

Financial Markets

6.1 A sound and well-functioning financial system helps mobilize savings, allocate resources, exert corporate control, facilitate risk management and ease trades and contracts by solving market frictions. Efforts continued in FY07 to establish a sound financial system in the country. Despite the Bangladesh economy faced challenges originating from price hike of some essential commodities in the international market coupled with upward adjustment in the domestic fuel prices and supply disruption of domestic front causing fluctuations in real sector in FY07, the overall financial market was sound functioning during the year. With a view to establishing a healthy, sound, well functioning and dynamically evolving financial system, a series of reform measures were initiated in FY07.

Money Market

6.2 During FY07, efforts were continued with a view to establishing a well functioning and stable money market. Efficient monetary operation, especially use of shorter term monetary instruments such as reverse repo and re-introduction of Bangladesh Bank Bills helped keep the money market sound and stable during the financial year 2007. Steps towards activation of secondary trading in treasury bills/bonds were also continued. As a result, the overall money market situation was stable and sound during FY07. Developments in the money market during FY07 are summarized below.

Call Money Market

6.3 The volume of transactions in the call money market depicted a mixed trend during FY07 (Table 6.1) reflecting some brisk activities in the money market particularly during the third quarter of the year. It remained sluggish till the beginning of the

Table 6.1 Volume of trade and weighted average interest rates in call money market in FY07

Period	Volume of trade (billion Taka)	Weighted average interest rates (%)
July 06	305.4	7.6
Aug 06	384.6	7.5
Sep 06	270.2	7.4
Oct 06	235.3	7.3
Nov 06	367.7	7.1
Dec 06	348.8	7.2
Jan 07	434.3	7.3
Feb 07	561.3	6.9
Mar 07	593.1	7.0
Apr 07	593.1	7.5
May 07	637.9	7.6
June 07	508.5	7.7
FY07	5231.5	7.3

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

second quarter of FY07 and crept up slowly since then. The volume of transactions, however, declined at the end of the year. On the other hand, the weighted average interest rates in the call money market witnessed stability in FY07 as against a degree of fluctuation in the last year (FY06). This may be due to excess liquidity in the market resulting from lower growth of demand for credit in the private sector as compared to the preceding year and huge inflow from foreign sector due mainly to increase in export earnings and workers' remittances. The weighted average interest rates in the call money market moved within the range of 6.9 to 7.7 percent during FY07 (Chart 6.1).

Repo Auctions - FY07

6.4 The repo injects required money in the system, and provides banks with necessary funds to maintain their liquidity. While pursuing a cautious monetary policy, Bangladesh Bank kept this window open for the banks to maintain the market liquidity at desired level. In FY07, the daily repo auctions in Bangladesh Bank continued to facilitate liquidity management within a short period of time by enabling the banks to place bids for funds collateralised by T-bills, T-bonds and Bangladesh Bank bill. A total of 17 repo auctions were held during FY07. In all, 17 bids for Taka 44.2 billion were accepted. The weighted average interest rates against the accepted bids ranged from 9.0 to 9.3 percent per annum in FY07 (Table 6.2) as against 8.0-8.5 percent per annum in the previous year.

Chart 6.1

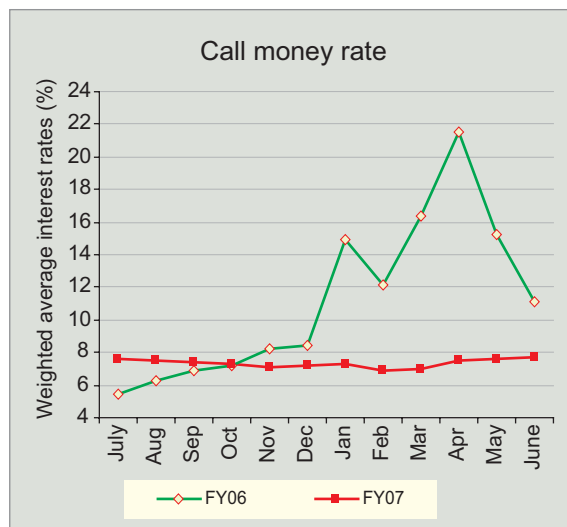


Table 6.2 Repo auctions - FY07

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)	
17	1-Day/2-Day	7	14.2	3	4.2	9.0
	3-Day/8-Day	10	30.0	3	6.5	9.0-9.3
	Total	17	44.2	6	10.7	9.0-9.3*

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

Reverse Repo Auctions - FY07

6.5 While the repo injects money in the system, the reverse repo takes it away from the system. As a counterpart of repo auctions, the reverse repo auctions continued in FY07. The reverse repo auctions were used to maintain intended level of liquidity in the market as well as a fine-tuning supplement to the weekly Bangladesh Bank bills auctions to contain the credit growth and to keep

the monetary aggregates on track during FY07. A total of 246 daily reverse repo auctions were held in the year under report. In all, 4020 bids of 1-17 day tenors for a total of Taka 2939.7 billion were received, of which 4019 bids amounting to total of Taka 2939.1 billion were accepted. The weighted average interest rates against the accepted bids ranged from 6.1 to 6.5 percent per annum in FY07 (Table 6.3) as against 4.5 to 6.5 percent per annum in FY06.

Table 6.3 Reverse repo auctions - FY07

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)	
246	1-Day/2-Day	2724	2075.1	2723	2074.5	6.1-6.5
	3-Day/17-Day	1296	864.6	1296	864.6	6.4-6.5
	Total	4020	2939.7	4019	2939.1	6.1-6.5*

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

Bangladesh Bank Bills Auctions

6.6 In FY07, automatic monetization through creation of ad hoc Treasury bills was discontinued and government borrowing directly from commercial banks was encouraged to avoid excess money supply arising from government borrowing from Bangladesh Bank. Hence, Treasury bills could not be used to mop up excess liquidity from the market. This induced Bangladesh Bank to reintroduce 30-day and 91-day Bangladesh Bank bills (BB-bills) in October 2006 to mop up excess liquidity linked to large inflow of remittances and export earnings.

6.7 Results of auctions of Bangladesh Bank bills in FY07 are summarised at Table 6.4. Bidders' preferred the shorter (30-day) tenor BB-bill because of its suitability in meeting SLR requirement of the banks and financial institutions. Thirty seven auctions of BB-bills were held in FY07. A total of 284 bids for an amount of Taka 106.5 billion were received in those auctions, of which 281 bids for a total of Taka 106.2 billion were accepted. The weighted average annual yield for BB-bills ranged from

7.3 to 7.6 percent. The amount of outstanding bills stood at Taka 28.3 billion as of end June 2007.

Government Securities Market

Government Treasury Bills Auctions

6.8 Market based system of auctions of Government Treasury bills (T-bills) was introduced in FY07 through publishing auction calendar containing date and amount of auctions. For matching the tenor of T-bills with international convention, the system of auction of 2-year T-bills was abolished with effect from 1 September 2006 (auctions of 5-Year T-bills were discontinued with effect from 10 March 2004). As creation of ad hoc Treasury Bills was discontinued and Government borrowing directly from commercial banks was introduced, a system of devolvement and private placement of T-bills with Bangladesh Bank was introduced to ensure financing in cases of inadequate response from the market. Weekly auctions of 28-day, 91-day, 182-day and 364-day T-bills continued to be important instruments for Government borrowing during the year under report.

Table 6.4 Auctions of Bangladesh Bank bills - FY07

Tenor of bonds	Bids offered		Bids accepted		Outstanding bills as of end June, 2007 (billion Taka)	Yield range* (%)
	No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)		
30-Day	278	105.8	275	105.5	27.8	7.3-7.4
91-Day	6	0.7	6	0.7	0.5	7.5-7.6
Total	284	106.5	281	106.2	28.3	7.3-7.6[@]

Source : Monetary Policy Department, Bangladesh Bank.

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

@ Overall range of Bangladesh Bank bills of different terms

6.9 Results of auctions of Treasury bills in FY07 are summarised at Table 6.5. 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. Provident Funds continued to invest in long-term T-bills because of their market-based yield rates. As noticed in Table 6.5 the bidders' preference shifted further in FY07 to the shortest (28-day) tenor bill from the 364-day bills.

Table 6.5 Auctions of Government treasury bills - FY07

Tenor of bills	Bids offered		Bids accepted		Outstanding bills as of end June 2007 (billion Taka)	Yield range*(%)
	No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)		
28-Day	940	416.5	857	358.7	16.0	7.1-7.4
91-Day	175	34.2	172	32.8	21.9	7.5-7.6
182-Day	73	7.7	58	6.0	4.8	7.8-7.9
364-Day	139	12.9	131	10.8	14.1	8.3-8.5
2-Year	49	7.1	37	5.4	11.6	9.2-9.3
5-Year	-	-	-	-	72.0	-
Devolvement to BB				40.3		
Total	1376	478.4	1255	454.0	140.4	7.1-9.3@

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

6.10 The yields of T-bills of different tenors varied within fairly wide ranges depending on the prevailing liquidity conditions in the money market. Overall yields on T-bills of all maturities maintained gradual increasing trend in FY07 as compared to previous two financial years owing to partly continued tight monetary policy stance in the year under report. The yields for various tenors T-bills also depicted further narrower range as of end June 2007 (Table 6.5) than the yields as of end June 2006 and 2005. The weighted average annual yield rate of the accepted bids ranged from 7.1 to 9.3 percent in FY07 as against 6.6 to 9.0 percent in FY06.

Bangladesh Government Treasury Bonds (BGTBs) Auctions

6.11 A market-based system of auction of 5-

year and 10-year maturity Bangladesh Government Treasury Bonds (BGTBs) bearing half-yearly interest coupons continued to be used as the ancillary instruments for Government's debt management. Eighteen auctions of these instruments were held in FY07. A total of 479 bids for Taka 82.6 billion were received in those auctions, of which 337 bids for a total of Taka 60.1 billion were accepted including Taka 0.9 billion devolvement to Bangladesh Bank. The weighted average annual yield ranged from 10.9 to 12.5 percent (Table 6.6). The amount of outstanding bonds stood at Taka 86.7 billion at the end of June 2007 as against Taka 26.6 billion at the end of June 2006.

Table 6.6 Auctions of Bangladesh Government treasury bonds - FY07

Tenor of bonds	Bids offered		Bids accepted		Outstanding bonds as of end June 2007 (billion Taka)	Yield range* (%)
	No. of bids	Face value (billion Taka)	No. of bids	Face value (billion Taka)		
5-Year	185	40.0	103	24.3	38.4	10.9-10.9
Devolvement to BB				0.04		
10-Year	294	42.6	234	34.9	48.3	12.1-12.5
Devolvement to BB				0.9		
Total	479	82.6	337	60.1	86.7	10.9-12.5@

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)

6.12 The operation of 6-month, 1-year and 2-year Bangladesh Government Islamic Investment Bond (Islamic Bond), introduced in FY05, in accordance with the rules of Islamic Shariah, continued in FY07. As per the rules, Bangladeshi institutions and individuals, and non-resident Bangladeshi, who agree to share profit or loss in accordance with Islamic Shariah, may buy this bond (Box 6.1). As on end June 2007 the total sale of this bond amounted to Taka 14.8 billion while balance of total amount of financing stood at Taka 6.6 billion and the net outstanding against the bond stood at Taka 8.3 billion. As of end June 2006 the total sale of this bond was Taka 6.4 billion against the balance of total financing of Taka 6.3 billion and the net outstanding of Taka 0.03 billion.

Capital Market

Investment Financing in Bangladesh: Minor Role of Capital Market

6.13 The amount of industrial term loans disbursement by banks and financial institutions stood at Taka 124.0^P billion, many-fold higher than the amount of Taka 3.1 billion raised by new capital issues through private placements and public offerings in the capital market in FY07. This indicates the overwhelming preference of bank finance in industrial investment financing. The Taka 339.2^P billion outstanding balances of industrial term loans of banks and financial institutions as of end June 2007 was, however, lower than the Taka 491.7 billion market capitalization of the securities listed in the Dhaka Stock Exchange (Tables 6.8 and 6.9), However, market capitalization of companies amounting to Taka 168.4 billion remained far below than the outstanding level of industrial term loan financing by the banks and financial institutions.

P =Provisional.

Table 6.7 Industrial term loans of banks and financial institutions

(billion Taka)			
Particulars	FY05	FY06	FY07 ^P
i. Disbursement	87.0	96.5	124.0
ii. Recovery	85.4	67.6	90.7
iii. Outstanding (end June)	226.3	273.8	339.2

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

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

6.15 The share market witnessed a robust growth during FY07 aimed at a strong economic prospect and outlook. As there was demand of securities having good fundamentals in the capital market, at the time of rise in demand, the prices of securities listed on exchanges showed an unusual upward trend that turned the capital market somewhat volatile. On the other hand, major economic indicators showed a positive trend to support the gradual development of the market. As a result, all the indicators of the capital market increased in FY07 as compared to FY06. The capital market was very active during FY07 because of significant improvements made in protecting investors' interests and boosting confidence of investors in capital market, introducing automated trading through electronic registration and transfer of securities, simplifying rules and regulations and notifying guidelines on corporate governance on comply or explain basis. These measures have created investment friendly atmosphere in the capital market and positive impact has been noticed in both primary and secondary market. Thus, the depth of share market and daily turnover of securities transactions have notably increased. Besides, positive public perception about the Bangladesh Bank supervision of banks and

Box 6.1

An Introduction to Bangladesh Government Islamic Investment Bond (Islamic Bond)

In Bangladesh, financial resource mobilization through issuance of Islamic financial instruments is at a nascent stage. Up to 2004, no Islamic bank or financial institution has issued any Islamic financial instruments like bonds, debentures, mutual funds in the primary or secondary market for mobilizing financial resources. They are fully dependent on the deposited funds. However, after a long research and discussion, Bangladesh Bank has issued a Mudaraba Bond named as "Bangladesh Government Islamic Investment Bond (Islamic Bond)" in October, 2004 on behalf of the Government to facilitate Islamic banks and financial institutions especially to invest their funds to be considered as liquid assets for meeting requirement of SLR. This bond is an approved security for the purpose of regulating the SLR as well as providing an outlet for investment or procurement of funds by the banks. This bond is also open for investment by any private individuals, companies or corporations.

The salient features of the Islamic Investment Bond are summed up below:

1. This Government Islamic Investment Bond (GIIB) will be governed by the Islamic Shariah i.e. the Islamic Bond will be governed on the principles of Mudaraba.
2. The GIIB means the document of definite value issued in the name of their owners against funds they pay to the issuer or Bangladesh Bank.
3. Profit Sharing Ratios (PSR) relating to the bond may be determined separately for each deal. Bangladesh Bank will act as Mudarib.
4. Under the Rules, any individual, private or public companies, Islamic banks and financial institutions may purchase the bond. Any non-resident Bangladeshi may also invest in the bond from his/her NFCD account maintained with any bank in Bangladesh.
5. The minimum amount of investment may be Taka 1,00,000.00 (one hundred thousand and multiples thereof) and the rates of return to be given to the investors are as follows:
 - h For the period of investment of six months: PSR is 80:20 in which 80 percent profit will be given to the bond holders and 20 percent will be retained by the Bangladesh Bank.
 - h For the period of investment of one year: PSR is 90:10 in which 90 percent profit will be given to the bond holders and 10 percent will be retained by the Bangladesh Bank.
 - h For the period of investment of two years: PSR is 95:05 in which 95 percent profit will be given to the bond holders and 5 percent will be retained by the Bangladesh Bank.
6. GIIB may be used as collateral for availing loan or investment from any financial institutions. In this case, bond must be recorded in the Subsidiary General Ledger (SGL).
7. GIIB is qualified securities for the purpose of complying with the liquid assets requirement to be maintained by the banks and financial institutions. With regard to this, the Bangladesh Bank may provide the discount window facility for banks and financial institutions to buy or sell GIIB with Bangladesh Bank.
8. There is a provision in the Rules that the bond holders will get interim profit on the maturity date of the bond. This interim profit will be adjusted after finalization of the investment accounts. The interim provision of profit is based on the received monthly profit realized on the invested funds in the Islamic banks or financial institutions (as per Clause No. 7-b of the Rules). The interim profit rates will be given as follows:
 - h For 6-month GIIB: 2 percent less from realized average rate of profit generated through financing of the Islamic investment bond proceeds.
 - h For 1-year GIIB: 1.5 percent less from realized average rate of profit generated through financing of the Islamic investment bond proceeds.
 - h For 2-year GIIB: 1 percent less from realized average rate of profit generated through financing of the Islamic investment bond proceeds.
9. The trading of the GIIB will be based on the interim profit rate derived from the investments of those with the Islamic banks. The interim profit rate will be reviewed on monthly basis.
10. The formula for calculation of the profit element to be paid to the bond investors is as follows:

$$B = \text{prt} (k) / Y$$

Where B = Profit payable to the bond investor; p = Principal investment to the GIIB; r = Rate of monthly profit received (in percent per annum) from the investment of bond proceeds for 6 months bonds; t = bond period (number of days invested); k = Profit sharing ratio to be applied to the bond investor; and Y = 365 days.

11. GIIB may not be a transferable instrument for more or less than its face (nominal) value. If it is returned to the Bangladesh Bank before maturity, then the bond holder may be eligible to get only the principal amount invested. No profit will be allowed for the period before or after maturity of the bond, if not encashed on maturity.

Government Islamic Investment Bonds are playing an important role in developing the Islamic banking system of Bangladesh, whereby Islamic banks and financial institutions are actively participating to park their cash surpluses.

financial institutions in addition to the general Securities and Exchange Commission (SEC) supervision of public companies continued to attract strong investor interest in the new capital issues of banks and financial institutions. This reawakened investor confidence in the capital market should extend to new issues of listed companies in other economic sectors with stronger SEC supervision, more demanding audit and financial disclosure standards, and credit rating of issuers by independent rating agencies.

Capital Market Activities in FY07

Primary Issuance

6.16 Twelve companies raised new equity of Taka 3.1 billion in the primary market in FY07, higher than the Taka 1.7 billion raised by fourteen companies in FY06. Of the new equity issues, Taka 0.04 billion raised through private placements and Taka 3.1 billion through public offerings in FY07 as against Taka 0.2 billion raised through private placements and Taka 1.5 billion through public offerings in FY06.

6.17 The volume of public offerings in FY07 was predictably oversubscribed more than seven times indicating the high demand of new securities in the primary market. Bonus shares valued at Taka 6.8 billion were issued in FY07 by fifty companies against retained profits, higher than the Taka 4.6^R billion issued in FY06 by fifty-three companies.

Secondary Market Activities

6.18 Market capitalization inclusive of new issues increased remarkably by 118.2 percent in Dhaka Stock Exchange and 103.7 percent in Chittagong Stock Exchange in FY07 than that of FY06 (Tables 6.8 and 6.9). In FY07, the amount of market turnovers in the secondary market also increased by 258.0 percent and 200.0 percent respectively at the Dhaka and Chittagong stock exchanges. The securities market got a momentum during the year under report when both local and foreign investors took part in the trading of securities in

R =Revised.

Table 6.8 Dhaka Stock Exchange (DSE) activities

Particulars	End June		
	FY05	FY06	FY07
i. No. of listed securities*	277	303	325
ii. Issued equity and debt (billion Taka)	66.4	85.7	164.3
iii. Equity through private placement & IPOs	1.2	1.7	3.1
iv. Market capitalization (billion Taka)	224.6	225.3	491.7
v. Turnover in value (billion Taka)	75.6	46.0	164.7
vi. Turnover in volume (no. in billion)	1.0	0.6	2.0
vii. All-share price index	1713.2	1339.5	1764.2

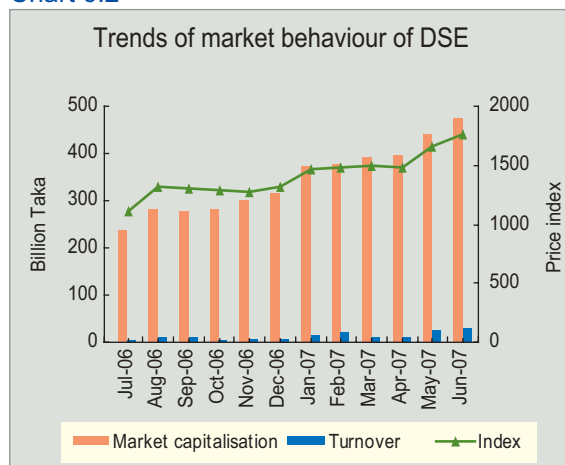
Source : Dhaka Stock Exchange.
* = including companies, mutual funds, debentures and treasury bonds.

Table 6.9 Chittagong Stock Exchange (CSE) activities

Particulars	End June		
	FY05	FY06	FY07
i. No. of listed securities*	198	213	219
ii. Issued equity and debt (billion Taka)	50.0	62.5	81.0
iii. Market capitalization (billion Taka)	201.7	195.6	398.5
iv. Turnover in value (billion Taka)	16.7	11.4	34.2
v. Turnover in volume (no. in billion)	0.35	0.25	0.59
vi. All-share price index	3347.1	2879.2	5194.8

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

Chart 6.2



wide scale. As a result, all indicators of the stock market increased notably in FY07. In FY07, all-share price index in Dhaka and Chittagong exchanges also increased by 31.7 percent and 80.4 percent respectively. Day to day changes in price indices and market capitalization in FY07 mainly reflected local conditions with a momentous sentiment during the year under report (Chart 6.2).

Non-resident Portfolio Investment

6.19 In FY07, gross investment inflow in shares and securities of the stock exchanges by non-residents through NITA stood at Taka 8.4 billion and gross outflow as repatriation of sale proceeds of Taka 1.5 billion. Gross investment inflow was Taka 2.4 billion and repatriation of sale proceeds was Taka 0.2 billion in FY06. From the beginning (April 1992) to till June 2007 the gross investment inflow stood at Taka 20.2 billion against gross outflow as repatriation of sale proceeds of Taka 15.1 billion.

Activities of the ICB

6.20 The three subsidiaries of state-owned Investment Corporation of Bangladesh (ICB) namely the ICB Capital Management Ltd. (ICM), the ICB Asset Management Company Ltd. (IAML) and the ICB Securities Trading Company Ltd. (ISTCL) under on going restructuring programme of the capital market development programme (CMP) are functioning in the capital market in Bangladesh. The ICB capital management subsidiary ICM acted in the roles of underwriter, issue manager and placement services provider. The net investment against the investors' accounts stood at Taka 0.33 billion in FY07. The net investment and the market prices of company's own portfolio stood at Taka 0.55 billion and Taka 0.77 billion respectively at the end of June 2007. The ICB asset management subsidiary IAML floated three closed-ends and two open-end mutual funds in FY07. The net investment in the portfolios of the funds stood at Taka 0.68 billion and the market prices of net investment stood at Taka 0.85 billion as of end June 2007. Besides, the own financing of IAML, the net

investment and the market prices of net investment of the mutual funds stood at Taka 0.22 billion and Taka 0.24 billion respectively as of end June 2007. The ICB securities trading subsidiary ISTCL emerged as the largest stockbroker in the country handling total turnover worth Taka 200.3 billion in FY07. The parent ICB itself sold unit certificates amounting Taka 0.18 billion against repurchase of unit certificates amounting Taka 0.26 billion in FY07. In FY07, the ICB received deposits of Taka 0.18 billion and approved loans of Taka 0.83 billion in investment accounts of investors. The volume of securities traded in FY07 of the ICB stood at Taka 4.32 billion against Taka 6.82 billion traded in FY06. Total commitments for investment made by the ICB in FY07 stood at Taka 0.43 billion of which, for pre-IPO placement of share Taka 0.57 billion, pre-IPO placement of debenture Taka 0.47 billion, purchase of preference share Taka 0.35 billion, investment in equity Taka 0.21 billion, purchase of debentures Taka 1.05 billion, investment in bond Taka 0.54 billion and in lease financing Taka 1.13 billion. In FY06 the total amount of commitments was Taka 3.53 billion.

Scheduled Bank Investments in Capital Market Securities

6.21 Holdings of capital market assets (equities, debentures) by scheduled banks stood at Taka 32.9 billion as of end June 2007 as against Taka 20.4 billion of end June 2006. Outstanding advances of scheduled banks against shares and securities amounted to Taka 2.9 billion at the end of June 2007, which was Taka 3.1 billion as of end June 2006.

Measures Supporting Capital Market Development

6.22 The Securities and Exchange Commission (SE) undertook following measures to strengthen capital market through build-up the confidence of the investors in capital market in FY07:

- ❖ Introducing a new category named N"for the listed companies on the stock exchanges for recently listed companies and that did not hold annual general meeting from the date of listing.

- ❖ Set-up a project named "Improvement of Capital Market Governance Programme" to improve the governance scenario of capital market in Bangladesh.
- ❖ Taking initiatives to set up an oversight body named "Financial Reporting Council" to ensure on time preparation of financial statement by the issuers reflecting true state of financial affairs of issuer companies and also to ensure objective auditing of the same by statutory auditors in adherence to International Standards on Auditing.
- ❖ Decision has been taken to establish a securities training institute named "Bangladesh Institute of Capital Market" to improve the knowledge of investors, intermediary institutions and to improve the corporate governance in the listed companies.

6.23 The measures declared in the national budget of FY07 in support of capital market development included:

- ❖ Increasing allowable investment for the purpose of tax credit from Taka 2.0 lac to Taka 2.5 lac irrespective of share purchase of a company.
- ❖ Introducing the provision of minimum income tax of Taka 5.0 thousand or 0.05 percent of turnover whichever is higher for investor of company irrespective of profit or loss.
- ❖ Exemption of capital gain tax in case of conversion of DSE membership into corporate entities if all the assets of proprietor membership are transferred to corporate membership.
- ❖ 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

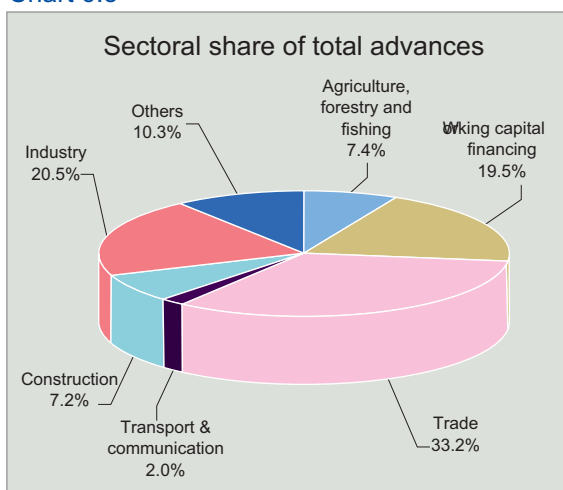
6.24 Total advances of scheduled banks by economic purposes showed an upward trend during FY07 (Table 6.10). Total advances of scheduled banks by economic purposes stood at Taka 1465.7 billion at the end of June in

Table 6.10 Advances of scheduled banks by economic purposes
(billion Taka)

Sector	End June		
	FY05	FY06	FY07
1. Agriculture, forestry and fishing	106.7	113.5	109.0
2. Industry	199.5	244.8	301.1
3. Working capital financing	220.7	258.0	285.1
4. Construction	74.6	86.7	105.1
5. Transport & communication	13.8	19.6	28.7
6. Trade	394.9	437.6	486.2
7. Others	107.1	131.5	150.5
Grand Total	1117.3	1291.7	1465.7

Source : Statistics Department, Bangladesh Bank.

Chart 6.3



FY07 which was 13.5 percent higher than the total advances of Taka 1291.7 billion in FY06. In recent years, significant changes have been taking place in the trends in total bank advances classified by economic purpose. Of the total advances, transport and communication sector recorded the significant improvement by 46.4 percent followed by industry sector 23.0 percent, construction sector 21.2 percent, trade sector 11.1 percent, working capital financing 10.5 percent and other sectors 11.1 percent in FY07 as compared to FY06. The advances for agriculture, forestry and fishing sector decreased by 4.0 percent in FY07 as compared to FY06. Sector-wise contribution of total advances shows that the trade sector plays the main role (33.2 percent) and industry sector

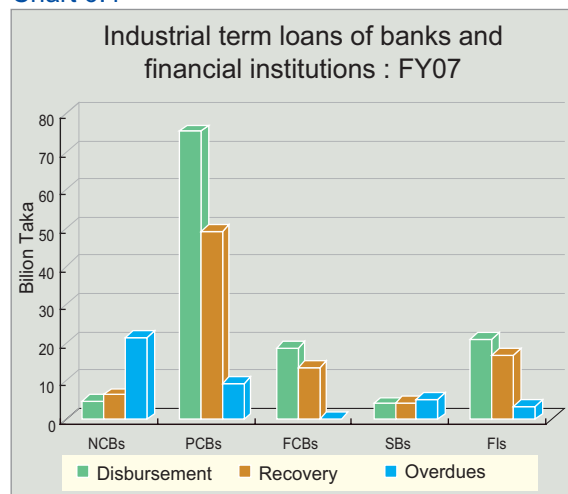
plays the second fiddle (20.5 percent), followed by advances for working capital financing (19.5 percent), agriculture, forestry and fishing (7.4 percent), construction (7.2 percent), transport and communication sector (2.0 percent) and other sectors (10.3 percent) in FY07. Sector-wise contribution of total advances is reported in Chart 6.3.

Industrial Term Loans of Banks and Financial Institutions

6.25 Disbursement and recovery of industrial term loans by banks and financial institutions increased by 28.5 percent to Taka 124.0^P billion and by 34.2 percent to Taka 90.7 in FY07. The outstanding balance showed a positive growth of 23.9 percent at the end June of FY07. The overdues increased in FY07 but as a percent of outstanding declined to 11.8 as of end June 2007 (Table 6.11).

6.26 The four NCBs and five state-owned specialized banks together had Taka 111.3 billion (32.8 percent) share of the total Taka 339.2 billion outstanding loans as of end June 2007, making them major players in industrial term lending (Table 6.11, Chart 6.4). However, with very high levels of past overdues, their actual role in current lending is quite minor, they disbursed only Taka 8.9 billion (7.2 percent) out of total Taka 124.0 billion disbursements in FY07. In relation to disbursement, private commercial banks were the major share holders

Chart 6.4



(Taka 75.4 billion) in FY07, followed by financial institutions (Taka 20.9 billion), foreign banks (Taka 18.8 billion), NCBs (Taka 4.8 billion) and state owned five specialized banks (Taka 4.1 billion).

6.27 The foreign banks had very low overdues (1.4 percent as of end June 2007), the overdues were low also for private commercial banks (5.8 percent), followed by financial institutions (6.9 percent). In FY07 overdues of the NCBs and the specialized banks were very high (24.4 percent and 23.8 percent), although declined from 26.3 percent for NCBs from the previous year.

6.28 As BKB and RAKUB are agriculture sector lenders they have insignificant role in industrial term lending. The specialized

Table 6.11 Industrial term loans of banks and financial institutions

Lender	(billion Taka)									
	Disbursement		Recovery		Outstanding		Overdues		Overdues as % of outstanding	
	FY06	FY07 ^P	FY06	FY07 ^P	FY06	FY07 ^P	FY06	FY07 ^P	FY06	FY07 ^P
i. NCBs	5.9	4.8	5.9	6.5	85.4	88.6	22.5	21.6	26.3	24.4
ii. PCBs	60.6	75.4	37.1	49.2	115.3	164.7	8.3	9.5	7.2	5.8
iii. Foreign banks	9.5	18.8	8.1	13.7	10.2	14.0	0.1	0.2	1.1	1.4
iv. Specialized banks (BSB, BSRS, BKB, RAKUB, BASIC)	3.0	4.1	3.3	4.3	21.9	22.7	4.7	5.4	21.5	23.8
v. Financial institutions	17.5	20.9	13.2	17.0	41.0	49.2	3.0	3.4	7.3	6.9
Total	96.5	124.0	67.6	90.7	273.8	339.2	38.6	40.1	14.1	11.8

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

industrial sector lenders with extremely high overdues have concentrated in recent years on recovery rather than fresh term lending. The amount of overdues of specialized state owned banks stood at 24.2 percent of outstanding as of end June 2007.

Measures for Strengthening Term Lending Practices

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

Substantial measures to strengthen term lending practices initiated in previous years were continuing under the continuous process of financial sector reforms. Among the new preventive and curative initiatives to strengthen term lending practices taken in FY07 were:

- ❖ It has been made mandatory from January 2007 for all banks to have themselves credit rated by a credit rating agency in order to safeguard the interest of the prospective investors, depositors and creditors and also the bank management as a whole for their overall performances in each relevant area including core risks of the banks. BB has instructed the banks to complete their credit rating by 30 June 2007. Credit rating will be an ongoing process and it should be updated in all respects on a continuous basis from year to year, within six months from the date of close of each year and be submitted to Bangladesh Bank. The report should be made public within a period of one month of the notification of rating by the credit rating agency. Banks will disclose their credit rating prominently in their published annual & half yearly financial statements.
- ❖ Decision has been made to replace "General Provision (1% of Unclassified

loans)" by "General Provision maintained against Unclassified loans" in case of determining capital adequacy for Supplementary Capital (Tier-2). For the expansions of large loans of the banks in case of credit facilities provided against AAA rated multilateral development banks (MDBs) guarantee, the policy related to large loan shall not be applicable. Moreover, in case of determining capital adequacy, claims on AAA rated multilateral development banks (MDBs) have been brought under the risk weighted assets.

- ❖ Banks have been instructed to take into cognizance the inter-bank consultation and arrangement, verification of audited financial statements, borrowers rating by a credit rating agency and the issues such as: capital size, business volume, ownership structure etc. while financing large institutions or group of companies and extending credit facilities by more than one bank without consortium arrangements, to ensure proper monitoring/controlling over credit exposure.
- ❖ Decision has been taken to allocate minimum 10% of total fund of Small and Medium Enterprises (SMEs) provided by the Bangladesh Bank to women entrepreneurs of SMEs in order to ensure balanced and organized industrial development in the country through more institutional credit facility at easy terms and conditions. Credit disbursed by banks/ financial institutions as term loan or working capital for single borrower range from Taka 0.01 billion to Taka 0.05 billion with a maximum of 100% refinance facility at bank rate provided by Bangladesh Bank. Fund allocated for women entrepreneurs will be used at revolving way for refinance.

Broadening of Fund Base for Industrial Term Lending

6.30 Dependence of banks on shorter-term deposit resources for funding long-term industrial loans increases their liquidity risks. Providing refinance facilities to banks and financial institutions for broadening the base of longer-term funds for small and medium scale

industrial lending under some special schemes and programmes taken by Bangladesh Bank in FY07 were:

- ❖ BB has launched a 100 percent refinance scheme of Taka 0.5 billion out of its own fund at bank rate against term loans (medium and long term) for agro-based industries in rural areas initiated in FY01 with fixed capital not exceeding Taka 0.05 billion. Under this project Taka 0.6 billion has been disbursed till end June 2007.
- ❖ Another window of refinancing scheme named Small Enterprise Fund (SEF) BB has introduced Taka 2.0 billion out of its own fund at bank rate. Under the scheme refinance facilities was extended for the banks and financial institutions against their financing for development of small enterprises, usually left out by the formal sector financing. Under this scheme the total amount of Taka 1.2 billion has been refinanced to different PFIs in FY07. For high demand, the scheme is financing the amount of recovery as a revolving fund to provide loans to SME sector. Under this project Taka 2.5 billion has been disbursed upto 30 June 2007.
- ❖ Under the Enterprises Growth and Bank Modernization Programme (EGBMP) Government of Bangladesh has provided Taka 1.0 billion including an additional fund of Taka 0.6 billion (USD 10.0 million) from the World Bank's IDA wing to refinance in the project of development of small enterprises, of which Taka 0.5 billion has been disbursed as a term loan to SME sector during FY07 and Taka 1.3 billion has been disbursed upto June 2007.
- ❖ For another refinancing project Asian Development Bank has provided USD 30 million under a Loan Agreement with the Government of Bangladesh to develop the SME sector. From this fund, Taka 0.6 billion has been disbursed during FY07 and Taka 0.8 billion has been disbursed upto June 2007.
- ❖ BB is implementing a project named "Investment Promotion and Financing Facility (IPFF)" with a total estimated cost

of USD 105.2 million on behalf of Government of Bangladesh (GOB) as per agreement signed on 21 August 2006 between BB and GOB for financing Government approved private sector infrastructure projects (i.e. power generation, transmission and distribution and services, port (sea, river and land) development, environmental, industrial and solid waste management, highways and expressways including flyovers, water supply and distribution, sewerage and drainage, industrial estates and park development etc.). Of the total, USD 50.0 million would be provided by the International Development Association (IDA) as soft loan under a financing agreement signed between the GOB and IDA on 1 June 2006, USD 10.0 million provided by GOB, 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 and maximum 70 percent would be provided as debt financing; out of which 20 percent from PFIs and the rest 80 percent from IPFF. Out of 13 PFIs, so far BB has signed Master Facility Agreement (MFA) with 11 PFIs, of which 7 non-bank financial institutions and 4 private banks. The IDA has already disbursed USD 5.0 million as initial deposit. The PFIs are supposed to bear all commercial risks associated with debt financing.

Equity and Entrepreneurship Fund (EEF)

6.31 Initiated in FY01 with the amount of Taka 1.0 billion Equity and Entrepreneurship Fund (EEF) created by the Government through budgetary allocation was active in FY07 to encourage investments with equity participation in the risky but prospective agro-based, food processing and IT sector projects. Bangladesh Bank has been administering the fund on behalf of the Government. From EEF in FY07, a total amount of Taka 0.7 billion (including disbursement against projects sanctioned prior

to FY07) were disbursed and on amount of Taka 0.03 billion was sanctioned against 3 projects involving total project cost of Taka 0.08 billion. Taka 1.1 billion was disbursed in FY06. Up to 30 June 2007 with the project cost of Taka 17.0 billion, a total of 252 projects (including 218 agro-based and food processing projects, and 34 IT projects) has been disbursed Taka 4.3 billion against the sanctioned of Taka 6.5 billion.

Housing Finance

6.32 Total housing loans from banks and financial institutions as of end June 2007 amounted to Taka 124.6 billion (Table 6.12), which was 7.3 percent of total credit to the private sector.

6.33 The state owned House Building Finance Corporation (HBFC) has the second largest share of Taka 25.2^P billion in outstanding housing loans as of end June 2007. 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 0.4 billion and Taka 1.2 billion in FY06 and FY07 were disbursed out of recoveries of Taka 3.6 billion and Taka 3.9 billion respectively.

6.34 The NCBs and private sector banks with ample deposit resources have been expanding their housing loan portfolios, and now have dominant market position with the largest share of Taka 86.1 billion in outstanding housing loans as of end June 2007. 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.

^P=provisional.

Table 6.12 Outstanding housing loans

(billion Taka)			
Lenders	Outstanding as of end June		
	FY05	FY06	FY07 ^P
a. Specialized housing finance providers			
i) HBFC	27.8	26.2	25.2
ii) Delta-BRAC Housing Finance	4.4	5.5	7.1
iii) National Housing Finance	1.8	1.9	1.9
b. Banks			
i) NCBs	24.1	25.8	28.6
ii) Other banks	26.2	38.2	57.5
c. Other financial institutions	1.6	2.9	4.1
d. Microcredit lenders			
Grameen Bank	0.9	0.4	0.2
Total	86.8	100.9	124.6

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

6.35 The Grameen Bank provides housing loans for basic shelter housing in rural areas to its microcredit borrower members. Some NGOs also have small involvements in lending for basic shelter housing, financed from a Grihayan Tahbil created by the Government. In FY06 and FY07, the Tahbil has recovered Taka 0.09 billion and Taka 0.2 billion respectively as against of disbursed Taka 0.09 billion and Taka 0.1 billion through NGOs for this purpose. The Tahbil also disbursed Taka 1.2 billion from its beginning in FY98 to end June 2007. Besides, to provide safe, healthy and cheap housing facilities for the women labourers working in the garments and other industries, 2000-seated hostel has been constructed by BRAC at Askona, Uttara, Dhaka with worth of Taka 0.1 billion financing facility from the Tahbil.

Foreign Exchange Market

6.36 Bangladesh Bank floated its exchange rate for Taka with effect from May 31, 2003. Under this arrangement, banks and authorised dealers are free to set their own rates of foreign exchange against Bangladesh Taka for their inter-bank and customer transactions. The exchange rate is being determined in the market on the basis of market demand and supply forces of the respective currencies. However, to avoid any unusual volatility in the exchange rate, BB occasionally engages itself to intervene

in the market through purchase and sale 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

6.37 The exchange rates of Bangladesh Taka against major international currencies remained somewhat stable at the floating regime. In FY07 Taka-Dollar exchange rates experienced a mixed trend. During the first quarter of FY07 Taka-Dollar rate experienced a pressure within the range Taka 69.49 - Taka 69.85. During the period under report with the beginning of the second quarter Taka started to gradually recover its lost value and by mid October 2006 it appreciated up to Taka 66.00 against Dollar. It again weakened and recorded an ever high depreciation of Taka 72.95 against Dollar by the end November 2006. Analysis shows that pressure in the foreign exchange market started from ceaseless price hike for import of oil & petroleum products and other major commodities in the world market coupled with higher growth in lending to the private sector, which led to higher demand for import of capital machinery in the first half of FY07.

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

(million US\$)			
Particulars	FY05	FY06	FY07
Sale	459.5	413.0	Nil
Purchase	70.1	77.0	649.5

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

But due to adoption of cautious monetary policy together with substantial inflow of foreign exchange from export earnings and remittances, the situation eased later on and at end of FY07 Taka-Dollar exchange rates remained relatively stable with a range of Taka 68.70-Taka 69.30. The weighted average Taka-Dollar exchange rate appreciated from Taka 69.72 per US Dollar at end June 2006 to Taka 68.80 at end June 2007. In FY07, to absorb excess liquidity from the foreign exchange market, BB purchased USD 649.50 million from banks.

Inter-bank Foreign Exchange Transactions

6.38 The volume inter-bank foreign exchange transactions in FY07 stood at USD 19.2 billion, which was 5.4 percent lower than the USD 20.3 billion in FY06. 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 FY07 as well as in FY06.