DEVELOPMENTS IN THE BANKING SYSTEM

The banking system showed greater resilience in the second quarter of 2005. Capitalisation remained strong, accompanied by continued growth in profits and improvements in the quality of the loan portfolio enabling the banking system to register robust lending activities.

Capitalisation remained strong

The capital position of the banking system remained strong, albeit recording a slight decline in both the risk-weighted capital ratio (RWCR) and core capital ratio (CCR) to 13.3% and 10.4% respectively as at end-June 2005. The decline was due primarily to an increase in risk-weighted assets of RM25.1 billion (+4.3%) as a result of the inclusion of market risk in the capital adequacy framework that was made effective from 1 April 2005. This increase, coupled with higher lending activities, offset the expansion in capital base of RM0.7 billion (+0.9%).

Banking System: Capital Position

	2004				2005	
	1Q	2Q	3Q	4Q	1Q	2Q
Capital						
CCR (%)	11.0	11.7	11.4	11.3	10.9	10.4
RWCR (%)	13.7	14.3	13.9	14.3	13.8	13.3

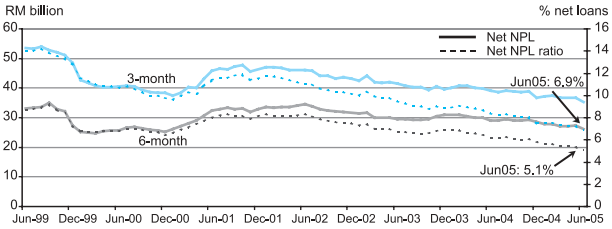
Improved profitability

Pre-tax profits of the banking system rose by RM0.3 billion (+10.9%) to RM3.1 billion during the second quarter of 2005. The growth was attributed mainly to higher operating income, driven by higher investment income (+RM0.3 billion or +97.8%) and net interest income (+RM0.4 billion or +7.3%). Despite a slight increase in loan loss provisions of RM0.3 billion, the annualised return on average assets and equity of the banking system remained strong at 1.4% and 17.3% respectively (1Q 2005: 1.3% and 15.6% respectively).

Continued improvements in NPLs

Improvements were evident in the asset quality of the banking system, where net non-performing loans (NPLs) based on the 6-month and 3-month classifications

Banking system: Non-performing loans



declined to RM26.1 billion and RM35.2 billion respectively. This resulted in the net NPL ratios improving to 5.1% (1Q 2005: 5.4%) based on the 6-month classification, and 6.9% based on the 3-month classification (1Q 2005: 7.3%). The improvement was due primarily to lower incidences of new NPLs, continued write-offs and higher reclassification of NPLs to performing accounts.