Prioritizing fiscal discipline over growth

Federal budget FY25

Accelerating the documentation drive

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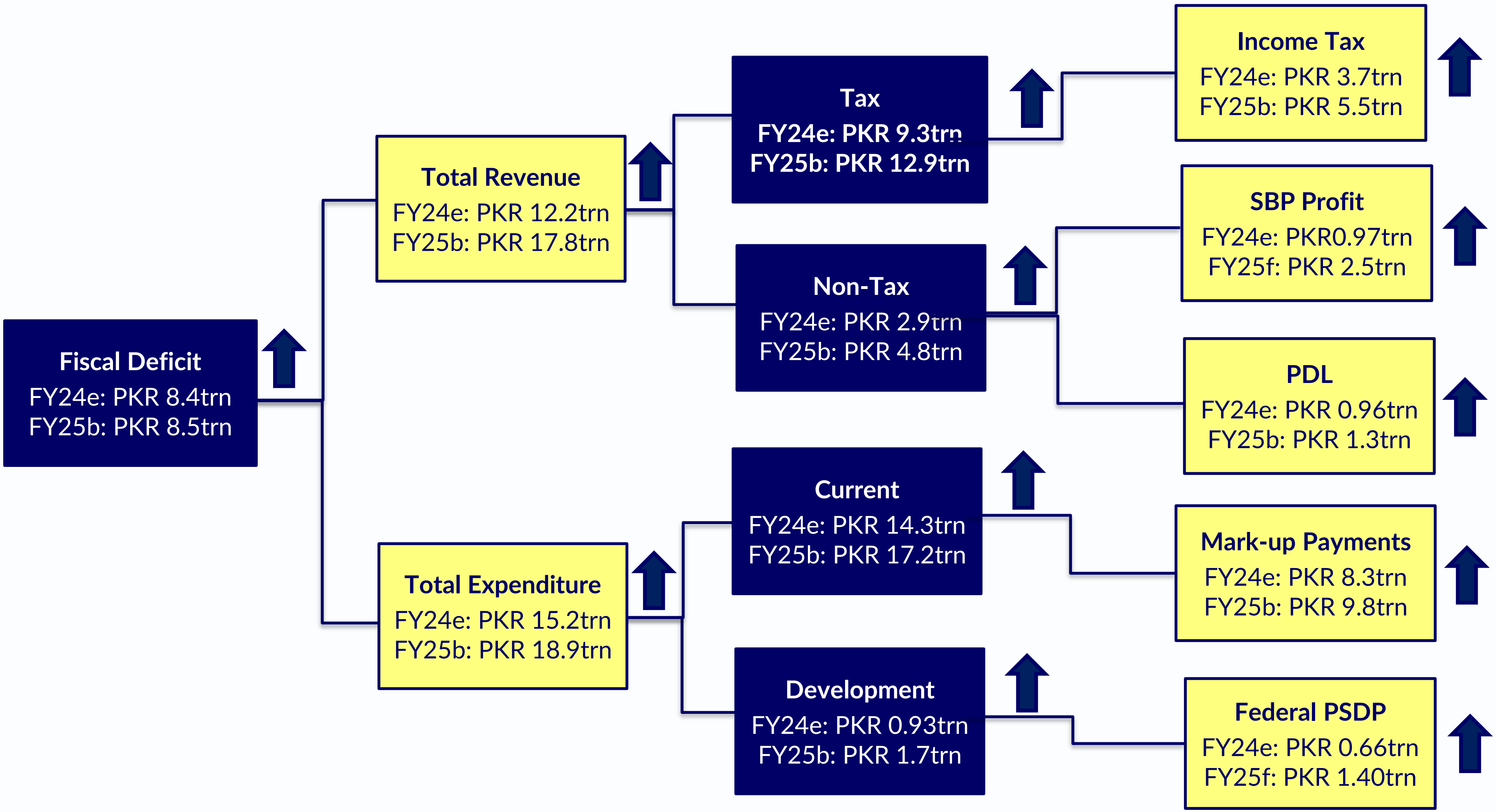
Table of Contents

Budget FY25: Fiscal Landscape



Economy — Prioritizing fiscal discipline over growth

Budget FY25 attempts to build on the progress made last year to achieve fiscal consolidation after having achieved significant control over the current account. Fiscal and revenue targets seem ambitious given limited direct tax measures. Primary focus has been on structural reform to heavily tax non-filers and strengthen regulation to curb tax evasion.

Government is targeting fiscal deficit of 5.9% (in % of GDP) and primary surplus of 2.0% (in % of GDP) for FY25, in an attempt to unlock the Extended Fund Facility program under IMF. GoP has budgeted total outlay of PKR18,877bn, which is 25% higher than FY24 revised expenditure of PKR15,160bn. Development spending has been budgeted at PKR1,674bn, up 47% YoY. We believe the budgeted development spending would remain underutilized to counter revenue slippages. Government is targeting 30% YoY increase in current expenditures, the increase is mainly emanating from the 33.8% YoY growth in markup payments on account of elevated interest rates.

Gross revenue receipt targets a growth of 46% from revised FY24 numbers, based on a massive 48% rise in income tax. This seems a bit stretched since a normal tax regime for exporters (especially if applicable for IT) will face significant backlash. Most of the increase in non-tax revenue is emanating from the 157% increase in SBP profits to PKR2,500bn.

GDP growth target of 3.6% and CPI inflation expectation of 12%, looks attainable given the lower economic output (FY24p GDP growth is 2.4%) and high CPI base (11MFY24 average CPI 24.5%) of the ongoing year.

Overall, the Budget is negative from corporate earnings standpoint owing to i) inclusion of exporters in normal tax regime and ii) added tax burden on Banks due to reduction in tax shield on provisioning. Other key developments for listed space include, increase in CGT for non filers progressively to 45% and no benefit of holding period for CGT.

Budget Snapshot

1

Budget FY25 a key to unlock IMF program

IMF has set specific benchmarks as pre-condition for a new Extended Fund Facility (EFF). A key condition included structuring a budget ensuring broadening of tax base and fiscal consolidation.

2

Tax collection target

FBR aims to increase tax revenue by 40%YoY to PKR12.97trn. The measures include a wide array of proposals to strengthen the documentation drive. Hence, income tax collection is estimated 48%YoY higher at PKR5.45trn.

3

Non-tax revenue a life saver

Government has budgeted a growth of 64% growth in Non tax revenues to PKR4.84trn. Majority of this increase is emanating from PKR1.53trn growth in SBP profits and PKR0.32trn rise in PDL collection.

4

Current expenditure scaled up

Budget FY25 targets current expenditure at 17.20trn, up 21%YoY. Markup payments are expected to constitute a lion's share, however, a 47%YoY growth in development spending comes as a shock. The amount has probably been budgeted to create a buffer to counter potential revenue slippages.

5

Fiscal balance improving

Fiscal deficit is expected to reduce to 5.9% in response to easing burden of markup payments amid reducing price pressures. Primary surplus is targeted at 2.0%, a level not seen in the last decades.

6

Funding the fiscal gap

Government plans to fund PKR0.66trn through external financing (commercial and Euro bond) while PKR7.68trn will be borrowed locally through govt securities.

7

Key economic projections

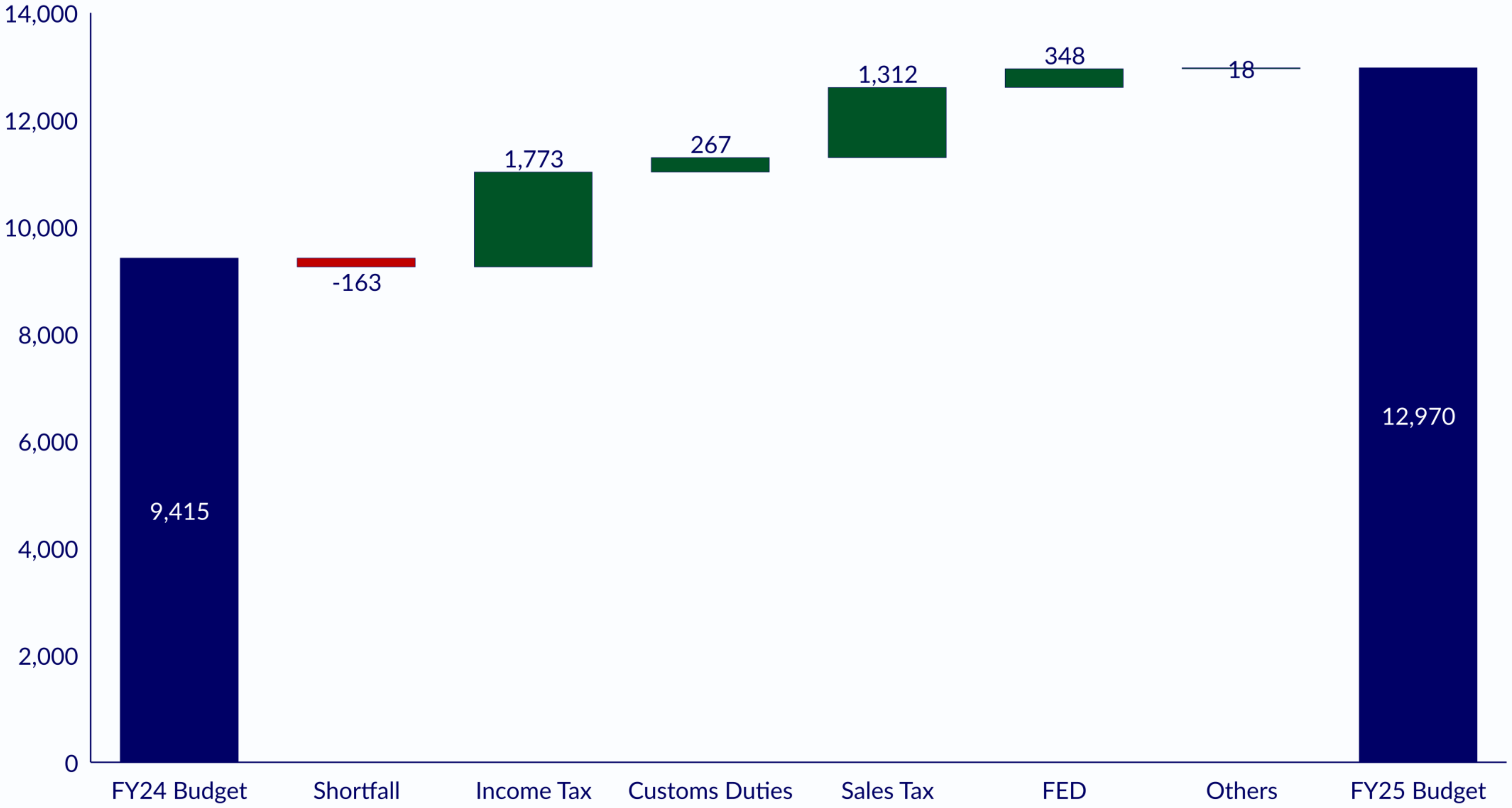
GDP growth has been projected to grow at 3.6%. CPI Inflation is expected to decelerate to 12% in FY25 from 24% (FY24E) in the corresponding period last year.

8

Sector Summary

Gainers: Steel and Power
Losers: Banks, Textile, Technology
Neutral: Cement, E&Ps, OMCs, Fertilizer

Tax Revenue growth for FY25



Accelerating the documentation drive

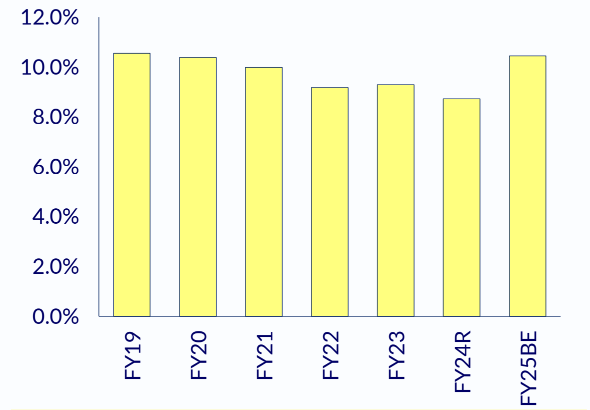
Budget FY25 attempts to further squeeze the informal economy by widening the financial impact of being a non-filer. Widening coverage of added tax burden for non-filers across sectors and supply chains coupled with punitive actions would significantly accelerate the documentation drive in Pakistan.

Become a filer or pay-up: 12%/6% higher tax (average) on purchase/sale of immovable property, higher CGT on immovable property, upto 30ppts higher CGT on sale of securities, 20ppts higher tax on profit on debt, WHT of 2% on dealers, distributors and wholesalers and 2.5% for retailers.

Not just financial implications anymore: In a bold move, the govt has decided to ban exit/travel of non filers with the exception of Hajj and Umrah, minors, students and overseas Pakistanis. This is in addition to the already ongoing drive to block sims and disconnect utility connections. In order to ensure compliance, the implementing agencies will be exposed to significant fines for non-compliance.

In addition, penalties have been proposed for non registration of traders and shopkeepers under the respective schemes (e.g. Tajir dost scheme) with non-compliance being made a punishable offence carrying an imprisonment for six months.

Tax to GDP %



Source: Budget FY25, Alfalah CLSA Research

Fiscal targets ambitious but achievable

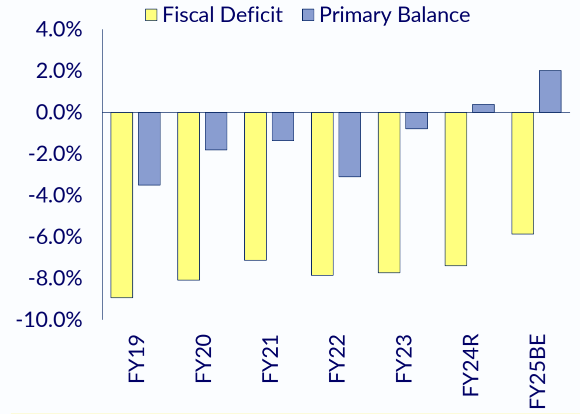
Revised expenditures for FY24 are expected to exceed budgeted projections by 5%, whereas net revenue for federal government is forecasted to undershoot the budgeted amount by 3%. Hence, revised fiscal deficit for FY24 is expected to widen to -7.4% (in GDP term) as compared to budgeted number of -6.5% (in GDP term). However, government is expected to post a primary surplus of 0.4% (in GDP terms) in FY24, inline with budget estimates.

Expanding primary surplus to appease IMF: Government is targeting fiscal deficit of 5.9% (% of GDP) and primary surplus of 2.0% (% of GDP) for FY25, as it tries to enter an Extended Fund Facility program under the IMF. GoP has budgeted total outlay of PKR18,877bn, which is 25% higher than FY24 revised expenditure of PKR15,160bn.

Continuing the PML-N legacy, development spending target has been set at a massive PKR1,674bn, up 47% YoY. We doubt that this massive increase in development spending would materialize, as development budget will be the first target to reduce expenditure in order to balance any revenue slippages.

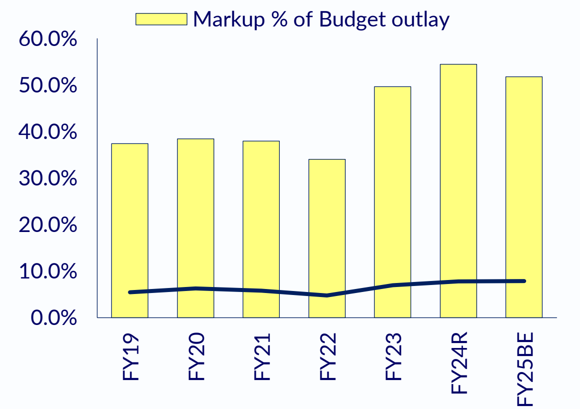
Mark-up still constitutes a large portion of budget: FY25 budgeted markup payments are expected to rise 18%YoY, a much smaller pace compared to 42%YoY in FY24. Expanding primary surplus coupled with easing interest rates would help contain the growth in markup payments. However, markup will still constitute ~51.8% (FY24: 54.4%) of total budget outlay and 7.9% (FY24: 7.8%) of GDP.

Fiscal consolidation continues



Source: Budget FY25, Alfalah CLSA Research

Current expenditure rapidly growing



Source: Budget FY25, Alfalah CLSA Research

Fiscal targets ambitious but achievable

Budgeted subsidies, surprisingly, have escalated 27%YoY to PKR1,363bn. Power sector subsidy has increased by a whopping 103%YoY to PKR1,190bn.

Gross revenue receipt growth of 46% to PKR17,815bn, primarily banking on 48% budgeted increase in income tax collections. This seems a bit stretched since a normal tax regime for exporters (especially if applicable for IT) will face significant backlash. Also, this may promote under reporting of profits to evade tax.

We highlight most of the increase in non-tax revenue is emanating from the 157% increase in SBP profits to PKR2,500bn. In-direct taxes are budgeted to increase by 34.8% to PKR7,458bn backed by 20%, 36.3% and 58% growth in customs duties, sales tax and Exide duty collections.

To our surprise, GoP is targeting raising Euro Bonds despite elevated CDS on Pakistan. Another interesting point to note is that the govt does not expect to raise any money under floating debt (prize bonds and T-bills) in FY25; whereas, majority of the funding will be done through Ijara Sukuk bonds.

Key economic targets

	FY24R	FY25b
GDP growth	2.4%	3.6%
Inflation	24.0%	12.0%
Fiscal deficit	7.4%	5.9%
Primary surplus	0.4%	2.0%

Source: Budget FY25, Alfalah CLSA Research

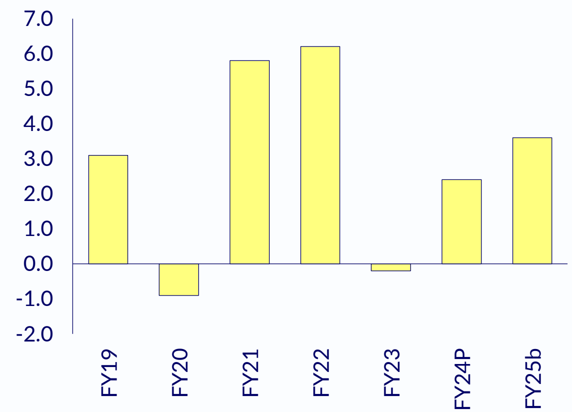
Economic growth and inflation estimates aren't over-optimistic

GDP growth target of 3.6% and CPI inflation expectation of 12%, looks attainable given the lower economic output (FY24p GDP growth is 2.4%) and high CPI base (11MFY24 average CPI 24.5%) of the ongoing year. However, upside risk will remain in the form of PKR depreciation and revived food inflation due to extreme weather events.

Output growth contingent on agriculture and exports: A GDP growth target of 3.6% for FY25 seems reasonable as Agri revival post FY23 floods in addition to easing import restrictions for manufacturing sector has uplifted growth prospects. Growth will most likely be driven by increased remittances in response to stable PKR coupled with a mass exodus of skilled labor in the last 3 years. However, extreme weather event being witnessed across Pakistan may pose a risk to these expectations.

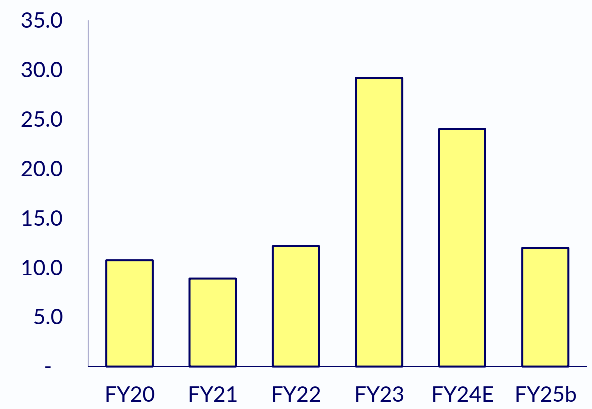
High base effect to tame CPI inflation in FY25: Softening global commodity prices toward their long term mean along with stable PKR will certainly assist in keeping price pressures under manageable levels. The budget FY25 avoided large inflationary tax measures to sustain the downwards trajectory of inflation for the year. High base carried into FY25 will also play its part in keeping CPI inflation upward sticky.

GDP growth target of 3.6% is attainable



Source: Eco. Survey, Alfalah CLSA Research

CPI to fall due to base effect (%)



Source: PBS, Alfalah CLSA Research

Budget largely negative from corporate earning standpoint

Budget FY25 is negative from corporate earnings standpoint owing to i) inclusion of exporters in normal tax regime and ii) added tax burden on Banks due to reduction in tax shield on provisioning. Other key developments for listed space include, increase in CGT for non filers to 45% from 30% and no benefit of holding period for CGT. However, from market's perspective the budget was positive as it missed key taxation risk being anticipated.

Key positives for the market:

- No increase in CGT on filers
- Increased dividend tax on mutual funds deriving 50% income from debt (capital mobilization).
- Heavy taxation on real-estate (capital mobilization)
- Increased financial inclusion amid documentation drive

Key negative for sectors:

- Transition of exporters from 1% FTR to minimum tax regime (Textile and possibly Technology).
- Increased tax burden on banks due to reduced tax shield on provisioning and resumption of ADR tax.

Tax on salaries and non salaried individuals increased

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Current tax slabs for income individuals

Salaried individuals

Income	Tax rate	Fixed rate
upto 600,000	0.0%	0
600,001 - 1,200,000	2.5%	0
1,200,001 - 2,400,000	12.5%	15,000
2,400,001 - 3,600,000	22.5%	165,000
3,600,001 - 6,000,000	27.5%	435,000
Above 6,000,001	35.0%	1,095,000

Non salaried individuals/AOPs

Income	Tax rate	Fixed rate
upto 600,000	0.0%	0
600,001 - 800,000	7.5%	0
800,001 - 1,200,000	15.0%	1,500
1,200,001 - 2,400,000	20.0%	75,000
2,400,001 - 3,000,000	25.0%	315,000
3,000,001 - 4,000,000	30.0%	465,000
Above 4,000,001	35.0%	765,000

Proposed tax slabs for income individuals

Salaried individuals

Income	Tax rate	Fixed rate
upto 600,000	0.0%	0
600,001 - 1,200,000	5.0%	0
1,200,001 - 2,200,000	15.0%	30,000
2,200,001 - 3,200,000	25.0%	180,000
3,200,001 - 4,100,000	30.0%	430,000
Above 4,100,000	35.0%	700,000

Non salaried individuals/AOPs

Income	Tax rate	Fixed rate
upto 600,000	0.0%	0
600,001 - 1,200,000	15.0%	0
1,200,001 - 1,600,000	20.0%	90,000
1,600,001 - 3,200,000	30.0%	170,000
3,200,001 - 5,600,000	40.0%	650,000
Above 5,600,001	45.0%	1,610,000

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

Budget estimates 2024-25

(PKR bn)	Revised FY24	Budget FY25
Revenue Receipt (FBR)	**9,252**	**12,970**
Non Tax Revenue	**2,947**	**4,845**
Gross Revenue (FBR+NTR)	**12,199**	**17,815**
Less: Transfer to Provinces (-)	-5,427	-7,438
Net Revenue for Federal Government	6,772	10,377
Expenditure	15,160	18,877
Federal Budget Deficit	**-8,388**	**-8,500**
Provincial Surplus	539	1,217
Overall Budget Deficit	-7,849	-7,283
Overall Fiscal Deficit as %GDP	**-7.4%**	**-5.9%**
Primary Balance	402	2,492
Primary Deficit as %GDP	0.4%	2.0%
Nominal GDP	106,045	124,150

(PKR bn)	Budget FY24	Revised FY24	Budget FY25
FBR taxes	**9,415**	**9,252**	**12,970**
Direct taxes	**4,255**	**3,721**	**5,512**
Income tax	4,203	3,681	5,454
Others	52	40	58
Indirect taxes	**5,160**	**5,531**	**7,458**
Custom duties	1,211	1,324	1,591
Sales tax	3,411	3,607	4,919
FED	538	600	948
Current expenditure	**13,344**	**14,232**	**17,203**
Subsidies	**1,064**	**1,071**	**1,363**
Federal PSDP	**950**	**659**	**1,400**

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

Sectoral Impacts

Sector	Measure	Impact	Comment
Market	Capital gains tax on sale of securities shall no more be taxed on the basis of holding period; a flat tax rate of 15% shall be charged.	Negative	Can discourage investors from holding equities for longer horizon.
	Dividend derived from a mutual fund which earns 50% or more of its income from profit on debt is proposed to be enhanced from 15% to 25%.	Positive	Shall encourage investors to move towards equity funds
	Capital gains tax has been increased for non-filers; minimum rate of 15% and maximum rate of 45%.	Neutral	Number of non-filers is relatively low in the equity market
	Capital gains income from mutual funds and collective investment schemes has also been enhanced from 10% to 15%	Neutral	

Sector	Measure	Impact	Comment
Banks	The amount of "bad debts" classified as "substandard" or "doubtful" or provisions for advances, off-balance sheet items or any other financial asset shall not be allowed as expense.	Slightly Negative	Effective tax rate shall increase. Broadly, every 1% increase in tax rate affects earnings by 2%
	Provisions or ECL for Advances and off balance sheet items or any other financial asset existing before or after Jan 1, 2024 under IFRS 09 shall not be allowed as an expense or deduction.	Slightly Negative	Effective tax rate shall increase. Broadly, every 1% increase in tax rate affects earnings by 2%
	Additional taxation due to lower ADR has been reinstated since no extension in exemption was provided in the budget	Negative	On average, effective tax rate shall climb from current 49% to a range of 52-55%

Sectoral Impacts

Sector	Measure	Impact	Comment
Cement	PSDP Allocation at PKR 1.4 trillion vs PKR 950 bn in FY24, up 47% YoY	Positive	Demand for cement can increase significantly if proceeds are actually materialized
	Increase in FED on Cement from PKR2/kg to PKR3/kg	Neutral	Impact is PKR50/bag, which can be passed on
	Increased rate of WHT on sale and purchase of immovable property	Negative	May reduce mobility of capital to construction sector
	Holding period benefit revoked for CGT on immovable property	Negative	May reduce mobility of capital to construction sector
	An FED of 5% has been imposed on commercial properties and first sale of residential properties.	Negative	New construction activity may slow down

Sector	Measure	Impact	Comment
Textiles	Exporters to be put under normal tax regime	Negative	Profits will decline due to higher taxation. ILP to be affected in our coverage companies.
	GST to be increased to 18% on supplies made by the POS retailers dealing in leather and textile products	Neutral	Price effect will be passed on - IMAGE

Sectoral Impacts

Alfalah CLSA

Sector	Measure	Impact	Comment
Autos	Introduction of 10% sales tax on Tractors	Negative	Will increase tractor prices. Likely to reduce tractor demand (MTL, AGTL)
	Hybrid Electric Vehicles shall now be charged a higher sales tax of 18% from 8.5% and 12.75% depending on engine capacities.	Negative	Increase in prices of locally assembled HEVs of SAZEW and INDU
	Reduction in concession of customs duties on import of Electric vehicles having value above US$ 50,000.	Positive	May displace imported EV demand to locally manufactured HEV vehicles.
	Levy of Additional Customs Duty on localized auto parts to incentivize local manufacturing sector.	Mixed	Positive for auto parts manufacturers Could be negative for auto assemblers
	Advance tax on automobiles now based on market value against engine capacity previously.	Negative	Advance tax will increase on vehicles and will escalate with rising prices going forward

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Sector	Measure	Impact	Comment
OMCs	Petroleum Development Levy (PDL) cap increased from PKR60/ ltr to PKR80/ltr	Negative	Official POL demand may reduce as gap between smuggled and official price expands. Working capital requirements for smaller OMCs will increase
	Zero-rating of petroleum products being converted into exemption.	Neutral	Any cost impact resulting thereof will be passed on in prices

Sectoral Impacts

Alfalah CLSA

Sector	Measure	Impact	Comment
Power	PKR 253bn has been budgeted to improve grid efficiency	Positive	Reduced line losses may curtail circular debt flow
	PKR1,190bn has been budgeted under power sector subsidy	Positive	Realization of the amount will improve power sector cash flows

Sector	Measure	Impact	Comment
Steel	Iron and steel scrap have been exempted from sales tax	Positive	Improved cash flow for long steel (Rebar) manufacturers
	Exporters to be put under normal tax regime	Negative	Higher effective tax on copper income for MUGHAL
	A phased withdrawal of sales tax exemption has been granted to ex-FATA/PATA	Positive	Improved competitive position of MUGHAL in the northern steel market
	Exemption from income and withholding taxes may be extended for another one year up to 30th day of June, 2025 for FATA/PATA regions		

Sector	Measure	Impact	Comment
Others	Custom duty on Aerosol Product Containers increased from 11% to 16%	Negative	NICL makes Aerosol products on tolling for Mortein.
	Exporters to be put under normal tax regime	Negative	Possible application on Technology sector (clarity awaited)
	Increased rate of 18% on DAP	Negative	Will increase working capital requirement of fertilizer companies.
	Mobile phones to be taxed at standard rate (other than mobile phones valuing exceeding US$ 500 which will remain chargeable to existing rate of 25%)		

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