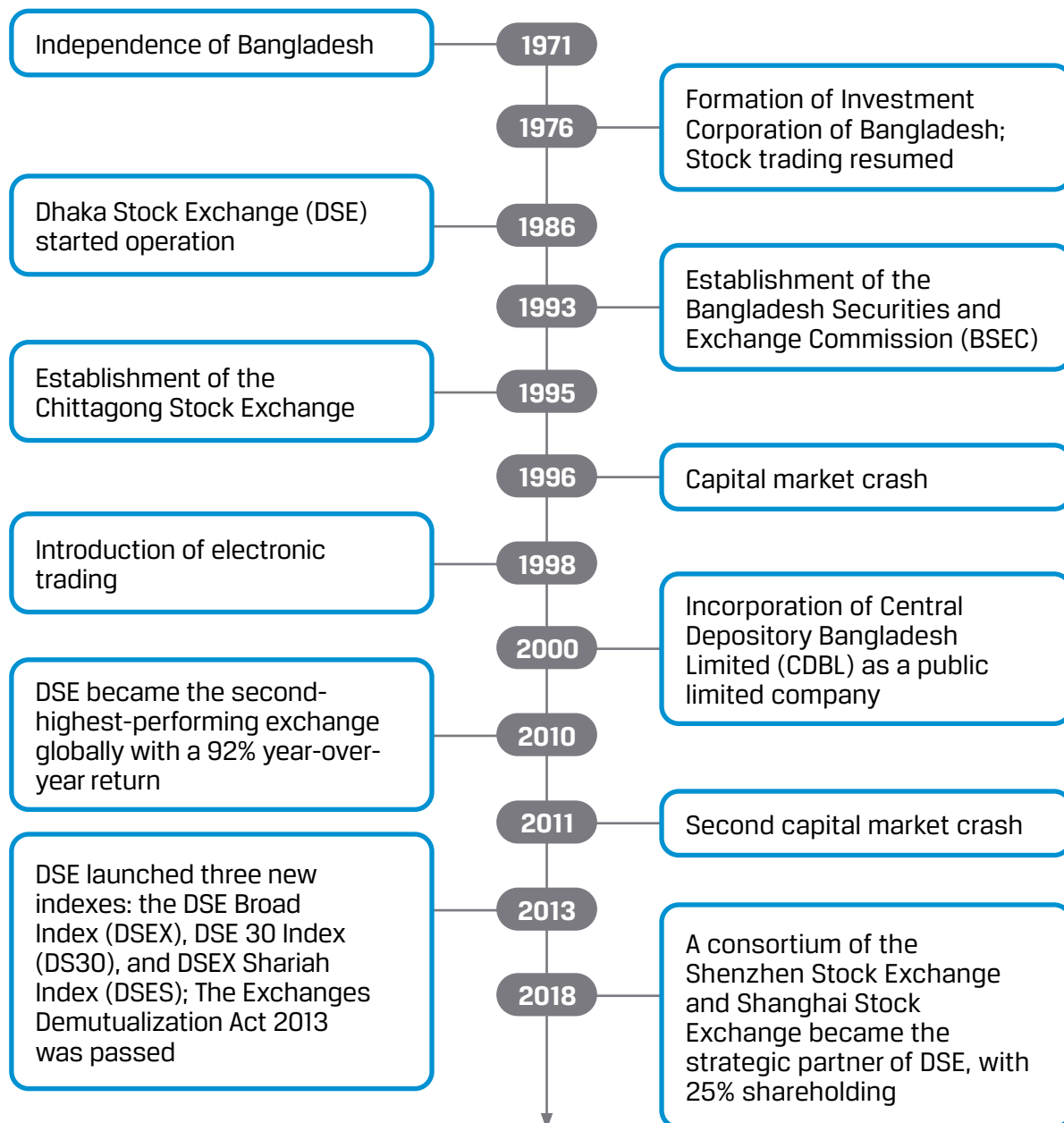


BANGLADESH



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| | | | |
|------------------------------------|--------------------|--------------------|--------------------------------------|
| Equity Market Capitalization (USD) | 40.67 Bn* | 25.04 Bn* | Debt Market Capitalization (USD) |
| Domestic Equity Market Cap/GDP | 14%* | 8%* | Domestic Debt Market Cap/GDP |
| Equity Market Share Volume Traded | 17,280 Mn** | 2,250 Mn*** | Debt Market Instrument Volume Traded |
| Number of Listed Companies | 317* | 5* | Number of Issuers (Bonds) |

* As of June 2019

** June 2018–June 2019

*** As of June 2020

OVERVIEW

Bangladesh has an impressive recent track record for growth (8.15% GDP growth rate in 2019).¹ This growth resulted from a fast-growing manufacturing sector—which includes the second-largest garment industry in the world—and solid remittance inflows. Sustained reforms, prudent macroeconomic policies, and political stability have also contributed to this growth. In the last decade, the economy has experienced a GDP growth rate of close to 7% (according to the International Monetary Fund),

¹Sources: World Bank national accounts data and OECD National Accounts data files.

with stable and moderate inflation, a low level of public debt, and adequate foreign reserves.

BANK-DOMINATED FINANCIAL SYSTEM

The financial system of Bangladesh is bank dominated. In 2019, the ratio of banking sector assets to GDP stood at 64%, and the market capitalization of listed domestic companies to GDP stood at 14%. These numbers imply there may be scope for capital market deepening. A wide range of reforms and initiatives have been put in place—including the Bangladesh Capital Market Development Master Plan 2012–2022—to

bolster raising funds in a cost-effective manner, enhance financial intermediation, expand alternative sources of credit, enable investors to gain access to alternative investment opportunities, and boost investor confidence.

STOCK MARKET HISTORY

The history of the stock market in Bangladesh dates back to 1954, when the East Pakistan Stock Exchange Association Ltd. was formed. After the Bangladesh Liberation War ended in 1971, trading was halted for five years; it resumed in 1976. In 1986, the country's premier bourse took on its current name, Dhaka Stock Exchange (DSE). In 1993, the Bangladesh Securities and Exchange Commission (BSEC) was established as the regulator of the country's capital markets through the enactment of the Bangladesh Securities and Exchange Commission Act, 1993. Chittagong Stock Exchange (CSE), the country's second stock exchange, was established in 1995.

The two exchanges have similar equity market capitalization, around USD29 billion. As of 19 July 2020, DSE had 359 listed stocks and closed-end mutual funds and CSE had 329. The two exchanges have a lot of overlap in listed stocks, and it is possible to buy shares of a company on one exchange and sell them on the other. DSE dominates turnover, with more than 90% of the total trade volume on any given day. Therefore, we will focus primarily on DSE in the rest of this chapter.

Even though the capital market started functioning in 1976, the lack of infrastructure, a socioeconomic crisis, and political instability limited activity until the 1990s. The 1996 capital market crash triggered reforms, such as the introduction of electronic trading in 1998, the establishment of Central Depository Bangladesh Limited (CDBL) in 2000, and the formation of

the independent Central Depository System (CDS) in 2004. These reforms, coupled with the Grameenphone IPO in 2007, helped build investor confidence, making DSE the second-highest-performing exchange in the world. The IPO book-building method, introduced in 2010, represented a major change from prior fixed-price IPOs. In 2013, DSE, in collaboration with S&P Dow Jones Indices, introduced the DSE Broad Index (DSEX), DSE 30 Index (DS30), and DSEX Shariah Index (DSES).

Another significant change came in 2013 when the exchange was demutualized. In 2018, a consortium of the Shenzhen Stock Exchange and Shanghai Stock Exchange became the strategic partner of DSE, with a 25% shareholding and plans for technological upgrades, new product development, and promotion of Bangladeshi indexes in China.

EQUITY MARKET STRUCTURE, INVESTOR PROFILE, AND TURNOVER

The ratio of market capitalization to GDP stood at only 14% in Bangladesh in June 2019 (see **Table 1**). The stock market is not a good representation of the economy, with many companies remaining private. As an example, the ready-made garment industry, which makes up 80% of the country's exports, has almost no presence in the stock exchange. The market has also performed poorly. From 2014 through 2019, the DSEX had a cumulative aggregate geometric return of 0.08%, in contrast to nominal GDP growth of 12%–14% per year.

There are about 2.55 million beneficiary owner (BO) accounts in Bangladesh. BO accounts are used to uniquely identify buyers and sellers of instruments, and therefore, it is mandatory to

TABLE 1. SUMMARY OF STOCK MARKET

| Item | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 |
|----------------------------|---------|---------|---------|---------|---------|
| MCAP (BDT billions) | 2,276 | 2,327 | 1,932 | 1,977 | 2,386 |
| Percentage of GDP | 29% | 25% | 18% | 16% | 18% |
| ADTV (BDT millions) | 10,593 | 13,466 | 4,841 | 3,542 | 4,650 |
| Number of listed companies | 273 | 267 | 279 | 296 | 307 |
| Item | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| MCAP (BDT billions) | 2,702 | 2,614 | 3,239 | 3,263 | 3,436 |
| Percentage of GDP | 18% | 15% | 16% | 14% | 14% |
| ADTV (BDT millions) | 4,643 | 4,432 | 7,460 | 6,574 | 6,032 |
| Number of listed companies | 326 | 330 | 334 | 343 | 355 |

Notes: MCAP = market capitalization. ADTV = average daily trading value. GDP = gross domestic product. BDT = Bangladesh taka.

Source: DSE.

have one before trading in the stock market. Active stock trading occurs in only 100,000–200,000 BO accounts, however, which implies that the stock market is not a popular investing destination for the vast majority of the Bangladeshi population of 170 million–180 million people. Fixed-income securities—such as fixed deposits and national savings certificates—and land tend to dominate asset allocation.

Figure 1 shows the sectoral market capitalization breakdown for DSE. The main sectors are telecommunication, financials, pharmaceuticals, consumer goods, and power. The top 20 companies by total market capitalization make up 54% of the market. In terms of shareholding, sponsors own the highest percentage, followed by foreign investors, the general public, institutions, and the government.

In terms of turnover, the market is dominated by local investors. Over the years, however, foreign institutional investors have been increasing their participation in daily activity. Compared

with a daily market share of 1%–2%, foreign institutional investors in the last few years contributed around 6%–8% to daily transactions.

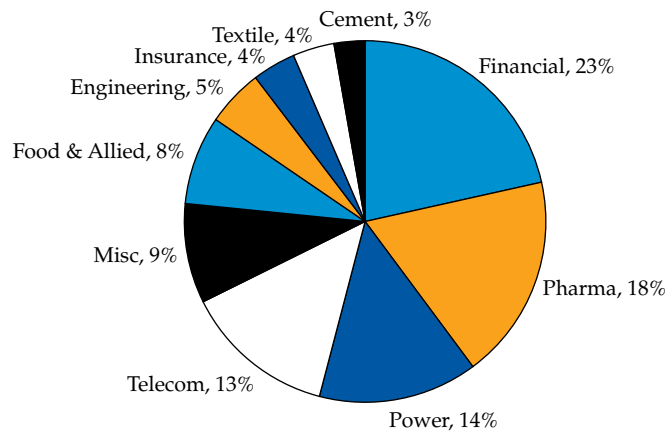
FIXED-INCOME MARKET IN BANGLADESH: POTENTIAL NOT YET EXPLORED

The fixed-income market in Bangladesh is dominated by government Treasury bills and bonds. Issuance of debt instruments by quasi-government entities and corporations is at a nascent stage because of a small investor base, relatively high issuance costs, and a lengthy time to issue compared with bank loans.

The Bangladeshi fixed-income market is relatively small. The government bond market accounts for only 7.9% of GDP, and the corporate bond market accounts for only 0.01% of GDP.

Since 2011, the settlement of government bonds has taken place on a platform called Market

FIGURE 1. DSE SECTORAL MARKET CAP BREAKDOWN AS OF 23 JULY 2020



Note: The data do not sum to 100% because of rounding.

Source: DSE.

Infrastructure Module, which is owned and maintained by the central bank.

FIXED-INCOME MARKET STRUCTURE

Government-issued instruments can broadly be categorized into three segments: Treasury bills and bonds, savings instruments, and government-entity-issued captive bonds, the latter two of which are non-tradable. **Figure 2** presents outstanding positions of debt instruments. As of June 2020, total outstanding debt securities stood at USD69.7 billion, of which USD33.27 billion (47.7%) were Treasury bills and bonds, USD1.25 billion (1.8%) were government-entity-issued captive bonds, USD35.5 billion (50.4%) were savings instruments, and the remaining USD45.6 million (0.1%) were listed corporate bonds.

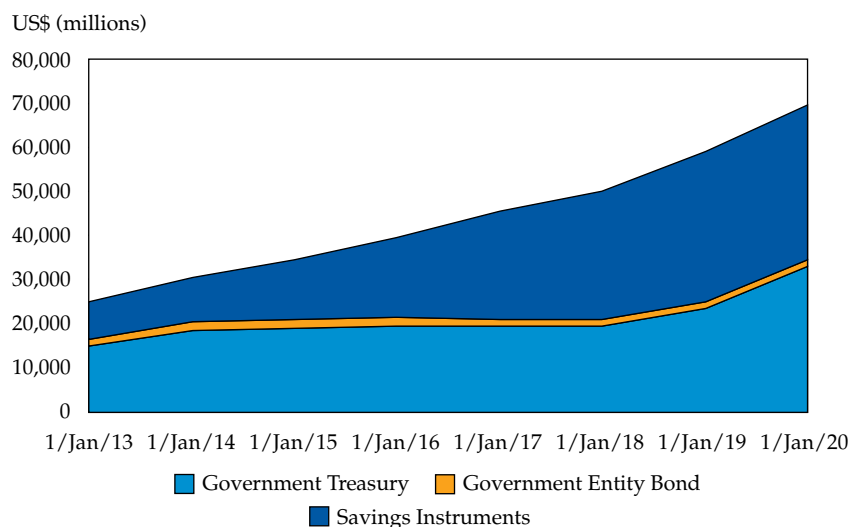
From June 2015 to December 2020, 88 firms received approval to raise debt by issuing bonds

in private placements, totaling USD4.48 billion. From July 2018 to June 2019, USD1.518 billion in bonds were issued in the form of private placements, mostly by banks in the form of debt for Tier 2 capital to comply with Basel III requirements. The fixed-income market in Bangladesh is denominated in local currency, and the country has not yet explored issuing debt instruments in foreign currency. Local companies are not allowed to invest in foreign-currency-denominated securities.

Yearly issuance of government Treasuries fluctuates with the interest rate cycle, which is the determining factor in the sale of government savings certificates. The government adjusts its fiscal deficit by fine-tuning issuance of Treasury bills and bonds. The corporate bond market is almost nonexistent.

The largest investors in the fixed-income market are commercial banks: In June 2019, investments from commercial banks and financial institutions (FIs) in government securities totaled

FIGURE 2. OUTSTANDING DEBT INSTRUMENTS



Sources: Bangladesh Bank; BSEC; Department of National Savings.

USD16.7 billion (70.4%; see **Table 2**). The second-largest investors are insurance companies (including the deposit insurance fund of the central bank), which held USD2.8 billion (11.6%) in government securities. Foreign investment in the bond market is at nascent stage, although there are no capital controls. The Bangladeshi

taka has been a stable currency over the last two decades.

The automated process of trading and settlement of government bonds began in 2011, after which secondary trading started to flourish. Commercial banks are a major player in the secondary market. With a small investor base and

TABLE 2. TREASURY BILL AND BOND INVESTMENTS BY INVESTOR TYPE (IN USD MILLIONS)

| | Central Bank | Commercial Banks and FIs | Insurance Companies | Corporate Bodies | Mutual Funds and Pension Funds | Foreign Investors | Individuals |
|-----------|--------------|--------------------------|---------------------|------------------|--------------------------------|-------------------|-------------|
| June 2016 | 597.75 | 15,958.86 | 2,218.34 | 114.68 | 655.84 | 54.79 | 31.69 |
| June 2017 | 635.78 | 15,578.51 | 2,421.15 | 74.53 | 660.44 | 5.43 | 43.75 |
| June 2018 | 1,300.97 | 15,199.11 | 2,400.59 | 91.78 | 655.90 | 2.80 | 50.55 |
| June 2019 | 3,363.06 | 16,704.51 | 2,753.16 | 73.65 | 785.28 | — | 48.24 |

Source: Bangladesh Bank (June 2019).

TABLE 3. RETURN COMPARISON OF DURATION-WEIGHTED PORTFOLIO AND 5- AND 10-YEAR GOVERNMENT BONDS, JULY 2015–JUNE 2020

| | Weight | Avg. | Worst | Best | Std. Dev. |
|------------------------------|-------------------|-------|-------|-------|-----------|
| <i>1-Year rolling return</i> | | | | | |
| Hypothetical portfolio | Duration weighted | 7.6% | -3.3% | 25.1% | 8.7% |
| 5-year bond | 100% on 5 year | 6.6 | -5.3 | 24.6 | 8.8 |
| 10-year bond | 100% on 10 year | 9.1 | -1.6 | 32.3 | 11.7 |
| <i>3-Year rolling return</i> | | | | | |
| Hypothetical portfolio | Duration weighted | 9.8% | 1.6% | 17.1% | 5.9% |
| 5-year bond | 100% on 5 year | 9.4 | 0.7 | 17.7 | 6.4 |
| 10-year bond | 100% on 10 year | 11.0 | 1.7 | 19.3 | 7.0 |
| <i>5-Year rolling return</i> | | | | | |
| Hypothetical portfolio | Duration weighted | 10.2% | 7.2% | 12.8% | 1.9% |
| 5-year bond | 100% on 5 year | 10.1 | 6.3 | 13.1 | 2.5 |
| 10-year bond | 100% on 10 year | 11.5 | 7.9 | 14.0 | 1.8 |

Sources: Authors' calculations; Bangladesh Bank; Reuters.

the above-market interest rate of non-tradable savings certificates, there is limited secondary trading of government bonds. The average monthly transaction volume was USD202.9 million at the end of June 2020. The majority of the transactions took place in the OTC market.

There is no fixed-income index in Bangladesh. For a hypothetical market-duration-matched portfolio with semiannual rebalancing,² as of June 2020, the five-year (one-year) rolling total return would be 7.5% (8.3%). From July 2015 to June 2020, the average 1-year return of a 5-year

(10-year) bond would be 6.6% (9.1%), as **Table 3** shows. Returns on all three-portfolios improve significantly over a longer time frame.

CHALLENGES, OPPORTUNITIES, AND THE WAY FORWARD

The following issues pertain to the future of the Bangladeshi stock market.

Lack of quality IPOs: The Bangladeshi stock market is not a good representation of the economy, because some key sectors, such as the garment industry, are not represented in the market. Also, with a new generation of technology companies emerging, IPO rules can be modified to foster listings.

²The portfolio is constructed by matching the duration of the portfolio with market duration. The portfolio is rebalanced semiannually by replacing older issues with fresh issues and is matched with market duration at each rebalancing date. Any cash flow received between rebalancing times is reinvested until the next rebalancing date at the prevailing T-bill rate. Cash flows for less than 30 days until rebalancing, however, are not reinvested.

Corporate governance and market integrity: Similar to other frontier markets, Bangladesh lags behind developed markets in terms of minority investor protection, corporate governance, and insider trading regulation. Making progress in these areas can lead to substantial benefits.

Lack of new products: Currently, an investor can take only long positions in equity securities via the stock market. Adding new types of products—such as index funds and exchange-traded funds—can attract different types of clients with higher or lower risk appetites.

Technology upgrades: During the initial stages of the COVID-19 pandemic, the stock market remained closed for two months because the stock exchange is not fully automated. With rising internet penetration and a more tech-savvy population, now is the perfect time to make the market fully automated by leveraging technology.

The following issues pertain to the future of the Bangladeshi fixed-income market.

Dual risk-free interest rate: Retail investors are not interested in government and corporate bonds, because they can earn higher interest rates on national savings certificates. To overcome this challenge, savings certificate rates must be aligned with market interest rates.

Creating a sizable demand side: The creation of pension funds and fixed-income mutual funds should help generate stable demand, an additional reason for the government to consider starting these initiatives.

Listing of government bonds: Currently, government securities are not listed on any exchange. Regulators should give priority to the listing of government securities. Additionally, older issues should be replaced with newer issues to reduce the number of instruments and to increase market liquidity.

Simplified listing requirements for corporate bonds: For corporate bonds, listing regulations should be simplified and listing costs reduced. Tax incentives should be considered. Semiautonomous bodies may consider issuing project-based bonds against a government guarantee to create a high-quality and stable source of supply.

Showcasing the strength of the country to global investors: Bangladesh is one of only a few countries with an average GDP growth rate of at least 7% over the last decade. Also, the Bangladeshi taka has been a stable currency in comparison to peer countries' currencies. New initiatives could be developed to increase the interest of global investors.