Day Break

Saturday, 27 May 2017

Economy

Exhibit: GDP growth component wise

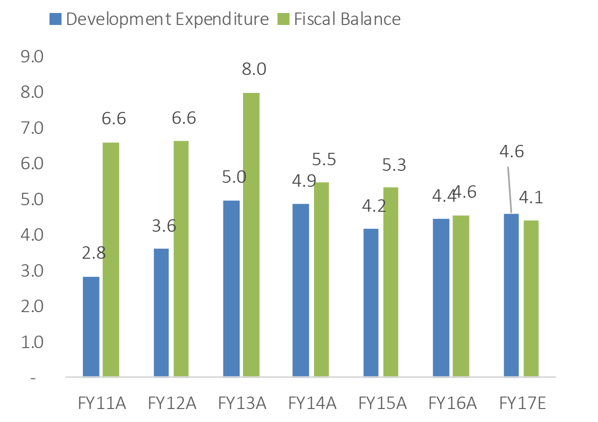

Exhibit: Fiscal and economic forecast

	FY17R	FY18B	FY19F	FY20F
GDP growth %	5.3	6.0	6.5	7.0
Inflation %	4.5	6.0	6.0	6.0

Exhibit: Fiscal Account

	FY17R	FY18B	FY19F	FY20F
Total Revenue	16.2	17.2	17.3	17.5
Tax Revenue	13.1	13.7	14.2	14.6
FBR Tax Revenue	11.1	11.2	11.8	12.2
Non Tax Revenue	3.1	3.5	3.2	2.9
Total Expenditure	20.4	21.3	21.3	21.4
Fiscal Balance	(4.2)	(4.1)	(4.0)	(3.9)
Revenue Balance	0.2	2.2	2.7	2.9
Total Public Debt	64.8	61.4	57.8	54.3

Source: SBP, MoF & IGI Research

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Budget 2017-2018

Initial Impressions: Something for everyone

- Finance Minister presented the budget for year 2017-18, with a budget deficit target of 4.1% (FY17 fiscal deficit of 4.2%) of the GDP
- From market perspective, we believe budget FY18 to be relatively a **"Neutral"** event.

Finance Minister presented the budget for year 2017-18, with a budget deficit target of 4.1% (FY17 fiscal deficit of 4.2%) of the GDP and tax collection at 13.7% (up by +13.2%). On expenditure side, major portion has been allocated on development spending (6.3% of the GDP or up by +36.8%YoY) mainly surrounding CPEC and Energy, relief packages for low-income / farmer and increase in government employees' salaries along with increase in pension. Amongst the rest Sector-wise textiles and agricultural, stood out as major beneficiary while steps to enhance/strengthen financial systems.

- **Total Budget outlay** is set at PKR 5.10trn, up by +4.3%YoY from last year budget.
- **Tax revenues** are targeted at PKR 4.33trn, up by +13.2%YoY or 13.7% of the GDP. This is led by +15.7%YoY growth in direct taxes to PKR 1.59trn and +12.9%YoY rise to PKR 2.42trn in indirect taxes. Non-tax revenues are targeted at PKR 980bn (+7%YoY).
- **Current expenditure** is reduced to PKR 3.76trn, 10.5% of GDP compared to 11.4% of GDP in FY17.
- **Subsidies** have been scaled back to PKR 139bn from PKR 169, with major cuts coming from subsidies to K-Electric.
- **Total development expenditure** is targeted at PKR 1.34trn (3.7% of the GDP) up by a massive ~+43%, of this PKR 1001bn (~40%YoY growth) has been allocated for Federal PSDP and PKR 180bn has been allocated for CPEC.
- **Overall fiscal deficit** target is set at PKR 1.48trn or 4.1% of GDP, including provincial surplus of PKR 347bn.
- **Major financing** remains skewed towards domestic sources (PKR 968bn or ~65% of the total fiscal deficit) with banks contributing nearly 40.2% or PKR 390bn and non-banks contributing the rest of PKR 578bn.

Equity Market: Not a lot to cherish upon

From market perspective, we believe budget FY18 to be relatively a "Neutral" event. We understand extension of Super tax, increase in minimum turnover tax and dividend income would be taken negative in terms of corporate earnings, but on a broader scale increase development project spending, several relief measures for farmers/agri and textile sector and steps to enhance financial system penetration would generally be corporate earning positive. From market specific point, changes in Capital gains tax slabs will increase overall liquidity in our view as incentive for longer holding period diminishes.

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Equity Market (Neutral)

- **Reduction in Tax Rate for Companies:** Continuing with the policy of reducing corporate tax rates, the rate has been reduced further from 31% to 30% for the Tax Year 2018.
- **Super tax** is extended for another year at 4% on banks and 3% on non-bank companies.
- **Extending period for which tax credit on enlistment is available:** At present, upon enlistment of a company in the stock exchange, 20% tax credit for a period of two tax years is available on the tax payable by such company. In order to further incentivize the enlistment of companies on the stock exchange such tax credit is being extended for another two tax years, however, such tax credit shall be allowed @10% of the tax payable for each of these subsequent two tax years.

Exhibit:

Extension of period of tax credit on enlistment on PSX

	Year 1	Year 2	Year 3	Year 4
Previous	20%	20%		
Current	20%	20%	10%	10%

- **Simplification of rate structure on Capital Gains Tax:** At present there is a three tier rate structure for capital gains tax on securities based upon the holding period of securities i.e. less than 12 months, more than 12 months but less than 24 months and more than 24 months but less than 5 years. For the purposes of simplification and promotion of stock market transactions, a flat /single rate of tax of 15% for filers and 20% for non-filers is being introduced.

Exhibit:

Capital Gain tax (CGT)

			Tax Year 2017		Tax Year 2018	
Holding period	2015	2016	Filer	Non-Filer	Filer	Non-Filer
Less than 12 months	12.5%	15.0%	15.0%	18.0%	15.0%	20.0%
between 12 and 24 months	10.0%	12.5%	12.5%	16.0%	15.0%	20.0%
More than 24 months	0.0%	7.5%	7.4%	11.0%	15.0%	20.0%
Acquired before 1st July, 2012	0.0%	0.0%	0.0%	0.0%	15.0%	20.0%
Future Commodity contracts	0.0%	0.0%	5.0%	5.0%	15.0%	20.0%

- **Advance Withholding tax rate of 0.02% adjustable;** on commission of members of Stock Exchange is now being moved to final tax
- **Increase in minimum turnover tax:** Minimum tax of 1.25% will now also be charged on turnover for the companies incurring gross loss compared to 1%. (Note: not applicable on OMCs)
- **Reduced rate of minimum tax on services rendered by the Pakistan Stock Exchange:** Presently, services rendered by Pakistan Stock Exchange Limited are subjected to 8% minimum tax which results in an effective tax rate which is much higher than the prevalent corporate rate of tax. To further improve the performance of the Stock Exchange it is being subjected to reduced rate of minimum tax @ 2% on its services.
- **Incentivizing distribution of dividend:** At present, there is exemption from tax on the undistributed reserves of a public company, other than a banking company or a modaraba if the lesser of at least 40% of after tax profit or 50% of the paid up capital is distributed as dividend. In order to protect the interest of small investors and to promote payment of dividends the condition regarding distribution of 50% of paid up capital is being omitted.

- **Taxation of Dividend:** The present rate of tax of 12.5 % on dividend income is proposed to increase to 15%. Furthermore, rate of tax on dividend received from mutual funds is being rationalized and enhanced from existing 10% to 12.5%.
- **Enhancing the Limit of Raw Material Importable under Exemption Certificate:** The limit for importing raw material by manufacturers through exemption from income tax at import stage is proposed to be enhanced from 110% of the quantity imported in the last year to 125% of the quantity imported in the last year to promote industrial expansion and facilitate industry

Banking Sector and insurance sector (Neutral)

- **Exemption on cash withdrawal by branchless banking agents:** At present, tax @ 0.3% and 0.6% is deducted upon aggregate cash withdrawals exceeding PKR 50,000 / day from filers and non-filers respectively; exemption is being accorded to branchless banking agents operating under the Asaan Mobile Account Scheme from withholding tax on cash withdrawals
- **Tax neutrality in Islamic Banking viz-a-viz conventional banking:** Tax neutrality has been accorded in the case of Musharika financing by extending the benefit of depreciation on assets co-owned in the case of a Musharika arrangement
- Super tax is extended for another year at 4% on banks
- **Rationalization of rates on interest income**: In order to rationalize taxation of interest income and to reduce the incidence of tax upon persons earning lesser interest income slabs have been introduced to; 10% up to PKR 5mn, 12.5% PKR 5mn ><PKR25mn and 15% for >PKR 25mn.
- **Loans for Farmers:** ZTBL and National Bank of Pakistan will launch a new scheme for small farmers with holdings of 12.5 acres who will be provided agricultural loans at a reduced rate of 9.9% per annum. The volume of agriculture credit is being enhanced to PKR 1,001bn.
- **Risk Sharing Guarantee Scheme (house financing):** Risk Sharing Guarantee Scheme for low-income housing will be launched. Under this scheme, the Government will provide 40% credit guarantee cover to Banks and DFIs for home financing for up to PKR 1mn. This along with Land Revenue Records will be used for Mortgage Financing to ensure more security for banking sector
- **A PKR 8.0bn fund will be created at the State Bank of Pakistan** to provide loans to low-income segments through microfinance banks
- **Enhancement of Exemption Limit for Withholding Tax on Insurance Premium: Basic** Limit is proposed to be enhanced to PKR 0.3mn from PKR 0.2mn for 1% withholding tax currently being charged on non-filers

Fertiliser sector (Neutral)

- **Rationalizing tax on import of DAP fertilizers:** Commercial import of DAP fertilizer both by commercial importers as well as urea manufacturers is proposed to be brought into the final tax regime.
- **DAP will be subject to fixed sales tax:** As a result, GST is being reduced from PKR 400/bag to PKR 100/bag
- **Prices of NP, NPK, SSP and CAN fertilizers:** Maintained at their current price levels through appropriate tax adjustments.
- **As a further measure to support farmers**, the government has already decided to sell the existing stock of imported Urea Fertilizer available with NFML at a concessional PKR 1,000/bag instead of current PKR 1,200/bag

Agricultural (Neutral to Positive)

- **Exemption from Custom Duty extended on import of combined harvesters** threshers up to 5 years old while 10% and 20% Regulatory Duty levied on five to ten years and more than ten years old respectively.
- **Exemption from sales tax on agriculture diesel engine:** Sales tax on agricultural diesel engines (from 3 to 36 HP) is proposed to be exempted.
- **Reduction of sales tax rate on imported machinery for poultry:** Sales tax rate from 17% to 7% on certain imported machinery/equipment for poultry is being made

Construction and Materials (Positive)

- **Increase PSDP allocation:** Increase in Federal Public Sector Development Program (PSDP) to PKR 1,001bn in FY18 from PKR 715bn (revised) in FY17, up by 40%
- **Formation of Infrastructure bank/fund:** Formation of Pakistan Infrastructure Bank (PIB) and Pakistan development fund (PDF). PKR 6.0bn fund allocated for housing infrastructure with 40% government loan guarantee for bank
- **Increase in Federal Excise Duty on cement:** Federal Excise Duty on cement is proposed to be enhanced from PKR 1 /kg to PKR 1.25 / kg.
- **Normal tax regime:** Reintroduced for land developers and builders.
- **Increase of tax rate on Steel sector electricity:** Steel sector is currently paying sales tax on the basis of consumption of electricity at the rate of PKR 9/unit of electricity. The existing rate of Rs 9/unit of electricity is proposed to be enhanced to PKR 10.5/unit and corresponding increase shall be made in ship breaking and other allied industry

Auto assembler/Auto parts (Neutral)

- **Reduction in sales tax on import and supply of hybrid electric vehicles:** Reduction in sales tax for vehicle engine size up to 1800cc to 50%, 25% restricted for 1801-2500cc.
- **Reduce WHT on transfer of vehicle:** WHT on registration and transfer of motor vehicles having engine capacity up to 850cc, 851cc to 1000cc and 1001cc to 1300 cc is being reduced from existing PKR 10,000/-, PKR 20,000/- and PKR 30,000/- to PKR 7,500/-, PKR 15,000/- and PKR 25,000/- respectively.

Energy (Neutral)

- **Exemption from extra tax to lubricating oil:** Withdrawal of levy of 2% sales tax on lubricating oils.
- **Reduce custom duty on coal import:** CD rate on Bituminous coal and other coal equalized @ 5%. However, for the Power Projects in IPPs Mode, CD on import of both types of coal reduced to 3%

Exporters and Textile (Positive)

- **Zero Rated Sales tax regime** to continue for 5 export oriented sectors including textile.
- **Machinery import:** Duty Free import of Machinery to continue
- **Financing Rate:** ERF/LTF of 3%/5% to continue in FY18. Agriculture loan mark up 9.9% for restricted area.
- **RD on imported synthetic yarn and on fabric:** 5% Regulatory Duty levied on import of synthetic filament yarn (of polyesters). And, proposed to levy sales tax @ 6% on commercial import of fabrics.
- **Payment of sales tax on retail sales of five export oriented sectors:** Retail sales of five export oriented sectors are chargeable to sales tax @ 5%. It is proposed to increase the said rate to 6%.

- **Metalized yarn is used in the traditional wearing:** To provide relief to this industry, it is proposed that 5% Regulatory Duty may be levied on its finished product while rate of customs duty on its vital raw materials may be reduced from 20% to 11%.
- **CD exemption on stamping foil for Leather manufactures:** Stamping foil used in producing high value added finished leather will also be exempted from customs duty; and Exemption of 3% CD on raw skins & hides
- **Formation of Brand Development Fund:** In consultation with public and private stakeholders, the government will launch Brand Development fund for textile sector

I.T / Telecommunication (Positive)

- **Reduction in Federal Excise Duty on Telecommunication Services:** Federal Excise Duty on telecommunication services is proposed to be reduced from 18.5% to 17.0%.
- **WHT reduce for mobile phone subscribers:** In order to promote mobile phone density, the rate of withholding income tax for mobile phone subscribers is being reduced from 14% to 12.5%.
- **Reduction in smartphone custom duty**: In order to encourage use of smart / android phones, custom duty shall be reduced from PKR 1,000/unit to PKR 650/unit
- **IT Software Park in Islamabad:** The Government will set up an IT software park in Islamabad with the help of Korean Government at a cost of PKR 6bn. The financial arrangements for this have been concluded and the construction work shall start soon. Exports of IT services from Islamabad and other Federal territories shall be exempted from Sales Tax.

Pharma / Consumer (Positive)

- **Limit on advertising expenditure:** The limit for expenditure incurred by pharma companies on sales promotion, advertisement and publicity is being enhanced from 5% to 10% of turnover.
- **Reduction in CD of fabricated/non-fabricated modular:** Reduction of CD on pre-fabricated modular clean rooms panels from 20% to 3% and on fabric (non-woven) for pharmaceutical industry from 16% to 5%.
- **Documentation of Purchase of Tobacco:** In order to document purchase of tobacco, Pakistan Tobacco Board is being entrusted with collection of withholding tax on purchase of tobacco by manufacturers of cigarettes at the rate of 5% of the purchase value of tobacco, at the time of collecting cess.
- **Manufacturers/wholesaler to collect withholding tax from distributors/dealers of batteries:** Distributor, dealer, wholesaler while making sales to retailers will now collect withholding tax at the rate of 0.5% of the amount of sales of batteries.

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