FINANCIAL STABILITY REPORT 2010

Issue 1
October 2011

Bangladesh Bank

This edition is published in October 2011 and is based on data and information available as of December 2010, unless stated otherwise.

FINANCIAL STABILITY REPORT 2010

Department of Off-site Supervision

Bangladesh Bank

FINANCIAL STABILITY REPORT 2010
BANGLADESH BANK

Chief Coordinator:

Mr. S. K. Sur Chowdhury, Executive Director

Coordinators:

1. Mr. Sultan Ahmed, General Manager
2. Mr. K.M. Gousuzzaman, General Manager
3. Mr. Md. Tariqul Haque, Joint Director

Editors:

1. Mr. Md. Ala Uddin, Deputy Director
2. Mr. Mohammad Shahriar Siddiqui, Deputy Director
3. Mr. Md. Aminur Raman Chowdhury, Deputy Director
4. Mr. Abdul Hye, Deputy Director

Data Support:

1. Department of Off-site Supervision
2. Banking Regulation & Policy Department
3. Department of Financial Institutions and Markets
4. Monetary Policy Department
5. Research Department
6. Department of Currency Management and Payment System
7. Deposit Insurance Department
8. Statistics Department

The coordinators and editors would like to thank Mr. Muhammad Allah Malik Kazemi, Senior Consultant and Mr. Glenn Tasky, Banking Supervison Advisor for their valuable suggestions and comments on earlier draft report.

Foreword

Financial stability is gaining increasing importance in macroeconomic management towards sustainable economic growth. Global financial crises of the recent past and sovereign debt crises of a number of European countries and of the US prompted policy makers to review financial stability on a periodic interval.

A financial system can be treated as stable if it fulfills its functions and is able to withstand the shocks to which it is exposed. As the financial system of Bangladesh is made-up of banks, non-bank financial institutions (NBFIs), insurance companies, securities & exchange commission and micro-credit organizations, it is an important responsibility of Bangladesh Bank (BB) to discharge its responsibilities as regulator of banks and NBFIs in coordination with regulators of other financial institutions with a view to maintaining stability and public confidence in the financial system.

It is widely believed that a strong and resilient banking system is the pedestal for sustainable economic growth since banks serve as the hub of the credit intermediation process between depositors and investors. Taking this in mind, BB has put special emphasis on maintaining stability in the banking sector. It is noteworthy that BB has already trained all banks about how to conduct periodic stress tests and put emphasis on the adoption of various risk management tools so that they can withstand different endogenous and exogenous shocks. Besides, BB has initiated steps to prepare a financial stability report from 2010 onward on a regular basis replacing the existing Off-site Supervision Report.

This is the inaugural issue of the Financial Stability Report. It discusses major trends in the banking industry and NBFIs in Bangladesh with respect to their impact on financial stability. Through this report, the BB conveys its assessment of the stability of the financial system, the banking sector in particular, and attempts to highlight the strength of the financial system as well as risks and fragilities exist therein that could jeopardise financial stability.

I hope that financial institutions, market participants, businesses and households of the country will obtain important insights from the report that might make them better prepared to withstand and adapt to possible shocks.

Dr. Atiur Rahman
Governor

Contents

		Page
	Foreword	v
	Acronyms	xv
Chapter 1	Overview	1
Chapter 2	Macroeconomic Developments	9
Chapter 3	Banking Sector	13
	3.1 Financial system of Bangladesh	13
	3.2 Asset structure of the banking sector	13
	3.3 Banking sector classified loans, provisioning & write off	16
	3.4 Liability structure of the banking sector	19
	3.5 Banking sector deposit safety net	21
	3.6 Banking sector profitability	22
	3.7 Capital adequacy	25
	3.8 Capital regulation issued by BB in CY10	27
	3.9 Free capital	28
	3.10 Leverage ratio	28
	3.11 Banking sector liquidity	29
Chapter 4	Islamic Banking	31
	4.1 Introduction	31
	4.2 Growth of Islamic banking	31
	4.3 Market share of Islamic banks	32
	4.4 Profitability of Islamic banks	32
	4.5 Islamic banks' liquidity	33
	4.6 Islamic banks' capital adequacy	33
	4.7 Classified Investment of Islamic banks	34
Chapter 5	Banking Sector Risks	35
	5.1 Credit risk structure in Bangladesh	35
	5.2 Structure of market risk under Basel II	35
	5.2.1 Interest rate risk	36
	5.2.2 Exchange rate risk	36
	5.2.3 Equity price risk	37
	5.3 Operational risk	38
	5.4 Credit rating companies (CRCs)	39

		Page
Chapter 6	Stress Testing	41
	6.1 Resilience of the banking sector	41
Chapter 7	Non-Bank Financial Institutions	45
	7.1 Introduction	45
	7.2 Funding sources	45
	7.3 Assets and financing	45
	7.4 Non-performing assets and provisioning	46
	7.5 Profitability	47
Chapter 8	Capital Markets	49
	8.1 Market capitalization and issued capital	50
	8.2 Price earnings ratio	52
Chapter 9	Financial Infrastructure	53
	9.1 Payments and settlement system	53
	9.2 Bangladesh automated clearing house (BACH)	53
	9.3 Mobile-technology based financial services	54
	9.4 E-payment activities	54
	9.5 Legal and regulatory framework	54
	9.6 Electronic banking operations	54
	9.7 CDBL transactions and settlement system	56
	9.8 Treasury bills/bond electronic registry	56
Chapter 10	Development in the Financial System	57
	10.1 Basel II implementation	57
	10.2 Risk management unit	57
	10.3 Enterprise data warehouse	58

Appendices

		Page
Appendix I	Banking Sector Aggregate Balance Sheet	59
Appendix II	Banking Sector Aggregate Share of Assets	60
Appendix III	Banking Sector Aggregate Share of Liabilities	60
Appendix IV	Banking Sector Aggregate Income Statement	61
Appendix V	Banking Sector Assets, Deposits & NPL Concentration (CY10)	61
Appendix VI	Banking Sector Loan Loss Provisions	61
Appendix VII	Banking Sector Year-wise Classified Loans Ratios	62
Appendix VIII	Banking Sector Deposits Breakdown (CY10)	62
Appendix IX	Banking Sector Call Money Investment & Borrowing	62
Appendix X	Banking Sector Selected Ratios	63
Appendix XI	Banking Sector ROA & ROE (CY10)	63
Appendix XII	Banking Sector Year-wise CDR	63
Appendix XIII	Banking Sector CDR in CY10	64
Appendix XIV	Banking Sector Year-wise Deposit & Advance Rate	64
Appendix XV	Banking Sector Month-wise Deposit & Advance Rate	64
Appendix XVI	Islamic Banks Aggregate Balance Sheet	65
Appendix XVII	Islamic Banks Aggregate Income Statement	66
Appendix XVIII	Share of Islamic Banks in the Banking Sector (CY10)	66
Appendix XIX	Market Share of Islamic Banks and Conventional Banks (CY10)	67
Appendix XX	Selected Ratios of Islamic Banks and the Banking Sector (CY10)	67
Appendix XXI	Islamic Banks' Capital Adequacy Ratio (CY10)	67
Appendix XXII	Islamic Banking Sector Investment-Deposit Ratio (as of 31.12.2010)	68
Appendix XXIII	Key Financial Indicators of NBFIs	68
Appendix XXIV	Month-wise Capital Market Performance	69
Appendix XXV	Sector-wise Contribution of Capital Market	69
Appendix XXVI	Bangladesh Automated Clearing House (BACH) Operations	70
Appendix XXVII	Electronic Banking Transactions	70
Appendix XXVIII	Classified Loan Concentration Ratio (CY10)	70

List of Charts

		Page
Chart 3.1	Banking sector asset structure	13
Chart 3.2	Top 5 banks based on asset size of the banking sector	14
Chart 3.3	Top 10 banks based on asset size of the banking sector	14
Chart 3.4	Distribution of banks by classified loans to total loans ratio	16
Chart 3.5	Banking sector loan loss provisions	17
Chart 3.6	Worst 5 banks based on classified loans of the banking sector	18
Chart 3.7	Worst 10 banks based on classified loans of the banking sector	18
Chart 3.8	Year-wise classified loans ratios of the banking sector	19
Chart 3.9	Banking sector liability structure	19
Chart 3.10	Banking sector deposit structure by types of account	20
Chart 3.11	Top 5 banks based on deposit size of the banking sector	20
Chart 3.12	Top 10 banks based on deposit size of the banking sector	21
Chart 3.13	Safety net on banking sector deposits	21
Chart 3.14	Sector return on assets (ROA)	22
Chart 3.15	Banking sector return on equity (ROE)	22
Chart 3.16	Banking sector asset turnover and net interest margin (NIM)	23
Chart 3.17	Banking sector non-interest expenses to total income	23
Chart 3.18	Banking sector sources of total income	24
Chart 3.19	Banking sector monthly weighted average interest rate & spread	24
Chart 3.20	Capital adequacy ratio of the banking sector	25
Chart 3.21	Asset Share of Banks based on CAR in CY10	25
Chart 3.22	Tier-1 ratio and overall CAR of the banking industry	26
Chart 3.23	Distribution of risk weighted assets (RWA) in CY10	27
Chart 3.24	Equity & free capital of the banking industry	28
Chart 3.25	Leverage ratio of banks as of end CY10	28
Chart 3.26	Banking sector year-wise credit-deposit ratio	29
Chart 3.27	Banking sector credit-deposit ratio	30
Chart 3.28	Banking sector call money investment & borrowings	30

		Page
Chart 4.1	Islamic banking growth trend	31
Chart 4.2	Market share of Islamic banks and the banking sector in CY10	32
Chart 4.3	Selected income ratios of Islamic banks & the banking sector	32
Chart 4.4	IDR (CDR) of Islamic banking & the overall banking sector	33
Chart 4.5	Capital adequacy ratio of Islamic banks	34
Chart 4.6	Classified investment (loans) of Islamic banks and the banking industry	34
Chart 5.1	Credit risk structure	35
Chart 5.2	Market risk structure	36
Chart 5.3	Exposure rating status in Bangladesh	40
Chart 7.1	NBFI capital, deposit and borrowing trend	45
Chart 7.2	NBFI assets & financing trend	46
Chart 7.3	NBFIs NPA & provisioning trend	46
Chart 7.4	NBFIs ROA & ROE trend	47
Chart 8.1	DSE general index movement	49
Chart 8.2	Movement of DSE market capitalization & issued capital	50
Chart 8.3	Sector-wise breakdown (percent) of total market capitalization	50
Chart 8.4	DSE monthly turnover	51
Chart 8.5	Movement of market price-earnings ratio	51
Chart 9.1	Bangladesh automated clearing house operations	53
Chart 9.2	Number of banks providing electronic banking facility	55
Chart 9.3	Volume of electronic banking transactions	55

List of Tables

		Page
Table 3.1	International comparison of capital adequacy indicators	27
Table 5.1	Credit risk in the banking system	35
Table 5.2	Interest rate risk in the banking system	36
Table 5.3	Exchange rate risk in the banking system	37
Table 5.4	Equity price risk in the banking system	37
Table 5.5	Operational risk (OR) under Basel II basic indicator approach	38
Table 5.6	Commencement of credit rating agencies in Bangladesh	39

List of Boxes

		Page
Box 1	Sector-wise loans concentration (CY10)	15
Box 2	Shocks to different risk factors based on data as of end December 2010	42

Acronyms

ACG	Asia Pacific CSD Group
ADB	Asian Development Bank
ANNA	Association of National Numbering Agencies
ATM	Automated Teller Machine
BACH	Bangladesh Automated Clearing House
BACPS	Bangladesh Automated Cheque Processing Systems
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BCBS	Basel Committee on Banking Supervision
BDBL	Bangladesh Development Bank Limited
BDT	Bangladeshi Taka
BoP	Balance of Payments
BPSSR	Bangladesh Payment and Settlement Systems Regulations
BSB	Bangladesh Shilpa Bank
BSRS	Bangladesh Shilpa Rin Shanstha
CAR	Capital Adequacy Ratio
CBCL	Central Bank of Sri Lanka
CC	Cash Credit
CDBL	Central Depository Bangladesh Limited
CDR	Credit Deposit Ratio
CDS	Central Depository System
CP	Core Principles
CPI	Consumer Price Index
CR	Credit Risk
CRC	Credit Rating Company
CRR	Cash Reserve Requirement
CSE	Chittagong Stock Exchange
CY	Calendar Year
DFID	Department for International Development (UK)
DSE	Dhaka Stock Exchange
ECAI	External Credit Assessment Institutions
EDW	Enterprise Data Warehouse
EGSR	Electronic Government Securities Registry
EPR	Equity Price Risk
ERR	Exchange Rate Risk
EU	European Union
FC	Foreign Currency
FI	Financial Institution
FSDC	Financial Stability and Development Council
FSU	Financial Stability Unit
FY	Fiscal Year

GDP	Gross Domestic Product
HBFC	House Building Finance Corporation
HHI	Herfindal-Hirchman Index
HV	High Value
ICB	Investment Corporation of Bangladesh
IDR	Investment Deposit Ratio (for Islamic banks)
IMF	International Monetary Fund
IRR	Interest Rate Risk
ISIN	International Securities Identification Number
IT	Information Technology
M2	Broad Money
MCR	Minimum Capital Requirement
MR	Market Risk
NBDC	Non-Bank Depository Corporation
NBFI	Non-Bank Financial Institutions
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NII	Net Interest Income
NIM	Net Interest Margin
NPA	Non-Performing Assets
NPL	Non-Performing Loan
NPM	Net Profit Margin (for Islamic banks)
NSD	National Savings Directorate
OD	Over Draft
OR	Operational Risk
OTC	Over the Counter
P/E	Price Earnings
RBCA	Risk Based Capital Adequacy
RBI	Reserve Bank of India
RMU	Risk Management Unit
ROA	Return on Assets
ROE	Return on Equity
RV	Regular Value
RWA	Risk Weighted Assets
SAFE	South Asian Federation of Exchanges
SBP	State Bank of Pakistan
SEC	Securities & Exchange Commission
SLR	Statutory Liquidity Requirement
SME	Small and Medium Enterprise
T-bill	Treasury Bill
USD	United States Dollar
y-o-y	Year over Year

Chapter 1 Overview

Global financial stability has improved in 2010 with strong growth in emerging market countries, attributable to better macroeconomic performance and continued accommodative macroeconomic policies. World real GDP also recorded a notable growth.

Advanced economies demonstrated modest growth while emerging ones recorded robust expansion, a scenario termed as 'Two Speed Recovery' (see the April 2011 Global Financial Stability Report of IMF for details). In advanced economies the health of financial institutions has not recovered in line with the growth in the overall economy; governments and households are still suffering from a heavy debt burden, though in varying degrees. Sovereign balance sheets are highly vulnerable to growth shocks; the turmoil in sovereign debt markets is still a problem in Europe, which is aggravating increased vulnerabilities of banks and sovereign balance sheets arising from the crisis. In the United States, the housing market is not functioning well, and legacy mortgage problems still exist. Besides, a backlog of foreclosures are putting pressure on the banking system and thus restraining credit creation and creating impediments in the return of the mortgage market to a fully functioning state.

On the other hand, emerging market economies have continued to gain from strong growth relative to that in advanced economies, where increasing portfolio capital inflows have taken place. However, emerging economies also are facing new challenges in connection with rapid credit growth, strong domestic demand, relatively supportive macroeconomic policies, and large capital inflows. These indicate that there are still some uncertainty and fragilities in the global financial system.

It is worth noting that the global growth trend became interrupted in the prevalence of concerns over debt sustainability issues in some EU-member states. Measures taken there are distorting public debt balances as well as making concerns over spillover effects and thus creating an adverse impact on debt dynamics.

In the severe state of global financial crisis, the impact on the Bangladesh economy was limited due to its limited openness, but in the subsequent two years (2009-2010) the effect was felt strongly. Nevertheless, the Bangladesh economy continued to demonstrate a moderate level of resilience during financial year (FY) 2010 making a notable real GDP growth compared with that of the previous fiscal year. Real GDP growth was much higher than the world real level. The industrial production index recorded notable and higher growth; the service sector contributed predominantly to the GDP, followed by industry and agriculture thus demonstrating structural transformation of the economy from agriculture to industry and services.

Inflation (Consumer Prices Index-General), on a 12-month average basis, was in upward trend in all quarters of calendar year (CY) 10 attributable to a surge in many food and non-food commodity prices in the international market, a rise in domestic prices of food grains and a high base effect.

Government relied on foreign sources as well as collected increased tax and non-tax revenue domestically with a view to financing different commitments. The budget deficit remained below 5 percent of GDP, reflecting prudence in overall fiscal management of the country. Domestic borrowing was in an increasing trend as financing through grants and credit from external sources narrowed.

Bangladesh Bank (BB)'s monetary policy in CY10 continued to pursue the dual objectives of maintaining price stability and supporting faster economic growth. To this aim, BB maintained a cautious watch to locate and neutralize likely inflationary pressures from the growth supportive monetary and credit policies.

BB continued to follow an accommodative monetary policy; broad money (M2) recorded notable growth, driven mainly by higher growth in net foreign assets; credit to the public sector decelerated sharply compared with projected growth due to a downward revision of the annual development program, higher revenue collection and inflow of foreign assistance. Credit to the private sector recorded notable growth compared to the previous fiscal year. The money multiplier slightly increased, attributable to lower growth in reserve money compared to the growth in broad money.

Demand for money grew largely as of end-December 2010 year-on-year. The sustained growth in net foreign assets continued to fuel the expansion in domestic liquidity, which could be traced largely to the continued build-up of the BB's international reserves as a result of strong foreign exchange inflows from exports receipts and overseas remittances.

Domestic interest rates in the primary market for deposits eased slightly during the third quarter of 2010 relative to the previous quarter as the inflation environment remained favourable. Yields on the 5-year to 20-year Treasury bond were lower than the same offered against different government savings bonds.

Purchases of foreign exchange inflows from the market to retain Taka on a slight undervaluation bias for export competitiveness were only partly sterilized by liquidity management operations.

Exports improved steadily throughout FY10, but it took up to fourth quarter to make good for the negative growth rates of initial months, limiting export growth to a low single digit level. Growth in actual import of capital goods remained slow because of scarcities in power and gas supply; the scarcities also caused under utilization of installed capacities.

The balance of payments showed an overall deficit in the fourth quarter of CY10. Higher import growth as compared to growth of exports widened the trade deficit.

Banking sector

In 2010, the Bangladesh banking sector demonstrated a moderate level of resilience as reflected in the improvement in key financial indicators of the banking industry, favored by a congenial domestic macroeconomic environment. The banking sector's balance sheet recorded sizable growth, which was broad-based as most of the income-earning assets registered positive growth; banking assets were not too much concentrated among a small number of banks; and loans also were not heavily concentrated.

The rates for savings and time deposits continued to decline during the first half of the year and lending rates also declined in the review period. Similarly, bank lending rates for all maturities decreased, indicating the pass-through effect of the BB's imposition of caps in lending rate in the year 2009. Credit quality demonstrated an improvement as reflected by the declining trend in the classified loan ratio. Classified loans were not concentrated and were widely shared by banks.

The provision shortfall in the banking sector was reduced to BDT 3.99 billion as at end-2010. A specialized commercial bank and 3 domestic private commercial banks incurred significant provision shortfalls, reflected in a net shortfall in the banking sector in CY10. All other banks have shown strong resilience to the early headwinds of credit risk.

Deposits financed the lion's share of banking sector assets. Besides, deposits were only moderately concentrated in a few sectors and were not concentrated in a small number of banks. The percentage of fully insured depositors largely increased with respect to the same of CY09, indicating a better safety net for small depositors. The deposit rate decreased largely compared with the decrease of the same in the previous year, resulting from the persistent efforts of BB to encourage the banks to reduce their spread to a reasonable level to facilitate investment and growth.

Banking sector *operating profit* and *net profit* increased by 47.03 percent and 53.80 percent respectively in CY10. The *Return on assets* (ROA) and *return on equity* (ROE) increased parallel to the surging net profit, reaching levels of 1.72 percent and 19.89 percent respectively in CY10. Overall interest income increased proportionately more than interest expense, resulting in a surge in net interest margin (NIM) which favorably affected the sector's profitability in CY10. The rise in asset turnover ratio and net interest margin were instrumental in the increase in profitability ratios. The *asset turnover ratio* and the *net profit margin* was 5.90 percent and 3.05 percent in 2010.

The interbank money market faced some liquidity stress at the end of CY10. However, the intervention of BB and prudent policies of the financial institutions let business quickly return to the pre-stress level. The stressed condition of the interbank market suggests that banks need to monitor their asset-liability mismatch closely while making financing decisions.

Although the overall credit-deposit ratio as at end-December 2010 was at a tolerable level, investment in call money market decreased by 11.61 percent while, borrowings increased by 30.96 percent in CY10 compared to CY09. This excess of borrowing growth over lending growth in the banking sector evinces the misuse of excess liquidity, by heavily engaging in the capital market by banks in 2010. In fact, there was no liquidity crisis in the banking sector in 2010. Banks' funds were simply deployed in the secondary share market.

The Basel-II capital adequacy framework came into force on 1 January 2010 on a regulatory basis. Under this framework, a majority of the banks were found to have maintained the minimum required capital adequacy ratio (CAR). The lion's share of banking assets was within the compliant CAR group.

Risk weighted assets of banking sector comprised credit risk, market risk and operational risk. As of end December 2010, credit risk weighted assets accounted for nearly 85 percent of total risk weighted assets, followed by operational and market risk weighted assets.

As of end December 2010, most of the banks maintained the required minimum CAR and Tier-1 ratio. An increasing trend in these two ratios was observed during the four quarters of CY10, which indicates that banks are gradually becoming sounder financially. However, a cross-country scenario of capital adequacy suggests that the Bangladesh banking sector still has a long way to go, as the industry CAR of some South Asian countries namely India, Sri Lanka and Pakistan, is much higher than that of Bangladesh.

Banks were restricted from exceeding the prudential limit of share holding, i.e. 10 percent of a bank's liabilities. In terms of banks' liabilities, at the end December 2010, the aggregate exposure was nearly 6.0 percent as against the ceiling. 9 commercial banks, with an asset share of 16 percent, were found to have their exposure in excess of the approved limit.

Free capital, defined by equity minus fixed assets, of the banking industry was in a rising trend during CY08 to CY10, implying that the amount of capital available to absorb losses was also in an increasing trend. However, a majority of the banks maintained a leverage ratio (equity/asset) lower than 10 percent implying that there is still further room for them to improve their financial soundness.

Islamic banks

Islamic banks are playing a significant role in the banking sector of Bangladesh, recording a remarkable growth in CY10. The ongoing expansion of the Islamic banking network is also impressive.

As a proportion of the overall banking industry, the combined share of 7 Islamic banks (excluding Islamic banking branches/windows of conventional banks) was 15.11 percent in assets, 17.95 percent in investments (loans), 16.32 percent in deposits, 13.05 percent in equity and 15.30 percent in liabilities as of end-December 2010.

A majority of Islamic banks maintained a CAR significantly higher than the industry CAR. Islamic banks' classified investments to total investments ratio of 3.48 percent showed a relatively good position as compared with 7.05 percent for the overall banking sector in CY10.

Non-Bank financial institutions

Non-bank financial institutions (NBFIs) constitute an important part of the Bangladesh financial system. NBFIs' total assets increased sizably in CY10 compared with that of CY09. The major funding sources of NBFIs are capital, term & other deposits and borrowings from banks & financial institutions. Banks are a major source for NBFIs to fund their asset deployment, either directly or indirectly. Banks also are major investors in bonds/debentures issued by NBFIs, resulting in a dependence of NBFIs on banks.

The ROE and the ROA ratios of NBFI showed a nascent trend over last five years. Better utilization of assets and equity resulted in the rising trend of these key ratios. Total operating expenses of the NBFIs is increasing due to staff and increasing outsourcing of business operations; however, profitability is still improving. NBFIs maintained surplus provisions against NPA.

Capital market

The Bangladesh capital market recorded strong and significant growth in CY10. A lower pace of investment activities, reduced interest rates on deposit and saving certificates, and increasing enthusiasm among people flooded the capital market with huge liquidity. The financial sector (including banks, financial institutions, insurance and mutual funds) comprised the major part of total market capitalization, followed by the manufacturing sector. Banks represented a nearly one-third share of total market capitalization, recording the highest among all other sectors. The overall weighted average price earnings (P/E) ratio of the Dhaka Stock Exchange (DSE) was slightly higher in CY10 compared with that of the previous year. The P/E ratios of financial institutions, engineering, jute, textile, pharmaceuticals, service and real estate, cement, IT, ceramic, insurance, and travel & leisure were also above the overall market P/E ratio. Notably, the DSE index reached an all time high level in December 2010.

Payments and settlement system

The payment and settlement systems in Bangladesh remained resilient and continued to operate smoothly throughout CY10, contributing to the stability of the financial system. Remarkable progress has been achieved in the shift from paper-based payments to electronic form; however, cash and cheques remain popular. With the technical and financial assistance from DFID, UK, BB started live operation of the Bangladesh Automated Clearing House (BACH) in Dhaka region, the first electronic clearing house in the country, from 07 October 2010.

Electronic banking transactions increased significantly in CY10 compared with that of CY09. Out of 47 scheduled banks, 43 banks were engaged in some sort of electronic banking operations during CY10.

BB approved several mobile-technology based financial services aiming at financial inclusion of the non-banked population of the country. In addition, BB approved some 'E-Payment Activities'. It is to note that in order to give legal and regulatory support to electronic exchange of images of paper items and electronic transfer of funds, BB approved and assigned the "Bangladesh Payment and Settlement Systems Regulations (BPSSR), 2009", which is the bedrock of modern payment systems in Bangladesh.

CDBL transactions and settlement system

Central Depository Bangladesh Limited (CDBL) was established to provide services to the Bangladesh capital market, covering settlement of trades on stock exchanges as well as settlement of OTC transactions of treasury bills and government bonds issued by the central bank. Live operations of the Central Depository System (CDS) commenced with the inauguration of the Electronic Government Securities Registry (EGSR) on 20 October 2003, which serves as a platform for secondary market sale/purchase as well as repo transactions of government securities to commercial banks linked online to the CDS.

Stress testing and resilience of the banking sector

In order to understand and appreciate the risks the banking industry is exposed to, ensure the soundness and sustainability of the banking industry, and make the banks more shock resilient, BB issued guidelines on stress testing in April 2010. Under stress testing the impact of a number of risk scenarios, namely credit risk, interest rate risk, exchange rate risk, equity price risk, liquidity risk related shocks and some combination of those, on CAR of the banks are evaluated.

Only a few banks with a small market share in the industry were found to be facing the threat of erosion of their capital base; fortunately, however, banks with a dominant share in the sector were found to have the capacity to absorb loss emanating from a further deterioration in asset quality.

Overall, the banking industry was found to be fairly resilient towards various market risk shocks. However, the combined application of credit and market shocks resulted in significant declines in CAR. Besides, deposit withdrawal at a moderate rate keeps liquidity ratio resilient, however, it has been found that banks could withstand a moderate rate of deposit withdrawal but not a high rate.

Financial inclusion initiatives

In CY10, BB strengthened financial inclusion of under-served/un-served productive economic sectors and population segments. The initiatives continued strong support for adequate lending to agriculture, SMEs, renewable energy and other productive sectors; while discouraged expansion in lending to wasteful consumption and unproductive speculative investment.

Prudential measures taken in CY10

BB took a number of prudential measures to sustain financial stability and soundness of banks and non-bank financial institutions. Amongst the most important ones are: limiting banks' exposures in the capital market, issuing amended guidelines on risk based capital adequacy and guidelines on supervisory review evaluation process, instructing banks to consolidate investment in subsidiaries and implication of other capital market exposures for the purpose of computing eligible regulatory capital, issuing guidelines on subordinated debt for inclusion in regulatory capital, and issuing action-plan/roadmap for implementations of Basel-II Accord in the NBFIs from early 2012.

Chapter 2 Macroeconomic Developments

In spite of the global economic meltdown, the economy of Bangladesh continued to demonstrate considerable resilience during FY10. Amidst the risks of falling export earnings and remittances inflows, coupled with lowering domestic demand, economic growth demonstrated satisfactory performance. According to the provisional estimates of Bangladesh Bureau of Statistics (BBS) real GDP grew by 5.8 percent in FY10, which was 0.1 percentage point higher than the growth recorded in FY09. Besides, the industrial production index recorded around 9.0 percent growth in March 2010 compared to 5.8 percent growth recorded in March 2009. In FY10, the country's per capita GDP increased by about 4.5 percent in real terms and about 11.2 percent in nominal terms. The service sector contributed around 50 percent in GDP, while the contributions of the industrial and agricultural sectors were nearly 30 percent and 20 percent respectively. Structural transformation in the economy is taking place from agriculture to industry and services.

With a view to financing different commitments, the Government relied on domestic as well as foreign sources. It is noteworthy that the Government collected increased tax and non-tax revenue in FY10 compared to the previous fiscal year. In FY10, the budget deficit as percentage of GDP stood at 4.5 percent, 0.5 percentage points higher than the previous fiscal year. A deficit lying below 5 percent of GDP during the past few years reflects prudence in overall fiscal management of the country. Domestic borrowing has shown an increasing trend after FY07, since financing through grants and credits from external sources has been narrowing down.

Inflation (changes in the Consumer Prices Index-General), on a 12 month average basis, was in an upward trend in all quarters of CY10 due to surges in many food and non-food commodity prices in the international market, a rise in domestic prices of food grains and a high base effect. Noteworthy in CY10, food inflation showed an upward trend with minor fluctuation while a declining trend was demonstrated in non-food inflation.

Broad money (M2) growth has been on an upward trend for the last 5 years and reached to 22.4 percent in FY10, which was 3.2 percentage points higher than the growth recorded in FY09 and was also higher than the target under the monetary program. The growth in broad money was driven mainly by higher growth in net foreign assets; net foreign assets of the banking system increased by 41.3 percent with respect to that of the previous fiscal year. Credit to the public sector decelerated sharply by 5.2 percent compared with projected growth of 11.9 percent and actual growth of 20.3 percent in FY09 due to downward revision of the annual development program, higher revenue collection and inflow of foreign assistance. Credit to the private sector grew by 24.2 percent in FY10, which was 9.6 percentage points higher than the growth in FY09 and also higher than the projection of 16.7 percent, reflecting the positive attitude of investors as the global economy begins to recover from the recession. The money multiplier increased to 4.9 in FY10 as compared to the actual number of 4.7 in FY09, attributable to lower growth in reserve money compared to broad money.

Demand for money grew by 20.1 percent year-on-year (y-o-y) as of end-December 2010, similar to the growth posted during the previous half-year. The sustained growth in net foreign assets (NFA) at 14.1 percent y-o-y in December 2010 (from 5.2 percent in June 2010) continued to fuel the expansion in domestic liquidity. This can be traced largely to the continued build-up of the BB's international reserves because of strong foreign exchange inflows from exports receipts and overseas remittances. On the other hand, net domestic assets (NDA) expanded by 22.3 percent in December 2010 (y-o-y) as the steady expansion of the net other items account (which includes high growth in National Savings Directorate [NSD] and Non-Bank Depository Corporations [NBDCs]) pulled up domestic liquidity. Net domestic credit growth remained strong as lending to both the public and private sectors grew steadily. Credits extended to the public sector increased by 14.1 percent in December 2010 (y-o-y). Meanwhile, credits extended to the private sector rose by 28.9 percent in December 2010 (y-o-y), consistent with the observed uptrend in bank lending activities.

Domestic interest rates in the primary market for deposits eased slightly during the third quarter of 2010 relative to the previous quarter as the inflation environment remained favorable. By contrast, yields on the 5-year to 20-year Treasury bond varied between 7.8 to 9.1 percent and different government savings bonds profits rates varied from 10.0 to 11.0 percent.

The rates for savings and time deposits continued to decline during the first half of the year and lending rates also declined in that review period. Similarly, bank lending rates for all maturities decreased, indicating the pass-through effect of the BB's imposition of caps in lending rate in the year 2009.

BB has been announcing its monetary policy stance through half-yearly Monetary Policy Statements since January 2006. BB's monetary policy for July-December, 2010 continued to pursue the dual objectives of maintaining price stability and supporting faster economic growth. To this aim, BB maintained a cautious watch to locate and neutralize likely inflationary pressures from the growth supportive monetary and credit policies.

BB pursued an accommodative monetary policy stance in FY10 to support investments and productive economic activities and also to uphold domestic demand in the backdrop of the recessionary global environment. In the beginning year (2008) the impact of the financial crisis on Bangladesh was limited due to its limited openness, but in the subsequent two years (2009-2010) the effect has been felt strongly. The export-import growth slowed down.

To sustain buoyancy in domestic demand and output activities, BB continued to follow strong agricultural and SME credit programs supported by BB refinance lines, and expanded financial inclusion of under-served/un-served productive economic sectors and population segments. Domestic demand, output and investment activities thus strengthened were expected to use up the liquidity overhang from FY09. BB's financial inclusion initiatives continued strong support for adequate lending for agriculture, SMEs, renewable energy and other productive sectors; while discouraging expansion in lending for wasteful consumption and unproductive speculative investment. Accordingly, BB remained proactive in liquidity management operation. Policy interest rates, Cash Reserve Ratio (CRR), and Statutory Liquidity Ratio (SLR) were adjusted as warranted. The financial stability of banks and financial institutions has been kept under the constant watch of BB.

To compensate for the loss in external demand by creating more domestic demand, monetary policy operations in FY10 were light fingered rather than heavy handed. Purchases of foreign exchange inflows from the market to retain Taka on a slight undervaluation bias for export competitiveness were only partly sterilized by liquidity management operations during FY10.

Exports improved steadily throughout FY10, but it took up to the fourth quarter to make good for the negative growth rates of initial months, limiting FY10 export growth to a low single digit level. Growth in actual import of capital goods remained slow because of scarcities in power and gas supply; the scarcities also caused underutilization of installed capacities. Agriculture sector activities remained buoyant however, with favorable overall climatic conditions and with strong hands-on support from the Ministry of Agriculture and BB credit programs ensuring timely access to adequate inputs and financing.

The balance of payments showed a deficit of USD 0.3 billion during the fourth quarter of CY10 against a surplus of USD 0.75 billion during the same quarter of CY09. Due to higher import growth compared to export growth, the trade deficit widened by 10.0 percent (from BDT 3240.5 billion in FY09 to BDT 3564.1billion) in FY10. Offsetting this increase in the trade deficit, the narrower deficit on the services account and expanded income accounts, along with higher remittances-induced current transfers, substantially increased the current account balance surplus by 55.5 percent in FY10. Current account balance as a percentage of GDP stood at 3.7 in FY10 against 2.7 in FY09.

The Bangladesh economy showed its robustness in the period of global economic crisis by retaining an upward trend in foreign exchange reserves. The gross foreign exchange reserves stood at BDT 743.7 billion (US$10.7 billion) in FY10, which is about 44.7 percent higher than the same in FY09.

Overall, the domestic macroeconomic environment was favourable and contributed to the resilience of the banking sector.

Chapter 3 Banking Sector

3. 1 Financial system of Bangladesh

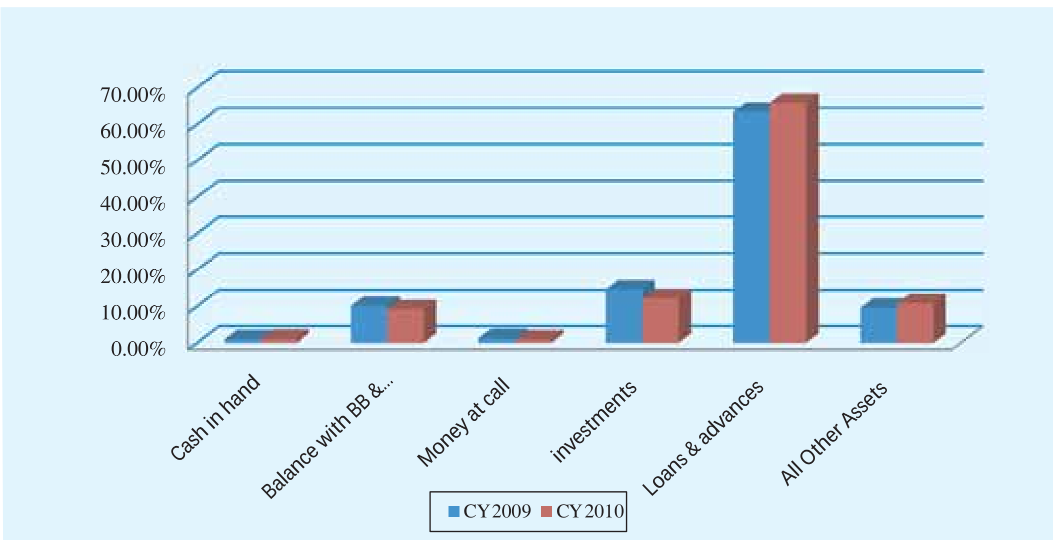
The financial system of Bangladesh consists of Bangladesh Bank (BB) as the central bank, 4 state-owned commercial banks, 4 government-owned specialized banks, 30 domestic private commercial banks, 9 foreign commercial banks and 29 non-bank financial institutions. The financial system also embraces Investment Corporation of Bangladesh (ICB), House Building Finance Corporation (HBFC), Securities and Exchange Commission (SEC) as the regulator of the capital markets, 2 stock exchanges, insurance companies, micro-credit organizations and co-operative banks. The banking sector is the dominant sector in the financial system of Bangladesh. The regulatory and supervisory arrangements for these entities are well defined, with strong legal underpinnings.

There were no significant changes in the structure of the financial system of Bangladesh during CY10. However, 2 specialized commercial banks named Bangladesh Shilpa Rin Shangstha (BSRS) and Bangladesh Shilpa Bank (BSB) merged and started functioning as Bangladesh Development Bank Limited (BDBL) from January 2010.

3. 2 Asset structure of the banking sector

Underpinned by the strong macroeconomic fundamentals, the banking sector balance sheet size grew by 23.47 percent compared with end-2009 and reached to BDT 4855.04 billion as of end-2010. The growth was broad-based as most of the income earning assets registered positive growth.

Chart 3.1 Banking sector asset structure



The share of loans and advances, the largest share among asset items, increased by 2.47 percentage points in CY10. However, the share of investment in government and other securities decreased by 2.52 percentage points. The share of balance with BB and other banks & FIs decreased by 0.88 percentage points and the share of investment in call money market decreased by 0.35 percentage points at end-2010 compared with end-2009. Of the banking sector assets, 65.88 percent were deployed in loans and advances in CY10. The share of other assets increased by 0.63 percentage points, implying new investments in IT infrastructure and branch expansion & renovation during CY10.

Chart 3.2 Top 5 banks based on asset size of the banking sector

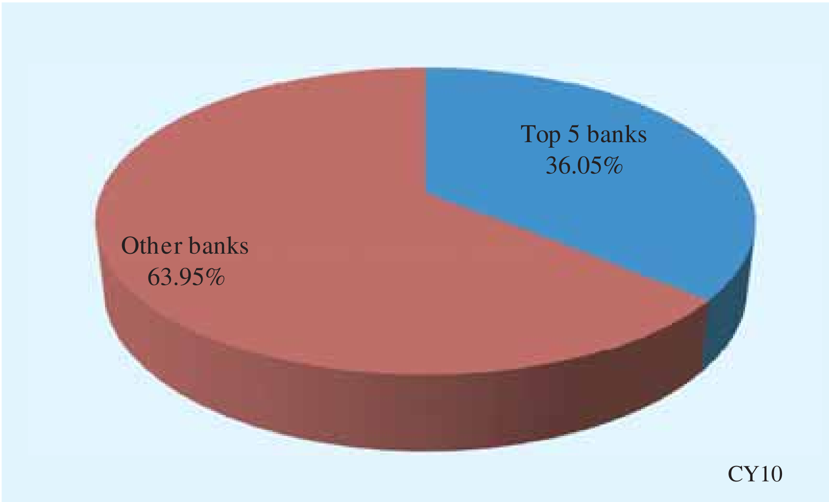
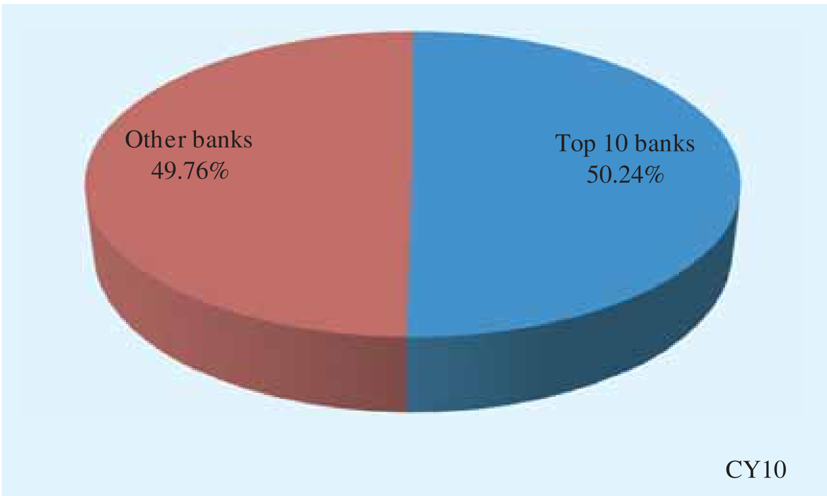


Chart 3.3 Top 10 banks based on asset size of the banking sector



Compared with other countries, the banking sector is not concentrated, which contributes to financial sector stability. The concentration ratios of the top 5 banks and top 10 banks within the total assets were only 36.05 percent and 50.24 percent respectively at end-2010. Among the top 10 banks, 3 were state-owned commercial banks, 5 were domestic private commercial banks, 1 was a specialized development bank and the remaining one was a foreign commercial bank.

Box 1 Sector-wise loans concentration (CY10)

(In Billion Taka)

Sl.	Sector	Amount	% of Total	HHI*
1	Agriculture	153.11	5	25
2	Fishing/Pisciculture	15.23	1	1
3	Forestry & Logging	0.10	0	0
4	Large & Medium Scale Industries	954.70	32	1,024
5	Small Scale & Cottage Industries	36.12	1	1
6	Service Industries	66.24	2	4
7	Construction (Housing Societies & Companies)	49.67	2	4
8	Construction (Urban Housing)	86.74	3	9
9	Construction (Rural Housing)	5.78	0	0
10	Road Construction/Repairing	19.23	1	1
11	Construction (Apartment/House Renovation)	16.09	1	1
12	Other Constructions	29.74	1	1
13	Water Works	0.34	0	0
14	Sanitary Services	0.03	0	0
15	Road Transport	19.48	1	1
16	Water Transport	10.90	0	0
17	Air Transport	0.99	0	0
18	Public Utilities	11.53	0	0
19	Warehousing	0.55	0	0
20	Cold Storage	5.64	0	0
21	Wholesale & Retail Trade	539.85	18	324
22	Procurement by Government	5.37	0	0
23	Export Financing	151.55	5	25
24	Import Financing	380.31	13	169
25	Lease Financing	31.38	1	1
26	Leasing	19.83	1	1
27	Miscellaneous	362.94	12	144
	Total Loans & Advances**	**2,973.44**	**100**	**1,736**

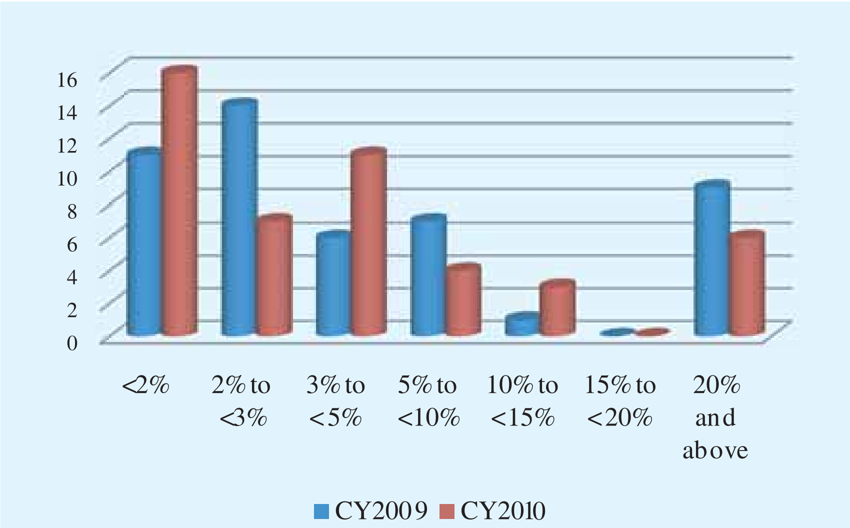
** HHI = Herfindal-Hirchman Index*
*** Total loans & advances excluding bills payable*

The Herfindahl-Hirschman Index (HHI) is a commonly accepted measure of market concentration. The above table exposes that banking sector loans indicate HHI 1736 points. Generally, activities or industries with HHI between 1000 and 1800 points are considered to be moderately concentrated. The above scenario reveals that banking sector loans were not too heavily concentrated in a few sectors in CY10. However, large and medium scale industries showed a 32 percent concentration of the total loan portfolio.

3. 3 Banking sector classified loans, provisioning & write off

Classified loans[1] emanate from the deterioration in the quality of the loan portfolio which is expected to transpire due to the rapid credit expansion in recent years. However, the classified loans of the banking sector actually fell to 7.05 percent from 9.21 percent, a decrease by 2.16 percentage points as at end-2010 compared with end-2009.

Chart 3.4 Distribution of banks by classified loans to total loans ratio



Note: Number of banks in 2009 was 48 & 2010 was 47

Bank-wise information indicates that banking sector classified loans were widely shared by banks. The distribution of banks based on their classified loans to total loans ratio indicates that the number of banks with double-digit values of classified loans to loan ratios was 9 in both CY09 and CY10. Moreover, 6 banks have their classified loans to loans ratio over 20

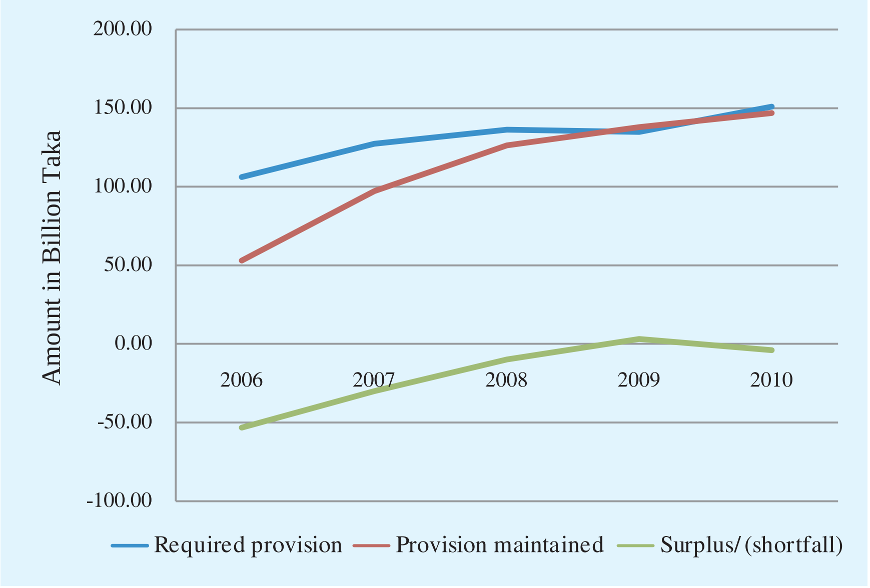
---

[1] *Classified loans are those loans which are classified as `Sub-Standard', 'Doubtful' or `Bad/Loss' as per BRPD circular # 05, dated 05.06.2006.*

percent. Notably, the classified loans to loans ratio of 4 state-owned commercial banks ranged between 5 percent and 24 percent. Out of 9 foreign banks, 6 were below 4 percent, 1 was below 6 percent and 1 was above 20 percent at end-2010. All private commercial banks' classified loans to loans ratios were below 6 percent, except for 2 problem banks.

The high classified loans to loans ratio has strong implications for the overall financial performance of the banks. High volumes of classified loans required banks to create cumulative provisions amounting to BDT 146.83 billion as at end-2010, which was BDT 8.98 billion higher than the cumulative provisioning amount of the previous year. Due to this increase in provisions, the provisions to classified loans ratio shifted to 65.08 percent by end CY10, compared with 61.31 percent a year ago.

Chart 3.5 Banking sector loan loss provisions



The provision shortfall in the banking sector has been reduced to BDT 3.99 billion as at end-2010 from BDT 53.19 billion in CY2006. A specialized commercial bank and 3 domestic private commercial banks incurred significant provision shortfalls, reflected in a net shortfall in the banking sector in CY10. All other banks have shown strong resilience to early headwinds of credit risk.

As per central bank's regulations, scheduled banks are allowed to write off loans adversely classified for more than 5 years. A total of BDT 23.50 billion adversely classified loans were written off from the books in CY10. The cumulative write off loans amounted to BDT 189.50 billion as at end-2010.

Chart 3.6 Worst 5 banks based on classified loans of the banking sector

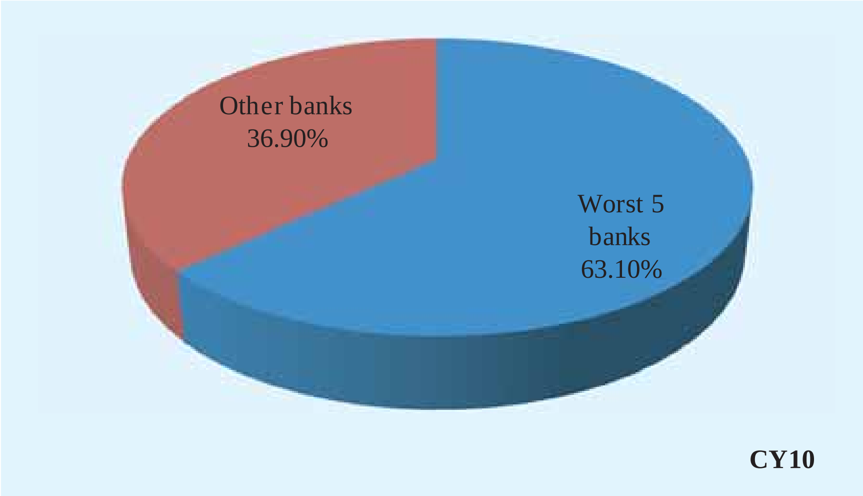
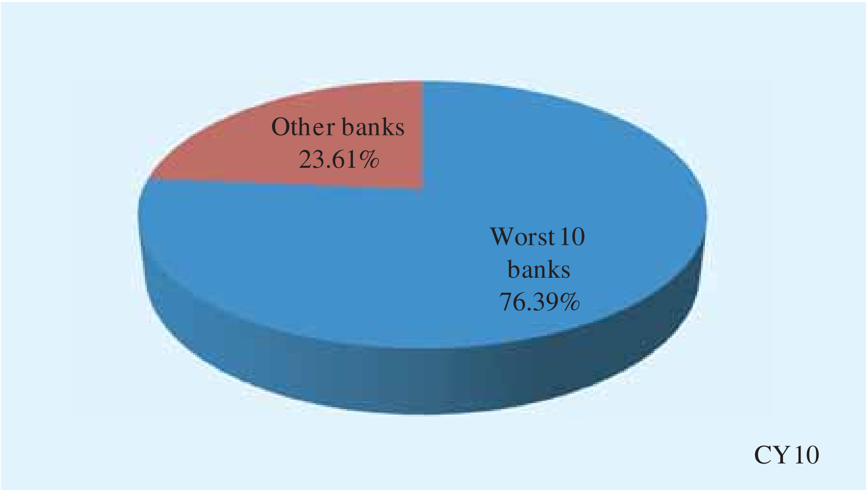


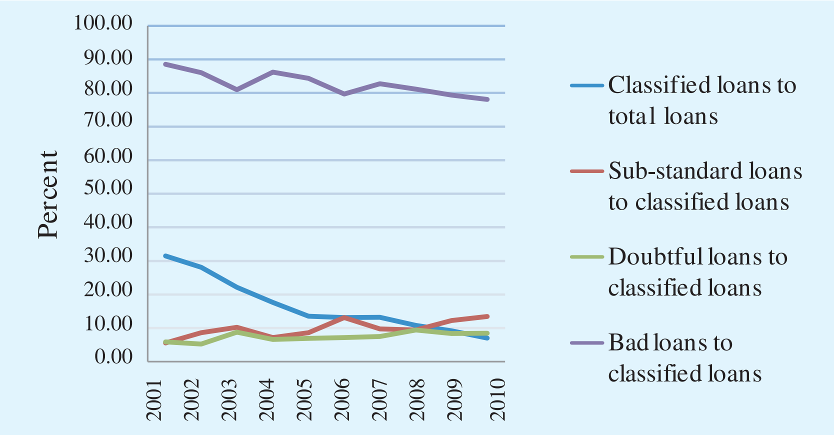
Chart 3.7 Worst 10 banks based on classified loans of the banking sector



Classified loan concentration ratios[2] of the worst 5 banks and worst 10 banks were 63.10 percent and 76.39 percent respectively at end-2010. Among the worst 10 banks, 4 were state-owned commercial banks, 4 were domestic private commercial banks and 2 were specialized development bank. The classified loans in the state-owned commercial banks were higher due to the nature of their operations (lack of efficiency in fund management and political lending).

[2]*See Appendix: XXVIII for details*

Chart 3.8 Year-wise classified loans ratios of the banking sector



The classified loans to total loans ratio has decreased to 7.05 percent in CY10 from 31.49 percent in CY01. Bad loans to total classified loans ratio decreased to 78.11 percent in CY10 from 88.53 percent in CY01, still it shows significant inferior asset quality of the banking sector.

The adverse effect on bank balance sheets arising out of high classified loans is a major concern for the monetary authority. Bangladesh Bank's recent directives to the banks to take precautions while extending loans to high risk sectors and prioritize loans to productive sectors, in conjunction with the government's enactment of laws prohibiting loan defaulters to take part in elections and similar other measures, should help to further improve the classified loans situation in the country.

3. 4 Liability structure of the banking sector

Deposits are the largest source of external funds in the banking sector. The share of total deposits was 85.25 percent of the total liabilities as at end-2010. Total banking sector deposits were composed of 86.82 percent urban and 13.18 percent rural deposits in CY10.

Chart 3.9 Banking sector liability structure

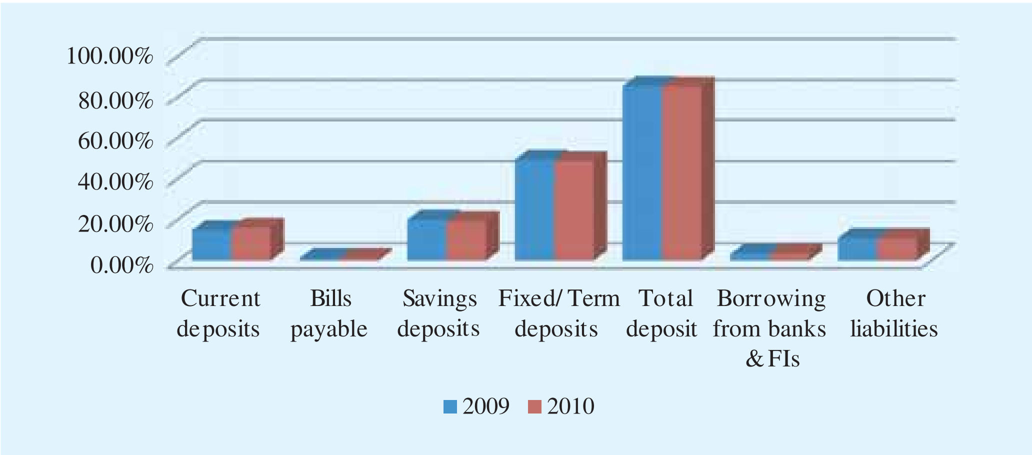
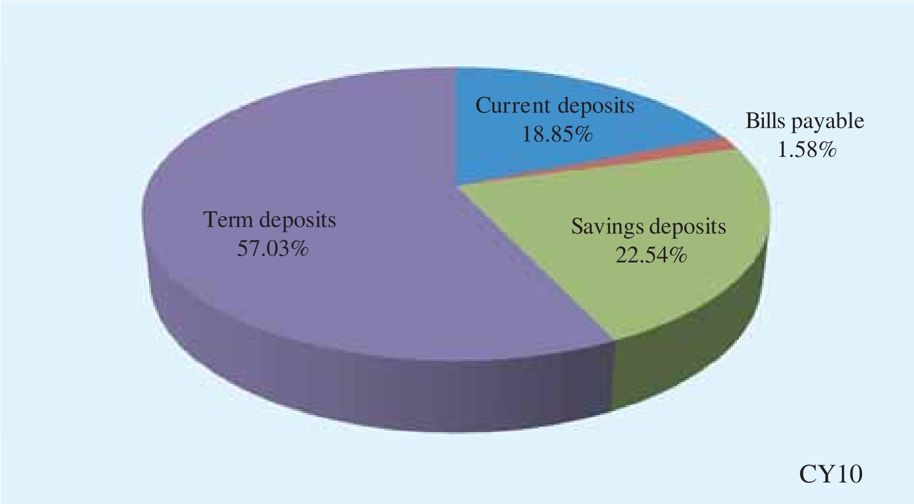


Chart 3.10 Banking sector deposit structure by types of account



As of end-2010, deposits increased by 20.80 percent and borrowing from other banks & FIs increased by 30.96 percent, whereas other liabilities increased by 21.61 percent compared with end-2009. The share of term deposits was 57.03 percent of total deposits, whereas, the share of savings deposits and current deposits were 22.54 percent and 18.85 percent respectively of total deposits at end-2010. Overall deposit structure shows a greater reliance on term deposits, which is good for financial stability.

Chart 3.11 Top 5 banks based on deposit size of the banking sector

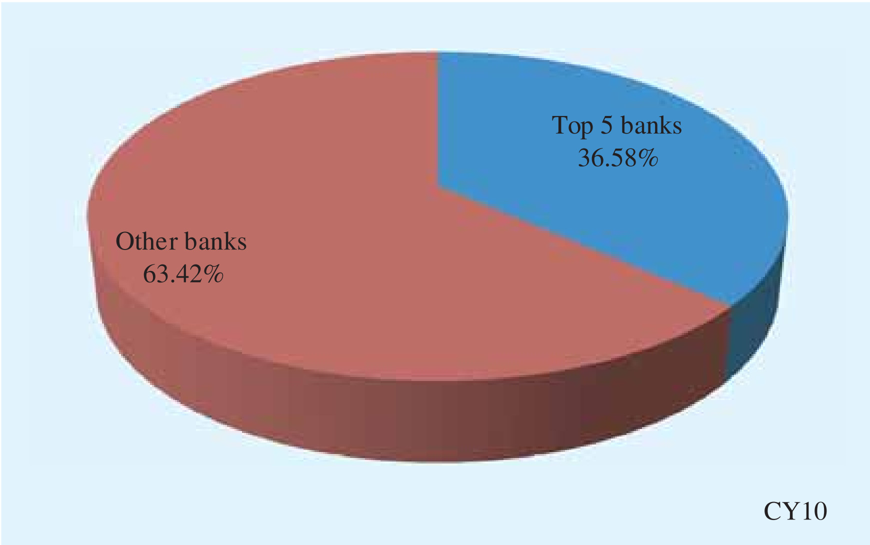
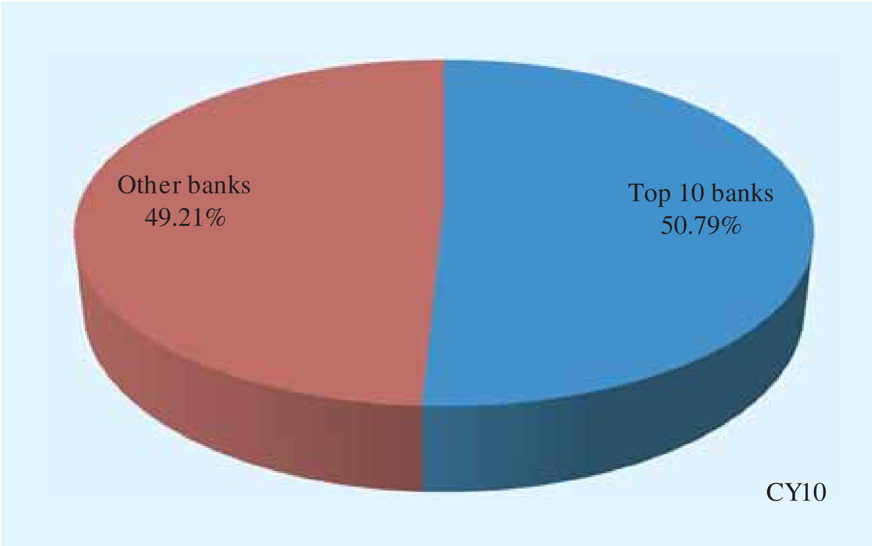


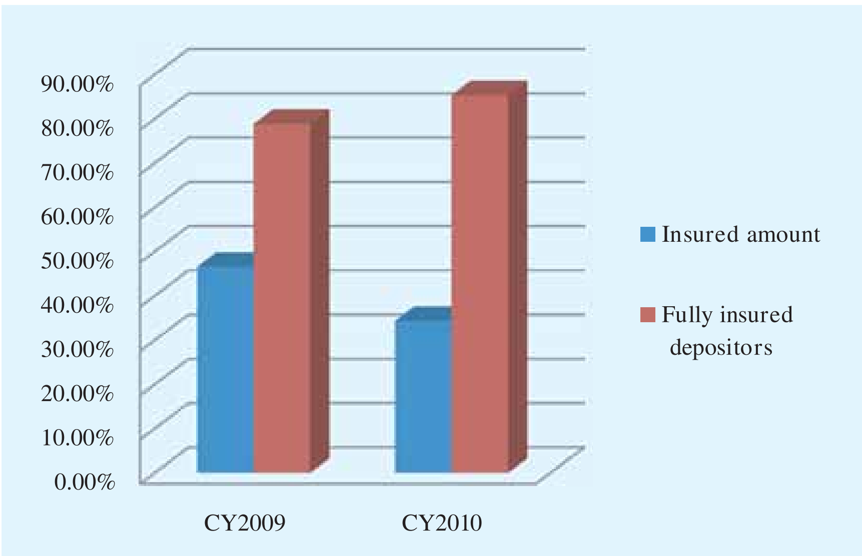
Chart 3.12 Top 10 banks based on deposit size of the banking sector



The concentration ratios of the top 5 banks and top 10 banks within total deposits were 36.58 percent and 50.79 percent respectively at end-2010. Among the top 10 banks, 3 were state-owned commercial banks, 5 were domestic private commercial banks, 1 was a specialized development bank and 1 was a foreign commercial bank.

3. 5 Banking sector deposit safety net

Chart 3.13 Safety net on banking sector deposits



The deposit insurance system aims at minimizing the risk of loss of depositors' funds with banks. The present coverage of the deposits is BDT 100 thousand per depositor per bank. The percentage of insured amount of deposits decreased from 46.59 percent in CY09 to 34.37

percent in CY10 as the number of large depositors (balance more than BDT 100 thousand) increased in CY10. However, the percentage of depositors that are fully insured increased from 78.87 percent in CY09 to 85.38 percent in CY10, which indicates a comprehensive safety net for small depositors, who make up the vast majority of total depositors.

3. 6 Banking sector profitability

Banking sector *operating profit* increased by 47.03 percent from BDT 116.25 billion in CY09 to BDT 170.92 billion in CY10. The *net profit* increased by 53.80 percent from BDT 54.15 billion in CY09 to BDT 83.28 billion in CY10. Banking sector *Return on assets* (ROA) and *return on equity* (ROE) increased parallel to the surging net profit in CY10. ROA and ROE increased by 34 basis points and 3 basis points in CY10, reaching levels of 1.72 percent and 19.89 percent respectively.

Chart 3.14 Sector return on assets (ROA)

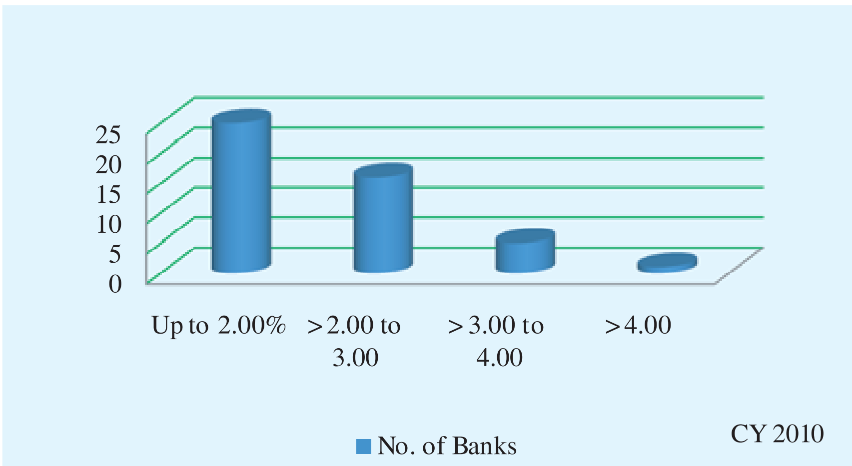
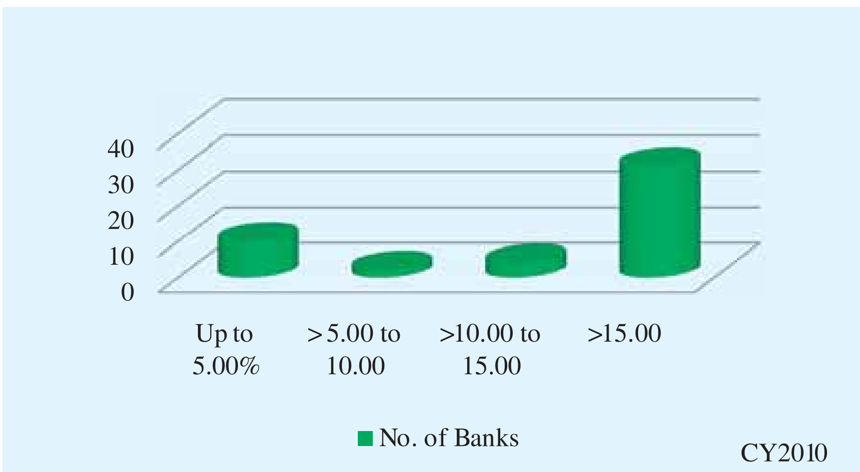
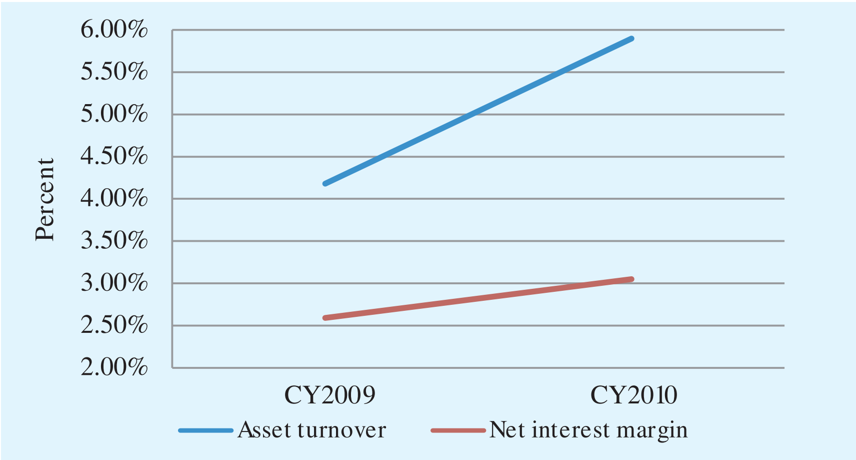


Chart 3.15 Banking sector return on equity (ROE)



Banking sector interest income increased proportionately more than interest expense in CY10. This development resulted in a surge in net interest margin (NIM) and favorably affected the sector's profitability. The NIM increased from 2.59 percent in CY09 to 3.05 percent in CY10.

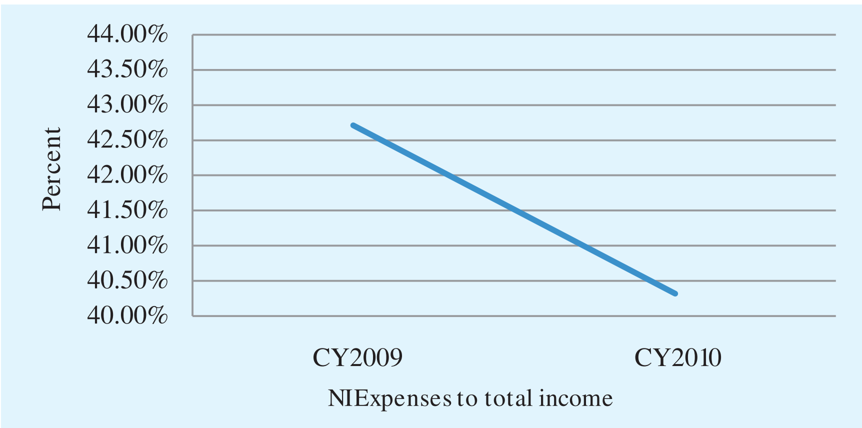
Chart 3.16 Banking sector asset turnover and net interest margin (NIM)



Asset Turnover = (Net Interest Income + Non-Interest Income) / Total Assets
Net Interest Margin = Net Interest Income / Gross Earning Assets
Net Interest Income = Interest Income - Interest Expense

The rise in asset turnover ratio and net interest margin were instrumental in the increase in profitability ratios. While the asset turnover ratio was 4.18 percent in 2009, it went up to 5.90 percent in 2010. Meanwhile, the net interest margin increased from 2.59 percent in 2009 to 3.05 percent in 2010.

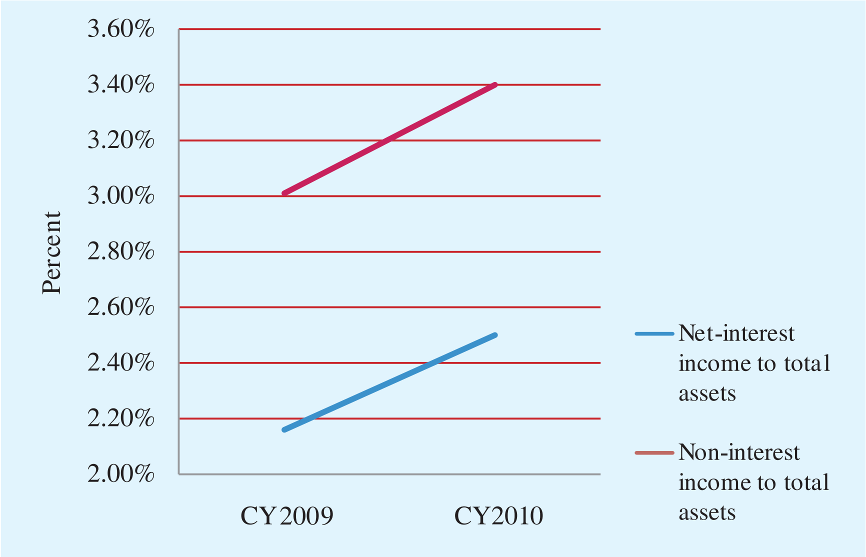
Chart 3.17 Banking sector non-interest expenses to total income



Total Income = Net Interest Income + Non- interest Income

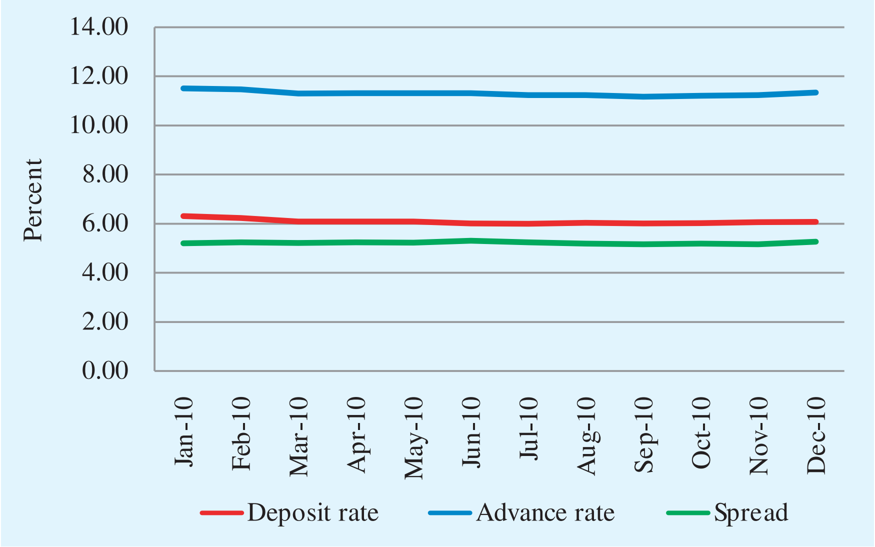
Due to proportionate increase in total operating income compare to operating expenses, the ratio of *non-interest expenses to total income* decreased by 2.39 percentage points from 42.71 percent in CY09 to 40.32 percent in CY10.

Chart 3.18 Banking sector sources of total income



The ratio of net-interest income to total assets increased by 34 basis points from 2.16 percent in CY09 to 2.50 percent in CY10 and the ratio of non-interest income to total assets increased by 39 basis points from 3.01 percent in CY09 to 3.40 percent in CY10.

Chart 3.19 Banking sector monthly weighted average interest rate & spread

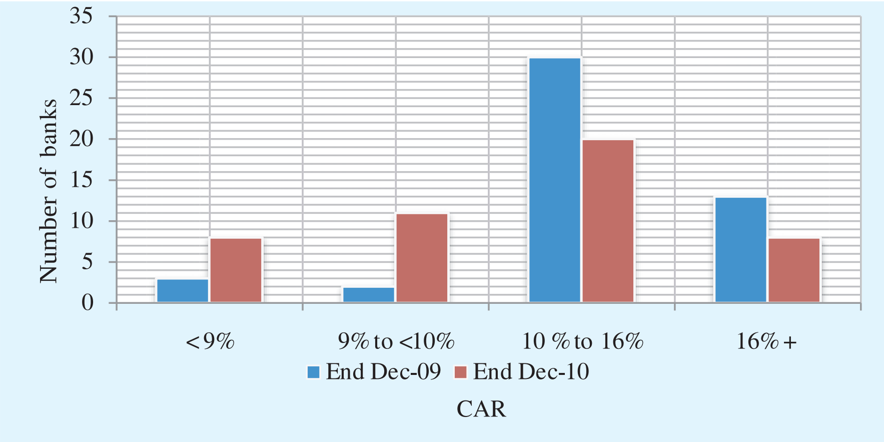


Deposit rates decreased by 23 basis points and advance rates decreased by 17 basis points between January 2010 to December 2010 resulting from persistent efforts of BB to encourage the banks to reduce overall level of interest rates to reasonable level to facilitate investment and growth. However, the spread between advance and deposit rates increased by 6 basis points which indicated the persistence of a high spread during CY10.

3. 7 Capital adequacy

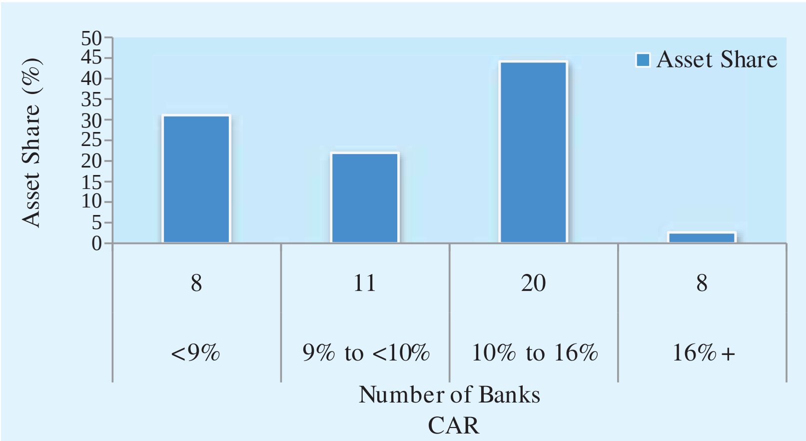
Till the end of CY09, banks had to maintain capital in line with Basel-I as a regulatory compliance mandate. Under that framework, 90 percent of banks were compliant in terms of the minimum required capital adequacy ratio (CAR) of 10 percent as of end December 2009. However, after the introduction of Basel-II on 1 January 2010 as a regulatory requirement, 83 percent of banks have been able to maintain required CAR of 9 percent as of end December 2010. The reason that banks' capitalization has seemed a bit worse than that under Basel-I is the fact that in the new framework banks had to take into account two additional risks-credit risk and market risk-for determination of their capital adequacy.

Chart 3.20 Capital adequacy ratio of the banking sector



On the other hand, as evident from Chart 3.21, a lion's share of the banking assets were free from being concentrated to the banks lying within the non-compliant CAR group. Pertinently, 20 banks' CARs were within the range of 10-16 percent and their assets accounted for nearly 44 percent of the total banking industry's assets as of end December 2010. Indeed, a notable number of banks maintained a CAR of 10 percent or higher, which could be treated as an indicator of financial soundness of the banking industry.

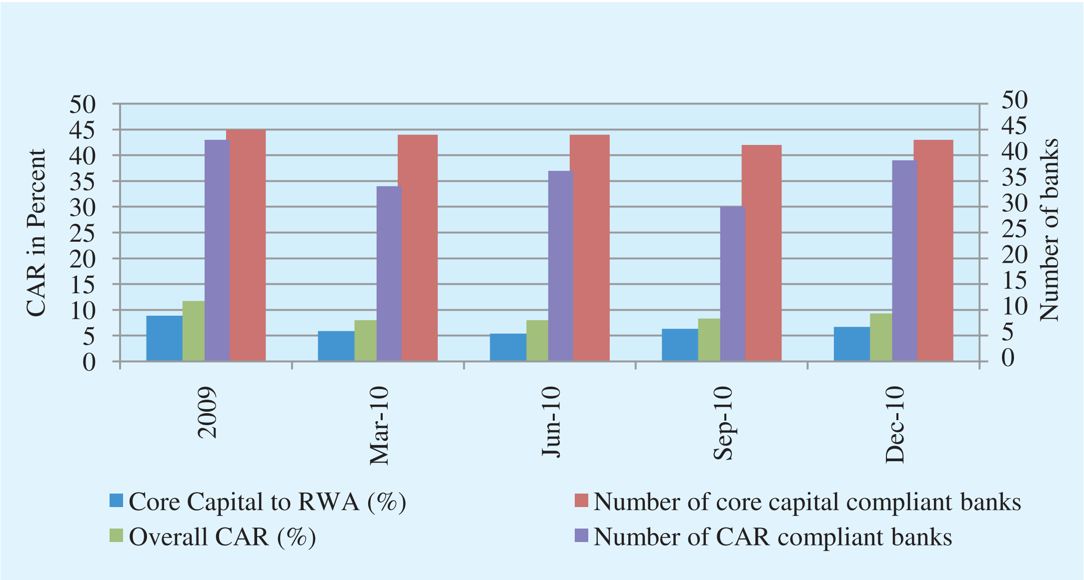
Chart 3.21 Asset Share of Banks based on CAR in CY10



Since Basel-II was in the initial stage of implementation in CY10 from a regulatory point of view, most of the banks could not rate all their exposures to the full extent though exposure rating plays vital role in determining capital adequacy of a bank. Nevertheless, the banking sector demonstrated a moderate level of soundness throughout CY10, as evident from movement of CAR and core capital in CY10. For instance at end Dec-2009, the capital adequacy of the banking industry was 11.7 percent; the same stood at 8.0, 8.0, 8.3 and 9.3 percent in the first, second, third and fourth quarters of CY10.

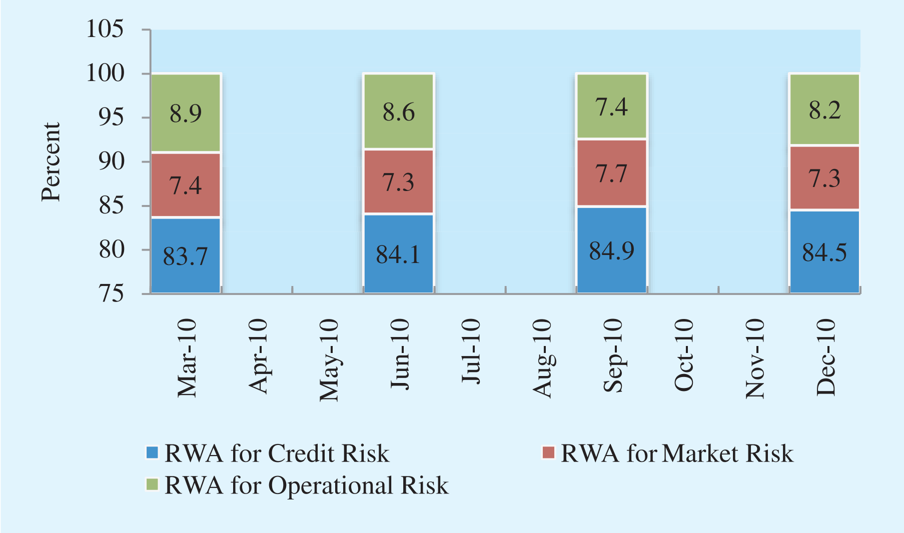
What is more, Tier-I ratios were 5.9, 5.9, 6.3 and 6.7 percent in the first, second, third and fourth quarters of CY10 respectively. This implies that the banks became increasingly compliant in the Tier-1 ratio (i.e. the purest capital ratio) in commensurate with the regularity requirement in CY10. This also implies improvement in the financial soundness of the banks as well.

Chart 3.22 Tier-1 ratio and overall CAR of the banking industry



As of end December 2010, under the Basel-II capital adequacy framework, risk weighted assets arising from credit risk accounted for by nearly 84 percent of the total industry risk weighted assets, and the next positions were held by operational and market risks respectively. Since credit risk accounted for the lion's share of the banking industry's risk weighted assets, credit quality matters a lot here. Encouragingly, during the last couple of years, the non-performing loan (NPL) ratio has been in a downward trend. Nevertheless, banks have to pay due attention to bring down the NPL ratio to the minimum possible level.

Chart 3.23 Distribution of risk weighted assets (RWA) in CY10



If a cross-country scenario is taken into account (Table 3.1), Bangladesh has a long way to go, as the industry CAR of Bangladesh is still far below than that of some South Asian countries namely India, Sri Lanka and Pakistan.

Table 3. 1 International comparison of capital adequacy indicators

Countries	CAR (%)	
	2009	2010
India	14.0*	14.6*
Pakistan	14.0	14.0
Sri Lanka	16.1	14.9
Bangladesh	11.7	9.3

Source: RBI, SBP, CBSL, BB
**As of end March*

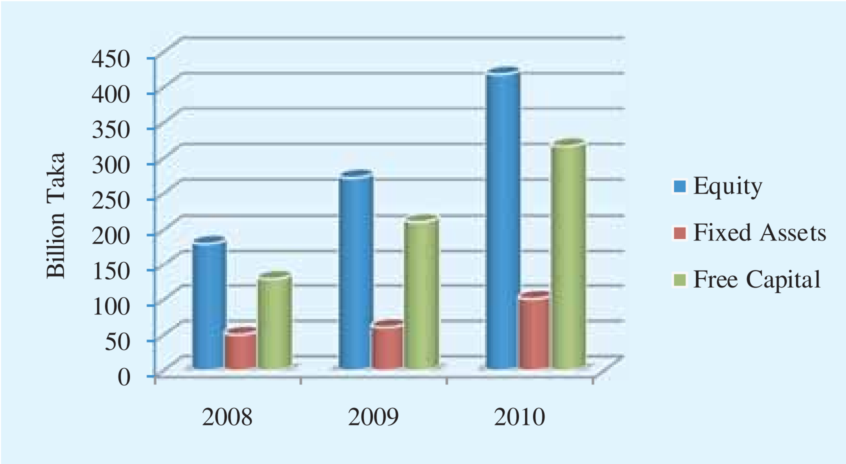
3. 8 Capital regulation issued by BB in CY10

In the CY10, BB issued a number of directives regarding risk based capital adequacy (RBCA) of banks. For instance, BB partially modified the guidelines of RBCA in line with Basel-II, issued guidelines on subordinated debt for inclusion in regulatory capital, instructed the banks about consolidation of exposures to subsidiaries and relevant capital treatment, issued a guideline on the supervisory review evaluation process, and issued a mapping of ratings of two newly approved external credit assessment institutions with BB ratings. Besides, BB issued another set of revised guidelines on Basel II in December 2010, which is more comprehensive and user friendly.

3. 9 Free capital

Apart from capital adequacy, the free capital of banks, defined by equity minus fixed assets could also serve as a financial soundness indicator, especially in the event of any shock. As seen in Chart 3.24, free capital of the banking industry was in a rising trend during CY08 to CY10 implying that the amount of capital available to absorb losses was in an increasing trend.

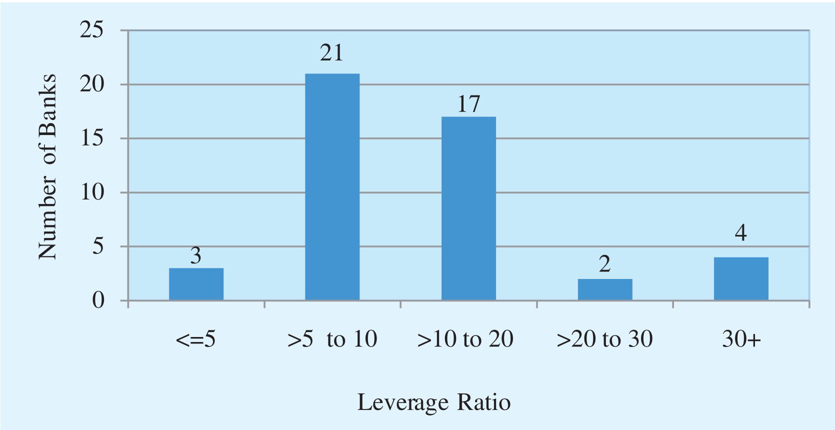
Chart 3.24 Equity & free capital of the banking industry



3. 10 Leverage ratio

A majority of the banks maintained a leverage ratio (equity/total assets, not risk-weighted) higher than 5 percent. As evident from Chart 3.25, out of 47 banks, 44 banks had a leverage ratio higher than 5 percent. Out of these, 21 banks had a leverage ratio higher than 5 percent and less than 10 percent, and 23 banks' leverage ratios were higher than 10 percent. The distribution of the leverage ratio indicates that there is still further room for the banks to improve their financial soundness in terms of the leverage ratio.

Chart 3.25 Leverage ratio of banks as of end CY10

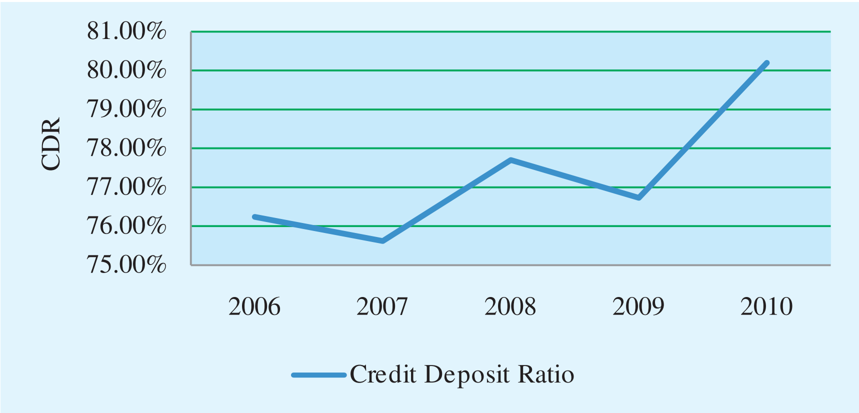


3. 11 Banking sector liquidity

Deposits are the main sources of funding for the banking sector, with capital, reserves and borrowings constituting a small portion thereof. Banks mainly use funds to provide loans and invest in debt and equity securities. The credit deposit ratio is therefore, a useful indicator of a bank's liquidity adequacy.

The interbank money market faced some liquidity stress at the end of CY10. However, activities quickly returned to a business-as-usual situation with supportive measures from the BB and prudent policies of the financial institutions. The recent stress condition of the interbank market, though, suggests that banks need to monitor their asset-liability mismatch closely while making financing decisions.

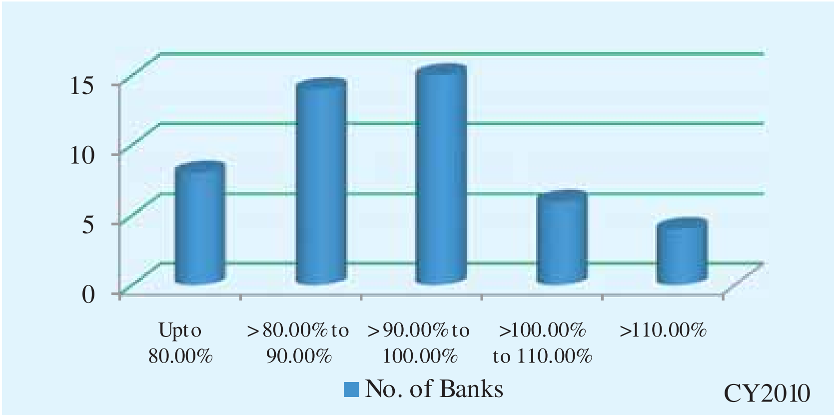
Chart 3.26 Banking sector year-wise credit-deposit ratio



Source: Various issues of Schedule Bank Statistics, Bangladesh Bank.

The statutory liquidity requirement (SLR) for scheduled banks (except Islamic banks and specialized banks) was 19.00 percent and for Islamic banks was 11.5 percent as of end-December 2010. Three specialized banks were exempted from maintaining SLR. During 2010, 4 banks failed to maintain SLR on different dates in December 2010. Total SLR maintained by the banking sector was BDT 814.19 billion against requirement of BDT 602.43 billion, showing an excess of BDT 211.76 billion as of end-December 2010. The average SLR maintained by the banking sector was 23 percent of total demand & time liabilities.

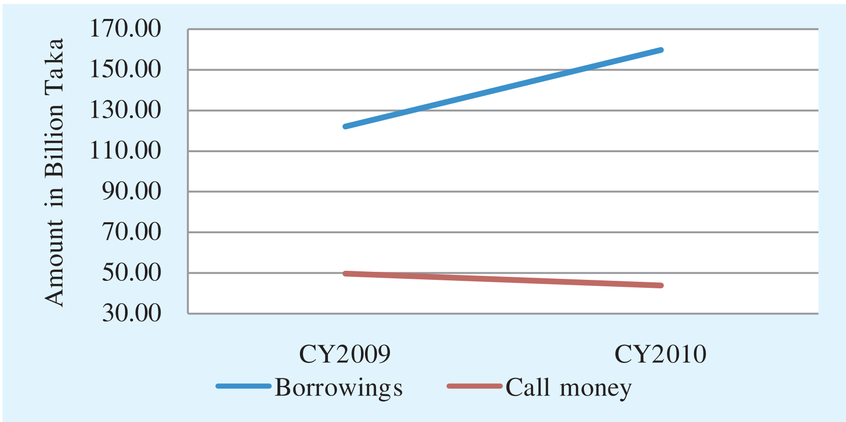
Chart 3.27 Banking sector credit-deposit ratio



Source: Various issues of Schedule Bank Statistics, Bangladesh Bank.

The credit-deposit ratio of individual banks reveals that the CDRs of 8 banks were up to 80 percent, 14 banks were between 80-90 percent, 15 banks were between 90-100 percent, 6 banks were between 100-110 percent and 4 banks were above 110 percent in CY10. Among the 47 scheduled banks, 7 banks were Islamic banks for which statutory liquidity requirement was 11.50 percent.

Chart 3.28 Banking sector call money investment & borrowings



Although the overall credit-deposit ratio as at end-December 2010 was at a tolerable level, investment in call money market decreased by 11.61 percent while, borrowings increased by 30.96 percent in CY10 compared with CY09. This excess of borrowing growth over lending growth in the banking sector evinces the misuse of excess liquidity by banks that were heavily engaged in the capital market in 2010.

Chapter 4 Islamic Banking

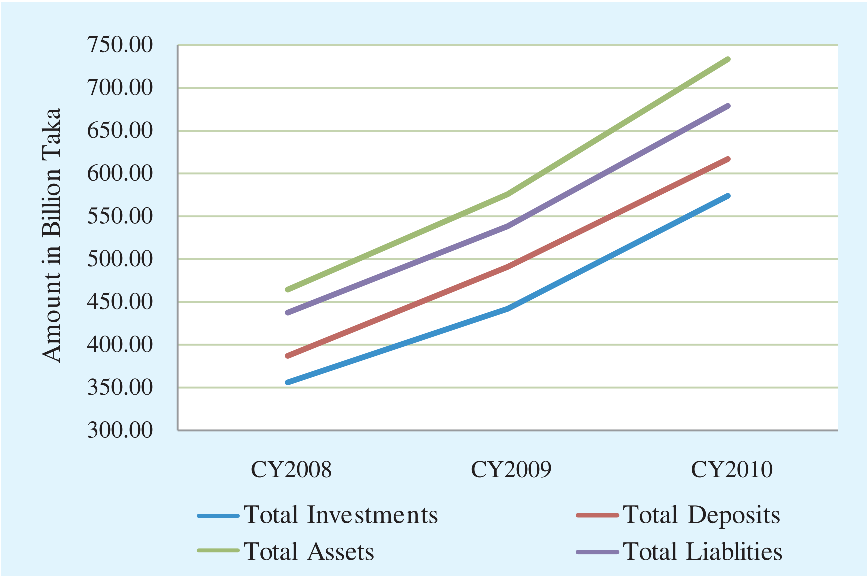
4. 1 Introduction

At birth, Bangladesh inherited an interest based banking system, which was introduced here earlier when the country was a British colony. Islami Bank Bangladesh Limited was the first Islamic bank in Bangladesh, and started its operation in 1983. After that Islamic banking has grown progressively alongside with the traditional banks. At present, 7 banks are operating as purely Islamic banks, and 16 conventional banks are doing Islamic banking through setting up 20 Islamic banking branches and 21 Islamic banking windows. Islamic banks are now focusing on the SME, microfinance and agriculture sectors.

4. 2 Growth of Islamic banking

Islamic banks in the banking sector showed a remarkable growth in CY10. The ongoing expansion of the Islamic banking network is also impressive.

Chart 4.1 Islamic banking growth trend



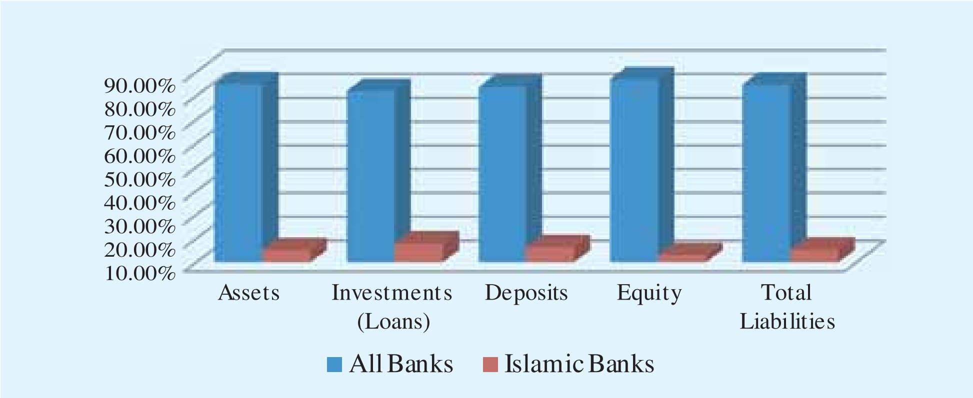
Note: Excluding Islamic banking branches/windows of conventional banks.

Islamic banks' asset base grew by 27.35 percent; deposits grew by 25.69 percent; investments (loans & advances) grew by 29.88 percent and shareholders' equity grew by 46.65 percent in CY10 compared with CY09. Besides, net profit also showed a lucrative growth of 104.20 percent in CY10 compared with CY09.

4. 3 Market share of Islamic banks

As a proportion of the overall banking industry, the combined share of Islamic banks (excluding Islamic banking branches/windows of conventional banks) was 15.11 percent in assets, 17.95 percent in investments (loans), 16.32 percent in deposits, 13.05 percent in equity and 15.30 percent in liabilities as of end-December 2010. Moving on to the composition of liabilities, the share of deposits in total liabilities at 90.90 percent suggests that like conventional banking industry, deposits were Islamic banks' main source of financing their assets.

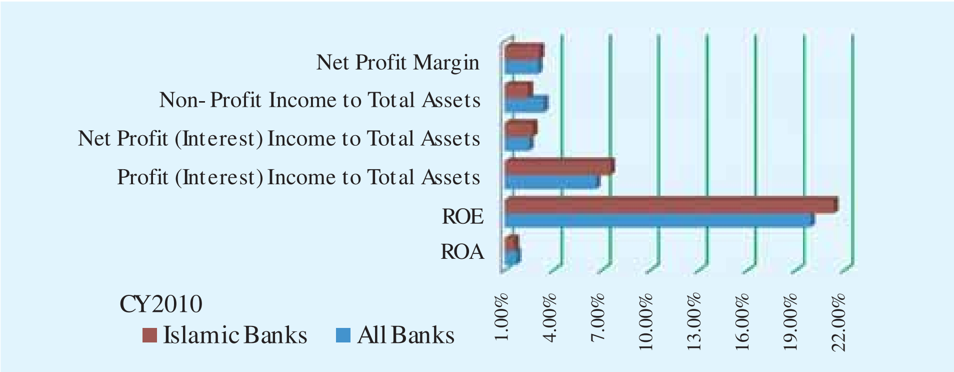
Chart 4.2 Market share of Islamic banks and the banking sector in CY10



4. 4 Profitability of Islamic banks

The key financial indicators reflect a healthy financial position and intense potential for future expansion of Islamic banks. Islamic banks managed healthy earnings in the form of profit income, which is a major contributor to their profitability.

Chart 4.3 Selected income ratios of Islamic banks & the banking sector



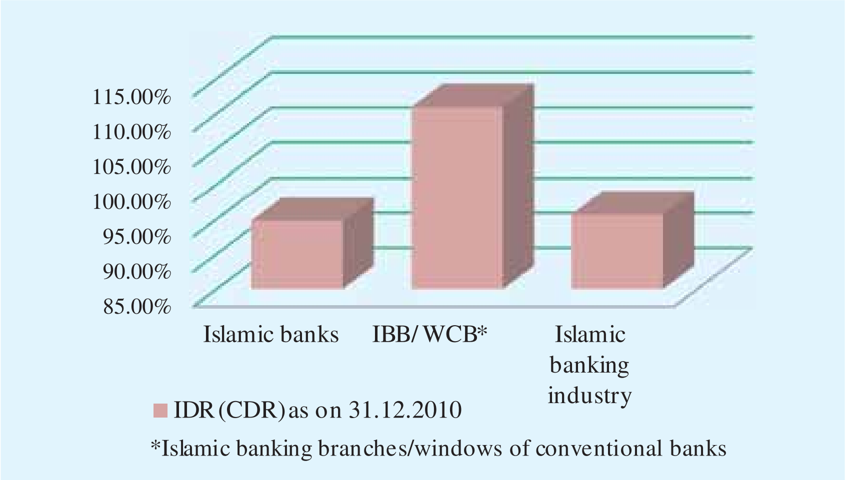
Net profit margin = net profit income/ Gross earning assets
Gross earning assets = Balance with other banks & FIs + Investment in securities + Loans & advances

During CY10, the profit income to total assets ratio at 7.51 percent was slightly higher than the industry average of 6.63 percent. On the other hand, the non-profit income to total assets ratio was only 2.45 percent as compared to the industrial average of 3.40 percent, representing comparatively lower income from off-balance sheet (OBS) items. However, the ROA of the Islamic banking industry was lower compared with the overall banking industry in CY10. On the other hand, ROE of Islamic banking industry was higher than the overall banking industry in CY10 as the earnings of Islamic banks were higher compared to their equity position.

4.5 Islamic banks' liquidity

In recognition of the low volume of Shariah-compliant SLR eligible instruments, Bangladesh Bank has generally maintained concessionary SLR requirements for Islamic banks in comparison with conventional banks. Islamic banks comply with their SLR requirements at 11.5 percent of total demand & time liabilities.

Chart 4.4 IDR (CDR) of Islamic banking & the overall banking sector

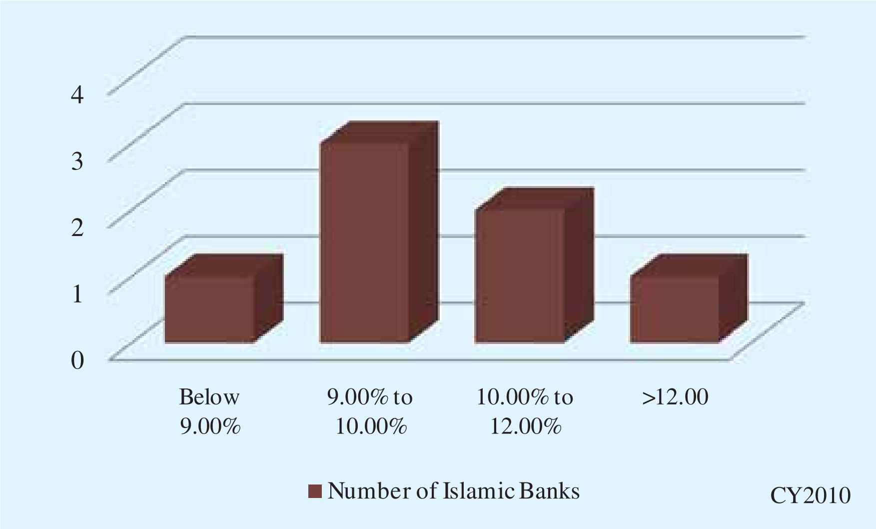


The investment-deposit ratio (IDR) of full-fledged Islamic banks was 94.73 percent as of end-December 2010. However, the IDR of conventional banks having Islamic banking branches/windows reached to 110.91 percent as of end-December 2010. The high IDR of Islamic banking branches/windows of conventional banks was due to providing investment (credit) by taking inter-bank borrowings (among Islamic banks). Since, there are limited sources of Shariah-compliant funds, Islamic banks can borrow funds either from the Islamic inter-bank money market or from the "Islami Investment Bond's Fund" issued by the Bangladesh Government. The average IDR of the Islamic banking industry was 95.67 percent as at end-December 2010.

4.6 Islamic banks' capital adequacy

Given the minimum capital requirement (MCR) of 9.0 percent under the Basel-II accord for CY10, the significantly higher CARs of 5 Islamic banks in the banking sector indicate both the financial strength and ample compliance of minimum capital requirements (MCR). The stronger capital base ensures that Islamic banks are well equipped to meet various kinds of shocks, if and when they arise. However, one Islamic bank's CAR was negative due to a huge cumulative loss and provision shortfall.

Chart 4.5 Capital adequacy ratio of Islamic banks

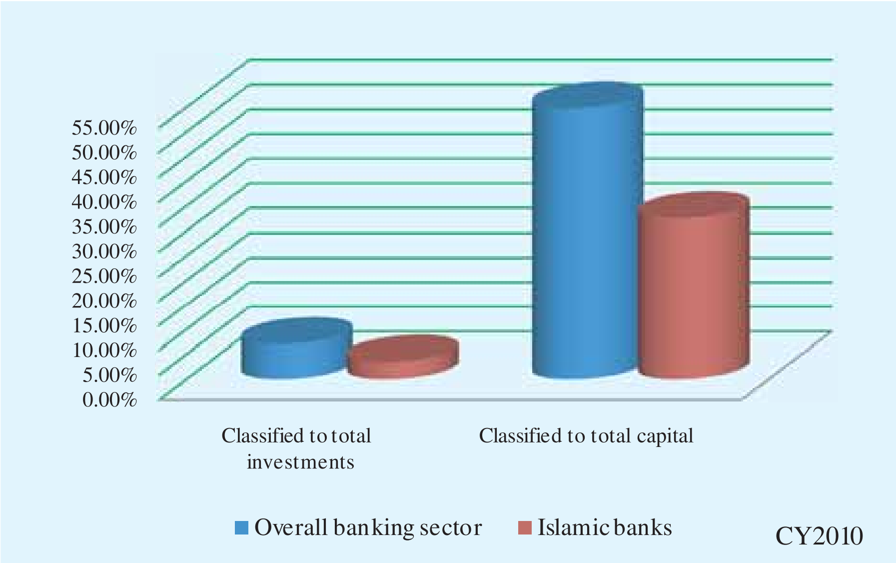


Note: Excluding Islamic banking branches/windows of conventional banks

4.7 Classified investment of Islamic banks

Islamic banks' classified investments to total investments ratio of 3.48 percent showed a relatively good position as compared with 7.05 percent for the overall banking industry in CY10. The classified investment to capital ratio of 32.56 percent for Islamic banks as compared with 54.77 percent for the overall banking industry indicates that the onslaught of classified investments (loans) hit the conventional banks harder than the Islamic banks in CY10.

Chart 4.6 Classified investment (loans) of Islamic banks and the banking industry



Note: Excluding Islamic banking branches/windows of conventional banks

Chapter 5 Banking Sector Risks

5.1 Credit risk structure in Bangladesh

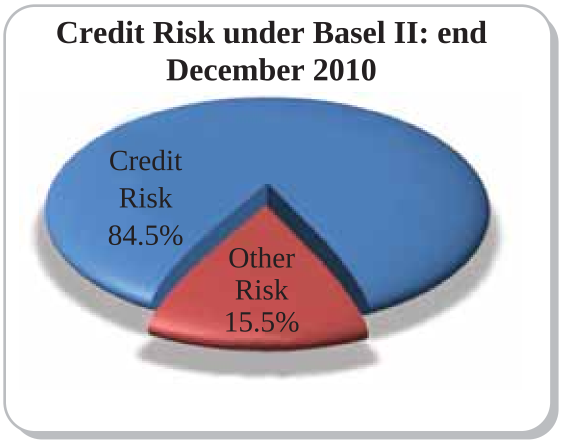
High credit growth was inseparable from mounting credit risk, as reflected by non-performing bank loans. Banks tended to become more selective when extending credit as the probability of non-performing loans increased. Data for end December 2010 indicates that the share of risk weighted assets (RWA) assigned to credit risk is 85 percent of the total RWA of the banking system, whereas the RWA associated with market risk and operational risk are only 7 and 8 percent respectively. Given the capital adequacy ratio of the banking sector at 9.3 percent, the banks' capital charge for credit risk is BDT 3367.25 billion. Top 5 banks' credit risk accounted for nearly one third of aggregate credit risk while top 10 banks' possess almost half. This risk is mostly concentrated in the banking book.

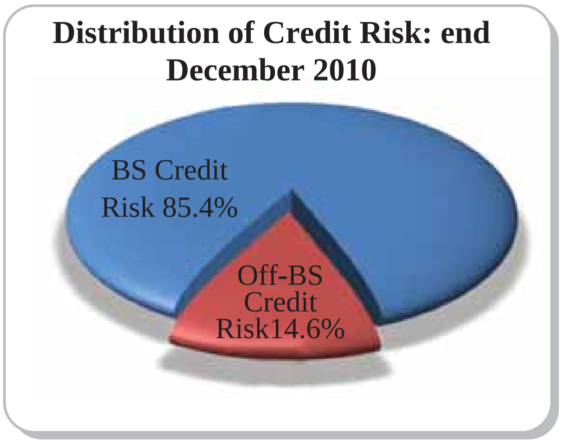
Table 5.1 Credit risk in the banking system

Banks	Credit Risk as percentage of Industry Credit Risk	Credit risk as percentage of overall industry risk
Top 5 Banks	28%	23%
Top 10 Banks	45%	38%

Source: Department of Off-site Supervision, Bangladesh Bank.

Chart 5.1 Credit risk structure



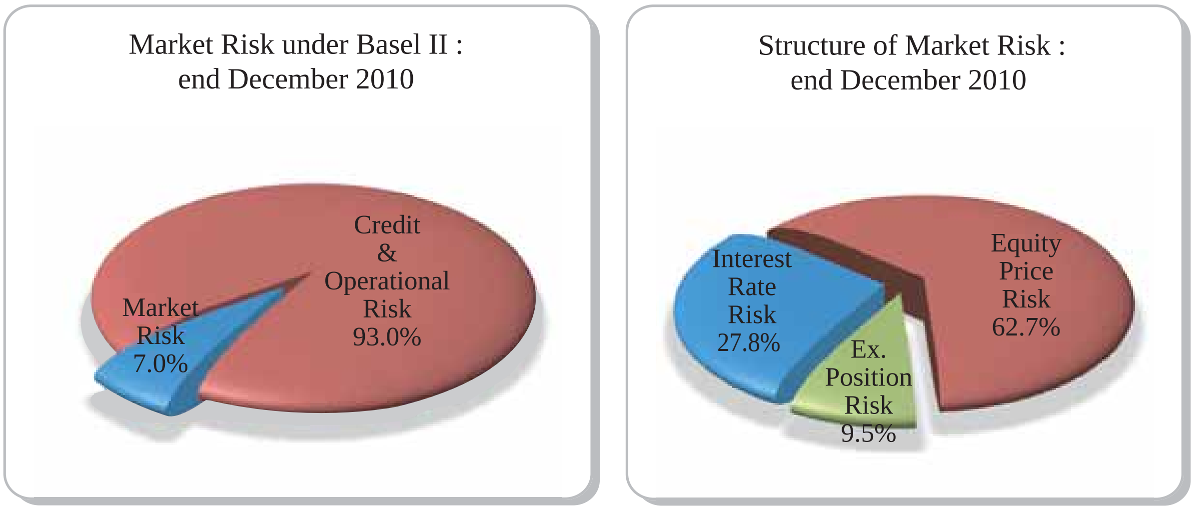


Source: Department of Off-site Supervision, Bangladesh Bank.

5.2 Structure of market risk under Basel II

A considerable degree of volatility in domestic financial markets during CY10 contributed to the increase in market risk for banks. However, its impact on their financial performance is likely to be well-contained given BB's stringent prudential requirements on various market risk exposures. The direct impact of three major components of market risk including interest rate risk, exchange rate risk and equity price risk is analyzed in the following section:

Chart 5.2 Market risk structure



Source: Department of Off-site Supervision, Bangladesh Bank.

5.2.1 Interest rate risk

The first important source of market risk is interest rate risk, which is primarily driven by banks' investments in securities and adverse movement in security prices, in addition to the direct exposure in government securities. Data of end December 2010 indicates that the share of risk weighted assets (RWA) assigned to interest rate risk is only 2 percent of total risk weighted assets in the banking system, whereas the RWA related to overall market risk is only 7. The banks' capital charge for interest rate risk is BDT 80.81 billion at end December 2010. Only 5 banks (11 percent of the industry) contain almost 50 percent of industry interest rate risk and 37 banks (79 percent of the industry) materially contain no or insignificant interest rate risk. It is noteworthy that three state-owned banks and two private banks ranked as the top 5 in capital charge for interest rate risk in the banking system.

Table 5.2 Interest rate risk in the banking system

Banks	Interest rate risk	Share in market risk	Share in overall risk
Top 5 Banks	46%	36%	13%
Top 10 Banks	69%	38%	19%

Source: Department of Off-site Supervision, Bangladesh Bank.

5.2.2 Exchange rate risk

The second important source of market risk is exchange rate risk, which is primarily driven by banks' investments in foreign exchange dealings and adverse movement in exchange rates, in addition to the direct exposure arising from foreign exchange placements in different exchange markets. Data as of end December 2010 indicates that the share of risk weighted assets (RWA) assigned to exchange rate risk is less than 1 percent of total risk weighted assets in the banking system, whereas it is 10 percent of the market risk. The banks' capital charge for exchange rate risk is BDT 2.77 billion. However, only 10 banks contain almost 62 percent of industry exchange rate risk and 37 banks (79 percent of the industry) contain the remaining 38 percent of exchange rate risk in the banking system. In particular, two state-owned banks and three private banks represented themselves in the top ranked risk positions with exchange rate risk.

Table 5.3 Exchange rate risk in the banking system

Banks	Exchange rate risk	As percentage of market risk	As percentage of overall risk
Top 5 Banks	45%	4%	0.3%
Top 10 Banks	62%	6%	0.4%

Source: Department of Off-site Supervision, Bangladesh Bank.

5.2.3 Equity price risk

The third important source of market risk is equity price risk, which is primarily driven by banks' investments in equities and adverse movement in equity prices, in addition to the indirect exposure from the quantum of bank loans collateralized by shares. Notably, the DSE index reached an all time high level of 8918.51 points in December 2010. From 15/12/2010 onwards, it started its descent, losing nearly 6.72 percent of its value on 19/12/2010 at the beginning of the crashing of the market.

Insofar as banks' investment in shares is concerned, the overall exposure of such investments is capped by section 26(2) of Bank Company Act, 1991. Specifically, the total holdings of banks in shares cannot exceed 10.0 percent of their total liabilities. In terms of banks' liabilities, at the end of December 2010, the aggregate exposure was 5.59 percent as against the ceiling of 10.0 percent. Bank-wise information indicates that 9 commercial banks with an asset share of 16 percent have their exposure in excess of the 10 percent.

Table 5.4 Equity price risk in the banking system

Banks	Share of equity price risk	Share of total market risk	Share in the banking system risk
Top 5 Banks	47%	30%	2.2%
Top 10 Banks	72%	45%	3.3%

Source: Department of Off-site Supervision, Bangladesh Bank.

Data as of end December 2010 indicate that the share of risk weighted assets (RWA) assigned to equity position risk is only 4.6 percent of total risk weighted assets in the banking system, whereas it is 63 percent of the market risk. The banks' capital charge for equity price risk is BDT 18.25 billion at yearend December 2010. Ten top banks contain more than 70 percent of industry equity price risk and 37 (79 percent of the industry) banks materially contain no risk from the movement of equity price. One state owned commercial bank and four private commercial banks are ranked in the top 5 for equity price risk.

5.3 Operational risk

Operational risk has always been important for the banking system due to the strong role of customers' confidence in the banking business. Its importance has been increased manifold over the last two decades.

In practice, it is quite difficult to predict disruptions to the continuity of business and associated losses. However, this is not to articulate that such events cannot be dealt with appropriately. Efforts can be exerted to identify key operational risk indicators and put in place potential safeguards to minimize the occurrence of unforeseen events.

Table 5.5 Operational risk (OR) under Basel II basic indicator approach

Banks	OR as percentage of Total OR	Share of OR risk in the industry overall risk
Top 5 Banks (11%)	29%	2.3%
Top 10 Banks (21%)	46%	3.8%

Source: Department of Off-site Supervision, Bangladesh Bank.

Data as of end December 2011 indicate that the share of risk weighted assets (RWA) assigned to operational risk is 8 percent of the total risk weighted assets of the banking system, whereas the RWA related to market risk is 7 percent. Given the capital adequacy ratio of the banking sector at 9.34 percent, the banks' capital charge for operational risk is BDT 32.52 billion at end December 2010. However, only 10 banks (21 percent of the industry) contain 46 percent of industry operational risk and the remaining 37 (79 percent of the industry) banks contain 54 percent of operational risk.

In sum, although banks are maintaining capital for operational risk according to the basic indicator approach under Basel II, the difficulty of going from a series of isolated, infrequent operational incidents to a comprehensive capital charge is a source of concern for both the banking sector and the central bank. Lack of sophisticated techniques and insufficient data on actual loss events aggravate the challenges faced by the regulator and banks for managing operational risks. In addition to imposing this capital charge for operational risk under the Basel II requirement, the BB also monitors the gravity of threats stemming from lapses in banks' internal control environments. Banks are, for this purpose, advised to follow the core risk guidelines on 'Internal Control and Compliance'.

5.4 Credit rating companies (CRCs)

Regulators use credit ratings for regulatory purposes. Under the Basel II agreement of the BCBS, banking regulators can allow banks to use credit ratings from certain approved credit rating companies (called 'External Credit Assessment Institutions', ECAIs) when calculating their capital requirements. In Bangladesh, the Securities and Exchange Commission (SEC) enacted the Credit Rating Companies Rules to establish the mandatory rating process for some type of issues and debt instruments. Apart from this as per Bangladesh Insurance Law, insurance companies are also bound to do the rating annually. The SEC so far has permitted the following 4 (four) companies for operating as a Credit Rating Company.

Table 5.6 Commencement of credit rating agencies in Bangladesh

Sl. No.	Rating Agency	Year of Inception
1.	Credit Rating Information and Services Ltd (CRISL)	1995
2.	Credit Rating Agency of Bangladesh Ltd. (CRAB)	2003
3.	Emerging Credit Rating Ltd. (ECRL)	2009
4.	National Credit Rating Ltd. (NCRL)	2010

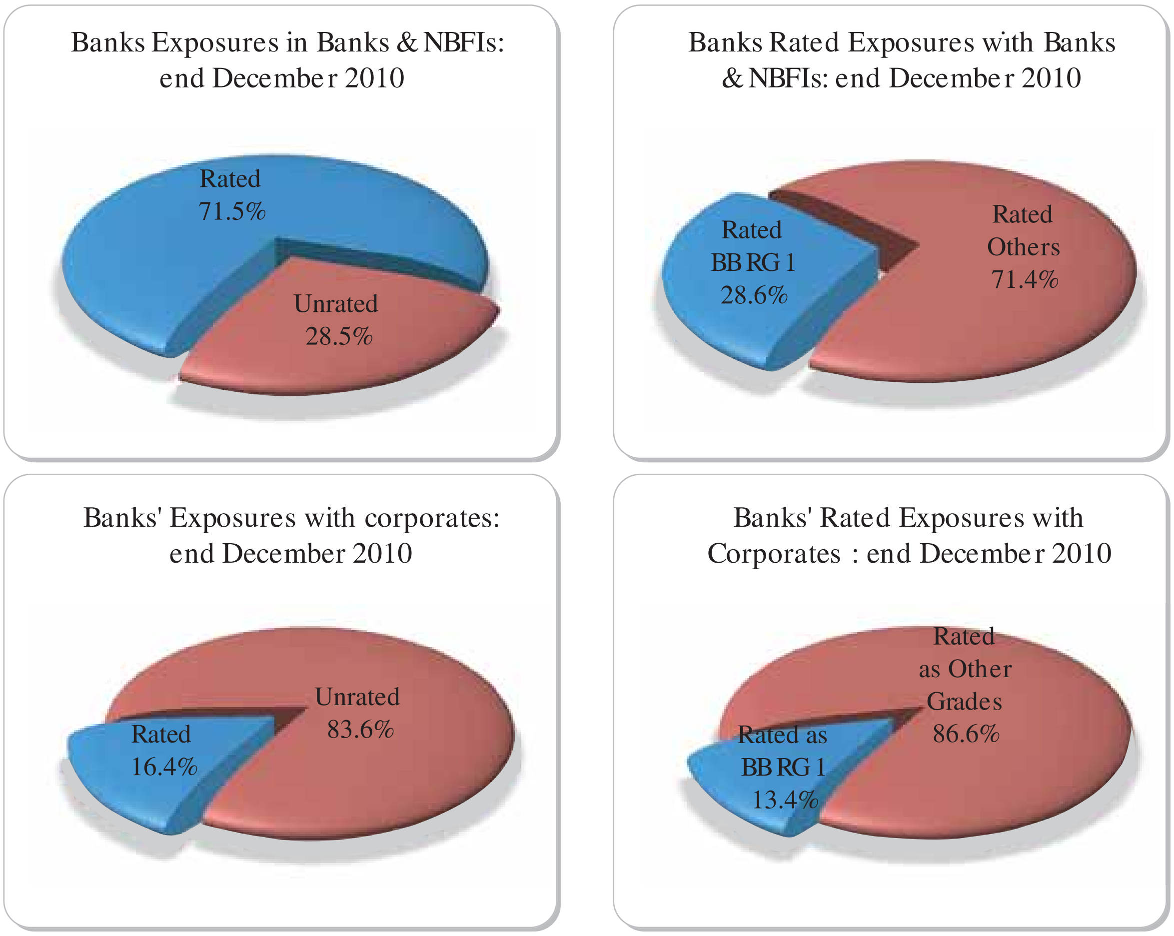
Source: website of the respective rating companies.

The history of credit rating in Bangladesh is not very old, and in fact this industry is in the nascent and budding stages. Under the Credit Rating Companies Rules, 1996, all issues of debt securities or public issue of shares (including rights shares) at a premium shall require credit rating. Thus, banks and FIs listed in the stock market need to be rated. Moreover, banks and FIs can use these ratings of the corporate securities as a benchmark of measuring risk under the adopted frameworks of Basel II.

Under both the Basel II standardized approach and SEC regulations, not just any credit rating agency (CRA)'s ratings can be used for regulatory purposes. The Basel II guidelines, for example, describe certain criteria that bank regulators should look to when permitting the ratings from a particular CRA to be used. These include "objectivity," "independence," "transparency," and others. Bangladesh Bank as a banking regulator has issued its own discussion papers in 2010 on this subject, to further define how these terms will be used in practice.

Though rating agencies have been implicitly playing as a quasi-regulatory role, they are pro-profit entities and their incentives may be misaligned with the regulatory objectives. Conflicts of interest often arise because the rating companies are paid by the entities issuing the securities or extending exposures- an arrangement that has come under fire as a disincentive for the agencies to be vigilant on behalf of investors. Moreover, the quality of the rating also depends on the quality and integrity of the persons and institutions that rate others.

Chart 5.3 Exposure rating status in Bangladesh



Source: Department of Off-site Supervision, Bangladesh Bank.

The scheduled banks have exposures both to financial institutions (banks and non-bank financial institutions) and to non-financial corporations. Exposure to financial institutions tends to be rated, as shown in the upper left quadrant of Chart 5.3. However, since the concept of external credit assessment is quite new in Bangladesh, a very low percentage of nonfinancial corporate exposures have been rated, as shown in the lower left quadrant. For both financial and nonfinancial exposures, a relatively small percentage of the exposures have received the best credit rating, as shown in the upper right and lower right quadrants.

Chapter 6 Stress Testing

In order to understand and appreciate the risks the banking industry is exposed to, ensure the soundness and sustainability of the banking industry and make the banks more shock resilient, guidelines on stress testing were issued in April 2010 (and updated in February 2011). Banks have been advised to carry out stress testing in line with the issued guidelines on a quarterly basis. Through these stress tests, the impact of a number of risk scenarios, namely credit risk, interest rate risk, exchange rate risk, equity price risk and liquidity risk related shocks, and a combination of those, on the capital adequacy ratio (CAR) of the banks is evaluated. The first round of results indicates that the banking industry is resilient when minor shocks are applied. Bangladesh Bank has a plan to evaluate the results more rigorously in the coming quarters.

6.1 Resilience of the banking sector

The analysis of the different risk factors and the risk-absorbing capacity of the banking industry under stressed situations indicate that the risk absorbing capacity of banks was high at end December 2010. This part examines the resilience of the banking system by assessing the impact of the plausible threat of worsening in asset quality in terms of banks' capital base and sensitivity analysis.

The amount of net NPLs (NPLs adjusted for provisions and interest suspense) is a key indicator in measuring the potential risks to banks' solvency positions. Banks' net NPLs fell sharply to Tk. 31.58 billion at end December 2010, against Tk. 38.93 billion in the previous year, a decrease of 19 percent on year on year basis. Compared with 14.3 percent in December 2009, the net NPLs to capital ratio improved to 7.5 percent by the end of December 2010. Bank wise information reveals that in 2010, 2 banks, with a share of 3.7 percent in industry assets, have recorded an overall negative net NPL to capital ratio. In fact, 26 banks, with a 49.9 percent share in total assets, materially contained no NPL. Moreover, 16 banks, with 39.7 percent share in total assets, posted a net NPL to capital ratio in the range of 0 to 20 percent. It is expected that these banks can reasonably manage the potential shock of the net NPLs on their respective capital base. However, the ratio of one bank, with a 1 percent asset share, is over 100 percent. This bank does not pose any systemic risk as it is working as a specialized bank in the field of agriculture in the northern part of Bangladesh. Furthermore, there are 2 banks with net NPLs to capital ratio in the range of 20 to 100 percent; however their share of the total assets in the industry is only 5.7 percent. All this information suggests that a few banks with a small market share in the industry are facing the threat of erosion of their capital base; however banks with a dominant share in the sector have the capacity to absorb loss emanating from a further deterioration in asset quality.

To test the resilience of the banking sector based on the single-factor sensitivity analysis, Bangladesh Bank conducted stress tests with three major risk factors i.e. credit risk, market risk and liquidity risk. The magnitude of shock in the risk factors is driven by the historical volatility in each variable and an analysis of future movement based on hypothetical scenarios. Specific shocks used in the analysis are summarized in Box 1. Under each scenario, the after shock CAR is compared with the minimum required CAR of 9 percent at end 2010 to assess banks' resilience towards specific shocks set with explicit and implicit assumptions. The results are based on the unaudited data for end December 2010. These results are not forecasts of expected outcomes, since the scenarios have been designed as "what if" situations under plausible but extreme assumptions.

Box 2 Shocks to different risk factors based on data as of end December 2010

Shocks	Impact on CAR	After Shock CAR
Credit Risk		
CR-1: 5% of performing loans directly downgraded to bad/loss category, 50% downward shift in the NPLs categories and 10% decline in the forced sale value of mortgaged collateral.	(2.4%)	7.9%
CR-2: 10% of performing loans directly downgraded to bad/loss category, 80% downward shift in the NPLs categories and 20% decline in the forced sale value of mortgaged collateral.	(3.9%)	6.4%
CR-3: 15% of performing loans directly downgraded to bad/loss category, 100% downward shift in the NPLs categories and 40% decline in the forced sale value of mortgaged collateral.	(5.6%)	4.7%
Market Risk		
Interest Rate Risk		
IR - 1: An increase in interest rates by 100 basis points.	(0.6%)	9.7%
IR - 2: An increase in interest rates by 200 basis points.	(1.2%)	9.1%
IR - 3: An increase in interest rates by 300 basis points.	(1.8%)	8.5%
Exchange Rate Risk		
ER - 1: Depreciation/Appreciation of Exchange Rate by 5%.	(0.0%)	10.3%
ER - 2: Depreciation/Appreciation of Exchange Rate by 10%.	(0.1%)	10.2%
ER - 3: Depreciation/Appreciation of Exchange Rate by 15%.	(0.1%)	10.2%
Equity Price Risk		
EQ - 1: Fall in the equity prices by 10%.	(0.2%)	10.1%
EQ - 2: Fall in the equity prices by 20%.	(0.3%)	10.0%
EQ - 3: Fall in the equity prices by 40%.	(0.4%)	9.9%
Combined Shocks: Market & Credit		
COMBND - 1: CR-1, IR - 1, ER - 1 & EQ - 1 sector (25%) directly downgraded to doubtful category, and fall in equity prices by 30%.	(3.4%)	6.9%
COMBND - 2: CR-2, IR - 2, ER - 2 & EQ - 2 %, substandard to doubtful: 15%, doubtful to loss: 20%), fall in the equity prices (50%).	(6.3%)	4.0%
COMBND - 3: CR-3, IR - 3, ER - 3 & EQ - 3	(9.4%)	0.9%
Liquidity Risk		
Shocks	**Impact on LR**	**After Shock LR**
LQ - 1: Liquidity Ratio [LR] (Deposits withdrawal at the rate of 10%)	(2.4%)	30.6%
LQ - 2: Liquidity Ratio [LR] (Deposits withdrawal at the rate of 20%)	(12.3%)	20.8%
LQ - 3: Liquidity Ratio (Deposits withdrawal at the rate of 30%)	(24.3%)	8.8%

Source: Department of Off-site Supervision, Bangladesh Bank.
Note: Stress Test conducted on 41 banks (excluded 6 banks from the test due to non availability of data.)

The results suggest that credit risk is the most dominant risk factor in terms of its impact on CAR. Amongst the credit shocks, CR1 is the most rigorous, causing the overall CAR of the banking sector to decline to 7.9 percent. While the overall post-shock CAR is above the minimum required benchmark of 9 percent, 14 banks in addition to the 5 banks whose CAR is already below the required level, would experience deterioration in their respective CARs in case of such a scenario. However, the banking industry is fairly resilient in the face or various market risk shocks (interest rate, exchange rate and equity price movements). The CAR of none of the banks would be impacted under the market risk shocks except for the 5 banks with their pre-shock CARs already below 9 percent. The combined application of credit and market shock (COMBND-1) assumes 5% of performing loans directly downgraded to bad/loss category, 50% downward shift in the NPLs categories and 10% decline in the forced sale value of mortgaged collateral, increase in interest rates by 100 basis points, appreciation/depreciation of exchange rate by 5% and fall in equity prices by 10%, and results in overall CAR declining by 340 bps to 6.9 percent. In order to assess the resilience of banks towards liquidity risk, a shock on deposits withdrawal by 10, 20 and 30 percent has been assumed. This type of shock would have a substantial impact on the banking sector. Even though at 10% of withdrawal of deposits the industry liquidity ratio shows resilience, banks are vulnerable to the higher withdrawal rates.

Chapter 7 Non-Bank Financial Institutions

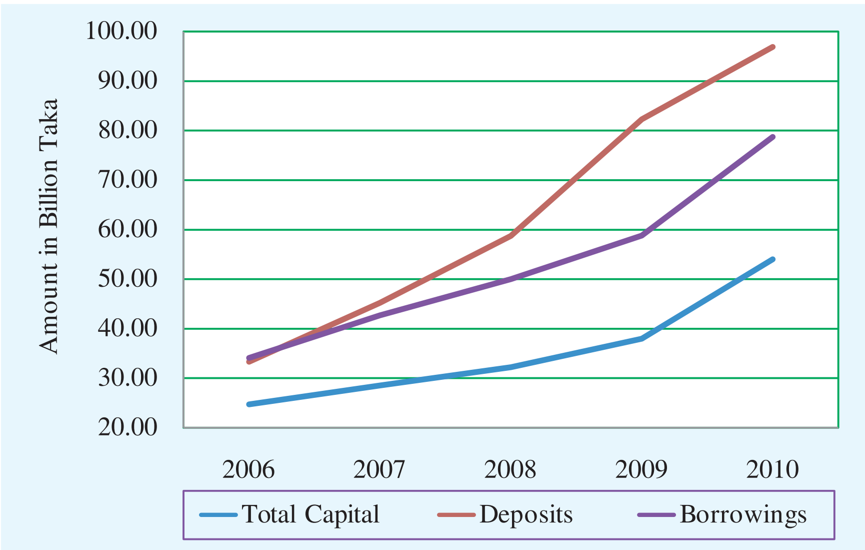
7.1 Introduction

Non-bank financial institutions (NBFIs) constitute a rapidly growing segment of the financial system in Bangladesh. At present, 29 NBFIs are operating their business across the country, of which 1 is government owned, 15 are privately owned local companies, and the remaining 13 are established under joint venture with foreign participation.

7.2 Funding sources

The major funding sources of NBFIs are capital, term and other deposits, and borrowings from banks & financial institutions. Banks are a major source for NBFIs to fund their asset deployment, either directly or indirectly. Banks also are major investors in bonds/debentures issued by NBFIs, resulting in a dependence of NBFIs on banks.

Chart 7.1 NBFI capital, deposit and borrowing trend



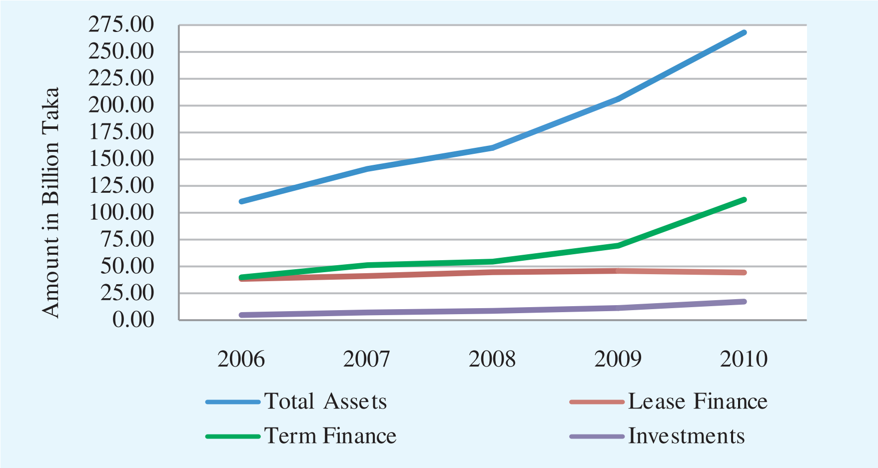
Source: Department of Financial Institutions & Markets, Bangladesh Bank.

NBFI capital, deposits and borrowings increased by 42.18 percent, 17.76 percent and 33.85 percent respectively in CY10 compared with the previous year. The trend of increasing capital shows a healthy financial base of the NBFIs.

7.3 Assets and financing

NBFI total assets increased by 30.01 percent in CY10 compared with CY09. The size of the total assets of this sector relative to GDP (at constant prices, base year: 1995-96, BDT 3600.47 billion in 2009-10) was 7.44 percent in CY10. However, NBFIs still account for only 5.52 percent of the assets of the overall banking sector.

Chart 7.2 NBFI assets & financing trend



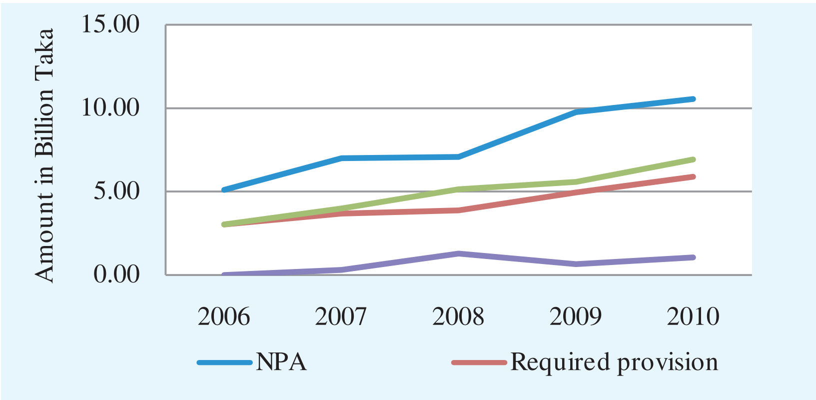
Source: Department of Financial Institutions & Markets, Bangladesh Bank.

The major portion of NBFI funds were deployed in term financing and lease financing. The volume of term financing increased by 61.66 percent in CY10 compared with CY09. However, lease financing decreased by 3.35 percent in CY10 compared with the previous year.

7.4 Non-performing assets and provisioning

Non-performing assets (NPA) of NBFIs increased by 8.10 percent and reached BDT 10.54 billion as of end-December 2010. The NPA represented 19.52 percent of total capital. Provisions maintained against NPA showed a BDT 1.05 billion surplus over required provisions.

Chart 7.3 NBFIs NPA & provisioning trend

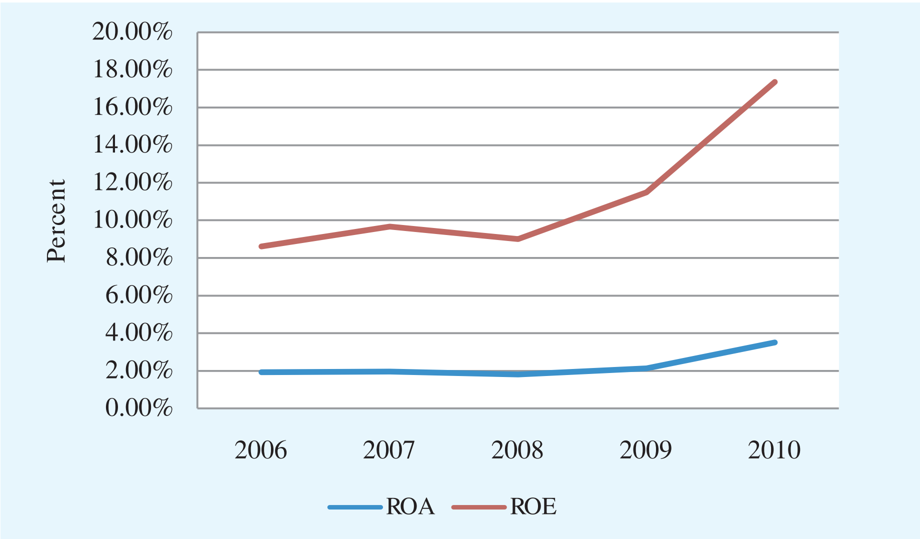


Source: Department of Financial Institutions & Markets, Bangladesh Bank.

7.5 Profitability

NBFIs' after-tax profits have shown continuous growth over the last five years. The Return on Equity (ROE) and the Return on Assets (ROA) ratios have also shown a positive trend over the last five years.

Chart 7.4 NBFIs ROA & ROE trend



Source: Department of Financial Institutions & Markets, Bangladesh Bank.

Aggregate ROA increased by 1.38 percentage points and ROE increased by 5.87 percentage points in CY10 compared with CY09. Better utilization of assets and equity results in the rising trend of these key ratios. A decomposition of the sources of total income shows that the dominant contribution is on account of interest income from traditional business, which lends to higher profitability. Expenses are increasing due to increasing staff and increasing outsourcing of business operations. However, if profits decline due to deterioration in asset quality, increase in provisions, etc., it will be a challenge to this sector to maintain its existing ROA and ROE level in future.

Chapter 8

Capital Markets

There are 2 Stock Exchanges in Bangladesh- Dhaka Stock Exchange Limited (DSE) and Chittagong Stock Exchange Limited (CSE). DSE is the country's prime bourse considering its ample contribution in the capital market.

The Bangladesh capital market is gradually growing strong and registered significant growth during CY10. Because of the slower pace of investment activities, reduced interest rate on deposits and saving certificates and increasing enthusiasm among people, the capital market was flooded with huge liquidity. Due to a growing number of ordinary investors in the capital markets, a limited supply of securities, and investors' expectation for more profit, at times a situation of overheating is created, making the market volatile. However, market monitoring has been made stronger and various steps have been taken to maintain market stability and to establish a transparent and vibrant capital market.

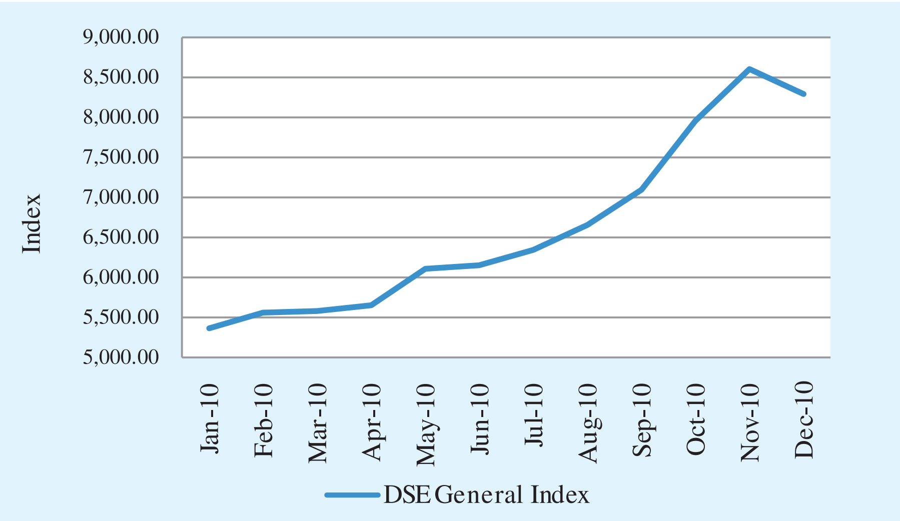
The primary regulator of the stock market is the Securities & Exchange Commission (SEC). However, BB, as a regulator of the banking sector, regulates the scheduled banks and non-bank financial institutions for stock market activities. As a regulatory stance, BB instructed the banks

a. to establish separate subsidiaries in the form of either merchant bank or brokerage house or both in order to continue their brokerage/merchant banking activities.

b. not to provide any margin loan.

By this time, 25 banks have established separate merchant bank/brokerage house and 1 bank is under process.

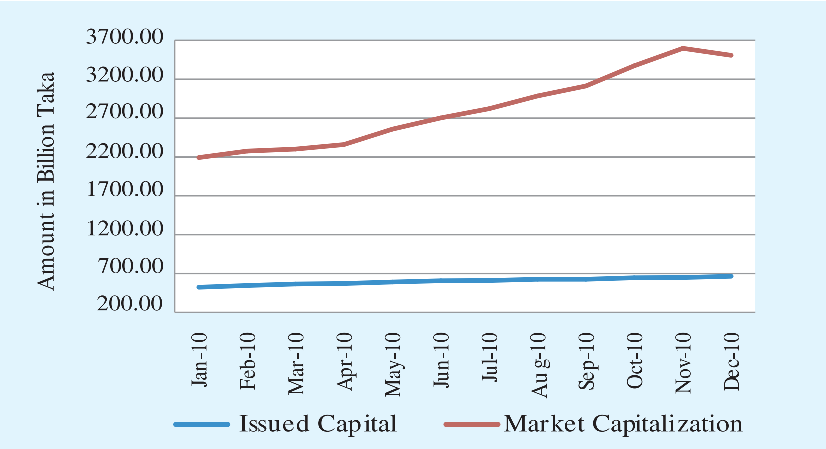
Chart 8.1 DSE general index movement



Source: Monthly Review, December 2010, Vol. 25, No. 12, Dhaka Stock Exchange Limited

During January-December 2010, the DSE general index increased by 54.47 percent showing an abnormal growth. The index crossed 8918.51 points (on 05 December 2010) for the first time. However, the number of listed securities decreased to 445 in December 2010 from 463 in September 2010 as some securities were transferred to the OTC market. All other market barometers rose in CY10 reflecting investors' high level of confidence on the securities market.

Chart 8.2 Movement of DSE market capitalization & issued capital

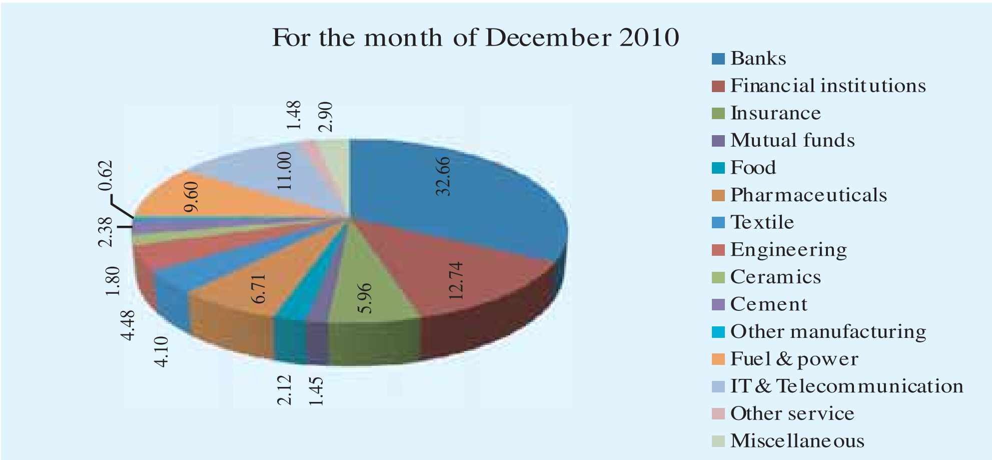


Source: Monthly Review, December 2010, Vol. 25, No. 12, Dhaka Stock Exchange Limited

8.1 Market capitalization and issued capital

A total of 168 listed companies out of 218 increased their paid-up capital during CY10 through issuing either bonus or right shares. Besides, a total of 18 companies floated IPOs in CY10. As a consequence, the total market capitalization at DSE increased by BDT 1604.78 billion or 84.32 percent and stood at BDT 3508.01 billion on 30 December 2010 from BDT 1903.23 billion on 30 December 2009. Market capitalization reached a record high of BDT 3680.71 billion on 05 December 2010, and subsequently market capitalization to GDP also rose to 53.30 percent, marking a significant record. Total issued capital increased by 27.22 percent as of end-December 2010 compared with end-December 2009.

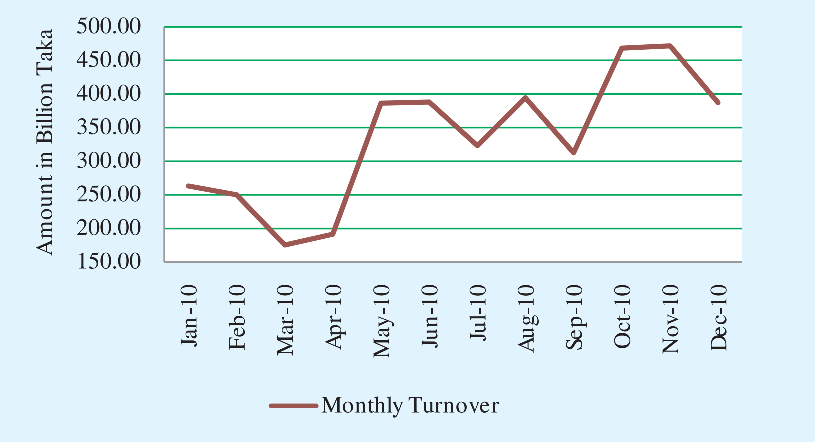
Chart 8.3 Sector-wise breakdown (percent) of total market capitalization



Source: Monthly Review, December 2010, Vol. 25, No. 12, Dhaka Stock Exchange Limited

In terms of sector composition, the financial sector (including banks, financial institutions, insurance and mutual funds) holds a 52.81 percent share of total market capitalization, while the manufacturing sector holds a 22.21 percent share as of end-December 2010. Banks hold a 32.66 percent share of total market capitalization, which was the highest among all sectors.

Chart 8.4 DSE monthly turnover



Source: Monthly Review, December 2010, Vol. 25, No. 12, Dhaka Stock Exchange Limited

During the year 2010, DSE turnover reached the highest peak with BDT 471.72 billion in November, and the lowest was BDT 175.12 billion in March. The daily average turnover was BDT 18.44 billion in CY10, which was significantly above the BDT 8.96 billion in CY09. The financial sector dominated the DSE turnover, with 63.36 percent of the total DSE turnover in 2010. Banks' turnover was 40.57 percent of the overall sector. Among the other sectors, the manufacturing sector contributed 22.21 percent to the total turnover, with textiles remaining on the top (7.49 percent) of this sector. The fuel and power sector contributed 7.0 percent to the turnover of DSE in 2010.

Chart 8.5 Movement of market price-earnings ratio

Source: Monthly Review, December 2010, Vol. 25, No. 12, Dhaka Stock Exchange Limited, http:/ www.dsebd.org

8.2 Price earnings ratio

The P/E ratio depicts the relationship between market valuation of a company's shares and the earnings of the company. The overall weighted average P/E ratio of DSE was 25.65 in 2009, increasing to 29.16 in 2010. Sector-wise evaluation shows that the highest P/E ratio of 126.93 was observed for the paper & printing sector in 2010, compared with 27.59 in 2009. The weighted average P/E ratio of the banking sector rose to 25.24 in 2010 from 16.46 of 2009. The financial institutions' P/E ratio rose to 47.27 in 2010 from 32.45 of 2009. However, P/E ratio of the mutual funds decreased to 17.53 in 2010 from 29.06 of 2009.

Chapter 9 Financial Infrastructure

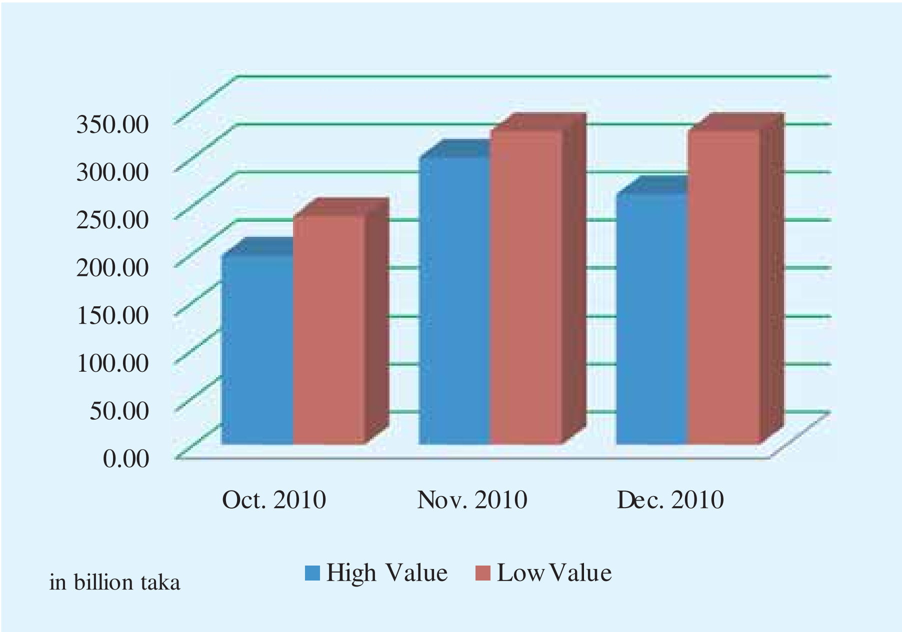
9.1 Payments and settlement system

The payment and settlement systems in Bangladesh remained resilient and continued to operate smoothly throughout 2010, contributing to the stability of the financial system. Although remarkable progress has been achieved in the shift from paper-based payments to electronic form, cash and cheques remain popular.

9.2 Bangladesh automated clearing house (BACH)

With the technical and financial assistance from DFID, UK, Bangladesh Bank started live operation of Bangladesh Automated Clearing House (BACH) in Dhaka region, the first electronic clearing house in the country, from 07 October 2010.

Chart 9.1 Bangladesh automated clearing house operations



Source: Department of Currency Management & Payment Systems, BB.

Under the automated cheque processing system, two types of clearing are processed-high value (HV) and regular value (RV). Instruments of BDT 0.50 million and above are processed under high value clearing. Starting from October 2010 to end-December 2010, about 96.89 thousand HV items of BDT 757.22 billion and 3.86 million RV items of BDT 892.19 billion were processed under the Bangladesh automated clearing system.

9.3 Mobile-technology based financial services

Bangladesh Bank has approved the following mobile-technology based financial services (in broad categories) aiming at financial inclusion of the non-banked population of the country.

- Inward foreign remittance disbursement
- Cash in/out using m-wallet account through agents/ bank branches/ ATM's/ mobile operator's outlet
- Person to business payment (e.g. utility bill payment)
- Business to person payment (e.g. salary disbursement by corporate bodies/industries /offices etc.)
- Government to person payment (e.g. elderly allowances, Freedom fighter allowances etc.)

9.4 E-payment activities

The following services under 'E-Payment Activities' have been approved by Bangladesh Bank:

- Online payment of utility bills from client's accounts to recipients' accounts.
- Transfer of money from one account of a client to another account in the same bank.
- Payment/collection of money from/to buyers' bank account to sellers' bank account for purchase/sale of products under e-commerce system.
- Transaction via internet using credit card in local currency.

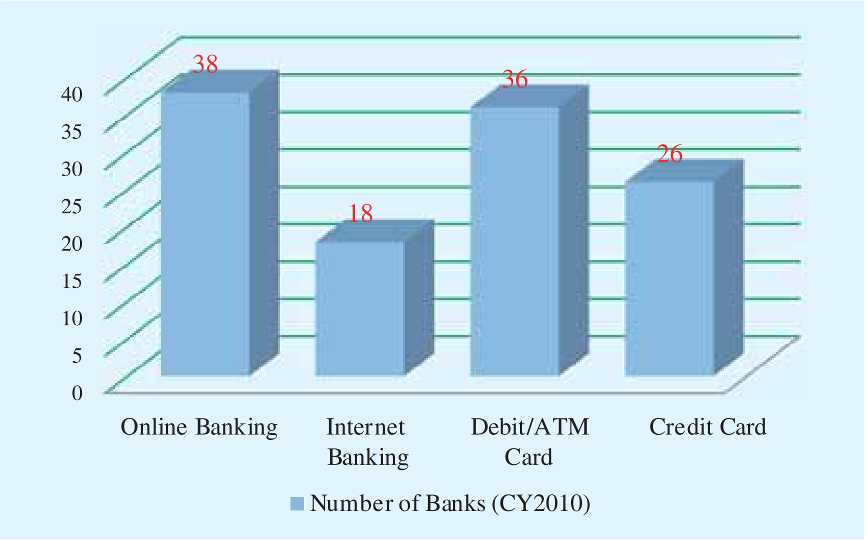
9.5 Legal and regulatory framework

In order to give legal and regulatory support to such electronic exchange of images of paper items and electronic transfer of funds, Bangladesh Bank has approved and assigned the "Bangladesh Payment and Settlement Systems Regulations (BPSSR), 2009". This regulation is the bedrock of modern payment systems in Bangladesh. BACPS operating rules and guidelines on mobile-technology based financial transactions for the banks have been published.

9.6 Electronic banking operations

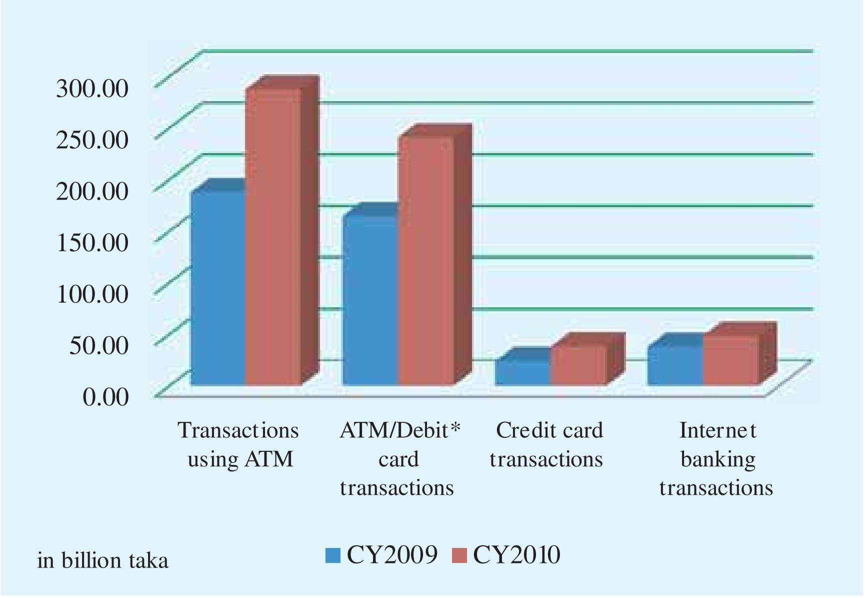
Out of 47 scheduled banks, 4 banks (BKB, BDBL, RAKUB & Rupali) were not engaged in electronic banking operations during CY10. Information about the remaining 43 banks' electronic banking operations during CY10 is given below:

Chart 9.2 Number of banks providing electronic banking facility



The above chart reveals that out of 47 scheduled banks, 38 banks were providing online banking facilities and 18 banks were providing internet banking facilities in CY10. On the other hand, 36 banks were providing ATM/Debit card facilities whereas 26 banks were providing credit card facilities in CY10.

Chart 9.3 Volume of electronic banking transactions



** Some banks use the word 'Debit Card' as a synonym of ATM card.*

Automated Teller Machine (ATM) transactions and internet banking transactions increased by 53.22 percent and 28.85 percent respectively in CY10. On the other hand, ATM/debit card transactions and credit card transactions increased by 46.43 percent and 59.70 percent respectively in CY10.

9.7 CDBL transactions and settlement system

Central Depository Bangladesh Limited (CDBL) provides services to the Bangladesh capital market, covering settlement of trades on stock exchanges as well as settlement of OTC transactions in treasury bills and government bonds issued by the central bank.

CDBL was incorporated on 20 August 2000 sponsored by the country's state-owned commercial banks, Investment Corporation of Bangladesh, private commercial banks, foreign banks, merchant banks, publicly listed companies, insurance companies and Dhaka Stock Exchange and Chittagong Stock Exchange with the collaboration of the Asian Development Bank (ADB).

The legal basis for CDBL's operations is set out in the Depositories Act 1999, Depositories Regulations 2000, Depository (User) Regulations 2003, and the CDBL By- Laws.

Live operations of the Central Depository System (CDS) commenced with the inauguration of the Electronic Government Securities Registry (EGSR) on 20 October 2003. The EGSR also serves as a platform for secondary market sale/purchase as well as repo transactions of government securities to commercial banks linked online to the CDS. Equity market securities dematerialization process commenced on 24 January 2004. Since 14 February 2003 CDBL has been acting as the national numbering agency for the International Securities Identification Number (ISIN), as the partner in Bangladesh of the Association of National Numbering Agencies (ANNA) based in Germany. CDBL is a member of Asia Pacific CSD Group (ACG) and an associate member of South Asian Federation of Exchanges (SAFE).

9.8 Treasury bills/bond electronic registry

Bangladesh Bank (BB) has opted for the use of an electronic registry for its Treasury Bills (T-bills) to foster the development of a secondary market in T-bills in Bangladesh. CDBL has provided the infrastructure for BB's electronic registry by linking up all banks participating in T-bills auctions to the Central Depository System of CDBL.

Chapter 10 Development in the Financial System

10.1 Basel II implementation

To comply with international best practices and to make the banks' capital more risk-sensitive as well as to make the banking industry more shock absorbent and stable, a risk based capital adequacy framework (Basel-II) has been brought into operation on a trial basis for one year since 1 January 2009 and as a regulatory requirement since 1 January 2010. Three sets of guidelines have been issued in this regard -the first on 31 December 2008, and the second and third on 3 August 2010 and 29 December 2010 respectively.

Under the revised regulatory capital framework, BB is entrusted with ensuring that banks are accurately assessing all the risks they are exposed to and that they are determining the necessary capital in commensurate with their risk profile. BB receives the risk based capital position of banks on a quarterly basis.

In the concluding stage of the Basel-I regime, the minimum required regulatory capital (MCR) was 10 percent of banks' risk weighted assets, with at least 5 percent in core capital or Taka 2 billion, whichever is higher. Besides, banks were instructed to raise their paid up capital and reserve to Taka 4.0 billion, of which paid up capital would be minimum Taka 2.0 billion, with effect from 11 August 2011. Meanwhile, for the Basel-II capital adequacy framework, the MCR of the banks has been phased in to 8 percent of risk-weighted assets (RWA) for the period from 1 January 2010 to 30 June 2010, 9 percent for the period from 1 July 2010 to 30 June 2011 and 10 percent from July 2011 onward.

10. 2 Risk management unit

Following the global economic recession, banks were advised on 10 June 2010 to establish a separate Risk Management Unit for proper management of all existing and future potential risks. In this regard, directives and an organogram regarding the activities of the risk management unit were issued to all banks for better understanding of the risk issues as well as to bring more uniformity to the risk management report.

In order to make risk management effective, banks are advised to arrange a monthly meeting based on the risk management paper containing every possible analysis of all risks existing in the bank. As compliance, banks are preparing and submitting to BB the risk management papers along with minutes of the meetings on a quarterly basis. It is noteworthy that BB has also established a separate Risk Management Monitoring Section in the Department of Off-Site Supervision with a view to reviewing risk management functions, stress testing reports, the shareholding and liquidity profiles of the banks, and other issues relating to risk.

10.3 Enterprise data warehouse

BB currently collects most of the data from banks and financial institutions as hard copies. There exists the problem of data redundancy and inaccuracy in this form of data collection. Besides, collected data are processed and stored in a distributed environment. These serve as hindrances toward prompt analysis of banking sector's performance, stress testing and macroeconomic research at BB's end. To improve the existing situation, BB initiated implementation of Enterprise Data Warehouse (EDW) in late 2009. Under EDW, data will be collected from banks and financial institutions electronically. Besides, all collected data will be stored in a central database. These will contribute to saving a considerable amount of time and effort. Moreover, data accuracy will be increased and data redundancy will be considerably reduced. In addition, since the use of paper will be considerably reduced, this initiative will contribute to Green Banking as well.

After successful implementation of EDW, BB will be in a position to conduct prompt analysis on banking sector's performance, scenario analysis, stress test, and different macroeconomic research. Thus, it is expected that EDW will play an important role in the financial stability of Bangladesh.

Appendices

Appendix I Banking Sector Aggregate Balance Sheet

	Amount in Billion Taka			Change (%)
	2008	2009	2010	2009 to 2010
Property & Assets:				
Cash in Hand (including FC)	35.26	37.35	52.04	39.33
Balance with BB & SB (including FC)	196.90	256.55	300.62	17.18
Balance with other Banks & FIs	108.96	140.45	146.63	4.40
Money at Call & Short Notice	32.97	49.70	43.93	(11.61)
Investments:				
Government	398.13	532.24	490.78	(7.79)
Others	32.14	44.05	98.50	123.61
Total	430.27	576.09	589.28	2.29
Loans & Advances:				
Loans, CC, OD etc.	2002.28	2361.62	2973.44	25.91
Bills purchased & Discounted	129.53	131.55	225.18	71.17
Total	2131.81	2493.17	3198.62	28.29
Fixed Assets	51.07	61.33	101.65	65.74
Other Assets	302.60	316.23	421.13	33.17
Non-banking Assets	0.93	1.12	1.14	1.79
Total Assets	3290.77	3932.19	4855.04	23.47
Liabilities:				
Borrowings from other Banks/FIs/Agents	120.18	121.98	159.75	30.96
Deposits & Other Accounts:				
Current Deposit	442.57	544.25	712.73	30.96
Bills Payable	42.88	48.65	59.82	22.96
Savings Deposit	586.28	731.75	852.37	16.48
Fixed/Term Deposit	1537.08	1805.93	2156.72	19.42
Total	2608.81	3130.58	3781.64	20.80
Other Liabilities	381.02	406.93	494.87	21.61
Total Liabilities	3110.01	3659.49	4436.26	21.23
Capital/Shareholder's Equity	180.76	272.70	418.78	53.57
Total Liabilities & Shareholder's Equity	3290.77	3932.19	4855.04	23.47
Off-balance Sheet Items	834.18	911.62	1985.83	117.84

Appendix II Banking Sector Aggregate Share of Assets

(Amount in Billion Taka)

	2009	% of Total Assets	2010	% of Total Assets
Property & Assets:				
Cash in Hand (including FC)	37.35	0.95	52.04	1.07
Balance with BB & SB (including FC)	256.55	6.52	300.62	6.19
Balance with other Banks & FIs	140.45	3.57	146.63	3.02
Money at Call & Short Notice	49.70	1.26	43.93	0.91
Investments:				
Government	532.24	13.54	490.78	10.11
Others	44.05	1.12	98.50	2.03
Total	576.09	14.66	589.28	12.14
Loans & Advances:				
Loans, CC, OD etc.	2361.62	60.06	2973.44	61.24
Bills purchased & Discounted	131.55	3.35	225.18	4.64
Total	2493.17	63.41	3198.62	65.88
Fixed Assets	61.33	1.56	101.65	2.10
Other Assets	316.23	8.04	421.13	8.67
Non-banking Assets	1.12	0.03	1.14	0.02
Total Assets	3932.19	100.00	4855.04	100.00

Appendix III Banking Sector Aggregate Share of Liabilities

(Amount in Billion Taka)

	2009	% of Total Liabilities	2010	% of Total Liabilities
Liabilities:				
Borrowings from other Banks/FIs/Agents	121.98	3.33	159.75	3.60
Deposits & Other Accounts:				
Current Deposit	544.25	14.87	712.73	16.07
Bills Payable	48.65	1.33	59.82	1.35
Savings Deposit	731.75	20.00	852.37	19.21
Fixed/Term Deposit	1805.93	49.35	2156.72	48.62
Total	3130.58	85.55	3781.64	85.25
Other Liabilities	406.93	11.12	494.87	11.15
Total Liabilities	3659.49	100.00	4436.26	100.00
Capital/Shareholder's Equity	272.70	7.45	418.78	9.44
Total Liabilities & Shareholder's Equity	3932.19	-	4855.04	-

Appendix IV Banking Sector Aggregate Income Statement

	Amount in Billion Taka			Change (%)
	2008	2009	2010	2009 to 2010
Interest Income	227.70	271.26	321.78	18.62
Less: Interest Expense	156.82	186.84	200.24	7.17
Net Interest Income	70.88	84.42	121.54	43.97
Non-Interest/Investment Income	96.53	118.48	164.87	39.15
Total Income	167.41	202.90	286.41	41.16
Operating Expenses	63.00	86.65	115.49	33.28
Profit before Provision	104.41	116.25	170.92	47.03
Total Provision	24.24	26.15	35.59	36.10
Profit before Taxes	80.17	90.10	135.33	50.20
Provision for Taxation	40.87	35.95	52.05	44.78
Profit after Taxation/Net Profit	39.30	54.15	83.28	53.80

Appendix V Banking Sector Assets, Deposits & NPL Concentration (CY10)

(Amount in Billion Taka)

Assets	Top 5 banks	Other banks	Top 10 banks	Other banks
Amount	1750.46	3104.58	2439.22	2415.82
Share (%)	36.05%	63.95%	50.24%	49.76%
Deposit	**Top 5 banks**	**Other banks**	**Top 10 banks**	**Other banks**
Amount	1383.44	2398.20	1920.57	1861.07
Share (%)	36.58%	63.42%	50.79%	49.21%
Classified Loans	**Top 5 banks**	**Other banks**	**Top 10 banks**	**Other banks**
Amount	142.38	83.25	172.37	53.26
Share (%)	63.10%	36.90%	76.39%	23.61%

Appendix VI Banking Sector Loan Loss Provisions

(Amount in Billion Taka)

Year	Required provision	Provision maintained	Surplus/ (shortfall)
2005	88.31	42.56	-45.75
2006	106.12	52.92	-53.19
2007	127.18	97.07	-30.11
2008	136.13	126.23	-9.9
2009	134.77	137.85	3.08
2010	150.82	146.83	-3.99

Appendix VII Banking Sector Year-wise Classified Loans Ratios

(Figure in percent)

Year	Classified loans to total loans	Sub-standard loans to classified loans	Doubtful loans to classified loans	Bad loans to classified loans
2001	31.49	5.6	5.87	88.53
2002	28.1	8.65	5.27	86.06
2003	22.13	10.24	8.75	80.97
2004	17.63	7.2	6.6	86.19
2005	13.55	8.66	6.96	84.37
2006	13.15	13.13	7.15	79.72
2007	13.23	9.75	7.51	82.74
2008	10.79	9.43	9.42	81.14
2009	9.21	12.24	8.35	79.41
2010	7.05	13.44	8.44	78.11

Appendix VIII Banking Sector Deposits Breakdown (CY10)

(Amount in Billion Taka)

Items	Amount	% of Total Deposit
Current deposits	712.73	18.85
Bills payable	59.82	1.58
Savings deposits	852.37	22.54
Term deposits	2156.72	57.03
Total deposit	3781.64	100.00

Appendix IX Banking Sector Call Money Investment & Borrowing

(Amount in Billion Taka)

Items	CY09	CY10	% of Change
Borrowings	121.98	159.75	30.96%
Call money	49.70	43.93	-11.61%

Appendix X Banking Sector Selected Ratios

(Figure in percent)

Ratio	CY09	CY10
ROA	1.38	1.72
ROE	19.86	19.89
Net Interest Margin	2.59	3.05
Asset Turnover	4.18	5.90
Interest Income to Total Assets	6.90	6.63
Net- Interest Income to Total Assets	2.16	2.50
Non-Interest Income to Total Assets	3.01	3.40
Non-interest expense to Total Income	42.71	40.32
Capital Adequacy Ratio	11.74	9.31
Classified Loans to Total Loans	9.21	7.05
Classified Loans to Capital	79.68	54.77
Provision to Classified Loans	61.31	65.08

Appendix XI Banking Sector ROA & ROE (CY10)

ROA	Number of Banks	ROE	Number of Banks
Up to 2%	25	Up to 5%	10
> 2% to 3%	16	> 5% to 10%	20
> 3% to 4%	5	>10% to 15%	4
> 4%	1	>15%	31

Appendix XII Banking Sector Year-wise CDR

(Amount in Billion Taka)

Year	Deposits (Excluding Inter-bank)	Credits (Excluding Inter-bank)	Credit-Deposit Ratio
2006	1829.26	1394.60	76.24%
2007	2116.12	1600.19	75.62%
2008	2527.56	1963.85	77.70%
2009	3042.77	2334.8	76.73%
2010	3689.20	2958.81	80.20%

Appendix XIII Banking Sector CDR in CY10

Range (In percent)	Number of Banks
Up to 80	8
> 80 to 90	14
> 90 to 100	15
>100 to 110	6
>110	4
Total	47

Appendix XIV Banking Sector Year-wise Deposit & Advance Rate

(Figure in percent)

Year	Bank Rate	Deposit Rate	Advance Rate	Spread
2005	5.00	5.90	11.25	5.35
2006	5.00	6.99	12.60	5.61
2007	5.00	6.84	12.78	5.95
2008	5.00	7.09	12.40	5.32
2009	5.00	6.29	11.51	5.22
2010	5.00	6.08	11.34	5.26

Appendix XV Banking Sector Month-wise Deposit & Advance Rate

(Figure in percent)

Month	Deposit rate	Advance rate	Spread
Jan-10	6.31	11.51	5.20
Feb-10	6.23	11.47	5.24
Mar-10	6.09	11.30	5.21
Apr-10	6.09	11.32	5.23
May-10	6.09	11.31	5.22
Jun-10	6.01	11.31	5.30
Jul-10	6.00	11.24	5.24
Aug-10	6.04	11.23	5.19
Sep-10	6.01	11.17	5.16
Oct-10	6.03	11.21	5.18
Nov-10	6.07	11.23	5.16
Dec-10	6.08	11.34	5.26

Appendix XVI Islamic Banks' Aggregate Balance Sheet

	Amount in Billion Taka			Change (%)
	2008	2009	2010	2009 to 2010
Property & Assets:				
Cash in Hand (including FC)	4.89	4.95	7.29	47.27
Balance with BB & SB (including FC)	42.67	57.90	64.05	10.62
Balance with other Banks & FIs	26.68	14.88	13.38	(10.08)
Money at Call & Short Notice	0.00	14.52	19.36	33.33
Investments:				
Government	14.68	18.77	21.21	13.00
Others	1.21	3.38	6.61	95.56
Total	15.89	22.15	27.82	25.60
Investments & Advances:				
Investments & Advances	330.54	414.45	527.84	27.36
Bills Purchased & Discounted	25.59	27.59	46.30	67.81
Total	356.13	442.04	574.14	29.88
Fixed Assets	6.54	10.28	12.12	17.90
Other Assets	11.68	9.29	15.41	65.88
Non-banking Assets	0.00	0.00	0.00	0.00
Total Assets	464.48	576.01	733.57	27.35
Liabilities:				
Borrowings from other Banks/FIs/Agents	12.83	15.09	21.41	41.88
Deposits & Other Accounts:				
Current Deposit	37.58	58.70	86.79	47.85
Bills Payable	4.60	5.38	6.78	26.02
Savings Deposit	91.00	115.46	136.43	18.16
Fixed/Term Deposit	253.90	311.45	387.12	24.30
Total	387.08	490.99	617.12	25.69
Other Liabilities	37.75	32.65	40.37	23.64
Total Liabilities	437.66	538.73	678.90	26.02
Capital/Shareholder's Equity	26.84	37.28	54.67	46.65
Total Liabilities & Shareholder's Equity	464.50	576.01	733.57	27.35
Off-balance Sheet Items	115.72	138.40	241.07	74.18

Appendix XVII Islamic Banks' Aggregate Income Statement

	Amount in Billion Taka			Change (%)
	2008	2009	2010	2009 to 2010
Profit Income	40.26	46.97	55.07	17.25
Less: Profit Expenses	27.21	31.49	35.12	11.53
Net Profit Income	13.05	15.48	19.95	28.88
Non-Profit/Investment Income	10.28	10.27	17.94	74.68
Total Income	23.33	25.75	37.89	47.15
Operating Expenses	7.48	9.27	13.04	40.67
Profit before Provision	15.85	16.48	24.85	50.79
Total Provision	3.83	5.50	6.32	14.91
Profit before Taxes	12.02	10.98	18.53	68.76
Provision for Taxation	6.26	5.27	6.86	30.17
Profit after Taxation/Net Profit	5.76	5.71	11.66	104.20

Appendix XVIII Share of Islamic Banks in the Banking Sector (CY10)

(Amount in Billion Taka)

	All Banks	Islamic Banks	% of overall banking Industry
Property & Assets:			
Cash in hand	52.04	7.29	14.01
Due from BB & other banks/FIs	491.18	96.79	19.71
Investments in securities	589.28	27.82	4.72
Investments (Loans & advances)	3198.62	574.14	17.95
Other Assets	523.92	27.53	5.25
Total Assets	4855.04	733.57	15.11
Liabilities:			
Due to financial institutions	159.75	21.41	13.40
Total deposits	3781.64	617.12	16.32
Other liabilities	494.87	40.37	8.16
Total Liabilities	4436.26	678.90	15.30
Capital/Shareholder's Equity	418.78	54.67	13.05
Total Liabilities & Shareholder's Equity	4855.04	733.57	15.11
Off-balance Sheet Items	1985.83	241.07	12.14

Appendix XIX Market Share of Islamic Banks and Conventional Banks (CY10)

(Figure in percent)

	Islamic Banks	Conventional Banks	Total
Assets	15.11	84.89	100
Investments (Loans)	17.95	82.05	100
Deposits	16.32	83.68	100
Capital/Shareholder's Equity	13.05	86.95	100
Total Liabilities	15.30	84.70	100

Appendix XX Selected Ratios of Islamic Banks and the Banking Sector (CY10)

(Figure in percent)

Ratio	Overall Banking Sector	Islamic Banking Sector
ROA	1.72	1.59
ROE	19.89	21.33
Net Profit Margin	3.05	3.14
Profit (Interest) Income to Total Assets	6.63	7.51
Net-profit (Interest) Income to Total Assets	2.50	2.72
Non-Profit (Interest) Income to Total Assets	3.40	2.45
Investment (Credit)-Deposit Ratio	80.20	94.73
Capital Adequacy Ratio	9.31	9.06
Classified Investment (Credits) to Investments	7.05	3.48
Classified Investment (Credits) to Capital	54.77	32.74

Appendix XXI Islamic Banks' Capital Adequacy Ratio (CY10)

CAR	Number of Islamic Banks
Below 9%	1
9% to 10%	3
10% to 12%	2
>12%	1
Total	7

Appendix XXII Islamic Banking Sector Investment-Deposit Ratio (as of 31.12.2010)

(Amount in Billion Taka)

Items	Islamic Banks	Islamic Branches /Windows	Islamic Banking Sector
Deposits (Excluding Interbank)	594.43	36.44	630.87
Credits (Excluding Interbank)	563.12	40.42	603.54
IDR	94.73%	110.92%	95.67%

Appendix XXIII Key Financial Indicators of NBFIs

(Amount in Billion Taka)

Items	CY06	CY07	CY08	CY09	CY10
Number of Total NBFIs	29	29	29	29	29
Number of Government NBFI	1	1	1	1	1
Number of NBFIs under Foreign Joint Venture	15	15	15	15	15
Number of Branches	64	72	80	88	108
Number of Employees	1182	1336	1670	1926	2198
Total Capital	24.73	28.53	32.24	37.98	54.00
Deposits	33.32	45.25	58.77	82.26	96.87
Borrowings	34.11	42.74	49.99	58.82	78.73
Other Liabilities	18.52	24.39	19.73	27.06	38.37
Total Liabilities & Capital	110.68	140.91	160.73	206.12	267.97
Cash in Hand	0.44	0.77	0.32	0.65	1.12
Lease Finance	38.38	41.32	44.76	45.93	44.39
Term Finance	39.94	51.25	54.63	69.48	112.32
Investments	4.85	7.11	8.84	11.50	17.36
Other Assets	27.07	40.46	52.18	78.56	92.78
Total Assets	110.68	140.91	160.73	206.12	267.97
Non-performing Assets	5.10	6.99	7.08	9.75	10.54
Required Loan Loss Provisions	3.03	3.68	3.88	4.94	5.88
Maintained Loan Loss Provision	3.03	3.99	5.15	5.58	6.93
Provision Surplus/(Shortfall)	0.00	0.31	1.27	0.64	1.05
Interest Income	10.64	12.31	15.22	17.73	21.40
Non-interest Income	1.42	3.08	2.78	4.52	11.34
Total Income	12.06	15.39	18.00	22.25	32.74
Total Expenses	7.59	9.87	11.81	13.05	16.16
Operating Profit	4.47	5.52	6.19	9.20	16.58
Total Provisions (for the year)	1.66	1.99	2.65	3.79	6.68
Profit before Taxes	2.81	3.53	3.54	5.41	9.90
Provision for Taxation	0.68	0.77	0.64	1.05	0.53
Net Profit after Taxation	2.13	2.76	2.90	4.36	9.37
ROA (percent)	1.92	1.96	1.80	2.12	3.50
ROE (percent)	8.61	9.67	9.00	11.48	17.35

Source: Department of Financial Institutions & Markets, Bangladesh Bank.

Appendix XXIV Month-wise Capital Market Performance

(Amount in Billion Taka)

Month	DSE General Index	P/E Ratio	Issued Capital	Monthly Turnover	Market Capitalization
Dec-09	4535.53	25.65	522.10	179.26	1903.23
Jan-10	5367.11	29.35	525.26	262.87	2191.83
Feb-10	5560.56	30.58	548.07	249.98	2275.30
Mar-10	5582.33	27.59	566.58	175.12	2302.58
Apr-10	5654.88	27.55	571.91	191.30	2360.45
May-10	6107.81	27.73	592.97	386.24	2557.47
Jun-10	6153.68	24.08	607.25	387.73	2700.75
Jul-10	6342.76	24.55	610.31	322.77	2821.70
Aug-10	6657.97	25.81	628.71	394.44	2984.51
Sep-10	7097.38	26.29	627.02	312.56	3113.23
Oct-10	7957.12	28.46	646.74	468.01	3371.00
Nov-10	8602.44	29.71	650.25	471.72	3598.33
Dec-10	8290.41	29.16	664.24	387.17	3508.01

Appendix XXV Sector-wise Contribution of Capital Market

(For the month of December 2010)

Sector	% of Market Capitalization	% of Market Turnover	P/E Ratio
Financial Sector			
Banks	32.66	40.57	25.24
Financial institutions	12.74	10.76	47.27
Insurance	5.96	8.52	64.64
Mutual funds	1.45	3.51	17.53
Sector Total	**52.81**	**63.36**	**-**
Manufacturing Sector			
Food & Allied	2.12	1.78	27.30
Pharmaceuticals	6.71	3.21	34.12
Textile	4.10	7.49	52.44
Engineering	4.48	4.96	50.10
Ceramics	1.80	2.61	106.86
Cement	2.38	1.58	33.44
Paper & Printing	0.04	0.02	126.93
Tannery	0.55	0.46	20.66
Jute	0.03	0.05	55.66
Sector Total	**22.21**	**22.16**	**-**
Service & Miscellaneous			
Fuel & Power	9.60	7.00	21.57
IT	0.17	0.34	64.91
Telecommunication	10.83	2.03	20.35
Service & Real Estate	0.98	0.66	43.93
Travel & Leisure	0.50	1.34	65.45
Miscellaneous	2.90	3.11	19.54
Sector Total	**24.98**	**14.48**	**-**
Market Total	**100.00**	**100.00**	**29.16**

Appendix XXVI Bangladesh Automated Clearing House (BACH) Operations

Month	High Value (HV)		Regular Value (RV)	
	Item (in thousands)	Amount in Billion Taka	Item (in thousands)	Amount in Billion Taka
October 2010	25.25	196.77	970.62	238.15
November 2010	39.72	299.39	1428.07	326.99
December 2010	31.92	261.06	1465.28	327.05
Total	96.89	757.22	3863.97	892.19

Appendix XXVII Electronic Banking Transactions

(Amount in Billion Taka)

Item	CY09	CY10	Change (%) 2009 to 2010
Transactions using ATM	187.43	287.18	53.22
ATM/debit Card Transactions	164.49	240.87	46.43
Credit Card Transactions	23.87	38.12	59.70
Internet Banking Transactions	37.51	48.33	28.85

Appendix XXVIII Classified Loan Concentration Ratio (CY10)

(Amount in Billion Taka)

	Concentration	
	Amount of NPL	% of Total
Worst* 5 Banks	142.38	63.10%
Rest 42 Banks	83.25	36.90%
Banking Sector (47 Banks)	225.63	100.00%
Worst* 10 Banks	172.37	76.39%
Rest 37 Banks	53.26	23.61%
Banking Sector (47 Banks)	225.63	100.00%

**Worst banks are the ones having highest amount of NPL in the total banking sector*
Note: *Worst 10 banks include 4 state-owned commercial banks, 4 domestic private commercial banks and 2 specialized development banks.*

Prepared by :
Department of Off-site Supervision
Bangladesh Bank, Head Office, Dhaka, Bangladesh

Website : www.bb.org.bd
www.bangladeshbank.org.bd
www.bangladesh-bank.org

Published by Dr. M. Golam Mustafa, General Manager, Department of Printing and Publications, Bangladesh Bank, Head Office, Motijheel, Dhaka-1000, Bangladesh
Phone : 88-02-7120951, Fax : 88-02-7110211
E-mail : golam.mustafa@bb.org.bd

Printed by Srout Advertising, Tel : 8356741, 01819251898

DPP 10-2011-300