

Leaves more to the imagination

FY21 FEDERAL BUDGET COMMENTARY

13th June 2020





To say the latest budget has been unveiled in a unique backdrop would be a sugar-coated understatement. After wreaking havoc in the developed world, the COVID-19 pandemic has now turned its gaze towards the **more vulnerable developing nations** where Pakistan is swiftly climbing charts in terms of number of new cases and deaths. Just last evening the **US Federal Reserve shared a morbid economic outlook** that naturally pushed global markets in the red. *“We’re not even thinking about thinking about raising rates”* said the Fed Chairman as he highlighted that *“many millions of people”* would not be able to quickly return to work. Expressing his concerns on the sluggish retraction of unemployment rates and impact on the overall economy, he further shared that he would keep interest rates close to zero **at least** until the end of 2022. Currently, the US Fed is buying ~US\$4bn worth of treasuries a day. This makes US\$20bn a week which, to give perspective, is about the same as Pakistan’s annual remittances. Domestically, Pakistan’s agri-based economy faces another threat: the **largest crop eating locust swarms** seen in the last 25 years! Authorities have gone as far as claiming that this could be a bigger threat to the country than COVID-19. Emergency funds kept aside for the pandemic are already being diverted towards the infestation emergency. Efforts are underway to control the attack before it causes serious damage to agricultural exports or, in a worst-case scenario, results in a nation-wide food shortage. While on the topic of shortages, the **latest dearth of POL products** in the country is yet another developing story now on the **government’s**

Consolidated Fiscal Projections

(% age)	Forecast				
	FY20 B	FY20 R	FY21 B	FY22	FY23
Real GDP Growth	2.4	-0.4	2.1	4.0	4.5
Inflation	11 - 13	11 - 12	6.5	6.2	6.0
as % of GDP					
Total Revenue	16.7	14.3	15.9	16.6	17.3
Tax Revenue	14.4	11.0	13.2	13.9	14.5
FBR Tax Revenue	12.6	9.4	10.9	11.8	12.6
Non Tax Revenue	2.3	3.3	2.8	2.8	2.7
Total Expenditure	23.8	23.5	22.9	22.3	22.1
Current	20.2	20.9	20.0	19.4	18.8
Development	3.6	2.6	2.9	2.9	3.3
Fiscal Balance	-7.1	-9.1	-7.0	-5.6	-4.8
Total Public Debt (Net)	73.0	82.5	83.1	80.8	77.8
GDP at market prices (Rs bn)	44,003	41,727	45,567	50,443	55,991

Source: Ministry of Finance (MoF)



investigative radar much like the recent sugar and wheat crises. And let us not forget the government's stance on the power sector. Side by side, the **accountability drive of the government** has continued seemingly unaffected by the above developments.

As far as the lockdowns are concerned, Pakistan had no choice but to employ a dangerous strategy which seems to have complicated the annual budgeting exercise, leaving some head-scratching anomalies. For instance, increasing the FBR revenue target by ~Rs1,000bn to an 'aspirational' ~Rs4.9tn without imposing any additional taxes and the estimated 2.1% GDP growth rate give the impression that the pandemic is nearing its end, if it hasn't already passed. However, the country's steep COVID-19 infection curve reveals a very different reality, as mentioned above. **Premature easing of the lockdowns has left a thicker mist of uncertainty than ever before. And this limited visibility stands to question the basis of the budget.**

From where we currently stand it seems that a **higher FY21 fiscal deficit** is writing on the wall, landing at least around this year's provisional deficit of 9.1% (which itself, given historical trends, could be revised upwards), if not higher. In such circumstances it is natural to assume that government debt levels will rise. Furthermore, given that **3/4th of the deficit financing is planned to be sourced domestically** – not to mention the sheer size of the financing required – **bond yields should remain sticky in the coming year.**

Fiscal Summary

(Rs bn)	FY20 B	FY20 R	FY21 B
Tax Revenue	5,822	4,208	5,464
Non Tax Revenue	894	1,296	1,109
Gross Revenue Receipts	6,717	5,504	6,573
Provincial Share	3,255	2,402	2,874
Net Revenue Receipts	3,462	3,102	3,700
Current Expenditure	6,197	6,373	6,345
PSDP –Federal	701	564	650
Other Dev. Expenditure	86	66	70
Federal Deficit	(3,574)	(3,716)	(3,437)
Provincial Surplus	423	-81	242
Consolidated Deficit	(3,151)	(3,797)	(3,195)

Source: MoF



Apart from some tariff rationalisation to support exports, the broader budget honestly seems to more or less echo the last one. It wouldn't be entirely wrong to say that it raises more questions than it answers. Some notable points are highlighted below:

- There has been an **increase in FBR revenues across all categories**, direct & indirect.
- However, the **Petroleum Levy** of Rs450bn (under Other Revenues) seems comfortably achievable even if volumetric sales of POL products remain constant in the upcoming year.
- There remains a **heavy reliance on SBP profits**, which contribute to over half of non-tax revenues.
- Credit should be given where due: the modest Rs100bn expected from privatisation proceeds and **the substantial fall in subsidies** seem closer to reality than some other aspects of the report.
- Any shortfall in revenue will hit **PSDP**, as it always has. Despite ~Rs137bn worth of under-spending in the outgoing year, the federal PSDP has still been set 15% higher than last year's spending.
- Similarly, after a shortfall of ~Rs500bn (~Rs422bn FY20 budgeted surplus vs ~Rs80bn FY20 revised deficit) in **provincial surplus** in FY20, the government has budgeted for a more modest provincial surplus for the forthcoming year.



- An amount of Rs1,413bn (~US\$8.6bn as per current exchange rate) has been allocated for **foreign loan repayments** while Rs2,631bn has been earmarked for **domestic debt servicing** (11% higher than last year). Note that this is after the 525bps cumulative interest rate cuts. **If interest rates had not been reduced, we would have been looking at additional Rs600bn in interest costs, as per our calculations.**
- It would not be entirely wrong to use the term **non-event** to describe the FY21 Federal Budget, at least on face value. However, perhaps in a more practical sense, some were expecting a more empathetic 'Corona Budget' (CGT cuts, deeper cut in FED on Cements, reduction in Auto sector taxes, zero rating for textiles and the list goes on), particularly considering pre-Budget news flows. **Given the high expectations, the resultant disappointment might take its toll on the market after Friday's bearish performance which was more on account of international markets.**
- **Post budget, the market's focus might revert to COVID19.** Another item on the radar might be the trend in global markets, which in recent days had already bit more than they could chew. In this backdrop, **volatility in global markets** might become norm in the coming days. **Focus will also be on the IMF program**, with the upcoming review expected to conclude in the coming weeks. Moreover, if the COVID-19 situation continues, what more would the government be able to do in terms of stimulus, given its limited resources? **Considering so, we wouldn't be shocked to see a minibudget later in the year.**



Consolidated Fiscal Analysis

Revenues			
(Rs bn)	FY20 B	FY20 R	FY21 B
FBR Taxes	5,555	3,908	4,963
Direct Taxes	2,082	1,623	2,043
Income Taxes	2,073	1,618	2,037
Others	9	5	6
Indirect Taxes	3,473	2,285	2,920
Custom Duties	1,001	546	640
Sales Tax	2,108	1,427	1,919
Federal Excise Duty	365	312	361
Other Taxes	267	300	501
GIDC	30	11	15
GDS	10	10	10
Petroleum Levy	216	260	450
Others	11	19	26
Total Tax Revenue	5,822	4,208	5,464

Expenses			
(Rs bn)	FY20 B	FY20 R	FY21 B
Markup Payment	2,891	2,709	2,946
Domestic Debt	2,532	2,374	2,631
Foreign Debt	360	335	315
Pension	421	463	470
Defense	1,153	1,227	1,289
Grants / Transfers	835	1,177	905
Subsidies	272	350	209
Civil Government	431	446	476
Total Current Expenditure	6,197	6,373	6,345

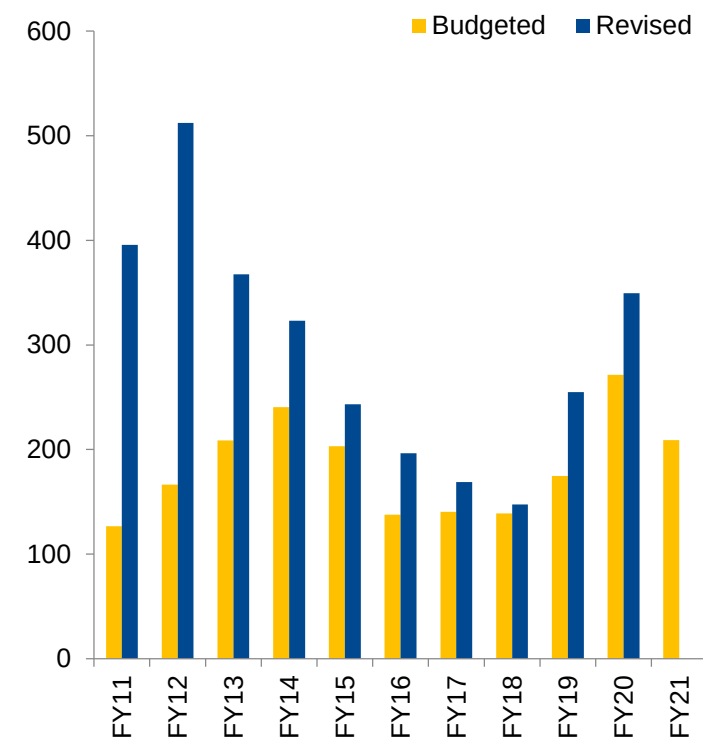
Source: MoF



Subsidies

Subsidies (Rs bn)	Revised									Budgeted
	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
WAPDA / PEPCO	419.0	265.0	245.1	185.0	117.8	102.6	81.5	189.9	201.0	124.0
KEL	45.2	84.3	64.3	36.0	53.4	15.4	33.5	40.5	59.5	25.5
USC	2.0	6.0	6.0	10.3	5.0	7.0	4.0	6.0	43.5	3.0
PASSCO	18.7	6.2	6.5	10.9	10.0	18.6	17.5	18.3	15.5	7.0
Food & Research	0.0	0.0	0.0	0.0	10.0	25.1	10.8	0.0	0.0	0.0
Others	27.3	6.0	1.1	1.1	0.3	0.3	0.3	0.3	30.0	49.5
Total Subsidies	512.3	367.5	323.0	243.2	196.5	169.0	147.6	255.0	349.5	209.0

Subsidies: Budgeted vs Revised (Rs bn)



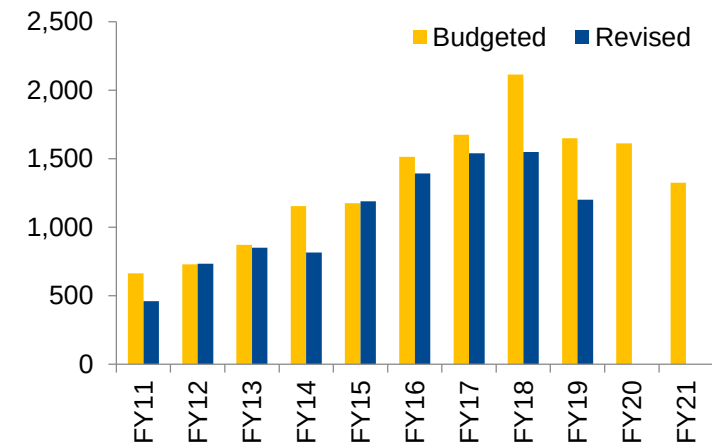
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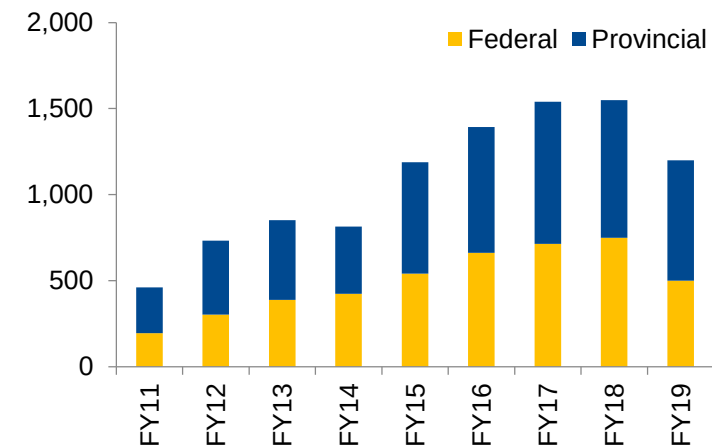
Public Sector Development Programme (PSDP)

PSDP (Rs bn)	Budget	Budget
	FY20	FY21
Federal Ministries	348	419
Corporations	198	158
Pak SDGs & Community Development Programme	24	-
Clean Green Pakistan Movement / Tourism	2	-
ERRA	5	3
COVID Responsive and Other Natural Calamities Programme	-	70
FATA 10 Year Plan	48	-
Relief and Rehabilitation of IDPs	17	-
Security Enhancement	53	-
Prime Minister's Initiative	5	-
GIDC	1	-
Federal PSDP	701	650
Provincial PSDP	912	674
Total PSDP	1,613	1,324

PSDP: Budgeted vs Revised (Rs bn)

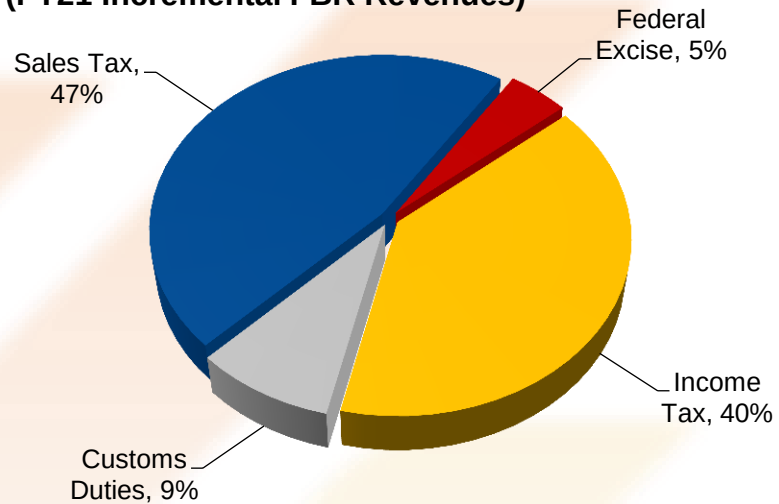


PSDP: Historical Allocation (Rs bn)

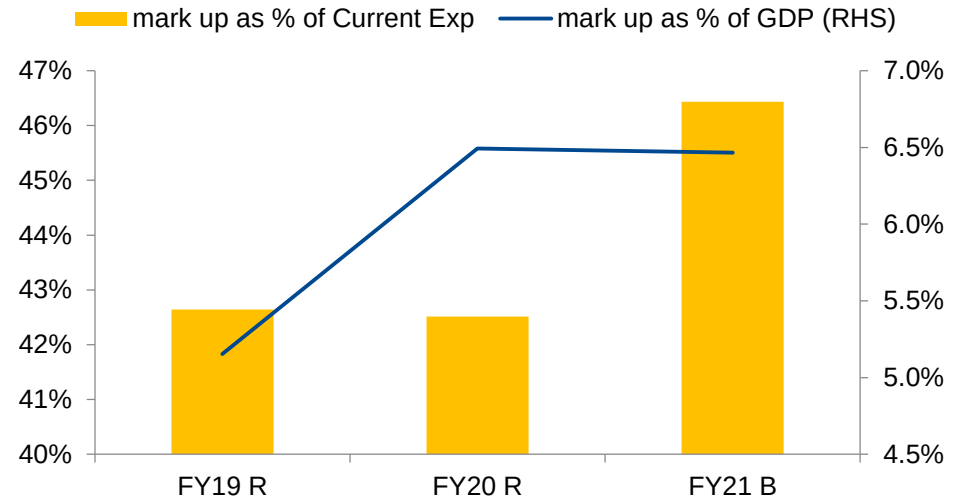




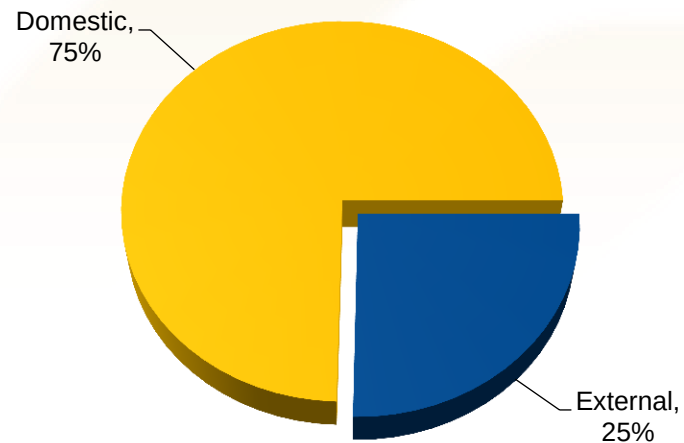
Rs1,055bn breakdown (FY21 Incremental FBR Revenues)



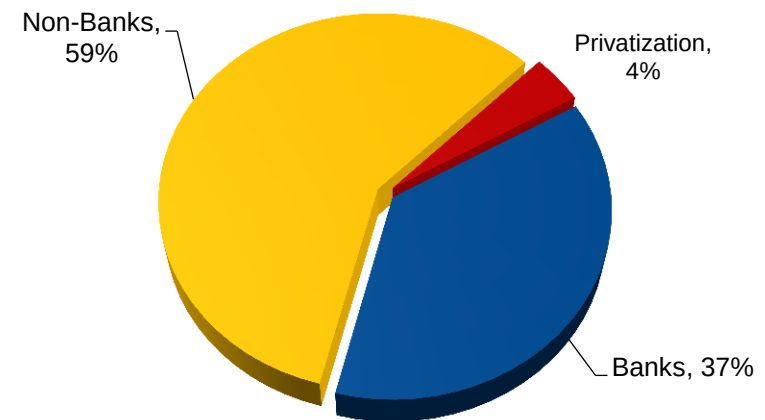
Interest payments



Fiscal deficit financing mix



Domestic funding sources



SECTORS



Sector	Budgetary Measure	Impact	Remarks
Banks	Treasury Single Account in final stages	Neutral	TSA would impact National Bank of Pakistan (NBP) if initially applied only on Federal Govt. deposits
	Super Tax on Banks extended to FY21	Neutral	Super Tax is already incorporated in our base case for years beyond FY20
	WHT exempted on Cash Withdrawal from Foreign Remittances	Neutral	Will encourage more remittances and positively impact sector's Fee Income; limited impact on the sector's bottom-line
	Ijara Sukuk Bonds budgeted at Rs450bn (almost 2x above FY20 revised numbers)	Positive	Will provide fresh investment avenues for Islamic banks and banking windows (limited avenues currently)
Steel	RD reduced from 12.5% to 6% and from 17.5% to 11%	Neutral	Non-event for ISL and ASL since they are paying concessionary duty at 5% as per SRO 565 (i) 2006. RD doesn't apply to them.
		Positive	Positive for INIL and CSAP as it will decrease their input cost
	Removal of WHT on steel melters	Neutral	Minimal impact on cash flows of steel melters
	PSDP at Rs650bn (+15% YoY)	Neutral	Higher PSDP is strongly correlated to steel demand
	ACD of 2% on steel scrap	Neutral	In our view, it will remain unchanged but await further clarity



Sector	Budgetary Measure	Impact	Remarks
Cements	FED reduced from Rs2/kg to Rs1.75/kg (~Rs14.5/bag)	Positive	Approximately 200bps incremental impact on sector GMs
	PSDP at Rs650bn (+15% YoY)	Neutral	Higher PSDP is strongly correlated to cement demand
	ACD of 2% on coal	Neutral	In our view, it will remain unchanged but await further clarity
Auto Assemblers & Auto Parts	7.5% FED on local double-cabin pickup vehicles	Negative	Negative for INDU which assembles double cabin Hilux and Revo and GHNI's DMAX
	25% FED on imported double-cabin pickup vehicles	Neutral	Limited import within this category
	Reduction in CD/ACD on Rubber	Positive	Positive for GTYR and SRVI
	Removal of advance tax on engine capacity <200 cc	Neutral	This will only slightly impact cash flows of ATlh and SAZEW
	Reduction in RD on HRC	Positive	This will reduce raw material cost for tractor manufacturers
	Agricultural Package	Positive	This will increase demand for tractors
Fertilizers	Agricultural Package	Positive	Subsidy on Fertilizer prices to help improve offtakes
Pharmas	Corona Relief Package of Rs70bn	Positive	Demand of Pharma products will be boosted. Moreover, textile companies producing masks/PPE will also benefit
	Reduction in duties on raw materials on APIs	Positive	This will reduce raw material costs of pharmaceutical companies



Documentation

- Real-time access to information and databases (NADRA, FIA, development authorities, Discos and gas transmission companies, etc.) to be provided to FBR
- No deduction shall be allowed in computing the income of a person under the head “Income from Business” for any expenditure attributable to sales made to unregistered persons

Stock Market

- No change in CGT in FY21 from last year

Food and Consumer

- Reduction in CD and removal of ACD on import of raw material by food packaging industry
- Extension of exemption from 2% ACD on edible oils and oil import seeds under PM’s COVID19 Relief Package
- Reduction in ACD on Palm Stearin used in soap manufacturing industry

Other relief measures

- The value addition tax shall not be charged on raw materials and intermediary goods imported by manufacturers for own manufacturing, i.e. not for resale/trading purposes.
- Exemption of advance tax on dealers, commission agents and arhatis (middleman)



- Exemption of advance tax on insurance premium
- Exemption of advance tax on tobacco
- Minimum limit for obtaining CNIC of purchaser by retailers to be increased to Rs100k from Rs50k
- Relief to organized retail sector that is integrated with FBR through POS system via reduction in sales tax rate to 12% from 14%.
- Uniform Tax Rate for Profit on Debt at 15%, (10% for profit <Rs500,000/annum)

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