Lucky Investments

# ECONOMIC OUTLOOK

# Federal Budget FY2026

## A Balancing Act

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# KEY REVENUE MEASURES

- **The Government of Pakistan has proposed a PKR17.57 trillion Budget for FY26, which is 2% higher than the revised Budget for FY25.**
- The Gov't is targeting an overall fiscal deficit of 3.9% of GDP and a primary surplus of 2.4% of GDP, compared with the projected fiscal deficit of 5.6% and primary surplus of 2.2% for FY25. The government is targeting to grow FBR's tax revenues by 19% YoY to PKR14.1tn and maintain total expenditures at PKR 16.3 trillion.
- **Among the key revenue measures are:**
  - Withholding tax on non-filers on cash withdrawal from banks of over PKR50,000 will be increased from 0.6% to 0.8%.
  - A carbon levy of PKR2.50/liter will be imposed on petroleum products, which will increase to PKR5.0/liter in FY27.
  - Uniform GST of 18% on cars of under 850cc engine, from 12.5% presently.
  - A 2.5% withholding tax on cigarette distributors.
  - Phase-wise removal of sales tax exemption for goods produced in the FATA/PATA region—from 10% in FY26 to 16% in FY29.
  - Tax rate on profit on debt paid by a bank or financial institution to be increased from 15% to 20%.
  - Dividend received from mutual funds deriving income from investments in both equity and debt securities be taxed at the rate of 15% and 25%, respectively, contingent upon proportionate income derived from average annual investment in debt and equity securities, respectively.
  - EV Adaptation levy of 1% on cars below 1,300cc, 2% on cars between 1,300-1,800cc and 3% for cars above 1,800cc.

# REVENUE SOURCES

| Tax Revenues (PKR billion) | FY25B | FY25R | Deviation | FY26B | YoY |
|---|---|---|---|---|---|
| **FBR Taxes (I+II)** | **12,970** | **11,900** | **-8%** | **14,131** | **19%** |
| I. Direct Taxes | 5,512 | 5,826 | 6% | 6,902 | 18% |
| - Income Tax | 5,454 | 5,749 | 5% | 6,811 | 18% |
| - Others | 58 | 77 | 32% | 91 | 18% |
| **II. Indirect Taxes** | **7,458** | **6,074** | **-19%** | **7,229** | **19%** |
| - Customs Duties | 1,591 | 1,316 | -17% | 1,588 | 21% |
| - Sales Tax | 4,919 | 3,984 | -19% | 4,753 | 19% |
| - Federal Excise Duty | 948 | 774 | -18% | 888 | 15% |
| **Non-Tax Revenues (PKR billion)** | **FY25B** | **FY25R** | **Deviation** | **FY26B** | **YoY** |
| SBP Profit | 2,500 | 2,620 | 5% | 2,400 | -8% |
| Petroleum Levy | 1,281 | 1,161 | -9% | 1,468 | 26% |
| Dividends | 139 | 198 | 43% | 206 | 4% |
| Mark up | 294 | 245 | -17% | 284 | 16% |
| Others | 631 | 678 | 7% | 789 | 16% |
| **Total** | **4,845** | **4,902** | **1%** | **5,147** | **5%** |
| **Gross Revenues** | **17,815** | **16,802** | **-6%** | **19,278** | **15%** |

# EXPENDITURES

- **Relief measures include:**
  - Super tax proposed to be reduced by 0.5% for income slabs between PKR 200-500 million.
  - Reduction of income tax rate for salaried individuals earning up to PKR 3.2 million annually. Similarly, the surcharge rate on income above PKR 10 million will be reduced by 1% from 10% to 9%.
  - Proportionate tax credit on profit on debt obtained for construction or acquisition of a house of 250 sq. yd. and a flat having 2000 sq. ft. or less area.
  - Withholding tax on purchase of property to be lowered from 4.0% to 2.5%, 3.5% to 2.0%, and 3.0% to1.5%.
  - The government will abolish the 7% federal excise duty (FED) on the transfer of commercial properties, plots and houses.
- **On the Expenditure side**:
  - The government envisions a 9% YoY decline in domestic debt servicing in FY26, thanks to sharp monetary easing during FY25.
  - Defense budget is targeted to increase by 17% YoY, while the government plans to curtail subsidies by 14% YoY.
  - The government has allocated PKR 1.0 trillion for Federal PSDP, similar to last year's allocation. About 30% of this allocation will be used for transport infrastructure projects.

# EXPENDITURES

| Expenditure (PKR billion) | FY25B | FY25R | Deviation | FY26B | YoY |
|---|---|---|---|---|---|
| **Current Expenditure** | **17,203** | **16,390** | **-5%** | **16,286** | **-1%** |
| - Domestic Interest Payment | 8,736 | 7,907 | -9% | 7,197 | -9% |
| - Foreign Interest Payment | 1,039 | 1,039 | 0% | 1,009 | -3% |
| - Pension | 1,014 | 1,014 | 0% | 1,055 | 4% |
| - Defence | 2,122 | 2,181 | 3% | 2,550 | 17% |
| - Subsidies | 1,363 | 1,378 | 1% | 1,186 | -14% |
| - Provision for Emergency | 313 | 223 | -29% | 389 | 74% |
| - Running of the Civil Govt | 839 | 886 | 6% | 971 | 10% |
| **Development Expenditure** | **1,100** | **659** | **-40%** | **1,400** | **112%** |
| - Federal PSDP | 1,100 | 1100 | 0% | 1,000 | -9% |
| - Provincial PSDP | 2,383 | 2,383 | 0% | 2,869 | 20% |
| **Total** | **18,877** | **17,249** | **-9%** | **17,573** | **2%** |
| **Fiscal Deficit** | **-8,500** | **-7,444** | **2%** | **-6,501** | **-13%** |
| **GDP** | **124,150** | **114,692** | **-8%** | **129,567** | **13%** |
| **Federal Budget Deficit - % GDP** | **-6.8%** | **-6.5%** | | **-5.0%** | |
| **Overall Fiscal Deficit - % GDP** | **-5.9%** | **-5.6%** | | **-3.9%** | |
| **Primary Surplus - % GDP** | **2.0%** | **2.2%** | | **2.4%** | |

# KEY MACRO INDICATORS

| Key indicators | | FY24A | FY25P | FY26B | Expectations for FY26 |
|---|---|---|---|---|---|
| **GDP growth** | **YoY** | 2.51% | 2.68% | 4.20% | Growth is expected to be broad-based, backed by lower interest rates, single-digit inflation and favorable government policies for the agriculture and export sectors. |
| **Agriculture** | **YoY** | 6.40% | 0.56% | 4.50% | After a rough year, government is looking to support the farmers with collateral free loans, reduce competition from imported cotton, and allocating PSDP funds towards improving water availability. |
| **Industry** | **YoY** | -1.37% | 4.77% | 4.30% | LSM growth in March 2025 was a positive 1.8% YoY, breaking through a period of prolonged contraction. Improved construction activity and recovering consumer demand will sustain industrial production. |
| **Services** | **YoY** | 2.19% | 2.91% | 4.00% | Services is the largest sector in Pakistan, contributing about 58% of the overall GDP. It will benefit from growth in commodity-based and retail segments of the economy due to rising consumption. |
| **Inflation** | **Average** | 23.87% | 5.00% | 7.50% | High-base effect ended in May 2025; hence, headline CPI is expected to pick up in FY26. However, it is likely to remain in the single digits—backed by controlled food inflation, relatively stable exchange rate and weak global oil prices. |
| **Fiscal deficit** | **% GDP** | 6.90% | 5.60% | 3.90% | Fiscal deficit of 3.9% will be the lowest reading in more than a decade. This will be attributed to recent reforms aimed at expanding the tax net and containing expenditure have been key factors, besides significantly lower debt servicing due to lower sharply interest rates. |
| **Primary surplus** | **% GDP** | 0.90% | 2.20% | 2.40% | FY26 could be the third consecutive year of a primary surplus—which will be a testament to the strength of present macroeconomic recovery |
| **CA balance** | **% GDP** | -0.6% | 0.5% | -0.5% | CA should remain manageable on the back of strong remittances and moderately widening trade deficit. Growth in goods imports will be checked by a flexible exchange rate. |
| **Exchange rate** | **Year end** | 278.34 | 282.20 | 295.00 | Supporting factors for moderate depreciation include, two IMF programs where Pakistan will receive USD2-2.5 billion in the next 12 months, Panda bond issue in China by end of 2025, and Gov't looking to recommence privatization, with PIA and Roosevelt Hotel. |

# POSITIVE OUTLOOK FOR THE STOCK MARKET

- The FY26 Budget is broadly positive for the Equity market. The government did not announce some anticipated negative measures, such as an increase in CGT on sale of equities or higher tax on dividend income. But the government also refrained from expansionary fiscal policies that could have undermined the present recovery in Pakistan's economy.
- Relaxation in income tax rates for the salaried class and super tax, though moderate, will help to boost investor confidence.
- Given the increase in tax on profit on debt securities, capital should rotate into the equity market from other asset classes. The higher liquidity will help to continue market's rerating. Its forward price-to-earnings (PE) multiple is 6.5x, which still has room to catch up to its long-term average PE of around 7.5x.
- Meanwhile, the Budget had neutral to positive measures for  most of the major sectors on the PSX. Key beneficiaries include Cement, Pharmaceutical, Fertilizer, and Energy sectors. However, increased restrictions for non-filers could be negative for Banks and Autos in the near term.
- Government's focus on rooting out non-documentation and smuggling of illicit goods would also bode well for the long-term corporate profitability of industries in Pakistan.

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## QUESTIONS? WE WOULD LOVE TO HELP!

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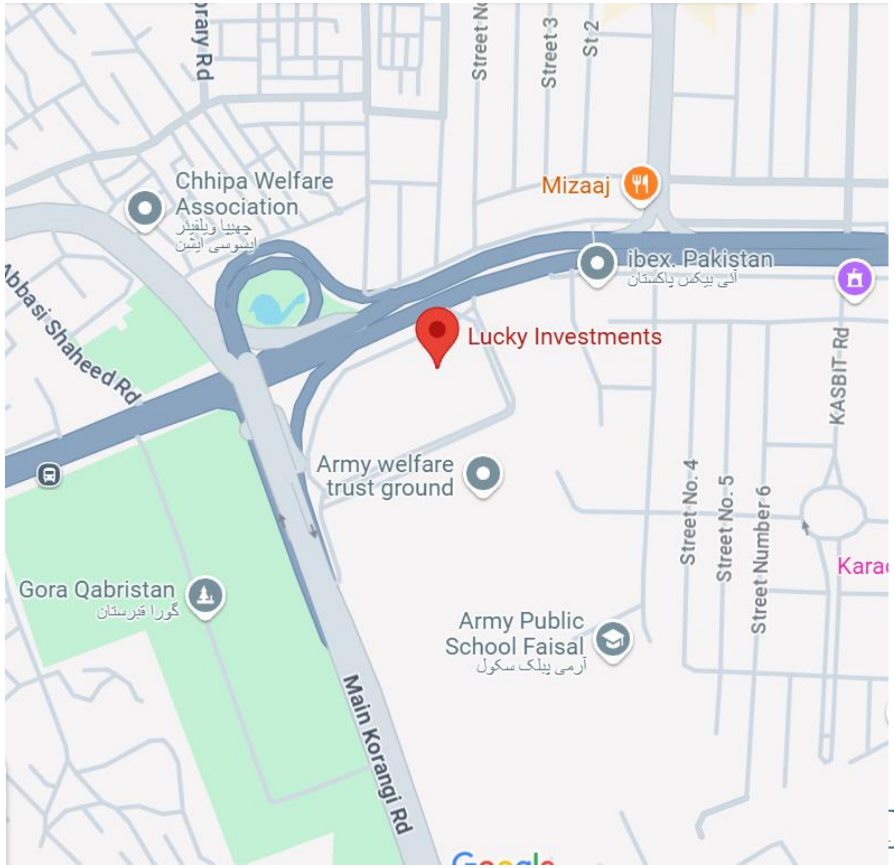


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