REP-300

Pakistan Budget Preview

Revving up the Growth Engine

04-Jun-2021

AHL Research

D: +92 21 32462742

UAN: +92 21 111 245 111, Ext: 355

F: +92 21 32420742

E: research@arifhabibltd.com

Best Corporate & Investment Bank: 2020

Best Domestic Equity House

Top 25 Companies

Corporate Finance House of the Year: 2020

Best Equity Research Analyst: 2020

Budget Preview FY22

Revving up the Growth Engine

AHL's Blueprint of the FY22 Budget is presented below whereby the key objective of the government is to continue the growth momentum of the economy that has been witnessed over the last year. The budget is likely to focus on helping the economy enter a high growth mode and improving the welfare of the masses, whilst also maintaining fiscal health. We have summarized some key expected features below:

1. Further build up on the growth momentum witnessed in the economy over the last year and work towards achieving 5-6% GDP growth

a. Increase Development Expenditure

   i. *Expenditure on PSDP likely to increase to PKR 900bn from PKR 650bn last year*

b. Increase incentives for capital investment

   i. *Removal of import duty on raw material for export oriented sectors*

c. Promote industrialization and improve import substitution

   i. *Reduction in turnover tax from 1.5% to 0.5%*

2. IMF pressure to maintain fiscal health to be achieved through higher revenue

a. Dependence of higher revenue is expected to rely primarily on expanding the tax base

   i. *Improve documentation of the economy and bring informal sectors into the tax net*

   ii. *Implement taxation system reforms to improve efficiency and make the process less cumbersome*

b. Higher GDP and inflation to achieve almost PKR 400-500bn higher revenue

c. No major additional taxes to be imposed that would compromise growth momentum

Budget Preview FY22

Revving up the Growth Engine

3. Fiscal relief for improving welfare of the masses

a. Decrease the burden of tax payment on people from the lower-income ceiling

i. Additional taxes are likely to be levied on the higher income salary bracket and by broadening tax net

b. Salary increment for government employees

i. The salaries of government employees are expected to be increased by 10-15%

c. Special provisions may be made under the Ehsaas programme

i. Government expected to continue supporting the local health care system and provide cash relief to daily wage earners as well as shield domestic businesses

d. Measures aimed at increasing inflation would be curtailed

i. While the country is coursing through the third wave of the pandemic, government would avoid taking any measure that results in increasing inflation

Budget Preview FY22

Juggling between Growth and Fiscal Discipline

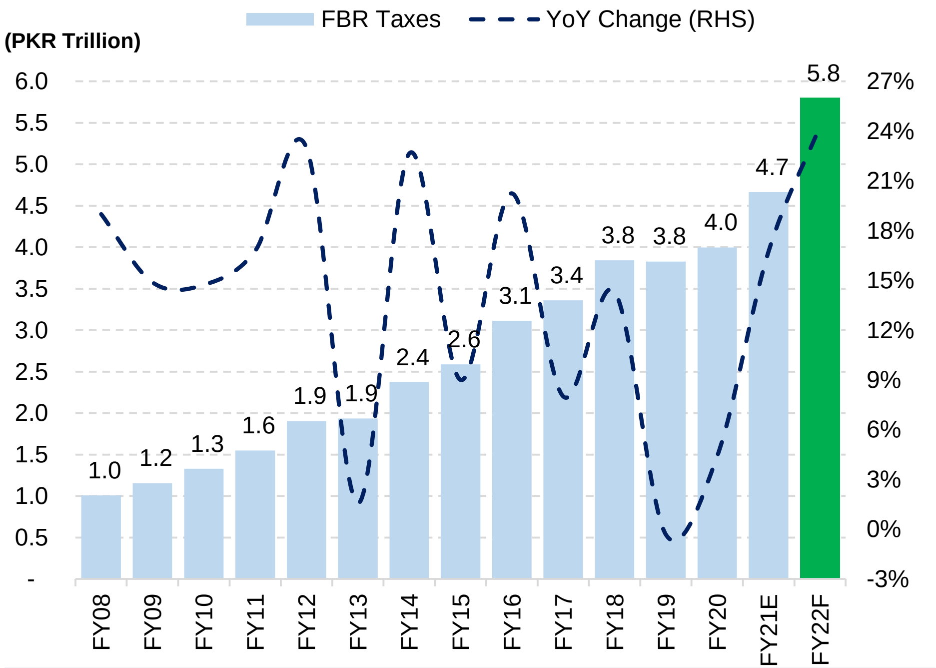
- The federal government is expected to announce the budget for FY22 on 11th Jun’21. With the economy gradually moving past the stabilization phase into the recovery phase past the initial COVID-19 slowdown, we expect the forthcoming budget to depict an expansionary fiscal policy. The new finance chief in the government has also categorically stated that his efforts during his tenure will be concentrated towards reviving and improving the growth rate of the economy. It is clear from media reports and from his communication that the focus of the budget would be towards welfare of the masses, and towards fueling growth in the economy. Power tariff hikes are unlikely while clearing up of the daunting circular debt would be achieved through other means.
- The SBP has also adopted a pro-growth stance in its monetary policy and indicated through its communication that financial conditions are stable and do not as yet warrant a rate hike. The PM has also talked about a focus on increasing development expenditure to boost activity and growth rates, in the upcoming budget.

Budget Preview FY22

Juggling between Growth and Fiscal Discipline

- That said, the IMF sword still looms over and while the incumbent Minister of Finance and Revenue has expressed his intent to negotiate with the IMF over taxation measures, we believe that revenue targets are once again likely to be stringent and daunting. The IMF has given a target of PKR 5.8trn for FBR tax collection next year. The government is expected to target this by focusing on broadening the tax base through augmented documentation as opposed to introducing various new major taxes. News reports also indicate that improving fiscal health will be achieved through a focus on taxation reforms and harmonization of taxes. Apart from increasing the tax base, there are likely to be improvements in the system to reduce interaction between taxpayers and the authorities. We expect major reforms directed towards reducing compliance burden and enhanced simplification of the entire tax filing process. Work towards automation of the tax system and implementation of the 'track and trace' system is likely to be a key focus in achieving higher tax revenue. Furthermore, the taxation system is likely to be more progressive with reports as per media coming in of a possible reduction in income tax slabs from 11 to 5 with higher incidence of taxation to fall on the higher income groups. This is also in-line with IMF recommendations.
- Maintaining fiscal stability and improving the fiscal health, while adopting a pro-growth and expansionary fiscal policy will be a real challenge for the government. Successfully striking this balance depends largely on successful negotiations with the IMF. With the ongoing third wave of COVID-19, we view that the stance of the IMF would be more lenient. Tightening of the economy in this backdrop would be harmful for public welfare, an undesirable outcome during the economic revival phase in the country.

Exhibit: Government eyeing to raise PKR 5.8trn (FBR) tax in FY22



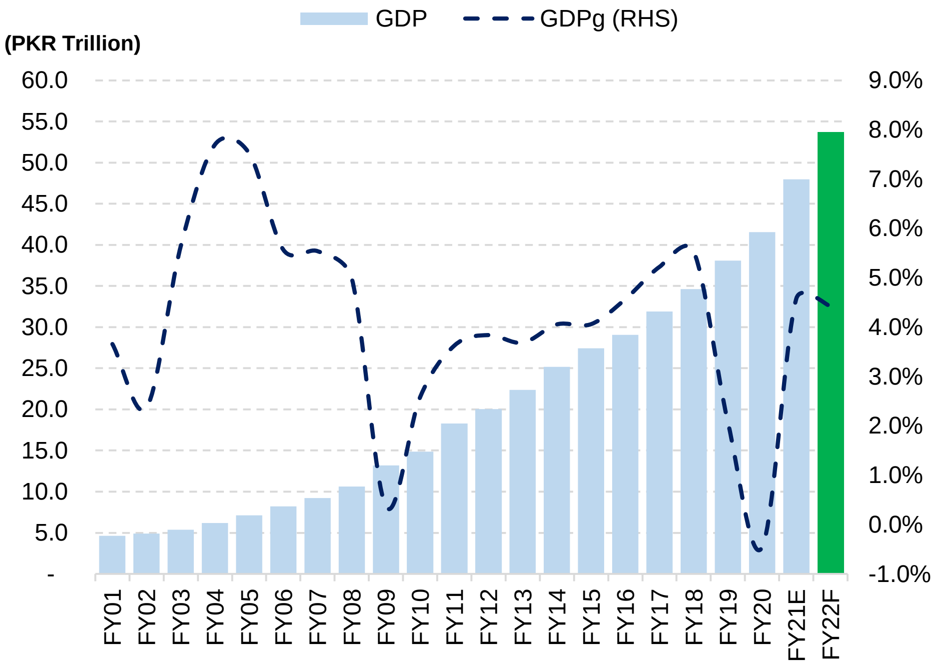
Source (s): MoF, AHL Research

Budget Preview FY22

Juggling between Growth and Fiscal Discipline

- The faster than expected rebound in economic activity across the country on the back of supportive and proactive measures undertaken by the SBP and the government helped to achieve a provisional GDP growth of 3.94% in FY21P, much higher than IMF and World Bank projections of 1.5% and 1.3% respectively. Services sector contributed 2.72% to the overall growth, highest amongst all the sectors followed by industries which contributed 0.69%, while agriculture contributed 0.54% during the period under review.
- We expect the final GDP growth rate to clock-in even higher than the provisional estimate of 3.94%. LSM is expected to post a much higher growth YoY for the year and should clock-in at 14.1%. Moreover improved trade volumes are likely to further stimulate the growth estimates of Wholesale and Retail category which majorly contributes to the services sector, which accounts for ~60% of the GDP. We expect GDP growth rate to clock-in at 4.57% for FY21.
- GDP growth during FY22 should continue its charged momentum that it gained during the outgoing fiscal year. A growth friendly budget with an expansionary fiscal policy coupled with a low interest rate regime is likely to keep economic activity upbeat. We expect the Wholesale & Retail Trade segment to be the predominant driver behind the growth engine next year. Vaccination rollout across the world should significantly improve the COVID situation and open up global trade thereby giving a drastic push to the trade volumes. Moreover the manufacturing sector should post healthy numbers on the back of robust activity across all cyclical sectors. We expect GDP growth to clock in at 4.42% during FY22.

Exhibit: GDP growth is expected to clock in at 4.5% in FY21



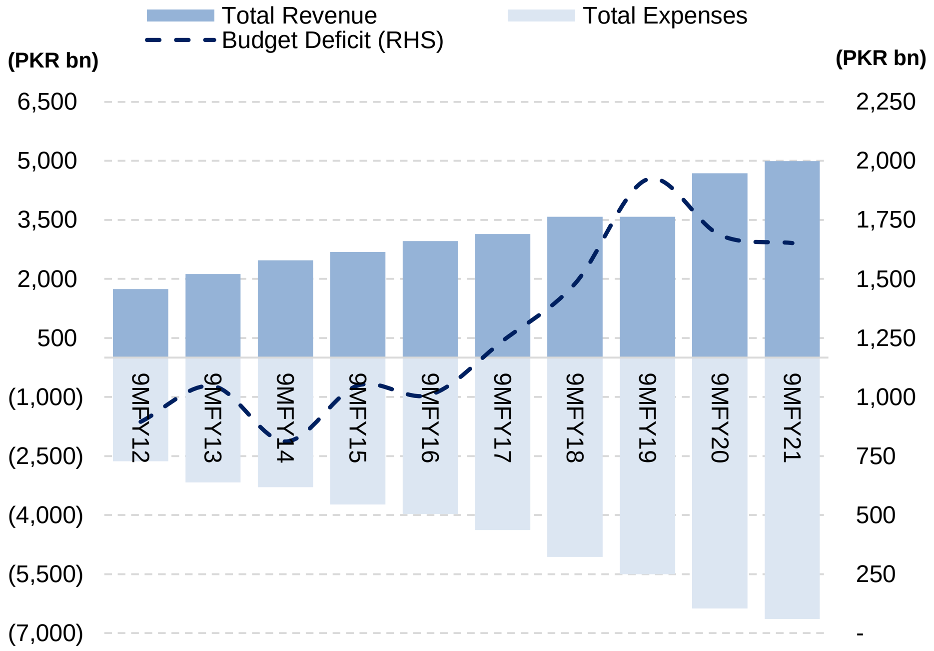
Source (s): SBP, AHL Research

Budget Preview FY22

Fiscal Relief to Continue to avoid Fiscal Cliff

- Pakistan's fiscal balance in FY21TD has strengthened over prior year, with the deficit arriving at PKR 1.65trn in 9MFY21 (3.6% of GDP) compared to PKR 1.69trn in 9MFY20 (3.8% of GDP), down by 2% YoY. Moreover, the primary surplus during the period at PKR 452bn (1.0% of GDP in 9MFY21) fares better compared to a primary surplus of PKR 194bn witnessed last year (0.4% of GDP). Primarily, total revenue growth at 6% in 9MFY21 to PKR 5.0trn (9MFY20: PKR 4.7trn) aided the fiscal balance, translating into 11.0% of GDP vs. 10.7% last year. The total tax revenue collection has gone up by 5% YoY to PKR 3.8trn. Indirect taxes (+13% YoY to PKR 2.15trn), sales tax (+14% YoY to PKR 1.42trn), and direct taxes (+9% YoY to PKR 1.25trn amid higher number of tax payers), contributed to the overall collection.
- For FY21, the government refrained from introducing any new taxation measures in the budget and only undertook a variety of measures for tariff rationalization in order to revive the stalled economic activity. With this, we expect fiscal deficit to clock-in at 6% in FY21 (5.6% in FY22B) against the government's target of 6.5%. This budget is understandably so since the outbreak of COVID-19, which disrupted economic activities, and essentially forced the government to play a leading role in salvaging the economy from the ruins of recession.
- Keeping in view the recent pick-up in the economic activities, we anticipate an 11% YoY growth in total revenue collection during FY21 from last year's collection of PKR 6.3trn. This growth is primarily expected to come from tax revenue which is expected to post a jump of 8% YoY, to PKR 5.1trn. Moreover, we expect the total expenditure to clock-in at 21% of the GDP (PKR 10.3trn in FY21E and PKR 8trn in FY22B). On a yearly basis this increase would be 7% and -21% in FY21E and FY22B, respectively.

Exhibit: Fiscal Deficit down by 2.0% YoY to PKR 1,652bn in 9M



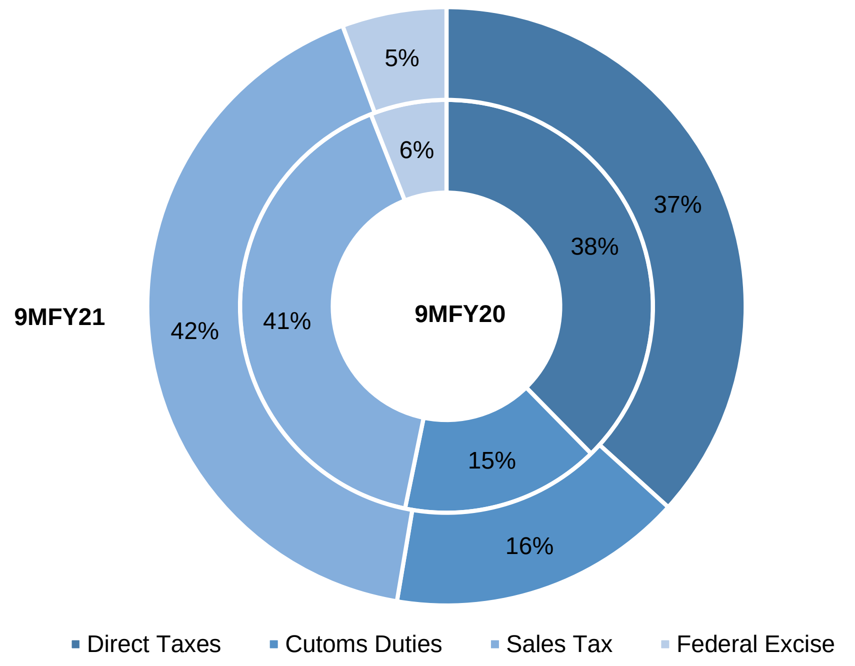
Source (s): MoF, AHL Research

Budget Preview FY22

Revenue - Economic Recovery Increased Revenue Collection

- Ease in lockdown situation and rebound in economic activity helped attain a V-shaped recovery which led to improvement in tax collection of the country (total tax revenue up by 5% YoY during 9MFY21). On the other hand, proactive measures by SBP to combat a sharp contraction in aggregate demand also helped the economy to depict a rapid inflection and improved purchasing power parity. Likewise, to support economic growth, IMF also relaxed its FBR tax revenue target to PKR 4.72trn compared to PKR 4.96trn earlier, which was a much needed sigh of relief. As per 9MFY21, FBR tax revenues have clocked-in at PKR 3,395bn which is up 11.5% YoY. During 3QFY21, FBR tax revenue settled at PKR 1,185bn – albeit 25% YoY higher but 1.2% lower QoQ as the third wave of COVID-19 led to certain protective measures by the government. While tax collection has exceeded the PKR 4trn mark for the first time in 11MFY21, as per media sources. Major contribution to the tax revenue jump emanated from indirect taxation which increased by 13.2% in 9MFY21 due to surge in imports by 10%, resulting in higher collection from custom duties and sales tax by 14.1% and 14.0% YoY, respectively.
- As mentioned earlier, to maintain growth momentum, we believe that the government will not put additional major tax burden on the business community and might relax some taxation measures in order to stir up economic activity in the country.
- We expect the government to reduce custom and regulatory duties on import of key raw materials to bring down prices of goods to encourage local production and discourage imports. We also expect the government to keep Petroleum Development Levy (PDL) on lower side to curtail inflationary pressure.

Exhibit: Break-up of Federal Tax Revenue Collection



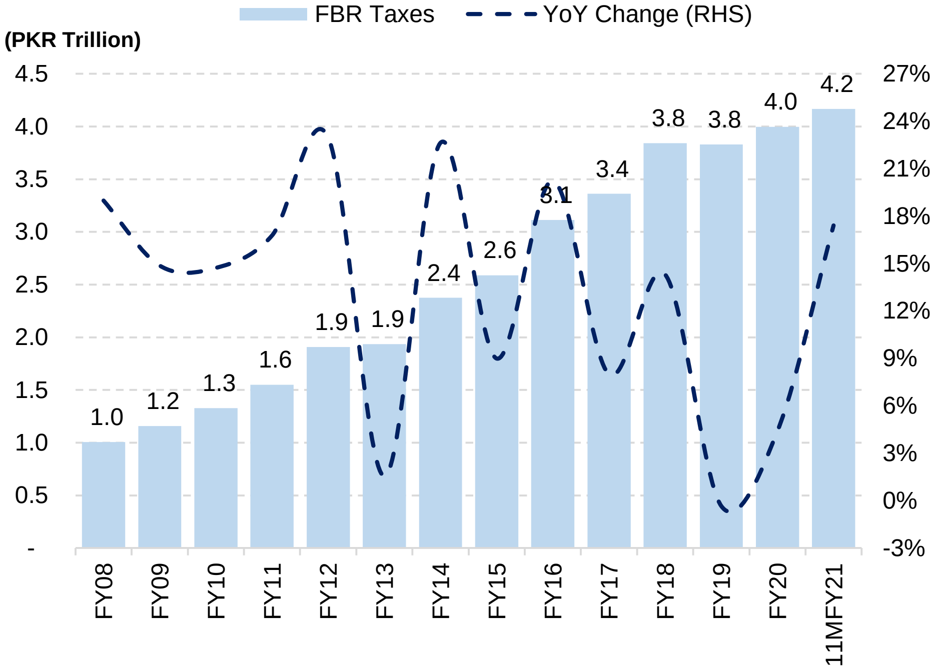
Source (s): MoF, AHL Research

Budget Preview FY22

Revenue - FBR All Set to Achieve Revised Tax Collection Target

- FBR has collected tax revenue of PKR 3.4trn in 9MFY21, exceeding its revised target on the back of higher tax collection from indirect taxes. Contribution of Indirect tax collection increased by 93bps in 9MFY21 to 63% while rest of the tax collection came from direct taxation. Indirect tax constitutes of three major heads including Custom Duty, Sales tax and Federal Excise Duty which contributed around 25%, 66% and 9%, respectively to the total indirect tax collection. Share of sales tax and custom duty increased in 9MFY21 due to surge in imports of key raw materials amid revival of economic activity.
- Despite decline in profits of State Bank of Pakistan by 22% YoY to PKR 498bn during 9MFY21, non tax revenue share increased by 1.3% due to 86% YoY growth in petroleum development levy to PKR 369bn in 9MFY21. We expect PDL collection to settle at PKR 420bn in FY21, which is up by 43% YoY compared to PKR 294bn in FY20.
- The government expects the tax revenue collection to settle at PKR 7.1trn for FY22B, a jump of 36% YoY compared to tax revenue of PKR 5,207bn for FY21E.

Exhibit: 11% Growth in FBR tax Collection during 11MFY21



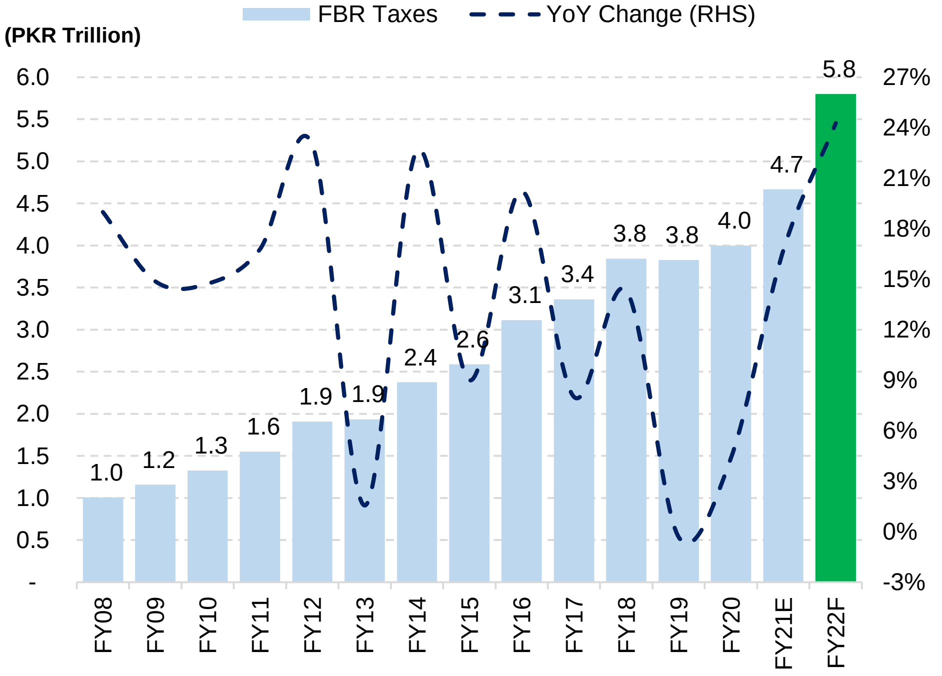
Source (s): MoF, AHL Research

Budget Preview FY22

Revenue - Government eyeing to raise PKR 7.1trn tax in FY22

- The government is planning to raise an enormous tax collection target of PKR 7.1trn through new taxes worth of PKR 350bn, additional taxes on higher income salary bracket, raising PKR 200bn through sales tax measures, and the rest is likely to be be collected from administrative measures by bringing more people under the tax net while also planning to implement “track and trace” system to curb tax evasion.
- Indirect tax contribution is likely to increase due to higher sales tax by almost PKR 200bn while higher import bill is likely to earn more tax revenue from custom duties.
- Government expects non-tax revenue collection to decrease by ~15% to PKR 1.4trn in FY22 with major contribution expected from State Bank’s profits around PKR 650-700bn while Petroleum Development Levy (PDL) may decline to around PKR 100-200bn. The collection in lieu of PDL is likely to decline significantly because the PDL target for last year was PKR 30/litre while currently it stands at almost half of that.
- We believe tax net for salaried class is expected to remain unchanged while direct tax collection will likely increase due to broadening tax base as income tax filers are expected to increase by 5% in the upcoming year.

Exhibit: Government eyeing to raise PKR 5.8trn (FBR) tax in FY22



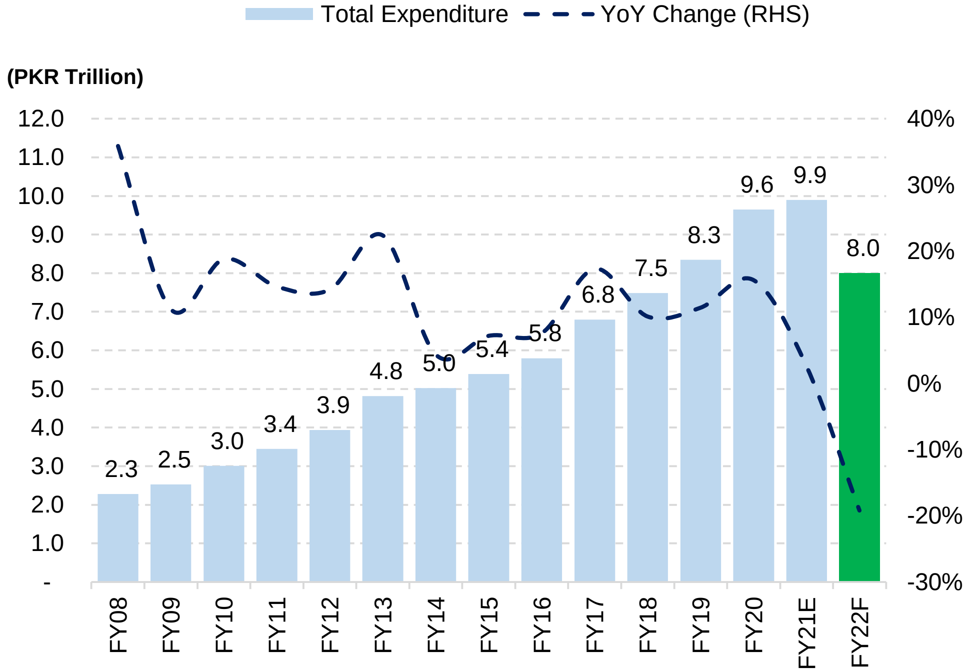
Source (s): MoF, AHL Research

Budget Preview FY22

Expenditure - Conscious Spending to Keep a Lid

- The incumbent government must be lauded for its strategic economic planning in the outgoing year, including keeping a lid on expenditure, which (amongst other things) allowed the economy to successfully keep fiscal health in check. To recall, as of 9MFY21, total expenditure has clocked-in at PKR 6.6trn, which is 4% YoY higher led by 8% YoY higher current expenditure. During 3QFY21, total expenditure registered a 15% QoQ decline.
- Primary focus in FY21 had been on providing support to the low income strata / daily wage earners, shielding domestic businesses and maintaining financial stability of the economy. Pertinently, the private sector was equipped to undertake expenditure on its own so as to revive business activity, without adding any additional burden on the governments fiscal flows, by means of incentives such as announcement of a construction package and enhanced mortgage loans etc. Going forward, although the government will primarily target constraining fiscal imbalances, it will have to pivot towards pro-growth policies (undertaking projects that aid aggregate demand) which should provide tailwinds to the ongoing impressive economic revival. Total expenditure for FY22 is estimated at PKR 8trn.

Exhibit: Total expenditure for FY22 is estimated at PKR 8trn



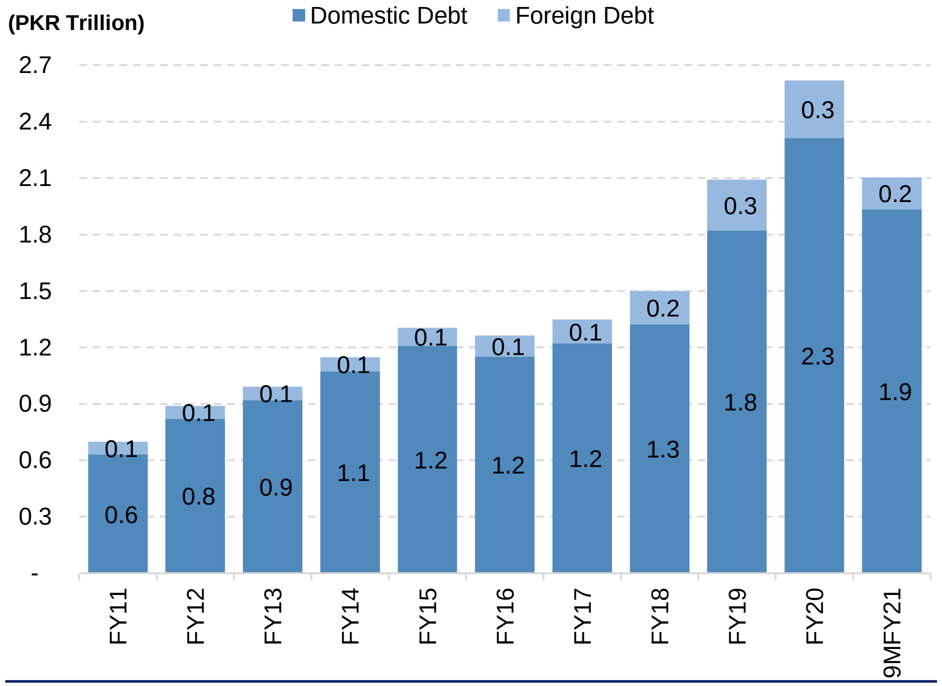
Source (s): MoF, AHL Research

Budget Preview FY22

Expenditure - Debt Servicing

- Pakistan's total debt position settled at PKR 43.4trn as at end of Mar'21, marking a jump of 6.2% YoY. The domestic debt amounted to PKR 25.6trn (up 13.8% YoY) while the foreign debt remained stagnant on YoY basis, standing at PKR 16.4trn. As a percentage of GDP, the total debt arrived at 93.1% as at Mar'21.
- Of the total domestic debt stock, almost 56% comprised of Pakistan Investment Bonds (PIBs), which rose to PKR 14.4trn by the end of 9MFY21. This shift of debt profile from shorter tenor to longer improves duration of the portfolio, providing longer space for maturity of the instruments. Meanwhile, the floating debt increased by 7.6% to PKR 6trn as at Mar'21 from FY20 end. This floating debt mainly comprises of Market Treasury Bills.
- Going forward, we expect the SBP to increase policy rate by 50bps in 1HFY22, which would result in the incremental debt servicing to amount to ~PKR 100bn, we estimate.
- Pertinently, the government is expected to allocate 38% of total expenditure for debt servicing under the FY22 budget at PKR 3.1trn in contrast to last years budgeted figure of PKR 2.9trn.

Exhibit: Historical Trend of Debt Servicing



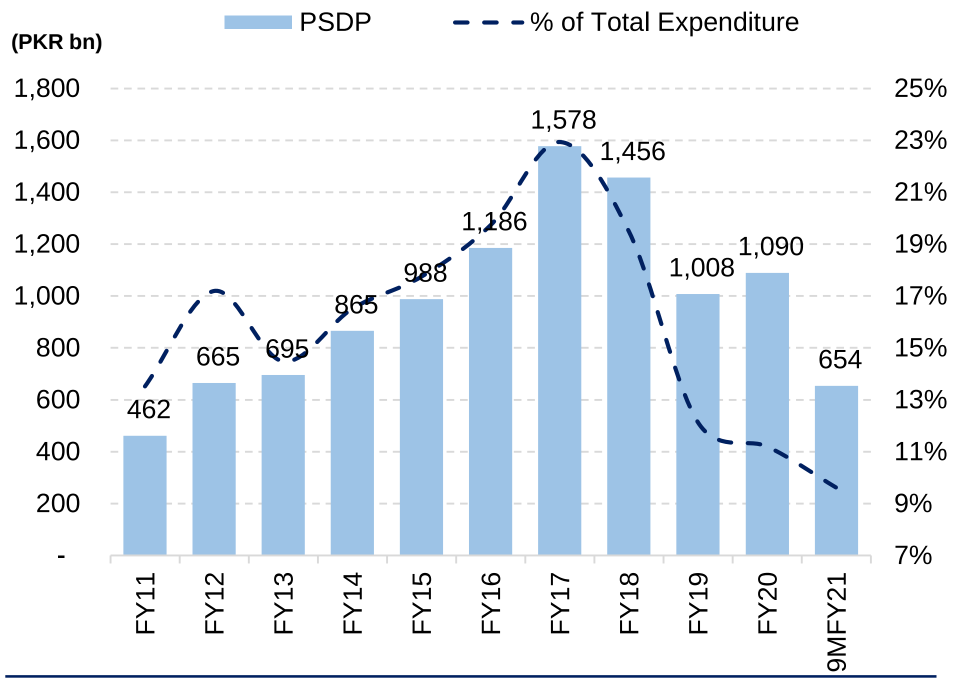
Source: MoF, AHL Research

Budget Preview FY22

Expenditure - PSDP

- Compared to the world economy, the domestic climate remains relatively well managed and the struggle to get acclimatized to the post COVID world seemed less punitive. The government had already targeted fiscal prudence during the last budget, hence it may have to very slightly revise downwards its Federal Public Sector Development Programme (PSDP) target by 4% to PKR 622bn against PKR 650bn initially budgeted.
- As per latest update, the government has disbursed PKR 566bn for various projects under the Federal PSDP as at Apr'21. With utilization currently at 87% of the original target (and historically it has peaked in the last quarter), it is commendable that the government nearly hit target this year despite augmented need of funds for social welfare, job security and financial assistance for SME's, to counter the economic consequences of the novel Coronavirus and provide relief to the masses.
- Going forward, we do highlight that among major expenditure headers, total federal spending under PSDP for FY22, envisaged at PKR 900bn, will be PKR 250bn higher than the initial FY21 target. Pertinently, the government is expected to launch a PSDP-plus Public Private Partnership model, with 50 projects (under the communication, health, science and technology, and social sector) being apprised for inclusion in a phase wise manner. Thus far PKR 233bn has been earmarked for the Sialkot-Kharian and Sukkur-Hyderabad Motorway. In addition, spending target for provinces will be around PKR 1,000bn (FY21B: PKR 674bn).

Exhibit: Historical Trend of PSDP



Source (s): MoF, AHL Research

Budget Preview FY22

Expenditure - Defence and Subsidies

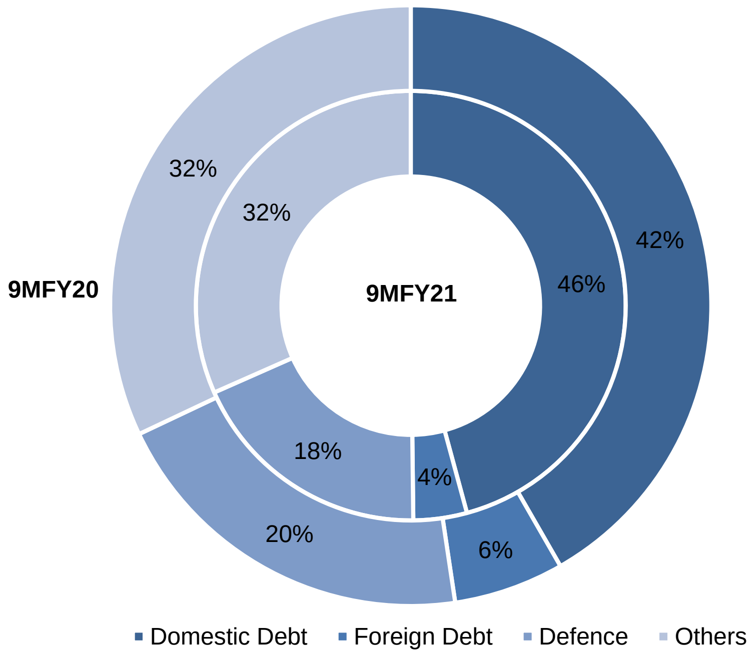
➢ **Defence Budget**

- FY21 defense expenditure portfolio was set at PKR 1,289bn (5% higher YoY), contributing 20% to the total current expenditure and 14% to the total budget outlay.
- For FY22, out of the total expected outlay of ~PKR 8trn, the Ministry of Finance has proposed a defense budget of PKR 1,400bn (18% of projected budget).

➢ **Subsides**

- Subsidies in FY21 were budgeted at PKR 209bn. To recall, power subsidy (WAPDA/PEPCO and KEL) was budgeted at PKR 150bn, posting a decline of 43% YoY from FY20R. This curtailment was on account of IMF's requirement to gradually phase out power subsidies.
- Albeit, subsidies in FY22 are expected at PKR 530bn. We believe a notable chunk of this will be set aside for food and social security.

Exhibit: Current Expenditure Break-up



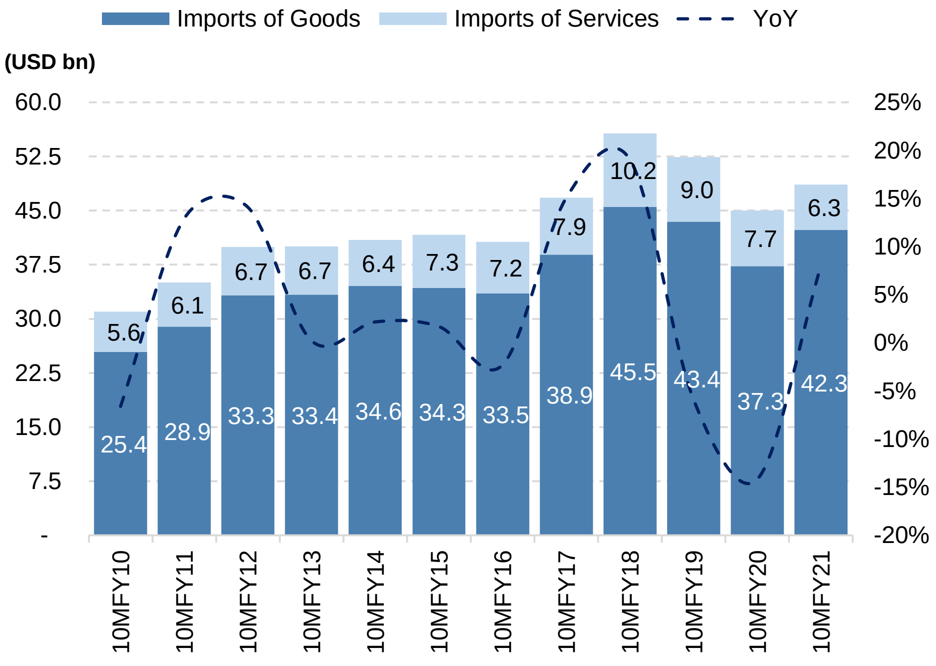
Source (s): MoF, AHL Research

Budget Preview FY22

Imports - All Signs Point North

- Despite government following a policy of limiting the import of certain products, rationing imports and increasing reliance on local production, we still expect a 14% likely jump in total imports - goods & services in FY21; pace, however, slowing down to 13% YoY in FY22F due to higher base.
- In terms of incoming goods, the two most significant categories of the goods' import bill of USD 52.3bn and USD 58.5bn in FY21E and FY22F, respectively, in absolute terms, are likely to be Petroleum (5% YoY in FY21E | 34% YoY in FY22F), and machinery (36% YoY in FY21E | 13% YoY in FY22F). The overall petroleum imports will remain high mainly due to price effect, on account of noticeably higher crude oil prices underpinned by the better-than-expected global vaccination rate, output cuts and faster economic recovery. However, as aggregate demand is likely to inflect next year, we believe volumetric growth in petroleum products will also kick-in. Petroleum imports are likely to be 3.5% of the GDP in FY21E and are expected to remain 4.5% of the GDP in FY22F. Moreover, the increase in machinery group during FY22, we expect, will be on the back of major expansionary cycles of the cement, steel and related sectors which have already resumed as economy starts to grow. In addition, machinery purchased against TERF will also add to the overall import numbers. To recall, SBP has so far approved PKR 436bn as at Apr-01-21.
- The food group import, however, is likely to remain contained in FY22F (-2% YoY) as country has already created buffers of essential food items such as wheat, this year.

Exhibit: Total imports increased by 8% YoY during 10MFY21



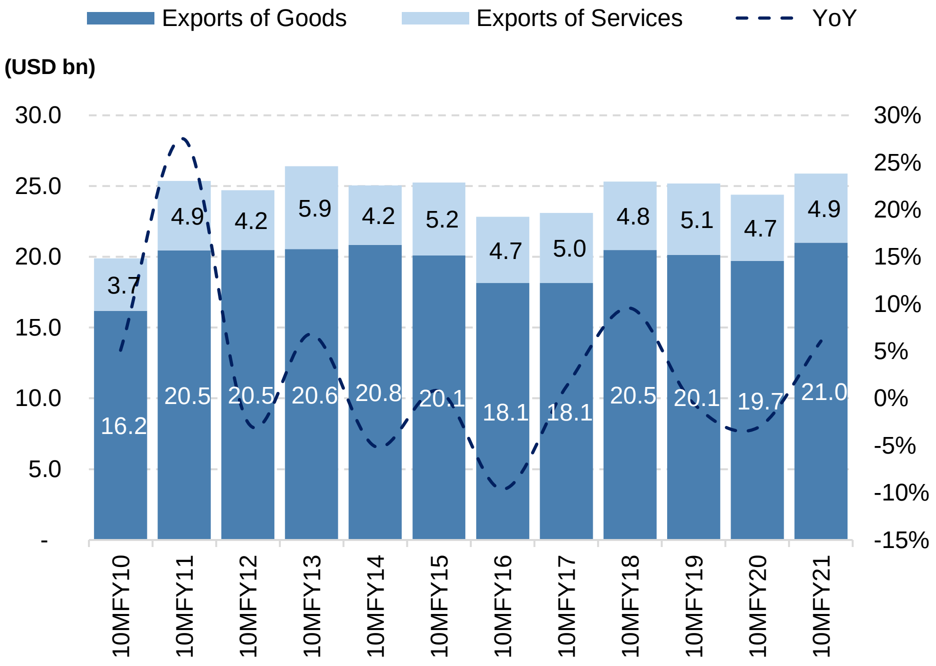
Source (s): SBP, AHL Research

Budget Preview FY22

Exports - Are positive surprises possible?

- Despite the challenging times, we have so far limited the long-term damage to our exports and facilitated the recovery, backed by SBP's monetary stimuli and liquidity support. As a result, we saw total exports (goods and services) increasing by 6% YoY during 10MFY21 to USD 25.9bn. Going forward, we expect exports of goods to improve by 13% YoY in FY21E (15% in FY22F). This would hugely depend on trading partners starting their rehabilitation phase more robustly. We expect food category to remain subdued with climate change affecting crops, marking a meagre 0.4% YoY growth in FY21E (4.2% YoY in FY22F).
- In the backdrop of muted global demand, our concerns double when it comes to textile exports of the country. Even the recent numbers show that textile exports grew 6% YoY (USD 11.7bn) during 10MFY21. For FY22F, we expect textile exports to improve, posting a growth of 12% YoY. However, downside risks associated with this sector remain such as: cotton crop shortage owing to supply constraints and any uptick in cost of production and any further appreciation of the Rupee.
- One sector that remained in the limelight during the pandemic was the technology sector particularly due to the global shift towards digitization. Out of the total services exported by Pakistan during 10MFY21, technology recorded exports worth USD 1,708mn contributing 35% to the overall services' export and marking a ~45% YoY jump. With the recent measures taken and incentives given by the government to move towards digitization we expect a growth of 30% YoY for FY22F to USD 2.7bn (FY21E: USD 2.1bn).

Exhibit: Total exports increased by 6% YoY during 10MFY21

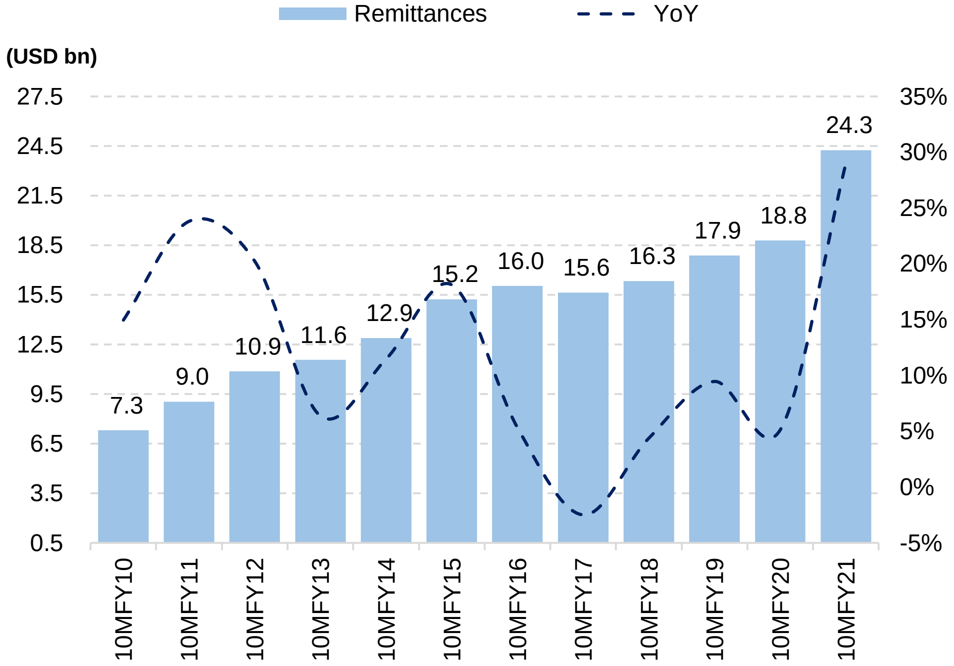


Source (s): SBP, AHL Research

Remittances - Boom to continue or flows to stabilize?

- The remittances inflows so far have panned out stronger than expected. During 10MFY21, remittances are up by 29% YoY to USD 24,246mn as the strong momentum of inflows continued to take the cumulative figure to an unprecedented level. Remittances by overseas Pakistanis registered an increase of 56% YoY to USD 2,778mn during Apr'21 compared to USD 1,785mn during Apr'20. The country wise data reveals that inflow from KSA, UAE, UK and USA amounted to USD 664mn (+21% YoY, -4% MoM), USD 549mn (+19% YoY, -7% MoM), USD 431mn (+130% YoY, +16% MoM) and USD 315mn (+106% YoY, +11% MoM), respectively. We remain bullish over workers remittances which so far have registered above USD ~2.4bn/month on average. Continuation of this trend holds a potential growth opportunity of 27% YoY to the tune of USD 29bn in FY21. Some of the possible reasons for this uptick are: suspension of international travelling, crackdown on illegal channels of remitting and workers sending money to their families more than usual during the pandemic. In addition, government is also putting in efforts to attract more foreign investment by offering products like Roshan Digit Account, lucrative rates on government securities, to name a few. Moreover crackdown on unofficial channels such as “Hundi” and “Hawala” have stimulated inflows through official banking channels. However, in FY22F, we expect the inflows to stabilize and reach USD 30bn, marking a 2% growth only.

Exhibit: Remittances up by 29% YoY during 10MFY21



Source (s): SBP, AHL Research

Budget Preview FY22

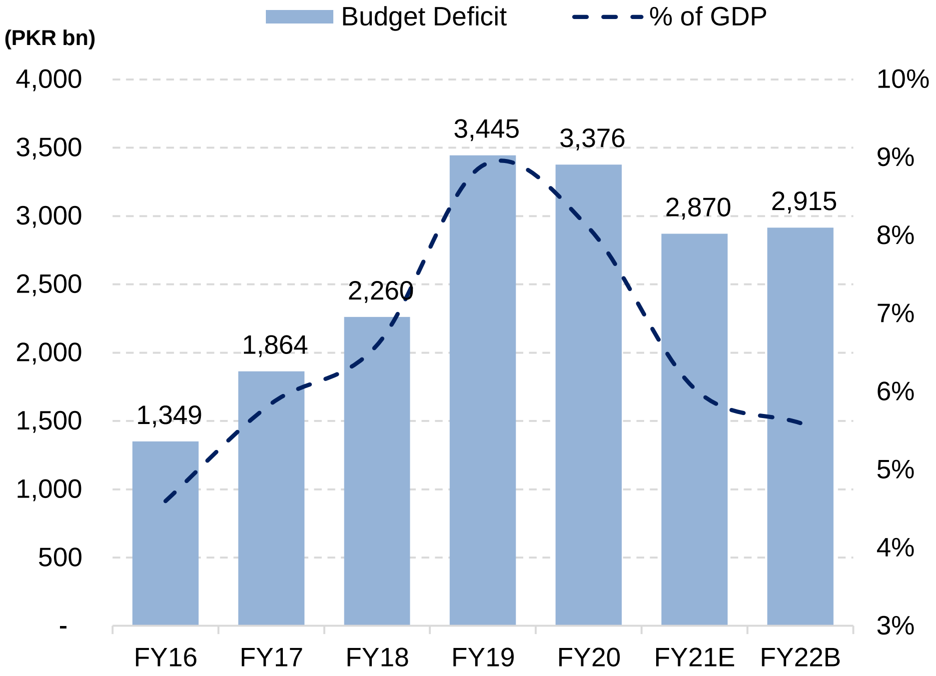
Budgetary Trend

Exhibit: Budgetary Trend

PKR bn	FY16	FY17	FY18	FY19	FY20	FY21B	FY21E	FY22B
Gross Revenue Receipts	**4,080**	**4,549**	**4,696**	**4,436**	**5,782**	**6,573**	**6,884**	**8,540**
Net Revenue Receipts	**2,218**	**2,583**	**2,479**	**2,038**	**3,278**	**3,699**	**4,012**	**5,048**
Tax Revenue	3,377	3,647	4,066	4,072	4,334	5,464	5,207	7,120
FBR Taxes	3,112	3,361	3,842	3,829	3,998	4,963	4,717	5,820
Non-Tax	**787**	**967**	**761**	**427**	**1,524**	**1,109**	**1,677**	**1,420**
Less: Provincial Share	1,862	1,966	2,217	2,398	2,504	2,874	2,872	3,492
Total Expenditure	**4,480**	**5,188**	**5,399**	**5,982**	**7,248**	**7,670**	**10,098**	**7,963**
Current Expenditure	3,178	3,494	3,814	4,804	6,093	6,346	8,898	6,063
Mark-up Payments	1,263	1,348	1,500	2,091	2,620	2,946	3,250	3,060
Defence	758	888	1,030	1,147	1,213	1,289	1,250	1,400
Others	1,157	1,258	1,284	1,566	2,260	2,111	4,398	1,603
Development Expenditure & net lending	1,301	1,693	1,584	1,178	1,155	1,324	1,200	1,900
Budget Deficit	**1,349**	**1,864**	**2,260**	**3,445**	**3,376**	**3,195**	**2,870**	**2,915**
% of GDP								
Total Revenue	15.0	15.5	15.2	12.7	15.0	15.9	14.5	16.4
Tax Revenue	12.4	12.5	13.0	11.6	11.4	13.2	11.0	13.7
Non-Tax Revenue	2.7	3.0	2.2	1.1	3.7	2.8	3.5	2.7
Total Expenditure	19.6	21.3	21.8	21.6	23.1	22.9	20.8	15.3
Current Expenditure	15.9	16.3	17.0	18.4	20.4	20.0	18.7	11.6
Mark-up Payments	4.3	4.2	4.4	5.4	6.3	7.1	6.8	5.9
Defence	2.6	2.8	3.0	3.0	2.9	3.1	2.6	2.7
Budget deficit	4.6	5.8	6.6	8.9	8.1	7.0	6.0	5.6

Source: MoF, AHL Research

Exhibit: Historical Trend of Budget Deficit



Source: MoF, AHL Research

Capital Markets

Budget Preview FY22

Historical Market Performance

- Observing market performance since FY14, we noted a positive momentum on average being displayed by the KSE-100 index in anticipation of the budget. 30, 60 and 90 days prior to the announcement of the Federal budget, the domestic equity bourse generated an average return of 3.4%, 7.4% and 6.1%, respectively.
- Meanwhile post budget data displayed a mixed trend (during FY18 & FY19 foreign outflows and uncertainty on the political front suppressed market performance while investors remained hesitant post FY20 budget due to uncertainty over IMF programme conditions). On average, the local bourse garnered less enthusiasm, with returns of -1.0%, 2.4% and 6.5% over 30, 60 and 90 days respectively, subsequent to the budget announcement.

Exhibit: KSE-100 Performance

Budget Year	30-Days	60-Days	90-Days
Before Budget			
FY21	2.7%	11.5%	-4.0%
FY20	-0.2%	-7.2%	-11.0%
FY19	0.8%	6.1%	2.2%
FY18	5.6%	8.1%	7.4%
FY17	5.4%	10.1%	14.7%
FY16	0.5%	7.1%	2.3%
FY15	2.0%	3.9%	11.2%
FY14	10.3%	19.3%	25.8%
Average	**3.4%**	**7.4%**	**6.1%**
After Budget			
FY21	4.6%	7.4%	16.6%
FY20	-2.3%	-2.4%	-9.3%
FY19	-7.6%	-6.9%	-2.0%
FY18	-12.0%	-7.0%	-4.8%
FY17	1.5%	7.0%	11.8%
FY16	4.2%	4.8%	11.7%
FY15	0.7%	2.7%	4.5%
FY14	3.2%	13.8%	23.1%
Average	**-1.0%**	**2.4%**	**6.5%**

Source: PSX, AHL Research

Budget Preview FY22

Pakistan Capital Market

- The Federal Budget for FY22 is expected to be positive for the equity market along with different listed sectors. Our prognosis of the FY22 budget is primarily based on pro growth approach of the gov't alongside support to different sectors to achieve their exports target and encourage local production. In addition, to achieve the GDP growth target of 4.4% in FY22, we believe that government is expected to focus on agriculture and industrial sector.
- From the stock market perspective, there is a high probability that CGT on securities and withholding tax on dividend will be reduced to 10% from current 15%, thus this should act as a major stimulant and aid the market to record additional gains.
- From a sectoral perspective, we expect the budget to be positive for the following sectors: Cements and Steel (higher PSDP allocation and provision of subsidy for construction and housing), Refineries (Refinery policy), Fertilizers (agriculture package and abolishment of minimum tax regime on import stage) and Autos (Reduction in import duty).

Exhibit: Budget Impact on Different Sectors

Sector	Impact
Market	Positive
Banks	Neutral
Fertilizer	Positive
Cement	Positive
Power	Neutral
Textile	Positive
Autos	Positive
Steel	Positive
Chemicals	Neutral

Source: AHL Research

Budget Preview FY22

Capital Market Proposals – Positive

Proposed Measures	Comment	Probability
Alignment of CGT on disposal of securities with rates applicable on the mutual fund industry	PSX has proposed a cut in CGT to 10% for securities sold within 12 months of acquisition and elimination from the tax thereafter. Hence, reduction in said tax (under section 37A) will attract foreign capital and garner revenue collection for FBR. Recommendations are in the table below.	Likely
CGT for non-resident Pakistani's recommended in-line with CGT on filers under section 37A of the Income Tax Ordinance	Capital gains tax on disposal of securities by non-residents should be aligned with CGT for tax filers under section 37A of the Income Tax Ordinance (ITO). This would encourage foreign inflows in the stock market and also improve participation via the Roshan Digital Account (RDA) regime.	Unlikely

Exhibit: Current and Expected Rates of Capital Gains Tax

S. No	Condition	Current	Proposed by PSX
Filers			
1	Where the security was acquired before 01-Jul-2013	0.00%	0.00%
2	Where the security was acquired before 01-Jul-2016, where the holding period of a security is 24M or more but the security was acquired on or after 01-Jul-2013	7.50%	0.00%
3	Security was acquired on or after 01-Jul-2016	15.00%	10.00%
Non-Filers			
1	Where the security was acquired before 01-Jul-2013	0.00%	0.00%
2	Where the security was acquired before 01-Jul-2016, where the holding period of a security is 24M or more but the security was acquired on or after 01-Jul-2013	15.00%	15.00%
3	Security was acquired on or after 01-Jul-2016	30.00%	30.00%

Source (s): PSX, AHL Research

Budget Preview FY22

General PSX Proposals – Neutral

Proposed Measures	Comment	Probability
Corporate tax rate to be lowered by means of a 20% tax credit for listed companies that maintain a minimum of 25% free float throughout	Corporate tax rate of 29% in Pakistan compares unfavorably to other Asian countries (average rate of 21.32%). Hence, rationalization of tax by a 20% credit on tax payable should be offered to companies maintaining a minimum free float of at least 25% throughout by reinstating section 65C on the ITO.	Unlikely
Elimination of minimum tax on listed companies	Since listed companies already operate in and follow a stringent regulatory environment, removal of minimum tax will encourage documentation of the economy and reduce downwards pressure on bottom-lines already recognizing current and brought forward losses.	Unlikely
Tax refunds to be paid as soon as assessment is completed	Stuck repayments create undue financial pressure, hence, it has been proposed that tax refunds for a particular year be immediately released upon completion of assessment.	Unlikely
Reduction of WHT on income from margin financing transactions to 2.5%	Withholding tax on gross income (profit or markup or interest) earned on Margin Financing (MF) transactions should be reduced from 10% to 2.5%, or 10% should be charged on the net income earned from such transactions under section 233A of the Ordinance.	Likely
Abolishment of tax on dividends to avoid double taxation	The problem of double taxation arises as tax is once paid by the company on corporate profits (profit before distribution) and later on shareholders income i.e. dividends. It has been recommended to eliminate double taxation by removing the tax on dividends (15% currently).	Likely
Removal of tax on dividends for small investors	Under section 5 of the ITO, if a company pays no tax during a year due to exemption of income or carry forward of losses or claims tax credit, investors of that company pay 25% in tax on dividends (50% for non-filers). It has been proposed to reduce tax for such category. Whereas WHT on dividends for small investors (generating dividend income of up to PKR 600,000 per annum) should be removed.	Unlikely

Budget Preview FY22

General PSX Proposals – Neutral

Proposed Measures	Comment	Probability
Tax on brokerage & commission to be slashed to 3% for services provided by PSX and the Pakistan Mercantile Exchange	It has been recommended to reduce the tax on brokerage and commission under section 233 of the Income Tax Ordinance to 3% for services provided by PSX and the Pakistan Mercantile Exchange, against 10% for advertising agents, 8% for Life Insurance Agents and 12% for others currently.	Unlikely
Explanation of the definition of "Security" under Section 37A of the Income Tax Ordinance to be added	It has been recommended to add the following for removal of doubt regarding the holding period of a security “share of a company, disposed of in a tax year for which the company has the status of a public company, “becomes a security” with effect from the date of acquisition, irrespective of the status of said company at the time of acquisition of the said share.”	Unlikely
Rationalize tax on dividend from REITs and exempt CGT on all categories	Rate of tax on dividend from REITs, which is 25% at present, be synchronized with mutual funds (15%) and apply CGT exemption under clause 99A, Part 1, 2nd schedule of the ITO on all categories of REITs (including mixed-use projects) so as to promote REITs structures.	Llikely
Introduction of registered savings and investment accounts (RSIAs)	To help bring a major chunk of the undocumented economy under the formal sector, the government has been advised to put forth a regulatory structure routing savings in to investments (aiding capital formation at the stock market) via registered savings and investment accounts (RSIAs).	Unlikely
Augment tax credit for small and medium enterprises (SME)	In order to encourage small and medium enterprises (SME) get listed and become part of the documented economy, the incidence of tax should be lower by means of a tax credit of up to 50% for 3 to 4 years of listing and then 20% going forward of the tax payable.	Unlikely
Tax incentives ETFs to be at par with those available for investment in new shares	Tax credit available for investment in new shares and collective investment schemes (CIS) under section 62 of the Income Tax Ordinance be made available for ETFs to remove disparity from other asset classes and encourage launch of new ETFs in the Pakistani market.	Unlikely

Budget Preview FY22

Banks – Neutral

Proposed Measures	Impact	Comment	Probability
Reduction in Corporate Tax rate	Positive	Banking sector faces a corporate tax rate of 35% (plus 4% super tax) while other industries are taxed at 29%. The said measure would boost earnings of banks by ~6%.	Unlikely
Abolition of Super Tax	Positive	Banks face a super tax of 4% which raises effective tax rate to 39%. Removal of this tax can uplift earnings by ~4%	Unlikely
Banks be given KIBOR based compensation on utilization of banks' money as monthly advance tax	Positive	Banks demand a KIBOR based return on the advance tax that is paid on monthly basis	Unlikely

Budget Preview FY22

Fertilizers – Positive

Proposed Measures	Impact	Comment	Probability
Agriculture package	Positive	The agriculture package which is worth PKR 110bn. This includes provision subsidy on DAP fertilizer amounting PKR 40bn for ~2mn tons which translates to PKR 1,000 per bag. With this the DAP sales are expected to improve. Furthermore, in order to grow number of crops the government is anticipated to allocate PKR 30bn, aiming to improve share of fruits and vegetable crops..	Likely
Decline in GST on RLNG/Natural Gas to 0% for feedstock and fuel	Positive	Presently, GST on output stands at 2% (which was reduced from 5% in 2018); while input tax is still in the range of 5% to 17%. As a result imbalance between input and output tax has mounted up to PKR 7.8bn per annum. At the moment, industry is paying input tax of around PKR 101 to PKR 144 per urea bag while output tax is PKR 33 per urea bag. A reduction in input GST will ease cash flow challenges for the fertilizer industry	Unlikely
Reduction in input & rock GST on phosphoric acid phosphate	Positive	For local manufacturers, input Tax on phosphoric acid and rock phosphoric is maintained at 5% and 10%, respectively, alongside custom duty of 5%. Meanwhile, GST stands at 2%. Reducing GST on industrial inputs to zero will decrease the mismatch between input and output GST and improve margins for DAP, NP and SSP manufacturers.	Unlikely
Normal tax regime for fertilizer imports by manufacturers	Neutral	Currently, minimum tax regime of 2% of the import value is applied on importing fertilizers by fertilizer manufacturers. If normal taxation regime is brought back, tax distortions will be tackled and local fertilizer manufacturers will reap benefits	Likely

Budget Preview FY22

Cements – Positive

Proposed Measures	Impact	Comment	Probability
Allocation of PKR 900bn for PSDP alongside introduction of a public private partnership authority (PPPA)	Positive	A 38% YoY jump in the allocation for federal PSDP target under the FY22 budget at PKR 900bn, together with announcement of a PPPA, is likely to propel cement demand.	Likely
Stepwise reduction in FED on cement from PKR 1,500/ton to zero	Positive	Gradual elimination of FED (post sales tax impact of PKR 88/bag), may translate into augmented offtake and improved profitability. Albeit, such relaxation may not be permitted given the governments aggressive revenue collection target.	Unlikely
Removal of custom duty on import of coal (5% currently)	Positive	A recurring proposal over the years has been to align treatment of coal parallel to other imported fuels (such as LNG), by eliminating custom duty to zero. Although this will materially reduce the costs of domestic players (as it forms roughly ~40% of COGS), the government will lose out on its revenue collection.	Unlikely
Abolishment of CD on import of plant and machinery (0-30%) and capital goods (16-35%)	Positive	Since most players have announced new expansions (scheduled to come online between FY23 to FY25), local players would benefit from reduced duty on import of equipment necessary for capacity addition. Hence, abolishment of CD on plant and machinery (0-30%), prime movers (20%), trailers (16-35%), mining equipment (30-35%), and off highway dump trucks (30%) would encourage investment.	Unlikely
Recommended cut in GST to 15% against 17% at present and eventually at 10% for mega projects	Positive	In contrast to neighbouring and regional economies (5-10% in Malaysia; 15% in Bangladesh), the rate of GST imposed on the domestic cement sector compares unfavouably. At 17%, it roughly translates to PKR 75-85/bag at present. Reduction in the same would alleviate refund issues as well as benefit end consumers (lower prices). This will also augur well for mega projects (CPEC-related, low cost housing scheme, dams).	Unlikely

Budget Preview FY22

Cements – Positive

Proposed Measures	Impact	Comment	Probability
Restoration of tax credit on BMR of plant and machinery at 10%	Positive	Prior to FY19, tax credit on BMR of plant and machinery was set at 10% but was modified to 5% for the year ending June 30, 2019. Reinstatement of the same till FY23 would assist companies in planned investments and encourage industrialization.	Unlikely
Imposition of Import Trade Price (ITP) on dumped Iranian cement and higher CD on import from other countries	Positive	Imposition of ITP will discourage dumping of substandard quality cement from Iran. Whereas it has been proposed to increase CD on import of clinker and cement from 11% and 20%, respectively to a uniform rate of 35% to safeguard the local industry against low-grade dumping.	Unlikely
Rate of advance tax on consumption of electricity to be slashed to 3%	Positive	Industrial consumers (including the cement sector) should be given relief with the rate of advance tax on consumption of electricity reduced to 3% against 5% at present, as they already bear the burden of federal and provincial taxes in the form of income tax, FED, and royalty to the tax authorities.	Unlikely
100% allowance of depreciation in the first year of new investment	Positive	Post amendment in the Finance Act 2020, only 50% of depreciation has been allowed in the first year of investment. Reversing said change to prior allowance (100%) would encourage investment in capital intensive projects and improve industrialization.	Unlikely

Budget Preview FY22

Power – Neutral

Proposed Measures	Impact	Comment	Probability
Allocation of PKR 330bn for Power Subsidy	Neutral	Power subsidy is expected to increase due to higher electricity production on the back of induction of power plants in the system.	Likely

Budget Preview FY22

Textile – Positive

Proposed Measures	Impact	Comment	Probability
Restoration of zero rated status for export oriented sector	Positive	Restoration of zero rated tax status will reduce cost of doing business as export oriented companies will be eligible to claim tax rebates on input levels. This will also improve liquidity and ease working capital requirement.	Unlikely
Abolish turnover tax and reduce corporate tax to 25%	Positive	Elimination of turnover tax and reduction in corporate tax to 25% from 29% will be material positive for textile sector as this will increase their profitability and allow them to expand without liquidity constraints.	Unlikely
Continuation of Drawback of Local Taxes and Levies (DLTL) till 2027	Positive	Continuation of DLTL scheme for export oriented sectors will help the government to achieve export led growth and this will also provide a level playing field to exporters to compete against regionally competitive countries.	Likely
Reduction in additional custom duty on imported raw materials	Positive	The said measure will support local players' margins and encourage local production	Likely
Exempting Export oriented companies from levy of withholding sales tax	Neutral	Currently, 5% withholding sales tax is charged on corporate sector against purchases from unregistered persons. Exemption will provide relief to export oriented companies.	Unlikely

Budget Preview FY22

Automobile – Positive

Proposed Measures	Impact	Comment	Probability
Auto sector demands reduction in additional custom duty and regulatory duty on raw material	Positive	Reduction in additional custom duty and regulatory duty on import of raw material will decrease costs and increase sales of locally manufactured automobiles.	Likely
Government to provide special incentives for localization	Positive	This will serve to curtail investment barriers for new and encourage existing players to expand their capacity. Special incentives should be provided to those who make investment or joint venture with other local players in the industry.	Likely
Proposed to reduce turnover tax from 1.50% to 0.75%	Positive	Reduction in turnover tax rate will support new players as well as loss making automobile companies, as the auto sector is operating on low margins with high turnover. This will attract new investment in automobiles sector.	Unlikely
Proposal to remove of Federal Excise Duty on locally manufactured vehicles below 800cc	Positive	It has been proposed to remove FED on locally manufactured vehicles below 800cc engine capacity. This will decrease prices of locally manufactured vehicles.	Likely

Budget Preview FY22

Steel – Positive

Proposed Measures	Impact	Comment	Probability
Allocation of PKR 900bn for PSDP alongside introduction of a public private partnership authority (PPPA)	Positive	Public sector construction demand is usually triggered by the federal PSDP disbursement. Hence, a robust allocation as well as added focus on the construction sector in FY22 suggests that the ensuing steel demand will remain upbeat.	Likely
Reduction in minimum tax on dealers and distributors of the steel sector from 1.50% to 0.25%	Positive	For manufacturers and downstream retailers / traders of the steel sector, turnover tax should be reduced to 0.25% from 1.50% currently so as to provide cash flow relief to the sector as it continues to operate in a period of high uncertainty on thin margins.	Likely
Removal of RD (5%) and ACD (2%) on import of steel scrap	Positive	Since steel raw material (scrap) is not locally available, duties on its import should be abolished (especially the additional custom duty as there is no custom duty currently), so as to reduce the cost of manufacturing rebar's.	Likely
For companies posting a loss for a tax year, minimum tax should be allowed to be carried forward for 5 years	Positive	Under section 113 (3) (b) of the Income Tax Ordinance, minimum tax (1.5%) can not be carried forward by companies posting a loss during a particular tax year which implies that even entities with zero income, are taxed. This discrepancy should be removed and carry forward adjustment should be allowed.	Unlikely
Clause 72 B permitting exemption from withholding at import stage to be made part of the Income Tax Ordinance	Positive	For industrial undertakings, if the higher of i) tax liability for a certain year (forecast), or ii) tax liability of any of the preceding two years, exceeds the deductions at import stage, the concerned commissioner may allow companies to not pay any further tax. This will reduce tax refundable of companies which otherwise pressurizes the cash flow.	Unlikely
Synchronization of treatment / taxability of WWF & WPPF paid under both provincial and federal laws	Positive	Payment of employee benefits under WWF (2%) and WPPF (5%) is an allowable expense, if paid to the Federal government. Albeit, deductible allowance shall be allowed for any amount paid as WWF and WPPF, whether paid under provincial laws or federal laws, as the nature of the expense remains identical.	Unlikely

Budget Preview FY22

Steel – Positive

Proposed Measures	Impact	Comment	Probability
Input tax claimed on the invoices of a person prior to his black listing shall be allowed	Positive	Under Section 21 (3) of the Sales Tax Act, rejection of claims to tax refunds retrospectively against a black listed person (RM supplier) is unjust for active tax payers. However, once a supplier has been black listed, trade with them should be discouraged by rejecting any refund against future invoices issued by them.	Unlikely
Removal of requirement of obtaining quota for concessional HRC import and audit of CRC manufacturers at the beginning of the year	Positive	CRC manufacturers should have free license to import HRC (under concessional tariff regime) as and when required since the current process delays procurement at the beginning of the year. However, to ascertain whether the HRC imported is used for production of CRC only, CRC producers should be required to report on a quarterly or half-yearly basis to the Input-Output Co-efficient Organization (IOCO).	Unlikely
To ease the taxpayer, taxes at import stage should be amalgamated into a single head	Positive	Currently various taxes and duties are collected at the import stage like custom duty, sales tax, income tax, additional sales tax, additional income tax, additional custom duty and regulatory duty. These should be clubbed into one head.	Unlikely

Budget Preview FY22

Others – Positive

Proposed Measures	Impact	Comment	Probability
Dairy: Reinstating of zero rated sales tax facility	Positive	This will reduce the cost of processing milk and help narrow the gap between loose milk and packaged milk in terms of price. Along with this packaged milk volumes and profitability of related companies will improve.	Likely
Beverage: FED on production to be gradually finished	Positive	At the moment there is double taxation in the form of FED and Sales Tax on manufacturing in beverage industry. Removal of FED will reduce the cost of production and discourage smuggling.	Unlikely
Removal of FED on Fruit Juices	Positive	Complete abolishment of 5% FED on fruit juices will increase sales and improve margins.	Unlikely
Information Technology: Reduction of Sales Tax on IT Services by 50%	Positive	This will improve bottom-line of IT companies and will give incentive to new players to enter the market.	Unlikely
Taxes on hardware components and equipment to be reduced by 5%	Neutral	With this, usage of grey channel and under-invoicing will be discouraged.	Likely
Promotion and development of IT Parks	Positive	This will support the growth of the technology sector and encourage the entry of new players. .	Likely
Footwear: Additional customs and regulatory duty on raw materials to be waived off	Positive	Implementation of this will promote local manufacturing and improve gross margins.	Likely

Budget Preview FY22

Others – Positive

Proposed Measures	Impact	Comment	Probability
Pharma: i) Exemption of GST on excipients, packaging materials and services	Positive	Currently, the sector is exempted from sales tax. GST on some of the said purchases is part of the product cost. Removal of GST on these purchases will reduce costs and the benefit will be passed on to consumers.	Unlikely
ii) Zero rated sales regime	Positive	This will assist pharmaceutical companies in handling their liquidity and cash flow issues along with withholding sales tax at separate levels of value addition.	Unlikely
Tobacco: 30% jump in Sales Tax	Negative	The government aims to lower consumption of cigarettes. Given, tobacco has inelastic demand, this measure will be able to produce incremental revenue for the government but might adversely affect earnings of tobacco companies.	Likely
Paper and Board: Custom Duty to be reduced on raw materials and semi finished goods	Positive	This will improve margins of Paper and Board companies and will increase sales to local printing industry.	Likely
E&P: Decreasing tax rates by 10% for a period of 3-Yrs	Positive	Reduction in tax rates will increase profitability of oil and gas exploration companies, enabling companies such as OGDC and PPL to improve funding in exploration activities despite being constrained by circular debt.	Unlikely
Sugar: Increase in FED on sugar for sweetening beverages, fruit juices, energy drinks etc.	Neutral	Beverage producers will increase the price of finished goods	Unlikely

Disclaimer

Analyst Certification: The research analyst(s) is (are) principally responsible for preparation of this report. The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject security (ies) or sector (or economy), and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. In addition, we currently do not have any interest (financial or otherwise) in the subject security (ies). Furthermore, compensation of the Analyst(s) is not determined nor based on any other service(s) that AHL is offering. Analyst(s) are not subject to the supervision or control of any employee of AHL's non-research departments, and no personal engaged in providing non-research services have any influence or control over the compensatory evaluation of the Analyst(s).

Equity Research Ratings
Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec'19 for Target Price. In addition, return excludes all type of taxes. For more details kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +10% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -10% and +10% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than -10% from last closing of market price(s)

Equity Valuation Methodology
AHL Research uses the following valuation technique(s) to arrive at the period end target prices;
- Discounted Cash Flow (DCF)
- Dividend Discounted Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

Risks
The following risks may potentially impact our valuations of subject security (ies);
- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk

Disclaimer

This document has been prepared by Research analysts at Arif Habib Limited (AHL). This document does not constitute an offer or solicitation for the purchase or sale of any security. This publication is intended only for distribution to the clients of the Company who are assumed to be reasonably sophisticated investors that understand the risks involved in investing in equity securities. The information contained herein is based upon publicly available data and sources believed to be reliable. While every care was taken to ensure accuracy and objectivity, AHL does not represent that it is accurate or complete and it should not be relied on as such. In particular, the report takes no account of the investment objectives, financial situation and particular needs of investors. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. AHL reserves the right to make modifications and alterations to this statement as may be required from time to time. However, AHL is under no obligation to update or keep the information current. AHL is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Past performance is not necessarily a guide to future performance. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for any investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his or her own advisors to determine the merits and risks of such investment. AHL or any of its affiliates shall not be in any way responsible for any loss or damage that may be arise to any person from any inadvertent error in the information contained in this report.

Please remove the below footer.

Disclosure required under Research Analyst Regulations, 2015:

In order to avoid any conflict of interest, we hereby disclosed that;

• Arif Habib Limited (AHL) has shareholding in OGDC, NBP, BOP and PSO.