Bangladesh

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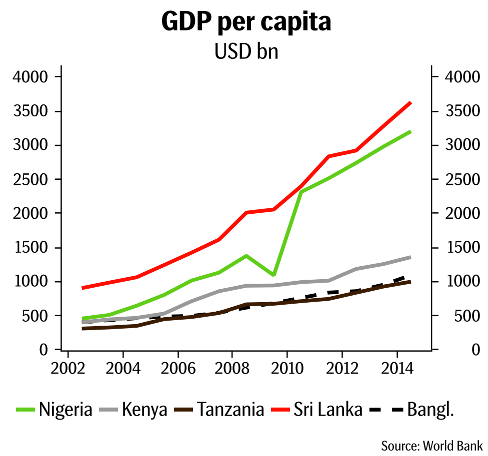
The economy once again has defied expectations, showing steady and high growth despite deep political unrest early this year. External balances remain favourable with the current account swinging into a manageable deficit and reserves rising steadily.

Country Risk Analysis

Growth stays high despite turbulence. The economy has grown at a slightly more brisk pace than we expected one year ago. The authorities' who had targeted 7% growth estimate that real GDP expanded by 6.5% in the fiscal year (FY) 2015 ending in June, an acceleration from 6.1% in the previous year. Should this be confirmed it would be yet another year of economic activity largely defying significant political unrest and turbulence. The crisis defying resilience of the economy has been met with some scepticism among observers such as the World Bank which recently expressed concerns over exaggerated headline growth numbers. This being said, average GDP growth of nearly 6.5% in the past five years is higher and more stable than average for economies in the same risk class.

Domestic spending lifted activity. Household spending, standing for about 80% of GDP, was very strong in the past year buoyed by higher remittances from abroad and low inflation. Solid public investment contributed to making domestic demand the main growth driver as exports faltered due to the global slowdown and supply disruptions. Meanwhile, political uncertainty appeared to be weighing on private investments which stood for a decreasing share of GDP. On the supply side, manufacturing and services, standing for 28 and 56% of GDP respectively, grew briskly.

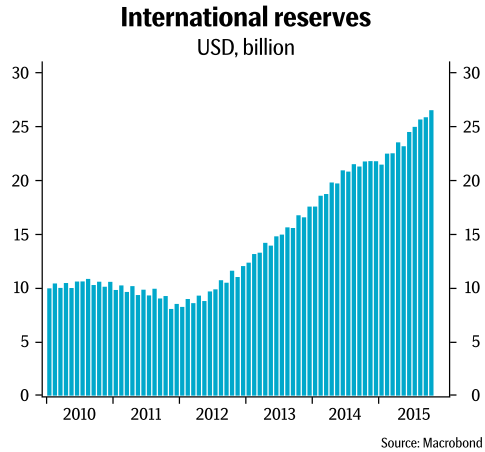


Inflation: Inflation declined to 6.4% in FY 2015 from over 7% mainly due to lower food prices. On the other hand there was no effect from declining oil prices as fuel prices are regulated. As a consequence, core inflation has risen. The authorities have not taken the opportunity, like several other oil importing/subsidizing governments, to remove fuel subsidies. Going hand in hand with high growth, average inflation of nearly 7.5% in the past five years is higher than most countries in the similar risk class.

External balances remain 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 current account in surplus or close to balance during the past 10 years. However, shrinking exports in the past year pushed the current account into a small deficit. This occurred despite an upswing in workers' remittances. Bangladeshis working abroad return funds that on average amount to nearly 10% of GDP in the past three years. This is comparable to countries such as the Philippines and Sri Lanka, and makes it the second largest source of foreign exchange after proceeds from the garment industry. A poor business climate and a weak governance record continue to discourage foreign direct investment, which has averaged 1% of GDP or less per year since 2000.

Low external debt. External debt is very low compared to peers. Government foreign debt is merely 15% of GDP, it is entirely due to official creditors, a significant share is on concessional terms and its average maturity is 36 years according to Standard&Poor's.

Rising foreign reserves. Capital inflows have 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 although the appreciation of the USD against most other currencies has yielded an appreciating trade weighted exchange rate. The inflows have led to a continued accumulation of foreign reserves which reached over USD 26 bn in October, sufficient to cover about 6 months of imports.



IMF programme concluded. The government's three-year IMF programme was concluded in October 2015. Although there were delays under the programme, a successful completion may be seen as a sign of policy continuity and of the authorities' capacity to implement important structural reforms. While intentions regarding a new programme are unclear at this time, we assume that cooperation with the Fund will remain close.

Structural reform agenda is extensive. A successful transformation of the economy's structures, with a declining importance of the agriculture sector in favour of higher value-added manufacturing and service sectors, has through the years lifted the growth potential of the economy. Most observers agree that there is room for further structural increases in economic growth. However, at this stage, it requires significant improvements in the business climate, in governance and in physical and social infrastructure. On the former, the country slipped one place to 174 out of 189 countries in the World Bank's most recent doing business indicator. However, on infrastructure, progress has reportedly been made on a number of large projects in the past year, including on motorways, an important bridge project and a metro in the Dhaka area.

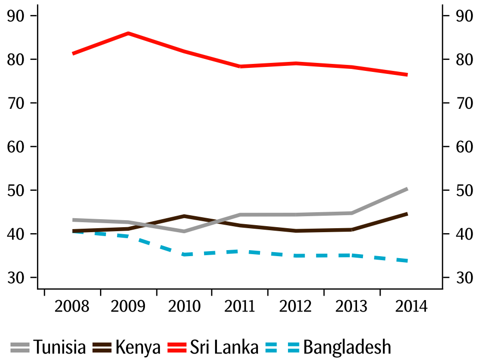
Fiscal policies struggle with low revenues. Bangladesh has comparably high nominal tax rates but one of the lowest tax revenue to GDP ratios in the world. While budget deficits, despite this, have been manageable, low revenues puts limits to growth critical expenditures as well as the government's room for manoeuvre in case of sudden shifts in the economic environment.

Ongoing efforts to improve this include getting more people to pay income tax and, more importantly introducing a new VAT. Implementation of the new VAT, which features for example a simpler rate structure, has repeatedly been delayed but is now scheduled to be implemented in July 2016. The budget for next year promises more of the same. Implementation remains the main challenge. Growth assumptions of 7% and revenue targets appear on the optimistic side.

Debt burden remains low. Overall public debt to GDP has declined significantly in past decade and following a small additional decrease in the past year debt is expected to reach about 34%. Although most debt metrics compare very favourably with peers, the interest rate burden remains a weakness. Interest rate costs are low compared to GDP but they compare very unfavourably to the country's minimal revenues. Bangladesh has a default-free track record.

General Government Gross Debt

Percent of GDP



Source: IMF, WEO

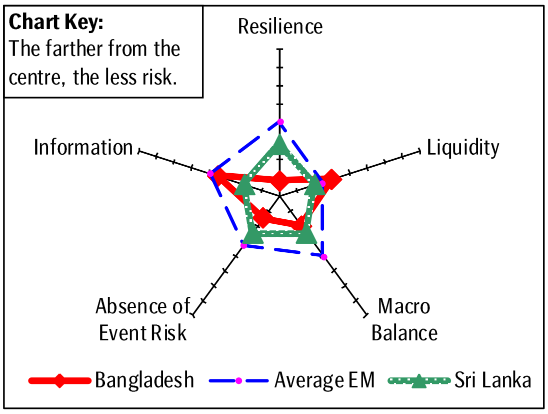
Health of banking sector is still poor. Bangladesh's banking sector is relatively large considering the country's level of development. Hence, financial problems in the sector would risk spilling over to the sovereign. The main risks stem from the poor health of the state-owned banks where governance remains very weak, despite small improvements in the past year. State-owned banks account for about 25% of the banking sector's assets, about the same as one year ago. On an aggregate level, the banking sector's capital adequacy and share of non-performing loans have changed very marginally since our last review. Profitability has declined. The central bank's supervisory and regulatory capacity is weak.

Political unrest remains most important risk. The dramatic political unrest seen early in 2015 served as an important reminder that political risk remains one of the most important constraints on Bangladesh's economic performance and on country risk. Politics are 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. Unfortunately, there seems to be no end in sight of this long-standing fierce rivalry.

Loss of competitiveness is medium-term risk. Another risk is the loss of export competitiveness. If the exchange rate remains stable or is allowed to appreciate against the USD against the backdrop of a continued strengthening of the USD vis a vis the EUR, Bangladesh real effective exchange rate would appreciate. This would risk eroding the country's cost competitiveness in the important European market.

Bangladesh: Risk Profile

Key ratios	2015
Population (mn)	159
GDP/capita (USD)	1357
Real GDP growth (%)	6.6
Inflation (%)	6.3
Current account balance (% of GDP)	-1.1
Reserves/imports (months)	5
Budget balance (% of GDP)	-3
Government debt (% of GDP)	34



External Ratings:
Fitch: BB- / Stable
Moody's: Ba3 / Stable
S&P: BB- / Stable

Peers:
Kenya
Nigeria
Serbia
Sri Lanka

Graph: Weak institutions and low GDP per capita hold back "resilience". "Event risk" is high due to the deep-rooted antagonism between the two main parties and their respective begum. A low external debt supports the liquidity score.

Bangladesh: Key Indicators*

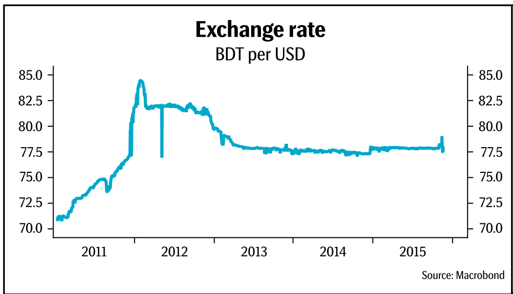
Macroeconomic	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
GDP real (chg)	6.5%	6.0%	6.1%	6.5%	6.6%	6.2%	5.9%	6.1%
GDP (bn USD)	142.3	146.5	173.0	194.9	218.5	240.4	259.9	281.2
GDP/capita (USD)	927	943	1 100	1 225	1 357	1 476	1 577	1 687
Investments/GDP	20%	18%	17%	17%	16%	15%	14%	13%
Trade/GDP (%)	30%	29%	27%	27%	25%	24%	24%	24%
Money & Prices								
CPI inflation (%)	10.7%	6.2%	7.5%	7.0%	6.3%	6.2%	5.5%	4.7%
Interest rates	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Exch. Rate (US$)	74.2	81.9	78.1	77.6	78.5	80.5	83.2	85.4
Government Finances								
Budget balance/GDP	-3.1%	-2.9%	-2.9%	-2.7%	-3.0%	-2.8%	-2.7%	-2.6%
Govt debt/GDP	35%	35%	35%	34%	34%	34%	34%	35%
Balance of Payments (USD bn)								
Current account	-0.2	2.6	2.1	-1.7	-2.5	-1.5	0.3	0.5
(% of GDP)	-0.1	1.8	1.2	-0.9	-1.1	-0.6	0.1	0.2
Export of goods	2.5	2.7	3.0	3.2	3.3	3.6	3.9	4.3
Imports of goods	39.8	39.2	43.6	50.2	51.3	55.3	59.5	63.9
Other current acct flows	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Net FDI	1.1	1.3	1.6	1.6	2.0	2.1	2.3	2.4
Chg in intl reserves	2.6	5.7	7.1	10.9	13.9	11.3	7.2	4.2
External Debt & Liquidity (USD bn)								
Reserves	7.8	11.4	16.6	20.8	21.7	22.7	23.8	25.0
Gross external debt (% of GDP)	19	18	16	15	15	14	14	14
Gross External Debt	27.3	26.2	27.8	29.8	31.9	34.1	36.4	38.9
o/w short term debt	3.7	1.7	1.5	1.5	1.5	1.5	1.5	1.5
Oil price (Brent)	$112	$109	$99	$54	$53	$59	$63	$68

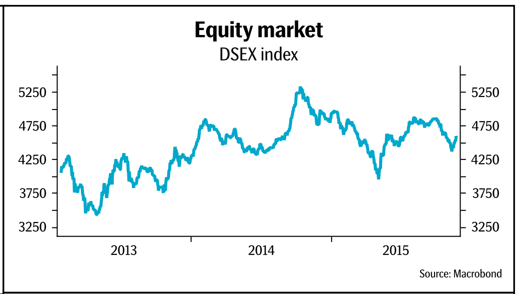
** Fiscal year (July 1 - June 30).*

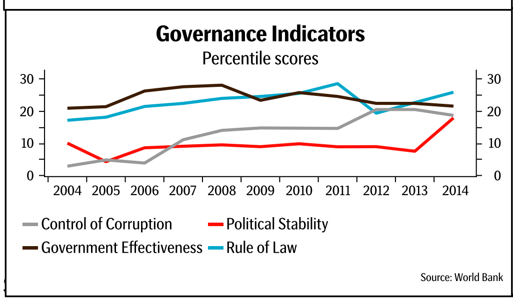
Source: OEF (Oxford Economic Forecasting), IMF and SEB estimates.

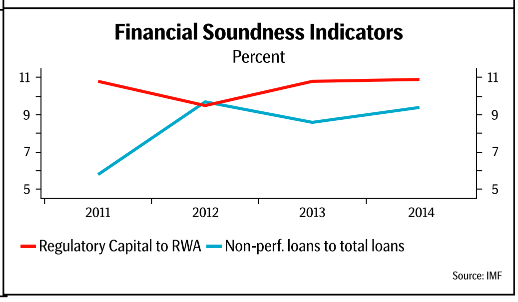
Rating history				
Fitch (eoy)	n.a.	n.a.	n.a.	BB-
Moody's (eoy)	n.a.	n.a.	n.a.	Ba3
S&P (eoy)	n.a.	n.a.	n.a.	BB-

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, expired October 2015









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