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SBP stresses upon banks to devise ingenious strategies to tackle rising NPLs

The State Bank of Pakistan has stressed upon the banks to devise ingenious strategies to deal with the high level of Non-Performing Loans (NPLs) so that promising businesses, which are facing transitory difficulties due to a constrained macro environment, continue to contribute in economic growth and service their obligations in an orderly manner, says SBP's Quarterly Performance Review of the Banking System for the quarter ended September 2010 which was released today.

The Report pointed out that the growth in NPLs, which decelerated during the first two quarters of CY10, grew by 7.4% during the quarter under review reaching Rs 494 billion as banks' lending portfolio, to some extent, was effected by recent unprecedented floods and torrential rains. "This coupled with over-the-quarter decline in lending portfolio amplified the deterioration in infection ratios," it said and added that however, since these fresh NPLs required only partial provisioning coverage, the system's baseline earning indicators remained positive.

The Report highlighted that the State Bank has responded to the changed and challenging circumstances and rationalized its regulatory requirements on loan loss recognition in respect of advances in flood-affected areas.

It said that asset base of the banking system contracted by 2.3 percent to Rs 6,626 billion which was in line with the established trend for the July-September quarter. "The *Ramadan* and pre-*Eid* withdrawals and increase in currency in circulation during the quarter led to a narrowing of the deposit base," it added.

The Report pointed out that the shrinking of the asset base, particularly advances, resulted in a decline in size of the risk-weighted asset (RWA) over the quarter. However, the higher regulatory deductions from Tier-1 capital reduced the eligible capital as well as risk-based capital adequacy ratio (CAR), which deteriorated marginally to 13.8 percent, while staying above the regulatory requirement of 10 percent, it added.

The report forecast that the usual inventory build up, particularly by Kharif crop-based industries, during the last calendar quarter will create additional demand for bank credit. "Although the banks are expected to remain liquid; the heightened demand for credit from the public sector will mean that the banks ability to finance additional private sector loans will be predicated upon mobilization of fresh deposits and retirement of commodity finance by government-owned agencies which continues to be extremely high," the Report stated said and added that banks will need to reduce their large portfolio of government paper and lending to the public sector agencies so as to reduce their sovereign exposure as well as to make credit available to the private sector for maintaining economic growth, and thereby enhance and diversify revenues of the banking system. Nevertheless, the aggregate earnings of the system are expected to be satisfactory, although these will continue to be concentrated in banks endowed with a wide network and competetively better placed to raise stable and relatively cheap funds, the Report said. However, it added that the increased credit risk will remain a major challenge for banks in the near future.

The detailed Report is available at State Bank's website www.sbp.org.pk

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