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

Budget FY 12-13 - Implications for Investors

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Impact on Inflation, Interest Rates and Exchange Rates

The budget seems ambitious both in terms of the revenue targets and rationalizing Government expenditures. Thus, the budget deficit for the next fiscal year is again expected to touch around 7.5% of GDP or around Rs 2 trillion. The deficit is expected to be predominantly financed by domestic borrowing via National Savings Schemes and from commercial banks due to lack of significant foreign flows. This would fuel inflationary pressures, which may force State Bank of Pakistan to increase the discount rate. The Pakistani rupee is also expected to further weaken against foreign currencies due to rising pressures on the external accounts emanating from muted Foreign Direct Investment, Foreign Portfolio Investment and scheduled payments to IMF. Therefore, investors are advised to invest in instruments and bank deposits of 1-year maturity or less to avoid pricing and interest rate risk.

Implications for the Stock Market

The Finance Bill has proposed to incorporate the newly introduced Capital Gains Tax Ordinance wherein no source of income will be asked by FBR for investments in listed securities made for over 120 days. This will give comfort to investors. Also, the reduction in turnover tax from 1% to 0.5% will help companies presently incurring losses or earning small profits. However, if inflation and interest rates rise, as stated above, the stock market may react negatively.

Impact on Mutual / Pension Funds Investors

The Government has proposed to increase limit of investment eligible for tax credit for individual investors (salaried & non-salaried) from 15% to 20% of the taxable income. Further, the maximum amount allowable for tax credit is increased to Rs 1,000,000 from Rs 500,000. As the Table below depicts, individuals who avail the tax credit can significantly enhance return on their investment in money market funds. For instance, the tax benefit for an individual investor with taxable income of Rs 5,000,000 is Rs 148,500. In other words, for this investor the expected return on a money market fund increases to 25% p.a.

Salaried Individuals

Taxable Income (Rs per annum)	Tax on Salary (Rs)	Allowable Mutual Fund Investment for Tax Credit (Rs)	Expected Return on Money market Mutual Fund (Rs)	Tax Saving (Rs)	Total Benefit (Rs)	Overall Expected Return on Money Market Mutual Fund (p.a.)
			10% p.a.			
500,000	5,000	100,000	10,000	1,000	11,000	11.00%
750,000	17,500	150,000	15,000	3,500	18,500	12.33%
1,000,000	42,500	200,000	20,000	8,500	28,500	14.25%
1,500,000	92,500	300,000	30,000	18,500	48,500	16.17%
2,000,000	167,500	400,000	40,000	33,500	73,500	18.38%
2,500,000	242,500	500,000	50,000	48,500	98,500	19.70%
3,000,000	342,500	600,000	60,000	68,500	128,500	21.42%
3,500,000	442,500	700,000	70,000	88,500	158,500	22.64%
4,000,000	542,500	800,000	80,000	108,500	188,500	23.56%
5,000,000	742,500	1,000,000	100,000	148,500	248,500	24.85%

**Benefits for the non-salaried class individual investor are significantly higher than the salaried class for the same taxable income level*

In addition, to encourage savings for retirement, the Government has proposed benefit to the pension fund investors. Any monthly installment received by the pension fund investor from any income payment plan by the pension fund manager will be tax exempt if the investment is held for a period of 10 years. Moreover, any withdrawal of accumulated balance by the pension fund investor from an approved pension fund that represents the transfer of balance from an approved provident fund will also be tax exempt.