PAKOMAN ASSET MANAGEMENT

Dated: May 31, 2011

Pre – Budget 2011-12

Budget Snapshot (Expected)	
PKR bn	**FY12F**
Budget Outlay	3,750
Tax Revenue	2,077
Non-Tax Revenue	784
Total Revenue	2,861
Budget Deficit	889
as % of GDP	4.5%
Current Expenditure	2,782
Defense	562
Debt Servicing	929
Development	968
PSDP	710
GDP	20,638
GDP Growth	4.2%
Agriculture Growth	3.4%
Manufacturing Growth	3.7%
Services Growth	5.1%
CPI Inflation (YoY)	12.0%-13.0%

The Budget for FY2011-12 is expected to be announced on 4th of June 2011.

Salient features of the budget

- The FY12 budget will be focused more in expanding the tax base and pacing down if not curtailing down the overall expenditure growth.

- Removal of exemptions/zero ratings, broadening of tax base and gradual removal of subsidies are on the cards.

- The consolidated allocation for subsidies after a reduction of 20% has been projected at PKR 225bn against PKR 283bn allocation for the outgoing FY11. Out of the total subsidy, PKR 148bn was allocated for power subsidy, PKR 52bn for food, oil (zero) and PKR 26bn for fertilizers. The continued govt. borrowing from the SBP and commercial banks to plug the deficit would not only result in crowding out private sector credit with a resultant negative impact on the economic growth and employment while also heating up inflation.

- Flood tax of 15% that was imposed in Mar-11 is set to expire on June 30, 2011; we expect this will continue in FY12.

- There is also a proposal to provide tax credits for expenditure on education and health, in order to promote documentation in the economy.

- The government has decided to finance current account deficit in FY12 through foreign direct investments.

- Withholding tax (WHT) on imported items could be increased to 5-6% from 3%.

- Implementation of Gross Asset Tax or Minimum Alternate Tax on assets @ 1.0-1.5% is expected to bring undocumented sectors into tax net.

- The federal budget FY12 will stipulate a three-tier sales tax system of zero, five and seventeen percent, while maintaining the higher rates for certain specific industries such as telecom and steel melters.

- Broader slabs of tax on salary are likely to remain intact; a new slab could be introduced, taking the highest rate on salary taxes to 25% from 20%.

IMPACT ON Capital Market: Brokerage industry and Asset Management industry is waiting for the fate of CGT, as SECP and KSE has proposed CVT/WHT in lieu of CGT and in this regard various meetings have been held between the Government and Stakeholders.

If CGT will be reversed then we expect the market to be driven by a bullish sentiment otherwise it will remain neutral to negative.

Sectors Expectations

Banks & Insurance: The government is expected to undertake include raising corporate tax for banks and insurance from 35% to 40%; The Federal Board of Revenue (FBR) is planning to reduce withholding tax on cash withdrawal from banks from 0.3 percent to 0.2 percent in the coming budget for 2011-12. **Impact: 'Neutral to Negative'**

Chemicals: Imposition of additional tax on commercial gas consumers is expected; Govt. is also expected to set more than Rs280bn agricultural credit target for FY12. This target would be higher than FY11 target of Rs260bn. Banks have already disbursed agri- credit of Rs171bn during first 8MFY11. Lotte Pakistan (LOTPTA) has proposed the government to increase the duty protection on Purified Terepethelic Acid (PTA) from 3% to regional competitive level (6% China and 5.5% India). However we do not think this will happen. We believe govt. would maintain zero custom duty on Paraxylene (Px), the prime raw material for producing PTA. **Impact: 'Neutral'**

Textiles: Sales tax on yarn 4% and processed cloth 6% were imposed recently, is expected to continue in FY12 budget. Special Excise Duty (SED) of 1% that was also imposed recently would be extended to whole textile product chain. It is expected that government would further reduce the gap between Export Refinance Rates (ERR) and conventional lending rates as IMF's requirement. **Impact: 'Neutral to Negative'**

Oil & Gas: 5-10% levy on gas – this could be in the form of an adjustable tax (WHT) or a flat charge akin to the one charged on petroleum products. Owing to surge in global oil prices, the GoP has been forced to cut down Petroleum Levy on POL products to provide some respite from ever-present inflationary pressures. **Impact: 'Neutral to Negative'**

Power: Subsidy is expected to be lower at PKR 170bn against expected subsidy of PKR 220bn in FY11. Government would reaffirm its commitment to gradually phase out electricity subsidy and power sector restructuring in the upcoming budget as agreed with

IMF. The government is considering a proposal to increase the General Sales Tax (GST) rate from 17% to 30% for industrial and commercial users of electricity in the next budget in order to raise additional revenue of PKR 25bn. At present, the FBR collects about PKR20bn from 17% GST on industrial and commercial users of electricity. Cement PSDP allocation of ~PKR720 (~Rs290 federal and ~Rs430 provincial): The main factor is how much PSDP is utilized. Federal Excise Duty (FED) is expected to remain at Rs700/ton. **Impact: 'Neutral to positive'**

Telecommunication: GST is likely to stay intact at 19.5%, with a downward revision only likely when reformed GST is implemented whereas, WHT rate on cellular services had been raised by 1.5% to 11.5% in 4QFY11. **Impact: 'Neutral'**

Automobiles: Development Plan (AIDP), High Tech parts are imported at 32.5% custom duty presently and if not localized by June 2011, the custom duty will be increased to 50%. It has also been proposed that new entrants be allowed to import 100% CKD at a reduced rate equivalent to 50% of the existing rate i.e. 32.5% or 30%. In addition to this, Government may remove the 50% regulatory duty on luxury items that was imposed in 2008. The duty is applicable on cars above 850cc engine size, in addition to normal duties. Despite 10% increase in maximum duty to 60%, used car importers have asked govt. to increase deprecation rates from 1% to 2%. Proposals have been made to reduce custom duty on CBUs (used and new) to flat 25% while Regulatory Duty (RD) on imported CBUs is also proposed to be abolished. **Impact: 'Neutral to Negative'**