

September 02, 2010

## Pakistan Market

## Pakistan deficit soars to 6.3% in FY10

MORNING BRIEFING



KSE100 Index: Closing 9,735.38 ↓ (-77.67)

Even against the revised budgeted estimate of 5.1%, the actual deficit for the year ended Jun'10 came in at a far worse 6.3%. After analyzing fiscal accounts, we came to the conclusion that fiscal indiscipline was primarily blown out of proportion by current expenditure mainly on grants, general public service and safety affairs. Provinces (mainly Punjab & Sindh) too joined the federal government in this respect and reported aggressive deficits. Encouragingly, the FBR has managed to meet tax revenue targets for the year and helped raise tax-to-GDP to 10% from 9.2% in the year earlier. Due to limited external receipts, the federal government has opted to finance 80% of the Rs930bn deficit through domestic sources, thus exerting pressure on the interest rates and crowding out private credit off take.

### Too much spending leading higher deficit

In FY10, the current expenditure reached 16.3% of GDP from 15.6% in the previous fiscal year. We believe, higher expenditure was incurred on a mix of both necessary and unnecessary heads, as the federal government spent over Rs250bn in grants vs. Rs114bn in FY09 and Rs232bn on General Public Service vs. Rs138bn in FY09. (For details on expenditure incurred on grants, refer to the table.) On a positive note, the development expenditure pie has expanded to 4.2% of GDP from 3.4% in the last fiscal year.

### 2010 floods and our fiscal deficit outlook

The GoP is yet to arrive at the final numbers for losses suffered in the floods thus far. However, preliminary estimates suggest, GDP growth will trim by 1-1.5% and in turn, the revenue targets possibly missed. Additionally we opine, expenditure on rehabilitation and reconstruction could go as high as Rs300bn to 500bn in FY11. The impact on taxes, expenditure and deficit and remedies are as follows;

**Tax target:** We expect the federal government to keep the targets for FY11 intact and impose additional tax measures to offset the tax losses. Inspiration can be taken from the floods

#### A glimpse at government expenditures for FY10(Rs mn)

Subsidy to PEPCO on a/c of Inter Disco Tariff Differential	58,762
Subsidy to pick-up KESC tariff differential	23,000
Interest Payment under Floating Debt	18,290
Repayment of principal against TFCs loan	15,293
Bridge financing loan to PEPCO for PSO	15,000
Add. req. of pension charges for Defence Services	13,112
Payment to PEPCO on a/c of tariff differential	11,000
Law and order expenditure in KP	9,856
Carrying cost for maintenance of 2mn tons of wheat	8,001
Payment to PIA	3,000
Mark up payment against TFCs for PHPL	2,260
Add. requirement of pensionary charges of Civil	2,210
Bridge financing loan to Wapda for MCB	2,060
Payment to CDA in lieu of land to Chinese Embassy	2,000
Establishment of Peace committees	850
Compensation to the victims of terrorists acts in FATA	800
Return Package of IDP's FATA	750
Interest Payment under Bahbood Saving Certificate	726
Expenditure requirements of reinstated employees	498
Construction and Furnishing of Supreme Court building	447
Grant in Aid to Bar Council / Association	439
Issuance of free of cost CNICs by NADRA	300
Procurement of tents and blankets for ERC	298
Electricity consumed by IDP's Army & FC	273
Repair and maintenance of Aiwan-e-Sadr, Islamabad	250
Media Campaign on Counter Terrorism	250
Individual claims of Pakistan Rangers	240
Creation of new posts for Federal Levies	215
Purchase of security equipment for VVIPs	173
Payment of law charges for defending Dr. Afia Siddiqui	157
Repair and maintenance of Parliamentary Lodges	63
Operating expenses of PM Secretariat	26
Repair and maintenance of Presidency, Islamabad	12
Treatment of Federal Minister for Religious Affairs	5
Treatment of Mr. Ilyas Ahmed Bilour, Senator	4

Source: Budget Document 2009-10

in 1992, when the federal government imposed a 1% surcharge on imports. We are not ruling out the one-off tax surcharge on income of individuals & companies either. A 1% increase in custom duty and income tax will contribute approximately Rs18bn and Rs13bn, respectively. To raise an additional Rs100bn, FBR needs to impose a surcharge on imports of 2-3% and on income tax of 3-5%. This will have a negative bearing on the stock market, as a 1% increase in the corporate tax rate would erode FY11 earnings growth by around 1.25% (currently 18%).

**Expenditures:** We expect current expenditures to over run by Rs300bn, and only Rs150bn of that to be compensated through a cut in development expenditure.

**Fiscal Deficit:** Keeping every thing constant the deficit for the year ending FY11 is expected to overshoot by 1%, and we anticipate the GoP to report a deficit in the vicinity of 5.5-6.0%.

**Financing:** As a result of the massive destruction, Pakistan is expected to receive substantial funding from the global, multilateral and bilateral institutions as well as the government is likely to get a waiver from the IMF on borrowing from the SBP, hence we expect the pressure on domestic borrowing to reduce considerably in FY11.

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