Bangladesh

Analyst: Martin Carlens. Tel: +46 8-763 96 05. E-mail: martin.carlens@seb.se

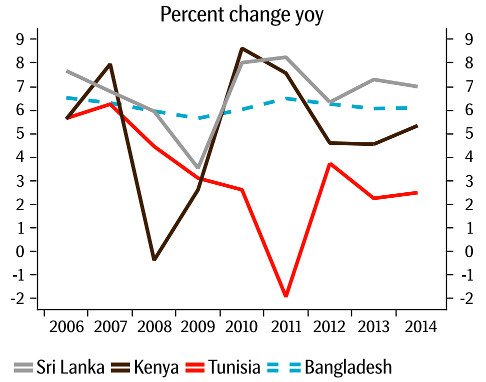
The political turbulence in the period before the parliamentary elections in January 2014 had only a moderate impact on economic growth, which remained steady above 6%. However, the events served as an important reminder that political risk in Bangladesh remains high. The government's three-year IMF programme is broadly on track, including the implementation of structural reforms. External balances remain relatively favourable. While the current account surplus has narrowed, reserves have risen significantly in the past year.

Country Risk Analysis

Stable, high economic growth. Real GDP expanded by an estimated 6.1% in the fiscal year (FY) 2014 ending in June, up from 6.0% in the previous year. This was slightly higher than most analysts had expected given the political uncertainty and social unrest in the run-up to the elections in January this year. The World Bank estimated that the political turmoil caused value-added losses to the economy in the last quarter of 2013 of about USD 1.4 bn. Despite supply chain disruptions during the unrest, garment exports remained strong, compensating for a decline in household consumption which was dampened by dismal sentiment and declining remittances. Private domestic demand did however remain the most important engine of growth making up more than 90% of GDP.

GDP

Percent change yoy



Source: Oxford Economics, Macrobond

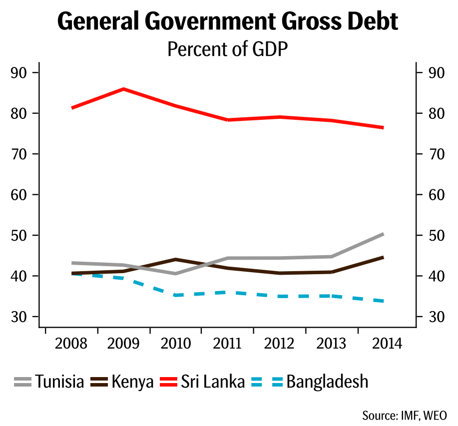
On the supply side, agriculture and services standing for about 18 and 54% of GDP respectively grew briskly. In sum, growth was broadly in line with the average growth rate of 6.2% in the past decade. This is high compared to peers in a similar risk class.

Inflation is also stable and high although falling below 7% in the summer on the back of lower food prices. In the past five years, inflation has averaged about 7.5%. The central bank which, among other objectives, strives to push inflation below 6.5% by mid-2015 has left interest rates unchanged in the past year while marginally tightening reserve requirements.

The economic base is narrow, weighing on country risk, with garment manufacturing accounting for 17% of GDP and about 80% of export revenue last year. In addition, 85% of these exports go to the US and the EU. This being said, the garment industry has gone through positive developments following the fire and building collapse accidents in 2012. Although minimum wages in garment factories were raised by close to 80% last year Bangladesh is still considered the most wage-competitive among major producers in Asia. For example, minimum wages are roughly one half of those in China. However, Bangladesh's advantage, and in some way its growth model, cannot be taken for granted. Continued work on improving the sector's reputation in general and working conditions in particular is necessary for it to maintain competitiveness also in the longer run.

The government's three-year IMF programme running on its last year is broadly on track, mitigating country risk. The Fund recently noted that progress has been made on various structural reforms, including improving working and safety conditions in the garment industry and gradually liberalizing the foreign exchange regulations. However, the introduction of a new VAT, a key reform aimed at strengthening the government's fiscal position has been delayed.

Expansionary fiscal policies. The government recently agreed with the IMF on a slightly higher budget deficit for the current fiscal year than originally outlined in the IMF programme. Rather than the 4.1% deficit previously agreed, the budget is now aiming for a 5% of GDP deficit. Lower than expected tax revenue growth appears to have been one of the main underlying reasons. Bangladesh has comparably high nominal tax rates but one of the lowest tax revenue to GDP ratios in the world. The past year's 9.6% compares to about 13% in Sri Lanka, 15% in India, 18% in China and 24% in Vietnam.

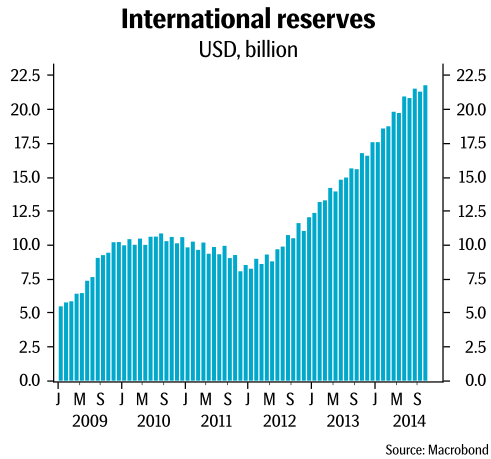


In the past year, domestic borrowing to finance the budget deficit shifted slightly away from bank financing towards other sources. While this generally implies higher interest rate costs, it is positive since the old habit of turning to the banking system and the central bank have been crowding out the private sector and squeezing bank liquidity. The government still finances itself relatively cheaply since nearly all of its external debt, which is roughly half of total debt, is on concessional terms. The average interest rate on external debt is less than 1% and average maturity is about 40 years, according to Fitch. Overall public debt to GDP in the past year remained on a very gradual downward trend and is expected to reach about 34% this year. The country's debt metrics, in particular the level of external debt, compares favourably with peers. Bangladesh has a default-free track record.

External balances remain relatively favourable. An emerging market economy normally runs deficits on the current account as it imports capital goods needed to expand the economy. Bangladesh on the contrary has had a stable surplus on the current account during the past 10 years. Imports are low, and a poor business climate and weak governance record has discouraged foreign direct investment (FDI), which has averaged 1% or less of GDP per year since 2000. This has led to a reliance on more volatile portfolio investments and debt inflows. Despite a lower trade deficit, the current account surplus is estimated to have narrowed to USD 0.7 bn (0.4% of GDP) in the past fiscal year mainly due to declining remittances, one of the main drivers of household spending.

However, following a weak start of the year, remittances rose during the early summer to record highs in July 2014 but have subsequently declined slightly. Bangladeshis working abroad normally return funds equivalent to around 10% of GDP each year. This is at a level comparable to countries such as the Philippines and Sri Lanka, and makes it the second largest source of foreign exchange after the garment industry.

Rising foreign reserves. Capital inflows put upward pressure on the nominal exchange rate prompting the central bank to intervene actively with foreign exchange purchases. This has kept the exchange rate stable to the USD in the past year and led to an accumulation of reserves. Foreign exchange reserves reached nearly USD 22 bn in October, sufficient to cover close to 6 months of imports. This implies a more rapid build-up than expected.



Vulnerable banking sector.
Bangladesh's banking sector is relatively large considering the country's level of development, with assets close to 80% of GDP. Hence, problems in the sector would risk spilling over to the sovereign. The main risks stem from the poor health of the state-owned banks where governance remains very weak. The central bank's discovery of large amounts of illegally provided loans in two of the banks is one concrete example. While the share of private banks is increasing state-owned banks still account for about 25% of the banking sector's assets. In December 2013 the government injected new capital in the state-owned banks equivalent to 0.4% of GDP, but asset quality remains poor. In the first quarter of the year, non-performing loans rose to more than 20% of total loans in these banks while the ratio is about 10% in the banking sector as a whole. The central bank's supervisory and regulatory capacity is weak.

Political risk remains high. Bangladesh politics is dominated by two main parties, the Awami League and the Bangladesh Nationalist Party (BNP), and the personal rivalry between its two leaders, Sheikh Hasina Wajed, the current prime minister, and Khaleda Zia. The political turbulence and protests in the period before the parliamentary elections in January 2014 had only a moderate impact on economic activity. However, the events served as an important reminder that political risk remains high. Following the January elections, the main opposition party BNP which boycotted the elections is divided and weak. The trial of its party leader, standing accused of corruption during her term as prime minister, risks deepening the political polarization which in turn raises the risk of violence and turbulence. Furthermore, the ongoing trials in the country's war crimes tribunal are increasingly becoming another source of political instability.

Bangladesh: Key Indicators*

Macroeconomic	2010	2011	2012	2013	2014	2015	2016	2017
GDP real (chg)	6.1%	6.7%	6.2%	6.0%	6.1%	6.1%	6.2%	6.0%
GDP (bn USD)	99.7	107.4	112.2	134.0	152.8	169.1	185.8	202.1
GDP/capita (USD)	660	702	724	855	963	1 054	1 145	1 232
Investments/GDP	22%	21%	20%	19%	17%	16%	15%	15%
Trade/GDP (%)	49%	55%	51%	47%	47%	47%	46%	46%
Money & Prices								
CPI inflation (%)	8.1%	10.7%	8.7%	6.8%	7.4%	7.0%	6.2%	5.3%
Interest rates	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Exch. Rate (US$)	69.6	74.2	81.9	78.1	77.5	79.1	81.1	83.2
Government Finances								
Budget balance/GDP	-3.2%	-3.0%	-3.0%	-2.8%	-3.0%	-2.7%	-2.1%	-1.8%
Govt debt/GDP	35%	36%	35%	35%	34%	33%	32%	32%
Balance of Payments (USD bn)								
Current account	1.2	0.4	3.2	2.4	0.7	0.3	0.3	0.1
(% of GDP)	1.2	0.4	2.9	1.8	0.4	0.2	0.2	0.1
Export of goods	21.1	25.6	25.4	28.6	32.2	35.5	38.9	42.5
Imports of goods	28.0	34.0	31.9	35.0	40.3	44.0	47.4	50.8
Other current acct flows	8.1	8.8	9.7	8.7	8.7	8.8	8.8	8.4
Net FDI	0.9	1.2	1.5	1.5	1.7	1.8	2.0	2.1
Loan repayments	--	--	--	--	--	--	--	--
Chg in intl reserves	4.7	2.1	1.9	6.7	9.8	7.4	3.7	4.2
External Debt & Liquidity (USD bn)								
Reserves	9.9	7.8	11.4	16.6	17.5	18.8	20.2	21.8
Gross external debt (% of GDP)	26	25	23	21	20	19	18	18
Gross External Debt	25.8	27.3	26.1	28.0	29.8	31.9	34.1	36.4
o/w short term debt	2.1	2.3	2.7	2.7	-	-	-	-
Oil price (Brent)	$80	$111	$112	$109	$100	$70	$81	$91

** Fiscal year (July 1 - June 30).*

Source: OEF (Oxford Economic Forecasting), IMF and SEB estimates.

Rating history				
Fitch (eoy)	n.a.	n.a.	n.a.	BB-
Moody's (eoy)	n.a.	n.a.	n.a.	Ba3
S&P (eoy)	n.a.	n.a.	n.a.	BB-
Type of government:	Parliamentary democracy			
Next elections	Parlimentary - By January 2019. Presidential - 2018			
Other:				
Latest PC deal	None			
Recent IMF programmes	Three-year Extended Credit Facility, approved April 2012			