# Day Break

Saturday, 28 April 2018

## Budget 2018-19

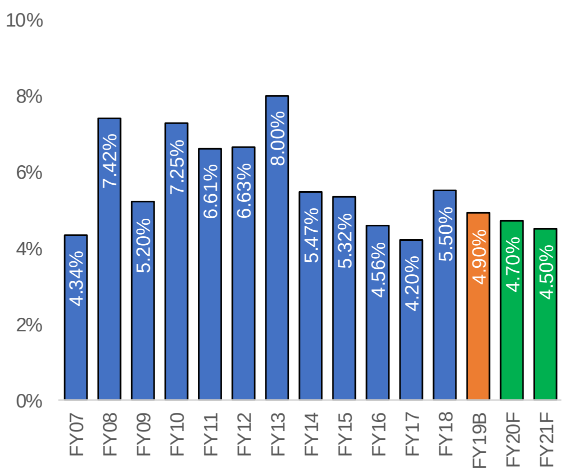
**GDP, GDP Growth and Inflation targets**

| | FY17 | FY18 | FY19B | FY20F | FY21F |
|---|---|---|---|---|---|
| GDP growth % | 5.3 | 5.8 | 6.5 | 7.0 | 7.0 |
| Inflation % | 4.5 | 4.5 | 6.0 | 6.0 | 6.0 |
| GDP PKRtn | 31.9 | 34.4 | 38.4 | 43.5 | 49.5 |

**Fiscal Account (%age of GDP)**

| | FY17 | FY18 | FY19B | FY20F | FY21F |
|---|---|---|---|---|---|
| Total Revenue | 16.2 | 16.0 | 16.3 | 16.4 | 16.5 |
| Tax Revenue | 13.1 | 13.2 | 13.9 | 14.1 | 14.3 |
| Non Tax Revenue | 3.1 | 2.8 | 2.4 | 2.3 | 2.2 |
| Total Expenditure | 20.4 | 21.5 | 21.2 | 21.1 | 21.0 |
| Current | 15.9 | 16.6 | 16.5 | 16.1 | 16.0 |
| Development | 4.5 | 4.9 | 4.7 | 5.0 | 5.0 |
| Fiscal Balance | (4.2) | (5.5) | (4.9) | (4.7) | (4.5) |
| Public Debt (gross) | 64.8 | 70.1 | 68.0 | 65.2 | 62.1 |

**Fiscal Deficit / GDP**




Source: Ministry of Finance, IGI Research

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# Budget 2018-19
## Initial Impressions

As expected, the 6th and the last budget presented by the incumbent government did not make for particularly pleasant reading by the opposition. The government has revised its FY18 fiscal deficit target by a good PKR 430bn or 1.24% of the GDP to 5.5%. Major slippages came from higher than budgeted debt servicing cost and lower than collected tax revenue, off by nearly PKR 183bn. To make up for the losses, government slashed overall development budget by PKR 278bn.

For FY19, government has yet again set an ambitious target of consolidating deficit in years ahead (by 2021, government projects fiscal deficit to drop to 4.5% of the GDP). For a starting point, government now aims to reduce fiscal deficit to 4.9% of the GDP or at PKR 1.89tn (PKR 1.91tn in FY18) in FY19. The way to achieve this is by gradual reduction of corporate tax rates for the corporates and income tax for individuals. Moreover, development budget was kept loose in order to make way for rising debt servicing and defense cost, both of which are expected to take up 56% of the total tax revenues in FY19B compared to 61% in FY18.

From market perspective we expect investors to receive Budget 2019 rather well, given reduce corporate tax burden and other tax incentives.

Nevertheless, government has set aside long-term inflation target of 6.0% and 7.0% growth target by 2021.

### Key Budget features

- **Total Budget outlay** is set at PKR 5.93trn, up by +16.2%YoY from last year estimated budget.
- **Tax revenues are targeted** at PKR 4.89trn, up by +17.9%YoY or 12.7% of the GDP. This is led by +11.0%YoY growth in direct taxes to PKR 1.74trn and +13.8%YoY rise in Indirect taxes to PKR 2.70trn. Non-tax revenues are targeted at PKR 0.77trn (down by 0.9%YoY).
- **Current expenditure** is increased to PKR 4.8trn, 12.5% of GDP compared to 12.5% of GDP in FY17.
- **Subsidies** have been scaled up to PKR 174.8bn from PKR 147.6, with major increase coming from subsidies to WAPDA/PEPCO under Tariff differential subsidy.
- **Total development expenditure** is targeted at PKR 1.15trn (~3% of the GDP) up by ~8.4%, of this PKR 800bn (~+21%YoY growth) has been allocated for Federal PSDP. Though total Federal PSDP is PKR 1,030bn out of which PKR 230bn would be self-financed by the corporation/authorities.
- **Overall fiscal deficit** target is set at PKR 1.89trn or 4.9% of GDP, including provincial surplus of PKR 286bn leaving federal deficit of PKR 2.18trn or 5.7% of the GDP.
- **Major financing** remains skewed towards domestic sources (PKR 1.55trn or ~81.9% of the total fiscal deficit) with banks contributing nearly ~53.7% or PKR 1.02trn and non-banks contributing the rest of PKR 533bn.

- **Corporate tax** would be reduced gradually by 1% from FY19 onwards to 25% in FY23.
- In addition, **super tax** on banking and non-banking companies will be reduced by 1% from FY19 onwards.

Exhibit:

**Corporate Tax Rate and Super tax**

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| **For non-banks** | | | | | | |
| Corporate Tax Rate | 30% | 29% | 28% | 27% | 26% | 25% |
| Super Tax | 3% | 2% | 1% | 0% | 0% | 0% |
| **For Banks** | | | | | | |
| Corporate Tax Rate* | 35% | 35% | 35% | 35% | 35% | 35% |
| Super Tax | 4% | 3% | 2% | 0% | 0% | 0% |

*Source: IGI Research, Ministry of Finance*

**Unclear whether reducing Corporate Tax Rate will also be applicable on banks*

- The condition of **distributing 40% after tax profit** is being reduced to 20% with applicable tax rate levied at 5% from 7.5%, but does not include bonus.
- **Tax credit** under section 65B, 65D and 65E is being extended till Jun21
- Withdrawal on **withholding tax on issuance of bonus shares** from 5% to 0%.
- **Exemption on plant and machinery** used for setting up Special Economic Zone.
- The tax credit limit on investment in shares/sukkuks has been increased to PKR 2Mn from PKR 1.5Mn
- Exemption given to **mutual funds on withholding tax** from 5% to 0%.
- **Tax on commission earned by members of the stock will now be adjustable**
- **Unabsorbed depreciation losses can be carried forward indefinitely** however it has been limited to 50% of the business income for tax year except where the taxable income does not exceed PKR 10 MN.
- **Additional custom duty to be increased from 1% to 2%.**
- Rate of **withholding tax rate on dividend payment by REIT** will be reduced from 12.5% to 7.5%

## Banking Sector and insurance sector

**Negative**

- Advance tax rate on banking transaction has been reduced from 0.6% to 0.4% for non-filers. (Neutral)
- Reduction in withholding tax on banking transaction for non-filers from 0.6% to 0.4%. (Neutral to Positive)
- Super tax on banking will be reduced by 1% from current 4% in FY19. (Negative)
- Amendment has been introduced which will restrict provisions for advances and off balance sheet items of foreign branches of resident banks to be made against their income. (neutral)

## Fertiliser and agricultural sector

**Positive**

- Sales tax on fertilizer products to be reduced by 3% with tax on feed gas to be reduced from 10% to 5% (positive)
- The federal government will remove subsidy (neutral to negative)
- In addition, tax exemption is proposed on LNG imported as feed by the manufacturers
- Sales tax on agriculture machinery reduced from 7% to 5%
- Super tax (negative)
- Reducing Corporate tax (positive)

## Construction (Cements and Steel)

**Neutral to Negative**

- Federal PSDP budgeted at PKR 1.03tn up from PKR 750btn in FY18. (Positive for demand)
- FED on cement is being increased from PKR 1.25 per kg to PKR 1.50 per kg. (Negative – this translate into PKR 12.5/bag price increase)
- Import duty on coal to be reduced from 5.0% to 3.0% (Positive)
- Sales tax on electricity increased to PKR 13/kWh from PKR 10.5/kWh. (negative)
- Cumulatively PKR 138bn has been allocated for power sector which include projects such as Dasu hydropower project, Neelum Jhelum Hydropower project and Tarbela fourth extension hydro power project. (positive for demand)
- Super tax (negative)
- Reducing Corporate tax (positive)

## Automobile Assemblers and Autoparts Manufacturers

**Neutral to Negative**

- Non-fillers will not be able to purchase new motor vehicles manufactured (assembled) in Pakistan or import (negative for demand)
- For electric vehicles, custom duty will be reduced to 25%, previously 50%, with exemption given on regulatory duty (negative for local assemblers)
- In addition, customs duty on import of CKD kits will be reduced from 50% to 10% (negative for local assemblers)

- Custom duty on Carbon Black (rubber grade) will be reduced from 20% to 16% (positive for tire manufacturers)
- To safeguard domestic manufacturer custom duty on rickshaw tyres will be increased from 11% to 20% (positive to tire manufacturers)
- Super tax (negative)
- Reducing Corporate tax (positive)

## Exports and Textiles

**Positive**

- **LTFF and ERF Rates:** Reduced mark-up rates shall continue to be available as per SBP policy under Long Term Finance Facility and Export Refinance Facility respectively.
- Move towards zero rating of import materials for export sector will significantly reduce creation of new refund claims.
- Refund claims currently pending will be cleared in a phased manner over the next 12 months starting 1st July 2018. After 1st July 2018 all new refund claims will be paid as per the time stipulated in law and regulations on monthly basis and there will be no delay (positive for textile)
- The government will announce a new export package with focus on value added exports and non-traditional markets.
- Super tax (negative)
- Reducing Corporate tax (positive)

## Oil & Gas and Chemicals

**Positive**

- The Petroleum Development Levy (PDL) on petroleum product has been increased to PKR 30/liter from PKR 10/litre for petrol and PKR 8/litre. (negative for POL demand)
- Tax emption proposed for twenty years for setting up deep conversion refineries between the periods 1 July 2018 to 30 June 2023 with a minimum capacity of 100,000bpd. This exemption is also extended to existing refineries that opt for increasing their capacity by 100,000bpd falling under the deep conversion category. (negative for existing refineries)
- Sales tax on import and supplies of furnace oil has been reduced to 17% from 20%. (neutral to positive)
- Tax on dealer margin of HSD will now be collected on the ex-depot price at the rate of 0.5% for filers and 1% from a non-filer, which was previously charged on commissions or discounts given to dealers at the rate of 12% for filers and 17.5% for non-filers. (neutral)
- Waiver of value addition tax at 3% and reduction in sales tax from 17% to 12% on import of LNG (positive for O&G marketing companies)
- Custom duty will be withdrawn on catalysts used by PTA industry (positive for manufacturers)
- Custom duty increased on dioctyl terephthalate used as a raw material for PVC from 3% to 20%
- Super tax (negative)
- Reducing Corporate tax (positive)

## Consumer and Pharmaceuticals

**Positive**

- Federal excise duty on locally produced cigarettes is proposed to be enhanced (negative)
- Custom duty on Acetic Acid has been reduced to 16% from 20% (positive for food)
- Exemptions given on custom duty on anti-cancer medicine (positive for Pharmaceutical companies)
- Regulatory duty on optical fiber cables reduced to 10% from 20% with custom duty on various input materials to stand at 5%
- Proposal to reduce custom duty on silicon electrical steel sheets from current 10% to 5% which is used for transformer manufacturing (positive for transformer manufacturers)
- Custom duty on import feed for livestock and growth promoters for poultry sector to be reduce from 10% to 5% (positive for meat producers)
- Animal feed for dairy farm to be exempted from sales tax (positive for dairy sector)
- Reduction in custom duty from 20% to 18% and 16% on Multiply /Aluminum foil and ethylene film used by Liquid Food Packaging industry (positive for packaging industry)

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