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Ratings

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Research Update:

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

May 30, 2019

Overview

- Bangladesh faces the vulnerabilities of a low-middle-income economy, fiscal constraints, and heavy development needs, but benefits from low external debt and resilient economic growth.
- We are affirming our 'BB-' long-term and 'B' short-term sovereign credit ratings on Bangladesh.
- The stable outlook reflects our expectation that the country's healthy growth prospects will overcome risks to the external profile over the next 12 months.

PRIMARY CREDIT ANALYST

YeeFarn Phua
Singapore
(65) 6239-6341
yeefarn.phua
@spglobal.com

SECONDARY CONTACT

Andrew Wood
Singapore
+ 65 6239 6315
andrew.wood
@spglobal.com

ADDITIONAL CONTACTS

Ruchika Malhotra
Singapore
(65) 6239-6362
ruchika.malhotra
@spglobal.com

Raphael Mok
Singapore
raphael.mok
@spglobal.com

Rating Action

On May 30, 2019, 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 is unchanged at 'BB-'.

Outlook

The stable outlook reflects our expectation that Bangladesh's solid growth path will continue raising average income and prevail over risks to external metrics over the next 12 months.

We may raise the ratings if the government implements fiscal measures that strengthen future fiscal performances.

We may lower the ratings if fiscal or external metrics weaken materially from current levels. This could happen if persistent fiscal slippages cause net general government debt to rise to, and is sustained at, levels above 30% of GDP. We may also lower the ratings if the external profile worsens materially, possibly due to significantly weakened export demand.

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, high debt-servicing costs, and heavy spending to improve its basic infrastructure and government services. Administrative and institutional weaknesses represent additional rating constraints. We weigh these factors against a sound external position, reflecting support from substantial donor engagement, large remittances by Bangladesh citizens outside back to the country, and a globally competitive garment sector.

Institutional and economic profile: Consistently stronger economic outcomes than peers despite institutional weaknesses

- Bangladesh's political landscape constrains the effectiveness of institutions and impedes sound policymaking.
- However, the economy continues to sustain high, steady economic growth supported by a competitive garment sector.

Bangladesh's domestic political conditions distract from stable policymaking and generally hampers policy implementation. The confrontational stance between the incumbent Awami League and opposition Bangladesh Nationalist Party (BNP) 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 country's polarized political landscape has evolved into a highly centralized decision-making environment, which could make future policy responses unpredictable. The Awami League-led coalition swept the elections held last year, winning more than 80% of the parliamentary seats. A period of uncertainty followed the election results with allegations of voting irregularities by the BNP. The opposition's recent decision to join parliament has brought some stability to the fractious environment. That said, the opposition is likely to try to reclaim lost ground. Nevertheless, strikes and politically motivated violence have not been overly disruptive to overall economic growth in the past. Bangladesh has grown steadily faster than its peers despite bouts of tension, and we expect its economy to stay resilient and among the fastest growing globally.

Low economic development, as represented by per capita GDP of US$1,900 for 2019, has been 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. Despite the low income level and numerous structural impediments, particularly in infrastructure, Bangladesh's real per capita GDP growth of about 5.9% over 2013-2022 indicates consistently strong real economic growth. We assess its economic performance as being much stronger than sovereigns at similar income levels.

Flexibility and performance profile: Bangladesh's narrow revenue base and high interest costs reflect structural weaknesses in its fiscal profile.

- Garment exports and worker remittances are key anchors of Bangladesh's strong external position but face risks from global factors and maturing of construction boom in host countries.
- Fiscal revenue remains low while VAT reforms are likely to be watered down.
- The country's fiscal flexibility is constrained by a large interest burden from the issuance of high-yield National Savings Certificates (NSCs).

Bangladesh tends to run moderate fiscal deficits. We forecast the change in net general government debt will average 4.2% of GDP annually over fiscals 2019-2022 (ending June 30).

However, many basic social and infrastructure needs remain unmet, implying higher outlays ahead for which the fiscal capacity of the government is lacking. Although the government's debt burden is low, its high interest expense at 20% of revenue limits fiscal flexibility. We project net general government debt at 25% of GDP as of the end of the fiscal year on June 30, 2019.

Due to the government's increasing reliance on the costlier NSC scheme rather than commercial borrowing, we expect its debt-servicing ratio to remain well above 15% for 2019-2022. Furthermore, 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 9% of GDP in fiscal 2018--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. With the elections concluded last year, the government may be able to implement VAT reforms albeit in a attenuated manner with multiple rates rather than the initial proposed single harmonized rate. We do not expect significant revenue increases from the new initiatives.

We assess a limited risk related to contingent liabilities from financial institutions. The banking sector remains small with assets less than 100% of GDP, which informs our view of the contingent risk it poses. We classify Bangladesh's banking sector in group '9' under our Banking Industry Credit Risk Assessment (with '1' being the highest assessment and '10' being the lowest). Although the private sector banks are in better shape, significant risks reside in state-owned commercial banks (SOCBs). SOCBs account for about 26% of total banking sector assets, and the sector's nonperforming loans had exceeded 28% of its total loans as of June 2018.

Bangladesh's credit profile benefits from low external borrowings. The country has 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 and reduced remittances resulting from 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 and a widening in 2018. Since then, Bangladesh's exports have gained momentum, which narrowed the deficit in the first half of fiscal 2019. We expect the trend of export recovery to continue. While food-related imports will be lower, imports related to infrastructure projects will continue, leading to current account deficits averaging about 1.85% of GDP over 2019-2022.

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 gradual rising trend, averaging 89% of current account receipts plus usable reserves over 2019-2022. In the past few years, the lower remittance flows had affected reserves accumulation. We expect remittances to recede and stabilize once the construction boom in host countries for Bangladeshi workers mature over 2019-2020. This implies that the gap between the country's external debt and its liquid external assets is unlikely to reduce. But given some factors, we project Bangladesh's narrow net external debt to stabilize at about 40% of current account receipts through the forecast period. Those factors are oil price stabilizing, exports rebounding, and capital imports declining with the completion of mega infrastructure projects in the country.

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 condition 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 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 gradual depreciation in the exchange rate since 2015, Bangladesh's real effective exchange rate (REER) has been rising, reflecting the currency depreciation of its trading partners. Should the REER continue to rise, it could strain the competiveness of the country's export garment sector. However, some early signs of reversal have appeared with the REER falling for first time in 2018.

Bangladesh's 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

(BDT mil.)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Economic indicators (%)										
Nominal GDP (bil. LC)	11,989	13,437	15,158	17,329	19,758	22,505	25,594	29,029	32,925	37,344
Nominal GDP (bil. $)	154	173	194	221	246	270	303	340	381	427
GDP per capita (000s $)	1.0	1.1	1.2	1.4	1.5	1.6	1.8	2.0	2.2	2.4
Real GDP growth	6.0	6.1	6.6	7.1	7.3	7.9	7.8	7.0	7.0	7.0
Real GDP per capita growth	4.8	4.8	5.4	6.0	6.2	6.6	6.6	5.8	5.8	5.8
Real investment growth	5.4	9.9	7.1	8.9	10.1	10.5	7.8	8.0	8.0	8.0
Investment/GDP	29.3	28.6	29.6	29.6	30.6	31.5	30.9	30.9	30.9	31.1
Savings/GDP	28.9	29.4	31.0	31.6	30.0	27.9	28.9	29.0	29.1	29.4
Exports/GDP	19.5	19.0	17.3	16.6	15.0	14.8	14.8	14.2	13.6	13.0
Real exports growth	2.5	3.2	(2.8)	2.2	(2.3)	8.1	8.8	4.5	4.5	4.5
Unemployment rate	4.3	3.5	3.5	4.2	4.2	4.0	4.0	4.0	4.0	4.0
External indicators (%)										
Current account balance/GDP	(0.4)	0.8	1.5	1.9	(0.5)	(3.6)	(2.0)	(1.9)	(1.8)	(1.7)
Current account balance/CARs	(1.4)	2.9	5.8	8.1	(2.6)	(17.4)	(9.7)	(9.9)	(10.0)	(9.9)
CARs/GDP	29.0	27.7	25.6	23.7	20.8	20.9	20.5	19.3	18.2	17.2
Trade balance/GDP	(6.5)	(3.9)	(3.6)	(2.9)	(3.9)	(6.8)	(5.3)	(4.8)	(4.4)	(4.0)
Net FDI/GDP	1.1	0.9	0.9	0.6	0.7	0.6	0.6	0.5	0.5	0.4
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

Table 1

Bangladesh--Selected Indicators (cont.)

(BDT mil.)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Gross external financing needs/CARs plus usable reserves	84.8	76.6	75.0	70.8	74.7	85.3	86.2	87.8	90.0	92.3
Narrow net external debt/CARs	21.9	22.7	13.6	12.0	17.4	34.0	34.6	38.6	42.7	45.7
Narrow net external debt/CAPs	21.6	23.4	14.4	13.1	17.0	29.0	31.6	35.2	38.8	41.6
Net external liabilities/CARs	39.0	39.5	36.9	35.4	44.6	59.4	60.4	65.8	70.9	74.8
Net external liabilities/CAPs	38.4	40.7	39.1	38.5	43.5	50.6	55.1	59.9	64.5	68.1
Short-term external debt by remaining maturity/CARs	7.8	8.4	14.4	16.1	19.4	18.6	21.0	22.1	22.7	23.5
Usable reserves/CAPs (months)	3.4	4.7	5.7	6.9	7.4	6.1	5.6	5.5	5.2	4.9
Usable reserves (mil. $)	18,086	22,317	27,494	32,285	33,434	32,029	32,942	32,840	32,726	33,366
Fiscal indicators (general government; %)										
Balance/GDP	(3.7)	(3.1)	(3.4)	(3.7)	(4.5)	(4.9)	(4.1)	(4.2)	(4.2)	(4.2)
Change in net debt/GDP	0.5	1.6	1.5	3.1	2.9	3.5	4.1	4.2	4.2	4.2
Primary balance/GDP	(1.8)	(1.0)	(1.4)	(1.8)	(2.7)	(3.1)	(2.3)	(2.4)	(2.3)	(2.3)
Revenue/GDP	12.1	10.9	9.6	10.1	9.1	8.7	9.0	10.0	11.0	11.0
Expenditures/GDP	15.8	14.0	13.0	13.8	13.6	13.5	13.1	14.2	15.2	15.2
Interest/revenues	16.1	19.2	20.4	18.9	19.7	20.0	19.9	18.5	17.3	17.7
Debt/GDP	30.0	29.6	27.9	27.7	27.6	28.3	29.1	29.9	30.6	31.2
Debt/revenues	248.1	271.1	289.9	274.6	304.3	326.5	323.0	298.9	278.3	284.0
Net debt/GDP	25.3	24.1	22.9	23.1	23.2	23.8	25.0	26.3	27.4	28.3
Liquid assets/GDP	4.7	5.5	5.0	4.6	4.5	4.5	4.0	3.6	3.2	2.9
Monetary indicators (%)										
CPI growth	7.5	7.0	6.2	5.5	5.7	5.6	5.5	6.0	6.0	6.0
GDP deflator growth	7.2	5.7	5.9	6.7	6.3	5.6	5.5	6.0	6.0	6.0
Exchange rate, year-end (LC/$)	77.75	77.95	78.50	78.70	82.70	83.90	85.00	86.00	87.00	88.00
Banks' claims on resident non-gov't sector growth	8.2	18.0	14.0	16.7	19.3	13.0	13.0	13.0	13.0	13.0
Banks' claims on resident non-gov't sector/GDP	42.9	45.2	45.7	46.6	48.8	48.4	48.1	47.9	47.7	47.5

Table 1

Bangladesh--Selected Indicators (cont.)

(BDT mil.)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
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	9.5	4.3	14.2	5.7	2.4	(1.7)	0.0	0.0	0.0	0.0

Definitions: 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. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. 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. Sources: Bangladesh Bureau of Statistics, International Monetary Fund (Economic Indicators); Bangladesh Bank, Central Bank of Bangladesh, International Monetary Fund (Monetary and External Indicators); Ministry of Finance (Fiscal, Debt Indicators).

Ratings Score Snapshot

Table 2

Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	5	Future policy responses are difficult to predict because of increasingly centralized decision-making. Respect for the rule of law is not assured, owing to high perceived corruption and interference by political institutions.
Economic assessment	4	Based on “GDP per capita (US$)” as per Selected Indicators in table 1. Weighted average real GDP per capita trend growth over a 10-year period is at 5.98%, which is higher than peers.
External assessment	2	Based on Narrow Net External Debt and Gross External Financing Needs/(CAR+useable reserves) as per the Selected Indicators table above.
Fiscal assessment: flexibility and performance	6	Based on "Net general government (GG) debt / GDP (%)" and "GG interest paid / GG revenues (%)" as per Selected Indicators in table 1. The sovereign faces shortfalls in basic services and infrastructure, as reflected, for instance, by its low ranking on the U.N. Development Program's human development index. The sovereign has limited ability to raise GG revenues compared with sovereigns with a similar level of development due to large informal economy and material delays in VAT reforms since 2012.
Fiscal assessment: debt burden	4	Based on net general government debt (% of GDP) as per Selected Indicators in table 1. 43% of gross government debt is denominated in foreign currency.
Monetary assessment	4	Bangladesh's exchange rate regime is a managed float, challenged by the effect of interest rates. the central bank intervenes intermittently in foreign exchange markets, etc. The Bangladesh Bank's operational independence is limited by perceived political interference and structural issues in monetary policy transmission.
Indicative rating	bb	As per table 1 of "Sovereign Rating Methodology."

Table 2

Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Notches of supplemental adjustments and flexibility	-1	External metrics have weakened closer to the threshold levels recently and risks are that the weakening trends could continue in the near future to result in materially worse indicators than we currently project.
Final rating		
Foreign currency	BB-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	BB-	

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 Dec. 18, 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

- Sovereign Ratings List, May 6, 2019
- Sovereign Ratings History, May 6, 2019
- Sovereign Ratings Score Snapshot, May 3, 2019
- Sovereign Risk Indicators, April 12, 2019; a free interactive version is available at http://www.spratings.com/sri
- Default, Transition, And Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 16, 2019
- Asia-Pacific Sovereign Rating Trends 2019, Jan. 15, 2019
- Global Sovereign Rating Trends 2019, Jan. 14, 2019

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.