All Eyes on the IMF

Pakistan Budget FY24

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Budget FY24

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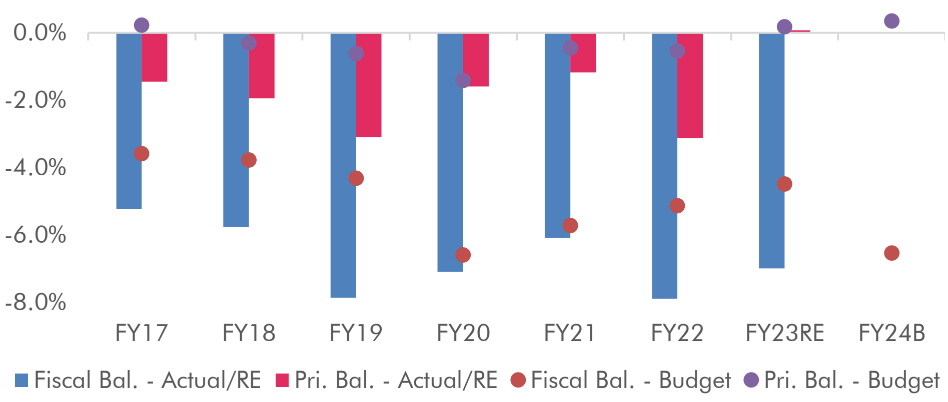
- Federal Minister Finance Mr. Muhammad Ishaq Dar presented the Federal budget for FY24 in the National Assembly on June 9, 2023 with a total outlay of PKR14.5tn compared to revised estimates of PKR11.3tn for the ongoing year.
- The overall budget deficit is targeted at 6.5% compared to revised estimate of 7.0% for the ongoing year.
- Primary balance is estimated to post a surplus of 0.4% of GDP in FY24 compared to a deficit of 0.5% of GDP for the ongoing year.
- Being the final budget of the sitting government before elections, the policymakers have tried to please the general population while keeping the focus on IMF requirements of curtailing the deficits.
- Key relief measures include 30-35% increase in salary of government employees, 17.5% increase in pension of ex government employees along with a similar increase in pension of EOBI, increase in minimum wage to PKR35,000, increase in cash transfer through BISP, and laptop schemes etc.
- Higher amounts allocated to social protection and lesser untargeted subsidies would be appreciated by the IMF in our opinion.
- On the expenses side, interest payments, majority of which are against the domestic borrowings, are projected at PKR7.3tn that itself exceeds net revenues of the federal government of PKR6.9tn leading to borrow to service existing debt and to finance remaining expenses.
- Subsidies are allocated PKR1.1tn, which although is a high number but it is 2.6% lower than the revised estimate for the ongoing year. Restricted subsidies are mainly attributed to lower untargeted subsidies.

Financing of the Federal deficit (PKRbn)

Fiscal Deficit		Financing	
Federal Revenue (Net)	6,887	Net External Financing	2,527
Total Federal Expenditure	14,460	Multilateral & Bilateral	926
Current Expenditure	13,320	Commercial	1,601
Development & Net Lending	1,140	Net Domestic Financing	5,031
Federal PSDP	950	Bank	5,023
Net Lending	190	Non-Bank	7
		Privatization Proceeds	15
Federal Deficit	-7,573	Total Financing	7,573

Source: MoF, Next Capital Research

Actual fiscal deficits compared to targets



Source: PBS, Next Research

Budget FY24

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- As far as financing of the federal deficit is concerned, the government is heavily relying on the domestic sources while 33% of the deficit is projected to be financed through external resources. We believe that not much avenue of external financings of the deficit are available considering Pakistan credit rating in the absence of an IMF program. Hence huge reliance would be made on bilateral flows from friendly countries.
- As per the claims of the government, these budget proposals have already been shared with the IMF and there has been no objection from their side so far.
- Moreover, the PM and the FM are very hopeful the 9th review would be completed during the month as the program expires on June 30, 2023.
- We believe that the IMF would not agree with the overall fiscal deficit target of 6.5% and the FBR target of PKR9.2tn. We may see some required adjustments from the IMF's side.
- While we see negative implications of the budget on the overall performance of the market with negative impacts on corporate profitability, all eyes would be focused on the response of the IMF.
- If we are unable to get the 9th review completed with the approval of the IMF's Executive Board by the end of this month, then the next IMF program is unlikely to be seen in the near term, which would be a major sentiment dampener for the market where economic activity would continue to remain dull amid external account pressures and import restrictions.
- On the positive side, PSX offers historically low valuations and handsome dividend yields that largely incorporates current state of economy. A positive development on the IMF front would lead to a decent rally in the market.

Details of external financing (PKRbn)

	FY23B	FY23RE	FY24B
External Loans	5,503	3,208	6,874
Project Loans	267	400	592
Federal	57	151	68
Provinces	210	249	524
Program Loans	1,243	856	771
Other Aid	3,994	1,951	5,511
KSA Oil Facility	149	195	0
KSA Time Deposit	558	447	870
New Deposit KSA	0	0	580
New Deposit UAE	0	0	290
Eurobond/Sukuk	372	0	435
Commercial Banks	1,390	522	1,305
Chine SAFE Deposits	744	596	1,160
IMF	558	173	696
Others	223	19	175
Grants	29	33	48
Federal Departments	3	0	2
Autonomous Bodies	0	4	2
Provinces	26	28	44
External Resources	5,533	3,241	6,922
Outside PSDP	13	83	49
Loans	13	66	32
Grants	0	17	17
Total External Resources	5,546	3,324	6,972
Repayments	3,935	3,319	4,445
External Resources Net	1,611	5	2,527

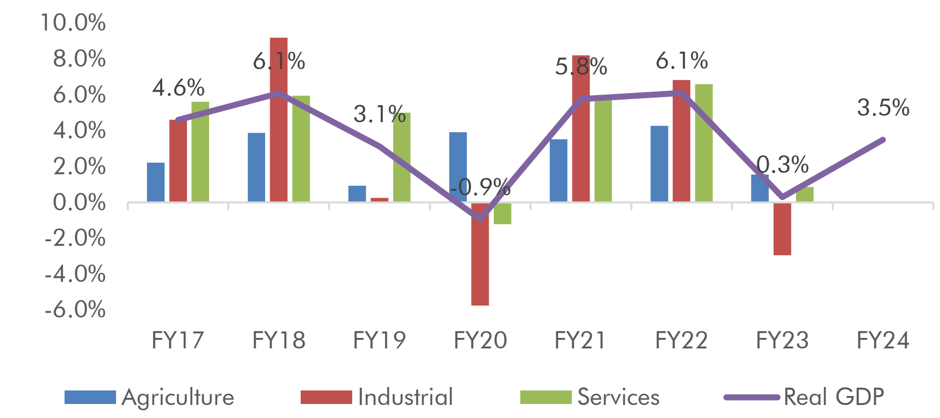
Source: MoF, Next Capital Research

Budget FY24

Relatively realistic target for inflation growth may under-perform

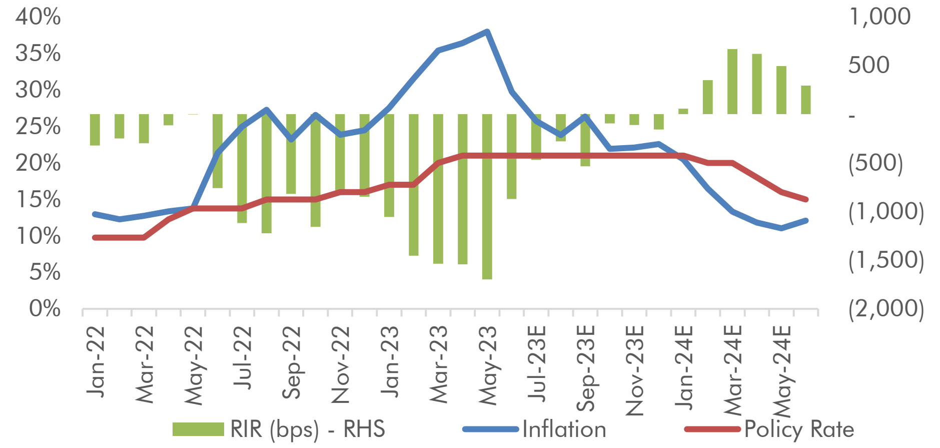
- According to provisional numbers, real GDP growth for FY23 is estimated at 0.3% following 5.8% and 6.1% growth in FY21 and FY22, respectively.
- The FY23 growth is contributed by estimated growth of 1.6% in agriculture sector, -2.9% in industrial sector and 0.9% in services.
- The National Economic Council (NEC) has approved a target for real GDP growth of 3.5% for FY23.
- We are of the opinion that the target for real GDP growth rate is on the higher side with external account challenges, inflationary pressures, and high tax and tight monetary policy environment.
- The government has also set a target for inflation at 21% compared to estimated average of 29% for the ongoing year. We agree with the inflation target as our working suggest a similar number for FY24 average inflation.
- As we highlighted earlier in our reports, inflation readings are expected to come down from Jun'23 primarily owing to high-base effect even with MoM increase of 1%.
- We therefore expected interest rates to remain unchanged for the rest of the CY provided no shocks to food or energy prices there.

Real GDP Growth Trend



Source: PBS, MoF, Next Capital Research

Outlook for inflation and interest rates



Source: PBS, Next Research

Budget FY24

Tax target appear optimistic

- The government has projected FBR revenue of PKR9.2tn (compared to PKR7.2tn, 27.8% from revised estimates of FY22) contributed by PKR3.8tn (+31.8%) of direct taxes and PKR5.4tn (+25.1%) of indirect taxes.
- The estimated and targeted tax collection for FY22 and FY23, respectively are still short of the stipulated targets of the IMF, which were at PKR7.6tn and PKR9.8tn (as per media reports), respectively.
- Tax to GDP for FY23 is estimated to continue hovering below 9% in FY24 as well (8.5% and 8.7% of GDP, respectively).
- The tax collection target is lower than the recommendation of the IMF, PKR9.8tn as per media reports and significantly higher that what FBR has reportedly set (PKR8.6tn).
- We understand that achievement of this target is an optimistic assumption.
- Non-tax revenue is estimated to increase by 83% over the revised estimates for FY23 (+PKR1.3tn) of PKR1.6tn.
- The projected growth in non-tax revenue is primarily attributable to 200% increase in SBP’s profits of PKR1.1tn compared to PKR371bn for the ongoing year. This growth is due to high interest rates and higher lending to the commercial banks through OMOs – injection.
- Currently PL per liter is set at PKR50/liter for both petrol and diesel and the government may increase it further, however the current level of PL/listed may result in achieving the target of PKR869bn with some increase in volumes.
- We therefore believe that the target of non-tax revenue is largely realistic.

Budget at a glance

Resources (PKRbn)		Expenditure (PKRbn)	
Tax Revenue (FBR)	9,200	Interest Payment	7,303
Non-Tax Revenue	2,963	Defence	1,804
Gross Revenues	12,163	Grants & Transfers	1,464
Less: Provincial share	5,276	Subsidies	1,074
Net Revenues	6,887	Others	1,675
Non-Bank Borrowings	1,906	Current Expenditure	13,320
Bank Borrowings	3,124		
Net External Receipts	2,527	PSDP - Federal	950
Est. Provincial Surplus	650	Net Lending	190
Privatization	15	Development Expenditure	1,140
Total Resources	**15,109**	**Total Expenditure**	**14,460**
Federal Deficit	(7,573)	As %age of GDP	-7.2%
Overall Deficit	(6,923)	As %age of GDP	-6.5%
Primary Deficit	381	As %age of GDP	0.4%

Source: MoF, Next Capital Research

Budget FY24

PSDP will be slashed like in most cases

- Significant increase in projected debt servicing cost of PKR7.3tn, +32.3% from the last year's revised estimates, is leading to an increase of 27.8% increase in overall expenses to PKR14.5tn.
- Current expenditures are estimated at PKR13.3tn, which is 26.5% higher over the revised estimates FY22.
- 26.7% higher grants and transfers may be attributable to increased allocation towards social safety and incentives programs, cash subsidies, and election and census related spending.
- Defence expense is projected to increase by 13.7% to PKR1.8bn.
- Allocation for subsidies (PKR1.1tn) is still a high number in absolute terms but it is 2.6% lower than the revised estimates for the ongoing year.
- We believe that debt servicing expense may overshoot expectations as borrowings for deficit financing are expected to remain high and the interest rate on both domestic and international borrowings are unlikely to come down in the near term.
- The government has allocated PKR950bn under Federal PSDP along with PKR200bn for public-private partnerships. Revised estimate for PSDP spending during the ongoing year is PKR714bn whereas during 9MFY23, PKR329bn, -27.3%YoY, have been spent under the federal PSDP.
- Major focus was given to improving water resources and building road infrastructure.
- As it has been the case in history, in case of lower revenue collection PSDP spending would suffer, however, considering election year ahead, we do not see any major decline from FY22's revised numbers during FY23.

Sector Outlook in response to budgetary measures

Sectors	Impact	Sectors	Impact
Market	Negative	Autos	Negative to Positive
Banks	Negative	Tech. & Comm.	Positive
Oil & Gas	Negative		
Fertilizer	Negative		
Construction	Neutral to Negative		

Budget FY24

Pakistan Fiscal Accounts (PKRbn)	FY21		FY22		FY23		FY23		FY24	
	Actual	% of GDP	Actual	% of GDP	Budgeted	% of GDP	Revised	% of GDP	Budgeted	% of GDP
FBR Taxes	**4,764**	**8.5%**	**6,143**	**9.2%**	**7,470**	**8.8%**	**7,200**	**8.5%**	**9,200**	**8.7%**
Direct Taxes	1,732	3.1%	2,280	3.4%	3,039	3.6%	2,851	3.4%	3,759	3.6%
Indirect Taxes	3,032	5.4%	3,862	5.8%	4,431	5.2%	4,349	5.1%	5,441	5.1%
Customs Duties	765	1.4%	1,009	1.5%	953	1.1%	1,084	1.3%	1,178	1.1%
Sales Tax	1,990	3.6%	2,532	3.8%	3,076	3.6%	2,808	3.3%	3,538	3.3%
Federal Excise	277	0.5%	321	0.5%	402	0.5%	457	0.5%	725	0.7%
Non-Tax Revenue	**1,505**	**2.7%**	**1,185**	**1.8%**	**1,935**	**2.3%**	**1,618**	**1.9%**	**2,963**	**2.8%**
Mark-up	101	0.2%	121	0.2%	140	0.2%	148	0.2%	195	0.2%
Dividends	44	0.1%	43	0.1%	80	0.1%	82	0.1%	121	0.1%
SBP Profits	651	1.2%	474	0.7%	300	0.4%	371	0.4%	1,113	1.1%
Petroleum Levy	425	0.8%	128	0.2%	855	1.0%	542	0.6%	869	0.8%
Others	285	0.5%	420	0.6%	560	0.7%	475	0.6%	665	0.6%
Total Revenues	**6,270**	**11.2%**	**7,328**	**11.0%**	**9,405**	**11.1%**	**8,818**	**10.4%**	**12,163**	**11.5%**
Share of Provinces	2,742	4.9%	3,589	5.4%	4,373	5.2%	4,129	4.9%	5,276	5.0%
Net Revenues	**3,528**	**6.3%**	**3,739**	**5.6%**	**5,032**	**5.9%**	**4,689**	**5.5%**	**6,887**	**6.5%**
Total Expenditure	**7,138**	**12.8%**	**9,153**	**13.7%**	**9,580**	**11.3%**	**11,315**	**13.4%**	**14,460**	**13.7%**
Current Expenditure	**6,349**	**11.4%**	**8,452**	**12.7%**	**8,709**	**10.3%**	**10,528**	**12.4%**	**13,320**	**12.6%**
Interest Payments	2,750	4.9%	3,182	4.8%	3,950	4.7%	5,520	6.5%	7,303	6.9%
Defence	1,316	2.4%	1,412	2.1%	1,563	1.8%	1,587	1.9%	1,804	1.7%
Pension	440	0.8%	542	0.8%	609	0.7%	609	0.7%	761	0.7%
Grants	912	1.6%	1,239	1.9%	1,174	1.4%	1,155	1.4%	1,464	1.4%
Subsidies	425	0.8%	1,530	2.3%	664	0.8%	1,103	1.3%	1,074	1.0%
Others	506	0.9%	547	0.8%	748	0.9%	553	0.7%	914	0.9%
Development Expenditure	**789**	**1.4%**	**701**	**1.1%**	**871**	**1.0%**	**787**	**0.9%**	**1,140**	**1.1%**
Federal PSDP	667	1.2%	558	0.8%	727	0.9%	714	0.8%	950	0.9%
Others	122	0.2%	143	0.2%	144	0.2%	73	0.1%	190	0.2%
Statistical Discrepancy	**107**	0.2%	**197**	0.3%	-	0.0%	(225)	-0.3%	-	0.0%
Budget Balance - Federal	**(3,717)**	**-6.7%**	**(5,611)**	**-8.4%**	**(4,547)**	**-5.4%**	**(6,401)**	**-7.6%**	**(7,573)**	**-7.2%**
Provincial Surplus	314	0.6%	351	0.5%	750	0.9%	459	0.5%	650	0.6%
Budget Balance - Consolidated	**(3,403)**	**-6.1%**	**(5,260)**	**-7.9%**	**(3,797)**	**-4.5%**	**(5,942)**	**-7.0%**	**(6,923)**	**-6.5%**
Primary Balance	**(654)**	**-1.2%**	**(2,077)**	**-3.1%**	**153**	**0.2%**	**(421)**	**-0.5%**	**380**	**0.4%**
External Financing	**1,338**	**2.4%**	**1,178**	**1.8%**	**1,611**	**1.9%**	**5**	**0.0%**	**2,527**	**2.4%**
Domestic Financing	**2,065**	**3.7%**	**4,081**	**6.1%**	**2,090**	**2.5%**	**5,935**	**7.0%**	**4,381**	**4.1%**
Privatization	**-**	**0.0%**	**-**	**0.0%**	**96**	**0.1%**	**1**	**0.0%**	**15**	**0.0%**

Source: MoF, PBS, Nsxt Capital Research

Market and Sector Outlook

Budget FY24

Likely impacts of key budgetary announcements on the market and related sectors

No.	Relevant budgetary measures	Impacts	Comments
Capital Market - Negative			
1	**Rationalization of Super Tax** While keeping super tax rates at 3% for incomes of up to PKR300mn and exempting incomes below PKR150mn, 3 new rates and slabs are introduced: 4% for incomes exceeding PKR300mn up to PKR350mn, 6% for incomes exceeding PKR350mn up to PKR400mn, 8% for incomes exceeding PKR400mn up to PKR500mn, and 10% for incomes exceeding PKR500mn. These rates are applicable from TY23 onwards.	Negative	Majority of the leading companies from the KSE100 Index fall under the last slab and hence would be subject to 10% super tax from TY23 onwards. A 4% super tax was already incorporated in earnings estimates of companies under our coverage including banks, therefore, an additional 6% super tax from TY23 onwards would erode earnings of most of the leading companies with pre-tax profits in excess of PKR500mn by 9-13% with a similar downward impact on target prices.
2	Reimposition of tax 10% withholding tax on issuance of bonus shares, 20% for non-filers.	Negative	This measure (5% instead of 10%) was also implement through Finance Act 2014, but it was abolished a few year back. The recent announcements by companies for increasing authorized capital and subsequently issuing bonus shares in anticipation of tax on undistributed reserves had witnessed rallies in these stocks lately. This measure may negatively impact the performance of those stocks in the near term.
3	**Introduction of section 99D** Under this new section an additional tax not exceeding 50% shall be imposed on unexpected income, gain or profit arising due to any economic factor including fluctuations in international prices and foreign currency, for any of the 5 preceding tax years from TY23.	Negative	This is an open-ended proposal with a lot of clarifications needed. As per the Finance Bill, the 'Federal Government through a notification in the official Gazette would determine the relevant economic factors, the rate of tax that would not be exceeding 50%, and other details including scope, time period etc. Overall, this would be taken as a major negative by the market impacting major index heavy weight companies. We do not rule out the possibility of this measure being challenged in the court of law.
4	Reduction of minimum turnover tax for listed companies from 1.25% to 1%.	Positive	As an incentive for listed companies, the turnover tax on listed companies have been reduced to 1% from 1.25% impacting positively the companies with thin and volatile margins.

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Budget FY24

Likely impacts of key budgetary announcements on the market and related sectors

No.	Relevant budgetary measures	Impacts	Comments
Technology and Communication - Positive			
5	Duty free import of IT related equipment and hardware.	Positive	Exporters of IT and IT enabled services can import related equipment and hardware duty free equivalent to 1% of value of their export proceeds or USD50,000, whichever is lesser.
6	Extension of concessionary fixed tax rate of 0.25% on IT exports.	Positive	Concessionary fixed tax rate of 0.25% on IT exports is extended from last year to TY26.
7	Inclusion in SME category	Positive	This would allow the IT industry to avail the benefits available for SMEs including incentivized lending by banks (20% tax on increment lending by banks instead of 39% normal tax rate for banks), and other tax benefits.
8	Increase in super tax, and up to 50% tax on unexpected income for any of the 5 preceding tax years from TY23.	Negative	Higher super tax on PBTs exceeding PKR350mn compared to 4% currently would deteriorate earnings growth outlook. Exchange gains would attract taxation under section 99D.
Commercial Banks - Negative			
9	Reimposition of advance adjustable withholding tax on cash withdrawals of PKR50,000/day and above from banks, at 0.6% for non-filers.	Negative	This measures was first implemented in budget FY16 to encourage documentation of the economy. But adversely this measure led to a significant increase in currency in circulation that was hovering around 22% of broad money (M2) for several years to over 25% and further up to over 30% during the pandemic in FY20. Currently it is around 29%. This step is likely to hamper deposit growth for banks also.
10	Increase in withholding tax from 1% to 5% on payment to non-resident through debit/credit or prepaid cards. (2% to 10% for non-filers)	Negative	This step would negatively impact the cards related income of banks.
11	Concessionary tax rate of 20% extended for 2 more years on incremental advances to agriculture sector, low-cost housings, and SMEs including IT & ITES sector.	Positive	The benefit of this concession has been extended for next 2 years and IT & ITES sector is also included in the eligible sectors as this sector has now been classified in SMEs. This would encourage banks to lend more to these sectors for effective tax management.
12	Increase in super tax, and up to 50% tax on unexpected income for any of the 5 preceding tax years from TY23.	Negative	Super tax of 10% compared to 4% currently would negatively impact earnings growth outlook. Gains from dealings in foreign exchange (significantly high gains were made during 2022 and in the current year) and unusually high NIMs particularly for Islamic banks may attract taxation under section 99D.

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Budget FY24

Likely impacts of key budgetary announcements on the market and related sectors

No.	Relevant budgetary measures	Impacts	Comments
Construction including cement, steels and REITs - Neutral to Negative			
13	Allocation of PKR950bn for Federal PSDP, PKR200bn for public-private partnership, and PKR157bn for NHA.	Neutral	These allocations are significantly higher than the revised estimates for FY23. It should be noted however, that during 9MFY23, federal PSDP spending stood at PKR329bn, PKR385bn left to be spent in 4QFY23.
14	Waiver of 2% tax on purchase of immovable property for non-resident individual.	Positive	This waiver is available where the immovable property is acquired through foreign remittances remitted from abroad. This would encourage overseas Pakistanis to invest in the real estate market of Pakistan allowing some fresh inflows of US Dollars.
15	Tax credit of 10% of PKR5mn, whichever is lesser, for both builders and general public on construction of new houses for the next 3 years.	Positive	This is likely to encourage construction activities in the country as tax credit offered appears significant.
16	Extension of sales tax exemption for steel manufacturers from FATA/PATA region for one more year.	Negative	This extension would continue hampering the pricing power of formal steel manufacturers.
17	Extension in exemption for 1 year on profits and gains on sale of immovable property or share of special purpose vehicle to any type of REIT.	Positive	This extension would make investments in REITs, REIT funds, and REIT SPVs more attractive and would help in documentation of the real sector.
18	Increase in super tax, and up to 50% tax on unexpected income for any of the 5 preceding tax years from TY23.	Negative	With increasing margins and profitability of the relevant sectors, higher super tax would be negative for earnings growth outlook. Furthermore, inventory gains for steel sector would be impacted by taxed under section 99D.
Fertilizers – Negative			
19	Allocation of PKR6bn subsidy for urea imports.	Neutral	Similar to the previous year, this measure would ensure a sufficient supply of urea fertilizer in the market.
20	PKR40bn target set for GIDC.	Neutral	Despite higher targets, collection of GIDC remained insignificant with the matter being subjudice.
21	Allocation of PKR30bn subsidy for provision of RLNG to urea plants.	Positive	With doubling of this allocation, RLNG based urea plants would be operating for a longer period this year compared to the previous year.
22	Measures for agriculture sector	Positive	Exemption from customs duties on import of seeds for sowing, enhancement in limit for farm loans.

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Budget FY24

Likely impacts of key budgetary announcements on the market and related sectors

No.	Relevant budgetary measures	Impacts	Comments
Textiles – Neutral			
23	Increase in sales tax from 12% to 15% on POS retailers.	Negative	This increase in tax would negatively impact margins of domestic sales of textiles units through retail outlets. Leading companies may include GATM, NML, IMAGE.
24	Reduction in custom duty on import of pet scrap for polyester filament yarn.	Positive	Positively impact margins of manufacturers of polyester filament yarn.
25	Increase in super tax, and up to 50% tax on unexpected income for any of the 5 preceding tax years from TY23.	Negative	Higher super tax on PBTs exceeding PKR350mn compared to 4% currently would deteriorate earnings growth outlook. Exchange gains would attract taxation under section 99D.
Automobile Assemblers and Parts – Neutral to Positive			
26	Reduction in customs duty from 10% to 5% on non-localized CKD) f Heavy Commercial Vehicles.	Positive	Positively impact companies assembling HCVs.
27	Withdrawal of capping of fixed duties and taxes on import of old and used vehicles of Asian makes above 1,300cc.	Positive	This would positively impact local assemblers with increase in costs of imported used cars and CBUs from Asian markets.
28	Reduction in turnover tax of listed companies.	Positive	Positive for low margin and variable PBTs particularly PSMC and HCAR.
29	Increase in super tax, and up to 50% tax on unexpected income for any of the 5 preceding tax years from TY23.	Negative	Higher super tax on PBTs exceeding PKR350mn compared to 4% currently would further deteriorate earnings growth outlook. Exchange gains, if any, could potentially attract taxation under section 99D.
Oil & Gas - Negative			
30	Exemption from customs duties on imports of raw materials and inputs for mining machinery.	Positive	This would be a positive for earnings of mining subsidiaries of OGDC and PPL along with their exposure to Riko Diq mining project.
31	Increase in super tax, and up to 50% tax on unexpected income for any of the 5 preceding tax years from TY23.	Negative	Higher super tax of 10% compared to 4% currently would negatively impact earnings growth outlook. Gains from fluctuations in international oil prices and exchange gains for E&P companies, and exchange and inventory gains for OMCs, would attract taxation under section 99D.

Source: MoF, Media, Next Capital Research

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Annexure

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Rating	Definition
BUY	Total stock return > 15%
NEUTRAL	Total stock return between 0% - 15%
SELL	Total Stock return < 0%

* Total stock return = capital gains + dividend yield

Valuation Methodology:

- To arrive at our period end target prices, Next Capital Limited uses different valuation methodologies including but not limited to:
- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)