Institutional Fragility of Central Banking in Bangladesh

Bangladesh Economic Update

March 2016

উন্নয়ন অন্বেষণ
UNNAYAN ONNESHAN

Bangladesh Economic Update
Volume 8, No.3, March 2016

Acknowledgement
Bangladesh Economic Update is a monthly publication of the Economic Policy Unit of Unnayan Onneshan, a multidisciplinary research organisation based in Dhaka, Bangladesh. The report has been prepared by **Nabila Nasrin** under the guidance of Dr. Rashed Al Mahmud Titumir .

উন্নয়ন অন্বেষণ
UNNAYAN ONNESHAN

For orders and request, please contact:
UNNAYAN ONNESHAN
16/2, Indira Road, Farmgate Dhaka-1215, Bangladesh
Tell: + (880-2) 8158274, 9110636
Fax: + (880-2) 8159135

Institutional Fragility of Central Banking in Bangladesh

I. Introduction

The current issue of Bangladesh Economic Update discusses the effectiveness of the monetary policy and the risk management by the country's central bank, the Bangladesh Bank (BB). This allows to make a reality check into the achievements of targets announced in the successive monetary policy statements (MPS), growth in credit to private sector rate of interest, position of liquidity, situation of loan performance, management of risk, supervision of banks, governance and oversight.

Central bank of a country plays the leading role in formulating monetary policy,stabilising financial sector and supervising the whole system to ensure growth and employment. Effective monetary policy not only strengthens the financial system but also provides fuel for the whole economy.

A core objective of monetary policy is to stimulate the growth through invigorating the sluggish investment by fueling the private sector credit growth. It has, however, been cautioned in previous Updates of the trend of shortfall in targets of growth in private sector credit. In previous analyses, the Unnayan Onneshan has argued that the declined rate of growth in creditmay further worsen the prevailing sluggish rate of private investment triggered by high lending rate, inadequate infrastructure and dis-favourable business environment, setting the economy in inertia causing the rate of growth in gross domestic product (GDP) not to reach the target of 7 percent in FY2015-16.

In Bangladesh, inflation is more related to the cost of production than to monetary variables. In recent time, the inflation is sliding because of decrease in global oil price, falling import price of primary commodities and no supply disruption due to absence of natural hazards.

Of late crisis in the banking sector has made the financial sector in Bangladesh worst among the emerging Asian countries reflecting the poor risk management ability of Bangladesh Bank(BMI,2016).A strong financial system is needed for successful implementation of monetary policy (Kholi, 2015).The running crisis in the banking sector mainly due to increase in default loan reflects the institutional weakness of the financial system in the country. Recent consecutive heists in banking sector again shake the financialsystem as well as the economy.Continuous default loans, scams, and heist cause increased cost of fund and shortfall in capital in the banks. This situation is more upsetting in the State Owned Commercial banks (SCBs) and Development Financial Institutions (DFIs) for which they face huge capital shortfall every fiscal year. Government recapitalizes the shortfall with taxpayer's money instead of correcting the faults of the institutions, which not only increases the burden on taxpayers but also causes a loss to the economy.

Considering the overall economic situation the current issue of the Bangladesh Economic Update attempts to assess the performance of the Bangladesh Bank. First, the targets and the achievements of the previous MPSs will be investigated. Then the effectiveness of MPSs will be discussed as regards inflation, private investment, sector wise credit growth, and performance of banking sector.Second, overall banking sector is assessed through indicators like capital adequacy, asset quality. Third an attempt will be made to find outsome non-economic factors responsible for the weak supervisory ability of the BB.

II. Current Status of the Economy

The sluggish private investment, declining growth in revenue collection, and underperformance in external sector have been exhibited during the first half of the current fiscal year, setting inertia on the growth in GDP for the fiscal year (FY) of 2015-16. The stifling of productive capacity expansion due to stagnation in private investment, less-than-adequate infrastructure and sluggishness in productivity growth in recent years have been dragging the growth in GDP from targeted climbing up over the stationary six per cent mark.

The situation has been further aggravated by confrontational polity, the contingent political competition for primitive capital accumulation and the punctured institutions, which have ditched enterprise making at the bay, dwindling the actual realisation of potential job-creating economic growth, social development and environmental sustainability.

The continuation of modest economic growth has, however, mostly been driven by consumption, which can also otherwise be called "auto-pilot rate of growth." The underemployed people in rural areas, who either migrated to cities or abroad to fuel the consumption through sending remittance, largely contributed to keep largely the current pace of the economic growth at six per cent. Consumption is one of the four elements of GDP and others are - investment, government spending, and net of export and import. The continual greater than before participation of women in labour market and women entrepreneurship along with their demonstrated resilience are making inspiring changes. The farmers have continued to work tirelessly in their green croplands, with innovation and intensity, despite distress sale of products, without fair prices, high input cost, and changing climatic conditions.

This begs question: will the economy be steered through creative strategies, effective policies and prudent instruments to achieve growth rate at the level of 8 per cent to 10 per cent?

The declining rate of growth in revenue mobilisation is likely to shrink development financing for removing supply side bottlenecks, decrease falling social sector spending and increase government borrowing further in the backdrop of expanding non-development expenditure. Ambitious fiscal targets of income and expenditure, earmarked for FY 2014-15 did not materialize at the end of the fiscal year nor the current status of revenue collection implies that the target set in current annual budget might be achieved at the end of FY 2015-16. Several persisting structural bottlenecks such as narrow tax base, regressive tax structure and tax evasion as well as tax avoidance have not been adequately dealt through policy innovation and rigorous implementation mechanisms. The allocation for public investment or Annual Development Programme (ADP) has been continuously increasing over the last twenty years while implementation has been consistently falling short of targets, thus pointing to shortage in supply of physical and social infrastructure.

Finally, poor energy infrastructure and underdevelopment in road and transportation system are directly related to below the target performance of the economy and cause the rate of growth to slow down.

III. Targets and Achievements of MPSs

Monetary policy to a great extent is the management of certain expectations by setting targets for achieving those. The Bangladesh bank announces these targets twice a fiscal year. The following table shows the targets and their achievement since 2009.Lets take quick look to the several MPSs:

Table – 1: Targets and Achievements of MPSs

Indicator/year	2009		2010		2011		2012		2013		2014		Jan-jun15		Jul-Dec'15		Jan-Jun'16	
	T	A	T	A	T	A	T	A	T	A	T	A	T	A	T	A	T	A
Inflation	6.5	5.4	6.5	8.1	7	10.7	7.5	6.2	7.5	7.5	7	7	7		6.2	6.2	6.2	
Private sector credit growth	16.7	14.62	16.7	24.2	16	25.84	16	20	18.5	11.4	16.5	14.3	15.5	14.3	15.5	14.9	14.8	-
Growth Rate In GDP	5.5-6	6.19	5.5-6	6.07	7	6.71	6.5-7	6.23	7.2	6.03	5.8-6.1	6.01	7.2	6.51	7.3	-	6.8-7	

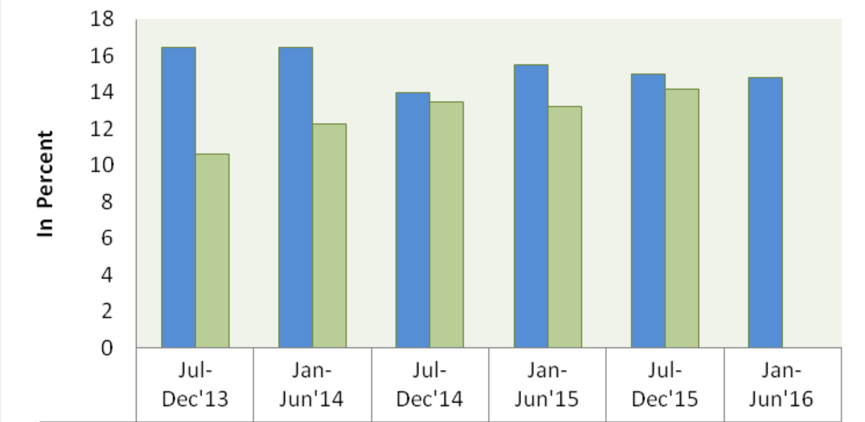
Note: T= Target and A= Actual Source: Bangladesh Bank, various issues of MPSs

Non-achievements of targets is clearly visible, raising the issue of credibility and realism in the target setting.

The private sector credit growth has increased by 14.19 percent amount to77099.70 crorein December, 2015 where the target was set to 15 percent in the MPS (July-December, 2014);a gap of 0.81 percentage point between the target and the actual. The private sector credit growth stood at 12.3 percent against the targeted 16.5 percent in MPS for H2, 2014 (Jan-Jun, 2014). The private sector credit growth rate slightly rose to 13.5 percent in December'14 and then declined to 13.2 percent in June'15 from the targeted 14 percent and 15.5 in theMPS(July-Dec'14)and MPS (January-June, 2015) consecutively.

Considering weak physical infrastructure, inconvenient business environment as well as high interest rate BB has lowered its target continuously since FY15 instead of policy prescription to improve the situation or boosting the demand for private credit.

Figure - 1: Private Sector Credit Growth Rate (target and actual)

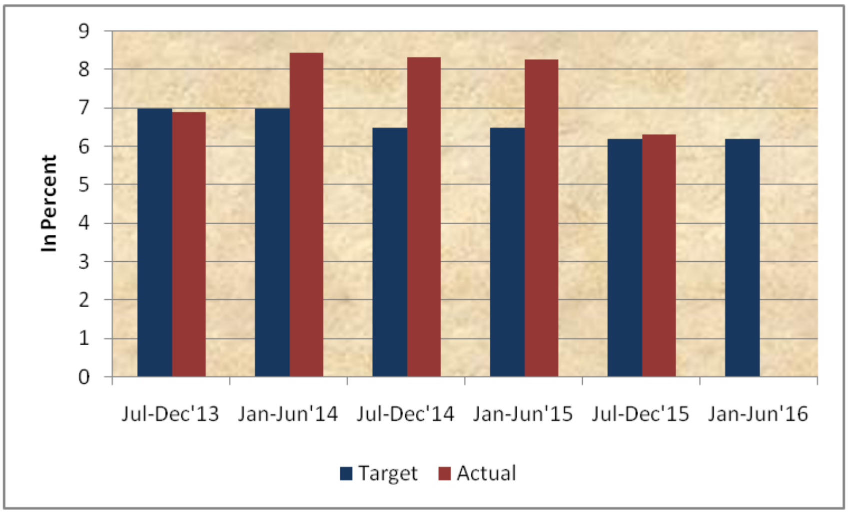


	Jul-Dec'13	Jan-Jun'14	Jul-Dec'14	Jan-Jun'15	Jul-Dec'15	Jan-Jun'16
Target	16.5	16.5	14	15.5	15	14.8
Actual	10.6	12.3	13.5	13.2	14.19	

Source: Bangladesh Bank,2016

Keeping the inflation pressure low remains the core objective of the monetary policy for decades. Apart from the January – December 2013 and January – December 2015, the BB has not been able to realize the targeted rate of inflation. This is particularly because of the fact that inflation is Bangladesh is supply driven and corresponds to costs to production. With its faulty diagnosis of inflation being pushed by demand, the BB in the past raised the rate of interest which also put a dent on the country's investment scenario due to raise in the cost of funds. It has been, therefore, taking too long for the rate of interest to slide down.

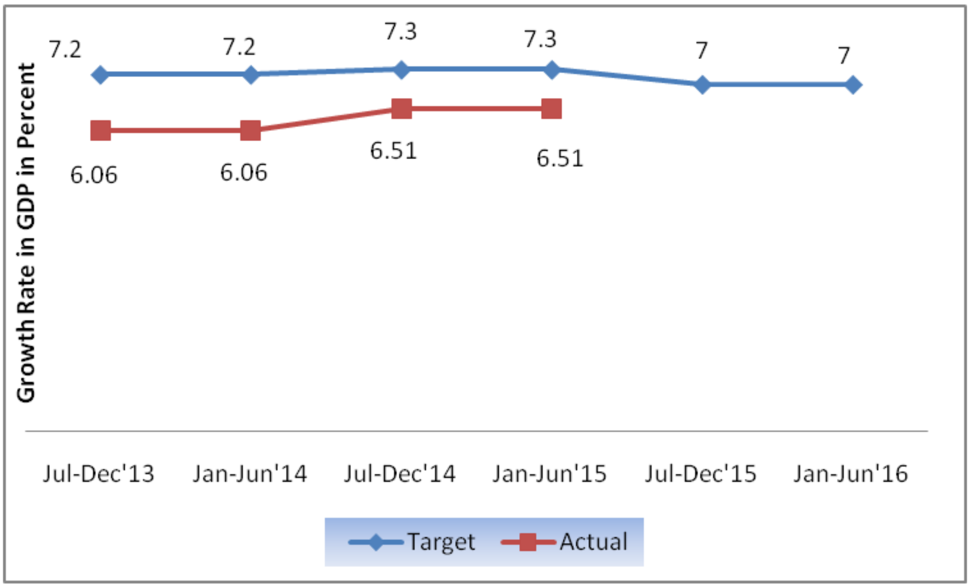
Figure - 2: Inflation (Target and Actual)



Source: Bangladesh Bank,2015

In the current monetary policy for second half of FY 2015-16 BB projects that the rate of growth in GDP might be 6.8-6.9 percent where the budgetary target was set to 7.0 percent. The prolong sluggish private investment, declining rate of growth in revenue collection, and underperformance in external sector set inertia on the growth in gross domestic product (GDP) for FY 2015-16.Considering the historical trend of the growth rate in GDP and assuming the same business scenario, it t seems that the rate of growth in FY 2015-16 is likely to fall below the target of 7 percent.

Figure 3: Rate of Growth (Actual and Target)



Source:Ministry of Finance,2015; Bangladesh Bank,2015

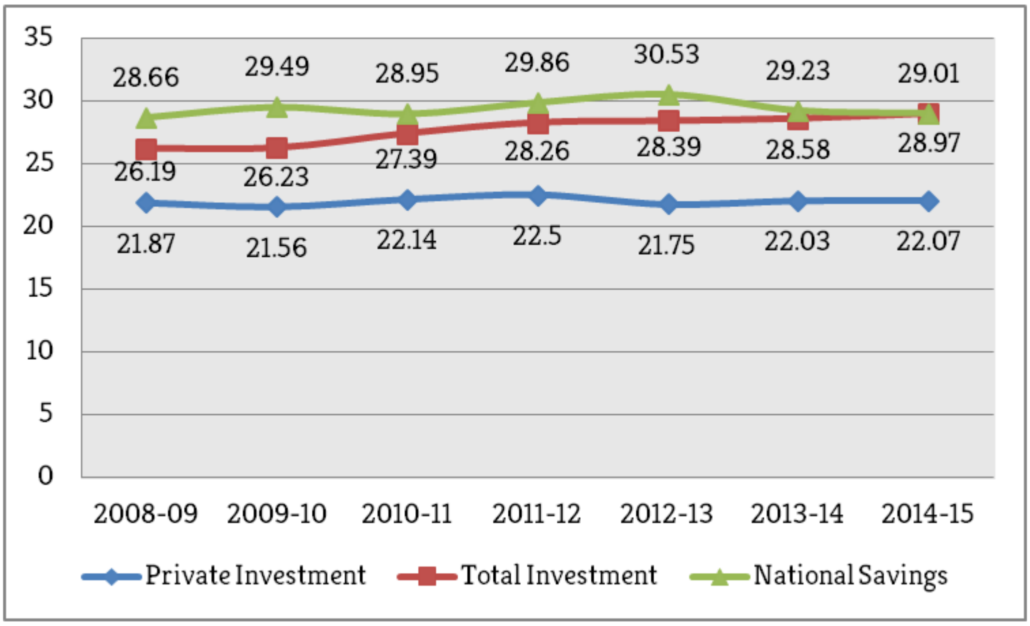
IV. Investment and MPS

Monetary policy influences investment in a number of ways. First, monetary policy is assumed to create better investment opportunity by stabilising the price level. Second, monetary policy ensures a steady flow of funds to private sector for generation of investment. Third, monetary policy instruments channel funds to productive sectors that create positive benefits to other sectors.

The monetary policies declared by Bangladesh Bank, however, have been failing to bring the expected results in all the three areas. Monetary policy has little influence in decreasing inflationary pressureas in Bangladeshas it is much more a supply side phenomenon.The private sector credit growth has fallen below the target and channelling of funds is hindered due to institutional weaknessin the banking sector.

Investment has stagnated for several fiscal years. The private investment as percentage of GDP increased by only 0.27 percent on average since FY 2008-09. Private investment stood 21.87, 21.56, 22.14, 22.50, 21.75, 22.03, and 22.07 percent of GDP in FY 2008-09, 2009-10, 2010-11, 2011-12, 2012-13, 2013-14, and 2014-15 respectively. The targets of increasing private investment to 24 percent and public investment to 7.8 percent are unlikely to be achieved. This stagnation in private investment may stifle the productive capacity expansion dragging the growth in GDP from targeted climbing up over the stationary six percent mark.

Figure - 4: Private Investment, Total Investment and National Savings

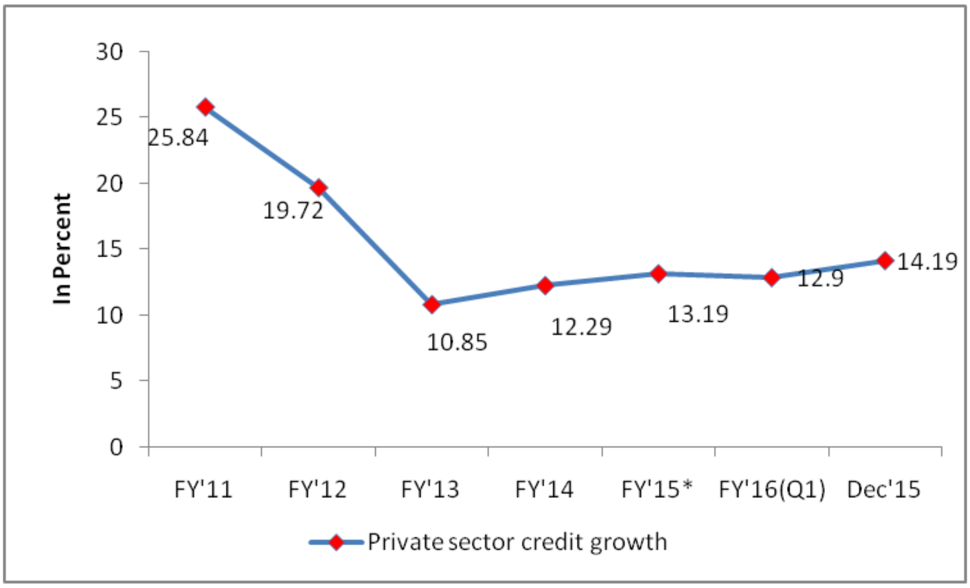


Source: Ministry of Finance, 2015

Private sector credit growth

Lack of adequate physical infrastructure, high lending rate and derisory business confidence depressed private investment demand for a long time reflected by the slow trajectory of the private sector credit growth since FY'11. The rate of growth of actual disbursement of credit to the private sector in FY'11 was 25.84 percent which drastically fall to19.72 percent in FY'12and then further to10.85 percent in FY '14.Infy'15. It slightly increased to13.19 percent where the target was set to 15.5 percent in monetary policy of July-dec'15.In the first quarter of FY 16 the credit growth reach to12.9 percent and in December 2015 jumped to14.19 percent(year toyear basis) mainly due to a slight decrease in lending rate in second quarter of FY'16 and tranquil political situation.But this supplicates question: is this sufficient to expand the economy at the 8 percent or 10 Percent by 2021(7th five year plan, Perspective Plan of BangladeshVision 21) with this level of credit growth? Most probably the answer is no because the rate at which the economy is expanding and there is enough space to enhance if the credit flow could be increased, in addition to raising of capital from the country's ailing capital market.

Figure 5: Private Sector Credit Growth



Source: Bangladesh Bank,2015

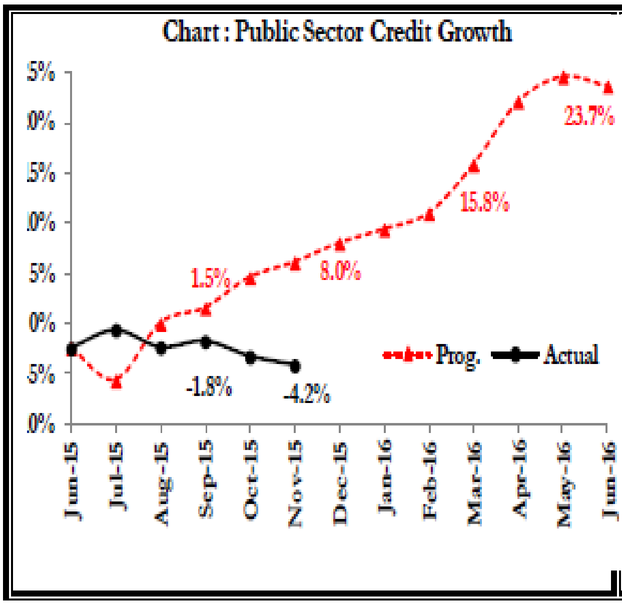
Public Sector credit growth

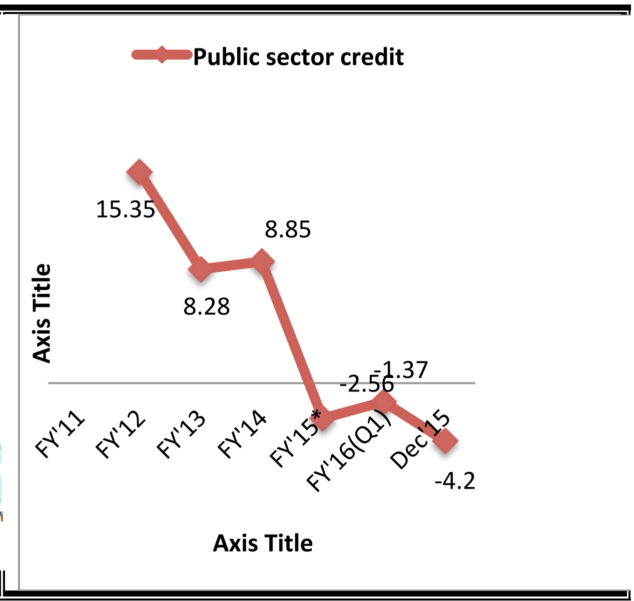
Government borrowing through the banking system also has fallen downfurther increasing the excess liquidity in the banking system. .The total domestic credit growth also remained slower due to negative growth in public sector. The domestic credit growth stood at 9.93 percent in Dec'15 compared to 11.18 percent in Dec'14 against where the ceiling of 13.8 percent set for Dec'15 monetary programme. The government has to pay more if it takes money from saving instrument instead of banking system (like higher payment over NSD).

The rate of growth of actual disbursement of credit to the public sector in FY'11 was 15.35 percent which fall to 8.28 percent in FY'12and then slightly increased to8.85 percent in FY '14.In FY'15 the growth rate recorded an negative 2.56 percent growth rate which stood at negative1.37 at the end of the first quarter of 201.In December 2016 credit growth to the public sector stood atnegative 7.82percentcompared to the same period of the previous fiscal year percent where the target was positive 8 percent;a 15.82 percentage point gap. In January2016the public sector credit growth reached the negative 8.7 percent from 8.1 in December 2015 whereas the target was 8 percent.

FIGURE NO

Figure:Public Sector Credit Growth(Target Actual	**Figure:Public Sector Credit Growth(Trends)**



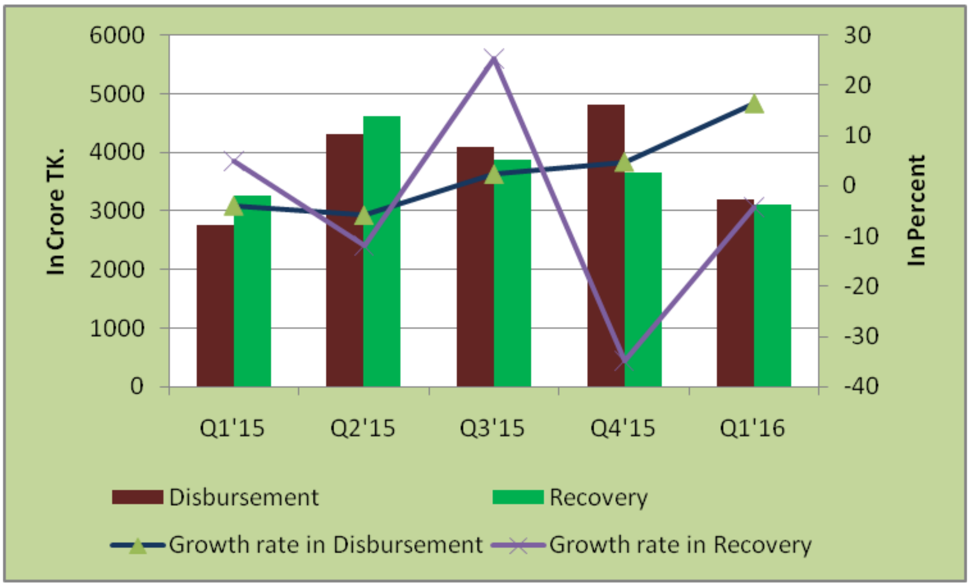


Source Bangladesh Bank,2015

Agricultural Credit

The rate of growth of agricultural credit disbursement and recovery of credit have been experiencing lower trend as well as negative rate of growth since July 2015 compared to the previous fiscal year. The disbursement of agricultural credit stood at Tk. 4320 crore in October-December 2015; a decrease of 5.8 percent compare to the previous year. At the end of the FY 2014-15, the disbursement of agricultural credit also increased by Tk. 4.8percent compared to the same time period in the previous FY 2013-14. In the first quarter of FY 2015-16 the disbursement stood at 3200 crore(an increase of 16.5 percent) where the celling is set to16400 crore that is 19.51 percent of the target is registered. The rate of growth of the recovery of the agricultural credit, therefore, stood at negative 9.6 percent in July-Juneperiodof FY'15 where it was positive 28.44 percent in the same time period of the FY 2014-15. The growth rate in the recovery stood to negative4.3 in the first quarter of FY'16.

Figure -8: Agricultural credit



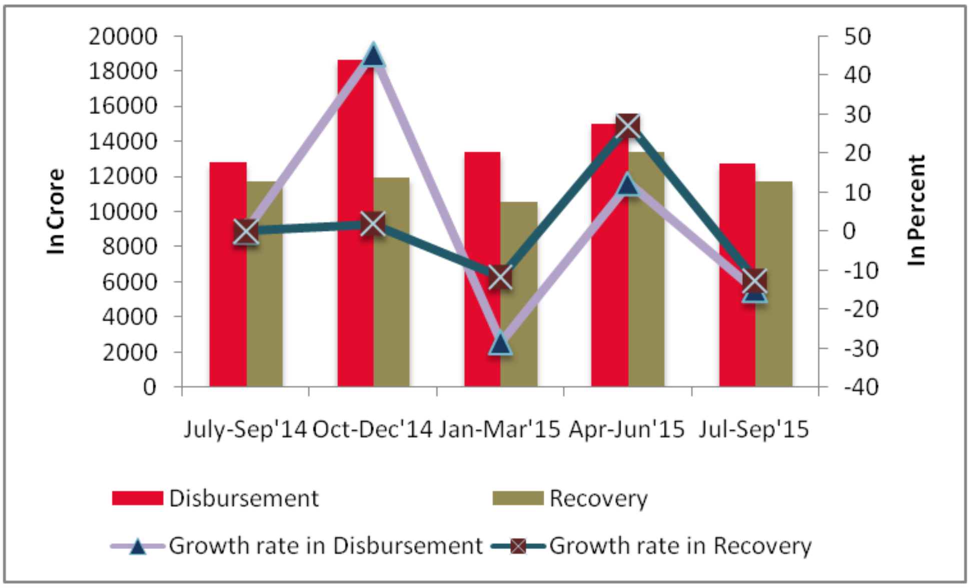
Source: Bangladesh Bank, 2014

Industrial Credit

The rate of growth in the industrial term loan has been experiencing frequent negative rate of growth. Adequate capital is needed for industrialisation of a country. Loan is one of the most important factors of capital formation in a developing country like Bangladesh.

The disbursement of industrial term loan stood at12699.68in the July-September'15 (Q1'16)whereas it was Tk.12809.4 crore in the July-September'2014 representing0.85 percent decrease. The rate of growth of the disbursement of the industrial term loan stood negative at 15.22 percent in the first quarter of the FY 2015-16 where the sum stood at TK. 11672 crore. The quantity were Tk. 11462.4 crore and Tk. 9283.5 crore (lowest among the last five quarters) in April-June and January-March quarters of the FY 2013-14. . The condition of the recovery of the industrial term worsen in the first quarter of FY2016 compared to same time period of the previous year FY'15. The recovered sum stood at 11672 crore compared to the 11713 Tk. in the previous year and 13382 crore in the previous quarter. The growth rate in recovery was negative 0.35 percent in comparison with the previous year and negative 12.78percent than the previous quarter.

Figure - 9: Industrial Term Loan

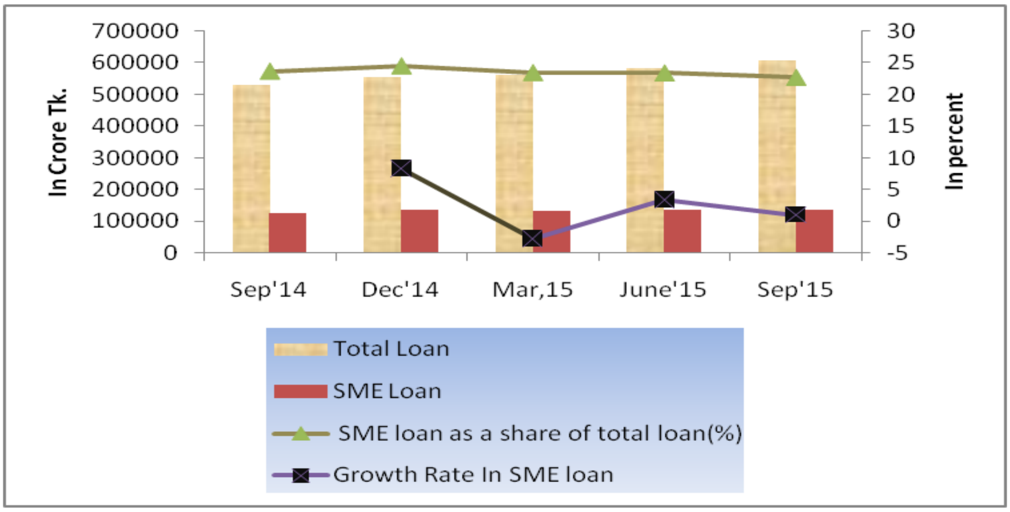


Source: Bangladesh Bank,2014

SME loan

The growth rate in the disbursement in SME loan and as a percentage share of total loan both are moving downward.The SME loan as a percentage of total loan stood at 22.74 percent or138330 croreat the end of September'15 where the share was23.73 percent or 1125614 crore inSeptemtember'14; a decrease of one percentage point. The amount of disbursement were136148.5 crore,132406.6crore 136908crore in Deceber'14, March'15 and June '15consecutively. The growth rate in SME loan were negative2.74percent,positive3.4percent and 1.03 percent consecutively.

Figure - 10: SME Loan



Source: Bangladesh Bank, 2015

Interest rate

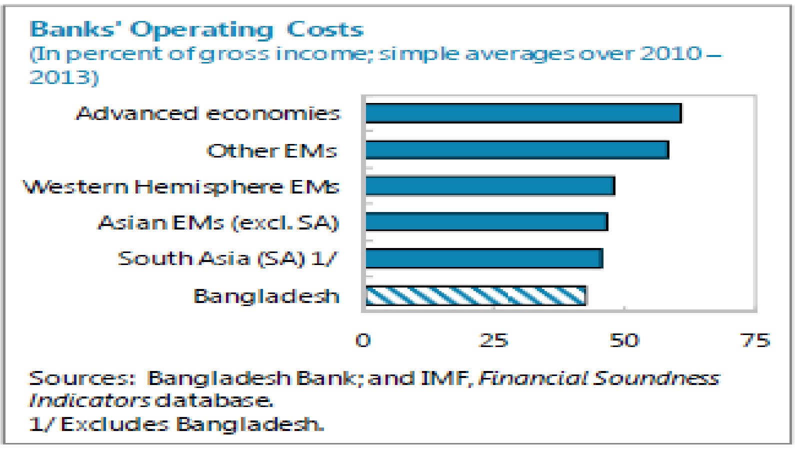
Despite promoting financial sector liberalization lending rate remain over two-digit number over a decade which depressing the private sector lending thus discouraging the private investmentas it increases the cost of capital. To understand the reason two determinants can be considered. One is the cost of fund and other is the interest rates rate spread.

Cost of Fund

Interest rate on deposit is the first considerable cost as banks depends mainly on deposit for funding.Deposits accounted for85 percent of banks' liabilities as of end-2013 (IMF, 2016) Bank deposit rates in Bangladesh have averaged about7 percent over the past decade. However, average real deposit rates in Bangladesh have been lower than for most comparative country groups. In fact, they have been negative on average(that is, nominal deposit rates have been lower than inflation on average).This suggests two conclusions. First, real deposit rates have not been a factor pushing upreal lending rates in Bangladesh. Second, relatively high inflation has been a contributing factor driving up the nominal deposit rate (IMF,2016).Another reason of high lending rate is that they have to compete with the NSD.When the highest fixed deposit rate is 6.25offered by the state own commercial banks where the lowest rate of NSD certificate is 11.04 percent.

The second cost is the operating cost.The average operating cost of banks is comparatively lower than other countries in the world and appears to be lower on average thanthose of banks in other countries, at least whenexpressed as a share of gross income. These aretherefore unlikely to be driving up interest ratespreads in Bangladesh when compared toother countries (IMF,2016).

Figure -11 :Banks operating cost

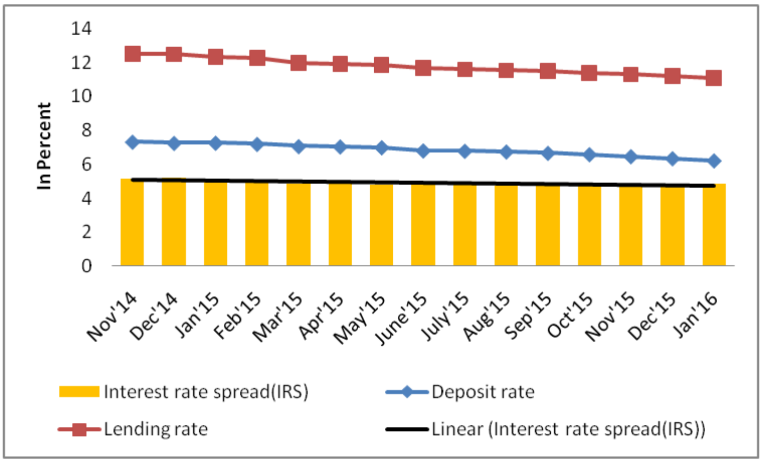


Source:IMF,2016

Interest rate Spread

The spread of lending and deposit rate is hovering near 5percent(more or less).In January,2016 however, increased to 4.84 percent in from 4.77 percent in August, 2015.It was 4.87 in March 15which was 5.15 percent in March 2014. The average rate of interest on depositor and lender were 7.26and 12.32 percent respectively in January'15 stood at 6.21 percent and 11.05 percent respectively in June 2014. Of late the lending rate is on slight decrease. The rate is still too high to attract the small and medium investors and enterprises in the economy.

Figure 12: Interest rate

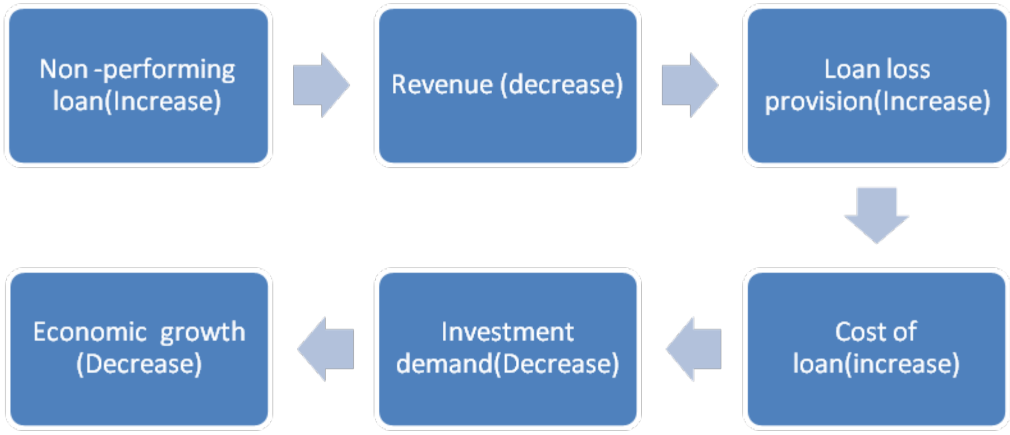


Source: Major Economic Trends, Bangladesh Bank, 2014

Including both the interest income and non-interest income banks real profitability is determined by the return on assetafter deducting the loan loss provision. The higher the provision the lower the return. In Bangladesh the interest rate spread is high or bank cannot low the lending rate because of several reasons like high non-performing loanand weak institutional structure.

High NPLs coupled with low loan recovery ratios is forcing banks to expand their provisions and the correspondingly large provisions for loan losses contract the profit and banks keepinterest rate spreads high to recover the losses.

Figure - 13:Impact of increasing non-performing loan



The institutional structure(for example, credit history information contract enforceability and bankruptcy procedures) is very weak, which affects banks'capacity to identify credit risks and to recoverfunds from non-performing loans.

Another reason behind the high interest is traditional malpractice. In Bangladesh once the price increases it is veryuncommon seeing any decrease in that price even the situation improves.Bangladesh Bank once soared the lending rate to squeeze the inflation when inflation was near two digit. Noweven the inflation is on the downward trajectory the interest rate remain over the two digit.

Mounting foreign loan

High domestic lending rate has been encouraging private sector to secure lending from abroad where the rate of interest is much lower than the domestic one(LIBOR+3 percent wherasthe domesticrate is over 10 percent).

Though it is cheap to borrow from external sources than domestic ones there are three areas of concern with foreign loans.. First,these loans areshort term in nature so there have been some instances where a country struggled to manage amount of dollar required to pay its total foreign borrowing. Such a situation depreciates local currency. The most common example may be the East Asian crisiswhich originated from the excessive inflow of short term foreign loan (Radelet and Sachs ,1998).Second, the foreign loans has little role in contributing towardsnational savings. Third, borrowing from foreign sources at lower interest rates make entrepreneurs reluctant to take loans at high rates from the country's financial marketswhich in turn increase the excess liquidity, which is already very high.

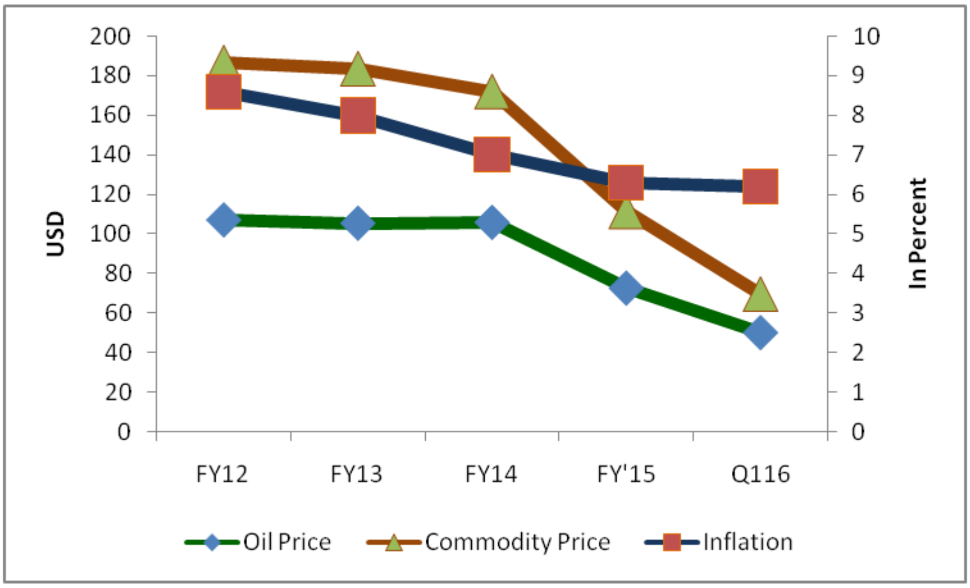
Inflation and effectiveness of the MPS

The pressure of inflation is decreasing from the beginning of the FY2014 due to three reasons. First, the oil price all around the world is decreasing. Oil dropped below USD 50 a barrel on January, 2015 from around USD 115 a barrel in June, 2014 and was heading for its biggest annual decline since 2008, pressured by weakening demand and a supply glut prompted by the US shale boom and Organisation of Petroliam Exporting Countries (OPEC's) refusal to cut output(BBC,2014).Time series data exhibits Oil price and inflation has a positive relation. In FY 14 the inflation dropped by 1.6 percentage point from 8.6 percent to 7.0 percent compared to FY12 where the oil price go down USD to105.9 form USD 107.2.in the corresponding period.In FY2015 the oil price drastically fell to USD72.5 when inflation also went down to 6.3 percent during the period. In July –September Period of FY'16 the inflation further decreased to 6.2 percent from where the oil price dropped down to USD 50.

Secondly, there were no big natural hazards for what there was no supply side disruption like drought, flood, or cyclone etc. Thirdly, due to decrease in oil price the price of the primary commodities which Bangladesh importslike rice, wheat, edible oil, sugar decreased. For example the price of rice shrunk from USD 451in FY 14 toUSD374,the soyabin oil price went down from USD721.3 to USD 638.3in the first quarter of FY16. Data shows that in FY 12 the overall primary commodity price index was USD 186 fell to USD171.8 (8.06 percent decrease) in FY 2014 when inflation went down from 8.6 percent to 7 percent.In FY 2015 price declined to 111.2 and the inflation went down to 6.3 percent.

So oil price and price reduction in international market have been playing a vital role in the reduction ofthe inflation, with hardly any role played by the central bank.

Figure - 14: Movement of Oil price, Primary Commodity Price(International) and Inflation Rate



Source: IMF 2016; Bangladesh Bank, 2015

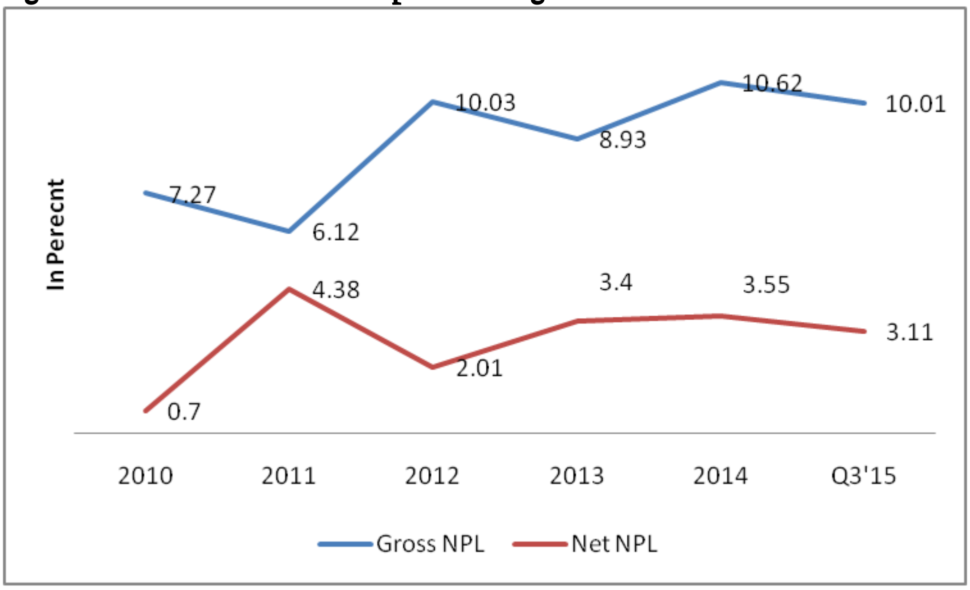
V. Crisis in banking sector: Regulation and monetary policy

Country's banking sector has been caught in trap and is infected by high rate of interest, excess liquidity and declining growth in disbursement of credit to private sector, intermediating lower investment, coupled with poor risk management, fraudulence, driven by captured governance and lax oversight, resulting in lower profitability to the shareholders and institutional weakness in the economy.

Non Performing loan

A huge portion of the loan is in default. In FY 2010 the overall net non-performing loan wasonly0.7 percent where it increased to3.55 percent in FY 12 representing a 2.85 percentage point increase. Overall net non-performing loan (NPL) increased to 3.69 percent in July-September 2014 from 2.69 percent in April-June 2014 and then slightly decreased to2.84percent in January- March'15. On the other hand gross non-performing loan compared to the total loan increases from 7.27 in2010 to 10.62 percent in 2014;representing a3.35 percentage point increase. At the end of January- March period of2015 the gross NPL stood at 10.01 percent.

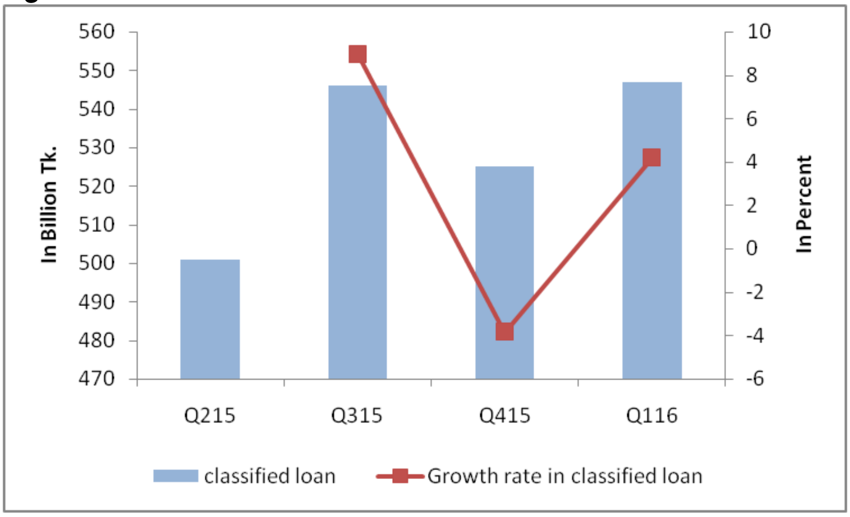
Figure 15: Gross and Net Nonperforming Loan



Source: Bangladesh Bank,2014

Loans that are not paid on time and are nominated as troubled assets by banks are classified loans. Classified loans are usually issued according to terms and regulations of the bank. The extent of default loans increased in the third quarter due to tightening the loan classification guideline, sluggish business activities during the political uncertainty and interruption in energy supplies. The percentage share of classified loan to total outstanding loan has been increasing in every year. The classified loans increased to 54700 crore in the July- September quarter of 2015-16 from Tk.52500crore of the October-Decemberr quarter of FY 2014-15; an increase of per cent. On the other hand, written-off bad debt increases by 17.13 percent from Tk. 321.1 billion in June'14 to Tk. 376.5 billion in June'15.

Figure 16: Total Classified Loan



Source:Bangladseh Bank,2014

Scrap in loan in Financial Sector

Consecutive financial heists are making thesectorvulnerable. Last one and decade near seven thousand crore was stolen from the financial sector from six big scams with which development project like Padma Bridge can be implemented (The Prothom alo,2016). Neither this huge amount is recovered nor there is any exemplary punishment encouraging the criminals to make attempt of stealing money from the system.Sofinancial scams in banking sector as well as the non-banking sector have shook the economy.

The biggest blow to the banking sector in recent time shook both the domestic and international is 100 million cyber heist from Bangladesh bank (the Daily Star,2016).Though Governor quits from his chair but main culprit remains out of the picture. The process of money transmit may even defeat the best-selling thriller. A group or single hacker theft the password of BBs network through malware to the cyber system of Bangladesh bank then use its swift code to send 35 advice to pay money ofUSD 101 million to The Federal Reserve Bank of New York,USA. Then USD 81 million is sent to the fiveaccount held in the Philippines and the rest USD 20 million is sent to Sri Lanka. The BB claimedthat they rescue the money from Sri Lanka and hopeful about the Philippines, though it is like black hole: once gone,gone forever. (The Prothom-Alo, 2016)

BB's reserve larceny is the recent one but not new in the financial sector. In2012 the Hallmark group swindled Tk.4500 crorefrom SonaliBank,amost near the same amount was stolen from the BASIC bank in the same year which turned a good bank into an infected one. Fund embezzlement of Bismillah group(1100 crore) from Janata Bank and the recent 1.5 crore by a bank executive are the examples of fraudulence.These have taken a toll on the common people of the countryasfinally it's their money. Frequent incidents of bank fraudulence are forcing common people,business unit, and investors to loose their confidence on the banks.**B**anking sector's performance in Bangladesh is now considered as the worst among the Asian emerging countries(BMI,2016).

Scams in Non-Banking Financial Sector

Along with the banking sector non-banking sector is also vulnerable to heist. Share market scam, Destitiny and Jubokfraudulences are notorious examples.

Share market scam in 1996 and 2010 caused a huge loss to the small and mediuminvestors and many become penniless. Near Tk. 15000 crore in 2010 and crore in 1996 were lost in share market rift-off. In1996 the price of the shares rose unusually which attracted a lot of people for quick profit having very little or no knowledge about stocks. For example, one popular stock, Confidence Cement, sold for 1,060 times of 1996's earnings, after a 1,400 percent increase in its price. Market capitalisation went up by 265 percent and the average daily turnover increased by over 1000 percent. As all bull runs eventually end in tears, the bubble was eventually burst: stock market prices dropped by close to 70 percent in end-April 1997 from the peak in November 16, 1996. Countless of investors lost their lifetime savings in the blink of an eye.

After 14 years, it was repeated in 2010 where the bullish trend started at the 2009 with a 62 percent hike in the general index reached to 83 percent in 2010, but then went down to 10 percent in January 2011.The gloomy situation has been continuing as investors have lost their confidence of investing in the market.

Destiny and Jubokthrough MLM(Medium Level Marketing) captured around 9 thousand crore by luring people for quick and huge profit.Destiny alone embezzled 4119crore from its 8.5 lakh customer through microcredit investment and opening of new firms up to June2012 (The Prothom Alo,2016). On the other hand the 3.7 lac clients of JUBOK have been waiting for their money amounting to 2600 crore for nine years though BB ordered JUBOK to return the money.

Scams become common incident and are happening on the continuous basis a brief description of loan scrap is given below:

Table - 2: Major Scams

Name of Company	Amount(Taka)	Name of Branch & Bank
AnonymousHackers	101million	Bangladesh bank
RajibulHasan, Bank Executive	1.9 crore	Local office,Janata Bank,Motijheel
Hall Mark	4500crore	Ruposhi Bangla branch of Sonali Bank

Bismillah Group	1100 crore	Four private banks(Prime Bank, Jamuna Bank, ShahjalalIslami Bank
BASIC Bank Limited	4500crore	By Dilkusha, Gulshan and Shantinagar Branch
Imran Group	101crore	Sholoshahar , Chittagong branch of Bangladesh Krishi Bank
Director of ShahjalalIslami Bank limited	140 crore	ShahjalalIslami bank
Ideal Cooperative society	1000 crore	Directly from 70000 clients
Destiny Group	3800 crore	Directly from clients
Paragon Group	146.60 crore	Sonali bank
T&Brothers	609.9 crore	Sonali bank

Source: The Daily star, April, September and July 2013, The New age,2012 The Daily Prothom-alo,July,2014 The daily Star,23 march,pp.

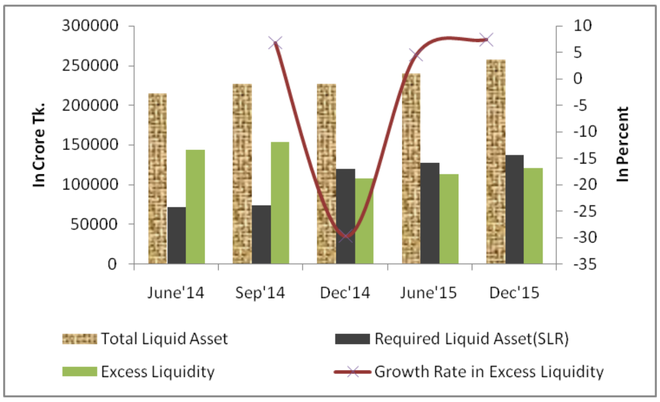
SCBs and DFIs incur a huge loss because of these huge scams such as Hallmark and Bismillah group and experienced a huge capital shortfall. Government, as owner of these banks, come forward to help these public banks in the form of recapitalization with the taxpayer's money. No improvement is seen because of corruption and poor management in these banks. Recapitalisation of government is proved as waste of money whereas more important sectors like social sectors had to witness the shrinkages in their budgetary allocation. This type of recapitalization did not work and probably will not work without fixing the reasons for the deterioration of the public banks.

Excess Liquidity

Excess liquidity is escalating, as banks cannot lend the money because of gloomy business situation.As a result the deposit is increasing but and so does the liquidity. If there is huge liquidity that will increase the cost as bank has to pay on this.

Excess liquidity become Tk120678.9 croreat the end of Dce'15(actual257793.8 croreagainst the requirement ofTk137114.9crore representing 7.41 percent increase compared to the June'15when it was Tk.1123851 crore.

Figure - 17:Liquidity Position of scheduled bank



Source: Bangladesh Bank

Risk management

Risk management comprises of capital adequacy, asset quality, expenditure- income ratio, return on Asset (ROA), return on Equity (ROE) and non-performing loan(NPL) which indicates the lack of presence of prudential surveillance on the financial sector and profitability of bank. Here, ROA is the ratio of net earnings of a year to average whole assets of a business in a financial year while ROE means the measurement of the rate of return on the ownership interest of the common stock owners and the term NPL refers to the loan that is in default.

Capital Adequacy

Capital adequacy is determined by Capital to Risk Weighted Assets (CRAR) which is most important to determine the solvency. Currently, a banking company is to maintain 10 percent of Risk Weighted Assets (RWA) or Tk. 200 crore whichever is higher as its minimum required capital. Overall Capital adequacy ratio of banks satisfies the requirement but the ratio is declining. Capital adequacy ratio decreased to10.53 in September, 2015 from 11.35 percent in December,2014 whereas it was 11.4percent, 10.5percent,11.5percent, 10.5 percent in 2011,2012,2013 and 2014 respectively.

SBs and DFIs capital adequacy ratio remain below the required 10 percent. Capital adequacy ratio decreased to10.53 in September, 2015 from 11.35 percent in December ,2014.

Table - 3: Capital to risk weighted assets ratio by type of bank

(Percent)

Bank type	2007	2008	2009	2010	2011	2012	2013	2014	2015 June
SCBs	7.9	6.9	9.0	8.9	11.7	8.1	10.8	8.3	4.9
DFIs	-5.5	-5.3	0.4	-7.3	-4.5	-7.8	-9.7	-17.3	-18.1
PCBs	10.6	11.4	12.1	10.1	11.5	11.4	12.6	12.5	11.8
FCBs	22.7	24.0	28.1	15.6	21.0	20.6	20.2	22.6	24.1
Total	**9.6**	**10.1**	**11.6**	**9.3**	**11.4**	**10.5**	**11.5**	**11.3**	**10.3**

Source: Bangladesh Bank,2015

Earnings/Asset Quality

Return on Assets (ROA) indicates the productivity of the assetsi.e. how much income is earned from per unit of assets. According to Basel accord, ROA should be more than one percent. On the other hand, Return on Equity (ROE) is anotherimportant measure of earning and profitability determination which indicates net income after tax to total equity. Return on asset, returns on asset and capital adequacy ratio are continuously decreasing after 2011. In 2011, overall ROA in the banking sector was 1.5 percent whereas it stood to 0.64 percent in 2014. At the end of FY 2014-15 the performance of banking sector deteriorates. In June of FY 2014-15, the ROA decreased to 0.47 percent and ROE decreased from 8.09 percent to 6.61percent.To put this in context, the ROA for Filipino banks averaged around 1.2 percent in the third quarter of fiscal 2015, while ROE was reported at around 10.1 percent.(BMI,2016).

Expenditure Income Ratio

Expenditure income ratio is an indicator to measure the soundness of the management of the banking sector. The expenditure-income (EI) ratio of the DFIs was the highest among the bank clusters. The EI ratio of the SCBs was 84.1 in 2013, the second highest, which could mainly be attributable to high administrative and operating expenses. The EI ratio of SCBs increased from 73.2 percent in 2012 to 84.1 percent in 2013. The EI ratio of SCBs, PCBs, FCBs declined to 83.3, 75.8, 46.5 percent respectively and rose to 112.0 percent for DFIs at end June 2014.

Figure: Expenditure-Income Ratio

Types of Ba	2006	2007	2008	2009	2010	2011	2012	2013	June,2014
SCBs	100	100	89.6	75.6	80.7	62.7	73.2	84.1	83.3
DFIs	130.5	107.7	103.7	112.1	87.8	88.6	91.2	94.8	112
PCBS	90.2	88.8	88.4	72.6	67.6	71.7	76	77.9	75.8
FCBs	71.1	72.9	75.8	59	64.7	47.3	49.6	50.4	46.5
Total	91.4	90.4	87.9	72.6	70.8	68.6	74	77.8	77.8

Source:Bangladesh Bank,2015

Advance-Deposit Ratio

ADR is another indicator to assessing the banks capability to make investment(as making loan is the main investment of banks.)Though Bangladesh Bank allows commercial banks to makeloanup to 85 percentagainst/of their total deposit, banks are not able to lend that much due to doomed demand for fund. ADR fell down in June 2014 to71 percent from 81.1 percent in 2012;representing a 10.1 percentage point decrease.

In sum, banking stance bleak on the backdrop of every indicators of sound banking performance.The overall picture is summerised below:

Table - 4:Risk Management in Banking Sector

	2009	2010	2011	2012	2013	2014	2015	
Return on assets	1.1	1.8	1.5	.64	.88	.64	.47	

Return on equity	21.7	21	17.02	8.2	10.8	8.09	6.61	
Capital adequacy ratio	-	-	-	10.46	11.3	11.35(Dec '14)	10.53(Sep'15	
Expenditure-Income ratio	72.6	70.8	68.6	74	77.8	77.8		
Liquidity	20.6	23	25.4	27.1	32.5	27.4June ,2014)		
Loan to deposit ratio				81.1	71	70.98		

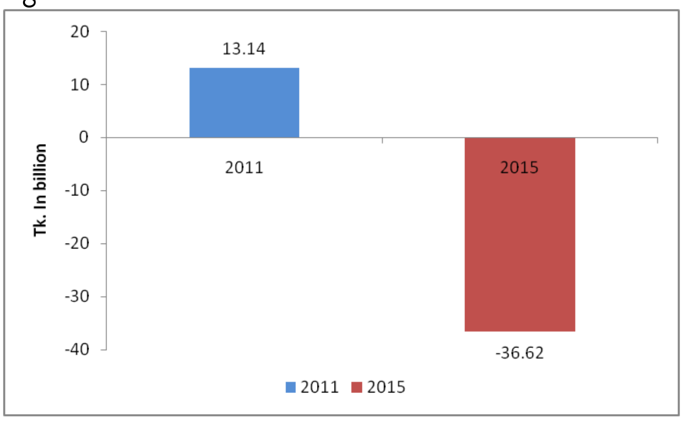
Source: Bangladesh Bank,2015

Profit/loss of Central bank

The overall doom situation in the financial sector also touches the balance sheet of Bangladesh Bank.The total operating income of the Bank (excluding foreign currency revaluation gain/loss) for FY15 decreased by Taka 9.19 billion (24.67 percent) to Taka 28.07 billion compared with Taka 37.26 billion in FY14. With foreign currency revaluation, BB incurred a loss of Taka 8.55 billion in FY15 against a income of Taka 50.40 billion in FY14. The income were 50.4 billion and 16.85 billion in Fy12 and FY13 consecutively.

In fY 15 BB's profit from foreign exchange reserve had turned into losses which amount to Tk. 36.62 billion as major currencies held by the bank specially the USD became weaker against the Bangladeshi currency taka and the interest rate on bills and bond on which BB invested had declined. The BB suffered losses of Tk. 36.62 billion where Tk 482.38 crore for gold price devaluation and Tk 7.48 crore for silver price devaluation during the same time.

Figure -18:Profit/loss of BB

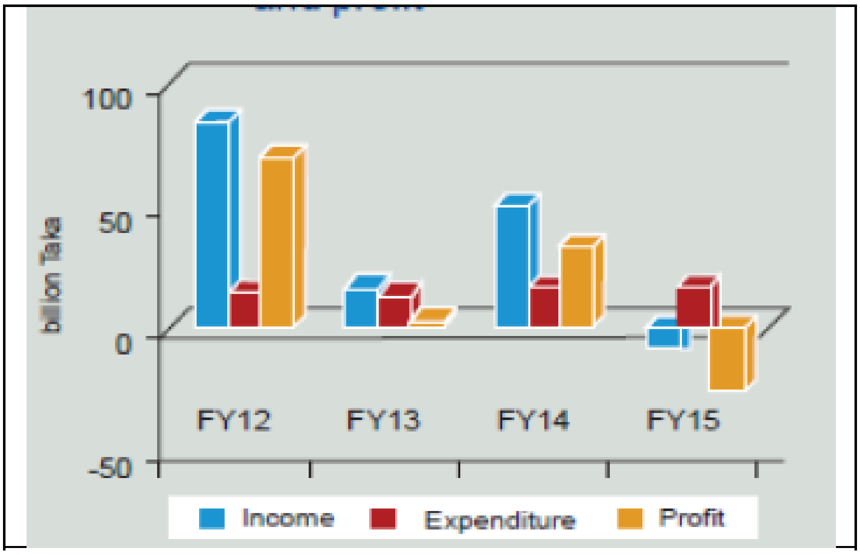


Source: Bangladesh Bank,2015

An increase in general and administrative cost total expenditure of the Bank increased by Taka 0.80 billion (4.74 percent)to Taka 17.68 billion in FY15 compared with Taka 16.88 billion in FY14.

Operating profit of the Bank (excludingforeign currency revaluation gain/loss) is Taka10.39 billion in FY15 compared to operatingprofit amounting Taka 20.38 billion in FY14.After includingforeign currency revaluation loss of FY 15 the profit turned in to loss which is Taka 26.23billion in FY15 compared to operating profit mounting Taka 33.52 billion in FY14.

Figure -19:Income, Expenditure and profit

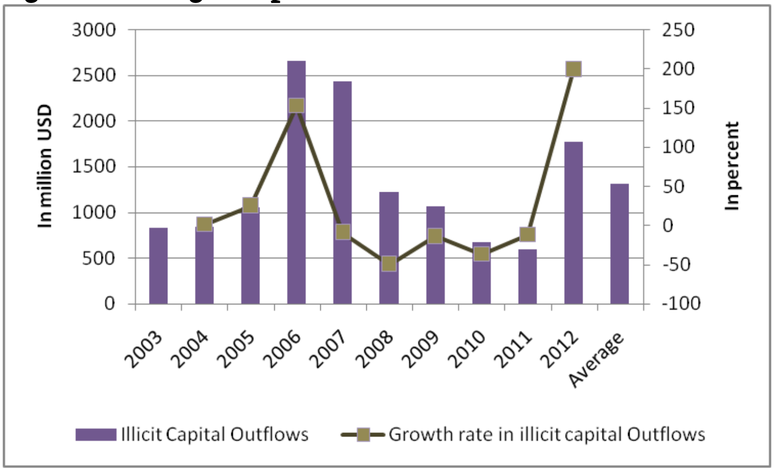


Source:Bangladesh Bank,2015.

Illegal Capital Flight

Huge illegal capital flight from the country is causing heavy loss to the economy. Bangladesh counts millions of dollars in capital flight every year owing to leakage in the balance of payments and trade mis-invoicing by businesses.

Figure 20: Illegal Capital Outflow



Source: Global Financial Intrigrity,2014

Illicit outflows were roughly 0.72 times bigger than the USD 1292 million in total FDI, and it was 61 percent of the USD 2126 billion in foreign aid received in 2012.

The main reasons behind capital flight from Bangladesh are economic crimes that generated through huge illegal incomes, whether from the wilful default of bank loans, corruption in tax administration, manipulation in stock exchanges, over-invoicing and under-invoicing in trade settlements, leakage in public development expenditure, or illegal financial deals in the running of state-owned enterprises (Sarkar,2014).Among these means leakages in the balance of payment and trade misinvoicing by business are key conduits of capital flight.(The daily Star,2014). In 2012 the outflow of money through balance of payment leakages (which is also known as hot money outflows) was USD 1026 million where it was USD 593 million in 2011; represents a 73.02 percent increase. During 2003-2012 period total trade misinvoicing was USD 8058 million(61.23percent of total illicit capital flight) among which export under invoicing was 6844 million and import over-invoicing was 1214 million,

Table - 5: Component of Capital Flight (in million USD)

Catagory	2012
BoP Leakages	1026
Export misinvoicing	6844
Import misinvoicing	1214
Total trade invoicing(outflow)	8058

Source: Global Financial Integrity, 2014

Supervision and Regulation

This segment of the paper examines the performance of Bangladesh on the backdrop of its monitoring and supervision on the financial sector. As the BB is the bankers of all banks and main safe keeper of the financial sectorit is theresponsibility of the BB that it properly supervise the banks activities and regularities.

Captured governance and oversight

The present inefficiency in banking sector can partially be attributed to captured governance and oversight. Lack of good management, poor surveillance over the bank, political instability and abuse of political power in this sector are worsening the situation**.**

High percentage of non-performing loans in the banks generally causes 'credit crunch' i.e. shrinkage in credit flow from the supply side of the bank. At the same time,comparatively poor administration, lack of transparency, weak regulations and monitoring cell, interest rate spread and rent seeking behavior of the politician are also noticeable causes for increasing NPLs. NPLs reduce profitability, as banks cannot take interest income from their classified loans. It also reduces loanable funds by preventing recycling.

The appointment of Directors of the Board of the SCBs based on the political loyalty and affiliation has traditionally been practiced for a long time. Members of the Board of the SCBsand DFIs are hardly independent, qualified, efficient and socially acceptable persons with integrity. Their political background is more considerable than their qualification and efficiency. Nepotism is not only a problem for public banks but also for the private banks. Although political influence is less the top level officials like chairman or directors are chosen from the family tree. For example, if the present chairman is Mr. X then next will be his son or daughter or brother even if there is more efficient person in that bank.

Although Bangladesh Bank (is the highest monetary authority of the financial system it holds limited control over the economy. A bill was passed in the national parliament in 2003 to bring reforms in the banking sector. Most important of the relevant initiatives was the Bangladesh Bank Amendment bill 2003 through which Bangladesh Bank received the autonomy to operate on its own and also to formulate the monetary policy which increases the power of BB over financial system. The bill gave BB the authority over the scheduled private commercial banks but SCBs and DFIs are under the authority of the Ministry of Finance. As most of the scrap loans are from SCBs and DFIs, the BB only can alert the ministry of finance but cannot takeany action. Moreover the BB is not free from the political manipulation and deceptions.

Feeble enforcement of the legal frameworks is another reason for increasing nonperforming loans. Anti corruption Commission (ACC) Act- 2004, the Bank Companies Act-1991 and the Companies Act-1994 are the suitable laws to prevent the bank fraudulence but their implementation is very rare. A functioning financial intelligence is needed to collect information and identify specific cases and trend of committing fraud, money laundering and other financial crime. The investigation agencies are not well trained with adequate knowledge and procedure to investigate financial crimes. Lack of human resource policy, especially in SCBs and DFI motivates the inefficiency of the banks.

CONCLUSIONS

A healthy and sound banking sector is needed for successful implementation of monetary policy which ensure proper channelling of funds thus stimulate the growth. But recent crisis in banking sector is increasing the opacity of the financial system. To get rid of this crisis BB must play a more active role through strong vigilance over banking system.

For preventing the illegal capital flight lower interest rate, stable political environment, and strong law enforcement are essential for preventing the illegal transfer of capital. Although it is very hard to deal with the problem of illegal capital flight the key state entities like Anti-Corruption Commission (ACC), National Board of Revenue (NBR) and Anti Money Laundering Unit of the Bangladesh Bank must start the process of bringing back the funds in a coordinated way.

Besides, the current pressure on economy can be checked by the policy harmonization since increased private investment and employment creation will ensure the use of money in productive sectors and cause both the money and fiscal multiplier effects to work in the economy. As a result, the vicious causality (declined private sector credit growth decreases investment which, in turn, causes growth of the economy to turn down) can be neutralised through channeling adequate resources to productive sectors that will eventually restrain the inflationary pressure and ensure an increasing trend in economic growth in the country.

Reference:

Radelet, S, and J. Sachs (1998a),1998. “The East Asian Financial Crisis: Diagnosis, Remedies, Prospects,” Paper presented at the Brookings Panels, Washington D.C., March 27. (Brookings Papers on Economic Activity, 1:1998.

Bangladesh Bank. 2015, Selected indicators, December 2015. Dhaka, Bangladesh: Bangladesh Bank.

Bangladesh Bank. 2015, Major Economic Indicators.December, 2015. Dhaka, Bangladesh: Bangladesh Bank.

Bangladesh Bank. 2015, Monthly Economic Trend, December, 2015. Dhaka, Bangladesh: Bangladesh Bank.

Bangladesh Bank,2015. Anual report,2014-15. Bangladesh Bank's Accounts for 2014-2015,2015.Ch-145. Dhaka, Bangladesh: Bangladesh Bank.

Ministry of Finance (MoF).2015, Bangladesh Economic Review, 2015. Dhaka, Bangladesh: Finance Division, Ministry of Finance, Government of Bangladesh.

TheProthom-alo,2016. “*দিনপঞ্জিতেবাংলাদেশ,ব্যাংকেররিজার্ভেরঅর্থচুরি*”*, March25,2016.*Dhaka Bangladesh.(Available at: http://www.prothomalo.com/economy/article/809785/%E0%A6%A6%E0%A6%BF%E0%A6%A8%E0%A6%AA%E0%A6%9E%E0%A7%8D%E0%A6%9C%E0%A6%BF%E0%A6%A4%E0%A7%87-%E0%A6%AC%E0%A6%BE%E0%A6%82%E0%A6%B2%E0%A6%BE%E0%A6%A6%E0%A7%87%E0%A6%B6-%E0%A6%AC%E0%A7%8D%E0%A6%AF%E0%A6%BE%E0%A6%82%E0%A6%95%E0%A7%87%E0%A6%B0-%E0%A6%B0%E0%A6%BF%E0%A6%9C%E0%A6%BE%E0%A6%B0%E0%A7%8D%E0%A6%AD%E0%A7%87%E0%A6%B0-%E0%A6%85%E0%A6%B0%E0%A7%8D%E0%A6%A5-%E0%A6%9A%E0%A7%81%E0%A6%B0%E0%A6%BF).Accsess:30March,2016

TheProthom-alo,2016. ***অতিমুনাফারফাঁদপেতেপ্রতারণা***,27 March,2016. Dhaka ,Bangladesh.

(Available at:http://m.prothom-alo.com/economy/article/810796/%E0%A6%85%E0%A6%A4%E0%A6%BF-%E0%A6%AE%E0%A7%81%E0%A6%A8%E0%A6%BE%E0%A6%AB%E0%A6%BE%E0%A6%B0%E0%A6%AB%E0%A6%BE%E0%A6%81%E0%A6%A6-%E0%A6%AA%E0%A7%87%E0%A6%A4%E0%A7%87 %E0%A6%AA%E0%A7%8D%E0%A6%B0%E0%A6%A4%E0%A6%BE%E0%A6%B0%E0%A6%A3%E0%A6%BE

The New Age, 2014.*Recapitalisation fund for scam –hit state-opwnedbanks* ,29 December,2014.

Available at: http://www.hawker.com.bd/news_details.php?news_id=392111

The New Age, 2016.Tk 4,152cr losses from BB forex reserve in FY15,March,2016.Available at:http://newagebd.net/211261/tk-4152cr-losses-from-bb-forex-reserve-in-fy15/

Unnayan Onneshan. 2014, Banking Sector Caught in Trap, Bangladesh Economic Update Volume 5,No. 7, July 2014. Dhaka: Unnayan Onneshan. Available at: http://www.unnayan.org/reports/meu/MEU_July_2014/MEU_July_2014.pdf

Unnayan Onneshan. 2014,Monetary Policy Statement (July-December, 2014): A Rapid Assessment, Bangladesh Economic Update Volume 5, No.8, August 2014. Dhaka: Unnayan Onneshan.Availableat:http://www.unnayan.org/reports/meu/MEU_August_2014/MEU_MPS_August_2014.pdf

TheProthom-alo,2016

Available at:http://m.prothom-alo.com/economy/article/810799/%E0%A6%B6%E0%A7%87%E0%A7%9F%E0%A6%BE%E0%A6%B0%E0%A6%AC%E0%A6%BE%E0%A6%9C%E0%A6%BE%E0%A6%B0-%E0%A6%95%E0%A7%87%E0%A6%B2%E0%A7%87%E0%A6%99%E0%A7%8D%E0%A6%95%E0%A6%BE%E0%A6%B0%E0%A6%BF-%E0%A6%A7%E0%A6%B0%E0%A6%BE%E0%A6%9B%E0%A7%87%E0%A6%BE%E0%A6%81%E0%A7%9F%E0%A6%BE%E0%A6%B0-%E0%A6%AC%E0%A6%BE%E0%A6%87%E0%A6%B0%E0%A7%87-%E0%A6%B8%E0%A6%AC%E0%A6%BE%E0%A6%87

The Asian News Network,2016.Banking outlook bleak for Bangladseh,20March,2016.

Available at:http://www.asianews.network/content/banking-outlook-bleak-bangladesh-analysis-12097

The Dhaka Tribune,2013. The Demand For Foreign Loan rises.17 November,2013.Available At:http://www.dhakatribune.com/money/2013/nov/17/demand-foreign-loans-rises.

IMF, 2016. Bangladesh selected issues. IMF Country Report No. 16/28, 2016. Washington DC., USA.