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Bank margins continue to improve

KARACHI: Banking spread - the difference between interest rate that banks take from borrowers and the rate that banks pay to depositors - improved for the second consecutive month in October 2020, meaning banks' profit margins have gone up.

The spread stands as a major component in banks' net profit or loss. It has widened as demand for credit picked up with the recovery in economic activities in the middle of Covid-19.

On the other hand, the rates on deposits have continued to fall due to increase in current accounts (maintained by businesses that are not entitled to profit on deposits) as well as maturity of expensive term deposits.

"Interestingly, yields on fresh loans are up 18 basis points month-on-month, increasing for the second consecutive month, reflecting an uptick in Kibor (Karachi Interbank Offered Rate) and economic recovery as credit demand gains pace," said Taurus Securities Head of Research Mustafa Mustansir.

"However, the rates on fresh deposits continue to go down." The provisional banking sector spread on outstanding loans and deposits edged up to 4.65% for October 2020, he said while citing the central bank's update.

"Lending yields were down 434 basis points since December 2019 levels, compared to 292-basis-point fall in deposit rates."

In the current calendar year to date (Jan-Oct), the average spread on outstanding loans was recorded at 5.19%, down 63 basis points from the average of 5.82% in 2019. Similarly, average spread on fresh loans stood at 5.11% since January 2020, he said.

Outstanding loans of banks to the private sector slightly increased to Rs8.11 trillion in October 2020 compared to Rs8.09 trillion in October 2019, according to the central bank.

On the other hand, deposits at banks grew a staggering 20% to Rs16.66 trillion in October compared to Rs13.91 trillion in the same month of last year. The outlook for private sector advances showed a mixed picture.

The largescale manufacturing (LSM) index increased 3.66% year-on-year during JulAug 2020. Furthermore, a seasonal uptick during second half may stimulate demand.

"However, downside risks remain due to the possibility of another wave of the disease that may trigger reimposition of strict lockdowns," the central bank said the other day.

"Similarly, looming uncertainty about the timing of recovery in foreign markets could subdue demand from export-oriented sectors such as textiles."

Profitability of the banking sector may come under stress in the next half of the current fiscal year, mainly from the prevailing low interest rate environment.

However, revaluation gains on government securities, if realised, 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.

Banking spread mostly moves up or down with the change in benchmark interest rate. The central bank has cut the benchmark rate by 625 basis points during Mar-Jun 2020 to 7% in a bid to revive economic activities and help businesses and individuals avert default on bank loans.

Since the beginning of the year to date, the average industry credit spread (spread of lending yields over investment yield on government debt securities) stood at 1.30% on outstanding loans.

On the other hand, the average industry lending spread (spread of lending yields over Kibor) on outstanding loans increased to 0.94%, Mustansir said.

The lagged effect of the significant fiscal, monetary and credit stimulus injected during the pandemic should continue to shore up growth in coming quarters, the SBP said.

To recall, the government announced Rs1.2 trillion for businesses and households during Covid-19 to help the business and people cope with the pandemic.

In addition to this, the central bank has taken measures to inject financing amounting to Rs1.58 trillion through different packages, including rescheduling and deferment of loans till December 2020, cheap loans for salary payments by businesses, setting up new businesses and self-employment.

The government's relief package and central bank measures together helped the economy to pick up and helped businesses to make higher demand for credit.

"The domestic (economic) recovery has gradually gained traction in line with expectations for growth of slightly above 2% in the ongoing fiscal year 2021 and business sentiment has improved further," the SBP said.