S&P Global Ratings

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Research Update:

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

August 25, 2022

Overview

- Bangladesh is weathering a period of heightened external pressure, characterized by an elevated current account deficit and declining foreign exchange reserves.
- Nevertheless, Bangladesh's economic growth trajectory remains sound, and we expect external conditions to gradually stabilize over the next 12 months.
- We affirmed our 'BB-' long-term and 'B' short-term sovereign credit ratings on Bangladesh.
- The stable outlook reflects our expectation that Bangladesh's external position will stabilize following a recent deterioration, with solid economic growth continuing to support gradual fiscal consolidation.

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Rating Action

On Aug. 25, 2022, S&P Global Ratings affirmed its 'BB-' long-term and 'B' short-term sovereign credit ratings on Bangladesh. The outlook remains stable.

Outlook

The stable outlook reflects our expectation that Bangladesh's solid growth prospects and policy adjustments will manage the risks associated with a challenging external landscape over the next 12 months.

Downside scenario

We may lower the ratings on Bangladesh if net external debt or financing metrics worsen further, such that narrow net external debt surpasses 100% of current account receipts, or gross external financing needs exceed 100% of current account receipts plus usable reserves, on a sustained basis. Lower generation of current account receipts than we expect, higher overall current account deficit than we forecast, or a further material decline in foreign exchange reserves would be indications of further weakening.

Upside scenario

We may upgrade Bangladesh if the government materially improves its fiscal outcomes, including its very low revenue generation and elevated fiscal deficits, and experiences a substantial improvement in its external settings. We may also raise the ratings if we observe that Bangladesh's institutional settings have markedly improved.

Rationale

The ratings on Bangladesh reflect the country's modest per capita income and limited fiscal flexibility owing to a combination of diminished revenue-generation capacity and elevated interest burden. Evolving administrative and institutional settings represent additional rating constraints. We weigh these factors against consistently high economic growth and an external position that's supported by substantive engagement with bilateral and multilateral development partners, large remittances from overseas Bangladeshi workers, and a globally competitive garment sector. These factors should help to stabilize Bangladesh's broader external conditions over time, assuming a normalization in domestic demand and global inflation dynamics.

Institutional and economic profile: Sound growth prospects underpin durable economic recovery

- Bangladesh's economic recovery remains on a sound footing, and we project real GDP growth to average 7% per year over the next three years.
- The normalization of economic activity domestically and abroad is supporting strong momentum in Bangladesh's labor market and export industries.
- Bangladesh's highly concentrated political landscape may constrain the effectiveness of institutions and limits checks and balances on the government.

Bangladesh's economy accelerated in fiscal 2022 (year ended June 30), and underlying momentum remains sound. The normalization of the global economy continues to drive a strong pick-up in Bangladesh's garment sector, contributing to a 12.3% expansion in manufacturing activity in fiscal 2022. The sector's recovery has also underpinned a durable recovery in the condition of Bangladesh's labor market, supporting robust domestic demand conditions.

Pandemic-driven restrictions are no longer acting as a major drag on economic activity in Bangladesh, and this is likely to remain the case in the absence of a more dangerous variant of the coronavirus that evades natural and vaccine-derived protection or causes more severe symptoms. Nevertheless, new challenges have emerged, including exceptionally strong domestic demand conditions that are exerting pressure on Bangladesh's external settings.

Private consumption growth in fiscal 2023 is likely to cool after rising 13.2% in fiscal 2022 due to tightening financial conditions and faster inflation associated with global economic trends, including elevated commodity prices. Economic growth from an expenditure perspective is also likely to be more balanced going forward, following a year of exceptionally high import growth.

Modest per capita income, which we estimate at less than US$2,700 for fiscal 2023, remains one of Bangladesh's main rating constraints. This level of per capita income limits the fiscal and monetary flexibility needed to respond to exogenous shocks.

Bangladesh's 10-year weighted average real per capita GDP growth of about 5.6% helps to mitigate these weaknesses. The economy's structural growth rate is much stronger than sovereigns at a similar level of income, which is supportive of our credit ratings on Bangladesh.

The Bangladesh economy has proven its resilience through a variety of political and financial crises over the past two decades, and we expect its strong trend growth performance to remain largely intact. The country's garment industry remains highly competitive on a global basis, with low unit labor costs and ample supply of labor. Demographics continue to favor Bangladesh, and the government is working on strengthening access to key external markets ahead of its expected graduation from least developed country (LDC) status in 2026.

Bangladesh's highly concentrated domestic political conditions may undermine the predictability of future policy responses. The confrontational stance between the ruling Awami League and opposition Bangladesh Nationalist Party (BNP) reflects the deep division between the historically prominent political parties. Bangladesh's foreign direct investment has remained persistently low, given the country's evolving institutional settings, infrastructure deficiencies, high levels of perceived corruption, and uneven business environment.

The political landscape in Bangladesh remains polarized, with considerable power centered with the ruling Awami League. The opposition's representation in parliament remains extremely small, limiting checks and balances on the government.

Flexibility and performance profile: High commodity prices, surging domestic demand, and tighter monetary conditions exerting pressure on Bangladesh's external profile

- Challenging external conditions are exerting pressure on Bangladesh's current account and foreign exchange reserve positions.
- Bangladesh's net external debt position has weakened. A longer period of high commodity prices and extremely strong import demand could give rise to additional weakness in the Bangladeshi taka and a sustained drain on foreign exchange reserves, which would further undermine Bangladesh's external buffers.
- Despite its moderate net debt position, the Bangladesh government's interest burden is considerable. Its foreign currency-denominated debt, though predominantly borrowed from multilateral and bilateral sources, is subject to exchange rate risk.

Bangladesh's external profile has weakened following a marked rise in its current account deficit driven by surging domestic demand and higher commodity prices. These trends have driven net outflows of foreign exchange from the economy, resulting in declining reserves and depreciatory pressure against the taka. At the same time, inward worker remittances that have long acted as a crucial support to Bangladesh's external financial flows fell in fiscal 2022 because fewer workers repatriated their assets amid a normalization in global labor markets.

Vigorous domestic demand coupled with a fast recovery in the garment sector drove Bangladesh's goods import bill to more than US$82 billion in fiscal 2022, far higher than its previous record of around US$60 billion, and the key driver behind a surge in its current account deficit to around 4.2% of GDP, versus just 1.1% of GDP in fiscal 2021.

The trajectory of Bangladesh's current account dynamics will be critical to the stabilization of its broader external metrics. We foresee a gradual decline in the current account deficit from its level in fiscal 2022, with an average shortfall of 2.8% of GDP through fiscal 2025. This is driven by our expectations of a decline in energy commodity prices over that period, combined with cooling domestic demand driven by the weaker taka, and tighter monetary conditions.

Nevertheless, there are risks to this forecast, including the possibility that commodity prices remain higher for longer, or that nominal import growth more generally outperforms on resilient demand for intermediate and final consumer goods.

Bangladesh's weaker current account dynamics, falling foreign exchange reserves, and the recent depreciation of the taka have contributed to a much weaker net external debt position, which we estimate will average around 75% of current account receipts over the forecast period. Similarly, Bangladesh's gross external financing needs have risen from 78.4% in fiscal 2021 to around 93% in fiscal 2022.

Bangladesh's external profile draws substantial donor support, ensuring that the bulk of public external debt is low-cost borrowing with long maturities. Additionally, donors and multilateral lenders have in the past provided some degree of direct budgetary support, which may carry conditions for policy formulation.

Recent reports indicate that Bangladesh is in early stage negotiations with the IMF to establish a loan program under the Fund's Resilience and Sustainability Trust, which aims to resolve longer-term structural challenges including climate change and pandemic preparedness. While the quantum of the support under the program has not been determined, the agreement may also include various structural reform benchmarks that would be constructive for fiscal and external settings over the long run. The program could also help Bangladesh to coalesce broader multilateral and bilateral financial support.

We expect the Bangladesh government's fiscal deficit to gradually decline over the next few years, following a shortfall in fiscal 2022 that we estimated at 5.1% of GDP. However, we forecast Bangladesh's change in net general government debt to be higher, owing to continued depreciation in the Bangladesh taka, and the government's material exposure to foreign currency-denominated debt, which we project at more than 40% of its outstanding debt stock.

Despite higher pandemic spending and continued efforts to boost capital expenditure over recent years, many basic social and infrastructure needs in Bangladesh remain unmet, implying a higher potential expenditure burden in the future.

Bangladesh's higher fiscal deficits amid the pandemic, and a recent depreciation in the taka, have led to a material rise in net general government debt, which we estimate will average 32.4% of GDP through fiscal 2025, versus 23.6% in fiscal 2020.

The government continues to fund itself partially through the issuance of costly national savings certificates (NSCs), with interest rates well above the market rate. While we expect the government to eventually shift toward less costly borrowing over the long term, this transition is likely to take a while, because it will require the broader development of Bangladesh's debt capital markets.

The costly nature of NSC funding contributes to Bangladesh's elevated interest burden. We forecast the government's interest payments will account for greater than 20% of revenue through at least 2025.

The government will also rely more heavily on banks for local currency funding. Should the resident banking sector's claims on the government continue to rise as a share of its overall balance sheet, this could crowd out private-sector borrowing or limit the availability of additional funds available to the government, in our view.

Bangladesh's narrow revenue base constrains the government's flexibility to provide fiscal support to the economy during periods of stress, and to fund important social and capital expenditure requirements.

We estimate that general government revenue has risen as a proportion of GDP over the past two fiscal years, helped by a strong economic recovery and the introduction of new value-added tax rules in 2019. However, we estimate total revenue generation will still average less than 10% of GDP through fiscal 2025--among the lowest of rated sovereigns globally.

Some measures introduced during the pandemic will act as a continued drag on the government's fiscal accounts over the longer term. These measures include a hike to the taxable income threshold for individuals, and sequential reductions in the tax rates for both unlisted and listed companies. These steps have curtailed upside for the government's weak revenue generation framework.

The sovereign faces limited risk of contingent liabilities from the banking sector. The sector is relatively small with assets less than 100% of GDP. 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 private sector banks are in better shape, there are notable risks in the state-owned commercial banks (SOCBs). SOCBs account for less than 30% of total banking sector assets, and their nonperforming loans ratio is considerably higher than that of peer commercial banks.

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 crawl-like arrangement, though the trading mechanism was further liberalized in June 2022. Since then, the taka's nominal exchange rate has depreciated by about 10% against the U.S. dollar, marking a notable shift in foreign exchange dynamics for Bangladesh.

Following an extended period of appreciation in the currency's real effective exchange rate, more flexibility should help to restore competitiveness relative to key trading partners, and to cool very strong domestic demand for imports. At the same time, depreciation in the currency will add to domestic inflation pressures, and make external debt servicing costs more expensive.

Bangladesh's central bank has made progress in managing inflationary expectations. Since 2015, inflation has generally remained below 6% annually, though it has risen to around 7.5% as of July 2022, largely based on cost-push factors.

Key Statistics

Bangladesh - Selected Indicators

Economic indicators (%)	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Nominal GDP (bil. BND)	20,758	23,243	26,392	29,514	31,705	35,302	40,039	45,197	51,166	57,759
Nominal GDP (bil. US$)	265	289	316	349	374	415	447	449	467	513
GDP per capita (000s US$)	1.7	1.8	2.0	2.1	2.3	2.5	2.7	2.6	2.7	2.9
Real GDP growth	7.1	6.6	7.3	7.9	3.4	6.9	7.2	7.0	7.0	7.0
Real GDP per capita growth	5.9	5.4	6.2	6.8	2.4	5.7	6.0	5.8	5.8	5.8

Bangladesh - Selected Indicators (cont.)

Real investment growth	8.9	8.4	12.1	6.9	3.9	8.1	6.1	6.8	6.5	7.4
Investment/GDP	30.8	31.4	33.6	32.3	32.5	31.7	31.1	30.6	30.1	29.9
Savings/GDP	32.4	31.0	30.6	31.0	31.0	30.6	26.9	27.1	27.5	27.8
Exports/GDP	13.9	12.8	12.7	13.1	10.4	10.7	12.4	13.9	14.4	14.2
Real exports growth	2.2	(1.8)	6.1	11.5	(17.5)	9.2	16.0	8.0	7.0	5.5
Unemployment rate	4.2	4.2	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
External indicators (%)										
Current account balance/GDP	1.6	(0.5)	(3.0)	(1.3)	(1.5)	(1.1)	(4.2)	(3.5)	(2.6)	(2.1)
Current account balance/CARs	8.1	(2.6)	(17.0)	(7.0)	(9.4)	(6.5)	(23.0)	(17.7)	(12.6)	(10.3)
CARs/GDP	19.8	17.7	17.8	18.3	15.5	16.9	18.2	20.0	20.6	20.4
Trade balance/GDP	(2.4)	(3.3)	(5.7)	(4.5)	(5.0)	(5.7)	(7.4)	(7.1)	(6.3)	(5.8)
Net FDI/GDP	0.5	0.6	0.6	0.8	0.3	0.3	0.5	0.5	0.5	0.5
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	71.0	74.8	84.1	84.2	88.3	78.4	93.0	93.6	92.4	91.5
Narrow net external debt/CARs	15.4	16.7	35.3	49.8	40.1	48.6	61.3	70.8	76.3	78.1
Narrow net external debt/CAPs	16.7	16.3	30.2	46.5	36.6	45.6	49.8	60.1	67.8	70.8
Net external liabilities/CARs	38.8	44.0	60.8	73.9	68.1	72.9	85.9	95.6	101.9	104.1
Net external liabilities/CAPs	42.2	42.9	52.0	69.1	62.3	68.4	69.8	81.2	90.5	94.4
Short-term external debt by remaining maturity/CARs	16.4	19.5	16.9	19.4	28.9	20.2	22.8	19.5	19.6	18.4
Usable reserves/CAPs (months)	6.9	7.4	6.1	5.6	6.2	7.0	5.5	4.7	4.6	4.4
Usable reserves (mil. US$)	32,285	33,434	32,029	32,694	43,175	46,170	41,827	41,513	42,587	45,052
Fiscal indicators (general government; %)										
Balance/GDP	(3.1)	(3.8)	(4.8)	(4.7)	(4.8)	(3.7)	(5.1)	(4.9)	(4.7)	(4.5)
Change in net debt/GDP	2.6	2.4	3.0	3.7	3.3	3.9	6.1	6.1	5.1	4.8
Primary balance/GDP	(1.5)	(2.3)	(3.2)	(3.0)	(3.0)	(1.7)	(3.0)	(2.7)	(2.3)	(2.1)
Revenue/GDP	8.4	7.7	7.4	8.6	8.5	9.4	9.7	9.5	9.4	9.3
Expenditures/GDP	11.5	11.6	12.2	13.3	13.3	13.0	14.8	14.4	14.1	13.8
Interest/revenues	18.9	19.7	21.4	19.5	21.7	21.3	21.7	23.6	25.4	25.5

Bangladesh - Selected Indicators (cont.)

Debt/GDP	23.1	23.4	24.1	25.6	28.1	29.4	32.1	34.6	35.7	36.5
Debt/revenues	274.6	303.3	326.5	297.7	332.3	313.8	331.0	364.1	379.8	392.2
Net debt/GDP	19.3	19.6	20.3	21.8	23.6	25.1	28.2	31.1	32.6	33.7
Liquid assets/GDP	3.9	3.8	3.8	3.8	4.5	4.3	3.9	3.5	3.1	2.8
Monetary indicators (%)										
CPI growth	5.5	5.7	5.5	5.6	5.7	5.5	6.5	6.8	6.0	6.0
GDP deflator growth	6.7	5.0	5.8	3.7	3.8	4.1	5.8	5.5	5.8	5.5
Exchange rate, year-end (BND/US$)	78.70	82.70	83.90	84.90	84.80	85.80	93.45	108.00	111.00	114.00
Banks' claims on resident non-gov't sector growth	16.7	19.3	13.2	9.8	7.7	10.8	13.0	13.0	13.0	13.0
Banks' claims on resident non-gov't sector/GDP	38.9	41.4	41.3	40.5	40.6	40.5	40.3	40.3	40.3	40.3
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	5.7	2.4	(1.9)	5.9	6.7	(2.7)	N/A	N/A	N/A	N/A

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).
Adjustments: None.
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 claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending.
BND--Bangladeshi taka. N/A--Not applicable. 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

Bangladesh - 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.

Bangladesh - Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
		Weighted average real GDP per capita trend growth over a 10-year period is significantly higher than peers, and among the highest in the world.
External assessment	3	Based on narrow net external debt and gross external financing needs/(CAR + usable reserves) as per the Selected Indicators table above.
Fiscal assessment: flexibility and performance	6	Based on change in net general government (GG) debt / GDP (%) as per selected indicators in table 1.
		The sovereign has limited ability to raise GG revenue compared with sovereigns with a similar level of development due to large informal economy and limited revenue reforms.
		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.
Fiscal assessment: debt burden	5	Based on net GG debt (% of GDP) and GG interest paid / GG revenues (%) as per selected indicators in table 1.
		Foreign currency debt is over 40% of total debt.
Monetary assessment	4	Bangladesh's exchange rate regime is classified as a crawl-like arrangement.
		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."
Notches of supplemental adjustments and flexibility	0	None.
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

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

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.

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').