Pakistan Banking Sector

State Bank raises CRR requirement by 1% to 6%

Monday, November 15, 2021

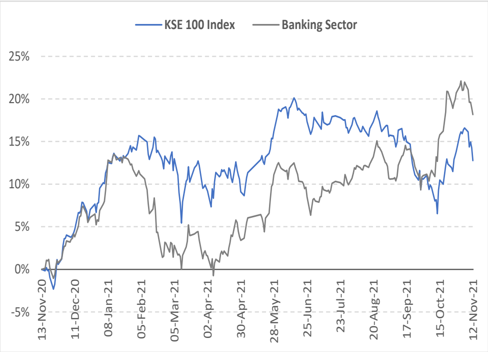
In a recent announcement, the State Bank of Pakistan has increased minimum Capital Reserve Requirement (CRR) to be maintained by banks over two weeks by 1% to 6%. Similarly, daily CRR has been scaled up by 1% to 4%. The fortnightly requirement change came into effect from Nov 12th, 2021 while the daily CRR maintenance requirement will be effective from today, Nov 15th, 2021. As per SBP, the move comes as a measure to streamline policy action including monetary aggregates like M2 which have undergone healthy increases aided by strong economic recovery. The primary aim, as highlighted by SBP is to assist economic growth, maintain medium term inflation in the range of 5-7% and ease off pressure on the weakening PKR. We opine this move will address concerns with regards to a major rate hike in the near term. We expect a 75 bps rate hike in the upcoming monetary policy meeting while our CY22 end target is 9.5%. Assuming ceteris paribus, earnings of BMA Banking universe are expected to be negatively impacted by 2-3.5% given an outflow of ~PKR 174Bn (1% of total demand and time liabilities of ~PKR 17.4Trn as at Sep'21) however, as NIMs have largely bottomed out, rate hikes from hereon will likely mitigate any impact from this end, in our view.

What is CRR and how is it calculated? Cash Reserve Requirement (CRR) is the balance that scheduled banks maintain in current accounts (thus generating no returns) with the SBP. The calculation is based on the total of demand liabilities and time deposits with a tenor of less than 12 months.

What implications will it have on the banking sector? Increase in CRR will reduce available liquidity for banks which could otherwise have been used to scale up the loan book or invested in federal government securities thus we can expect a slight contraction in core revenues. On the flip side, while banks are consistently striving for low cost deposits and improving their CASA ratios, we do not opine that banks will go out and add higher costs deposits just to gage the additional reservation requirement. If that turns out not to be the case, then we can expect interest expense to increase and hence a slight reduction in NIMs. Moreover, to counter any negative earnings impact, banks will likely seek to add up deposits of longer tenors where the CRR is not applicable. Just to recall, banks are already penalized with an additional tax charge of 2.5% and 5.0% on income from debt securities if ADR falls below 50% and 40% respectively. That said, given this requirement, the said targets (maintaining ADR over 50%) become a little more stringent for banks to meet.

Our outlook on the banking sector: We maintain our Overweight stance on the banking sector where we opine strong balance sheet expansion and improving NIMs on the back of rising interest rates will keep earnings sturdy going forward. That said, we recommend HBL & MEBL in the large banks space while we maintain a liking for BAFL & BAHL among mid-tier banks.

Banking Sector vs. KSE-100 Index



%	3M	6M	12M
Absolute	5	11	18
Relative	2	10	5

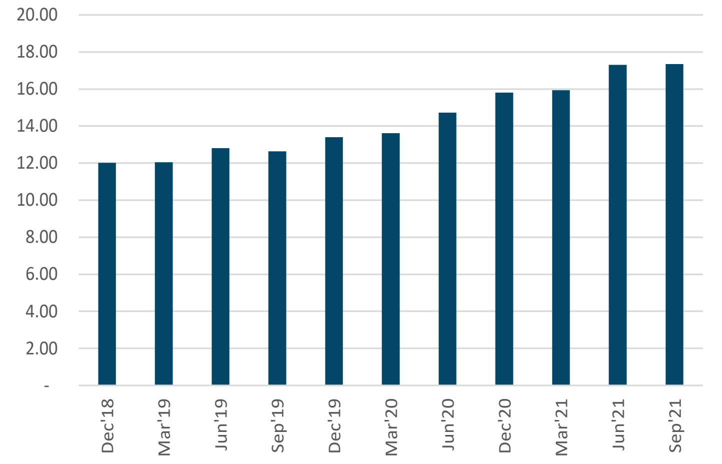
Source: PSX

Abdul Rehman Siddiqui
Senior Research Analyst
Tel: 111-262-111 ext. 2006
E-mail: abdul.rehman@bmacapital.com

BMA Capital Management Ltd.

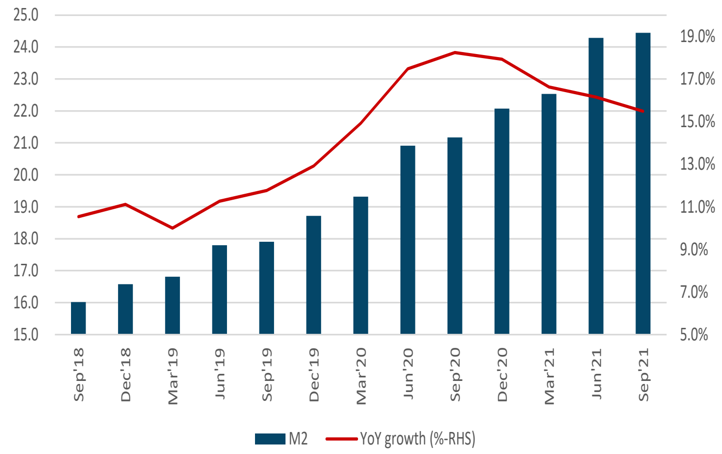
Monetary Aggregates

Chart 1: Demand & Time Liabilities (PKR Trn)



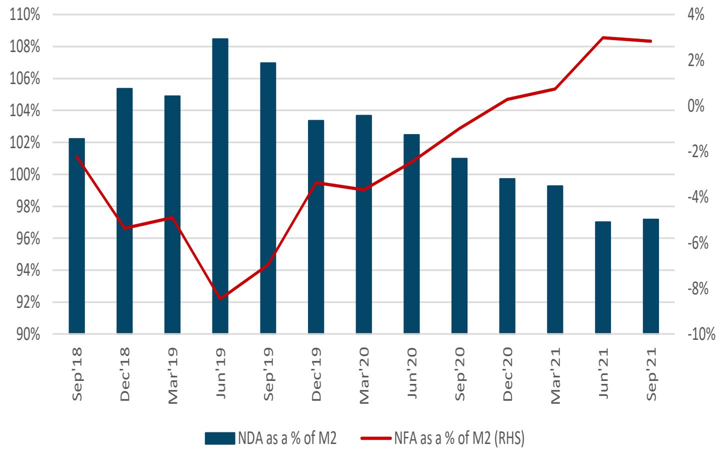
Source: SBP, BMA Research

Chart 2: M2 (PKR Trn) on the way up



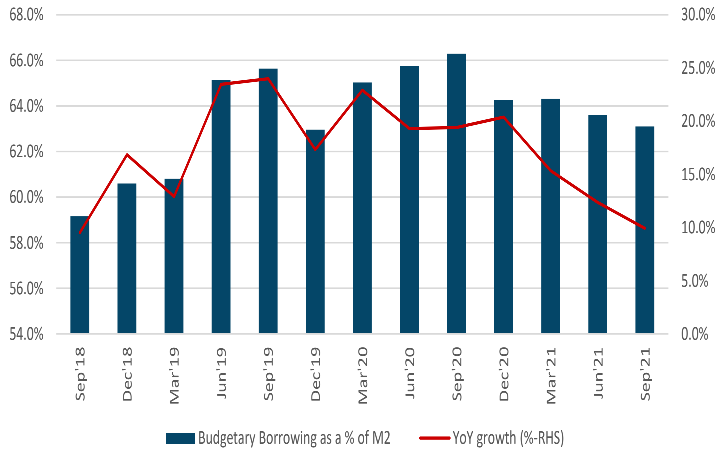
Source: SBP, BMA Research

Chart 3: NDA & NFA as a % of M2



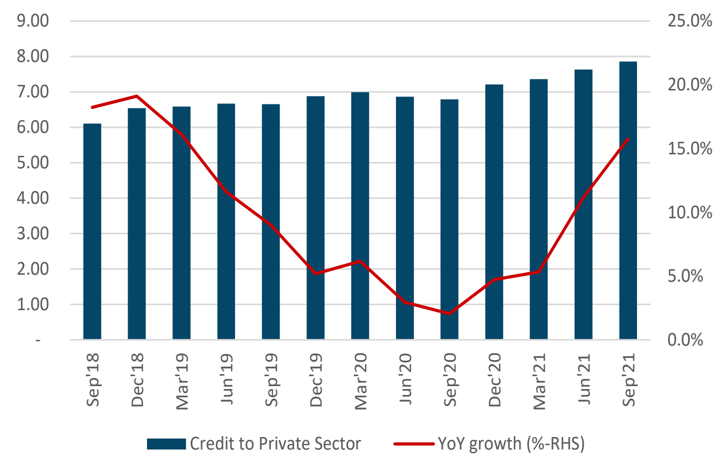
Source: SBP, BMA Research

Chart 4: Budgetary Borrowings



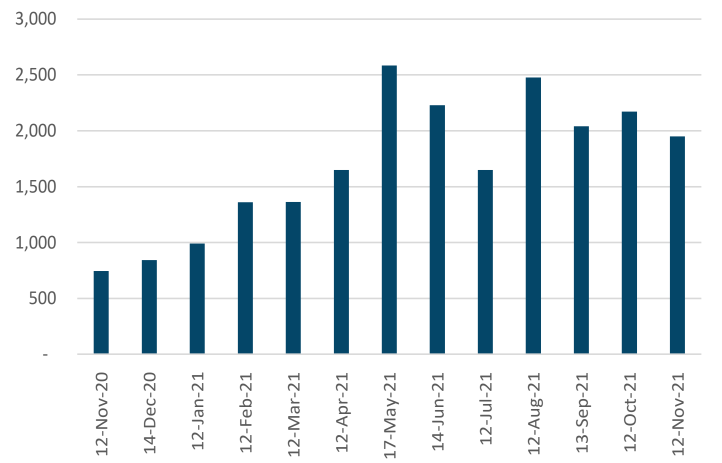
Source: SBP, BMA Research

Chart 5: Private sector credit (PKR Trn)



Source: SBP, BMA Research

Chart 6: Outstanding OMO (PKR Bn)



Source: SBP, BMA Research

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Buy	>15% expected total return
Hold	10%-15% expected total return
Underperform	<10% expected total return
*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
Marketweight	Expected market return
Underweight	Total stock return < expected market return

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)