

Bhutanese Financial Sector Performance Review (December 2009)

Introduction

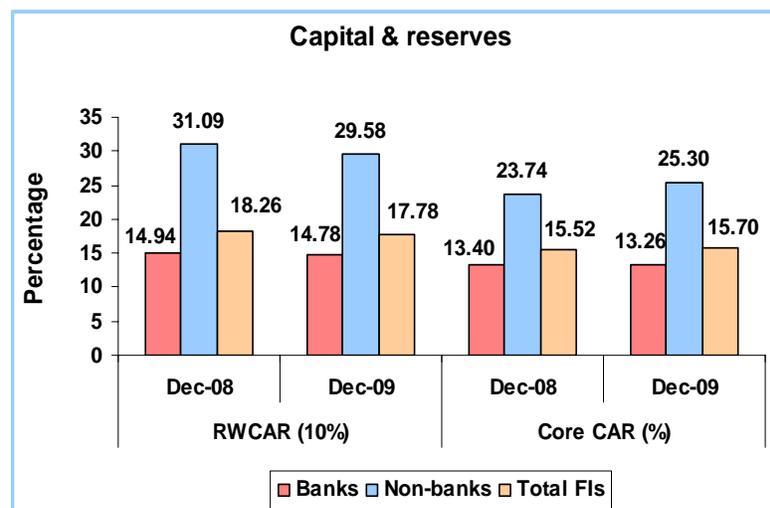
The financial system in Bhutan consists of the central bank, four commercial banks, one development finance bank, two insurance companies, one pension fund and a stock exchange. However, this financial sector review report contains the performance of the only two commercial banks (BNBL & BOBL), one insurance company (RICBL) and one development bank (BDFCL) for the period ended December 2009 in comparison to the corresponding period of the previous year. The information contained in this report is based on the RMA returns submitted by the financial institutions to the RMA for the quarter ended December 2009. The observations are summarized below:

1. Business size and growth.

The Bhutanese financial institutions as on December 2009 are well-capitalized and profitable with huge excess liquidity despite the global economic slowdown. The total assets of the financial system expanded by 32 percent during the period under review and stood at Nu.56.09 billion as of December 2009 compared to Nu.42.39 billion a year ago. The growth has been mainly contributed by an increase in the assets of the CBs¹ by Nu.12.39 billion, followed by NBFIs² with Nu.1.31 billion. Total deposit liabilities of the banking sector rose to Nu.43.31 billion as on December 2009, reflecting a significant growth of 31.94 percent during the period. The rise in deposits was largely due to an increase in deposits by Government Corporations by Nu.7.43 billion or by 79.45 percent. Similarly, borrowings of the NBFIs increased modestly by 18.99 percent during the period and stood at Nu.2.74 billion. Of the total borrowing, about 90 percent was financed from domestic sources and the remaining 10 percent from external sources. Meanwhile, the off-balance sheet exposures (OBS) of the financial sector rose by 53.31 percent from Nu.2.68 billion in December 2008 to Nu.4.11 billion in December 2009.

2. Capital & Reserves

The qualifying capital fund of the financial system has substantially strengthened, with a growth of about 22.13 percent during the period under review. Banking system's capital fund increased to Nu.3.78 billion from Nu.3.04 billion while the capital fund of the non-banks rose to Nu.1.93 billion from Nu.1.63 billion. The rise is mainly due to increase in



¹ CBs refer to Commercial Banks (BNBL and BOBL)

² NBFIs refer to Non-bank Financial Institutions (BDFCL, RICBL & NPPF).

the transfer to retained earnings and to general reserves from the profits during the year ended December 2009.

However, the position of the regulatory capital requirement (RWCAR) has slightly decreased from 18.26 percent to 17.78 percent mainly due to an increase in risk weighted assets (particularly due to increase in the high risk weighted assets such as loans) by 25.42 percent as against 22.13 percent increase in capital fund. Nonetheless, the core capital ratio (CCAR) has slightly increased to 15.70 percent from 15.52 percent during the period.

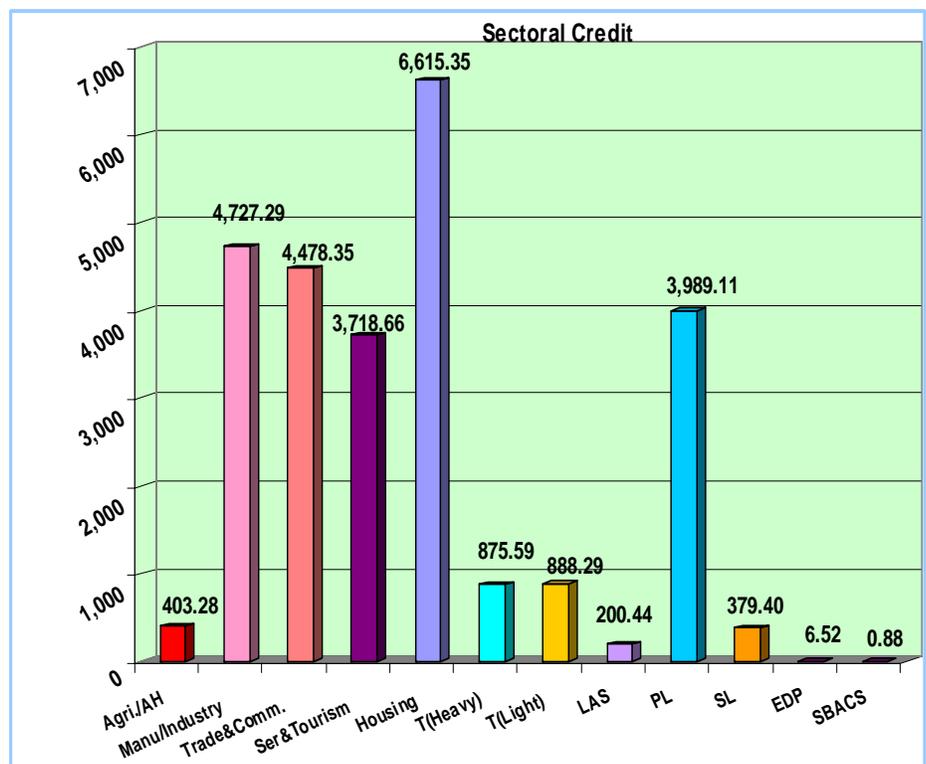
3. Total Assets

Financial sector total assets have increased to Nu.56.09 billion from Nu.42.39 billion, reflecting an increase of around 32 percent. Of the total assets, the CBs constitute 88.21 percent while the NBFIs hold 11.79 percent. The CBs experienced a growth of 33.40 percent from Nu.37.09 billion in December 2008 to Nu.49.48 billion in December 2009 with the main contributing factor being the loans and advances (by 19.18 per cent). The NBFIs experienced a growth of 24.60 percent from 5.31 billion in December 2008 to Nu.6.61 billion in December 2009 mainly due to increase in the loan assets (by 25.15 per cent) as well.

In terms of holding, liquid assets forms the major component of assets with Nu.26.88 billion (47.93 per cent) followed by loans & advances (net of provision) with Nu.24.97 billion (44.51 per cent).

4. Credit Distribution by Sector

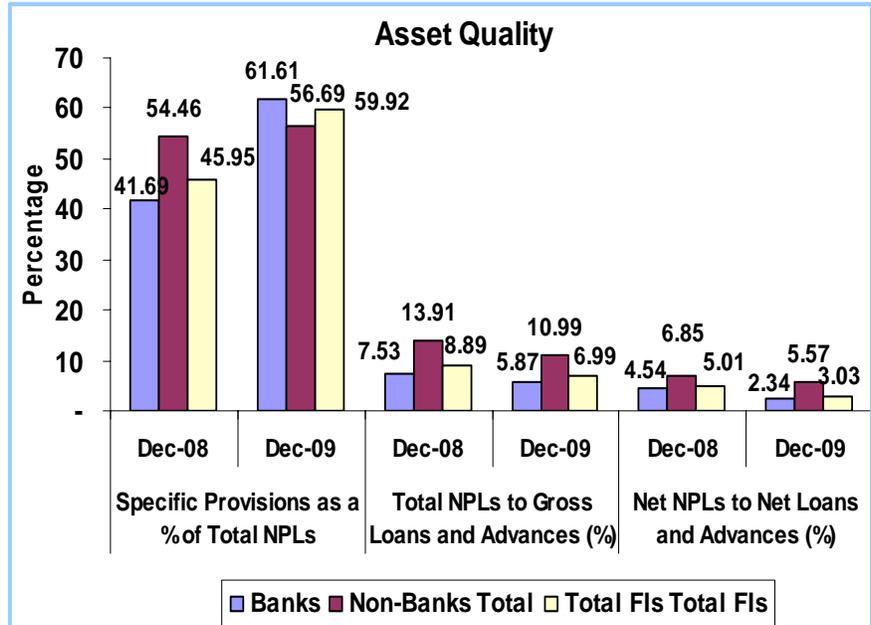
At the end of December 2009, the financial sector's total credit portfolio stood at Nu.26.28 billion, up slightly from Nu.21.98 billion in December 2008, an increase of 19.56 percent. The growth was mainly due to an increase in the personal loan which increased by Nu.1.02 billion (45.26 percent) during the period. Banks' total loans and advances increased by Nu.3.23 billion (18.69 percent) as against about Nu.1.07 billion (22.78 percent) increase in the total loans and advances of the non-banks.



Housing sector credit, which accounts for 25.17 percent of overall total loans and advances, continues to lead the sectoral credit concentration, followed by the Manufacturing & Industry sector and Trade & Commerce with 17.99 percent and 17.04 percent share respectively. However, the Agriculture sector credit abated by 1.53 percent during the period.

5. Asset Quality (Credit Portfolio)

Financial system non-performing loans have improved slightly from Nu.1.95 billion to Nu.1.83 billion despite an increase in the total loans and advances by Nu.5.30 billion. Much of this is due to an improvement in the portfolios appraisal processes and continuous monitoring and recovery of NPLs. Consequently, the ratio of NPL to total loans has improved by 1.90 percent during the period.

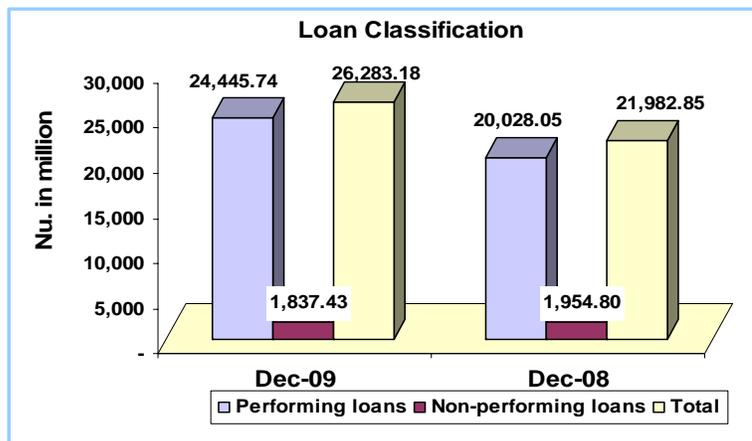


The downturn in the NPL is seen in both banks and the non-banks with an average decrease of about 5.24 percent. As a result, percentage of total NPLs to total loans and advances has improved to 6.99 percent from 8.89 percent.

Meanwhile, the percentage of provisions provided for such default has increased from Nu.45.95 percent to 59.92 percent mainly due to increase in specifics provisions by 22.50 percent.

6. Consolidated Loan Classification of the FIs

The credit appraisal and recovery process of the financial institutions seems to have improved during the period. Of the total loans of Nu.20.53 billion of CBs, 94.13 per cent are performing loans and only 5.87 percent constitutes non-performing loans. Similarly, 89.01 percent of the total loans and advances (Nu.5.75 billion) of the non banks is performing loans and the remaining



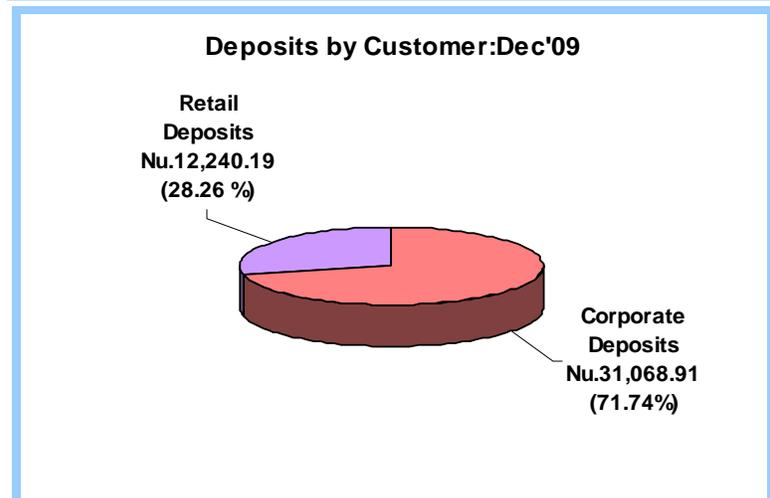
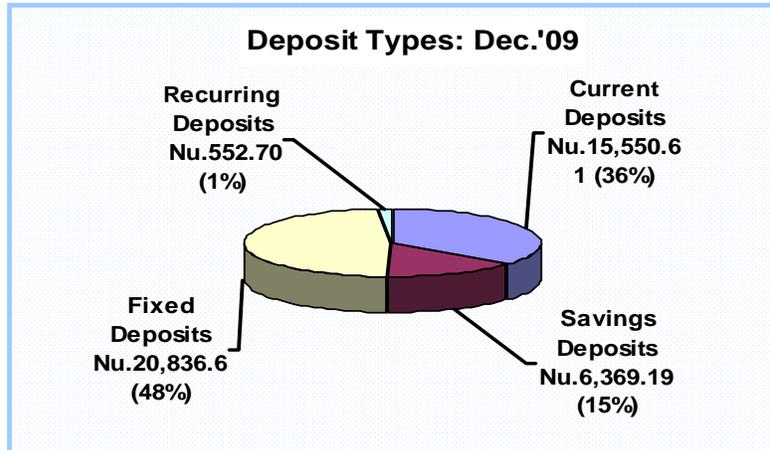
10.99 percent is non-performing loans.

7. Liabilities

The total liabilities of the financial sector amounted to Nu.56.09 billion in December 2009 as compared to Nu.42.39 billion in December 2008. Majority of the liabilities comprised of deposit liabilities with 77.22 percent, followed by capital & reserves with 8.05 percent and borrowings with 4.89 percent.

8. Distribution of Deposits by Customer

Deposits liabilities of the banking sector (including Bhutan Development Finance Corporation Ltd.) rose considerably to Nu.43.31 billion in December 2009 from Nu.32.83 billion in December 2008, achieving a growth of 31.94 percent. The growth in deposits base was mainly driven by an increase in the time deposits by 41.43 percent. In terms of deposits by customer holding, corporate deposits³ accounts for around 71.74 percent and the remaining 28.26 percent constitutes the retail deposits. In other words, corporate deposits have dominated the deposit holding pattern of the financial institutions. As a share of total deposits, demand deposits (current and saving) accounted for 50.61 percent and time deposits (fixed and recurring) comprised of 49.39 percent.



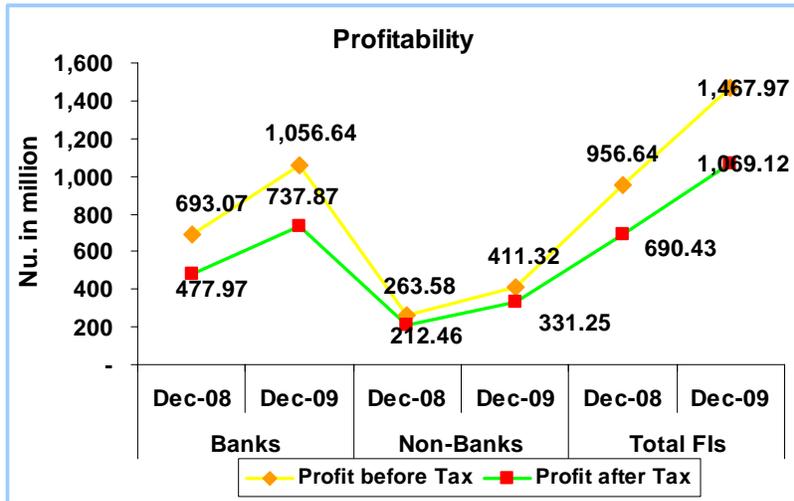
³ Corporate Deposits – refers to government, government corporations, joint corporations, private companies, NBFIs and CBs.

9. Profitability

Profit of the financial sector rose to 1.45 billion in December 2009, from Nu.0.96 billion in December 2008. Substantial increase in the interest income mainly from loans and advances by 35.04 percent (Nu.0.72 billion) coupled with an increase in the operating income by 9.47 percent (0.051 billion) has resulted in the rise in profit of the financial institutions during the period. Non-

interest income in the form of commission has also contributed to a rise in the overall profit. On the expense side, although the interest expense of the FIs dropped by 32.99 percent, the operating cost increased by 30.47 percent. Financial institutions' net interest income grew by about 29 percent.

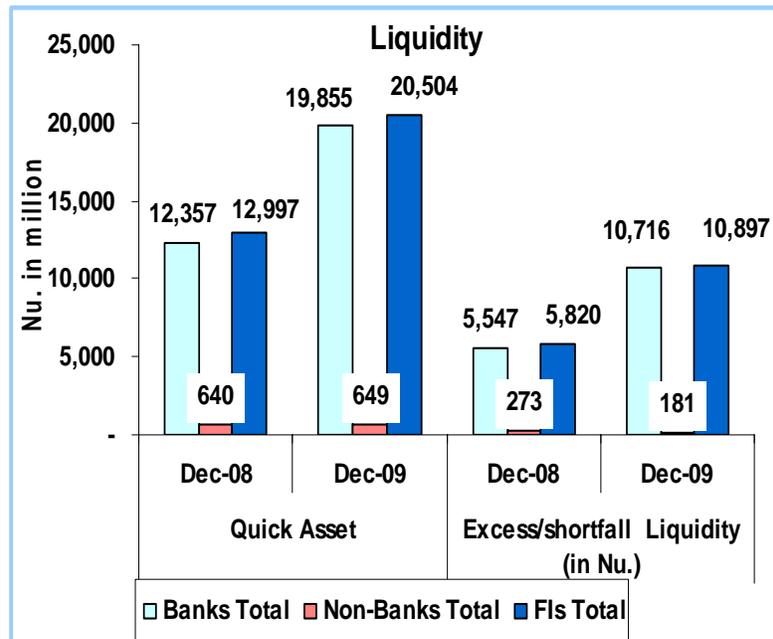
The revenue of the commercial banks increased to Nu.0.74 billion or by 54.38 percent while the non-banks' net profit increased to Nu.0.33 billion or by 55.91 percent.



10. Liquidity

Despite RMA's effort to sterilize excess fund through imposition of reserve requirement of 37 percent (20 percent for SLR & 17 percent for CRR) for deposit taking financial institutions and 10 percent (for SLR only) for non-bank financial institutions, excess liquidity in the financial system remains substantial. The Excess liquidity of the FIs more than doubled from Nu.5.82 billion to Nu.10.90 billion during the period under review. This increase was largely contributed by an increase

in the excess liquidity of the banks from Nu.5.55 billion to Nu.10.72 billion, which was in turn increased by a rise in the quick assets. On the other hand, the non-banks



experienced a decrease in the excess liquidity by 33.79 percent (from Nu.0.27 billion to Nu.0.18 billion). Correspondingly, the SLR ratio position of the financial institutions increased from 34.46 percent to 40.70 percent, indicating lack of investment avenues of cash, collateralized credit/lending (high collateral requirements) and etc.