Day Break

Wednesday, 02 August 2017

SECTOR UPDATE

Exhibit: Fresh WADR and Fresh WALR over the year

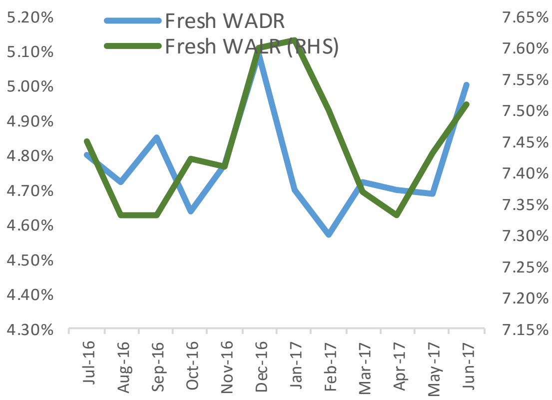


Exhibit: Rising deposit growth

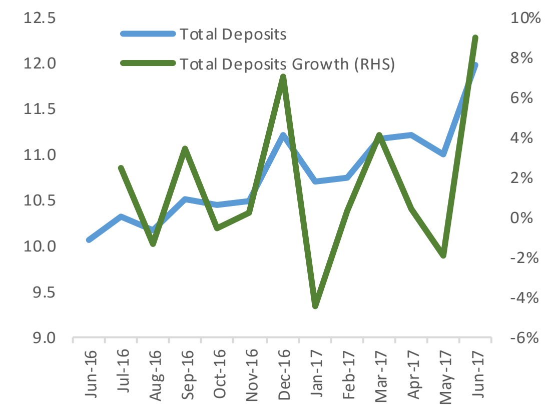
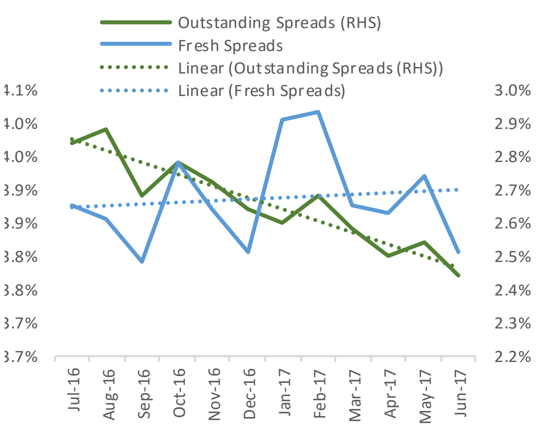


Exhibit: Trend in fresh and outstanding spreads



Source: SBP, Bloomberg, KSE 100 & IGI Research

Syed Daniyal Adil
Research Analyst
daniyal.adil@igi.com.pk
Tel: (+92-21) 111-234-234 Ext.: 973

Commercial Banks

Banking spreads continue to descend, with fresh spread printing +2.51%

- Fresh spreads recorded a nine-month low figure of +2.51% while outstanding spreads fell to +3.77%; more than a decade low.
- The primary reason for decline in fresh spreads is the 31bps rise in fresh WADR (+5.00%) while decline in fresh WALR (+7.51%) by 8bps further compressed the spreads to a decade low level.
- The general trend over the year indicates steadily rising fresh spreads which reflect the market sentiment of an interest rate hike sooner rather than later.
- We believe that banking NIMs will remain under pressure with the expanding balance sheet size counteracting this pressure on NIMs.

Outstanding spreads at a decade low level

Recently published data by the State Bank of Pakistan (SBP) on banking spreads shows a sharp deterioration of spreads, as fresh spreads fell by 66bps on an annual basis with a 23bps fall from last month, while outstanding spreads declined by 32bps YoY and 5bps on a MoM basis. Consequently, fresh spreads recorded a nine-month low figure of +2.51% while outstanding spreads fell to +3.77%; more than a decade low.

WADR leading the decline in spreads

The primary reason for decline in fresh spreads is the 31bps MoM rise in fresh WADR (+5.00%) while decline in fresh WALR (+7.51%) by 8bps MoM further compressed the spreads to a decade low level. With +19.1%YoY (or +9%MoM) growth in deposits to PKR ~12tn, the cost of deposit has gone up due to the nature of these incremental deposits. Since CASA is already close to a decade high level, to increase the deposit size banks are being made to explore other costlier options to gain market share and to increase their balance sheet size. Last month, ADR reached +54%, but with seasonal increase in deposits the figure for ADR has come back down to +52%. Yet it must be highlighted that the advances have grown by +4.1%MoM, which will elevate some pressure on banking NIMs.

Coopetition the main culprit in compressing spreads

The falling spreads indicate growing competition in the industry. Fresh spreads have declined much faster than outstanding spreads. This was primarily led by steep rise in fresh deposit rates over the month. However, the general trend over the year indicates steadily rising fresh spreads which reflect the market sentiment of an interest rate hike sooner rather than later. This supposition is also supported by lack of bank participation in bond auctions with major focus of investments in treasury bills to safeguard against an interest rate hike in the near future.

Outstanding spreads continue the declining trend

Outstanding spreads declined by 5bps MoM primarily due to outstanding WADR rising faster compared to falling WALR. The falling outstanding spread is a result of persistently low interest rate, wherein, organic growth by the banks require expansion of balance sheet using expensive liabilities (non-CASA deposits) and relatively low yielding assets (advances). Notable is the impact of this fall in spreads on banking profitability. Given that the core earnings of the bank depends on the spread it earns on its interest bearing assets and liabilities, a fall in these spreads is indicative of struggling future profitability from core earnings. Therefore, we believe that banking NIMs will remain under pressure with the expanding balance sheet size counteracting this pressure on NIMs.

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IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009

Contact Details

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Tanweer Kabeer	Research/Fund Select	Tel: (+92-21) 111-234-234 Ext: 966	tanweer.kabeer@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Ejaz Rana	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	ejaz.rana@igi.com.pk
Gul Hussain	Branch Manager (Faisalabad)	Tel: (+92-41) 2540843-45	gul.hussain@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 719, 7th Floor, PSX Building, Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 , Fax: (+92-21) 32429607

Lahore Office
5-F.C.C. Ground Floor, Syed Maratib Ali Road,
Gulberg II, Lahore
Tel: (+92-42) 35777863-70, 35876075-76
Fax: (+92-42) 35763542

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area, Islamabad
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Faisalabad Office
Room #: 515-516, 5th Floor, State Life
Building, 2- Liaqat Road, Faisalabad
Tel: (+92-41) 2540843-45
Fax: (+92-41) 2540815

Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road, Rahim Yar Khan
Tel: (+92-68) 5871653-6, 5871652
Fax: (+92-68) 5871651

Multan Office
Mezzanine Floor, Abdali Tower,
Abdali Road, Multan
Phone: (92-992) 408243 - 44

Abbottabad Office
Ground Floor, Al Fatah Shoppinig Center , Opp. Rad
Station, Mansehra Road, Abbottabad
Phone: (+92-99) 2408243 - 44

Peshawar Office
2nd Floor, The Mall Tower,
35 The Mall Peshawar Cantt.
Phone: (92-91) 5253035, 5278448