ROYAL MONETARY AUTHORITY OF BHUTAN

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BHUTANESE FINANCIAL SECTOR PERFORMANCE REVIEW

(June 2013 - 2014)

Financial Regulation & Supervision Department

This report presents an objective assessment of the performance of the Bhutanese financial sector on peer group basis for the quarter ended June 2014 in comparison to the corresponding quarter of the previous year. The information contained in this report is based on the returns submitted by the financial institutions to the RMA. The observations are summarized below:

1. Overview

The financial sector remained stable with continued improvement in the reserves of capital and liquidity. The credit growth has accelerated during the period under review. A number of regulatory measures were announced with a view to tightening the prudential infrastructure, plugging gaps in regulation and ensuring that regulatory and supervisory set up reflected international best practices.

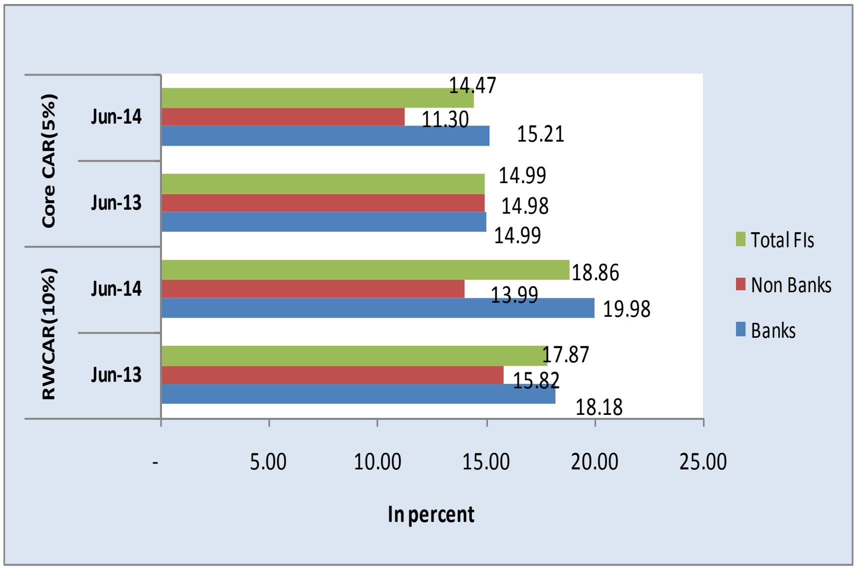
Business size and growth.

The total assets of the financial system as of June 2014 stood at Nu. 98.81 billion as compared to Nu. 88.44 billion in June 2013 indicating a growth of 11.72%. The growth has been recorded in the assets of banks which have increased from Nu. 79.34 billion to Nu.87.14 billion, and that of non-banks from Nu. 9.11 billion to Nu. 11.66 billion. However, in terms of the percentage growth of the total assets, banks and non-banks total assets has increased by 9.84% and 28.07% respectively. The composition of the balance sheet of the banks continued to be dominated by traditional balance sheet items. The deposits constituted about 77% of liabilities and loans and advances (net of provision) comprised about 59%. The cash and bank balances constitute about 38% of total assets of the bank. The investments (securities and equity) which accounted for 1% of assets mostly consisted of Government and RMA securities. For non-banks (insurance companies), 65% of total assets comprise of loans and advances and about 25% comprise of cash and bank balances of non bank assets.

The increase in the total assets of the banks was mainly contributed by the increase in the cash and bank balances by 25%, from Nu. 26.46 billion in June 2013 to Nu. 33.12 billion in June 2014, followed by the increase in loans and advances (net of Provision) from Nu. 47.50 billion to Nu.51.11 billion indicating a growth of 8%. Similarly, for the non-banks the increase in the total assets was mainly due to increase in cash & bank balances by 63.56%, from Nu.1.76 billion to Nu. 2.88 billion, which was followed by increase in loans and advances by 21.95%. In terms of the asset composition of the financial sector, the banking system constitutes 88% of the total assets and the remaining 12% constitutes non-bank's assets.

Out of total liabilities of the financial sector, it was observed that the capital and reserves increased by 17% (from Nu. 15.10 billion in June 2013 to Nu.17.67 billion). Deposit liabilities of banks increased by 12.46%, from Nu. 59.28 billion in June 2013 to Nu. 66.67 billion in June 2014.The borrowing for non-banks also increased by Nu.3.31 billion from Nu. 1.38 billion to Nu. 4.69 billion during the period under review.

2. Capital & Reserves

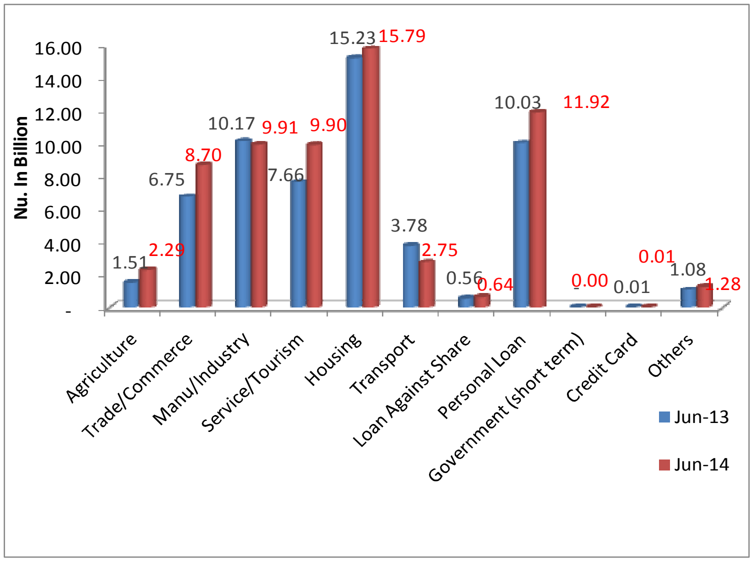


The risk weighted capital adequacy ratio (CAR) of the financial system has increased to 18.86% in June 2014 from 17.87% in June 2013 although CAR were well above the regulatory requirement. The total risk weighted assets of the financial sector increased by 12.95%, from Nu.81.91 billion in June 2013 to Nu.92.52 billion in June 2014. The improvement in the capital adequacy ratio within the financial sector during the period was mainly due to the injection of capital in the form of subordinated debt by the Government as well as injection of capital by the investors in some of the banks. The RWCAR of banks increased from 18.18% to 19.98% during the period under review.

However, the RWCAR of non-banks has slightly decreased from 15.82% to 13.99% despite the equity contribution by the Government. This was mainly because of the increase in the total risk weighted assets of the non-banks from Nu. 10.76 billion to Nu.17.40 billion (61.71%) which has offset the increase in the capital fund of non-banks increased, from Nu. 1.70 billion to Nu.2.43 billion (42.93%) during the period under review.

The core capital ratio of the financial sector has slightly decreased from 14.99% in June 2013 to 14.47% in June 2014 which is also maintained well above the requirement of 5%.

3. **Sectoral Credit Analysis (including the credit extension by theinsurance companies)**



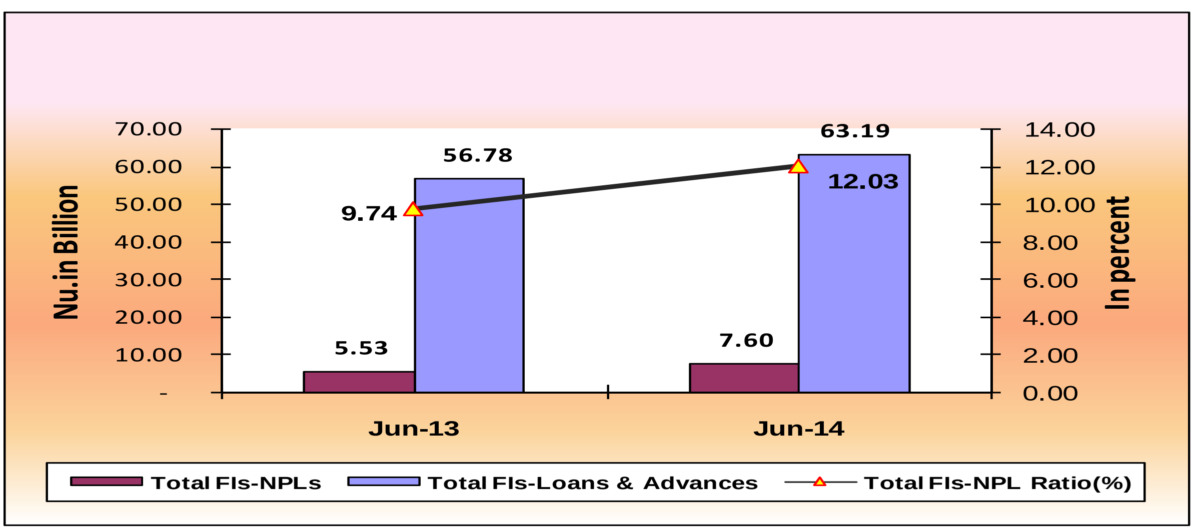
The financial institutions continued to play an active role in providing financing to both the household and corporate/private sectors. During the period ended June 2014, the financial sector's total credit increased to Nu. 63.19 billion from Nu.56.78 billion in June 2013 indicating a growth of 11.29%.

The lending activity was attributable to the strong demand to the housing, personal, manufacturing and service sector. In terms of the sectoral exposures to total loans, 24.98% constitutes housing loan and personal sector with 18.87% which was followed by manufacturing and service sector with 15.69% and 15.66% respectively. However, in the case of the sectoral growth during the period under review, loans to agriculture sector experienced the highest sectoral growth of 51.06% (from Nu. 1.51 billion to Nu. 2.29 billion) followed by service sector with 29.23 % (from Nu.7.66 billion to 9.89 billion).

Majority of credit are provided by the banks. Out of total credit of Nu.63.19 billion, 87.48% (Nu. 55.27 billion) are provided by banks and remaining 12.52% (Nu. 7.92 billion) are credit provided by non-banks.

4. **Credit Quality (Loans and Advances including the non-banks)**

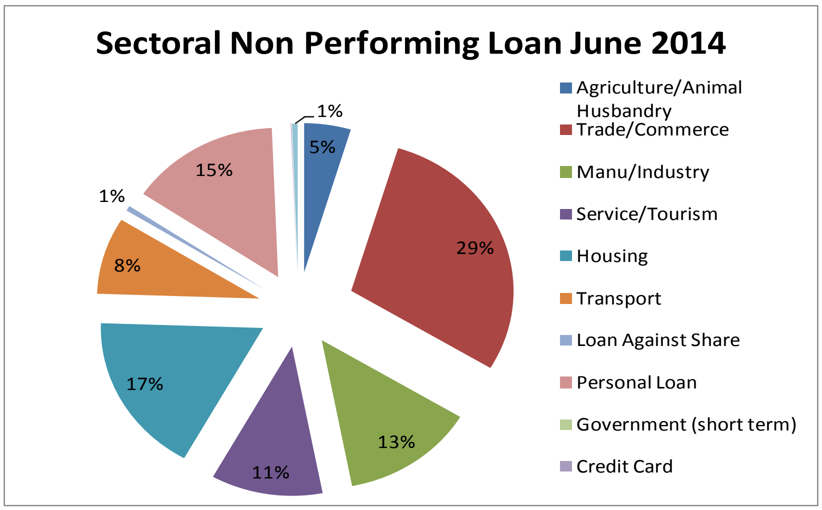
As against the total loans of Nu. 63.19 billion within the financial sector, the NPL



increased from Nu.5.53 billion in June 2013 to Nu.7.60 billion in June 2014. The NPL to loan ratio stood at 12.03% as compared to 9.74% during the period under review.

The increase in the NPL ratio is due to the increase in the NPL by 37.45% as against the increase in the total loans by 11.29% percent. Out of the total NPL of Nu.7.60 billion, doubtful and loss assets comprises of 61.84% (Nu. 4.69 billion) and the remaining 38.16% comprises of substandard assets (Nu. 2.90 billion).

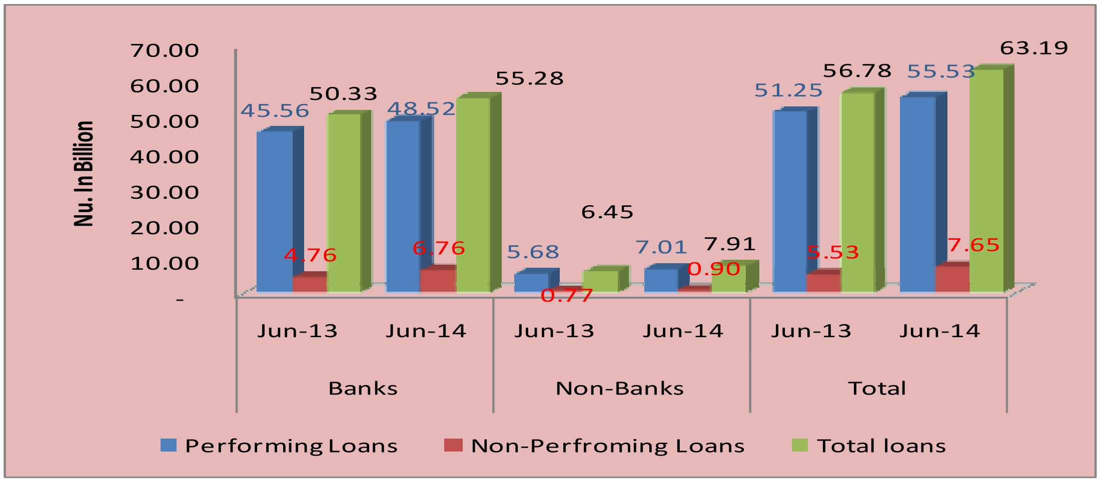
Meanwhile, the percentage of provision as a percentage of NPLs provided for impaired loans has increased from 47.81% in June 2013 to 50.68% in June 2014. The NPL of the banks increased from Nu. 4.76 billion to Nu.6.70 billion as against the increase in the total loans from Nu. 50.33 billion to 55.28 billion during the period under review. The gross NPL ratio of banks stood at 12.13% as compared to 9.46% during the period under review. The NPL for non-banks has also increased from Nu.0.77 billion to Nu.0.90 billion as against the increase in the total loans to Nu. 7.91 billion from Nu.6.45 billion during the period under review. The NPL ratio of non-banks stood at 11.33% as of June 2014.



Out of the total NPL of Nu. 7.60 billion as of June 2014, Trade and commerce sector represented the highest NPL with 28.97% (Nu. 2.20 billion). Housing and Personal sector has also the highest NPL amongst others and constitutes around 17.42% (Nu. 1.32 billion) and 14.98% (Nu.1.14 billion) respectively of total NPL. The gross NPL ratio of financial sectors as of June 2014 is 12.03%.

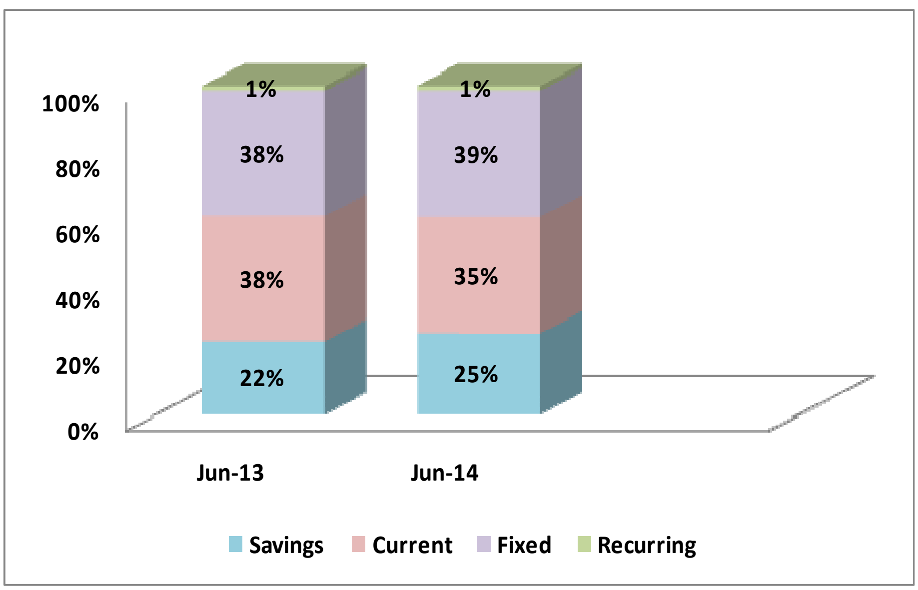
6. **Consolidated Loan Classification of the FIs**

Analysis on asset classification indicates that 87.97% of total loans disbursed by the financial sector are performing loans. As against the total loans of Nu.63.19 billion for financial sector, 87.97% (Nu. 55.59 billion) are performing and remaining 12.03% (Nu. 7.60 billion) are non-performing. Out of the total loans of Nu. 55.28 billion of banks, 87.87% are performing loans and only 12.13% are non-performing. Similarly, out of the total loans of Nu.7.91 billion of non banks 88.67% are performing loans and the remaining 11.33% were non-performing loans for the period under review.



7. **Deposits**

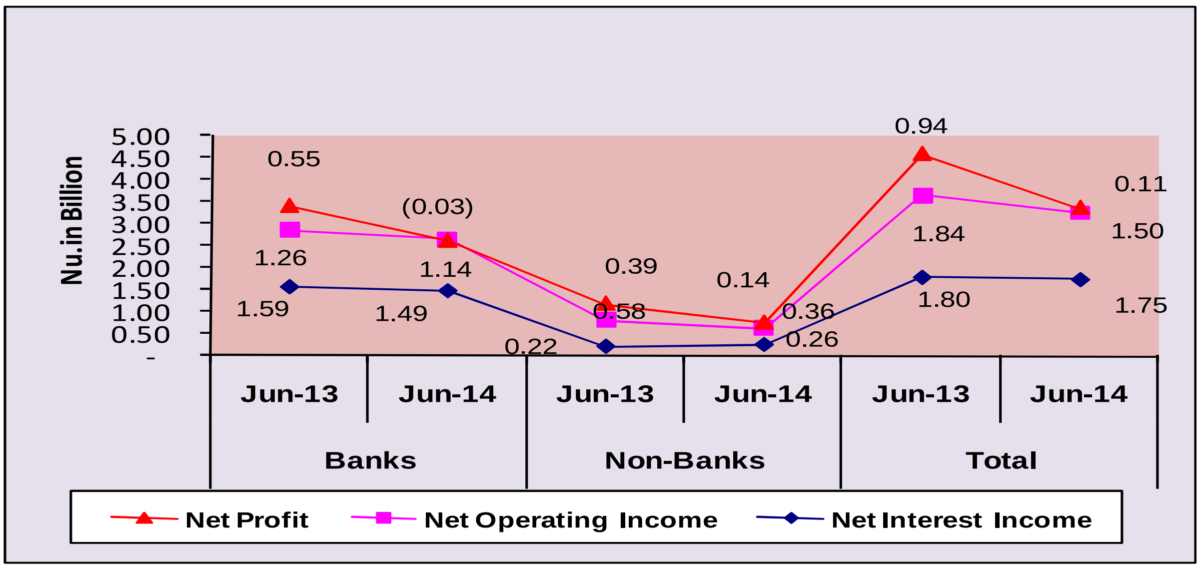
The total deposit base of the banking sector has increased significantly by 12.46%, from Nu. 59.29 billion in June 2013 to Nu. 66.67 billion in June 2014. The increase in the overall deposit base is mainly due to increase in both the demand and time deposits by 11.82% and 13.42% respectively. Demand deposits increased from Nu. 35.68 billion to Nu. 39.89 billion (From Nu. 22.52 billion to Nu. 23.51 billion for Current Account and from Nu. 13.15 billion to Nu. 16.38 billion for Saving Account) and time deposits from Nu. 23.61 billion to Nu. 26.77 billion (from Nu. 22.72 billion to Nu. 25.78 billion in Fixed Account and from Nu. 0.88 billion to Nu. 0.98 billion in Recurring Account) during the period under review.



In terms of customer holdings, corporate deposits accounts for 50.05% (Nu. 33.37 billion) of the total deposits and remaining 49.95% (Nu. 33.30 billion) constitutes retail deposits as compared to 54% of corporate deposits and 46% of retail deposits in June 2013.Although corporate deposits continued to dominate the deposit holding pattern of the financial institutions, it is on the decreasing trend. Out of the total deposits of Nu.66.67 billion in June 2014, demand deposits (current and saving) accounted for 59.84%(Nu.39.89 billion) and time deposits (fixed and recurring) comprised of 40.16% (Nu.26.77 billion).

8. **Profitability**

During the quarter under review, the net profit of the financial sector has decreased when compared to the corresponding quarter of the previous year.



The net profit of the financial sectors stood at Nu.0.11 billion in June 2014 as compared to a net profit of Nu. 0.94 billion in June 2013.For the period ended June 2014, the banks has incurred a loss of 31.70 million, this is mainly due to the decrease in profit in few banks and also due to decrease in the bank's net interest income by 5.75%.

Both net interest income and net operating income of the financial sector has decreased by 2.85%(from Nu.1.80 billion in June 2013 to Nu.1.75 billion in June 2014) and 18.50 % (from 1.84 billion in June 2013 to Nu.1.50 billion in June 2014)respectively. The decrease in net interest income and operating income has led to decrease in net profit from Nu.0.94 billion to Nu.0.11 billion during the period under review.

9. **Liquidity**

On the liquidity front, the financial sector has an excess liquidity of Nu.15.51 billion in June 2014 as against the excess of Nu. 10.57 billion in June 2013.For the period ended in Q2FY'14, the total quick asset of the financial sector has also increased from Nu.24.59 billion to Nu.30.86. The statutory liquidity Requirement (SLR) position of the financial sectors stood at 37.93% in June 2014 as compared to 33.32% in June 2013.

The SLR of the banks stood at 38.78% (18.76% above the regulatory requirement of 20 percent) in June 2014 as compared to 34.38% in June, 2013. The increase is due to increase in the quick assets of the banks by 22.55% (from Nu. 22.83 billion to Nu. 27.97 billion). Similarly, the non-banks' SLR position for the June 2014 stood at 31.24% as compared to 23.81% in June 2013. The quick assets of non-banks have increased by 63.59% (from Nu1.76 billion to Nu. 2.88 billion).