

FY19 Budget: The Much Awaited Catalyst for the Stock Market



Budget Highlights

- Total budget outlay is Rs 5.93 trillion, which is 10.7% higher than the FY18 revised estimate
- The total revenue is estimated at Rs.4.9 trillion, which is a 3.0% increase from revised estimates of FY17-18
- FBR tax collections are estimated at around PKR 4,435bn, up 12.7% from FY18 revised estimates. Of this, the government expects to raise 39% from direct taxes while indirect taxes are expected to yield 61%
- Federal PSDP is targeted at PKR 800 billion; this is a cut of 20% from budget FY18 but an increase of 6.7% from FY18 revised estimate
- GDP growth target is set at 6.2% for FY19
- Inflation target has been set at 6.0% for FY19
- Overall deficit is targeted at Rs. 1.89 trillion, 4.9% of GDP

Key points from Economic Survey

- Country's overall economic growth rate was recorded at 5.8 percent, while last year it was 5.3 per cent. This number was the highest growth rate recorded in the last 13 years.
- FBR tax collection grew by 8.2 percent and stood at Rs 3,367.9 billion against Rs 3,112.5 billion recorded in FY 2016.
- Agriculture sector recorded a remarkable growth of 3.81 percent during 2017-18 and surpassed its targeted growth of 3.5 percent and last year's growth of 2.07 percent. This

high and broad based growth was achieved on the back of initiatives such as expansion in credit to agriculture sector, better quality seeds and timely availability of agriculture inputs.

- Expenditure under PSDP has posted a growth of 25.4 percent and reached to Rs 558.8 billion during July-December, FY 2018 against Rs 445.7 billion in the same period of FY2017.
- The industrial sector (20.9% of GDP) has grown by decent 5.8% (5.5% in last year) but lower than Govt. target of 7.3%. Major contribution to this came from Large Scale Manufacturing, which recorded a growth of 6.13% (provisional 9 month growth), the highest in ten years.
- Total public debt recorded an increase of Rs. 1,413 billion during 1HFY18, as it reached RS. 22,820 billion. Domestic debt saw an increase of RS. 582 billion while increase in external debt stood at RS.830 billion.
- Accordingly, fiscal deficit registered decline from 8.2 percent in FY 2013 to 5.8 percent of GDP in FY 2017.
- Inflation remained significantly below the target level of 6% as it averaged around 3.8% in 9MFY18. Weak food and non-alcoholic beverages prices helped offset the increase in international oil prices.
- After a prolonged spell of maintaining interest rates at historical low levels, Monetary Policy Committee (MPC) of State Bank of Pakistan (SBP) finally raised interest rates by 25bps in Jan-18 to 6.00%.
- Per capita income increased to \$1629 from \$1333 last year.

Stock market has staged a spectacular rally since late December last year, owing to improved clarity on the continuity of existing political setup. The positive steps taken for investors in the sixth budget presented by the sitting government will add to factors leading to improvement in investor confidence. Despite the chaotic conditions under which it was presented in the National Assembly, the FY19 budget is expected to be positive for the market in general. The government chose to undertake populist measures marked by tax concessions and reduction in cost of farm inputs, hence, setting stage for the pre-election campaign to appease voters.

Key changes that are expected to impact the stock market are the following:

- **Enhanced Benefits for Mutual Fund Investors:** Now Investors can avail greater tax credit on mutual funds since the Investment limit for tax credit in mutual fund investment has been raised from PKR1.5 million to PKR2 million. In addition to this, Withholding tax @ 5% on issuance of bonus shares by mutual funds have also been exempted.
- **Increasing Investment Restrictions for Real-Estate Sector:** Non-filers will not be able to purchase property having declared value over PKR 4mn. Furthermore, FBR will have the right to purchase the property over 100% declared value in the initial years, a right that will be exercised if declared value varies from market price of property. This may draw more liquidity towards mutual funds
- **Corporate Tax rate:** Tax rates have been reduced to 29% which is expected to have limited impact on large-cap focused portfolios since these companies usually exceed minimum threshold required to avail the benefit of reduced tax rate
- **Tax on Bonus shares:** The much awaited abolishment of tax on bonus shares materialized in the final budget proposal, this is expected to support prices of companies that are expected to rely on stock dividends
- **Payout restrictions reduced to 20% of after tax profit and rate has been reduced to 5%:** The minimum payout restriction was reduced to 20% which will reduce dividend flows. It remains to be seen if this restriction has been made completely redundant by the abolishment of tax on bonus shares
- **PTR adjustments:** This is expected to be positive for the brokerage community and support their profitability
- **Amnesty Scheme:** The formal introduction of the provisions to provide one-time amnesty is expected to provide a liquidity boost to the market. However, success of the scheme will depend on nod by the Supreme Court, hence, impact is not expected to materialize immediately. However, this should set a positive tone
- **Super Tax:** The levy of super tax up to FY20 will be a dampener for prices of major blue-chip companies since it has been clarified that the tax is to stay for the next two years. On a positive note the rate has reduced by 1%

Banks (Positive)	Reduction in super tax from 4% to 3% , Withholding tax on non-filers to be reduced from 0.6% to 0.4% , advance tax of 1% from filers and 3% from non-filers on transactions abroad.
Textiles (Positive)	Zero rating, export refinance, LTFF rates at 3%/5% to continue. Another export-related policy in the near future which will be positive for the sector
Chemicals (Positive)	CD withdrawn from Hydrogen Bromide (11%) and Palladium-on-carbon (3%).
Oil & Gas (Positive)	Tax holiday for 20 years for new refineries or expansion of existing refineries with minimum capacity of 100,000bpd for refineries established till FY23 Sales Tax on LNG reduced from 17% to 12%, VAT of 3% on import of RLNG to be removed. FO sales tax reduced to 17% from 20% on import
Fertilizers (Positive)	GST on all fertilizers reduced to 3% coupled with subsidy removal of Rs 100/bag. GST on Feed gas reduced from 10% to 5%. GST on import of RLNG for feed stock has been eliminated (Positive for AgriTech, Fatima Fert, Pak Arab)
REIT (Positive)	The rate of tax on dividends issued to the unit holders of Rental REIT has been reduced from 12.5% to 7.5%. Effective dividend yield for DCR to improve
Cement (Negative)	Increase in FED from Rs 1.25/kg to Rs 1.5/kg ~price increase of Rs 15/bag Import duty on coal is proposed to be reduced from 5.0% to 3.0%. (Positive) 37% YoY higher federal PSDP revised target of Rs1,030 bn. (Positive)
Steel (Negative)	Increase in Sales Tax on electricity to Rs13.0/unit from Rs10.5/unit. (Negative) CD on coils of aluminum alloys for the manufacture of beverage cans to be reduced to 8% from 16% (Positive for STPL)

KSE-100 index is expected to consolidate around these levels and gather energy for the next leg up as the takeover setup is announced and elections are held subsequently.