BANK SUPERVISION DIVISION

BANKING SECTOR REPORT

FOR

QUARTER ENDED 31 MARCH 2018

1. EXECUTIVE SUMMARY

1.1. The banking sector remained stable and continued to exhibit resilience as at 31 March 2018, buoyed by adequate capitalization and sustained earnings performance.

1.2. During the period under review, all banking institutions were adequately capitalised and compliant with prescribed minimum capital requirements.

1.3. Banking sector deposits declined marginally during the quarter under review from $8.48 billion as at 31 December 2017 to $8.24 billion as at 31 March 2018. Banking sector loans and advances marginally declined by 0.53%, from $3.80 billion as at 31 December 2017 to $3.78 billion as at 31 March 2018.

1.4. Asset quality marginally declined as reflected by ratio of non - performing loans to total loans of 7.06% as at 31 March 2018, from 7.08% as at 31 December 2017. The continued improvement in the ratio is largely due to a number of measures instituted by banking institutions, including enhanced credit underwriting standards, risk management practices and increased usage of the Credit Registry.

1.5. The banking sector recorded improved earnings, on the back non-interest income, mainly fees and commissions, as a result of the rise in digital transactional volumes, as well as interest income from the core business of lending.

1.6. As part of IFRS 9 implementation preparedness, all banking institutions submitted IFRS 9 compliant financial statements to the Reserve Bank by 31 March 2018, based on financial statements for the year ended 31 December 2017. It was noted that there were some provisioning adjustments which, however, did not have a major impact on the institutions' capital levels.

1.7. Stress testing results indicate that the banking sector can withstand moderate shocks including credit, market and liquidity risks.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 31 March 2018, there were 19 operating banking institutions and other institutions under the purview of Reserve Bank.

Table 1: Architecture of the Banking Sector

Type of Institution	Number
Commercial Banks	13
Building Societies	5
Savings Bank	1
Total Banking Institutions	**19**
Other Institutions under the supervision of Reserve Bank	
Credit-only-MFIs	185
Deposit-taking MFIs	5
Development Financial Institutions (SMEDCO and IDBZ)	2

3. CONDITION AND PERFORMANCE OF THE BANKING SECTOR

3.1. The performance of the banking sector was considered satisfactory over the quarter ended 31 March 2018, on the back of improvement in capitalization, profitability and asset quality indicators.

3.2. The financial soundness indicators for the review period are shown in Table 2 below.

Table 2: Financial Soundness Indicators

Key Indicators	Benchmark	Mar-17	Sep-17	Dec-17	Mar-18
Total Assets	-	$8.87bn	$10.26bn	$11.25bn	$10.95bn
Total Loans	-	$3.57bn	$3.73bn	$3.80bn	$3.78bn
Net Capital Base	-	$1.37bn	$1.43bn	$1.58bn	$1.61bn

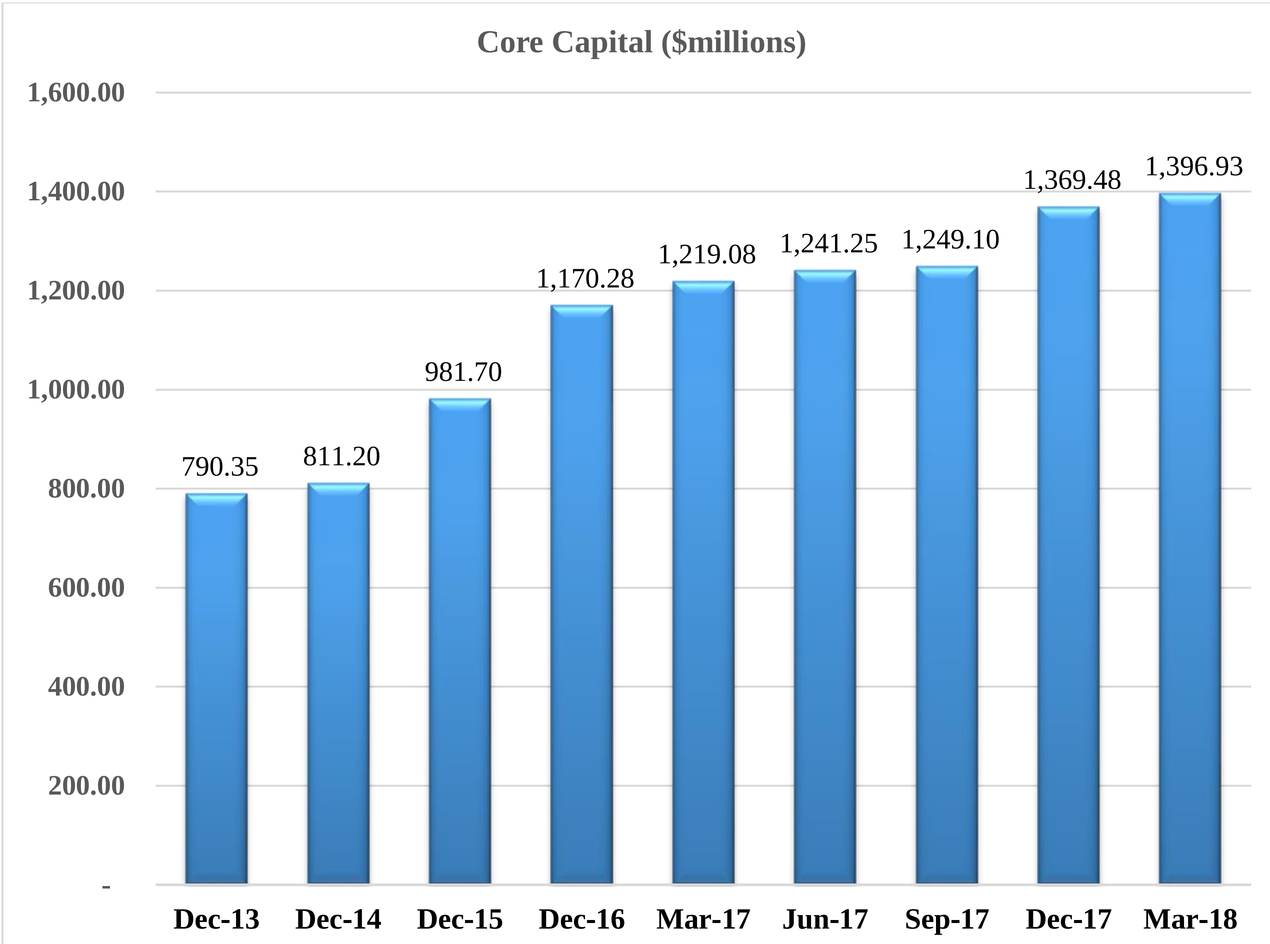
Key Indicators	Benchmark	Mar-17	Sep-17	Dec-17	Mar-18
Total Deposits	-	$6.55bn	$7.62bn	$8.48bn	$8.24bn
Net Profit	-	$50.34m	$160.73m	$241.94m	$85.58m
Return on Assets	-	0.69%	1.89%	2.61%	0.92%
Return on Equity	-	3.65%	11.15%	15.48%	5.19%
Capital Adequacy Ratio	12%	26.66%	26.98%	27.63%	27.91%
Loans to Deposits	70%	54.82%	49.01%	44.81%	45.88%
Non-Performing Loans Ratio	5%	8.39%	8.63%	7.08%	7.06%
Provisions to Adversely Classified Loans	-	190.68%	83.37%	90.26%	106.96%
Liquidity Ratio	30%	63.79%	62.49%	62.62%	62.37%
Cost to Income Ratio		76.58%	77.02%	75.36%	68.58%

Capitalisation…

3.3. The banking sector continues to build capital, through organic growth, to meet the 2020 regulatory minimum core capital. The aggregate core capital increased by 2.19%, from $1.37 billion as at 31 December 2017 to $1.40 billion as at 31 March 2018, on the back of improved earnings performance.

3.4. The trend in the banking sector core capital levels for the period December 2013 to March 2018 is shown in the graph below:

Figure 1: Core Capital Trends 2013 to March 2018

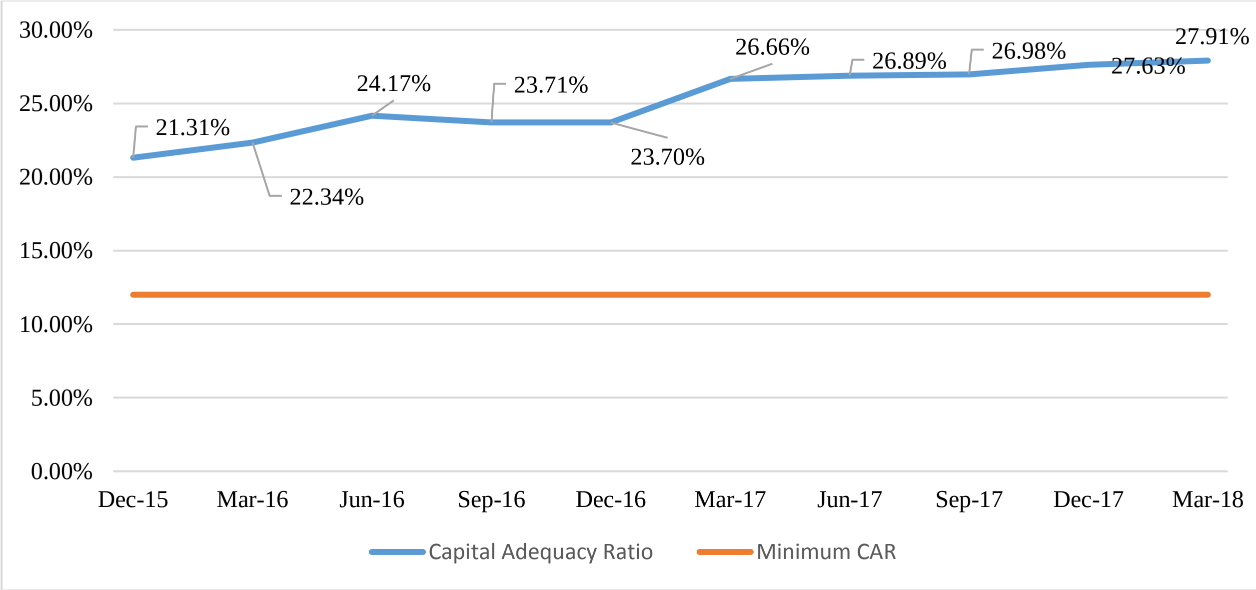


3.5. As at 31 March 2018, three (3) banking institutions had surpassed the 2020 minimum core capital requirements of $100 million for tier 1 strategic group, while other banking institutions remain on course with their capital plans.

3.6. All banking institutions were adequately capitalised as at 31 March 2018. The average capital adequacy and tier 1 ratios were 27.91% and 24.16%, against the required minima of 12% and 8%, respectively.

3.7. The banking industry's average capital adequacy ratios (CARs) from December 2015 to March 2018 are shown in the figure below.

Figure 2: Capital Adequacy Ratios Trend



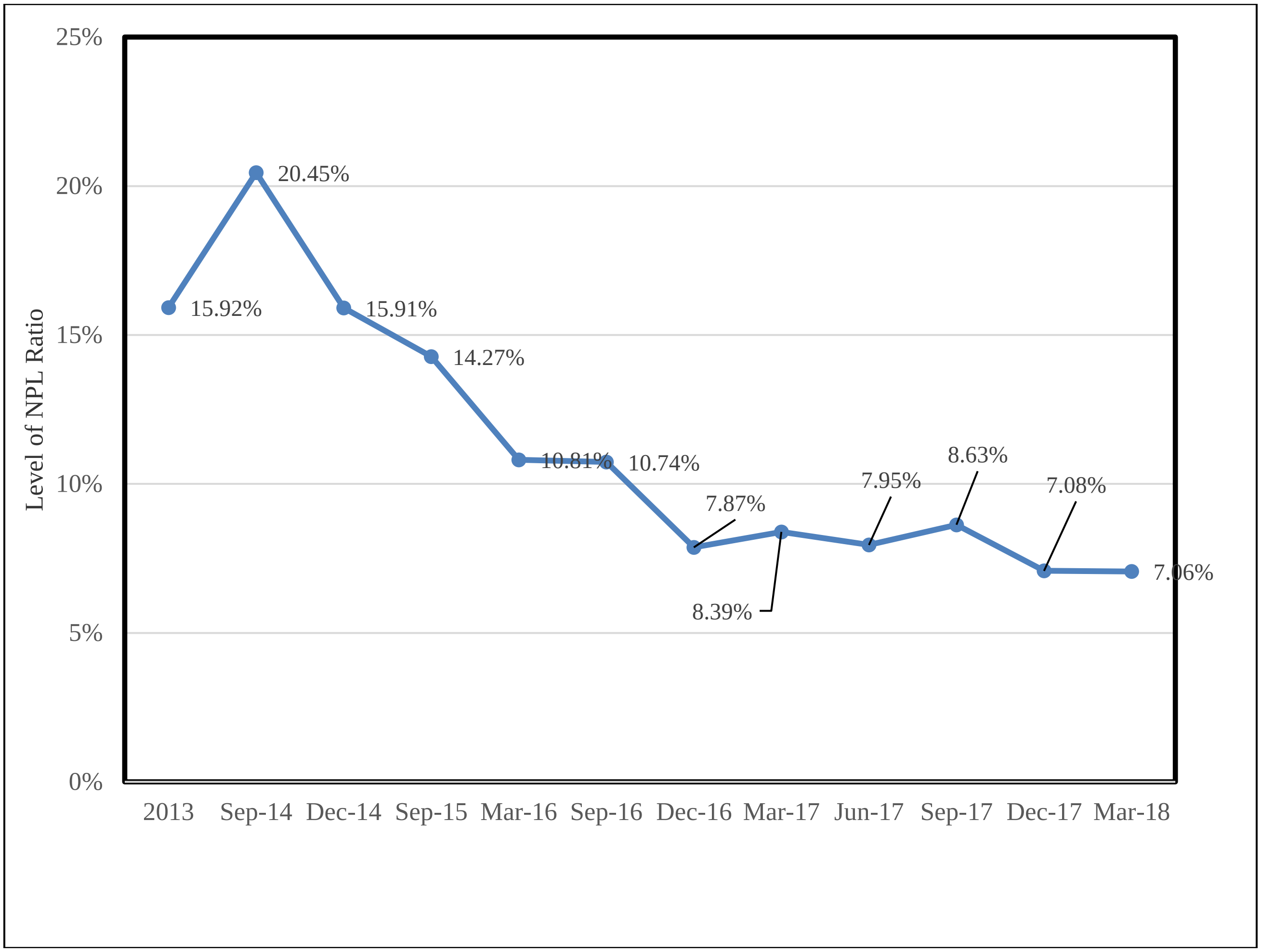
3.8. The Reserve Bank continues to monitor implementation of the banking institutions' recapitalisation plans and progress towards attainment of the 2020 minimum capital thresholds, on an on-going basis.

Asset Quality...

3.9. The quality of the banking sector loan portfolio continues to improve as reflected by the ratio of non-performing loans (NPLs) to total loans ($3.78bn) of 7.06% as at 31 March 2018, from high levels of 20.45% in September 2014. The combined impact of continued enhancement in the banks' credit risk management systems, use of the Credit Registry, as well as, disposals of NPLs to ZAMCO largely explains the improvement in asset quality.

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

Figure 3: Trend in Non-Performing Loans ratio 2013 – March 2018

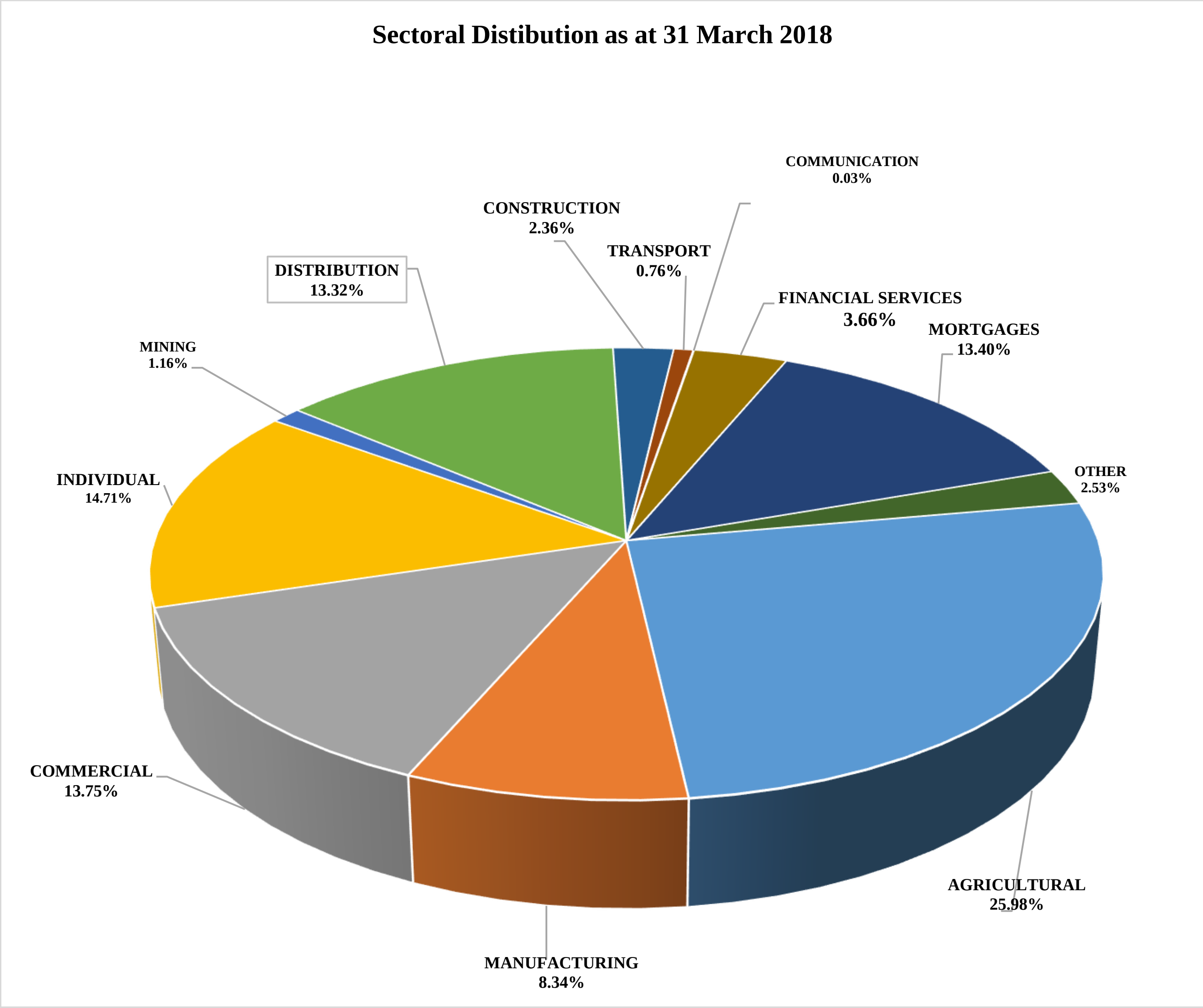


3.11. The Reserve Bank continues to monitor the effectiveness of strategies implemented by banking institutions to reduce NPLs which is expected to result in stronger banks' balance sheets thus enhancing banking sector's safety and soundness.

Sectoral Distribution of NPLs

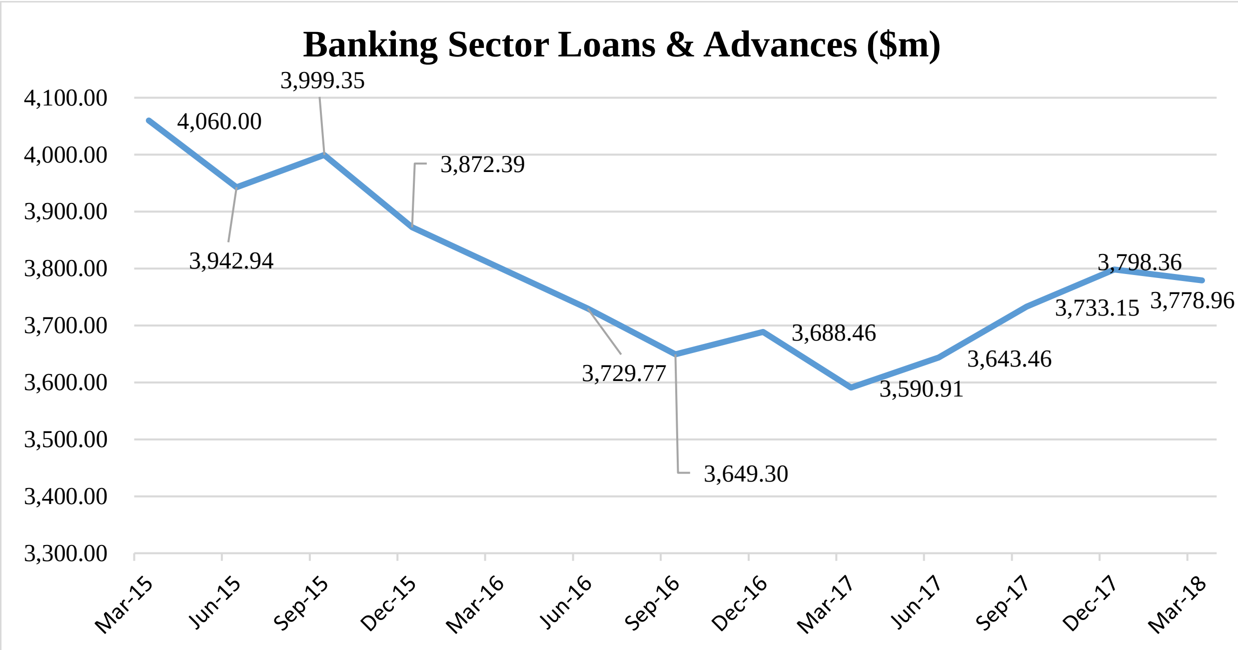
3.12. As at 31 March 2018, sectors with the largest proportions of NPLs were agriculture (25.98%) and individuals (14.71%) as shown in the figure below.

Figure 4: Sectoral Distribution of Non-Performing Loans



3.13. Banking sector loans and advances marginally declined by 0.53% from $3.80 billion as at 31 December 2017 to $3.78 billion as at 31 March 2018. The figure below shows trend in banking sector loans and advances.

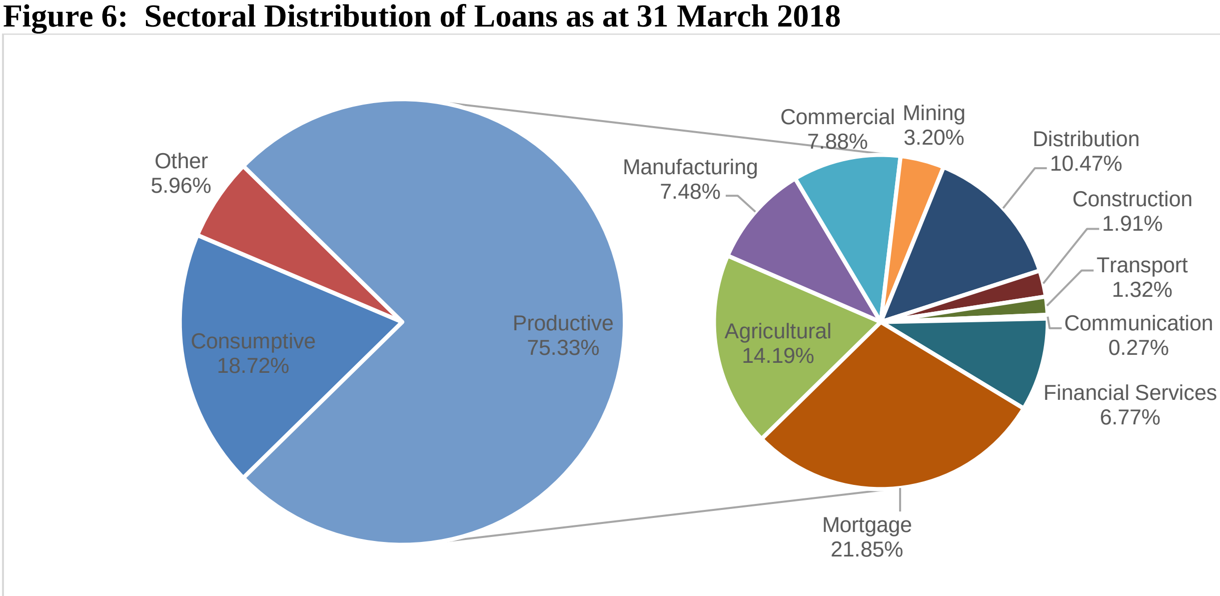
Figure 5: Banking Sector Loans & Advances



Distribution of Loans and Advances…

3.14. Banking sector lending continued to be predominantly composed of loans to productive sectors of the economy constituting 66.28% of total sector loans as at 31 March 2018 as shown in the diagram below.

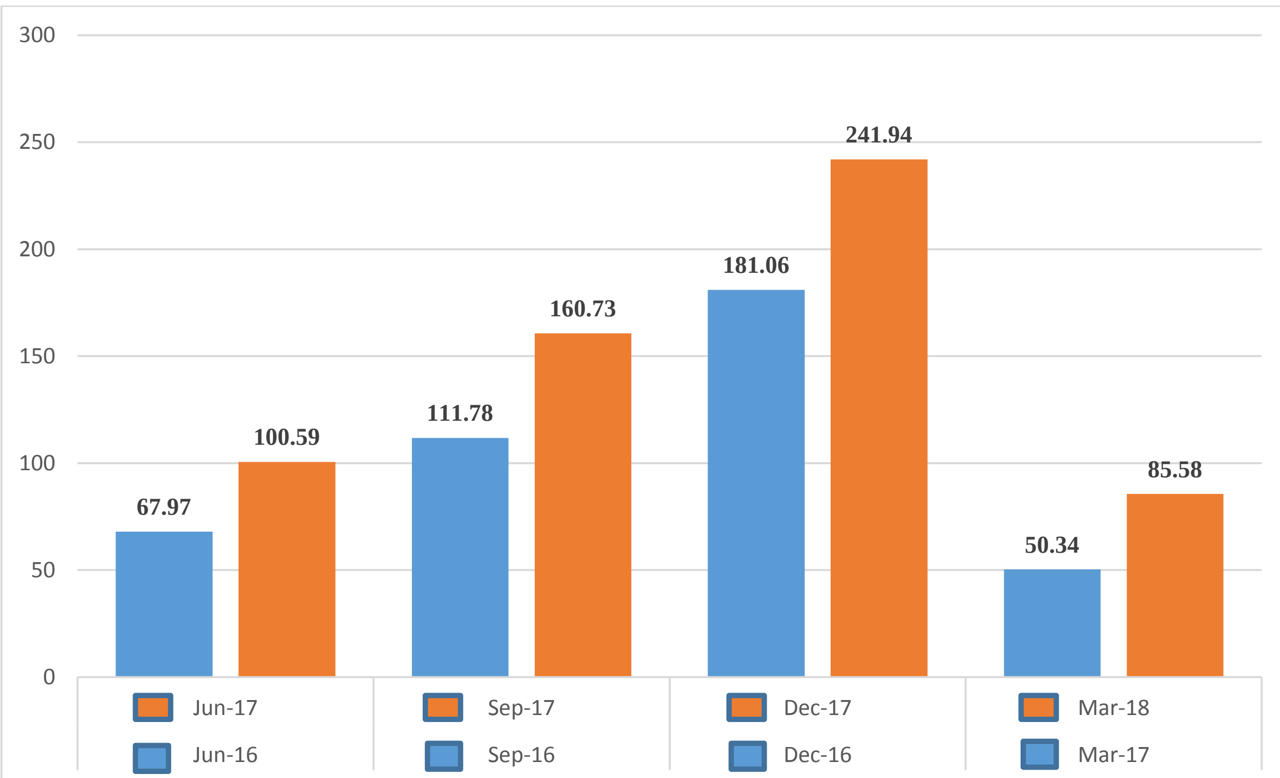
Figure 6: Sectoral Distribution of Loans as at 31 March 2018



Earnings Performance...

3.15. The banking sector remained profitable, with an aggregate net profit of $85.58 million for the quarter ended March 2018, representing a 70.0% increase from $50.34 million reported in the corresponding period in 2017 due to a combination of interest income and transactional income. The increase in profitability translated to improved average return on assets and return on equity from 0.69% and 3.65%, to 0.92% and 5.19%, respectively.

Figure 7: Earnings Performance for the quarter ended 31 March 2018

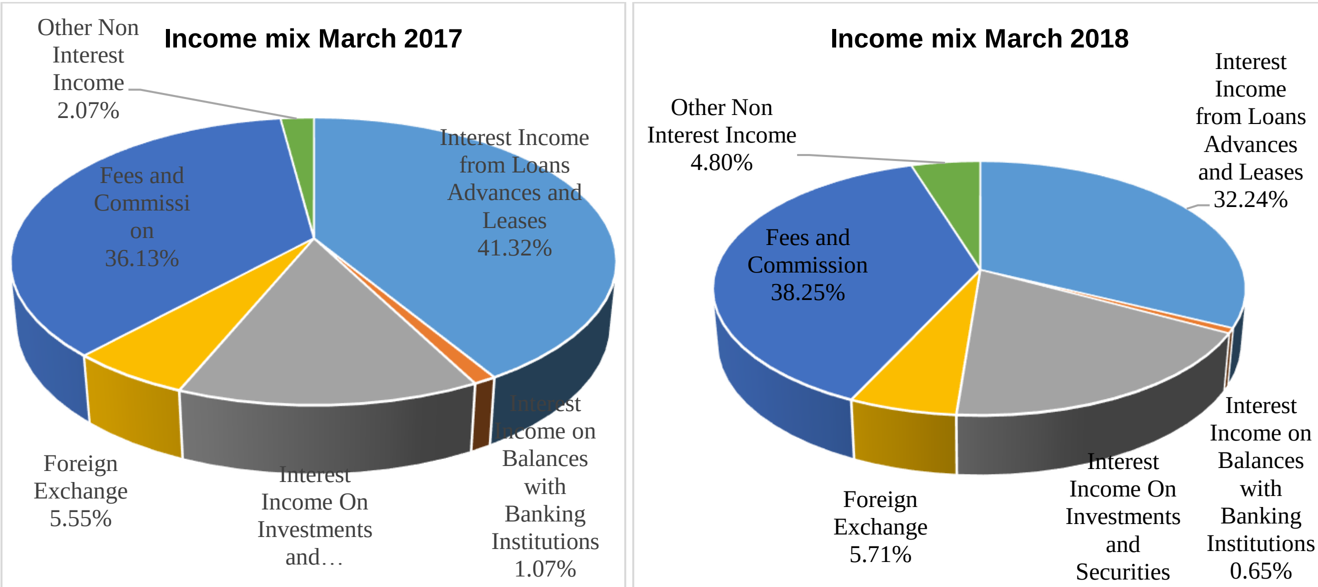


3.16. Eighteen (18) out of 19 operating banking institutions recorded profits during the period under review.

3.17. The income mix in the banking sector was skewed towards fees and commissions driven by transactional income due to increased uptake of plastic money.

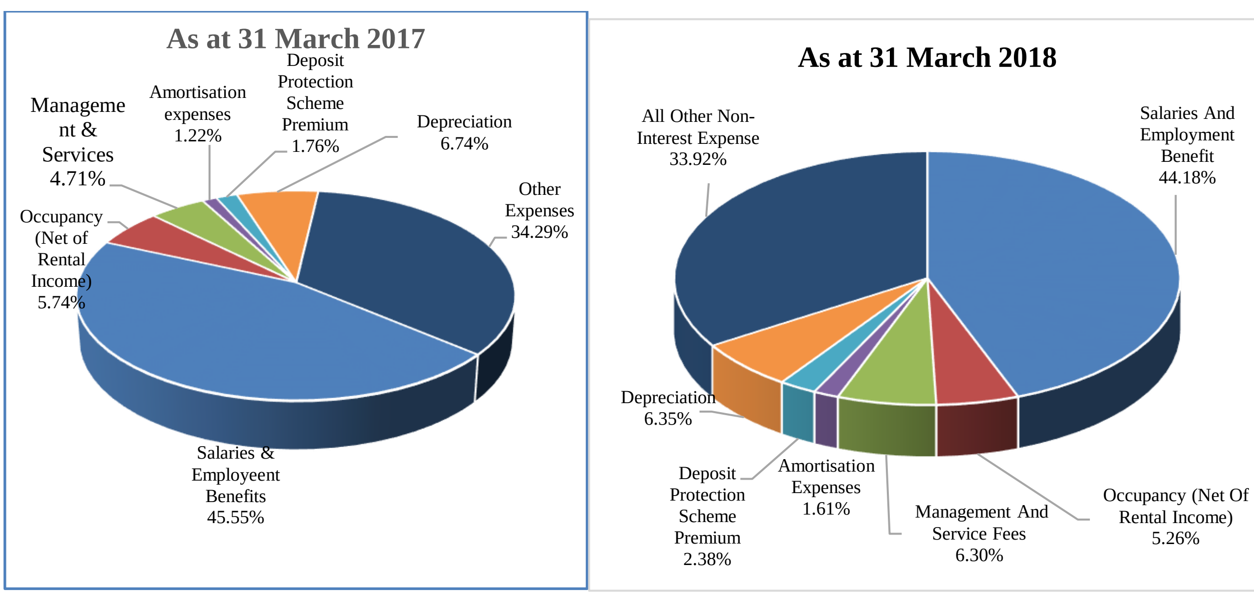
3.18. The income mix for the sector is shown in the figure below:

Figure 8: Banking Sector Income Mix as at 31 March 2017 and 31 March 2018



3.19. As at 31 March 2018, salaries & employment benefits constituted 44.18% of total banking sector costs as shown in the figure below.

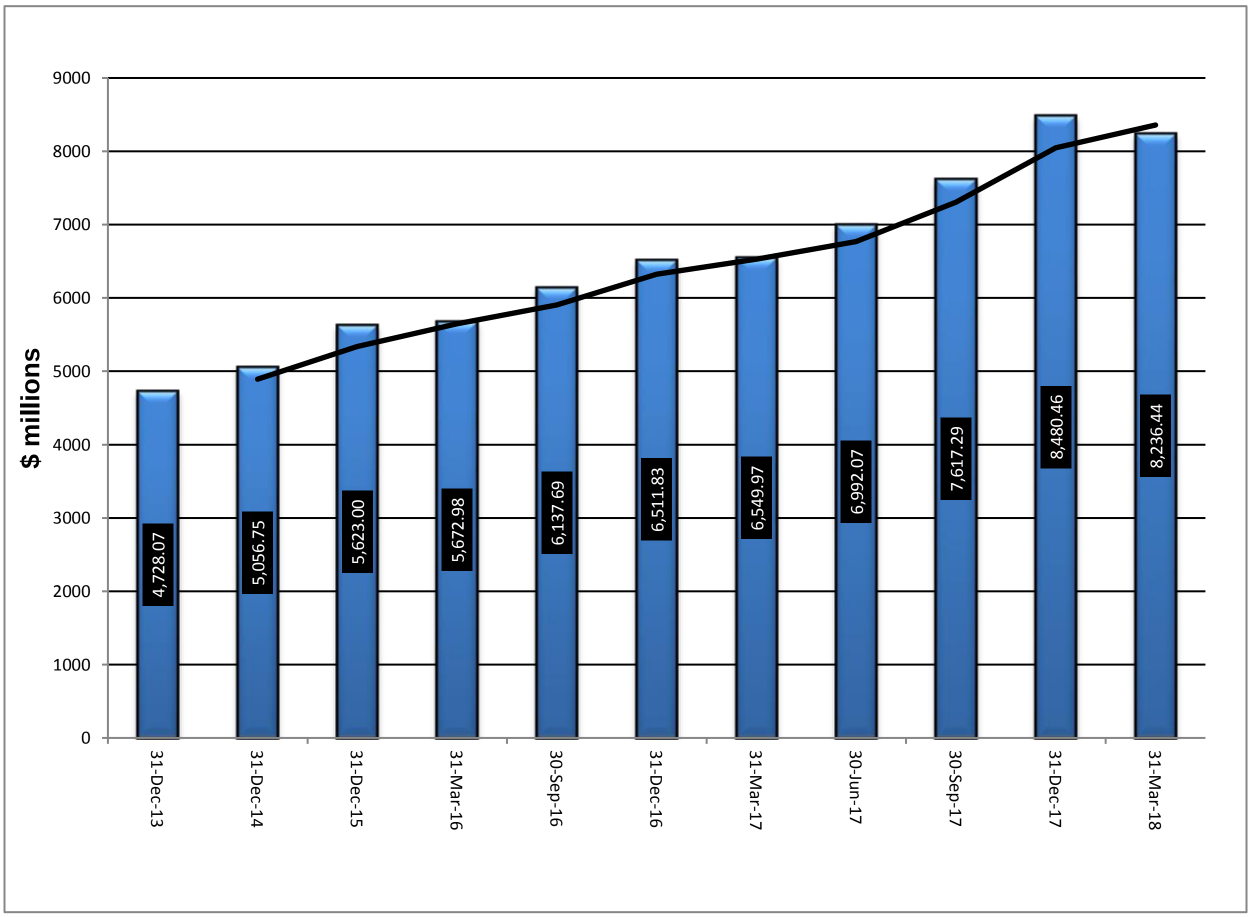
Figure 9: Banking Sector Operating Expenses



Liquidity and Funds Management...

3.20. The aggregate banking sector deposits declined by 2.91%, from \$8.48 billion as at 31 December 2017 to \$8.24 billion as at 31 March 2018. During the quarter, there was an increased uptake of the Reserve Bank 7% savings bond, mainly by wholesale depositors such as insurance companies and pension funds. The figure below shows the trend of banking sector deposits over the period 31 December 2013 to 31 March 2018.

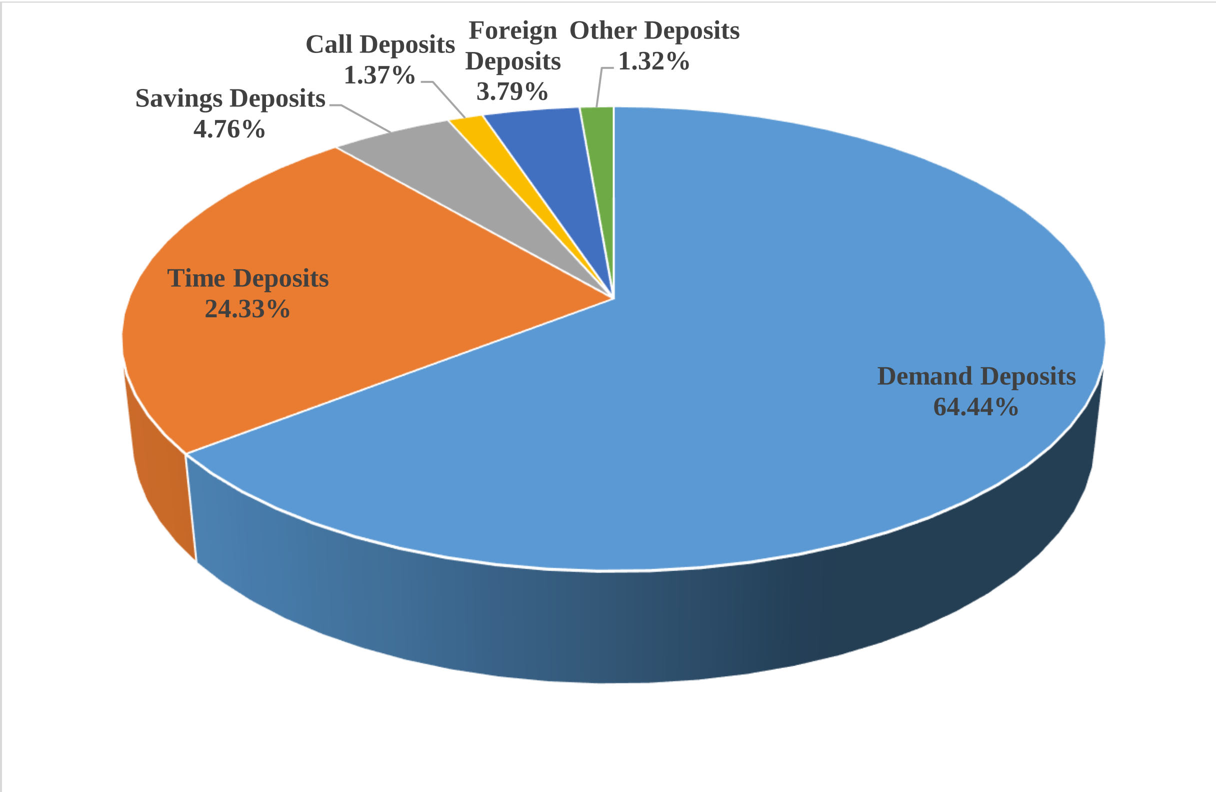
Figure 10: Trend of Banking Sector Deposits



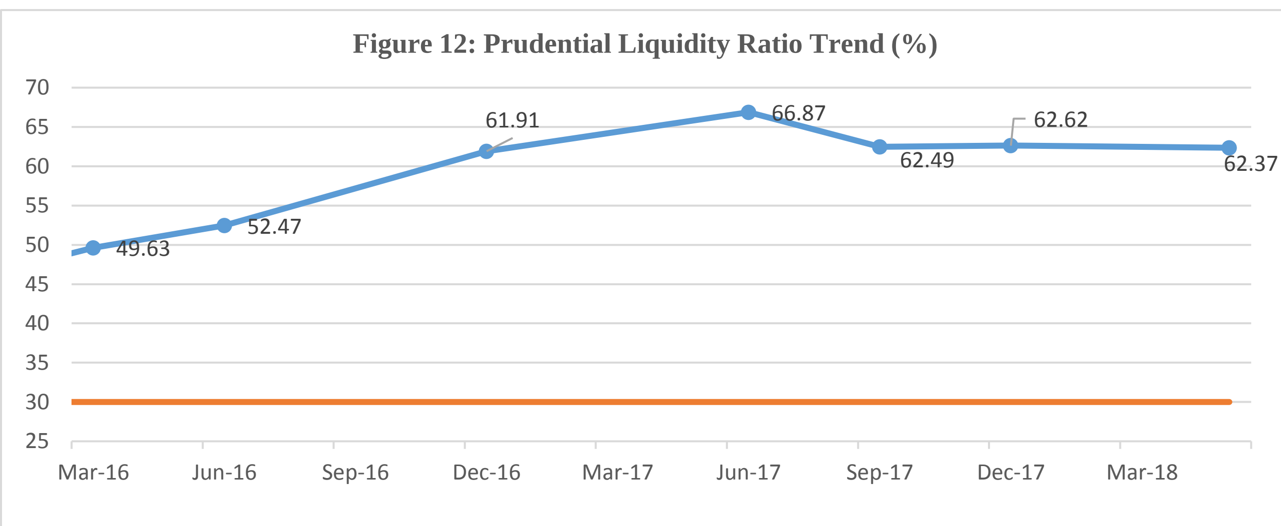
3.21. Banking sector was predominantly funded by demand deposits which accounted for 64.47% of total deposits as at 31 March 2018.

3.22. The composition of total banking sector deposits as at 31 March 2018 is depicted in Figure 11 below.

Figure 11: Banking Sector Deposits Mix as at 31 March 2018



3.23. The average prudential liquidity ratio for the banking sector was 62.37% as at 31 March 2018, against the minimum regulatory requirement of 30%. The figure below shows the trend in the banking sector average prudential liquidity ratio since March 2016.



3.24. All banks, except one, were compliant with the minimum prudential liquidity ratio as at 31 March 2018.

3.25. The high average prudential liquidity ratio is largely attributed to high levels of treasury bills (TBs) held by banking institutions, which accounted for 46.38% of net available liquid assets of $5.30 billion held by banking institutions.

3.26. Notwithstanding the high average prudential liquidity ratios recorded across the sector, the banking industry continued to be confronted by foreign currency shortages due to structural challenges in the economy.

3.27. The Reserve Bank will continue to encourage use of plastic money through digital platforms.

Sensitivity to Market Risk...

3.28. The banking sector's exposure to foreign exchange rate risk remained low on account of limited trade in foreign exchange by banks and are not taking positions on their own account.

3.29. 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%.

3.30. As at 31 March 2018, fourteen (14) banking institutions had liability sensitive books, implying that the banks would benefit from a decrease in market interest rates.

3.31. Stress testing results indicate that the sector is resilient to a major foreign exchange risk shock of an appreciation of the USD against major currencies by 15% as the average capital adequacy ratio will remain above 12%, at 20.56%.

31 March 2018