State Bank of Pakistan

Banking Surveillance Department

Quarterly Performance Review of the Banking System

MARCH 2008

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List of Abbreviations

CAR	Capital Adequacy Ratio
CB	Commercial Bank
CDR	Credit to Deposit Ratio
CRR	Cash Reserve Requirement
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
SLR	Statutory Liquidity Requirement
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 fulfils 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 /un-remitted 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.

Quarterly Performance Review of the Banking System
March 2008

1. Overview

The statistics of the quarter under review and the latest available information on domestic operations of the banking system suggest that, after achieving vibrant growth over the last four years, the banking system has started to show the signs of stabilization. The system's asset base grew at a passive rate over the quarter. However, there was strong increase in demand for bank credit from corporate sector. Since this growth was not supported by concomitant growth in deposits, the banking system had to divest a part of their liquid assets for meeting the additional credit demand. Therefore, the asset mix of the banking system shifted towards the loans from investments. Moreover, the tight monetary policy started to reflect its signs in squeezing liquidity indicators and the surplus liquidity within the banking system further contracted. Nonetheless, banking system very effectively managed its asset-liability profile without facing any serious liquidity concerns.

The slack down in economic activities and allied macroeconomic indicators are affecting the loan repayment capacity of the borrowers. NPLs of the banking system, which have been gradually increasing for the last two years, further inched up during the quarter. However, one third of the quarter's increase was contributed by one bank that booked extraordinary loan losses during the quarter. The banking system however managed to provide for a part of the additional loan losses through its satisfactory operating performance. The returns indicators though declined slightly as compared with past results, the decline was mainly caused by the large losses posted by one bank. Moreover, the contraction in spread between returns on fresh advances and returns on fresh deposits as well as the higher base effect also dampened the return ratios. On the back of satisfactory earnings, the solvency of the banking system remained firm during the quarter, with key solvency indicators maintaining their levels – though the quarter statistics also include the capital charge for the operational risk, which has been introduced for the first time under Basel-II regime. The overall solvency of the banking system stays above satisfactory levels; however, a recent trend of gradual rise in NPLs presents caveat for the system, which so far has been able to cover the additional infections through its strong earnings. The market risk, however, remained quite contained to pose any major solvency concerns. Moreover, the results of the stress tests signify that the system maintained its strong resilience against unusual but plausible shocks in major risk factors.

Executive Summary

Asset and Funding Structure:

Asset base of the banking system grew at a passive rate during the quarter under review. Growth in total assets of the system was slower than that in corresponding quarters of the previous years – over the quarter growth of 1.3 percent compared with 4.0 percent growth for Mar-07, 2.3 percent for Mar-06. The latest available statistics also show the signs of stabilization in growth of the banking system. Strong demand for bank credit from corporate sector helped , advances of the banking system to grow at fast pace of 4.3 percent, even when other major sectors viz. SME and consumer reduced their borrowings from the banking system. Unaccompanied by concomitant growth in the deposits (0.8 percent), growth in advances caused banks reduce their investments by 6.8 percent.

Solvency

Solvency position of the banking system remained firm during the quarter, as CAR of the system remained close to the level of last quarter i.e. 13.0 percent (13.1 percent in Dec-07). It is despite that current quarter's risk weighted assets include the charge for operational risk i.e. Rs 446.5 billion that has been introduced for the first time under Basel-II regime. The qualifying risk based capital increased by Rs31 billion (6.6 percent) over the quarter. The composition of the risk based capital shows that the share of core capital slightly increased to 80.5 percent in Mar-08 against 79.2 percent in Dec-07. The increase in NPLs have though aroused the concern for the solvency; however, this risk remains low as the impairment ratio stands within manageable limits i.e. 6.8 percent.

Profitability

The profitability of the banking system showed the signs of slight slow down compared with the results of the last full year and corresponding quarter of last year. The system posted a before tax profit of Rs28.1 billion, compared with Rs 33.1 billion for the corresponding first quarter of CY-07. Accordingly, the return on assets and equity (ROA: 1.4 percent and ROE: 13.2 percent) also shrank as compared with the corresponding quarter as well as the full year of CY-07. However, the major reason for this deterioration was the significant losses posted by one bank during the quarter. Further, higher base effect due to growth in assets and equity base dampened the returns ratios, while the spread between returns on additional loans and deposits further contracted during the quarter. Group-wise, LPBs and FBs have shown improvement over the quarter though both ROA and ROE remain lower than the corresponding quarter of the last year. The PSCBs, with better return ratios otherwise, experienced sharp decline mainly due to losses in one bank of the group.

Credit Risk

The rapid credit growth in recent years has resulted in high Credit Risk of the banking system during Mar-08 quarter. Non-performing loans (NPLs) further increased by Rs 18 billion to Rs 232 billion. However, around one third of the contribution in the increase was from a PSCB. This has also led to the corrosion of asset quality indicators during the quarter. NPLs to Loan ratio increased to 7.7 percent and Net NPLs to Net Loans ratio inched up to 1.3 percent while NPL coverage ratio declined to 84 percent

Liquidity

During the quarter under review Liquidity position of the banking system started reflecting the signs of tight monetary policy, exhibited by decreasing liquid assets to total assets ratio and growing loan to deposit ratio to 72.6 from 70.3 percent at Dec-07. Though deposit increased, they failed to match the growing demand for advance, forcing banks to relinquish some of their liquid assets. Due to good liquidity management position in the LPBs group, asset liability gap of the overall banking sector remained within manageable limit of +_ 10%. Some of the smaller banking groups experienced significant gap as percentage of total assets beyond 10% limit in different maturity buckets. However, thanks to availability of sufficient market based liquidity, overall liquidity risk was subdued.

Market risk

During the quarter under review, market risk, which emanates mainly from interest rate risk, have slightly increased. Interest rates shifted upwards following increase in SBP policy discount rate by 50 basis points to 10.5 percent in the first week of February, 2008. Overall, re-pricing gaps of the banking system were largely within the acceptable range, though negative for SB & PSCB in three months bucket. On exchange rate risk side, rupee dollar exchange rate which had remained stable during the last year, depreciated to the level of Rs 70 per USD by May-07 in the interbank market. As inflationary expectations and trade imbalances continue to put pressure on the rupee and interest rate, market risk is likely to rise in future. Further, equity exposure of the banking system has increased to Rs42.76 billion from Rs40.4 billion in CY07, with LPBs continuing to hold the major portion. While exposure of equity market for all banking groups remained within the manageable limit, it stands subject to equity price risk

Performance of Islamic Banking

Islamic banking has evolved tremendously over the years. Starting with a single bank in 2002, it has grown to seven full-fledged Islamic Banks (IBs) and 12 conventional banks operating with 313 Islamic Banking branches across Pakistan. Continuous growth of Islamic Banking stretched over 5 years has increased the size of its balance sheet. Islamic banking now holds 4.07 percent of the total assets of the banking sector. Major developments regarding the Islamic banking sector are higher financing and associated rise in Non Performing Financing. Banks are increasingly shifting their funds from cash balances to investment and financing in wake of tight monetary policy by the central bank. While financing is still predominantly Murabaha based, other modes are also gaining popularity. Improvements in asset quality, adequate capitalization of banks and expansion of branch network will pave the way for IBIs to further increase their market share in the banking system.

Resilience of the Banking System-Sensitivity Analysis

Increased capital base and well contained risk profiles of the banking system enable it to comfortably withstand the adverse shocks to the key risk factors. The. Capital base of the system can fairly absorb the losses arising from 10 percent increase in NPLS, and all banks are likely to maintain the required CAR of 8 percent. The impact of increase in consumer finance's NPLs ratio by 10 percentage points would have significant impact on the system, however group-wise all the groups are likely to maintain their CAR above 8 percent though the intensity of the impact could vary among the banks where consumer finance has relatively higher concentration. However, the impact of interest rate, exchange rate and equity price shocks remains nominal and the strong capital base of the banking system could fairly absorb these shocks. The shift in asset mix and constrained liquidity position of the banking system has squeezed the system's resilience. The liquid asset coverage ratio under high shock scenario however remains above 25 percent.

2. Assets and Funding Structure

Asset base of the banking system witnessed a lackluster growth during the quarter under review. Growth in total assets of the system was slower than that in corresponding quarters of the previous years – over the quarter growth of 1.3 percent as compared with 4.0 percent growth for Mar-07, 2.3 percent for Mar-06, and 2.7 percent for Mar-05 quarters (see Figure-2.1) Though the higher-base achieved through strong growth over the last four years moderated the quarter's growth rate, the increase in absolute terms was also slightly less than corresponding quarters of the recent years and may continue in the short term.

Figure 2.1: Total Assets Growth Rates (Quarterly Basis)

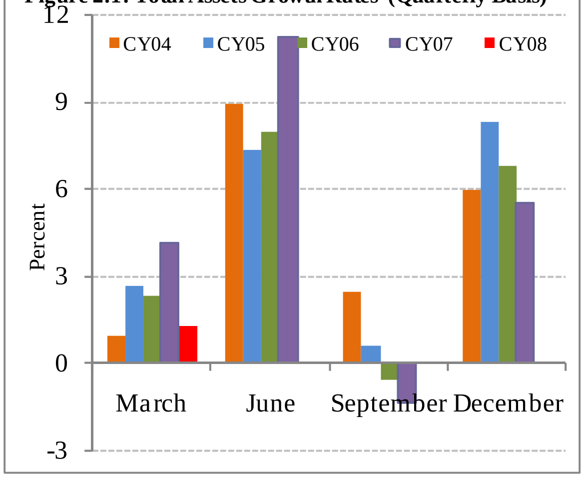
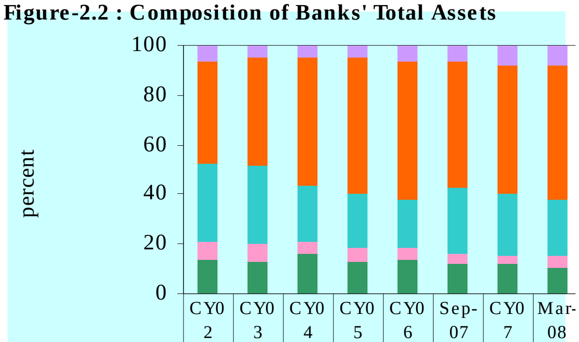
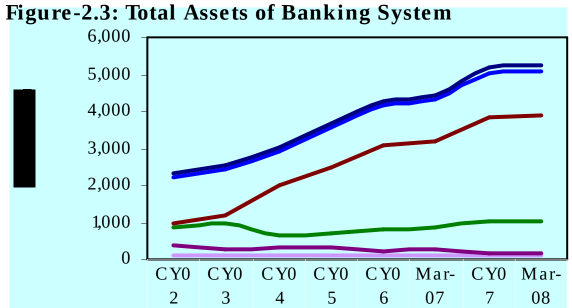


Figure-2.2 : Composition of Banks' Total Assets



	CY02	CY03	CY04	CY05	CY06	Sep-07	CY07	Mar-08
Other Assets	6.4	5.2	5.1	5.2	6.4	6.6	7.7	7.9
Advances	41.4	43.6	51.7	54.4	55.8	50.4	52.0	53.8
Investments	31.5	30.9	22.3	21.9	19.2	26.6	24.7	22.8
Lending to FIs	6.6	7.7	4.7	5.8	4.9	4.4	3.7	4.7
Cash & Balances	14.0	12.6	16.1	12.8	13.7	12.0	11.9	10.8

Figure-2.3: Total Assets of Banking System

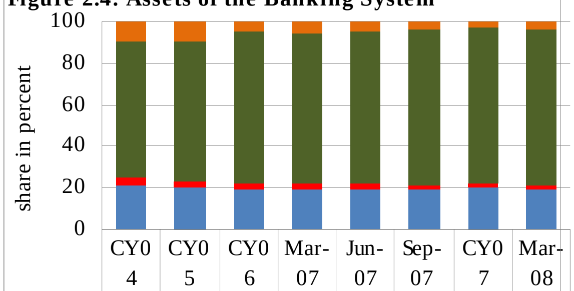


	CY02	CY03	CY04	CY05	CY06	Mar-07	CY07	Mar-08
PSCBs	878	959	653	724	836	864	1,036	1,007
SBs	98	100	106	113	120	118	127	123
LPBs	967	1,212	1,980	2,483	3,102	3,215	3,836	3,904
FBs	389	272	304	339	224	256	173	188
CBs	2,234	2,443	2,937	3,547	4,162	4,334	5,044	5,099
All	2,332	2,542	3,043	3,660	4,282	4,453	5,171	5,221

As the banks were repositioning their lending strategy due to slackness in the demand for bank credit in the face of slow down in economic growth and tightening of monetary regime, the asset structure of the banking system continued to gradually shift from advances to investments during the first three quarters of the last year. This trend reversed in the last quarter of CY-07 when demand for advances started to show liveliness and their share in total assets started to rise. The quarter under review witnessed a further shift in the asset mix from investments to advances, which grew by Rs119 billion over the quarter and contributed 53.8 percent of the total asset base as compared with 52.0 percent in Dec-07 and 50.4 percent in Sep-07. This increase in advances primarily emerged from the increased demand from Corporate Sector and Commodity Operations. On the other hand, SME, Agriculture, and Consumer sectors reduced their borrowings from the banking system. While the advance component regained its weight in total assets during the quarter, the investments over the last couple of quarters have considerably shed their weight by registering a decline in outstanding amount. Accordingly the share of investment in total assets declined from 26.6 percent in Sep-07 through 24.7 in Dec-07 to 22.8 percent in Mar-08. The rising interest rates and margins present a strong incentive for banks to optimize their fund utilization in terms of liquidity and returns. Accordingly, the proportion of Cash and Bank Balances in total assets has been slightly and gradually declining. A part of this optimization, however, was neutralized by slight increase in the proportion of non-earning Other Assets (see Figure-2.2).

The group-wise composition of the assets shows that LPBs have marginally increased their market share by 60 bps to 74.8 percent. FBs whose market share due to mergers and reorganization has shown a persistent decline for last many years slightly regained their market share. The market share of PSCBs, which showed a slight improvement during the last quarter of CY-07, receded to 19.3 percent due to decline in asset base of the two large banks (see Figure 2.3 & 2.4).

Figure 2.4: Assets of the Banking System

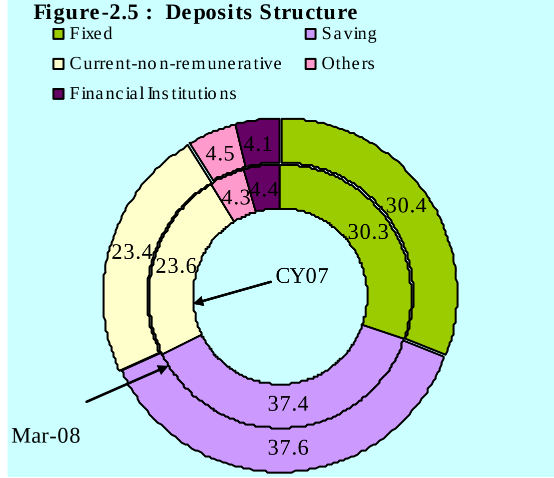


	CY04	CY05	CY06	Mar-07	Jun-07	Sep-07	CY07	Mar-08
FBs	10.0	9.3	5.2	5.7	5.1	3.5	3.3	3.6
LPBs	65.1	67.8	72.4	72.2	72.9	75.1	74.2	74.8
SBs	3.5	3.1	2.8	2.7	2.5	2.4	2.5	2.4
PSCBs	21.5	19.8	19.5	19.4	19.5	19.1	20.0	19.3

The market concentration in terms of the share of the top five banks in total asset base of the banking system is still significantly skewed. This phenomenon had been gradually ebbing out till the third quarter of the last year. While the last quarter witnessed a rise in market share of top five banks to 52.0 percent, the quarter under review witnessed a dilution in share of top five banks to 51.2 percent. The number of banks holding 2 percent or more of the market share remained 14.

2.1 Deposits and Other Accounts finance the largest portion of the asset base. In line with slow growth in asset base, deposit component also grew at passive rate i.e. 0.8 percent (Rs 31 billion) over the quarter and contributed 47 percent of the increase in asset base. Accordingly, their share in overall funding structure declined by 30 bps over the quarter under review to 74.4 percent. Year-on-Year growth statistics since corresponding quarter of last year (15.5%) is also slightly slower than previous quarter growth rates: 17.9% for Mar-07 and 17.3 percent for Mar-06 quarters. The deposits of the banking system have been showing a strong growth for the last four years that has accumulated higher base which also tempers the growth rates. One of the leading factors which underlies the strong growth in deposits in recent years viz. the workers' remittances maintained its momentum during the quarter under review. However, the quantum of net inflow of private net investment substantially squeezed compared with corresponding quarter of the last year.

Figure-2.5 : Deposits Structure



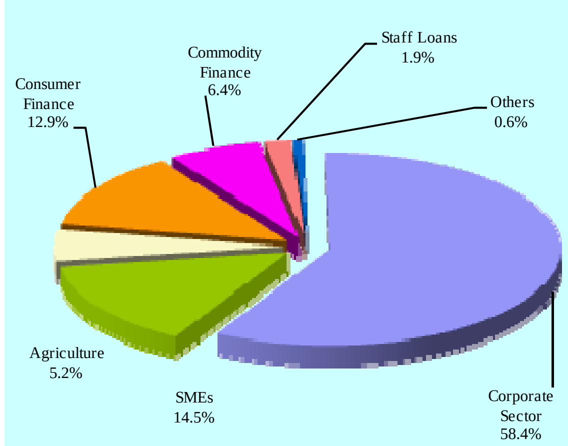
A cross sectional analysis of the deposits in terms of composition depicts that the different components did not register any major shift during the quarter. Saving deposits constitute the largest share of deposits followed by fixed and non-remunerative current deposits. A phenomenon of a gradual shift in deposits from Savings to Fixed has been prevailing in the industry for quite some time. This phenomenon was also augmented by SBP's policy drive to encourage the banks to mobilize matching longer terms deposit for funding their longer-terms assets. Resultantly, fixed deposits have gained a significant share of savings deposits since 2004. The results of the last few quarters however signify that this trend of gradual shift has stabilized to some extent. During the quarter under review the share of both fixed deposits as well as savings deposits inched up slightly at the cost of current non-remunerative deposits and deposits from financial institutions (see Figure- 2.5). The currency-wise composition of deposits also shifted towards foreign currency deposits which rose from 12.3 percent to 13 percent over the quarter under review.

The ***capital*** is the second largest source of funding for the banking system, accounting for 10.4 percent of their overall funding structure.. This component recorded a marginal increase of 0.7 percent over the quarter; this growth was mainly constrained by significant losses posted by one of the PSCBs. Nevertheless, the year-on-year growth of 25.8 percent since corresponding quarter of the last year surpassed the total assets growth of 17.3 percent. Accordingly, the capital reached Rs545 billion and its support towards asset base improved from 9.7 percent in March-07 to 10.4 percent in Mar-08, signifying salubrious effect on the solvency of the banking system. This increase in capital cushion also owes a great deal to the MCR policy which has induced not only the retaining of higher portion of earnings but also the injection of fresh equity for meeting the enhanced MCR.

2.2 Borrowings of the banking system grew at 0.9 percent over the quarter and their support towards asset base of the banking system remained at 8.7 percent.

The composition of the borrowings shows that the banks shifted their preference from secured borrowings to unsecured one. The secured borrowings which mainly comprise borrowings from SBP under EFS and others declined by 2.5 percent over the quarter and their share in total borrowings declined to 84.3 percent (87.2 percent in Dec-07). The unsecured borrowings increased by 23.6 percent; this increase mainly came from the banks' increased reliance on call borrowings which registered a strong increase of 51.6 percent.

Figure-2.6 : Loans by Type of Borrowers-March-08



2.3 Advances (net) of the banking system showed the liveliness and registered an over the quarter growth of 4.3 percent and a year-on-year growth since Mar-07 of 18.6 percent which are unprecedented for the March quarters of the previous years. Advances in fact showed a lackluster demand during the first three quarter of the last years; it was only in the last quarter that the advances, following the seasonal pattern, rose at strong pace. The quarter under review maintained this momentum and the advances grew by Rs 116 billion and their share in total asset base of the banking system rose to 53.8 percent.

Detailed composition of the advances[1] shows that the increase in demand for advances mainly emerged from corporate sector and commodity financing, while all other sectors in fact reduced their borrowing from banks. The corporate sector, the largest user of banks advances, borrowed additional advances of Rs127 billion. This increase coupled with an increase of Rs 34 billion in lending for commodity financing was large enough to neutralize the decline of Rs 28 billion in lending to SME sector and Rs6 billion to consumers. The composition of the advances shows that corporate sector further inched up its share in overall advances of the banking system. SME and consumer sector, second and third largest users of bank credit respectively, have shed their share in the overall advances of the banking sector (see Figure-2.6). There was only a slight shift in the end use of advances. Working capital and trade finance loans showed a slight rise in their share, while the fixed investment loans showed a stable position.

[1] The following analysis of composition of advances and shift therein is based on the banks' domestic operations only.

The **consumer finance**, which has been showing a consistent increase though at passive rate for the last few quarters, has for the first time registered a decline of Rs6 billion and its share in overall loans contracted by 80 bps to 13.0 percent (see Table-2.1). The breakup of consumer finance data shows that lending to all the categories squeezed during the quarter. However, the decline was more evident in credit card and mortgage loans which declined by 4.2 and 2.6 percent respectively over the quarter. Nonetheless, the internal composition of the consumer finance categories did not witness any major shift: personal loans contributing the largest share of consumer finance followed by auto and mortgage loans (see Figure-2.7).

Figure-2.7: Composition of Consumer Loans - Mar-08 (Domestic Operations)

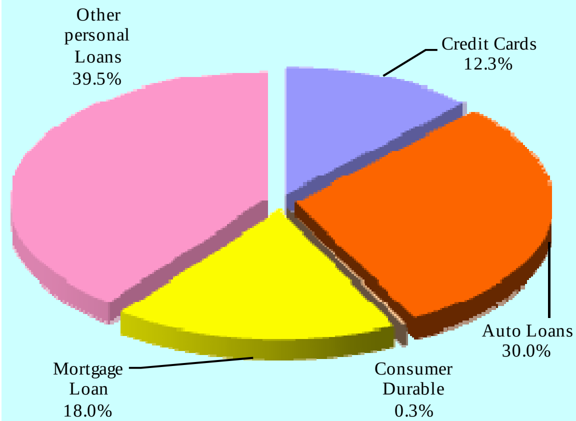


Table 2.1: End-use of Advances (net)

Amount in billion Rs, share in percent

	Jun-07		Sep-07		Dec-07		Mar-08	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Fixed Investment	**534.4**	**21.6**	**546.1**	**22.3**	**609.2**	**22.6**	**637.2**	**22.6**
Corporate Sector:	490.0	19.8	499.0	20.4	549.0	20.3	582.5	20.7
SMEs:	44.4	1.8	47.1	1.9	60.3	2.2	54.7	1.9
Trade Finance	**369.6**	**14.9**	**393.9**	**16.1**	**415.9**	**15.4**	**442.8**	**15.7**
Corporate Sector:	309.5	12.5	329.9	13.5	348.0	12.9	385.3	13.7
SMEs:	60.1	2.4	64.0	2.6	67.9	2.5	57.5	2.0
Working Capital*	**1,135.6**	**45.8**	**1,074.5**	**43.9**	**1,231.6**	**45.6**	**1,306.3**	**46.3**
Corporate Sector:	543.8	21.9	504.3	20.6	623.2	23.1	679.3	24.1
SMEs:	278.3	11.2	283.7	11.6	309.1	11.4	297.4	10.5
Agriculture	144.3	5.8	148.1	6.0	150.8	5.6	147.6	5.2
Commodity Financing	169.2	6.8	138.4	5.7	148.4	5.5	182.0	6.5
Consumer Finance:	**354.4**	**14.3**	**356.6**	**14.6**	**371.4**	**13.8**	**365.3**	**13.0**
Credit Cards	44.5	1.8	47.5	1.9	46.8	1.7	44.8	1.6
Auto Loans	107.6	4.3	111.4	4.5	111.4	4.1	109.7	3.9
Consumer Durable	1.0	0.0	1.4	0.1	1.1	0.0	1.0	0.0
Mortgage Loan	58.1	2.3	60.6	2.5	67.4	2.5	65.6	2.3
Other personal Loans	143.3	5.8	135.8	5.5	144.7	5.4	144.2	5.1
Staff Loans	**48.9**	**2.0**	**50.6**	**2.1**	**52.2**	**1.9**	**51.7**	**1.8**
Housing Finance	34.7	1.4	35.7	1.5	36.8	1.4	36.4	1.3
Others	14.2	0.6	14.8	0.6	15.4	0.6	15.3	0.5
Others	**35.9**	**1.4**	**26.4**	**1.1**	**20.6**	**0.8**	**17.1**	**0.6**
Total	**2,478.8**	**100.0**	**2,448.1**	**100.0**	**2,700.9**	**100.0**	**2,820.4**	**100.0**

* agriculture and commodity finance are added in this category for analysis in this section only

2.4 Investments (net), the second largest component of the banks' asset base, has observed a contraction during the last quarter. During the quarter under review the decline of Rs 87 billion or 6.8 percent was however significant. Resultantly, the share of investment in total assets of the banking system declined by 190 bps to 22.8 percent slightly above the 22.0 percent for the corresponding quarter of the last year. A disaggregated analysis of the investment portfolio shows that this decrease came from the reduction in govt. papers which declined by Rs125 billion: a decline of 18 percent in T.Bill holding and 0.6 percent in PIB holdings. However, an increase in other categories of investments like investment in bonds and debenture, equity, and subsidiaries and associates make for a part of the decline in govt. papers. The overall investment structure shows that the govt. papers, despite a sharp decline in their holdings over the quarter, still dominate the investment portfolio (see Figure-2.8). The breakup of investment in govt. papers shows that the sharp decline in the holdings of T. Bills has squeezed their relative share in overall stock of govt. papers as compared with PIBs and other federal govt. securities, which witnessed an increase during the quarter (see Figure-2.9).

Figure-: 2.8: Break up of Investments - Mar-08

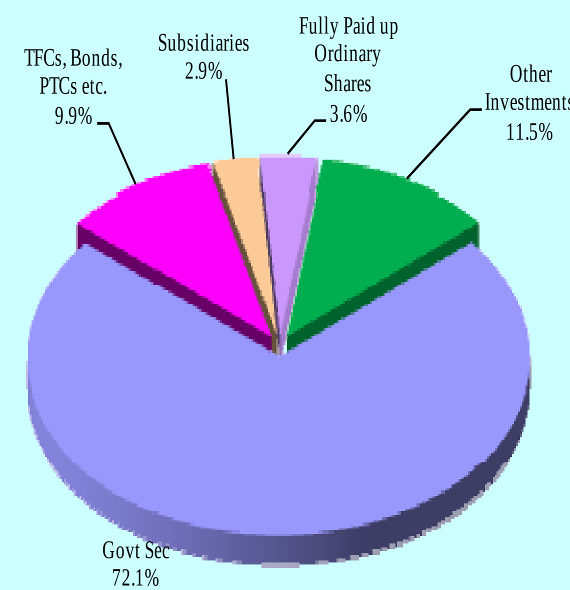
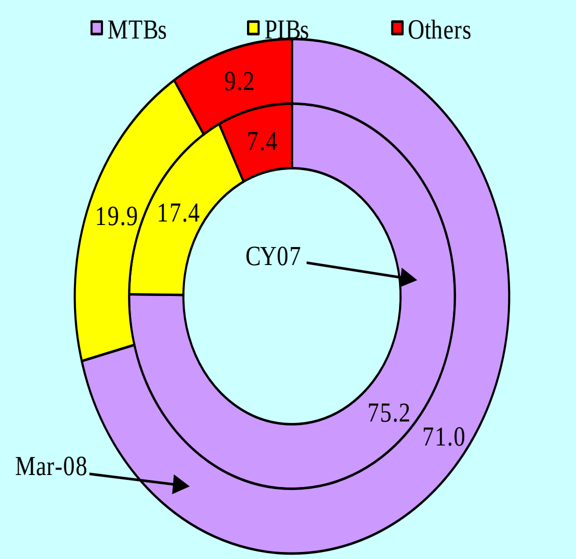


Figure-2.9: Break up of Federal Govt. Securities



3. Financial Soundness of the Banking System

3.1 Solvency

Solvency position of the banking system remained firm during the quarter, despite the fact that capital adequacy is being measured on the basis of BASEL-II framework with effect from Jan-08 which, among other things, requires additional capital for operational risk.

The qualifying risk based capital of the banking system stood at Rs497.2 billion in Mar-08 quarter up from Rs.466.2 in CY07 which was based on Basel-I framework. The core capital mainstay of banks' capital continued to rise, though the supplementary capital declined marginally during the quarter under review (see Figure-3.1.1). As a result share of Core capital in total capital increase to 80.5 percent of total capital in Mar-08 against 79.2 percent in Dec-07 (see Figure-3.1.2).

Total Risk Weighted Assets of the banking system increased by 8.2 percent to Rs3813.5 billion in Mar 08. This increase is inclusive of operational risk charge which was not included for the the purpose of calculation of Capital Adequacy in Basel-I framework; operational risk weighted assets stood at Rs 446.5 billion out of the total risk weighted assets. (see Figure: 3.1.3).

Due to relatively higher growth in the risk weighted assets of the banking industry with respect to increase capital, the capital adequacy ratio (CAR) further declined to 13.0 percent during the quarter as compared with 13.2 percent in CY07. (see Table 3.1.1). Core Capital to RWAs ratio however remained at the level of CY07. Both the ratios exceeded the generally acceptable benchmarks for well capitalized banks.

Figure-3.1.1: Risk-based Capital Position

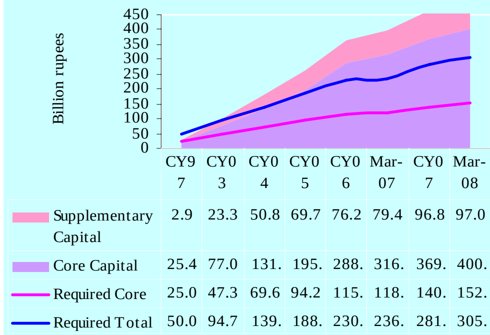


Figure:-3.1.2 Capital Structure and Capital Adequacy

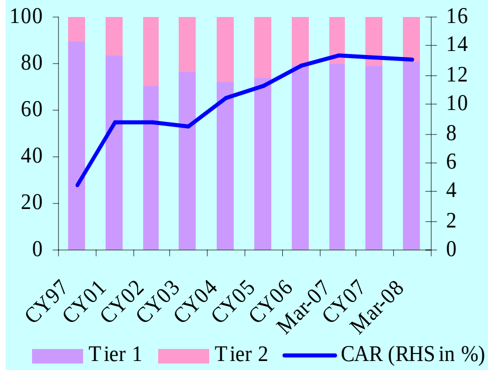
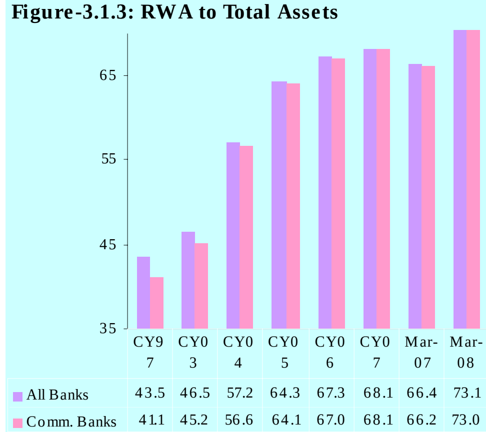


Figure-3.1.3: RWA to Total Assets



Group wise, while FBs managed to register higher increase in their CAR, PSCB's CAR witnessed a declined by 1.9 percentage point. Out of the four SBs two have been exempted from Basle-II compliance due to their on going restructuring, resulting in extraordinary increase Capital adequacy indicators for the SBs. Excluding SBs, Core Capital to RWAs of PSCBs remained the highest at 15.5 percent.

Table-3.1.1: Capital Adequacy Indicators

	Basel-I							Basel-II
Percent	CY97	CY03	CY04	CY05	CY06	CY07	Mar-07	Mar-08
CAR								
PSCBs	(1.3)	11.0	13.4	14.5	15.2	17.4	17.4	15.5
LPBs	11.9	9.0	10.1	10.6	12.7	12.8	12.7	12.0
FBs	14.6	23.0	17.4	16.4	15.0	13.5	12.9	14.9
CBs	6.0	11.1	11.4	11.9	13.3	13.8	13.6	12.8
SBs*	(6.2)	(28.2)	(9.0)	(7.7)	(8.3)	(7.8)	(6.2)	24.81
All banks	4.5	8.5	10.5	11.3	12.7	13.2	13.1	13.0
Tier 1 Capital to RWA								
PSCBs	(2.0)	8.2	8.6	8.8	11.1	13.0	12.4	11.3
LPBs	11.4	7.0	7.5	8.3	10.4	10.5	10.2	9.9
FBs	14.4	23.0	17.1	16.1	14.3	12.9	12.3	14.2
CBs	5.5	9.1	8.6	9.1	10.7	11.1	10.7	10.3
SBs*	(6.3)	(28.7)	(15.0)	(13.6)	(13.3)	(13.5)	(12.0)	19.8
All banks	4.1	6.5	7.6	8.3	10.0	10.5	10.1	10.5
Capital to Total Assets								
PSCBs	0.3	6.1	8.7	12.6	12.2	13.7	13.7	13.7
LPBs	4.9	5.3	6.5	7.0	9.2	10.2	10.1	10.1
FBs	7.9	9.9	8.9	9.5	10.1	11.2	10.3	10.3
CBs	3.1	6.1	7.2	8.4	9.9	10.9	10.8	10.8
SBs	8.8	(10.0)	(9.4)	(8.1)	(8.0)	(5.5)	(6.2)	(6.2)
All banks	3.5	5.5	6.7	7.9	9.4	10.5	10.4	10.4

**** Position does not include two Specialized Banks***

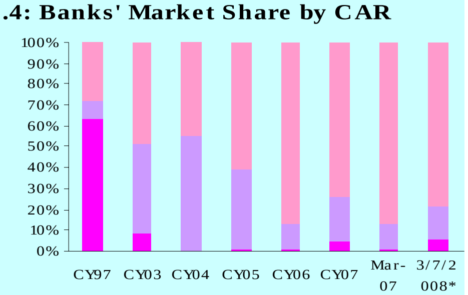
The other key solvency ratios stood firm during the quarter; Capital to total assets ratio stood at 10.4 percent in Mar-08 which is almost at the level of CY07(see Table-3.1.1). After adjusting the capital with net NPLs, this ratio stood at around 9.7 percent.

Table-3.1.2: Distribution of Banks by CAR

	Total	Below 8%	8 to 10 %	10 to 15 %	Over 15 %
CY02	40	4	4	9	23
CY03	40	4	10	5	21
CY04	38	1	13	9	15
CY05	39	2	7	13	17
CY06	39	3	4	15	17
CY07	39	3	6	12	18
Mar-08	36	2	5	13	16

Out of the 39 banks, 36 that have reported on the Basle-II reporting standards. hold 99.4 percent assets of the banking system. The disaggregated analysis shows that out of these banks, the number of well capitalized banks i.e., the banks with CAR of more than 10 per cent stood at 29 (see Figure-3.1.2). Of the remaining 7 five banks has its CAR above 8 percent. The share of well capitalized banks stood at 77.8 percent in Mar-08 (see Figure-3.1.4).

Figure-3.1.4: Banks' Market Share by CAR



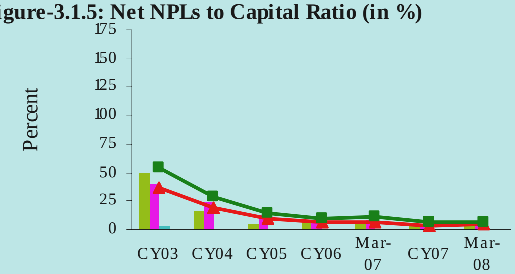
	CY97	CY03	CY04	CY05	CY06	CY07	Mar-07	3/7/2008*
10 percent and above	28.0	48.2	44.5	60.5	86.7	73.8	86.9	77.8
8 to 10 percent	8.7	43.8	55.1	38.8	12.1	21.6	12.6	16.3
Below 8 percent	63.3	8.0	0.4	0.7	1.2	4.6	0.5	5.3

As regards the compliance with minimum capital requirement, 33 out of 39 banks are satisfactorily meeting this requirement including 5 foreign banks, which are required to keep Rs2 billion. Of the remaining 6 banks, five are under process of restructuring/ privatization while one has been allowed short extensions to meet this requirement.

Owing to increase in NPLs, Net NPLs to Capital ratio, increased to 6.8 percent in Mar-08 from 5.6 percent in CY07. However, it still presents a better picture when compared with 11.2 per cent for the corresponding period of CY07 (see Figure 3.1.5). Group wise PSCBs witnessed the highest increase of 1.4 percentage points during the quarter under review.

The overall solvency position of the banking system remained firm during the quarter, despite conversion of capital adequacy regime from Basel-I to Basel-II. However, given the rise in the NPLs, the need to exercise care about the quality of assets for sustained profitability and solvency profile remains imperative.

Figure-3.1.5: Net NPLs to Capital Ratio (in %)



	CY03	CY04	CY05	CY06	Mar-07	CY07	Mar-08
PSCBs	50.0	16.2	5.4	6.4	6.9	3.4	4.80
LPBs	39.1	24.3	12.7	7.1	8.0	4.2	5.20
FBs	3.2	(0.2)	-3.0	(5.1)	(4.7)	(4.1)	(3.10)
SBs	-	-	-	-	-	-	-
CBs	36.9	19.0	8.8	6.2	7.0	3.7	4.80
All Banks	54.4	29.2	14.1	9.7	11.2	5.6	6.80

3.2 Profitability

The profitability of the banking system for the first quarter of CY08 witnessed a slow down. The system posted a before tax profit of Rs28.1 billion as compared with Rs 33.1 billion for the corresponding first quarter of CY-07. Accordingly, the return on assets and equity also shrank as compared with the corresponding quarter as well as the full year results of CY-07 (see Table 3.2.1 & 3.2.2). The major reason for this deterioration was the significant losses posted by one of the PSCBs during the quarter. Further, it is worth mentioning that the asset and equity base of the banking system has significantly increased since corresponding quarter of the last year, i.e. 26 percent growth in equity and 17 percent in asset base. This higher base effect also moderates the returns of the banking system.

Table-3.2.1: Profitability of Banking System

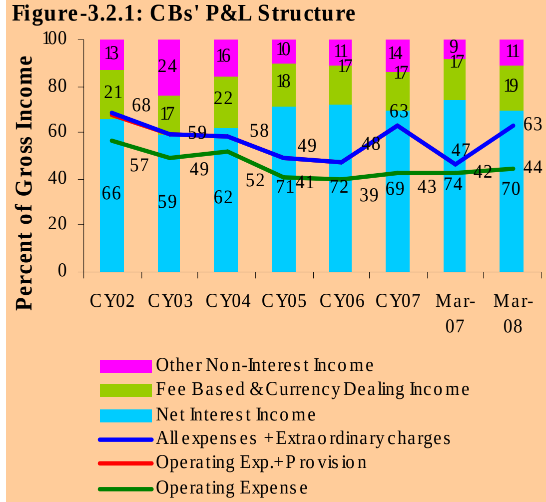
(Billion Rs)	CY03	CY04	CY05	CY06	CY07	Mar-07	Mar-08
Profit before tax							
PSCBs	16.1	14.2	22.8	31.5	33.2	7.8	3.2
LPBs	23.8	31.0	60.5	85.6	69.7	24.4	24.5
FBs	7.1	7.2	11.6	6.3	2.5	2.1	0.8
CBs	47.0	52.4	94.9	123.5	105.4	34.3	28.5
SBs	(3.3)	(0.4)	(1.1)	0.1	1.7	(1.3)	(0.5)
All Banks	43.7	52.0	93.8	123.6	107.1	33.1	28.1
Profit after tax							
PSCBs	9.4	8.0	15.5	21.2	23.9	5.2	1.6
LPBs	14.8	21.8	41.1	59.1	47.4	16.4	16.4
FBs	4.2	5.8	8.0	4.3	1.2	1.3	0.3
CBs	28.4	35.6	64.6	84.6	72.4	22.9	18.4
SBs	(3.7)	(0.9)	(1.3)	(0.5)	0.9	(1.3)	(0.5)

Table-3.2.2: Profitability Indicators

(Percent)	CY03	CY04	CY05	CY06	CY07	Mar-07	Mar-08
After Tax ROA							
PSCBs	1.0	1.3	2.2	2.7	2.5	2.4	0.6
LPBs	1.4	1.2	1.8	2.1	1.4	2.1	1.7
FBs	1.5	2.0	2.5	1.5	0.7	2.1	0.8
CBs	1.2	1.3	2.0	2.2	1.6	2.2	1.5
SBs	(3.7)	(0.8)	(1.2)	(0.4)	0.7	(4.2)	0.0
All Banks	1.0	1.2	1.9	2.1	1.5	2.0	1.4
After Tax ROE *(based on Equity plus Surplus on Revaluation)*							
PSCBs	17.3	17.2	20.9	21.7	19.5	19.8	4.7
LPBs	25.8	20.2	27.2	25.3	13.9	22.1	16.6
FBs	14.8	21.5	27.1	15.6	6.3	22.0	7.1
CBs	20.3	19.6	25.4	23.7	15.0	21.5	13.3
SBs	-	-	-	-	-	-	-
All Banks	20.0	20.3	25.8	24.2	15.5	20.6	13.2

Group-wise, LPBs remained the highest contributors of system's profits, as their pre and after tax profit stood at Rs24.5 billion and Rs16.4 billion respectively, which were around the same levels as in Mar-07 quarter. PSCB and FBs witnessed decline in their profitability. The pre and after tax profits of PSCBs declined from Rs7.8 billion and Rs5.2 billion respectively in Mar-07 to Rs3.2 billion and Rs1.6 billion respectively in Mar-08. This significant decline largely emerged from the unusually large losses posted by one PSCB due to its substaintial loan loss provisioning during the quarter. The pretax and after profit of FBs declined from Rs 2.1 billion and Rs1.3 billion to Rs.0.8billion and Rs0.3 billion, respectively. The group wise analysis of efficiency in utilization of assets and capital shows that LPBs and FBs have shown improvement over the quarter. However both ROA and ROE remain lower than the corresponding quarter of the last year. The PSCBs which were enjoying a better ROA and ROE, experienced sharp decline due to losses in one bank of the group. The after tax ROA and ROE of LPBs have reached 1.7 percent and 16.6

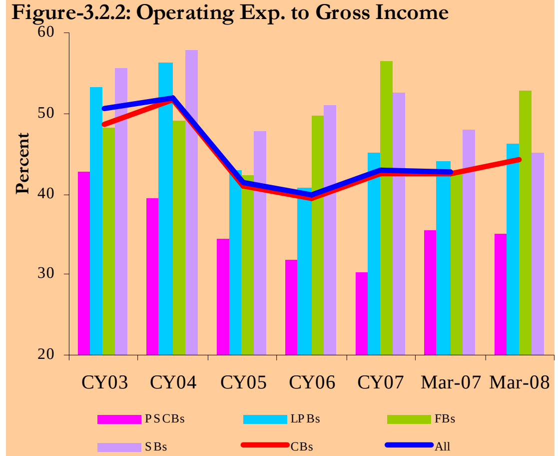
Figure-3.2.1: CBs' P&L Structure



percent in Mar-07 from 1.4 percent and 13.9 percent in CY07. Likewise, after tax ROA and ROE of FBs increased to 0.8 percent and 7.1 percent, respectively.

The detailed analysis of the commercial banks' profit and loss composition shows that during the quarter under review, the income composition of CBs witnessed a slight change. The share of net interest income in the gross income increased by 0.5 percentage points to 69.8 percent, whereas the non-interest income declined by equal percentage point to 30.2% of total gross income. Among the non-interest income, the fee based and currency-dealing income showed strong growth and their share in the gross income increased by 1.5 percentage points to 18.7 percent. The share of other non-interest incomes, comprising of non- recurring incomes like trading gains and dividend incomes also shrank from 13.5 percent in CY07 to 11.5 percent in Mar-08. However, in volume terms these are Rs. 8.8 billion against Rs. 5.6 billion in the corresponding period of CY-07.

Figure-3.2.2: Operating Exp. to Gross Income

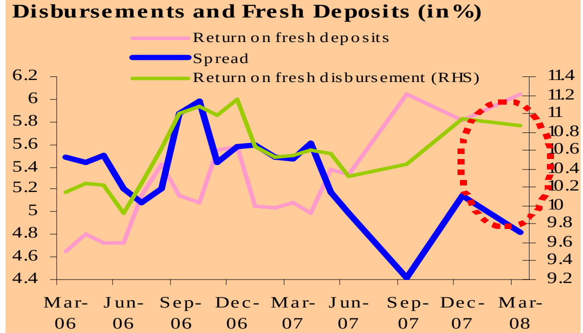


On overall basis, due to increased loan loss provisioning, all expenses as a percentage of gross income increased from 62.6 to 63.0 percent during the quarter under review (see Figure 3.2.1).

Detailed analysis of the expenses shows that operating expenses as percent of gross income increased by 3 percentage points in Mar-08. However, FBs and SBs have shown some improvement in their operating efficiency as their operating expense to gross income ratio decreased by 3 percent to 53 percent and by 8 percent to 45 percent, respectively; PSCBs and LPBs, on the other hand, showed deterioration as their ratios increased by 5 percent to 35 percent and by 1.2 percent to 46 percent, respectively. (see Figure 3.2.2).

The analysis of core income reveals that CBs' net mark up/interest income kept increasing though at a slower rate. It has increased to Rs53.8 billion in Mar-08 quarter from Rs48.0 billion for the corresponding period of March 07. The slower increase may be attributed to higher cost of deposits during the quarter. It also suggests that deposit rates are also responding to the increasing lending rates. The declining interest rate

Figure-3.2.3: Weighted Average Rates for Fresh Disbursements and Fresh Deposits (in%)



spread between the weighted average rates of returns on incremental loans and fresh deposits also corroborates this viewpoint. The spread has dropped to 4.8 percent in Mar-08 from 5.47 percent in Mar-07 and 5.14 percent in CY07 (see Figure:-3.2.3). The return on fresh deposits has increased to 6.05 percent from 5.81 percent in CY07 and 5.08 percent in Mar-07.

The further analysis of ROA shows that 18 banks have ROA of one percent and above and their market share stood at 76.6 percent in Mar-08 (see Table 3.2.3). However the number of banks having ROA 0.5 percent to 1.0 percent increased to 6 in Mar-08 from 4 in Dec-07. Further, banks having less than 0 percent ROA have increased from 10 to 11 in Mar-08. Some of the banks in this category have either been established recently or have undergone a change of management during the last couple of years.

Table:3.2.3: %age Breakdown of Banking System's Total Assets (TA) by ROA

	CY05		CY06		Mar-07		CY07		Mar-08	
ROA	No. of Banks	% Share in TA	No. of Banks	% Share in TA	No. of Banks	% Share in TA	No. of Banks	% Share in TA	No. of Banks	% Share in TA
0 and below	7	3.5	6	2.1	7	4.6	10	8.5	11	9.5
0 to 0.5	4	2.8	3	1.8	6	3.4	2	2.4	4	7.8
0.5 to 1	2	7	6	9.9	4	7.5	4	1.9	6	6.2
1.0 to 1.5	5	4	5	9.6	5	6.7	10	34.9	8	22.3
1.5 and Over	21	82.7	19	76.6	18	77.8	13	52.3	10	54.3

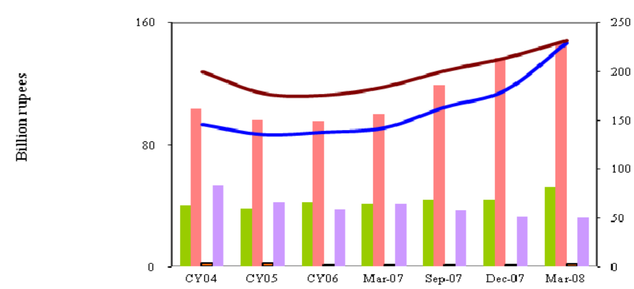
Despite the downward economic trend at both domestic and global front, banking system has preformed remarkably well during the quarter under review, when compared with corresponding first quarters of the years 2005, 2006, and 2007 that enjoyed more conducive environment for the businesses. The banking system in Pakistan over these years has build up capacities in terms of strong capital base, higher coverage of NPLs, and improved technologies and human resources. It will help the system sail through the current era of slack economic growth and take advantage of the opportunities arising in domestic market.

4. Risk Assessment of the Banking System

4.1 Credit Risk

Non Performing Loans (NPLs) of the banking system registered further increase during the Mar-08 quarter with key asset quality indicators witnessing marginal deterioration.

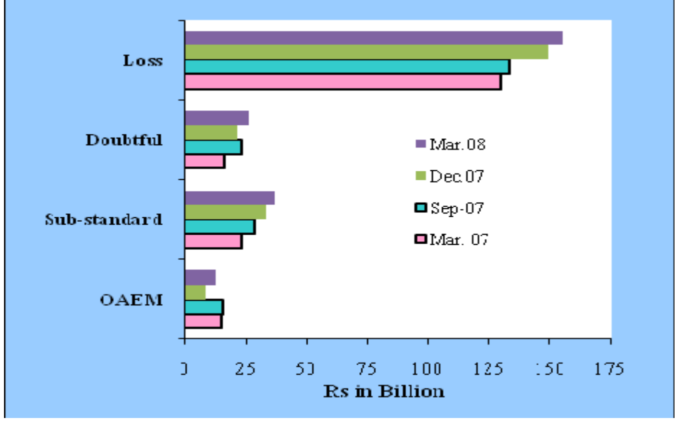
Figure-4.1.1: NPLs of Banking System



	CY04	CY05	CY06	Mar-07	Sep-07	Dec-07	Mar-08
PSCBs	40	38	42	41	44	44	53
LPBs	103	96	95	100	119	137	146
FBs	3	2	1	1	1	1	2
SBs	54	42	37	41	37	33	32
CBs(RHS)	146	136	138	143	164	181	229
All (RHS)	200	177	175	184	201	214	232

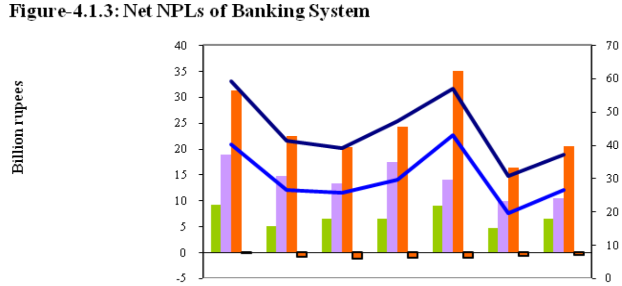
After experiencing a persistent decline in absolute terms, NPLs of the banking system have witnessed a gradual increase since CY06. During the March 2008 quarter, the level of NPLs increased by Rs 18 billion to Rs 232 billion (see Figure 4.1.1). Around one third of the increase came from one major Public Sector Commercial Bank, which hold around 4 percent share in total assets of the banking system. Group wise, PSCBs which hold one fifth of the total pie in terms of assets, contributed one half of the total increase in NPLs. LPBs, holding around industry share of 75 percent, witnessed almost an equal increase in NPLs.

Figure:-4.1.2 Category-wise Breakup of NPLs



The category-wise break-up of NPLs shows that the major infected portfolio lies in the Loss category, though fresh NPLs continue to pile up(see Figure 4.1.2). While degradation of loans in substandard and doubtful categories increased the loss category NPLs, increase has been provoked due to recognition of huge loan

Figure-4.1.3: Net NPLs of Banking System



	CY04	CY05	CY06	Mar-07	Sep-07	Dec-07	Mar-08
PSCBs	9	5	6	7	9	5	7
SBs	19	15	13	17	14	10	11
LPBs	31	22	20	24	35	16	20
FBs	(0)	(1)	(1)	(1)	(1)	(1)	(1)
CBs(RHS)	40	27	26	30	43	20	26
All (RHS)	59	41	39	47	57	31	37

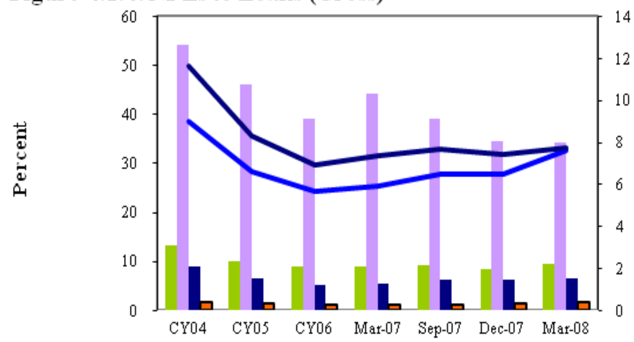
portfolio of one of the major PSCBs into loss category.

Despite increase in NPLs, the banks managed to contain its impact on net NPLs by creating higher provisioning against their infected loan portfolio. Consequently, net NPLs of the banking system increased not only in absolute terms but also increased in percentage terms. (see Figure 4.1.3 and 4.1.5) The increase is also reflected in deterioration of key asset quality indicators. NPLs to loans ratio of the banking system increased to 7.7 percent from 7.4 percent in Dec-07. Group wise, PSCBs, due impairment of laons of one bank, experienced greater deterioration in these ratios. (see Figure 4.1.4).

Provisions against NPLs also witnessed increase of Rs11 billion during the quarter. It, however, failed to keep pace up with that of the increase in NPLs, reducing NPLs coverage ratio to 84 percent from **86** percent (see Figure 4.1.6).

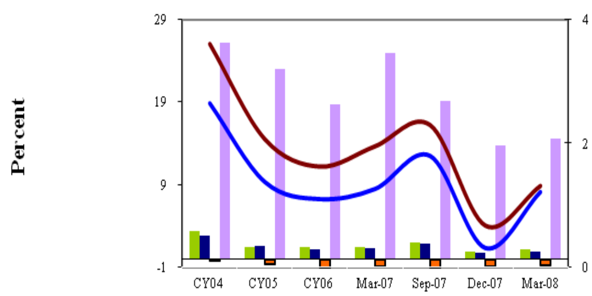
Disaggregated analysis reveals that NPLs of corporate sector increased by Rs 15 billion to Rs125 billion. With this increase, its NPLs to loans ratio also deteriorated to 7.6 percent from 7.2 percent in Dec-07. However, SME sector witnessed a decline in their NPLs by Rs5 billion. Resultantly, NPLs to loans ratio of this sector improved to 8.9 percent. (Table 4.1.1)

Figure-4.1.4: NPLs to Loans (Gross)



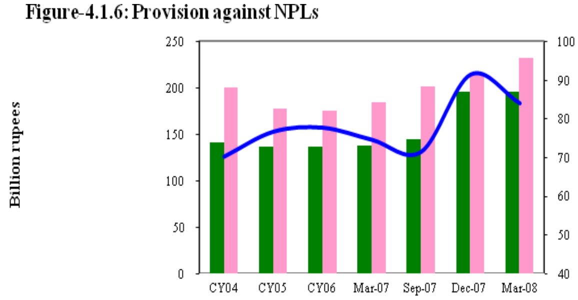
	CY04	CY05	CY06	Mar-07	Sep-07	Dec-07	Mar-08
PSCBs	13	10	9.0	9.0	9.1	8.3	9.4
SBs	54	46	39.0	44.3	38.9	34.5	34.2
LPBs	9	6	5.2	5.5	6.1	6.3	6.5
FBs	2	1	1.0	1.1	1.2	1.3	1.7
CBs(RHS)	9	7	5.7	5.9	6.5	6.5	7.6
All (RHS)	12	8	6.9	7.4	7.7	7.4	7.7

Figure-4.1.5: NPLs to Loans (net)



	CY04	CY05	CY06	Mar-07	Sep-07	Dec-07	Mar-08
PSCBs	3	1	1.5	1.5	2.0	0.9	1.3
LPBs	3	2	1.1	1.4	1.9	0.8	1.0
FBs	(0)	(1)	(1.0)	(0.9)	(1.0)	(0.8)	(0.7)
SBs	26	23	18.7	25.0	19.2	13.8	14.6

Figure-4.1.6: Provision against NPLs



	CY04	CY05	CY06	Mar-07	Sep-07	Dec-07	Mar-08
Provision	141	136	137	138	144	196	195
NPLs	200	177	175	184	201	214	232
Provision to NPLs (RHS)	70	77	78	75	72	91	84

Table: 4.1.1 Segmentwise Infection of Loans Portfolio (Domestic Operations)									(in %)
Sector	**CBs**			**SBs**			**All**		
	Sep-07	**Dec-07**	**Mar-08**	**Sep-07**	**Dec-07**	**Mar-08**	**Sep-07**	**Dec-07**	**Mar-08**
Corporate	6.9	7.0	7.4	100.0	100.0	500.8	7.2	7.2	7.6
SMEs	8.5	7.7	8.5	84.6	91.3	25.4	10.4	9.4	8.9
Agriculture	11.6	10.6	12.5	31.7	26.4	26.4	22.0	18.7	19.7
Consumers	4.4	4.4	4.6	10.0	21.2	18.0	4.4	4.4	4.6
Credit Cards	6.3	3.4	3.6	-	-	-	6.3	3.4	3.6
Auto Loans	3.8	4.6	5.7	14.8	15.8	116.7	3.9	4.7	5.7
Consumer Durables	46.4	8.4	18.1	27.2	27.5	-	45.3	9.8	16.8
Mortgage Loans	4.3	5.4	4.0	-	-	-	4.3	5.4	4.0
Others	3.8	4.1	4.2	-	-	-	3.8	4.1	4.2
Commodity Finance	0.9	1.0	0.9	-	-	-	0.9	1.0	0.9
Staff Loans	0.8	1.2	3.5	0.1	0.2	0.1	0.8	1.2	3.3
Others	3.6	17.3	7.6	15.4	17.2	20.9	3.8	18.9	7.8
Total	**6.4**	**6.5**	**6.8**	**39.0**	**34.9**	**45.2**	**7.7**	**7.5**	**7.5**

All in all, loan portfolio of the banking system underwent some corrosion during the first quarter of 2008 which was not unexpected but certainly not pleasing. Massive rise in advances during the last two years has not only complemented this corrosion but has made the management of asset quality even more challenging. Banks in view of the tight monetary conditions and to avoid further deterioration of the loans portfolio may have to improve on their lending policies as well.

4.2 MARKET RISK

Market risk profile of the banking system largely emanates from **interest rate risk**.

During the Mar-08 quarter, interest rates along the yield curve showed an upward shift following the announcement of SBP raising its policy discount rate by 50 basis points to 10.5 percent in the first week of February, 2008. Concurrently, CRR was also raised by 100 basis points for deposits up to one year maturity while leaving term deposits of over a year zero rated.

Short term interest rates moved up in the range of 21 to 67 basis points while the long term rate increased by 74 to 95 basis points from Dec-07 level for the different time maturities (see Figure:-4.2.1). This is also obvious in the increasing trend of yield spread between the 3m and 10 year interest rates (see Figure:4.2.2). Since the movements along the yield curve were not significant, interest rate risk remained subdued.

Re-pricing gaps, i.e. the GAPs between the rate sensitive assets and rate sensitive liabilities of the banking system were largely with in the acceptable range. For all the three time buckets, upto 3 months, 3-12 months and over 1 year buckets, the repricing GAP was well below the +/- 10 percent of the total assets (see Figure:-4.2.3).

Group wise, SB & PSCB maintained negative GAP in the three months bucket, which is highest for the PSCBs. In 3 month to 12 month bucket the gap was positive in all the groups though highest for PSCBs. This may warrant re-pricing risk since the banks are carrying short positions in the shorter tenure buckets. The yield curve movement suggests increase in the interest rates in the wake of inflationary expectation associated

Figure-4.2.1: Shift in Yield Curve

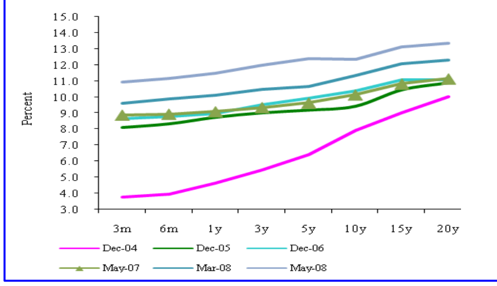


Figure-4.2.2: 3m & 10y PKRV Rates

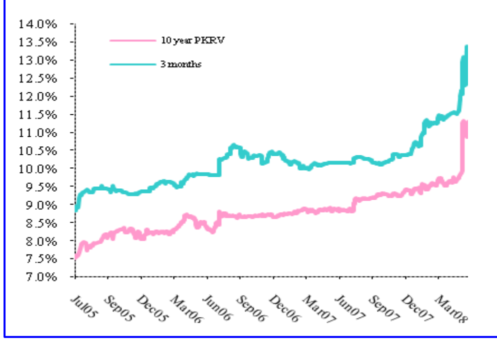


Figure:-4.3.3 GAP between Rate Sensitive Assets and Laibilities to Total Assets (in %)

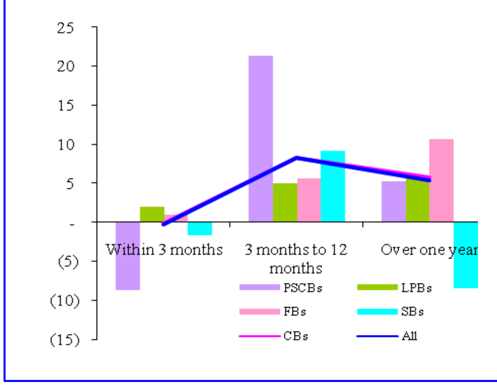
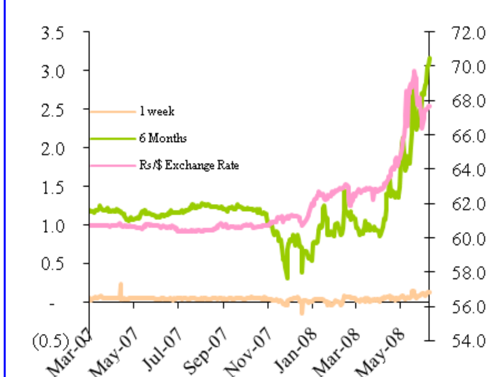


Figure:-4.2.4 Exchange Rate and Swap Point



with growth.

Exchange rate risk, takes into account the impact of changes in the exchange rate on the net value of foreign currency assets and liabilities. Rupee dollar exchange rate which has remained stable around Rs 60 during the last year, experienced depreciation since September 2007 and increased to 62.8 rupees(see Figure:-4.2.4). The rupee came under further pressure and depreciated to the level of Rs 70 per USD in May-07 in the interbank market. The trend is likely to continue with additional strain on rupee dollar parity in the period ahead.

Swap points, also experienced slight increase owing to the expectation of depreciation in exchange rate in the coming months. Net open position of the banks, which remained positive during the couple of years, showed mixed trend. While it was negative during the quarter, it turned positive towards the end of period under review. (See Figure:-4.2.5).

Equity exposure of the banking system (which includes investments fully paid up shares both in listed and unlisted stocks excluding the subsidiaries and associates) has increased to Rs42.76 billion from Rs40.4 billion in CY07 (see Figure:-4.2.6). Investments in terms of capital (percentage of the net assets) experienced slight increase to 7.8 percent as compared to 7.46 percent in CY07 due to marginal increase in capital. Group wise, LPBs have the largest equity exposure of Rs36 followed by Rs4.6 billion of PSCBs. In terms of capital, this exposure remained less than 10 percent for all the banking groups.

Figure:-4.2.5 NOP in Million $

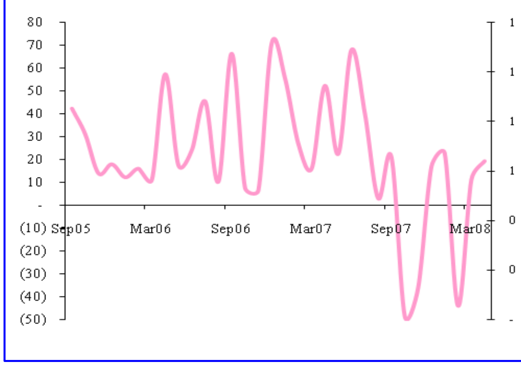
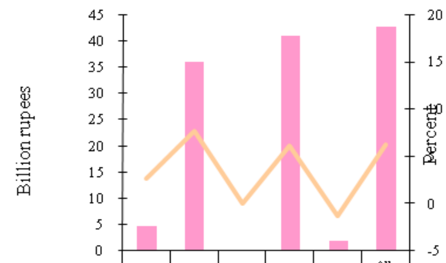
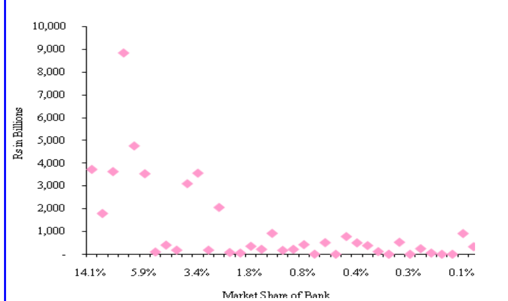


Figure-4.2.6: Exposure of Banks in Equities-Mar-08



	PSCBs	LPBs	FBs	CBs	SBs	All Banks
Actual Exposure	4.6	36.0	0.2	40.9	1.8	42.7
Exposure to Capital (RHS)	2.6	7.6	0.0	6.1	-1.3	6.2

Figure:-4.2.7 Investment in Fully Paid up Ordinary Shares-Mar-08

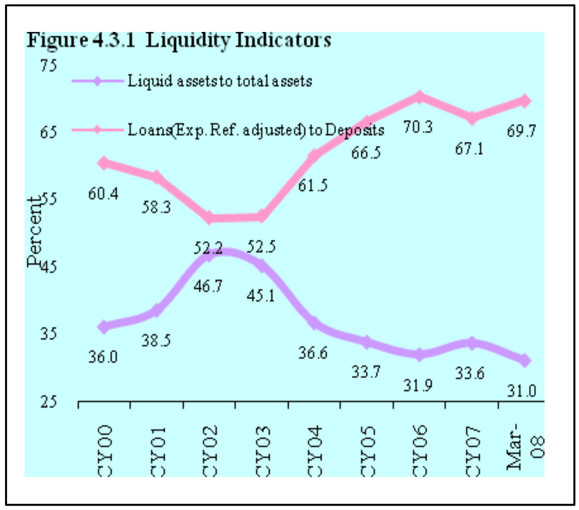


Disaggregated analysis show that top 5 banks with 51 percent share in total assets, hold around 53 percent exposure in the total equity investment (see Figure:-4.2.7). Further 22 out of 39 banks had equity exposures of less than 5 percent in terms of their net assets (see Figure:4.2.8).

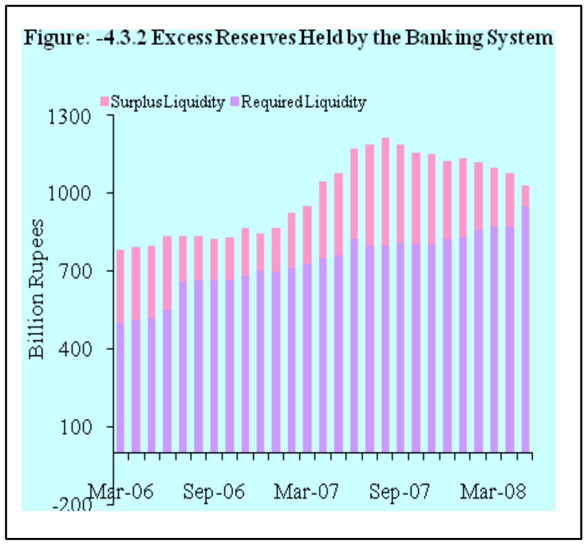
In short, movements in the interest rates and exchange rate are putting some pressure on the market risk, particularly in a period of inflationary expectations and worsening trade imbalances. While the exposure of equity market is within the manageable limit for the overall banking sector, it remains subject to equity price risk.

4.3 Liquidity Risk

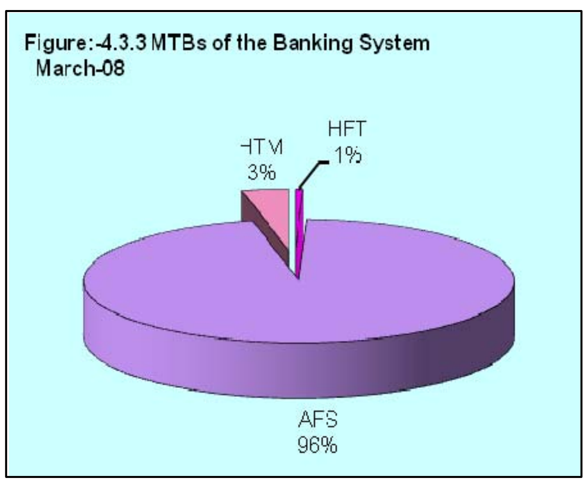
Liquidity position of the banking started to reflect the signs of contracting monetary policy as reflected in the decline of liquid assets to total assets ratio. During the quarter under review loan to deposit ratio, increased to 72.6 percent from 70.3 percent at Dec-07 (see Figure:-4.3.1). Though the deposit increased, they failed to match the growing demand for advances, forcing banks to relinquish some of their liquid resources. Resultantly, liquid assets to total assets ratio of the banking system witnessed considerable decline to 31 percent from 34.0 percent in CY07.



Liquidity of the banking system though at comfortable levels, continues to decline since Aug-07. Total liquidity which was about 36.3 percent of the TDL in Aug-07 stood at 30.7 percent in Mar-08. Higher liquidity requirements partially resulting from increase in SLR left the banks less liquid. (See Figure: 4.3.2). Post quarter development shows the same trend in excess reserve thus further tightening the liquidity position.

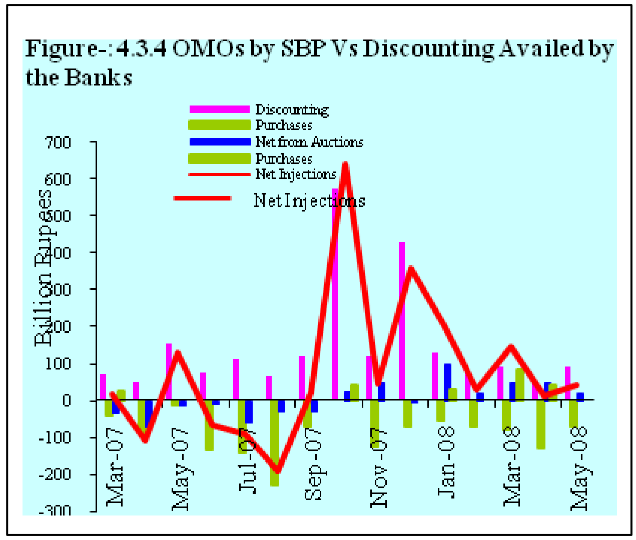


Various categories of Government securities in Held for Trading (HFT), Available for Sale (AFS) and Held to Maturity (HTM) also reflect the liquidity available with the banking system. Total investment in the PIB & MTBs decreased from Dec-07 level but was still higher than the Mar-07 level. Around 97 percent of MTBs have been placed in both the HFT and AFS categories (see Figure:-4.3.3). The market based liquidity (MTB holdings)

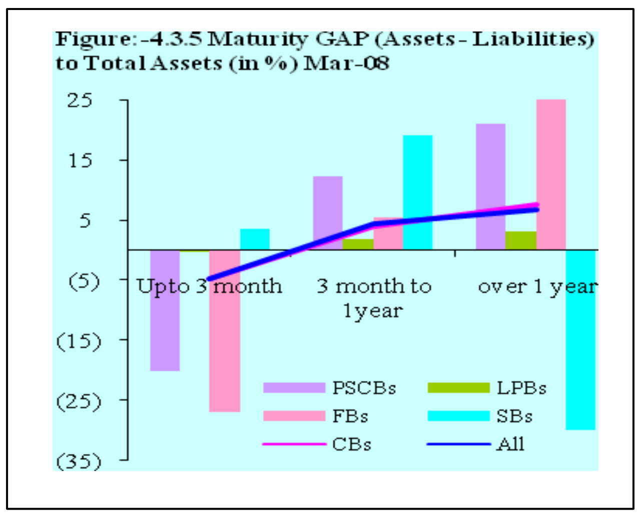


has increased moderately by 10.8 percent from the Mar-07 level due to increased MTBs holding in AFS categories by 12.8 percent.

To implement its tight monetary policy stance, the SBP continued to focus on the shorter-end of the yield curve by effectively using Open Market Operations (OMOs). These interventions in the interbank market, by draining out excess liquidity, were aimed at keeping overnight repo rates in a desired range consistent with the monetary policy stance. The frequent open market operations (OMOs) during this period has mopped up excess liquidity from the banking system (see Figure:4.3.4). However, significant discounting has also been observed during the period to avail short term liquidity support.



GAPs between the maturity of assets and liabilities, a measure of funding liquidity risk, were on the satisfactory level for overall banking sector. The PSCB, FB & SB groups experienced significant gap as percentage of total assets beyond 10% limit in different maturity buckets. However, due to good liquidity management position in the LPBs group, that holds significant share in the banking sector, overall banking sector remained within the manageable limit of ±10% range.(see Figure:4.3.5).



In general the liquidity of the banking system has remained within acceptable limits due to effective management of Asset Liability gap in the LPBs. While the pinch of tight monetary policy is evident from declining trend in liquid assets and increasing loans to deposit ratio of the banking sector, current market based liquidity is sufficient to support the overall position of the system.

5. Performance of Islamic Banking

Islamic Banking in Pakistan has evolved over the years. The first Islamic Bank was established in CY 2002 now this segment comprise six full fledged Islamic Banks (IBs) having 210 branches whereas 12 conventional banks are operating with over 100 Islamic Banking branches. (see Table-5.1).

Table-5.1: Islamic Banking Participants

	CY02	CY03	CY04	CY05	CY06	CY07	Mar-08
No. of Islamic Banks (IBs)	1	1	2	2	4	6	6
No. of Branches	6	10	23	37	93	186	210
No. of conventional banks operating Islamic Banking Branches	-	3	7	9	12	12	12
No. of Islamic Banking Branches (IBBs)	-	7	21	33	57	103	103

A review of the channels of funds reveals that the deposits and financing continue to dominate the balance sheet components of the Islamic Banking System. The share of deposits witnessed slight increase of 0.4 to 71.9 percent during quarter March 08. Though deposits grew at a meager rate of 3.5% during the period under review, on Y-O-Y basis deposits exhibited a substantial growth of 63.8%.

Table-5.2: Sources and Uses of Funds (Billion rupees)

	CY03	CY04	CY05	CY06	CY07	Mar-08
SOURCES						
Deposits	8.4	30.2	49.9	83.7	147.4	152.5
Borrowings	1.9	6.6	9.0	10.8	15.0	13.3
Capital & other funds	2.0	5.1	7.8	16.3	29.5	31.2
Other liabilities	0.6	2.3	4.7	8.4	14.4	15.4
	12.9	**44.1**	**71.5**	**119.3**	**206.2**	**212.3**
USES:						
Financing	8.7	27.5	45.8	65.6	106.4	119.7
Investments	1.2	2.0	1.9	7.3	31.2	31.9
Cash, bank balance, placements	2.0	11.9	19.3	31.4	50.8	42.9
Other assets	1.0	2.7	4.5	15.0	17.9	17.8
	12.9	**44.1**	**71.5**	**119.3**	**206.2**	**212.3**

Financing has increased its share in the total assets by 48 percent points to 56.4 percent during Mar-08 quarter. Financing showed over the quarter growth of 12.5% and YOY growth of 71%. During the quarter under review Investments increased by 2.3 percent (YoY growth 279.8%) whereas Cash, bank balance and placements experienced a decline of 15.5 percent The size of Islamic Banking system grew by 3 percent during the quarter (YoY growth 57%) against an increase of 1.3 percent of all banks. Consequently the share of Islamic Banks in the banking system continues to increase i.e. it increased from 3.95 percent in Dec-07 to 4.07 percent in March 08.

Asset quality of the Islamic banks is evident from NPFs to total financing ratio of 1.5% over the years. The indicator for the first time has demonstrated signs of stress. The Non Performing Financing of the system has suddenly increased by 42.1% during Mar-08. The increase in the ratio of NPF to total financing was largely the result of overall economic slack down in the economy that also reflects in the increasing trend of NPLs for conventional banks (see Table 5.3). However the Net NPFs to financing ratio is 0.2% which though represents increase over the previous quarter is still reasonable. Financing to deposits ratio increased from around 72.2 percent in December 07 to 78.5 percent in March

08. The financing to deposits ratio has traditionally been on a decline during the formative phase of the Islamic Banking system. However, with the maturity in the system, increased Islamic banking awareness among the general public, continued expansion and entry of new players, and in response to monetary tightening, Islamic banks are shifting their funds from cash and balances to more productive uses to cater to the needs of different sectors of the economy.

Table-5.3: Key Performance Indicators

Percent

Indicator	CY03	CY04	CY05	CY06	CY07	Mar-08
NPFs to total financing	0.7	0.9	1.0	1.3	1.2	1.5
Net NPFs to net financing	-	0.2	0.2	0.4	(0.1)	0.2
Provision to NPFs	100.0	82.3	80.6	72.0	108.7	84.2
Net Markup Income to total assets	1.7	1.4	2.3	2.4	2.9	4.1
Non Markup Income to total assets	2.2	1.4	1.7	0.9	1.2	1.0
Operating Expense to Gross Income	54.6	65.3	49.9	72.8	70.0	74.3
ROA (average assets)	2.2	1.2	1.7	0.9	0.9	0.8
Growth in Assets	84.5	241.8	62.0	66.9	16.1	3.0
Growth in Deposits	64.6	259.5	65.4	67.7	18.5	12.5
Growth in Financing	147.0	218.2	66.3	43.3	20.5	3.5

IBIs capital, one of the funding sources has increased its share from 12.40% in December 07 to 12.60% in March 08. Capital adequacy of the IBIs though declined by 20 basis point to 18.2% during March-08 quarter is still well above the minimum required CAR of 8 percent of risk weighted assets. The CAR above the minimum required rate is indicative of the fact that IBIs are in a comfortable position to support these Institutions in expansion of their business.

The composition of deposits shows that there is clears shift in deposits mix. The break up of deposits reveals that fixed deposits have increased from 36.2 percent in December 07 to 38.9 percent in March 08, while saving deposits have declined by 1.1% percent to 31.3 percent in March 08. Current Account non-remunerative deposits have increased from 20.1 percent in December 07 to 20.6 percent in March 08 whereas deposits from financial institutions have declined from 10.3 percent in December 07 to 8 percent in March 08. (see Figure-5.1).

Figure-5.1: Composition of Deposits

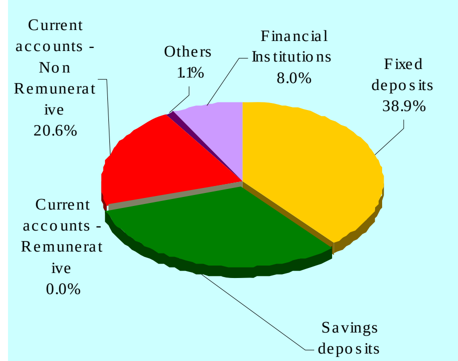
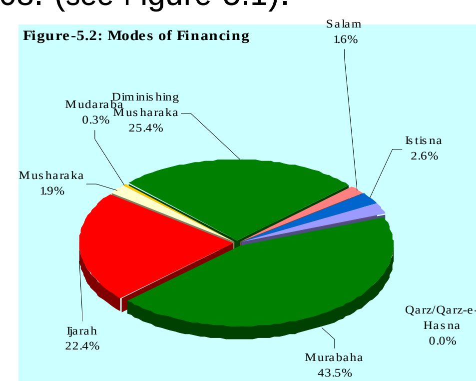


Figure-5.2: Modes of Financing



The composition of financing reflects that Murabaha and Ijarah continued to remain the major source of financing; however, they are losing their share to other modes like Musharika, Diminishing Musharika and Istisna. The share of Murahaba and Ijarah decreased by 1.7% and 3.7% during the quarter. The share of Diminishing Musharaka has increased from 23.9 percent in December 07 to 25.4 percent in March 08. The combined share of these three modes of financing constitutes 91.3 percent of the total financing by Islamic Banking Institutions. (see Figure-5.2).

Table-5.4: Income Statement						(Rs. Billion)
	CY03	CY04	CY05	CY06	CY07	Mar-08
Markup Income	0.4	1.1	3.2	6.4	12.7	4.2
Markup Expense	0.2	0.5	1.5	3.5	6.8	2.1
Net Markup Income	0.2	0.6	1.6	2.9	5.9	2.2
Provision Expense	(0.0)	0.0	0.2	0.2	0.8	0.2
Non Markup Income	0.3	0.6	1.2	1.1	2.4	0.5
Operating Expense	0.3	0.8	1.4	2.9	5.9	2.0
Profit Before Tax	0.2	0.4	1.2	0.8	1.7	0.5
Tax	0.0	0.0	0.3	(0.0)	(0.2)	0.1
Profit After Tax	0.2	0.3	1.0	0.9	1.6	0.4

Despite increase in NPF, IBBs have managed to enhance their profitability, which is reflected from the profit after tax of Rs. 410 million for the quarter under review as compared with Rs 288 million in corresponding quarter of 2007 (YoY growth 42%). Net markup income and non-mark-up income also reflected increasing trend during the quarter under review as compared to corresponding period of the last year (see Table-5.4). However, the incidence of higher Operating expense as percentage of gross income i.e. 74.3 percent has resulted in lower net mark-up income to total asset and non mark-up income to total assets at 4.1 percent and 1.0 percent respectively. The ROA has decreased slightly to 0.8 percent from 0.9 percent for the last year (see Table-5.3). Opening of 118 new branches by the IBI since September 2007, induction of qualified and experienced personnel, better product development as well as institution of technology and risk management regime may well explain the increase in operating expenses in relation to total assets.

The overall performance of IBIs during the quarter remained promising despite the slowed down of the economy. With improving profitability coupled with capital adequacy well above the required ratio and expanding branch network, the IBIs appear firmly placed to gain further share in the banking system.

6. Resilience of the Banking System towards Stress Tests

The significance of assessing the potential vulnerabilities in the financial system and the measures to evade these vulnerabilities is getting due attention especially due to rising volatilities in the financial markets. Stress testing is one of the risk management techniques which, when used along with the other risk assessment tools, help both the managers and regulators to understand the risks. SBP has also been carrying out this analysis for the banking system.

This stress testing exercise employs simple sensitivity analysis, which looks for quantifying the impact of plausible shocks to the risk factors of the banking system. These shocks are based on both historic and hypothetical moves in the financial markets risk factors. These reference shocks have been devised and the impact of the shocks has been assessed for individual banks as well as all the three commercial banking groups viz. Public Sector Commercial Banks (PSCBs), Local Private Banks (LPBs) and Foreign Banks (FBs) (see Box 6.1). This exercise assumes the stress shocks along three risk factors i.e. credit, market and liquidity in three months time horizon.

Box: 6.1

Reference Shocks for Stress Tests

For the Year ended on March 31, 2008

Credit Shocks

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

Credit Shock C-2 assumes a downward shift of NPLs from Substandard to Doubtful and from Doubtful to Loss category.

Credit Shock C-3 assumes a cumulative impact of the above two shocks (C-1 & C-2)

Credit Shock C-4 assumes an increase in NPLs of consumer loans upto 10%age points rise in NPLs to Loans ratio of consumer finance (with 100% provisioning against increased NPLs)

Market Shocks

Interest Rate Shocks:

Market Shock IR-1 assumes an increase in interest rates by 200 basis points along all the maturities.

Market Shock IR-2 assumes a shift and steepening in the yield curve by increasing interest rates of all the three maturities (by 50, 100, and 150 basis points)

Market Shock IR-3 assumes a shift coupled with flattening of the yield curve by increasing 150,120 and 100 basis points in the three maturities respectively.

Exchange Rate Shocks:

Market Shock ER-1 assumes a depreciation of ER by 13 percent (closer to the highest change in the monthly average PRS/US$ exchange rate (12.83) over the period since 1994, in September 2000).

Market Shock ER-2 assumes an appreciation of rupee by 10 percent-(double of the last 10 years' largest quarterly appreciation of ER) .

Equity Price Risk Shocks:

Market Shock E-1 assumes the impact of a 20 percent decline in the price of stock holdings.

Market Shock E-2 assumes the impact of a 40 percent decline in the price of stock holdings.

Liquidity Shocks

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

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

Box: 6.2

Stress Tests on Commercial Banks

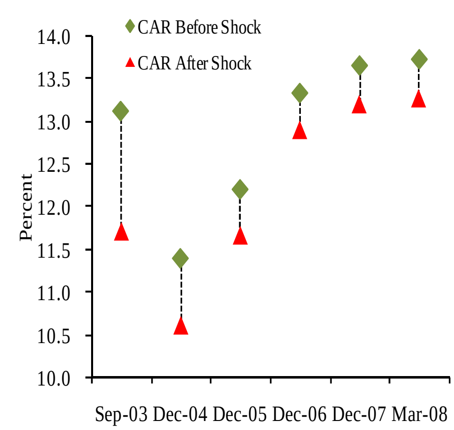
Shocks			**March 31, 2008**		**December 31, 2007**	
			%age Point Change in CAR	***Adjusted CAR-After Shock***	***%age Point Change in CAR***	***Adjusted CAR-After Shock***
Credit Shocks						
Credit Shock	C-1	Deterioration in the qualityof loan	-0.5	13.3	-0.5	13.2
Credit Shock	C-2	Shift in categories of classified loans	-0.5	13.3	-0.4	13.2
Credit Shock	C-3	Cumulative impact of all shocks in 1and 2	-0.9	12.8	-0.9	12.8
Credit Shock	C-4	Deterioration in NPLs ratio of consumer finance	-0.9	12.9	-0.9	12.7
Market Shocks						
Interest Rate Shocks						
Market Shock	IR-1	Shift in the yield curve	-0.5	13.3	-0.6	13.0
Market Shock	IR-2	Shift and steepening of the yield curve	-0.3	13.4	-0.4	13.2
Market Shock	IR-3	Shift & flattenining of the yield curve	-0.3	13.5	-0.3	13.3
Exchange Rate Shocks						
Market Shock	ER-1	Depreciation of Rs/US$ exchnage rate (the historical high)	0.2	13.9	0.4	14.1
Market Shock	ER-2	Appreciation of Rs/US$ exchnage rate (hypothetical)	-0.1	13.6	-0.3	13.3
Equity Price Shocks						
Market Shock	E-1	Fall in the KSE index (historical)	0.0	13.7	-0.1	13.6
Market Shock	E-2	Fall in the KSE index (hypothetical scenario)	-0.1	13.6	-0.2	13.4
Liquidity Shocks						
Liquidity Coverage Ratio			***Actual***	***Stressed***	***Actual***	***Stressed***
Liquidity Shock	L-1	5 Percent Fall in the Liquid Liabilities	34.1	30.6	37.0	33.7
Liquidity Shock	L-2	10 Percent Fall in the Liquid Liabilities	34.1	26.8	37.0	30.0

Note: The results have not been adjusted for the impact of deferred tax benefits.

The impact of credit and market shocks to the risk factors has been calibrated on capital whereas for the liquidity shocks, the level of stressed liquidity position is measured in terms of liquidity coverage ratio[2]. Summary of the impact of these shocks has been given in Box 6.2.

These shocks and their impact have briefly been discussed in the ensuing paragraphs.

Figure:-6.1 Impact of 10% Rise in NPLs on CAR- Credit Shock C-1



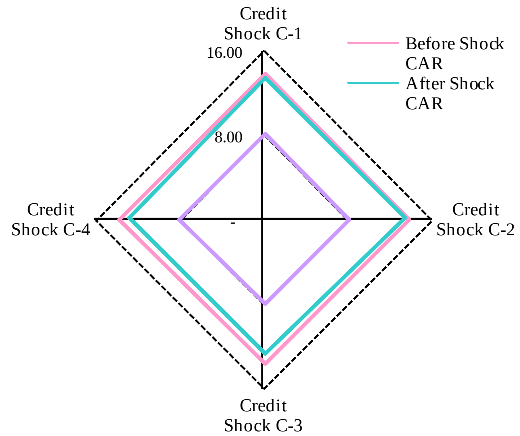
As for the credit, NPLs have been given four shocks. Under Credit Shock C-1 an increase in NPLs by 10 percent has been assumed with a provisioning requirement of 100 percent. Generally all the banks seem fairly resilient to this shock. In fact, the healthy capital base can sustain this level of shock comfortably. In terms of CAR, commercial banks, would likely to lose only half a percentage point under this shock. Adjusted CAR would remain above the 13 percent level (see Figure:-6.1). Individually, none of the banks would experience a fall in their CAR to below 8 percent with this shock.

Under Credit Shock C-2, which assumes an adverse shift in the categories of NPLs, commercial banks would require an additional provisioning of around Rs 20 billion, which again may reduce the CAR of this group by half a percentage points to 13.3 percent. It

[2] Ratio of liquid assets to liquid liabilities

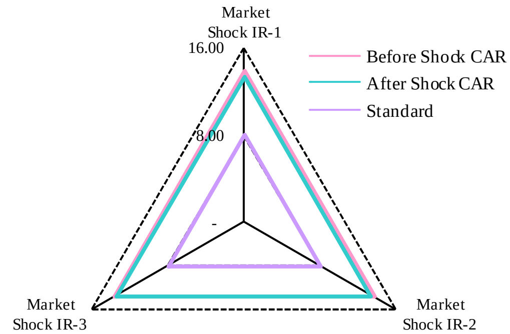
is due to the fact that around two third of NPLs lie in loss category, which already requires a 100 percent provisioning. Under the combined effect of the above mentioned two shocks discussed as Credit Shock C-3, the CAR of commercial banks would experience a decline of around one percentage point but still the level would remain comfortable at 12.8 percent.

Figure:-6.2 Impact of Credit Shocks on CAR, Mar-08



Recent rise in NPLs of consumer finance raised concern both for the banks as well as regulator. To assess the resilience of the banking system against adverse movement in NPLs of consumer portfolio, a 10 percent rise in NPLs to loans ratio of consumer sector has been taken under Credit Shock C-4. The results show that the impact of this shock would also be not that large since consumer loans do not carry a big share in total loans. Under this shock, the commercial banks would have to create an additional provisioning of Rs 36 billion, which may lower the CAR of this group by about 0.9 percentage point to 12.9 percent (see Figure:-6.2). Group-wise, both PSCBs & LPBs would experience a decline in their CARs by almost 0.8 percentage points. Foreign Banks (FBs) are most effected under this shock as their CAR is reduced by 1.3 percentage points to 11.6 percent.

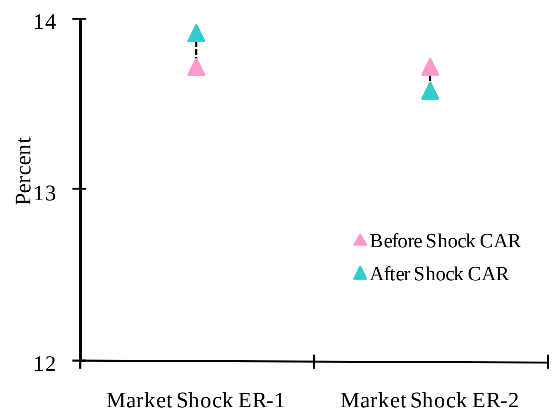
Figure:-6.3 Impact of Interest Rate Shocks on CAR, Mar-08



To measure the interest rate sensitivity of banks, three shocks (IR-1 to IR-3) have been identified. Market Shock IR-1 takes into account an upward shift in the yield curve by 200bps. Since the banking system has positive duration gap between the rate sensitive assets and liabilities, any increase in interest rate would actually reduce the market value of equity of banks. The result shows that commercial banks would experience a decline in their market value of equity by about Rs20 billion, the impact of which if taken on capital, may lower the CAR by about 0.5 percentage point (see Figure:-6.3). Group-wise, LPBs would experience a highest fall in their market value of equity, which in terms of rupees would be around 14billion.

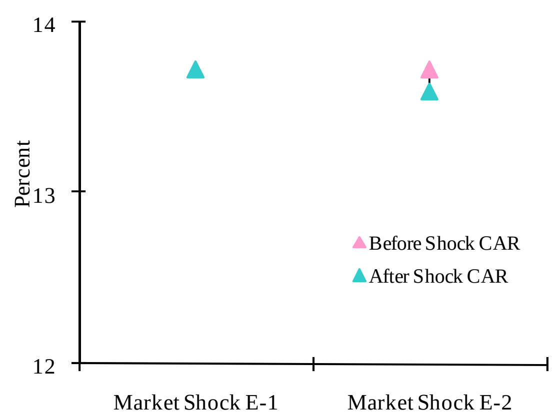
Market Shock IR-2 considers steepening of the yield curve by increasing interest rates of all the three maturities by 50, 100 and 150 basis points respectively. The commercial banks would experience a decline in its market value of equity by almost Rs14 billion, the impact of which when measured in terms of CAR would be around 0.3 percentage points. The stressed CAR of commercial banks in this case would stay at 13.4 percent. Market Shock IR-3 considers flattening of the yield curve assuming increase in interest rates of all the three maturities by 150, 120 and 100 basis points respectively. This shock would have a lower impact since longer term yield are given a lower shock. However, the market value of equity of the banks would experience a decline of Rs10 billion under this shock, which may lower the CAR of this group by 0.3 percentage points.

Figure:-6.4 Impact of Exchange Rate Shocks on CAR, Mar-08



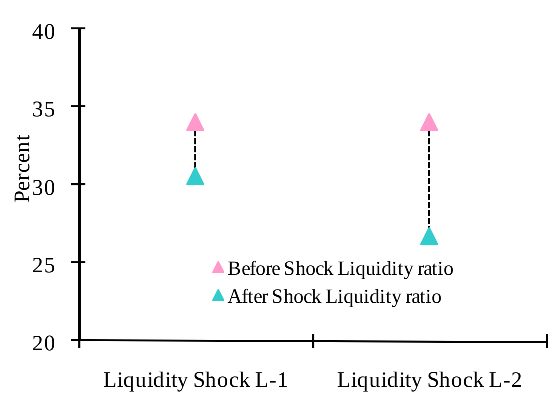
The exchange rate shocks have been assumed under Market Shock ER-1 & ER-2. The first shock considers a historical level of depreciation in the rupee by 13 percent. Since the foreign currency assets of the banking system exceed the foreign currency liabilities, the banking system would actually gain from this depreciation (see Figure:-6.4). However, a hypothetical shock of appreciation in rupee Market Shock ER-2 may cost the commercial banks by around Rs6 billion, which in turn may reduce their CAR to 13.6 percent.

Figure:-6.5 Impact of Equity Price Shocks on CAR- Mar-08



To gauge the sensitivity of the banks towards equity price movements, two shocks (E1 & E2) have been assumed. Under Market Shock E-1, which assumes a 20% fall in the price of direct equity investment, the banks can fairly sustain this level of shock. Since 9 out of 39 banks do not have exposure in equities and the rest of the banks have sufficient surplus available against such share, the impact of this shock is insignificant (see Figure:-6.5). Market Shock E-2, assumes a 40% fall in the price of direct equity investment. Under this shock to direct equity investments of the banks, the banking system would experience a

Figure:-6.6 Liquidity Coverage Ratio Calculated After Excluding HTM Portfolio- Mar-08



loss of around Rs6 billion, which may reduce the CAR of commercial banks by about 0.1 percentage points to 13.6 percent. Group wise, it would be LPBs, which would share almost all of this loss and the CAR of this group may fall by 0.2 percentage points.

Liquidity coverage ratio- a ratio of liquid assets to liquid liabilities- has been used to assess the liquidity position of the banks. Two liquidity shocks L-1 & L-2 have been assumed for this purpose. Under Liquidity Shock L-1, which assumes a decline of 5 percent in the liquid liabilities, liquidity coverage ratio (calculated after excluding HTM securities from liquid assets) of commercial banks stayed at 30.6 percent which seems comfortable (see Figure:-6.6). Under Liquidity Shock L-2, a 10 percent decline in the liquid liabilities, the ratio may decrease to 26.8 percent.

Summing up, the results of credit and market risk shocks show that the banks are generally resilient towards the historical as well as hypothetical shocks envisaged in this exercise. Among the credit risk shocks, the increase in NPLs of consumer finance may put higher strain on the solvency of the banks. Of the market risk shocks, since the banks' exposures in interest rate, foreign exchange and equity positions are not that high, the banking system can fairly sustain these shocks. However, the banks must position themselves for the increasing volatilities in the risk factors.

Financial Soundness Indicators of the Banking System Annexure-I

Indicators	2000	2001	2006	2007	Mar-08
CAPITAL ADEQUACY					
Risk Weighted CAR					
Public Sector Commercial Banks	10.4	9.6	15.2	17.8	15.5
Local Private Banks	9.2	9.5	12.7	12.8	12.0
Foreign Banks	18.0	18.6	15.0	13.5	14.9
Commercial Banks	**11.4**	**11.3**	**13.3**	**13.8**	**12.8**
Specialized Banks	(3.3)	(13.9)	(8.3)	(7.8)	24.8
All Banks	**9.7**	**8.8**	**12.7**	**13.2**	**13.0**
Tier 1 Capital to RWA					
Public Sector Commercial Banks	7.7	7.1	11.1	13.0	11.3
Local Private Banks	8.1	8.4	10.4	10.5	9.9
Foreign Banks	17.9	18.6	14.3	12.9	14.2
Commercial Banks	**9.8**	**9.7**	**10.8**	**11.1**	**10.3**
Specialized Banks	(3.4)	(13.9)	(13.3)	(13.5)	19.8
All Banks	**8.3**	**7.3**	**10.0**	**10.5**	**10.5**
Capital to Total Assets					
Public Sector Commercial Banks	4.6	3.7	12.2	13.7	13.7
Local Private Banks	3.5	3.8	9.2	10.2	10.1
Foreign Banks	8.8	8.5	10.1	11.2	10.3
Commercial Banks	**4.9**	**4.6**	**9.9**	**10.9**	**10.8**
Specialized Banks	(1.1)	(10.3)	(8.0)	(5.5)	(6.2)
All Banks	**4.5**	**3.8**	**9.4**	**10.5**	**10.4**
ASSET QUALITY					
NPLs to Total Loans					
Public Sector Commercial Banks	26.3	25.9	9.0	8.4	9.4
Local Private Banks	15.4	16.3	5.2	6.0	6.5
Foreign Banks	4.7	4.3	1.0	1.6	1.7
Commercial Banks	**19.5**	**19.6**	**5.7**	**6.3**	**6.9**
Specialized Banks	52.4	53.0	39.1	34.3	34.2
All Banks	**23.5**	**23.4**	**6.9**	**7.2**	**7.7**
Provision to NPLs			0		
Public Sector Commercial Banks	59.2	56.6	84.5	89.0	87.5
Local Private Banks	36.9	40.5	78.7	87.2	86.0
Foreign Banks	65.9	74.1	191.7	157.0	138.4
Commercial Banks	**53.9**	**53.2**	**81.5**	**88.2**	**86.8**
Specialized Banks	58.1	59.2	64.1	68.6	67.1
All Banks	**55.0**	**54.7**	**77.8**	**85.1**	**84.1**
Net NPLs to Net Loans					
Public Sector Commercial Banks	12.7	13.1	1.5	1.0	1.3
Local Private Banks	10.3	10.4	1.1	0.8	1.0
Foreign Banks	1.7	1.1	(1.0)	(0.9)	(0.7)
Commercial Banks	**10.1**	**10.3**	**1.1**	**0.8**	**1.0**
Specialized Banks	31.6	31.5	18.7	14.0	14.6
All Banks	**12.2**	**12.1**	**1.6**	**1.1**	**1.3**
Net NPLs to Capital					
Public Sector Commercial Banks	124.5	160.2	6.4	3.4	4.8
Local Private Banks	153.5	125.2	7.1	4.2	5.2
Foreign Banks	9.0	5.8	(5.1)	(4.1)	(3.1)
Commercial Banks	**96.7**	**100.7**	**6.2**	**3.7**	**4.8**
Specialized Banks	-	-	-	-	-
All Banks	**131.3**	**150.5**	**9.7**	**5.6**	**6.8**
EARNINGS					
Return on Assets (Before Tax)					
Public Sector Commercial Banks	0.5	-	4.0	3.6	1.3
Local Private Banks	(0.1)	0.9	3.1	2.0	2.5
Foreign Banks	1.4	1.7	3.2	1.5	1.7
Commercial Banks	**0.4**	**0.6**	**3.2**	**2.3**	**2.3**
Specialized Banks	(2.3)	(8.4)	(1.3)	1.4	0.0
All Banks	**0.3**	**0.1**	**3.1**	**2.2**	**2.2**
Return on Assets (After Tax)					
Public Sector Commercial Banks	0.2	(0.5)	2.7	2.5	0.6
Local Private Banks	(0.7)	0.4	2.1	1.4	1.7
Foreign Banks	0.6	0.8	2.1	0.7	0.8
Commercial Banks	**(0.0)**	**(0.0)**	**2.2**	**1.6**	**1.5**
Specialized Banks	(2.3)	(8.8)	(1.8)	0.7	0.0
All Banks	**(0.2)**	**(0.5)**	**2.1**	**1.5**	**1.4**

Indicators	2000	2001	2006	2007	Mar-08
ROE (Avg. Equity & Surplus) (Before Tax)					
Public Sector Commercial Banks	10.9	0.5	32.4	27.2	9.6
Local Private Banks	(3.2)	25.4	36.2	20.4	24.7
Foreign Banks	15.6	19.3	30.0	13.5	16.0
Commercial Banks	**8.8**	**12.2**	**34.7**	**21.9**	**20.7**
Specialized Banks	-	-	-	-	-
All Banks	**5.7**	**1.4**	**35.2**	**22.6**	**20.7**
ROE (Avg. Equity & Surplus) (After Tax)					
Public Sector Commercial Banks	4.9	(12.2)	21.7	19.5	4.7
Local Private Banks	(17.4)	10.3	25.0	13.9	16.6
Foreign Banks	6.1	9.1	20.4	6.3	7.1
Commercial Banks	**(0.3)**	**(0.3)**	**23.7**	**15.0**	**13.3**
Specialized Banks	-	-	-	-	
All Banks	**(3.5)**	**(12.6)**	**23.8**	**15.5**	**13.2**
NII/Gross Income			-		
Public Sector Commercial Banks	61.8	69.9	69.5	65.9	66.2
Local Private Banks	63.2	72.1	73.5	70.8	71.5
Foreign Banks	54.0	59.4	65.8	59.1	57.9
Commercial Banks	**61.2**	**68.9**	**72.1**	**69.3**	**69.8**
Specialized Banks	78.6	86.7	40.1	42.8	56.2
All Banks	**62.3**	**70.4**	**70.9**	**68.3**	**69.1**
Cost / Income Ratio					
Public Sector Commercial Banks	70.1	62.3	31.8	30.2	35.0
Local Private Banks	80.9	67.3	40.7	45.2	46.2
Foreign Banks	59.4	54.5	49.8	56.4	52.8
Commercial Banks	**71.6**	**62.7**	**39.4**	**42.6**	**44.3**
Specialized Banks	70.5	59.0	62.6	52.5	45.1
All Banks	**71.6**	**62.4**	**40.3**	**43.0**	**44.6**
LIQUIDITY					
Liquid Assets/Total Assets					
Public Sector Commercial Banks	37.1	36.5	33.9	37.5	32.3
Local Private Banks	34.0	39.8	31.1	32.5	30.6
Foreign Banks	45.2	50.3	41.0	41.5	39.0
Commercial Banks	**37.5**	**39.9**	**32.2**	**33.8**	**31.2**
Specialized Banks	12.7	13.6	23.0	25.9	22.1
All Banks	**36.0**	**38.5**	**31.9**	**33.6**	**31.0**
Liquid Assets/Total Deposits					
Public Sector Commercial Banks	45.0	43.4	42.6	47.7	41.6
Local Private Banks	44.3	49.6	40.6	42.8	40.4
Foreign Banks	67.7	78.3	61.1	61.0	54.8
Commercial Banks	**48.0**	**50.3**	**42.0**	**44.4**	**41.2**
Specialized Banks	90.8	79.8	205.4	229.6	204.3
All Banks	**48.5**	**50.7**	**42.7**	**45.1**	**41.7**
Advances/Deposits					
Public Sector Commercial Banks	54.0	53.8	64.6	60.0	65.9
Local Private Banks	67.5	57.9	74.5	70.1	72.2
Foreign Banks	71.5	66.8	80.1	75.2	66.6
Commercial Banks	**60.5**	**56.9**	**72.7**	**68.1**	**70.7**
Specialized Banks	553.0	450.5	528.4	507.2	544.5
All Banks	**66.2**	**61.7**	**74.6**	**69.8**	**72.3**

Note: The indicators for March 2008 are based on Un-audited returns.

Annex-II

Selected Indicators for Different Categories of Banks in terms of Size, Mar-08

Indicators	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Share of Total Assets	51.2%	73.8%	93.4%	100%
Share of Total Deposits	53.2%	75.8%	94.5%	100%
Share of Gross Income	56.4%	75.0%	94.5%	100%
Share of Risk Weighted Assets	51.3%	71.7%	93.2%	100%
Capital Adequacy				
Capital/RWA	13.6%	12.4%	12.2%	13.2%
Tier 1 Capital / RWA	10.3%	9.6%	9.5%	10.7%
Net Worth / Total Assets	11.0%	10.9%	10.3%	10.4%
Asset Composition				
Sectoral Distribution of Loans (Domestic)				
- Corporate Sector	46.5%	72.3%	94.0%	100%
- SMEs	46.4%	71.5%	90.6%	100%
- Agriculture	35.1%	43.8%	93.9%	100%
- Consumer Finance	55.4%	76.3%	96.1%	100%
- Commodity Financing	67.3%	89.7%	98.0%	100%
- Staff Loans	59.2%	78.0%	93.0%	100%
- Others	33.4%	61.9%	74.6%	100%
- **Total**	**48.8%**	**72.6%**	**94.1%**	**100%**
NPLs / Gross Loans	8.0%	7.5%	7.4%	7.7%
Net NPLs / Capital	10.2%	11.2%	11.2%	10.3%
Earning & Profitability				
ROA	2.5%	1.7%	1.5%	1.4%
ROE	23.3%	15.7%	14.5%	13.2%
Net Interest Income / Gross Income	72.7%	70.2%	69.6%	68.7%
Income from Trading & Foreign Exchange / Gross Income	16.2%	17.5%	17.6%	18.0%
Non-Interest Expense / Gross Income	27.3%	29.8%	29.9%	30.8%
Liquidity				
Liquid Assets / Total Assets	31.8%	31.1%	30.7%	30.9%
Liquid Assets held in Govt. Securities / Total Liquid Assets	55.9%	55.6%	54.6%	52.9%
Liquid Assets / Total Deposits	41.1%	40.7%	40.8%	41.6%

Annex-III

Bank-wise Major Statistics-March 2008

(Rs. In Million)

Sr.#	Name of the Banks	Assets	Deposits	Equity
1	The Bank of Khyber	32,435.3	22,767.1	5,989.8
2	The Bank of Punjab	227,801.6	187,619.9	16,417.4
3	First Women Bank Ltd	8,007.4	6,563.5	1,113.7
4	National Bank of Pakistan	738,285.7	564,475.6	114,437.2
5	Industrial Development bank of Pakistan	7,439	5,324	(28,567)
6	Zarai Taraqiati Bank Ltd	95,314	4,090	15,089
7	Punjab Provincial Co-operatie Bank Ltd	13,026	1,875	3,033
8	SME Bank Ltd	6,959	2,003	2,805
9	Allied Bank Ltd	332,687	277,854	21,131
10	Bank Alfalah Ltd	308,680	263,467	16,371
11	Bank Al Habib Ltd	153,443	123,409	8,293
12	Askari Commercial Bank Ltd	177,517	134,867	11,960
13	Crescent Commercial Bank Ltd	19,001	11,302	6,144
14	Atlas Bank Ltd	24,787	16,053	5,119
15	Habib Bank Ltd	667,538	516,498	58,961
16	Faysal Bank Ltd	146,150	101,254	15,744
17	KASB Bank Ltd	45,850	37,977	4,392
18	Dubai Islamic Bank Pakistan Ltd.	25,818	20,191	4,234
19	JS Bank	22,082	13,858	5,343
20	Bank Islami Pakistan Ltd.	14,827	9,806	4,140
21	Arif Hbib Rupali Bank Ltd.	21,608	13,612	6,430
22	Emirates Global Islamic Bank	9,348	3,936	4,272
23	First Dawood Islamic Bank	7,796	3,414	4,102
24	ABN Amro Bank	111,881	86,155	5,202
25	MCB Bank Ltd.	396,686	301,671	56,029
26	Meezan Bank Ltd.	67,433	54,287	5,983
27	Metropolitan Bank Ltd.	188,572	131,870	13,608
28	Mybank Ltd.	41,344	28,619	6,138
29	NIB Bank Ltd.	183,180	115,124	36,736
30	PICIC Commercial Bank Ltd.	-	-	-
31	Prime Commercial Bank Ltd.	-	-	-
32	Saudi Pak Commercial Bank Ltd.	49,441	41,397	1,770
33	Soneri Bank Ltd.	80,586	63,648	6,937
34	United Bank Ltd.	538,145	407,509	42,606
35	Standard Chartered Bank (Pakistan) Ltd.	269,876	177,799	43,653
36	Oman International Bank	2,605	550	2,011
37	Hong Kong & Shanghai Banking Corporatior	38,122	28,960	2,590
38	Deutche Bank Ltd.	19,695	9,495	3,786
39	Bank of Tokyo	6,763	597	2,462
40	Citibank N.A.	100,326	78,168	6,198
41	Bank Albaraka	20,348	15,669	2,358

Annex-IV

Group-wise Composition of Banks, March 31, 2008

2005	2006	2007	Mar-08
A. Public Sector Com. Banks (4)	**A. Public Sector Com. Banks (4)**	**A. Public Sector Com. Banks (4)**	**A. Public Sector Com. Banks (4)**
National Bank of Pakistan	National Bank of Pakistan	National Bank of Pakistan	National Bank of Pakistan
First Women Bank Ltd.	First Women Bank Ltd.	First Women Bank Ltd.	First Women Bank Ltd.
The Bank of Khyber	The Bank of Khyber	The Bank of Khyber	The Bank of Khyber
The Bank of Punjab	The Bank of Punjab	The Bank of Punjab	The Bank of Punjab
B. Local Private Banks (20)	**B. Local Private Banks (24)**	**B. Local Private Banks (26)**	**B. Local Private Banks (25)**
Askari Commercial Bank Ltd.	Askari Commercial Bank Ltd.	Askari Bank Ltd.	Askari Bank Ltd.
Bank Al-Falah Ltd.	Bank Alfalah Ltd.	Bank Alfalah Ltd.	Bank Alfalah Ltd.
Bank Al Habib Ltd.	Bank AL Habib Ltd.	Bank AL Habib Ltd.	Bank AL Habib Ltd.
My Bank Ltd.	Mybank Limited	Mybank Limited	Mybank Limited
Faysal Bank Ltd.	Faysal Bank Ltd.	Faysal Bank Ltd.	Faysal Bank Ltd.
Metropolitan Bank Ltd.	Habib Metropolitan Bank Ltd.	Habib Metropolitan Bank Ltd.	Habib Metropolitan Bank Ltd.
KASB Bank Ltd.	KASB Bank Ltd.	KASB Bank Ltd.	KASB Bank Ltd.
Prime Commercial Bank Ltd.	Prime Commercial Bank Ltd.	ABN AMRO Bank (Pakistan) Ltd 1	ABN AMRO Bank (Pakistan) Ltd 1
Saudi Pak Commercial Bank Ltd	Saudi Pak Commercial Bank Ltd	Saudi Pak Commercial Bank Ltd	Saudi Pak Commercial Bank Ltd
PICIC Commercial Bank Ltd.	PICIC Commercial Bank Ltd.	PICIC Commercial Bank Ltd.	Soneri Bank Ltd.
Soneri Bank Ltd.	Soneri Bank Ltd.	Soneri Bank Ltd.	Standard Chartered Bank (Pakistan) Ltd.
Union Bank Ltd.	Standard Chartered Bank (Pakistan) Ltd.	Standard Chartered Bank (Pakistan) Ltd.	MCB Bank Ltd.
MCB Bank Ltd.	MCB Bank Ltd.	MCB Bank Ltd.	Allied Bank Limited
Allied Bank Limited.	Allied Bank Limited	Allied Bank Limited	United Bank Ltd.
United Bank Ltd.	United Bank Ltd.	United Bank Ltd.	Meezan Bank Limited
Meezan Bank Limited	Meezan Bank Limited	Meezan Bank Limited	NIB Bank Limited
NIB Bank Ltd.	NIB Bank Limited	NIB Bank Limited	Crescent Commercial Bank Ltd.
Crescent Commercial Bank Ltd.	Crescent Commercial Bank Ltd.	Crescent Commercial Bank Ltd.	Habib Bank Limited
Habib Bank Ltd	Habib Bank Limited	Habib Bank Limited	Atlas Bank Limited.
Dawood Bank Ltd.	Atlas Bank Limited.	Atlas Bank Limited.	Arif Habib Bank Ltd.
C. Foreign Banks (11)	Arif Habib Rupali Bank Ltd.	Arif Habib Bank Ltd.	Dubai Islamic Bank Pakistan Ltd.
ABN AMRO Bank N.V.	Dubai Islamic Bank Pakistan Ltd.	Dubai Islamic Bank Pakistan Ltd.	BankIslami Pakistan Ltd.
Albaraka Islamic Bank B.S.C.	BankIslami Pakistan Ltd.	BankIslami Pakistan Ltd.	JS Bank Limited
American Express Bank Ltd [7].	JS Bank Limited	JS Bank Limited	Emirates Global Islamic Bank Ltd.
The Bank of Tokyo – Mitsubishi.	**C. Foreign Banks (7)**	Emirates Global Islamic Bank Ltd.	Dawood Islamic Bank Ltd
Citibank N.A.	ABN AMRO Bank N.V.	Dawood Islamic Bank Ltd	
Deutsche Bank AG	Albaraka Islamic Bank B.S.C.		
Habib Bank AG Zurich	Bank of Tokyo - Mitsubishi UFJ, Limited	**C. Foreign Banks (6)**	**C. Foreign Banks (6)**
The Hongkong & Shanghai Banking Corporation	Citibank N.A.	Albaraka Islamic Bank B.S.C.	Albaraka Islamic Bank B.S.C.
Oman International Bank S.A.O.G.	Deutsche Bank AG	Bank of Tokyo - Mitsubishi UFJ, Limited	Bank of Tokyo - Mitsubishi UFJ, Limited
Rupali Bank Ltd.	The Hongkong & Shanghai Banking Corporation	The Hongkong & Shanghai Banking Corporation	The Hongkong & Shanghai Banking Corporation
Standard Chartered Bank	Oman International Bank S.A.O.G.	Deutsche Bank AG	Deutsche Bank AG
D. Specialized Banks (4)		Citibank N.A.	Citibank N.A.
Zarai Taraqiati Bank Ltd.	**D. Specialized Banks (4)**	Oman International Bank S.A.O.G.	Oman International Bank S.A.O.G.
Industrial Development Bank of Pakistan	Zarai Taraqiati Bank Ltd.		
Punjab Provincial Co-operative Bank Ltd.	Industrial Development Bank of Pakistan		
SME Bank Ltd	Punjab Provincial Co-operative Bank Ltd.	**D. Specialized Banks (4)**	**D. Specialized Banks (4)**
Commercial Banks (35)	SME Bank Limited	Zarai Taraqiati Bank Ltd.	Zarai Taraqiati Bank Ltd.
Include A + B + C	**All Commercial Banks (35)**	Industrial Development Bank of Pakistan	Industrial Development Bank of Pakistan
All Banks (39)	Include A + B + C	Punjab Provincial Co-operative Bank Ltd.	Punjab Provincial Co-operative Bank Ltd.
Include A + B + C + D	**All Banks (39)**	SME Bank Limited	SME Bank Limited
	Include A + B + C + D	**All Commercial Banks (36)**	**All Commercial Banks (35)**
		Include A + B + C	Include A + B + C
		All Banks (40)	**All Banks (39)**
		Include A + B + C + D	Include A + B + C + D