December 02, 2009

Pakistan Market

MORNING BRIEFING

Banks: Spreads sticky despite weak credit appetite

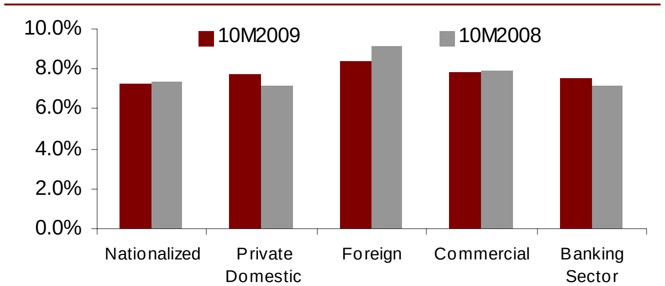
KSE100 Index: Closing 9013.04 ↓ (-193.17)

After witnessing a 30bps fall in the first 5 months (Jan-May) of 2009, the banking sector spreads have remained sticky amid a tight liquidity situation and attractive risk free yields. This can be traced from the trend in 6MKIBOR which reverted to 12.56% in August after hitting a low of 11.87% in July. Resultantly, average spread in the first 10 months (Jan-Oct) of 2009 was recorded at 7.51%, up 30bpsYoY while the October spread was up by 3bpsMoM. Though we maintain the view that spreads are bound to slide, the pace of the decline is expected to be slower than anticipated earlier. Our full year expectation for the average industry spreads in 2009 now stands at 7.45% (earlier estimate: 7.3%).

October data reinforces the sticky KIBOR dynamics

October's data released by the SBP shows that spreads rose by 3bpsMoM to 7.41%. Lending rates remained unchanged MoM at 13.67%, while a low credit appetite allowed banks to shed expensive fixed deposits, helping rates fall marginally by 3bps to 6.26%. Hence, average spreads for the 10M2009 stood at 7.51% versus 7.21% in 10M2008. While spreads currently are 37bps lower than the peak levels of 7.78% in January, an interesting scenario has evolved since August whereby the cost of deposit fell by 15bps while lending rates have declined by only 6bps. We believe a lackluster credit appetite (credit growth of 2% in 10M2009) has been the driving factor behind this fall.

Graph: Segment-wise average spreads



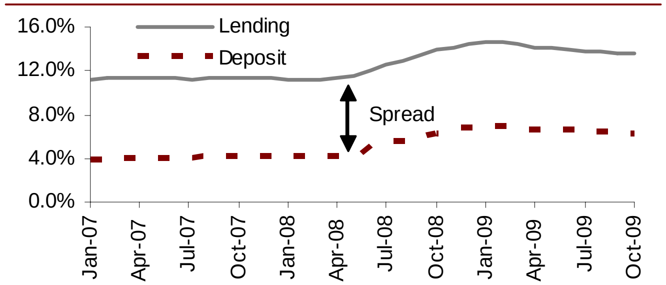
Source: SBP

Going forward though, ease in monetary policy (50bps cut in Nov) is likely to lower KIBOR rates. We have already seen a 24bps reduction in the 6MKIBOR post the announcement of the 50bps interest rate cut. That said, since KIBOR is a liquidity driven instrument, any major decline has to coincide with improved liquidity particularly expected foreign flows. Considering US$1.7bn worth of foreign flows expected over the next 3-6 months and 100bps rate cut assumption for January policy, we expect KIBOR to decline by 50-60bps by Mar 2010.

Deposit rates to remain firm going forward

Though cost of deposits has witnessed a 44bps fall to 6.26% since the beginning of the year, we don't foresee any major decline going forward. This is owing to the fact that most of the deposit mix readjustment (fixed deposit had occupied an increased share, post the Sep 2008 liquidity crunch) has already taken place. Moreover, a 5% minimum rate on savings (36% of total deposits) also sets a floor on the cost structure. On the basis of the above, we expect deposit rates to consolidate while easing on lending side occurs. As a result, we expect spreads to fall by 35-40 bps in the next 3-6 months.

Graph: Lending and deposit rates trend (2007 to date)



Source: SBP

Outlook: 'Market-Weight' maintained

Despite the improvement seen in key economic indicators during the last few months, the banking sector performance remains weak demonstrated by a 23% decline in profits in 9M2009. Higher provisions for NPLs, weak credit appetite and recognition of impairment losses have scarred the sector's performance during the period. Recent relaxation in the FSV regime, a slowdown in NPL accretion and improved credit offtake over the next few months will however support the sector's earnings in 4Q2009. Reiterating our 'Market-Weight' stance, we flag BAFL as a likely outperformer given its decent fundamentals and a potential earnings trigger in case of the Warid sell off materializing, as BAFL holds 8.7% stake in the company.

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Also in focus

Possible delay in IMF tranche worth US$1.2bn

According to news reports, delay in signing of a Letter of Intent (LOI) over a US$800mn financing gap, might hold up disbursement of the fourth tranche of IMF worth US$1.2bn. The signing of the LOI is a pre requisite for the release of the money. Earlier reports had suggested that the payment would be released sometime mid December. We believe this delay would be short term in nature as Pakistan has successfully met all major preconditions for the release of the 4th tranche.

UBL clarifies about its Dubai World exposure

United Bank Limited has explained over its exposure to Dubai World via a press release issued to the exchange yesterday. The bank stated that its exposure to Dubai World and its entities stands at US$20mn (Rs1.7bn) or 2% of its UAE book & 0.3% of its total book. It further stated that its operations in the UAE are healthy and robust and the bank does not expect to be affected by the current challenges sprung up in Dubai.

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