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Banking sector MPR for H1CY19, Global slowdown may hit exports, advances: SBP

KARACHI: The State Bank of Pakistan (SBP) has said that the projected slowdown in global economic activity, particularly in the US and Euro area is likely to affect exports and the demand for bank advances.

The SBP has issued the Mid-Year Performance Review (MPR) of the Banking Sector for the Calendar Year 2019 (H1CY19) Monday. The review comprehensively covers the performance and soundness of the banking sector.

The report said that despite challenging macroeconomic environment, banking sector maintained its growth trajectory during the first half of CY19 (H1CY19) largely, backed by decent growth in deposits. “The banking sector remained sound and stable during HICY19. Although some dimensions witnessed moderation, the overall risk profile of the banking sector remained satisfactory H1CY19”, the report said.

Asset quality saw some deterioration, with increased volume and share of non-performing loans, particularly in agriculture and energy sectors. While investments observed a marginal rise, banks renewed their interest in PIBs due to favorable interest rate dynamics.

The asset base of the banking sector expanded by 5.3 percent during H1CY19 compared to growth of 4.7 percent in H1CY18. This growth largely came on the back of rise in deposits, a portion of which was mobilized in June 2019, leaving banks with little time to deploy the funds in higher yielding earning assets. Besides seasonal factors, rise in minimum saving rate and inflows related to amnesty scheme increased the flow of deposits, the MPR mentioned.

Among the advances, flow of private sector advances observed a broad-based slowdown owing to subdued economic activity and continued monetary tightening, while flow of public sector advances declined due to lower utilization of commodity financing and retirement of energy sector advances.

Advances (net) decelerated to 1.9 percent in H1CY19 compared to a growth of 12.3 percent in H1CY18, investments saw a slight increase of 0.7 percent in H1CY19 against contraction of 3.6 percent, during H1CY18. On the funding side, deposits accelerated to 6.8 percent during the reviewed period (YoY: 10.7 percent) as compared to 5.7 percent in H1CY18 (YoY: 9.4 percent).

In addition to increase in deposits, the meager rise in advances and the shift in government borrowing from scheduled banks to central bank reduced the banks need for borrowings. Resultantly, banks borrowings declined by 12.7 percent and the advances to deposit ratio dipped to 53.2 percent in June 2019 from 55.8 percent in December 2018.

The report said that the overall risk profile of the banking sector remained satisfactory. The earnings of the banking sector improved owing to increase in Net Interest Income (NII), which improved all the profitability indicators.

The resilience of the banking sector remained robust as the Capital Adequacy Ratio (CAR) at 16.1 percent was well above the local and international minimum benchmarks of 11.9 percent and 10.5 percent, respectively. With the approaching deadline, banks need to ensure effective implementation of their plans for meeting the enhanced capital requirement of 12.5 percent by end December, 2019.

While, discussing the outlook of banking sector for Second half of CY19, SBP is expecting slow economic activity. While macro stabilization measures have started to show favorable results, particularly on external front, the economic activity is expected to remain muted and accordingly, the private sector financing demand is likely to remain subdued during H2CY19, SBP said.

“Moreover, projected slowdown in global economic activity particularly in the US and Euro area is likely to influence exports and the demand for advances. In addition, owing to perceived weakening in re-payment capacity of firms and recent pick-up in the NPLs, banks may remain risk averse in their lending behavior,” the report said.

The government’s commitment to cease its borrowing from SBP is expected to increase government reliance on banks for meeting its financing needs, which will further increase the banks’ exposure to the public sector. Particularly, banks overall investments in government securities are expected to rise, though the maturity choice will largely hinge upon their views about the interest rate movements.

According to MPR, the expected increase in investments will enhance the funding requirements of banks. While deposits will remain the key source of funding, some uptake in borrowings could also happen. The rise in Minimum Savings Rate (MSR) is likely to induce depositors to opt for more savings and fixed deposits, while banks may face challenges in mobilizing low cost deposits.

The earnings of the banking sector are likely to remain decent in the half year ahead, due to higher interest earning and expected pick-up in banks’ investment in government securities. However, increase in credit risk due to deterioration in asset quality, in the face of tighter macro financial conditions, may put earnings under some stress.