DEVELOPMENTS IN THE BANKING SECTOR

The banking system remained financially sound and resilient during the first quarter of 2006 against the backdrop of strong capitalisation and profitability as well as improvement in asset quality. This has further strengthened the banking system's position to extend financing to support economic growth.

Capitalisation sustained at strong level

The level of capitalisation remained strong despite recording a decline. The lower capital ratios were due largely to payment of dividends and expansion in lending activities. As at end-March 2006, the risk-weighted capital ratio (RWCR) and core capital ratio (CCR) were sustained above 13% and at 10% respectively.

Banking system: Capital Position

	2005				2006
	1Q	2Q	3Q	4Q	1Q
Capital					
CCR (%)	10.9	10.8	10.7	10.7	10.0
RWCR (%)	13.8	13.6	13.5	13.6	13.1

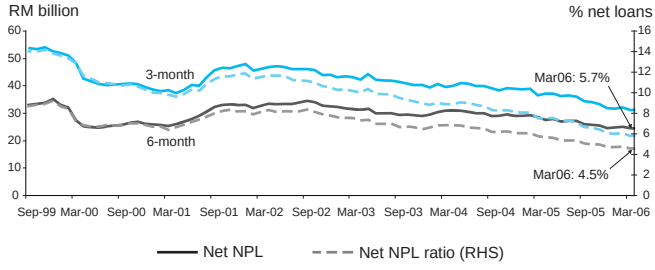
Profitability remained strong

The banking system registered pre-tax profit (PBT) totalling RM3.2 billion during the first quarter of 2006, a decline of RM0.3 billion attributable largely to higher investment income from dividend receipts in the final quarter of 2005. The profit level was, nonetheless, higher by 12.3% vis-à-vis the corresponding quarter of 2005. This was achieved on account of higher net interest and fee-based income totalling RM0.6 billion, as well as higher net gains from trading activities of RM0.1 billion. These increases more than offset the higher operating expenses (+RM0.4 billion or +9.3%) and lower recoveries (-RM0.1 billion or -9.6%). Consequently, the return on average assets remained unchanged at 1.3% whilst the return on average equity showed an improvement to 16.8% (1Q 2005: 1.3% and 14.9% respectively).

Continued downtrend in NPLs

Asset quality of the banking system continued to improve during the quarter with net non-performing loans (NPLs) based on the 6-month classification declining by 0.7% to RM24.4 billion. The improvement was due primarily to reclassifications of NPLs to performing status (+24.4%), recoveries (+17.4%) and write-offs (+15.3%). As a result, the net NPL ratio declined to its lowest level of 4.5% since the Asian financial crisis (4Q 2005: 4.6%). Similarly, net NPLs based on the 3-month classification recorded a decline of 0.7% to RM31 billion or 5.7% of total net loans (4Q 2005: 5.8%). The NPLs for the SME sector recorded an increase of RM0.4 billion to account for 10.4% of SME loans due primarily to the adoption of the broader SME definitions[1] (as endorsed by the National SME Development Council) by several banking institutions. Meanwhile, the household NPLs remained at 7.4% of household loans.

Banking system: Non-performing loans



[1] Definitions of SMEs differ in accordance with the economic sectors and have wider coverage following the redefinition of the qualifying criteria of **either** number of full-time employees **or** annual sales turnover.