Fitch Affirms Bangladesh at 'BB-'; Outlook Stable

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Fitch Ratings-Hong Kong-11 January 2018: 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

Bangladesh's ratings balance strong foreign-currency earnings and high real GDP growth against weak structural indicators, significant political risk and weak banking-sector health.

Bangladesh exhibits one of the highest real GDP growth rates in the sovereign space. Its 6.6% five-year average real GDP growth and 7.3% growth in the financial year ended 30 June 2017 (FY17) well exceed the 'BB' category medians of 3.5% in both cases. Fitch forecasts real GDP growth to decelerate slightly to 6.9% in FY18 and 6.7% in FY19, as severe floods during the summer of 2017 will probably affect agricultural output and increased political uncertainty related to general elections, to be held no later than January 2019, is likely to lead to postponed investment. At the same time, Fitch expects garment exports and overseas workers' remittances to hold up well and some fiscal loosening will support growth. Bangladesh's inflation is relatively high compared with peers, averaging 5.9% in the first half of FY18, and 6.4% over the past five years (BB median: 3.1%).

Bangladesh's external finances remain strong, even though Fitch expects moderate current account deficits to continue (-0.6% in FY17) after several years of surpluses. Foreign-exchange reserve buffers are comfortable, amounting to USD32.6 billion in November 2017 (7.3 months of current external payments, compared with 4.4 months for peers in the BB category). Remittances (USD13.6 billion in 2017) recovered in the second half of 2017 and are likely to stabilise, in part due to an increase in Bangladeshi overseas workers over the past year. A total of 932,000 Bangladeshis emigrated to work abroad in the first 11 months of 2017, almost 250,000 more than in the same period in 2016. Bangladeshi ready-made garment exports continued to be strong, accounting for 81% of total exports and earning the country USD26.4 billion in the first 11 months of 2017 (USD26.1 billion in 2016).

Political and safety risks remain substantial, but security conditions seem to have improved in the past 12 months. Foreign investors and buyers of Bangladeshi goods, especially ready-made garments, have continued to do business in Bangladesh and have resumed visiting the country more frequently after a slow period following a notorious terrorist attack in July 2016. Security incidents or political turmoil could inflict long-term economic harm if it deters them from doing so in the future. Calm has returned after political violence erupted in 2014 and 2015, but continued strong political polarisation could again lead to widespread violence and blockades, especially nearer to the general elections.

The banking sector's health and governance standards are generally weak, particularly in public-sector banks. The official non-performing loan ratio is high at 10.1% in June 2017, the capital adequacy ratio (CAR) is low at 10.9% and the CAR for the six state-owned commercial banks is well below the 10% regulatory minimum. At the same time, the risk that the sovereign will need to provide considerable additional support to the banking sector is mitigated by the small size of private credit, at 37% of GDP.

Bangladesh's general government debt/GDP ratio of 32.7% in FY17 compares well with the 'BB' median of 44.5%. However, the debt burden equals 320% of government revenue, significantly higher than the 'BB' median of 184%. The government's revenue intake of 10.2% of GDP is the second lowest of all rated sovereigns after Nigeria, implying limited fiscal space to boost badly needed infrastructure development. Implementation of a new VAT law has the potential to boost revenue, but has been postponed to 2019. Spending pressure may arise in the context of upcoming elections. Expenditure related to the large inflow of refugees from Myanmar will likely be limited, as the international community is likely to bear most of the burden.

The Bangladeshi economy is less developed on a number of metrics than many of its peers. Average per capita GDP remains low at USD1,585 compared with the 'BB' range median of USD5,611, although major improvements have taken place over the past decade on a number of social metrics. Governance also continues to be weak, as illustrated by a low score for the World Bank governance indicator (24th percentile versus the BB median of 51st percentile). The difficult business environment is illustrated by the country's position of 177th out of 190 countries in the World Bank's latest Ease of Doing Business report, while a large infrastructure deficit also hampers investment. However, the government seems focused on making progress on some large ongoing infrastructure projects.

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

Fitch's proprietary SRM assigns Bangladesh a score equivalent to a rating of '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 rated peers, as follows:

- Structural features: -1 notch, to reflect political risk arising from a polarised political environment and domestic security concerns, as well as weak banking-sector health and governance.

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.

RATING SENSITIVITIES

The Stable Outlook reflects Fitch's assessment that upside and downside risks to the rating are well-balanced.

The main factors that individually, or collectively, could trigger positive rating action are:

- A reduction in political risk or domestic security concerns

- Sustained high GDP growth, which would support development and bring per capita GDP closer in line with peers

- An improvement in governance, which would strengthen the business climate and could improve banking-sector health

The main factors that individually, or collectively, could trigger negative rating action are:

- Substantial slowdown in GDP growth, for example, related to materialising political risk or a deterioration in the security situation

- A significant rise in the government debt-to-GDP ratio, for example, due to substantial government support for the banking sector

KEY ASSUMPTIONS

- The global economy performs broadly in line with Fitch's Global Economic Outlook (December 2017).

The full list of rating actions is as follows:

Long-Term Foreign-Currency IDR affirmed at 'BB-'; Outlook Stable

Long-Term Local-Currency IDR affirmed at 'BB-'; Outlook Stable

Short-Term Foreign-Currency IDR affirmed at 'B'

Short-Term Local-Currency IDR affirmed at 'B'

Country Ceiling affirmed at 'BB-'

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