B A N G L A D E S H

Yearly Economic & Market Roundup 2005

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Unprecedented growth in imports and remittances, turnaround in investment, high inflation, a vibrant capital market, and a deteriorated political ambience mark the year

The movers

- Overall economic performance on the track with a 5.7% growth in GDP in FY2005 compared to 5.5% last year. In FY2006, growth forecast at 6.0-6.8% by the Government and development partners.
- Though the balance of payment remains under pressure due to higher oil price, the adverse effects were greatly moderated by rapid growth in worker's remittances.
- Foreign investors demonstrate growing interest in various sectors like telecommunications, gas, fertilizer, steel, etc.
- Import payments move up due to rise in import of capital equipments and industrial raw materials, suggesting the burgeoning growth in the backward linkage industries like textile, etc.
- Remittances from Bangladeshi nationals working aboard surpassed previous records as informal transfer of money has continuously been under check by a corresponding improvement in the formal channel.
- Monetary policy continues to accommodate the buoyant growth in domestic demand.
- Private commercial banks' operating profits record larger growth despite a government pressure to reduce lending rates and curbing other profiteering attitudes.
- The National Economic Council approves the full-fledged Poverty Reduction Strategy Paper (PRSP), which would smoothen the inflow of the pledged foreign assistance.
- Agriculture output rebounds in the summer of 2005 after the flood-introduced damages of last year.

The shakers

- Inflation is on an upsurge due to higher domestic food prices and higher petroleum import prices, which may dilute the growth trend. The point-to-point inflation rate hit a new 8-year high of 7.95% in November last due to the sudden leap in food prices, with a tilt on the rural areas than the urban ones, aggravating the continued miseries of the rural poor.
- Till mid-December 2005 government bank borrowing was Tk43.68b of which Tk35.0b taken from the commercial banks, leaving a risk to rise in government expenditure.
- Taka lost about 9% of its value against US dollar over the year.
- Foreign exchange reserves stood at $2,870m at the end of the year, lower by $353m or 10.95% against last year's $3,223m.
- Slow utilization of foreign assistance due to bureaucratic hurdle, political intervention and inter-ministerial divergence on respective jurisdiction.
- Corruption continues to eat up development budgets. WB has recently asked a certain amount of aids back due to corruption.
- In the post-MFA situation, future of RMG sector, which is the single largest item in the export basket remains still under threat, though initially the country showed resilience against the phase out shocks.
- Because of deterioration of the law and order situation and terrorists attack investment is predicted to decline in the upcoming year.
- Velocity of poverty reduction and social development was sluggish due to delay in release of foreign funds of some NGOs.
- Gap between the rich and the poor became wider in the last year. Income differential between the poorest and the richest 10% of the population increased from 20 times in 1999 to 24.5 times. Unemployment increases over the previous years leading more rural people to migrate to urban areas.
- The concrete regional cooperation, being facilitated by SAARC remains yet at the minimum level.

Towards a growth spurt

Bangladesh economy has been growing on an average rate of 5.5% for the past few years, which is however, lower than 7%, expected to achieve the millennium development goal. Amid a band of economic parameters that act as barriers, such as huge population, tiny industrial base, narrow export base, unplanned import, small foreign exchange reserve, high inflation emanated from a politics-influenced monetary policy, pandemic corruption etc, the growth is encouraging. However, the economic sectors are so proportionate that a mere 1% growth in agriculture and service sector may bring over 3% growth in GDP. Thus the growth figures remain a dreary indicator to represent the productivity of the entire populace of the country.

Though Bangladesh is predominantly an agrarian economy, its recent growth is largely centered on non-agricultural and non-manufacturing sectors. The growth is now more or less service sector driven, which is not usually labor-intensive. This leaves the trickle down effect of growth flow mainly on the upper echelon of economic classes. The poor thus had failed to benefit proportionally from incremental growth due to an inequitable distribution process. The income inequality at the national level had increased significantly, as has been revealed by the fact that the income differential between the poorest and the richest 10% of the population increased from 20 times in 1999 to 24.5 times in 2004. The experts suggest that a 6.0% or even 7.0% growth will have limited impact on poverty reduction, if not the present inequality is well addressed.

Overall growth in industrial sector during FY2005 increased to 8.6%, a little higher than last year's 7.6%. Agriculture had only a paltry 0.3% growth during the year, down from 4.1% in FY2004, while service sector displayed a robust 6.6% growth compared to 5.7% in the previous year.

The balance of payment (BoP) situation remains one of the major macroeconomic concerns for the last half of 2005, as fiscal measures taken by the Government failed to reign in the soaring imports. Besides repayment of foreign aids, an extra cost of overpriced petroleum fuels, huge purchase of capital machinery, luxury items and wet lease of airliners, etc have additional load on the balance of payments as well as the foreign exchange reserve.

Despite the concerns, most indicators suggest that the year 2006 would see a further spurt in growth, over 6.5%. As has been recorded by the central bank, exports and remittances would mark a new record in the coming years, while despite severe political interruptions, manufacturing sector would do better than 2005. Agriculture sector might also fare better in the year. However, it is service sector that would dominate the growth pie, and contribute most to the GDP growth.

Export

Export earning reached a record high in the first 9 months of the calendar year, $6,673m compared to $6,372m in the same period last year, amid many dire predictions by the various experts and international agencies about the open trade regime in the post-MFA era. The export felt the initial shock of MFA phase out with export earnings from woven garments falling by 21% in January 2005 from that of 2004. Woven products continued to show a negative trend, while knitwear products in some major markets has increased substantially. Exporters hoped the trend in the sector to continue in the coming months as it has a strong backward linkage support. Besides, exporter community in the sector went for an aggressive campaign in some major markets including USA to raise its income from this sector. The table below shows the calendar year-wise actual export and import: (m$)

Year	Export	Growth	Import	Growth
2000	6,405	17.35%	8,025	6.52%
2001	6,033	-5.81%	8,081	0.70%
2002	6,066	0.55%	8,555	5.87%
2003	6,990	15.24%	9,374	9.57%
2004	8,302	18.77%	10,839	15.63%
2005	7,546[a]	8.17%[b]	10,808[a]	20.71%[b]

[a] up to October 2005 [b] growth based on corresponding period

Earning from jute goods, raw jute, leather, chemical products, ceramic tableware, agro-products, petroleum byproducts, computer services, bicycle, textile fabrics and handicrafts recorded growth during 2005. However, earning from some major areas including frozen food, electronics, tea, and home textile, etc slipped. Exports of local pharmaceuticals products rose to 62 countries including Germany, Malaysia, South Korea, Hong Kong, Iran, Taiwan and Thailand. Many industry experts suggest Bangladesh can tap over $500m a year through exporting medicine if it could set up an active pharmaceutical ingredient (API) park for basic raw materials along with an effluent treatment plant (ETP) and a drug testing laboratory (DTL) as per a World Trade Organization (WTO) deal on medicines. As WTO decided to waive patent protection for the least developed countries (LDCs) till 2016, Bangladesh has indeed a prospect during this interim period, since out of 49 LDCs only Bangladesh has the required strong base to utilize this opportunity. This would simply allow the country to earn a Tk100b export per year.

Meanwhile, export from the export processing zones (EPZs) have also grown significantly during the year. Some 231 enterprises, with investment from 24 countries for $885m in 6 EPZs, exported goods worth over $1,600m, compared to last year's little over $1,400m.

Among the fledgling industries the ceramic sector witnessed an accumulated export growth of 56% in the last 10 years, and now expects a double-digit growth that would break $100m mark from the current $34m by 2008. However, in spite of the good export prospects, a persistent gas crisis appears to be depriving the sector from a smooth rise. Starting production in 1980s to feed the local consumers, ceramic tableware took a slow but steady progression to approach foreign markets. During the year leather goods also fared quite well, as for the first time in past 3 decades exports exceeded the target set for FY2005, by achieving over $230m. Lack of scientific preservation and processing leading to improper flaying of hides and skins causing a loss of at least $150m per year. Of a total of 206 tanneries in Bangladesh, only 112 have wet blue leather processing facilities, the rest units produce crust and finished leather for export.

Bangladesh's concentration in the perspective of WTO HK summit was market access in the areas of industrial and agricultural goods and services and improving special and differential treatment provisions, reducing trade distortion in cotton, ensuring food aid discipline, identifying and prohibiting harmful fisheries subsidies and increasing real assistance for trade related supply side capacities. In the run-up to the HK Ministerial, 5 issues were addressed: Agriculture, Non-Agriculture Market Access (NAMA), Services, Rules and Development Provisions. The ministerial declaration does not effectively project the pro-development promises of Doha Development Agenda. Bangladesh's ambitions from the Ministerial remain largely frustrated, as it did not get significant market access. Bangladesh needs to reexamine its trade promotion and industrialization strategies in the light of HK outcomes.

Import

Imports have increased in 2005 that dented the foreign exchange reserve. During the first 10 months, import inched close to the entire previous year's figure, marking a likely growth of nearly 21%. The rise has been attributed to the growth in import of scrap vessels to $236.3m from $35.8m last year, rice to $229.7m from $112.9m, wheat to $306.0m from $146.3m and fertilizer to $284.18m from $133.44m, to name a few at the top. Letters of credit (LCs) for capital machinery stood at $895.3m against $555.7m last year. Most of the machinery was for setting up spinning, weaving, knitting and knit-dying plants and woven fabric processing units. For intermediate goods, the growth was 59.8% and petroleum products 49.5%.

As anticipated at the end of last year, the withdrawal of LCs margin by Bangladesh Bank for all products to fulfill an IMF condition on poverty reduction growth facility loan led to huge import spurt creating a mismatch between import and export. This ended up to a further furrow in trade deficit.

Remittances keep soaring on

The year 2005 saw a major rise in the overseas workers' remittances that stood $4,241.55m by the yearend, marking a robust 18.77% growth over last year's $3,571.15m. The figure is a record high and the growth second highest. The table below shows the inward foreign remittance for the past few years (figures in $m):

Year	Remittance	Growth	Year	Remittance	Growth
2000	1,955.04	8.80%	2003	3,171.48	11.37%
2001	2,068.70	5.81%	2004	3,571.15	12.60%
2002	2,847.79	37.66%	2005	4,241.55	18.77%

Some 70% of Bangladeshis working abroad are employed in Middle East. As global fuel prices increase, so does the demand for expatriate workers in the Middle East, and so do the wages paid to the expatriates employed there. This combination of factors appear to explain the sharp rise in workers' remittances. The increase in remittance worked in favor of a waning foreign exchange reserve and weaker exchange rate. The growth has also been attributed to devaluation of the local currency and a stronger monitoring of inflow by the central bank. Strict anti-money laundering measures and aggressive remittance service provided by the banks also dissuaded people to send money through illegal channels. It is assumed that another large part of the remittances come illegally through *hundi*, the undocumented transfer of foreign exchange.

FDI grew amid negative country image

Despite a pale political picture and an image smeared by the recent spate of religious terrorists, Bangladesh remains a preferred country for many informed foreign investors, who reckons its economic potential, especially the colossal size of competitively cheaper yet skilled labor forces, a host of skilled managers, gradually improving infrastructure, a vast rapidly rising middle class ending up in a market, steadily maturing regulators, etc and above all the generous incentives over its kaleidoscopic political fallibility. It has received a foreign direct investment (FDI) worth $454m during first half of the year against $660m registered with the Board of Investment (BoI). BoI also registered another $3,180m investment in the second half of the year. The size is not only much lower compared to the registered amount, but also its other Asian compeers like Vietnam, which has managed $5,290m in 11 months in 2005, and Pakistan, $1,813m, it was quite remarkable for the country itself, which has achieved 228% growth over the same period last year. The figure is close to the entire FDI received last year, $460.4m, of which only $138.3m came during the first half. Overall macroeconomic stability, changing global investment situation, buying capacity of people and confidence of the foreign investors in the existing investment environment are the reasons for Bangladesh to become a destination for FDI inflow. The aggressive marketing campaigns for attracting foreign investment and better services to investors by BoI helped achieve such a growth in FDI. Bangladesh Bank's latest statistics also showed $247.3m as investment in the equity capital, $140.8m as in reinvestment and $65.6m in intra-company loan during the period. The figures were $155.9m, $239.8m and $64.7m respectively in 2004. The following table shows the total FDI in the country over the years and inward FDI index ranking among 140 states:

Year	Inflow	Outflow	Total FDI	WIR Ranking
2000	280	2	278	-
2001	79	21	58	127
2002	52	3	49	127
2003	268	3	265	132
2004	460	4	456	122
2005*	-	-	454	NA

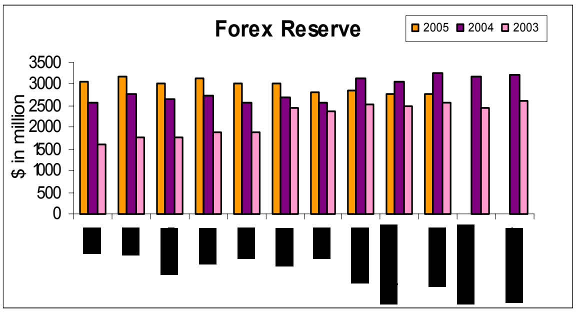
* up to June 2005

With FDI growing in the last couple of years, Bangladesh has now advanced to the 122nd position from the previous 132nd in the World Investment Report (WIR) 2005 index of the United Nations Conference on Trade and Development (Unctad). Improved investment environment, privatization of assets, etc have been identified as major reasons behind the high FDI flow in 2004. Bangladesh attracted $460m with 72% growth, 2nd highest in South Asia with Pakistan racing 1st at 74% in that year. Bangladesh's overall performance in capturing FDI is positive compared to other neighboring states, as it has advanced 11 steps, while India paced 2, both Nepal and Pakistan 5 and Sri Lanka 8 steps ahead. Global FDI rose 2% to $648b in 2004 after 3 years of decline. Inflows to the developing states surged by 40% to $233b, while the developed economies experienced 14% drop to $380b.

FDI is expected to boost radically in the coming years, as Dhabi Group, the Middle East industrial giant, and Tata, the Indian industrial giant, have signed agreement to invest in prodigious scale. Dhabi proposed to invest $1.0b to set up a 5-star hotel, a mobile phone company and a pharmaceutical company. While Tata is interested to invest $2.0b in steel, power and fertilizer plants and also proposed to buy a 5-star hotel in the city. Moreover, 5 reputed Indian groups have also expressed interest to invest in textile sector, making the sector going to have over $1.0b as FDI in next couple of years. South Korean conglomerate Luxon Global, as a part of its aggressive expansion in Asia, has expressed interest to invest $1.0b in coal mining, fertilizer, gas transmission, power, and infrastructure development sectors. Besides, the Warid group of United Arab Emirates is also interested to invest $1.0b in the telecommunication sector in Bangladesh.

Forex reserve slides amid robust import spree

The foreign exchange reserve has become one of the major concerns during the year. Import, especially of petroleum fuels, rice, scrap vessels, capital machinery, raw materials and luxury goods, has pushed the reserve stumble against moderate growth in export and robust rise in remittances. The tumble started in October 2004, when the reserve was at a record high of $3,273m, and ever since, with occasional rises, the reserve declined gradually to $2,870m by the yearend. Delay in disbursement of the pledged assistance by the multilateral financing agencies also aggravated the situation. The following graph shows the foreign exchange reserve of the country over the past 3 years:



The central bank relaxed some foreign exchange regulations to improve the reserve situation. The changes were made to ease import and to reduce the lead-time to export. It also waived the prior approval from Bangladesh Bank to accept cheques from foreign embassies/international organizations or foreign nationals employed in Bangladesh. Besides, in a move to encourage foreign and nonresident Bangladeshi (NRB) investors to invest in the capital market, BB relaxed its foreign exchange regulations relating to Non-Resident Investors Taka Account (NITA) transactions. As per the new provisions, balances in NITA may be used freely to buy shares of local listed companies and transferred to foreign currency (FC) account of the same person. However, the measure is yet to make any major impact.

Current account balance runs deficit

The current account deficit might put pressure on foreign exchange reserve and also affect the exchange rate. Trade gap also widened during the year. The galloping imports of 20.71% and slow growth in exports of 8.17% in the year pushed the trade gap to $3,262m. Various irregularities in import are hindering the government's effort to strengthen the foreign exchange reserve. Discrepancy between import of capital goods and raw materials has given rise to strong suspicion of capital flight. The table below shows the current account balance for the past few years: ($m)

Year	Surplus/Deficit	Year	Surplus/Deficit
2000	16.55	2003	(36.67)
2001	(33.44)	2004	(29.43)
2002	(47.95)	2005	(44.68)*

*up to August 2005

Inflation:

The year 2005 saw 9.77% increase in cost of living, second highest in the decade, as consumers passed an unnerving year of price spiral proving the government's machinery nonchalant to rein in commodity market. The Consumers Association of Bangladesh (CAB) calculated annual cost of living on average prices of 156 commodities, utilities and services under 26 categories. Prices of food, fuel, clothing, soap and bullion as well as hikes in transport fare and house rent are included in the survey that excluded cost of education and healthcare. For the consumers 2005 was a year of frustration and strain, hit hard by unabated price hike of all essentials, especially the food items. Prices of essential including food increased by 6.32% on an average, while in nonfood categories, it was 8% in house rent, 36% in fuels, 12% in transport and 5.04% in water and electricity. The cost of living increased by 7.10% in 2004 with 3.42% increase in commodity prices while in 2003 it was 10.48%, at the decade's peak where 4.84% was in commodity prices. The following table shows general and food inflation indices in recent years:

Year	Inflation (General)	Inflation (Food)
2001	1.91	1.17
2002	3.72	2.04
2003	5.36	5.81
2004	6.10	7.49
2005	6.83*	8.20*

*Up to September 2005 (12 -month average)

As per Bangladesh Bureau of Statistics the point-to-point rate of inflation was 7.95% in November 2005, compared to 7.93 in August. Inflation in food items was 8.58 and nonfood items 7.03. In the rural areas it hit the hardest, 8.70, but in the urban area it was contained at 4.96. The state-owned Trade Corporation of Bangladesh (TCB) has measured the price hike of the most essential commodities at 15.75%. The TCB has prepared a report on the basis of retail prices of 46 commodities, including 43 food, 16 of them being graded as 'sensitive essentials' that peaked by 15.75% against their price levels in 2004.

Currency loses much of its teeth against dollar

The local foreign exchange market experienced 3 major phenomena in 2005: The local taka faced the highest ever depreciation in a single year, increasingly started to trade against third currencies other than US dollar in the local market and state-owned banks turning as dollar buyers from sellers. After remaining somewhat stable in the previous two years, taka has been depreciated by almost 9.0% in 2005. Only in the month of February, taka went down by 3.32%. After a depreciation of 5.0% in the first quarter, it remained relatively stable in the second quarter, with only 0.33%, however, an all time high oil prices stepped up the US dollar demand in the local market in the subsequent periods. As large import demands hit the local market, taka fell by a total of 4% in next two quarters of 2005.

Repatriation of sizeable fund by some leading multinational companies, especially of profits by the mobile operators, and increased import payments pushed the US dollar on a tilt against the local currency, reaching as high as Tk68.30 before the Eid festival that later slipped to Tk66.25 at the yearend. Annual profit transferred by multinational mobile phone operators were around $50m, while payments against imports, including petroleum products, etc were over $547m during the first 3 weeks of December alone, registering a 12.23% growth over $487.88m in the same period of the previous year.

Against a continuous plummeting of value of taka, a part of the market routed higher price of US dollar through trading of a third currency, especially euro, UK pound and Japan yen, partly in apprehension of regulatory interventions. As a result, a larger volume of the trade in US dollar shifted to this new market. Notably, by the yearend more than 95% of total interbank foreign currency trade took place in the third currency market. As the effective US dollar-taka rate in the third currency market was quite sensitive to foreign currency supply and demand situation, the market experienced larger price shocks compared to the traditional dollar-taka market. Taka depreciated by some 12.8% against dollar considering the price movements in the third currency market.

Usually the state-owned banks were major supplier of dollar in the local market. Despite huge foreign exchange demand for oil and other imports, the banks had stable supply of dollars from the nonresident Bangladeshis and exporters. But higher oil prices inflated the import payment obligations, which pushed them to buy dollars in the local interbank market.

Money market relatively stable

The call money market was relatively stable compared to past few years. Call rates stuck at a high level until May this year when overnight rates ranged from 10-20% in most of the trades. The rates later calmed down in late June. Even during the Eid festival, when the market usually experience liquidity crunch because of enormous cash withdrawals out of the banking sector, the rates showed some restraint. However, in December these rates began to stagger again as Sonali Bank started borrowing and became the single largest borrower. The shift of Sonali Bank's usual position as a lender to borrower has caused the call rates to shoot above 8% in the yearend.

The decline in Treasury bills (T-bills) and bonds rates, since early 2003, eventually came to a halt at the yearend. After 25 months of ceaseless dive, the T-bill and Bond rates for the first time moved up in March 2005 and kept the swing unaltered. However, the rise of rates was higher in shorter tenors. The 28-days T-bill rate has moved up by almost 300 basis points while the 2-years bills moved only 103 points. As a result, the term structure of the government securities formed a flatter shape in 2005.

Total amount of primary issues of Government securities decreased marginally by 1.4% during 2005 over 2004. Outstanding Government debt in Treasury securities also decreased by 9% (around Tk167.0b) in 2005 over that of 2004. However, increase in borrowings through National Savings deposit kept total government borrowing unchanged at the previous year's level (Tk531.0b). Primary dealers of the Government securities remained inactive in 2005, as were in the previous years.

Commercial banks frequently enjoyed the central bank's Repo facility during the relatively high call rates in the first 5 months. Although the Repo rate was around 10% at the onset of the year, Bangladesh Bank lowered it to 7% by March to combat the soaring call rates. But after May banks and financial institutions were scarcely present in the Repo auction due to improved liquidity in the money market, rather they jumped on the Reverse Repo facility from June to November. Toeing a Government strategy to raise the interest rates, the overnight Reverse Repo rate was lifted by 300 basis points at 5.50% from 2.50%. The interbank Repo activities, however, increased compared to the past two years. Tenor of inter-bank Repo increased from overnight weekly basis in most of the transactions in 2005.

In another move, Bangladesh Bank lifted the restriction on US dollar-taka Swap in February, though until June there was no major trade in the market. The volume picked up in the second half of the year after dollar became costly in the local market amid rising demand. As a large number of banks used Swap to fund foreign currency accounts, local supply and demand scenario became the price determinant for dollar-taka swap points in 2005. By the yearend, interest rate differentials rarely had any implication in the dollar-taka Swaps points traded in the local market.

Banks thrive on country's growth

The private commercial banks (PCBs) steadily surpassed nationalized commercialized banks (NCBs) in both deposit collection and loan disbursement by offering more attractive and competitive banking products. As per a Bangladesh Bank (BB) statistics, share of NCBs have declined around 5% from December 2004 when these banks have disbursed some 42.7% of the total credit. On the other hand, share of the PCBs increased by around 7% from 41% of total disbursed loans in December 2004. Up to September 2005 commercial banks disbursed an accumulated amount of Tk1,220.91b as credit to different sectors and also collected Tk1,463.17b as deposit. Of the total disbursed loans, share of the PCBs was 48.1% compared to the NCBs' 37.0%. The specialized state-owned banks (SCB) disbursed 8.5% of the total credit, and foreign banks (FCB) 8.7%. Share of PCBs in total deposits in the banking sector stood about 46%, whereas the NCBs' was 40%. The following table shows the share of total deposits and advances made by commercial banks:

	Deposit (bTk)		Advance (bTk)	
	Dec-04	Sep-05	Dec-04	Sep-05
NCBs	568.00	586.47	395.87	451.74
PCBs	588.00	682.24	484.23	586.04
SCBs	75.10	83.14	94.49	97.67
FCBs	95.52	111.32	72.52	85.46
Total	1,326.62	1,463.17	1,047.11	1,220.91

Growth of the credit disbursement by PCBs place 16% over the same period last year, while the rate was only 3.4% for the NCBs.

At the beginning of the year BB set a target of recovering Tk9.92b default loans out of Tk106.21b lying with 4 NCBs, including Tk2.32b from top 20 defaulters, by December. NCBs were to reduce default loan and operating expenses, improve recovery and control credit growth as per a memorandum signed with the central bank in 2003. These banks, however, made some progress in recovery of default loans, but could not make any major breakthroughs as the public sector itself represents over 50% of the top loan defaulters.

The country's PCBs witnessed a robust growth by about 29.10% of their aggregate operating profits in 2005 over that of the previous year. Operating profit of 29 PCBs out of a total of 30 increased by over Tk6.0b to Tk28.24b, from Tk21.88b last year. Islami Bank, Prime Bank and Uttara Bank are the top 3 profit earners.

As a contractionary policy of the government, interest rates were lowered in 2004, but later it slipped into expansionary threshold in 2005, as continuous pressure from International Monetary Fund since April pushed it up. Both lending and deposit rates showed upward trend during the third quarter of the year. The weighted average interest rate for lending stood at 10.75% in September compared to 10.48% in June, while deposit rate stood at 5.73% up from 5.60%. The rise in deposit rate is marginal compared to lending rate, but the commercial banks have not narrowed the spread. As part of its measures to tighten money supply, Bangladesh Bank suggested that commercial banks should raise lending rates to cap excessive rise in opening of letter of credits that put the foreign exchange reserve under pressure. The rate hike, which central bank described as demand driven, is substantiated by a robust 32% growth in industrial credit in the last fiscal year along with credit rise in the private sector in general. Interest rate for housing loans increased to 13% from 12%, making the house financing costlier. Average lending rate is still in double digit level mainly due to higher rate in private commercial banks. NCBs lowered weighted average lending rate to single digit more than a year ago.

During the year another take over of a foreign bank took place. The Bangladesh wing of Shamil Bank of Bahrain with assets worth Tk3.14b was handed over to Bank Alfalah on May 15. Meanwhile, the wrapping up of the local banking operations of American Express Bank, one of the oldest foreign banks in Bangladesh, has been completed as a part of their ongoing restructuring strategy at the middle of the year. Standard Chartered Bank took over their operations.

Bangladesh Bank as a regulator made a number of major changes to make the banking sector more disciplined:

- As a part of introducing prudential norms in line with the best international practice, classification and provisioning of loan has been further tailored. Under this new system, loans overdue for 90 days or more have to be placed in a 'Special Mention Account' (SMA) and accrued interest of that need to be credited in 'Interest Suspense Account' instead of previous 'Income Account'. SMA had come into effect from March 31, 2005 and would not be treated as default loan, thus, no reporting to credit information bureau (CIB) would be required.
- To curb the inflationary trend through tightening the flow of liquidity in the market, cash reserve ratio (CRR) was raised to 4.5% of their total deposits on a fortnightly average basis from the existing 4.0%, with effect from March 01, 2005. However, the existing rate of statutory liquidity ratio (SLR) still remains at 11.5% that was earlier cut from 20% for enhancing banks' lending ability.
- To stop ill competition and strengthen lending discipline lending risk analysis has been made mandatory for all lending equivalent to Tk10m and above for both fresh and renewal cases. The banks have also been given the authority to fix interest rates and other conditions based on risk factors. At the pre-sanction stage, credit grading would help deciding whether to lend or not. It would also help determine the loan price, extent of exposure and appropriate credit facility and various risk mitigation tools to put a cap on the risk level.
- To check illegal fund transfer through opening fake LCs all banks are directed to follow the 10-point instructions issued on December 15 strictly for opening the LCs against import through land port. Banks must collect the lists of goods, certified invoices and bills of entry through own representatives of approved dealers. Dealers must take steps to preserve all import related information in the computer and customs department will take similar measures so that both can share them. LCs worth $5,000 or above must be sent to the advising bank through SWIFT. Complete information of goods including HS Code (ITC Code) must be mentioned in LCs. Banks must collect the credit reports of exporters as per the rules of the guideline for foreign exchange transaction.

Leasing companies make a difference

Ever since the advent in mid-1980s, the leasing companies in Bangladesh made consistent growth. However, despite a gradual but noteworthy rise of leasing business, the existing companies have been running without a strong structural risk management system. Considering the predicament, BB decided to draw up a uniform guideline for the nonbanking financial institutions (NBFIs) to ensure globally accepted best practices for core risks management under a well defined and unified system like commercial banks. BB has identified 3 core risk areas for NBFIs: credit, internal cost compliance and asset-liability management, and formed 3 committees to devise guidelines on the selected risk areas. It already has issued a circular in this connection and directed the NBFI managing directors to take initiative to implement the guidelines by June 2006.

As an initial measure to tame NBFIs BB has restricted that they would no longer be allowed to borrow more than 15% of their net assets from call money market effective from July 01, 2005. It found that NBFIs had gradually become heavily dependent on inter-bank market to meet short-term fund requirement and had weaknesses in their treasury and related risk management. Bulk borrowers among them have been advised to avert asset-liability mismatch in the long run through alternative long-term fund sources like credit line, mortgage-based securitization and asset securitization.

Insurance receives policy support

As per Annual Report published by Bangladesh Insurance Association total premium income of the private sector life insurance companies rose from Tk10.6b in 2003 to Tk14.1b in 2004 marking a 33% growth. While the general insurance companies' income increased from Tk5.11b to Tk6.22b with a 21.84%. Though the figures for 2005 are not available yet, it is expected to tick almost similar growths. The following table shows premium income from private life and general insurance companies over the past 3 years: (mTk)

Year	Life Insurance	General Insurance
2002	8,274.28	4506.86
2003	10,589.55	5,105.25
2004	14,085.96	6,220.49

The government at long last took initiative for enacting new laws to overcome the chaotic state that was prevailing in the sector due to lack of a sound regulatory framework. Already 3 new draft acts, i.e. Independent Insurance Regulatory Authority Act, 2005, Insurance Act, 2005 and Takaful Act, 2005 for reforming and regulating the insurance operations have been finalized by an 8-strong committee headed by

Chief Controller of Insurance (CCI). The proposed Insurance Act 2005 would replace the existing Insurance Act, 1938 and new rules are on the table to replace Insurance Rules, 1958. Provisions include establishment of a Policyholders' Protection Fund through which valid claims of policyholders would be settled once the insurers fail to pay the claimed money, creation of brokerage houses for insurance policies and requirement of a minimum solvency margin for running their operation. The brokerage houses would replace the existing commission agents, and would bring an end to the irregularities allegedly indulged in by a large section of the general insurance companies under the existing system. The committee has suggested that the paid up capital of the general insurance companies should be raised to Tk250m from the existing Tk150m and that of life insurers to Tk150m from Tk75m. It also proposed an independent regulatory authority to replace the existing Department of Insurance (DoI) to bring all insurance companies, both private and state-run, under a uniform regulatory framework. Currently, the CCI regulates private insurance companies, while state-owned Sadharan Bima Corporations (JBC) and Jiban Bima Corporation (JBC) are regulated by Insurance Corporation Act, 1973. The proposed Takaful Act is aimed to regulate the Islamic insurance business, in line with the experiences of those existing in some other Muslim countries, such as Malaysia, etc. It includes a provision for establishment of a Shariah Advisory Board to oversee the operations of the Islamic insurance companies.

Meanwhile, some 20 new insurance companies are likely to make debut by the first quarter of 2006. The CCI at the Ministry of Commerce has received some 103 applications to start insurance business, of which 55 seeking permission to start Islamic life insurance companies. At present, there are 2 state-owned and 60 private insurance (17 life and 43 non-life) companies operating in the country. Of these, 22 general insurance and 10 life insurance companies failed to issue initial public offering (IPO) despite repeated requests from the regulators. The DoI earlier imposed a fine of about Tk30.5m and issued show-cause notices to these failing companies. In 2005, only 5 of the total 25 IPO applicants got go-ahead signal to go public. Securities & Exchange Commission (SEC), the capital market regulator, refused 13 companies for having deficit or cumulative losses on their valuation balance sheets.

Index downward despite record number of IPOs

During the year Securities & Exchange Commission (SEC) approved a record 20 initial public offerings (IPOs) of which 17 have come to the market to raise Tk3,207m equity capital. Of these 17, some 14 issues have been listed in the local bourses. Most of the IPOs were under regulatory compulsion, however, investors' response was enthusiastic and cogent. The upward trend that set in at the end of 2003 remained hovering somewhat above the water line, though punctuated by periodic political upheavals, annual festivals and market dampers.

The market had occasional surges of bullish run that some times created panic instead of relief. In March, the first such run almost sent headburn to some investors, but heartache to the rest, who reigned in their spiraling anticipations with the experiences drawn from 1996. The regulators were also wary enough to put a muzzle. However, the sizzle later fizzed out in the second half of the year, as the Government adopted an expansionary monetary policy that allowed bank deposit rates go up enough to compete with investment in capital market. Later the political turmoil, fueled by terrorism and rivalry, further dampened the market. Especially the August serial bomb carnages sent a serious and dour signal to the investors that a sour political situation is in the offing and may not revert till the election in January 2007.

Indicators	2005	2004	Chng%
DSE All Share Price Indx	1677.35	1,971.31	(14.91)
Market capital (bTk)	215,404	224,159	(3.91)
Market capital (m$)	3,313.9	3,627.2	(8.64)
No of listed securities	266	256	3.91
No of listed companies	248	237	4.64
No of listed mut. funds	13	11	18.18
No of listed debenture	5	8	(37.50)
Tot. issued capital (mTk)	68,950	49,846	38.33
No of IPOs floated	17	3	466.67
No of issues listed	14	6	133.33
Capital thru IPO (mTk)	3206.9	568.0	464.60
Cos held AGM regularly	241	191	26.18
Cos with min 10% div	47	59	(20.34)

During the year the primary market was buoyant due to 17 new issues most of which were insurance companies and nonbanking financial institutions under regulatory obligation. The issues attracted numerous small investors, as most of these issues fetched copious capital gains, sometimes over 500% exposing the usual valuation and pricing distortion pervasive in the market since long. Enthusiasm for reaping cash benefits from an imperfect market by the investors was manifest in the secondary market, which almost ran dry whenever an IPO was on subscription. Besides, an imperfect distribution system pervaded when the beneficiary owner's (BO) account with the central depository was introduced in the IPO application, and an individual was allowed to apply for only one market lot of an issue to ensure that the profit pie in the primary market be shared among the maximum number of retail investors kept the institutional investors at bay. No institutional investor was in a position to participate in the IPO other than in Grameen Mutual Fund One that had a pre-IPO offer. The new distribution system also led to the mushrooming of the BO accounts to a prodigious number, aimed basically at grabbing a larger share by an individual or group of investors. The degree of owning more than one BO account shot so much so that a number of merchant banks were either reprimanded or put in watch list by the SEC for conniving with the unscrupulous investors to grab a large part of IPO during subscription by faking BO accounts, and an offer by a bank was cancelled before subscription began.

However, the spill over effect of the primary market was not much for the secondary market, which was manifest in the index that lost nearly 300 points. Despite relatively a large number of IPOs entered the market, and most of them had fetched preposterous debut prices, the effect failed to lift the secondary market, or even sustain the price levels.

The secondary market was to an extent vibrant during the first half of the year. Banks, NBFIs and insurance companies played the major role in infusing fresh blood. Backed by better operational performance, regular yet greater dividend yield, bright market and expansion prospects, and above all, stronger regulatory control, etc led these companies being treated blue chips. And they contributed to most of the market volatility during the year. However, some large local and most multinational companies in the pharmaceuticals, information technology sectors, etc have also fared well.

The regulators were active during the year as usual. There was, however, no new development in dealing with the past delinquencies. The 1996 cases that once rocked the market confidence severely still remain out of contemplation. Change in rights issue rules, which suggests announcing 2 separate dates for book closure/record, one for shareholders' decision on the proposed rights issue and the other for entitlement of rights issue after getting the SEC clearance, has created consternation among the listed companies, as it appears cumbersome and anti-market mechanism to most of them. Besides, the new rule that all companies are now to take prior approval from SEC for raising capital to Tk100m or to inform SEC if a company already had capital of Tk100m also created irritation to the private companies who think SEC should not be concerned with their activities as they neither raise capital from public nor come under any direct SEC jurisdiction.

The banking sector was a potent competitor for the capital market in 2005. Lower lending rates attracted many capital-starving companies. For managing large loans syndication has been proved effective. In 2005 only 4 large enterprises received syndicated loan of Tk6.7b from the banking sector after the lending rate came down to substantially lower than in the past decades.

No major incentive has been introduced during the year in the budget for FY2006. However, there was a tax incentive for the unlisted companies. In an undocumented economy where tax evasion by known big business enterprises goes unpunished, effect of such incentive remain under question. But raising tax limit from 37.5% to 40% for the unlisted private companies instead of lowering tax limit for 260 listed companies appear not only ineffective to the capital market, but also counterproductive for the industrial sector as a whole that has the major contribution to the productivity and employment.

The year 2006 may not be so promising as it should for the capital market, had it been not a heated year for politics. As the national election inches by, the political milieu becomes hotter plunging both the investors and issuers to be shaky over major investment decisions. However, long experience and seasoned wisdom are likely to play in the field as well, and the year may have usual ambience like that of 2005, if not better.

Trading

Despite weekly holidays were doubled in August the market was active in more days than in any previous year. Trading took place in 259 days on DSE and a total of 882.8m shares worth Tk64.86b were transacted. This suggests that average daily transaction was around Tk250m, quite large compared to even a couple of years back. The highest transaction in a single day was 10.86m shares worth Tk585.85m while the lowest transaction was 1.03m shares worth Tk86.87m.

Index

Though in the first half of the year the market had gradual rise, later it slipped slowly. DSE General Index had 16.12% annual fall to close at 1677.35 points on the last trading day of the year, starting with 1999.71 points on January 1, 2005, which was also the highest in the year. The lowest was 1434.65 points on May 2. DSE All Share Price Index also declined 15.03% to close at 1275.05 points on December 29 from 1500.50 on January 1. The index reached highest 1500.5 points on March 28 while the lowest was 1099.07 on May 2. The DSE 20 Index declined by 26.12% to close at 1608.63 points on the last trading day from 2177.4 on the first trading day. This index rose to the highest 2214.17 points on March 13 and the lowest was 1536.68 on May 2. The CSE All Share Price Index lost 259.07 points or 7.12% from the opening day of 2005 to close at 3378.68 points on the last trading day.

Dividend

Among 248 listed companies and 11 mutual funds, only 132 (51%) declared dividends till the yearend. Almost 36% of these securities paid dividends within the range of 11-20%, which was above the interest rates of Government savings certificates and FDR in all commercial banks. A large number of companies, basically banks, insurance and NBFIs offered stock dividends as a step to muster capital to meet regulatory compulsions, while 9 companies raised further capital through rights offer. There was a 10% flat tax on dividend as tax on dividend distribution has been withdrawn in FY2005. Tax on mutual funds, however, has remained the same as was in FY2004. The following table shows the dividend distribution scenario:

Dividend range	No of cos	Dividend range	No of cos
Below 10%	45	51-100%	7
11-20%	47	Above 100%	2
21-30%	18	Bonus Share	54
31-50%	13	Right Share	9

More companies, compared to the past years, held annual general meetings (AGMs) regularly. During 2005, some 218 companies held AGMs, while 18 failed to hold it in time. For failing to hold AGMs in time, delay in paying or even non-payment of declared dividends, failure to submit audited annual reports to SEC, etc, a number of companies were reprimanded, warned and fined as well. Some 9 companies received reprimand letters, 18 received show cause letters, while all directors of 8 companies were fined between Tk0.1m and Tk0.2m in 2005.

Compliance	No of cos	Compliance	No of cos
AGM held	218	No dividend	66
Dividend	132	No AGM held	18

Notes:

a. Information disseminated up to 29 Dec 2005
b. Year end of a good number of companies- in June 2005
c. 4 Companies declared dividend for irregular year-end
d. Information extracted from DSE Disclosure
e. Bangladesh Hotels has multiple class of stock & obliged to distribute preferred dividend of 8%

Growth matrix

In 2004 the market encountered huge surge reflecting in the DGEN with 103% uplift, while in 2005 it dipped and lost 14% compared to the last year's index. As irregular market movement is a common phenomenon in the emerging markets like ours, for 2006 a conservative index growth has been estimated by smoothing early changes in growth pattern.[1]

Mkt. Indicators	2000	2001	2002	2003	2004	2005P	2006E
DGEN	642.68	829.61	848.41	967.88	1971.31	1675.64	1724.03
Growth-%	-	29.09	2.27	14.08	103.67	-14.05	2.89
Turnover in bTk	40.27	39.87	34.98	19.15	53.18	61.16	61.71
Growth-%	-	-1.00	-12.25	-45.25	177.68	14.99	0.91
Mrkt Cap in bTk	62.92	63.77	71.26	97.44	224.16	234.21	239.61
Growth-%	-	1.34	11.75	36.74	130.04	4.48	2.31
Issued Capital bTk	31.19	33.25	35.20	46.06	49.53	69.78	70.84
Growth-%	-	6.61	5.86	30.83	7.55	40.88	1.52
Listed Scripts	241	249	260	267	256	285	295
Growth-%	-	3.32	4.42	2.69	-4.12	11.33	3.53

Notes:

- P=Provisional, E= Estimated
- Indicators other than DGEN and listed scripts are also estimated using natural log to reflect the tandem behavior with index
- DGEN was introduced on 27 Nov 2001. Prior to that, it was DSE-all share price index. Here in 2000 DSE index has been used as proxy of DGEN. This could have non-synchronize bias along data set. But, it is found less vibrating as market sentiment was relatively dull during the period.
- Scripts growth is an independent number. Rather than influenced by price or other market parameters, its growth depends more on the company's outlook toward capital market and legislative pressure imposed by SEC. In Bangladesh, SEC is working hard to bring more companies in the stock market. So, estimated growth of 2006 is an arbitrary average of prior growth numbers.
- Time series data have been employed to estimate some selected market indicators, while retrospective data array reflects random walk through for the period. Several facts might have influence on the market parameters.

Rationale behind the likely 2006 scenario drawn

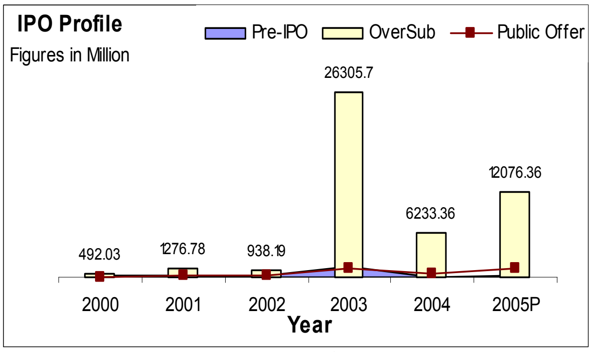
a. Upcoming 2006 is an election year, while political uproar may restrain the nominal growth of the market. Government shifting, ignited agitation could imbalance the normal progression of the market.

b. Terrorism as a new dimension of risk has a significant impact on the market normalcy. Prior observation suggests that bomb blasts in different locations across the country caused sharp fall in market indices.

c. Moreover, next year fresh IPO offer will be available for primary investment, as SEC is encouraging more companies to float shares. Like 2005, for primary market response, there will be temporary downturn in the secondary market.

IPO profile

This year SEC approved 17 companies to issue shares for raising Tk3,207m from the capital market, all of which were massively oversubscribed, pushing up the oversubscription multiple to 10.25 within a range of 2-23x. Multiples highly varied among the issues depending on investors' sentiment, supply of fund during the subscription period and frequency of consecutive offerings. Even though it seems, a very high appetite subsisted for IPO investment, it was not based on the investment fundamentals. Rather they invested to reap short-term capital gains. As investing through BO accounts and allotment per account was minimal, many investors were lured to open multiple BOs using fake profile. All those had cyclic effect and eventually crowded the market around the year. SEC is reportedly working on this issue to ease pressure on primary market and introducing 'book building method' in the market.



Primary market response for the past 6 years

The above graph shows that the highest pre-IPO placement was in 2003 amounting to Tk1,626.5m, which came down to Tk165.9m due to regulatory restrictions imposed to thwart a powerful coterie grabbing good number of shares by a few number of investors. Secondly, public offer was also higher in 2003, over Tk1,351m, compared to Tk1,175m in 2005.

During the period, the highest oversubscription rate was recorded in 2003 (19.47x). This was a manifestation of long starvation of the investors, who after 1996 upheaval fell for an interminable decline until late 2003. Subsequently the rates came down to 13.15x and 10.25x in 2004 and 2005 respectively. In 2003 the highest public offers of Tk13.52b were made in the past 6 years.

Some 14 IPOs were listed in 2003, 3 in 2004 and 14 in 2005. Three issues that were subscribed in 2005 are likely to be listed in early 2006. A few banks and NBFIs are also likely to come in 2006.

The regulatory restriction on a single market lot allocation to each BO in the IPO application rendered adoption of unfair means by the zealous investors to get a larger chunk in the primary market. In an alleged attempt to grab a large portion of Premier Bank shares the sponsors of the Bank were found guilty of opening 25,000 fake BO accounts and numerous bank accounts with fake addresses. SEC later suspended Premier's Tk550m IPO on February 12. A probe committee of Bangladesh Bank also found the Bank's managing director guilty of conniving the arrangement. The MD was later removed under the central bank directive.

Banks, NBFIs and insurance companies have regulatory compulsion to go public. Out of 30 PCBs, already 24 have been listed with the bourses, while 9 NBFIs out of a total 32 have so far been listed. However, most of the insurance companies are yet to be listed. As per Insurance Rules,

[1] For estimation, natural log was employed on each indicator. It roughly helped to smooth the changes over the period. Log distribution is used to reduce the price discreteness, though it is not totally free of bias.

1958, insurance companies must issue IPO within 3 years of registration, and offload 60% of its paid-up capital. The government considering the regulatory urge has initiated a fresh move to expedite the process of floating shares of the unlisted insurance companies, amounting to Tk2.43b, in the capital market in order to bring discipline in the insurance sector.

Mutual funds

The year is also remarkable for mutual funds, as the second mutual fund under private initiative was launched and listed in record time. Grameen Mutual Fund One, a Tk170m close end fund, sponsored by the microfinance pioneer Grameen Bank, was designed and launched by AIMS of Bangladesh Limited, the first ever and only asset management company under private initiative, and was responded overwhelmingly both in the pre-IPO and IPO subscription. Simultaneously, the first private sector mutual fund, AIMS First Guaranteed Mutual Fund, has got an extra lease of life for another 10 years and its size doubled to Tk140m in an unprecedented move by its investors. The fund offered a handsome 18% dividend this year. Earlier ICBAMCL, the state-owned asset manager, also launched its second close-end mutual fund, which received well response.

Though private sector mutual funds appear to gain grounds in the market, there still remains the uneven playing field between the state-owned and private sectors, which is the reason the second private fund emerged after long 5 years of the first, and yet from the only investment manager. Due to regulatory discrimination, as it always was, no new asset management company under private initiative came forward with mutual fund, and there is no sign to emerge in the near future. Despite repeated attempts by the private sector to bring the state-owned fund managers to the level playing field, no steps were taken during the year. The state-owned investment agencies still remain under their own regulatory framework only to enjoy the privileges that strongly seem contradicting the market philosophy of the present order and morally incongruent.

The bond market

The secondary bond market, which was introduced on DSE on January 1 2005, remained dysfunctional during the year, as only a few transactions took place during the whole year. Though encouraged by the Government, the regulators and the Exchange, the bond market failed to intrigue general investors.

New rules and regulations

- SEC further widened the price movement restriction on the well-performing category-A share from June 2004, against relaxation on the category-B, -G and -Z in May. Securities of all the categories with closing price up to Tk200 will be allowed to fluctuate by 20% or Tk35, those closing above Tk200 to Tk500 can move 17.5% or Tk75. The circuit breaker will be lifted for 24 hours if there is a price sensitive declaration.
- SEC has banned trading by the insiders like employees, sponsors, directors, auditors, consultants, and beneficial owners of the listed companies through an amendment to the SEC (Beneficiary Trading Ban) Regulations, 1995.
- SEC withdrew the provision of declaring annual book closure for companies adopting CDS, as CDS outdated the need for announcing the usual 2-week book closure and replaced it by a newly introduced 'record day' by which a publicly traded company will record names of the shareholders eligible for dividend and trading of shares will remain suspended on the day.
- All private limited companies will be required to get prior consent from SEC before raising paid up capital above Tk100m and companies that have already raised capital over Tk100m will also have to inform SEC and provide details of operational activities.
- Mandatory provision of opening beneficiary owner (BO) account during applying for primary shares reintroduced, as delay in trading in the bourses and in dematerializing scrips with the CDS is yet to be overcome.
- Credit extending facility by brokers, 67% on the value of a security has been suspended, and the members' margin requirements increased.

Special moves

- The trading of government bonds started in the Dhaka Stock Exchange on January 1, 2005 that added a new investment product for the investors in the capital market. Government Bonds of 5-years and 10-years maturity are now traded in the stock market.
- The Securities and Exchange Commission (SEC) reduced clearing and settlement period of securities transactions in the stock exchanges to T+1 and T+3 respectively for A, B and G category shares.

[Sources used include daily newspapers, preferably The Financial Express, The Daily Star, The New Age and other national dailies; DSE Monthly Review throughout the year, ADB Quarterly Review, SEC Quarterly Review, Monthly Economic Trends, B.Bank Annual Report 2003-04 and the Scheduled Banks Statistics of Bangladesh Bank, miscellaneous sources from Internet etc.]

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To take the extra mile to meet the customer's needs through continuous innovation of suitable financial products and offering the best services.
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To strive for achieving and maintaining the highest ethical and moral standards to earn the trust of our clients and patrons.

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