Flying in a blue dream

FY24 Budget Commentary | JS Investments

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In economics, where numbers hold sway and rationality reigns supreme, the recently announced fiscal budget feels like a daring tightrope walk between optimism and delusion.

Whether one considers it an exercise in smoke and mirrors or a valiant attempt to calm the restless seas amidst the rising tides of economic uncertainty, the budget process this time has been adorned in a cloak of tranquility.

Such is the commitment to upholding the serene atmosphere that reigned during the budget speech, an unprecedented occurrence in recent times, that the official documents have yet to grace the Ministry's website as we pen this piece.

Witnessing the artful act of delaying the inevitable (read “reforms”) must have undoubtedly failed to resonate with those of us who view the present moment as a decisive crossroad, a pivotal tipping point, or a now-or-never juncture.

BUDGET AT A GLANCE FY2023-24.

(Rs. In Billion)

RESOURCES			EXPENDITURE		
	FY23R	FY24B		FY23R	FY24B
Tax Revenue (FBR) - Federal Consolidated Fund	7,200	9,200	A. Current	10,526	13,320
			Interest Payments	5,520	7,303
Non-Tax Revenue	1,618	2,963	Pension	609	761
			Defence Affairs & Services	1,586	1,804
a) Gross Revenue Receipts	8,818	12,163	Grants and Transfers to Provinces & Others	1,155	1,464
b) Less Provincial Share	4,129	5,276	Subsidies	1,103	1,074
			Running of Civil Govt.	553	714
I. Net Revenue Receipts (a-b)	4,689	6,887	Provision for Emergency and others	-	200
II. Non Bank Borrowing (NSSs & Others) - Public Account*	1,996	1,906	B. Development & Net Lending	564	1,140
III. Net External Receipts - Fed. Consolidated Fund*	533	2,527	Federal PSDP	714	950
IV. Bank Borrowing (T-Bills, PIBs, Sukuk) - Fed. Cons. Fund*	800	3,124	Net Lending	(150)	190
V. Privatization Proceeds - Fed. Consolidated Fund*	1,172	15			
Total (II + III + IV + V)	4,501	7,572			
TOTAL RESOURCES (I to V)	11,090	14,460	TOTAL EXPENDITURE(A+B)	11,090	14,460

* Budgeted FY23 Numbers

Source: Ministry of Finance & JSIL Research

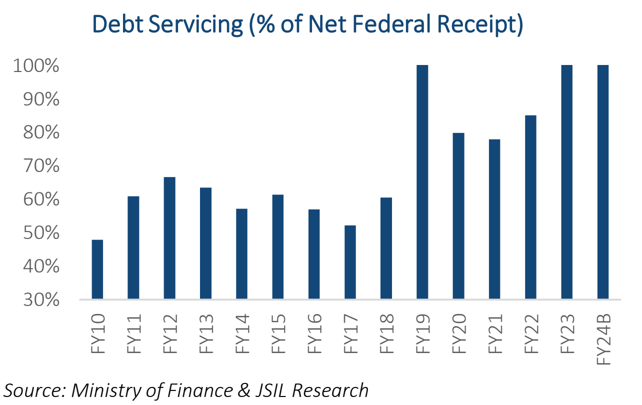
On a whimsical note, while building upon the budget's momentum, the Monetary Policy Committee (MPC) in its today's decision, maintained the status quo. This was also in line with expectations given the recent injection of liquidity through a 77-day Open Market Operation (OMO) conducted last Friday. Anticipate significant OMO injections in response to heightened budgetary financing demand going forward.

Upon reviewing the anticipated GDP growth and inflation figures for the upcoming year, these conform to market expectations, save for one notable exception: the budget estimates themselves. This may be just another one of those run-of-the-mill "election year budgets," and it's probably a matter of weeks before this government bids us farewell, as some are suggesting; while the chatter on mini-budget(s) also remains commonplace like it's no big deal. But here's the thing, when it comes to the expenses and the necessary funding, especially through external sources, it all seems quite far-fetched.

While some may effortlessly bask in the illusion of tranquility, those of us immersed in financial markets know all too well that maintaining such a facade is no cakewalk. Barring any exclusive insights reserved solely for the leadership steering the ship of affairs, we can only assume there might be a secret stash of wisdom hidden from our humble comprehension. The endeavor to envision approximately $24 billion worth of gross external funding poses the most formidable challenge in the present circumstances. Moreover, this predicament arises when the net federal receipts are expected to be surpassed by interest payments, which appear to have been understated. And with that, the time is drawing near when the need to reassess the National Finance Commission (NFC) award will become pressing.

Key Economic Indicators	FY23E	FY24B
GDP Growth	0.3%	3.5%
CPI Inflation (Avg.)	29.3%	21.0%
Exports of Goods (US$mn) - SBP	27,366	30,000
Imports of Goods (US$mn) - SBP	53,115	65,000
Trade Deficit of Goods (US$mn)	(25,749)	35,000)
Remittances	27,290	33,000
Current Account Balance	(3,986)	(5,800)
Budget Deficit (% GDP)	6.90%	6.50%

External Financing Sources	
(US$mn) (PKR/US$ assumed at 290)	FY24B
EXTERNAL LOANS	23,705
Project Loans	2,043
Federal Government	236
Provinces	1,807
Programme Loans	2,660
Other Aid	19,002
Saudi Arabia (Time Deposit)	3,000
New Deposit KSA	2,000
New Deposit UAE	1,000
Euro Bond/International Sukuk	1,500
Commercial Banks	4,500
SAFE China Deposit	4,000
IMF Loan for Budgetary Support	2,400
Others	602
EXTERNAL GRANTS	166
External resources	23,870
Project Loans & Grants Outside PSDP	169
Gross External Resources	24,040
Foreign Loans and Repayment	(15,166)
Repayment of Foreign Credits	(161)
Net External Resources:	8,713



Source: Ministry of Finance & JSIL Research

Amidst the pursuit of the path of least resistance, it becomes challenging to ascertain the direction we are traversing or the specific allegiance we are aligning with, particularly within the current global geopolitical landscape. Whether it pertains to the United States or China, both sides appear inclined to defer rescue responsibility to others. With numerous countries teetering on the brink of default, this impasse could serve as a foreboding sign for the economies in distress across the globe.

Even though some perceive the situation solely through the prism of economic mismanagement, others view it within the context of the earlier-mentioned complex entanglement between the United States and China, where their relationship has considerably soured in recent times. The truth likely lies somewhere amidst the interplay of these two perspectives.

While, on one hand, the idea of cross-subsidy on fuel was dropped, and efforts to contain subsidies and demonstrate a surplus in the primary balance have also been highlighted in this budget, it is worth noting that the tax exemptions worth over Rs2 trillion during the outgoing year have taken precedence over aggressive resource mobilization. So much for the IMF Program!

Given that Pakistan has relied on its allies for debt relief and emergency funding over the years, we have consequently developed a certain expectation for miracles at the eleventh hour. However, this time, the assistance from these friendly nations has been evasive. In the absence of substantial aid from these sources, the responsibility would shift to the country's affluent class, as well as the real estate and agriculture sectors. If inadequate support is found there, the burden will only intensify in the industrial and financial sectors, where the trend of retrospective taxation is already gaining traction. Net-net, the budget does not bode well for the corporate sector as a whole. Besides, the haphazard proposals like the retrospective tax on Windfall profits as well as tax on bonus shares may not yield any tangible results. Regarding the former, there is a potential for legal challenges, while in the case of the latter, it raises questions as to why any company would presently consider announcing a bonus share issue. Not to forget, deemed taxation on immovable property, introduced last year, is still hanging in the air.

Due to the substantial corporate taxation, there will be adverse effects on earnings growth and equity valuations. The potential implementation of a tax on windfall profits could significantly disrupt those stock rallies in cyclical industries, which are prone to exhibiting bull/bear patterns influenced by international price fluctuations impacting commodity prices and foreign currency movements. Hence, this will negatively reflect on the market volumes. Conversely, the prospect of increased cash dividend expectations from state-owned enterprises (SOEs) remains uncertain, particularly in light of the persistent circular debt issues, notably within the Gas sector. It is difficult to imagine how PSO (Pakistan State Oil) would be able to distribute a cash dividend of Rs 28.50 per share.

Dividend on Listed State-owned entities (SOEs)

Companies	Govt. Holding	FY23B	FY23R	FY24B	FY24E
		(PKR mn)			(PKR/share)
OGDC	75%	36,500	30,000	61,000	19.0
PTC	52%	2,000	2,000	2,000	1.0
PPL	68%	8,000	5,000	14,000	7.5
SNGP	32%	2,000	1,507	2,000	10.0
PSO	19%	2,500	2,500	2,500	28.5
PAKRI	45%	700	559	700	1.8
MARI	18%	4,000	3,704	4,000	163.0
NBP	75%	45	45	45	0.02
Total		55,745	45,315	86,245	

Source: Ministry of Finance & JSIL Research

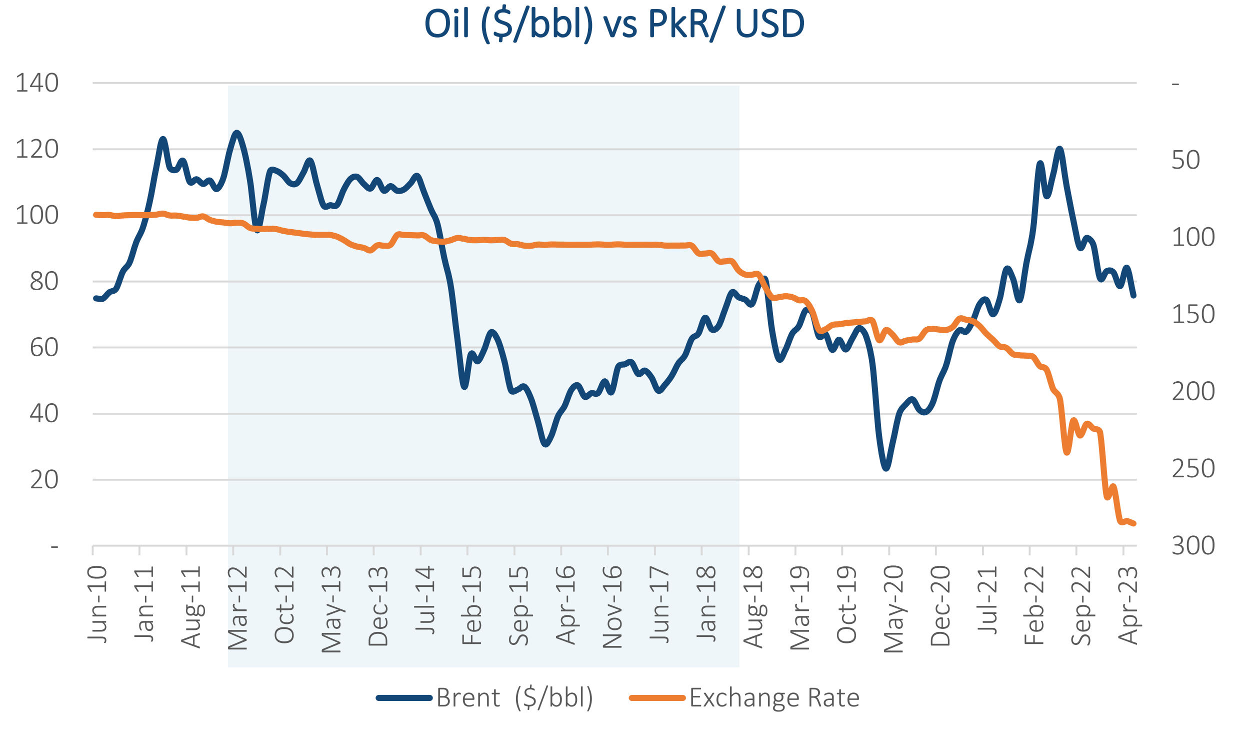
The budget has maintained the status quo regarding capital gains and dividend taxes, without introducing any alterations that would affect mutual funds and capital market investors. However, the government plans to implement a new system allowing direct sales of treasury bills to the general public by way of disintermediation of banks. Furthermore, the Central Directorate of National Savings (CDNS) is expected to introduce digital accounts with higher interest rates for micro-deposits.

Investors continue to express concern over two significant areas of interest that lack clarity. Firstly, the General Elections, which have garnered considerable attention from the masses, have been allocated funds, but the timeline remains uncertain. Secondly, the debt restructuring debate lacks a definitive plan of action, leaving investors in anticipation.

In conclusion, the primary aspect requiring utmost consideration pertains to external financing, as it will have a significant impact on the value of the rupee. Over time, our exchange rate policy has exhibited a bias favoring importers at the expense of exporters, resulting in severe depletion of our valuable foreign exchange reserves. This apprehension has hindered the adoption of a flexible exchange rate regime. The remarkable growth in imports over the years serves as a clear indication of this issue. Rather than acknowledging the actual causes behind our dismal export growth, we deceive ourselves and advocate for stabilization by attempting to fix the value of the Rupee against the dollar.

The fear of embracing flexibility and the disregard for its advantages have become customary and echo through the corridors of power across successive administrations. A striking example of this is evident in the dissipation of the windfall earned from the substantial decline in international oil prices between 2012 and 2016 when the prices dropped from approximately $100 per barrel to around $40. Instead, we remained attuned to supporting the rupee, ultimately leading to a sharp increase in the trade deficit during 2013-2018.

Given the precarious situation we currently find ourselves in, it is imperative that we accept the harsh reality that the exchange rate will significantly influence both inflation and monetary policy. This juncture presents us with an opportune moment for self-correction, as we may not have any alternative but to embrace a flexible exchange rate regime. Though it will be a bitter pill to swallow but doing so will significantly enhance our export performance!



Source: Ministry of Finance & JSIL Research

Better Investments for a Better Future!

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