State Bank of Pakistan

Banking Supervision Department

Quarterly Performance Review of the Banking System

September 2003

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PERFORMANCE REVIEW OF THE BANKING SYSTEM

For the Quarter Ended September 30, 2003

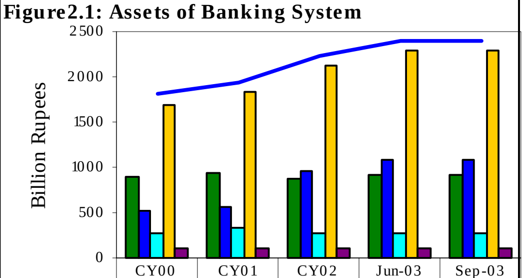
1. Overview

The rapid expansion in the balance sheet of the banking industry came to a halt during this quarter. Deceleration in deposits growth as well as steep reduction in borrowings converged to affect the fall in total assets. Although deposits grew by Rs 42.2 billion in this quarter to Rs 1,887.8 billion, the growth compared with the previous quarters remained on the lower side as the home remittances contracted to more sustainable levels. Decline in borrowings was much sharper i.e. Rs 39.5 billion, but consistent with the changed market perception about future course of interest rate direction. This entire financing squeeze brought about a crunch in the balance sheet expansion that waned off to Rs 2,387.4 billion, a reduction of Rs 8.6 billion over the last quarter. Following the seasonal trend loans also decreased. But the decline of mere Rs 3.5 billion during this quarter was not that sharp as experienced during the corresponding quarters of previous years. Profitability of the banking system, despite the poor results of the specialized banks, strengthened even further as pre-tax profits reached to Rs 35.4 billion. However, in this quarter as well the capital gains accounted for 37 percent of the pre-tax profits. Capital adequacy ratio of the banking system has further strengthened this quarter while the gross and net NPLs ratios have remained stable.

2. Sources and uses of funds

Asset growth showed a slight decline of 0.4 percent this quarter i.e. Rs 8.6 billion in absolute terms (see **Figure-2.1**). Loans, more or less, remained static at Rs 1,122.8 billion. Investments, on the other hand, gained another Rs 44.8 billion to stretch their level to Rs 829.2 billion at the expense of lending to financial institutions and cash and bank balances. This further increased the share of investments in the total assets (see **Table 2.1**).

Figure2.1: Assets of Banking System



	CY00	CY01	CY02	Jun-03	Sep-03
PSCBs	902.0	946.5	877.6	920.8	926.3
LPBs	513.5	565.9	968.3	1,086.9	1,089.9
FBs	280.6	323.7	280.9	280.1	273.7
CBs	1,696.1	1,836.1	2,126.8	2,287.9	2,289.9
SBs	111.5	106.2	98.5	108.1	97.5
All	1,807.6	1,942.3	2,225.2	2,396.0	2,387.4

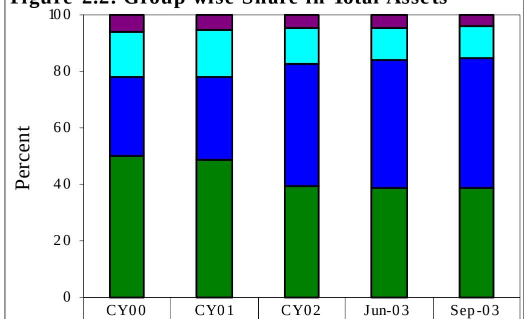
Group-wise, both specialized banks and foreign banks experienced a decline of Rs 10.6 billion and Rs 6.4 billion respectively in their total assets, which now stand at Rs 97.5 billion and Rs 273.7 billion respectively. Public sector commercial banks (PSCBs) and local private banks (LPBs) succeeded in keeping some of their momentum in the current quarter as well with a nominal rise of Rs 5.5 billion and Rs 3.0 billion in their asset base leading to a slight increase in their respective market share (see **Figure- 2.2**).

Table 2.1: Major Sources and Uses of Funds

(Percent)	CY00	CY01	CY02	Jun-03	Sep-03
Source					
Deposits	74.2	75.9	75.3	77.0	79.1
Borrowings	14.8	13.8	12.5	12.3	10.7
Equity	4.5	3.8	4.8	5.0	5.0
Others	6.5	6.5	7.3	5.7	5.3
Total	100.0	100.0	100.0	100.0	100.0
Uses					
Loans	49.1	46.9	41.5	40.8	40.4
Investments	16.8	18.1	31.5	32.7	34.7
Others	34.0	35.1	27.0	26.5	24.8
Total	100.0	100.0	100.0	100.0	100.0

On the liability side deposits also rose by just 2 percent (or Rs 42.2 billion over Rs 1,845.6 billion of June-03) but the sharp decline of Rs 39.5 billion in borrowings coupled with decline in other liabilities brought about an overall negative growth.

Figure-2.2: Group-wise Share in Total Assets

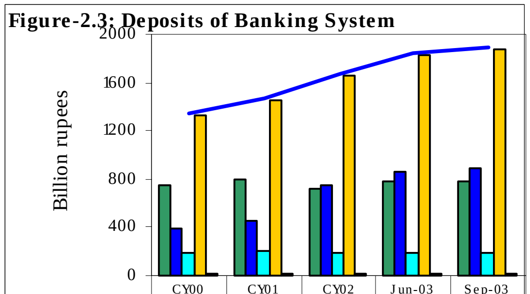


	CY00	CY01	CY02	Jun-03	Sep-03
SBs	6.2	5.5	4.4	4.5	4.1
FBs	15.5	16.7	12.6	11.7	11.5
LPBs	28.4	29.2	43.5	45.4	45.7
PSCBs	49.9	48.8	39.4	38.4	38.8

2.1 Deposits

This quarter experienced a relatively slow deposit growth as compared to the previous quarters with addition of only Rs 42.2 billion or 2.3 percent from Rs 1,845.6 billion in June 2003 to Rs 1,887.8 billion in September 2003 (see **Figure-2.3**). Domestic deposits accounted for around 87 percent of the total increase. Just like the previous quarters the continuous inflow of home remittances from abroad (around US$ 0.9 billion during the quarter) was the main contributor towards deposits growth.

Figure-2.3: Deposits of Banking System

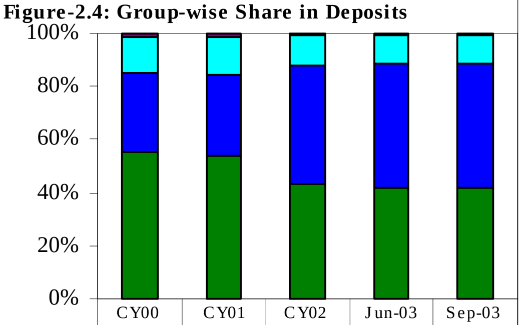


	CY00	CY01	CY02	Jun-03	Sep-03
PSCBs	743.7	795.2	721.9	777.9	788.5
LPBs	394.2	453.7	754.2	864.3	887.6
FBs	187.4	207.8	184.1	186.8	195.1
CBs	1,325.3	1,456.7	1,660.2	1,829.0	1,871.3
SBs	15.6	18.0	16.4	16.6	16.5
All	1,340.9	1,474.7	1,676.5	1,845.6	1,887.8
Domestic All	1,159.0	1,308.4	1,534.8	1,712.6	1,749.2

Local private banks again managed to attract a major portion (55.2 percent) of growth in deposits followed by PSCBs (25.1 percent). Foreign banks, with only 1.3 percent share of the total deposit growth in the last quarter recovered to a share of 19.7 percent in this quarter. The group-wise share in the total deposits of the banking system, however, did not see any major change over the previous quarter (see **Figure-2.4**).

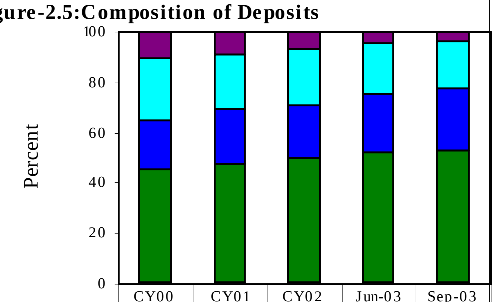
The composition of deposits shows that largest increase was observed in the saving deposits which grew by around 4 percent or Rs 38 billion followed by non-remunerative current deposits by around 5 percent or Rs 18 billion over the last quarter. Almost all the groups managed to divest a portion of their costlier fixed deposits and concentrated on mobilizing low cost saving and current deposits. The LPBs seemed to do pretty good in this respect too as most of the current deposits mobilized by them were non-remunerative while PSCBs gained much of their remunerative current deposits at the cost of their non-remunerative current deposits. The saving deposits continued to form almost one half of the total deposits of the banking system (see **Figure-2.5**).

Figure-2.4: Group-wise Share in Deposits



	CY00	CY01	CY02	Jun-03	Sep-03
SBs	1.2	1.2	1.0	0.9	0.9
FBs	14.0	14.1	11.0	10.1	10.3
LPBs	29.4	30.8	45.0	46.8	47.0
PSCBs	55.5	53.9	43.1	42.1	41.8

Figure-2.5:Composition of Deposits



	CY00	CY01	CY02	Jun-03	Sep-03
From Fin. Instit.	10.4	8.8	6.5	4.3	4.0
Fixed Deposits	24.9	22.1	22.3	20.1	18.5
Current Accounts	19.2	21.4	21.4	23.3	24.3
Saving Deposits	44.9	47.3	49.2	51.7	52.5
Others	0.6	0.5	0.5	0.6	0.7

2.2 Borrowings

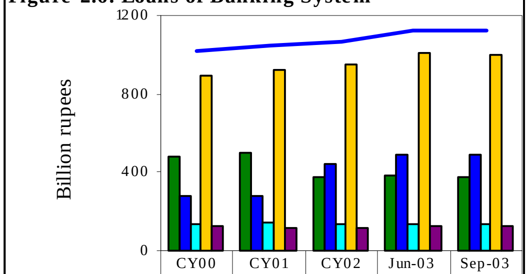
There was an across the board decline in borrowings portfolio of all groups. The overall borrowings portfolio decreased by Rs 39.5 billion from its June-03 level of Rs 293.8 billion. Borrowings under export refinance scheme, however, showed an increase of Rs 5.9 billion to Rs 62.6 billion. The rise can be traced to increased export performance-year-on-year increase of over 14 percent- and very low financing rates. During the quarter, market was so awash with liquidity that not a single recourse was made by the banks to the discount window of SBP. The fact that SBP was net absorber of the excess liquidity-swap window operation of Rs 29.9 billion- also provide some indication of the extent of excess liquidity in the market. But then much of these characteristics have been prevalent in the market for well over a year now. There were bullish expectations on the future course of interest rate direction- which were quashed by SBP moves. These sentiments really prevented banks from over-stretching themselves and resort to excess borrowing.

2.3 Loans

Despite an unusually large upsurge in private sector credit the robust growth witnessed in the last quarter failed to carry through into the current quarter. The overall loan portfolio registered a nominal decline of Rs 3.5 billion[1] whereas the domestic loans dropped by Rs 2.9 billion (see **Figure-2.6**). Given the established past trend loans portfolio tend to decline during the September quarter. A relatively smaller decline this year, is indicative of the salutary impact of the soft monetary stance (see **Table-2.2**).

The behavior of the private and the public sectors in the loans growth remained in sharp contrast during the current quarter. Whereas the private sector's demand for loans continues to surge with an increase of around Rs 16 billion during the quarter, the public sector exhibited a marked reduction of around Rs 19 billion in its demand for loans in the same period. This is an encouraging development as it indicates that private sector activity is picking up, which will have positive impact on the economic growth. The low demand by the public sector is welcome and reflects improved financials of major corporations.

Figure-2.6: Loans of Banking System



	CY00	CY01	CY02	Jun-03	Sep-03
PSCBs	475.7	501.0	374.2	382.1	373.7
LPBs	282.2	281.2	438.9	485.7	491.8
FBs	138.3	143.4	135.4	137.3	131.5
CBs	896.2	925.6	948.5	1,005.1	997.0
SBs	123.9	118.4	117.0	121.2	125.8
All	1,020.1	1,043.9	1,065.4	1,126.3	1,122.8
Domestic All	926.4	963.6	982.6	1,043.1	1,040.2

Table-2.2 : Interest Rate structure

(Percent)	CY00	CY01	CY02	Jun-03	Sep-03
Discount Rate	13	10	7.5	7.5	7.5
W.A. Lending Rates	13.88	13.4	10.31	7.58	5.2
W.A. Deposit Rates	5.23	4.96	3.6	1.9	1.5
Export Finance Rate	8	10	7	3.5	3
Export Refin. Rate	6	8.5	5.5	2	1.5
$ Export Rate	-	5.65	3.84	1.93	1.93
PIB rates					
3y	12.5	10.5	7	7	6
5y	13	11	8	8	7
10y	14	12	9	9	8
PIBs Yield *					
3y	12.45	10.49	4.56	3.08	4.11
5y	12.95	11	4.86	4.16	5.1
10y	13.97	11.92	5.52	5.61	6.22
T. Bill Rate wt.avg					
3m	10.23	7.65	3.9	1.66	1.38
6m	10.96	7.93	4.32	1.67	1.61
12m	11.49	8.4	4.36	2.37	1.93
T. Bill Rate cut off					
3m	10.23	7.65	3.9	1.66	1.39
6m	10.96	7.93	4.32	1.65	1.66
12m	11.49	8.4	4.36	2.36	1.99

** Information for Sep-03 are based on Oct 6, 2003 auction results*

[1] Global position and only principal amount.

The allocation of bank credit is taking place in the desired direction.

The agriculture, SMEs and consumer finance improved their relative share (see **Table-2.3**). The rise in the lending to these sectors may be attributed to the increased focus of banks on them in recent times. Although all the components of consumer financing have been showing strong growth, the most notable is the expanding housing finance. The recent stir up in rates, however, heightens the need for covering the yield risk on more sustainable basis. Arranging corresponding long-term funds from the market would be a good move, as it would facilitate, at a later stage, in developing risk mitigation instruments.

Table-2.3. : Sector-wise Break Up of Loans Domestic Operations

	Jun-03		Sep-03	
(Billion Rupees)	Amount	% age	Amount	% age
Corporate Sector	524.3	50.3	511.4	49.2
SMEs	145.3	13.9	158.8	15.3
Agriculture	119.4	11.4	128.0	12.3
Consumer Finance	45.0	4.3	63.6	6.1
Credit Cards	*6.7*	0.6	*8.0*	0.8
House Loans	*3.8*	0.4	*7.9*	0.8
Auto Loans	*15.8*	1.5	*19.4*	1.9
Others	*18.7*	1.8	*28.4*	2.7
Commodity Operations	83.5	8.0	74.2	7.1
Staff Loans	33.4	3.2	33.0	3.2
Others	92.4	8.9	71.2	6.8
Total	1,043.10	100	1,040.20	100

The overall demand for credit from corporates faltered as the net retirement of about Rs 17 billion by public sector corporates overshadowed the net increase of Rs 4 billion in the loans to private corporates.

Group-wise, local private banks and specialized banks succeeded in sustaining an upward momentum and showed a rise of Rs 6.1 billion and Rs 4.6 billion over the last quarter.

2.4 Investments

Investments of the banking system continued to witness rising trend during this quarter. The major contributors to this increase were the MTBs with an investment of Rs 60.8 billion. The heavy investment in MTBs was due to the fact that other avenues of investment were less attractive.

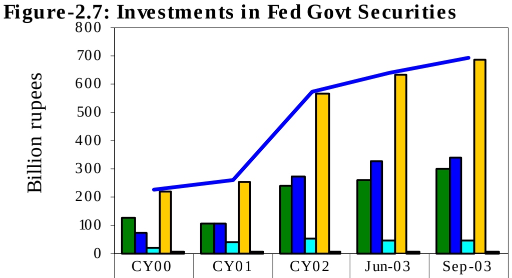
Table-2.4: Total Investment of banking sector

(Billion rupees)	CY00	CY01	CY02	Jun-03	Sep-03
Government papers:					
MTBs	95.8	126.6	373.9	420.6	481.4
FIBs	84.0	53.9	42.2	26.5	24.3
PIBs	2.0	42.0	116.7	150.9	143.2
Provincial Govt. Securities	1.7	1.6	1.4	1.2	0.6
Others	46.8	36.9	40.2	42.3	44.1
Equity investment *	16.0	25.4	29.0	35.1	37.3
TFCs, bonds, debentures and PTCs	40.7	49.0	55.5	66.1	63.8
Others	23.9	20.5	19.8	22.8	23.0
Total investment	311.0	356.0	678.6	765.5	817.7
Provision/surplus/deficit	-6.6	-5.0	22.9	18.9	11.5
Total after provision/surplus/deficit	**304.3**	**351.1**	**701.5**	**784.4**	**829.2**

*Including Investment in Subsidiaries and associate undertakings

Banking system, however, did divest a small portion of its PIBs holding expecting a rise in the yield on forthcoming issues of PIBs. The off-loading of PIBs by the banking sector resulted in deepening of secondary market and net increase in investment by Rs 44.8 billion or 5.7 percent (see **Table-2.4**).

Figure-2.7: Investments in Fed Govt Securities



	CY00	CY01	CY02	Jun-03	Sep-03
PSCBs	129.8	106.2	242.7	259.3	299.5
LPBs	72.9	108.0	270.4	328.1	341.6
FBs	20.0	41.0	55.2	47.3	46.9
CBs	222.8	255.2	568.3	634.7	688.0
SBs	5.8	4.3	4.7	5.6	5.0
All	228.6	259.5	573.0	640.3	693.0

Group-wise position of banks shows that public sector commercial banks contributed most in the increase in government securities i.e. about 76 percent of the total increase (see **Figure- 2.7**)

The decline in the credit to public sector during the quarter led to a fall in its share in the overall credit. However, the relatively larger increase in the investment in government papers slightly raised the total exposure of banks to public sector (see **Table 2.5**).

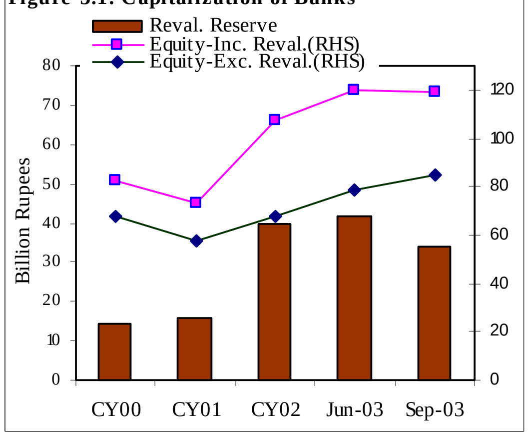
Table- 2.5: Banks' Exposure to Public Sector					
(Percent)	CY00	CY01	CY02	Jun-03	Sep-03
Credit	19.3	20.7	16.9	15.3	13.1
Total (Credit+Govt. papers)	36.6	35.5	44.3	44.7	45.5
Source: Weekly Statement					

3. Performance of the Banking System

3.1 Capital Adequacy

Solvency of the banking system has been improving for the last year or so. This improvement was augmented during the quarter under review mainly through improved profitability and fresh injection (see **Figure 3.1**) The revaluation reserves, however, slightly waned as they have been partly translated into equity thorough capital gains. The other contributing factor was slightly improved yield on government securities.

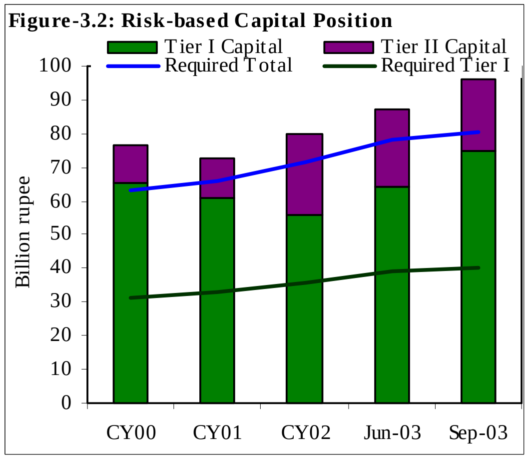
Figure-3.1: Capitalization of Banks



As regards the statutory capital requirements, 12 banks were deficient in maintaining the free-of-losses capital of Rs 1 billion in the last quarter. However, in the post review development two more banks have become compliant with the minimum capital requirement. This happened as one of these banks underwent the merger process while the other managed to meet the MCR through improvement in its profitability. The number of non-compliant banks is expected to reduce even further once the merger process of the remaining banks reaches its conclusion.

Risk based capital position of the banking system[1] shows that profitable operations and fresh injection have had salutary impact on the capital adequacy position of the banking system. The core capital after following a declining course for a number of years has shown a rising trend (see **Figure-3.2**). Better capital adequacy ratios (CAR) for the current quarter further signify the role of improved earning performance and capital injection (see **Table-3.1**).

Figure-3.2: Risk-based Capital Position



[1] The position of Jun-03 is updated.

The group-wise position of banking sector shows that all the groups managed to improve their capital adequacy ratios. The specialized banks though, still with negative capital adequacy ratio, also improved their position by reducing the losses.

It is heartening to note that banks with better CARs have increased their market share as banks with weak capital position can trigger systemic risk. (see **Table-3.2**)

Table3.1: Capital Adequacy Indicators

(Percent)	CY00	CY01	CY02	Jun-03	Sep-03
Capital Adequacy Ratio (CAR)					
PSCBs	10.4	9.6	12.3	13.7	14.1
LPBs	9.2	9.5	9.7	10.2	10.3
FBs	18.0	18.6	23.2	20.3	22.3
Comm. Banks	11.4	11.3	12.6	12.8	13.1
SBs	-3.3	-13.9	-31.7	-37.3	-33.3
All banks	9.7	8.8	8.8	8.9	9.6
Tier 1 Capital to Risk Weighted Assets					
PSCBs	7.7	7.1	8.6	10.4	10.9
LPBs	8.1	8.4	6.6	7.5	8.3
FBs	17.9	18.6	23.0	20.3	22.2
Comm. Banks	9.8	9.7	9.7	10.2	10.9
SBs	-3.4	-13.9	-31.7	-37.4	-33.4
All banks	8.3	7.3	6.2	6.6	7.5
Capital to Total Assets					
PSCBs	4.6	3.7	5.6	5.9	6.1
LPBs	3.5	3.8	5.3	5.6	5.4
FBs	8.8	8.5	10.6	9.2	9.8
Comm. Banks	4.9	4.6	6.1	6.2	6.2
SBs	-1.1	-10.3	-23.0	-19.2	-24.5
All banks	4.5	3.8	4.8	5.0	5.0

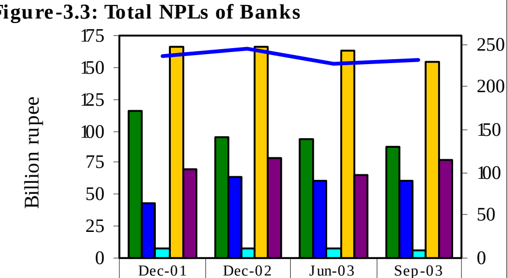
Table 3.2: Distribution of Banks by CAR with Market

CAR	Below 8%	8 to 10%	10 to 15%	Over 15%
CY00	5 (13.4%)	6 (31.6%)	16 45.0%)	17 (10.0%)
CY01	5 (12.2%)	5 (38..7%)	11 (34.9%)	22 (14.2%)
CY02	4 (10.1%)	4 (31.1%)	9 (12.7%)	23 (46.2%)
Jun-03	5 (10.4%)	5 (17.3%)	10 (43.5%)	20 (28.7%)
Sep-03	5 (9.9%)	5 (9.9%)	8 (45.8%)	22 (34.4%)

3.2 Non-Performing Loans[2]

Total Non-performing loans (NPLs) of all commercial banks maintained their downward trend in the quarter under review. In absolute terms, NPLs decreased from Rs 162.4 billion as of June 30, 2003 to Rs 153.7 billion as of September 30, 2003. However, specialized banks, again mainly because of peculiar movement in the NPLs of one of them, brought about an increase of Rs 3 billion in NPLs of all banks to Rs 230.7 billion.

Figure-3.3: Total NPLs of Banks



	Dec-01	Dec-02	Jun-03	Sep-03
PSCBs	115.4	95.3	94.1	86.8
LPBs	43.4	63.1	61.4	60.5
FBs	7.8	7.1	6.9	6.3
CBs	166.6	165.4	162.4	153.7
SBs	69.6	78.8	65.2	77.0
All (RHS)	236.1	244.2	227.7	230.7

[2] Covering domestic operations only.

The SBP's write-off guidelines mainly enabled the commercial banks to bring down their non-performing loans during this quarter. It is expected that process will carry on into the future and will bring about further reduction in the NPLs of the banking system. The outstanding amount of cases settled under these guidelines by all commercial banks reached to Rs 31.9 billion, an increase of Rs 14 billion over the last quarter.

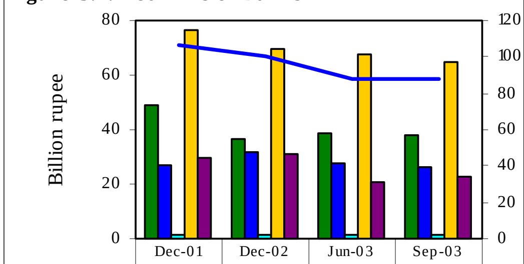
Net NPLs of commercial banks declined to Rs. 65 billion from Rs 67.7 billion in the last quarter (see **Figure-3.4**).

Enhanced provisioning against NPLs by specialized banks also contained the rise of net NPLs of these banks. This is in turn, reduced the impact of Net NPLs on all banks. Net NPLs of all banks registered a fractional decline of Rs. 0.6 billion during the current quarter.

Public sector commercial banks out performed all other banks in reducing their NPLs by Rs 7.3 billion. In fact, they accounted for about 84 percent of total decrease in the NPLs of all commercial banks.

During the current quarter, NPLs to total loans and net NPLs to net loan ratios remained stable at 21 percent and 9.5 percent respectively (see

Figure-3.4: Net NPLs of Banks



	Dec-01	Dec-02	Jun-03	Sep-03
PSCBs	48.7	36.4	38.9	37.9
LPBs	26.7	31.5	27.3	25.9
FBs	1.4	1.6	1.4	1.2
CBs	76.8	69.5	67.7	65.0
SBs	29.8	31.0	20.4	22.5
All (RHS)	106.6	100.5	88.1	87.5

Figure-3.5: NPLs to Loans (Gross)

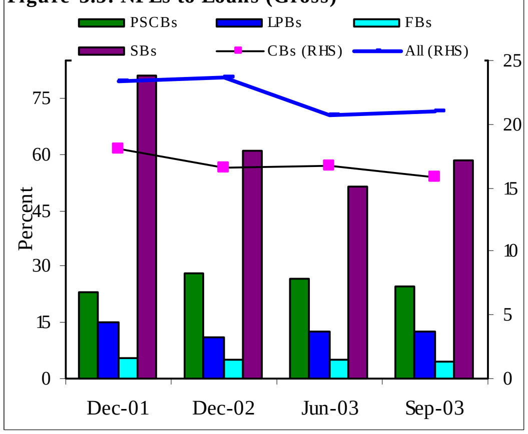


Figure-3.6: Net NPLs to Net Loans

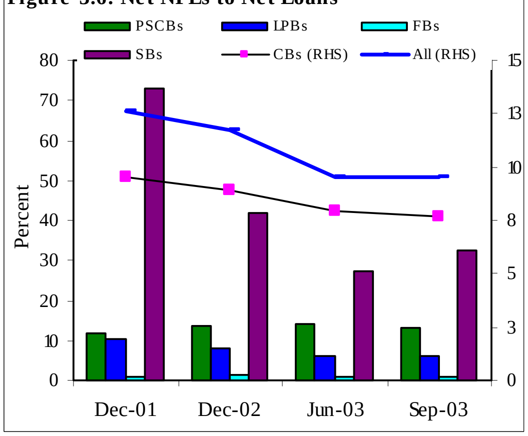
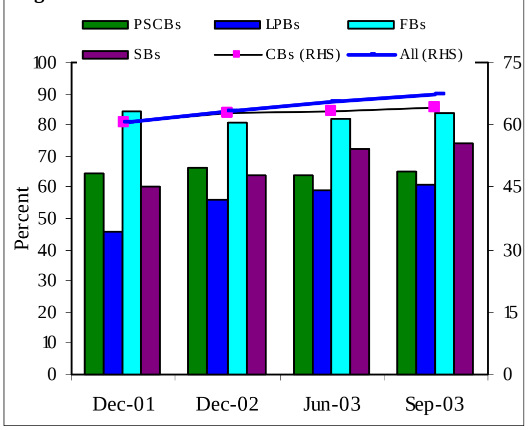


Figure-3.5 & 3.6). However, in case of commercial banks these ratios improved from 16.7 percent to 15.9 percent and 7.9 percent to 7.7 percent respectively over the last quarter.

The banks continued to make provisions against their infected portfolio. This is also manifested by the rising coverage ratio of all the groups, which reached to 67.3 percent (see **Figure-3.7**).

Figure-3.7: Provisions to NPLs



3.3 **Profitability**

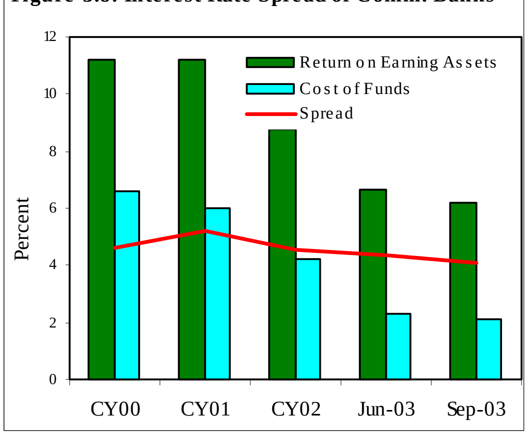
Results of banks operation during the September, 2003 quarter further strengthened the profit position of banks. Pre-tax profit at Rs 35.4 billion was about double the level registered in CY-02. Profitability indicators registered visible improvement: ROA, 1.2 percent and ROE, 24.0 percent, up from 0.1 percent and 2.7 percent respectively in CY02 (see **Table-3.4**).

Table 3.3: Profitability of Banking System

Billion rupees	CY00	CY01	CY02	Jun-03	Sep-03
Profit before tax					
PSCBs	3.9	0.2	10.9	7.3	11.1
LPBs	-0.6	5	11.3	12.8	20.5
FBs	3.7	5	6.6	4	5.9
Comm. Banks	7	10.3	28.9	24.2	37.5
SBs	-2.5	-9.2	-10.5	2	-2.1
All Bank	4.5	1.1	18.4	26.2	35.4
Profit after tax					
PSCBs	1.8	-4.6	4.8	4.4	7.4
LPBs	-3.5	2	5.9	7.5	12.2
FBs	1.4	2.4	4.2	2.3	3.4
Comm. Banks	-0.2	-0.2	14.8	14.1	23
SBs	-2.6	-9.5	-12.4	0.1	-2.1
All Banks	-2.8	-9.8	2.4	14.3	20.9

This improvement in banks' profits resulted from two developments. Firstly, lower cost of funds and expanded business volumes led to a significantly strengthened net interest income (NII). Secondly, gains on sale of securities further improved the profit level as the banks were able to foresee a declining interest rate regime and hence they concentrated on government securities that fetched revaluation surpluses and margins for capital gains with each

Figure-3.8: Interest Rate Spread of Comm. Banks



successive fall in interest rate. While improved performance of the capital market has also augmented the earnings, containment of operating expenses and lower provisions added to profit margins.

The growth of net interest income, contributing 58.2 percent of gross income, somewhat slowed down, mainly due to contraction in interest margins. Unlike previous quarters, cost of funds, with the deposits rate already touching lowest levels, remained very low, whereas the returns on earning assets remained depressed during most part of the quarter (see **Figure- 3.8**).

The quarter under review witnessed an extraordinary increase in gain on sale of securities, a capital gain of non-recurring nature that contributed around 14 percent of the year-to-date gross income. The quarter was marked with common expectation of rise in yields on government securities, which induced the banks to get the revaluation surpluses realized into capital gains before they disappear due to rise in rates.

Though the banking system's profits benefited from capital gains, the banks' core incomes also improved over the last couple of years. These incomes are not only covering the operating expenses and other charges but are generating increasing profits (see **Figure-3.9**).

Growth in operating expenses remained subdued. Provisions were also low i.e. around 11 percent of

Figure-3.9: Comm. Banks' P&L Structure

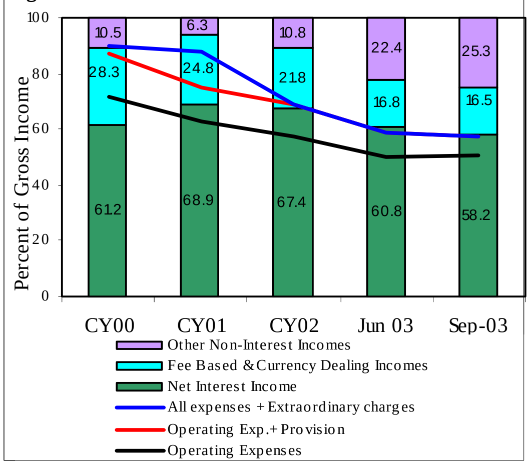


Table-3.4: Earnings and Profitability Indicators

(Percent)	CY00	CY01	CY02	Jun-03	Sep-03
Before Tax ROA					
PSCBs	0.5	0.0	1.3	1.6	1.6
LPBs	-0.1	0.9	1.3	2.5	2.6
FBs	1.4	1.7	2.3	2.9	2.9
Comm. Banks	0.4	0.6	1.5	2.2	2.2
SBs	-2.3	-8.4	-10.2	0.1	-3.4
All Banks	0.3	0.1	0.9	2.3	2.0
Before Tax ROE					
PSCBs	10.9	0.5	26.3	28.8	27.5
LPBs	-3.2	25.4	30.5	46.7	47.1
FBs	15.6	19.3	24.2	28.5	29.2
Comm. Banks	8.8	12.2	26.9	35.8	36.0
SBs	-	-	-	-	-
All Banks	5.7	1.4	20.3	46.3	40.5
ROA (after tax)					
PSCBs	0.2	-0.5	0.6	0.9	1.1
LPBs	-0.7	0.4	0.7	1.5	1.5
FBs	0.6	0.8	1.5	1.7	1.7
Comm. Banks	0.0	0.0	0.8	1.3	1.4
SBs	-2.3	-8.8	-12.1	0.0	-3.4
All Banks	-0.2	-0.5	0.1	1.2	1.2
ROE (after tax)					
PSCBs	4.9	-12.2	11.5	16.8	18.4
LPBs	-17.6	10.3	15.9	27.4	27.9
FBs	6.1	9.1	15.2	16.7	17.4
Comm. Banks	-0.3	-0.3	13.0	20.9	22.1
SBs	-	-	-	-	-
All Banks	-3.5	-12.6	2.7	25.3	24.0
Net Interest Margin					
PSCBs	3.6	4.3	4.1	3.9	3.6
LPBs	3.4	4.3	4.0	3.8	3.7
FBs	3.2	3.3	3.3	3.6	3.5
Comm. Banks	3.5	4.1	3.9	3.8	3.6
SBs	3.2	3.3	3.3	11.3	4.6
All Banks	3.5	4.3	4.4	4.1	3.7
Operating Exp. to Gross Income (NII +Non-interest Income)					
PSCBs	70.1	62.3	57.7	52.2	54.5
LPBs	80.9	67.3	60.4	50.1	49.2
FBs	59.4	54.5	45.4	42.7	43.3
Comm. Banks	71.6	62.7	57.3	50.0	50.4
SBs	70.5	59.0	84.7	35.0	49.8
All Banks	71.6	62.4	59.6	48.8	50.4
Intermediation cost					
PSCBs	3.4	3.2	2.9	2.8	2.9
LPBs	3.9	3.6	3.3	3.2	3.1
FBs	2.9	2.5	2.3	2.6	2.6
Comm. Banks	3.4	3.2	3.0	3.0	2.9
SBs	3.2	3.9	7.3	2.8	2.6
All Banks	3.4	3.2	3.2	3.0	2.9

gross income. Though these charges are subject to any end-of-year adjustments, as banks make more provisions at the end of year, the burden of these charges is on the decline. Provision to gross income ratios were 25.0 percent and 22.0 percent for CY01 and CY02 respectively. Also, improved asset quality, strengthened financial position of borrowers due to general recovery of the economy, and the fact that most of the problem-ridden banks have cleaned up their balance sheets, suggest lower provisions for the current year.

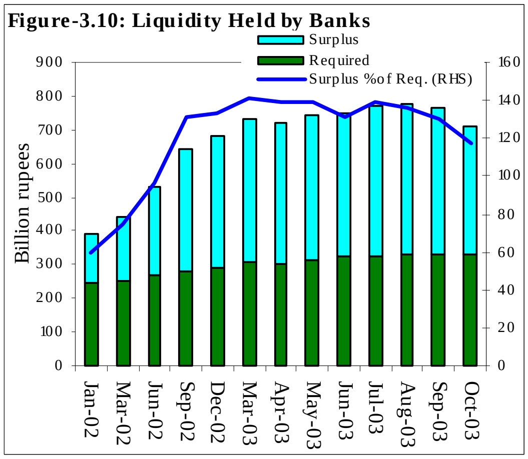
Group-wise, LPBs contributed more than 50 percent of the profits of the banking system. Foreign banks, enjoying the lowest intermediation costs and infected portfolio, remained the most efficient group. Specialized banks, after showing improvement in previous quarter, relapsed. Poor assets quality, entailing increased provision charges and meager interest income, caused their poor performance.

3.4 Liquidity & Sensitivity

During the quarter, market sentiment about the future direction of interest rate turned bullish, largely resulting from announcement of an unexpectedly high target for PIBs issue in June 2003. Just when initial euphoria associated with this was beginning to subside came the news of the government decision of a jumbo issue of Rs 50 billion PIBs, with subsequent hike of 40 bps in weighted average yield of 6-month T-bills in September 2003.

The market view on interest rate direction was, however, at odds with that of SBP that wanted to signal a bottoming out of rate with a rise in 6-month cut-off yield. The situation needed reconciliation. The market was made to tow the SBP line with post quarter developments. Nonetheless, this episode helped banks realize the thorny issue of yield risk (something which SBP had been trying to make them realize for quite some time) associated with their over-indulgence in PIBs. The quarter saw a welcome change in this regard with a reduction of Rs 7.7 billion in PIBs holding of banking industry to Rs.143.2 billion. Though amount is small, this could be repeated in coming days. However, lack of depth in the market could be a constraint in this regard.

Figure-3.10: Liquidity Held by Banks



Liquid assets as a percentage of total assets witnessed further strengthening to 47.3 percent as they gained a few basis points (see **Figure-3.11**). Statutory liquid assets maintained are, as usual, well above the required liquid assets (See **Figure-3.10**). However the level of surplus as percentage of required liquid assets registered a decline as SBP is sticking to its strategy of reduced auction targets in view of matching the inflows and outflows. Negative growth of loans led to a fall in loans to deposit ratio (See **Table-3.5**).

Figure-3.11: Liquidity Indicators

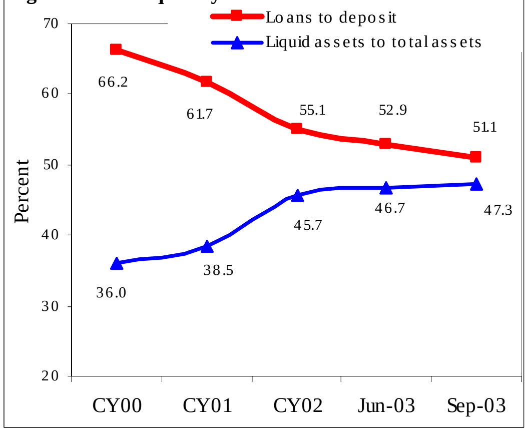


Table-3.5: Growth in Loans and Deposits

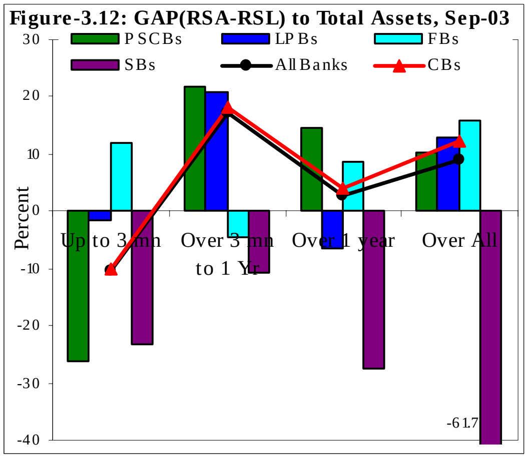
(Percent)	CY00	CY01	CY02	Jun-03	Sep-03
Loan Growth rate	14.7	2.3	2.1	6.6	-0.3
Deposits Growth Rate	6.9	10.0	13.7	6.3	2.3

Growth rates for Jun and Sep-03 are on quartelry basis.

Weighted average yields, though continued to fluctuate in the lower bands, exhibited a patterned movement in the rates. Gradually falling weighted average yields on MTBs experienced a dip of around 50 percent in the mid of the quarter on account of liquidity position. With the help of OMOs it managed to restore its opening level and came up with a marginal gain.

Yields on long term bonds in the secondary market started rising from mid of the quarter after shedding a few basis points in the beginning of the period under review. Yields on benchmark of 10 year PIBs rose by 118 basis points to 6.08 percent. Major reason for this being the expectation of higher rates on the Jumbo supply of PIBs.

Figure-3.12: GAP(RSA-RSL) to Total Assets, Sep-03



Pick-ups in the rates are translated into sensitive position of banks' assets. In the different time frames of maturity/ repricing schedule, the banking sector remained comfortable with the cumulative positive GAPs with in the acceptable band of +/- 10 percent (See **Figure-3.12**). However for three-month period the negative GAP remained greater than the tolerable limit. Sector wise, public sector commercial banks as well as local private banks remained aggressive while maintaining asset sensitive position, as percentage of total assets at 21.9 percent and 20.8 percent respectively, for one-year investment. Taking the riskier stance, public sector commercial banks are running large negative GAP at 26.3 percent for the shorter period of three months.

More or less stable exchange rate parity gives greater strength to the external transactions of banks. Frequent oversold positions of the banks during the quarter, however, reflect their riskier stance.

Glossary

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Risk weighted Assets Each asset and off-balance sheet item is assigned to one of the four broad risk categories based on the perceived credit risk of the obligor. These risk categories are assigned weights of 0 percent, 20 percent, 50 percent and 100 percent.

The standard risk category is 100 percent. The rupee value of the amount in each category is multiplied by the risk weights associated with that category. The off-balance sheet items are first converted to credit equivalent values by using the conversion factors. The resulting values for each of the risk categories are added together. The resulting sum is the total risk weighted assets.

SME Sector Means an entity, not being a public limited company, which does not employ more than 250 persons (if it is manufacturing concern and50 persons (if it is trading /services concern) and also fulfils any of the following criteria:

- **i.** A trading/ services concern with total assets excluding land and building upto Rs 30 million.
- **ii.** A manufacturing concern with original value of total assets excluding land and building up to Rs 50 million.
- iii. Any concern (trading, services or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.

Tier I capital The risk based capital system divides capital into two tiers**-** core capital (Tier I) and supplementary capital (Tier II). Tier I capital is defined as common stockholders' equity (including common stock, surplus and undivided profits), non-cumulative perpetual preferred stock and minority interest in consolidated subsidiaries.

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

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

Appendix-II

Abbreviations

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

Appendix-III

Group-wise Composition of Banks

2001	2002	June 30, 2003	September 30, 2003
A. Public Sector Comm. Banks Habib Bank Limited National Bank of Pakistan United Bank Limited First Women Bank Limited The Bank of Khyber The Bank of Punjab	**A. Public Sector Comm. Banks** Habib Bank Limited National Bank of Pakistan First Women Bank Limited The Bank of Khyber The Bank of Punjab	**A. Public Sector Comm. Banks** Habib Bank Limited National Bank of Pakistan First Women Bank Limited The Bank of Khyber The Bank of Punjab	**A. Public Sector Comm. Banks** Habib Bank Limited National Bank of Pakistan First Women Bank Limited The Bank of Khyber The Bank of Punjab
B. Local Private Banks Askari Commercial Bank Limited Bank Al-Falah Limited Bank Al Habib Limited Bolan Bank Limited Faysal Bank Limited Metropolitan Bank Limited Platinum Commercial Bank Ltd Prime Commercial Bank Limited Saudi Pak Commercial Bank Ltd PICIC Commercial Bank Limited Soneri Bank Limited Union Bank Limited Muslim Commercial Bank Limited Allied Bank of Pakistan	**B. Local Private Banks** Askari Commercial Bank Limited Bank Al-Falah Limited Bank Al Habib Limited Bolan Bank Limited Faysal Bank Limited Metropolitan Bank Limited KASB Bank Limited Prime Commercial Bank Limited Saudi Pak Commercial Bank Ltd PICIC Commercial Bank Limited Soneri Bank Limited Meezan Bank Union Bank Limited Muslim Commercial Bank Limited Allied Bank of Pakistan United Bank Limited	**B. Local Private Banks** Askari Commercial Bank Limited Bank Al-Falah Limited Bank Al Habib Limited Bolan Bank Limited Faysal Bank Limited Metropolitan Bank Limited KASB Bank Limited Prime Commercial Bank Limited Saudi Pak Commercial Bank Ltd PICIC Commercial Bank Limited Soneri Bank Limited Meezan Bank Union Bank Limited Muslim Commercial Bank Limited Allied Bank of Pakistan United Bank Limited Mashreq Bank	**B. Local Private Banks** Askari Commercial Bank Limited Bank Al-Falah Limited Bank Al Habib Limited Bolan Bank Limited Faysal Bank Limited Metropolitan Bank Limited KASB Bank Limited Prime Commercial Bank Limited Saudi Pak Commercial Bank Ltd PICIC Commercial Bank Limited Soneri Bank Limited Meezan Bank Union Bank Limited Muslim Commercial Bank Limited Allied Bank of Pakistan United Bank Limited Mashreq Bank
C. Foreign Banks ABN Amro Bank Al Baraka Islamic Bank American Express Bank Standard Chartered Grindlays Bank The Bank of Ceylon The Bank of Tokyo – Mitsubishi CITI Bank Credit Agricole Indo Suez Deutsche Bank Doha Bank Emirates Bank Habib Bank A. G. Zurich Hong Kong Shangai Banking Corporation IFIC Mashreq Bank PJSC Oman Bank Rupali Bank Society General Standard Chartered Bank	**C. Foreign Banks** ABN Amro Bank Al Baraka Islamic Bank American Express Bank The Bank of Ceylon The Bank of Tokyo – Mitsubishi CITI Bank Credit Agricole Indo Suez Deutsche Bank Doha Bank Habib Bank A. G. Zurich Hong Kong Shangai Banking Corporation IFIC Mashreq Bank PJSC Oman Bank Rupali Bank Standard Chartered Bank	**C. Foreign Banks** ABN Amro Bank Al Baraka Islamic Bank American Express Bank The Bank of Ceylon The Bank of Tokyo – Mitsubishi CITI Bank Credit Agricole Indo Suez Deutsche Bank Doha Bank Habib Bank A. G. Zurich Hong Kong Shangai Banking Corporation IFIC Oman Bank Rupali Bank Standard Chartered Bank	**C. Foreign Banks** ABN Amro Bank Al Baraka Islamic Bank American Express Bank The Bank of Ceylon The Bank of Tokyo – Mitsubishi CITI Bank Credit Agricole Indo Suez Deutsche Bank Doha Bank Habib Bank A. G. Zurich Hong Kong Shangai Banking Corporation IFIC (now NIB) Oman Bank Rupali Bank Standard Chartered Bank
D. Specialized Banks Agriculture Development Bank of Pak. Industrial Development Bank of Pakistan Federal Bank for Co-Operatives Punjab Provincial Co-operative Bank Limited	**D. Specialized Banks** Zari Tarqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Limited	D. Specialized Banks Zari Tarqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Limited	D. Specialized Banks Zari Tarqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Limited
All Commercial Banks Includes A + B + C	**All Commercial Banks** Includes A + B + C	**All Commercial Banks** Includes A + B + C	**All Commercial Banks** Includes A + B + C
All Banks Includes A + B + C + D	**All Banks** Includes A + B + C + D	**All Banks** Includes A + B + C + D	**All Banks** Includes A + B + C + D

1. On its privatization, UBL shifted from PSCB to LPB in 2002.
2. Platinum Commercial Bank Limited was purchased by KASB and renamed as KASB Bank Limited – 08-05-2002.
3. Emirates Bank International – Pakistan Operations were purchased by Union Bank Limited – 02-09-2002.
4. Society Generale _Pakistan Operations – were acquired by Meezan bank Limited – 30-04-2002.
5. ANZ Grindlays Bank was merged into / acquired by Standard Chartered – 30-11-2002.
6. FBC is under liquidation, hence excluded from 2002.
7. Mashreq Bank, after merger with Crescent Investment Bank, converted to a local private bank just after the close of quarter Jun-03.
8. IFIC, after merger with NDLC, converted to NIB (a local private bank) on 03-10-2003.