State Bank of Pakistan

Banking Surveillance Department

Quarterly Performance Review of the Banking System

September 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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Quarterly Performance Review of the Banking System
September 2006 [1]

Overview

During the September 2006 quarter, the banking system was able to set further high standards in terms of profitability and strengthening the capital base. Strengthening capital base further added to the resilience of the banking system. The key financial soundness indicators continued to follow an improving trend. Despite further expansion in loans portfolio and rise in interest rates, the banking system was able to cope with the credit, liquidity and market risks.

Like previous quarter, high profitability remained the most prominent feature of the banking system's performance during September 06 quarter. With an increase of Rs21.5 billion, year-to-date net profit reached to Rs61.7 billion from Rs40.2 billion in Jun-06; almost equal to the profit for last full year. This growth in profits resulted into a further improvement in return on assets (ROA), which increased to 2.13 percent from 2.11 percent in Jun-06; however, return on equity (ROE) of the banking system witnessed slight decrease, and was 26.09 percent in Sep-06 as compared to 26.54 percent in Jun-06 quarter, owing to enhanced equity base of the banking system. Mainly the expanded business volume, better asset mix and healthy NIM contributed towards this exceptional earning performance.

This impressive earning performance of the banking system further strengthened its solvency profile. During the quarter under review, total equity of the banking system improved by another 10 percent to Rs275 billion from Rs250 billion in Jun-06, and capital adequacy ratio (CAR) of

[1] The review is based on the data mainly taken from the Quarterly Reports of Conditions and Annual Audited Accounts submitted by the banks. It covers their global operations, unless otherwise mentioned. 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 nineteen domestic private banks. The composition of these four groups has been given at Annex-IV. The performance of the overall banking system, particularly these groups of banks, has been evaluated using the financial soundness indicators.

all banks increased to 12.72 percent from 11.89 percent of last quarter. This increase in CAR was remarkable in a scenario evidencing a persistent rise in risk-weighted assets, which increased to Rs2,645 billion from Rs2,599 billion in Jun-06, on the back of fast growing loans portfolio of the banking system. Earning performance of the banking system also provided the banks with an avenue to finance the enhanced Minimum Capital Requirement (MCR).

The fortified profitability and solvency can be attributed to the significant expansion in business volume of the banking system. This is evident from a considerable expansion in loans portfolio of the banks over the last few quarters. However, after witnessing an aggressive expansion during preceding quarter, the credit growth slowed down corresponding to the seasonal slackness in business activities, and increased by mere Rs48 billion to Rs2,347 billion (Jun-06: Rs2,299 billion). During this quarter, most of the credit intake viz. Rs36 billion was by the corporate sector. The consumer finance segment continued to contribute towards credit growth and absorbed Rs21.8 billion even in a rising interest rates scenario. While total outstanding loan portfolio of the consumer finance increased to Rs318 billion from Rs297 billion in Jun-06. Such growth can be attributed to the lucrative returns on consumer financing. Credit to the agriculture and SME sector maintained the rising trend, however, financing to commodity operations reduced significantly.

Despite further expansion of credit portfolio and rise in interest rates, the banking system has so far been able to manage the credit risk within reasonable limits which led to further improvement in the key asset quality indicators. NPLs of the banking system came down by Rs2.3 billion to R181.5 billion from Rs183.8 billion in Jun-06. However, commercial banks, holding around 97 percent of the banking system’s assets, experienced an increase of Rs2.2 billion, to Rs143.7 billion from R141.5 billion in Jun-06, in their NPLs. This increase has resulted in addition of Rs8.1 billion in NPLs portfolio of commercial banks since December 2005. However, the threat posed by the NPLs was mitigated through sufficient provisioning of Rs141.3 billion. Net NPLs of the banking system witnessed significant decline of Rs5.3 billion to Rs40.2 billion from Rs45.5 billion during the previous quarter. However, the rising trend in NPLs of the commercial banks, particularly in consumer finance segment, which increased to Rs6.7 billion from Rs5.5 billion in Jun-06 quarter. This undesirable trend in the NPLs needs to be closely monitored and checked to avoid any serious implication on profitability and solvency of the banks.

Besides credit risk, the banking system well mitigated the liquidity and market risks as well. The SBP continued to follow a tighter monitory policy in order to curb the inflationary tendencies and mopped up liquidity from the market besides gradually raising the benchmark rates in auctions. The policy announcement of increase in the liquidity requirement has also put some strain on the inter bank rates and overnight rates remained quite volatile during the period. The key liquidity indicators showed further tightening. Significant loan growth coupled with a fall in deposit base of the banks to Rs3,013 billion from R3,091 billion in Jun-06, has also raised the loans to deposits ratio to 73.2 percent from 69.9 percent in Jun-06 quarter. Market risk was mainly the reflection of interest rate risk and that too the yield curve risk. A gradual rise in interest rates raised the interest rate risk for banks with significant repricing gaps; however, the banks generally were in comfortable gap position. During the quarter, movements in the yield curve have lead to the yield curve risk. As regards exchange rate risk, the exchange rate against major currencies remained almost stable. However, the demand side pressures in the form of heavy import bills on account of rising oil prices and import of machinery caused slight volatility in exchange rates and Rs/US$ exchange rate hovered around Rs60.4 during September quarter. As far the currency exposure of the banking system, it holds favourable position and would actually gain from any depreciation in exchange rate. Although, the direct equity market investments of banks slightly rose to Rs38 billion from Rs36.8 billion in Jun-06, their individual exposure was generally well managed and on lower side in terms of their equity.

The issue of lower rates of returns to depositors and higher banking spread further highlighted during the quarter. Though weighted average deposits rates improved during the quarter, the increase was minimal. The banks continued to exploit the peculiar structure of their deposits dominated by zero or low yield current and saving deposits. However, as anticipated, the recent regulatory measure of introduction of separate cash reserve requirement (CRR) for demand and fixed deposits has lead to certain shift in this peculiar deposit structure. Resultantly, the share of overall fixed deposits has increased from 27 percent to 29[2] percent with a corresponding decrease in share of zero or low yield current and saving deposits. However, the share of zero or low yield current and saving deposits was still quite high and undermined the overall weighted average deposits' rate. The interest rate spread has witnessed some mixed trend over the quarter.

To conclude, with outstanding results during quarter under review, the overall performance of the banking system in the first three quarters of CY06 can be termed impressive. The trends infer that CY06 might prove to be yet another milestone for the banking system in terms of profitability, solvency and growth of key variables. However, performance of the banking system in remaining part of CY06 pivots a great deal on its key risk management capabilities, as the expanding portfolio, particularly in a rising interest rate scenario, might translate into further NPLs, which eventually would affect the future profitability and solvency. The next quarter is of special significance from the solvency perspective, as a number of banks would strive to meet the enhanced MCR of Rs3 billion, effective from December 31, 2006. These banks besides retaining profits will have to inject additional capital, which would further fortify the solvency position of the banking system.

[2] It may be noted that the definition of time liabilities for the purpose of CRR only includes liabilities having maturity of six months and above. Hence, share of time liabilities for the purpose of CRR is lower than reported above.

BOX-1

An extract from " Moody's Report on Banking System Outlook of Pakistan"*

> ***"Robust credit growth is benefiting the banks, which are gradually showing signs of revival with stronger financial fundamentals."***

"The efficiency of Pakistan's financial system has improved as a result of privatisation, consolidation and restructuring. In recent years, the rated Pakistani banks, and in general the banking system as a whole, have gone a long way in improving solvency and becoming financially viable. The privatisation of two government-owned banks has been instrumental in this respect, with the majority (80%) of banking assets in private hands at the end of 2005 compared to 43% in 2003 and 34% in 2000. Extensive restructuring at these banks has meant a much more efficient use of capital and an added focus on enhancing customer service, which in turn has stimulated competition, especially among the larger banks. This trend has also been facilitated by an increasing credit penetration and client base in Pakistan.

Meanwhile robust credit growth is helping the banks diversify their loan books, fuelled by the relatively favourable operating environment, together with spiraling consumer demand, with record levels of loan growth in 2004 followed by moderate growth in 2005. Such new lending, however, remains untested in a possible economic downturn. We welcome improved oversight by the State Bank of Pakistan in the form of a strengthened regulatory framework and increased transparency, among others, along with a sharp decline in non-performing loans. The banks' strong profits have allowed them to improve provisioning coverage to satisfactory levels, while we note their higher economic capitalization and ample liquidity.

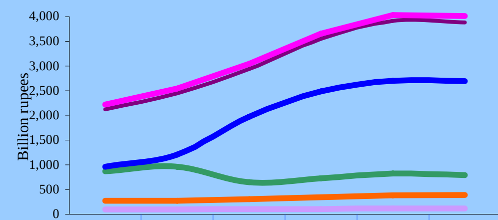
At the same time, the somewhat challenging operating environment still constrains the evolution of the banks' ratings despite a favourable business cycle, while the country's shallow and narrow capital markets limit the scope of the banks' operations. We also note the possibility of increased risks against a background of rising interest rates and the still sizeable problematic exposures, which are nonetheless declining."

* ***M**oody's **R**eport on **B**anking **S**ystem **O**utlook of **P**akistan - **D**ecember **2**006*

2. Assets and Funding Structure

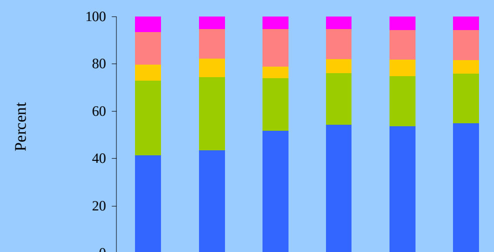
During the quarter under review, the rapidly expanding balance sheet of the banking system witnessed some consolidation and **total assets** of the banking system declined in contrast to the increasing trend during first two quarters of CY06. The quarterly growth in assets was -0.6 percent as compared to 7.9 percent of last quarter. However, the year to date growth in total assets was 9.8 percent (annualized 13.0 percent) as compared to annual growth of 20.0 percent in CY05 (see **Figure 2.1**).

Figure-2.1: Total Assets of Banking System



	CY02	CY03	CY04	CY05	Jun06	Sep06
PSCBs	878	959	653	724	827	800
SBs	98	100	106	113	119	121
LPBs	967	1212	1,980	2,483	2,704	2,696
FBs	280	272	304	339	380	389
CBs	2,125	2,443	2,937	3,546	3,911	3,885
All	2,223	2,542	3,043	3,659	4,029	4,005

Figure-2.2: Composition of Banks' Total Assets



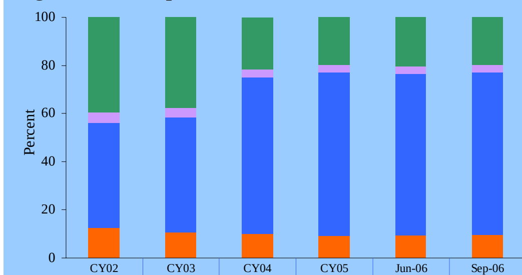
	CY02	CY03	CY04	CY05	Jun-06	Sep-06
Other Assets	6.4	5.2	5.1	5.2	5.8	5.6
Cash & Bank Balances	14.0	12.6	16.1	12.8	12.2	12.8
Lending to FIs	6.6	7.7	4.7	5.8	7.1	5.6
Investments	31.5	30.9	22.3	21.9	21.3	20.9
Advances	41.4	43.6	51.7	54.4	53.6	55.1

The composition of banks' total assets reveals more or less same pattern as that of CY05 (see **Figure 2.2**). However, over the last quarter, the share of advances increased from 53.6 percent to 55.1 percent. This surge in share of advances corresponded to a decline in the share of liquid funds viz. cash & bank balances, lending to financial institutions and investments. Investments declined mainly due to certain maturities of government securities.

Group-wise position of the banks reveals that the share of PSCBs, after breaking a persistent downward trend in the last quarter, again witnessed a decline of 0.5 percent (see **Figure 2.3**). Resultantly, share of the other groups viz. LPBs, FBs and SBs improved slightly. The decline in assets of PSCBs was the main contributory factor towards shrinkage of the balance sheet of the banking system. In turn, the erosion in the share of PSCBs was a result of decrease in the assets base of one big player in this group. On the whole, the LPBs continued to hold the major share of the banking system, followed by PSCBs.

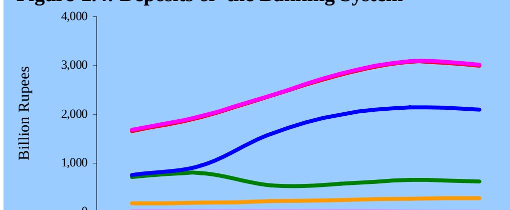
A further analysis of total assets as per size of banks shows that the assets distribution is highly skewed towards top five banks, which hold more than half of the total assets of the banking system. However, the share of top five banks decreased by 0.8 percentage point to 52.6 percent in Sep-06. On the other hand, share of next five banks improved from previous quarter level of 19.1 percent to 19.3 percent. Interestingly, out of the total 41 banks, 20 smallest banks hold only 7.1 percent of the total assets.

Figure-2.3: Group-wise Share in Total Assets



	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	39.5	37.7	21.5	19.8	20.5	20.0
SBs	4.4	3.9	3.5	3.1	2.9	3.0
LPBs	43.5	47.7	65.1	67.8	67.1	67.3
FBs	12.6	10.7	10.0	9.3	9.4	9.7

Figure-2.4: Deposits of the Banking System



	CY02	CY03	CY04	CY05	Jun06	Sep06
PSCBs	722	799	545	578	663	624
LPBs	757	954	1,604	1,995	2,143	2,096
FBs	183	194	227	245	272	280
CBs	1662	1947	2376	2818	3077	3000
SBs	16	17	17	16	13	13
All	1678	1964	2393	2834	3091	3013

The negative growth of total assets of the banking system was mainly triggered by Rs77.7 billion or 2.5 percent decrease in deposits of the banking system during the September quarter. However, borrowing, another major funding source witnessed slight increase of Rs7.7 billion or 2.0 percent over Jun-06 quarter.

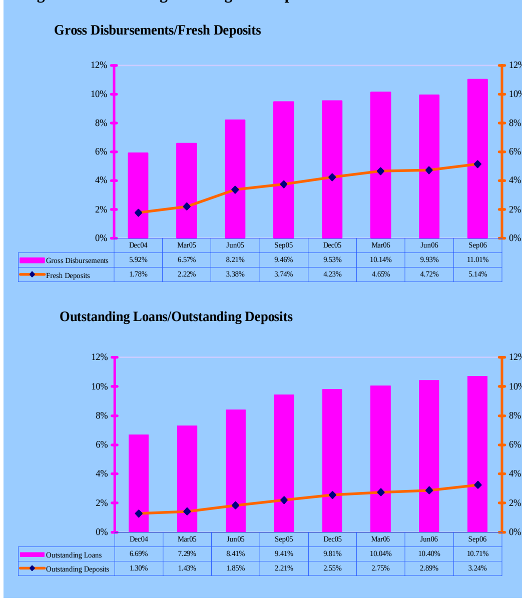
The **deposit** mobilization, in contrast to an impressive quarterly growth of 8.4 percent during Jun-06, witnessed a substantial fall of 2.5 percent during Sep-06 (see **Figure 2.4**). In absolute terms, total deposits of the banking system declined by Rs77.7 billion during the Sep-06 quarter as compared to huge increase of Rs238.3 billion in Jun-06 quarter. The deposits trends reveal that deposits of the banking system tend to exhibit sluggishness during September quarter of the year. The pre-Ramadan deposits withdrawal also contributed towards this seasonal sluggishness of deposit mobilization.

Further, the inflow of workers' remittances, one of the major contributory factors towards deposits' rise in recent years, witnessed a fall of 10 percent over the last quarter. However, their quantum expanded by more than 20 percent over the corresponding quarter of last fiscal year.

Like assets, deposits of the banking system are also concentrated into top five banks and their share in total deposits of the banking system stood at 55.4 percent. The share of next five banks was 20.4 percent. Similarly, the small 20 banks, in terms of their assets size, hold only 5.7 percent of the deposits of the banking system. To get competitive in such a challenging environment, the small banks will have to explore better alternatives to broaden their deposit base in terms of size, product array, outreach and IT.

The deposits of the banking system comprised of local currency deposits with a predominant share of 87.3 percent and foreign currency deposits forming 12.7 percent of total deposits. The quarterly decline in deposits was more evident in case of foreign currency deposits, which fell by 8.47 percent as compared to 1.59 percent for local currency deposits. In other words, around half of the quantum of deposits erosion was attributed to the foreign currency deposits.

Figure-2.5: Wtd. Avg. Lending and Deposits Rates



In the backdrop of tight monetary policy stance, rising interest rates on international front and increased market competition, the weighted average deposits' rates are on gradual rise. This is evident by an increase of 194 bps in the weighted average deposits rates[3] since CY04. During the quarter under review, these rates increased by 35 bps. However, the increase in rates for the fresh incremental deposits was more impressive viz. 3.36 percent since CY04 and 42 bps over Jun-06 (see **Figure 2.5**).

[3] Total outstanding deposits including zero rate deposits.

However, the peculiar structure of deposits with significant preponderance of zero or low yield current and saving deposits can be held responsible for still low return paid on all deposits. The combined share of such deposits, although reduced from 68 percent of last quarter to 66 percent, is by all means still quite high (see **Figure 2.6**). Such dominance of zero or low yield current and saving deposits undermined the weighted average deposits' rate for the current quarter by 123 bps.

Figure-2.6: Deposits Structure of Banks

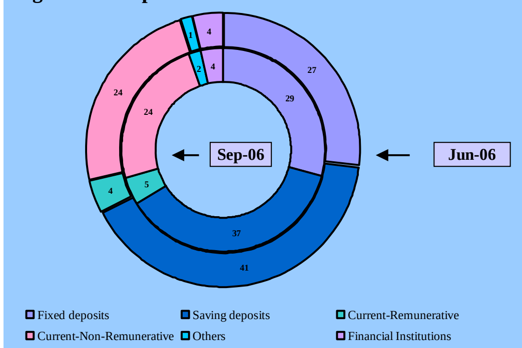
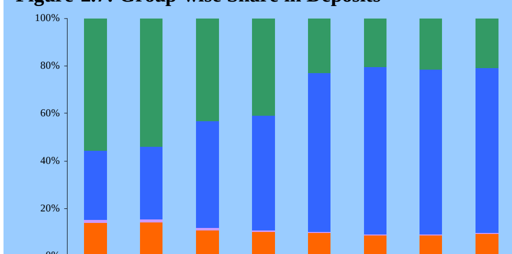


Figure-2.7: Group-wise Share in Deposits



	CY00	CY01	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	55.5	53.9	43.0	40.7	22.8	20.4	21.5	20.7
LPBs	29.4	30.8	45.1	48.5	67.0	70.4	69.3	69.6
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	8.8	9.3

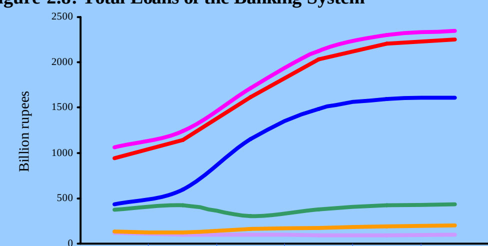
The rising interest rates have witnessed some positive impact on the deposits structure of the banking system. The share of fixed deposits increased to 29 percent from 18 percent in CY04 and 27 percent in Jun-06. The rates are expected to increase further given the growing liquidity strains, increased Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR), stiffer competition for funds and the concern of SBP over low rates of return paid to the deposits and large banking spread. This could help further increase the share of fixed deposits in total deposits of the banking system in days ahead.

On group-wise basis, the decline in deposits during the quarter under review, in absolute terms, was witnessed in LPBs, PSCBs and SBs. However, the decline was shared more by the PSCBs and LPBs. The review of group-wise share of banks in total deposits reveals that all the groups except PSCBs remained successful in maintaining or even improving their position. The share of PSCBs fell by 0.8 percent (see **Figure 2.7**). While in absolute terms, the deposits of PSCBs and LPBs dropped by Rs39 billion and Rs46.3 billion respectively.

The **borrowings**, another major funding source for the assets growth of the banking system, have witnessed persistent increase in demand by the banking system. During the quarter under review, total borrowings of the banking system slightly increased by Rs7.7 billion. The break up shows that borrowings against repurchase agreement (Repo) and export finance together made up 58 percent of total borrowings against 66 percent in Jun-06. The borrowings against both these heads decreased by Rs24.5 billion and Rs0.6 billion respectively. However, a corresponding increase of Rs25.5 billion was witnessed in call borrowings. The future trend in borrowings rests on the availability of liquidity as well as credit 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, corresponding to the seasonal slackness in industrial activities, witnessed slow down in growth during Sep-06 quarter (see **Figure 2.8**). Although, the absolute increase in loans of Rs48 billion was much lower than the previous quarter's increase of Rs125 billion, it noticeably exceeded the growth of Rs21 billion during corresponding quarter of last year. Like previous quarter, all the four groups of banks contributed to the increase in loans. Group-wise, LPBs contributed Rs20 billion to the increase in loans i.e. 42 percent of the total increase followed by PSCBs with Rs12 billion in the growth in absolute advances. The loans of FBs and SBs witnessed growth during the quarter at a better rate as compared to LPBs and PSCBs.

Figure-2.8: Total Loans of the Banking System



	CY02	CY03	CY04	CY05	Jun06	Sep06
PSCBs	374	422	302	379	423	435
SBs	117	97	99	91	92	97
LPBs	435	597	1153	1486	1593	1613
FBs	135	127	162	171	191	202
CBs	945	1146	1616	2036	2207	2250
All	1062	1243	1715	2126	2299	2347

The analysis of sector wise break-up of loans of the banking system reveals that the share of loans to the corporate sector slightly improved to 52.8 percent from 52.4 percent in the last quarter. However, it shows consistency over CY05. As for SME sector, there was a slight decline in terms of share but in absolute terms loans to this sector increased by Rs1.9 billion. The share of SME sector loans continued to squeeze from 17.7 percent in CY05 to 16.1 percent in Sep-06 mainly because of decline in the working capital credit needs. The decline in the share of loans to SME sector can be attributed to the expansion in corporate and consumer credit. Further, the credit intake for commodity operations declined due to cyclical factors (see **Table 2.1**).

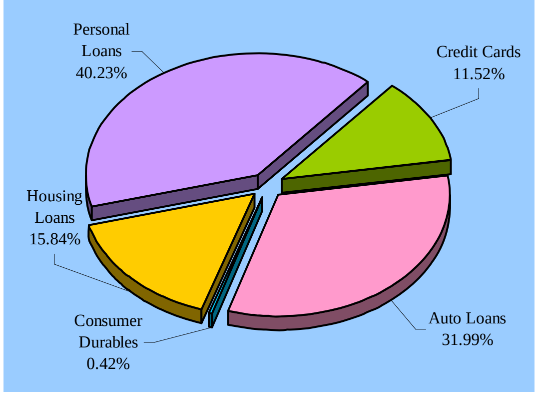
Table-2.1: Sector-wise Break Up of Loans (Domestic Operations**)*** (Rs. in Billion)

	Dec-05		Jun-06		Sep-06	
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
Corporate Sector	**1076.2**	**52.7**	**1,140.9**	**52.4**	**1176.6**	**52.8**
Fixed Investments	440.3	21.6	457.4	21.0	468.1	21.0
Working Capital	411.1	20.1	463.8	21.3	480.6	21.6
Trade Finance	224.8	11.0	219.7	10.1	227.9	10.2
SMEs	**361.4**	**17.7**	**356.7**	**16.4**	**358.6**	**16.1**
Fixed Investments	34.1	1.7	34.8	1.6	38.9	1.7
Working Capital	267.7	13.1	261.3	12.0	257.6	11.6
Trade Finance	59.6	2.9	60.6	2.8	62.1	2.8
Agriculture Production	**138.0**	**6.8**	**134.0**	**6.2**	**142.1**	**6.4**
Consumer Finance	**252.8**	**12.4**	**296.5**	**13.6**	**318.3**	**14.3**
Credit Cards	27.1	1.3	33.5	1.5	36.7	1.6
Auto Loans	82.1	4.0	97.8	4.5	101.9	4.6
Consumer Durables	1.7	0.1	1.5	0.1	1.3	0.1
Housing Loans	33.8	1.7	43.1	2.0	50.4	2.3
Personal Loans	108.0	5.3	120.5	5.5	128.1	5.7
Commodity Operations	**140.6**	**6.9**	**180.0**	**8.3**	**157.3**	**7.1**
Staff Loans	**42.4**	**2.1**	**43.3**	**2.0**	**47.6**	**2.1**
Other	**31.6**	**1.5**	**27.7**	**1.3**	**27.8**	**1.2**
Total	**2,043.0**	**100**	**2,179.0**	**100**	**2,228.2**	**100**

Loans to both Public and Private Sectors
Also include Export Finance

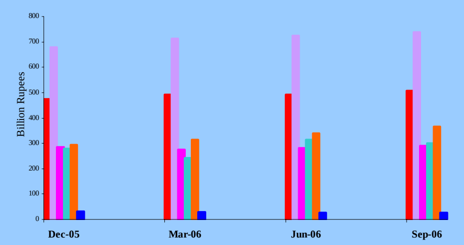
The share of consumer finance has been growing persistently. During the quarter under review, the consumer sector contributed another Rs21.8 billion to the growth in absolute amount of loans. The break-up of the consumer finance (see **Figures 2.9**) shows that personal loans continued to carry the highest share of 40 percent followed by auto loans at 32 percent of total consumer portfolio. In comparison to CY05 position, the personal loans and auto loans recorded the highest growth and contributed 61 percent of the increase in the consumer loans. The agriculture sector also experienced increase in its share during Sep-06 quarter.

Figure-2.9: Breakup of Consumer Loans



The end-use distribution of credit also reflects the same trend (see **Figures 2.10**). The consumer finance increased by 24 percent when compared with CY05. Fixed investment loans, working capital loans and agriculture loans increased by 7 percent, 9 percent and 7 percent respectively.

Figure-2.10: End-Use Distribution of Loans



	Sep-06	Jun-06	Mar-06	Dec-05
Fixed Investment	507.01	492.22	491.10	474.35
Working Capital	738.13	725.08	713.10	678.77
Trade Finance	290.07	280.24	275.30	284.47
Agriculture	299.34	314.00	243.00	278.60
Consumer	365.93	339.79	313.80	295.18
Others	27.75	27.70	30.00	31.59

As regards the overall growth in the credit intake since CY05, private sector played major role. The credit to private sector rose by Rs123 billion since CY05, however, the loans to public sector rose by Rs62 billion.

Besides increase in loans portfolio of the banking system, its outreach also increased in a consistent and significant way (see **Table 2.2**). The number of borrowers in all the major sectors, except agriculture loans, increased over the last quarter. The highest growth in the number of borrowers was recorded in consumer sector which grew by 4.5 percent over the last quarter and constituted 60 percent of the total borrowers in Sep-06. Conclusively, the volume of bank loans and outreach has witnessed persistent growth despite increase in the lending rates.

Table-2.2: Sector-wise Number of Borrowers

	Dec-02	Dec-03	Dec-04	Dec-05	Jun-06	Sep-06
Corporate Sector	14,256	17,743	19,333	19,881	19,604	20,499
SME Sector	67,520	91,663	106,248	161,316	158,050	163,691
Agriculture	1,339,961	1,411,508	1,503,827	1,534,502	1,535,112	1,449,319
Consumer Finance	252,156	721,201	1,619,207	2,407,806	2,476,352	2,587,938
Commodity Operations	1,458	2,069	3,207	6,730	5,815	5,509
Staff Loans	72,570	69,796	72,633	72,927	70,800	76,840
Others	56,683	63,696	73,735	44,144	42,596	42,056
Total	**1,804,604**	**2,377,676**	**3,398,190**	**4,247,306**	**4,308,329**	**4,345,852**

Domestic Operations Covering both Public and Private Sector Borrowers

The **investment** portfolio of the banking system exhibited the trend of last quarter and reduced by another Rs19.2 billion. The single contributor towards this end was a significant decline of Rs25.8 billion in investments in the federal government securities. This decline resulted into reducing its share in total investment to 72.5 percent from 74 percent in Jun-06 (see **Figure 2.11**). In percentage terms, the decline in overall investment was 2.1 percent and that of federal government securities was 4.1 percent.

Figure-2.11: Breakup of Investments

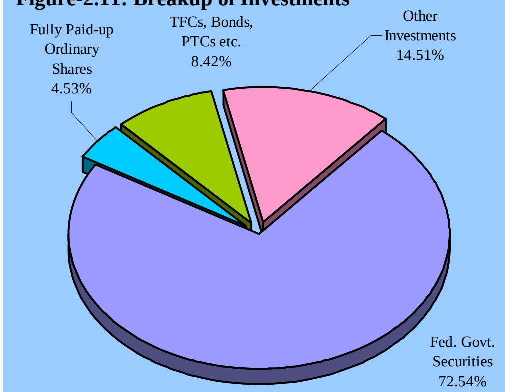
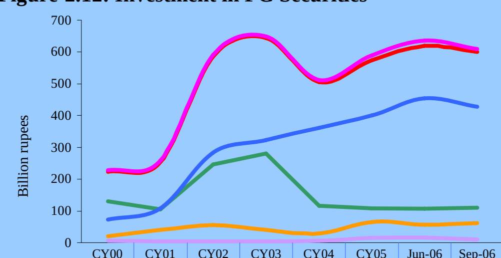


Figure-2.12: Investment in FG Securities



	CY00	CY01	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	130	106	246	280	117	109	106	110
SBs	6	4	5	5	6	15	17	10
LPBs	73	108	285	323	361	400	455	428
FBs	20	41	55	41	29	66	58	62
CBs	223	255	586	644	506	575	619	600
All	229	260	591	650	513	590	636	611

The break-up analysis of federal government securities reveals that the decline was mainly because of the MTBs that reduced by Rs12.7 billion or 3.1 percent. In turn, this decline was mainly owing to more maturities of MTBs during Sep-06 quarter. The overall investment in PIBs held by the banking system also reduced by around Rs7 billion, due mainly to the disposal of some PIBs holdings of longer maturities as well as maturities falling due during the quarter.

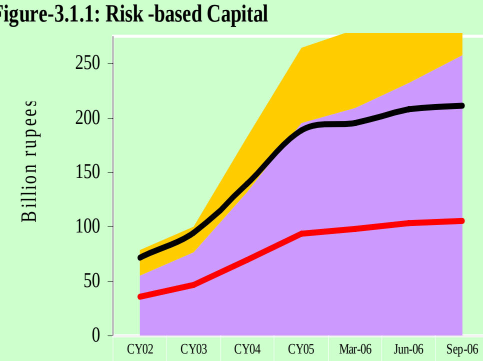
Group-wise composition of investments in federal government securities shows that LPBs and SBs were mainly responsible for the decline in such investments (see **Figure 2.12**). During the quarter under review, they recorded a decline of Rs27 billion and Rs7 billion. Conversely, PSCBs and FBs witnessed slight increase of Rs4 billion each.

3. Financial Soundness of the Banking System

3.1 Solvency

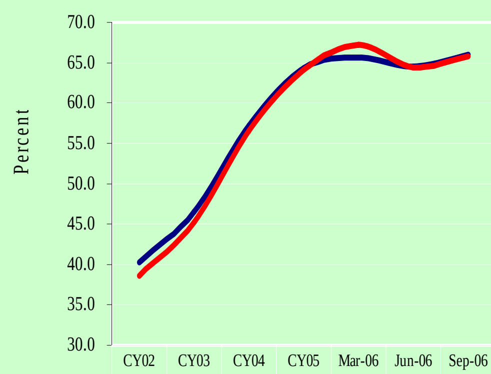
The solvency profile of the banking sector showed a visible improvement on the back of strong profitability and responding to the enhanced capital requirement. The qualifying risk-based capital of the banking system witnessed further strengthening and has increased to Rs336 billion from Rs309 billion in Jun-06 showing a quarterly growth of 8.8 percent. Though both the core capital and supplementary capital contributed to this increase, however, the core capital remains the mainstay of the capital base as its share in the total capital also increased to 76.7 percent as compared to 75.1 percent in the last quarter (see **Figure 3.1.1**).

Figure-3.1.1: Risk -based Capital



	CY02	CY03	CY04	CY05	Mar-06	Jun-06	Sep-06
Suppl. Capital	23.5	23.3	50.8	69.7	71.4	76.9	78.5
Core Capital	55.2	77.0	131.7	195.3	209.6	232.2	257.9
Required Core	35.9	47.3	69.6	94.2	97.9	104.0	105.8
Required Total	71.8	94.7	139.3	188.3	195.8	207.9	211.6

Figure-3.1.2: RWA to Total Assets



	CY02	CY03	CY04	CY05	Mar-06	Jun-06	Sep-06
All Banks	40.3	46.5	57.2	64.3	65.6	64.5	66.0
CBs	38.6	45.2	56.6	64.1	67.2	64.4	65.8

During the quarter under review, the total assets have shown a decline of half the percentage point mainly because a decline in the deposit base of the banking system. However, the risk weighted assets of the banking system witnessed a growth, though at relatively slower pace i.e. 1.8 percent as compared to the 6.2 percent of the previous quarter. This happened because of the shift in the asset mix of the banking system remained more towards the loans. As a result of this the risk weighted assets to total assets ratio crept up to 66.0 percent from 64.5 percent in the preceding quarter (see **Figure 3.1.2**).

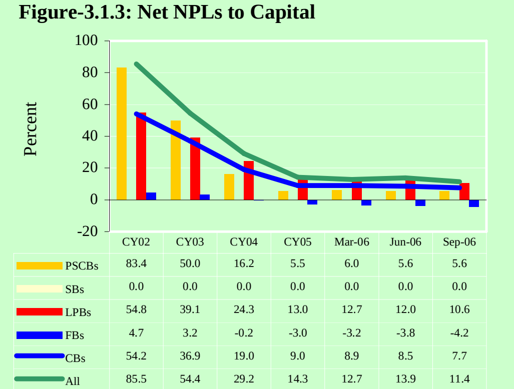
The relatively higher growth in the capital of the banking industry has further strengthened the solvency indicators. The capital adequacy ratio (CAR) further increased to 12.7 percent from 11.9 percent in the preceding quarter (see **Table 3.1.1**). The group wise analysis shows that LPBs registered highest improvement

Table-3.1.1: Capital Adequacy Indicators

Percent	CY00	CY01	CY02	CY03	CY04	CY05	Mar-06	Jun-06	Sep-06
CAR									
PSCBs	10.4	9.6	12.3	11.0	13.4	14.5	15.5	15.7	16.4
LPBs	9.2	9.5	9.7	9.0	10.1	10.6	11.0	11.5	12.6
FBs	18.0	18.6	23.2	23.0	17.4	16.4	16.1	13.5	13.9
CBs	11.4	11.3	12.6	11.1	11.4	11.9	12.3	12.6	13.5
SBs	(3.3)	(13.9)	(31.7)	(28.2)	(9.0)	(7.7)	(12.4)	(9.1)	(10.6)
All banks	9.7	8.8	8.8	8.5	10.5	11.3	11.6	11.9	12.7
Tier 1 Capital to RWA									
PSCBs	7.7	7.1	8.6	8.2	8.6	8.8	9.8	9.9	10.8
LPBs	8.1	8.4	6.6	7.0	7.5	8.3	8.7	9.2	10.2
FBs	17.9	18.6	23.0	23.0	17.1	16.1	15.8	12.9	13.3
CBs	9.8	9.7	9.7	9.1	8.6	9.1	9.5	9.7	10.7
SBs	(3.4)	(13.9)	(31.7)	(28.7)	(15.0)	(13.6)	(18.2)	(14.9)	(15.5)
All banks	8.3	7.3	6.2	6.5	7.6	8.3	8.6	8.9	9.8
Capital to Total Assets									
PSCBs	4.6	3.7	5.6	6.1	8.7	12.6	13.5	12.8	14.0
LPBs	3.5	3.8	5.2	5.3	6.5	7.0	7.4	7.4	8.0
FBs	8.8	8.5	10.6	9.9	8.9	9.5	9.4	8.3	8.6
CBs	4.9	4.6	6.1	6.1	7.2	8.4	8.8	8.6	9.3
SBs	(1.1)	(10.3)	(23.0)	(10.0)	(9.4)	(8.1)	(10.7)	(8.4)	(8.4)
All banks	4.5	3.8	4.8	5.5	6.7	7.9	8.2	8.1	8.8
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	13.4
LPBs	(1.9)	(1.0)	2.4	3.2	4.9	6.1	6.4	6.5	6.0
FBs	8.0	8.0	10.1	9.6	9.0	9.8	9.6	8.6	9.0
CBs	0.2	(0.0)	2.8	3.9	5.9	7.6	8.1	7.9	7.8
SBs	(25.5)	(34.4)	(44.5)	(30.9)	(27.2)	(21.1)	(20.1)	(22.7)	(18.8)
All banks	(1.4)	(1.9)	0.7	2.5	4.7	6.7	7.2	7.0	7.0

in their CAR, which increased by 1.1 percent to 12.6 percent by the end of September 06 quarter. Comparatively higher increase in Tier 1 capital has also improved the tier 1 capital to risk weighted assets ratio to 9.8 percent from 8.9 percent in the last quarter. Group wise, the tier 1 capital ratio of LPBs registered the highest improvement to 10.2 percent from 9.2 percent in the previous quarter.

Figure-3.1.3: Net NPLs to Capital

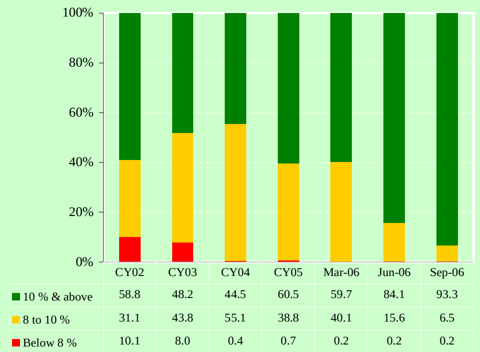


The other key solvency ratios also witnessed improvement over the quarter. Capital to total assets ratio increased to 8.81

percent from 8.11 percent in Jun-06. After adjusting the capital with net NPLs, this ratio stayed around 7.0 percent, signifying the managed credit risk profile of the banks. Capital impairment ratio, the ratio of net NPLs to capital ratio of the banking system also improved to 11.4 percent from 13.92 percent in Jun-06 both due to a decline in the net NPLs and increase in the capital of the banks (see **Figure 3.1.3**).

The share of the well capitalized banks in terms of their total assets, increased during the quarter ended Sept-06. Now, the banks, having capital adequacy ratio of 10 percent and above, hold around 93 percent share in the total assets of the banking system, which by all means is quite good (see **Figure 3.1.4**).

Figure-3.1.4: Bank's Market Share by CAR



The distribution of banks falling in the well-capitalized CAR position also showed improvement during the quarter. One bank having CAR between 8-10 percent in Jun-06 has been shifted to the higher bracket in Sep-06, thus the number of banks with CAR of over 15 percent increased to 18 during the quarter (see **Table-3.1.2**).

Table-3.1.2: Distribution of Banks by CAR (Numbers)

Periods	Total	Below 8%	8 to 10 %	10 to 15 %	Over 15 %
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
Sep-06	42	1	5	17	18

Overall, the banks were able to further strengthen their solvency position on the back of strong profits and the capital injections to meet the enhanced minimum capital requirement. However, individually some banks may find it difficult to meet the minimum capital requirement of Rs3 billion by the end of December 2006. Nevertheless, the current practice of mergers and capital injections by the banks experiencing significant shortfall may help them to meet the same.

3.2 Profitability

The pace of growth in the profitability of the banking system remained on the track and year-to-date after tax profit increased to Rs61.7 billion, closer to the one achieved in the full CY05. These profits were backed by higher economic activity, a shift in the assets mix towards high yield assets like consumer finance products and increasing spreads as a result of gradual rise in interest rates.

Almost all the banks especially PSCBs and LPBs contributed to this remarkable increase in profits during Sept-06 quarter. The year-to-date after tax profits of PSCBs and LPBs were Rs17.4 billion and Rs38.1 billion respectively **(see Table 3.2.1).**

The key performance indicators witnessed strengthening over the quarter. The after tax return on assets (ROA) of all banks inched up to 2.13 percent as compared to 2.11 percent of the last quarter. Group wise, the ROA of LPBs remained intact at the level of 2 percent while PSCBs registered further

Table-3.2.1: Profitability of the Banking System

(Billion Rupees)	CY02	CY03	CY04	CY05	Mar-06	Jun-06	Sep-06
Profit before tax							
PSCBs	10.9	16.1	14.2	22.8	6.6	15.6	24.5
LPBs	11.9	23.8	31.0	60.5	16.7	36.9	56.5
FBs	6.6	7.1	7.2	11.6	3.5	6.9	9.9
CBs	29.4	47.0	52.4	94.9	26.7	59.4	90.9
SBs	(10.4)	(3.3)	(0.4)	(1.1)	(3.0)	(0.7)	(0.6)
All Banks	**19.0**	**43.7**	**52.0**	**93.8**	**23.7**	**58.7**	**90.3**
Profit after tax							
PSCBs	4.8	9.4	8.0	15.5	4.3	10.6	17.4
LPBs	6.4	14.8	21.8	41.1	11.2	25.5	38.1
FBs	4.2	4.2	5.8	8.0	2.4	4.9	6.9
CBs	15.3	28.4	35.6	64.6	17.9	41.0	62.4
SBs	(12.4)	(3.7)	(0.9)	(1.3)	(3.0)	(0.8)	(0.7)
All Banks	**2.9**	**24.7**	**34.7**	**63.3**	**14.9**	**40.2**	**61.7**

strengthening to 3.0 percent from 2.8 percent in the last quarter (see **Table 3.2.2**). The drive to increase capital base significantly increased the equity of the banking system and hence return on equity (ROE) of the banking system experienced slight decline to 26.1 percent from 26.5 percent in the previous quarter. However, the ratio has improved for PSCBs to 23.6 percent from 22.7 percent in Jun-06 quarter mainly due to the higher increase in profits earned by one of the largest

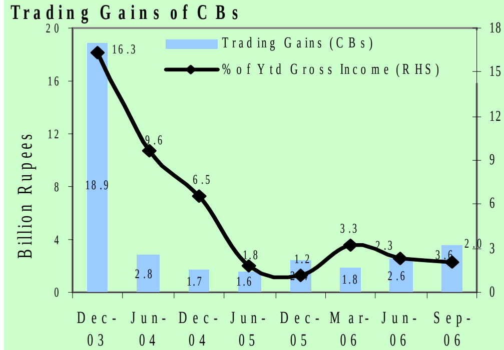
PSCBs. Of the constituents of total income, the share of net interest income in gross income of the banking system remained almost intact at 73 percent.

Table-3.2.2: Profitability Indicators

(Percent)	CY02	CY03	CY04	CY05	Mar-06	Jun-06	Sep-06
After Tax ROA							
PSCBs	0.6	1.0	1.3	2.2	2.4	2.8	3.0
LPBs	0.8	1.4	1.2	1.8	1.8	2.0	2.0
FBs	1.5	1.5	2.0	2.5	2.7	2.7	2.5
CBs	0.8	1.2	1.3	2.0	2.0	2.2	2.2
SBs	(12.1)	(3.7)	(0.8)	(1.2)	(11.1)	(1.4)	(0.8)
All Banks	**0.1**	**1.0**	**1.2**	**1.9**	**1.6**	**2.1**	**2.1**
After Tax ROE (based on Equity plus Surplus on Revaluation)							
PSCBs	11.5	17.3	17.2	20.9	19.9	22.7	23.6
LPBs	17.3	25.8	20.2	27.2	24.8	27.3	26.2
FBs	15.2	14.8	21.5	27.1	28.9	30.2	27.9
CBs	14.3	20.3	19.6	25.4	23.8	26.2	25.6
SBs	-	-	-	-	-	-	
All Banks	**3.2**	**20.0**	**20.3**	**25.8**	**20.5**	**26.5**	**26.1**

Although the total trading gains of commercial banks increased in absolute amount, the overall share of trading income in the gross income dropped marginally (see **Figure 3.2.1**). The gain on sale of securities as percentage of gross income dropped to 2.0 percent as compared to 2.3 percent in the last quarter. The trading gain on sale of shares was the major contributory factor in the overall trading income, owing a share of 89 percent as compared to 84 percent of the last quarter.

Figure-3.2.1: Periodic Growth in Trading Gains of CBs



The profit & loss structure of commercial banks depicts a slight change over the quarter as the share of net interest income in the gross income increased marginally to73 percent from 72.7 percent in the Jun-06 quarter (see **Figure 3.2.2**). Corollary to this, the share of non-interest income experienced a slight decline, which happened due to a fall in the share of "Fee based income and income from dealing in currency". Operating expenses experienced slight increase over the quarter and in terms of gross income, it slightly inched up to41.3 percent from 40.7 percent in the last quarter. As a preventive measure and to shield their loans portfolio, the banks have increased their provisioning for bad portfolio during the quarter. This increase can safely be attributed to State Bank's more stringent classification criteria. The commercial banks' net interest income alone is quite sufficient to meet all the operating expenses including the provisioning.

Figure-3.2.2: CBs' P&L Structure

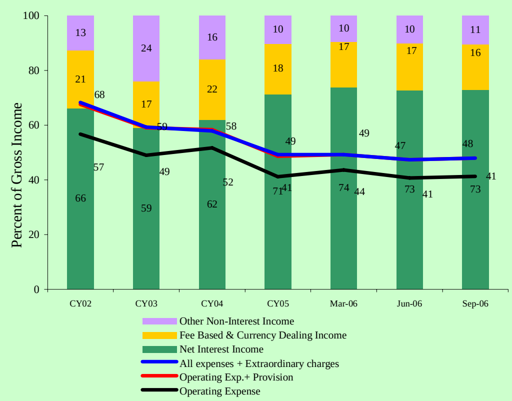
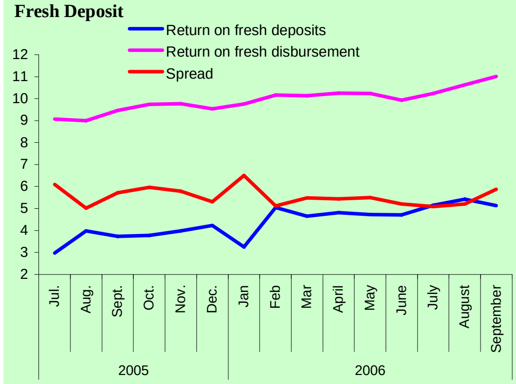


Figure-3.2.3: Wtd. Avg. Rates on Fresh Disbursements and Fresh Deposit



Though the assets of the banking system experienced slight contraction over the quarter, the shift in the asset mix away from the lower return assets like lending to financial institutions, balances with other banks and investments to the assets with higher returns i.e. loans added to the income stream of the banking system. The banks' advances net of provision increased by Rs45.2 billion in the current quarter. This shift in asset mix resulted in the interest/mark-up income to touch the level of Rs232.6 billion as compared to Rs150.1 billion in the last quarter.

Looking at the flows, return on fresh deposits stayed a bit higher and crossed the five percent level during the quarter, however, the spread between the return paid on fresh deposits and charged on fresh advances slightly also went up to 5.9 percent from 5.2 percent due to comparatively higher increase in the returns charged on the later ones (see **Figure 3.2.3**).

Although the extraordinary profits on the back of increased loans portfolio has strengthened the profitability of the banking system yet it remains exposed to higher credit risk, which if continues to increase may impact the performance of the banking system in future.

4. Risk Assessment of the Banking System

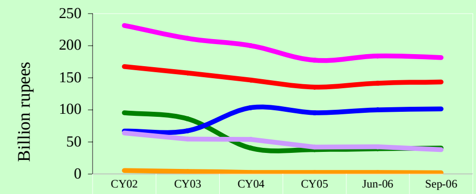
4.1 Credit Risk

The NPLs of the banking system witnessed a mixed trend amidst significant loan growth and the rising interest rates. Despite the fact that total non-performing loans (NPLs) of the banking system came down by Rs2.3 billion, commercial banks (CBs) contributing around 97 percent of the banking system's assets, experienced an increase of Rs2.2 billion in their NPLs (see **Figure-4.1.1**). This was attributable to the fact that significant decline in NPLs of one of the specialized banks has more than offset the increase in the NPLs of the commercial banks.

It was due to the comparatively higher provisioning that net NPLs of the banking system also registered a significant decline of Rs5.3 billion. Though not significantly, commercial banks also contributed in this decline of net NPLs by Rs0.7 billion during the quarter under review (see **Figure-4.1.2**).

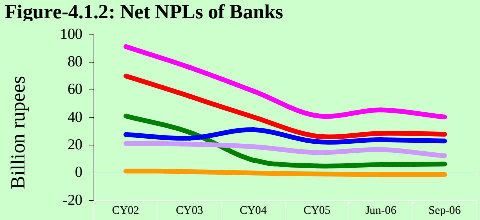
Of the key indicators, the NPLs to loans ratio came down to 7.7 percent (Jun-06: 8.0 percent) for all banks while for commercial banks, despite the fact that their over all NPLs increased, the relatively greater increase in their loan portfolio has forced the ratio

Figure-4.1.1: Total NPLs of Banks



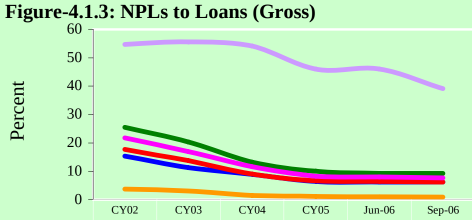
	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	95.5	85.9	40.1	38.0	39.6	40.6
LPBs	66.9	67.4	103.4	95.6	99.8	101.2
FBs	5.2	4.0	2.5	2.1	2.0	1.9
CBs	167.6	157.2	146.1	135.6	141.5	143.7
SBs	63.9	54.1	53.7	41.7	42.4	37.8
All	231.5	211.3	199.8	177.2	183.8	181.5

Figure-4.1.2: Net NPLs of Banks



	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	41.0	29.4	9.2	5.0	5.9	6.2
LPBs	27.7	25.1	31.1	22.5	23.9	23.1
FBs	1.4	0.8	(0.0)	(1.0)	(1.2)	(1.4)
CBs	70.1	55.4	40.3	26.6	28.6	27.9
SBs	21.2	20.8	18.8	14.7	16.8	12.3
All	91.3	76.2	59.1	41.2	45.5	40.2

Figure-4.1.3: NPLs to Loans (Gross)



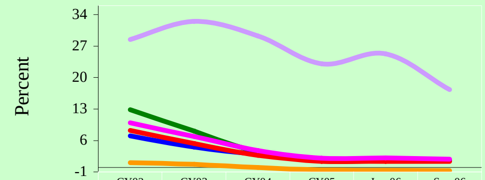
	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	25.5	20.4	13.3	10.0	9.4	9.3
LPBs	15.4	11.3	9.0	6.4	6.3	6.3
FBs	3.8	3.1	1.6	1.2	1.1	1.0
CBs	17.7	13.7	9.0	6.7	6.4	6.3
SBs	54.7	55.6	54.1	46.0	46.0	39.1
All	21.8	17.0	11.6	8.3	8.0	7.7

down to 6.3 percent (Jun-06: 6.4 percent) (see **Figure-4.1.3**). The ratio of net NPLs to net loans declined to 1.8 percent for all banks, and 1.3 percent for the commercial banks (see **Figure-4.1.4**). This improvement in the net NPLs to net Loans ratio has been witnessed primarily due to the higher coverage ratio and the provisions to NPLs ratio has been increasing over the last few years (see **Figure-4.1.5**).

Group-wise analysis reveals that LPBs witnessed an increase of Rs1.3 billion in their NPLs followed by PSCBs, the NPLs of which increased by Rs1.0 billion. Specialized banks, due to the peculiar nature of their business and the seasonal movements in their NPLs profile, reported a significant fall in their NPLs.

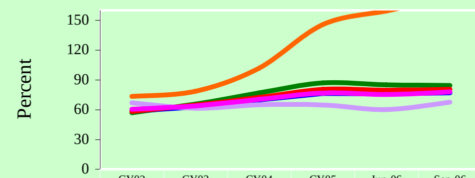
Of the key asset quality indicators, NPLs to loans ratio of PSCBs improved to 9.3 percent from 9.4 percent while net NPLs to net loans ratio went up to 1.56 percent from 1.52 percent in the previous quarter. However, the level does not show any serious concern for this group. Specialized banks, following a seasonal pattern, registered significant decline and NPLs of one of the large specialized bank declined substantially, which also reduced the NPLs of this groups to Rs37.8 billion from 42.4 billion in the previous quarter.

Figure-4.1.4: Net NPLs to Net Loans



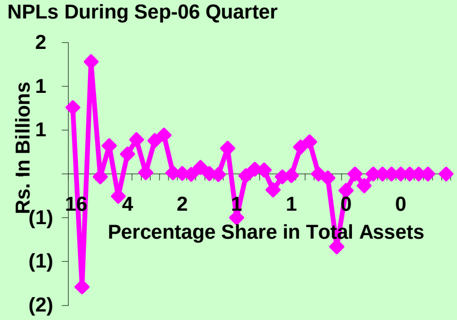
	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	12.8	8.1	3.4	1.5	1.5	1.6
LPBs	7.0	4.5	2.9	1.6	1.6	1.5
FBs	1.1	0.7	(0.0)	(0.6)	(0.6)	(0.7)
CBs	8.3	5.3	2.7	1.4	1.4	1.3
SBs	28.5	32.5	29.3	23.1	25.3	17.3
All	9.9	6.9	3.8	2.1	2.1	1.8

Figure-4.1.5: Provisions to NPLs



	CY02	CY03	CY04	CY05	Jun-06	Sep-06
PSCBs	57.1	65.8	77.0	86.9	85.0	84.6
LPBs	58.6	62.7	69.9	76.4	76.0	77.2
FBs	73.3	78.7	101.9	145.8	159.5	173.3
CBs	58.2	64.8	72.4	80.4	79.8	80.6
SBs	66.9	61.5	64.9	64.8	60.3	67.5
All	60.6	63.9	70.4	76.8	75.3	77.8

Figure-4.1.6: Bank-wise Increase/ (Decrease) in NPLs During Sep-06 Quarter



As for LPBs, though the NPLs of this largest group increased, growth in loan portfolio has kept the NPLs to loans ratio around 6.3 percent, which other wise might have experienced deterioration. It was due to the higher provisioning that Net NPLs and its key ratio of this group registered further improvement and net NPLs to net loans ratio came off to 1.5 percent. Significant fall in the NPLs of the specialized banks has also improved the NPLs to loan ratio and net NPLs to net Loans ratios of this group. FBs, experiencing a persistent decline in their NPLs, continued enjoying comfortable asset quality and its NPLs further reduced. Net NPLs of this group stayed negative in this quarter as well on account of excess provisioning.

Bank-wise, the analysis shows that the increase in NPLs of the commercial banks has been shared by 18 banks holding 61 percent share in the overall assets of the banking system, of which the 5 banks with highest rise in NPLs accounts for 34 percent of the total assets of the banking system (see **Figure-4.1.6**). There were around 17 banks, with the share of 38 percent in the assets of the banking system, which witnessed decline in their NPLs over the June quarter. Looking into the details of the constituents of NPLs, the "Loss" category dominates both in the number terms and percentage terms, followed by "Substandard" and "Doubtful".

A good momentum can be seen in the consumer finance activity over the last few years. Increasing number of banks have been daring to step into this comparatively risky area for want of lucrative returns and hence the share of consumer finance, in terms of its volume in the total loan portfolio, has increased to 14.3 percent by the end of Sep-06 quarter. Though it is heartening that the banks have increased their outreach by offering diversified products to the middle income group, the increasing NPLs against this segment raises concerns. During the quarter under review, the NPLs to loans ratio of this segment inched up to 2.1 percent from 1.9 percent in Jun-06.

This increase in the NPLs of the consumer finance has also inched up its share in the NPLs of the banking system. As of end of Sep-06 quarter, the NPLs of consumer finance have increased to 4.1 percent (Jun-06: 3.3 percent) of the total NPLs of the banking system (see **Table-4.1**). Of the key products offered under consumer finance, auto loans remained the highest contributor in the NPLs of this segment. Though the deteriorating loan quality of this segment is a concern for the banks which are aggressively going into this, the level of infection in this segment as well as its share in the total loans portfolio of the banking system still do not pose a serious threat.

NPLs of the corporate sector, both in terms of number and its share in the over all, experienced slight improvement over the quarter. An increase in the loans of this segment has kept the NPLs to loans ratio around 7.3%. Both SMEs and agriculture

Table 4.1 Segmentwise Infection of Loans Portfolio

(Domestic Operations) (Rs in billions)

Sector	Loans Outstanding		Share in Total Outstanding Loans		NPLs		Share in Total NPLs		NPLs as % of Outstanding Loans	
	Jun-06	Sep-06	Jun-06	Sep-06	Jun-06	Sep-06	Jun-06	Sep-06	Jun-06	Sep-06
Corporate	1,140.9	1,176.6	52.4%	52.8%	83.9	85.8	50.3%	52.2%	7.4%	7.3%
SMEs	356.6	358.6	16.4%	16.1%	40.1	38.2	24.1%	23.2%	11.3%	10.7%
Agriculture	134.0	142.1	6.1%	6.4%	31.4	28.7	18.8%	17.4%	23.4%	20.2%
Consumers	296.6	318.3	13.6%	14.3%	5.6	6.8	3.3%	4.1%	1.9%	2.1%
Credit Cards	33.5	*36.7*	1.5%	1.6%	0.3	*0.4*	0.2%	*0.3%*	1.0%	*1.1%*
Auto Loans	97.8	*101.8*	4.5%	4.6%	1.3	*1.6*	0.8%	*1.0%*	1.4%	*1.6%*
Consumer Durables	1.5	*1.3*	0.1%	0.1%	0.1	*0.2*	0.1%	*0.1%*	8.6%	*13.9%*
Mortgage Loans	43.1	*50.4*	2.0%	2.3%	0.2	*0.7*	0.1%	*0.4%*	0.5%	*1.3%*
Others	120.7	*128.1*	5.5%	5.7%	3.6	*3.8*	2.1%	*2.3%*	3.0%	*3.0%*
Commodity Finance	180.0	157.3	8.3%	7.1%	2.1	1.5	1.3%	0.9%	1.2%	1.0%
Staff Loans	43.3	47.6	2.0%	2.1%	0.5	0.7	0.3%	0.4%	1.2%	1.7%
Others	28.0	27.8	1.3%	1.2%	3.0	2.8	1.8%	1.7%	10.6%	7.8%
Total	**2,179.3**	**2,228.2**	**100.0%**	**100.0%**	**166.6**	**164.5**	**100.0%**	**100.0%**	**7.6%**	**7.4%**

have actually improved their assets quality and their NPLs declined both in terms of numbers as well as their share in total NPLs. NPLs to loans ratio of these two segments also eased off over the quarter.

Despite the fact that NPLs of the commercial banks increased over the Sep-06 quarter, the banking system as a whole has so far been able to manage its credit risk. However, this rising trend in the NPLs needs to be closely monitored and should be reversed to avoid any serious implication on both the profitability and the solvency of the banks. Banks, while dealing with specially the new areas like consumer finance, need to closely adhere to the effective credit appraisal and monitoring standards and follow prudent lending and risk management practices.

4.2 Market Risk

Figure-4.2.1: Differential b/w 6m MTB & US Treasury

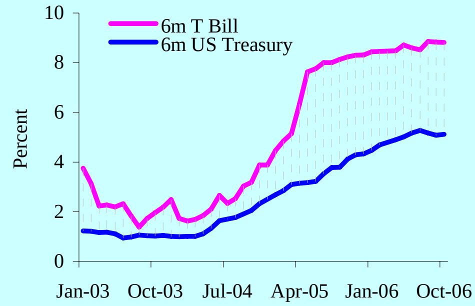
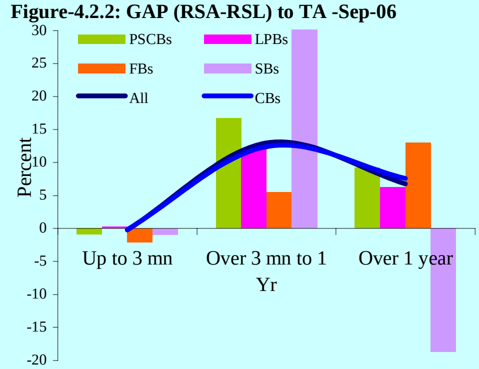


Figure-4.2.2: GAP (RSA-RSL) to TA -Sep-06



Interest rates witnessed gradual increase in response to the inflationary pressures and the rising interest rates on international front. The pace of this increase in the domestic interest rates remained slower during the year, when compared with the interest rates on US Treasuries thus leading to some significant slow down, rather witnessed some reversal in the previously widening GAP between the two (see **Figure-4.2.1**).

Though the rise in interest rates over the quarter remained gradual, it raises the ***interest rate risk*** especially for the banks with significant repricing GAPs. The analysis reveals that banks generally were maintaining comfortable GAP between their rate sensitive assets and liabilities. For the three months timeframe, the negative GAP of all banks, when measured in terms of total assets, significantly reduced to less than 1 percent from around 5.5 percent in Jun-06 (see **Figure-4.2.2**). GroupWise, only FBs had the highest repricing GAP in this shorter term band, which still was comfortably lower than the minimum acceptable +/- 10 percent level. However, for the three months to one year bucket this GAP was significantly high. As for all banks, the GAP in terms of total assets was around 13 percent. Group wise, after the SBs, PSCBs had the highest GAP, which in terms of their total assets stood at 16.7 percent. It was due to this fact that the overall GAP of this group also stayed highest, after the SBs. Hence PSCBs, due to their higher repricing GAPs are more prone to the risk of revaluation.

During the quarter under review, the increase in interest rates was not equal across all maturities thus giving rise to the yield curve risk (see **Figure-4.2.3**). The greater increase in the longer term yields steepened the yield curve over the quarter. However, post quarter development again witnesses some flattening due to the fall in the longer term yields (see **Figure-4.2.4**). This volatility in the longer term yields signifies that the longer term yields are finding some optimum balance in terms of yield spreads, which widened during the quarter due to the steepening of the yield curve and again came down after the quarter ended (see **Figure-4.2.5**).

The exchange rate against major currencies remained almost stable during the quarter. Though the demand side pressures in the form of heavy import bills for meeting the rising oil prices and the heavy import of machinery were there, the supply side was managed to cope with the demand. These demands were primarily met through the inflows especially the workers remittances coupled with the SBP interventions. As a result of this rupee witnessed slight volatility, experiencing slight depreciation against dollar. The rupee dollar exchange rate went slightly up to Rs60.75 by the end of November 2006 from Rs60.30 in June this year.

Figure-4.2.3 PKRV Rates (in %)

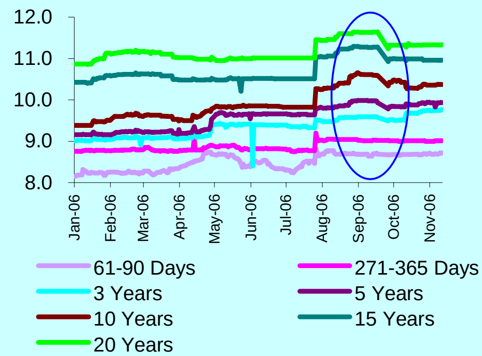


Figure-4.2.4: Shift in Yield Curve

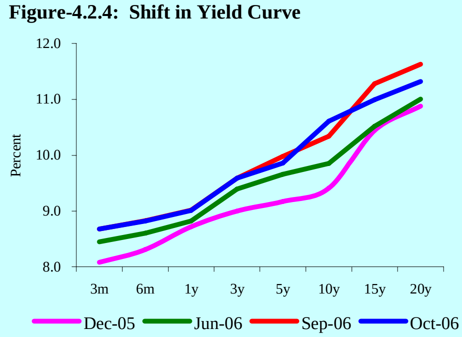
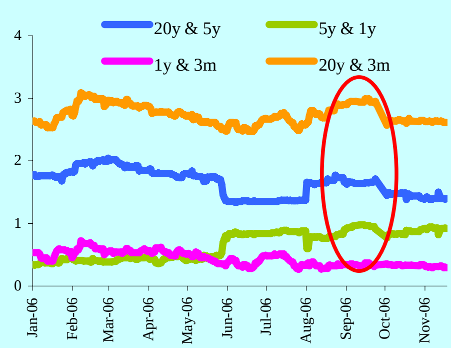


Figure -4.2.5: Yield Spread in PKRV Rates (in %)



As for the currency exposure of our banking system, actually the banks have foreign currency assets significantly surpassing the liabilities in foreign currency. Hence, they would actually gain from any depreciation in the exchange rate. Positive net open position (NOP) of the banks well explains the banks' foreign currency exposure (see **Figure-4.2.6**). NOP of the banks though remained with in the acceptable limit of +/- 10 percent of equity of the banks, the positive

Equity price risk of the bank is mainly driven by the direct exposure of the banks in the equities market. In absolute terms the direct investment of the banks in ordinary shares has gone slightly up during the September 06 quarter to Rs38.15 billion from 36.81 billion in June 2006 (see **Figure-4.2.7**). Though its share in terms of total investment of the banks has also gone slightly up to 4.5 percent from 4.3 percent in jun-06, yet its level is well contained.

Group wise, LPBs continued to carry the highest exposure in terms of capital, however the level remained even less than 15 percent for all the groups. Individually, the equity exposure of banks is generally well

Figure-4.2.6: NOP Vs Rs/$ Exchange Rate

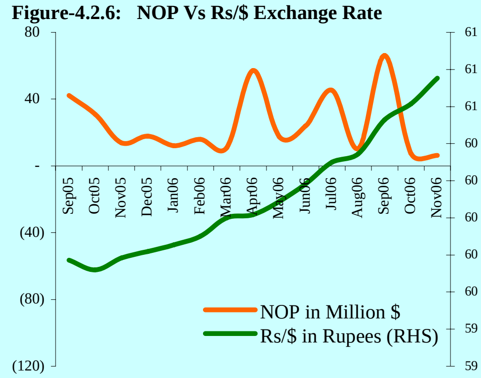


Figure-4.2.7: Exposure of Banks in Equities-Sep-06

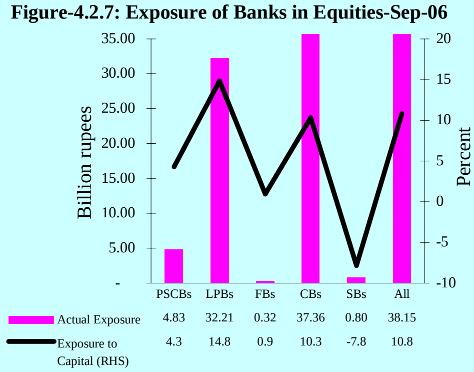
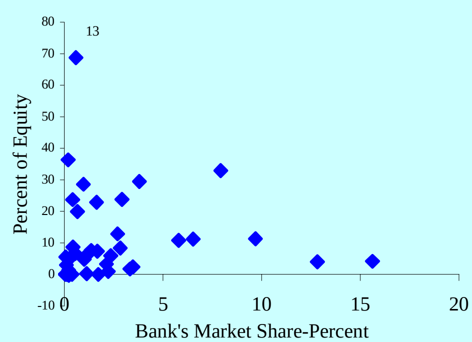
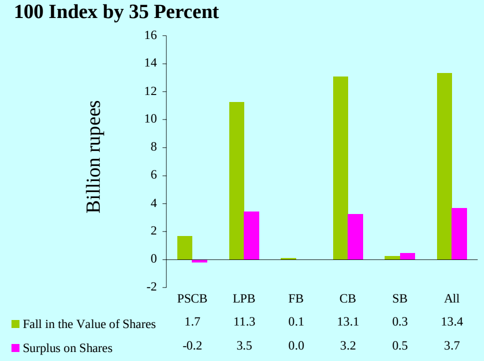


Figure-4.2.8: Total Exposure of Banks-Sep-06



managed and in terms of equity are at lower side as well. However, for a couple of banks, carrying a smaller share in the whole banking system, it is on higher side (see **Figure 4.2.8**).

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



By the end of the quarter under review, 15 banks were carrying deficit against equity investment. Given the volatile nature of the equity market, a stress scenario reveals that with a 35 percent fall in the prices of equity investment held by the banks, whole of the surplus of the banking system booked against the revaluation of equity investment will be reversed into deficit (see **Figure-4.2.9**). Group wise, the surplus of both LPBs and FBs will also be converted into deficit. However, the fortified capital base of the banks can sustain this level of shock.

4.3 Liquidity Risk

During the quarter under review, SBP continued to follow a tighter monitory policy in response to curb the inflationary tendencies and actually mopped up liquidity from the market besides gradually raising the benchmark rates in the auctions.

One of the major supervisory developments of the quarter was the increase in the liquidity requirements, in terms of both the increase in the base of time and demand liabilities by actually withdrawing some of the exemptions previously given, and increase in the statutory liquidity requirement (SLR) to 18 percent from the previous 15 percent of both the time and demand liabilities.

Moreover, the cash reserve requirement (CRR) has also been separately defined as 7 percent of the demand liabilities and 3 percent of the time liabilities as against the previous 5 percent for both the time and demand liabilities. Since the share of demand liabilities, in the total liabilities, is quite significant, hence the overall cash reserve requirement also increased for the banks. However, the analysis shows that since the banks were already holing liquidity significantly in excess of what was required as per the previous CRR and SLR, this change in the definitions and the increase in the liquidity reserve requirements was comfortably met by the banks (see **Figure-4.3.1**).

Figure-4.3.1: Liquidity Held by Banks

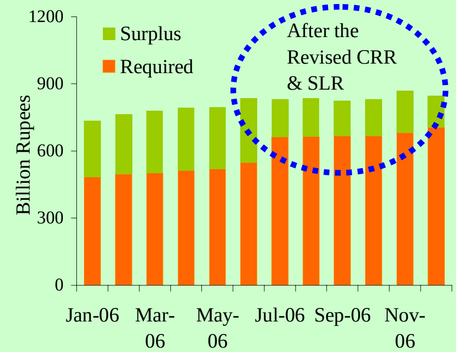
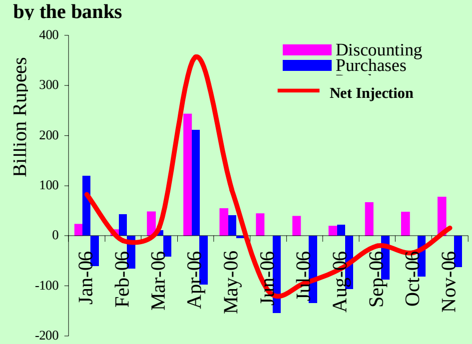


Figure-4.3.2: OMOs by SBP Vs Discounting availed by the banks



Frequent mop ups by SBP continued for this quarter as well, which left the banking system with lower available liquidity. Though the banks were also availing the SBP discount window for meeting their short term liquidity needs, however the actual mop ups by SBP has resulted into net squeezing of liquidity from the market (see **Figure-4.3.2**). This has also put some strain on the inter bank rates and overnight rates remained quite volatile during the period (see **Figure-4.3.3**).

The key liquidity indicators show further tightening. Significant loan growth coupled with the fall in the deposit base of the banks has also raised the loan to deposit ratio to 73.2 percent from 69.9 percent in June-06 quarter (see **Figure-4.3.4**). Excluding the export refinance, it hovered around 72.1 percent as against 68.8 percent during the previous quarter. This has also reduced the liquid assets available with the banks and hence liquid assets in terms of total assets squeezed to 32.7 percent from 34.1 percent in the previous quarter.

Market based liquidity, which is provided by the secondary market activity, has remained squeezed since the significant

Figure-4.3.3: Volatility in O/N Rates Jun-06-(in%)

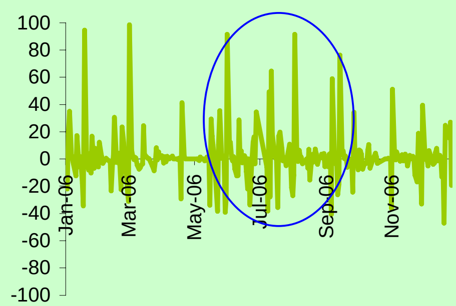


Figure-4.3.4: Liquidity Indicators

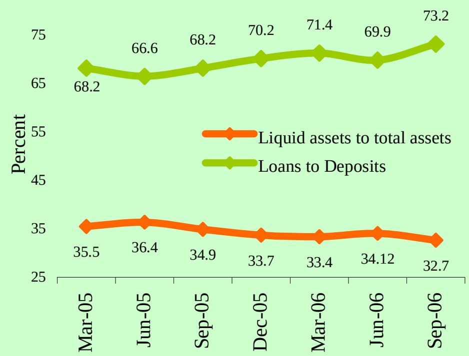
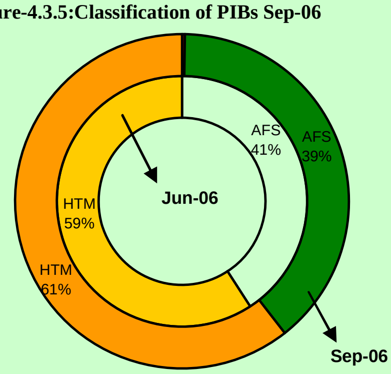


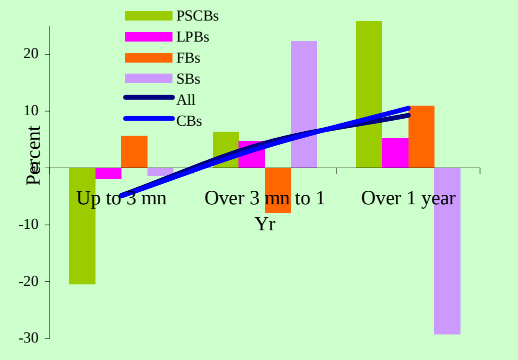
Figure-4.3.5:Classification of PIBs Sep-06



portion of the banks' investment has been kept under held-to-maturity (HTM) category and the banks have very negligible share of their investments as their trading portfolio (see **Figure-4.3.5**).

Funding liquidity risk has also remained a concern due to the undesirable GAP position of the banking system. As for the three months bucket, the GAP between the rate sensitive assets and liabilities was negative (see **Figure-4.3.6**), which was a source of concern given the current rising interest rate expectations. Group-wise, PSCBs were running significantly high negative GAP i.e. 20 percent in terms of total assets, in this shorter term bucket, thus exposing them to the interest rate risk. However, for the rest of the banking groups, the exposure was with in the acceptable limit of +/- 10 percent of total assets.

Figure-4.3.6: GAP (Assets-Liabilities) to TA-Sep-06



5. Performance of Islamic Banking

The Sep-06 quarter witnessed further growth in Islamic banking. During this quarter, focus of the Islamic Banking Institutions was geared towards expansion of branch network. While the number of Islamic Banks (IBs) remained the same, the number of branches operated by them rose from 48 in Jun-06 to 66 during Sep-06 (see **Table-5.1**). Similarly, the number of Islamic Banking Branches (IBBs) operated by conventional banks rose from 39 in Jun-06 to 47 in Sep-06.

Table-5.1: Islamic Banking Players

	Dec-03	Dec-04	Dec-05	Jun-06	Sep-06
No. of Islamic Banks (IBs)	1	2	2	4	4
No. of Branches	10	23	37	48	66
No. of conventional banks operating Islamic Banking Branches	3	7	9	11	11
No. of Islamic Banking Branches (IBBs)	7	21	33	39	47

With the expansion in branch network, total balance sheet footing of the Islamic banking system saw a growth of 8.5 percent over the quarter and increased to Rs 95 billion in Sep-06 (see **Table-5.2**).

Table-5.2: Sources and Uses of Funds

(Million Rupees)

	Dec-03	Dec-04	Dec-05	Jun-06	Sep-06
SOURCES:					
Deposits	8,397.11	30,184.80	49,931.77	59,657.47	66,010.91
Borrowings	1,898.96	6,559.05	9,005.80	8,538.97	7,910.78
Capital & other funds	1,993.66	5,123.09	7,811.03	12,284.52	12,777.18
Other liabilities	624.85	2,276.11	4,744.75	7,121.66	8,320.90
	12,914.59	**44,143.05**	**71,493.35**	**87,602.62**	**95,019.76**
USES:					
Financing	8,652.21	27,535.47	45,786.15	51,602.78	52,620.81
Investments	1,242.25	2,007.03	1,854.19	6,333.13	6,642.16
Cash, bank balance, placements	1,978.47	11,899.75	19,314.32	22,877.44	27,656.22
Other assets	1,041.66	2,700.81	4,538.69	6,789.27	8,100.56
	12,914.59	**44,143.05**	**71,493.35**	**87,602.62**	**95,019.76**

Review of the balance sheet of Islamic banking system reveals the predominance of deposits and financings as major source and use of funds respectively. The share of deposits increased from 68.1 in Jun-06 to 69.5 in Sep-06 and it remained the largest source of funds for the banks followed by funds from owners viz. capital. On assets side, financings remained the largest component, however, its share in total assets declined from 58.9 percent of last quarter to 55.4 percent in Sep-06. Similarly, the share of investments also witnessed a slight decline from 7.2 percent in Jun-06 to 7 percent Sep-06.

Table-5.3: Key Performance Indicators

Percent

Indicator	Dec-03	Dec-04	Dec-05	Jun-06	Sep-06
NPFs to total financing	0.7	0.9	1.0	2.3	1.7
Net NPFs to net financing	-	0.2	0.2	1.4	0.7
Provision to NPFs	100.0	82.3	80.6	40.3	59.1
Net Markup Income to total assets	1.7	1.4	2.3	3.2	3.0
Non Markup Income to total assets	2.2	1.4	1.7	1.0	1.0
Operating Expense to Gross Income	54.6	65.3	49.9	55.9	64.3
ROA (average assets)	2.2	1.2	1.7	1.6	1.2
Growth in Assets	84.5	241.8	62.0	10.5	8.5
Growth in Deposits	64.6	259.5	65.4	11.2	10.6
Growth in Financing	147.0	218.2	66.3	5.9	2.0

A growth of 2 percent was witnessed in financings over the quarter, which was lower than growth of 10.6 percent in deposits. Resultantly, financings to deposits ratio declined from 86.5 percent of Jun-06 to 79.7 percent. During Sep-06 quarter, the quantum of non-performing financings (NPFs) declined whereas provisions increased by 12.5 percent. These trends depict improvement in asset quality of the

Islamic banking system (see **Table-5.3**). However, high deposits to financings ratio calls for stringent monitoring of financing portfolio by IBIs to check any deterioration in their asset quality in future.

The capital position of IBIs shows that their capital increased by 4 percent over the quarter, trailing behind the growth in assets. Resultantly, the capital to total assets ratio further declined from 14.02 percent in Jun-06 to 13.45 percent in Sep-06. However, the IBIs were fairly meeting the capital adequacy requirements. Owing to decrease in NPFs, the net NPFs to capital ratio improved from 5.8 percent in Jun-06 to 2.9 percent in Sep-06.

The break-up of deposits reflects compositional shift in all the major deposit categories. The fixed deposits comprised 36.5 percent of total deposits as against 29.1 percent in Jun-06. On the other hand, the share of saving deposits declined from 32.5 percent to 28.6 percent and that of non-remunerative current accounts declined from 25.8 percent to 22.8 percent (see **Figure-5.1**). The review of deposits structure reveals that increase in the share of fixed deposits was not entirely at the cost of saving deposits. This growth was largely the outcome of incremental fixed deposits, which may be attributed to the expansion of Islamic banking branches.

Figure-5.1: Composition of Deposits

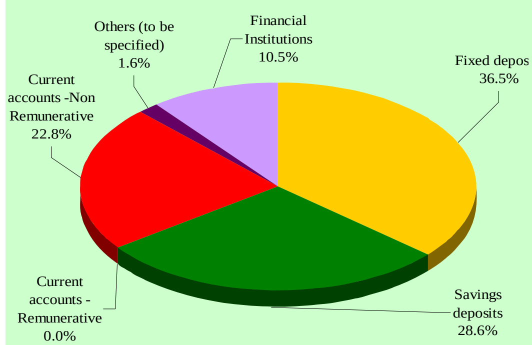
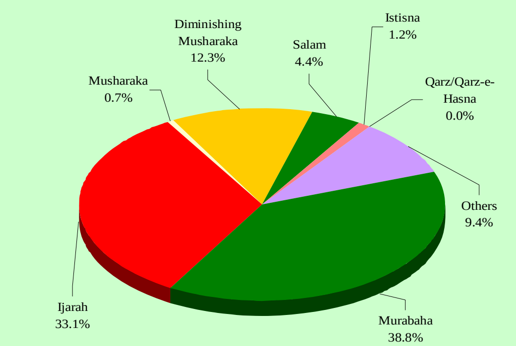


Figure-5.2: Modes of Financing



The composition of financings reflects that though Murabaha and Ijarah continue to maintain their dominance, their collective share in total financings has reduced from 74.2 percent in Jun-06 to 71.9 percent in Sep-06. Besides, the share of Diminishing Musharaka and Istisna declined and that of Salam increased during the quarter (see **Figure-5.2**).

Table-5.4: Income Statement

(Million Rupees)

	Dec-03	Dec-04	Dec-05	Jun-06	Sep-06
Markup Income	406.4	1,081.0	3,164.3	2,898.9	4,547.9
Markup Expense	188.5	483.7	1,542.3	1,483.6	2,416.1
Net Markup Income	217.9	597.2	1,622.0	1,415.3	2,131.9
Provision Expense	(15.8)	36.0	175.6	91.9	152.3
Non Markup Income	287.4	596.0	1,206.6	422.1	725.5
Operating Expense	276.0	779.0	1,410.5	1,027.7	1,836.0
Profit Before Tax	245.0	378.2	1,242.6	762.2	869.1
Tax	27.0	36.2	265.2	75.6	53.7
Profit After Tax	218.0	342.0	977.4	686.6	815.4

Expansion in Islamic banking operations and financings portfolio has enabled the IBIs to improve 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 (annualized) also improved to 3.0 percent from 2.3 percent for CY-05. However, increase in operating expenses as a percentage of gross income from 55.9 percent in Jun-06 to 64.25 percent has reflected in a 20.8% decline in after-tax profit from June-06 position. Resultantly, ROA of the Islamic banking system declined from 1.6 percent in Jun-06 to 1.2 percent in Sep-06.

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 improvement in key performance indicators. However, the IBIs need to seek diversification in their financing operations while exercising caution at the same time to keep any chances of increase in NPFs remote.

Financial Soundness Indicators **Annex-I**

Indicators	2002	2003	2004	2005	Mar-06	Jun-06	Sep-06p
CAPITAL ADEQUACY							
Risk Weighted CAR							
Public Sector Commercial Banks	12.3	11.0	13.4	14.5	15.5	15.7	16.4
Local Private Banks	9.7	9.0	10.1	10.6	11.0	11.5	12.6
Foreign Banks	23.2	23.0	17.4	16.4	16.1	13.5	13.9
Commercial Banks	**12.6**	**11.1**	**11.4**	**11.9**	**12.3**	**12.6**	**13.5**
Specialized Banks	**(31.7)**	**(28.2)**	**(9.0)**	**(7.7)**	**(12.4)**	**(9.1)**	**(10.6)**
All Banks	**8.8**	**8.5**	**10.5**	**11.3**	**11.6**	**11.9**	**12.7**
Tier 1 Capital to RWA							
Public Sector Commercial Banks	8.6	8.2	8.6	8.8	9.8	9.9	10.8
Local Private Banks	6.6	7.0	7.5	8.3	8.7	9.2	10.2
Foreign Banks	23.0	23.0	17.1	16.1	15.8	12.8	13.3
Commercial Banks	**9.7**	**9.1**	**8.6**	**9.1**	**9.5**	**9.7**	**10.6**
Specialized Banks	**(31.7)**	**(28.7)**	**(15.0)**	**(13.6)**	**(18.2)**	**(14.9)**	**(15.5)**
All Banks	**6.2**	**6.5**	**7.6**	**8.3**	**8.6**	**8.9**	**9.8**
Capital to Total Assets							
Public Sector Commercial Banks	5.6	6.1	8.7	12.6	13.5	12.8	14.0
Local Private Banks	5.2	5.3	6.5	7.0	7.4	7.4	8.0
Foreign Banks	10.6	9.9	8.9	9.5	9.4	8.3	8.6
Commercial Banks	**6.1**	**6.1**	**7.2**	**8.4**	**8.8**	**8.6**	**9.3**
Specialized Banks	**(23.0)**	**(10.0)**	**(9.4)**	**(8.1)**	**(10.7)**	**(8.4)**	**(8.4)**
All Banks	**4.8**	**5.5**	**6.7**	**7.9**	**8.2**	**8.1**	**8.8**
ASSET QUALITY							
NPLs to Total Loans							
Public Sector Commercial Banks	25.5	20.4	13.3	10.0	10.0	9.4	9.3
Local Private Banks	15.4	11.3	9.0	6.4	6.5	6.3	6.3
Foreign Banks	3.8	3.1	1.6	1.2	1.1	1.1	0.9
Commercial Banks	**17.7**	**13.7**	**9.0**	**6.7**	**6.7**	**6.4**	**6.4**
Specialized Banks	**54.7**	**55.6**	**54.1**	**46.0**	**42.4**	**46.0**	**39.1**
All Banks	**21.8**	**17.0**	**11.6**	**8.3**	**8.1**	**8.0**	**7.7**
Provision to NPLs							
Public Sector Commercial Banks	57.1	65.8	77.0	86.8	85.2	85.0	84.6
Local Private Banks	58.6	62.7	69.9	76.4	75.9	76.0	77.2
Foreign Banks	73.3	78.7	101.9	145.9	155.3	159.5	173.3
Commercial Banks	**58.2**	**64.8**	**72.4**	**80.4**	**79.7**	**79.8**	**80.6**
Specialized Banks	**66.9**	**61.5**	**64.9**	**64.8**	**71.7**	**60.3**	**67.5**
All Banks	**60.6**	**63.9**	**70.4**	**76.7**	**78.0**	**75.3**	**77.8**
Net NPLs to Net Loans							
Public Sector Commercial Banks	12.8	8.1	3.4	1.5	1.6	1.5	1.6
Local Private Banks	7.0	4.5	2.9	1.6	1.6	1.6	1.5
Foreign Banks	1.1	0.7	(0.0)	(0.6)	(0.6)	(0.6)	(0.7)
Commercial Banks	**8.3**	**5.3**	**2.7**	**1.4**	**1.4**	**1.4**	**1.3**
Specialized Banks	**28.5**	**32.5**	**29.3**	**23.1**	**17.2**	**25.3**	**17.3**
All Banks	**9.9**	**6.9**	**3.8**	**2.1**	**1.9**	**2.1**	**1.8**
Net NPLs to Capital							
Public Sector Commercial Banks	83.4	50.0	16.2	5.5	6.0	5.6	5.6
Local Private Banks	54.8	39.1	24.3	13.0	12.7	12.0	10.6
Foreign Banks	4.7	3.2	(0.2)	(3.0)	(3.2)	(3.8)	(4.2)
Commercial Banks	**54.2**	**36.9**	**19.0**	**9.0**	**8.9**	**8.5**	**7.7**
Specialized Banks	-	-	-	-	-	-	-
All Banks	**85.5**	**54.4**	**29.2**	**14.3**	**12.7**	**13.9**	**11.4**
EARNINGS							
Return on Assets (Before Tax)							
Public Sector Commercial Banks	1.3	1.8	2.4	3.3	3.7	4.2	4.3
Local Private Banks	1.4	2.2	1.7	2.7	2.7	2.9	2.9
Foreign Banks	2.3	2.6	2.5	3.6	4.0	3.8	3.6
Commercial Banks	**1.5**	**2.1**	**2.0**	**2.9**	**3.0**	**3.2**	**3.2**
Specialized Banks	**(10.2)**	**(3.3)**	**(0.4)**	**(1.0)**	**(8.7)**	**(0.4)**	**(1.1)**
All Banks	**0.9**	**1.8**	**1.9**	**2.8**	**2.6**	**3.1**	**3.1**
Return on Assets (After Tax)							
Public Sector Commercial Banks	0.6	1.0	1.3	2.2	2.4	2.8	3.0
Local Private Banks	0.8	1.4	1.2	1.8	1.8	2.0	2.0
Foreign Banks	1.5	1.5	2.0	2.5	2.7	2.7	2.5
Commercial Banks	**0.8**	**1.2**	**1.3**	**2.0**	**2.0**	**2.2**	**2.2**
Specialized Banks	**(12.1)**	**(3.7)**	**(0.8)**	**(1.2)**	**(8.7)**	**(0.5)**	**(1.1)**
All Banks	**0.1**	**1.0**	**1.2**	**1.9**	**1.6**	**2.1**	**2.1**

Financial Soundness Indicators **Annex-I**

Indicators	2002	2003	2004	Dec-05	Mar-06	Jun-06	Sep-06p
ROE (Avg. Equity & Surplus) (Before Tax)							
Public Sector Commercial Banks	26.3	29.9	30.8	30.7	30.1	33.4	33.3
Local Private Banks	32.3	41.5	28.8	40.1	36.8	39.5	38.7
Foreign Banks	24.2	25.0	26.7	38.9	42.7	42.6	40.2
Commercial Banks	**27.5**	**33.7**	**29.0**	**37.2**	**35.5**	**38.0**	**37.3**
Specialized Banks	-	-	-	-	-	-	-
All Banks	**21.1**	**35.4**	**30.5**	**38.2**	**32.6**	**38.8**	**38.2**
ROE (Avg. Equity & Surplus) (After Tax)							
Public Sector Commercial Banks	11.5	17.3	17.2	20.9	19.9	22.7	23.6
Local Private Banks	17.3	25.8	20.2	27.2	24.8	27.3	26.2
Foreign Banks	15.2	14.8	21.5	27.1	28.9	30.2	27.9
Commercial Banks	**14.3**	**20.3**	**19.6**	**25.4**	**23.8**	**26.2**	**25.6**
Specialized Banks	-	-	-	-	-	-	-
All Banks	**3.2**	**20.0**	**20.3**	**25.8**	**20.5**	**26.5**	**26.1**
NII/Gross Income							
Public Sector Commercial Banks	69.5	64.1	63.7	71.3	76.7	70.3	68.9
Local Private Banks	65.5	55.9	62.0	73.0	73.8	74.1	74.9
Foreign Banks	57.5	55.3	57.7	61.5	69.1	69.4	69.6
Commercial Banks	**66.1**	**58.9**	**61.9**	**71.3**	**73.8**	**72.7**	**73.0**
Specialized Banks	**78.0**	**62.2**	**81.9**	**87.7**	**88.6**	**86.5**	**80.5**
All Banks	**67.1**	**59.2**	**62.8**	**72.0**	**74.3**	**73.2**	**73.3**
Cost / Income Ratio							
Public Sector Commercial Banks	56.9	43.9	39.5	34.3	33.9	30.4	29.7
Local Private Banks	60.0	53.2	56.2	43.1	47.0	43.7	44.2
Foreign Banks	45.4	48.2	49.0	42.2	41.0	42.2	45.3
Commercial Banks	**56.7**	**49.0**	**51.7**	**41.2**	**43.7**	**40.7**	**41.3**
Specialized Banks	**84.7**	**67.5**	**57.8**	**47.8**	**51.6**	**57.1**	**61.7**
All Banks	**59.1**	**50.5**	**52.0**	**41.5**	**45.0**	**41.8**	**41.6**
LIQUIDITY							
Liquid Assets/Total Assets							
Public Sector Commercial Banks	49.0	49.1	43.9	35.6	32.5	33.3	31.6
Local Private Banks	47.1	42.9	34.3	32.4	32.6	33.6	32.3
Foreign Banks	48.5	49.2	39.8	41.8	42.7	41.6	41.7
Commercial Banks	**48.1**	**46.1**	**37.0**	**33.9**	**33.6**	**34.3**	**33.1**
Specialized Banks	**16.4**	**22.9**	**25.3**	**25.8**	**28.9**	**28.1**	**20.1**
All Banks	**46.7**	**45.1**	**36.6**	**33.7**	**33.4**	**34.1**	**32.7**
Liquid Assets/Total Deposits							
Public Sector Commercial Banks	59.6	59.0	52.6	44.7	40.9	41.6	40.5
Local Private Banks	60.2	54.5	42.3	40.3	41.1	42.4	41.5
Foreign Banks	74.2	68.9	53.4	57.9	60.2	58.1	58.0
Commercial Banks	**61.5**	**57.8**	**45.7**	**42.7**	**42.8**	**43.6**	**42.8**
Specialized Banks	**98.5**	**135.0**	**154.1**	**183.2**	**277.4**	**252.1**	**192.8**
All Banks	**61.8**	**58.5**	**46.5**	**43.5**	**43.8**	**44.5**	**43.5**
Advances/Deposits							
Public Sector Commercial Banks	44.3	45.7	49.7	59.8	62.2	58.7	64.3
Local Private Banks	52.3	58.2	67.3	70.8	71.6	70.8	73.2
Foreign Banks	72.0	63.8	70.1	68.7	69.9	69.2	71.0
Commercial Banks	**51.0**	**53.6**	**63.6**	**68.4**	**69.5**	**68.0**	**71.1**
Specialized Banks	**453.8**	**379.1**	**370.5**	**400.7**	**517.2**	**503.0**	**566.8**
All Banks	**54.9**	**56.4**	**65.8**	**70.2**	**71.4**	**69.9**	**73.2**

Note: The indicators for June and September 2006 are based on un-audited returns

Selected Indicators for Different Categories of Banks, Sep-06 Annex-II

Indicators	Top 5 Banks	Top 10 Banks	Top 20 Banks	Industry
Share of Total Assets	52.6%	71.9%	91.8%	100%
Share of Total Deposits	55.4%	75.8%	93.2%	100%
Share of Gross Income	57.7%	76.3%	95.0%	100%
Share of Risk Weighted Assets	51.0%	71.3%	91.0%	100%
Capital Adequacy				
Capital/RWA	14.1%	13.3%	13.3%	12.7%
Tier 1 Capital / RWA	10.2%	9.9%	10.1%	9.8%
Net Worth / Total Assets	9.9%	9.5%	9.0%	8.8%
Asset Composition				
Sectoral Distribution of Loans (Domestic)				
- Corporate Sector	46.3%	71.5%	91.5%	100%
- SMEs	52.2%	68.5%	86.1%	100%
- Agriculture	38.1%	45.3%	94.4%	100%
- Consumer Finance	57.9%	73.2%	95.8%	100%
- Commodity Financing	73.6%	93.3%	99.4%	100%
- Staff Loans	60.6%	75.8%	94.0%	100%
- Others	52.3%	59.6%	77.8%	100%
- **Total**	**50.7%**	**71.1%**	**91.9%**	**100%**
NPLs / Gross Loans	8.0%	7.1%	7.1%	7.7%
Net NPLs / Capital	7.3%	7.6%	10.1%	11.4%
Earning & Profitability				
ROA	2.5%	2.6%	2.3%	2.1%
ROE	28.5%	29.0%	26.9%	26.1%
Net Interest Income / Gross Income	76.3%	74.8%	73.7%	73.3%
Income from Trading & Foreign Exchange / Gross Income	4.7%	4.8%	5.3%	5.6%
Non-Interest Expense / Gross Income	38.5%	37.3%	39.5%	41.6%
Liquidity				
Liquid Assets / Total Assets	32.8%	32.0%	32.5%	32.7%
Liquid Assets held in Govt. Securities / Total Liquid Assets	45.5%	46.5%	48.2%	46.6%
Liquid Assets / Total Deposits	41.4%	40.3%	42.5%	43.5%

Bank-wise Major Statistics- September 2006 Annex-III

(Rupees in million)

S. No.	Name of the Bank	Assets	Deposits	Equity
1	The Bank of Khyber	26,522	19,440	3,057
2	The Bank of Punjab	139,223	114,898	15,779
3	First Women Bank Ltd.	8,232	6,385	831
4	National Bank of Pakistan	625,592	483,232	92,623
5	Industrial Development Bank of Pakistan	9,217	7,117	(28,189)
6	Zarai Taraqiati Bank Ltd.	85,479	2,645	12,471
7	Punjab Provincial Co-operative Bank Ltd.	17,379	1,441	3,284
8	SME Bank Limited	8,677	1,361	2,270
9	Allied Bank Limited	232,178	198,030	16,691
10	Bank Alfalah Ltd.	261,499	214,843	10,753
11	Bank AL Habib Ltd.	108,205	88,003	6,078
12	Askari Commercial Bank Ltd.	152,484	122,701	10,475
13	Crescent Commercial Bank Ltd.	7,689	4,169	1,842
14	Atlas Bank Limited.	16,938	8,453	3,014
15	Habib Bank Limited	513,876	411,246	47,699
16	Faysal Bank Ltd.	116,847	78,229	13,369
17	KASB Bank Ltd.	23,461	19,051	2,070
18	Dubai Islamic Bank Pakistan Ltd.	4,631	2,305	2,147
19	BankIslami Pakistan Ltd.	2,758	614	2,003
20	Arif Habib Rupali Bank Ltd.	4,372	1,040	3,040
21	MCB Bank Ltd.	317,608	251,092	30,541
22	Meezan Bank Limited	38,831	29,447	3,453
23	Metropolitan Bank Ltd.	94,298	60,377	6,973
24	Mybank Limited	22,129	16,212	3,940
25	NIB Bank Limited	40,258	21,709	4,232
26	PICIC Commercial Bank Ltd.	65,349	53,150	4,081
27	Prime Commercial Bank Ltd.	54,458	42,659	3,609
28	Saudi Pak Commercial Bank Ltd	49,480	40,692	3,736
29	Soneri Bank Ltd.	67,014	50,931	4,840
30	United Bank Ltd.	388,177	308,065	27,070
31	Union Bank Ltd.	113,556	73,385	5,262
32	ABN AMRO Bank N.V.	68,984	53,077	5,397
33	Oman International Bank S.A.O.G.	1,810	718	1,014
34	Habib Bank AG Zurich	45,186	33,191	3,324
35	The Hongkong & Shanghai Banking Corp. Ltd.	15,544	10,753	2,351
36	Deutsche Bank AG	7,581	2,649	2,368
37	The Bank of Tokyo - Mitsubishi	6,097	1,209	2,369
38	Citibank N.A.	89,088	61,905	5,915
39	Albaraka Islamic Bank B.S.C.	14,992	10,727	2,104
40	Standard Chartered Bank	133,132	100,107	8,128
41	American Express Bank Ltd.	6,660	5,581	678
	Total	**4,005,491**	**3,012,836**	**352,692**

Group-wise Composition of Banks Annex-IV

1997-1998	2003	2004	2005	Sep.2006
A. Public Sector Com. 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 Alfalah 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 N.V. Albaraka Islamic Bank B.S.C. 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 AG Doha Bank Emirates Bank International Habib Bank AG 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 Com. 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 Alfalah 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 Limited NDLC-IFIC Bank Ltd. Crescent Commercial Bank Ltd. **C. Foreign Banks (14)** ABN AMRO Bank N.V. Albaraka Islamic Bank B.S.C. American Express Bank Ltd. Bank of Ceylon [2] The Bank of Tokyo - Mitsubishi Citibank, N.A. Credit Agricole Indosuez [3] Deutsche Bank AG Doha Bank [4] Habib Bank AG Zurich The Hongkong & Shanghai Banking Corporation Ltd. Oman International Bank S.A.O.G. Rupali Bank Ltd. Standard Chartered Bank **D. Specialized Banks (3)** Zarai 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 Com. 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 Alfalah 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 Limited NDLC-IFIC Bank Ltd. Crescent Commercial Bank Ltd. Habib Bank Ltd. Dawood Bank Limited **C. Foreign Banks (11)** ABN AMRO Bank N.V. Albaraka Islamic Bank B.S.C. American Express Bank Ltd. The Bank of Tokyo – Mitsubishi Citibank, N.A. Deutsche Bank AG 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)** Zarai 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 Com. 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 Limited NIB Bank Ltd. Crescent Commercial Bank Ltd. Habib Bank Ltd Dawood Bank Ltd.[5] **C. Foreign Banks (11)** ABN AMRO Bank N.V. Albaraka Islamic Bank B.S.C. American Express Bank Ltd. The Bank of Tokyo - Mitsubishi Citibank N.A. Deutsche Bank AG Habib Bank AG Zurich The Hongkong & Shanghai Banking Corporation Ltd. Oman International Bank S.A.O.G. Rupali Bank Ltd.[6] Standard Chartered Bank **D. Specialized Banks (4)** Zarai Taraqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Ltd.[7] **All Commercial Banks (35)** Include A + B + C **All Banks (39)** Include A + B + C + D	**A. Public Sector Com. Banks (4)** National Bank of Pakistan First Women Bank Ltd. The Bank of Khyber The Bank of Punjab **B. Local Private Banks (23)** Askari Commercial Bank Ltd. Bank Alfalah Ltd. Bank AL Habib Ltd. Mybank Limited 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 Limited NIB Bank Limited Crescent Commercial Bank Ltd. Habib Bank Limited Atlas Bank Limited. Arif Habib Rupali Bank Ltd. Dubai Islamic Bank Pakistan Ltd.[8] BankIslami Pakistan Ltd.[9] **C. Foreign Banks (10)** ABN AMRO Bank N.V. Albaraka Islamic Bank B.S.C. American Express Bank Ltd. The Bank of Tokyo - Mitsubishi UFJ Limited Citibank N.A. Deutsche Bank AG Habib Bank AG Zurich The Hongkong & Shanghai Banking Corporation Limited Oman International Bank S.A.O.G. Standard Chartered Bank **D. Specialized Banks (4)** Zarai Taraqiati Bank Ltd. Industrial Development Bank of Pakistan Punjab Provincial Co-operative Bank Ltd. SME Bank Limited **All Commercial Banks (36)** 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 (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.