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Why consumer lending is low

Is Pakistan's current economic situation ideal for banks to boost consumer lending?

When economic growth begins to slow down, as we see now, joblessness increases and income levels decline. That means more people need to take personal loans from banks.

Inflation is rising and the rupee is down. That means those people who can afford to buy a car or construct a house or purchase consumer durables need more money to do so.

Joblessness and a fall in income levels also mean people who have credit cards need to draw down more consistently on them and for longer periods. So there is more scope for banks to boost consumer lending.

But in the first half of the current fiscal year, this has not happened. Banks' net fresh consumer financing has fallen to Rs30 billion from Rs36bn in the first half of the last fiscal year. Why?

"When interest rates are high and government borrowing from banks is up, banks normally go for safer areas of private-sector lending. Their risk-taking appetite increases only when the government begins to borrow less than the banks' own projection," says a senior executive of the state-run National Bank of Pakistan.

Consumer finance becomes costlier as interest rates on treasury bills and bonds rise

Taking this as a rule of thumb, banks' consumer finance, which is part of private-sector lending, should have increased in the first half of this fiscal year as the government kept retiring bank loans on the net basis. Why did that not happen? In fact, Rs30bn consumer lending in July-Dec 2018 constituted just 5.5pc of banks' overall private-sector lending of Rs541bn. Why?

"When interest rates move up, as they did in July-Dec, consumer finance is the first to take the hit. Most consumer lending products are on floating rates tied with the treasury bills and bonds' yields. When interest rates on bills and bonds rise, consumer finance becomes costlier."

Because of the very nature of consumer lending that involves greater risks and higher cost of making, monitoring and recovering loans, its products have to be priced higher than, say, corporate loans. When economic or market conditions do not leave room for banks to keep consumer loans costlier than other loans, they simply reduce consumer lending.

Some bankers offer other reasons for the fall in consumer lending. Strategies for consumer loans offered in July-December 2018 were, in large part, set in the April-June quarter. Political uncertainty was high ahead of the general elections in July. Making consumer loans is a difficult job involving millions of transactions. That was not possible due to the frequent absences of bank employees who were participating in election campaigns. Besides, in July-December 2018, both housing and auto sectors remained in trouble due to a weaker rupee, which led to sharp increase in prices. The crackdown against the largest realtor of the country for its alleged irregularities, judicial activism against high-rise buildings and the anti-encroachment drive had dampened demand for housing loans.

If the government's proposal to allow non-filers of tax returns to purchase domestically assembled cars of up to 1,300cc is approved by the legislature, it is expected to push up the sales of automobiles and, by extension, consumer car financing. The finance committee of the National Assembly wants this relaxation to be limited to the purchase of cars of up to 800cc.

Auto loans, which are part of consumer loans, fell to just Rs12bn in July-Dec 2018 from Rs21bn a year ago. The main reasons included an increase in car prices, weaker rupee and restrictions imposed on car purchasing by non-filers of tax returns.

Consumer financing in the housing sector remained particularly depressed in the first half of this fiscal year. There was only Rs8bn worth of fresh disbursement against more than Rs12bn in the year-ago period. But a recent $58m World Bank loan to Pakistan Mortgage Refinance Company (PMRC) and the subsequent offering of subsidised refinance by the company to banks can encourage the latter to disburse more housing loans.

Askari Bank and Bank Alfalah have already got Rs1.2bn for this purpose, according to PMRC officials. Banks' participation in the low-cost housing scheme can also expand their portfolio of housing loans. But bankers say it is just difficult to predict anything about it because the scheme is still at an initial stage.

Credit cards are emerging as a significant product of consumer finance. In July-Dec 2018, consumer lending via these cards remained almost unchanged at the year-ago level of Rs4bn. There is a lot of scope for promoting consumer finance under the present tough economic situation where a lot of people must be drawing down on their credit cards just to make both ends meet.

But unless banks resist the temptation of charging high rates, consumer lending via credit cards cannot rise substantially.

Users of credit cards have long been complaining of high charges and poor services. Complaints about hacking and the misuse of these cards have also gone up recently.

Personal loans for unspecified purposes have seen an increase of about Rs6bn in the first half of this fiscal year as opposed to a decline of Rs3bn in the year-ago period. But watchers of the Pakistan economy would agree this is not just because of the base effect. A decline in the people's income level due to slower economic growth during this fiscal year also appears to have caused this surge in personal loans.

There is a potential for sustainable growth if banks come up with tailor-made products suitable for different income groups. Promoting these loans is good for the banking sector also because this is the area where they are in direct competition with grey banking.

People who fail to get personal loans from banks turn to borrow from networks of traditional money lenders who operate in the parallel economy and charge very high rates on funds.

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