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Problem, Prospect, and Challenges in Bangladesh Bond Market

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Abstract: *One of the reasons that the stock market in Bangladesh is volatile because the market is less diversified. Bangladesh Capital market is frontier in nature and the market is heavily dominated by equity products. Worldwide stock/Equity is much riskier compared to bond/debt, as equity is more dominant in the market, its risk is not possible to shift it elsewhere. Developing a vibrant Capital Market there is no alternative to the bond market. According to the Seven Five-Year Plan (7FYP), one of the major goals of Bangladesh governments' is to build a dynamic bond market for the stock market advancement. A strong bond market not only ensures long-term finance but also reduces dependence on banks and other Financial Institutions. Besides, there is a less volatility in bonds as well as the limited risk associated with it. This article attempts to analyze the problem, prospect, and challenges of Bond Market in Bangladesh.*

Keyword: *Stock/Equity Market, Capital Market, Bond Market.*

1. Background

A mature capital market comprises various market instruments like stocks or equities, bonds, debentures, Mutual Funds and derivatives in the world perspective. But the capital market in Bangladesh is at a nascent stage. It is a matter of sorrow that "the activity of the bond market in Bangladesh is limited and fragmented. It is still dominated by the government securities. There are Treasury Bills (T-bills) and Bangladesh Government Treasury Bonds (BGTB or T-bonds) with different maturity periods. T-bills are short-term and t-bonds are long-term fixed income government securities. Latest statistics of the central bank show that total turnover of the secondary trading of the t-bills and t-bonds stood at Tk. 282.91 billion in 2017 while the value was Tk. 514.08 billion in 2016."[1] Bangladesh Capital Market is mainly equity-based.

Very few bonds, treasury bills and debentures are available here. Of the three namely bonds, debentures, and treasury bills the bond is the main debt instrument. In the market

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1 This part of the writing is from the Financial Express. [https://thefinancialexpress.com.bd/views/views/a-long-wait-for-a-dynamic-bond-market-1518537189]/ A long wait for a dynamic bond market

where there are **only three bonds**. But the bond market could be developed to a great extent.

It’s a long arduous journey for Bangladesh’s capital market. The market is not yet an effective investment avenue. It has failed to emerge as a source of enough fund generation in the absence of adequate debt instruments. Most of the foreign institutional investors, as well as local investors, are very conservative in attitude in view of the risks in an equity-based market. In general, a debt instrument is less risky than any equity. Enough funds could be raised from small savers and corporate bodies through bonds, especially after the two big market crashes (Bangladesh’s capital market experienced the two biggest debacles in 1996 and 2010). The bond market has not developed that much in Bangladesh. If it could be developed, it might have left its spillover effect on the economy. For example, the bond market directly influences the macroeconomic factors like exchange rate, inflation etc and vice versa. In 2010 the contractionary monetary policy left its negative spillover effect on the bond market impeding its development.

A strong capital market can easily provide ample funds to meet the demand for low-cost capital and thus aid economic development. If the capital market ensures a proper mix of diversified products like debt instruments and equities, then it will be better for our financial market as well.

2. Literature Review

The author wanted to tell about the necessity of the bond market. **Patil (2001)** mentioned that the Indian financial system is not well developed and diversified. One major missing element is an active, liquid, and large debt market. In terms of outstanding issued amount, Indian debt market ranks as the third largest in Asia, next only to that of Japan and South Korea. Further, in terms of the primary issues of debt instruments, the Indian market is quite large. The government continues to be a large borrower, unlike South Korea where the private sector is the main borrower. If we compare the size of the Indian GDP with the outstanding size of the debt flotation, Indian debt market is not very much underdeveloped. There is no doubt in the Indian market that the bonds have bright prospects.

Through the bond, financial innovation is possible by the author. **Fabozzi (1989)** argued that “Market- broadening instruments, which augment the liquidity of markets and the availability of funds by attracting new investors and offering new opportunities for borrowers.”

Japan's financial market has been termed as less risky to government bonds. **Boudoukh and Whitelaw (1993)** showed their study that in Japan, almost identical government bonds can trade at large price differentials. Motivated by this phenomenon, we examine the issue of the value of liquidity in markets for riskless securities.

Spiegel (2012) showed the concept of the new bond market namely currency bond market. This article viewed that another motivation for encouraging the development of local currency bond market is that it allows markets to reach transaction volumes sufficient to achieve economies of scale and reduce funding cost for issuing domestic firm.

Making of funds in the stock market, the focus of the bond market has been highlighted. Bond market link issuers having long-term financing needs with investors willing to place funds in long-term, interest-bearing securities. A mature domestic bond market offers a wide range of opportunities for funding the government and the private sectors. **(World Bank hand Book)**

The author tried to create a link to the bond market with the Foreign Exchange Reserves here, **McCauley (2003)** identified that a potential synergy between the growth of foreign exchange reserves and the development of regional bond markets. The synergy arises from the use of public obligations to finance (or to sterilize) holdings of foreign exchange reserves. The fact that these obligations have commonly taken the form of central bank debt, however, has meant that much of the opportunity for them to develop the bond market has been missed. Drawing on Singapore's experience, one can envision how changes in debt management practices by governments, and corresponding changes in the liability structures of central banks, could help realize the potential.

The author discussed the bond market prospects in the context of Bangladesh. **Jahur and Quadir (2009)** their study has found that the size of the debt market of Bangladesh is very low as compared to other SAARC Countries; has huge growth potentiality; and identified important impediments to the growth and development of Bond Market in Bangladesh such as risk and return factor, liquidity and government policy factor, issue management factor, investment policy factor, macroeconomic and regulatory factor, and market & issue related factor. The study has suggested some important policy measures such as regulatory change, the establishment of the long-term yield curve, offering fiscal benefits, encouraging companies raising funds through corporate bond issues, keeping treasury rate low etc. for the development of Bond Market in Bangladesh.

The authors discuss various aspects of bonds in the context of East Asia. **Fabella and Madhur, (2003)** their study revealed that a initiatives to develop bond markets in East Asia should focus on: (i) sustaining a stable macroeconomic environment with low inflation and stable interest rates, (ii) developing a healthy government bond market that would serve as a benchmark for the corporate bond market, (iii) completing the post-crisis agenda of banking sector restructuring, (iv) improving corporate governance, (v) strengthening the regulatory framework for bond market, (vi) rationalizing tax treatment of bonds, (vii) broadening the investor base, and (viii) promoting the growth of regional bond market centers.

Batten and Kim (2001) mentioned that three points about why a bond market does not grow. They viewed that there was a cheaper financing offered through borrowing unhedged in yen and US dollars during a period of financial liberalization, significant interest rate differentials and overvalued currencies in a protected exchange rate regime. Second, the bank-centered domestic financial systems characteristic of the region, while appropriate for high-growth outcomes, resulted in the neglect of capital market development. Third, corporate governance structures were complicated by the presence of founding families exerting influence over the funding activities of the firm.

Chowdury (2012) has shown his study "Investor's Confidence increases due to a Vibrant bond market, at the same time, showed why bond market underdeveloped. 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 the 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 the fulfillment of their statutory obligations, this has crowded out financial resources for the private sector and distorted the overall financial market.

Herring and Chatusripitak (2007) have argued that the bond market is behind the overall economy. Their research article revealed that "In emerging economies in Asia, bond markets are very small relative to the banking system or equity markets. Moreover, the most striking theoretical results flow from a comparison of the debt contracts with equity contracts and at a high level of abstractions of bank lending can proxy for all debt."

Edwards et al. (2007) commenced a study regarding 'Corporate bond market transaction costs and transparency'. Researchers discussed the nature of the bond transaction at the market in their paper. They viewed that "transaction costs decrease significantly with trade size. Highly rated bonds, recently issued bonds, and bonds close to maturity have lower transaction costs than do other bonds. Costs are lower for bonds with transparent trade prices, and they drop when the TRACE system starts to publicly disseminate their prices."

Ahmed (2017) have viewed that borrowing from the banks for medium to long-term capital requirement remains open and cheap, the corporate houses will not bother to issue corporate bonds. The investors are also skeptical about the honesty of corporate houses. A few corporate houses that issued fixed or variable interest-bearing debentures or bonds failed to live up to their commitments. In the end, though individual debenture holders got back the money, the institutional investors had to forgo a part of their receivables. This author also thinks that the bond market is not coming up in Bangladesh as the investors here want more of return which is possible from equity investment only.

In the above literature, the concerned authors discuss the importance of the bond market but this article explores the current status of Bangladesh Bond market.

3. Objectives of the Study

The article has the following key objectives

- To discuss the importance of the bond market for Bangladesh Capital Market;
- To highlight the status of the World bond Market, especially in the investment scenario in the USA;
- To Identify some of the key timeline considerations associated with the bond market in Asia;
- To analyze some critical issues of Bangladesh bond market and accordingly focus on some forward-looking steps.

4. Methodology and Sources of Data

The article is very significant in this sense that this piece has been highlighted a comprehensive picture of Bangladesh's Bond market with the world's bond market. There is much notable information which will help the stakeholder's associated with the market. Nature of this article is descriptive and there is a limited piece of article about bond market in Bangladesh.

This article is based on secondary information includes

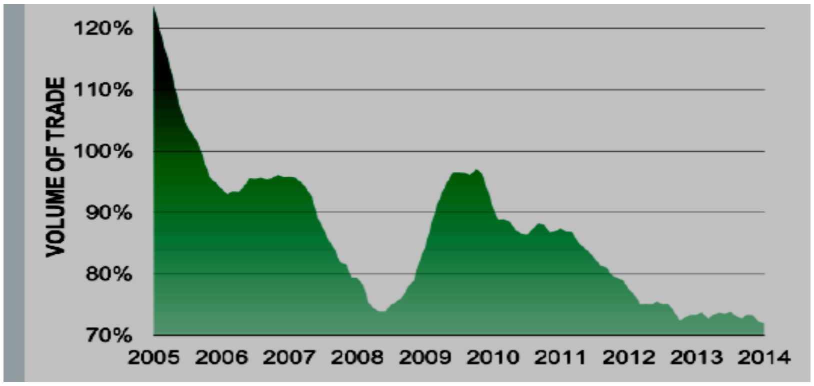
- Publish Report (Dhaka Stock Exchange Monthly Review; Bangladesh Bank Annual Report);
- Relevant books and journals and
- The research publications of relevant Financial Institutions.

So this article can be considered as a preliminary analysis of the overall bond market of Bangladesh.

5. World Bond market statistics

At present 'corporate bond' is the single most important source of capital for the most of the companies around the globe. A well-structured, sound and efficient bond market is a principal instrument of financial market structure, providing capital for issuers and investment opportunities for a greater number of savers and investors.

Figure 1: USA investment grade Bond volume as % of outstanding debt[2]



In **figure 1**, to see there are five lines. The line represents the 12-month rolling value of trade as a share of the outstanding debt.

5.1 The bond market in Asia

The capital market actually originated and flourished in Europe. Then it came to Asia. So the capital market wings like bonds are very strong in Europe unlike in Asia. Of late, the market players in Asia are introducing different debt instruments. In recent years corporate borrowers in Asia were very much attracted towards long-term debt instruments, especially bond market. The reasons are given below:

Strong fundamentals and reasonable interest rates along with smooth creditworthiness are the key factors that spurred Asia's borrowing spree;

The strong bond market can serve as a resilient weapon to spare 'tire effect'. That means in case of any money market crisis the bond market plays a significant role where the money market is interlinked with the capital market.

If we look at other Asian markets we see local and other international banks stepped in to fill the gap when the European lenders reined in financing activities abroad. On the supply side, corporate bond issuance received a strong boost from regulatory and policy initiatives aimed at deepening bond markets and improving related infrastructure.

In addition, the stable and expeditious growth of Asia's corporate bond markets has been partly an outcome of the region's efforts to establish domestic government bond markets.

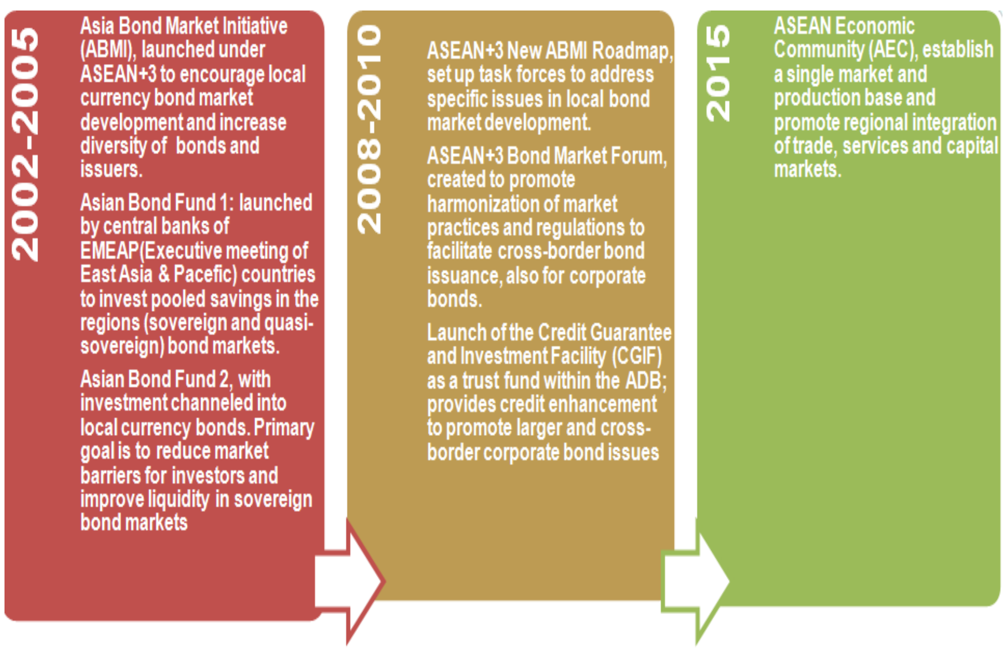
It is an example of other emerging market countries trying to build their strong bond markets to boost up the capital market function. It becomes a role model for Bangladesh's capital market also, though we have no currency crisis. Our neighboring

[2] *source: Market Axess. As of September 2014

country India experienced a rupee crisis. India's capital market is far stronger than our capital market with a diverse mix of long-term instruments.

Various initiatives taken in Asia (**see figure2**) to strengthen cooperation among Asian countries have contributed immensely to the development of the bond market. The initiatives have been taken following a systemic crisis triggered by balance sheets in 1997/98. Fabella and Madhur (2003) explained the key initiatives of bond markets in EAST ASIA. Their study showed that "Initiatives to develop bond markets in East Asia should focus on: (i) sustaining a stable macroeconomic environment with low inflation and stable interest rates, (ii) developing a healthy government bond market that would serve as a benchmark for the corporate bond market, (iii) completing the post-crisis agenda of banking sector restructuring, (iv) improving corporate governance, (v) strengthening the regulatory framework for bond market, (vi) rationalizing tax treatment of bonds, (vii) broadening the investor base, and (viii) promoting the growth of regional bond market centers.'

Figure 2: Timeline of bond market development in Asia[3]



6. Importance of long-term debt instrument: Prospect of Bangladesh

Capital Market includes stock, bond, derivative and others. But unfortunately, the capital market activities in Bangladesh are limited to banks, merchant banks or investment

[3] Source: The timeline figure prepared by the author based on Asian Development Bank inclusive report 2012

banking, stock brokerage, asset management companies and so on. Only three bonds are available here. So, it is clear that the bond market is simply under-developed. Why under-developed?

Basically, the Bangladesh Bank sells bonds on behalf of the government and the main buyer of the bond is the Financial Institution especially in banks. When the government is in need of its own financing and require to provide credit to the government-owned enterprises and institutions, they offer the bond into the market through the auction of the Bangladesh Bank. Generally, commercial banks participate in this auction. As Bangladesh Bank sells bonds to other commercial banks at a discount that is why commercial banks easily get their capital during the bond maturity period at par values.

On the other hand, lack of trading procedure of bonds in the secondary market is the major reason for stock market under-developed. The activities of secondary market are limited to T- bills and T- bonds. Besides, there is no chance of bond trading Over the Counter Market (OTC).

Bangladesh already experienced two massive debacles respectively in 1996 and 2010-11. If the bond market was there, the market might have been fundamentally strong.

Basically, a strong bond market helps other non-financial base companies, especially small and medium-sized enterprises (SMEs), provide ample funds through the issuance of corporate bonds. On the other hand, a strong domestic corporate bond market provides secure or long-term financing, when business firms face any crisis or need financing. Emerging countries' markets can get the potential benefit if they have strong bond markets. Strong domestic corporate bond market not only provides long-term financing but also limits the reliance on public-sector funds and fuels economic growth. As a result, today's larger companies have adopted global bond markets for providing funds for longer-term projects aimed at industrial infrastructure development.

7. The Scenario of Bangladesh's Capital Market in terms of different instruments[4]

The capital market in Bangladesh is dominated by securities or stocks or equities. At present, the total number of listed securities is 569 from 302 companies in the Dhaka Stock Exchange (DSE). But according to the DSE statistics, there are only two bonds and all belong to the A category and are corporate in nature.

There are also eight debentures and two hundred twenty-one Bangladesh government treasury bonds inside the market. **See the figure-3**

[4] This figures (Fig3 to Fig 7)were made extensive use of Dhaka Stock Exchange Year End Special Edition and data rearranged by author

Figure 3: Portion of the market instruments inside the market

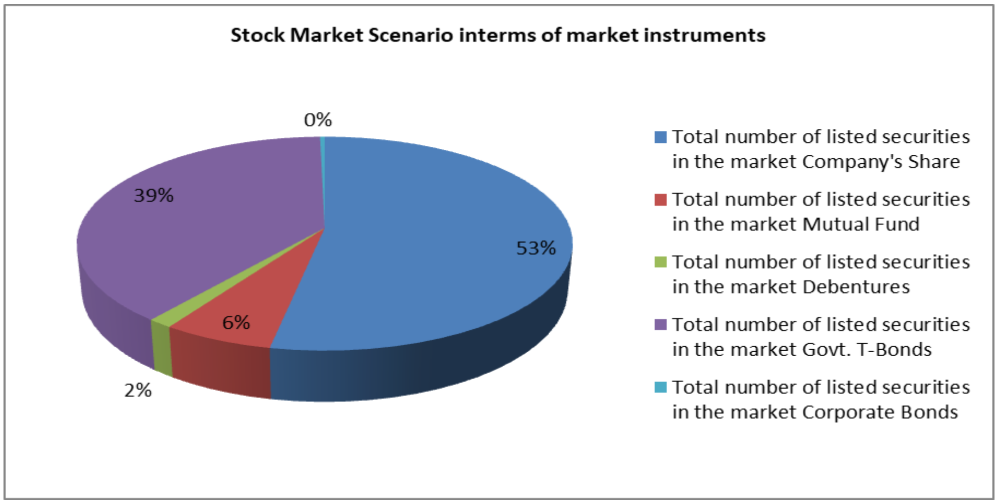
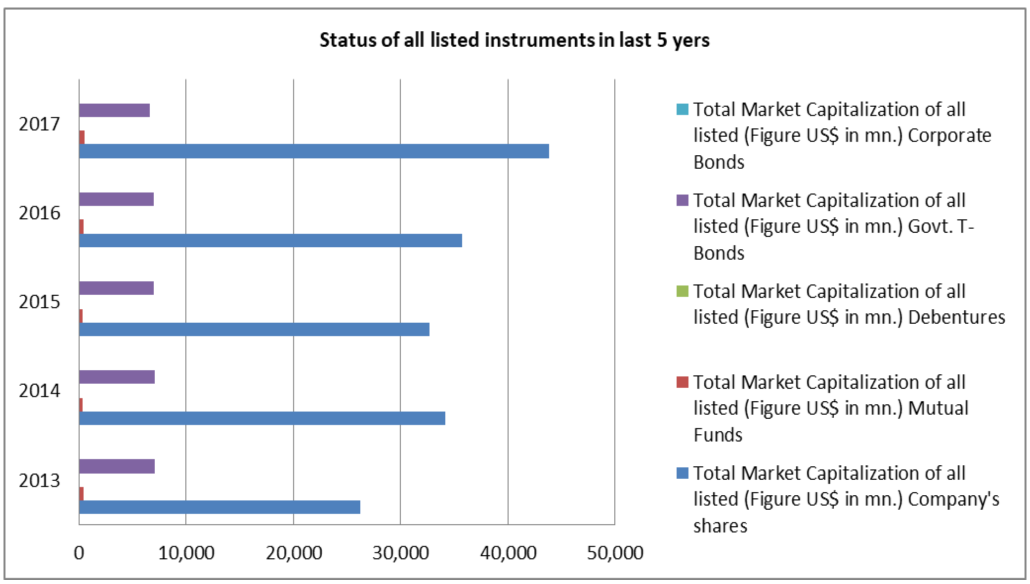


Figure 4: Market diversification in terms of listed instrument's status



In **figure 4** we see the total Market Capitalization of all listed instruments in the Dhaka Stock Exchange. An analysis of the last five years has been done where it is seen, the company's listed shares reached 43,857 USD in million in 2017. The mutual funds are in the next position the value stood at 512 USD in million. The growth of bonds in all instruments is very low that is 73 USD in million in 2017. In fact, the corporate bonds are just two in the market that is why this sector growth rate is very low.

8.Overall analysis

The share of a corporate bond is very small. The corporate bonds are only 1percent compared to 4percent debentures and 95 percent Treasury bonds inside the market. On the other hand, the whole market is dominated by stocks or securities. They account for 70% while corporate bonds, Debentures and Treasury bonds altogether account for only 30% in the current market. The statistics show it clear that the capital market in Bangladesh is fully equity-based. If we look at other South Asian markets, we see our capital market is lagging far behind them **(See Table1)**

Table 1: South Asia's Bonds, Equities, and Banking Assets (2006)[5]

	Bonds (in billion dollars)	% of Total	Equities (in billion dollars)	% of Total	Banking Assets (in billion dollars)	% of Total	Total	%
Bangladesh	7.35	1.93	3.61	0.41	32.74	4.78	43.69	2.25
India	325.68	85.62	818.88	93.36	587.38	85.69	1731.94	89.14
Nepal	1.22	0.32	1.31	0.15	4.33	0.63	6.86	0.35
Pakistan	32.41	8.52	45.52	5.19	50.7	7.4	128.63	6.62
Sri Lanka	13.71	3.6	7.77	0.89	10.3	1.5	31.78	1.64
Total South-Asia	380.36	100	877.09	100	685.45	100	1,942.90	100
Total East-Asia	2,700.85	100	5942.45	100	5,562.52	100	14,205.82	100
Total selected OECD	36,181.01	100	32355.3	100	32,583.12	100	101,119.43	100

9. Bond Market Performance in Bangladesh

"The activity of bond market in Bangladesh is limited and fragmented. It is still dominated by the government securities. There are Treasury Bills (T-bills) and Bangladesh Government Treasury Bonds (BGTB or T-bonds) with different maturity periods. T-bills are short-term and t-bonds are long-term fixed income government securities. Latest statistics of the central bank show that total turnover of the secondary

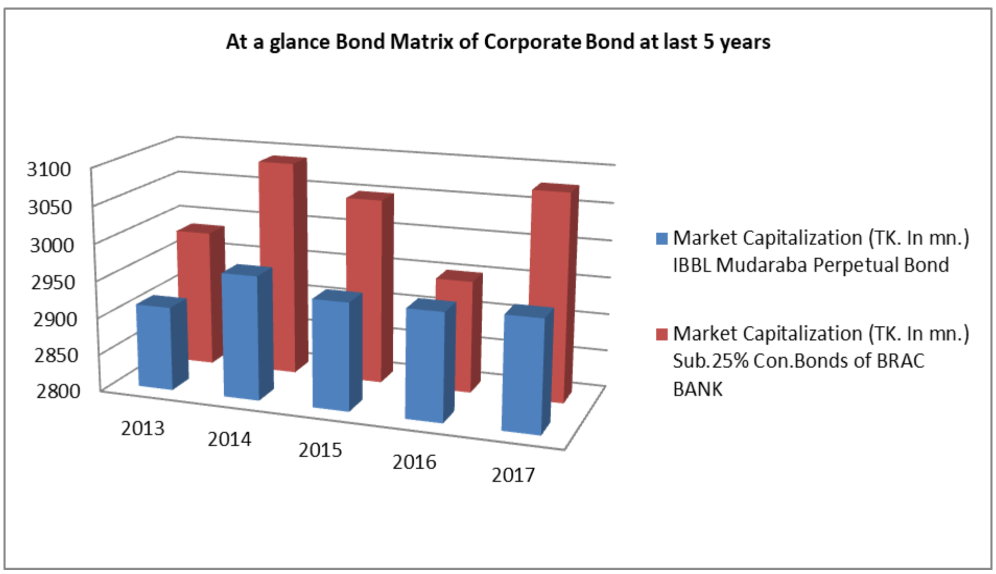
[5] *Source: Bonds--BIS data from Bangladesh, Nepal & Sri Lanka central banks, Banking Assets--IMF IFS data base, Equities –World Federation of Exchanges.

trading of the T-bills and t-bonds stood at Tk. 282.91 billion in 2017 while the value was Tk. 514.08 billion in 2016". (Financial Express)[6]

According to Bangladesh Securities and Exchange Commission report (2011-2012), there are debentures worth Tk. 140 million of 8 companies listed in the two stock exchanges. In order to popularize the government bond and increase the depth of market, trading in government treasury bonds was introduced in stock exchanges with effect from January 2005. But there was no transaction in the bond market in the financial year (FY) 2010-2011.

As on 30 June 2012, 221 government treasury bonds, 3 corporate bonds, and 8 debentures were listed with the DSE. Their total market capitalization was Tk. 55,5749.7 million. But bonds are not yet popular. Banking and Financial Institution Division, Ministry of Finance, Bangladesh Bank, Bangladesh Securities, and Exchange Commission, and the National Board of Revenue are working together to establish a strong bond market.

Figure 5: Performance of corporate Bond in Capital Market in Bangladesh



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[6] See on Reference Section

Figure 6: Performance of corporate Bond in terms of Turnover in Value

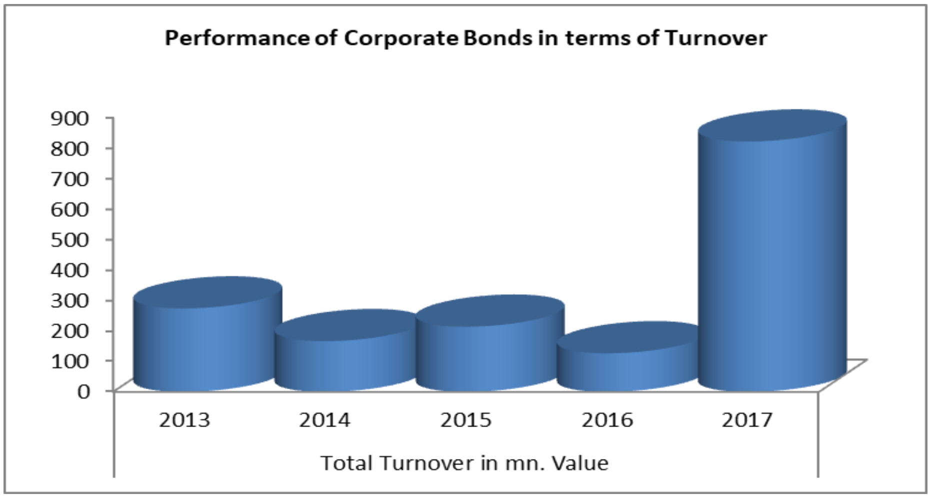
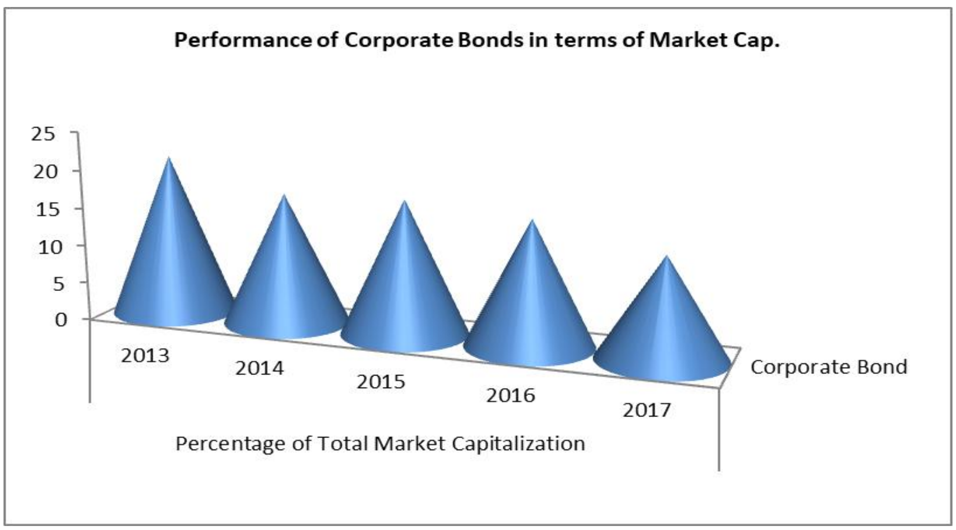


Figure 7: Performance of corporate Bond in terms of Market Capitalization



In 2017, there was a moderate increase in the turnover of the bond but the market capitalization did not increase too much. During 2017 there was a turnover in value stood at 822.66 million where that was only 127 million in 2016 **(see figure 6).** Whereas, the percentage of market capitalization of corporate bonds reached 13.17 percent in 2017 and 16.32 percent in 2016 **(see figure 7)**.

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10. Findings of the Study

i. Traditional thinking about bond market worldwide

Traditionally, the bond market has not been friendly to individual investors, because brokerage firms act as dealers and quote net prices to investors, making it difficult to know, if the price is “Fair”. Moreover, it has always been difficult for investors to compare bond prices or verify the fairness of the price being paid because information is not available to do so.

ii. Bond transaction in the financial market

It is not clear how the bond will deal in the primary and secondary markets. Since the inception, Bangladesh Capital Market just two corporate bonds in the secondary market. But investors lack knowledge about how to sell bonds in the capital market because there is a difference between equity selling and bond selling. Another factor is calculating the bond price is not an easy task. Coupon payment and principal amount are related to the bond.

In addition, the tax policy on interest income from bonds, high per-unit value of treasury bonds as well as default rate of corporate debentures along with conversation of bonds to other assets and some pitfalls made the bond market flavorless.

iii. Capital Market depends on the Banking sector and the Impact of GDP

Bangladesh Economy is totally bank based economy where the role of the other sector is very little especially in the Capital Market.

It appears from the following **Figure 8**, in Bangladesh's financial system is heavily dependent on the banking industry, which shoulders 62 percent of the financing needs, followed by the stock market at 20 percent, bond 15 percent and insurance 3 percent.

Figure 8: Industry Dependency-based on financial needs

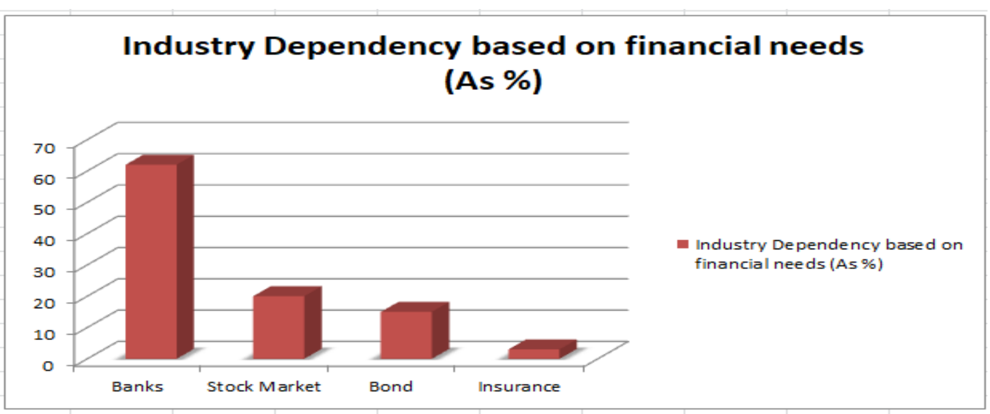

Figure 9: A Bond contribution in GDP (Global Perspective)

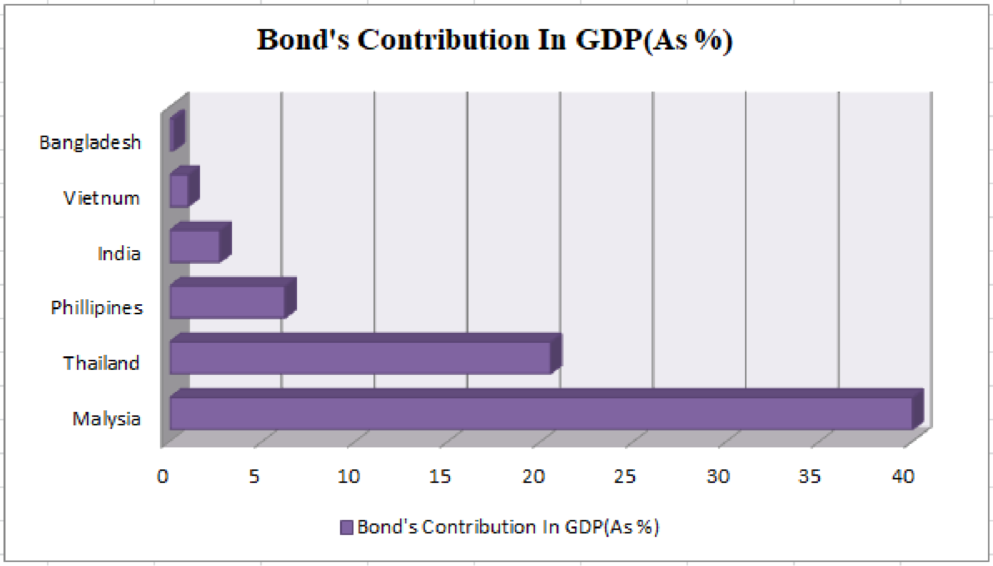

Figure 9 shows that the peer countries the prevalence of corporate bonds is much higher. It is over 40 percent of GDP in Malaysia, 20.5 percent in Thailand, 6.2 percent in the Philippines, 2.7 percent in India, 1 percent in Vietnam, while it is just 0.2 percent in Bangladesh. (Daily Star)7

11. Policy Measures

According to the Bangladesh Bank Annual Report[8], “the Ministry of Finance (MoF) and Bangladesh Bank (BB) are working together since 2003 towards bringing about vibrant well-functioning markets for primary issues and secondary trading in T-Bills and T-Bonds. T-Bills of 91,182, and 364 days tenors and T-Bonds of 2,5,10,15 and 20 years tenors are now in the market. Besides, work on introducing a Floating Rate T-Bond is also ongoing. BB also introduced the issuance process for BGTBs in 2013 that will prevent fragmentation of government debt instruments.”

Secondly, The Investment Corporation of Bangladesh (ICB) is planning to issue a long-term bond of Tk. 2,500 crore for stock market development[9].

Third, a good initiative is there in the budget for the FY 2018-19[10]. Bangladesh government is also planning to introduce a Floating Rate Treasury Bond for stock market development. And as part of this, Islamic-Sharia Bond will emerge soon.

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[7] The figure 7 and 8 is prepared based on exclusive report of Daily Star [Strong bond market needed to finance infrastructure: analysts] Date: May 24,2017

[8] Bangladesh Bank Annual Report 2016-2017, page 75.

[9] Financial Express, 22 March, 2018.

[10] Daily Star, June 8, 2018.

12. Challenges of Bond Market in Bangladesh[11]

The bonds in the financial sector of Bangladesh mean that the treasury bills that dominated the market. On the other side, bank deposits almost 70 percent that compared to the remaining 30 percent stock and debt instrument. As a result, domestic savings are made based on a bank deposit.

Second, most of the banks offer 5 to 6 percent interest for a fixed deposit while bonds offer the same interest but that depends on bond maturity. Third, the five years savings scheme offers 11.50 percent interest. So, a huge percentage gape (5 to 6 percent) is made between a saving certificate and others investment instrument. These issues can be considered as the challenges of bond market development. Under the following figure 9, let us understand the matter further-

Figure10: Bond Yield Vs. Saving Certificate Interests

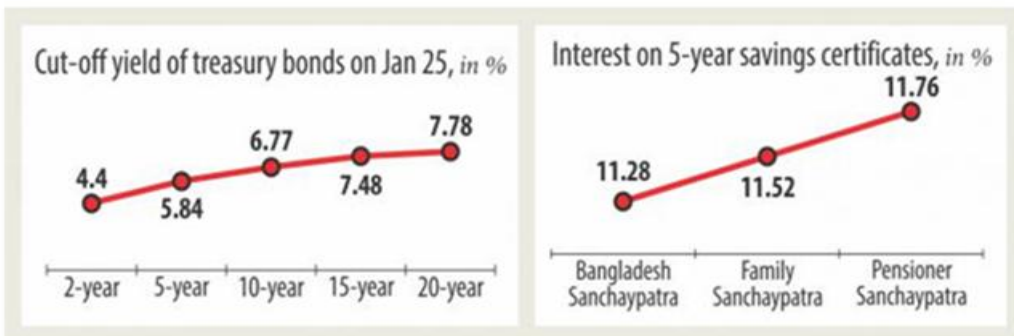

Figure 10 shows that rising high-interest rate on government saving certificate during 2017 compare government treasury bonds.

As reported by **Bangladesh Institute of Bank Management (BIBM)**[12] currently, the number of corporate bonds in Bangladesh is very less (0.2 percent) compared to government bonds (7.86 percent). Furthermore, Bond demand is not being created due to the dominance of the Saving Certificate in the financial market.

13. Conclusion

There is a three-pronged relation that exists between the bond market, the stock market and macro-economy. Bond is such a long-term instrument that easily provides an ample amount of fund for a long-term project. As a result, by issuing bonds both government

[11] Data is collected based on the Daily Star, February 3, 2017. https://www.thedailystar.net/business/savings-certificates-choke-bond-market-1355164

[12] This information has been taken from the Financial Express, the piece is entitled by "BD bond market one of the lowest in Asia: Experts blame banks' poor corporate governance at BIBM seminar". Date July 27, 2018. http://today.thefinancialexpress.com.bd/first-page/bd-bond-market-one-of-the-lowest-in-asia-1532626390

and non-government sectors can be benefitted. General people or small investors can use bond as a good savings instrument. The nature of a long-term debt instrument like bond is it provides long-term financing. In Bangladesh, the bond market is in a very sorry state as is judged by the number of issues, volume of trade, number of participants, long-term yield curve and so on.

Stock Market crash cropped up in early 2010-11 when commercial banks invested in the stock market beyond the limit. The over-exposure of banks to long-term loans and the subsequent market crash left them with inadequate funds to meet the people’s primary need for commercial loans as working capital and import credit. In such a situation some banks were caught in a trap, as they lent a big amount of long-term substandard loans by deducting funds from their profit margins. Later they could not recover the loans and finally, they were in a deeper trouble. As a result, they could not lend large long-term loans despite being important stakeholders of the money market. If the bond market was developed enough, they could take recourse to it to tide over the situation.

It is; therefore, clear that the capital market should not be dependent on only one sector like banks in the greater interest of the financial market of the country. The capital market must be utilized judiciously to ensure smooth flow of capital to spur economic activities in the country.

Moreover, the capital market regulators and the government are trying to reform our stock market on a sustainable basis. Developing the bond market can be a handy option in this regard. It is a matter of fact that investors, as well as general people, are less familiar with the ethics as well as the etiquette of this market fundamental and they are also not adequately familiar with the bond market trade.

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