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State Bank sees lending flows subdued amid pandemic uncertainties

KARACHI: The State Bank of Pakistan (SBP) on Wednesday said banks' risk-averse behaviour may keep lending flows subdued as the pandemic-related uncertainties will take time to subside.

The SBP said government securities may remain a preferable alternative.

"While financial conditions in the form of interest rates and asset prices remain supportive, the recent uptrend in virus infections presents a challenging scenario," the SBP said in the mid-year performance review of the banking sector for 2020. "Globally the situation also remains uncertain, especially in key trading economies such as the United States, Euro Area, and the Middle East."

The State Bank said the outlook for the private sector advances presents a mixed picture.

The large scale manufacturing index has increased 3.66 percent year-on-year during July-August. Further, seasonal uptick during H2CY20 may stimulate demand.

"However, the downside risks remain due to the possibility of another wave of the disease that may trigger re-imposition of strict lockdowns," said the SBP. "Similarly, looming uncertainty about the timing of recovery in the foreign markets could subdue demand from export oriented sectors such as textiles."

The SBP said the re-payment capacity of the borrowers could weaken that may lead to further rise in non-performing loans (NPLs). Banks' investments are likely to remain strong during the second half of CY20.

"Profitability of the banking sector may come under stress in the next half of the year, mainly, from prevailing low interest rate environment," said the SBP. "However, revaluation gains on government securities, if realized, may offset the impact to a certain extent and the rise in zero risk weighted government securities will likely strengthen capital adequacy ratio of the banking sector."

The SBP said banking sector's performance and resilience remained satisfactory during H1CY20.

"Despite elevated economic stress driven by the COVID-19 pandemic—the assets of the banking sector witnessed a decent expansion of 7.8 percent during H1CY20," said the SBP. "Robust increase in investments, funded by surge in deposits, explains this growth. Advances, on the contrary, observed mild downtick owing to the economic slackness caused by the disruption in the business activities after the outbreak."

The State Bank said the banking sector, both conventional and Islamic, managed to grow by focusing mostly on risk-free earning assets. The asset base expanded 7.8 percent during H1CY20 (5.3 percent in H1CY19) due to acceleration in investments by 22.8 percent. The net advances, however, contracted by 2.2 percent. The strong inflow of deposits – a surge of 9.8 percent against 6.8 percent last year – provided the necessary funding support.

Without SBP supportive measures, the contraction in advances could have been much higher, it said.

The SBP said policy measures facilitated the banking sector in conserving the capital, enhancing the lending capacity and increasing the loss absorption ability. As a result, despite some increase in credit risk, banking sector demonstrated improved profitability and enhanced resilience. The NPLs ratio increased from 8.6 percent as of December-end to 9.7 percent as of June-end. However, net NPLs to loans ratio, which is a better measure of credit risk, increased only marginally from 1.7 percent to 1.9 percent. The earnings marked visible improvement as profitability jumped 52 percent year-on-year.

“This improvement resulted from higher interest income, deceleration in interest expenses and rise in non-interest income. With better profitability, the soundness of the banking sector further strengthened as capital adequacy ratio increased to 18.7 percent in June from 17 percent in December,” it said.