CHAPTER 5

MONETARY MANAGEMENT AND FINANCIAL MARKET DEVELOPMENT

[*Soaring global food prices coupled with increasing oil prices has posed inflationary pressure around the world, particularly in the emerging and developing economies. This has created inflationary pressure in the country despite good domestic production. In this context, Bangladesh Bank raised policy interest rates (repo and reverse repo rates) in four steps both totaling by 225 basis points from 4.50 percent and 2.50 percent to 6.75 percent and 4.75 percent respectively during FY2010-11. Moreover, in the face of uptrend in inflation rate, Bangladesh Bank has increased CRR and SLR of the scheduled banks by 50 basis points to 6.00 percent and 19.00 percent respectively in December 2010. Besides, in order to prevent the higher lending rate against the deposit rate, Bangladesh Bank has alerted all the banks and enhanced supervision over the implementation of sanctioned investment ceiling in capital market by the banks from June, 2010. Following the sharp market correction, the government commissioned a thorough investigation by a committee into the causes behind over blowing of prices of stocks in the market leading to eventual collapse of price bubble. As per the recommendations of the committee, the Securities and Exchange Commission (SEC) has been restructured to control volatility of the stock markets and to regain investors' confidence. It is expected that these initiatives will regain investors' confidence in the capital market****]***

Monetary Policy and Monetary Management

Against the backdrop of global recessionary environment, Bangladesh Bank pursued an accommodative monetary policy to ease credit flow with an aim to provide adequate liquidity in the money market. For this reason, Bangladesh Bank refrained from conducting repo and reverse repo for mopping up excess liquidity from the third quarter of FY2008-09. However, despite adequate supply of money and credit, demand for credit did not increase during this period. As a result, liquidity increased in the money and the call money rate plummeted below 1 percent. It is to be noted that, at the beginning of FY2009-10, despite the declined growth in net domestic asset, higher growth in net foreign asset induced an increase in money supply. Under the circumstances, Bangladesh Bank started operating 30-day Bangladesh Bank Bills from the first quarter and resumed its' reverse-repo operation from the second quarter of FY2009-10, fixing repo and reverse-repo at 4.50 percent and 2.50 percent respectively, lowering both the rates by 200 basis points. However, a large portion of the excess liquidity was absorbed to provide credit to the private sector and import payments as the economic activities boosted up in the middle of FY2009-10. Moreover, the inter-bank call money rates exceeded 4 percent. In spite of substantial decline in the excess liquidity, inflation continued to show upward trend. In order to contain such inflationary pressure by restraining expansion of monetary base, Bangladesh bank raised Cash Reserve Requirements (CRR) and Statutory Liquidity Ratio (SLR) by 50 basis points to 5.50 percent and 18.50 percent respectively which were effective from 15 May 2010.

Soaring global food prices coupled with increasing oil prices has posed inflationary pressure around the world, particularly in the emerging and developing economies having rebounded rapidly and strongly

from the 2008 global economic crisis. This has created inflationary pressure in the country despite good domestic production. In this context, Bangladesh Bank raised policy interest rates (repo and reverse repo rates) in four steps both totaling by 225 basis points from 4.50 percent and 2.50 percent to 6.75 percent and 4.75 percent respectively during FY2010-11. It should be mentioned that, in order to prevent higher lending rate against the deposit rate as well as to prevent the violation of lending rules and regulation by the banks, Bangladesh bank has alerted all the banks for their use of loans and enhanced supervision over the implementation of sanctioned investment ceiling in capital market by the banks from June, 2010. In addition, from October, 2010 the compulsory loan provision against stocks and shares was doubled to 2 percent and from December, 2010 preserving 50 percent margin for all consumer financing was made mandatory to prevent speculative stocks. Moreover, in the face of uptrend in inflation rate, Bangladesh Bank has increased CRR and SLR of the scheduled banks by 50 basis points to 6.00 percent and 19.00 percent respectively in 15 December 2010.

However, with the increased demand for domestic credit as the economy paced up to the expected buoyant economic growth coupled with heavy outflows for imports and other external payments, put the banks into liquidity crisis from December 2010. Moreover, unauthorised investment of the banks in the unproductive sector also put the banks under liquidity pressure. Despite the uptrend in inflationary pressure Bangladesh Bank has been providing liquidity support to the banks in respect of increased demand in the money market. Finally, country's economic activities paced up in expected path during FY2010-11 aided by strong export demand due to gradual recovery from global recession and also strongly contributed by fiscal stimulus provided by the government and supportive monetary operations by the Bangladesh Bank.

Trends in Monetary Aggregates

During FY2010-11, year-on-year growth in narrow money (M_1) decreased sharply while broad money (M_2) decreased marginally and reserve money (RM) increased significantly as compared to the preceding fiscal year. The deceleration in growth of narrow money was largely on account of the sharp decrease of both currency notes and coins with the public and demand deposit. However, moderate increase in time deposit has resulted slight decrease in broad money. Moreover, the increase in reserve money was largely attributed to the increase in net domestic asset instead of net foreign asset. Table 5.1 figures out the trends in monetary aggregates since FY2005-06.

Table 5.1: Trends in Monetary Aggregates

(Year-on-year percentage change)

Indicator	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Narrow Money	20.47	17.62	18.23	11.99	32.46	17.18
Broad Money	19.30	17.06	17.63	19.17	22.44	21.34
Reserve Money	27.12	17.90	19.78	31.45	16.03	21.09

Source: Bangladesh Bank

Narrow Money (M_1)

Narrow money increased by 17.18 percent during FY2010-11 as compared to an expansion of 32.46 percent in FY2009-10. During FY2010-11, the year-on-year growth of M_1 was lower mainly due to

significant decrease of both currency notes and coins with the public and demand deposit. During this period, year-on-year growth of currency notes and coins with the public increased by 18.71 percent compared to the increase of 28.04 percent a year earlier. Similarly demand deposit increased by 15.48 percent during FY2010-11, compared to the increase of 37.70 percent a year earlier.

Broad Money (M_2)

The broad money increased by 21.34 percent during FY2010-11, which was slightly lower than 22.44 percent growth a year earlier. During this period, time deposit increased by 22.68 percent from 19.55 percent a year earlier. The supply of broad money increased by Tk.77,488.70 crore to Tk.440,519.90 crore at the end of June 2011 from Tk.363,031.20 crore at the end of June 2010. Table 5.1, and figures 5.1 and 5.2 show the composition of money supply and credit and their movements over time.

Table 5.2: Money and Credit

Indicator	June, 2008	June, 2009	June, 2010	June, 2011
	End period stock (In crore Taka.)			
1. Net foreign assets of the banking system	37317.9	47459.4	67073.7	70541.9
2. Net domestic assets of the banking system	211477.0	249040.4	295957.5	369978.0
a. Domestic credit	248677.3	288552.4	340213.6	433419.2
a.1. Government sector (net)[1]	46909.1	58185.2	54392.3	73368.4
a.2. Public sector (other)[1]	11632.4	12439.7	15060.7	19338.1
a.3. Private sector[1]	190135.8	217927.5	270760.6	340712.7
b. Other assets (net)	-37200.1	-39512.0	-44256.1	-63441.2
3. Narrow money	59314.4	66426.9	87988.3	103101.1
a. Currency notes and coins with the public	32689.9	36049.2	46157.1	54795.1
b. Demand deposit[2]	26624.5	30377.7	41831.2	48306.0
4. Time deposit	189480.5	230072.9	275042.8	337418.8
5. Broad money [(1)+(2)] or [(3)+(4)]	248794.9	296499.8	363031.2	440519.9
	Year-on-year percentage change (%)			
1. Net foreign assets of the banking system	15.07	27.18	41.33	5.17
2. Net domestic assets of the banking system	18.10	17.76	18.84	25.01
b. Domestic credit	20.95	16.03	17.90	27.40
a.1. Government sector (net)	30.41	24.04	-6.52	34.89
a.2. Public sector (other)	-33.36	6.94	20.07	28.40
a.3. Private sector	24.94	14.62	24.24	25.84
b. Other assets (net)	39.77	-6.21	-12.01	-43.35
3. Narrow money	18.23	11.99	32.46	17.18
a. Currency notes and coins with the public	22.69	10.28	28.04	18.71
b. Demand deposit	15.45	14.10	37.70	15.48
4. Time deposit	17.11	21.42	19.55	22.68
5. Broad money	17.63	19.17	22.44	21.34

Source: Bangladesh Bank

Note: 1. Including accrued interest, 2. Including deposits of other financial institutions and government agencies.

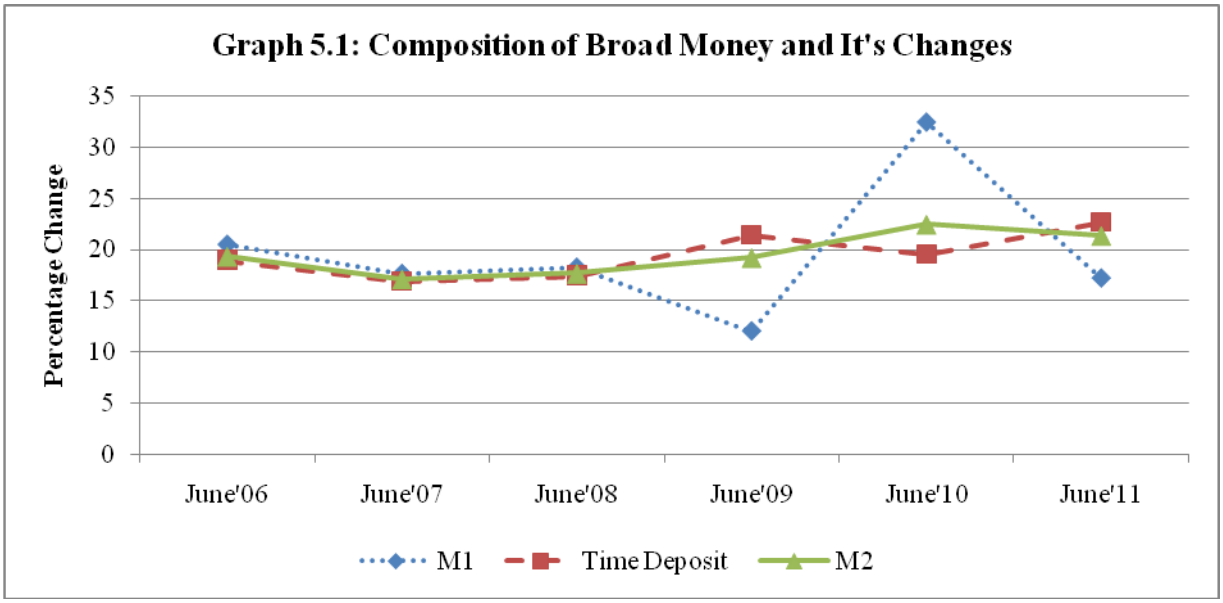
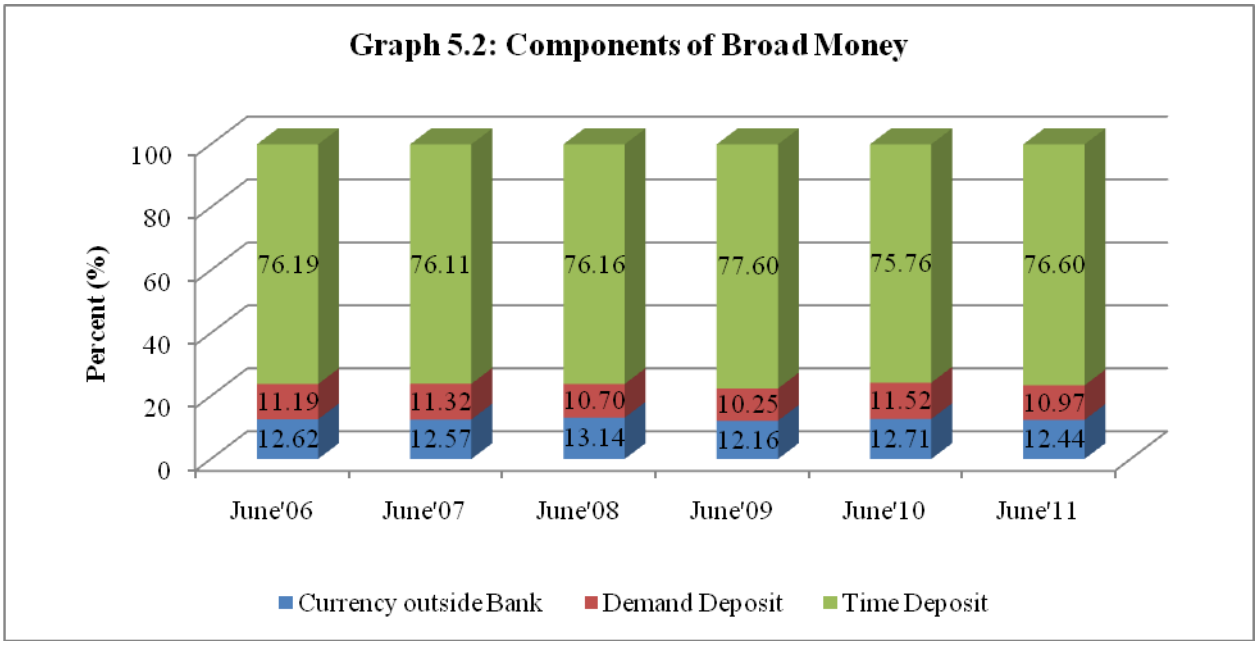


Figure 5.1 depicts the movement of broad money and its components. It reveals the fact that, since FY2008-09 the narrow money growth has been showing significant fluctuations. Recently currency in circulation and demand deposit has decreased, while the time deposit increased (Figure 5.2).



Domestic Credit

Year-on-year growth in domestic credit was 27.40 percent during FY2010-11, up from 17.90 percent during FY2009-10. Sector-wise analysis of domestic credit indicates that the net credit to the government sector increased by 34.89 percent at the end of June 2011 due to declined external and non-bank sources of financing. The net credit to government was declined by 6.52 percent during the previous year. Private

sector credit growth was 25.84 percent in FY2010-11, slightly higher than year-on-year growth of 24.24 percent of previous fiscal year. Private sector credit increased mainly due to providing higher subsidy/cash incentives under the 2nd stimulus package declared by the Government in foreign trade, increase in credit to agriculture, small and medium scale enterprises, and term loan including different expansionary economic activities. However, the increase in private sector credit was mainly occurred in the productive sectors. But it is evident that, a part of this private sector credit is used in the unproductive sectors.

Reserve Money

In FY2010-11, reserve money increased by 21.09 percent at the end of June 2011, up from 16.03 percent in the previous year. The growth of reserve money was mainly attributable to the increase in net domestic assets (NDA) of Bangladesh Bank by 87.42 percent. However, net foreign assets (NFA) of Bangladesh Bank increased by only 0.17 percent during the period. Bangladesh Bank's claims on deposit money banks (DMBs), government sector (net) and non-bank depository corporations (NBDCs) increased by 204.74 percent, 43.28 percent and 17.42 percent respectively which eventually contributed to increase reserve money growth, while net other asset and Bangladesh Bank's claims on other public sector declined by 42.26 and 6.97 percent respectively. On the other hand, widening the trade gap and slower growth in remittances inflow was mainly responsible for the negligible growth of net foreign assets of Bangladesh Bank. Table 5.3 shows the composition of reserve money and table 5.4 shows the sources of reserve money and its changes over time.

Table 5.3: Reserve Money and Its Components

Particular	**June 2008**	**June 2009**	**June 2010**	**June 2011**
	End period stock (In crore Taka)			
1. Currency issued	35648.5	39448.7	50465.4	60526.9
2. Balances of scheduled banks with BB	17034.2	29800.2	29835.5	36766.8
3. Reserves of other financial institutions with the BB	106.9	141.2	209.4	199.8
4. Reserve money [(1)+(2)+(3)]	**52789.6**	**69390.1**	**80510.3**	**97493.5**
	Year-on-year percentage change (%)			
1. Currency issued	19.78	10.66	27.93	19.94
2. Balances of scheduled banks with BB	23.83	74.94	0.12	23.23
3. Reserves of other financial institutions with the BB	11.89	32.09	48.30	-4.58
4. Reserve money	**73.26**	**31.45**	**16.03**	**21.09**

Source: Bangladesh Bank

Table 5.4: Reserve Money and Its Sources

Particular	June 2008	June 2009	June 2010	June 2011
		Period end stock (In crore Taka.)		
1. Net foreign assets of BB	32835.8	43244.9	61204.9	61310.6
2. Net domestic assets of BB	19953.8	26145.2	19305.4	36182.9
a. Domestic credit	35927.2	38632.4	31492.9	53520.6
a.1. Claims on Government sector (net)	25997.3	28955.5	22320.6	31982.0
a.2. Claims on other public sector	898.9	808.1	793.0	737.7
a.3. BB's claims on DMBs	7334.2	6846.7	5852.0	17833.4
a.4. BB's claims on NBDCs	1696.8	2022.1	2527.3	2967.5
b. Other assets (net)	-15973.4	-12487.2	-12187.5	-17337.7
3. Reserve Money [(1)+(2)]	**52789.6**	**69390.1**	**80510.3**	**97493.5**
		Year-on-year percentage change (%)		
1. Net foreign assets of BB	14.00	31.70	41.53	0.17
2. Net domestic assets of BB	31.19	31.03	-26.16	87.42
a. Domestic credit	2.97	7.53	-18.48	69.94
a.1. Claims on Government sector (net)	0.26	11.38	-22.91	43.28
a.2. Claims on other Public sector	-4.21	-10.10	-1.87	-6.97
a.3. BB's claims on DMBs	-13.85	-6.65	-14.53	-204.74
a.4. BB's claims on NBDCs	7.66	19.17	24.98	17.42
b. Other assets (net)	17.79	21.83	2.50	-42.26
3. Reserve Money	**19.78**	**31.45**	**16.03**	**21.09**

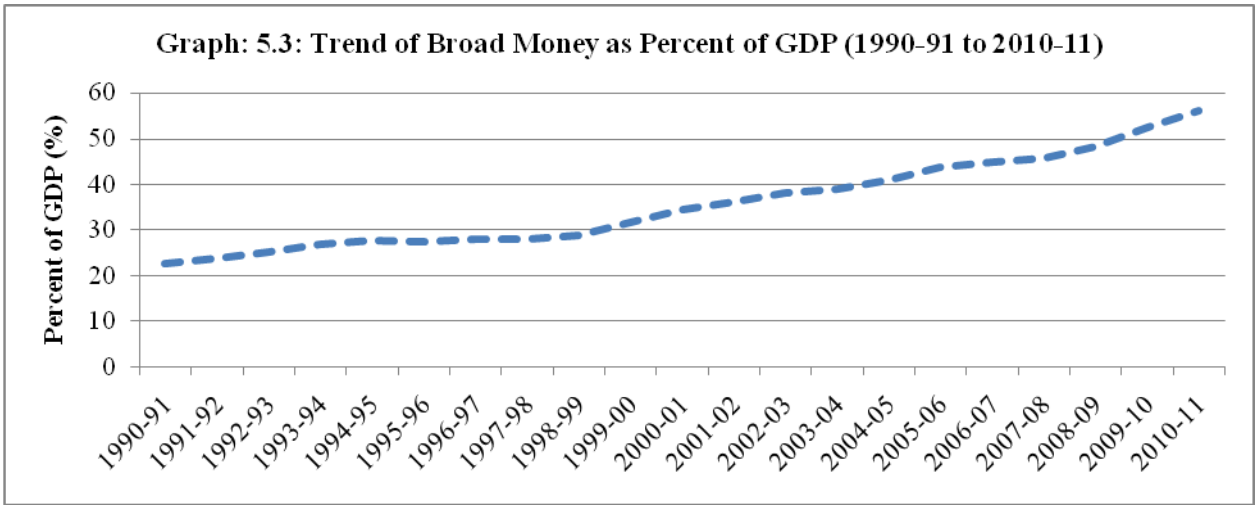
Source: Bangladesh Bank

Money Multiplier

Because of lower growth in reserve money compared to broad money, money multiplier (M_2/RM) increased to 4.51 in FY2009-10 as compared to 4.72 in FY2008-09. Money multiplier increased slightly to 4.52 at the end of June 2011 from 4.51 at the end of June 2010. This outcome was mainly because of increased in reserve-deposit ratio to 0.111 from 0.108 in FY2009-10. Currency-deposit ratio, on the other hand, declined to 0.142 from 0.146 in FY2009-10. The consequence of change in both these ratio have been reflected in the growth in money multiplier.

Income Velocity of Money

The income velocity of money declined from 1.91 percent in FY2009-10 to 1.79 percent in FY2010-11. The rate of decline in FY2010-11 was 6.54 percent, against a decline of 7.75 percent in FY2009-10. Such decline was recorded at 5.48 percent, 1.79 percent and 3.04 percent in FY2008-09, FY2007-08 and FY2006-07 respectively. The declining trend of income velocity of money over the past several years indicates increased monetisation and financial deepening in the economy. The trends of M2 as percent of GDP since FY1990-91 are shown in Graph 5.3. The stock of broad money was 22.63 percent of GDP in FY1990-91, which stood at 52.43 percent of GDP in FY2010-11.



Financial Market Management

Financial market in Bangladesh essentially consists of banks and non-bank financial institutions and capital market which include 4 state owned commercial banks (SCBs), 30 private commercial banks (PCBs), 9 foreign commercial banks (FCBs), 4 government owned specialized banks, 29 non-banking financial institutions (NFIs). Besides, several non-scheduled banks like, Investment Corporation of Bangladesh (ICB), House Building Finance Corporation (HBFC), Dhaka Stock Exchange (DSE), and Chittagong Stock Exchange (CSE) are operating in the country.

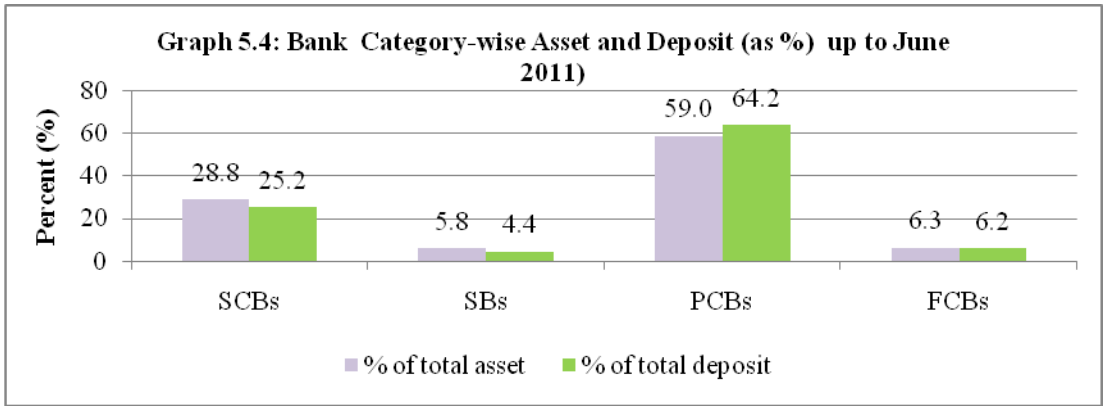
Banking Sector

As of June 2011, 47 scheduled banks which include state-owned commercial and specialised banks, local private commercial banks and foreign commercial banks, are operating in Bangladesh through a network of 7,712 branches. Among these branches as many as 3,414 belong to state-owned commercial banks, 2,847 branches to local private banks, 63 branches to foreign banks and 1,388 branches to specialised banks. Moreover, 1 National Co-operative Bank, 1 *Ansar VDP* Bank, 1 *Karmasangsthan* Bank and 1 *Grameen* Bank are operating as the non-scheduled banks. Besides, a bank named *'Probashi Kalayan* Bank' (Expatriate Welfare Bank) has started its operation since April 2011. The structure of banking system and individual bank's share (in percent) of total deposits and assets are shown in Table 5.5 and Figure 5.4 respectively at the end of June, 2011.

Table 5.5: Structure of the Banking System in Bangladesh (up to June 2011)

Type of Banks	No.	No. of Branches	% of total asset	% of total deposit
SCBs	4	3414	28.81	25.23
SBs	4	1388	5.84	4.43
PCBs	30	2847	59.01	64.18
FCBs	9	63	6.34	6.16
Total	47	7712	100.00	100.00

Source: Bangladesh Bank

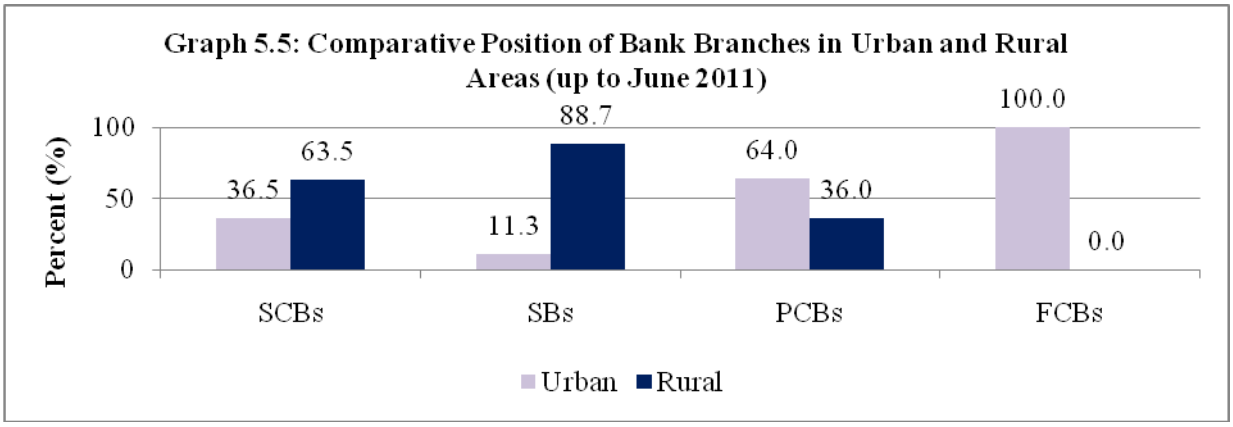


Although private and foreign banks are performing better in terms of capital adequacy, qualities of assets, income-expenditure ratio etc, they offer only limited access. On the contrary, there is much more access of mass people to the state-owned commercial banks and specialized banks because of wider distribution of their branch network. As of June, 2011 while there was no branch of the foreign banks in the rural areas, only 36.04 percent of the total branches of the local private banks were located in rural areas. On the other hand, 63.53 percent and 88.69 percent of the total branches of state-owned commercial banks and specialized banks are located in the rural areas respectively. Regional distribution of the branches of the banks (in percentage) and their categories (up to June 2011) are shown in Table 5.6 and Graph 5.5 respectively.

Table 5.6: Comparative Position of Bank Branches in Urban and Rural Areas(up to June 2011)

Type of Banks	**No. of**	**No. of Branches**			**As % of Total Branches**		
	Banks	Urban	Rural	Total	Urban	Rural	Total
SCBs	4	1245	2169	3414	36.47	63.53	100
SBs	4	157	1231	1388	11.31	88.69	100
PCBs	30	1821	1026	2847	63.96	36.04	100
FCBs	9	63	0	63	100.00	-	100
Total	**47**	**3286**	**4426**	**7712**	**42.61**	**57.39**	**100**

Source: Bangladesh Bank



In order to achieve greater efficiency, stability and transparency in the financial sector, there is an ongoing reform agenda and as a result, the financial indicators have remained at the satisfactory levels. Due to expansion of economic activities, bank credit increased by 23.16 percent at the end of June, 2011 in comparison with the same at the end of June, 2010. In spite of credit expansion, excess liquidity in the banking sectors (considering Government Securities) decreased by 1.28 percent (point to point basis) in June 2011 whereas it decreased by 0.72 percent in June 2010. Despite slight increase in the disbursement of loans and advances in the year 2011 compared to 2010, the income and profitability of the banking system slightly decreased. The Return on Asset (ROA) declined to 1.31 percent in June, 2011 from 1.58 percent in June, 2010 (considering profit after provision and tax).

To comply with international best practices and to make the bank's capital more resilient to unforeseen shocks as well as to build the banking industry more risk sensitive and stable, Bangladesh Bank commenced implementation of Basel-II capital adequacy framework from January 2010 as regulatory requirement for banks. Before unveiling the programme there had been a test run period of one year with four trial-reporting in 2009. It is to be noted that from 1996 to 2009, the banks inside Bangladesh maintained capital on the basis of risk-weighted asset in line with Basel-I wherein only credit risk was taken into account. However, under Basel-II, credit risk as well as the market and the operational risks are being considered for calculating Minimum Capital Requirement (MCR). Moreover, necessary action has been taken to ensure public disclosure of information about bank’s capital structure through market disclosure. It is also to be noted that the minimum capital requirement of a bank is a certain percentage of risk weighted assets as fixed by Bangladesh Bank from time to time or Tk. 200 crore, whichever is higher. Bangladesh Bank has fixed up minimum required Capital Adequacy Ratio (CAR) and Minimum Capital Requirement (MCR) for banks at 8 percent up to June 2010, 9 percent up to June 2011 and 10 percent from July 2011 and onward. It is pertinent that banks will have to have paid up capital and reserves (at least Tk. 200.00 crore as paid up capital) of at least Tk. 400 crore by 11 August 2011. The CAR of the banking industry under Basel-II was 9.94 percent in March 2011 compared to 9.31 percent in December 2010.

Non-bank Financial Institutions

Some of the non-bank financial institutions (NBFIs) along with banking sector made significant contribution to the financing of certain important sectors of the economy such as industry, commerce, housing, transportation and information technology. There are 30 licensed non-bank financial institutions in the country until 30 June 2011, while 29 of them are engaged in business. At present 115 branches including 30 head offices of NBFIs are operating in Dhaka city and different areas of the country. Total paid up capital and reserve of these institutions stood at Tk.5,098.77 crore as on 30 June, 2011, in which paid up capital was Tk.2,200.50 crore. Total assets and deposits of NBFIs stood at Tk.27,631.34 crore and Tk.10,627.62 crore respectively as on 30 June, 2011. Their investment in different shares and securities stood at Tk.1,238.37 crore at the end of June, 2011. NBFIs also participated in the call money market. They can borrow from this market up to 15 percent of their net assets. The rules of loan/lease classification and provisioning for non-bank financial institutions like scheduled banks remained active in order to make non-bank financial institutions strong and effective through strengthening recovery along with reviewing credit situation. Total loan and lease of the NBFIs stood at Tk.19,039.86 crore at the end of June, 2011 and the rate of classified loan of the financial institutions stood at 6.19 percent as on 30 June, 2011.

Interest Rate

Due to excess liquidity in the banking system during the last quarter of FY2008-09 and the first quarter of FY2009-10, the Bangladesh Bank resumed reverse repo auction since October 2009. Eventually, the rate on repo (1-3 Day tenure) plunged into 4.5 percent in November, 2009 from 8.5 percent in September, 2009 and remained unchanged at 4.5 percent up to June, 2010. On the other hand, the rate on reverse repo (1-3 Day tenure) declined to 2.5 percent in October, 2009 from 6.5 percent in March, 2009 and also remained unchanged at 2.5 percent up to June 2010. In line with the trend of liquidity, the inter-bank bank weighted average call money rate increased to 3.33 percent in June, 2010 from 1.08 percent in June, 2009, with some irregular fluctuations within this period.

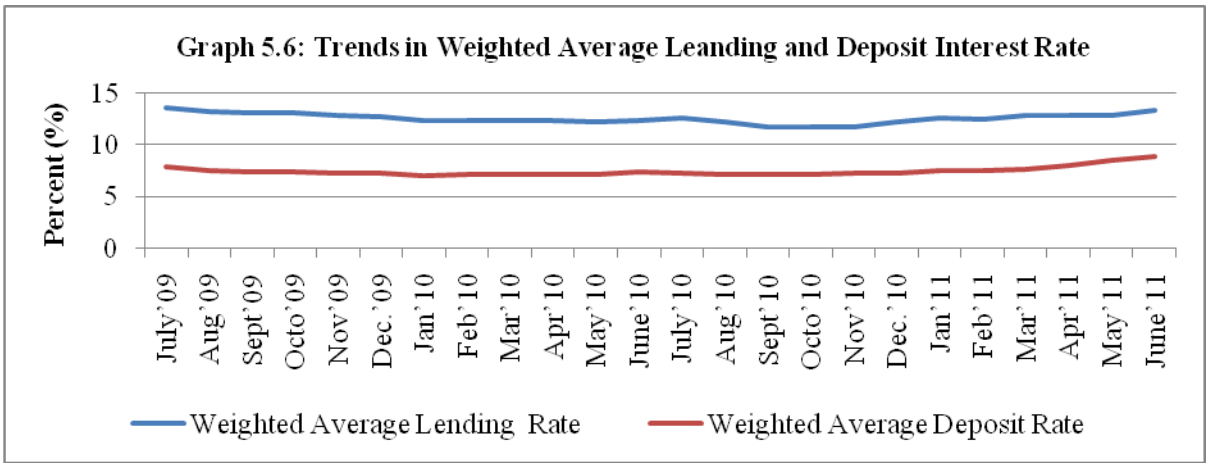
However, to contain inflationary pressure resulting from high oil and food prices in the international markets and domestic markets, the repo and reverse repo rates were enhanced by 100 basis points in August 2010 and stood at 5.5 percent 3.5 percent respectively. This has resulted in slightly reduced liquidity and the weighted average call money rate increased to 6.63 percent. Moreover, in the context of upward inflationary trend, the repo and reverse repo rates were enhanced by 50 basis points in March 2011, which were further increased by 25 basis points in April 2011 and stood at 6.75 percent and 4.75 percent respectively.

Considering the necessity of reducing interest rates to face the current inflationary pressure, the maximum rate of interest on agricultural credit, term loan for large and medium scale industries and working capital loan, housing, and trade financing including financing to NBFIs (Non-Bank Financial Institutions) by banks had been fixed at 13 percent per annum from April 19, 2009. Interest rate caps on bank lending introduced earlier in the backdrop of global economic slowdown became untenable in the changed context of high and rising credit demand as economic activities speeded up in FY2010-11. In March 2011 Bangladesh Bank initiated phase out of these caps, beginning with loans other than industrial term loans and loans for export, agriculture, essential edibles import. Liquidity management, credit deposit ratios and asset-liability maturity mismatches in banks came under Bangladesh Bank's intensive supervisory surveillance in the last quarter of the fiscal year. Moreover, Bangladesh Bank continues moral suasion on banks to keep the interest rate on working capital to industries below 15 percent

In addition, with a view to ensuring adequate supply of essential commodities and keeping the price of these commodities within a reasonable limit the maximum rate of interest on import financing of rice, wheat, edible oil (crude and refined), pulse, gram, onions, dates and sugar (refined and raw sugar/raw cane sugar) has been fixed at 12 percent. Moreover, the advances on export sector, which was fixed at 7 percent since January 10, 2004. Banks are allowed to differentiate interest rate among the borrowers in the same lending category up to a maximum of 3 percent considering comparative risk elements involved With progressive deregulation of interest rates, banks have been advised to announce the mid-rate of the limit, if any for different sectors and they may change interest 1.5 percent more or less than the announced mid-rate on the basis of the comparative credit risk. In cases where the maximum interest rate has been fixed by Bangladesh Bank, banks shall report their own maximum cap. Banks have also been advised to upload their interest rate on deposit and lending of their respective website. Bangladesh Bank monitored closely to rationalise the bank interest rate spread on credit and deposit, and fixed the

charge/fees for different sectors. Bangladesh Bank published the interest rate statements of different banks in their journal and websites on a monthly basis to create competitive environment for fixing interest rates.

Graph 5.6 depicts the monthly movement of weighted average rate of interest on commercial lending and deposit since July 2009. The weighted average rate of interest on commercial lending increased to 12.39 percent in June 2011, from 12.37 percent in June 2010 and the deposit rate increased to 8.85 percent from 7.40 percent over the same period. Thus the interest rate spread narrowed to 4.54 percent in June 2011 from 4.97 percent in June 2010.



Financial Sector Management and Policy Reforms

Legal Reforms

To expedite the settlement of disputes regarding loan recovery of financial institutions, the Money Loan Court Act, 2003 *(Artha Rin Adalat Ain, 2003)* has been made effective. In order to strengthen the process of recovering defaulted loans, banks, under this Act are now empowered to sell the collaterals without prior approval of the court. Effective application of this Act has started yielding encouraging results. As of June 2011, 1,12,965 cases were filed, of which 79,687 cases were settled accruing the recovery of Tk. 6,765.42 crore against the claim of Tk. 36,697.43 crore.

Reforms in the Banking Sector

Bangladesh Bank

The Bangladesh Bank is implementing the Central Bank Strengthening Project (CBSP) with the financial assistance of the International Development Agency (IDA). The project started in 2003 and expected to be completed by December 2011. The main objective of the project is to transform Bangladesh Bank into a modern and dynamic central bank capable of playing appropriate regulatory and supervisory role in the monetary and banking sector. The main objectives of the project are:

- Strengthening the Legal Framework
- Reorganisation and Modernisation
- Capacity Building

Some of the works that have been done (up to June 2011) under the project include the following:

- Review of the existing laws (Bangladesh Bank Order, Bank Companies Act, Financial Institution Act) has been completed and the Bangladesh Bank has already examined the consistency of draft BBO, BCA and FIA.
- Reviewed the necessity for appointing consultant on Anti-money Laundering (AML) and Counterfeiting Financial Terrorism (CFT) to defend the modern financial crime. The procurement process of an adviser for AML/CFT is almost at the final stage.
- Functional reorganisation of the Bank has been done through abolishing and merging a number of departments of the Bank. Besides, functions of some departments have been reorganised.
- Departments' objective and key performance indicators were set ensuring that they are perfectly aligned with the overall mission and vision of Bangladesh Bank. With a view to implementing the Enterprise Resource Planning (ERP) and Banking Application Solution successfully, Standard Operating Procedure of several departments has been prepared.
- Introduction of the Banking Application Package for the automation of its banking system are at the final stage. The software development is almost completed and is expected to be in operation within December, 2011.
- LAN and WAN infrastructures are in place and connectivity has been established between head office and branch offices.
- A modern Performance Management System (PMS), Recognition and Award Policy, Training Need Assessment (TNA) and a new Training Policy and Procedure have already been formulated and are being followed now.
- Policies on licensing, good governance, policies on accounting (disclosure), loan classification and provisioning, capital adequacy, liquidity risk management and credit risk management have been formulated and adopted to reinforce prudent regulation and to strengthen supervision activities of Bangladesh Bank.

Modernisation of Payment System

Bangladesh Bank has been working to implement a secured and efficient modern National Payment and Settlement System in the country consistent with international standards. Current updates on the activities of Payment Systems are as follows:

- Bangladesh Automated Clearing House (BACH) with its two wings Bangladesh Automated Cheque Processing System (BACPS) and Bangladesh Electronic Funds Transfer Network (BEFTN) have been implemented successfully under RPP (Remittance and Payments Partnership) Project.
- Among these systems- BACPS started its "Live Operation" on 7 October 2010 while BEFTN on 28 February 2011. Both the systems are fully operational.
- Sylhet, Chittagong, Rajshahi, Barisal and Khulna regions have already joined BACPS. Other clearing regions (Bogra and Rangpur) will be linked shortly.

- At present, approximately 85,000 regular and 3000 high value cheques and other instruments are cleared through BACPS. On an average, 85 percent of the clearing instruments are cleared through the clearing house.
- Aiming at financial inclusion, Bangladesh Bank has approved some Mobile Financial Services, such as- Inward foreign remittance disbursement, Cash in/out using m-wallet account through agents/ Bank branches/ ATM's/ Mobile Operator's outlet.
- Guidelines for Mobile Financial Services (MFS), 2011 has been drafted and has been sent to the stakeholders for their opinions.
- To reap the benefits of already implemented modern payment systems, all scheduled commercial banks have been instructed to install Core Banking Solution (CBS) and to establish inter-branch connectivity network.
- In order to start M-Commerce in Bangladesh, mobile network operators have been given permission to sell railway tickets and tickets of cricket matches organized by the Bangladesh Cricket Board (BCB) using mobile technology.
- Decision has been taken for starting e-Commerce activities like online payment of utility bills; online funds transfer between clients of the banks, credit card based internet payment in local currency, etc. in the country.
- Steps have been taken to establish National Payment Switch (NPS) in order to facilitate interbank electronic payments originating from different delivery channels e.g. Automated Teller Machines (ATM), Point of Sales (POS), Internet, Mobile Applications, etc.

Reforms in State Owned Commercial Banks

During FY2010-11, the overall progress of four state-owned commercial banks-*SCBs (Sonali Bank Ltd., Janata Bank Ltd., Agrani Bank Ltd. and Rupali Bank Ltd.)* was monitored and reviewed under the MOU (Memorandum of Understanding) signed by the respective banks at the beginning of the year 2010. Key financial indicators along with agricultural credit, SME and corporate social responsibilities (CSR) have been incorporated in their (SCBs) MOU. Besides, the development of the *Krishi Bank* and the *Rajshahi Krishi Unnayan* Bank have been examined and reviewed under the MOU compiled and signed in FY2010-11.

Money and Financial Market Reforms

In order to reform and build up a banking system of international standards and to strengthen, fortify and reinforce the overall banking system of the country, several initiatives have been taken in recent years. Some of the initiatives of FY2010-11 are discussed below:

- Considering the investment risk of the banks in capital market, the general provision has increased from 1 percent to 2 percent against the unclassified portion of loan disbursed by them for their own/separate subsidiary companies and any other companies/enterprise/individual.
- Decision has been taken that, direct loan facilities disbursed by any bank company to the individual or institution or joint-institution should not be above 15 percent of their total capital.
- Considering the interest of the depositors/investors/customers, it has been decided that, maximum charges have been fixed on saving and monthly savings accounts for rationalising the

charges/commission though banks are free to determine interest on deposits and advances including charges/fees/commission against different services under the financial sector reform programme.

- Bangladesh Bank has started taking necessary corrective and preventive steps against lending discipline lapses in banks leading to loan diversion into unauthorized uses.
- With a view to ensuring compliance surveillance on permitted ceiling of holding of capital market assets by banks with reporting instructions and supervisory arrangements, the general provisioning requirement on bank loans against stock and shares has doubled to two percent from October, 2010.
- In order to prevent speculative stocks fifty percent margin requirement on all consumer financing was made mandatory from December 2010.

Capital Market

Although the capital markets of Bangladesh were buoyant during FY2009-10, but it became volatile from the second half of FY2010-11. The market capitalisation of the Dhaka Stock Exchange (DSE) rose from 39.00 percent of GDP at the end of FY2009-10, which was 21.4 percent of GDP at the end of FY2008-09. During this period, the DSE general index increased by 98.43 percent from 3,010.26 to 6,153.68 indicating keen interests showed by the investors in the capital market. By the end of June 2010, the number of BO (Beneficiary Owner) accounts has increased to 25.64 lakh from 14.15 lakh at the end of June 2009. At the beginning of FY2010-11, the capital market showed buoyant. The DSE general index stood at 8,290.41 in December 2010, up by 34.72 percent compared to June 2010. Similarly, market capitalisation stood at 44.1 percent at that time. However, the overheated capital markets undergone sharp price correction in January 2011 and was in process of recovery and stabilization during the last quarter of FY2010-11. Market capitalisation and general index of DSE stood at 36.24 percent of GDP and 5,093.19 at the end of FY2010-11.

Following the sharp market correction the government commissioned a thorough investigation by a committee into the causes behind over blowing of prices of stocks in the market leading to eventual collapse of price bubble, with a view to bringing about necessary reforms in regulatory authority and market structure based on findings of the investigation. As per the recommendations of the committee, the Securities and Exchange Commission (SEC) has been restructured to control volatility of the stock markets and to regain investors' confidence. Steps have already been taken to identify the problems of book building method and make correction of the system. In order to separate the ownership, management and trading of stock exchange, the process of demutualisation in Dhaka and Chittagong Stock Exchanges has begun. To regain investors' confidence in the capital market by providing adequate liquidity, a Tk. 5,000 crore open-end mutual fund known as Bangladesh Fund, has been established. In addition, there is an initiative to frame Financial Reporting Act to maintain stability in capital market. Side by side, the government has been considering a plan to establish a Financial Reporting Council to oversee the audit and accounting standards and their transparency. It is expected that these initiatives will regain investors' confidence in the capital market.

Market Situation

Dhaka Stock Exchange

The comparative statement of DSE at the end of FY2009-10 and FY2010-11 is shown below:

Indicator	As on 30th June 2010	As on 30th June 2011	% Increase
No of listed securities (including mutual funds, debentures and bonds)	450	490	8.89
Issued capital of all listed securities (Tk in crore)	60726.3	80,683.9	32.86
Market capitalization(Tk in crore)	270074.5	285389.2	5.67
All share price index	5111.6	5093.2	-0.36

Source: Dhaka Stock Exchange

The number of securities (including mutual funds, debentures and government bonds) listed with the DSE increased from 450 as of June 2010 to 490 by June 2011. By the end of June 2011, the issued capital of listed securities stood at Tk. 80,683.9 crore, which is 32.86 percent higher than that of June 2010. Up to June 2011, market capitalisation of securities stood at Tk. 2,85,389.2 crore (36.24 percent of GDP) which is 5.67 percent higher than that of June 2010. General share price index of the DSE stood at 5,093.2 in June 2011, which was 5,111.6 in June 2010. The trading operation in the Dhaka Stock Exchange since 1995 to June 2011 is shown in Table 5.7 below:

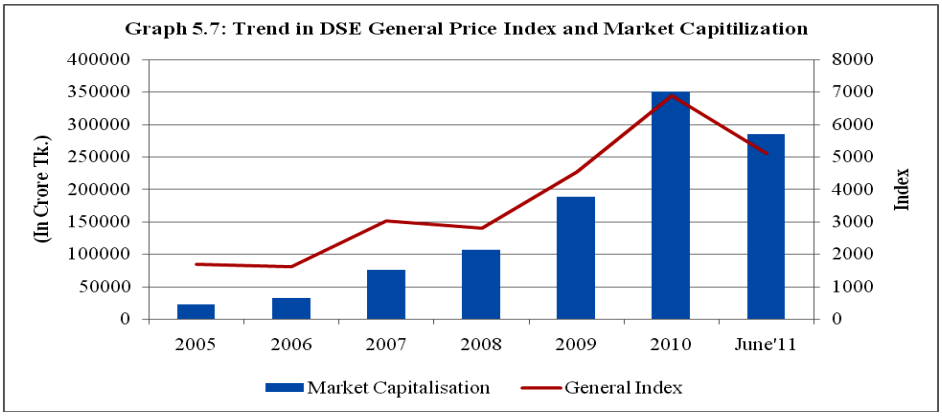
Table 5.7: Trading Operation in the Dhaka Stock Exchange

Calendar Year/ Month-End	No. of Listed Securities	Initial Public Offering (IPO)	Issued Capital (In crore Tk.)	Market Capitalisation (In crore Tk.)	Turnover (In crore Tk.)	Price Index*
2005	286	22	7,031.3	22,829.0	6,483.6	1,275.1
2006	310	12	11,843.7	31,544.6	6,506.9	1,321.4
2007	350	14	21,447.0	74,219.6	32,282.0	2,336.0
2008	412	12	37,215.6	104,379.9	66,796.5	2,309.4
2009	415	18	52,209.9	190,322.8	147,530.1	3,747.5
2010	445	18	66,434.0	350,800.6	400,991.3	6,877.7
June 11	490	6	80683.9	285389.2	325915.3	5093.2

Source: Dhaka Stock Exchange.

**All share price index is calculated on weighted average method from 24 November, 2001.The index base earlier was 100 for DSE.*

**All share price index is calculated on General Share Price Index (excluding 'Z' group) by withdrawing weighted average method from 9 December, 2003.The index base earlier was 100 for DSE. The DSE reintroduced All Share Price Index on March 28, 2005.*



Chittagong Stock Exchange:

The comparative statement of CSE at the end of FY2009-10 and FY2010-11 is shown below:

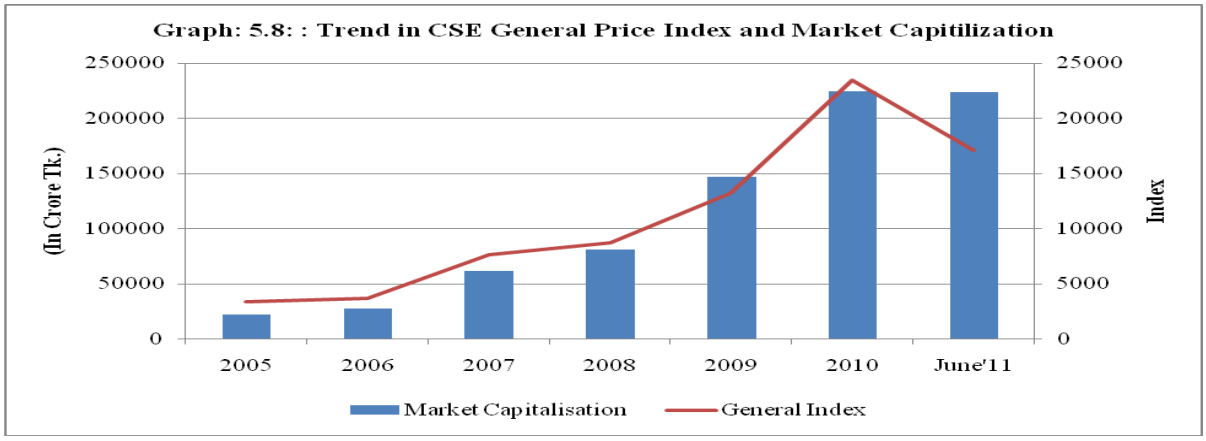
Indicators	As on 30th June 2010	As on 30th June 2011	% Increase
No.of Listed Securities (including mutual fund ,debentures)	232	238	2.59
Total Issued Capital of all Listed Securities.(in crore)	20111.6	30291.7	50.62
Market Capitalization (in crore)	253439.3	223758.5	-11.71
All Share Price Index	18116.1	17059.5	-5.83

Source: Chittagong Stock Exchange.

The number of securities (including mutual funds and debentures) listed with the CSE stood at 232 as of June 2010 which was 245 as of June 2009. By the end of June 2010, the issued capital of listed securities stood at Tk. 20,111.56 crore which is 46.35 percent higher than that of end June 2009. As of June 2010, market capitalisation of securities reached Tk.2,53,439.33 crore (36.6 percent of GDP) which is 163.32 percent higher than that of end June 2009 . General share price index of the CSE reached 18,116.05 as on June 2010, which was 10,477.67 on June 30, 2009. The trading operation in the Chittagong Stock Exchange since 1995 to June 2010 is shown in Table 5.9 below:

Table 5.8: Trading Operation in Chittagong Stock Exchange

Calendar Year/ Month-End	No. of Listed Securities	Initial Public Offering (IPO)	Issued Capital (In crore Tk.)	Market Capitalisation (In crore Tk.)	Turnover (In crore Tk.)	Price Index*
2005	210	16	5,551.9	21,994.3	1,404.3	3,378.7
2006	213	6	6,937.9	27,051.1	1,589.3	3,724.4
2007	227	13	8,917.4	61,258.0	5,259.0	7,657.1
2008	238	12	12,160.3	80,768.4	9,980.4	8,692.8
2009	217	18	15,512.5	147,080.7	16,256.3	13,181.4
2010	232	17	20,677.4	224,176.8	21,711.2	23,449.0
June'11	238	6	30291.7	223758.5	32168.2	17059.5

Source: Chittagong Stock Exchange

**All share price index is calculated on General Share Price Index (excluding 'Z' group) by withdrawing weighted average method from 9 December, 2003.The index base was 1000 for CSE from the year 2000. Previously it was 100.*