

Day Break

Tuesday, 11 July 2017

Sector Update

Exhibit: **Weighted average spreads**

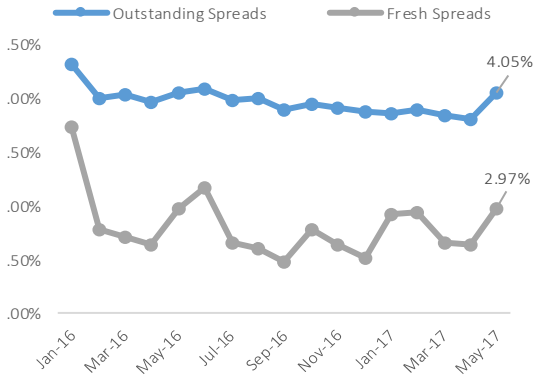


Exhibit: **Advances growth picked up sharply in CY17**

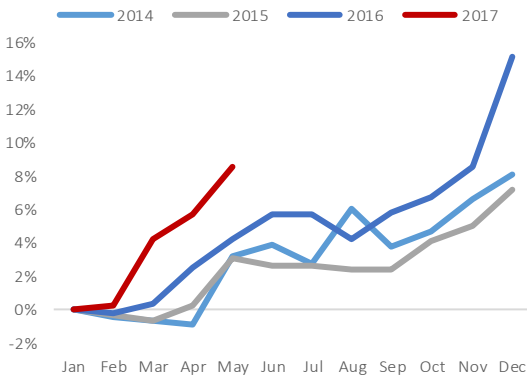
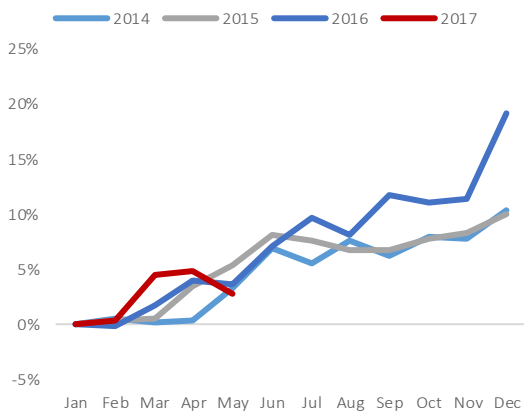


Exhibit: **Deposit growth slowing down in CY17**



Source: SBP, IGI Research

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Commercial Banks

May-17 banking spreads advances on rate hike expectation to an 11-month high level of +2.97%

- Recently published data by State Bank of Pakistan (SBP) on banking spreads shows a slight improvement, with fresh spreads standing at an 11 month high of 2.97%.
- Differential in growths between WADR and WALR translated into 34bps rise in fresh spreads.
- Rising lending rate possibly indicates towards a change in interest rate outlook in our view.
- with credit demand slowing down and interest rates expected to increase in coming months, slowdown in advances growth along with increase in deposit growth is likely to keep banking spreads tepid, we think.
- We highlight HBL, UBL, BAH and FABL as our preferred picks.

May-17 Banking spreads recorded at an 11month high of 2.97%

Recently published data by State Bank of Pakistan (SBP) on banking spreads shows a slight improvement, with fresh spreads standing at an 11 month high of 2.97% indicating a 49bps increase from the 11-month low of 2.48% (reported in Sep-16). Nevertheless, despite uptick witnessed during the month, average banking spreads for 5MCY17 still stand at 2.82%, a decade low (2.96% in 5MCY16).

Higher lending rate relative to deposit rate led to increase in monthly spreads

The weighted average deposit rates (WADR) for fresh deposits has been on consistent rise with May-17 average deposit rate standing at 4.85% (up by +15bps). However, noteworthy is the change in weighted average lending rates (WALR) which rose to 7.82% (up by +49bps) during the month, outstripping the increase in WADR. This differential in growths between WADR and WALR translated into 34bps rise in fresh spreads. To highlight, banks outstanding WALR also showed a sharp increase to 8.98% (up by +70bps) during the month, bringing the 5MCY17 average to +8.49% (down by 98bps YoY compared to 5MCY16; 9.47%), whereby average deposit rate fell down to 4.61% (down by 79bps YoY compared to 5MCY16; 5.40%).

...increasing lending rate also indicate changing interest rate perception

Rising lending rate possibly indicates towards a change in interest rate outlook in our view. So far inflation rates have remained under control averaging 4.16% in FY17, while increasing risks of currency depreciation and rising oil prices could easily push real interest rates, currently positive ~2%, into negative territory. Recent consumer confidence survey (CCS) for the month of May-17, conducted by State Bank of Pakistan (SBP) shows that a rising interest rate is widely anticipated in upcoming months. This, along with a low consumer purchase

Exhibit: Interest Rates Expectations at all time high level

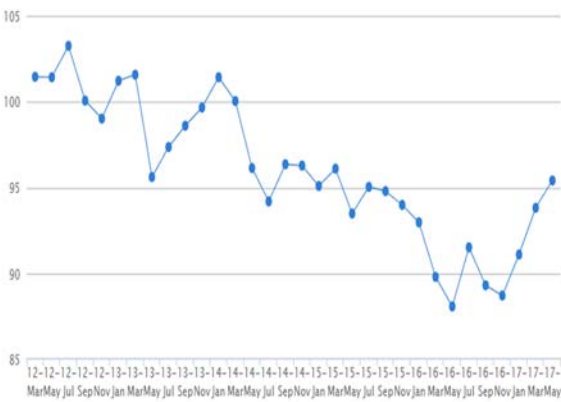
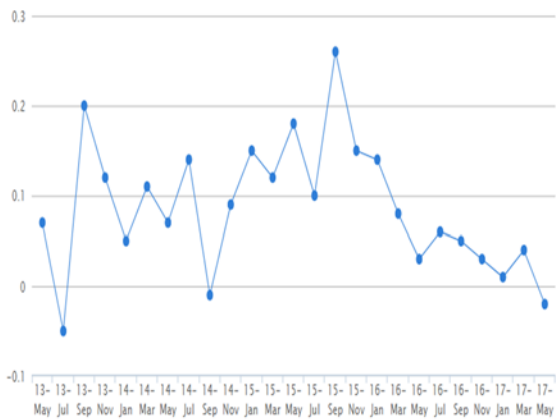


Exhibit: Automobile purchase expectations, YoY change



Source: SBP, CCS, IGI Research

expectation indicate an overall slowdown in private sector credit demand. Henceforth, recent rise in advance-to-deposit ratio (ADR) to 54% (almost a 29 months high) is a mere reflection of slowdown in deposit growth witnessed during the period under review; deposits down by 2% CY17td. With cyclical deposit growth expected by June, we are likely to witness ADR dropping from its current level of 54%.

Rising interest rate expectation and growth in deposits to keep banking spreads constrained

On the outlook, risk of interest rate hike has increased significantly in the past few months. Recent deterioration in external account and weakening of PKR will lead to increase in price level in the 2HCY17. This is also affirmed by Consumer index on expectation of interest rate. Hence, with credit demand slowing down and interest rates expected to increase in coming months, slowdown in advances growth along with increase in deposit growth is likely to keep banking spreads tepid, we think.

Recommendation

For us, we prefer banks having high interest earning investment bond buffer and high CASA deposit, while equally important is the growth in advances to sustain healthy NIMs. Thus, we highlight HBL, UBL, BAML and FABL as our preferred picks.

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