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NBP Performance at a Glance

Editor's Corner

Dear Readers,

The Federal Budget 2009-10 has been prepared to obtain the twin objectives of stabilization with a human face and growth with equity. This is a welcome development. Past policies which expected the benefits of growth to trickle down to reach the poor, have been a disappointment. In the last nearly eight years, the percentage of population living below the poverty line increased from 30 percent in 1998-99 to almost one-third, with an additional 16 million people being pushed into poverty during this period. The rich became richer and the poor became poorer. The deepening income and wealth inequalities, the poor access of the general population to public services such as education, health and safe water has brought despair among those affected.

It is a daunting task for the government, which needs to bring about much needed fundamental changes in the structure of incomes and delivery of basic social services, in the provision of employment opportunities, improving governance, developing agri business and small & medium enterprise sectors, so that the poor segments of society are able to earn enough to sustain the basic needs of life and have access to the services available. The prospects for achieving a wide range of the millennium development goals, especially in the education sector, in gender inequalities could improve markedly.

Poverty is a multidimensional concept, and is characterized by lack of income, deprivation in education and health, gender disparity and low levels of human capital development. While the incidence of poverty declined in the country between 2000-01 and 2005-06, the last few years witnessed an increase. The proportion of population living below the poverty line fell sharply from 34.5 percent in FY01 to 22.3 percent in FY06, but rose to between 30-35 percent in 2008-09. Large numbers have been pushed into a state of hunger and poverty attributable among other factors to rising food and fuel prices. Food inflation has risen from a low of 6.9 percent in FY06 to 17.6 percent in FY08, touching a record high of 34.1 percent in August '08. As the poorest spend more than 70 percent of their income on food, large sections of population live in absolute poverty, unable to protect themselves against diseases, illiteracy and the means to buy essentials of daily life.

Human development has come to be accepted as a fundamental aspect of determining poverty in developing countries. Despite improvements in certain areas, the pace of overall progress on human development remained slow and Pakistan continued to lag behind other countries in the region in social sector attainment.

The Human Development Index for Pakistan, which looks beyond GDP to a broader definition of well being, ranks the country at 136th out of 177 countries, which shows Pakistan is well below other emerging economies on human capital development. On the Global Hunger Index (ranks countries on under nourishment, prevalence of child malnutrition and rates of child mortality), Pakistan ranks 61 out of 88 countries. Here however, there has been some improvement in the GHI scores for the country between 1990 and 2008. Pakistan's score improved by 3.6 points from 25.3 in 1990 to 21.7 in 2008.

The *Asian Development Bank*, in its report, *Poverty Assessment Update, Pakistan*, *December 2008*, states, "Pakistan's progress on human and social development has not been commensurate with the surge of economic growth witnessed in recent years. The Government is aware of the momentous challenge of human development and has significantly increased expenditures in the pro-poor sectors in recent years, including for higher education, technical education, and for vocational training. But despite the increase in pro-poor expenditures, education sector expenditures, although increased in absolute terms, have, however, stagnated as percentage of GDP at around 2 percent, compared to the minimum of 4 percent of GNP recommended by UNESCO for developing countries. Health sector expenditures similarly have remained constant as percentage of GDP at around 0.6 percent – 0.7 percent in recent years."

In a country like Pakistan which has a growing population in the working age group, if they are educated, trained and healthy they can be productively employed and assist in Pakistan's economic transformation.

Successive governments in Pakistan have adopted various programmes for poverty alleviation. Among these have been initiatives designed to build rural infrastructure; cash transfers, Zakat, Baitul Mal, employment creation by promoting small and medium enterprises; microcredit programmes, Khushal Pakistan Programme, Rural Support Programmes, the Social Action Programmes, the adoption of the Poverty Reduction Strategy Programme. In addition, several large NGO porgrammes supported by international donors have undertaken major rural development efforts in Pakistan in parallel with government programmes.

Poverty alleviation is receiving focus by policy makers. This issue can no longer be regarded as something that can be safely left to the process of growth and the subsequent trickle down process. The policy framework should be such that it generates a growth process which ensures an adequate flow of benefits to the poor. Social safety nets play a crucial role in any comprehensive poverty alleviation strategy. People living in poverty are extremely vulnerable and social safety nets help alleviate the suffering and contribute to a more self reliant, economically viable population.

More emphasis is now being placed by developing countries on developing well targeted direct transfers, either in the form of cash transfers or subsidized food rations. The Grameen Bank in Bangladesh has been able to pull some 700,000 women above the poverty line, which has been replicated in some 43 countries. In Jamaica, the government introduced a food stamp programme in the early 1980s replacing the general food subsidies. The new programme was specifically targeted to the indigent and most nutritionally at risk population. This programme proved to be more efficient than direct food subsidies. 57 percent of the benefits reached the poorest 40 percent of the population, only 34 percent of food subsidies had reached this same group.

Efforts to reduce poverty are unlikely to succeed in the long run unless there is greater investment in the human capital of the poor. Improvements in education, health and nutrition directly address the worst consequences of being poor.

Poverty is now widely treated as an explicit objective, and national plans have targets for reduction in poverty and creation of employment and provision of basic needs. The government also has policies of targeted interventions, aimed at directly improving the conditions of identified groups of poor households. Thus it is the combination of policies which could prove more effective than any single policy, as each would address different aspects of poverty.

The Federal Budget 2009-10, has the Benazir Income Support Programme, a direct poverty intervention measure, which provides direct cash transfers to the most vulnerable. Simultaneously, the Government has enhanced the allocation for the People's Works Programme, for workers welfare, providing affordable housing for the low income through community participation and squatter settlement regulations, focusing on agriculture to ensure food security and generate jobs, support the SME sector are some of the measures, directed towards alleviating the suffering of millions.

Ayesha Mahmud

Federal Budget 2009–10

Economic Scenario

In the outgoing fiscal year 2008-09 the economy faced unprecedented set of challenges. The major challenges were, security concerns, loss of investor confidence, drop in investment inflows, outflow of capital from the equity market, rising fuel and commodity prices in the international market affected the terms of trade and the impact of global financial crisis was felt on the external demand for exports and on the availability of external capital to finance fiscal and current account deficits.

Economic targets have been missed

The overall effect of these challenges has resulted in sluggish growth in the economy. Most of the targets set for economic growth (GDP), agriculture, manufacturing, have been missed, there has been a substantial fall in foreign direct investment inflows and drop in investment to GDP and domestic savings to GDP ratio, inflation rose, equity market declined, the outstanding external debt climbed and the external account remains exposed to uncertainties. The economic cost of the war on terror, according to conservative estimates has cost Pakistan around $35 billion since 2001-02, exerting pressure on public finance.

IMF programme

In October 2008, the Government entered into an agreement with the IMF aimed at addressing Pakistan's macroeconomic imbalances. This programme, supported by SBA, envisages a significant tightening of fiscal and monetary policies, as well as several structural measures in the fiscal and financial sectors. Strengthening the social safety net is a key priority under the programme.

As these reforms took hold, some semblance began to emerge. The economy also benefited from a sharp decline in international commodity and fuel prices. Exchange rate shows some stability, the current account deficit has narrowed and inflation has come down and the fiscal deficit also shows some improvement.

Despite some improvements in the economy, some weaknesses persist, so also the risks attached to the current macroeconomic situation. The tax GDP ratio ranges between 9-10 percent as the tax base continues to be narrow, and with the government's expenditure stretched because of the ongoing war on terror, there is the risk of slippage in the fiscal deficit target.

Need to raise tax-base

The need to raise domestic resources to finance expenditures is of paramount concern. As a substantial reduction in current expenditure is not possible, given the interest payments and defence and civil administration expenses that fall under this head, the burden of any reduction in expenditure falls on development expenditure. This is not a desirable option as it impacts the country's human and physical infrastructure.

Raise value added exports

Manufactured exports are basically textiles and clothing, making up for more than 80 percent of the total. Export of manufactured goods, other than textiles, is very small. Even in textiles and clothing, the low level of productivity and low levels of value added provides opportunities for improving competitiveness and raising export earnings. Sustainable improvement can only be achieved by increasing exports and market diversification.

Infra-structural constraints

Infrastructural constraints are a great impediment to growth. Inadequate investment in infrastructure projects in the past has led to shortages affecting all sectors of the economy. Last year's sluggish growth in large scale manufacturing (decline of 7.7%) was caused mainly by severe energy shortages among other factors. This not only constrained the growth of the sector, but affected employment and exports and created shortages of various manufactured goods, as reflected by a double digit increase in prices.

Cost of power outages

The Second Annual Report 2009, State of the Economy: Emerging from the Crisis, Institute of Public Policy, has estimated the economic costs of power outages in the industrial sector, which accounts for about 28 percent of total

power consumption. Industries which have been affected more by outages are textiles, machinery, and equipment, food, glass and allied products. The overall costs of loadshedding to the industrial sector is estimated to be to the tune of Rs157 billion. Besides this financial cost there is a loss of industrial employment of about 300,000 workers, having grave consequences for the level of poverty in the country, which is already on the rise due to escalating prices and lower growth.

Under the Standby Arrangements with the IMF, Pakistan is pursuing policies directed at reducing the fiscal deficit, lowering inflation and strenghtening the external position. Expanding the social safety net will continue to be the focus of the programme, as poverty afflicts thousands more every day. The policies pursued are directed towards achieving higher investment and growth over the medium term and ensuring vulnerable groups are protected.

The Government it its Annual Plan 2009-10 has set the following targets for FY10.

(In %)

		Targets 2009-10
GDP		3.3
Agriculture		3.8
Major crops		3.5
Livestock		4.0
Fishery		2.4
Forestry		1.0
Manufacturing		1.8
Large Scale		1.0
Services		3.9
Wholesale & Retail Trade		3.3
Finance & Insurance		3.0
Investment as % of GDP		20.0
National Saving as % of GDP		14.7
CPI Inflation		9.0
Exports	($ bn)	18.3
Imports	($ bn)	28.9
Trade Deficit	($ bn)	10.6
Remittances	($ bn)	6.7
Current Account Deficit	($ bn)	9.4
as % of GDP		5.3
Fiscal Deficit	(%)	4.9

Source: Annual Plan 2009-10

The Federal Budget 2009-10 has been presented against a background of some semblance of macroeconomic stability having emerged as the government sought to restore macroeconomic stability and entered into a Standby Arrangement with the IMF. The economy has benefited from a decline in fuel and commodity prices. The rising trend in prices has been contained, the current account deficit has narrowed and the fiscal deficit has been brought down.

However, the country faces grave security concerns as it fights insurgency and terrorism.

Economic costs on war on terror

Government estimates of costs of terrorism are expected to approach Rs678 billion (approximately $8.4 billion) in 2008-09, about 5 percent of GDP. The cumulative economic cost since 2001-02 is over $35 billion.

The war on terror has both direct and indirect costs for the economy. Direct costs include the loss of human life, the infrastructure or property destroyed and the costs of enhanced spending on security. The indirect costs accrue due to loss of exports, inflows of foreign investment, investor confidence, industrial output, tax collection, and the adverse consequences for the local economy where the war is taking place.

The overall economy has suffered greatly because of fight against terrorism. "Potentially, GDP could have been higher by almost Rs590 billion if the problems of security and power shortage alone were not adversely impacting on the economy. The concomitant repercussions for exports, employment and poverty are also sizable," states the *Second Annual Report 2009, State of the Economy: Emerging from the Crisis, Institute of Public Policy.*

Federal Budget 2009-10

The Federal Budget 2009-10 has a total outlay of Rs2482 billion. This size is 19 percent higher than the revised estimates for the year. Current expenditure receives 68.4 percent of the budget allocations, development expenditure (PSDP) 26 percent, an operational shortfall of 0.8 percent has been budgeted, while 6.4 percent has been set aside for other development expenditure.

Box

Economy 2008-09
Highlights

Growth Trends

- The economy slowed down and the performance of major sectors fell short of the targets set for the year FY09.

	2008-09		2007-08
	Achieved	Target	Actual outcome
GDP	2.0	4.5	4.1
Agriculture	4.7	3.5	1.1
Major crops	7.7	4.5	(-)6.4
Minor crops	3.6	2.0	10.9
Manufacturing	(-)3.3	6.1	4.8
Large scale	(-)7.7	5.5	4.0
Services	3.6	6.1	6.6

- The per capita income rose from $1042 in FY08 to $1046 in FY09.
- Total investment as a proportion of GDP declined from 22.0 percent in FY08 to 19.7 percent in FY09.
- National Savings as a percentage of GDP stood at 14.3 percent in 2008-09, while domestic savings was 11.2 percent.
- Net inflow of foreign investment was $2.22 billion during 2008-09 (July-May), compared to $4.23 billion in the comparable period a year earlier. During this period, while foreign direct investment showed more resilience and stood at $3.3 billion, compared to $4.1 billion in the same period last year, it was the portfolio component which showed an outflow of $1103.6 million, against an inflow of $87.2 million in the comparable period.

Fiscal and Monetary Developments

- Fiscal deficit showed substantial reduction from 7.6 percent of GDP in FY08 to 4.3 percent in FY09, largely based on reduction of oil subsidies and a slash on development spending.
- FBR tax collection to GDP stood at around 9 percent.
- FBR revenue collection for FY09 was targeted at Rs1250 billion. Tax collection during the first ten months amounted to Rs898.6 billion. The tax collection performance has felt the impact of slowing economy and falling imports.
- The year witnessed a decline in current expenditure as a percent of GDP to 15.8 percent from 18 percent in FY08. The development expenditure meanwhile fell to 2.8 percent from 4.4 percent.
- Fiscal consolidation was at the top of macroeconomic stabilization agenda for 2008-09.
- The State Bank of Pakistan pursued a tight monetary policy stance upto April '09. The central bank continued to maintain a balance between promoting growth and containing inflation on the one hand and maintaining a stable exchange rate environment on the other.
- The year saw a reduction in CRR by 2 percent. The discount rate was raised in November '08 to 15 percent, and later in April '09, a downward adjustment of 1 percentage in the policy rate was announced.
- SBP's tight monetary policy, and rationalization of fiscal subsidies and expenditure controls are the key factors that contributed a reasonable progress towards macroeconomic stability.
- Domestic inflationary pressures have started to ease, due to improved fiscal discipline and falling international oil and commodity prices.
- CPI inflation May '09 rose by 14.4 percent year-on-year, against 19.3 percent in the comparable period a year earlier. It had touched a high of 25.3 percent in August '08.
- Government's reliance on budgetary borrowings from State Bank has declined since the committed implementation of the macroeconomic stabilization programme in Nov '08.
- The government has financed its additional borrowings needs from the scheduled banks and non-bank sources.
- Credit to the private sector declined sharply during the year. As a percentage of GDP it fell to 22.2 percent compared to 28.1 percent a year earlier.
- The decline is attributed mainly to reduced demand and reluctance of scheduled banks to extend credit. This is constricted by low deposit generation and heightened risk due to rising NPLs.
- There has been a change in the auction process for government paper. Now the Ministry of Finance has replaced the SBP in the core decision making regarding the cut off rates in the primary auction based on target volumes.
- Alongwith the tight monetary policy stance, the SBP continued recourse to open market operations more frequently to manage liquidity at the desired levels in the interbank market.
- The non-performing loans of the banking system have increased.

Balance of Payments

- During FY09 (July-May) exports are provisionally estimated at $16.26 billion, a fall of 5.1 percent against $17.14 billion in the corresponding period a year earlier. Meanwhile, imports declined by 12.4 percent to $31.48 billion from $35.94 billion.
- The trade deficit stood at $15.2 billion against $18.8 billion in the comparable period.
- The current account deficit improved due to a deceleration in import growth, increase in workers' remittances and reduction in services account deficit.
- It stood at $8.5 billion during July-April 2008-09 as against $11.17 billion in the corresponding period a year earlier.
- Workers' remittances totalled $7.0 billion in the first eleven months of FY09 against $5.9 billion in the corresponding period of FY08.
- Total liquid foreign exchange reserves stood at $11.6 billion by end of May '09.

Revised estimates for 2008-09 show that current expenditure at Rs1649.2 billion exceeded the budgeted figure of Rs1493.2 billion by 10.4 percent. This increase is mainly attributable to rising debt servicing, which was higher by Rs132.3 billion over the budgeted figure for the year.

Servicing of debt rising

Servicing of domestic debt and foreign loan repayments rose by 21.7 percent and 26.1 percent respectively.

Debt Servicing

(Rs Bn)

	2008-09 Budget	2008-09 Revised	2009-10 Budget
Debt Servicing	619.3	751.6	779.6
Servicing of Foreign Debt	64.1	71.7	70.3
Foreign Loans Repayment	96.2	121.3	132.4
Servicing of Domestic Debt	459.1	558.6	576.8

Source: Annual Budget Statement 2009-10

In the general public services category, besides enhanced debt servicing, transfer payments were 37.6 percent higher over the year's budgeted figure.

Lower subsidies

The Government has been providing subsidies on petroleum products, power tariffs, wheat, fertilizer and other items, so as to provide some relief to the citizens from the impact of high international fuel and food prices. Expenditure on this account which was estimated at Rs407 billion in FY08, has within a year's time been brought down to Rs252.0 billion in revised estimates for FY09, as the government pursues a policy of gradually bringing down subsidies.

The IMF programme which provides $7.6 billion to Pakistan seeks a reduction in the budget deficit to more sustainable levels. This is to be achieved by raising revenues and restraining expenditures, including phasing out of fuel and electricity subsidies. The elimination of energy subsidies expected to create fiscal space for higher development expenditures.

For FY10, subsidies are budgeted at Rs132.0 billion, nearly 47.6 percent lower, over preceding year's estimate of Rs252. 0 billion. Subsidies to oil refineries has been brought down substantially and to KESC on account of tariff differential.

Subsidies

(Rs Bn)

	2007-08 Revised	2008-09 Budget	2008-09 Revised	2009-10 Budget
WAPDA	113.7	74.6	92.8	62.9
Inter Disco Tariff Differential	87.0	65.0	82.0	10.0
KESC	19.6	13.8	18.8	3.8
TCP/Import of Wheat	40.0	20.0	20.0	25.5
Oil Refineries/ OMCs/Others	175.0	140.0	70.0	15.0
R&D Support to Textile	19.0	0	4.0	0
Development Subsidies on Fertilizer	29.5	35.0	31.7	10.0

Source: Budget in Brief 2008-09 & 2009-10

Petroleum development levy replaces carbon tax

The Budget had levied a carbon tax on POL and CNG for the forthcoming fiscal year, which was to net in Rs134 billion (Rs122 billion from POL and Rs12 billion from CNG), replacing the existing petroleum development levy. Internationally carbon tax has been levied in developed countries such as Finland, UK, Canada, New Zealand on POL products, electricity, natural gas, coal etc.

This measure was not welcomed and a petition was filed in the Supreme Court for its withdrawal. The Supreme Court suspended the Government's decision to levy carbon surcharge on petroleum products. While the decision for withdrawal of carbon surcharge was implemented, the government promulgated an ordinance to reimpose the petroleum development levy on kerosene, diesel and patrol.

Decline in PSDP

Revised estimates for 2008-09 show a reduction of 23.8 percent in the development expenditure, declining to Rs418.9 billion against the budgeted Rs549.7 billion, because of resource constraints. Substantial decline in allocation against the budgeted figure were recorded for water & power (-50%), food & agriculture (-30%), health (-26%), industries & production (-75.8%), Railways (-41.8%), Special Programmes (-55.1%). PSDP for FY10 has been raised to Rs646 billion.

Revenue Receipts

Revised estimates for 2008-09 show that revenue receipts (net) exceeded the budgeted figure of Rs1110.9 billion by 10.2 percent. This is attributable to higher (41%) non-tax revenue, for tax revenue fell short of the target of Rs1251.5 billion by 5.7 percent. Both direct and indirect tax collection fell short of the target. The slowdown in revenue realization could be ascribed among other factors to deteriorating law & order situation, strikes and power outages constraining investors in undertaking any investment plans in the country and significant reduction in voluntary compliance and withholding taxes.

Tax revenue decline

For fiscal 2009-10, tax revenue is budgeted at Rs1513.06 billion, an increase of 28.2 percent over last year's revised estimate. Direct taxes would contribute Rs557.3 billion, while Rs955.7 billion would be generated from indirect taxes on commodities and transactions.

A disaggregated analysis of tax revenue for FY09 shows that direct taxes at Rs461 billion (revised) would be short of the budgeted figure by Rs35 billion. The performance of the various components of direct taxes are responsible for this decline. There has been poor compliance of tax payers under voluntary payments, mainly attributable to poor tax facilitation and weak audit system. The overall growth in voluntary payments has declined. In figures, the payment with returns has fallen to Rs14 billion during July-March 2008-09 as against Rs48 billion in 2006-07.

Fall in direct taxes

The decrease has been due to a decline in the payments received from the corporate sector. And the second component of voluntary payments, i.e. advance tax has not shown any encouraging growth.

Revised estimates for indirect tax collection places it at Rs719.5 billion, a decline of 4.8 percent from the budgeted figure of Rs755.5 billion, mainly due to a fall in collections from customs and sales tax.

Revenue Receipts

(Rs Bn)

	2008-09		2009-10
	Budget	Revised	Budget
Tax Revenue*	**1251.5**	**1180.5**	**1513.1**
Direct Taxes	**496.0**	**461.0**	**557.3**
Income Tax	477.0	443.3	536.2
Workers Welfare Tax	3.5	0	0
Workers Participation Tax	9.0	11.6	13.9
Capital Value Tax	6.5	6.0	7.2
Indirect Taxes	**755.5**	**719.5**	**955.8**
Customs	170.0	145.0	167.2
Sales Tax	472.0	457.0	515.6
Federal Excise	112.0	116.0	137.4
Other Taxes	1.4	1.4	1.5
Airport Tax	0.06	0.06	0.06
Carbon Surcharge on POL**	0	0	122.0
Carbon Surcharge on CNG**	0	0	12.0
Non-Tax Revenue	**427.8**	**603.1**	**513.6**
Income from Property & Enterprises	**128.1**	**107.8**	**118.7**
Profits of PTA	5.8	0	0
Profits of Pak Post	0.6	0.2	1.3
Interest (Provinces)	17.0	18.4	16.8
Interest (PSEs & Others)	22.6	24.2	25.4
Dividends	82.0	64.9	75.2
Receipts from Civil Admn & Other Functions	**183.1**	**236.9**	**281.0**
General Admn	1.6	1.0	1.0
SBP Profits	110.0	150.0	150.0
Defence	70.0	84.2	128.2
Law & Order	0.4	0.6	0.7
Community Services	0.7	0.6	0.7
Social Services	0.3	0.4	0.4
Miscellaneous Receipts	**116.6**	**258.4**	**113.9**
Economic Services	2.2	1.7	1.8
Petroleum Development Levy	14.0	129.2	0
Gas Development Surcharge	17.4	26.3	30.0
Discount Retained on Local Crude Prices	23.5	23.6	15.0
Royalty on Oil	12.7	15.1	8.0
Royalty on Gas	21.3	31.2	27.0
Passport & Copyright Fee	8.2	8.2	8.9
Others	17.4	22.9	23.2

* Of which FBR collection had been projected at Rs1250.0 billion for 2008-09, at Rs1179.0 billion for RE 2008-09 and at Rs1377.5 billion for 2009-10 (BE).

**Replaced by Petroleum Development Levy

Source: Federal Budget in Brief 2009-10

As one of the leading sources of federal tax receipts, the scope of sales tax has enlarged from only manufacturers to importers, wholesalers, distributors and retailers to

Fiscal Measures – Highlights

Some of the measures adopted in the Federal Budget 2009-10

Income Tax

- Exemption limit in respect of a salaried person has been enhanced from the existing Rs180,000 to Rs200,000 and for a woman salaried tax payer from Rs240,000 to Rs260,000.
- Senior citizens enjoy a tax relief of 50% in their tax liability on an income not exceeding Rs500,000. This limit has now been raised to Rs750,000.
- For the Internally Displaced Persons, a 5% tax would be payable by individuals whose taxable income is Rs1 million or more.
- Bonus paid or payable to a corporate employee receiving income Rs1 million or more would be charged a tax at the rate of 30%.
- Income tax collected on export proceeds is being made final discharge of liability of the exporters to facilitate export oriented activities.
- Manufacturers have been allowed tax credit @2.5% of tax payable, if they are able to make at least 90% of their sales to sales tax registered persons.
- Withholding tax on exports is proposed at 4% from the existing rate of 2%.
- Salaried tax payer having income of Rs500,000 or more required to file income tax return alongwith wealth statement.
- Filing of wealth reconciliation statement has now been made compulsory for tax payers who file wealth statement.
- Commissioner of Income Tax authorised to delegate powers to a firm of Chartered Accountants for conducting audit of a tax payer.
- Tax collected on monthly electricity bills exceeding Rs30,000 adjustable against final tax liability.
- A person is entitled to tax credit on interest payment of housing loans upto 45% of the taxable income or Rs500,000, whichever is low. The said limits are proposed to be enhanced to 50% and Rs700,000 respectively.
- Minimum tax at 0.5% of turnover has been restored which was abolished last year.
- Accelerated depreciation on plant, machinery and equipment installed for generation of alternate energy projects has been proposed to be allowed at the rate of 90% of the cost of the asset.

Customs Duty

- Duty on mobile phones reduced from Rs500/ set and removal of RD @Rs250/set.
- Concession/exemption given on pharmaceutical raw materials, live saving drugs and cancer diagnostic .
- Continuation of exemption of duty on import of agricultural tractors.
- Reduction of duty on import of kits for 4-stroke auto-rickshaws from 32.5% to 20%.
- Duty on hydrogen peroxide increased from 5% to 10%.
- Duty on welded stainless pipes increased from 5% to 15%.
- Duty reduced on raw materials of transformers and control panels.
- Duty increased on plastic sanitary ware from 20% to 25%.
- Exemption from duty on steel tubes used for manufacturing of CNG cylinders.
- Increase of duty on tufted carpets from 10% to 15% to avoid mis-declaration with other types of carpets.
- Rationalization of duty on certain items.
- Continuation of regulatory duty on luxury/nonessential goods.
- Some amendments have been proposed in the Custom Act, 1969.
- If a passenger avails the facility of green channel for clearance of his baggage, it would be taken as declaration made by him that no duitable or contraband goods are in his possession.
- No refund shall be allowed if the custom authorities are satisfied that the incidence of customs duty and other levies has been passed on to the buyer or consumer.
- The time period has been enhanced of reopening of cases from two to three years.
- A time limit of 30 days has been prescribed for filing of review application with Director Customs Valuation against determination of customs value.
- Enhancing powers of the Director Customs Valuation.
- Changes in the Definition Clauses.

Sales Tax/Federal Excise

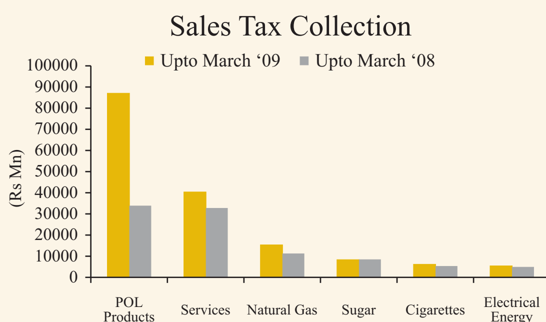
- Records and documents are to be retained till the later of five years or until the final decision in any proceedings.
- Default surcharge will be imposed at the rate of KIBOR plus 3% per annum.
- Reduction in the period by which the Collector/Federal Excise Officer can extend the time limit for adjudication of cases under the Sales Tax Act 1990 and Federal Excise Act 2005.
- Harmonization of provisions regarding appeals to Appellate Tribunal.
- Regularization of the system of Alternate Dispute Resolution.
- Import and supply wheel chairs for special people have been made zero rated.
- Activation charges on cellular phones have been reduced from Rs500 to Rs250.
- Exemption on import of ware potato and onions has been withdrawn.
- The rate of FED on locally produced cigarettes has been enhanced.
- Rate of FED on cement has been reduced from Rs900 to Rs700 per metric ton.
- FED on telecommunications services has been reduced from 21% to 19%.
- 5% FED on motor cars has been withdrawn.
- FED has been levied on advertisement in newspapers, periodicals, hoarding boards, pole signs, signboard and shop board.
- FED on insurance services enhanced from 10% to 16%.
- FED @16% has been levied on fund/non-fund services provided by banking companies and non-banking financial companies.
- FED @16% has been levied on services provided by stockbrokers.
- FED @16% has been levied on services provided by port and terminal operators in respect of imports.

specified services @16 percent generally, except few commodities having 18.5 percent and 21 percent rate of sales tax.

Sales tax misses target

During FY09, sales tax contributed nearly 64 percent of the indirect taxes. It is collected both at the import and domestic stage. However, the target for the year has been missed by 3.2 percent implying a shortfall of Rs15 billion. This is mainly due to import compression. Under the import sub-head, POL products account for more than 33 percent of the sales tax collection at import stage. A decline has been witnessed since November '08, in the tax collected from POL.

Domestic sales tax collection has been higher, except from three sectors, namely, sugar, services and beverages. Collection from POL products has increased substantially from preceding year's collection. The decline in sales tax from three commodity groups was due to procedural bottlenecks and in case of sugar a decline in the production of sugarcane and early closure of crushing season.



Decline in custom duty

Customs duty collection fell short of the target of Rs170 billion by 14.7 percent. In the earlier months of FY09, as fuel and commodity prices rose in the international market, value of imports went up with a corresponding increase in custom duties. In the later period, the prices of petroleum products, iron & steel and other items registered a considerable fall. Import of automobiles, one of the major revenue earners, also fell due to slowdown in demand because of restrictions on car financing by banks. Cost of exemptions remains high, despite Federal Board of Revenue discouraging undue exemptions. Duty free imports on account of imports by hospitals/charitable institutions, on items subjected to 0 percent tariff, etc are also quite high. All these factors have cumulatively led to a decline in customs duty collection.

FED surpasses target

Revised estimates for federal excise duty for FY09 show that Rs116 billion was collected during the year, surpassing the target of Rs112 billion. For FY10, a target of Rs137.4 billion has been set, 18.4 percent higher over last year's estimates. The major revenue earners under this head, included, cigarettes & tobacco, cement, beverages and natural gas. A shortfall in FED collection against the budgeted figure was registered for cement and natural gas. The 1 percent special excise duty levied in the budget 2007-08, has contributed Rs14.3 billion towards excise duty revenue and has helped enhance the FED collection.

Non tax receipts of the federal government were substantially higher (41%) in FY09 against the budget figure, primarily because of larger receipts from SBP profits, defence and petroleum development levy. These three heads constituted 60 percent of the non-tax revenue during the year.

External resources

During the year 2008-09, inflow of external resources projected at Rs300.2 billion, were higher by 22.4 percent at Rs367.4 billion. A substantial increase was recorded in commodity aid (non-food) (budgeted Rs145.6 billion revised figure Rs191.3 billion) and aid flow from the Islamic Development Bank was higher at Rs52.48 billion(target Rs31.25 billion) and from China Rs40 billion (target 0 rupees).

Privatization which had stalled last year is expected to pick up during the year, and proceeds are expected to rise sharply to Rs19.35 billion against Rs1.3 billion in FY09.

The government has set targets for various areas of the economy for FY10. It has through the Budget provided support for the development of agriculture, livestock & dairy farming, fisheries, for village electrification for industries, removing infrastructural bottlenecks, higher PSDP allocations for power sector, and for bringing about a reduction in poverty and improving the lives of millions. Achieving all this is a huge challenge for the government.

Sectoral Implications of the Federal Budget

Banking & Insurance Sectors

Budgetary Impact - Banking Sector

Measures

- Recent amendment in seventh schedule of Income Tax ordinance deprived banks in claiming tax deduction on provisions of NPLs. Facility has been restored and restricted to maximum 1% of total advances in tax year.
- Increase in withholding tax from currently 2% to 4% on importers may indirectly hamper the banks.
- Large import houses previously exempted from WHT on imports will now be taxed which will have indirect implications on banks.
- Customs budgetary measures mainly aim at providing Industrial incentives for growth & expansion, boosting of export oriented sectors and maintains its stance at discouraging import of non essential and luxury items.
- Levy of FED at 16% at VAT mode has been levied on fund/non fund services provided by the banking companies and non banking financial services.
- Enhancement of FED rate on Insurance services from 10% to 16% in VAT mode.

Implications - Neutral

The recent measures taken by Government of Pakistan in the budget on the banking sector are more likely geared to have indirect impact then a direct impact. The higher allocation of PSDP by PKR 646bn (including federal and provincial) is expected to bode well for the banking sector as it would mean more labor being employed in different industries like construction which in turn would fuel other industries like textiles, pharmaceutical and agriculture which would result in more cash influx in the banking system and eventual increase in per capita income.

Despite recent fondness of the government in attracting money through National Saving schemes, we believe that liquidity will find its way back into the banking system arising from employment generation and industry revival.

The Seventh schedule under Income Tax ordinance deprived banks in claiming Income tax deduction on provisions of non performing loans. The facility has been restored and will bode well for the banking sector profits; however the government has capped the deduction at 1% of total loans instead on provisioning of NPL.

Levy of Federal Excise duty enhancement to 16% under VAT mode on fund/non fund services like cheque book issuance etc will result in increased cost of doing banking for individuals/corporations. The impact maybe neutral for the banks as they will pass on the costs to the end consumers; however this may result in decline in number of such transactions.

Trade businesses for the banks stand to lose out as we may see decreased import transactions as the government aims at keeping the current account in check; therefore we see WHT on importers being from 2% to 4%, furthermore the larger import houses which previously were exempted from WHT now comes under the tax bracket.

Government aims at keeping its stance on curbing non-essential and luxury items import through taxes which in some cases exceed 100% of the import value. The budget has also emphasized on proper checks and balances on under-invoicing at import stages which could bode well for the revenue stream of the banks as declaration amount on LC/s would enhance and could result in increased commission for the banks.

Cement Sector

Measures

- Government has set an ambitious target of PKR 646bn for PSDP which is 14% higher than the initial target of PKR 550bn and 78% higher than the revised target of PKR 363bn for the FY09.

Federal component of the PSDP stands at PKR 446bn where as Provincial component has been increased to PKR 200bn from the initial target of PKR 150bn for FY09.

- Reduction of 22% in Federal Excise Duty from PKR 900 per ton (PKR 45 per bag) to PKR 700 per tons (PKR 35 per bag).

Implica-tions - Positive

The government has proposed an overwhelming size of Public Sector Development Program which looks quite optimistic given the fiscal constraints and IMF shackled economy. Track record of the government paints the picture even gloomier as the government couldn't absorb the fiscal pressures on the economy last year making PSDP the ultimate casualty axing a major chunk from the initial target. So the biggest question mark would be the availability of funds as the government is likely to miss the revenue target too given the overall condition of the economy.

In our view, PSDP spending would heavily depend on the swiftness of fund release promised by the Friends of Pakistan. Timely acquisition of these funds would ease some pressure off the fiscal situation providing the vital breathing space for the fiscal starved government. PSDP spending creates a multiplier effect in the economy.

Higher PSDP spending can revert the downward trend in the local cement consumption which so far has suffered a decline of 19%. As PSDP spending and cement consumption are knitted in a strong positive correlation of 0.99, we expect the cement consumption to boost in the next year.
Government has announced:

- PKR 25bn for reconstruction in Earthquake Effected Areas
- PKR 15bn for water courses
- PKR 12bn for Mangla dam raising
- Construction of 9,469 housing units

These allocations breath some life in the local cement consumption. During FY09, extraordinary export growth absorbed the demand pressures from the local front, but going forward as regional demand is expect to decline going forward given the financial slow down and capacity addition by the regional peers. In major demand contraction from abroad, PSDP spending would be of vital importance for the Pakistani cement manufacturers.

Government has reduced the FED by PKR 200 per ton (PKR 10 per bag) from PKR 900 per ton to PKR 700 per ton. Theoretically, this should bring the prices down by at least PKR 10 a bag, but in the past cement manufacturers have pocketed the reduction in the FED, depriving the benefits to end consumers. On the consumption side, 10 rupee per bag reduction in FED won't cause a miraculous turnaround in local demand. Macro economic stability, PSDP spending and improved law and order situation will be the key factors to uplift the cement demand locally.

Oil Sector

Upstream Division (E&P), Midstream(refinery), Downstream (OMC's)

Measures

- Petroleum Development Levy has been replaced by Carbon Surcharge tax.
  The government levied PDL in place of carbon surcharge, through an Ordinance wef July 9, 2009.

Implica-tion-Neutral

We expect this tax will be charged on sales of CNG, HSD and regulated oil products directly from refineries and resale by oil marketing companies. This tax has a fixed nature as compared to PDL. We expect that this tax will be charged at OMC level and will not be a part of the formula for calculation of OMC margin.

We expect that this measure will have a neutral effect on the sector as it does not effect the earnings of refineries and OMCs.

Subsidy for the sector: In the Budget 2009-2010 Government has decided to phase out subsidy gradually from sector therefore it has

slashed the subsidy from PKR 55bn to PKR 15bn for the current year. Moreover, Government has allocated PKR 1.87bn in PSDP for Natural Resources Division for the completion of ongoing petroleum projects.

Auto Assembler Sector

Measures

- Removal of 5% FED on locally manufactured cars.
- PKR 4bn subsidy is proposed for farmers for purchasing tractors under the Benazir Tractor scheme.
- Reduction of duty on imports of Kits for 4-stroke auto rickshaws from 32.5% to 20%.
- Custom Duty on CBU motorcycles is proposed to be reduced from 70% to 65%.

Budgetary Impact - Positive

The automobile industry has been going through the hardest of times, with sales down in the pit and taxes going through the roof. After 8% YoY sales decline in FY08 and another 45% drop in 10MFY09, the industry is in a need of immediate bailout. The exemption of 5% FED on locally produced vehicles would help in easing the skyrocketing vehicles prices and aide in attracting price sensitive buyers; therefore its impact is positive for the local manufacturers. It is highly expected that the local manufacturers will fully pass the FED exemption in a bid to attract to budget conscious consumers. We believe Pak Suzuki would be the major beneficiary of this FED exemption as the company had already reduced the price in the range PKR 20,000-PKR 55,000 in April last. But customers of INDU may not benefit much as INDU had already enhanced car prices by average PKR 30,000.

Subsidized tractor scheme should help local assemblers

A subsidy of PKR 4bn announced for farmers for purchasing tractors under Benzair Tractor Scheme would boost the sales of local tractor manufacturers as it should bring down the existing prices.

Telecommunication Sector

Measures

- Reduction of duty on mobile phones from PKR 500/set to PKR 250/set and removal of RD at Rs.250/set.
- Reduction of activation charges on cellular phone from PKR 500 to PKR 250 per set to reduce cost of new connection on mobile phones.
- FED of twenty paisas per SMS in addition to the existing rates specified to be aimed at meeting revenue requirements.
- Reduction of federal excise duty on telecommunication services from 21% to 19% to reduce the cost of service.
- Fees charged by electronic media on advertisements in the form of 16% FED.

Budgetary Impact - Neutral to Positive

The government in its budget has shown intentions of continuing with the attractive telecom growth and policies in the past. The budget has provided relief measures to the cellular sector which includes the cellular importers.

It has been decided to reduce the Custom duties on mobile hand sets being imported from previously PKR 500/set to PKR 250/set and removal of Regulatory duties of PKR 250/set. This aim has been introduced to stimulate cellular growth in the economy where high inflation (November peak at 25%), decreasing purchasing power, rising unemployment and increased duties at import stages of mobiles have seen the demand of cellular sets declining in the recent past; this reduction in custom duties and elimination of regulatory duty may help in reviving the growth.

Reduction of activation charges from PKR 500 to PKR 250 per set may have a neutral impact on cellular companies but may benefit the consumers as activation charges to the government have now been reduced; however the cellular companies may stand to benefit from such reduction as such activation removal charges schemes introduced from time to time may result in decline in revenue out flow for

the companies. Furthermore, levy of additional 20paisas per sms may result in increased revenue stream for the government but may result in squeezed profits for cellular companies along with decline in outgoing sms. FED on telecommunication services have also been reduced from 21% to 19% to reduce the cost of service.

The above measures bode positive for the telecommunication sector and may aid in attracting further Foreign Direct Investment needed to stimulate growth in the sector. Reduction in custom duties will result in increased penetration (currently standing at 90mn users) which ultimately will help the government in meeting its revenue requirement. Increased revenue for Ufone as a result of above mentioned factors can increase the revenue stream for PTCL in the form of dividends which may increase our target price for the stock from our current fair value of PKR 27.8/ share.

Fertilizer Sector

Measures

- The subsidy on import of urea has been enhanced from PKR 3bn to PKR 10bn million whereas the PKR 21bn provided for the import of DAP fertilizer during the outgoing fiscal year has been withdrawn. Similarly the PKR 7.62bn subsidy for phosphatic and postassic fertilizer has been retreated.
- Feedstock gas subsidy will gradually be eliminated. No additional details are provided with reference as to over in what period the gas subsidy will be terminated.
- BT cotton seeds will be provided to farmers on subsidized rates.
- PKR 18bn has been allocated for agricultural PSDP.

Budgetary Impact - Neutral to Positive

There were no surprises in the FY10 budget for the agricultural sector; therefore we expect the impact on the sector to be neutral. We highlight FY10E would be last year before the domestic industry reaches excess capacity on urea (1.3mn tons will be added in FY11) and then eventually government will not import expensive urea but would probably export the excess urea.

Elimination of subsidy on DAP, phosphatic and postassic was inline with the market expectations as the international price declined substantially and therefore there is no need to give subsidies. The forecasted growth of 3.8% in FY10E is very much achievable provided the much needed water availability.

The PKR 18bn allocated for agricultural PSDP would be used for development of new technologies, creating necessary infrastructure, ensuring availability of agricultural credit, encouraging research and extension and etc consequentially resulting in a medium to long term positive impact on the sector.

Power Sector

Measures

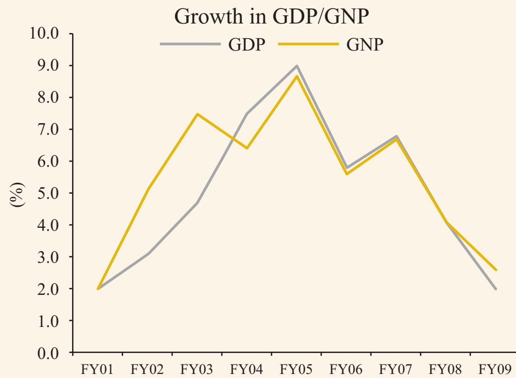
- Power subsidy has decreased by 40% in Budget 2009-2010

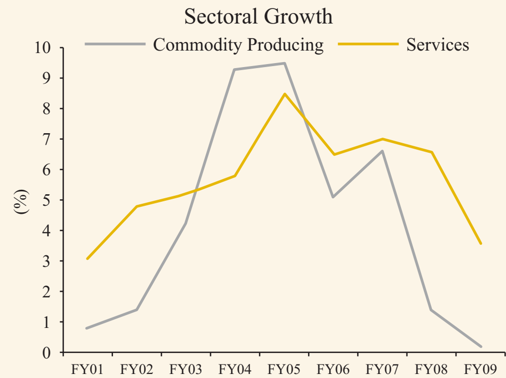
Budgetary Impact - Positive

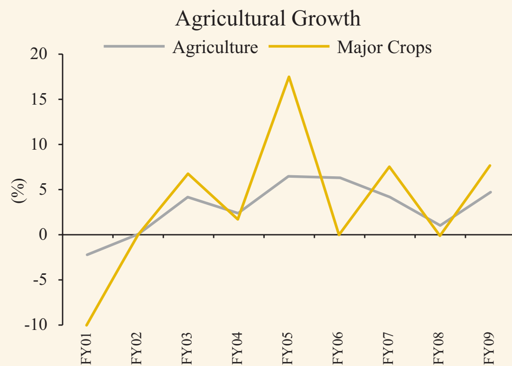
Government has decreased the power subsidy from PKR 111.64bn to PKR 66.70bn this will likely result in an increase in power tariff and better cash flows for PEPCO and KESC. This measure will have a positive effect on the whole energy chain which is haunted by the circular debt. Fiscal starvation of the government had made the power and energy sector, a victim of circular debt, removal of subsidy will enhance the efficiency in the power chain improving cash flow scenario for the power sector. This will reduce the mammoth short term financing cost and may result in better payout from the sector.

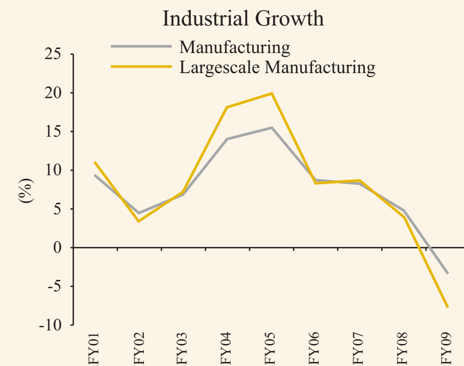
(Contributed by Taurus Securities Ltd, a subsidiary of National Bank of Pakistan)

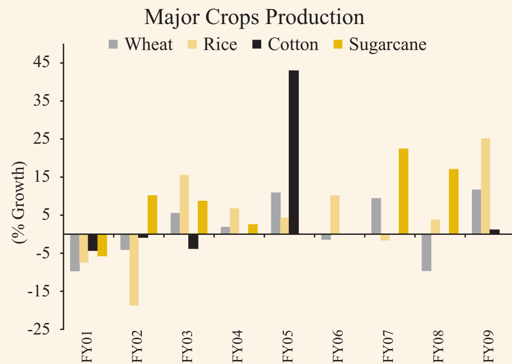
Economy at a Glance

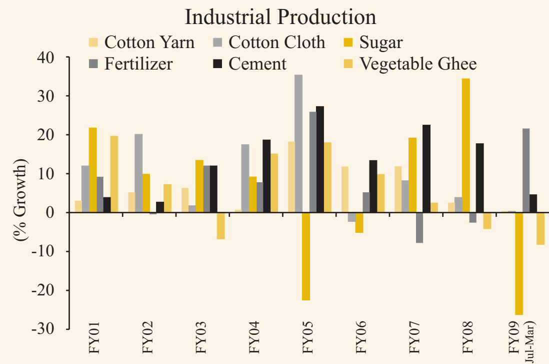


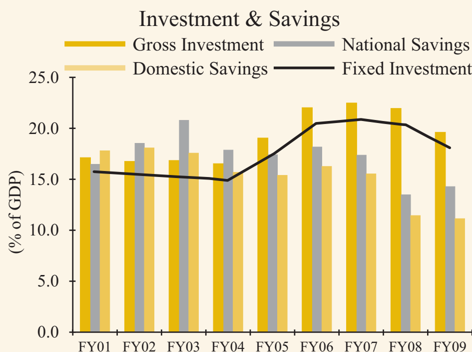


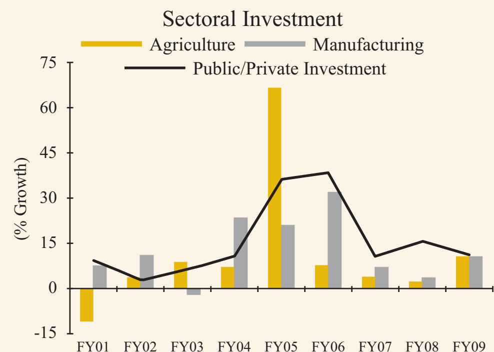


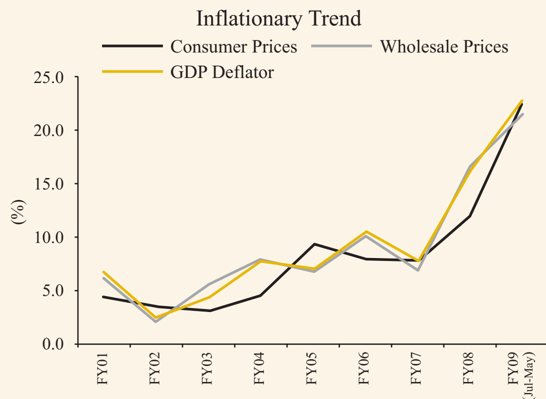


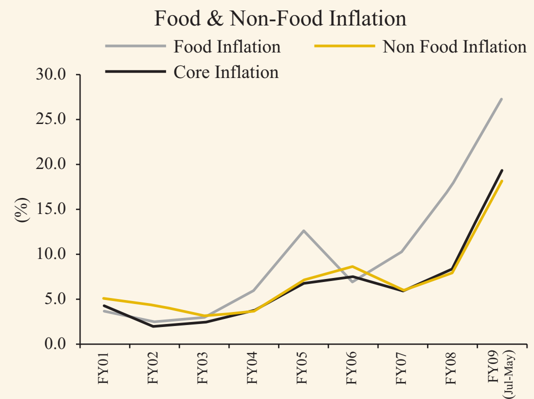


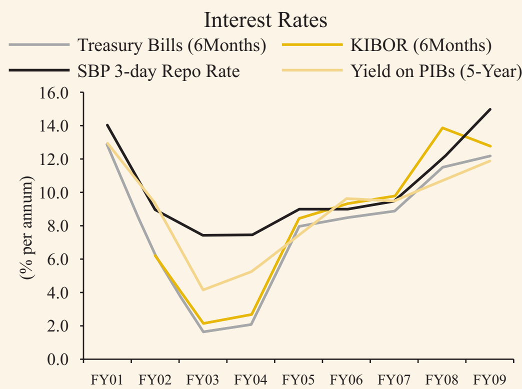


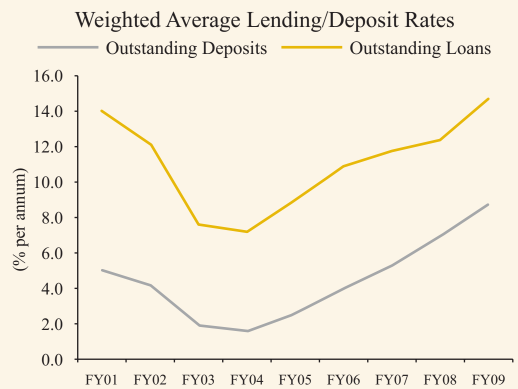


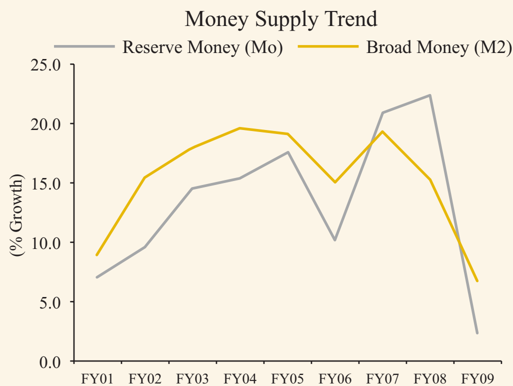


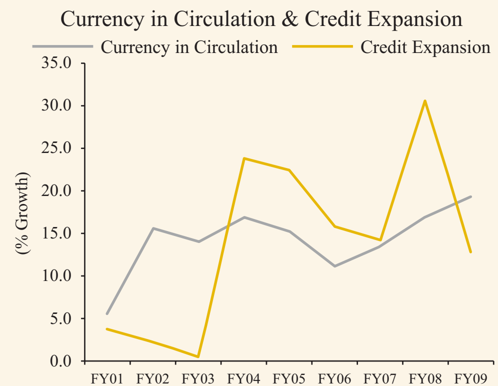

Inflationary Trend
Consumer Prices
Wholesale Prices
GDP Deflator
(%)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09 (Jul-May)

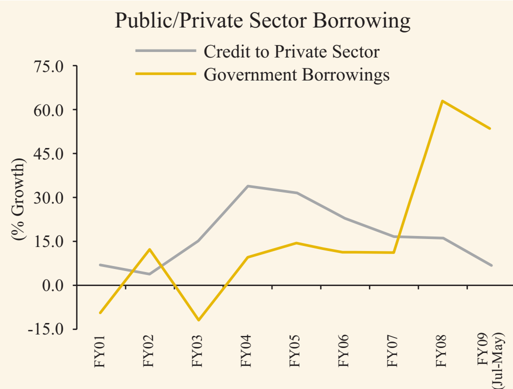

Food & Non-Food Inflation
Food Inflation
Non Food Inflation
Core Inflation
(%)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09 (Jul-May)

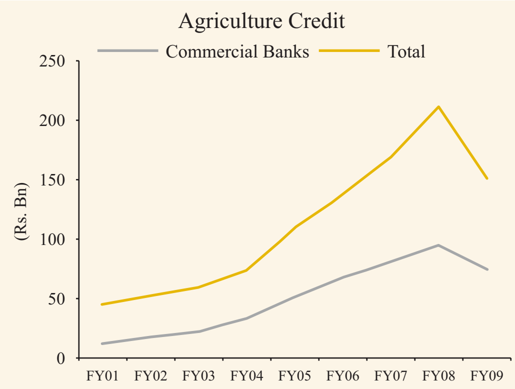

Interest Rates
Treasury Bills (6Months)
KIBOR (6Months)
SBP 3-day Repo Rate
Yield on PIBs (5-Year)
(% per annum)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09

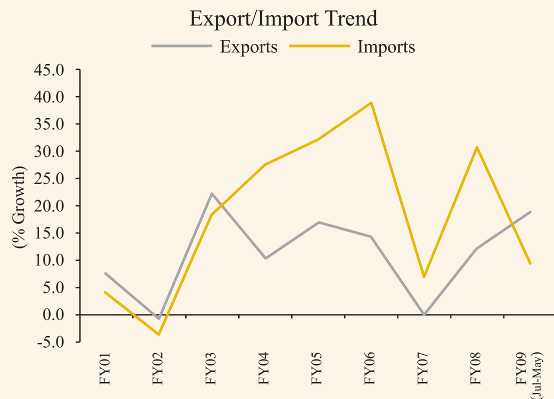

Weighted Average Lending/Deposit Rates
Outstanding Deposits
Outstanding Loans
(% per annum)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09

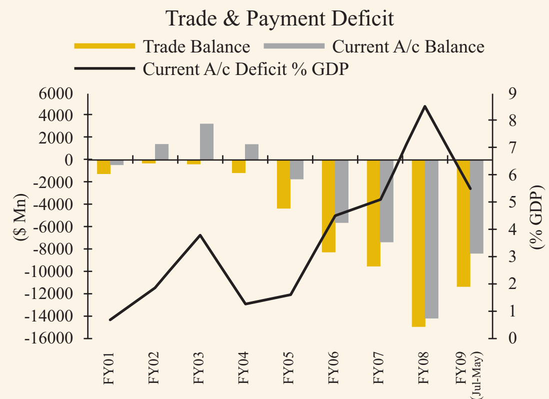

Money Supply Trend
Reserve Money (Mo)
Broad Money (M2)
(% Growth)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09

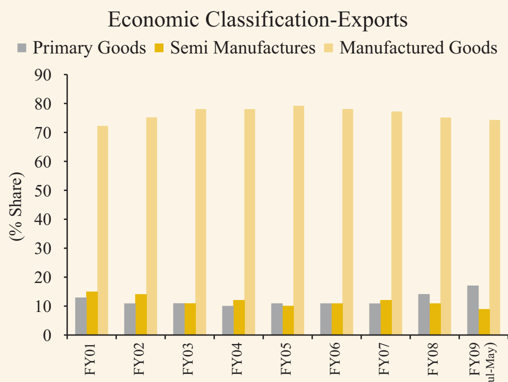

Currency in Circulation & Credit Expansion
Currency in Circulation
Credit Expansion
(% Growth)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09


Public/Private Sector Borrowing
Credit to Private Sector
Government Borrowings
(% Growth)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09 (Jul-May)

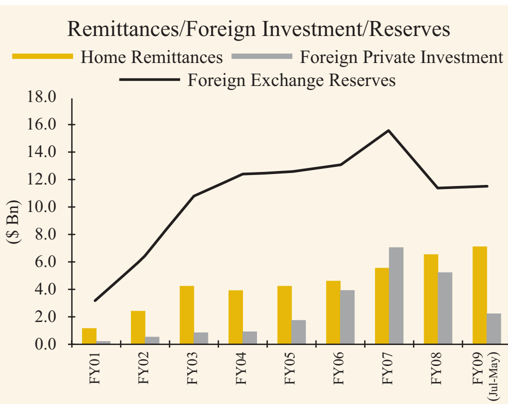

Agriculture Credit
Commercial Banks
Total
(Rs. Bn)
FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09

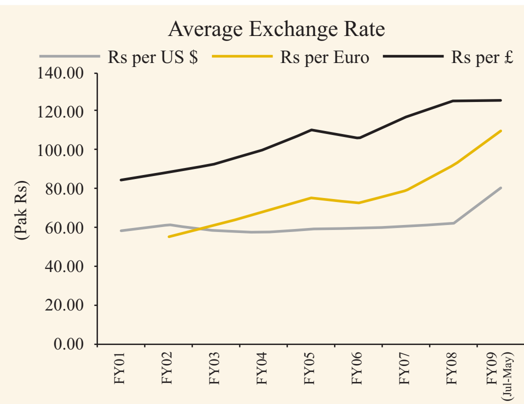

Export/Import Trend
Exports
Imports
(% Growth)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-May)

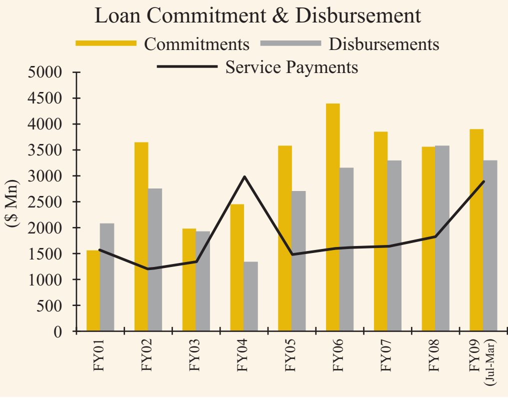

Trade & Payment Deficit
Trade Balance
Current A/c Balance
Current A/c Deficit % GDP
($ Mn)
(% GDP)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-May)

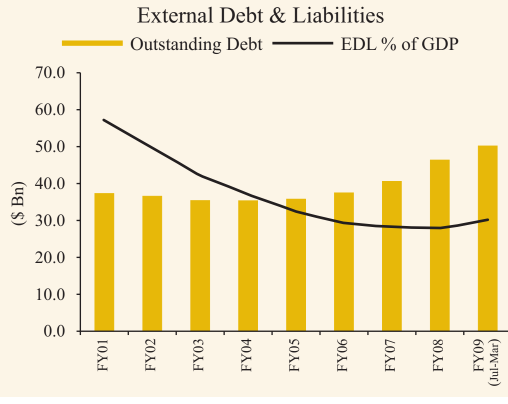

Economic Classification-Exports
Primary Goods
Semi Manufactures
Manufactured Goods
(% Share)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-May)

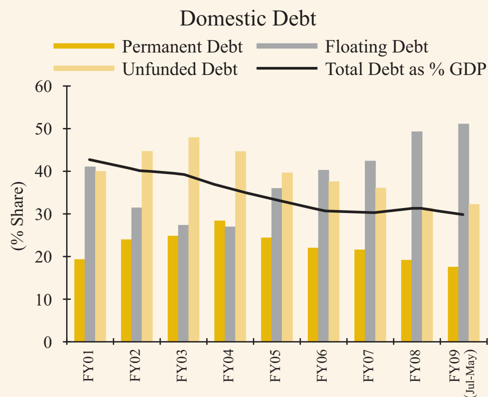
Economic Classification-Imports
Capital Goods
Consumer Goods
Raw Material for Consumer/Capital Goods
(% Share)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-May)

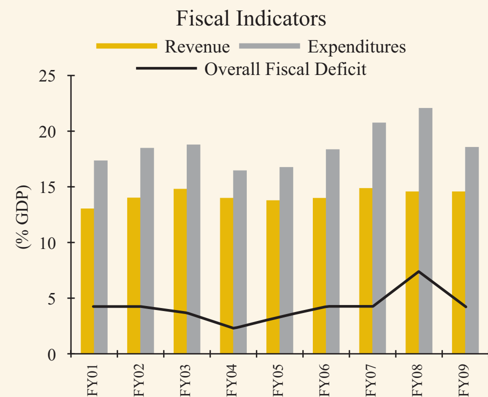

Remittances/Foreign Investment/Reserves
Home Remittances
Foreign Private Investment
Foreign Exchange Reserves
($ Bn)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-May)

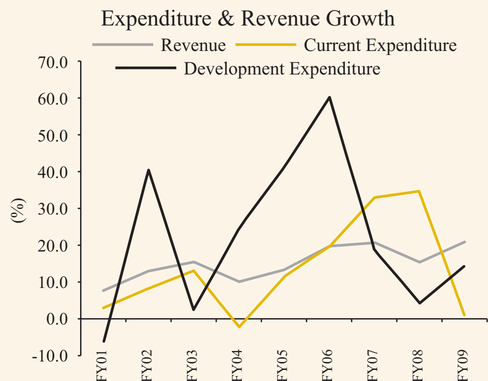

Average Exchange Rate
Rs per US $
Rs per Euro
Rs per £
(Pak Rs)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-May)

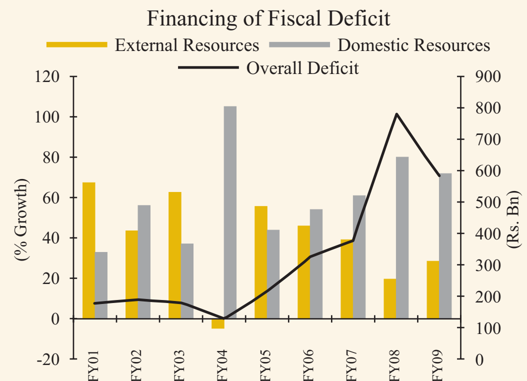

Loan Commitment & Disbursement
Commitments
Disbursements
Service Payments
($ Mn)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-Mar)

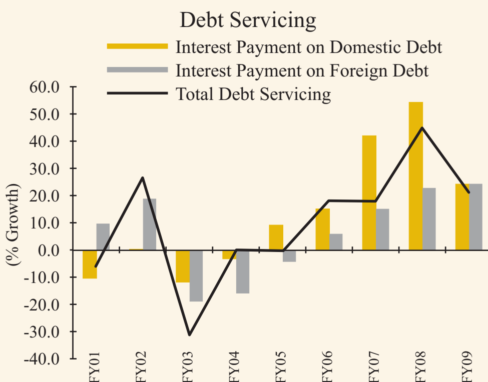

External Debt & Liabilities
Outstanding Debt
EDL % of GDP
($ Bn)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-Mar)

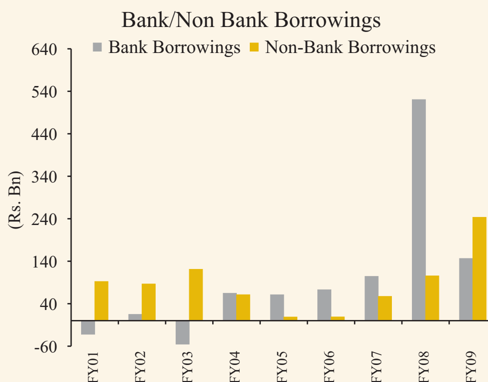

Domestic Debt
Permanent Debt
Floating Debt
Unfunded Debt
Total Debt as % GDP
(% Share)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09 (Jul-May)

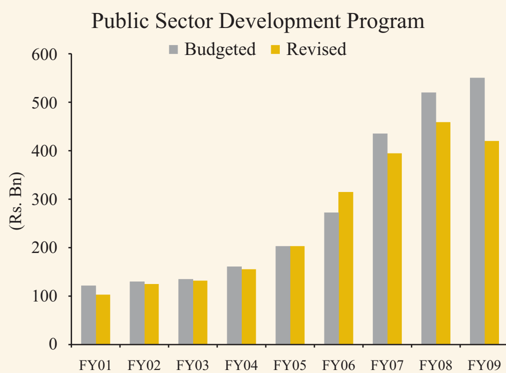

Fiscal Indicators
Revenue
Expenditures
Overall Fiscal Deficit
(% GDP)
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09

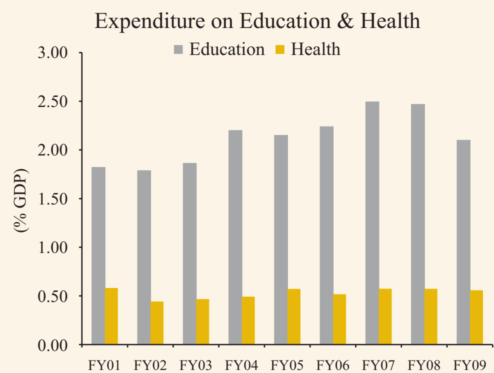

Expenditure & Revenue Growth
Revenue
Current Expenditure
Development Expenditure
(%)


Financing of Fiscal Deficit
External Resources
Domestic Resources
Overall Deficit
(% Growth)
(Rs. Bn)


Debt Servicing
Interest Payment on Domestic Debt
Interest Payment on Foreign Debt
Total Debt Servicing
(% Growth)


Bank/Non Bank Borrowings
Bank Borrowings
Non-Bank Borrowings
(Rs. Bn)


Public Sector Development Program
Budgeted
Revised
(Rs. Bn)


Expenditure on Education & Health
Education
Health
(% GDP)

Provincial Budgets 2009-10

Highlights

Punjab

- Overall size of the provincial government budget for 2009-10 has been proposed at Rs490 billion, nearly 26 percent higher than the budgetary allocations of FY09.
- The proposed budget has earmarked Rs175 billion for the Annual Development Program, 9.4 percent higher over the budgetary allocation for FY09.
- Current expenditure is budgeted to rise by 11.5 percent to Rs314.9 billion in FY10 against preceding year's revised estimates. General Public Services receives more than 50 percent of this amount.
- General revenue receipts in FY10 would be higher by 17.7 percent at Rs423.5 billion. The province is expected to get Rs321 billion from the federal divisible pool, Rs11.1 billion under straight transfers and federal grant of Rs4.6 billion. Provincial share in Federal Tax Assignments is higher by 19.4 percent while federal grant would be nearly 36 percent less than the previous year's revised estimates.
- Provincial own revenue receipts are budgeted to rise by 27.5 percent at Rs86.7 billion, comprising of provincial tax revenue of Rs49.6 billion and provincial non-tax revenue of Rs37 billion. Provincial tax revenue is higher by 76.5 percent but provincial non-tax revenue is lower by 7 percent over the revised estimates of FY09.
- The budget shows a revenue surplus of Rs108.6 billion, which is 40.3 percent more than the revised estimates of 2008-09. After taking account of net inflows under capital receipts and public account net, the surplus could further rise to Rs135.5 billion in 2009-10, up 15.3 percent over 2008-09.
- Under the proposed ADP, allocations have been made for the implementation of 70 on-going schemes and only 9 new schemes. Priority has been assigned to the development of social sectors.
- 34 percent of the ADP has been earmarked for the improvement of education, sports, health, water and sanitation and regional planning.
- Main focus would be on poverty alleviation. Rs30 billion has been allocated for subsidy on Sasti Roti, eatables, stipends to poor students, medical and other facilities.
- No new tax has been proposed in the budget. The provincial government will try to cut current account expenditure by Rs5 billion.
- The planned cost cutting measures include the rationalization of provincial departments and ban on official functions in hotels.
- The budget reveals an overall deficit of over Rs66 billion.

Sindh

- The provincial government has announced Rs327.2 billion budget for 2009-10, envisaging 22.3 percent increase over the revised budget of FY09.
- Annual development program has an outlay of Rs75 billion, while Rs15 billion has been earmarked for Local Governments. These allocations are higher by 37 percent and 25 percent respectively over the preceding year's revised estimates.
- The proposed budget reveals total development outlays of Rs112.9 billion, after taking account of Rs16.6 billion under federal PSDP grant and Rs6.3 billion under foreign project assistance. The development portfolio represents a rise of 29.6 percent over revised estimates.
- A sum of Rs213.4 billion has been earmarked for current expenditures, showing a 15.4 percent rise over revised budget estimates.
- In FY10, total revenue receipts are budgeted at Rs310.4 billion.
- Sindh's share in Federal Tax Divisible Pool is budgeted at Rs125.2 billion 2009-10, 20.2 percent higher over last year's revised estimates. Provincial tax receipts are budgeted at Rs39.1 billion. Besides, Rs50 billion are expected under Straight Transfers, while Rs29.2 billion would be available as District Support Grant and Production Bonus (Special Grant).
- The budget shows a huge deficit of Rs16.8 billion in FY10 against a surplus of Rs703 million in the revised estimates. The government hopes to meet this deficit through improving revenue collection, mobilizing additional resources and containing current expenditures.
- The government will continue emphasizing development of agriculture, building roads, construction of housing units for low paid workers, improving transport and communication, education, health, water & sanitation and developing mega projects for Karachi.
- The government plans to undertake major programs in 2009-10. These include initiating a Rs4 billion 'Cash Grant Program' to support the incomes of poor targeting 500,000 women. It will also implement a Rs2 billion 'School Nutrition Program' for providing nutrition to children and encouraging greater school participation.
- The government has allocated funds for providing support to street children under a project for 'Rehabilitation of Street Children through Civil Society Organizations'.
- Efforts are being made to harness alternate energy source such as Solar, Wind and Geo thermal in collaboration with international and national companies.
- The government has decided to set up Sindh Bank.

- The government has proposed 15 percent increase in salaries and pension of serving and retired government servants w.e.f. July 1, 2009.
- Major initiative in 2009-10 would be installation of Solar Powered water pumping units and desalination plants of rural areas of Sindh. Use of Wind/Solar/Bio-gas energy for irrigation and agriculture projects will be encouraged.

NWFP

- The overall size of NWFP budget for 2009-10 has been proposed at Rs214.2 billion, about 34.3 percent higher over the revised budget estimates of 2008-09.
- A sum of Rs51.2 billion has been allocated for annual development program (ADP), which envisages an increase of 31.3 percent over the current year's revised ADP.
- Current revenue expenditure for 2009-10 is budgeted to be higher by 5.8 percent at Rs80 billion. Major portion of current expenditure has been allocated for General Public Services and Public Order and Safety Affairs (Rs30.9 billion). Local Governments have been provided Rs34.9 billion.
- General revenue receipts are budgeted to rise by 18.1 percent to Rs113.7 billion consisting of provincial taxes of Rs3.88 billion (+27.6%), Federal Tax Assignment of Rs67.8 billion (+20.9%), Straight Transfers inclusive of GST on services of Rs9.6 billion (+65.5%), Grant-in-Aid of Rs14.8 billion (+12.1%), Other receipts including provincial non-tax receipts and net hydel profits of Rs17.6 billion (+6.7%).
- The budget shows revenue surplus of Rs33.7 billion, up 62.8 percent over the preceding year's revised revenue surplus.
- No new tax has been imposed in the budget but minor upward changes have been proposed in provincial taxes to generate additional revenue.
- The budget mainly focuses on development of social sector, hydel power generation and economic development of province.
- Despite limited resources, substantial allocations have been made in the budget for poverty alleviation, maintaining law & order and for the rehabilitation of internally displaced persons (IDPs) in the wake of military operation to fight insurgency in the province.
- Since the province has limited tax base, the government relies on Federal Government for 92 percent of its revenue.
- Despite financial crunch, the government has allowed 15 percent increase in salaries and pension of serving and retired employees in the province. The government has also created a provincial employment fund with Rs500 million to help young unemployed to set up small businesses.

Balochistan

- The provincial government has proposed a Rs71.6 billion budget for 2009-10. 74.2 percent of the budget has been allocated for current revenue expenditure and the remaining 25.8 percent for development program.
- Special focus in the 2009-10 budget would be on agriculture, education and health sectors. Some 4000 new jobs would be created in these sectors to reduce unemployment.
- The budget envisages annual development program of Rs18.6 billion. This includes foreign project assistance of Rs5. billion. The proposed ADP is higher by 58 percent over preceding year's revised ADP.
- Current revenue expenditure has been budgeted at Rs53.1 billion. Of this amount, 53.5 percent has been set aside for maintaining law & order and improving socio-economic and community services.
- 40 percent of the public sector development program is proposed to be spent on on-going schemes and 60 percent on new schemes.
- General revenue receipts in the FY10 are proposed at Rs59.05 billion, which is 5.3 percent lower than the previous year's budget estimates.
- Provincial own receipts are budgeted at Rs3.65 billion. It comprises of tax revenue of Rs1.13 billion and non-tax receipts of Rs2.51 billion. The government expects to get Rs55.41 billion as share in Federal Receipts including Rs29.2 billion as provincial share in federal tax divisible pool.
- Duty/surcharge and royalty on gas, subvention and grants and share from 2.5 percent GST will account for generation of Rs26.2 billion in general revenue receipts.
- In the proposed budget, the government has allocated Rs6 billion for the construction of new roads. The government will also undertake 13 irrigation projects in collaboration with federal government at a cost of Rs29.4 billion, which includes construction of new dams in different parts of the province.
- The government has also allocated funds for setting up 111 new schools and 14 new colleges, besides upgradation of 109 primary schools to middle school level and 108 middle schools to high school level.
- The major initiatives proposed in the budget include increase in food subsidies (on wheat) from Rs0.6 billion to Rs1 billion and continuation of the annual subsidy of Rs2 billion for agriculture tubewells.
- The budget for 2009-10 shows a deficit of upto Rs8.83 billion which the government hopes to finance from budgetary support grant of Rs3 billion promised by the federal government, another Rs3 billion set aside for public representative program (PRP) and the remaining gap of Rs2.33 billion to be met by enhancing province's own resources.

Market Analysis

Market Review

The market performance was mixed and lackluster for the period under review. The KSE-100 Index during the two-month period of May and June 2009 shed 40 points to close at 7,1622 on June 30, 2009. The average daily turnover during the period under review was 119.25m shares exchanging hands.

The market was choppy throughout the month of May due to a lack of investor confidence and the volatile law and order situation in the country. The KSE-100 Index gained 128 points or 1% during May 2009 to close at 7,276 while the KSE-30 Index improved by 179 points or 2.33% to 7,862. The average daily turnover during May was 128.58m as against 287.37m shares in April. The net outflow of foreign funds according to SCRA figures during May 2009 was US$8.671m and the financial year to date net outflow stands at US$585.47m.

The month started on a negative note as the KSE-100 Index shed 139 points on the first trading day due to the overall law and order situation in the country and speculation about the upcoming budget. This did not last too long as institutional support entered the market to prop up the Index. The Index rallied by 136 points from May 4 to 6 to reach 7,198, but profit taking set in for the next few sessions from May 8 to 11. On May 12, the Index surged by 173 points on the back of institutional buying because of the slow down in the inflation rate reflected in the April data. This led to positive expectations among most investors that the SBP would further ease the discount rate in the next monetary policy statement in July.

However, the market went into a slump from May 13 to 21 because of jittery investor sentiments due to the following factors:

- There was apprehension over the budget as statements made by various government officials were ambiguous regarding tax measures on the stock markets;
- Uncertainty of further decline in inflation leading to doubts over additional cuts in the discount rate by the SBP and
- Fear about the direction and outcome of the military operation in Swat.

The Index shed 136 points during this period to close below the psychological level of 7,000.

Fortunately, the market staged a recovery on the back of institutional support in major Index stocks from various sectors such as fuel and energy, banking and telecom. The Advisor on Finance to the Prime Minister in an interview to a foreign newspaper clarified that new tax measures on untaxed sectors would be introduced gradually and that the equity markets would not see any new measures until next year's budget. The markets welcomed this clarification. The final week saw the Index improve by 130 points with most of the activity concentrated in the financial and fuel and energy sectors.

However, the market experienced another correction from May 28 to June 4 in which the KSE-100 Index shed 409 points to dip below the 7,000-level due to again anxiety over the budget as rumor and speculation among the investor community was rampant regarding possible new tax measures. Also, the absence of a leverage product was a key concern among investors in order to spur activity as volumes had contracted. The Index staged a minor rally to cross the 7,000-mark in the run-up to the federal budget announced on June 13, but the immediate market reaction was adverse, as there were no notable incentives for industry to stimulate activity. For the last 2 weeks of June, the market was range bound and dull because of confusion over the procedural application of FED (Federal Excise Duty) on stockbroker services that was introduced in the FY10 federal budget.

Regional Valuation

The Pakistan market PE at 6.36x is trading at a 55% discount to the regional average of

14.32x. Based on dividend yield, Pakistan is the most attractive at 8.20% followed by Thailand at 7.58% while the regional average is 3.40%.

On the political front, the war against militancy within the tribal areas remains intense, as the Pakistan military have reported gains and successes so far. The main concern is the duration of this operation that it does not drag on any further than needed. However, we feel that the operation would continue until the top leadership of the militants is eliminated. The issue of the internal refugees could be become a political hot potato for the government if the refugees are not resettled back into their areas as soon as possible. Fortunately for Pakistan, it is receiving both diplomatic and financial support from most of its Western allies and so, receiving some breathing space on the geopolitical front. We still believe that resumption of dialogue with India will be difficult unless external pressure is not applied onto both countries.

Looking Ahead

The SBP released its 3QFY09 Report on the State of Pakistan's Economy in the first week of June. The SBP has again downgraded the major macroeconomic targets for a third consecutive quarter. The GDP growth target for FY09 has been revised down to 2.0-3.0% from 2.5-3.5% stated in the 2QFY09 report. The poor economic growth can be attributed to the global recession as well as the stifling of industrial growth as aggregate demand became weak. The average CPI inflation for FY09 is estimated at 20.5-21.5%. However, the YoY CPI inflation for June 2009 is expected to slowdown to 10-11%, which will be a significant feat as CPI peaked at 25% in August 2008. This declining trend would augur well for the new fiscal year as inflation is expected to be in single digit and thus, leading to further cuts in the discount rate by the central bank.

As per the data unveiled that major economic indicators which earlier engulfed in later part of CY08, crisis continue to turn towards the positive such as narrowing current account deficit, stabilizing exchange rate, improving fiscal deficit; however as emphasized by the central bank that these measures although showing recovery still remain weak and if not addressed correctly can hamper economic recovery. The fiscal deficit target will be achieved due to the deep cut in development spending. The current account deficit target will also be sanguine, as the trade deficit has been reduced due to curtailment of imports because of weakening aggregate demand and falling commodity prices.

In the Annual Plan 2009-10 prepared by the Planning Commission, it states the real GDP growth target to be 3.3% for the next fiscal year. The sectoral growth rates are expected to be 3.8% for agriculture, 1.8% for manufacturing and 3.9% for services sectors. The plan envisages a 10.6% YoY rise in per capita GNP to PKR 91,233. The fiscal deficit is estimated to be 4.9% of GDP according to the budget speech, but we feel the achievement of the fiscal deficit could be in jeopardy because of the ambitious revenue target and uncertainty over the external financial inflows.

The current account deficit is estimated at US$9.4bn or 5.3% of GDP in the Annual Plan. CPI inflation during FY10 is expected to be 9-9.5%. We expect CPI inflation to be lower in FY10 due to the base effect and easing in commodity prices, but with oil prices starting to rally again, this would have negative consequences for inflation, the external account situation and the exchange rate. In addition, imposition of new FEDs and WHTs would have a one time inflationary impact on the economy. Monetary expansion should be in line with nominal GDP growth of around 12.3-12.8%.

Also, at the end of July, the SBP Governor is expected to announce the monetary policy statement for 1QFY10. We can expect a further discount rate cut in the next monetary policy of about 100-125bps cut in the wake of expected drop in head line inflation to single digits by end CY09. However with rising commodity prices and oil touching USD 70/bbl this can impact the trade deficit in negative and may put upward pressure on Rupee Dollar parity and may negatively impact the inflation.

(Contributed by Taurus Securities Ltd, a subsidiary of National Bank of Pakistan)

Pakistan Economy – Key Economic Indicators

	Unit	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Output and Prices									
GNP Size	$ bn	70.3	72.1	85.0	100.1	111.7	129.8	146.6	171.4
GDP Size	$ bn	71.3	71.7	82.4	97.9	109.4	127.3	143.9	167.6
Income Per Capita	$	501	504	579	669	732	835	927	1065
Real Growth	(%)								
GNP		1.9	5.1	7.9	6.4	8.3	5.6	6.7	6.1
GDP		1.8	3.1	4.7	7.5	8.6	5.8	6.8	5.8
Agriculture		-2.2	0.1	4.1	2.4	6.7	6.3	3.7	1.5
Manufacturing		9.3	4.5	6.9	14.0	12.6	8.7	8.2	5.4
Services Sector		3.1	4.8	5.2	5.8	8.0	6.5	7.6	8.2
Prices									
Consumer Price Inflation*	(%)	4.4	3.5	3.1	4.6	9.3	7.9	7.8	12.0
Wholesale Price Inflation*	(%)	6.2	2.1	5.6	7.9	6.8	10.1	6.9	16.4
Food Inflation*	(%)	3.6	2.5	2.8	6.0	12.5	6.9	10.3	17.6
Non Food Inflation*	(%)	5.1	4.2	3.3	3.6	7.1	8.6	6.0	7.9
Core Inflation*	(%)	4.2	2.0	2.5	3.8	7.2	7.5	5.9	8.4
Gold Tezabi	$/10 grams	91.8	95.5	109.0	127.2	138.3	172.2	208.2	267.1
Motor Gasoline Premium	Rs/Ltr	29.34	31.60	33.08	33.91	40.75	55.21	56.09	57.83
Kerosene oil	Rs/Ltr	16.84	18.58	22.48	24.95	29.11	36.19	39.09	43.44
Light Speed Diesel	Rs/Ltr	13.50	16.70	21.15	22.72	26.50	36.45	38.40	40.97
GDP Deflator	%	8.02	2.49	4.42	7.74	7.02	9.20	7.80	13.41
Savings and Investment									
National Savings	% GDP	16.5	18.4	20.6	17.9	17.5	17.7	17.8	13.3
Domestic Savings	% GDP	17.8	17.9	17.4	15.7	15.4	15.3	16.0	11.0
Gross Capital Formation	% GDP	15.8	15.3	15.1	15.0	17.5	20.5	21.3	20.0
Public	% Gross Capital	5.7	4.1	3.9	4.0	4.3	4.8	5.7	5.7
Private		10.2	11.2	11.2	10.9	13.1	15.7	15.6	14.2
Public Finance									
Revenue Receipts	% GDP	13.3	14.1	14.5	13.8	13.5	13.4	13.9	18.47
Tax Revenue	% GDP	9.9	9.2	9.5	9.2	9.1	9.2	9.6	9.6
Total Expenditure	% GDP	17.2	17.9	16.2	13.9	15.4	15.4	15.6	18.3
Fiscal Deficit	% GDP	4.3	4.3	3.7	2.4	3.3	4.3	4.3	7.4
Domestic Debt	Rs.bn	1731	1718	1854	1979	2150	2322	2601	3266
Funded	% Domestic Debt	58.9	53.9	51.0	54.6	59.4	62.0	63.9	68.8
Non Funded	% Domestic Debt	41.1	46.1	49.0	45.4	40.6	38.0	36.1	31.2
FBR Tax Collection	Rs.bn	392	404	461	521	590	713	847	1001
Direct Taxes	% share	31.9	34.9	33.0	31.7	31.0	31.6	39.4	38.3
Indirect Taxes	% share	68.1	65.1	67.0	68.3	69.0	68.4	60.6	61.7
Monetary Sector									
Net Domestic Assets (NDA)**	Rs.bn	1498	1531	1539	1903	2329	2697	3080	4022
Net Foreign Assets (NFA)**	Rs.bn	28.3	231	540	583	637	710	985	667

** Period Average   ** End-June Stocks*

	Unit	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Credit to Private Sector	Rs.bn	750	841	949	1274	1712	2114	2480	2888
Net Credit to Government	Rs.bn	602	677	599	657	753	834	927	1510
Borrowings for Budgetary Support	Rs.bn	4999*	567	511	575	647	708	810	1365
Broad Money (M2)	growth %	9.0	15.4	18.0	19.6	19.1	15.1	19.3	15.3
Reserve Money (Mo)	growth %	7.1	9.6	14.5	15.4	17.6	10.2	20.9	22.3
Capital Market									
SBP General Index	2000-01=100	118.7	106.7	204.1	323.3	362.8	427.0	547.5	455.4
KSE 100 Index	1991=1000	1366	1770	3402	5279	7450	9989	13772	12289
Market Capitalisation	$ bn	5.8	6.6	12.8	24.4	34.3	46.2	65.7	59.9
National Saving Scheme**	$ bn	13.0	13.8	16.8	17.1	15.8	15.6	16.5	17.4
Banking Sector									
Scheduled Banks Deposits	$ bn	21.9	23.1	28.7	34.8	40.9	47.0	55.7	61.0
Scheduled Banks Advances	$ bn	13.6	14.4	16.6	21.6	28.5	34.5	39.2	45.0
Scheduled Banks Assets	$ bn	34.0	37.5	43.4	52.1	62.9	61.3	77.6	80.7
Lending and Deposit Rates	weighted average								
Deposits Outstanding	% pa	5.0	4.17	1.90	1.61	2.55	4.01	5.30	6.94
Advances Outstanding	% pa	13.97	12.03	7.58	7.20	8.98	10.90	11.80	12.42
Open Market Operation	weighted average								
SBP 3-Day Repo	% pa	14.00	9.00	7.50	7.50	9.00	9.00	9.50	12.00
Treasury Bills Yield - 6 Months	% pa	12.88	6.28	1.66	2.08	7.96	8.49	8.90	11.47
KIBOR - 6 Months	% pa	-	6.21	2.12	2.69	8.46	9.36	9.77	13.94
Pakistan Investment Bonds - 5 yrs	% pa	12.99	9.39	4.16	5.27	7.50	9.65	9.53	-
Overnight Call Money Rate	%	8.96	6.74	4.23	1.86	4.34	8.46	9.37	13.55
SBP Export Finance Rate	%	9.00	6.50	2.00	1.50	6.50	7.50	6.50	6.50
External Sector									
Exports	$ bn	8.93	9.14	10.97	12.46	14.48	16.55	17.28	20.12
Imports	$ bn	10.20	9.43	11.33	13.74	19.00	24.99	26.99	35.42
Trade Balance	$ bn	-1.27	-0.29	-0.36	-1.28	-4.52	-8.44	-9.71	-15.70
Current Account	$ bn	-1.95	0.09	3.16	1.30	-1.78	-5.70	-7.40	-14.46
	% GDP	-2.9	0.1	3.7	1.3	-1.6	-6.6	-5.1	-8.6
Worker Remittances	$ mn	1087	2389	4237	3872	4168	4600	5494	6451
Foreign Private Investment	$ mn	182	475	816	922	1677	3872	6960	5172
Direct	$ mn	322	485	798	950	1524	3521	5140	5153
Portfolio	$ mn	-140	-10	18	-28	153	351	1820	19
External Debt and Liabilities	$ bn	37.2	36.5	35.5	35.3	35.8	37.6	40.5	46.3
	% GDP	52.2	50.9	42.6	36.1	32.7	29.5	28.1	27.6
External Debt Servicing	$ mn	3395	4095	3150	4969	2716	2805	2769	2923
Gold & Forex Reserves	$ mn	3810	7065	11472	13155	13338	14590	17924	11828
Gold	$ mn	566	667	725	831	917	1288	1366	1931
Cash	$ mn	3244	6398	10747	12324	12421	13302	16558	9897
Crude Oil Spot Prices (Brent)	$/barrel	26.1	25.5	28.2	33.0	55.4	73.3	71.9	141.0
Exchange Rate (Average)	Rs/US$	58.4	61.4	58.5	57.6	59.4	59.9	60.6	62.5

** Special Account-Debt Repayment Adjusted*   *** Outstanding Amount*