POLICY BRIEF

August 2025

Domestic Debt Market in Bangladesh: Risks, Reforms, and the Road Ahead

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Abstract: Bangladesh's domestic debt now makes up 57 per cent of its total public debt. Although this debt is in local currency and avoids direct exchange rate risk, the rising cost of interest payments is putting heavy pressure on the national budget. This limits the government's ability to fund public investments and social services. Heavy borrowing from banks—which supply 58 per cent of domestic debt—along with costly non-bank instruments like National Savings Certificates (NSCs), leads to three major problems: it reduces credit available to businesses, increases the risk of the government being unable to refinance its debt, and maintains a weak and inefficient financial market. This policy brief examines the structure and risks of Bangladesh's domestic debt market, highlighting both vulnerabilities and reform opportunities. It identifies core bottlenecks such as short maturities, weak secondary trading, and a shallow investor base that constrain market depth and resilience to recommend practical, globally aligned reforms to modernise, broaden, and strengthen the market so it can better anchor financial stability and support sustained economic growth.

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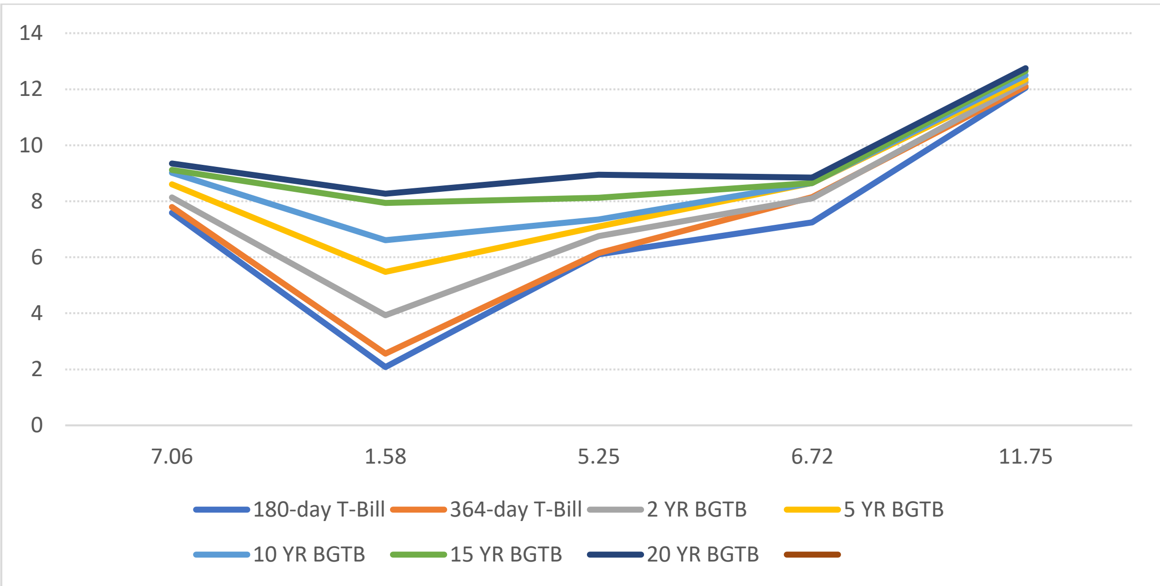
I. Introduction

Domestic debt has emerged as the dominant component of Bangladesh's public debt profile. As of FY2024, domestic debt accounted for 57 per cent of total public debt, reaching over BDT 10 trillion and characterised by a heavy concentration in short-term treasury instruments and costly non-bank liabilities (Ministry of Finance, 2024a), primarily National Savings Certificates (NSCs), which carry interest rates as high as 12.4 per cent depending on the instrument type and tenure (Figure 1).

This strategic shift towards domestic borrowing has been a conscious effort to mitigate external vulnerabilities and avoid the currency mismatch problems that have plagued other developing economies. However, this perceived safety comes at a significant price. The cost of servicing this domestic obligation is high and rising precipitously, with interest payments consuming nearly one-sixth of the national budget, raising pertinent questions regarding medium-term debt sustainability and fiscal flexibility.

Figure 1: Cost of Borrowing (interest rate) from domestic sources (%)



Source: Data from various issues of Quarterly Debt Bulletin, Finance Division, Ministry of Finance, Government of the People's Republic of Bangladesh.

This debt evolution is occurring against a troubling backdrop of slowing revenue mobilisation, with a tax-to-GDP ratio stagnating below 8 per cent and persistently growing fiscal deficits. The government's increasing recourse to domestic borrowing, particularly from the banking sector, risks crowding out private sector credit. This phenomenon occurs when substantial government borrowing drives up interest rates, making it more expensive for businesses to borrow and invest, thereby undermining the very private investment and long-term growth that Bangladesh needs to graduate from Least Developed Country (LDC) status and achieve its Vision 2041 (GED, 2020).

Consequently, transitioning from a regime of ad hoc borrowing to building a liquid, transparent, and efficient domestic debt market is no longer a technical aspiration but an urgent policy priority for ensuring macroeconomic stability and sustainable development (Ministry of Finance, 2024b).

Table 1: Structure of domestic debt (Trillion BDT)

	30 June 2021	30 June 2022	30 June 2023	30 June 2024
Domestic debt (1+2)	7.24	8.48	9.44	10.20
1. Debt from Banking Sources	3.34	4.2	5.08	5.97
1.1. Treasury Bills	0.51	0.77	1.24	1.33
1.2. Treasury Bonds & SPTB	2.75	3.25	3.66	4.44
1.3. Sukuk	0.08	0.18	0.18	0.19
2. Debt from Non-Bank Sources	3.9	4.28	4.37	4.23
2.1. Debt from NSCs	3.46	3.66	3.65	3.44
2.2. Others (GPF)	0.44	0.63	0.71	0.79

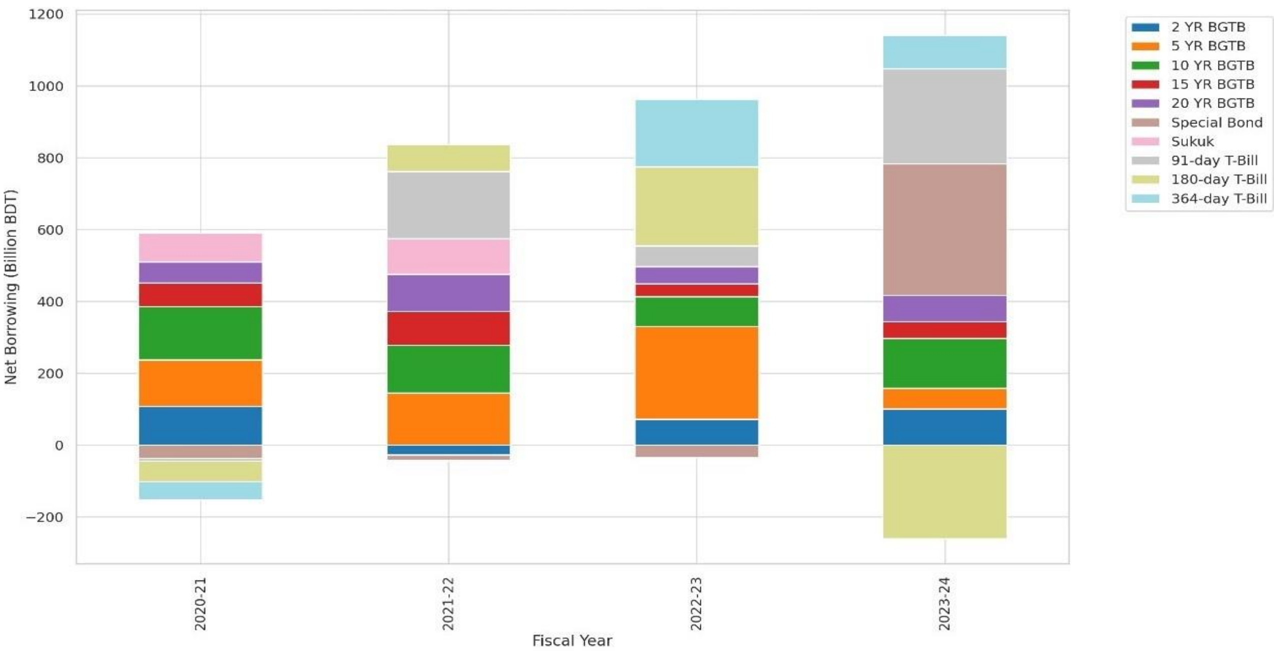
Source: Quarterly Debt Bulletin, Issue No. 11, Finance Division, Ministry of Finance.

II. Structure of Bangladesh's Domestic Debt Market

The structure of Bangladesh's domestic debt market is distinctly segmented into banking and non-banking sources, each with its own dynamics and implications.

- **Banking sources**, constituting 58 per cent (BDT 5.97 trillion) of the total, are primarily composed of Treasury Bills (T-Bills) of various tenors (91-day, 182-day, 364-day) and longer-term Bangladesh Government Treasury Bonds (BGTBs), alongside a growing segment of Islamic Sukuk instruments aimed at tapping into Shariah-compliant liquidity (Figure 2) (Bangladesh Bank, 2024a). These instruments are issued through auctions where a network of 20 Primary Dealers (PDs) is obligated to participate. However, the PD system remains underdeveloped, lacking sufficient incentives for market-making activities in the secondary market. PDs often act as mere conduits for primary issuance rather than active intermediaries that provide liquidity and facilitate price discovery.
- **Non-banking sources**, accounting for the remaining 42 per cent (BDT 4.23 trillion), are overwhelmingly dominated by National Savings Certificates (NSCs), which alone represent BDT 3.44 trillion. NSCs offer administratively set, above-market returns (often 11-12%), making them exceedingly popular among retail households seeking risk-free, high-yield savings products. Nevertheless, they are profoundly costly for the government, with interest costs on NSCs significantly exceeding those on comparable marketable bonds, creating a large interest rate subsidy and a significant fiscal burden. Other non-bank sources include the General Provident Fund (for government employees) and various statutory liabilities.

Figure 2: Net borrowing by instruments from the banking sector (Billion BDT)



Source: Data from various issues of Quarterly Debt Bulletin, Finance Division, Ministry of Finance, Government of the People's Republic of Bangladesh.

While auctions for T-Bills and bonds are held with regularity twice a week, the secondary market for these securities remains moribund (Bangladesh Bank, 2024b). Trading is minimal, which severely limits price discovery and the development of a reliable benchmark yield curve, essential for pricing all other long-term debt in the economy (Mortaza & Shadat, 2024). Furthermore, the investor base is exceptionally narrow and homogenous, dominated by commercial banks that are often compelled to hold government securities to meet Statutory Liquidity Ratio (SLR) requirements (Bangladesh Bank, 2024). Institutional investors—such as pension funds (e.g., Bangladesh Labour Welfare Foundation), insurance companies, and mutual funds—which are cornerstone investors in deep debt markets globally, currently play only a marginal role in Bangladesh due to regulatory constraints and the absence of a liquid secondary market (Mortaza & Shadat, 2024).

III. Key Challenges in Market Development

Several interconnected structural weaknesses impede the development of an efficient domestic debt market in Bangladesh.

- **Short Average Maturity and Rollover Risk**: The government's debt portfolio is characterised by a short-term bias, with an average time to maturity of just 3.8 years. Alarmingly, nearly 31 per cent of domestic debt matures within one year, creating persistent rollover risks and exposing the fiscal account to refinancing shocks should investor sentiment shift or domestic inflation and interest rates rise abruptly (Ministry of Finance, 2024a). This constant need to refinance short-term debt creates vulnerability to changing market conditions.

- **High and Distortionary Borrowing Cost**: The heavy reliance on National Savings Certificates (NSCs), which carry interest rates often 300–400 basis points above market rates, artificially elevates the government's overall cost of borrowing. This creates a significant fiscal burden, consuming a larger share of revenue, and acts as a high benchmark, distorting the entire interest rate structure of the economy and making capital more expensive for private enterprises (National Savings Directorate, 2025)
- **Weak and Illiquid Secondary Market**: A vibrant secondary market is essential for liquidity and efficient price discovery. In Bangladesh, trading activity is negligible as most investors, primarily banks, follow a "buy and hold to maturity" strategy to satisfy Statutory Liquidity Ratio (SLR) requirements (Bangladesh Bank, 2024a). This illiquidity discourages new entrants (like foreign investors and asset managers) and makes it difficult to mark portfolios to market, thereby increasing hedging costs and risk.
- **Concentrated and Mandated Investor Base**: The overwhelming dependence on commercial banks creates a conduit for systemic risk. Large bank holdings of government bonds tie bank profitability and balance sheet health directly to sovereign health. Furthermore, as banks are the main source of credit, this dominance actively crowds out lending to the private sector, particularly to small and medium enterprises (SMEs), stifling economic growth and job creation (Bangladesh Bank, 2024b).
- **Institutional and Infrastructural Gaps**: The existing market infrastructure is underdeveloped. The Primary Dealer system lacks a proper balance of obligations (e.g., underwriting auctions, market-making) and incentives (e.g., exclusive access to new issues, liquidity facilities). Furthermore, the technological infrastructure for settlement (e.g., full integration with the Bangladesh Bank's Real-Time Gross Settlement system) and trading (e.g., a modern, anonymous order-matching platform) remains fragmented and lacks transparency, deterring sophisticated institutional participation (Ministry of Finance, 2024b).

IV. Reform Agenda and International Support

Recognising these challenges, the Government of Bangladesh has outlined an ambitious reform agenda in its Medium-Term Debt Management Strategy (MTDS) for FY2025–FY2027. The strategy prioritises lengthening the maturity profile of debt through a more strategic and predictable issuance calendar, reducing reliance on short-term T-Bills and curbing the growth of NSCs, and expanding market-based financing (Ministry of Finance, 2024b). Key reforms include revitalising the Primary Dealer system by enhancing their market-making responsibilities alongside providing corresponding privileges (like preferential access to open market operations), improving auction mechanisms to enhance transparency and allow for more competitive price discovery, and implementing measures to broaden the investor base (FICCI, 2025).

This domestic agenda is being bolstered by significant international technical support. The World Bank–IMF Local Currency Bond Market (LCBM) initiative provides diagnostic tools and policy advice to strengthen market fundamentals, including the development of a robust primary dealer system, the fostering of a diversified investor base, and the development of a benchmark yield curve (IMF & World Bank, 2021). Complementarily, the World Bank's Joint Capital Markets

Program (JCAP) is providing targeted support to improve the regulatory framework for institutional investors, enhance the efficiency of trading and settlement infrastructure, and develop new asset classes such as green bonds to attract specialised investment (IFC, 2025). The collective objective of these initiatives is to build a vibrant, liquid, and transparent market that aligns with international benchmarks, thereby reducing borrowing costs and mitigating fiscal risks over the long term.

V. Policy Implications and Recommendations

To navigate the road ahead, a multi-pronged, sequenced, and politically committed policy approach is essential:

1. **Deepen and Diversify the Investor Base:** Regulatory reforms should be enacted to encourage, or even mandate, the participation of large domestic institutional investors like pension funds and insurance companies in the bond market, setting prudent investment limits. Furthermore, introducing new savings instruments targeted at retail investors, such as inflation-indexed bonds or simplified, market-linked savings accounts, can channel household savings directly into the market, reducing dependence on NSCs.

2. **Lengthen the Maturity Profile Proactively:** The Debt Management Office should commit to a predictable and transparent calendar for issuing more long-term bonds (10-year, 15-year, and beyond). Introducing new instrument types like green bonds or sustainability bonds can tap into dedicated environmental, social, and governance (ESG) investor pools and extend the maturity profile while financing critical climate-resilient infrastructure projects.

3. **Strengthen Secondary Market Infrastructure and the PD System:** Investment in a modern, integrated electronic trading platform is crucial. Consolidating settlement systems under a central securities depository and ensuring complete post-trade transparency will enhance liquidity and facilitate efficient price discovery. The PD system must be overhauled with a clear quid-pro-quo: binding market-making obligations must be matched with exclusive privileges, such as preferential access to primary auctions and liquidity windows.

4. **Rationalise the National Savings Scheme Strategically:** A gradual and carefully communicated strategy is needed to align NSC returns with market rates over a multi-year period. To protect small savers, the government could introduce a tiered system where a subsidised rate is offered up to a specific investment threshold, beyond which a market-linked, variable rate would apply. This would contain the fiscal cost while preserving the social safety net function for target groups.

5. **Enhance Debt Management Capacity and Transparency:** Building technical capacity within the Ministry of Finance's Debt Management Unit is paramount. This includes strengthening analytical frameworks for risk assessment (e.g., using software like the IMF's MTDS toolkit), conducting regular and sophisticated Debt Sustainability Analyses (DSAs), and integrating debt management with medium-term fiscal planning to ensure borrowing decisions are strategic, cost-effective, and transparently reported.

VI. Conclusion

Bangladesh's domestic debt market stands at a critical crossroads. While it has provided an essential and stable source of financing, its current structure is inherently costly, shallow, and inefficient. The status quo is unsustainable; without decisive and coordinated reforms, the risks of crowding out private investment, exacerbating fiscal stress, and encountering a rollover crisis will intensify, potentially jeopardising macroeconomic stability. The strategic path forward requires unwavering political commitment to transform the market from a simple financing tool into a robust platform for stability and growth. By decisively lengthening maturities, deepening and diversifying the investor base, rationalising the NSC programme, and modernising market infrastructure, it is possible to build a domestic debt market that not only secures its fiscal future but also fuels its ambitious development goals for decades to come. The time for incrementalism has passed; bold and concerted action is now imperative.

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