BANK SUPERVISION DIVISION

BANKING SECTOR REPORT

FOR

QUARTER ENDED 31 MARCH 2015

1. EXECUTIVE SUMMARY

1.1. As at 31 March 2015, a total of 13 banking institutions were compliant with the regulatory minimum capital requirements. The non-compliant banks are instituting various measures towards compliance.

1.2. Thirteen (13) out of 18 banks reported profits, while five (5) banks recorded losses during the period under review. The sector registered a decline in aggregate net profit from $22.40 million in the quarter ended 31 March 2014 to $4.02 million for the quarter ended 31 March 2015.

1.3. The deterioration in aggregate net profit was largely attributed to loan impairment charges which increased from $12.31 million as at 31 March 2014 to $40.18 million as at 31 March 2015, and softening yields on loans.

1.4. Credit and liquidity risks remained the major risks facing the banking sector. Credit risk remained high as evidenced by the average non-performing loans to total loans (NPL/TL) ratio which declined marginally to 15.19% as at 31 March 2015, from 15.91% as at 31 December 2014. The ratio is above the internationally acceptable benchmark of 5%. Banking institutions are institution various measures to address the challenges of non-performing loans

1.5. To mitigate increasing credit risk, the banking sector maintained high liquidity ratios as evidenced by the average prudential liquidity ratio of 34.37% as at 31 March 2015.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 31 March 2015, the composition of the banking sector was as shown in the table below.

Architecture of the Banking Sector

Type of Institution	**Number**
Commercial Banks	13
Merchant Banks	1
Building Societies	3
Savings Bank	1
Total Banking Institutions	**18**
Credit-only-MFIs	142
Deposit taking MFIs	1
Development Institutions	2

2.2. During the quarter under review, Allied Bank Limited and AfrAsia Bank Zimbabwe Limited's operating licences were cancelled and the institutions were placed under liquidation.

3. CONDITION AND PERFORMANCE OF THE BANKING SECTOR

3.1. The financial condition of the banking sector was considered satisfactory as at 31 March 2015.

3.2. The following table summarises the financial soundness indicators of the banking sector as at 31 March 2015:

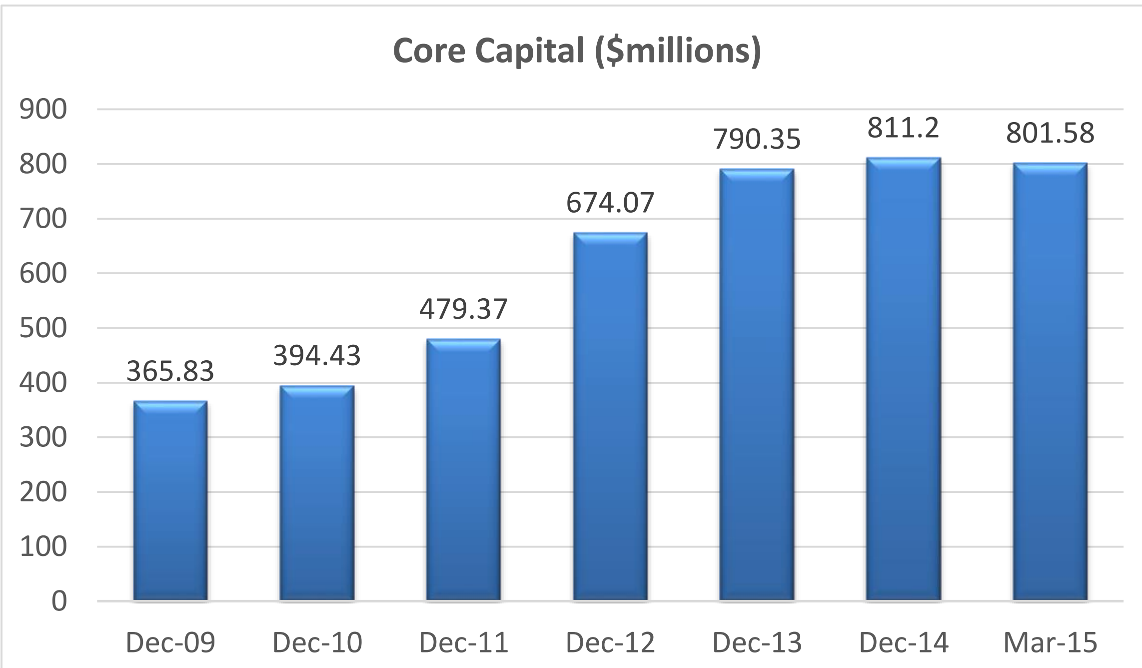
Financial Soundness Indicators

Key Indicators	Dec -09	Dec-10	Dec -11	Dec - 12	Dec – 13	Mar – 14	Dec -14	Mar-15
Total Assets	$2.19bn	$3.69bn	$4.74bn	$6.12bn	$6.74bn	$6.81bn	$7.12bn	**$7.19bn**
Total Loans	$693m	$1.56bn	$2.76bn	$3.56bn	$3.08bn	$3.82bn	$4.01bn	**$4.06bn**
Net Capital Base	$382m	$458m	$512m	$644m	$706m	$689m	$926.6m	**$926.3m**
Total Deposits	$ 1.36bn	$ 2.31bn	$ 3.04bn	$4.41bn	$ 4.73bn	$4.89bn	$5.08bn	**$5.29bn**
Net Profit	$9.50m	$37.95m	$86.00m	$69.20m	$4.46m	$22.40m	$50.84m	**$4.02m**
Return on Assets	0.60%	-2.02%	2.43%	1.64%	0.06%	0.26%	0.92%	**0.08%**
Return on Equity	2.47%	0.57%	15.13%	9.17%	0.51%	2.12%	5.37%	**0.40%**
Capital Adequacy Ratio	27.26%	27.34%	13.51%	13.07%	14.01%	14.10%	17.33%	**17.97%**
Loans to Deposits	50.99%	86.25%	90.59%	93.27%	102.36%	78.03%	78.94%	**76.75%**
Non-Performing Loans Ratio	1.80%	10.95%	7.55%	13.46%	15.92%	16.96%	15.91%	**15.19%**
Provisions to Adversely Classified Loans	112.81%	175.42%	57.53%	207.45%	70.88%	46.73%	54.72%	**61.35%**
Net Interest Margin	3.29%	5.75%	8.21%	14.81%	15.26%	(0.15%)	4.24%	**0.45%**
Liquidity Ratio	97.44%	70.88%	56.80%	55.70%	40.57%	39.75%	39.34%	**34.37%**
Cost to Income Ratio	94.38%	86.93%	82.17%	86.41%	96.60%	94.84%	93.72%	**97.55%**

Capital Adequacy…

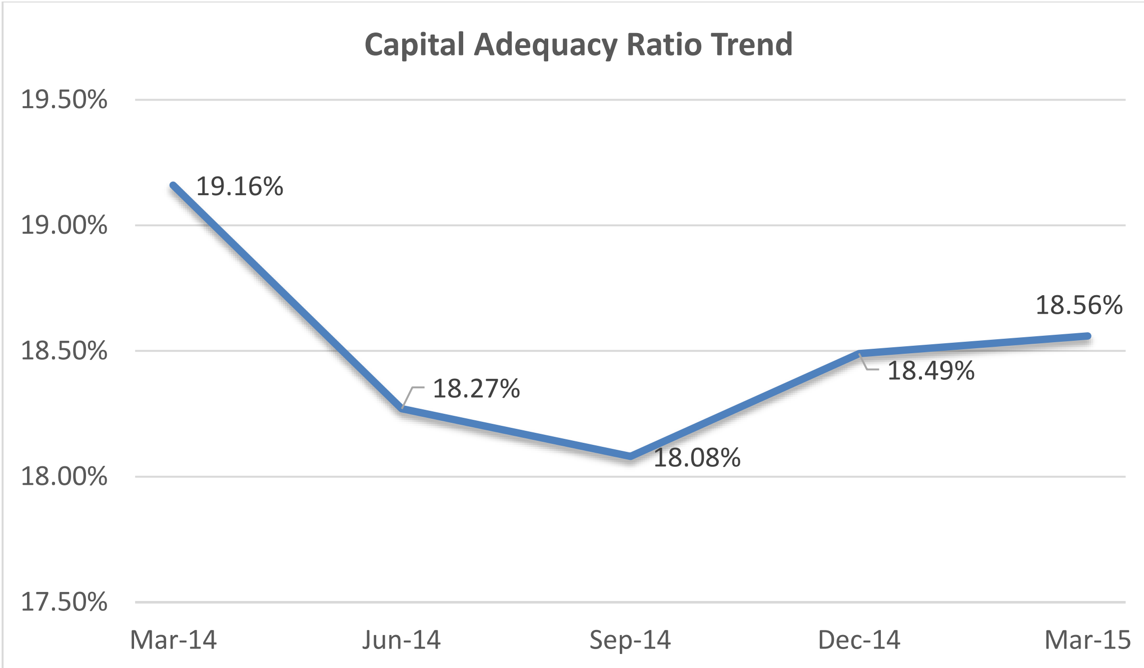
3.3. The banking sector's net capital base increased to $957.02 million as at 31 March 2015 from $926.57 million as at 31 December 2014. However, the sector's aggregate core capital base deteriorated from $811.20 million reported as at 31 December 2014 to **$801.58 million** as at 31 March 2015. The decrease in the aggregate core capital position was largely attributed to losses recorded by a few banking institutions as well as regulatory adjustments following on-site examinations conducted at some banking institutions during the quarter.

3.4. The graph below shows banking sector core capital trends from 2009 to March 2015:



3.5. The banking sector remained adequately capitalised during the period ended 31 March 2015, with the average capital adequacy ratio of 18.56%, against the minimum regulatory capital adequacy ratio of 12%.

3.6. The trend in the banking industry's average capital adequacy ratios (CARs) from March 2014 to March 2015 is indicated in the figure below.



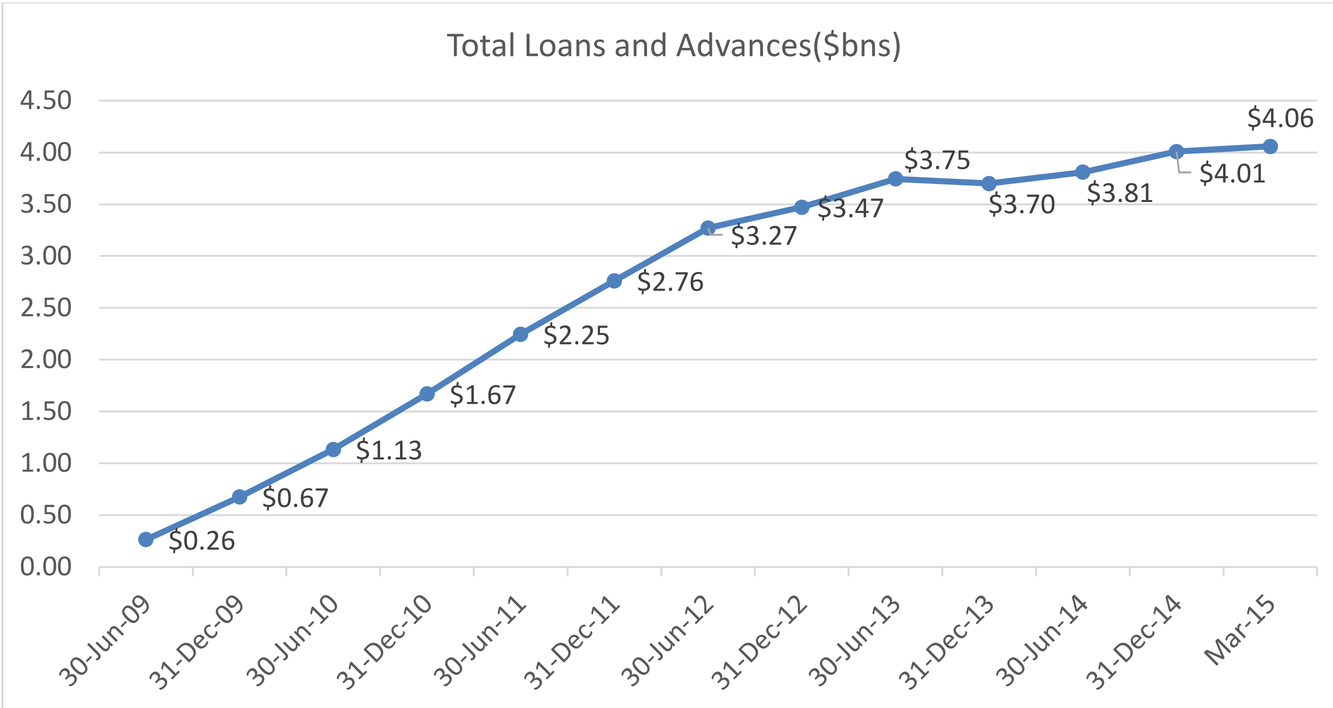
3.7. As at 31 March 2015, a total of 13 out of 17 operating banking institutions (excluding POSB), were in compliance with the prescribed minimum capital requirements. There were two (2) banking institutions that were capitalized post 31 March 2015 and are now in compliance with the minimum capital requirements.

3.8. The sector's capitalization, however, remains under threat from losses being recorded by a few banking institutions and the high levels of non-performing loans in the sector.

3.9. The Reserve Bank is monitoring implementation of capitalisation plans presented by banking institutions to comply with the 2020 minimum capital requirements.

Asset Quality...

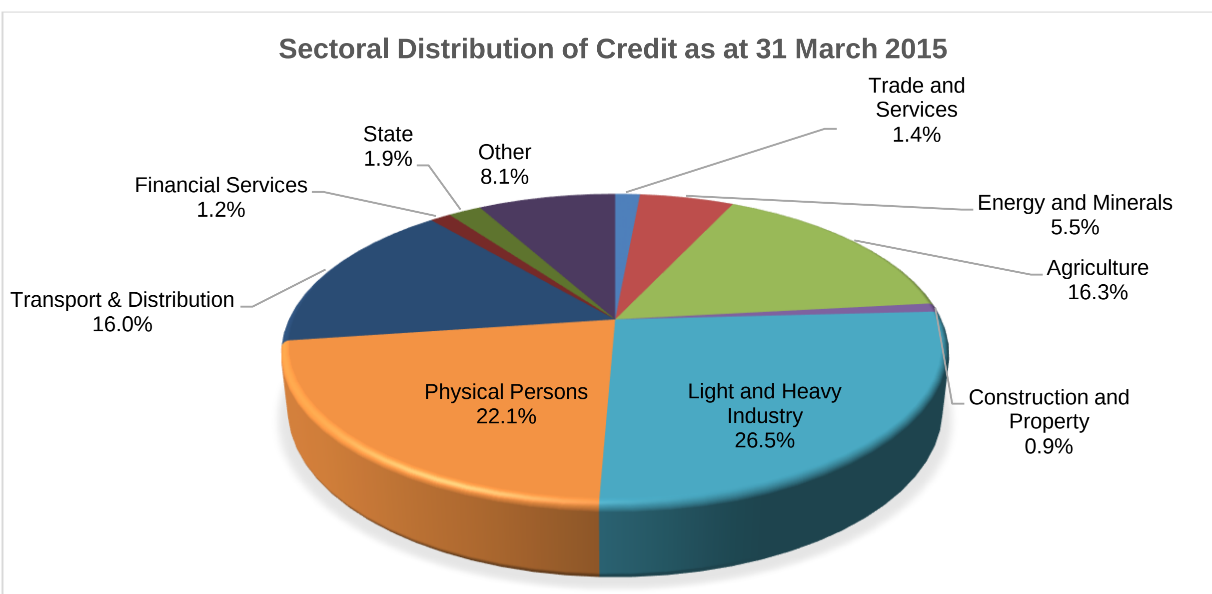
3.10. Total banking sector loans & advances amounted to **$4.06 billion** as at 31 March 2015, up from $4.01 billion as at 31 December 2014. The graph below depicts the upward growth trajectory in total loans and advances since June 2009.



3.11. As at 31 March 2015, commercial banks accounted for 79.02% of total banking sector loans and advances.

3.12. The top five banks had loans & advances amounting to **$2.48 billion**, which accounted for **61.15%** of total banking sector loans & advances as at 31 March 2015.

3.13. The distribution of the banking sector lending to the various sectors as at 31 March 2015 is indicated below:

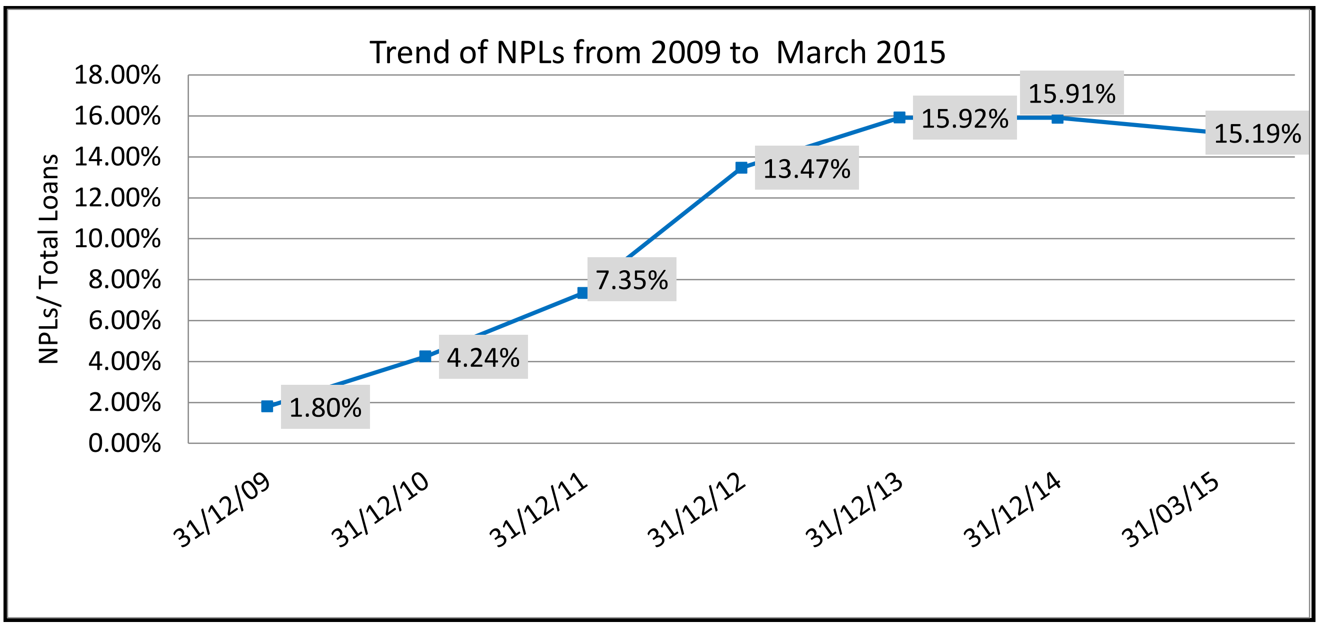


3.14. The distribution of credit remained largely unchanged from the previous quarter with three largest credit proportions in light & heavy industry, physical persons and agriculture, at 26.5%, 22.1% and 16.3% respectively.

3.15. Exposure to credit risk remained a key challenge to the banking sector, as evidenced by the average non-performing loans to total loans (NPL/TL) ratio of **15.19%** as at 31 March 2015 compared to 15.91% as at 31 December 2014.

3.16. High credit risk in the sector is attributed to a combination of exogenous factors impacting on the performance of borrowers and endogenous factors relating to credit risk management practices at some banking institutions.

3.17. The trend in the banking sector's NPL ratio since March 2009 is shown in the figure below.



3.18. Against a background of high levels of NPLs, the Reserve Bank has instituted some holistic measures to resolve non-performing loans in the banking sector. The initiatives include establishment of Zimbabwe Asset Management Corporation (ZAMCO) and creation of a Credit Reference System. ZAMCO will acquire eligible non-performing loans thereby cleansing banks' balance sheets of toxic assets while the Credit Reference System will address information asymmetry and credit culture.

3.19. On their part, banking institutions have instituted various measures to resolve the NPLs including the formation of dedicated loan recoveries units, refining of credit underwriting standards as well as restructuring of some facilities.

3.20. It is envisaged that the above complementary initiatives will reduce NPLs and enable banks to underwrite more business and contribute to economic growth.

Earnings Performance...

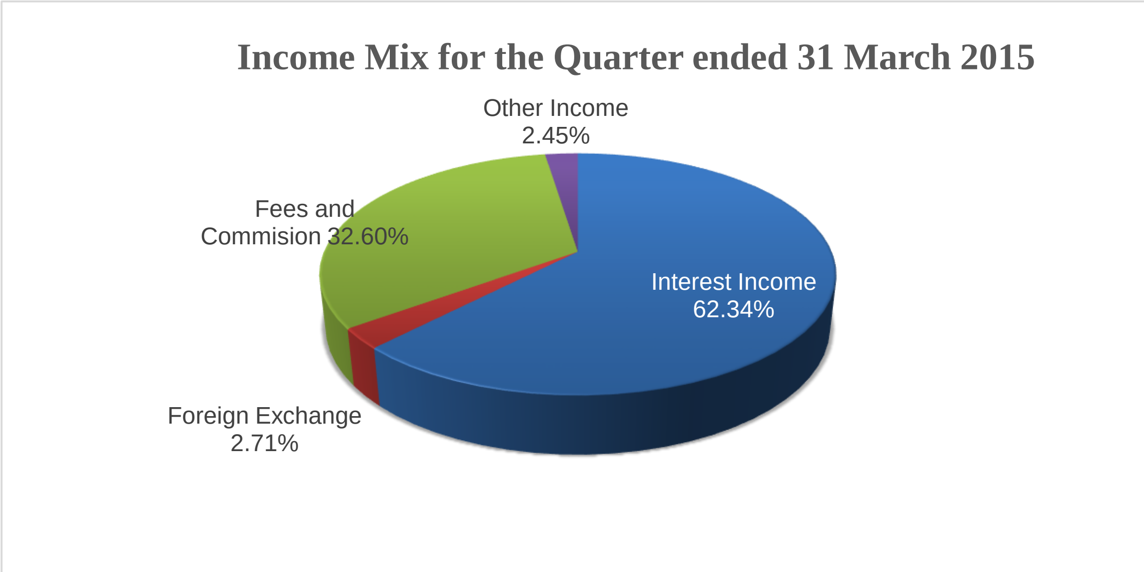
3.21. Reflecting the challenges in the operating environment, banking sector earnings performance deteriorated as shown by a decrease in aggregate net profit from $22.40 million as at 31 March 2014 to $4.02 million for the quarter ended 31 March 2015. The subdued earnings performance is also reflective of the conservative lending approach and a sub-optimal tradeoff between high liquidity and profitability.

3.22. Out of the 18 operating banking institutions, 13 institutions reported profits for the quarter ended 31 March 2015. The losses recorded by the remaining institutions were attributed to high loan impairments due to deterioration in asset quality, lack of critical mass to cover operating expenses, refinancing costs of liquidity challenges and adjustments to reasonable and responsible pricing.

3.23. Profitability indicators for the banking sector as measured by the average return on assets (ROA) and return on equity (ROE) deteriorated from 0.26% and 2.12% as at 31 March 2014 to 0.08% and 0.40% as at 31 March 2015, respectively on the back of subdued earnings in some banking institutions.

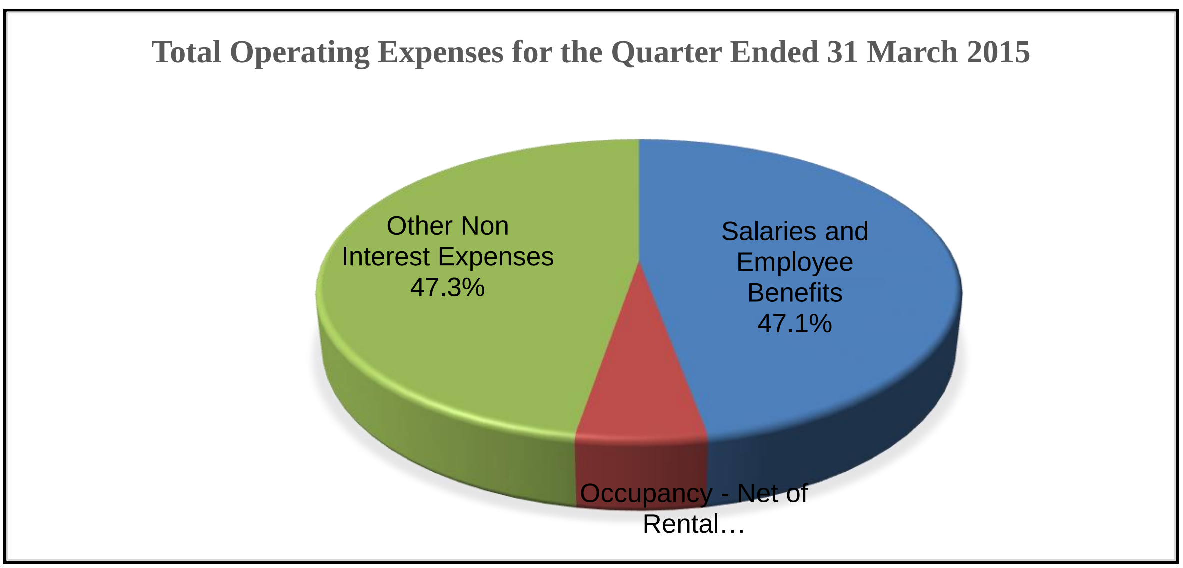
3.24. The major source of income for the banking sector in the quarter ended 31 March 2015 was interest income, which constituted 62.34% of total income, largely from loans & advances and non-interest income accounting for 37.66%, largely comprised of fees and commissions.

3.25. The graph below shows the sources of income of the banking sector as at 31 March 2015.



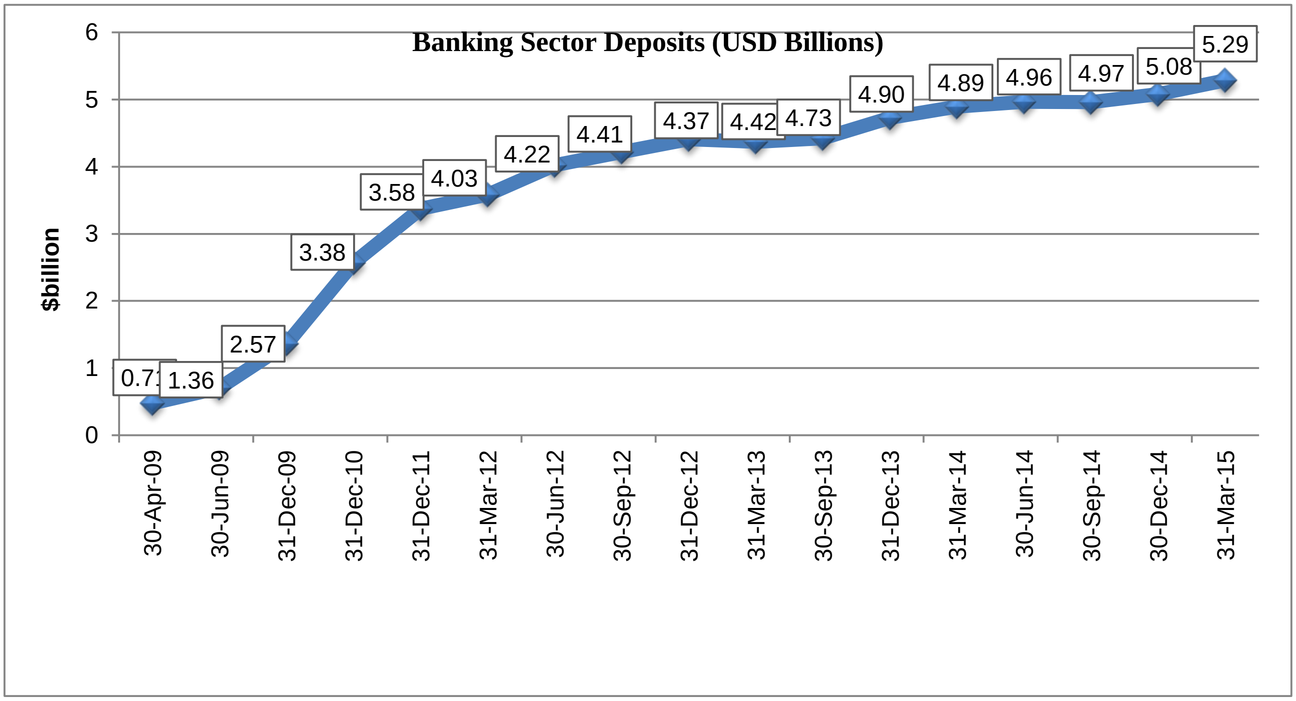
3.26. Operating expenses for the sector amounted to $136.78 million for the quarter ended 31 March 2015 and were largely composed of salaries and employment benefits which accounted for 47.14% of total operating costs. Other non-interest expenses which including depreciation, deposit protection premiums and administration costs, constituted 47.3% of operating expenses

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

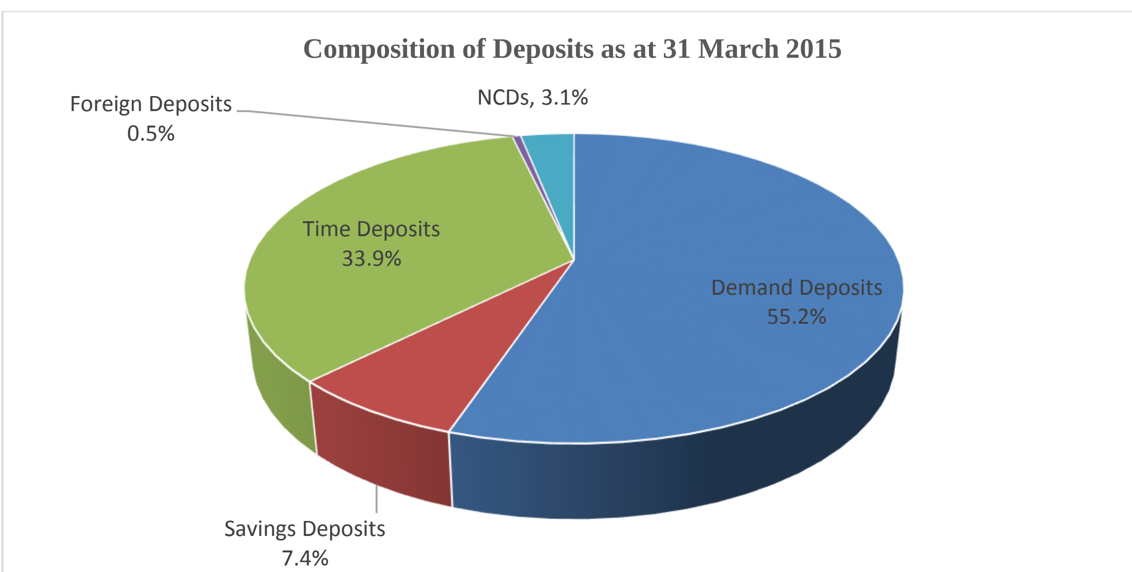


Liquidity and Funds Management...

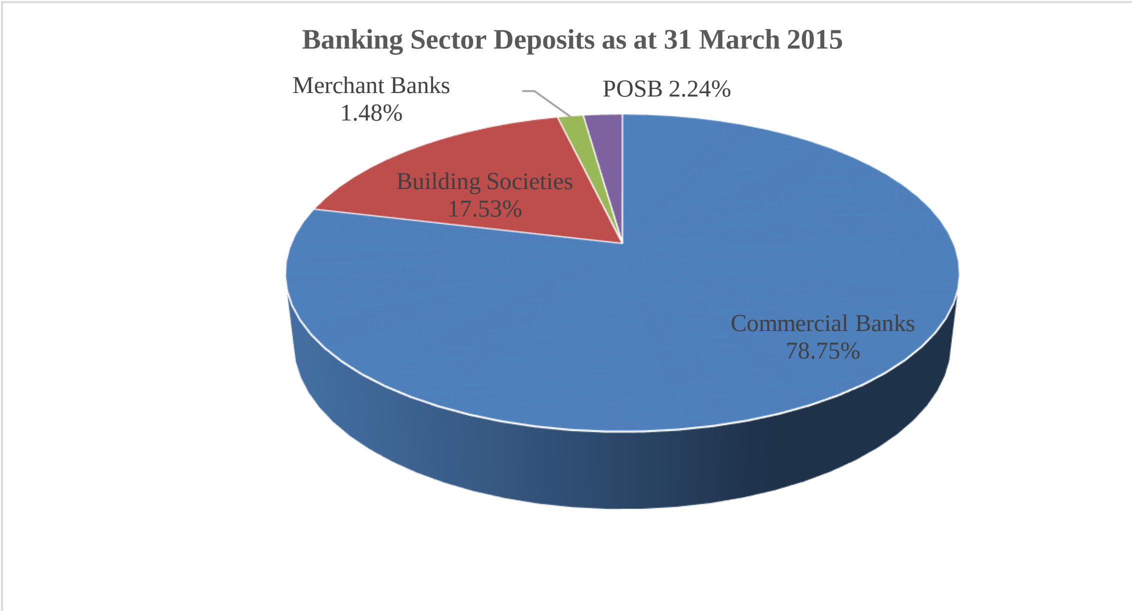
3.28. Total banking sector deposits amounted to **$5.29 billion** as at 31 March 2015 and the figure below shows a trend in deposits from 30 June 2009.



3.29. The sector deposits continued to be dominated by demand deposits which accounted for 55.15% of total deposits as at 31 March 2015 as indicated below.



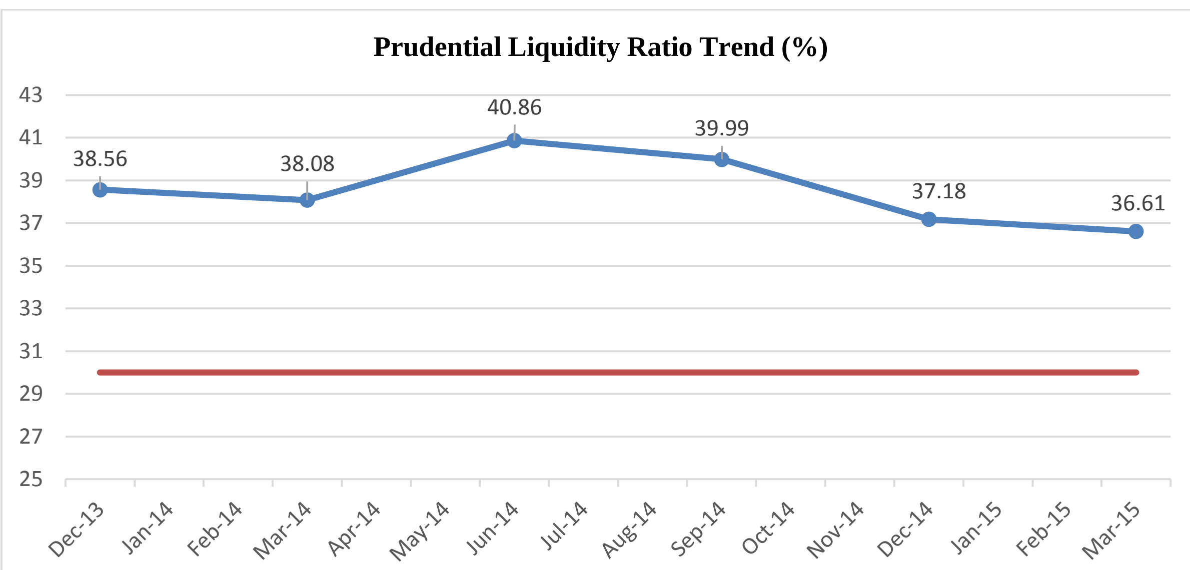
3.30. Commercial banking sub-sector held 78.75% of total banking sector deposits as at 31 March 2015.



3.31. The top five (5) banks, in terms of deposits, had deposits amounting to $2.61 billion as at 31 March 2015, representing **62.88%** of total banking sector deposits.

3.32. The banking sector average prudential liquidity ratio of 34.37% as at 31 March 2015 was in compliance with the regulatory minimum of 30%, notwithstanding the general liquidity challenges in the economy.

3.33. The diagram shows average prudential liquidity ratios since December 2013.



3.34. As at 31 March 2015, five (5) banking institutions were not compliant with the minimum regulatory requirement and a few of these institutions faced liquidity challenges.

Sensitivity to Market Risk…

3.35. Generally, the sector's exposure to market risk remained low. Under the current operating environment, the sector's exposure to interest rate risk was mainly in the banking book.

3.36. Aggregate stress test results reflect strong resilience to market risk shocks for the banking system as a whole.

3.37. Inherent foreign exchange rate risk remained low given banks' current balance sheet structures. The banking sector had an overall positive net Foreign Exchange open position of $462.51 million as at 31 March 2015.

3.38. Stress tests conducted to assess the vulnerability of banking institutions' to foreign exchange rate movements showed that 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.

31 March 2015