Euler Hermes Economic Research

Country Report

Bangladesh

Difficult business environment weighs on economic performance

General Information

GDP	USD115.61bn (World ranking 59, World Bank 2012)
Population	155 million (World ranking 8, World Bank 2012)
Form of state	Parliamentary Democracy
Head of government	Sheikh Hasina
Next elections	Presidential in 2018 and legislative in 2019

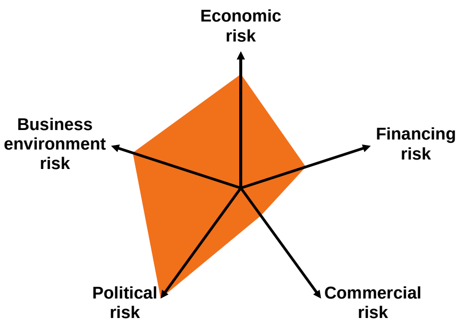
Strengths

- Adequate level of public debt
- Large workers' remittances inflows shifted the current account into surplus
- Low wage costs
- Low external debt stock
- Competitive in low-end manufacturing

Weaknesses

- Fragile political environment, illustrated by the violence during January 2014 elections
- Large trade deficit
- Weak business environment : infrastructure shortcomings, redtape
- Vulnerable to natural disaster
- Vulnerable export base (heavily dependent on garment industry)

Country Rating D3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	20%	1	19%	China
Germany	15%	2	15%	India
United Kingdom	10%	3	5%	Malaysia
France	6%	4	5%	Singapore
Spain	5%	5	5%	Korea, Republic of

By product (% of total)

Exports		Rank		Imports
Articles of apparel & clothing accessories	76%	1	16%	Textile yarn and related products
Textile yarn and related products	8%	2	9%	Petroleum and related products
Fish and processed fish	4%	3	7%	Vegetable oils and fats
Leather and dressed furskins	2%	4	5%	Cereals and cereal preparations
Textiles fibres and their wastes	1%	5	5%	Textiles fibres and their wastes

Source: UNCTAD (2012)

Despite high growth rates, Bangladesh remains one of the poorest country in Asia

Bangladesh economic development is dependent on rain-fed agricultural production (agriculture accounts for 17% of GDP but employs about half of the population) and the country is highly subject to natural disasters, principally severe flooding. The other main economic driver is the clothing and textile sector (almost 90% of exports) with large clothing industry principally oriented toward the US and the EU.

Economic growth averaged +6% during the past decade but with a population about 160 million, Bangladesh remains one of the poorest countries in Asia. However, the 2014 UNDP Human Development Report upgraded Bangladesh to Medium Human Development category with increased income of the bottom 40 percent of the population.

In FY14 (July 2013 to June 2014), GDP increased by +6.1% despite political tensions during January elections. Going forward, the economy is expected to pick up supported by rising public infrastructure investment and gradual improvement in global demand. Risks to the Central scenario include (i) recurrent political uncertainties which dampen domestic growth, (ii) further deterioration in state owned bank finances and (iii) strong vulnerability to external conditions (especially demand from Eurozone;, remittances from the Gulf countries).

The political situation and business environement remain problematic

Bangladesh political situation is fragile, illustrated by the violence during recent legislative elections held in January 2014. The main opposition party, the Bangladesh Nationalist Party (BNP), boycotted the January 2014 election after the current government (Awami League) did not accept to follow the tradition to hand over power to a non-partisan interim government during the election period. Large protests before and during the elections led businesses to close and hampered economic activity. Over 20 persons were killed. Despite lower protests, the political situation is still precarious as many political leaders from the opposition are being judged combined with allegations of disappearance. Active military and Islamic fundamentalist militants add to this volatile mix.

Bangladesh ranks 173 out of 189 economies in the Doing Business 2015 survey. It is almost the lowest in the world for getting electricity and enforcing contracts (ranked 188th for both sub-components).

Inflation is set to decelerate in 2015

Monetary policy remains very cautious to limit inflationary pressures and preserve macro-stability (keep sufficient reserves buffer and limit currency volatility) Restrained monetary policy (anchored on a moderate reserve money growth target) since late 2011 has curbed inflationary pressures. From +10.7% y/y in 2011, average inflation reached +7.5% y/y in 2013. It should further slow down to 7.0% y/y in 2014. The policy rate remains unchanged, at 5%.

Mismanagement fragilizes the banking system

The banking system is quite fragile with four large state-owned commercial banks owing 25% of banking system assets. Non-performing loans are high (approximately 12% of total loans) driven up by poor credit decisions, bank frauds, slower economic activity, and tightening of loan classification standards, mostly in the state-owned banks.

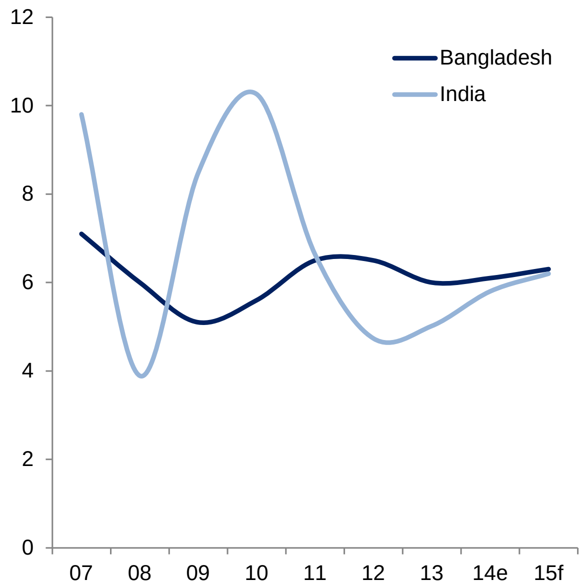
Key economic forecasts

	FY12	FY13	FY14	FY15f
GDP growth (% change)	6.5	6.0	6.1	6.3
Inflation (%, year average)	6.2	7.5	7.0	6.8
General gov. net lending (% of GDP)	-3.0	-3.4	-2.7	-3.3
Public debt (% of GDP)	35.1	35.2	33.9	32.9
Current account (% of GDP)	0.7	1.2	0.1	-0.7
External debt (% of GDP)	23.3	21.4	20.1	20.5

*Fiscal years run from July to June. For example, FY12 runs from July 2011 to June 2012

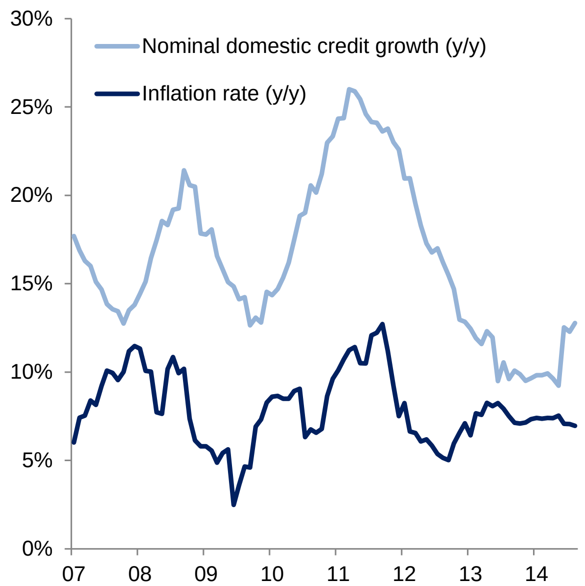
Sources: WB, IMF, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Inflation and nominal credit growth (y/y)



Sources: National sources, IHS, Euler Hermes

Despite low revenue collection, public finances are at reasonable levels

The fiscal deficit is relatively contained, at -2.7% of GDP in FY14. Based on FY15 governmental budget, it should however deepen to -3.3% of GDP in FY15. Revenue only accounts for approximately 11% of GDP and tax collection slowed down last year because of weak imports. The VAT law, introducing a 15% VAT rate, should help strengthen revenue collection. To contain fiscal deficit, expenditures are relatively constrained at approximately 14% of GDP (twice lower than India), not sufficient to effectively target the lack of infrastructure and poverty. The subsidy bill (food, fuel and fertilizers) has moderated but still represents more than 3% of GDP.

Public debt represents 34% of GDP and is on a decreasing trend. About half of the public debt is externally financed.

Remittances and foreign aid cushion the large trade deficit

The clothing industry represents about 80% of Bangladesh's exports, marketed largely in the EU and the US. To date, Bangladesh appears to be a net winner from the termination at the end of 2004 of the Multi-Fibre Arrangement (MFA). However, the industry may experience a backlash from factory safety issues and minimum wages increase. Following the April 2013 garment factory collapse that claimed the lives of over 1,000 people, the US has suspended the Generalized System of Preferences (GSP) agreement with Bangladesh. Since then, several initiatives to improve working conditions and factory standards have been implemented. The industry will face higher operating costs and delocalization to cheaper countries can lower prospects for Bangladesh.

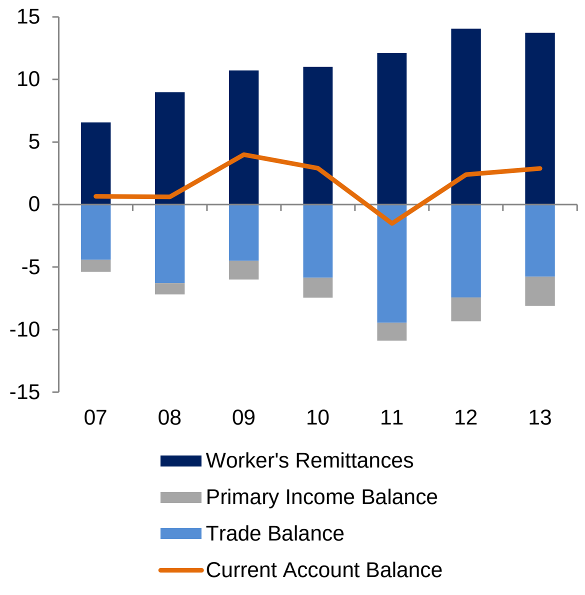
Bangladesh records large trade deficits, but thanks to rapidly increasing workers' remittances inflows (USD14.1 bn in FY14) the current account records surpluses (+0.1% of GDP in FY14). However, flows of workers' remittances are subject to business conditions in the Middle East, particularly the GCC, where Bangladeshi workers are employed in the construction and services sectors. Given poor global economic performances, EH expects the current account balance to narrow to -0.7% of GDP in FY15.

Relatively sound external position

External debt represents 20% of GDP in FY14 and should remain at a similar level in FY15.

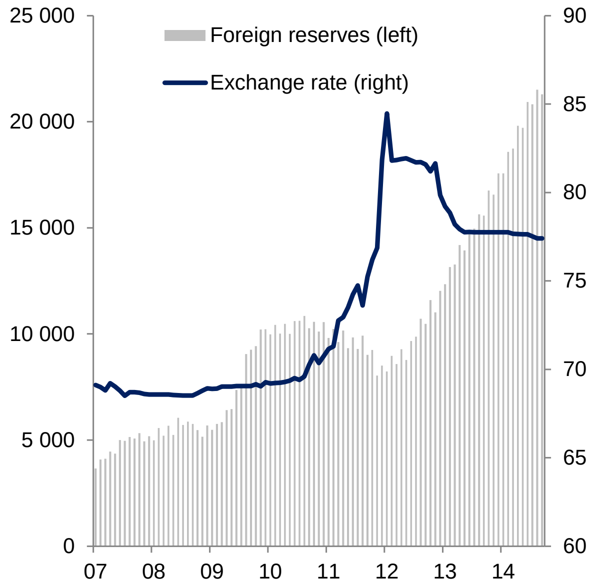
Under the managed floating system, Bangladesh Bank has intervened extensively to slow the appreciation of the Taka since the end of 2012. As a result of sterilization procedures, foreign reserves rapidly increased, standing at USD21 bn in September 2014. Reserves cover now approximately 6 months of imports.

Current account balance (USD billion)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves (USD millions) and exchange rate (Taka per USD)



Sources: National sources, IHS, Euler Hermes

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