Financial Markets

7.1 Bangladesh Bank adopted a monetary policy stance in FY12 aimed at limiting domestic credit growth and bringing inflation down to a single digit by FY12, while BB discouraged credit growth for conspicuous consumption and unproductive, speculative uses. Besides, a comprehensive financial inclusion drive is working towards ensuring adequate credit flows to supply side activities including farm and non-farm productive pursuits of micro and small enterprises.

Money Market

Call Money Market FY12

7.2 The banking industry observed steady growth path in terms of interest rate throughout the year. BB provided repo, special repo and Liquidity Support Facility (LSF) to the Primary Dealers (PDs) and non-PD banks against the eligible holding of treasury bills and bonds. BBs prudential policy measures resulted in a weighted average interest rate in the call money market ranging from 9.8 percent to 19.7 percent during FY12 (Table 7.1 and Chart 7.1). During FY12, the average volume of trade in the call money market increased to Taka 1018.3 billion, which was 45.7 percent higher than that of FY11. Both the volume of transaction in the call money market and the weighted average interest rate showed mixed trends during FY12 as shown in Table 7.1.

Repo Auctions - FY12

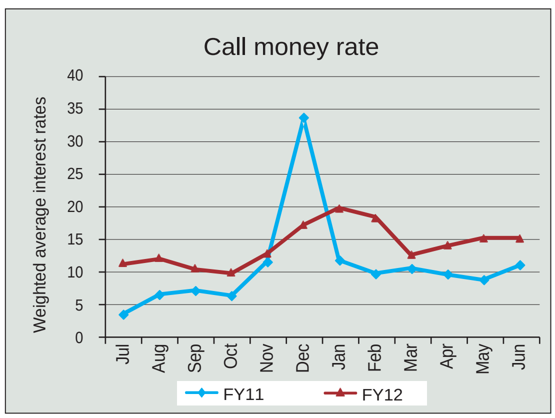
7.3 A repo deal is one where the PDs and the non-PDs make a contract to borrow money usually overnight at a pre-determined policy rate of BB against the collateral face value of Government treasury bills and bonds. The repo injects money in the system and provides the banks with necessary funds to maintain their very short term exposure. The rate of interest for repo, special repo and LSF

Table 7.1 Volume of trade and weighted average interest rates in call money market

Periods	Volume of trade (billion Taka)	Weighted average interest rates (%)	Volume of trade (billion Taka)	Weighted average interest rates (%)
	FY11		FY12	
July	857.67	3.33	781.86	11.21
August	835.53	6.36	864.30	12.03
September	669.36	6.97	1102.84	10.41
October	875.79	6.19	1094.70	9.77
November	758.23	11.38	1055.05	12.70
December	652.87	33.54	853.01	17.15
January	649.81	11.64	1090.13	19.66
February	454.88	9.54	826.71	18.18
March	517.80	10.35	1033.09	12.51
April	613.11	9.50	1272.74	13.98
May	783.79	8.64	1110.31	15.05
June	715.32	10.93	1134.52	15.02
Average	**698.68**	**10.70**	**1018.27**	**13.97**

Source: Debt Management Department, Bangladesh Bank.

Chart 7.1



was 7.75, 10.75 and 7.75 percent respectively for 1-2 day tenor. The rates were five basis points higher for 3-7 day tenor. Special repo rate was higher due to particular need of liquidity of the banks. Banks apply for funds at late hour usually after 12.0 PM in a business day. BB kept these windows open for the banks to maintain liquidity at a desired level, while pursuing a cautious monetary policy.

It, therefore, encouraged borrowing from the market first with a view to maintaining its Lender of the Last Resort (LOLR) stance. In FY12, the banks were provided a reasonable amount of repo funds through daily repo auction. In order to achieve monetary policy objectives, BB raised the repo and reverse repo rate by one hundred basis points during FY12. Repo and reverse repo rate was fixed at 7.75 percent and 5.75 percent respectively as on 8 January 2012.

7.4 A total of 242 repo auctions (including special repo and LSF auctions) were held during FY12. Out of the 6500 bids for Taka 60242.3 billion, 6499 bids for a total of Taka 21943.1 billion were accepted (Table 7.2). During FY11, 3764 bids for Taka 34255.2 billion were received, of which bids for Taka 8032.1 billion were accepted. The volume of accepted bids increased by 2.73 times during FY12. The range of interest rate against the accepted bids was 6.75-10.80 percent per annum in FY12 as against 4.50-8.80 percent per annum in the previous year.

Table 7.2 Repo auctions - FY12

Total No. of auctions held during the year	Tenor	Bids received		Bids accepted		Interest rate of the accepted bids (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)	
242	1-Day/2-Day	4943	47042.55	4942	16944.97	6.75-10.75
	3-Day/7-Day	1557	13199.76	1557	4998.14	6.75-10.80
	Total	**6500**	**60242.31**	**6499**	**21943.11**	**6.75-10.80***

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

Reverse Repo Auctions - FY12

7.5 In the operation of reverse repo deal, money is moped up from the banks to BB. In case of reverse repo BB does not provide any collateral to the banks. It applies the reverse repo to maintain intended level of liquidity in the market and to keep up reserve money and money multiplier on track. A total of 41 daily reverse repo auctions were held in FY12. All the 55 bids - 46 bids of 1-2 day and 9 bids of 3-7 day tenors, for a total of Taka 81.7 billion, were all accepted. During FY11, bids for Taka 763.2 billion were received, of which Taka 684.8 billion were accepted. The interest rate range against the accepted bids was 4.75-5.75 percent per annum during FY12 (Table 7.3).

Bangladesh Bank Bill

7.6 Operations of Bangladesh Bank Bill was revived during FY09 and continued till FY12 as a tool of Open Market Operation (OMO) in order to maintain liquidity of the banking system more effectively. In order to maintain stable interest rate and exchange rate position

Table 7.3 Reverse repo auctions - FY12

Total no. of auctions held during the year	Tenor	Bids received		Bids accepted		Interest rate of the accepted bids (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)	
41	1-Day/2 Day	46	68.60	46	68.60	4.75-5.75
	3-Day/7 Day	9	13.10	9	13.10	4.75-5.75
	Total	**55**	**81.70**	**55**	**81.70**	**4.75-5.75***

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

BB prudently decided not to apply this instrument during the period under report.

Government Securities Market

Government Treasury Bills Auctions

7.7 Treasury bills and bonds are short-term and long term obligations issued by Bangladesh Bank on behalf of the Government of Bangladesh. These are the indirect monetary instruments the BB use for debt management. The securities are issued through a treasury style French Auction where the allotments are awarded to the bids which fill the notified issue amount ranging from the lowest to highest yield. Pro-rata partial allotments are made for bids at the cut-off-yield. The objectives of issuing these securities are two-fold. The first is to provide a mechanism for financing Government deficit at a low cost and the second is to manage excess liquidity prevailing in the market. In FY12, 15 Primary Dealers (PDs) acted as underwriters and market makers with commitments to bid in auctions.

7.8 Weekly auctions of 91-day, 182-day and 364-day treasury bills continued to be the main instruments for debt management of the Government during the year under report. The results of treasury bills auction in FY12 are summarised in Table 7.4 The auctions of 91-day, 182-day and 364-day tenor bills were under-subscribed. Consequently, devolvement amount to PDs/ Bangladesh Bank increased. The cut-off-rate of most of the treasury bills increased during FY12.

7.9 Depending on the liquidity conditions in the money market, the cut off yields of treasury bills of different maturities varied within modest ranges. The yields for various tenors as of end June 2012 depicted a moderate range than the yields as of end June 2011.

7.10 A total of 1064 bids amounting to Taka 293.2 billion were received, of which 740 bids amounting to Taka 338.0 billion (including Taka 168.0 billion as devolved amount) were accepted during FY12. The weighted average yield-to-maturity against the accepted bids ranged from 7.01 percent to 11.43 percent during the year (Table 7.4). In FY11 a total of 1051 bids amounting to Taka 224.8 billion were received, of which bids amounting to Taka 206.3 billion were accepted.

Bangladesh Government Treasury Bonds (BGTBs) Auctions

7.11 Treasury Bonds, bearing half yearly interest coupons, with tenors of 5-year, 10-year, 15-year and 20-year are auctioned in every month following a preannounced auction calendar. This calendar is prepared by BB and ministry of finance considering liquidity and macroeconomic indicators. The BGTB auction committee determined cut-off

Table 7.4 Auctions of government treasury bills - FY12

Tenor of bills	Bids offered		Bids accepted		Outstanding bills as of end June, 2012 (billion Taka)	Weighted average yield (WAR) range* (%)	
	No.	Face value (billion Taka)	No.	Face value (billion Taka)		FY11	FY12
91-Day	389	137.2	254	74.7	80.0	2.43-7.00	7.01-11.40
182-Day	317	85.9	213	49.4	62.0	3.49-7.25	7.26-11.41
364-Day	358	70.1	273	46.0	80.5	4.24-7.55	7.60-11.43
Devolvement to Bangladesh Bank/PD				168.0			
Total	**1064**	**293.2**	**740**	**338.0**	**222.5**	**2.43-7.55**	**7.01-11.43**

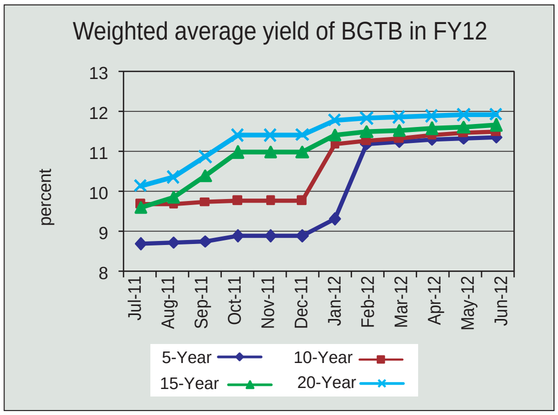
Source: Monetary Policy Department, Bangladesh Bank.
* Range of the weighted average annual yield of the accepted bids.

coupon rate is used for bond pricing. The lowest coupon rate bidders are needed to deposit premium amount to the BB in view of face value. Banks are eligible to use Government treasury bills and BGTBs for Statutory Liquidity Requirement (SLR) purpose in the form of Held to Maturity (HTM) and Held for Trade (HFT). HTM securities are amortised at the end of the year to converge face value and HFT securities values are amortised weekly following marking to market method. These bills and bonds are eligible for secondary trading. 48 auctions of these instruments were held in FY12. A total of 673 bids for Taka 163.4 billion were received and 467 bids for Taka 182.4 billion were accepted, of which Taka 91.0 billion was devolved on BB/PDs. The amount of outstanding bonds was increased by 28.3 percent from Taka 534.0 billion at the end of June 2011 to Taka 685.1 billion at the end of June 2012.

7.12 The coupon rate for the treasury bonds ranged from 8.26 percent to 12.12 percent in FY12. The coupon rates on all tenors of treasury bonds were increased during the period. This is shown in Table 7.5. The movements of the weighted average yield-to-maturity of all the treasury bonds are depicted in the Chart 7.2.

7.13 It is mentionable that in FY11, bids for a total of Taka 151.1 billion were received and those for Taka 142.7 billion were accepted of which Taka 42.0 billion was devolved on BB/PDs. The overall weighted average yield-to-maturity ranged from 7.88 percent to 9.65 percent in FY11.

Chart 7.2



Bangladesh Government Islamic Investment Bond (Islamic Bond)

7.14 Government issues bond as guarantee against the pool of funds formed by the Islamic banks and individuals in order to develop money market in Islamic banking sector. Virtually the Government does not borrow money from this sector. The return on the bonds depends on profit or loss in line with the Islamic Shariah savings rate and related factors reflected in the balance sheet of the Islamic bank. The operations of 6-month, 1-year and 2-year Bangladesh Government

Table 7.5 Auctions of Bangladesh government treasury bonds - FY12

Total no. of auctions held during the year	Tenor of bonds	Bids offered		Bids accepted		Outstanding bonds as of end June, 2012 (billion Taka)	Yield range *(%)
		Number	Face value (billion Taka)	Number	Face value (bllion Taka)		
48	5-Year	194	53.67	153	34.70	231.27	8.2585-11.4500
	Devolvement to BB/PDs				26.80		
	10-Year	192	52.45	145	30.07	285.40	9.4482-11.6000
	Devolvement to BB/PDs				31.43		
	15-Year	143	28.81	70	11.14	94.36	9.6483-11.8000
	Devolvement to BB/PDs				21.11		
	20-Year	144	28.46	99	15.49	74.07	9.9989-12.1200
	Devolvement to BB/PDs				11.67		
	Total	**673**	**163.39**	**467**	**182.41**	**685.10**	**8.2585-12.1200@**

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.

Islamic Investment Bonds, (Islamic Bond) introduced in FY05, continued in FY12. This bond is operated in accordance with the rules of Islamic Shariah. As per the rules, Bangladeshi institutions, individuals and non-resident Bangladeshi who agree to share profit or loss in accordance to Islami Shariah may buy this bond. As of end June 2012, the total sale against this bond amounted to Taka 31.5 billion while balance of total amount of financing stood at Taka 31.3 billion and the net outstanding against the bond stood at Taka 0.2 billion. As of end June 2011, the total sale against this bond was Taka 25.3 billion against the balance of total financing of Taka 22.8 billion and the net outstanding of Taka 2.5 billion. The overall transactions of this bond are summarised in Table 7.6.

Table 7.6 Bangladesh Government Islamic Investment Bond

(billion Taka)

Particulars	FY10	FY11	FY12
Sale	23.4	25.3	31.48
Financing	15.4	22.8	31.26
Net outstanding	8.0	2.5	0.22

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

Capital Market

Investment Financing in Bangladesh: Moderate Role of Capital Market

7.15 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.

Table 7.7 Disbursement & recovery of industrial term loans of banks and financial institutions

(billion Taka)

Particulars	FY11	FY12	% Change
Disbursement	321.6	352.8	9.7
Recovery	250.2	302.4	20.8
Outstanding (end June)	685.1	802.3	17.1

Source: SME and Special Programmes Department, Bangladesh Bank.

7.16 The amount of industrial term loans disbursed by banks and financial institutions stood at Taka 352.8 billion in FY12. This was 21.5 times higher than the amount of Taka 16.4 billion raised by new capital issues through private placements and public offerings in the capital market. This indicates the overwhelming preference of bank finance in industrial investment financing.

The outstanding balances of Taka 802.3 billion against industrial term loans of banks and financial institutions as of end June 2012 was lower than Taka 2491.6 billion market capitalisation of the securities listed in the Dhaka Stock Exchange (Tables 7.8). However, market capitalisation of the industries (manufacturing, services and miscellaneous) amounting to Taka 1211.8 billion was also higher than the outstanding level of industrial term loan financed by the banks and financial institutions.

7.17 The capital market plays a significant role in the economy as a source of long term financing. During FY12 the market went through massive correction in market capitalisation and index. At the same time different measures have been taken to bring stability as well as investors' confidence in the stock market. The face value of a share of all listed companies and mutual funds of the two stock exchanges has been reset at Taka 10. It has been made mandatory for the sponsors-directors of a company to hold a portion of share of the paid-up capital. The legal provisions on book-building procedure, mutual fund and paid up capital have been updated. Initiatives have been taken to amend the relevant laws to make the activities of Securities and Exchange Commission transparent and accountable, to establish special tribunal for completion of capital market related cases rapidly, to set up separate clearing and settlement company for completion of transaction within short time and to strengthen the monitoring system through establishing high quality surveillance software.

Capital Market Activities in FY12

Primary Issuance

7.18 Fifteen companies raised new equity of Taka 16.4 billion in the capital market in FY12. This was lower than Taka 27.9 billion raised by the nineteen companies in FY11. Of the new equity issued, Taka 2.6 billion was raised through private placements and Taka 13.8 billion was raised through public placements. In FY11, equity issued through private and public placements were Taka 7.6 billion and Taka 20.3 billion respectively.

7.19 The volume of public offerings in FY12 was oversubscribed more than three times indicating a shortage of new securities in the primary market. Bonus shares worth of Taka 43.0 billion were issued in FY12 by one hundred and fifty seven companies against retained profits. This was lower than Taka 48.7 billion issued in FY11 by one hundred and fifty companies.

Secondary Market Activities

7.20 In market capitalisation excluding treasury bonds and debentures, the financial sector dominated with 43.8 percent share, followed by services and miscellaneous (31.6 percent), manufacturing (24.3 percent) and corporate bonds (0.3 percent) at the end of June FY12. Market capitalisation inclusive of new issues decreased remarkably by 12.7 percent to Taka 2491.6 billion or 27.2 percent of GDP at the end of FY12 from Taka 2853.9 billion at the end of FY11 in Dhaka stock exchange (DSE). In Chittagong Stock Exchange (CSE), it was decreased by 16.4 percent to Taka 1871.5 billion or 20.5 percent of GDP at the end of FY12 (Table 7.8 and 7.9). In FY12, the amount of turnovers in the secondary market also decreased by 64.1 and 58.1 percent respectively at DSE and CSE. In FY12, all-share price index in DSE decreased by 23.9 percent while in CSE it decreased by 19.5 percent.

Non-resident Portfolio Investment

7.21 Gross investment inflow in shares and securities of the stock exchanges by non-residents through Non-resident Investor Taka Account (NITA) increased to Taka 15.7 billion in FY12 from 13.8 billion in FY11. Gross outflow as repatriation of sale proceeds declined to Taka 6.7 billion in FY12 from Taka 16.7 billion in FY11. From April 1992 to June 2012, the gross investment inflow stood at Taka 69.4 billion against gross outflow as repatriation of sale proceeds of Taka 67.3 billion.

Activities of the ICB

7.22 Investment Corporation of Bangladesh (ICB) was established in the backdrop of a series of measures undertaken by the Government to accelerate the pace of industrialisation and develop a well organised and vibrant capital market particularly securities market in Bangladesh. The ICB provides institutional support to meet the equity gap of the industrial enterprises. The scope of ICB's capital market development programme activities has been expanded through the formation and operation of the subsidiaries of ICB namely the ICB Capital Management Ltd. (ICML), the ICB Asset Management Company Ltd. (IAMCL) and the ICB Securities Trading Company Ltd. (ISTCL). In order to help mobilise savings, encourage and broaden the base of investment, the ICML plays important roles as underwriter of public issues of shares/debentures, portfolio manager, issue manager of investment account and placement services provider. By the end of June 2012, the net investment made against the investors' accounts stood at Taka 1.6 billion while deposit received stood at Taka 5.5 billion. The IAMCL emerged as

Chart 7.3

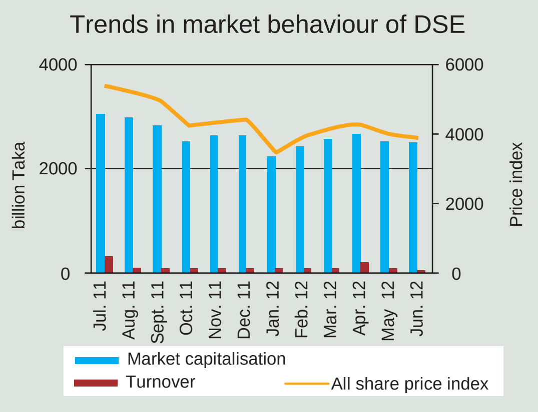


Table 7.8 Dhaka Stock Exchange (DSE) activities

(billion Taka)

Particulars	End June		
	FY10	FY11	FY12
No. of listed securities*	450	490	511
Issued equity and debt*	607.3	806.8	933.6
Equity through private placement & IPOs	18.2	27.9	16.4
Market capitalisation	2700.7	2853.9	2491.6
Turnover in value	2563.5	3259.2	1171.5
Turnover in volume (no. in billion)	10.1	19.7	18.6
All-share price index	5111.6	5093.2	3877.6

Source: Dhaka Stock Exchange.
* = including companies, mutual funds, debentures and Government Treasury Bonds.

Table 7.9 Chittagong Stock Exchange (CSE) activities

(billion Taka)

Particulars	End June		
	FY10	FY11	FY12
No. of listed securities*	232	220	251
Issued equity and debt*	201.1	302.9	375.2
Market capitalisation	2534.4	2237.6	1871.5
Turnover in value	217.1	321.8	134.9
Turnover in volume (no. in billion)	1.40	2.7	2.5
All-share price index	18116.1	17059.5	13736.4

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

one of the fast expanding asset management company of the country. Up to end June 2012, the company floated eleven close-end and three open-end mutual funds of which one special purpose open-end mutual fund was the "Bangladesh Fund". Net investment in the portfolios of the fourteen funds stood at Taka 27.6 billion and its market value was Taka 22.4 billion. The ISTCL emerged as the largest stockbroker in the country handling total turnover worth Taka 105.4 billion in FY12 which was 8.1 percent of the total turnover of DSE and CSE. The parent ICB itself sold unit certificates amounting to Taka 0.7 billion against the repurchase of unit certificates amounting to Taka 0.1 billion in FY12. In FY12 the ICB received deposits of Taka 0.3 billion and approved loans of Taka 1.4 billion in investment accounts of investors. Total commitments for investment made by the ICB in FY12 stood at Taka 2.3 billion of which, pre-IPO placement of share stood at Taka 0.3 billion, purchase of preference share was Taka 0.5 billion, investments in equity and bonds were Taka 0.5 billion and Taka 0.1 billion, purchase of debentures was Taka 0.4 billion and bank guarantee was Taka 0.5 billion. In FY11 the total amount of commitments was Taka 4.6 billion.

Scheduled Banks Investments in Capital Market Securities

7.23 Holdings of capital market assets (equities, debentures) by scheduled banks stood at Taka 160.6 billion as of end June 2012 as against Taka 139.5 billion as of end June 2011. Outstanding advances of scheduled banks against shares and securities declined to Taka 9.1(provisional) billion in June 2012 from Taka 9.7 billion in June 2011.

Measures Supporting Capital Market Development

7.24 The Securities and Exchange Commission (SEC) undertook several measures to strengthen the capital market through strengthening investors' confidence in capital market during FY12:

- A modern surveillance system has been set up to modernise the market monitoring and surveillance system under the Insurance Governance Project with the financial assistance of Asian Development Bank.
- Market demutualisation of stock exchange has been started under the Capital Market Development Programme-II.
- Interest remission of margin loan has been declared and longer maturity of loan repayment has been arranged to reduce the loss of small investors. Moreover, quota at IPO for the affected small investors has been introduced.
- It has been made compulsory for the sponsor-directors of a company to hold individually 2.0 percent and collectively 30.0 percent share of paid up capital to bring long term stability in the stock market.
- Corporate governance guideline has already been amended and it has been made mandatory to have at least 20.0 percent independent directors. Moreover, a directive has been given to establish corporate finance department in the stock exchange to examine the company's financial statement more accurately.
- To provide more accurate information about the capital market and listed securities to the investors, research publication rules and regulations are under process.
- The book building method has been revised to prevent misuse and to ensure transparency. Maturity limit of closed-end mutual fund has been fixed at 10 years.

7.25 The measures declared in the national budget of FY13 in support of further development of the capital market included:

- Company issuing 20.0 percent share of paid up capital through IPO, will be allowed 10.0 percent tax rebate on the relevant year.
- Tax exemption on dividend income will be up to Taka 5000.
- Income tax on merchant banks will be reduced to 37.5 percent from 42.5 percent.
- A portion of the fund for establishing a deep sea port will be collected from the capital market.
- Demutualisation activities of stock exchange will be started in next financial year.
- To keep stability of capital market, Financial Reporting Act has been drafted and initiatives will be taken to complete it within FY13.

Credit Market

Advances of Scheduled Banks by Economic Purposes

7.26 Total advances of scheduled banks by economic purposes showed an upward trend during FY12 (Table 7.10). Total advances of scheduled banks by economic purposes stood at Taka 3859.3 billion at the end of June 2012 which was 20.1 percent higher than the total advances of Taka 3212.8 billion at the end of June 2011. In recent years, significant changes have been taken place in the trends in total bank advances classified by economic purposes. Of the total advances, the transport and communication sector recorded the significant improvement of 57.8 percent followed by the 37.7 percent in other sectors in FY12 compared to FY11. The share of total advances declined in other different sectors during the year which were: construction sector 32.5 percent, trade sector 22.6 percent, industry sector 13.7 percent, agriculture, fishing and forestry sector 6.3 percent and working capital financing 6.3 percent.

Sector-wise contribution of total advances shows that the trade sector has the highest share (38.6 percent), followed by industrial term loans (20.6 percent), working capital financing (13.0 percent), construction (8.3 percent), agriculture, fishing and forestry (5.4 percent), transport and communication sector (2.1 percent) and others (12.0 percent) in FY12. Sector-wise contribution of total advances is reported in Chart 7.4.

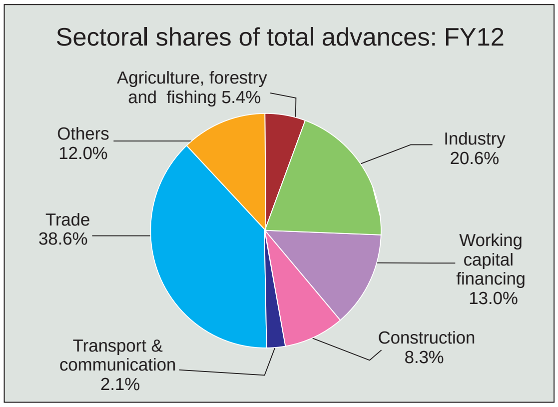
Table 7.10 Advances of scheduled banks by economic purposes

(billion Taka)

Sector	End June		
	FY11	FY12	% change
1. Agriculture, forestry and fishing	196.6	208.9	6.3
2. Industry	700.5	796.3	13.7
3. Working capital financing	470.6	500.1	6.3
4. Construction	241.9	320.4	32.5
5. Transport & communication	50.5	79.7	57.8
6. Trade	1216.8	1491.5	22.6
7. Others	335.9	462.4	37.7
Total	**3212.8**	**3859.3**	**20.1**

Source: Statistics Department, Bangladesh Bank.

Chart 7.4



Box-7.1

Macroprudential Policy for Financial Stability

Macroprudential policy has a system wide perspective which addresses the system failure. It relates concerns over the financial system's stability and its link with the macro economy. Such concerns are associated with the impact of financial innovation and the development of capital market, the effect of regulation on the procyclicality of the financial system, and the implications of the failure of systemically important institutions.

The following instruments are most frequently applied to achieve macroprudential objectives:

- Caps on the loan-to-value (LTV) ratio
- Caps on the debt-to-income (DTI) ratio
- Caps on foreign currency lending
- Ceilings on credit or credit growth
- Limits on net open currency positions/currency mismatch
- Limits on maturity mismatch
- Reserve requirements
- Countercyclical/ time-varying capital requirements
- Time-varying/dynamic provisioning
- Restrictions on profit distribution

Caps on the loan-to-value (LTV) ratio may serve as a constraint for the extension of mortgage credit beyond a particular portion of the value of housing collateral.

Caps on the debt-to-income (DTI) ratio may be used to restrain the extension of mortgage credit beyond a multiple of borrowers' annual income.

Caps on foreign currency lending may be used to address the systemic risk emanated from loans in foreign currency (large common exposure).

Limits on net open currency positions/currency mismatch restrain banks' common exposure to foreign currency risks. The limits may also be used to address sharp fluctuations in exchange rate caused by a convergence of purchases/sales of foreign exchange by banks.

A ceiling on credit or credit growth may be used to dampen the cyclicality in credit/asset price. In addition, a ceiling on credit to any particular sector may be used to contain a specific type of asset price increment or limit common exposure to a specific risk.

The inability of a financial institution to meet its short-term obligations emanated from maturity mismatches may compel it to liquidate assets and impose a fire sale cost on the remaining part of the financial system. Limits, on maturity mismatch may be used to address such sort of systemic risk.

Reserve requirements may be used to address systemic risk and dampen the credit/asset price cycle. Besides, it may be used to address a systemic liquidity crunch when situation warrants.

Countercyclical/time-varying capital requirements, in the form of a ratio or risk weights, may be raised during an upturn as a restraint on credit expansion and reduced during a downturn to provide a cushion so that banks do not reduce assets to meet their capital requirements. A permanent capital buffer built up during an upturn and withdrawn during a downturn serves the same purpose.

Time-varying/dynamic provisioning can be used to dampen the cyclicality in the financial system. Such provisioning can be increased during an upturn to build a buffer and limit credit expansion. This provisioning can be reduced during a downturn to facilitate bank lending.

Restrictions on profit distribution can be used in downturn to bring counter cyclical pattern in bank lending. Similar role can be played by capital conservation buffer as recommended in Basel III.

Source : Lim, Columba, Costa, Kongsamut, Otani, Saiyid, Wezel and Wu, Macroprudential Policy: What Instruments and How to Use Them? Lessons from Country Experiences, IMF working paper, October 2011 for details.

Table 7.11 Industrial term loans of banks and financial institutions

(billion Taka)

Lender	Disbursement		Recovery		Outstanding		Overdue		Overdue as % of outstanding	
	FY11	FY12	FY11	FY12	FY11	FY12	FY11	FY12	FY11	FY12
SCBs	48.7	61.8	22.7	56.5	140.9	174.7	30.7	27.0	21.8	15.5
PCBs	216.1	224.8	175.7	194.6	408.7	469.1	21.9	33.6	5.4	7.2
FCBs	11.5	12.9	16.3	10.4	15.1	17.1	0.4	0.5	2.6	2.9
Specialised banks (BDBL, BKB, RAKUB, BASIC)	9.9	15.2	6.6	8.5	32.6	39.6	6.0	5.5	18.4	13.9
Financial institutions	35.3	38.0	28.9	32.33	87.8	101.8	5.9	7.3	6.7	7.2
Total	**321.6**	**352.8**	**250.2**	**302.3**	**685.1**	**802.4**	**64.9**	**73.9**	**9.5**	**9.2**

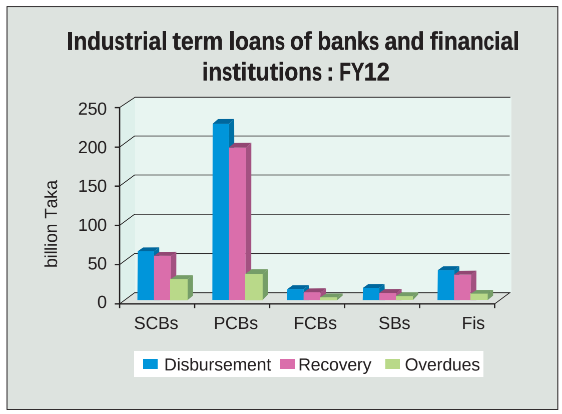
Source: Agricultural and Special Studies Department, Bangladesh Bank.
P= Provisional.

Industrial Term Loans of Banks and Financial Institutions

7.27 Disbursement of industrial term loans by banks and financial institutions increased by 9.7 percent to Taka 352.8 billion in FY12. The recoveries also increased by 20.8 percent to Taka 302.3 billion. The outstanding balance showed a positive growth of 17.1 percent as of end June 2012 and the overdue amount as a percent of outstanding declined to 9.2 as of end June 2012 (Table 7.11)

7.28 Private Commercial Banks (PCBs) had 58.5 percent of the total outstanding loans of Taka 802.4 billion as of end June 2012, making them major players in industrial term lending (Table 7.11 and Chart 7.5). The four SCBs and four state-owned specialised banks together had 26.7 percent shares of outstanding loans. However, with very high levels of overdue loans, their actual role in current lending was quite minor. They disbursed only Taka 77.0 billion (21.8 percent) out of Taka 352.8 billion total disbursement in FY12. In relation to disbursement, the PCBs were the major share holders (Taka 224.8 billion) in FY12, followed by the SCBs (Taka 61.8 billion), financial institutions (Taka 38.0 billion), foreign banks (Taka 12.9 billion) and the state-owned four specialised banks (Taka 15.2 billion).

Chart 7.5



7.29 The foreign banks had very low overdue loans (2.9 percent) as of end June 2012. They were low also for the PCBs (7.2 percent) and the financial institutions (7.2 percent). Overdue loans of the SCBs and the state-owned specialised banks were higher (15.5 percent and 13.9 percent) as of end June 2012.

7.30 Since BKB and RAKUB are agriculture sector lenders, they have insignificant role in industrial term lending. The specialised industrial sector lenders with high overdues have concentrated on recovery in the recent years.

Measures for Strengthening Term Lending Practices

7.31 Issues related to overdue term loans have received the 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 were initiated in the previous years under the continuous process of financial sector reforms. Among the new preventive and curative initiatives to strengthen term lending practices taken in FY12 were:

- With a view to developing SME sector, some policy guidelines of Bangladesh Bank fund under small enterprises refinance scheme have been redefined. Now, like small enterprises, the application of refinance against cottage industries and micro enterprises will also be considered. In case of women entrepreneurs from cottage and micro enterprises, the existing refinance programme at the rate of 10 percent (bank rate+5 percent) for small enterprises will be applicable. The limits of refinance have been increased from Taka 10,000 to Taka 5,00,000 for cottage industry and from Taka 20,000 to Taka 10,00,000 for micro industry.

- In order to provide solar electricity to the deprived rural areas of the country with establishment of solar home system, it has been decided to distribute bank loan through Micro Finance Institutions (MFIs). The MFIs are allowed to charge a maximum of 12 percent interest rate using reducing balance method at the beneficiary level.

- Loan-margin ratio for fresh loans must be maintained at 70:30 in case of house finance under consumer financing and 30:70 for all other consumer loans including motor car loans.

- With a view to achieving targeted economic growth through increasing credit flow to productive sector and by reducing credit flow from consumer credit, it has been decided that growth of consumer credit must not exceed the average growth of total credit of the bank.

Broadening of Fund Base for Industrial Term Lending

7.32 Dependence of banks on shorter-term deposits 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 industries, industrial lending went under some special schemes and programmes taken by the Bangladesh Bank in FY12. They were:

- BB initiated a 100 percent refinance scheme of Taka 1.0 billion out of its own fund at bank rate against term loans for agro-processing industries in rural areas from FY01. Under this project Taka 1.6 billion has been disbursed till end June 2012.

- BB has introduced a refinance scheme named Small Enterprise Fund (SEF) of Taka 6.0 billion out of its own fund for supporting the development of small enterprises of the country. Under this scheme, refinance facilities were extended for the banks and non-bank financial institutions at the bank rate against their financing of small entrepreneurs, usually left out by the formal sector financing. Up to June 2012, a total of Taka 14.6 billion refinance facilities have been provided to 43 banks and non-bank financial institutions against 16102 enterprises.

- The SME & Special Programmes Department, BB is encouraging all banks and NBFIs to provide loans to women entrepreneurs at 10 percent interest rate. 15 percent of all SME funds are exclusively reserved for women entrepreneurs. Up to June 2012, a total of Taka 4.0 billion has been refinanced to women entrepreneurs against 5165 enterprises.

- Under the Enterprises Growth and Bank Modernisation Programme (EGBMP), the Government of Bangladesh has provided USD 10.0 million including an additional fund of USD 10.0 million from the World Bank's IDA wing to refinance the SME sectors. Till now Taka 1.8 billion has been received against the said agreement for refinancing. Up to June 2012, a total of Taka 3.1 billion refinance facilities have been provided to 32 banks and financial institutions as term loan against 3160 small and medium sector enterprises.

- Asian Development Bank has provided USD 30 million under a Loan Agreement with the Government of Bangladesh to develop the SME sector. Out of this fund, a total of Taka 3.3 billion refinance facilities have been provided to 13 banks and 15 financial institutions against 3264 small and medium sector enterprises up to June 2012. Moreover, ADB and the Government of Bangladesh jointly provided an additional amount of USD 95.0 million to further broaden the SME refinance facility. Out of this additional fund, a total of Taka 2.9 billion refinance facilities have been provided to 16 banks and financial institutions against 5913 small and medium sector enterprises up to June 2012.

- Under the Financial Sector Project for the Development of Small and Medium Sized Enterprise (FSPDSME), JICA will provide 5000 million Japanese Yen including a technical assistance component. The principal component of this fund is JPY 4787.5 million. A separate Project Implementation Unit (PIU) has been formed under SME&SPD to implement this project. 21 banks and 18 NBFIs signed participating agreement with the Bangladesh Bank on 11 June 2012. Participating Financial Institutions (PFI) will be provided refinance of pre-finance at the bank rate for lending to SME sub-projects with medium to long term duration in the market rate.

  It should be mentioned that all the recovered loans of the above schemes will be used for further refinancing of the SME sectors. Up to June 2012, a total of Taka 24.0 billion refinance facilities have been provided to different banks and financial institutions against 28439 small and medium sector enterprises from the aforesaid funds.

- Bangladesh Bank (BB) has been implementing a project named "Investment Promotion & Financing Facility (IPFF) Project" on behalf of Finance Division, Ministry of Finance. An Administration Agreement (AA) was signed on 21 August 2006 (for first phase) and on 7 July 2010 (for second phase) between the BB and the Finance Division. The IPFF is an On-lending based Technical Assistance (TA) project to supplement the resource of the financial markets to provide term finance for infrastructure and other investment projects beyond the capacity of local financial institutions. It also promotes the private sector entrepreneurs in the development of capital projects, specially infrastructure. Under the IPFF, Government -approved private infrastructure development projects, implemented on Public-Private Partnership (PPP) basis are being financed through selected Participating Financial Institutions (PFIs). The eligible sectors for financing under the IPFF are power generation, transmission, distribution and services, port development (sea, river and land), environmental, industrial and solid waste management, highways and expressways including flyovers, water supply and distribution, sewerage and drainage, industrial estates and park development etc. One of the main features of the project in the second phase is that at least 25 percent cost of any approved project is to be borne by the entrepreneurs' own sources as equity and at least 15 percent of the project cost is to be borne by the PFI. The remaining 60 percent may be financed by the IPFF. The PFIs are supposed to bear all the commercial risks associated with debt financing. The IPFF consists of 2 (two) components: 1) Infrastructure Development Lending Component and 2) Technical Assistance (TA) component. In the first phase of the IPFF, total cost of the project was USD 60.0 million (Taka 4.2 billion) where IDA has provided USD 50.0 million (USD 2.5 million for TA & USD 47.5 million for on-lending) as soft loan and the GoB fund was USD 10.0 million (for On-lending only). In the second phase, total project cost has increased to USD 367.0 million (Taka 25.7 billion) where IDA is providing an additional soft loan of USD 257.0 million (USD 7.0 million for TA & USD 250.0 million for On-lending) and the GoB will provide USD 50.0 million (for On-lending only).

It is worth mentioning here that the IPFF has been able to disburse 100 percent (Taka 4.2 billion equivalent to USD 57.5 million) of its On-lending component to 7 small power plants with capacity of 178 MW within 4th year of the project tenure in the first phase and so far, Taka 28.7 crore has been disbursed under the new credit. The power plants which have been financed under the IPFF are Doreen Power House and Technologies Limited (Three power plants 22 MW each), Doreen Power Generation System Limited (11 MW), Regent Power (22 MW) and two power plants of united power (one in Chittagong EPZ with a capacity of 44 MW and the other in Dhaka EPZ with a capacity of 35 MW). All the power plants are contributing power to the national grid.

Equity and Entrepreneurship Fund (EEF)

7.33 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. The fund was maintained by the Bangladesh Bank until 2009. As per Government decision, an agreement has been signed on 1 June 2009 between BB and ICB regarding the transfer of operational activities of EEF. Under this agreement ICB is now performing the operational activities of EEF while the EEF Unit of Bangladesh Bank is doing the activities related to policy making, fund management and performance monitoring. So far Taka 12.3 billion has been released to the fund by the Government out of total budgetary allocation of Taka 21.0 billion in different fiscal years. Up to 30 June 2012 with the project cost of Taka 45.9 billion, a total of 1085 projects (including 1022 agro-based/food processing projects and 63 IT projects) got EEF sanction at different stages of disbursement. The cumulative equity disbursement stood at Taka 7.4 billion at the end of FY12 against the total fund disbursement of Taka 12.3 billion from the Government. Till now forty three EEF supported companies availed share buy-back facilities partially or fully of Taka 0.9 billion. So far three EEF supported projects have paid dividend of Taka 0.1 million to EEF.

Financial Sector Fraud

7.33 Bangladesh's financial system remained sound and resilient throughout 2012, though it had to address issues related to a financial sector fraud as discussed below. The banks have strengthened their funding base over the year and are prepared to meet future credit demand and support economic growth. The risk weighted capital adequacy ratio improved in FY12 from 10.35 in September 2011 to 11.31 in June 2012. Most of the banks are now able to comfortably meet the regulatory requirements for core funding. A new Financial Stability Department was set up and a Financial Stability Report produced and disseminated.

In the second half of FY12, BB detected a large financial fraud in a branch of a state-owned bank. BB promptly referred the case to the Anti-Corruption Commission and the process of bringing the perpetrators of this fraud to justice is underway. Bangladesh Bank investigated this scam and found weakness in loan sanctioning within this bank including poor control over fund management of the Treasury Department, no regular meeting by the Asset-Liability Management Committee, no effective coordination between Treasury Department and branches regarding loan expansion, etc.

Bangladesh Bank has stepped up its financial supervision role following this scam. Highlights include:

- Appointment of a Fraud Risk Detection and Risk Mitigation Advisor who is training BB officials and bank staff on ways to detect and reduce fraud. In addition, an international, IMF-supported consultant is working to strengthen off-site and on-site supervision.
- An electronic dashboard has been set up for real-time monitoring of letters of credit and other banking transactions so that abnormalities can be detected faster.
- Corporate Memory Management System (CMMS) has been established to preserve the disciplinary record of officers and directors of scheduled banks and non-bank financial institutions.
- Quick Review Report (QRR) of banks is being done on quarterly basis with a view to identifying existing risk specially capital, resource management, earning capacity, liquidity etc.
- Information on serious irregularities detected by the Department of Off-site Supervision is sent regularly to Bank Inspection Department to check these at field level.

Housing Finance

7.35 Total housing loans from banks and financial institutions as of end June 2012 amounted to Taka 352.1 billion (Table 7.12), which was 8.6 percent of total credit to the private sector.

7.36 In recent years, significant changes have been taking place in total housing loan portfolios. Of the total, private sector banks with ample deposit resources have been expanding their housing loan portfolios. They have (Table 7.12) the largest share of Taka 191.8 billion in outstanding housing loans as of end June 2012. The SCBs have the second largest share of Taka 63.4 billion and other banks Taka 31.6 billion in outstanding housing loans as of end June 2012. Besides, two private sector specialised housing finance companies also provide a significant amount of loan. They supply fund for their operations by taking long term deposits including some contractual deposit schemes.

7.37 The state owned House Building Finance Corporation (HBFC) has the third largest share of Taka 26.0 billion in outstanding housing loans as of end June 2012. 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 organisations. 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 to Taka 1.0 billion, it could not sell them. So, sufficient surplus cash fund could not be generated from the Corporation's own cash in-flow after payments of debenture instalments, 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 came down. In FY11 and FY12 Taka 2.2 billion and Taka 3.0 billion were disbursed out of recoveries of Taka 4.1 billion and Taka 4.4 billion respectively.

Table 7.12 Outstanding housing loans

(billion Taka)

Lenders	Outstanding as of end June		
	FY10	FY11	FY12P
a. Specialised housing finance providers	45.9	48.3	51.5
i) HBFC	25.1	25.1	26.0
ii) Delta-Brac Housing Finance	17.4	20.7	23.1
iii) National Housing Finance	2.4	2.5	2.4
b. Banks	**162.4**	**220.6**	**286.8**
i) PCBs	99.0	147.6	191.8
ii) SCBs	48.1	53.0	63.4
iii) Other banks (foreign and specialised)	15.3	20.0	31.6
c. Other financial institutions	**9.2**	**11.3**	**13.8**
d. Microcredit lenders			
Grameen Bank	0.2	0.1	0.1
Total	**216.7**	**280.8**	**352.1**

Sources: Department of Financial Institutions and Markets, Statistics Department, Bangladesh Bank and Grameen Bank.
P= Provisional.

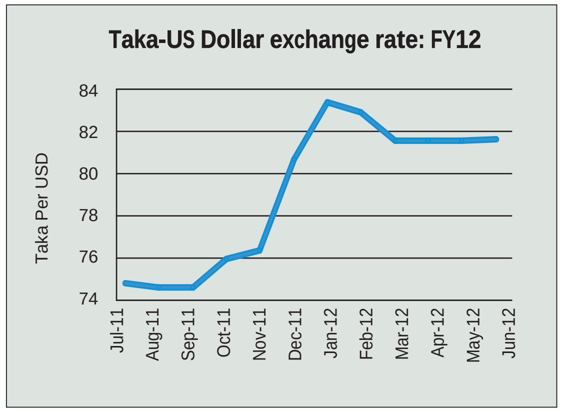
7.38 The Grameen Bank provides housing loans to its members in rural areas. Some NGOs also have small involvement in lending to housing. The Grihayan Tahbil created by the Government of Bangladesh provides housing loan to the NGOs at the rate of 2.0 percent simple interest who in turn provides housing credit to the rural poor at the rate of 6.0 percent simple interest. As on June 2012, the Grihayan Tahbil has been released Taka 1.3 billion against allocation of Taka 2.4 billion through 523 NGOs for rural housing programme which have covered 450 upazilas of 64 districts of the country and 51685 houses have already been constructed. In addition, for the people adversely affected by different natural calamities, Taka 0.1 billion has been released as grants as per decision by the authority concerned.

So far the Tahbil has recovered Taka 0.97 billion against the total recoverable amount of Taka 1.10 billion. As on June 2012, recovery rate was 87.9 percent. Since its beginning in FY98, the Tahbil received an amount of Taka 1.6 billion from the GoB up to end June 2012.

Foreign Exchange Market

7.39 Bangladesh floated its exchange rate for Taka with effect from 31 May 2003. Under this regime, the exchange rate is determined by demand and supply of the respective currencies. Authorised Dealer banks are now allowed to set their own rates for inter-bank and customer transactions. However, in order to maintain stability in the foreign exchange market, Bangladesh Bank remains vigilant over the developments in the foreign exchange market by closely monitoring the buying and selling of foreign exchanges.

Chart 7.6



7.40 Taka witnessed 10.0 percent depreciation against US dollar in FY12 mainly due to the higher import demand for enhanced domestic investment activities and the increase in fuel prices.

The weighted average interbank rate stood at Taka 81.9 per USD as of 30 June 2012 against Taka 74.2 as of 30 June 2011. However Bangladesh Bank continued its role in the foreign exchange market in line with its monetary policy goal to ensure stability in the market.