



State Bank of Pakistan
Banking Supervision Department

Quarterly Performance Review
of the Banking System

March 2006

Team Members

Muhammad Akhtar Javed

Zahid Mahmood

Amer Hassan

Javed Ahmed

Muhammad Rizwan

Rizwana Rifat

Sheema Fareed

Ayaz Ali

Khurram Shahzad

Team Leader

Jameel Ahmad

List of Abbreviations

CAR	Capital Adequacy Ratio
CB	Commercial Bank
CY	Calendar Year
FB	Foreign Bank
HTM	Held-to-Maturity
IB	Islamic Bank
IBB	Islamic Bank Branch
IBI	Islamic Banking Institution
LPB	Local Private Bank
MCR	Minimum Capital Requirement
MTB	Market Treasury Bill
NII	Net Interest Income
NOP	Net Open Position
NPF	Non Performing Finance
NPL	Non Performing Loan
NSS	National Saving Scheme
OMO	Open Market Operation
PIB	Pakistan Investment Bond
PSCB	Public Sector Commercial Bank
ROA	Return on Asset
ROE	Return on Equity
RSA	Rate Sensitive Asset
RSL	Rate Sensitive Liability
RWA	Risk Weighted Asset
SBP	State Bank of Pakistan
SB	Specialized Bank
SME	Small and Medium Enterprise

Glossary

Capital Adequacy Ratio is the amount of risk-based capital as a percent of risk-weighted assets.

Consumer Financing means any financing allowed to individuals for meeting their personal, family or household needs. The facilities categorized as Consumer Financing include credit cards, auto loans, housing finance, consumer durables and personal loans.

Corporate means and includes public limited companies and such entities, which do not come under the definition of SME.

Credit risk arises from the potential that a borrower or counter-party will fail to perform an obligation or repay a loan.

Discount rate is the rate at which SBP provides three-day repo facility to banks, acting as the lender of last resort.

Duration (Macaulay's Duration) is a time weighted present value measure of the cash flow of a loan or security that takes into account the amount and timing of all promised interest and principal payments associated with that loan or security. It shows how the price of a bond is likely to react to different interest rate environments. A bond's price is a function of its coupon, maturity and yield.

GAP is the term commonly used to describe the rupee volume of the interest-rate sensitive assets versus interest-rate sensitive liabilities mismatch for a specific time frame; often expressed as a percentage of total assets.

Gross income is the net interest income (before provisions) plus non-interest income; the income available to cover the operating expenses.

Interbank rates are the two-way quotes namely bid and offer rates quoted in interbank market are called as interbank rates.

Interest rate risk is the exposure of an institution's financial condition to adverse movement in interest rates, whether domestic or worldwide. The primary source of interest rate risk is difference in timing of the re-pricing of bank's assets, liabilities and off-balance sheet instruments.

Intermediation cost is the administrative expenses divided by the average deposits and borrowings.

Liquid assets are the assets that are easily and cheaply turned into cash – notably cash and short-term securities. It includes cash and balances with banks, call money lending, lending under repo and investment in government securities.

Liquidity risk is the risk that the bank will be unable to accommodate

decreases in liabilities or to fund increases in assets. The liquidity represents the bank's ability to efficiently and economically accommodate decreases in deposits and to fund increases in loan demand without negatively affecting its earnings.

Market risk is the risk that changes in the market rates and prices will impair an obligor's ability to perform under the contract negotiated between the parties. Market risk reflects the degree to which changes in interest rates, foreign exchange rates, and equity prices can adversely affect the earnings of a bank.

Net interest income is the total interest income less total interest expense. This residual amount represents most of the income available to cover expenses other than the interest expense.

Net Interest Margin (NIM) is the net interest income as a percent of average earning assets.

Net loans are the loans net of provision held for NPLs.

Net Non-Performing Loans (NPLs) is the value of non-performing loans minus provision for loan losses.

Net NPLs to net loans means net NPLs as a percent of net loans. It shows the degree of loans infection after making adjustment for the provision held.

Non-Performing Loans (NPLs) are loans and advances whose mark-up/interest or principal is overdue by 90 days or more from the due date.

NPLs to loans ratio/Infection ratio stands for NPLs as a percent of gross loans.

Paid-up capital is the equity amount actually paid by the shareholders to a company for acquiring its shares.

Rate Sensitive Assets (RSA) are assets susceptible to interest rate movements; that will be re-priced or will have a new interest rate associated with them over the forthcoming planning period.

Repricing risk arises from timing differences in the maturity of fixed rate and the repricing of floating rates as applied to banks' assets, liabilities and off-balance sheet positions

Return on assets measures the operating performance of an institution. It is the widely used indicator of earning and is calculated as net profit as percentage of average assets.

Return on equity is a measure that indicates the earning power of equity and is calculated as net income available for common stockholders to average equity

Risk weighted Assets: Total risk weighted assets of a bank would comprise two broad categories: credit risk-weighted assets and market risk-weighted assets. Credit

risk weighted assets are calculated from the adjusted value of funded risk assets i.e. on balance sheet assets and non-funded risk exposures i.e. off-balance sheet item. On the other hand for market risk-weighted assets, first the capital charge for market risk is calculated and then on the basis of this charge amount the value of Market Risk Weighted Assets is derived.

Secondary market is a market in which securities are traded following the time of their original issue.

SME means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing/ service concern) and 50 persons (if it is trading concern) and also fulfills the following criteria of either 'a' and 'c' or 'b' and 'c' as relevant:

- (a) A trading / service concern with total assets at cost excluding land and building upto Rs50 million.
- (b) A manufacturing concern with total assets at cost excluding land and building upto Rs100 million.
- (c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs300 million as per latest financial statements.

Tier I capital: The risk based capital system divides capital into two tiers-core capital (Tier I) and supplementary capital (Tier II and Tier III). Tier 1 capital includes fully paid up capital, balance in share premium account, reserve for issue of bonus shares, general reserves as

disclosed on the balance-sheet and un-appropriated /unremitted profit (net of accumulated losses, if any).

Tier II capital or Supplementary Capital (Tier II & III) is limited to 100 percent of core capital (Tier I). Tier II includes; general provisions or general reserves for loan losses, revaluation reserves, exchange translation reserves, undisclosed reserves and subordinated debt.

Tier III capital consists of short-term subordinated debt and is solely held for the purpose of meeting a proportion of the capital requirements for market risks.

Yield risk is the risk that arises out of the changes in interest rates on a bond or security when calculated as that rate of interest, which, if applied uniformly to future time periods sets the discounted value of future bond coupon and principal payments equal to the current market price of the bond.

Yield curve risk materializes when unanticipated shifts have an adverse effect on the bank's income or underlying economic value.

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Quarterly Performance Review of the Banking System March 2006

The review is based on the data mainly taken from the Quarterly Reports of Conditions and Annual Audited Accounts submitted by banks. It covers their global¹ operations, unless otherwise indicated. The banks have been divided into four groups namely, Public Sector Commercial Banks (PSCBs), Local Private Banks (LPBs), Foreign Banks (FBs) and Specialized Banks (SBs). PSCBs include two nationalized commercial banks and two provincial banks, whereas LPBs consist of four privatized banks and seventeen domestic private banks. The composition of these four groups has been given in Annex-IV. The performance of the banking industry as a whole and these groups in particular has been evaluated by using the financial soundness indicators.

Overview

The first quarter of the current year proved very productive for the banking system. By keeping intact the strong profitability momentum, the banking system added further strength to its solvency position. Total net profit of Rs14.9 billion visibly eclipsed the net profit of Rs9.9 billion in the corresponding quarter of the previous year. The underlying factors remained the large volume of high yield assets along with the persistent growth in net margins. Net mark-up income accounted for 74.3 percent of the gross income, and it was large enough to cover the operating expenses and provision charges. This was despite the fact that operating expenses as a percentage of gross income have been increasing gradually because of expanding operations and growing technological network.

The healthy profits have also been very salutary for the solvency profile of the banking system, which has grown from strength to strength over the past many quarters. The current quarter saw further addition to risk-based capital as it increased to Rs283 billion from Rs265 billion. An important feature of the risk-based capital is that the proportion of core capital is on the rise, which is depictive of the inherent strength of capital. This is evident by an increase in the share of core capital to 75 percent from 74 percent in CY05. The persistent build up of capital has also impacted positively the capital adequacy ratio (CAR) of the banking system, which improved to 11.6 percent from 11.3 percent in CY05.

¹ Domestic operations of all the banks operating in Pakistan plus operations of overseas branches of Pakistani banks

While banks have relied heavily on strong growth in loans for their record profits, and thus has helped them stay on course to meeting the higher capital requirements in phased manner, it has at the same time exposed them to higher credit risk. Particularly, the rising interest rates have the potential of undermining the debt repayment capacity of borrowers, and such a scenario might not be conducive for the capital build-up plans of banks. These concerns got fuel from the rise of Rs3.5 billion in total non-performing loans of commercial banks during the quarter. However, a decline of Rs4.1 billion in the NPLs of specialized banks helped more than offset the rise in NPLs of commercial banks. Consequently, total NPLs of the banking system fell to Rs176.7 billion from Rs177.2 billion in CY05. This impacted positively the key asset quality ratios of NPLs to loans and net NPLs to net loans, which decreased to 8.1 percent and 1.9 percent respectively. Going by the international standards, the key asset quality indicators fall within reasonable levels, particularly, the ratio of net NPLs to net loans indicate that banks have already booked losses against the portfolio of chronic NPLs.

However, improved indicators of asset quality do not obviate the need to apply strict and incisive credit appraisal and monitoring standards against fresh loans. In a noticeable departure from the trend in the past quarters, lending activities of banks saw deceleration in this quarter. The increase of Rs48 billion was quite low if compared with the strong growth trends witnessed during CY05. While the loans tend to lose momentum during this part of the year on account of seasonal downturn in economic activities, higher lending rates as well as optimal level of loans utilization in previous quarters might also have contributed to lowering the growth in loans this time around.

Corporate and consumer sectors remained the major beneficiaries of the growth in loans during this quarter. Conversely, loans to agriculture and SMEs saw a decline.

The faster increase in loans in the past quarters had rested heavily on the ample liquidity generated through huge influx of deposits. However, deposits recorded only a modest increase of Rs18.4 billion during the current quarter. Apart from the seasonal impact and tighter monetary policy stance, higher trade deficit might also have played significant role in dampening the pace of deposits' growth. The slow down in deposits eventually brought about a moderation in the rapidly expanding balance sheet of the banking system.

While tight monetary policy is the natural reaction to high inflation rates, and the current monetary policy posture is expected to sustain till the discernible moderation in inflation, the ensuing high interest rates contain ominous overtones for liquidity and market risk management of the banking system. Liquidity

constraints continued to radiate higher risks in the presence of rising ratio of loans to deposits, and mismatches in the maturity profile of assets and liabilities. Loans to deposits ratio increased to 71.4 percent from 70.2 percent in CY05. Market risk also arises because of negative mismatches in the shorter-term maturity buckets of risk sensitive assets (RSAs) and risk sensitive liabilities (RSLs). This coupled with the positive duration Gap in longer term brackets might undermine the market value of equity on the back of rising interest rates.

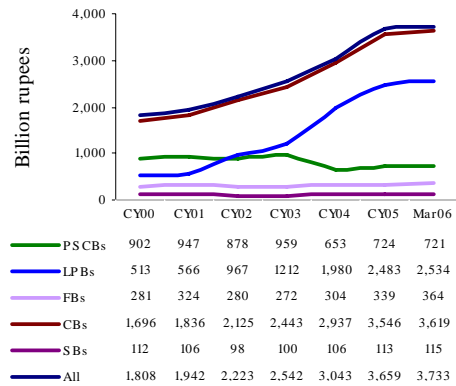
While the overall performance of the banking system remained impressive in the first quarter of the current year, its sustainability depends heavily on the ability of banks to manage the brewing pressures in the form of credit, liquidity and market risks. In this respect, containment of credit risk holds special significance because further rise in NPLs of commercial banks might seriously undercut earnings streak, which would have negative implications for banks' efforts to augment their capital in line with the growing requirements each year.

Another potential factor, which might also pressurize net interest margins of banks, is the demand for higher returns on deposits. With the launch of PIBs, higher return on National Saving Schemes (NSS) instruments and growing disenchantment of depositors, the banks are expected to indulge in more intense competition to mobilize funds in an environment showing signs of growing liquidity constraints. Consequently, the rate of return on deposits is expected to go up as well. This will ultimately squeeze their interest margins. The emerging financial scenario requires banks to adopt a prudent and balanced approach in managing the building pressures as well as ensuring sustainable earnings streams to maintain profitability and solvency.

2. Assets and Funding Structure

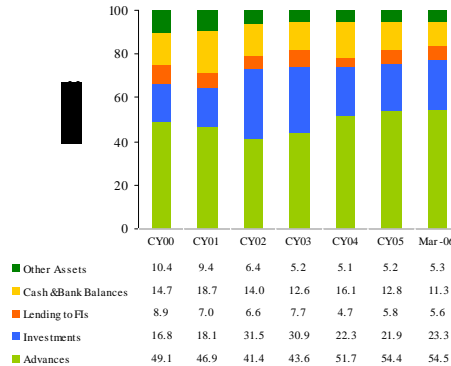
In a sharp contrast to the growth patterns of the past quarter, total assets of the banking system grew at a noticeably muted pace in the first quarter of CY06 (see **Figure 2.1**). Growth of 2 percent is not only far below the annual growth of 20.2 percent during CY05 but also is lower if compared with the growth of 2.8 percent in the corresponding quarter of the previous year. The significant slow down in the balance sheet expansion finds its explanation in the simultaneous deceleration in deposits and loans growth, which responded to the seasonal sluggishness of economic activities and tightened monetary policy stance.

Figure-2.1: Total Assets of Banking System



The persistent tight monetary policy stance is reflected in the asset mix of the banking system, which displays faster increase in the share of investment portfolio as compared with the negligible increase in the share of loans (see **Figure 2.2**). The increase in policy rates has also started to make investments relatively more lucrative. Consequently, the share of investments in the assets composition grew by 1.4 percentage points as compared to 0.1 percentage points increase in loans share. Without cutting substantially the supply of funds for loans, the banking system released the funds locked in cash and bank balances to meet their growing appetite for investments. The utilization of these low yield funds into higher yield avenues is likely to help banks in maintaining their income streams at reasonable levels.

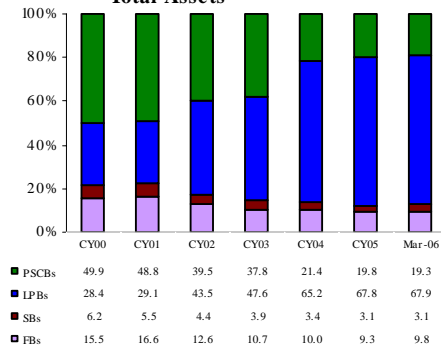
Figure-2.2: Composition of Banks' Total Assets



The group-wise position shows further increase in the share of local private banks (LPBs) whereas the share of public sector commercial banks (PSCBs) continued

the downward trend (see **Figure 2.3**). However, the pace of increase in the share of LPBs slowed down visibly as the banks mainly responsible for the rapidly rising share of this group experienced marked deceleration in their assets expansion during the quarter. The relatively slower growth of LPBs enabled foreign banks to increase their share to 9.8 percent from 9.3 percent in CY05. In this respect, the three large foreign banks accounted for 84 percent of the increase in total assets of this group. Specialized banks (SBs) saw their share remaining unchanged during the period under review.

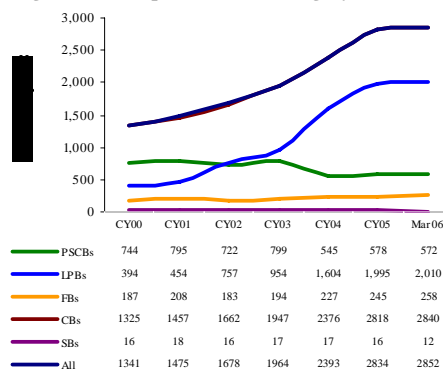
Figure-2.3: Group-wise Share in Total Assets



In recent years, the role of medium size banks has been significant in promoting competition in the banking system as they have been striving hard to increase their share of the total assets pie. The growing competition being put up by these banks has led to persistent fall in the share of top five banks. The same trend continued during the quarter as the share of top five banks declined to 53 percent from 54 percent in CY05. Conversely, the share of next five banks increased to 19 percent from 18 percent in CY05. The share of next ten banks remained the same at 20 percent while those of the remaining banks increased to 8 percent from 7 percent. The increase in the share of the small banks is on account of the increase in the number of these banks from 19 to 20 because of the granting of license to a new Islamic bank.

Following the prolific rise during the last quarter of CY05, total **deposits** of the banking system increased by a much slower rate of 0.6 percent (see **Figure 2.4**). The increase of Rs18.4 billion is also lower when compared with the addition of Rs40.3 billion in the corresponding quarter of the previous year. While the pace of workers' remittances remained unhindered, one of the major factors responsible for deposits rise in recent

Figure-2.4: Deposits of Banking System



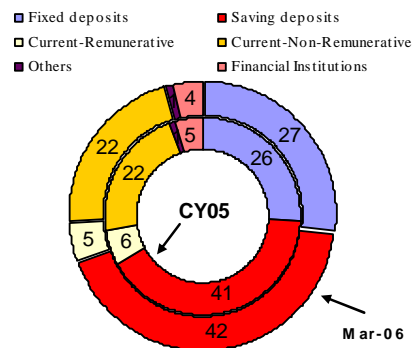
years, the widening trade gap and tight monetary policy stance appeared to be casting shadow on the deposits expansion. Moreover, the process of multiple deposits creation also received a blow on account of lower growth in loans, which tend to lose momentum during this part of the year because of normal seasonal slow down.

Another factor, which becomes more pronounced at year end, is that some banks are engaged in intense competition to capture greater market share, and hence they usually tend to augment their balance sheets through aggressive mobilization of deposits during the last quarter of the year. A significant portion of the deposits thus mobilized flows out of the system in the ensuing weeks of the new year. This is substantiated by the sharp surge in deposits by Rs129.5 billion during the last fortnight of CY05 followed by an outflow of Rs89.2 billion during the first fortnight of CY06.

Of late, depositors have also started to show greater interest in foreign currency deposits. This is apparent by an increase of Rs8.3 billion in foreign currency deposits, which ultimately proved very helpful to the overall growth in deposits. The growing appetite for foreign currency deposits springs from the developing pressure on Pak rupee on the back of rising deficit on external front.

The issue of lower return being paid on deposits has been debated extensively in recent times, and banks have been target of scathing criticism in this respect. While banks have been found wanting in sharing their huge profits with depositors, the peculiar structure of deposits with significant preponderance of zero or low yield current and saving deposits has also been responsible for the low return on all deposits. The combined share of such deposits works out to be 68 percent, which by all means is quite high (see **Figure 2.5**).

Figure-2.5: Deposits Structure

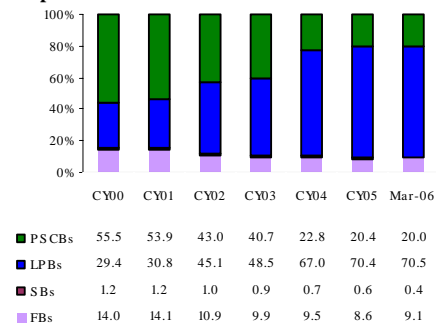


However, weighted average deposits rates have started to increase persistently on the back of tightened monetary policy stance. This is evident by an increase of 145

bps in the weighted average deposits rates² since CY04. During the quarter under review, these rates increased by another 20bps. The rising rates have also had positive impact on the share of fixed deposits, which increased to 27 percent from 18 percent in CY04 and 26 percent in CY05. The rates are expected to increase further given the growing liquidity strains, and the resultant stiff competition for funds. This would help further increase the share of fixed deposits in the total deposits of the banking system.

The share of foreign banks in the deposits' increase was conspicuous. By growing at a rate of 5.4 percent, FBs added Rs13 billion to the total deposits growth during the quarter. This helped FBs to reverse their declining share in the total deposits of the system (see **Figure 2.6**). While in absolute terms, LPBs' contribution at Rs15 billion was the highest; the growth of 0.8 percent in their deposits was far lower if compared with the trends in the past quarters. On the other hand, the share of PSCBs and SBs declined further on account of fall in their deposits during the quarter.

Figure-2.6: Group-wise Share in Deposits



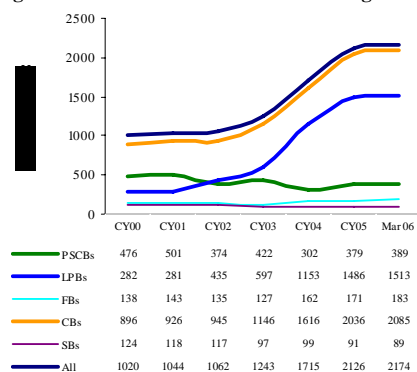
In the ensuing quarters, banks would have to strive harder to recoup the healthy growth trends of deposits witnessed in the past quarters. For this purpose, banks will have to offer higher returns to attract deposits keeping in view the fact that the Government has recently raised rates on National Saving Schemes instruments. This might catalyze the individual depositors to divert their savings to these instruments. Additionally, the recent auction of PIBs coupled with more in the coming days might also lead to the flight of institutional deposits. Above all, the sustained tight monetary policy might also further squeeze the liquidity conditions in the financial market making it difficult for banks to mobilize deposits at hitherto easy rates. However, expected pick up in lending activities and the fiscal stimulus as envisaged in the budget for the upcoming year would help fuel economic activities. This might help banks in recovering the lost momentum of deposits growth in the remaining part of the year.

² Including zero rate total outstanding deposits.

The slow growth in deposits and higher liquidity strains are also manifested by persistent increase in demand for **borrowings** by the banking system. During this quarter, total borrowings of the banking system increased by another Rs26.6 billion. The break up shows that borrowings against repurchase agreement (Repo) and export finance together make up 62 percent of total borrowings, and during the current quarter, borrowings against both these heads increased by Rs9.1 billion and Rs1.5 billion respectively. The future trend in borrowings rests on availability of liquidity as well as loan demand by the various segments of the economy. The present scenario indicate further rise in borrowings in the coming quarters.

After witnessing very high growth in CY05, **loans** portfolio of the banking system increased at much lower pace during the quarter under review. The growth of Rs48 billion is well below the growth of Rs99 billion in the corresponding quarter of the previous year (see **Figure 2.7**). While the current quarter characterizes relative slow down in business activities as well as retirement of loans for commodity operations, the lower growth this time around might also have responded to higher lending rates and constrained liquidity.

Figure-2.7: Total Loans of the Banking



Further analysis shows that level of credit intake by the corporates as well as other growing segments during CY04 and CY05 was very large. This is evident by the fact that during these two years, banks extended loans amounting to Rs883 billion out of the outstanding Rs2,126 billion, which represents 71.0 percent growth in two years. Therefore, slow-down in loans growth indicates that industry is now moving towards optimal level of credit intake.

LPBs topped all other groups by claiming around 57 percent share (Rs27 billion) in overall growth followed by FBs, which shared 26 percent (Rs12 billion) whereas PSCBs shared

Table 2.1 Sector-wise Break Up of Loans (Domestic Operations)*

(Billion Rupees)	Mar-05		Dec-05		Mar-06	
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
Corporate Sector	924.4	54.1	1,076.2	52.7	1,122.3	54.3
Fixed Investments	367.5	21.5	440.3	21.6	456.6	22.1
Working Capital	376.9	22.0	411.1	20.1	450.4	21.8
Trade Finance	180.0	10.5	224.8	11.0	215.2	10.4
SMEs	294.8	17.2	361.4	17.7	357.3	17.3
Fixed Investments	25.9	1.5	34.1	1.7	34.5	1.7
Working Capital	209.8	12.3	267.7	13.1	262.7	12.7
Trade Finance	59.1	3.5	59.6	2.9	60.1	2.9
Agriculture production	124.5	7.3	138.0	6.8	124.1	6.0
Consumer Finance	177.1	10.4	252.8	12.4	270.9	13.1
Credit Cards	15.5	0.9	27.1	1.3	29.7	1.4
Auto Loans	57.2	3.3	82.1	4.0	89.5	4.3
Consumer Durables	1.6	0.1	1.7	0.1	1.6	0.1
Housing Loans	21.7	1.3	33.8	1.7	41.2	2.0
Personal Loans	81.2	4.8	108.0	5.3	108.8	5.3
Commodity Operations	111.6	6.5	140.6	6.9	118.9	5.8
Staff Loans	41.1	2.4	42.4	2.1	42.9	2.1
of which Housing Loans	27.9	1.6	30.1	1.5	30.7	1.5
Other	36.1	2.1	31.6	1.5	30.0	1.5
Total	1,709.7	100	2,043.0	100	2,066.3	100

* Loans to both Public and Private sectors

Also include Export Finance

around 22 percent (Rs10 billion). On the other hand, SBs saw a decline in their loans during the quarter. The sector-wise distribution of increase in loans reveals that private sector played key role in loans growth during the quarter. Conversely, loans to public sector declined by around Rs9.5 billion due to retirement of loans extended for commodity operations. The noticeable aspect of the period under review was the performance of corporate and consumer finance sectors. The credit intake of corporate sector grew by Rs46.0 billion (see **Table 2.1**), which helped reverse the declining trend in its share in total loans of the banking system. Corporate sector now holds 54.3 percent of total loans as against 52.7 percent in CY05. This increase in loans was mainly utilised to finance the working capital needs of corporate sector. The general perception of higher rate of default in the wake of rising interest rates and consequent reduction in credit intake by consumer

Figure-2.8: End-Use Distribution of Bank Loans - Mar-05

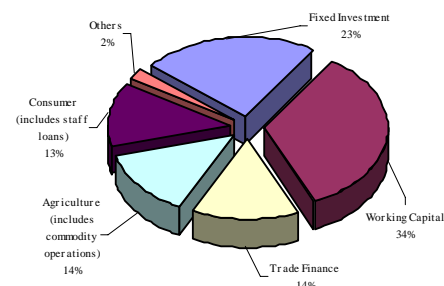
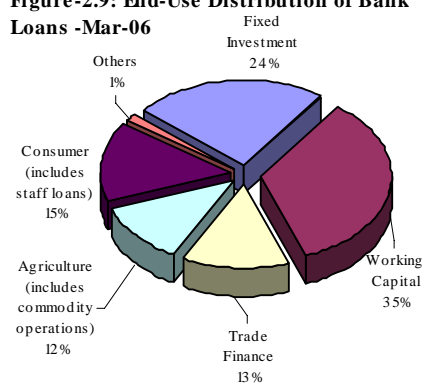


Figure-2.9: End-Use Distribution of Bank Loans -Mar-06



finance still did not come to fore, which depicts that the consumer finance sector still holds great potential. By adding another Rs18.1 billion, its contribution in overall loans growth (domestic operations) was around 78 percent and it also registered the highest growth rate of 7.2 percent among all other sectors. Consequently, its share in overall loans portfolio augmented to 13.1 percent from 12.4 percent in the past quarter. The break-up of consumer finance into different sub-sectors shows, in absolute terms, the auto loans and mortgage loans recorded almost same level of growth around Rs7.4 billion, whereas in percentage terms the mortgage loans registered the highest growth rate of 21.8 percent followed by auto loans of 9.6 percent. Further analysis of consumer finance shows that the personal loan category borrowers availing 40.2 percent of total consumer finance were on the top, followed by auto loans borrowers availing 33.0 percent. The rest belonged to other categories of consumer finance. However, on the other hand, the share of SME sector slightly reduced to 17.3 percent from 17.7 percent due to reduction in

their working capital needs during this period. The Agriculture sector also witnessed negative growth due to seasonal impact. The healthy growth in credit brought about by corporate and consumer finance sectors, despite slack period, were more than enough to compensate the negative growth reported by SME and agriculture sectors.

The increase in share of corporate sector in overall loans portfolio also had its impact on end-use distribution of loans (see **Figure 2.8 & 2.9**). The share of both working capital and fixed investment improved by one percentage point each to 35 percent and 24 percent respectively from 33 percent and 23 percent at the end of the corresponding quarter last year. The share of agriculture and commodity operations slightly reduced to 12 percent from 14 percent at the end of corresponding quarter last year due to the reason cited above.

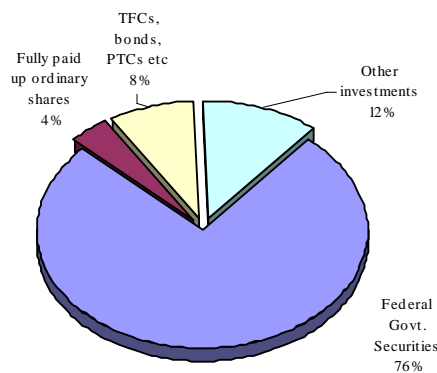
Due to seasonal slackness, the borrowers-base also recorded reduction in almost all sectors, except consumer finance (see **Table 2.2**). On this front, once again, consumer finance outperformed all other sectors by adding 49,610 more borrowers.

	Dec-02	Dec-03	Dec-04	Dec-05	Mar-06
Corporate Sector	14,256	17,743	19,333	19,881	19,546
SME Sector	67,520	91,663	106,248	161,316	161,008
Agricultuer	1,339,961	1,411,508	1,503,827	1,534,502	1,526,062
Consumer Finance	252,156	721,201	1,619,207	2,407,806	2,457,416
Commodity Operation	1,458	2,069	3,207	6,730	6,026
Staff Loans	72,570	69,796	72,633	72,927	73,255
Others	56,683	63,696	73,735	44,144	42,372
Total	1,804,604	2,377,676	3,398,190	4,247,306	4,285,685

Domestic operations covering both public and private sector borrowers

The **Investment** portfolio of the banking system further increased by Rs65.9 billion during the quarter under review. Since investment in federal government securities form significant portion of total investment, any movement in this component have its impacts on total investments, usually in the same direction. Since the return on government securities is consistently improving over the last many quarters, therefore, investment in this component attracted banks' attention to earn risk free returns. By growing at a rate of 12.3 percent during the current quarter, the investment in federal government securities increased to Rs 662.1 billion from Rs589.5 billion as at end of last quarter. Consequently, its share in overall investment increased to 76 percent (see **Figure 2.10**), from 73 percent in CY05.

Figure-2.10: Breakup of Investments Mar-06

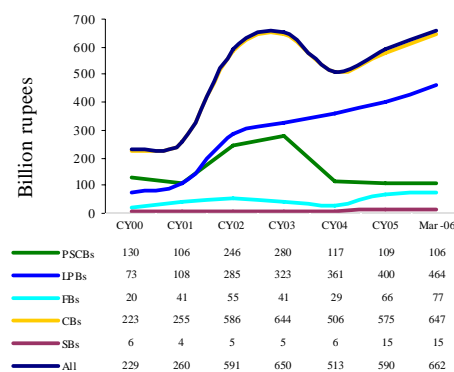


The investment in MTBs was mainly responsible for enhancement in

federal government securities portfolio. By growing at a rate of 15.5 percent, investment in MTBs reached to Rs439.3 billion from Rs380.4 billion, registering growth of Rs58.9 billion. The investment in PIBs decreased by Rs1.3 billion, thereby reducing its share to 23.0 percent from 26.1 percent over the quarter. The declining share of PIBs is expected to reverse in the coming quarters with the recent launch of PIBs auctions after a long interval.

The group-wise analysis shows LPBs and FBs were mainly responsible for increase in investments in government securities (see **Figure 2.11**). LPBs accounted for 88.9 percent of the increase in federal government securities while FBs brought about the rest. On the other hand, PSCBs reduced their portfolio of government securities. Further analysis reveals that of their total investments, FBs hold 96.6 percent in government securities followed by LPBs, which are keeping 80.6 percent in the same.

Figure 2.11: Investment in FG Securities

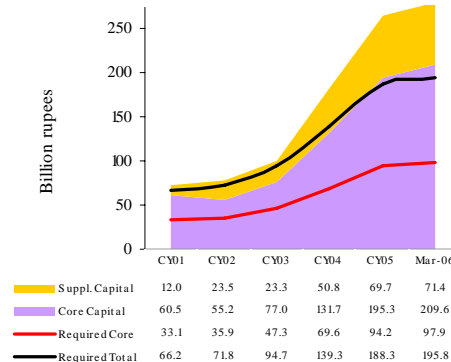


3. Financial Soundness of the Banking System

3.1 Solvency

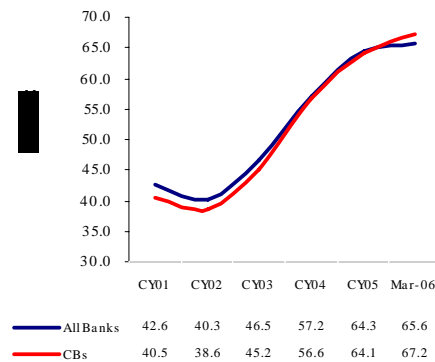
The banking system stayed on course in terms of improvement in its capital position. Drifting mainly on the back of stronger profitability, the solvency position of banking system further strengthened. A discernable improvement has been registered not only in core capital but also in supplementary capital. However, the mainstay has been the core capital, which continues to depict a major share of 75 percent of overall capital. Besides, the core capital alone meets the overall regulatory capital requirements (see **Figure 3.1.1**).

Figure-3.1.1: Risk-based Capital



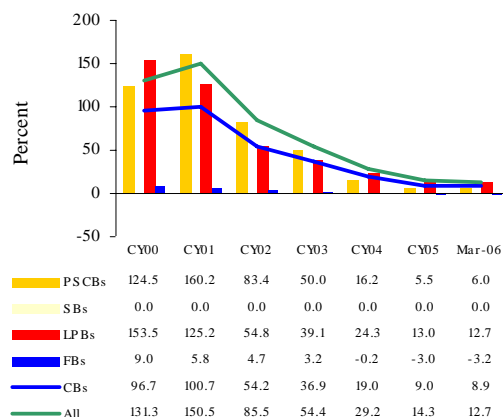
Maintaining the ongoing momentum, year-on-year growth in capital (46 percent) undoubtedly outstripped the growth in assets (20 percent) during Mar-06. Such continuous growth in capital and improvement in profitability indicates further strengthening of solvency position. Although the growth in assets had no match with growth in capital yet total risk weighted assets grew by a sizeable amount. Therefore, risk weighted assets to total assets ratio slightly crept up to 65.6 percent from 64.3 percent during the quarter under review (see **Figure 3.1.2**).

Figure-3.1.2: RWA to Total Assets



During the last couple of years the pace of fresh NPLs' creation has been very low. This coupled with increased provisioning contributed to reduction of the quantum of net NPLs to Rs39 billion during the quarter. Persistent fall in net NPLs in conjunction with sharp pickup in capital brought about marked decline in net NPLs to capital ratio to 12.7 percent against 14.3 percent in CY05 (see **Figure 3.1.3**).

Figure-3.1.3: Net NPLs to Capital



Moreover, threat to capital from un-provided NPLs has further reduced. Argument is substantiated by discernable improvement in adjusted capital to total assets ratio², which has inched up to 7.2 percent in quarter under review from 6.7 percent in CY05. Capital gaining further strength, in conjunction with remarkable slip in NPLs has contributed in strengthening the adjusted capital to total assets ratio.

Driven primarily by the stellar growth in capital, solvency indicators of the banking system have shown further improvement during the quarter under review. In this connection, subtle signs of amelioration in capital adequacy ratio for all banks have been witnessed. CAR improved from 11.3 percent in CY05 to 11.6 percent during the current quarter (see **Table 3.1.1**). Likewise, tier I capital to RWAs has inched up to 8.6 percent from 8.3 percent in the preceding quarter. Remarkable growth in capital has also

Table-3.1.1: Capital Adequacy Indicators

Percent	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06
CAR							
PSCBs	10.4	9.6	12.3	11.0	13.4	14.5	15.5
LPBs	9.2	9.5	9.7	9.0	10.1	10.6	11.0
FBs	18.0	18.6	23.2	23.0	17.4	16.4	16.1
CBs	11.4	11.3	12.6	11.1	11.4	11.9	12.3
SBs	(3.3)	(13.9)	(31.7)	(28.2)	(9.0)	(7.7)	(12.4)
All banks	9.7	8.8	8.8	8.5	10.5	11.3	11.6
Tier I Capital							
PSCBs	7.7	7.1	8.6	8.2	8.6	8.8	9.8
LPBs	8.1	8.4	6.6	7.0	7.5	8.3	8.7
FBs	17.9	18.6	23.0	23.0	17.1	16.1	15.8
CBs	9.8	9.7	9.7	9.1	8.6	9.1	9.5
SBs	(3.4)	(13.9)	(31.7)	(28.7)	(15.0)	(13.6)	(18.2)
All banks	8.3	7.3	6.2	6.5	7.6	8.3	8.6
Capital to Total Assets							
PSCBs	4.6	3.7	5.6	6.1	8.7	12.6	13.5
LPBs	3.5	3.8	5.2	5.3	6.5	7.0	7.4
FBs	8.8	8.5	10.6	9.9	8.9	9.5	9.4
CBs	4.9	4.6	6.1	6.1	7.2	8.4	8.8
SBs	(1.1)	(10.3)	(23.0)	(10.0)	(9.4)	(8.1)	(10.7)
All banks	4.5	3.8	4.8	5.5	6.7	7.9	8.2
Capital (free of net NPLs) to Total Assets							
PSCBs	(1.1)	(2.2)	0.9	3.1	7.3	11.9	12.9
LPBs	(1.9)	(1.0)	2.4	3.2	4.9	6.1	6.4
FBs	8.0	8.0	10.1	9.6	9.0	9.8	9.6
CBs	0.2	(0.0)	2.8	3.9	5.9	7.6	8.1
SBs	(25.5)	(34.4)	(44.5)	(30.9)	(27.2)	(21.1)	(20.1)
All banks	(1.4)	(1.9)	0.7	2.5	4.7	6.7	7.2

² Balance sheet capital less net non-performing loans to total assets.

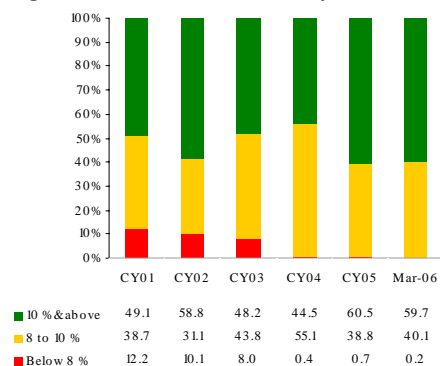
translated into the capital to total assets ratio, which has increased up to 8.2 percent against 7.9 percent in CY05, portraying well-capitalized¹ state of banking system.

Group wise analysis of capital adequacy indicators divulge across the board improvement except for SBs. All solvency indicators for SBs have plummeted, due to losses incurred by one of the SBs and partly to persistent and excessive provisioning by another SB. However, adjusted capital to total assets ratio in case of SBs has slightly recovered owing to increased resistance against fresh infections as well as to fall in net NPLs. There is sufficient evidence signalling continuous improvement in the solvency position of PSCBs. During the quarter under review, PSCBs have registered uniform improvement in all relevant indicators.

Nos.	Total	Below 8%	8 to 10 %	10 to 15 %	Over 15 %
CY97	46	7	5	12	22
CY98	46	2	4	17	23
CY99	44	3	6	16	19
CY00	44	5	6	16	17
CY01	43	5	5	11	22
CY02	40	4	4	9	23
CY03	40	4	10	5	21
CY04	38	1	13	9	15
CY05	39	2	7	13	17
Mar-06	40	1	9	11	19

The bank-wise position reveals certain shifts in the number of banks falling into various CAR brackets (see **Table 3.1.2**). Largely on account of their expanding loans portfolio, one more bank joined the group of the banks with CAR less than 10 percent, while the number of banks with CAR more than 10 percent remained the same at 30 in CY05. However, the number in most well capitalized CAR category i.e. above 15 percent has increased due to the entry of a new Islamic bank. In addition to it, market share of banks with CAR greater than 10 percent has slightly decreased to 59.7 percent in current quarter from 60.5 in CY05 (see **Figure 3.1.4**).

Figure-3.1.4: Bank's Market Share by CAR



¹ Capital adequacy ratio for a well capitalized bank should be more than 10 percent, similarly tier I capital to RWA ratio and capital to total assets ratio should be more than 5 percent.

While majority of banks has significantly improved its capital base because of higher profits and frequent capital injections on the back of higher capital requirement, its true impact on CAR has remained restricted due to fast expansion in loans. The coming quarters are expected to experience high loans growth and it will further increase the level of risk-weighted assets, which ultimately might pressurize the CAR. However, banks are expected to aggressively increase capital to comply with the higher regulatory requirement by the year's end. To achieve this goal and also to ensure smooth transition to Basel-II, banks should exercise strict vigilance against the quality of loans, and sustain the current profitability levels.

3.2 Profitability

The banking system continued the pace of strong earnings during the quarter Mar-06. Supportive economic scenario, increase in high yield assets and significant rise in the net interest income led to further improvement in the profits of the banking system. This impressive profitability was mainly contributed by LPBs; however, SBs incurred heavy losses during the period. The year-to-date after tax profits attained the level of Rs14.9 billion (see **Table 3.2.1**).

Among the profitability indicators of CBs, ROA before tax further improved to 3.0 percent from 2.9 percent in CY05. While PSCBs and FBs succeeded in improving their ROA before tax, the same for LPBs remained unchanged. On the other

hand, ROE before tax of CBs saw a slight decline to 35.5 percent from 37.2 percent in CY05. It was mainly due to the comparatively faster increase in equity. Almost the same trend is visible for ROA after tax and ROE after tax (see **Table 3.2.2**).

Consolidated position for the quarter under review reflects that commercial banks are consistent in their performance. The CBs, holding 97 percent assets of the banking industry, have managed to consolidate their profitability on solid footing as net interest income, considered hard core earnings, constituted 73.8 percent of the gross income. Though fee based

Table-3.2.1: Profitability of Banking System
(Billion Rs)

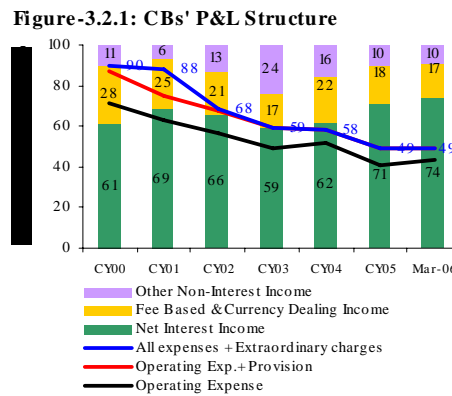
	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06
<i>Profit before tax</i>							
PSCBs	3.9	0.2	10.9	16.1	14.2	22.8	6.6
LPBs	(0.6)	5.0	11.9	23.8	31.0	60.5	16.7
FBs	3.7	5.0	6.6	7.1	7.2	11.6	3.5
CBs	7.0	10.3	29.4	47.0	52.4	94.9	26.7
SBs	(2.5)	(9.2)	(10.4)	(3.3)	(0.4)	(1.1)	(3.0)
All Banks	4.5	1.1	19.0	43.7	52.0	93.8	23.7
<i>Profit after tax</i>							
PSCBs	1.8	(4.6)	4.8	9.4	8.0	15.5	4.3
LPBs	(3.5)	2.0	6.4	14.8	21.8	41.1	11.2
FBs	1.4	2.4	4.2	4.2	5.8	8.0	2.4
CBs	(0.2)	(0.2)	15.3	28.4	35.6	64.6	17.9
SBs	(2.6)	(9.5)	(12.4)	(3.7)	(0.9)	(1.3)	(3.0)
All Banks	(2.8)	(9.8)	2.9	24.7	34.7	63.3	14.9

Table-3.2.2: Profitability Indicators
(Percent)

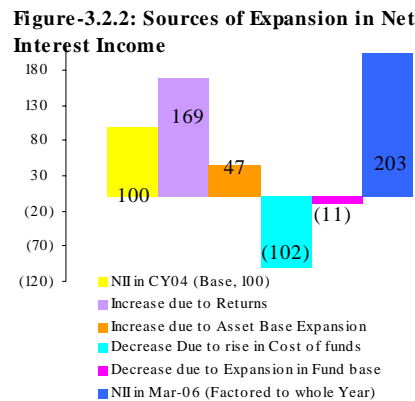
	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06
<i>After Tax ROA</i>							
PSCBs	0.2	(0.5)	0.6	1.0	1.3	2.2	2.4
LPBs	(0.7)	0.4	0.8	1.4	1.2	1.8	1.8
FBs	0.6	0.8	1.5	1.5	2.0	2.5	2.7
CBs	(0.0)	(0.0)	0.8	1.2	1.3	2.0	2.0
SBs	(2.3)	(8.8)	(12.1)	(3.7)	(0.8)	(1.2)	(11.1)
All Banks	(0.2)	(0.5)	0.1	1.0	1.2	1.9	1.6
<i>After Tax ROE (based on Equity plus Surplus on Revaluation)</i>							
PSCBs	4.9	(12.2)	11.5	17.3	17.2	20.9	19.9
LPBs	(17.4)	10.3	17.3	25.8	20.2	27.2	24.8
FBs	6.1	9.1	15.2	14.8	21.5	27.1	28.9
CBs	(0.3)	(0.3)	14.3	20.3	19.6	25.4	23.8
SBs	-	-	-	-	-	-	-
All Banks	(3.5)	(12.6)	3.2	20.0	20.3	25.8	20.5

income has been consistently increasing, its share in the gross income has remained on decline. Dividend income of the banks shrank as most of the corporate sector is yet to finalize its annual accounts. On expense side, operating expenses as percentage of gross income increased from 41.2 percent to 43.6 percent but it is still within the acceptable range. Operating expenses grew with moderate pace as compared to strong growth in the gross income. This increased

share of operating expenses in the gross income is mainly due to increase in business volume and branch expansion policy adopted by LPBs. The PSCBs have been able to further reduce this ratio from 34.3 percent in CY05 to 33.9 percent in Mar-06. Increase in the provisioning charges is mainly attributed to change in the regulatory requirements for provisioning against NPLs. However, the net interest income of Rs38.9 billion was sufficient to cover the operating expenses and provision charges (see **Figure 3.2.1**).



Tremendous growth in net interest income since start of CY05 is contributed by gradual increase in the interest rates. Increase in lending rates was instrumental in enhancing the profitability of banks. Increased return on government securities further amplified the earnings. Despite some uptick, return on deposits remained largely subdued. This resulted in improved net interest income of CBs which reached to Rs38.9 billion, which is well above Rs26.4 billion achieved during the corresponding quarter last year. Growth in assets base coupled with shift in assets mix towards high yield assets also caused volume driven expansion in the net interest income (see **Figure 3.2.2**, which shows the sources of rise in net interest income considering CY04 as base year).



Excess liquidity due to domestic savings and tremendous inflow of foreign remittances during last few years benefited the banks in the form of availability of low cost deposits. Coupled with rise in the lending rates, this resulted in widened gap between lending and deposit rates and enabled the banks to achieve unprecedented profitability in CY05. This gap has also to do with the structure of deposits. The current account deposits of banks carry no return as they provide the on-demand-withdrawal facility and their share in overall deposits is quite high. Increase in these zero return deposits has also pushed down the average return further. Spread after excluding non-remunerative deposits decreased by 98 basis points. The reducing gap between weighted average lending and deposit rates during the quarter under review has led to a minor decrease in the spread for the banking system (see **Figure 3.2.3**). This decline in spread is visible when comparison between weighted average rates for fresh disbursements and fresh deposits is made. (see **Figure 3.2.4**) shows trend in spread for fresh disbursements and deposits since Jul-05.

Trading gains of the banks are increasing mainly due to the surge in the equity, which have become attractive for the banks. Of the trading gains, 84.9 percent came from trading in quoted shares (see **Figure 3.2.5**).

Figure-3.2.3: Weighted average lending and deposit rates

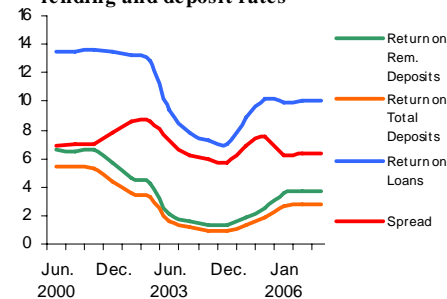


Figure-3.2.4: Weighted average rates for fresh disbursements and fresh deposits

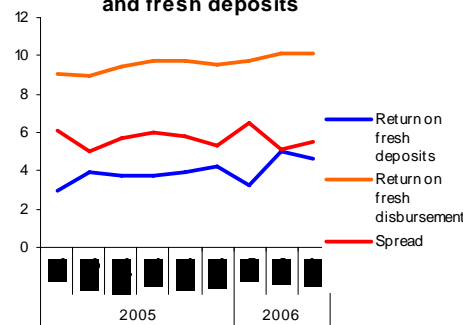
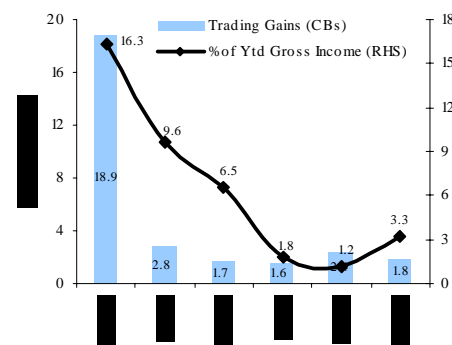


Figure-3.2.5: Periodic Growth in Trading Gains of CBs



The banking sector has gone through massive changes during the last decade. Marked with shift in ownership from public to private sector, mergers and acquisitions, significant improvement in the quality of human resource base, huge technological up gradation, and introduction of variety of products and services; the banking industry is consolidating its profitability. The level of growth in the earning assets and movement in the interest rate scenario backed by macro economic environment will largely shape the future course of the banking industry. The quality of assets and level of appropriate risk management policies adopted by the banks will have direct bearing on the future profitability indicators.

4. Risk Assessment of the Banking System

4.1 Credit Risk

Given the positive correlation between loans and default rate, credit risk of the banking system had started to rise following the fast expansion in loans in recent years. Addition of Rs3.5 billion in the NPLs of CBs during the quarter lends support to the concerns that banks are faced with higher level of credit risk. Consequently, NPLs of CBs increased to Rs139.1 billion from Rs135.6

billion in CY05 (see **Figure 4.1.1**). The rise in gross NPLs also impacted net NPLs of CBs which registered an increase of Rs1.7billion, causing total net NPLs of commercial banks to increase to Rs28.3 billion from Rs26.6 billion (see **Figure 4.1.2**).

While CBs witnessed a rise in their NPLs, SBs managed to reduce their NPLs by Rs4.1 billion. This helped mitigate the impact of increase in NPLs of CBs, rather gross NPLs and net NPLs of all banks declined by Rs0.5 billion and Rs2.3 billion respectively. The substantial decline in NPLs of SBs owes overwhelmingly to one large bank in the group, which resorted to aggressive write-offs and provisions against its chronic NPLs.

The key asset quality indicators however do not show any serious concern. In fact, NPLs to loans and net NPLs to net loans ratios of all banks kept their downward course

Figure-4.1.1: Total NPLs of Banks

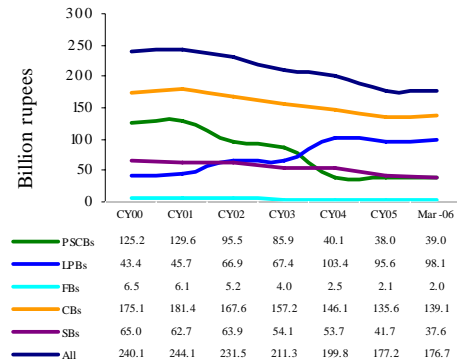


Figure-4.1.2: Net NPLs of Banks

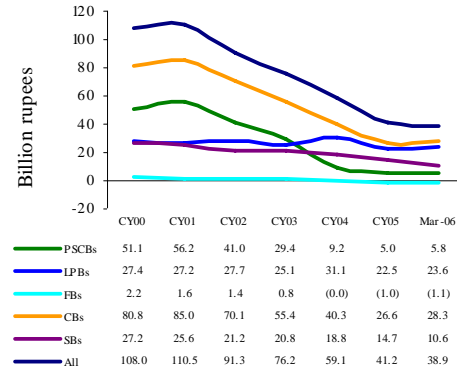
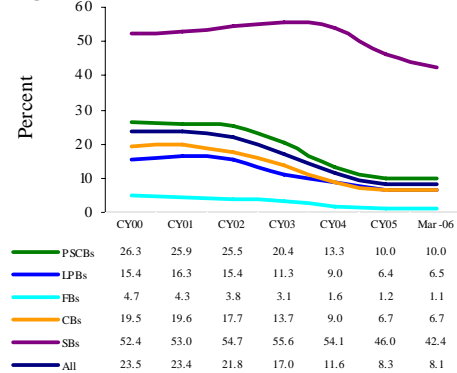


Figure-4.1.3: NPLs to Loans (Gross)



(see **Figures 4.1.3 & 4.1.4**). Despite increase in their NPLs in absolute terms, both the key ratios for CBs remained unchanged over the quarter. The rise in NPLs was neutralized by increase in loans of CBs.

One encouraging aspect of asset quality in recent times has been that net NPLs to net loans ratio of all banks continued to improve persistently. This depicts declining threat to the solvency position of the banking system. The increasing provision against NPLs has been instrumental in this regard. During the current quarter, the coverage ratio for all banks improved further to 78 percent from 76.8 percent in CY05. However, for CBs it declined because of relatively faster increase in NPLs. Despite the decline, the coverage ratio of CBs at 79.7 percent is still higher if compared with the ratio for all banks, and indicates lower level of threat to asset quality of banking system as significant portion of losses has already been booked by the banking system (see **Figure 4.1.5**).

The group-wise analysis shows that PSCBs and LPBs were mainly responsible for the increase in NPLs of CBs. On the other hand, FBs continued the downward trend in their NPLs. The deeper analysis reveals that there were 17 banks in all, which experienced increase in their NPLs.

Corporate sector is the major beneficiary of banks loans, and thus holds great significance for the asset quality of banks. During the quarter, loans to this segment experienced minor deterioration (see **Table 4.1**). However, the increase in NPLs ratio of this sector does not generate serious concern if viewed in the background of rapid increase in loans to this segment over the past couple of years.

Figure-4.1.4: Net NPLs to Net Loans

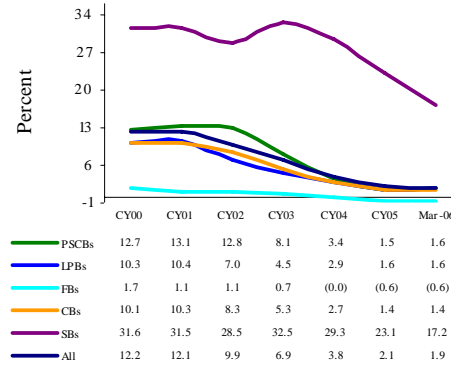
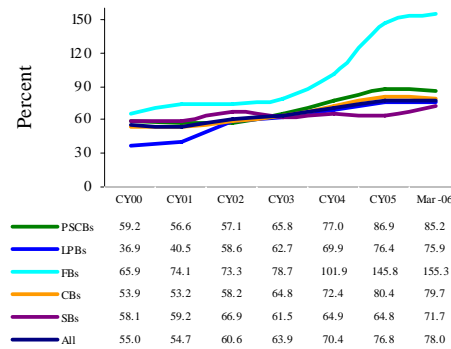


Figure-4.1.5: Provisions to NPLs



In contrast to fears surrounding the quality of loans to consumer segment, incidence of default against this portfolio of bank loans has so far remained well contained. This is reflected by an improvement in the ratio of NPLs to loans of this sector. The fall in the ratio owes largely to persistent increase in lending to this segment. The break-up shows higher level of default against consumer durable, which, however, absorbs very low proportion of total consumer finance, and thus does not cause any serious concern for the overall quality of loans. Other sub-sectors, which utilize greater loans, portray significantly low default rate.

Segment	CBs		SBs		All Banks	
	5-Dec	6-Mar	5-Dec	6-Mar	5-Dec	6-Mar
Corporate	6.9	7.0	95.8	99.9	7.2	7.4
SMEs	8.9	8.7	92.6	93.1	11.9	11.6
Agriculture	6.5	7.6	47.0	31.6	31.2	21.0
Consumers	1.9	1.3	18.4	26.5	1.9	1.3
<i>Credit Cards</i>	0.8	0.9	0.0	0.0	0.8	0.9
<i>Auto Loans</i>	0.9	0.9	17.5	34.8	0.9	0.9
<i>Consumer Durables</i>	6.2	10.3	31.9	29.3	7.3	11.2
<i>Mortgage Loans</i>	0.6	0.4	0.0	0.0	0.6	0.4
<i>Others</i>	3.3	1.8	0.0	0.0	3.3	1.8
Commodity Finance	1.2	1.4	0.0	0.0	1.2	1.4
Staff Loans	1.1	1.1	0.0	0.8	1.0	1.1
Others	21.1	9.8	9.2	9.1	21.0	9.7
Total	6.3	6.1	53.2	42.4	8.7	7.7

In terms of quality of loans, the performance of agriculture and SMEs segments was noticeable. NPLs to loans ratios for these segments declined over the quarter. In this respect, agriculture registered the highest decline in its ratio mainly because of heavy write-offs by a specialized bank. However, the sustainability of the downward trend is doubtful considering the past volatile behaviour of NPLs to this sector. This corresponds to the exposure of this sector to vagaries of weather.

The overall quality of the loans portfolio of the banking system remained satisfactory despite the fact that some CBs saw, at the end of Mar-06, increase in their NPLs portfolio. Banks however, will have to further tighten their credit appraisal and monitoring standards to stem increase in their NPLs portfolio. This becomes even more crucial keeping in view the fact that loans classification and provisioning criteria has now become more stringent. Any deterioration in asset quality will now quickly translate into additional provisioning, thereby adversely affecting the profitability and ultimately the solvency position of the banking system.

4.2 Market Risk

Though gradually, the rise in interest rates has been adding to the market risk profile of the banks. Changes in the macroeconomic variables both on national and international fronts have raised concerns for further rise in interest rates. This has inflated the interest rate risk especially for the banks with largely positive duration GAP.

Significant mismatches in the repricing profile drive the rate risk exposure of the banks. For all banks, though the repricing GAP is within the acceptable limit of +/- 10 percent of the total assets, the negative GAP is undesirable in the prevailing rising interest rate scenario (see **Figure 4.2.1**). Group wise, PSCBs, with the largest negative GAP of 17.2 percent followed by FBs are more prone to interest rate risk. Corollary to the significant negative GAPs in the short term buckets, the positive GAPs in the longer term bucket are on higher side, which prompts the risk of revaluation of such assets if the interest rates increase.

Maturity mismatches along with the yield curve movements have raised the yield curve risk for the banks. Though the increase in the interest rates remained gradual, (see **Figure 4.2.2**), comparatively higher increases in the shorter term interest rates has further flattened the yield curve. This flattening continued after

Figure-4.2.1: GAP (RSA-RSL) to TA -Mar-06

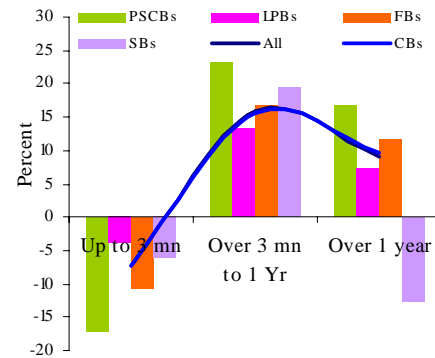


Figure-4.2.2 PKRV Rates (in %)

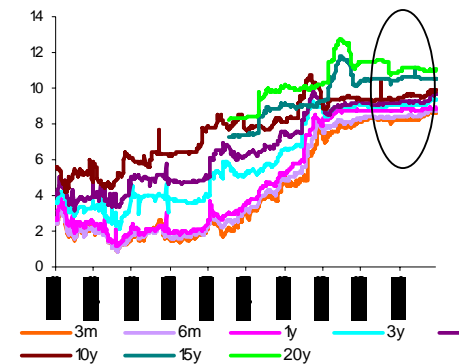
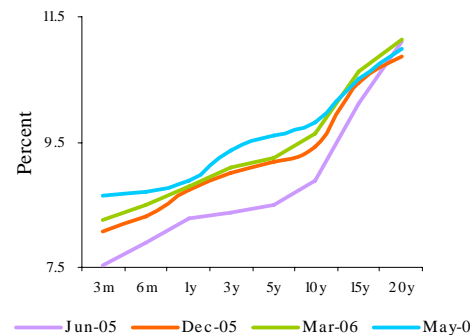


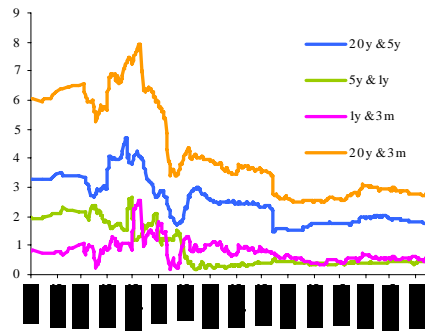
Figure-4.2.3: Shift in Yield Curve



the March-06 quarter as well (see **Figure 4.2.3**). Consequently, the yield spreads have also been squeezing further (see **Figure 4.2.4**).

There is a risk that any steepening in the yield curve due to increase in the long term interest rates would negatively affect the market value of equity of the banks especially with longer term fixed income assets and having positive duration GAPs.

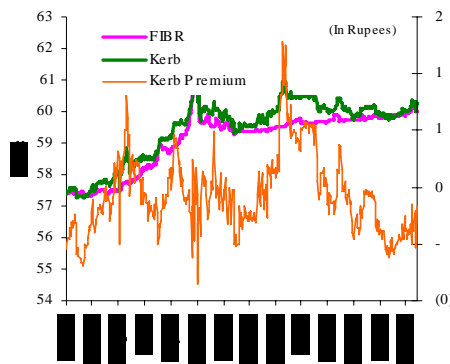
Figure -4.2.4: Yield Spread in PKRV Rates (in %)



Moreover, the increase in the interest rates also attracts the risk of revaluation especially for the banks with largely positive duration. Of the total portfolio, Pakistan Investment Bonds (PIBs) are more prone to this risk. Though the existing classification structure of investment extends some comfort to the banks in the form of not requiring them to book the revaluation deficits on their Held to Maturity (HTM) portfolio, if any, however, one should not neglect the hidden losses against such portfolio. Infact, banks, fearing revaluation losses on account of category shift, appear to be content with low returns on the securities by keeping them in the HTM category.

On external front, rising trade deficits and the interest rates have slightly weakened PKR against Dollar. Rupee Dollar exchange rate, which remained stable between the range of 59 and 60 for quite some time, crossed its psychological barrier of 60, and presently it hovers around 60.20 (see **Figure 4.2.5**). Kerb market premiums, however, remained on lower side.

Figure-4.2.5: FIBR Vs Kerb Rate



Risk against direct foreign currency exposure remained minimal, since the banks have their foreign currency assets significantly exceeding the foreign currency liabilities. In this position, infact, the banks would gain against any further depreciation of rupee. However, it is the appreciation of rupee, which may be a concern for such banks.

Rupee Dollar forward points remained positive, signalling the expectations of further weakening of Rupee against Dollar in near future. Responding to which, the Net Open Position (NOP) of all banks largely stayed positive (see **Figure 4.2.6**) and with-in the acceptable limits.

The total investment of banks in shares³ reduced slightly from Rs34.6 billion in CY05 to Rs34.4 in Mar-06 (see **Figure 4.2.7**). This is also reflected in the overall exposure of the banks in equities as percentage of their capital, that reduced to 11.3 percent from 12.0 percent in CY05; hence reducing the overall *equity price risk* of the banking sector. The equity of the banks also improved which caused the ratio to decline. Furthermore, the investments in shares as percentage of total investment of the banking sector also slightly came off to 4 percent from 4.3 percent in the Dec-05.

Group-wise, PSCBs showed significant reduction in their investments in shares; however, the impact of this fall was largely nullified by the increase in equity investments of LPBs by almost the same quantum. The equities exposure of PSCBs as percentage of its capital came off to 5.4 percent in Mar-06 from 10.1 percent in CY05, while that of LPBs increased to 15.2 percent from 14.2

Figure-4.2.6: NOP Vs Rs/\$ Exchange Rate

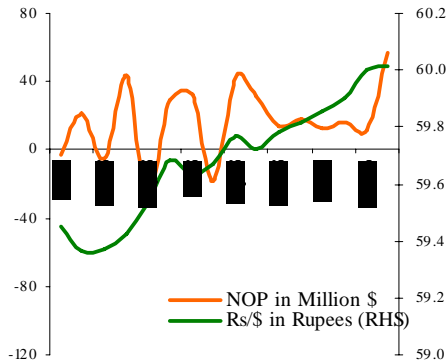


Figure-4.2.7: Exposure of Banks in Equities-Mar-06

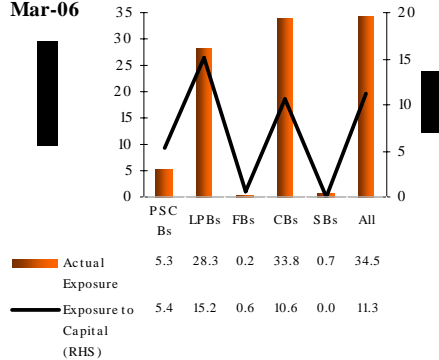
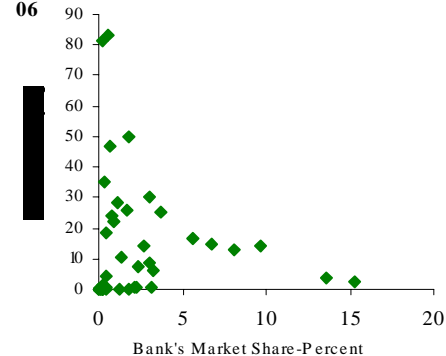


Figure-4.2.8: Total Exposure of Banks-Mar-06



³ At market value

percent during the same period. The exposure of FBs remained negligible in terms of their capital.

Whilst the overall exposure⁴ of most of the banks as percentage of their capital remained within reasonable limits, a few banks with relatively smaller share in the banking system carried high exposures, including indirect exposure as well (see **Figure 4.2.8**). This is further substantiated by the fact that only five banks account for 54 percent of the carry over transactions of the banking system. These banks need to contain their exposures at their individual end.

As behaviour of the stock market remains erratic, it holds special connotations for the banks carrying exposure therein. Resultantly, it is pertinent to gauge the resilience of banking system towards any unexpected fall in the market value of such investments. An exercise has thus been carried out to gauge the sensitivity of the banks towards fall in the stock market. Considering the volatility of the stock market and adopting a conservative approach, the exercise assumes a 35 percent fall in the stock market. Further, it has been assumed that the fall in the market index will translate into decline in the value of equity investments of the banks by same percentage. The decline in the value of shares has been compared with the surplus available with the banks against such investments. A comparison with CY05 position shows that surplus available with the overall banking sector increased by around 20 percent over the quarter. However, on a bank wise basis, 6 banks were already carrying deficit against equity investments. With the fall in the market value of shares by 35 percent, 21 more banks shall have their surplus converted into deficit. Group wise, PSCBs and SBs have sufficient surplus available against decline in the value of equity investments. However, LPBs show significant erosion in the available surplus, which converts to deficit at the

Figure-4.2.9: Impact of Adverse Movement in KSE-100 Index by 35 Percent

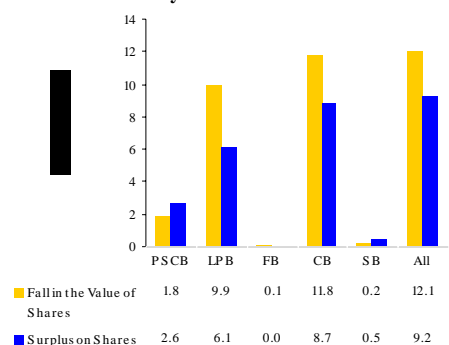


Table-4.2.1: Impact of 35 Percent Fall in Market Value of Shares on CAR of Banks

	Revised CAR	Actual CAR
Below 8	1	1
8 to 10	9	9
10 to 20	17	17
20 to 100	9	9
above 100	4	4

⁴ The exposure includes investment in shares at cost and investment in COT

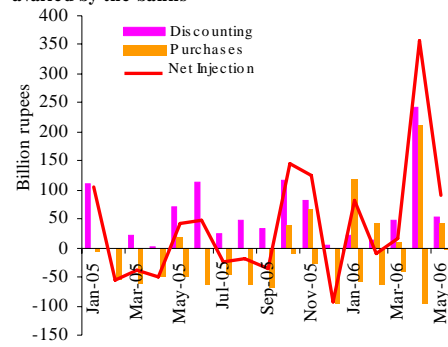
assumed fall in the value of such investments, and is also reflected in the position of CBs and all banks (see **Figure 4.2.9**). However, the calibration of such shock in the capital adequacy position of individual banks shows that none of the banks moves to lower capital adequacy brackets (see **Table 4.2.1**).

4.3 Liquidity Risk

Following the sharp growth in loans portfolio and the subsequent tight monetary policy stance, liquidity conditions in the market had started to show signs of strain in the past quarters. During March-06, liquidity pressures intensified even further.

Though SBP continued to manage the liquidity tightening through frequent OMOs, the Mar-06 quarter has witnessed net injections into the system (see **Figure 4.3.1**). These along with the substantial injections in the post quarter period were both solicited in the form of discounting as well as unsolicited i.e. the purchases made by SBP through OMOs following the frequent mop-ups. Such liquidity support was aimed at easing the apparently high liquidity pressures. During the period, overnight rates remained very close to the discount rate.

Figure-4.3.1: OMOs by SBP Vs Discounting available by the banks



While the primary objective of the current monetary policy stance has been to control inflation through prudent management of market liquidity, it has also been ensured not to stifle the growth objectives by raising interest rates too high. This is

Figure-4.3.2: Liquidity Indicators

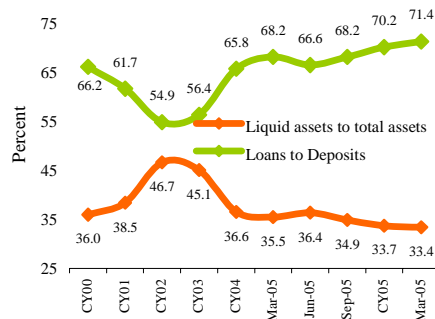
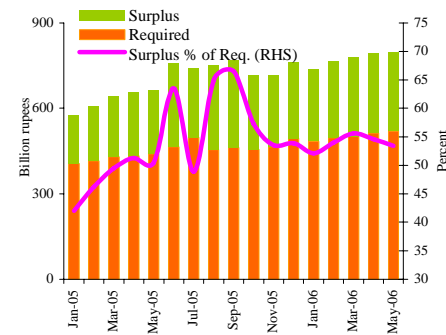
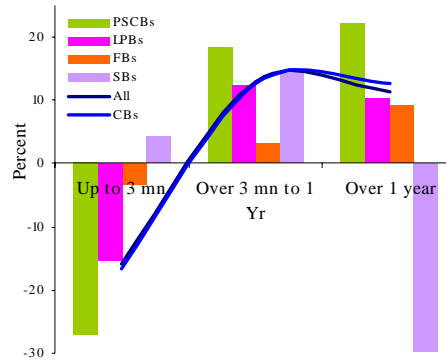


Figure-4.3.3: Liquidity Held by Banks



reflected by the fact that banks have not only been overbidding in the auctions but have also been able to meet corporates' demand for loans. Consequently, loans to deposit ratio further rose to 71.4 percent from 70.2 percent in CY05 (see **Figure 4.3.2**). Liquid assets to total assets ratio with a marginal decline stayed at 33.4. The banks are holding more than 50 percent excess reserves against their statutory liquidity requirement (see **Figure 4.3.3**). Liquidity coverage ratio, i.e. liquid asset to liquid liabilities ratio remained at 36 percent.

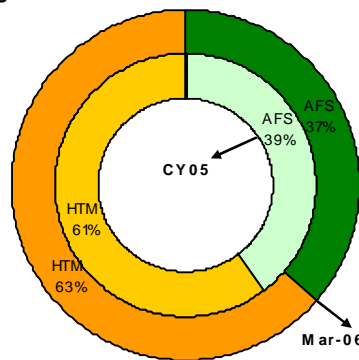
Figure-4.3.4: GAP (Assets-Liabilities) to TA-Mar-06



Significant mismatches in the maturity profile of assets and liabilities, however, add to the concern, especially when the banks are running negative GAPs in the short term buckets. For all banks, the maturity GAP in the three months bucket was around 16 percent of total assets (see **Figure 4.3.4**). Group wise, PSCBs and LPBs, owing to their negative GAP to total asset ratio of 27.9 percent and 15.4 percent respectively in the three months bucket, are more prone to the liquidity risk.

Market based liquidity may provide a solution to this if the banks are able to easily trade their fixed term assets in the secondary market. However, in the absence of active secondary market, which has become shallower after the banks have decided to place the majority of their tradable investments in Held-to-Maturity category. The banks have placed less than 1% of their total MTBs and PIBs in Held-for-Trading category; whereas around 63 percent of PIBs have been placed in HTM (see **Figure 4.3.5**). This classification decision of the banks has drained much of the market based liquidity. Moreover, since the banks have been raising liquidity against their HTM portfolio by entering into repo contracts, the heavy discounting may not actually represent the true liquidity constraint in the market. However, this liquidity would not be available with the banks as SBP has restricted any

Figure-4.3.5: Classification of PIBs Mar-06



repo against HTM securities from July-06 onwards and hence the liquidity conditions are expected to tighten further.

While the banks are finding new avenues of placing their funds in the form of advances of preferably higher maturities, largely financed through a steady flow of current or shorter term deposits, any pause in this inflow or rise in the interest rates due to further tightening of monetary policy may raise a funding liquidity risk especially for those having large negative GAPS in the short term.

5. Performance of Islamic Banking

The first quarter of CY06 witnessed further growth in the Islamic banking. The number of Islamic banking institutions (IBIs) rose during the Mar-06 (see **Table 5.1**). With one more

bank starting its operations, the number of operational full fledged Islamic banks (IBs) rose to 3⁵ as of Mar-06, the number of licensed IBs though remained at 5. Moreover, the number of licensed conventional banks to conduct Islamic banking business through Islamic Banking Branches (IBBs) increased to 10 with the IBBs standing at 34⁶. Furthermore, during the post quarter period, one more bank viz. First Dawood Islamic Bank Limited was licensed, increasing the number of IBs to 6.

With the expansion in branch network, total balance sheet footing of the Islamic banking system increased to Rs79 billion in Mar-06 after posting a growth of 11 percent over the quarter (see **Table 5.2**). The share of Islamic banking in the overall banking system, however, increased slightly to 2.1 percent in Mar-06 from 2.0 percent in CY05 given the growth in the assets of the banking system as a whole. Similarly, the share of deposits and financings also grew to 1.9 percent and 2.4 percent of banking system's deposits and financings respectively from

	Dec-03	Dec-04	Dec-05	Mar-06
No. of Islamic Banks (IBs)	1	2	2	3
No. of Branches	10	23	37	39
No. of conventional banks operating Islamic Banking Branches	3	7	9	10
No. of Islamic Banking Branches (IBBs)	7	21	33	34

	2003	2004	2005	Mar-06
SOURCES:				
Deposits	8,397.1	30,184.8	49,931.8	53,667.0
Borrowings	1,899.0	6,559.1	9,005.8	8,948.2
Capital & other funds	1,993.7	5,123.1	7,811.0	10,268.9
Other liabilities	624.8	2,276.1	4,744.8	6,416.9
	12,914.6	44,143.0	71,493.4	79,301.1
USES:				
Financing	8,652.2	27,535.5	45,786.2	48,717.6
Investments	1,242.3	2,007.0	1,854.2	6,034.8
Cash, bank balance, placements	1,978.5	11,899.7	19,314.3	19,718.7
Other assets	1,041.7	2,700.8	4,538.7	4,829.9
	12,914.6	44,143.0	71,493.4	79,301.1

Indicator	2003	2004	2005	Mar-06
Percent				
NPFs to total financing	0.7	0.9	1.0	0.9
Net NPFs to net financing	-	0.2	0.2	0.1
Provision to NPFs	100.0	82.3	80.6	86.3
Net Markup Income to total assets	1.7	1.4	2.3	3.2
Non Markup Income to total assets	2.2	1.4	1.7	1.4
Operating Expense to Gross Income	54.6	65.3	49.9	46.5
ROA (average assets)	2.2	1.2	1.7	2.0
Growth in Assets	84.5	241.8	62.0	10.9
Growth in Deposits	64.6	259.5	65.4	7.5
Growth in Financing	147.0	218.2	66.3	6.4

⁵ Meezan Bank Limited, AlBaraka Islamic Bank and Dubai Islamic Bank were fully operational till Mar-06, whereas Bank Islami Pakistan Limited started its operations after Mar-06 and Emirates Global Islamic Bank Limited has yet to start its operations

⁶ Number of licensed branches was 35 as of Mar-06, of which 34 branches were operating

1.8 percent and 2.3 percent in CY05. A look at the sources and uses of funds shows that the deposits and financings continue to dominate the balance sheet of the Islamic banking system. Though the share of deposits came off to 68 percent from 70 percent in CY05, it remained the highest, followed by funds from owners viz. capital. On the assets side, the asset composition remained on CY05 pattern and despite a slight increase in share of investments; the share of financings remained dominant. Even though the financings in absolute terms increased, the non performing financings (NPFs) increased only slightly, coupled with enhanced provisioning thereagainst; hence improving the asset quality indicators for Mar-06 (see **Table 5.3**). However, with the increase in financings, the IBIs would need to strictly monitor the chances for any deterioration in their asset quality in future.

The capital position of the IBIs shows that the capital grew at 31.5 percent over the quarter, higher than the growth in assets. Resultantly, the capital to total assets ratio improved from 10.9 percent in CY05 to 12.9 percent in Mar-06. Moreover, the IBIs are fairly meeting the capital adequacy requirements. The net NPFs to capital ratio also improved from 1.2 percent to 0.6 percent in Mar-06, owing to contained credit risk and strengthened capital, on account of improved profitability.

The break up of deposits reflects that the share of savings deposits that had declined in CY05, increased slightly in Mar-06 (see **Figure 5.1**). Also the fixed deposits comprised 33.3 percent of total as against 31.4 percent in CY05. The increase in both deposits types comes from a decline in the share of current deposits, which is well reflective of the growing interest of the Islamic banking clientele towards maintaining long term banking relationship with the IBs.

The composition of financings continue to reflect the predominance of Murabaha and Ijarah, the share of which further strengthened to 51 percent and 30 percent in Mar-06 from 44 percent and 29 percent in CY05 respectively (see **Figure-5.2**).

Figure-5.1: Composition of Deposits

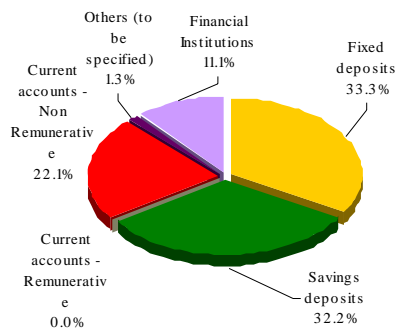
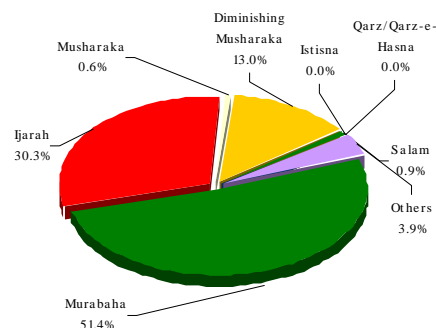


Figure-5.2: Modes of Financing



The significant increase in financings portfolio and islamic banking operations helped IBIs to improve their profitability (see **Table 5.4**). As IBIs mostly derived their profits from core business

	2003	2004	2005	Mar-06
Markup Income	406.4	1,081.0	3,164.3	1,358.9
Markup Expense	188.5	483.7	1,542.3	728.5
Net Markup Income	217.9	597.2	1,622.0	630.4
Provision Expense	(15.8)	36.0	175.6	27.8
Non Markup Income	287.4	596.0	1,206.6	276.2
Operating Expense	276.0	779.0	1,410.5	421.4
Profit Before Tax	245.0	378.2	1,242.6	457.3
Tax	27.0	36.2	265.2	88.8
Profit After Tax	218.0	342.0	977.4	368.6

activity, the net markup income as percentage of total assets also improved to 3.2 percent from 2.3 percent in CY05. Furthermore, as their operating expenses as a percentage of gross income came down, the profit after taxes improved during the quarter. Resultantly, the profits (annualized) showed a 51 percent growth from CY05, which outstripped the growth in assets. For that matter, the ROA of the Islamic banking system improved to 2.0 percent from 1.7 percent in CY05.

The overall performance of IBIs during the March quarter remained on a promising track as evident by the improvement in its key performance indicators and growth in balance sheet. However, this should not allow the complacency to set in as the IBIs need to exercise caution while expanding their financings portfolio to keep any chances for increase in NPFs remote.

6. Resilience of Pakistan's Banking System to Stress Tests

As part of its endeavour to monitor the resilience of banking system towards univariate and multivariate shocks to risk factors, SBP has been conducting this stress testing exercise. The stress testing exercise assumes the stress scenarios along the three factors i.e. credit quality, market and liquidity shocks (see **Box 6.1**). The ensuing paragraphs discuss the impact of various stress scenarios on the capital of commercial banks (CBs), both individually as well as group-wise viz. Public Sector Commercial Banks (PSCBs), Local Private Banks (LPBs) and Foreign Banks (FBs) (see **Box 6.2**). As for liquidity, the impact of the shocks has been gauged in terms of liquidity coverage ratio⁷.

BOX - 6.1

Reference Scenarios

Credit Risk

Scenario C-1 assumes a 10 percent increase in NPLs (with a provisioning rate of 100 percent).

Scenario C-2 assumes a withdrawal of benefit of FSV against NPLs.

Scenario C-3 refers to the NPLs to total loans ratio, which would wipe out capital (with a 50 percent provisioning rate for additional NPLs).

Market Risk: Interest Rate Risk

Scenario IR-1 assumes an increase in interest rates by 200 basis points.

Scenario IR-2 assumes an increase in interest rates of outlying maturities (by 0, 100, and 200 basis points)

Scenario IR-3 assumes a shift coupled with flattening of the yield curve by increasing 150,100 and 50 basis points in the outlying maturities respectively.

Market Risk: Exchange Rate Risk

Scenario ER-1 assumes a depreciation of ER by 25 percent (around double of the change in the monthly average PRS/US\$ exchange rate (12.83) over the period from Jan 1994 to Dec 2005, in September 2000).

Scenario ER-2 is based on the hypothetical assumption of appreciation of rupee by 10 percent.

Scenario ER-3 assumes a 10 percent depreciation of the rupee and deterioration in the quality of 10 percent of unhedged foreign currency loans with 50 percent provisioning requirement.

Market Risk: Equity Price Risk

Scenario E-1 assumes the impact of a 20 percent fall in the index.

Scenario E-2 assumes the impact of a 40 percent decline in the Stock Market Index.

Liquidity Risk

Scenario L-1 assumes a 5 percent decline in the liquid liabilities and its impact on liquidity coverage ratio is calculated after excluding Govt. securities under Held to Maturity category from liquid assets.

Scenario L-2 assumes a 10 percent decline in the liquid liabilities and its impact on liquidity coverage ratio is calculated after excluding Govt. securities under Held to Maturity category from liquid assets.

Scenario L-3 assumes a 5 percent decline in the liquid liabilities and its impact on liquidity coverage ratio is calculated after including Govt. securities under Held to Maturity category in liquid assets.

Scenario L-4 assumes a 10 percent decline in the liquid liabilities and its impact on liquidity coverage ratio is calculated after including Govt. securities under Held to Maturity category in liquid assets.

Box 6.2

Results of “Stress Tests” of Pakistani Banking System

<i>Single and multifactor sensitivity tests</i>		Dec-05		Mar-06	
		<i>%age Point Change in CAR</i>	<i>Revised CAR After Shock</i>	<i>%age Point Change in CAR</i>	<i>Revised CAR After Shock</i>
Credit Shocks					
Scenario	C-1 Deterioration in the quality of loan	-0.54	11.66	-0.52	11.83
Scenario	C-2 Withdrawal of Benefit of FSV	-1.04	11.16	-0.98	11.37
Scenario	C-3 Level of NPLs to loans ratio where capital wipes out (i.e. 33.52% in Dec-05 and 34.74% in Mar-06)	-12.20	0.00	-12.35	0.00
Market Shocks; Interest Rate Shocks					
Scenario	IR-1 Shift in the yield curve	-0.57	11.63	-0.94	11.41
Scenario	IR-2 Shift and steepening of the yield curve (large shock)	-1.10	11.10	-0.84	11.51
Scenario	IR-3 Shift & flattening of the yield curve	-0.30	11.90	-0.28	12.07
Market Shocks; Exchange Rate Shocks					
Scenario	ER-1 Depreciation of Rs/US\$ exchnage rate (double of the historical high)	0.50	12.70	1.42	13.77
Scenario	ER-2 Appreciation of Rs/US\$ exchnage rate (hypothetical)	-0.41	11.79	-0.58	11.77
Scenario	ER-3 Depreciation in ER along with deterioration of quality of FX Loans (50 % Provisioning)	-0.01	12.19	0.00	12.35
Market Shocks; Equity Price Shocks					
Scenario	E-1 Fall in the KSE index (historical high)	-0.02	12.22	0.00	12.35
Scenario	E-2 Fall in the KSE index (hypothetical scenario)	-0.32	12.52	-0.31	12.04
Liquidity Shocks					
<i>Liquidity Coverage Ratio</i>		<i>Actual</i>	<i>Stressed</i>	<i>Actual</i>	<i>Stressed</i>
Scenario	L-1 5 Percent Fall in the Liquid Liabilities	36.3	32.9	32.9	29.4
Scenario	L-2 10 Percent Fall in the Liquid Liabilities	36.3	29.2	32.9	25.5
Scenario	L-3 5 Percent Fall in the Liquid Liabilities	39.4	36.2	39.4	36.2
Scenario	L-4 10 Percent Fall in the Liquid Liabilities	39.4	32.6	39.4	32.6

Note: The results have not been adjusted for deferred tax benefits accruing on these losses.

Credit Risk

Three scenarios (C1 - C3) have been assumed to gauge the sensitivity of the banks towards deterioration in credit quality. **Scenario C-1** shows that banks are quite resilient towards this shock. The CAR of CBs falls by 52 basis points only (see **Figure 6.1**), while that of the groups, remains comfortably above 8 percent required benchmark. On individual basis too, banks are quite resilient mainly owing to low level of NPLs. The impact of shock assumed in **Scenario C-2** is somewhat on a higher side as a few banks rely excessively on the forced sale value of collateral. Though the CAR of CBs falls by 98 basis points after shock, it remains well above required benchmark. Also the group wise CAR remains comfortable. However, two banks experience significant decline in their CAR after shock, which falls below 8 percent. **Scenario C-3** determines the NPLs (with 50 percent provisioning) to total loans ratio that would wipe out the capital. The ratio of 6.67 percent for CBs, if increases to 34.7 percent would wipe out the

⁷ ratio of liquid assets to liquid liabilities

Figure-6.1: Impact of Credit Shocks on CAR, Mar-06

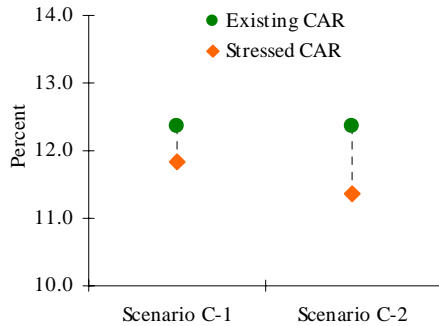
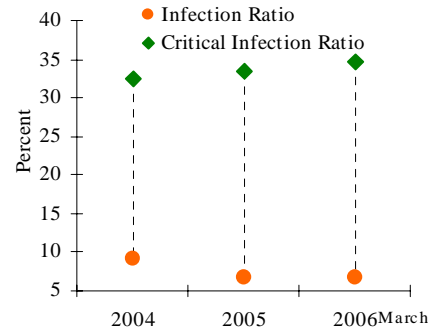


Figure-6.2: NPLs to Loans Ratio Vs the NPLs to Loans Ratio Which Wipes Out Capital



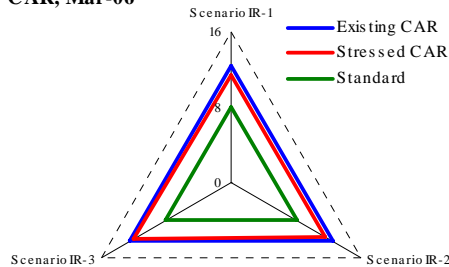
capital of all commercial banks (see **Figure 6.2**). Amongst groups, FBs have highest margin due to already low level of NPLs, followed by PSCBs and LPBs.

Market Risk

Interest Rate Risk

To gauge the interest rate sensitivity of CBs, three stress scenarios (IR-1 to IR-3) have been envisaged. The impact of shock assumed in **Scenario IR-1** remains on lower side as the CAR of CBs falls from 12.35 percent to 11.41 percent (see **Figure 6.3**). The CAR of all the groups remains well above 8 percent required CAR. Bank-wise, CAR of only one bank falls below 8 percent though it remains around 7.63. The impact of shock in **Scenario IR-2** is on a higher side. Whereas, the CBs experience a fall of 0.84 percentage points in their existing CAR of 12.35 percent, it remains safely above the required level. Group wise CAR remains comfortably above required level. Bank wise, three banks had their CAR fall below 8 percent benchmark, however slightly. The overall impact of shock assumed in **Scenario IR-3** on a cumulative basis is on the lower side as the CAR of CBs declines to 12.07 percent after the calibration of shock. Group wise, the fall in CAR for none of the groups exceeds 0.5 percentage points. As for the individual banks, CAR of one bank falls to 7.96 percent, slightly below 8 percent required level.

Figure-6.3: Impact of Interest Rate Shocks on CAR, Mar-06

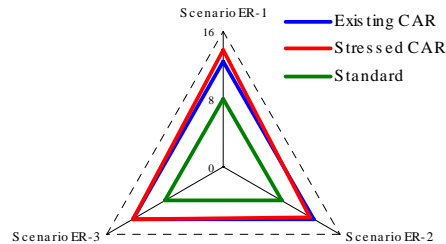


Exchange Rate Risk

Three different scenarios (ER-1 to ER-3) have been envisaged to assess the exchange rate risk of the banks. The impact of the shock in **Scenario ER-1** is rather positive on the CAR of the banks as the foreign currency (FCY) assets are more than FCY liabilities and any depreciation of exchange rate would actually benefit the banks as evident by the overall CAR of CBs that increases by 1.42 percentage points after shock (see **Figure 6.4**). In **Scenario ER-2**, as

opposed to Scenario ER-1, an increase in value of rupee would lower the value of net assets; hence the banks would experience a net decline. The impact of this appreciation in rupee shows that the CBs have a 0.58 percentage points decline in their CAR. Amongst all the groups, PSCBs experience the greatest fall in their CAR. On individual basis, CAR of none of the banks falls below 8 percent benchmark. **Scenario ER-3** assumes a 10 percent depreciation of the rupee which on one side increases the value of net assets but on the other side may end up hampering the loan repayment capacity of the borrower. This scenario taxes the benefit attained from the exchange rate depreciation by assuming deterioration in the quality of 10 percent of unhedged foreign currency loans with 50 percent provisioning requirement. The impact of this shock is also not that large as the FCY loans do not form a significant portion of total FCY assets. The CAR of one of the banks falls below 8 percent, however, on a group basis, CAR remains unchanged.

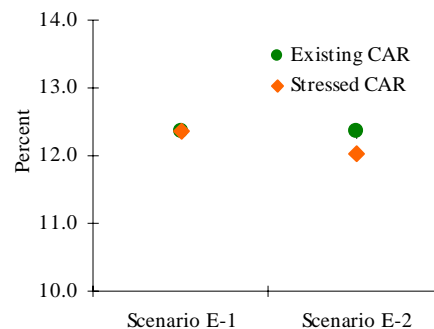
Figure-6.4: Impact of Exchange Rate Shocks on CAR, Mar-06



Equity Price Risk

Two scenarios (E1 & E2) have been assumed to gauge the sensitivity of the banks towards equity price movements. The impact of **Scenario E-1** is not significant as the direct equity investments of the banks are not a significant portion of their total investments (see **Figure 6.5**). The CAR of CBs remains unchanged, while that of LPBs and FBs falls merely by few basis points. On

Figure-6.5: Impact of Equity Price Shocks on CAR- Mar-06



individual basis, no bank has its adjusted CAR to fall below 8 percent. In *Scenario E-2*, since the LPBs carry the highest share in such investments, of all the groups, the fall in their CAR though still quite comfortable, is greatest at 40 basis points. As for CBs, their CAR falls from 12.35 percent to 12.04 percent. Individually, all banks are quite comfortable.

Liquidity Risk

Since liquidity risk relates to the inability of a bank to meet its short term liquidity demands, four scenarios (L1 to L4) seek to measure the liquidity risk of the banks through liquidity coverage ratio. As the statutory liquidity requirement is 20 percent of time and demand liabilities (inclusive of cash reserve requirement), the exercise considers 25 percent as minimum acceptable level and 30 percent and above for comfortable liquidity stance. Further, in Scenarios L1 and L2, liquid assets do not include investments in Held to Maturity category, whereas, L3 and L4 measure liquidity risk including such investments as well.

The result in *Scenario L-1* shows that the liquidity coverage ratio of CBs declines from 32.9 percent to 29.4 percent after shock and remains quite close to comfortable ratio of 30 percent (see **Figure 6.6**). Amongst groups, LPBs experience greatest decline in liquidity coverage ratio, which falls from 29.7 to 26.0 percent. Individually, 5 banks have their liquidity coverage fall below the minimum acceptable benchmark of 25 percent while 6 banks experience severe liquidity shortage with their ratio falling below the regulatory requirement of 20

Figure-6.6: Liquidity Coverage Ratio After Excluding HTM Portfolio-Mar-06

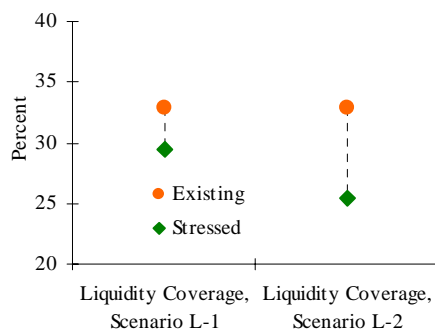
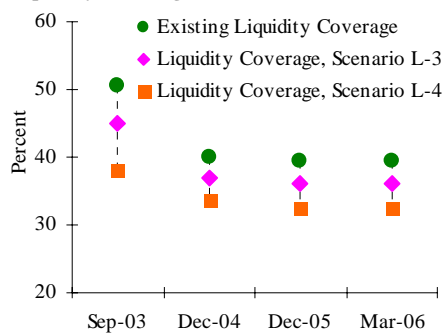


Figure-6.7: Impact of Liquidity Shocks on Liquidity Coverage Ratios-Mar-06



percent. *Scenario L-2*, since it is an extreme shock condition, though not implausible, results into greater deterioration in the liquidity stance of the banks. Though the liquidity coverage ratio of CBs remains above minimum acceptable

benchmark of 25 percent; the ratio of LPBs falls to 21.9 percent, just slightly above the regulatory requirement of 20 percent. For other groups, liquidity stance is within acceptable benchmark. Individually, 7 banks have their ratio fall below 25 percent, and 10 banks stand unable to meet the regulatory requirement of 20 percent. The impact of shock assumed in *Scenario L-3* on the liquidity ratio of the banks is not that large. The ratio of all the groups remains above comfortable benchmark of 30 percent after the calibration of shock (see **Figure 6.7**). However, 3 banks have their liquidity coverage ratio fall below 25 percent. The liquidity coverage ratio of all the groups in *Scenario L-4* remains well above the comfortable benchmark of 30 percent after shock. However, on individual basis, 2 banks have their ratio fall below 25 percent benchmark while 3 banks stand unable to meet regulatory requirement of 20 percent.

Financial Soundness Indicators

Annex-I

Indicators	2000	2001	2002	2003	2004	2005	Mar-06
CAPITAL ADEQUACY							
Risk Weighted CAR							
Public Sector Commercial Banks	10.4	9.6	12.3	11.0	13.4	14.5	15.5
Local Private Banks	9.2	9.5	9.7	9.0	10.1	10.6	11.0
Foreign Banks	18.0	18.6	23.2	23.0	17.4	16.4	16.1
Commercial Banks	11.4	11.3	12.6	11.1	11.4	11.9	12.3
Specialized Banks	(3.3)	(13.9)	(31.7)	(28.2)	(9.0)	(7.7)	(12.4)
All Banks	9.7	8.8	8.8	8.5	10.5	11.3	11.6
Tier 1 Capital to RWA							
Public Sector Commercial Banks	7.7	7.1	8.6	8.2	8.6	8.8	9.8
Local Private Banks	8.1	8.4	6.6	7.0	7.5	8.3	8.7
Foreign Banks	17.9	18.6	23.0	23.0	17.1	16.1	15.8
Commercial Banks	9.8	9.7	9.7	9.1	8.6	9.1	9.5
Specialized Banks	(3.4)	(13.9)	(31.7)	(28.7)	(15.0)	(13.6)	(18.2)
All Banks	8.3	7.3	6.2	6.5	7.6	8.3	8.6
Capital to Total Assets							
Public Sector Commercial Banks	4.6	3.7	5.6	6.1	8.7	12.6	13.5
Local Private Banks	3.5	3.8	5.2	5.3	6.5	7.0	7.4
Foreign Banks	8.8	8.5	10.6	9.9	8.9	9.5	9.4
Commercial Banks	4.9	4.6	6.1	6.1	7.2	8.4	8.8
Specialized Banks	(1.1)	(10.3)	(23.0)	(10.0)	(9.4)	(8.1)	(10.7)
All Banks	4.5	3.8	4.8	5.5	6.7	7.9	8.2
ASSET QUALITY							
NPLs to Total Loans							
Public Sector Commercial Banks	26.3	25.9	25.5	20.4	13.3	10.0	10.0
Local Private Banks	15.4	16.3	15.4	11.3	9.0	6.4	6.5
Foreign Banks	4.7	4.3	3.8	3.1	1.6	1.2	1.1
Commercial Banks	19.5	19.6	17.7	13.7	9.0	6.7	6.7
Specialized Banks	52.4	53.0	54.7	55.6	54.1	46.0	42.4
All Banks	23.5	23.4	21.8	17.0	11.6	8.3	8.1
Provision to NPLs							
Public Sector Commercial Banks	59.2	56.6	57.1	65.8	77.0	86.8	85.2
Local Private Banks	36.9	40.5	58.6	62.7	69.9	76.4	75.9
Foreign Banks	65.9	74.1	73.3	78.7	101.9	145.9	155.3
Commercial Banks	53.9	53.2	58.2	64.8	72.4	80.4	79.7
Specialized Banks	58.1	59.2	66.9	61.5	64.9	64.8	71.7
All Banks	55.0	54.7	60.6	63.9	70.4	76.7	78.0
Net NPLs to Net Loans							
Public Sector Commercial Banks	12.7	13.1	12.8	8.1	3.4	1.5	1.6
Local Private Banks	10.3	10.4	7.0	4.5	2.9	1.6	1.6
Foreign Banks	1.7	1.1	1.1	0.7	(0.0)	(0.6)	(0.6)
Commercial Banks	10.1	10.3	8.3	5.3	2.7	1.4	1.4
Specialized Banks	31.6	31.5	28.5	32.5	29.3	23.1	17.2
All Banks	12.2	12.1	9.9	6.9	3.8	2.1	1.9
Net NPLs to Capital							
Public Sector Commercial Banks	124.5	160.2	83.4	50.0	16.2	5.5	6.0
Local Private Banks	153.5	125.2	54.8	39.1	24.3	13.0	12.7
Foreign Banks	9.0	5.8	4.7	3.2	(0.2)	(3.0)	(3.2)
Commercial Banks	96.7	100.7	54.2	36.9	19.0	9.0	8.9
Specialized Banks	-	-	-	-	-	-	-
All Banks	131.3	150.5	85.5	54.4	29.2	14.3	12.7
EARNINGS							
Return on Assets (Before Tax)							
Public Sector Commercial Banks	0.5	-	1.3	1.8	2.4	3.3	3.7
Local Private Banks	(0.1)	0.9	1.4	2.2	1.7	2.7	2.7
Foreign Banks	1.4	1.7	2.3	2.6	2.5	3.6	4.0
Commercial Banks	0.4	0.6	1.5	2.1	2.0	2.9	3.0
Specialized Banks	(2.5)	(8.4)	(10.2)	(3.3)	(0.4)	(1.0)	(11.1)
All Banks	0.3	0.1	0.9	1.8	1.9	2.8	2.6
Return on Assets (After Tax)							
Public Sector Commercial Banks	0.2	(0.5)	0.6	1.0	1.3	2.2	2.4
Local Private Banks	(0.7)	0.4	0.8	1.4	1.2	1.8	1.8
Foreign Banks	0.6	0.8	1.5	1.5	2.0	2.5	2.7
Commercial Banks	(0.0)	(0.0)	0.8	1.2	1.3	2.0	2.0
Specialized Banks	(2.3)	(8.8)	(12.1)	(3.7)	(0.8)	(1.2)	(11.1)
All Banks	(0.2)	(0.5)	0.1	1.0	1.2	1.9	1.6

Financial Soundness Indicators

Annex-I

Indicators	2000	2001	2002	2003	2004	Dec-05	Mar-06
ROE (Avg. Equity & Surplus) (Before Tax)							
Public Sector Commercial Banks	10.9	0.5	26.3	29.9	30.8	30.7	30.1
Local Private Banks	(3.2)	25.4	32.3	41.5	28.8	40.1	36.8
Foreign Banks	15.6	19.3	24.2	25.0	26.7	38.9	42.7
Commercial Banks	8.8	12.2	27.5	33.7	29.0	37.2	35.5
Specialized Banks	-	-	-	-	-	-	-
All Banks	5.7	1.4	21.1	35.4	30.5	38.2	32.6
ROE (Avg. Equity & Surplus) (After Tax)							
Public Sector Commercial Banks	4.9	(12.2)	11.5	17.3	17.2	20.9	19.9
Local Private Banks	(17.4)	10.3	17.3	25.8	20.2	27.2	24.8
Foreign Banks	6.1	9.1	15.2	14.8	21.5	27.1	28.9
Commercial Banks	(0.3)	(0.3)	14.3	20.3	19.6	25.4	23.8
Specialized Banks	-	-	-	-	-	-	-
All Banks	(3.5)	(12.6)	3.2	20.0	20.3	25.8	20.5
NI/Gross Income							
Public Sector Commercial Banks	61.8	69.9	69.5	64.1	63.7	71.3	76.7
Local Private Banks	63.2	72.1	65.5	55.9	62.0	73.0	73.8
Foreign Banks	54.0	59.4	57.5	55.3	57.7	61.5	69.1
Commercial Banks	61.2	68.9	66.1	58.9	61.9	71.3	73.8
Specialized Banks	78.6	86.7	78.0	62.2	81.9	87.7	84.5
All Banks	62.3	70.4	67.1	59.2	62.8	72.0	74.3
Cost / Income Ratio							
Public Sector Commercial Banks	70.1	62.3	56.9	43.9	39.5	34.3	33.9
Local Private Banks	80.9	67.3	60.0	53.2	56.2	43.1	47.0
Foreign Banks	59.4	54.5	45.4	48.2	49.0	42.2	41.0
Commercial Banks	71.6	62.7	56.7	49.0	51.7	41.2	43.7
Specialized Banks	70.5	59.0	84.7	67.5	57.8	47.8	88.1
All Banks	71.6	62.4	59.1	50.5	52.0	41.5	45.0
LIQUIDITY							
Liquid Assets/Total Assets							
Public Sector Commercial Banks	37.1	36.5	49.0	49.1	43.9	35.6	32.5
Local Private Banks	34.0	39.8	47.1	42.9	34.3	32.4	32.6
Foreign Banks	45.2	50.3	48.5	49.2	39.8	41.8	42.7
Commercial Banks	37.5	39.9	48.1	46.1	37.0	33.9	33.6
Specialized Banks	12.7	13.6	16.4	22.9	25.3	25.8	28.9
All Banks	36.0	38.5	46.7	45.1	36.6	33.7	33.4
Liquid Assets/Total Deposits							
Public Sector Commercial Banks	45.0	43.4	59.6	59.0	52.6	44.7	40.9
Local Private Banks	44.3	49.6	60.2	54.5	42.3	40.3	41.1
Foreign Banks	67.7	78.3	74.2	68.9	53.4	57.9	60.2
Commercial Banks	48.0	50.3	61.5	57.8	45.7	42.7	42.8
Specialized Banks	90.8	79.8	98.5	135.0	154.1	183.2	277.4
All Banks	48.5	50.7	61.8	58.5	46.5	43.5	43.8
Advances/Deposits							
Public Sector Commercial Banks	54.0	53.8	44.3	45.7	49.7	59.8	62.2
Local Private Banks	67.5	57.9	52.3	58.2	67.3	70.8	71.6
Foreign Banks	71.5	66.8	72.0	63.8	70.1	68.7	69.9
Commercial Banks	60.5	56.9	51.0	53.6	63.6	68.4	69.5
Specialized Banks	553.0	450.5	453.8	379.1	370.5	400.7	517.2
All Banks	66.2	61.7	54.9	56.4	65.8	70.2	71.4

Note: The indicators for March 2006 are based on Un-audited returns

Annex-II

Selected Indicators for Different Categories of Banks, Mar-31, 2006

Indicators	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Share of Total Assets	53.3%	72.1%	92.4%	100%
Share of Total Deposits	56.9%	76.4%	93.5%	100%
Share of Gross Income	57.1%	76.1%	95.0%	100%
Share of Risk Weighted Assets	52.2%	71.3%	92.4%	100%
<u>Capital Adequacy</u>				
Capital/RWA	12.0%	11.8%	12.0%	11.6%
Tier 1 Capital / RWA	8.4%	8.6%	8.9%	8.6%
Net Worth / Total Assets	8.9%	8.5%	8.5%	8.2%
<u>Asset Composition</u>				
Sectoral Distribution of Loans (Domestic)				
- Corporate Sector	47.6%	70.1%	92.4%	100%
- SMEs	54.3%	71.1%	88.9%	100%
- Agriculture	36.3%	42.5%	93.7%	100%
- Consumer Finance	60.5%	80.0%	96.6%	100%
- Commodity Financing	65.0%	86.7%	95.4%	100%
- Staff Loans	67.1%	84.4%	94.8%	100%
- Others	47.8%	64.8%	85.7%	100%
- Total	51.2%	71.1%	92.5%	100%
NPLs / Gross Loans	8.3%	7.5%	7.1%	8.1%
Net NPLs / Capital	7.8%	9.0%	9.9%	12.7%
<u>Earning & Profitability</u>				
ROA	2.1%	2.2%	1.8%	1.6%
ROE	25.6%	26.7%	21.5%	20.5%
Net Interest Income / Gross Income	76.8%	75.8%	75.0%	74.3%
Income from Trading & Foreign Exchange / Gross Income	5.7%	5.6%	6.4%	6.9%
Non-Interest Expense / Gross Income	44.2%	42.6%	42.1%	45.0%
<u>Liquidity</u>				
Liquid Assets / Total Assets	34.1%	33.1%	32.9%	33.4%
Liquid Assets held in Govt. Securities / Total Liquid Assets	52.5%	53.4%	54.5%	53.0%
Liquid Assets / Total Deposits	41.8%	41.0%	42.6%	43.8%

Annex-III

Major Banking Statistics, March 31, 2006

S. NO	Name of Bank	Assets	Deposits	Equity
1	Bank of Khyber	23,814	16,107	3,289
2	Bank of Punjab	114,813	90,089	14,907
3	First Women Bank Limited	9,690	8,414	778
4	National Bank of Pakistan	572,247	457,237	78,275
5	Industrial Development Bank of Pakistan	7,408	7,884	26,899
6	Zarai Taraqiati Bank Limited	85,048	1,829	10,733
7	Punjab Provincial Cooperative Bank	14,866	1,524	1,761
8	SME Bank	7,297	686	2,178
9	Allied Bank Limited	208,547	171,821	14,171
10	Bank Alfalah Limited	251,601	209,193	7,865
11	Bank Alhabib Limited	99,441	80,460	5,300
12	Askari Commercial Bank Limited	137,086	107,381	9,042
13	Crescent Commercial Bank Limited	10,972	7,552	2,003
14	Atlas Bank Limited	9,377	4,653	1,518
15	Habib Bank Limited	506,513	426,777	41,040
16	Faysal Bank Limited	112,031	71,129	14,672
17	KASB Bank Limited	21,216	16,237	2,097
18	Dubai Islamic Bank Pakistan Limited	2,174	-	2,099
19	MCB Bank Limited	301,373	242,339	27,422
20	Meezan Bank Limited	31,422	22,926	3,191
21	Metropolitan Bank Limited	87,475	58,154	5,959
22	Mybank Limited	17,418	13,274	2,594
23	NDLC-IFIC Bank Limited	33,994	23,050	4,205
24	PICIC Commercial Bank Limited	66,690	55,417	3,856
25	Prime Commercial Bank Limited	51,914	40,595	3,548
26	SaudiPak Commercial Bank Limited	40,122	30,416	3,914
27	Soneri Bank Limited	63,486	47,671	4,377
28	United Bank Limited	358,969	288,677	22,554
29	Union Bank Limited	122,048	92,561	5,127
30	ABN Amro Bank	66,651	51,763	4,517
31	Rupali Bank Limited	648	123	164
32	Oman International Bank	1,753	497	1,025
33	Habib Bank AG Zurich	45,404	32,007	2,967
34	HongKong & Shanghai Banking Corporation	15,981	10,475	2,243
35	Deutsche Bank Limited	7,001	2,008	2,245
36	Bank of Tokyo	5,435	2,647	1,749
37	Citibank	79,526	50,604	6,159
38	Albaraka Islamic Bank	14,995	10,663	2,392
39	Standard Chartered Bank	119,500	92,000	9,705
40	American Express Bank	7,513	5,373	1,087

Group-wise Composition of Banks, March 31, 2006

1997-1998	2003	2004	2005	March-2006
A. Public Sector Comm. Banks (6) - Habib Bank Ltd. - National Bank of Pakistan - The Bank of Khyber - The Bank of Punjab - United Bank Ltd. - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab	A. Public Sector Comm. Banks (5) - Habib Bank Ltd. - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab B. Local Private Banks (18) - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd. - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Mezzan Bank - NDLC-IFIC Bank Ltd. - Crescent Bank Ltd.	A. Public Sector Comm. Banks (4) - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab B. Local Private Banks (20) - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd. - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Mezzan Bank - NDLC-IFIC Bank Ltd. - Crescent Bank Ltd. - Habib Bank Ltd. - Dawood Bank C. Foreign Banks (11) - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - The Bank of Tokyo - Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez ² - Deutsche Bank A.G. - Doha Bank ³ - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank D. Specialized Banks (3) - Zari Taraqqai Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd.	A. Public Sector Comm. Banks (4) - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab B. Local Private Banks (20) - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - My Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd. - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - MCB Bank Ltd. - Allied Bank Limited. - United Bank Ltd. - Mezzan Bank - NIB Bank Ltd. - Crescent Commercial Bank Ltd. - Bank Ltd. - Habib Bank Ltd. - Dawood Bank ³ C. Foreign Banks (11) - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - The Bank of Tokyo - Mitsubishi UFI Ltd. - Citibank, N.A. - Deutsche Bank A.G. - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank D. Specialized Banks (4) - Zari Taraqqai Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. - SME Bank Limited ⁴ All Commercial Banks (35) Include A + B + C All Banks (39) Include A + B + C + D	A. Public Sector Comm. Banks (4) - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab B. Local Private Banks (21) - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd. - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - MCB Bank Ltd. - Allied Bank Limited. - United Bank Ltd. - Mezzan Bank - NIB Bank Ltd. - Crescent Commercial Bank Ltd. - Habib Bank Ltd. - Atlas Bank Limited. - Dubai Islamic Bank Pakistan Limited ⁵ C. Foreign Banks (11) - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - The Bank of Tokyo - Mitsubishi UFI Ltd. - Citibank, N.A. - Deutsche Bank A.G. - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank D. Specialized Banks (4) - Zari Taraqqai Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. - SME Bank Limited All Commercial Banks (36) Include A + B + C All Banks (40) Include A + B + C + D

1. HBL now stands as local private bank after being privatized on 26-02-2004.
2. Bank of Ceylon was merged with Dawood Commercial Bank(Now Atlas Bank Limited) on 25-03-2004.
3. Credit Agricole was merged with NDLC-IFIC Bank on 19-04-2004.
4. Doha Bank was merged with Trust Commercial Bank which was later merged with Crescent Commercial Bank.
5. The name of the bank was changed to Atlas Bank Limited on March 04, 2006.
6. SME Bank Ltd has been included in Specialized Banks category after it has been granted the banking license during Jun 2005 quarter.
7. Dubai Islamic Bank Limited started its operation during March quarter of 2006.