Bangladesh

SEB COUNTRY RISK ANALYSIS December 15, 2021

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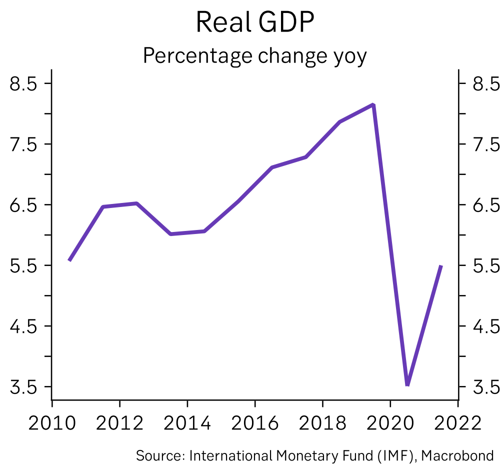
New lockdowns in 2021 have weighed on the economic recovery but the pace of GDP growth is expected to return to pre-pandemic levels in the medium-term. External balances have remained relatively strong. Political risk and the weak banking sector remain key credit challenges.

Country Risk Analysis

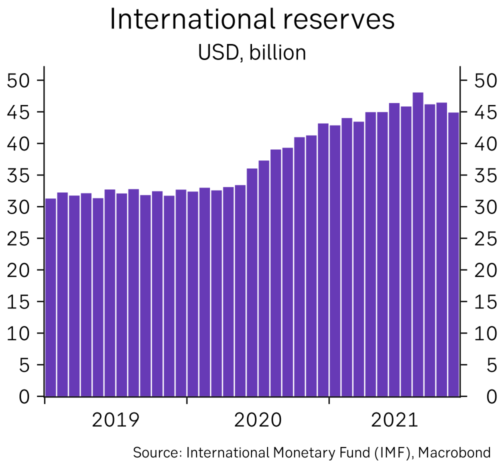
Economy recovering following lockdowns. High and stable economic growth has long been one of Bangladesh's main credit strengths. Following a very mild downturn in FY20 real GDP growth accelerated to 5.5% in FY21 (ended in June 2021). This is a decent growth rate in an emerging market perspective. However, it is still below Bangladesh's average pace in the past five years of 6.2%, and it was lower than expected at the start of the year, mainly due to new lockdowns. While health restrictions and a low vaccination rate continue to weigh on economic activity, there are a couple of bright spots. Two of the most important growth drivers and sources of foreign income, garments exports (equivalent to about 13% of GDP) and remittances, have proven resilient over the past year. The latter fuels household spending which normally makes up around 75% of GDP. Inflation, which normally is less volatile in Bangladesh than in many peer economies, has hovered around 5.5% in the past year.



Moderate current account deficits. A broadly balanced current account has helped to limit Bangladesh's need for external borrowing and has contributed to limiting country risk. Following a small surplus in 2020, the current account shifted into a deficit of about 1% of GDP in FY21 (ended in June 2021). Although solid imports contributed to a rising trade deficit, remittance flows worked to limit the rise in the deficit. Remittances (chiefly from the Gulf states) rose by more than one third helped by government incentives to use formal transmission channels. Although the resumption of large-scale infrastructure projects should push up imports in the near-term, the current account deficit is expected to remain broadly stable.

FX reserve cushion is getting thicker. Capital inflows have contributed to keeping international reserves on a rising trend in the past year as the central bank has been buying foreign exchange to relieve appreciation pressures on the currency. The country also received about USD 1.4 bn through the IMF's general SDR allocation. Official reserves recently reached new record highs of USD 47 bn. This is equivalent to 8-9 months of next year's imports and cover about 80% of the general government's outstanding external debt. We would note that the lack of transparency when it comes to FX reserves management warrants caution in interpreting the official data.

Stable taka and appreciating real effective exchange rate. The exchange rate versus the USD has remained stable over the past year as the central bank has stuck to its managed float policy. Given inflation differentials, the real effective exchange rate has appreciated since the start of the year indicating some loss of competitiveness.



Low external debt. External debt is low compared to peers, both as a share of GDP and as a share of exports. The vast majority of it is owed by the government and around 90% is on concessional terms (according to Moody's).

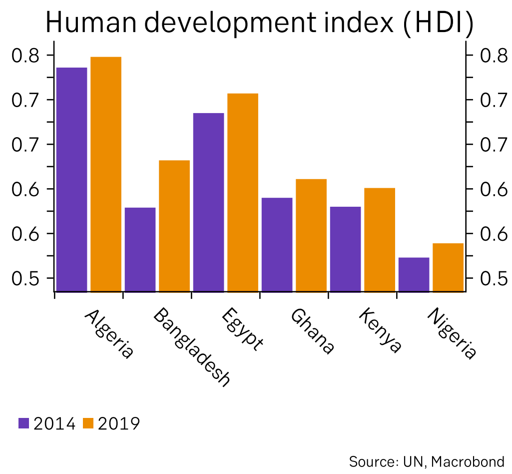
Structurally low government revenues. The country has one of the lowest revenue to GDP ratios in the world (nearly 10%). Average incomes are low and a very low share of the population pays taxes. In addition, tax administration is poor despite gradual improvements over the past few years. The low level of government revenues limits the government's ability to invest in necessary infrastructure and counter economic shocks such as the ongoing pandemic.

Government budget deficit is moderate. The general government budget deficit edged down to 6.1% in FY21, implying a continued deviation from the government's long-standing commitment to cap the deficit at 5%. The budget for the current fiscal year plans for a broadly unchanged balance. This is moderate for a fast-growing poor economy. Foreign donors continue to play an important role in budget financing. The budget assumes foreign assistance equivalent to about 3% of GDP (according to FitchRatings). National Savings Certificates (NSC), carrying high interest rates, continue to be an important source of budget financing.

Public debt is lower than among peers. High economic growth and modest debt repayment costs have helped keep government debt as a share of GDP below average among peers. Debt has remained at about 40% of GDP through the economic slowdown. Risks that fiscal contingent liabilities will materialise have risen as weaker economic activity has pressured state-owned enterprises and banks. Some other debt ratios show less strength. For example, the government's low revenues generate an interest payments- to-revenues ratio that is higher than peers. While our house forecasters Oxford Economics expect interest rate costs to decline (helped by a phasing out of NSC), some other observers expect such costs to consume more than 20% of government revenues for the next few years. This is despite the fact that nearly half of the government's debt is on concessional terms. Bangladesh has a default-free track record.

Weak banking sector. The banking sector is weak, burdened by frail state-owned commercial banks accounting for about 30% of total assets. Capital adequacy is low among these banks and non-performing loans are high. This likely weighs on the credit supply to the economy. Further capital injections by the government are likely. The risk of higher than expected recapitalization needs imply a moderate contingent liability for the government. Total banking system assets were equivalent to 67% of GDP in 2020.

Governance and institutions. Governance indicators generally compare unfavourably to peers and thus weigh on country risk. The country ranks particularly low on political stability and absence of violence and on corruption. It scores slightly more favourable on the World Bank's rule of law indicator. An average of six of the World Bank's governance indicators indicate a broadly stable global ranking over the past five years. On the other hand, development indicators such as the human development index (HDI) have seen a steady rise in the past few years. The UN ranks the country 133 of 189 countries, narrowly leading Kenya and Ghana but lagging Egypt.



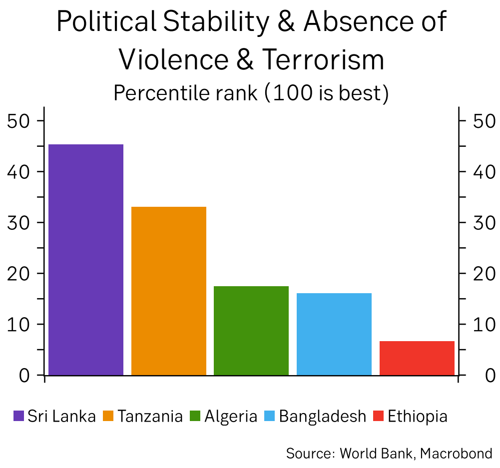
Per capita incomes are catching up but are lower than most peers. Growth in real income per capita has been slightly higher than among peers recently, enabling the economy to gradually converge with countries such as Kenya and Pakistan. Still, a low level of GDP per capita remains one of the country's key weaknesses as it limits fiscal flexibility.

External sovereign credit ratings remain unchanged. The major external credit rating agencies have left their sovereign ratings for Bangladesh unchanged over the past year, with stable outlooks.

Outlook: Back to steady growth of around 6%. The economy has proven to be resilient during a variety of political and financial crises over the past two decades. Relatively expansionary economic policies are expected to continue to support activity in the near-term. The country's textile factories which have largely been able to operate through-out the pandemic are expected to step up production further as pent-up household spending abroad should lead to rising demand for textile exports. Oxford Economics expect steady GDP growth of 6-6.5% in the coming few years.

Pandemic has not altered medium-term outlook. Our main scenario is that the economy's strong trend growth performance will remain largely intact. Favourable demographics are often singled out as a key factor that supports the economy's potential. The large and inexpensive pool of labour should reasonably let the country maintain a competitive edge in its exports of ready-made garments. An ongoing shift in lower end manufacturing out of China may give the industry a further boost. So could the trade tensions between the US and China. Little evidence of the latter has been seen so far. The country's potential continues to be held back by various bottlenecks to supply, including from poor infrastructure and heavy regulations. In addition, in the longer-term, focusing solely on the garments industry would risk locking the economy into the lower end of the value chain.

Political risk is important. Domestic political risk is high with a tense and polarised political climate that hampers the implementation of economic policies. The Awami League is governing for a third consecutive term and is widely expected to hold on to power until general elections in 2023. The long time at power has allowed Sheikh Hasina's party to establish almost total control over domestic institutions. The opposition coalition which previously has contested election results by not participating in parliament has decided to return. This is positive, but the still high concentration of power limits the workings of checks and balances. Together with the ongoing suppression of the political opposition this risks fuelling increased discontent among the population, raising the risk of political violence and social instability. Geopolitical risk in Bangladesh is low compared to most countries in the region.



Religious tensions reflect security risks. Some observers have concluded that the security situation has improved somewhat in the past couple of years. However, domestically oriented Islamist groups that oppose secularism have become increasingly violent in the past months. This serves as a reminder of the existing security risks, which also include international militant Islamist networks operating in the country.

Natural hazard risks are high. Bangladesh is, by some measures, classified as one of the top 10 countries in the world facing the risk of natural hazards with potentially severe economic consequences. The country is particularly exposed to floodings being a low-lying country with vast coastal areas. This poses economic and social risks.

Bangladesh: Key Economic Indicators*

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Macroeconomic									
GDP (% chg)	7,3	7,9	8,2	3,5	5,5	6,0	6,5	6,1	6,0
GDP (USD bn)	246	270	301	323	351	388	428	469	508
GDP/capita (USD)	1538	1671	1847	1960	2109	2312	2528	2747	2949
Investments/GDP	33%	34%	34%	33%	32%	35%	35%	35%	35%
Trade/GDP	34%	35%	31%	25%	29%	28%	28%	27%	27%
Money & Prices									
CPI inflation (%)	5,8	5,4	5,8	5,3	5,5	6,0	6,1	6,5	6,4
Money supply, M2 (% chg)	10,4	10,4	10,3	9,8	10,0	10,6	10,3	10,3	10,2
Interest rates, short-term	3,33	2,59	5,1	5,53	5,3	6,3	6,3	6,3	6,3
Oil price (USD, Brent)	54,3	71,1	64,4	41,8	71,0	72,5	63,6	60,1	61,0
Government Finances									
Budget balance/GDP	-3,36	-2,09	-2	-6,62	-6,02	-5,12	-3,87	-3,77	-3,76
Govt debt/GDP	18%	18%	18%	24%	27%	29%	29%	30%	30%
Interest rate costs/revenues	14%	16%	13%	17%	15%	13%	10%	10%	9%
Balance of Payments (USD bn)									
Current account	-6,0	-7,1	-2,9	1,1	-4,8	-5,9	-9,4	-13,0	-15,7
as % of GDP	-2,4	-2,6	-1,0	0,3	-1,4	-1,5	-2,2	-2,8	-3,1
Exports of goods	35,3	38,7	38,7	32,5	41,7	45,1	47,7	50,7	54,1
Imports of goods	48,3	56,0	54,7	48,8	58,5	64,7	70,6	77,0	83,4
FDI, net	1,7	2,4	1,9	1,1	2,8	3,0	3,2	3,4	3,7
as % of GDP	0,7	0,9	0,6	0,4	0,8	0,8	0,7	0,7	0,7
Loan repayments	1,5	2,1	4,8	3,0	3,2	3,5	3,8	4,0	4,3
External Debt & Liquidity (USD bn)									
Total debt	46,8	52,1	57,1	67,7	72,7	77,7	82,8	88,2	93,9
o/w short term debt	10,8	9,0	9,7	11,0	10,8	10,8	10,8	10,8	10,8
as % of GDP	19,1	19,3	19,0	21,0	20,7	20,0	19,3	18,8	18,5
Reserves (ave.)	31,3	30,0	30,6	41,0	39,7	39,5	36,8	29,9	20,2
months of imports	7,8	6,4	6,7	10,1	8,2	7,3	6,3	4,7	2,9
Exchange rate vs USD	80,44	83,47	84,44	84,87	85,91	90,35	92,53	95,03	98,65

** Fiscal year (July 1 - June 30).*
Source: Oxford Economics, IMF

Rating history (eoy)

	2017	2018	2019
Fitch	BB-	BB-	BB-
Moody's	Ba3	Ba3	Ba3
S&P	BB-	BB-	BB-

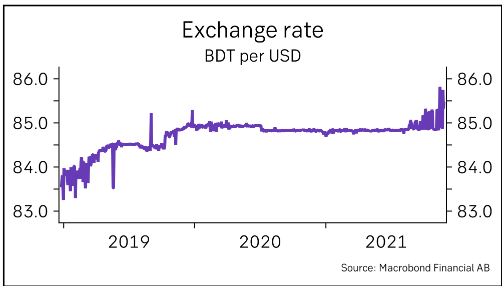
Type of government:

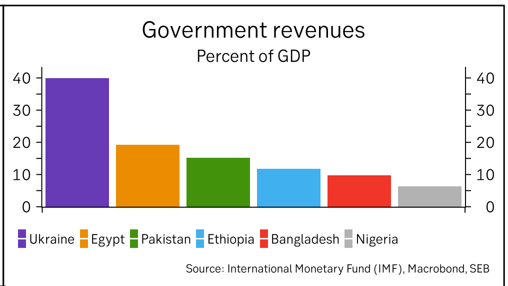
Next elections — Parlimentary - 2023. Presidential - 2023

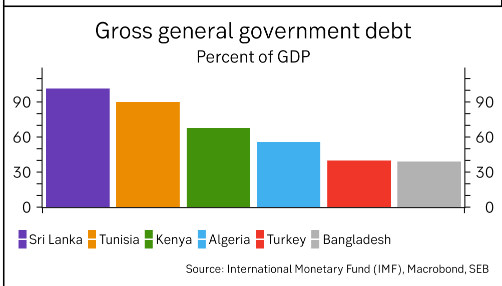
Other:

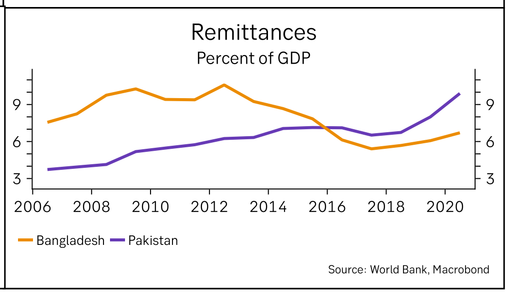
Latest PC deal — None

Latest IMF arrangements — Three-year Extended Credit Facility, expired October 2015









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