Standard Capital
Securities (Pvt) Ltd

April 25, 2016
Pakistan Research| Economics

Interest Rate Corridor – Good for Banks Profitability

REP-033

Complete financial liberalization is neither feasible nor possible. This assertion is more valid for developing economies where protection of immeasurable industries is assured through regulations. State Bank of Pakistan (SBP) has also adopted strict regulations for controlling discount rates and for that they have introduced new variables in Interest Rate Corridor during CY15.

SBP introduced target rates (policy rates) for money market overnight repo rates which is addition to SBP reverse repo rates that acts as ceiling rates and SBP repo rates acts as floor rates.

The reason for introducing target rates as new variable is to minimize volatility in interest rates because earlier width of Interest rate corridor was 250 bps.

SBP introduced target rate between SBP repo rate and SBP reverse repo rate and by using liquidity management tools mainly Open Market Operations (OMO's) and sale/purchase of government securities.

SBP aims to keep money market weighted average overnight rate close to SBP target rate by controlling liquidity of money through Open Market Operations (OMO's) and for that SBP increases/decreases frequency of OMO's.

More frequent OMO's has reduced volatility in overnight repo rates which was mostly due to liquidity shock arising from government borrowing and banks accessing for taking benefit of volatility.

Decreasing policy rates and stability in overnight repo rates has caused increase in repurchase agreement for banking sector (as reported in CY15). In CY15 overall borrowing of prominent banks increased by 95% to Rs1.422 trillion as compared to Rs730.8bn in CY14. We expect that banking sector borrowing will increase more rapidly in 1QCY16 as SBP discount rate is around 6% from last two quarters.

In CY15 overall banking sector experienced decreases in reverse repurchase agreement because of declining inflation and SBP discount rate throughout the year.

Lower interest rate has encouraged overall banking sector investments and it increased by 30% in CY15 and reached to Rs.5.972 trillion from Rs.4.6 trillion (CY14).

SBP policy of lowering interest rates has in fact encouraged banks to increase investments which resulted in banking sector profitability.

Borrowing	2014	2015	% change
ABL	66,096	137,960	109%
AKBL	13,742	57,323	317%
BAFL	55,233	172,393	212%
BAHL	78,455	62,592	-20%
FABL	60,927	90,565	49%
HBL	99,631	314,485	216%
HMB	24,884	31,463	26%
JSBL	50,538	54,638	8%
MCB	59,543	118,459	99%
NBP	37,541	21,911	-42%
NIB	62,751	85,677	37%
SCBPL	17,245	21,784	26%
SMBL	25,313	49,756	97%
SNBL	25,825	39,876	54%
UBL	53,065	163,132	207%
Total	730,788	1,422,015	95%

We found that REM (Random effect model) is more suited for our model.

REM regression shows that Capital adequacy is positively related with NIMs. Thus we can say that Increase in borrowing will increase NIMs.

Analyst
Nasir Ali
0092 21 32461427

www.scstrade.com

www.jamapunji.pk

'Research Analyst' Certification: 'Research Analyst' involves in this 'Research Report' certifies that:

- 'Research Analyst' or any of his close relatives do not have a financial interest in the securities of the 'Subject Company' aggregating more than 1% of the value of the 'Subject Company'
- Research Analyst or his close relative has neither served as a director/officer in the past 3 years nor received any compensation from the Subject Company in the previous 12 months
- his compensation will not be related to the recommendations or views given in Research Report

Distribution of 'Research Report'

Standard Capital Securities (Pvt.) Ltd. will distribute Research Report to clients in a timely manner through electronic distribution vide email or through physical distribution such as courier express. Standard Capital will make all efforts; even so it is possible that not all clients may receive Research Report at the same time given technical glitches or breakdown/slowdown of internet during the process of sending emails.

'Research Entity' Disclosures

- Standard Capital Securities (Pvt.) Ltd. or any of its officers and directors does not have a significant financial interest (above 1% of the value of the securities) of the subject company.
- Standard Capital Securities (Pvt.) Ltd. employee including directors, officers or associates has not served the subject company in preceding 36 months.
- Subject Company is not been a client for Standard Capital Securities (Pvt.) Ltd. during the publication of Research Report
- Standard Capital Securities (Pvt.) Ltd. has not managed public offering, take-over or buyback of securities for the Subject Company in the past 12 months neither receives any compensation from the subject company for corporate advisory or underwriting services in the past 12 months.
- Standard Capital Securities (Pvt.) Ltd. may make markets in securities or other financial instruments described in this publication, in securities of issuers described herein or in securities underlying or related to such securities. Standard Capital Securities (Pvt.) Ltd. may have recently underwritten/or in the process of underwriting the securities of an issuer mentioned herein. Standard Capital Securities (Pvt.) Ltd. may also have provided/providing advisory services to the issuer mentioned herein.

Rating System

- Standard Capital Securities (Pvt.) Ltd. standardized recommendation structure i.e. Buy/positive, Hold/neutral and Sell/negative, based on Target, if any or vide various valuation methods.
- For the determination of target price, Analyst shall use Price to earnings, price to book, Discounted cash flows etc as valuation method; buy above 10% target price – sell above target price
- The time duration is the financial reporting period of Subject Company.