

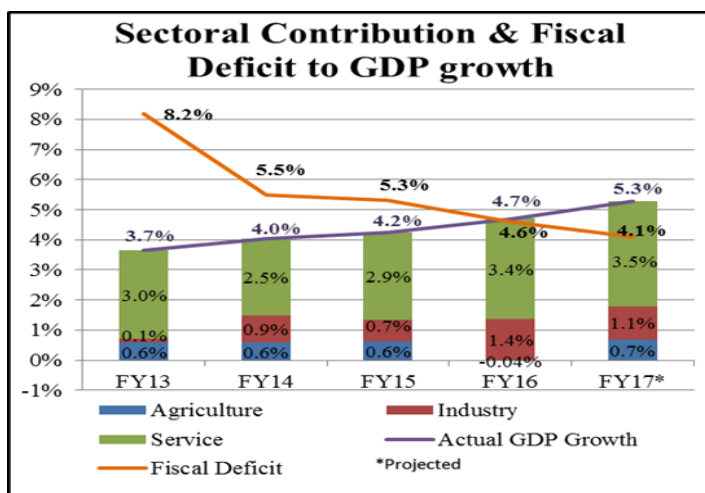


# **BUDGET FY18 SNAPSHOT**

## **IMPACT ON MICROFINANCE PROVIDERS**

June 2017

Budget Summary - PKR Bln			
	FY17 (R)	FY18 (B)	% change
<b>Total Budget Outlay</b>	<b>4,841</b>	<b>5,104</b>	<b>5.4</b>
<b>Inflows</b>	<b>4,841</b>	<b>5,104</b>	<b>5.4</b>
<b>Internal Resources</b>	<b>3,086</b>	<b>3,826</b>	<b>24</b>
i. Tax Revenue	3,825	4,330	13.2
ii. Others	1,382	1,880	36
iii. Provincial Share	-2,121	-2,384	12.4
<b>External Resources</b>	<b>996</b>	<b>838</b>	<b>-15.9</b>
<b>Privatization Proceeds</b>	<b>18</b>	<b>50</b>	<b>181.3</b>
<b>Bank Borrowings</b>	<b>741</b>	<b>390</b>	<b>-47.4</b>
<b>Outflows</b>	<b>4,841</b>	<b>5,104</b>	<b>5.4</b>
<b>Current Expenditure</b>	<b>3,905</b>	<b>3,764</b>	<b>-3.6</b>
i. General Public Services	2,741	2,554	-6.8
ii. Defence Affairs & Services	841	920	9.4
iii. Others	322	290	-10
<b>Development Expenditure</b>	<b>936</b>	<b>1,340</b>	<b>43.1</b>
i. Federal PSDP	715	1,001	40
ii. Others	221	339	53.2



- ❖ The Government presented its fifth consecutive budget for FY18 with total outlay of PKR 5,104bln. The focus of initial three budgets was fiscal consolidation. However, there is a gradual shift and the Government now aims to stimulate growth through promotion of exports, job creation, and better agriculture productivity, as macroeconomic indicators have stabilized.
- ❖ During FY17, Pakistan became a USD 300bln economy. The country continued its growth trajectory by achieving a GDP growth of 5.3% and increased per capita income of USD 1,629. The fiscal deficit is projected to be 4.2% (3.8% in July-April FY17) while inflation remained subdued at 4.1%. The remittance and foreign reserves slowed down amid tough conditions in GCC region and higher than expected trade deficit.
- ❖ The agriculture sector bounced back and posted growth of 3.4% against the target of 3.5%. Better availability of agricultural inputs and higher credit disbursement were stimulus to 3% growth in crops vis-à-vis negative growth of ~5% in FY16. Large scale manufacturing growth stood at 5% while small scale manufacturing posted a growth of ~8.2%. Services sector grew by 5.9% (FY16: 5.5%) as wholesale and retail segments attained 6.8% growth.
- ❖ Government's drive to document the economy, focus on enhancing tax revenues, and increasing cost for non-filers persists.
- ❖ Social net is expected to strengthen further with allocation of grants for Benazir Income Support Programme (BISP), low rate loans for farmers, and various initiatives and loan schemes to generate employment.

Economic Indicators	FY16	FY17 (Jul-Apr)	FY18 Target
i) Per-Capita Income (USD)	1,531	1,629	N.A
ii) Inflation (Average)	2.9%	4.1%	below 6%
iii) Policy Rate (Average Discount Rate)	6.0%	5.8%	N.A
iv) Fiscal Deficit to GDP	4.6%	3.8%	4.1%
v) Remittances (USD mln)	19,917	15,600	N.A
vi) Forex Reserve (USD mln)	23,099	21,019	4 Months of Import Cover
<b>Social Safety</b>			
i) BISP disbursements (PKR mln)	102,000	112,000	121,000
ii) Prime Minister's Initiatives (Expenditure Incurred, PKR mln)	20,000	5,219	20,000

Areas	Proposals																				
<b>FUNDING SCHEMES</b>	<p><b><u>Positives:</u></b></p> <ul style="list-style-type: none"> <li> <p><b>BISP Beneficiary Graduation Program: Grants to Self-Sustaining Individuals of BISP beneficiary families willing to start their own business. One time cash grant of PKR 50,000 along with training to be provided to 250,000 families initially.</b></p> <p><b>Impact:</b> Successful implementation of this scheme will provide potential market for MFPs to expand the lending portfolio in future.</p> </li> <li> <p><b>Allocation of funds for Crop Loan Insurance Scheme, Livestock Insurance Scheme and Credit Guarantee Scheme for small farmers. Credit Guarantee Scheme for small farmers provides 50% coverage against loan losses.</b></p> <table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <thead> <tr> <th></th> <th>(PKR)</th> <th>FY17 (B)</th> <th>FY17(R)</th> <th>FY18 (B)</th> </tr> </thead> <tbody> <tr> <td><b>Crop Loan Insurance</b></td> <td></td> <td>500mln</td> <td>500mln</td> <td>700mln</td> </tr> <tr> <td><b>Livestock Insurance Scheme</b></td> <td></td> <td>-</td> <td>-</td> <td>1,000mln</td> </tr> <tr> <td><b>Credit Guarantee Scheme</b></td> <td></td> <td>1,000mln</td> <td>-</td> <td>1,000mln</td> </tr> </tbody> </table> <p><b>Impact:</b> These schemes will protect microfinance lenders against potential losses and may reduce financing cost for borrowers.</p> </li> <li> <p><b>Phase II of the Prime Minister’s National Health Insurance Program has been launched with a cost of PKR 10bln.</b></p> <p><b>Impact:</b> The scheme will provide coverage against expenses due to health problems to 3.1mln beneficiaries with a coverage limit of PKR 50,000 for secondary care services and PKR 250,000 for tertiary care for specified diseases as per the program. Thus, it protects MFPs against potential losses and expenses.</p> </li> <li> <p><b>Risk Sharing Guarantee Scheme for home financing. Government to provide 40% Credit Guarantee Cover to financing institutions including MFBs for home financing for up to PKR 1mln. For this purpose, PKR 6bln have been allocated.</b></p> <p><b>Impact:</b> This presents an opportunity for MFBs to expand and diversify their portfolio with an additional benefit of credit cover against potential losses. MFBs can increase their loan size as well.</p> </li> <li> <p><b>Financial inclusion fund of PKR 8bln to be setup at SBP to provide loans to low-income segments through MFBs.</b></p> <p><b>Impact:</b> This scheme will provide funding for MFPs and is beneficial for the industry. The exact mechanism of distribution remains to be seen.</p> </li> <li> <p><b>Enhancement in Agriculture Credit to PKR 1,001bln.</b></p> <p><b>Impact:</b> For FY18, the target for agriculture credit through has been at PKR 1,001bln, which is 43% higher than last year and equal to PSDP. This will be beneficial for MFPs as they may extend credit facilities to meet targets.</p> </li> </ul>		(PKR)	FY17 (B)	FY17(R)	FY18 (B)	<b>Crop Loan Insurance</b>		500mln	500mln	700mln	<b>Livestock Insurance Scheme</b>		-	-	1,000mln	<b>Credit Guarantee Scheme</b>		1,000mln	-	1,000mln
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### Neutral:

- **Prime Minister’s youth schemes to continue with allocation of PKR 20bln**

**Impact:** These schemes cover: (i) Business loan scheme, (ii) Interest free loan scheme, (iii) Training scheme, (iv) Skill development programme, (v) fee reimbursement, and (vi) Provision of laptops. These loans are offered at subsidize rate are in direct competition with MFPs. However, loans routed through PPAF will continue to provide funding for MFPs and are beneficial for the industry.

It remains to be seen how these interest free loans will be disbursed considering PPAF has been classified as non-profit organization and incorporation of Pakistan Microfinance Investment Company (PMIC).

- **Rise in allocations for BISP by 5% and 50% for Bait-ul-Maal**

BISP (PKR)	FY17 (B)	FY17(R)	FY18 (B)
Allocation	115bln	112bln	121bln
Targeted Families	5.3mln	5.4mln	5.5mln
<b>Bait-Ul- Maal</b>	4bln	4.5bln	6bln

**Impact:** BISP is disposable income meant for basic necessities. Hence, it is not likely to impact MFPs and may reduce the risk of micro loans being used for consumptive purposes.

### Negative:

- **Agriculture loans with a low mark-up rate of 9.9% per annum to be provided to small farmer with land holding of up to 12.5 acres. These loans will be given to two million farmers with loan size of up to PKR 50,000 through ZTBL, NBP and other banks.**

**Impact:** This scheme is not only in direct competition, the low mark-up rate will put MFPs at a significant competitive disadvantage.

**FISCAL MEASURES**

**Positives:**

- **Exemption from withholding tax on cash withdrawals by Branchless Banking Agents.**

**Impact:** The bill proposes exemption from withholding tax on withdrawal of cash from branchless banking (BB). This will be beneficial for MFBs (due to their vast network of agents and BB operations) and is a positive incentive from the SBP and Ministry of Finance for the industry.

- **Use of Land Revenue Records for Mortgage Financing.**

**Impact:** SBP will take required measures to align banking system with the Land Record Management Information System. This will help the farmers in attaining credit by mortgaging their properties. This provides MFPs an opportunity to collateralize and expand their portfolio.

- **Various relief incentives and concessions on inputs of Agriculture sector to continue.**

**Impact:** The budget offers several measures to support agriculture sector. The continuous concessional fertilizer prices and reduction in GST on DAP from PKR 400 to PKR 100 will enable farmers in earning better profits, which, in turn, will improve their repayment ability.

- **Tax credit on tax payable for enlistment in stock exchange to be made available for 4 years instead of 2.**

**Impact:** MFBs intending to get listed will gain tax benefit for 4 years in the following way:

Period	Rate of tax credit
Year of enlistment and following one year	20% of tax payable
Subsequent two years	10% of tax payable

- **Advance tax on telephone and internet users reduced.**

**Impact:** Reduction in the rate of collection of tax from 14% to 12.5% for the mobile, internet subscription and pre-paid internet or telephone card will result in lower operating expenses for the MFPs.

**Neutral:**

- **Rationalization of Capital Gains Tax on disposal of securities to a flat 15% (for filers) and 20% (for non-filers).**

- **Impact:** The three tiered taxation structure that incentivized holding securities for a longer period has been replaced with a flat rate of 15%. This will be applicable for securities acquired after July 01, 2013.

- **Exemption to Income of certain Non-Profit Organizations – Gulab Devi Chest Hospital, Pakistan Poverty Alleviation Fund (PPAF) and National Academy of Performing Arts.**

**Impact:** PPAF is now declared a Non-Profit Organization with no budgetary allocation in the backdrop of establishment of Pakistan Microfinance Investment Company. The exact role and activities undertaken by PPAF remains to be seen.

### Negatives:

- **Increase in Capital gain tax on dividends from stocks and mutual funds.**

Type of Dividend	Existing	Proposed
Dividend other than dividend declared by power projects	12.5%	15%
Dividend from Stock Fund	10%	12.5%

**Impact:** MFPs that intend to have an investment portfolio will have to pay more tax on dividends.

- **Super Tax Rate of 4% on banking companies extended for another year.**

**Impact:** The extension of super tax for another year will impact the profitability of MFBs.

- **Tax on undistributed profits of public companies at 10%.**

**Impact:** Any public company (other than a scheduled bank, a modaraba or an IPP and a Government owned public company) will be subject to 10% tax provided that it does not distribute 40% of its after tax profits either through cash dividend or bonus shares. This will be applicable on MFIs registered as public companies and MFBs.

- **Tax Credit for Not for Profit Organizations (NPOs): “Surplus Funds” to be taxed at 10%, Limit on administrative expenses upto 15% of receipts.**

**Impact:** NPOs were tax exempt till 2014. A special regime was introduced through section 100C in the Finance Bill where tax exemption was replaced by 100% tax credit on fulfillment of certain conditions. This included that 75% of income/receipts of a NPO has to be spent on charitable activities. The Finance Bill 2017 proposes that in case of NPOs: i) the management and administrative expenditure does not exceed 15% of total receipts, and ii) the “Surplus Funds” of NPO will be taxed at 10%.

There seems to be some ambiguity as the clause in Finance Bill is not in line with Finance Minister’s speech where he said that if the NPO does not spend more than 75% of its income/receipts on charitable activities, the amount not spent shall be taxed at the rate of 10% while the non-profit status will remain intact. Further clarity on the matter will be sought.

- **Slabs for Profit on Debt lowered to PKR 5mln.**

Existing		Proposed	
Amount	Rates	Amount	Rates
Does not exceed PKR 25mln	10%	Does not exceed PKR 5mln	10%
Exceeds PKR 25mln but not exceed PKR 50mln	2.5mln+12.5% of the amount exceeding PKR 25mln	Exceeds PKR 5mln but not exceed PKR 25mln	12.5%
Profit on debt exceeds PKR 50mln	PKR 5.625mln +15% of the amount exceeding PKR 50mln	Profit on debt exceeds PKR 25mln	15%

**Impact:** The slab for profit from debt has been lowered as summarized in the above table. This will result in higher tax expense for non-corporate clients of MFBs. However, since this is applicable across the board, it will also impact banks.

### OTHERS/ REGULATORY

#### Positives:

- **China Pakistan Economic Corridor (CPEC): Addition of 10,000 MW of electricity to the national grid by summer 2018.**

**Impact:** A major macroeconomic factor for Pakistan CPEC and various infrastructure projects initiated under it, especially energy projects. Availability of energy will improve the business environment and assist MFPs in portfolio expansion as benefits of these projects reach common person.

- **Low Inflation scenario envisaged to continue.**

**Impact:** Continuous low average rate of inflation, though slightly higher than previous year (FY17: 4.09%; FY16: 2.8%), is positive for MFPs target market. The inflation is expected to rise from preceding year. However, this is not expected to put significant strain on borrowers as the Government aims to keep inflation below 6% in FY18.

- **Poverty Reduction and inclusion of women in work force: Vision 2023**

**Impact:** The Government, over the next five years, aims to focus on poverty reduction while targeting to bring it down from current 29% to 10%. Moreover, 30% of women are envisaged to be part of labour force. These initiatives are in line with MFPs and could offer areas of potential collaboration and synergies.

- **Access to financing for SMEs through PKR 3.5bln Risk Mitigation facility to be made available with SBP, Establishment of E-gateway at SBP with a cost of PKR 200mln, Establishment of Innovation Challenge fund of PKR 500mln.**

**Impact:** This will provide support to MFPs to mitigate the potential loss risk against their SME financing portfolio.

#### Neutral:

- **Policy rate remained unchanged at 5.75% in FY17**

**Impact:** The low policy rate environment is expected to prevail barring unforeseen events. It will have two-prong effect on the sector. The cost of funds for MFPs will go down in line with low interest rate environment. However, return on interest bearing deposits and investments will also come down. The proportionately higher decline in cost of funds will improve spreads.

- **Minimum wage rate enhanced from PKR 14,000 to PKR 15,000.**

**Impact:** All employees of MFPs earning below PKR 14,000 will now be paid more impacting the institutions' bottom-line. On the other side, micro-borrower's disposable income will go up, in turn, enhancing their ability to repay loans.