BUDGET SNAPSHOT

BDT Billion	FY20B	FY19R	FY19B	Revision
Expenditure	5,231.9	4425.4	4,645.7	-4.7%
Revenue	3,778.1	3,166.1	3,392.8	-6.7%
Deficit	1453.8	1,259.3	1,252.9	0.5%
Financing				
External	680.2	471.8	540.7	-12.7%
Domestic	773.6	787.5	712.3	10.6%
From Bank	473.6	309.0	420.3	-26.5%

As % of GDP	FY20B	FY19RB	FY19B	FY18A
Expenditure	18.1%	17.4%	18.3%	14.3%
ADP	7.0%	6.6%	6.8%	5.3%
Revenue	13.1%	12.5%	13.4%	9.6%
Tax	11.8%	11.4%	12.1%	8.6%
Deficit Financing	5.0%	5.0%	4.9%	4.7%
External	2.4%	1.9%	2.1%	1.2%
Domestic	2.7%	3.1%	2.8%	3.5%
Bank	1.6%	1.2%	1.7%	0.5%

Source: Ministry of Finance & LR Global Research

The national budget for Fiscal Year (FY) 2019-20 estimates an aggregate expenditure of BDT 5,231.9 billion riding on a 19.3% higher revenue estimate of BDT 3778.1 billion. The fiscal deficit is estimated to be BDT 1,453.8 billion (5% of GDP). 47% of this deficit is expected to be financed from external sources and the remaining 53% from domestic sources. In the budget for FY 2019-20, the Government proposed to raise expenditure-to-GDP ratio to 18.1% from a revised 17.4% in the outgoing fiscal.

The targets for revenue collection and deficit financing from external sources are also set higher although **there was significant downward revision of both these items in the revised budget of 2018-19. Moreover, the Revenue-to-GDP ratio is set overwhelmingly optimistic (13.1%) whereas the Government was able to collect only 58.8% of the revised target in the first nine months of FY2018-19.** In terms of deficit financing, the government is still relying significantly on domestic sources (53.2%). The already-stressed banking sector is projected to provide 32.6% of the domestic financing and emerge as the major domestic source for FY2019-20. National Savings Certificate, which is expected to provide 18.6% of the domestic finance during FY2019-20, was most heavily tapped into during the outgoing fiscal.

MACROECONOMIC TARGETS & IMPLICATIONS

Indicators	FY20B	FY19P	FY19B
GDP Growth Rate	8.20%	8.13%	7.80%
Average Inflation Rate	5.50%	5.40%	5.60%
Investment to GDP Ratio	32.80%	31.60%	33.54%
Public Investment to GDP Ratio	8.60%	8.20%	8.39%
Private investment to GDP Ratio	24.20%	23.40%	25.15%
Tax to GDP Ratio	11.80%	11.40%	12.10%

Source: Ministry of Finance

There are some contradictions among the macro-economic targets set by the Government. Although average inflation rate is targeted to be 5.5%, the new VAT and Tax Laws, if implemented, will pass the increased cost through the consumers and create an upward pressure on price level. This will likely raise inflation above the target rate. There is also a **mismatch between monetary policy and fiscal policy**. While the monetary policy indicates that private sector credit will grow, the fiscal policy suggests an increased dependency on domestic financing of deficit. This will eventually crowd out private sector credit growth and thereby, private investment. Hence, we are very skeptical about the growth of private credit and investment.

GOVERNMENT EXPENDITURE

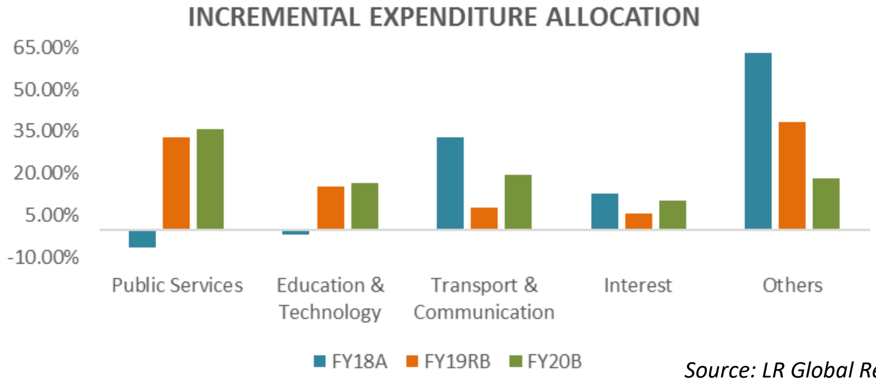
Use of Fund (% of Total)	FY20B	FY19RB	FY18A
Public Services	18.4%	15.3%	8.7%
Local Government	7.2%	7.8%	6.7%
Defense Services	6.1%	6.9%	6.6%
Public Order & Safety	5.3%	6.3%	6.9%
Education & Technology	15.2%	15.0%	14.8%
Health	4.9%	5.0%	5.2%
Social Security & Welfare	5.6%	6.0%	5.6%

Use of Fund (% of Total)	FY20B	FY19RB	FY18A
Energy & Power	5.4%	6.0%	8.9%
Agriculture	5.4%	5.7%	5.9%
Industrial & Economic Services	0.7%	0.8%	0.8%
Transport & Communication	12.4%	11.1%	12.5%
Interest	10.9%	11.0%	13.0%
Memorandum Item	0.2%	0.5%	2.6%
Others	2.1%	2.4%	2.0%

Source: Ministry of Finance & LR Global Research

Interestingly, the emergence of education & technology as the highest allocated sector is due to the **inclusion of Rooppur Nuclear power plant and some other unrelated projects in the education and technology sector.** The allocation for FY20B and FY19RB becomes 11.7% & 12.1% against 15.2% & 15.0% respectively if we exclude these big budget projects. Although the allocation for the education sector seems to have increased, in reality, the relative allocation has decreased in FY20B from FY19RB.

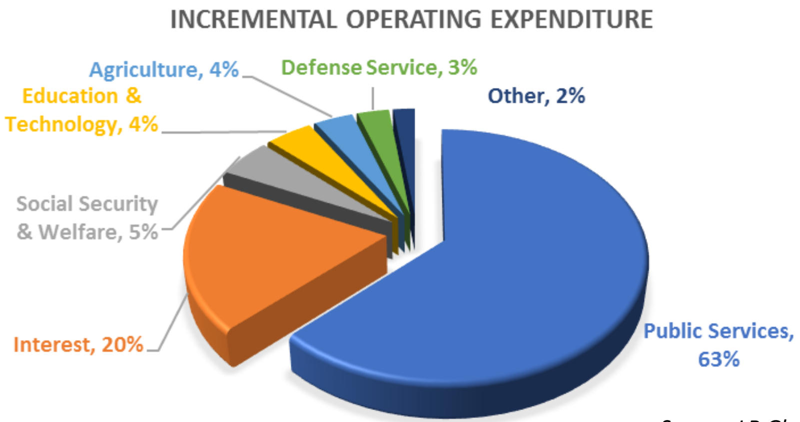
In FY20, 82% of the incremental expenditure of BDT 806.5 billion has been allocated to public services, education & technology, transport & communication and interest payment. Over the time, Government has gradually shifted its incremental allocation to public services sector from other sectors.



Source: LR Global Research

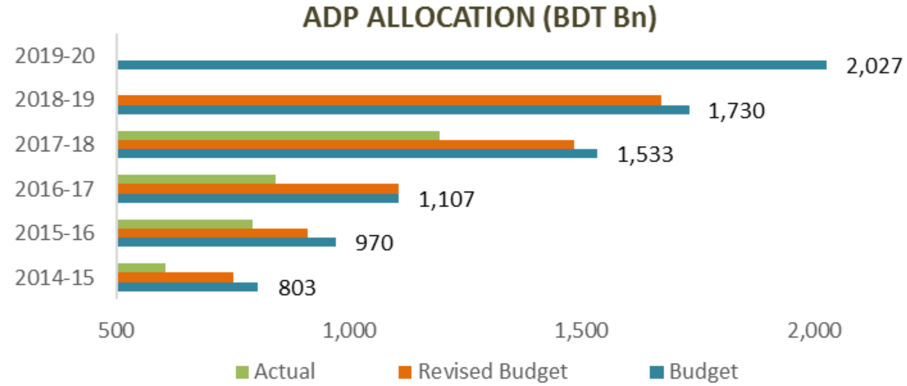
OPERATING EXPENDITURE

The composition for non-developmental expenditure remained similar to the previous year's proportions in most cases. Public Services and interest payment are the two segments with the highest expenditure and constitute a whopping 83% of the increment in non-development expenditure. Public Services sector alone accounts for 63% of the BDT 42,451 crore increment expenditure while interest payment accounts for another 20%. On the other hand, expenditure on Public Order & Safety, Housing, Industrial & Economic Services, and Memorandum Item is estimated to decrease from the previous FY. The proportions of expenditure attributed to Health and Education & Technology continue on their recent declining trend.



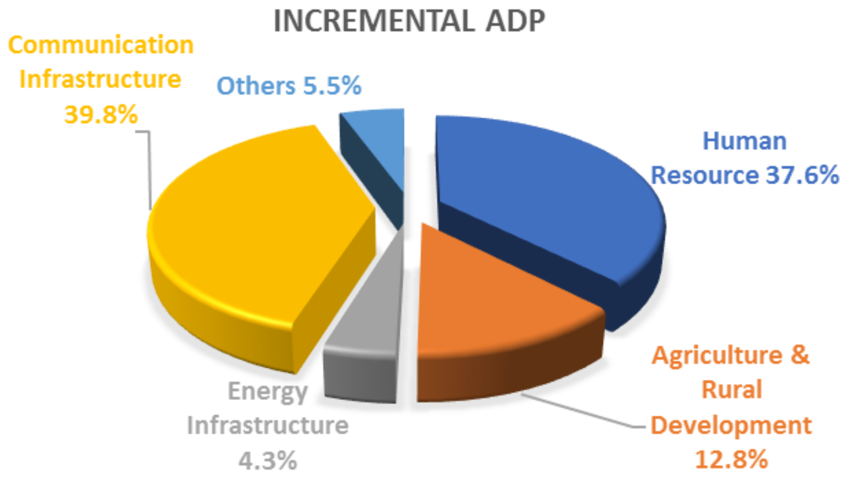
Source: LR Global Research

DEVELOPMENT EXPENDITURE



Source: LR Global Research

The size of the ADP expenditure revealed that ADP allocation almost doubled in the last three years whereas it rose by 38% from FY15 to FY17. Government had allocated a smaller amount when there was no current account deficit, liquidity crisis, or political instability in the country. Paradoxically, the allocation has grown larger during a time a when the economy is facing liquidity crisis, current account deficit, and thereby, increasing pressure on the currency.



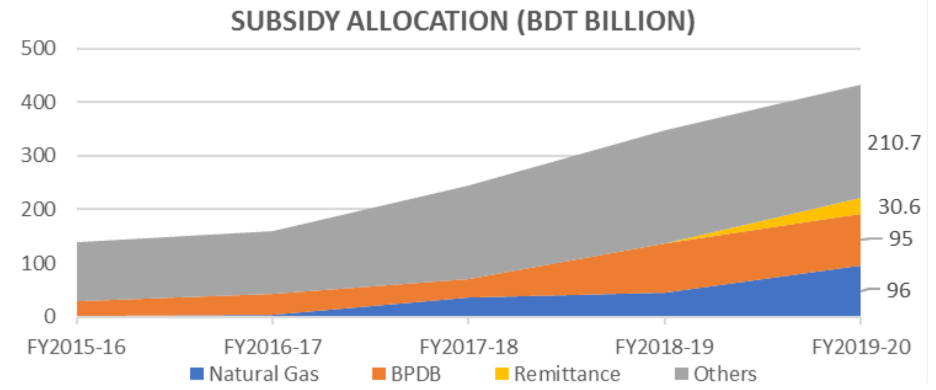
Source: LR Global Research

Government has implemented 78% of the budgeted ADP expenditure from FY15 to FY18 on an average. The implementation rate of the revised annual development program was recorded at 67.97% in the first 11 months of the outgoing FY 2018-19. Despite failing to accomplish the ADP target every year, the Government has set an even higher target for FY2019-20. In our opinion, the ADP expenditure target is not realistic.

SUBSIDY EXPENDITURE

Government allocated total BDT 432.3 billion for subsidy expenditure which is almost 8.3% of the total budget. Allocation for subsidy increased by 24.5% from the revised budget of FY19. Over the years, the composition of subsidy allocation has shifted from Agriculture & Food to Gas & Power Development sector. Since FY2015-16, the Government has not allocated any subsidy for oil amid lower global price.

Furthermore, the subsidy allocation for agriculture has remained stable around BDT 90 billion for the last three years. However, in last three years allocated subsidy in agriculture sector remained underutilized due to low fertilizer prices in the global market.



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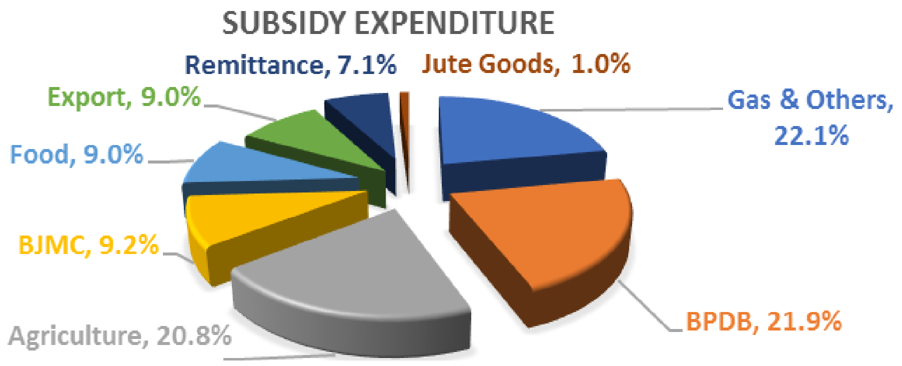


Source: LR Global Research

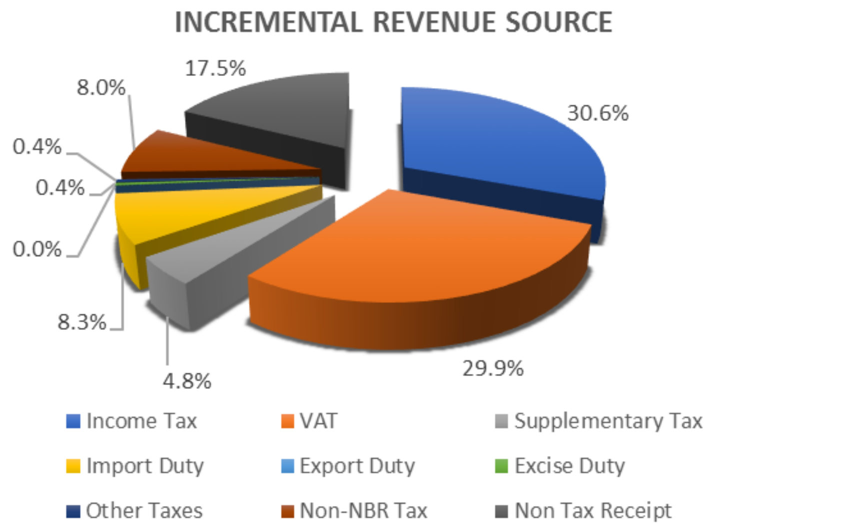
Power and energy sector received the highest (44.2%) of the total subsidy expenditure witnessing a rise of 39% from FY19. Of the incremental BDT 52 billion subsidy allocated in power and energy, natural gas sector has received BDT 51 billion. Relative increase of expensive LNG in supplied gas mix may require additional subsidy in gas if the Government is unable to partially pass the incremental cost to users.

Moreover, the Government has not allocated any subsidy for BPC as low oil prices in the global market have kept it within a profitable margin. However, the Government may be forced to come in aid of BPC if increasing geo-political turmoil in Persian Gulf pushes up global oil price.

GOVERNMENT REVENUE STREAM

FY20 budget has set a goal of collecting BDT 3,778 billion revenue which is 19% higher than the revised budget of FY19. Main sources of additional revenue as per government projection are VAT, Income Tax, and Supplementary tax. The government had projected to collect BDT 3,392.8 billion in FY19. In the first nine months of FY19, the government was able to collect only 54.90% of revenue projected in the original budget of FY19. Government revised down its revenue collection target by 6.7% in RBFY19. However, revised target is 46% higher than the actual revenue collection of FY18. Considering the economic trend and lack of robust revenue collection system, the Government is set to miss its revised target by a huge margin in both FY19 and FY20. Moreover, the Government has kept individual and corporate tax rate unchanged in FY20. It has also decided to implement the much talked about VAT Law 2012 after several delays and amendments.

Government's optimistic revenue collection target is based on expected incremental revenue generation from new VAT law and the widening of tax net. However, lack of concrete action plan to expand tax net, inconsistencies within the amended VAT law, and lack of preparation for its implementation may render the optimism of the government as misplaced.



Source: LR Global Research

INVESTMENT FOR RECAPITALIZATION

The Government has allocated BDT 144.82 billion in budget for equity investment which includes funds allocated for recapitalization of State-owned Banks (SoB) and other equity investment. The Government had allocated BDT 159.52 billion in FY19 but it was revised down to BDT 19.94 billion in RBFY19. Similar downward revision is expected to take place in FY20 and this will provide the government with buffer within the fiscal framework. Funds for recapitalization of SoBs are not earmarked separately in the budget making it difficult to assess the stance of government with respect to ailing SoBs.

IMPACT ON CAPITAL MARKET

Tax on Retained Earnings & Stock Dividend: In any income year, at least 30% of the net profit of any company must be distributed to the investor otherwise the company will face 10% tax on the total transferred amount to retained earnings and reserve. Furthermore, if the amount of stock dividend exceeds the amount of cash dividend in an income year, 10% tax will be imposed on the total value of stock dividend.

Using this measure, the Government is encouraging cash dividend at the same time discouraging stock dividend payout. This will impose a double taxation on profits at the company level and directly intervene in the major corporate finance decisions of all the companies. We believe that this will not be beneficial for the investors as more money will be shifted to the Government's coffer from the investors.

MOST AFFECTED SECTORS

Bank & NBFI

Banking sector will be negatively affected by the tax levied on stock dividend and profit transfer to the retained earnings due to its adverse impact on the capitalization and liquidity condition of banks. In our point of view, this measure is not realistic for banks especially considering the current condition of the banking sector.

Telecommunication

- Minimum turnover tax raised to 2% from 0.75%.
- Supplementary duty on mobile usage increased from 5% to 10%.
- Custom duty of smartphone raised to 25% from 10%.
- SIM tax raised to BDT 200 from BDT 100

Increase in the minimum turnover tax will not impact the large profitable operators but will exert additional pressure on the loss-making telecom operators. Additional supplementary duty will increase the voice call and data tariff rate of all mobile operators considering immediate pass through to the users. Increased SIM tax & import duty on smartphone may slower the penetration growth of the industry.

Food & Allied

- Regulatory Duty and Specific Duty on both raw and refined sugar has been increased
- Import duty on milk powder have been increased from 5% to 10% and 5% supplementary duty has been imposed on ice-cream.
- 10% export duty on unmanufactured tobacco has been withdrawn.
- Tobacco sector has been allowed to claim input tax credit under the new VAT law.
- There was no change on SD of cigarettes. However, minimum prices of all four tiers have been increased.

Tier	Price Increase	SD
Premium	17.1%	55%
High	24.0%	65%
Medium	31.3%	65%
Low	5.7%	65%

Source: Ministry of Finance

Increase of specific duty and regulatory duty on sugar will have adverse impact on confectionery and food processing companies. Import duty on milk powder and supplementary duty on ice-cream will adversely impact ice-cream manufacturers.

Increase of price of cigarettes will decrease sales volume of cigarette manufacturing companies. However, down trading induced by greater price change in upper tier may increase sale in lower segment. Tobacco companies were not allowed to claim input tax credit earlier. Hence, input tax credit allowed in new VAT law will improve profitability by considerable margin.

MOST AFFECTED SECTORS

Construction

- Source tax reduction on rod import from BDT 800 per ton to BDT 500 per ton.
- Imposition of source tax of 3% on the rod and cement manufacturer.
- Decreased duty tax on chrysotile fibers used for corrugated cement sheet production from 10% to 5%.
- Imposition of 5% Advance tax for raw material import which will be adjusted later.
- New VAT law has changed VAT for rod producers in the following way-

Stage	Existing (BDT)	New (BDT)
VAT on Scrap	300	1,000
Fixed VAT on Billet Sales	450	1,000
Fixed VAT on MS Rod Sales (Re-rolling)	450	1,200
Fixed VAT on MS Rod Sales (Meltable)	450	2,000

Source: Ministry of Finance

Government's initiative regarding the increased VAT will increase the price of locally produced rod while reduced source tax will encourage more import of rod. In both ways, domestic producers will lose their competitiveness. The flat TDS rate will increase their direct import cost and affect COGS of cement manufacturers.

Advance tax of 5% on the imported raw materials will harshly affect the industrial sectors' companies. This will increase the cost, working capital requirement and financing need of the companies significantly because most of the companies are import dependent. This will also accelerate the liquidity crisis of banks.

Transport

- Concessionary duty on raw materials of motor-cycle manufacturing industry has been continued with additional three inputs in the concessionary list.
- Imposition of VAT on the full value of the motorcycle instead of the commission at 5% at the business level. Additional 10% supplementary duty on registration and ownership transfer.
- Reduced Custom duty on air filter and breaks to 15% from existing 25%.
- Increased regulatory duty from 3% to 5% on import of tire of rim size of 16 inch and tire of a kind used on motorcycles. New regulatory duty of 5% on Inner tube import.

Domestic motorcycle manufacturers will be benefitted from the concessionary rate of duty on raw materials import and initiatives taken to reduce foreign competition. On the contrary, the new VAT law will increase the price of motorcycle by a range of BDT 4,000 to BDT 21,000 which will affect the affordability of buyers.

MOST AFFECTED SECTORS

Consumer Durables

- Concessionary rate on import of some essential raw materials of lift, refrigerator, compressor, air conditioner, electric motor and mold.
- Imposition of 20% import tax on blender, mixer and grinder.
- Increased supplementary duty from 10% to 30% on imported refrigerator, freezer and similar products.
- Reduction of duty tax from 10% to 5% for the VAT registered refrigerator manufacturing companies.

Consumer electronics industry players especially the refrigerator manufacturers will be able to fetch better margins and reduced foreign competition.

LEAST AFFECTED SECTORS

Pharmaceuticals

- Removal of all duty on the raw materials of cancer medicine (Oncology).
- VAT exemption by NBR on the imports of raw materials of active pharmaceutical ingredients (API) and reagents for six years till 2025.
- Decrease regulatory duty from 20% to 15% on import of liquid Oxygen, Nitrogen, Argon and Carbon Dioxide.
- Withdrawal of advance tax of 5% on import of a number of medicines including medicines for cancer, malaria, and tuberculosis, preventive medicines, antibiotics, medicines and solution for kidney dialysis, and vaccines.

Manufacturers of the oncology medicines will be benefitted from their reduced cost of production. Companies that produce API will be able to reduce their cost due to the exemption of VAT by NBR on raw materials of API. Withdrawal of advance tax will help the companies to run smoothly.

Textile

- Four sectors of RMG industry used to enjoy 4% cash incentive. For the remaining sectors 1% cash incentive has been proposed in the budget.
- Specific duty of BDT 4/kg has been imposed on local yarn sale.

Cash incentive to all RMG exporters will increase profitability of companies by allowing them to enjoy virtually two exchange rates in business.