BUDGET INSIGHTS 2016-17

BACKGROUND

The national budget for FY17 has been proposed in a stable macroeconomic context propped by healthy exports, moderate inflation, low interest rate and turnaround in private sector credit growth. While GDP growth and inflation figures in last fiscal year were within Government's target, budgeted expenditure and revenue were largely off-target as we had predicted.
Although the problems behind such subpar performance have been rightly identified by the Government, reform measures need time to be implemented. **With the fragile system still in its place, we believe achieving a 29% bigger budget and 37% higher revenue will be challenging.**

BUDGET SNAPSHORT

The national budget for FY17 estimates an aggregate expenditure of BDT 3,406 billion riding on a 37% higher revenue estimate of BDT 2,428 billion. The fiscal deficit is estimated to be BDT 979 billion (5% of GDP), 37% of which is expected to be financed from external sources and 63% of which is expected to be financed from domestic sources.

BDT Billion	FY16B[1]	FY16R[2]	Off-target[3]	FY17B[1]	Change[4]
Expenditure	2,951.0	2,645.7	11.5%	3,406.1	28.7%
Revenue	2,084.4	1,774.0	17.5%	2,427.5	36.8%
Deficit	-866.6	-871.7	-0.6%	-978.5	12.3%
Financing					
External	301.3	249.9	20.6%	363.1	45.3%
Domestic	565.2	621.8	-9.1%	615.5	-1.0%
From Bank	385.2	316.8	21.6%	389.4	22.9%

1.B=Budget, 2.R=Revised; 3.Percentage of revision in FY16 Budget, 4.Change in FY17B over FY16R *Source: Ministry of Finance*

In the proposed budget for FY 2016-17, Revenue Collection target and deficit financing target from external sources remain significantly high considering the substantial cut in both the items in revised budget for FY 2015-16. Government aims to raise Expenditure to GDP ratio to 17.4% in the forthcoming fiscal from 15.3% in revised budget, while the peak achievement figure that it could reach in last 5 years was 14.5%. The Revenue to GDP ratio has been declining since FY12, suggesting poor tax coverage. The Government aims to improve the Tax-to-GDP ratio in the coming fiscal to 12.4% from the earlier ratio of 10.3%. In terms of deficit financing the Government still remains heavily dependent on domestic source (National Savings Certificate) and this dependence is expected to increase further as the government cannot utilize foreign funds in optimal manner.

As % of GDP	FY15A*	FY16B**	FY16R***	FY17B**
Expenditure	13.5%	17.2%	15.3%	17.4%
Revenue	9.6%	12.1%	10.3%	12.4%
Deficit	3.9%	5.0%	5.0%	5.0%
Financing				
External	0.5%	1.8%	1.4%	1.9%
Domestic	3.4%	3.3%	3.6%	3.1%
From Bank	0.0%	2.2%	1.8%	2.0%

**A=Actual, **B=Budget, ***R=Revised*
Source: Ministry of Finance

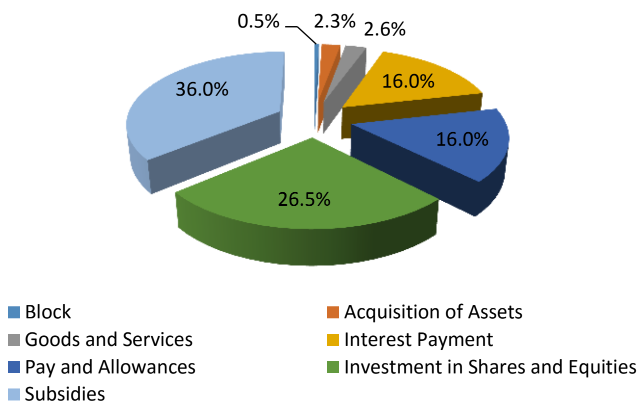
GOVERNMENT EXPENDITURE

- Out of the estimated expenditure of BDT 3,406 billion, 55.5% has been allocated for non-development expenditure and 34.4% has been allocated for development expenditure.

Non-Development Expenditure

- The government has proposed to allocate BDT 2,161 billion for non-development expenditure in FY17, 31.5% higher than that of revised budget for FY16.
- Of the incremental allocation of BDT 518 billion, Subsidies, Investment in shares and equities and interest payment received the highest share.

Sectoral Allocation of Incremental Fund



Allocation for Investment in shares and equities has increased significantly this year. Government has allocated BDT 20 billion for recapitalization of State Owned Banks against BDT 18 billion in last year's revised budget while it has allocated BDT 18 billion for equity investments against BDT 4 billion in last year's revised budget.

ANNUAL DEVELOPMENT EXPENDITURE

- Annual Development Program for FY17 has been proposed to be set at BDT 1,107 billion, 21.6% higher than the BDT 910 billion ADP in the revised budget of FY16.
- In the proposed ADP, Human Resource and Transport & communication has received the highest increase in allocation by 39% and 50% respectively while allocation for power and energy received a 10% cut.
- The four carryover projects of the last fiscal year are scheduled to be completed by FY17. These projects are- Joydebpur-Mymensingh Road Development Project, Shahjalal Fertilizer Project, Tannery Industrial Estate and Construction of 520m long Bridge in Nagarpur-Mirzapur via Mokna.

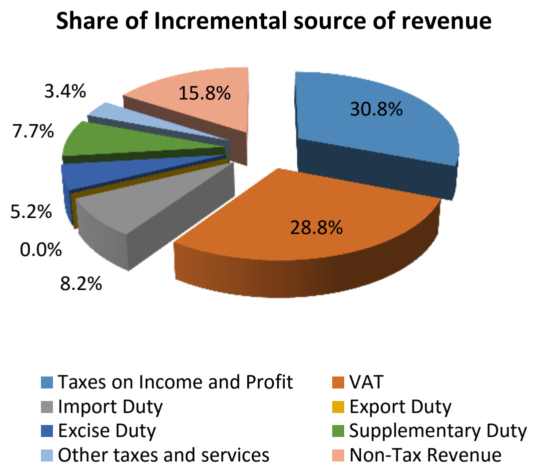
ADP Allocation (%)	FY17B	FY16R	FY16B	FY15A	FY14A
Human Resource	24.6	21.5	22.0	26.8	24.9
Agriculture	24.5	26.6	25.3	32.3	29.1
Power and Energy	13.5	18.2	19.1	9.7	17.9
Transport	25.8	21.0	22.3	22.0	18.8
Others	11.7	12.8	11.4	9.1	9.3

**A=Actual, **B=Budget, ***R=Revised*
Source: Ministry of Finance

Speed, efficiency and quality of ADP projects continue to be unsatisfactory despite several promises from the government. Against the backdrop, 22% higher allocation in ADP in FY17 remains an unrealistic target considering the government could implement a meager 32% of revised ADP target for FY16 up to March'16.

GOVERNMENT REVENUE

- The proposed budget for FY17 estimates a revenue collection of BDT 2,428 billion, up 37% from that of the revised budget revenue in FY16.
- Three biggest source of incremental revenue are Taxes on Income and Profit, VAT and Supplementary duty.



- Tax Day- A fixed deadline for return filing has been proposed to be set on 30 October each year for individual taxpayers.

The government had to revise down its last year's revenue collection target by 18%. In first 9 months of last fiscal, the government could realize only 67% of that revised target. Expecting a 37% rise in FY17 over the already unachievable revised target remains highly unrealistic.

We welcome the fact that Government has put more focus on ensuring compliance of existing tax laws by proposing some reforms. We believe this focus on reforms instead of hiking tax rates will be more conducive towards tax collection scenario in future years. However, the pressure on regular salaried individuals in formal sector is gradually increasing and failure to rationalize tax for other tax payers will put the general people under undue stress. Unless the government widens its tax net to include the potentially large taxpayers from informal sectors of the economy, tendency to evade tax in the formal sector might rise in the future.

DEFICIT FINANCING

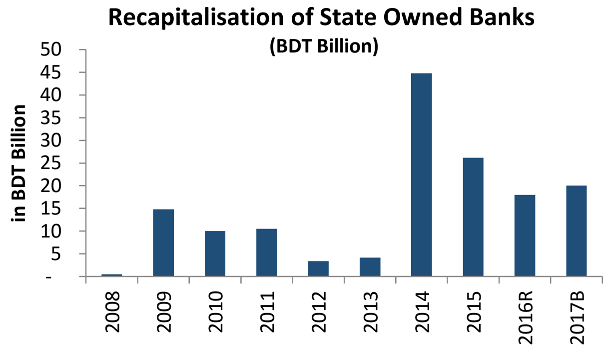
- The expected budget deficit is BDT 979 billion, 37% of which is expected to be financed from external sources and the rest is expected to be financed from domestic sources (63% of domestic financing will be sourced from banking sector).
- The government expects to reduce its dependence on savings certificate in FY17 by 30%. However, in revised budget for FY16, the financing from savings certificate increased 87% despite its high cost.
- Digitalization of project monitoring system is at the final stage with a view to ensuring timely implementation as well as quality in project spending. On implementation, it will ensure close monitoring of project activities and instant retrieval of updated data on ongoing projects which in turn will enable ECNEC members to observe the latest project status at the end of a week and give directives accordingly

It is highly important that the government improves its spending quality and enhances the transparency in government projects. It needs to source low cost capital from foreign sources rather than increasing its dependence on high cost savings certificate. The proposed digital monitoring system is a much appreciated step towards achieving transparency in government projects.

CAPITAL MARKET AND SECTORAL ANALYSIS

BANK

- Government has allocated BDT 20 billion for recapitalization of state owned banks against BDT 18 billion in the revised budget for FY16.



- A council to bring financial reporting system of public interest bodies including banks and financial institutions under a regulatory framework and to develop standards for accounting and auditing professions has been proposed to be formed within FY17.

Between 2008 and 2015, the government has been consistently injecting funds into the ailing state owned banks. Despite that the NPL scenario remained the same over the years: NPL in state owned banks in Q415 was 21.5% against 25.4% in Q408. We believe strong reform measures such as: privatization of State Owned Banks and overhaul of incompetent management need to be taken to address the high amount of non-performing assets in the banking sector.

While we appreciate the steps taken to develop regulatory framework, we believe stronger dose of reforms will be necessary to iron out the inefficiencies in the sector.

PHARMACEUTICALS

- The government has proposed to take steps against pharmaceutical companies that are exploiting the government benefits to encourage local production of medicines and to control the prices of medicines.
- Equipment used to set up pharmaceutical industry such as Laboratory Refrigerator, Laboratory Stability/Humidity Chamber will be treated as capital goods (Supplementary duty will be reduced from 30% to 0% and Customs Duty will be reduced from 25% to 1%).

*Major listed pharmaceuticals such as **SQURPHARMA, RENATA, BXPHARMA, ACI, and ACMELAB** will benefit from the duty benefit. Price control mechanism, if implemented, will ensure fair competition in the market.*

TELECOM

- Tax on gross receipts for telecom operators has been proposed to be increased from 0.30% to 0.75%.
- Rate of Supplementary Duty on SIM Card related services has been proposed to be increased from 3% to 5%.

Subsequent imposition of taxes on Telecom Operators will be passed on to the consumers in most likely case, hurting both the consumers and telecom operators.

INDUSTRIAL

- Supplementary duty (SD) on the imported bars and rods, hot rolled iron or non-alloy steel has been proposed to be 45%. SD on imported angle, shapes and sections of iron or non-alloy steel has been proposed to be 20%.
- Customs Duty (CD) on bars and rods, hot rolled, irregularly wound coils, angles, shapes and sections of iron and non-alloy steel has been proposed to be 5% from the existing 10% - 25%.
- Custom duty (CD) and tax on parts of compressor, HR steel sheet and motor protector has been proposed to be 5% from the existing 10% - 25%. CD on household washing machine has been proposed to be 25% from 1%.
- Concession of duty and taxes has been proposed on pre-fabricated building materials (hot and flat rolled iron and non-alloy steel, I-sections, H-sections, etc.).

*Local steel manufacturing companies such as: **BSRMSTEEL, RSRMSTEEL** and **GPHISPAT** will be benefited from the increased SD on imported rods and bars as the imported iron products will be more expensive. In addition to this, reduction in the customs duty will minimize the cost of locally manufactured iron products. **SINGERBD** will be benefitted from the curtailed CD on the production cost of refrigerator and air conditioner and will be hurt by the higher CD on manufacturing cost of washing machine. Concession of duty and taxes on pre-fabricated building materials will benefit **BBS.***

TEXTILE

- The government has proposed to reduce the corporate tax for RMG companies to 20% from 35%.
- Proposed Budget includes a hike in tax at source on all exports from 0.6% to 1.5% for RMG products.
- VAT exemption of fabrics woven by power loom has been proposed to be withdrawn.
- Duty on stripping chemical is proposed to be reduced to 15% from the existing 25% and duty on flax fiber and spandex/elastrametrics has been proposed to be reduced to 5% from existing 10%.
- The government has proposed to withdraw VAT from dyeing, printing, finishing and calendaring of grey fabrics.
- Customs Duty applicable to the chemicals and other raw materials importable by the textile sector has been proposed to be increased from 3% to 5%.
- Customs duty on cutting table has been proposed to be reduced from 25% to 10%.

Uniform tax rate of 20% for all RMG exporters will enhance the profit margin of the companies offsetting the revenue loss from strong exchange rate. The listed textile companies will be benefitted from the reduced CD on stripping chemical and cutting table and VAT exemption of dyeing of grey fabrics.

However, increased tax at source, higher CD on chemicals and other basic raw materials and withdrawal of VAT exemption from fabric woven by power loom will hurt the RMG and textile companies.

FOOD & ALLIED

- VAT exemption from hand-made loaf, bun, similar kinds of bread and cake and biscuit valuing up to Tk. 100 per kg has been proposed to be withdrawn.
- Government has proposed to double the VAT for small traders, wholesalers and retailers maintaining four different slabs depending on turnover and location.
- VAT exemption from Palm oil and Soybean oil has been proposed to be extended up to 30 June, 2017.
- Tax rate on manufacturers of Bidi, zarda, chewing tobacco, gul or any other smokeless tobacco has been proposed to be increased from 25%- 35% to 45%.
- Supplementary Duty on smokeless tobacco products has been proposed to be increased from 60% to 100%.
- The proposed budget mentioned increasing the supplementary duty of lowest slab of cigarette to 50% from the existing 48% and the price from BDT 18 to BDT 23.
- There was no price increase for the medium and high segment cigarettes at BDT 45 and above. But the supplementary duty rate of these two segments has been proposed to be increased from existing 61% and 63% to 62% and 64% respectively.
- The SD on bidi has been proposed to increase from the existing rate of 25% and 30% to 30% and 35% respectively while increasing the price of 25 sticks and 20 sticks of filter bidi will stand at BDT 10.61 and BDT 12.03 from the existing BDT 7.06 and BDT 7.98 respectively.

*Withdrawal of VAT exemption from handmade bakery products will increase the price of non-branded bakery goods and will benefit branded biscuit manufacturers like **OLYMPIC**.*

The package VAT for small traders has been doubled. As sales of companies such as- ***OLYMPIC, BATBC, GHAIL, AMCL (PRAN)*** *are retail-channel driven, this new VAT burden may increase the commission expenses of these companies to compensate the retailers for increased tax expense in the short term.*

EMERALDOIL, *the manufacturer of rice bran oil will continue to face competition from palm oil and Soybean oil manufacturers because of the extended VAT facility provided to them.*

The SD on non-cigarette tobacco products such as- bidi, zarda, chewing gum has been significantly increased along with the price and SD of lowest slab of cigarettes. The medium and high slab tobacco products will face a comparatively low increase in SD and no increase in prices. This proposed taxation on tobacco industry will help ***BATBC*** *by reducing the down-trading and brand switching incidence from their products. Also this will reduce the market share of non-tobacco manufacturing companies benefitting BATBC as historical incidences have shown that such taxation makes consumers up-trade and shift to cigarettes.*

ICT

- Government plans to establish Base Transmission Stations (BTS) in all metropolitan cities, districts and upazilas and install 300 km long optical fiber lines and transmission equipments throughout the country for interconnecting the BTSs.
- Customs duty on server rack, which is required for expansion of ICT industry, will be halved to 5%.
- Duty on LAN card and access-point for Wi-Fi and WiMAX services will also be reduced to 15% from 25%.

Aligning with the Digital Bangladesh vision, proposed budget has taken multiple initiatives in infrastructure development, duty reductions and long term projects for overall ICT adoption and capability enhancement of Bangladesh. ***AAMRATECH, AAMRANETWORK (upcoming in December 2016), AGNISYSL*** *will be in a favorable position if the projects and initiatives are implemented.*

CEMENT

- The customs duty on imported fly ash (which is a raw material for cement manufacturing) has been proposed to be set at 5% from existing 10%.
- The net VAT rate of Construction services has been proposed to increase from existing 5.5% to 6.0%.

Lower duty on fly ash will marginally lower the cost of production for cement manufacturers who use fly ash in the production process.

POWER

- Government has set a target of generating 24,000MW electricity by 2021 to meet the increasing demand for power.
- Keeping the national energy target in perspective, the government proposed to lower concessionary duty of the cost of LPG cylinders from 25.0% to 10.0%.
- The net VAT rate of Transportation of petroleum products and other transport services has been increased from existing 2.25% and 7.5% to 4.5% and 10%.

MJLBD is expected to benefit from Lowering of concessionary duty on LPG cylinders. Increased VAT rate on transportation of petroleum products may marginally hurt the revenue income for petroleum distribution companies such as ***MPETROLEUM, JAMUNAOIL and PADMAOIL***. ***POWERGRID*** *and* ***DESCO*** *are expected to generate higher revenue as electricity generation increases gradually. Market potential for major power generation companies such as:* ***UPGDCL*** *and* ***KPCL*** *might increase considering increasing involvement of private sector in such projects.*