



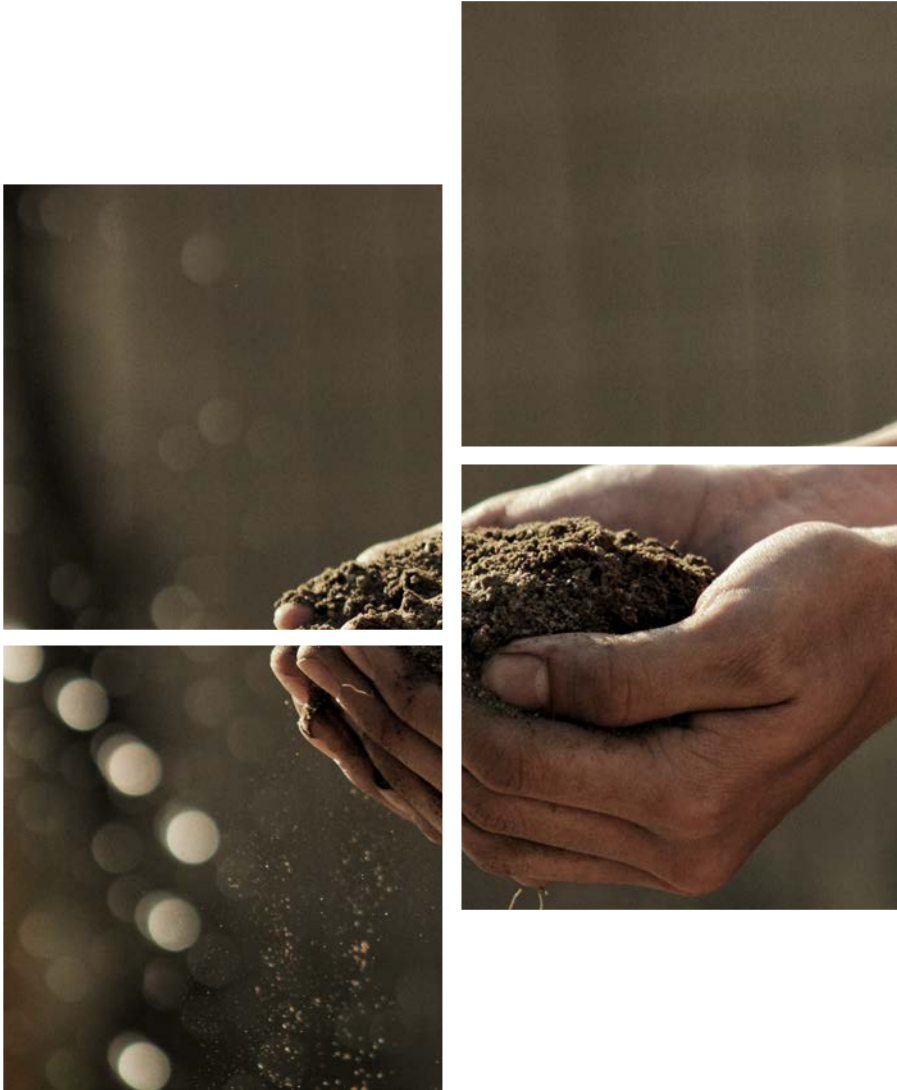
MICROFINANCE

Sector Study
September 2023



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Values in PKR bln except otherwise stated.

Particulars	FY18	FY19	FY20	FY21	FY22	FY23
GDP Nominal	39,190	43,798	47,540	55,836	63,271	79,336
GDP Real	33,860	34,916	34,587	36,582	38,815	38,927
GDP Growth Rate	6.10%	3.12%	-0.94%	5.77%	6.10%	0.29%
LSM Growth Rate	7.00%	3.40%	-11.00%	11.60%	11.90%	-10.32%
Fiscal Deficit as a % of GDP	6.20%	9.30%	9.20%	8.70%	12.70%	-4.90%
Government Debt	24,212	31,787	35,107	38,704	47,832	60,840
<i>Domestic</i>	16,416	20,732	23,283	26,265	31,085	38,809
<i>External</i>	7,796	11,055	11,825	12,439	16,747	22,031
Remittances	19,914	21,739	23,132	29,450	31,279	27,028
Current Account Balance (USD mln)	-19,195	-13,434	-4,449	-2,820	-17,481	-2,387
Trade Balance USD mln	-30,903	-27,612	-21,109	-28,155	-39,050	-24,076
Exchange Rate (Avg) – USD/PKR	110.11	136.45	158.40	160.46	191.87	247.57
KIBOR (Avg)	6.39%	10.43%	11.95%	7.43%	10.83%	18.30%
MPR (Avg)	5.95%	9.69%	11.75%	7.00%	9.67%	22.00%
Inflation (Avg)	3.90%	7.30%	10.70%	8.90%	12.10%	29.40%

Notes:

- Exchange rate as at 31st August, 2023 stood at 305.54.
- Inflation rate as at 31st August, 2023 stood at ~27.4%.
- Kibor rate as at 31st August, 2023 stood at 23.21%.
- Remittances for 2MFY24 is PKR~4,122bln.
- Government debt as at 31st July 2023 stood at PKR~61,747bln.
- Projected GDP of Pakistan for FY24 will be ~3.5% (IMF).

Pakistan's economy faced a myriad of challenges in FY23, including, but not limited to, persistent inflation, low foreign exchange reserves, and currency depreciation. These difficulties were further compounded by the flashfloods of 1QFY23, that resulted in an estimated loss of a whopping USD~30bln (or ~11% of the country's GDP of FY22) followed by delays in securing financial support from the IMF. Additionally, the LSMI also dipped by ~8.1% during FY23. Consequently, the country posted a modest GDP growth of ~0.3% (FY22: ~6.0%).

The country has entered into FY24 carrying the weight of economic vulnerabilities from the outgoing fiscal year. Despite IMF's SBA of USD~3bln in Jun'23 propping up the foreign exchange reserves and the country escaping from the brink of default, factors such as external imbalances and soaring levels of inflation are still keeping the economic recovery in check. Following disbursement of IMF's tranche, the benchmark KSE-100 index recorded an impressive streak of ~5.5% growth during Jul'23, which later tapered down to ~6.3% in Aug'23 and again increased by ~2.7% in Sep'23.

The current economic woes are characterized by all-time high inflation levels of ~38.0% in May'23, particularly pertaining to energy and food prices, high interest rates, external imbalances and steep devaluation of the rupee against dollar (USD/PKR, in Sep'23, hitting historic low of ~307 in the Interbank market). While the latter was resolved vis-à-vis administrative controls such as nationwide crackdown on currency smugglers/ hoarders and the SBP introducing reforms in Exchange Companies Regulations, a lot still needs to be done.

With international oil prices tracing an upward trajectory and the economy remaining largely import-driven, inflationary pressures are expected to persist in the short to medium term. Furthermore, with the next IMF tranche not due before Dec'23, improving exports is the dire need of the hour in order to earn the much-needed foreign reserves and rejuvenate the stagnant economy.

The ongoing economic downturn presents substantial challenges to the businesses operating in almost all sectors of the economy. High interest rates have pushed up the debt-servicing costs of the businesses, potentially impacting their profits and cashflows. Moreover, this has also led to an increase the risk of non-repayments, especially for businesses facing higher debt leverage amid the economic slump.

Financial Institutions are no exception when it comes to Microfinance Institutions also encounter difficulties vis-à-vis balancing revenue generation with deposit acquisition, as traditional banking often offers more attractive returns. Additionally, obtaining short-term funds becomes more challenging, further pressuring the financial stability and operations of these Institutions.

In a nutshell, increased operational costs, diminished loan demand, and a shift towards traditional banking form some of the significant hurdles for Microfinance sector players. Addressing these challenges necessitates astute management of interest rate risks and strategic implementation of adaptations.

Executive Summary

- The Sector's Gross Loan Portfolio (GLP) clocked in at PKR~510bln as of Mar'23, up ~4% since End-Dec'22, when it recorded at PKR~491bln.
- As of Mar'23, Microfinance Banks (MFBs) maintained the highest share of the total GLP at ~77%, while NBMFCs (including MFIs and RSPs) made up the remaining ~23%.
- The Sector's total active borrowers increased to ~9.3mln as of Mar'23, up ~2% from ~9.1mln as at End-Dec'22. Among peer groups, MFBs accounted for ~66% of the active borrowers while the share of NBMFCs clocked in at ~34%.
- With respect to credit quality of the Sector, the Portfolio-At-Risk rose to ~6% as at End-Dec'22, while during 1QCY23, the ratio returned to the initial ~5% level. Among peer groups, MFBs, holding the largest share in the pie, witnessed a weakened credit health with PAR>30 days increasing to ~9.5% as of Mar'23 from ~8.8% at End-Dec'22. Meanwhile, RSPs recorded at ~ 3.0% in Mar'23 (End-Dec'22: ~4.2%).
- Deposit base of the Sector clocked in at PKR~514bln as at End-Dec'22, up ~22% YoY (End-Dec'21: PKR~423bln). In 1QCY23, however, Sector's deposit base stood at PKR~488bln, down by ~5%, compared against End-Dec'22.
- The Sector's bottom line dipped into the negative zone, subject to ~40% increase in administrative expenses in CY22, and stood at PKR~63bln (CY21: PKR~45bln). During 1QCY23, Sector's administrative cost accumulated to PKR~25bln.

GLP (MFBs + MFIs + RSPs & Others)	CY21	CY22	3MCY23
Outreach			
Number of Branches	3,823	4,058	4,037
Growth (YoY)	0%	6%	-1%
Gross Loan Portfolio			
Gross Loan Portfolio (PKR bln)	393	491	510
Growth (YoY)	21%	25%	4%
Active Borrowers (mln)	8.12	9.09	9.25
Growth (YoY)	16%	12%	2%
Average Loan Size	48,335	54,031	55,081
Portfolio At Risk (PAR>30 days)	4.9%	5.8%	5.2%
Funding			
Value of Deposits (PKR bln)	423	514	488
Growth (YoY)	13%	22%	-5%
Number of Deposit Accounts (mln)	79	94	98
Growth (YoY)	23%	19%	4%
Average Deposit Size (PKR)	5,367	5,474	4,969
Growth (YoY)	-8%	2%	-9%

Sector Outlook: Negative

Pakistan's Microfinance Sector has historically (CY15-21) exhibited a CAGR of ~22.8% driven by technological advancements and institutional support. Even during the challenging times of the COVID-19 outbreak, the sector remained resilient to the shocks and slowdown, as regulatory relief in the form of deferment and restructuring of loans came to the rescue. However, following expiration of the relief schemes, the provision and recovery of restructured/deferred portfolio had begun posing a bigger challenge to the Sector. Almost PKR~121bln of the MFBs GLP was approved by the SBP for principal deferments and loans restructuring (Apr'16, 2021), which is ~31% of the total MFBs GLP (as at Dec'22).

With the emergence of economic turbulence and massive flashfloods, the probability of recovery from the carried forward restructured loans has considerably narrowed down. As of Dec'22, the NPLs pertaining to the restructured/deferred portfolio represented almost 52% of the total NPLs of the MFBs sector.

Alongside this challenge, the Sector continues to grapple with economic woes, characterized by all-time high inflation and interest rates. The shrink in disposable incomes, particularly of the low-income segments of the society, can impact the repayment capacity of the sector's borrowers. The flash floods that occurred in Jul-Aug'22 have caused an estimated loss of a whopping USD~30bln, almost ~11% of the country's GDP (FY22). As per estimates, one-third of the country was submerged in water, impacting ~33mln people, displacing ~8mln individuals and causing a loss of almost USD~4bln in the agriculture, livestock, and fisheries sectors. Agriculture and Livestock collectively constitute over ~50% of the loan portfolio of the Microfinance Sector.

The Gross Loan Portfolio (GLP) of the Sector crossed the PKR~500bln mark in Mar'23 (PKR~491bln in Dec'22 and PKR~392bln in Dec'21). The NPL ratio, on the other hand, clocked in at ~5.2% in March'23 (~5.8% in Dec'22) as compared to ~4.8% in Dec'21.

MFBs, possessing the largest share in the sector's GLP (~77%) posted a sharp increase in their NPL ratio at ~8.8% during CY22 and ~9.5% in 3MCY23.

Meanwhile, MFIs and RSPs, which make around 23% of the sector's GLP, had their infection ratio contained at ~4.2% as at Dec'22, which improved further down to ~3.0% in Mar'23, most likely due to their smaller businesses, direct relationship with the borrowers and their loan rollover options.

The MFBs' true Infection ratio against bad loans has increased from ~6% in CY21 to ~8% in CY22, signaling a potential drag on the sector's equity, it is still expected to remain high in CY23. Meanwhile, the internal capital formation of the MFBs has also suffered with losses swelling by ~21% to PKR ~(9bln) in CY22. Write-offs of the sector (MFBs, MFIs & RSPs) also increased by ~36% and were recorded at PKR~15bln in CY22 (CY21: PKR~11bln). The risks impacting the lending portfolio have pressured the capital structure and liquidity profile of the sector as well.

MFBs' Average CAR was recorded at ~19.66% in CY22 (~24.16% in CY21). Meanwhile, Average Capital Adequacy Ratio (CAR) of the MFBs, excluding small players (Advans, Pak Oman, Sindh MFB) has dropped to below the minimum regulatory requirement of 15% to ~9.9% in Dec'22 (~16.5% in Dec'21).

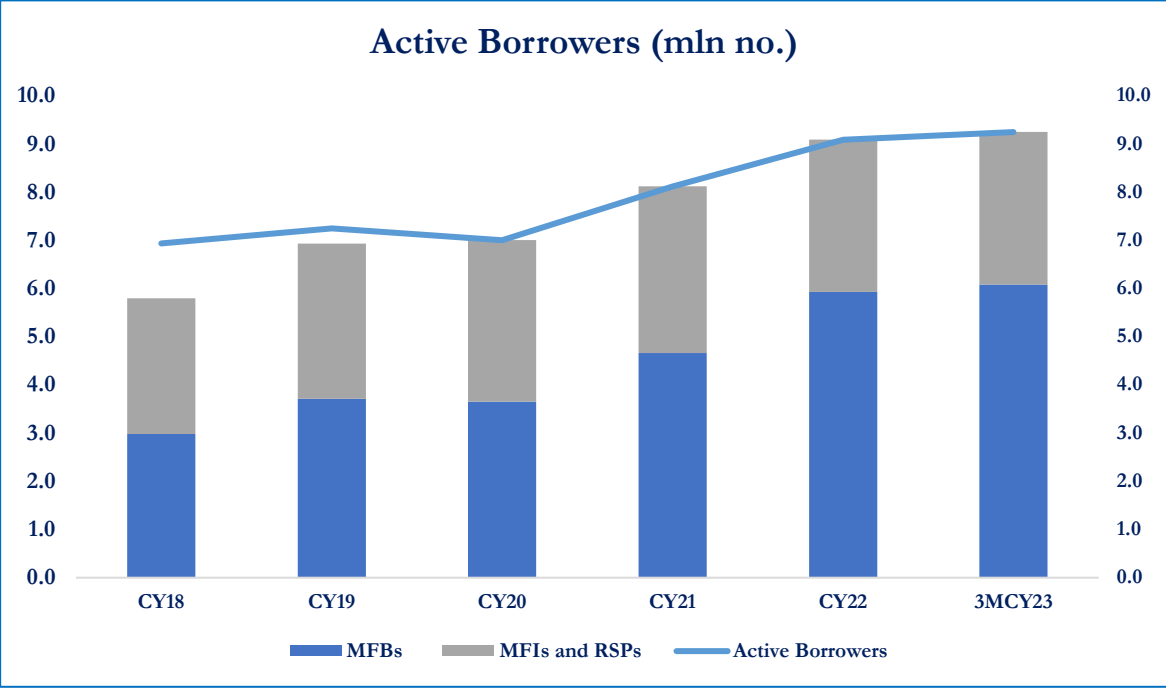
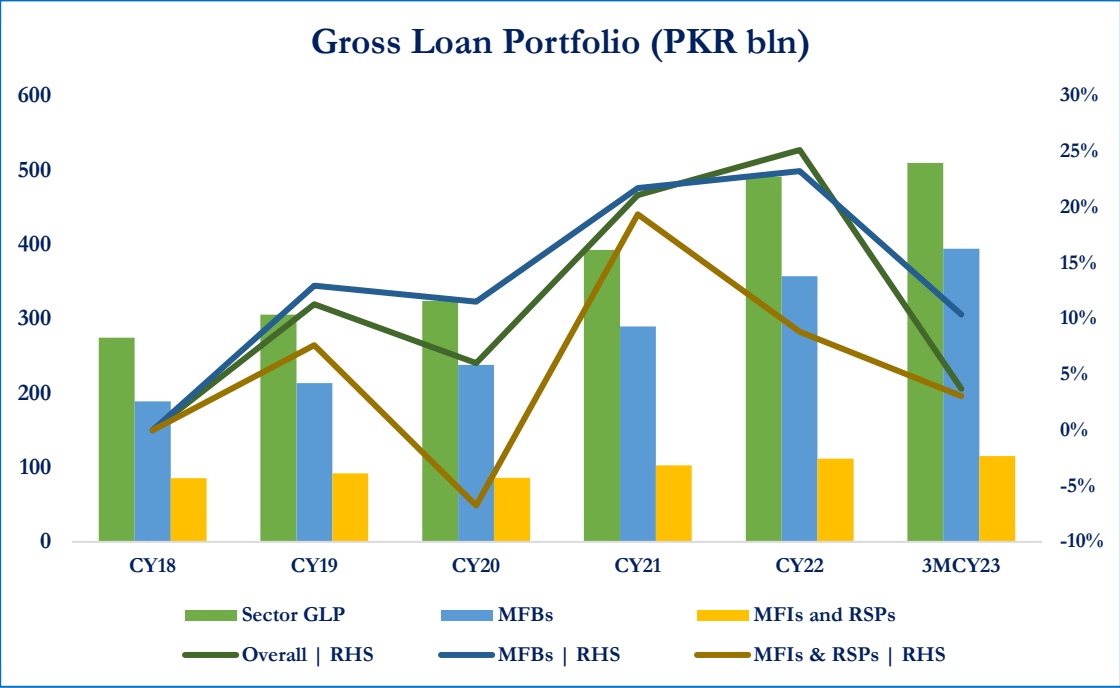
On the funding side, the deposit base of the MFBs clocked in at PKR~488bln in Mar'23 (PKR~514bln in Dec'22 and PKR~423bln in Dec'21), a drop of ~5% in 3MCY23. The overall cost of funds for the MFBs increased to ~12% during CY22 (~8% in CY21) while Advances-to-deposits (ADR) ratio clocked in at ~75% in Dec'22 (~72% in Dec'21). With a sharp reduction in liquidity, owed to continued trend of modest recoveries and negative profits, the MFBs' Liquid Assets to Deposits & Borrowings ratio also dropped from ~40% in Dec'21 to ~35% in Dec'22.

MFI & RSPs are generally smaller in scale as compared to MFBs and tend to manage their asset portfolio through borrowed funds. Liquidity management is of critical significance to the MFIs & RSPs as their costs of doing business are generally high. On average, ~60% of the borrowings of the MFIs are from commercial banks, while the next highest share pertains to foreign lenders (~12%) followed by PMIC (~9%) and SBP (~2%).

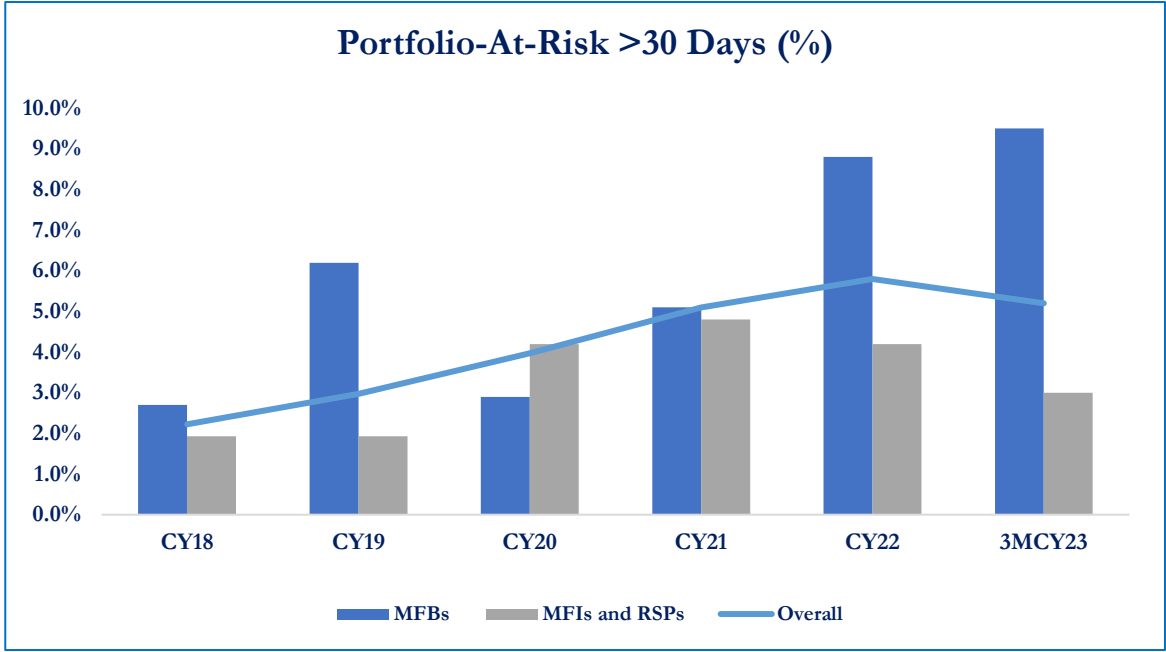
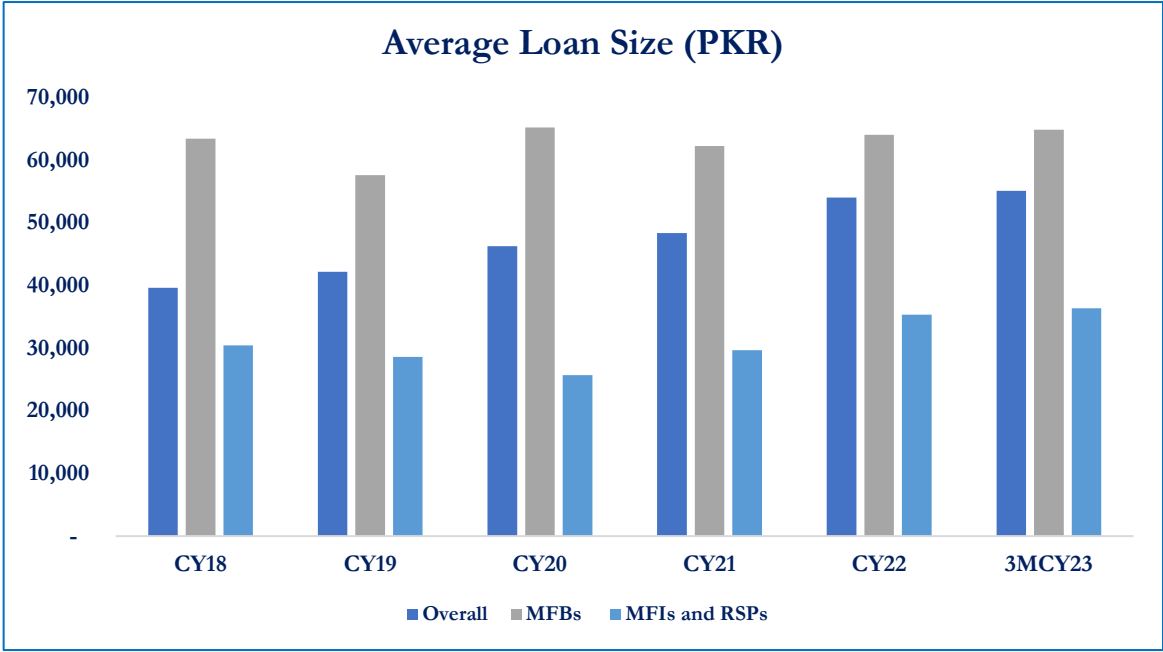
In conclusion, the Microfinance sector is going through a distressed phase on account of unavoidable systemic risks as well as its higher delinquencies. Concerns regarding defaults on certain debt instruments and losses by various MFBs highlight a potential problem within the Sector. The Sector's prevalent risks emanate from the current economic jolts, which are expected to subside gradually in their due course of recovery and stabilization. However, in the transitional period, support from sponsors and regulators to realign the Sector's risk matrix and consolidate its financial position is a critical need of the hour.

Key Statistics | Trend Analysis

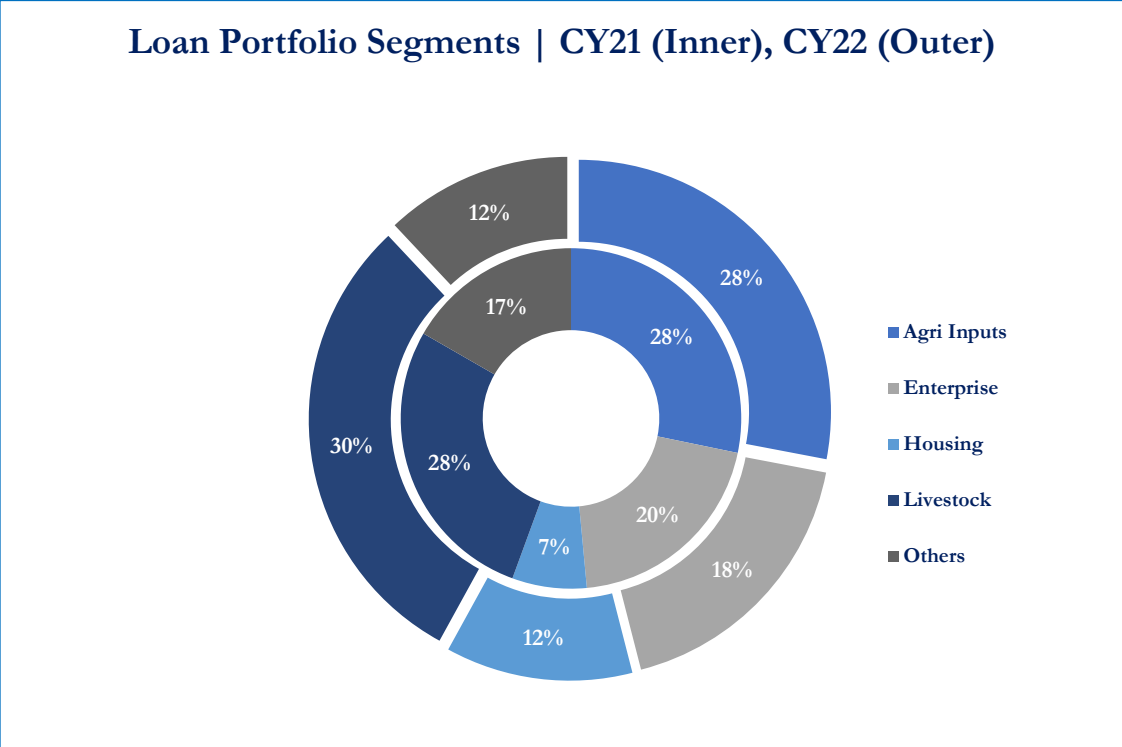
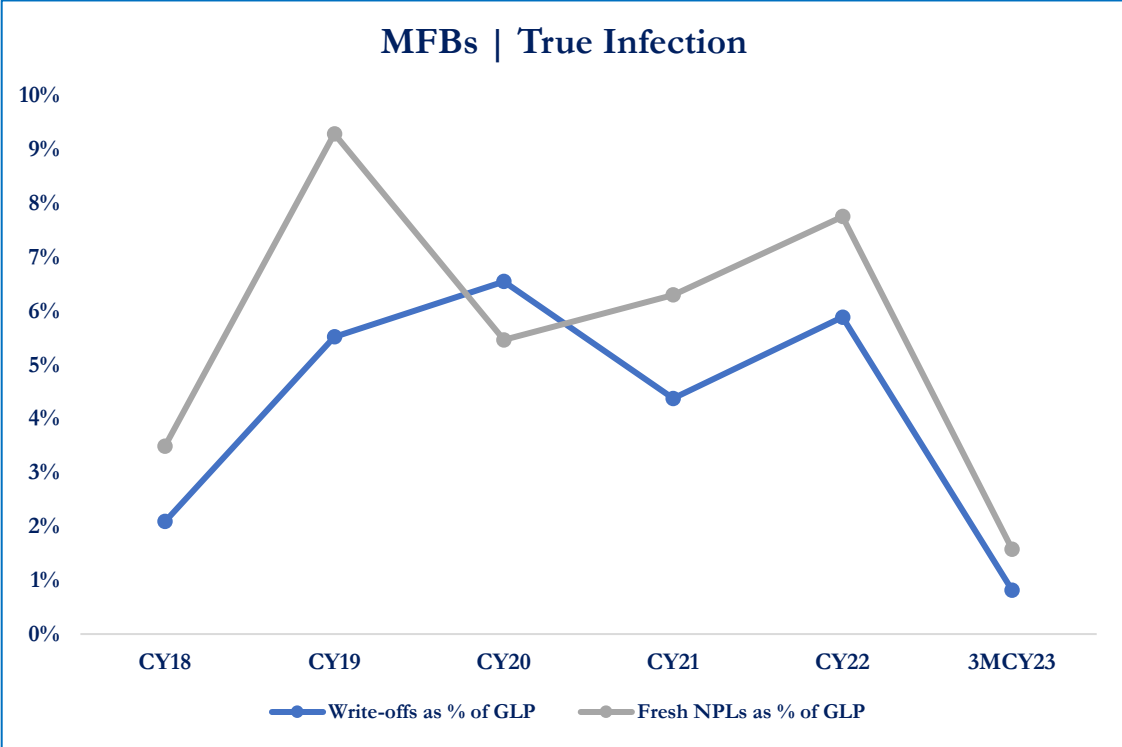
GLP (MFBs + MFIs + RSPs & Others)	CY18	CY19	CY20	CY21	CY22	3MCY23
Outreach						
Number of Branches	4,239	4,036	3,828	3,823	4,058	4,037
<i>Growth (YoY)</i>	15%	-5%	-5%	0%	6%	-1%
Assets						
Gross Loan Portfolio (PKR bln)	275	306	324	393	491	510
<i>Growth (YoY)</i>	36%	11%	6%	21%	25%	4%
Active Borrowers (mln)	6.94	7.25	7.01	8.12	9.09	9.25
<i>Growth (YoY)</i>	20%	5%	-3%	16%	12%	2%
Average Loan Size	39,603	42,173	46,269	48,335	54,031	55,081
Portfolio-At-Risk (PAR>30 days)	2.2%	4.8%	3.7%	4.9%	5.8%	5.2%
Funding						
Value of Deposits (PKR bln)	240	268	374	423	514	488
<i>Growth (YoY)</i>	28%	12%	40%	13%	22%	-5%
Number of Deposit Accounts (mln)	35	48	64	79	94	98
<i>Growth (YoY)</i>	14%	35%	35%	23%	19%	4%
Average Deposit Size (PKR)	6,799	5,617	5,839	5,367	5,474	4,969
<i>Growth (YoY)</i>	13%	-17%	4%	-8%	2%	-9%



- During 3MCY23, total GLP of the Sector was recorded at PKR~510bln. Among the peer groups, Microfinance Banks comprised ~77% of the Sector’s total GLP, amounting to PKR~395bln, while GLP of both the MFIs & RSPs was collectively recorded at PKR~115bln. Segment-wise, MFBs’ growth rate has historically remained higher than the industry average, while MFIs and RSPs have witnessed a slower growth momentum. Over the past five years (CY18-22), GLP across the MFBs grew at a CAGR of ~15%, while that for the MFIs exhibited a nominal growth of ~2% during the same period.
- Within the Microfinance Sector, MFBs also led in terms of the active number of borrowers, capturing ~66% of the market share in 3MCY23. While the number of total active borrowers was recorded at ~9.3mln in 3MCY23, those for MFBs amounted to ~6.1mln.



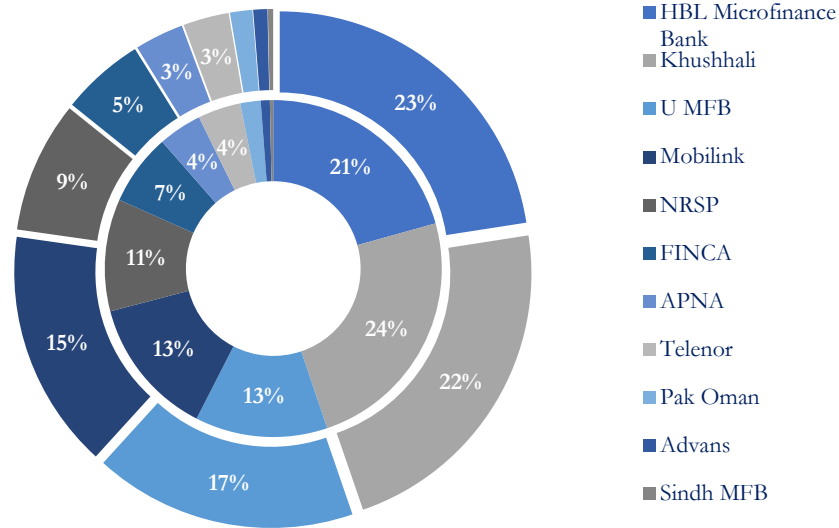
- In 3MCY23, the average loan size increased across all segments, with MFBs being the prominent player. During this period, while the average loan size for the Microfinance Sector, comprising 17 Microfinance players, increased by ~2% and recorded at PKR~55,081 (End-Dec'22: PKR~54,031), average loan size for MFBs stood at PKR~64,853.
- The increase in Sector's average loan size can likely be attributed to an increase of ~3% in the average loans size across MFIs and RSPs, reflecting currency depreciation and the concomitant rise in cost of living, especially for the society's low-income segments.
- In terms of credit quality, MFBs exhibited significant deterioration in 3MCY23, with average PAR>30 days shooting up to ~9.5% from ~8.8% in CY22. Across the Sector, however, this number evidently improved during the same period, declining to ~5% from ~6% previously in CY22. In the case of MFIs and RSPs, the figure has been on a consistent downward trend since CY21, declining to ~3% during 3MCY23 (CY22: ~4%; CY21: ~5%).



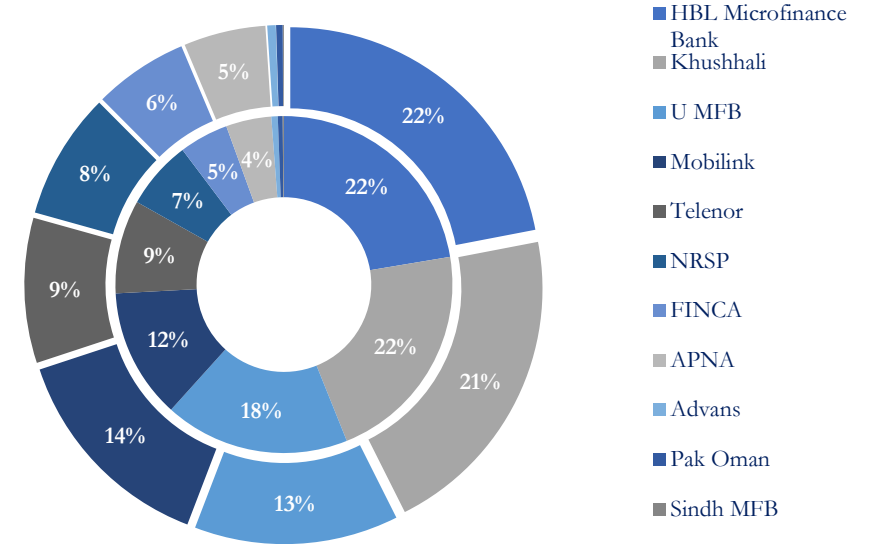
- In 3MCY23, the MFBs’ infection ratio decreased to ~2%, as against ~8% in CY22. With respect to write-offs to GLP, the ratio gets downward from ~6% in CY22 to ~1% in 3MCY23.
- The chart on the right illustrates product-wise distribution of GLP for Microfinance Sector for the period CY22. The Livestock sector represented the largest share, comprising approximately ~30% of the overall product portfolio, followed by Agriculture, which formed ~28% of the overall product mix.

Note: True Infection ratio pertains MFBs only, while Loan Portfolio presents the sector as a whole.

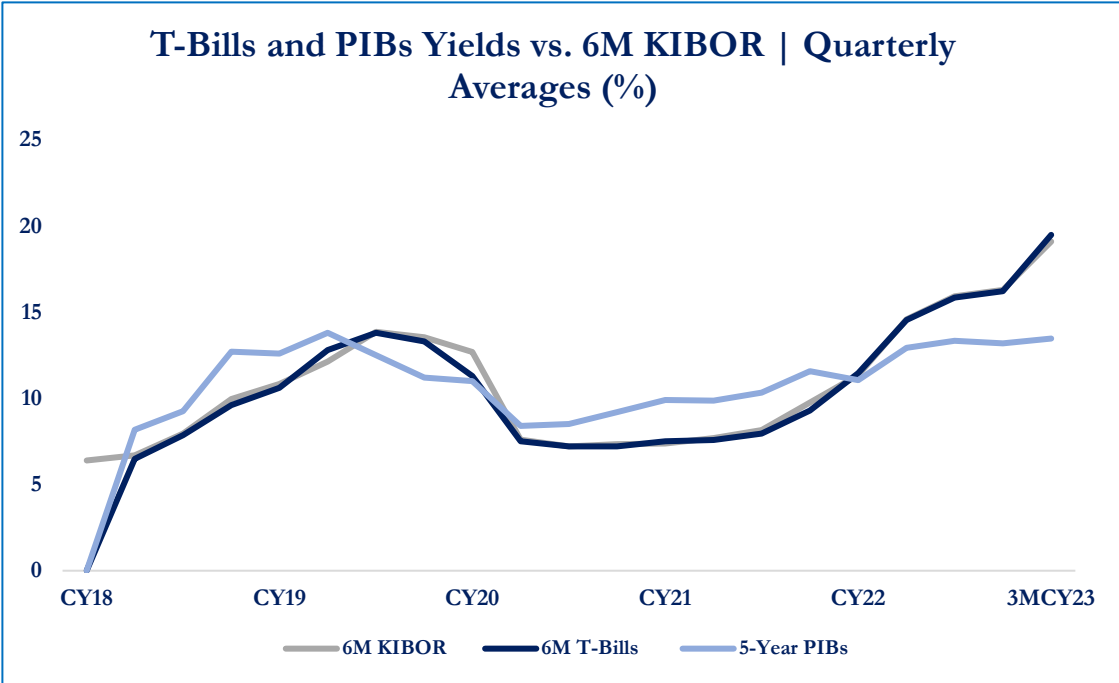
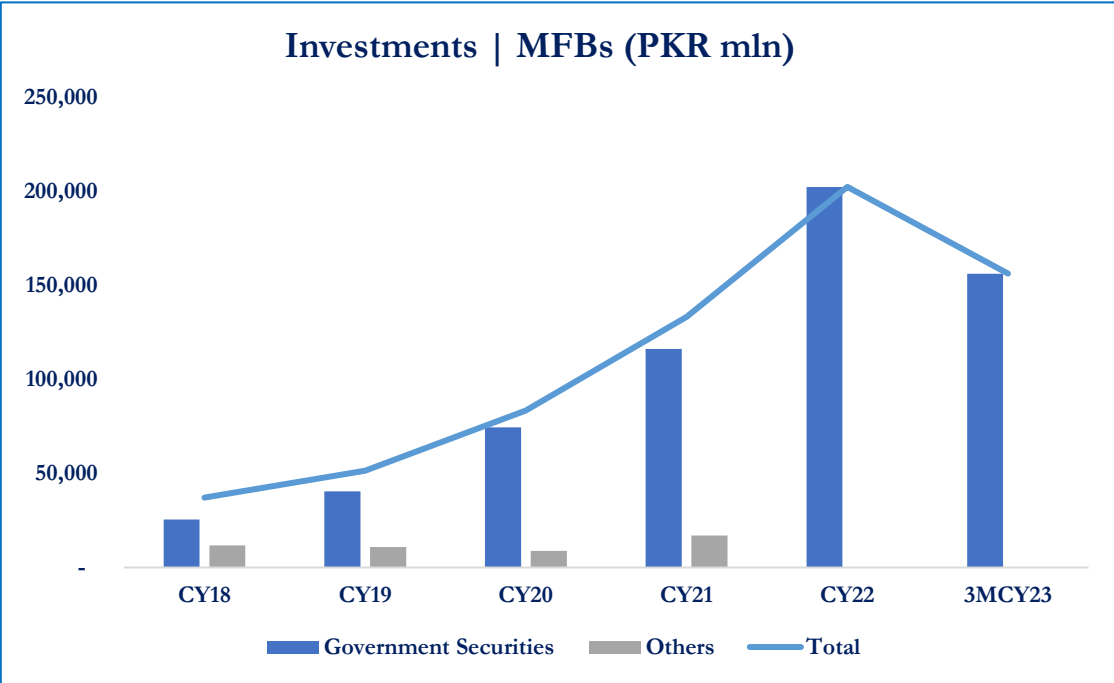
Market Share (GLP) | CY21 (Inner), CY22 (Outer)



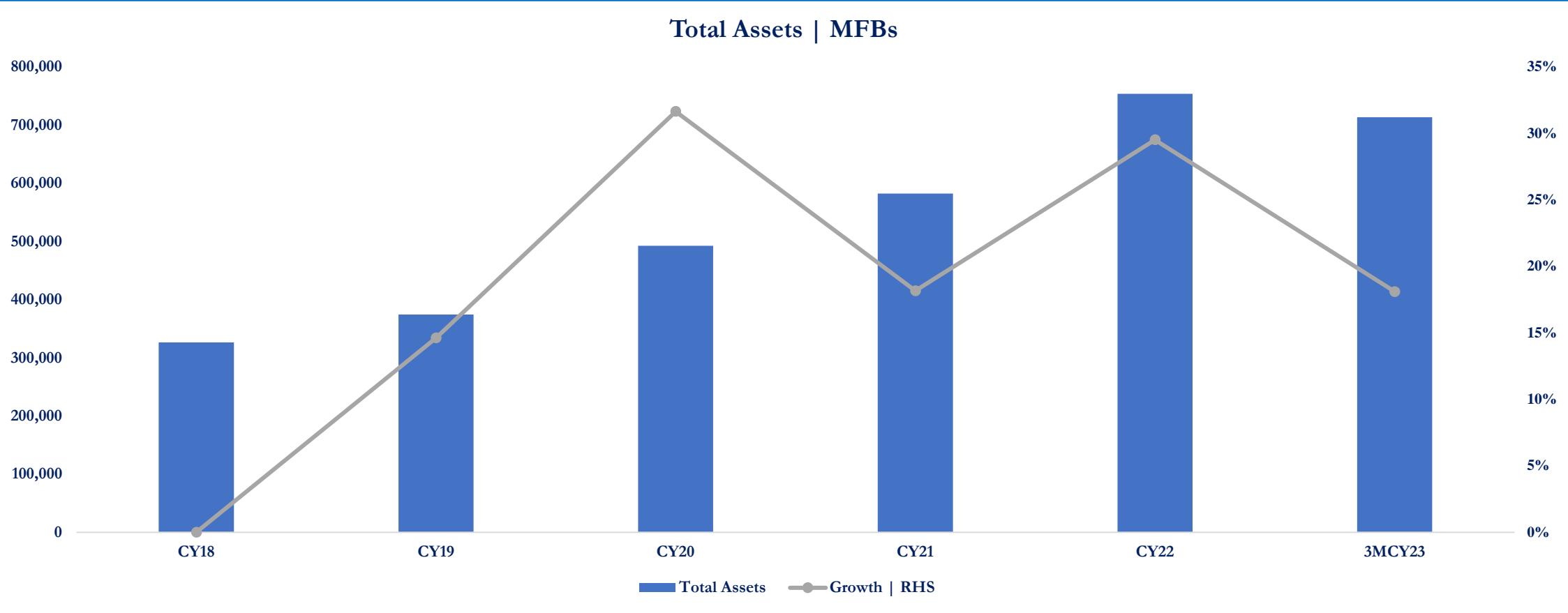
Market Share (Deposit) | CY21 (Inner), CY22 (Outer)



- In terms of MFBs’ assets, aggregate GLP was recorded at PKR~357bln as at End-Dec’22 (End-Dec’21: PKR~290bln). A player-wise breakdown reveals that HBL Microfinance Bank remained the prominent player across both time periods, with GLP amounting to PKR~86bln in CY22 and ~59bln in CY21. Other big players included Khushhali, U-MFB, Mobilink and NRSP. Together, the top five players accounted for ~86% of Segment’s total GLP during CY22.
- With respect to MFBs’ deposit base, total deposits of the Segment stood at PKR~514bln during CY22 (CY21: PKR~423bln), an increase of ~22% YoY. The top five players with respect to deposit base include The Fist MFB, Khushhali, U-MFB, Mobilink and Telenor, together forming ~79% of the Segment’s total deposits.

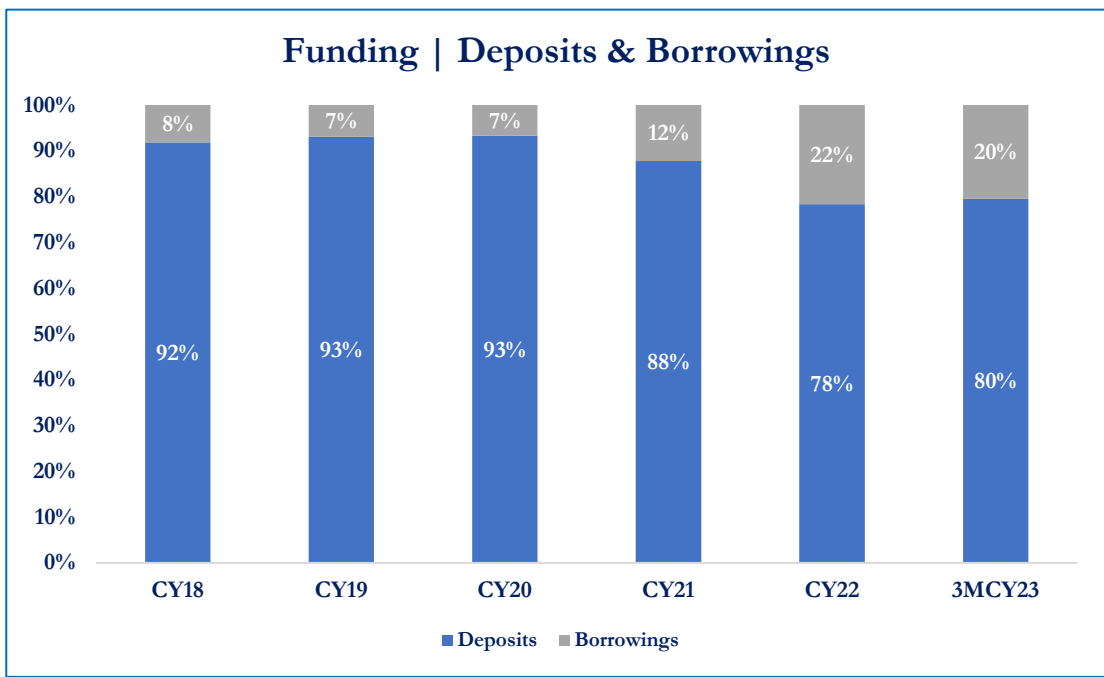
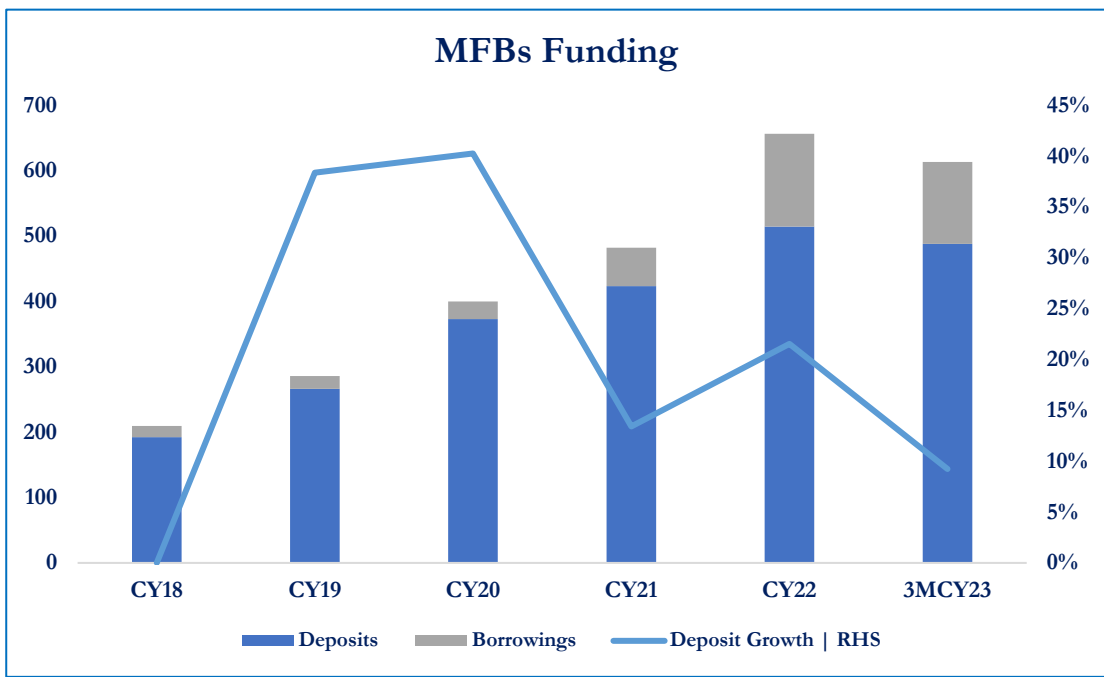


- As at End-CY22, total investments of the MFBs amounted to PKR~203bln, a ~66% growth compared to the previous year, when these were recorded at PKR~133bln.
- The cut-off yields on short and long-term securities clocked in at ~19.5% and ~13.5%, respectively, in 3MCY23. Since these were previously recorded at ~11.5% and ~11.0% in CY22, the steep increase in 3MCY23 is reflective of the interest rate hikes as per SBP’s hawkish stance pertaining to high inflation levels and the resultant monetary tightening that picked pace especially during 1HCY23.

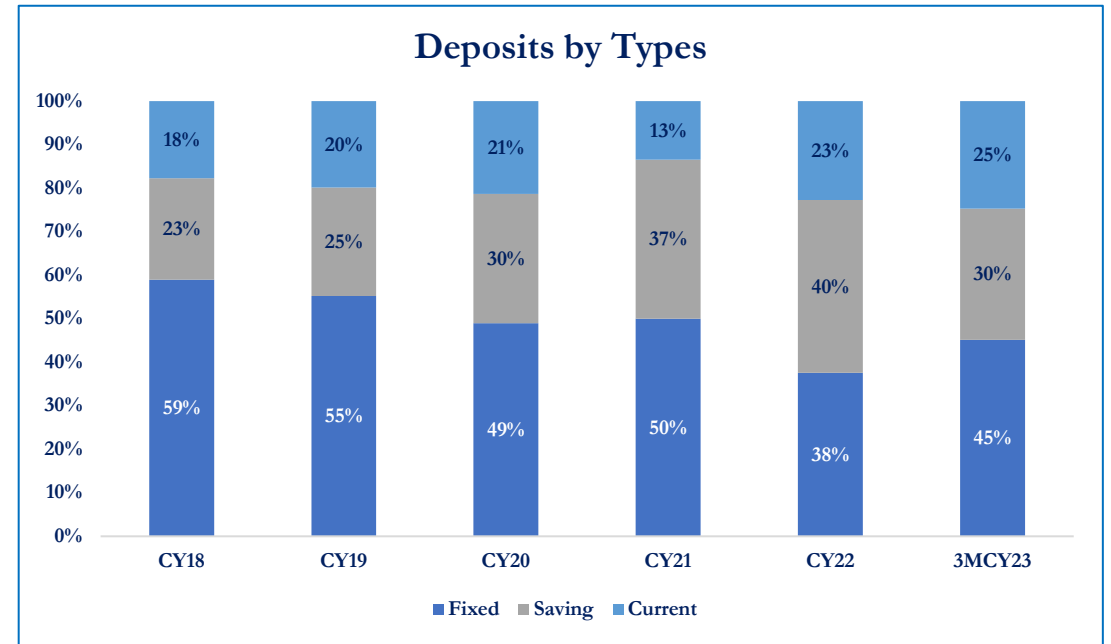
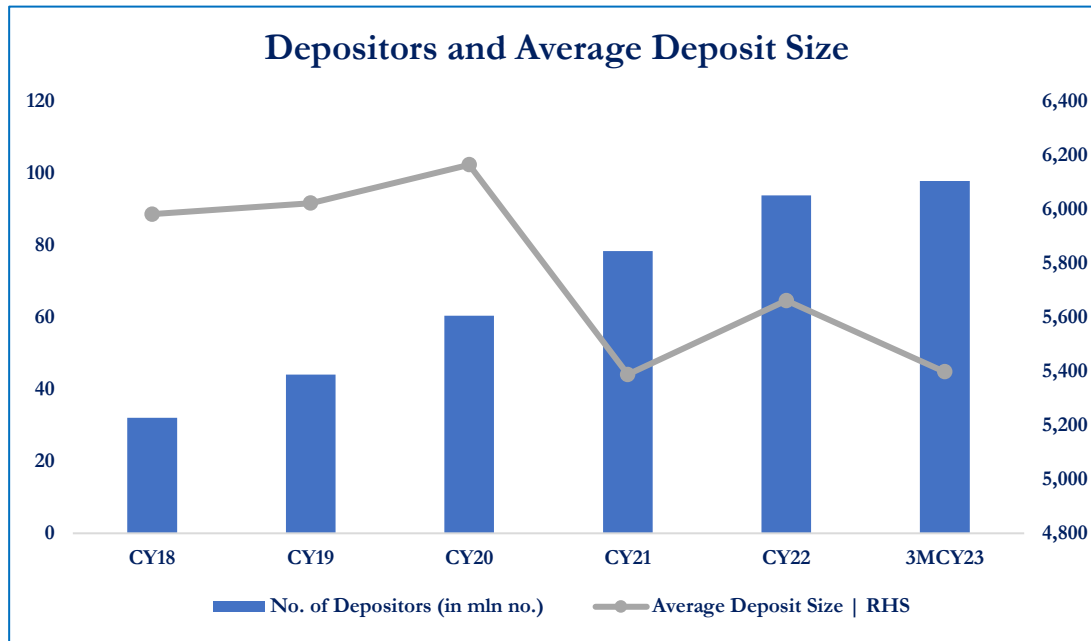


- Total assets of the MFBs have been increasing at CAGR of ~25% from CY18 to CY22. In 3MCY23, the total assets stood at PKR~714bln while they were recorded at PKR~754bln in CY22. Almost 88% of the MFBs’ assets are deployed in Advances and Investments, which implies that the sector has at minimum ~88% earning assets on its books. The Sector’s asset footing has sharply increased in the past decade due to a wide potential to grow.

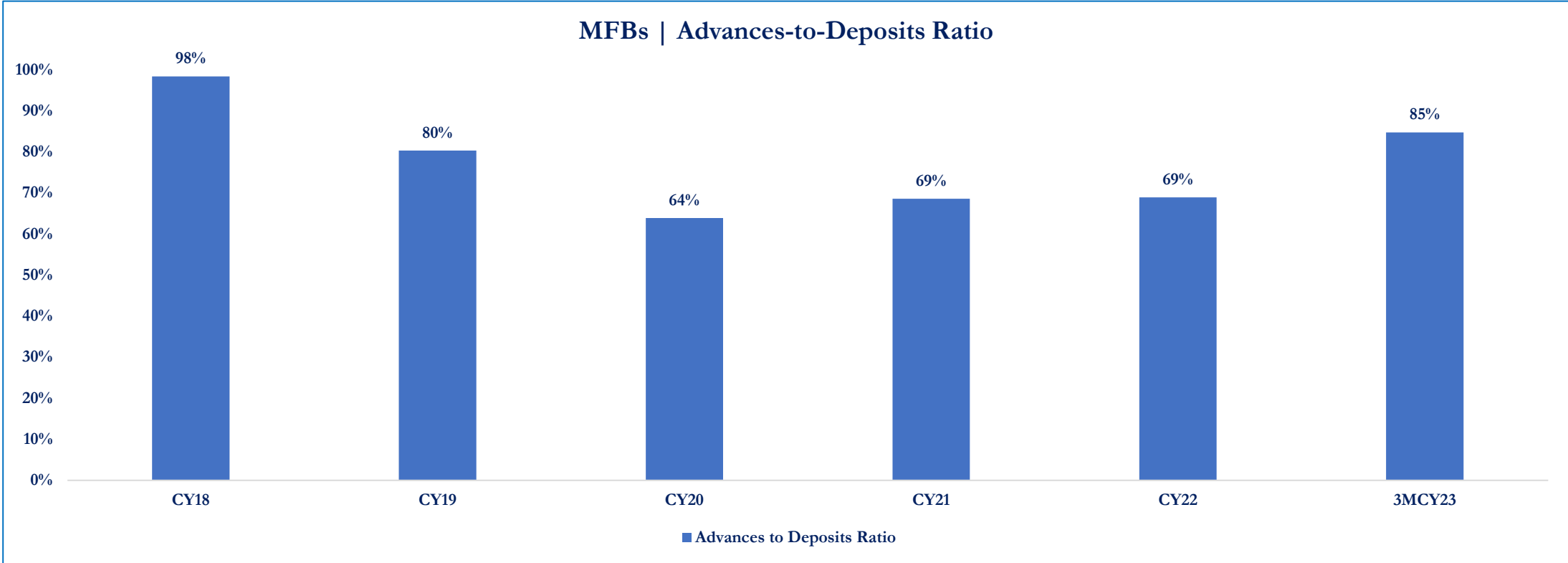
Microfinance Banks | Liabilities



- The MFBs are the exclusive contributors to the Sector’s deposit base, with approximately ~94mln active depositors in CY22, compared to ~79mln in CY21. Total deposits amounted to PKR ~514bln as at End-Dec’22, YoY growth of ~22%. The substantial increase in the number of depositors is primarily driven by branchless banking, where the average deposit size per account holder recorded at PKR~5,703 during the year.
- For the period 3MCY23, MFBs’ deposit size, in terms of value, was recorded at PKR~488bln while borrowings amounted to PKR~125bln (CY22: PKR~142bln). Of MFBs’ total funding, borrowing comprises ~20%, while deposits made up ~80% in 3MCY23, with the funding mix remaining largely stagnant across CY22-3MCY23.

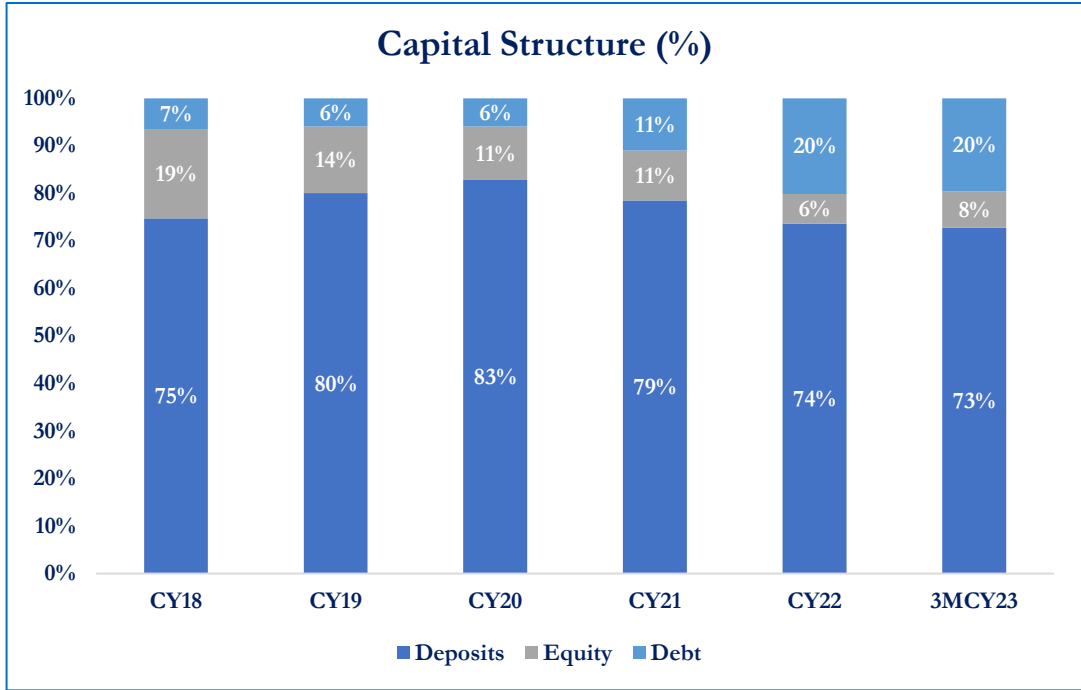
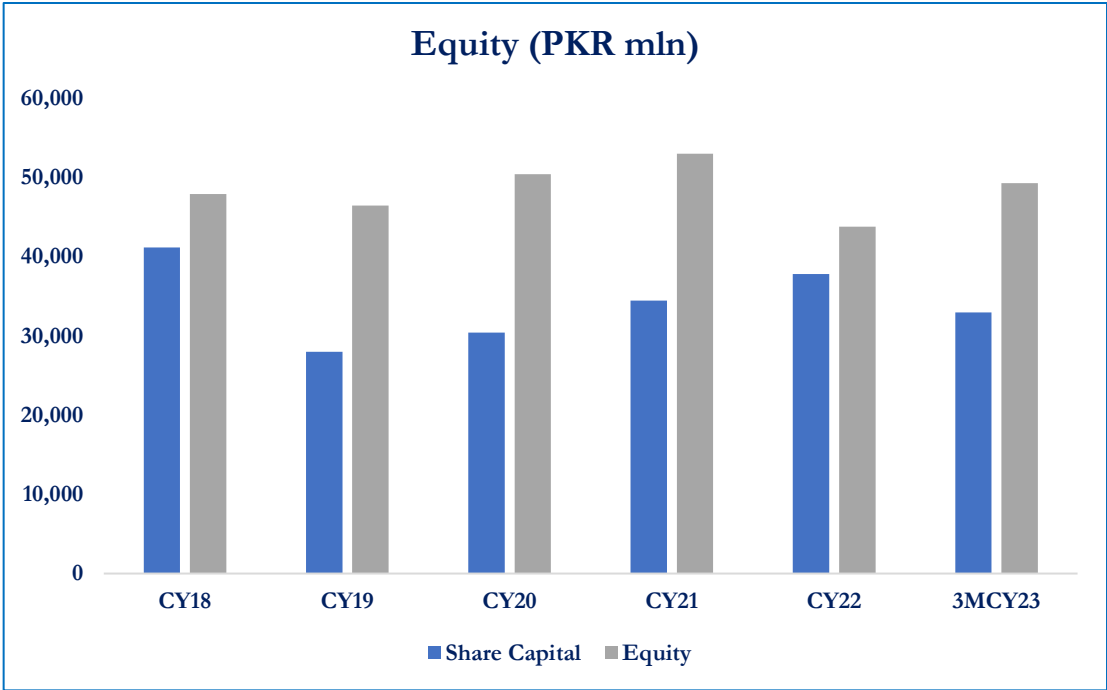


- The total number of MFBs' Deposit Accounts as at End-Mar'23 was recorded at ~98mln (End-Dec'22: ~94mln). The average deposit size increased from PKR~5,389 in CY21 to PKR~5,663 in CY22. However, in 3MCY23, the number of depositors increased by ~4.3% while deposits in value terms registered a decrease of ~5.1% as at End-Mar'23.
- Furthermore, MFBs' Deposit Mix largely comprises Fixed Deposits and Saving Accounts (SA), which collectively formed ~75% of the Segment's deposit base as at End-Mar'23. , the Segment's CASA (Current Accounts and Savings Accounts) accounted for ~55% of the total deposit base as at End-Mar'23.
- While the Segment's CASA is high, the share of CA remains low, despite having a significant mix of branchless/m-wallet deposit accounts. Interestingly, M-wallets account for ~80mln of the MFBs' deposit holders but only ~16% of the deposit value. This mismatch is justified based on the very low-ticket size of M-wallet deposit accounts.



- Total deposits of the MFBs stood at as PKR~514bln at End-Dec'22 (CY21: PKR~423bln), posting an increase of ~22%, while the Segment's advances stood at PKR~357bln for the same period (CY21: PKR~289bln). With respect of the Segment's liquidity, the average Advances-to-Deposits Ratio of the MFBs averaged ~73% during the period CY19-3MCY23. The ADR has oscillated a broad range over the past five years, recording at exorbitantly high level of ~98% in CY18 to registering a low of ~64% in CY20. Keeping in line with the historical pace, the ratio has improved significantly to ~85% in 3MCY23, from ~69% recorded as at End-Dec'22.

Microfinance Banks | Capital Structure



- Total equity of the MFBs Segment was recorded at PKR~49bln as of End-Mar'23 (End-Dec'22: PKR~44bln), up ~11% during this period. Moreover, the Segment's equity represents ~7% of its total assets. During 3MCY23, Gross Loans advanced by the MFBs were ~8x the average equity, while deposits attracted remains a multiple of ~10.5 of the segment's total equity.

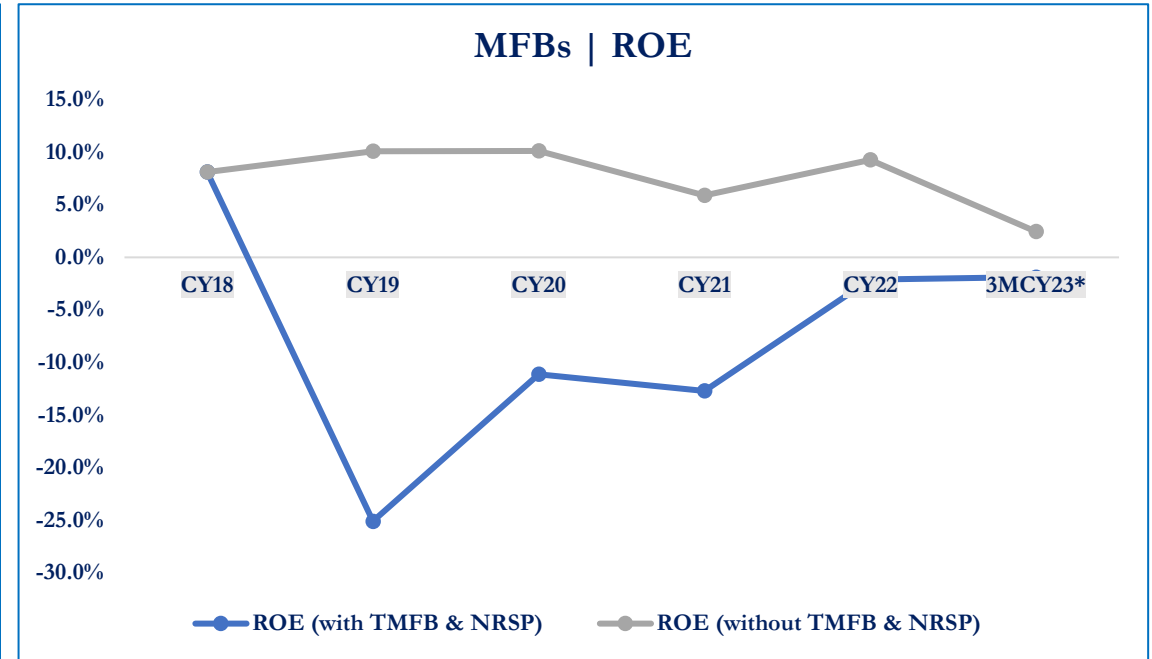
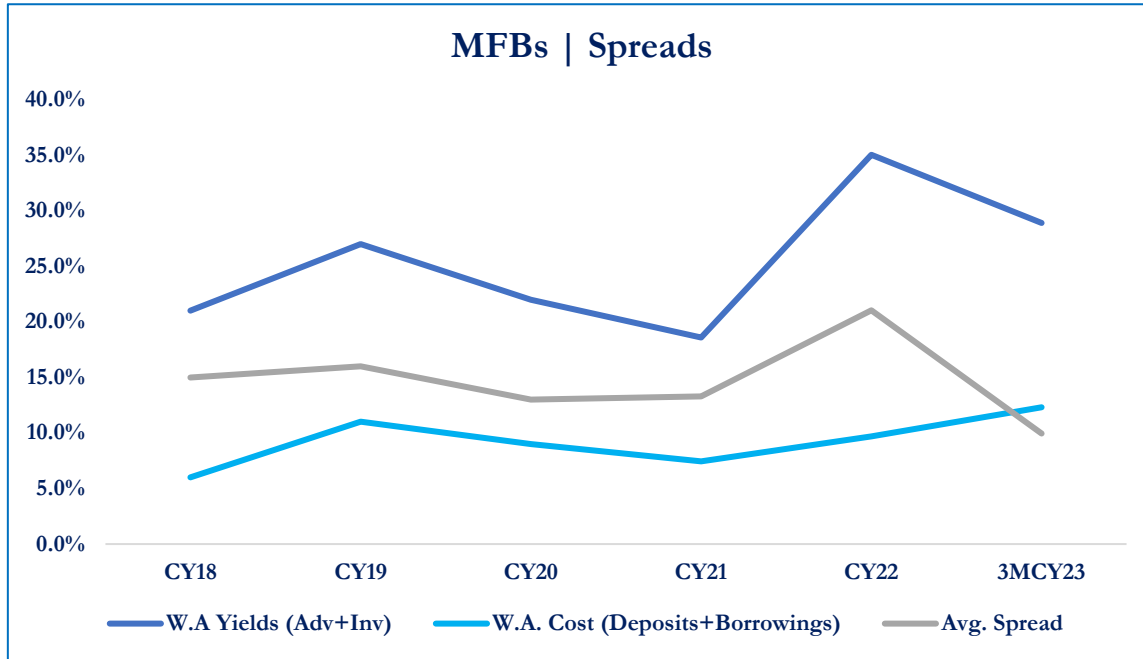
Capital Adequacy Ratio		
MFBs	CY21	CY22
Khushali	19.60%	11.33%
The First MFB	17.00%	15.00%
U-MFB	16.40%	18.25%
Mobilink	16.10%	11.10%
NRSP	11.10%	-14.84%
FINCA	15.30%	-
Telenor	24.90%	19.00%
APNA	11.80%	-
Pak Oman	39.10%	37.90%
Advans	21.10%	15.80%
Sindh MFB	73.40%	63.40%
Segment Average	24.16%	19.66%

- MFBs’ Average CAR was recorded at ~19.66% in CY22 (~24.16% in CY21). However, excluding the small-sized banks (Advans, Pak Oman, and Sindh MFB), the Sector’s average CAR dropped to ~9.97% during the same period.
- This decline can likely be explained by a faster growth in MFBs’ asset base (including growth in lending portfolio) as compared to available capital. Sponsors of a few loss-making institutions have fulfilled their commitments by injecting further equity to meet the capital requirement and support their operations.

Microfinance Banks | Financial Performance

Operating Performance	CY18	CY19	CY20	CY21	CY22	3MCY23
Mark-up/Return/Interest Earned	50,401	66,026	75,333	68,492	104,186	37,804
Mark-up/Return/Interest Expensed	(15,845)	(26,674)	(30,972)	(28,882)	(53,527)	(21,036)
Net Mark-up / Interest Income	34,556	39,353	44,361	39,610	50,659	16,768
Administrative Expenses	(35,879)	(47,104)	(48,542)	(44,794)	(63,261)	(23,054)
Profit / (Loss) Before Taxation	7,507	(9,957)	(3,071)	(10,060)	(8,999)	(1,901)
Profit / (Loss) After Taxation	3,893	(11,663)	(5,602)	(9,253)	(5,945)	(1,285)
Earnings Per Share	1.47	(2.50)	(0.43)	(1.55)	(6.19)	(1.02)

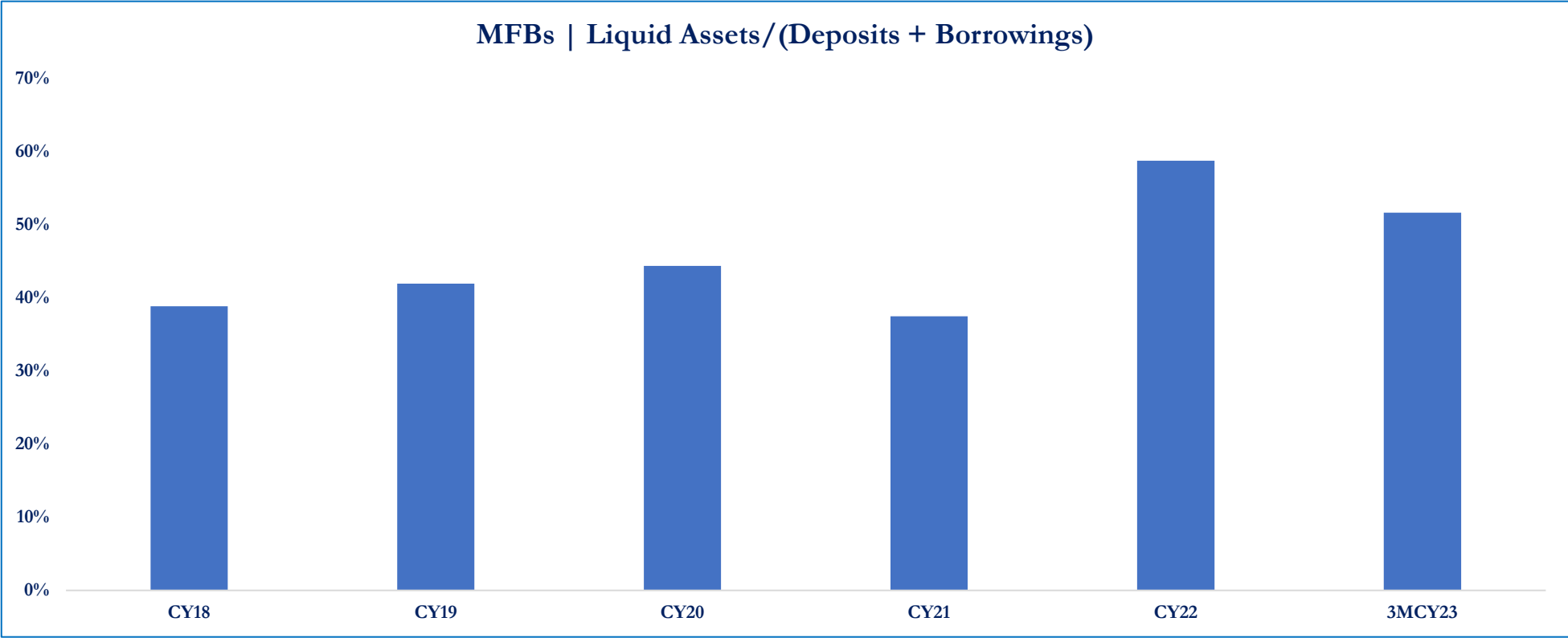
- Post-CY18, MFBs registered losses for the fourth consecutive term as at End-Dec'22, however, the growth in losses subsided to ~36%, as against ~65% YoY increase as at End-Dec'21. For the period 3MCY23.
- Most of the larger MFBs are incurring losses too in CY22 and 3MCY23. The bottom line of MFBs went negative because of high administrative and provisioning costs. The administrative cost increased to ~41.2% in CY22.



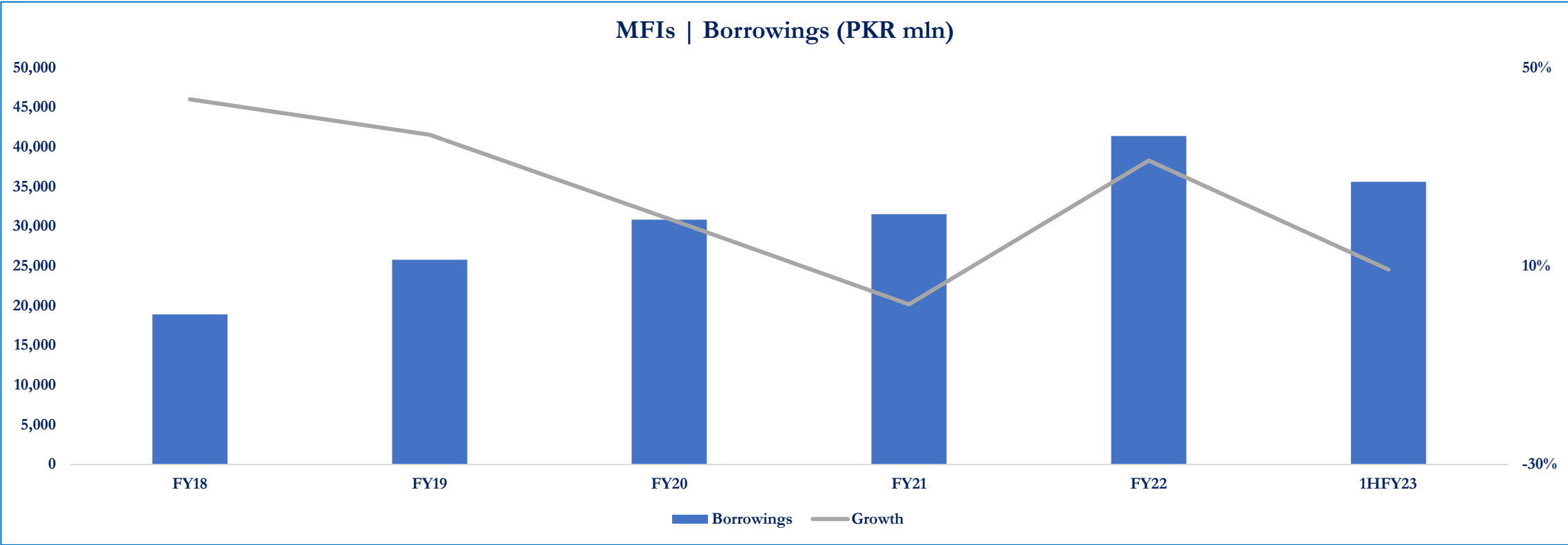
Note: 3MCY23 data is representative of 5 segment players while that for CY18-22 includes 11 players.

Note: Pertaining to ROE without TMFB and NRSP, and for the period 1QCY23, NRSP reported heavy losses, therefore, along with TMFB, it has been excluded for the same period. Prior to this, only TMFB had been excluded.

- In CY22, the MFBs' focus was inclined towards securing investments as well as doling out loans, in order to earn higher margin incomes. Resultantly, the average spread of Segment players increased to ~21% in CY22 while previously being recorded at ~13.3% in CY21. However, during 3MCY23, yields on advances and investments declined to ~28.9% while the weighted average cost increased to ~12.3%.
- A negative ROE of MFBs majorly reflects heavy losses sustained by Telenor and NRSP. Excluding these two sector players, the ROE of MFBs stood at ~2.5%, in 1QCY23 while ~9.3% in CY22.



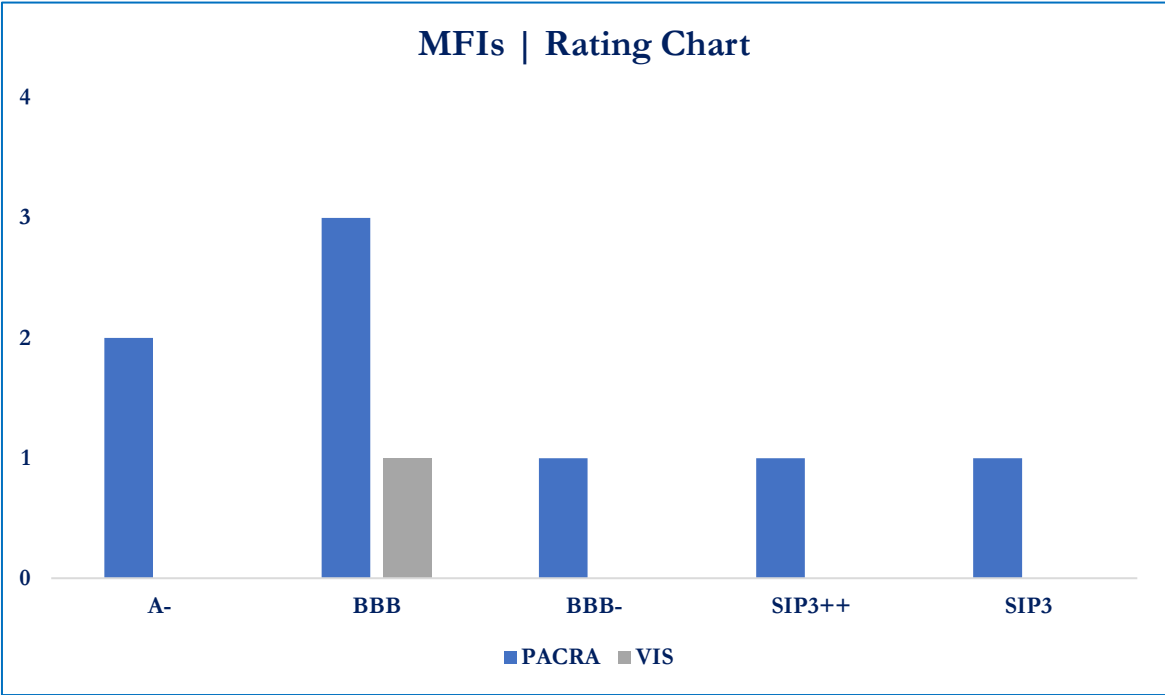
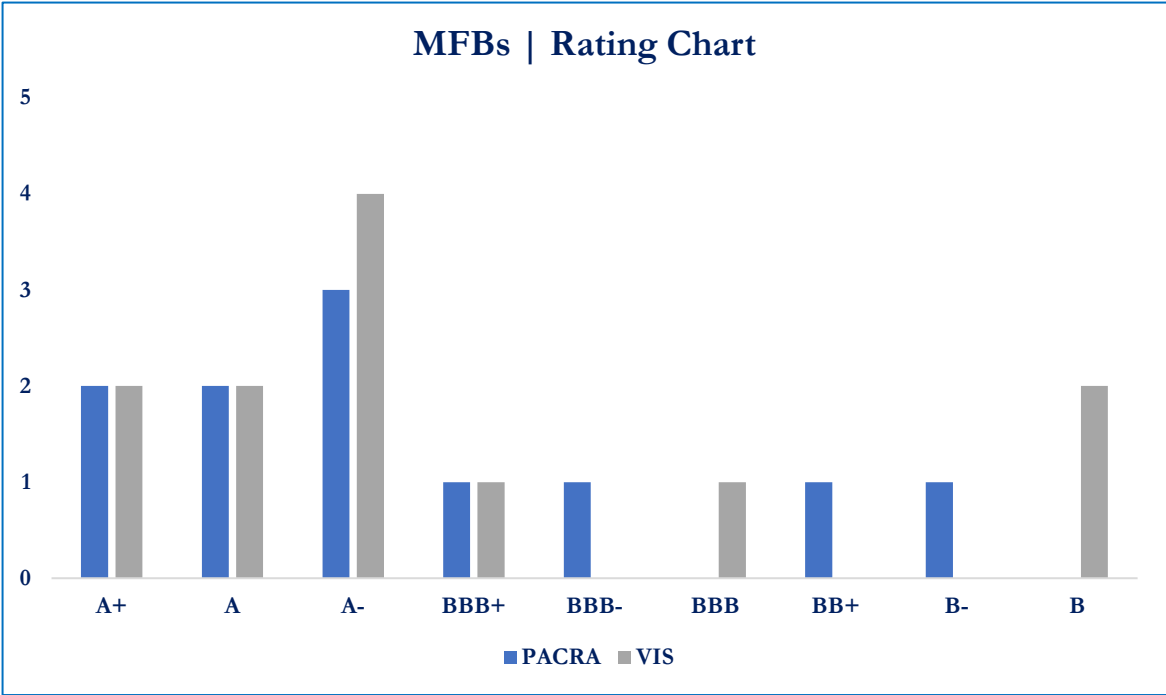
- The Sector’s liquidity profile is analyzed by calculating the percentage of liquid assets it holds against its total funding, i.e., deposits + borrowings. During CY22, the liquidity profile increased to ~59% (~37% in CY21) on account of a increase in liquid assets, particularly placed in short-term secured investments and deposits.



Note: Data is based on Six (06) PACRA-rated MFIs.

- There has been a constant decline in the borrowing trend for the last four years till FY21 and revive again in FY22 with ~31% increase in the borrowings of MFIs. Meanwhile in 1HFY23, the trend again going down with ~9% growth at PKR~36bln (FY22: PKR~41bln)

Microfinance Sector | Rating Chart



- PACRA rates 19 clients in the Microfinance Sector. Rating Bandwidth of the sector ranges from A+ to B-.
- VIS rates 13 clients in the Microfinance Sector. Rating Bandwidth of the sector ranges from A+ to BBB.

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