Budget Review: FY 2012-13

June 10, 2012

- ✓ Achieving twine goal of GDP growth (7.20%) and curbing inflation to single digit (7.50%), at the same time, may seem "Unrealistic".
- ✓ Tight money market may continue with higher interest rates resulting in "Crowding Out" effect. Also, such condition may encourage investment in short term money market instruments rather than long term investment in the capital market, limiting "Upside' of the capital market.
- ✓ In Budget Allocation, repayment of loan and interest is taking up a significant portion indicating our increasing dependency on debt financing, importantly from costlier sources. Also, agriculture and fuel & energy sector might have got more allocation in the budget due to high importance of these sectors for sustainable economic growth.
- ✓ Incentives in Budget for FY 2011-12 for capital market are to be continued in FY 2012-13 with some added incentives and reformation program. We expect a "well functioning" capital market if the proposed policy and reformation are in place.
- ✓ Ceramic, Pharmaceutical and Energy sector are expected to be positively affected while, Cement and Bank sector are expected to be negatively affected from the proposed budget. Effect on Textile sector will be netting off element due to impact of different policy changes. Policy effect on Tobacco is negligible due to pass-through capacity of the sector while top line of telecom operators may be affected due to low pass-through capacity of the increased tax burden.

Table 1: Budget at a Glance FY 2012-13

Particulars (Amounts in Billion BDT)	Budget 2010-11	Revised 2010-11	Budget 2011-12	Revised 2011-12	Budget 2012-13
Revenue	**928.47**	**951.87**	**1183.85**	**1148.85**	**1396.7**
Tax Revenue	**760.42**	**790.52**	**957.85**	**962.85**	**1168.24**
Non-Tax Revenue	168.05	161.35	226	186	228.46
Foreign Grants	48.09	42.24	49.38	44.6	60.44
Total Revenue and Foreign Grants	**976.56**	**994.11**	**1233.23**	**1193.45**	**1457.14**
Non-Development Expenditure	857.86	831.77	1029.03	1009.86	1116.75
Development Expenditure	427.70	396.14	506.42	456.5	601.37
others	36.14	72.20	100.44	145.77	199.26
Total Expenditure	**1321.7**	**1300.11**	**1635.89**	**1612.13**	**1917.38**
Total Deficit (Including Grants)	**345.14**	**306.00**	**402.66**	**418.68**	**460.24**
(in % of GDP)	4.4%	3.9%	4.5%	4.6%	4.4%
Total Deficit (Excluding Grants)	**393.23**	**348.24**	**452.04**	**463.28**	**520.68**
(in % of GDP)	5.0%	4.4%	5.0%	5.1%	5.0%
Financing					
Net Foreign Borrowing	108.34	57.83	130.58	73.99	125.40
Foreign Borrowing	159.68	109.2	186.85	140.37	203.98
Amortization	(51.34)	(51.37)	(56.27)	(66.38)	(78.58)
Domestic Borrowing	236.80	248.17	272.08	344.69	334.84
Net Bank Borrowing	**156.80**	**183.79**	**189.57**	**291.15**	**230.00**
Net Non-Bank Borrowing	80.00	64.38	82.51	53.54	104.84
Net National Saving Schemes	74.77	59.19	60.00	35.00	74.00
Others	5.23	51.90	22.51	18.54	30.84
Total Financing	**345.14**	**306.00**	**402.66**	**418.68**	**460.24**
Net Bank Borrowing as % of Total Deficit	**45.43%**	**60.06%**	**47.08%**	**69.54%**	**49.97%**
GDP	**7802.90**	**7874.95**	**8996.70**	**9147.84**	**10413.6**

Source: Budget FY 2012-13; Ministry of Finance (MOF).

Restrained Monetary Policy is to be continued for FY 2012-13 to curb inflation with a target inflation rate of 7.50%.

While, current restrained monetary policy is in effect with decline of money supply (M2) growth and private sector credit growth, it has created pressure on the money market creating interest rate hike with probable ‘crowding out’ effect.

Continuation of the restrained monetary policy may create further pressure in the money market in FY 2012-13.

Overall, achievement of twine goal of accelerating GDP growth target to 7.2% and curbing inflation to single digit, at the same time, may seem ‘Unrealistic’. **Also, if actual inflation exceeds the target, GDP growth may fall well short than the target.**

Table2: Major Macroeconomic Variables

Particulars	Budget 2009-10	Budget 2010-11	Budget 2011-12	Budget 2011-12p	Budget 2012-13	Mid Term
GDP (in Bilions)	6905.71	7874.95	8996.70	9147.84	10413.6	
GDP Growth	6.10%	6.70%	7.00%	6.30%	7.20%	8%
Inflation	7.30%	8.80%	7.50%	10.86%	7.50%	5%
Money Supply (M2) Growth	22.40%	21.30%		17.60%*		
Private Sector Credit Growth	24.20%	25.80%		19.40%*		
Export Growth	4.10%	41.50%	14.50%	8.40%		
Import Growth	5.50%	41.80%	14.00%	8.70%		
Remittance Growth	13.40%	6.00%	10.00%	10.40%		
Foreign Exchange Reserve (in months of imports)	5.10	3.70		3.00		
Foreign Exchange Reserve (Billion US $)	10. 70	10.90		9.58**		

***** July-March, 2012

**Reserve on 29 May 2012.

Source: Budget FY 2012-13, Ministry of Finance (MOF), The Financial Express (FE).

Budget FY 2012-13 & Sector wise allocation

GDP growth target is aimed to 7.2% (FY 2012-13) on the basis of expected satisfactory growth in trade and agriculture sector. However, GDP growth target is aimed to 8% by FY 2014-15 (Table: 2). Budget size has increased by 18.93% with compare to revised budget for 2011-12.

Budget deficit is 5% of target GDP and 27.16% of the budget itself. Financing the deficit from domestic bank borrowing is expected to decline from actual domestic bank borrowing in FY 2011-12 though it is still on the higher side in compare to historical figures. (Table 1)

Sector wise allocation: It is noticeable that high priority has been shifted to feeding Public Services (12.57%) from Education & Technology (11.55%). However, significant increase in repayment of Interest and Loans is a potential red flag denoting national’s increasing dependence on debt financing and particularly from costlier sources.

Also, allocation in Agriculture and Fuel & Energy roughly in line with that of 2011-12 while these two might have got more allocation in the budget because of their important role in sustainable economic growth.

Table 3: Sector wise Allocation

Particulars	Revised Budget 2010-11	Budget 2011-12	Revised Budget 2011-12	Budget 2012-13
Public Services	**7.68%**	**14.66%**	**10.80%**	**12.57%**
Local Government and Rural Development	8.07%	7.50%	7.45%	7.41%
Defense Services	7.17%	7.31%	7.58%	6.72%
Public Order and Safety	5.79%	5.17%	5.33%	4.81%
Education and Technology	**14.29%**	**12.42%**	**11.63%**	**11.55%**
Health	5.86%	5.42%	5.06%	4.87%
Social Security and Welfare	8.02%	6.76%	6.41%	5.73%
Housing	1.00%	0.92%	0.85%	0.76%
Recreation, Culture and Religious Affairs	1.25%	1.04%	0.95%	0.83%
Fuel and Energy	**5.58%**	**5.08%**	**4.94%**	**4.98%**
Agriculture	**10.05%**	**7.65%**	**8.90%**	**7.54%**
Industrial and Economic Services	0.71%	0.80%	0.97%	1.44%
Transport and Communication	6.66%	6.90%	6.49%	6.95%
Interest	**11.21%**	**11.00%**	**12.28%**	**12.15%**
Loans and Advances - Net	**5.17%**	**5.75%**	**8.80%**	**10.21%**
Non-ADP Employment Generation Programmes	1.10%	1.24%	1.33%	1.29%
Food A/c Operation	0.27%	0.39%	0.24%	0.19%
Structural Adjustment	0.12%	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%	100.00%

Capital Market Implications

Recognizing importance of capital market in economic development, the budget has declared several incentives (Table 4) which is expected to ensure a well-functioning capital market, in future. We believe that **proper implementation of some reformation program and declared incentives will increase accountability and transparency of the capital market which will boost investment confidence.**

Table 4: Capital Market Incentives

Capital Market Intensives to be continued with some additional incentives	Keeping intact the incentives for capital market in Budget 2011-12, following additional incentives has been proposed in Budget 2012-13, ✓ Reduced income tax rate for merchant banks from 42.5% to **37.5%.** ✓ If any company transfers 20 % of it's paid up capital through Initial Public Offering (IPO) to capital market, it will enjoy **10 % tax rebate** on its payable tax in the relevant year. ✓ Dividend income amounting to BDT 5,000 will be exempted from tax.

Sectors – Positively Affected

1. Infrastructure Development and associated industries.	✓ Infrastructure projects namely Dhaka Elevated Expressway, Dhaka-Ashulia Elevated Expressway, Padma Bridge, Bekutia Bridge and four satellite towns around Dhaka city has been considered to be underway in FY 2012-13. ✓ **Implementation of the named projects will increase demand for construction materials such as rod, cement, welding rod etc favoring the relevant industries.**
2. Uniform Trade VAT at all levels of wholesale and retail sales may simplify business activities and reduce cost of doing business.	✓ A **uniform trade VAT rate at 4%** at all levels of wholesale and retail sales including advance VAT is proposed. ✓ Presently, advance VAT is applicable at 3 % on commercial imports at import stage, 2 % at local wholesale and retail stage, 4 % on supplies by procurement providers, 15 % for traders paying tax on actual value addition, BDT 100 per MT on M.S. rod and bar, and BDT 1800 to BDT 6000 per year for small shopkeepers depending on turnover and locations. ✓ **Uniform trade VAT will make business activities simple and thus may reduce cost of doing business.**
3. Ceramic sector may register a boost driven by favorable tax policy.	✓ The prevailing 15 % supplementary duty on domestically produced ceramic products such as bathtub, washbasin, and commode is proposed to be fully withdrawn to protect the domestic industry. ✓ Supplementary duties of tiles and crockery have been increased to 60% from 45% in order to protect the ceramic and glass industry. ✓ Supplementary Duty on Silex/lining/abrasive/polishing disc imported by VAT registered ceramic products manufacturing industries has been withdrawn from existing 60%. ✓ **Above favorable tax policy will help the local industry to grow.**

4. **Pharmaceuticals sector may continue its growing phase riding on favorable tax policy on capital machinery, essential items and continuation of tax holiday benefits.**	✓ The govt. is establishing a Pharmaceuticals Industrial Park at Gazaria, Munshigonj. Local Manufacturers would be a major beneficiary of the park once it is completed. ✓ Import Duty reduced for 46 essential items of Pharmaceuticals Industry from 12%-25% range to 5%. ✓ Tax Burden reduced for AUC and HVAC Machineries from 152% to 3%. In addition, tax burden has been removed from streptokinase and Insulin Pen import. ✓ Tax Holiday Benefits announced in budget 2011-12 are unchanged. ✓ **The above incentives are expected to support the existing growth phase of the sector.**
5. Textile Sector- local fabrics manufacturers are expected to be benefited	✓ Increased Supplementary VAT on several kinds of woven and knit fabrics import. ✓ **This will be beneficial for local fabrics manufacturers. Right now, they are in a dire situation as RMG exporters were importing fabrics from outside due to the relaxation of GSP rules.**
6. Energy Sector	✓ 8294 MW of electricity generation has been planned within FY 2012-13. ✓ Additional 1285 MMCFD of natural gas has been planned to add in the national grid in FY 2012-13. ✓ **Increased electricity generation will facilitate industrial development. Also, power distribution and transformation companies like DESCO, Power Grid may experience volume growth due to the increased electricity generation.** ✓ **Increased supply of natural gas would positively affect down stream companies in the value chain like Titas Gas.**
7. Others Sector	✓ Withdrawal of 20% regulatory duty on refrigerators and motor cycles. ✓ **It may positively impact refrigerator and motor cycles importer like Singer Bangladesh and Atlas Bangladesh.**

Sectors – Negatively Affected

1. Major exporting sectors may be affected from higher uniform tax rate deducted at source on export.	✓ A uniform rate of tax of 1.20 % deducted at source on all kinds of exports has been proposed in place of existing rates of 0.60 % and 0.70 %. ✓ **Higher tax at source may discourage exporting sectors like as RMG, Ship Building and Tannery.** ✓ Deduct tax at source at the rate of 5 % and 3 % considering the location of property at the time of selling land by any land developer company. ✓ **Higher tax at source may negatively affect real estate sector.**
2. Telecommunication operators may be affected due to tax at source.	✓ To deduct tax at source at the rate of 2 % on the post-paid mobile phone bill and on the amount to be recharged or on prepaid card amount. ✓ **New tax at source may affect top line of the mobile operators as it may not pass-through the tax burden due to higher competition in the industry.**

3. Tobacco Industry may not be affected by the increased duty.	✓ To enhance the existing value slabs of cigarettes by 10 % and supplementary duty from existing 36, 55, 58, and 60 % to 39, 56, 59 and 61 % respectively is proposed. ✓ Supplementary duty on Cigarette paper excluding imported by VAT registered manufacturing industries increased to 100% from 60%. ✓ **While, it is a burden on the tobacco companies, the companies may pass through it to the customers through higher price making them unaffected.**
4. Cement Industry may be adversely affected due to high duty on clinker import.	✓ 66% increase in Duty on cement clinker imported by VAT registered manufacturers of cement is proposed. ✓ 36% increase of duty on cement clinker imported by others is also proposed. ✓ Custom duty on Fly ash, another raw material of cement, has been reduced to 12% from 25%. ✓ **Notably, clinker is the main raw material which contributes 70-75% of COGS of the cement manufacturers. Import based industry is currently suffering from high COGS due to increase of international price of raw materials and devaluation of local currency. Additionally, this increase of duty may decrease profitability of the cement companies like Heidelberg, MI cement, Meghna Cement, Confidence Cement etc.**
5. Banking Sector may face another year of challenge due to government borrowing from the sector to finance deficit budget.	✓ The target of Government borrowing from the banking system has been set for the next fiscal at BDT 230 bn. ✓ **Private sector will be crowded out if the government depends largely on banks. Also, present tight money market may continue due to government dependency on the sector.**

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