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Flows of private sector advances: Rising credit risk, other factors behind massive contraction: SBP

KARACHI: The rising credit risk followed by a tight monetary policy and lower aggregate demand has resulted in massive contraction in the flows of private sector advances.

According to State Bank of Pakistan (SBP), the sector-wise flow of advances during first half (Jan-June) of this calendar year (H1CY19) indicated a broad based reduction. The private sector advances flows were some Rs 128.2 billion in H1CY19 compared to Rs 468 billion in the same period of last fiscal year (H1CY18).

Current slowdown in private sector advances resulted from increased risk aversion by banks, besides the seasonality. In addition, the softening of aggregate demand in turn reflected in a dip in growth of private sector advances, SBP said in its Mid-Year Performance Review of the Banking Sector.

The report said that continued tightening of macro financial conditions and another 225 basis points (bps) rise in policy rate in H1CY19 along with the regulatory measures relating to import duties taken during FY19 eventually impacted the production activity as there was broad-based decline in Large Scale Manufacturing (LSM) Index, which fell 3.6 percent during FY19 compared to 6.4 percent expansion in FY18.

On the supply side, banks became risk averse as they anticipated rise in defaults in the private sector due to hike in interest rates as well as a slowdown in economic activity. Simultaneously, the increased return on risk-free securities including T-bills and PIBs, due to monetary tightening, made investment in such securities attractive for the banks in second half of this year. In this backdrop, the shift in demand for and supply of advances reinforced the slowdown.

The sector-wise flow of advances during H1CY19 shows that significant retirement of Rs 86.6 billion was made by the textiles vs. Rs 6.5 billion in first half of last year. The retirement is more than their usual seasonal trend and SBP expects that it may be supported by the improved export revenues in Pak Rupee terms owing to currency depreciation, which enabled the sector to retire its borrowings.

Despite deceleration in growth, with some 33 percent share the sugar sector was remained a major contributor to the total private sector advances flow. However, the borrowed amount of Rs 42.2 billion in H1CY19 was less than Rs 76.8 billion in H1CY18). Relatively lower disbursements in the sugar sector could be due to a substantial decline in sugarcane production as well as improved cash flow of sugar mills on the back of higher domestic sugar prices during the reviewed period.

The energy sector also availed lesser advances possibly because of completion of some projects related to the CPEC and delay in commencement of new wind energy projects. Energy sector credit was Rs 38.3 billion in H1CY19 down from Rs 62.1 billion in H1CY18.

The substantial fall in advances uptake in “others” category was related to ‘food products and beverages’, which advances were Rs 43.4 billion in H1CY19 vs. Rs 139.5 billion in H1CY18, ‘basic metals’ Rs 8.4 billion in H1CY19 vs. Rs 25.1 billion in H1CY18, and ‘commerce and trade’ Rs 11.7 billion in H1CY19 vs. Rs 23.7 billion in H1CY18.

In terms of segments, the slowdown in corporate advances was, primarily, driven by working capital loans and trade finance. In the past few quarters, despite receding demand, the increased input costs drove up flow of working capital advances in the private sector.

However, with deepening slack in the economy, notable deceleration in working capital advances was observed despite prevailing cost pressures. Similarly, the drop in trade financing manifested the impact of exchange rate dynamics that resulted in decline in imports, SBP mentioned.

Fixed investment advances flow also weakened due to decline in PSDP spending, completion of projects under CPEC and prevalent uncertainty among the market participants about the future economic direction.