January 21, 2019

PAKISTAN
STRATEGY

REP-019
MARKET
VISTA

Mini-budget to set the tone for policy action

- **The GoP is set to announce mini budget on Jan 23'18 (second since coming to power), reportedly to plug the PkR150-160bn revenue shortfall ailing the economy, while possible indications of future direction will be provided by severity of actions**
- **The said measures potentially reduce the deficit to ~5.9% (as per AKD estimate). That said, a fiscal deficit of 5.5% of GDP seems comfortable for IMF, which opens tail risks to already revised PSDP (33.4% released of the revised target of PkR675bn in 1HFY19).**
- **Revenue measures like increase in FED on cement and increase in GST and PDL on petroleum products will not be of much significance given the declining trend in offtake, according to our calculations.**
- **Stock market incentives could provide adrenaline rush for the market in the short run. However, medium to long-term trend is dependent on the policy direction set by the supplementary budget.**
- **We view the mini-budget could bring upon inflationary pressure (hike in fuel prices, cements etc.) setting the course for interest rate hikes (Positive for Banks), while would be conducive for import substitution industries (Autos, selected chemicals, tile manufacturers, paper & board), while negative for OMCs and Cements.**

Mini-budget likely to reduce fiscal deficit to ~5.9%: Government is set to announce mini budget on Jan 23'18, reportedly to plug-in PkR150-160bn revenue shortfall. At one hand, this mini-budget will be no different than the previous one where Government looked towards indirect tax measures to boost collection while amongst the direct tax measures, it plans to partially withdraw income tax concessions for both salaried and non-salaried class (concessions announced costed Government ~PkR25bn). It plans on reducing tax-free slab to PkR0.8mn vs. PkR1.2mn previously, potentially changing tax rates on other slabs. However, on the other hand, it seeks to address issues related to local growth such as incentives to stock market, removal of non-filer ban for vehicles up to the mid-eco segment range of 1300CC (<1300CC constitutes ~50% of total annual volumes), streamlining policies for vehicle imports, and rationalization of duty slabs. As per AKD estimates, Pakistan's Fiscal deficit is likely to be recorded at 6.3% of GDP, where the said measures can potentially reduce the deficit to ~5.9%. We believe, taking cue from last IMF program, Government might target fiscal deficit of 5.5% of GDP, which opens tail risks to already revised PSDP (33.4% released of the revised target of PkR675bn in 1HFY19).

Govt likely to introduce various indirect taxes: The Government plans to announce various indirect tax measures including tax on the usage of mobile credit above PkR500/month, increasing duties on imported vehicles above 1600CC, cements and tobacco, and pulling up duties/ levies and standardizing tax on POL products. To highlight, FED on cements currently stands at PkR75/bag where a PKR10/bag increase in the FED should translate into PKR3.6bn additional revenue for the Government. For the downstream oil space, severe curtailment in GST and PDL (1HFY19 GST/PDL average on ex-depot price for HSD at 7.6/9.7% vs. 15.8/13.4%) leaves a revenue shortfall of PkR16.4bn during 6MFY19. Jan'19 pricing set out to reverse this trend, where GST/PDL on MS and HSD was raised to 14.5/15.0% of Ex-depot price, where declining volumes (HSD/MS volumes down 21.5/2.5%YoY during 6MFY19) are expected to weaken the GoP's ability to raise revenues from GST and PDL on MS/HSD. Assuming Jan'19 augmented rate for GST and PDL are to prevail for 2HFY19, we expect the GoP to raise PkR230.9/272.8bn from PDL/GST levies on HSD and MS volumes, moving +18/-24%YoY over FY18 collections. The Government is also considering 50% waiver on outstanding amount of GIDC relating to Fertilizer sector. As of Sep'18, the total outstanding amount under the header stands at PkR61bn, where in a straight-

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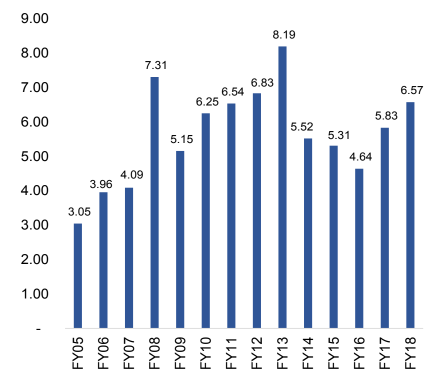
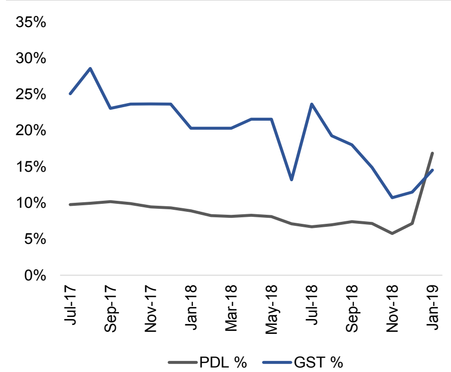
Budget Balance (%GDP)

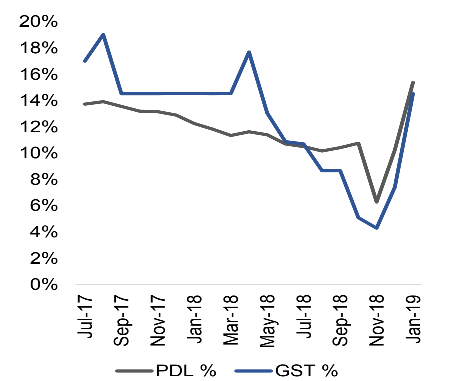


Source: Pakistan Economic Survey & AKD Research

Levies and taxes on HSD



Levies and taxes on MS



Source: OGRA and AKD Research

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forward scenario (Authorities not adjusting the receivables with subsidy payable), Government could raise PkR30.5bn additional revenue.

Sector Implications

General	Comments
Rationalization of Super Tax	Positive for Conglomerates
Rationalization of taxation of holding companies on inter cooperate dividend	Positive
Decrease withholding tax on cash transaction for non-filers	
Increase in duty on smart phones	Negative for PTCL (Ufone)
Autos	
Increase in duty on import of luxury cars	Subsititution effect to promote sales of newly laucnhed upgraded variants of local OEMs
Lift ban on purchase of cars of up to 1300cc for non-filers and for overseas Pakistanis	15.5%YoY dip in 1300cc and below segment sales in 6MFY19 show that the indsutry's largest segment is particularly vulnerable to non-filer ban. Removal of the same would be clear tailwind
Increase in duty on import of tyres	Positive for local manufacturers, particularly in after-market sales
Tobacco	
Increase Federal Excise Duties (FED) on cigarettes	Manufacturers need to balance cost pass through with decrease in volumes as demand for sumgulled cigrattes could increase
Fertilizer	
50% waiver of outstanding GIDC for fertilizer sector	One-off gains for the manufacturers however, we expect manufacturers to pass-on the impact translating into PkR200/bag. Positive for FFBL, Neutral for FFC and negative for EFERT and FATIMA.
OMC	
Standardize sales tax on petroleum products likely at 17%	Incremental demand due to falling oil prices will get dettered, discretionary demand may falter. Jan-19 applicable GST and PDL rates were raised; if continued, the benefits will get offset by volumetric decline
Cement	
Increase Federal Excise Duties (FED) on cements	Chances of a full pass-on of increase in FED seem low given low pricing power in the wake of upcoming capacity additions
Paper & Boards	
Increase in duty on import of paper	Positive for local manufacturers. Psoitive margin headwinds for packaging companies
Ceramics	
Increase in duty on import of tiles	Positive for local manufacturers
Textile	
Increase in duty on import of yarn	Positive for spinning sector

Source: AKD Research

Budget to offer short term boost to the market: Stock market incentives such as, i) abolishment of 0.02% advance tax on shares sale/purchase, ii) carry forward of capital losses for up to 3 years, iii) standardization of CGT at 15% with 0% tax if holding period is less than three years (Currently CGT varies from 7.5-15% for filers and 11-18% for non-filers), and iv) reducing tax on dividends, could provide adrenaline rush for the market in the short run. However, medium to long-term trend is dependent on the policy direction set by the supplementary budget. At present, while IMF entry is certain, different policies are given out with respect to Government's agenda ranging from populist measures (removal of CGT on banking transactions), import substitution (raised import duties on vehicles, white goods, finished good), and fiscal/external balance. From hawkish lens, we view the mini-budget to bring upon inflationary pressure (hike in fuel prices, cements etc.) setting the course of interest rate hikes (Positive for Banks), while It can potentially be conducive for import substitution industries (Autos, selected chemicals), while negative for OMCs and Cements.

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Buy	**> 19% expected total return (Rf: 13% + Rp: 6%)**
Neutral	**> 13% to < 19% expected total return**
Sell	**< 13% expected total return (Rf: 13%)**

Old Rating Definitions (Discontinued)	
Buy	**> 20% upside potential**
Accumulate	**> 5% to < 20% upside potential**
Neutral	**< 5% to > -5% potential**
Reduce	**< -5% to > -20% downside potential**
Sell	**< -20% downside potential**
Not Rated	**No investment opinion or recommendation**

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To arrive at our period end target prices, AKDS uses different valuation techniques including:

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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