

## Banks: Fourth quarter drives credit growth in 2009

KSE100 Index: Closing 9386.92 ↓ (-121.03)

After subdued performance in the first nine months of the calendar year, credit offtake gained ground in the final quarter of 2009 to post an annual growth of 4.2% to Rs3.27trn (US\$38.8bn), still its worst performance since 2002. Seasonal pick up in the final quarter, on account of a rise in borrowings from the agricultural & textile (ginning) sectors have helped the advances grow by 4.5% in the 4Q alone, reversing the decline of 0.3% in 9M2009. Deposits too gathered pace in the final quarter (up 4.9%) to post a growth of 13.8% in 2009, while reversals on account of relaxation in FSV regulations saw provisions fall by 1%.

### 4Q demand propels 2009 credit growth to 4.2%

Credit offtake increased in the final quarter of 2009 as seasonal demand helped gross advances grow by 4.5% to Rs3.27trn (US\$38.8bn). Higher demand from agriculture and an improvement in the private sector in general have supported the growth in gross advances. Private sector credit which had witnessed a contraction of Rs228bn in 9M2009, displayed a significant jump in the last quarter with credit offtake of Rs151bn as of Dec 19, 2009. These statistics could go even higher once data is released for the last fortnight of 2009.

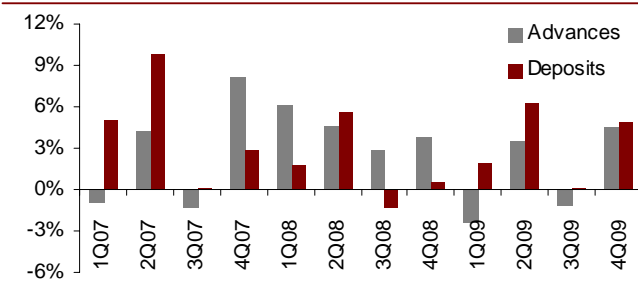
Despite a marked improvement in the 4Q2009, overall growth in 2009 stood at 4.2%, the lowest since 2002 (2.9%) and well below the 5 year (2004-08) average growth of 22%. Higher interest rates (average 6M KIBOR of 13.1%), rising Non Performing Loans (NPLs), lower commodity prices and a massive contraction in LSM, particularly in first half of 2009, were major reasons for a weak credit flow as banks shifted liquidity to high yielding risk free investments.

### Deposits up 14%, in line with M2 growth of 13%

Deposits of the banking industry have reached Rs4.3tn (US\$ 51.3bn) as of Dec 26 2009, registering a growth of 13.8% in 2009. After growing by 8.5% in 9M2009, deposits rose by 4.9% in the final quarter as compared to a growth of 0.5% in 4Q2008. An improved money supply situation, initially rising

net foreign assets and subsequently growing domestic assets have contributed to the double digit deposit growth in 2009 which corresponds with the 13.3% M2 growth for the period. Though the annual deposit growth is a marked improvement when compared to the 6.6% growth recorded in 2008, it is lower than the 5 year (2004-08) average annual growth of 16%.

Graph: Quarterwise advances and deposit growth trend



Source: SBP

### Investments up 68%, provisions rose by Rs55bn

Given high interest rates and rising NPLs, banks preferred to invest in government securities (particularly T bills) as investment surged by 68% to Rs1.64tn (US\$19.5bn) as of Dec 26, 2009. This is supported by the M2 data which shows government borrowings from banks stood at Rs411bn (US\$4.9bn) during the year. The trend of parking excess liquidity to investments reversed in 4Q2009, as improved private sector offtake saw growth slowing down to 5.8% versus the average quarterly growth of 16.7% in nine months of 2009.

A respite in the quantum of provisions for Non Performing Loans (NPLs) remained a major highlight of 4Q2009, as relaxation in FSV regulation helped provisions decline by 1%. Resultantly, provisions for full year 2009 arrived at Rs55bn up 26%YoY. The quantum of provisions are likely to go up once banks take up audit and year end adjustments, the details of which would be reflected in the subsequent weekly data.

### Sector Outlook: 4Q to boost profits in 2009

Although recent data depicts early signs of recovery we expect the sector to continue facing challenges until the 1H2010. That said, recent relaxation in the FSV regime, a relative decline in NPL accretion and improved credit offtake will support the sector's earnings in 4Q2009. We expect earnings to grow by 12% in 2009, driven by a combination of improved 4Q2009 performance and weak performance in 4Q2008, when provisions for NPLs and impairment were at peak levels.

Going forward, amid expected external flows from KLB & FoDP, we expect the SBP to go ahead with quantitative easing alongside the policy rate cut. Thus the expected decline in KIBOR should help boost private sector offtake. As a result, advances are likely to post double digit growth in 2010, while we expect deposits to grow by 13% in line with our money supply forecast. Reiterating our 'Market-Weight' stance, we flag BAFL and NBP as preferred picks.

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### Also in focus

#### Urea prices rise to Rs750/bag

As anticipated, to counter the recent hike in fuel stock gas prices (up 18% to Rs382.37/mmbtu), major fertilizer companies due to their pricing power have increased ex-factory urea prices by Rs20/bag to Rs750/bag. We expect this rise in urea prices to have a positive per share impact of Rs0.5 & Rs0.2 on Engro and FFC's earnings, respectively. However, since nearly half of FFBL's production comprises DAP, the increase would only mute the impact of the gas price hike.

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