FY2020-21 BUDGET ANALYSIS

Assessing the implications for capital market

18 June 2020

ROYAL CAPITAL

Research & Innovation Lab

Budget 2020-21 : At a glance

Tk. 5.68 trillion

Budget 2020-21 size

8.2%

Real GDP growth Target

5.4%

Inflation Target

Tk. 3.78 trillion

Revenue targets

Tk. 3.49 trillion

Domestic borrowing

Tk. 5.68 trillion

Total expenditure

Tk. 2.05 trillion

Proposed ADP

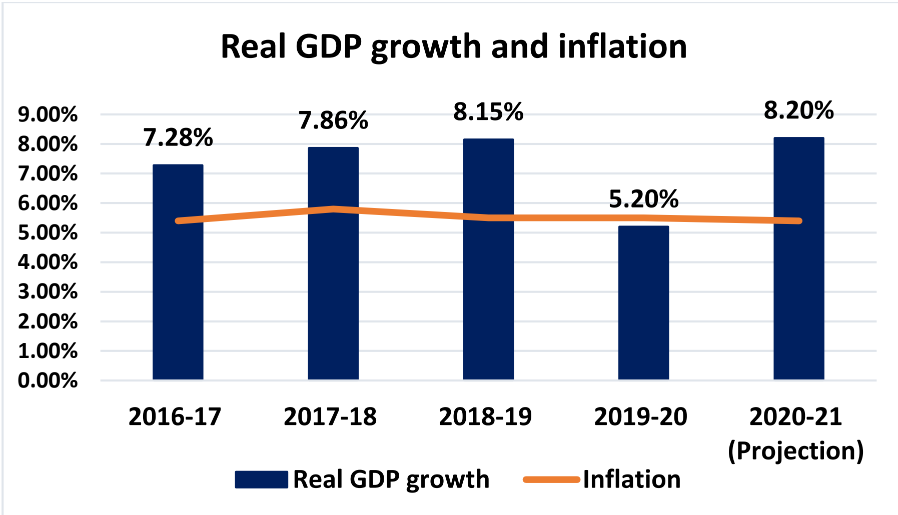
Tk. 1.9 trillion

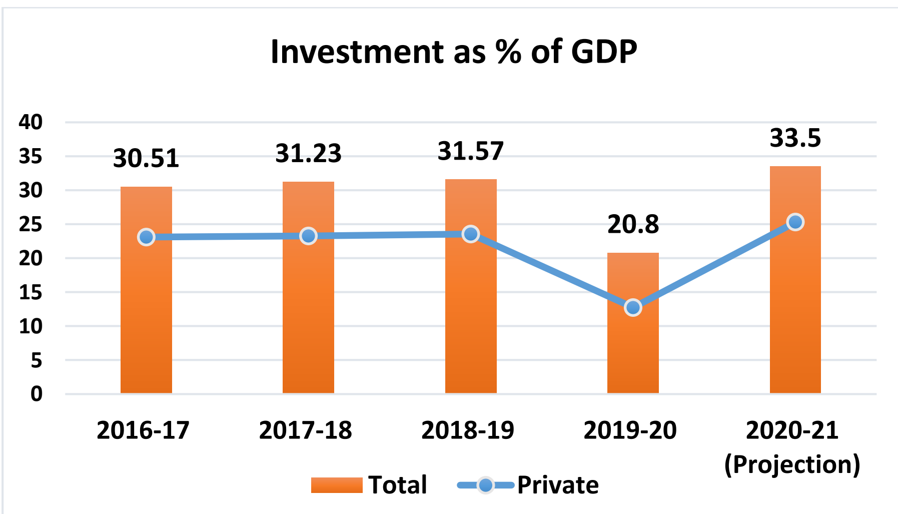
Budget deficit

Points to be noted

- 8.2% GDP target is unrealistic as per many economists;
- keeping inflation rate to 5.4% is challenging;
- Tk. 3.78 trillion revenue target may be unachievable COVID-19 induced economic slowdown;
- Tk. 3.49 trillion domestic borrowing could limit private sector growth;
- ADP utilization could face setbacks due to the COVID-19 slowdowns;
- Budget deficit may exceed the estimated Tk. 1.9 trillion due to lower revenue receipts.

Macro-economic highlights





GDP and inflation paradox

- COVID-19 effects slashed the 2019-20 Real GDP Growth to 5.20% from 8.15% in FY2018-19;
- The target 8.20% Real GDP (RGDP) growth is ambitious as there is uncertainty about the timing and nature of economic recovery;
- Taking COVID into account, the World Bank predicts RGDP growth at merely 1% for FY2020-21;
- Inflation rates may significantly deviate (possibly to be lower) from 5.4%, as production and demand falls in the economy, and money supply likely to become constrained.

Sluggish private investment

- As a reflection of lockdown-driven economic slowdown, investment to GDP ratio for FY2019-20 during March-June 2020 has dropped significantly compared to previous years;
- Private investment figures for FY2020-21 seems overestimated, since economic activities may not recover soon, private credit demand could go negative, and large government borrowing could slash lending capacity of banks.

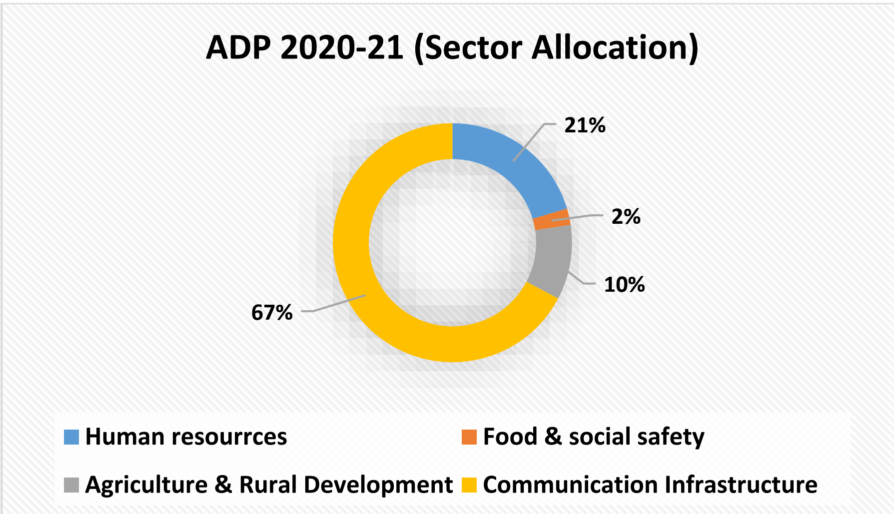
Proposed budget structure

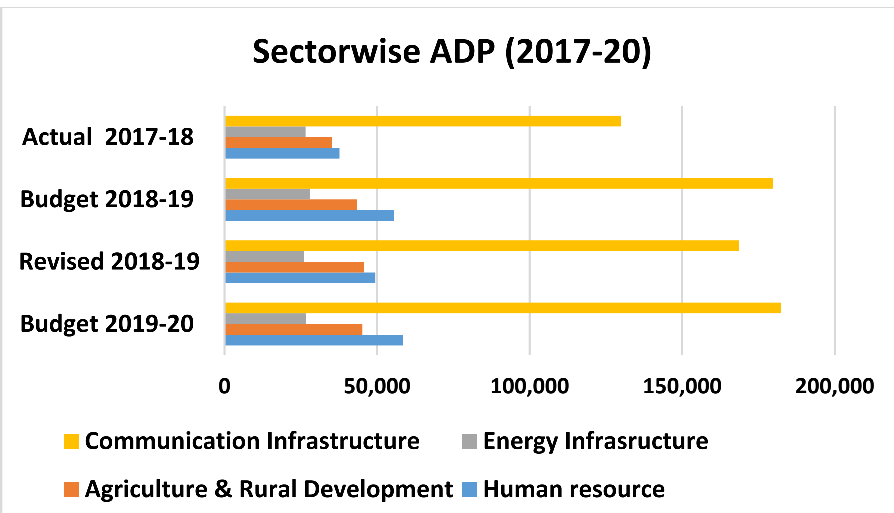
Proposed Budget Structure for FY 2020-21 (Tk. Crore)				
Sector	**Budget 2020-21**	**Revised 2019-20**	**Budget 2019-20**	**Actual 2018-19**
Total Tax Revenue	**378,000**	**348,069**	**377,810**	**251,879**
as % of budget	11.9	12.4	13.1	9.9
Total Expenditure	**568,000**	**501,577**	**523,190**	**391,690**
as % of budget	17.9	17.9	18.1	15.4
Non-Development Revenue Exp.	311,190	274,907	277,934	217,807
as % of budget	9.8	9.8	9.6	8.6
Development Expenditure	**215,043**	**202,349**	**211,683**	**151,055**
as % of budget	6.8	7.2	7.3	6
In which,				
Annual Development Programme	205,145	192,921	202,721	147,287
as % of budget	6.5	6.9	7	5.8
Other Expenditure	41,767	24,321	33,573	22,828
as % of budget	1.3	0.9	1.2	0.9
Budget Deficit	**-190,000**	**-153,508**	**-145,380**	**-139,811**
as % of budget	(-6.0)	(-5.5)	(-5.0)	(-5.5)
Financing				
External source (including grants)	80,017	56,163	68,016	32,966
as % of budget	2.5	2	2.4	1.3
Domestic source	**109,983**	**97,345**	**77,363**	**101,737**
as % of budget	3.5	3.5	2.7	4
In which, Banking source	84,980	82,421	47,364	29,479
as % of budget	2.7	2.9	1.6	1.2
GDP	**3,171,800**	**2,805,700**	**2,885,872**	**2,536,177**

Key Takeaways

- Estimated total government expenditure for FY2020-21 is set to be 13.24% more than that of FY2018-19.
- Larger expenditure increases (by Tk. 1763 billion) relative to revenue increases (by Tk. 1261 billion) a major reason why budget deficit is set to be increased by 35% or Tk. 502 billion between the respective years.
- There is Tk. 12,224 crore additional ADP in FY2020-21 compared to the previous year, which may be challenging to implement due to the unlikely economic revival soon.
- Financing from banking channel is set to rise by 3% is FY2020-21, which will deter consumer spending and hamper private sector credit supply;
- External financing, mainly from development agencies/governments set to grow by 42%, mainly to fund

Annual Development Programme (ADP)- Sector Allocation

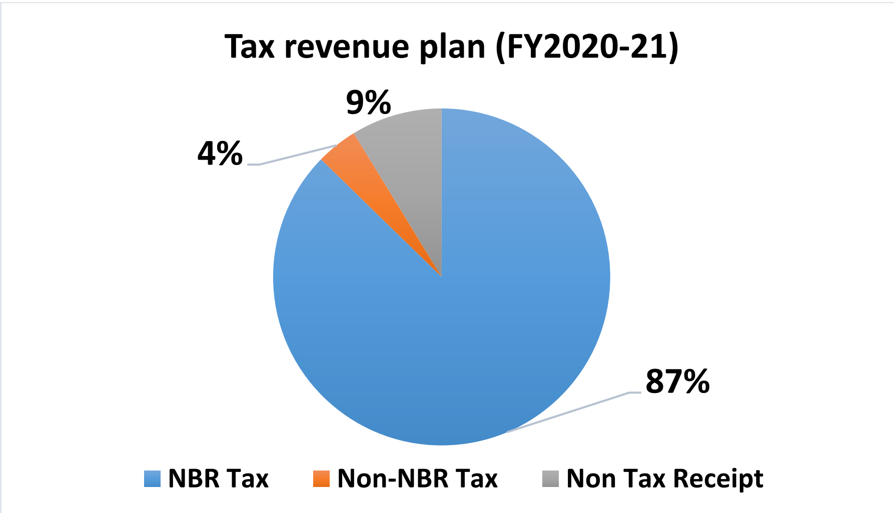


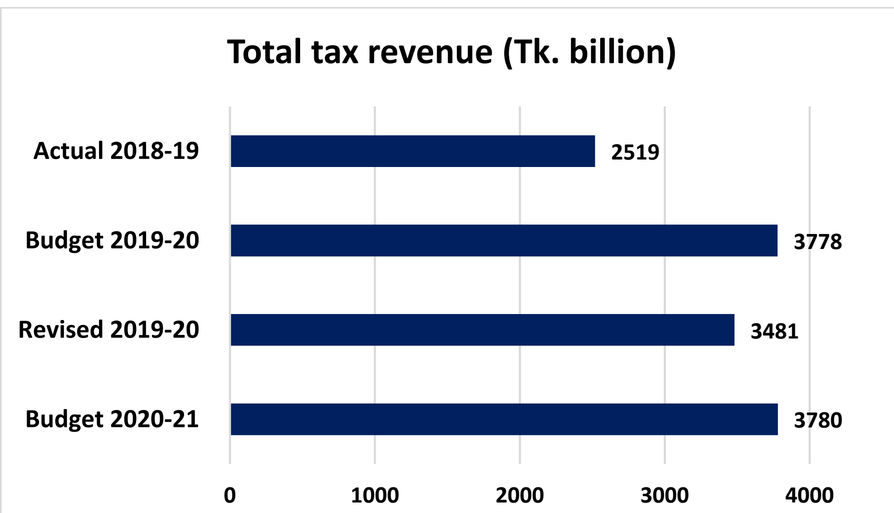


Key remarks

- Bangladesh's ADP is growing faster. Tk. 2051 billion of ADP proposed for FY2020-21, which is 2.5 times larger than what it was six years before (from Tk. 816 billion in FY2014-15 to). ADP expansion supports progresses in critical projects nationwide, mainly in the form of construction of roads, bridges, highways, flyovers, and government mega-projects such as Padma Bridge, Payra Deep-Seaport, Metro Rail, Ruppur Nuclear Power Plant etc.
- Among the broad sectors, communication infrastructure got the top priority, which is reflected by the highest figure of ADP between FY217-20.
- The proposed ADP 2020-21 reaffirms the highest priority in the communication sector.
- ADP under Food & social safety got a greater importance specially to combat the COVID-19 pandemic. In this context, the total stimulus package for the COVID-19 pandemic is proposed at Tk. 1,031 billion for FY2020-21 to combat against the adverse economic impacts.

Financing the Budget





Tax revenue for FY2020-21

- Total tax revenue target for FY2020-21 is Tk. 3,780 billion which is 9% higher than the revised budget of 2019-21; the figure looks ambitious due to the COVID-19 driven socio-economic crisis.

- About 58% of the budget 2020-21 will be financed by NBR tax revenue, which is challenging given the economic slowdown.

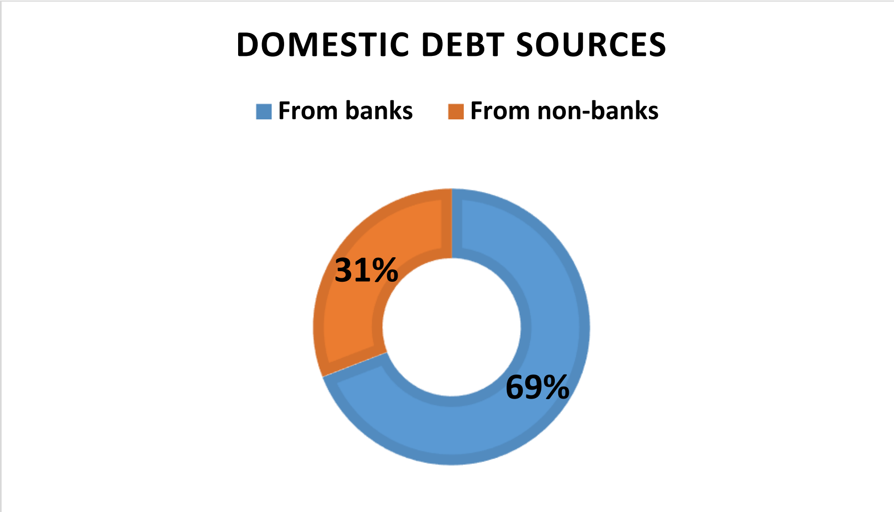
- Of the NBR tax revenue targets, Income Tax and Value Added Tax (VAT) are set to earn 31% and 38% revenue respectively.

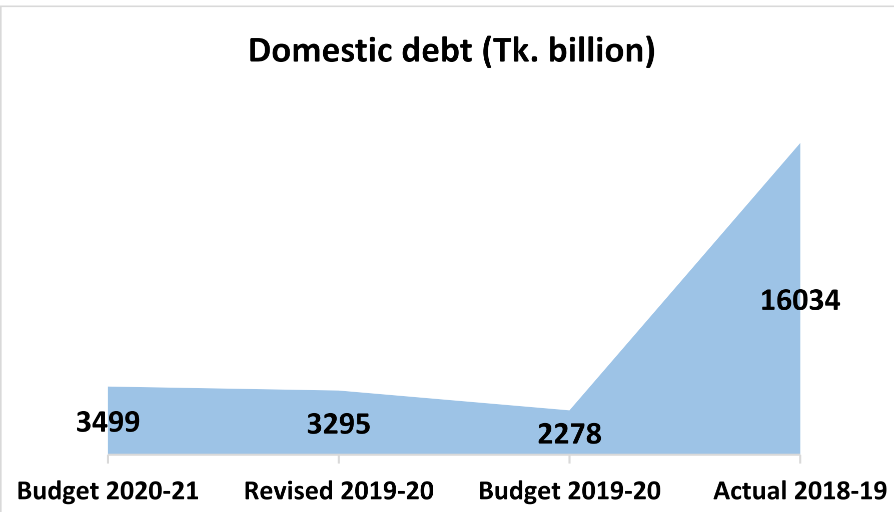
- Excise duty target is lowered by Tk. 16.6 billion compared to the revised budget of 2019-20. This will favor the local manufacturers to some extent.

- Non-tax revenue target for FY2020-21 is estimated to reduce by Tk. 20 billion compared to the revised budget of 2019-20.

- Non-NBR tax accounts 4% of total tax plan, of which 79% Non-NBR tax revenue is set to arise from selling of Non-Judicial Stamps.

Domestic borrowing FY2020-21





Domestic borrowing for FY2020-21

- About 69% (Tk. 2419 billion) of the domestic debt will be sourced from the banking sector, which is 7% or Tk. 168 billion higher than the revised budget 2019-20 figure. Increased government borrowing may slowdown private sector credit growth; this could lead to fewer private investment and deceive tax revenue targets.

- Borrowings from non-banking sources is proposed to be Tk. 1,080 billion for FY2020-21, which is 3% higher than the revised budget of 2019-20.

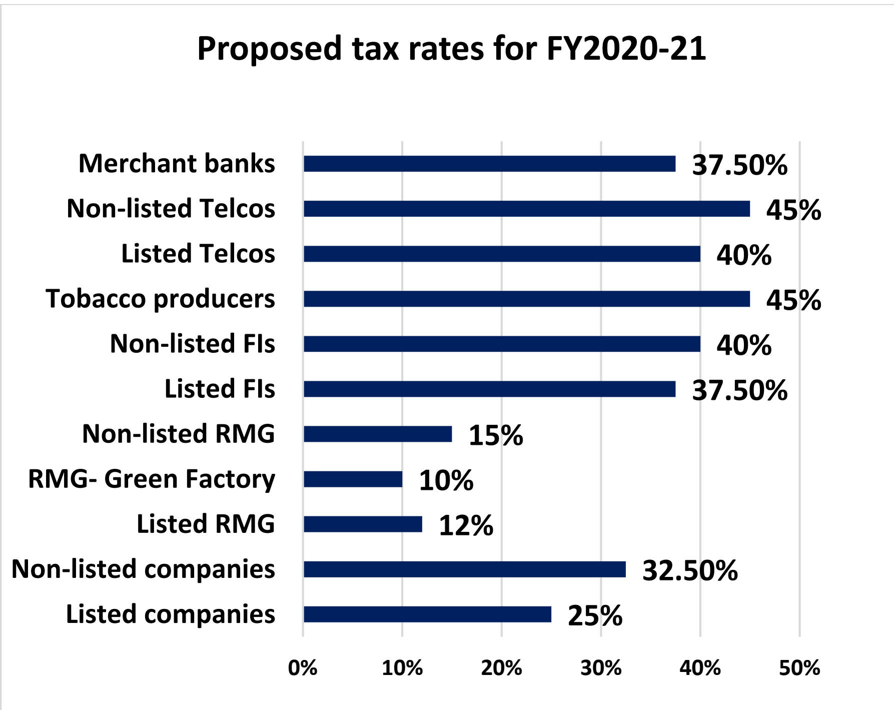
- The government also shows increased reliance on direct public borrowing, as 83% non-banking are set to arise through National Savings Schemes compared to 76% in the previous year.

- Compared to previous year, an increased National Savings Certificates (NSC) of additional Tk. 97 billion is planned; this may further deepen the liquidity crisis in the banking sector and capital markets, as NSCs generally offer double digit interest rates.

- Overall domestic debt to rise by Tk. 204 billion or 6% in comparison to the revised budget of 2019-20

Tax changes (FY2020-21)

Personal Income Tax Rates	
Total income	Tax rate
(A) On first Tk. 3,00,000/-	Nil
(B) On next Tk. 1,00,000/-	5%
(C) On next Tk. 3,00,000/-	10%
(D) On next Tk. 4,00,000/-	15%
(E) On next Tk. 5,00,000/-	20%
(F) On the balance of total income	25%



Proposed income tax for FY2020-21

- The proposed tax-free income limit for the individual taxpayers is raised to Tk. 3 lac from existing Tk. 2.5 lac to give relief to people in the lower-income bracket, in an effort to allow low-income people mitigate the pandemic better.

- The minimum and maximum income tax rates are reduced to 5% and 25% respectively, from the current 10% and 30% to facilitate economic relief from COVID-19 effects.

- Proposed rise in the tax-free income threshold for women and senior citizens, physically challenged people, and gazetted war-wounded freedom fighters to Tk. 3.50 lac, 4.50 lac and Tk. 4.75 lac respectively from the current levels of Tk. 3 lac, Tk. 4 lac and Tk. 4.25 lac.

- The proposed income tax rates for the non-listed companies to change from 35% to 32.5%. The other sectors' tax rates would remain unchanged.

Capital market incentives

- ✓ The budget proposes investment of undisclosed money to the capital markets by paying 10% tax, which is subject to lock-in period of 3 years from the date of securities purchase. The undisclosed funds will be allowed for investment only in Real estate, Banks as deposits, Savings certificate, and Capital market.

- ✓ No authority including the NBR will raise any question on investing the undisclosed money to the capital markets, if the 10% tax is paid.

- ✓ The tax-fee limit of dividend income has been proposed at Tk. 50,000 instead of existing Tk. 20,000.

- ✓ Double taxation on dividend from listed companies is set to be removed.

- ✓ The budget proposes to make the mandatory provision of declaration of cash dividend on at least 50% of total dividend payment made by any listed company.

- ✓ Introducing withholding tax deduction on the trading commission (transaction cost) fixed by the Securities and Exchange Commission, instead of the current provision of deducting the tax being charged on the value of bond transactions.

- ✓ Provision of Tax Deduction at Source (TDS) on interest payment and discount on bonds has been proposed instead of existing provision of deduction at source tax upfront on interest payment and discount.

Possible implications of the stock market measures

Proposed	Existing	Stock market implications
Introducing withholding tax deduction charged on the trading commission (transaction cost) fixed by the SEC.	Investors pay taxes on the value of bond transaction.	- This is a measure to encourage bond market. Charging tax on brokerage commission instead of transaction value will reduce investor cost burdens in the bond market.
The tax-free limit of dividend income has been proposed at Tk. 50,000.	Existing tax-free limit of dividend income is Tk. 20,000.	- This measure will reduce tax burden on investors' dividend income, particularly for small investors who earn relatively smaller dividend. - It could also encourage investors to invest in companies that are fundamentally stronger and pay regular dividend.
The budget proposes to cut the income tax rates of unlisted companies to 32.50% from 35%.	All companies – listed and unlisted – pay the same 35% tax on their pre-tax profit.	- The tax rate cut will not be an encouraging measure for the stock market, since currently unlisted companies may not want to get listed in the stock exchanges to avoid additional tax burdens. - This means, the stock market may see fewer new IPOs and listings, as it may discourage potential companies, particularly fundamentally well-off companies.
Removal of double taxation on dividend is proposed. It means only companies will pay taxes on profit and investors will pay no taxes on dividend incomes.	Double taxation is applied on dividend income; companies pay tax on profit and investors again pay taxes on dividend incomes.	- This will reduce tax burden on dividend incomes for all investors. It could also encourage investors to invest in companies that are fundamentally stronger and pay regular dividend.

Proposed	Existing	Stock market implications
Making a mandatory provision for companies to declare cash dividend equal to at least 50% of total dividend announced.	No such mandate or provision is in place currently.	- The mandatory provision will ensure investors receive a minimum amount of hard-cash return, which will encourage both existing and new investors in the market. - However, it could restrain many companies who are not fundamentally strong, unable to generate significant cash, have a poor and irregular dividend payment history, and/or have a tendency to consume cash internally and deceive investors.
Allowing investments of undisclosed money to the capital markets by paying 10% tax, which is subject to a lock-in period of 3 years from the date of securities purchase. The offer is also allowed for real estates, bank deposits, and savings certificates.	No such mandate or provision is in place currently.	- The offer may not bring significant investment injections to the capital market, since the alternative opportunities allowing the same offer are likely to be safer and higher return generating. Potential investors may choose alternatives rather than the stock market. - Potential investors with undisclosed money may be more interested in fixed income instruments like savings certificate or FDR in banks with no risk rather than risky investments in stock market. - Despite some new investment injections could happen in the stock market.

Budgetary measures for different sectors and stock market implications

Target sector	Proposed measures	Stock market implications
SME Sector	SME sector enterprises will enjoy reduced import duty at different rates on raw materials in 2020-21.	Listed companies engaged in producing light engineering products will see reduced cost of sales and higher profitability. Listed companies that fall in the definitions of SME could be benefited, particularly those that will be listed in the SME segment of DSE.
Export-oriented RMG	- A 1% extra cash incentives proposed; - The withholding tax rate is proposed to set at 0.5% from the existing 1%; - Import duty for specific products like RFID tag, Industrial racking system, Cutting table etc. to be reduced to 15% from existing 25%	As most of the listed textile companies are export oriented, the overall sector will enjoy extra revenue and cash generation and reduced production cost, which overall may help contribute to higher profitability.
Local-Electronics Manufacturers	Expanding the concessionary duty benefits for importing raw materials for refrigerators and air conditioner compressor; new rates will be brought down from existing 14% level.	Listed local manufacturers of electronic goods such as Walton may see cheaper imports and lower production cost, resulting in a higher profitability.
Shipbuilding Industry	The budget proposed to slash the existing duty exemption for the ship building industry. This will increase the customs duty to 5% from existing 1%.	It will increase the cost of sales of the shipbuilding companies and decrease the profitability in result, for listed companies such as Western Marine Shipyard.
Steel Industry	- Increases of regulatory duty to 15% from existing 10% for three raw materials, i.e. Ferro-manganese, Ferro-silicon, and Ferro-silico-manganese. - Source tax on MS scrap supply to set at 0.5% from existing 5%.	The measure will protect local manufacturers, as it will help reduce production cost, possibly resulting in a higher profitability, for listed companies like BSRM, RSRM, GPHISPAT and SS Steel.

Target sector	Proposed measures	Stock market implications
Footwear Industry	A duty cut to 15% from existing 25% on importing raw materials.	Listed footwear manufacturers such as Bata shoe and Apex Footwear are likely to enjoy cost reductions, possibly resulting in a higher profitability.
Pharmaceuticals & Healthcare Sector	- To combat COVID-19 pandemic, exemptions of all import duties and taxes are proposed on coronavirus testing kits, masks, personal protective equipment (PPE) and raw materials for hand sanitizer. - Reducing duty on raw materials purchases of locally producing autoclave machines (used for sterilizing medical instruments). - Customs duty on raw materials of sanitary napkins to come down to 15% from 20%.	Listed companies in the Pharma and Chemical sector such as Square, Beximco, Beacon, and Ambee Pharma are likely to see cheaper imports and higher sales, possibly resulting in a higher profitability.
Food and Allied	- Slashing the rates of tax deduction at source to 2% from existing 5% on all types of staple foods like rice, wheat, onion, garlic, potato etc. - For potato flake manufacturers, VAT to come down to 5% from existing 15%. - Local master oil producers will be exempted from VAT. - TDS of poultry feed manufacturers will be slashed to 2% from existing 5%.	Among the listed companies, AMCL (Pran), Amaan Feed and National Feed may be benefitted in the form of reduced cost of sales and thus higher profitability in result.
Tobacco Industry	Increasing the supplementary duty for low-price (but high nicotine) cigarettes to 57% from existing 55%.	As the industry is mostly price inelastic, effects on listed company like BATBC may remain minor.
ICT Sector	Rationalizing all the existing tax concessions and making it more investment-friendly. However, no specification of concessions outlined in the budget.	No clear benefit can be deduced for the IT sector till date.

Target sector	Proposed measures	Stock market implications
Telecommunication	Increasing supplementary duty on SIM/RIM to 15% from existing 10%.	This may erode the profitability of listed company like Grameenphone and other unlisted operators.
Automobile	Slashing customs duty to 1% from existing 10% on purchase of agricultural machineries.	IFAD Autos and Atlas BD may see lower import and production cost from the concession, possibly resulting in a higher profitability.
Ceramic Industry	Imposition of supplementary duty of 10% is proposed on ceramic sink, basin etc.	This measure will erode profitability of the listed company like RAKCERAMIC only as it only produces sanitary products out of all the listed ceramic companies.
Real-estate	Undisclosed money can be used to buy housing property by paying 10% tax.	Listed realtors such as Eastern Housing may see higher business volume and sales, possibly resulting in a higher profitability.
Banks	Undisclosed money can be officially kept as deposits or used to buy national saving schemes at banks by paying 10% tax.	All listed banks may see greater inflows of liquidity, which may help them mitigate liquidity crisis arising due to heavier government borrowing.
Oil and Gas Industry	Concessionary tax benefit for the LPG industry. However, no specification of concessions outlined in the budget.	Listed companies engaged in LPG imports such as Mobile Jamuna will be able to minimize its cost of sales and thus higher profitability ultimately.
Paper & Printing	Reducing import duty on washing and clearing agent for the paper industry to 15% from 25%.	Listed companies such as Bashudhara Paper Mill will see lower processing cost, possibly resulting in a higher profitability.

Concluding Remarks

- The 8.2% growth target is over-optimistic as COVID-19 recovery remains highly uncertain.
- Tk. 5.68 trillion budget size is 13% higher than the previous year; implementation remains a big challenge.
- Tk. 3.78 trillion revenue targets is challenging considering the ongoing economic slowdown.
- Tk. 2,419 billion borrowing from banking sources are likely to drive away private sector credit supply, which could contradict with the tax revenue targets outlined.
- Increases in personal tax free income limit will help COVID-19 driven economic woos by increasing consumer spending and demand for goods and services, particularly for low-income households.
- Most of the proposed tax, VAT and duty rescheduling may benefit local industries; many listed companies in different sectors in the stock market will be able to boost financial and business performance.
- Whitening the black money to the capital markets, real estates, bank deposits and savings certificates may increase liquidity in the financial markets.
- The black money option however may not benefit the stock market much since potential investors might chose to opt for risk-free alternatives such as bank deposits and savings certificates.

The report is based on assessment conducted by the Research and Innovation Lab (RIL) at Royal Capital Limited. Budget data in this report are mainly sourced from: https://mof.portal.gov.bd/ (Accessed 12 June 2020). RIL will not bear any responsibility for any changes in the original budget data and estimates made after the mentioned access date. This report is available at: www.royalcapitalbd.com

RIL is committed to deliver high quality research for all. For any further query or information about this report or other research of RIL, contacts can be made using the following detail.

Research and Innovation Lab
Royal Capital Limited
Ittefaq Bhaban (2nd Floor)
1, R.K. Mission Road, Dhaka-1203
Tel: 02 7114309, 7114093
Fax: 02 9571352
Email: ril@royalcapitalbd.com
Web: www.royalcapitalbd.com

Disclaimer: *This publication is produced by Research and Innovation Lab at Royal Capital Limited (RCL) solely for the information of Clients of RCL. Clients are expected to make their own investment decisions using any information contained herein. The contained information in the report should not be interpreted as an offer to sell, or a solicitation of any offer to buy any investment. Projections of potential risk is based on published information but does not guarantee of any actual risk or return to be materialized.*