

2017 Budget Proposals

Fiscal consolidation continues with a focus on investments

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Yesterday, the Minister for Finance presented the 3rd budget of the Unity Government in Parliament. Following the presentation, the proposals will be debated until the 10th of December at which point the vote will be taken. We note that the proposals are focused on longer term development goals set within constraints of meeting the IMF targets. From an asset class point of view, we believe that this is negative towards fixed income and property while having a mixed view on the equity market. In the near term the Consumer sector will be positively affected, in our view, on greater disposable income while most other sectors will be negatively impacted. We do not see any major sensitive proposals which could result in implementation issues this time as both main parties in the Unity Government have discussed these in depth prior to presentation in Parliament. While implementation remains vulnerable to political headwinds and would cause pressure on multiple sectors in the near term, we believe that this budget is a step in the right direction towards gearing up for long term growth.

Sector view	
Consumer	Positive
Banking	Negative
Telecom	Negative
Healthcare	Negative
Energy	Negative
Leisure	Negative
Finance	Neutral
Insurance	Neutral
Manufacturing	Neutral
Construction	Neutral

Source: Asia Securities

Fiscal consolidation gathers steam

The platform for the 2017 budget set by the Finance Minister is focused on meeting the IMF's fiscal consolidation targets while attracting FDIs. Of particular note within the proposals are the capital allowances being given for investments with a focus on job creation. Several changes are proposed in terms of increasing corporate taxes and removing exemptions while the threshold for personal income tax is being increased. We expect the budget deficit would be at a range of 5.5-6.0% for 2016E, and improve to 5.0-5.5% by 2017E with GDP growth of 4.5-5.0% in 2016E, and expect this to pick up slightly to 5.0-5.2% on the back of construction, tourism and maritime growth in 2017E.

Fixed income assets become unattractive

From an asset class point of view, we believe that the 2017 budget proposals makes investing into fixed income assets and property relatively unattractive options. Tax exemptions which were granted for on unit trusts will be removed for the corporate sector while listed corporate debt will no longer be a tax free investment. Furthermore, taxes on treasury bills and bonds are set to be increased by 4pp to 14.0%. Property will become eligible for capital gains tax at a rate of 10.0% but, no further details have been provided. However, we do not expect the changes to the fixed income instruments to result in a significant shift towards equities as they do not provide the liquidity or risk profile required by a fixed income investor.

Consumer most positive, banks negative near term, construction neutral

We believe that the Consumer sector would be the prime beneficiary of the proposals through the changes to personal income tax leading to higher disposable income. The smaller Banks are looking at significant headwinds on the requirement to increase the capital base to a minimum of LKR 20bn (currently LKR 10bn). However, this will force consolidation over the medium term which is a positive in our view. While Construction will get hit by higher income taxes, the planned expenditure on infrastructure and housing will offset most, if not all, of the impact.

Key indicators	2013	2014	2015	2016E	2017E	2018E
GDP growth (%)	3.4	4.5	4.8	4.5-5.0	5.0-5.2	5.2-5.5
Headline inflation (%)	6.9	3.3	2.8	5.0-5.5	5.3-5.5	4.5-5.0
Core inflation (%)	2.1	3.2	4.5	5.0-5.5	5.0-5.5	4.5-5.0
Fiscal balance (% of GDP)	(5.9)	(6.0)	(7.4)	(6.0)-(6.5)	(5.0)-(5.5)	(4.5)-(5.0)
Trade balance (% of GDP)	(10.5)	(10.4)	(10.2)	(10.5)-(11.5)	(10.5)-(11.5)	(10.0)-(10.5)
Current balance (% of GDP)	(3.7)	(2.5)	(2.4)	(2.5)-(3.0)	(2.5)-(3.0)	(2.2)-(2.3)
FX reserves (months of imports)	3.9	4.1	4.0	4.5-5.0	4.5-5.0	5.0-6.0
12M T-Bill yield (%)	8.3	6.0	7.3	10.7-11.0	11.0-11.5	9.5-10.0
LKR/USD	129	131	143	148	152-155	160

Source: CBSL, MoF, Asia Securities

Analyst Certification

We, Kanishka Perera, Mangalee Goonetilleke, Hasantha Uswatta, and Lakshini Fernando, certify that the views expressed in this report accurately reflect our personal views about the content in the report. We also certify that no part of our compensation was, is, or will be, indirectly or directly, related to the specific view or recommendation expressed in this report.

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