RESERVE BANK OF ZIMBABWE

BANKING SECTOR

REPORT FOR QUARTER ENDED 30 JUNE 2014

1. EXECUTIVE SUMMARY

1.1. Notwithstanding the challenging operating environment, the banking sector remained generally stable.

1.2. The banking sector remains well capitalized with 14 out of the 20 operating institutions compliant with the minimum capital requirements as at 30 June 2014. The remaining non-compliant banks have embarked on capital raising initiatives to strengthen their capital positions.

1.3. Despite the decline in the overall net income of the banking sector for the half year ended 30 June 2014, 13 out of 20 operating institutions recorded profits.

1.4. Credit risk remains a significant challenge facing the banking sector as reflected by rising non-performing loans.

1.5. A few banking institutions continued to face liquidity challenges. Capital Banking Corporation's licence was cancelled with effect from 4 June 2014, following the bank's voluntary surrender of its licence and request for cancellation in terms of **section 14(4) of the Banking Act** on 7 February 2014.

1.6. As at30 June 2014, banking sector deposits amounted to **$4.96 billion,** whilst loans and advances were **$3.81billion,** translating into loans to deposits ratio of **76.82%.** Banks' lending portfolio continue to be skewed towards consumptive lending.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 30 June 2014, the architecture of the banking sector was as shown below.

Table 1: Architecture of the Banking Sector

Type of Institution	Number
Commercial Banks	15
Merchant Banks	1
Building Societies	3
Savings Bank	1
Microfinance Institutions	156

3. MACROECONOMIC ENVIRONMENT

3.1. The following characteristics remained prevalent in the **macroeconomic** environment during the half year ended 30 June 2014:

a) widening current account balance on the back of progressive expansion in imports against static exports;

b) low aggregate demand due to low disposable income;

c) low industry capacity utilization; and

d) market illiquidity characterised by transitory nature of deposits, limited inflows of foreign direct investment and limited foreign lines of credit.

3.2. The aforementioned macroeconomic constraints and indicators as well as institution-specific deficiencies translated into capitalisation, asset quality, earnings performance and liquidity challenges at a few banks.

4. CONDITION AND PERFORMANCE OF THE SECTOR

4.1. The performance and condition of the banking sector is summarised by the key banking sector statistics depicted in the table below:

Table 3: Banking Sector Statistics

Key Indicators	Dec -09	Dec-10	Dec -11	Dec - 12	Dec - 13	Mar -14	Jun - 14
Total Assets	$2.19 billion	$3.69 billion	$4.74 billion	$6.12 billion	$6.74 billion	$6.81 billion	$6.90 billion
Total Loans	$693 million	$1.56 billion	$2.76 billion	$3.56 billion	$3.08 billion	$3.82 billion	$3.81 billion
Net Capital Base	$382 million	$458 million	$512 million	$644 million	$706 million	*$909 million	*$893 million
Total Deposits	$ 1.36 billion	$ 2.31 billion	$ 3.04 billion	$4.41 billion	$ 4.73 billion	$4.89 billion	$4.96 billion
Net Profit	$9.50 million	$37.95 million	$86 million	$69.23 million	$4.46 million	*$20.47 million	*$26.53 million
ROA	0.60%	-2.02%	2.43%	1.64%	0.06%	0.26%	0.49%
ROE	2.47%	0.57%	15.13%	9.17%	0.51%	2.12%	2.72%
CAR	27.26%	27.34%	13.51%	13.07%	14.01%	14.10%	18.56%
Loans to Deposits	50.99%	86.25%	90.59%	93.27%	102.36%	78.03%	76.82%
ACL/TL	1.80%	10.95%	7.55%	13.46%	15.92%	16.96%	18.49%
Provisions to ACL	112.81%	887.71%	57.53%	207.45%	70.88%	46.73%	39.29%
NIM	3.29%	5.75%	8.21%	14.81%	15.26%	-0.15%	2.03%
Liquidity Ratio	97.44%	70.88%	56.80%	55.70%	40.57%	38.10%	38.20%
Cost to Income Ratio	94.38%	148.95%	185.11%	99.95%	173.43%	87.15%	164.69%

*Excluding one bank which is under curatorship

4.2. The Reserve Bank continues to closely monitor a few banking institutions with a combined market share of 7.36% in terms of assets, which were facing liquidity and solvency challenges.

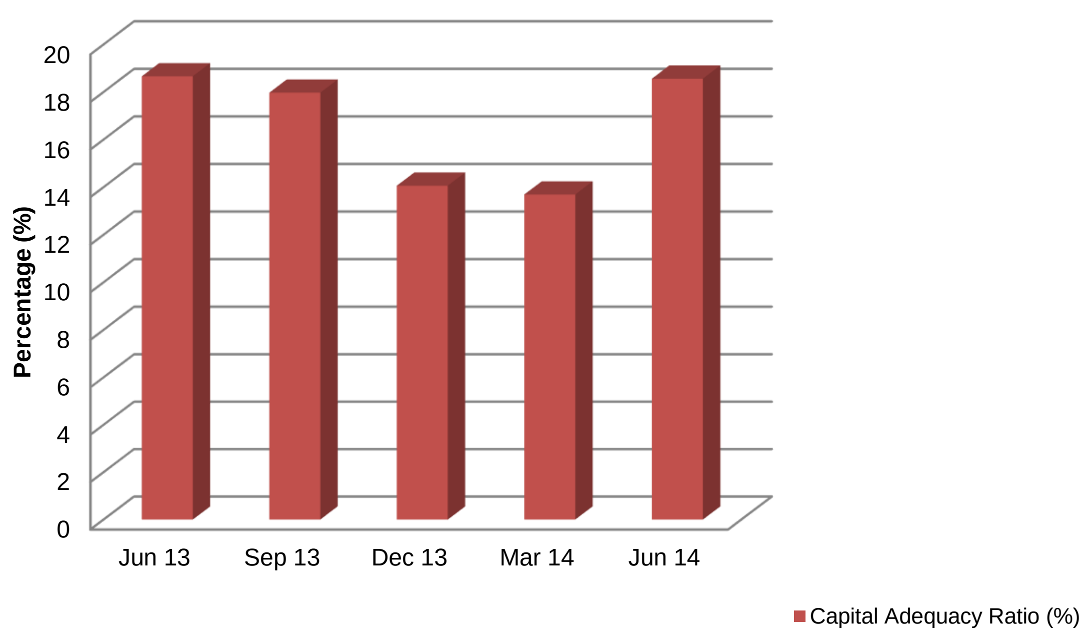
4.3. A summary of the condition and performance of the sector based on the CAMELS framework is provided hereunder.

Capital Adequacy…

4.4. The banking sector remained adequately capitalised during the period ended 30 June 2014, with the average capital adequacy ratio above the required minimum regulatory capital adequacy ratio of 12%.

4.5. The trend in the banking industry's average capital adequacy ratios (CARs) from June 2013 to June 2014 is indicated in figure 2 below.

Figure 2: Capital Adequacy Ratio

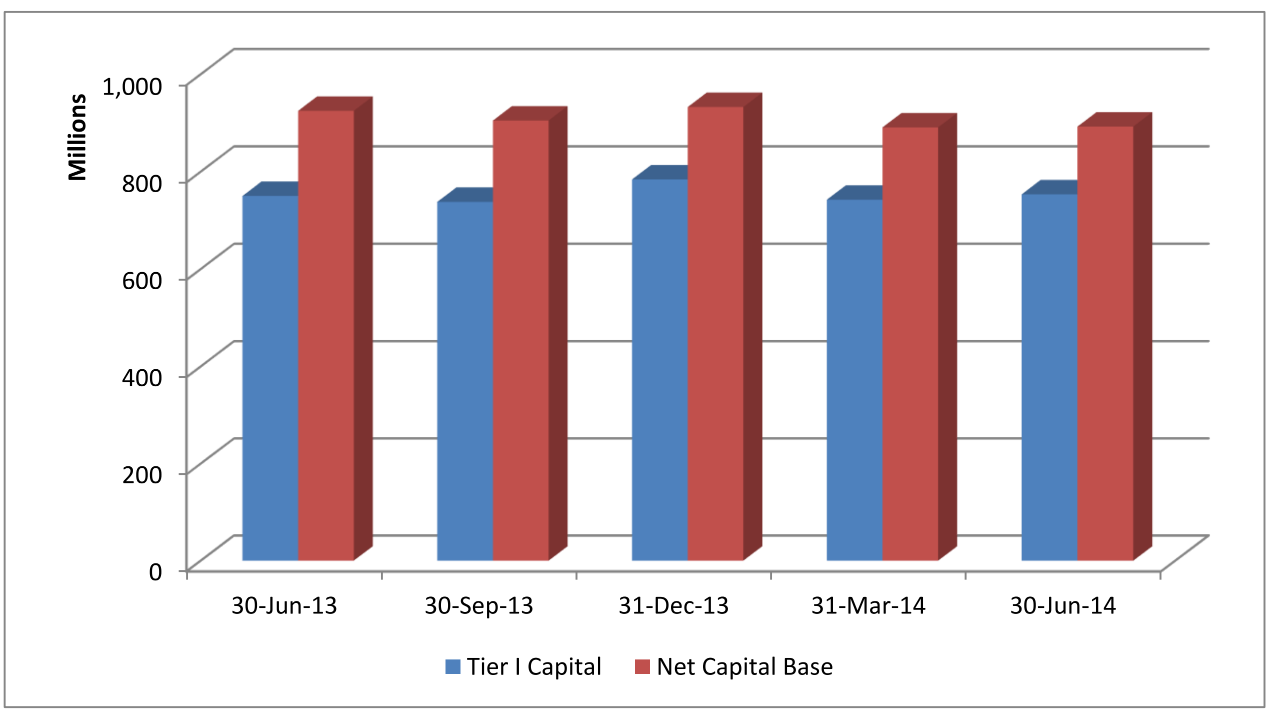


4.6. The increase in CAR, over the quarter, was attributable to the decline in risk weighted assets (sector loans & advances) relative to capitalisation levels.

4.7. Despite the decline in the **net capital base** and **core capital** from $909 million and $755 million as at 31 March 2014 to $893 million and $753.3 million as at 30 June 2014, respectively, the banking sector remained well capitalized. The decline in core capital is largely attributed to operating losses recorded by a few banking institutions during the quarter under review.

4.8. Figure 1 shows the trend in net capital base and core capital levels from June 2013 to June2014.

Figure 1: Banking Sector Capitalisation Levels

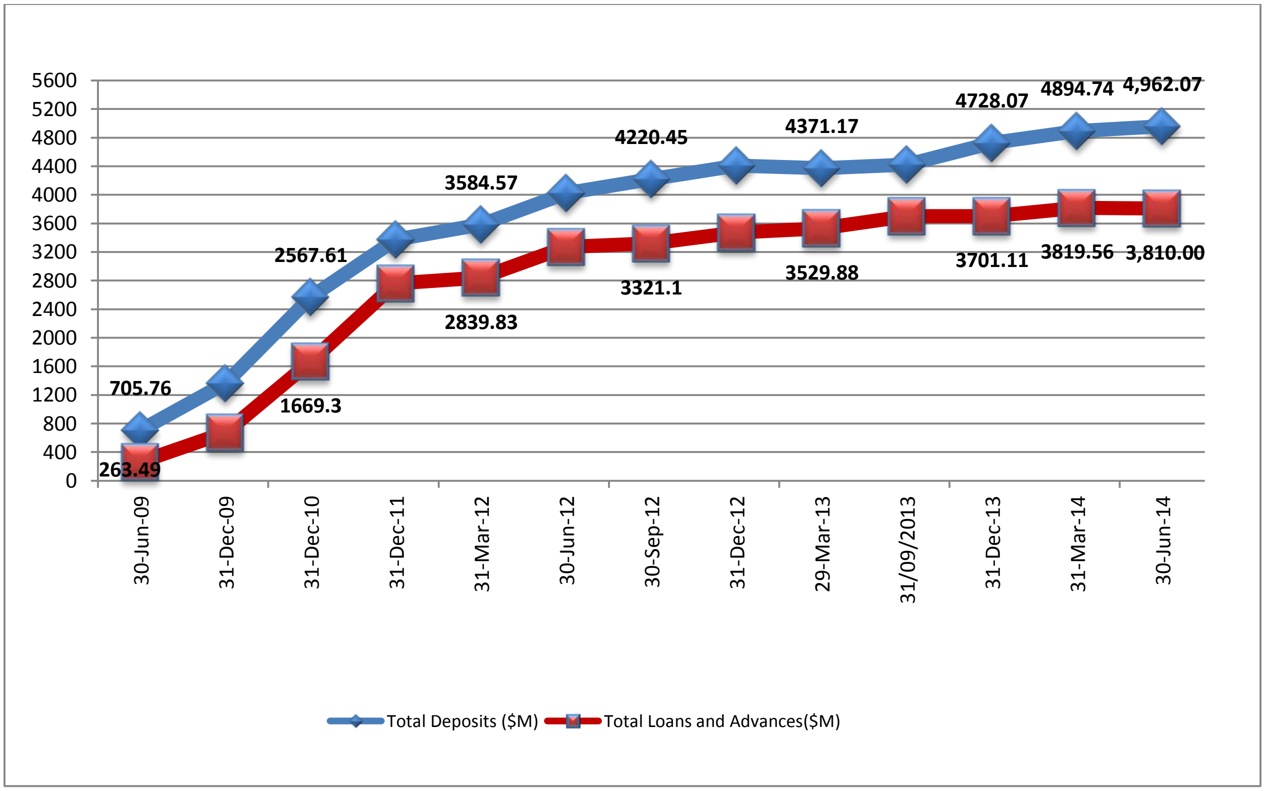


4.9. As at 30 June 2014, a total of 14 out of 20 operating banking institutions were in compliance with the prescribed minimum capital requirements. Non-compliant banks are taking various measures to regularize their capital positions which are at different stages of implementation.

4.10. Two banking institutions have already surpassed the minimum capital requirement targets, effective 2020.

Asset Quality...

4.11. Total loans and advances decreased by 0.26% from $3.82 billion as at 31 March 2014 to $3.81 billion as at 30 June 2014. Generally, there has been a growth in the level of total loans and advances since 2009 as depicted below:



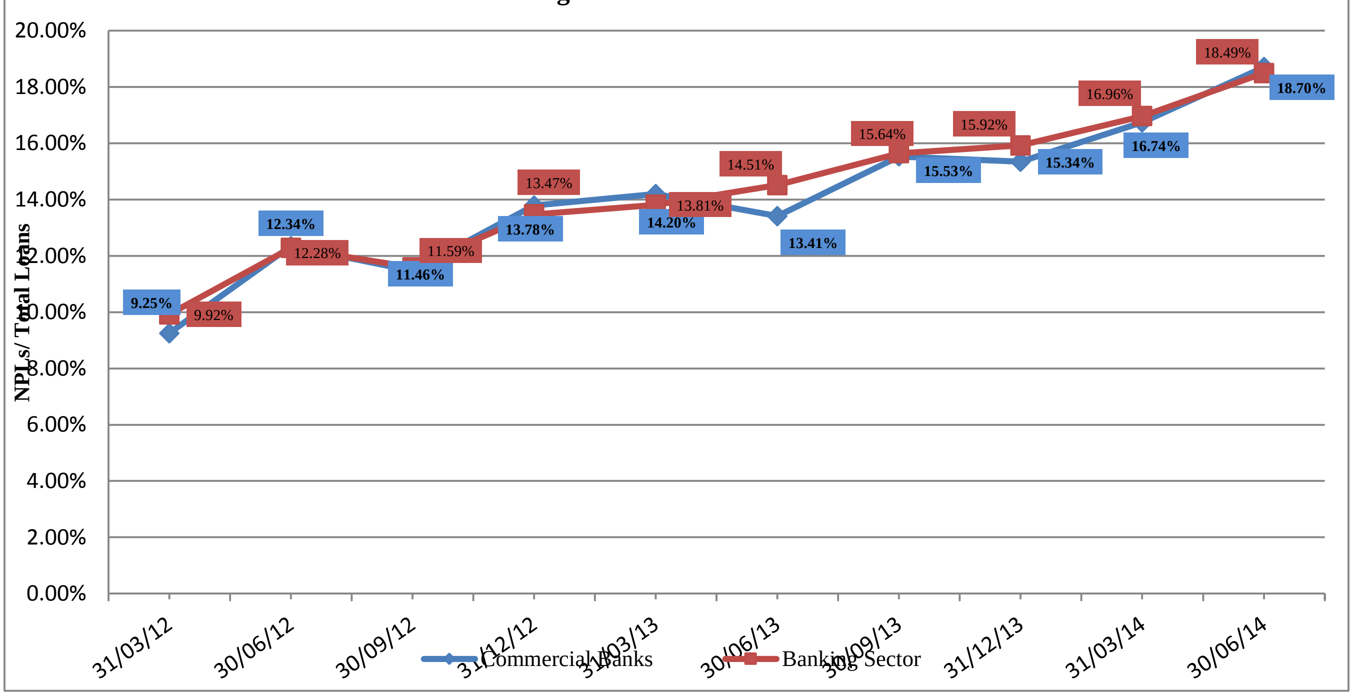
4.12. Commercial banking institutions continue to dominate the banking sector as they accounted for 82.02% of total banking sector loans and advances.

4.13. Six (6) banks had loans & advances amounting to **$2.35 billion**, which accounted for **61.67%** of total banking sector loans &advances as at 30 June 2014.

4.14. Credit risk remained a key challenge as evidenced by the average ratio of non-performing loans to total loans (NPL/TL), which increased to **18.49%**as at 30 June2014, up from **16.96%** as at 31 March 2014. This trend is partly a reflection of macroeconomic challenges that have militated against borrowers' ability to service loans, as well as, institution specific weaknesses.

4.15. The trend of the banking sector NPLs ratio is depicted below:

Figure 3: Trend of NPL's



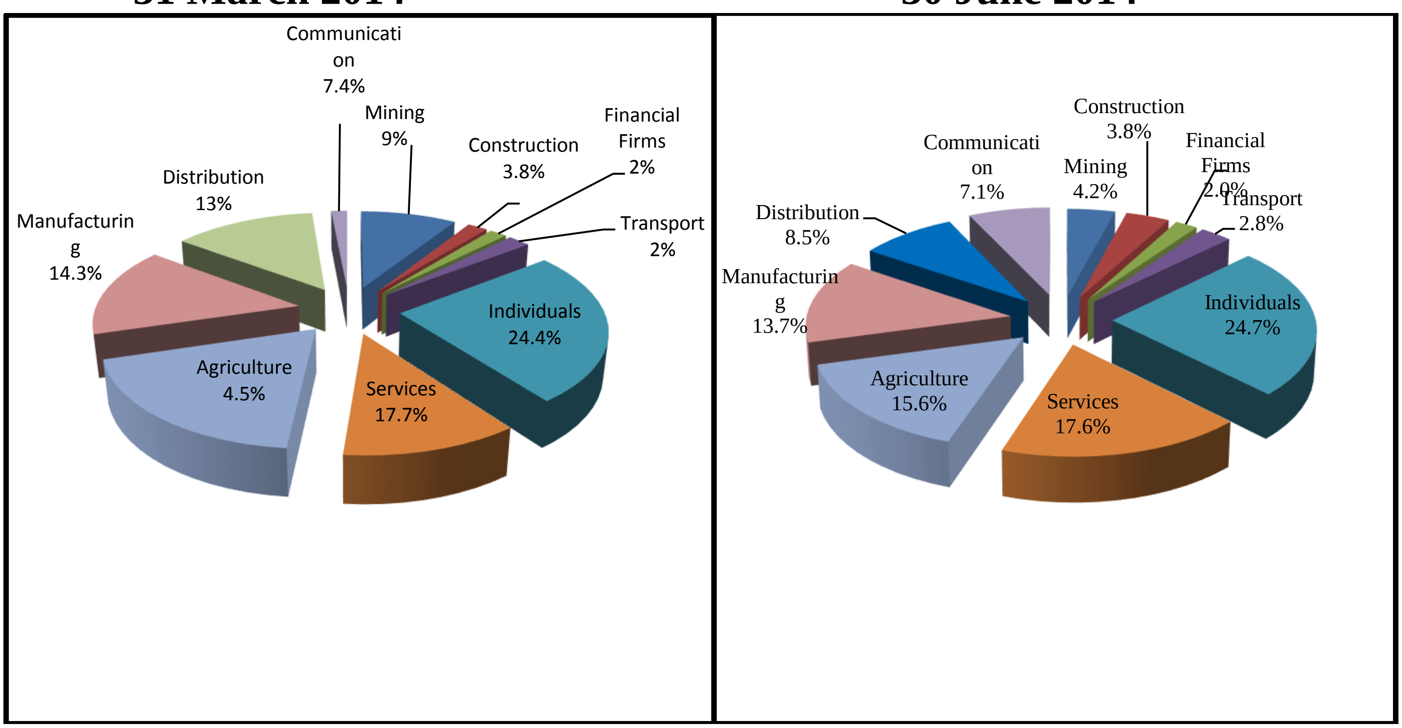
4.16. The rise in asset impairment has resulted in a dip in profitability. The surge in delinquencies and loan losses has dampened banks' risk appetite. Resultantly, banks have increasingly adopted a risk averse approach to lending.

4.17. Banking sector lending was largely for consumptive purposes at the expense of the key productive sectors, with the individuals or household sector constituting 24.7% of total credit. Construction and mining sectors constituted 3.80% and 4.2% of total banking sector credit, respectively.

4.18. The figure below shows the sectoral distribution of credit as at 30 June 2014:

Figure 4: Sectoral Distribution of Credit

31 March 2014 **30 June 2014**



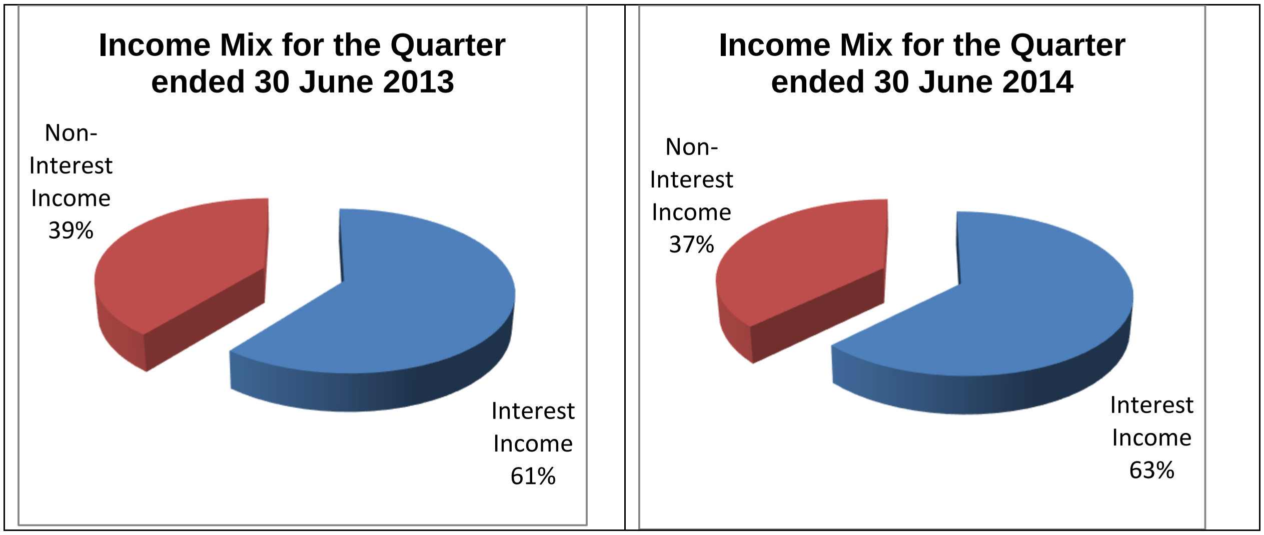
Earnings...

4.19. The banking sector remained profitable with an aggregate net profit of **$26.53 million** (excluding bank under curatorship) for the half year ended 30 June 2014, up from $4.90 million during the corresponding period ended June 2013.

4.20. A total of 13 banks out of the 20 operating banking institutions (including a savings bank) recorded profits for the half year ended 30 June 2014. The losses recorded by the few banking institutions in the current period are attributed to high levels of non- performing loans, lack of critical mass in terms of revenue to cover high operating expenses and deliberate strategy by some banks to clean up bad loan books through provisioning.

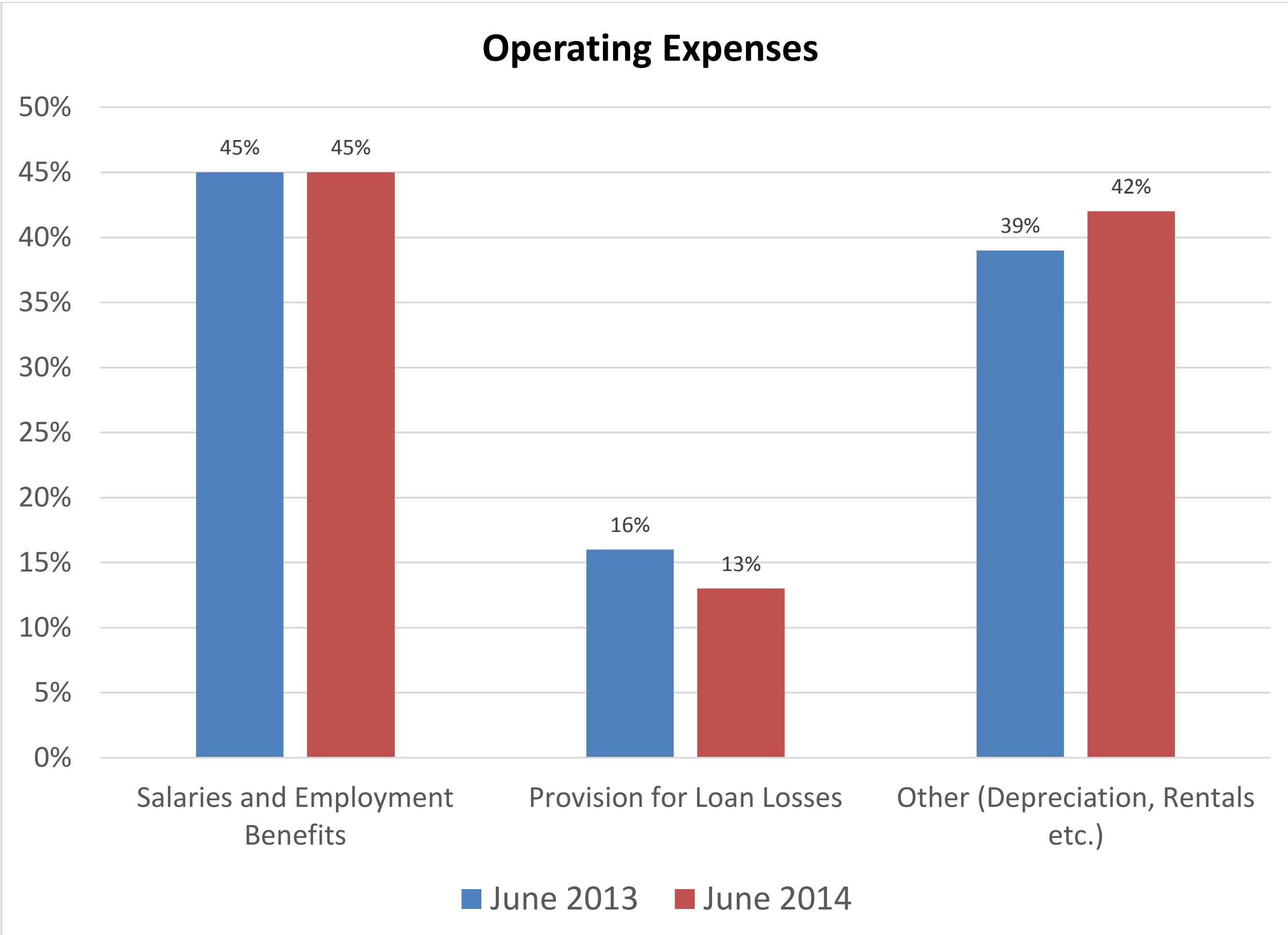
4.21. The income mix for the banking sector is indicated below.

Figure 5: Distribution of Total Income for periods 30 June 2013 & 2014



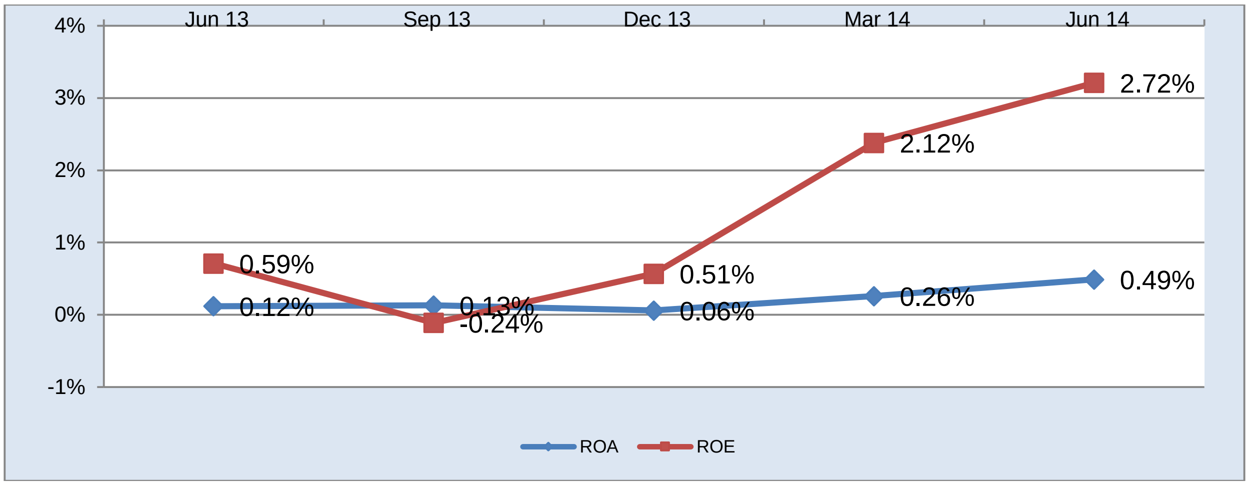
4.22. The composition of operating expenses is shown in the figure below.

Figure 6: Composition of Operating Expenses



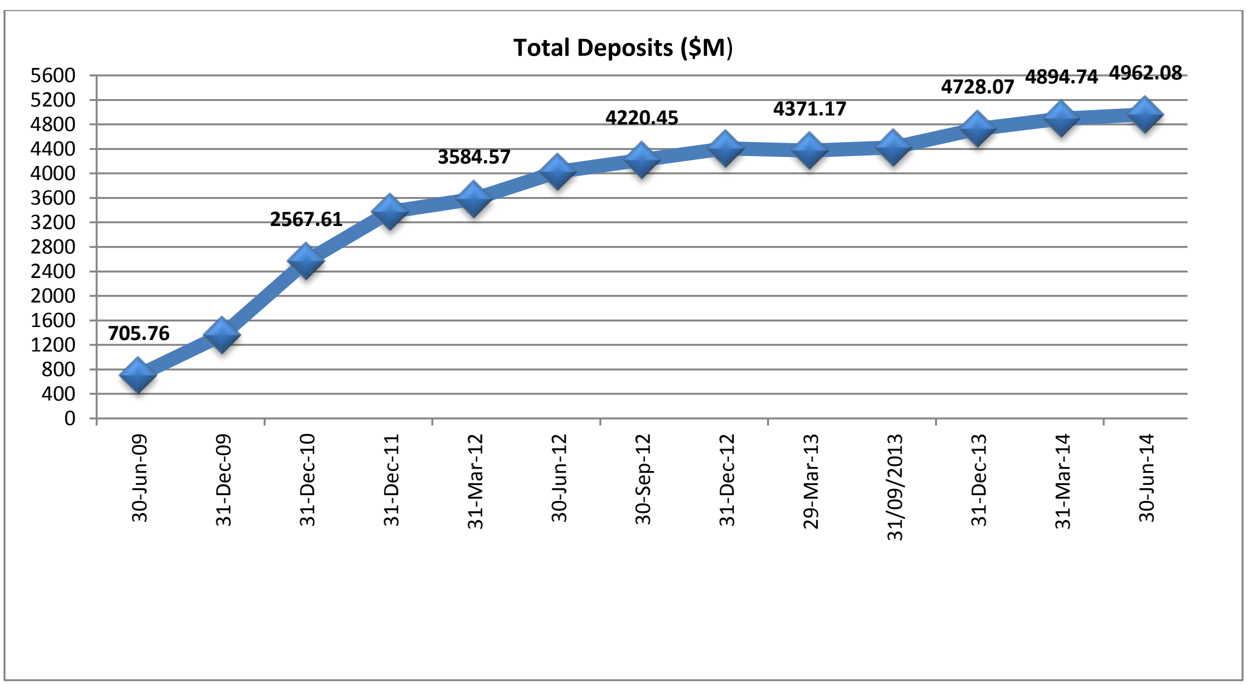
4.23. Profitability indicators for the banking sector as measured by the average return on assets (ROA) and return on equity (ROE) improved during the half year ended 30 June 2014compared to 30 June 2013 as reflected in figure 7.

Figure 7: Profitability Indicators



Liquidity and Funds Management...

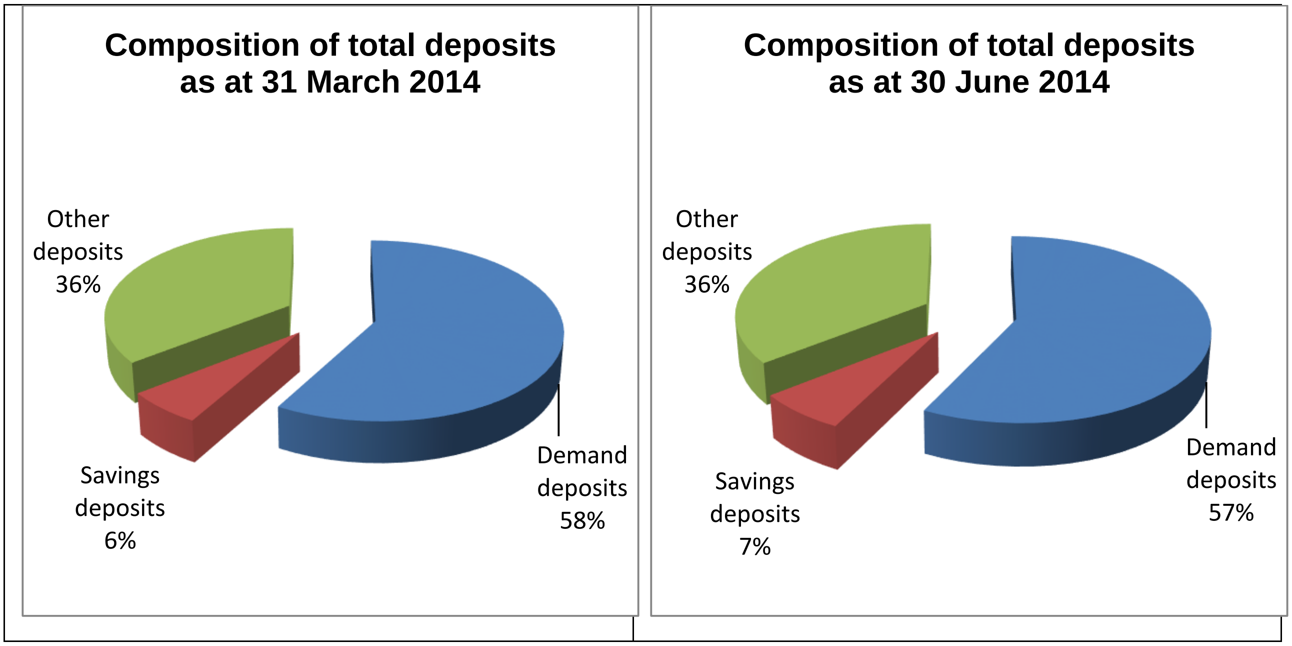
4.24. The trend in the level of deposits is shown below.



4.25. Banking sector deposits continued to be dominated by demand deposits which accounted for 43.83% of total deposits as at 30 June 2014 as indicated in figure 8 below:

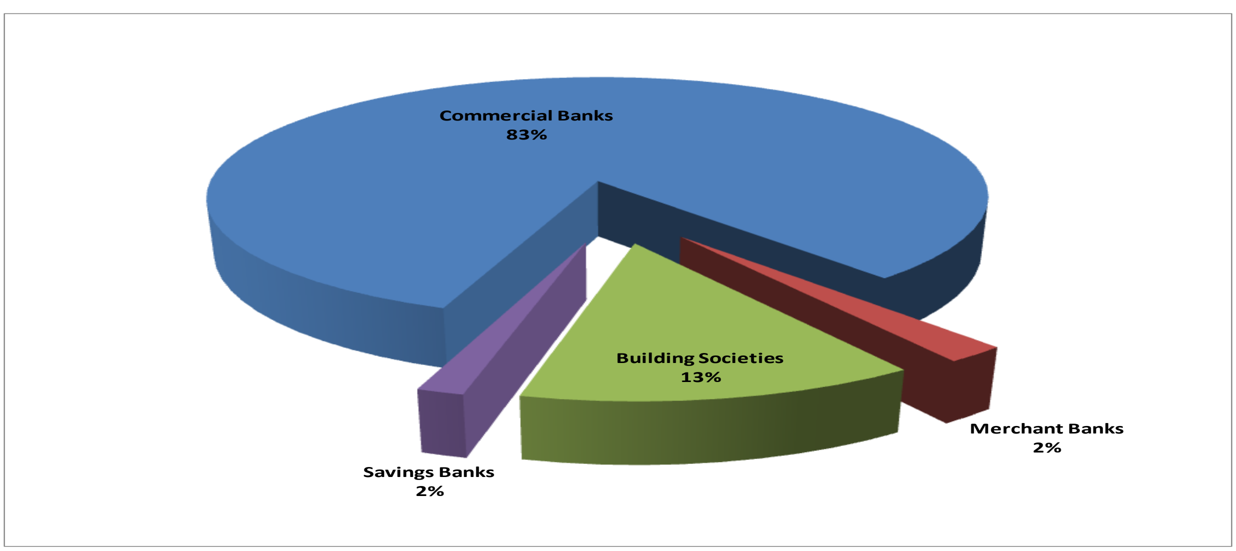
Figure 8: Deposit Structure

31 March 2014 **30 June 2014**



4.26. In terms of concentration, the commercial banking sub-sector dominated the market for deposits, controlling 83% of total banking sector deposits as at 30 June 2014.

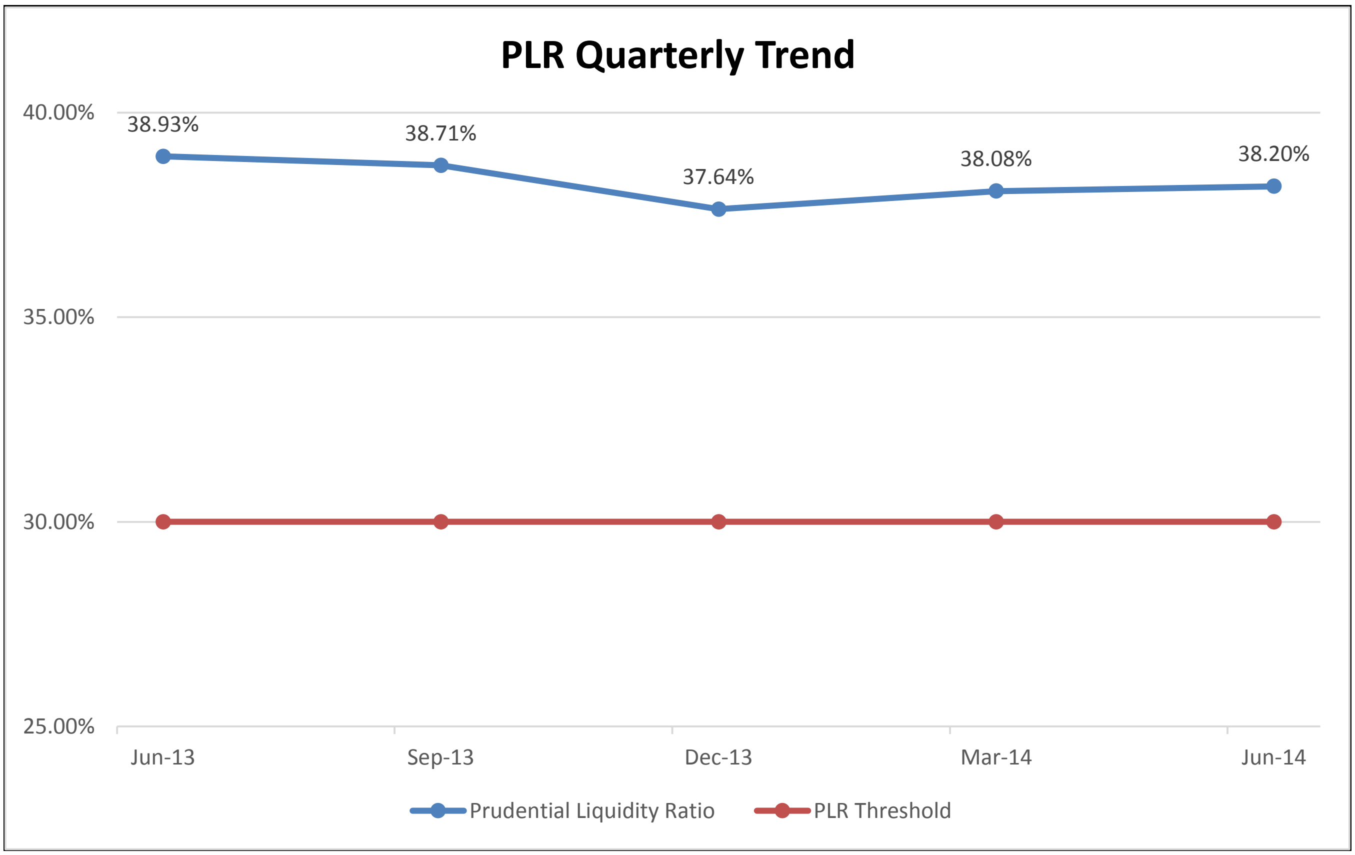
Fig 9: Distribution of Banking Sector Deposits



4.27. As at 30 June 2014, six (6) banking institutions had deposits above $300 million each, amounting to **$3.35 billion,** and representing **67.45%** of total banking sector**,** indicative of the systemic importance of these institutions.

4.28. The banking sector average prudential liquidity ratio of 38.20% as at 30 June 2014, was above the regulatory minimum of 30%, and has been stable since 30 June 2013 as shown below.

Figure 10: Prudential Liquidity Ratio Trend



4.29. While the majority of the banking institutions are compliant with the minimum prudential liquidity ratio, the sector is beset by various underlying liquidity constraints that mirror the real economy structural rigidities. Consequently, a few institutions faced liquidity challenges

Sensitivity to Market Risk…

4.30. As at 30 June 2014, the banking sector's sensitivity to market risk was moderate. The ratio of Rate Sensitive Assets to Rate Sensitive Liabilities and Net Open Position to Core Capital were 149.16% and 51.99%, compared to 159.69% and 43.36%, recorded as at 31 March 2014 respectively.

4.31. The table below shows the average interest rate sensitivity ratios for the banking sector as at 30 June 2014 and 31 March 2014, respectively.

Table 4: Interest Rate Sensitivity Ratios

Period	3 months	6 months	9 months
Mar-14	127.50%	172.70%	159.69%
June-14	145.18%	147.50%	154.80%

30 June 2014