FitchRatings

Fitch Affirms Bangladesh at 'BB-'; Outlook Stable

Fitch Ratings-Hong Kong-25 November 2019: 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 GDP growth, high foreign-exchange reserve buffers and moderate, although rising, general government debt against weak structural indicators, including a challenging business environment relative to peers, exceptionally low fiscal revenue and poor banking-sector health.

Bangladesh's high economic growth has proved resilient to a number of severe shocks over the past decade, including political crises and natural disasters. The country exhibits one of the highest real GDP growth rates of all sovereigns; its 7.4% average real GDP growth over the past five years well exceeds the 'BB' category median of 4.2%. The government estimates growth of 8.1% for the financial year ended June 2019 (FY19), underpinned by strong domestic demand given high remittances and a solid net export contribution. Fitch forecasts growth to decelerate slightly to 7.5% in FY20 and 7.2% in FY21, as external demand for Bangladeshi exports has been falling in recent months, following the trend of slowing world trade. Bangladesh's inflation is high against the 'BB' median of 3.4%, averaging 5.5% in 10M19, but is on par with Bangladesh Bank's target ceiling for FY20.

Foreign reserve buffers remain comfortable, amounting to USD32.4 billion in October 2019 - 5.5 months of current external payments, compared with 4.3 months for 'BB' category peers - even though Bangladesh continues to run a modest current account deficit, which we forecast at 2.2% of GDP in 2019. This is due to several large infrastructure projects requiring significant imports of capital goods. International reserves, though, could come under pressure if Bangladesh Bank decides to intervene aggressively to support the exchange rate. Remittances from overseas workers continue to perform strongly, as USD17.1 billion flowed in through official channels in the 12 months through September 2019, up by 10% from a year prior, even though average emigration fell by 22% over the same period.

Bangladeshi ready-made garments, which make up 84% of total exports, earned the country USD34.1 billion in FY19 - USD3.5 billion more than in FY18. Export growth will likely slow this fiscal year, however. Bangladesh's share in the global apparel market has gradually risen to 6.5% in 2017, but the country now faces weaker global trade and is not seeming to benefit much from a redirection in trade due to the US-China trade spat.

Fitch estimates the fiscal deficit to have slightly widened to 4.8% in FY19, from 4.6% in FY18, due to weak revenue and for the revenue ratio to have fallen to 9.6% of GDP, the lowest ratio among all Fitch-rated sovereigns with the exception of Nigeria. The implementation of a new value-added tax law from July 2019 is unlikely to significantly improve the revenue ratio in the near term.

Fitch expects fiscal deficits of just under 5.0% of GDP for the next few years, which implies a gradually rising general government debt ratio from a low 34.0% of GDP in FY18. Nevertheless, government debt/revenue of

367% in FY19 is already more than double the 167% 'BB' median and is increasing at a faster pace. The government has indicated that it aims to stop annual recapitalisation of public-sector banks to improve banking management practices, but we believe there is upside risk to the government's debt trajectory due to further capital injections into public entities.

Government interest payments/revenue was a high 17.6% relative to the 7.6% 'BB' median, but Bangladesh still benefits from external concessional financing. The lower use of national saving certificates to finance the deficit is positive, given the double-digit interest rates paid on such instruments, but a greater role by domestic banks to finance the deficit may crowd out private-sector borrowing.

The banking sector's health and governance standards are weak, particularly at public-sector banks. The official gross non-performing loan (NPL) ratio was a high 11.7% in June 2019, up from 10.4% a year earlier, although the NPL ratio net of provisions was significantly lower at 2.5%. According to the IMF the published NPL ratios are likely to underestimate problems in the sector, also indicating that the stressed asset ratio has risen to over 20%. In spite of the positive macroeconomic environment, gross NPLs at state-owned commercial banks rose to 31.6% in June 2019, from 28.2% a year prior. The capital adequacy ratio for the sector is a low 11.7% and is only 8.5% for state-owned commercial banks. The risk that the sovereign will need to provide additional financial support to the banking sector is somewhat mitigated by the small size of private credit, at 37% of GDP.

Weak governance standards are illustrated by a low score for the World Bank governance indicator - 22nd percentile versus the 'BB' median of 44th percentile; this constrains the effectiveness of economic policies. The country ranks lowest in the 'BB' category for the Ease of Doing Business index, at 168th of 190 countries. The security situation in Bangladesh seems to have improved significantly over recent years and no longer seems to deter foreign visitors, even though recurrence of security incidents and political turmoil cannot be ruled out. A large infrastructure deficit continues to hamper investment, although the government has in recent years significantly enhanced electricity generation capacity and is focused on progressing some large 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 IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final Long-Term Foreign-Currency IDR by applying its QO, relative to rated peers, as follows:

- Structural features: -1 notch, to reflect weak governance hindering the strength and effectiveness of economic policy, weak health and governance in Bangladesh's banking sector as well as a challenging business environment from red tape, polarised political settings and domestic security issues.

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 Long-Term Foreign-Currency 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 or not fully reflected in the SRM.

RATING SENSITIVITIES
The main factors that individually, or collectively, could trigger positive rating action are:
- Sustained improvement in the structure of public finances in terms of higher government revenue and lower risk of contingent liabilities
- Improved governance that strengthens the business climate and banking-sector health

The main factors that individually, or collectively, could trigger negative rating action are:
- A significant rise in the government debt/GDP ratio due to the crystallisation of contingent liabilities related to banks or other state-owned enterprises
- A drop in foreign-exchange reserves, for instance, in combination with a widening of the current account deficit
- Substantial slowdown in GDP growth, for example, related to materialising political risk or a deterioration in security

KEY ASSUMPTIONS
- The global economy performs broadly in line with Fitch's latest Global Economic Outlook (September 2019).

FULL LIST OF RATING ACTION

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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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.

Bangladesh has an ESG Relevance Score of '5' for Rule of Law, Institutional and Regulatory Quality, and Control of Corruption as World Bank Governance Indicators have the highest weight in the SRM and are therefore highly relevant to the rating and a key rating driver.

Bangladesh has an ESG Relevance Score of '4' for Human Rights and Political Freedoms, as World Bank

Governance indicators have the highest weight in the SRM and are relevant to the rating and a rating driver.

Bangladesh has an ESG Relevance Score of '4' for Creditor Rights, as willingness and ability to service debt are relevant to the rating and a rating driver, as for all sovereigns.

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Applicable Criteria
Country Ceilings Criteria (pub. 05 Jul 2019)
Sovereign Rating Criteria (pub. 26 May 2019)

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