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Research Update:

Bangladesh 'BB-/B' Ratings Affirmed; Outlook Stable

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Ratings

Foreign and local currency: BB-/Stable/B
For further details see Ratings List.

Overview

- Bangladesh faces the vulnerabilities of a low-middle-income economy, fiscal constraints, and heavy development needs, but benefits from low external debt.
- We are affirming our 'BB-' long-term and 'B' short-term sovereign credit ratings on Bangladesh.
- The stable outlook balances the country's healthy economic growth prospects and an improving external profile against fiscal weaknesses and development requirements.

Rating Action

On May 31, 2018, S&P Global Ratings affirmed its 'BB-' long-term and 'B' short-term sovereign credit ratings on Bangladesh. The outlook remains stable. The transfer and convertibility (T&C) assessment remains 'BB-'.

Outlook

The stable outlook reflects our expectation that Bangladesh's consistent economic growth trajectory and strong donor support will continue to raise average income and broadly sustain the country's external profile over the next 12 months. These factors are balanced against enduring governance and fiscal weaknesses, and infrastructure deficits.

We may downgrade the sovereign if fiscal slippages result in rising public debt and external donor support declines materially.

Conversely, we may raise the ratings if measures targeted at growing the revenue base and boosting collection efficiency materially improve Bangladesh's fiscal performance. We may also upgrade Bangladesh if the government significantly reduces energy, infrastructure, and administrative bottlenecks, resulting in higher investment and eventually a sustained increase in trend growth for real per capita GDP.

Rationale

The ratings on Bangladesh reflect the country's low economic development and limited fiscal flexibility owing to a combination of constrained revenue-generation capacity, rising debt-servicing costs, and high spending to improve its basic infrastructure and government services. The country's volatile political setting combined with administrative and institutional weaknesses represent additional rating constraints. We weigh these factors against a relatively modest external debt burden, reflecting support from substantial donor engagement, and large remittances from Bangladeshis outside the country.

Institutional and Economic Profile: Administrative and institutional weaknesses constrain stronger economic growth development

- Bangladesh's polarized political landscape constrains the effectiveness of institutions and heightens social tensions.
- The economy continues to sustain high, steady economic growth.

Bangladesh's fractious domestic political conditions distract from stable policymaking. The polarized political landscape generally hampers policy implementation and makes responses unpredictable at times. The confrontational stance between the incumbent Awami League and opposition Bangladesh Nationalist Party harbors the potential for conflict. Given a weak institutional setting, infrastructure deficiencies, and difficult business environment, Bangladesh's foreign direct investment has remained persistently low.

The next general elections are generally expected to be held by end-2018. Although the domestic security situation has improved recently, we do not rule out the possibility of violence leading up to the elections. That said, strikes and politically related violence have not been overly disruptive to overall economic growth in the past. We expect Bangladesh's economy to remain resilient to such bouts of social turbulences.

Low economic development, as represented by per capita GDP of US$1,620 for 2018, is one of Bangladesh's main rating constraints. This income level offers a weak and narrow revenue base, in turn limiting the fiscal and monetary flexibility needed to respond to exogenous shocks. Nevertheless, Bangladesh's real per capita GDP growth of about 5.4% over the 2012-2021 period indicates consistently strong real GDP growth despite numerous structural impediments, in particular the shortage of power. We assess Bangladesh's economic performance as being in line with sovereigns at similar income levels. Should these impediments be addressed, we believe Bangladesh's growth trajectory would be stronger than peers'.

Flexibility and Performance Profile: Bangladesh's narrow revenue base and high interest costs inhibit fiscal flexibility.

- Garment exports and worker remittances are key anchors of Bangladesh's strong external position.
- Fiscal revenue remains low while value-added tax (VAT) harmonization is further delayed.
- The country's fiscal flexibility is constrained by a large interest burden from the issuance of high-interest national savings certificates.

Bangladesh tends to run moderate fiscal deficits. We forecast the change in net general government debt will average 3.0% of GDP annually over fiscal 2018-2021 (ending June 30), which is low compared with peers'. However, many basic social and infrastructure needs remain unmet, implying higher outlays ahead. Although the government's debt burden is low, with net general government debt at our projection of 23% of GDP as of the end of fiscal 2018, its high interest expense at 17.0% of revenues limits fiscal flexibility.

Due to the government's increasing use of the costlier national savings certificates scheme rather than commercial borrowings, we expect its debt-servicing ratio to rise to above 19% from 2018. Additionally, more than 40% of total government debt is denominated in foreign currency, albeit mostly from official concessional donors.

Bangladesh's narrow revenue base constrains the government's flexibility to mitigate economic downturns or other potential shocks. It has only 2 million registered taxpayers (out of a population of approximately 160 million). General government revenue was 10% of GDP in fiscal 2017, among the lowest of rated sovereigns globally. The government has outlined numerous initiatives to expand the tax base, most notably the plan to reform the complicated VAT system. However, the plan has been repeatedly delayed over the past few years since the law was first passed in 2012. We do not expect significant revenue enhancement reforms to be implemented until at least after the elections in 2019-2020.

We assess a moderate risk related to contingent liabilities from financial institutions, in particular the state-owned commercial banks (SOCB) sector. Although the private sector banks are in adequate shape, significant risks reside in the SOCBs. SOCBs account for about 28% of total banking sector assets and the sector's nonperforming loans had reached about 25% of total loans as of end 2017. Although the government has begun to recapitalize some of the SOCBs, in our view, the sector remains undercapitalized and we expect it to continue to require budgetary support from the government.

Bangladesh's credit profile benefits from low external borrowings. The country enjoys large remittance inflows and an internationally competitive garment export sector, resulting in current account surpluses over the past few years.

However, a combination of increased food imports due to flooding in the country and reduced remittances due to the oil price slump taking its toll on the Gulf States (largest hosts of Bangladeshis working outside the country), caused a modest current account deficit in 2017. We envisage remittance inflows to increase moderately, although imports related to infrastructure projects are expected to rise, leading to small but sustained current account deficits over our forecast period.

In our view, Bangladesh's external balance sheet and liquidity will remain key credit-supporting factors. Nevertheless, we expect gross external financing needs to continue their rising trend, averaging 88% of current account receipts plus usable reserves over 2018-2021. The lower remittance flows have affected reserves accumulation, further increasing the gap between the country's external debt and its liquid external assets. We project narrow net external debt to be about 19% of current account receipts by end 2018.

Bangladesh's external profile draws substantial donor support, ensuring that the bulk of public external debt is low-cost borrowing with long maturity. Additionally, donors and multilateral lenders influence policy formulation and provide direct budgetary support. An example of support is the current Rohingya crisis, where multilateral and bilateral agencies cover the increased food imports needed for the refugees.

We view Bangladesh's monetary assessment as a neutral factor to the rating. The central bank's limited independence, multiple mandates, and underdeveloped capital markets hamper monetary flexibility. We consider Bangladesh's exchange rate regime as a managed float, which provides some flexibility to mitigate external shocks. However, despite modest gradual depreciation in the exchange rate since 2015, Bangladesh's real effective exchange rate has been rising, reflecting the currency depreciation of its trading partners. Should this persist, it could strain the competiveness of the country's export garment sector.

The central bank has made progress in managing inflationary expectations. In the past two years, inflationary pressure subsided with reduced government borrowing from the banking sector. Inflation has stayed in the single digits since 2011.

Key Statistics

Table 1

Bangladesh - Selected Indicators										
ECONOMIC INDICATORS (%)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Nominal GDP (bil. LC)	10,552	11,989	13,437	15,158	17,329	19,758	22,558	25,706	29,238	33,256
Nominal GDP (bil. $)	129	154	173	194	220	246	271	308	354	408
GDP per capita (000s $)	0.8	1.0	1.1	1.2	1.4	1.5	1.6	1.8	2.1	2.4

Table 1

Bangladesh - Selected Indicators (cont.)

ECONOMIC INDICATORS (%)	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth	6.5	6.0	6.1	6.6	7.1	7.2	6.9	6.7	6.5	6.5
Real GDP per capita growth	5.3	4.8	4.8	5.4	6.0	6.0	5.6	5.4	5.2	5.2
Real investment growth	10.6	5.4	9.9	7.1	8.9	8.8	10.3	7.5	7.5	7.5
Investment/GDP	29.0	29.3	28.6	29.6	29.6	30.6	31.7	31.4	31.1	31.0
Savings/GDP	28.7	28.9	29.4	31.0	31.6	30.0	28.0	28.2	27.9	27.8
Exports/GDP	20.2	19.5	19.0	17.3	16.6	15.0	13.6	13.2	12.7	12.1
Real exports growth	12.5	2.5	3.2	(2.8)	2.2	(0.6)	1.0	5.0	4.0	2.8
Unemployment rate	3.0	4.3	3.5	3.5	4.2	4.2	4.0	4.0	4.0	4.0
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(0.3)	(0.4)	0.8	1.5	1.9	(0.6)	(3.6)	(3.2)	(3.3)	(3.2)
Current account balance/CARs	(1.1)	(1.4)	2.9	5.8	8.1	(2.9)	(19.2)	(17.8)	(19.1)	(20.1)
CARs/GDP	31.3	29.0	27.7	25.6	23.8	20.8	18.9	18.0	17.1	16.0
Trade balance/GDP	(7.2)	(6.5)	(3.9)	(3.6)	(2.9)	(3.9)	(6.3)	(5.5)	(5.2)	(4.8)
Net FDI/GDP	0.9	1.1	0.9	0.9	0.6	0.7	0.9	1.1	1.0	0.7
Net portfolio equity inflow/GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	88.8	84.8	76.6	72.9	68.2	73.9	84.4	87.3	94.3	101.7
Narrow net external debt/CARs	36.3	21.9	21.3	10.9	9.0	14.6	19.1	28.1	36.2	45.9
Narrow net external debt/CAPs	35.9	21.6	21.9	11.6	9.8	14.2	16.0	23.8	30.4	38.2
Net external liabilities/CARs	48.8	39.0	38.0	34.1	32.4	41.8	59.1	79.5	95.2	111.2
Net external liabilities/CAPs	48.2	38.4	39.2	36.2	35.3	40.6	49.6	67.5	79.9	92.6
Short-term external debt by remaining maturity/CARs	7.9	7.8	8.4	11.4	12.1	17.8	20.5	20.6	22.4	23.1
Usable reserves/CAPs (months)	2.7	3.4	4.7	5.7	6.9	7.4	6.6	6.0	5.0	4.1
Usable reserves (mil. $)	12,754	18,086	22,317	27,494	32,285	33,434	32,407	30,252	26,708	23,444
FISCAL INDICATORS (%, General government)										
Balance/GDP	(4.0)	(3.7)	(3.1)	(3.4)	(3.7)	(3.4)	(4.5)	(4.0)	(3.8)	(3.6)
Change in net debt/GDP	0.8	0.5	1.6	1.5	3.1	2.9	3.5	3.0	2.8	2.6
Primary balance/GDP	(2.1)	(1.8)	(1.0)	(1.4)	(1.8)	(1.6)	(2.6)	(2.1)	(1.9)	(1.7)
Revenue/GDP	11.3	12.1	10.9	9.6	10.1	10.2	11.0	11.0	11.0	11.0
Expenditures/GDP	15.3	15.8	14.0	13.0	13.8	13.6	15.5	15.0	14.8	14.6
Interest /revenues	16.6	16.1	19.2	20.4	18.9	16.9	17.6	17.7	17.5	17.2
Debt/GDP	31.9	30.0	29.6	27.9	27.7	27.6	27.8	27.4	27.0	26.4
Debt/Revenue	281.9	248.1	271.1	289.9	274.6	270.4	252.5	249.4	245.2	239.7
Net debt/GDP	28.1	25.3	24.1	22.9	23.1	23.1	23.8	23.9	23.8	23.5
Liquid assets/GDP	3.8	4.7	5.5	5.0	4.6	4.5	4.0	3.6	3.2	2.9

Table 1

Bangladesh - Selected Indicators (cont.)										
ECONOMIC INDICATORS (%)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
MONETARY INDICATORS (%)										
CPI growth	6.2	7.5	7.0	6.2	5.5	5.8	6.5	6.0	6.0	6.0
GDP deflator growth	8.2	7.2	5.7	5.9	6.7	6.3	6.8	6.8	6.8	6.8
Exchange rate, year-end (LC/$)	79.8	77.8	77.9	78.5	78.7	82.7	84.0	83.0	82.0	81.0
Banks' claims on resident non-gov't sector growth	16.3	8.2	18.0	14.0	16.7	19.2	17.0	17.0	17.0	17.0
Banks' claims on resident non-gov't sector/GDP	45.1	42.9	45.2	45.7	46.6	48.7	49.9	51.3	52.8	54.3
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	0.6	9.4	3.9	14.2	5.6	N/A	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Bangladesh - Ratings Score Snapshot	
Key rating factors	
Institutional assessment	5
Economic assessment	5
External assessment	2
Fiscal assessment: flexibility and performance	5
Fiscal assessment: debt burden	5
Monetary assessment	4

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Banking Industry Country Risk Assessment: Bangladesh, Feb. 26, 2018
- Sovereign Ratings History, May 7, 2018
- Sovereign Risk Indicators, April 10, 2018
- Global Sovereign Rating Trends: First-Quarter 2018, April 11, 2018
- Asia-Pacific Sovereign Rating Trends 2018, Jan. 10, 2018
- Asia-Pacific Central Governments Likely To Issue US$3 Trillion In Sovereign Debt In 2018, Feb. 22, 2018

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Bangladesh	
Sovereign Credit Rating	BB-/Stable/B
Transfer & Convertibility Assessment	
Local Currency	BB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.