

June 04, 2010

Pakistan Market**Banks: Commodity lending drives offtake in 5M2010** KSE100 Index: Closing 9621.30 ↑ (+122.24)

After subdued offtake in 1Q2010, where it declined by 0.5%, credit offtake picked up in Apr-May to post a cumulative growth of 2.3% in 5M2010 (Jan-May). While advances to private sector lost ground in the last two months, borrowing by the government for commodity operations helped advances to increase. Further, total deposits grew by 5.8% to Rs4.6trn (US\$53.8bn) in the five months period, broadly inline with the previous two years. Moreover, the extra liquidity continues to flow into investments, as they rose 5.6% to Rs1.7trn (US\$20.4bn) in the period.

Deposits up 5.6% in 5M2010, NDA rises 4%

As of May 28, 2010, deposits of the industry rose 5.8% in 5M2010 to reach Rs4.6trn (US\$53.8bn) compared to growth of 6.3% and 3.7% in the same period of 2009 and 2008, respectively. The rise is primarily attributable to Net Domestic Assets (NDA), which increased by Rs192bn, on increased government borrowing from the central bank.

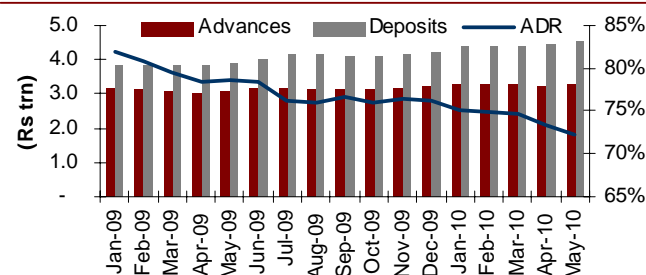
Commodity borrowing drives advances up 2.3%

Gross advances in 5M2010 rose 2.3% to Rs3.4trn (US\$39.3bn), with growth predominantly coming in the Apr-May period. The rise was primarily on the back of increased government borrowing from banks for commodity operations in the past two months. According to the data available, government had retired Rs55.4bn in 1Q2010, while new borrowing in Apr-May totalled around Rs99bn.

On the contrary, though credit to private sector has improved significantly in the current fiscal year, a declining trend was witnessed in the last two months as it went down by Rs8.5bn, highlighting that the recovery is still fragile.

Investments up 5.6%, Provisions up Rs32bn

Investments rose 5.6% to Rs1.7trn (US\$20.4bn) in 5M2010, as excess liquidity from deposit growth continues to be parked into investments. This effect is very much visible in the gradually declining ADR ratio, which currently stands at 73%.

Advances, Deposits & ADR trend

Source: SBP

Provisions on the other hand, rose by Rs32bn or 11.6%, in 5M2010 compared to Rs20.8bn and Rs37.6bn in the same period in 2009 and 2008, respectively. We believe, the rise in provisions is skewed towards smaller and specialized banks, as most large banks witnessed lower quantum of provisions in 1Q2010.

Outlook: 'Market-Weight' maintained

Earnings performance of the sector remained strong in 1Q2010, as profits rose by 17%YoY, driven by higher Non Interest Income and lower provisions. However, credit growth still remains a concern, especially with no clear trend in offtake towards private sector.

Moreover, correction in the equity market coupled with concerns on tax hike by 2.5% have led banks to loose 12% of market capitalization since start of May, bringing many of the scrips to compelling levels. We believe with further relaxation in FSV benefit relating to land, banking scrips have become an attractive proposition. We flag UBL, MCB, ABL and NBP as favorable picks at current levels.

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Also in focus**FX reserves cross US\$16bn mark after 30 months**

Foreign exchange reserves for the first time since November 2007 have crossed US\$16bn mark to stand at US\$16.01bn (as of May 28, 2010) compared to US\$15.95bn in the previous week. The increase in reserves reflects US\$288mn received under Coalition Support Fund (CSF) funds last week. The CSF flow has helped SBP reserves to rise to US\$12.31bn compared to US\$12.25bn a week earlier.

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