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POLICY BRIEF

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Inflation, Poverty, and Policy: Rethinking Approaches with Expanded Social Protection

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Abstract: Inflation in Bangladesh has become a major policy challenge in recent years, with rates hovering around 10 per cent compared to the usual range of 5–6 per cent. Initially triggered by external factors such as the COVID-19 pandemic and the Russia-Ukraine war, domestic policy mismanagement—until the recent initiation of the Interim Government—has amplified the crisis. Prolonged inflation has eroded purchasing power, deepened poverty, and impeded economic growth, thereby intensifying socio-economic vulnerabilities. Drawing upon the most recent official poverty incidence data from the Household Income and Expenditure Survey (HIES) 2022, this policy brief estimates that, accounting for both rising price levels and wage adjustments over the past two years, nearly 7.9 million additional individuals have been pushed into poverty. Furthermore, the size of the vulnerable population—defined as those living above the poverty line but by no more than 25 per cent of it—has increased by approximately 10 million.

Bangladesh's current responses, centred on contractionary monetary policy, including significant policy rate hikes, have yielded limited success. The reliance on Consumer Price Index (CPI) inflation metrics fails to address structural drivers and risks triggering stagflation. This policy brief advocates for adopting a core inflation-based monetary policy to better capture long-term price trends and recommends reallocating resources to expand social protection coverage. These measures are essential to mitigate inflation's impact on the poor and vulnerable while ensuring sustained economic growth.

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Inflation, Poverty, and Policy: Rethinking Approaches with Expanded Social Protection

I. Background

Inflation in Bangladesh has emerged as a significant policy challenge in recent years, with rates persistently hovering around 10 per cent, far exceeding the typical range of 5–6 per cent (Figure 1). This has created profound economic and social challenges. Following the political regime change in early August 2024 and the initiation of the Interim Government, the central bank implemented rigorous contractionary monetary policies, including raising the policy interest rate to an all-time high of over 10 per cent. While these measures aim to curb inflation by reducing the money supply and demand, their effectiveness remains limited. This is due to insufficient time for the impact of monetary tightening to materialise, as well as structural issues such as supply-side rigidities and pressure on foreign reserves, which have restricted the growth of imports necessary to dampen domestic prices.

This policy brief analyses the underlying causes of sustained inflationary pressure in Bangladesh and its impact on poverty and vulnerability. It also evaluates the efficacy of current monetary policies and explores how these can be improved by transitioning to a core inflation-based monetary policy framework. Furthermore, the brief proposes specific measures to protect poor and vulnerable populations during inflationary periods, particularly while contractionary policies are in effect.

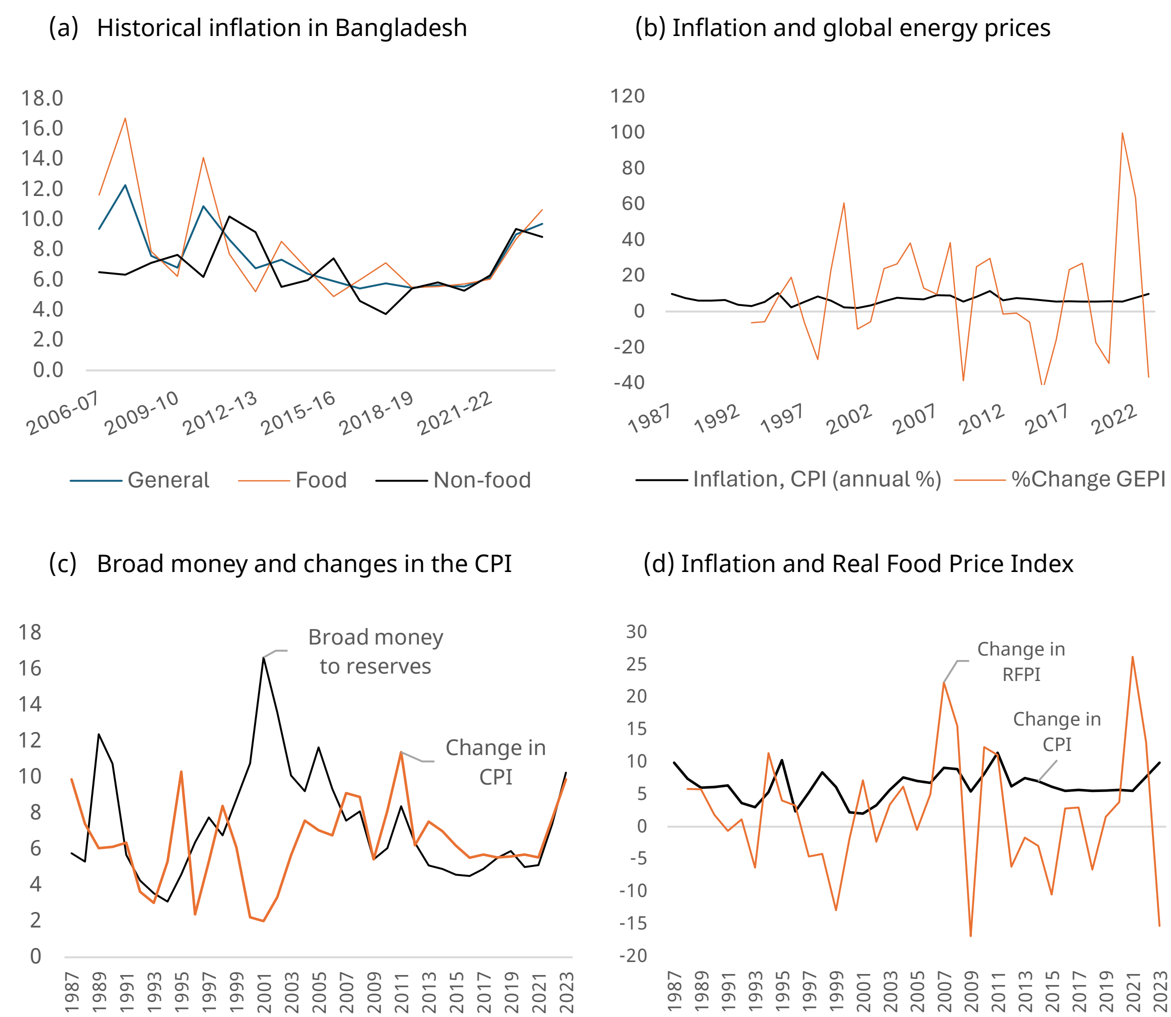
II. Causes of Inflation in Bangladesh

Domestic policy mismanagement has likely been a critical driver of inflation in Bangladesh, overshadowing global factors in recent years. A key contributor has been the government's heavy reliance on borrowing from Bangladesh Bank to finance budget deficits. This approach has significantly expanded the money supply, intensifying inflationary pressures. The indiscriminate printing of money under the previous political regime, often justified as a means to address fiscal shortfalls, has further fuelled price increases across essential commodities. Such fiscal practices have exacerbated economic imbalances, driving inflation to levels that cannot be attributed solely to global phenomena.

Although the global COVID-19 pandemic and the Ukraine-Russia conflict undoubtedly disrupted supply chains and escalated energy and food prices worldwide, attributing Bangladesh's inflation entirely to these events overlooks the persistent price hikes. While these global shocks triggered price pressures during 2021–22, domestic policy failures—including irresponsible monetary policies and efforts to sustain unrealistically high growth through large deficit financing—aggravated macroeconomic imbalances and perpetuated inflationary pressures.

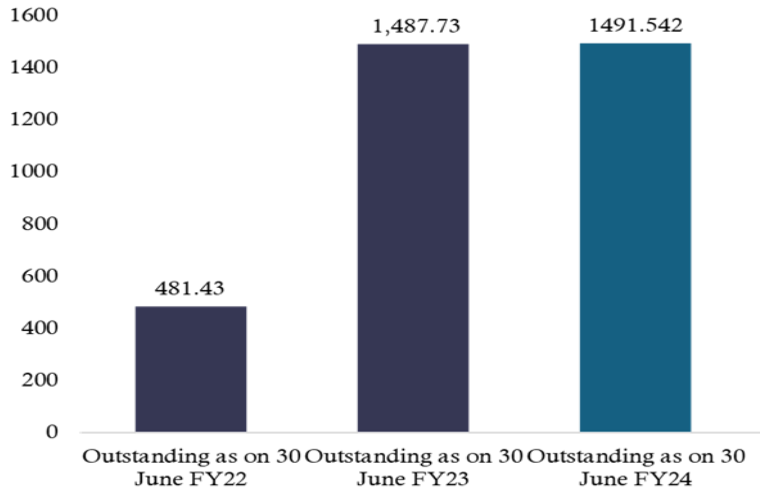
Government borrowing from Bangladesh Bank reached an unprecedented scale, exceeding BDT 1 trillion within a single fiscal year, from FY22 to FY23 (Figure 2). This amount is more than double the cumulative borrowing from the central bank over the previous 50 years. Such an extraordinary surge in borrowing has had profound consequences. By injecting excessive liquidity into the economy, it has devalued the currency and eroded consumers' purchasing power, fuelling a broader and more persistent inflationary trend. This unchecked borrowing, combined with the absence of substantial structural reforms to address fiscal deficits, has severely undermined the stability of the macroeconomic environment.

Figure 1: Bangladesh inflation and other indicators



Source: Data from Bangladesh Bank, Bangladesh Bureau of Statistics, St. Louis FED and Trading Economics.

Figure 2: The government's domestic borrowing tripling during 2022-23



Source: Bangladesh Bank

The reliance on printing money to cover budget deficits has created a perilous feedback loop. As inflation rises, the real value of government debt declines, incentivising further borrowing and money creation. This vicious cycle not only intensifies inflationary pressures but also undermines public confidence in economic governance. The resulting inflation has disproportionately affected low- and middle-income households, who are the least equipped to withstand the escalating costs of living.

Beyond expanding the money supply, domestic policy mismanagement has failed to address critical supply-side bottlenecks that exacerbate inflation. Poor governance in key sectors such as agriculture, energy, and transportation has led to inefficiencies that inflate production and distribution costs. When combined with expansionary fiscal and monetary policies, these structural shortcomings have entrenched inflationary trends even further.

III. Impact of High Inflation: Increased Poverty and Vulnerability

To assess the impact of sustained high inflation on poverty and vulnerability in Bangladesh, an analysis was conducted on changes in both the Consumer Price Index (CPI) and the wage index over the period from FY 2021-22 to November 2024. According to the latest report by the Bangladesh Bureau of Statistics (BBS), the CPI increased by 32.99 percentage points in urban areas and 32.26 percentage points nationwide during this period. In contrast, the wage index rose by only 23.83 percentage points, highlighting a lag in income adjustments relative to the rising cost of living.

At the division level, significant disparities in wage index changes were identified. Rangpur division experienced the highest increase in the wage index, at 29.85 percentage points, while Dhaka division recorded the smallest increase, at just 21.66 percentage points. These regional differences in wage growth were incorporated into the analysis by adjusting individuals' incomes based on the respective divisional wage changes. This approach provides a more appropriate representation of regional disparities in income and living standards when estimating the poverty and vulnerability impacts of inflation. To account for inflation, the poverty lines were adjusted using the following methodology:

I. Inflation-Adjusted Lower Poverty Line (IALPL) (extreme poverty):

$$IALPL = LPL\ in\ 2022\ HIES \times Price\ adjustment$$

II. Inflation-Adjusted Upper Poverty Line (IAUPL) (the standard or moderate poverty line income):

$$IAUPL = UPL\ in\ 2022\ HIES \times Price\ adjustment$$

III. Inflation-Adjusted Income for the Vulnerable Population (IAVPL):

$$IAVPL = UPL\ in\ 2022\ HIES \times 1.25 \times Price\ adjustment$$

Price adjustments are the percentage change in prices (CPI) from 2022 to November 2024. These adjustments ensure that the poverty lines reflect the increased cost of living due to inflation. The vulnerable population comprises individuals whose incomes are above the poverty line but within a narrow margin, making them highly susceptible to falling into poverty due to economic shocks or rising costs of living. Following the guidelines outlined in the National Social Security Strategy (NSSS), the vulnerability income line is defined as income up to 25 per cent above the upper poverty line income, identifying those at risk of falling into poverty due to economic shocks or rising living costs.

To measure the proportion of the population living in poverty, the *Poverty Headcount Ratio* was calculated using the formula:

$$Poverty\ Headcount\ Ratio = \frac{Number\ of\ People\ Below\ the\ Poverty\ Line}{Total\ Population} \times 100$$

The analysis reveals a significant rise in poverty levels in Bangladesh due to high inflation between 2022 and 2024 (Table 1).

- The extreme poor population—those unable to meet basic subsistence needs—experienced a notable increase. Nationally, the proportion of extreme poor rose from approximately 6 per cent in 2022 to nearly 8 per cent in 2024, representing an additional 3.8 million individuals.
- The proportion of moderate poor increased from approximately 18 per cent in 2022 to around 23 per cent in 2024, adding an estimated 7.9 million people to this category. Rural areas saw the rise by about 5 percentage points while the urban area more than 4 percentage points.
- The proportion of vulnerable population rose from 34 per cent in 2022 to nearly 40 per cent in 2024. That is, an additional 10 million people became vulnerable. The rise of rural vulnerable population is over 6 percentage points and the same for urban areas is 5 points, reflecting inflation's widespread impact.

Table 1: Rising poverty and vulnerability because of sustained high inflation

	Rural		Urban		National	
	Number (Million)	Per cent	Number (Million)	Per cent	Number (Million)	Per cent
Extreme poor in 2022 (HIES)	7.42	6.50	1.98	3.80	9.40	5.65
Extreme poor after inflation and wage adjustments in 2024	10.17	8.91	3.05	5.84	13.22	7.95
Added to extreme poverty during 2022-24	2.76	2.41	1.06	2.04	3.82	2.30
Moderate poor in 2022	22.67	19.86	7.64	14.65	30.31	18.22
Moderate poor after inflation and wage adjustments in 2024	28.31	24.79	9.87	18.93	38.18	22.95
Added to moderate poverty during 2022-24	5.63	4.93	2.23	4.28	7.86	4.73
Vulnerable population in 2022	41.51	36.35	14.88	28.52	56.38	33.90
Vulnerable population after price and wage adjustments in 2024	48.60	42.56	17.61	33.76	66.21	39.80
Added to vulnerability during 2022-24	7.09	6.21	2.73	5.24	9.82	5.90

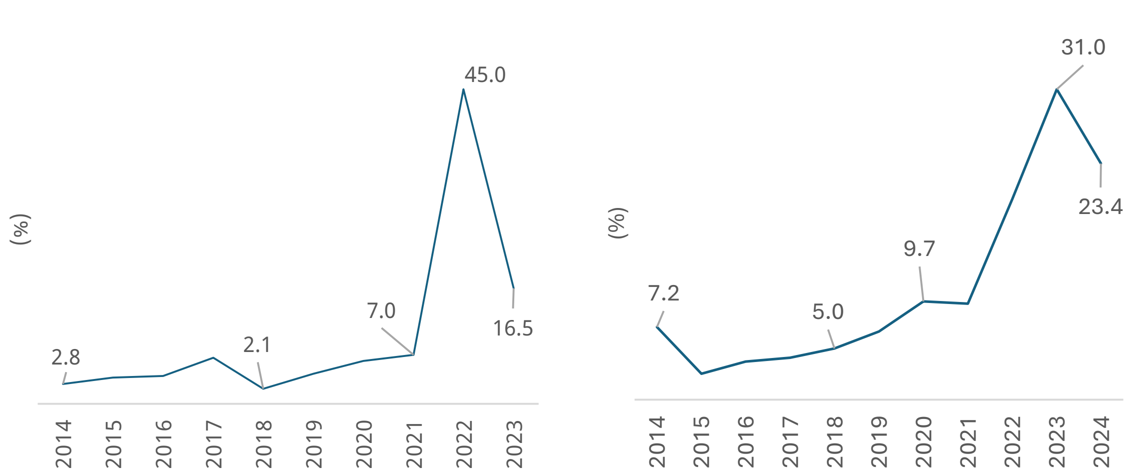
Source: Estimated using HIES 2022 and methodologies mentioned above.

IV. Comparing Inflation Management: Sri Lanka and Pakistan

Sri Lanka faced hyperinflation of approximately 70 per cent in 2022, driven by a severe foreign exchange crisis, debt defaults, and political instability. In response, the government enacted stringent monetary and fiscal measures under an International Monetary Fund (IMF) bailout programme. Key actions included reducing subsidies to enforce fiscal discipline, stabilising the currency by bolstering foreign exchange reserves, and adopting tight monetary policies to control the money supply. Although these measures caused short-term hardship, they successfully reduced inflation significantly by 2023. Sri Lanka's experience highlights the necessity of coordinated fiscal and monetary policies, coupled with structural reforms, to address inflation sustainably and effectively.

Figure 3: Sri Lanka and Pakistan have been able to curb inflation using contractionary policies

(a) Inflation in Sri Lanka (b) Inflation in Pakistan



Source: World Development Indicators (WDI), World Bank.

Pakistan, on the other hand, is confronting inflationary pressures stemming from a combination of currency devaluation, trade deficits, and political instability. The government adopted a contractionary monetary policy, raising policy rates to 22 per cent in 2023. It also implemented IMF-recommended fiscal reforms and restricted imports to reduce the trade deficit. These measures lowered inflation from 30 per cent in 2023 to 23 per cent in 2024 but came at a high cost, including reduced private investment and slower economic growth. Pakistan’s experience underscores the limitations of relying solely on monetary tightening, as it can entail significant trade-offs and leave structural inefficiencies unaddressed.

For Bangladesh, there are several key lessons to draw from the experiences of Sri Lanka and Pakistan. First, coordinated fiscal and monetary policies are essential for managing inflation effectively. Fiscal discipline must complement monetary tightening to ensure inflationary pressures are addressed holistically. Second, structural reforms are critical to resolving underlying economic inefficiencies, such as addressing supply chain bottlenecks and improving governance in key sectors. Finally, pre-emptive actions to stabilise the prices of essential commodities can help mitigate the social and economic impacts of inflation, ensuring that vulnerable populations are protected while the broader economy stabilises.

V. Balancing Contractionary Measures with Core Inflation-Based Monetary Policy

Bangladesh Bank recently raised the policy rate to 10 per cent to curb inflation by increasing borrowing costs and restricting credit availability. This contractionary monetary policy aims to suppress aggregate demand and control the money supply. However, such measures come with significant trade-offs, as higher borrowing costs discourage private sector investment, reducing the economy's productive capacity. This decline in investment, combined with efforts to control inflation, risks slowing economic growth and increasing the likelihood of stagflation—a challenging condition of stagnant growth and persistently high inflation.

A key limitation of the current approach lies in its reliance on Consumer Price Index (CPI)-based inflation metrics, which include volatile components such as food and energy prices. These fluctuations often distort the assessment of long-term price trends, leading to policy responses that may not address structural inflationary pressures. Transitioning to a core inflation-based framework, which excludes volatile components and focuses on persistent price trends, could enhance the effectiveness of monetary policy. Core inflation enables policymakers to differentiate between temporary price shocks and structural inflation, reducing the risk of overcorrection or misaligned policy interventions.

Countries like the United Kingdom demonstrate the advantages of such an approach, where the Bank of England uses core inflation as a key metric to guide monetary policy, ensuring interest rate adjustments are aligned with stable, long-term price trends. For Bangladesh, adopting a core inflation-based framework would allow the central bank to address underlying inflationary pressures more effectively without overreacting to short-term price volatility.

This shift could help mitigate the risks of stagflation by targeting structural factors while avoiding excessive borrowing costs that stifle investment and consumption. Furthermore, aligning monetary policy with long-term economic objectives would support sustained growth, critical for poverty reduction and improving living standards in a developing economy like Bangladesh.

VI. Complementary Measures to Control Price Hike of Essential Commodities

One of the fundamental limitations of monetary policy is its inability to directly address price volatility in essential commodities such as food and energy. To mitigate this, a joint working group comprising representatives from key ministries, including the Ministry of Commerce, the Ministry of Food, the Ministry of Agriculture, and the Bangladesh Bank, is essential to develop a comprehensive and proactive strategy for stabilising the prices of essential goods through inter-agency collaboration.

The working group's primary responsibilities would focus on stabilising the prices of essential commodities through three key strategies:

- Estimation of supply and demand: Reliable and well-informed data collection and analysis are crucial to estimate domestic production, consumption, and potential shortages. Anticipating supply-demand mismatches can help avert disruptions effectively.
- Proactive import strategies: Timely imports of essential items, such as wheat, rice, or edible oil, should be coordinated to avoid price surges. For example, early imports can shield domestic markets from projected global cereal stock declines and international price hikes.
- Market interventions: Active monitoring and intervention are essential to curb anti-competitive practices like hoarding and syndication, which inflate prices. Ensuring fair market practices would help prevent unwarranted price hikes that burden consumers.

Developing a Daily Necessity Index (DNI)

To better reflect the daily realities faced by households, Bangladesh should develop a Daily Necessity Index (DNI). This metric would track the price changes of 10–15 essential items frequently purchased by low- and middle-income households, such as rice, cooking oil, onions, eggs, and medicines, providing policymakers with real-time insights into cost-of-living pressures.

The DNI would serve three critical functions:

- Guide targeted social protection programmes by focusing resources on those most affected by rising prices.
- Assist in designing short-term fiscal measures, such as temporary subsidies or direct cash transfers, to alleviate inflationary pressures.
- Support better-informed fiscal and monetary policies by offering a nuanced perspective on immediate household challenges.

VII. Expanding Social Protection Alongside Contractionary Monetary Policy

While contractionary monetary policy, such as raising policy rates, is critical to curbing inflation, it must not come at the expense of support for the poor and vulnerable. In fact, the government should reallocate resources to expand social protection spending to ease off the pressure from these groups, providing targeted relief, while undertaking monetary policy efforts to contain the inflation.

The Annual Development Plan (ADP) for this fiscal year presents a valuable opportunity for reallocation, as historical trends and recent data consistently reveal a gap between budgeted targets and actual implementation, with the first half of the on-going fiscal year showing exceptionally sluggish progress that has been further exacerbated by disruptions linked to the recent political transition. Reducing ADP spending can serve as a practical fiscal policy adjustment, complementing monetary tightening by:

- Curbing aggregate demand: Lower ADP spending aligns with the contractionary objectives of monetary policy, reducing excess demand and inflationary pressures.
- Reducing deficit financing: A smaller ADP outlay reduces the need for deficit financing, which is particularly critical in a year focused on stabilising inflation.
- Enhancing social protection: Savings from reduced ADP allocations can be redirected to bolster social protection programmes, mitigating inflation's impact on vulnerable populations.

Table 2: Key social protection programmes to expand for enhanced inflation relief for poor and vulnerable Populations

Programme name	Allocation for FY2025 (Crore BDT)	Additional funding required to double the current allocation (as share of ADP, %)
Food friendly Programme	3,257.98	1.23
Open market sales (OMS)	2,004.22	0.76
Food for work	1,024.01	0.39
Old age allowances	4,350.97	1.64
Allowances for physically challenged persons	3,321	1.25
Vulnerable group feeding (VGF)	1,747.84	0.66
Vulnerable women benefit (VWB) programme	2,195.46	0.83
Allowances for widow, deserted and distressed women	1,844.32	0.70
Mother and child benefit program	1,622.75	0.61
Total	21,368.55	8.06

Source: Author's construction.

For instance, a modest 2.3 per cent reallocation of ADP spending could double the funding for three major food-based social protection programmes, while an 8 per cent reallocation could double resources for nine critical schemes. These targeted adjustments would ensure that the fight against inflation does not exacerbate hardships for those already at risk, while still aligning with broader fiscal and monetary objectives. This integrated approach underscores the importance of balancing inflation control with safeguarding social equity, ensuring that economic stabilisation efforts do not leave poor and vulnerable populations behind.

VIII. Policy Recommendations

To comprehensively address inflation while safeguarding the poor and vulnerable, this policy brief recommends the following actions:

- Transition to core inflation-based monetary policy: Shift the focus from Consumer Price Index (CPI)-based inflation, which includes volatile items like food and energy, to core inflation. Core inflation provides a clearer understanding of underlying price trends and supports the formulation of long-term monetary policies that stabilise the economy without overreacting to short-term fluctuations.

- Enhance social protection spending: Prioritise the expansion of social protection programmes to mitigate the impact of inflation on the poor and vulnerable. Reallocate resources from underutilised Annual Development Plan (ADP) spenditure to scale up food-based social protection schemes and cash transfer programmes.

- Strengthen fiscal and monetary policy coordination: Improve collaboration between fiscal and monetary authorities to implement complementary measures that stabilise the economy. Establish a joint task force involving key ministries and the central bank to monitor supply-demand trends, stabilise essential commodity prices, and address anti-competitive practices like hoarding and syndication.

- Develop a daily necessity index (DNI): Create a DNI to track price changes in 10–15 essential items frequently consumed by low- and middle-income households. The DNI would offer policymakers real-time insights into cost-of-living pressures and serve as a basis for guiding social protection programmes, short-term fiscal interventions, and inflation-focused reforms.

- Adopt structural fiscal reforms: Reduce the reliance on deficit financing by rationalising government spending, particularly by limiting inefficiencies in the ADP. Redirect savings to targeted subsidies or direct cash transfers for vulnerable populations, ensuring fiscal responsibility without compromising social equity.

- Balance monetary tightening with private sector support: Avoid crowding out private sector investment by ensuring that contractionary monetary policies are accompanied by measures to sustain productive capacity. Provide incentives and targeted support for private enterprises to maintain economic growth while addressing inflation.

Inflation remains a significant economic challenge for Bangladesh, posing risks to both economic progress and social stability. While contractionary monetary policies are necessary to curb inflation, their limitations—particularly in addressing volatile commodity prices—underscore the need for a broader, more integrated approach.

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