Targets overstretched, Corporates over-taxed

Federal budget FY24

An attempt to take on the recurring BoP problem of Pakistan

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Targets overstretched, Corporates over-taxed

Budget FY24 attempts to take on the recurring of balance of payments problem, the Achilles heel of Pakistan economy, by incentivizing Pakistan's budding IT sector (2019-23 export CAGR of 20%p) and penalizing forex outflows. However, we believe fiscal targets are overstretched and corporates have been over-taxed in Budget FY24.

Government is targeting fiscal deficit of 6.54% (in % of GDP) and primary surplus of 0.4% (in % of GDP) for FY24, in a bid to win over IMF. GoP has budgeted total outlay of PKR14,460bn, which is 30.4% higher than FY23 revised expenditure of PKR11,090bn. Development spending target has been set at PKR950bn, up 67.5% YoY. We doubt that this massive increase in development spending would materialize, specially under the IMF program. Government is targeting 26.5% YoY increase in current expenditures, the increase is mainly emanating from the 32.3% YoY growth in markup payments on account of record high interest rates.

Gross revenue receipt growth of 37.9%/PKR3,345bn, based on the 31.8% and 58.6% increase in income tax and FED, also seems a bit stretched, especially since the retrospective implementation of windfall tax might be challenged in the court of law. Most of the increase in non-tax revenue is emanating from the 199.8%/PKR742bn increase in SBP profits. To our surprise, GoP is targeting raising USD1.5bn through Euro Bond/ international sukuk despite severe credit derating.

GDP growth target of 3.5% and inflation expectation of 21%, are not overly-optimistic given the lower economic output (FY23p GDP growth is 0.29%) and higher CPI base (FY23p) of the ongoing year.

Budget is negative from corporate earnings standpoint, owing to the introduction of progressive super tax regime with rates ranging from 1% to 10% (previously super tax was capped at 4%) and imposition of windfall tax on unexpected income/gains from fluctuation in international commodity prices. Other key developments for listed space include, imposition of 10% tax on bonus shares, reduction of minimum turnover tax from 1.25% to 1%.

Despite historic low valuation (PE of 3.1x), we advise staying defensive. We like yield plays, MCB, UBL, BAHL, MARI, EFERT, FFC, & HUBC. We also like SYS, MLCF and LUCK.

Attempt to take on the recurring BoP problem of Pakistan

Budget FY24 attempts to take on the recurring of balance of payments problem, the Achilles heel of Pakistan economy, by facilitating Pakistan's budding IT sector (20% IT exports CAGR between 2019-23) and penalizing forex outflow (by taxing overseas debit/credit card transactions). There is also increased focus on small and medium enterprises and agriculture sector, that incurred huge losses this year due to historic floods.

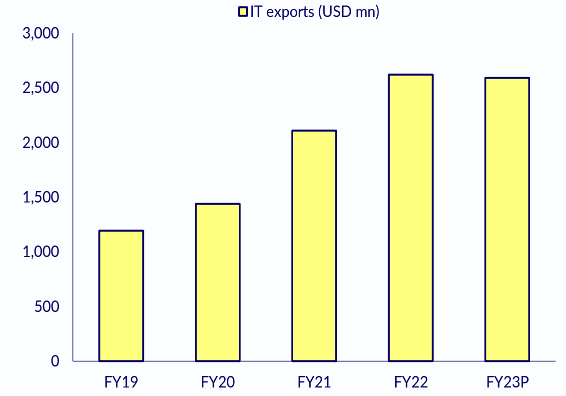
Incentives for IT sector: Income tax rate of 0.25% on IT sector is to be maintained for three years. IT freelancers earning up to USD24,000, have been exempted from sales tax registration and filing. Tax free import equal to 1% of export proceeds has been allowed to IT companies (with a cap of USD50,000). The sector has been given the status of SME, which attracts lower income tax rate.

Incentives for the SME sector: SME turnover threshold has been raised from PKR250mn to PKR800mn. Government would bear 20% credit risk of SME lending, this would help SME's avail SBP's concessional finance scheme. A special credit rating agency to be set up for the SME sector.

Incentive for the Agriculture: The total allocation of agriculture loans has been raised to PKR2,250bn from PKR1,800bn. 50,000 tube wells are to be shifted to solar power. Government has abolished duties and taxes on import of seeds, saplings combine harvesters, seeders, rice planters and dryers.

Income of banks on advances made to SME/Agri/construction sector to be taxed at a reduced income tax rate of 20%, for two years.

IT exports have grown at a 20% CAGR



Source: Eco. Survey, Alfalah CLSA Research

Fiscal targets are a bit stretched

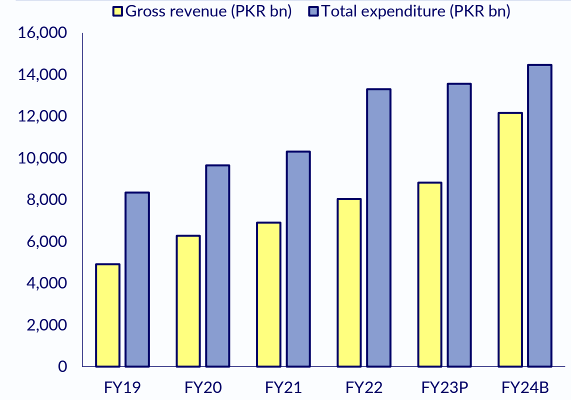
Revised expenditures for FY23 are expected to exceed budgeted projections by 15.8%, whereas net revenue for federal government is forecasted to undershoot the budgeted amount by 6.2%. Hence, revised fiscal deficit for FY23 is expected to widen to -7.0% (in GDP term) as compared to budgeted number of -4.9% (in GDP term). According to revised estimates, government is expected to post a primary deficit of 0.5% (in GDP terms) in FY23, vs budget target of 0.2% surplus.

Targeting a primary surplus to appease IMF: Government is targeting fiscal deficit of 6.54% (in % of GDP) and primary surplus of 0.4% (in % of GDP) for FY24, as it tries to restart the stalled IMF program. GoP has budgeted total outlay of PKR14,460bn, which is 30.4% higher than FY23 revised expenditure of PKR11,090bn.

Development spending target has been set at PKR950bn, up 67.5% YoY, total development outlay will surge by 102.8% YoY if we include PKR200bn from public-private-partnership. We doubt that this massive increase in development spending would materialize, specially under the IMF program.

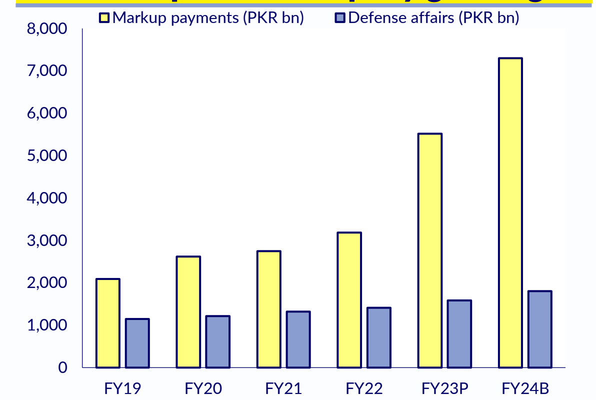
Markup taking up the lions share of current expenditure: The 26.5% budgeted increase in current expenditures is mainly coming from the 32.3% increase in markup payments (due to increase in interest rates) and 13.7% increase in defense expenditure. Subsidies are largely unchanged at PKR1074bn, however grants are projected to increase 26.7% to PKR1464bn in FY24. IPP subsidies have been raised by 72.2% YoY to PKR310bn.

Direct tax target looks unrealistic



Source: Eco. Survey, Alfalah CLSA Research

Current expenditure rapidly growing



Source: Eco. Survey, Alfalah CLSA Research

Fiscal targets are a bit stretched

Gross revenue receipt growth of 37.9%/PKR3,345bn, based on the 31.8% and 58.6% budgeted increase in income tax and FED, seems a bit stretched, especially since the retrospective implementation of windfall tax might be challenged in the court of law.

We highlight that most of the increase in non-tax revenue is emanating from the 199.8%/PKR742bn increase in SBP profits. Whereas on tax revenue side, income tax and sales tax collections are expected to increase by 31.8%/PKR897bn and 26.0%/PKR730bn.

To our surprise, GoP is targeting raising USD1.5bn through Euro Bond/ international sukuk despite severe credit derating.

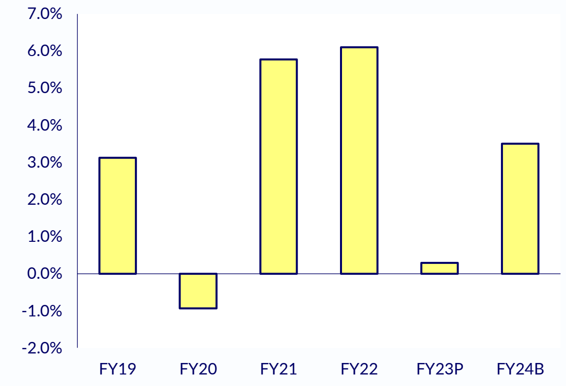
Economic growth and inflation estimates aren't over-optimistic

GDP growth target of 3.5% and CPI inflation expectation of 21%, look attainable given the lower economic output (FY23p GDP growth is 0.29%) and higher CPI base (11MFY23 average CPI 29.2%) of the ongoing year.

Low economic output for FY23: Pakistan's provisional GDP growth for FY23 clocked in at a meagre 0.29% vs budgeted estimate of 5.0% and 6.1% recorded in FY22. Per capita income declined 11.1% in FY23 to USD1568 vs USD1765 in the preceding year. Agriculture sector (22.9% of GDP) was hit the hardest following historic flooding with estimated losses (including related categories) to the tune of USD3.73bn. However, the sector still managed to post a growth of 1.55% YoY in output in FY23 vs target of 3.9%. Industrial sector (18.5% of GDP) suffered greatly following import curbs and historic high interest rates leading to a 2.94% YoY decline. Large Scale Manufacturing (LSM) contracted 8.1% YoY in 9MFY23 with Automobiles, Food, Textile and Pharmaceuticals being the major drags.

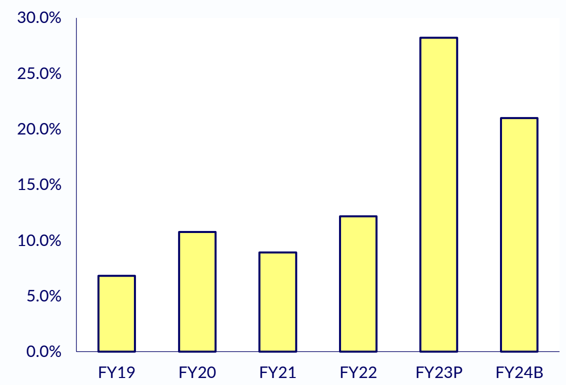
High base effect to tame CPI inflation in FY24: CPI inflation for 11MFY23 clocked in at multi decade high of 29.2% given trimmed subsidies, increased tax burden on fuel prices, revision in gas prices, PKR depreciation, supply shortages due to import curbs and food inflation owing to crop losses. In response to soaring inflation, SBP continued its tightening stance where interest rates were increased to all time high of 21%.

GDP growth target of 3.5% is attainable



Source: Eco. Survey, Alfalah CLSA Research

CPI to fall due to base effect



Source: Eco. Survey, Alfalah CLSA Research

Budget largely negative from corporate earning standpoint

Budget is largely negative from corporate earnings standpoint due to, introduction of progressive super tax regime with rates ranging from 1% to 10% (previously it was capped at 4%) and windfall tax on unexpected income/gains from fluctuation in international commodity prices. Other key developments for listed space include, imposition of 10% tax on bonus shares, reduction of turnover tax from 1.25% to 1%.

Key relief measures: Income of banks on additional advances made to SME/Agri/construction sector to be taxed at a reduced rate of 20%, for two years. Government would bear 20% credit risk of SME lending. Income tax rate of 0.25% on IT sector is to be maintained for three years. Tax free import equal to 1% of export proceeds has been allowed for IT companies (with a cap of USD50,000). IT sector has been given the status of SME, which has lower income tax rates. Customs duty of caustic soda increased to 16% (Prev. it was fixed at PKR4000). Duty on Liquid paraffin reduced from 3% to 0%. Increase of Customs duty on Carbides of Calcium from 3% to 11% to protect the local industry. Tax concessions given to REIT to be extended till 30th June 2024. Increase / levy of RD on import of articles of glass. Incentive for Pharma sector by including one more API and 03 drugs in the existing duty free regime. Reduction of Customs duty on import of pet scrap for manufactures of polyester filament yarn. Reduction of RD on import of polyester filament yarn not manufactured locally. Bonded Bulk Storage facility for Refinery/OMCs. Removal of Regulatory duty on Silicon Steel Sheets.

We like yield plays, **MCB, UBL, BAHL, MARI, EFERT, FFC, & HUBC.** We also like **SYS, MLCF** and **LUCK**.

Budget estimates 2023-24

(PKR bn)	Revised FY23	Budget FY24
Revenue Receipt (FBR)	**7,200**	**9,200**
Non Tax Revenue	**1,618**	**2,963**
Gross Revenue (FBR+NTR)	**8,818**	**12,163**
Less: Transfer to Provinces (-)	-4,129	-5,276
Net Revenue for Federal Government	4,689	6,887
Expenditure	11,090	14,461
Federal Budget Deficit	**-6,400**	**-7,574**
Provincial Surplus	459	650
Overall Budget Deficit	-5,941	-6,924
Overall Fiscal Deficit as %GDP	**-7.0%**	**-6.5%**
Primary Deficit	-421	379
Primary Deficit as %GDP	-0.5%	0.4%
Nominal GDP	84,658	105,817

(PKR bn)	Budget FY23	Revised FY23	Budget FY24
FBR taxes	**7,470**	**7,200**	**9,200**
Direct taxes	**3,039**	**2,851**	**3,759**
Income tax	3,024	2,817	3,714
Others	15	34	45
Indirect taxes	**4,431**	**4,349**	**5,441**
Custom duties	953	1,084	1,178
Sales tax	3,076	2,808	3,538
FED	402	457	725
Current expenditure	**8,708**	**10,528**	**13,319**
Subsidies	**664**	**1,103**	**1,074**
Federal PSDP	**727**	**714**	**950**

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

Sector	Measure	Impact	Comment
Banks	Super tax cap increased to 10% from 4%	Negative	2QCY23 earnings will be significantly stressed (Incl. the impact of first quarter).
	Tax on windfall gain (past 5 yrs and forward) at a maximum rate of 50%	Negative	FX income to be primary target
	0.6% tax has been imposed on cash withdrawal by non-ATL.	Neutral	The measure did not have any material impact on banks when previously imposed
	Income of banks from additional advances made to IT companies, would have a reduced tax rate of 20%	Positive	
	Income of banks on additional advances made to SME/Agri/construction sector to be taxed at a reduced rate of 20%, for two years.	Positive	Currently, banking sector's advances composition is 8.4/3.7/2.6% for Agri, SME and construction respectively
	Government would bear 20% credit risk of SME lending.	Positive	
	Tax rates for banks based on advance to deposit ratio is not applicable for tax year 2024.	Positive	This is continuation of status quo for one year

Sectoral Impacts

Sector	Measure	Impact	Comment
Technology	Income tax rate of 0.25% on IT sector is to be maintained for three years.	Positive	Tax regime was not changed
	IT freelancers earning up to USD24,000, have been exempted from sales tax registration and filing.	Positive	Operational ease to promote documentation
	Tax-free import equal to 1% of export proceeds has been allowed for IT companies (with a cap of USD50,000).	Positive	
	Income of banks from additional advances made to IT companies, would have a reduced tax rate of 20%	Positive	More financing avenues for IT companies
	Government would bear 20% credit risk of SME lending.	Positive	
	IT sector has been given the status of SME, which has lower income tax rates.	Positive	Will assist start up and mid scale ventures

Sectoral Impacts

Sector	Measure	Impact	Comment
Fertilizers	Super tax cap increased to 10% from 4%	Negative	
	The limit of agriculture loans to be raised to PKR2,250bn from PKR1,800bn. 50,000 tube wells to be shifted to solar power	Positive	This could increase the buying power of farmers
	Imported urea subsidy allocation of PKR6.0bn	Neutral	Ensure smooth availability of fertilizers

Sectoral Impacts

Sector	Measure	Impact	Comment
Chemicals	Super tax cap increased to 10% from 4%	Negative	
	Customs duty of caustic soda increased to 16% (Prev. it was fixed at PKR4000)	Positive	Positive for EPCL, SITC, ICL and NICL if price increase is passed on
	Duty on Liquid paraffin reduced from 3% to 0%	Positive	Positive for NICL
	Increase of Customs duty on Carbides of Calcium from 3% to 11% to protect the local industry.	Positive	Positive for GCIL's upcoming project of Calcium Carbide

Sector	Measure	Impact	Comment
Construction	Super tax cap increased to 10% from 4%	Negative	
	Federal PSDP outlay has been set at PKR950bn, up 67.5% YoY	Positive	Positive for cements, however the realization of budgeted amount will remain a threat
	2% final tax abolished on purchase of immovable properties by expats	Positive	Will improve capital flow in construction industry
	Any construction for self-use would get a tax credit of 10% or PKR1Mn whichever is lower	Positive	Will promote construction activities across the country
	Tax concessions given to REIT to be extended till 30th June 2024	Positive	
	Tax concessions of 10% or PKR5Mn, whichever is lower for construction enterprises (Applicable for projects post 1st July, 2023)	Positive	Will promote construction activities across the country
	Increase / levy of RD on import of articles of glass	Positive	Positive for TGL and GHGL

Sectoral Impacts

Sector	Measure	Impact	Comment
Pharma	Incentive for Pharma sector by including one more API and 03 drugs in the existing duty free regime.	Positive	
	Super tax cap increased to 10% from 4%	Negative	

Sector	Measure	Impact	Comment
Textiles	Minimum Wage increased to PKR32,000/month.	Negative	Cost of production will jack up significantly
	Reduction of Customs duty on import of pet scrap for manufactures of polyester filament yarn.	Positive	
	Reduction of RD on import of polyester filament yarn not manufactured locally.	Positive	
	Sales tax increased to 15% from 12% if supplied goods are finished fabric, and locally manufactured finished articles of textile and textile made-ups and leather and artificial leather	Neutral	3% increase in prices of high-end brands will not have significant effect on demand
	Tax on windfall gain (past 5 yrs and forward) at a maximum rate of 50%	Negative	

Sector	Measure	Impact	Comment
Autos	Super tax cap increased to 10% from 4%	Negative	
	Reduction of Customs duty from 10% to 5% on non-localized (CKD) of Heavy Commercial Vehicles (HCVs).	Positive	Positive for local manufacturers of HCV's namely GHNI, GHNL and HINO
	Withdrawal of capping of the fixed duties and taxes on the import of old and used vehicles of Asian Makes above 1300 CC under SRO 577(I)/2005 by omitting serial number 4,5 and 6 of the said SRO.	Positive	Capping of 5% removed.

Sector	Measure	Impact	Comment
OMCs/E&Ps	Super tax cap increased to 10% from 4%	Negative	
	Bonded Bulk Storage facility for Refinery/OMCs	Positive	Bonded Bulk Storage facility for Refinery/OMCs
	Petroleum Development Levy (PDL) cap maintained at PKR50/ltr	Positive	Petroleum Development Levy (PDL) cap maintained at PKR50/ltr
	OGDC's dividend estimated at PKR16.5/sh for FY24	Positive	OGDC's dividend estimated at PKR16.5/sh for FY24
	Tax on windfall gain (past 5 yrs and forward) at a maximum rate of 50%	Negative	E&Ps specifically included for this tax

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