State Bank of Pakistan

Banking Supervision Department

Quarterly Performance Review of the Banking System

March 2005

The Team

Team Members

Muhammad Anwar Saeed

Aziz Morris

Zahid Mahmood

Amer Hassan

Rizwana Rifat

Sheema Fareed

Ayaz Ali

Khurram Shahzad

Team Leader

Jameel Ahmad

C o n t e n t s

Section		Page
1	Overview	1
2	Assets and Funding Structure	3
2.1	Deposits	4
2.2	Borrowings	5
2.3	Loans	5
2.4	Investments	7
3	Financial Soundness of the Banking System	9
3.1	Solvency	9
3.2	Profitability	11
4	Risk Assessment of the Banking System	14
4.1	Credit Risk	14
4.2	Market Risk	16
4.3	Liquidity Risk	19
5	Performance of Islamic Banking	22
6	Assessment of “Stress tests” conducted on the Banking System	25
Annex-I	Financial Soundness Indicators	31
Annex-II	Selected Indicators for Different Categories of Banks	33
Annex-III	Bank-wise Major Statistics	34
Annex-IV	List of Abbreviations	35
Annex-V	Glossary	36
Annex-VI	Group-wise Composition of Banks	39

Quarterly Performance Review of the Banking System
March 2005

The review is based on the data mainly taken from the Quarterly Reports of Condition and Annual Audited Accounts submitted by banks. It covers their global[1] operations, unless otherwise indicated. The banks have been divided into four groups[2] namely, Public Sector Commercial Banks (PSCBs), Local Private Banks (LPBs), Foreign Banks (FBs) and Specialized Banks (SBs). PSCBs include nationalized commercial banks and two provincial banks, whereas LPBs consist of privatized banks and domestic private banks. The performance of the banking industry as a whole and these groups in particular has been evaluated by using the financial soundness indicators.

1. Overview

The banking system, gaining strength from the impressive performance during the year 2004, started the new-year on a very positive note. The key financial indicators continued to show improvement. The net profit of Rs9.9 billion posted by the banks during the current quarter is more than double the profit for the same period of last year. As a result, return on assets improved to 1.3 percent from 0.6 percent in the corresponding quarter of last year. The rapidly growing balance sheet of the banking system has been instrumental in providing greater opportunities to banks to increase their earnings. The same trend persisted during the current quarter as the banking system added another Rs84 billion to its asset base. In this respect, the role of fast increasing loan portfolio, which grew by another 4.9 percent during the quarter, has been significant. It helped in increasing the share of core income in the overall profits, which shows considerable improvement in the quality of income.

While the increase in loans has moderated since the previous quarter, it is still quite substantial, considering the historical trend whereby loans tend to decline in the first quarter of the year because of seasonal slow-down. An important feature of the loan growth was that it remained broad-based. Yet another feature was the better quality of new loans. Despite the fast acceleration in loans and gradual rise in lending rates, asset quality kept its improving trend. This is reflected by an improvement in the ratio of net NPLs to net loans to 2.9 percent from 3.6 percent in CY04.

A noticeable outcome of the rising interest rates was the reversal of declining trend in investments as banks resorted to take advantage of higher yields on the government securities. Resultantly, the investments of the banking system grew by Rs52billion during the quarter. The risk of any significant fall in the value of these securities on account of rising interest rates might not be ominous as major portion of these

---

[1] Domestic operations of all the banks operating in Pakistan plus operations of overseas branches of Pakistani Banks
[2] The composition of these groups has been given in Annex-VI.

investments was made in short-term papers i.e. MTBs, which are usually held to maturity.

Liquidity condition showed signs of tightening, as SBP gradually raised interest rates to tackle the inflationary pressures. High demand for loans coupled with relatively decelerated growth in deposits during the quarter, further pushed up the loans to deposits ratio. Despite these developments, the overall condition is still comfortable as the banking system continues to hold sufficient liquid assets to meet any contingencies.

On the back of positive trends during the quarter, the solvency position improved further. Growth in capital, aided by strong profits and fresh injections, was enough to offset the rise in risk-weighted assets. This resulted in an improvement in the capital adequacy ratio (CAR) of the banking system to 10.7 percent from 10.5 percent in the previous quarter.

The Islamic banking operations also continued growing both in terms of market players and asset base. There are now three full fledged Islamic banks with the licensing of another bank during the quarter. The branch net work of Islamic banking participants has also expanded to 54 from 48 in CY04. The market share of Islamic banking operations in the overall banking system, though still very small at 1.6 percent, is expected to rise with the increasing number of market players and Shariah compliant product offerings.

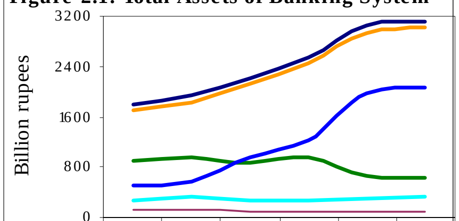
Given the buoyant economic activities, the year 2005 promises to be yet another year of significant achievements for the banking system. The persisting demand for credit and improving asset quality augurs well for the profitability of the system. Further cut in tax rate will also benefit the banking system in higher profits and better returns. The healthy operational results coupled with expected capital injections, in response to enhanced minimum capital requirement (MCR) of Rs2 billion, would help consolidate the solvency position. However, these brighter prospects are not without certain caveats. Interest rates so far have remained negative in real terms, which helped in sustaining the demand for credit. Any sharp rise beyond the expectations of market participants has the potential of straining the solvency profile of borrowers. Moreover, it also holds special connotations with regard to liquidity and market risks, which have already started to cause some concerns. However, stress test results show the resilience of the banking system against minor to moderate shocks. Nevertheless, managements of banks will have to be extra-vigilant in realigning their strategies with the changing market conditions.

2. Assets and Funding Structure

The banking system helped by persistent inflow of deposits continued to augment its balance sheet during the quarter under review and grew by another 2.8 percent (see **Figure-2.1**). However, comparing with the steep rise in the previous year, the growth lost pace significantly. This may be attributed mainly to the substantial decline in government deposits of a large public sector bank. Despite the deceleration, the growth is still impressive; about four times if compared with the growth in the corresponding quarter of the last year. This is because of the strong momentum of the economy, which is keeping the demand for bank loans fairly high. The asset mix reflects the trend as the share of loans increased further (see **Figure-2.2**). To take advantage of the rising yields on government securities, the banking system also increased its investments substantially.

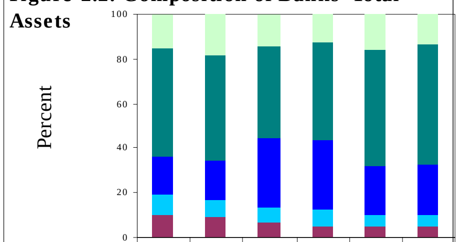
While the public sector commercial banks (PSCBs) experienced a decline of 3.4 percent, the share of LPBs increased further as they registered a growth of 4.6 percent (see **Figure-2.3**). However, in terms of the rate of growth, foreign banks surpassed the rest as they grew by 5.9 percent. The largest bank in this group contributed almost two-third of the increase on the back of significant surge in its deposits. This led to an increase in the share of FBs, which has been on a persistent decline for quite some time. The share of specialized banks continued to shrink as their asset base squeezed by 2.5 percent.

Figure-2.1: Total Assets of Banking System



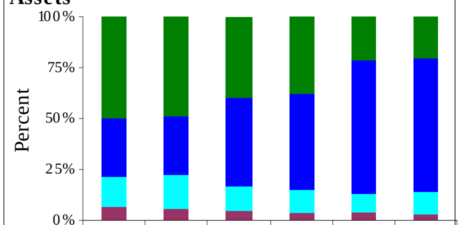
	CY00	CY01	CY02	CY03	CY04	Mar05
PSCBs	902	947	878	959	650	627
LPBs	513	566	967	1212	1,980	2071
FBs	281	324	280	267	304	322
CBs	1,696	1,836	2,125	2,438	2,933	3,020
SBs	112	106	98	100	104	101
All	1,808	1,942	2,223	2,538	3,036	3,121

Figure-2.2: Composition of Banks' Total Assets



	CY00	CY01	CY02	CY03	CY04	Mar-05
Cash &Bank Balances	14.7	18.7	14.0	12.5	16.1	13.7
Advances	49.1	46.9	41.4	43.6	51.9	53.2
Investments	16.8	18.1	31.5	31.0	22.2	23.2
Lending to FIs	8.9	7.0	6.6	7.7	4.7	4.6
Other Assets	10.4	9.4	6.4	5.2	5.1	5.3

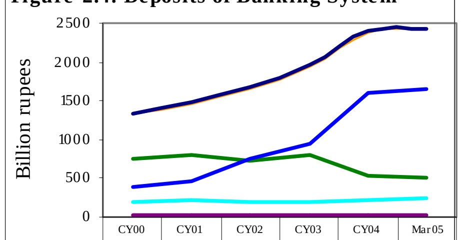
Figure-2.3: Group-wise Share in Total Assets



	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	49.9	48.8	39.5	37.8	21.4	20.1
LPBs	28.4	29.1	43.5	47.6	65.2	66.4
FBs	15.5	16.6	12.6	10.7	10.0	10.3
SBs	6.2	5.5	4.4	3.9	3.4	3.2

The banking system added another Rs40.3 billion to its **deposit** base during the quarter under review (see **Figure-2.4**). The role of workers' remittances remained significant as they continued to keep the system fairly liquid by supplying the all important funds. The growth in deposits (1.7 percent), however, is considerably slower if compared with the growth (7.6 percent) in the last quarter. The relatively slower growth in deposits may be explained in terms of outflows on account of certain payments on behalf of the government.

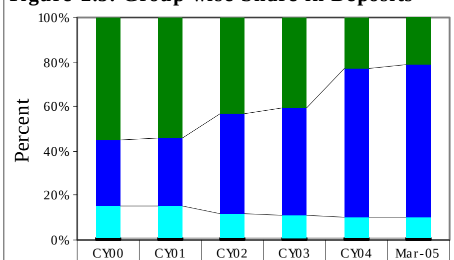
Figure-2.4: Deposits of Banking System



	CY00	CY01	CY02	CY03	CY04	Mar05
PSCBs	744	795	722	799	545	520
LPBs	394	454	757	954	1603	1662
FBs	187	208	183	192	227	236
CBs	1325	1457	1662	1945	2375	2418
SBs	16	18	16	17	17	14
All	1341	1475	1678	1962	2392	2432

The sharp decline in the deposits of the public sector bank also influenced the overall share of PSCBs in the total deposits of the banking system (see **Figure-2.5**). However, this decline if seen in the right perspective does not raise any concern. The withdrawn deposits were, in fact, kept temporarily to make some payment on behalf of the government and hence their outflow does not represent any structural consequence for the bank. The share of PSCBs also depends on the performance of this one bank, which has a disproportionately large size.

Figure-2.5: Group-wise Share in Deposits

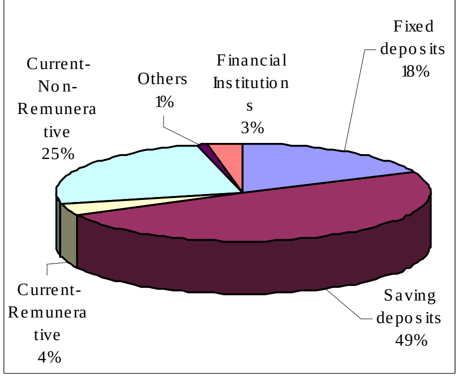


	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	55.5	53.9	43.0	40.7	22.8	21.4
LPBs	29.4	30.8	45.1	48.5	67	68.3
FBs	14.0	14.1	10.9	9.9	9.5	9.7
SBs	1.2	1.2	1.0	0.9	0.7	0.6

The LPBs driven by the strong competitive pressures have not only encroached upon the shares of other groups but also are engaged in stiff competition within the group. This has resulted in their increasing penetration in until now untapped areas as well as delivery of customer-tailored services. Consequently, their share in total deposits of the system is also growing gradually. During the quarter under review, their deposits increased by 3.7 percent which brought about 1.3 percentage point increase in their share. Foreign banks, which were buckling under the pressure exerted by LPBs, also managed to increase their share by growing at 3.8 percent during the quarter. However, this depended heavily on the growth registered by one bank in the group, which mobilized enough deposits to offset the cumulative decline in deposits of the rest of the banks in this group.

While the rate of return on deposits displayed some upward movement since the previous quarter, the rates were still too low, rather negative in real terms, to cause any significant shift in the type-wise distribution of deposits, which remained almost stable over the quarter. The persistent inflow of funds through workers' remittances has kept the system fairly liquid and hence banks so far have managed to keep their cost of funds quite low. The saving deposits continue to hold the major chunk (see **Figures 2.6**). The only noticeable shift is visible in deposits from financial institutions, which declined to 3 percent from 4 percent in the last quarter.

Figure-2.6: Deposits Structure- Mar-05

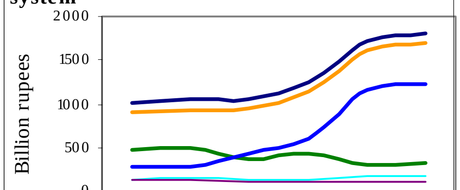


Foreign currency deposits, which had been increasing steadily over the last few quarters, declined by Rs6.9 billion during the period under review. The LPBs on the other hand increased their foreign currency deposits whereas FBs saw a decline during the quarter. Thus the increase in total deposits came entirely from the local currency deposits, which constitute 85.6 percent of all deposits.

Because of relatively slower growth in deposits and the persisting demand for loans, the banking system's **borrowings** increased by Rs16.8 billion during the quarter. Borrowings under export refinance form the major part of borrowings i.e. 35.4 percent. On the back of positive trends on the exports front, the export refinance borrowings increased by another Rs5.8 billion in this quarter. This happened despite the increase in export refinance rates, and hence may be considered a healthy sign for the economy. An increase of Rs4.3 billion and Rs2.5 billion in call borrowings and repo borrowings may be seen in the background of gradual tightening of the liquidity conditions. Together, these two accounts make up around 34 percent of the total borrowings of the banking system.

The **loans** portfolio of the banking system kept growing, though at a decelerated pace, during the quarter (see **Figure-2.7**). While the increase of Rs85 billion appears small if compared with the exceptional growth witnessed in the previous quarter, it is still very significant in many respects: 1) it came in the period when economic activities tend to slow down, 2) it remained broad-based despite gradual increase in interest rates and the consequent apprehensions surrounding fall in consumer loans, 3) it signifies the continuation of economic activities and, 4) it generates optimism for yet

Figure-2.7: Total Loans of the Banking system



	CY00	CY01	CY02	CY03	CY04	Mar 05
PSCBs	476	501	374	422	302	314
LPBs	282	281	435	597	1156	1223
FBs	138	143	135	125	162	167
CBs	896	926	945	1143	1620	1704
SBs	124	118	117	97	99	100
All	1020	1044	1062	1241	1719	1804

another profitable year for the banking system because of the greater proportion of high-yield assets.

Since the role of private sector has become pivotal in fuelling the economic activities, therefore, all the funds flowed to this sector to finance its expanding businesses. The public sector on the other hand saw a reduction of around Rs10 billion mainly on account of retirement of loans for commodity operations. More than 60 percent of the decline in public sector loans was accounted for by the large six banks, which finance most of lending to the public sector, particularly for commodity operations.

Contrary to the general perceptions, the loans growth remained broad-based. Concerns pertaining to probability of higher default and ultimate fall in lending in the wake of rising interest rates, especially to consumer sector, did not materialize. Consumer financing kept growing apace and contributed 27.5 percent to the overall loans growth (see **Table 2.1**). In percentage terms, the growth of 16.1 percent in consumer financing also exceeded the growth witnessed by other sectors. Consequently, the share of consumer financing in total loans went up appreciably. The break-up of growth in consumer financing into sub-sectors shows that, in absolute terms, personal loans registered the highest increase followed by auto loans. The housing loans which were growing at snail's pace a few quarters back have started to show a comparatively faster upward movement. The growth during the current quarter was the highest ever witnessed during a single quarter.

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

(Billion Rupees)	Mar-04		Dec-04		Mar-05	
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
Corporate Sector	**653.0**	**54.2**	**873.0**	**53.9**	**924.4**	**54.1**
Fixed Investments	269.2	22.3	356.2	22.0	367.5	21.5
Working Capital	228.9	19.0	341.8	21.1	376.9	22.0
Trade Finance#	154.9	12.8	174.9	10.8	180.0	10.5
SMEs	**225.2**	**18.7**	**284.0**	**17.5**	**294.8**	**17.2**
Fixed Investments	30.5	2.5	23.9	1.5	25.9	1.5
Working Capital	147.6	12.2	204.2	12.6	209.8	12.3
Trade Finance#	47.1	3.9	55.9	3.4	59.1	3.5
Agriculture production	**102.7**	**8.5**	**119.3**	**7.4**	**124.5**	**7.3**
Consumer Finance	**83.0**	**6.9**	**152.6**	**9.4**	**177.1**	**10.4**
Credit Cards	9.7	0.8	14.1	0.9	15.5	0.9
Auto Loans	27.6	2.3	49.6	3.1	57.2	3.3
Consumer Durables	1.2	0.1	1.6	0.1	1.6	0.1
Housing Loans	5.5	0.5	16.7	1.0	21.7	1.3
Personal Loans	39.0	3.2	70.5	4.4	81.2	4.7
Commodity Operations	**70.6**	**5.9**	**122.1**	**7.5**	**111.6**	**6.5**
Staff Loans	**39.6**	**3.3**	**40.8**	**2.5**	**41.1**	**2.4**
of which Housing Loans	27.4	2.3	28.7	1.8	27.9	1.6
Other	**31.3**	**2.6**	**28.6**	**1.8**	**36.1**	**2.1**
Total	**1,205.4**	**100**	**1,620.4**	**100**	**1,709.7**	**100**

* Loans to both Public and Private sectors

\# Also include Export Finance

In spite of the encouraging trends in consumer financing, majority of the funds i.e. 58 percent flowed to the corporate sector. This corresponds to the disproportionate size of this sector in banks' loans as well as to the ongoing drive for business expansion on the back of strong demand for their products and brighter prospects of profitability. Resultantly, the share of this sector also grew further during the quarter under review. The increased emphasis on the SMEs has produced positive results as banks have gradually expanded their exposure to this sector. The SMEs absorbed around 12 percent of the loans growth during the quarter. Considering its untapped potential and significance to the economy, the banking system has a plenty of scope to penetrate deeper into this sector. Agriculture has been another important sector, which has come to occupy greater attention of the commercial banks. Comparing with the sluggish growth in the previous quarter, the growth in loans to this sector was fairly satisfactory. This sector contributed 5.8 percent to the overall loans growth. Despite increasing lending to the SMEs and agriculture sectors, the respective shares of these sectors decreased further as corporate and consumer sectors grew relatively faster.

Around one third of the loans finance working capital needs. The current quarter also saw larger chunk going to finance the working capital needs of corporates and SMEs. This caused further increase in the share of loans for working capital purposes (see **Figure-2.8 & 2.9**). With the economy exhibiting strong performance, lending for fixed investment has also been increasing gradually. However, the share of loans for fixed investment declined fractionally owing to faster increase in working capital loans as well as consumer loans. The overwhelmingly large portion of loans for fixed investments is locked into the corporate sector. SMEs rely mainly on the working capital loans.

Figure-2.8: End-Use Distribution of Bank Loans - Mar-04

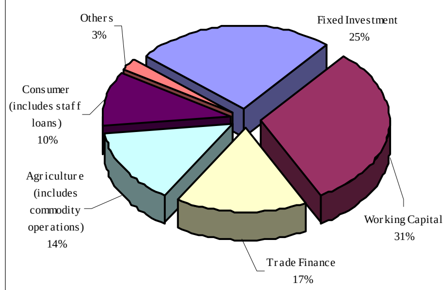
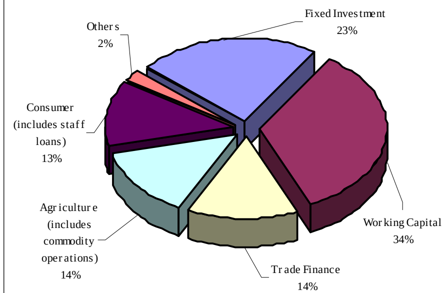


Figure-2.9: End-Use Distribution of Bank Loans - Mar-05

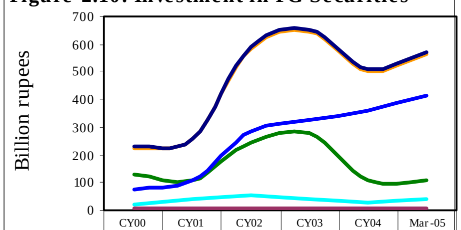


The contribution by all groups was another significant feature of the loans growth during the current quarter. However, LPBs grew much faster by contributing 79.6 percent leading to increase in their share to 67.8 percent in the total outstanding loans of the banking system. The faster growth in loans of the LPBs also resulted in a decline in the respective shares of other groups.

After witnessing a gradual fall in the previous quarters, the **investment** portfolio of the banking system increased by Rs52 billion during the quarter under review. The increase came as yields on government securities, mainly the MTBs, increased at a relatively faster pace, which induced banks to channel more funds towards investments.

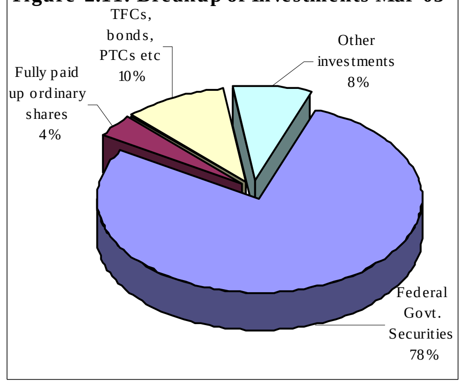
The government securities, which saw an increase of 12.2 percent during the quarter (see **Figure-2.10)**, enlarged their share in total investments of the banking system to 78 percent from 75 percent in the previous quarter (see **Figure-2.11**). The break-up of government securities shows a significant increase in MTBs, as investment in PIBs declined further. The reason for the persistent fall in PIBs remained the absence or

Figure-2.10: Investment in FG Securities



	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	129.8	106.2	246.1	280.3	111.4	108.2
LPBs	72.9	108.0	284.7	323.3	361.1	415.6
FBs	20.0	41.0	55.1	40.7	28.7	39.5
CBs	222.8	255.2	586.0	644.3	501.2	563.2
SBs	5.8	4.3	4.7	5.2	6.4	6.1
All	228.6	259.5	590.7	649.5	507.6	569.4

Figure-2.11: Breakup of Investments Mar-05



scrapping of auctions as market players made bids at rates, which were unacceptable to SBP. Consequently, investment in PIBs kept on declining with each maturity of previous issues.

LPBs remained more active as they accounted for around 80 percent of the increase in total investment of the banking system. Resultantly, their share also went up to 69.5 percent from 68.7 percent in the last quarter. The rest was contributed by FBs as PSCBs and SBs kept their investments almost at the previous quarter's level.

Because of very fast growth in loans to the private sector, the exposure of the banking system to public sector has been on gradual decline since CY02 (see **Table 2.2**). During the quarter under review it decreased further despite the fact that overall investment in government securities increased.

Table 2.2 Banks' Exposure to Public Sector

(Percent)	Dec-00	Dec-01	Dec-02	Dec-03	Dec-04	Mar-05
Credit	19.3	20.7	16.9	10	10.9	8.6
Total (Credit+Govt. papers)	36.6	35.5	44.3	39.9	32.4	29.1

Source: Weekly Statement

3. Financial Soundness of the Banking system

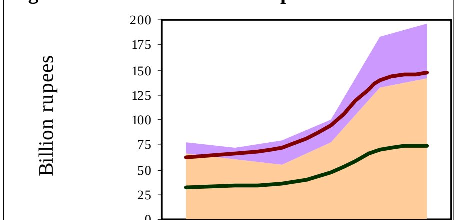
3.1 Solvency

The solvency indicators of the banking system further improved during the quarter under review. The major support came from strong profitability, which not only provided the banks further base for their continued business expansion, but also kept the rising trend in solvency indicators. Besides, increase in sub-ordinated debt and revaluation of securities augmented the supplementary capital. The overall risk-based capital of the banking system rose to Rs196.6 billion from Rs182.5 billion in CY04 (see **Figure-3.1.1**).

The risk profile of the banking system also maintained the rising trend, as among assets major expansion was witnessed in loans to private sector which attract 100 percent risk weight. As a result, the risk-weighted assets as percentage of total assets went up to 58.8 percent from 57.3 percent in CY04 (see **Figure-3.1.2**).

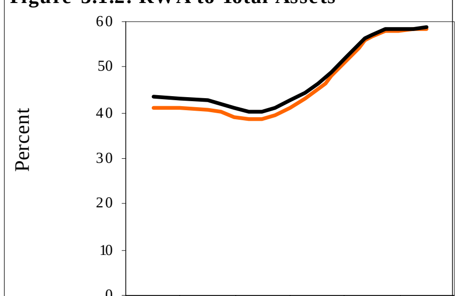
However, the relatively higher growth in capital as compared to assets led to improvement in all the solvency indicators (see **Table 3.1.1**). The overall capital adequacy ratio and tier 1 capital to risk-weighted assets ratio ameliorated to 10.7 percent and 7.7 percent respectively from 10.5 percent and 7.6 percent in CY04. The balance sheet capital to total assets ratio also improved by 0.2 percentage point to 6.7 percent. All the three ratios are well above the respective internationally accepted benchmarks for well capitalized banks[3].

Figure-3.1.1: Risk-based Capital Position



	CY00	CY01	CY02	CY03	CY04	Mar-05
Suppl. Capital	11.3	12.0	23.5	23.3	50.8	54.9
Core Capital	65.1	60.5	55.2	77.0	131.7	141.7
Required Tier I	31.5	33.1	35.9	47.3	69.6	73.7
Required Total	63.1	66.2	71.8	94.7	139.3	147.5

Figure-3.1.2: RWA to Total Assets



	CY00	CY01	CY02	CY03	CY04	Mar-05
CBs	41.2	40.5	38.6	45.1	56.7	58.3
All Banks	43.6	42.6	40.3	46.5	57.3	58.8

Table 3.1.1 Capital Adequacy Indicators

Percent	CY00	CY01	CY02	CY03	CY04	Mar-05
CAR						
PSCBs	10.4	9.6	12.3	11.0	13.4	14.4
LPBs	9.2	9.5	9.7	9.0	10.1	10.4
FBs	18.0	18.6	23.2	23.0	17.4	17.2
Comm. Banks	11.4	11.3	12.6	11.1	11.4	11.8
SBs	(3.3)	(13.9)	(31.7)	(28.2)	(9.0)	(14.4)
All banks	9.7	8.8	8.8	8.5	10.5	10.7
Tier 1 Capital to RWA						
PSCBs	7.7	7.1	8.6	8.2	8.6	9.2
LPBs	8.1	8.4	6.6	7.1	7.5	7.8
FBs	17.9	18.6	23.0	23.0	17.1	16.8
Comm. Banks	9.8	9.7	9.7	9.1	8.6	8.9
SBs	(3.4)	(13.9)	(31.7)	(28.7)	(15.0)	(20.2)
All banks	8.3	7.3	6.2	6.5	7.6	7.7
Capital to Total Assets						
PSCBs	4.6	3.7	5.6	6.1	8.2	9.3
LPBs	3.5	3.8	5.2	5.1	6.5	6.6
FBs	8.8	8.5	10.6	10.0	9.0	8.9
Comm. Banks	4.9	4.6	6.1	6.0	7.1	7.4
SBs	(1.1)	(10.3)	(23.0)	(9.5)	(11.3)	(13.5)
All banks	4.6	3.8	4.8	5.4	6.5	6.7
Capital (Free of net NPLs) to Total Assets						
PSCBs	(1.1)	(2.2)	0.9	3.1	6.8	7.7
LPBs	(1.9)	(1.0)	2.4	3.2	4.9	5.2
FBs	8.0	8.0	10.1	9.6	9.0	9.0
Comm. Banks	0.2	(0.0)	2.8	3.9	5.8	6.1
SBs	(25.5)	(34.4)	(44.5)	(30.9)	(27.6)	(24.3)
All banks	(1.4)	(1.9)	0.7	2.5	4.6	5.2

[3] For a well-capitalized bank the capital adequacy ratio should be above 10%, tier 1 capital to RWA ratio and capital to total assets ratio should be above 5%.

As regards the impact of asset quality on the solvency position of the banking system, the adjusted capital to total assets ratio[4], which measures the capacity of the capital to absorb the maximum possible loss from uncovered portion of NPLs, shows the diminishing threat from the NPLs. The ratio of the banking system, which used to be in red till CY01, improved to 5.2 percent in Mar-05 as compared to generally accepted benchmark of upto 1.5 percent. This is largely the result of declining non performing loans coupled with enhanced provisioning thereagainst and the capital strengthening led by the enhanced regulatory requirements.

The group-wise position of the CAR shows that the major improvement was recorded by PSCBs, followed by LPBs. However, the CAR of FBs is consistently declining since 2003 given the fact that they are expanding their business at much faster pace compared to the capital. Despite this, the CAR of the FBs is still the highest amongst all groups as they are already quite comfortable at expanding their business in the presence of ample support from their strong capital base. This ratio of SBs, however, deteriorated due to loss sustained by one of them.

The size-wise groups of banks show mixed picture (see **Table 3.1.2**). The top 5 and 20 banks made improvement in their solvency indicators, while top 10 banks experienced slight decline over the CY04. This shows that next 5 largest banks, which were growing rapidly, expanded their asset base greater than their capital during this quarter. The ratios of all the three groups, however, are not only well above the internationally accepted benchmark but also above the industry average. On the face of it, the small banks appear to have relatively low capital adequacy ratio. A deeper analysis, however, shows that the lower ratio of small banks is simply because of one undercapitalized bank.

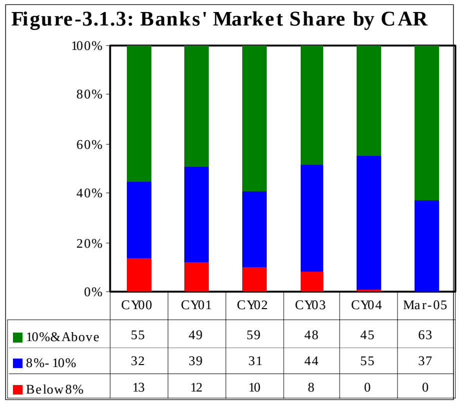
Table 3.1.2 Capital Adequacy Indicators of Top Banks in terms of Size

(Percent)	Capital/RWA		Tier 1 Capital / RWA		Net Worth / Total Assets	
	Dec-04	Mar-05	Dec-04	Mar-05	Dec-04	Mar-05
Top 5	10.3	10.9	6.6	7.1	6.6	6.9
Top 10	11.6	11.2	8.1	7.9	7.1	7.0
Top 20	11.3	11.6	8.2	8.5	6.9	7.2

Table 3.1.3 Distribution of Banks by CAR

	Total	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
CY04	38	1	13	9	15
Mar-05	38	1	10	11	16

Figure-3.1.3: Banks' Market Share by CAR



On individual basis, most of the banks improved their capital adequacy ratio. This is manifested by the distribution of banks by CAR (see **Table 3.1.3**). While the undercapitalized bank remained 1, the banks moved from lower bands to higher. Accordingly, the market share of well capitalized banks (with capital adequacy ratio of above 10 percent) increased to 63

[4] Capital less net NPLs to total assets

percent from 45 percent in CY04 (see **Figure- 3.1.3**). The share of undercapitalized bank is less than 1 percent. As regards the adjusted capital to total assets ratio, there are only two banks with less than 1.5 percent ratio. With the positive outlook of profitability, the solvency position of the banking system is expected to improve further in the coming days.

3.2 Profitability

The first quarter of CY05 further strengthened the last year's trend of strong profits, as the net interest income registered significant growth. This quarter's incomes were evenly supported by increased returns and volume expansion. Fee based incomes also showed improvement and profit margins were helped by controlled growth in operating expenses and lower loan loss charges.

Table 3.2.1 Profitability of Banking System

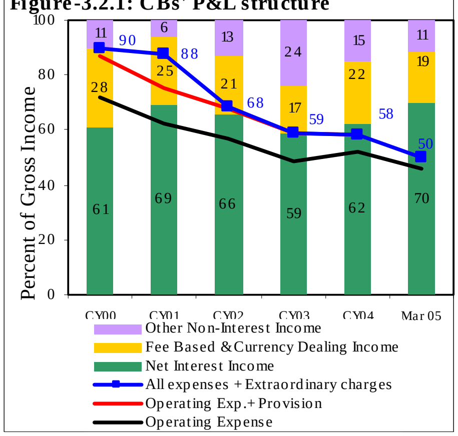
(Billion Rs)	CY00	CY01	CY02	CY03	CY04	Mar-05
Profit before tax						
PSCBs	3.9	0.2	10.9	16.1	14.3	3.8
LPBs	(0.6)	5.0	11.9	23.8	30.7	12.4
FBs	3.7	5.0	6.6	7.4	7.2	2.1
Comm. Banks	7.0	10.3	29.4	47.4	52.1	18.3
SBs	(2.5)	(9.2)	(10.4)	(3.3)	(2.6)	(2.1)
All Banks	4.5	1.1	19.0	44.1	49.6	16.2
Profit after tax						
PSCBs	1.8	(4.6)	4.8	9.4	8.0	2.4
LPBs	(3.5)	2.0	6.4	14.8	21.7	8.2
FBs	1.4	2.4	4.2	4.6	5.8	1.4
Comm. Banks	(0.2)	(0.2)	15.3	28.7	35.5	12.0
SBs	(2.6)	(9.5)	(12.4)	(3.7)	(2.6)	(2.1)
All Banks	(2.8)	(9.8)	2.9	25.1	32.9	9.9

Table 3.2.2 Profitability Indicators

(Percent)	CY00	CY01	CY02	CY03	CY04	Mar-05
After Tax ROA						
PSCBs	0.2	-0.5	0.6	1.0	1.3	1.5
LPBs	-0.7	0.4	0.8	1.4	1.2	1.6
FBs	0.6	0.8	1.5	1.5	2.0	1.8
CBs	-0.01	-0.01	0.8	1.2	1.3	1.6
SBs	-2.3	-8.8	-12.1	-3.2	-2.6	-7.8
All Banks	-0.2	-0.5	0.1	1.1	1.2	1.3
After Tax ROE *(based on Equity plus Surplus on Revaluation)*						
PSCBs	4.9	-12.2	11.5	17.3	18.0	18.6
LPBs	-17.4	10.3	17.3	26.2	20.1	24.8
FBs	6.1	9.1	15.2	14.9	21.7	20.1
CBs	-0.3	-0.3	14.3	20.5	19.8	22.7
SBs	-	-	-	-	-	-
All Banks	-3.5	-12.6	3.2	20.5	19.5	19.7

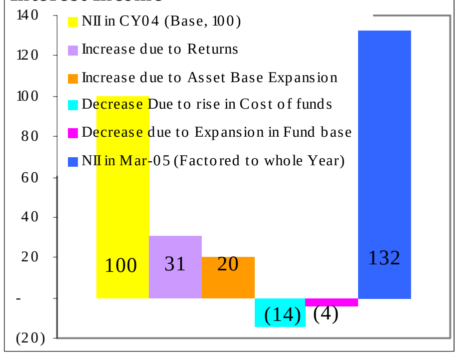
Consolidated results for the quarter show that commercial banks posted after tax profit of Rs 12.0 billion that amounts to 34 percent of last year's figure. Accordingly, their ROA improved to 1.6 percent and ROE to 22.7 percent (see **Tables 3.2.1 & 3.2.2**). These results appear even more conspicuous when compared with the results in the corresponding period of the last year - an 80 percent growth in the bottom line. The overall strengthening in earning position is apparent from **Figure-3.2.1**. Net interest income not only covers all charges but also leaves sufficient margins, which are strongly augmented by well diversified and stable non-interest income.

Figure-3.2.1: CBs' P&L structure



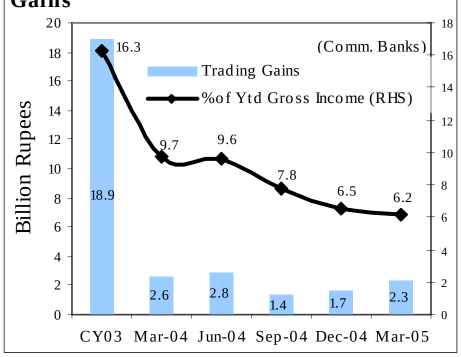
The banking system had achieved a high-yield, loan-dominated asset-mix by the end of last year. During the quarter under review, the asset mix got further enriched and the lending rates maintained their rising trend. As a result, the interest income posted higher-than-proportional growth i.e. 34 percent of CY04's whole year income. The rising deposit rates had their impact on the interest expense which grew at slightly faster pace. And the net interest income for the quarter reached to 33 percent of last year's level. Detailed analysis of this more than proportionate growth in net interest income shows that major contributing factors were improved returns on loans and expansion in the asset base, while expansion in fund base and rise in costs thereon marginally offset the increase in the net interest income (see **Figure-3.2.2**).

Figure-3.2.2: Sources of Expansion in Net Interest Income



Net interest income was adequately supported by non-interest incomes, which, though, grew at slightly slower pace during the quarter (24 percent of last year's level). Of these incomes, fee-based income performed better, at 26.4 percent of last year's level, as the active business activity maintained the demand for banks' fee earning services. Since this was the first quarter of the year with a few corporates finalizing their accounts, the dividend income squeezed significantly. Though trading gains maintained their steam (28 percent of last year's level), their share in overall gross income remained low, contributing 6.2 percent of total gross income. Growth in these trading gains has been showing a patterned expansion since the end of CY03, a year marked with exceptional gains (see **Figure-3.2.3**). However, the gains in the recent quarters are mainly emanating from trading in equity instruments, as the rising trend in interest rates has significantly dampened the potential for gains on fixed income securities.

Figure-3.2.3: Periodic Growth in Trading Gains



In the wake of a general strategy of expansion in the industry, operating expenses for the quarter represented 26 percent of last year's level. However, due to even stronger growth in income, cost income ratio improved to 44.8 percent (51.8 percent in CY04). Banks have been quite successful in not only stemming the flow of fresh non-performing loans; their efforts to reduce the level of existing NPLs have also been promising. Consequently, the charges for loan provision are on the decline. During the quarter under review also these charges remained low, consuming 4.1 percent of the commercial banks' year-to-date gross income.

Group-wise position shows that LPBs holding around 70 percent of market share contributed accordingly to the system's profits. They were followed by PSCBs, while

FBs were showing the strongest efficiency in terms of returns on the assets employed. But SBs mainly due to high loan loss charges posted negative results.

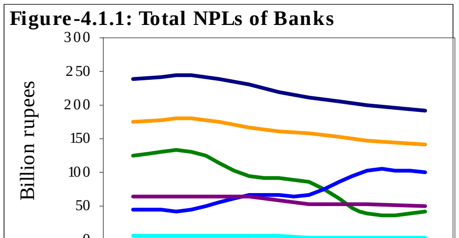
Strong results for the first quarter suggest that the system is all set to achieve the unprecedented profits this year. A high-yield asset-mix that is likely to get further enriched in the latter quarters with the pick up in economic activity, strong support from non-interest income and improving asset quality indicators support this assertion. However, this should not go without caveat, that is, hazard of deterioration in lending portfolio. The hazard demands an extra caution on the part of banks, though they are focusing considerable efforts to improve their risk management practices, which have already come a long way in the recent years. Besides, the banks might need to revisit their policy for loan loss provisioning so as to build sufficient cushions for countering cyclical patterns of economy.

4. Risk Assessment of the Banking System

4.1 Credit Risk

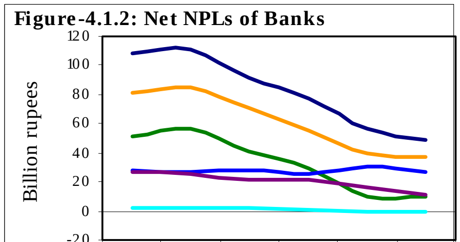
In the face of rapid increase in loans in recent quarters, the banking system has managed its credit risk quite successfully. This is evident by persistent decline in NPLs despite the fast growth in loans. The same trend persisted during the current quarter. While loans increased by Rs85 billion, NPLs of the banking system declined by Rs7.9 billion; a decline of 3.9 percent (see **Figure-4.1.1 & 4.1.2**). No doubt, the major portion of the decline owes a great deal to one of the specialized banks because of the cyclical pattern of its NPLs portfolio, the fall of Rs3.3 billion in the NPLs of commercial banks is a good reflection of their strengthened credit appraisal and monitoring systems. This decline in NPLs is even more significant considering the gradual rise in lending rates in recent months.

Figure-4.1.1: Total NPLs of Banks



	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	125.2	129.6	95.5	85.9	40.1	41.3
LPBs	43.4	45.7	66.9	67.4	103.4	99.1
FBs	6.5	6.1	5.2	4.0	2.5	2.4
CBs	175.1	181.4	167.6	157.2	146.1	142.8
SBs	65.0	62.7	63.9	54.1	53.7	49.1
All	240.1	244.1	231.5	211.3	199.8	191.9

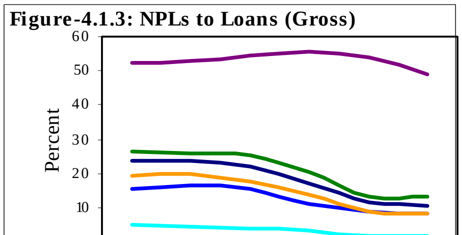
Figure-4.1.2: Net NPLs of Banks



	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	51.1	56.2	41.0	29.4	9.2	10.2
LPBs	27.4	27.2	27.7	25.1	30.8	27.2
FBs	2.2	1.6	1.4	0.9	0.0	-0.2
CBs	80.8	85.0	70.1	55.4	40.0	37.2
SBs	27.2	25.6	21.2	21.2	16.8	10.9
All	108.0	110.5	91.3	76.7	56.8	48.2

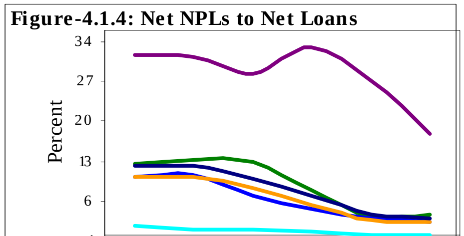
The falling NPLs as well as the growing loans had a salutary impact upon the key indicators of the banking system; the ratio of NPLs to loans declined to 10.6 percent from 11.6 percent in CY04 whereas the ratio of net NPLs to net loans fell to 2.9 percent from 3.6 percent in CY04. For commercial banks, these ratios give even

Figure-4.1.3: NPLs to Loans (Gross)



	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	26.3	25.9	25.5	20.4	13.3	13.2
LPBs	15.4	16.3	15.4	11.3	9.0	8.1
FBs	4.7	4.3	3.8	3.1	1.6	1.4
CBs	19.5	19.6	17.7	13.7	9.0	8.4
SBs	52.4	53.0	54.7	55.6	54.1	49.2
All	23.5	23.4	21.8	17.0	11.6	10.6

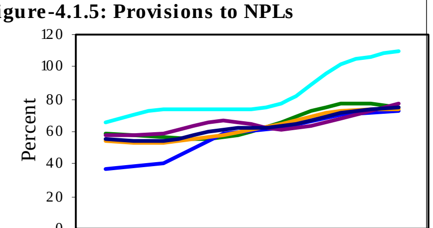
Figure-4.1.4: Net NPLs to Net Loans



	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	12.7	13.1	12.8	8.1	3.4	3.6
LPBs	10.3	10.4	7.0	4.5	2.8	2.4
FBs	1.7	1.1	1.1	0.7	(0.0)	(0.1)
CBs	10.1	10.3	8.3	5.3	2.6	2.3
SBs	31.6	31.5	28.5	33.0	27.0	17.7
All	12.2	12.1	9.9	6.9	3.6	2.9

better reading (see Figures **4.1.3 & 4.1.4**). The improvement in the ratio of net NPLs to net loans was mainly the result of decrease in NPLs as no significant addition to the provisions was seen during the quarter. For the same reason the NPLs coverage ratio increased by 3.3 percentage points (see **Figure-4.1.5**). The ratio is expected to further improve given the strong profitability indicators and the likelihood that banks would provide for their bad portfolio in this relatively benign period to make up for any stress on credit quality in future.

Figure-4.1.5: Provisions to NPLs



	CY00	CY01	CY02	CY03	CY04	Mar-05
PSCBs	59.2	56.6	57.1	65.8	77.0	75.3
LPBs	36.9	40.5	58.6	62.7	70.2	72.5
FBs	65.9	74.1	73.3	77.4	101.9	109.3
CBs	53.9	53.2	58.2	64.7	72.7	73.9
SBs	58.1	59.2	66.9	60.8	68.6	77.8
All	55.0	54.7	60.6	63.7	71.6	74.9

The group-wise analysis shows LPBs recorded the highest reduction in their NPLs by Rs4.3 billion and net NPLs by Rs3.6 billion. This naturally had a positive influence on the ratios of NPLs to loans and net NPLs to net loans of this group, which improved by 0.9 and 0.4 percentage points respectively. As LPBs hold the largest pie of the NPLs, the persistent improvement in their asset quality is a good omen for the overall financial stability. Foreign banks, which account for merely 1.3 percent of the infected portfolio of all banks, have been consistent in improving their asset quality. They further reduced their NPLs during the quarter. An important feature of the asset quality of FBs is that they have fully provided for their NPLs, hence no threat to their capital from NPLs. PSCBs experienced a slight increase of Rs1.2 billion over the previous quarter.

A time series analysis of the ratios of NPLs to loans and net NPLs to net loans reveals that net NPLs to net loans ratio for all the banking groups (discounting the effect of category shift of HBL and UBL from PSCBs to LPBs) experienced a sharper decline than gross NPLs to gross loans ratio mainly because of banks making more provisions for their bad loans. What the banks now need is to maintain the health of their existing good portfolio by introducing and adopting better risk management practices and clean up their balance sheets of the chronically bad portfolio either through write-offs or through concerted recovery drives which will further strengthen their balance sheets.

Table 4.1 Segmentwise Infection of Loans Portfolio as of 31-03-05

(Domestic Operations) (Rs In Billions)

Sector	Amount Outstanding	Share %	NPLs	Share	NPLs as % of Outstanding
Corporate	924.4	54.1%	91.8	53.2%	9.9%
SMEs	294.8	17.2%	29.8	17.3%	10.1%
Agriculture	124.5	7.3%	42.8	24.8%	34.3%
Consumers	177.1	10.4%	1.4	0.8%	0.8%
Credit Cards	*15.5*	*0.9%*	*0.2*	*0.1%*	*1.5%*
Auto Loans	*57.2*	*3.3%*	*0.4*	*0.3%*	*0.8%*
Consumer Durables	*1.6*	*0.1%*	*0.1*	*0.1%*	*6.4%*
Mortgage Loans	*21.7*	*1.3%*	*0.1*	*0.0%*	*0.3%*
Others	*81.2*	*4.8%*	*0.5*	*0.3%*	*0.6%*
Commodity Finance	111.6	6.5%	1.4	0.8%	1.3%
Staff Loans	41.1	2.4%	0.6	0.3%	1.4%
Others	36.1	2.1%	4.8	2.8%	13.4%
Total	**1,709.7**	**100.0%**	**172.6**	**100.0%**	**10.1%**

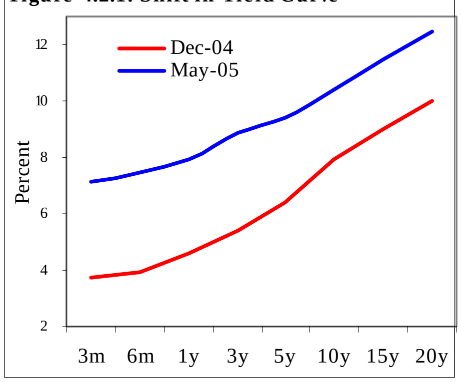
Compared with the sector-wise breakup as of Dec-04, the share of corporate sector in overall domestic loans and NPLs slightly inched up by 20 basis points each. However, the infection ratio displayed an improvement of 1.0 percentage point (see **Table 4.1**). Similarly, other sectors also showed improvement in asset quality resulting in reduction of 1 percentage point in the overall NPLs to loans ratio. SMEs and Consumers sectors have so far not shown any deterioration in their asset quality as for both the sectors ratio of NPLs to total loans has come down over the quarter. Anyhow, the rising interest rate scenario and inflationary pressures in the economy, which by impairing the repayment capacity of the household and SMEs sector particularly, may create stressful conditions for asset quality of these sectors. So the banks need to be extra careful in appraising the borrowers. The agriculture sector also continued to improve its performance as its loans infection ratio further declined by 3.9 percentage points from 38.2 percent as of last quarter on account of both increase in outstanding loans to this sector and reduction in NPLs.

The banking system, no doubt, has succeeded not only in containing the credit risk but has also managed to reduce its NPLs quite significantly in recent times. However, the achievement on this front should not allow complacency to creep in and banks will have to keep aloft their credit appraisal standards as well as to ensure strict monitoring to minimize the chances of default in distress-like conditions.

4.2 Market Risk

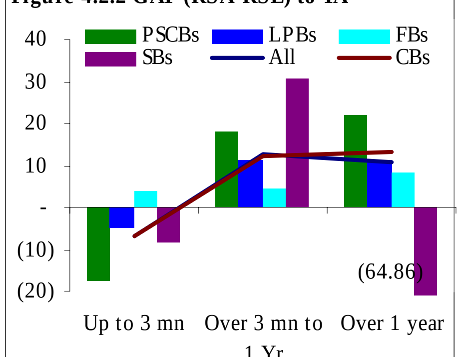
Though SBP has been finding a balance between the tightening of monetary policy to check inflationary pressures and pursuing gradual rise in interest rates so as to preserve the growth momentum since CY04, it allowed significant rise in interest rates during the first five months of CY05 (see **Figure-4.2.1**). This rise in interest rates naturally adds to the market risk especially for banks with large chunk of fixed income long-term securities.

Figure-4.2.1: Shift in Yield Curve



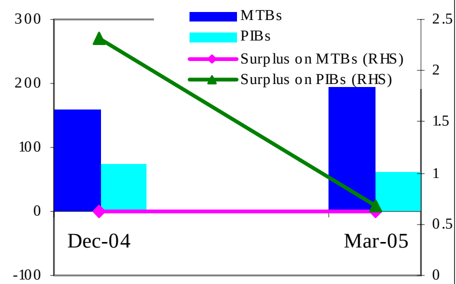
This rise in interest rate generates interest rate risk by changing the underlying value of assets and liabilities and thus deteriorating the present values of cash flows. So the banks with significant liability sensitive mismatches happen to be more susceptible to this ***repricing risk***. **Figure-4.2.2** reveals that though the banking system as a whole is maintaining a somewhat balanced repricing schedule, a few groups are holding moderate to high exposure in

Figure 4.2.2 GAP (RSA-RSL) to TA



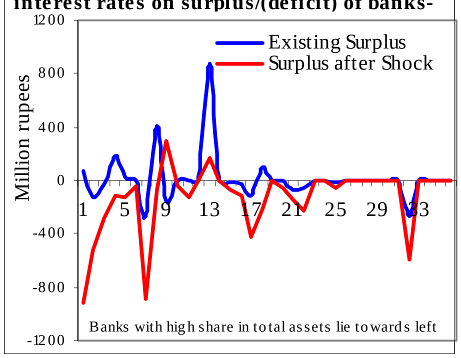
longer time buckets. The impact of repricing risk exacerbates by the ***yield curve risk*** i.e. unparallel shift in the interest rates over different tenors, particularly the increase for longer tenors leads to greater fall in economic value of equity of the banks with large liability sensitive positions. The term structure since Dec-04 has actually flattened as SBP allowed greater rise in shorter tenors. Such unparallel shift in the yield curve though may not have that strong impact on the overall economic value of banks, it has bearings on the current period's income statements.

Figure 4.2.3 PIBs* and MTBs* Vs Revaluation Surplus/(Deficit) (Billion Rs.)



* Only those which are subject to mark-to-market

Figure-4.2.4: Impact of 2%age point rise in interest rates on surplus/(deficit) of banks-



In the Pakistani scenario where lending portfolio does not have readily available resale market, it is only the fixed income securities that are revalued to the changes in yield cure. With each rise in yield curve value of such securities comes down and this decline is greater for the longer-term securities. During the quarter banks made a significant shift away from the PIBs (14 percent reduction) to MTBs (23 percent increase) so as to curb the rising revaluation losses on the former. Of the total holdings of PIBs, around 63 percent lie in held-to-maturity (HTM) category, which are not subject to revaluation but are the source of embedded losses. The banks have been compromising on lower returns on this portfolio, and every rise in the rates on funds squeezes the margins. As regards the available-for-sale (AFS) portfolio, an already slender surplus on PIBs has further squeezed by the end of the quarter (see **Figure-4.2.3**). There was also a concomitant decline in the price sensitivity i.e. weighted average Macaulay's duration which came down to 0.59 for MTBs and 4.41 for PIBs from 0.88 and 4.52 respectively in Dec-04. But the system remains susceptible to further rise in interest rates that would turn the system's surplus into deficit with varying impact on the position of individual banks (see **Figure-4.2.4**).

As for ***exchange rate risk***, the current account deficit, which was mainly driven by the extraordinary increase in imports, took its toll on the exchange rate. However, the rupee witnessed contained depreciation since SBP was there to meet the demand for dollars in the market. Swap points have remained positive for the quarter (see **Figure-**

4.2.5). Since the banks are holding foreign currency assets in excess of foreign currency liabilities, the depreciation in rupee value bears positive impact on the banks' profitability. The Net Open Position (NOP) of the banks also remained positive.

Equity price risk of the banking system has somewhat increased in March-05. During the quarter under review, the absolute investment in shares[5] rose to Rs29 billion from Rs25 billion in Dec-04 (see **Figure-4.2.6**). Resultantly, the overall exposure of banking system in equities increased to 13.9 percent from 12.7 percent in terms of its capital, despite the strengthening of the overall capital base. The investment in equities as percentage of total investment has also gone up, though slightly, to 4 percent from 3.7 percent in Dec-04.

The increase in these investments is mainly because of the LPBs, carrying the highest exposure amongst all groups. For the remaining groups, the exposure remained intact to some extent. Bank-wise, a few banks are carrying quite high exposures in equities[6] (see **Figure-4.2.7**). Their exposure in terms of capital stands as high as more than 100 percent of their capital; however, their market share in the banking system is not very significant. Though any move on part of these banks to rationalize their high exposure is expected to bring the high exposure of the LPBs down.

Figure-4.2.5: Rs/$ Swap Points

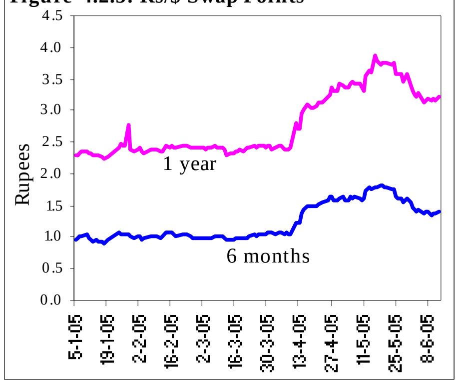
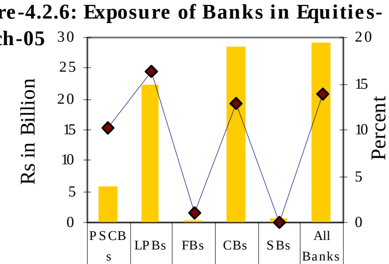
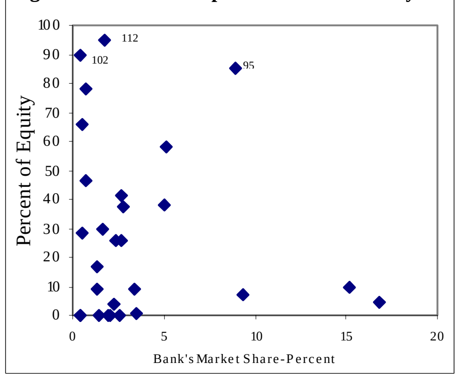


Figure-4.2.6: Exposure of Banks in Equities-March-05



	PSCBs	LPBs	FBs	CBs	SBs	All Banks
Actual Exposure	5.9	22.2	0.3	28.5	0.6	29.0
Exposure to Capital (RHS)	10.2	16.4	1.1	12.8	0.0	13.9

Figure-4.2.7:Total Exposure of Banks-May-05



---

[5] Market value of investment in shares (other than investment in subsidiaries and associated undertakings)

[6] The exposure includes investment in shares at cost, badla financings and others as of May, 2005

In order to check the resilience of the banking system towards fluctuation in the value of these investment holdings, the market value of equities investment of the banks has been discounted by 20 percent. The surplus of the LPBs shall fall short of the expected decline in the value of these investments at the assumed shock rate (see **Figure-4.2.8**). On a bank-wise basis, 8 banks are already carrying deficit; however, 16 more banks shall have their surplus converted into deficit at the given shock rate. Resultantly, the capital adequacy position of the banks shall be affected, though slightly. Two banks shall move to the lower capital adequacy brackets (see **Figure-4.2.9**). Keeping in view the high exposure in equities of a few banks and the volatile nature of the stock market, it is necessary for the banks to rationalize their exposures in equities, both direct and indirect.

Figure-4.2.8: Impact of Adverse Movement of KSE-Index by 20 Percent

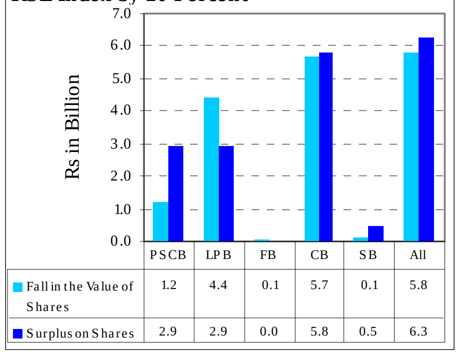
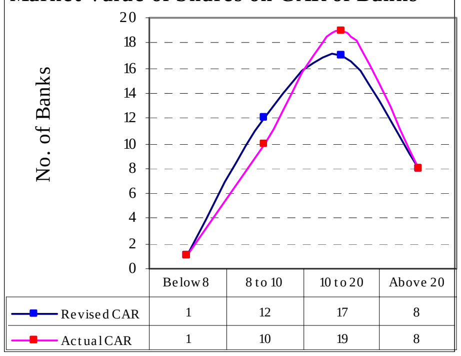


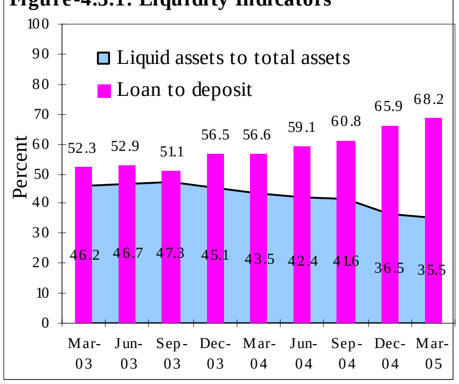
Figure-4.2.9: Impact of 20 Percent Fall in Market Value of Shares on CAR of Banks



4.3 Liquidity Risk

The monetary response towards rising inflationary pressures has put strains on the liquidity of banks. The excessive credit demands further squeezed the liquidity cushion available with the banks. Moreover, negative external account balances continue to build pressures on dollar-based liquidity.

Figure-4.3.1: Liquidity Indicators



Of the key liquidity indicators, liquid assets to total asset ratio further dropped to 35.5 percent by the end of Mar-05 quarter (Dec-04: 36.5 percent). Loan to deposit ratio surged to 68.2 percent (Dec-04: 65.9 percent) (see **Figure-4.3.1**). The loan to deposit ratio adjusted for export refinance also moved up to 63.8

percent from 61.6 percent in CY04. The liquid assets held in excess of the required liquid assets have reduced significantly.

The successive upward moves in the yields of Market Treasury Bills (MTBs) continue to reduce the difference between the benchmark discount rate and the market rates. The restoration of discount rate to 9 percent in April-05 was not an unanticipated move, as the MTBs auction had witnessed a significant rise in the interest rates (see **Figure-4.3.2**). This rise in the discount rate signals the tighter monetary policy stance of SBP. The momentous increases in the interest rates coupled with the frequent liquidity mop ups by SBP has drained much of the interbank liquidity leaving the banks to resort to SBP discount window to meet their liquidity requirements (see **Figure-4.3.3**). All this put significant pressure on the *market based liquidity*. Moreover, since the banks have less than 1 percent of their total fixed income securities in the held-for-trading (HFT) portfolio, the secondary market bid ask spreads of the securities continue to widen.

Figure-4.3.2: Yield on 3-months MTBs Vs Discount Rate

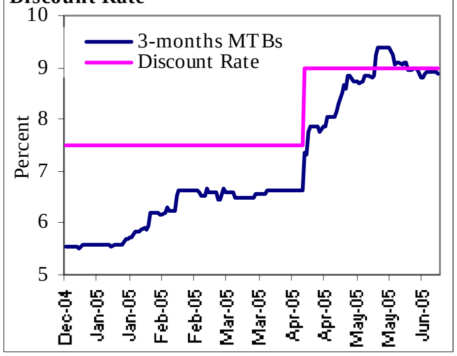
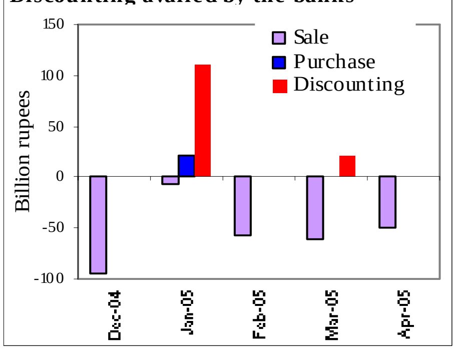
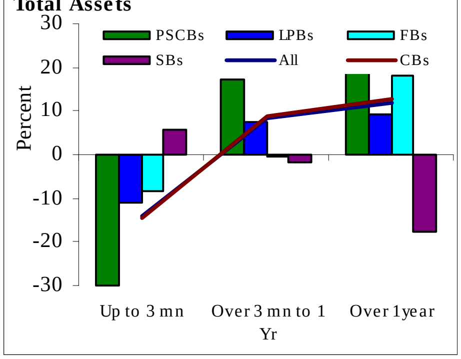


Figure 4.3.3 OMOs by SBP Vs Discounting availed by the banks



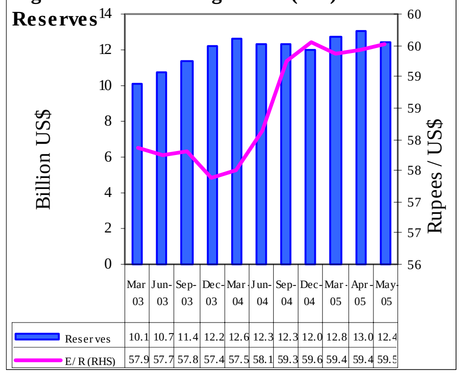
The maturity profile of the assets and liabilities at the end of the quarter under review shows that the banks are also exposed to *funding liquidity risk* since the liabilities maturing in the three months bucket far exceed the assets maturing in the same time bucket (see **Figure-4.3.4**). Though for the long term buckets the banks are running positive GAPs since more of the assets are of long-term maturity, the squeezed market based liquidity may become unable to provide sufficient liquidity cushion. Group wise, PSCBs are more prone to this risk since their GAPs in terms of total assets are significantly high.

Figure 4.3.4 GAP (Assets - Liabilities) To Total Assets



With regard to the dollar-based liquidity, the increasing demands for dollar to meet the requirements of importers continue to put pressure on rupee for this quarter too. Since the systematic interventions of the SBP provided much of the support to the rupee against dollar, the depreciation in Rs/$ exchange rate was not so pronounced. The external account inflows pushed the reserves up in April-05 adding to the dollar based liquidity, and the Rs/$ exchange rate witnessed little appreciation to Rupees 59.36 from Rupees 59.55 in Dec-04 (see **Figure-4.3.5**). However, for onwards, the rupee again showed little depreciation and kerb premiums continue to rise. By the end of May05, though the banks have sufficient foreign exchange reserves to meet the demands of the importers, however, if the trade deficit further rises, the banks may face squeezed dollar liquidity to meet the growing demand.

Figure-4.3.5: Exchange Rate (E/R) Vs Forex Reserves



5. Performance of Islamic Banking

Islamic banking has started the CY05 on a very positive note. With the licensing of one more Islamic bank viz. Bank Islami Pakistan Limited[7] during the quarter under review, the number of full-fledged Islamic banks increased to three. At the same time, the branch network of the existing Islamic banking participants has now increased to 54 as against 48 in Dec-04. Both, the Islamic banks and the conventional banks operating through Islamic Banking Branches (IBBs) contributed towards this enhanced outreach. The IBBs of Bank Al Habib and Habib Bank Limited started operations during this quarter, while IBB of Soneri Bank had started operations on 31st December, 2004. Given the increase in branch network, the overall balance sheet footing of the Islamic Banking System (IBS) has registered expansion, whereby the full-fledged Islamic banks continue to hold major chunk of the asset base. The total assets now stand at Rs50.2 billion after recording a growth of 13.6 percent from Dec-04 **(**see **Table 5.1)**. As a result of this growth, the share of IBS in the overall banking system has slightly increased to 1.6 percent in Mar-05 from 1.5 percent in Dec-04.

Table 5.1: Sources and Uses of Funds

(Million rupees)	Dec-04		Mar-05	
SOURCES:	Amount	Percent	Amount	Percent
Deposits	30,184.8	68.4	33,266.0	66.3
Borrowings	6,559.1	14.9	6,820.5	13.6
Capital & other funds	5,123.1	11.6	5,761.3	11.5
Other liabilities	2,276.1	5.1	4,319.8	8.6
	44,143.0	**100.0**	**50,167.6**	**100.0**
USES:				
Financing	27,535.5	62.4	32,202.6	64.2
Investments	2,007.0	4.5	2,236.1	4.5
Cash, bank balances, placements	11,899.7	27.0	13,211.6	26.3
Other assets	2,700.8	6.1	2,517.2	5.0
	44,143.0	**100.0**	**50,167.6**	**100.0**

A detailed analysis of the sources and uses of funds shows that the deposits for Mar-05 at Rs33.3 billion continue to provide main support to the expansion in business. Though the share of deposits has somewhat declined, still they dominate the sources of funds. The asset composition reflects some reshuffling during the quarter. Most of the funds were utilized to enhance the core business of the IBS, as reflected from the further increase in the share of financings. Investments have increased in absolute terms, though their share in the assets remained intact. While the IBS already had strong asset quality, they made further improvement on this front during the quarter under review. Enhanced share of financings and contained credit risk together have brought down the already low infection ratios **(**see **Table 5.2)**. The non-performing financings (NPFs) to total financings and net NPFs to net financings have come down during the quarter from their already low levels. Enhanced provisioning also helped the IBS in keeping these ratios to the minimum. Given the strong asset quality indicators and adequate support from the capital, the Islamic banking system is at much comfort to expand its business in future.

Table 5.2 Key Performance Indicators

	Dec-04	Mar-05
NPFs to total financing	0.9%	0.8%
Net NPFs to net financing	0.2%	0.0%
Provision to NPFs	82.3%	97.3%
Net Markup Income to total assets	1.4%	2.4%
Non Markup Income to total assets	1.4%	2.2%
Operating Expense to Gross Income	65.3%	52.3%
ROA (average assets)	1.2%	1.6%

[7] The bank is expected to start its operations by the end CY05.

Product-wise break-up of financings shows the predominance of Murabaha and Ijarah at 81 percent of the total financings **(**see **Figure-5.1)**; while the break up of deposits reflects the savings deposits carrying the highest share **(**see **Figure-5.2)**. On the liquidity front, as most of the funds were routed to the financings side, the cash and bank balances reduced in terms of their share in total assets. However, the liquidity maintained by the Islamic banks and Islamic banking branches is well above the statutory requirements.

The expansion in business of the IBS, as reflected from the growth in financings, has paid off during the quarter. The profitability indicators show noticeable improvement from the last year. During the quarter, the quality of income has also improved as the reliance on core income has increased, whereas the overall strengthening of the Profit & Loss statement is well reflected by **Figure-5.3**. All income heads stand at more than 40 percent of last year's level (see **Table 5.3**). Although the provisioning and operating expenses also increased, stronger growth in income has rationalized these expenses in relative terms and the operating expenses now stand at 52.3 percent of gross income i.e. well within the generally accepted level of 60 percent. As a result the overall profits after tax stood at Rs192 million representing 56 percent of the CY04 profits and the return on average assets improved to 1.6 percent (annualized) from 1.2 percent in CY04. Given the pace of profit growth, the indicators are likely to improve further in the coming quarters.

Figure-5.1: Breakup of Financings- March-05

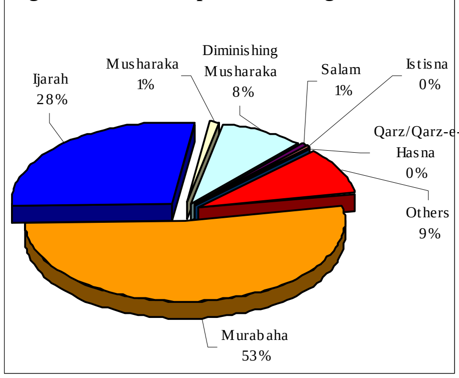


Figure-5.2: Breakup of Deposits- March-05

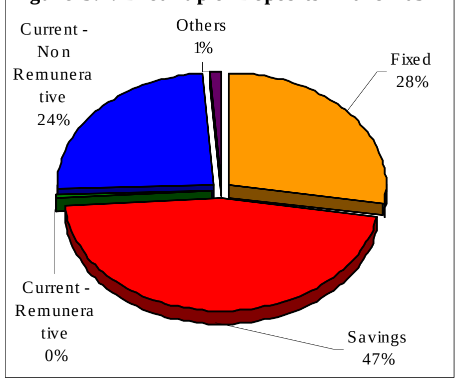


Figure-5.3: P&L Structure of Islamic Banking

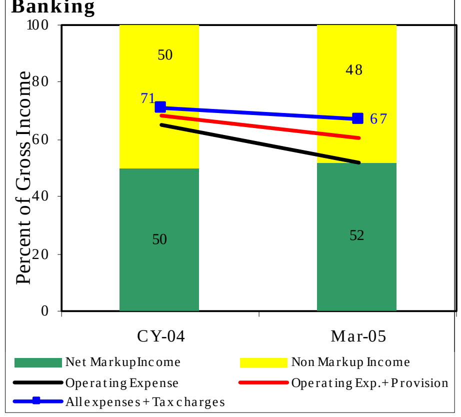


Table5.3 Profit & Loss Statement

(Million rupees)	Dec-04		Mar-05	
	Amount	Percent	Amount	Percent
Markup Income	1,081.0	100.0	525.8	100.0
Markup Expense	483.7	44.8	227.1	43.2
Net Markup Income	597.2	55.2	298.7	56.8
Provision Expense	(35.8)	3.3	(47.7)	-9.1
Non Markup Income	596.0	55.1	279.6	53.2
Operating Expense	(779.2)	72.1	(302.2)	-57.5
Profit Before Tax	378.2	35.0	228.4	43.4
Tax	(36.2)	3.4	(36.3)	-6.9
Profit After Tax	342.0	31.6	192.1	36.5

The future outlook for the Islamic banking system is quite promising in the backdrop of increase in the number of Islamic banking participants, expansion in the overall asset base, strengthening profitability indicators and contained credit and market risk. Further, 34 branches have been allowed to be opened as per Annual Branch Expansion Plan for the year 2005, which do not include new market players whose applications are under consideration. During the quarter, Dubai Islamic Bank has been granted in principle, approval to open an Islamic bank in Pakistan.

6. Assessment of "Stress tests" conducted on the Banking System

Stress tests, carried out on the pattern of FSAP methodology, depict the banking system as generally resilient to the historical and hypothetical shocks of both the univariate and multivariate types. The stress test exercise employs the macroprudential approach and focuses primarily on 12 largest commercial banks as well as three groups of commercial banks namely PSCBs, LPBs and FBs. The shocks have been calibrated in the light of different historical and hypothetical scenarios to measure the vulnerability in terms of deterioration in the quality of credit portfolio, exchange rate, interest rate, equity price movements and liquidity withdrawals. In addition to the risk scenarios used by the FSAP mission, this study takes into account some other risk scenarios as well.

The stress scenarios have been classified in three types of instantaneous shocks, including credit quality, market, and liquidity shocks (see **Box 6.1**).

Box 6.1
Reference Scenarios

Credit Risk

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

Scenario 2 assumes a shift in categories of classified loans (all loans classified as OAEM become substandard, all substandard loans become doubtful, and all doubtful loans become loss).

Scenario 3 assumes a 50 percent decline in the value of real estate collateral held by banks.

Scenario 4 assumes a cumulative impact of all shocks used in Scenarios 1, 2, and 3.

Scenario 5 refers to the NPLs to total loans ratio, which would wipe out capital (with a 50 percent provisioning rate for additional NPLs).

Market Risk: Interest Rate Risk

Scenario 6 assumes an increase in interest rates by 300 basis points.

Scenario 7 assumes an increase in interest rates of outlying maturities (by 100, 300, and 500 basis points)

Scenario 8 assumes a shift coupled with flattening of the yield curve by increasing 150,100 and 50 basis points in the outlying maturities respectively.

Scenario 9 assumes a shift coupled with steepening of the yield curve by increasing 50,100 and 150 basis points in the outlying maturities respectively

Market Risk: Exchange Rate Risk

Scenario 10 assumes a depreciation of ER by 25 percent (around double of the change in the monthly average PRS/US$ exchange rate (12.83) over the period from Jan 1994 to Dec 2003, in September 2000).

Scenario 11 is based on the hypothetical assumption of appreciation of rupee by 20 percent.

Scenario 12 assumes a 10 percent depreciation of the rupee and deterioration in the quality of 20 percent of unhedged foreign currency loans with 50 percent provisioning requirement.

Scenario 13 assumes a 10 percent depreciation of the rupee and deterioration in the quality of 50 percent of unhedged foreign currency loans with 100 percent provisioning requirement.

Market Risk: Equity Price Risk

Scenario 14 assumes the impact of a 20 percent fall in the index, based on largest percent change in the monthly Karachi Stock Exchange Index (KSE100 Index) over the period from Jan 2000 to Dec 2003, in May 2000 (19.2 percent), on the total direct and indirect exposure of banks on Stock Market-assuming equal percentage fall in the value of the overall exposure.

Scenario 15 assumes the impact with a 40 percent decline in the Stock Market Index.

Combined Credit and Market Risk

Scenario 16 assumes 10 percent increase in overall NPLs (100 percent provisions), depreciation in rupee by 25 percent, deterioration in the quality of 50 percent of unhedged FX loans (100 percent provisions), and an increase in rates of outlying maturities by 100, 300 and 500 basis points.

Scenario 17 assumes 10 percent increase in overall NPLs (100 percent provisions), depreciation in rupee by 25 percent, deterioration in the quality of 50 percent of unhedged FX loans (100 percent provisions), and an increase in rates of outlying maturities (by 100, 300 and 500 basis points) and a stock market crash by 40 percent.

Liquidity Risk

Scenario 18 assumes a 10 percent decline in the liquid liabilities.

Scenario 19 assumes a 20 percent decline in the liquid liabilities.

Calibration of Shocks

The results of the stress tests have been summarized in the (see **Box 6.2)**. For each type of stress scenario, the impact has been gauged in terms of solvency, the CAR of the banks. The impact has also been shown in terms of earnings and the estimated change in the gross income has been calculated in percentage terms.

Box 6.2

Results of "stress tests" of Pakistani Banking System, Mar-05

Single and multifactor sensitivity tests			*Loss as %ageof Gross Income (Factored to whole year)*	*%age Point Change in CAR*	*Revised CAR- After Shock*
Credit Shocks					
Scenario	1	Deterioration in the qualityof loan	(8.7)	(0.6)	11.1
Scenario	2	Shift in categories of classified loans	(3.3)	(0.2)	11.5
Scenario	3	Decline in the value of real estate collateral	(4.3)	(0.3)	11.5
Scenario	4	Cumulative impact of all shocks in 1,2 and 3	(18.3)	(1.4)	10.4
Scenario	5	Level of NPLs to loans ratio where capital wipes out i.e. 32.7 percent	(140.7)	(11.8)	0.0
Market Shocks; Interest Rate Shocks					
Scenario	6	Shift in the yield curve	(19.6)	(1.5)	10.3
Scenario	7	Shift and steepening of the yield curve (large shock)	(30.5)	(2.3)	9.5
Scenario	8	Shift & flattening of the yield curve	(3.8)	(0.3)	11.5
Scenario	9	Shift and steepening of the yield curve	(9.3)	(0.7)	11.1
Market Shocks; Exchange Rate Shocks					
Scenario	10	Depreciation of Rs/US$ exchnage rate (double of the historical high)	5.5	0.4	12.2
Scenario	11	Appreciation of Rs/US$ exchnage rate (hypothetical)	(4.4)	(0.3)	11.5
Scenario	12	Depreciation in ER along with deterioration of quality of FX Loans (50 % Provisioning)	(3.4)	(0.3)	11.5
Scenario	13	Depreciation in ER alongwith deterioration of quality of FX Loans (100 percent provisioning)	(25.7)	(1.9)	9.8
Market Shocks; Equity Price Shocks					
Scenario	14	Fall in the KSE index (historical high)	(5.6)	(0.4)	11.4
Scenario	15	Fall in the KSE index (hypothetical scenario)	(14.8)	(1.1)	10.7
Combined Credit and Market Shocks					
Scenario	16	Combines credit and market risk (1)	(33.3)	(2.5)	9.2
Scenario	17	Combines credit and market risk (2)	(56.8)	(4.4)	7.4
Liquidity Shocks					
Liquidity Coverage Ratio			***Actual***		***After Shock***
Scenario	18	Fall in the Liquid Liabilities (1)	38.0		31.1
Scenario	19	Fall in the Liquid Liabilities (2)	38.0		22.5

Note: The results are not adjusted for deferred tax benefit accruing on these losses

Analysis of the Results

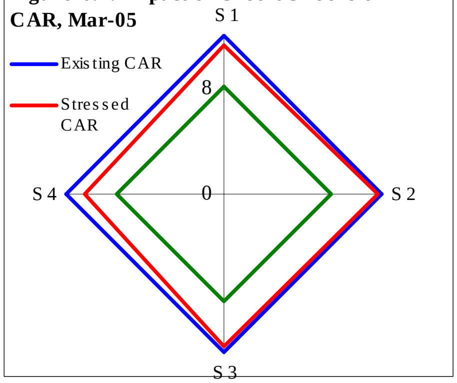
The results of the stress scenarios in three types of shocks, including credit quality, market, and liquidity shocks have been summarized as follows:

Credit Shocks

The banking system is showing strong resilience towards the different credit risk shocks. This resilience mainly emanates from the improved solvency position as reflected in strong capital adequacy ratios which are well above the required standard and adequate level of loan loss provisioning for lending portfolio which has been showing immunity to fresh infection.

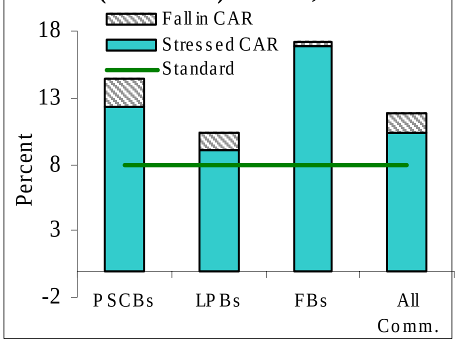
Of the different credit stress scenario identified for this exercise, scenario 1 (10 percent increase in NPLs requiring 100 percent provisioning) puts the highest strain on the banks capital adequacy ratio. However the intensity of this shock remains quite contained given the strong CAR as well as adequate provisioning against NPLs and surplus cushion available in the form of general provisions; the CAR lowers to 11.1 percent from 11.8 percent for all commercial banks. Since the lion share of banks' existing NPLs is lying in loss category, the downgrading of NPL categories (***scenari-2***) impairs the CAR by only 30 basis points to 11.5 percent. Banks are having low reliance on the value of mortgaged properties to meet the provisioning requirements. Therefore, their susceptibility to fall in value of the mortgaged property (***scenario-3***) is also low i.e. CAR falls to 11.5 percent from existing 11.8 percent. The combined effect of these three individual stresses (***scenario-4***) too has quite contained impact on the system's solvency ratio that comes down to 10.4 percent and stays well above the 8 percent standard (see **Figure-6.1).** The system is operating well within the limits of critical infection levels i.e. the level of NPLs to loans ratio that completely erodes the system's capital base – prevailing infection ratio of 8.4 percent vis-à-vis critical ratio, 32.7 percent (***scenario 5***).

Figure-6.1: Impact of Credit Shocks on CAR, Mar-05



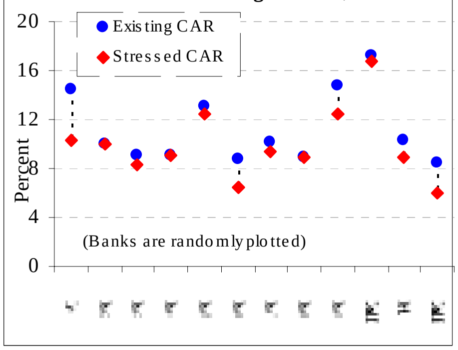
Mainly due to relatively lower CARs and high proportion of loan portfolio in their asset base, the local private banks show the highest sensitivity to credit risk shocks. However, the group maintains its solvency ratio above the minimum standard in all individual as well as combined credit shocks scenarios (i.e. scenario 1, 2, 3 and 4). Foreign Banks show the highest resilience, as they have the strongest CAR and provisioning coverage (see **Figure-6.2**).

Figure-6.2: Combined Impact of Credit Shocks (Scenario-4) on CAR, Mar-05



Bank-wise analysis of the twelve large banks, which are strategically significant for the system's stability shows that ten of these banks preserve their CARs above the 8 percent standard in individual as well as combined scenario. The CAR of the two banks would fall below the 8 percent standard under scenario 4, which captures the combined impact of the three individual credit shocks (see **Figure-6.3**).

Figure-6.3: Combined Impact of Credit Shocks on CAR of 12 Large Banks, Mar-05

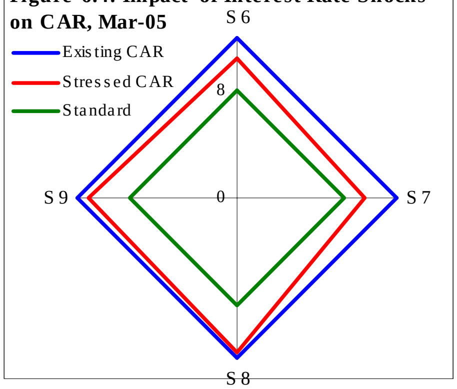


Market Shocks

As for the ***interest rate***, the banking system shows its resilience towards all the four types of shocks including parallel shift, the flattening and steepening of the yield curves.

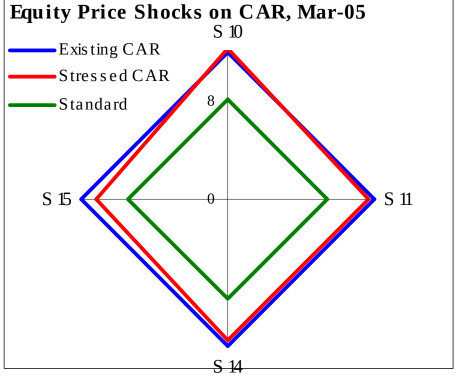
The stress tests computations show that with a shock of parallel shift of the yield curve by 300 basis points the estimated loss would be around 20 percent of the annualized gross income. In terms of the CAR, the fall is gauged to be around 1.5 percentage points to 10.3 percent, which is still well above the benchmark of 8 percent. PSCBs with the highest repricing GAPs show the highest vulnerability to this shock and their CAR after shedding 2.6 percentage points reduced to 11.8 percent. On consolidated basis, commercial banks are also resilient towards the large shock of an increase in the interest rates of outlying maturities by 100, 300 and 500 basis points (***scenario-7***) in addition to the comparatively lower level of shocks under scenarios 8 & 9 (see **Figure-6.4**). Group wise, FBs show the highest resilience towards such shocks due to their well-contained repricing GAPs. However, the dispersion in the level of fall in CAR among the 12 banks under study is considerable. Under the scenario 7, the CAR of five banks would fall below the required level of 8 percent. Of the remaining seven banks, five banks show strong resilience as their CAR would remain in double digit.

Figure-6.4: Impact of Interest Rate Shocks on CAR, Mar-05



The ***exchange rate*** shocks too do not show any significant bearing on the already strengthened CAR of all commercial banks. Since the banks are largely long in foreign currency, the depreciation in rupee value would not be of concern. However, under the hypothetical scenario of 20 percent appreciation in rupee value the CAR of the commercial banks would fall slightly by 32 basis points (see **Figure-6.5**). Taking the indirect impact of depreciation, i.e. deterioration in the credit quality of the foreign currency loans due to exchange rate movements, the results are heartening as well (***scenario 12 & 13***). Group wise- all the groups show their buoyancy towards these exchange rate shocks.

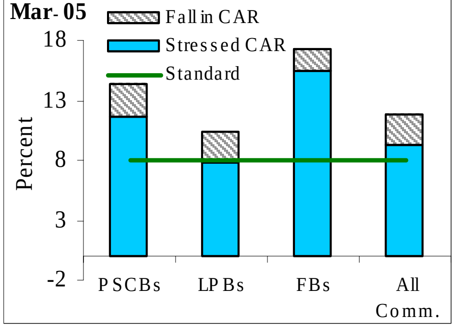
Figure-6.5: Impact of Exchange Rate & Equity Price Shocks on CAR, Mar-05



The ***equity price*** shocks cover both the direct as well as indirect exposure of the banks towards the stock market. The results of simple univariate shocks of decline in the stock market index by 20 percent and 40 percent show smaller impact on the CAR of all the commercial banks, which falls by 0.4 and 1.1 percentage points under each scenario respectively (see **Figure-6.5**). Group wise, LPBs are carrying highest exposure, nevertheless CAR of this group remains above the 8 percent level.

The above analysis shows that the system is showing resilience towards the different credit and market shocks. This resilience more or less stays even in the face of extreme multivariate scenarios where the simultaneous occurrence of large shocks to both credit and market risk factors may creates a crisis like situation (***scenario 16 & 17***). Under scenario 16, which calibrates the combined shocks to NPLs, interest rates and exchange rate (both direct and indirect impact), the overall CAR of commercial banks would stay at 9.3 percent. Except that of LPBs, whose CAR breaks the 8 percent level by just 14 basis points, all the groups would enjoy a comfortable capital adequacy level (see **Figure-6.6**). However, when the large shock to stock market is also combined with the shocks under scenario 16, the overall CAR would fall to 7.4 percent (***scenario 17***), which of course is not that alarming given the severity of shock.

Figure-6.6: Combined Impact of Credit & Market Shocks (Scenario-16) on CAR, Mar-05

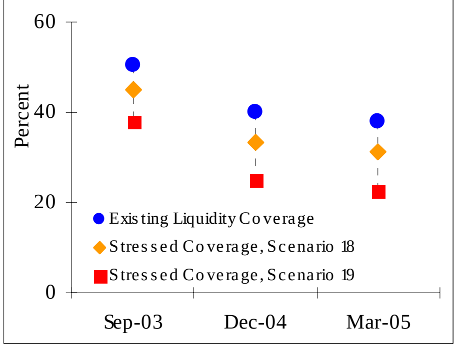


Liquidity Risk:

The two scenarios (***Scenarios 18 and 19***) have been identified to gauge the system's resilience to liquidity shocks. These scenarios assume 10 and 20 percent squeeze in the liquid liabilities, respectively. And the impact has been calibrated in terms of residual liquidity coverage ratio after these shocks.

In recent quarters banks have significantly expanded their lending portfolio. This has squeezed the excess liquidity cushion which the system was enjoying in the recent past, but the system is still having comfortable liquidity cushion to operate within safe limits (**see Figure-6.7**). As regards the 12 strategically significant banks, all the banks preserve their liquidity coverage in extreme shock scenario, and the individual groups are quite immune to these shocks as well.

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



Findings:

Certain findings of the stress test exercise can be drawn as follows:

The banking system seems to be generally resilient to the historical and hypothetical shocks of both the univariate and multivariate types. Among the shocks studied, the cumulative impact of 10 percent increase in the NPLs along with the total shift in the categories of existing NPLs and fall in the value of real estate collateral would lead to the fall in the CAR of commercial banks by 1.4 percentage points to 10.4 percents, still well above the required level of 8 percent. The other scenarios as well, like large shifts in the yield curve, big movements in the yield curves and large exchange rate and equity price shocks would have a contained effect on the capital adequacy. More over the banks are also generally resilient towards the simultaneous occurrence of the credit and market shock. Group wise, LPBs, though with a double digit CAR, are more susceptible to the large shocks due to their comparatively lower CARs and the high credit and market exposures followed by PSCBs and FBs.

Financial Soundness Indicators **Annex-I**

Indicators	2000	2001	2002	2003	2004	Mar-05
CAPITAL ADEQUACY						
Risk Weighted CAR						
Public Sector Commercial Banks	10.4	9.6	12.3	11.0	13.4	14.4
Local Prixate Banks	9.2	9.5	9.7	9.0	10.1	10.4
Foreign Banks	18.0	18.6	23.2	23.0	17.4	17.2
Commercial Banks	**11.4**	**11.3**	**12.6**	**11.1**	**11.4**	**11.8**
Specialized Banks	(3.3)	(13.9)	(31.7)	(28.2)	(9.0)	(14.4)
All Banks	**9.7**	**8.8**	**8.8**	**8.5**	**10.5**	**10.7**
Tier 1 Capital to RWA						
Public Sector Commercial Banks	7.7	7.1	8.6	8.2	8.6	9.2
Local Prixate Banks	8.1	8.4	6.6	7.1	7.5	7.8
Foreign Banks	17.9	18.6	23.0	23.0	17.1	16.8
Commercial Banks	**9.8**	**9.7**	**9.7**	**9.1**	**8.6**	**8.9**
Specialized Banks	(3.4)	(13.9)	(31.7)	(28.7)	(15.0)	(20.2)
All Banks	**8.3**	**7.3**	**6.2**	**6.5**	**7.6**	**7.7**
Capital to Total Assets						
Public Sector Commercial Banks	4.6	3.7	5.6	6.1	8.2	9.3
Local Prixate Banks	3.5	3.8	5.2	5.1	6.5	6.6
Foreign Banks	8.8	8.5	10.6	10.0	9.0	8.9
Commercial Banks	**4.9**	**4.6**	**6.1**	**6.0**	**7.1**	**7.4**
Specialized Banks	(1.1)	(10.3)	(23.0)	(9.5)	(11.3)	(13.5)
All Banks	**4.5**	**3.8**	**4.8**	**5.4**	**6.5**	**6.7**
ASSET QUALITY						
NPLs to Total Loans						
Public Sector Commercial Banks	26.3	25.9	25.5	20.4	13.3	13.2
Local Prixate Banks	15.4	16.3	15.4	11.3	9.0	8.1
Foreign Banks	4.7	4.3	3.8	3.1	1.6	1.4
Commercial Banks	**19.5**	**19.6**	**17.7**	**13.7**	**9.0**	**8.4**
Specialized Banks	52.4	53.0	54.7	55.6	54.1	49.2
All Banks	**23.5**	**23.4**	**21.8**	**17.0**	**11.6**	**10.6**
Proxision to NPLs						
Public Sector Commercial Banks	59.2	56.6	57.1	65.8	77.0	75.3
Local Prixate Banks	36.9	40.5	58.6	62.7	70.2	72.5
Foreign Banks	65.9	74.1	73.3	77.4	101.9	109.3
Commercial Banks	**53.9**	**53.2**	**58.2**	**64.7**	**72.7**	**73.9**
Specialized Banks	58.1	59.2	66.9	60.8	68.6	77.8
All Banks	**55.0**	**54.7**	**60.6**	**63.7**	**71.6**	**74.9**
Net NPLs to Net Loans						
Public Sector Commercial Banks	12.7	13.1	12.8	8.1	3.4	3.6
Local Prixate Banks	10.3	10.4	7.0	4.5	2.8	2.4
Foreign Banks	1.7	1.1	1.1	0.7	(0.0)	(0.1)
Commercial Banks	**10.1**	**10.3**	**8.3**	**5.3**	**2.6**	**2.3**
Specialized Banks	31.6	31.5	28.5	33.0	27.0	17.7
All Banks	**12.2**	**12.1**	**9.9**	**6.9**	**3.6**	**2.9**
Net NPLs to Capital						
Public Sector Commercial Banks	124.5	160.2	83.4	50.0	17.2	17.5
Local Prixate Banks	153.5	125.2	54.8	40.5	24.1	20.1
Foreign Banks	9.0	5.8	4.7	3.3	(0.2)	(0.8)
Commercial Banks	**96.7**	**100.7**	**54.2**	**37.5**	**19.2**	**16.7**
Specialized Banks	-	-	-	-	-	-
All Banks	**131.3**	**150.5**	**85.5**	**55.4**	**28.8**	**23.0**
EARNINGS						
Return on Assets (Before Tax)						
Public Sector Commercial Banks	0.5	-	1.3	1.8	2.4	2.4
Local Prixate Banks	(0.1)	0.9	1.4	2.2	1.7	2.4
Foreign Banks	1.4	1.7	2.3	2.6	2.5	2.7
Commercial Banks	**0.4**	**0.6**	**1.5**	**2.1**	**1.9**	**2.5**
Specialized Banks	(2.3)	(8.4)	(10.2)	(2.5)	(2.5)	(7.8)
All Banks	**0.3**	**0.1**	**0.9**	**1.9**	**1.8**	**2.1**
Return on Assets (After Tax)						
Public Sector Commercial Banks	0.2	(0.5)	0.6	1.0	1.3	1.5
Local Prixate Banks	(0.7)	0.4	0.7	1.4	1.2	1.6
Foreign Banks	0.6	0.8	1.5	1.5	2.0	1.8
Commercial Banks	**(0.0)**	**(0.0)**	**0.8**	**1.2**	**1.3**	**1.6**
Specialized Banks	(2.3)	(8.8)	(12.1)	(3.2)	(2.6)	(7.8)
All Banks	**(0.2)**	**(0.5)**	**0.1**	**1.1**	**1.2**	**1.3**

Indicators	2000	2001	2002	2003	2004	Mar-05
ROE (Axg. Equity& Surplus) (Before Tax)						
Public Sector Commercial Banks	10.9	0.5	26.3	29.9	32.1	29.7
Local Prixate Banks	(3.2)	25.4	32.3	42.2	28.5	37.5
Foreign Banks	15.6	19.3	24.2	25.2	26.7	30.6
Commercial Banks	**8.8**	**12.2**	**27.5**	**34.0**	**29.1**	**34.7**
Specialized Banks	-	-	-	-	-	-
All Banks	**5.7**	**1.4**	**21.1**	**36.4**	**29.4**	**32.2**
ROE (Axg. Equity &Surplus) (After Tax)						
Public Sector Commercial Banks	4.9	(12.2)	11.5	17.3	18.0	18.6
Local Prixate Banks	(17.4)	10.3	17.3	26.2	20.1	24.9
Foreign Banks	6.1	9.1	15.2	14.9	21.5	20.1
Commercial Banks	**(0.3)**	**(0.3)**	**14.3**	**20.5**	**19.8**	**22.7**
Specialized Banks	-	-	-	-	-	-
All Banks	**(3.5)**	**(12.6)**	**3.2**	**20.5**	**19.5**	**19.7**
NII/Gross Income						
Public Sector Commercial Banks	61.8	69.9	69.5	64.1	64.1	72.3
Local Prixate Banks	63.2	72.1	65.5	56.8	62.8	69.5
Foreign Banks	54.0	59.4	57.5	55.3	57.6	65.0
Commercial Banks	**61.2**	**68.9**	**66.1**	**59.4**	**62.5**	**69.6**
Specialized Banks	78.6	86.7	78.0	75.8	90.9	89.2
All Banks	**62.3**	**70.4**	**67.1**	**60.5**	**64.0**	**70.6**
Cost / Income Ratio						
Public Sector Commercial Banks	70.1	62.3	56.9	42.8	39.4	40.4
Local Prixate Banks	80.9	67.3	60.0	53.2	56.3	47.9
Foreign Banks	59.4	54.5	45.4	48.3	49.0	45.7
Commercial Banks	**71.6**	**62.7**	**56.7**	**48.6**	**51.8**	**46.2**
Specialized Banks	70.5	59.0	84.7	55.6	47.9	56.0
All Banks	**71.6**	**62.4**	**59.1**	**49.1**	**51.6**	**46.7**
LIQUIDITY						
Liquid Assets/Total Assets						
Public Sector Commercial Banks	37.1	36.5	49.0	49.0	43.4	39.3
Local Prixate Banks	34.0	39.8	47.1	42.9	34.3	34.3
Foreign Banks	45.2	50.3	48.5	49.8	39.9	39.6
Commercial Banks	**37.5**	**39.9**	**48.1**	**46.0**	**36.9**	**35.9**
Specialized Banks	12.7	13.6	16.4	22.2	25.7	24.3
All Banks	**36.0**	**38.5**	**46.7**	**45.1**	**36.5**	**35.5**
Liquid Assets/Total Deposits						
Public Sector Commercial Banks	45.0	43.4	59.6	59.0	51.7	47.5
Local Prixate Banks	44.3	49.6	60.2	54.5	42.3	42.7
Foreign Banks	67.7	78.3	74.2	69.7	53.4	54.1
Commercial Banks	**48.0**	**50.3**	**61.5**	**57.9**	**45.5**	**44.8**
Specialized Banks	90.8	79.8	98.5	131.5	153.2	169.6
All Banks	**48.5**	**50.7**	**61.8**	**58.5**	**46.3**	**45.6**
Advances/Deposits						
Public Sector Commercial Banks	54.0	53.8	44.3	45.6	49.8	54.3
Local Prixate Banks	67.5	57.9	52.3	58.3	67.6	69.2
Foreign Banks	71.5	66.8	72.0	63.9	70.1	69.9
Commercial Banks	**60.5**	**56.9**	**51.0**	**53.6**	**63.7**	**66.1**
Specialized Banks	553.0	450.5	453.8	381.5	359.3	426.1
All Banks	**66.2**	**61.7**	**54.9**	**56.5**	**65.9**	**68.2**

Annex-II

Selected Indicators for Different Categories of Banks, March 31, 2005

Indicators	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Share of Total Assets	55.4%	72.8%	92.8%	100%
Share of Total Deposits	59.8%	77.5%	94.1%	100%
Share of Gross Income	53.7%	72.8%	94.4%	100%
Share of Risk Weighted Assets	51.4%	69.4%	92.0%	100%
Capital Adequacy				
Capital/RWA	10.9%	11.2%	11.6%	10.7%
Tier 1 Capital / RWA	7.1%	7.9%	8.5%	7.7%
Net Worth / Total Assets	6.9%	7.0%	7.2%	6.7%
Asset Composition				
Sectoral Distribution of Loans (Domestic)				
- Corporate Sector:	49.4%	70.9%	91.9%	100%
- SMEs:	53.2%	70.6%	90.8%	100%
- Agriculture	25.0%	27.2%	94.3%	100%
- Consumer Finance:	57.0%	81.2%	95.2%	100%
- Commodity Financing	67.8%	80.4%	97.3%	100%
- Staff Loans	68.4%	85.9%	95.7%	100%
- Others	48.3%	56.9%	83.9%	100%
- Total	50.7%	69.4%	92.5%	100%
NPLs / Gross Loans	10.9%	10.0%	10.1%	10.6%
Net NPLs / Capital	20.4%	19.9%	18.9%	23.0%
Earning & Profitability				
ROA	1.5%	1.6%	1.3%	1.3%
ROE	22.5%	24.6%	19.0%	19.7%
Net Interest Income / Gross Income	71.6%	71.1%	71.7%	70.6%
Income from Trading & Foreign Exchange / Gross Income	9.4%	9.0%	9.1%	9.8%
Non-Interest Expense / Gross Income	48.3%	46.4%	44.5%	46.7%
Liquidity				
Liquid Assets / Total Assets	37.8%	36.1%	35.5%	35.5%
Liquid Assets held in Govt. Securities / Total Liquid Assets	55.1%	54.5%	52.3%	51.4%
Liquid Assets / Total Deposits	44.9%	43.5%	44.9%	45.6%

Bank-wise Major Statistics (Unaudited) March 31, 2005   Annex-III

(Million rupees)

Name of Bank	Total assets	Deposits	Equity
BOK	22,986	13,931	2,255
BOP	69,065	52,761	8,869
FWBL	9,591	8,668	608
NBP	525,706	444,421	46,526
IDBP	9,346	11,133	- 24,956
ZTBL	79,855	1,619	9,383
PPCB	11,745	1,698	1,927
Allied Bank	157,473	136,536	10,700
Bank Alfalah	158,848	134,476	6,583
Bank Alhabib	82,017	63,706	4,039
Askari Bank	107,203	80,848	6,393
Bolan Bank	12,800	9,491	1,784
Crescent Bank	10,780	5,088	2,387
Dawood Bank	4,736	116	1,516
Faysal Bank	87,539	58,950	11,616
Habib Bank	474,814	395,893	32,664
KASB	16,069	10,836	1,758
Meezan	22,551	15,548	2,376
MCB	279,269	235,044	15,295
Metro	74,065	53,223	4,411
NIB	17,308	10,277	1,406
PICIC	55,231	42,603	3,940
Prime	42,484	30,341	3,033
Saudipak	42,294	29,977	1,709
Soneri	51,702	38,032	3,178
UBL	290,328	245,588	17,508
Union	83,365	65,910	3,541
ABN AMRO Bank	62,399	50,771	2,966
Habib Bank AG Zurich	43,413	29,149	2,543
Bank Al-Baraka	11,527	7,390	1,993
American Express Bank	8,347	4,912	1,021
Citibank	64,748	42,285	6,507
Deutsche Bank	5,663	3,076	1,353
Hongkong & Shanghai Bank	12,147	8,562	1,654
Oman International Bank	1,769	530	1,031
Rupali Bank Limited	525	200	96
Standard Chartered Bank	107,398	87,109	7,726
Bank of Tokyo	3,619	1,656	1,859
Total	**3,120,728**	**2,432,354**	**209,197**

List of Abbreviations **Annex-IV**

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

Glossary

Annex-V

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 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 the SBP provides three-day repo facility to banks, acting as the lender of last resort.

Duration (Macauley 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 are classified as non-performing.

NPLs to loans 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 concern) and 50

persons (if it is trading / service concern) and also fulfills the following criteria of either ‘a’ and ‘c’ or ‘b’ and ‘c’ as relevant:
(a) A trading / service concern with total assets at cost excluding land and building upto Rs50 million.
(b) A manufacturing concern with total assets at cost excluding land and building upto Rs100 million.
(c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs300 million as per latest financial statements.

Tier I capital: The risk based capital system divides capital into two tiers-core capital (Tier I) and supplementary capital (Tier II and Tier III). Tier 1 capital includes fully paid up capital, balance in share premium account, reserve for issue of bonus shares, general reserves as disclosed on the balance-sheet and un-appropriated /unremitted profit (net of accumulated losses, if any).

Tier II capital: 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: The tier III capital consisting of short-term subordinated debt would be solely 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.

Group-wise Composition of Banks 1997 – March 2005

Annex-VI

1997-1998	2003	2004	Mar-2005
<u>A. Public Sector Comm. Banks</u> (6) - Habib Bank Ltd. - National Bank of Pakistan - United Bank Ltd. - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **<u>B. Local Private Banks</u> (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. **<u>C. Foreign Banks</u> (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 **<u>D. Specialized Banks</u> (4)** - Agriculture Development Bank of Pakistan - Industrial Development Bank of Pakistan - Federal Bank for Co-operatives - Punjab Provincial Co-operative Bank Ltd. **<u>All Commercial Banks</u> (42)** Include A + B + C **<u>All Banks</u> (46)** Include A + B + C + D	**<u>A. Public Sector Comm. Banks</u> (5)** - Habib Bank Ltd[1] - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **<u>B. Local Private Banks</u> (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. **<u>C. Foreign Banks</u> (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 **<u>D. Specialized Banks</u> (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **<u>All Commercial Banks</u> (37)** Include A + B + C **<u>All Banks</u> (40)** Include A + B + C + D	**<u>A. Public Sector Comm. Banks</u> (4)** - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **<u>B. Local Private Banks</u> (20)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Meezan Bank - NDLC-IFIC Bank Ltd - Crescent Bank Ltd. - Habib Bank Ltd - Dawood Bank **<u>C. Foreign Banks</u> (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 **<u>D. Specialized Banks</u> (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **<u>All Commercial Banks</u> (36)** Include A + B + C **<u>All Banks</u> (38)** Include A + B + C + D	**<u>A. Public Sector Comm. Banks</u> (4)** - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **<u>B. Local Private Banks</u> (20)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Meezan Bank - NDLC-IFIC Bank Ltd - Crescent Bank Ltd. - Habib Bank Ltd - Dawood Bank **<u>C. Foreign Banks</u> (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 **<u>D. Specialized Banks</u> (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **<u>All Commercial Banks</u> (36)** Include A + B + C **<u>All Banks</u> (38)** Include A + B + C + D

1. *HBL now stands as local private bank after being privatized on 26-02-2004.*
2. *Bank of Ceylon was merged with Dawood Commercial Bank on 25-03-2004.*
3. *Credit Agricole was merged with NDLC-IFIC Bank on 19-04-2004.*
4. *Doha Bank was merged with Trust Commercial Bank which was later merged with Crescent Commercial Bank.*