

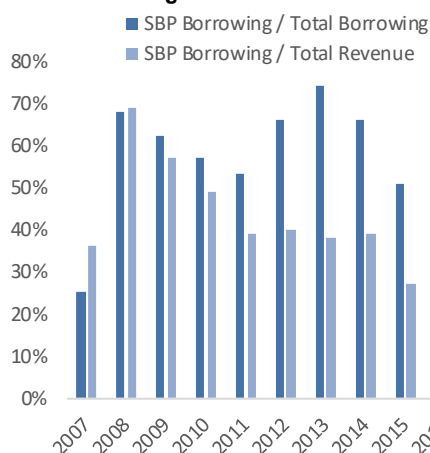
Day Break

Thursday, 18 April 2019

Economy

Bank	GoP Deposits / Total Deposits	Deposit Share %
NBP	33%	34%
BOP	56%	17%
AKBL	33%	10%
HBL	7%	8%
ABL	12%	6%
BOK	63%	6%
MCB	5%	3%
UBL	4%	3%
JSBL	17%	3%
BAFL	6%	2%
SNBL	13%	2%
HMB	6%	2%
FABL	7%	1%
SILK	18%	1%
BAHL	2%	1%
MEBL	2%	1%
SBL	16%	1%
SCBPL	0%	0%
Average	14%	100%

SBP Borrowing



Source: Company Financials, SBP & IGI Research

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Economy

Treasury Single Account eventual but gradual; Expecting a limited impact on banking sector

- News regarding government to introduce Treasury Single Account (TSA) has been circulating. SBP clarified that proposal to introduce TSA is being examined by the Government of Pakistan as part of its agenda to reform public financial management, however, no decision has yet been made to implement
- As per our understanding TSA will play an important role in cash management operation of government which is and will be helpful in budgeting and will come handy fiscal management issues. But we think, given the harsh implication on banking sector it likely that TSA will be introduced gradually in phase manner

TSA eventual but gradual

Yesterday the State Bank of Pakistan (SBP) issued a press release citing misinformation being circulated on social media regarding government plans to introduce Treasury Single Account (TSA). However, SBP further clarified that proposal to introduce TSA is being examined by the Government of Pakistan as part of its agenda to reform public financial management. However, no decision has yet been made to implement the TSA and that any decision in this regard will be taken after due consultation with all the stakeholders and assessing its impact on the banking industry. We think possibility of introduction of TSA is very likely with the advent of IMF program in coming months and as fiscal consolidation takes the front seats for policymakers. Nevertheless, we assess the possible implication of TSA on banking sector and why we think it is important.

What it is?

A Treasury Single Account (TSA) is a management tool wherein in contrary to operating segregated multiple banking accounts with various commercial banks the government instead employs either a single account or a single control account with fully integrated multiple accounts. For that purpose, either State Bank of Pakistan (SBP) or single/multiple commercial banks can act as custodian of TSA.

Why it is Important?

The main objective of TSA is to improve government's cash management by consolidating government cash resources. It effectively erodes potential delays in government revenue collection and expenses which can associated costs attached to it. A unified system helps in a reliable forecast of government cash flow which becomes important during budget times. Key objective benefits include;

- Efficient cash flow management
- Efficient flow of information
- Optimal management of borrowing costs

What implication does it hold for Government Fiscal Management?

Given its importance back in 2008, the International Monetary Fund (IMF) made TSA as one of the structural benchmark for its Stand-by Arrangements Program (SBA). TSA leads to a better coordination of cash management. This will not help achieve fiscal discipline but can also aid towards monetary policy transmission mechanism. Government borrows from central banks to meet up its short-term budgetary needs.

In absence of a well-coordinated cash management system such as TSA, these borrowing could rise substantially from central banks and carry cost. As it has been the case in Pakistan. Government borrowing from SBP have been highest in 2007-2011 and have risen sharply again lately in 2018 onwards. To recall, in 2014 IMF placed a ceiling on government net domestic assets (NDA) and borrowing from SBP, which pushed secondary market yields as demand from commercial banks was expected to rise sharply further raising government borrowing cost. Not only will TSA help achieve similar results; that is reduce borrowing from SBP and subsequently any cost associated with it; but reduce demand from commercial banks will likely keep secondary market yields depress as well in our view.

What implication does it hold for banks?

Amongst our sample of 18 commercial banks taken, government deposit made up for nearly ~14% of the total deposit size. For provincial banks the amount is even higher at ~57% of total deposit size. Clearly a deposit migration of this size from commercial banks to TSA can have a major implication for commercial banks in terms of liquidity and thus profitability as these deposits act funding source for their assets. For Pakistan a full deposit migration seems less likely at this point in our view, but a gradual migration could be a possibility in short to medium term. Primarily we say this due to;

Exhibit: Government Deposits held by Commercial Banks

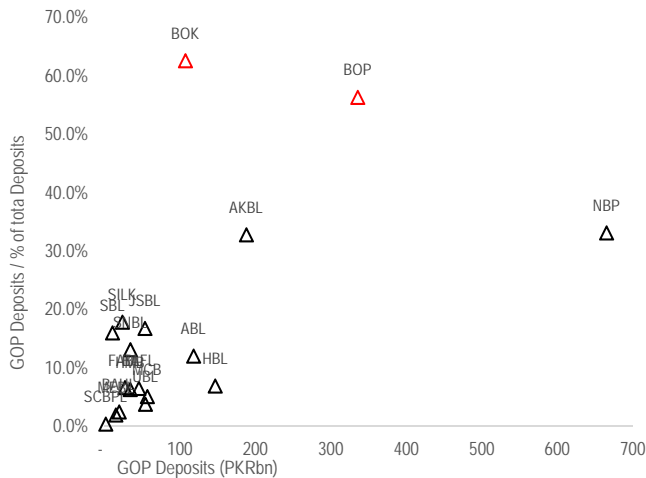
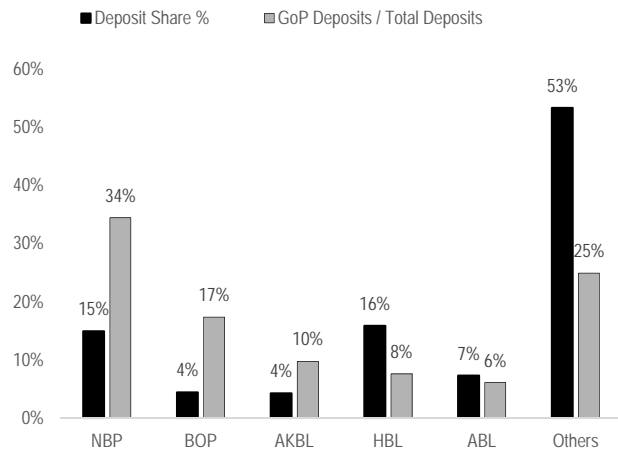


Exhibit: ~75% of government deposit concentrated in 5 banks, while they only make up less than 50% of total bank deposit



Source: IMF, SBP, IGI Research

- This will **limit banks’ asset expansion** which will impact capital ratios severely; particularly at time of rising capital requirements. While reduction in bank deposits will impact bank’s liquidity ratio significantly.
- **Degree of financial integration** (payment settlement systems and institutional structures) will determine whether TSA will be managed by central bank in case of Pakistan, SBP or by commercial banks. Often countries with higher degree of financial integration (payment settlement systems and institutional structures) have central bank as a sole custodian of TSA; while countries with less integrated financial systems have multiple or single commercial as manager of TSA. In case TSA is fully managed by SBP, deposit migration at commercial bank will be significant.

- In addition, **segregation of federal versus provincial deposits** will be another challenge. Bank of Punjab and Khyber (BOP and BOK) have the highest share of government deposits; ~56% and ~63% of total deposit size respectively. However as per our understanding this exercise pertains on a federal level which may exclude any material impacts on BOP and BOK, provided they maintain substantial balances of provincial governments as against federal governments.

Outlook

As per our understanding TSA will play an important role in cash management operation of government which is and will be helpful in budgeting and will come handy fiscal management issues. But we think, given the harsh implication on banking sector it likely that TSA will be introduced gradually in phase manner, as it has been elsewhere in countries with less integrated financial system. We maintain our overweight stance on banking stocks with likings of UBL, HBL, AKBL, BAFL and BAHL.

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