REP-300

Budget Review FY24

Juggling priorities

10-Jun-2023

Best Securities House: 2022
Best Investment Bank: 2022

Best Investment Bank: 2022

Best Equity House: 2022

Best Equity Advisor: 2021

Best Brokerage House: 2022
Corporate Finance House: 2022
Best Economic Research House: 2022
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AHL Research

D: +92 21 32462742

UAN: +92 21 111 245 111, Ext: 322

F: +92 21 32420742

E: ahl-research@arifhabibltd.com

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Pakistan Economy

Budget Review FY24

Budget at a glance

- In this report we aim to discuss Pakistan's Budget for FY24. After reviewing the Budget document presented by the Ministry of Finance and Revenue, we dissect deep into the numbers and analyze the government's targets for the upcoming year. The report also presents a detailed prognosis of what the road ahead could entail.

- The Federal Government yesterday announced the Budget for the next fiscal year FY24, with a total budgeted outlay of PKR 14.5trn (up 51% compared to the budgeted outlay of FY23).

- The government has allocated PKR 13.3trn for current expenditure (predominantly mark-up payments which are expected to be 53% YoY higher from FY23 target), and is up 27% YoY compared to FY23 revised estimates.

- Defence budget is targeted at PKR 1.8trn (+19% YoY from FY23R).

- Subsidies to different sectors would be set at PKR 1.1trn, 3% YoY lower than FY23's revised estimate.

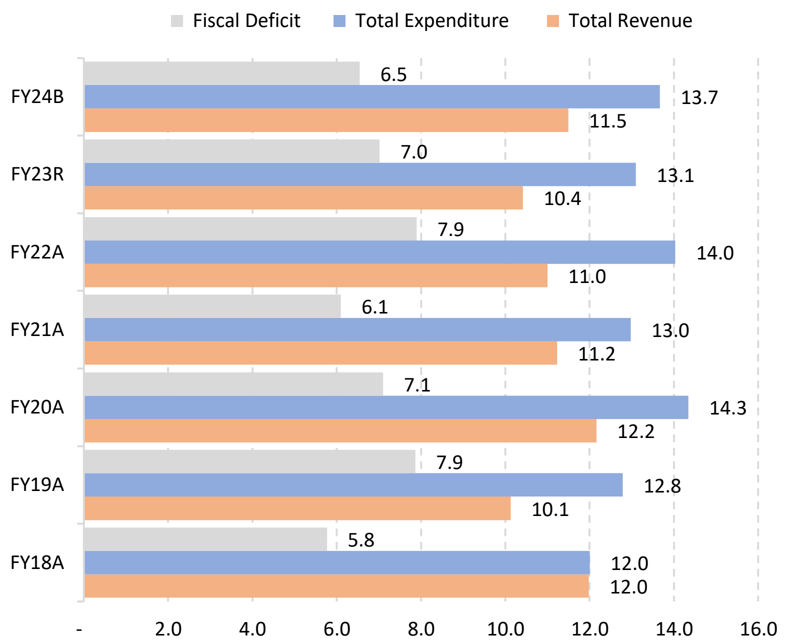
- Total PSDP is budgeted at PKR 2.5trn of which the Federal PSDP is budgeted at PKR 950bn (31% YoY higher than the FY23 budgeted allocation of PKR 727bn).

- Gross Revenue receipts are expected at PKR 12.2trn a jump of 38% YoY from FY23 revised estimates, contributed primarily by a 28% YoY jump in FBR taxes from FY23R which are budgeted at PKR 9.2trn. Non-tax Revenue is envisaged at PKR 2.9trn which is 83% higher YoY from FY23R.

- The fiscal deficit is budgeted at PKR 6.9trn, which forms 6.5% of GDP as compared to 7.0% for FY23 revised estimates.

- **Total Budget Outlay:** PKR 14.5trn (+30% YoY)
- **Current Expenditure:** PKR 13.3trn (+27% YoY)
- **Total PSDP:** PKR 2.5trn (+9% YoY)
- **FBR revenue:** PKR 9.2trn (+28% YoY)
- **Fiscal Deficit:** PKR 6.9trn (6.5% of GDP)

Figure: Revenue vs. Expenditure (Fiscal Balance) % of GDP



Source (s): MoF, AHL Research

Budget Review FY24

Battling subdued GDP headwinds

- The outgoing fiscal year witnessed a significant decline in Pakistan's GDP growth, falling to 0.29% compared to the previous fiscal year's growth rate of 6.1%. This decline can be attributed to a multitude of challenges faced by the economy. Firstly, devastating floods have caused extensive damage, impacting infrastructure and disrupting agricultural activities. The destruction of crops and displacement of communities have had severe repercussions on agricultural output, contributing to the overall decline in GDP growth. In addition, the economy has been grappling with surging inflationary pressures, leading to the implementation of strict monetary and fiscal policies. These measures, aimed at curbing inflation, have resulted in higher policy rate, reduced government spending, and increased taxes. While necessary to stabilize the economy, these policies have had a short-term negative impact on GDP growth, as businesses face higher production costs and individuals have less disposable income, limiting consumer spending and overall economic activity. The lack of stability and consistent policy frameworks hampered economic growth and impeded GDP expansion.

- The government forecasts 3.5% growth in agriculture, 3.4% growth in the industrial sector (where LSM growth is likely to be targeted at 3.2% for FY24) and 3.6% growth in services vis-à-vis 1.5%, -2.9% and 0.9% last year, respectively. The downside risks to overall pace of growth are measures taken by the monetary (such as policy rate hikes) and fiscal authorities to moderate overall growth. Gov't envisages inflation to settle at 21% in FY24B (FY23B: 11.5%). For FY24, the government is targeting rationalization of taxes, withdrawal of some exemptions and other measures in order to improve the fiscal deficit to 6.5% of GDP from 7.0% of GDP in FY23R.

Exhibit: Gross Domestic Product

Growth	FY23		FY24
	Target	Provisional	Target
Agriculture	**3.9%**	**1.5%**	**3.5%**
Important Crops	3.5%	-3.2%	3.0%
Livestock	3.7%	3.8%	3.6%
Industrial Sector	**5.9%**	**-2.9%**	**3.4%**
Manufacturing	7.1%	-3.9%	4.3%
Large Scale	7.4%	-8.0%	3.2%
Service Sector	**5.1%**	**0.9%**	**3.6%**
Wholesale & Retail trade	6.5%	-4.5%	2.8%
GDP	**5.0%**	**0.3%**	**3.5%**

Source (s): PBS, Planning Commission, AHL Research

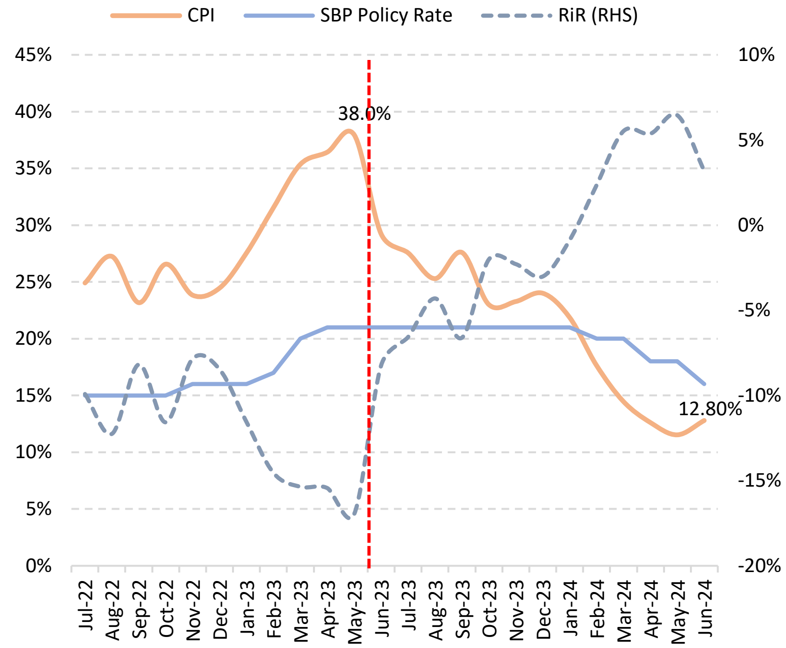
Budget Review FY24

Navigating the storm of soaring inflation

- Pakistan finds itself caught in the grip of soaring inflation and unraveling the details of Pakistan's recent inflationary trends unveils that a troubling mix of factors contributing to this economic challenge. Higher taxes, the phasing out of untargeted subsidies, the aftermath of devastating floods, and fluctuations in exchange rates have all come together to fuel a relentless surge in prices. Inflation peaked in May 2023 when headline numbers soared to unprecedented heights, registering an alarming 38.0%. This surge was propelled by across-the-board price increases, with essential sectors bearing the brunt of the impact. Urban centers witnessed a 20% YoY upswing in core inflation, while rural areas were dealt an even heavier blow, grappling with a staggering 26.9% YoY surge.

- While in the forthcoming months, it is projected that headline inflation will gradually subside, primarily due to the impact of a high base effect, which will come into play starting from the June 2023 readings. Anticipating an average monthly inflation rate of 0.99% until December 2023, we expect the headline inflation to fluctuate within the range of 23-29% during this period. On a year-on-year basis, based on our estimations, the CPI is anticipated to average slightly above 29% in FY23, significantly decreasing to ~20% YoY in FY24. Looking ahead, we anticipate a shift towards positive real interest rates in the second half of FY24, allowing room for policy rate cuts. Consequently, we foresee the initiation of monetary policy easing in the latter part of the upcoming fiscal year (FY24), with a potential reduction of 400-500 basis points in the policy rate. The rolling back of some fiscal relief measures, additional/revision in taxation along with impact of passing-on of any shock in global commodity prices – are factors that are likely to keep inflation in-check.

Figure: CPI and Policy rate



Source (s): SBP, PBS, AHL Research

- **We estimate average inflation of 29.2% and 20.3% for FY23 and FY24, respectively.**
- **Monetary easing is expected to begin in 2HFY24.**

Budget Review FY24

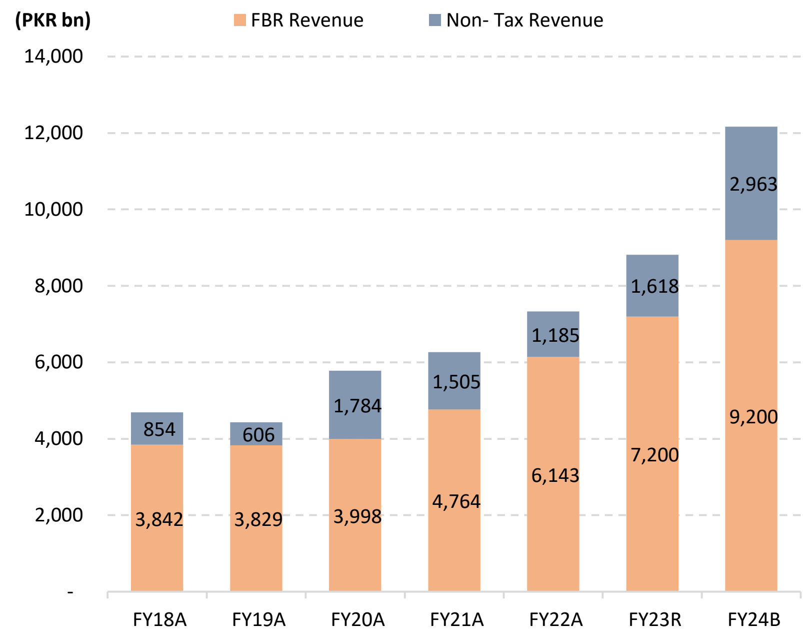
The Herculean task of meeting revenue targets

- In line with the conditions set forth in the recent IMF negotiations, the government has aimed for an increase in overall revenue target on the back of higher FBR tax collections and non-tax income. With these goals, government aims to solidify its medium-term target of expanding the tax base, streamlining the collection process and formalizing the economy, in effort to minimize budget deficits. The government has targeted for an increase in overall revenue (gross revenue receipts) by 38% YoY in FY24, with hopes that FBR tax collections will rise to PKR 9.2trn. We believe, given the current economic scenario, there is a significant level of over-optimism and despite revenue measures by the government, it highly unlikely that the projected revenue figures will be met. We believe that there will be a revenue shortfall of PKR 170bn in the FY24, despite the measures laid out in the budget. Our analysis indicates that the FBR will likely collect around PKR 9.0trn, falling short of the targeted revenue collection. In order to ensure unhindered revenue collection, government highlighted certain areas that can be tapped in this regard. This includes increasing energy tariffs, raising direct and indirect taxes and continuation/re-imposition of previously introduced taxes alongside administrative reforms for the government to strengthen its footing in the revenue collection space.

- To recall, total revenue growth of 18% in 9MFY23 stood at PKR 6.9trn (9MFY22: PKR 5.9trn), translating to 8.2% of GDP. The total tax revenue collection was up by 17% YoY to PKR 5.6trn. FBR taxes clocked-in at PKR 5.16trn during the period, 18% YoY higher than 9MFY22's collection of PKR 4.38trn. Growth in indirect taxes posted a meagre growth of 1% YoY during 9MFY23 mainly on the back of 2% YoY growth sales tax while Customs Duty declined 3% YoY. On the other hand, direct taxes jumped +46% YoY to PKR 2.3trn mainly contributing to the overall revenue collection.

- **Total Revenue:** PKR 12.1trn (+38% YoY)
- **FBR Revenue:** PKR 9.2trn (+28% YoY)
- **Non-tax revenue:** PKR 3.0trn (+83% YoY)

Figure: Tax and Non-Tax Revenue



Source (s): MoF, AHL Research

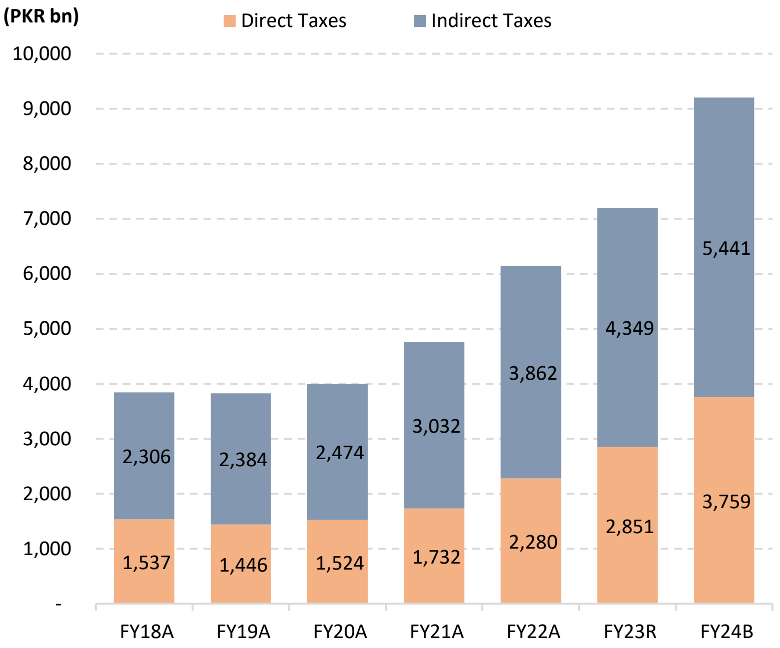
Budget Review FY24

Revenue targets

- The total revenue (gross receipts) collection target for FY24 is targeted for PKR 12.2trn (38% higher than FY23R), with FBR's tax collection target of PKR 9.2trn (28% higher than FY23R of PKR 7.2trn). Indirect taxation is set to increase by 25% YoY to PKR 5.4trn while direct taxation target is set for PKR 3.8trn (32% YoY higher than FY23R target of PKR 2.9trn). Similarly, a growth of 83% YoY is expected in Non-Tax revenues which is budgeted at PKR 2.9trn. Indirect taxation is expected to climb as a result YoY increase in:
    - Sales tax (budgeted at PKR 3.5trn vis-à-vis actual collection of PKR 2.8bn in FY23R),
    - Custom duty (budgeted at PKR 1.2trn vis-à-vis actual collection of PKR 1.1trn in FY23R),
    - Federal Excise Duty expected to generate PKR 725bn (against collection of PKR 457bn in FY23R).
- Direct taxation is expected to be PKR 3.8trn powered by a 32% YoY increase in Income Tax which is budgeted at PKR 3.7trn versus PKR 2.8trn for FY23R.
- Non-Tax revenues are budgeted at PKR 2.9trn, with an expected rise of 60% to PKR 869bn in PDL collection. The government has proposed to amend Petroleum Products (Petroleum Levy) Ordinance whereby it may change the quantum of PDL through a notification in the official gazette, which suggests a change in petrol prices at any given time.
- FBR's Tax to GDP ratio is targeted for a promising 8.7% for FY24B versus FY23R of 8.5% based on increased budgeted tax revenue.

- **Indirect taxation:** PKR 5.4trn (+25% YoY)
    - **Sales tax revenue:** PKR 3.5trn (+26% YoY)
    - **Custom duty:** PKR 1.2trn (+9% YoY)
    - **Federal excise duty:** PKR 725bn (+59% YoY)
- **Direct tax revenue:** PKR 3.8trn (+32% YoY)

Figure: Direct and Indirect Taxes



Source (s): MoF, AHL Research

Budget Review FY24

Government expecting Dividend of PKR 121bn from SOEs

- Government is expecting an increase in dividend from government investments by 90% to PKR 86.4bn in FY24 compared to revised target of PKR 45.4bn. The breakdown of PKR 86.4bn (from listed companies) includes: i) PKR 61.0bn from OGDC which translates into a dividend of PKR 19.00/share, ii) PKR 14.0bn from PPL (DPS of PKR 7.50/share), iii) PKR 2.0bn from SNGP (DPS of PKR 10.0/share), iv) PKR 2.0bn from PTC (DPS of PKR 1.00/share), v) PKR 2.5bn from PSO (DPS of PKR 28.50/share), vi) PKR 0.7bn from PAKRI (DPS of PKR 1.75/share), and vii) PKR 4.0bn from MARI (DPS of PKR 163/share).

Exhibit: Dividend on Government Investments (Listed)

	Total (mn share)	Govt. Holding (%)	Govt. Holding (mn share)	FY23B (PKR mn)	FY23R (PKR mn)	FY24B (PKR mn)	FY24E (PKR/share)
OGDC	4,301	75.0%	3,225	36,500	30,000	61,000	19.00
PTC	3,774	52.1%	1,966	2,000	2,000	2,000	1.00
PPL	2,721	67.5%	1,837	8,000	5,000	14,000	7.50
SNGP	634	31.7%	201	2,000	1,507	2,000	10.00
PSO	469	18.7%	88	2,500	2,500	2,500	28.50
PAKRI	900	44.9%	404	700	559	700	1.75
MARI	133	18.4%	25	4,000	3,704	4,000	163.00
FFC	1,272	0.7%	9	120	100	100	11.25
NBP	2,128	75.2%	1,600	45	45	45	-
PSEL	33		-	6	6	6	nm
Total				**55,871**	**45,420**	**86,351**	

Source: MoF, AHL Research

Exhibit: Dividend on Government Investments (Unlisted)

PKR mn	FY23B	FY23R	FY24B
National Investment Trust	300	250	300
Pak Oman Investment co	200	154	200
Pak Brunie Investment	200	150	200
Pak Iran Joint Investment	150	175	200
Pak Kuwait Investment Company (Pvt.) Ltd.	600	-	-
Saudi Pak Industrial & Agricultural Investment	100	-	-
State Bank of Pakistan	10	-	-
Exim Bank	-	-	1,000
Pakistan Development Fund Ltd	-	-	500
Pakistan Mortagage Refinance Co. Ltd	-	135	200
Pak Arab Refinery	10,000	22,020	18,000
GHPL	8,000	8,000	8,000
PMDC	200	200	300
SLIC	2,000	2,000	2,000
NIC	700	700	700
PIDC	80	80	85
National Shipping Corp	400	1,156	2,000
NESPAK	80	80	80
NFC	200	200	200
NTDC	600	600	600
Trading Corporation of Pakistan	300	300	300
Tourism Promotion Services	3	3	3
PERAC	6	5	6
PASCO	300	60	200
Total	**24,429**	**36,268**	**35,074**

Source: MoF, AHL Research

Budget Review FY24

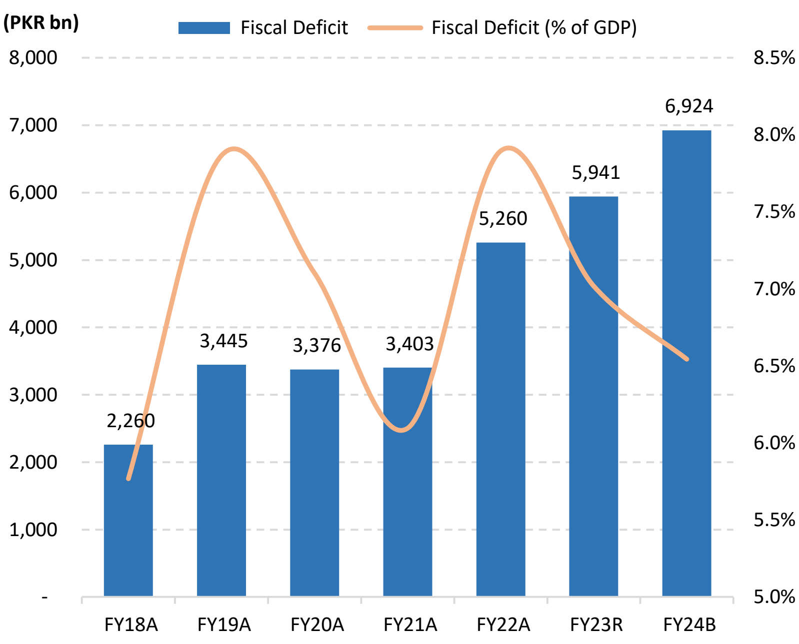
Heavy expenditure blitz

- With limited revenue and the need to allocate resources efficiently, increase in government expenditure by 30% YoY, raises concerns regarding how the government plans to manage its fiscal side. Total expenditure is budgeted at PKR 14.5trn with a significant portion (51%) of the budget allocated to interest payments, creating a risk of diverting resources away from key sectors such as education, healthcare etc. Moreover, the allocation of a higher expense for pensions (~17.5% YoY) and salaries (ranging 30-35%) as a relief measure, given the existing fiscal constraints, raises concerns about the realism of the decision. While providing relief to employees and pensioners is undoubtedly important, it is crucial to adopt a realistic and sustainable approach. In addition, Federal PSDP allocation for FY24 is PKR 950bn, reflecting a substantial increase of 30.8% compared to FY23. Concurrently, PKR 1.6trn has been earmarked for provincial PSDP, representing a decrease of 6.0% YoY. The combined PSDP of PKR 2.5trn sets a new record and is expected to contribute 2.4% to the country's GDP.

- To note, markup payments marked a growth of 69% YoY to PKR 3.6trn. Moreover, development expenditure and net lending undertaken by the government decreased by 36% YoY to PKR 1,060bn. Total PSDP expenditure arrived at PKR 1.0trn (-2% YoY) with provincial expenditure at PKR 721bn (-0.4% YoY), outdoing federal disbursement of PKR 293bn (-5% YoY). We believe that the current expenditure will exceed the budgeted amount by 9%, primarily due to higher markup payments (our working suggests ~PKR 8.5trn) resulting from the prevailing high interest rate scenario and the government's reliance on domestic borrowing to finance the deficit. Moreover, these factors (higher markup payments and salaries/pension) combined will create a challenging fiscal environment, limiting its capacity to allocate sufficient funds to critical sectors especially for PSDP allocation thus, hindering the overall development.

- **Total Expenditure:** PKR 14.5trn (+30% YoY)
- **Current Expenditure:** PKR 13.3trn (+27% YoY)
  - Mark-up Payments: PKR 7.3trn (+32% YoY)
- Total PSDP: PKR 2.5trn (+9% YoY)

Figure: Fiscal Deficit



Source (s): MoF, AHL Research

Budget Review FY24
Expenditure targets

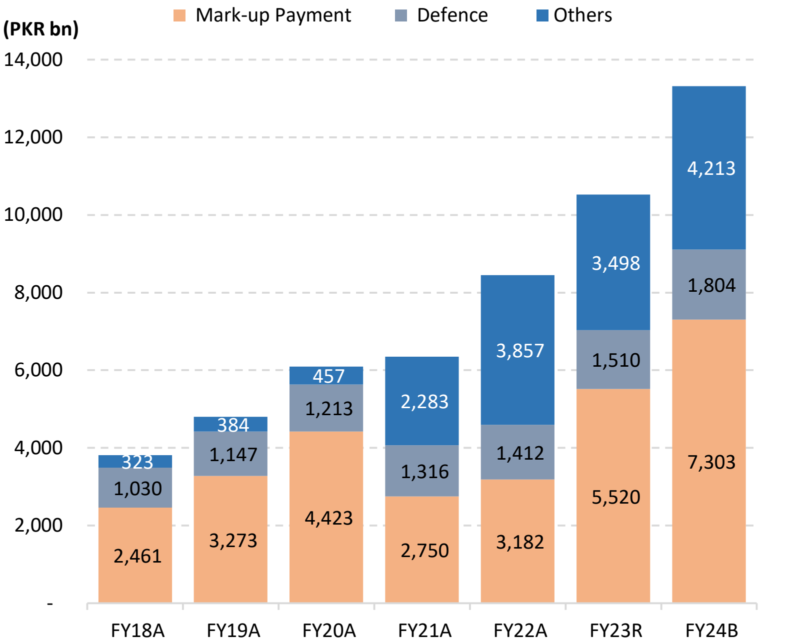
- Total expenditure outlay for FY24 is budgeted at PKR 14.5trn (30.63% higher YoY than FY23R of PKR 11.1trn). Current Expenditure is budgeted to contribute 92% to total expenditure (last year: 92%) while Development Expenditure is budgeted to contribute 6.6% to the total budgeted expenditure.

- **Current Expenditure:** The target for current expenditure is PKR 13.3trn (10.5% higher than FY23R). Pertinently, mark-up payments are budgeted at PKR 7.3trn (33% higher than FY23R amid higher interest rates and augmented domestic borrowing from banks which is budgeted at PKR3.1 trn) and contribute 50% to total current expenditure vs. 50% in SPLY. Defence affairs expenditure is budgeted at PKR 1.8trn (20% higher than FY23R), contributing 12.41% to total current expenditure. Subsidies are budgeted at PKR 1.1Bn. While Grants and Transfers are budgeted at PKR 1.5trn (25% higher than FY22R)

- **Social Relief:** Gov't has announced some relief measures for lower income strata which includes (but not limited to): Increase in allocation of BISP from PKR 415bn to PKR 460bn, subsidy allocation of PKR 35bn for utility stores corporation, addition PKR 5bn for Ramzan package, 9 million additional families to be added to eligibility for Benazir Kafalat cash Transfer (allocated PKR 266bn), Benazir Educational Grants Program extended to 2.3 million additional children, etc.

- **Subsidies** are set to contribute 8.3% to FY24 current expenditure vis-à-vis 8% in FY23R. Power subsidies budgeted at PKR 894bn (subsidy to WAPDA/PEPCO PKR 269bn and KEL PKR 315bn) are set to witness an increase of 57% YoY from FY23R.

Figure: Current Expenditure



Source (s): MoF, AHL Research

Budget Review FY24

Government's "fearless" pursuit of ambitious development expenditure

- The federal PSDP outlay for FY24 has been set at PKR 950bn (+30.8% YoY from FY23B) while PKR 1,559bn (-6.0% YoY) has been set aside for provinces (total PSDP of PKR 2,509bn - highest ever - will contribute 2.4% to the GDP. Pertinently, the federal PSDP FY24 is 33% higher than the revised estimate of PKR 714bn for FY23. Albeit, the growth this year has been announced in order to support the overall economic growth.

- Federal Ministries/Divisions are budgeted at PKR 645bn (+14.8% higher than FY23R) with Special Areas (AJK and GB) allocated PKR 61bn. Whereas PKR 33bn allocated for the Railways Division as compared to PKR 32.6bn last year (FY23R: PKR 26.1bn), and PKR 36.7bn allotted to the Housing & Works Division vis-à-vis PKR 17.7bn last year (FY23R: 21.2bn), will directly propel cyclical (cement and steel) demand. To recall, in the current year as at Apr'23, only PKR 374bn has been spent against the figure of PKR 609bn authorized to date.

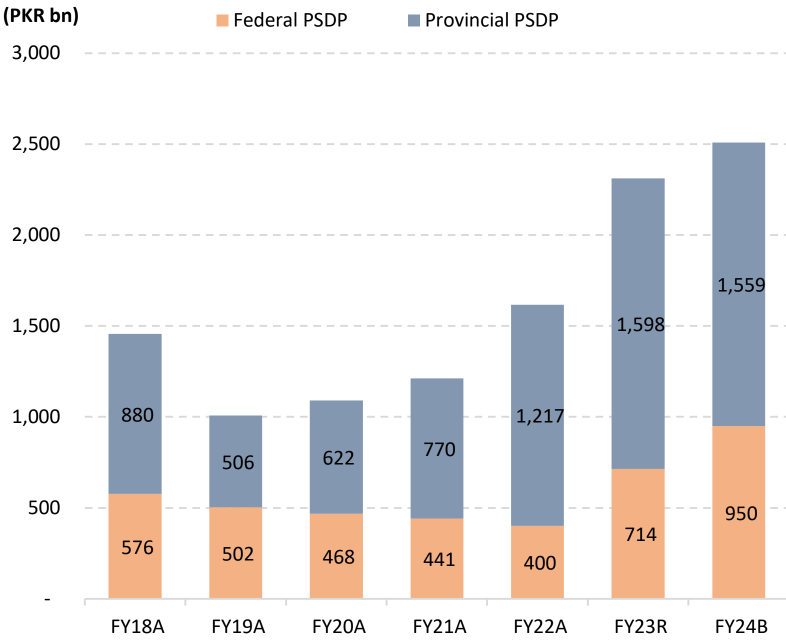
- To highlight, provision for Infrastructure (Energy, Transport & Communication, Water and Physical Planning and Housing) under Federal PSDP has been increased by 37% YoY to PKR 491bn.

- Meanwhile the Corporations category is budgeted at PKR 215bn which is dominated by the National Highway Authority (NHA), for which PKR 161bn has been allocated (58.7% higher than FY23R).

- Pertinently, given the threat to social security post slowdown in the economy, the government has assigned PKR 241bn under the social head (+24.5% YoY).

- Apart from this, the government has launched a fund for Public-Private Partnership (PPP) projects under PSDP and allocated PKR 200bn for the same compared to PKR 73bn in SPLY.

Figure: Federal and Provincial PSDP



Source (s): MoF, AHL Research

Budget Review FY24

Debt servicing dilemma: Climbing uphill

- In the realm of deficit financing, the gov't finds itself at a crossroads, where borrowing becomes the focal point. With a greater emphasis on domestic sources, the gov't aims to raise the necessary funds to bridge the funding gap. The gov't has allocated ~66% of total expenditure for debt servicing under domestic borrowing during FY24 which comes out to be around PKR 5.0trn. Financing the deficit via domestic sources remains skewed towards banking channels, around 62%. Moreover, the gov't is expecting to raise PKR 2.5trn (USD 8.6bn) external financing with majority inflows from commercial and Eurobonds (~64%). However, we believe, the task of securing external debt in the current economic climate will be a formidable challenge. Realistically speaking, expecting external borrowing of this magnitude appears to be a far-fetched notion considering the imminent end of on-going IMF EFF program in Jun'23. The complexities and macroeconomic hurdles that are adversely affecting the economy make the prospect of raising external funds an uphill task. As a result, the government's reliance on domestic financing becomes imperative, requiring strategic measures to navigate these financial challenges. To highlight, Pakistan's total public debt position settled at PKR 59trn as at end of Mar'23, marking a jump of 33% YoY. The domestic debt amounted to PKR 35trn (up 25% YoY) while the foreign debt also increase by 48% YoY, standing at PKR 22trn.

- Moreover, the prospect of negotiations for a new program becomes increasingly imminent, as also emphasized by the Finance Minister during his recent media interactions. He also hinted towards the likelihood of reprofiling of external debt which will provide immediate relief to the country's financial burden by spreading out repayment obligations over an extended period. To reiterate, we highlighted the need to reprofile our debt in our report "Debt reprofiling or restructuring?".

- **Deficit financing:** PKR 7.6trn (+67% YoY)
- **Domestic financing:** PKR 5.0trn (+77% YoY)
- **External financing:** PKR 2.5trn (+57% YoY)

Exhibit: Fiscal Deficit and Financing

PKRbn	FY24B
Non Bank Borrowing	1,906
Net External Receipts	2,527
Multilateral & Bilateral Sources	926
Commercial & Euro Bond	1,601
Bank Borrowing	3,124
Privatization Proceeds	15
Federal Deficit	**7,572**

Source (s): MoF, AHL Research

Budget Review FY24

Budgetary Trend

Exhibit: Budgetary Trend

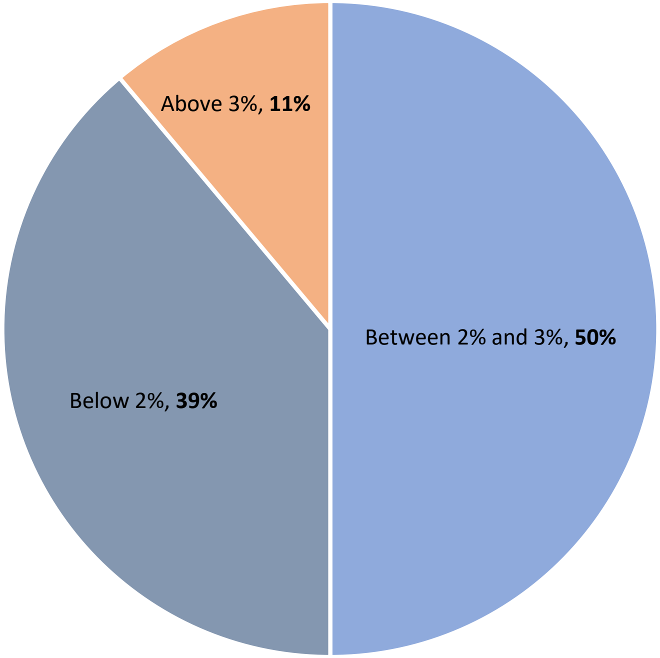
PKR bn	FY18	FY19	FY20	FY21	FY22	FY23B	FY23R	FY24B	FY24F
Gross Revenue Receipts	4,696	4,436	5,782	6,270	7,328	9,405	8,818	12,163	11,856
Net Revenue Receipts	2,479	2,038	3,278	3,528	3,739	5,032	4,689	6,887	6,645
FBR Taxes	3,842	3,829	3,998	4,764	6,143	7,470	7,200	9,200	9,030
Non-Tax Revenue	854	606	1,784	1,505	1,185	1,935	1,618	2,963	2,826
Less: Provincial Share	2,217	2,398	2,504	2,742	3,589	4,373	4,129	5,276	5,212
Total Expenditure	4,704	5,599	6,819	7,245	9,350	9,579	11,090	14,461	15,205
Current Expenditure	3,814	4,804	6,093	6,349	8,452	8,709	10,528	13,320	14,465
Mark-up Payments	1,500	2,091	2,620	2,750	3,182	3,950	5,520	7,303	8,452
Defence	1,030	1,147	1,213	1,316	1,412	1,527	1,510	1,804	1,800
Others	1,284	1,566	2,260	2,283	3,857	3,232	3,498	4,213	4,213
PSDP	576	502	468	441	400	727	714	950	550
Budget Deficit	2,260	3,445	3,376	3,403	5,260	3,797	5,941	6,924	7,910
% of GDP									
Total Revenue	12.0	10.1	12.2	11.2	11.0	12.0	10.4	11.5	11.3
FBR Revenue	9.8	8.7	8.4	8.5	9.2	9.6	8.5	8.7	8.6
Non-Tax Revenue	2.2	1.4	3.8	2.7	1.8	2.5	1.9	2.8	2.7
Total Expenditure	12.0	12.8	14.3	13.0	14.0	12.2	13.1	13.7	14.5
Current Expenditure	9.7	11.0	12.8	11.4	12.7	11.1	12.4	12.6	13.8
Mark-up Payments	3.8	4.8	5.5	4.9	4.8	5.1	6.5	6.9	8.1
Defence	2.6	2.6	2.6	2.4	2.1	2.0	1.8	1.7	1.7
Development Expenditure and net lending	3.0	3.0	2.5	2.4	2.5	1.1	0.7	1.1	0.7
Budget deficit	5.8	7.9	7.1	6.1	7.9	4.9	7.0	6.5	7.6

Source (s): MoF, AHL Research

AHL Survey

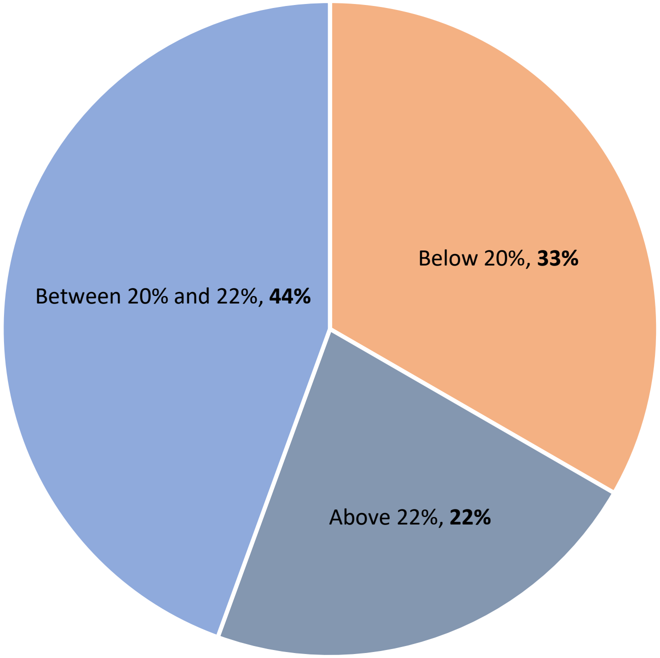
Budget Review FY24
AHL Survey

Figure: GDP growth | FY24



Source (s): AHL Research

Figure: Average Inflation | FY24



Source (s): AHL Research

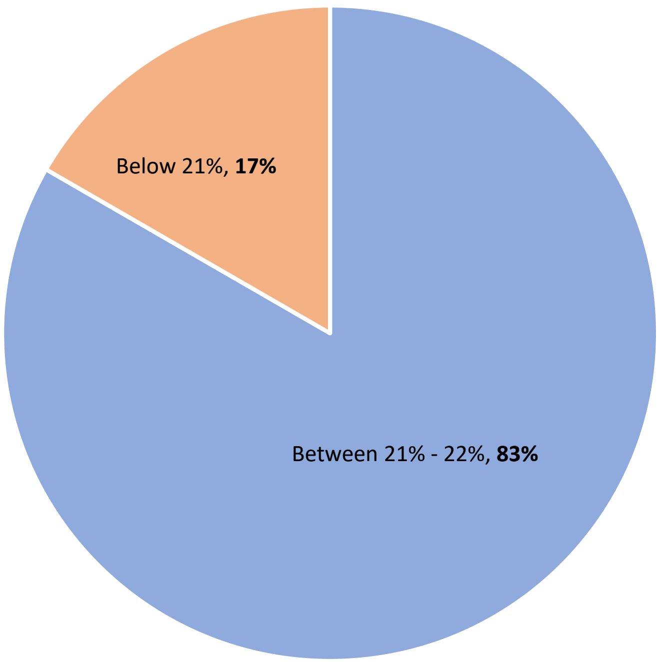
Half of our survey participants predict a GDP growth between 2% to 3% in FY24.

Majority of our participants (44%) believe the average inflation rate to be between 20% and 22% in FY24.

Budget Review FY24

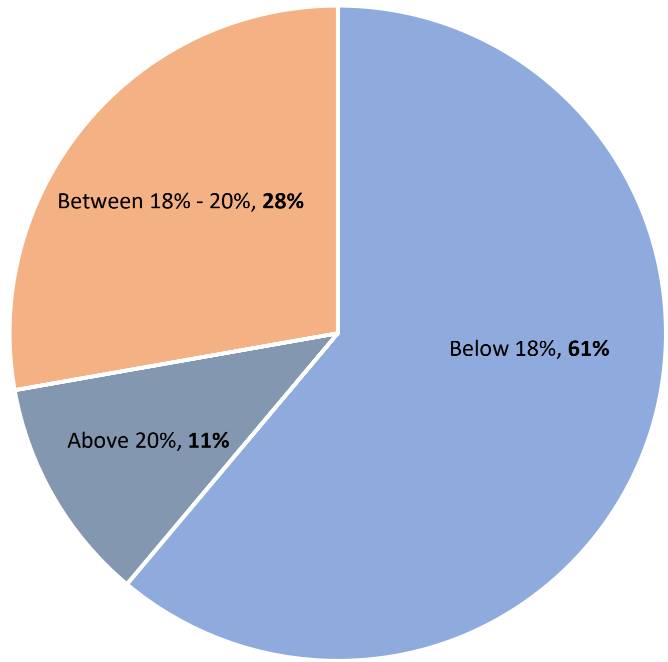
AHL Survey

Figure: Interest rates for period end | June 2023



Source (s): AHL Research

Figure: Interest rates for period end | June 2024



Source (s): AHL Research

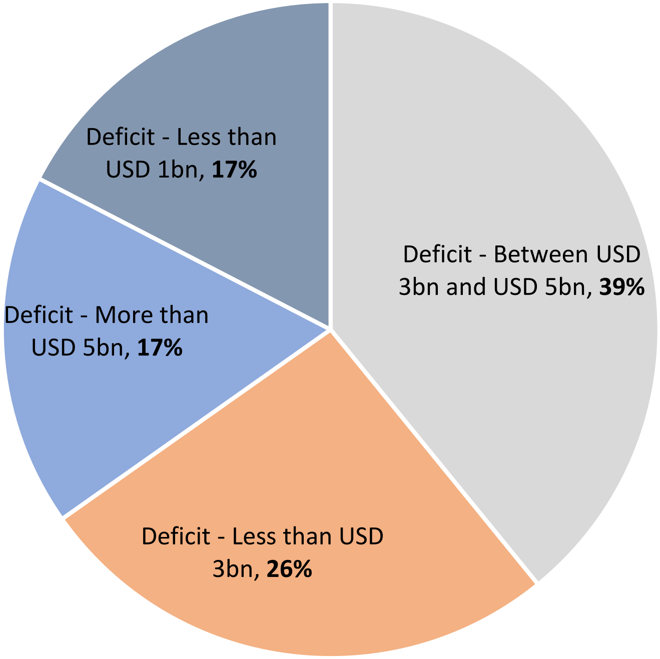
83% of the participants believe the interest rate for period end Jun'23 to be between 21% to 22%.

For Jun'24, 61% of the participants expect the interest rate to be below 18%.

Budget Review FY24

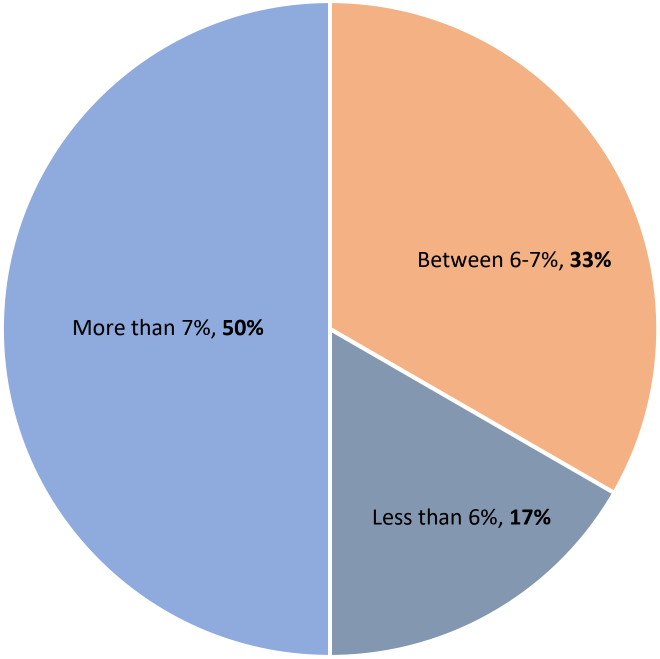
AHL Survey

Figure: Current Account Balance | FY24



Source (s): AHL Research

Figure: Fiscal Deficit (% of GDP) | FY24



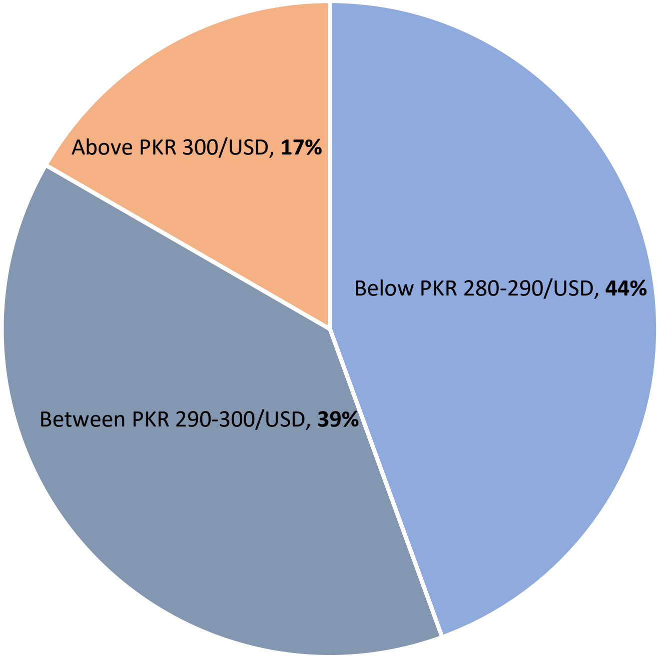
Source (s): AHL Research

All participants agree on a deficit in the current balance, the majority (39%) expecting it to be between USD 3bn and 5bn in FY24.

Half of the participants anticipate the fiscal deficit to be more than 7% of the GDP in FY24 with the other half majorly (33%) expecting it to be between 6-7%.

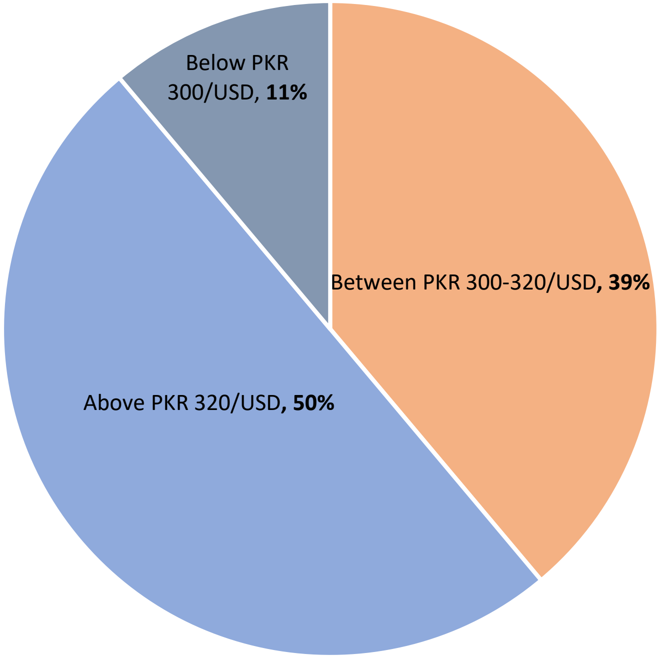
Budget Review FY24
AHL Survey

Figure: Currency | June 2023 end



Source (s): AHL Research

Figure: Currency | June 2024 end



Source (s): AHL Research

44% of the participants predict the currency rate to remain between PKR 280-290/USD by Jun'23 end while 39% expect it to be between PKR 290-300/USD

By Jun'24 end, half forecast the currency to rise above PKR 320/USD while 39% anticipate it to fall between PKR 300-320/USD.

Key Budgetary Measures

Budget Review FY24

Relief Measures

- Salaries of government servants between grade 1-16 to be increased by 35%, and by 30% for grade 17 and above employees.
- Pensions augmented by 17.5% across the board.
- Exporters of Information Technology (IT) and IT enabled services have been incentivized through duty free import of IT related equipment equivalent to 1% value of their export proceeds.
- Sales tax to be exempted on import of IT equipment by exporters of IT and ITeS registered with Pakistan Software Export Board.
- Rate of tax on IT based system development consultants to be cut to 15% from 16%.
- One more API and 03 drugs added to the existing duty free regime for the Pharma sector.
- Continuation of concession on import of flavouring powders for food preparation for manufacturers of snacks till Jun'24.
- Extension in exemption of sales tax to NMDs (FATA/PATA) for another one year ending Jun'24.
- Grant of sales tax exemption on plant saplings, combine harvesters, dryer for agricultural products, no-till-direct seeder, planters, trans-planters, other planters and bovine semen.
- For tax year 2024, 2025 and 2026 there has been a continuation of concessionary fixed tax rate of 0.25% for IT and ITeS exports
- Removal of sales tax return filling requirement to avail concessionary fixed rate of 0.25% for IT and ITeS.
- There has been an increase in business turnover limit to qualify for concessionary tax regime for a manufacturer from Rs 250 Mn to Rs 800 Mn for SMEs and inclusion of IT and ITeS in SMEs definition.
- 20% of concessionary tax rate instead of 39% on banking company's income from additional advances to IT and ITeS exports.
- Source of income/assets to not be explained for foreign remittance remitted from outside Pakistan of up to rupee equivalent of USD 100,000 (previously PKR 5mn).

Budget Review FY24

Relief Measures

- On purchase of immovable property, a waiver of 2% final withholding for non-resident individual POC/NICOP holder where immovable property is acquired through foreign remittances remitted from abroad.
- For a builder, 10% reduction in tax liability or PKR 5mn (whichever is lower) and 10 % reduction or PKR 1mn (whichever is lower) for an individual for own construction of house for 3 years.
- 50% reduction in tax liability for a period of 3 years for youth entrepreneurship (maximum limit of PKR 2mn for Individual / AOP and PKR 5mn for a company). A person up to the age of 30 years is defined as youth.
- Two years extension for concessionary tax of 20% for banking company's income from additional advances to low-cost housing, agriculture, and SMEs including IT & ITeS.
- 1% concessionary final tax rate to indirect exporters to encourage export of commodities (Agriculture produce, gems, metals etc) through online platform.
- Reducing of minimum tax liability on turnover from 1.25% to 1% for companies listed on PSX.
- Extension of exemption for one-year granted to a person to profits and gains on sale of immovable property or share of special purpose vehicle to any type of REIT scheme i.e., up to Jun'24.
- Agro based industries being set up as SMEs on or after 1st July, 2023 (from tax year 2024 to 2028) being granted a 5-year tax holiday.

Budget Review FY24

Revenue Measures

- Withdrawal of exemption of sales tax on edible products sold in bulk under brand names or trademarks.
- Augmented sales tax from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products.
- Electric power transmission services to be taxed @ 15% (ICT only).
- 0.6% advance adjustable withholding tax re-imposed on non-ATL persons on cash withdrawal.
- Super tax slabs for tax year 2023 i) 0% for income below PKR 150mn, ii) 1% for income between PKR 150-200mn, iii) 2% for income between PKR 201-250mn, iv) 3% for income between PKR 251-300mn, v) 4% for income between PKR 301-350mn, vi) 6% for income between PKR 351-400mn, vii) 8% for income between PKR 401-500mn, and viii) 10% for income exceeding PKR 500mn.
- 10% final withholding tax on issuance of bonus shares by a company (20% for non-ATL).
- Imposition of additional tax not exceeding 50% on profit and gains of a person or class of persons on account of extraordinary gains due to exogenous factors.
- Increase in WHT from 1% to 5% on payment to non-resident through debit /credit or prepaid cards (2% to 10% for Non-ATL person).

Budget Review FY24

Key Measures

Custom Duty:

- CD exempted on import of machinery, equipment and inputs used for manufacturing of solar panels, inverters and batteries.
- Reduction of CD from 10% to 5% on non-localized (CKD) of Heavy Commercial Vehicles (HCVs).
- CD on import of pet scrap for manufactures of polyester filament yarn has been reduced.
- CD exemption on raw materials / inputs for rice mill machinery.

Regulatory Duty:

- Reduction of RD on 151 PCT codes relating to second hand clothing, fish, tiles, sports goods.
- RD removal on IT related equipment to encourage information technology sector.
- RD removal on Synthetic Filament yarn of Polyester not manufactured locally.
- Removal of RD on Silicon Steel sheets.
- Removal of RD proposed on flat panels, monitors, and projectors.
- Exemption of RD on special steel round bars and rods of non-alloy steel exceeding diameter 50 mm
- To protect local industry there has been an increment/ levy of RD on imports of articles of glass.
- 20% of RD imposed to discourage the use of inefficient Tungsten Filament Incandescent Bulbs.
- An increase from 10% to 15% of RD on export of Molasses.

Budget Review FY24

Capital Market Overall Take - Negative to Neutral

- **Market:** Tough tax measures have been undertaken to meet the mammoth revenue collection target of PKR 9.2trn. Pertinently, imposition of super tax (higher quantum and wider slabs), would hit earnings of most corporates listed at the PSX. Moreover, re-imposition of 10% tax on income arising to the shareholder of a company, from the issuance of bonus shares. This could be a sentiment dampener, particularly due to the high influx of bonus announcements witnessed recently. While a levy of up to 50% to be imposed on companies on income and gains booked between 2019 to 2023 on account of extraordinary gains due to exogenous factors such as exchange or inventory gains; although we believe this will attract significant litigation. Albeit, minimum turnover tax on listed companies has been reduced to 1% from 1.25% previously, providing some relief to corporates.

- **REITs and Real Estate**: Moreover, real estate and REITs measures are expected to encourage a shift in investments to those assets. These include i) extension of exemption for one-year granted to profits and gains on sale of immovable property or share of special purpose vehicle to any type of REIT scheme up to Jun'24, ii) on purchase of immovable property, a waiver of 2% final withholding for non-resident individual POC/NICOP holder where immovable property is acquired through foreign remittances remitted from abroad, and iii) for a builder 10% reduction in tax liability or PKR 5mn (whichever is lower) and 10% reduction or PKR 1mn (whichever is lower) for an individual for own construction of house for 3 years. Whereas indirect benefits consist of a two years extension in concessionary tax of 20% for banking company's income from additional advances to low-cost housing, encouraging mortgages.

Exhibit: Budget Impact on Different Sectors

Sector	Impact
Market	Negative to Neutral
Banks	Negative
Cement	Neutral to Positive
Fertilizer	Negative to Neutral
Power	Neutral
Autos	Neutral to Positive
Textile	Neutral to Positive
Steel	Negative to Neutral
Chemicals	Negative to Neutral
E&P and OMCs	Negative to Neutral
IT	Positive

Source (s): AHL Research

Exhibit: Super Tax Slabs

Slabs	FY23	FY24
Income < PKR 150mn	0.0%	0.0%
PKR 150mn < Income < PKR 200mn	1.0%	1.0%
PKR 200mn < Income < PKR 250mn	2.0%	2.0%
PKR 250mn < Income < PKR 300mn	3.0%	3.0%
PKR 300mn < Income < PKR 350mn	4.0%	4.0%
PKR 350mn < Income < PKR 400mn	4.0%	6.0%
PKR 400mn < Income < PKR 500mn	4.0%	8.0%
Income > PKR 500mn	4.0%	10.0%

Source (s): MoF, AHL Research

Budget Review FY24

Overall Take - Negative to Neutral

- **Banks:** From the sectoral perspective, the budget will garner a mixed reaction. First off, all corporates whose income exceeds PKR 150mn will be subjected to a 1-10% super tax, which will hit all major sectors. In particular, the budget will be negative for the heavy-weight banking sector which will face the brunt of augmented taxes (43% to 49%) amid augmented super tax. This is expected to erode the bottom-line of banks by 11% on average in CY23. Moreover, withholding tax has been re-imposed on withdrawals above PKR 50,000 in a single day from the bank account of the non-filers. This will discourage non-filers from depositing their money in banks. On the other hand, a two years extension in concessionary tax of 20% for banking company's income from additional advances to low-cost housing, agriculture, and SMEs including IT & ITeS, encouraging mortgage and agro sector.

- **OMCs and E&Ps:** In addition, the government has proposed an amendment to the Petroleum Products (Petroleum Levy) Ordinance whereby the government may change the quantum of PDL through a notification in the official gazette, as opposed to via a Bill passed by the Parliament, which suggests a change in petrol prices at any given time. Impact on OMCs will be neutral. Furthermore, the exemption of customs duties on raw materials / inputs for mining machinery is proposed by the Govt. Keeping in view companies such as OGDC, and PPL have diversified into mining project (Reko Diq Mining), it will save additional CAPEX of E&P companies.

- **Power:** Moreover, the Govt. has proposed to exclude companies engaged in production, transmission and distribution of electricity from the scope of sales tax as recommended by National tax council. The said tax would be treated as provincial tax starting from 1st Jul'23 and revenue of which will be received by respective provinces. We view this to be neutral for the power sector.

Budget Review FY24

Overall Take - Negative to Neutral

- **Information Technology:** In order to support Information Technology (IT) Sector, the government has proposed a series of relief measures: removal of regulatory duty on IT related equipment to encourage IT sector, reduction of tax from 16% to 15% on IT based system development consultants, scope of IT and IT enabled services is proposed to be harmonized with scope envisaged under the Income Tax Ordinance, 2001, continuation of concessionary fixed tax rate of 0.25% for IT & ITeS exports for Tax years 2024, 2025 and 2026, withdrawal of sales tax return filing requirement for availing concessionary fixed tax rate of 0.25% for IT & ITeS exports, increase in business turnover limit of a manufacturer from PKR 250mn to PKR 800mn to qualify for concessionary tax regime for SMEs and inclusion of IT & ITeS in SMEs definition, and concessionary tax rate of 20% on banking company's income from additional advances to IT & ITeS sector instead of standard rate of 39%.

- **Cement & Steel:** Some other optimistic developments have also been made. Federal PSDP has been increased from PKR 727bn to PKR 950bn, with provision for infrastructure under Federal PSDP increased by 37% YoY to PKR 491bn. Whereas allocation for provinces has jumped up to PKR 1.6trn, taking the overall PSDP to PKR 2.5trn vis-à-vis PKR 2.3trn last year. Albeit, we believe the expenditure may supports the public sector led demand for cement and steel sectors. While extension in sales tax exemption by another year for players operating in the FATA / PATA region will remain negative for the formal steel sector.

- **Tiles:** For the tiles sector, a reduction of regulatory duty on import of tiles will be negative for local manufacturers given it will encourage the influx for imported tiles.

Budget Review FY24

Overall Take - Negative to Neutral

- **Automobile:** Whereas, the removal of the cap on fixed duties and taxes for the import of old and used vehicles of Asian make above 1300cc will give a positive boost to local auto assemblers. In addition, the reduced 1% import duty on hybrid vehicles is now exclusively applicable to locally assembled variants, only benefiting the assemblers who import them. This, coupled with reduction of CD from 10% to 5% on non-localized heavy commercial vehicles (CKDs), will aid the sector.

- **Synthetic and Rayon & Textiles:** Sector is set to benefit from the reduction in customs duty on import of pet scrap for manufactures of polyester filament yarn, which will improve the gross margins of the manufacturing companies. In addition to this, it has been proposed to remove regulatory duty on synthetic filament yarn of polyester not manufactured locally. However, sales tax is proposed to be increased from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products.

- **Glass, Appliances and Personal care:** Whereas the exemption of custom duties on raw material / input for rice mill machinery has been proposed which will support companies such as MFL to undergo repairs and expansion if required. Additionally, in order to protect the local industry, the Govt. proposes to increase regulatory duty on import of glass articles to the tune of 15-30%. The Govt. also recommends removing regulatory duty on parts for flat panels, monitors, projectors, as well as eliminating regulatory duty on silicon steel sheets, which will bode well for appliances manufacturers such as PAEL and SIEM. Abolishment of customs duty on raw materials of diapers, sanitary napkins and adhesive tape has been proposed, which will be positive for the personal care sector.

Budget Review FY24

Overall Take - Negative to Neutral

- **Sugar and Food:** It has also been proposed to increase export regulatory duty on the export of Molasses from 10% to 15%. This will hurt gross margins of exporting sugar producing companies. The government has proposed to withdraw exemption of sales tax on edible products sold in bulk under brand names or trademarks, which is expected to hurt the gross margins of the companies producing edible products (food sector).

- **Chemical and Pharmaceuticals:** It has also been suggested to increase custom duty on calcium carbides to 11% from 3%. Moreover, it is proposed to abolish customs duty on organic composite solvent and thinners for companies manufacturing Butyl Acetate and Dibutyl Orthophthalates. These measures are positive for the chemical sector given their gross margins will improve. The government proposes to include one more active pharmaceutical ingredient (API) and three drugs in the present duty free regime, which will be positive for the pharmaceutical sector (improving the gross margins of the importing companies).

Budget Review FY24

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 3.2%, 5.7% and 5.1%, 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 the IMF program conditions). On average, the local bourse garnered less enthusiasm, with returns of -1.1%, -0.3% and -1.3% over 30, 60 and 90 days respectively, subsequent to the budget announcement.

Exhibit: KSE100 Performance

Budget Year	30-Days	60-Days	90-Days
Before Budget			
FY24	2.0%	5.2%	0.3%
FY23	-2.0%	-9.0%	-3.8%
FY22	6.9%	7.4%	10.3%
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	**3.1%**	**5.7%**	**5.0%**
After Budget			
FY23	-1.6%	0.2%	-0.5%
FY22	-1.5%	-2.4%	-3.5%
FY21	4.6%	17.2%	23.2%
FY20	-2.3%	-15.1%	-12.1%
FY19	-7.6%	-9.4%	-7.6%
FY18	-12.0%	-12.8%	-19.7%
FY17	1.5%	6.9%	6.8%
FY16	4.2%	5.6%	1.1%
FY15	0.7%	2.7%	-3.4%
FY14	3.2%	4.1%	3.0%
Average	**-1.1%**	**-0.3%**	**-1.3%**

Source: PSX, AHL Research

Sectors

Budget Review FY24

Banks – Negative

Proposed Measure	Impact	Comment
Increase in super tax rate to 10%	Negative	Tax rate on the banking sector has been increased from 43% to 49% (39% corporate tax + 10% super tax) for CY23. This will erode the overall profitability of the sector by an average 11%.
Withholding tax on cash withdrawals	Negative	Withholding tax has been imposed on withdrawals above PKR 50,000 in a single day from the bank account of the non-filers. This will discourage the non-filers from depositing their money in banks.
Concessionary tax rate on income from additional advances to low cost housing, agriculture, and SMEs including IT & ITeS	Positive	Extension has been given for two years of concessionary tax rate of 20% for banks' income from additional advances to low cost housing, agriculture, and SMEs including IT & ITeS. This will encourage banks to extend more financing to the aforementioned sectors.
Additional tax on extraordinary gains	Negative	Additional tax of up to 50% has been imposed on profit and gains on account of extraordinary gains earned by the banks.
Increase in WHT rate on international transactions	Negative	With increase in withholding tax rate from 1% to 5% (2% to 10% for Non-ATL person) on payment to non-resident through debit/credit or prepaid cards, banks' credit card business is likely to be adversely affect.

Our take on the sector:

The aforementioned measures are likely to adversely affect banking sector denting the overall profitability. Despite these measures, we believe the current levels at which banks are trading make them a good 'BUY'. Currently, banks are trading at 0.5x P/B and 2.8x P/E vs. their historic 10-yr average of 1.07x P/B and 7.8x P/E. Our top picks are UBL, MCB and MEBL.

Budget Review FY24

E&Ps & OGMCs – Negative to Neutral

Proposed Measure	Impact	Comment
E&P: Increase in super tax rate to 10%	Negative	Tax rate on the E&P sector has been increased from 33% to 39% (29% corporate tax + 10% super tax) for FY23. This will plummet the overall profitability of the sector by an average 9.7% in FY23.
Exemption of taxes for mining projects	Positive	Keeping in view companies such as OGDC and PPL have diversified into mining project (Reko Diq Mining), this exemption on all machinery import will save additional CAPEX of E&P companies. Moreover, the project has been exempted from taxes of income (including CGT), WHT, as well as minimum and final taxes.
OGMCs: Increase in super tax	Negative	Tax rate on the OMC sector has been increased from 33% to 39% (29% corporate tax + 10% super tax) for FY23. This will erode the overall profitability of the sector by an average 9-12% in FY23.
Allocation of PKR 11bn as subsidy to pay off remaining PDC on MS (Petrol) to OMCs	Positive	The payment of leftover PKR 11bn PDC on MS (petrol) will improve cash flows of the OMCs
Amendment to the Petroleum Product (Petroleum Levy) Ordinance	Neutral	The government has proposed to amend Petroleum Products (Petroleum Levy) Ordinance whereby it may change the quantum of PDL through a notification in the official gazette, which suggests a change in petrol prices at any given time. Currently, government has kept petroleum levy collection target at PKR 869bn (which translates into PDL of PKR 45.43/liter each on average on petrol and diesel) compared to PKR 855bn in FY23B.

Our take on the sector:

E&P: Keeping in view Pak Rupee depreciation against greenback, profitability of the sector is expected to remain robust. Impact of last gas tariff hike is expected to be visible from Jun'23 ending quarter of E&P companies. Expected further gas price hike is likely to improve cash earnings significantly. OGDC, PPL and MARI are our top picks.

OGMCs: The earnings of marketing companies are expected to decline amid inventory losses due to decline in oil prices. Whereas gas utilities are set to benefit from the revision in WACC. SNGP is our top pick in the sector

Budget Review FY24

Fertilizer - Negative to Neutral

Proposed Measure	Impact	Comment
Increase in super tax rate to 10%	Negative	Tax rate on the Fertilizer sector has been increased from 33% to 39% (29% corporate tax + 10% super tax) for CY23. This will plummet the overall profitability of the sector by an average 17.0% in CY23.
Govt. sets aside subsidy for fertilizer plants	Neutral	Subsidy for fertilizer plants worth PKR 30bn for FY24B (PKR 15bn in FY23B) will ensure smooth supply of gas to the sector for urea availability (~545K tons of urea).
Increase in allocation of agriculture loans from PKR 1,800bn to PKR 2,250bn	Positive	Expanding allocation of loans will improve agronomics of the farmers.
GIDC target of PKR 40bn has been set aside for FY24	Neutral	The government has set a target of PKR 40bn (which was previously PKR 30bn in FY23B) despite the fact that the matter has subjudice.
Subsidy on import of urea	Neutral	The government has allocated PKR 6bn for import of urea, in order to maintain urea availability (~119k urea tons estimated).

Our take on the sector:

Offtake of the fertilizer sector appears stable given focus on food security and agriculture in the country. Moreover, we expect the domestic manufacturers will effectively pass on the impact of any jump in costs (gas price hike) which will keep profitability of the sector shielded. Our top picks are FFC and ENGRO.

Budget Review FY24

Cement - Neutral to Positive

Proposed Measure	Impact	Comment
PKR 950bn allocation for PSDP against targeted PKR 727bn last year	Positive	Federal PSDP outlay has been set at PKR 950bn, while PKR 1,559bn (-6.0% YoY) has been set aside for provinces (total PSDP of PKR 2,509bn - highest ever). The Corporations category under the Federal head budgeted at PKR 215bn, which is dominated by the National Highway Authority (NHA) whereby PKR 161bn has been allocated (58.7% higher than FY23R), is likely to propel public sector led demand for cement and steel.
Allocation of PKR 200bn through Public Private Partnership	Positive	Qualified projects under the Public Private Partnership are likely to support cement demand.
Super tax at 10% for the tax year 2023 onwards vs. 4% earlier	Negative	The imposition of augmented super tax on FY23 will erode earnings of the cement sector by ~9% per annum.

Our take on the sector:

A hit from higher super tax is likely to be a sentiment dampener, as it will slash sector wide earnings. Moreover, while the PSDP target seems robust, chances of expenditure being realized appear slim. Albeit, despite the aforementioned, we view earnings next year to post a growth as thus far, no signs of price war have emerged. Moreover, companies are trading at attractive levels and once the industry comes out on the other side of the post consolidation period (i.e. demand recuperates and the impact of a decline in commodities comes into play after ease in LC opening), we believe risks to earnings outlook will be curbed. One year out, potential interest rate cuts will also provide relief in borrowing costs. Our top picks are LUCK, MLCF and FCCL.

Budget Review FY24

Information Technology - Positive

Proposed Measure	Impact	Comment
Continuation of concessionary fixed rate for IT and ITes and withdrawal of sales tax for filing return	Positive	Fixed rate of 0.25% to continue for tax year 2024, 2025 and 2026, whereas sales tax on filing of returns to be withdrawn. This will be positive for the IT sector.
Increase in business turnover limit of a manufacturer to qualify for concessionary rate	Positive	Increase in turnover limit to PKR 800mn from PKR 250mn will result in more companies qualifying for the concessionary rate. This will improve the margins for IT sector.
Extension in concessionary tax rate of 20% instead of 39% on advances from banks	Positive	It is proposed to reduce tax rate from from 39% to 20% for advances from banks to the IT sector for another two years. This will increase the quantum of loans available for the sector.
Removal of regulatory duty	Positive	Removal of regulatory duty on IT related equipment will improve cash flow position of the sector.

Budget Review FY24

Power - Neutral

Proposed Measure	Impact	Comment
Power subsidy	Neutral	The Govt. has announced a subsidy of PKR 894bn for FY24 compared to the revised target of PKR 870bn for FY23. Govt has allocated PKR 127bn for K-Electric TDS arrears taking the total subsidy amount for K-Electric to PKR 315bn for FY24.
Power transmission has been declared as a service	Neutral	The Govt. has proposed to exclude companies engaged in production, transmission and distribution of electricity from the scope of sales tax as recommended by National Tax Council. The said tax would be treated as provincial tax starting from 1st Jul'23 whereby the revenue will be received by respective provinces. As a result, impact on the prevailing tariff should be nil.

Our take on the sector:

Gov't is expected to increase the electricity tariff due to currency depreciation and a rise in interest rates. Timely increase in the tariff will improve the cash flow of the sector. Moreover, we believe the cash flow position of CPEC-based IPPs will be in a better position than others. Our top pick is HUBC.

Budget Review FY24

Auto Assemblers – Neutral to Positive

Proposed Measure	Impact	Comment
Removal of cap on fixed duties	Positive	The removal of fixed duties cap on used Asian market vehicles may lead to higher import costs translating to curbed competition for local assemblers. This would increase the demand for locally assembled vehicles.
Reduced import duty on hybrid vehicles	Positive	The reduced 1% import duty on hybrid vehicles is now exclusively applicable to locally assembled variants, only benefiting the assemblers who import them. Positive for INDU.
Reduction in custom duty on Heavy Commercial Vehicle (HCV)	Positive	The reduction of CD from 10% to 5% on non-localized heavy commercial vehicles (CKDs) will aid the local truck manufacturers. Positive for HINO, GHNL and GHNI.

Our take on the sector:

Despite the government's budgetary benefits to the auto sector, the continued restrictions on imports by the State Bank of Pakistan (SBP) requiring prior permission for importing CKD units and raw materials will limit production and keep the auto sector under pressure in the upcoming year.

Budget Review FY24

Engineering - Negative to Neutral

Proposed Measure	Impact	Comment
PKR 950bn allocation for PSDP against targeted PKR 727bn last year	Positive	Federal PSDP outlay has been set at PKR 950bn, while PKR 1,559bn (-6.0% YoY) has been set aside for provinces (total PSDP of PKR 2,509bn - highest ever). The Corporations category under the Federal head budgeted at PKR 215bn, which is dominated by the National Highway Authority (NHA) whereby PKR 161bn has been allocated (58.7% higher than FY23R), is likely to propel public sector led demand for cement and steel.
Allocation of PKR 200bn through Public Private Partnership	Positive	Qualified projects under the Public Private Partnership are likely to support steel demand.
Continuation of exemption on import stage sales tax for the FATA / PATA region	Negative	Unregistered steel players from the FATA / PATA region continue to manipulate the FBR in order to avoid taxes and dump cheap steel rebars in the market. One year extension in this exemption will harm the formal rebar and flat steel industry.
Super tax at 10% for the tax year 2023 onwards vs. 4% earlier	Negative	The imposition of augmented super tax on FY23 will erode earnings of the steel sector by 9% per annum.

Our take on the sector:

A hit from higher super tax is likely to be a sentiment dampener, as it will slash sector wide earnings. Moreover, while the PSDP target seems robust, chances of expenditure being realized appear slim. Albeit, despite the aforementioned, we view earnings next year to post a growth amid demand rebound post ease in opening LCs (availability of imported raw material) and improvement in GDP. In addition, local players resorted to several price hikes this year (+17% in FYTD in long steel price to PKR 275,000 per ton - after touching a high of PKR 305k in Feb’23, and +21% FY23TD in CRC and Galvanized steel prices to PKR 289.5k and PKR 298.9k per ton), which should carry forward in the following year.

Budget Review FY24

Chemical - Negative to Neutral

Proposed Measure	Impact	Comment
Increase in super tax rate	Negative	The tax rate on the chemical sector has been increased from 33% to 39% (29% corporate tax + 10% super tax) for CY23. This will erode the overall profitability of the sector by an average of 10%-23% in 2023.
Increase in custom duty on calcium carbides	Positive	It has also been suggested to increase the custom duty on calcium carbides to 11% from 3%, which is a raw material for the chemical sector. **This would be positive for GCIL.**
Abolishment of customs duty on organic composite	Positive	It is proposed to abolish customs duty on organic composite solvent and thinners for companies manufacturing Butyl Acetate and Dibutyl Orthophthalates, which will improve their margins. **Positive for BERG and BUXL**

Our take on the sector:

The international margins (PTA and PVC) are expected to remain low due to overall low demand. However, PKR depreciation will bode well for companies due to dollarized margins.

Budget Review FY24

Textile - Neutral

Proposed Measure	Impact	Comment
Reduction in CD on import of pet scrap for polyester filament yarn manufacturing	Positive	With this, the polyester filament yarn manufacturers such as GATI will be able to improve their gross margins.
Removal of regulatory duty on import of synthetic filament yarn	Negative	This will hurt the demand for locally produced synthetic filament yarn.
Sales tax to increase from 12% to 15% on POS retailers of textile products	Neutral	The proposal suggests increasing sales tax on POS retailers, which will augment final product prices, and may hamper demand.

Our take on the sector:

Soaring energy prices and curtailment in gas and electricity supply is likely to hit production and translate to lower margins. Moreover, unavailability of imported raw materials and lower local cotton harvest will adversely affect textile companies revenue. While demand slowdown in North America and Europe will reduce the flow of orders. Our top pick is ILP.

Budget Review FY24

Real Estate - Positive

Proposed Measure	Impact	Comment
REITs: Renew benefit under REIT scheme	Positive	Extension of exemption granted on profits and gains on sale of immovable property or share of special purpose vehicle to any type of REIT scheme up to Jun'24, to encourage a shift to this asset class.
Real estate: A waiver of 2% final withholding tax on purchase of immovable property	Positive	For non-resident individual POC/NICOP holder, a waiver of 2% on purchase of immovable property where it is acquired through foreign remittances from abroad, will encourage foreign inflows in real estate.
Reduction in tax liability for a builder	Positive	A 10% reduction in tax liability or PKR 5mn (whichever is lower) for a builder will augment construction activity due to lower liability incurred by the builder.
Reduction in tax liability for individuals constructing own house for 3 years	Positive	A 10% reduction in tax liability or PKR 1mn (whichever is lower) to be granted to an individual for own construction of house for 3 years. This will improve the demand for real estate.
Extension of concessionary tax on banks income from additional advances to low cost housing.	Positive	Concessionary tax of 20% on additional advances to low cost housing for an additional two years will encourage mortgages.

Budget Review FY24

Others - Neutral

Proposed Measure	Impact	Comment
Tiles: Reduction of regulatory duty on import	Negative	Lower regulatory duty on imports of tiles will adversely impact the demand for local manufacturers such as STCL.
Pharmaceutical: One more API and three drugs added to the duty regime	Positive	Government proposes to include one more active pharmaceutical ingredient and three drugs in the present duty free regime. This will improve margins of pharmaceutical companies.
Leather and Tanneries: Sales tax to increase from 12% to 15%	Neutral	Increase in the sales tax of POS retailers by 3% will increase the price of final leather products.
Cable and electrical goods: Removing regulatory duty on parts of electrical goods	Positive	Government recommends removing regulatory duty on raw material imports of flat panels, monitors, projectors, as well as on silicon steel sheets, will be positive for appliances manufactures.
Food: Exemption of custom duties on raw material for rice machinery	Positive	Exemption from CD on import of rice mill machinery will positively impact the cash position of rice mills including MFL and UNITY.
Withdrawal of sales tax exemption on edible products	Negative	It is proposed by the government to withdraw exemption of sales tax on edible products sold in bulk under brand names or trademarks. This is expected to hurt gross margins for companies producing edible products and selling in bulk.
Sugar: Increase regulatory duty on export of Molasses	Negative	Increasing regulatory duty on the export of Molasses from 10% to 15% will hurt margins of exporting sugar companies.

Budget Review FY24
Others - Neutral

Proposed Measure	Impact	Comment
Glass: Increase in regulatory duty on import of glass articles	Positive	To protect the local industry, the incumbent government has proposed to increase regulatory duty on imports of glass to the tune of 15-30%.
Personal care: To abolish custom duty on raw materials of diapers, sanitary napkins, and adhesive tape	Positive	Abolishment of custom duty on raw materials of diapers, sanitary napkins and adhesive tape will have a positive impact for the personal care sector.

Contact Details

Shahid Ali Habib	Chief Executive Officer	shahid.habib@arifhabibltd.com	92 -21-3240-1930

Research Team

Tahir Abbas	Director Research	tahir.abbas@arifhabibltd.com	92-21-3246-2742
Sana Tawfik	VP – Senior Investment Analyst	sana.tawfik@arifhabibltd.com	92-21-3246-2589
Rao Aamir Ali	AVP – Senior Investment Analyst	amir.rao@arifhabibltd.com	92-21-3246-1106
Misha Zahid	AVP – Senior Investment Analyst	misha.zahid@arifhabibltd.com	92-21-3246-2589
Muhammad Iqbal Jawaid	Investment Analyst	iqbal.jawaid@arifhabibltd.com	92-21-3246-2589
Muhammad Abrar	Investment Analyst	muhammad.abrar@arifhabibltd.com	92-21-3246-2589
Naseem Akhtar Khattak	Manager Database	naseem.akhtar@arifhabibltd.com	92-21-3246-1106
Muhammad Sameer	Officer Database	muhammad.sameer@arifhabibltd.com	92-21-3246-1106

Equities Sales Team

Bilal Khan	Director – Head of International Sales	bilal.khan@arifhabibltd.com	92-21-3246-5894
Usman Taufiq Ahmed	Head – HNWI / Corporates	usman.ta@arifhabibltd.com	92-21-3246-8285
Furqan Aslam	Deputy Head Equities	furqan.aslam@arifhabibltd.com	92-21-3240-1932
Farhan Mansoori	VP – Equity Sales	farhanmansoori@arifhabibltd.com	92-21-3242-9644
Afshan Aamir	VP – Equity Sales	afshan.aamir@arifhabibltd.com	92-21-3244-6256
Junaid Shaharyar Godil	SVP – Institutional Sales	junaidsgodil@arifhabibltd.com	92 21-3246-0232

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Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec 2023 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 +15% from last closing of market price(s)
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AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

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- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk

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

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

ARIF HABIB LIMITED