ANNUAL FEDERAL BUDGET 2022-23

Tough measures are the need of the hour

Saturday, June 11, 2022

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REP- 005

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EXECUTIVE SUMMARY

Time to pull the plug

Saturday, June 11, 2022

The newly formed coalition government presented its first budget for the upcoming fiscal year yesterday where the prime focus was moving away from the above expected growth said to be achieved in FY22 and more towards economic stabilization and fiscal consolidation. Given how swiftly leading macroeconomic indicators worsened for the country particularly after the turn of the year, it was high time to pull the plug. The incumbent government had repeatedly stressed upon tightening the screws ever since coming into power and that was set in stone when retail fuel prices were revised up by ~40% in a matter of days while electricity base tariffs were hiked by ~47% (to come into effect from 1st July). Similarly, there are increasing chances that a similar adjustment will be seen in gas prices over the next few weeks. Thus, the measures proposed in the budget did not come as a surprise. The idea was clear; to get the IMF on board by reducing the fiscal deficit, targeting the affluent/undocumented and protecting the low-income masses. Though, the measures taken along with hike in energy tariffs/petroleum prices will be inflationary, we can expect the dust to slowly settle down as the year phases out. From the equity market standpoint, we see the budget as a negative development when it comes to sector profitability as all major sectors will be impacted however, the reforms proposed in the real estate sector and roll-back of taxation benefits available to individuals on investments in mutual funds can potentially result in greater flows into the KSE-100 index and we can expect the UIN's, which have long been stuck at around ~250k, to inch up. We expect the budget and recent fiscal plugs to be welcomed by the IMF and the resumption of the program will likely bring back flows and enthusiasm into the local bourse. We remain bullish on Banks, E&P's, Fertilizers, Textiles and IT.

Revenue targets jacked up to PKR 9.0Trn: After the monetary tightening drive that the SBP had embarked upon roughly 6 months ago, it was time to bring the fiscal tools into the act. Though, fiscal tightening had already started when energy subsidies were rolled back, the budget announcement only reaffirmed that fiscal consolidation is well and truly at play. Putting it into figures, the government aims to collect PKR 9.0Trn over the next fiscal year implying a growth of 13.8% YoY with FBR collection projected to be PKR 7.0Trn while PKR 2.0Trn are to be contributed via non-tax revenue. We would like to flag that these revenue growth targets will move in line with GDP growth and any deviation from the 5% growth target will make it an uphill task to collect the projected numbers. Furthermore, similar to last year, non-tax revenue estimates rely heavily on the collection of petroleum levy (PDL) and Gas infrastructure development CESS (GIDC) which did not turn out to be the case on the back of multi-year high oil prices and will continue to pose a challenge for the government this year as well.

GDP growth to *'slow'* down to 5% in FY23: Following a robust FY22, where growth exceeded expectations, the opportunity cost was ominously too big to bear for the government on a sustainable basis. The above expected growth brought with it yawning twin deficits, weakened Pak Rupee, dwindling forex reserves and double digit inflation. Going into FY23, the government expects the growth momentum to slightly ease off as domestic demand is curbed but bets on improved management of the twin deficits and increased revenue streams to keep it sustainable in the near term.

Table 1: Budget Summary

PKR Bn	FY22B	FY23B	% Chg.
Gross Revenue	**7,909**	**9,004**	**13.8%**
Tax Revenue	5,829	7,004	20.2%
Non-Tax Revenue	2,080	2,000	-3.8%
Transfer to Provinces	**-3,412**	**-4,100**	**20.2%**
Net Revenue	**4,497**	**4,904**	**9.1%**
Total Expenditure	**8,487**	**9,502**	**12.0%**
Current Expenditure	7,523	8,694	15.6%
Dev. Exp. & Net Lending	964	808	-16.2%
Fiscal Balance	**-3,990**	**-4,598**	**15.2%**
Provincial Surplus	570	800	40.4%
Cons. Fiscal Balance	**-3,420**	**-3,798**	**11.1%**
% of GDP	-6.3%	-4.9%	-22.2%
Primary Balance	**-360**	**152**	**142.2%**
% of GDP	-0.7%	0.2%	-128.6%
GDP (PKR Bn)	**53,867**	**78,197**	**45.2%**

Source: Budget in Brief 2022-23

Table 2: GoP's Macro Forecast

Description	FY22B	FY23B
GDP (PKR Bn)	53,867	78,197
GDP Growth (% YoY)	6.0%	5.0%
Inflation (% YoY)	8.2%	11.5%
Federal Rev. (% GDP)	14.7%	11.5%
Federal Exp. (% GDP)	15.8%	12.2%
Fiscal Bal. (% of GDP)	-6.3%	-4.9%
Primary Bal.(% GDP)	-0.7%	0.2%

Source: Annual Budget Statement 2022-23

Market vantage point: From the equity market perspective, we expect the budget announcement to be negative in terms of profitability as almost all major sectors make profits in excess of PKR 300Mn. Thus, the incremental tax burden of 2% on taxable income alongside the additional 6% tax charge on the banking sector barring the supplementary charge on income from fixed income investments will dampen sentiment. That said, we can expect higher participation in the local bourse following the roll-back of tax incentives on investment in mutual funds by private individuals thus advocating greater direct investment and the incidence of taxation on rental income from immovable properties which will likely slow down flows into real estate and reduce construction activity, in our view. That said, we maintain our liking for local equities in the wake of cheap market multiples, strong earnings growth and robust dividend yields on offer. Our preferential picks remain Banks (HBL, UBL, MEBL, BAFL), E&P's (MARI), Fertilizers (EFERT, FFC, ENGRO), Textiles (ILP, GATM) and Technology (SYS).

BUDGET AT A GLANCE

Table 3: FY23 Budget at a Glance

PKR Bn	FY20	FY21	FY22B	FY22R	% Chg.	FY23B	% YoY
Fiscal Revenue	**5,782**	**6,395**	**7,909**	**7,315**	**-7.51%**	**9,004**	**23.09%**
Tax Revenue	3,998	4,691	5,829	6,000	2.93%	7,004	16.73%
Non-Tax Revenue	1,784	1,704	2,080	1,315	-36.77%	2,000	52.07%
Fiscal Expenditure	**7,248**	**7,341**	**8,487**	**9,066**	**6.82%**	**9,502**	**4.81%**
Current Expenditure	6,093	6,561	7,523	8,516	13.20%	8,694	2.09%
Debt Servicing	2,620	2,851	3,060	3,144	2.74%	3,950	25.65%
Defense Expenditures	1,213	1,295	1,370	1,480	8.05%	1,523	2.89%
Other Current Expenditures	2,260	2,415	3,094	3,892	25.80%	3,221	-17.25%
Development Expenditure & Net Lend.	1,155	780	964	550	-42.95%	808	46.91%
Provincial Transfers	**2,504**	**2,704**	**3,412**	**3,512**	**2.93%**	**4,100**	**16.74%**
Net Revenue Receipts	**3,278**	**3,691**	**4,497**	**3,803**	**-15.43%**	**4,904**	**28.94%**
Overall Fiscal Balance	**(3,970)**	**(3,650)**	**(3,990)**	**(4,263)**	**6.84%**	**(4,598)**	**7.86%**
Provincial Surplus	594	242	570	500	-12.28%	800	60.00%
Cons. Fiscal Balance	**(3,376)**	**(3,408)**	**(3,420)**	**(4,763)**	**39.27%**	**(3,798)**	**-20.26%**
Total Fiscal Financing	**(3,970)**	**(3,650)**	**(3,990)**	**(5,601)**	**40.37%**	**(4,598)**	**-17.90%**
External Fiscal Financing	896	1,323	1,246	1,383	10.98%	1,667	20.56%
Domestic Fiscal Financing	3,074	2,327	2,492	4,218	69.26%	2,835	-32.79%
Privatization Proceeds	-	-	252	-	-1	96	N/A
Primary Fiscal Balance	**(756)**	**(557)**	**(360)**	**(1,607)**	**346.33%**	**152**	**-109.46%**
GDP	**41,556**	**47,709**	**53,867**	**66,950**	**24.29%**	**78,197**	**16.80%**

Source: Budget in Brief 2022-23, MoF, BMA Research

BUDGET IMPACT ON MARKET & LISTED SECTORS

Sector	Key Changes	Impact	Importance	Our View
Market	Companies having net annual income in excess of PKR 300Mn are now subject to pay an additional 2% tax for poverty alleviation	Negative	High	Will lead to a decline in corporate profitability.
	Advance tax on purchase of property to increase from 1% to 2% for filers (5% for non-filers)	Positive	Moderate	This will divert attention from the real estate sector to more productive sectors.
	15% CGT applicable on the sale of immovable property if holding period is less than 12 months which will decline by 2.5% with each passing year before becoming 0% in Year 6	Positive	Moderate	Will result in increased documentation of the real estate sector and might direct greater flow of investment into the financial markets.
	Allowance for initial depreciation has been increased from 50% to 100%	Positive	Moderate	This will encourage capital investments and improve profitability.
	Imposition of regulatory duties on imports to protect local industries	Positive	Moderate	Will promote import substitution thus reducing import bill and supporting infant industries.
Banks	Effective tax rate increased to 45% from 39%, including super tax. Furthermore, 2% poverty alleviation tax has also been imposed	Negative	High	This move will sizably increase tax charge for industry players and reduce profitability and thus pay-outs.
	Tax on government securities; if ADR declines to <40%, applicable tax rate to increase from 44% to 55%. If ADR is in range of 40-50%, tax rate to rise from 41.5% to 49%. If ADR is above 50%, tax rate will increase from 39% to 47%	Negative	High	This move will sizably increase tax charge for industry players and reduce profitability particularly for banks with ADR of less than 40%.
	1/2% advance WHT rate to be charged on foreign payment made via debit, credit and prepaid cards for filers and non-filers respectively	Negative	Low	Will discourage foreign payments and reduce fee income.

BUDGET IMPACT ON LISTED SECTORS & ECONOMY

Sector	Key Changes	Impact	Importance	Our View
Power	Subsidy allocation of PKR 180Bn for IPPs and PKR 225Bn have been set aside to settle DISCOs tariff differential	Positive	High	Will improve cashflow position of IPPs and result in increased recovery rate by the govt.
	Sales tax exemptions on the import of machinery, equipment and spares meant for initial installation, BMR or expansion of projects for power generation including hydel, oil, gas, coal, nuclear and renewable energy sources	Positive	High	This will incentivize industry players to undertake new projects and eventually result in additional generation capacity for the country.
E&Ps/OMCs	PKR 750Bn targeted as Petroleum Development Levy	Negative	Moderate	This can result in further increases in fuel prices, which can cause a decline in volumetric sales.
Cement & Steel	Reduction in PSDP allocation to PKR 727Bn	Negative	Moderate	We opine that the said measure would result in reduced construction activity thus leading to lower demand for cements & steel products
	Abolishment of Sales Tax on locally produced coal and import of construction machinery & equipment for undertaking new projects	Positive	Moderate	This will incentivize industry players to undertake new projects while reducing initial investment outlay.
	15% CGT applicable on the sale of immovable property if holding period is less than 12 months which will decline by 2.5% with each passing year before becoming 0% in Year 6	Negative	Moderate	This might lead to reduced inflows in the real estate sector, resulting in a decline in demand for cement and steel products.
	PKR 100Bn to be allocated to Water Division for construction of Dams	Positive	Moderate	This will result in increased demand for cement and steel products.
	Subsidies for Naya Pakistan Housing Scheme and markup on Naya Pakistan housing loans have been reduced to PKR 1Bn from PKR 33Bn	Negative	High	This will result in lower attraction towards new housing projects and thus, have a knock-on impact on demand for cement & steel products.
	Reduced rate of 3% on provision of REIT management services rendered by NCCPL	Positive	Moderate	The said development will result in greater regulated investment in the sector as more people will be able to invest through REITs.
Fertilizer	PKR 21Bn earmarked for agriculture and food security	Positive	Moderate	This measure will provide much needed price stability in food prices and will ensure timely procurement of essential food items.
	Sales tax abolished on the procurement of seeds, agricultural equipment, tractors, wheat, flour, canola and rice	Positive	Moderate	Will reduce input cost for farmers and increase income.

BUDGET IMPACT ON LISTED SECTORS & ECONOMY

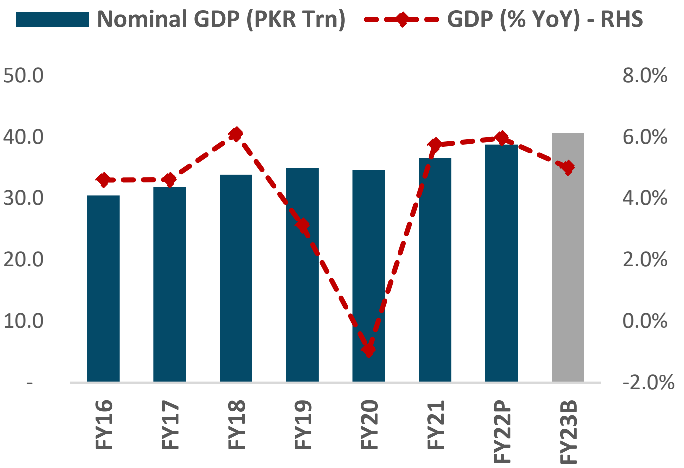
Sector	Key Changes	Impact	Importance	Our View
	Sales tax on fertilizer increased from 2% to 10%	Neutral	Moderate	Will likely be a pass through item and will eventually result in higher urea prices .
	Sales tax on feed gas and import of phosphoric acid increased from 5% to 10%	Neutral	Moderate	The increase in GST at output stage will be adjusted against refunds from the govt.
	GIDC collection target set at PKR 200Bn	Negative	High	Will likely alleviate liquidity concerns for industry players.
Automobiles	Sales Tax reduced on Tractors from 5% to 0%	Positive	High	Will lower retail prices and ease liquidity concerns for industry players
	Advance tax for non filers increased from 100 to 200%	Negative	Moderate	Will lead to contraction in demand due to higher prices.
	Increase in sales tax on imported EVs from 12.5% to 17%	Positive	Moderate	Local players will remain competitive as they will have greater pricing power.
	Withholding Tax on purchase of vehicles above 1600cc increased	Negative	Moderate	Will lead to contraction in demand due to higher prices.
	Levy of 2% Capital Value Tax on motor vehicles if retail price exceeds PKR 5Mn	Negative	Moderate	Will lead to contraction in demand due to higher prices.
IT	Export proceeds of Computer software/IT services/IT Enabled services by persons registered with Pakistan Software Export Board will be subject to a tax rate of 0.25% of the proceeds	Positive	Moderate	Reduction in rate by 0.75% will result in higher profitability for IT firms.
	The government has set aside PKR 17Bn to support IT exports	Positive	Moderate	This will provide a much needed push for the sector and enhance exports in the future.
Pharma	Customs duty abolished on 30 Active Pharmaceutical Ingredients (APIs)	Positive	High	Profitability of pharma companies will increase due to reduced input costs.
	DLTL worth PKR 40.5Bn to be released immediately	Positive	High	Will ease liquidity constraints for industry players.
	Advance income tax payable at import stage in case of raw materials is proposed to be made 'adjustable'.	Positive	Moderate	Will ease liquidity constraints for industry players.

BUDGET IMPACT ON LISTED SECTORS & ECONOMY

Sector	Key Changes	Impact	Importance	Our View
Textiles	Government has allocated PKR 21Bn to ensure seed quality, improve acreage and expenditure on R&D	Positive	Moderate	Higher cotton production could rationalize cotton prices and lift profit margins.
	Rationalization of Regulatory duty on the import of textile machinery and polyester fiber (man-made)	Positive	Moderate	Will incentivize capital investment in the sector.
	DLTL worth PKR 40.5Bn to be released immediately to ease working capital constraints.	Positive	High	Will ease liquidity constraints for industry players and improve profitability.
Food	Reduction in customs duties on the import of flavoring powders	Positive	Moderate	This will incentivize import substitution and lower production costs.
Others	RD on import of optical fibre cables has been increased from 10% to 20% to encourage local manufacturers.	Positive	Moderate	This will support the local industry by making them more competitive compared to imports.
	10% sales tax levied on mobile phones having value of more than USD 100 in CKD/SKD condition.	Negative	Moderate	Negative for local manufacturers/assemblers of mobile phones as prices will increase.
	Film makers allowed 5 year tax holiday, 10 year tax rebate on export of films and dramas	Positive	Moderate	This will encourage production of local content especially drama serials and films in the media industry.
	Abolishment of sales tax on import of machinery for entertainment industry	Positive	Moderate	This will encourage production of local content especially drama serials and films in the media industry.
	8% withholding tax on producers and distributors abolished.	Positive	Moderate	This will encourage production of local content especially drama serials and films in the media industry.
	Termination of CD and ACD on import of raw materials of paper sizing industry.	Positive	Moderate	This will reduce input costs for the industry and improve profitability.
	Tax collection from tobacco industry to surge to PKR 200Bn from PKR 150Bn	Positive	Moderate	This will result in increased prices and reduced consumption.

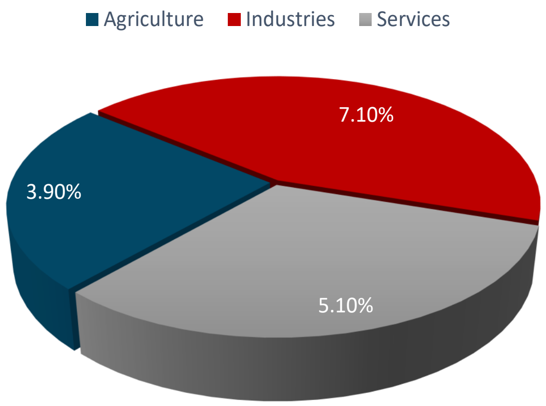
BUDGET FY22 FOCUS CHARTS

Chart 1: GDP growth to moderate to 5% in FY23



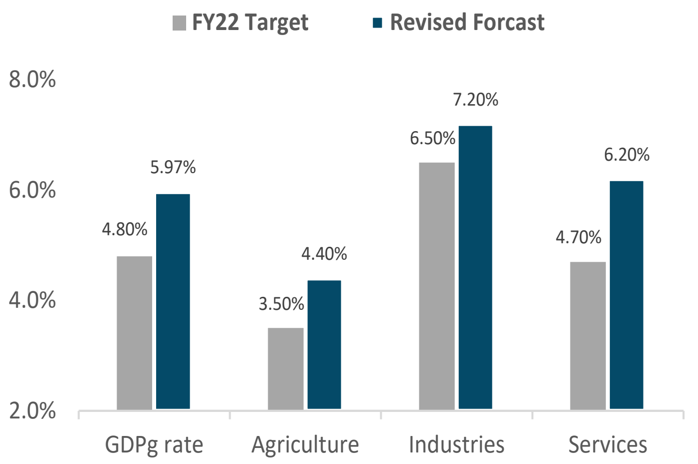
Source: MoF, BMA Research

Chart 2: Growth target for FY23



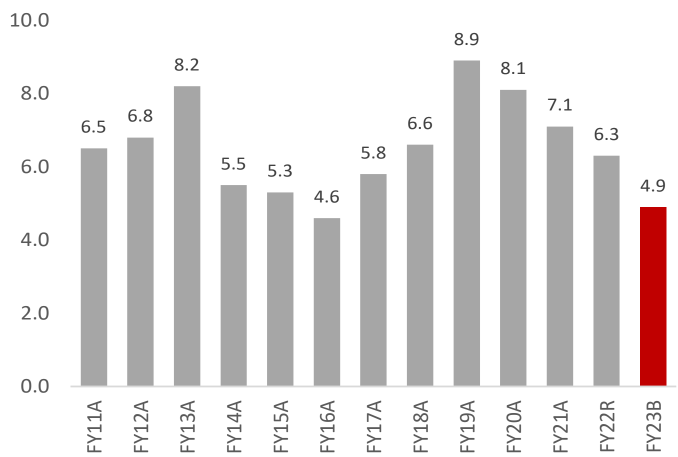
Source: MoF, Economic Survey, BMA Research

Chart 3: Growth in FY22 exceeded expectations



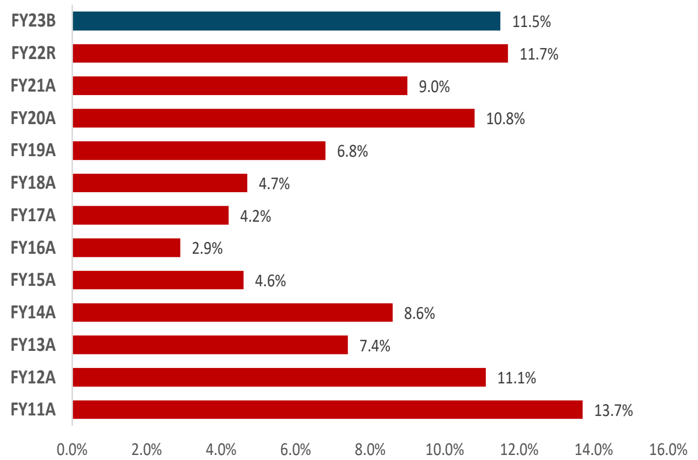
Source: MoF, Economic Survey, BMA Research

Chart 4: Fiscal deficit (% of GDP)



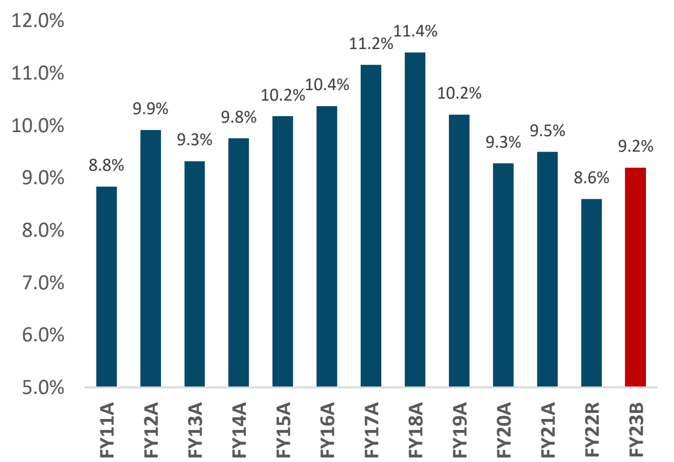
Source: MoF, Budget Brief 2022-23, BMA Research

Chart 5: Govt. inflation projections remain elevated



Source: MoF, BMA Research

Chart 6: Aiming for higher tax collection next year



Source: PBS, BMA Research

Tax revenues to follow the lead of GDP growth

FBR collection target scaled up by 20% to PKR 7.0Trn: The government has earmarked total collection (tax and non-tax) to be slightly over PKR 9.0Trn (↑13.8%) in the upcoming fiscal year. FBR's revenue target is set at PKR 7.0Trn (↑20.2%), of which, the government expects to generate PKR 2,573Bn (↑ 17.9%) through direct taxes while PKR 4,431Bn (↑ 21.5%) are expected to come from indirect means. Surge in direct taxes is expected to be driven by income tax (PKR 2.6Trn; ↑17.8%) while indirect taxes are forecasted to stem from higher custom duty collection (PKR 953Bn, ↑21.4%) and sales tax (PKR 3.1Trn; ↑22.7%). Non-tax revenues, on the flip side, are expected to undergo a slight attrition primarily on the back of lower SBP profits (↓ PKR 350Bn) to PKR 2.0Trn (↓3.8%).

Heavy reliance on petroleum levy to meet non-tax revenue of PKR 2.0Trn: The government has slightly trimmed its non-tax revenue collection to PKR 2.0Trn (↓3.8%; PKR 80Bn) compared to the last fiscal year. Despite the revision, the onus continues to remain on how successful the government is in collecting petroleum levy. Note that, the government had earmarked collection of PKR 610Bn from petroleum levy in the last budget which was later revised down by a sizable 78% to PKR 135Bn on the back of multi-year high oil prices and announcement of fuel subsidy by the previous government. This time around, the government has gone a step ahead and projected petroleum levy kitty to rise to PKR 750Bn which we opine to be an uphill task. For that number to be achieved, either the international oil prices will need to come down sharply without adjustment in local retail prices or the retail fuel prices would need to be jacked up by a further 15-20% which would only aggravate inflationary concerns going forward.

Table 4: Revenue Receipts Target

PKR Bn	FY22B	FY22R	% Chg.	FY23B	% YoY
FBR Tax Revenues	**5,829**	**6,000**	**2.93%**	**7,004**	**16.73%**
Direct Taxes	**2,182**	**2,204**	**1.01%**	**2,573**	**16.74%**
Income Tax	2,172	2,191	0.88%	2,558	16.74%
Others	10	13	27.84%	15	16.74%
Indirect Taxes	**3,647**	**3,796**	**4.09%**	**4,431**	**16.73%**
Custom Duties	785	817	4.08%	953	16.65%
Sales Tax	2,506	2,635	5.15%	3,076	16.74%
Federal Excise	356	344	-3.37%	402	16.86%
Non-Tax Revenues	**2,080**	**1,315**	**-36.77%**	**2,000**	**52.07%**
Levies & Fees	**30**	**30**	**-0.37%**	**35**	**17.61%**
Fee Collected by ICT Admin	20	22	9.19%	25	14.93%
Others	9	8	-10.56%	10	24.88%
Income from Property & Enterprise	**266**	**300**	**12.81%**	**280**	**-6.81%**
PTA (3G / 4G) Licences	4	4	-12.50%	9	157.14%
Mark-up (Provinces)	36	36	-0.69%	40	10.91%
Mark-up (PSEs & others)	90	90	0.00%	100	11.11%
PSE Dividends	90	70	-21.94%	80	14.29%
Others	46	101	118.63%	51	-49.59%
Receipts from Civil Administration	**684**	**509**	**-25.64%**	**354**	**-30.39%**
SBP Profit	650	474	-27.08%	300	-36.71%
Others	34	35	1.90%	54	55.99%
Misc. Receipts	**1,101**	**477**	**-56.72%**	**1,331**	**179.32%**
Petroleum Levy	610	135	-77.87%	750	455.56%
GIDC	130	25	-80.77%	200	700.00%
Royalty on Natural Gas	65	60	-7.69%	70	16.67%
Royalty on Crude Oil	35	40	14.29%	46	15.00%
Others	261	217	-17.04%	265	22.41%
Total Fiscal Revenues	**7,909**	**7,315**	**-7.51%**	**9,004**	**23.09%**

Source: Budget in Brief FY22-23, MoF, BMA Research

High domestic borrowings to keep expenditures elevated

Debt servicing conundrum to continue in this fiscal year as well: Despite fiscal austerity being at the heart of the broader macroeconomic targets set out in the federal budget, the government envisages current expenditure to surge 15.6% in the upcoming fiscal year to PKR 8.7Trn courtesy burgeoning finance costs. The long looming dilemma of high interest rate payments on outstanding debt will continue to grapple in the forthcoming fiscal year as mark-up payments surge to PKR 4.0Trn (↑29.1%). We opine this to be on the back of high exposure to the domestic market where 6MKIBOR has surpassed 15% and government's inability to borrow from the Central Bank given tough IMF conditions. On the other hand, there are minor upward adjustments in subsidies and grants to PKR 699Bn (↑2.5%) and PKR 1,242Bn (↑6.4%) respectively while COVID/Emergency/Disaster fund has been scaled back by 20% to PKR 100Bn.

Table 5: Current Expenditures

PKR Bn	FY22B	FY22R	% Chg.	FY23B	% YoY.
Mark-up Payment	**3,060**	**3,144**	**2.73%**	**3,950**	**25.66%**
Mark-up on Domestic Debt	2,757	2,770	0.49%	3,439	24.14%
Mark-up on Foreign Debt	303	373.183	23.16%	510.972	36.92%
Pension	**480**	**525**	**9.38%**	**530**	**0.95%**
Military	360	394	9.44%	395	0.25%
Civil	120	131	9.17%	135	3.05%
Defence Affairs & Services	**1,370**	**1,480**	**8.05%**	**1,523**	**2.89%**
Grants & Transfers	**1,168**	**1,090**	**-6.64%**	**1,242**	**13.89%**
Grants to Provinces	106	94.35	-10.99%	82	-13.09%
Grants to Others	1,061	996	-6.12%	1,160	16.44%
Subsidies	**682**	**1515**	**122.13%**	**699**	**-53.86%**
Pay & Pension	**160**	**0**	**-100.00%**	**100**	**N/A**
Running of Civil Government	**479**	**530**	**10.65%**	**550**	**3.77%**
Provision for Disaster / Covid	**125**	**232**	**85.60%**	**100**	**-56.90%**
Total Current Expenditures	**7,523**	**8,516**	**13.20%**	**8,694**	**2.09%**

Source: Budget in Brief FY22-23, MoF, BMA Research

Some major movements in individual heads: Though, on the outset, allocations for grants and subsidies haven't moved much, it is worth noting that subsidies to the petroleum sector and fertilizer plants have gone up to PKR 71/15Bn respectively from PKR 20/6Bn in the previous fiscal year. Interestingly, subsidies for Naya Pakistan Housing Authority and mark-up on Naya Pakistan housing loans have almost been shelved as the budgeted amount has been scaled back from PKR 33Bn in the previous year to a meager PKR 1Bn for FY23. On the grants side, notable movement can be seen in Benazir Income Support Program (BISP) that has been revised up from PKR 246Bn to PKR 360Bn.

Major reforms for the real estate sector: In a bid to go after non-productive assets, the government set forth some key changes for the real estate sector. The government announced an annual tax equaling 1%, in case of second home on the market value of the property if the fair value exceeded PKR 25Mn. This calculation is based upon deemed rental income of 5% of the market value of the property of which 20% (1% of market value) will need to be paid out to the govt. Advance tax on the purchase of property has also been increased to 2% from 1% for filers while for non-filers the applicable rate will be 5%. Furthermore, capital gains tax on sale of immovable property within a period of 12 months was jacked up to 15%. This CGT rate will self-adjust by 2.5% with each passing year thus concluding at 0% in Year 6.

Table 6: Development Expenditure & Net Lending

PKR Bn	FY22B	FY22R	% Change	FY23B	% Change
Dev. Expend. & Net Lending	**964**	**622**	**-35.48%**	**808**	**29.90%**
Total PSDP	**2,135**	**1,550**	**-27.40%**	**2,159**	**39.28%**
Federal	900	550	-38.89%	727	32.18%
Provincial	1,235	1,000	-19.03%	1,432	43.18%
Net Lending	**64**	**72**	**12.50%**	**81**	**12.50%**

Source: Budget in Brief FY22-23, MoF, BMA Research

Table 7: Subsidies

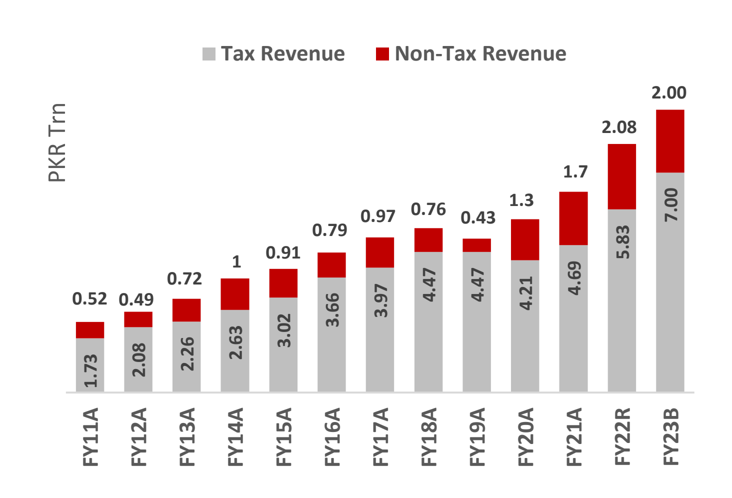
PKR Bn	FY22B	FY22R	% Chg.	FY23B	% YoY.
WAPDA/PEPCO	511	989	93.54%	490	-50.46%
KESC	85	83	-2.35%	80	-3.61%
Petroleum	20	377	1785.00%	71	-81.17%
PASSCO	7	7	0.00%	7	0.00%
Utility Stores Corporation	6	21	250.00%	17	-19.05%
Others	53	38	-28.49%	34	-10.29%
Total Subsidies	**682**	**1,515**	**122.13%**	**699**	**-53.86%**

Source: Budget in Brief FY22-23, MoF, BMA Research

Negatives have largely been priced in: While we agree that performance of the local bourse has been marred by economic and political upheaval, cheap market multiples suggests that the negatives have largely been priced in. Though the initial reaction will be negative for the market because of higher incidence of tax on all major sectors, we opine further correction to be a good opportunity to take fresh positions. Trading at a P/E multiple of ~4x with double digit earnings growth and healthy dividend yields, we opine the market is nearing its bottom. That said, we recommend keeping a close eye on how macros unfold over the next few months while maintaining exposures in modestly leveraged, high yielding and low P/E scrips and shying away from highly leveraged, low yielding and cyclical sectors.

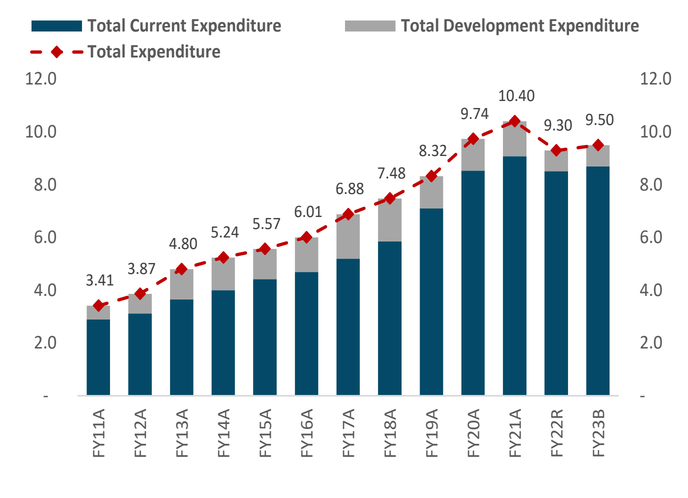
BUDGET FY22 BUDGET BREAKDOWN

Chart 7: Taxation Target Breakups



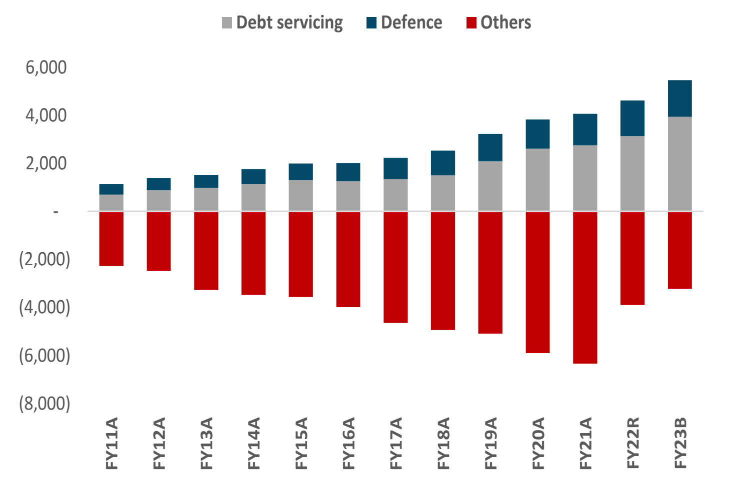
Source: MoF, BMA Research

Chart 8: Expenditures Breakdown



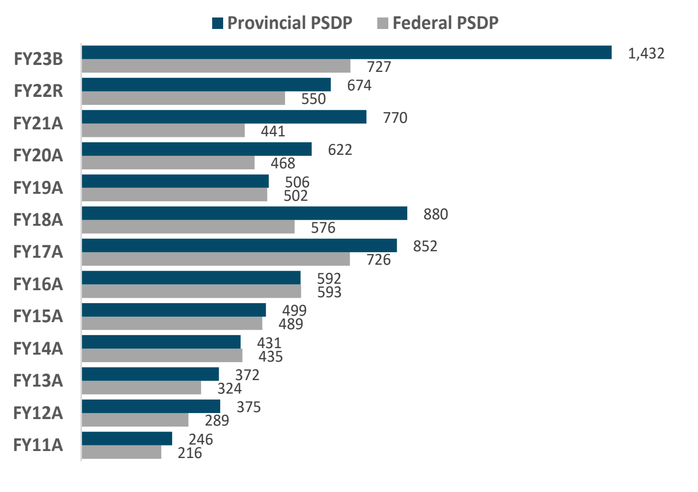
Source: MoF, BMA Research

Chart 9: Budgeted Expenditures (PKR Bn)



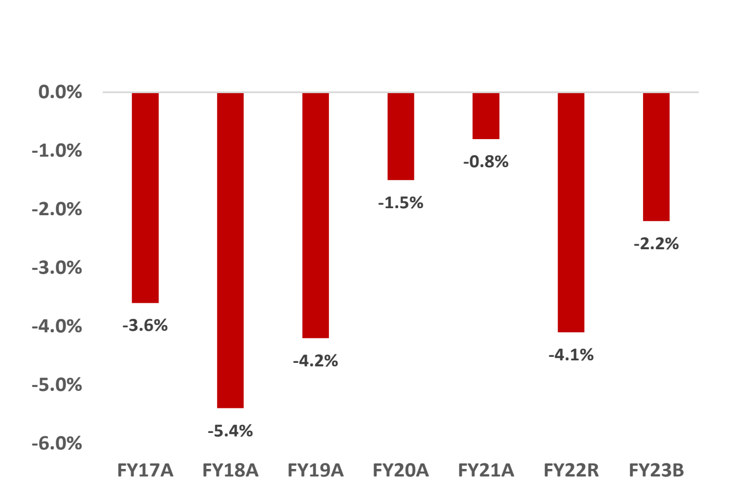
Source: MoF, BMA Research

Chart 10: Ambitious target set for PSDP disbursements



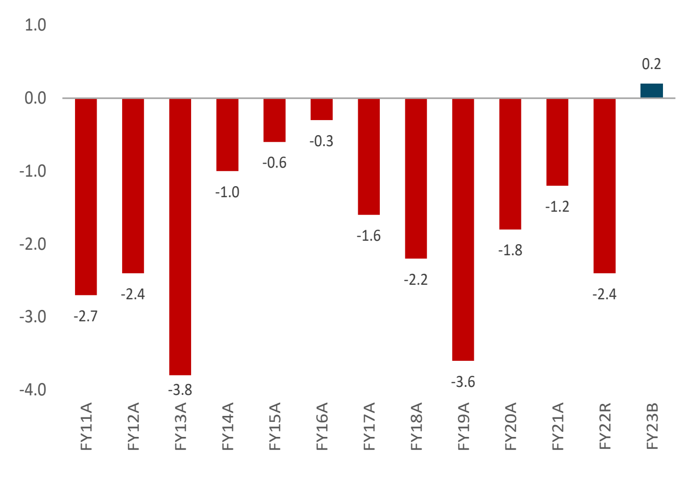
Source: MoF, BMA Research

Chart 11: Current Account Deficit (% of GDP)



Source: MoF, BMA Research

Chart 12: Primary Balance (% of GDP)



Source: MoF, BMA Research

Summary of FY2022-23 budget

Macroeconomic Targets

- Budget outlay of PKR 9.5Trn has been set for FY23.
- The govt. has set a target of 5% GDP growth for FY23 while increasing the overall GDP size from PKR 67Trn to PKR 78.3Trn.
- Govt. expects inflation to average 11.5% next year compared to 11.7% in the ongoing fiscal year.
- FBR tax collection target has been set at 9.2% of GDP (PKR 7.0Trn, ↑20% against FY22 target) as compared to 8.6% in the current fiscal year. Direct taxes are budgeted at PKR 2.6Trn while indirect taxes are budgeted at PKR 4.4Trn.
- Fiscal deficit target is set at 4.9% of GDP (PKR 3.8Trn) as compared to 6.3% in FY22 (PKR 3.4Trn).
- Govt. is targeting a primary surplus of 0.2% in FY23 against a deficit of 2.4% in FY22.
- The govt. is expecting CAD at 2.2% of GDP (~USD 9Bn) in FY23 as compared to 4.1% (~USD 16Bn) of GDP in FY22.
- Imports are expected to come down from USD 75Bn in FY22 to USD 70Bn in FY23 while exports are expected to increase by ~12% to USD 35Bn.
- Remittances are projected at USD 33.2Bn as compared to USD 31.1Bn in FY22.

Expenditures

- Expenditure set aside for development is PKR 808Bn of which PSDP related spending will be PKR 727Bn.
- Interest payments are budgeted to be PKR 3,950Bn for FY23 (Domestic: PKR 3,439Bn; External: PKR 511Bn) vs. PKR 3,144Bn for FY22 (Domestic: PKR 2,770Bn; External: PKR 373Bn).
- PKR 1,941Bn have been earmarked for targeted subsidies (PKR 699Bn) and grants & BISP (PKR 1,242Bn).
- PKR 21Bn have been allocated for agriculture and food security.
- Govt. has sanctioned PKR 73Bn for power sector development of which PKR 12Bn will be used to develop Mohmand Dam.

Relief Measures

- A total of PKR 40.5Bn will be released under DLTL along with complete disbursement of sales tax refunds for exporters.
- Interest free loans to individuals up to PKR 0.5Mn while business loans up to PKR 25Mn will be provided on easy instalments to support youth development.
- To promote the film industry, producers, cinema houses, production houses and film museums have been provided tax exemptions up to 5 years. Moreover, cinema and producers have been exempted from income tax as well.
- Govt. has set aside PKR 17Bn for the IT sector to promote exports, provide laptops and improve the overall network.
- Salaried individuals drawing up to PKR 1.2Mn/annum are now exempt from Income Tax while the number of applicable taxation slabs have been reduced to 7 from 12 along with a reduction in effective tax rate for individuals earning up to PKR 1.5Mn/month.
- Tax on Behbood certificates has been reduced from 10% to 5% for the incoming fiscal year for pensioners.
- Fixed income and sales tax regime has been introduced for retailers which will be based on their electricity consumption and will range between PKR 3-10k per annum.
- Sales tax on tractors, wheat, maize, canola etc has been removed.
- Customs duty on the import of 400 items in the manufacturing sector has been rationalized.
- Tax on synthetic yarn has been adjusted downward.
- All import level taxes to be made adjustable for industrial units to ease working capital constraints.
- Custom duties on more than 30 APIs have been abolished.

Summary of FY2022-23 budget

Tax Measures

- Immovable properties valuing more than PKR 25Mn (in case of second home) will be assumed to generate 5% of their fair market value as rental income, of which 20% will be taxed.
- 15% CGT has been imposed on gain on sales of immovable properties if sold within a period of 12 months, which will reduce by 2.5% every year and become 0% in Year 6.
- Advance tax on filers to be increased to 2% (5% for non-filers) from 1% on purchase of property.
- Companies and AOPs earning more than PKR 300Mn will be subject to additional 2% tax on annual income.
- Advance tax on autos having engine capacity of 1601cc or more to be increased.
- Corporate Tax on banks has been increased from 39% (including Super Tax) to 45%.
- Credit/debit card payments made outside the country to be taxed at 1% for filers and 2% for non-filers.

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Buy	>15% expected total return
Hold	10%-15% expected total return
Underperform	<10% expected total return
*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
Marketweight	Expected market return
Underweight	Total stock return < expected market return

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)