

Financial Markets

6.1 A healthy, transparent and dynamically evolving financial system helps mobilize savings and allocate resources, ensure safe and efficient payment and settlement arrangements and ease financial crisis management. Efforts continued in FY08 to establish a healthy and transparent financial system in the country. In addition to the challenges emanating from the internal and external shocks that affected the real sector, there were signs of strain both in the interbank call market and forex market. Volatility in these two markets was tamed through repo operation and intervention by the Bangladesh Bank.

Money Market

6.2 Money market, the important segment of financial market that basically channelizes the short term fund in the country was quite active and vibrant with the participation of both banks and non-bank financial institutions during FY08. The major participants in the money market were commercial banks, development finance institutions (DFIs) and non-bank financial institutions operating in the country. Bangladesh Bank, as the leader of the money market and armed with the instruments of monetary management, effectively controlled and guided the institutions of the money market during FY08. With limited diversified instruments, the organized money market in Bangladesh achieved a remarkable development in the recent years. During FY08, efforts were continued with a view to establishing a well functioning and stable money market. Efficient monetary operation, especially the use of shorter term monetary instruments such as repo, reverse repo, collateralized continuous liquidity support from Bangladesh Bank to the primary dealers and Bangladesh Bank Bills

Table 6.1 Volume of trade and weighted average interest rates in call money market in FY08

Month/Year	Volume of trade (billion Taka)	Weighted average interest rates (%)
Jul-07	404.5	7.0
Aug-07	436.5	6.9
Sep-07	399.8	6.9
Oct-07	458.1	7.1
Nov-07	508.9	7.1
Dec-07	365.9	9.3
Jan-08	377.4	9.6
Feb-08	360.6	9.0
Mar-08	402.8	12.9
Apr-08	326.0	14.8
May-08	370.1	13.5
Jun-08	569.3	9.7
FY08	4979.9	9.3

Source : Forex Reserve & Treasury Management Department, Bangladesh Bank.

helped to keep the money market sound and stable during the financial year 2008. A number of steps were taken for activation of secondary trading in treasury bills/bonds. As a result, the overall money market situation was moderate during FY08. Developments in the money market during FY08 are summarized below:

Call Money Market

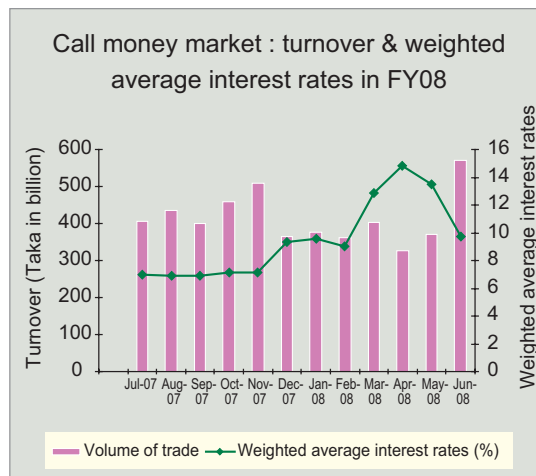
6.3 The volume of transactions in the call money market depicted a mixed trend during FY08 (Table 6.1) reflecting some brisk activities in the money market particularly during the second quarter of the year. It remained sluggish

in the third quarter of FY08 and crept up slowly since then. The volume of transactions, however, increased at the end of the year. On the other hand, the weighted average interest rates in the call money market started increasing from March 2008 and by end June 2008 it came down. Credit growth driven by the appetite of a rapidly growing economy amid revival of economic and business activities created some liquidity pressure in the banking system. In order to fine tune the liquidity situation, BB provided adequate support to keep overall call money rate reasonably stable through repo and liquidity support to the primary dealers. As a result the weighted average interest rates in the call money market moved within the range of 6.90 percent to 14.8 percent during FY08 (Table 6.1 and Chart 6.1).

Repo Auctions - FY08

6.4 The repo injects required money in the system, and provides banks with necessary funds to maintain their liquidity. While pursuing a prudent monetary policy, Bangladesh Bank kept this window open for the banks to maintain the market liquidity at desired level. In FY08, the daily repo auctions in Bangladesh Bank continued to facilitate liquidity management within a short period of time by enabling the banks to place bids for funds collateralised by T-bills, T-bonds and Bangladesh Bank Bills. A total of 73 repo auctions were held during FY08.

Chart 6.1



received, of which 313 bids for a total of Taka 182.4 billion were accepted. During FY07, 17 bids for Taka 44.2 billion were received, of which 6 bids for Taka 10.7 billion were accepted. The volume of accepted bids increased 17 times during FY08 (Table 6.2). The interest rate against the accepted bids was 8.5 percent per annum in FY08 as against interest rate range of 8.0-9.0 percent per annum in the previous year.

Reverse Repo Auctions - FY08

6.5 While the repo injects money in the system, the reverse repo takes it away from the

Table 6.2: Repo auctions - FY08

Total No. of auctions held during the year	Tenor	Bids received		Bids accepted		Interest rates of the accepted bids (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)	
73	1-Day/2-Day	125	95.3	92	77.7	8.5
	3-Day/9-Day	251	119.6	221	104.7	8.5
	Total	376	214.9	313	182.4	8.5*

Source: Monetary Policy Department, Bangladesh Bank.
* Overall interest rates of different tenors.

reverse repo auctions continued in FY08. The reverse repo auctions were used to maintain intended level of liquidity in the market to keep up monetary aggregates on track. A total of 150

daily reverse repo auctions were held in FY08 which included reverse repo auctions against sale of foreign exchange to AD banks for financing oil imports. In all, 1688 bids of 1-2 day

Box 6.1

Inclusive Financial Sector Development

In many developing countries, small and medium enterprises (SMEs) and micro entrepreneurs face severe financing constraints. But with access to finance, they can involve fully in the economic activities, create employment for themselves and others and realize their full potentials. Where such business is given opportunities to develop, countries will have a better chance to flourish. Indeed, the importance of access to financial services was recognized by world leaders at the 2005 World Summit. It is felt that inclusive financial sector can go a long way toward breaking the vicious circle of poverty. Inclusive financial sector is nothing but providing of financial services at a reasonable cost to the poor and low income people. While appreciating the variety of approaches, the richness of diverse experiences and the differing policies among countries, one may discern a vision of inclusive financial sector development.

Inclusive financial sector development refers to broad availability of financial services and credit to financially excluded sections of the society. The access to the financial services is basically needed for low income households and small firms. Small deposits and loans for these groups can affect the financial sector. Therefore, credit to micro, small and medium enterprises along with national savings schemes for low and middle income people are essential for development of the financial sector. Banks and financial institutions can play effective role on facilitating financial services for the unprivileged groups through appropriate instruments including special savings and credit schemes.

A simple yardstick to measure the degree of access to the financial services is the number of deposit accounts held as a ratio to population and the number of advances accounts as a ratio to population. In Bangladesh context, the ratio of deposit accounts as on 30 June 2008 was 26 percent and the ratio of advances accounts was 6 percent. The spread of banking facilities is, thus, uneven in Bangladesh with a substantial proportion of the households, specially in rural areas, still outside the coverage of the formal banking system and is unable to access mainstream financial products such as bank accounts and low cost loans. Such households are linked to use the informal market at high interest rates.

In Bangladesh, the access of people involved in agriculture who mostly live in rural areas to banking services is not sufficient with respect to their contribution to GDP. In FY08 the share of agriculture sector in GDP was 24 percent whereas the share of advances in total advances to this sector stood at 7 percent as of June 2008. It may be mentioned that in terms of opening bank branches, it has been made mandatory that one in five branches must be in rural areas to encourage bank business there. But the capacity of mobilizing savings and disbursing loans in the rural areas is very poor in spite of the existence of 58 percent of total bank branches in that areas. The shares of rural bank branches in total deposits and advances were 13 percent and 8 percent respectively as of June 2008 which indicating a very low exposure of rural people to the formal banking system. Besides, a large portion of the population of low income brackets both in rural and urban areas has a limited reach of the financial services. Therefore, some initiatives and incentives are required to breaking down the impediments to access to financial services for low and middle income people. Financial services should be provided on a sustainable basis. Besides, promotion of financial literacy may increase access as well as the ability of customers to get the financial services they need on terms

In Bangladesh, financing SMEs from banking sector is a long standing demand that has been high on the agenda of the economists and the policymakers. Despite significant improvement in SMEs resulting from the priority given to the sector with the government's poverty reduction agenda and recognizing it as a thrust sector, increasing the access of the SMEs sector to required finance still faces several challenges. The current level of support is not adequate and the sector needs more resources to support new and potential SMEs. Recently, Bangladesh Banks has taken some measures to increase the access of entrepreneurs of SMEs to banking services which are as follows:

- For the necessity of strengthening, encouraging and expanding SME sector, fund for refinance scheme for small enterprise sector has been raised from Taka 3 billion to Taka 5 billion with effect from 12 June 2008.
- With a view to ensuring balanced and organized development in the country, fund allocation for women entrepreneurs under the refinance scheme has been raised from 10 percent to 15 percent. Out of this 15 percent, 40 percent will be allocated for small women entrepreneurs.
- In order to expand credit in small and medium sectors, banks/financial institutions have been advised to take assistance of NGOs in selection of borrowers, disbursement and recovery of credit in order to reduce supervision cost in credit disbursement and recovery.
- Banks are advised to open limited number of SME service centres only in such area where no branch of the same bank exists.

Microcredit programmes (MCPs) in Bangladesh are implemented by various formal institutions (state owned commercial banks and specialized banks), specialized government organizations and non-governmental organizations. The total coverage of MCP is approximately 33.0 million borrowers while near about 90 percent of the clients of this sector are female. Microcredit is increasingly gaining credibility in the mainstream finance industry and many traditional large finance organizations are contemplating microcredit projects as a source of their future growth.

Due to the heterogeneity of socio-economic structures there are diverging views and different solutions in different countries. So, individual countries need to design their own national strategies for inclusive financial sector development. In Bangladesh, it is imperative to design a sustainable long-run strategy regarding inclusive financial sector for overall economic development of the country.

and 3-7 day tenors for a total of Taka 1358.5 billion were received, of which 1597 bids amounting to Taka 1290.5 billion were accepted. During FY07, 4020 bids for Taka 2939.7 billion were received, of which 4019 bids

Lower volumes were seen in the reverse repo market during FY08. The interest rate against the accepted bids remained unchanged at the previous year level of 6.5 percent per annum during FY08 (Table 6.3).

Table 6.3: Reverse repo auctions-FY08

Total No. of auctions held during the year	Tenor	Bids received		Bids accepted		Interest rates of the accepted bids (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)	
150	1-Day/2-Day	1171	946.6	1113	896.9	6.5
	3-Day/7-Day	517	411.9	484	393.6	6.5
	Total	1688	1358.5	1597	1290.5	6.5*

Source: Monetary Policy Department, Bangladesh Bank.
* Overall range of the rates of different tenors.

Bangladesh Bank Bills Auctions

6.6 Bangladesh Bank reintroduced 30-day and 91-day Bangladesh Bank Bills in October 2006 as the monetary policy instruments following decision that Government treasury bills/bonds auctions will exclusively be used for Government debt management. However, the auction of 91-day Bangladesh Bank Bill was discontinued to avoid its duplication with 91-day Government treasury bill from 8 January 2008. There was also no auction of 30-day Bangladesh Bank Bill from 8 January 2008.

6.7 The results of auctions of Bangladesh Bank Bills in FY08 are summarized at Table 6.4. Bidders preferred the shorter (30-Day) tenor BB Bill because of its suitability in meeting SLR

requirement of the banks and financial institutions. Twenty eight auctions of BB Bills were held in FY08. A total of 255 bids amounting to Taka 111.4 billion were offered in those auctions, of which 245 bids for a total of Taka 109.0 billion were accepted. The weighted average annual yield for BB-bills ranged from 7.34 percent to 7.63 percent. There were no outstanding bills as of end June 2008 although the amounts of outstanding bills were Taka 28.3 billion as of end June 2007.

Government Securities Market

Government Treasury Bills Auctions

6.8 Market based system of auctions of Government Treasury Bills (T-bills) which was introduced in FY07 through publishing auction

Table 6.4 Auctions of Bangladesh Bank Bills - FY08

Total No. of auctions held during the year	Tenor of bills	Bids offered		Bids accepted		Outstanding bills as of end June 2008 (billion Taka)	Yield range* (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)		
28	30-Day	252	110.0	242	107.6	-	7.34-7.40
	91-Day	3	1.4	3	1.4	-	7.62-7.63
	Total	255	111.4	245	109.0	-	7.34-7.63@

Source: Monetary Policy Department, Bangladesh Bank.
* Range of the weighted average annual yield of the accepted bids.
@ Overall range of Bangladesh Bank Bill of different terms.

calendar containing date and amount of auctions continued in FY08. For matching the tenor of T-bills with international convention, the central bank dropped the 2-year tenure T-bill from its regular auction in the line with the Cash and Debt Management Committee's recommendations. Earlier the auction of 5-year T-bill was discontinued in FY04. Therefore, 28-day, 91-day, 182-day, and 364-day treasury bills continued to be the main instruments for weekly auctions of Government treasury bills during the year under report. The objective for issuing these securities is to provide a mechanism for financing of the government deficit at lower cost according to volumes pre-announced in the borrowing calendar.

6.9 Results of Treasury bills auction in FY08 are summarized at Table 6.5. The bidder's preference of short term T-bill (28-day) remained unchanged because of its suitability in meeting their SLR requirements as well as its

considerable return for a shorter period. The volume of overall offered bids increased although the volume of the accepted bids declined during FY08. A shift in the bidder's preference to the 91-day, 182-day, and 364-day tenor bills was also significant.

6.10 Depending on the liquidity conditions in the money market, the cut off yields of T-bills of different maturities varied within wide ranges. The yields for various tenors as of end June 2008 depicted somewhat narrower range (7.28-8.48%) than the yields as of end June 2007 (7.10-9.34%). A total of 2681 bids amounting to Taka 646.9 billion were received, of which 972 bids amounting to Taka 438.7 billion (including Taka 213.8 billion as devolved amount) were accepted. The weighted average yield-to-maturity against the accepted bids ranged from 7.28 percent to 8.48 percent in FY08.

Table 6.5 Auctions of government treasury bills - FY08

Tenor of bills	Bids offered		Bids accepted		Outstanding bills as of end June 2008 (billion Taka)	Yield range*(%)
	No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)		
28-Day	1253	410.2	584	165.6	20.0	7.28-7.50
91-Day	724	140.9	194	31.8	23.3	7.61-7.74
182-Day	316	44.0	83	12.8	16.4	7.89-7.97
364-Day	388	51.8	111	14.7	33.5	8.42-8.48
2-Year	-	-	-	-	4.0	-
5-Year	-	-	-	-	16.5	-
Devolvement to BB/PD				213.8		
Total	2681	646.9	972	438.7	113.7	7.28-8.48

Source: Monetary Policy Department, Bangladesh Bank.

* Range of the weighted average annual yield of the accepted bids.

Bangladesh Government Treasury Bonds (BGTBs) Auctions

6.11 Treasury Bonds, bearing half yearly interest coupons, with tenors of 5-year, 10-year, 15-year and 20-year are auctioned in every month. These instruments have been used as the ancillary instruments for Government debt management (Box 6.2). Forty eight auctions of these instruments were held in FY08. A total of 1147 bids for Taka 269.3 billion were received

of which 305 bids for Taka 104.0 billion were accepted. The amount of outstanding bonds was more than doubled stood at Taka 192.7 billion at the end of June 2008, against Taka 86.7 billion at the end of June 2007. The coupon rate for the Treasury Bonds ranged from 10.60 percent to 15.95 percent. It was found that the coupon rate on all tenors of T-bonds decreased sharply during the year, as was expected. The movement of the weighted average yield-to-maturity of all the T-bonds are given in Table 6.6.

Table 6.6: Auctions of Bangladesh government treasury bonds - FY08

Total No. of auctions held during the year	Tenor of bonds	Bids offered		Bids accepted		Outstanding bonds as of end June 2008 (billion Taka)	Weighted average yield range* (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)		
48	5-Year Devolvement to BB/PDs	299	84.6	67	18.8	78.4	10.60-10.82
	10-Year Devolvement to BB/PDs	332	102.8	98	21.2	96.3	11.71-12.17
	15-Year Devolvement to BB/PDs	267	47.8	72	18.1	12.0	12.22-14.00
	20-Year Devolvement to BB/PDs	249	34.1	68	6.7	6.0	13.08-15.95
					3.3		
					5.9		
	Total	1147	269.3	305	104.0	192.7	10.60-15.95@

Source : Monetary Policy Department, Bangladesh Bank.
* Range of the weighted average annual yield of the accepted bids.
@ Overall range of treasury bonds of different terms.

Box 6.2

Government Bond Market in Bangladesh

To mobilize long-term fund for financing government expenditure programme Bangladesh Government Treasury Bonds (BGTB) under Public Debt Rules 1946 with maturity of 5, 10, 15 and 20 years have been introduced. The Bonds are being issued at par through yield-based multiple price auction held in Bangladesh Bank. The Bonds are redeemable at maturity as well as freely tradable in secondary market. The salient features of the Bonds are follows:

1. Individuals and institutions residents in Bangladesh are eligible to purchase BGTB.
2. Non-residence individuals and institutions are also eligible to purchase these with fund from non-resident foreign currency account with a bank in Bangladesh in the name of the investor. These cannot be resold to a resident within one year of purchase.
3. The Bonds are issued at coupon rates which are determined at their auction dates and are payable at six monthly interval from the date of issue.
4. Bonds are eligible for SLR of the banks and financial institutions.
5. Primary issues of the BGTBs shall be sold by BB in auctions as per auction calendar announced prior to each financial year and also as per auction notice announced one week prior to each auction.
6. Banks and financial institutions maintaining current account with the BB for Cash Reserve Requirement (CRR) fulfillment, including those designated for secondary trading as PDs, may submit bids on own account and on behalf of other clients.
7. The bids shall be for face value amount in multiples of Taka 1.00 lac. The bidding bank/financial institution must ensure sufficient balance in excess of CRR in its current account with the BB to cover the full purchase price and premium if any.
8. Separate bids shall be submitted for BGTBs of different maturities. Bids in sealed covers shall be received upto 10.00 AM on the auction date at the Public Debt Office at BB, Motijheel Office. The bids shall be opened at 11.00 AM on the same day and placed before the Auction Committee. The Committee shall accept bids in ascending order of yields upto the intended volume of issue. Results of the auction shall be announced by 3.00 PM on the auction day. BGTBs shall be issued against the accepted bids on the following day by debiting the current accounts of the bidders with the BB for the purchase price.
9. BGTBs purchased in primary issues through auctions may subsequently be traded freely. The PDs shall undertake such secondary purchase and sale, quoting two-way prices.

Government Bond Market in Bangladesh

(Contd.)

10. The PDs shall report their secondary market trading of BGTBs to BB Motijheel Office on a daily basis, separately for each issue, from the date of issue in first auction. Other banks and financial institutions shall use the same form for reporting their total holdings, on a weekly basis.
11. Shut period for transfer transactions shall commence three days before each due date of half yearly coupon payment on a BGTB issue. No transfer effected over this shut period shall be accepted.
12. Redemption of face value at maturity: Shut period on transfer transactions shall commence three days before the maturity date of a BGTB issue and all accountholders of the issue under redemption shall be sent letters in Form BGTB-10 asking them to return duly signed receipt of Form BGTB-11 along with position statement in Form BGTB-8 for reconciliation of their balances maintained with the BB. On the maturity date the face value on the reconciled balances shall be credited to the current accounts of the concerned banks and financial institutions with the BB, by debit to Government account.

Bangladesh Government Islamic Investment Bond (Islamic Bond)

6.12 The operation of 6-Month, 1-Year and 2-Year Bangladesh Government Islamic Investment Bond (Islamic Bond), introduced in FY05, in accordance with the rules of Islamic Shariah, continued in FY08. As per the rules, Bangladeshi institutions and individuals and non-resident Bangladeshis, who agree to share profit or loss in accordance with Islamic Shariah, may buy this bond. As of end June 2008 the total sale against this bond amounted to Taka 15.58 billion while balance of total amount of financing stood at Taka 15.55 billion and the net outstanding against the bond stood at Taka 0.03 billion. As of end June 2007 the total sale against this bond was taka 14.8 billion against the balance of total financing of Taka 6.6 billion and the net outstanding of Taka 8.3 billion.

Capital Market

Investment Financing in Bangladesh: Minor Role of Capital Market

6.13 The amount of industrial term loans disbursement by banks and financial institutions stood at Taka 201.5 billion, many-fold higher than the amount of Taka 7.4 billion raised by new capital issues through private placements and public offerings in the capital market in FY08. This indicates the overwhelming preference of bank finance in industrial investment financing. The Taka 400.9 billion outstanding balances of industrial term loans of

banks and financial institutions as of end June 2008 was, however, lower than the Taka 964.8 billion market capitalization of the securities listed in the Dhaka Stock Exchange (Tables 6.7 and 6.8). However, market capitalization of the companies (manufacturing and services) amounting to Taka 289.3 billion remained far below the outstanding level of industrial term loan financing by the banks and financial institutions.

6.14 The dominance of term loans in investment financing implies low equity stake and risk exposure of the owners, with disproportionately high incidence of risk on the lending banks and financial institutions, including liquidity risk arising from the funding of these long-term loans with typically shorter-term deposits.

6.15 The share market witnessed a robust growth during FY08 supported by strong economic prospect and outlook. As there is demand of securities having good fundamentals in the capital market, at the time of rise in demand, the price of securities listed on exchanges showed a remarkable upward trend that turned the capital market strong. On the other hand, major economic indicators showed a positive trend to support the gradual development of the market. As a result, all the indicators of the capital market increased in FY08 as compared to FY07. The capital market was so active during FY08 because of significant improvements made in protecting investors' interest and boosting confidence of

investors in capital market, introduction of automated trading through electronic registration and transfer of securities, simplifying rules and regulations and notifying guidelines on corporate governance on comply or explain basis. These measures created investment friendly atmosphere in the capital market and positive impact noticed in both primary and secondary market. Thus, the depth of share market and daily turnover of securities transactions have notably increased. Besides, positive public perception about the Bangladesh Bank supervision of banks and financial institutions in addition to the general Securities and Exchange Commission (SEC) supervision of public companies continued to attract strong investor interest in the new capital issues of banks and financial institutions. This reawakened investor confidence in the capital market should extend to new issues of listed companies in other economic sectors with stronger SEC supervision, more demanding audit and financial disclosure standards, and credit rating of issuers by independent rating agencies.

Capital Market Activities in FY08

Primary Issuance

6.16 Twelve companies raised new equity of Taka 7.4 billion in the primary market in FY08, higher than the Taka 3.1 billion raised by the same number of companies in FY07. Of the new equity issued, Taka 1.5 billion raised through private placement and Taka 5.9 billion (of which Taka 2.4 billion was collected by three SOEs from the capital market in direct listing opportunities) through public offerings in FY08 as against Taka 0.04 billion raised through private placements and Taka 3.1 billion through public offerings in FY07.

6.17 The volume of public offerings in FY08 was predictably oversubscribed more than four times indicating the high demand of new securities in the primary market. Bonus shares valued at Taka 9.2 billion were issued in FY08 by seventy-one companies against retained profits, higher than the Taka 6.8 billion issued in FY07 by fifty companies.

Table 6.7 Industrial term loans of banks and financial institutions

(billion Taka)

Particulars	FY06	FY07	FY08 ^P
i. Disbursement	96.5	123.9	201.5
ii. Recovery	67.6	90.7	136.2
iii. Outstanding (End June)	273.8	337.2	400.9

Source : Agricultural Credit and Special Programmes Department, Bangladesh Bank.
P= Provisional.

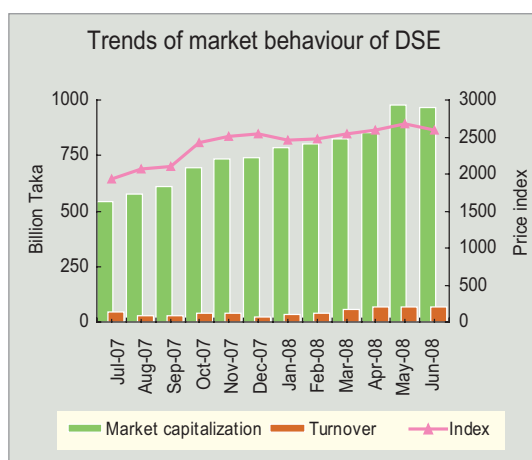
Table 6.8 Dhaka Stock Exchange (DSE) activities

Particulars	End June		
	FY06	FY07	FY08
i. No. of listed securities*	303	325	378
ii. Issued equity and debt* (billion Taka)	85.7	164.3	284.4
iii. New equity through private placement & IPOs (billion Taka)	1.7	3.1	7.4
iv. Market capitalization (billion Taka)	225.3	491.7	964.8
v. Turnover in value (billion Taka)	46.0	164.7	543.3
vi. Turnover in volume (no. in billion)	0.6	2.0	3.8
vii. All-share price Index	1339.5	1764.2	2588.0

Source : Dhaka Stock Exchange.

* Including companies, mutual funds, debentures and Government Treasury Bonds.

Chart 6.2



Secondary Market Activities

6.18 Market capitalization inclusive of new issues increased remarkable by 96.2 percent in Dhaka Stock Exchange and 94.8 percent in Chittagong Stock Exchange in FY08 than that of FY07 (Tables 6.8 and 6.9). In FY08, the amount of market turnovers in the secondary market also increased by 229.9 percent and 134.5 percent respectively at the Dhaka and Chittagong Stock Exchanges. The securities market got a momentum during the year under report when both local and foreign investors took part in the trading of securities in wide scale. As a result, all indicators of the stock market increased notably in FY08. In FY08, all-share price index in Dhaka and Chittagong exchanges also increased by 46.7 percent and 74.2 percent respectively. Day to day changes in price indices and market capitalization in FY08 mainly reflected local conditions with a momentous response during the year under report (Chart 6.2).

Non-resident Portfolio Investment

6.19 In FY08, gross investment inflow in shares and securities of the stock exchanges by non-residents through NITA stood at Taka 11.3 billion and gross outflow as repatriation of sale proceeds of Taka 7.3 billion. Gross investment inflow was Taka 8.4 billion and repatriation of sale proceeds was Taka 1.5 billion in FY07. From the beginning (April 1992) to till June 2008 the gross investment inflow stood at Taka 30.5 billion against gross outflow as repatriation of sale proceeds of Taka 21.9 billion.

Activities of the ICB

6.20 The three subsidiaries of state-owned Investment Corporation of Bangladesh (ICB) namely the ICB Capital Management Ltd (ICML), the ICB Asset Management Company Ltd. (IAMCL) and the ICB Securities Trading Company Ltd. (ISTCL) under on going restructuring programme of the capital market development programme (CMDP) are functioning in the capital market in Bangladesh. The ICB capital management subsidiary ICML

Table 6.9 Chittagong Stock Exchange (CSE) activities

Particulars	End June		
	FY06	FY07	FY08
i. No. of listed securities*	213	219	231
ii. Issued equity and debt* (billion Taka)	63.8	81.0	102.2
iii. Market capitalization (billion Taka)	195.6	398.5	776.1
iv. Turnover in value (billion Taka)	11.4	34.2	80.2
v. Turnover in volume (no. in billion)	0.25	0.59	0.74
vi. All-share price Index	2879.2	5194.8	9050.6

Source: Chittagong Stock Exchange.
* Including companies, mutual funds and debentures.

acted in the roles of underwriter, issue manager of investment account, portfolio manager and placement services provider. In FY08, the net investment against the investors' accounts stood at Taka 2.57 billion while deposit received stood at Taka 3.06 billion. The net investment of company's own portfolio stood at Taka 0.61 billion and the market prices of which stood at Taka 0.58 billion as on end June 2008. The ICB asset management subsidiary IAMCL floated four closed-ends and two open-end mutual funds up to end June 2008 and the net investment in the portfolios of the six funds stood at Taka 0.55 billion and the market prices of which stood at Taka 1.85 billion. Besides, from IAMCL own financing the net investment of the mutual funds stood at Taka 0.21 billion and the market prices of net investment stood at Taka 0.47 billion as on end June 2008. The ICB securities trading subsidiary ISTCL emerged as the largest stockbroker in the country handling total turnover worth Taka 60.58 billion in FY08 which was 10.1 percent of total turnover of both DSE and CSE. The parent ICB itself sold unit certificates amounting Taka 0.21 billion against repurchased of unit certificates amounting Taka 0.30 billion in FY08. In FY08 the ICB received deposits of Taka 0.33 billion and approved loans of Taka 2.1 billion in investment accounts of investors. The volume of securities traded in FY08 by the ICB was Taka 43.12 billion against Taka 13.06 billion traded in FY07. Total commitments for investment made by the ICB in FY08 stood at Taka 4.65 billion, of which, for

pre-IPO placement of share and debenture Taka 0.60 billion and Taka 0.46 billion respectively, purchase of preference share Taka 0.45 billion, investment in equity Taka 0.21 billion, purchase of debentures Taka 1.17 billion, investment in bond Taka 0.54 billion and in lease financing Taka 1.22 billion. In FY07 the total amount of commitments was Taka 4.32 billion.

Scheduled Banks Investment in Capital Market Securities

6.21 Holdings of capital market assets (equities, debentures) by scheduled banks stood at Taka 43.1 billion as of end June 2008 as against Taka 32.9 billion as of end June 2007. Outstanding advances of scheduled banks against shares and securities amounted to Taka 6.3 billion as of end June 2008, which was Taka 2.9 billion as of end June 2007.

Measures Supporting Capital Market Development

6.22 The Securities and Exchange Commission (SEC) undertook following measures to strengthen capital market during FY08:

- ❖ Ensured that no sponsor or director shares of 'Z' category companies, excluding bank, insurance and financial institutions, are transacted on the stock exchanges or transferred outside the stock exchanges in any other form until further order with a view to facilitating the interest of investors and securities market.
- ❖ Decision was taken that the existing price limit prescribed for A, B, G, and N-category companies shall also be applicable for 'Z'-category companies.
- ❖ Re-fixed the maximum rate of margin loan @1:1 for Merchant Banker (Portfolio Manager). Based on this, Merchant Banker can provide loan to their clients up to that ratio or equivalent to the amount of securities sold by its clients with effect from 10 February 2008 until further order.
- ❖ 205 enforcement actions were by the Commission against the issuers and other

market intermediaries who failed to comply with the securities related rules during FY08.

- ❖ Started a project named "Improvement of Capital Market Governance Programme" funded by ADB and GoB to improve the governance scenario of Bangladesh capital market.
- ❖ Initiatives were taken to set up an oversight body named "Financial Reporting Council" to ensure on time preparation of financial statements by the issuers reflecting true state of financial affairs of issuer companies and also to ensure objective auditing of the same by statutory auditors in adherence to International Standard on Auditing.
- ❖ Decision was taken to establish a securities training institute named "Bangladesh Institute of Capital Market" to improve the knowledge of investors, intermediary institutions and to improve the corporate governance in the listed companies in association with other stakeholders.

During FY08, Mudaraba Perpetual Bond amounting Taka 1.5 billion was issued by Islami Bank Bangladesh Limited according to an accord between SEC and Islami Bank Bangladesh Limited on 10 July 2007. Besides, the Commission approved issuance of prospectus of ICB AMCL second NRB Mutual Fund and "Grameen One: Scheme 'Two'" - the second scheme of Grameen Mutual Fund One during FY08.

6.23 The measures declared in the national budget of FY08 in support of capital market development included:

- ❖ Decision has been taken to offload shares of State-owned Enterprises (SoEs) under power, telecommunication and energy sectors.
- ❖ Imposition of 45 percent corporate tax on mobile phone companies if they do not get listed on the stock exchanges instead of 35 percent corporate tax.
- ❖ Tax rebate facility to the non-resident Bangladeshi investors has been extended.

- ❖ Exemption of income from zero-coupon bonds.
- ❖ Abolition of provision of all upfront and advance tax on government bonds.

Credit Market

Advances of Scheduled Banks by Economic Purposes

6.24 Total advances of scheduled banks showed an upward trend during FY08 (Table 6.10). Total advances of scheduled banks stood at Taka 1815.5 billion at the end of June 2008 which is 23.9 percent higher than the total advances of Taka 1465.7 billion in FY07. In recent years, significant changes have been taking place in the trends in total bank advances classified by economic purpose. Of the total advances, transport and communication sector recorded the significant improvement by 37.6 percent, followed by trade sector 31.7 percent, industry sector 22.4 percent, working capital financing 15.2 percent, agriculture, fishing and forestry sector 12.2 percent, construction sector 11.0 percent and other sectors 32.6 percent in FY08 as compared to FY07. Sector-wise share of total advances showed that the trade sector played the main role (35.3 percent) and industry sector played the second fiddle (20.3 percent), followed by advances for working capital financing (18.1 percent), agriculture, fishing and forestry (6.7 percent), construction (6.4 percent), transport and communication sector (2.2 percent) and other sectors (11.0 percent) in FY08. Sector-wise contribution of total advances is reported in Chart 6.3.

Industrial Term Loans of Banks and Financial Institutions

6.25 Disbursement and recoveries of industrial term loans by banks and financial institutions increased by 62.6 percent to Taka 201.5 billion and by 50.2 percent to Taka 136.2 in FY08. The outstanding balance showed a positive growth of 18.9 percent as of end June of 2008. The overdues increased in FY08 and as a percent of outstanding also increased to 12.4 as of end June 2008 (Table 6.7).

Table 6.10 Advances of scheduled banks by economic purposes

Sector	End June		
	FY06	FY07	FY08 ^P
1. Agriculture, fishing and forestry	113.5	109.0	122.3
2. Industry	244.8	301.1	368.6
3. Working capital financing	258.0	285.1	328.3
4. Construction	86.7	105.1	116.7
5. Transport & communication	19.6	28.7	39.5
6. Trade	437.6	486.2	640.5
7. Others	131.5	150.5	199.5
Total	1291.7	1465.7	1815.5

Source: Statistics Department, Bangladesh Bank.
P= Provisional.

Chart 6.3

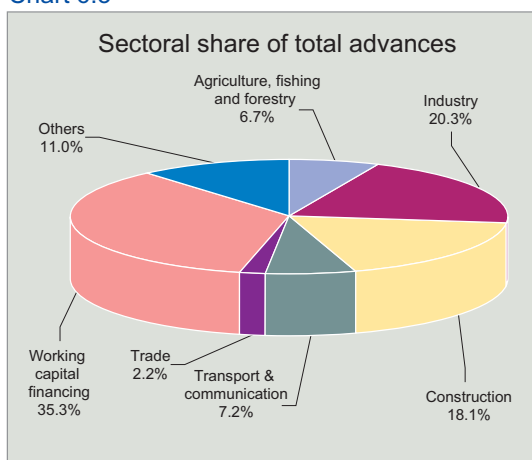
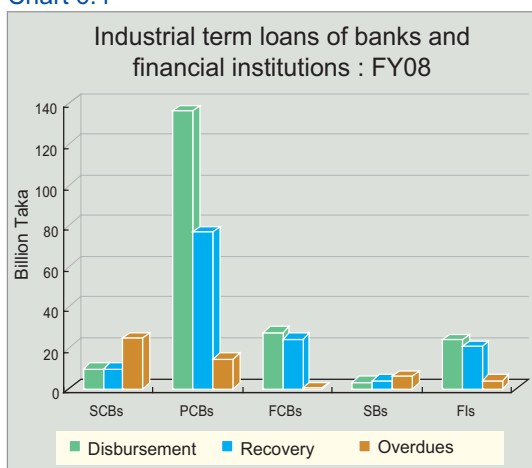


Chart 6.4



6.26 The four SCBs and five state-owned specialized banks together had Taka 105.1 billion (26.2 percent) share of the total Taka 400.9 billion outstanding loans as of end June 2008, making them major players in industrial term lending (Table 6.11, Chart 6.4). However, with very high levels of past overdues, their actual role in current lending is quite minor, they disbursed only Taka 13.2 billion (6.6 percent) out of total Taka 201.5 billion disbursed in FY08. In relation to disbursement, private commercial banks were the major shareholders (Taka 136.5 billion) in FY08, followed by foreign banks (Taka 27.9 billion), non-bank financial institutions (Taka 23.9 billion), SCBs (Taka 9.8 billion) and state-owned five specialized banks (Taka 3.4 billion).

6.27 The foreign banks had very low overdues (1.7 percent as of end June 2008), the overdues were low also for non-bank financial institutions (6.4 percent), followed by private commercial banks (6.7 percent). In FY08 overdues of the SCBs and the specialized banks were very high (30.6 percent and 25.8 percent), compared to 24.9 and 24.2 percent respectively of previous year.

6.28 As BKB and RAKUB are agriculture sector lenders have insignificant role in industrial term lending. The specialized industrial sector lenders with extremely high overdues concentrated in the recent years on recovery rather than fresh term lending. In

Lender	Disbursement		Recovery		Outstanding		Overdues		Overdues as % of outstanding	
	FY07	FY08 ^P	FY07	FY08 ^P	FY07	FY08 ^P	FY07	FY08 ^P	FY07	FY08 ^P
i. SCBs	4.8	9.8	6.5	9.9	86.8	81.5	21.6	24.9	24.9	30.6
ii. PCBs	75.4	136.5	49.2	76.9	164.7	217.3	9.5	14.5	5.8	6.7
iii. Foreign banks	18.8	27.9	13.7	24.6	14.0	17.6	0.2	0.3	1.4	1.7
iv. Specialized banks (BSB, BSRS, BKB, RAKUB, BASIC)	4.1	3.4	4.3	4.2	22.7	23.6	5.5	6.1	24.2	25.8
v. Non-bank financial institutions	20.9	23.9	17.0	20.6	49.2	60.9	3.4	3.9	6.9	6.4
Total	123.9	201.5	90.7	136.2	337.2	400.9	40.2	49.7	11.9	12.4

Source: Agricultural and Special Studies Department, Bangladesh Bank.
P= Provisional.

FY08, the disbursement by specialized banks stood at Taka 3.4 billion which was lower than 4.1 billion in FY07.

Measures for Strengthening Term Lending Practices

6.29 The persistent high levels of overdue term loans have received intensive corrective attention of the authorities. Amongst the salient measures adopted over the past several years were the stricter income recognition and provisioning standards for banks in line with international best practices, prohibition of new credit accommodation to loan defaulters, stringent restrictions on lending to directors and

their connected interests. Substantial measures to strengthen term lending practices initiated in previous years were continuing under the continuous process of financial sector reforms. Among the new preventive and curative initiatives to strengthen term lending practices taken in FY08 were:

- ❖ Banks/financial institutions have been advised to give more endeavour in providing credit facility to Small and Medium Enterprises (SMEs) and to invest their excess liquidity in different emerging productive SME sectors including women entrepreneurs.

- ❖ BB has been raised fund allocation for women entrepreneurs under the refinance scheme of SME from 10 percent to 15 percent with a view to extending participation of women entrepreneurs in industrial development in the country and to ensure availability to credit to more women entrepreneurs for establishing industry and to operate business activities. Out of this 15 percent fund, 40 percent will be allocated for small women entrepreneurs.
 - ❖ BB has taken a decision in principle to accord permission for opening SME Service Centres to strengthen SME sector.
 - ❖ For strengthening, encouraging and expanding SMEs sector, banks/financial institutions have been given instructions for their compliance that BB shall be informed the target of loan that will be disbursed in SMEs sector for the year and to allocate at least 40 percent to small entrepreneurs and the rest to medium entrepreneurs out of the fund fixed for SMEs. Besides, fund for "Refinance Scheme for Small enterprise Sector" has been raised from Taka 3.0 billion to Taka 5.0 billion with effect from 12 June 2008.
 - ❖ Decision has been made to raise the paid up capital and statutory reserve of all banks at the minimum of Taka 2.0 billion. In this regard at least 50 percent of shortfall of required capital must be fulfilled within June 2008 and the residual portion must be fulfilled within June 2009. Banks may raise the reserve by keeping profit after tax, by issuing right shares or IPO, merging with other banks and financial institutions. Any bank having shortfall of required capital and reserve, will not pay or declare cash dividend and foreign banks will not repatriate the profit or bring in additional capital from abroad within the said time limit.
 - ❖ Decision has been taken that banks/ financial institutions can accept new IT project proposals from entrepreneurs for EEF assistance. Only those new entrepreneurs who are creative, efficient, and prospective and have difficulty in availing of traditional institutional credit facility can apply for EEF assistance in favour of new IT project.
- Broadening of Fund Base for Industrial Term Lending**
- 6.30 Dependence of banks on shorter-term deposit resources for funding long-term industrial loans increases their liquidity risks. Providing refinance facilities to banks and financial institutions for broadening the base of longer-term funds for small and medium scale industrial lending under some special schemes and programmes taken by Bangladesh Bank in FY08 were:
- ❖ BB initiated a 100 percent refinance scheme of Taka 0.5 billion out of its own fund at bank rate against term loans (medium and long term) for agro-processing industries in rural areas with fixed capital not exceeding Taka 0.05 billion in FY01. Under this project an amount of Taka 0.9 billion has been disbursed upto end of June 2008.
 - ❖ In another window BB has introduced a refinancing scheme named Small Enterprise Fund (SEF) of Taka 5.0 billion out of its own fund at bank rate. Under the scheme refinance facilities were extended for the banks and non-banks financial institutions against their financing for development of small entrepreneurs, usually left out by the formal sector financing. Under this scheme a total amount of Taka 1.2 billion was refinanced to different PFIs in FY08. For high demand, the recovery amount of the loan will be used in revolving way for refinance the SME sectors. Under this project an amount of Taka 4.1 billion has been refinanced through 30 banks and non-bank financial institutions against 430 enterprises up to 30 June 2008.
 - ❖ Under the Enterprises Growth and Bank Modernization Programme (EGBMP),

Government of Bangladesh has provided Taka 1.0 billion including an additional fund of Taka 0.6 billion (USD 10.0 million) from the World Bank's IDA wing to refinance the development projects of small enterprises. Bangladesh Government allocated Taka 0.6 billion under the said agreement and Taka 1.1 billion has been received combining the IDA credit fund and Bangladesh Government fund for refinancing. Upto June 2008 an amount of Taka 1.6 billion has been refinanced to 24 banks and non-bank financial institutions as term loan to 1962 small enterprises.

- ❖ For another refinancing project Asian Development Bank has provided USD 30 million under a Loan Agreement with the Government of Bangladesh to develop the SME sector. From this fund, an amount of Taka 1.9 billion has been disbursed upto end of June 2008 to 14 banks and non-bank financial institutions against 1764 small and medium sector enterprises.
- ❖ BB has been implementing a project named "Investment Promotion and Financing Facility (IPFF)" with a total estimated cost of USD 105.2 million on behalf of Government of Bangladesh (GoB) as per agreement signed on 21 August 2006 between BB and GoB for financing government approved private sector infrastructure projects (i.e. power generation, transmission and distribution and services, port (sea, river and land) development, environmental, industrial and solid waste management, highways and expressways including flyovers, water supply and distribution, sewerage and drainage, industrial estates and park development etc.). However, the highest priority is given to power sector. Of the total, International Development Association (IDA) will provide USD 50.0 million as soft loan under a financing agreement signed between the IDA and GoB on 1 June 2006, and as co-finance GoB will provide USD 10.0 million. Besides, under on-lending component the PFIs and concerned entrepreneurs will provide USD

14.4 million and USD 30.8 million respectively.

One of the main features of the project is that at least 30 percent cost of any approved project should be borne from entrepreneur's own source and maximum 70 percent would be provided as debt financing; out of which 20 percent will be provided by the PFIs and the rest 80 percent will be financed from IPFF. The PFIs are supposed to bear all commercial risks associated with debt financing. Out of 13 PFIs, so far BB has signed Master Facility Agreement (MFA) with 11 PFIs, of which 7 non-bank financial institutions and 4 private banks. The IDA has already disbursed an amount of USD 24.0 million in favour of National Credit and Commerce Bank Limited for financing three 22 MW power plant of Doreen Power Generation and Systems Limited being built in Feni, Tangail and Narsindi. The power plants would be able to add power in national grid by November 2009.

Equity and Entrepreneurship Fund (EEF)

6.31 Equity and Entrepreneurship Fund (EEF) was formed by the Government in FY01 through budgetary allocation of Taka 1.0 billion to encourage investments in the risky but prospective agro-based/food processing and IT sector projects. Bangladesh Bank is administering the fund since inception. So far the Government out of total national budgetary allocation of Taka 15.0 billion has released Taka 5.2 billion. Notably in FY08 and FY09, Taka 1.0 billion was allocated each year only for IT sector. In FY08, total amount of Taka 522.7 million (including the disbursement against those projects which were sanctioned in the previous years) was disbursed against different projects. It should be mentioned that in FY08, only one agro-based project, having total project cost of Taka 25.6 million, got EEF sanction of Taka 8.5 million. In FY07, Taka 734.7 million was disbursed from EFF. Upto 30 June 2008, a total of 251 projects (including 217 agro-based/food processing projects, and 34 IT projects) with the project cost of Taka 16.4 billion, got disbursement of Taka 4.9 billion against the EFF sanction of Taka 6.3 billion.

Housing Finance

6.32 Total housing loans from banks and financial institutions as of end June 2008 amounted to Taka 142.5^P billion (Table 6.12), which was 7.5 percent of total credit to the private sector.

6.33 In recent years, significant changes have been taking place in total housing loan portfolios. Of the total, the private sector banks with ample deposit resources have been expanding their housing loan portfolios, and now have dominant market position (Table 6.12) with the largest share of Taka 50.8 billion in outstanding housing loans as of end June 2008. The SCBs had the second largest share of Taka 33.6 billion and other banks Taka 16.6 billion in outstanding housing loans as of end June 2008. Besides, two private sector specialized housing finance providers are also slowly gaining ground. They provide fund for their operations with long term deposits including some contractual deposit schemes.

6.34 The state-owned House Building Finance Corporation (HBFC) had the third largest share of Taka 24.4 billion in outstanding housing loans as of end June 2008. The sources of Corporation's fund are paid-up capital by the government and the proceeds as received by selling government guaranteed interest bearing debentures to different organizations. The second mode of funding has been unavailable in recent years. In the past, the HBFC funded its housing loans by issuing low interest debentures bought by the SCBs and the Bangladesh Bank. Though in FY04, the Corporation got approval from the government to sell debenture amounting Taka 1.0 billion, it could not sell them till today. So, sufficient surplus cash fund could not be generated from the Corporation's own cash inflow after payments of debenture installments, government debts, operational expenses and income tax. The HBFC has been constrained to rely on recoveries of past loans for new lending after defraying operating and debt servicing costs. Consequently, its new lending has been small. Amount of Taka 1.2 billion and Taka 1.5

Table 6.12 Outstanding housing loans
(billion Taka)

Lenders	Outstanding as of end June		
	FY06	FY07	FY08 ^P
a. Specialized housing finance providers			
i) HBFC	26.2	25.2	24.4
ii) Delta-Brac Housing Finance	5.5	7.1	9.5
iii) National Housing Finance	1.9	1.9	1.9
b. Banks			
i) PCBs	35.1	43.7	50.8
ii) SCBs	25.8	28.9	33.6
iii) Other banks	3.0	13.5	16.6
c. Other financial institutions	2.9	4.1	5.5
d. Microcredit lenders			
Grameen Bank	0.4	0.2	0.2
Total	100.9	124.6	142.5

Source : Department of Financial Institutions & Markets, Statistics Department, Bangladesh Bank, HBFC, and Grameen Bank.
P= provisional.

billion in FY07 and FY08 were disbursed out of recoveries of Taka 3.9 billion and Taka 4.0 billion respectively.

6.35 The Grameen Bank provides housing loans to its members in rural areas. Some NGOs also have small involvement in lending to housing. Grihayan Tahbil created by the government, provides housing loan to the NGOs at the simple interest rate of 1.0 percent which in turn provides housing credit to the rural poor at the simple interest rate of 5.0 percent. In FY07 and FY08, the Tahbil has recovered Taka 0.20 billion and Taka 0.15 billion respectively as against disbursed amount of Taka 0.12 billion and Taka 0.07 billion through NGOs for this purpose. Since its beginning in FY98, the Tahbil disbursed an amount of Taka 1.23 billion upto end June 2008.

Foreign Exchange Market

6.36 Under the floating exchange rate regime, authorised dealers banks are free to set their own rates of foreign exchange against Bangladesh Taka for their inter-bank and customer transactions. The exchange rate is being determined in the market on the basis of market demand and supply forces of the respective currencies. However, to avoid any unusual volatility in the exchange rate, BB remains vigilant over the developments in the

foreign exchange market and intervenes by buying and selling foreign currencies whenever it deems necessary to maintain stability in the foreign exchange market. Bangladesh Taka is fully convertible for current international transactions. Repatriation of profits or disinvestment proceeds on non-resident FDI and portfolio investment inflows are permitted freely.

Exchange Rate

6.37 Foreign exchange market of the country enjoyed good liquidity during FY08 due mainly to more than expected foreign currency inflow (equivalent USD 7.9 billion) throughout the year from Bangladeshi nationals working abroad along with the usual export proceeds. As a result, the exchange rate of Bangladesh Taka against the US Dollar remained almost stable and moved within the range of Taka 68.48 - 68.85 during FY08. Taka-Dollar exchange rate started from Taka 68.85 with a modest pressure on the exchange rate in FY08, due to higher demand in the foreign exchange market. But with the beginning of the 2nd quarter Taka started to appreciate and in mid-December it stood at Taka 68.48. During the 3rd quarter of FY08, Taka remained relatively stable with exchange rates ranging Taka 68.56-68.60. However, at the end of FY08 Taka gained slightly and stood at Taka 68.53. The weighted average Taka-Dollar exchange rate appreciated from Taka 68.80 per US Dollar at end June 2007 to Taka 68.53 at end June 2008. The movement of Taka per US Dollar during FY08 is shown in Chart 6.5.

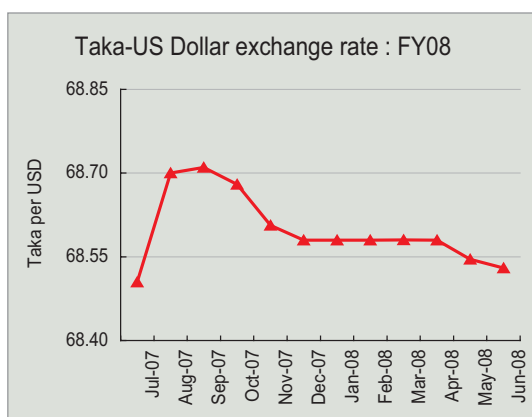
6.38 Exchange rate of Bangladesh Taka against the US Dollar remained almost stable during FY08. However, two deluges and the devastating cyclone 'Sidr' on southern part of the country wrecked havoc on the Bangladesh economy during FY08. Thus, liquidity of the foreign exchange market got pressurized during the second quarter of FY08 due to sharp rise in

Table 6.13: Sales and purchases of foreign exchange by the Bangladesh Bank

(million USD)			
Particulars	FY06	FY07	FY08
Sale	413.0	Nil	735.5
Purchase	77.0	649.5	202.5

Source: Forex Reserve & Treasury Management Department, Bangladesh Bank.

Chart 6.5



import payments for food grains, crude oil and fertilizer. With a view to managing the excess demand of foreign exchange, BB injected USD 735.5 million into the market. At the end of FY08, BB bought a total of USD 202.5 million from banks, absorbing excess supply of foreign exchange from the market and thereby maintaining stability in the exchange rate of Taka.

Inter-bank Foreign Exchange Transactions

6.39 The volume of inter-bank foreign exchange transactions in FY08 stood lower by 18.6 percent to USD 3.5 billion. Of the total transactions, spot, forward, swap and other transactions were USD 2.4 billion, USD 0.04 billion, USD 0.8 billion and USD 0.3 billion respectively. The volume of inter-bank foreign exchange transactions stood at USD 4.3 billion in FY07.