Budget good enough for IMF?

Federal budget FY23

Budget targets to remain under threat

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Budget targets to remain under threat

Budget FY23 focuses on rationalizing expenditures, and abiding by the fiscal limits being negotiated with the IMF. For the upcoming year, GoP has budgeted total outlay of PKR9,502bn, which is just 4% higher than FY22 revised expenditure of PKR9,118bn. Government plans on limiting the fiscal deficit to 4.9% of GDP (FY22r: 8.6%), which in our view, may come at the expense of development spending cuts.

Gross revenue receipt growth of 23.1% seems a bit stretched. Petroleum levy target of PKR750bn (PKR135bn in FY22r) will remain under threat due to volatile global oil prices. Moreover, FBR direct tax collection target of PKR2,573bn (up 17%) is also looking over optimistic, keeping in mind FY17-22 CAGR of just 10%.

Cognizant of current global energy price trends, and government's subsidy & non-tax revenue targets, we find budgeted economic growth (5.0%) and CPI inflation (11.7%) targets overly-optimistic.

A key area of focus in FY23 budget is progressive taxation. Taxes on high income individuals and companies have been increased. Whereas, tax exemption limits for low income individuals and businesses have been raised. In a bid to channel investments into productive assets and away from real estate, taxes on stock market and real estate (open plots) investments have been harmonized.

From corporate earnings standpoint, budget is largely negative as effective tax rate on banks has been increased from 39% to 41% in 2022, and 47% in 2023. Furthermore, 2% additional levy for poverty alleviation has been imposed on companies earning more than 300mn.

We believe prevailing valuations (PE of 4x) already price in the negatives. We like yield plays, MCB, UBL, HMB, EFERT, FFC, & MARI. We also like HUBC, OGDC & PPL as they will benefit from structural improvements in the energy chain.

Note that due to the ongoing Russia-Ukraine war and its spillover effects on energy (oil distillates) and food prices, economic outlook would remain uncertain globally. Hence, integrity of budget numbers will remain under threat.

Economy	Budget targets to remain under threat

After the 7.4% upwards revision in expenditures, FY22 fiscal deficit (FD) would expand to 8.6% (in terms of GDP) vs budgeted number of 5.1%. For FY23 government plans on limiting the FD to 4.9% of GDP, with a primary budget surplus of 0.2%. FY23 gross revenue growth target of 23.1% looks unrealistic. Moreover, there are chances that current expenditures (especially energy subsidies) might exceed target, making 40% expansion in development expenditure hard to attain.

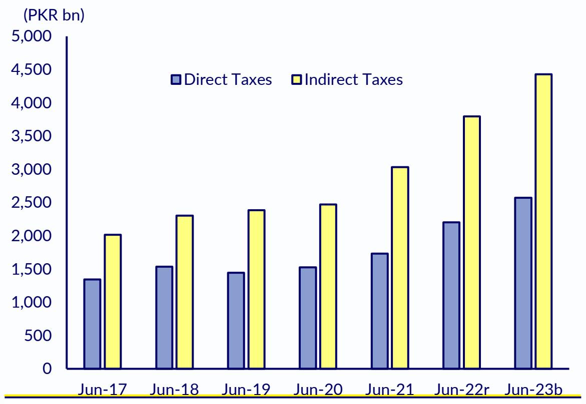
Direct tax & PL targets are stretched and inflationary: For FY23, government has set a gross revenue target of PKR9trn, this is an increase of 23.1%/PKR1,688bn over FY22 revised numbers. Around 36% of the aforementioned increase is attributable to Petroleum levy (budgeted at PKR750bn vs PKR135bn in FY22r), which will remain under threat due to volatile global oil prices. FBR direct tax collection target of PKR2,573bn (up 17%) is also looking a bit far-fetched, keeping in mind FY17-22 CAGR of just 10%.

Also a notable increase has been targeted in GIDC head, where collections target is set at PKR200bn in FY23 vs PKR25bn in FY22r. On the flip side surplus profit of State Bank of Pakistan (SBP) is expected to decline by 37%/PKR174bn.

Government is targeting FBR indirect taxes to register a growth of 17% in FY23 (FY17-22 CAGR 13%), which is plausible given that inflation is projected to average around 15%.

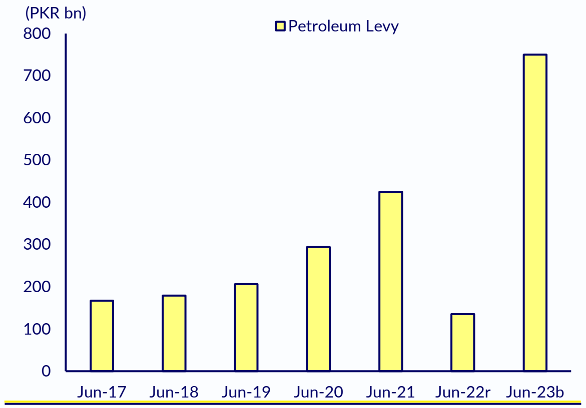
Revenue targets seem unlikely, moreover raising collections through PL will further fuel inflation.

Direct tax target looks unrealistic



Source: Budget docs, Eco. Survey, Alfalah CLSA Research

PL collections will remain under danger



Source: Budget docs, Eco. Survey, Alfalah CLSA Research

Budget targets to remain under threat

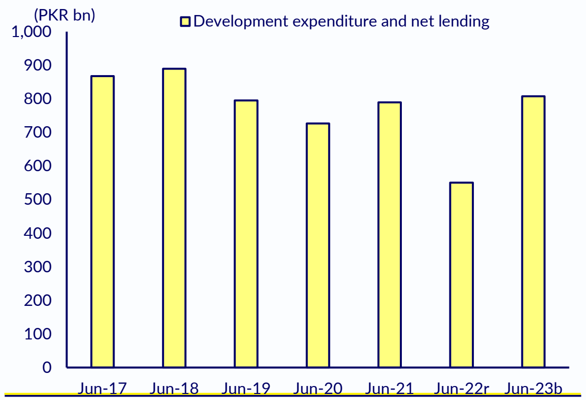
40% increase in development expenditure looks difficult to attain: Government's focus is on rationalizing expenditures, and abiding by the fiscal limits being negotiated with the IMF. GoP has budgeted total outlay of PKR9,502bn, just 4% higher than FY22 revised expenditure of PKR9,118bn.

Budget FY23 aims curtailing current expenditure growth to a minuscule 2.1%/PKR178bn, moreover a massive 40% expansion in development expenditure (PKR770bn) is planned for FY23.

Within current expenditure, Govt has deliberated a 54%/PKR816bn cut in subsidies (subsidies to IPPs has been slashed by 58.5%/PKR254bn to PKR180bn in FY22). Defense expenditures are almost flattish (up 2.9%) at PKR1,523bn. Markup payments are budgeted at PKR3,950bn, up 26%/PKR806bn YoY, thanks to increase in interest rates and rapid PKR devaluation.

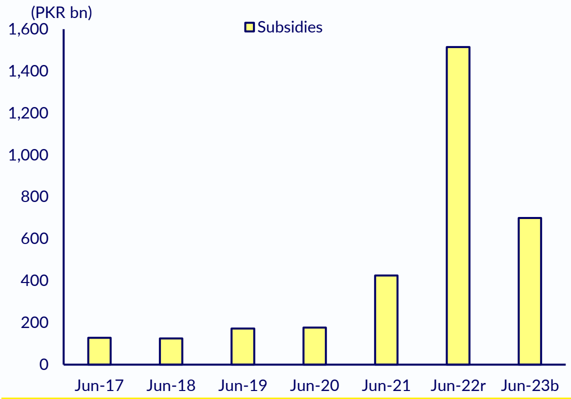
We seriously doubt that the development expenditure target would materialize. We see a repeat of FY22, where actual development spending was 38.9% lower than initial budget target of PKR900bn. Development spending cuts will make up for any slippages on the revenue collections and current expenditure front.

Federal PSDP target up 54%



Source: Budget docs, Eco. Survey, Alfalah CLSA Research

Subsidies slashed by 54%



Source: Budget docs, Eco. Survey, Alfalah CLSA Research

Economy

Budget targets to remain under threat

Economic growth and inflation estimates are over-optimistic: Cognizant of current global energy price trends, and government's subsidy (PDC) & non-tax revenue targets, we find budgeted economic growth and CPI targets overly-optimistic.

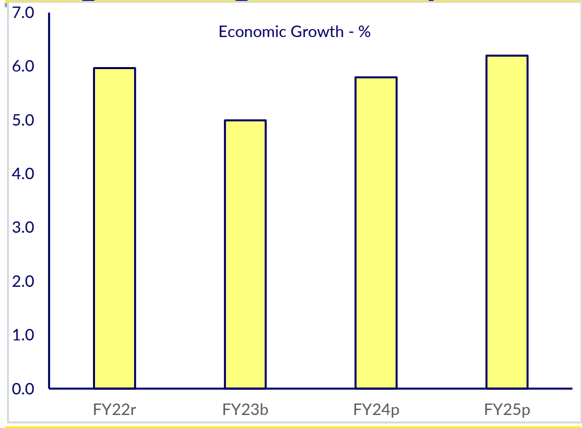
Government has set a GDP growth target of 5.0% for FY23, compared to 5.97% witnessed in FY22. We estimate FY23 GDP growth to remain near the lower end of the 3.5-4.5% range, thanks to a hawkish monetary policy and a severely cash strapped government.

Thanks to the imposition of PL, roll back of power subsidies, and revision in gas tariffs (to be announced soon) inflation is all set to make new highs. We estimate CPI inflation to spike up to 20% in the near term and average around 15.3% in FY23; sizably above governments target of 11.7%.

This means interest rates would stay elevated throughout FY23, and interbank rates will continue to stretch up in the coming months.

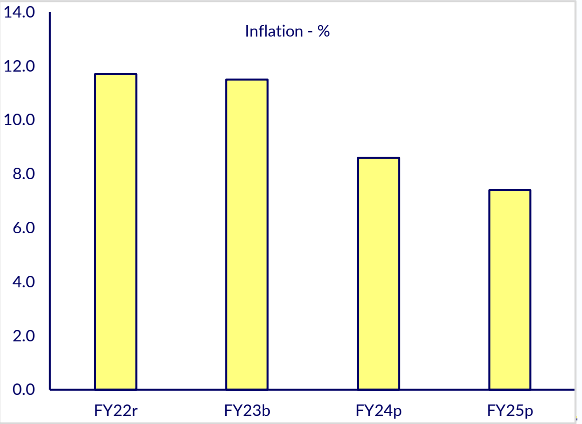
Note that due to the ongoing Russia-Ukraine war and its spillover effects on energy (oil distillates) and food prices, economic outlook would remain uncertain globally. Hence, integrity of budget numbers will remain under threat.

GDP growth target of 5% is optimistic



Source: Budget docs, Eco. Survey, Alfalah CLSA Research

CPI to surpass government estimate



Source: Budget docs, Eco. Survey, Alfalah CLSA Research

Taxing the rich, helping the poor: A key area of focus in FY23 budget is progressive taxation. On this front Government has imposed additional income tax of 2% on AOPs and companies having income in excess of PKR300mn. Govt has levied, additional income tax of 1% of fair market value of second property (worth at least PKR25mn) on perceived rental income of 5% of fair market value.

On the flipside, tax exemption limit for individuals is proposed to be raised from PKR600,000 to PKR1,200,000. For AoPs and business individuals tax exemption limit is to be raised from PKR400,000 to PKR600,000.

Moreover, maximum tax on Behbood saving certificate, Pensioners benefit account and Shuhada family welfare is to be reduced to 5% from 10%.

Tractors and seeds are proposed to be exempted from sales tax. Currently 5% sales tax is applicable on tractors. Agriculture machinery is also proposed to be made tax exempt.

Budget targets to remain under threat

Harmonization of stock market and real estate tax rates a welcome development: As a major positive surprise, in the bid to channel investments into productive assets and away from real estate, government has reduced Capital Gains Tax (CGT) on securities. 15% CGT would be reduced by 2.5% annually, and will be zero for securities held for more than six years.

Also government has imposed/harmonized taxes on immovable properties. CGT of 15% would be levied on sale of open plots with holding period of less than one year, rate of tax would be reduced by 2.5% annually, and will be zero for plots held for more than six years. Advanced tax of 20% on deemed rental income of 5% of fair market value of second property, and tax on buying and selling of property would channel investment flows into the stock market.

In our view, reduction in maximum tax on savings certificates from 10% to 5% is slightly negative for equity market.

Corporate earnings to take a hit: From corporate earnings standpoint, budget is largely negative as effective tax rate on banks has been increased from 39% to 41% in 2022, and 47% in 2023. Furthermore, 2% additional levy for poverty alleviation has been imposed on companies earning more than 300mn. Moreover, banks with ADR of upto 40%, 40% to 50%, >50% would pay 55%, 49%, 42% tax on income from government securities, respectively.

Key relief measures for industries include, increase in initial depreciation limit from 50% to 100%. All import taxes are proposed to be made adjustable for industries.

Federal PSDP target up 43%

Holding period	CGT on stocks
less than 1 year	15%
1-2 years	13%
2-3 years	10%
3-4 years	8%
4-5 years	5%
5-6 years	3%
Beyond 6 years	0%

Source: Budget docs, Eco. Survey, Alfalah CLSA Research

Tax rates for banks hiked

Banks	2022	2023
Corporate tax	35%	45%
Super tax	4%	0%
Poverty alleviation tax	2%	2%
Total tax	41%	47%

Source: Budget docs, Eco. Survey, Alfalah CLSA Research

Medium term macroeconomic indicators

	Budget FY22	Revised FY22	Budget FY23	Projections FY24	Projections FY25
Real GDP growth (%)	5	6	5	5.8	6.2
Inflation (%)	8.2	11.7	11.5	8.6	7.4
			As a % of GDP		
FBR tax	10.7	9	9	9.4	10
Overall deficit	6.3	7.1	4.9	4	2.8
Overall primary balance	-0.7	-2.4	0.2	0.9	1.8

Source: Budget docs, Eco. Survey, Alfalah CLSA Research

Budget estimates 2022-23

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(PKR bn)	Budget FY22	Budget FY23
Revenue Receipt (FBR)	**5,829**	**7,004**
Non Tax Revenue	**2,080**	**2,000**
Gross Revenue (FBR+NTR)	**7,909**	**9,004**
Less: Transfer to Provinces (-)	-3,412	-4,100
Net Revenue for Federal Government	4,497	4,904
Expenditure	8,487	9,502
Federal Budget Deficit	**-3,990**	**-4,598**
Provincial Surplus	570	800
Overall Budget Deficit	-3,420	-3,798
Overall Fiscal Deficit as %GDP	**-6.3%**	**-4.9%**
Primary Deficit	-360	152
Primary Deficit as %GDP	-0.7%	-0.2%
Nominal GDP	53,867	78,197

(PKR bn)	Budget FY22	Revised FY22	Budget FY23
FBR taxes	**5,829**	**6,000**	**7,004**
Direct taxes	**2,182**	**2,204**	**2,573**
Income tax	2,172	2,191	2,558
Others	10	13	15
Indirect taxes	**3,647**	**3,796**	**4,431**
Custom duties	785	817	953
Sales tax	2,506	2,635	3,076
FED	356	344	402
Current expenditure	**7,523**	**8,516**	**8,693**
Subsidies	**682**	**1,514**	**699**
Federal PSDP	**900**	**550**	**770**

Source: Budget docs, Eco. Survey, Alfalah CLSA Research

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Sector	Overall Impact	Measure	Impact	Comment
Banks	**Negative**	Tax on banks raised to 45% from 39% for tax year 2023 onwards. Moreover, additional 2% tax on companies earning more than PKR300Mn a year (for poverty alleviation purpose) shall be imposed. This shall take total tax rate for CY22/23 to 41/47% respectively and 47% onwards. Incremental tax on banks for income attributable to investment in the Federal Government securities: ❑ 55% (prev: 40%) if the gross advances to deposit ratio on last day of the tax year is upto 40% ❑ 49% (prev: 37.5%) if the gross advances to deposit ratio on last day of the tax year is>40% but<=50%	Negative	Higher tax will bring down CY22/CY23 earnings of the sector by ~4.5/15.0% on average and valuations by ~15%. Note that banks with ADRs lower than 50% (HBL, UBL MCB, ABL) will see a higher earnings decline (16-17%) while those with ADRs greater than 50% will experience a relatively lower decline (12-13%) in CY23.

Sector	Overall Impact	Measure	Impact	Comment
Energy	Neutral	Imposition of petroleum levy of PKR750bn	Negative	Can affect fuel demand due to higher prices (Negative for Oil Marketing companies)
		Increase in gas tariffs (to be announced)	Positive	This will significantly reduce the pace of circular debt accumulation, and open up cash flows for OGDC and PPL.
		10% CD rate on import of motor spirit has been replaced with 10% RD	Neutral to Negative	This will remove the anomaly on import of MS as those who were paying 0% CD due to FTA exemption will now have to pay 10% RD. This could also possibly result in erosion of MS margins for refineries, however, we await further clarification.

Sector	Overall Impact	Measure	Impact	Comment
Power	**Positive**	Subsidy allocation of PKR570bn	Neutral	This will support liquidity position of the IPPs.
		Sales tax exemption on import of plant and machinery by power generation companies that entered into an implementation agreement with the government prior to 15th Jan, 2022	Positive	This will bring down project cost. CPEC companies had been requesting the government to restore the sales tax exemption originally committed with them.
		Income tax exemption on profits derived from power generation projects is reinstated. It will now be restricted to the lifecycle of the project or 25 years from COD, whichever is earlier.	Neutral	Earlier, this exemption was withdrawn for power projects that obtained LOI after 30th June 2021 and was causing operational delays for new projects.
		Sales tax exemption on photovoltaic cells and import & local supply of solar panels (PV module)	Positive	Will promote renewable energy (solar-based power generation) in the country.

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Sector	Sector Stance	Measure	Impact	Comment
Cement	Slightly Positive	Federal PSDP allocation set at PKR727bn higher than revised FY22 allocation of PKR550bn	Neutral to slightly positive	These targets may not be met like last year where in targeted amount was PKR900bn while disbursements are PKR550bn
		Water resources division allocated PKR99.6bn up 10% YoY from revised estimates	Slightly positive	Construction of dams will lift public sector cement offtake
		Infrastructure projects under NHA allocated PKR 118.4bn up 38% YoY from revised estimates	Positive	Construction of road and bridges will lead to higher cement offtake
		Reduction in Naya Pakistan subsidy and reduced markups from PKR 33bn to PKR1bn	Negative	Allied cement demand from builders will slow down
		Sales tax on locally produced coal reduced from 17% to 0%	Neutral	Northern players also use local coal as a fraction of overall coal requirement
		Advance tax on imported coal reduced from 2% to 1%	Neutral	This tax is adjustable
		Allowable depreciation in first year increased from 50% to 100%	Positive	Beneficial for upcoming expansions
		Tax on transfer of property increased from 1% to 2% for files and to 5% for non filers	Negative	May dampen construction demand

Sector	Sector Stance	Measure	Impact	Comment
Fertilizer	Neutral to Slightly Positive	Sales tax exemption on seeds and tractors	Positive	Higher farmer's disposable income leads to higher fertilizer offtake
		Customs duty abolished on import of agriculture related machines	Positive	Higher farm income
		Increase of sales tax from 2% to 10%	Positive	No more pileup of sales tax receivable as previously sales tax on output (2%) was lower than that of input (5%). Impact will be passed on.
		Increase in sales tax on natural gas from 5% to 10%	Neutral	Will be adjusted against sales tax on fertilizer
		Subsidy for fertilizer set at PKR15bn, lower than PKR25bn revised for FY22 but higher than PKR6bn budgeted for FY22	Neutral	Subsidy mechanism has changed to direct subsidy to farmers. So, cash flow problems don't arise any more
		GIDC collection target set at PKR200bn as opposed to PKR25bn in the outgoing year	Negative	High outstanding balances of all fertilizer companies.
		Sales Tax on phosphoric acid increased from 5% to 10%	Neutral	FFBL uses phosphoric acid in DAP production. Output tax has also been increased to 10%

Sector	Overall Impact	Measure	Impact	Comment
Textile	**Positive**	Immediate clearance of DLTL claims of PKR40.5bn for the exporters.	Positive	Improved liquidity for the sector
		Sales tax refunds to be cleared immediately	Positive	Improved liquidity for the sector
		Industrial feeders to be exempted from load-shedding to provide uninterrupted electricity to the industrialists	Positive	Production efficiencies for the sector

Sector	Sector Stance	Measure	Impact	Comment
Steel	**Neutral**	Imposition of 3% tax on import of compressor	Negative	MUGHAL uses compressor to make copper ingots
		Customs duty on tubes, pipes and hollow profiles of iron and steel reduced from 5% to 0%	Negative	INIL may have to compete with lower priced imports now
		Higher PSDP allocation for infrastructure projects	Positive	Will increase demand for long steel
		Tax on steel dealers changed to 0.25% if in active tax payer list	Positive	May encourage shift of dealers away from non-graded to graded segment due to lower tax

Sector	Overall Impact	Measure	Impact	Comment
Autos & Allied	Neutral to Negative	Advance tax on Purchase, Registration and Transfer of Motor Vehicles increased for vehicle capacities upto 1000cc and for 1600 cc and above. Whereas, for non-filers, rate of collection of tax on purchase / transfer of motor vehicles is increased by 200% as against 100%.	Negative	Can impact vehicle demand in general
		Import of electric vehicles in CBU condition exempted from sales tax (previously: 12.5%)	Negative	Negative for INDU as it is coming up with HEVs as a part of its expansion strategy
		Tractors exempted from sales tax	Positive	Positive for MTL, AGTL
		Levy of tax on capital value on motor vehicle held in Pakistan where the value of motor vehicle exceeds rupees five million	Negative	Can impact vehicle demand in general

Sector	Overall Impact	Measure	Impact	Comment
Chemicals	Neutral	Custom duty on palm oil & its fractions reduced to PKR6,000/ton from PKR8,000/ton	Positive	NICL to be the key beneficiary as palm oil is the main raw material for soap noodle manufacturing
		Custom duty on Stearic Acid reduced to 16% from 20%.	Negative	It will impact NICL as it manufactures Stearic Acid locally.
		Increase in gas tariffs (to be announced)	Negative	For EPCL/LOTCHEM, an increase in gas price by PKR 50/mmbtu decreases the earnings roughly by 2-2.5%/1.5-2%.
Pharma	Positive	Customs duties on 26 APIs and on one drug “Grafalon” have been abolished.	Positive	Local manufacturing incentivized
		Sales tax refunds to be cleared immediately	Positive	Will improve cash flow position of manufacturers

Sector	Overall Impact	Measure	Impact	Comment
Technology	**Neutral**	PSEB subsidy for IT exports set at PKR1bn	Positive	Generally positive for IT exporters
		Increase in FED on Telecom services from 16% to 19.5%	Negative	Negative for PTC
		Withdrawal of tax exemption on export of IT services. Now 0.25% turnover tax will be imposed.	Negative	Marginally negative implications for SYS, NETSOL, AVN
Paper & Board	**Neutral to Positive**	10% RD imposed on import of Other paper and paperboard	Positive	Local paper and board industry to benefit from this
		Customs duty reduced to 16% from 20% on Semi chemical fluting paper	Positive	Cost reduction for paperboard manufacturers
		Reduction in customs duty on corrugated carton boxes from 20% to 16%	Negative	PKGS, CEPB, and RPL to be impacted

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Sector	Overall Impact	Measure	Impact	Comment
Food & FMCGs	**Positive**	Reduction of customs duties on flavorings powders for food preparation for snacks manufacturers	Positive	Cost reduction for NATF and other local snack manufacturers
		FED increased from PKR1,650 to PKR1,850 per thousand cigarettes on retail price below PKR5,960. For retail prices above PKR5,960, FED has been increased to PKR5,600 from previous 5,200 per thousand cigarette.	Neutral	Impact will be passed on
		Custom duty on palm oil & its fractions reduced to PKR6,000/ton from PKR8,000/ton	Positive	This will improve gross margins of Unity Foods

Sector	Overall Impact	Measure	Impact	Comment
Entertai-nment	**Positive**	5-Yr tax holiday for cinemas, film-makers, and production houses.	Positive	Will fare well for HUMNL
		Tax rebate on exports of film and drama for 10 years and 5-Yr custom duty exemption on imports of film and production equipment.	Positive	
		Withdrawal of 8% WHT on producers and Distributors	Positive	
		Removal of sales tax and entertainment duties levied on films and dramas	Positive	

Sector	Measure	Impact
Other Measures	Advance income tax on purchase & sale of property to be increased from 1% to 2% for filers and to 5% for non filers.	Negative
	Capital gain tax to be imposed on immovable properties in the first year of holding period at 15%, and reduced by 2.5% every year over the next six years	Positive
	Immovable property worth over PKR 25mn to be subjected to 20% tax on deemed rental income (assumed at 5% of FMV)	Positive
	Capital gain tax to be imposed on disposal of listed equities in the first year of holding period at 15%, and reduced by 2.5% every year over the next six years	Positive
	Increase in Custom duty on CBU Cellphones	Positive for AIRLINK
	Sales tax on import of cellphones in CKD/SKD condition now subjected to 10% ad valorem tax	Negative

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Sector	Measure	Impact
Other Measures	Removal of tax credit from Investments in IPOS, Mutual funds, & Insurances.	Negative
	Additional tax of 2% on annual income of more than PKR300mn to affect corporate profitability	Negative
	Income from Behbood Savings Certificates & Pension benefit accounts to be taxed at 5% than 10%	Negative for stock market
	Previously, the tax payable by a person other than a banking or insurance company in respect of profit on debt from investment in Federal Government securities was 15% of the gross amount of the profit on debt. Now normal rate will be applicable. This will impact cash-rich companies, including: ENGRO, LUCK, FFC, INDU, LOTCHEM, PSMC, KOHC & HCAR	Negative

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