Budget 2020-21

Budget 2020-21: Tough Road Ahead for Government Finances

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- ✓ We do not expect major change or introduction of new taxes, while infrastructure capital expenditure is likely to see some major cuts. A relief bend towards Covid19 affected business/individuals and a higher expenditure is likely to be allocated under health and social benefits.
- ✓ From a market standpoint we expect budget 2020-21 is likely to be a "market-neutral". For sectors like banks, oil and gas and utilities, Budget proposals are expected to be neutral. While it may hold some positive measures for autos, construction, fertiliser, consumer and real estate.

Tough road ahead for government finances
The federal budget for Fy21 is expected to be presented on 12th June, 2020. As per news flow budget is more or less likely a continuity of previous budget policies. However, given a weak starting point post Covid-19 economy, government pace of fiscal consolidation will be slower this time around.

Reduced infrastructure spending, higher expenditure and generous tax target
We do not expect major change or introduction of new taxes, while infrastructure capital expenditure is likely to see some major cuts. A relief bend towards Covid19 affected business/individuals and a higher expenditure is likely to be allocated under health and social benefits.

Building up on a weak starting point
Growth is expected to see major contraction by 1.5% in Fy20 as per IMF while a tepid recovery is expected in Fy21 which will put growth at 2.0% well below of Emerging and developing countries at 6.6%. Major slowdown in industrial sector is expected as large-scale manufacturing (LSM) has already shown a contraction of -23% by May-20.

Fiscal deficit all set to cross ~9.0% in 2020
Similar fate is expected for country's public finances. The consolidated deficit of federal and provinces already stands at an elevated +8.9% of GDP as of Fy19 and progress so far in 9m Fy20 has neither been ideal. So far in first 3qaurters of Fy20, government has managed to restrict budget deficit to 5.1% of GDP (PKR 1.7trn) which compared to 5year average of 5.3% seems less impressive. With 4q of Fy20, taking in the full impact of Coivd19 estimates by IMF, World Bank puts Pakistan consolidated deficit at ~9.2%, a multi-decade high.

Exhibit: Pakistan consolidated finances

PKRbn	2015		2016		2017		2018		2019		9m2019	9m2020	
Total Revenue	**3,931**	**8%**	**4,447**	**13%**	**4,937**	**11%**	**5,228**	**6%**	**4,901**	**-6%**	**3,584**	**4,690**	**31%**
Tax Revenues	3,018	18%	3,660	21%	3,969	8%	4,467	13%	4,473	0%	3,162	3,594	14%
Tax Revenues / GDP	11.0%		12.4%		12.5%		13.0%		11.6%		11.0%	10.9%	
Direct taxes	1,029	16%	1,192	16%	1,343	13%	1,537	14%	1,446	-6%	997	1,146	15%
Indirect Taxes	1,783	20%	2,186	23%	2,304	5%	2,529	10%	2,626	4%	1,877	2,127	13%
Sales Tax	1,089	9%	1,453	33%	1,494	3%	1,715	15%	1,668	-3%	1,191	1,413	19%
Excise Duty	170	18%	197	16%	205	4%	214	4%	243	13%	159	189	19%
Petroleum Levy	131	27%	149	14%	167	12%	179	7%	206	15%	141	198	40%
Non-Tax Revenues	913	-15%	787	-14%	967	23%	761	-21%	427	-44%	422	1,096	160%
Non-Tax Revenues / GDP	3.3%		2.7%		3.0%		2.2%		1.1%		1.5%	3.3%	
Total Expenditure	**5,388**	**7%**	**5,796**	**8%**	**6,801**	**17%**	**7,488**	**10%**	**8,346**	**11%**	**5,506**	**6,376**	**16%**
Current Expenditure	4,425	10%	4,694	6%	5,198	11%	5,854	13%	7,104	21%	4,798	5,612	17%
Current Expenditure / GDP	16.2%		15.9%		16.3%		17.0%		18.4%		16.7%	17.0%	
Debt Payment	1,304	14%	1,263	-3%	1,348	7%	1,500	11%	2,091	39%	1,459	1,880	29%
Defense	698	12%	758	9%	888	17%	1,030	16%	1,147	11%	775	802	4%
Health	11	8%	12	12%	15	24%	17	11%	17	1%	11	8	-31%
Education	73	12%	83	13%	91	10%	98	8%	97	-1%	69	53	-23%
Others	2,339	8%	2,579	10%	2,856	11%	3,209	12%	3,752	17%	2,484	2,868	15%
Development Expenditure	1,141	-8%	1,314	15%	1,681	28%	1,622	-4%	1,219	-25%	684	781	14%
PSDP	988	14%	1,186	20%	1,578	33%	1,456	-8%	1,008	-31%	578	722	25%
PSDP / GDP	3.6%		4.0%		5.0%		4.2%		2.6%		2.0%	2.2%	
Federal	489	12%	593	21%	726	22%	576	-21%	502	-13%	302	340	12%
Provincial	499	16%	592	19%	852	44%	880	3%	506	-42%	276	382	38%
Budget Balance	**(1,457)**		**(1,349)**		**(1,864)**		**(2,260)**		**(3,445)**		**(1,922)**	**(1,686)**	**-12%**
Budget Balance / GDP	-5.3%		-4.6%		-5.8%		-6.6%		-8.9%		-6.7%	-5.1%	
Primary Balance	(153)		(86)		(515)		(760)		(1,354)		(463)	194	
Primary Balance / GDP	-0.6%		-0.3%		-1.6%		-2.2%		-3.5%		-1.6%	0.6%	
Financing	1,439	4%	1,349	-6%	1,864	38%	2,260	21%	3,445	52%	1,922	1,686	-12%
External	181	-65%	370	105%	541	46%	785	45%	417	-47%	524	682	30%
Domestic	1,258	43%	979	-22%	1,322	35%	1,475	12%	3,028	105%	1,398	1,004	-28%
Privatisation	-		-		-		2		-	n.a.	-	-	

Key Budgetary Measures

Tax Revenue

While imposition of new taxes remains unlikely, government is expected to put forward an ambitious tax target PKR 4.95tn for FY21. So far in 9m Fy20 FBR tax has shown a +14%y/y collection growth to PKR 3.2trn. With economy slowing down significantly, tax collection in 4q are expected to decline by almost 50%. This puts total collection to PKR 3.8trn in Fy20, (Fy20 tax collection target was initially set at PKR 5.5trn for FBR). Hence given a 4.95trn tax target implies a growth of +30%y/y which according to us seems rather over-optimistic.

- FBR tax revenue target set at PKR 4.95trn.
- Additional taxes on luxury items (high-end automobiles, farm houses and others) and cigarettes and beverages.
- Sales tax likely to remain at 17% however talks of increase by 1% seems unlikely at this time
- Likely reduction of FED on cements from current PKR 2,000/ton to PKR 1,500/ton.
- Reduction in import duties on raw materials for non-agri products

- Inclusion of one-time Corona tax remains a possibility.

Non-tax revenues
As sales and excise duty is expected to show a significant slowdown, government eyes to ramp up non-tax revenue through petroleum levy.

- A likely increase in Petroleum Levy which currently stands at PKR 30/ltr on petrol and POL products estimated to generate PKR 300-350bn

Development Budget
Given the tough revenue targets in Fy21 wherein substantial reliefs to business to support economic activity its seems obvious that there will be substantial curtailment in in infrastructure expenditure. Moreover, it is expected the development budgeted will largely focused on social and health sectors this time around.

- Federal Public Sector Development Projects (PSDP) is expected to be set at PKR 650bn (PKR 701bn in Fy20). Break-up wise 59% of the total PSDP will be utilised for infrastructure development, 35% for social sectors and 6% for others.
- The allocated percentage for social sector is expected to increase from 16% currently to subside the negative impacts of Covid-19.
- Prime Minister Office has developed a concept of PSDP Plus regime to attract investment in projects designed by the ministries on Public Private Partnership (PPP) mode of financing. As per news the government expects to collect USD 5bn in the oil and gas sector through this program.
- Post Covid-19 the most critical and focused sector around the globe has been the health sector. Thus in the upcoming budget, the government has proposed more funds towards social sectors (35%) than the previous years which will likely lead towards building and improving the health care system of the country.

Subsidy
- Power sector subsidy is likely to be reduced by PKR 50-70bn
- On fertiliser, PKR 243/bag for Urea, and PKR 925/bag as part of PKR 50bn agriculture relief package already announced.

Other expenditure
Defence spending is expected to go up by +20%y/y to PKR 1.38trn (Fy20 budgeted amount for defence was set at PKR 1.15trn). Moreover, civil administration expenses are expected to remain relatively unchanged this time around. A key relief is expected from domestic debt servicing with 525bps reduction in Fy20 and eyeing additional easing could potential bag in further debt saving. On foreign debt servicing the government has already asked for debt relief amounting to USD 2bn.

Other relief measures
- **Agricultural, Construction and Export-oriented sectors to remain government main focus**: In our view agriculture, construction and export sector will remain main focus of government incentives in the budget. The government has already announced agri-package worth PKR 50bn and construction package which include reduced FED, fix-

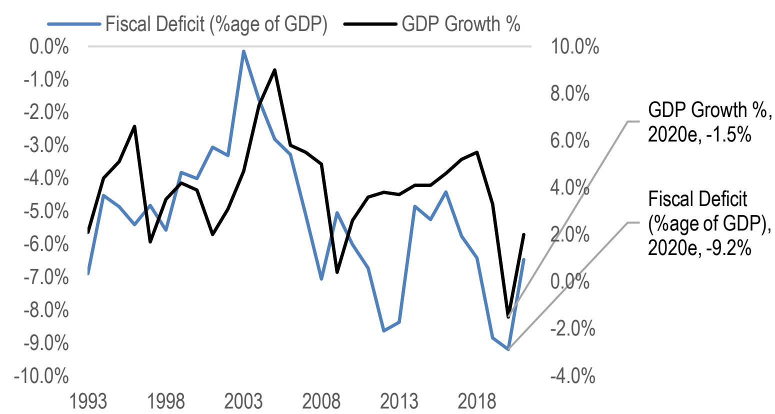
tax regime, lower tax rates for 'Naya-Pakistan Scheme' and likely reduction of sales tax for construction raw materials.

- **Enhancing limit on CNIC requirement:** Talks of possible enhancing the limit for CNIC condition to PKR 100,000 from current PKR 50,000. This should facilitate small-retailers/businesses/traders in terms of cost of transaction and boost economic activities.
- **Continuation of Covid19 fiscal stimulus package:** Continuation of already announced fiscal package worth PKR 1.2trn to the low-income/vulnerable section of the population amid covid19 outbreak. This include direct cash to daily wagers and affected, deferment of bank loan payments, relief in fuel prices, accelerated tax refunds to export and other financial support to food and other essential items industry.

Budget Deficit

The consolidated deficit of federal and provinces stood at an elevated +8.9% of GDP as of Fy19 and progress so far in 9m Fy20 has neither been ideal. So far in first 3qaurters of Fy20, government has managed to restrict budget deficit to 5.1% of GDP (PKR 1.7trn) which compared to 5year average of 5.3% seems less impressive. With 4q of Fy20, taking in the full impact of Coivd-19 estimates by IMF, World Bank puts Pakistan consolidated deficit at ~9.2%, a multi-decade high. Similar to that, the government is also eyeing a target close to 9.0% of the GDP or PKR 3.9trn.

Exhibit: Fy20 the twin problem, high public finances deficit and slowing GDP growth



Source: IGI Research, IMF

Financing

Financing of deficit in context of slowing domestic demand amid disruptions related to Covid-19, will likely route to primarily to domestic sources as it has been the case. More ideally we see government restoring to short-term treasury bills as way of financing. However, this could potentially increase macro stability risks including weakening PKR and crowding out of private sector funding.

- Moreover, on foreign funding, government has earmarked international bond issuance worth USD 2.0bn in Fy20, which in current situation will be difficult.
- In addition, government will likely source some funding through privatisation of public enterprises and government held shares

Budget to Be 'Market-Neutral' Event

From a market standpoint we expect budget 2020-21 is likely to be a "market-neutral".

- **Corporate tax rate** (29%) is likely to continue as included in Fy20 budget for banks it will remain at 35%. However, proposal in place to reduce non-banking corporates CTR by it by 1% to 28%, which in our view seems less likely to be considered.

Exhibit: Rate of tax of companies

Rate (tax year)	2018	2019	2020	2021
Commercial Banks	35.0%	35.0%	35.0%	35.0%
Corporates other than banks	30.0%	29.0%	29.0%	29.0%

Source: Income Tax Ordinance

- **Super tax** to continue; 4% on banks and no further tax on corporates/individuals with income over PKR 500mn.

Exhibit: Super Tax

Rate (tax year)	2018	2019	2020	2021
Banking Company	4.0%	4.0%	4.0%	4.0%
Individuals/ Corporates with income >= PKR 500mn	3.0%	2.0%	0.0%	0.0%

Source: Income Tax Ordinance

- Reduction in **minimum turnover tax** from 1.5% to 0.5-0.25% (varying sector wise)
- Possibility of imposition of new **additional one-time tax** on corporates to counter covid-19 impact
- **With-holding tax (WHT)** on dividends is unlikely to be changed
- **Capital Gain Tax (CGT)** rates unlikely to change
- Tax rate on **dividend from REIT** is likely to be unchanged at 25%
- Changes in **dividend on mutual funds** currently at 15% unlikely
- **WHT on income from Margin Financing transaction** (MFS) is unlikely to be changed from 10% to 2.5% proposed by PSX.
- **Reduction and rationalizing tax structure for Exchange Traded Funds (ETFs)**, particularly CGT charge on disposal/sale of ETFs as to increase attractiveness of ETFs.

Sector-wise budgetary impacts

For sectors like banks, oil and gas and utilities, Budget proposals are expected to be neutral. While it may hold some positive measures for autos, construction, fertiliser, consumer and real estate.

Exhibit: Budget 2020-21 expected measures

Sectors	Measures	Impact
Automobile Assemblers	Increase WHT on registration and transfer of motor vehicles	Negative
	Reduce import duty on CKD units from current 35% to 10% till Dec-20	Neutral
	PKR2.5bn subsidy on sales tax on locally manufactured tractors for 1 year under PKR50bn Agriculture package	Positive
	Allow commercial import of used cars	Negative
	Removal of FED on locally manufactured vehicles	Positive
Cements	Overall PSDP allocation reduced to PKR 650bn, with major reduction likely to come in infrastructure development.	Negative
	Reduction in FED from PKR 2,000/ton to PKR 1,500	Positive
	Removal of additional customs duty on coal	Positive
Chemicals	Withdrawal of Additional Custom duty on Para-xylene and Ethylene, currently at 2%.	Positive
	GIDC waiver	Neutral
Fertiliser	Removal of minimum tax regime on import stage	Positive
	Subsidy of PKR243/BAG on urea and PKR925/BAG on DAP through scratch card schemes under Agricultural package of PKR50bn	Positive
	Reduction in sales tax on DAP 3%	Positive
Textiles	Restoration of Zero rating status	Positive
	Increase in minimum wage	Negative
	Continuation of subsidised electricity and RLNG	Positive
	Withdrawal of customs and regulatory duty on import of polyester and dyes & chemicals	Positive
Consumer Electronics	Abolishment of additional customs duty on electrical appliances, CKD Kits and copper	Positive
	Input Tax adjustment up to 100% from 90% at present	Positive
Pharmaceutical	Relief for healthcare in form of subsidized financing for R&D in the wake of COVID-19	Positive
	Removal of additional custom duties	Positive
Steel	Overall PSDP allocation reduced to PKR 650bn, with major reduction likely to come in infrastructure development.	Negative
	Abolish clause (iv) of SRO 641(I)/2018 to allow concessionary import of HRC which was amendment of SRO 565	Positive
	Reduction of customs duties to 5% under various HS Codes on import steel products.	Positive
Power	Power sector subsidy is likely to be reduced by PKR 50-70bn to PKR 220bn	Negative
Commercial Banks	KIBOR based compensation on utilization of banks' money as monthly advance tax	Positive
	Reduction in corporate tax rate on microfinance banks from 29% to 20%	Positive
	Capital loss on listed shares to be carried forward for adjustment against capital gains	Positive
	Reduction in corporate tax rate and withdrawal of super tax	Positive
	Treasury Single Account (TSA) which was approved in last year's budget is yet to be implemented	Neutral
	Bank borrowing target of government from commercial banks to increase	Positive
	Possible change in tax treatment of bad debts	Positive
	WHT on Cash withdrawal over PKR 50,000 likely to be reduced	Neutral
E&P	Rationalization of corporate tax aligning it with 29% corporate tax which in our view is most likely to remain unchanged. As tax rate of E&Ps is 40% while effective tax rate stands at 30-35%. This would most likely be done through amendment in respective petroleum policies	Neutral
OMC	We expect minimum turnover tax to remain unchanged at 0.75%.	Neutral
Food/Consumer	Zero rating for dairy sector	Positive

Source: IGI Research, Newsprint

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