BANK SUPERVISION DIVISION

BANKING SECTOR REPORT

FOR

QUARTER ENDED 31 DECEMBER 2016

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY 3

2. FINANCIAL ARCHITECTURE 4

3. CONDITION & PERFORMANCE OF THE BANKING SECTOR 5

Capital Adequacy… 6

Asset Quality… 7

Earnings Performance… 10

Liquidity & Funds Management… 12

Sensitivity to Market Risk… 14

1. EXECUTIVE SUMMARY

1.1. The banking sector remained generally resilient during the quarter under review, on the back of various measures being implemented to bolster confidence and promote the stability of the sector.

1.2. As at 31 December 2016, all operating banking institutions were in compliance with the prescribed minimum capital requirements and were making progress towards compliance with 2020 minimum capital requirements.

1.3. Total banking sector deposits increased by 6.03%, from $6.14 billion as at 30 September 2016 to $6.51 billion as at 31 December 2016. The total loans and advances also marginally increased from $3.65 billion as at 30 September 2016 to $3.69 billion as at 31 December 2016.

1.4. The banking sector asset quality has improved as reflected by the non-performing loans (NPLs) ratio, which declined from a peak of 20.45% as at September 2014 to 7.87% as at 31 December 2016.

1.5. The banking sector remained profitable during the year ended 31 December 2016, with an aggregate **net profit of $181.06 million**, an increase of 42.36% from $127.47 million reported for the corresponding period in 2015.

1.6. The average prudential liquidity ratio was 61.91% as at 31 December 2016, against the minimum regulatory requirement of 30%, largely as a result of the cautious lending approach adopted by some banking institutions.

1.7. The various policy measures put in place by the Reserve Bank to promote the usage of electronic payments have assisted in reducing the demand for cash. Further in line with the financial inclusion drive banking institutions are increasing their focus on serving previously unserved and underserved segments.

1.8. As at 31 December 2016, interest rate spreads continued to be considerably high with the average effective lending rate pegged at 17.74% against an average deposit rate of 3.79%.

2. FINANCIAL ARCHITECTURE

2.1. The architecture of the banking sector as at 31 December 2016 is shown in the table below.

Architecture of the Banking Sector

Type of Institution	**Number**
Commercial Banks	13
Building Societies	5
Savings Bank	1
Total Banking Institutions	**19**
Other institutions supervised by the Reserve Bank	
Credit-only-MFIs	185
Deposit-taking MFIs	4
Development Financial Institutions	2

2.2. The Reserve Bank authorized Collarhedge Financial Services, a deposit taking microfinance institution to commence deposit taking operations on 27 September 2016 and change of name to Success Microfinance Bank Limited effective 2 December 2016.

2.3. Lion Microfinance Limited was authorised to commence deposit-taking microfinance business in December 2016 following a pre-opening inspection by the Reserve Bank.

3. CONDITION & PERFORMANCE OF THE BANKING SECTOR

3.1. The banking sector remained safe and sound despite underlying macroeconomic constraints facing the economy and the cash challenges experienced during the quarter under review.

3.2. The performance of the banking sector is indicated by the financial soundness indicators as at 31 December 2016 shown in the table below.

Financial Soundness Indicators

Key Indicators	Dec -11	Dec - 12	Dec – 13	Dec -14	Dec -15	Mar-16	June-16	Sep-16	Dec-16
Total Assets	$4.74bn	$6.12bn	$6.74bn	$7.12bn	$7.83bn	$7.79bn	$8.01bn	$8.25bn	$8.73bn
Total Loans	$2.76bn	$3.56bn	$3.08bn	$4.01bn	$3.87bn	$3.81bn	$3.73 bn	$3.65bn	$3.69bn
Net Capital Base	$512m	$644m	$706m	$926.6m	$1.14bn	$1.16bn	$1.22bn	$1.24bn	$1.34bn
Total Deposits	$ 3.04bn	$4.41bn	$ 4.73bn	$5.08bn	$5.62bn	$5.67bn	$5.91bn	$6.14bn	$6.51bn
Net Profit	$86.00m	$69.20m	$4.46m	$50.84m	$127.47m	$38.44m	$67.97m	$111.30m	$181.06m
Return on Assets	2.43%	1.64%	0.06%	0.92%	2.11%	0.42%	0.98%	1.56%	2.26%
Return on Equity	15.13%	9.17%	0.51%	5.37%	10.96%	2.79%	3.53%	8.85%	12.64%
Capital Adequacy Ratio	13.51%	13.07%	14.01%	17.33%	21.31%	22.34%	24.17%	23.71%	23.70%
Loans to Deposits	90.59%	93.27%	102.36%	78.94%	68.86%	67.19%	63.45%	59.46%	56.64%
Non-Performing Loans Ratio	7.55%	13.46%	15.92%	15.91%	10.82%	10.81%	10.05%	10.74%	7.87%
Provisions to Adversely Classified Loans	57.53%	207.45%	70.88%	54.72%	69.22%	77.36%	69.87%	68.05%	68.51%
Net Interest Margin	8.21%	14.81%	15.26%	4.24%	8.62%	2.03%	3.52%	5.53%	6.99%
Liquidity Ratio	56.80%	55.70%	40.57%	39.34%	45.35%	49.63%	52.47%	54.15%	61.91%
Cost to Income Ratio	82.17%	86.41%	96.60%	93.72%	84.40%	86.30%	84.26%	82.88%	79.20%

3.3. The performance of the banking sector for the period ended 31 December 2016 is discussed hereunder.

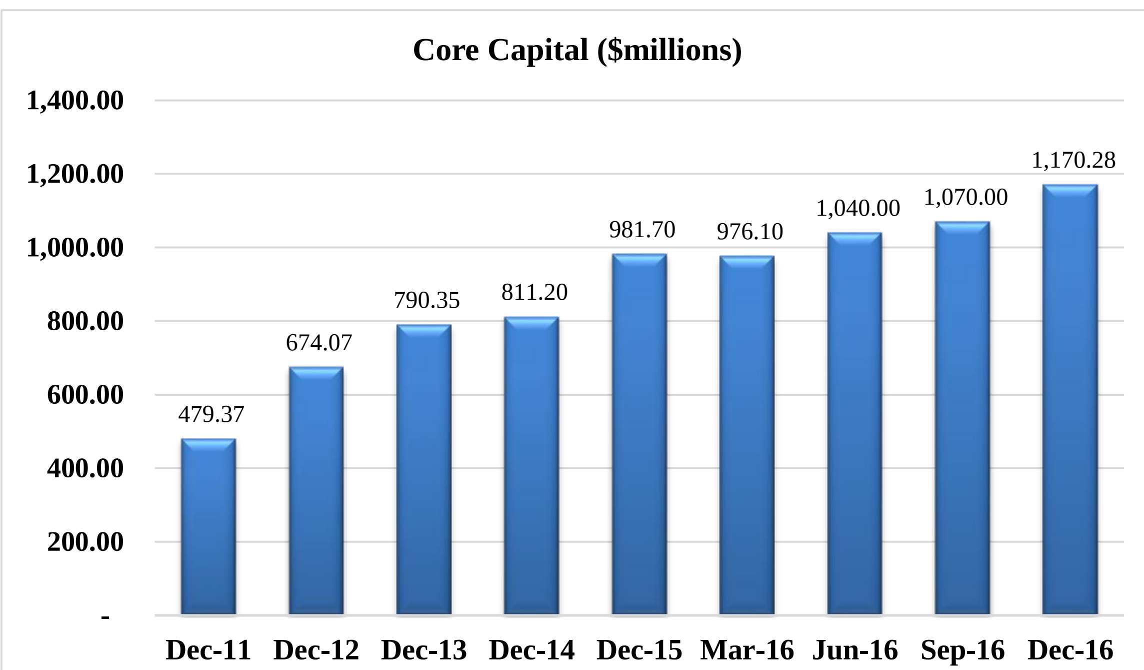
Capital Adequacy…

3.4. As at 31 December 2016, all operating banking institutions were in compliance with the prescribed minimum capital requirements.

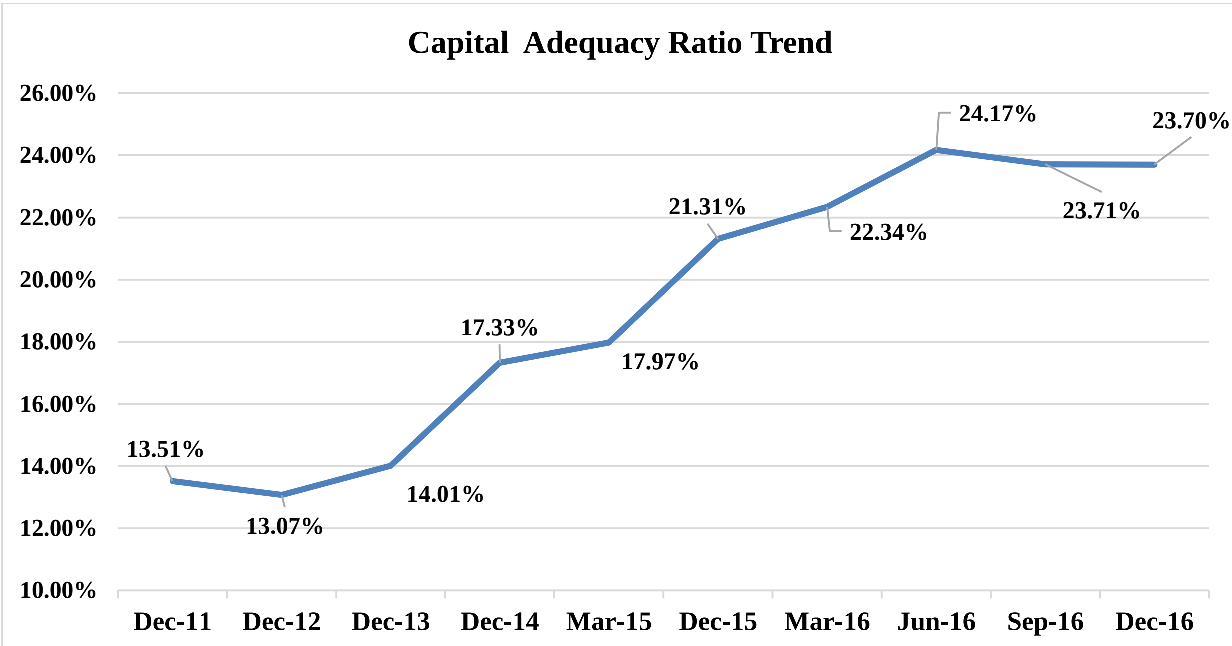
3.5. The banking sector's aggregate core capital increased by 7.48%, from \$1.07 billion as at 30 September 2016 to \$1.17 billion as at 31 December 2016, on the back of satisfactory earnings performance.

3.6. The banking sector remained adequately capitalized with an average capital adequacy and tier 1 ratios of 23.70% and 20.83% as at 31 December 2016, respectively.

3.7. The graph below shows banking sector core capital trends from December 2011 to December 2016:



3.8. The figure below shows the trend in the banking industry's average capital adequacy ratios (CARs) from December 2011 to December 2016.

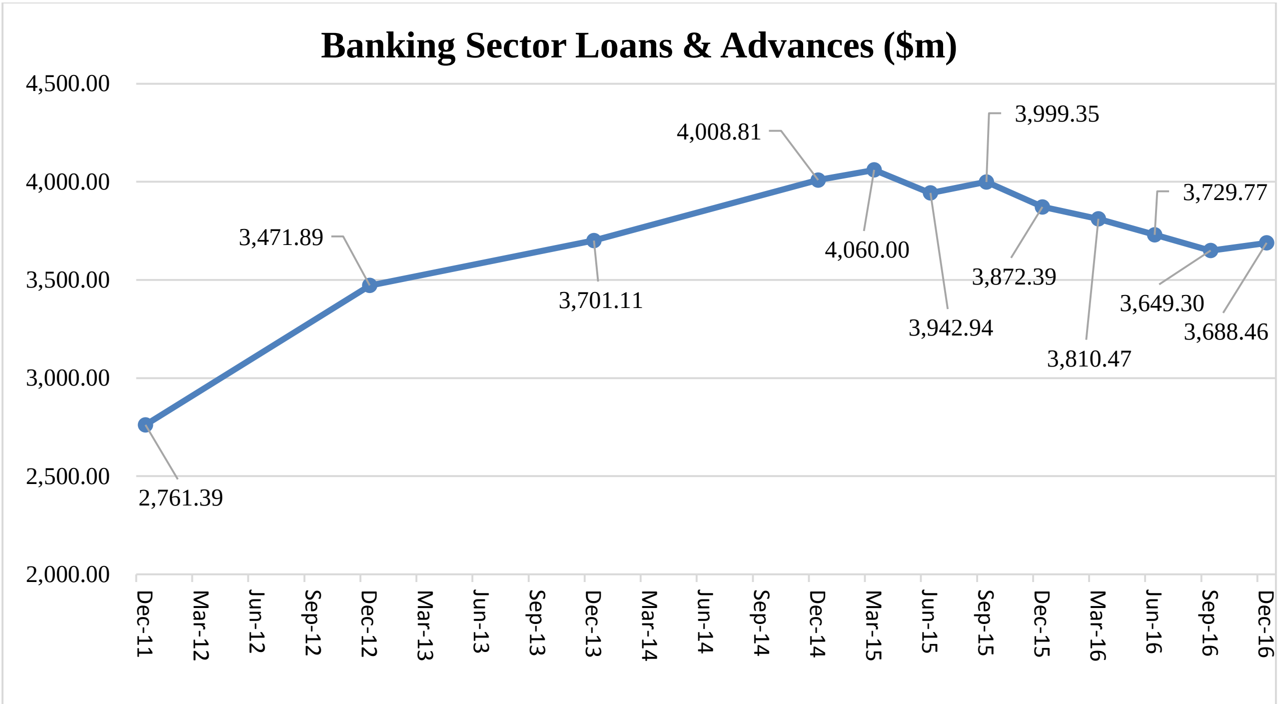


3.9. As at 31 December 2016, tier 1 capital constituted 86.56% of net capital base of $1.35 billion.

3.10. The Reserve Bank continues to monitor implementation of the banking institutions' capital plans and progress towards compliance with the 2020 minimum capital requirements.

Asset Quality…

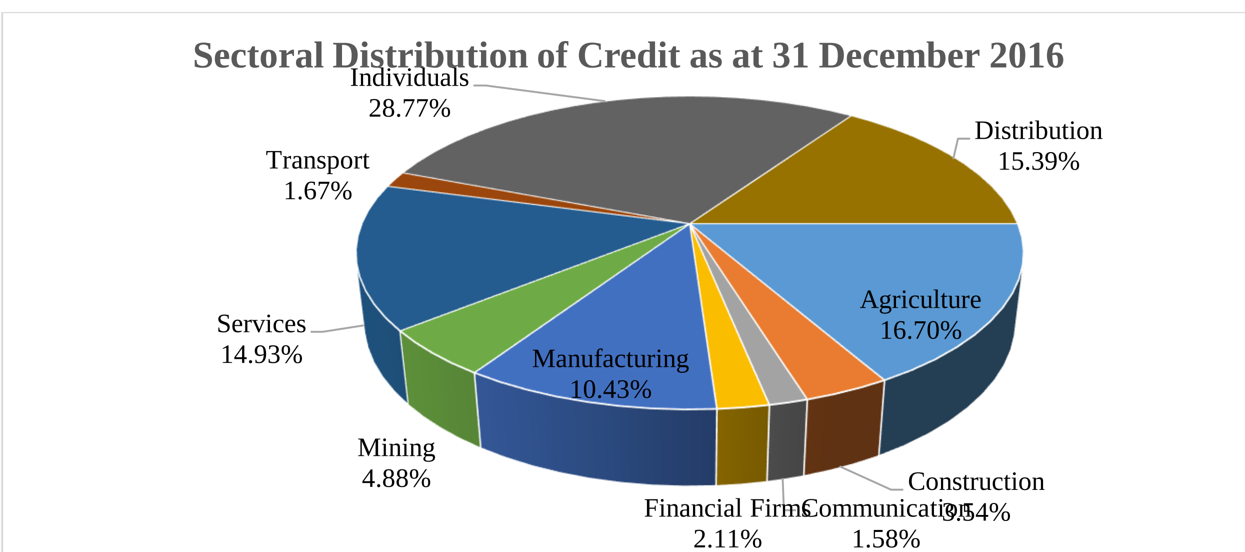
3.11. Banking sector loans and advances marginally increased from **$3.65 billion** as at 30 September 2016 to **$3.69 billion** as at 31 December 2016. The graph below shows the trend of banking sector loans and advances from 31 December 2011 to 31 December 2016.



3.12. The gradual drop in the level of banking sector loans from 2014 is mainly a reflection of the more cautious approach to lending by banks and the sale of non-performing loans to ZAMCO.

Sectoral Distribution of Loans and Advances

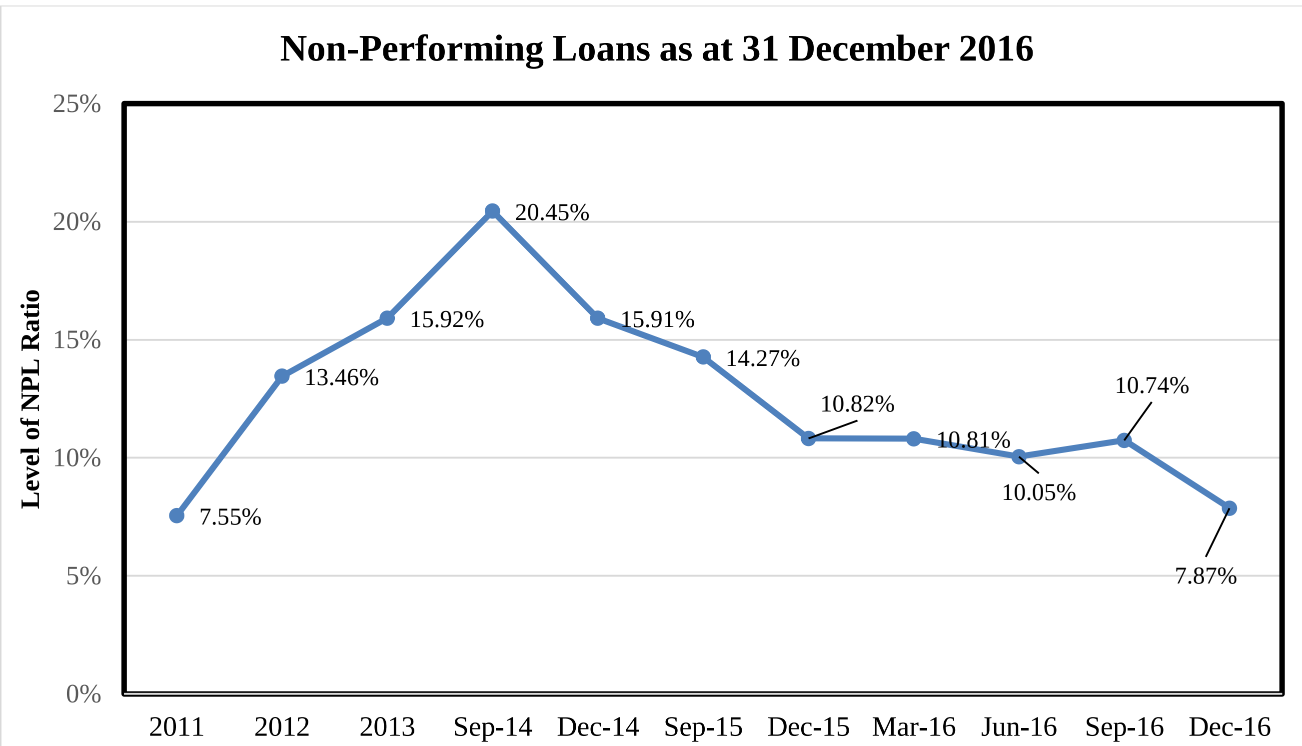
3.13. The distribution of credit remained largely unchanged from the first half of the year and is indicated in the figure below:



3.14. It is important to note that the lending to individuals also includes loan facilities that individuals accessed in order to fund their productive activities in farming and other business ventures.

Non-Performing Loans

3.15. The quality of the banking sector loans has improved over the year. The ratio of non-performing loans (NPLs) to total loans declined from **10.74%** as at 30 September 2016 to **7.87%** as at 31 December 2016.The figure below shows the trend in the NPLs ratio from 2011 to 31 December 2016.

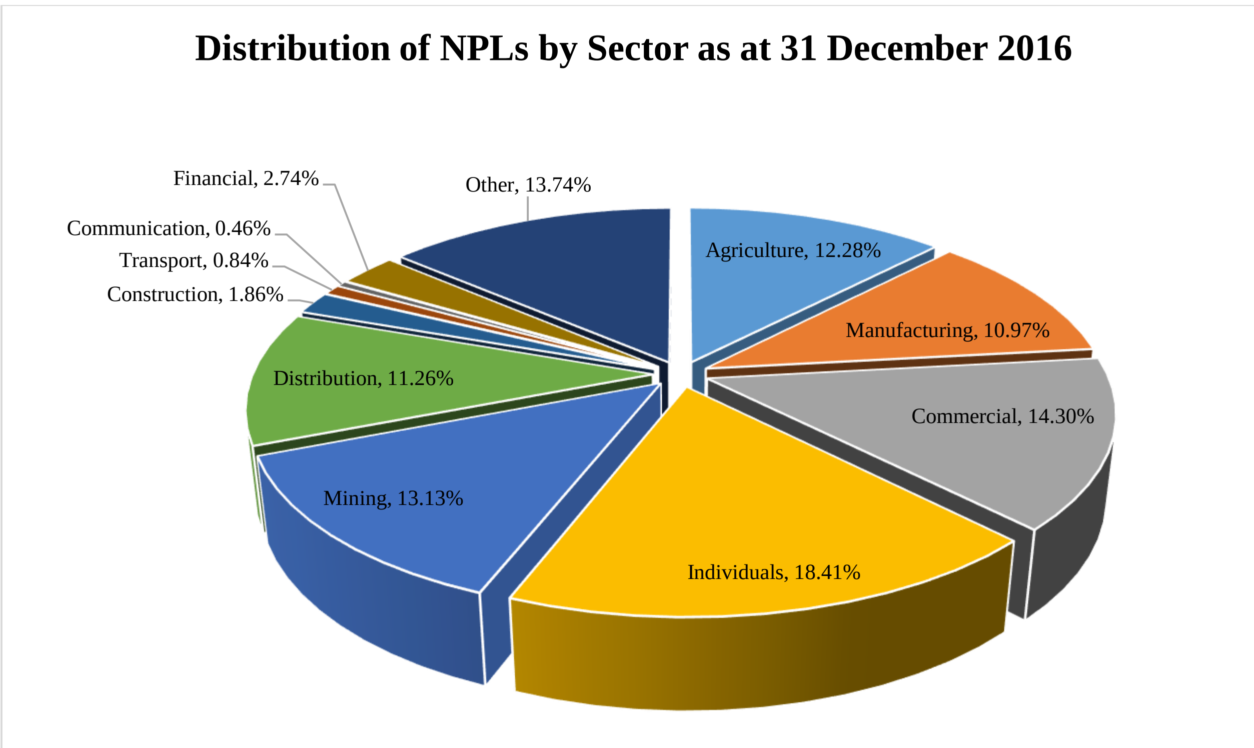


3.16. The enhanced credit management systems and collection efforts by banking institutions during 2016, and , as well as disposal of qualifying NPLs to the Zimbabwe Asset Management Company (ZAMCO), has contributed significantly to improved asset quality in the sector during the period under review.

3.17. The level of NPLs is expected to further improve in response to various policy initiatives by the Reserve Bank including establishment of the credit reference system.

3.18. Reflecting the sectoral distribution of banking sector loans and advances, the proportions of NPLs from individuals, manufacturing, commercial and agriculture sectors constituted 18.41%, 14.30%, 13.13% and 12.28% of total non-performing loans, respectively, as at 31 December 2016.

3.19. The figure below shows the sectoral distribution of NPLs as at 31 December 2016.



Earnings Performance…

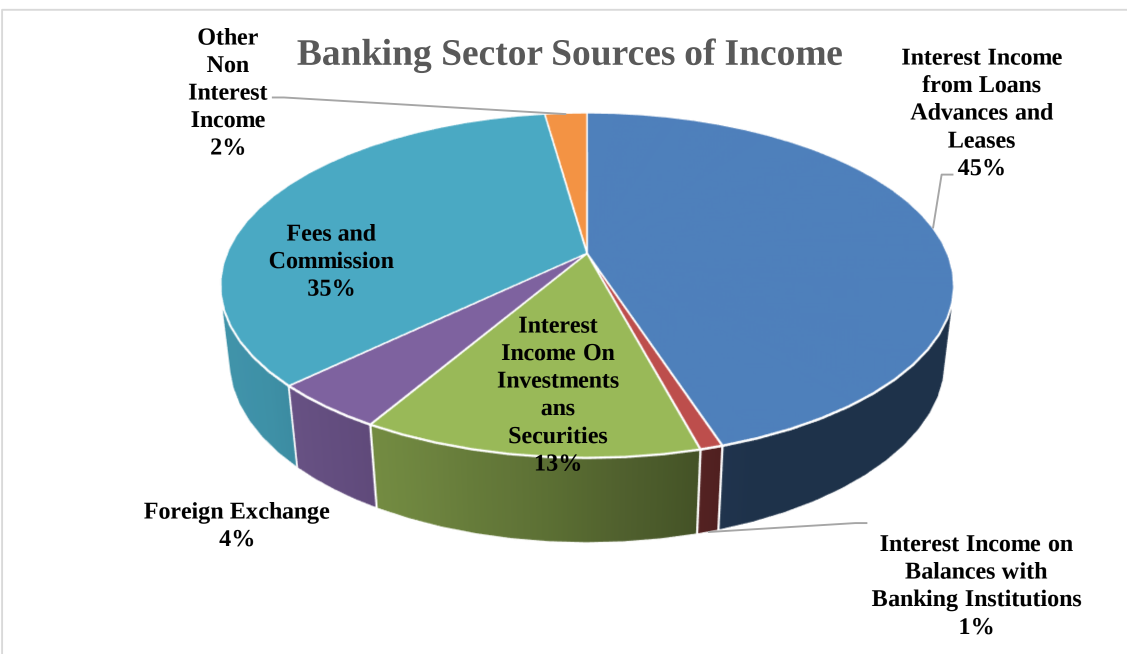
3.20. The earnings performance of the banking sector was satisfactory during the period ended 31 December 2016. The aggregate net profit was $**181.06 million**, representing an increase of 42.04% from the $127.47 million reported for the same period in 2015.

3.21. Eighteen (18) out of 19 operating banking institutions recorded profits during the period ended 31 December 2016. The loss recorded at one institution is largely due to start-up costs and these losses are projected to decline as the institutions increases its business volumes.

3.22. The average return on assets and return on equity improved to 2.26% and 12.64% as at 31 December 2016, from 2.11% and 10.96% recorded for the period ended 31 December 2015, respectively.

3.23. Interest income continued to be the major income driver, constituting 58.40% of total income of $1.05 billion for the period ended 31 December 2016 while salaries & employment benefits dominated total costs for banking institutions as they accounted for 46.03% of total banking sector costs.

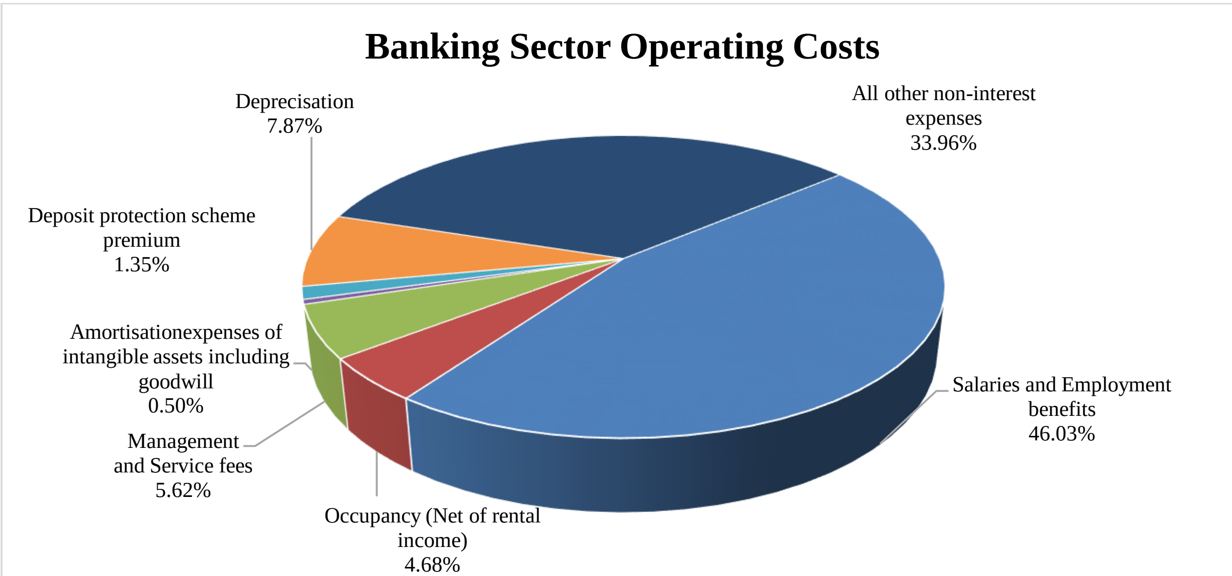
3.24. The sources of income for the banking sector as at 31 December 2016 are shown in the figure below.



3.25. As at 31 December 2016, salaries and employment benefits (46.03%) dominated total costs for banking institutions, whilst all other non-interest expense constituted 33.34% of the total costs.

3.26. The figure below shows the decomposition of the banking sector's aggregated operating costs.

3.27. Fees and commission increased by 6.69 % from 32.66% as at 31 December 2015 to 35% as at 31 December 2016 and was stable between Quarter 3 and Quarter 4 of 2016 at 35%.

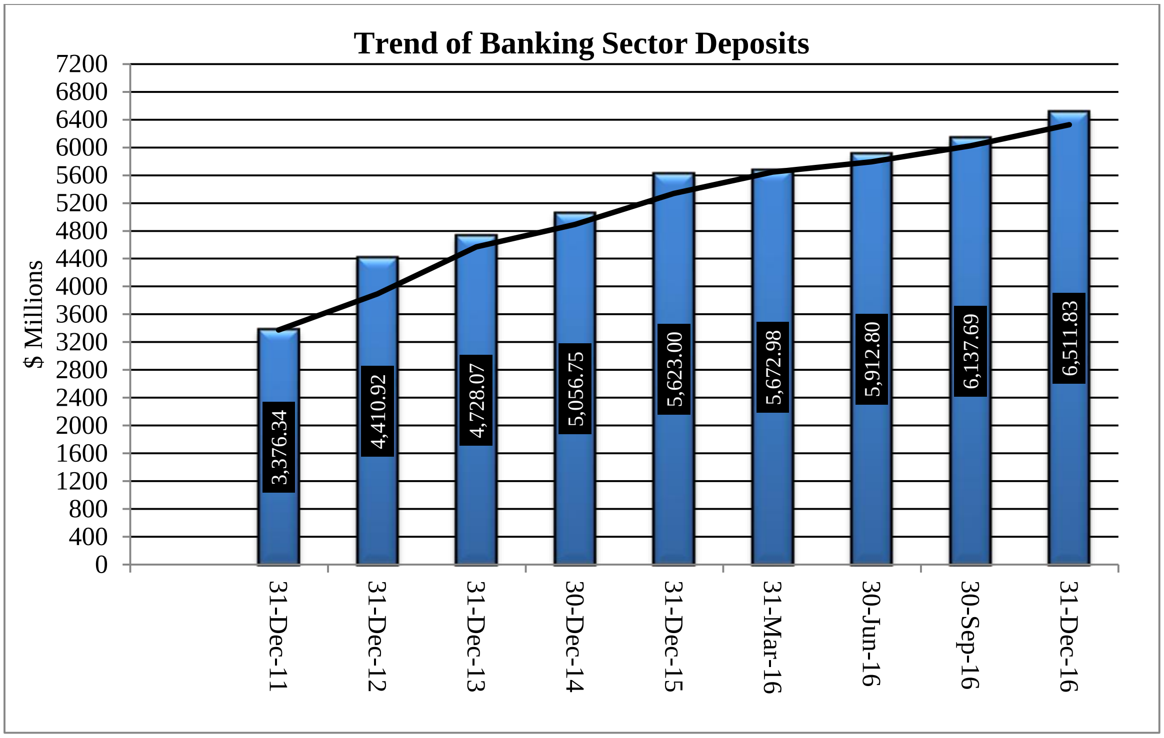


3.28. As part of measures to improve their financial performance, banking institutions continue to implement revenue enhancement measures such as adoption of digital finance and agency banking, while simultaneously instituting cost containment measures, including staff rationalization and branch optimization.

Liquidity & Funds Management…

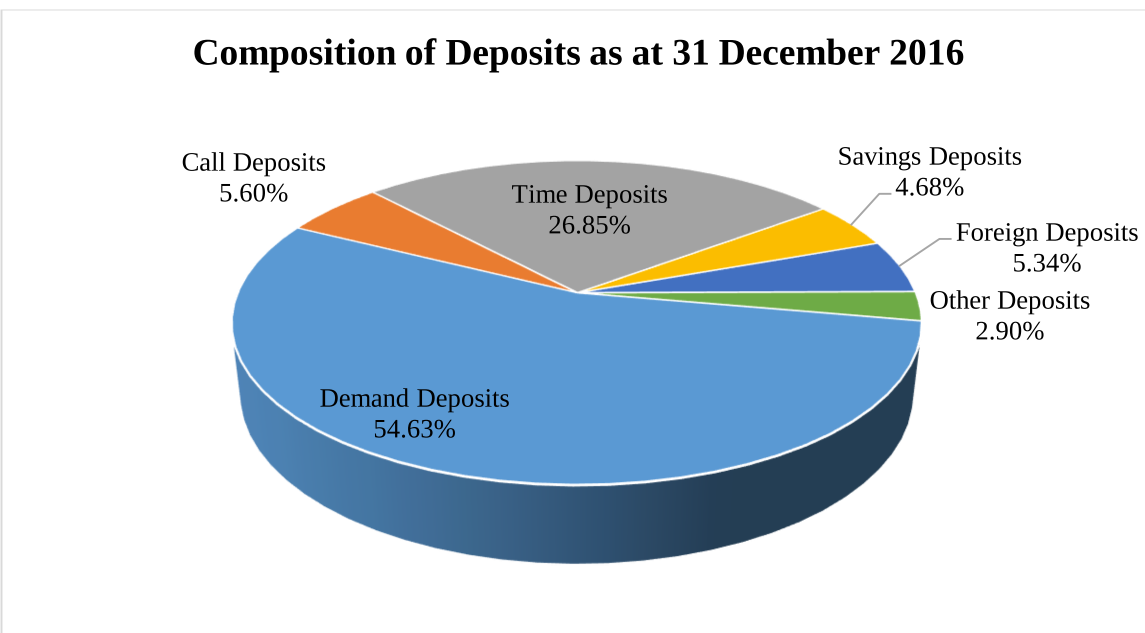
3.29. Total banking sector deposits increased by 6.03%, from $6.14 billion as at 30 September 2016 to $6.51 billion as at 31 December 2016.

3.30. The figure below shows the trend of banking sector deposits over the period 31 December 2011 to 31 December 2016.



3.31. The commercial banking sub-sector accounted for 82.02% of the banking sector deposits and 74.18% of the total banking sector loans as at 31 December 2016.

3.32. The composition of total banking sector deposits as at 31 December 2016 is depicted below:



3.33. As at 31 December 2016, banking sector deposits were dominated by demand and time deposits, which accounted for 54.63% and 26.85% of total deposits, respectively.

Sensitivity to Market Risk…

3.34. The banking sector's sensitivity to market risk remained low during the quarter under review. Most banking institutions were not undertaking proprietary trading positions, while client transactions were mainly currency switches. The aggregate banking sector net foreign exchange open position was **$1.47 billion** as at 31 December 2016 an increase of 40.11% from **$1.04 billion** as at 31 December 2015.

3.35. All banking institutions were resilient to a major foreign exchange rate risk shock of a 15% appreciation of the US dollar against major currencies.

Financial Inclusion

3.36. Financial institutions have instituted a number of initiatives targeting the identified priority groups in the National Financial Inclusion Strategy, namely, SMEs, women, small holder farmers and the youth. The measures include loans with preferential interest rates & products targeting women and the youth, and innovative products for group savings, training and capacity building programs.

3.37. A number of banks in Zimbabwe have set up SME units and established women desks. Through the SME units and women desks, banks are now able to focus on developing products and services that meet the specific needs of MSMEs and women entrepreneurs.

3.38. The Revolving Women Empowerment Fund, whose operational modalities are currently being finalized, will be made available for on-lending through commercial banks, selected Microfinance Institutions (MFIs) and People's Own Savings Bank

(POSB).

3.39. Low income groups, who are the target under the National Financial Inclusion Strategy are now able to open bank accounts, which facilitate access to other formal financial services.

3.40. Significant progress has been recorded by banks regarding opening of low cost or ‘no frills’ accounts with very low KYC requirements and minimal bank charges.

3.41. There has been an increase in low cost accounts across the banking sector in 2016 from 229,264 as at 31 March 2016 and 412,383 as at 30 September 2016 to 1,230,057 as at 31 December 2016.

Outlook

3.42. The performance of the banking sector and its contribution to the growth of the economy is expected to improve in 2017 on the back of a number of policy measures currently underway to bolster confidence and foster financial stability, as well as, strategic realignment and cost rationalisation initiatives by banking institutions.

RESERVE BANK OF ZIMBABWE
March 2017