State Bank of Pakistan

Banking Surveillance Department

Quarterly Performance Review of the Banking System

June 2006

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List of Abbreviations

CAR	Capital Adequacy Ratio
CB	Commercial Bank
CDR	Credit to Deposit Ratio
CRR	Cash Reserve Requirement
CY	Calendar Year
FB	Foreign Bank
HTM	Held-to-Maturity
IB	Islamic Bank
IBB	Islamic Bank Branch
IBI	Islamic Banking Institution
LPB	Local Private Bank
MCR	Minimum Capital Requirement
MTB	Market Treasury Bill
NII	Net Interest Income
NOP	Net Open Position
NPF	Non Performing Finance
NPL	Non Performing Loan
NSS	National Saving Scheme
OMO	Open Market Operation
PIB	Pakistan Investment Bond
PSCB	Public Sector Commercial Bank
ROA	Return on Asset
ROE	Return on Equity
RSA	Rate Sensitive Asset
RSL	Rate Sensitive Liability
RWA	Risk Weighted Asset
SBP	State Bank of Pakistan
SB	Specialized Bank
SLR	Statutory Liquidity Requirement
SME	Small and Medium Enterprise

Glossary

Capital Adequacy Ratio is the amount of risk-based capital as a percent of risk-weighted assets.

Consumer Financing means any financing allowed to individuals for meeting their personal, family or household needs. The facilities categorized as Consumer Financing include credit cards, auto loans, housing finance, consumer durables and personal loans.

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

Credit risk arises from the potential that a borrower or counter-party will fail to perform an obligation or repay a loan.

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

Duration (Macaulay's Duration) is a time weighted present value measure of the cash flow of a loan or security that takes into account the amount and timing of all promised interest and principal payments associated with that loan or security. It shows how the price of a bond is likely to react to different interest rate environments. A bond's price is a function of its coupon, maturity and yield.

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

Gross income is the net interest income (before provisions) plus non-interest income; the income available to cover the operating expenses.

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

Interest rate risk is the exposure of an institution's financial condition to adverse movement in interest rates, whether domestic or worldwide. The primary source of interest rate risk is difference in timing of the re-pricing of bank's assets, liabilities and off-balance sheet instruments.

Intermediation cost is the administrative expenses divided by the average deposits and borrowings.

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

Liquidity risk is the risk that the bank will be unable to accommodate decreases in liabilities or to fund increases in assets. The liquidity represents the bank's ability to efficiently and economically accommodate decreases in deposits and to fund increases in loan demand without negatively affecting its earnings.

Market risk is the risk that changes in the market rates and prices will impair an obligor's ability to perform under the contract negotiated between the parties. Market risk reflects the degree to which changes in interest rates, foreign exchange rates, and equity prices can adversely affect the earnings of a bank.

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

Net Interest Margin (NIM) is the net interest income as a percent of average earning assets.

Net loans are the loans net of provision held for NPLs.

Net Non-Performing Loans (NPLs) is the value of non-performing loans minus provision for loan losses.

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

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

NPLs to loans ratio/Infection ratio stands for NPLs as a percent of gross loans.

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

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

Repricing risk arises from timing differences in the maturity of fixed rate and the repricing of floating rates as applied to banks' assets, liabilities and off-balance sheet positions

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

Return on equity is a measure that indicates the earning power of equity and is calculated as net income available for common stockholders to average equity

Risk weighted Assets: Total risk weighted assets of a bank would comprise two broad categories: credit risk-weighted assets and market risk-weighted assets. Credit risk weighted assets are calculated from the adjusted value of funded risk assets i.e. on balance sheet assets and non-funded risk exposures i.e. off-balance sheet item. On the other hand for market risk-weighted assets, first the capital charge for market risk is calculated and then on the basis of this charge amount the value of Market Risk Weighted Assets is derived.

Secondary market is a market in which securities are traded following the time of their original issue.

SME means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing/ service concern) and 50 persons (if it is trading concern) and also 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 or Supplementary Capital (Tier II & III) is limited to 100 percent of core capital (Tier I). Tier II includes; general provisions or general reserves for loan losses, revaluation reserves, exchange translation reserves, undisclosed reserves and subordinated debt.

Tier III capital consists of short-term subordinated debt and is solely held for the purpose of meeting a proportion of the capital requirements for market risks.

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

Yield curve risk materializes when unanticipated shifts have an adverse effect on the bank's income or underlying economic value.

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June 2006

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

Overview

The overall financial performance of the banking system remained impressive during the quarter under review. With the continuing growth momentum, the banking system succeeded in making heavy gains in the form of growing profits besides strengthening solvency. While the continuous fast expanding loans portfolio and rising interest rates started to translate into relatively higher credit, liquidity and market risks, the banking system with better operational strategies so far has managed to restrict them within safer bounds.

The most prominent feature of this quarter's performance remained significantly higher profits and exceptional growth in deposits. With an increase of Rs25.3 billion, total after tax profits (year-to-date) reached at a very high level of Rs40.2 billion; by far the highest ever in the first two quarters of a calendar year. The massive growth in profits reflected a salutary impact on the key profitability indicators, as return on assets (after tax) and return on equity (after tax) increased to 2.1 percent and 26.5 percent respectively. The healthy NIM and greater volume of business remained the main contributory factors behind such earning performance. In turn, the growth in loans remained helpful in yielding high returns for the banking system.

The continuing strong profits have also helped banks to stay on course to meet the enhanced Minimum Capital Requirement (MCR) in line with the regulatory instructions. The banks, besides retaining profits, have also been injecting additional capital. While, some of them have also been exploring merger and consolidation options to meet the stiffening capital requirement set for each year till 2009. During the quarter under review, capital adequacy ratio (CAR) of all banks increased to 11.9 percent from 11.6 percent in the preceding quarter. The persistent increase in CAR is remarkable given the fact that risk-weighted assets of the banking system continued to grow at a steady pace on the back of fast growing loans portfolio.

After experiencing relative sluggishness in the preceding quarter, loans once again picked up momentum and increased by Rs125 billion. This increase is extraordinary in the sense that it came in a period during which credit demand by the corporate sector generally tends to subside due to seasonal factors. In fact, the major catalyst this time around proved to be the loans for commodity operations, which availed Rs61.1 billion from the banking system. Consumer finance segment once again played significant role in overall loans growth as it absorbed Rs25.6 billion, which is higher if compared with the growth of Rs18.1 billion in the preceding quarter. Consequently, total exposure to consumer finance increased to Rs296.5 billion. The persistent fast growth in consumer loans appears even more significant if seen in the backdrop of rising interest rates. In fact, the higher returns on consumer financing have also been one of the major factors behind banks' growing exposure to this segment. Moreover, the low incidence of default vis-à-vis the rapid growth in consumer financing so far has also kept the banks' interest increasing in this sector. Despite increase in non-performing loans (NPLs) in absolute terms, the ratio of consumer NPLs to consumer loans at 1.9 percent remains within tolerable limits. Because of its low share in total loans and adequate provisioning standards, the threat to financial stability is yet to assume any serious proportions.

While the key asset quality indicators do not appear to pose any serious threat, the gradual increase in NPLs is nevertheless undesirable; and if the trend persists in the coming quarters, it will have the potential to reverse the accomplishments made by the banking system on profitability and solvency fronts. Total NPLs of all banks increased by another Rs7.2 billion, which though is quite high but is largely due to the increase of Rs4.8 billion in the NPLs of one of the specialized banks. This surge in NPLs of the specialized bank is due to the peculiar nature of classification reporting and recovery cycle. Since, the share of specialized banks in the total asset base of the banking system is almost negligible, it does not pose any serious threat to the banking system stability. However, the increase of Rs2.4 billion in the NPLs of commercial banks which translates into an increase of Rs5.9 billion to their NPLs portfolio since December 2005 is a real cause of concern. The growing threat is mitigated to some extent by the fact that the banking system has already made adequate provisions against these NPLs, resultantly increase in net NPLs of commercial banks comes to only Rs0.3 billion, which, if seen in the background of prolific rise in loans over the past many quarters, does not appear very alarming. Similarly, net NPLs to net loans ratio at 1.4 percent stayed at a tolerable level.

The other two important risks i.e. liquidity and market risks were also kept at bay despite the gradual rise in interest rates, because of State Bank's measure to rein in inflationary pressures. While SBP remained engaged in frequent mop-ups of excess liquidity and banks had to come to SBP's discount window for short-term liquidity support, the strong deposits inflow averted any serious liquidity strain on the banking system. Total deposits, with an increase of Rs238.3 billion, not only outshone the increase of Rs203.1 billion in the corresponding quarter of the previous year but also helped in bringing down credit to deposits ratio (net of export refinance) to 68.81 percent from 70.14 percent in March 2006. Market risk remained dominated by interest rate risk, and it arose mainly in the form of yield curve risk. However, banks were able to manage their GAP position within low risk bands.

In the backdrop of consistently rising trend in profits of the banking sector, the issue of lower rate of return to depositors and higher spread remained under discussion. Banks are taking advantage of peculiar structure of their deposits, which is significantly dominated by zero or low yield current/ saving deposits. The combined share of such deposits works out to be around 70 percent, which by all means is quite high, and undermines the overall weighted average deposits' rate. However, recent regulatory measure of introduction of separate cash reserve requirement (CRR) for demand and longer term deposits (higher for demand and lower for term) would encourage the banks to shift this peculiar deposit structure which would eventually help in raising the overall return to the depositors. The banks should further enhance the information about their liability product menu like assets products and should also design new products to meet the market demand. The depositors as vital market participants need to be more active and should profile their savings among different categories of deposits so as to optimise their liquidity-return trade-off. Further, in market-based economy, the depositors, through switching to the various products/banks, could play important role in determining the fair market rate of return that would help in narrowing down the interest rate spread.

If seen in the historical perspective, the banking system has performed exceptionally well in the first half of CY06; and given the current momentum this year might prove to be yet another milestone in terms of profits and solvency. However, the performance of the banking system in the remaining part of the year hinges a great deal on how it manages its key risks, particularly the credit and liquidity risks. The gradual rising trend in NPLs would affect the future profits and solvency. There is general apprehension that excessive credit expansion often leads to some erosion in asset quality. To manage it effectively, banks would have to ensure robust quality of their fresh loans by following stringent credit appraisal and monitoring standards. In this respect, the snowballing consumer finance exposure deserves special attention, and banks should adequately strengthen their risk management system and IT infrastructure to manage their retail operations before expanding too far in this profitable but risky arena.

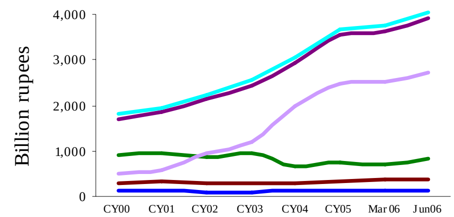
2. Assets and Funding Structure

In comparison to the first quarter of CY06, the **total assets** of the banking sector increased at a relatively faster pace during the June quarter. Although the growth in assets at 7.9 percent was way below the annual growth of 20.2 percent in CY05, this surpassed the respective growth in both, the previous quarter and the corresponding quarter of previous year (see **Figure 2.1**). The high inflows of deposits remained the major stimulating factor behind this surge in assets.

Though the assets mix of the banking system during the Jun-06 quarter resembled more or less the CY05 pattern (see **Figure 2.2**), the share of conventional earning assets i.e. investments and advances declined mainly due to certain maturities of government securities and comparatively slow growth in advances, Corresponding to this decline in the share of these two components, the share of liquid funds viz. cash and balances and lending to financial institutions increased by 2.4 percentage points.

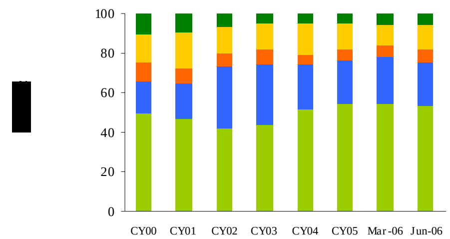
Group-wise position of the banks shows that the share of the PSCBs that was persistently following a downward trend, improved during Jun-06 quarter by 1.2 percentage points (see **Figure 2.3**). Consequently, the share of the other

Figure-2.1: Total Assets of Banking System



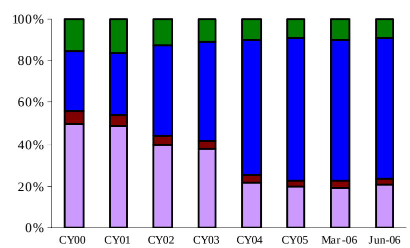
	CY00	CY01	CY02	CY03	CY04	CY05	Mar 06	Jun06
PSCBs	902	947	878	959	653	724	721	827
SBs	112	106	98	100	106	113	115	119
LPBs	513	566	967	1212	1,980	2,483	2,534	2,704
FBs	281	324	280	272	304	339	364	380
CBs	1,696	1,836	2,125	2,443	2,937	3,546	3,619	3,911
All	1,808	1,942	2,223	2,542	3,043	3,659	3,733	4,029

Figure-2.2 : Composition of Banks' Total Asse



	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
Other Assets	10.4	9.4	6.4	5.2	5.1	5.2	5.3	5.8
Cash &Bank Balances	14.7	18.7	14.0	12.6	16.1	12.8	11.3	12.2
Lending to FIs	8.9	7.0	6.6	7.7	4.7	5.8	5.6	7.1
Investments	16.8	18.1	31.5	30.9	22.3	21.9	23.3	21.3
Advances	49.1	46.9	41.4	43.6	51.7	54.4	54.5	53.6

Figure-2.3: Group-wise Share in Total Assets



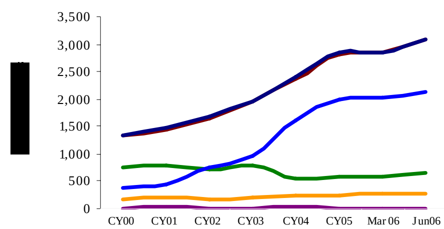
	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
FBs	15.5	16.6	12.6	10.7	10.0	9.3	9.8	9.4
LPBs	28.4	29.1	43.5	47.6	65.2	67.8	67.9	67.1
SBs	6.2	5.5	4.4	3.9	3.4	3.1	3.1	2.9
PSCBs	49.9	48.8	39.5	37.8	21.4	19.8	19.3	20.5

three groups viz. LPBs, FBs and SBs, declined slightly. Most of this enhanced share of PSCBs is due mainly to the increase in the asset base of two prominent players in this group whereas the share of LPBs dropped by 0.8 percentage points due to relatively slower growth in the assets of the banks that contributed towards the overall asset growth of this group in last couple of quarters. On the whole, the LPBs continued to hold the major share of the banking system, followed by PSCBs. A further analysis of total assets as per the size of banks shows that the share of big five banks increased slightly by 0.1 percentage point to 53.4 percent. Similarly the share of next five banks also slightly improved from previous quarter level of 18.8 percent to 19.1 percent in Jun-06. Despite the fact that a new Islamic bank started its operations during the quarter, the share of remaining banks squeezed by 0.4 percentage points.

A major portion, around 90 percent, of the assets growth of Rs.295.8 billion over the last quarter was funded through deposits and borrowings, which surged by Rs.238.3 billion and Rs.32.6 billion respectively.

The **deposit** mobilization, after witnessing a slow down in the last quarter, again got momentum in the current quarter and total deposits of the banking system increased at a much accelerated pace of 8.4 percent as compared to increase of only 0.6 percent during last quarter (see **Figure 2.4**). In absolute terms, total deposits of the banking system increased by Rs.238.3 billion as compared to increase of mere Rs.18.4 billion for the last quarter. Workers' remittances, one of the major contributory factors towards deposits' rise in recent years, kept up the momentum and their inflow increased by 17 percent over the last quarter and their overall quantum during current fiscal expanded by more than 10 percent over the last fiscal year. Other major factors, which contributed towards this end, include, but not confined to, further expansion in the banks' branch network during the quarter and enhanced marketing efforts by the banks.

Figure-2.4 : Deposits of Banking System

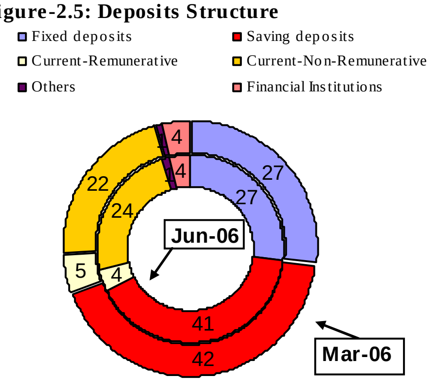


	CY00	CY01	CY02	CY03	CY04	CY05	Mar 06	Jun06
PSCBs	744	795	722	799	545	578	572	663
LPBs	394	454	757	954	1,604	1,995	2,010	2,143
FBs	187	208	183	194	227	245	258	272
CBs	1325	1457	1662	1947	2376	2818	2840	3077
SBs	16	18	16	17	17	16	12	13
All	1341	1475	1678	1964	2393	2834	2852	3091

The deposits of the banking system comprised of local currency deposits with a predominant share of 86.5 percent and foreign currency deposits forming 13.5 percent of total deposits. The foreign currency deposits, although grew at a slower pace of 4.63 percent as compared to growth rate of 8.96 percent for the local currency deposits, yet proved to be contributory towards the overall growth in deposits. The depositors' continued interest in foreign currency deposits helped maintain their share in total deposits over the period.

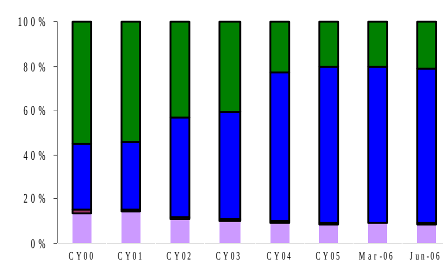
The weighted average deposits' rates are persistently on rise on the back of tightened monetary policy stance and increased competition among the market participants. This is evident by an increase of 159 bps in the weighted average deposits rates[1] since CY04. During the quarter under review, these rates increased by 14 bps. The peculiar structure of deposits with significant preponderance of zero or low yield current and saving deposits can be held responsible for low return paid on all deposits. The combined share of such deposits works out to be 68 percent, which by all means is quite high and it undermines the weighted average deposits' rate for the current quarter by 112 bps (see **Figure 2.5**).

Figure-2.5: Deposits Structure



However, the rising interest rates have witnessed positive impact on the deposits structure and the share of fixed deposits increased to 27 percent from 18 percent in CY04. The rates are expected to increase further given the growing liquidity strains, increase in the Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR) and the resultant stiff competition for funds. This would help further increase the share of fixed deposits in the total deposits of the banking system.

Figure-2.6: Group-wise Share in Deposits



	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	55.5	53.9	43.0	40.7	22.8	20.4	20.0	21.5
LPBs	29.4	30.8	45.1	48.5	67.0	70.4	70.5	69.3
SBs	1.2	1.2	1.0	0.9	0.7	0.6	0.4	0.4
FBs	14.0	14.1	10.9	9.9	9.5	8.6	9.1	8.8

LPBs and PSCBs had the major share of 55.6 percent and 38.2 percent respectively in the overall deposits' increase of Rs.238.3 billion. The share of PSCBs in the deposits' increase was conspicuous. By growing at a rate of 15.9

[1] Including zero rate total outstanding deposits.

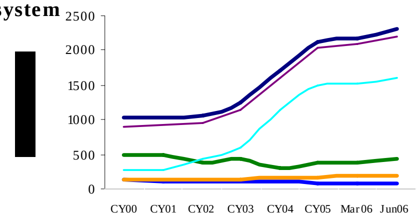
percent, PSCBs added Rs.91 billion to the growth in total deposits during the quarter. This helped PSCBs to reverse their declining share in the total deposits of the system (see **Figure 2.6**). While in absolute terms, LPBs' contribution at Rs.133 billion was the highest; the growth of 6.6 percent in their deposits was lower if compared with the PSCBs and resultantly they lost a portion of their share in deposits.

In order to maintain the healthy growth trend in the banking system, the banks, in the times ahead, will have to strive hard to get more deposits to finance their lending operations. Further, the banks, in view of rising interest rates and stiffer competition for funds, will have to offer better returns to attract fresh deposits.

The **borrowings**, another major funding source for the assets growth of the banking systems, also witnessed persistent increase in demand by the banking system. During this quarter, total borrowings of the banking system increased by another Rs32.6 billion. The break up shows that borrowings against repurchase agreement (Repo) and export finance together made up 66 percent of total borrowings, and during the current quarter, borrowings against both these heads increased by Rs26.0 billion and Rs4.6 billion respectively. The future trend in borrowings rests on the availability of liquidity as well as loan demand by the various segments of the economy. The present scenario indicates further rise in borrowings in the coming quarters.

The **loans** portfolio of the banking system witnessed significant growth during the June quarter (see **Figure 2.7**). Whilst the absolute increase in loans of Rs125 billion was way more than the previous quarter's increase of Rs48 billion, it also noticeably exceeded the growth of Rs99 billion in the corresponding quarter of the previous year. Main contribution to this increase in the loans came from LPBs and PSCBs, Group-wise, LPBs contributed Rs80 billion to this increase in the loans i.e. 64 percent of the total increase followed by PSCBs with Rs34 billion in the growth in absolute advances. The loans of FBs and SBs also increased during the quarter, as opposed to the previous quarter where the SBs experienced decline in their loan portfolio.

Figure-2.7: Total Loans of the Banking system



	CY00	CY01	CY02	CY03	CY04	CY05	Mar06	Jun06
PSCBs	476	501	374	422	302	379	389	423
SBs	124	118	117	97	99	91	89	92
LPBs	282	281	435	597	1153	1486	1513	1593
FBs	138	143	135	127	162	171	183	191
CBs	896	926	945	1146	1616	2036	2085	2207
All	1020	1044	1062	1243	1715	2126	2174	2299

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

(Billion Rupees)	Jun-05		Dec-05		Jun-06	
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
Corporate Sector	**944.0**	**52.3**	**1,076.2**	**52.7**	**1140.9**	**52.4**
Fixed Investments	369.2	20.5	440.3	21.6	457.4	21.0
Working Capital	385.4	21.4	411.1	20.1	463.8	21.3
Trade Finance	189.3	10.5	224.8	11.0	219.7	10.1
SMEs	**313.6**	**17.4**	**361.4**	**17.7**	**356.7**	**16.4**
Fixed Investments	31.7	1.8	34.1	1.7	34.8	1.6
Working Capital	224.0	12.4	267.7	13.1	261.3	12.0
Trade Finance	57.8	3.2	59.6	2.9	60.6	2.8
Agriculture production	**131.5**	**7.3**	**138.0**	**6.8**	**134.0**	**6.2**
Consumer Finance	**206.1**	**11.4**	**252.8**	**12.4**	**296.5**	**13.6**
Credit Cards	*19.3*	*1.1*	27.1	1.3	33.5	1.5
Auto Loans	*66.0*	*3.7*	82.1	4.0	97.8	4.5
Consumer Durables	*1.6*	*0.1*	1.7	0.1	1.5	0.1
Housing Loans	*27.1*	*1.5*	33.8	1.7	43.1	2.0
Personal Loans	*92.0*	*5.1*	108.0	5.3	120.5	5.5
Commodity Operations	**140.3**	**7.8**	**140.6**	**6.9**	**180.0**	**8.3**
Staff Loans	**40.5**	**2.2**	**42.4**	**2.1**	**43.3**	**2.0**
of which Housing Loans	28.8	1.6	30.1	1.5	31.3	1.4
Other	**28.0**	**1.6**	**31.6**	**1.5**	**27.7**	**1.3**
Total	**1803.9**	**100**	**2,043.0**	**100**	**2,179.0**	**100**

* Loans to both Public and Private sectors

Also include Export Finance

A detailed analysis of the sector wise break-up of loans reflects that the share of corporate sector loans declined to 52.4 percent from 54.3 percent in the last quarter despite an increase in advances of Rs19 billion over the quarter. However, a comparison to the corresponding quarter of the previous year shows almost consistent share of the corporate sector (see **Table 2.1**). As for SME sector, there was a decline not only in terms of share but also in absolute terms, despite the fact that the overall loans marked significant increase. Therefore, the share of SME sector loans continued to squeeze from 17.7 percent in CY05 to 16.4 percent in Jun-06 mainly because of decline in the working capital credit needs. For this quarter, the decline in the share of corporate and SME sector loans can be attributed to the heavy credit intake by the public sector for commodity operations due to cyclical factors. On the other end, the share of consumer finance has been growing persistently. During the first two quarters of CY06 as well, the consumer sector contributed another Rs44 billion to the growth in absolute loans of banking system. The break-up of the consumer finance shows that the personal loans continued to carry highest share of 41 percent followed by auto loans at 33 percent of the total consumer portfolio. In comparison to the Dec-05 position, the auto loans recorded the highest growth and contributed 36 percent of the increase in the consumer loans. The agriculture sector experienced a further decline in its share

Figure-2.8: End-Use Distribution of Bank Loans - Jun-05

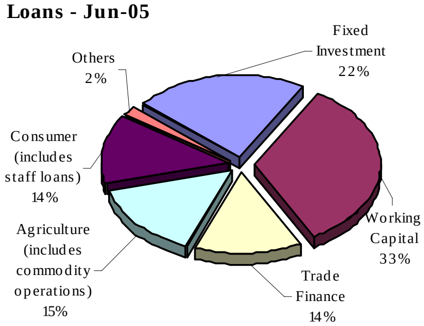
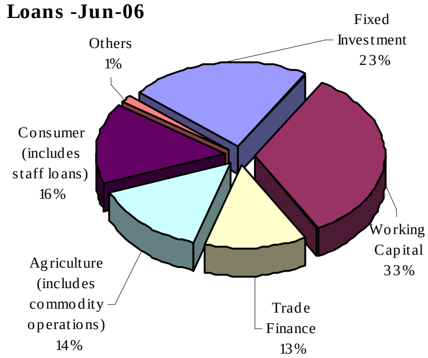


Figure-2.9: End-Use Distribution of Bank Loans -Jun-06



during the quarter.

The end-use distribution of credit also reflects the same (see **Figures 2.8 & 2.9**). The share of consumer finance increased from 14 percent to 16 percent when compared with the corresponding quarter of the previous year. Similarly fixed investment loans also increased by 1 percentage point, whilst the distribution of credit for trade finance and agriculture sectors experienced a decline.

As regards the overall increase in the credit intake, private sector played major role. The credit to this sector rose by Rs80 billion from Dec-05, however, the loans to public sector also jumped by Rs56 billion during the first two quarters.

In line with the increase in overall loans portfolio, outreach of the banking system increased significantly (see **Table 2.2**). The number of borrowers in almost all the sectors increased except for the SMEs and staff loans. The highest and much expected growth in the number of borrowers was in consumer sector that contributed 84 percent of the overall increase in the borrower base. Overall, the loans of the banking system have recorded significant growth, despite the increase in the lending rates. However, the surge in NPLs during the same quarter is a source of concern and might check the excessive lending by the banks in future.

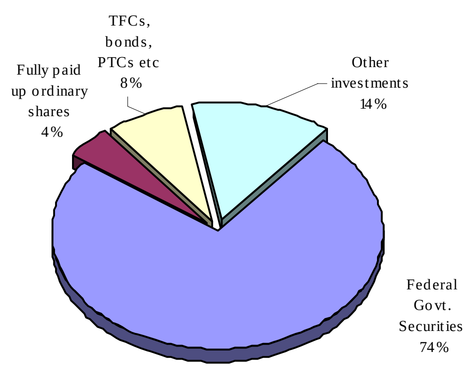
Table-2.2 : Sector-wise number of Borrowers

	Dec-02	Dec-03	Dec-04	Dec-05	Mar-06	Jun-06
Corporate Sector	14,256	17,743	19,333	19,881	19,546	19,604
SME Sector	67,520	91,663	106,248	161,316	161,008	158,050
Agricultuer	1,339,961	1,411,508	1,503,827	1,534,502	1,526,062	1,535,112
Consumer Finance	252,156	721,201	1,619,207	2,407,806	2,457,416	2,476,352
Commodity Operation	1,458	2,069	3,207	6,730	6,026	5,815
Staff Loans	72,570	69,796	72,633	72,927	73,255	70,800
Others	56,683	63,696	73,735	44,144	42,372	42,596
Total	**1,804,604**	**2,377,676**	**3,398,190**	**4,247,306**	**4,285,685**	**4,308,329**

Domestic operations covering both public and private sector borrowers

During Jun-06, the **investment** portfolio of the banking system reduced by Rs10.2 billion which is quite an anomaly over the last couple of quarters. A major decline of Rs25.7 billion was witnessed in the investments in federal government securities, which have had its impact on the overall investment portfolio as well. This also resulted into reducing its share in total investment to 74 percent from 76 percent in Mar-06 (see **Figure 2.10**). In percentage terms, however, the decline in overall investment was not that large at 1.4 percent and that of FG securities at 4 percent.

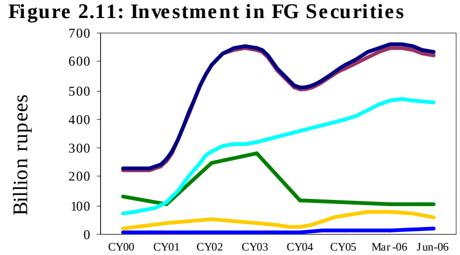
Figure-2.10: Breakup of Investments Jun-06



The break-up of these federal government securities shows that the decline was mainly because of the MTBs that reduced by 5 percent viz. Rs22 billion in absolute terms. Peculiar to this quarter, the banks avoided lock up of their funds in longer tenor MTBs, while at the same time preferring to stay liquid. Furthermore there were more maturities of such securities during the quarter that caused the reduction in the MTBs portfolio. As for the PIBs, despite the auction after a long gap, the overall investment in PIBs held by the banking sector reduced by Rs0.9 billion, due mainly to the fact that a major share of the auctioned PIBs were picked by the corporate sector, while there were also some maturities falling due during the same period.

Group wise investment in FG securities shows that the FBs were mainly responsible for the decline in such investments followed by LPBs (see **Figure 2.11**). During the quarter under review, they recorded a decline of Rs19 billion, whilst holdings of LPBs reduced by Rs10 billion. Conversely, SBs and PSCBs experienced a slight increase of Rs2 billion and Rs0.9 billion respectively.

Figure 2.11: Investment in FG Securities



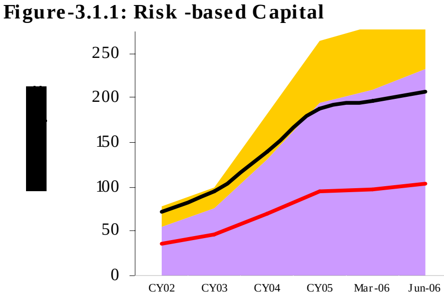
	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	130	106	246	280	117	109	106	106
SBs	6	4	5	5	6	15	15	17
LPBs	73	108	285	323	361	400	464	455
FBs	20	41	55	41	29	66	77	58
CBs	223	255	586	644	506	575	647	619
All	229	260	591	650	513	590	662	636

3. Financial Soundness of the Banking System

3.1 Solvency

On the back of re-capitalization drive and strengthening profitability, the solvency profile of the banking system kept improving. The persistent increase in capital is expected to provide greater resilience to banks in the coming months to absorb budding pressures on credit risk front.

Figure-3.1.1: Risk -based Capital



	CY02	CY03	CY04	CY05	Mar-06	Jun-06
Suppl. Capital	23.5	23.3	50.8	69.7	71.4	76.9
Core Capital	55.2	77.0	131.7	195.3	209.6	232.2
Required Core	35.9	47.3	69.6	94.2	97.9	104.0
Required Total	71.8	94.7	139.3	188.3	195.8	207.9

With an increase of Rs28.2 billion (10.0 percent), total risk-based capital increased to Rs309.1 billion from Rs280.9 billion in Mar-06. A noteworthy feature of the increase in capital is that it consisted mainly of the core capital; it accounted for 80.4 percent of the increase. Consequently, the share of core capital in the total risk-based capital increased to 75.1 percent from 69.5 percent in the previous quarter. Another positive aspect of the solvency profile is that core capital is not only well above the required core capital but also is comfortably above the required total risk-based capital, and the gap keeps on widening providing inherent strength to the banking system to bear adverse shocks of low to medium intensity[1] (see **Figure 3.1.1**).

Table-3.1.1: Capital Adequacy Indicators

Percent	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
CAR								
PSCBs	10.4	9.6	12.3	11.0	13.4	14.5	15.5	15.7
LPBs	9.2	9.5	9.7	9.0	10.1	10.6	11.0	11.5
FBs	18.0	18.6	23.2	23.0	17.4	16.4	16.1	13.5
CBs	11.4	11.3	12.6	11.1	11.4	11.9	12.3	12.6
SBs	(3.3)	(13.9)	(31.7)	(28.2)	(9.0)	(7.7)	(12.4)	(9.1)
All banks	9.7	8.8	8.8	8.5	10.5	11.3	11.6	11.9
Tier 1 Capital to RWA								
PSCBs	7.7	7.1	8.6	8.2	8.6	8.8	9.8	9.9
LPBs	8.1	8.4	6.6	7.0	7.5	8.3	8.7	9.2
FBs	17.9	18.6	23.0	23.0	17.1	16.1	15.8	12.9
CBs	9.8	9.7	9.7	9.1	8.6	9.1	9.5	9.7
SBs	(3.4)	(13.9)	(31.7)	(28.7)	(15.0)	(13.6)	(18.2)	(14.9)
All banks	8.3	7.3	6.2	6.5	7.6	8.3	8.6	8.9
Capital to Total Assets								
PSCBs	4.6	3.7	5.6	6.1	8.7	12.6	13.5	12.8
LPBs	3.5	3.8	5.2	5.3	6.5	7.0	7.4	7.4
FBs	8.8	8.5	10.6	9.9	8.9	9.5	9.4	8.3
CBs	4.9	4.6	6.1	6.1	7.2	8.4	8.8	8.6
SBs	(1.1)	(10.3)	(23.0)	(10.0)	(9.4)	(8.1)	(10.7)	(8.4)
All banks	4.5	3.8	4.8	5.5	6.7	7.9	8.2	8.1
Capital (free of net NPLs) to Total Assets								
PSCBs	(1.1)	(2.2)	0.9	3.1	7.3	11.9	12.9	12.2
LPBs	(1.9)	(1.0)	2.4	3.2	4.9	6.1	6.4	6.5
FBs	8.0	8.0	10.1	9.6	9.0	9.8	9.6	8.6
CBs	0.2	(0.0)	2.8	3.9	5.9	7.6	8.1	7.9
SBs	(25.5)	(34.4)	(44.5)	(30.9)	(27.2)	(21.1)	(20.1)	-22.71
All banks	(1.4)	(1.9)	0.7	2.5	4.7	6.7	7.2	7.0

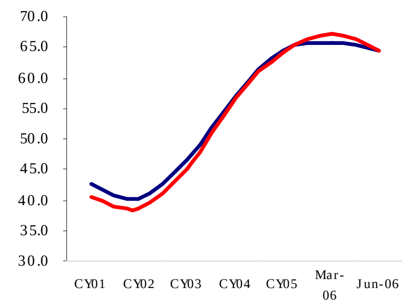
As the total capital of the banking system has gathered momentum to grow at increasing pace, the key solvency indicators have also shown gradual improvement. This is evident by further increase in capital adequacy ratio (CAR) to 11.9 percent from 11.6 percent in Mar-06 (see **Table 3.1.1**). While the banking

[1] see the section on stress testing.

system kept increasing its capital, its total risk-weighted assets also grew at a very fast pace on the back of snowballing loans portfolio. Consequently, the growth in CAR remained rather restricted. Despite this, the CAR for all banks well-exceeds the internationally recognized benchmarks.

The major contribution of core capital to strengthening solvency profile is also evident by the gradual increase in tier 1 capital to RWAs ratio for all banks. It increased to 8.9 percent from 8.6 percent in the preceding quarter. The remaining two indicators as given in the table, however, depicted some decline largely on account of relatively fast increase in total assets. While loans portfolio of the banking system registered a healthy growth, deposits grew at a much faster pace. Consequently, increase in total assets outstripped the increase in RWAs, which led to a fall in the ratio of RWAs to total assets during the quarter (see **Figure 3.1.2**).

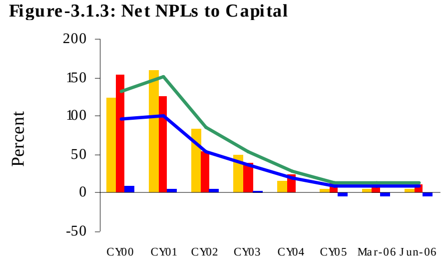
Figure-3.1.2: RWA to Total Assets



	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
All Banks	42.6	40.3	46.5	57.2	64.3	65.6	64.5
CBs	40.5	38.6	45.2	56.6	64.1	67.2	64.4

Besides restricting the growth in CAR through fast increase in RWAs, the rapidly growing loans portfolio of the banking system has also shown developing strain on capital in the form of gradual increase in NPLs. The strain is not evident by the ratio of net NPLs to capital for CBs, which decreased to 8.5 percent from 8.9 percent in the preceding quarter (see **Figure 3.1.3**). This is mainly because of faster increase in capital as compared to increase in NPLs of CBs. However, the ratio for all banks increased during the quarter owing to substantial increase in NPLs of a specialized bank.

Figure-3.1.3: Net NPLs to Capital



	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	124.5	160.2	83.4	50.0	16.2	5.5	6.0	5.6
LPBs	153.5	125.2	54.8	39.1	24.3	13.0	12.7	12.0
FBs	9.0	5.8	4.7	3.2	-0.2	-3.0	-3.2	-3.8
CBs	96.7	100.7	54.2	36.9	19.0	9.0	8.9	8.5
All	131.3	150.5	85.5	54.4	29.2	14.3	12.7	13.9

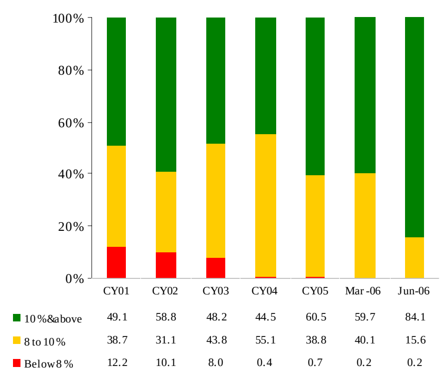
The group wise solvency profile shows gradual decline in CAR of FBs. The decline during this quarter was quite substantial as it decreased to 13.5 percent from 16.1 percent in Mar-06 and 16.4 percent in Dec-06. Heavy repatriation of profits by the two large FBs was mainly responsible for this significant fall. On the other hand, LPBs and PSCBs continued to add strength to their respective CARs.

A disaggregated analysis also shows substantial increase in the number of banks falling in the well-capitalized CAR position (see **Table 3.1.2**). During this quarter, banks with their CAR above 10 percent increased to 34 in number as compared to 30 in Mar-06. The most significant aspect of this increase is that it includes some large systemically important banks, and their classification among this group would be very salutary for the overall financial stability. Another indicator of the sustained improvement in solvency is the share of well-capitalized banks in the total assets of the banking system. As a result of the shift of two large banks, the share of the well-capitalized banks in total assets increased sharply to 84.1 percent from a relatively modest 59.7 percent in Mar-06 (see **Figure 3.1.4**). As regards the compliance of Minimum Capital Requirement of 2 billion, 8 banks were non-compliant, which by the end of Sep-06 further reduced to 6.

Table-3.1.2: Distribution of Banks by CAR

Nos.	Total	Below 8%	8 to 10 %	10 to 15 %	Over 15 %
CY97	46	7	5	12	22
CY98	46	2	4	17	23
CY99	44	3	6	16	19
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
CY05	39	2	7	13	17
Mar-06	40	1	9	11	19
Jun-06	41	1	6	17	17

Figure-3.1.4: Bank's Market Share by CAR



Given the current trends in profits and the increasing minimum capital requirements, the banking system is expected to remain on the path of persistent improvement in its capital in the coming quarters. Besides the above, the mergers trend in the banking industry is also likely to continue for some time, and the driving factors remain the enhanced MCR as well as the desire to capture the maximum market share by large banks to capitalize on the profitable opportunities offered by the booming market. However, it is absolutely essential for the banking system to ensure high quality of rapidly rising loans to shield capital against unexpected losses.

3.2 Profitability

For another quarter the banking system remained progressive and profitable sector of the economy. The year to date after tax profits of the banking system rose to Rs40.2 billion against Rs14.9 billion in the preceding quarter. The role of LPBs and PSCBs has been remarkable in boosting the profitability of banking system for yet another quarter of CY06 (See **Table 3.2.1**)

Table-3.2.1: Profitability of Banking System

(Billion Rs)	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
Profit before tax								
PSCBs	3.9	0.2	10.9	16.1	14.2	22.8	6.6	15.6
LPBs	(0.6)	5.0	11.9	23.8	31.0	60.5	16.7	36.9
FBs	3.7	5.0	6.6	7.1	7.2	11.6	3.5	6.9
CBs	7.0	10.3	29.4	47.0	52.4	94.9	26.7	59.4
SBs	(2.5)	(9.2)	(10.4)	(3.3)	(0.4)	(1.1)	(3.0)	(0.7)
All Banks	4.5	1.1	19.0	43.7	52.0	93.8	23.7	58.7
Profit after tax								
PSCBs	1.8	(4.6)	4.8	9.4	8.0	15.5	4.3	10.6
LPBs	(3.5)	2.0	6.4	14.8	21.8	41.1	11.2	25.5
FBs	1.4	2.4	4.2	4.2	5.8	8.0	2.4	4.9
CBs	(0.2)	(0.2)	15.3	28.4	35.6	64.6	17.9	41.0
SBs	(2.6)	(9.5)	(12.4)	(3.7)	(0.9)	(1.3)	(3.0)	(0.8)
All Banks	(2.8)	(9.8)	2.9	24.7	34.7	63.3	14.9	40.2

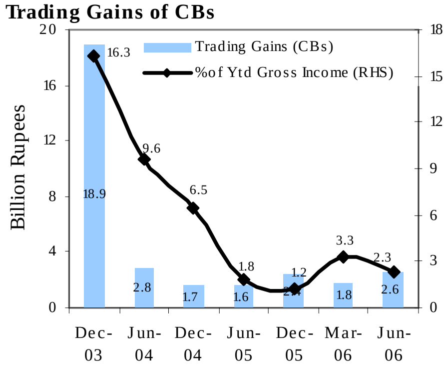
Commercial banks witnessed persistent rise in their profits and further improvement in the earning ability. Resultantly, after tax ROA of CBs improved to 2.2 percent from 2.0 percent in the preceding quarter. PSCBs recorded the highest rise in after tax ROA, which improved from 2.4 percent in Mar-06 to 2.8 percent in Jun-06. A mild but discernable upward shift has also been witnessed in case of LPBs with after tax ROA improving to 2 percent from 1.8 percent in Mar-06. However, the aforementioned ratio remained unchanged for foreign banks. Likewise, after tax ROE of banking system as a whole depicted further strength reflecting across the board improvement in all groups. (See **Table 3.2.2**)

Table-3.2.2: Profitability Indicators

(Percent)	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
After Tax ROA								
PSCBs	0.2	(0.5)	0.6	1.0	1.3	2.2	2.4	2.8
LPBs	(0.7)	0.4	0.8	1.4	1.2	1.8	1.8	2.0
FBs	0.6	0.8	1.5	1.5	2.0	2.5	2.7	2.7
CBs	(0.0)	(0.0)	0.8	1.2	1.3	2.0	2.0	2.22
SBs	(2.3)	(8.8)	(12.1)	(3.7)	(0.8)	(1.2)	(11.1)	(1.4)
All Banks	(0.2)	(0.5)	0.1	1.0	1.2	1.9	1.6	2.11
After Tax ROE *(based on Equity plus Surplus on Revaluation)*								
PSCBs	4.9	(12.2)	11.5	17.3	17.2	20.9	19.9	22.7
LPBs	(17.4)	10.3	17.3	25.8	20.2	27.2	24.8	27.3
FBs	6.1	9.1	15.2	14.8	21.5	27.1	28.9	30.2
CBs	(0.3)	(0.3)	14.3	20.3	19.6	25.4	23.8	26.2
SBs	-	-	-	-	-	-	-	-
All Banks	(3.5)	(12.6)	3.2	20.0	20.3	25.8	20.5	26.54

The profitability of CBs remained buoyant and the core earnings constituted a major share of 73 percent of their gross income. Non core sources of income have also shown significant growth in absolute terms, though their share in gross income remained intact. This growth in non-core income was driven by fee, commission and brokerage income. Although relatively slower but similar tendency has been depicted by dividend income as well.

Figure-3.2.1: Periodic Growth in Trading Gains of CBs



Despite a considerable increase in absolute amount, the share of trading in gross income has declined (see **Figure 3.2.1**). Though, income from dealing in foreign currencies registered year-on-year growth of 52 percent, the gain on sale of securities has witnessed 34 percent fall compared to corresponding quarter of last year. Keeping the ongoing trends intact, income from trading in shares continues to constitute the largest share of 84 percent in total trading gains.

Although with the expansion of business volume, the expenditure side was also expected to grow robustly, but the growth in expenses has been relatively slower. During the quarter under review, banking system seems to have been successful in its efforts to contain the expenses. Though in absolute terms the growth in expenses is quite significant, gauging the variable in terms of gross income, which is more useful indicator, the situation has significantly improved. Cost income ratio has declined to 40.8 percent against 43.7 percent in the preceding quarter. Except FBs, the other two groups have successfully managed to reduce their operating expenses as evident from cost income ratio of LPBs falling from 46.95 percent in Mar-06 to 43.69 percent in Jun-06 and for PSBs it remained 30.38 percent, creeping down from 33.90 percent in Mar-06.

In context of rise in NPLs, the provisioning expenses have slightly crept up. As a result, the loan loss provisions to gross income ratio increased to 6.6 percent against 5.2 percent in corresponding quarter of last year. This rise could also be attributed to SBP's more stringent classification and provisioning criteria.

Conversely, operating expenses (including provision expenses) to gross income ratio at 47.3 percent for June 2006 has significantly reduced from 52.4 percent in June 2005(See **Figure 3.2.2**), providing an ample evidence of improved results of corporate restructuring, privatization and good governance which meant better operating efficiencies. Other things aside, net interest income of Rs 82 billion is sufficient to cover the operating expenses and provisioning charges.

Growth in high yield assets in conjunction to rising lending rates contributed substantially in enlarging the earnings of banking system. In addition, other relevant factors have also performed well in the improvement of profitability. By most standards, overall earnings have shown improvement; highest growth has been registered in earnings on account of repo-transactions, likewise, return on other categories including loans and advances to customers, financial institutions, on investments and deposits with other financial institutions have registered noticeable growth compared to the corresponding quarter in the previous year. This resulted in improvement of net interest income which touched Rs150 billion, far above Rs89 billion for the corresponding quarter of previous year.

Expansion in net interest income was contributed primarily by sustainable rise in returns coupled with substantial growth in asset base. **Figure 3.2.3** shows the sources of rise in net interest income.

The overall interest rate spread, determined on the basis of total outstanding deposits/loans, has been hovering around 7.20-7.50 percent in

Figure-3.2.2: CBs' P&L Structure

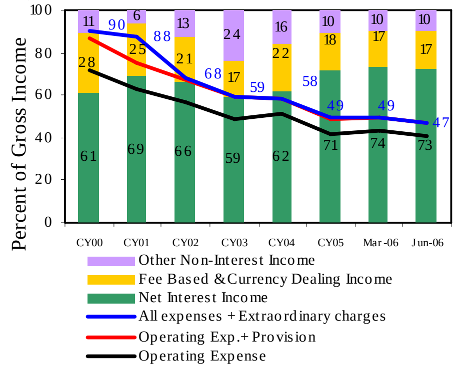


Figure-3.2.3: Sources of Expansion in Net Interest Income

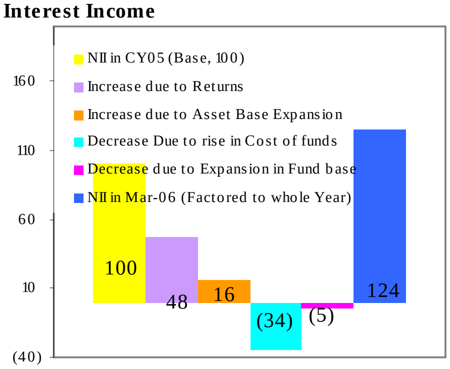
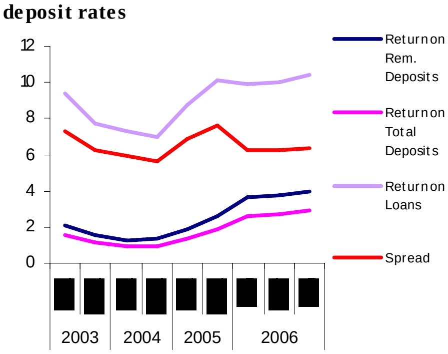
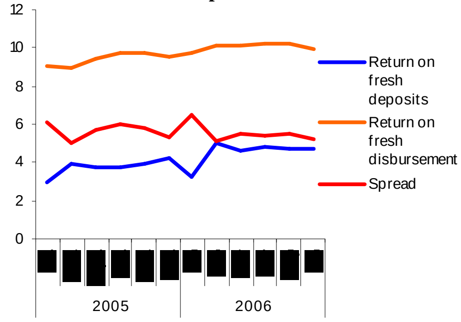


Figure-3.2.4: Weighted average lending and deposit rates



the first half of 2006 against 7.26 percent in Dec. 05 (See **Figure 3.2.4**). On the other hand, spread for the quarter, determined on the basis of incremental deposits and fresh disbursements during the quarter, has declined to 5.21 percent in Jun-06 against 5.49 percent in Mar-06, mainly owing to increase in return on fresh deposits. (See **Figure 3.2.5**)

Figure-3.2.5: Weighted average rates for fresh disbursements and fresh deposits



The banking system is on its way to make extraordinary profits for yet another year. However, its sustainability in the backdrop of excessive credit risk would be a challenge for the banks. During the quarter under review, a slight but alarming jump in NPLs has also been witnessed. Since, loans classification and provisioning criteria has now become more stringent and infection to assets quickly translates into provisioning, there is a dire need for further tightening of credit appraisals and monitoring standards to contain future increase in NPLs portfolio, which can adversely affect the profitability of banking system.

4. Risk Assessment of the Banking System

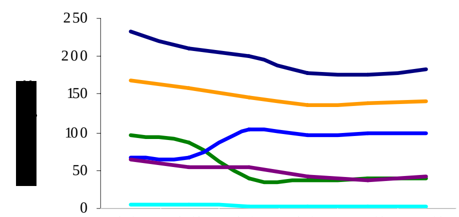
4.1 Credit Risk

On the back of persistent and strong growth in loans, the concerns about high credit risk continued to overhang the other wise impressive all round performance of the banking system in this quarter. This is evident by an increase of another Rs2.4 billion in total gross non-performing loans (NPLs) of commercial banks (see **Figure 4.1.1**). Resultantly, total NPLs of CBs reached to Rs141.5 billion from Rs139.1 billion in Mar-06.

Specialized banks experienced even greater increase of Rs4.8 billion in their NPLs; the major reason remains the peculiar nature of financing and recovery operations of a large specialized bank. Consequently, total NPLs of all banks surged to Rs183.8 billion from Rs176.7 billion in Mar-06.

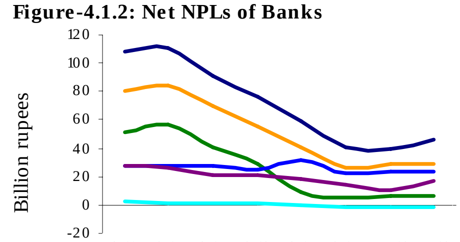
The higher credit risk is also evident by the concomitant increase in net NPLs of all banks (see **Figure 4.1.2**). While the increase of Rs0.3 billion is relatively less pronounced for commercial banks, it nevertheless reflects building pressures on the asset quality of this vital segment of the financial sector, and the banking system can ill-afford the persistent increase in this ratio considering its potential adverse impact on capital.

Figure-4.1.1: Total NPLs of Banks



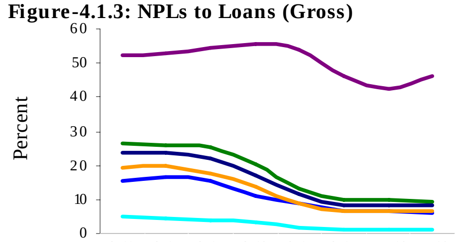
	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	95.5	85.9	40.1	38.0	39.0	39.6
LPBs	66.9	67.4	103.4	95.6	98.1	99.8
FBs	5.2	4.0	2.5	2.1	2.0	2.0
CBs	167.6	157.2	146.1	135.6	139.1	141.5
SBs	63.9	54.1	53.7	41.7	37.6	42.4
All	231.5	211.3	199.8	177.2	176.7	183.8

Figure-4.1.2: Net NPLs of Banks



	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	51.1	56.2	41.0	29.4	9.2	5.0	5.8	5.9
LPBs	27.4	27.2	27.7	25.1	31.1	22.5	23.6	23.9
FBs	2.2	1.6	1.4	0.8	(0.0)	(1.0)	(1.1)	(1.2)
CBs	80.8	85.0	70.1	55.4	40.3	26.6	28.3	28.6
SBs	27.2	25.6	21.2	20.8	18.8	14.7	10.6	16.8
All	108.0	110.5	91.3	76.2	59.1	41.2	38.9	45.5

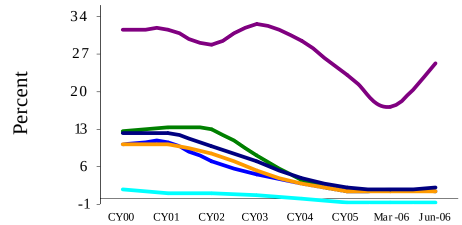
Figure-4.1.3: NPLs to Loans (Gross)



	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	26.3	25.9	25.5	20.4	13.3	10.0	10.0	9.4
LPBs	15.4	16.3	15.4	11.3	9.0	6.4	6.5	6.3
FBs	4.7	4.3	3.8	3.1	1.6	1.2	1.1	1.1
CBs	19.5	19.6	17.7	13.7	9.0	6.7	6.7	6.4
SBs	52.4	53.0	54.7	55.6	54.1	46.0	42.4	46.0
All	23.5	23.4	21.8	17.0	11.6	8.3	8.1	8.0

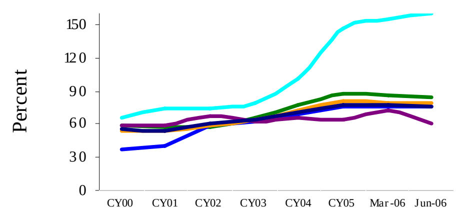
A glance across key asset quality indicators, however, does not appear to show any serious concern (see **Figure 4.1.3**). NPLs to loans ratio declined slightly for both CBs and all banks. In fact, the fast growing loans portfolio helped in shrouding the rise in NPLs as discussed above. The impact of rising NPLs, however, is more evident in case of net NPLs to net loans ratio (see **Figure 4.1.4**). This ratio stayed unchanged for CBs while it increased for all banks. This is depictive of the fact that provisioning against NPLs, mainly for SBs, fell short of increase in NPLs during the quarter, thus causing deterioration in the ratio for all banks. With increasing provisions by FBs, the provisions to NPLs ratio for CBs improved slightly to 79.8 percent in Jun-06 from 79.7 percent in Mar-06 (see **Figure 4.1.5**). Despite some stress, the key asset quality indicators stay beyond the standard asset quality indicators.

Figure-4.1.4: Net NPLs to Net Loans



	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	12.7	13.1	12.8	8.1	3.4	1.5	1.6	1.5
LPBs	10.3	10.4	7.0	4.5	2.9	1.6	1.6	1.6
FBs	1.7	1.1	1.1	0.7	(0.0)	(0.6)	(0.6)	(0.6)
CBs	10.1	10.3	8.3	5.3	2.7	1.4	1.4	1.4
SBs	31.6	31.5	28.5	32.5	29.3	23.1	17.2	25.3
All	12.2	12.1	9.9	6.9	3.8	2.1	1.9	2.1

Figure-4.1.5: Provisions to NPLs



	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06
PSCBs	59.2	56.6	57.1	65.8	77.0	86.9	85.2	85.0
LPBs	36.9	40.5	58.6	62.7	69.9	76.4	75.9	76.0
FBs	65.9	74.1	73.3	78.7	101.9	145.8	155.3	159.5
CBs	53.9	53.2	58.2	64.8	72.4	80.4	79.7	79.8
SBs	58.1	59.2	66.9	61.5	64.9	64.8	71.7	60.3
All	55.0	54.7	60.6	63.9	70.4	76.8	78.0	75.3

Considering their overwhelming share in the total banking assets, LPBs occupy a very high systemic importance. However, their NPLs over the past few quarters have continued to show a gradual upward trend, and if this trend persists in the coming quarters, the situation would require serious effort on the part of key players to reverse this trend. In this quarter, LPBs saw an increase of Rs1.7 billion in their gross NPLs and Rs0.3 billion in net NPLs. The position is not different for PSCBs, which also experienced an increase of Rs0.6 billion and Rs0.1 billion in their gross NPLs and net NPLs respectively. On the other hand, FBs continued to enjoy comfortable position, as their gross NPLs remained unchanged whereas net NPLs stayed in the negative zone as they are already maintaining excess provision against NPLs.

Consumer financing has been a noticeable activity of a good number of banks in recent years, and total exposure, both in terms of volume and number of borrowers, has grown appreciably. While more number of banks has ventured into consumer financing because of higher returns, they have started to experience some strains on the quality of their consumer finance portfolio of late. During the current quarter, the ratio of NPLs to loans for consumer sector increased to 1.9 percent from 1.3 percent in Mar-06 (see **Table 4.1**).

Table-4.1 Segmentwise NPLs to Loans Ratios

(Domestic Operations) (Percentage)

Segment	CBs		SBs		All Banks	
	06-Mar	06-Jun	06-Mar	06-Jun	06-Mar	06-Jun
Corporate	7.0	7.0	99.9	99.9	7.4	7.4
SMEs	8.7	8.5	93.1	91.0	11.6	11.3
Agriculture	7.6	7.1	31.6	37.2	21.0	23.4
Consumers	1.3	1.9	26.5	23.1	1.3	1.9
Credit Cards	0.9	1.0	0.0	0.0	0.9	1.0
Auto Loans	0.9	1.3	34.8	38.6	0.9	1.4
Consumer Durables	10.3	7.5	29.3	28.5	11.2	8.6
Mortgage Loans	0.4	0.5	0.0	0.0	0.4	0.5
Others	1.8	3.0	0.0	0.0	1.8	3.0
Commodity Finance	1.4	1.2	0.0	0.0	1.4	1.2
Staff Loans	1.1	1.3	0.8	0.8	1.1	1.2
Others	9.8	10.6	9.1	8.3	9.7	10.6
Total	**6.1**	**6.0**	**42.4**	**46.0**	**7.7**	**7.6**

As a result of increase in NPLs against consumer finance, the share of this segment in the total NPLs of the banking system increased to 3.3 percent from 2.2 percent in the preceding quarter. The break up of NPLs reveals that NPLs against unsecured products like personal loans constitute the major share followed by auto loans which are adequately secured. Despite the increase in NPLs, the threat to financial stability at present does not appear to be ominous keeping in view the proportion of consumer finance in the total loans of the banking system.

Total NPLs in the corporate sector, the main user of bank loans, increased by Rs1.2 billion during the quarter. However, the ratio of NPLs remained unchanged because of almost proportionate increase in total loans to this segment. The share of corporate sector in total NPLs declined to 50.3 percent from 52.1 percent in Mar-06. It happened because of increase in NPLs in consumer financing and agriculture segments. In contrast to the decline in the preceding quarter, NPLs in the agriculture sector increased by Rs5.3 billion, leading to increase in its share in total NPLs to 18.8 percent from 16.4 percent in Mar-06. While the major factor remains the increase in the NPLs of one large specialized bank, the high share of agriculture in total NPLs is a cause of real concern as total loans in this segment account for a mere 6.1 percent.

The downward trend of NPLs in the SME segment continued in this quarter as well. Total NPLs in this segment declined by Rs1.2 billion, and this decline is an encouraging sign considering the vital importance of this segment to the economy. Its share in total NPLs also declined to 24.1 percent from 26.1 percent in Mar-06.

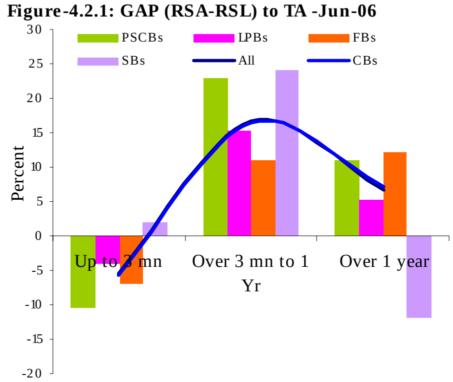
Going by the current indicators, the asset quality of the banking system does not pose any significant threat to the profitability and capital position of the banking system. However, the slow but steady increase in NPLs needs to be checked in order to prevent it from assuming any alarming posture. This calls for prudent and rational lending practices with a vigilant eye on the borrowers’ credit worthiness coupled with intense and thorough monitoring of the credit portfolio by banks.

4.2 Market Risk

Of the three market risk factors, interest rate risk continued to dominate the market risk profile of the banking sector.

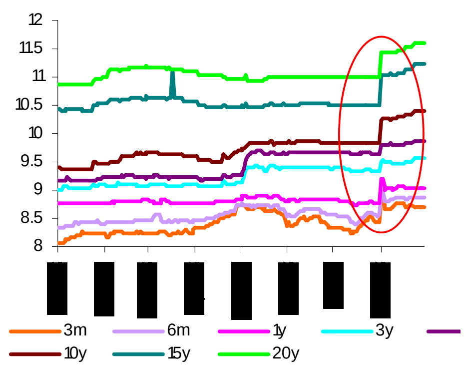
Further, among various interest rates factors; repricing GAPs are one of the major sources of interest rate risk for the banks. In response to the rising interest rate, the banks rationalized the mismatches in the maturities of their rate sensitive assets and liabilities and hence the overall GAP position improved over the quarter. For the three-month bucket, the negative GAP of all banks reduced from 7.2 percent of total assets in Mar-06 to 5.5 percent (see **Figure 4.2.1**). Group-wise, this negative GAP in the three-month time frame rationalized to about 10 percent of total assets as against 17 percent in Mar-06. Corollary to this, the large positive GAPs in the longer term buckets also came down, reducing the risk arising from the revaluation.

Figure-4.2.1: GAP (RSA-RSL) to TA -Jun-06



However, the yield curve risk has remained a concern for the banks since the interest rates have started rising. Though the longer term interest rates remained stable over the Jun-06 quarter, the increase in discount rate and the liquidity requirements in late July-06 have pushed the interest rates up across all the maturities (see **Figure 4.2.2**).

Figure-4.2.2 PKRV Rates (in %)



The yield curve flattening continued during Jun-06 quarter as well, which can be seen in the squeezing interest rate spread across different maturities. However, by the end of Jul-06, the increase in both the liquidity reserve requirement and discount rate increased the interest rates of 3y, 5y and 10y maturities (see **Figure 4.2.3)**. This has also slightly moved the yield curve towards some steepening and the interest rate spread across different maturities started to pick up (see **Figure 4.2.4)**. This raises a concern especially for those banks with longer term assets since any further steepening of the yield curve may lower the value of longer term fixed assets.

On exchange rate side, the increasing trade deficit on account of heavy oil payments and the other year end outflows put some strain on the rupee during Jun-06. The rupee dollar exchange rate, after crossing the psychological barrier of 60 in the last quarter stayed around 60.28 during the June quarter and by the end of August the all time high was 60.39. Kerb market rate reached to 61 in the last week of Jul-06, widening the Kerb premium to 0.67, which started to fall in Aug-06(see **Figure 4.2.5)**.

With this depreciation of rupee, the banks were not exposed to the risk of loss in value of their portfolio since they had their foreign currency assets well exceeding the foreign currency liabilities. This is also reflected in the positive net open position (NOP) of the banks (see **Figure 4.2.6)**. Banks' foreign exchange exposures (FEE) are also within their limits i.e. +/-10 percent of their capital. In swaps, premiums for longer tenors are higher, signifying the market expectations of further strengthening of dollar against rupee.

Figure-4.2.3: Shift in Yield Curve

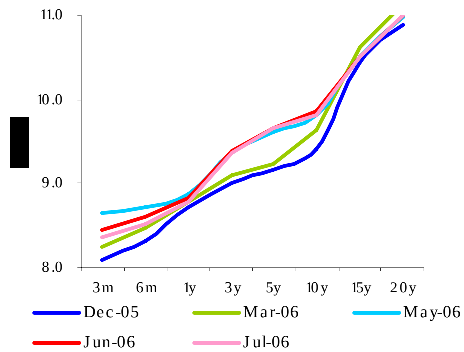


Figure -4.2.4: Yield Spread in PKRV Rates (in %)

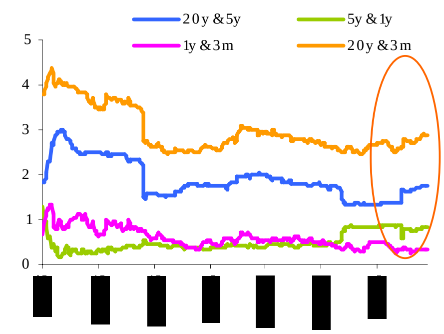
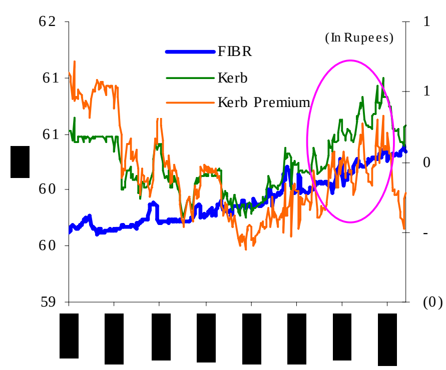


Figure-4.2.5: FIBR Vs Kerb Rate



During the quarter under review, the banks' overall investment in shares[2] increased. Recording a growth of 6.8 percent over the quarter, equity investments increased from Rs34.4 billion in Mar-06 to Rs36.8 billion in Jun-06 (see **Figure 4.2.7**). However, the capital base of the banks also increased by same percentage, keeping the equities investment exposure of the banking system within justifiable limits, hence the equity price risk stagnant at 11.3 percent when seen in terms of capital.

Group-wise, LPBs showed increase in their investment in shares while there is a decline in such investments held by PSCBs. However, the addition by LPBs is relatively larger than the decline recorded by the latter. As percentage of capital, the investment exposure of LPBs increased to 15.6 percent from 15.2 percent, whereas the PSCBs reduced their exposure to 4.4 percent from 5.4 percent in Mar-06. The exposure of FBs though increased to 1 percent of their capital, it is still negligible. Further analysis of the bank wise position reveals that while the overall exposure[3] of most of the banks as percentage of their capital remained within reasonable limits, a few banks carried high exposures (including indirect exposure) (see **Figure 4.2.8**). However, these banks constituted a

Figure-4.2.6: NOP Vs Rs/$ Exchange Rate

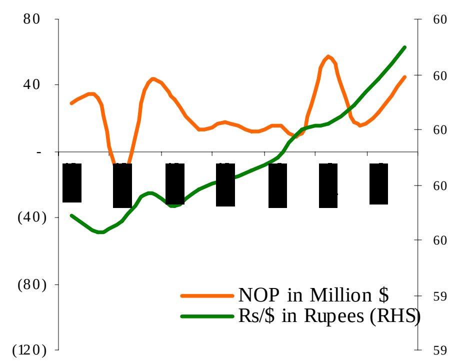
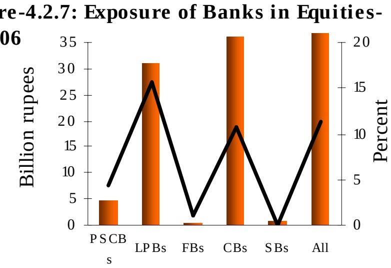
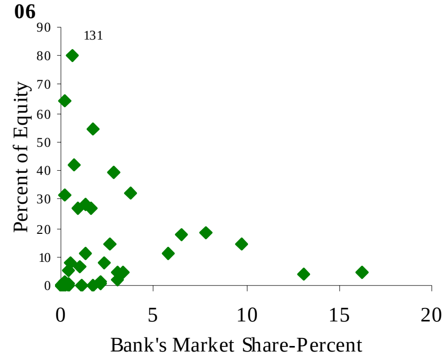


Figure-4.2.7: Exposure of Banks in Equities-Jun-06



	PSCBs	LPBs	FBs	CBs	SBs	All
Actual Exposure	4.7	31.1	0.3	36.0	0.8	36.8
Exposure to Capital (RHS)	4.4	15.6	1.0	10.7	0.0	11.3

Figure-4.2.8: Total Exposure of Banks-Jun-06



2 At market value
3 The exposure includes investment in shares at cost and investment in CFS

meagre market share in the banking system. The Continuous Funding System (CFS) exposure remained concentrated to few banks as 63 percent of the overall CFS exposure of the banking system is held by only five banks. These banks need to check their exposures at their respective ends.

Considering the volatile nature of stock market, and in order to gauge the resilience of the banking system towards any unanticipated fall in the market value of such investments, a study has been conducted. As the stock market remains erratic therefore the study assumes a conservative approach and applies a 35 percent fall in the stock market index. Moreover, regarding the impact of stock market decline on the banks' investment in shares, an assumption of equal impact has been made. The study reveals that as the result of such fall in stock market index, the revaluation surplus of the banks available against such investments decreased noticeably from Rs9.2 billion in Mar-06 to Rs4.5 billion in Jun-06. Moreover, on individual basis, 13 banks were already carrying deficit against equity investments; and the number of these banks rose to 29 after the calibration of the assumed shock. Group wise, only SBs had their surplus in excess of the expected fall, and for the rest of the groups, the available surplus is way less than the fall in the value of investment (see **Figure 4.2.9**). The calibration of shock in the capital adequacy position of the banks shows that the CAR of two banks that are currently compliant would fall below the required level of 8 percent (see **Figure 4.2.10**).

Figure-4.2.9: Impact of Adverse Movement in KSE-100 Index by 35 Percent

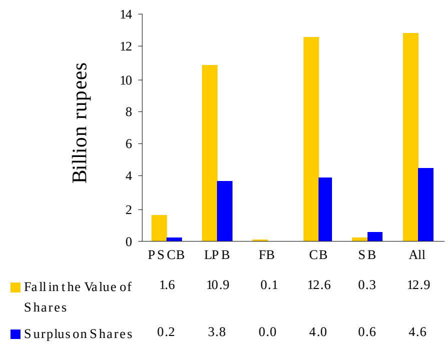
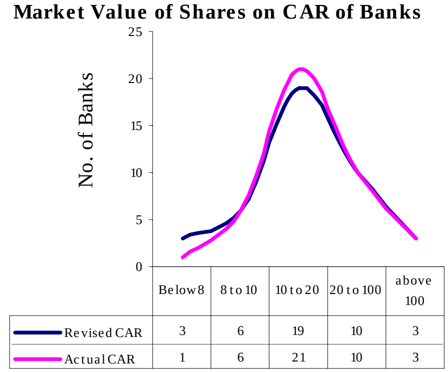


Figure-4.2.10.: Impact of 35 Percent Fall in Market Value of Shares on CAR of Banks



4.3 Liquidity Risk

Liquidity risk has been stemming as a concern in the wake of aggressive credit expansion by the banks and the moves of SBP to pursue tight monetary policy leaves the market with fewer liquid funds available.

Liquidity tightening continued during the Jun-06 quarter as well. SBP continued to mop up excess liquidity during the Jun-06 quarter through OMOs, however, there have also been frequent requests from the banks for liquidity support. Further, in response to the heavy discounting by the banks SBP injected liquidity into the system through OMOs during the first half of the Jun-06 quarter. During the second half of the quarter, frequent mop ups from the market through the OMOs squeezed the interbank liquidity (see **Figure 4.3.1**). This trend continued during the July-06 as well.

Figure-4.3.1: OMOs by SBP Vs Discounting availed by the banks

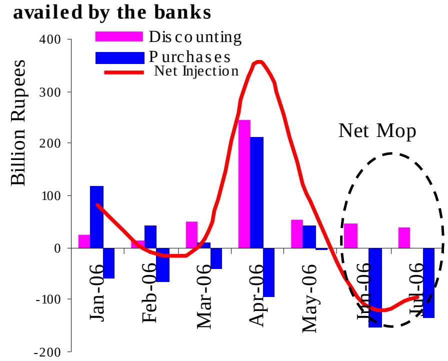
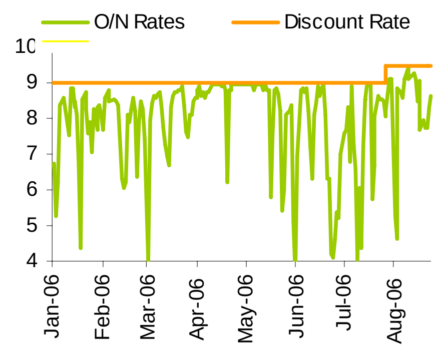


Figure-4.3.2: O/N Rates Vs Discount Rate Jun-06-(in%)



Interbank rates during the Jun-06 quarter remained volatile in response to squeezing liquidity. Overnight rates remained under pressure and at times these rates also escalated to a level closer to the discount rate. This, along with the other monetary tightening signals, warranted the need for raising the discount rate, hence, by the end of July-06 SBP raised discount rate by 50bps to 9.5 percent (see **Figure 4.3.2**).

The revision in CRR and SLR was a major policy initiative of SBP to rein in inflation and manage the liquidity risk faced by banks. Despite pursuing the tight monetary policy signalled by gradual hike in interest rate, credit growth to various segments of the economy remained higher, overshooting the credit growth targets for fiscal year 2005-06. The continued inflow of funds helped the banking system to lend aggressively, making it quite challenging for SBP to effect susceptible restrain in monetary expansion. Hence, to supplement the commonly used monetary policy tool of Open Market Operations (OMOs), SBP also opted for other non-conventional tools of CRR and SLR. These measures would help in checking the aggressive credit expansion.

As a result of policy announcement whereby the banks have been restricted to use the securities categorized under Held-to-Maturity for repos, there has been a shift in the investment portfolio away from Held-to-Maturity to Available-for-Sale. This shift would help foster the market based liquidity.

Of the target liquidity ratios, credit to deposit ratio (CDR) eased to 69.91 percent from 71.4 percent in Mar-06 (see **Figure 4.3.3**). Moreover, after excluding the export refinance, the CDR has further dropped to 68.81% from 70.14% in the last quarter. With the increase in liquidity held by the banks, liquid assets to total assets ratio improved to 34.12 percent from 33.4 percent in Mar-06 (see **Figure 4.3.4**).

Figure-4.3.3: Liquidity Indicators

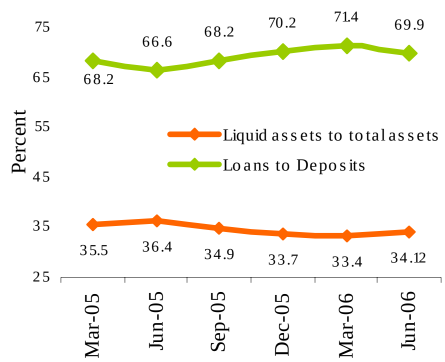
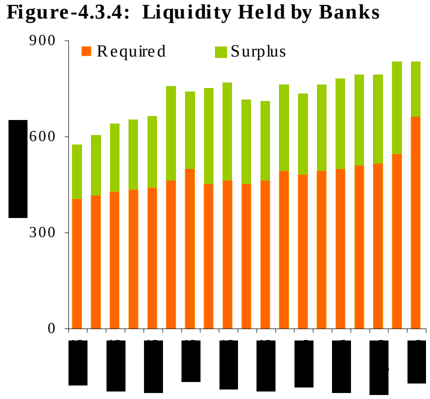


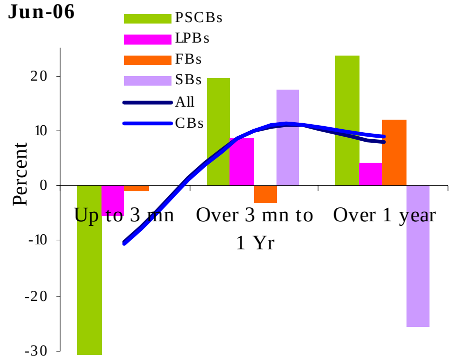
Figure-4.3.4: Liquidity Held by Banks



The maturity profile analysis reveals that the maturity GAPs remained significant especially in the PSCBs. This substantially negative GAP, between the maturities of assets and liabilities of PSCBs, in the three months bucket questions the liquidity comfort of these banks. For the other commercial bank groups, these GAPs are well with in the acceptable range. However, the negative GAP of all the groups in the three months bucket poses some threat to the available liquidity with the banks. Specialized banks are experiencing significant negative GAP in the longer term bucket (See **Figure 4.3.5**).

The wider GAPs in almost all the time horizons depict mismatches in the maturity structure of the assets and liabilities, which can expose the banks to liquidity risk. The recent regulatory measure of separate CRR for demand and term deposits also encourages the banks to rationalize these GAPs.

Figure-4.3.5: GAP (Assets-Liabilities) to TA-Jun-06



5. Performance of Islamic Banking

The current quarter of CY06 witnessed an overall further growth in the Islamic banking. The number of Islamic banking institutions (IBIs) also rose during this quarter (see **Table-5.1**). With the launch of operations by one of the already licensed Islamic banks during the quarter, the number of operational Islamic banks (IBs) rose to 4[4] as of Jun-06. Besides, the number of licensed IBs also rose to 6. Moreover, the number of licensed conventional banks to conduct Islamic banking business through Islamic Banking Branches (IBBs) increased to 11 with the IBBs standing at 39.

Table-5.1: Islamic Banking Players

	Dec-03	Dec-04	Dec-05	Mar-06	Jun-06
No. of Islamic Banks (IBs)	1	2	2	3	4
No. of Branches	10	23	37	39	48
No. of conventional banks operating Islamic Banking Branches	3	7	9	10	11
No. of Islamic Banking Branches (IBBs)	7	21	33	34	39

Besides expansion in Islamic banking outlets, total balance sheet footing of the Islamic banking system witnessed a growth of 10.5 percent over the period and increased to Rs87.6 billion as on quarter end (see **Table-5.2**).

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

	2003	2004	2005	Mar-06	Jun-06
SOURCES:					
Deposits	8,397.1	30,184.8	49,931.8	53,667.0	59657.5
Borrowings	1,899.0	6,559.1	9,005.8	8,948.2	8539.0
Capital & other funds	1,993.7	5,123.1	7,811.0	10,268.9	12284.5
Other liabilities	624.8	2,276.1	4,744.8	6,416.9	7121.7
	12,914.6	**44,143.0**	**71,493.4**	**79,301.1**	**87602.6**
USES:					
Financing	8,652.2	27,535.5	45,786.2	48,717.6	51602.8
Investments	1,242.3	2,007.0	1,854.2	6,034.8	6333.1
Cash, bank balance, placements	1,978.5	11,899.7	19,314.3	19,718.7	22877.4
Other assets	1,041.7	2,700.8	4,538.7	4,829.9	6789.3
	12,914.6	**44,143.0**	**71,493.4**	**79,301.1**	**87602.6**

A review of the channels of funds reveals that the deposits and financings continue to dominate the balance sheet components of the Islamic banking system. The share of deposits though remained almost constant at 68 percent with a slight increase and it remained the highest, followed by funds from owners viz. capital. The asset composition of the Islamic banking system followed the previous quarter pattern. However, the share of both the dominant components i.e. financings and investments witnessed slight decrease over the period.

Financings remained the dominant component of assets structure of the Islamic banking system and their share is evident by the financings to deposit ratio of 86.5 percent. The financings to deposits ratio though improved from 90 percent for the last quarter, yet could expose the Islamic banks to high credit risk.

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4 Meezan Bank Limited, AlBaraka Islamic Bank, Dubai Islamic Bank and Bank Islami Pakistan Limited are fully operational whereas Emirates Global Islamic Bank Limited and First Dawood Islamic Bank Limited have yet to start their operations.

In contrast to a handsome growth in the size of Islamic banking operations, their assets quality has deteriorated over the quarter. As compared to the growth of 6.4 percent in financings, the quantum of non-performing financings (NPFs) surged almost threefold, whereas, on the other hand provisions, increased by only 16 percent, lagging much behind the huge surge in NPFs. These trends have deteriorated the asset quality indicators for Jun-06 and alarm the IBIs to strictly monitor their financing portfolios to check further deterioration in their asset quality in future (see **Table-5.3**).

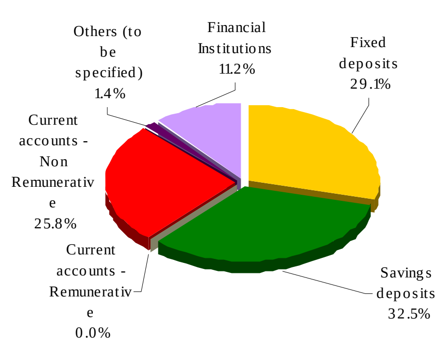
Table-5.3: Key Performance Indicators

Percent

Indicator	2003	2004	2005	Mar-06	Jun-06
NPFs to total financing	0.7	0.9	1.0	0.9	2.3
Net NPFs to net financing	-	0.2	0.2	0.1	1.4
Provision to NPFs	100.0	82.3	80.6	86.3	40.3
Net Markup Income to total assets	1.7	1.4	2.3	3.2	3.2
Non Markup Income to total assets	2.2	1.4	1.7	1.4	1.0
Operating Expense to Gross Income	54.6	65.3	49.9	46.5	55.9
ROA (average assets)	2.2	1.2	1.7	2.0	1.6
Growth in Assets	84.5	241.8	62.0	10.9	10.5
Growth in Deposits	64.6	259.5	65.4	7.5	11.2
Growth in Financing	147.0	218.2	66.3	6.4	5.9

The capital position of IBIs shows that the capital grew at 19.6 percent over the quarter, higher than the growth in assets. Resultantly, the capital to total assets ratio further improved from 12.9 percent in Mar-06 to 14.0 percent in Jun-06. Moreover, the IBIs are fairly meeting the capital adequacy requirements. However, the net NPFs to capital ratio deteriorated from 0.6 percent in Mar-06 to 5.8 percent in Jun-06.

Figure-5.1: Composition of Deposits

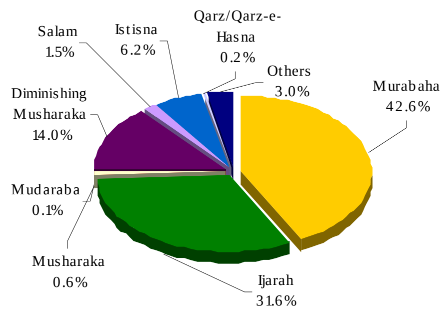


The break-up of deposits reflects that, except fixed and non-remunerative current deposits, the share of all deposit categories has remained almost constant over the period (see **Figure-5.1**). The fixed deposits comprised 29.1 percent of total deposits as against 33.3 percent in Mar-06. On the other hand, the share of current deposits increased from 22.1 percent in Mar-06 to 25.8 percent in Jun-06. The review of deposits structure reveals that the increase in the share of current deposits was not at the cost of long term fixed deposits, the share of which has shrunk. This growth in share was actually the outcome of incremental current deposits, which in turn was a result of expansion in Islamic banking branches.

The composition of financings reflects that though the predominance of Murabaha and Ijarah continues, their collective share in total financings has reduced from

81.7 percent in Mar-06 to 74.2 percent for the current quarter. On the other hand, share of other modes viz. Diminishing Musharaka, Salam and Istisna has increased, which reflects diversification in the portfolio of Islamic banking Institutions and development of Islamic modes of financing (see **Figure-5.2**).

Figure-5.2: Modes of Financing



The significant increase in financings portfolio and Islamic banking operations has helped IBIs to imporve their profitablity (see **Table-5.4**). As IBIs mostly derived their profits from core business activity, the net markup income as percentage of total assets also improved to 3.2 percent from 2.3 percent in Dec-05. However, as their operating expenses as a percentage of gross income have increased from 46.5 percent in Mar-06 to 55.9 percent in Jun-06, the profit after taxes declined during the quarter. Resultantly, the profits (annualized) showed a 6.85 percent decline from Mar-06 position, as against 51 percent growth during previous quarter, notwithstanding 10.5 percent growth in assets. For that matter, the ROA of the Islamic banking system declined from 2.0 percent in Mar-06 to 1.6 percnt in Jun-06.

Table-5.4: Income Statement (Million rupees)

	2003	2004	2005	Mar-06	Jun-06
Markup Income	406.4	1,081.0	3,164.3	1,358.9	2,898.9
Markup Expense	188.5	483.7	1,542.3	728.5	1,483.6
Net Markup Income	217.9	597.2	1,622.0	630.4	1,415.3
Provision Expense	(15.8)	36.0	175.6	27.8	91.9
Non Markup Income	287.4	596.0	1,206.6	276.2	422.1
Operating Expense	276.0	779.0	1,410.5	421.4	1,027.7
Profit Before Tax	245.0	378.2	1,242.6	457.3	762.2
Tax	27.0	36.2	265.2	88.8	75.6
Profit After Tax	218.0	342.0	977.4	368.6	686.6

The overall performance of IBIs during the quarter under review remained on a promising track as evident by the expansion in Islamic banking operations, growth in balance sheet and diversification and development of Islamic banking products. However, the unhealthy trend in assets quality indicators is alarming and the IBIs need to exercise caution while expanding their financings portfolio.

6. Resilience of Pakistan's Banking System to Stress Tests

In order to monitor the resilience of banking system towards univariate and multivariate shocks to risk factors, SBP conducts this stress testing exercise. The stress testing exercise assumes the stress scenarios along the three factors i.e. credit quality, market and liquidity shocks (see **Box 6.1**). The ensuing paragraphs discuss the impact of various stress scenarios on the capital of commercial banks (CBs), both individually as well as group-wise viz. Public Sector Commercial Banks (PSCBs), Local Private Banks (LPBs) and Foreign Banks (FBs) (see **Box 6.2**). As for liquidity, the impact of the shocks has been gauged in terms of liquidity coverage ratio[5].

BOX - 6.1

Reference Scenarios

Credit Shocks

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

Scenario C-2 assumes a withdrawal of benefit of FSV against NPLs.

Scenario C-3 assumes a cumulative impact of the two shocks under Scenarios C-1 and C-2.

Scenario C-4 assumes an increase in NPLs equivalent to 5 percent of gross advances (with a provisioning rate of 50 percent for additional NPLs).

Scenario C-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 Shocks

Scenario IR-1 assumes an increase in interest rates by 200 basis points.

Scenario IR-2 assumes an increase in interest rates of outlying maturities (by 0, 100, and 150 basis points)

Scenario IR-3 assumes a shift coupled with flattening of the yield curve by increasing 150,100 and 50 basis points in the three maturities respectively.

Market Risk: Exchange Rate Shocks

Scenario ER-1 assumes a depreciation of ER by 25 percent (around double of the change in the monthly average PKR/US$ exchange rate (12.83) over the period from Jan 1994 to Dec 2005, in September 2000).

Scenario ER-2 is based on the hypothetical assumption of appreciation of rupee by 10 percent.

Scenario ER-3 assumes a 10 percent depreciation of the rupee and deterioration in the quality of 10 percent of unhedged foreign currency loans with 50 percent provisioning requirement.

Market Risk: Equity Price Risk Shocks

Scenario E-1 assumes the impact of a 20 percent decline in the Stock Market Index.

Scenario E-2 assumes the impact of a 40 percent decline in the Stock Market Index.

Liquidity Shocks

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

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

Scenario L-3 assumes a 5 percent decline in the liquid liabilities and its impact on liquidity coverage ratio calculated after including Govt. securities under Held to Maturity category in liquid assets.

Scenario L-4 assumes a 10 percent decline in the liquid liabilities and its impact on liquidity coverage ratio calculated after including Govt. securities under Held to Maturity category in liquid assets.

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[5] ratio of liquid assets to liquid liabilities

Credit Risk

Credit shocks assume an increase in the provisioning due to increase in NPLs and withdrawal of benefit of FSV against NPLs. Four Scenarios (C1 – C4) have been assumed, in this respect. Under ***Scenario C-1,*** which presents the impact of 10 percent increase in NPLs, the capital of commercial banks easily absorbs this shock and their after shock CAR stands at 12.07 percent. However, ***Scenario C-2,*** which takes into account the withdrawal of FSV against NPLs, puts a greater strain and the CAR of CBs experiences a fall of 0.98 to 11.59 percent (see **Figure 6.1**). Bank-wise, CAR of three banks falls below 8 percent with this shock. ***Scenario C-3*** combines the impact of the above two scenarios and the CBs are also resilient towards this multivariate shock. ***Scenario C-4*** assumes a scenario where 5 percent of gross loans become classified and 50 percent provisioning is needed against this increased NPLs. This scenario puts the highest strain on the CAR of CBs which comes down to 10.6 percent from 12.6 percent. It is due to the strengthening of capital that is critical NPLs to loan ratio, which wipes out the capital if 50 percent provisioning is required against additional NPLs (***Scenario C-5***), become more distant and now stands at 35.09 percent as against 34.74 percent in March-06 (see **Figure 6.2**).

Figure-6.1: Impact of Credit Shocks on CAR, Jun-06

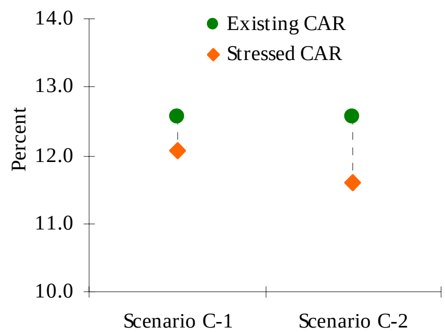
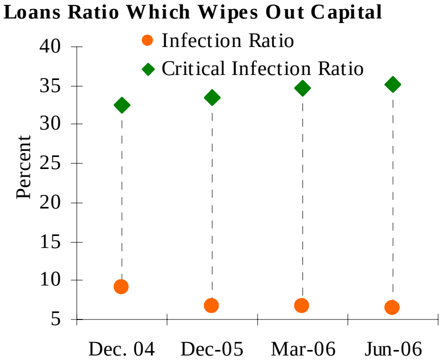


Figure-6.2: NPLs to Loans Ratio Vs the NPLs to Loans Ratio Which Wipes Out Capital



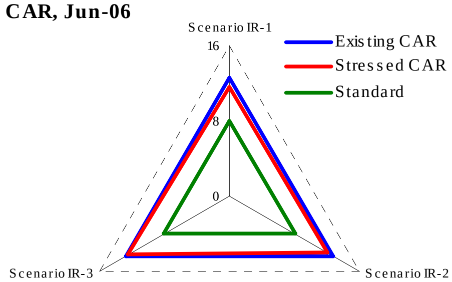
Market Risk

Interest Rate Risk

Three stress scenarios IR-1 to IR-3 have been devised to gauge the impact of change in interest rate on the value of the equity and hence CAR of the banks.

Scenario IR-1 assumes a shift in the yield curve by 2 percentage points. Though the shock is significant under the current scenario, the banks are generally resilient towards this shock due to comparatively reduced GAPs between the maturities of their RSAs and RSLs and the CAR of CBs falls from 12.57 percent to 11.69 percent (see **Figure 6.3**). Group wise, all the groups can fairly absorb this shock however bank-wise two banks may face a fall in their CAR to below 8 percent but it remains more than 7.5 percent for each bank. The impact of ***Scenario IR-2*** is on lower side and CBs experience a fall of 0.62 percentage points in their existing CAR of 12.57 percent. All the groups stayed resilient to this shock however, bank wise two banks may experience a fall in their CAR to below 8 percent but not below 7.8 percent. The banks are not sensitive to any flattening of the yield curve and under ***Scenario IR-3*** the CAR of CBs fall by 0.27 percentage points to 12.3 percent. All the groups are fairly resilient and banks wise, no bank experience any significant fall.

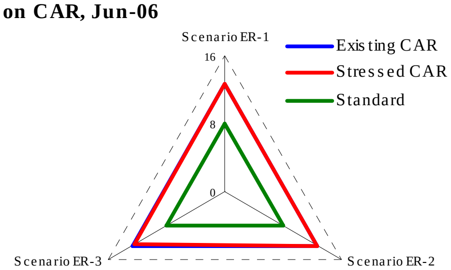
Figure-6.3: Impact of Interest Rate Shocks on CAR, Jun-06



Exchange Rate Risk

Three different scenarios (ER-1 to ER-3) have been envisaged to assess the exchange rate risk of the banks. Since the FCY assets are more than FCY liabilities, the impact of the shock in ***Scenario ER-1*** is positive on the CAR of the banks. This means that any depreciation of exchange rate would improve the capital adequacy position of the banks as revealed by the overall CAR of CBs that increases slightly by 0.03 percentage points after shock (see **Figure 6.4**). ***Scenario ER-2*** assumes an increase in the value of rupee which would lower the value of net assets, declining the CAR of the banks. The impact shows that the CBs have a 0.01 percentage points decline in their CAR. On a group wise basis, FBs experience the greatest fall in their CAR. On individual basis, CAR of two banks falls below 8 percent benchmark. ***Scenario ER-3*** assumes a 10 percent

Figure-6.4: Impact of Exchange Rate Shocks on CAR, Jun-06



depreciation of the rupee which on one side increases the value of net assets but on the other side may end up hampering the loan repayment capacity of the borrower. This scenario checks the benefit so attained from the exchange rate depreciation through the assumption of deterioration in the quality of 10 percent of unhedged foreign currency loans with 50 percent provisioning requirement. As the FCY loans form a small portion of total FCY assets, the impact of this shock is also slight. Both for the groups and individual banks, the CAR remains well above the required level.

BOX 6.2

Results of "Stress Tests" of Pakistan's Banking System

Single and multifactor sensitivity tests			**Mar-06**		**Jun-06**	
			%age Point Change in CAR	***Revised CAR-After Shock***	***%age Point Change in CAR***	***Revised CAR-After Shock***
Credit Shocks						
Scenario	C-1	Deterioration in the quality of loan	-0.52	11.83	-0.49	12.08
Scenario	C-2	Withdrawal of Benefit of FSV	-0.98	11.37	-0.98	11.59
Scenario	C-3	Combined impact of Scenario C1 & C2	-1.50	10.85	-1.47	11.10
Scenario	C-4	Deterioration in the quality of loan by 5%	-1.97	10.38	-1.96	10.61
Scenario	C-5	Level of NPLs to loans ratio where capital wipes out (i.e. 34.74% in Mar-06 and 35.09% in Jun-06)	-12.35	0.00	-12.57	0.00
Market Shocks; Interest Rate Shocks						
Scenario	IR-1	Shift in the yield curve	-0.94	11.41	-0.88	11.69
Scenario	IR-2	Steepening of the yield curve (large shock)	-0.84	11.51	-0.62	11.95
Scenario	IR-3	Shift & flattening of the yield curve	-0.28	12.07	-0.27	12.30
Market Shocks; Exchange Rate Shocks						
Scenario	ER-1	Depreciation of Rs/US$ exchnage rate (double of the historical high)	1.42	13.77	0.03	12.60
Scenario	ER-2	Appreciation of Rs/US$ exchnage rate (hypothetical)	-0.58	11.77	-0.01	12.56
Scenario	ER-3	Depreciation in ER along with deterioration of quality of FX Loans (50 % Provisioning)	0.00	12.35	-0.21	12.36
Market Shocks; Equity Price Shocks						
Scenario	E-1	Fall in the KSE index (historical high)	0.00	12.35	-0.14	12.43
Scenario	E-2	Fall in the KSE index (hypothetical scenario)	-0.31	12.04	-0.42	12.15
Liquidity Shocks						
Liquidity Coverage Ratio			***Actual***	***Stressed***	***Actual***	***Stressed***
Scenario	L-1	5 Percent Fall in the Liquid Liabilities	32.9	29.4	36	32.6
Scenario	L-2	10 Percent Fall in the Liquid Liabilities	32.9	25.5	36	28.9
Scenario	L-3	5 Percent Fall in the Liquid Liabilities	39.4	36.2	40	36.9
Scenario	L-4	10 Percent Fall in the Liquid Liabilities	39.4	32.6	40	33.4

Note: The results have not been adjusted for deferred tax benefits accruing on these losses.

Equity Price Risk

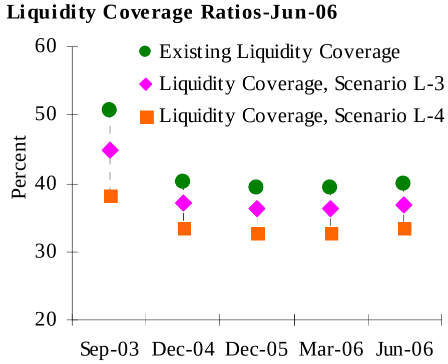
Equity shocks have been envisaged under two scenarios (E1 & E2). The ***Scenario E-1,*** which takes into account a 20 percent fall in the value of equity shares held by the banks, does not pose any threat to the banking system and CAR of CBs fall by only 0.14 percentage points to 12.43 percent. All groups are fairly resilient to this shock however, bank-wise, one bank experiences a fall to below 8 percent due to its lower cushion available in capital. Under ***Scenario E-2***, a 40 percent fall in the value of equity investments has been assumed and the CAR of CBs experience a fall of 0.42 percentage points to 12.15 percent. Under this scenario, CAR of one more bank falls below 8 percent.

Liquidity Risk

As liquidity risk relates to the inability of a bank to meet its short term liquidity demands, four scenarios (L1 to L4) have been envisaged to measure the liquidity risk of the banks through liquidity coverage ratio. The statutory liquidity requirement is 20 percent of time and demand liabilities (inclusive of cash reserve requirement), the exercise considers 25 percent as minimum acceptable level and 30 percent and above for comfortable liquidity stance. Further, in Scenarios L1 and L2, liquid assets do not include investments in Held to Maturity category, whereas, L3 and L4 measure liquidity risk including such investments also.

The result in ***Scenario L-1*** shows that the after shock liquidity coverage ratio of CBs remains above the comfortable ratio of 30 percent. Amongst groups, the liquidity coverage ratio of SBs, which was already below the assumed acceptable level of 25 percent before shock, experience greatest decline from 23.1 percent to 19.0 percent. On individual basis, 6 banks have their liquidity coverage fall below the minimum acceptable benchmark of 25 percent while 2 banks experience severe impact of the shock with their ratio falling below the regulatory requirement of 20 percent. ***Scenario L-2*** assumes a greater deterioration in the liquidity stance of the banks. The impact of this shock shows that the liquidity coverage ratio of all the groups remains above minimum acceptable benchmark of 25 percent. Individually, 6 banks have their ratio fall below 25 percent, and 7 banks stand unable to meet the regulatory requirement of 20 percent. The impact of shock assumed in ***Scenario L-3*** on the liquidity ratio of the banks is not that significant, however, ratio of SBs falls somewhat below the comfortable benchmark of 30 percent (see **Figure 6.5**). However, 1 bank has its liquidity coverage ratio fall below 25 percent. The impact of shock assumed in ***Scenario L-4*** is relatively large. On a group basis, SBs have their ratio fall below the comfortable benchmark of 30 percent after the shock. However, on individual basis, 3 banks have their ratio fall below 25 percent benchmark while 2 banks stand unable to meet regulatory requirement of 20 percent.

Figure-6.5: Impact of Liquidity Shocks on Liquidity Coverage Ratios-Jun-06



Financial Soundness Indicators

Annex-I

Indicators	2000	2001	2002	2003	2004	2005	Mar-06	Jun-06p
CAPITAL ADEQUACY								
Risk Weighted CAR								
Public Sector Commercial Banks	10.4	9.6	12.3	11.0	13.4	14.5	15.5	15.7
Local Private Banks	9.2	9.5	9.7	9.0	10.1	10.6	11.0	11.5
Foreign Banks	18.0	18.6	23.2	23.0	17.4	16.4	16.1	13.5
Commercial Banks	**11.4**	**11.3**	**12.6**	**11.1**	**11.4**	**11.9**	**12.3**	**12.6**
Specialized Banks	(3.3)	(13.9)	(31.7)	(28.2)	(9.0)	(7.7)	(12.4)	(9.1)
All Banks	**9.7**	**8.8**	**8.8**	**8.5**	**10.5**	**11.3**	**11.6**	**11.9**
Tier 1 Capital to RWA								
Public Sector Commercial Banks	7.7	7.1	8.6	8.2	8.6	8.8	9.8	9.9
Local Private Banks	8.1	8.4	6.6	7.0	7.5	8.3	8.7	9.2
Foreign Banks	17.9	18.6	23.0	23.0	17.1	16.1	15.8	12.8
Commercial Banks	**9.8**	**9.7**	**9.7**	**9.1**	**8.6**	**9.1**	**9.5**	**9.7**
Specialized Banks	(3.4)	(13.9)	(31.7)	(28.7)	(15.0)	(13.6)	(18.2)	(14.9)
All Banks	**8.3**	**7.3**	**6.2**	**6.5**	**7.6**	**8.3**	**8.6**	**8.9**
Capital to Total Assets								
Public Sector Commercial Banks	4.6	3.7	5.6	6.1	8.7	12.6	13.5	12.8
Local Private Banks	3.5	3.8	5.2	5.3	6.5	7.0	7.4	7.4
Foreign Banks	8.8	8.5	10.6	9.9	8.9	9.5	9.4	8.3
Commercial Banks	**4.9**	**4.6**	**6.1**	**6.1**	**7.2**	**8.4**	**8.8**	**8.6**
Specialized Banks	(1.1)	(10.3)	(23.0)	(10.0)	(9.4)	(8.1)	(10.7)	(8.4)
All Banks	**4.5**	**3.8**	**4.8**	**5.5**	**6.7**	**7.9**	**8.2**	**8.1**
ASSET QUALITY								
NPLs to Total Loans								
Public Sector Commercial Banks	26.3	25.9	25.5	20.4	13.3	10.0	10.0	9.4
Local Private Banks	15.4	16.3	15.4	11.3	9.0	6.4	6.5	6.3
Foreign Banks	4.7	4.3	3.8	3.1	1.6	1.2	1.1	1.1
Commercial Banks	**19.5**	**19.6**	**17.7**	**13.7**	**9.0**	**6.7**	**6.7**	**6.4**
Specialized Banks	52.4	53.0	54.7	55.6	54.1	46.0	42.4	46.0
All Banks	**23.5**	**23.4**	**21.8**	**17.0**	**11.6**	**8.3**	**8.1**	**8.0**
Provision to NPLs								
Public Sector Commercial Banks	59.2	56.6	57.1	65.8	77.0	86.8	85.2	85.0
Local Private Banks	36.9	40.5	58.6	62.7	69.9	76.4	75.9	76.0
Foreign Banks	65.9	74.1	73.3	78.7	101.9	145.9	155.3	159.5
Commercial Banks	**53.9**	**53.2**	**58.2**	**64.8**	**72.4**	**80.4**	**79.7**	**79.8**
Specialized Banks	58.1	59.2	66.9	61.5	64.9	64.8	71.7	60.3
All Banks	**55.0**	**54.7**	**60.6**	**63.9**	**70.4**	**76.7**	**78.0**	**75.3**
Net NPLs to Net Loans								
Public Sector Commercial Banks	12.7	13.1	12.8	8.1	3.4	1.5	1.6	1.5
Local Private Banks	10.3	10.4	7.0	4.5	2.9	1.6	1.6	1.6
Foreign Banks	1.7	1.1	1.1	0.7	(0.0)	(0.6)	(0.6)	(0.6)
Commercial Banks	**10.1**	**10.3**	**8.3**	**5.3**	**2.7**	**1.4**	**1.4**	**1.4**
Specialized Banks	31.6	31.5	28.5	32.5	29.3	23.1	17.2	25.3
All Banks	**12.2**	**12.1**	**9.9**	**6.9**	**3.8**	**2.1**	**1.9**	**2.1**
Net NPLs to Capital								
Public Sector Commercial Banks	124.5	160.2	83.4	50.0	16.2	5.5	6.0	5.6
Local Private Banks	153.5	125.2	54.8	39.1	24.3	13.0	12.7	12.0
Foreign Banks	9.0	5.8	4.7	3.2	(0.2)	(3.0)	(3.2)	(3.8)
Commercial Banks	**96.7**	**100.7**	**54.2**	**36.9**	**19.0**	**9.0**	**8.9**	**8.5**
Specialized Banks	-	-	-	-	-	-	-	-
All Banks	**131.3**	**150.5**	**85.5**	**54.4**	**29.2**	**14.3**	**12.7**	**13.9**
EARNINGS								
Return on Assets (Before Tax)								
Public Sector Commercial Banks	0.5	-	1.3	1.8	2.4	3.3	3.7	4.2
Local Private Banks	(0.1)	0.9	1.4	2.2	1.7	2.7	2.7	2.9
Foreign Banks	1.4	1.7	2.3	2.6	2.5	3.6	4.0	3.8
Commercial Banks	**0.4**	**0.6**	**1.5**	**2.1**	**2.0**	**2.9**	**3.0**	**3.2**
Specialized Banks	(2.3)	(8.4)	(10.2)	(3.3)	(0.4)	(1.0)	(8.7)	(0.4)
All Banks	**0.3**	**0.1**	**0.9**	**1.8**	**1.9**	**2.8**	**2.6**	**3.1**
Return on Assets (After Tax)								
Public Sector Commercial Banks	0.2	(0.5)	0.6	1.0	1.3	2.2	2.4	2.8
Local Private Banks	(0.7)	0.4	0.8	1.4	1.2	1.8	1.8	2.0
Foreign Banks	0.6	0.8	1.5	1.5	2.0	2.5	2.7	2.7
Commercial Banks	**(0.0)**	**(0.0)**	**0.8**	**1.2**	**1.3**	**2.0**	**2.0**	**2.2**
Specialized Banks	(2.3)	(8.8)	(12.1)	(3.7)	(0.8)	(1.2)	(8.7)	(0.5)
All Banks	**(0.2)**	**(0.5)**	**0.1**	**1.0**	**1.2**	**1.9**	**1.6**	**2.1**

Financial Soundness Indicators

Annex-I

Indicators	2000	2001	2002	2003	2004	Dec-05	Mar-06	Jun-06p
ROE (Avg. Equity & Surplus) (Before Tax)								
Public Sector Commercial Banks	10.9	0.5	26.3	29.9	30.8	30.7	30.1	33.4
Local Private Banks	(3.2)	25.4	32.3	41.5	28.8	40.1	36.8	39.5
Foreign Banks	15.6	19.3	24.2	25.0	26.7	38.9	42.7	42.6
Commercial Banks	**8.8**	**12.2**	**27.5**	**33.7**	**29.0**	**37.2**	**35.5**	**38.0**
Specialized Banks	-	-	-	-	-	-	-	-
All Banks	**5.7**	**1.4**	**21.1**	**35.4**	**30.5**	**38.2**	**32.6**	**38.8**
ROE (Avg. Equity & Surplus) (After Tax)								
Public Sector Commercial Banks	4.9	(12.2)	11.5	17.3	17.2	20.9	19.9	22.7
Local Private Banks	(17.4)	10.3	17.3	25.8	20.2	27.2	24.8	27.3
Foreign Banks	6.1	9.1	15.2	14.8	21.5	27.1	28.9	30.2
Commercial Banks	**(0.3)**	**(0.3)**	**14.3**	**20.3**	**19.6**	**25.4**	**23.8**	**26.2**
Specialized Banks	-	-	-	-	-	-	-	-
All Banks	**(3.5)**	**(12.6)**	**3.2**	**20.0**	**20.3**	**25.8**	**20.5**	**26.5**
NII/Gross Income								
Public Sector Commercial Banks	61.8	69.9	69.5	64.1	63.7	71.3	76.7	70.3
Local Private Banks	63.2	72.1	65.5	55.9	62.0	73.0	73.8	74.1
Foreign Banks	54.0	59.4	57.5	55.3	57.7	61.5	69.1	69.4
Commercial Banks	**61.2**	**68.9**	**66.1**	**58.9**	**61.9**	**71.3**	**73.8**	**72.7**
Specialized Banks	78.6	86.7	78.0	62.2	81.9	87.7	88.6	86.5
All Banks	**62.3**	**70.4**	**67.1**	**59.2**	**62.8**	**72.0**	**74.3**	**73.2**
Cost / Income Ratio								
Public Sector Commercial Banks	70.1	62.3	56.9	43.9	39.5	34.3	33.9	30.4
Local Private Banks	80.9	67.3	60.0	53.2	56.2	43.1	47.0	43.7
Foreign Banks	59.4	54.5	45.4	48.2	49.0	42.2	41.0	42.2
Commercial Banks	**71.6**	**62.7**	**56.7**	**49.0**	**51.7**	**41.2**	**43.7**	**40.7**
Specialized Banks	70.5	59.0	84.7	67.5	57.8	47.8	51.6	57.1
All Banks	**71.6**	**62.4**	**59.1**	**50.5**	**52.0**	**41.5**	**45.0**	**41.8**
LIQUIDITY								
Liquid Assets/Total Assets								
Public Sector Commercial Banks	37.1	36.5	49.0	49.1	43.9	35.6	32.5	33.3
Local Private Banks	34.0	39.8	47.1	42.9	34.3	32.4	32.6	33.6
Foreign Banks	45.2	50.3	48.5	49.2	39.8	41.8	42.7	41.6
Commercial Banks	**37.5**	**39.9**	**48.1**	**46.1**	**37.0**	**33.9**	**33.6**	**34.3**
Specialized Banks	12.7	13.6	16.4	22.9	25.3	25.8	28.9	28.1
All Banks	**36.0**	**38.5**	**46.7**	**45.1**	**36.6**	**33.7**	**33.4**	**34.1**
Liquid Assets/Total Deposits								
Public Sector Commercial Banks	45.0	43.4	59.6	59.0	52.6	44.7	40.9	41.6
Local Private Banks	44.3	49.6	60.2	54.5	42.3	40.3	41.1	42.4
Foreign Banks	67.7	78.3	74.2	68.9	53.4	57.9	60.2	58.1
Commercial Banks	**48.0**	**50.3**	**61.5**	**57.8**	**45.7**	**42.7**	**42.8**	**43.6**
Specialized Banks	90.8	79.8	98.5	135.0	154.1	183.2	277.4	252.1
All Banks	**48.5**	**50.7**	**61.8**	**58.5**	**46.5**	**43.5**	**43.8**	**44.5**
Advances/Deposits								
Public Sector Commercial Banks	54.0	53.8	44.3	45.7	49.7	59.8	62.2	58.7
Local Private Banks	67.5	57.9	52.3	58.2	67.3	70.8	71.6	70.8
Foreign Banks	71.5	66.8	72.0	63.8	70.1	68.7	69.9	69.2
Commercial Banks	**60.5**	**56.9**	**51.0**	**53.6**	**63.6**	**68.4**	**69.5**	**68.0**
Specialized Banks	553.0	450.5	453.8	379.1	370.5	400.7	517.2	503.0
All Banks	**66.2**	**61.7**	**54.9**	**56.4**	**65.8**	**70.2**	**71.4**	**69.9**

Note: The indicators for March and June 2006 are based on Un-audited returns

Annex-II

Selected Indicators for Different Categories of Banks, June 30, 2006

Indicators	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Share of Total Assets	53.4%	72.5%	92.2%	100%
Share of Total Deposits	56.2%	76.3%	93.4%	100%
Share of Gross Income	55.8%	75.7%	94.7%	100%
Share of Risk Weighted Assets	51.7%	71.6%	91.7%	100%
Capital Adequacy				
Capital/RWA	12.8%	12.1%	12.4%	11.9%
Tier 1 Capital / RWA	8.9%	8.8%	9.2%	8.9%
Net Worth / Total Assets	8.9%	8.4%	8.4%	8.1%
Asset Composition				
Sectoral Distribution of Loans (Domestic)				
- Corporate Sector	46.2%	70.1%	91.1%	100%
- SMEs	53.9%	69.6%	87.7%	100%
- Agriculture	37.3%	44.0%	94.3%	100%
- Consumer Finance	58.6%	79.2%	96.5%	100%
- Commodity Financing	70.3%	92.6%	99.4%	100%
- Staff Loans	64.9%	83.0%	93.7%	100%
- Others	51.8%	59.3%	78.6%	100%
- **Total**	**51.0%**	**71.6%**	**92.1%**	**100%**
NPLs / Gross Loans	8.0%	7.2%	7.3%	8.0%
Net NPLs / Capital	7.8%	8.5%	12.3%	13.9%
Earning & Profitability				
ROA	2.3%	2.4%	2.3%	2.1%
ROE	26.6%	28.7%	27.3%	26.5%
Net Interest Income / Gross Income	77.0%	75.0%	73.5%	73.2%
Income from Trading & Foreign Exchange / Gross Income	5.5%	5.3%	5.9%	6.2%
Non-Interest Expense / Gross Income	40.3%	39.1%	39.3%	41.8%
Liquidity				
Liquid Assets / Total Assets	34.4%	33.5%	33.9%	34.1%
Liquid Assets held in Govt. Securities / Total Liquid Assets	46.6%	47.3%	47.9%	46.3%
Liquid Assets / Total Deposits	42.6%	41.5%	43.6%	44.5%

Annex-III

Major Banking Statistics, June 30, 2006

Rs in Million

S.#	Name of Bank	Assets	Deposits	Equity
1	Bank of Khyber	26,716	19,852	3,138
2	Bank of Punjab	136,289	114,472	15,508
3	First Women Bank Limited	8,835	7,091	822
4	National Bank of Pakistan	655,135	521,536	86,192
5	Industrial Development Bank of Pakistan	9,791	7,287	- 27,390
6	Zarai Taraqiati Bank Limited	85,201	3,171	13,290
7	Pumjab Provincial Cooperative Bank	15,734	1,657	1,933
8	SME Bank	7,933	1,107	2,251
9	Allied Bank of Palistan	234,081	198,468	15,590
10	Bank Alfalah Limited	260,030	206,770	8,218
11	Bank Alhabib Limited	104,945	84,923	5,740
12	Askari Commercial Bank Limited	150,896	122,543	9,974
13	Crescent Commercial Bank Limited	9,323	6,076	2,118
14	Atlas Bank Limited	9,394	5,365	1,436
15	Habib Bank Limited	529,322	425,988	43,528
16	Faysal Bank Limited	113,899	78,152	13,601
17	KASB Bank Limited	23,515	18,696	2,083
18	Dubai Islamic Bank Pakistan Ltd	3,464	1,360	2,059
19	Bank Islami	2,281	163	2,002
20	MCB Bank Limited	316,430	256,011	29,051
21	Meezan Bank Limited	34,928	26,220	3,311
22	Metropolitan Bank Limited	92,766	60,022	6,465
23	Mybank Limited	21,381	15,684	3,895
24	NIB Bank Limited	40,108	25,647	4,219
25	PICIC Commercial Bank Limited	70,498	58,880	3,783
26	Prime Commercial Bank Limited	54,155	40,216	3,588
27	SaudiPak Commercial Bank Limited	51,896	43,533	3,814
28	Soneri Bank Limited	66,576	52,146	4,672
29	United Bank Limited	392,288	325,513	24,691
30	Union Bank Limited	121,849	90,338	5,515
31	ABN Amro Bank	69,409	51,509	4,989
32	Rupali Bank Limited	539	89	164
33	Oman International Bank	1,777	699	1,020
34	Habib Bank AG Zurich	46,610	33,653	3,169
35	HongKong & Shanghai Banking Corporation	15,164	10,566	2,323
36	Deutche Bank Limited	7,379	2,924	2,259
37	Bank of Tokyo	6,040	2,115	2,369
38	Citibank	85,085	55,488	5,298
39	Bank Albaraka	15,268	11,210	2,054
40	Standard Chartered Bank	124,729	97,952	6,851
41	American Express Bank	7,630	5,420	1,077
	Total	**4,029,287**	**3,090,511**	**326,668**

Annex-IV

Group-wise Composition of Banks, June 30, 2006

1997-1998	2003	2004	2005	June-2006
A. Public Sector Comm. Banks (6) - Habib Bank Ltd. - National Bank of Pakistan - United Bank Ltd. - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (16)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - Platinum Commercial Bank Ltd - Prime Commercial Bank Ltd. - Prudential Commercial Bank Ltd - Gulf Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd - Allied Bank of Pakistan - Trust Bank Ltd. - Indus Bank Ltd. **C. Foreign Banks (20)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - ANZ Grindlays Bank - Bank of America - Bank of Ceylon - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez - Deutsche Bank A.G. - Doha Bank - Emirates Bank International - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - IFIC Bank Ltd. - Mashreq Bank PJSC - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Societe Generale - Standard Chartered Bank **D. Specialized Banks (4)** - Agriculture Development Bank of Pakistan - Industrial Development Bank of Pakistan - Federal Bank for Co-operatives - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (42)** Include A + B + C **All Banks (46)** Include A + B + C + D	**A. Public Sector Comm. Banks (5)** - Habib Bank Ltd[1] - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (18)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - Bolan Bank Ltd. - Faysal Bank Ltd. - Metropolitan Bank Ltd. - KASB Bank Ltd. - Prime Commercial Bank Ltd. - Saudi Pak Commercial Bank Ltd - PICIC Commercial Bank Ltd. - Soneri Bank Ltd. - Union Bank Ltd. - Muslim Commercial Bank Ltd. - Allied Bank of Pakistan - United Bank Ltd. - Meezan Bank - NDLC-IFIC Bank Ltd - Crescent Bank Ltd. **C. Foreign Banks (14)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - Bank of Ceylon[2] - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Credit Agricole Indosuez[3] - Deutsche Bank A.G. - Doha Bank[4] - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank **D. Specialized Banks (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (37)** Include A + B + C **All Banks (40)** Include A + B + C + D	**A. Public Sector Comm. Banks (4)** - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (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 **C. Foreign Banks (11)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Deutsche Bank A.G. - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank **D. Specialized Banks (3)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. **All Commercial Banks (36)** Include A + B + C **All Banks (38)** Include A + B + C + D	**A. Public Sector Comm. Banks (4)** - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (20)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - My 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. - MCB Bank Ltd. - Allied Bank Limited. - United Bank Ltd. - Meezan Bank - NIB Bank Ltd - Crescent Commercial - Bank Ltd. - Habib Bank Ltd - Dawood Bank[5] **C. Foreign Banks (11)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Deutsche Bank A.G. - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank **D. Specialized Banks (4)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. - SME Bank Limited[6] **All Commercial Banks (35)** Include A + B + C **All Banks (39)** Include A + B + C + D	**A. Public Sector Comm. Banks (4)** - National Bank of Pakistan - First Women Bank Ltd. - The Bank of Khyber - The Bank of Punjab **B. Local Private Banks (22)** - Askari Commercial Bank Ltd. - Bank Al-Falah Ltd. - Bank Al Habib Ltd. - My 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. - MCB Bank Ltd. - Allied Bank Limited - United Bank Ltd. - Meezan Bank - NIB Bank Ltd - Crescent Commercial Bank Ltd. - Habib Bank Ltd - Atlas Bank Limited. - Dubai Islamic Bank Pakistan Limited[7] - Bank Islami Pakistan Limited[8] **C. Foreign Banks (11)** - ABN Amro Bank - Al Baraka Islamic Bank - American Express Bank Ltd. - The Bank of Tokyo – Mitsubishi - Citibank, N.A. - Deutsche Bank A.G. - Habib Bank A. G. Zurich - The Hongkong & Shanghai Banking Corporation Ltd. - Oman International Bank S.A.O.G - Rupali Bank Ltd. - Standard Chartered Bank **D. Specialized Banks (4)** - Zari Taraqiati Bank Ltd. - Industrial Development Bank of Pakistan - Punjab Provincial Co-operative Bank Ltd. - SME Bank Limited **All Commercial Banks (37)** Include A + B + C **All Banks (41)** 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 Limited (Now Atlas Bank Limited) 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.
5. The name of the bank was changed to Atlas Bank Limited on March 04, 2006.
6. SME Bank Ltd has been included in Specialized Banks category after it has been granted the banking license during Jun 2005 quarter.
7. Dubai Islamic Bank Limited started its operations during March quarter of 2006.
8. Bank Islami Pakistan Limited started its operations during June quarter of 2006.