

Expectations on BUDGET 2013

1H2012 Performance comparison

LKR bn	1H2011	1H2012	% Change
Tax revenue	315.8	353.3	12%
Income tax	59.3	71.8	21%
VAT	86.9	90.4	4%
Excise Tax	70.8	79.9	13%
PAL	24.2	27.8	15%
Import Duty	30.1	30.2	0%
Nation Building Tax	13.3	15.8	19%
Other	31.3	37.4	20%
Non Tax Revenue	38.5	33.3	-13%
Total Revenue	354.3	386.7	9%
Current Expenditure	360.3	445.4	24%
Salaries and wages	108.2	112.1	4%
Interest	142.3	173.7	22%
Samurdhi	3.1	4.2	36%
Fertilizer Subsidy	5.6	13.0	131%
Pension	32.2	37.1	15%
Other expenditure	68.8	105.3	53%
Public Investment	103.9	152.4	47%

Source: Department of fiscal policy

Analysis

- Income tax contribution to government revenue increased from 17% to 19% for 1H 2012 in comparison with 1H 2011, despite the fall in tax rates and increase in tax free thresholds.
- This is mainly on account of the 71.5% YoY increase in Withholding tax(WHT) from interest and dividend income
- Customs and import duties account for 51% of total tax proceeds and due to the relative inelasticity of the country's imports, is expected to continue to account for the bulk of consumer taxes in spite of the depreciation of the Rupee.
- Despite this tax proceeds % of GDP remains low at 12.4% in 2011 relative to peers due to inefficiencies in the tax collection process.
- Government recurrent expenditure rose by 24% YoY in 1H2012 on the back of high fertilizer costs which rose 131% YoY due to the expansion of the program to cover any crop as well as due to the significant increase in other expenditure by 53% YoY on account of high interest costs.
- However recurrent expenditure is expected to remain within budgeted estimates with the shift in focus towards public investment which accounted for 29% of government expenditure in 1H2012 as opposed to 26% in 1H2011.
- Sri Lanka's interest expenditure % of government revenue stands at 43.1% which is relatively high in comparison to the South Asian regions average of 27.1%
- Governments total outstanding debt grew by 23% to LKR 5,951.6 billion by end of June 2012
- More worryingly domestic debt grew 15% to LKR 3,155.3bn YoY while external debt increased faster by 34% to LKR 2,796.3bn

Actual Vs. Budgeted performance

LKR bn	Budgeted	Actual*	% Change
Tax Revenue	1,000.6	840.7	-16%
Income Tax	190.3	163.5	-14%
Non Tax Revenue	105.5	112.6	7%
Grants	20.0	14.4	-28%
Total Revenue	1,106.1	953.1	-14%
Total Revenue and Grants	1,126.1	967.5	-14%
Total Expenditure	1,594.9	1,538.1	-4%
Recurrent	1,107.9	1,080.8	-2%
Salaries and Wages	367.9	324.7	-12%
Interest	370.0	426.9	15%
Subsidies and Transfers	236.4	122.9	-48%
Other Goods and Services	133.5	206.5	55%
Public Investment	497.5	457.2	-8%
Revenue % GDP	14.7	12.3	-16%
Expenditure/GDP (%)	21.2	23.7	12%
Current Expenditure/GDP (%)	14.7	17.7	20%
Public Investment/GDP (%)	6.6	6.0	-9%
Budget Deficit/ GDP (%)	-6.2	-11.4	83.9%

Source: Budget Speech, Department of Fiscal policy & Asia Wealth Management Co. (Pvt) Ltd estimates

*Actuals are based on annualized values of 7-months of fiscal data for 2012

Implications

- Government will be more inclined to raise taxes of products with low elasticity's such as Cigarettes, Alcohol, imported Sugar via overnight Gazette's in order to meet any shortfalls
- Further consistent with the budget proposal for 2012 we expect most tax concessions to be focused on encouraging new investments for import substituting activities rather than for existing enterprises.
- We expect policy concerning agriculture to be consistent with the government policy objective of revitalizing agriculture and hence expect firms to continue to benefit from the extension of the fertilizer subsidy to all crops introduced in May 2011.
- We therefore expect the tax policy for budget 2013 to be consistent with the "pro consumer/pro investor" budget of 2011.
- We do not expect a dramatic shift in government policy With respect to State owned Enterprises (SOE's), given the present regime's reluctance to opt for privatization and scaling down of the civil service.
- The government is expected to push ahead with its investments in infrastructure regardless of the burgeoning budget deficit as evident in the 41% YoY increase in public investment in 1H2012 and is expected to account for 6% of GDP which is in line with government expectations.
- In line with this, data released by the Central Bank indicates that government expenditure is expected to reach LKR2,520 bn for 2013.
- Interest payments on foreign borrowings are expected to rise as a result of the depreciation of the Rupee and limited access to lower cost borrowings along with Sri Lanka's graduation to a lower-middle income economy.
- As a result and given that the large foreign borrowing account for more than 60% of existing public investment projects, increasing interest payments could result in a moderation of the rate at which the government takes on new public development projects in the future.