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Implications of FY15 Budget for the Capital Market

The Federal government has recently unveiled its FY15 Budget. Through removal of tax concessions, levy of additional taxes mainly on undocumented sector, and tight control over expenditures, the government aims to bring down the fiscal deficit to 4.9% of GDP. The target for GDP growth is set at 5.1% based on higher expected growth in agriculture and services sector, and continued momentum in the industry sector. Inflation is anticipated to clock at around 8.0%, indicating that government expects price pressures to remain subdued in the next fiscal year as well.

	FY11	FY12	FY13	FY14E	FY15F
GDP Growth (%)	3.7%	3.8%	3.7%	4.1%	5.1%
Inflation (%)	13.7%	11.0%	7.4%	8.5%	8.0%
Tax Revenue % of GDP	9.3%	10.2%	9.8%	10.6%	11.5%
Fiscal Deficit % of GDP	6.5%	6.8%	8.2%	5.8%	4.9%

Source: Economic Survey & Government Projections

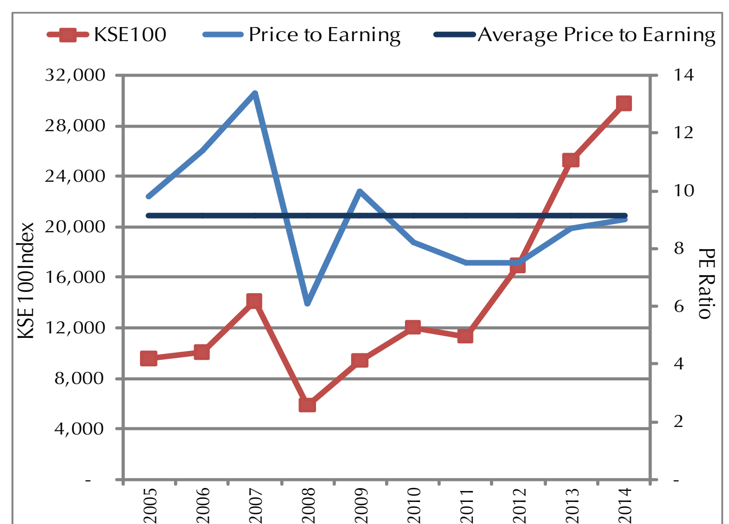
Though we find FY15 macroeconomic government targets a bit ambitious, we expect the government to achieve a fair degree of fiscal consolidation with next year budget deficit of around 6% of GDP. Further, despite an expected 20-30% increase in gas and electricity tariffs, we anticipate headline inflation to remain in single digits due to stable global commodity prices, government's net retirements to SBP, and recent appreciation of PKR against the US dollar. With inflation likely to remain in control, we expect interest rates to remain at current levels over the next 12 months.

We anticipate external account position to further strengthen in FY15 due to: 1) a manageable deficit on current account driven by decent remittances growth, strong exports and continued Coalition Support Funds (CSF) receipts; 2) a sizable surplus on the financial account on the back of higher multilateral lending, privatization proceeds, portfolio in flows and a likely pick-up in Foreign Direct Investment (FDIs) especially from China in the energy sector. Thus, we expect country's foreign exchange reserves to increase to over USD17bn by the end of FY15.

Reduction in corporate tax rate to 33% and lower than expected increase in CGT (12.5% vs. 17.5% scheduled) for holding period of up to one year were the key positives for the stock market. However, the budget carried some negative surprises including 10% CGT on 1-2 year holding period, 5% tax on stock dividends, and 5% adjustable additional tax on dividends.

For listed sectors, the budget was a mixed bag. For instance, to offset the recent appreciation in Pak Rupee (PKR) and enable it to benefit from GSP plus status, the textile sector was given a number of incentives including reduction in export refinance/long term financing rates, early processing of refund cases, duty drawbacks on additional exports and extension in period of duty-free machinery imports. Cement sector should benefit from increase in PSDP allocation, while increase in Gas Infrastructure Development Cess (GIDC) would be a negative for the fertilizer sector and industries, in general.

On an overall basis, the budget has no negative implications for the stock market. Further, given the favorable macroeconomic backdrop, we expect stock market performance to remain healthy for FY2014-15. During the last two years, the market has depicted very strong return averaging 47% p.a. We do not expect the stock market to repeat the above performance in FY15. However, given reasonable market valuations as captured in 9 times forward earnings, and 20% expected corporate earnings growth in FY15, we expect the stock market to rise by 20% in the next fiscal year. We have positioned the portfolios of our equity- related funds accordingly. Based on our performance track record, we expect our equity-related funds to perform better than the market.



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