NBP Fullerton
Asset Management Ltd.
A Subsidiary of
National Bank of Pakistan

Dr. Amjad Waheed, CFA
Chief Executive Officer

FY17 Budget-Implications for Economy and Stock Market

The federal government has unveiled its FY17 Budget. After achieving considerable macroeconomic stability during the first three years of its tenure, mostly owing to global developments notably significant decline in crude oil prices, the government in the latest budget has aimed to boost the GDP growth rate, as well as achieve further fiscal consolidation.

The government has set an ambitious economic growth target of 5.7% for FY17, compared to 4.7% provisional number for the outgoing fiscal year. The government plans to lift GDP growth rate through (i) incentivizing agriculture sector and export-oriented industries, the two growth laggards for FY16; (ii) higher development expenditures (up 20% to Rs. 1.675 trillion) with focus on energy and infrastructure sectors; and (iii) formidable fiscal incentives for private investment in different sectors of the economy. For instance, tax credit equal to ten percent of the amount invested in Balancing, Modernization and Replacement (BMR) of plant and machinery already installed has been extended till June 2019 that was expiring on June 2016. Where a company opts for enlistment on stock exchange a tax credit equal to 20% of tax payable shall be allowed for a period of two years. Tax credit for a company formed for establishing and operating new industrial undertaking has been extended from 30th June 2016 to 30th June 2019 and eligibility clause for having 100% equity has been revised down to 70%.

We expect GDP growth to remain below government forecasts as the crops sector, especially cotton and rice, is still mired by weak prices and subdued international demand, while large-scale manufacturing growth could be below target due to capacity constraints and higher base following strong performance in some industries during FY16. Services sector growth may also be below projections due to subdued performance of the financial sector. Nonetheless, supported by robust consumption and rising investment demand, GDP growth is likely to touch 5% mark in FY17 on the back of strong performance by Construction, Electricity, and Gas Generation & Distribution sectors.

Key Macroeconomic Indicators and Targets	FY13	FY14	FY15	FY16E	FY17 Budget	FY17 NAFA
GDP Growth	3.7%	4.1%	4.0%	4.7%	5.7%	5.0%
Agriculture	*2.7%*	*2.5%*	*2.5%*	*-0.2%*	*3.5%*	*2.5%*
Industry	*0.8%*	*4.5%*	*4.8%*	*6.8%*	*7.7%*	*7.0%*
Services	*5.1%*	*4.5%*	*4.3%*	*5.7%*	*5.7%*	*5.1%*
Inflation	7.4%	8.6%	4.5%	3.5%	6.0%	6.0%
Fiscal Deficit (% GDP)	8.2%	5.5%	5.3%	4.3%	3.8%	4.5%
Current Account Balance (% GDP)	(1.1%)	(1.3%)	(1.0%)	(0.6%)	(1.5%)	(1.5%)
Foreign Exchange Reserves (USDbn)	11.0	14.1	18.7	21.6	23.6	22-23

Source: NAFA Research, Economic Survey, Annual Plan

Through removal of some tax concessions, levy of higher taxes on non-filers, tight control over current expenditures, especially subsidies, and a sizable provincial fiscal surplus, the government aims to bring fiscal deficit down to 3.8% of GDP. We find the fiscal deficit target formidable and would like to mention the following risks (i) election considerations and no IMF oversight after the completion of the current program in September may tempt the government to go for additional spending; (ii) budgetary allocation for subsidies being unrealistically low, actual subsidy bill could be significantly higher; (iii) revenue collection may be below target; and (iv) provincial governments may not achieve the desired fiscal discipline. Further, from a structural perspective, the budget fell well short of the efforts to broaden the tax base and document the economy to tap large tax evaders i.e. agriculture, services business, especially wholesale and retail trade, and real estate. In our opinion, FY17 fiscal deficit would be around 4.5% of GDP.

The government expects inflation to pick up to a still benign 6.0% in FY17 due to a measured increase in commodity prices and a relatively stable exchange rate. Current account deficit is projected to increase to 1.5% of GDP (US4.8bn) due to higher growth in imports especially those related to energy and infrastructure projects. However, overall balance of payments position is projected to remain comfortable on higher financial inflows. Subject to seemingly benign global crude oil prices, we largely concur with official forecasts on inflation and external account.

For listed sectors, the budget is a mixed bag. For instance, in line with its theme, the budget is extremely positive for textile (zero rating, lower financing rates, reduction in duties, extension in DLTL and resolution of pending refunds) and fertilizer sectors (GST reduction to 5%, higher subsidies, enhanced agriculture credit). While insurers (uniform taxation), steel manufacturers (higher sales tax) and food (dairy) producers (removal of zero rating, regulatory duty on powdered milk import) would be negatively impacted due to increased taxation. For banks and energy stocks, budget has neutral implications. Though cement sector would face higher Federal Excise Duty (FED), it would also benefit from higher Public Sector Development Program (PSDP) expenditures.

Barring some minor negatives, the budget has no surprises for the broader stock market as most of the proposals, such as one-year extension in super tax and decreases in corporate tax rate by 1%, have already been well anticipated and priced in. With budget behind us, the market participants would now wait for MSCI decision on up-gradation of Pakistan to MSCI Emerging Market Index from MSCI Frontier Market Index. Given the favorable macroeconomic backdrop, reasonable stock market valuations, ultra-low yields on fixed income avenues, improving security conditions, and expected inclusion of Pakistan in the aforesaid Index which would attract sizable foreign portfolio inflows we expect the stock market to deliver healthy returns over the next 12 months.