

## Development Finance Institutions

# 6.1

*The balance sheet of Development Finance Institutions (DFIs) contracted owing to a continued decline in investments in government securities and a concomitant retirement of borrowings. In contrast, advances portfolio registered a healthy growth. However, the overall asset mix remained concentrated in government securities. Earnings remained healthy, mainly supported by a considerable growth in net interest income, while non-interest income remained steady due to modest dividend growth and a decline in gain on securities. Indicators for solvency, i.e., CAR, and profitability, viz., ROA and ROE, improved on the back of healthy earnings.*





## 6.1 Development Finance Institutions

### *Asset Base of DFIs continued to shrink in CY25 ....*

The asset base of DFIs contracted by 31.7 percent in CY25, following a 15.3 percent decline in CY24 (**Table 6.1.1**). The contraction in both years was primarily driven by fall in investments. However, the sector's asset mix shifted towards advances, in line with the improving macroeconomic conditions. Investments, largely consisting of government securities, witnessed a steep decline of 38.5 percent during the year under review. Accordingly, their share in asset base dropped to 74.9 percent (83.2 percent in CY24); however, it remained the largest component of total assets.

The advances, on the other hand, recorded strong growth of 23.2 percent in CY25, compared to a marginal increase of 1.5 percent in CY24. With this expansion, their share in asset base inched up to 17.4 percent (9.7 percent in CY24). In terms of composition, private sector advances, which constitute around 95.5 percent of DFIs' advances, increased by 21.5 percent, while domestic public sector exposure rose by 16.2 percent.

Key Variables and Financial Soundness Indicators Table 6.1.1

	CY21	CY22	CY23	CY24	CY25
<b>billion Rupees</b>					
Investments (net)	338	1,168	2,025	1,648	1,013
Advances (net)	140	188	188	191	235
Total Assets	539	1,430	2,338	1,979	1,352
Borrowings	348	1,223	2,117	1,652	1,003
Deposits	34	38	45	78	79
Equity	136	145	144	191	234
NPLs	15	15	15	17	16
<b>percent</b>					
CAR	38.7	36.5	43.3	52.5	56.7
NPLs to Advances	9.5	7.3	7.4	8.0	6.3
Net NPLs to Net Advances	1.6	0.9	(1.2)	(0.4)	(0.7)
ROA (After Tax)	2.4	1.6	0.9	1.2	2.3
ROE (After Tax)	8.9	10.1	13.3	17.1	16.8
Cost to Income Ratio	32.5	26.9	24.0	20.6	18.7
Liquid Assets to Short-term Liabilities	98.0	98.2	95.9	110.1	95.1
Advances to Deposits	412.6	493.4	417.7	243.6	298.8

Source: State Bank of Pakistan

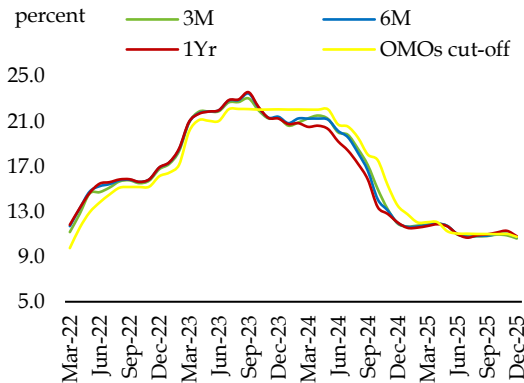
### *Investment in government securities continued to moderate...*

The decline in investment portfolio was broad-based, including government securities, bonds and TFCs. However, the fall was primarily driven by government securities, which constitute around 94.6 percent of total investments. These securities contracted sharply by 40.8 percent in CY25, compared to a decline of 19.2 percent in CY24. Earlier in CY23, DFIs substantially expanded their asset base mainly by investing in liquid government securities – financed through borrowings – in a rising interest rate environment. However, due to unfavorable market dynamics the DFIs' Net Interest Margin (NIM)<sup>1</sup> turned negative in H1CY24, inducing DFIs to reduce investments and expensive borrowings. With easing

<sup>1</sup> Net Interest Margin (NIM) is defined as = Net Interest Income (NII) / average earning assets.

monetary cycle leading to convergence of rates across tenors, the margins between yield on investments and cost of borrowing squeezed. Thus, DFIs continued to further slash their holdings of government securities and retired borrowings (Figure 6.1.1).

Secondary Market Yields and Cut-off rate on OMOs Injection Figure 6.1.1



Source: MUFAP and State Bank of Pakistan

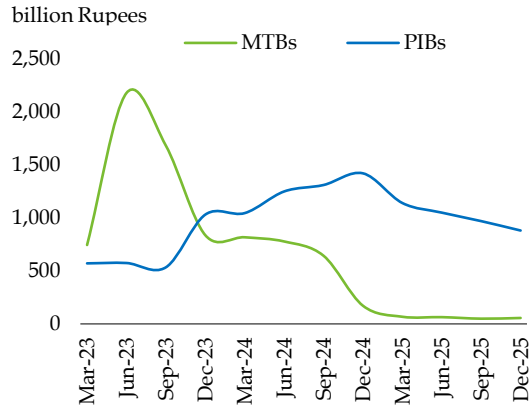
Within government securities, DFIs reduced exposure in both short-term MTBs and longer tenor PIBs. On the other hand, investments in equity stock, which is a small fraction of overall investments (1.1 percent), increased by 9.4 percent to Rs 11.4 billion, as portfolio value increased due to the booming stock market during the year.

*While investments declined across all tenors, PIBs continued to dominate the portfolio ...*

During CY25, contraction was recorded in short term MTBs and long term PIBs. The MTBs shrank by 66.9 percent to Rs 57 billion by end December 2025 (decline of 79.4 percent in CY24), whereas PIBs declined by around 38 percent to Rs 883 billion (increase of 37.7 percent in CY24). This broad-based reduction suggests a portfolio rebalancing strategy by DFIs, foreseeing further decline in yields. However, government securities remained skewed towards PIBs, which accounted for 93.3 percent of total risk-free securities. Within PIBs, DFIs preferred to invest in floating-rate instruments that have

relatively lower sensitivity to changes in interest rates (Figure 6.1.2).

Stock of MTBs and PIBs Figure 6.1.2

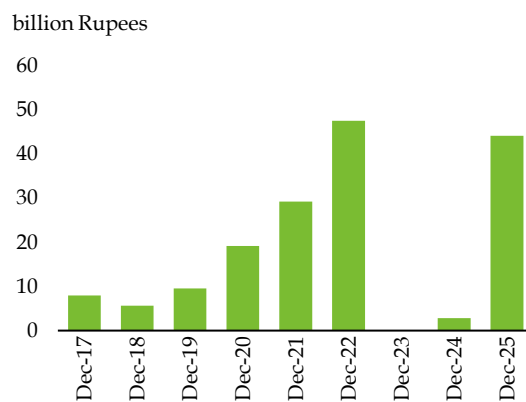


Source: State Bank of Pakistan

*Advances growth rebounded strongly....*

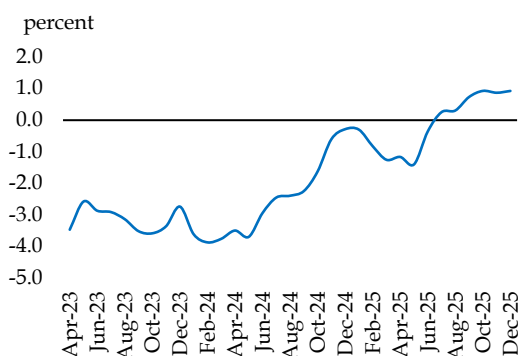
Advances witnessed healthy growth of 23.2 percent compared to a nominal increase of 1.5 percent in CY24, pushing their share in the overall asset base to 17.4 percent, up from 9.7 percent in CY24. The strong thrust for portfolio rebalancing came from declining interest rates, which stimulated credit demand by borrowers and, at the same time, increased spreads on lending by DFIs (Figure 6.1.3 and Figure 6.1.4).

Yearly flow of Advances (Net) Figure 6.1.3



Source: State Bank of Pakistan

**Recovering Spread between Lending and Deposit Rates\*** **Figure 6.1.4**

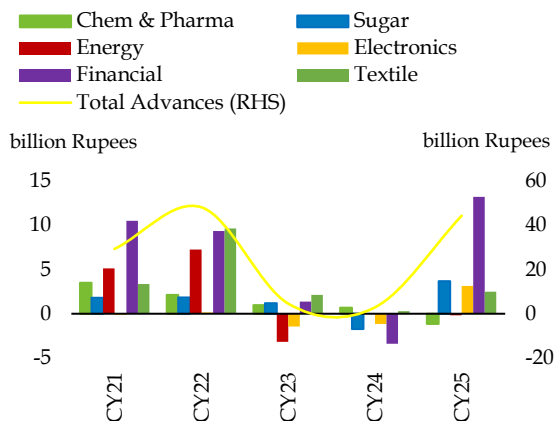


\* Weighted Average Rates

Source: State Bank of Pakistan

Corporate sector remained the main user of financing, largely for fixed investment purposes, followed by working capital requirements. The growth momentum was broad-based, with both public and private sector advances contributing to the increase. Sector-wise data reveals that within the private sector advances, disbursements increased to financial, transportation, electronics and sugar sectors, however, net retirements in other sectors such as cement and chemicals slightly moderated these gains. Just like CY24, the growth in public sector advances during CY25 was largely supported by housing finance extended by a single DFI (Figure 6.1.5).

**Sector-wise Flow in Advances** **Figure 6.1.5**

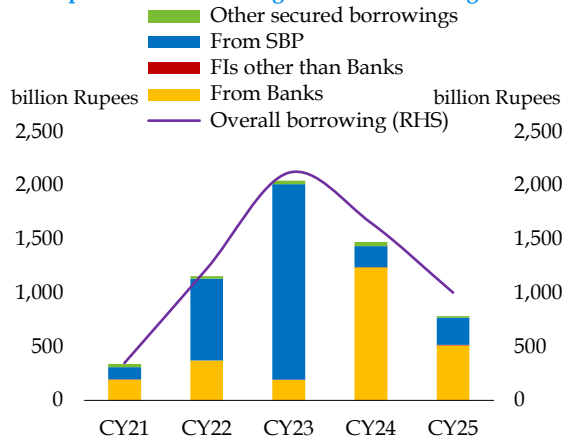


Source: State Bank of Pakistan

*Borrowings continued to decline in line with the fall in investments...*

Borrowing has remained the major source of funding for DFIs in recent years, as the sector cannot raise checking deposits from the public. However, continuing the declining trend observed last year, borrowings contracted by 39.3 percent or Rs 649 billion during the period under review (22 percent or Rs 466 billion decline in CY24). DFIs opted to retire borrowings using proceeds from maturing investments amid declining yields, which reduced the incentive to maintain a large investment portfolio funded through relatively costly borrowings. It may be recalled that DFIs observed negative net interest income during H1CY24, on the back of a higher fall in yields compared to funding costs, which remained relatively sticky (Figure 6.1.1). Likewise, CY24, the composition of borrowings in CY25 remained tilted towards bank funding, largely in the form of long-term financing (Figure 6.1.6).

**Composition of Borrowings** **Figure 6.1.6**



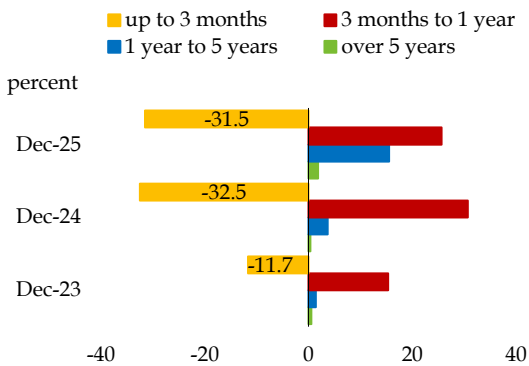
Source: State Bank of Pakistan

*Maturity mismatch widened amid significant redemption of short-term investments...*

The maturity-wise analysis of rate sensitive assets (RSA) and liabilities (RSL) indicates that DFIs remain liability sensitive at short tenors but asset sensitive at longer ones, with average gaps remaining stable (Figure 6.1.7). This was broadly aligned with redemption of short-term

investments and build up in long-term assets in a falling rate environment.

**Gap of Rate Sensitive Assets (RSA) and Liabilities (RSL) as Percent of Total Assets** Figure 6.1.7



Source: State Bank of Pakistan

*Majority of earning assets continued to be repriced in the short term...*

A significant portion of earning assets had relatively shorter maturity, i.e., up to one year. For instance, at the end of CY25, around 57 percent of earning assets were under one year bucket compared with 86 percent in CY24. In line with the prevailing easing monetary policy, DFIs accumulated more earning assets in 'over one year' bucket during CY25 relative to CY24 to lock funds at higher rates. Within earning assets, the investments, which constitute the major share (84 percent), around 53 percent were repriced within one year in CY25. In contrast, around 73 percent of advances were repriced within that tenor. An asset mix dominated by treasury investments, implies a conservative strategy of DFIs, especially in lending activity, which is unlike their specialized purpose of project-based financing for development purposes.

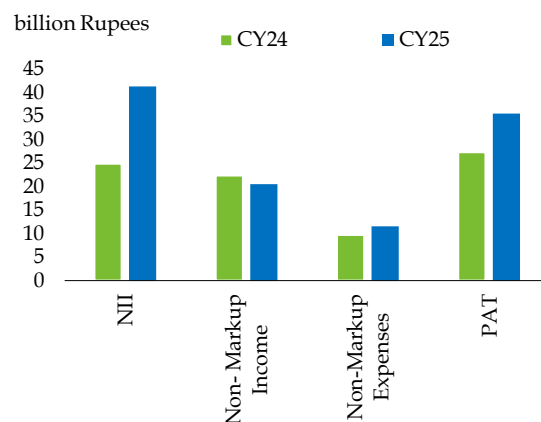
*Profitability improved owing to a significant rise in net-interest income ...*

After-tax profit of DFIs increased by 30.2 percent to Rs 35.6 billion in CY25 (Rs 27.3 billion in

CY24), owing to a healthy growth in net interest income. Net markup income rose significantly by 66.2 percent to Rs 41.4 billion (Rs 24.9 billion in CY24), as DFIs optimized their investment portfolio in a declining interest rate environment, and managed funding–placement mix with increased utilization of long-term bank credit lines and a reduced reliance on OMOs facilities.<sup>2</sup> Non-interest earnings decreased by 8 percent or Rs 1.8 billion, as dividend income, which forms a major part of non-markup income, largely remained stable at Rs 17.1 billion (Rs 17.6 billion in CY24). Besides, the gains on sales of securities declined slightly to Rs 2.1 billion (Rs 2.9 billion in CY24).

On the other hand, non-interest expenses grew at a moderate pace of 18.5 percent to Rs 11.6 billion in CY25 (Rs 9.8 billion in CY24), primarily driven by higher operating expenses (Figure 6.1.8).

**Earnings of DFIs** Figure 6.1.8



Source: State Bank of Pakistan

*Growth in earnings improved ROA, though ROE moderated...*

With a robust growth in earnings and a contraction in asset base, the after-tax return on assets (ROA) improved to 2.3 percent during CY25 (1.2 percent in CY24). However, return on equity (ROE) fell slightly to 16.8 percent during CY25 (17.1 percent in the preceding year), as the

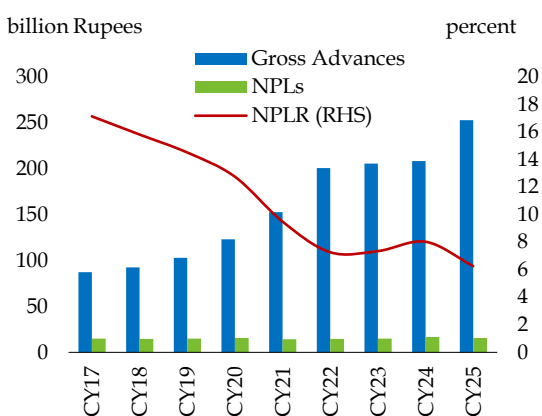
<sup>2</sup> SBP allowed all DFIs to participate in Open Market Operations in 2022. For details see DMMD Circular No. 11 of 2022.

impact of higher earnings was partly offset by a modest increase in equity.

#### *Asset quality indicators improved with expansion in advances...*

NPLs to advances ratio improved to 6.3 percent by the end of CY25 from 8.0 percent in CY24 (Figure 6.1.9). The improvement in the infection ratio was driven by robust growth in advances, Rs 44 billion during the year, along with marginal decrease of Rs 0.9 billion (Rs 2 billion increase in CY24) in gross NPLs. The provisioning coverage further strengthened to 101.5 percent during CY25 (78.6 percent last year). Accordingly, net NPLs to net loans and capital impairment ratios improved to -0.1 percent in CY25 (1.9 percent in CY24) and -0.1 percent (1.9 percent in CY24), respectively.<sup>3</sup> These ratios remained in a comfortable range, indicating that the solvency risk to DFIs is well contained.

**Asset Quality of DFIs in CY25** Figure 6.1.9



Source: State Bank of Pakistan

#### *CAR of the DFIs sector improved in line with robust earnings...*

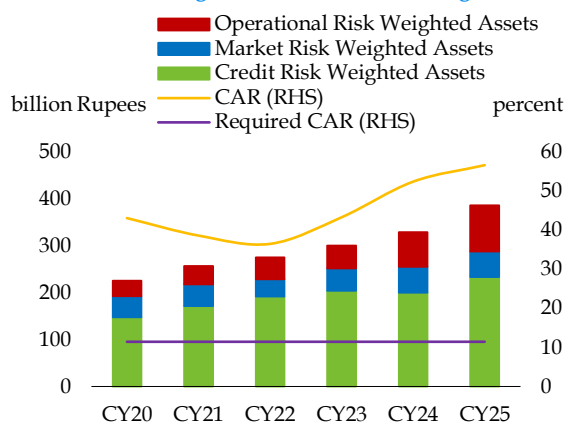
The aggregate CAR of DFIs has historically remained well above the required requirement of 11.5 percent, supported by a strong asset base largely concentrated in risk-free government securities, whereas the share of lending has relatively remained low and directed towards

resilient and high-potential sectors. During the year under review, CAR further improved to 56.7 percent (52.3 percent at end CY24).

The improvement in CAR stemmed from relatively higher growth (26.7 percent) in regulatory capital compared to risk-weighted assets, supported by healthy earnings and revaluation surpluses. Accordingly, both key components of capital, Tier-I and Tier-II, registered growth during CY25. Total risk weighted assets (TRWAs), however, grew at a slower pace of 17.3 percent in CY25 compared to capital, which further improved the solvency ratio.

Further analysis of DFIs' regulatory capital requirement shows the credit risk, which forms the major part of RWAs, i.e., 60.4 percent, expanded moderately owing to strong growth in advances. In tandem with credit RWAs, Operational RWAs surged by a notable 33.8 percent, on the back of higher gross income in recent years, which forms the basis of operational risk under the Basic Indicator Approach (BIA) for calculation of capital requirement for operational risk. However, market risk weighted assets slightly contracted by 1.2 percent (Figure 6.1.10).

**CAR and Risk Weighted Assets of DFIs** Figure 6.1.10



Source: State Bank of Pakistan

<sup>3</sup> Negative ratio indicates higher ECL (Expected Credit Loss) allowance available relative to non-performing loans.

In view of relatively limited prospects of earnings amid shrinking yields on government securities, DFIs have started to adopt alternative strategies to unlock new growth avenues.

Towards this end, DFIs diversified their operations by investing in digital banks, venture capital initiatives, and launching a dedicated Islamic Finance division to provide a broader array of Sharia-compliant financial products. At the same time, DFIs are focusing on expanding advances to strengthen core income and reduce reliance on returns from investments in risk-free securities.

#### *Way Forward...*

DFIs were established to promote development finance and support capital formation in the economy. However, various challenges have hindered their growth, leading them to adopt a conservative business approach. The sector faces structural constraints, including limited access to the capital market, which also lacks depth, a low national savings rate, and subdued demand for long-term financing due to multiple factors. DFIs have limited access to deposits compared to commercial banks, and unlike their counterparts in other jurisdictions, do not benefit from concessional lending schemes for development objectives. Given these limitations, DFIs need to adopt innovative ways to promote development finance and support the capital formation process in the country. In this regard, exploring options such as alternative financing models and public-private partnerships could help DFIs play a more effective role in the development of the country.