

June 10, 2009

**Pakistan Market****MORNING BRIEFING****Banks: Advances & deposits trend during 5M2009**

KSE100 Index: Closing 7086.78 ↑ (+194.78)

The protracted economic slowdown, high interest rates & increase asset quality concerns remained major reasons behind lack luster 1% growth in credit offtake in first five months (Jan-May) 2009. In contrast, amid improving money supply situation particularly Net Foreign Assets (NFA), deposit growth arrived at the respectable 6%. Moreover, with deposit growth outpacing credit offtake performance, banks decided to park excess liquidity in investments portfolio particularly T-bills as reflected by 32% growth in Investments.

**Deposit up 6% as NFA rises by 4%**

According to latest statistics released by SBP, total customer deposits of the banking industry have reached Rs4.0tn (US\$49.8bn) as of May 30, 2009, depicting a growth of 6% from Rs3.8tn (US\$48.2bn) at the end of Dec 2008.

After witnessing lackluster performance in the first 4 months of the year, deposits have picked in May 2009 posting a MoM growth of 3%, driven primarily by improved money supply situation, particularly Net Foreign Assets (NFA). M2 expanded by 3.6% in May 2009, while NFA grew by 2%. Moreover, a 70bps-140bps fall in NSS rates was another contributing factor towards stability in deposits.

The 6% deposit growth for (Jan-May) 2009 is line with past trends however it is marginally higher than the 4% growth witnessed in the corresponding period last year.

**Gross advances up 1%, provisions jump 15%**

In contrast to deposit performance, the gross advances of scheduled banks grew by a paltry 1% to Rs3.2tn (US\$39.1bn) as of May 30, 2009, however after adjusting these advances against provisions of Rs244bn, net advances of the industry remained flat at Rs2.9tn (US\$36.1bn). Going forward, despite sharp fall in lending rates (6-month KIBOR down 205bps in 2009), slowdown in economic growth particularly 7.7% contraction in LSM during (Jul-Mar) FY09 is likely to keep credit offtake under pressure.

Moreover, provisions for Non Performing Loans (NPLs) continue to pose a major risk to earnings rising by Rs32.1bn or 15% in 2009. This rising trend follows a record increase of Rs97bn and Rs52bn respectively in NPLs and provisions during 2008.

**Investments surge by 32% in (Jan-May) 2009**

On the back of declining interest rate expectations and higher risk of NPLs, banks preferred investing in government securities as investments surged by 32% to Rs1.3tn (US\$15.9bn) as of end May 2009. This is also reflective in the M2 statistics, as net flow of govt borrowings from banks stood at Rs172bn in 2009 to date. Given stability in deposits and no major pick up in advances, we could see investments consolidating at current levels in 2009.

**Outlook: NPL concerns to keep earnings depressed**

The banking sector continues to remain under distress due a combination of economic slowdown & increasing asset quality concerns, which has forced banks to book heavy provisions for NPLs as well as impairment loss on equity investments. This is 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.

Moreover, contraction in spreads & NIM and lower credit offtake is expected to keep Net Interest Income (NII) under pressure. Resultantly, we expect profits to decline by 5% in 2009. We therefore maintain a 'Market-Weight' stance on the sector with deposits and advance growth forecast of 8% and 6% respectively in 2009. Amongst the major scrips, post recent correction in the share price, we reiterate our liking for MCB and NBP at current levels.

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**Also in focus****Subsidy package likely for Textile industry**

In order to help the ailing textile industry, the government is set to announce a substantial package of subsidies for the sector in the upcoming budget 2009-10. The proposed package is likely to be between Rs20-30bn, which is an addition to the already approved Rs40bn package, for the industrial sector, by the Prime Minister. According to the reports, the proposed package also includes revised rates of duty drawbacks and concessions in the mark up rates. We believe, this new package can somewhat help the industry to cut its costs and resultantly be more competitive in the international market.

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