QUARTERLY BANKING SECTOR REPORT

30 SEPTEMBER 2016

BANK SUPERVISION DIVISION

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY

1.1. The banking sector remained generally resilient on the back of various measures implemented by the Reserve Bank and Government to bolster confidence and promote the safety and soundness of the sector.

1.2. As at 30 September 2016, all operating banking institutions were in compliance with the prescribed minimum capital requirements and were making progress towards attaining compliance with 2020 regulatory capital requirements.

1.3. Banking sector loans and deposits amounted to **$3.65 billion** and **$6.14 billion**, respectively, translating to loan to a deposit ratio of 59.46% as at 30 September 2016.

1.4. For the period ended 30 September 2016, the ratio of non-performing loans (NPLs) in the banking sector stabilised at **10.74%.**

1.5. Earnings performance improved during the period ended 30 September 2016, on the back of revenue growth, lower loan loss provisions in line with improving asset quality, and realignment of cost structures. The banking sector aggregate net profit increased to **$111.30 million**, from the $86.09 million reported for the same period in 2015.

1.6. The banking sector average prudential liquidity ratio was 54.15% as at 30 September 2016, against the minimum regulatory requirement of 30%, largely as a result of the cautious lending approach adopted by most banks.

1.7. The average effective lending rate for the sector marginally declined from 17.36% to 17.31% per annum during the quarter under review. Average deposit rates ranged between 1.63% and 8.50% per annum.

1.8. Significant progress has been made towards the establishment of a credit registry. The deployment process is underway.

1.9. The rollout of the National Financial Inclusion Strategy is progressing well, with subcommittees having been established to spearhead the implementation of the strategy including development of policies and guidelines.

2. FINANCIAL ARCHITECTURE

2.1. The architecture of the banking sector as at 30 September 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	
Deposit-taking MFIs	4
Credit-only-MFIs	164
Development Financial Institutions	2

2.2. Collarhedge Financial Services was authorised to commence deposit taking operations on 27 September 2016 following a pre-opening inspection by the Reserve Bank. Lion Microfinance was licensed on 31 May 2016 and a pre-opening inspection of the institution will be conducted during the quarter ending 31 December 2016.

3. CONDITION & PERFORMANCE OF THE BANKING SECTOR

3.1. The banking sector remains generally safe and sound despite underlying macroeconomic challenges in the economy. The financial soundness indicators as at 30 September 2016 are shown in the table below:

Financial Soundness Indicators

Key Indicators	Dec -11	Dec - 12	Dec – 13	Dec -14	June - 15	Dec -15	Mar-16	June-16	Sep-16
Total Assets	$4.74bn	$6.12bn	$6.74bn	$7.12bn	$7.59bn	$7.83bn	$7.79bn	$8.01bn	$8.25bn
Total Loans	$2.76bn	$3.56bn	$3.08bn	$4.01bn	$3.94bn	$3.87bn	$3.81bn	$3.73 bn	$3.65bn
Net Capital Base	$512m	$644m	$706m	$926.6m	$1.04bn	$1.14bn	$1.16bn	$1.22bn	$1.24bn
Total Deposits	$ 3.04bn	$4.41bn	$ 4.73bn	$5.08bn	$5.60bn	$5.62bn	$5.67bn	$5.91bn	$6.14bn
Net Profit	$86.00m	$69.20m	$4.46m	$50.84m	$43.01m	$127.47m	$38.44m	$67.97m	$111.30m
Return on Assets	2.43%	1.64%	0.06%	0.92%	0.63%	2.11%	0.42%	0.98%	1.56%
Return on Equity	15.13%	9.17%	0.51%	5.37%	3.26%	10.96%	2.79%	3.53%	8.85%
Capital Adequacy Ratio	13.51%	13.07%	14.01%	17.33%	19.72%	21.31%	22.34%	24.17%	23.71%
Loans to Deposits	90.59%	93.27%	102.36%	78.94%	71.40%	68.86%	67.19%	63.45%	59.46%
Non-Performing Loans Ratio	7.55%	13.46%	15.92%	15.91%	14.52%	10.82%	10.81%	10.05%	10.74%
Provisions to Adversely Classified Loans	57.53%	207.45%	70.88%	54.72%	64.29%	69.22%	77.36%	69.87%	68.05%
Net Interest Margin	8.21%	14.81%	15.26%	4.24%	2.22%	8.62%	2.03%	3.52%	5.53%
Liquidity Ratio	56.80%	55.70%	40.57%	39.34%	38.14%	45.35%	49.63%	52.47%	54.15%
Cost to Income Ratio	82.17%	86.41%	96.60%	93.72%	90.76%	84.40%	86.30%	84.26%	82.88%

3.1 The performance of the banking sector for the period ended 30 September 2016 is discussed hereunder.

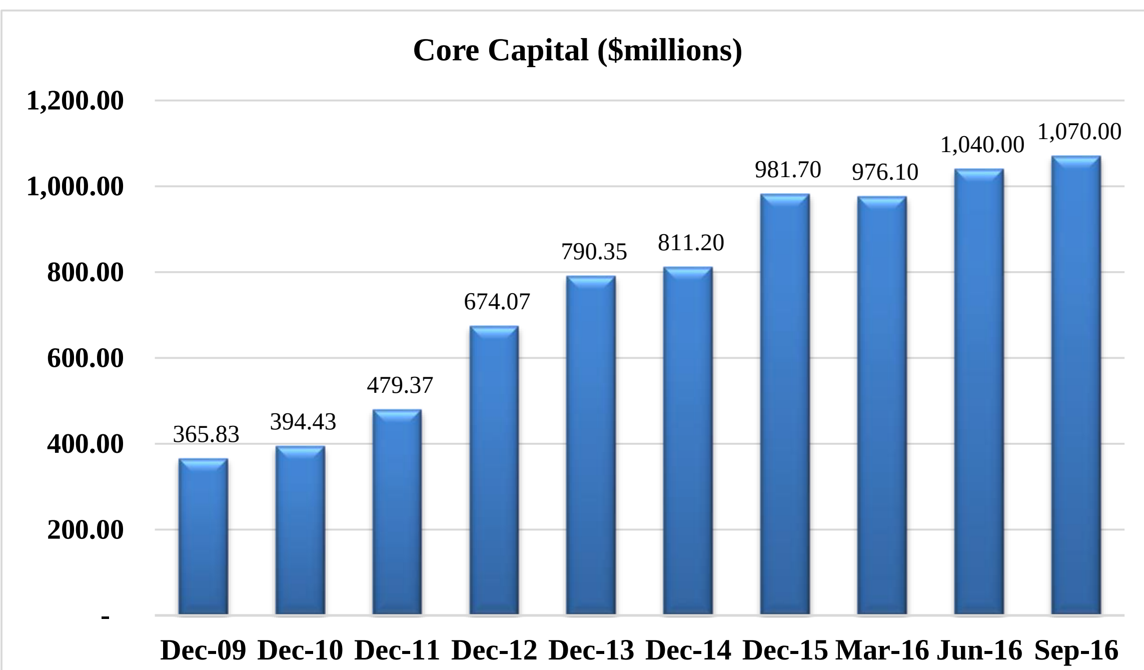
Capital Adequacy…

3.2 The banking sector registered increased capital levels in the quarter ended 30 September 2016 on the back of satisfactory earnings performance. Aggregate core capital increased by 2.87%, from $1.04 billion as at 30 June 2016 to $1.07 billion as at 30 September 2016.

3.3 As at 30 September 2016, all operating banking institutions were in compliance with the prescribed minimum capital requirements. The Reserve Bank is monitoring implementation of the banking institutions' capital plans and progress towards compliance with the 2020 minimum capital requirements on a quarterly basis.

3.4 The graph below shows banking sector core capital trends from December 2009 to September 2016:

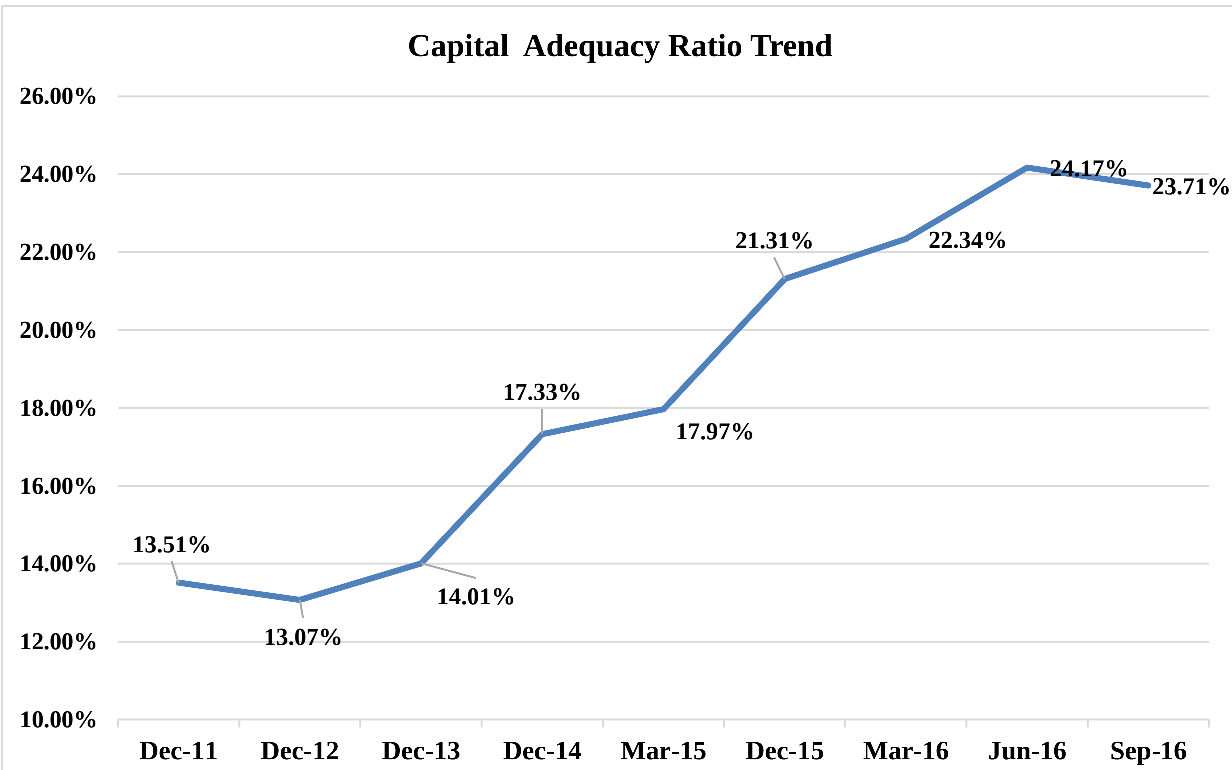
Figure 1: Trend of Core Capital



3.5 The banking sector remained adequately capitalized with average capital adequacy and tier 1 ratios of 23.71% and 20.58% as at 30 September 2016, respectively. All banking institutions were in compliance with the minimum capital adequacy and tier 1 ratios of 12% and 8%, respectively.

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

Figure 2: Trend of Capital Adequacy Ratio



3.7 As at 30 September 2016, tier 1 capital constituted 86.77% of net capital base of $1.24 billion.

Asset Quality…

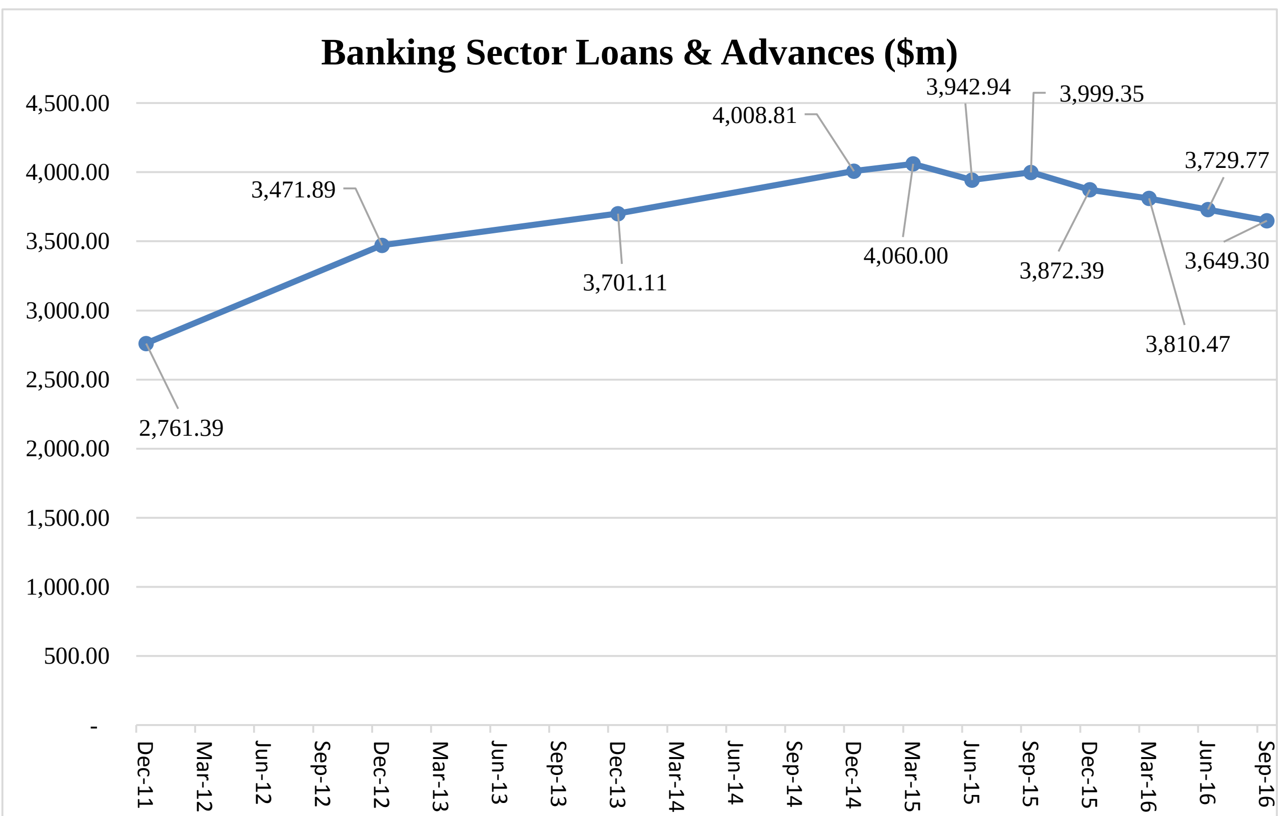
3.8 Banking sector loans and advances marginally declined by 2.15%, from $3.73 billion as at 30 June 2016 to $3.65 billion as at 30 September 2016. The decrease was largely attributable to the adoption of a cautious approach to lending by most banking institutions in light of the adverse operating environment, as well as, acquisition of NPLs by ZAMCO from the sector.

3.9 As at 30 September 2016, banking institutions had disposed non-performing loans amounting to $537.34 million to ZAMCO, up from $528.40 million as at 30 June 2016.

3.10 To date, a number of companies are benefitting from the relief brought about by the restructuring of the loans through the reduction in interest rates and elongated repayment periods.

3.11 The graph below shows the trend of banking sector loans and advances from 31 December 2011 to 30 September 2016.

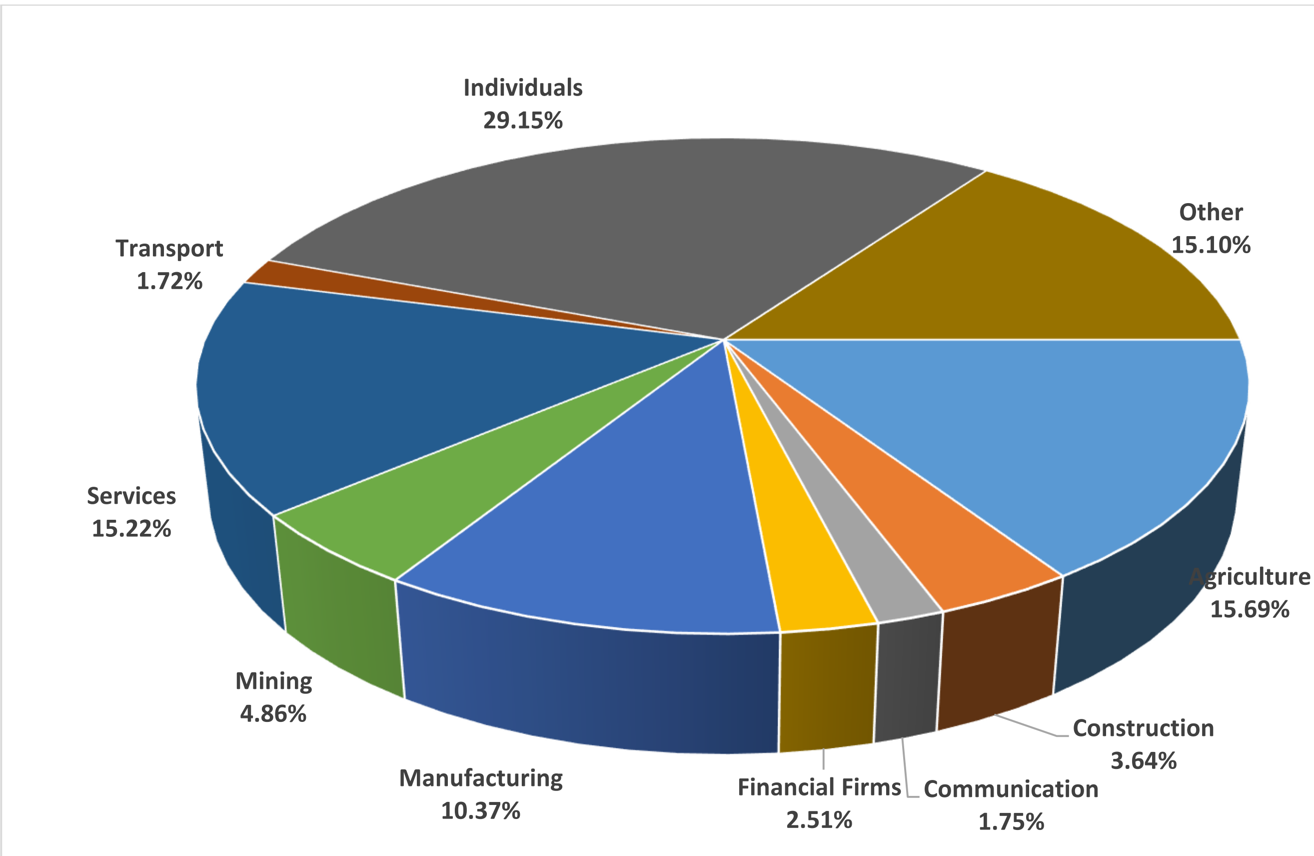
Figure 3: Trend of Banking Sector Loans



Sectoral Distribution of Loans and Advances

3.12 The distribution of credit remained largely unchanged from the previous quarter, wherein lending to individuals dominate the banking sector loan portfolio as indicated in figure 4.

Figure 4: Sectoral Distribution of Credit as at 30 September 2016



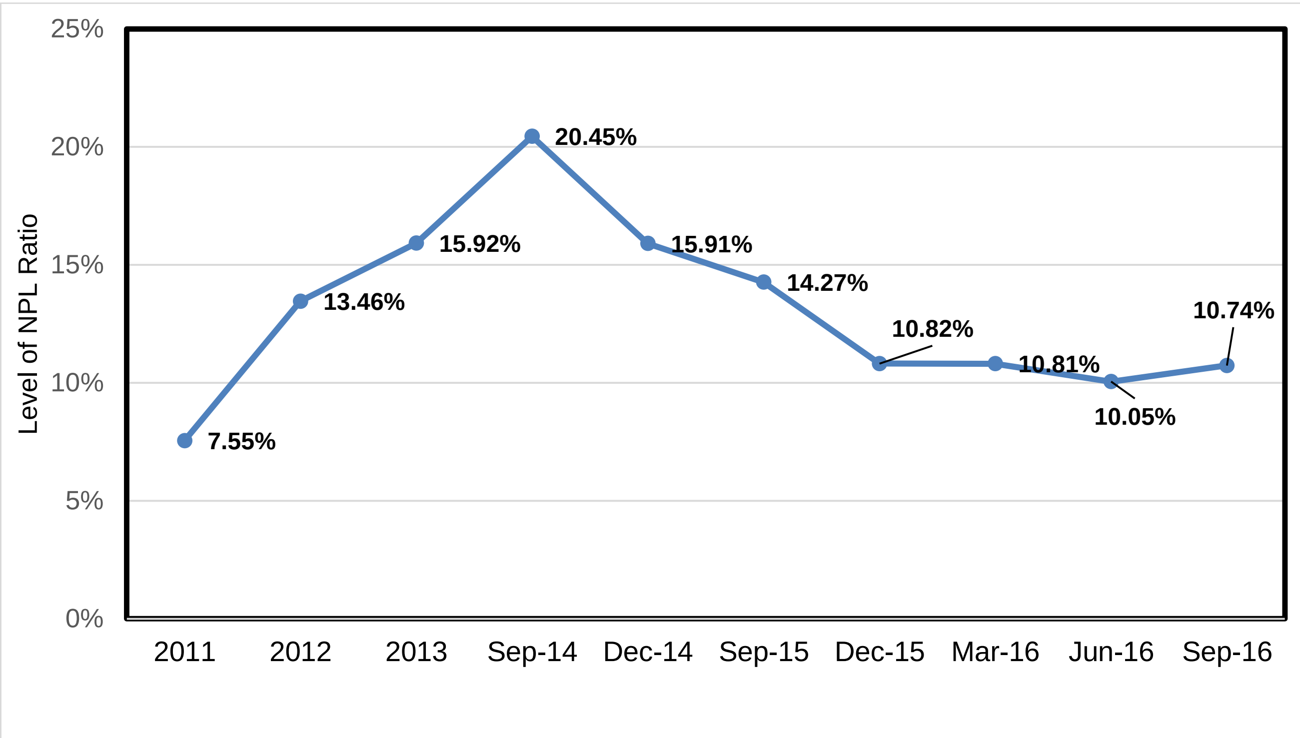
Non-Performing Loans

3.13 The ratio of non-performing loans (NPLs) in the banking sector was 10.74% as at 30 September 2016, compared to 10.05% as at 30 June 2016. The decrease in the banking sector loan book over the quarter largely explains the marginal increase in the ratio of non-performing loans.

3.14 Banking institutions remain resolute in strengthening credit risk management systems and collection efforts. In addition, banking institutions continued to dispose of qualifying NPLs to the Zimbabwe Asset Management Company (ZAMCO).

3.15 The graph below shows the trend in NPLs from 2011 to 30 September 2016.

Figure 5: Trend in Non-Performing Loans 2011 -2016



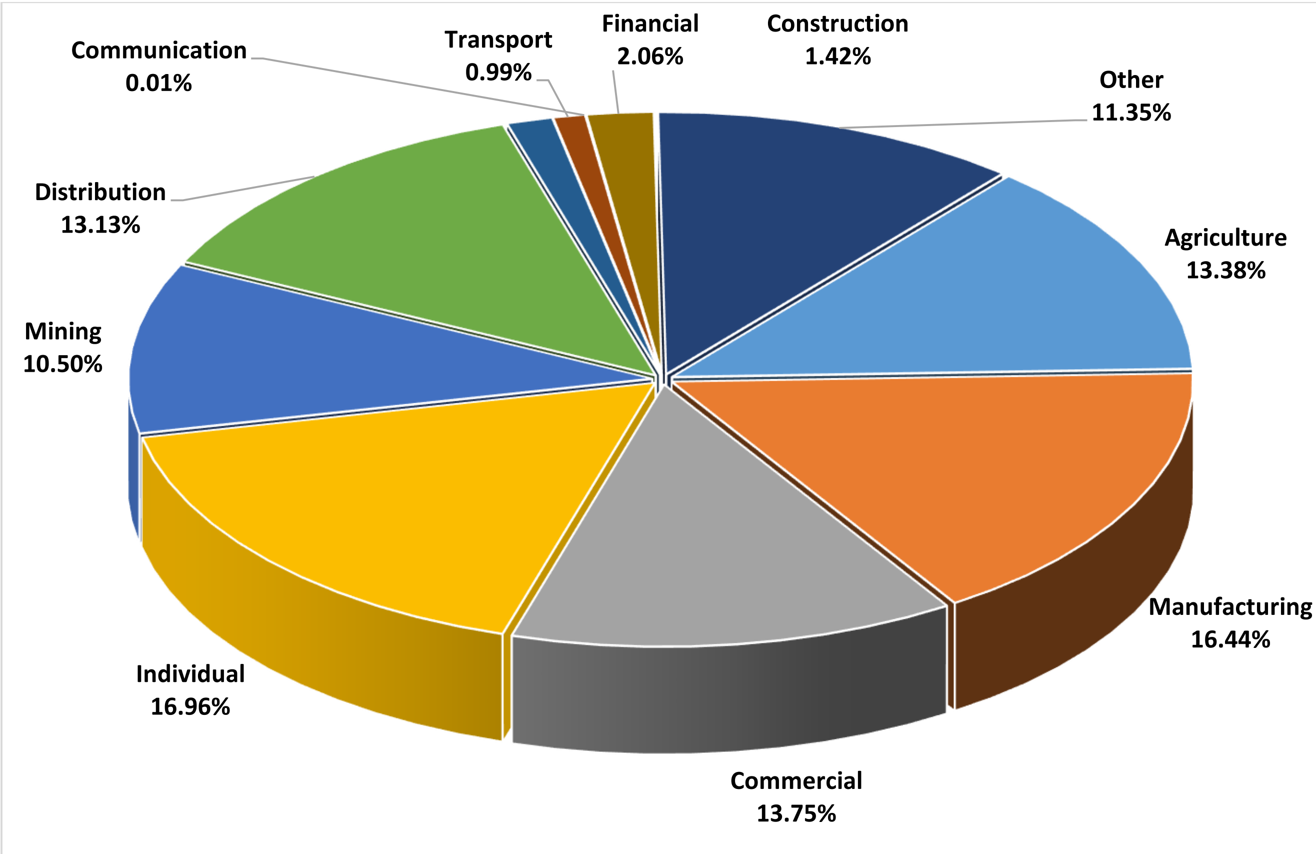
3.16 The level of NPLs is expected to improve in response to a number of NPL resolution policy measures by the Reserve Bank and the Government.

3.17 As at 30 September 2016, twelve (12) banks were compliant with the recommended NPL target ratio of 10%. The remaining banks are instituting measures to improve the quality of their credit portfolios.

3.18 Sectors with the largest proportions of NPLs were individuals, manufacturing, commercial and agriculture sectors, which constituted 16.96%, 16.44%, 13.75% and 13.38% of total non-performing loans, respectively.

3.19 The chart below shows the sectoral distribution of NPLs.

Figure 6: Distribution of NPLs by Sector as at 30 September 2016



Earnings Performance…

3.20 The banking sector remained profitable during the period ended 30 September 2016, with an aggregate net profit of **$111.30 million**, representing an increase of 29.28% from the $86.09 million reported for the same period in 2015.

3.21 Seventeen (17) out of 19 operating banking institutions recorded profits during the period ended 30 September 2016.

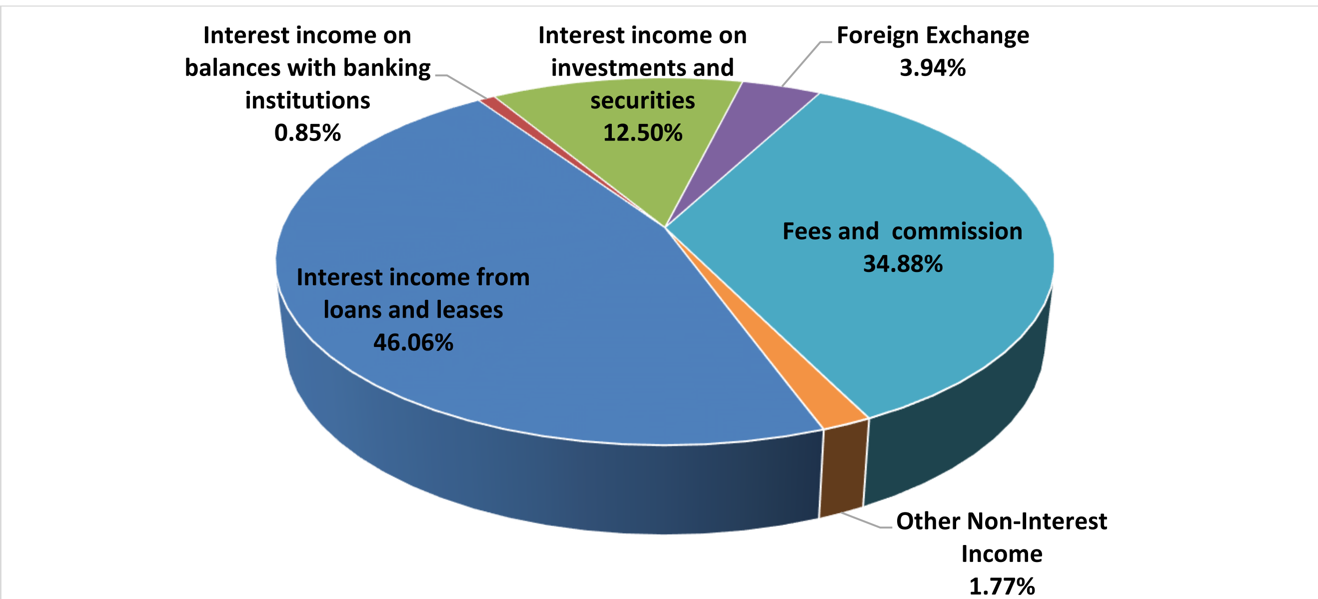
3.22 The average return on assets and return on equity improved to 1.56% and 8.85% as at 30 September 2016, from 1.37% and 7.91% recorded for the period ended 30 September 2015, respectively.

3.23 Interest income was the major driver of total income of $0.73 billion for the period ended 30 September 2016, constituting 59.41%. Non-interest income accounted for 40.59 % of total income, comprising fees & commission (34.88 %), foreign exchange fees (3.94%) and other non-interest income (1.77%).

3.24 Fees and commission increased by 4.78% from $250.51 million to $262.48 million, over the review period. The increase was partly attributed to increased volumes of cash withdrawal transactions associated with lower cash withdrawal limits imposed by some banks.

3.25 The sources of income for the banking sector as at 30 September 2016 are shown in figure 7 below.

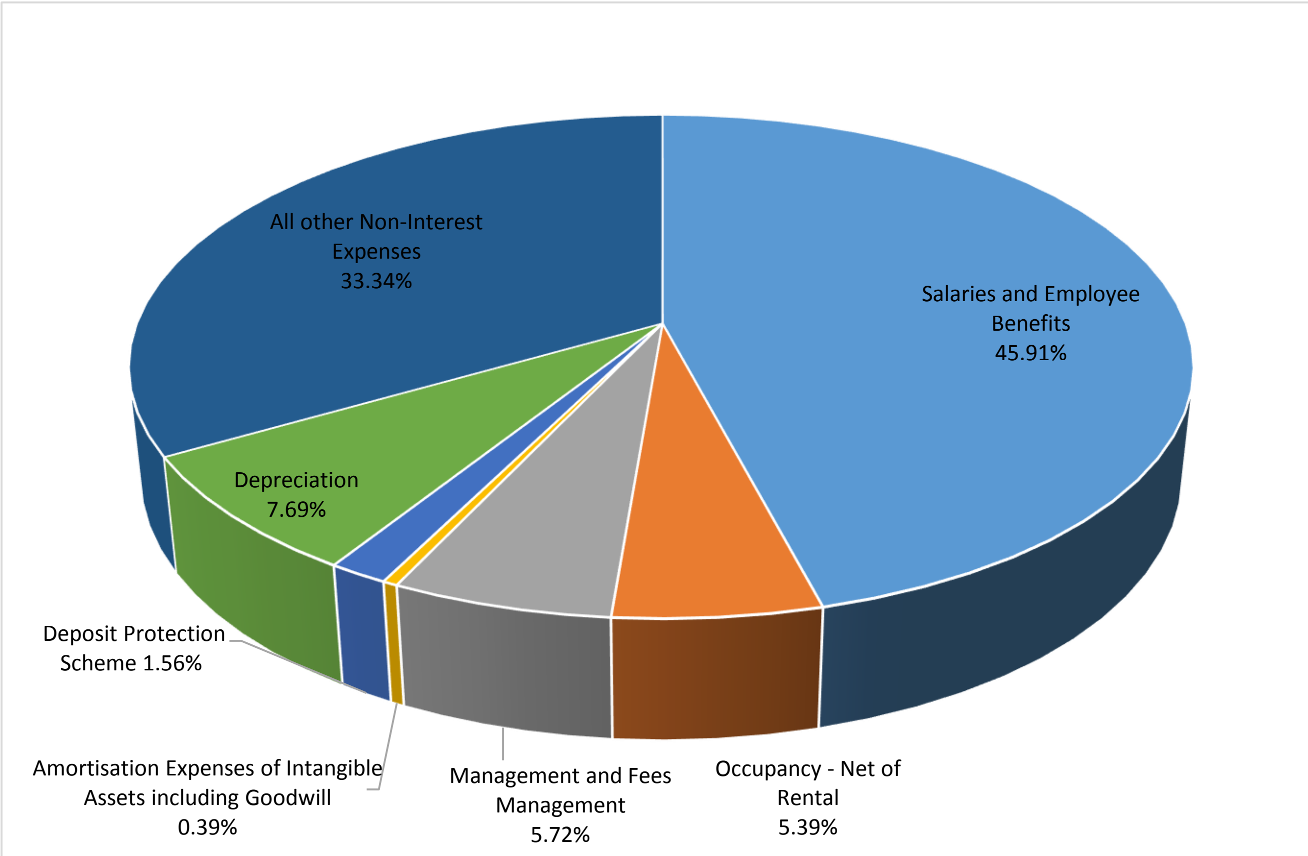
Figure 7: Banking Sector Sources of Income



3.26 For the period ended 30 September 2016, salaries & employment benefits (45.91%) dominated total costs for banking institutions, whilst all other non-interest expenses constituted 33.34% of the total costs.

3.27 Figure 8 below shows the decomposition of the banking sector's aggregated operating costs.

Figure 8: Decomposition of operating costs



3.28 Banking institutions continue to implement revenue enhancement measures such as digital finance and agency banking, while instituting cost containment measures, including staff and branch rationalization as well as renegotiating contracts with suppliers, among others.

Liquidity & Funds Management…

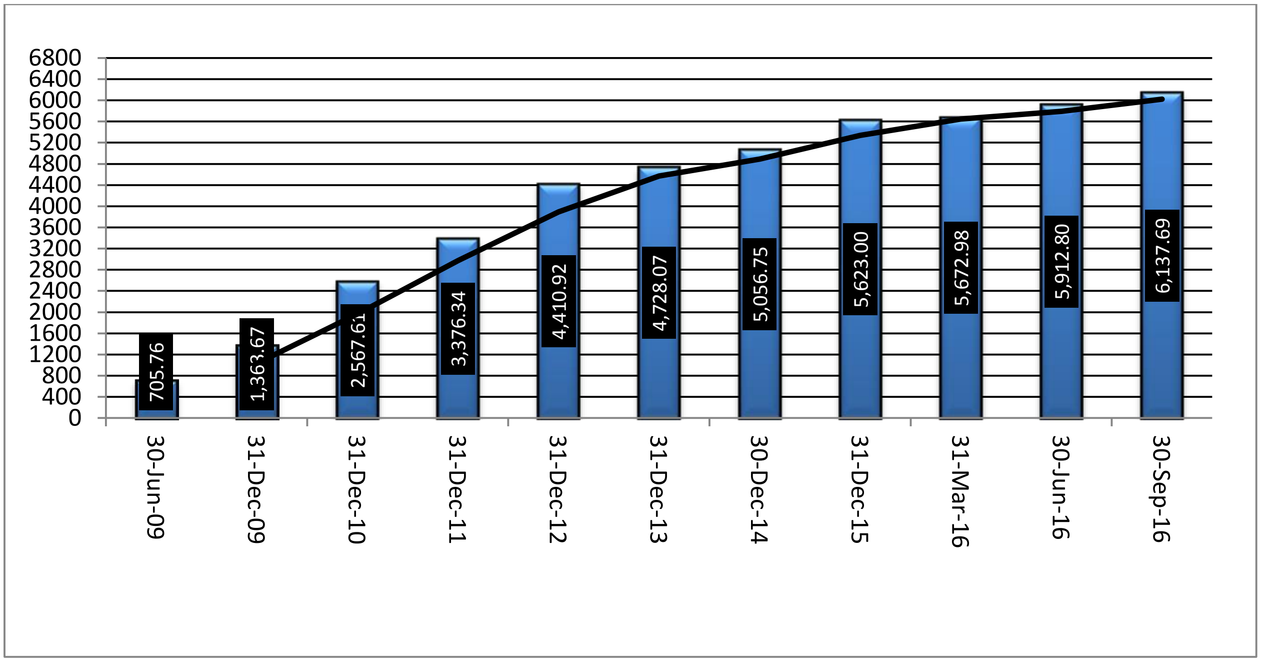
Deposits

3.29 Total banking sector deposits increased by 8.29%, from **$5.67 billion** as at 30 June 2016 to **$6.14 billion** as at 30 September 2016.

3.30 The figure below shows the trend of banking sector deposits over the period 30 June

2009 to 30 September 2016.

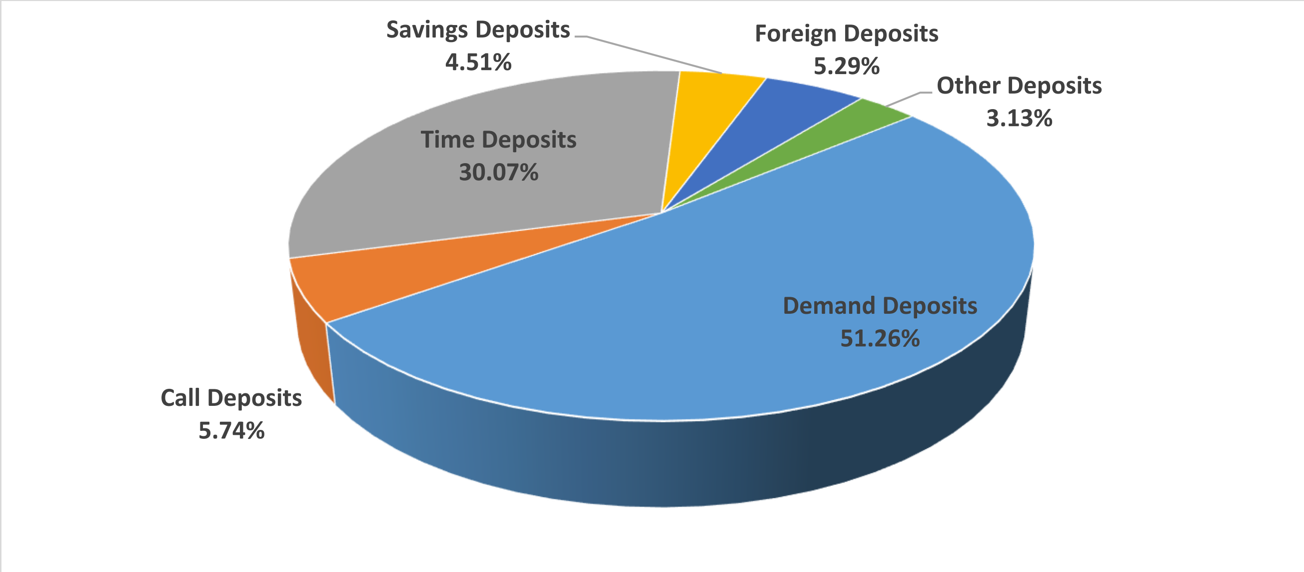
Figure 9: Trend of Banking Sector Deposits (June 2009 – Sep 2016)



3.31 The commercial banking sub-sector accounted for 84.36% of the banking sector deposits and 75.61% of the total banking sector loans as at 30 September 2016.

3.32 The composition of total banking sector deposits as at 30 September 2016 is depicted below:

Figure 10: Composition of Deposits as at 30.09.16

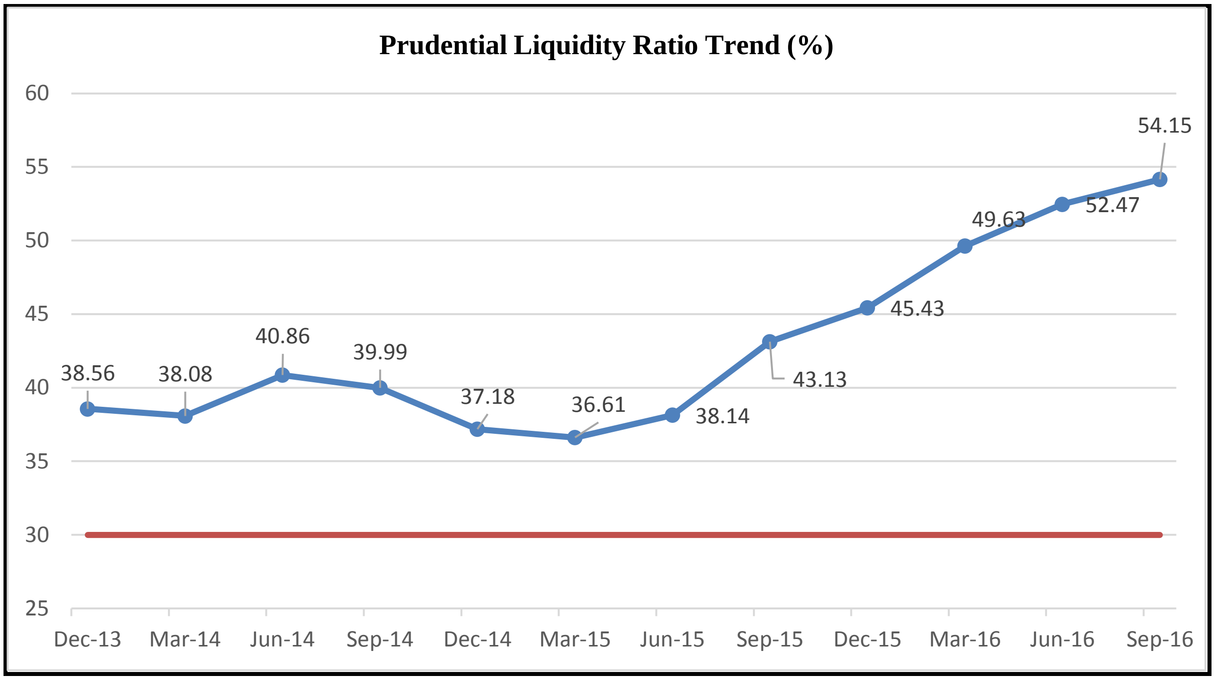


3.33 Banking sector deposits were dominated by demand and time deposits, which accounted for 51.26% and 30.07% of total deposits, respectively, as at 30 September 2016.

3.34 The average prudential liquidity ratio of 54.15% as at 30 September 2016 was above the minimum regulatory requirement of 30%. Eighteen (18) out of the nineteen (19) operating banks were compliant with the prudential liquidity ratio as at 30 September 2016. The non-compliant institution is taking corrective measures including loan collection, revenue enhancement and deposit mobilization to ensure compliance.

3.35 The graph below shows the trend in the banking sector average prudential liquidity ratio since December 2013.

Figure 11: Prudential liquidity ratio December 2013 - September 2016



3.36 The banking sector continued to experience underlying cash challenges during the quarter ended 30 September 2016. In an effort to manage the high demand for cash, banking institutions have set cash withdrawal limits and are increasingly making use of alternative payment platforms.

Sensitivity to Market Risk…

3.37 The banking sector's exposure to market risk remained low during the quarter under review as exposure to interest rate risk remains predominantly in the banking book.

3.38 Foreign exchange rate risk was low as most banking institutions were not undertaking proprietary trading positions, while client transactions were mainly currency switches. The banking sector had an overall positive net foreign exchange open position as at 30 September 2016.

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

Outlook

3.40 Liquidity risk and credit risk will remain the significant risks confronting the banking sector in the next quarter. However, overall, the banking sector is expected to achieve improved performance for the year ended 31 December 2016 on the back of strategic realignment and cost rationalisation, as well as adoption of innovative and cost effective distribution channels. The banking sector will continue to partner retail entities as agents in offering basic banking services.

RESERVE BANK OF ZIMBABWE
September 2016