ROYAL MONETARY AUTHORITY OF BHUTAN

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BHUTANESE FINANCIAL SECTOR PERFORMANCE REVIEW

2010

Financial Regulation & Supervision Department

Introduction

This report presents a review about the performance of the Bhutanese financial sector for the year 2010 in comparison with the previous year. However, this report does not reflect the true performance of the financial institutions during the period because the y-o-y assessment includes the data of newly licensed financial institutions (DPNB Bank Ltd & T-Bank Ltd.). The only development bank, Bhutan Development Finance Corporation Ltd. was also re-categorized as a bank after it was granted a specialized deposit taking license in March 2010. The information contained in this report is based on the RMA returns submitted by the financial institutions. The observations are summarized below:

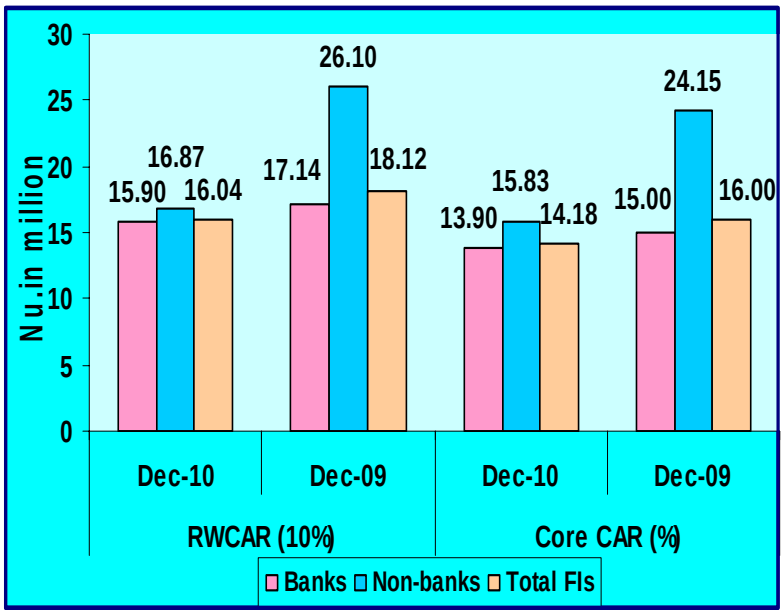
1. Business size and growth.

At the end of 2010, the size of the balance sheet of Bhutanese financial system rose by 29.19 percent on a year on year basis to Nu.72.61 billion from Nu.56.21 billion a year ago, driven primarily by an increase in net loans and advances by 38.40 percent (or by Nu.9.59 billion). The rise was seen in banks[1] whose total assets expanded by Nu.13.97 billion (or by 26.62 percent), followed by a relatively smaller expansion in the non-banks'[2] assets by Nu.2.44 billion (or by 65.34 percent). Banking deposit liabilities rose by 22.15 percent to Nu.52.90 billion in 2010, of which customer deposits accounts for 86.01 percent and the remaining constitute inter-bank deposits. Borrowings of the NBFIs (including BDFCL) increased by 61.55 percent during the period and stood at Nu.4.43 billion, which were largely financed by domestic financial institutions (about 92 percent).

Meanwhile, the financial sector exposure to the off-balance sheet items such as letters of credit, performance bonds and other form of guarantees, increased drastically to Nu.6.32 billion from Nu.4.11 billion during the period.

2. Capital & Reserves

Capital base of the Bhutanese financial sector increased by 24.22 percent to Nu.7.23 billion from Nu.5.82 billion a year ago. The increase is mainly seen in banks with almost 25 percent to Nu.6.15 billion.



The sector's capital adequacy ratio (CAR) in 2010 (computed as per Basel I) remained strong at 16.04 percent, as against the minimum regulatory requirement of 10 percent. Tier-I CAR was 14.18 percent as against the

[1] Banks refers to BNBL, BOBL, Druk PNBL, T Bank Ltd. & BDFCL
[2] Non-banks refers to RICBL & BIL

regulatory minimum of 5 percent.

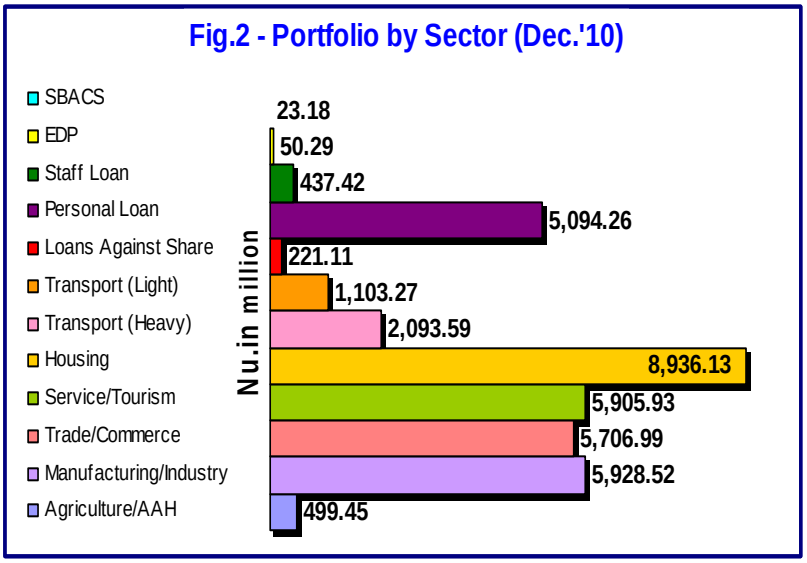
Banks' capital fund reached to Nu.6.15 billion in 2010 from Nu.4.91 billion a year ago. The increase is hugely attributable to the increase in general reserves (by Nu.517.05 million) and paid-up capital of new banks (by Nu.432 million). Meanwhile, the non-banks' capital base increased from Nu.0.91 billion to Nu.1.08 billion or by 18.54 percent during the period.

3. Total Assets

Financial sector combined total assets expanded by 29.19 percent to Nu.72.61 billion from Nu.56.21 billion. This expansion was mainly driven by a huge increase in the assets of the commercial banks (Nu.13.97 billion or by 26.62 percent) and a relatively smaller increase in the assets of non-banks (2.44 billion or by 65.34 percent). Of the total assets, CBs constitute 91.50 percent while the NBFIs hold the remaining 8.50 percent.

Net loans and advances constituted nearly 48 percent of total assets. The currency and deposits, which accounted for another 47 percent of assets, mostly consisted of balances with the central bank. The remaining assets include equity investments, fixed and others.

4. Credit Distribution by Sector



Financial sector's total lending at the end of December 2010 totalled about Nu.36 billion, a 36.97 percent increase from Nu.26.28 billion in 2009 on the back of supportive macroeconomic environment. The growth was observed to be primarily on account of incremental advances or new lending to the housing sector as well as service and tourism sector. Housing finance provided by the financial institutions has risen by Nu.2.32 billion (or by 35.08 percent), making it the most concentrated portfolio of total financial sector while the credit to service and tourism sector increased by Nu.2.19 billion (by 58.82 percent). Banks' total loans and advances increased by Nu.7.73 billion (or by 33.11 percent) as against about Nu.2 billion (67.66 percent) increase in the total loans and advances of the non-banks.

Housing loans forms the highest component of credit in Bhutan accounting for 24.82 percent, followed by the Manufacturing & Industry sector and Trade & Commerce Sector with 16.47 percent and 16.41 percent share respectively. The Agriculture Sector, on the other hand, holds a very minimal share (1.39 percent) in the overall total financial sector credit.

5. Asset Quality (Credit Portfolio)

The consolidated NPL ratio, which was 6.99 percent at the end of previous year, retreated to 5.39 percent in 2010, mainly due to an increase in loan base (by 36.97 percent) vis-à-vis an increase in NPLs (by 5.68 percent). The non-performing loans of the financial sector grew by 5.68 percent to Nu.1.94 billion in 2010 due to increase in delinquencies in personal sector. Nevertheless, in terms of concentration, the Housing sector has the highest NPLs with 22 percent, followed by Personal Sector with 16 percent.

Consequently, specific provisions as a percentage of NPLs have increased to 64.61 percent from 59.92 percent during the period.

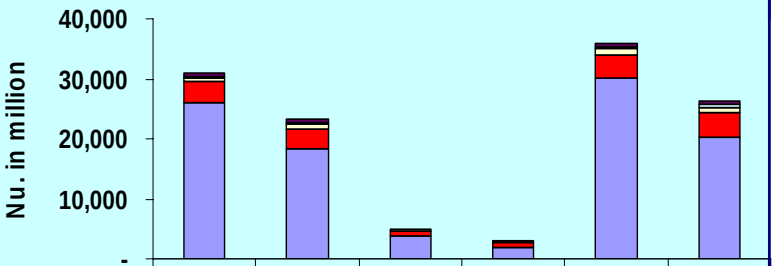
The NPLs ratio of both banks and non-banks has decreased from 6.83 percent and 8.27 percent to 5.20 percent and 6.59 percent respectively during the period.

6. Consolidated Loan Classification of the FIs

Of the total loans of Nu.36 billion granted by the FIs, 94.61 percent were performing in 2010 (compared to 91 percent in Sept. 2010 and 93.01 percent in 2009).

Similarly, analysis on the asset classification of CBs and non-banks reveals that about 95 percent and 93 percent of its respective total loans outstanding are performing and the remaining 5 percent and 6.59 percent are non-performing loans in December 2010.

Fig.5: Loan Classification



	Banks		NBFIs		TOTAL	
	Dec-10	Dec-09	Dec-10	Dec-09	Dec-10	Dec-09
Loss	550.46	569.17	55.81	80.14	606.27	649.32
Doubtful	330.48	240.60	17.34	93.54	347.83	334.14
Substandard	736.52	785.06	251.17	68.92	987.69	853.98
Watch	3,305.10	3,372.25	755.34	760.97	4,060.44	4,133.21
Standard	26,157.59	18,381.62	3,845.21	1,930.91	30,002.80	20,312.53

7. Liabilities

The total liabilities (inclusive of capital and reserves) of the financial sector amounted to Nu.72.61 billion in 2010 as compared to Nu.56.21 billion in 2009. Deposit liabilities of the banks constituted nearly 73 percent of total liabilities, followed by capital & reserves with 9.96 percent and borrowings of non-banks (including BDFCL) with 6.10 percent.

8. Distribution of Deposits by Customer

Deposits liabilities of the banking sector continued to grow during 2010 by about 22.15 percent from Nu.43.31 billion to Nu.52.90 billion. Deposit liabilities constitute the largest component of liabilities of the balance sheet of the banks. The substantial growth (43.31 percent) in the deposit base was due to an increase in the deposit rates as well as improved confidence in the banking system. The persistent growth in the country's GDP, which has resulted in the improvement in the household income, has also led to the increased bank deposits.

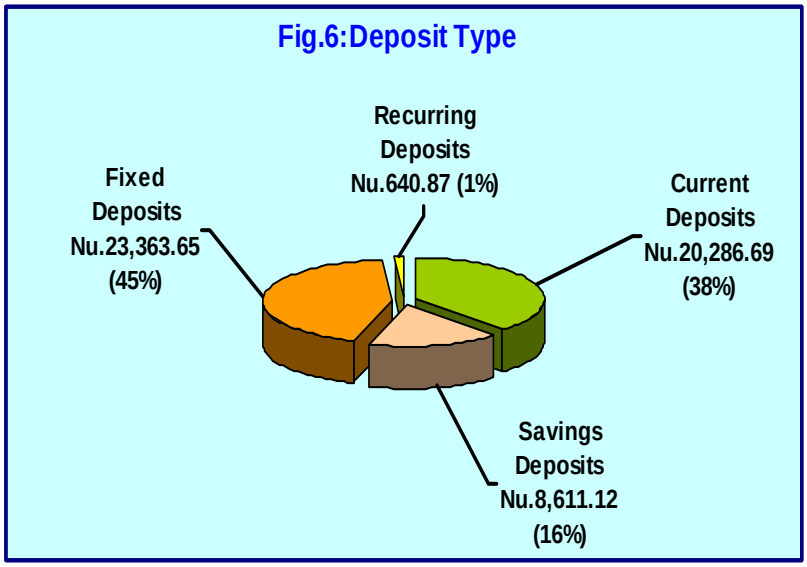
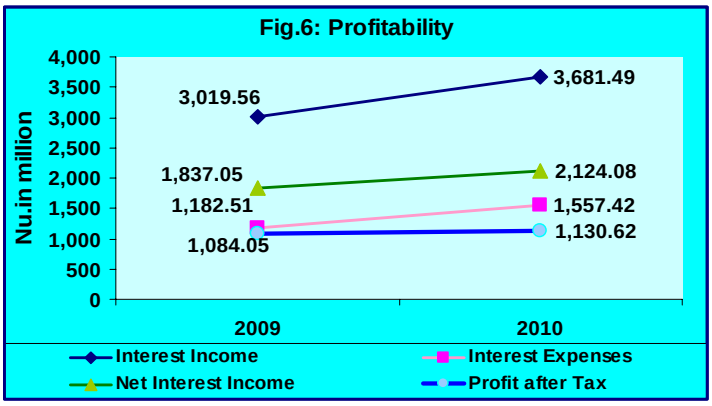


Chart 5 shows the types of deposit with the banks in Bhutan. Within deposits, the low-cost CASA (current & saving accounts) deposits rose by 31.83 percent, from Nu.21.92 billion to Nu.28.90 billion while the high cost term deposits (fixed and recurring) deposits increased by only 12.23 percent to Nu.24 billion. A further analysis on deposit reveals that demand deposits increased both in absolute terms (by 6.98 billion) as well as a proportion of total deposits (from 50.61 percent to 54.62 percent). However, time deposits increased only in absolute terms (by Nu.2.62 billion) but declined as a proportion of total deposits (from 49.39 percent to 45.38 percent). Nevertheless, both CASA and long-term deposits have almost equal holding in the total deposits. In terms of deposits by customer holding, corporate deposits[3] accounts for around 67.72 percent and the remaining 32.28 percent constitutes retail deposits. In other words, corporate deposit continues to be an important source of funding for Bhutanese banks.

9. Profitability

In 2010, profitability of the Bhutanese financial sector reached Nu.1.13 million, registering 4.30 percent increase over Nu.1.08 billion in 2009. The rise in the net profit is mainly attributed to the increase in the profit of non-banks by 13.45 percent or by Nu.26.38 million as against 2.27 percent (or by Nu.20.20 million) increase in the banks' profit.



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

Net interest income of the FIs rose by 15.62 percent, largely as a result of an increase in interest income from loans and advances (by Nu.0.66 billion), partly offset by a rise in interest payment on deposits (by Nu.0.29 billion). Similarly, non-interest income from businesses such as fee and commission income, trading income, rental income and other income also grew by 16.55 percent to Nu.0.73 billion, mainly due to increase in fee from guarantees by 59.82 percent.

On the other hand, total operating cost for the year increased by 23.88 percent to Nu.0.95 billion, of which personal costs accounted for about 55.11 percent. The net profit of banks has risen to Nu.0.91 billion from Nu.0.89 billion while the non-banks' net profit increased to Nu.0.22 billion from Nu.0.20 billion.

10. Liquidity

The excess liquidity of financial sector decreased to Nu.9.93 billion in 2010 from Nu.10.78 billion in 2009, down by 7.89 percent. The decrease was mainly seen in one of the banks with almost 43 percent. However, this position still reflects significant excess liquidity in the financial system reflecting the need to recalibrate monetary conditions to lower excess liquidity. The excess liquidity also reflects limited investment choices of FIs, besides loans & advances, RMA Treasury Bills and Govt. Treasury Bills. The overall excess liquidity with the commercial banks stood at Nu.9.64 billion, registering 9.41 percent decrease over that of 2009. However, the statutory liquidity requirement of the banks stood at a very comfortable position at 36 percent, which is around 16 percent above the regulatory requirement of 20 percent. Meanwhile, the non-banks also experienced an increase in their excess liquidity from Nu.0.14 billion to Nu.0.29 billion during the period. The SLR position of non-banks stood 15.70 percent above the minimum prudential requirement of 10 percent.

Stress Test

In the year 2009/2010 Bhutanese financial system has seen almost 100 percent growth in the number of banks and insurance companies in the country, with the licensing of two new commercial banks (in early 2010) and one insurance company (in September 2009). The only development bank in the country was also issued a deposit taking license to extend domestic banking services to the urban centre. At present, the Bhutanese financial sector consists of five banks (Bank of Bhutan Ltd., Bhutan National Bank Ltd., Druk PNBL and T-Bank Ltd.) including one development bank (Bhutan Development Corporation Ltd.), two insurance companies (Royal insurance Corporation of Bhutan Ltd. and Bhutan Insurance Ltd.), a pension and provident fund (National Pension & Provident Fund) and one stock exchange (Royal Securities Exchange of Bhutan).

The entry of new banks and non-banking institution has injected much needed competition and has improved financial intermediation in the financial system. However, with more players in the market and in light of the rapid credit growth, it may have also increased credit risk and other systemic vulnerabilities. Therefore, stress testing is a useful tool to analyze the resilience of financial system to adverse events. FRSD of the Royal Monetary Authority of Bhutan conducted stress testing of commercial banks with year-end data (December 2010), the observation of which is summarized below:

1. ***Substantial impairment in capital of one of the banks****: Stress test on credit risk faced by the Bhutanese financial institution demonstrates a reasonable degree of resilience of the financial sector. However, considerable impairment in the capital position of one of the private banks with low capital adequacy ratio is evidenced in case of 5% increase from the current NPA in all the sectors. The capital adequacy of that bank stands 2.5 percent below the minimum requirement of 10 percent. Supportive lending environment, relatively low capital ratio and a generous dividend policy may require fresh injection of capital, putting forecasted growth and/or future dividend at risk.*

2. ***Provisions need to be increased:*** *The stress test analysis suggest that even though the existing loan classification and provisioning requirements for the financial institutions are adequate in the current scenario, the financial institutions have just enough provisions for loan losses. Therefore, it would be better to have more buffer against losses that may arise in the future.*