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Pakistan Strategy

REP:039

Pakistan Federal
BUDGET
FY24

CFA Society Pakistan

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P@SHA

Pakistan Software Houses Association for IT & ITES

Runners Up in Finance Category 2021

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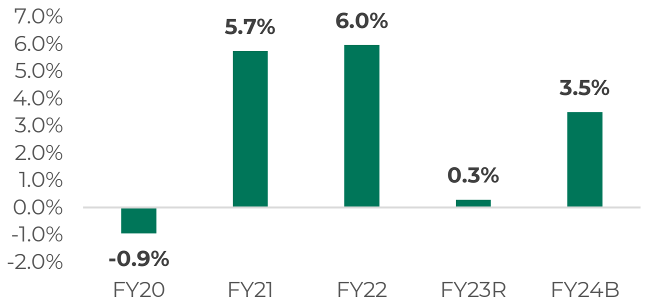
Executive Summary (1/2)

Ambitious targets necessitating tough measures

- The Federal Budget 2023-24 proposed a lot of tough revenue measures to ensure the economic targets are achieved. The total outlay is budgeted at **PkR 14.5tn (+61% YoY),** a sharp increase from PkR 9.5tn budgeted a year prior. The outlay intends to support the **3.5% GDP growth target** and the surging debt servicing costs, which is projected to hover around the PkR 7.3tn mark.

GDP Growth Rate targeted at 3.5%



- The outlay will be financed through a sharp increase in tax collection, budgeted at **PkR 9.2tn in FY24**, an increase of 28% YoY compared to PkR 7.2tn projected to be collected in FY23. Several taxation measures were introduced to ensure that the **tax to GDP ratio of 8.7%** would be achieved. Notable proposals include the **rationalization of the super tax** to be applicable on all persons across the board. Moreover, the government also proposed an **additional 50% tax on profits** emanating from extraordinary gains due to exogenous factors.

- The current expenditure is budgeted to rise to PkR 13.3tn, the bulk of which constitutes debt servicing. Moreover, the **development budget is set at PkR 1.14tn**, of which the **federal PSDP amount if budgeted at PkR 950bn.**

Summary of Budgetary Estimates

PKR bn	FY21	FY22	FY23E	FY24B
Tax Receipts	**4,691**	**6,000**	**7,200**	**9,200**
FBR Taxes	4,691	6,000	7,200	9,200
Direct Taxes	1,789	2,204	2,851	3,759
Indirect Taxes	2,902	3,796	4,349	5,441
Non-tax Receipts	**1,704**	**1,315**	**1,618**	**2,963**
Capital Receipts	**1,701**	**2,508**	**3,420**	**2,531**
External Receipts	**2,287**	**3,114**	**3,324**	**6,972**
Privatization Proceeds	**0**	**0**	**96**	**15**
less: Provincial Share	**2,704**	**3,512**	**4,129**	**5,276**
Total Expenditure	**8,489**	**10,624**	**12,421**	**14,460**
Current Expenditure	**7,626**	**7,523**	**10,528**	**13,320**
Defence	1,299	1,484	1,587	1,804
Debt Servicing	2,851	3,144	5,520	7,302
Development Expenditure	**863**	**434**	**1,024**	**1,140**

Executive Summary (2/2)

- The Federal Budget 2023-24 aimed at balancing austerity with targeted relief. The total outlay is budgeted at **PkR 14.5tn (+61% YoY),** a sharp increase from PkR 9.5tn budgeted a year prior. The outlay intends to support the **3.5% GDP growth target** and the surging debt servicing costs, which is projected to hover around the PkR 7.3tn mark.
- The outlay will be financed through a sharp increase in tax collection, budgeted at **PkR 9.2tn in FY24**, an increase of 28% YoY compared to PkR 7.2tn projected to be collected in FY23. Several taxation measures were introduced to ensure that the **tax to GDP ratio of 8.7%** would be achieved. Notable proposals include the **rationalization of the super tax** to be applicable on all persons across the board. Moreover, the government also proposed an **additional 50% tax on profits** emanating from extraordinary gains due to exogenous factors.
- The current expenditure is budgeted to rise to PkR 13.3tn, the bulk of which constitutes debt servicing. Moreover, the **development budget is set at PkR 1.14tn**, of which the **federal PSDP amount if budgeted at PkR 950bn.**

Market Outlook

We think the market will likely have a neutral to a negative tilt towards the budget. Given the ambitious tax target of PkR 9.2tn, certain revenues measures were introduced that could hamper investor sentiments. Most notable of these measures were the continuation of the super tax and taxation on bonus shares.

Certain sectors, particularly the IT sector, are likely to benefit from certain relief measures that were introduced. Moreover, the REITs industry is also likely to benefit from the extension of tax exemptions.

Macroeconomic Overview

PKR mn	FY21	FY22E	FY23F	FY23F
Total Revenues	**6,903**	**7,315**	**8,818**	**12,163**
Tax Revenues	**5,273**	**6,000**	**7,200**	**9,200**
Non-tax Revenues	**1,631**	**1,315**	**1,618**	**2,963**
Total Expenditure	**10,307**	**10,624**	**11,090**	**14,460**
Current Expenditure	**9,084**	**7,523**	**10,528**	**13,320**
Mark-up	2,750	3,144	5,520	7,303
Defence	1,316	1,484	1,587	1,804
Development	**1,316**	**434**	**1,025**	**1,140**
Budget Balance (% of GDP)	-7.1%	-8.6%	-7.6%	-7.2%
Primary Balance (% of GDP)	-1.4%	-2.4%	-0.5%	0.4%
Pakistan Economic Overview				
Imports (USD bn)	54.3	76.0	70.0	65.0
Exports (USD bn)	25.6	31.3	35.0	30.0
Remittances (USD bn)	29.5	31.1	33.2	33.0
CAD (% of GDP)	-0.8%	-4.1%	-2.2%	-1.7%
Inflation (%)	8.9%	11.7%	11.5%	21.0%

Economic Snapshot

Key Data Points

		FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24F
GDP growth	%	4.6%	6.1%	3.1%	-0.9%	5.8%	6.1%	0.3%	3.5%
Nominal GDP	USD bn	339.6	356.8	321.8	300.8	348.9	374.7	391.5	362.0
Trade Deficit	USD bn	-32.5	-37.6	-31.8	-23.2	-31.1	-48.4	-18.1	-35.0
Export	USD bn	20.4	23.2	23.0	21.4	25.3	31.8	27.0	30.0
Import	USD bn	52.9	60.8	54.8	44.6	56.4	80.2	55.1	65.0
Remittances	USD bn	19.4	19.9	21.7	23.1	29.5	31.3	27.1	33.0
Reserves	USD bn	21.4	16.4	14.5	18.9	24.4	15.5	7.8	10.0
Policy Rate - ending	%	5.8%	6.5%	12.3%	7.0%	7.0%	13.8%	21.0%	17.0%
FBR Revenue	PkR bn	3361.0	3842.1	3829.5	3997.9	4764.3	6143.0	7200	9200
Budget Deficit	%	5.8%	6.6%	8.9%	8.1%	7.1%	7.9%	7.0%	6.5%
Current Account Balance	% GDP	5.4%	4.2%	5.4%	1.5%	0.8%	4.7%	1.1%	1.7%
Trade Deficit	% GDP	9.6%	10.5%	9.9%	7.7%	8.9%	12.9%	-4.6%	-9.7%

Source: SBP, MOF, PBS, KTrade Research

Revenue Measures (1/2)

Tax growth targeted at 28% YoY

FBR tax collection set at PkR 9.2tn

- Pakistan's tax collection target is set at **PkR 9.2tn, a jump of 28% YoY** compared to previous year's estimated collection of PkR 7.2tn.
- The bulk of the growth in tax collection is estimated to originate from an increase in direct taxation to PkR 3.8tn (+32% YoY). Other heads are also budgeted to witness similar increases, likely supported by inflation, projected economic growth, and the removal of trade restrictions.

Corporate Taxation

- **Super tax** is proposed to be implemented on all persons and entities with income over PkR 150mn. Additional slabs have been introduced with the tax rate peaking at 10% for income over PkR 500mn.
- Proposal to implement **additional tax of up to 50% on income profit** of a person on extraordinary gains emanating from exogenous factors. This proposal is likely to affect OMCs, E&Ps, and Banks.

Energy

- The government is targeting a **Petroleum Development Levy (PDL) collection of PkR 869bn**, up from estimated collections of PkR 542bn. Based on our estimates of fuel sales, **an average PDL of PkR 50-55/liter on MS and HSD** may need to be collected.
- The government has also earmarked **GIDC collections of PkR 40bn**, likely implying the collection of the overdue balance.

Revenue Targets and Receipts

PKR bn	FY21	FY22	FY23R	FY24B
FBR Taxes	**4,691**	**6,000**	**7,200**	**9,200**
Direct Taxes	1,789	2,204	2,851	3,759
Customs	700	817	1,084	1,178
Sales Tax	1,927	2,635	2,808	3,538
FED	275	344	457	725
Other Taxes	**n/a**	**n/a**	**n/a**	**n/a**
PDL	n/a	n/a	n/a	n/a
Non-tax Revenues	**1,704**	**1,315**	**1,618**	**2,963**
Dividends	40	70	82	121
Share of SBP Profits	700	474	371	1,113
Petroleum Levy	500	135	542	869
GIDC	25	25	9	40
PTA License	34	100	74	73

Revenue Measures (2/2)

Capital Markets

- Re-imposition of 10% final withholding tax on issuance of bonus shares by a company (20% for non-ATL). This development would be negative for capital market investors as it dis-incentivizes bonus share issues by companies.

Automobile

- Withdrawal of capping of the fixed duties and taxes on the import of old and used vehicles of Asian Makes above 1300 CC. This development may result in an increase in the cost of imported vehicles, likely supporting the domestic industry.

Consumer Industry

- Withdrawal of exemption of sales tax on edible products sold in bulk under brand names or trademarks.

Textiles

- Enhancement in reduced rate of sales tax from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products. The would be negative for textile companies with a domestic footprint.

Banking Industry

- The 0.6% advanced withholding tax on the withdrawal of cash is being implemented for non-filers. Historically, this tax has incentivized cash transactions as non-filers avoid depositing cash in banks to bypass the tax.

Others

- 0.5% increase in WHT for commercial importers.
- Increase in withholding tax rate from 1% to 5% on payment to non-resident through debit/credit or prepaid cards.

Development Expenditures

PSDP Increased to PkR 950bn

- Pakistan's development budget was increased **to PkR 1,150bn for FY24** as against PkR 787bn estimated for FY23.
- The federal PSDP was enhanced to PkR 950bn for FY24 vs. PkR 714bn estimated for FY23.
- Notably, the government has allocated PKR 108bn on the development of water resources.
- The National Highway Authority was **allocated PKR 158bn** for the development of highways.
- The IT & Telecommunications sector was allotted PKR 6.0bn.
- Increased focus on development spending is projected to support Pakistan's construction industry, particularly the cement and steel sector.

Federal PSDP

PKR bn	FY23E	FY24B
Total PSDP	**787**	**1,150**
Federal PSDP	**714**	**950**
Water Resource	98	108
National Highway Authority	101	158
IT & Telecom	6	6

Capital Receipts

PkR 2.53tn earmarked for FY24

- The government has **earmarked PkR 2.53tn in net capital receipts** for the fiscal year, a decline from the previous year's PkR 3.42tn.
- The government aims to raise **PkR 1,431 from Ijarah Sukuk Bond**s and a net of PkR 245bn from PIBs.
- From international resources, the government has earmarked USD 3.0bn from Saudi Arabia's time deposits, USD 2.0bn from Saudi Arabia's new deposits, and USD 1.0bn UAE's deposits.
- Notably, the government has **earmarked USD 1.5bn inflows from the issuance of international Sukuk or Eurobond.**
- **USD 4.5bn** has been budgeted to be received from commercial banks and USD 4.0bn has been budgeted from China's SAFE deposits.
- Moreover, the government has earmarked **USD 2.4bn from** the IMF.

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Capital Receipts

PkR bn	FY23	FY24B
Public Debt	**1,547**	**1,699**
PIBs	281	245
Ijarah Sukuk	901	1,432
T-Bills	1,563	189
Others	365	23
Total Receipts	**3,420**	**2,531**
External Receipts		
IDB	4	145
Saudi Time Deposit	447	870
Saudi Oil Facility	195	0
New Deposit Saudi	0	580
New Deposit UAE	0	290
Eurobond/Sukuk	0	435
Commercial Banks	522	1,305
SAFE Deposit	596	1,160
IMF Loan	173	696

Subsidies

Subsidies budgeted to cross PkR 1.0tn

- The government has **earmarked PkR 1.07tn in subsidies** for the fiscal year, a slight decline from the previous year's PkR 1.10tn.
- **PkR 579bn** is allocated to WAPDA/PEPCO, **of which PkR 310bn** is allocated for IPPs, likely to clear the sector's overdue receivables.
- Notably, the **industrial support package was removed**, from the PkR 7.0bn allocated the previous year.
- Moreover, the recently withdrawn zero-rated industrial subsidy will not be reinstated as the budget did not allocate any amount to the head, compared to **PkR 64bn the year prior.**
- Notably, **PkR 127bn** was allocated for the arrears of KE's TDS.
- The subsidy on RLNG was also withdrawn against the **PkR 40bn** allocated the year prior.
- **PkR 10.0bn** was allocated to clear the OMC PDC.
- **PkR 30bn** has been allocated to the fertilizer plants for subsidized gas.

Subsidies

PkR bn	FY23	FY24B
Total Subsidies	**1,103**	**1,074**
WAPDA/PEPCO	**677**	**579**
IPPs	180	310
Tariff Differential	225	150
Industrial Support Package	7	0
Zero-Rated Subsidy	64	0
Others	201	119
KESC	**193**	**315**
Tariff Differential	173	171
TDS Arrear	0	127
Others	20	17
Petroleum	**102**	**54**
LNG	40	0
PDC	0	11
Others	62	43

Snapshot of Sectors

IT and Agri are the winners

Sector	Proposals	Impact
Agriculture	Exemption of Customs duties on import of seeds for sowing to promote growth in agricultural sector 5yr tax holiday for agro based industries being SMEs set up on or after 1st July, 2023 from tax year 2024 to tax year 2028 Encouraging export of commodities through online platform by providing 1% concessionary final tax rate to indirect exporters Grant of exemption of sales tax on plant saplings, combine harvesters, dryer for agricultural products, no-till-direct seeder, planters, trans-planters, other planters AND bovine semen.	Positive
Autos	Reduction of Customs duty from 10% to 5% on non-localized (CKD) of Heavy Commercial Vehicles (HCVs) Alignment of Part(V) of Fifth Schedule to the Customs Act with Auto Industry Development and Export Policy (AIDEP) 2021-26 Withdrawal of capping of the fixed duties and taxes on the import of old and used vehicles of Asian Makes above 1300 CC	Neutral
Banks	Concessionary tax rate of 20% on income from additional advances from low cost housing, agriculture, and SMEs including IT & ITeS sector instead of 39% Removal of technical mistake in banking sector super tax regime by substituting tax year 2022 with tax year 2023 Imposition of additional tax up-to 50% on income profit and gains on account of extraordinary gains due to exogenous factors	Negative
Construction	Development Budget outlay to PkR 1,150bn 10% reduction in tax liability or PkR 5 mn whichever is lower for a builder and 10% reduction or PkR 1 mn whichever is lower for an individual for own construction of house for 3yrs	Positive
Sugar	Export Regulatory Duty on the export of Molasses increased from 10% to 15%	Negative
IT and Telecom	Duty free import of IT related equipment equivalent to 1% value of their export proceeds Continuation of concessionary fixed tax rate of 0.25% for IT & ITeS exports for Tax years 2024, 2025 and 2026 Minimum wage increased to PkR 30,000/month Grant of exemption of sales tax on import of IT equipment by exporters of IT and ITeS registered with Pakistan Software Export Board	Positive
Glass	Increase / levy of regulatory duty on import of articles of glass to protect the local industry	Positive
Pharma	Included one more API and 03 drugs in the existing duty free regime	Positive
Textile	Removal of 5% Regulatory duty on Synthetic Filament Yarn of Polyester not manufactured locally Imposition of additional tax up-to 50% on income profit and gains on account of extraordinary gains due to exogenous factors Enhancement in ST from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products	Neutral to Negative
REITs	Extension of exemption for one-year granted to profits/gains on sale of immovable property or share of SPV to REIT scheme	Positive

IT and Telecommunication - Positives

A clear winner

KEY MEASURES

- Duty free import of IT related equipment equivalent to 1% value of their export proceeds (maximum limit USD 50k)
- Exemption of ST on import of IT equipment registered with Pakistan Software Export Board
- Reduction of tax from 16% to 15% on IT based system development consultants
- Continuation of concessionary fixed tax rate of 0.25% for IT & ITeS exports for Tax years 2024, 2025 and 2026
- Reduction in ST for IT Services from 15% to 5%
- Concessionary tax rate of 20% on banks income from additional advances from IT & ITeS sector instead of 39%
- Decrease in minimum turnover tax by 0.25% to 1.0%
- Minimum wage increased to PkR 30,000/month

OUR ASSESSMENT

More than 30% of the services exports originate from ICT sector. Consequently, the govt has announced various incentives including duty free import and reduction in ST to increase IT exports.

Top Picks: SYS and TRG are our top picks in the sector. For SYS, NDC Tech business has a massive opportunity in gaining additional business in the banking and fintech space in Saudi Arabia and the Gulf Region Temenos. TRG continues to trade at a significant discount to the value of its holding.

Commercial Banks – Negative

New taxation measures to dent the profits

KEY MEASURES

- Concessionary tax rate of 20% on income from additional advances from low cost housing, agriculture, and SMEs including IT & ITeS sector instead of 39%
- Removal of technical mistake in banking sector super tax regime by substituting tax year 2022 with tax year 2023
- Imposition of additional tax up-to 50% on income profit and gains on account of extraordinary gains due to exogenous factors
- Imposition of 10% super tax for profits above PkR 500mn
- Re-imposition of 0.6% advance adjustable withholding tax on non-ATL persons on cash withdrawal

OUR ASSESSMENT

Banking profitability has benefited from margin expansion amidst higher interest rates. The FY24 Budget rationalizes these gains through imposition of Super Tax that would reduce the annual earnings by ~15%. Moreover, additional tax up-to 50% on gains amidst exogenous factors would also keep the exchange gains in check.

On a positive side, concessionary tax rate of 20% to promote lending to low cost housing, agri and SMEs including IT & ITeS sectors. However, we think banks would remain reluctant to lend to these sectors given higher NPL risk formation.

Top Picks: MEBL and MCB are our top picks because of strongest asset quality and highest CASA in the industry, respectively. Our target prices are PkR 167/sh and PkR 155/sh, respectively.

Autos - Negative

Import restrictions to continue

KEY MEASURES

- Concessionary Custom Duty of 1% imposed on Commercial Vehicles only. However, the concession is only offered if the local companies plan to manufacture or assemble the vehicle locally.
- Second hand CBU import duties were capped for vehicles above 1800cc but now the cap is removed and the benchmark is moved to vehicles above 1300cc
- The 4% Custom Duty on the import of parts of HEV and 3% Custom Duty on Plug-in Hybrid Electric Vehicle (PHEV) are unchanged; there is no concession or exemption in this regard.

OUR ASSESSMENT

In FY23, Auto Industry was facing serious challenges due to import restrictions and currency devaluation. The deteriorating foreign reserves led to import restrictions on CKDs and CBUs, resulting in temporary closure of manufacturing plants. While the currency devaluation led to a sharp rise in car prices resulting in a drop of affordability. The budget has not proposed material changes to affect the sector's performance thus we expect the volumes to remain as low as 50% of the capacity, during FY24

Top Picks: INDU is our top pick because of its high cash balance. The company posted a gross profit of merely PKR 197mn in 9MFY23 while an other income of PKR 11.6bn during the same period.

Construction – Neutral to Positive

Limited fiscal space to restrict spending

KEY MEASURES

- Allocation of PkR 950bn under Federal PSDP coupled with PkR 190bn for net lending taking the Development Budget outlay to PkR 1,150bn
- Resumption of activity of CPEC based projects, SEZs and construction of Mohmand Dam (PkR 10.5bn allocated)
- 10% reduction in tax liability or PkR 5mn whichever is lower for a builder and 10% reduction or PkR 1mn whichever is lower for an individual for own construction of house for 3yrs
- Extension of exemption for one-year granted to profits/gains on sale of immovable property or share of SPV to REIT scheme

OUR ASSESSMENT

Key policy measures announced in the Budget FY24 are overall positive for the sector. Notably, funds earmarked for federal PSDP represent a growth of 33% from the revised estimates for FY23. However, limited fiscal space because of higher tax collection target and increased mark up payments, may possibly restrict the development spending for the construction industry..

Imposition of super tax would reduce the sector's annual earnings by ~12%.

Top Picks: LUCK and FCCL are our top picks because of diversified business mix, upcoming expansions and efficient fuel mix. Our target prices are PkR 700/sh and PkR 24/sh, respectively.

Agriculture and Fertilizer - Positive

Incentives introduced to promote sector

KEY MEASURES

- Exemption of customs duties on import of seeds for sowing to promote growth in agricultural sector
- 5yr tax holiday for agro based industries being SMEs set up on or after 1st July, 2023 from tax year 2024 to tax year 2028
- Encouraging export of commodities through online platform by providing 1% concessionary final tax rate to indirect exporters
- Grant of exemption of sales tax on plant saplings, combine harvesters, dryer for agricultural products, no-till-direct seeder and planters

OUR ASSESSMENT

The government has proposed key incentives and exemptions for the Agriculture sector being essential in nature. This would indirectly have a positive impact on Food and Fertilizer sectors as these measures would improve the production and yield for various crops.

Imposition of super tax would reduce the sector's annual earnings by ~12%.

Top Picks: Within Fertilizer sector, ENGTO and FFC are our top picks because of diversified business mix, strong dividend yield and stable demand. Our target prices are PkR 350/sh and PkR 135/sh, respectively.

Textile – Neutral to Negative

Incentives withdrawn as per IMF's terms

KEY MEASURES

- Removal of 5% Regulatory duty on Synthetic Filament Yarn of Polyester not manufactured locally
- Discontinuation of power subsidy for five zero rated sectors
- Imposition of additional tax up-to 50% on income profit and gains on account of extraordinary gains due to exogenous factors
- Enhancement in ST from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products
- Decrease in minimum turnover tax by 0.25% to 1.0%

OUR ASSESSMENT

Budget FY24 shows that the government has taken tough decisions to maintain fiscal discipline. Notably, power subsidy has been discontinued this year that was granted to the sector each year, in-line with the IMF's conditions. This would deteriorate the competitiveness of local players in international market. Additionally, increase in ST by POS retailers (including IMAGE and GATM) may lead to decrease in demand amidst deteriorating purchasing power.

Some relief has come from decrease in turnover tax by 0.25% and withdrawal of 5% RD on synthetic filament yarn.

Top Picks: ILP is are our top pick in the sector because of strong brand value and new expansions ahead. Our target price is PkR 77/sh.

Oil and E&P - Neutral

CD withdrawal to reduce CAPEX

KEY MEASURES

- Exemption of Customs duties on raw materials/ inputs for Mining machinery
- Imposition of additional tax up-to 50% on income profit and gains on account of extraordinary gains due to exogenous factors
- Decrease in minimum turnover tax by 0.25% to 1.0%

OUR ASSESSMENT

Withdrawal in custom duties on raw material for mining would reduce the investment size for E&P sector. This would bode positive for OGDC and PPL.

OMC sector recognizes inventory gains/losses depending on oil price movement. In an event of high exchange gains, the tax liability would increase significantly for the sector.

Top Picks: MARI is our top pick in the E&P sector because of high growth trajectory and limited sector specific risk. Our target price is PkR 2,658/sh.

Miscellaneous - Neutral

Balance between relief and revenues

KEY MEASURES

- **Glass:** Increase / levy of regulatory duty on import of articles of glass to protect the local industry
- **Pharma:** Included one more API and 03 drugs in the existing duty free regime
- **Food:** Export Regulatory Duty on the export of Molasses increased from 10% to 15%
- **Food:** Withdrawal of exemption of sales tax on edible products sold in bulk under brand names or trademarks
- **Food:** Exemption of Customs duties on raw materials/ inputs for Rice mill machinery

OUR ASSESSMENT

The govt has undertaken revenue measures in the form of increasing RD on export of Molasses. This is expected to hurt the profits of sugar companies. Moreover, the govt has proposed to remove exemption of ST on edible products which would impact Food sector including UPFL, NESTLE, FFL, NATF and SHEZ.

Several incentives have also been introduced comprising duty free regime for few APIs boding well for Pharma sector. Moreover, exemption of CD for rice machinery is expected to benefit MATCO foods.

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