FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Bangladesh at 'BB-'; Outlook Stable

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Fitch Ratings - Hong Kong - 08 Nov 2021: Fitch Ratings has affirmed Bangladesh's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BB-' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

The 'BB-' rating reflects Bangladesh's resilient external finances, relatively strong growth despite the pandemic and government debt levels that remain below the peer median, against low government revenues, and weak governance indicators and banking sector.

Bangladesh's economic growth slowed significantly to 3.5% in the financial year ended June 2020 (FY20) due to the impact of Covid-19. Growth recovered to 5.5% in FY21 as pandemic containment measures were eased and consumption spending improved. We expect economic growth to accelerate to 7.0% in FY22 and 7.2% in FY23, almost double the 'BB' median's 3.7% average for 2022-2023. The global evolution of the pandemic may create risks to our growth forecast. Daily infections have been declining since August and supply disruptions that caused delays early in the vaccination programme have eased, but vaccination rates are low, as about 18% of Bangladesh's population has been fully vaccinated as of 3 November 2021.

Readymade garment (RMG) exports, which make up 80% of total exports and about 8.5% of GDP, declined in FY20 to USD27.9 billion due to lower demand from key markets, including the EU (62%) and US (18%). RMG exports rebounded to USD31.5 billion in FY21, as demand recovered in the key markets. Total exports have recovered significantly, rising by about 26% yoy in 9M21.

Remittances reached a record high of USD21.7 billion in 2020, driven by a shift to more formal remittance channels and Bangladesh Bank's 2% cash incentive for inward remittances. Growth in remittances has slowed this year, reaching USD18.9 billion by October. Authorities have indicated that the 2% cash incentive is likely to remain in place. We believe the large yoy increase in 2020 is unlikely to be repeated as some of the factors that drove the big jump in remittances were temporary.

Bangladesh's foreign-exchange (FX) reserves increased to about USD46 billion by end-September 2021, from USD43 billion at end-2020, due to the higher remittances, increased external borrowings primarily for Covid-19 relief and a pick-up in exports. We estimate FX reserve coverage of current external payments (CXP) to remain healthy at about 9.2 months by end-2021, above the 6.6 months forecast for the 'BB' median. Recent media reports suggest that according to the IMF, the actual level of international reserve assets could be lower due to the potential investment of reserves in non-liquid assets. In addition, the government could also be considering the use of a portion of international reserves to finance infrastructure projects. Bangladesh's international reserve buffers are currently adequate, but the lack of transparency in reserve management could create uncertainty and hurt the credibility of the existing policy framework.

We believe Bangladesh Bank will maintain its policy stance for a stable and competitive exchange rate through FX intervention. FX reserves could come under pressure if the authorities were to intervene aggressively to support the exchange rate in the event of an external or confidence shock. Bangladesh will continue to run modest current account deficits (averaging about -0.9% of GDP in 2022-2023) as domestic demand improves and imports of capital goods associated with large infrastructure projects resume picking up. External financing requirements in the near term are manageable. Fitch forecasts external debt servicing to be manageable in 2022 and 2023 at around 4% of current external receipts.

The pandemic has raised risks to the fiscal outlook. Revenues in FY21 exceeded the authorities' estimates and the budget deficit is likely to be lower than their current expectations. We estimate the FY21 budget deficit at 5.8% of GDP, slightly above the 5.7% forecast for 'BB' rated peers. The authorities forecast a budget deficit of about 6.2% of GDP in FY22. We expect spending on Covid-19 relief measures to continue until FY22 and withdrawn from FY23. Risks to our forecasts remain if economic recovery is weaker than the authorities' expectations or due to the extension of support measures. Fiscal risks from contingent liabilities have increased due to the economic fallout of the pandemic on state-owned enterprises (SOE) and forbearance measures still in place for the banking sector.

Bangladesh's low government revenue-to-GDP ratio remains a key weakness in the sovereign's credit profile. The official revenue-to-GDP ratio in FY20 was 9.8%, a fraction of the 'BB' median of around 28%. Introduction of a new VAT law from July 2019 has not been effective in raising the revenue ratio so far. We estimate government debt to GDP at about 38.8% in FY20, below the 'BB' median of 58.3%, but the debt-to-revenue ratio of about 396% in FY20 was far above the 'BB' median of 232%. A high proportion, almost 50%, of external debt is concessional, thus mitigating refinancing risks and reining in debt-servicing costs.

The health of Bangladesh's banking sector and its governance standards remain weak, especially among public-sector banks. The system's gross non-performing loan (NPL) ratio rose modestly to 8.2% by June 2021 from 7.7% at end-2020, but the reported figure is likely understated because of an extensive loan moratorium. State-owned commercial banks' NPL ratio of 20.6% is substantially higher than private-sector banks' 5.4%, but we expect both to rise significantly when repayment relief is withdrawn next year, provided it is not extended again. Banks' capitalisation is thin relative to prevailing risks in the market, with the system's capital ratio at 11.6% as of June 2021, and state-owned banks' at 6.8%. We believe the banking sector could be a source of contingent liability for the sovereign if credit stress intensifies.

Bangladesh's structural indicators remain a weakness relative to its peers. In addition to weaker governance indicators, foreign direct investment remains constrained by large infrastructure gaps, although the government's focus on building large infrastructure projects in the next few years could bode well for investment. The security situation in Bangladesh has improved in recent years and is now less of a concern to foreign visitors, although the risk of a recurrence of security incidents and political turmoil remains.

ESG - Governance: Bangladesh has an ESG Relevance Score of '5' for both Political Stability and Rights and the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Bangladesh has a low WBGI ranking in the 21st percentile, reflecting the relatively weak rights for participation in the political process and institutional capacity, uneven application of the rule of law and a high level of corruption.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Public Finances: A sustained and rapid increase in government debt over the medium term, for example, due to the absence of structural improvements in public finances or the crystallisation of contingent liabilities related to banks or other SOEs

- Macro: Weaker medium-term growth prospects, for example, caused by a lasting impact from the Covid-19 pandemic on key sectors of the economy such as RMGs, lower remittances, or a deterioration in internal security.

- External Finances: Rapid weakening of external finances, for instance, through a significant decline in FX reserves or a sustained widening of the current account deficit.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Public Finances: Increased confidence in Bangladesh's capacity to deliver fiscal consolidation and debt stabilisation over the medium term, for example, through sustained improvement in the structure of public finances in terms of a higher revenue base and lower contingent liabilities

- Structural: Significant improvement in structural indicators, for example, in terms of governance standards, including regulatory quality, political stability, control of corruption as well as the authorities' strengthening capacity and willingness to address economic challenges such as weaknesses in the banking sector.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Bangladesh a rating equivalent to 'BB' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to SRM data and output, as follows:

Structural features: -1 notch to reflect weak institutional capacity and political will to address fiscal and broader economic vulnerabilities, including long-standing vulnerabilities in the banking sector in terms of governance, asset quality and capitalisation.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Bangladesh has an ESG Relevance Score of '5' for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Bangladesh has a percentile rank below 50 for the Governance Indicator, this has a negative impact on the credit profile.

Bangladesh has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Bangladesh has a percentile rank below 50 for the Governance Indicator, this has a negative impact on the credit profile.

Bangladesh has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver. As Bangladesh has a percentile rank below 50 for the governance indicator, this has a negative impact on the credit profile.

Bangladesh has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Bangladesh, as for all sovereigns. As Bangladesh has a record of more than 20 years without restructuring public debt, which is captured in our SRM variable, this has a positive impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Bangladesh	LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
•	ST IDR	B	Affirmed	B
•	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
•	LC ST IDR	B	Affirmed	B
•	Country Ceiling	BB-	Affirmed	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 26 Apr 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.2 (1)

Debt Dynamics Model, v1.3.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.12.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bangladesh	EU Endorsed, UK Endorsed

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Sovereigns Asia-Pacific Bangladesh
