BANK SUPERVISION DIVISION

BANKING SECTOR REPORT

FOR

QUARTER ENDED 31 DECEMBER 2017

1. EXECUTIVE SUMMARY

1.1. The banking sector remained sound and generally resilient as at 31 December 2017, on the back of adequate capitalisation, satisfactory asset quality, improved earnings and liquidity.

1.2. Stress testing results show that the banking sector is largely resilient to various shocks including credit, market and liquidity risks.

1.3. As at 31 December 2017, all banking institutions were adequately capitalised and complied with minimum regulatory capital requirements. Growth in banks' core capital levels was mainly attributed to capitalisation of retained earnings.

1.4. There was a general increase in the level of banking sector deposits and loans. The notable increase in deposits is partly attributed to increased exports receipts and the multiplier effect of the new deposits. The banking sector deposits are generally short term in nature thus constraining the capacity of banks to effectively support the long term funding requirements of the productive sectors of the economy.

1.5. Asset quality, as measured by the ratio of non - performing loans to total loans improved marginally during the review period, owing a number of measures employed by banking institutions, including enhanced credit risk management practices and greater usage of the Credit Registry.

1.6. Banking sector remained profitable, buoyed by non-interest income arising from a surge in digital transactional volumes as well as interest income from the core business of lending.

1.7. The banking sector has made significant progress in preparing for IFRS 9 implementation. The banking institutions are required to submit IFRS 9 compliant financial statements as at 31 December 2017 to the Reserve Bank by 31 March 2018.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. Nineteen banking institutions were operating as at 31 December 2017, as shown in the table below.

Table 1: Architecture of the Banking Sector

Type of Institution	Number
Commercial Banks	13
Building Societies	5
Savings Bank	1
Total	**19**
Development Financial Institutions (SMEDCO and IDBZ)	2
Total (including development financial institutions)	21

2.2. In addition, the institutions indicated in Table 2 below are under the purview of the Reserve Bank.

Table 2: Other Institutions under the supervision of Reserve Bank

Credit-only-MFIs	183
Deposit-taking MFIs	5

3. CONDITION AND PERFORMANCE OF THE BANKING SECTOR

3.1. The performance of the banking sector was satisfactory during the year ended 31 December 2017, as reflected by the improvement in the key risk and performance indicators. Total assets increased to $11.25 billion, while capitalisation and profitability indicators also reflected improved performance.

3.2. The financial soundness indicators for the review period are provided in Table 3 below.

Table 3: Financial Soundness Indicators

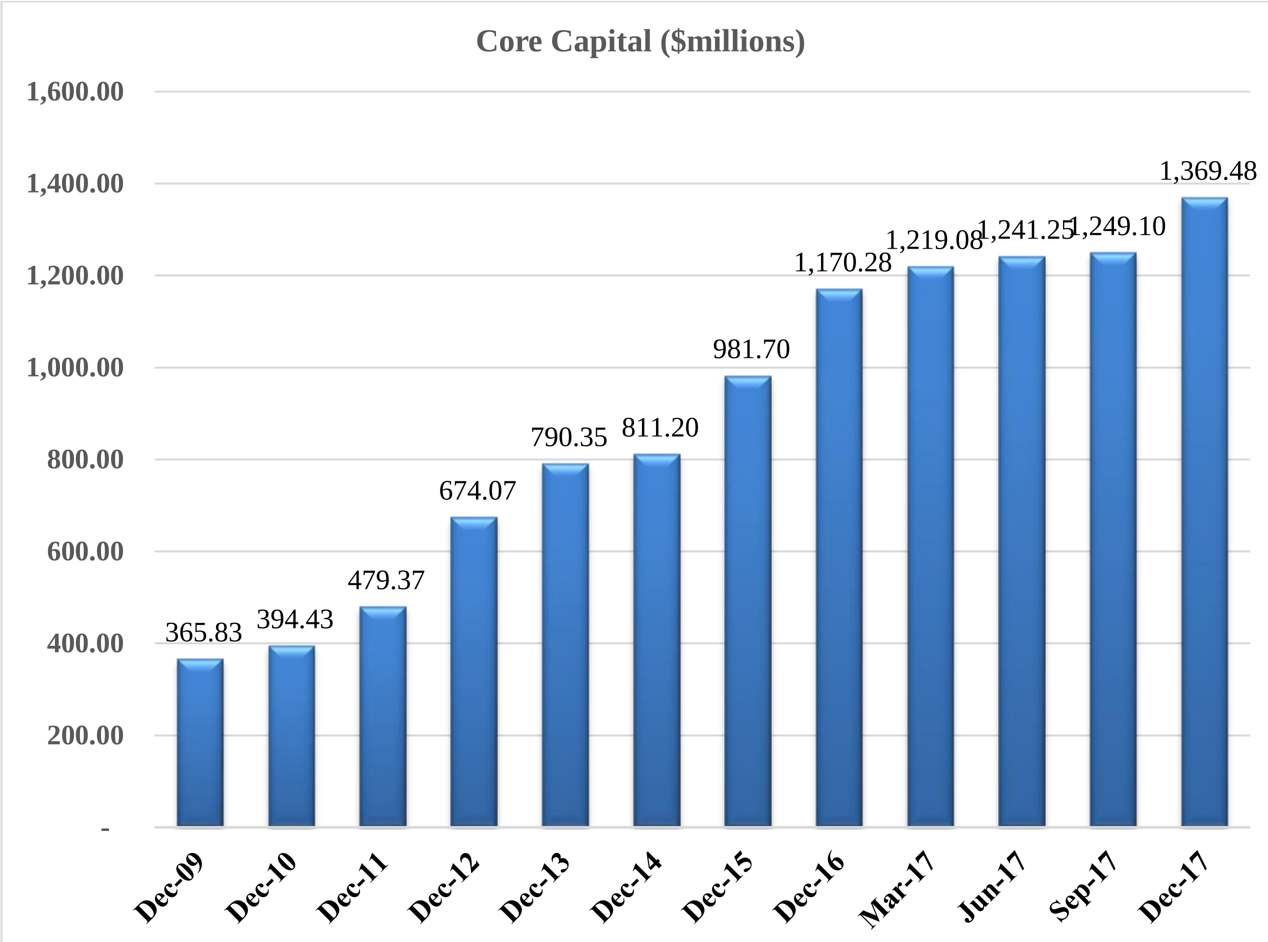
Key Indicators	Benchmark	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Total Assets	-	$8.73bn	$8.88bn	$9.65bn	$10.26bn	$11.25bn
Total Loans	-	$3.69bn	$3.59bn	$3.64bn	$3.73bn	$3.80bn
Net Capital Base	-	$1.34bn	$1.37bn	$1.38bn	$1.43bn	$1.58bn
Total Deposits	-	$6.51bn	$6.55bn	$6.99bn	$7.62bn	$8.48bn
Net Profit	-	$181.06m	$50.34m	$100.59m	$160.73m	$241.94m
Return on Assets	-	2.26%	0.69%	1.26%	1.89%	2.61%
Return on Equity	-	12.64%	3.65%	6.80%	11.15%	15.48%
Capital Adequacy Ratio	12%	23.70%	26.66%	26.89%	26.98%	27.63%
Loans to Deposits	70%	56.64%	54.82%	52.11%	49.01%	44.81%
Non-Performing Loans Ratio	5%	7.87%	8.39%	7.95%	8.63%	7.08%
Provisions to Adversely Classified Loans	-	68.51%	65.86%	126.29%	83.37%	90.26%
Liquidity Ratio	30%	61.91%	60.20%	66.87%	62.49%	62.62%
Cost to Income Ratio		79.20%	76.58%	72.50%	77.02%	75.36%

Capitalisation…

3.3. The aggregate core capital increased by 10.48%, from $1.24 billion as at 30 June 2017 to $1.37 billion as at 31 December 2017, on the back of improved earnings performance. All banking institutions were adequately capitalized and complied with minimum capital requirements.

3.4. The graph below shows banking sector core capital trends from December 2009 to December 2017:

Figure 1: Core Capital Trends 2009 to 2017

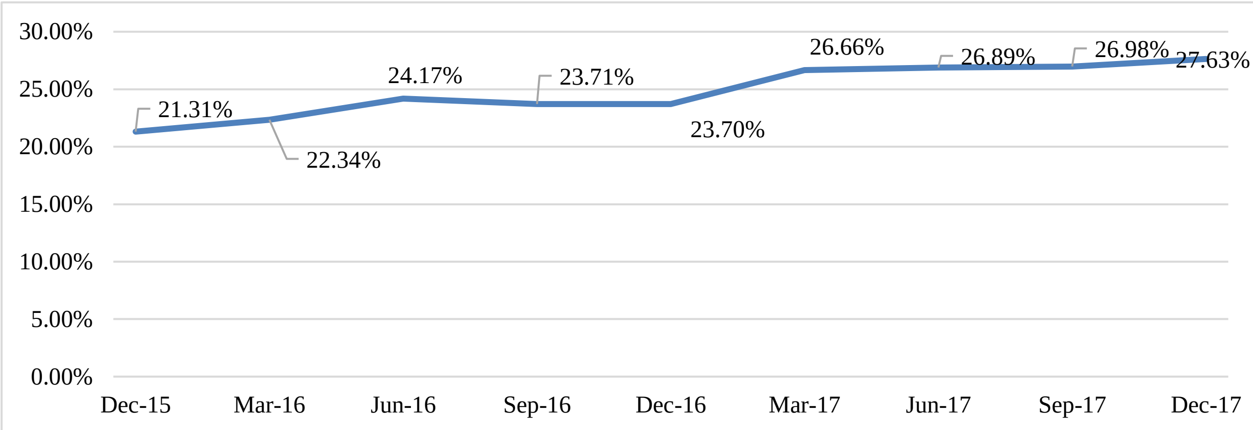


3.5. All banking institutions were adequately capitalised as reflected by average capital adequacy and tier 1 ratios of 27.63% and 23.97% as at 30 December 2017, against the required minima of 12% and 8%, respectively.

3.6. As at 31 December 2017, three (3) banking institutions were already compliant with the 2020 minimum capital requirements of $100 million for tier 1 strategic group, while other banking institutions remain on course with their capital plans.

3.7. The trend in the banking industry's average capital adequacy ratios (CARs) from December 2015 to December 2017 is shown in the figure below.

Figure 2: Capital Adequacy Ratios Trend

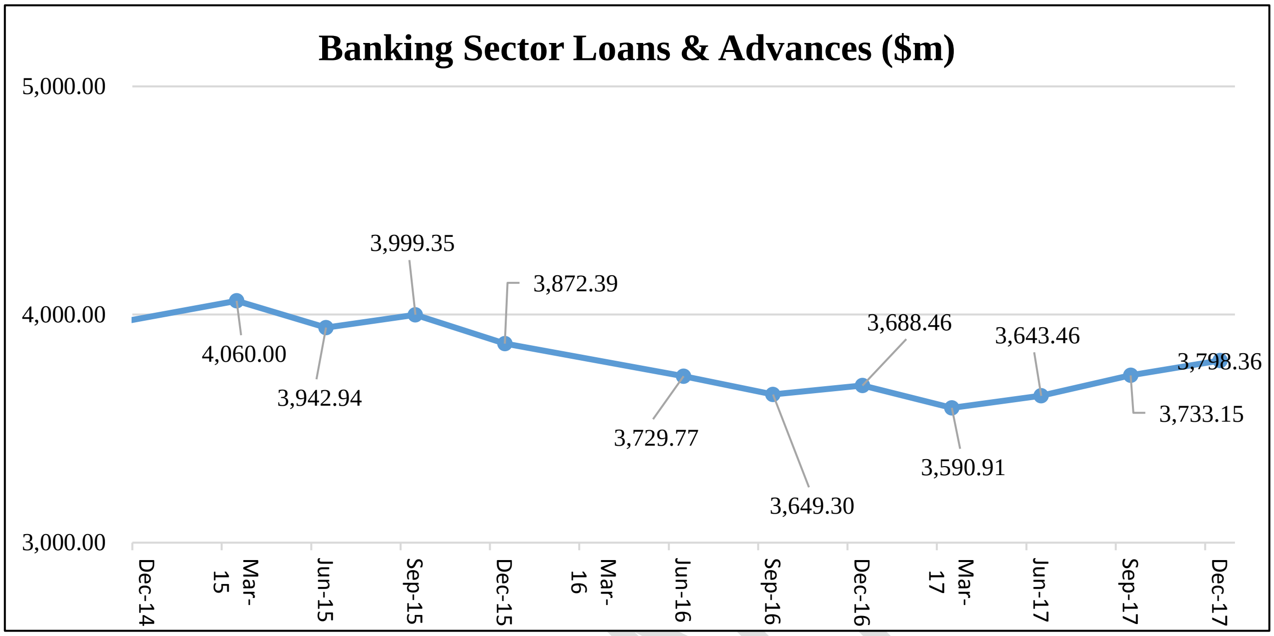


3.8. The Reserve Bank is monitoring implementation of the banking institutions' capital plans and progress towards compliance with the 2020 minimum capital requirements, on an on-going basis.

Asset Quality...

3.9. Banking sector loans and advances increased from $3.64 billion as at 30 June 2017 to $3.80 billion as at 31 December 2017. The figure below shows trend in banking sector loans and advances.

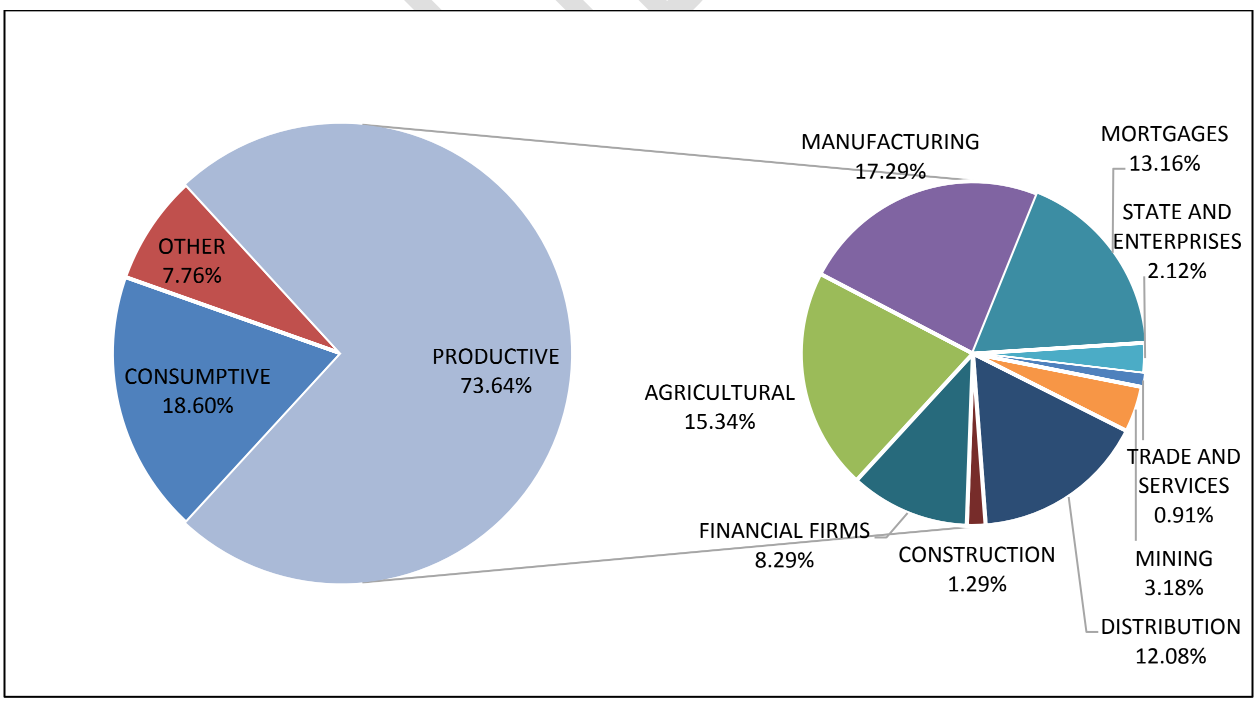
Figure 3: Banking Sector Loans & Advances



Distribution of Loans and Advances…

3.10. Lending to the productive sectors of the economy constituted 73.64% of total sector loans as at 31 December 2017 as shown in the diagram below.

Figure 4: Sectoral Distribution of Loans as at 31 December 2017

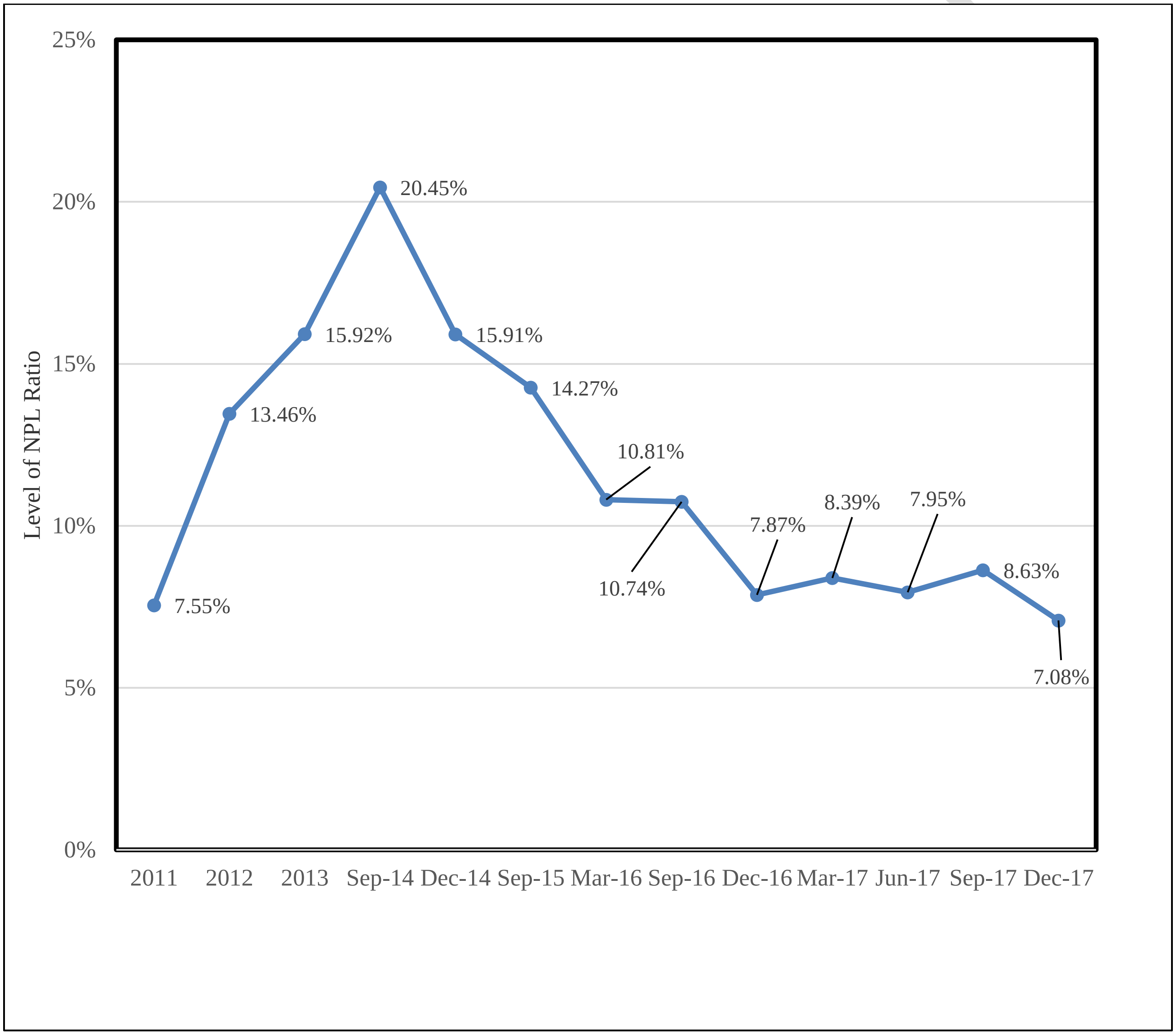


Non-Performing Loans

3.11. The ratio of non-performing loans to total loans improved from 8.63% as at 30 September 2017 to 7.08% as at 31 December 2017, as banks continue to strengthen their credit risk management systems as well as greater use of the Credit Registry.

3.12. The trend in the level of non-performing loans is indicated in the figure below:

Figure 5: Trend in Non-Performing Loans 2011 – December 2017

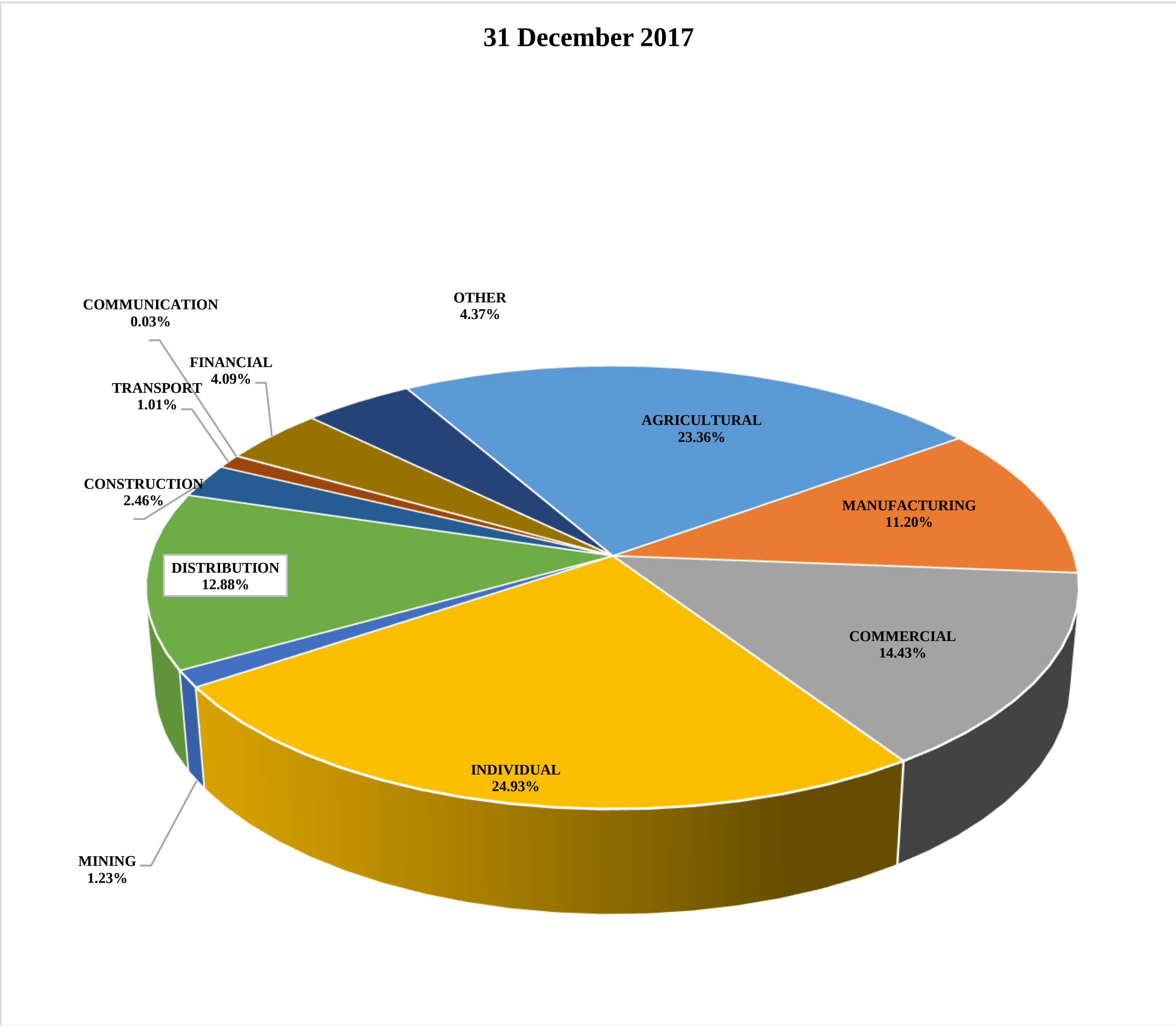


3.13. The Reserve Bank continues to monitor the level of NPLs and the effectiveness of banks' credit risk management practices.

Sectoral Distribution of NPLs

3.14. Sectors with the largest proportions of NPLs were individuals (24.93%) and agriculture (23.36%) as shown in the figure below.

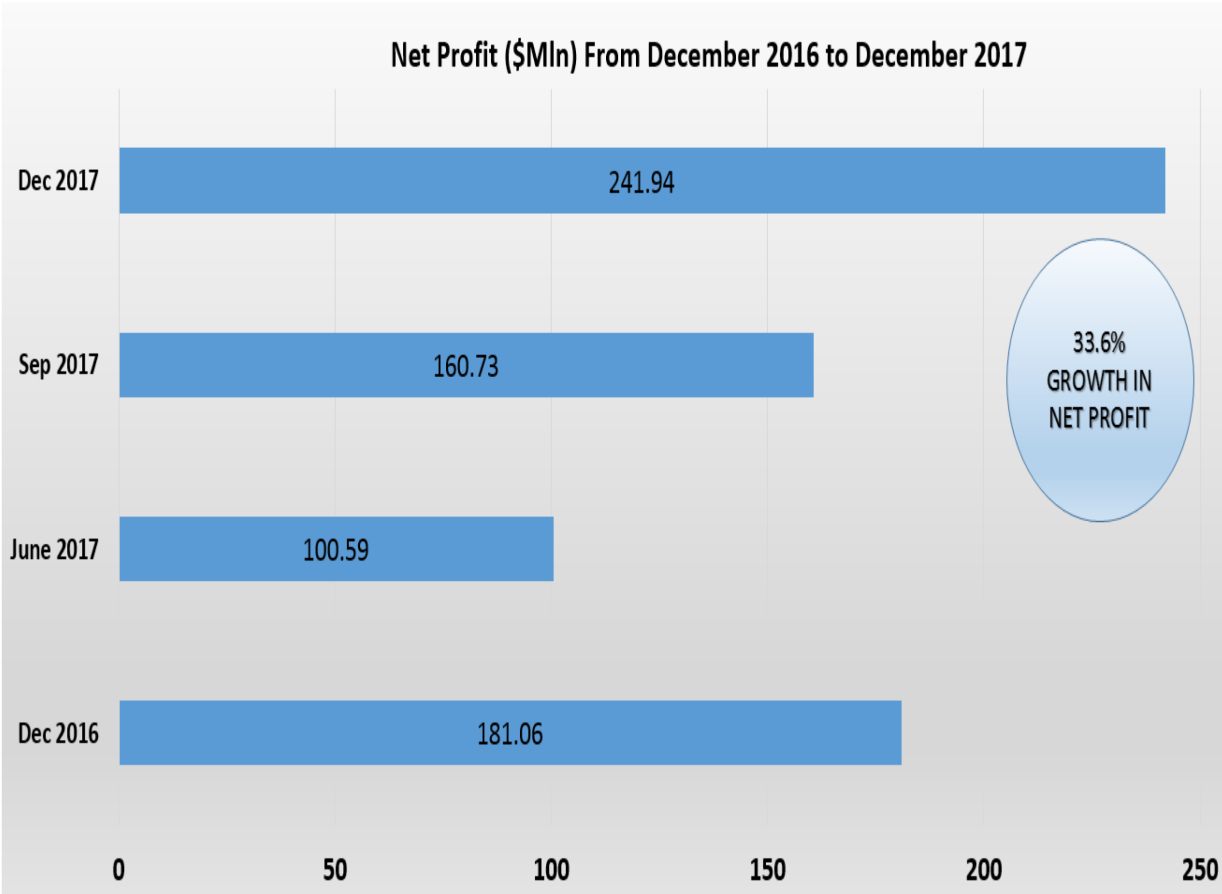
Figure 6: Sectoral Distribution of Non-Performing Loans



Earnings Performance...

3.15. The net profit for the period ended 31 December 2017 amounted to $241.94 million, representing an increase of 33.62%, from $181.06 million reported in corresponding period in 2016.

Figure 7: Earnings Performance for the year ended 31 December 2017

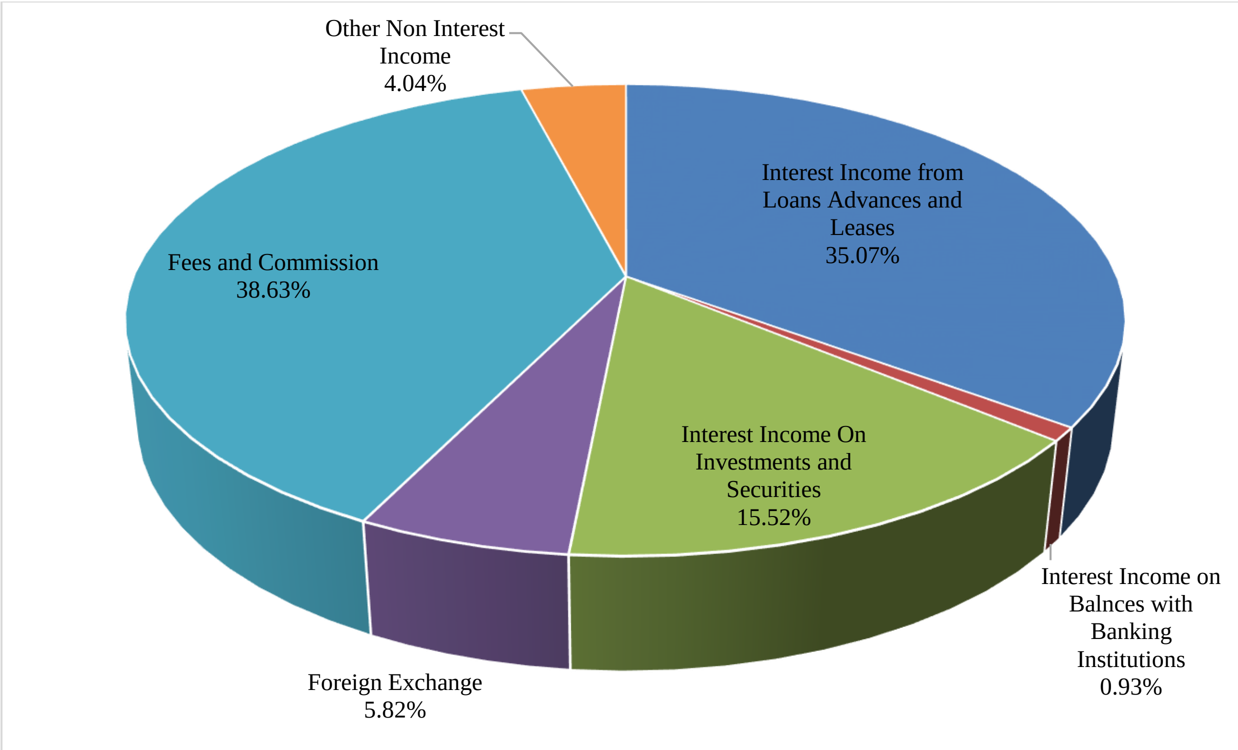


3.16. Eighteen (18) out of 19 operating banking institutions recorded profits during the period ended 31 December 2017.

3.17. Banking sector profitability was mainly driven by non-interest income from fees & commission and interest income from loans & advances which accounted for 38.63% and 35.07%, of total income for the year ended 31 December 2017, respectively. Non-interest income was buoyed by increases in digital transactional volumes, due to the greater usage of plastic money in the economy.

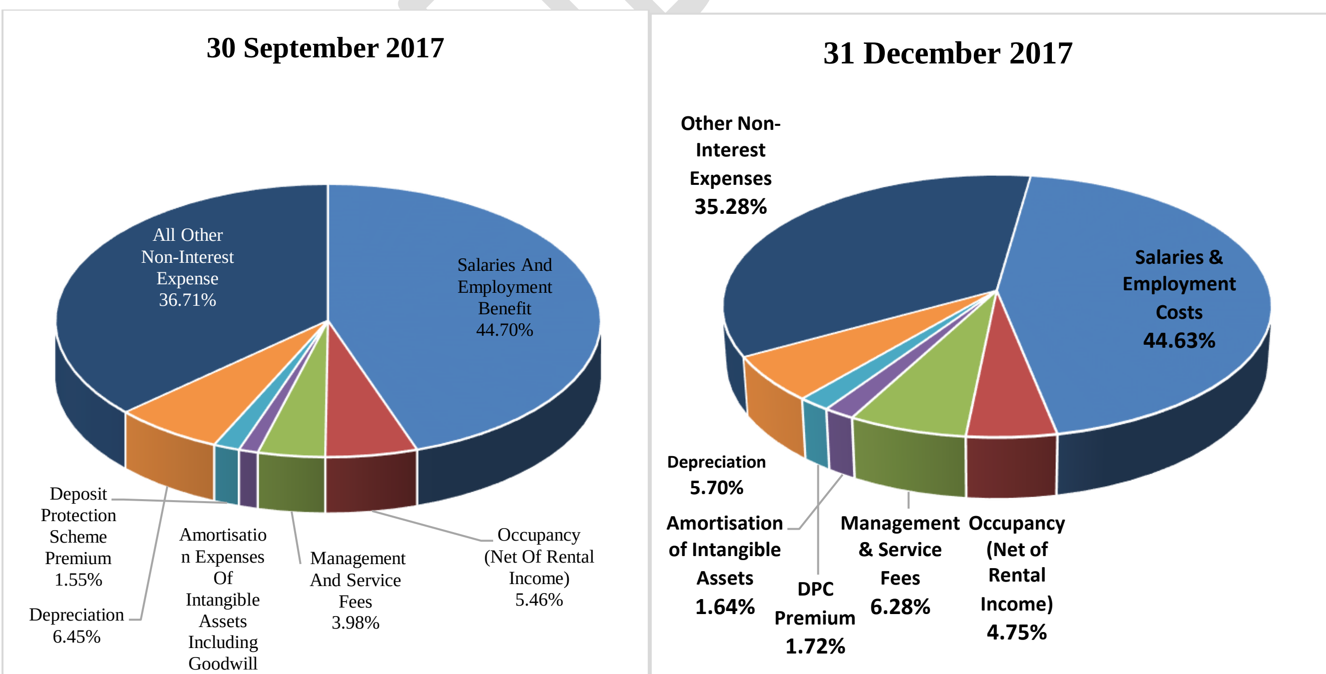
3.18. The income mix for the sector is shown in the figure below:

Figure 8: Banking Sector Income Mix as at 31 December 2017



3.19. As at 31 December 2017, salaries & employment benefits constituted 44.63% of total banking sector costs as shown in the figure below.

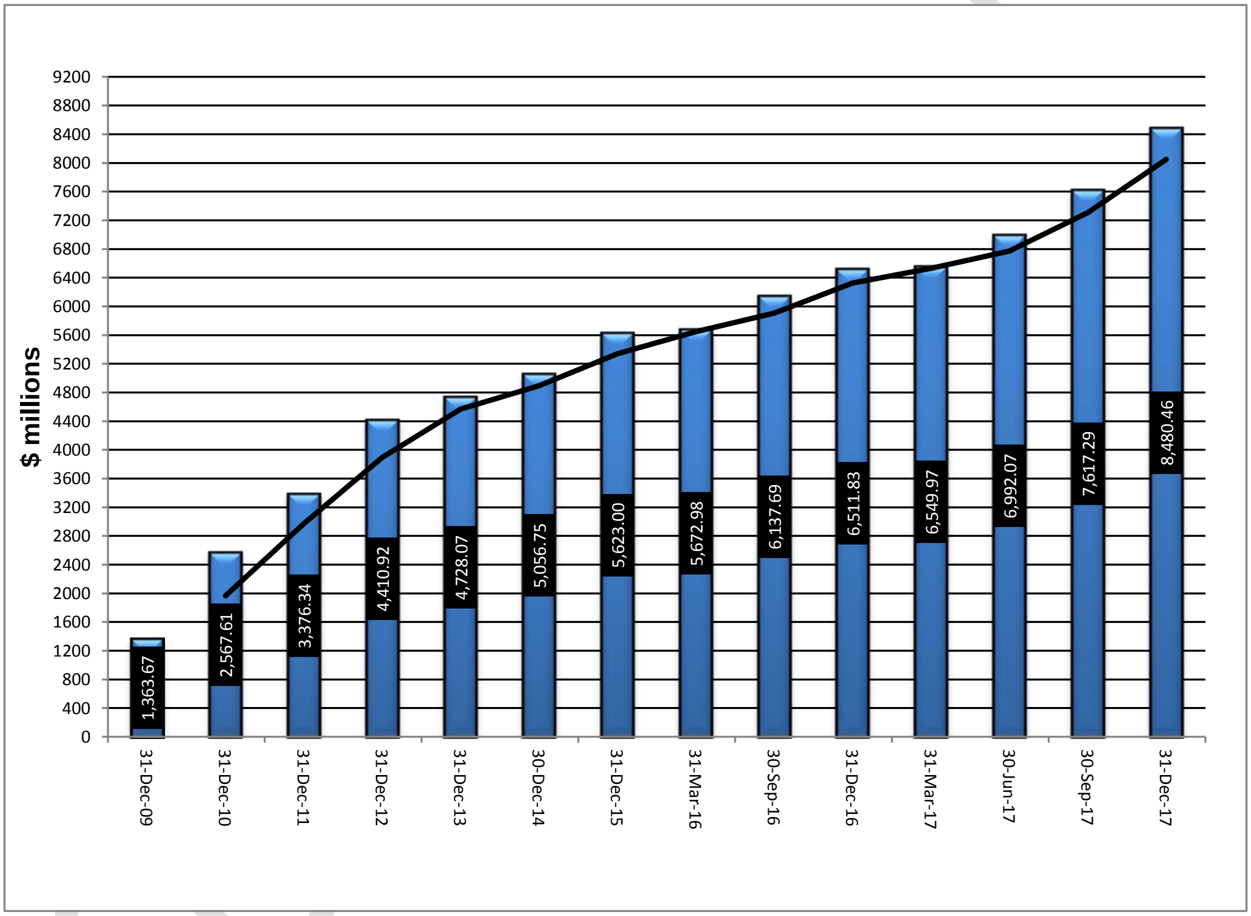
Figure 9: Banking Sector Operating Expenses



Liquidity and Funds Management...

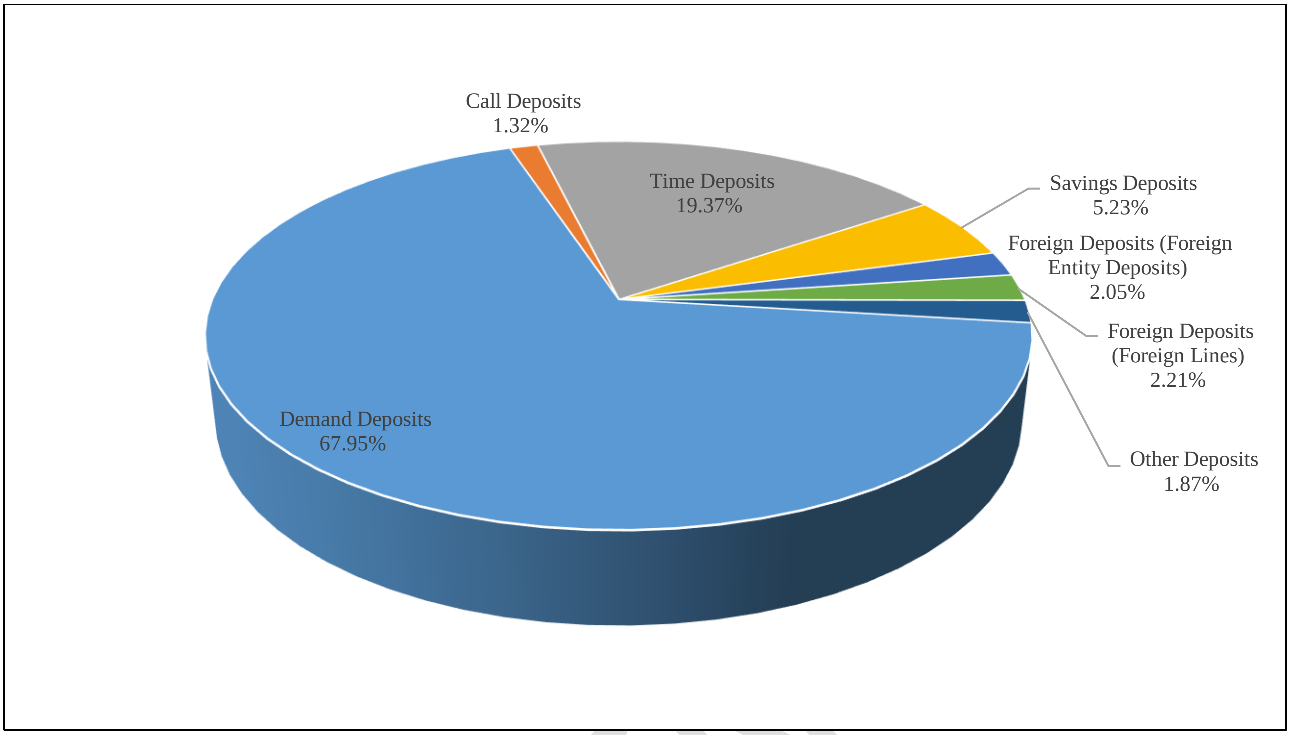
3.20. Banking sector deposits increased by 11.29% from $7.62 billion as at 30 September 2017 to $8.48 billion as at 31 December 2017. The figure below shows the trend of banking sector deposits over the period 31 December 2009 to 31 December 2017.

Figure 10: Trend of Banking Sector Deposits



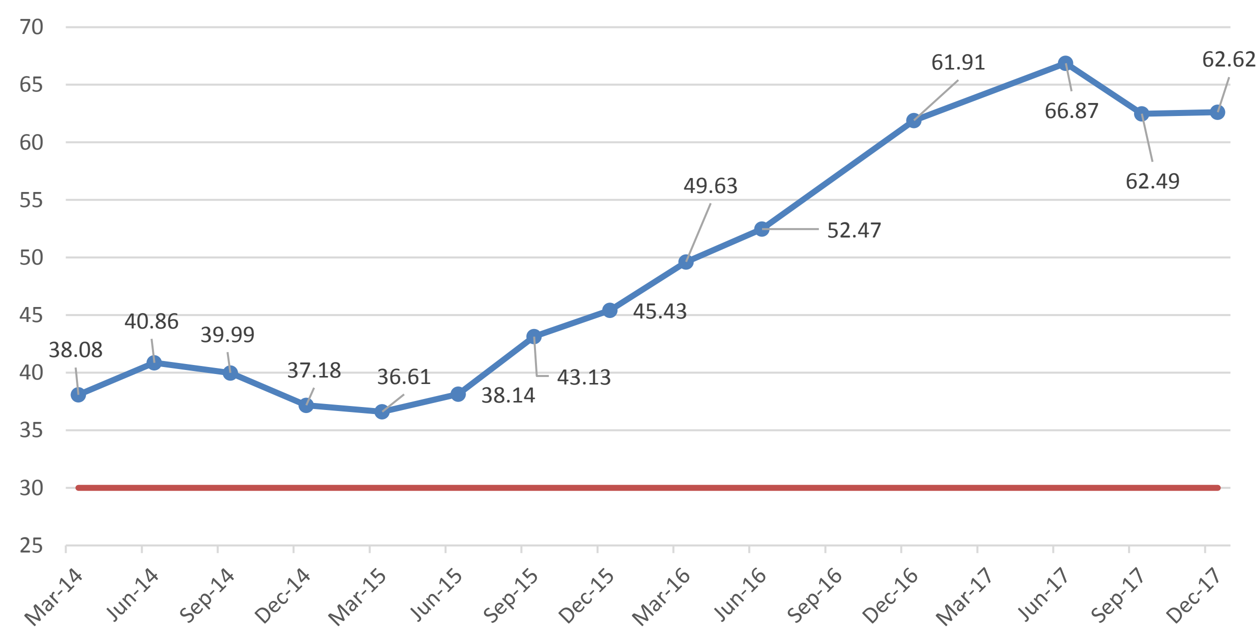
3.21. Banking sector deposits were dominated by demand and time deposits, which accounted for 67.95% and 19.37% of total deposits, respectively, as at 31 December 2017. The composition of total banking sector deposits as at 31 December 2017 is depicted in Figure 11 below.

Figure 11: Banking Sector Deposits Mix as at 31 December 2017



3.22. The average prudential liquidity ratio for the banking sector of 62.62% as at 31 December 2017, was above the regulatory requirement of 30%. Figure 12 below shows the trend in the banking sector average prudential liquidity ratio since March 2014.

Figure 12: Prudential Liquidity Ratio Trend (%)



3.23. All banks were compliant with the minimum prudential liquidity ratio as at 31 December 2017.

3.24. The high average prudential liquidity ratio is largely attributed to high levels of treasury bills (TBs) held by banking institutions. TBs account for 44.94% of net available liquid assets of $5.39 billion.

3.25. Notwithstanding the high average prudential liquidity ratios recorded across the sector, the banking industry continued to experience underlying foreign currency shortages on the back of structural challenges in the economy.

3.26. The Reserve Bank will continue to work towards a cash-lite society by encouraging increased usage of digital platforms.

Sensitivity to Market Risk...

3.27. The banking sector's exposure to market risk was considered low, in light of the low level of trading book assets and depressed trading activity in financial markets.

3.28. All banking institutions were resilient to a major level interest rate risk shock of 10% increase or decrease in interest rates as their capital adequacy ratios would remain above the prescribed minimum of 12%.

3.29. As at 31 December 2017, twelve (12) banking institutions had liability sensitive books, implying that the banks would benefit from a decrease in market interest rates.

3.30. All banking institutions were resilient to a major foreign exchange risk shock of an appreciation of the USD against major currencies by 15%.