PAKISTAN ECONOMY

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MARKET VISTA

SBP increases CRR to 6%

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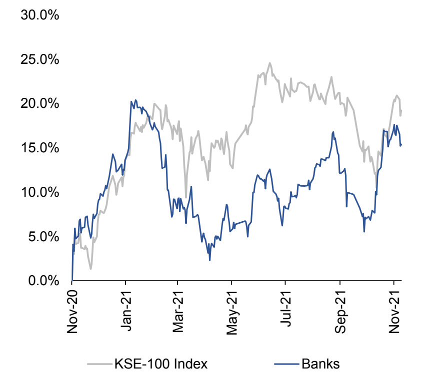
- **In a move that will clip the lending capacity of the banks and contain aggregate money supply growth, SBP raises statutory Cash Reserve Ratio by 100bps to 6%.**
- **The most recent regulatory measure maybe seen as a continuation of earlier move where SBP increased the requirements for auto-financing in order to curb consumer demand and bring the growth to more sustainable levels.**
- **With more money tied up to meet the new statutory requirements, the lending capacities of the bank will be reigned in slightly, however, this will have a minimal impact on banks where we anticipate the earnings to trim by 1% - 2%.**
- **With more interest rate hikes on cards, we expect the profitability of the banks to remain on solid footings. NIMs are expected to pick up as the assets get repriced at higher rates while the robust asset quality and coverage ratio will protect an downside in earnings.**
- **Having underperformed the broader index by 5.2%CYTD, the banks are likely going to outperform in the coming months as interest rate reversal cycles gains intensity. We highlight MCB, UBL and MEBL as potential outperformers.**

Universe Banking Sector vs. KSE100 Index



Source: PSX & AKD Research

SBP introducing yet another tool to contain demand side pressures: Targeting to moderate demand side pressures other than through interest rate hikes, the Central Bank in a latest move increased Cash Reserve Requirements (CRR) to 6% from 5% previously. The step is a continuation of SBP exacting conditions for auto financing which had grown to an all time high level of PkR338bn as of September, reflective of ensuing demand side pressures. To recall, CRR has been kept stable at 5% since 2008, during which time it was increased to as high as 9% to slowdown money supply growth (FY08: 10.9% vs. FY07: 16.3%). Pakistan's money supply growth since COVID has surpassed historical annual growth rate of 12.0% (since Mar'20, avg. growth in money supply relative to previous year stands at 16.7%) attributable to cash concessions provided during the pandemic and rolling out incentives to stimulate growth. Assuming 91.5% of deposits being available for CRR deduction, the increase in CRR would reduce deposits available for earning assets by PkR181.4bn (or ~0.9% of deposits) with an even larger second round impact.

Minimal earnings impact however, door is open for other policy measures which have a larger impact on earnings: The increase in CRR is likely to have minimum earnings impact in the range of 2-3% across our banking universe, maintaining Status Quo on other variables. We continue to see interest rate expectations driving up asset yields in the near term (3M TBILL yields are +125bps since last monetary policy) with contraction in liquidity seemingly having little impact as accessed through participation rate of 2.1x in the past six TBILL auctions. Potential realignment of injections through OMO to further the objective of the Central Bank cannot be ruled out whereas at present, banks seems to be capitalizing on a spread of ~1% on investment in 3M TBILLs, which could also have a negative earnings implications. However, in a broader perspective where the Central Bank is looking to resume its pre-COVID policy-setting framework, an increase in Capital Conservation Buffer (CBB) to its original position of 2.5% from existing 1.5% cannot be rule out and would have a much larger implications for banks. As a result, we may see these banks continuing with their current dividend policy particularly where IFRS-9 is also expected to be applicable from CY22 onwards.

Investment perspective: The banking sector has underperformed the market by –5.2% CYTD however, given interest rate hikes materializing in the near future and a general shift to value stocks as the Govt. apply brakes on Pakistan's growth story could result in the sector's valuations (CY22F P/B: 0.7x) catching up. We continue to have preference for larger plays as in HBL, UBL, and MCB while we also like MEBL on strong earnings growth prospects. However, unsystematic risks should keep performance in check in the immediate run with key events being, MSCI-related rebalancing, and uncertainty on IMF front.

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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