DEVELOPMENTS IN THE BANKING SYSTEM

The banking system continued to record strong financial performance in the fourth quarter of 2005, with improvements in both profitability and asset quality, whilst maintaining a high level of capitalisation. The strengthened financial position has enabled the banking system to continue supporting economic growth via expanded lending activities.

Capitalisation level remained strong

Although the risk-weighted capital ratio (RWCR) and the core capital ratio (CCR) declined during the fourth quarter of 2005, the level of capitalisation of the banking system remained strong. RWCR and CCR were 13.1% and 10.2% respectively. The decline in the ratios was due mainly to an expansion in risk-weighted assets (+RM13.9 billion or 2.2%) and a marginal decline in the capital base (-RM0.5 billion or 0.5%). The lower capital base was attributed primarily to large dividend payouts by several banking institutions, whilst the increase in risk weighted assets was driven by higher lending activities.

Capital Position Remained Strong

	2004		2005			
	3Q	4Q	1Q	2Q	3Q	4Q
Capital						
CCR (%)	11.4	11.4	10.9	10.8	10.7	10.2
RWCR (%)	13.9	14.4	13.8	13.6	13.5	13.1

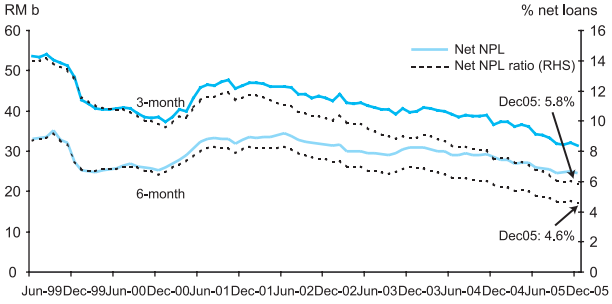
Favourable profitability performance

The banking system recorded an increase in pre-tax profits of RM0.6 billion (+21.9%) to RM3.5 billion during the quarter. The stronger performance was largely on account of higher net investment income (+RM639 million or 209.2%) and higher recoveries (+RM131.8 million or 10%) resulting from improved business conditions. These increases were partially offset by the marginal increase in operating expenses (+RM207.2 million or 6.1%). Consequently, the annualised return on average assets and equity of the banking system stood at 1.4% and 16.7% respectively (3Q 2004: 1.3% and 15.9%).

Asset quality improved further

The quality of the loan portfolio of the banking system continued to improve in the fourth quarter. Net NPLs based on 3-month classification declined by 2% to RM31.3 billion, thus lowering the net NPL ratio to

Banking system: Non-performing loans



5.8% (3Q 2005: 6.1%; end-2004: 7.5%). Similarly, net non-performing loans (NPL) ratio on a 6-month classification trended downwards to 4.6% (3Q 2005: 4.7%; end-2004: 5.8%). This improvement was driven largely by loans that were reclassified as performing, write-offs and lower incidence of new NPLs.