State Bank of Pakistan
Banking Supervision Department

Quarterly Performance Review of the Banking System

June 2004

The Team

Team Members

Muhammad Anwar Saeed

Amer Hassan

Aziz Morris

Zahid Mahmood

Rizwana Rifat

Junaid Ahmed

Sheema Fareed

Ayaz Ali

Team Leader

Jameel Ahmad

Contents

The data used in the quarterly review has been amassed from un-audited reports viz. Quarterly Report of Condition for June-04 and Annual Audited Accounts where reference is made to the previous years. Befitting the nature of review, the data reflects the global position, unless otherwise indicated, and will be offered in aggregate form based on the groupings deemed most suitable for analysis purposes; namely: Public Sector Commercial Banks, Local Private Banks, Foreign Banks and Specialized Banks. The analysis of the financial soundness has been carried out primarily using the micro-prudential indicators; however some of the macroeconomic variables- to which the banking sector may be susceptible- have also been taken into consideration.

1. Overview

The quarter under review is marked with pronounced growth in lending that grew by Rs151.4 billion or 11.8 percent over the last quarter. Such a rapid growth usually raises concerns; however, it has some mitigating factors as well. Namely, this growth is broad based, and the large corporate sector which is the major user of these funds, is performing robustly. The sector having achieved the optimal capacity in some critical segments has utilised substantial amount of credit under the fixed investments to overcome the capacity constraints and tap the idle capacity so as to realize the maximum growth potential. The banking system, barring specialized banks, has been quite successful in maintaining the improving trend in NPLs that came down by Rs3.6 billion during the quarter. However, the banks with such an aggressive lending need to tighten their credit appraisal processes to keep their credit risk within reasonable limits.

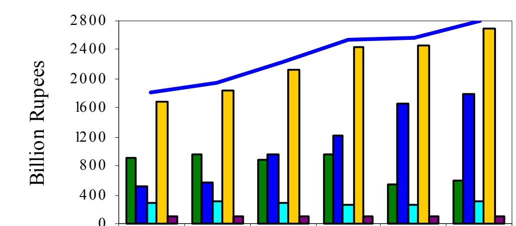
The banking system so far has largely dispelled the concern about the sustainability of its robust earnings trend as year-to-date profits are likely to reach the previous year's level; after tax profit of Rs12.8 billion (CY-03: Rs25.1 billion) and ROA at 1.0 percent (CY-03: 1.1 percent). The average CAR of the banking system stayed intact at 9.8 percent. Hike in interest rates has for the first time started to take its toll on system's net worth by eroding the value of excessively piled up government papers, which will reduce their ability to make similar capital gains during this year. The banks, therefore, have to continue generating more stable, recurring incomes, in order to strengthen the earnings' quality. Robust earnings will enable the banks to withstand the impact of significant growth in risk-weighted assets and allocation of capital for market risk on CAR.

Despite the improved profitability and asset quality, the banking system remains a bit vulnerable to the consequences of the rapidly growing lending portfolio. While there is a need for increased focus to mitigate the inherent risks, the banks would be well advised to provide in these benign years for any loan losses that may occur in the wake of cyclical patterns of economic activity in the future.

2. Assets and Funding Structure

Total assets of the banking system saw a rapid expansion during the quarter under review. In fact, the rise in total assets (by Rs228.7 billion - see **Figure-2.1**) is unparalleled for the last many quarters, which is supported by persistent rise in deposits. The asset-mix also shows noticeable shift towards loans as majority of funds mobilized during the quarter were utilized in lending activities (see **Table-2.1**). Investments in the government securities which had seen dramatic rise over the last couple of years declined during the quarter. This change was a natural outcome of rising interest rates, which started to erode the value of their investments. Moreover, the strong pick-up in economic activities gave rise to substantial demand for credit from the various sectors resulting in a strong growth of the loan portfolio.

Figure-2.1: Assets of the Banking System



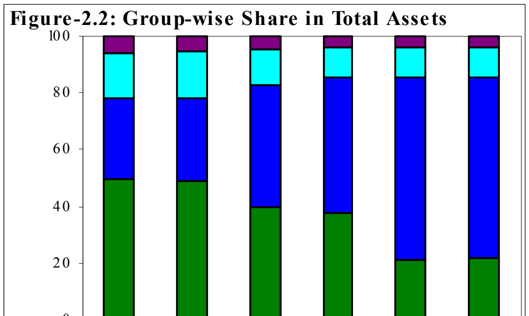
	CY00	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	902.0	946.5	877.6	963.1	544.7	603.0
LPBs	513.5	565.9	967.5	1,211.6	1,654.0	1,789.8
FBs	280.6	323.7	279.6	271.2	271.5	301.0
All CBs	1,696.1	1,836.1	2,124.6	2,446.0	2,470.2	2,693.8
SBs	111.5	106.2	98.5	100.0	100.7	105.8
All	1,807.6	1,942.3	2,223.1	2,546.0	2,570.9	2,799.6

Table-2.1: Major Sources and Uses of Funds

(Percent)	CY00	CY01	CY02	CY03	Mar-04	Jun-04
Source						
Deposits	74.2	75.9	75.3	77.1	78.9	78.4
Borrowings	14.8	13.8	12.5	11.8	9.9	11.4
Equity	4.5	3.8	4.8	5.4	5.8	5.1
Others	6.5	6.5	7.3	5.7	5.4	5.1
Total	100.0	100.0	100.0	100.0	100.0	100.0
Uses						
Loans	49.1	46.9	41.5	43.5	44.6	46.3
Investments	16.8	18.1	31.5	30.9	31.3	27.4
Others	34.0	35.1	27.0	25.5	24.1	26.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Local private banks (LPBs), with the privatization of large public sector banks, now dominate the banking sector of the country with an overwhelming share of 63.9 percent (see **Figure-2.2**). During the current quarter, however, their share diminished fractionally as the public sector commercial banks (PSCBs) and foreign banks (FBs) managed a proportionally faster growth in their balance sheets. A deeper analysis shows that the increase in total assets of the public sector commercial banks owes very

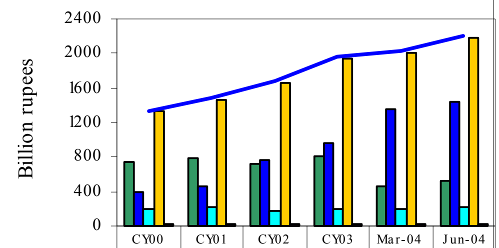
Figure-2.2: Group-wise Share in Total Assets



	CY00	CY01	CY02	CY03	Mar-04	Jun-04
SBs	6.2	5.5	4.4	3.9	3.9	3.8
FBs	15.5	16.6	12.6	10.7	10.6	10.8
LPBs	28.4	29.1	43.5	47.6	64.3	63.9
PSCBs	49.9	48.8	39.5	37.8	21.2	21.5

much to exceptional growth witnessed by the largest public sector commercial bank which alone accounted for 75 percent of the increase in the total assets of the public sector commercial banks and 19 percent of the growth of the total assets of the industry.

Figure-2.3: Deposits of the Banking System

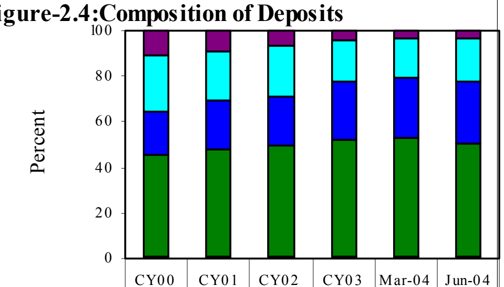


	CY00	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	743.7	795.2	721.9	799.4	466.3	522.7
LPBs	394.2	453.7	757.4	952.5	1,350.0	1,447.8
FBs	187.4	207.8	182.8	193.8	196.4	208.9
CBs	1,325.3	1,456.7	1,662.1	1,945.8	2,012.6	2,179.4
SBs	15.6	18.0	16.3	16.9	16.2	16.1
All	1,340.9	1,474.7	1,678.4	1,962.7	2,028.8	2,195.5

Deposits of the banking system increased at a strong pace during the quarter under review (see **Figure-2.3**). The growth of Rs166.7 billion (8.2 percent) is, perhaps, the highest ever witnessed during a single quarter. The steady inflow of overseas workers remittances, US$996.3 million, through the banking channel have been a key factor in growing the deposit base of the banking system during this quarter again.

This persistent inflow of funds into the banking system has not only created easy liquidity conditions but has also translated into very low rate of return on deposits which are touching historically low levels; much to the disadvantage of depositors who have got negative real return on their savings.

Figure-2.4:Composition of Deposits

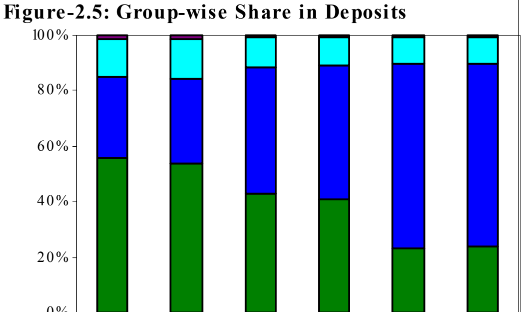


	CY00	CY01	CY02	CY03	Mar-04	Jun-04
From Fin. Instit.	10.4	8.8	6.5	3.8	3.4	3.6
Fixed Deposits	24.9	22.1	22.5	18.5	17.6	18.5
Current Accounts	19.2	21.4	21.3	25.4	25.8	27.5
Saving Deposits	44.9	47.3	49.1	51.7	52.6	49.6
Others	0.6	0.5	0.5	0.7	0.6	0.8

A glance at the composition of deposits depicts a rise in current deposits, which is in line with the expanding economic activities during which large corporates and businesses tend to keep their funds in current accounts (see **Figure-2.4**). Moreover, the low opportunity cost of funds also explains the rising share of current accounts to some extent. Saving deposits, despite a fall in their share during the quarter, continue to form the largest chunk of the total deposits of all banks. Currency-wise break up of deposits reveal that foreign currency deposits of the banking system also increased during the quarter under review by Rs5.3 billion.

The PSCBs were more active in deposits mobilization. Their deposits increased at the rate of 12.1 percent followed by LPBs at 7.2 percent and foreign banks at 6.4 percent. Specialized banks on the other hand experienced a fall. As noted earlier, the largest public sector commercial bank was pivotal in the exceptional growth of this sector. The same holds true for deposits as it accounted for 80 percent of the growth of PSCBs deposits while 27 percent of the growth in deposits of all banks. Resultantly, the extra ordinary performance of this bank materialized into an increased share of PSCBs in total deposits of the banking system (see **Figure-2.5**). LPBs, despite a fractional fall in their share, continue to possess almost two third of the deposits of all banks and accounted for 58.7 percent of the increase in total deposits of all banks.

Figure-2.5: Group-wise Share in Deposits

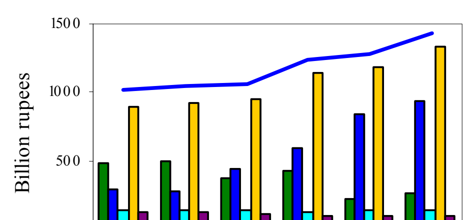


	CY00	CY01	CY02	CY03	Mar-04	Jun-04
SBs	1.2	1.2	1.0	0.9	0.8	0.7
FBs	14.0	14.1	10.9	9.9	9.7	9.5
LPBs	29.4	30.8	45.1	48.5	66.5	65.9
PSCBs	55.5	53.9	43.0	40.7	23.0	23.8

In a sharp contrast to the previous quarter, **borrowings** of the banking system increased significantly by Rs64.5 billion to Rs318.9 billion from Rs254.4 billion. Repo borrowings contributed Rs51.8 billion (80.3 percent) to this increase. The reasons for the high demand for funds may be the exceptional rise in loans as well as the SBP's policy to mop up funds to stabilize the increasing inflationary pressures. Despite a gradual rise in rates, export refinance borrowings also increased by Rs8.3 billion. This is in line with the increasing trend in exports.

The substantial improvement in economic indicators, strict adherence to reform agenda, uninterrupted policy measures, low cost of funds etc have produced strong optimism in business community about the future course of the economy. Consequently, demand for bank **credit** has increased. This is evident by an unprecedented rise of Rs151.4 billion or 11.8 percent in the gross loans of all banks during this quarter (see **Figure-2.6**). Apart

Figure-2.6: Loans of the Banking System



	CY00	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	475.7	501.0	374.2	421.4	214.0	260.5
LPBs	282.2	281.2	435.0	597.5	836.8	935.0
FBs	138.3	143.4	135.4	126.9	135.8	141.5
CBs	896.2	925.6	944.6	1,145.7	1,186.6	1337.1
SBs	123.9	118.4	117.0	97.2	97.8	98.7
All	1,020.1	1,043.9	1,061.5	1,242.9	1,284.4	1435.8
Domestic All	926.4	963.6	978.7	1,160.5	1,205.4	1350.9

from the strong demand from the private sector, a substantial portion of loans i.e. 41.8 percent also went to the public sector. A significant portion of these loans was extended at the tail end of the quarter to public sector enterprises. It is a normal practice of the public sector enterprises to utilize their credit limit at the year-end[1]. Moreover, seasonal pick up in loans for commodity operations also absorbed a considerable share of the loans growth.

Further analysis of the loan growth shows that the four largest banks accounted for 60 percent or Rs90.9 billion of the growth in total loan portfolio. Of this, 57.9 percent consisted of public sector loans, which make up 91.5 percent of the overall increase in the public sector loans by all banks.

The growing demand for credit and inflationary pressures have started to manifest themselves in rising yields on government securities and weighted average lending rates. The banks expect further rise in the interest rates and therefore have become wary of investing in government securities for fear of revaluation losses. As a result, more resources were released to finance the higher demand for loans during this quarter.

Table-2.2: Sector-wise Break Up of Loans (Domestic Operations)

(Billion Rupees)	Mar-04	Jun-04	Change during quarter	
			Amount	% age
Corporate Sector	**653.0**	**725.4**	**72.4**	**11.1**
Fixed Investments	269.2	313.7	44.5	16.5
Working Capital	228.9	247.9	19.0	8.3
Trade Finance	154.9	163.8	8.9	5.7
SMEs	**225.2**	**250.6**	**25.4**	**11.3**
Fixed Investments	30.5	40.8	10.3	33.8
Working Capital	147.6	155.6	8.0	5.4
Trade Finance	47.1	54.2	7.1	15.1
Agriculture production	**102.7**	**108.7**	**6.0**	**5.8**
Consumer Finance	**83.0**	**102.6**	**19.6**	**23.6**
Credit Cards	*9.7*	*11.2*	*1.5*	*15.5*
Housing Loans	*5.5*	*8.3*	*2.8*	*50.9*
Auto Loans	*27.6*	*33.1*	*5.5*	*19.9*
Consumer Durables	*1.2*	*1.4*	*0.2*	*16.7*
Personal Loans	*39.0*	*48.6*	*9.6*	*24.6*
Commodity Operations	**70.6**	**90.0**	**19.4**	**27.5**
Staff Loans	**39.6**	**39.7**	**0.1**	**0.3**
Of which Housing Loans	*27.4*	*28.0*	*0.6*	*2.2*
Others	**31.3**	**33.9**	**2.6**	**8.3**
Total	**1,205.4**	**1,350.9**	**145.5**	**12.1**

The sector-wise break-up reveals across the board increase in loans (see **Table-2.2**). Majority of the loans[2] i.e. Rs72.4 billion (49.8 percent), however, financed the corporate sector. The most encouraging aspect of this increase in lending to the corporate sector is that around 61 percent or Rs44.5 billion were channeled into fixed investment, which is twice the level of growth during the last quarter. This is a healthy sign of further improvement in productive capacity, which in turn is encouraging for overall macroeconomic conditions. The picture of the other sectors is also very promising. Opportunities offered by the SMEs and consumer finance coupled with surplus liquidity have resulted in loan growth in these sectors in recent times. SMEs attracted 17.4 percent of the overall loan growth and in their case, again, fixed investment received larger share. This together with the increase in fixed investment by the corporate sector led to an increase in the overall share of fixed investment in the end

[1] *This is substantiated by a subsequent fall in loans to PSEs in the first week of the new fiscal year.*
[2] *Domestic operations only*

use distribution of loans (see **Figure-2.7**) Consumer finance has seen remarkable growth over the last few quarters. A growth of around 24 percent helped the outstanding portfolio of consumer finance to surpass the hundred billion mark during the current quarter. This also increased its share to 7.6 percent of the total loans from 6.9 percent in the last quarter (see **Figure-2.8**). The break up of consumer finance shows that personal loans grew rapidly and represent 49 percent of the total increase in consumer finance. The possible explanation of this noticeable growth may be the popularity of a special scheme for salaried individuals launched by the largest bank, which accounted for most of the increase in this segment. Auto loans and mortgage financing maintained steady growth during this quarter as well.

Figure-2.7: End-Use Distribution of Bank Loans-June04

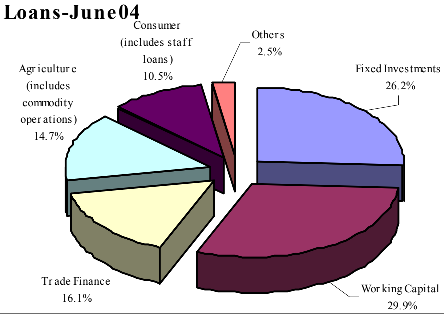
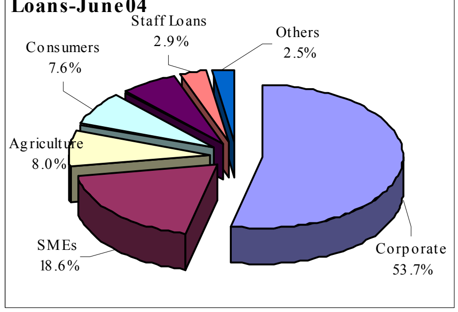


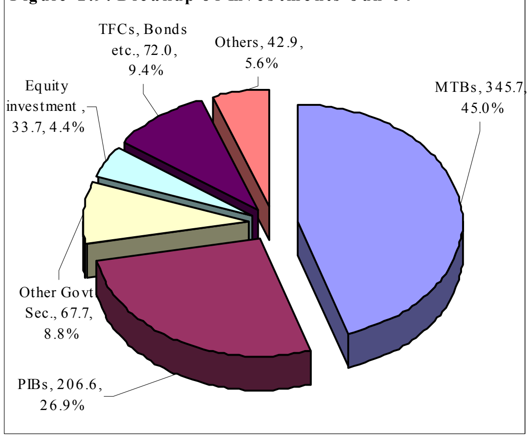
Figure-2.8: Sectoral Allocation of Bank Loans-June04



The group-wise position shows LPBs had an increase of Rs98.2 billion in their loans portfolio. However, in percentage terms PSCBs registered the highest growth of 21.7 percent vis-à-vis 11.7 percent by the LPBs. This is again attributed to the largest bank, which experienced exponential growth in its loans portfolio. Foreign banks managed a relatively slower growth of 4.2 percent as they adopted a relatively cautious approach.

The decline in **investments** by Rs38.9 billion was another noticeable development of the quarter. The changing market conditions had already slowed down the pace of growth in investments over the last couple of quarters. However, as stated earlier, the current quarter witnessed an unusually fast growth in lending activities and hence a substantial portion of funds found their way into more productive channels.

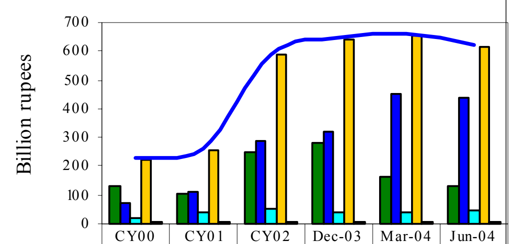
Figure-2.9: Breakup of Investments Jun-04



The federal government securities continue to constitute the largest share i.e. 80.7 percent of the total investments portfolio (see **Figure-2.9**). The breakup of federal government securities shows significant decline in MTBs by Rs59.7 billion. The possible explanation for this fall may be the scrapping of MTBs auctions by the SBP during the month of June because of unreasonably high rates quoted by the market players. Conversely, the PIBs increased further by Rs27.4 billion. This coincided with the higher target set by the SBP to meet fiscal needs.

The LPBs, by virtue of their size, hold the principal share i.e. 70.7 percent of the investments in F.G. Securities (see **Figure-2.10**). However, main contribution for the decline in investments came from the PSCBs, which reduced their investment portfolio by Rs37.6 billion followed by LPBs by Rs10.5billion. Foreign banks on the other hand remained active and increased their investments by Rs8.0 billion.

Figure-2.10: Investments in F.G. Securities



	CY00	CY01	CY02	Dec-03	Mar-04	Jun-04
PSCBs	129.8	106.2	246.1	280.3	166.4	128.8
LPBs	72.9	108.0	284.7	323.3	448.7	438.2
FBs	20.0	41.0	55.1	40.7	39.4	47.4
CBs	222.8	255.2	586.0	644.3	654.4	614.5
SBs	5.8	4.3	4.7	5.2	5.2	5.4
All	228.6	259.5	590.7	649.5	659.6	619.9

As noted in the loans section that lending to public sector increased substantially during the current quarter. Consequently, it had also increased the overall exposure of banks to the public sector despite a reduction in investment in government papers (see **Table-2.4**).

Table-2.4: Banks' Exposure to Public Sector

(Percent)	Dec-00	Dec-01	Dec-02	Dec-03	Mar-04	Jun-04
Credit	19.3	20.7	16.9	10	8.2	11.6
Total (Credit+Govt. papers)	36.6	35.5	44.3	39.9	38.2	39.2

Source: Weekly Statement

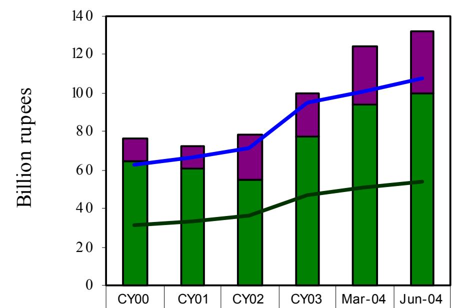
3. Financial Soundness of the Banking system

3.1 Solvency

The consolidation process, aimed at strengthening the solvency of the banking system, gathered further momentum. The acquisition and merger of two more banks took place during the quarter.

The improved solvency position is substantiated by improvement in the risk-based capital of the banking system (see **Figure-3.1**). The handsome profits, the issuance of subordinated debt and gradual improvement in the performance of specialized banks were the key factors effecting this improvement. On the other side, risk-weighted assets witnessed considerable rise during the quarter. Moreover, three FBs also remitted a sizable portion of their profits of Rs3.8 billion during the quarter. This restrained what otherwise would have been an improved CAR which remained at its previous quarter's level (see **Table-3.1**).

Figure-3.1: Risk-based Capital Position



	CY00	CY01	CY02	CY03	Mar-04	Jun-04
Tier II Capital	11.3	12.0	23.5	23.3	29.6	32.2
Tier I Capital	65.1	60.5	55.2	77.0	94.5	99.6
Required Tier I	31.5	33.1	35.9	47.3	50.5	54.0
Required Total	63.1	66.2	71.8	94.7	100.9	108.1

Table-3.1: Capital Adequacy Indicators

Percent	CY00	CY01	CY02	CY03	Mar-04	Jun-04
CAR						
PSCBs	10.4	9.6	12.3	11.0	12.4	12.2
LPBs	9.2	9.5	9.7	9.0	9.3	9.4
FBs	18.0	18.6	23.2	23.0	21.1	18.6
Comm. Banks	11.4	11.3	12.6	11.1	11.1	10.9
SBs	(3.3)	(13.9)	(31.7)	(28.2)	(10.0)	(8.2)
All banks	9.7	8.8	8.8	8.5	9.8	9.8
Tier 1 Capital to RWA						
PSCBs	7.7	7.1	8.6	8.2	9.3	9.0
LPBs	8.1	8.4	6.6	7.1	7.1	7.2
FBs	17.9	18.6	23.0	23.0	21.0	18.5
Comm. Banks	9.8	9.7	9.7	9.1	9.0	8.7
SBs	(3.4)	(13.9)	(31.7)	(28.7)	(15.5)	(13.6)
All banks	8.3	7.3	6.2	6.5	7.5	7.4
Capital to Total Assets						
PSCBs	4.6	3.7	5.6	6.1	6.9	6.2
LPBs	3.5	3.8	5.2	5.1	5.7	5.1
FBs	8.8	8.5	10.6	10.0	9.9	7.9
Comm. Banks	4.9	4.6	6.1	6.0	6.4	5.7
SBs	(1.1)	(10.3)	(23.0)	(9.5)	(10.5)	(9.3)
All banks	4.6	3.8	4.8	5.4	5.8	5.1

Group-wise position shows that the LPBs, managed to improve their CAR during the quarter which is quite encouraging considering their overall share in the system. As mentioned earlier, the issuance of the subordinated debt by two banks in this sector helped a great deal in the improvement of the ratio for this sector. The fall in the ratio of FBs owes largely to the remittance of profits. The PSCBs enjoy having the highest ratio among all the groups though they also witnessed a slight deterioration during this quarter.

The dispersion measure for CAR shows the rise in the number of well-capitalized banks from 26 in the last quarter to 27 banks in the current quarter, which is indicative of the strengthening of the system (see **Table 3.2**).

Table 3.2 Distribution of Banks by CAR

	Total No. of Banks	Below 8%	8 to 10 %	10 to 15 %	Over 15 %
CY00	44	5	6	16	17
CY01	43	5	5	11	22
CY02	40	4	4	9	23
CY03	40	4	10	5	21
Mar-04	40	3	11	6	20
Jun-04	39	2	10	11	16

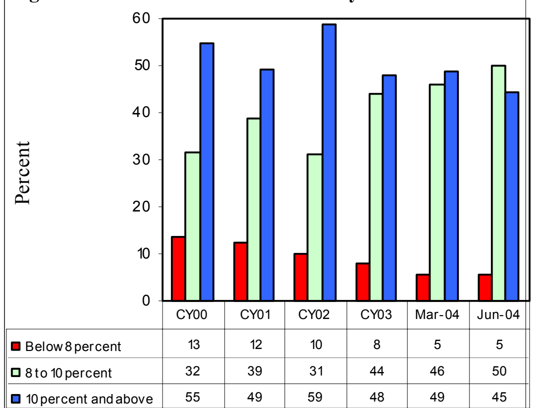
Although there was some internal shuffling of banks and their market share in the upper brackets, but the market share of banks with CAR below 8 percent level remained same at 5 percent (see **Figure-3.2**).

3.2 Profitability

The banking system consolidated its profits during the second quarter of the current year. Year-to-date profits are in direct proportion to last year's high levels, although it should be noted that these profits are based on more stable and core income stream, as the share of trading gains was low in the year-to-date incomes. Commercial banks posted year-to-date after tax profits of Rs14.4 billion (CY-03: Rs28.4 billion) but specialized banks' losses slightly pushed down the system's profit to Rs12.8 billion (CY-03: Rs25.1 billion) (see **Table-3.3**). Since these profits came in the backdrop of accelerated growth in asset base, efficiency indicator of ROA witnessed a slight deterioration over CY-03.

The enabling factors for this profitability were the increased volume of business both in the form of assets and non-fund based activities. The share of trading gains, the margin of which is squeezing in the face of diminishing revaluation surpluses, further contracted during the quarter, however this loss in income was offset by fee-based income.

Figure-3.2: Banks' Market Share by CAR

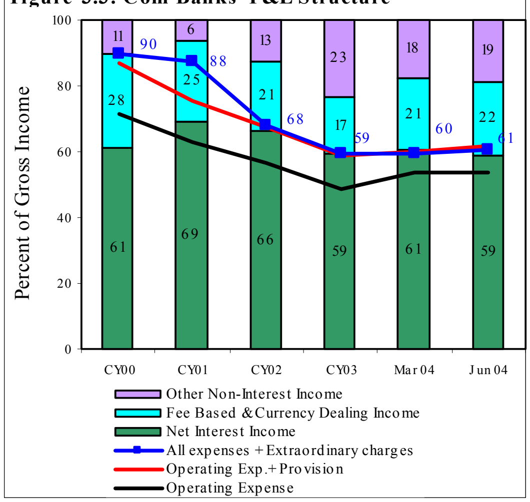


	CY00	CY01	CY02	CY03	Mar-04	Jun-04
Below 8 percent	13	12	10	8	5	5
8 to 10 percent	32	39	31	44	46	50
10 percent and above	55	49	59	48	49	45

Table-3.3: Profitability of Banking System

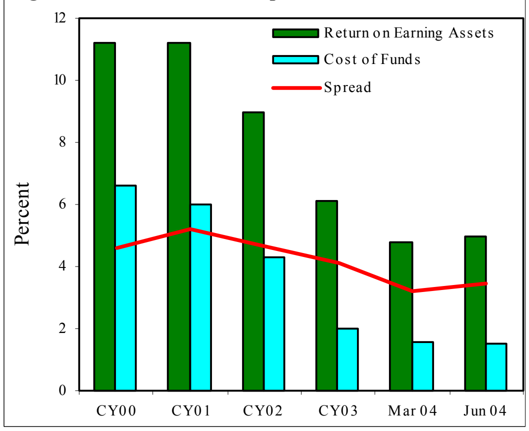
Billion rupees	CY00	CY01	CY02	CY03	Mar-04	Jun-04
Profit before tax						
PSCBs	3.9	0.2	10.9	16.1	2.3	5.5
LPBs	-0.6	5.0	11.9	23.8	7.0	13.5
FBs	3.7	5.0	6.6	7.1	1.3	3.2
Comm. Banks	7.0	10.3	29.4	47.1	10.6	22.2
SBs	-2.5	-9.2	-10.4	(2.5)	(2.5)	(1.4)
All Bank	4.5	1.1	19	44.6	8.1	20.7
Profit after tax						
PSCBs	1.8	-4.6	4.8	9.4	1.3	3.4
LPBs	-3.5	2.0	6.4	14.8	4.6	8.6
FBs	1.4	2.4	4.2	4.2	0.8	2.3
Comm. Banks	-0.2	-0.2	15.3	28.4	6.7	14.4
SBs	-2.6	-9.5	-12.4	(3.2)	(2.6)	(1.6)
All Banks	-2.8	-9.8	2.9	25.1	4.1	12.8

Figure-3.3: Com Banks' P&L Structure



The expenses grew at accelerated pace during the quarter; nevertheless, lower provision charges left the profits in good shape. **Figure-3.3** gives a brief structure of the commercial bank's profit and loss account for the last few years.

Figure-3.4: Interest Rate Spread



The quarter under review witnessed a remarkable increase in lending portfolio. Since a part of these disbursements was made in the later part of the quarter, this had not contributed so remarkably towards interest income by the end of quarter. This income was slightly lower than CY-03 figure in proportionate terms i.e. 45.8 percent. The deteriorating impact, however, came from decline in interest income on investments which came down during the quarter. Another reason for decline in interest income on investments was the rise in amortization of premia on account of increased trading of government papers. The lower interest income, however, was helped by lower interest expense so the net interest income amounted to 48.0 percent of CY-03 level. This all came in the backdrop of rise in returns on earning assets that was not matched by the rise in cost of funds, so the interest rate spread for the first time in the last more than two years witnessed a slight rise (see **Figure-3.4**). This phenomenon, along with movement in the composition of assets towards more favourable mix led to rise in net interest margin as well, 3.2 percent now vis-à-vis 3.1 percent in last quarter.

The commercial banks' non-interest income amounted to 49.6 percent of CY-03's figure. The composition of this income, however, shows a significant shift towards more stable income (see **Figures-3.5A & 3.5B**). While commission and brokerage

Figure3.5A: Composition of Earnings-CY-03

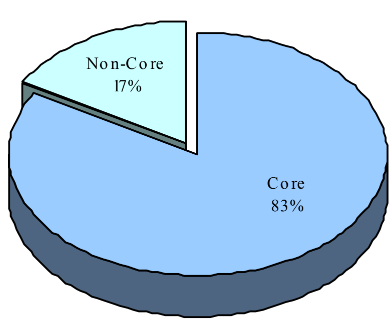
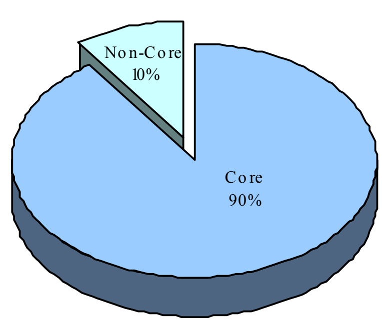


Figure3.5B: Composition of Earnings-Jun-04



income registered a strong growth (Rs 9.8 billion vis-à-vis Rs 14.8 billion for CY-03), contraction in trading gains which were Rs 5.4 billion as compared to Rs 19.1 billion for CY-03 held back the total non-interest income from exceeding the CY-03 level in proportionate terms.

On the expense side, banking system had been quite successful in maintaining a cap on the growth of operating expenses. The system, however, slightly lapsed in maintaining this control during the quarter. Operating expenses grew at slightly rapid pace, and amounted to around 54 percent of CY-03 level. Accordingly, cost income (operating expense coverage) ratio slightly deteriorated to around 54 percent (49 percent in CY-03) though still well below the acceptable 60 percent level. However, commercial banks showed an improved performance on asset quality front. As their NPLs are on the wane, so are the provision charges which took 7.7 percent of the year to date gross income (10.0 percent in CY-03).

Table-3.4: Earnings and profitability indicators

(Percent)	CY00	CY01	CY02	CY-03	Mar-04	Jun-04
ROA (after tax)						
PSCBs	0.2	-0.5	0.6	1.0	0.7	1.2
LPBs	-0.7	0.4	0.7	1.4	1.3	1.0
FBs	0.6	0.8	1.5	1.5	1.3	1.7
Comm. Banks	-0.01	-0.01	0.8	1.2	1.1	1.1
SBs	-2.3	-8.8	-12.1	-3.2	-10.1	-1.4
All Banks	-0.2	-0.5	0.1	1.1	0.6	1.0
ROE (after tax)						
PSCBs	4.9	-12.2	11.5	17.3	10.5	18.3
LPBs	-17.4	10.3	17.3	26.2	23.4	19.1
FBs	6.1	9.1	15.2	14.9	12.6	18.1
Comm. Banks	-0.3	-0.3	14.3	20.5	17.4	18.7
SBs	-	-	-	-	-	-
All Banks	-3.5	-12.6	3.2	20.51	11.5	18.3
Net Interest Margin						
PSCBs	3.6	4.3	4.0	3.7	2.3	3.1
LPBs	3.4	4.3	4.3	3.5	3.4	3.0
FBs	3.2	3.3	3.1	3.4	3.2	3.1
Comm. Banks	3.5	4.1	3.8	3.5	3.1	3.1
SBs	3.2	3.3	7.5	7.1	3.3	6.8
All Banks	3.5	4.3	4.0	3.7	3.1	3.2
Intermediation cost						
PSCBs	3.4	3.2	2.9	2.3	1.5	2.1
LPBs	3.9	3.6	3.2	2.9	3.1	2.9
FBs	2.9	2.5	2.3	2.8	2.8	2.6
Comm. Banks	3.4	3.2	3.0	2.6	2.6	2.4
SBs	3.2	3.9	7.3	3.6	4.1	2.9
All Banks	3.4	3.2	3.2	2.7	2.7	2.7

Group wise, the LPBs, in line with their relative size, contributed largest share in the overall profitability of the banking system. However, they lagged behind PSCBs and FBs on a number of efficiency measures (see **Table-3.4**). Losses posted by one specialized bank kept the profitability of group in the red.

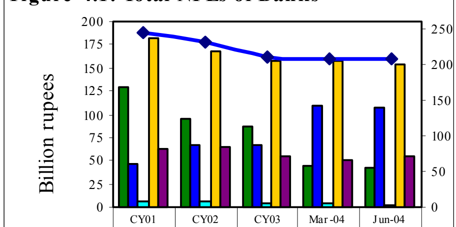
Banking sector has shown an impressive performance last year. The results for the second quarter of the current year suggest that banks are well on track to repeat that performance again. This view has been substantiated by the recent increase in high-yield earning assets and their expected increased contribution in the income stream of the banks. They have so far successfully withstood the contraction in trading gains through even more stable and recurring non-interest incomes. However, they would have to take care of their recently increased lending portfolio, for a significant part of this growth is going into the sectors in which their risk mitigating abilities are yet to be tested. Besides, the system might have to provide higher loan loss provisions against this elevated lending portfolio during these years so as to counter cyclical patterns in economic activity in the future.

4. Risk Assessment of the Banking System

4.1 Credit Risk

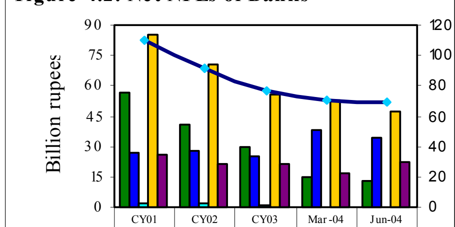
The non-performing loans of commercial banks continued to maintain the declining course during the current quarter as well. They reduced their NPLs by Rs 3.6 billion. The specialized banks, however, witnessed corresponding rise in their NPLs, nullifying the improvement made by the commercial banks (see **Figure-4.1**). To mitigate their credit risk, besides diversifying their credit portfolio into different sectors like corporate, SMEs, consumer and agriculture; banks continued making provisions against their existing stock of NPLs. Resultantly, the overall net NPLs of the banking system came down to Rs69.0 billion from Rs70.1 billion at the end of last quarter (see **Figure-4.2**). The improvement is more visible for commercial banks.

Figure-4.1: Total NPLs of Banks



	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	129.6	95.5	85.9	44.0	43.2
LPBs	45.7	66.9	67.4	108.8	107.0
FBs	6.1	5.2	4.0	3.7	2.8
CBs	181.4	167.6	157.2	156.6	153.0
SBs	62.7	63.9	54.1	50.4	54.8
All (RHS)	244.1	231.5	211.3	207.0	207.8

Figure-4.2: Net NPLs of Banks



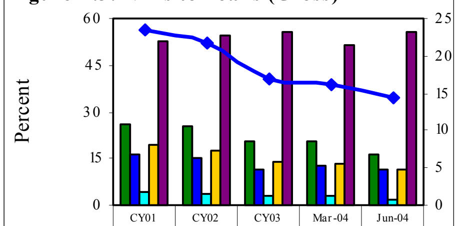
	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	56.2	41.0	29.4	14.5	13.1
LPBs	27.2	27.7	25.1	38.3	33.9
FBs	1.6	1.4	0.9	0.4	0.0
CBs	85.0	70.1	55.4	53.1	46.9
SBs	25.6	21.2	21.2	17.0	22.0
All (RHS)	110.5	91.3	76.7	70.1	69.0

Group-wise, PSCBs and LPBs have been successful in decreasing their NPLs (both gross and net). The LPBs reduced their NPLs, though two more foreign banks shifted to this group during the quarter. The exclusion of these banks from the FBs resulted in further decline of the already low level of NPLs of this group.

The stable level of NPLs despite a significant rise in the loans portfolio during the quarter is encouraging as it has positively impacted the key asset quality indicators.

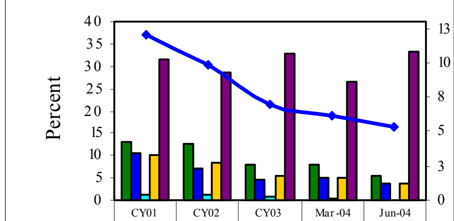
The ratios of NPLs to loans, both gross and net have come down to 14.5 percent and 5.3 percent respectively from 16.1 percent and 6.1 percent at the end of last quarter (see **Figures 4.3 & 4.4**). Looking at different groups of the industry, the PSCBs shed 4 and 2 percentage points in gross and net NPLs to loans ratios respectively. The LPBs also did a good job by improving these ratios by 1.6 and 1.1 percentage points respectively. The FBs, already having a sound quality of loan portfolio, have further improved these ratios to 2.0 and 0.0 percent respectively. The SBs, however, could not perform like the rest and their ratios deteriorated by 4 and 7 percentage points respectively.

Figure-4.3: NPLs to Loans (Gross)



	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	25.9	25.5	20.4	20.6	16.6
LPBs	16.3	15.4	11.3	13.0	11.4
FBs	4.3	3.8	3.1	2.8	2.0
CBs	19.6	17.7	13.7	13.2	11.4
SBs	53.0	54.7	55.6	51.5	55.5
All (RHS)	23.4	21.8	17.0	16.1	14.5

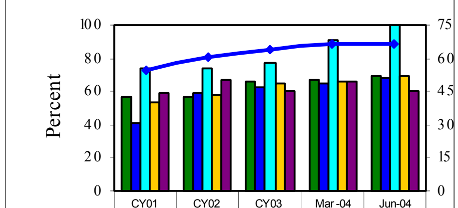
Figure-4.4: Net NPLs to Net Loans



	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	13.1	12.8	8.1	7.8	5.7
LPBs	10.4	7.0	4.5	5.0	3.9
FBs	1.1	1.1	0.7	0.3	0.0
CBs	10.3	8.3	5.3	4.9	3.8
SBs	31.5	28.5	33.0	26.4	33.4
All (RHS)	12.1	9.9	6.9	6.1	5.3

The NPLs coverage ratios for all the groups have also witnessed a continued improving pattern. From the point of view of credit risk mitigation, it is quite encouraging to note that now almost two-third of all the NPLs in banks are provided for and the rest are largely covered by collaterals **(see Figure-4.5)**. However, in ensuing quarters, banks may have to provide further on account of application of discounting factor on forced sale value (FSV) of collateral.

Figure-4.5: Provisions to NPLs



	CY01	CY02	CY03	Mar-04	Jun-04
PSCBs	56.6	57.1	65.8	67.2	69.8
LPBs	40.5	58.6	62.7	64.8	68.3
FBs	74.1	73.3	77.4	90.4	99.9
CBs	53.2	58.2	64.7	66.1	69.3
SBs	59.2	66.9	60.8	66.2	59.8
All (RHS)	54.7	60.6	63.7	66.1	66.8

Another interesting angle to look at the credit risk of the banking system would be to see the segment-wise break-up of its loans and NPLs (see **Table-4.1**). Loans to the corporate sector make up 54 percent of the total domestic loans whereas NPLs in this sector account for 57 percent of the total NPLs. Agriculture sector with around 8 percent share in total loans accounts for more than 24 percent of NPLs. This outcome exhibits the past poor performance of the specialized bank that was the single largest provider of credit to agriculture. The more recent data pertaining to commercial banks shows a much lower infection ratio. Although almost all the sectors of the economy have had their share of increase in financing by the banking sector, the major gainers like SMEs and consumers have comparatively low infection ratios. Since these sectors have gained closer attention by the banking sector only recently, it is imperative for the banks to institute proper risk management framework and an effective internal control environment to keep the risk associated with this phenomenal credit expansion under control. Furthermore, in the rising interest rates scenario, profitability of the corporates and SMEs may come under pressure due to increased costs and therefore their repayment capacity might be affected. However, major chunk of the credit expansion having gone into fixed investment and trade finance, it is hoped that the repayment capacity of firms and household will not be hampered a great deal as the economy is expected to make further progress at least in the short run.

Table:4.1 Segmentwise Infection of Loans Portfolio as of 30-06-04

(Domestic Operations) (Rs In Billions)

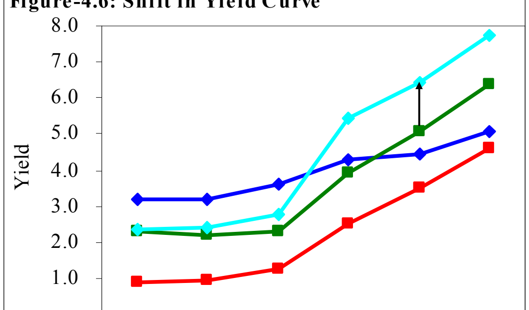
Sector	Amount Outstanding	Share %	NPLs	Share	NPLs as % of Outstanding
Corporate	725.4	53.7%	108.3	57.4%	14.9%
SMEs	250.6	18.6%	21.6	11.4%	8.6%
Agriculture	108.7	8.0%	45.9	24.3%	42.2%
Consumers	102.6	7.6%	1.1	0.6%	1.1%
Credit Cards	*11.2*	0.8%	*0.4*	0.2%	*4.0%*
Auto Loans	*33.1*	2.5%	*0.2*	0.1%	*0.6%*
Consumer Durables	*1.4*	0.1%	*0.1*	0.0%	*5.7%*
Mortgage Loans	*8.3*	0.6%	*0.0*	0.0%	*0.5%*
Others	*48.6*	3.6%	*0.3*	0.2%	*0.7%*
Commodity Finance	90.0	6.7%	1.1	0.6%	1.2%
Staff Loans	39.7	2.9%	0.5	0.3%	1.3%
Others	33.9	2.5%	10.2	5.4%	30.0%
Total	**1,350.9**	**100%**	**188.6**	**100%**	**14.0%**

4.2 Market Risk

Market risk tends to be on higher side due to excessive interest rate exposure and the rupee / dollar parity. However, the equity exposure of the banks stayed in check.

Despite the fact that SBP discouraged the rapid **interest rate** hike move of the banks by accepting less in the auctions or even scrapping the auctions, the average secondary market yields on 3m, 6m and 12 months MTBs increased from 1.52, 1.73 and 1.99 percent in the March-04 quarter to 2.35, 2.41 and 2.78 percent in June-04. By the same token yields on 3y, 5y, 10y, 15y and 20y PIBs are up by 167,168,106,142 and 148 basis points to 5.43, 6.43, 7.73, 8.80 and 9.80 percent respectively (see **Figure-4.6**). With these rising interest rates, the already piled up investment in fixed income securities makes the banks vulnerable. Though the weighted average duration of the assets has been falling, but still the level is on higher side. As for PIBs, the duration of 3y, 5y, 10y, 15y and 20-years bonds remained at 1.28, 3.05, 5.86, 8.32 and 8.84 respectively. Accordingly, the price sensitivity of these bonds, though moderated to a certain extent, is high. The price-yield relationship of these bonds reveals that with a 100bps rise in the interest rates the value of 3y, 5y, 10y, 15y and 20y bond would fall by 1.26 percent, 2.91 percent, 5.44 percent, 7.69 percent and

Figure-4.6: Shift in Yield Curve

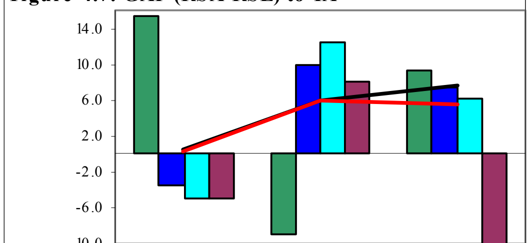


	3m	6m	1Y	3Y	5Y	10Y
Jan-03	3.2	3.2	3.6	4.3	4.4	5.1
Aug-03	0.9	0.9	1.3	2.5	3.5	4.6
Dec-03	2.3	2.2	2.3	3.9	5.1	6.4
Jun-04	2.4	2.4	2.8	5.4	6.4	7.7

8.07 percent respectively. MTBs having lower maturities would experience a fall of 0.41 percent with the same rise in interest rates. As the entire cushion available for the PIBs and MTBs in the form of revaluation surplus at the end of March-04 quarter has been completely eroded, any further rise in interest rates would affect the profitability of the banks with large holdings of such securities if necessary measures to mitigate this risk are not taken by them.

The cumulative GAPs between rate sensitive assets and rate sensitive liabilities largely remained positive and within the acceptable benchmark of ±10 percent across all the time buckets. However, the overall GAP marginally exceeded the benchmark signifying the positive duration GAP. Sector-wise, all except PSCBs, maintained negative GAP of below 10 percent for the three months maturity. Yet, for the one-year bucket the composite GAP stayed positive. This positive duration GAP would adversely affect the net worth of the banks in case interest rates further rise (see **Figure-4.7**).

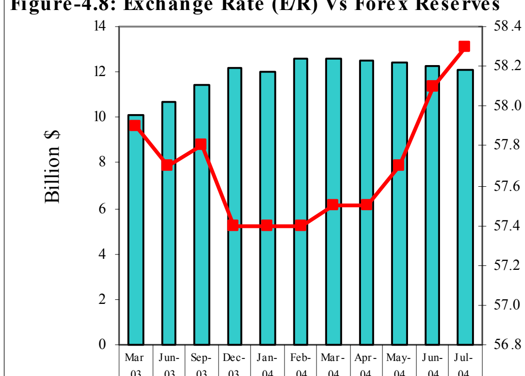
Figure-4.7: GAP (RSA-RSL) to TA



	Up to 3 mn	Over 3 mn to 1 Yr	Over 1 year
PSCBs	15.4	-9.0	9.3
LPBs	-3.6	9.8	7.3
FBs	-5.0	12.5	6.1
SBs	-4.9	8.1	-46.6
CBs	0.5	5.9	7.6
All	0.3	6.0	5.6

As for the **exchange rate,** the rupee was under slight pressure after Rupee / Dollar exchange rate bottomed out in November-03 (see **Figure-4.8**). Swap points, though stayed negative during the June-04 quarter, have turned into positive in the mid of July-04, indicating the market expectation about further depreciation. Yet the NOP of the overall banking sector witnesses short position. Although, bank-wise, the exposure is not that large but given the pressure on Rupee against the Dollar, the negative NOP of the banks may be risky.

Figure-4.8: Exchange Rate (E/R) Vs Forex Reserves



	Mar 03	Jun-03	Sep-03	Dec-03	Jan-04	Feb-04	Mar-04	Apr-04	May-04	Jun-04	Jul-04
Reserves	10.1	10.7	11.4	12.2	12.0	12.6	12.6	12.5	12.4	12.3	12.1
E/R (RHS)	57.9	57.7	57.8	57.4	57.4	57.4	57.5	57.5	57.7	58.1	58.3

The quarter ended on a positive note, in view of the conducive market conditions, but the investment of the banking sector in **equities** (excluding investment in subsidiaries and strategic) in absolute terms decreased to Rs27 billion as against Rs33 billion at the end of March-04. The direct exposure of the banking system in shares has also decreased from 22 percent in th0e last quarter to 19 percent in terms of their equity; however taking into account the indirect exposure (COT financing), the level is 25 percent. This reduction in exposure owes mainly to the pressure from SBP which imposed a cap on the portfolio.

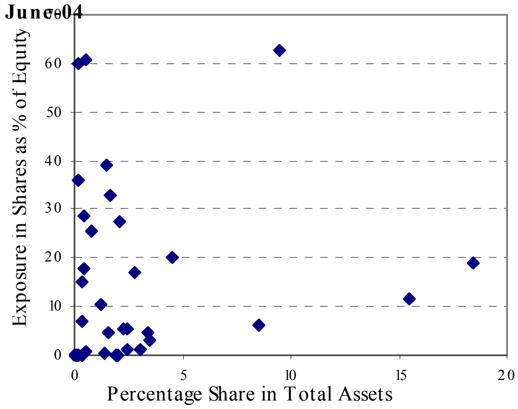
This cap will become effective from October 27, 2004 after expiry of one year transition period. However, the number of non-acquiescent banks that was 10 in June-04 (see **Table-4.2 & Figure-4.9**) has decreased to 7 in the post quarter period. Furthermore, the margin financing is likely to replace COT (badla financing) by the end of this year. In order to facilitate the transition to margin financing, and encourage active and prudent participation of the banks in this area, the State Bank has issued regulations for financing to brokers by banks. These regulations once fully enforced will mitigate the credit risk associated with the traditional COTs.

Table-4.2: Exposure in shares as percentage of Banks' Equity*

(Rs in Billions)	Below 20%	20 - 40 %	Above 40%
No of Banks	27	7	3
Amount	11.6	6.2	9.0

* Excluding banks with negative equity

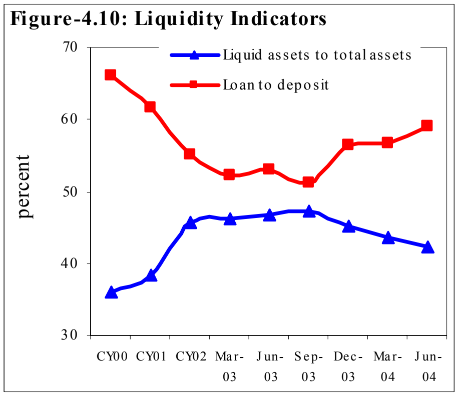
Figure-4.9: Bank-Wise Exposure in Shares-June-04

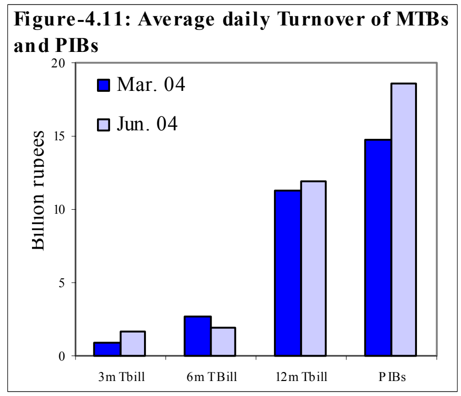


4.3 Liquidity Risk

The easy **liquidity** condition persisted for this quarter as well. This is reflected by the comfortable level of credit to deposit ratio at 59.1 percent, the fewer visits by banks to the SBP discount window and the SBP's efforts to mop up the liquidity through OMOs during the quarter under review. Liquid assets held by the banks are significantly in excess of the required liquid assets (180 percent). Loans to deposits ratio-net of borrowing against Export Refinance too is at a comfortable level of 55 percent. Liquid assets as percentage of total assets are at 42.4 percent (see **Figure-4.10**).

Active trading in secondary market provides liquidity comfort to the market. Average daily turnover of both the MTBs and PIBs increased significantly over the last quarter (see **Figure-4.11**). Increased supply of PIBs through Jumbo/Special issues coupled





with the market expectations of further rise in the yields of these securities supports this development. Resultantly the bid offer spread in the yields of these securities has been further squeezed.

Financial Soundness Indicators Annex-I

Indicators	1997	1998	1999	2000	2001	2002	2003	Mar-04	Jun-04
CAPITAL ADEQUACY									
Risk Weighted CAR									
Public Sector Commercial Banks	(1.3)	11.6	10.6	10.4	9.6	12.3	11.0	12.4	12.2
Local Private Banks	11.9	11.4	10.7	9.2	9.5	9.7	9.0	9.3	9.4
Foreign Banks	14.6	15.6	18.6	18.0	18.6	23.2	23.0	21.1	18.6
Commercial Banks	**6.0**	**12.5**	**12.2**	**11.4**	**11.3**	**12.6**	**11.1**	**11.1**	**10.9**
Specialized Banks	(6.2)	(1.4)	0.3	(3.3)	(13.9)	(31.7)	(28.2)	(10.0)	(8.2)
All Banks	**4.5**	**10.9**	**10.9**	**9.7**	**8.8**	**8.8**	**8.5**	**9.8**	**9.8**
Tier 1 Capital to RWA									
Public Sector Commercial Banks	(2.0)	8.3	7.7	7.7	7.1	8.6	8.2	9.3	9.0
Local Private Banks	11.4	10.2	9.3	8.1	8.4	6.6	7.1	7.1	7.2
Foreign Banks	14.4	15.4	18.4	17.9	18.6	23.0	23.0	21.0	18.5
Commercial Banks	**5.5**	**10.5**	**10.3**	**9.8**	**9.7**	**9.7**	**9.1**	**9.0**	**8.7**
Specialized Banks	(6.3)	(1.6)	0.3	(3.4)	(13.9)	(31.7)	(28.7)	(15.5)	(13.6)
All Banks	**4.1**	**9.1**	**9.2**	**8.3**	**7.3**	**6.2**	**6.5**	**7.5**	**7.4**
Capital to Total Assets									
Public Sector Commercial Banks	0.3	4.9	3.8	4.6	3.7	5.6	6.1	6.9	6.2
Local Private Banks	4.9	4.9	4.9	3.5	3.8	5.2	5.1	5.7	5.1
Foreign Banks	7.9	8.8	9.7	8.8	8.5	10.6	10.0	9.9	7.9
Commercial Banks	**3.1**	**5.6**	**5.0**	**4.9**	**4.6**	**6.1**	**6.0**	**6.4**	**5.7**
Specialized Banks	8.8	0.2	1.7	(1.1)	(10.3)	(23.0)	(9.5)	(10.4)	(9.3)
All Banks	**3.5**	**5.3**	**4.8**	**4.5**	**3.8**	**4.8**	**5.4**	**5.8**	**5.1**
ASSET QUALITY									
NPLs to Total Loans									
Public Sector Commercial Banks	30.8	29.0	30.7	26.3	25.9	25.5	20.4	20.6	16.6
Local Private Banks	10.2	11.1	15.5	15.4	16.3	15.4	11.3	13.0	11.4
Foreign Banks	5.0	5.3	5.1	4.7	4.3	3.8	3.1	2.8	2.0
Commercial Banks	**20.1**	**19.5**	**22.0**	**19.5**	**19.6**	**17.7**	**13.7**	**13.2**	**11.4**
Specialized Banks	50.6	47.2	51.6	52.4	53.0	54.7	55.6	51.5	55.5
All Banks	**23.5**	**23.1**	**25.9**	**23.5**	**23.4**	**21.8**	**17.0**	**16.1**	**14.5**
Provision to NPLs									
Public Sector Commercial Banks	52.9	55.6	48.8	59.2	56.6	57.1	65.8	67.2	69.8
Local Private Banks	57.8	53.3	35.0	36.9	40.5	58.6	62.7	64.8	68.3
Foreign Banks	65.9	75.0	63.4	65.9	74.1	73.3	77.4	90.4	99.9
Commercial Banks	**54.2**	**56.2**	**46.6**	**53.9**	**53.2**	**58.2**	**64.7**	**66.1**	**69.3**
Specialized Banks	22.8	65.3	54.2	58.1	59.2	66.9	60.8	66.2	59.8
All Banks	**46.6**	**58.6**	**48.6**	**55.0**	**54.7**	**60.6**	**63.7**	**66.1**	**66.8**
Net NPLs to Net Loans									
Public Sector Commercial Banks	17.0	15.0	18.5	12.7	13.1	12.8	8.1	7.8	5.7
Local Private Banks	4.6	5.5	10.7	10.3	10.4	7.0	4.5	5.0	3.9
Foreign Banks	1.8	1.4	1.9	1.7	1.1	1.1	0.7	0.3	0.0
Commercial Banks	**10.3**	**9.6**	**13.1**	**10.1**	**10.3**	**8.3**	**5.3**	**4.9**	**3.8**
Specialized Banks	44.1	23.6	32.8	31.6	31.5	28.5	33.0	26.4	33.4
All Banks	**14.1**	**11.1**	**15.3**	**12.2**	**12.1**	**9.9**	**6.9**	**6.1**	**5.3**
Net NPLs to Capital									
Public Sector Commercial Banks	2,081.0	119.9	212.0	124.5	160.2	83.4	50.0	38.5	34.7
Local Private Banks	43.3	51.4	103.5	153.5	125.2	54.8	40.5	40.8	36.8
Foreign Banks	10.0	7.1	9.9	9.0	5.8	4.7	3.3	1.4	0.0
Commercial Banks	**143.6**	**72.1**	**117.4**	**96.7**	**100.7**	**54.2**	**37.5**	**33.5**	**30.6**
Specialized Banks	380.0	11,139.0	1,502.3	-	-	-	-	-	-
All Banks	**183.8**	**92.6**	**149.8**	**131.3**	**150.5**	**85.5**	**55.4**	**47.4**	**48.1**
EARNINGS									
Return on Assets (Before Tax)									
Public Sector Commercial Banks	(3.4)	(0.4)	(0.4)	0.5	-	1.3	1.8	1.2	1.9
Local Private Banks	1.4	0.9	0.9	(0.1)	0.9	1.4	2.2	2.0	1.6
Foreign Banks	3.0	1.7	1.8	1.4	1.7	2.3	2.6	1.9	2.3
Commercial Banks	**(0.8)**	**0.4**	**0.3**	**0.4**	**0.6**	**1.5**	**2.1**	**1.7**	**1.8**
Specialized Banks	(0.2)	(9.4)	1.8	(2.3)	(8.4)	(10.2)	(2.5)	(10.1)	(1.2)
All Banks	**(0.8)**	**(0.3)**	**0.4**	**0.3**	**0.1**	**0.9**	**1.9**	**1.3**	**1.6**
Return on Assets (After Tax)									
Public Sector Commercial Banks	(3.1)	0.7	(1.0)	0.2	(0.5)	0.6	1.0	0.7	1.2
Local Private Banks	0.5	0.4	0.4	(0.7)	0.4	0.7	1.4	1.3	1.0
Foreign Banks	1.4	0.4	0.7	0.6	0.8	1.5	1.5	1.3	1.7
Commercial Banks	**(1.3)**	**0.5**	**(0.3)**	**(0.0)**	**(0.0)**	**0.8**	**1.2**	**1.1**	**1.1**
Specialized Banks	(0.2)	(9.4)	1.7	(2.3)	(8.8)	(12.1)	(3.2)	(10.1)	(1.4)
All Banks	**(1.2)**	**(0.1)**	**(0.2)**	**(0.2)**	**(0.5)**	**0.1**	**1.1**	**0.6**	**1.0**

Indicators	1997	1998	1999	2000	2001	2002	2003	Mar-04	Jun-04
ROE (Avg. Equity& Surplus) (Before Tax)									
Public Sector Commercial Banks	(272.7)	(14.6)	(9.6)	10.9	0.5	26.3	29.9	19.0	29.8
Local Private Banks	29.0	17.5	18.5	(3.2)	25.4	32.3	42.2	36.1	29.8
Foreign Banks	37.7	20.5	19.3	15.6	19.3	24.2	25.2	19.4	24.8
Commercial Banks	**(23.8)**	**8.0**	**6.5**	**8.8**	**12.2**	**27.5**	**34.0**	**27.8**	**28.9**
Specialized Banks	(1.8)	(211.0)	182.8	-	-	-	-	-	-
All Banks	**(20.2)**	**(6.4)**	**8.7**	**5.7**	**1.4**	**21.1**	**36.4**	**22.5**	**29.7**
ROE (Avg. Equity &Surplus) (After Tax)									
Public Sector Commercial Banks	(255.0)	24.0	(24.0)	4.9	(12.2)	11.5	17.3	10.5	18.3
Local Private Banks	10.9	7.3	8.1	(17.4)	10.3	17.3	26.2	23.4	19.1
Foreign Banks	17.2	5.1	7.1	6.1	9.1	15.2	14.9	12.6	18.1
Commercial Banks	**(36.2)**	**12.0**	**(6.2)**	**(0.3)**	**(0.3)**	**14.3**	**20.5**	**17.4**	**18.7**
Specialized Banks	(2.0)	(211.6)	179.1	-	-	-	-	-	-
All Banks	**(30.7)**	**(2.7)**	**(3.9)**	**(3.5)**	**(12.6)**	**3.2**	**20.5**	**11.5**	**18.3**
NII/Gross Income									
Public Sector Commercial Banks	36.1	58.6	56.5	61.8	69.9	69.5	64.1	69.5	61.2
Local Private Banks	50.2	54.9	53.4	63.2	72.1	65.5	56.8	58.9	58.3
Foreign Banks	56.1	50.1	50.0	54.0	59.4	57.5	55.3	56.6	56.2
Commercial Banks	**46.5**	**55.6**	54.3	**61.2**	**68.9**	**66.1**	**59.4**	**60.7**	**58.7**
Specialized Banks	88.5	85.1	71.7	78.6	86.7	78.0	75.8	76.9	86.3
All Banks	**48.7**	**59.3**	**55.6**	**62.3**	**70.4**	**67.1**	**60.5**	**61.2**	**60.2**
Cost / Income Ratio									
Public Sector Commercial Banks	140.0	92.1	84.7	70.1	62.3	56.9	42.8	48.6	45.1
Local Private Banks	60.9	73.8	76.6	80.9	67.3	60.0	53.2	55.5	57.4
Foreign Banks	43.6	55.5	57.0	59.4	54.5	45.4	48.3	50.9	48.9
Commercial Banks	**85.8**	**78.5**	**76.9**	**71.6**	**62.7**	**56.7**	**48.6**	**53.6**	**53.8**
Specialized Banks	74.6	32.2	62.2	70.5	59.0	84.7	55.6	124.5	56.9
All Banks	**85.2**	**72.7**	**75.8**	**71.6**	**62.4**	**59.1**	**49.1**	**56.0**	**54.0**
LIQUIDITY									
Liquid Assets/Total Assets									
Public Sector Commercial Banks	39.4	40.4	38.6	37.1	36.5	49.0	49.0	50.3	45.9
Local Private Banks	40.6	40.1	38.0	34.0	39.8	47.1	42.9	42.4	41.2
Foreign Banks	47.6	46.0	40.3	45.2	50.3	48.5	49.8	46.3	49.4
Commercial Banks	**41.4**	**41.3**	**38.7**	**37.5**	**39.9**	**48.1**	**46.0**	**44.5**	**43.1**
Specialized Banks	14.1	14.6	10.5	12.7	13.6	16.4	22.2	19.9	22.3
All Banks	**39.5**	**39.7**	**36.8**	**36.0**	**38.5**	**46.7**	**45.1**	**43.6**	**42.4**
Liquid Assets/Total Deposits									
Public Sector Commercial Banks	46.0	48.4	46.4	45.0	43.4	59.6	59.0	58.8	52.9
Local Private Banks	49.9	49.7	48.0	44.3	49.6	60.2	54.5	51.9	50.9
Foreign Banks	57.9	56.9	55.6	67.7	78.3	74.2	69.7	63.9	71.1
Commercial Banks	**49.4**	**50.3**	**48.2**	**48.0**	**50.3**	**61.5**	**57.9**	**54.7**	**53.3**
Specialized Banks	102.8	134.8	78.8	90.8	79.8	98.5	131.5	124.2	146.2
All Banks	**50.0**	**51.0**	**48.6**	**48.5**	**50.7**	**61.8**	**58.5**	**55.2**	**54.0**
Advances/Deposits									
Public Sector Commercial Banks	48.4	46.5	50.8	54.0	53.8	44.3	45.6	39.5	44.1
Local Private Banks	56.6	57.0	59.6	67.5	57.9	52.3	58.3	56.8	59.5
Foreign Banks	54.3	56.7	68.2	71.5	66.8	72.0	63.9	67.4	66.4
Commercial Banks	**51.8**	**51.2**	**55.9**	**60.5**	**56.9**	**51.0**	**53.6**	**53.8**	**56.5**
Specialized Banks	551.7	671.3	586.8	553.0	450.5	453.8	381.5	398.0	408.6
All Banks	**57.6**	**56.6**	**62.0**	**66.2**	**61.7**	**54.9**	**56.5**	**56.6**	**59.1**

List of Abbreviations **Annex-II**

CAR	Capital Adequacy Ratio
CBs	Commercial Banks
COT	Carry Over Transactions
CY	Calendar year
FBs	Foreign Banks
LPBs	Local Private Banks
MCR	Minimum Capital Requirement
MTBs	Market Treasury Bills
NII	Net Interest Income
NPLs	Non Performing Loans
OMOs	Open Market Operations
PIBs	Pakistan Investment Bonds
PSCBs	Public Sector Commercial Banks
PTCs	Participation Term Certificates
ROA	Return on Assets
ROE	Return on Equity
RSAs	Rate Sensitive Assets
RSLs	Rate Sensitive Liabilities
RWA	Risk Weighted Assets
SBP	State Bank of Pakistan
SBs	Specialized Banks
SMEs	Small and Medium Enterprises
TFCs	Term Finance Certificates
ZTBL	Zarai Taraqiati Bank Limited

Capital adequacy ratio The amount of risk-based capital (Tier I and II) as a percent of risk-weighted assets.

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

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

GAP 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.

Inter-bank rates The two way quotes namely bid and offer rates quoted in inter-bank market are called as inter-bank rates.

Intermediation cost Administrative expenses divided by the average deposits and borrowings.

Liquid assets 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.

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

Net interest margin (NIM) Net interest income as a percent of average earning assets.

Net loans Loans net of provision held for non-performing loans.

Net non-performing loans (NPLs) The value of non-performing loans minus provision for loan losses.

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

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

NPLs to loans ratio Non-performing loans as a percent of gross loans.

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

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

Return on assets It 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.

Risk weighted Assets Each asset and off-balance sheet item is assigned to one of the four broad risk categories based on the perceived credit risk of the obligor. These risk categories are assigned weights of 0 percent, 20 percent, 50 percent and 100 percent. The standard risk category is 100 percent. The rupee value of the amount in each category is multiplied by the risk weights associated with that category. The off-balance sheet items are first converted to credit equivalent values by using the conversion factors. The resulting values for each of the risk categories are added together. The resulting sum is the total risk weighted assets.

SME: means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing concern) and 50 persons (if it is trading / service 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). Tier I capital is defined as common stockholders' equity (including common stock, surplus and undivided profits), non-cumulative perpetual preferred stock and minority interest in consolidated subsidiaries.

Tier II capital Supplementary Capital (Tier II) is limited to 100 percent of core capital (Tier I). It includes cumulative perpetual preferred stock, mandatory convertible debt, the general provision or reserves for loan losses, term subordinated debt, limited life preferred stock and other hybrid capital instruments.

Yield risk The risk arising 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.

Group-wise Composition of Banks 1997 – June 2004

Annex-IV

1997-1998	1999-2000	2001	2002	2003	June-2004
A. Public Sector Comm. Banks (6) - Habib Bank Ltd. - National Bank of Pakistan - United Bank Ltd. - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (16)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - Platinum Commercial Bank Ltd - Prime Commercial Bank Ltd. - Prudential Commercial Bank Ltd - Gulf Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd - Allied Bank of Pakistan - Trust Bank Ltd. - Indus Bank Ltd. **C. Foreign Banks (20)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - ANZ Grindlays Bank - Bank of America - Bank of Ceylon - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez - Deutsche Bank A.G. - Doha Bank - Emirates Bank International - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - IFIC Bank Ltd. - Mashreq Bank PJSC - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Societe Generale - Standard Chartered Bank **D. Specialized Banks (4)** - Agriculture Development Bank of Pakistan - Industrial Development Bank of Pakistan - Federal Bank for Co-operatives - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (42)** Include A + B + C **All Banks (46)** Include A + B + C + D	**A. Public Sector Comm. Banks (6)** - Habib Bank Ltd. - National Bank of Pakistan - United Bank Ltd. - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (14)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - Platinum Commercial Bank Ltd - Prime Commercial Bank Ltd. - Prudential Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan **C. Foreign Banks (20)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - ANZ Grindlays Bank - Bank of America - Bank of Ceylon - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez - Deutsche Bank A.G. - Doha Bank - Emirates Bank International - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - IFIC Bank Ltd. - Mashreq Bank PJSC - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Societe Generale - Standard Chartered Bank **D. Specialized Banks (4)** - Agriculture Development Bank of Pakistan - Industrial Development Bank of Pakistan - Federal Bank for Co-operatives - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (40)** Include A + B + C **All Banks (44)** Include A + B + C + D	**A. Public Sector Comm. Banks (6)** - Habib Bank Ltd. - National Bank of Pakistan - United Bank Ltd. - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (14)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - Platinum Commercial Bank Ltd - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan **C. Foreign Banks (19)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - Standard Chartered Grindlays Bank - Bank of Ceylon - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez - Deutsche Bank A.G. - Doha Bank - Emirates Bank - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - IFIC Bank Ltd. - Mashreq Bank PJSC - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Societe Generale - Standard Chartered Bank **D. Specialized Banks (4)** - Agriculture Development Bank of Pakistan - Industrial Development Bank of Pakistan - Federal Bank for Co-operatives - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (39)** Include A + B + C **All Banks (43)** Include A + B + C + D	**A. Public Sector Comm. Banks (5)** - Habib Bank Ltd. - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (16)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Meezan Bank **C. Foreign Banks (16)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - Bank of Ceylon - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez - Deutsche Bank A.G. - Doha Bank - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - IFIC Bank Ltd. - Mashreq Bank PJSC - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank **D. Specialized Banks (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (37)** Include A + B + C **All Banks (40)** Include A + B + C + D	**A. Public Sector Comm. Banks (5)** - Habib Bank Ltd[1] - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (18)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Meezan Bank - NDLC-IFIC Bank Ltd - Crescent Bank Ltd. **C. Foreign Banks (14)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - Bank of Ceylon[2] - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez[3] - Deutsche Bank A.G. - Doha Bank[4] - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank **D. Specialized Banks (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (37)** Include A + B + C **All Banks (40)** Include A + B + C + D	**A. Public Sector Comm. Banks (4)** - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (21)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Meezan Bank - NDLC-IFIC Bank Ltd - Crescent Bank Ltd. - Habib Bank Ltd - Dawood Bank - Trust Bank **C. Foreign Banks (11)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Deutsche Bank A.G. - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank **D. Specialized Banks (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (36)** Include A + B + C **All Banks (39)** Include A + B + C + D

1. *HBL now stands as local private bank after being privatized on 26-02-2004.*
2. *Bank of Ceylon now stands as local private bank (Dawood Bank) after acquisition by a private group on 25-03-2004.*
3. *Credit Agricole now stands as local private bank after being merged into NDLC-IFIC Bank on 19-04-2004.*
4. *Doha Bank now stands as local private bank (Trust Bank) after acquisition by a private group on 05-05-2004.*