## DEVELOPMENTS IN THE BANKING SYSTEM

The banking system continued to exhibit a sound financial position. Favourable developments were observed with non-performing loans (NPLs) continuing to decline whilst capital was sustained at a high level, providing an adequate buffer to withstand any financial shocks to the system. Higher income was recorded as a result of stronger loan growth and, coupled with lower operating expenses, led to higher gross operating income.

### *Strong capital position supporting larger banking operations*

The capital base remained unchanged at a high level of RM69 billion as at end-September 2003. Meanwhile, the risk-weighted assets expanded by 2.1% during the quarter due mainly to the higher volume of loans. Consequently, the risk-weighted capital ratio declined by 0.3 percentage points to 13.4% at end-September 2003, whilst the core capital ratio was 0.2 percentage points lower at 10.9%.

**Strong capital position**

| | 2002 | | 2003 | | |
|---|---|---|---|---|---|
| | Sep. | Dec. | Mar. | Jun. | Sep. |
| **Capital** | | | | | |
| Core-capital ratio (%) | 11.0 | 11.1 | 11.0 | 11.1 | 10.9 |
| RWCR (%) | 13.3 | 13.2 | 13.2 | 13.7 | 13.4 |

### *Higher operating surplus due to strong operating income and contained costs*

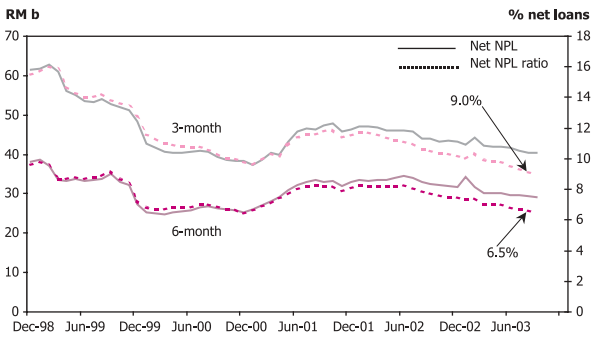
The banking system recorded a higher gross operating profit of RM3 billion in the third quarter (RM2.9 billion in the second quarter) due mainly to higher income from lending and financing activities, better returns on investment securities and stronger income from fee-based activities. Interest expense on deposits was lower in the third quarter while operating costs declined marginally by 0.8%.

Following the decline in NPLs, the amount of net loan loss provisioning charges declined substantially by RM1.1 billion during the quarter to RM2.2 billion. The higher operating surplus was, however, offset by a reduction in net income from trading and investment activities of RM0.7 billion, particularly for the commercial and merchant banks, largely attributed by the fall in bond yields during the quarter. Consequently, profit before tax during the third quarter amounted to RM2.4 billion (2Q 2003: RM2.7 billion).

### *Further improvements in NPLs*

Net NPL ratios on 6- and 3-month classifications declined to 6.5% and 9% respectively at end-September 2003 (end-June: 6.8% and 9.5% respectively). The lower NPLs were due

**Banking System: Non-performing loans**



mainly to the significantly lower amount of newly classified NPLs of RM5.3 billion (RM7.3 billion in the second quarter). In addition, the banking institutions continued to record strong recoveries and reclassification of RM4.9 billion. Meanwhile, the loan loss coverage ratio remained stable at 61.4%.

By economic sector, the level of NPLs for the business sector continued to record improvements. Gross NPL ratio declined to 15.9% as at end-September 2003 compared with 16.3% at end-June 2003. The largest decline was observed in NPLs for community, personal and social services sector, and financial services sector following the implementation of a number of restructuring exercises. NPLs for the household sector remained at 8.2%.