Report on

“The Prospect of Bond Market: Bangladesh Perspective”

By

Amir Khan Shraboan

17304013

An internship report submitted to Brac Business School in partial fulfilments of the requirements of the degree of Bachelor of Business Administration

Brac Business School

Brac University

February 2022

Student Declaration

I do hereby declare that the internship report titled **"The Prospect of Bond Market: Bangladesh Perspective"** Submitted by me to BRAC University, for the degree of Bachelors of Business Administration is an original work.

I also declare that the report has not been submitted earlier either partly or wholly to any other University or Institution for any Degree, Diploma, Associate-ship, Studentship, Fellowship, and other similar title or prizes.

Student Full Name & Signature:

X ____________________

Amir Khan Shraboan

ID: 17304013

Supervisors Full Name & Signature:

X ____________________

Mahmudul Haq

Professor

BBS

LETTER OF TRANSMITTAL

February 08, 2022.

Md. Mahmudul Haq

Professor

BRAC Business School

BRAC University

Dhaka-1213

Subject: Submission of Internship Report.

Dear Sir,

I respectfully state that I am a student of the BBS department of BRAC University and want to submit my internship report on **“The Prospect of Bond Market: Bangladesh Perspective”** as a part of fulfilling your instruction for acquiring the learning objectives of practical knowledge in the corporate field.

It was a great experience for me to work with United Commercial bank (UCB) Investment Ltd, which provides me a chance to relate the theoretical context with empirical evidence. This enhances not only my knowledge about the practical working areas but also my analytical ability.

I earnestly hope that you will kindly go through my internship report and evaluate its feasibility.

Thank you

Sincerely yours,

Amir Khan Shraboan

ID: 17304013

BRAC Business School

BRAC University

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Professor

BBS

Non-Disclosure Agreement

This agreement is made and entered into by and between UCB Investment Limited and the undersigned student at BRAC University named Amir Khan Shraboan for the commitment of avoiding the unlawful disclosure of privileged data of the organization.

……………………………………….

United Commercial Bank Investment Limited (UCBL)

……………………………………….

Amir Khan Shraboan.

ACKNOWLEDGMENT

First, I remember Almighty Allah for making me successful to prepare this report. At the very inception, I would like to thank my teacher Mr. Mahmudul Haq, Faculty of BBS, BRAC University who helped me from the very beginning of our report. From time to time our honorable teacher give us an appointment and proper suggestions to us to prepare this report that finally made us possible to complete this report which is a partial requirement of the BBS program.

I would like to thank all employees of UCB Investment Limited specially Md. Tanzim Alomgir Sir- Chief Executive Officer (CEO), Aroka Chowdhury- Senior Manager (Supervisor), H. A. Fattah- Senior Executive Officer (Finance & accounts), and all my college interns for their tremendous support.

Finally, a silent stream of gratitude is for our most adorned parents whose blessing is always with us in this windy world.

ABSTRACT

Bonds for Bangladesh are issued by Marchant Banks. In a country's economic development, the bond market acts as a buffer to equity markets. Through the issue of different types of bonds, particularly corporate bonds, the bond market can provide long-term finance to issuers. The current study has revealed the prospects for Bangladesh's corporate bond market in this respect. Bangladesh's bond market is hindered by a number of obstacles. Bond markets are currently in their infancy. A shortage of long-term debt instruments is responsible for this phenomenon. In this case, there is no reliable benchmark for bonds or debentures with long maturity dates. There is no liquidity on the market and no movement. By paying a relatively high rate of interest on the risk-free national savings scheme, though interest has been reduced lately, it slows the growth of the economy. Moreover, the insurance process of bonds is burdensome and costly, which inhibits the emergence of a competitive market for bonds. Lastly, a suitable investor education must be provided simultaneously with the expansion of the investor base. Bond market reform is recommended.

Key Words: Bond market, Investor, Issuer, corporate bond.

Table of Contents

VI

List of Tables

VII

List of Figures

VIII

List of Abbreviations

Short Forms

BB	Bangladesh Bank
BSEC	Bangladesh Securities and Exchange Commission
BGTBs	Bangladesh Government Treasury Bonds
ADB	Asian Development Bank
DSE	Dhaka Stock Exchange
IBBL	Islami Bank Bangladesh Ltd.
ACI	Advanced Chemical Industries
ICB	Investment Corporation of Bangladesh
FDR	Fixed Deposit rate
ISIN	International Securities Identification Number
BDT	Bangladesh Taka
CMDP2	Second Capital Markets Development Program
ICMA	International Capital Market Association
FYP	Five Year Plan
CSE	Chittagong Stock Exchange
CDBL	Central Depository Bangladesh Limited
DSE	Dhaka Stock Exchange
DNS	Directorate of National Savings
EU	European Union
WB	World Bank
FCB	Foreign Commercial Bank
GDP	Gross Domestic Product
GOB	Government of Bangladesh
ICB	Investment Corporation of Bangladesh
IPDC	Industrial Promotion and Development Company of Bangladesh Ltd.
IPO	Initial Public Offering
IRD	Internal Resources Division
MOF	Ministry of Finance
SEC	Securities and Exchange Commission
NCB	Nationalized Commercial Bank
NBFI	Non-Bank Financial Institution
OTC	Over The Counter
PCBs	Private Commercial Banks
SOE	State-Owned Enterprise
PDs	Primary Dealers
SOCBs	State Owned Commercial Banks
IOSC	International Organization of Securities Commissions
SLR	Statutory Liquidity Requirement

Chapter One

Introduction

1.1 Background

Any economy cannot function without the financial sector. The financial market impacts a country's business climate, investment environment, economic prospects, even social dimensions. Observations and analyses suggest that, in addition to other factors in the economy, the long-term economic growth and welfare of countries are influenced by the extent to which their financial sectors are developed. Developed countries have found that a strong government bond market is conducive to a successful corporate bond market, although it is not always as important for a country to create its security market. Financial markets are a pivotal part of the financial sector, playing important roles in the global economic system, including attracting and allocating savings, setting interest rates, and determining the value of financial assets (Rose 2003). The tenacity of the equity market, bond market, and banks is extremely dependent upon the well-diversified financial sector. Both developed and developing countries have developed government bond markets.

In Bangladesh, corporate and government bonds have been insufficient in generating economic growth to the extent that the economy has grown very slowly. Bangladesh's debt market is very small compared to other South Asian countries due to the dominance of commercial banks, especially State-Owned Commercial Banks (SOCBCs) (Mujeri and Rahman 2008). By analyzing the available literature on the government segment, the report aims to propose some recommendations for the development of the Bangladesh bond market in light of the above perspective. Its aim, however, is to suggest some valuable lessons for Bangladesh's bond market development and to put essential prerequisites for the development of bond markets in general.

1.2 Problem Statement

In Bangladesh, policymakers have long been concerned about the overall debt securities market. The economy is negatively affected by high government debt as a consequence of unrelenting budget deficits. With a per capita income of 700 US dollars, Bangladesh is one of the poorest countries in the world. External debt has historically been the country's main source of development. Since external debt has decreased, domestic debt has increased many folds in importance. On behalf of the Government of Bangladesh, Bangladesh Bank is an important source of domestic debt mobilization. Together with Bangladesh Bank, the finance ministry is assessing government finance needs: preparing the government securities auction calendar. The Government of Bangladesh (GOB) is banked by Bangladesh Bank (BB) and owed money by it. Debt management involves borrowing money for GOB as and when it is needed. Automatic monetization is part of the debt creation process.

Most countries practice it both in theory and in practice because they view keeping fiscal and monetary operations separate as desirable. As well as most of the developed countries, most Asian countries are affected, particularly in places like Bangladesh where debt markets have been actively developed to make financial systems more efficient. In addition, for better and cheaper financial systems to borrow from the Government. This requires an analysis. Identifying potential risks in government debt requires analysis. Additionally, it requires analysis to determine how government borrowing impacts the economy. The country's macroeconomic environment. In this report, we examine the effects of government borrowing on the economy. Our focus is on managing government debt.

1.3 Scope

Bangladesh Bank's role in managing the Government of Bangladesh's domestic debt and its limitations in developing a bond market are discussed. In addition, Bangladesh Bank's debt portfolio is examined for sustainability. It mainly focuses on domestic debt. Public debt data is analyzed only to check its sustainability.

1.4 Objectives

BB's role in effective debt management in Bangladesh is the primary objective of this study. We will examine:

Assume that:1. To gain a better understanding of how Bangladesh's bond market has evolved over time

The second is. Determining the specific features of the Bangladeshi market.

The third. Determine the Bangladesh Bank's role in domestic debt management.

Four, To estimate the government of Bangladesh's current debt burden.

Fifth, Recognize the constraints and identify solutions to enhance the efficiency of government operations. Developing and enhancing bond markets.

Lastly, Recommending improvements to it.

1.5 Methodology

Both the primary and the secondary data are used to make the report. They are

mentioned below:

Information about the primary data

To collect primary data, Bangladesh Bank (BB) and Securities and Exchange Commission (SEC) are largely relied upon. Central Depository Bangladesh Limited (CDBL) and Dhaka Stock Exchange (DSE). Information is collected by interviewing some key personnel.

Data derived from secondary sources

Following are the secondary sources of data:

1. Bangladesh Bank (BB), Department of Debt Management.

2. Papers published by the Policy Analysis Unit (BE).

3. Ministry of Finance, Economic Relations Division

4. Government of Bangladesh.

5. Division of Finance, GOB.

6. Publications of donors.

7. Publications of the government.

8. Clippings from newspapers.

9. Materials on the website.

Techniques of analysis/Analytical framework

It is primarily a descriptive report. Indicators of market risk and debt ratios are used to assess debt sustainability.

1.6 Limitations

Unavailable are certain data sets related to government borrowings, particularly those involving state-owned companies. Data characteristics require all data to be verified or validated.

1.7 Layout of the report

1. Describes the background, the scope, the methodology, and the objectives of chapter I of this report.

2. A description, description, features, risks, and participants are described in Chapter 2 of market.

3. The third chapter describes the history of Bangladesh's bond market and the constraints it faces as it develops

4. In Chapter 4, government securities are discussed on the secondary market and the primary market. We discuss the dealer system and Bangladesh's debt portfolio.

5. Recommendations are made in chapter 5

Chapter 2

Literature Review

2.1 Introduction

Markets are considered to be the primary pillar that supports and stimulates economic growth. As part of the economic circuit, markets allocate savings and decide on their optimal use. Traditionally, the markets offer opportunities for private, public, and government entities to raise capital. Even though they drift toward common ground with identical basic features gradually today, every capital market has its unique features resulting from history, culture, and legal structure.

Figure 2. l shows that the bond market and the financial market are both interconnected. In this research, the market is the focus, so the discussion is limited to markets. Towards this end, we will discuss Bond markets in Asian countries, their features, and the challenges they face in developing strategies.

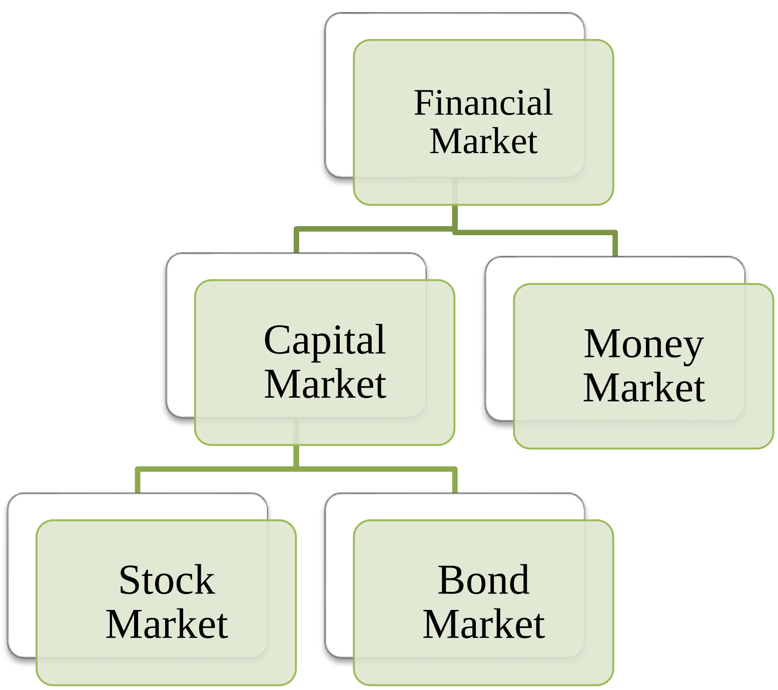

Figure 2.1: Simplified form of Financial Market

2.2 Definition of Bond

Bonds are debt instruments that are issued to raise funds by borrowing. Bonds are long-term obligations. Government, corporate, and other large entities issue Bonds, which are fixed interest financial instruments. Essentially, a bond is a contract that involves repayment of the principal and the interest. In some bonds, the interest rate is zero but the term is fixed. These bonds are known as deep discount bonds or zero-coupon bonds. Since these bonds have risk characteristics and market interest rates, their price is often much lower than their face value.

It is possible to trade bonds, and their price is determined by both the interest rate on the bond market for an equally risky instrument and the coupon they have. By facilitating long-term funding flows between surplus and deficit units, bonds play a key part in an economy.
Bonds act as loans where buyer holders of bonds are lenders and the issuer is borrowers and the coupons are interest.

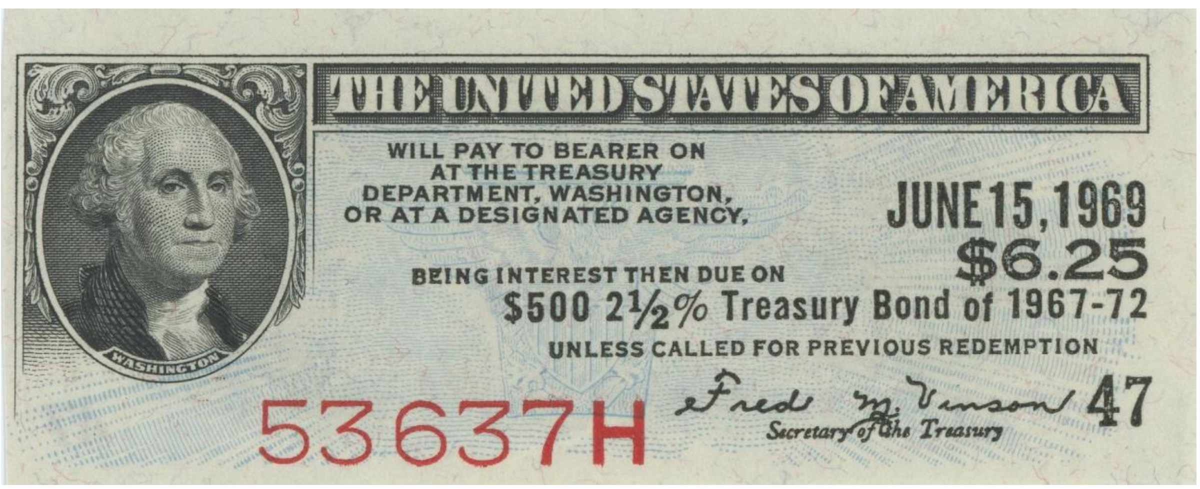

Figure 2.2: Coupon Bond

2.3 Types of Bonds

Bonds can be classified by the following:

Issuers include government bonds, municipal bonds, and corporate bonds. Corporations and government agencies issue bonds (Figure 2.2).

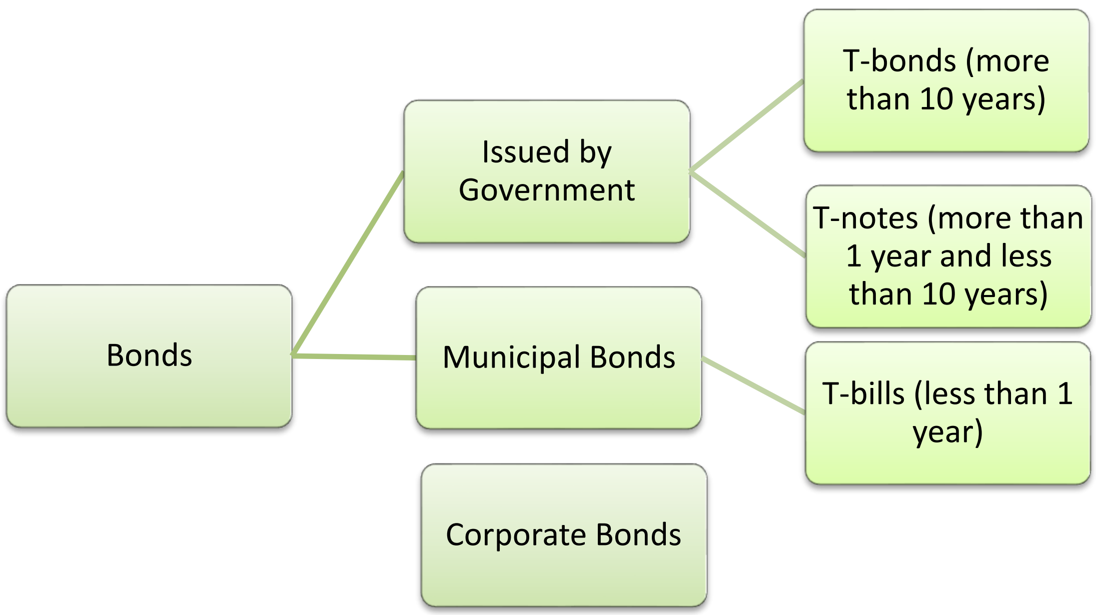

Figure 2.3 Major Types of Bonds

Bonds issued by the government

Three categories of government bonds can be grouped according to how long they have been outstanding. Let's take a look.

Government bills: securities with a short maturity.

Government notes: securities with a maturity of 1 to 10 years.

Bonds: securities with a maturity longer than 10 years.

Municipal Bonds

Bonds: Bonds issued by municipalities or government agencies. Governments do not issue these bonds directly to the public, but with government backing. Governments do not tax municipal bond returns in most countries. There is therefore a tax advantage. Municipal bonds tend to have a lower interest rate than taxable bonds. As a result, municipal bonds are an excellent after-tax investment opportunity.

Corporate Bonds

Bonds can be issued by a company like shares. The company can make more capital from the market in several ways, but its perimeter is determined by the market. A short-term (less than five-year) bond may be issued by the company. The bonds are categorized as short-term (5 to 10 years) and long-term (more than 10 years). Convertible bonds are bonds that can be converted into stock by the holder. A TV call can also be made to redeem the issue before maturity, allowing for early redemption by the company.

Bonds can also be classified as lottery bonds, war bonds, serial bonds, revenue bonds, climate bonds, etc.

Bonds are categorized into three types according to coupon and maturity:

Pure discount or zero-coupon bonds:

a. Do not pay coupons before maturity

b. Redeem the bond at its maturity price

c. Formula for value estimation P = FV/(1+r)n

Coupon bonds:

a. Make periodic payments prior to maturity of an obligated coupon

b. At maturity, give the bond its face value

c. Formula for valuing P = coupon payment/r ((1- 1/(1+r) n)] + FV/(1+r) n

Perpetual bonds or console:

a. The maturity date does not apply

b. Make periodic payments

c. Calculation of value P = coupon payment/r

d. Consider the following scenario: suppose a console with an annual interest rate of 6% and a market interest rate of 8%

receives Tk 50 from five UK bonds. How much do you calculate?

Therefore, coupon payment is equal to coupon payment / interest rate, which is equal to TK50 / 0.1 = TK500.

2.4 Features of Bonds

Here are some of the key characteristics of a bond.

1. **Face value:** The amount paid by an issuer as interest and which is typically repaid by the issuer at maturity. Principal: The amount paid by an issuer as interest.

2. **Issue price:** This is the price at which bonds are sold for the first time. Typically, the issue price equals the face value of the bonds. Price minus issuance fees is the net amount paid to the issuer.

3. **Maturity:** The date when it is due for the issuer to repay the principal. When the bondholders receive their principal amounts at maturity, the issuers have no further obligations to them. Maturity-based bond categories can typically be divided into three groups.

a. **Short-term:** Bonds that mature within 1 to 5 years;

b. **Medium-term:** Bonds with a maturity of five to ten years;

c. **Long-term:** Bonds with maturities of over ten.

4. **Bond coupon: It is the interest rate the issuer has to pay to the holders of the bonds.** This rate is normally fixed during the bond's life.

5. **Interest rate:** nominal interest rate, R = K+IP+DRP+LP+MRP

Where,

K = real risk-free interest rate

IP = inflation premium

DRP = default risk premium

LP = liquidity premium

MRP = maturity risk premium

the risk-free rate adjusted with inflation premium

i.e., R = K+IP

In real life, there is no real risk-free rate. However, govt. T-bill rate is the short-term risk-free rate and govt. I-bond rate is the long-term risk flee rate.

6. Convertibility: These bonds are convertible if they can be exchanged for the common stock of the issuer.

7. **Call provision:** A condition that the issuer must meet to pay the bondholder until maturity by "calling the bond in".

8. **Put provision:** Bond investors can sell their bonds back to the issuer when:

a. Rates rise on the market

b. Ratings deteriorate for issuers

c. A serious threat of credit quality deterioration

9. **Indenture:** The document that contains information about the issue such as repayment provisions and restrictive covenants.

10. **Extendibility:** The ability for bonds to be extended beyond their initial maturity date.

ll. **Retractibility:** The ability for bondholders to move their principal repayment to date sooner than the original maturity date

12. **Inflation-linked bond:** This type of bond protects investors from inflation. It is normal for inflation-linked bonds to have a principal index, which means that their principal will increase if inflation changes over time. Over time, the coupon rate increases as the principal amount increase with inflation. Also at maturity, the principal is repaid at an inflated amount. Hence, as long as the investor's inflation rate is higher than the inflation rate, the investor is completely protected from inflation.

2.5 Bond Credit Rating

Mooy's and Standard & Poor's (S&P) rate US bonds; Fitch rates European bonds. Moody's assigns credit ratings of Aaa, Aa, A, Bbb, Bb, B, ccc, Cc, C. am] Fitch assign credit ratings of AAA, AA, A. BBB. 13B, B, CCC, CC, C. The bonds of rating AAA/Aaa. AA/Aa, A. BBB/Bbb are known as invested bonds otherwise the bonds of rating BB/Bb. CCC/Ccc. C are junk bonds. Invested bonds have lower risk and lower coupon payments otherwise junk bonds have a higher risk and higher coupon payment. So, risk-taker investors like **Salman-f-Rahman** will invest in junk bonds.

2.6 Bond Market Participants

Market participants in bond markets and financial markets are similar. In both, buyers and sellers are involved. Typically, individual investors, traders, institutions, and governments participate in bond markets.

2.7 Risks Associated with Bonds

Although bonds have risks, they are generally seen as risk-free instruments. Bonds are generally more secure than Listed below are some risks that bondholders face.d below.

Interest rate risk

Is a negative correlation between bond prices and interest rates. Bond prices fall when interest rates rise. At the time of issuance, a bond's coupon (interest) is set. If interest rates rise, buyers in the secondary market are unlikely to purchase the bonds at an earlier rate. For example. if the coupon is 7% and the interest rate of an equally risky instrument in the market is at the interest rate on a bond is less what makes investors motivated to invest the high interest-bearing instruments. When interest rates are low, it can be risky to buy long-term bonds.
Two types of interest rate risk

a. Bond price risk: rising interest rates cause bond values to decline. With the rise of interest rates, investors may lose the value of their portfolios.

b. Interest rate reinvestment risk: OIE loses again when it reinvests when it gets cash following a drop in interest rates.

Credit risk

Some bonds are rarely defaulted on like some loans are occasionally defaulted on by a few organizations. These investments lose all value. Federal government bonds, on the other hand, are generally protected against default. Local government bonds are very rarely defaulted upon. Municipal and corporate bonds are best known for their higher interest rates because they compensate bondholders for taking on higher risks. Generally, corporate bonds offer a higher interest rate than municipal bonds, and municipal bonds offer a higher interest rate than government bonds. Additionally, investors can determine the risk level associated with each type of bond by using a rating system.

Call risk

Some of the earlier calls may be called back by the company. Redeeming existing bonds is a method of obtaining a better price for new bonds. Investors are kept from reinvesting their principal at a higher interest rate when this occurs, forcing them to reinvest the principal earlier than anticipated.

Inflation risk

Generally, the bond's yield and the principal that will be repaid at maturity are determined at the time of issuance. Over the period that the investor holds the bond, inflation will damage the value of the investment.

2.8 The Bond Market: Factors Influencing It

Economic factors (variables) that influence the bond market development in a country are outlined below. There are 14 fundamental variables in Table-2.1 that can be seen concerning bond market development.

Table: 2.1 Variables and Effects on Development or Bond Market in an Economy

SL No.	Name of the Variables	Relation	Nature of Bond Market Development
1	GDP as a measure of economic size	Positively associated	An economy that is larger develops bonds more rapidly, whereas an economy that is smaller develops bonds more slowly.
2	GDP per capita measures the economy's development stage.	Positively associated	when a country's economy is more expansive. The bond market will develop more quickly.
3	Export versus GDP as a measure of natural openness	Merely Associated	Market development of a country's bond market is directly related to its level of exports
4	The concentration of the Banking Sector: Used to persuade to issue public offerings	Negatively correlated	If the banks strongly discourage the issuer from a public placement or their spread is so large. There will be no bond market.
5	Size of the banking system	Association of togetherness	To play the role of the market, the bank must be present. The two must go hand in hand.
6	A measure of the riskiness of the investment environment	Positively correlated	issuers have a low risk for investors.
7	Rates of interest at the level	Negatively correlated	In a low-capitalized bond market, high interest rates tend to depress issuance

8	Variability in interest rates	Negatively correlated	Fixed income securities markets are characterized by high interest rate volatility, which hampers bond market development
9	Currency regime	Positively associated	with the development of bond markets are countries with stable exchange rates
10	Law and Order	Negatively correlated	Bond Market Development is correlated with lower levels of corruption
11	Legal system	Strongly associated	with a stronger bond market Development Stronger legal protection for investors
12	Absence of public sector funding needs	Positively associated	if the private and public sectors bond markets cooperate. This will lead to the development of the total bond market.
13	There is inadequate regulatory enforcement.	Positively associated	regulations tend to boost the bond market.
14	Transparency and corporate governance	Positively associated	high standards of accounting have led to positive developments.

2.9 Prerequisites for Development of Bond Market

A bond market that is efficient and effective needs to have the following characteristics.

- Sound monetary and fiscal policy;
- Stable and credible government;
- Safe, sound, and smooth settlement procedure;
- Efficient tax, legal and regulatory procedure: and
- A liberalized financial system with rational intermediaries.

Chapter 3

Bond Market in Bangladesh

3.1 History

A small part of Bangladesh's economy is currently devoted to the bond market. Comparatively, there is a very small bond market in Bangladesh. This market should be expanded by the government. End of 2006, Sri Lanka had outstanding bonds worth 2% of the GDP, compared to India (35%), Pakistan (31%), and Nepal (10%). Bangladesh was the South Asian country with the smallest bond market share with only 0.2%.

Fixed income instruments such as government debt dominate the market. Only one instrument, the National Savings Certificate, is used to mobilize the maximum savings of small investors. A saving certificate like higher interest rates than other bonds on the market. Aside from national savings certificates. Besides Treasury bonds and Treasury bills, there are other government debt instruments. During December 2003, the Treasury issued bonds with maturities of 5 and 10 years, and in July 2007, it issued bonds with maturities of 15 and 20 years. There has been an increase in treasury bonds rather than treasury bills in capital raising. In 2011, Treasury bills outnumbered Treasury Securities by 80:20, up from about 20:80 in 2005. Government bonds are mostly purchased by banks. Government securities are required to be purchased by commercial banks, as it is expected that it will help them meet their statutory liquidity requirements (SLR). However, this market is still the only participants in this market are banks and financial instruments that have SLR obligations traded on the exchange.

A yearly Treasury bill and bond auction calendar was published by the Ministry of Finance in September 2006. Each auction is listed with the date, the instrument, and the amounts. The results of each auction are also listed on the Bangladesh Bank website.

There is a very small market for corporate debt in Bangladesh. This represents only 0.2% of the country's GDP. The Bangladeshi economy is still in its infancy. In the period 1988-2011, only 3 corporate bonds and 14 debentures were offered publicly (Table-3.1). Several of these debt and equity instruments were partially convertible into common stock. During 2007, corporations issued the most corporate bonds. Perpetual bonds were issued by the IBBL Mudaraba with a face value of Taka million (roughly USS 40 million). As interest is prohibited by Sariah Principles, it is an Islamic business model based on profit sharing. As of 2011, there were eight debentures and three corporate bonds outstanding. Despite expected growth in the financial market, the Bangladeshi corporate bond market faces many obstacles. For a market structure to be efficient, long-term instruments must be available.

3.2 Constraints on Development of Bond market

There are several reasons for the slow growth of the Bangladeshi bond market. Here are some of them.

- **A Limited number of investors:** Bonds and stocks are only attractive to a small number of investors compared to the general population.

- **Capital gains:** The impact of clientele. While investing in Bangladesh, most investors are looking for capital gains rather than fixed income streams. If you invest in bonds, your chances of making money are limited.

- **High return in risk-free government bond:** The return rate on government bonds with no risk is too high, so corporations that issue bonds must offer higher rates to cover additional risk, making the rate unprofitable.

- **Alternative Of debt financing:** Commercial banks are one of the easiest and most popular sources of debt financing in Bangladesh. The interest rate charged by banks is lower than that charged on bonds. Bank borrowing is also quick and flexible. Consequently, using debt does not have to be the only means to design the capital structure of an issuer and to generate tax benefits.

- **Limited private management of pension funds:** Long-term pension funds in Bangladesh are very limited in terms of private management. Debt instruments are not issued by state-owned bodies & government organizations. Finance for their projects comes from deficit funding & money printing by the central bank. Hence, all these factors make bonds secondary market very uniquid & discourage bond issuance

- **Weak regulations and market infrastructure:** Inadequate laws and regulations govern the bond market. Bangladesh is prone to market failures. Investments in the stock market are preferred by risk-averse investors. Markets and corporations do not have enough investors.

- **Underdeveloped tax system:** Bangladesh has an underdeveloped tax system. A bribe or other unfair method can be used to evade taxes. Consequently, tax incentives are not very high to issue bonds, causing a corporate market.

- **Illiquid secondary market:** Government debt securities are not liquid in the secondary market, thus limiting treasury pricing in the primary market.

- **High interest-rate:** Individuals find national savings plans appealing because of the high interest rates. In addition to being risk-free, national saving certificates offer extremely high-interest rates, which makes them extremely competitive. To attract investors, companies often are forced to offer higher coupon rates, resulting in a loss for the company.

- **High transaction of bind issuance:** Stamp duties and registration fees, in particular, increase transaction costs by a lot. About bonds, the fees paid by bondholders towards the reduction of the outstanding amount.

- **Cheap syndicated loans:** It is not uncommon for banks to form a syndicate to finance large projects. Bonds are unattractive to corporate issuers since syndicated loans are cheap, tailor-made, and flexible.

- **Default on interest payment:** Some corporate debentures defaulted on their interest payments in the early 1990s. Around this time, there were no financial market regulations and no credit rating system. A lack of trust by trustees in protecting debenture holders' rights has eroded investors' confidence in corporate bonds, making them averse to investing in them.

- **Inexperienced investor:** Bangladesh has a large number of inexperienced investors. Most of them have a lot of experience with bonds. According to them, debt instruments have a very small return (interest) and no possibility of capital gains. This causes them to invest in stocks for a capital gain that is abnormal.

- **High inflation:** A high rate of inflation has persisted for quite some time now, making corporate securities less attractive to investors.

3.3 Corporate Debt Market in Bangladesh

Corporate finance is primarily provided by bank loans. In Bangladesh, there are very few corporate bond markets. Because other corporate debt instruments are underdeveloped, corporate debt is dominated by the banking sector. In order to establish a sound financial market in Bangladesh, Bangladesh should diversify its sources of funding other than bank loans. The corporate bond market must be promoted by a comprehensive set of guidelines on and debentures. To create a favorable environment for corporate bonds, the government must reduce the interest rate on national savings certificates.

Table: 3.1 Instruments Available in Bangladesh

Instruments	Nominal Amount (Billions of BDT)	Relative size %
Deposits	**4032**	**37.20%**
Bank Loans	**3501**	**32.30%**
Term Loans	**1333**	**12.30%**
Government savings certificates	**965**	**8.90%**
Government Bonds	**534**	**4.93%**
Treasury Bills	**271**	**2.50%**
Equity (issued value)	**192**	**1.77%**
Private placement	**Not Available**	**--**
Debentures and Bonds	**11**	**0.10%**

Source: DSE, NSB, and BB

3.4 Government Debt Market in Bangladesh

Order of the Bangladesh Bank of 1972. Treasury rules of 1998. In Section-3 of Appendix-I, Bangladesh Bank is empowered to manage issues of government securities. Under the above laws and regulations, Bangladesh Bank is entrusted with managing government bond issues. As the lender and debt manager to the Government of Bangladesh (GOB), Bangladesh Bank (BB). Taxes are the government's main source of revenue. This allows it to meet its deficit. By issuing debt securities when it exceeds its tax remittances. Using sample data in the past, Bangladesh was financing its budget deficit through debt securities. This is done by issuing 'ad hoc' Treasury Bills. The Bangladesh Bank then issues these bills. Through the issuance of 'ad hoc' Treasury Bills, some of these 'ad hoc' Treasury Bills are offloaded. The Government's cash positions are left unchanged as a result of the sale of Treasury bills and bonds to the market unchanged. So, 'ad hoc' Treasury Bills were accessed for both cash requirement and tax collection shortfalls. Using ad hoc Treasury Bills is no longer an option. Budget deficits cannot be funded through Treasury Bills. Government of Bangladesh issues -

a. Special bonds,

b. Bangladesh Government Treasury Bonds (BGTBs). and

c. Savings instruments (NSD).

However, there is a small deficit. In Bangladesh, Bangladesh Bank has a nice cash program called the Ways and Treasury Bills are normally used to borrow first from WMA and then from WMA. Treasury Bills. For this advance, a floating interest rate (bank rate + 1%) is charged. At present, the bank rate is 5%.

Chapter 4

Secondary market of Government Securities

4.1 History

Government securities continue to trade in the secondary market. A Bangladesh Bank subsidiary conducts periodic secondary trading and also buys back government securities based on government instructions.

This process of increasing liquidity is gradual. The development of institutional trading behavior requires significant effort and time. Creating an environment conducive to safe and efficient secondary markets is the best strategy for any institution intent on promoting secondary trading. In Bangladesh, government securities trade in a very low volume. It is crucial to encourage institutions (banks and other financial institutions) to create a trading culture, to develop safe and reliable trading and settlement systems, and to educate market participants on effective risk management practices and to stabilize market standards in order to activate the market.

As part of Bangladesh Bank's recommendations to solve bottlenecks impeding secondary market development, we identified the following challenges:

Problem: A large majority of bond markets around the world have removed settlement risks by introducing Delivery versus Settlement (DvS). In Bangladesh, the few transactions that occur in the secondary markets of bond markets are handled by an established settlement system.

Solution: From January 2010, all marketable government securities are subject to Delivery versus Payment (DvP) based settlement. However, electronic settlement systems and network connectivity have not yet been established. The increase in market activity could eventually lead to the introduction of more efficient DvP mechanisms.

Problem: Market development is in its early stages. Pricing is uncertain. In primary markets, a price discovery determined by market forces can provide effective anchors for pricing, but there remain questions regarding how to price securities in secondary markets.

Solutions: Given the characteristics of secondary market transactions, it may be beneficial for Primary Dealers (PDS) to distribute monthly a yield curve of Government securities based on secondary market transactions. A year or so after BB releases the yield curve to the public, it may be vetted by BB before being released to the public. It is possible for BB itself to announce a yield curve valid at year-end to facilitate year-end valuation.

Problem: Market participants lack effective mechanisms for communicating trade information.

Solution: BB could collect and disseminate information related to secondary market trades at the end of each day. In the initial phase, the information would be collected from banks and pos, consolidated, and then put on BB's website by the end of the day after the names of the buyers and sellers were revealed. Electronic networks for banks and other institutions, along with a system for reporting and settlement, will eventually allow real-time dissemination of trade information.

Problem: Usually, Government securities trade on an Over-the-Counter (OTC) market, although electronic trading is common in certain countries, for instance, the MTS system in Europe. It would greatly encourage secondary trading if an electronic trading platform were available,

Solution: The Dhaka Stock Exchange's trading platform could be modified to handle bond trading. Primary dealers should be able to make market for government securities on the exchange, and they should be held accountable for making these trades. OTC trading can also be an option for market participants.

4.2 Primary Dealers System

History

To deal with secondary transactions for Treasury bills and other government bonds, the Federal Reserve selected eight banks and one non-bank financial institution (NBFI) as primary dealers (POs). They are Sonali Bank Limited and Janata Bank Limited, respectively- Agrani Bank Limited, Uttara Bank Limited, Prime Bank Limited. Southeast Bank Limited. Jamuna Bank Limited. and NCC Bank Limited. and the only NBFI was International Leasing and Financial Service Limited. To eliminate the backlog of applications, all scheduled banks, financial institutions, and interested parties were invited to drop them off by August 21, 2003, at the

Foreign Exchange Reserve and Treasury Management Department of Bangladesh bank. The applications for primary dealer licenses were filed by eighteen commercial banks and one NBFI. As of July, Bangladesh Bank had activated its primary dealer system. During December of 2009, Bangladesh Bank granted licenses to six more banks and financial institutions to act as primary dealers. In addition, there is a total of fifteen primary dealers (Table-4.1).

Role of Primary Dealers in Money Market

Government securities are the responsibility of primary dealers. At primary auctions, primary dealers act as underwriters. By doing so, the government is able to raise money at a reasonable price from the market. Government/BB has the option to collect the required amount from pos at any time an interest rate for government securities is unacceptable at primary auctions. Consequently, government borrowing costs are reduced. Its main function is to facilitate the issuance and activation of Government securities on the secondary market.

They also aim to:

1. By developing underwriting capability and promoting price discovery for government securities, support the primary issue process of Government securities;

2. Facilitating monetary management open market operations and helping develop efficient and effective liquidity management.

3. Increase financial transparency.
Creating price detection can increase market liquidity and intensity.
Underwriters of government securities must participate in primary auctions.
Below is an overview of the rates.

Table: 4.1 Rate of Underwriting Obligations

SL No	Primary Dealer	Proportion of Underwriting Obligations (%)
1	**Sonali Bank Limited**	**9.00**
2	**Janata Bank Limited**	**9.00**
3	**Agrani Bank Limited**	**9.00**
4	**Prime Bank Limited**	**8.00**
5	**Southeast Bank Limited**	**8.00**
6	**Uttara Bank Limited**	**8.00**
7	**NCC Bank Limited**	**8.00**
8	**Jamuna Bank Limited**	**7.00**
9	**International Leasing and Financial Service Limited**	**1.00**

10	**Mutual Trust Bank Limited**	**7.00**
11	**Mercantile Bank Limited**	**8.00**
12	**Industrial Promotion and Development**	**1.00**
13	**Lanka Bangla Limited**	**1.00**
14	**AB Bank Limited**	**8.00**
15	**National Bank Limited**	**8.00**
Total		**100**

Source: Debt Management Department, BB

Bangladesh Bank issued a guideline for the primary dealers in order to stimulate and simplify the country's secondary bond market in 2003 and afterward also made some amendments. As per the guideline, the primary dealers will subscribe and underwrite primary issues and make secondary trading deals with two-way price quotes. The primary dealers cannot make sale in any particular issue and cannot carry a short position in secondary dealings. The primary dealers cannot act as inter-bank or inter-dealer brokers.

Current Scenario

Bangladesh Bank introduced the Scheme of PDS in October 2003. While the Scheme had the necessary prerequisites for a successful primary dealer system the PD system has kicked off yet. A major reason is the absence of secondary market. which deters PDS from bidding in primary auctions.

PDS have formed an association namely Primary Dealers Bangladesh Ltd (PDBL). The association has working to form and build up a strong market mechanism for government treasury bills and bonds. They are working on different aspects of making the treasury bills and bonds more striking to the prospective investors. PDBL is also involving the Central Bank and is attempting to make the association strong to develop the market mechanism by awareness building campaign among non-resident Bangladeshis (NRB's). They also help in arranging meetings and workshops with Bangladesh Bank and other related associates at regular intervals for strengthening the secondary market by inspiring prospective global investors and connecting them as panners.

4.3 Money Market Operations

As part of the Bank's efforts to stimulate and simplify the country's secondary bond market, Bangladesh Bank issued a guideline for primary dealers in 2003 and made a few amendments later. It is stipulated that the primary dealers will subscribe and underwrite primary issues and make a two-way price quotation for secondary issues. Neither the primary dealers nor the secondary dealers can sell any particular issue nor can they carry short positions. Interbank and interdealer brokers are not permitted to act as primary dealers.

Current Scenario

As of October 2003, the Bangladesh Bank has introduced a Primary Dealer Scheme. Primary dealer system has yet to start, despite the Scheme having the necessary prerequisites. This is due to the lack of a secondary market. As a result, PDS is unwilling to enter primary auctions.

Primary Dealers Bangladesh Ltd (PDBL) is an association formed by PDS. In order for government treasury bills and bonds to function effectively, the association has been working to establish a strong market mechanism. Various aspects of Treasury bills and bonds are being explored in order to make them more appealing to prospective investors. In addition to the Central Bank, PDBL is seeking to strengthen the association by conducting awareness building campaigns among non-resident Bangladeshis (NRBs). As well as arranging regular meetings with Bangladesh Bank and other stakeholders, they assist in stimulating and connecting prospective global investors with payers by arranging workshops and meetings with them.

4.3 Money Market Operations

Repo

Repo agreements (repurchase agreements) contain a contract that allows a security to be sold at market value, plus accrued interest, and then repurchased at a future date for the original repurchase amount plus accrued interest. In a buyback contract, securities are sold by the seller for a specified price and at a certain time. When the original owner of the securities repurchases the security, the cash loan is repaid to the buyer of the security.

The purpose of a repossession is varied. REPOs are used by central banks to promote a secondary market for government bonds and as tools to implement monetary policy. Dealers use REPOs to finance inventory more effectively. Investors in commercial banks use REPOs to temporarily manage cash.

As an indirect monetary instrument for day-to-day liquidity management, Bangladesh Bank has introduced a mechanism for commercial banks and other financial institutions, this will smooth short-term and unpredicted fluctuations in the supply and demand of money. With this opportunity, an eligible security will be able to access liquid money market liquidity without being required to actually acquire the security.

Reverse Repo

An agreement in which a security is purchased at market value (Reverse REPO) is a security resale agreement. The resale agreement contains a provision allowing the resale agreement to be resold to you at a future date for the original purchase price plus the accrued interest. Excess liquidity can be deposited in Bangladesh Bank by banks and financial institutions. Reverse repo is usually called this. Treasury bills are auctioned along with reverse repo auctions.

Inter-bank Repo

Treasury bills and government securities are traded on the interbank repo market. Founded in 2003, it began trading in August 2004. Using a repo agreement, banks may borrow from the interbank market in order to buy government securities. Lending banks do not fix their rates in these cases. Based on the amount of money available in the market and on the market price of securities, up until the maturity of the securities, it is determined. Funds can be made available for any purpose for any period of time through repo transactions in the interbank market.

4.4 There are several indicators of money market conditions

Treasury Securities Yield Curve

In a yield curve, yield (interest rate) is represented by a graphical representation of maturity dates at a specified point in time for a set of parallel bonds, in general Treasures. This is a graphical representation of how bonds of equal credit quality but different maturities can yield different yields. You can use this to accurately predict the turning point of a business cycle. An interest rate index on time to maturity represents the relationship between interest rates and an issuer's currency and time to maturity. Market-price calculations for bonds/portfolios of bonds are usually based on yield curves, especially zero-coupon curves. In an upward sloped yield curve, long-term bonds have usually higher interest rates than short-term bonds. Generally, the yield of long-term bonds is higher than short-term bonds due to the higher interest rates of long-term bonds. A number of factors affect the shape of the yield curve, such as the relative risks of long-term and short-term securities, as well as investors' expectations of future interest rates.

On the yield curve, maturities are plotted horizontally and yields are plotted vertically. The upward trend in the yield curve corresponds to higher interest rates for long-term securities than short-term securities, so it signals a higher level of long-term lending. These are known as normal yield curves. The yield curve for a short-term security with a negative slope represents a higher interest rate. Flat yield curves indicate a similar interest rate. The yield curves of government treasuries with varying maturities are most commonly plotted. These curves can be used to predict future interest rate trends.

4.5 Debt Portfolio of Bangladesh

Over the past decade, the outstanding debt of the Central Government has increased consistently, reaching US$40 billion by 2018. Domestic debt was the main factor behind this trend, since 2007. The Bangladesh Bank increased its overdraft facilities in FY2016, contributing to a rise in domestic debt. Borrowing from the market and selling more NSD instruments are government priorities.

A shift away from external to domestic debt is taking place. The percentage of domestic debt rose from 8% to 14% in 2018. In contrast, external debt has decreased, when compared to 2005, to 62% of total debt in 2017. This resulted from the government continuing to promote soft loan borrowing from the development partners. The policy and priorities of lenders have changed. Increasing levels of undisbursed loans, and the scarcity of external soft loans. Yet, despite its major share in total debt composition, the importance of external debt remains undiscovered.

Since 2005, domestic debt has increased by an estimated $1.1 trillion (in dollar terms). This indicates a move from non-marketable assets to marketable assets. Moreover, the government's preference for mobilizing funds domestically is emphasized.

BGTBs show a slight rise, however. From 2005 to 2018, their domestic share increased from 9% to 10%. Generally, government prefers to borrow money from the market at a rate. Governments can obtain long-term funds from the market through this avenue at a price that is lower than the NSD instruments. Government strategy currently involves maintaining a ratio of T-bills and T-bonds. During the financial year (FY 201 1-12) the ration is also expected to be increased to 80:20. Essentially, all these efforts aim to lower the financing risk by extending the average maturity of the outstanding debt stock.

Chapter 5

5.1 Status of Bangladeshi Bond Market

Government securities and non-Govt. securities, i.e., bonds and debentures, constitute most of the debt market in Bangladesh. Below is a summary of Bangladesh's bond market:

A study of government bond markets in some Asian countries shows that Bangladesh has a market size of 17.1% of GDP, not comparable to other emerging East Asian bond markets such as China, Singapore, Malaysia and (Table-5. l). Of all the south Asian countries, India is the country with the largest amount of Government bonds, while Bangladesh has the smallest with 17.1% of GDP.

Table 5.1 Sizes of Some Asian Bond Markets (% of GDP)

Category	Korea	China	Sing	Thailand	Philip	India	Sri	Pak	BD
Govt.	**48.8**	**46.1**	**41.2**	**40.7**	**33.3**	**36.1**	**36.1**	**27.5**	**17.1**
Corporate	**61.8**	**4.7**	**30.7**	**15.9**	**3.5**	**3.9**	**-**	**-**	**-**

With the growth of investors' confidence measured by their willingness to commit resources over longer timeframes, mature bond markets tend to have longer average maturities (Barry and Pipal 2004). South Asia's only risk-free sovereign yield curve has been developed by India, offering guidance for market participants across a wide range of maturities. As shown in Table 5.2, according to an assessment of the financial indicators, Indian financial systems are among the strongest in South Asia. Their overall composite score placed them first. Among three micro indicators, India has performed exceptionally well (ranked 1) on capital markets development, market concentration and competitiveness, and financial stability.

Table: 5.2 Finance Indicators for South Asian Countries during 2001-09

Individual Indicators rank	India	Pak	Sri	BD	Nepal
Overall rank	1	2	3	4	5
Access to finance	3	4	1	2	5
Performance and efficiency	3	1	2	4	4

Capital Market development	1	2	3	4	5
Market concentrations and competitiveness	1	4	5	2	3
Financial stability	1	2	3	4	5

Source: Getting Financial Indicators

5.2 How Bangladesh can improve its bond market

Although the market has been setbacks in the past, Bangladesh's bond market is ready to take off. As Bangladesh tries to expand its market, the following steps seem reasonable.

An established sovereign yield curve for the bond market would serve as a pricing guide: Bangladesh's debt securities market has been held back by the lack of benchmark bonds. The market is not benchmarked. All other debt securities are not benchmarked. This excludes corporate bonds. For example, if India were to issue bonds that have a maturity of 30 years, the maturity of bonds would be increased.

Credibility of government issuers and market developers: The developed financial markets have issued on a regular basis high-quality, diversified, and standard debt instrument. Among the government's Treasury bills are 91-day bills (91, 182day bills) and long-term bonds (floating rate bonds, capital index bonds). There are no coupon bonds. Options-linked bonds (the most popular and actively traded bonds) and plain vanilla bonds (the least popular and least actively traded bonds). The Bangladeshi government, on the other hand, issues Treasury bills, Treasury bonds, National Investment Bonds, and National Savings certificates. By establishing a high benchmark rate for the corporate sector, the government of Bangladesh has artificially distorted the market due to its excessive reliance on NSD certificates. Ultimately, this is the reason why the Government of Bangladesh should issue a wide range of government securities.

Equipping foreign and retail investors with the same opportunities: Bangladesh SEC will permit foreign institutional investors to invest in Bangladesh just like developed nations. Similarly, the Bangladeshi government must take necessary steps to encourage retail participation in government debt security markets.

Primary dealers need to be established: The Bangladesh government bond market is only equipped with 15 primary dealers (12 banks and 3 financial institutions). Bangladesh should emulate the size and regulations of the Indian market.

Taking steps to enhance secondary market liquidity: Government debt securities in Bangladesh have yet to develop a mature secondary market. There are 215 BGTBs listed in the DSE, worth Taka 534 billion, but only one 10 year BGTB has been traded since the issuance of debt securities in 2005. In Bangladesh's favor. PDS could offer wide range of facilities to BB if they lower the minimum denomination.

Market information improves transparency: Government debt securities are not transparent on the secondary market in Bangladesh. An OTC market information center is not available. While Bangladesh Bank receives reports from primary dealers on OTC trading, it does not publish the information. Press releases or publications from the Bank should provide information on debt securities and the money market.

In regards to delivery versus payment (DvP): Payments in securities transactions are handled manually as both the DSE and CSE have automated systems for trading securities, so delivery versus payment cannot be used. DvP mechanism may be beneficial for Bangladesh.

Developing bond indices: Indices are crucial for comparing market participants' and asset classes' performance. This sector can be benchmarked by a sovereign bond index that we can establish by the government of Bangladesh.

Developing qualitative strength: Bangladesh should improve its poor performance in macroeconomic environment, institutional environment, equity market development, corporate governance, accountability, and political stability, financial stability and regulatory quality.

5.3 Conclusion

This report examines Bangladesh's bond markets. The Bangladeshi bond market faces numerous challenges, including excessive reliance on bank credit, predominant use of primary auction-based government debt, lack of product variation, and lack of yield curves. prerequisites of the 1%'nd market development and factors to influence the bond market indicates that neighbor countries have dramatically progressed in almost all the categories while Bangladesh does not meet most of the preconditions to develop an efficient market. Adapting all viable strategies, experiences, and reform programs of developed bond markets may allow Bangladesh to accelerate its momentum in the bond market.

Chapter 6

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