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Banks are making huge interest income

BANKS did well in the first quarter of 2020. And chances are their performance during the second quarter will also be OK — thanks to their aggressive investment in government debt papers and modest growth in private-sector lending.

Relaxed rules for the treatment of bad loans and provisioning against them in the wake of Covid-19 may help banks in the second quarter. But a possible increase in the loan infection ratio of most borrowers hit by the lockdowns and recession may keep credit demand of companies and consumers low. That will likely result in limited lending to the private sector and will minimise banks' interest income from this source.

Net interest income of 17 out of 20 listed banks recorded a healthy 18 per cent year-on-year growth in Jan-March, according to a Topline Securities report. Non-interest income also grew 14pc. The increase in net interest income is obviously attributable to the banks' heavy investment initially in short-term treasury bills and then in long-term Pakistan Investment Bonds (PIBs).

This investment — or government borrowing from banks — is continuing through the second quarter. Besides, private-sector lending has also picked up pace, but overall credit demand is still low. So the banks' interest income is sure to remain better in April-June, but only to a limited extent. How well their non-interest income will grow cannot be predicted at this stage.

Non-interest income earned through banking services rendered to small businesses and individuals can or cannot show a rising trend in the April-June quarter

On the one hand, some project financing related to the ongoing China-Pakistan Economic Corridor (CPEC) continues, keeping the avenues of non-interest income open in the shape of investment consultancy fee. On the other, non-interest income earned through banking services rendered to small businesses and individuals can or cannot show a rising trend in the April-June quarter.

Small businesses and individuals have been hit hard by economic recession during this fiscal year and a sharp decline in economic growth in the last year. So, banking services they used to avail like investment and project consultancy or money transfers via bank vouchers or keeping valuables in bank lockers may have taken a hit. However, transfers of cash to millions of poor people by federal and provincial governments amid Covid-19 emergency may have increased banks' non-interest income. That's why it is difficult to predict net growth in banks' overall non-interest income during April-June.

In January-March, growth in net interest income of banks was affected by an increase in provisioning against bad loans as well against the diminishing value of long-term investment that began with the anticipation of interest rate cuts. The provisioning of bad loans has now been relaxed by the State Bank of Pakistan (SBP). But as the value of interest income on long-term investment of banks fell further during this quarter, it again can affect volumes of non-interest income for the ongoing quarter.

In the last two months, between mid-March and mid-May, the SBP has cut its policy rate by 525 basis points to 8pc to support people and businesses hit by Covid-19 and to help the economy fight recession. That has made it possible for the government to borrow excessively from banks to finance the fiscal deficit. Up to May 8, the federal government alone had borrowed Rs1.86 trillion from banks. But private-sector borrowing is still lower than that in last year — Rs298bn against Rs563bn. Between May 9 and May 30, government borrowing is expected to grow more as the government's fiscal woes are deepening.

Private-sector borrowing cannot increase dramatically though businesses would love to retire old high-priced loans and replace them with cheaper ones. The reason is banks are least interested in it. Influential borrowers would, however, get the deal and that, coupled with the banks' ongoing lending in the wake of Covid-19 to priority sectors, may inflate private-sector borrowing by the end of June.

Previously, banks used to make sizable interest income on transactions in interbank foreign exchange market, taking advantage of volatility and oft-occurring foreign exchange shortages. But foreign exchange rates are stable for the time being and though clouds of uncertainty are gathering over the external sector's health, the foreign exchange market is not too dry. A similar situation prevailed in the Jan-March quarter. So not much of the banks' interest income came from this source during the past quarter and not much is expected to come during this quarter.

The positioning of banks in terms of size, deposit base and vastness of branch networks matters a lot in the earning of interest income. That we saw in operation during the last quarter and that can hardly change during this quarter. Five major banks — Habib Bank, United Bank, MCB Bank, National Bank and Meezan Bank — reported the largest volumes of net interest incomes in the same order. United Bank, MCB Bank and Meezan Bank managed to contain their net interest expenses to net interest income ratio, which is a commendable thing.

According to Topline Securities, after-tax profit of 17 out of 20 listed banks grew 23pc year-on-year to Rs48.2bn in the Jan-March quarter. But this growth rate is sure to slip during this quarter chiefly because it turned out to be this much high due to some tax-adjustments. Otherwise, pre-tax profit of Rs81.3bn in Jan-March was just 1pc higher on a year-on-year basis. Given the buoyancy being seen in banking activities in April-June, one can expect the industry would remain profitable during this quarter too.