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The Art of Investment

Federal Budget - FY22

Calculated win through populism

Rating by VIS
AM2
Very Good Quality Management

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Table of Contents

Table of Contents

Calculated win through populism

With two years left until the next general elections coupled with the challenges posed by the pandemic, the PTI government has presented its third budget with a clear focus on growth. Incentives to the industry (direct subsidies, relaxation in raw material and other regulatory duties), stock market, aggressive revenue targets without additional taxation measures, higher development spending and improved social sector allocations support the GoP's emphasis on growth. This budget is a calculated win for the GoP going into an election year in FY23, however, it lacks tangible fiscal reforms (broadening of the revenue base, commitment to raise power tariffs to address the outstan expected slippages make continuation of the IMF program and the on-going dialogue process even more important, in our view. While this budget will likely be a hard sell to the IMF, support from Washington amidst its exit from Afghanistan cannot be ruled out. Shortfall in tax revenue collection (GDP growth is vulnerable) would require higher fiscal support and is a key underpinning for an upside risk in budgeted fiscal deficit which we estimate to reach 7.4% in FY22E (vs. GoP target of 6.3% in FY22B). Encouragingly, 'retailing' has been added to the definition of "smuggled goods" as a punishable offence in the Customs Act which is a paradigm shift and along with the Track & Trace system reportedly going online from Jul'21 lays the foundation for addressing the undocumented economy, in our view. Additionally, projected provincial surplus (PkR570bn) is a key swing factor which can significantly alter the actual deficit. While growth prospects are encouraging, economic activities remain vulnerable to the effects of the pandemic which rounds up a key event risk for GDP growth (~5.0% in FY22B), in our view.

Macroeconomic Outlook: GDP has provisionally recorded a growth of 3.9% in FY21P. Growth prospects remain encouraging led by a sizable increase in National/Federal PSDP allocations, up 61%/43% to PkR2.13tn/PkR900bn in FY22B. In this backdrop, GDP is targeted at ~5.0% in FY22B accompanied by aggressive tax collection efforts which can face downside slippages as the economy remains vulnerable to event risks. We expect GDP growth to clock in at ~4.5% in FY22F with LSM growth and wholesale & retail trade providing upside risks to our estimates. With demand-side inflationary pressures relatively contained and a stable external account outlook, the SBP is expected to continue its accommodative stance and is unlikely to materially reverse course on its monetary policy. However, risks emanate from inflationary pressures driven by demand side pressures on the back of improving economic activities. Given a relatively manageable CA outlook coupled with a well-funded financial account (materialization of budgeted inflows is key), we do not see significant pressures on the PkR in the near term which we expect to gradually reach PkR162/US$ by Jun'22,

Debunking power sector subsidies: The budget marks PKR682bn (1.27% of GDP) for subsidies (up 58.6%YoY) where majority ~87% (PKR596bn or 1.11% of GDP) are marked for the power sector. Higher subsidy allocation implies a lack or likely limited tariff hikes going forward. However, a materially sizable share of PKR266bn (~45% of budgeted power subsidies) is likely earmarked to settle the IPPs' arrears and to repay the PHPL's debt – an exercise to bring off-book circular debt to the GoP's book – likely required by the IMF/other IFIs, in our view. Our earlier discussions with GoP officials have also identified subsidy recognition as a major obstacle to bring off-book circular debt to the central gov't book, as the MoF has historically disputed subsidy claims by the MoE. Higher subsidy allocation is mainly driven by Industrial Support Package (ISP) and higher tariff differential subsidy for KE indicating that future tariff hikes are likely to be limited and at the same time also implies that this will be a hard sell to the IMF.

Impact on key sectors: From the stock market's perspective, the 2.5% reduction in CGT to 12.5% and removal of WHT on margin financing should extend the pre-budget rally of the PSX as valuations remain attractive (forward P/E ~7x vs. its mean of ~9x). Relief on raw material imports, higher developmental spending, incentives to various sectors (technology, construction and allied, autos and tractors, oil refining, pharmaceuticals and agriculture) should improve corporate profitability going forward. As growth improves, Pakistan can see significant valuation rerating over the medium-term, particularly if interest rates remain relatively soft.

Recommendation for investors: *The budget has laid grounds for a risk–on environment given successful growth policy execution and a lower for longer interest rate environment. With risk/return profile favoring risk assets, we recommend investors to be opportunistic and consider tactical allocation into equities and alternative assets (e.g. recent amendment in rules and incentives for REITs in the budget where we expect relatively quick roll out of innovative structures) since falling yields have reduced the expected returns and ballast properties of fixed instruments.*

Budget Snapshot

EXPENDITURES (PkRbn)	FY18	FY19	FY20	FY21R	FY22B
Defence	999	1,138	1,227	1,299	1,373
Pension	333	342	463	470	640
General Public Services:	2,977	4,048	5,538	4,491	5,435
Debt Service (Foreign)	194	306	335	240	303
Debt Repayment (Foreign)	428	929	1,245	842	1,428
Debt Service (Domestic)	1,332	1,682	2,374	2,611	2,757
Total Debt Servicing	**1,526**	**1,987**	**2,709**	**2,851**	**3,060**
Public order & Safety	119	133	153	169	179
Economic Affairs	81	142	106	192	115
Education Affairs	91	97	81	88	92
Health Affairs	13	14	12	52	28
Subsidies	148	255	350	430	682
Total Current Expenditures	4,298	5,589	6,130	6,561	7,523
Federal PSDP	750	500	564	630	900
TOTAL EXPENDITURE	**5,361**	**6,419**	**8,135**	**7,321**	**8,487**

RESOURCES (PkRbn)	FY18	FY19	FY20	FY21R	FY22B
Indirect Taxes	2,372	2,491	2,285	2,902	3,647
Direct Taxes	1,563	1,659	1,623	1,789	2,182
Petroleum Levy	170	203	260	500	610
Total Tax Revenue	**4,147**	**4,394**	**4,208**	**5,261**	**6,635**
Income from Property & Enterprise	236	285	243	177	266
Civil Admin & Other Receipts	284	171	810	728	684
Misc. Receipts	324	182	243	229	325
Total Non-Tax Revenue	**845**	**638**	**1,296**	**1,134**	**1,274**
Gross Revenue Receipts	**4,992**	**5,032**	**5,504**	**6,395**	**7,909**
(Less: Provincial Share)	2,316	2,463	2,402	2,704	3,412
Net Revenue Receipts	**2,676**	**2,569**	**3,102**	**3,691**	**4,497**
External Loans	1,182	1,353	2,181	2,201	2,693
Estimated Provincial Surplus	274	59	(81)	242	570
Bank Borrowing	**586**	**1,356**	**1,724**	**649**	**681**
TOTAL RESOURCES	**4,775**	**5,063**	**6,411**	**6,671**	**7,806**

% of EXPENDITURES	FY18	FY19	FY20	FY21R	FY22B
Defence	18.6%	17.7%	15.1%	17.7%	16.2%
Pension	6.2%	5.3%	5.7%	6.4%	7.5%
General Public Services	55.5%	63.1%	68.1%	61.3%	64.0%
Total Debt Servicing	28.5%	31.0%	33.3%	38.9%	36.1%
Public order & Safety	2.2%	2.1%	1.9%	2.3%	2.1%
Economic Affairs	1.7%	1.5%	1.0%	1.2%	1.1%
Education Affairs	1.7%	1.5%	1.0%	1.2%	1.1%
Health Affairs	0.2%	0.2%	0.1%	0.7%	0.3%
Subsidies	2.8%	4.0%	4.3%	5.9%	8.0%
Total Current Expenditures	80.2%	87.1%	90.7%	89.6%	88.6%
Federal PSDP	14.0%	7.8%	6.9%	8.6%	10.6%

% of RESOURCES	FY18	FY19	FY20	FY21R	FY22B
Indirect Taxes	49.7%	49.2%	35.6%	43.5%	46.7%
Direct Taxes	32.7%	32.8%	25.3%	26.8%	28.0%
Petroleum Levy	3.6%	4.0%	4.1%	7.5%	7.8%
Total Tax Revenue	86.9%	86.8%	65.6%	78.9%	85.0%
Civil Admin & Other Receipts	6.0%	3.4%	12.6%	10.9%	8.8%
Total Non-Tax Revenue	17.7%	12.6%	20.2%	17.0%	16.3%
Gross Revenue Receipts	104.6%	99.4%	85.8%	95.9%	101.3%
Net Revenue Receipts	56.1%	50.7%	48.4%	55.3%	57.6%
External Loans	24.8%	26.7%	34.0%	33.0%	34.5%
Estimated Provincial Surplus	5.7%	1.2%	-1.3%	3.6%	7.3%
Bank Borrowing	12.3%	26.8%	26.9%	9.7%	8.7%

*Source: Federal Budget Documents

Budgetary Implications on Sectors

Sector	Impact	Budgetary Measures	Research Comment
Capital Market	**POSITIVE**	CGT down by 2.5% to 12.5% with additional reductions going forward along with WHT removal on PSX & margin financing. Reduction in non energy companies turnover tax by 0.3% to 1.2%. Exemption from minimum tax turnover liability to enterprises in SEZs. Tax credit on new listing and relief on intercorporate dividend not restored.	This is significantly positive for market sentiments which should divert liquidity towards the stock market. The measure is also aimed at increaseing documentation. Reduction in turnover tax to improve corporates product volumes and bottom line.
Technology	**POSITIVE**	IT services (software design/development/maintenance) to be recognized as industry. Sector exports to be zero rated along with 100% tax credit for 80% exports proceeds brought back in Pakistan till 2025. Sales tax exemption on capital imports and 10 year income tax holiday for companies in special technology zones. Third party sales through e-commerce platforms to be brought in the purview of sales tax.	Sector focus to shift to exports Technological industry will grow in Pakistan especially in far flung areas where SEZs are being established. These measures should together help in decreasing the cost of setting up new IT ventures.
Cements	**POSITIVE**	National/Federal PSDP to increase to PkR2.13tn/PkR900bn. Time period for registration of construction amnesty scheme increased to Jun 21. Allocation of PkR100bn for dams and PKR 33bn for low cost housing and additional loans to low income for financing houses.	Domestic dispatches volumetric growth to remain strong absorbing upcoming cement expansion over medium term and support demand. This is also expected to support the industry's pricing power and sustain its margin profile.
Steel	**POSITIVE**	Higher PSDP allocation (see cements above) Reduction/exemption of regulatory duty on HRC and stainless steel to CD of 5%/11% for CRC/tubular and RD 0%/6%. 17% FED removed on steel ingots, billets, ship plates, bars and other long reporfiled profiles.	Big ticket infrastructure construction activity to boost demand for long steel products. Reduction in duties on HRC to favorably impact flat steel producers. Reduction in CD on stainless steel to benefit blade manufacturers.

Sector	Impact	Budgetary Measures	Research Comment
Autos, Parts & Tractors	**POSITIVE**	Sales tax on "850CC and below" CKD to go down by 4.5% to 12.5%. FED on 850CC and below removed. Sales tax on hybrid electric vehicles (import and local) at 8.5% (up to 1800cc) and 12.75% (1801-2500cc). Income Tax of 1% on import of CKD kits of electric vehicles for small cars. PkR 200K loan for tractors. Increase in regulatory duty on tires + taxation on "own" money	850CC and below cars prices to go down by PkR 0.1mn adding demand growth. EV industry may gain some momentum along with investment in specialized EV battery plants in medium term. Auto parts manufacturers to experience volumetric growth leading to improved profitability. Tractor manufacturers to witness increase in off takes. Additional taxation to generate income for GoP and reduce waiting time for customers.
Oil & Gas Refining	**POSITIVE**	Custom duty (CD) on HSD and MS increased to 10% and at the same time CD on crude has also been reduced to 2.5%, resulting in effective protection of 7.5% on MS (0% previously) and 7.5% on HSD (7.5% previously). 10 year income tax exemption for deep conversation new refineries or up-gradation (BMR) by an incumbent. Reduction in turnover tax by 0.25 pps to 0.5%.	Most anticipated fiscal incentives of the upcoming refinery policy to sigificantly improve industry GRMs Incentives for existing refineries to take up gradation leading to reduction in import volumes over medium term.
Chemical and "Paper packaging industry"	**POSITIVE**	Reduction in regulatory duties on inputs to paint industry, uncoated paper and paperboard for printing/graphic art industry.	Paints and packaging industry to find support for margins and volumetric growth led by cement industry; thus supporting P&L.
Food	**NEUTRAL TO POSITIVE**	Reduction in FED on juices and sales tax on Soya bean meal. Reduction in regulatory duties in feed additives used in inputs of poultry industry Withdrawal of GST exemption on local/imported supply of cooking fats, juices, meat and milk products.	Reduction in tax to absorb impact of rising palm oil prices on edible fats and entire dependent food chain. Withdrawl of GST exemption can prove inflationary.

Sector	Impact	Budgetary Measures	Research Comment
Pharmaceuticals	**POSITIVE**	Reduction in regulatory duties on imports of 350 APIs (out of +420 APIs), syringes manufacturing, certain life saving drugs, chemicals & diagnostic kits. from 5% to 0% Concessionary rate of 5% for import of plant and machinery. Allocation of US$1.1bn for procurement of COVID vaccines. Sehat card for 4-6 mn families	The local drugs manufacturers margins should find support. Incentives for investment to set up manufacturing companies to export medicines in medium term. Private hospital revenue to increase compared to public hospitals led by health insurance.
Diversified banks	**NEUTRAL**	Super tax at 4% to remain in effect. Central Bank to raise PKR 751/1,200 bn through PIBs/Ijara Sukuk to finance budget deficit. Removal of withholding tax (WHT) on banking transactions and FED on merchant discount rate charged on POS by banks	Extension in super tax was expected. Additional SUKUKs to open for Islamic banking to avenues of investments. Removal of WHT on banking transactions can decrease cash in circulation increasing deposit growth for banks.
Industrials	**NEUTRAL**	Reduction in raw material duties for electronics manufacturing industry. Advance tax on sales to retailers of electronic good has been reduced by 0.5pps to 0.5% PKR 118bn for electricity infrastructure Exemption in regulatory duty in import of raw materials for cables	Domestic raw material manufacturers may face pressure on margins However, end product manufacturers margins should find support. Companies manufacturing electrical equipments to find growth in volumes.
Fertilizers	**NEUTRAL**	Gov. allocation of PKR 12bn for agricultural emergency program with additional PKR 6bn for RLNG power plants PKR 150bn is targeted to be collected as GIDC. Dealers of fertilizers to be charged advance tax of 0.25%, if they appear in ATL or 1.25% from 0.75%.	Focus on food security to improve farm economics and improve offtake of fertilizer products. GIDC allocation is not surprising as ~PkR400bn was payable over 5 years. Govt effort to document agricultural sector will bear fruits as dealers can have significant savings if they file tax.

Sector	Impact	Budgetary Measures	Research Comment
Textile	**NEUTRAL TO POSITIVE**	Reduction in regulatory duties on raw imports of textile companies. Subsidy for PkR20bn for DLTL drawback. Continuation of duty free import of textile machinery. Improvement of refund system	Companies deriving revenue from value added segment against only spinning revenues to benefit from higher volumes. Higher DLTL to improve cash flows and the margin profile.
Utilities	**NEUTRAL TO POSITIVE**	Power tariffs not increased which can prove to be a hard sell to the IMF. Higher subsidies earmarked Gov. expects PKR 250bn from privatization proceeds (RLNG plants)	Higher subsidies are aimed towards addressing power sector arrears should improve sector liqudity. However, lack of intention to materially raise power tariffs is unlikely to control or resolve the outstanding circular debt, exposing the sector to possible liqudiity crunch going forward.
Sugar	**POSITIVE**	Sales tax on refined sugar at actual retail price against nominal price of PKR60/sh. Exemption of taxed for bagasse fired power generating units and reduced rate of 7.5% on dividend income from such projects. Reduction in RD on export of molasses.	Sugar companies, operating power plants, other income to further increase. Sugar volumes offtake from food companies can be expected to increase as well. Sugar mills with distilleries to benefit for molasses exports.
E&P	**NEUTRAL TO POSITIVE**	Higher dividend estimates from GoP owned E&P companies Higher power sector subsidies earmarked to address arrears in the chain. Increase in sales tax on RLNG by 5% to 17%	Higher power sector subsidies is an an exercise to bring off-book circular debt to the GoP's book and is not expected to resolve the circular debt as there is limited intention of the GoP to raise power tariffs, in our view. Enhanced dividend collection from GoP owned E&P cos is a positive but slippage risk has been historically high.
Miscellaneous	**NEUTRAL TO POSITIVE**	Reduction in regulatory duties on raw materials of footwear segment such as artificial chemicals for leather industry.	Domestic SME sector cost production to decline and footwear export volumes to grow.

Budget FY22 – Focus on growth but vulnerable to event risk

With two years left until the next general elections coupled with the challenges posed by the pandemic, the PTI GoP has introduced a growth-oriented budget focused on sustaining the economic recovery. From a policy perspective, the GoP is focusing on its Covid-19 inoculation program (the GoP has reportedly announced to allocate ~US$1.1 billion for importing vaccinations with a target to inoculate >100mn people by Jun'22) and at the same time boost growth to ~5.0% in FY22 through higher development spending (budgeted federal PSDP earmarked at PkR900bn, up 38% compared to FY21B). The GoP eyes to limit the fiscal deficit at PkR3.42tn or 6.3% of GDP in FY22B by envisaging FBR tax collection at PkR5.8tn, implying an increase of 24%YoY (total tax revenue earmarked at PkR6.6tn, up 26%YoY). Limiting the budget deficit would require aggressive tax collection efforts and controlling expenditures, in our view. Shortfall in tax revenue collection (GDP growth is vulnerable) along with higher than expected expenditures would require higher fiscal support and are together key underpinnings for an upward slippage in budgeted fiscal deficit which we estimate to reach 7.4% in FY22E. The GoP is also planning to re-approach the G20 countries for extension in debt relief up to an additional US$1bn for the period Jul'Dec'21. That said, estimated sizable provincial surplus (PkR570bn) is a key swing factor which can significantly alter the actual deficit. While growth prospects are encouraging, economic activities remain vulnerable to the effects of the pandemic which rounds up a key event risk for GDP growth.

Policy focus on covid-19 inoculation program and emphasis on growth through incentives to the industry (direct subsidies, relaxation in raw material duties), aggressive revenue targets without additional taxation measures, higher development spendnig, improved social sector allocations.

Encouragingly, 'retailing' has been added to the definition of 'smuggled goods' as a punishable offence in the Customs Act which is a paradigm shift and along with the Track & Trace system reportedly going online from Jul'21 lays the foundation for addressing the undocumented economy. Presently, a 'retailer' is not required to produce evidence that goods being sold have been legally imported in Pakistan. This step makes the implementation of this amendment in its true form and spirit even more important, in our opinion.

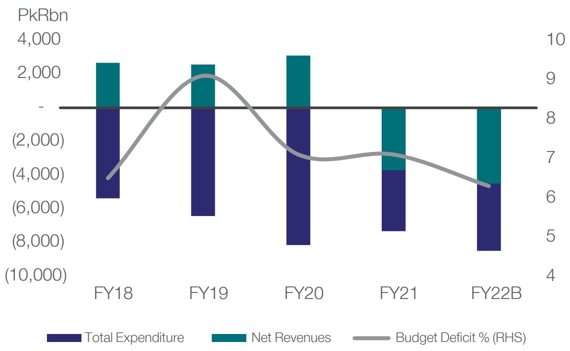
Key Highlights from Budget FY22 include:

- GDP growth recorded at 3.9% in FY21 (can potentially cross 4.5%) while it is budgeted at ~5.0% in FY22B. In this regard we expect GDP growth to clock in at ~4.5% in FY22F with LSM growth and wholesale & retail trade impacting services sector providing upside risks to our estimates.

- GoP has encouragingly contained the fiscal deficit to PkR3.38tn in FY21 against the budgeted fiscal deficit of PkR3.41tn during the same period. However, budget deficit for FY22B has been set at PkR3.4tn or 6.3% of GDP, while we anticipate fiscal deficit to record at 7.4% of GDP on expected slippages in revenue target in the backdrop of ambitious targets.

- Total budgetary outlay for FY22B has been earmarked at PkR8.5tn, up 15.9%YoY. In this regard, federal PSDP allocation has been encouragingly increased to PkR900bn, up 43%YoY (vs. FY21R). Relatively higher pay & pensions along (an additional head budgeted

Fiscal Deficit Trend



Source: Federal Budget Documents

to address planned rise in salaries and pension of GoP employees) along with some one-offs recording of power sector subsidies and higher debt servicing at PkR3.05tn (up 7%) are budgeted to be the largest drag on expenditures (a 100bps hike in the interest rate can raise domestic debt servicing by ~PkR260bn).

- While the GoP expects FBR tax collection at PkR5.8tn in FY22B, recording a growth of 13%YoY, we estimate FBR to under-shoot its tax collection target by PkR512bn with collection estimated to amount to PkR5.3tn in FY22E.

- Reliance on external financing has scaled up significantly over the years (23% CAGR since FY18) to support both — fiscal deficit and a weakening FX reserve position. In FY22B, gross external loans have been estimated at PkR2.69tn (up 22%YoY) vs PkR2.2tn in the outgoing year.

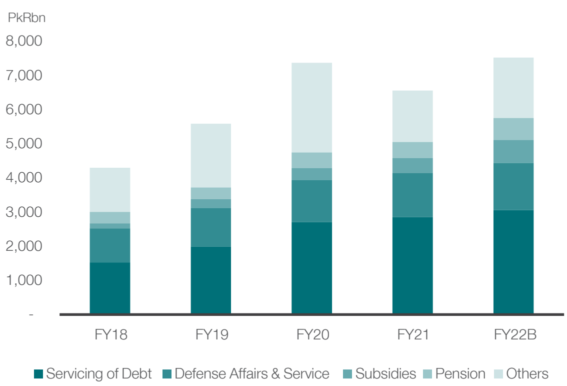
Tax to GDP (%)

Source: Economic Survey of Pakistan

EXPENDITURE

Efficient expenditure management: Total outlay in FY21R is estimated to record at PkR7.32tn against PkR8.13bn in FY20. Efficient expenditure management was led by contained current expenditures of ~PkR6.6tn in FY21R against PkR6.1tn in FY20. Despite covid related spending (subsidies and grants), a moderate rise in mark-up payments (up ~5%YoY to PkR2.8tn) due to a lower interest rate environment coupled with slow-down in defence expenditures (up 6%YoY to reach ~PkR1.3bn) together contributed to contain the growth in overall expenditures in FY21R. Total outlay for FY22B has been projected at PkR8.48tn, translating into a rise of ~16%YoY. Current expenditure in FY22B has been budgeted 15%YoY higher on the back of relatively higher foreign debt servicing (up 26%YoY) and heightened transfers (largely power sector subsidies as the GoP moves to gradually record unrecognized subsides, in our view). With regards to the latter, planned subsidies have been increased to PkR682bn in FY22B compared to PkR430bn in FY21R (up 59%YoY) with the major chunk going to the energy sector (IPPs and PHPL together account for PkR254bn). Debt servicing is budgeted at PkR3.06tn (up 7%YoY) and defense expenditures are expected to moderately rise by 6%YoY to PkR1.37tn in part driven heightened security requirements on the eastern and western borders.

Current Expenditure Breakdown



Source: Federal Budget Documents

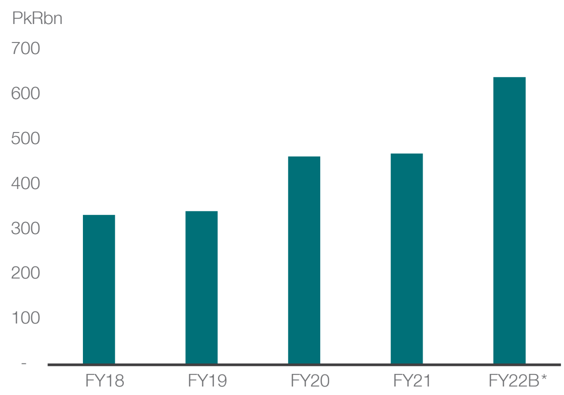
Debunking power sector subsidies: The budget marks PKR682bn (1.27% of GDP) for subsidies – up 58.6%/226.3% compared to last year's budget/revised allocation. Of the total, majority ~87% (PkR596bn or 1.11% of GDP) are marked for the power sector. Apparently higher subsidy allocation implies a llack of or likely limited tariff hikes going forward but a lion's share of PkR266bn (~45% of budgeted power subsidies) is to settle the IPPs' arrears and to repay the PHPL's debt – an exercise to bring off-book circular debt to the GoP's book – likely required by the IMF/other IFIs, in our view. Note our earlier discussions with GoP officials also identified subsidy recognition as a major obstacle to bring off-book circular debt to the central gov't book, as the MoF has historically disputed subsidy claims by the MoE. Besides, overall power subsidy (ex IPPs/PHPL) is 5% higher compared to revised estimates for FY21. Higher subsidy allocation is mainly driven by Industrial Support Package (ISP) and higher tariff differential subsidy for KE can indicate that future tariff hikes will be limited which will be a hard sell to the IMF.

The pension conundrum - an emerging macro challenge:

Heightened pension expenses is a key macro challenge stressing the fiscal accounts of Pakistan. On a federal level, pay & pensions together have been raised to PkR640bn in FY22B (additional hea budgeted at PkR160bn to address the planned rise in salaries and pensions of GoP employees) against PkR470bn in FY21R. Specifically, the pension expenditure at the federal level has risen by 18% CAGR since FY18. Provincial pension expenditure has also witnessed a similar surge. Lack of focus on this front rising from offhand policies, retrospective increments, early commutation and retirements, and generous survivorship regulations have manifested into a ~6x increase in pension expense over the last decade, with total annual pension expense (both federal and provincial) rising to ~PkR1trn (~18% CAGR over the last decade). The unfunded nature of the pension expense makes this trend even more unsustainable in the long run and makes it increasingly important to introduce reforms to address this emerging issue. Encouragingly, news reports quoting the Finance Minister indicate that the GoP is cognizant of this emerging challenge and pension related reforms are expected to be introduced in the next three to six months. Cross country comparison highlights some interesting trends where peer regional countries have adopted the defined contribution schemes for public and private sector employees vs. its non-contributory nature in Pakistan.

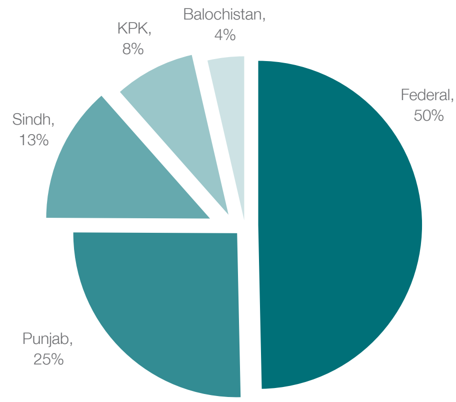
Changing gears to growth: Fiscal and monetary measures to stimulate growth during the pandemic have resulted in a strong rebound in economic activities, reflected through GDP provisionally recording a growth at 3.9% (vs. target of 2.1% and -0.47% in FY20). This has given room to the GoP to focus on growth despite economic activities remaining vulnerable to the covid outbreak. In this regard, the PTI govt has raised development expenditures with federal PSDP earmarked at - PkR900bn (up ~43% compared to FY21R) in FY22B. Total National PSDP for FY22B has been allocated at PkR2.13tn, 61% higher from previous allocation of PkR1.32tn in FY21B. Within this backdrop, infrastructure related divisions have been earmarked at PkR100bn allocated for construction of dams which include i) Dasu (PkR57bn), ii) Diamer Bhasha (PkR23bn), iii) Mohamand (PkR6bn) and iv) Neelum-Jehlum (PkR14bn), PkR33bn for low-cost housing and PkR25.4bn allocated for the Karachi Transformation Plan (total size: PkR739bn).

Federal Pension Expense Trend



*incl. Pay & Pensions
Source: Federal Budget Documents

Total National Pension Expense by Source - FY20



Source: Federal & Provincial Budget Documents

Total National PSDP Allocation

Source: Federal Budget Documents

REVENUE

Ambitious tax collection targets: Going into the next year, FY22B envisages FBR tax collection at PkR5.8tn, implying an increase of 24%YoY (gross revenue receipts earmarked at PkR7.9tn, up 24%YoY). The planned rise in collection reflects reliance on sales tax (projected to be PkR2.5tn, up 30%YoY) and federal excise duty (projected to be PkR356bn, up 29%YoY). We feel these targets to be quite aggressive as the GoP is banking on heightened economic activities (GDP growth projected to be ~5% in FY22B vs. 3.9% in FY21R) without necessary fiscal reforms while at the same time has announced taxation relief measures (WHT, sales tax and FED) for the industry. We are estimating total FBR taxes to rise by 13%YoY to reach PkR5.3tn as the economy is still vulnerable to the impact of the ongoing pandemic. Additionally, the GoP is targeting enhanced collection of (PL) petroleum levy which is projected at PkR610bn in FY22B, up 22%YoY. In a rising oil price scenario, downside risk to PL collection target cannot be ruled out as the GoP will have to raise the levy beyond PkR25/ltr (currently levied at PkR4.8/ltr for MS and PkR5.14/ltr for HSD) to realize the projected target. We optimistically estimate the GoP to collect PkR475bn PL (at a levy of PkR20/ltr) in FY22E. That said, GIDC collection is projected to be enhanced by 5.2xYoY to PkR130bn in FY22B due to pending GIDC payment of ~PkR456bn payable over 4 years. We expect GIDC collection to undershoot the target and conservatively estimate it at PkR90bn in FY22E. Enhanced dividend collection (up 2.24xYoY to PkR90bn) is being driven by settling arrears of the energy chain where historically dividend collected has fell short of budgeted targets. As a result, we conservatively model dividend collection to be PkR70bn in FY22E vs. PkR40bn in FY21R. Cumulatively, gross revenue for the year is budgeted at PkR7.91tn compared to revised estimates of PkR6.39tn in FY21R while transfer to provinces are budgeted at 43% of it. In this backdrop, we estimate gross revenue receipts to reach PkR7.11tn in FY22E.

We feel these targets to be quite aggressive as the GoP is banking on heightened economic activities (GDP growth projected to be ~5% in FY22B vs. 3.9% in FY21R) without necessary fiscal reforms while at the same time has announced taxation relief measures (WHT, sales tax and FED) for the industry.

In a rising oil price scenario, downside risk to PL collection target cannot be ruled out as the GoP will have to raise the levy beyond PkR25/ltr (currently levied at PkR4.8/ltr for MS and PkR5.14/ltr for HSD) to realize the projected target.

Budgeted Dividends (PkRmn)

Entity	FY21R	FY22B
NBP	45	45
PPL	4,592	15,000
MARI	197	110
PSO	528	1,000
SNGPL	401	2,000
OGDC	25,500	56,500
FFC	80	80
PTC	-	1,500
Others	8,985	14,128
Total	**40,328**	**90,363**

Source: Federal Budget Documents

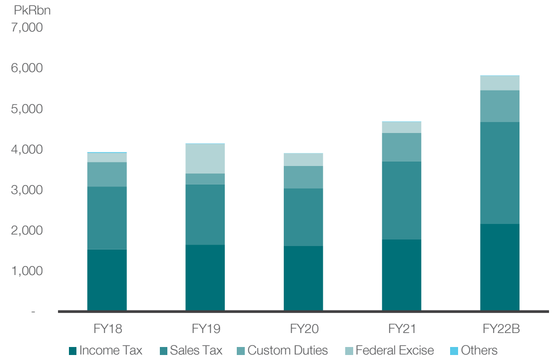
Revenue enhancing measures: The FBR has estimated that the total tax exemptions and concessions to various businesses, sectors, industries and investors have aggregated to PkR1.3tn in FY21R against ~PkR1.2tn in FY20, reflecting an increase of 8%YoY. While the GoP withdrew various income tax exemptions at the start of 2021 (PkR140bn), the GoP reportedly envisages to withdraw largely sales tax exemptions to generate PkR190bn as revenues in FY22B. Additionally, other measures like hike in customs duty on MS from 3% to 10% (estimated impact of PkR30bn), various administrative steps (extending real time point-of-sales mechanism to 500k retail outlets from 11k currently in the next two years by proposing tax credit to POS points) and expected rise in economic

Various tax exemptions have estimated to have cost the GoP around PkR1.3tn in FY21. The GoP envisages to withdraw sales tax exemptions to generate PkR190bn as additional revenues in FY22B.

activities is expected to support GoP's revenue enhancing measures.

Tax Revenue – leveraging economic growth: Even though economic activities were restricted in FY21 due to the pandemic, the FBR has gained much ground as a result of double-digit tax growth (estimated to be up 20%YoY vs. FY20R) in tax revenue in FY21R. This highlights successful efforts to improve tax collection through various policy and administrative reforms (focus on return filing, POS integration of Tier-1 retailers, investigation & prosecution, automation of customs procedures to reduce cost of doing business, rationalization of customs tariffs, e-audits, etc). In this regard, total FBR tax revenue for FY21R is estimated to reach PkR4.69tn compared to PkR3.90tn in FY20R. Indirect taxes are estimated to post a 27%YoY growth to reach PkR2.9tn in FY21R vs. ~PkR2.3tn collected in FY20R. This is expected to be driven primarily through higher sales tax revenues (up 35%) on the back of recovery in consumer spending, retail, robust trade activities and broad-based growth in activities among the real sectors assisted by the reopening of the economy. Additionally, the GoP is estimated to collect PkR500bn as Petroleum Levy in FY21R, up 92%YoY compared to FY20R as relatively lower oil prices provided room to raise the levy.

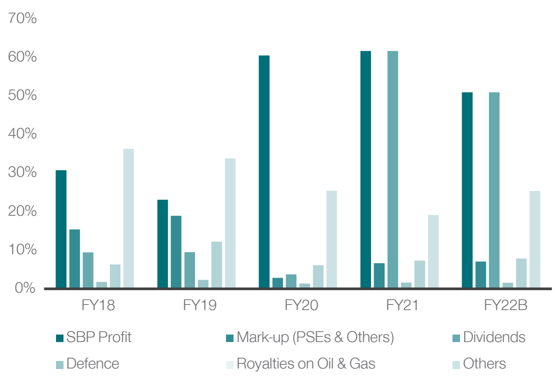
FBR Tax Breakdown



Source: Federal Budget Documents

Non-Tax Revenue – weak support: On the flip side, non-tax revenues are estimated to record a 13%YoY decline (vs. FY20R) to reach PkR1.1tn in FY21R (in line with budgeted target). This was mainly due to absence of a one-off renewal fee for GSM licenses from telecommunication companies (PTA revenue down 72%YoY to PkR37bn). Additionally, lower receipts from a surplus SBP profit (down 11%YoY to PkR700bn) and relatively lower dividend (down 16%YoY to PkR40bn) have also attributed to an overall drag in cumulative non-tax revenues. We estimate non-tax revenues to reach PkR1.16tn against budgeted PkR1.27tn in FY22 on expected shortfalls in expected dividend receipts from SOEs and surplus profit of SBP.

Non-Tax Revenue Breakdown



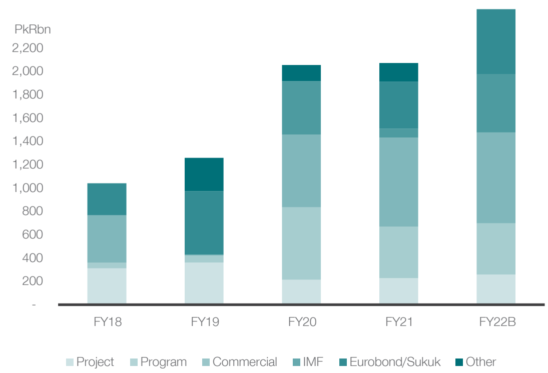
Source: Federal Budget Documents

FISCAL DEFCIT AND FINANCING

Fiscal deficit - rising concerns: The GoP is expected to contain the fiscal deficit at 7.1% in FY21R against the budgeted target of 7.49% in FY21B despite covid related spending. Led by direct tax and sales tax collections, FBR tax collection is earmarked to increase by 20%YoY in FY21R. Additionally, austerity measures coupled with restriction on supplementary grants have helped to contain the growth in current expenditures. As a result, the primary balance is estimated to record a deficit of 1.12% in FY21R. While the GoP has projected a fiscal deficit/primary deficit of 6.3%/0.7% in FY22B, we estimate slippages in revenues (also low likelihood of privatization inflow) and expenditures overshooting the target to result in a fiscal deficit/primary deficit of 7.4%/1.7% in FY22. In this backdrop, we project additional fiscal adjustments of 1.0% in FY22 for the GoP to meet its target primary deficit.

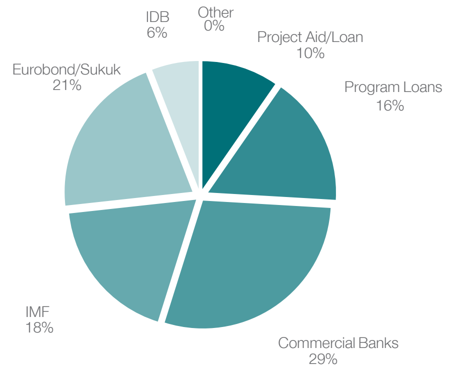
External resources - financing reserves: Reliance on external financing has scaled up significantly over the years (23% CAGR since FY18) to support both – fiscal deficit and a weakening FX reserve position. In FY22B, external loans have been estimated at PkR2.69tn (up 22%YoY) vs PkR2.2tn in the outgoing year. The 22%YoY jump remains concerning, particularly with increasing shift towards commercial borrowing (PkR779bn or US$4.8bn) in FY22B. Additionally, the GoP has earmarked Eurobond/Sukuk issues (PkR560bn or US$3.5bn), highlighting GoP's efforts to shore up FX reserves. Additionally, repayments of external loans have been budgeted at PkR1.4tn (US$8.8bn) which likely incorporates deferred G20 repayments with additional drag from repayments of multilateral and short-term commercial borrowing. That said, timely materialization of foreign inflows remains key ballast to FX reserves position to offset the threat of exogenous risks to the current account.

External Financing Trend



Source: Federal Budget Documents

External Financing by Source FY22B



Source: Federal Budget Documents

MACRO OUTLOOK

Growth remains vulnerable to event risk: While growth prospects remain in place led by envisaged implementation of development projects under the ambit of the PSDP. However, we believe GDP growth is likely to improve to ~4.5% vs. GoP projection of ~5% in FY22 as a fiscal deficit target of 6.3% (vs. our estimate of 7.4%) calls for aggressive tax collection efforts. Apart from being vulnerable to the impact of the ongoing pandemic (fresh waves), additional risk emanates from inflationary pressures where rising oil prices and recovering demand side pressures can encourage the central bank to reverse its monetary policy stance. That said, despite a current account (CA) surplus driven by higher inflows, downside risk can emerge from a relatively higher trade deficit as imports recover (~PkR59bn estimated in FY22) on the back of heightened economic activities as global inoculations pick up pace which is likely to result in a CA deficit in FY22F (1.6% of GDP), according to our estimates.

Medium Term Budgetary Framework: In its medium-term budgetary framework, the GoP is projecting a higher trajectory GDP growth which is expected to reach 5.0% in FY22 and 6.4% by FY24F. It is anticipated that the growth focused approach of the GoP in the FY22 budget particularly its focus on food, water and energy security along with improving road infrastructure and push in implementation of CPEC projects is expected to support the growth momentum in the economy. Additionally, achieving the 6.4% growth by FY24F would require sustained structural reforms while the economy has always been largely vulnerable to exogenous shocks. Average 7% inflation projected across the next three years face upside risks from a higher oil price scenario, demand side pressures on the back of improving economic activities and administrative measures (pending electricity and gas tariff hikes).

Key Macro Indicators	FY19	FY20	FY21TD	FY22B	FY22F*
GDP Growth (%)	2.1	-0.5	3.9	5.0	4.5
Avg. CPI (%YoY)	6.8	10.8	9.0	8.2	8.4
Policy Rate (%) - avg.	9.6	12.1	7.0	-	7.5
CA Balance (% of GDP)	-4.8	-1.7	0.3	-	-1.6
PkR/US$ (- dep/+ app) (%)	-32.0	-5.0	8.0	-	-5.0
Fiscal Deficit (% of GDP)	9.1	4.0	7.1	6.3	7.4

*FAML Research estimates
Source: Economic Survey, PBS, FAML Research

Medium Term Budgetary Framework

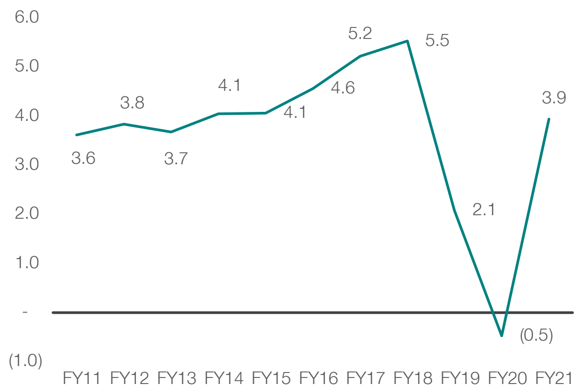
	FY22B	FY23F	FY24F
GDP (PkRbn)	53,867	60,811	70,151
GDP Growth (%)	5.0	5.7	6.4
CPI Inflation (%YoY)	8.2	7.2	6.4
As % of GDP			
Total Revenue	14.7	14.9	14.9
Tax Revenue	10.8	11.5	11.8
Non Tax Revenue	3.8	3.3	3.0
Total Fed Expenditure	15.8	14.6	13.2
Current	14.0	12.8	11.4
Development	1.8	1.8	1.8
Fiscal Balance	(6.3)	(5.3)	(3.9)
Primary Balance	(0.7)	0.2	1.2
Total Public Debt (Gross)	81.8	79.1	73.9

Source: Federal Budget Documents

FY21 Review - Looking Back

Despite a pandemic driven slowdown, growth prospects during FY21E have remained encouraging with GDP recording a provisional growth at 3.9% (vs. target of 2.1% and -0.47% in FY20) driven by pick-up in consumer spending and manufacturing activities post easing of covid related restrictions. Headline inflation is estimated to average around 9% in FY21 (close to the upper end target of SBP's range of 7-9%) and average around the same level during CY21 as inflation expectations remain reasonably anchored. The external account has also remained healthy with the current account (CA) registering a surplus of US$733mn (0.3% of GDP) during 10MFY21 driven by robust growth in inward remittances and foreign inflows. Consequently, SBP FX reserves have risen by US$4.0bn FYTD to stand at US$16.1bn (highest since 2017 and implying an import cover of ~4x) leading to 8% FYTD currency appreciation with currency parity currently around PkR154.1/US$. With demand-side inflationary pressures relatively contained coupled with a stable external account outlook, the SBP kept its key policy rate unchanged at 7.0% during the year.

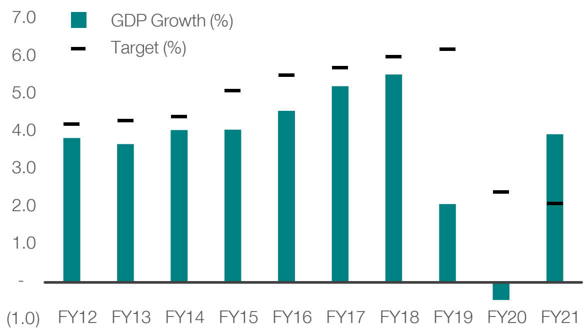
Recovering Economic Growth



Source: Economic Survey, Budget Documents

GDP growth surprises on the upside: Economic growth has recovered from crisis trough levels enabled by relatively early relaxation in lockdown restrictions and through a strong coherent policy response by the GoP (construction and agriculture packages, fiscal relief package of 2.5% of GDP) and the State Bank of Pakistan (lowered key policy rate by 625bps along with additional liquidity measures and incentives to the industry) cumulatively worth 4.8% of GDP (PkR1.99tn). In this backdrop, PBS has provisionally estimated GDP growth in FY21 at 3.9% (vs. GoP target of 2.1%) driven by multipliers emanating from a rebound in the services sector (up 4.4%YoY) likely led by pickup in consumer spending post easing of covid related restrictions and overall growth in trade volumes (wholesale & retail trade up 8.4%YoY). This was followed by growth in the large-scale manufacturing (LSM) sector (up 9.3%YoY) as the sector was quickly able to recover lost production well facilitated by a strong and coherent policy response by the GoP and the SBP. Enhanced yields in important crops (GVA up 4.7%YoY) and growth in livestock (3.1%YoY, in line with the average growth in the previous five years) pushed agriculture (making up 19% of overall GDP) to pencil in a growth of 2.8%YoY. There are upside risks to GDP growth as these estimates are based on 9MFY21 data points where LSM and retail & wholesale sub sectors are expected to capitalize on improving economic activities and a low base last year. Consequently, nominal GDP stands at PkR47.7trn (US$296bn), vs. PkR41.5trn in FY20, reflecting per capita income of US$1,543 vs. US$1,361 in FY20.

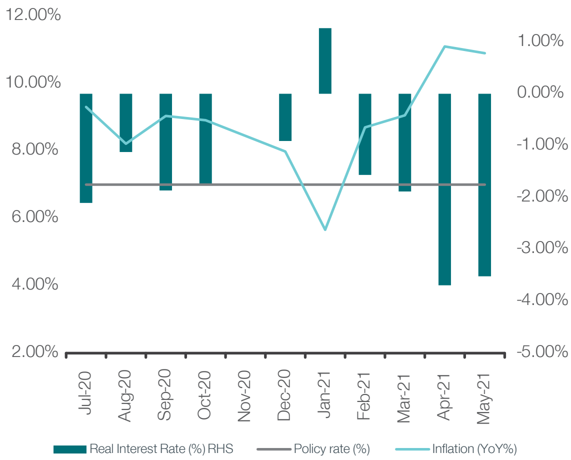
Economic Growth (Target vs. Actual)



Source: Economic Survey, Budget Documents

Accommodative Monetary Policy: Headline inflation has averaged 8.83% in FYTD (close to the upper end target of SBP's range of 7-9%) vs. 10.8%YoY in FY20), largely due to some administered price increases (e.g. electricity tariff annual rebasing in Feb'21) and supply side pressures during the pandemic. That said, core inflation has remained relatively tapered (urban averaging ~6%) due to policy response (tax relief measures and tariff concessions), appreciation of the Rupee against the US Dollar and relatively stable transportation costs with the latest reading in May'21 implying a moderate rise. To counter the pandemic driven uncertainty and relatively weaker domestic demand environment (negative output gap, wage growth is relatively muted) as economic activities have yet to recover to pre-covid levels, the SBP has continued its accommodative monetary policy by keeping its key policy rate unchanged during the year.

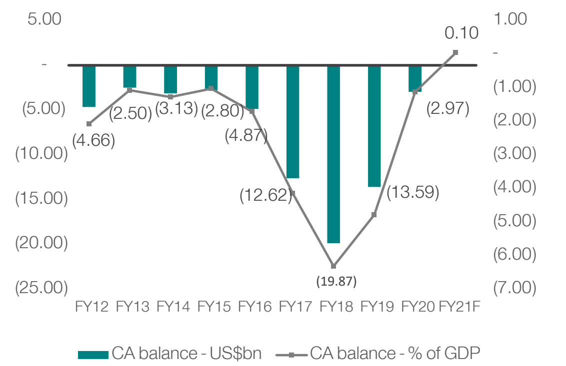
Nominal vs. Real Interest Rates



Source: PBS, SPB

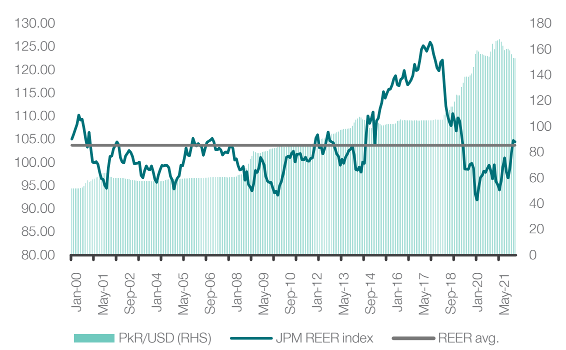
External Account – Higher Inflows Ensuring Stability: Pakistan has registered a Current Account (CA) surplus of US$773mn (0.3% of GDP) in 10MFY21 (vs. a CA deficit – CAD of -US$4.46bn (-2.1% of GDP) last year). Subdued domestic demand restricting overall import payments along with higher workers' remittances (up 29%YoY to ~US$24.2bn in 10MFY21 - remittances have continued to exceed US$2bn for the 11th consecutive month) are major drivers behind external account improvement. Restrictions on air travel have also contributed to the strength in inward remittances as expats switched to formal channels (PRI incentives). Atypically higher other current transfers (up ~96%YoY to reach ~US$3.2bn in 10MFY21) have also contributed to the strength in CA, reflecting potentially higher foreign social contributions during the pandemic and likely higher withdrawals in FCY deposits by non-resident Pakistanis in the backdrop of PkR appreciation. Strength in the PkR is also supported by the return to international capital markets through Eurobond/Wapda green bond proceeds of US$2.5bn/US$0.5bn, materialization of external funding flows from multiple sources (up 38%YoY/83% of budgeted to reach US$10.19bn in 10MFY21) and G20 debt deferment (US$3.7bn during May'20-Dec'21). Consequently, SBP FX reserves have risen by ~US$4.3bn FYTD to stand at US$16.4bn (highest since 2017 and implying an import cover of 4x) leading to 8% FYTD currency appreciation with currency parity currently around PkR154.1/US$.

Improving External Account



Source: SBP

PkR vs. REER Trend



Source: Bloomberg

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Performance Summary of Key Funds

MAY, 2021
Based on latest FMR

Fund Name	Risk Profile	Inception Date	FYTD Returns *	1 Year Trailing**
Faysal Asset Allocation Fund	High	July 24, 2006	96.22%	99.68%
Benchmark			35.36%	36.80%
Faysal Stock Fund	High	April 19, 2004	85.77%	87.64%
Benchmark			39.14%	41.16%
Faysal Islamic Stock Fund ***	High	July 24, 2020	43.66%	-
Benchmark			31.36%	-
Faysal Income & Growth Fund	Medium	October 10, 2005	6.52%	6.85%
Benchmark			7.74%	7.74%
Faysal Financial Sector Opportunity Fund	Medium	July 5, 2013	6.69%	6.88%
Benchmark			7.41%	7.44%
Faysal Savings Growth Fund	Medium	May 12, 2007	6.33%	6.64%
Benchmark			7.41%	7.44%

Fund Name	Risk Profile	Inception Date	FYTD Returns *	1 Year Trailing**
Faysal MTS Fund	Moderate	April 8, 2016	7.96%	8.03%
Benchmark			7.41%	7.44%
Faysal Islamic Savings Growth Fund	Moderate	July 14, 2010	6.72%	6.88%
Benchmark			3.60%	3.79%
Faysal Halal Amdani Fund	Low	October 10, 2019	6.69%	6.84%
Benchmark			3.45%	3.53%
Faysal Islamic Cash Fund ***	Low	August 11, 2020	6.88%	-
Benchmark			3.42%	-
Faysal Money Market Fund	Low	December 13, 2010	6.79%	6.95%
Benchmark			6.70%	6.79%

* 01 July, 2020 to 31 May, 2021
** 31 May, 2020 to 31 May, 2021
*** Since Inception

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Rating by VIS
AM2
(Very Good Management Quality)

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