GOVERNMENT SECURITIES MARKET IN BANGLADESH: ISSUES AND PROBLEMS

by

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ABSTRACT

A well developed government bond market can help government to finance expenditure and conduct monetary policy efficiently. When a government bond market functioning satisfactory, can significantly increase investors' confidence in the overall bond market. The Government securities market in Bangladesh has not yet developed because of unstructured market and many constraints from supply side and demand-side. Issues of Government securities held mainly from the Central Bank to meet the budget deficit of Government as the part of fulfillment of their statutory obligations, this has crowded out financial resources for the private sector and distorted the overall financial market.

The study shows the present scenario of Government securities market in Bangladesh with the analysis of secondary data collected from various sources. In this study also identify some problems relating to market development and make some recommendation to solve it.

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LIST OF ABBREVIATIONS

BB	Bangladesh Bank
BCR	Bid cover Ratio
BDT	Bangladesh Taka
BGTB	Bangladesh Government Treasury Bonds
CDBL	Central Depository Bangladesh Limited
CDMC	Cash and Debt Management Committee
CRR	Cash Reserve Requirement
DMD	Debt Management Department
DMB	Deposit Money Bank
DSE	Dhaka Stock Exchange
DvP	Delivery versus Payment
FD	Finance Division
FY	Financial Year (FY09 means: 2009-10)
GDP	Gross Domestic Product
GOB	Government of Bangladesh
NBFI	Non-Bank Financial Institution
NSD	National savings Directorate
PD	Primary Dealer
REPO	Re-purchase Agreement
SLR	Statutory Liquidity Requirement
T-Bills	Treasury Bills
T-Bonds	Treasury Bonds

CHAPTER 1

INTRODUCTION

1.1 Background

A well-developed Government securities market facilitates market-based conduct of monetary policy and provides a domestic credit risk-free yield curve serving as a benchmark for prices of other securities. The Government securities market in Bangladesh has not yet developed because of unstructured market and many constraints from supply side and demand-side. Issues of Government securities held mainly from the Central Bank to meet the budget deficit of Government as the part of fulfillment of their statutory obligations. The overall budget deficit in FY10 was at Tk. 310.39 billion (USD4.13billion, excluding grants i.e.4.5 percent of GDP). In FY10, deficit financing from domestic sources was at Tk. 173.25 billion (USD 2.31 billion). Among domestic sources, bank financing was at Tk. 86.61 billion (USD 1.15 billion) and non-bank financing at Tk. 86.64 billion (USD 1.15 bill).

In June 2011, the government debt market represented 37.1% of GDP which is comparable to the other emerging East Asian government bond market namely Malaysia, Singapore and Thailand the size of which is 58.0%, 42% and 52% of their respective GDP (Asian Bonds Online, 2011). Up to June 2010 the total Outstanding amount of Govt. Treasury bill is tk.97726.60 million (USD 1303.02 million) and Treasury Bond is tk.460296.30 million (USD 6137.28 million)

In an active and efficient secondary market, it is possible for investors to buy and sell existing issues on demand, at mutually acceptable prices, and to effect exchanges rapidly with low transaction costs. Such a market requires a clear structure and clearly established rules so that the parties to each transaction know their responsibilities. The efficient operation of a secondary market also needs a system by which buyers and sellers can become aware of each other, and through which the prices of securities can be advertised. Finally, a secondary market needs a way of ensuring that the transfer of securities against money takes place efficiently, at the correct time and between the correct participants, which is the function of a settlement system.

An active and efficient secondary market for government securities adds greatly to the attractiveness of government bonds to investors, at no cost to the government. Investors will be more ready to buy government securities if they know that they can reduce (or increase) their own holdings quickly, inexpensively and at a time of their choosing by trading in the secondary market. Thus the liquidity and efficiency of the market contributes towards the successful sale of primary securities and hence towards achieving financing of government in the long run.

1.2. Objectives of the Study

The principal objective of the study is to identify how to promote secondary market for Government securities in Bangladesh .To accomplish this principal objective, following specific objectives will be covered:

1) to review the Government securities Market status of Bangladesh
2) to highlight the objectives, benefits and impacts of Government securities market
3) to review the present secondary market for government securities
4) to identify the problems those obstruct the development of Secondary Market in Bangladesh
5) to suggest some important policy measures to promote government Securities market in Bangladesh

1.3. Scope and limitations of the study

To achieve the objectives, the study emphasize only on analysis of secondary data as well as some ideas or comments from experts. Issues related to primary market are not included here. The findings of the study would be used for the development of secondary Market in Bangladesh.

1.4. Methodology of the study

For the study both primary and secondary data collected from different sources.

1.4.1. Collection of Primary Data

Assessment of existing literature as well as of discussions with some experts associated with the Government securities market like Primary dealers, banks etc.

1.4.2. Collection of Secondary Data

The secondary data has been collected from different sources-Bangladesh Bank, Ministry of Finance, Central depository Bangladesh Limited (CDBL), published research journals, published books, websites, etc.

1.5. Organization of the Study

The Study will be organized into five sections.

The first section cover introduction, objective of the study, scope and methodology of the study.

The second section reviews the objectives, benefits and impacts of Government securities market.

The third section shows the Status of Bangladesh Government securities Market. The emphasis is placed on the status of secondary market for government securities.

The forth section identifies problems/obstructs relating to the secondary market development of the country.

The last section provides possible solution in promoting government securities market in Bangladesh.

CHAPTER 2

CONCEPTUAL FRAMEWORK AND LITERATURE REVIEW

2.1 Introduction

The Financial sector is a crucial sector of any economy. A vast empirical and analytical literature suggest that in addition to other economic factors, the performance of long term economic growth and welfare of a country are related to its degree of financial sector developments. A bond market provides a basic infrastructure for the development of financial system and the overall economy. A well diversified financial sector is highly dependent on the extreme collaboration of financing from equity market, bond market, and banks. The government bond market forms the backbone of a modern securities market in both developed and developing countries.

A large number of studies such as Aktaruzzaman et. al (2008), and Jahur (2009) have been conducted to diagnose the present context of government bond market in Bangladesh. The above studies argue that it is difficult to further develop bond market in Bangladesh for several reasons: weak governance at the institutional and market levels; high nonperforming assets among the nationalized commercial banks (NCBs); poorly defined and overlapping responsibilities of the Bangladesh Bank, Securities and Exchange Commission, and Ministry of Finance; and the lack of incentives and private initiative to drive market developments. He identifies these problems are the principal obstacles to the development of bond markets in Bangladesh. The government is aware of them, and the World Bank and other organizations have been pushing for solutions. However, change is slow.

Mr. T. Rabi Sankar, Deputy General Manager in the Internal Debt Management Department of Reserve Bank of India, has become a Bond Market Advisor to Bangladesh Bank since April 2005. The road map for the development of secondary market was conducted for Government debt. In this first phase of the project, the objective has been to set a basic reform agenda and identify specific action points. The recommendations were arrived after extensive discussions with various market participants - banks, PDs, insurance companies, on-bank financial institutions. Meetings were also held with officials of the Securities Exchange Commission and Finance Ministry. According to the recommendation of the study Bangladesh Bank reoriented primary issuing process, delivery vs payment system, primary dealer system etc. The study is still continuing.

Many studies pointed out that the bond market in Bangladesh faces manifold challenges from several sources including excessive reliance on bank credit, government debt instruments dominated by primary auction based activity, absence of benchmark yield curve, and lack of investor base.

2.2 What is Government Securities?

2.2.1. Definition

A Government security is a tradable debt instrument issued by the Government .It acknowledges the debt obligation of Government's. It may be short term (treasury bills, maturity of less than one year) or long term (Government bonds, maturity of more than one year).In Bangladesh, Government issues both treasury bills and bonds. Non-tradable fixed interest bearing securities also classified as Government securities.

2.2.2. Types of Government securities

Treasury Bills

Treasury bills are short-term marketable government securities that mature in one year or less from their issue date. They are issued at a discount and sold at a price less than their face (par) value. At maturity, the Government will pay the holder of the Treasury bill the full-face value of the security. Therefore, the interest earned on the Treasury bill is the difference between the purchase price of the security and its face (par) value. (Reserve Bank of India)

Treasury Bonds

Bonds are longer-term marketable securities of the Government. They pay a fixed rate of interest (coupon) semiannually for the life of the security and their face (par) value upon redemption at maturity. The coupon rate of the bond reflects the market interest rate at the time the bond was first issued. Tax exemption is an attractive feature of T.Bond, in most countries, i.e. the income from bond is exempted from tax. (Reserve Bank of India)

2.3. Issuance of Securities

Auction is the main method of issuance of Government securities. The rate of interest (coupon rate) is fixed through market based price discovery process. It may either be yield based or price based.

i) Yield based Auction: It is for a new issuance of Government security. Investors bid in yield and bids are arranged in ascending order. Cut-off yield is at the yield corresponding to the notified amount of the auction. The cut-off yield is taken as the coupon rate for the security.
ii) Price based Auction: Bidders quote in terms of price per 100 of face value of the security. It's called discount rate of securities. After arranging all bids in descending order, the successful bidders are those who have bid at or above the cut-off price

An investor may bid in an auction either of the following categories:

i) Competitive Bidding: Investors bids at a specific price/yield and is allotted securities if the price/ yield quoted is within the cut-off price/yield.

Competitive bids mostly used by institutional investors such as banks, financial institutions. Primary dealers, mutual funds and insurance companies.

ii) Non-Competitive bidding: It's for retail investors who may lack of skill and knowledge to participate in the auction directly. Here bidders are allotted securities in the weighted average price/yield of the auction.

2.3.1. Organization of Securities Market

Securities Market is structured in two different levels.

- Primary Market
- Secondary Market

Primary Market: It's a market for new issued securities. The issuers can sell securities on the market through auction or OTC with the help of financial institutions. This market provides funds to the primary issuer of securities.

Secondary Market: It provides trade of the primary securities. It helps to make securities market more liquid. It allows the investors to buy or sell the securities at calculated YTM.

2.3.2. Participants of Government securities Market

Bond market participants are similar to participants in most financial markets and are essentially either buyers (debt issuer) of funds or sellers (institution) of funds and often both. Participants include:

- Governments-Issuers
- Central Bank
- Institutional investor's i.e. commercial banks, mutual fund, insurance company, pension funds.
- Traders
- Individuals

Because of the specificity of individual bond issues, and the lack of liquidity in many smaller issues, the majority of outstanding bonds are held by institutions like pension funds, banks and mutual funds.

2.4 Impact of Government securities Market:

Government Securities market provides a basic infrastructure for the development of the financial system. This market can play a critical role in stabilizing government finances, conducting monetary policy and developing a country's financial capital markets. It considered as the least risky instrument compared to other financial market instruments. In the paper-about overview of bond market in Asia-published by Kim and Seleik (2001), senior economist of ADB, indicated some important functions of Government securities.

First, a government may use a treasury securities program to finance a portion of fiscal needs to cover budget deficit or fund specific national development projects.

Second, the central bank may use short term treasury bills to conduct open market operations to control money supply and interest rates.

Third, the most significance role of a treasury securities market is to increase investor confidence in overall bond and financial markets and provide a benchmark yield curve. This curve serves as the basic reference for pricing other types of securities in the market including corporate bond.

Other advantages include:

- Government securities offer the maximum safety as they carry the commitment for payment of interest and repayment of principal.
- It is scrip less form, thus obviating the need for safekeeping.
- Government securities can suit with durations of bank liabilities as it has a wide range of maturities from 91 days to 20/30 years.
- It can meet cash requirements through secondary market.
- It can also be used as collateral to borrow funds from central banks.
- Banks, financial institutions also required to hold government securities as Statutory Liquidity Ratio (SLR) requirement.

2.4.1 Factors required for developing Government securities Market:

- Regular, predictable and transparent issuance of Government bond.
- Adequate infrastructure i.e. legal and operational
- Wide investor base
- Active market participants
- Liquid secondary market.

CHAPTER 3

CURRENT STATUS OF THE GOVERNMENT SECURITIES MARKET

3.1 Introduction

Government's earn revenue from different sources and with this revenue meet its expenditure. In a budget formulation when expenditures exceed revenues, it is a deficit. Government meets this deficit from different sources like internal and external. Domestic sources that are borrowing from banking sector through issuance of government securities play a vital role in deficit finance. Government finances its deficit through the sale of debt obligations.

In every fiscal year Bangladesh has a huge budget deficit .Government has to deficit finance from both external and internal sector. Recently, Government deficit has been financed from internal sector, especially from banking system mostly. The financing of budget deficit of the Government of Bangladesh takes place through the issuance of (i) Special bonds, (ii) Bangladesh Government Treasury Bonds (BGTBs), and (iii) savings instruments (NSD).

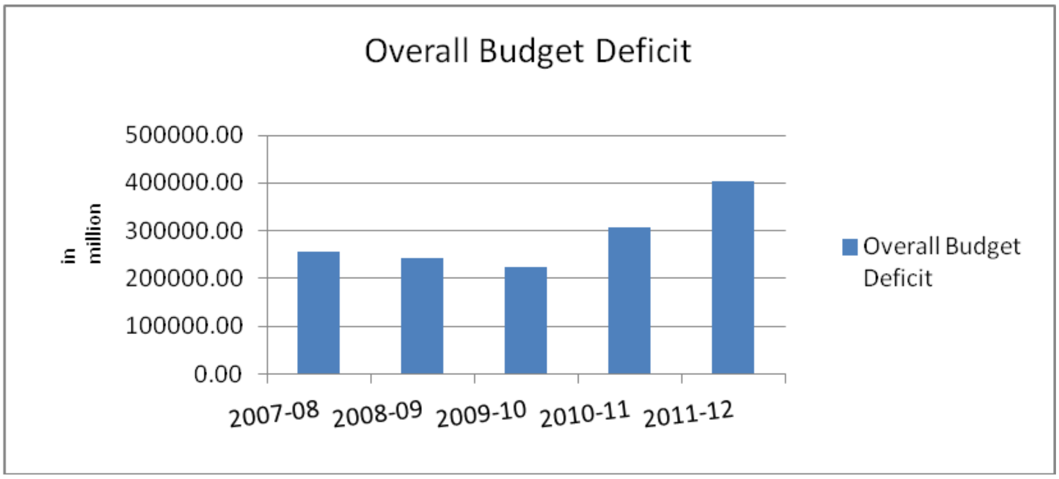
Table-3.1: Deficit Budget & Financing

(Tk in millions)

Description	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Overall Budget Deficit	255962.00	242360.00	224819.00	306005.00	402658.00
in % of GDP	4.80	4.86	3.24	3.89	4.56
Deficit Financing					
Foreign Borrowing(Net)	131442.00	58330.00	60356.00	57836.00	61223.00
Domestic Borrowing	124521.00	134010.00	158192.00	248166.00	272078.00
I) Borrowing from Banking system(Net)	103980.00	99010.00	-20925.00	156800.00	189570.00
II) Non Bank Borrowing(Net)	20020.00	35000.00	179117.00	7996.00	82508.00
Total Financing	255963.00	192340.00	218548.00	306002.00	333301.00
In Percent of GDP	4.80	2.80	4.70	3.95	4.26

Source: MOF, Bangladesh GOVT

Figure3.1: Overall Budget Deficit



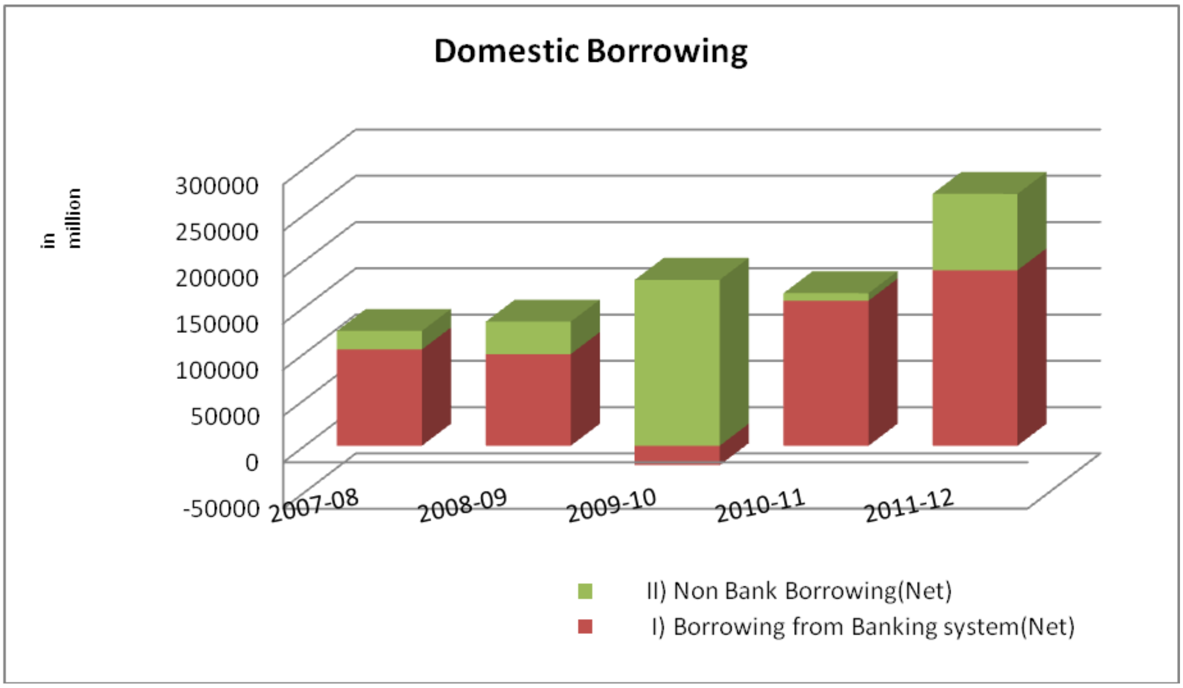
To meet the budget deficit Government take loan from foreign as well as domestic sources. Domestic sources include banking system and Non-banking system.

Table 3.2 Government Domestic borrowing

(Tk in millions)

Description	2007-08	2008-09	2009-10	2010-11	2011-12
I) Borrowing from Banking system(Net)	103980	99010	-20925	156800	189570
II) Non Bank Borrowing(Net)	20020	35000	179117	7996	82508

Figure 3.2 Domestic Borrowing trend



3.2 Mandate of Bangladesh Bank

Bangladesh Bank Order-1972, article 20 and Treasury rules-1998 empowers Bangladesh Bank for the issue and management of Government securities. As per the above mentioned laws & regulations, the Debt Management Department acts as the Debt Manager of the Government in consultation with the Ministry of Finance of the Government of Bangladesh.

3.2.1. Role of BB as debt manager of Government

The financing of budget deficit of the Government of Bangladesh used to takes place through the issuance of ad hoc Treasury Bills whenever the Governments cash balances turn negative, after a nominal Ways and Means advances is used up. Bangladesh Bank would subsequently and partially offloads these ad hoc T-Bills through the issuance of Treasury Bills and bonds to the market, leaving the Governments cash position unaffected. Ad hoc Treasury Bills were thus accessed both to meet cash mismatches as well as for financing the budget deficit. Issuance of Ad hoc Treasury Bills is now discontinued.

The accumulation of domestic debt of GoB takes place from three main sources: (i) Bangladesh Bank (BB), (ii) deposit money banks (DMBs), and (iii) non-banks (including NSD). The Bangladesh Bank and DMBs purchase Government securities/treasury bills to finance the budget deficit. When BB purchases Government treasury bills to finance the deficit, it involves in money creation.

3.3 Instruments Used by BB

a. Treasury Bills

Treasury bill or T-bill is a short-term debt instrument with a maximum maturity of one year. Treasury bills issued at discount, here the amount of interest is the difference between issue/purchase price and the price at maturity. Treasury bills are free from default risk as it is guaranteed by the government. T-Bills are popular as one of the few money market instruments. It is also affordable by the individual investors.

Dominant Buyers of T-Bills are mostly Primary Dealers, other commercial banks and non-bank financial institutions. Insurance companies, provident funds, other funds of corporate entities and individuals can also buy T-Bills in auction where they need to participate through Primary Dealers, other banks and financial institutions.

Basically, investors or institutions invest in T-bills due to:

1) Regularity requirement of Statutory Liquidity Reserve (SLR),
2) Provide adequate liquidity
3) to earn return or yields ,
4) to invest huge idle cash in banks, and
5) to avoid risky investments.

T-bills are sold at a discount to their face value at maturity. The discount is determined by the interest rate. As example a 364 days T-bill with a 5% discount rate, the primary investor pays 95% of the face value as Tk. 950, and then receives Tk. 1,000 after 364 days.

T-bills are indirect tools for open market operations of the central bank of a country. Three types of T-bills are available in Bangladesh: 28-day, 91-day, 182-day, and 364-day.

Types of Treasury Bills

- 91 Days
- 182 Days
- 364 Days

3.3.1 Main Features/Characteristics

Issue

- Weekly (usually on Sunday) auctions of Treasury Bills are held following a pre-announced auction calendar with a specified amount.
- A PD is required to underwrite a minimum specified percentage of the total amount of T. Bills and T. Bonds to be auctioned in each week.
- A committee comprising high officials of BB and the ministry of finance constitutes the auction committee.
- T-Bills are issued on a discount basis at competitive auction. Bidders quote their prices for 100 taka T-Bill. An arrangement for the submission of non-competitive bids (known as “WAR” meaning Weighted Average Rate which is determined on the basis of other accepted yields and their corresponding amount) especially by

the insurance companies, corporate provident/other funds and by the individuals are also in place. The auction Committee determines the cut-off price/yield among the offered prices arranged in descending order.

- There is an option of devolvement on Primary Dealers (PDs) in cases where the auction committee finds that the accepted amount is less than the notified amount. On the basis of their underwriting obligation the fewer amounts is devolved on the PDs.
- There is another option of devolvement on BB where the auction committee considers all bids are out of range and devolves the entire notified amount on BB at immediate previous cut-off price/yield.
- Operational activities are conducted jointly by Monetary Policy Department (MPD) and Motijheel office of Bangladesh bank.
- The Central depository Bangladesh limited (CDBL) is responsible for electronic transfer of T-Bills issued.

Maturity

On maturity the holders of T-Bills claim the redemption value along with the discount/interest from the Motijheel office of Bangladesh bank. After scrutiny, Motijheeel office debits the corresponding government A/c(s) and credits the principal and discount to the holders A/c.

b. Treasury Bonds

Treasury bond is a long-term debt issued by a government with a specified maturity period of two years and more. Treasury bonds are sold at par value and holders are given semi-annual coupon during the lifetime of the bond. Treasury bonds also default risk free due to guarantee by the government. 'BGTB' means a Bangladesh Government Treasury Bond of 5, 10, 15 and 20 years maturity, issued in accordance with Bangladesh Government Treasury Bond Rules, 2007. The process of Re-issuance/Re-opening of the existing treasury bonds (BGTBs) has not been started yet.

Dominant Buyers of BGTBs are mostly commercial banks and financial Institutions. Insurance companies, provident funds, other funds of corporate entities and individuals can also buy T-Bills in auction where they need to participate through Primary Dealers, other banks and financial institutions.

Types of Treasury Bonds

- 5 years BGTB
- 10 years BGTB
- 15 years BGTB
- 20 years BGTB

3.3.2 Main Features

Issue

- BGTBs are issued in almost in the same procedure as T-bills. Weekly (usually on Tuesday) auction of BGTB of a particular tenor is held following a pre-announced auction calendar with the specific amount. Here instead of price, bidders quote their expected yields.
- Bangladesh Bank has been issuing BGTBs at par (in face value) through a Yield based Multiple Price auction.

- Like T-Bill, the same devolvement process is followed for BGTBs.

Maturity

On maturity the holders of BGTBs claim the redemption value along with the last coupon from the Motijheel office of Bangladesh bank. After scrutiny, Motijheel office debits the corresponding government A/c(s) and credits the principal and interest to the holders A/c.

3.4 Primary Issuance of government securities

In primary market Marketable Treasury securities are issued through pre announced auctions schedule. The process is done by the Bangladesh Bank, which act as a executor of the auctions. BB conducts weekly auction for Treasury Bills, Treasury Bonds and Bangladesh Bank Bill when necessary.

In Bangladesh, Dutch auction Model is followed. Two types of bids may be submitted at the auction:

(a) Competitive bids

Competitive bids specify both the quantity of the security sought and a yield. If the specified yield is within the range accepted at the auction, the bidder is awarded the entire quantity sought (unless the specified yield is the highest rate accepted, in which case the bidder is awarded a prorated portion of the bid.)

(b) Non-competitive bids

Non-competitive bids specify only the quantity of the security sought.

Here eligible investors apply for a certain amount of securities without offering specified price or yield. Such kind of bidders is allotted securities at the weighted average yield /price of the auction.

3.4.1 Operational Procedure

1. In scheduled date and time, along with Primary Dealers other interested parties Drop their bids at Motijheel office of Bangladesh Bank.
2. Representative from DMD go over there and arrange the bids in an excel sheet. Examples of that sheet and subsequent results are given in appendix-I & II for BGTBs and III & IV for T-Bills.
3. The General manger of DMD represents the draft result to the auction committee.
4. The auction committee determines the acceptable amount and the cut-off rate/yields.
5. On the basis of the in-built functions of “Yield” and “Price” incorporated in the Microsoft Excel, the concerned officer(s) prepare the final result of T-bill and T.Bonds respectively.
6. Representatives from different banks collect the hard copy of result from DMD in the same day.
7. On the following day, Motijheel office debits current A/c of the successful bidders and credits the same to the respective government A/c.

3.4.2 Instruments wise holding of Government securities

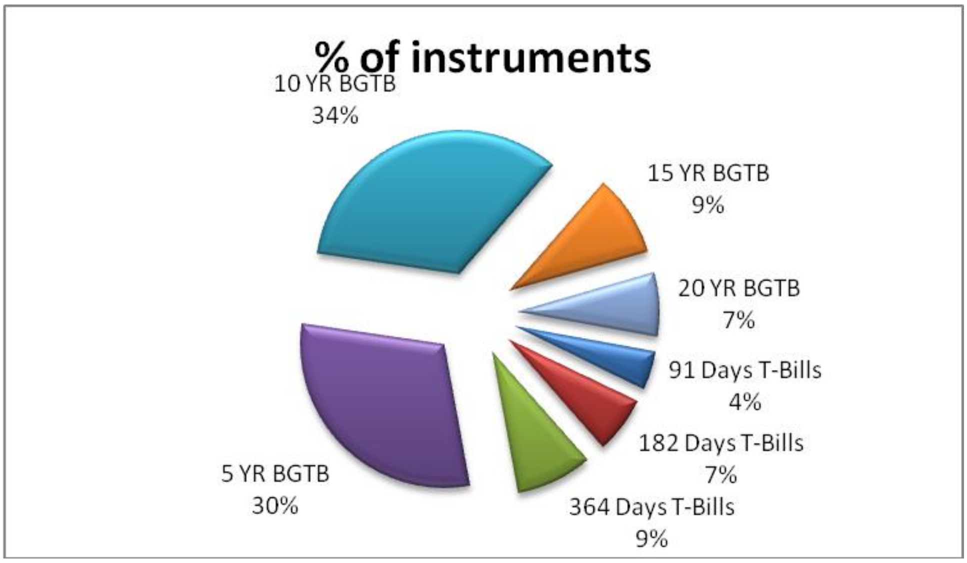
Until June 2011 the outstanding amount of Government securities is BDT 646364.80 million, where long term bond consists 80.66 % of total outstanding amount (Table 3.3) and rest 19.34% short term treasury bills.

Table: 3.3 Summary of Government securities (as on 30/06/2011)

(Tk in millions)

Instruments	30/6/2011	As percentage
91 Days T-Bills	28000.00	4.33
182 Days T-Bills	41500.00	6.42
364 Days T-Bills	55500.00	8.59
5 YR BGTB	195209.00	30.20
10 YR BGTB	219905.80	34.02
15 YR BGTB	59800.00	9.25
20 YR BGTB	46450.00	7.19
Total	646364.80	100.00

Figure 3.3 instrument wise Govt. securities



3.4.3 Holder of Government securities

Commercial bank is the captive investor of Government securities. Due to regularity purpose bank has to retain securities .Bank can divide the holding of securities into two ways i.e. HFT and HTM where HFT securities need weekly marking to mark and HTM for held to maturity. Total securities required for SLR also keep in two ways i.e. 25% HFT and 75% HTM. Table 3.3 shows that more than 50 % of government securities hold by commercial banks.

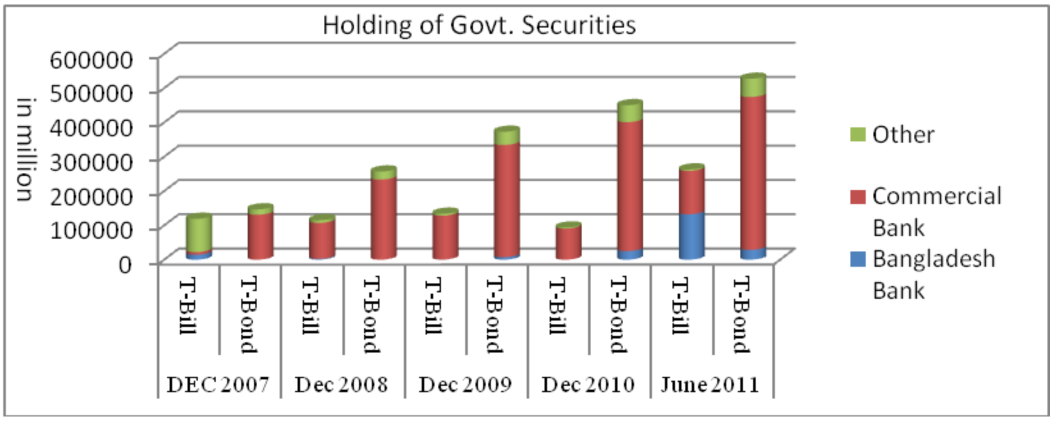
Table: 3.4 Holder of Government securities

(Tk.in million)

Holder	DEC 2007		Dec 2008		Dec 2009		Dec 2010		Dec 2011	
	T-Bill	T Bond	T-Bill	T Bond	T-Bill	T Bond	T Bill	T Bond	T-Bill	T Bond
Bangladesh Bank	14432	0	2319	0	245	7274	0	24932	132110	28519
DMB	7668	131136	104798	233562	1280580	326962	90836	376004	126843	445640
Other	97001	15518	7936	23408	5670	38597	2863	49167	4082.1	53148
Total	119101	146655	115053	256971	133973	372834	93700	450103	263036	527308

Source: Bangladesh Bank

Figure 3.4 Holders of Govt. Securities



3.5. Primary Dealers system

3.5.1. History

Bangladesh Bank selected eight banks and one non-bank financial institution as primary dealers (PDs) to handle secondary transactions of T-bills and other government bonds in 2003. The eight banks are Sonali Bank, Janata Bank, Agrani Bank, Prime Bank Ltd, Uttara Bank Ltd, South-East Bank Ltd, Jamuna Bank Ltd, and NCCBL, and the only NBFI is International Leasing and Financial Services Ltd. However, BB activated the PD system from July, 2007. Bangladesh Bank granted license to six more Banks and Financial Institutions to act as Primary dealers in December, 2009. With their addition the total number of PDs now stands at fifteen.

3.5.2. Role of Primary Dealers in money market

Primary Dealers are appointed to act as market maker of government securities. They act as underwriters of government securities at primary auction. This helps the government to raise money from the market at a cost it seems reasonable. Whenever government/BB finds the interest rates for government securities unacceptable at primary auctions, it can collect the required amount through devolvement on PDs. This reduces the borrowing cost for government. The main objective of appointing PDs is to support the primary issuance process of Government securities and activating the secondary market. However their other objectives are:

- To support the primary issuance process of Government securities by developing underwriting capabilities and promote price discovery process in auctions for government securities;
- To enhance liquidity and depth in the securities market by facilitating price discovery and turnover, encouraging voluntary holding of government securities amongst a wide investor base;
- To facilitate efficient liquidity management, and open market operations of monetary policy management.

PDs are required to underwrite government securities at primary auction at the following rates.

Table-3.5 Underwriting Obligations of Primary Dealers

Sl. No	**Primary Dealer**	**Rate of Underwriting Obligations (%)**
1	Sonali Bank Limited	9.00
2	Janata Bank Limited	9.00
3	Agrani Bank Limited	9.00
4	Prime Bank Limited	8.00
5	SouthEast Bank Limited	8.00
6	Uttara Bank Limited	8.00
7	NCC Bank Limited	8.00
8	Jamuna Bank Limited	7.00
9	International Leasing and Financial Services limited	1.00
10	Mutual Trust Bank Limited	7.00
11	Mercentile Bank Limited	8.00
12	Industrial Promotion and Development Company	1.00
13	Lanka Bangla Finance	1.00
14	AB Bank Limited	8.00
15	National Bank Limited	8.00
Total		**100**

Source: Bangladesh Bank

3.5.3. Incentives for PD's

i) A PD shall have the credential of a sub-depository of Treasury bills and Government securities, for custodial services to its customers.
ii) Between bids at the same yield/price for an issue in a primary auction, the bid of a PD will rank higher in priority for acceptance than those of other bidders.
iii) A PD shall be eligible for liquidity support from the BB for its operations, collateralized by Treasury bills and Government securities from its own positions, through the repo mechanism or such other arrangements as the BB may prescribe from time to time. At Now it is for 2 months.
iv) A PD shall be entitled to underwriting commission on the issues of dated government securities underwritten by it.
v) Elect best three PD's in every quarter according to the success ratio & Secondary turnover.
vi) Any investors, financial institutions, banks cannot eligible to participate in primary auction directly but through PDs.

3.5.4 Auction – Performance

The performance of bill auctions is detailed in Table 3.6 below. The noticeable feature is the large devolvement (41% in 2009-10 and 33% in 2010-11).

Table 3.6 – Auction Summary – Treasury Bills (Amt in BDT billion)

Instrument	Notified Amount	Bid Amt	Accepted Amt	Bid Cover Ratio*	Devolvement on				Cancelled
					PDs		BB		
2009-10									
91-day	95.00	177.39	40.94	1.87	49.56	52%	2.50	3%	2.00
182-day	61.50	111.74	37.28	1.82	16.98	28%	0.00	0%	7.24
364-day	64.50	128.60	39.94	1.99	24.56	38%	0.00	0%	0.00
Sum	221.00	417.73	118.16	1.89	91.10	41%	2.50	1%	9.24
2010-11 (Up to March 2011)									
91-day	53.00	54.53	29.99	1.02	17.16	32%	1.85	3%	4.00
182-day	47.70	55.61	33.94	1.17	12.71	27%	1.05	2%	0.00
364-day	42.50	47.04	23.48	1.11	17.83	42%	1.18	3%	0.00
Sum	143.20	157.18	87.41	1.10	47.7	33%	4.08	3%	4.00

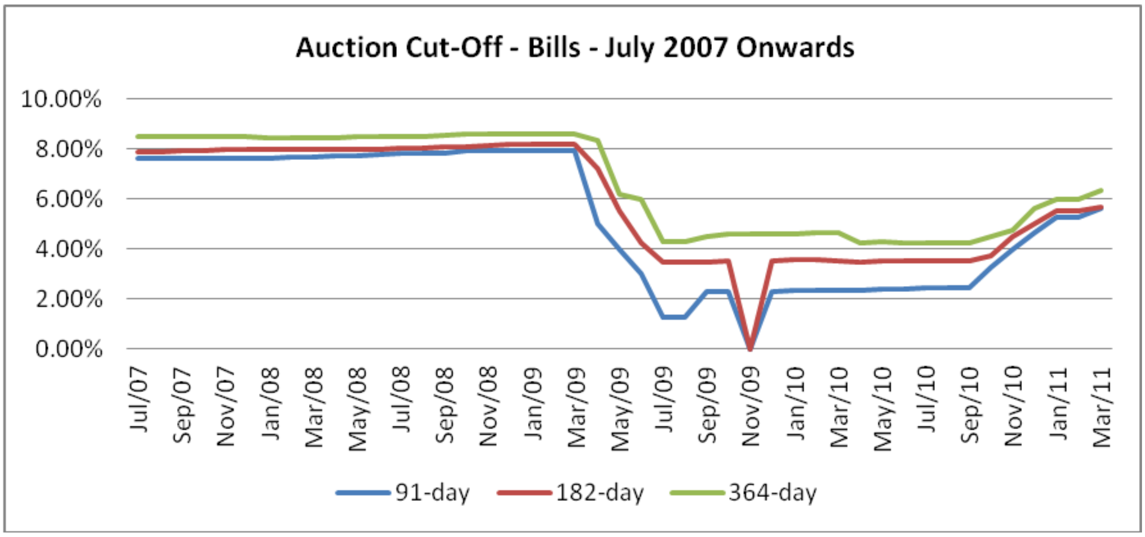
* Bid Cover Ratio = Amount Bid / Notified Amount
Source: Based on Data Provided by DMD, Bangladesh Bank

Table 3.7 – Bill Devolvement – 2010-11			
	91-Day	182-Day	364-Day
Jul-10	39%	30%	69%
Aug-10	0%	0%	0%
Sep-10	0%	0%	0%
Oct-10	88%	77%	79%
Nov-10	64%	51%	64%
Dec-10	30%	29%	37%
Jan-11	5%	15%	6%
Feb-11	1%	0%	4%
Mar-11	0%	4%	0%

Table 3.8 – Bill Cut-Off Yields – 2010-11			
	91-Day	182-Day	364-Day
Jul-10	2.44%	3.55%	4.26%
Aug-10	2.44%	3.55%	4.26%
Sep-10	2.44%	3.55%	4.26%
Oct-10	3.25%	3.75%	4.51%
Nov-10	3.98%	4.50%	4.75%
Dec-10	4.67%	5.00%	5.62%
Jan-11	5.25%	5.50%	6.00%
Feb-11	5.25%	5.50%	6.00%
Mar-11	5.60%	5.66%	6.35%

A look at the cut-off yields in the auctions (Table 3.6 and Figure 3.5) confirms the shift by authorities to adhere to market demand. The cut-off yields at auctions have gone up sharply across the instruments. This is a welcome change in the attitude of the authorities towards market determination of yields. BB and Government may continue this practice of avoiding devolvement and thus improve price discovery in auctions.

Figure 3.5 - Auction Cut-Off - Bills



With respect to bonds as well a similar change in strategy from regular devolvement to market clearing is visible. Although devolvement on PDs is still high at 41% in the current year up to March (Table 3.9), it has come down noticeably in recent months (Table 3.10).

Table 3.9 – Auction Summary – BGTBs (Amt in BDT billion)

Instrument	Notified Amount	Bid Amt	Accepted Amt	Bid Cover Ratio*	Devolvement on				Cancelled
					PDs		BB		
2009-10									
5-Year	29.00	42.14	12.62	1.45	11.88	41%	4.50	16%	0.00
10-Year	31.50	66.88	15.56	2.12	8.94	28%	0.00	0%	7.00
15-Year	10.00	25.65	5.08	2.57	3.42	34%	0.00	0%	1.50
20-Year	9.00	20.24	2.95	2.25	2.31	26%	0.00	0%	3.75
Sum	79.50	154.91	36.21	1.95	26.55	33%	4.50	6%	12.25
2010-11 (up to March 2011)									
5-Year	37.50	39.88	21.64	1.06	15.86	42%	0.00	0%	0.00
10-Year	37.50	40.42	21.55	1.08	15.95	43%	0.00	0%	0.00
15-Year	14.70	15.24	7.57	1.04	5.13	35%	0.00	0%	2.00
20-Year	12.10	13.78	7.26	1.14	4.84	40%	0.00	0%	0.00
Sum	101.80	109.31	58.02	1.07	41.78	41%	0.00	0%	2.00

* Bid Cover Ratio = Amount Bid / Notified Amount
Source: Based on Data Provided by DMD, Bangladesh Bank

Table 3.10 – Devolvement on PDs – 2010-11

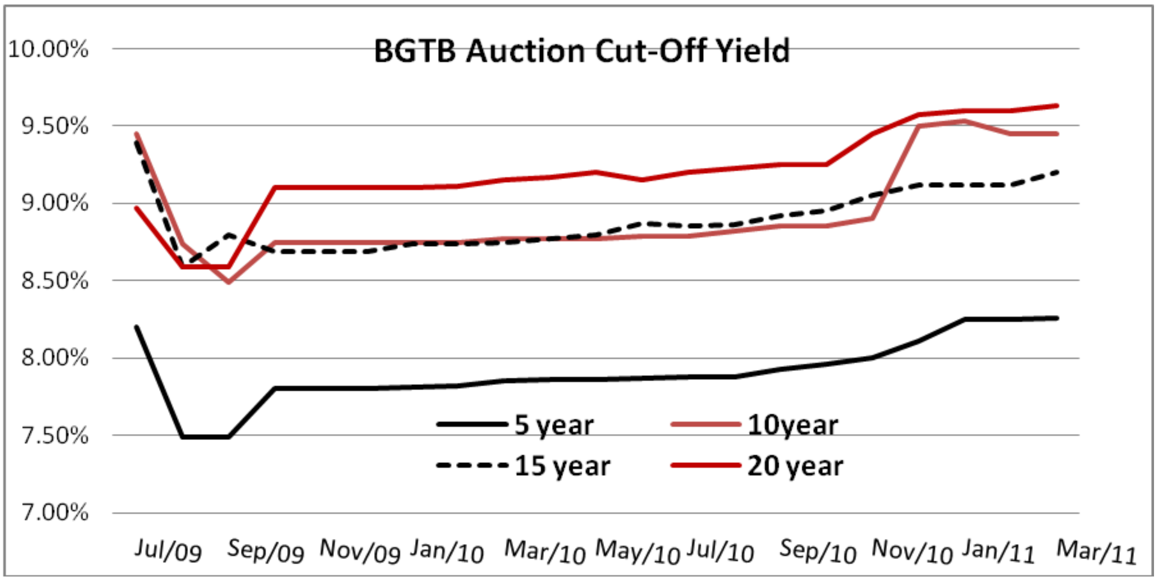
	5 year	10 year	15 year	20 year
Jul-10	92%	74%	55%	91%
Aug-10	97%	83%	99%	51%
Sep-10	70%	83%	59%	64%
Oct-10	85%	96%	65%	84%
Nov-10	64%	51%	67%	64%
Dec-10	11%	30%	9%	32%
Jan-11	9%	1%	0%	1%
Feb-11	0%	9%	1%	0%
Mar-11	0%	0%	0%	0%

Table 3.11 – Bond Cut-Off Yields – 2010-11

	5 year	10year	15 year	20 year
Jul-10	7.88%	8.79%	8.85%	9.20%
Aug-10	7.88%	8.82%	8.86%	9.23%
Sep-10	7.93%	8.85%	8.92%	9.25%
Oct-10	7.96%	8.85%	8.95%	9.25%
Nov-10	8.00%	8.90%	9.05%	9.45%
Dec-10	8.11%	9.50%	9.12%	9.57%
Jan-11	8.25%	9.53%	9.12%	9.60%
Feb-11	8.25%	9.45%	9.12%	9.60%
Mar-11	8.26%	9.45%	9.20%	9.63%

The cut-off yields in auctions bears out the authorities' tendency to go for market clearing levels (Table 3.11), particularly since December 2010. A discussion with the PDs gave the impression that they are desisting from bidding higher yield levels to avoid revaluation losses on their stock. This will keep their bidding behavior more aggressive than warranted. The authorities may continue with the practice in recent months of minimizing devolvement.

Figure 3.6 - Auction Cut-Off - Bills



3.5.5. Cash and Debt Management Committee

It's a high powered committee to manage and formulate Government borrowing policy headed by finance secretary. Others member includes Deputy Governor and executive Director and concern General manager of BB.

3.5.6 Strategy for Domestic Market Borrowing

Strategies for FY 2012

- Reduction of borrowing cost through borrowing at a time when there is a requirement of cash.
- Gradual shift towards long term borrowing;

Table 3.12 Ratio of Bank Borrowing

Term	Share(FY 09)	Share(FY 10)	Share(FY 11)	Share(FY 12)
T-Bonds	65%	75%	80%	84%
T-Bills	35%	25%	20%	16%

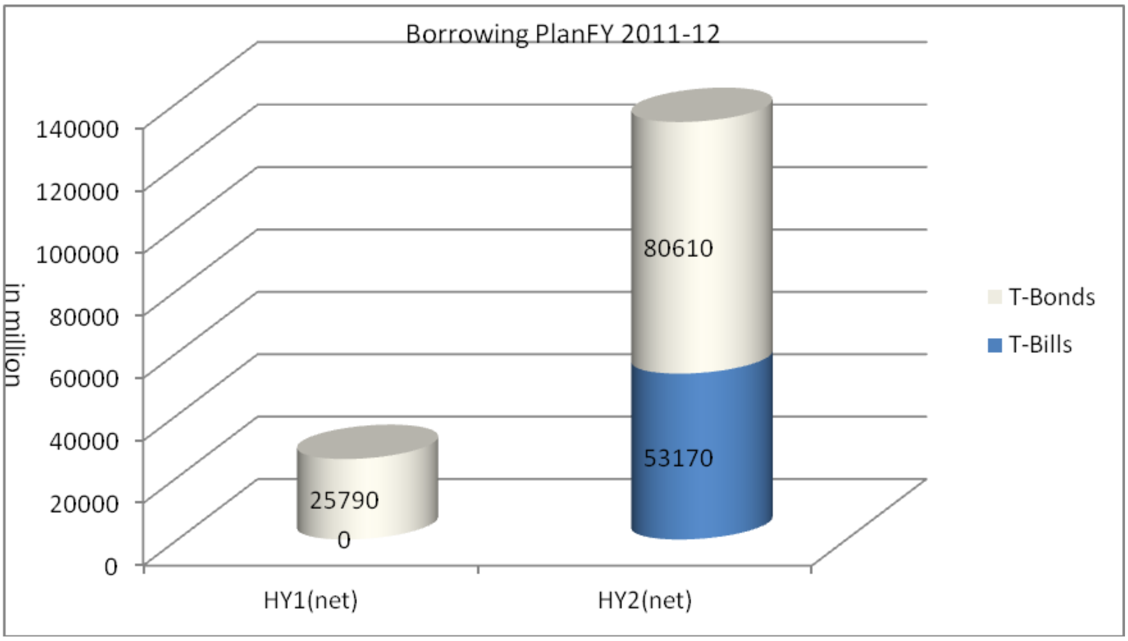
- Short term borrowing(T-bill) depending on the government cash position
- Long term borrowing (T.Bonds) based on month wise cash balance position
- Auction Calendar will be prepared on a Half Yearly basis.

Table -3.13 Borrowing Plan Summary FY 2011-12

(in million taka)

	T-Bills	T-Bonds	Total
Net Borrowing(Banking Source)(HY1+HY2)	25790	133780	159570
HY1(net)	0	53170	53190(34%)
HY2(net)	25790	80610	106400(66%)

Figure3.7: Borrowing Plan for FY 2011-12



3.6. Status of Secondary Market of government securities in Bangladesh

There was no secondary market for T-bills transaction in Bangladesh up to 2003. Government decided to introduce the secondary T-bill market in 2003 to broadening the government securities market. Citigroup's subsidiary Citibank, N.A. and local Prime Bank Limited took part in the first secondary transaction of T-bills in Bangladesh. Citibank, N.A. sold a T-bill of 2 years maturity bearing Taka 3 crore of face value to Prime bank. Bangladesh Bank took necessary steps to assist this transaction. This was regarded the first secondary T-bill transaction in the country. Secondary market for government securities is still not much active. Bangladesh Bank, from time to time, conducts secondary trading and also buys back the government securities as per instructions of the government.

Developing liquidity in the secondary market is a gradual process. It takes time for trading behavior to develop among institutions. What can of course be done is to create conditions that are conducive to developing a safe and efficient market place. Trading volume in Government securities in Bangladesh is currently negligible.

3.6.1 Market Structure

Participants: Banks and financial institutions who have a current account with Bangladesh Bank can directly participate in secondary trading. Other investor can come through these Institutions.

Settlement System for Transactions in Government Securities

BB introduces Delivery vs. Payment arrangement for settlement of Government securities transactions. The existing Delivery vs. Payment settlement arrangement is as follows.

<u>**Outright sale and purchase**</u>

Step 1 – Fill the Form

In case of outright sale buyer and seller both fill up the Securities Transfer Confirmation Form and Securities Purchase Confirmation Form within 2 PM on that working day and send it to BB.

Step 2 – Securities Transfer to BB

In the meantime the seller transfer the securities on Bangladesh Bank’s Clearing Account Interbank Outright Sales on CDBL system .Within a time buyer deposit necessary amount of money in its accounts with BB.

Step 3 - Funds Transfer

At BB, the Securities Department transfer the securities to Buyer B/O account and sends the voucher to DAB for transfer of funds from the Buyer’s Account to the Seller’s Account.

Above process also applied for BB with any financial institutions, Client between two different banks. In case of bank transactions or two clients of same bank don’t need to transfer securities BB clearing accounts.

Trading conventions

(i) All trades settle on the date of trade itself, that is, on T+0 basis.
(ii) Trades settle on a gross trade by trade basis.

From the month of 30th October 2011 Bangladesh bank introduce its own depository system through market infrastructure module. Now all the transactions, primary auction, outright sale /buy will be followed by this online window.
In Bangladesh Government securities is not traded by stock exchange. Now it is traded through depository window as well as over the counter.

3.6.2. Securities issue and outstanding

In Bangladesh the outstanding amount of Govt. securities increases with the proportion of issues: Table shows the amount in million taka.

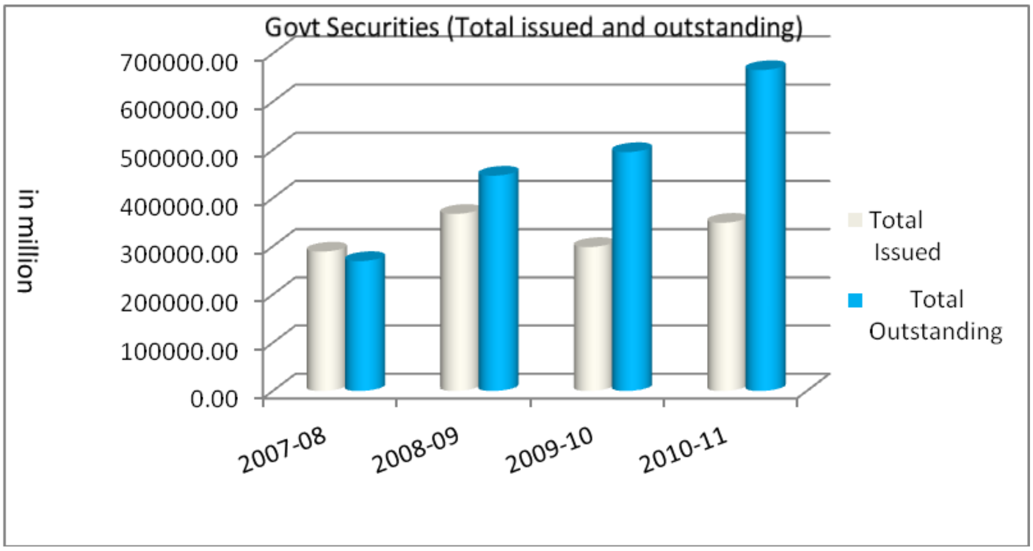
Table: 3.14 Government securities (Total Issued and Outstanding)

(Tk.in millions)

Year	Total Issued	Total Outstanding
2007-08	289134.00	269465.10
2008-09	367350.00	446634.10
2009-10	298600.00	495564.10
2010-11	348960.00	665694.10

Source: DMD, Bangladesh Bank

Figure: 3.8 Government securities (Total issued and outstanding)



3.6.3 Secondary trading

Secondary trading of Government securities in Bangladesh is still thin and negligible. Active trading of T-bills started from 2003 and T-bond from 2006.As the demand of securities still not created so trading mostly depends on activeness of PDs. The transactions in the market which was BDT 153557.40 million during 2007-08 has improved during the 2008-09 year to BDT 254173.40 million. But again it falls in 2010-11 as BDT 166021.85 mn. However, in absolute terms market activity continues to be thin. Table 3.15 shows the total trading of government securities in terms of total outstanding and issues.

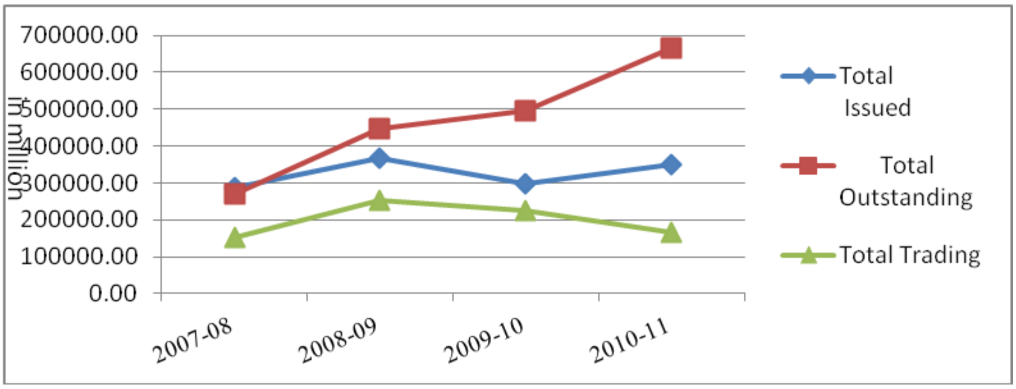
Table: 3.15 Total issued, Outstanding and trading amount

(BDT in million)

Year	Total Issued	Total Outstanding	Total Trading	% of Outstanding
2007-08	289134.00	269465.10	153,557.40	56.99
2008-09	367350.00	446634.10	254,173.40	56.91
2009-10	298600.00	495564.10	225,742.00	45.55
2010-11	348960.00	665694.10	166,021.85	24.94

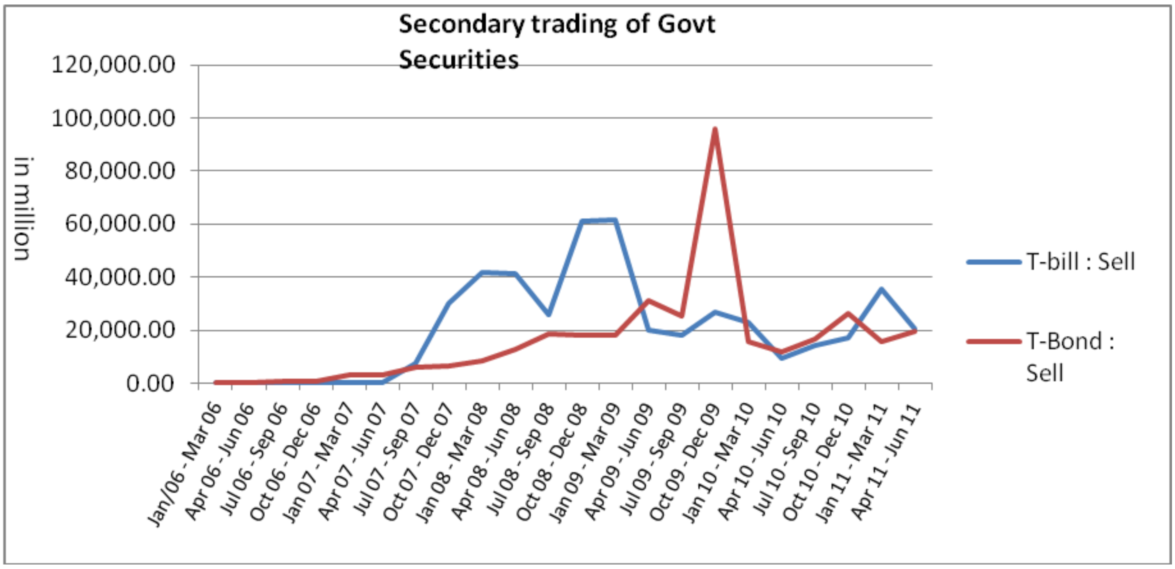
Source: Bangladesh Bank

Figure: 3.9 secondary trading of Govt. Securities



In 2009-10 to 2010-11 the trend of trading declining because yield of primary market increasing and due to marking to market price of securities become less attractive to others investor. It is observed that when primary yield goes down (see appendix) commercial bank intends to make profit as price of the securities increases. On that Bangladesh securities market still not dominant by foreign investor and portfolio so it has very low relation to other Asian countries.

Figure: 3.10 secondary trading of Govt. Securities



Instruments wise trading of securities (figure 3.9) in different quarter shows that in July 09-dec 09 trading of T-bond increases drastically. Actually on that time demand of long term bond increases due to regulatory SLR requirements of Non-PDs banks. During the FY 2009-10 Government net borrowing from banking system was negative. i.e. BDT 20925 million.

CHAPTER 4

CONSTRAINTS AND ISSUES IN GOVERNMENT SECURITIES MARKET DEVELOPMENT

4.1 Introduction

In the study secondary data regarding Government securities bond market has been analyzed and on the basis of this few conversations with the expert personnel have been conducted who are related with Government securities market and also primary dealers, Bangladesh bank etc. It appears that there are some problems and difficulties in Government securities market like artificial cut-off rates in primary auctions, narrow investor base which make constraints to develop vibrant secondary market as well as the development of primary markets .During the study the discussion held on various person like General Manager of Debt management Department, BB; Chairman of Primary dealers Bangladesh Limited, Treasury Head of few commercial Banks' and also with some general investors. The below parts provide the issue and constraints relating to the Government securities market in Bangladesh.

4.2 Constraints and Issues

4.2.1 Investor base

Competitive and wide investor base is needed for efficient bond market operations and of its success. In Bangladesh commercial banks along with Bangladesh Bank, dominate the holdings of marketable government securities (table4.1).They are typically buy-and-hold investors to maintain their statuary reserves. Banks must maintain reserves of, 19 percent: 13 percent in eligible assets such as government securities and 6 percent in cash. On the other hand, non bank investors play a limited role in the market for Government securities.

Table 4.1: Holder of Government securities

(Million in tk)

Holder	Dec /2011		Total	Percentage of total
	T-Bill	T-Bond		
Bangladesh Bank	132110.00	28519.70	160629.70	20.32
Comm. Bank	126843.90	445640.90	572484.80	72.43
Non-bank Investors	4082.10	53148.10	57230.20	7.24
			790344.70	100

Source: Debt Management Dept, BB

In most of the country's portfolio of Government securities always dominated by insurance and pension fund. According to the insurance act,1938 all insurance company have a obligation to maintain statutory reserves of 30 percent in Government securities but due to high interest rate of savings certificate they prefer it rather than tradable securities. In Bangladesh civil servants have two types of retirement plans. The first is a noncontributory; another is a contributory provident scheme, the General Provident Fund, which operates as an unfunded system: contributions deducted from workers' salaries are used to pay benefits, while the surplus is allocated to the budget. The Provident Fund Act, 1925 and Provident Fund Rules, 1979 apply to Government employees. There is no provision on investment of funds under these Act/Rules. Thus the provident fund contributions of the Government employees are not funded – the employee contributions finance the Budget during the year of receipt while pay-outs are treated as budget expenditure. The Income Tax Ordinance, 1984 covers tax treatment for PFs, and in that connection specifies the investment requirements of such PFs. Similarly, The Companies Act, 1994, lays down investment guidelines for PFs but does not mandate the employer to maintain such a fund.

In Bangladesh Mutual funds' investment mainly goes to equities and corporate because of low yields of government securities compared with market expectations. Foreign investor, both individual and institutional, has still no participation in the bond market of Bangladesh. According to Bangladesh Government Bond Rules, 2003; any individual and institutions not resident in Bangladesh be eligible to purchase the BGTBs, with coupon payments and redemption proceeds transferable abroad in foreign exchange. But operation modalities of foreign currency transaction are not properly defined. On the other hand, the BGTB purchased by a non-resident is not resalable to a resident in Bangladesh within one year of purchase. This also discourages foreign investment in Government securities.

In India 75% of Life insurance asset fund and 40% of pension fund invested in Government securities.

4.2.2 Less attractiveness of Government securities

In Bangladesh, Government securities are less attractive due to low return in comparison with other deposits and lending instruments. Interest rate structure of commercial bank and other non tradable savings instrument shows that return of government securities in less attractive than others. The following Table4.2 clarifies the fact.

Table 4.2: Fixed/Floating Interest rate of different instruments

Name of the Instrument	Tenor/Name	2009-10	2010-11	Up to Dec 11
Treasury Bills	91 day T-bill	2.29%	2.44%	9.00%
	182 day T-bill	3.56%	3.52%	8.50%
	364 day T-bill	4.47%	4.25%	9.50%
Bangladesh Govt. Treasury Bond(BGTBS)	5 Year BGTB	7.79%	7.88%	8.50%
	10 Year BGTB	8.00%	8.85%	9.50%
	15 Year BGTB	8.80%	8.92%	11.00%
	20 Year BGTB	9.06%	9.23%	11.50%
Existing National Savings Directorate Instrument (Non Tradable)	Saving Certificate with 3 months profit	11.50%	11.50%	10.78%
	5 yrs Bangladesh Sanchaypatra	12.00%	12.00%	11.55%
	Pension's Sanchaypatra	12.50%	12.50%	11.81%
	3- Yrs National Investment Bond	8.50%	8.50%	12.07%
	Wage earners Development Bond	12%	12%	11.80%
Commercial Bank	Weighted Av.Deposit Rate(3-6 months)	5.00%	7.50%	8.50%
	Weighted Av. Lending rate	12.74%	13.00%	14.74%

Source: Debt Management Dept, BB

Table 4.2 shows that savings certificate and banks' fixed deposit always profitable for retails investor. Here commercial banks' deposit and lending rate are more attractive than Government securities. Due to higher return in depositing banks and saving certificates general savers are not coming to the Government securities. Institutional investors are not investing in the Government securities for higher cost of fund.

4.2.3 Bid-Cover Ratio

A notable feature is that the bid-cover ratio (BCR) which is an indicator of market demand. BCR has come down noticeably in 2010-11 to 1.10 for Bills and 1.07 for bonds. Low BCR for bills reflects tight liquidity conditions and likely to improve once liquidity becomes comfortable. For bonds, however, this is particularly a concern, as this shows the lack of demand. Table 10 shows that BCR for bonds in recent months is just about 1, meaning bids received are just equal to amount auctioned.

Table 4.3 – Bid-Cover Ratio - Bonds 2010-11

	5 year	10year	15 year	20 year
Jul-10	1.0	1.2	1.0	1.0
Aug-10	1.0	1.0	1.0	1.4
Sep-10	1.1	1.0	1.0	1.3
Oct-10	1.1	1.1	1.3	1.3
Nov-10	1.3	1.2	1.0	1.3
Dec-10	1.2	1.1	1.0	1.0
Jan-11	1.0	1.0	1.0	1.0
Feb-11	1.0	1.0	1.0	1.0
Mar-11	1.0	1.0	1.0	1.0

Figure 4.1: Bid-cover ratio

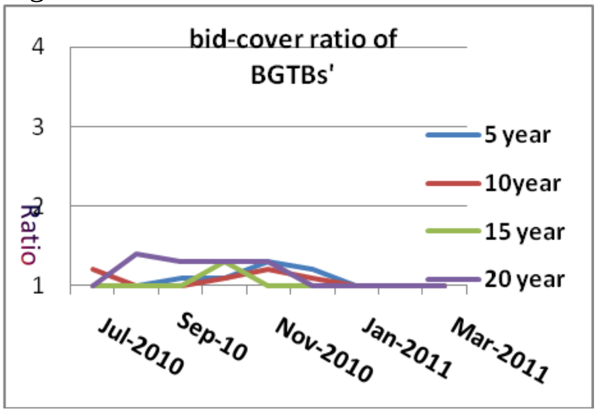


Figure 4.1 gives a longer-term depiction of BCR and it reinforces the sharp drop in demand in 2010-11. Clearly, PDs are bidding just to meet their bidding commitments. Given the fact that PDs hold about BDT 410 billion of securities against their regulatory requirement of BDT 210 billion, they too are being forced to accumulate because of their PD function. This has hurt the business model of the PDs as their resources for credit get constrained which would keep lending rates at elevated levels. More importantly, revaluation losses of such a large Government securities portfolio and difficulties in financing the holdings due to tight liquidity conditions are likely to hurt the profitability of PDs. During discussion, some PDs have expressed the possibility of even considering giving up the PD license. This would be a rather unfortunate turn of events, as PD business is likely to be seen as a burden rather than a privilege. Besides without a well-functioning PD system, Government will find it difficult to mobilize its borrowing.

The longer-term solution is to develop stable sources of demand for Government securities such as pension funds and insurance companies. But in the shorter term this would call for some unconventional measures. One possibility is for Bangladesh bank to absorb some of the supply through devolving on itself in auctions or even by buying in the secondary market.

4.2.3 Lack of commitment to Market-based borrowing

For macroeconomic stability market oriented economic framework is needed. In Bangladesh Government's have a lack of commitment to market oriented borrowing for its deficit finance. Due to excess borrowing from banking system for deficit financing banking system now facing liquidity crisis, shortage of fund for private sector. The government's net borrowing from all commercial banks and financial institutions through issuing T-bills and bonds stood at Tk. 93.55 billion during the July-March period of FY 11, according to the central bank statistics. During the period, the government has borrowed from the banking system up to 60 per cent of its annual borrowing target. (Bangladesh bank).

4.2.4 Non existence of market driven Yield

In Bangladesh authority always like to maintain a rigidly stable yield curve. An active secondary market requires that the yields arrived at in auctions are market determined. But the decision making process in auctions does not appear to be conducive to market determined rates. Excessive devolvement at artificially low interest rates, against market preference has led to a fall in demand for bills from non-PDs.

4.2.5 Absence of Price discovery

The auction process continues to be characterized by an unusually high degree of devolvement at artificial rates, affecting transparency and price discovery of auctions. This hurts the health of the Primary Dealer (PD) system and may potentially transform into a regulatory issue for the banking system. More importantly, it is impossible to develop the secondary market in an environment of artificially priced auctions. In the absence of a market for Government securities, the price discovery process is virtually non-existent. The TS (Treasury Securities) is almost entirely reliant on captive sources. The government is basically a price-maker instead of price-taker. Although TS are issued through auctions, the auction process is two-stage process. The government has been observed to consistently accept the lowest yield in first stage. The rest of the issuing amount will be allocated among the primary dealers based on their underwriting obligations. For example, on Feb 11, 2009, 12 bids were submitted with yields ranging from 2.3%to 3.5%. The government only accepted one lowest bid for 100 crore taka at a yield of 2.3%, and the rest of the volume was devolved amongst the PDs.

4.2.6 Funding risk

With a volatile overnight interest rate market, PDs would take on a large degree of funding risk. Because interest rate of Government securities is not determined by market. Because of volatile interest rate primary dealers of government securities faces a interest rate risk. Since the price discovery process in the primary auction is not seen to be entirely market driven, PDs find it difficult to get a clear idea of the risk entailed by their primary market obligations.

4.2.7 Burden of Primary dealers

Primary dealers have a responsibility to make market for government securities. They get liquidity support and underwriting commission from Bangladesh bank. But due to non existence of liquid and vibrant secondary market they face a lot of problem as follows:

- PD holds excessive securities than they need for statuary reserve. Due to devolvement the outstanding amount for PDs holding increases day by day. They cannot sale securities in secondary market because of no demand; it creates pressure on the PDs liquidity. Up to 30^{th} September,2011 primary dealers holding of total securities stands 411332.30 million taka, where they need only 227128.20 million for maintaining statuary reserve, excessive holding is total 184204.10 which is 55% higher than Statuary requirements. The devolvement on PDs was also high at 33% in 2009-10 and 52% in the current year so far.

- Because of low interest rate of government securities in terms of banks deposits collection, Primary dealers cost of fund increases. Quite often PDs are required to buy securities in auctions at yields below their cost of funds. Such assets eventually weaken their balance sheets and adversely affect the health of the banks and liquidity.

4.2.8 Dissemination of Information

In Bangladesh we have no publication of a government borrowing calendar, auction information and results, bond market data, Only PDs can collect information from Bangladesh Bank. Unlike stock market information related to transacted prices and volume in the secondary market is not generally recorded and widely disseminated to the public. Here retail investors away from the market because they have a lack of awareness regarding the yields prevailing in Government securities and the procedures for investment.

4.2.9 Inadequate bond market structure

In secondary trading real-time price and volume information is not readily available. Only over the telephone transactions held by Commercial banks. If any retail investor likes to invest in government securities he/she must go through commercial bank Beneficiary owner’s account .To know about bond yield, price investor depends on commercial banks, no real time window for secondary trading. In Bangladesh securities market Lack of know how of trading professionalism and also little understanding of the retail investors about the product of bond market. The payment and settlement system has not been modernized yet. Bangladesh bank just introduced online Settlement system in December, 2011.Before that it was settled manually.

4.2.10 Reissue of Securities

Reissue of securities helps to reduce ISIN number of securities and increase supply of securities. There are currently more than 190 BGTBs in existence with an average stock size of just over BDT 2 bn. But in Bangladesh we have no reissue system. Due to so many securities investor fails to identify the deserved securities for trading.

4.2.11 Volatile call money market

Our call money is more volatile. Due to this many banks and financial institutions like to make business through overnight market rather than long term investment in government securities. Below table shows the call money market volatility in Bangladesh. Table shows 4.3 volatility of the call money market. At the time of high call money rate ,the Non-PD banks are not willing to invest their fund in the lower yielding government securities as they do not get sufficient repo facility from Bangladesh bank against these securities.

Table:4.3 Call Money Market in BD

(Percent per annum)

Period	Borrowing Rate			Lending Rate		
	Highest	Lowest	Average	Highest	Lowest	Average
2009	19.00	0.05	4.39	19.00	0.05	4.39
2010	190.00	2.00	8.06	190.00	2.00	8.06
2011						
January	24.00	3.75	11.64	24.00	3.75	11.64
February	18.00	3.00	9.54	18.00	3.00	9.45
March	12.00	3.00	10.35	12.00	3.00	10.35
April	14.00	4.00	9.50	14.00	4.00	9.50
May	12.00	4.75	8.64	12.00	4.75	8.64
June	12.00	4.75	10.93	12.00	4.75	10.93
July	12.00	6.00	11.21	12.00	6.00	11.21
August	20.00	6.50	12.03	20.00	6.50	12.03
September	20.00	5.00	10.41	20.00	5.00	10.41
October	19.00	6.00	9.77	19.00	6.00	9.77
November	23.00	6.25	12.70	23.00	6.25	12.70

Source : Debt Management Dept, BB

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS:

5.1 CONCLUSIONS

The market for govt. securities in Bangladesh is still thin in the sense that the supply side is influenced by the budgetary financial requirements of the government, while the demand side comprises mainly the Deposit Money banks (DMBs) having SLR obligations. The demand side is also heavily influenced by the interest rates prevailing in the call-money market. The quantity of the securities to be issued is decided by the government depending upon the volume of its requirement for short/long term funds. In spite of presence of more flexible and competitive rates of interest on treasury bills/bonds, bidding behavior in their auctioning is yet to be stabilized. However, introduction of secondary market, treasury coupon bonds, Delivery versus Payments (DvP) and CDS system are forward looking steps for strengthening and streamlining the govt. securities market in Bangladesh.

As a guardian of government bond market as well as the custodian of money market of Bangladesh, Bangladesh Bank is working for bond market development. Though there is few corporate bond and financial derivatives in the market, BB is trying to develop a well functioning bond market by fine-tuning trading of the existing government securities. Currently Bangladesh Bank is reviewing its primary auction guidelines as well as primary dealers‟ performance for further development of bond market. However, BB has been conducting primary auction of government securities, repo, and reverse repo activities at a satisfactory level of performance.

Developing liquidity in the secondary market is a gradual process. It takes time for trading behavior to develop among institutions. What can of course be done is to create conditions that are conducive to developing a safe and efficient market place. Trading volume in Government securities in Bangladesh is currently negligible. To activate the market, it is necessary to push institutions (banks and other financial institutions) to inculcate a culture of trading, develop safe and efficient trading and settlement systems, sensitize market participants to internalize effective risk management practices and stabilize market standards.

5.2 RECOMMENDATIONS

5.2.1 Widening investor base

The Provident Fund Act, 1925 and Provident Fund Rules, 1979 apply to Government employees should be amended and make provision on investment of funds under these Act/Rules so that the provident fund contributions of the Government employees can be funded. Similarly, The Companies Act, 1994, laying down investment guidelines for PFs should also be amended to mandate the employer to maintain such fund. There should be law for compulsory provident fund contributions by any establishment that employs people.

To improve demand for BGTBs and T-Bills insurance companies may be permitted to invest in excess of 30 per cent of their funds in marketable Government securities. It was also suggested that in order to encourage wider participation of insurance companies, BB may consider allowing large insurance companies to open and maintain current accounts with BB. A discussion with insurance companies revealed that they are unable to invest more in Government bonds mainly because of the interpretation that the 30% limit on investments in Government securities is not a minimum limit. Government may take up with the Controller of Insurance to revise the investment norms for insurance companies.

5.2.2 Create Demand for Government securities

There should be a separate window for retail investor. To encourage foreign investment BGTB rules should be amended.

NBFIs maintaining SLR through deposits with banks, funded by call money borrowing. BB may consider requiring NBFIs to meet their SLR requirements through Treasury Bills and BGTBs. Apart from adding to demand for government securities, such a measure will improve safety of the financial system, and reduce volatility in the call money market. In order to reduce volatility in the call money market non-bank participants like NBFIs should be gradually moved away from the uncollateralized call money market to collateralized repo market for their borrowing requirements.

To make the yield curve as long as possible demand for government securities needs to be created by promoting secondary market. As well as retailer, pension fund, mutual fund is also being promoted for investment. In the absence of effective price discovery in secondary markets, the primary issuance process provides the best indicator of market yield. Especially if the primary issuance process is entirely market driven, primary yields act as anchors on which secondary market yield curve develops

5.2.3 Price discovery

Frequent devolvement compromises price discovery in auctions. There is little possibility of developing an active secondary market if there is no desire to subject the primary issuance process to market pricing. The attempts in recent months to minimize devolvement may be continued and devolvement should be used under exceptional circumstances. An active secondary market requires that the yields arrived at in auctions are market determined. Government securities market need market maker. Bangladesh Bank may encourage PDs to announce indicative secondary market yield curve on a monthly basis.

5.2.4 Interest rate structure

Interest rate should be determined by market force. Though there’s had a possibility of syndication. However central bank should make close monitoring of different interest rate.

Interest rates on savings instruments and any other special securities should be aligned to the yield on government securities. The auction process may be appropriately restructured so that yields/prices determined in the auctions are in alignment with underlying fundamentals and market expectations.

5.2.5 Improving the secondary market infrastructure

Real time transaction window like stock exchange should be introduced so that retail investors and others can follow the market. Create know how of trading professionalism. There is an urgent need to train banks and PDs about the importance of Government securities markets, managing interest rate risk in such instruments and related areas.

5.2.6 Government Commitment to market borrowing

Private credit flow should not be hampered by excessive borrowing culture of Government. So Government borrowing target must be coping with market demand and supply.

5.2.7 Promote Primary Dealer System

It would be beneficial in the long run to encourage PD activity in both primary and secondary market by way of well thought out incentives. In order to maximize PD performance, BB may consider the following suggestions:-PDs should be paid underwriting commission on the amount underwritten, without deducting allotted securities used for SLR requirement.

To encourage competitive behavior among PDs, they should be rewarded for better performance. The incentive system that has been instituted should be improved as it is now too low to act effectively as incentives – the maximum incentive is only about 4% of the underwriting budget. The actual incentive is even lower as few PDs are able to meet the requirements. So the incentive amount may be increased to about 25 percent of the underwriting budget. Incentive may be provided to the top three PDs without any minimum performance criteria. BB may encourage PDs to get more client bids by not making a distinction between client bids and own bids for the purpose of devolvement or for any other purpose.

Liquidity support should be given not only against devolved securities but against any security held by the PD in excess of its SLR requirement and the minimum stock required to be maintained by PDs. BB may consider providing incentives to encourage secondary market activity of PDs, by extending higher amount of liquidity support to the better performing PDs.

5.2.9 Reissuance of Existing Securities

There are currently more than 190 BGTBs in existence with an average stock size of just over BDT 2 bn. There is an urgent need for consolidation of stock. The importance of reissuing existing securities, to avoid excessive fragmentation of Government bonds, and thereby improving liquidity in the secondary market.

5.2.10 Provide ISIN Number

The ISIN numbering format needs change to ensure uniqueness for a security. Without this change, reissuance is not possible. In the long run, Bangladesh Bank needs to take on the responsibility of assigning **ISIN** numbers to Government securities.

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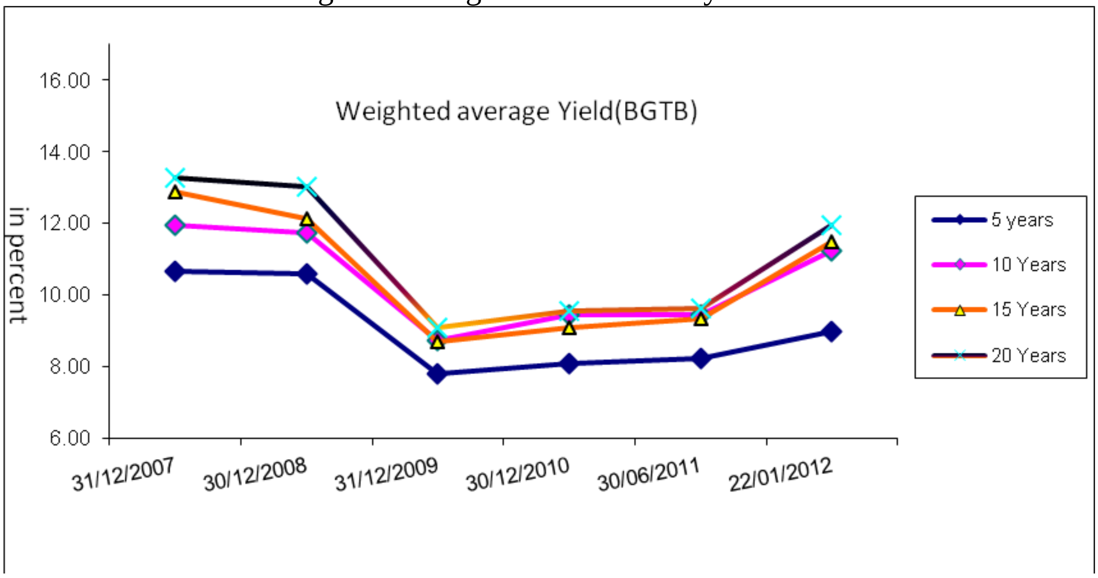
Appendix 1

Weighted Average Yield of Primary Auction

Tenor	31/12/2007	30/12/2008	31/12/2009	30/12/2010	30/06/2011	22/01/2012
5 Years BGTB	10.65	10.60	7.80	8.09	8.25	9.00
10 Years BGTB	11.95	11.72	8.75	9.45	9.44	11.25
15 Years BGTB	12.88	12.14	8.69	9.10	9.34	11.50
20 Years BGTB	13.28	13.02	9.10	9.55	9.64	11.95

Source: Bangladesh bank

Weighted average Yield of Primary Auction



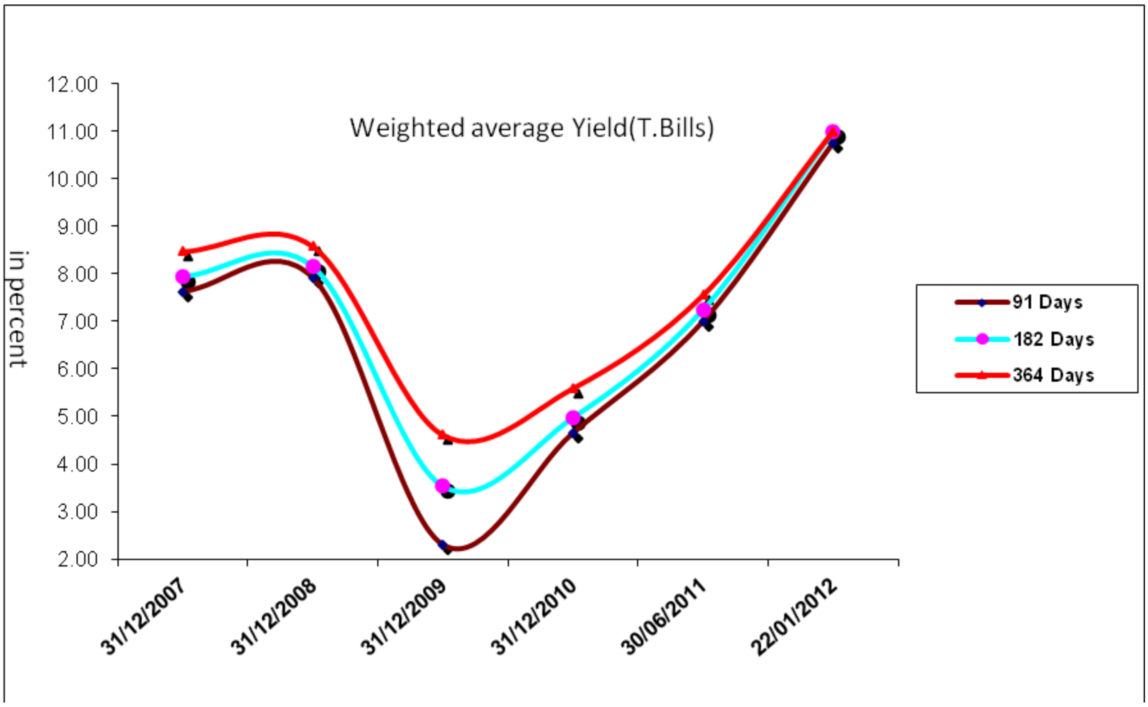
Appendix 2

Weighted average Yield of Primary Auction

Tenor(T-bill)	31/12/2007	31/12/2008	31/12/2009	31/12/2010	30/06/2011	22/01/2012
91 Days	7.63	7.92	2.30	4.65	7.00	10.75
182 Days	7.95	8.16	3.54	4.98	7.25	11.00
364 Days	8.47	8.58	4.61	5.59	7.55	11.00

Source: Bangladesh Bank

Weighted average Yield of Primary Auction



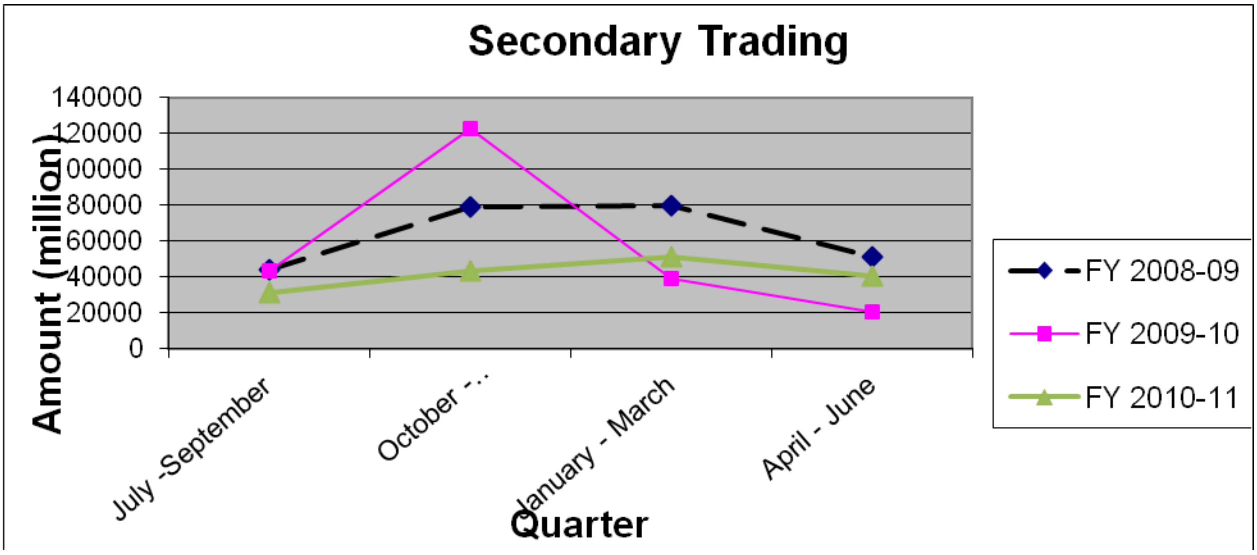
Appendix 3: Secondary Trading Amount of Government securities

Date	T-bill : Sell		T-Bond : Sell	
	Transaction	**FV - Tk. mln**	**Transaction**	**FV - Tk. mln**
Jan 06 - Mar 06	11	87.00	6	162.50
Apr 06 - Jun 06	5	68.00	8	210.00
Jul 06 - Sep 06	5	72.00	47	645.80
Oct 06 - Dec 06	6	129.00	37	589.10
Jan 07 - Mar 07	1	15.00	70	3,335.00
Apr 07 - Jun 07	19	324.8	257	8523.4
Jul 07 - Sep 07	72	7,502.70	76	5,802.00
Oct 07 - Dec 07	158	29,936.00	80	6,248.00
Jan 08 - Mar 08	304	41,596.80	64	8,295.70
Apr 08 - Jun 08	289	41,206.80	90	12,969.40
Jul 08 - Sep 08	188	25,750.00	111	18,530.90
Oct 08 - Dec 08	334	61,122.70	183	18,153.00
Jan 09 - Mar 09	317	61,515.60	222	18,122.10
Apr 09 - Jun 09	108	19,928.00	235	31,051.10
Jul 09 - Sep 09	75	18,317.00	162	25,248.00
Oct 09 - Dec 09	127	26,750.00	565	95,842.00
Jan 10 - Mar 10	132	23,057.00	139	15,733.00
Apr 10 - Jun 10	58	9,154.00	116	11,641.00
Jul 10 - Sep 10	51	14,406.00	145	16,641.00
Oct 10 - Dec 10	101	17,098.00	206	26,514.00
Jan 11 - Mar 11	195	35,315.00	119	15,841.00
Apr 11 - Jun 11	125	20,703.00	291	19,503.85

Appendix 4: Primary yield rate of Government securities

Name of the Instrument	Tenor/Name	FY2007-08	FY2008-09	FY2009-10	FY2010-11	Up to Dec 11
Treasury Bills	91 day T.Bill	7.61%	7.84%	2.29%	2.44%	9.00%
	182 day T.Bill	7.88%	8.01%	3.56%	3.52%	8.50%
	364 day T.Bill	8.46%	8.50%	4.47%	4.25%	9.50%
Bangladesh Govt. Treasury Bond(BGTBS)	5 Year BGTB	10.68%	10.58%	7.79%	7.88%	8.50%
	10 Year BGTB	11.83%	11.45%	8.00%	8.85%	9.50%
	15 Year BGTB	12.82%	11.90%	8.80%	8.92%	11.00%
	20 Year BGTB	13.75%	12.50%	9.06%	9.23%	11.50%

Appendix 5

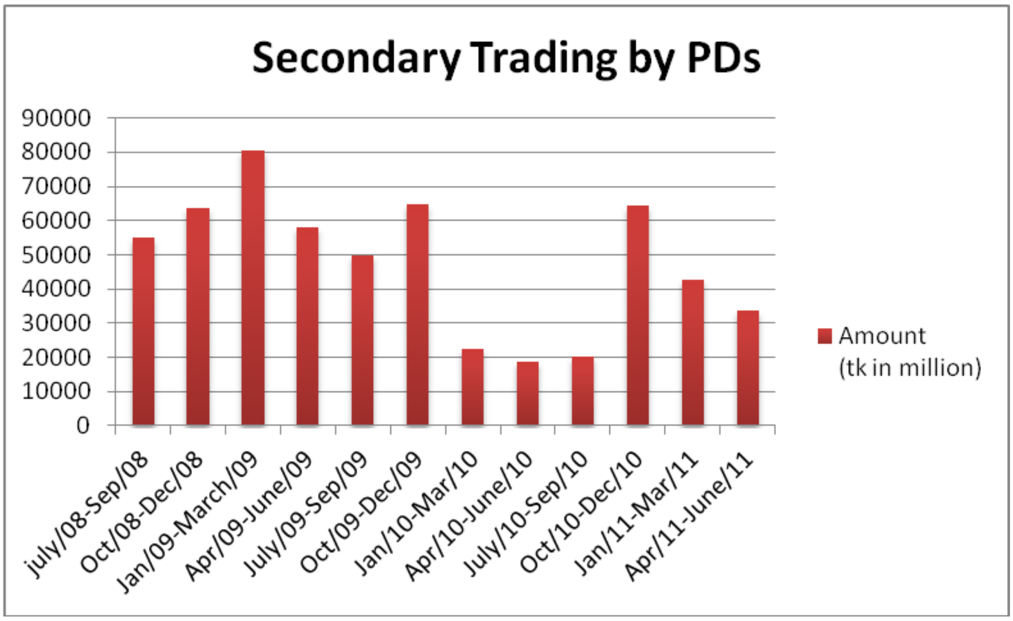

Secondary Trading
140000
120000
100000
80000
60000
40000
20000
0
Amount (million)
July -September
October -...
January - March
April - June
Quarter
FY 2008-09
FY 2009-10
FY 2010-11

Appendix 6

Development of Government securities market in Bangladesh

Measure	Action By	Action Taken
Adhoc treasury bills	Government and BB	2003
Formation of The Cash and Debt Management Committee comprising high level officials from Government and BB	Government and BB	CDMC formed in June 2006
Discontinue of 'ad hoc Treasury Bill' system of deficit financing	Government and BB	in July 2006
Introduction of Auction Calendar	Government and BB	FY 2006-07
Discontinuation of 2-year Treasury Bills	Government and BB	2-Year Treasury Bills discontinued in 2006
issue of BGTBs.	Government and BB	Process commenced from 2006-07
Rules for BGTB issuance	Government and BB	2006-07
Secondary trading of BGTB		2006-07
Activation of Primary Dealers obligations in auctions.	BB	Underwriting by PDs introduced in July 2007.
Extending the Yield Curve	Government	In 2007-08 BGTBs of 15-year and 20-year tenor introduced
Multiple price based Auction	BB	2007-08
Withdraw up-front tax on Government securities.	Government	Up front tax discontinued in June 2007
Delivery Vs Payment	BB	Settlement arrangements modified in 2005. DVP is not being strictly enforced. Further modification required to settlement arrangements.
Guidelines for Marking to Market Securities	BB	October 2008
Central depository system	BB	December 2011

Appendix 7


Secondary Trading by PDs
90000
80000
70000
60000
50000
40000
30000
20000
10000
0
july/08-Sep/08
Oct/08-Dec/08
Jan/09-March/09
Apr/09-June/09
July/09-Sep/09
Oct/09-Dec/09
Jan/10-Mar/10
Apr/10-June/10
July/10-Sep/10
Oct/10-Dec/10
Jan/11-Mar/11
Apr/11-June/11
Amount (tk in million)