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CREDIT OPINION
1 June 2017

Update

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RATINGS

National Bank of Pakistan

Domicile	Pakistan
Long Term Deposit	Caa1
Type	LT Bank Deposits - Fgn Curr

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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National Bank of Pakistan

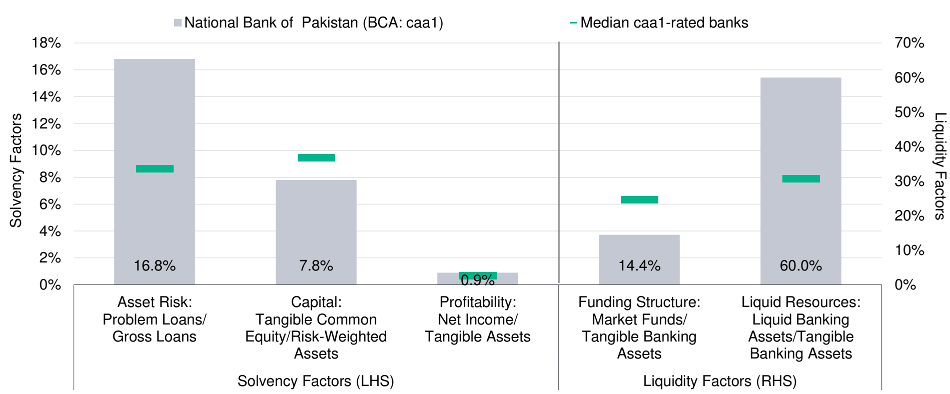
Semiannual Update

Summary Rating Rationale

National Bank of Pakistan's (NBP) B3/Not-Prime global local-currency deposit ratings reflect our assessment of the bank's standalone credit strength, based on a caa1 baseline credit assessment (BCA) and our assessment of a very high likelihood of support from the government of Pakistan (B3 stable). Our assessment for support reflects NBP's systemic importance as the country's second-largest bank, with a 14% market share in deposits and the government's majority ownership (at 76%). The bank's foreign-currency deposit ratings of Caa1/Not-Prime are constrained by Pakistan's relevant country ceiling and reflect foreign-currency transfer and convertibility risks.

NBP maintains a stable deposit-based funding profile, which we consider to be a key credit strength. However, its caa1 BCA also captures: (1) the high level of credit risks, driven by its significant and rising exposure to the Pakistan sovereign through holdings of government securities and government-related loans (at around 10.2x its common equity tier 1 (CET1) capital as of December 2016), which links the bank's creditworthiness to that of the government and an NPL ratio of 16.7% as of March 2017; (2) modest capital buffers in light of these high exposures - with Moody's adjusted 2016 CET1 ratio of 6.4%; and (3) weaker than peers profitability. However, sustained progress on structural reforms on the sovereign side should support lending growth going forward.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit Strengths

» Resilient deposit-funded franchise, benefiting from NBP's position as Pakistan's second-largest bank by assets

» Very high probability of government support in case of need

Credit Challenges

» High levels of credit risk, mainly resulting from NBP's large exposure to B3-rated government securities and government-owned entities, which links its creditworthiness to that of the government

» Modest capital buffers available to absorb losses

» Weaker than peers profitability levels

Rating Outlook

NBP's ratings carry a stable outlook, in line with the stable outlook on the sovereign (and in the context of NBP's significant exposure to the government, equivalent to 37% of assets as of December 2016).

Factors that Could Lead to an Upgrade

» Upward pressure on the bank's rating could arise from an improvement in Pakistan's operating environment and in the sovereign's credit-risk profile, and an improvement in NBP's asset quality metrics.

Factors that Could Lead to a Downgrade

» NBP's rating could come under downward pressure if further asset quality deterioration materially affects the bank's profitability and capitalisation. A weakening in the government's creditworthiness would also have negative rating implications.

Key Indicators

Exhibit 2

NATIONAL BANK OF PAKISTAN (Consolidated Financials) [1]

	3-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (PKR million)	1,941,317	1,981,417	1,711,874	1,549,659	1,372,249	11.3[4]
Total Assets (USD million)	18,519	18,984	16,345	15,416	13,045	11.4[4]
Tangible Common Equity (PKR million)	110,288	121,651	117,986	112,544	103,314	2.0[4]
Tangible Common Equity (USD million)	1,052	1,166	1,126	1,120	982	2.1[4]
Problem Loans / Gross Loans (%)	16.7	15.4	18.5	16.6	16.3	16.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	-	7.8	8.2	7.8	8.3	8.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	56.7	51.0	55.2	56.8	59.2	55.8[5]
Net Interest Margin (%)	2.5	3.0	3.5	3.4	3.1	3.1[5]
PPI / Average RWA (%)	-	2.7	3.4	2.8	2.5	2.9[6]
Net Income / Tangible Assets (%)	0.9	1.2	1.2	1.1	0.4	1.0[5]
Cost / Income Ratio (%)	63.3	52.8	45.5	51.0	53.0	53.2[5]
Market Funds / Tangible Banking Assets (%)	13.2	14.4	13.8	14.3	13.5	13.8[5]
Liquid Banking Assets / Tangible Banking Assets (%)	60.5	60.0	58.6	49.5	44.1	54.5[5]
Gross Loans / Due to Customers (%)	54.3	54.8	56.5	68.7	74.6	61.8[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

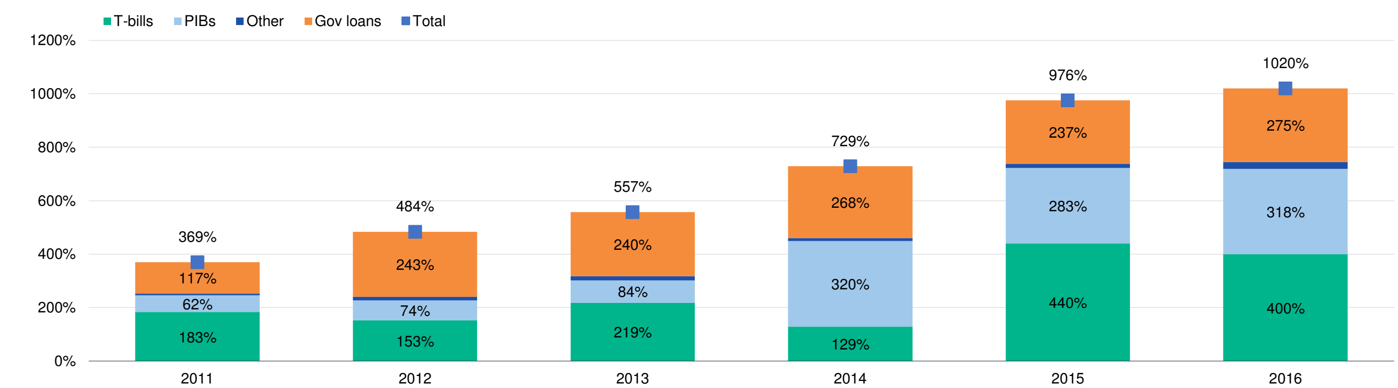
Detailed Rating Considerations

HIGH EXPOSURE TO THE B3-RATED PAKISTANI GOVERNMENT LINKS NBP'S CREDITWORTHINESS TO THAT OF THE GOVERNMENT

As of December 2016, NBP had direct exposure to the government through bonds and treasury bills (T-bills) which amounted to 37% of total assets and 7.5x its CET1 capital. If we include indirect government exposures through lending to government-owned entities, the total gross exposure increases to around 10.2x the bank's CET1 capital. This heavy exposure links the bank's credit profile to that of the government and renders the bank increasingly susceptible to event risk in relation to Pakistan's creditworthiness. Going forward, we expect NBP will maintain its significant government exposure, with the budget deficit forecasted at 4.7% and 5.0% for the fiscal years ending June 2017 and June 2018 respectively, and as the banking system will remain a major source of financing for the government.

Exhibit 3

NBP's high - and increasing - exposure to the Pakistani Government (as a % of Tier 1 capital)



Source: Bank's Financial Statements; Moody's Investors Service

The bank's NPLs also accounted for 16.7% of its gross loans ratio as of March 2017, a level which is considerably higher than its domestic peers, and is a credit weakness for the bank. NPLs continue to represent more than 50% of the bank's tangible common equity and loan-loss reserves.

Going forward, we expect NPL metrics to stabilise as a result of the accelerating economic growth, which is boosted by progress in structural reforms and China-funded infrastructure projects. Successful implementation of these projects will bolster Pakistan's growth potential by removing supply-side bottlenecks and infrastructure constraints and stimulate lending growth for the banks. However, the economic recovery is susceptible to risks arising from potential political instability, deterioration in domestic security, a disruption of the government's reform agenda or renewed pressure on the external front.

MODEST CAPITAL BUFFERS AVAILABLE TO ABSORB LOSSES

We view NBP's capital buffers to be modest in the context of the sizeable exposure to the low rated Pakistani government. NBP reported a CET1 ratio of 12.3% as of December 2016, with the bank's equity-to-assets ratio at 9.1%. We expect the bank's reported capital levels to decline slightly, owing to higher loan growth and high dividend payouts. Moreover, we consider NBP's capital buffers as modest when considering the high credit risks the bank faces. In our view, the regulatory zero risk-weight applied to government securities understates risk-weighted assets and inflates reported capital adequacy ratios. When applying a risk weighting of 100%, which is more in line with global standards for a B3 sovereign rating, we estimate that the bank's 2016 Tier 1 ratio decreases to 6.4%.

Moreover, under our stress scenario which incorporates the expected losses associated with B3-rated government securities, the bank's capital is insufficient to absorb losses.

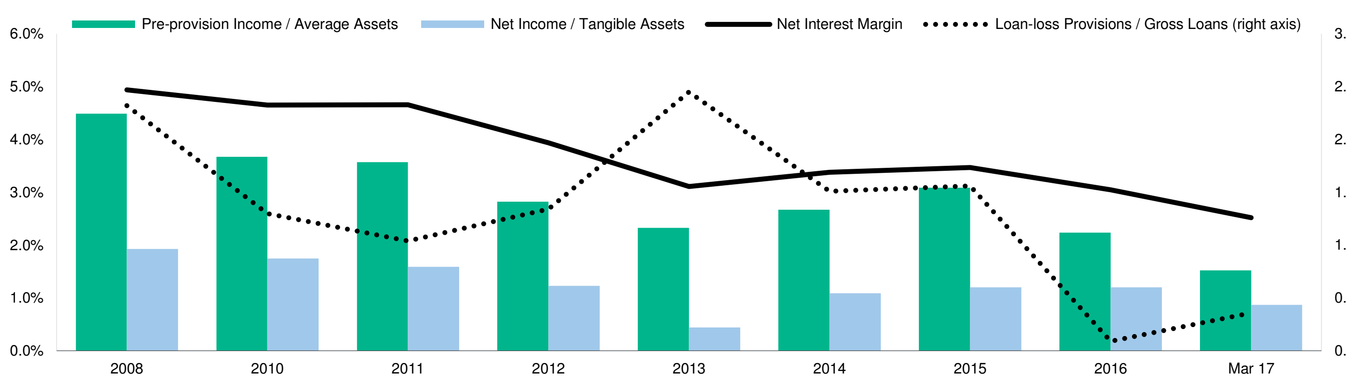
We also note that the bank is currently under litigation risk related to pension disputes, a case that is currently under appeal in the Supreme Court. An unfavorable outcome against the bank could have an immediate material impact on the bank's equity (estimated at PKR47.7 billion which accounts for 28% of the bank's equity) and an increase in its pension expenses going forward.

LOWER-THAN-PEERS PROFITABILITY METRICS

The bank has historically displayed weaker-than-peers profitability metrics owing to: (1) lower net interest margins as a result of its higher lending to the public sector and related entities (at 35% of total gross loans as of end-2016); (2) a less efficient cost base (with a cost-to-income ratio of 63.3% as of March 2017); and (3) consistently higher provisioning costs.

Despite lower provisioning expenses, NBP's profitability metrics have been under pressure in recent quarters due to lower interest rates and falling yields on government securities, with the bank's net income declining to 0.9% of tangible assets for the first three months of 2017. Pressure on the bank's bottom line was also a result of higher administrative expenses, which grew by 14% (on an annual basis) in the first quarter of 2017 and offset the rise in fees/commissions and gains on sale of securities.

Exhibit 4
NBP's profitability metrics



Source: Bank's Financial Statements; Moody's Investors Service

Going forward, we expect the bank's profitability metrics to remain broadly stable, supported by rising loan volumes, including in higher-yielding segments with the bank being a market leader in retail lending, and focus on building its fee franchise. Although we do not expect the bank's provisioning costs to remain at such low levels, these will remain contained compared to prior years and also support the bank's profitability.

RELATIVELY STABLE DEPOSIT-BASED FUNDING SUPPORTED BY NBP's POSITION AS THE LARGEST GOVERNMENT-OWNED BANK IN PAKISTAN

NBP is the second-largest bank in Pakistan and the largest government-owned bank, with estimated market shares of 14% in deposits and 15% in loans. During 2016, customer deposits grew by 16% and accounted for 72% of NBP's total assets. The predominance of these deposits (69% of total) was in the form of low-cost current and savings deposits, although this lags most of its domestic peers. Despite the short-term maturity profile of its deposit base, this has historically proved to be sticky and a stable funding source. Reliance on market funding is moderate, accounting for 14.4% of tangible banking assets as of December 2016, with the money raised invested predominantly in government bonds.

As of December 2016, cash and bank placements accounted for 15% of assets, while an additional 37% of assets is invested in government securities. In a crisis situation, we consider that the bank will use these securities as collateral in order to draw liquidity from the central bank, although we do acknowledge that the liquidity features of government securities is relatively limited given a shallow secondary market.

SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT

Unless noted otherwise, data related to system-wide trends is sourced from the central bank. Bank-specific figures originate from the bank's reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document: “Financial Statement Adjustments in the Analysis of Financial Institutions” (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_187419) published on 12 February 2016.

Notching Considerations

Government Support

We assume a very high likelihood of government support for NBP's deposits, which results in an one notch uplift from the bank's caa1 BCA. This reflects the bank's significant market share of 14% of domestic deposits, the government's majority ownership (76%), NBP's importance to the country's national payment system and the support that the bank itself provides to the sovereign through its large government securities holdings. In addition, Pakistani authorities have historically supported banks in difficulty, with no depositor losses recorded.

CR Assessment

NBP's B3(cr)/Not-Prime(cr) CR Assessment is one notch higher than its caa1 Adjusted BCA. We expect that authorities are likely to honour the operating obligations the CR Assessment refers to in order to preserve a bank's critical functions and reduce potential for contagion. No government support uplift is imputed, as the government's capacity to provide support is constrained at the B3 sovereign rating level.

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our rating committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Methodology and Scorecard Factors

Exhibit 5

NATIONAL BANK OF PAKISTAN

Macro Factors		
Weighted Macro Profile	**Very Weak +**	**100%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	16.8%	caa2	←→	caa2	Long-run loss performance	Quality of assets
Capital						
TCE / RWA	7.8%	caa2	←→	caa2	Stress capital resilience	
Profitability						
Net Income / Tangible Assets	0.9%	b3	←→	b3	Expected trend	Return on assets
Combined Solvency Score		caa2		caa2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	14.4%	b2	←→	b3	Deposit quality	Extent of market funding reliance
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	60.0%	ba3	←→	b2	Quality of liquid assets	Stock of liquid assets
Combined Liquidity Score		b1		b3		
Financial Profile				caa1		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				B3		
Scorecard Calculated BCA range				b3-caa2		
Assigned BCA				caa1		
Affiliate Support notching				0		
Adjusted BCA				caa1		

Instrument class	**Loss Given Failure notching**	**Additional Notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Assessment	1	0	b3 (cr)	0	B3 (cr)	--
Deposits	0	0	caa1	1	B3	Caa1

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	**Moody's Rating**
NATIONAL BANK OF PAKISTAN	
Outlook	Stable
Bank Deposits -Fgn Curr	Caa1/NP
Bank Deposits -Dom Curr	B3/NP
Baseline Credit Assessment	caa1
Adjusted Baseline Credit Assessment	caa1
Counterparty Risk Assessment	B3(cr)/NP(cr)

Source: Moody's Investors Service

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