Sustainable finance scramble reaches currency derivatives market

REUTERS, *London*

A rush by companies to boost their sustainability claims has reached foreign exchange markets in the form of currency hedging products where the cost is tied to a firm's environmental, social and governance (ESG) goals.

Sustainable finance to date has mostly centred around the issuance of debt to fund 'green' environmental or climate-related projects, or with interest payments linked to the achievement of social and governance targets.

But energy firms Drax and Italy's Enel are among those to have recently signed up to ESG-linked FX derivatives, the price of which depends on anything from cutting greenhouse emissions to improving workforce diversity.

Keen to promote their own sustainability pledges, banks selling the derivatives, which lock in a future exchange rate, tout them as a way for companies to tap into demand for ESG finance, a market that has soared in popularity but which critics say is often more marketing gimmick than a true incentive for change.

Early adopter Olam, a commodity trader, last year bought a US dollar/Thai baht forward contract at a discount to a conventional forward, on condition it meets several targets including cutting carbon emissions and boosting farmer training.

How a value is assigned to an ESG goal, and hence how such products are priced, for now remains between banks and their clients in the fledgling market, but Fabio Madar, global head of FX sales and structuring at NatWest Markets, said there can be decent financial gains for clients that buy and sell currencies frequently.

He cited the example of a company purchasing 400 million euros. If the euro/dollar swap rate was set at \$1.2130, the client could lock in a price of \$1.2128 if targets are met -- saving \$80,000.

The impetus is not just financial, he said, with firms keen "to show that it's not all talk and that the company is real about (sustainability)".

Jeremy Hamon, head of group finance at engineering business Primetals Technologies, thought sustainability-linked finance was limited to debt products such as those issued by Primetals' parent company Mitsubishi Heavy Industries.

But Primetals developed a framework with Deutsche Bank around its day-to-day currency hedging needs using "quantifiable" ESG targets, including increasing the proportion of revenue from projects that aim to cut greenhouse emissions, and promoting a "safe and healthy work environment".

If it misses the targets -- which are verified by a third party -- Primetals pays a penalty to a charity. It has already bought such options in more than 10 currency pairs.

"This represented all the FX options we have traded in 2021 since the ESG incentive pretty much ensures a strong competitiveness," Hamon said.

UK energy firm Drax has signed ESG-linked derivative deals with Barclays and NatWest, whereby it is paid a premium by the banks for meeting a carbon intensity reduction target.

"Most of our banking group, and even some banks not in our group, have contacted us to see how they can do something similar in the FX and financial derivative space," said Lisa Dukes, Drax's director of corporate finance and derivatives.

Sustainable finance has its critics who say it is too loosely-defined, with many products little more than marketing tools prone to so-called greenwashing where environmental claims don't stack up.

Banks insist targets in the ESG-linked derivatives are ambitious, measurable and independently verified.

"These structures are a very good way for a company that doesn't have a funding or capex need related to ESG, to still make a commitment to ESG," said Claire Coustar, Deutsche Bank's global head of ESG for fixed income and currencies.

Mimi Rushton, Barclays' co-head of global FX sales believes ESG incentives could start "extrapolating out to a number of other financial instruments" beyond FX.

One challenge is that banks must bear the cost of the premium or the discount -- the company's reward for hitting targets -- eroding its profit and limiting the size of incentives.

Market growth therefore hinges on such derivatives becoming tradeable. For that, banks must find a way to embed sustainability performance into the option.

REUTERS/FILE

Steam rises from chimneys on a cold day in Moscow, Russia on January 18.

Second wave hits demand more than supply in India

REUTERS, *Mumbai*

India's central bank said on Monday that the second wave of the Covid-19 pandemic in India has had a bigger impact on aggregate demand than on aggregate supply, and it believes the economic slowdown was not as severe as a year ago.

India reported a further decline in new coronavirus cases on Monday but daily deaths remained above 4,000 and experts said the data was unreliable due to a lack of testing in rural areas where the virus is spreading fast.

"The biggest toll of the second wave is in terms of a demand shock - loss of mobility, discretionary spending and employment, besides inventory accumulation, while the aggregate supply is less impacted," the Reserve Bank of India said in its monthly bulletin.

"The resurgence of Covid-19 has dented but not debilitated economic activity in the first half of Q1:2021/22," it added.

ADP gets 14pc bigger

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The combined estimated cost of 1,426 projects is Tk 16,60,807 crore. Of the sum, Tk 556,351 crore may be spent as of June this year.

The rest Tk 11,04,456 crore will be allocated in the coming years, and it may take four to 12 years to finish the projects at the current speed of execution.

An official at the planning ministry blamed meagre allocation, an excessive number of projects, delay in timely implementation, and inclusion of new projects for the lengthy execution period.

Many projects are usually included in the development plan every year, but they are not completed on time. These projects are granted lower allocation and see a repeated extension of the deadlines.

The NEC yesterday gave consent to a list of 596 new but unapproved projects, and no funds were allocated in favour of them. They will be included in the revised ADP following the go-ahead from the Executive Committee of the National Economic Council.

The deadline of at least 678 projects out of 1,426 projects will expire by June this year. The planning ministry, in its presentation, said their deadline needed to be pushed back by June 30.

The government has targeted to complete 356 projects in FY22. But they might not be completed by the year-end, the official said.

The current ADP has planned to finish 441 projects by FY21. But at least 57 projects will not be completed on time, so they were included in the new ADP.

The size of the original ADP in FY21 was Tk 205,144 crore. The planning ministry has proposed to slash it to Tk 197,643 crore in the revised budget as the coronavirus pandemic has hampered development works.

In the new ADP, the contribution of foreign assistance will stand at Tk 88,024 crore, which is up 39.72 per cent from the revised outlay of Tk 63,000 crore.

The portion of the government will be Tk 137,299 crore, an increase of 1.97 per cent year-on-year.

The transport and communication sector was given the highest allocation of Tk 61,721 crore among all the sectors, which accounted for 27.39 per cent of the new ADP.

It was followed by the power and energy sector Tk 45,868 crore, the housing and community services sector Tk 23,747 crore, the education sector Tk 23,178 crore, and the health sector Tk 17,306 crore.

The Rooppur Nuclear Power Plant received Tk 18,426 crore, Matarbari Coal-based Power Plant Tk 6,162 crore, the fourth primary education development programme Tk 5,053 crore, the Dhaka Mass Rapid Transit Development project Tk 4,800 crore, and the Padma Bridge Rail Link project Tk 3,823 crore.

The NEC also approved an additional Tk 11,468 crore for the state-owned enterprises.

Traders breathe a sigh of relief for better Eid sales

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Shaheen Ahmed, owner of Anjans, said traders had feared that shoppers would not come to shopping malls or other retail outlets amid concerns of contracting the deadly Indian-variant of Covid-19.

But luckily, that did not happen as customers came to shop and business was not bad at all.

In terms of overall sales volume, Anjans' sales reached about half of its pre-pandemic levels.

"I initially thought we wouldn't be able to reach even 20 per cent sales of normal times," added Ahmed, also president of the Fashion Entrepreneurs Association of Bangladesh.

Khalid Mahmood Khan, co-founder of Kay Kraft, had anticipated that sales would reach 40 per cent of previous levels.

"However, it improved significantly towards the end of Ramadan to reach 70 per cent compared to 2019," he said.

Ujjwal Das, owner of Lanthon Fashion House in Shahbagh, had shared a different view ahead of Eid as the turnout of university students, his key demographic, was very thin back then.

"But still, business has been good so far and I was able to pay salaries, shop rent, and bonuses," he said.

"I couldn't do that in 2020," Das added.

Md Asaduzzaman, proprietor of Ankhi Fashion Garden, said although sales were good, it was not as much as expected.

"I kept my shutters closed for much of 2020 and the same situation arose in 2021 due to the second wave. People don't have money like before, so we did business on a limited scale," he added.

Sharif Market, the largest wholesale market for panjabis in Sadarghat, meets about 70 per cent of the local demand for the popular attire.

Atul Chowdhury, a salesman of the market's Syed Garments store, said that sales have been quite good.

"Sales were close to the 2019 levels, which was beyond our comprehension. We sold the bulk of our products during the last minute of Ramadan. The owners as well as employees are all happy for it," Chowdhury added.

Nesar Uddin Mollah, general secretary of the Islampur Cloth Merchant Association, said Ramadan was prime time for business but the lockdown had coincided with it.

"We sold a fair amount of products after being allowed to open the shops. We managed to sell 60 per cent of what we had prepared for," he added.

Similarly, Arfanul Hoque, head of retail at Bata, said they had reached 75 per cent of the sales volume in 2019.

"But if we compare it with the hard-hit 2020, it has been a fourfold increase," he added.

Saikat Azad, marketing manager of Transcom Electronics, said that customer turnout was quite good two days before Eid.

Air conditioners did not sell well and the demand for televisions was also low as people are spending carefully amid the pandemic.

"The overall demand for these products was very low but refrigerators and deep fridges sold well," Azad added.

Selim H Rahman, managing director of Hatil, said business was around 25 to 30 per cent less than usual during this Eid.

People redecorate their houses ahead of the Eid, which is why furniture sales grow significantly in that period.

Furniture brands also offer discounts to attract buyers but this time, buyers diverted away from furniture to clothes because of the coronavirus.

"Business was not very good because furniture is not cheap like clothes, which is why sales have not picked up much," he added.

Helal Uddin, president of the Bangladesh Shop Owners' Association, said the return of capital was more important than profit for traders under the current circumstances.

Many businessmen had been idle for the last 14-16 months and so, they just want enough capital to survive.

"I want to thank the government for its timely decision to reopen the businesses, shopping malls, markets and shops for us before the prime spending season," he added.

Political economy analysis of tax reforms

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Unlike the original VAT Act, 2012 with a single VAT rate and little tax exemptions, the amended VAT Act, implemented in 2019, came with multiple rates (7) and widespread tax exemptions. The most fundamental criticism is that too many VAT rates can cause revenue leakage and severe economic distortions. Available evidence shows that the VAT performance has not improved relative to other taxes since the new law was implemented in July 2019.

The present Income Tax Ordinance, 1984, is outdated to keep pace with the changing need of time. So, a new income tax code is needed to put in place an efficient and modern income tax regime.

We also see this play out within the tax administration. Owing to the absence of substantial automation, the NBR has largely maintained an outdated control-based system, which has allowed tax officials to retain substantial discretion—and thus opportunities for collusion with, or extraction from, taxpayers.

For example, the authority of issuing statutory regulatory orders (SROs), bypassing the Parliament, is an expression of discretionary power of the NBR. At the core of current arrangements is an apparent contradiction: the system promises low and predictable tax rates to key business actors through collusion and corruption while also offering significant discretion and rent-seeking opportunities to some tax officials and political actors.

The basic inefficiency of the tax system has been exacerbated by a high degree of administrative fragmentation. Whereas there has been a trend in low-income countries toward greater integration across administrative units, the NBR remains divided into three highly autonomous tax wings: Income Tax, VAT, and Customs.

The relative absence of data sharing across tax wings severely undermines administration and opens space for collusion, arbitrariness, and abuse, while fragmentation also creates additional costs for taxpayers. The end result of these weaknesses is a tax system characterised by extremely high degrees of informality, widespread discretion, and the regular negotiation of tax liabilities.

At a broad level, the NBR itself has been found to be the most steadfast resistant to tax reforms. As the NBR officials enjoy substantial discretionary power, this opens the door to systemic corruption that is organised and sanctioned at every level of the administration. As such, some officials within the board are strongly resistant to any reform programme that would reduce their discretionary power, including through increased transparency.

For example, the NBR drew an outline of the Modernisation Plan covering tax policy and tax administration during 2011-2016. It was placed before the Parliament. However, with the retirement of the then chairman, little reform measures were undertaken. Thus the strength of bureaucratic resistance is consistent with patterns elsewhere in the civil service.

IDENTIFYING DYNAMICS THAT MIGHT TEND TO SHIFT EXISTING POLITICAL SETTLEMENTS

Except for registration in income tax and VAT, other tax processes are mostly manual. The outbreak of the Covid-19 pandemic has underscored the need and has given an opportunity for full automation of the core functions of income tax and VAT.

MAKING TAX REFORMS EFFECTIVE

Tax reforms must be homegrown. Reforms must be owned by the finance minister with the active support of the NBR and the strong backing of the Prime Minister's Office.

The NBR may draw up a five-year tax reform plan covering several issues.

The first issue may include rationalising corporate tax rates. While India and Pakistan have two corporate tax rates, we have six. The time has come to revisit the corporate tax rate structure to attain the dual objectives of reducing the cost of doing business and enhancing government revenue.

Second, the tax net may be broadened by giving emphasis on withholding taxes, reducing tax exemptions and linking different services with the tax system. Third, the digitalisation of the tax system is essential to improving tax compliance. Fourth, the tax administration needs to be strengthened to combat tax evasion and improve tax governance. Fifth, tax policy may be separated from the tax administration. The Internal Resources Division of the finance ministry should be entrusted with tax policymaking while tax administration should remain with the NBR.

Tax reforms should be properly reflected in the annual performance agreement of the government. The parliamentary standing committee on the finance ministry needs to monitor the progress of reforms, and the media may report to the public.

Development partners may get involved in the automation of core functional areas of income tax with a particular focus on integrating the automation of the tax system with the existing VAT reform strategy. Both income tax and VAT should use the same platform and share information seamlessly to create synergy.

Development partners may also help the NBR return to the original 2012 VAT Act to the extent possible by consolidating various differentiated rates and turnover-based regimes into a unified structure.

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Stocks break 8-day gaining streak

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The profit booking session was expected after a stretch of rise of the index, said stock investor Misbahul Haque.

A higher turnover is a positive sign for the market, he said.

As investors have regained their confidence, they are now investing funds and the regulator should work to retain this confidence, he added.

At the DSE, 103 companies' stocks rose, that of 215 fell and that of 47 remained the same.

Standard Insurance topped the gainers' list, rising 10 per cent, followed by City General Insurance Company, Index Agro Industries, Crystal Insurance Company and Maksons Spinning Mills.

Beximco's stocks were traded the most, hitting Tk 114 crore, followed by Prime Bank, British American Tobacco, Saif Powertec and National Feed Mills.

Bangladesh Industrial Finance Company shed the most, dropping 6.67 per cent, followed by Premier Leasing and Finance, FAS Finance and Investment, Fareast Finance and Investment and MIDAS Financing.

While almost every company witnessed corrections, insurance stocks remained bullish. Most insurers' stocks rose due to the active participation of some big investors.

Market analysts are saying that their participation resulted in the stocks becoming overvalued, so general investors need to be cautious.

Among the 50 insurance stocks, 37 rose, 10 dropped and three remained the same.

Chittagong Stock Exchange (CSE) also took a plunge. The CASPI, the general index of the port city bourse, fell 28 points, or 0.16 per cent, to 16,894.

Among 289 stocks to witness trade, 89 rose, 168 fell and 32 remained the same.

Crises in India, Myanmar diverting export orders to Bangladesh

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The same was true for Cambodia. Some work orders had been shifted to other countries because of a lockdown in the Southeast Asian nation. But it was a temporary measure as Cambodia was also a major sourcing hub for the company.

Myanmar has become an important link in the supply chains of well-known Western brands in the luggage, fast fashion and footwear industries.

For instance, US imports from Myanmar reached \$1.06 billion in the 12 months to November 30, 2020, from \$245 million in 2016, according to a report on Al Jazeera.

Of the sum, apparel and footwear accounted for more than 41 per cent. Luggage imports made up nearly 30 per cent, while fish accounted for 4.4 per cent.

When asked if the coup has affected its business in Myanmar, H&M Spokesperson Ulrika Isaksson told Al Jazeera in a statement, "We expect our production in Myanmar to be affected. We are in close dialogue with our suppliers and monitoring the situation as it develops."

The official was whether H&M plans to continue sourcing from its independent suppliers in Myanmar.

In response, Isaksson said, "While we are concerned about the situation in Myanmar and closely monitoring the developments, we refrain from taking any immediate action with regards to our presence in the country."

Md Saiful Islam, president of the Leathergoods and Footwear Manufacturers & Exporters Association of Bangladesh, said the sector had been receiving an increasing number of work orders over the last couple of months.

"Many leather and leather goods companies have shifted orders from Myanmar to Bangladesh because of the political uncertainty," he said.

The increase has significantly helped the recovery of Bangladesh's leather and leather goods shipments recently.

Earnings from leather and leather goods shipment were up 8.56 per cent year-on-year to \$760.92 million between July and April.

The receipts entered the positive territory after more than four years not just for the diversion of the orders from other countries but also for the clearing out of inventories and the receipts of past payments from retailers and brands, Islam said.

Faruque Hassan, president of the Bangladesh Garment Manufacturers and Exporters Association, also acknowledged that some work orders were shifting from Myanmar. However, Myanmar's total garment export volume was too little when compared with that of Bangladesh, he said.

"The shift has had little impact on Bangladesh's garment sector," he said, adding that the placement of work orders in India had slowed a bit due to Covid-19.

It does not mean that Bangladesh is receiving work orders of India due to the pandemic, he said.

Export from Bangladesh in the last 15 days dipped 16 per cent compared to that last year, said former BGMEA president Rubana Huq.

The only category that has had growth is knitwear, while woven witnessed a drop of almost 6 per cent between August 20 and April 21.

"I don't think there's an overall recovery, but knitwear is doing slightly better," Huq said.

Lingerie and artificial fibre-based anoraks have had a significant rise in export. Competition is still fierce, and Covid-19 has doubled the industry's suffering, she also said.

"I think it is too early to reach any conclusion from outside," said Zahid Hussain, a former lead economist of the World Bank's Dhaka office.