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Federal Budget FY2015-16-Implications For Economy and Capital Markets

The Federal budget 2015-16 reflects a shift in focus on growth along with further fiscal consolidation after the economy having achieved a reasonable degree of macroeconomic stability during the last fiscal year.

The government envisages to bring down FY16 fiscal deficit to 4.3% of GDP from 5.0% last year through new tax measure including removal of tax concessions granted through SROs, levy of additional taxes on both documented and undocumented sectors, and tight control over current expenditures especially subsidies. Inflation is expected to remain benign (at 6%) in the next fiscal year due to stable commodity prices (notably oil), restricted money supply growth and stable exchange rate. External account position is also projected to remain healthy due to (i) a contained current account deficit as a result of higher remittances and manageable trade deficit; (ii) healthy surplus on financial account driven by bilateral/multilateral disbursements and significant jump in Foreign Direct Investment (FDI) in infrastructure and energy sectors under the China Pakistan Economic Corridor (CPEC).

The government has set an ambitious GDP growth target of 5.5% for FY16, compared to 4.2% provisional estimates for FY15, supported by a boost in public investment. The government intends to achieve the above through (i) higher development expenditures (up 27% to Rs. 1.5 trillion) with emphasis on energy and infrastructure e.g. projects under CPEC have been allocated Rs. 178bn (ii) significant fiscal incentives for investment in different sectors of the economy e.g. agriculture, construction, infrastructure, energy, etc. Resultantly, investment to GDP ratio is projected to rise to 17.7% in FY16 from 15.1% in FY15.

	2013	2014	2015	2016 Budget
GDP Growth (%)	3.7	4.0	4.2	**5.5**
Inflation (%)	7.4	8.6	4.6	**6.0**
Fiscal Deficit (% GDP)	8.2	5.5	5.0	**4.3**
Current Account Deficit (% GDP)	1.1	1.3	0.6	**1.0**
Investments to GDP Ratio	15	15	15.1	**17.7**

Source: Economic Survey, Annual Plan

The budget carried a number of negative surprises for the stock market and individual companies such as (i) increase in Capital Gains Tax; (ii) increase in tax on dividends; (iii) levy of an all encompassing one-off super tax on 2015 earnings at 3% for non-banking companies and 4% for banks with 4.5-6.0% impact on their profitability; and (iv) a uniform 35% tax applicable on all sources of income for banks.

Excessive taxation and stuck-up tax refunds, power shortages, and an overvalued currency will negatively impact our growth and exports. Resultantly, we believe that growth and investment targets set by the government are ambitious and unlikely to be achieved. However, we estimate that driven by improving security situation, low interest rates, higher private sector credit off take, some improvement in energy supply, and progress on CPEC, economic growth could rise to 4.5% - 5% for the next year.

We expect inflation and interest rates to remain benign during FY 2015-16 on the back of largely contained fiscal deficit, soft commodity prices, and stable exchange rate. We hold a positive outlook on the stock market for this fiscal year on the back of improving macroeconomic fundamentals and ensuing corporate earnings growth coupled with easy monetary conditions. Based on this outlook, we expect the stock market to yield healthy double-digit return in FY16. Based on our superior performance track record, we expect our equity-related funds to out-perform the market in this fiscal year as well.