development expenditure under the interim government, and disruption to industrial activity and trade during the curfews, blockades, and internet blackout in July.

CAL's Updated View on the Key Macroeconomic Variables for 2H'2024

Inflation: *A Break in the Fever*

Inflation spiked to 11.7% in July, primarily due to enhanced transparency in economic reporting since the interim government's appointment and sharp food price increases caused by supply chain disruptions during July's curfews and blockades in the later weeks of July. Since then, prices have started to return to earlier levels due to improved supply conditions. We maintain our expectation for a 150-200bps decline in inflation by Dec-24E, driven by continued monetary tightening and a favorable base effect starting in August. The magnitude of expected easing in inflation is unchanged from our earlier forecast, but the decline will be from a higher level under more transparent reporting. Potential energy tariff hikes remain a downside risk to this outlook. However, swift and aggressive monetary tightening could result in a sharper decline in inflation.

Interest Rate: *One More Dose to Complete the Course*

We maintain our forecast of 1-year treasury bill rates at 12.5%-13.5% by December 2024, supported by further tightening measures and full subscription of auctions. However, we revise our policy rate forecast to 10.0%-10.5%, reflecting the impact of double-digit inflation and the new central bank governor's emphasis on price stability over growth. We expect rates to peak after the initial hike, influenced by (i) a higher policy rate differential as developed economies ease monetary policies, (ii) higher real interest rates as inflation gradually eases, and (iii) reduced credit demand due to high lending rates.

Exchange Rate: *Reaching a More Stable Pulse*

We expect the BDT to stabilize between 120-125 against the USD by December 2024, as the crawling peg adjusts to market conditions. Anticipated monetary tightening and a reduced current account deficit should ease forex reserve pressure, supporting currency stability. While export growth and foreign financing may face challenges due to political uncertainty, the interim government's goodwill and Western support could enhance buyer confidence and stabilize FDI and foreign debt inflows. Despite a decline in exports, reduced imports due to lower private credit growth and curtailed development spending should ease pressure on the current account. Despite initial concerns, remittance inflows have remained strong since the resumption of Internet and banking services, posing no significant for concern for the exchange rate.

Economic Activity: *Growth on Sedatives*

We have lowered our GDP growth expectation for FY25E to 3.5%-4.0%, as the interim government is likely to focus on price stability through monetary tightening and controlled expenditure rather than pursuing growth. Reduced development spending and a reassessment of priority expenditures are expected to moderate growth. Growth in net exports, driven by subdued import demand and improved export performance, should partially offset the negative impact of slower consumption and investment on GDP growth.

*Find the link to our Full Report on the Macroeconomic Outlook for 2H'2024 Published in July 2024: **https://tinyurl.com/cal2h2024***

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