## 3.8   Risks to the Household Sector

Limited data prevents the detailed assessment of financial soundness of the household sector. In terms of exposure, banking sectors advances to households (i.e. consumer loans) account for only 6.18 percent of total advances while deposits of households (i.e. individual deposits) constitute 48.72 percent of total deposits. Asset quality of consumer finance has improved though NPLR is high for mortgage financing. Steadily rising per capita income and a large 'youth bulge' in labor force provides an opportunity for households to create buffers against shocks. However, high unemployment rates for females, low-level of savings and high-level of borrowings as percentage of household income pose a risk to the financial soundness of the poorest households in the future. In light of the demographic trends, where the share of youth in the population is large and female unemployment is high, banks need to offer saving and credit products geared towards them.

Recently, and specifically after the GFC of 2008, viability of household balance sheets has become important. Various studies have traced the onset of the GFC in the United States of America to the rapid and unchecked increase in supply of mortgage loans in early 2000's to the US households having relatively low credit worthiness which resulted in very large delinquency rates on mortgage loans triggering the financial crisis[164]. In this respect, the household sector and the health of its balance sheet is critical to the stability of financial and banking system.

In Pakistan, households are the major savers in the economy but they are not the major borrowers. Household's share in bank deposits (individual deposits) is 48.72 percent while their share in bank loans (consumer loans) is 6.18 percent. So, in terms of credit risk, households do not pose any significant risk. Nevertheless, it is important to assess the dynamics of the household demographics and finances for the growth of the financial sector.

Figure 3.8.1

Distribution of Population by Age Group, Gender

FY15
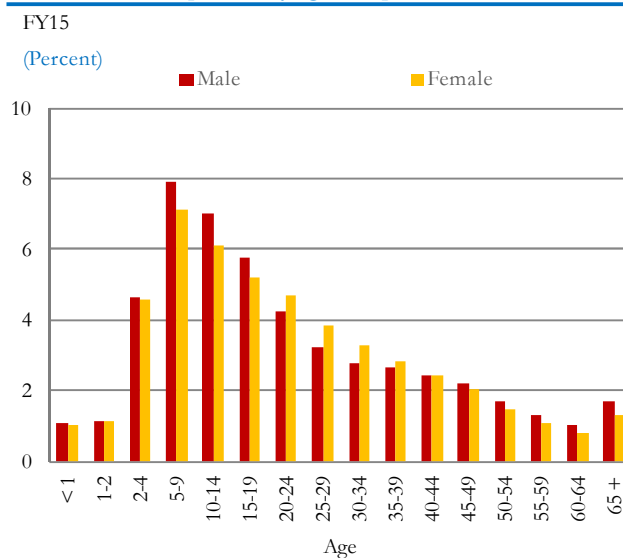
(Percent)

Source: Labour Force Survey 2014-15, Pakistan Bureau of Statistics

Population and Labor Force Trends

Pakistan is a country with a large *youth bulge* as approximately 80 percent of the population is 39 years or below[165] **(see Figure 3.8.1)**. The youth bulge is a common phenomenon in many developing countries where infant mortality has been reduced but female fertility rate is still high. As a result, the population of such countries comprises

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[164] Mian, A. and Sufi, A. (2011). Household Balance Sheets, Aggregate Demand And Unemployment. Pakistan Society of Development Economics – Quaid-e-Azam Lecture. Islamabad. < http://www.pide.org.pk/psde/pdf/AGM27/PSDE_QaideAzamLecture_Dec2011.pdf>

[165] Labour Force Survey 2014-15, Pakistan Bureau of Statistics < http://www.pbs.gov.pk/sites/default/files//Labour%20Force/publications/lfs2014_15/t01-pak.pdf>

of a large share of children and young adults[166]. The higher proportion of children and young adults in the population is bound to have effects on the balance sheet of Pakistani households. On the one hand, household expenditure is expected to be higher on education and skills/job trainings while on the other hand, household revenues could be higher if the youth gets employed.
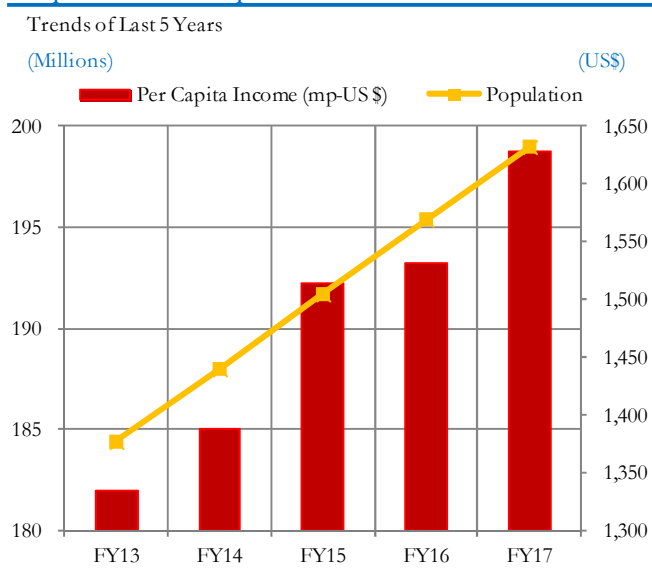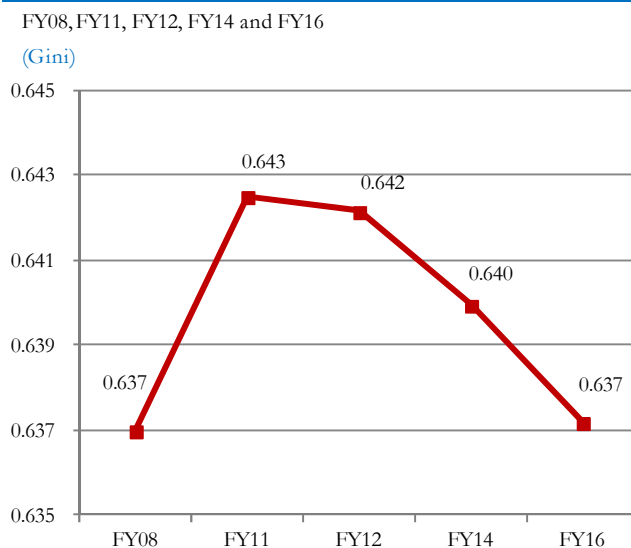
Per Capita Income is steadily rising but inequality is High

The Per Capita Income (PCI) is a useful statistic to understand income trends of households. In the five year period from FY13 to FY17, PCI in Pakistan has increased from US$ 1,334 (FY13) to US$ 1,629 (FY17) which translates into an increase of 22.14 percent over the five-year period **(see Figure 3.8.2)**. However, PCI adjusted for Purchasing Power Parity (PPP) shows an increase from US$ 4,461 in FY12 to US$ 5,011 in FY15 which

represents an increase of only 12.33 percent over the four year period.

Analysis of different rounds of Household Integrated Economic Survey (HIES) from FY08 to FY16 shows that Gini co-efficient[167] of income inequality has remained very high, average 0.639, and has hovered around this figure for the entire eight-year period.[168] Although Gini co-efficient of income inequality is high, it has been on a slightly downward trend from FY11 (0.643) to FY16 (0.637) as the economic growth has picked up pace **(see Figure 3.8.3)**. High and persistent level of inequality may harm the economy by causing financial crises. Inequality may lead to stagnation of incomes of a section of households in the economy and those households could increase their

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[166] Lin, J.Y. (2012). Youth Bulge: A Demographic Dividend or a Demographic Bomb in Developing Countries? <http://blogs.worldbank.org/developmenttalk/youth-bulge-a-demographic-dividend-or-a-demographic-bomb-in-developing-countries>

[167] As per Organization of Economic Cooperation and Development (OECD), the Gini coefficient is defined as "the comparison of cumulative proportions of the population against cumulative proportions of income they receive, and it ranges between 0 in the case of perfect equality and 1 in the case of perfect inequality". <https://data.oecd.org/inequality/income-inequality.htm>
[168] Gini coefficients have been computed using HIES surveys' Table 12. Household Integrated Economic Survey (HIES) provides income and expenditure data of households in quintiles.

borrowings in order to meet their rising consumption expenditures, eventually leading to high and unsustainable level of debts. Conversely, if the incomes of the richest households keep increasing disproportionately due to high inequality, these households could end up with excess savings, which fuels speculative investment and financial bubbles[169].

Labor Force Participation Rates for Males in some age brackets are Three Times that of the Females

As per the latest data available in the Labor Force Survey of 2014-15, the labor force participation rates[170] are more than 96 percent or more for males in the age brackets of 25 – 54 years while for females in the same age bracket, the participation rates range from 26 percent to 32 percent.[171] In comparative terms, labor force participation of males in the 25 to 54 years age bracket is more than three times that of the females in the same age bracket. This implies that females in the working-age population are not becoming part of the labor force and potential income streams are not being realized. Increasing female labor force participation rates will increase household income and increase resilience of households to income shocks.

Unemployment rates on downard trajectory after FY13

The Pakistan Economic Survey of 2016-17 shows that the unemployment rate in Pakistan has been hovering around 6 percent (on average) during

FY11-FY15, but the unemployment rate has declined since FY13 **(See Figure 3.8.4).** With pick-up in economic growth and steadily rising income per capita, unemployment is expected to decline further, which would positively impact households' repayment ability.

Figure 3.8.4

Unemployment Rate

Trend of 5 Years: FY11 to FY15

(Percent)
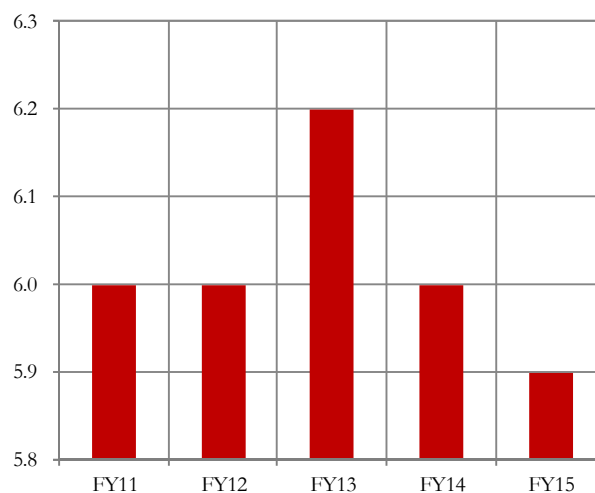
Source: Pakistan Economic Survey 2016-17, Ministry of Finance

Unemployment rates for females are consistently higher than those for males

Unemployment rates by age group and gender shows that unemployment rate in the 20-24 age bracket for males is 9.15 percent which drops below the average unemployment rate of 6 percent for the age bracket 25 - 59 years.[172] However, for females the unemployment rates are very high for the age brackets 20 – 24 years (16.35 percent) and are consistently higher than the male unemployment rates for all age brackets except the very young age bracket of 10-14 years and 65+ years **(See Figure 3.8.5)**. With low female participation rate and higher

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[169] Interview of Professor Lane Kaneworthy of University of Arizona on Inequality: <https://economix.blogs.nytimes.com/2014/03/25/qa-a-sociologist-on-inequality/?_r=0>

[170] As per OECD, the Labour Force Participation Rate is calculated as "the labour force divided by the total working-age. The working age population refers to people aged 15 to 64. This indicator is broken down by age group and it is measured as a percentage of each group." <https://data.oecd.org/emp/labour-force-participation-rate.htm>

[171] The labor force participation rate is for the following 6 age brackets presented in the survey: 25 - 29, 30 – 34, 35- 39, 40 – 44, 45-49, 50- 54. Pakisan Economic Survey 2015-16. http://www.finance.gov.pk/survey/chapters_16/12_Population.pdf

[172] The labor force participation rate is for the following 7 age brackets presented in the survey: 25 - 29, 30 – 34, 35- 39, 40 – 44, 45-49, 50- 54, 55 - 59.

female unemployment, the potential income streams are not being utilized by the households.

Figure 3.8.5

Unemployment Rates by Age Group, Gender

FY 2014-15

(Percent)
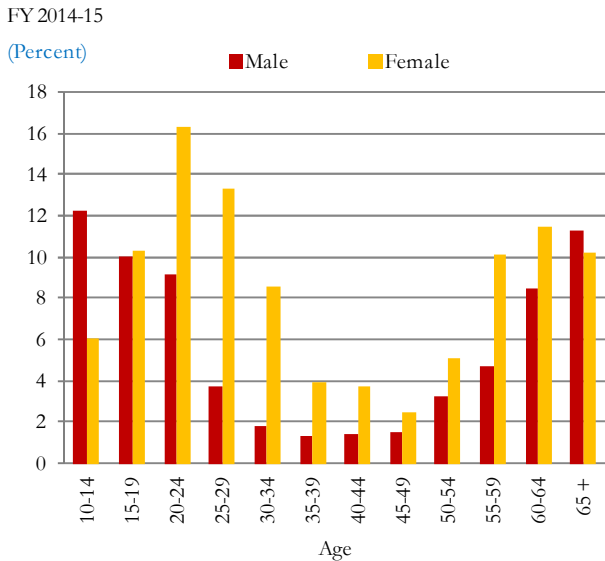
Source: Labour Force Survey 2014-15, Pakistan Bureau of Statistics

Income, Expenditure and Savings of Households

In order to ascertain the balance sheet position of households, two rounds of Household Integrated Economic Survey (HIES) published by Pakistan Bureau of Statistics (PBS) have been used. HIES is a pertinent source for analysis of income and expenditure trends of households and presents data pertaining to households in quintiles[173].

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[173] Consumption quintiles are used to distinguish the population according to their welfare: poorest households are grouped together into the 1st quintile, those with higher consumption into the 2nd quintile, and so on. Five quintiles rank the population from the poorest 20 percent to the richest 20 percent. The main aim of quintile is to analyze how social and economic indicators change in relation to people's welfare. (Household Integrated Economic Survey (HIES) 2016).
http://www.pbs.gov.pk/sites/default//pslm/publications/hies15-16/write%20up%2015-16-HIES-final_0.pdf

Household Income is much greater than Household Expenditure for the Fifth Quintiles

Analysis of household income and expenditure shows that household income and expenditure are almost equal to each other for the first three quintiles i.e. 1st, 2nd and 3rd quintiles because of which household savings (difference of household income and expenditure) is very low (**see Figure 3.8.6 and 3.8.7**).
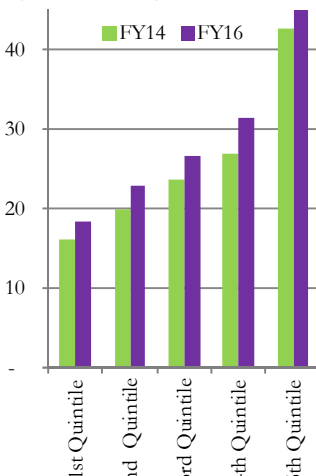
Figure 3.8.6

Household Income
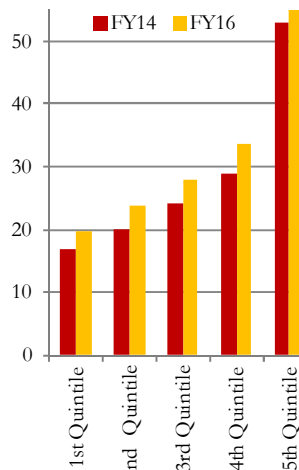
Quintile-wise FY14 & 16 position

(PKR Thousand)

Figure 3.8.7

Household Expenditure

Quintile-wise FY14 & 16 position

(PKR Thousand)

Source: HIES 2013-14, HIES 2011-12, PBS

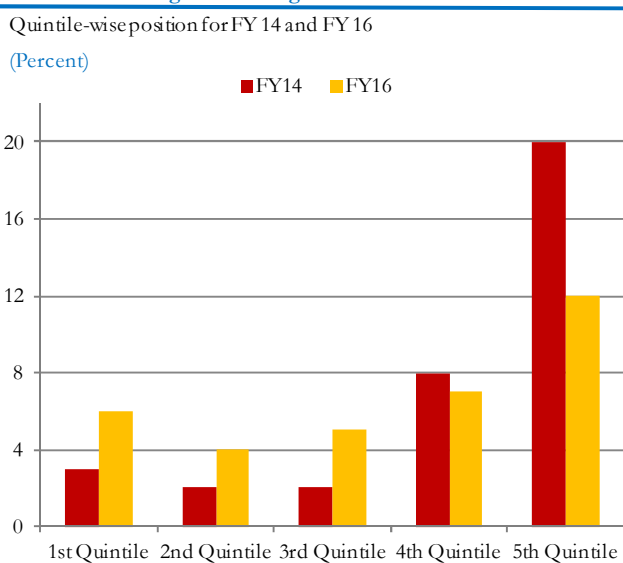Source: HIES 2013-14, HIES 2011-12, PBS

Household income is greater for the fifth quintiles as compared to household expenditure. It implies that relatively rich households are able to generate a higher level of savings as compared to the poorer ones. So as income rises, consumption, as a portion of income, falls and households are left with additional resources to save.

Savings in the Fifth Quintiles are disproportionately large but they have declined in FY16

In fact, households in the fifth quintile - which are the richest twenty percent of the households - have disproportionately large levels of savings, as

percentage of their household income, as compared to savings of households in the first four quintiles. (**see Figure 3.8.8**). However, in FY16 the household savings as percentage of household income in the 5th Quintile has dropped to 12 percent from 20 percent in FY14. This may not be a good sign for the richest households as low level of savings will reduce their resilience to any income shocks in the future. On the other hand, the saving capacity of the lower quintiles have improved as a percentage of their income.

Consumption expenditures dominate the income earned

Consumption expenditure is very high for all quintiles, constituting around 90 percent of all expenditure for all quintiles across the two HIES surveys except for the 5th quintiles in the HIES 2013-14 survey (where consumption expenditure is 86 percent) (**see Table 3.8.1**). This shows that consumption expenditure is a very large component of expenditure regardless of the income status of households.

Table 3.8.1

Comparison of Consumption Expenditure across two HIES Surveys

Consumption Expenditure	Quintiles				
	1st	2nd	3rd	4th	5th
	Percent				
HIES 2015-16	91	94	90	95	96
HIES 2013-14	93	95	97	92	86

Source: HIES 2015-16, HIES 2013-14

Debt Burden of Households

In order to ascertain the financial position of households, Net Borrowing and Net Sale of Other Assets are being considered. Debt burden of the households can be computed by taking ratio of Net Borrowing of Households against Total Household Income[174].

Households in all five Quintiles are, on average, Net Borrowers but the richest households are the least indebted

Interestingly, as per both rounds of HIES used for the current analysis, households in all five quintiles are on average net borrowers with households in the 1st, 2nd and 3rd quintiles being large net borrowers in terms of proportion of their incomes while households in the 5th quintile borrowing the least as proportion of their incomes (2 percent for HIES 2015-16 and 1 percent for HIES 2013-14) **(see Figure 3.8.9)**. The richest households are the least indebted as a proportion of their incomes.

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[174] As per HIES framework, the definition of Net Borrowing consists of two parts: (a) the value of loans obtained minus the loans repaid (including interest/profit) and (b) the difference between the values of loan given out minus repayments on such loan received. Net borrowing is net loans obtained minus net loans given out. Hence, a positive value of Net Borrowing for a household shows that a household is paying more amount for principal and interest payment for loans borrowed than the amount it is receiving in lieu of principal and interest payment for loans disbursed to other agents. (Household Integrated Economic Survey (HIES) 2016). http://www.pbs.gov.pk/sites/default/files//pslm/publications/hies15-16/write%20up%2015-16-HIES-final_0.pdf
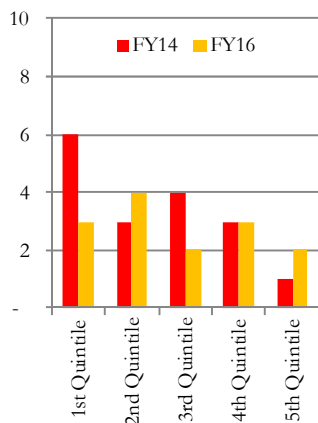
Households are making more investment in assets for future financial gains as income rises

Another important indicator of financial position of households is the Net Sale of Other Assets[175] which includes difference of sale and purchase of financial assets (stocks, shares and other securities) and some selected assets such as precious metal, jewelry etc. Hence, a negative value of Net Sale of Other Assets implies that a household is a net purchaser of other assets.

Both rounds of HIES used for the current analysis reveal that from the 1st Quintile to the 5th Quintile, households progressively purchase more 'other assets' as their household income increases **(See Figure 3.8.10).**

The trend of net purchasing of other assets across all quintiles implies that households are making investments in assets which could result in financial gains in the future.

From the above analysis of HIES surveys it is evident that as household income increases their investments in financial assets increases. The trend of investments in financial assets with increase in income is positive as it shows that households at all income levels and specially the high income households are using the financial and banking sector to channel their savings and investments.

Default Risks in the Household Sector:

This section briefly looks at the default risks by the households using infection ratios of consumer financing portfolio of banks[176].

The consumer finance portfolio has five sub-categories, namely: Credit cards, Auto loans, Consumer durables, Mortgage loans and Personal loans.

Infection ratios in mortgage loans, despie decline, remains highest…

The Consumer Financing Stability Map shows similar pattern of infection ratios of loans in Credit cards, Auto loans and Consumer durables for CY16 in comparison with CY15 **(see Figure 3.8.11)**. As discussed in Chapter 3.1, infection ratio in Mortgage loans have considerably declined in CY16 due to increased lending by medium-sized banks and Islamic banks, but infection ratio of the segment still remains the highest in the consumer finance segment.

Figure 3.8.9

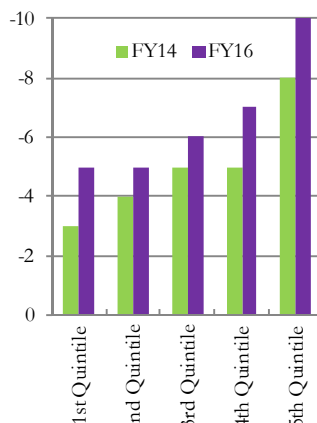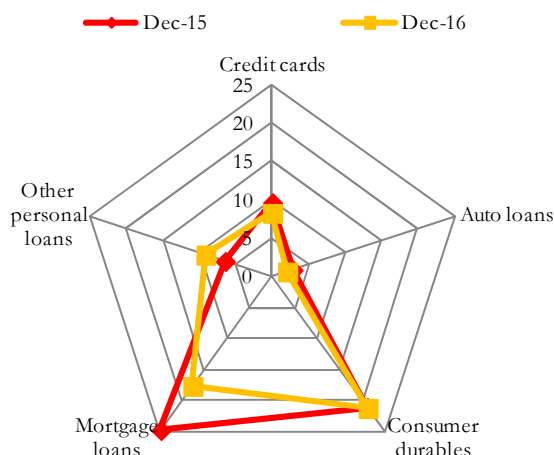**Net Borrowing as Percentage of Household Income**

Quintile-wise FY 14 & 16 position

(Percentage)

Source: HIES 2015-16, HIES 2013-14, PBS

Figure 3.8.10

Net Sale of Other Assets as Percentage of Household Income

Quintile-wise FY 14 & 16 position

(Percentage)

Source: HIES 2015-16, HIES 2013-14, PBS

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[175] In HIES, the definition of Net Sale of Other Assets includes sales minus purchases of stocks, shares and other securities; withdrawal from deposits minus savings added to deposits; sales minus purchases of gold, silver and precious metals (including jewellery), and the sale of durable items. Also cash transfers for dowry and inheritance have been considered asset movements and added to the net sale of assets (cash expenses minus values received). Finally, from this aggregate those amounts that households reported as losses of cash were deducted. (Household Integrated Economic Survey (HIES) 2016). http://www.pbs.gov.pk/sites/default/files//pslm/publications/hies15-16/write%20up%2015-16-HIES-final_0.pdf

[176] It must be noted that the consumer finance portfolio caters to households which have bank accounts and these households generally have higher education and income levels as compared to the rest of the population.

Source: FSD, SBP

Real estate sector may be unattarctive for banks …

In the Federal Budget of FY2016-17[177] and the subsequent amnesty scheme introduced in December 2016, the government levied fixed tax on builders and developers on the basis of developed or built up area for various cities across the country. The objective of these measures was to improve tax collection to match the level of investment and profits accruing in the construction sector. However, these taxation measures did not yield the expected results due to which the government has proposed to reintroduce the normal tax regime for land builders and developers in the Federal Budget FY2017-18.[178]

It is pertinent to mention that clarity in taxation rules is pivotal to remove uncertainty and price

escalation in the real estate market. From the perspective of the households, it is important to keep a check on prices of real estate, so that the low end segment of the population can actively participate in the real estate market.

The real estate sector in Pakistan has historically failed to generate enough interest from the banks in terms of mortgage finance schemes. In Pakistan housing finance uptake has remained low due to various factors such as weak foreclosure standards and lengthy judicial procedures, high interest rate spreads, non-automation of documentation, non-standardization of procedures amongst various housing schemes, and high portion of very low income group of population. However, as already mentioned in Chapter 3.1, a set of laws and legal amendments have been enacted that are expected to facilitate cleaning bad loans from the books of banks and enhance private credit. These new developments present opportunities to banks to increase lending in the mortgage finance sub-segment.

Outlook of the Auto Sector is positive…

The outlook of the Auto sector looks positive as the Board of Investment (BoI), Government of Pakistan has announced that French car manufacturing company Renault will start assembling cars in Pakistan by 2018 while efforts are being made to attract other foreign auto manufacturers to set up auto manufacturing plants in Pakistan[179]. Further, the increase in import of refurbished cars in the 600-1000 CC segment, growth of the ride-hailing services and the increased availability of hybrid cars will increase the choice set of consumers. It is expected that the banking sector

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[177] Federal Board of Revenue (2016). Finance Bill 2016-17. Islamabad. <http://www.fbr.gov.pk/budget2016-17/FinanceBill/Finance%20Bills%202016%20Final.pdf>
[178] Federal Board of Revenue (2017). Salient Features – Customs Salient Features – Budget FY2017-18. < http://www.fbr.gov.pk/Budget2017-18/SalientFeatures/SalientFeatures.pdf>

[179] Board of Investment (2016). Press Release to Review the Auto Policy. http://boi.gov.pk/ViewNews.aspx?NID=%201104

will also complement the surge in activity in the auto sector by introducing new auto loans schemes for the consumers.

Outlook of Household Sector

High unemployment rates (especially for females), low-level of savings, and high-level of borrowings as a percentage of household income, at the lower end of the distribution, pose a risk to their financial soundness. Nevertheless, households are making more investments in financial assets as their incomes increase. It is expected that with rising GDP per capita households would become more active agents of the financial system.

Furthermore, announcement of new investments in the Auto sector shows that consumers may have more choice for cars in the future. It may be reasonable to assume that the financial and banking sector will not be isolated from these developments and hence there may be an uptick in Auto loans. Further, the mortgage finance sector could also improve in the wake of legal and regulatory developments.

A potential for a win-win situation exists for banks and households, if banks are willing to cater to the needs of the young population especially women. Banks need to come up with more banking products specifically saving and credit products geared towards the youth and female population. For banks, this will result in greater deposit mobilization while it will also increase the savings of households and provide them more opportunities for credit uptake. Generally access to financial products geared towards females and youth will lead to improvement in the balance sheet of the households as well.