

# Day Break

Wednesday, 10 May 2017

## Economy

Exhibit: 9M budget deficit and primary balance trend

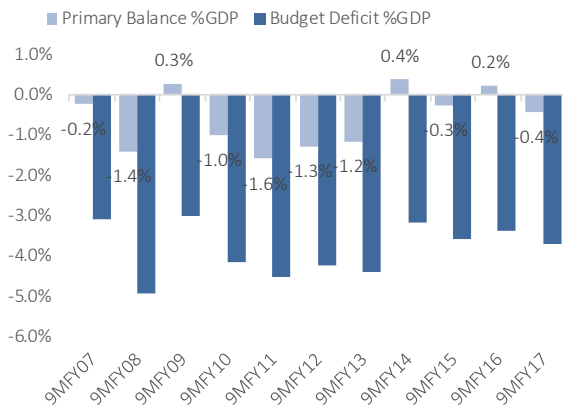


Exhibit: Tax Revenue Collection trend (PKRtrn)

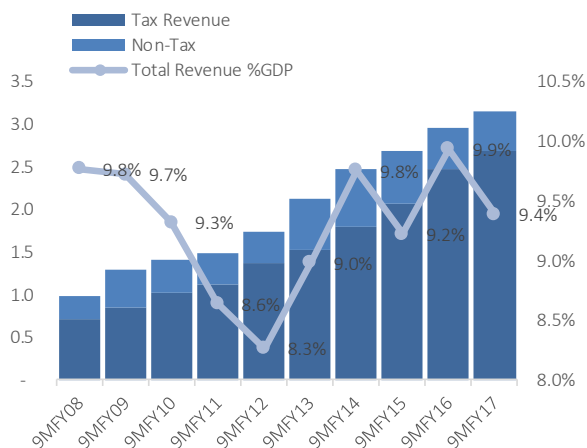
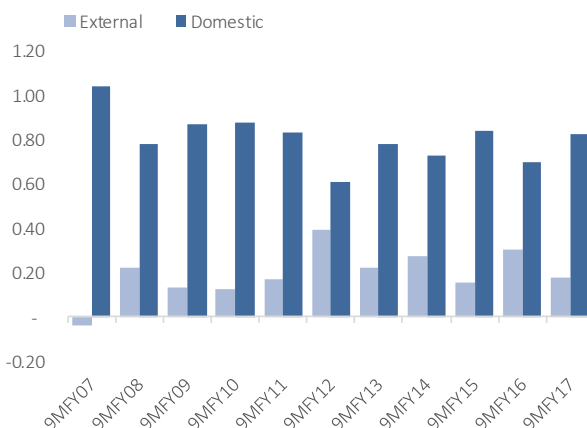


Exhibit: Budget Financing



Source: Bloomberg, SBP, MOF & IGI Research

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## Fiscal Balance

### Non-tax revenue sourcing the risk on fiscal side

- Fiscal deficit for the 9MFY17 period rose by +22.65%YoY to PKR 1.24tn (or +3.7% of GDP) compared to PKR 1.01tn (or +3.4% of the GDP) in 9MFY16.
- Reflecting sluggish growth in economic activity and onset of deflationary pressures, country's total revenue in 9MFY17 rose to PKR 3.15tn (or +9.4% of GDP); growing by +6.2%YoY compared to a growth of +10.4%YoY in 9MFY16 (or +9.9% of GDP).
- Total expenditure swelled to PKR 4.38trn (+13.1% of GDP), growing by +10.4%YoY compared to a growth rate of +6.4%YoY in the same period FY16.
- Disregarding the base effect, the burden of financing the deficit is being shifted from the external to domestic sources, with banks being the largest source of funding.

### Fiscal deficit deteriorates on sluggish tax revenue collection

Fiscal deficit for the 9MFY17 period rose by +22.65%YoY to PKR 1.24tn (or +3.7% of GDP) compared to PKR 1.01tn (or +3.4% of the GDP) in 9MFY16. Higher development and security related expenditure amidst declining tax/non-tax revenue, led to increase in overall fiscal deficit. We foresee higher probability of government exceeding its fiscal deficit target of PKR 1.28trn (or 3.8% of GDP) in FY17.

Exhibit:

### Budget Balance

	PKRbn	9MFY17	9MFY16	%YoY	3QFY17	2QFY17	1QFY17
Budget Deficit	1,238	1,009	23%	439	361	438	
Financing	1,238	1,009	23%	439	361	438	
External	220	223	-1%	-	21	172	69
Domestic	1,018	786	29%	460	189	369	
As a %GDP							
Budget Deficit	3.7%	3.4%		1.3%	1.1%	1.3%	
Financing	3.7%	3.4%		1.3%	1.1%	1.3%	
External	0.7%	0.7%		-0.1%	0.5%	0.2%	
Domestic	3.0%	2.6%		1.4%	0.6%	1.1%	

### Sluggish growth in non-tax revenue hampered total revenue generation...

Reflecting sluggish growth in economic activity and onset of deflationary pressures, country's total revenue in 9MFY17 rose to PKR 3.15tn (or +9.4% of GDP); growing by +6.2%YoY compared to a growth of +10.4%YoY in 9MFY16 (or +9.9% of GDP). The slowdown in overall revenue growth is attributed to the decline witnessed in non-tax revenues, which slipped by -6.2%YoY. Major drag on non-tax revenues came from reduction in surplus from State Bank of Pakistan (SBP) profits (down by 18%YoY, to PKR 145bn), despite receiving USD ~550mn (PKR 58bn) under Coalition Support Fund (CSF). On a quarterly basis, total revenue stood at +3.4% of GDP (PKR 9.53tn) compared to +3.4% in 2QFY17 and +2.6% in 1QFY17.

Exhibit:

**Revenue**

PKRbn	9MFY17	9MFY16	%YoY	3QFY17	2QFY17	1QFY17
Total Revenue	3,146	2,962	6%	1,155	1,128	862
Tax Revenue	2,694	2,481	9%	953	991	751
Non-Tax	451	481	-6%	202	138	112
As a %GDP						
Total Revenue	9.4%	9.9%		3.4%	3.4%	2.6%
Tax Revenue	8.0%	8.3%		2.8%	3.0%	2.2%
Non-Tax	1.3%	1.6%		0.6%	0.4%	0.3%

**...and expenditure edged higher on the back of rising PSDP expenditure**

In 9MFY17, total expenditure swelled to PKR 4.38trn (+13.1% of GDP), growing by +10.4%YoY compared to a growth rate of +6.4%YoY in the same period FY16. The hike in growth rate has primarily been influenced by Public Sector Development Projects (PSDP) expenditure, which grew by +19.8%YoY – total PSDP utilisation against the budgeted amount of PKR 1.67trn stood at ~44%. Current expenditure grew by +5.8%YoY and dropped to +10.8% of GDP compared to +11.4% in 9MFY16. On a quarterly basis, total expenditure as a percentage of GDP stood at +4.8% in 3QFY17 compared to +4.4% in 2QFY17 and +3.9% in 1QFY17.

Exhibit:

**Expenditure booked**

PKRbn	9MFY17	9MFY16	%YoY	3QFY17	2QFY17	1QFY17
Total	4,384	3,971	10%	1,594	1,490	1,300
Current	3,605	3,407	6%	1,364	1,171	1,071
Interest	1,094	1,079	1%	447	233	414
Defense	536	483	11%	199	185	151
Development	770	710	8%	279	300	191
PSDP	747	623	20%	301	279	167
As a %GDP						
Total	13.1%	13.3%		4.8%	4.4%	3.9%
Current	10.8%	11.4%		4.1%	3.5%	3.2%
Interest	3.3%	3.6%		1.3%	0.7%	1.2%
Defense	1.6%	1.6%		0.6%	0.6%	0.5%
Development	2.3%	2.4%		0.8%	0.9%	0.6%
PSDP	2.2%	2.1%		0.9%	0.8%	0.5%

**Domestic sector funding the major chunk of deficit**

Disregarding the base effect, the burden of financing the deficit is being shifted from the external to domestic sources, with banks being the largest source of funding. In 9MFY17, external financing decreased by -1.24%YoY whereas domestic financing increased by +29.42%. Within the domestic sector, both banks and non-bank sources increased financing by about ~+30%YoY each. However, it is worth noting that financing from the external sector increased by more than ~+60%YoY last year same period. Thus, the decrease in growth rate of external financing does not necessarily indicate a shift.

### **Rising primary deficit to burden country's public debt**

For the 9MFY17, country's primary balance recorded a deficit of 0.4% of the GDP compared to a surplus of 0.2% in 9MFY16. Key reason, as we highlighted, is sluggish growth in tax revenue. Going forward, although 4Q is expected to record higher growth in tax revenues, but so would the country's expenditure given low utilisation of PSDP funds. As per government FY17 budget target of total expenditure at PKR 4.39trn, PKR 4.38trn or 99.7% have been used. Henceforth, for government to contain budget deficit under 4% (budget deficit target of 3.8% in FY17) seems relatively unachievable.

Moreover, with primary balance in deficit; low nominal growth rate estimated in FY17 will add pressure on government debt. As of latest, country's gross public debt as at Dec-16 stood at PKR 20.3trn. In terms of funding the deficit, we see banks to be major financier primarily in the view of declining foreign debt inflows.

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