

Financial Markets

6.1 A sound and well-functioning financial system helps mobilise savings, allocate resources, exert corporate control, facilitate risk management and ease trades and contracts by solving market frictions. Efforts have been continued in FY06 to establish a sound financial system in the country. Despite the stronger growth of some major macroeconomic indicators, Bangladesh economy faced some challenges originating from price hike of oil and petroleum products and some major imported commodities in the international market causing fluctuations in real sector and foreign exchange market in FY06. As a result, the financial market was a little bit volatile in the second half of FY06. Except this temporary fluctuations in the financial market, the overall market was sound functioning during FY06. With a view to establishing a healthy, sound, well functioning and dynamically evolving financial system, a series of reform measures were initiated in FY06.

Money Market

6.2 Efforts were made effectively to establish a stable money market in FY06. Steps towards improved functioning and extending of the money market for activation of secondary trading in treasury bills/bonds have also been continued. Developments in the money market during FY06 are summarized below.

Call Money Market

6.3 The volume of transactions and weighted average interest rates in the call money market showed mixed trend during FY06 (Table 6.1) reflecting some noise in the activities of money market. The call money rates witnessed some

Table 6.1 Volume of trade and weighted average interest rates in call money market in FY06

Period	Volume of trade (billion taka)	Weighted average interest rate (%)
Jul 05	331.4	5.4
Aug 05	469.8	6.3
Sep 05	420.8	6.9
Oct 05	426.4	7.2
Nov 05	393.9	8.2
Dec 05	492.4	8.4
Jan 06	469.6	14.9
Feb 06	496.0	12.1
Mar 06	538.6	16.4
Apr 06	470.4	21.5
May 06	492.6	15.2
Jun 06	394.8	11.1
FY06	5396.7	11.5

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

degree of fluctuations in the last two quarters of FY06 resulting from the recent pressure in the foreign exchange market and tight liquidity situation in the money market. This stemmed mainly due to the increased demand of Government's credit that was met up from NCBs to finance the cost of imported petroleum products. Till the second quarter of FY06 the call money rates remained mostly stable but became somewhat volatile in the third quarter. At the beginning of the last quarter of FY06, the weighted average call money rate stood at 21.5 percent, substantially higher than 5.4 percent recorded in the beginning of the first quarter.

Repo Auctions - FY06

6.4 With a view to inject the required money in the economy the daily repo auctions were continued in FY06. This facilitated liquidity management within a short period by enabling the banks to place bids for funds collateralised by T-bills. Bangladesh Bank provided the banks with the needed funds against the repo facility thus maintaining the market liquidity at desired level. A total of 77 repo auctions were held during FY06. In all, 148 bids for Taka 341.9 billion were received in these auctions, of which 25 bids for a total of Taka 53.4 billion were accepted. The weighted average interest rates against the accepted bids ranged from 8.5 to 8.0 percent per annum in FY06 (Table 6.2) as against 10.0 to 4.5 percent per annum in FY05.

Chart 6.1

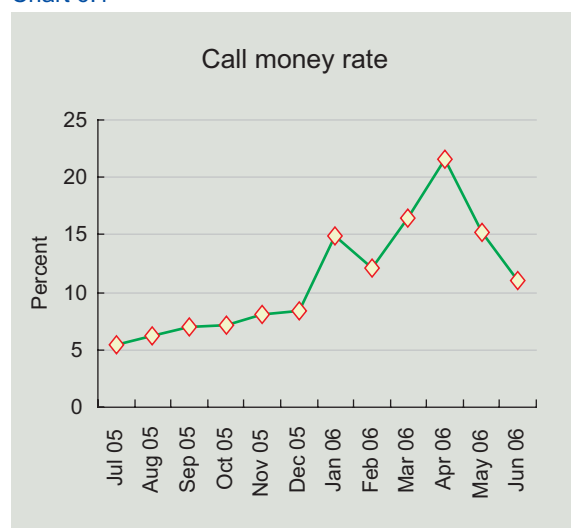


Table 6.2 Repo auctions - FY06

Total No. of auctions held during the year	Tenor	Bids received		Bids accepted		Range of the weighted average interest rates of the accepted bids (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)	
77	1-Day/2-Day	91	201.5	10	15.0	8.5 – 8.0
	3-Day/9-Day	57	140.4	15	38.4	8.3 – 8.0
	Total	148	341.9	25	53.4	8.5 – 8.0*

Source : Monetary Policy Department, Bangladesh Bank.

* Overall range of the rates of different tenors.

Reverse Repo Auctions - FY06

6.5 As a counterpart of repo auctions, to mop-up excess liquidity from the money market, the reverse repo auctions are being used as an instrument that continued in FY06. Bangladesh Bank maintained the intended level of liquidity in FY06. The reverse repo auctions were used as a fine-tuning supplement to the weekly T-bills auctions to contain the credit growth and to

keep the monetary aggregates on track during FY06. A total of 224 daily reverse repo auctions were held in FY06. In all, 1304 bids of 1-2 day and 3-9 day tenors for a total of Taka 964.2 billion were received in these auctions, of which 1299 bids amounting to Taka 962.1 billion were accepted. The weighted average interest rates against the accepted bids ranged from 4.5 to 6.5 percent per annum in FY06 (Table 6.3).

Table 6.3 Reverse repo auctions - FY06

Total No. of auctions held during the year	Tenor	Bids received		Bids accepted		Range of the weighted average interest rates of the accepted bids (%)
		No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)	
224	1-Day/2 Day	517	285.0	512	283.0	4.5 - 6.1
	3-Day/9 Day	787	679.2	787	679.1	4.7 - 6.5
	Total	1304	964.2	1299	962.1	4.5 - 6.5*

Source : Monetary Policy Department, Bangladesh Bank.

* Overall range of the rates of different tenors.

Government Securities Market

Government Treasury Bills Auctions

6.6 Weekly auctions of 28-day, 91-day, 182-day, 364-day and 2-year Government Treasury bills (T-bills) continued to be the main instruments for monetary policy management during the year under report. Bangladesh Bank actively used Treasury bill sales to mop up excess liquidity linked to large inflow of export earnings and remittances as well as huge government borrowing.

6.7 Treasury bills auction results of FY06 are summarised at Table 6.4. The bidders' preference of T-bills remained unchanged during the year under report because of its suitability as a stable base for banks and financial institutions in meeting their SLR requirements. The market-based yield rates of long term T-bills also made suitable for investment by the Provident Funds. The outstanding amount of Taka 104.4 billion holding of long term (2-Year and 5-Year) T-bills by banks

and other investors as of end June 2006 is, of course not large when seen against Taka 1380.2 billion time deposits in banks and financial institutions. A shift in the bidders' preference to the shortest (28-day) tenor bill from the 364-day and 2-year tenor bills in FY06 is observed in Table 6.4. It may be mentioned here that the weekly auctions of 5-year T-bills were discontinuing since 10 March 2004.

6.8 The yields of T-bills of different tenors varied within wide ranges, depending on the prevailing liquidity conditions in the money market. The yields for various tenors as of end June 2006 (Table 6.4) depicted narrower range than the yields as of end June 2005. Overall, yields on T-bills of all maturities depicted a gradual increasing trend during the year under report as compared to the previous year owing partly to tight monetary policy stance in FY06. The weighted average annual yield rate of the accepted bids ranged from 6.6 percent to 9.0 percent in FY06, which were 4.0 percent to 7.2 percent in FY05.

Table 6.4 Auctions of government treasury bills - FY06

Tenor of bills	Bids offered		Bids accepted		Outstanding bills as of end June 2006 (billion Taka)	Yield range* (%)
	No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)		
28-Day	882	398.8	871	396.8	14.6	6.6 - 7.1
91-Day	48	6.1	21	5.3	1.1	6.9 - 7.5
182-Day	61	3.3	18	2.1	1.1	6.8 - 7.8
364-Day	81	5.1	69	4.5	4.5	7.0 - 8.8
2-Year	68	6.6	52	6.2	19.5	7.2 - 9.0
5-Year	-	-	-	-	84.9	-
Total	1140	419.9	1031	414.9	125.7	6.6 - 9.0*

Source : Monetary Policy Department, Bangladesh Bank.

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

Bangladesh Government Treasury Bonds (BGTBs) Auctions

6.9 Bi-monthly auctions for 5-year and 10-year maturity Bangladesh Government Treasury Bonds (BGTBs) bearing half-yearly interest coupons have been used as the secondary instruments for government's debt and monetary policy management. Four auctions of

these instruments were held in FY06. A total of 146 bids for Taka 17.8 billion were received in these auctions, of which 80 bids for a total of Taka 12.4 billion were accepted. The weighted average annual yield ranged from 10.5 to 12.1 percent (Table 6.5). The amount of outstanding bonds stood at Taka 26.6 billion at the end of June 2006 as against Taka 14.3 billion at the end of June 2005.

Table 6.5 Auctions of Bangladesh government treasury bonds - FY06

Tenor of bonds	Bids offered		Bids accepted		Outstanding bonds as of end June 2006 (billion Taka)	Yield range* (%)
	Number	Face value (billion Taka)	Number	Face value (billion Taka)		
5-Year	48	7.1	22	4.9	13.8	10.5 - 10.7
10-Year	98	10.7	58	7.5	12.8	11.7 - 12.1
Total	146	17.8	80	12.4	26.6	10.5 - 12.1@

Source : Monetary Policy Department, Bangladesh Bank.

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

@ Overall range of treasury bonds of different terms.

Bangladesh Government Islamic Investment Bond (Islamic Bond)

6.10 The Government of the People's Republic of Bangladesh introduced a bond namely the Bangladesh Government Islamic Investment Bond (Islamic Bond) in accordance with the rules of Islami Shariah on 2 September 2004 (sale started from 14 October 2004) for 6-month, 1-year and 2-year maturity. As per the rules, Bangladeshi institutions and individuals who will agree to share profit or loss in accordance with Islamic Shariah, may buy this bond. Any non-resident Bangladeshi will also be eligible for buying the bond. As on June 2006 the total sale against this bond amounted to Taka 6.4 billion while balance of total financing stood at Taka 6.3 billion and the net outstanding against the bond stood at Taka 0.03 billion. As of end June 2005 the total sale against this bond was Taka 5.4 billion against the balance of total financing of Taka 4.4 billion and the net outstanding of Taka 1.0 billion.

Capital Market

Investment Financing in Bangladesh: Minor Role of Capital Market

6.11 The amount of industrial term loans disbursement by banks and financial institutions stood at Taka 96.5^P billion, many-fold higher than the amount of Taka 1.7 billion raised by new capital issues through private placements

P = Provisional.

and public offerings in the capital market in FY06. This indicates the overwhelming preference of bank finance in industrial investment financing. The Taka 273.8^P billion outstanding balances of industrial term loans of banks and financial institutions as of end June 2006 is also higher than the Taka 225.3 billion market capitalization of the securities listed in the Dhaka Stock Exchange (Tables 6.6 and 6.7).

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

6.13 The securities market witnessed a mixed trend during FY06. As there is dearth of securities having good fundamentals in the capital market, at the time of rise in demand, the price of securities listed on exchanges shows an unusual upward trend that makes the capital market somewhat volatile. Although all other economic indicators of the economy showed a positive trend, the performance of capital market showed somewhat downward movement in case of market capitalization, turnover and all-share price indices in FY06 as compared to FY05. The securities market, however, was not so active because of the liquidity crises created by the tight monetary policy adopted by BB. In order to arrest this

trend, to ensure the stability of stock market and to retain the investors' confidence, the regulatory bodies of the capital market have taken different reforms programmes. The increased minimum capital requirement for banks and financial institutions to Taka 1.0 billion and 0.25 billion respectively prescribed by the Bangladesh Bank has infused some impetus in the capital market. Positive public perception about the Bangladesh Bank supervision of banks and financial institutions in addition to the general Securities and Exchange Commission (SEC) supervision of public companies has attracted strong investor interest in the new capital issues of banks and financial institutions. This reawakened investor confidence in the capital market should extend to new issues of listed companies in other economic sectors with stronger SEC supervision, more demanding audit and financial disclosure standards, and credit rating of issuers by independent rating agencies.

Capital Market Activities in FY06

Primary Issuance

6.14 Fourteen companies raised new equity of Taka 1.7 billion in the primary market in FY06, higher than the Taka 1.2 billion raised by eight companies in FY05. Of the new equity issues, Taka 0.2 billion raised through private placements and Taka 1.5 billion through public offerings in FY06 as against Taka 0.1 billion raised through private placements and Taka 1.1 billion through public offerings in FY05.

6.15 The volume of public offerings in FY06 was predictably oversubscribed more than ten times indicating the high demand of new securities in the primary market. Bonus shares valued at Taka 4.6 billion were issued in FY06 by fifty-six companies against retained profits, much higher than the Taka 3.5 billion issued in FY05 by forty-five companies.

Secondary Market Activities

6.16 Market capitalization inclusive of new issues increased slightly by 0.3 percent in

Table 6.6 Industrial term loans of banks and financial institutions

Particulars	(billion Taka)		
	FY04	FY05	FY06 ^P
i. Disbursement	66.8	86.9	96.5
ii. Recovery	49.4	85.4	67.6
iii. Outstanding (end June)	203.9	226.3	273.8

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

Table 6.7 Dhaka Stock Exchange (DSE) activities

Particulars	End June		
	FY04	FY05	FY06
i. No. of listed securities*	267	277	303
ii. Issued equity and debt (billion Taka)	48.9	66.4	85.7
iii. Equity through private placements & IPOs (billion taka)	2.4	1.2	1.7
iv. Market capitalization (billion Taka)	142.4	224.6	225.3
v. Turnover in value (billion Taka)	24.8	75.6	46.0
vi. Turnover in volume (no. in billion)	0.5	1.0	0.6
vii. All-share price index	1319	1713	1340

Source : Dhaka Stock Exchange.

* = including companies, mutual funds, debentures and treasury bonds.

Table 6.8 Chittagong Stock Exchange (CSE) activities

Particulars	End June		
	FY04	FY05	FY06
i. No. of listed securities*	201	198	213
ii. Issued equity and debt (billion Taka)	45.0	50.0	63.8
iii. Market Capitalization (billion Taka)	127.2	201.7	195.6
iv. Turnover (billion Taka)	8.4	16.7	11.4
v. All-share price index	2292	3347	2879

Source : Chittagong Stock Exchange.

* = including companies, mutual funds and debentures.

Dhaka Stock Exchange and it decreased by 3.0 percent in Chittagong Stock Exchange in FY06 than that of FY05 (Tables 6.7 and 6.8). In FY06, the amount of market turnovers in the secondary market decreased by 39.2 percent and 31.7 percent respectively at the Dhaka and Chittagong stock exchanges. The main reasons for declining the turnover were increased fresh new investment through new issues in the capital market, which squeezed the trading. In FY06, all-share price index in Dhaka and Chittagong exchanges also decreased by 21.8 percent and 14.0 percent respectively. Day to day changes in price indices and market capitalization in FY06 mainly reflected local conditions with a mixed sentiment during the year under report (Chart 6.2).

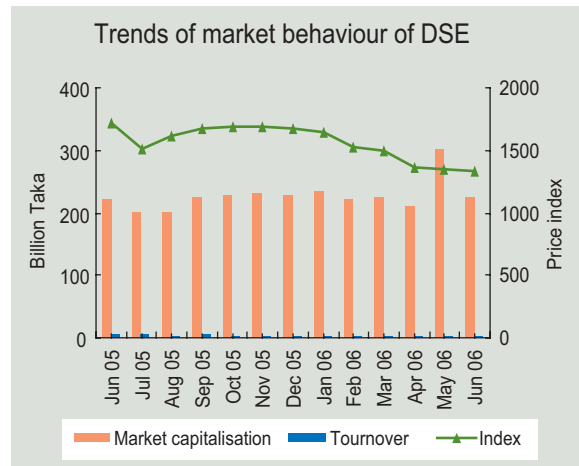
Non-resident Portfolio Investment

6.17 In FY06, net investment inflow by non-residents through NITA in the shares and securities of the stock exchanges stood at Taka 2.2 billion with gross investment inflow of Taka 2.4 billion and gross outflow as repatriation of sale proceeds of Taka 0.2 billion. Gross investment inflow was Taka 0.05 billion and repatriation of sale proceeds was Taka 0.3 billion in FY05. From the beginning (April 1992) to till June 2006 the gross investment inflow stood at Taka 11.8 billion against gross outflow as repatriation of sale proceeds of Taka 13.7 billion.

Activities of the ICB

6.18 The three subsidiaries of state-owned Investment Corporation of Bangladesh (ICB) namely the ICB Capital Management Ltd (ICML), the ICB Asset Management Company Ltd. (IAMCL) and the ICB Securities Trading Company Ltd. (ISTCL) under on going restructuring programme of the capital market development programme (CMDP) are functioning in the capital market in Bangladesh. The ICB capital management subsidiary ICML acted in the roles of underwriter, issue manager and placement services provider. The net investment against the investors' accounts stood at Taka 0.11 billion at the end of June 2006. The net investment and the market prices of company's own portfolio stood at Taka 0.27

Chart 6.2



billion and Taka 0.36 billion respectively at the end of June 2006. The ICB asset management subsidiary IAMCL floated four mutual funds. The net investment in the portfolios of the funds stood at Taka 0.58 billion and the market prices of net investment stood at Taka 0.52 billion at the end of June 2006. Besides, the own financing of IAMCL, the net investment and the market prices of net investment of the mutual funds stood at Taka 0.16 billion and Taka 0.16 billion respectively at the end of June 2006. The ICB securities trading subsidiary ISTCL emerged as the largest stockbroker in the country handling total transactions worth Taka 57.42 billion in FY06. The parent ICB itself sold unit certificates amounting Taka 0.18 billion against repurchased of unit certificates amounting Taka 0.19 billion in FY06. In FY06, the ICB received deposits of Taka 0.17 billion and approved loans of Taka 0.95 billion in investment accounts of investors. The volume of securities traded in FY06 by the ICB was Taka 6.82 billion against Taka 10.66 billion traded in FY05. Total commitments for investment made by the ICB in FY06 stood at Taka 3.53 billion of which, for direct investment (pre-IPO placement) in shares Taka 0.57 billion, (pre-IPO placement) in debentures Taka 0.47 billion, purchase of preference share Taka 0.32 billion, investment in equity Taka 0.21 billion, purchase of debentures Taka 0.96 billion, investment in bond Taka 0.10 billion and in lease financing Taka 0.92 billion. In FY05 the total amount of commitments was Taka 3.26 billion.

Scheduled Bank Investments in Capital Market Securities

6.19 Holdings of capital market assets (equities, debentures) by scheduled banks stood at Taka 20.4 billion as of end June 2006 as against Taka 19.9 billion as of end June 2005. Outstanding advances of scheduled banks against shares and securities amounted to Taka 3.1 billion at the end of June 2006, which was Taka 4.5 billion at the end of June 2005.

Measures Supporting Capital Market Development

6.20 The Securities and Exchange Commission (SEC) undertook following measures to strengthen capital market through build-up the confidence of the investors in capital market in FY06:

- ❖ “The Public Issue Rules, 1998” and “the Rights Issue Rules, 1998” have been replaced by amending “the Securities and Exchange Commission (Public Issue) Rules, 2006” and “the Securities and Exchange Commission (Rights Issue) Rules, 2006” to encourage companies to raise capital through public issue. Besides, SEC has made amendments to individual rules, requiring mandatory employment of compliance officer by the market intermediaries operating in the capital market and listed companies.
- ❖ Reducing the public offering (IPO) numerous costs viz. consent fee to commission, listing fee of securities to stock exchanges, underwriting and issue management fee to merchant bankers and banker to the issue fee for encouraging the companies to issue the securities through IPO.
- ❖ Simplifying the procedures of IPO floatation through withdrawal of requirement of publishing prospectus in widely circulated daily newspapers.
- ❖ Imposing condition that private limited companies whose paid-up capital

exceeded or will have exceeded Taka 0.4 billion must convert itself into a public limited company, and public limited companies whose paid-up capital exceeded or will have exceeded Taka 0.5 billion in a given point in time must raise 30.0 percent of capital through further issue of public offering of securities.

- ❖ Off-loading a part of existing shares of those companies having good fundamental through capital market directly in DSE and CSE according to “Dhaka and Chittagong Stock Exchange Direct Listing Regulation, 2006”.
- ❖ Issuing “Corporate Governance Guidelines” on complies or explain basis to elevate corporate governance scenario in Bangladesh and according to this guideline, provisioning has been made to have audit committee and independent director in a listed company.
- ❖ Increasing the supply side transitions of securities through the approved ‘CSE/DSE Short-sale Regulations, 2005”.
- ❖ The SEC accorded consent to issue Asset Backed Zero Coupon Bond of Taka 10.32 billion on private placement basis through a SPV for Jatrabari-Gulistan Flyover Securitization Trust 2005 and also accorded consent to issue Asset Backed securities worth of US\$ 0.18 billion through BRAC Micro Credit Receivables Securitization by BRAC Micro Credit Securitization Trust.
- ❖ Changing the settlement and clearing period for A, B & Z category companies on the T+3 basis in place of pervious T+4 basis, to create liquidity and to increase demand and trade of good securities in the capital market.

6.21 The measures declared in the national budget of FY06 in support of capital market development included:

- ❖ Increasing the corporate tax for non-listed companies from 37.5 percent to 40.0 percent to increase the tax gap of listed and non-listed companies to 10.0 percent.
- ❖ Extension of tax holiday up to 30 June 2008 for 18 thrust sectors.
- ❖ Withdrawal of provision of Dividend Distribution Tax and a new tax @ 10.0 percent has to be withheld at source for the listed companies.
- ❖ Introduction a new provision for income tax at source @ 0.015 percent on the transaction value of shares for the members of the Exchanges as final settlement of tax liability.
- ❖ Reducing the tax on approved securities and bond to 10.0 percent from 20.0 percent.
- ❖ Reducing the provision for banks' bad and doubtful debts to 1.0 percent from 2.0 percent.
- ❖ Extension the declaration time for undeclared income up to 30 June 2006 with a provision of 7.5 percent tax.
- ❖ Raising the minimum limit of taxable individual income to Taka 1.2 lac from Taka 1.0 lac.

Credit Market

Advances of Scheduled Banks by Economic Purposes

6.22 Total advances of scheduled banks by economic purposes showed an upward trend during FY06 (Table 6.9). Total advances of scheduled banks by economic purposes stood at Taka 1291.7^P billion at the end of June 2006 which is 15.6 percent higher than the total advances of Taka 1117.3 billion at the end of June 2005. In recent years, significant changes have been taking place in the trends in total bank advances classified by economic purposes. Of the total advances, transport and communication sector recorded the significant

Table 6.9 Advances of scheduled banks by economic purposes
(billion Taka)

Sector	End June		
	FY04	FY05	FY06 ^P
1. Agriculture, forestry and fishing	98.4	106.7	113.5
2. Industry	183.8	199.5	244.8
3. Construction	64.3	74.6	86.7
4. Transport & communication	11.7	13.8	19.6
5. Trade	320.3	394.9	437.6
6. Working capital financing	175.0	220.7	258.2
8. Others	97.9	107.1	131.5
Grand Total	951.4	1117.3	1291.7

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

improvement by 42.0 percent, followed by industry sector 22.7 percent, working capital financing sector 17.0 percent, construction sector 16.2 percent, trade sector 10.8 percent, agriculture, forestry and fishing sector 6.4 percent, and other sectors 22.8 percent in FY06 as compared to FY05. Sector-wise contribution of total advances show that the trade sector plays the main role (33.9 percent) and working capital financing plays the second fiddle (20.0 percent), followed by advances for industry (18.9 percent), agriculture, forestry and fishing (8.8 percent), construction (6.7 percent) and transport and communication sector (1.5 percent) and other sectors (10.2 percent) in FY06. Sector-wise contribution of total advances is reported in Chart 6.3.

Industrial Term Loans of Banks and Financial Institutions

6.23 Disbursement of industrial term loans by banks and financial institutions increased by 11.0 percent to Taka 96.5^P billion in FY06. The outstanding balance showed a positive growth of 21.0 percent at the end of June 2006, owing to a negative growth of 20.8 percent in recoveries indicating the poor management in banking system. The overdues have been declining, but were still high at 14.1 percent of outstanding as of end June 2006 (Table 6.10).

6.24 The four NCBs and five state-owned specialized banks together had Taka 107.3 billion (29.2 percent) share of the total Taka

P=provisional.

273.8 billion outstanding loans as of end June 2006, making them major players in industrial term lending (Table 6.10, Chart 6.4). However, with very high levels of past overdues, their actual role in current lending is quite minor, they disbursed only Taka 8.9 billion (9.2 percent) out of total Taka 96.5 billion disbursements in FY06. In relation to disbursement, private commercial banks were the major shares holders (Taka 60.6 billion) in FY06, followed by non-bank financial institutions (Taka 17.5 billion), foreign banks (Taka 9.5 billion), NCBs (Taka 5.9 billion) and state owned five specialized bank (Taka 3.0 billion).

6.25 The foreign banks had very low overdues (0.5 percent at end June 2006), the overdues were low also for both non-bank financial institutions and private commercial banks (7.3 percent). In FY06, overdues of the NCBs and the specialized banks were very high (26.4 percent and 2.15 percent), although declined from 31.7 percent for NCBs and 24.8 percent for the specialized banks from the previous year.

6.26 As, BKB and RAKUB are agriculture sector lenders have insignificant role in industrial term lending. The specialized industrial sector lenders extremely high overdues have concentrated in the recent years on recovery rather than fresh term lending. In FY06 there have been an improvement. The amount of overdues of specialized state banks owned at 21.5 percent of outstanding as of end June 2006.

Chart 6.3

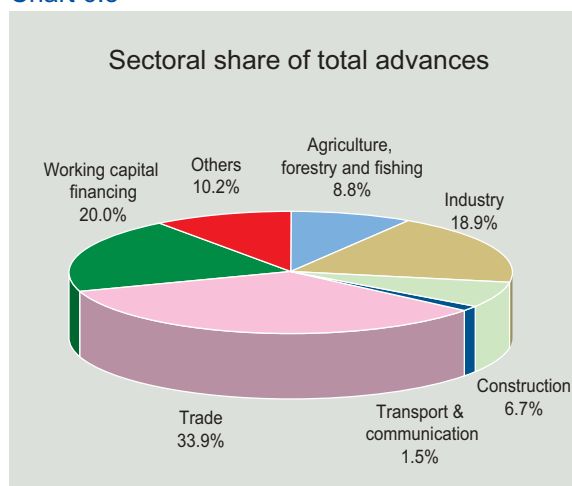


Chart 6.4

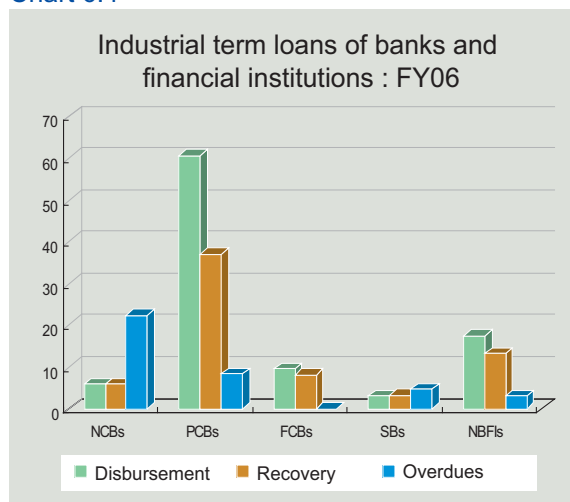


Table 6.10 Industrial term loans of banks and financial institutions

Lender	(billion Taka)									
	Disbursement		Recovery		Outstanding		Overdues		Overdues as % of outstanding	
	FY05	FY06 ^P	FY05	FY06 ^P	FY05	FY06 ^P	FY05	FY06 ^P	FY05	FY06 ^P
i. NCBs	4.5	5.9	4.0	5.9	78.3	85.4	24.8	22.5	31.7	26.4
ii. PCBs	50.8	60.6	55.0	37.1	82.6	115.3	8.2	8.4	9.9	7.3
iii. Foreign banks	11.4	9.5	10.2	8.1	8.8	10.2	0.03	0.05	0.3	0.5
iv. Specialized banks (BSB, BSRS, BKB, RAKUB, BASIC)	3.0	3.0	3.2	3.3	22.2	21.9	5.5	4.7	24.8	21.5
v. Non-bank financial institutions	17.2	17.5	13.0	13.2	34.4	41.0	2.6	3.0	7.6	7.3
Total	86.9	96.5	85.4	67.6	226.3	273.8	41.1	38.7	18.2	14.1

Source : Agricultural Credit & Special Programmes Department, Bangladesh Bank.

P = Provisional.

Measures for Strengthening Term Lending Practices

6.27 The persistent high levels of overdue term loans have received intensive corrective attention of the authorities. Amongst the salient measures adopted over the past several years were the stricter income recognition and provisioning standards for banks in line with international best practices, prohibition of new credit accommodation to loan defaulters, stringent restrictions on lending to directors and their connected interests. Substantial measures to strengthen term lending practices initiated in previous years were continuing under the continuous process of financial sector reforms. Among the new preventive and curative initiatives to strengthen term lending practices taken in FY06 are:

- ❖ BB has instructed the banks to make General Provision @ 5.0 percent on the outstanding amount of loans kept in the “Special Mention Account” after netting of the amount of Interest Suspense;
- ❖ BB has prepared and forwarded a guideline for Managing Core Risk in banking system. In case of sanctioning/renewal/rescheduling of loans, Credit risk Grading system has been introduced for all loans (other than short term agricultural credit and micro credit), where loans have been graded into eight categories as Superior (SUP), good (GD), Acceptable (ACCPT), Marginal/ Watchlist (MG/WL), Special Mention Account (SMA), Substandard (SS), Doubtful (BF) and Loss (BL).
- ❖ BB has launched a 100 percent refinance scheme of Taka 0.5 billion at bank rate against term loans (medium and long term) for agro-based industries in rural areas initiated in November 2001 with fixed capital not exceeding Taka 0.05 billion. Under this project Taka 0.63 billion has been disbursed till end June 2006.
- ❖ Under another BB’s refinance scheme of Taka 1.0 billion introduced at bank rate against term loans for development of small and medium enterprises effective from May 2004 with fixed capital not exceeding Taka 0.01 billion. Under this scheme the total amount of Taka 1.0 billion has been disbursed as early February 2005. For high demanding, the scheme is financing the amount of recovery as a revolving fund to provide loans to SME sectors.
- ❖ The World Bank’s IDA wing has been provided an additional fund of Taka 0.6 billion (US\$10.0 million) to refinance in the project of development of small enterprises, of which Taka 1.7 billion has been disbursed as a term lending till June 2006.
- ❖ Self-employment small enterprise Credit Scheme for voluntary retired officers and employees introduced in 1993 with a fund of Taka 0.2 billion and under this project Taka 0.04 billion has been disbursed till end June 2006.
- ❖ The major objective of the Financial Institutions Development Project (FIDP) is to promote the development of Financial Institutions (FIs) and improvements in investment financing on a sustainable basis through strengthening the quality of intermediation with a view to accelerating industrial growth in Bangladesh. Under this project, Taka 2.7 billion (USD 45.58 million) has been disbursed against 147 projects to the six Participating Financial Institutions (PFIs) upto June 2006. Under private placements of debt instruments worth Taka 1.4 billion were facilitated by the FIDP in FY06. So far, three of the PFIs and one non-PFI have been given NOC

Broadening of Fund Base for Industrial Term Lending

6.28 Dependence of banks on shorter-term deposit resources for funding long-term industrial loans increases their liquidity risks. Providing refinance facilities to banks and financial institutions for broadening the base of longer-term funds for small and medium scale industrial lending under some special schemes and programmes taken by Bangladesh Bank in FY06 were:

(No Objection Certificate) to form SPV (Special Purpose Vehicle) for issuing 'Zero-coupon' bonds and Taka 1.0 billion has been disbursed for this purpose. Besides, the prospect of securitizing the receivables of 'Jamuna Multipurpose Bridge' with the technical support of FIDP is currently under consideration.

- ❖ A project named "Investment Promotion and Financing Facility (IPFF)" for financing government approved private sector infrastructure projects (i.e. power generation, transmission and distribution and services, port (sea, river and land) development, environmental, industrial and solid waste management, highways and expressways including flyovers, water supply and distribution sewerage and drainage, industrial estates and park development etc.) has been signed 1 June 2006 between the Government of Bangladesh (GOB) and International Development Association (IDA). The estimated cost of the project is USD 105.2 million, of which USD 50.0 million would be provided by IDA, USD 10.0 million by GOB, and USD 14.4 million and USD 30.8 million by PFIs and concerned entrepreneurs respectively. One of the main features of the project is that 30 percent of the cost of any approved project should be borne by entrepreneurs' own source, 20 percent from PFIs and rest 50 percent from IPFF.

Equity and Entrepreneurship Fund (EEF)

6.29 Initiated in FY01 with the amount of Taka 1.0 billion Equity and Entrepreneurship Fund (EEF) created by the Government and managed by the Bangladesh Bank was active in FY06 to encourage investments with equity participation in the risky but prospective agro-based, food processing and IT sector projects. From EEF in FY06, a total amount of Taka 1.1 billion (including the fund released against projects sanctioned in the previous years) were disbursed as against the sanctioned Taka 0.5

billion of total of 31 projects in food processing and agro-based sectors, involving total project cost of Taka 1.2 billion. Taka 1.5 billion was disbursed from equity participation against the sanctioned Taka 2.8 billion to 134 projects in FY05. Up to 30 June 2006 with the project cost of Taka 17.8 billion, a total of 262 projects (including 228 agro-based and food processing projects, and 34 IT projects) has been disbursed Taka 3.5 billion against the sanctioned of Taka 6.9 billion.

Housing Finance

6.30 Total housing loans from banks and financial institutions as of end June 2006 amounted to Taka 96.1 billion (Table 6.11), which was 7.6 percent of total credit to the private sector.

6.31 The state owned House Building Finance Corporation (HBFC) has the largest share of Taka 26.8^P billion in outstanding housing loans as of end June FY06. Not a deposit taker, the HBFC in the past funded its housing loans by issuance of low interest debentures bought by the NCBs and the Bangladesh Bank. This funding mode has been unavailable in recent years; the HBFC has been constrained to rely on recoveries of past loans for new lending after defraying operating and debt servicing costs. Consequently, its new lending has been small. Taka 0.41 billion and Taka 0.42 billion in FY05 and FY06 were disbursed out of recoveries of Taka 3.42 and Taka 3.64 billion respectively.

6.32 The NCBs and private sector banks with ample deposit resources have been expanding their housing loan portfolios, attaining dominant market position (Table 6.11). Two newer private sector specialized housing finance providers are also slowly gaining ground, they fund their operations with long term deposits including some contractual deposit schemes.

6.33 The Grameen Bank provides housing loans for basic shelter housing in rural areas to its microcredit borrower members. Some

^P=provisional

microcredit NGOs also have small involvements in lending for basic shelter housing, financed from a *Grihayan Tahbil* created by the government. In FY05 and FY06, the *Tahbil* has recovered Taka 0.07 billion and Taka 0.08 billion respectively as against of disbursed Taka 0.15 billion and Taka 0.09 billion through NGOs for this purpose. The *Tahbil* also disbursed Taka 1.04 billion since its beginning from FY98 to end June 2006. Besides, to provide safe, healthy and cheap housing facilities for the women labourers working in the garments and other industries, 2000-seated hostels have been constructed by BRAC at Askona, Uttara, Dhaka with worth of Taka 0.1 billion financing facility from the *Tahbil*.

Foreign Exchange Market

6.34 Bangladesh Bank floated its exchange rate for Taka with effect from 31 May 2003. Under this arrangement, banks and authorised dealers are free to set their own rates for their inter-bank and customer transactions. The exchange rate is being determined in the market on the basis of market demand and supply forces of the respective currencies. For avoiding any unusual volatility in the exchange rate, BB may purchase and sell US Dollar as and when it deems necessary to maintain stability in the foreign exchange market. Bangladesh Taka is fully convertible for current international transactions. Repatriation of profits or disinvestment proceeds on non-resident FDI and portfolio investment inflows are permitted freely.

Purchases and Sales of Foreign Exchange by the Bangladesh Bank

6.35 The exchange rates of Bangladesh Taka against major international currencies remained somewhat stable at the floating regime. Very recently, however, the foreign exchange market experienced substantial pressure on demand of foreign currencies that made market depreciation of Taka against US Dollar. Analysis shows that pressure in the foreign exchange market arose mainly from continued price hike of oil and petroleum products and major import commodities coupled with higher growth in lending to the private sector, which led to rapid growth in imports demand in the face of

Table 6.11 Outstanding housing loans

(billion Taka)			
Lenders	Outstanding as of end June		
	FY04	FY05	FY06 ^P
a. Specialized housing finance providers			
i) HBFC	28.9	27.8	26.8
ii) Delta-BRAC Housing Finance	3.4	4.4	5.5
iii) National Housing Finance	1.3	1.8	1.9
b. Banks			
i) NCBs	23.6	24.1	25.7
ii) Other banks	22.9	26.2	32.9
c. Other financial institutions	1.0	1.6	2.9
d. Microcredit lenders			
Grameen Bank	1.3	0.9	0.4
Total	82.4	86.8	96.1

P = provisional.

Table 6.12 Sales and purchases of foreign exchange by the Bangladesh Bank

(million US dollar)			
Particulars	FY04	FY05	FY06
Sale	nil	459.5	413.0
Purchase	314.0	70.1	77.0

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

slowdown in export earnings in the first half of FY06. But due to adoption of contractionary monetary policy together with substantial inflow of foreign exchange from export earnings and remittances, the situations eased later on. To increase the supply of foreign currencies in the market, BB sold USD 413.0 million as against the purchase of USD 77.0 million in FY06. Overall trend in purchases of foreign currency by the BB, are showing declining trends during FY04 to FY06 indicating gradually less necessity for intervention by the Bangladesh Bank.

Inter-bank Foreign Exchange Transactions

6.36 The volume of inter-bank foreign exchange transactions in FY06 stood at USD 20.3 billion, which was 2.0 percent higher than the USD 19.9 billion of FY05. As authorised dealer banks were instructed not to undertake any non-real cross currency forward and swap transactions, volume of inter-bank forward transactions was almost nil in FY06 as against USD 0.3 billion in FY05.