BANK SUPERVISION DIVISION

BANKING SECTOR REPORT

FOR

QUARTER ENDED 31 DECEMBER 2014

1. EXECUTIVE SUMMARY

1.1. The banking sector remained generally stable during the quarter ended 31 December 2014. A few banks are facing liquidity and solvency challenges.

1.2. The number of operating banking institutions were 19 as at 31 December 2014. Interfin Banking Corporation's banking licence was cancelled on 31 December 2014, upon expiry of the bank's curatorship.

1.3. As at 31 December 2014, thirteen (13) banking institutions were compliant with the minimum capital levels. The six (6) non-compliant banks are instituting various measures towards compliance.

1.4. As at 31 December 2014, banking sector deposits amounted to **$5.08 billion**, whilst loans & advances were **$4.01 billion**, translating to a loan to deposits ratio of **78.94%.**

1.5. Credit risk remained the most significant challenge facing the banking sector. The average non-performing loans to total loans (NPL/TL) ratio declined from 20.45% as at 30 September 2014 to **15.91%** as at 31 December 2014.

1.6. The general market illiquidity has impacted negatively on the sector's ability to effectively promote financial intermediation.

1.7. The banking sector largely remained profitable, with 14 out of 19 operating banking institutions recording profits for year ended 31 December 2014.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 31 December 2014, the composition of the banking sector was as shown in the table below.

Architecture of the Banking Sector

Type of Institution	Number
Commercial Banks	14
Merchant Banks	1
Building Societies	3
Savings Bank	1
Total Banking Institutions	**19**
Credit-only-MFIs	147

2.2. On 31 December 2014, the Reserve Bank cancelled the banking licence for Interfin Banking Corporation, which had been under the management of a Curator since 11 June 2012. The cancellation followed various abortive recapitalisation initiatives. The Reserve Bank subsequently commenced the legal processes for provisional liquidation.

2.3. Following the amendments to the Banking Act, the Infrastructure Development Bank of Zimbabwe (IDBZ) and the Small & Medium Enterprises Development Corporation (SMEDCO) are now under the supervision of the Reserve Bank.

3. CONDITION AND PERFORMANCE OF THE SECTOR

3.1. Notwithstanding the challenging macro-economic environment, the banking sector generally remained resilient.

3.2. The following financial soundness indicators highlight the condition and performance of the banking sector as at 31 December 2014:

Banking Sector Key Indicators

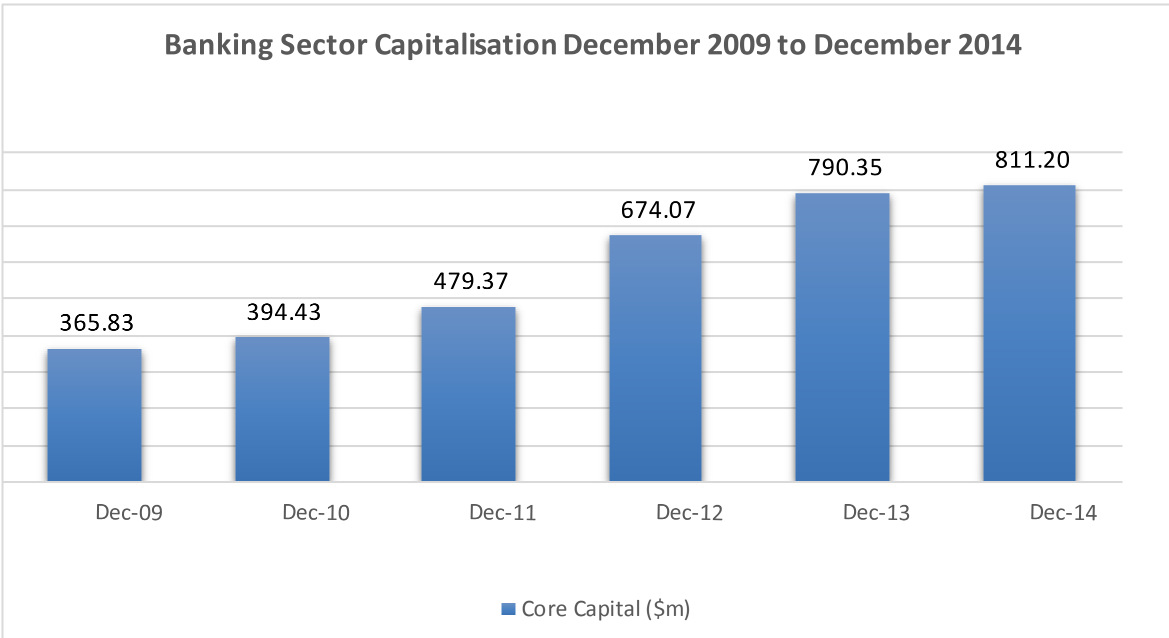
Key Indicators	Dec -09	Dec-10	Dec -11	Dec - 12	Dec - 13	Jun - 14	Sep -14	Dec -14
Total Assets	$2.19 bn	$3.69 bn	$4.74 bn	$6.12 bn	$6.74 bn	$6.90 bn	$7.11 bn	$7.12 bn
Total Loans	$693 m	$1.56 bn	$2.76 bn	$3.56 bn	$3.08 bn	$3.81 bn	$3.84 bn	$4.01 bn
Net Capital Base	$382 m	$458 m	$512 m	$644 m	$706 m	$893 m	$913 m	$926 m
Total Deposits	$ 1.36 bn	$ 2.31 bn	$ 3.04 bn	$4.41 bn	$ 4.73 bn	$4.96 bn	$4.96 bn	$5.08 bn
Net Profit	$9.50 m	$37.95 m	$86.00m	$69.20 m	$4.46 m	$14.50 m	$7.47 m	$50.84 m
Return on Assets	0.60%	-2.02%	2.43%	1.64%	0.06%	0.49%	0.37%	0.92%
Return on Equity	2.47%	0.57%	15.13%	9.17%	0.51%	2.72%	2.54%	5.37%
Capital Adequacy Ratio	27.26%	27.34%	13.51%	13.07%	14.01%	18.56%	18.20%	17.33%
Loans to Deposits	50.99%	86.25%	90.59%	93.27%	102.36%	76.82%	77.41%	78.94%
ACL/TL	1.80%	10.95%	7.55%	13.46%	15.92%	18.49%	*20.45%	15.91%
Provisions to ACL	112.81%	887.71%	57.53%	207.45%	70.88%	39.29%	47.76%	54.72%
Net Interest Margin	3.29%	5.75%	8.21%	14.81%	15.26%	2.03%	4.20%	4.24%
Liquidity Ratio	97.44%	70.88%	56.80%	55.70%	40.57%	38.20%	38.20%	34.76%
Cost to Income Ratio	94.38%	86.93%	82.17%	86.41%	96.60%	95.77%	98.64%	93.72%

*Includes Interfin

Capital Adequacy…

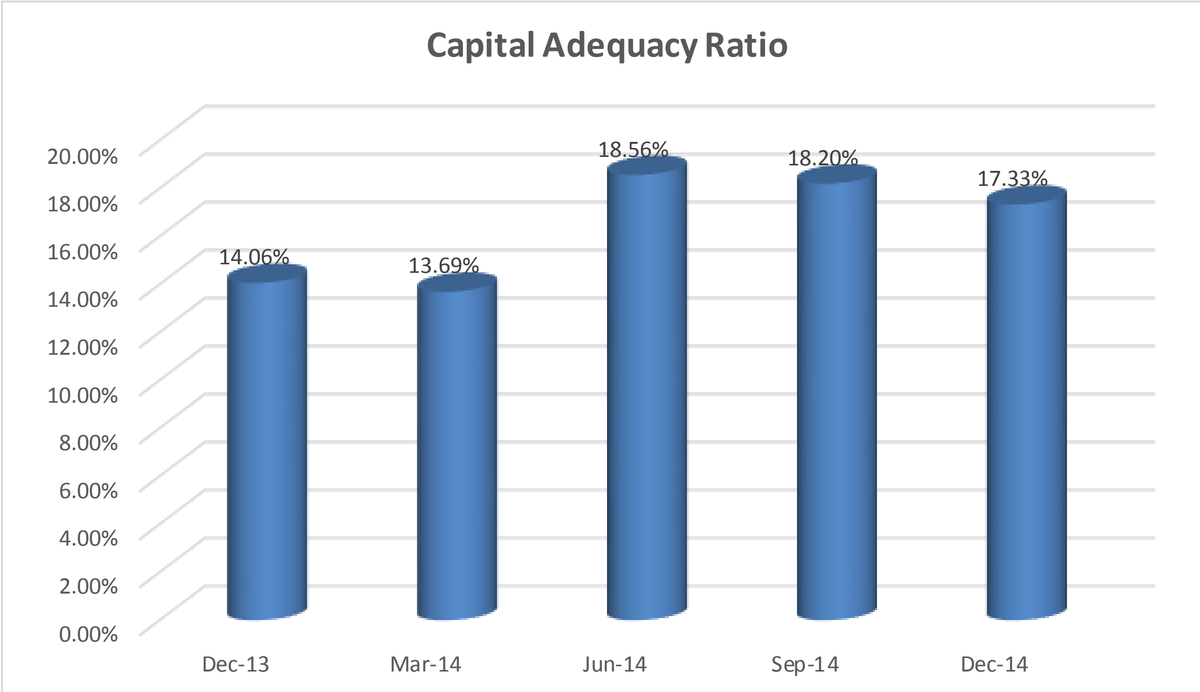
3.3. The banking sector reported a core capital base of **$811.20** million as at 31 December 2014 up from $790.35 million as at 31 December 2013. The increase in the capital position was largely attributed to retained earnings recorded by some banking institutions during the year, as well as, capital injection from shareholders.

3.4. The graph below shows banking sector capitalisation trends from 2009 to 2014:



3.5. The banking sector remained adequately capitalised during the period ended 31 December 2014, with the average capital adequacy ratio above the required minimum regulatory capital adequacy ratio of 12%.

3.6. The trend in the banking industry's average capital adequacy ratios (CARs) from December 2013 to December 2014 is indicated in the figure below.



3.7. The increase in CAR was attributable to the decline in risk weighted assets (sector loans & advances) with respect to capitalisation levels.

3.8. The persistent losses being recorded by some banking institutions and the high non-performing loans in the sector pose a threat to the sector's capital levels.

3.9. In August 2014, the Reserve Bank revised minimum capital requirements to promote strategic groups based on current banking classes noted in Section 6 of the Banking Act. The details are summarised in table below.

Minimum Capital Requirements Based on Strategic Tiers

Segments	Type of Institution	Capital requirements		Activities
		Current	Proposed	
Tier I	Commercial banks & All foreign banks	$25 million	$100 million	Core banking activities plus additional services

Segments	Type of Institution	Capital requirements		Activities
		Current	Proposed	
Tier II	Commercial banks, Merchant banks, Building societies, Finance & Discount houses	$25 million	$25 million	Core banking activities only
Tier III	Deposit Taking Microfinance banks	$5 million	$10 million	Deposit Taking Microfinance activities

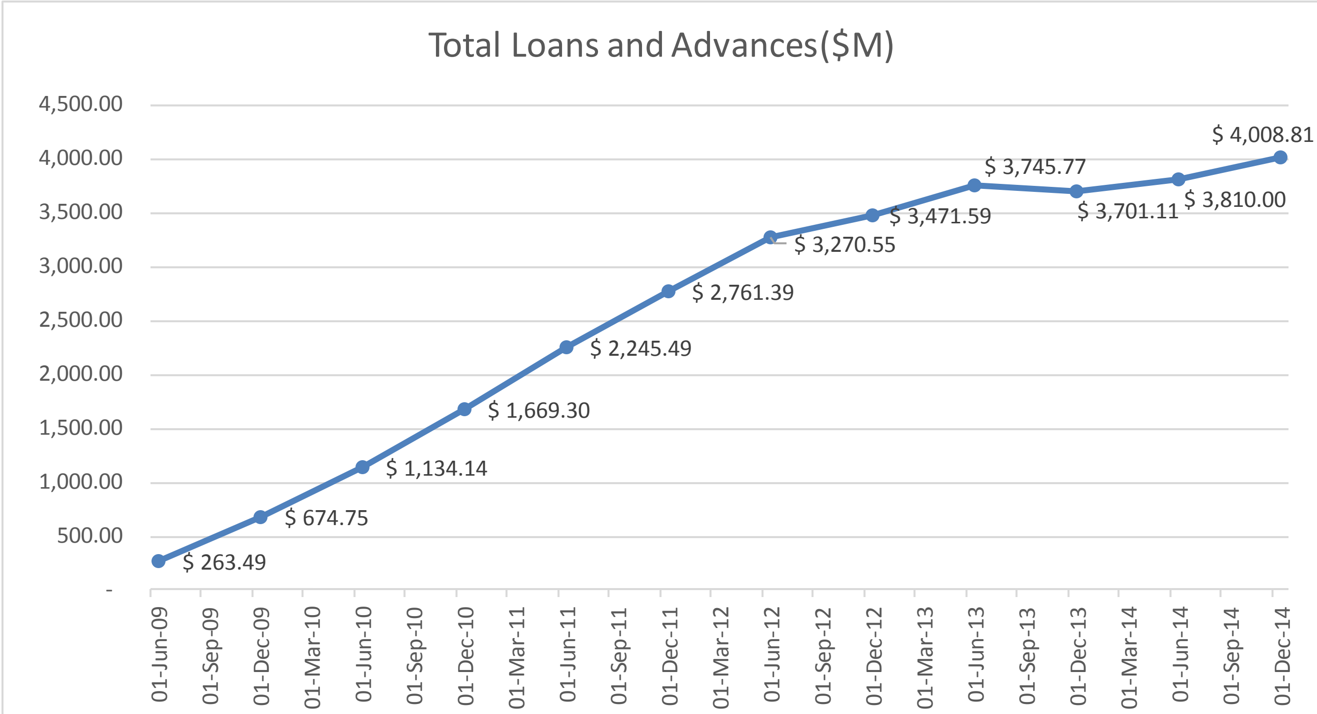
3.10. Banking institutions were required to submit plans indicating the preferred strategic group.

3.11. An evaluation of the recapitalisation plans has indicated a preference for Tier 1, to be achieved through organic growth, fresh capital injection, and rights issues. In addition, some banking institutions are proposing to rationalize operations by merging commercial banking and building society activities.

3.12. A total of 13 out of 19 operating banking institutions were in compliance with the prescribed minimum core capital requirements as at 31 December 2014.

Asset Quality...

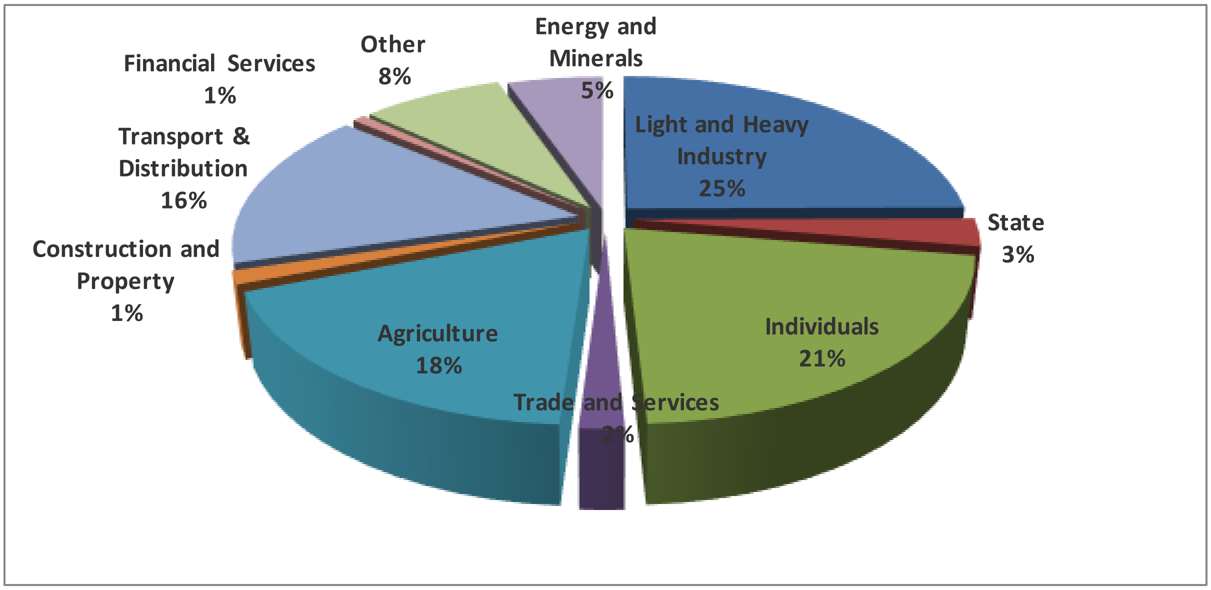
3.13. Total banking sector loans & advances amounted **to $4.01 billion** as at 31 December 2014, up from $3.84 billion as at 30 September 2014. The trend line showing the upward growth trajectory in total loans and advances is depicted below.



3.14. Commercial banks continues to dominate the banking sector as they accounted for 82.09% of total banking sector loans and advances.

3.15. Top five banks had loans & advances amounting to **$2.36 billion**, which accounted for **58.85%** of total banking sector loans & advances as at 31 December 2014.

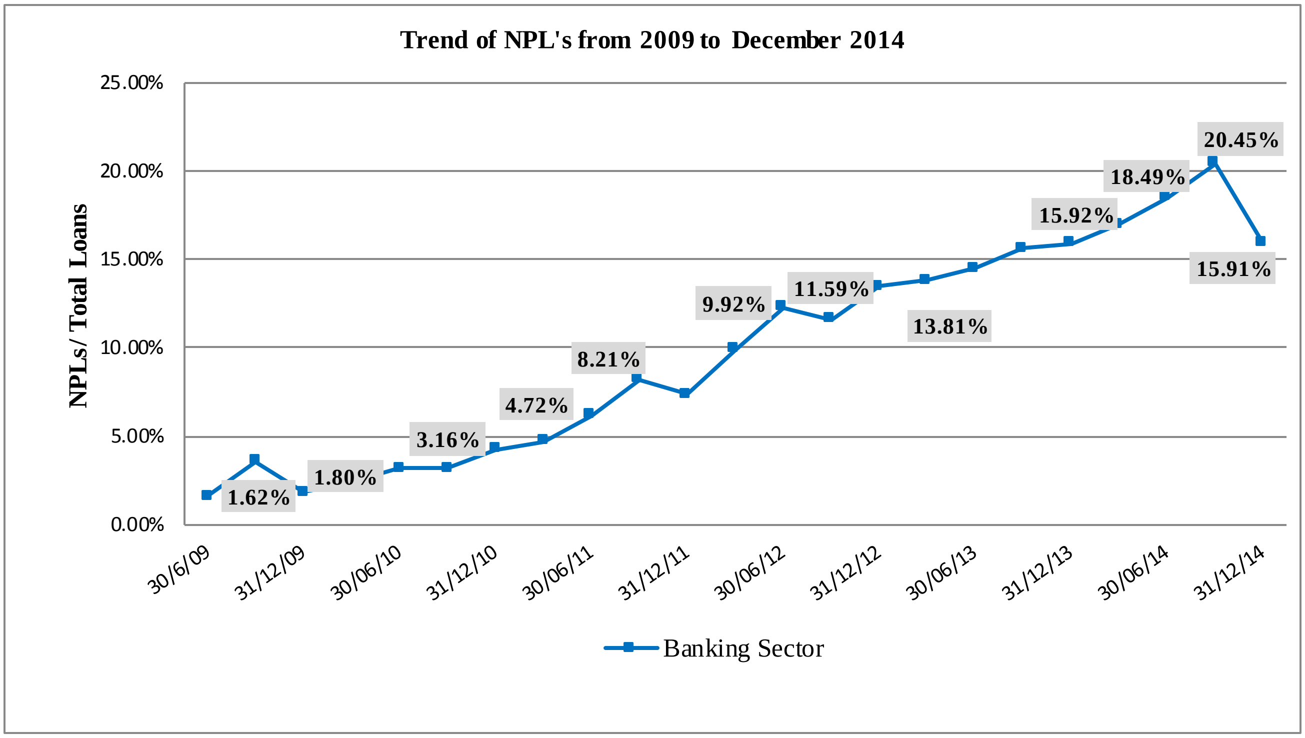
3.16. The distribution of the banking sector lending to the various sector as at 31 December 2014 is as indicated below:



3.17. Credit risk remained a key challenge, as evidenced by the average non-performing loans to total loans (NPL/TL) ratio of **15.91%** as at 31 December 2014, compared to 20.45% as at 30 September 2014.

3.18. The high level of non-performing loans is partly a reflection of macroeconomic challenges that have militated against borrowers' ability to service loans, institution specific weaknesses as well as a proactive decisions taken by some banks to adequately provide for loan losses.

3.19. The figure show the trend of the banking sector NPLs ratio since March 2009.



3.20. The decline in the NPL ratio noted over the quarter is largely attributable to the closure of Interfin and Allied Bank and general improvement in loan quality in a few banks.

3.21. Against a background of high levels of NPLs, the Reserve Bank established a Special Purpose Vehicle (SPV) known as Zimbabwe Asset Management Corporation (Pvt) Ltd (ZAMCO) whose primary objective is the acquisition or resolution of non-performing loans. The company is now operational, with the requisite governance structures.

3.22. Further, the Reserve Bank has made significant progress in operationalizing a credit reference system (CRS). The establishment of a credit reference system is expected to play a critical role in the management of credit risk by banking institutions and will help to minimize over-indebtedness by borrowing members of the public. Banks will be able to leverage off information available from the CRS to make sound lending decisions.

3.23. It is envisaged that these measures will go a long way in addressing the challenge of high MPLs.

Earnings Performance...

3.24. Notwithstanding the challenging macroeconomic environment, the banking sector recorded aggregate net profit of $52.75 million for the year ended 31 December 2014, a significant improvement from an aggregate profit of $3.39 million recorded for the same period in 2013.

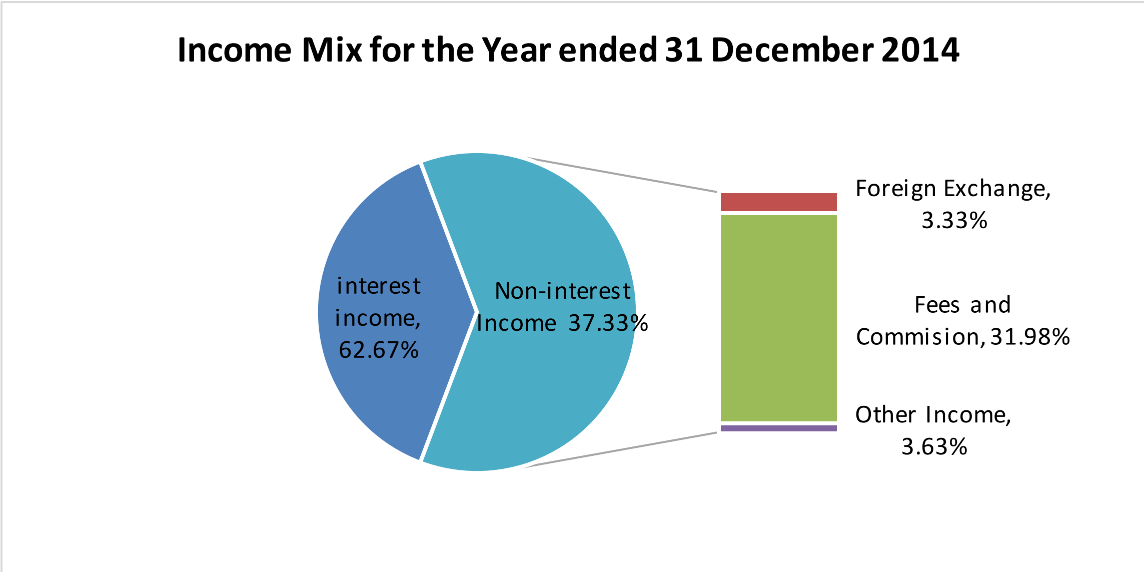
3.25. Out of the 19 operating banking institutions, 14 institutions reported profits for the year ended 31 December 2014.

3.26. The losses recorded by the remaining institutions are attributed to high levels of non-performing loans, liquidity challenges, lack of critical mass in terms of revenue to cover disproportionately high operating expenses and deliberate strategy by some banks to clean up bad loan books through provisioning.

3.27. Profitability indicators for the banking sector as measured by the average return on assets (ROA) and return on equity (ROE) improved from 0.06% and 0.51% as at 31 December 2013 to 0.92% and 5.37% as at 31 December 2014, respectively.

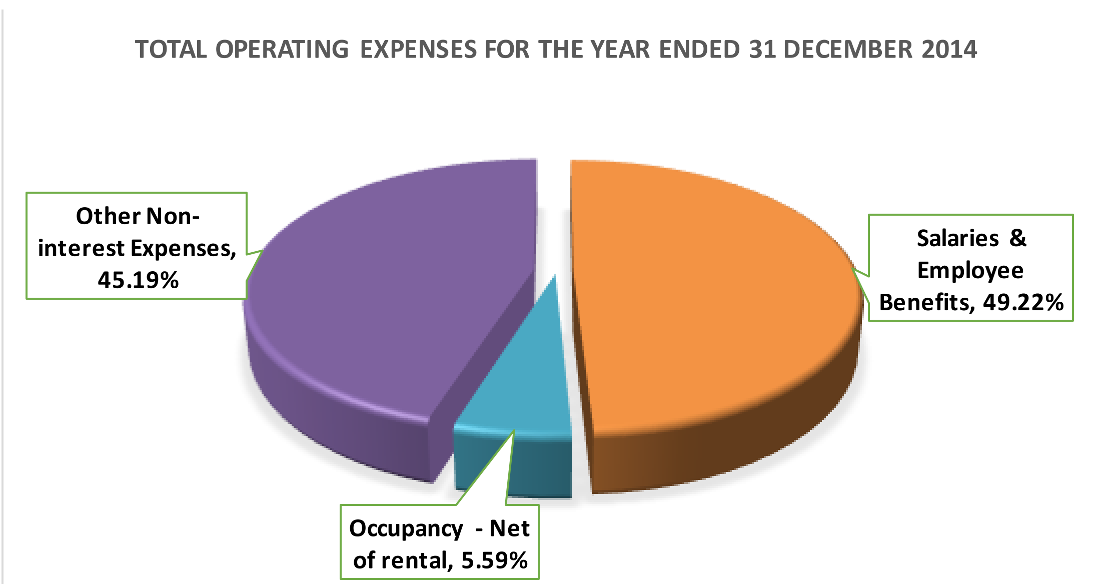
3.28. The major source of income for the banking sector as at 31 December 2014 was interest income which constituted 62.67% [loans and advances, (88.21%), interbank deposits (8.63%), securities and investments (3.16%)] of the total operating income of $1.04 billion earned by banks. Non-interest income accounted for 37.33% of total income and comprised of fees and commissions (87.35%), foreign exchange dealing profits (9.02%) and other (3.63%).

3.29. The graph below show the sources of income of the banking sector as at 31 December 2014.



3.30. Operating expenses for the sector amounted to $598 million as at 31 December 2014 and were largely composed of salaries and employment benefits which accounted for 49.22% of total operating costs.

3.31. The composition of operating expenses for the banking sector is shown in the figure below.

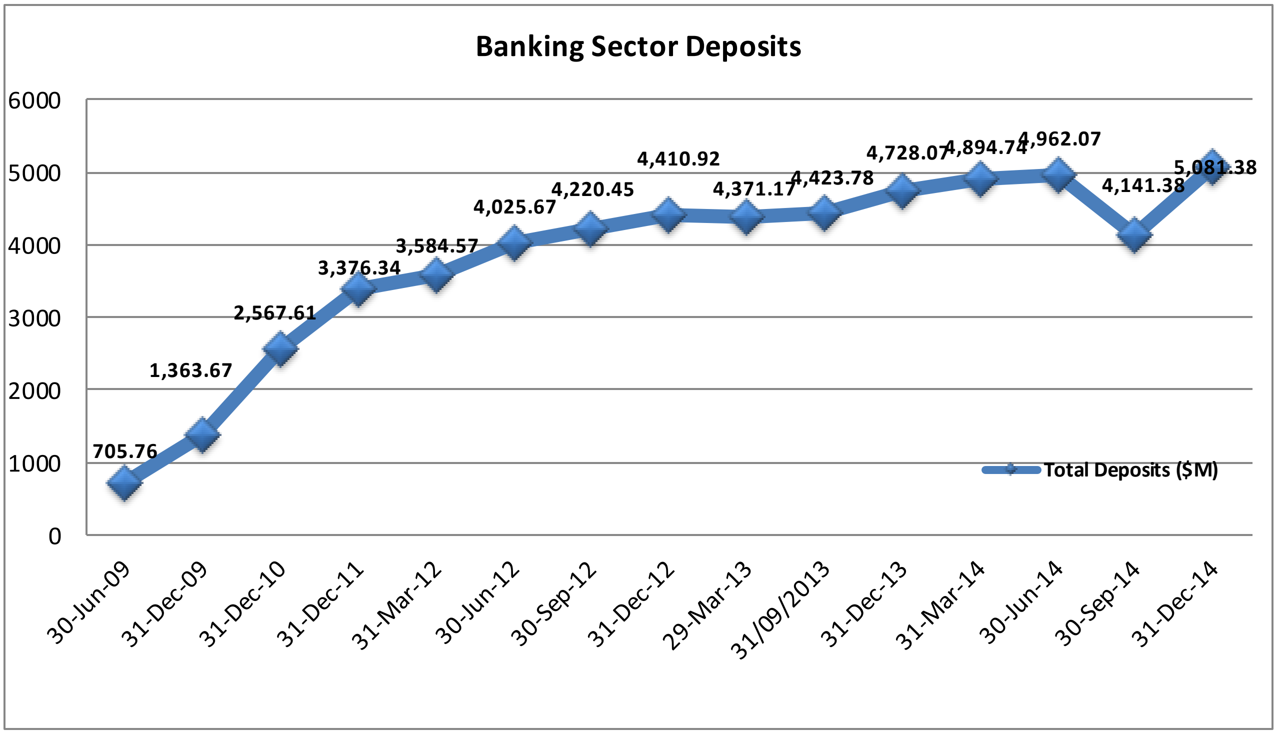


3.32. A number of banking institutions have instituted cost containment measures whilst concomitantly implementing revenue enhancement measures.

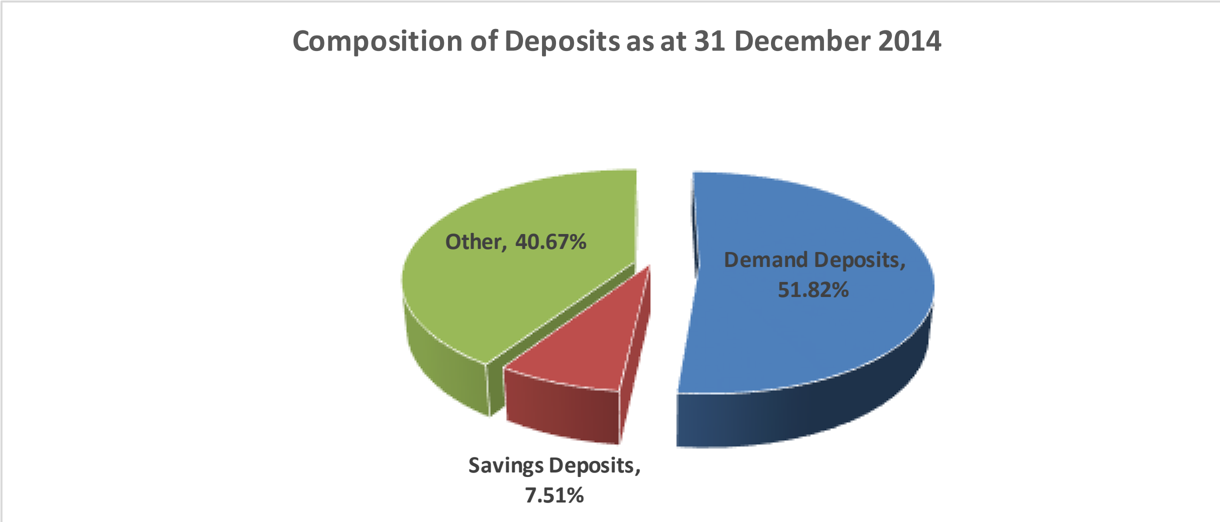
Liquidity and Funds Management...

3.33. A few banking institutions continued to face serious liquidity challenges.

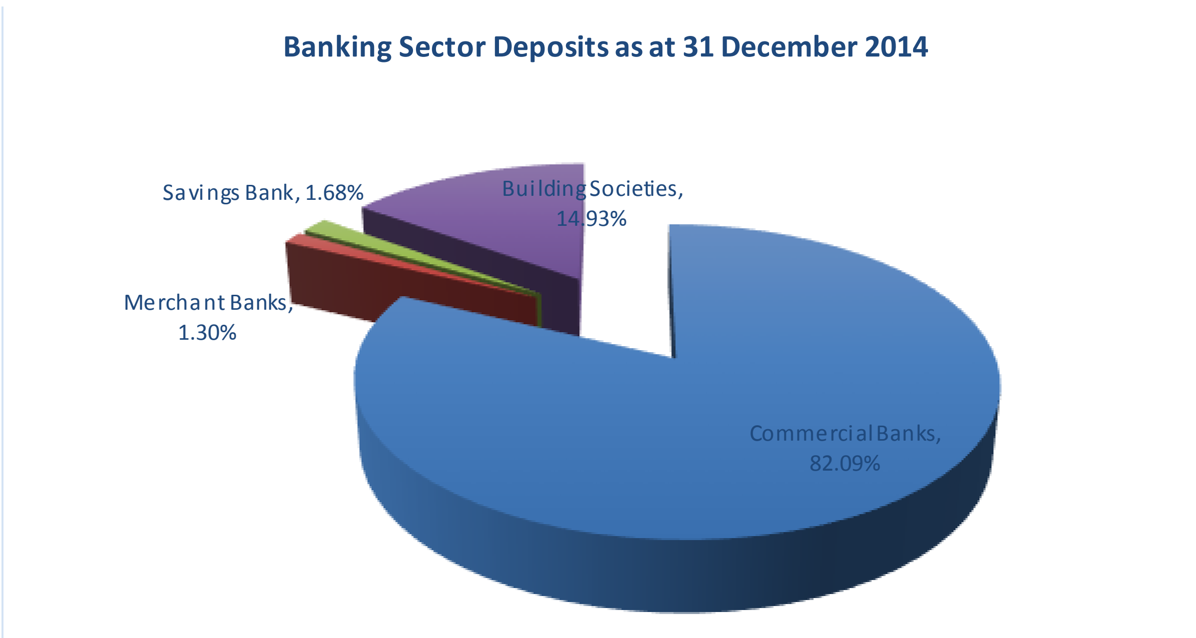
3.34. Total banking sector deposits amounted to **$5.08 billion** as at 31 December 2014 as shown below.



3.35. The sectors deposits continued to be dominated by demand deposits which accounted for 51.82% of total deposits as at 31 December 2014 as indicated below.



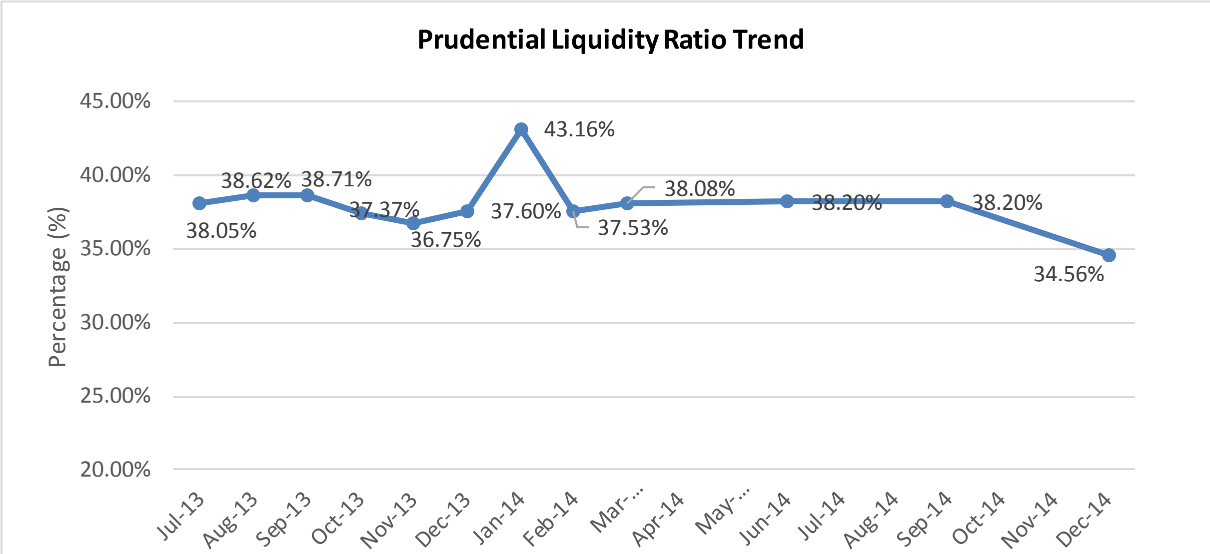
3.36. Commercial banking sub-sector held 82.09% of total banking sector deposits as at 31 December 2014.



3.37. Five (5) largest banking institutions, in terms of deposits, had deposits amounting to $3.20 billion as at 31 December 2014, representing 62.99% of total banking sector.

3.38. Notwithstanding the general liquidity crunch in the market, the banking sector average prudential liquidity ratio of 35.63% as at 31 December 2014 was above the regulatory minimum of 30%, and has been stable since 31 May 2013.

3.39. The diagram reflects average liquidity position since July 2013.



3.40. As at 31 December 2014, nine (9) banking institutions were not compliant with the minimum regulatory requirement and some of these institutions were beset by chronic liquidity constraints.

Sensitivity to Market Risk…

3.41. Generally, the sector's exposure to market risk remained low. Notwithstanding the non-transferability of balance sheet mitigants across banking institutions, aggregate results suggest strong resilience for the banking system as a whole to market risk shocks.

3.42. Inherent interest rate risk remains low. All banking institutions are resilient to a minor level interest rate risk shock and only one banking institution is vulnerable to a major level interest rate risk shock. All other banks are resilient to all considered shock levels.

3.43. Inherent foreign exchange rate continues to be low given banks' current balance sheet structures. The banking sector had an overall positive net FX open position of $208.89 million as at 31 December 2014. 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.