

Review of the Bhutanese Financial Sector Performance (June 2007-2008)

Introduction

This report presents in general the review of the Bhutanese financial sector for period ended June 2008 in comparison to the corresponding period 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 9 percent and stood at Nu.33.5 billion in June 2008, compared with Nu.30.70 billion during the same month of the previous year. The increase is mainly attributed to a marginal growth in the assets of the CBs² by Nu.1.60 billion and that of NBFIs³ by Nu.1.21 billion. An increase in short-term deposits has directly contributed to a significant climb in the overall deposit base of the banking sector (inclusive of BDFCL), from Nu.22.28 billion to Nu.23.56 billion or by 5.71 percent. Borrowings of the NBFIs increased substantially by 55.53 percent and stood at Nu.2.31 billion in June 2008, of which 89.53 percent was financed through domestic sources. The off-balance sheet exposures (OBS) of the financial sector also rose by 2.83 percent from Nu.2.14 billion to Nu.2.20 billion during the period mainly due to the increase in non-banks' OBS by 42.80 percent.

2. Capital & Reserves

The capitalization of the financial sector continued to improve as the total capital fund increased from Nu.3.50 billion in June 2007 to about Nu.4 billion in June 2008. However, both risk weighted capital adequacy ratio (RWCAR) and core capital adequacy ratio (CCAR) have dropped slightly during the period. The decrease in RWCAR, from 19.94 percent to 18.56 percent, was due to increase in high risk weighted assets such as loans and advances (up by 30.62 percent) and off-balance sheet items (up by 2.83 percent). The increase in risk-weighted assets, which went up by 23 percent, more than off sets the Tier 1 capital surge causing the CCAR to decrease by 1.31 percent.

Regulatory Compliance Indicators-June 2008				
Details	Period	Banks	Non-Banks	Total FIs
Capital Fund	Jun-07	2,344.73	1,153.93	3,498.66
	Jun-08	2,672.00	1,332.18	4,004.18
Total Risk Weighted Asset	Jun-07	13,900.15	3,642.55	17,542.71
	Jun-08	16,838.09	4,741.11	21,579.20
RWCAR (%)	Jun-07	16.87	31.68	19.94
	Jun-08	15.87	28.10	18.56
Tier I	Jun-07	2,049.39	852.43	2,901.82
	Jun-08	2,282.84	1,004.91	3,287.75
Core CAR (%)	Jun-07	14.74	23.40	16.54
	Jun-08	13.56	21.20	15.24

3. Total Assets

During the period ended June 2008, the total assets of the financial sector grew moderately by 9.13 percent, from Nu.30.70 billion to Nu.33.50 billion. Of the total assets, 28.64 billion (constituting 85.48 percent) pertains to two banks while the remaining 4.87 billion belongs to NBFIs. The

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

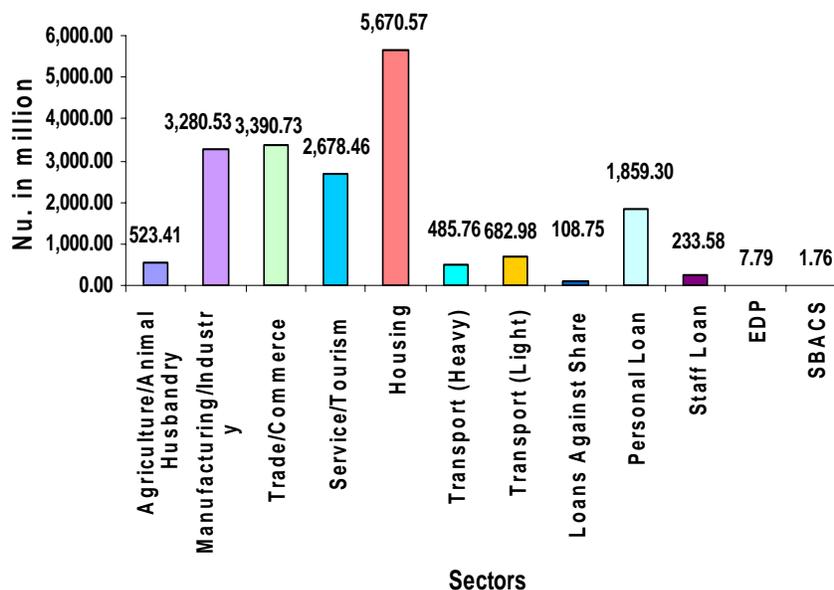
² CBs refer to Commercial Banks (BNBL and BOBL)

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

expansion was largely attributable to a substantial growth in their net loans and advances (up by 52.79 percent) and cash and bank balances (up by 39.54 percent).

4. Credit Distribution by Sector

A strong demand for housing loans nudged up the financial sector's total loan portfolio to Nu.19 billion in June 2008 from Nu.14.49 billion in corresponding period of the previous year. Banks' total loans and advances shot up by 32.30 percent to Nu.13.78 billion while the NBFIs's credit portfolio rose by 21.65 percent, from Nu.3.49 billion to Nu.4.45 billion. The sector-wise break down of the total loans outstanding shows that the Housing Sector constituted the highest share of 29.79 percent, followed by Manufacturing Sector with 18.74 percent, Trade/Commerce Sector with 18.26 percent and Service & Tourism Sector with 14.25 percent and the remaining being invested in other sectors.



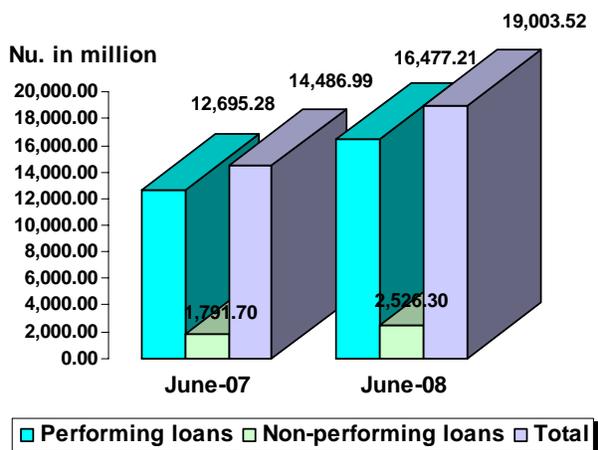
5. Asset Quality

Financial Sector's total non-performing loans (NPLs) increased significantly from Nu.1.79 billion to Nu.2.54 billion during the period. As a result, the provisions provided against such bad loans also increased from Nu.0.76 billion to Nu.1.04 billion. However, in terms of provisions as a percent of the total NPLs, the ratio has marginally

Details	Asset Quality Indicators-June 2008			
	Period	Banks		Non-Banks
		Total	Total	
Total NPLs	Jun-07	799.60	992.10	1,791.70
	Jun-08	1,478.75	1,058.43	2,537.17
Provisions for Credit Losses (Specific Provisions)	Jun-07	359.26	403.53	762.79
	Jun-08	608.77	431.02	1,039.78
Specific Provisions as a % of Total NPLs	Jun-07	44.93	40.67	42.57
	Jun-08	41.17	40.72	40.98
Total Loans and Advances	Jun-07	10,997.32	3,489.66	14,486.99
	Jun-08	14,549.62	4,453.90	19,003.52
Total NPLs to Gross Loans and Advances (%)	Jun-07	7.27	28.43	12.37
	Jun-08	10.16	23.76	13.35
Net NPLs to Net Loans and Advances (%)	Jun-07	4.14	19.07	7.50
	Jun-08	6.24	15.39	8.29

decreased from 42.57 percent to 40.98 percent mainly due to increase in the specific provisions for bad loans. However, both the gross NPL and net NPLs ratios deteriorated due to the increase in non-performing loans, which has more than off-set the increase in total loan portfolio.

Break down on loan repayments confirms that 86.71 percent of total loan portfolio of the financial sector comprises of performing loans and the remaining 13.29 percent constitute non-performing loans. Of the total NPLs of Nu.2.08 billion, banks' non-performing loans accounts for 58.28 percent (Nu.1.48 billion) whilst non-banks' non-performing loans accounts for 46.07 percent (Nu.0.73 billion).

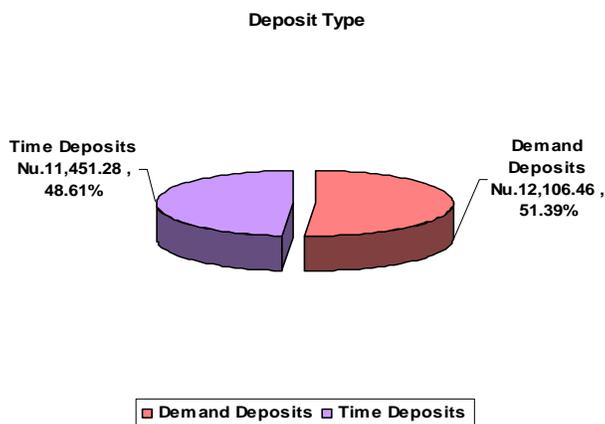


6. Liabilities

As of June 2008, the total liabilities of the financial sector amounted to Nu.33.5 billion, an increase of 9 percent from the same period last year. Majority of the liabilities comprised of deposit liabilities with 70.32 percent, followed by capital & reserves with 10.80 percent and borrowings of NBFIs with 6.88 percent.

7. Composition of Deposits Liabilities

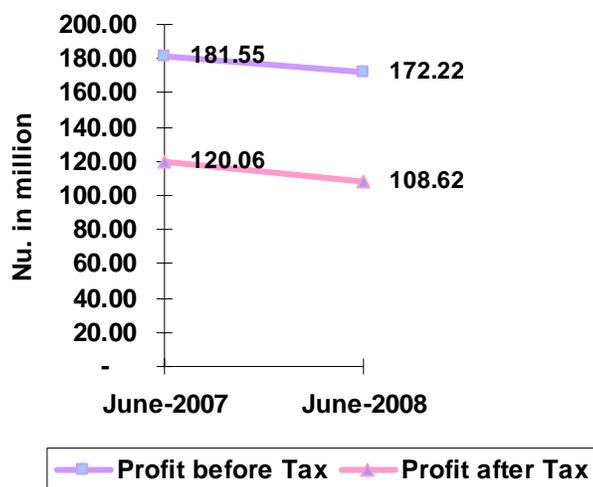
Deposit liabilities of banks (inclusive of Bhutan Development Finance Corporation) expanded by 5.71 percent during the period June 2007-2008. Demand deposits (or short term deposits), accounting for about 51.39 percent of the total deposit liabilities, rose by 0.28 percent from Nu.12.07 billion to Nu.12.11 billion. Time or long term deposits (which accounted for the remaining 48.61 percent of the total deposit liabilities) increased by 12.13 percent. In terms of deposits by customer holding, corporate deposits⁴ still continues to lead with 55.87 percent.



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

8. Earnings

The net profit of the FIs decreased from Nu.181.55 million to Nu.172.22 in June 2008, mainly owing to the decrease in the profit of one of the banks, and a relatively lesser reduction in the net profit of one of the NBFIs. Nevertheless, on the income side, the financial sector experienced a growth in their interest income (up by 16.88 percent) and operating income (up by 18.69 percent). The increase was mainly due to rise in return from loans and advances and the commission from the services rendered. On the other hand, the expenses also increased with interest expenses up by 16.72 percent. However, operating expenses decreased considerably (by 15.42 percent) during the period.



9. Liquidity

Excess liquidity of the financial institutions decreased to Nu.3.26 billion from Nu.4.66 billion during the period under review. The reduction came mainly from the decrease in the quick assets of one of the banks. Banks' quick assets decreased from Nu.9.46 billion in June 2007 to Nu.8.31 billion June 2007. However, the NBFIs experienced an

Regulatory Compliance Indicators (SLR)-June 2008

Details	Period	Banks	Non-Banks	FIs
Capital Fund	Jun-07	2,344.73	1,153.93	3,498.66
	Jun-08	2,672.00	1,332.18	4,004.18
Total Liabilities	Jun-07	27,038.14	3,087.19	30,697.47
	Jun-08	28,635.01	4,865.82	33,500.83
Quick Asset	Jun-07	9,457.23	387.76	9,844.99
	Jun-08	8,311.83	492.90	8,804.73
Statutory Liquidity Requirement (Position in %)	Jun-07	38.30	20.06	36.20
	Jun-08	32.01	13.95	29.85
Excess/shortfall Liquidity (in Nu.)	Jun-07	4,518.55	194.43	4,655.77
	Jun-08	3,119.23	139.53	3,258.76

increase in their quick assets by about 27.11 percent. In term of percent, the SLR position decreased from 36.98 percent to 29.85 percent.