RESERVE BANK OF ZIMBABWE

BANK SUPERVISION DIVISION

BANKING SECTOR REPORT

FOR

QUARTER ENDED 30 SEPTEMBER 2014

1. EXECUTIVE SUMMARY

1.1. The banking sector remained generally stable during the quarter ended 30 September 2014, despite the adverse operating environment.

1.2. Majority of banking institutions had capital which was in compliance with the minimum capital requirements. The non-compliant banks are instituting various measures towards compliance.

1.3. Banking sector deposits remained largely stable at **$4.96 billion** over the two quarters ended 30 June and 30 September 2014.

1.4. Total banking sector loans and advances amounted to **$3.84 billion,** as at 30 September 2014.The household sector borrowed 21% compared to 77%, by the corporations and 2% by central government and state enterprises.

1.5. The transitory nature of deposits and limited sources of long term funding has continued to hamper effective intermediation to productive sectors of the economy. The situation is further exacerbated by limited inter-bank trading, general market liquidity constraints and limited lender of last resort function.

1.6. Liquidity and credit risk remain the major challenges facing the banking sector. The average non-performing loans to total loans ratio was 20.45% as at 30 September 2014.

1.7. Nonetheless, the banking sector has been profitable despite the decline in the overall profit levels. As at 30 September 2014, 13 out of 20 operating institutions reported profits. The earnings capacity has been weighed down by rising level of non-performing loans.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 30 September 2014, the composition 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

2.2. In addition, there were 135 credit-only-microfinance institutions under the supervision of the Reserve Bank.

3. CONDITION AND PERFORMANCE OF THE SECTOR

3.1. The macroeconomic constraints as well as institution-specific deficiencies continue to affect the performance and condition of the banking institutions.

3.2. Economic performance remains fragile, on account of the various challenges the economy is facing, notably supply side bottlenecks, liquidity shortages, lack of long term financing, competition from cheap imports, company closures, and the slow pace of recovery in the advanced economies.

3.3. Meanwhile, the government through the 2015 National Budget announced on 27 November 2014, has instituted a number of measures to address some of the challenges by recommending a continuum of policies that seek to boost economic activities.

3.4. The overall performance of the banking sector based on the CAMELS rating framework was considered to be **satisfactory** as at 30 September 2014.

3.5. The following financial soundness indicators highlight the condition and performance of the banking sector:

Table 2: Banking Sector Statistics

Key Indicators	Dec -09	Dec-10	Dec -11	Dec - 12	Dec - 13	Mar -14	Jun - 14	Sep -14
Total Assets	$2.19 bn	$3.69 bn	$4.74 bn	$6.12 bn	$6.74 bn	$6.81 bn	$6.90 bn	$7.11 bn
Total Loans	$693 m	$1.56 bn	$2.76 bn	$3.56 bn	$3.08 bn	$3.82 bn	$3.81 bn	$3.84 bn
Net Capital Base	$382 m	$458 m	$512 m	$644 m	$706 m	$909 m	$893 m	$913 m
Total Deposits	$ 1.36 bn	$ 2.31 bn	$ 3.04 bn	$4.41 bn	$ 4.73 bn	$4.89 bn	$4.96 bn	$4.96 bn
Net Profit	$9.50 m	$37.95 m	$86 m	$69.2 m	$4.46 m	$20.4 m	$26.5 m	$24.35 m
Return on Assets	0.60%	-2.02%	2.43%	1.64%	0.06%	0.26%	0.49%	0.37%
Return on Equity	2.47%	0.57%	15.13%	9.17%	0.51%	2.12%	2.72%	2.54%
Capital Adequacy Ratio	27.26%	27.34%	13.51%	13.07%	14.01%	14.10%	18.56%	18.20%
Loans to Deposits	50.99%	86.25%	90.59%	93.27%	102.36%	78.03%	76.82%	77.41%
ACL/TL	1.80%	10.95%	7.55%	13.46%	15.92%	16.96%	18.49%	20.45%*
Provisions to ACL	112.81%	887.71%	57.53%	207.45%	70.88%	46.73%	39.29%	47.76%
Net Interest Margin	3.29%	5.75%	8.21%	14.81%	15.26%	-0.15%	2.03%	4.20%
Liquidity Ratio	97.44%	70.88%	56.80%	55.70%	40.57%	38.10%	38.20%	38.20%
Cost to Income Ratio	94.38%	148.95%	185.11%	99.95%	173.43%	87.15%	95.77%	96.63%

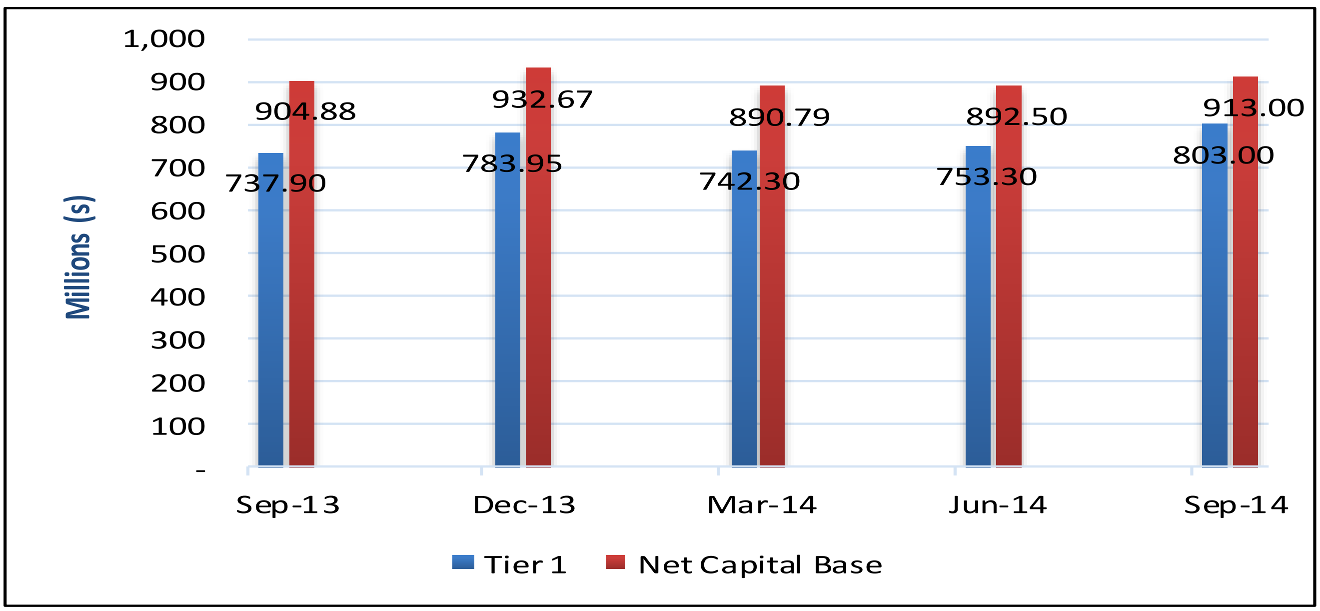
* *Excluding Interfin which is under curatorship ACL/TL is 16.89%*

Capital Adequacy…

3.6. The banking sector reported a **net capital base** and c**ore capital position of $913.00 million** and **$803.00 million** as at 30 September 2014, respectively. This represented an improvement from $893 million and $753.3 million, respectively, as at 30 June 2014. The increase in the capital position was largely attributed to profits recorded by some banking institutions during the quarter.

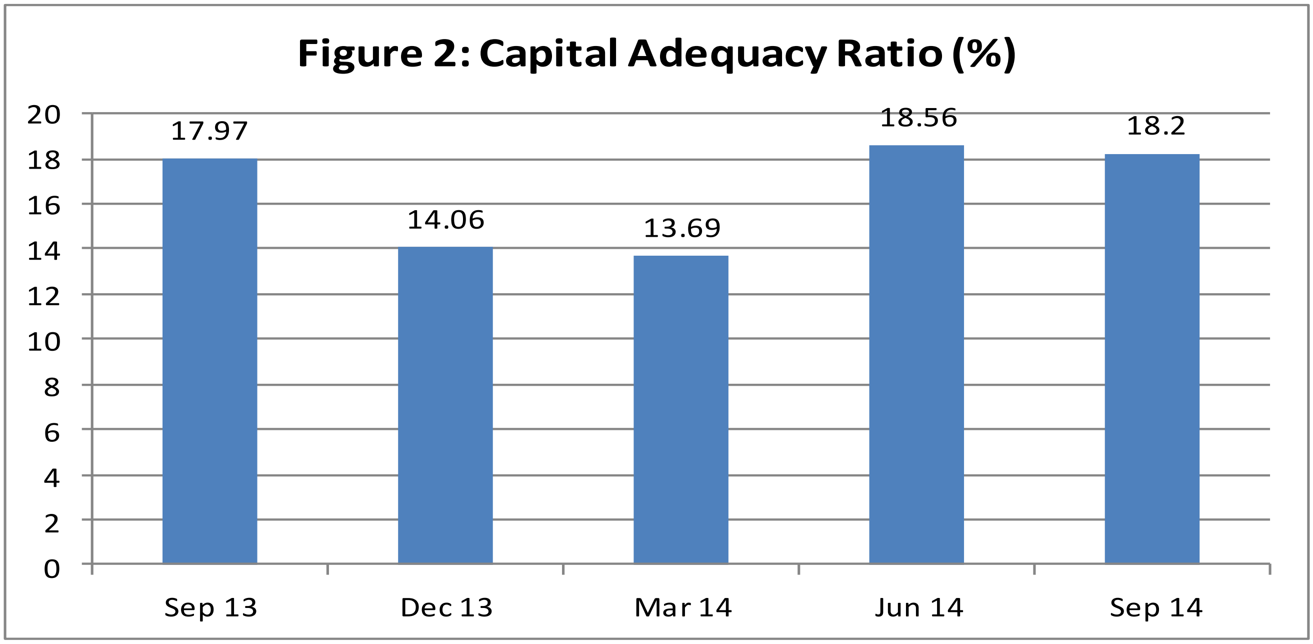
3.7. The following diagram shows the trend in net capital base and core capital levels from September 2013 to September 2014.

Figure 1: Banking Sector Capitalization Levels



3.8. As at 30 September 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.

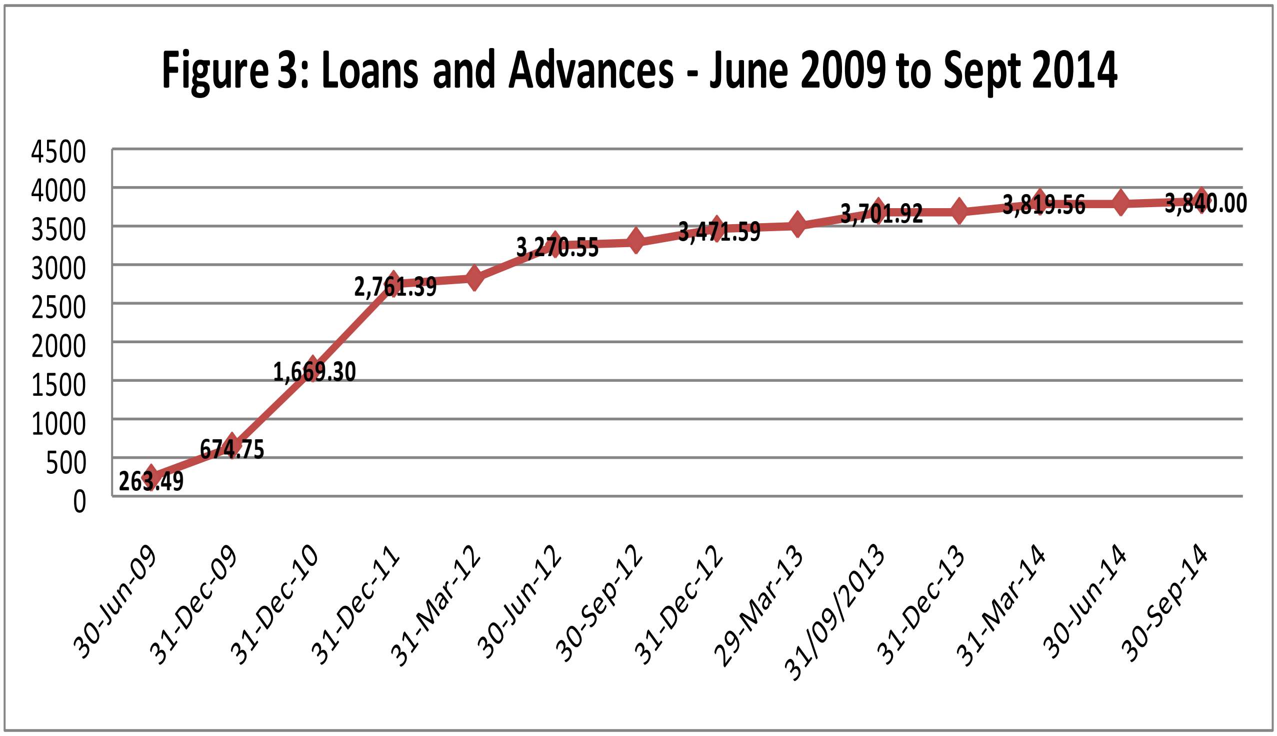
3.9. The average capital adequacy ratio of 18.20% for the period ended 30 September 2014 was above the minimum regulatory ratio of 12%. The trend in the banking industry's average capital adequacy ratios (CARs) from September 2013 to September 2014 is indicated below.



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

Asset Quality...

3.11. Total banking sector loans and advances amounted to **$3.84 billion,** as at 30 September 2014, up from $3.81 billion as at 30 June 2014. The trend line showing the upward growth trajectory in total loans and advances is depicted below.



3.12. Commercial banks continue to dominate the banking sector as they accounted for 80.72% of total banking sector loans and advances.

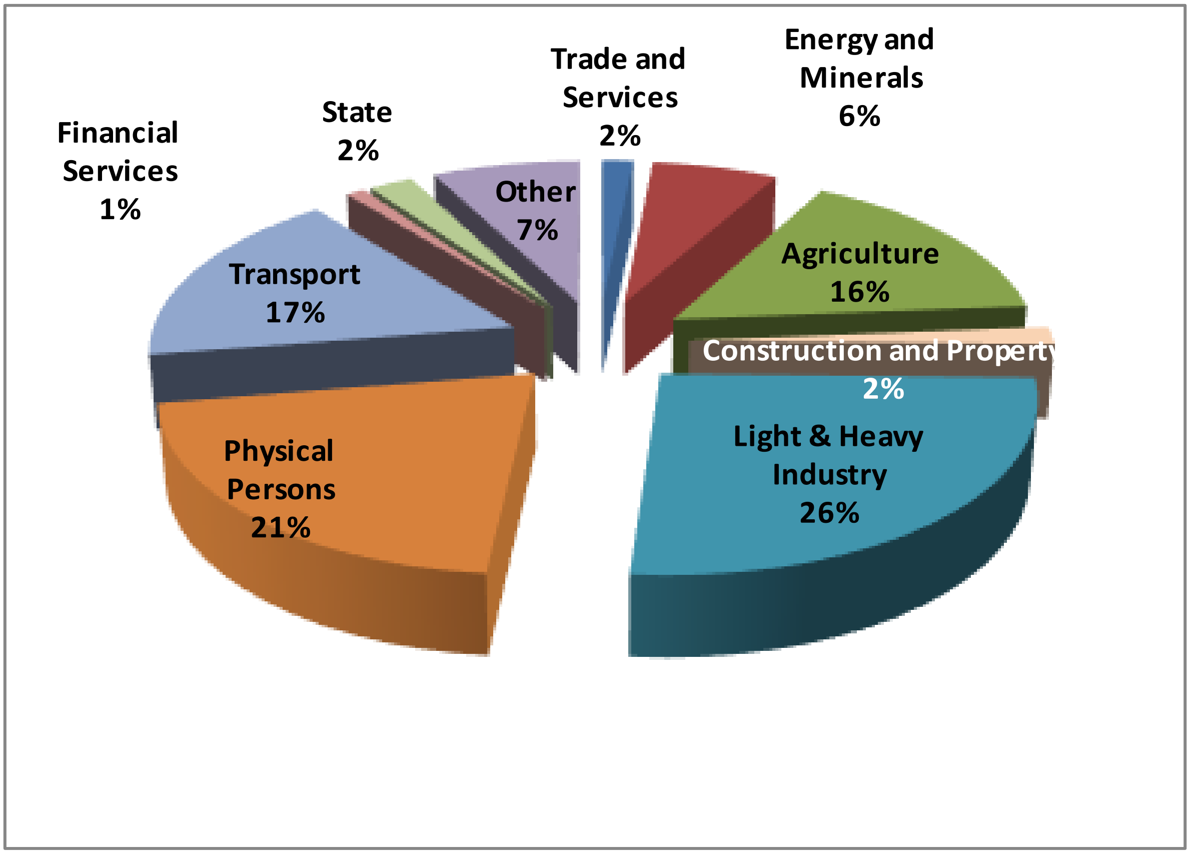
3.13. Top five banks had loans and advances amounting to **$2.44 billion**, which accounted for **63.54%** of total banking sector loans and advances as at 30 September 2014.

3.14. The banking sector had advanced 21% of their loan portfolio to the household sector compared to 77% to corporations and 2% to the State and state enterprises.

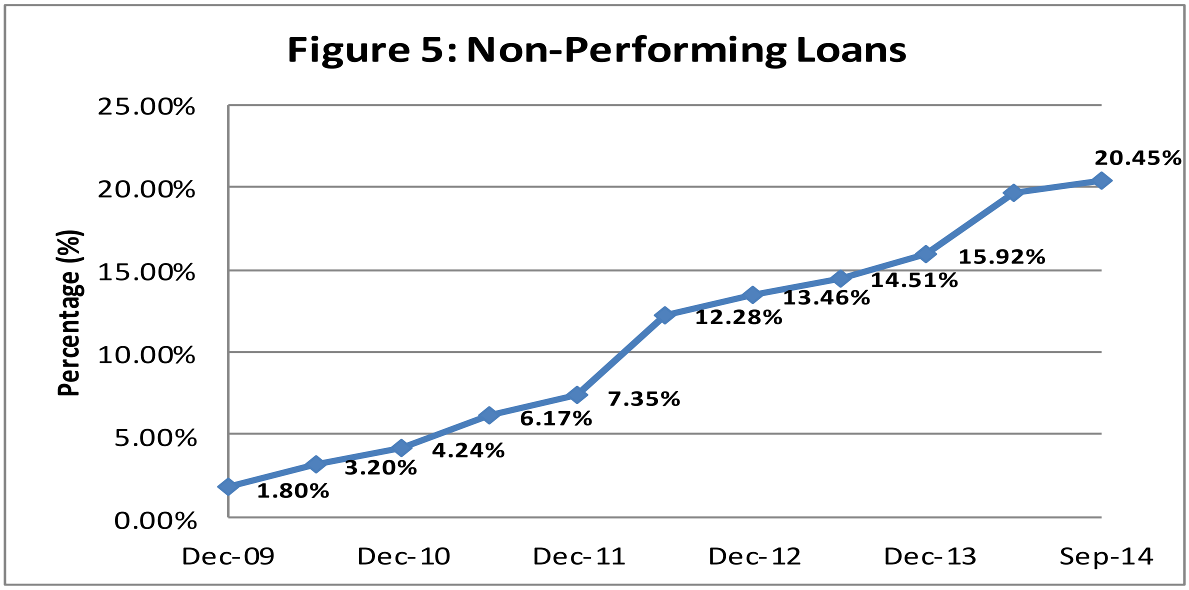
3.15. Within the corporate sector segment the light and heavy industries, transport and agriculture were the dominant sectors receiving banking sector credit.

3.16. The figure below shows the sectoral distribution of credit as at 30 September 2014:

Figure 4: Sectoral Distribution of Credit as at 30 September 2014



3.17. Credit risk remained a key challenge across a number of institutions. The average ratio of non-performing loans to total loans increased to **20.45%** as at 30 September 2014, up from **18.49%** as at 30 June 2014. The diagram show the trend of the banking sector NPLs ratio over the last few years.



3.18. In an effort to address the problem of NPLs, the Reserve Bank in collaboration with the Ministry of Finance, has established an asset management company (Zimbabwe Asset Management Company (ZAMCO)) which will buy non-performing loans from financial institutions.

Earnings...

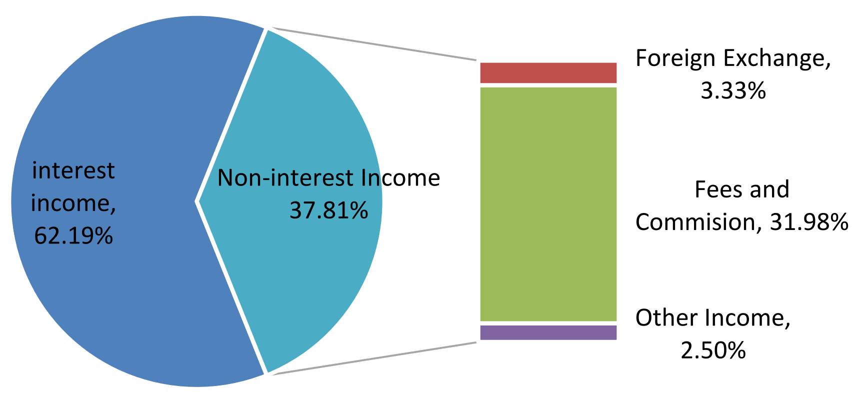
3.19. The banking sector reported an aggregate net profit of $24.35 million for the nine months ended 30 September 2014. This represents a marginally lower position compared to $29.93 million reported for the same period in 2013.

3.20. A total of 13 banks out of the 20 operating banking institutions recorded profits. The losses recorded by the other seven banking institutions are attributed to high levels of non- performing loans and lack of critical mass to generate sufficient revenue to cover high operating expenses.

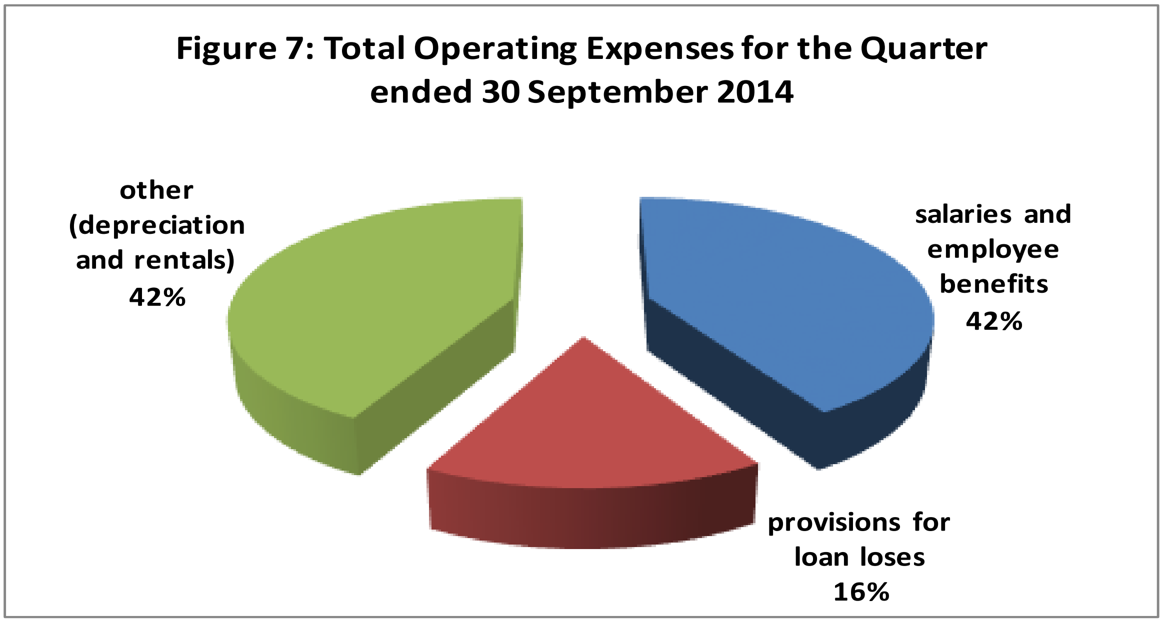
3.21. Profitability indicators for the banking sector, as measured by the average return on assets (ROA) and return on equity (ROE), deteriorated during the nine months to 30 September 2014 compared to 30 September 2013 as indicated in Table 2 above.

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

Figure 6: Income Mix for the Quarter ended 30 September 2014

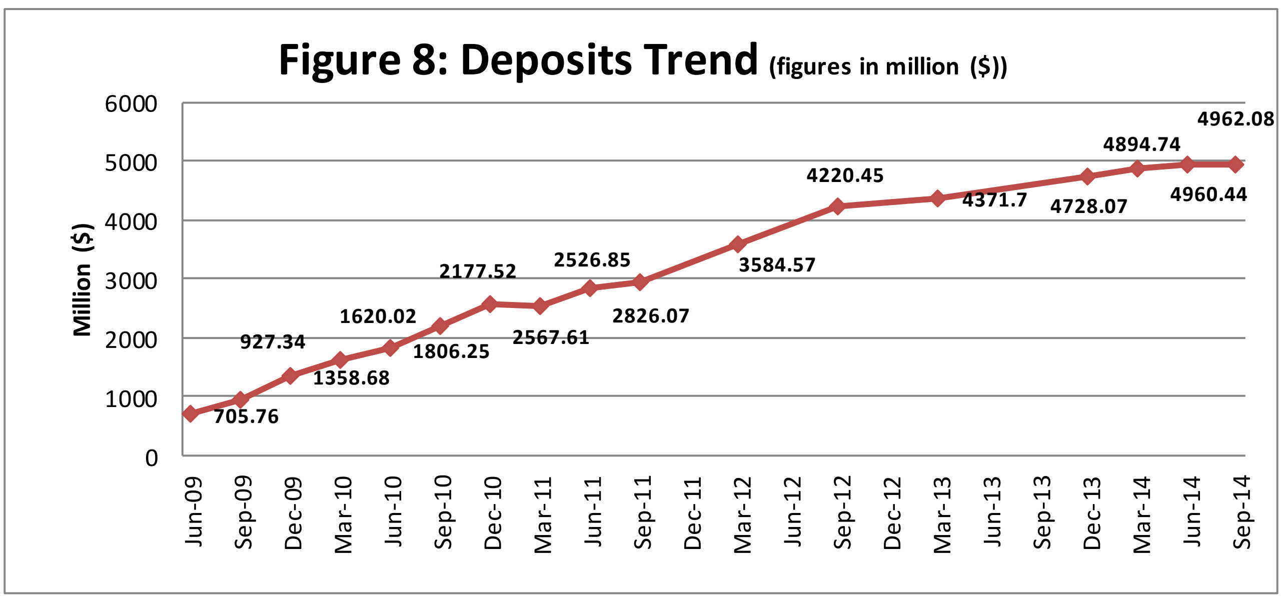


3.23. The composition of operating expenses for the banking sector is shown in the figure below.



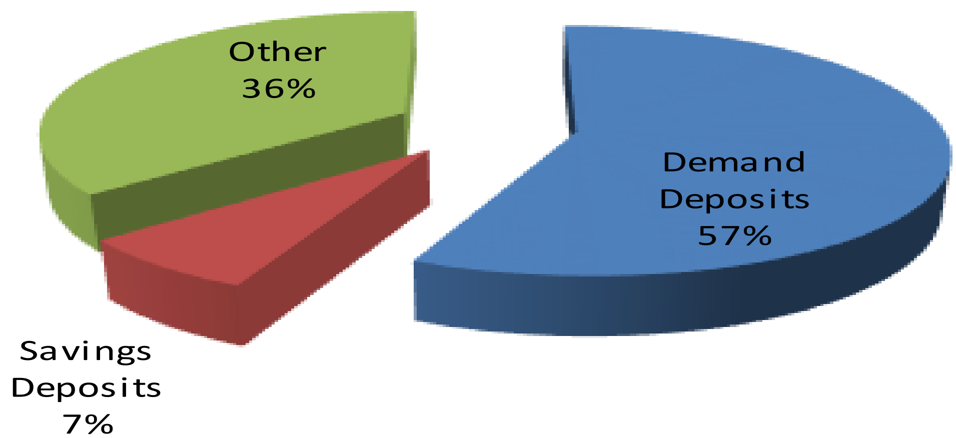
Liquidity and Funds Management...

3.24. As at 30 September 2014, the banking sector had mobilized deposits amounting to $4.96 billion as shown below.



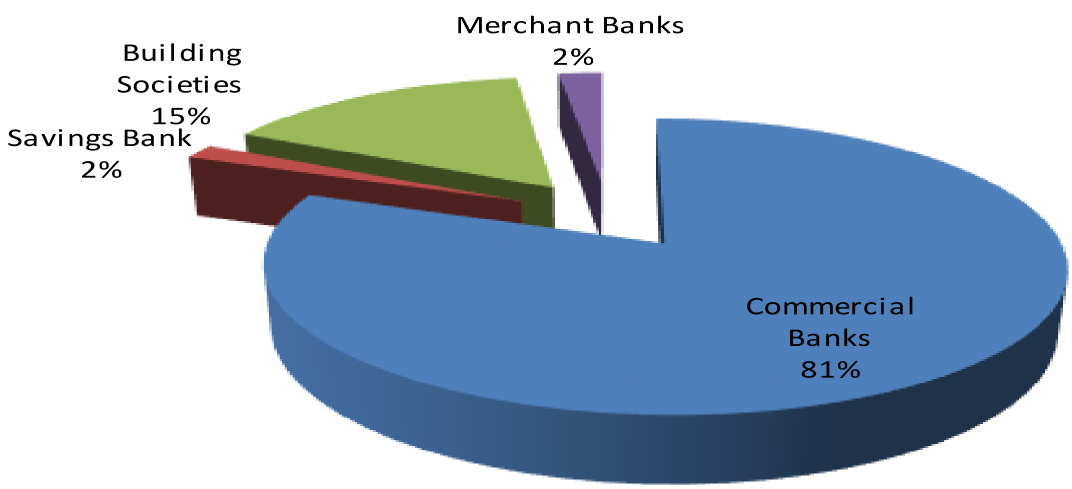
3.25. The deposits are dominated by demand deposits which accounted for 56.81% of total deposits as at 30 September 2014 as indicated below.

Figure 8: Composition of Deposits as at 30 September 2014



3.26. Commercial banking sub-sector held 81% of total banking sector deposits as at 30 September 2014.

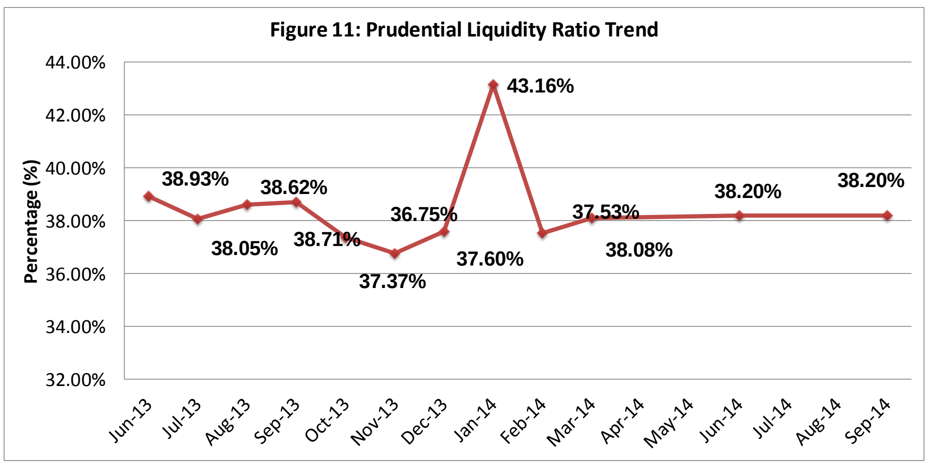
Figure 9: Banking Sector Deposits



3.27. As at 30 September 2014, the top five banking institutions had deposits above $300 million each, amounting to $2.53 billion, and representing 51.01% of total banking sector.

3.28. The banking sector average prudential liquidity ratio of 38.20% as at 30 September 2014 was above the regulatory minimum of 30%. While the majority of the banking institutions are compliant with the minimum prudential liquidity ratio, some banking institutions are however, beset by chronic liquidity constraints.

3.29. The diagram reflects average liquidity position since 30 June 2013.



Sensitivity to Market Risk…

3.30. The inherent interest rate risk in the banking system was considered to be low. Under the current operating environment, the sector's exposure to interest rate risk is mainly in the banking book.

3.31. Sources of funding for banks are predominantly retail deposits which are relatively less interest rate sensitive while re-pricing assets are mainly loans and advances.

3.32. In addition, the inherent foreign exchange risk was considered to be low. The banking sector had an overall positive net foreign exchange open position of $379.67 million as at 30 September 2014.

30 September 2014