

Review of the Bhutanese Financial Sector Performance (September 2006-2007)

Introduction

This report presents in general the review of the Bhutanese financial sector for the quarter ended September 2007, in comparison to the corresponding quarter of the previous year. The information contained in this report is solely based on the information submitted to the RMA by the financial institutions. The observations are summarized below:

1. Business size and growth.

The balance sheet size of the financial sector¹ expanded by 13 percent and stood at Nu.32.60 billion in the third quarter of 2007, compared with Nu.28.89 billion during the same quarter of the previous year. The increase is mainly attributed to a marginal growth in the assets of the CBs² by Nu.3.26 billion and that of NBFIs³ by Nu.0.44 billion. A huge short-term deposit in one of the CBs has directly contributed to a significant climb in the overall deposit base of the banking sector (inclusive of BDFCL), from Nu.22.45 billion to Nu.25.29 billion or by 12.65 percent. Borrowings of the NBFIs increased by 10 percent and stood at Nu.1.55 billion in the third quarter of 2007, of which 83.18 percent was financed through domestic sources. The off-balance sheet exposures (OBS) of the financial sector also drastically rose by 54.01 percent from Nu.1.61 billion to Nu.2.48 billion during the period, of which banks registered a growth of 47.41 percent and the non-banks with 94.82 percent.

2. Capital & Reserves

(Nu. in million)

The financial sector capital base markedly increased from Nu.3,271.17 million in the third quarter of 2006 to Nu.3,651.12 million in the third quarter of 2007. However, both risk weighted capital adequacy ratio (RWCAR) and core capital adequacy ratio (CCAR) have dropped significantly during the period. The decrease in RWCAR, from 21.77 percent to 18.65 percent, was due to the increase in high risk weighted assets such as off-balance sheet items (up by 54.01 percent) and loans and advances (up by 28.32 percent). The increase in risk-weighted assets, which went up by 30.30 percent, more than off set the Tier 1 capital surge causing the CCAR to decrease by 2.16 percent.

Details	Period	Banks	Non-Banks	Total Fls
		Total	Total	
Capital Fund	Sep-06	2,217.21	1,053.96	3,271.17
	Sep-07	2,469.85	1,181.27	3,651.12
Total Risk Weighted Asset	Sep-06	11,841.37	3,186.17	15,027.54
	Sep-07	15,506.03	4,074.36	19,580.39
RWCAR (8%)	Sep-06	18.72	33.08	21.77
	Sep-07	15.93	28.99	18.65
Tier I	Jun-06	1,842.66	723.33	2,565.99
	Jun-07	2,049.39	870.65	2,920.04
Core CAR (%)	Sep-06	15.56	22.70	17.08
	Sep-07	13.22	21.37	14.91

3. Total Assets

Total assets of the financial sector increased from Nu.28.89 billion to Nu.32.60 billion, experiencing an increase of 13 percent. The CBs experienced a growth of 12.77 percent from Nu.25.56 billion to Nu.28.82 billion whilst the NBFIs experienced a growth of 13.21 percent from Nu.3.33 billion to Nu.3.77 billion, both accelerated by 30.09 percent and 26.04 percent in its respective net loans and advances. Of the total assets, CBs hold 88.42 percent while the remaining 11.58 is held by the NBFIs.

¹ Financial System includes BOBL, BNBL, BDFCL and RICBL.

² CBs refer to Commercial Banks (BNBL and BOBL)

³ NBFIs refer to Non-bank Financial Institutions (BDFCL and RICBL).

In terms of composition, liquid assets (cash and bank balances) accounts for 44.79 percent (Nu.14.60 billion) followed by net loans and advances with 44.42 percent (Nu.14.48 billion).

4. Credit Distribution by Sector

(Nu. in million)

Sector	Total		Change		Holding in %
	Sep-06	Sep-07	In absolute fig	In %	
Loans and Advances					
Agriculture/Animal Husbandry	248.96	330.75	81.79	32.85	2.13
Manufacturing/Industry	2,137.52	2,939.40	801.88	37.51	18.96
Trade/Commerce	1,779.05	2,445.38	666.34	37.45	15.77
Service/Tourism	1,768.43	2,096.69	328.26	18.56	13.53
Housing	4,208.57	5,215.56	1,006.99	23.93	33.64
Transport (Heavy)	361.19	450.17	88.98	24.63	2.90
Transport (Light)	498.09	551.02	52.93	10.63	3.55
Loans Against Share	33.76	61.08	27.31	80.90	0.39
Personal Loan	962.32	1,291.11	328.79	34.17	8.33
Staff Loan	75.47	112.02	36.55	48.43	0.72
EDP	4.86	6.47	1.61	33.06	0.04
SBACS	2.39	2.33	-0.06	(2.58)	0.02
Total	12,080.62	15,501.98	3,421.36	28.32	100.00

Financial sector credit portfolio rose to Nu.15.50 billion in the third quarter of 2007, compared with Nu.12.08 billion during the quarter of the previous year, reflecting an increase of 28.32 percent. Banks' total loans and advances shot up by 29.58 percent to Nu.11.67 billion during the period. Similarly, the NBFIs' credit portfolio

increased by 24.62 percent, from Nu.3.08 billion to Nu.3.83 billion. In terms of credit concentration, Housing Sector leads with 33.64 percent, followed by Manufacturing Sector with 18.96 percent, Trade/Commerce sector with 15.77 percent and Service & Tourism with 13.53 percent.

5. Asset Quality

(Nu. in million)

The total non-performing loans of the financial sector increased by 27.47 percent, from Nu.1.49 billion to Nu.1.90 billion during the period. As a result, the provisions provided against such bad loans increased from Nu.0.68 billion to Nu.0.81 billion. Nevertheless, provisions as a percent of the total NPLs has marginally decreased from 45.65 percent to 42.76 percent due to increase in total NPLs which has off-set the increase in the

Details	Period	Banks	Non-Banks	Total Fls
		Total	Total	
Total NPLs	Sep-06	732.73	757.01	1,489.74
	Sep-07	890.92	1,008.12	1,899.04
Provisions for Credit Losses (Specific Provisions)	Sep-06	318.88	361.15	680.03
	Sep-07	395.30	416.79	812.08
Specific Provisions as a % of Total NPLs	Sep-06	43.52	47.71	45.65
	Sep-07	44.37	41.34	42.76
Total NPLs to Gross Loans and Advances (%)	Sep-06	8.14	24.60	12.33
	Sep-07	7.64	26.29	12.25
Net NPLs to Net Loans and Advances (%)	Sep-06	4.77	14.57	7.10
	Sep-07	4.40	17.29	7.40

specific provisions. The GNPL ratio marginally improved from 12.33 percent in the third quarter of 2006 to 12.25 percent in the third quarter of 2007, mainly due to increase in gross loans and advances. However, the net NPLs to net loans and advances has slightly deteriorated to 7.40 percent from 7.10 percent during the period under review.

(Nu.in million)

Loan Classification	Sep-06	Sep-07	% change
Performing loans	10,590.88	13,602.94	28.44
Non-performing loans	1,489.74	1,899.04	27.47
Total	12,080.62	15,501.98	28.32

non-performing loans accounts for 53.09 percent.

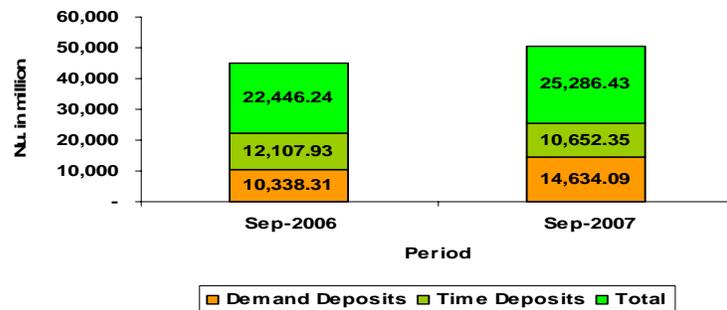
Breakdown on the loan classification confirms that 87.75 percent of total loan portfolio of the financial sector comprises of performing loans and the remaining 12.25 percent constitute non-performing loans. Banks' non-performing loans accounts for 46.91 percent whilst non-banks'

6. Liabilities

The financial sector experienced 13 percent increase in its total liabilities, from Nu.28.89 billion to Nu.32.60 billion. Majority of the liabilities comprised of deposit liabilities with 77.58 percent, followed by capital & reserves with 9.93 percent and borrowing of NBFIs with 4.76 percent.

7. Composition of Deposits Liabilities

During the third quarter of 2007, the deposit liabilities of banks (inclusive of Bhutan Development Finance Corporation) expanded by 12.65 percent. Demand deposits, which accounted for 57.87 percent of the total deposit liabilities, rose by 41.55 percent from Nu.10.34 billion to Nu.14.63 billion. However, time deposits (which accounted for the remaining 42.13 percent of the total deposit liabilities) decreased by 12.02 percent. In terms of deposits by customer holding, corporate deposits⁴ still continues to lead with 63.84 percent.



8. Earnings

(Nu. in million)

Particulars	Banks		Non-Banks		Total FIs		% Change
	Sep-06	Sep-07	Sep-06	Sep-07	Sep-06	Sep-07	
Interest Income	869.52	1,051.42	245.06	275.43	1,114.58	1,326.85	19.04
Interest Expenses	429.93	399.71	111.76	118.28	541.69	517.99	(4.38)
Net Interest Income	439.59	651.71	133.30	157.15	572.90	808.86	41.19
Other Operating income	143.22	152.91	111.00	107.52	254.21	260.43	2.44
Gross Operating Income	582.81	804.62	244.30	264.67	827.11	1,069.29	29.28
Operating Expenses	179.13	312.88	79.37	98.77	258.50	411.66	59.25
Net Operating Income	403.68	491.74	164.93	165.90	568.61	657.64	15.66
Sale of assets/write offs	-	-	0.41	-	0.41	-	(100.00)
Provisions	72.23	172.18	66.68	110.75	138.91	282.93	103.68
Profit before Tax	331.36	315.02	98.53	55.15	429.89	370.18	(13.89)
Tax	99.41	94.51	18.57	18.10	117.98	112.61	-4.56
Profit after Tax	231.95	220.52	79.96	37.05	311.91	257.57	(17.42)

The profit before tax of financial institutions fell substantially from Nu.0.43 billion in the third quarter of 2006 to Nu.0.37 billion in the third quarter of 2007. This fall was mainly due a huge drop in the profit of NBFIs, followed by a relatively marginal decrease in the profit of one of the banks. Banks' profit before tax decreased by 4.93 percent, mainly due to increase in provisions by Nu.0.09 billion and increase in the operating expenses by Nu.0.13 billion. The interest expenses of the banks

⁴ Corporate Deposits – refers to government, government corporations, joint corporations, private companies, NBFIs and CBs.

declined by 4.38 percent mainly due to decrease in fixed deposits by government corporations. The NBFIs also experienced a huge fall in their profit after tax by almost 53.66 percent. On the other hand, operating expenses rose by 59.25 percent, fueled mainly by larger legal and professional charges (up by 76.65 percent); new recruits and its emoluments; rent and insurance; stationary, publicity and other expenditures.

9. Liquidity

Nu. in million

Excess liquidity of the financial institutions subsided to 36.18 percent in the third quarter of 2007 from 44.79 percent of the previous year's quarter. In absolute terms, the excess liquidity decreased from Nu.6.58 billion to Nu.4.94 billion, resulting mainly from the decrease in the quick assets of NBFIs, followed by a relatively smaller decrease in the quick assets of one of the banks. The decrease in the banks' excess liquidity was mainly due to monetary tightening policy of the RMA in one of its tools (that is, increase in CRR from 13 percent to 15 percent).

Details	Period	Banks	Non-Banks	FIs
		Total	Total	Total
Capital Fund	Sep-06	2,217.21	1,053.96	3,271.17
	Sep-07	2,469.85	1,181.27	3,651.12
Total Liabilities	Sep-06	25,557.07	2,945.32	28,890.59
	Sep-07	28,821.62	3,773.93	32,595.55
Quick Asset	Sep-06	11,014.66	459.75	11,474.41
	Sep-07	10,304.27	168.71	10,472.98
Statutory Liquidity Requirement (Position in %)	Sep-06	47.19	24.31	44.79
	Sep-07	39.10	6.51	36.18
Excess/shortfall Liquidity (in Nu.)	Sep-06	6,346.68	270.62	6,578.48
	Sep-07	5,033.91	(90.55)	4,943.36

Banks' quick assets dropped by 6.45 percent due to the decrease in their demand deposits (down by 74.26 percent). Similarly, the NBFIs' quick assets fell by 63.30 percent mainly due to decrease in their demand deposits (down by 29.74 percent) as well as absence of time deposits with maturity of less than one year.