

CONNECTING THE DOTS

# Capital markets in Bangladesh



A. R. CHOWDHURY

THE performance of the Dhaka Stock Exchange during the last two years has raised questions about the structural impediments facing the capital markets in Bangladesh. Many small investors saw their life savings dissipate due to a free fall in the price of the stocks that they had invested in. This is not what it was supposed to be. Unfortunately, this phenomenon is not unique to Bangladesh. While the large emerging markets and world equity benchmarks are enjoying strong investor demand, the world's next emerging markets -- the so-called Next-11 (N-11) markets -- including, Bangladesh, Pakistan, Sri Lanka and Vietnam, have lost some of their attractiveness. Rampant inflation, chronic trade deficits, and a lack of structural reform have deterred investors.

Despite a growing global risk appetite in early 2012, which would usually see money flow into emerging markets, N-11 markets have barely moved. These markets are less liquid, although their relative underperformance probably means investors expect lower near-term growth. Investors find that it is much tougher to do business in these countries as rampant corruption has stifled economic reform and development. In Bangladesh, political and security concerns, in particular, add to the downside risk.

Another challenge is inflation. Rising food prices and energy shortages are driving up inflation, creating a headache for investors and policymakers. As the world's larger economies are easing off the mone-

tary breaks and beefing up liquidity to safeguard growth, a tightening bias persists in many of the Asian countries. Stocks in both Bangladesh and Sri Lanka, for example, have declined substantially in recent months as authorities have lifted interest rates to slow double-digit inflation, reduce credit growth, and narrow the trade deficit.

Experience has shown that development boosts imports and weakens currency. Most developing economies including Bangladesh run trade deficits, with a heavy reliance on imports of capital goods and oil to drive development. Machinery and equipment and energy products account for a large portion of Bangladesh's imports, for example. Since these economies typically produce low-value-added goods such as textiles, one unit of domestic production contains a high-import component. In Bangladesh, this ratio of imports to domestic production is estimated to be more than 75%, making it difficult to narrow the trade deficit without a substantial move up the value chain of production.

Strong import growth boosts foreign currency demand, which, alongside elevated inflation, causes the local currency to weaken and puts downward pressure on foreign reserves. Most emerging Asian currencies face downward pressure in 2012; the

Pakistani rupee has shed 1%, the Bangladeshi taka is flat, while the Vietnamese dong is up a mild 1.5%. Policy makers in Bangladesh need to bring inflation under control as well as reduce the adverse impact of a bloating trade deficit.

Yet the long-term growth outlook for Bangladesh's capital market is positive. The economy can benefit from low labour costs and a growing young population. As wages

production and exports as manufacturers diversify out of China.

So what are the main challenges facing the capital markets in Bangladesh? I believe the problems are mainly structural in nature. It is generally agreed that the Dhaka Stock Exchange is overvalued. Some of it may be due to the method used for calculating the index. This is a problem that the authorities could easily overcome. It is also

could include financial netting facility where investors buying any stock would have to wait a certain period before they could sell the stock. In addition, methods like short selling, introduction of equity derivatives, etc. should also be seriously considered by the SEC. More importantly, the SEC needs to have more regulators on the field to keep all stock transactions under surveillance.

It is true that the safety and integrity of the N-11 markets has greatly improved over the past decade, and their growing popularity with professional investors is testament to the fact that the risk-adjusted returns offered by these markets are indeed attractive.

I can think of a number of reasons for the attractiveness of capital markets in Bangladesh. First, unlike many other emerging markets, lower valuation and higher growth rates compensates for inherent risks. Higher dividend yields also provide income and may protect investors from management misallocation of corporate resources. In the near future, I expect returns on assets and equity to significantly improve due to technological and management advances. Higher earnings per share and cash flow growth will result due to economic growth and demographics.

Foreign investors often think of capital markets in countries like Bangladesh as inhospitable investing outposts where corruption is rampant and investors face out-sized risks. Challenges remain, but that shouldn't derail the long-term growth potentials of the capital markets in Bangladesh. A number of specific policy steps should be able to bring the markets back on the path of prosperity and development.

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WAHID ANWAR/DRINK NEWS

rise in China and across Asia, global manufacturing hub will start to shift to lower cost markets like Bangladesh; our garment industry has already experienced a lift in

ment in the stock market. These steps need to be strictly implemented.

Next, the SEC should introduce tools that would minimise the risk for investors. This

## Bangladesh is South Asia's standard-bearer

SADANAND DHUME

DESPITE its 160-million strong population, Bangladesh can find it hard to elbow its way onto the global stage. It's in an area where India is cast in the lead as the dominant economy, Pakistan plays the intermittent villain, and Sri Lanka and Nepal feature in cameos as countries with uncertain futures.

The world's third-most populous Muslim-majority country stands out as a model of moderation. Unlike in virtually every other country in the Muslim world, Islamists in Bangladesh are on the defensive. Seven people, including high profile leaders of the Jamaat-e-Islami, South Asia's most powerful Islamist group, face war crimes charges for their role in slaughtering Bangladeshi patriots, Muslim and Hindu alike, during the country's 1971 war of independence against Pakistan.

Current Prime Minister Sheikh Hasina Wazed's father, Sheikh Mujibur Rahman (1920-75) led that struggle, which claimed 3 million lives according to the Bangladesh government. The trial reveals the government's willingness to deal with one of the most painful episodes in the young nation's history. It also shows its refusal to allow Islamists to label the regime as "anti-Islam" for pursuing them, a form of blackmail that often obstructs justice in other places.

In a similar vein, Bangladesh can boast one of Asia's best records of fighting Islamist terrorism. The South Asia Terrorism Portal estimates that only nine people have lost their lives since Sheikh Hasina swept to power at the end of 2008. In the four years before that, terrorists claimed 56 lives at home, while the Bangladeshi terrorist group Harkat-ul-Jihad al-Islami (or Huji-B) carried out high-profile terrorist strikes in India.

Much of Bangladesh's success in confronting the most intolerant elements within its own society comes from crafting an inclusive national narrative. Unlike Pakistan, Bangladesh does not define itself by faith alone. Most Bangladeshis see no contradiction between being proud Muslims and proud Bengalis. This self-confidence gives the country the ability, which some other Muslim societies lack, to push back against extremism.

Then there's the down-to-earth pragmatism present in Dhaka's approach to development. Over the past five years, the economy has expanded on an average of 6% per year. Unlike India, which is hobbled by socialist-era labour laws that interfere with hiring and firing, Bangladesh has built a world-class apparel industry that employs more than 3.5 million people and supplies global brands like H&M, Walmart and Tommy Hilfiger. Thanks to this, the country is already the world's second largest exporter of readymade garments after China. If it plays its cards right, Bangladesh, more than any

other South Asian nation, could attract a fresh wave of labour-intensive manufacturing looking for cheaper alternatives to China. Goldman Sachs lists Bangladesh among its "Next 11," countries that have the potential to become major economies.

And after years of tensions with its bigger neighbour, Bangladesh is now being practical and seeking to normalise ties with India. The two countries have already settled long-festering territorial disputes and opened up trade. A landmark transit agreement would place Bangladesh at the heart of a potentially dynamic growth corridor encompassing northeastern India and a newly democratising Burma. This is currently being stymied by Indian politician Mamata Banerjee who, as chief minister of West Bengal state that borders Bangladesh, opposes an allied water-sharing agreement with Dhaka.

Still, Dhaka and New Delhi are pushing for this agreement and it could succeed, possibly ushering in a new peace dividend in the region. At any rate, Dhaka's pragmatism in its foreign relations stands in contrast to India, which can't always suppress its preachy rhetoric of non-alignment (toward the West), as well as Pakistan, which often sputters in a sea of Islamic fundamentalism and knee-jerk opposition to India.

That said, Bangladesh is hardly free of problems. Sheikh Hasina and her chief opponent, the Bangladesh Nationalist Party's Khaleda Zia, have created a poisonous zero-sum politics, which has come to the fore again in recent days. The BNP is up in

arms at the disappearance of one of its leaders last month and they blame Hasina's ruling party. They have shut down the country with crippling national strikes four times in the past month.

No one knows how the BNP official in question disappeared, though, and a string of similar disappearances reflect a deteriorating law and order situation. Either law enforcement is engaged in extra-judicial actions, or vigilantes can roam free with impunity. Neither is encouraging.

Meanwhile, the Islamist threat has been reduced but not eliminated. The BNP remains at best ambivalent and at worst actively sympathetic toward Islamist forces similar to those that have helped drag Pakistan in a downward spiral. And though Bangladesh's army deserves some credit for keeping its distance from politics since late 2008, it's by no means certain that the country's latest experiment with democracy, barely three and a half years old, will last.

But for now, these worries can take a back seat. A country once dismissed by former US Secretary of State Henry Kissinger as a basket case, showed one of his successors how wrong it has proven him.

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## Muzaffer Ahmed: A recollection

MAHFUZUR RAHMAN

IT was late 1973. I had just returned from abroad after a study leave and was back at the Planning Commission. Muzaffer Ahmed was the chief of the industries division, one of the major segments into which the Commission was then divided. I had joined another division, at a more junior post than Professor Ahmed's. We had offices in the same building of the Secretariat. One afternoon, at the end of a long working day, he offered me a lift in his old Volkswagen beetle.

The car had no ignition key. Those were the days of lawlessness, muggings, hijackings, car break-ins and much more. There was a colleague of mine who had a sheet of transparent plastic for windshield, the original having been stolen. Muzaffer Ahmed's car had perhaps been vandalised, part of the dashboard gone, wirings exposed. The ignition was achieved instead by a touch-and-let-go between the ends of two loose wires. The car sped through the chaotic streets of Dhaka. It soon stalled. Ignition again. The car was once more on its way. It stalled again, and had to be given renewed ignition. It was after several of stalls and starts that he dropped me off where I had wanted him to.

An image of a distant past. A little hazy, it has stuck with me.

We were not close friends, but we had known each other for many years. Muzaffer Ahmed was a year junior to me as a student at Dhaka University in the early 1950s. Our contact in the post-university days had been tenuous. Still, every time we met there was a mutual renewal of an intellectual acquaintance that had been maturing over the years. As economists we did not always see eye to eye with each other. He was a strong supporter of public enterprise and perhaps more than a little disdainful of liberal trade. I came to view the former with suspicion and the latter as something well worth exploiting for economic growth.

Neither did he seem happy to see the likes of me living in foreign land rather than contributing to nation-building. He could well have echoed Dr. Mazharul Haq, the wit, and teacher to both of us at Dhaka University: "I am not that kind of a patriot who would lie abroad." It was, however, only when we had both been abroad that we had the kind of opportunity to converse that we never had in Dhaka.

I lived in Manhattan. One day I got a surprise call from Muzaffer Ahmed. He was in Boston on an academic stint and was calling to find out if he and his family could come down to New York and stay with us for a couple of days. I said he certainly could.



A good deal of the few days they stayed with us was spent by them sightseeing. Muzaffer Ahmad and his wife spent a day shopping for books, exploring miles of shelves at the Strand bookstore situated not far from our neighbourhood, while we babysat their two children. Muzaffer Ahmed was a voracious reader. Back at our apartment, between meals and conversation, he always found time to perform his five daily prayers. He also fasted in Ramadan, even on the very long summer days in Boston. To him faith and intellect sat in perfect harmony with each other.

That was almost three decades ago. We lost touch with each other. But I was keenly aware of his work beyond the confines of economics. Corruption and environmental degradation had been eating into the heart of the society. He plunged into these issues and played a pioneering role in the fight on both fronts. To these was added the issue of good governance and the role of the civil society in it. They presented a huge tangle of wires, many of them dangerous, some crossed. And there was no magic ignition key. Still, he set the vehicle going, while flak kept coming in. Perhaps this was his greatest achievement.

Back in 2010, I was celebrating the launching of a book of mine in Dhaka. Unsure of his schedule and inclination, I failed to invite him to the launch. He turned up, having been briefed by a mutual friend. He sat through most of the discussions on the book from the dais where I sat. Towards the end, he got up and slowly made for the door, shaking me by the hand as he left, a faint goodbye on his breath. I never saw him again.

I wish I could tell him how sorry I was for the belatedness of this wholly inadequate tribute.

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