# Pakistan Strategy

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**Pakistan**
**Market Strategy**

## Budget FY21; More was expected

### Neutral from capital market's perspective

**The government has decided to impose no new taxes in Budget FY21. The focus is on tackling Covid-19 and limiting the socio-economic impact of the pandemic. Government targets, fiscal deficit as % of GDP to improve from 9.1% in FY20r to 7.0% in FY21. This is built on an optimistic expectation of a 27% increase in FBR revenues. PKR70bn have been earmarked for Covid-19 response and PKR209bn have been set aside for Subsidies. Overall, from stock market standpoint we see the budget as a neutral event. On a sectoral level the budget is slightly positive for Cements/Steels/Pharma/FMCGs, neutral for Banks/Fertilizers/Textiles and slightly negative for Power and Autos.**

**No new taxes; focus on tackling corona:** The Federal minister started budget announcement by stating that no new tax has been imposed in budget FY21. The focus is on reducing the spread of Corona virus, providing maximum relief to the vulnerable class, expanding the outreach of Ehsaas program, improving ease of doing business, and successfully following the IMF program. Where we weren't expecting any new taxes, we certainly were anticipating more concessions i.e. reduction in sales tax on essential items. However, it is clear that government's hands are tied.

**Resource target once again seems very difficult to achieve:** Government has set a resource collection target of PKR6,314bn for FY21, down 1.5% from FY20r. FBR collections are targeted to increase by 27% YoY. We believe these numbers would be hard to achieve, as even in the best case Corona led economic slowdown will continue in the 1QFY21. Total expenditure has been budgeted at PKR7,231bn, down 11.1% YoY from FY20r numbers. Federal PSDP has been set at PKR650bn (up 15.2% YoY), whereas, development expenditures outside PSDP have been set at PKR70bn up 6.4% from FY20r.

**70bn earmarked for Covid-19; but subsidies have been slashed:** Government has allocated PKR70bn for Covid-19 response and other natural calamities program. PKR209bn have been earmarked for subsidies, down 40.2% YoY, this implies that utility tariffs might be adjusted upwards in the coming months. The lion's share of the subsidies will go to WAPDA/PEPCO (PKR124bn), followed by Naya Pakistan Housing Authority (PKR30bn), K-electric (PKR25.5bn) and Fertilizer plants (PKR6.0bn).

**Economic targets for FY21:** Government targets, fiscal deficit as % of GDP to improve from 9.1% (FY20r) to 7.0% in FY21. Government has estimated GDP growth rate to increase to 2.1% vs -0.38% in FY20r. Inflation is estimated to fall down to 6.5%.

**Markets vantage point:** Overall the budget is neutral for the market. On a sectoral level the budget is slightly positive for Cements/Steels/Pharma/FMCGs, neutral for Banks/Fertilizers/Textiles and slightly negative for Power and Autos. There are no changes in dividend/Capital gains taxes. On the positive side, government's inflation estimate implies further room for monetary tightening.

**Resource target once again seems very difficult to achieve**

The government has budgeted total outlay of PKR7,231bn for FY21, down 11.1% from FY20 revised estimate. Federal Public Sector Development Program has been increased by 15.2% from FY20 revised estimates to PKR650bn.

Backing the aforementioned outlay is an overly ambitious internal resource availability target of PKR5,404bn (up 35.5%), that is built on underlying expectation of a PKR242.4bn provincial surplus and 27% YoY increase in FBR tax collections. Hence meeting budgeted fiscal deficit target of 7.0% of GDP for FY21 looks far-fetched.

Government has budgeted PKR2,222bn as gross external resources; compared to the outgoing year there would be higher mobilization from Euro Bond/international Sukuk issuances (PKR247.5bn), whereas inflows from IMF are expected to drop by 53.7% to PKR211bn.

| | Budgeted FY20 | Revised FY20 | Budgeted FY21 |
|---|---|---|---|
| **A) Internal resources** | 4,902 | 4,198 | 5,483 |
| 1) Net revenue receipts (i-ii) | 3,462 | 3,102 | 3,699 |
| (i) Gross revenue receipts | 6,716 | 5,504 | 6,573 |
| (ii)Less provincial shares in taxes | 3,254 | 2,402 | 2,873 |
| 2) Total capital receipts | 1,016 | 1,176 | 1,541 |
| 3) Estimated provincial surplus | 422 | -80 | 242 |
| **B) External resources** | 3,032 | 2,272 | 2,222 |
| **Total resources (A+B)** | 7,934 | 6,471 | 7,706 |

Source: Ministry of finance, Alfalah CLSA Research

FBR tax collections have been budgeted to increase by 27%. Direct tax collections are expected to increase 25.8%, whereas indirect tax collections are expected to jump 27.7% to PKR2,920bn.

| | Budgeted FY20 | Revised FY20 | Budgeted FY21 |
|---|---|---|---|
| **Tax revenue** | **5,822** | **4,208** | **5,464** |
| A) FBR taxes | 5,555 | 3,908 | 4,963 |
| -Direct taxes | 2,081 | 1,623 | 2,043 |
| -Indirect taxes | 3,473 | 2,285 | 2,920 |
| B) Other taxes | 267 | 300 | 501 |
| **Non-tax revenue** | **894** | **1,296** | **1,108** |
| **Gross revenue receipts** | **6,716** | **5,504** | **6,573** |
| **Net revenue receipts** | **3,462** | **3,102** | **3,699** |

Source: Ministry of finance, Alfalah CLSA Research

The size of National Public Sector Development Program has been increased by 17.9% from FY20 budget estimates to PKR1,324bn.

| | Budgeted FY20 | Revised FY20 | Budgeted FY21 |
|---|---|---|---|
| Federal PSDP | 701 | 564 | 650 |
| Dev. expenditure outside PSDP | **86** | **65** | **70** |

Source: Ministry of finance, Alfalah CLSA Research

**70bn earmarked for Covid-19; but subsidies have been slashed**

Government has allocated PKR70bn for Covid-19 response and other natural calamities program. PKR209bn have been earmarked for subsidies, down 40.2% YoY, this implies that utility tariffs might be adjusted upwards in the coming months. The lion's share of the subsidies will go to WAPDA/PEPCO (PKR124bn), followed by Naya Pakistan Housing Authority (PKR30bn), K-electric (PKR25.5bn) and Fertilizer plants (PKR6.0bn).

**Economic indicators**

Fiscal balance as % of GDP is expected to improve from -9.1% (FY20 revised) to -7.0% in FY21. Government has estimated GDP growth rate to increase to 2.1% vs -0.38% in FY20r. Inflation is estimated to fall down to 6.5%.

Pakistan's provisional GDP growth for FY20 is estimated at negative 0.38%. Sectoral breakup shows that Agriculture sector grew by 2.67%, due to the 2.9% growth posted by important crops.

The provisional growth in Industrial sector is estimated at -2.64%, mainly due to negative growth of 8.82% in mining and quarrying sector, and 7.78% decline in large-scale manufacturing. Due to the lock down the estimated growth in small scale industry is 1.52%.

Services sector also declined provisionally by 0.59%, mainly due to 3.42% decline of wholesale and retail trade sector, 7.13% decline in transport, storage and communication sector. Finance and insurance sector witnessed an increase of 0.79%.

**Market's standpoint**

The budget is slightly positive for Cements/Steels/Pharma/FMCGs, neutral for Banks/Fertilizers/Textiles and slightly negative for Power and Autos. There are no changes in dividend/Capital gain taxes. Government's inflation estimate implies further room for monetary tightening.

**Sectoral view point**

| Sector | Impact | Details |
|---|---|---|
| Banks | Neutral | Super tax extended for another year, already incorporated. |
| Steels | Positive | RD reduced on HRC, steel makers already pay concessionary duties |
| Textiles | Neutral | 5% CD on polyester import exempted for certain textile players |
| Autos | Negative | Imposition of FED on Double cabin pick-up |
| FMCGs | Positive | Exemption of 10% CD of skimmed milk powder |
| Cement | Positive | Reduction of FED on cements |
| Power | Negative | 42% reduction in power subsidy |
| Fertilizer | Neutral | PKR6bn allocated for climate change and PKR10bn for locust attack |
| Pharma | Positive | Reduction of duty on raw materials and PKR70bn corona relief package |
| E&Ps | Non-event | |
| OMCs | Non-event | |

Source: Alfalah CLSA Research

**Capital Markets (Neutral)**

- Budget FY21 is a non-event for the capital market.
- No changes have been made in capital gains tax or tax on dividend payments. There was an expectation that tax treatment of REIT dividend might be made consistent with mutual funds.
- Tax credit period for listing on PSX has been extended till FY22. This would encourage listings on PSX.

**Banks (Neutral)**

- Super tax on bank's earnings has been extended for another year. We had already incorporated this in our workings.
- Treasury Single Account is in the final stages of implementation, this would be negative for NBP.
- Sukuk issuance target has been set at PKR450bn, this would be positive for Islamic banks.
- WHT on remittances has been abolished this would encourage transactions through proper channels.

**Cements (Positive)**

- FED has been reduced from PKR2/kg to PKR1.75/kg, this implies a PKR12.5/bag reduction. We believe that some of the impact would be passed on to the consumers and some of it would be retained by cement companies.
- Additional custom duty of 2% currently applicable on coal import has been abolished.
- PKR30bn subsidy on Naya Pakistan housing scheme would increase the demand for cement.
- PSDP target of PKR650bn has been set for FY21.

**Fertilizers (Neutral)**

- PKR10bn have been earmarked to tackle locust attacks.
- Another PKR6bn have been allocated for climate change.
- There is no change in GST on any product.

**Autos (Negative)**

- FED on locally manufactured double cabin vehicles has been raised from 0% to 7.5%. INDU would be negatively impacted due to HILUX.
- Advance tax on three wheelers and bikes has been reduced to zero.
- Custom duty on rubber has been reduced this would be positive for General tyre.

**Steel (Positive)**

- Regulatory duty on HRC import has been reduced from 12.5% to 6%. This a non-event, as steel makers already import at 5% rate.
- Government has abolished PKR1/unit tax imposed on electricity used by steel melters, this is positive for long steel makers ASTL, MUGHAL.
- Reduction of additional custom duty on scrap import would benefit long steel makers.

**Textiles (Neutral)**

- Sales tax on retail sales has been reduced from 14% to 12%.
- 5% custom duty on import of polyester by button manufacturers and interlining makers would be exempted.

**Power (Negative)**

- PKR150bn have been budgeted for power sector subsidy which down 41% YoY.
- There is a high chance that power tariffs might be revised up to cover the shortfall.

**FMCGs (Positive)**

- 10% custom duty implemented on skimmed milk powder import has been exempted, this would be positive for FCEPL, NESTLE, FFL.
- FED on cigars, cheroots, cigarillos, and cigarettes has been increased from 65% to 100%.
- FED on filter rod has been increased from PKR0.75/filter to PKR1/filter; this would be negative for cigarette makers.
- Exemption from 2% additional custom duty on edible oils and oil seeds has been extended.
- CD/ACD on food packaging raw material has been reduced/exempted this would be positive for TRIPF, RPL, MERIT.

**Pharmaceutical (Positive)**

- The PKR70bn Corona relief package would increase demand for pharmaceutical products.
- Reduction in duties on API imports would improve margins.

**Other budgetary measures**

- PKR25bn for increasing foreign remittances
- PKR40bn allocated to railways
- Allotment for upgradation of Electrical supply: PKR80bn
- Allotment for upgradation of Water resources: PKR70bn
- Railway ML-1 project (CPEC): PKR24bn
- Education budget: PKR5bn
- Upgradation of IT/5G services: PKR5bn
- Environment protection and sustainability: PKR6bn
- Sustainable Development Goals: PKR24bn
- Food security: PKR12bn
- Point of sale (POS) sales tax down from 14% to 12%
- Reduction in duties on 200 custom lines
- Infant food products are now import duty exempt
- CNIC condition increased from PKR50,000 to PKR100,000
- FED on caffeine and energy drinks to be increased from 13% to 25%
- Sales tax on mobile phones made in Pakistan to be reduced
- WHT on bank profits set at uniform 15%
- Increase in ad volarem duty (FED) on double cabin pick up; 25% for imported, 7.5% for local
- Real time access of businesses to databases and information to NADRA and FIA
- Abolishment of advance tax on insurance premiums
- Various tax concessions on the import of plant and machinery for Gwadar Free Zone
- Increased focus on ease of doing business via the implementation of automated payment of refunds through a centralized system
- Tariff lines on which no customs duty is applicable have been exempted from Additional customs duty (ACD)
- Reduction in Custom duties on 40 raw materials for various industries

- Sales tax on Potassium Chlorate has been increased to PKR80/kg from PKR70/kg
- Rate of tax to be deducted on return on investment in Sukuk is to be increased from 15% to 25%
- Sales tax exemptions up till 2023 for the import and supply of ships and floating crafts
- Concessions already available to Special Economic Zones (SEZ's) to be further eased
- Increase in regulatory duty on the import of items that are locally manufactured
- 90 tariff lined to undergo reduction in customs duty from 11% to 3% and 0% for tariff rationalization
- Extension in exemption of custom duty on the import of 61 products for the treatment of Coronavirus
- No tax on income of REITs if set up till June 30, 2021
- Exemption in custom duty on the import of raw material by manufacturer of syringes and saline infusion sets
- Reduction in Additional Custom duty on palm stearin used in soap manufacturing

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