

July 06, 2009

Pakistan Market**Banks: Advances & deposits trend 1H2009 & FY09**

KSE100 Index: Closing 7471.28 ↓ (-27.06)

MORNING BRIEFING

A combination of high interest rates, protracted economic slowdown & asset quality concerns remained major reasons behind lack luster 1% growth in credit offtake in 1H (Jan-Jun) 2009. In contrast, deposit growth arrived at the respectable 8.4%. On a fiscal year basis however, the situation was markedly different as both advances and deposit grew by 8% in FY09.

Moreover, with deposit growth outpacing credit offtake performance in 1H2009, banks decided to park excess liquidity in investments portfolio particularly T-bills as reflected by 38% growth in Investments.

Deposit up 8% in 1H2009 as NFA rises by 33%

According to latest statistics released by SBP, total customer deposits of the banking industry have reached Rs4.1tn (US\$51bn) as of Jun 27, 2009, depicting a growth of 7.5% from Rs3.8tn (US\$56.2bn) at the end of Jun 2008.

After witnessing lackluster performance in the first half of FY09 (decline of 1%), deposits have picked in second half posting a handsome growth of 8.4%, driven primarily by improved money supply situation, particularly Net Foreign Assets (NFA). M2 expanded by 5.5% in 2HFY09, while NFA grew by 33%. Moreover, a 70-140bps fall in NSS rates in Mar 2009 was another contributing factor towards stability in deposits, which is likely to continue amid a recent 50-184bps cut in rates.

The 8.4% deposit growth for FY09 was however significantly lower than 5 year (FY04-08) average deposit growth of 17% and last year's growth of 11%.

Advances up 8%, provisions jump 38% in FY09

In line with the deposit performance, gross advances of scheduled banks grew by 8% to Rs3.2tn (US\$39bn) as of Jun 27, 2009, however after adjusting these advances against provisions of Rs252bn; net advances of the industry were up 6% at Rs2.9tn (US\$36bn). The 8% growth was a far cry from

the double digit 5 year (FY04-08) average growth of 20%, while the most depressing aspect is the performance in 1H2009 as rather subdued growth of a paltry 1%. Going forward, despite sharp fall in lending rates (6-month KIBOR down 294bps in 2009), offtake is expected to remain under distress due to the weak economic fundamentals reflected by 8.2% contraction in LSM during (Jul-Apr) FY09.

Moreover, provisions for Non Performing Loans (NPLs) continue to pose a major risk to earnings rising by Rs40bn or 19% in 1H2009. This rising trend follows a record increase of Rs129bn and Rs52bn respectively in NPLs and provisions during 2008.

Investments surge by 38% in 1H2009

On the back of declining interest rate expectations and higher risk of NPLs, banks preferred investing in government securities as investments surged by 38% to Rs1.3tn (US\$17bn) as of end Jun 2009. This is also reflective in the M2 statistics, as net flow of govt borrowings from banks stood at Rs197bn in 2009 to date. Due to mismatch of deposit and advances in 1HFY09, the overall growth was slightly lower at 34%. Given stability in deposits and no major pick up in advances, we could see investments consolidating at current levels in 2009.

Outlook: Provisions to mar earnings in 2009

Asset quality concerns and protracted economic slowdown continue to remain major challenges to the banking sector performance as reflected by Rs35bn increase in NPL's during 1Q2009 which has propelled the Net NPL ratio to 3.8% from 1.3% a year earlier. Resultantly profits have declined sharply down 21% in 2008 and 24% in 1Q2009.

Moreover, contraction in spreads & NIM and lower credit offtake is expected to squeeze Net Interest Income (NII). Resultantly profits are expected to fall by 5% in 2009. In light of these challenges, we maintain a 'Market-Weight' stance on the sector with deposits and advances growth forecast of 8% and 6% respectively in 2009. Amongst the major scrips, we

reiterate our liking for MCB and NBP at current levels.

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Also in focus**NIT to announce annual dividend today**

Pakistan's largest state owned mutual fund National Investment Trust (NIT), is expected to announce FY09 earnings and dividend in its board meeting today. We expect the company to declare a dividend of Rs2-Rs2.5 per unit with the results. NBP, BOP and FABL will be amongst the major beneficiaries from the dividend announcement as they hold sizeable units of the fund.

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