QUARTERLY BANKING SECTOR REPORT

30 JUNE 2016

BANK SUPERVISION DIVISION

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY

1.1. The performance of the banking sector remained satisfactory notwithstanding the challenging macroeconomic environment.

1.2. As at 30 June 2016, all operating banking institutions were in compliance with the prescribed minimum capital requirements and were making progress towards attaining compliance with 2020 minimum capital requirements.

1.3. Banking sector loans and deposits amounted to $3.73 billion and $5.91 billion, respectively, translating to a loans-to-deposit ratio of 63.11%.

1.4. The quality of the banking sector's loan portfolio continued to improve as reflected by a decline in the non-performing loans (NPL) to total loans ratio from 10.81% to 10.05% during the quarter ended 30 June 2016. The improvement in asset quality is partly attributed to maintenance of sound credit risk management systems in the sector coupled with further disposal of NPLs amounting to $109.78 million to the Zimbabwe Asset Management Company (ZAMCO) by banking institutions.

1.5. The banking sector reported an aggregate net profit of $67.97 million for the six months ended 30 June 2016**,** up from $34.89 million reported for the corresponding period in 2015. The increase was mainly driven by lower loan loss provisions in line with improving asset quality at some institutions, lower interest expenses and realignment of cost structures.

1.6. As at 30 June 2016, the banking sector average prudential liquidity ratio of 52.47% remained above the minimum regulatory requirement of 30%. The sector has, however, been facing cash challenges that are symptomatic of the macroeconomic challenges facing the country, including persistent current account deficits and lack of fiscal space. The various policy measures put in place by the Reserve Bank to lessen the demand for cash and promote the usage of electronic payments are expected to ameliorate the cash challenges.

1.7. The average effective lending rate for the sector further declined from 17.84% to 17.36% per annum during the quarter under review. Average deposit rates ranged between 1.6% and 8.50% per annum.

1.8. Significant progress was made towards the establishment of a credit registry. The credit registry software provider deployed the test version of the system in June 2016, to be followed by rollout of the system during the quarter ended 30 September 2016.

1.9. Following the launch of the National Financial Inclusion Strategy on 11 March 2016, the Reserve Bank is coordinating a number of activities including the constitution of various thematic committees and development of policies and guidelines.

2. FINANCIAL ARCHITECTURE

2.1 As at 30 June 2016, 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
Building Societies	5
Savings Bank	1
Total Banking Institutions	**19**
Other institutions supervised by the Reserve Bank	
Credit-only-MFIs	164
Deposit-taking MFIs	4
Development Financial Institutions	2

2.2 National Building Society Limited, which was licenced on 11 September 2015, commenced operations on 27 April 2016. Lion Microfinance Limited was licenced on 31 May 2016, bringing the number of deposit-taking microfinance institutions to four (4).

2.3 Collarhedge Financial Services (Private) Limited, which was licenced on 17 November 2015, was putting in place appropriate ICT and other infrastructure in line with minimum requirements for commencement of deposit-taking microfinance business.

3. CONDITION & PERFORMANCE OF THE BANKING SECTOR

3.1 The banking sector performed satisfactorily on metrics such as capital adequacy, asset quality and profitability. However, the performance of the banking sector was affected by the macroeconomic conditions, an overvalued exchange rate and depressed aggregate demand. The sector also experienced cash shortages.

3.2 The following table summarises the financial soundness indicators of the banking sector as at 30 June 2016.

Financial Soundness Indicators

Key Indicators	**Dec -11**	**Dec - 12**	**Dec – 13**	**Dec -14**	**June - 15**	**Dec -15**	**Mar-16**	**June-16**
Total Assets	$4.74bn	$6.12bn	$6.74bn	$7.12bn	$7.59bn	$7.83bn	$7.79bn	**$8.01bn**
Total Loans	$2.76bn	$3.56bn	$3.08bn	$4.01bn	$3.94bn	$3.87bn	$3.81bn	**$3.73 bn**
Net Capital Base	$512m	$644m	$706m	$926.6m	$1.04bn	$1.14bn	$1.16bn	**$1.21bn**
Total Deposits	$ 3.04bn	$4.41bn	$ 4.73bn	$5.08bn	$5.60bn	$5.62bn	$5.67bn	**$5.91bn**
Net Profit	$86.00m	$69.20m	$4.46m	$50.84m	$43.01m	$127.47m	$38.44m	**$67.79m**
Return on Assets	2.43%	1.64%	0.06%	0.92%	0.63%	2.11%	0.42%	**0.98%**
Return on Equity	15.13%	9.17%	0.51%	5.37%	3.26%	10.96%	2.79%	**5.54%**
Capital Adequacy Ratio	13.51%	13.07%	14.01%	17.33%	19.72%	21.31%	22.34%	**24.17%**
Loans to Deposits	90.59%	93.27%	102.36%	78.94%	71.40%	68.86%	67.19%	**63.11%**
Non-Performing Loans Ratio	7.55%	13.46%	15.92%	15.91%	14.52%	10.82%	10.81%	**10.05%**
Provisions to Adversely Classified Loans	57.53%	207.45%	70.88%	54.72%	64.29%	69.22%	77.36%	**69.87%**
Net Interest Margin	8.21%	14.81%	15.26%	4.24%	2.22%	8.62%	2.03%	**3.52%**
Liquidity Ratio	56.80%	55.70%	40.57%	39.34%	38.14%	45.35%	49.63%	**52.47%**
Cost to Income Ratio	82.17%	86.41%	96.60%	93.72%	90.76%	84.40%	86.30%	**84.25%**

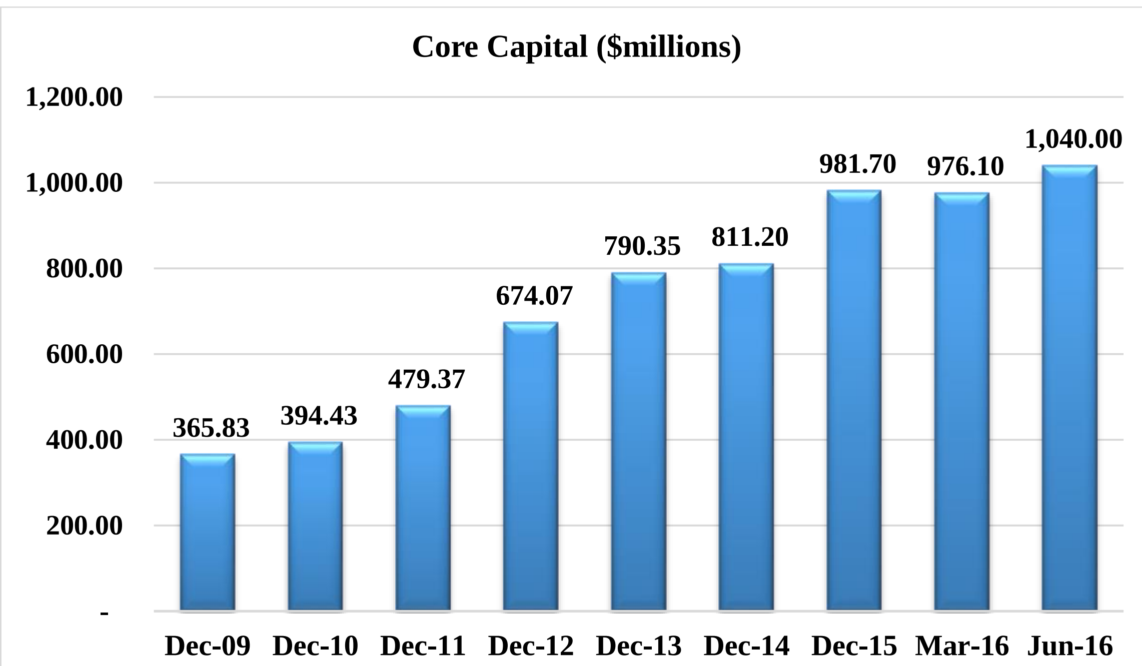
3.3 Below is a synopsis of the banking sector's performance during the review period;

Capital Adequacy…

3.4 The banking sector's aggregate core capital increased by 6.55% from $0.98 billion to $1.04 billion during the quarter ended 30 June 2016 on the back of satisfactory earnings performance.

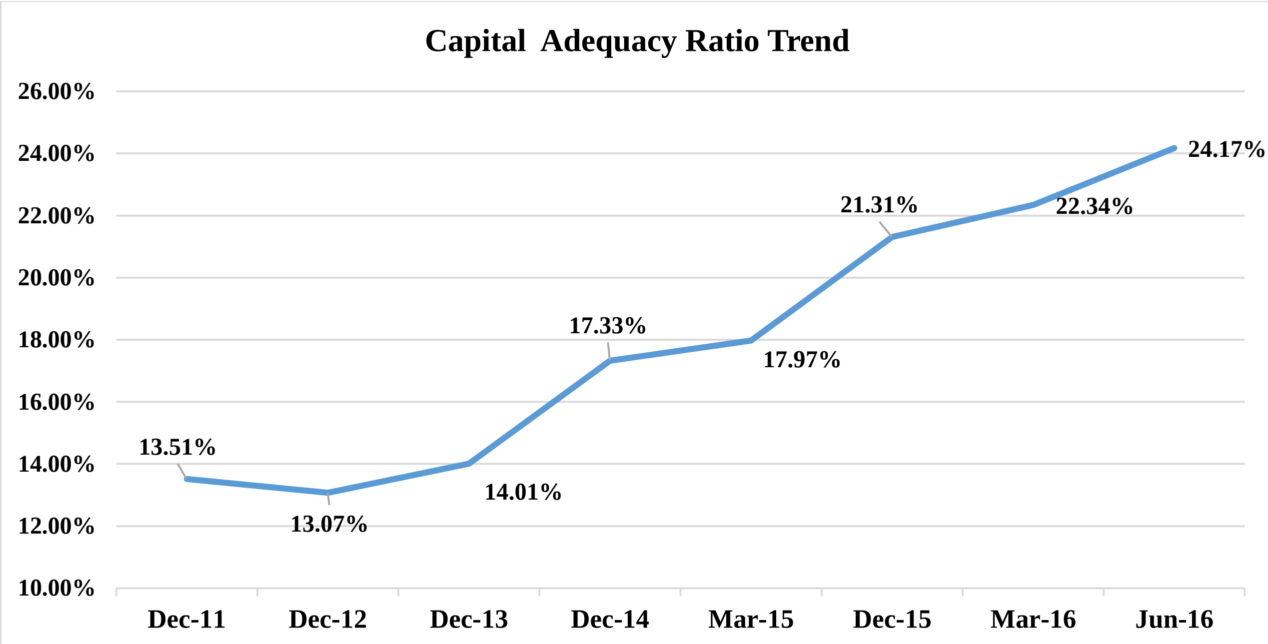
3.5 As at 30 June 2016, all operating banking institutions were in compliance with the prescribed minimum capital requirements.

3.6 The graph below shows banking sector core capital trends from December 2009 to June 2016:



3.7 The banking sector remained adequately capitalized with average capital adequacy and tier 1 ratios of 24.17% and 21.51% as at 30 June 2016, respectively. All banks complied with the minimum required capital adequacy and tier 1 ratios of 12% and 8%, respectively.

3.8 The trend in the banking industry's average capital adequacy ratios (CARs) from December 2011 to June 2016 is indicated in the figure below.



3.9 As at 30 June 2016, tier 1 capital constituted 85.60% of net capital base of $1.21 billion.

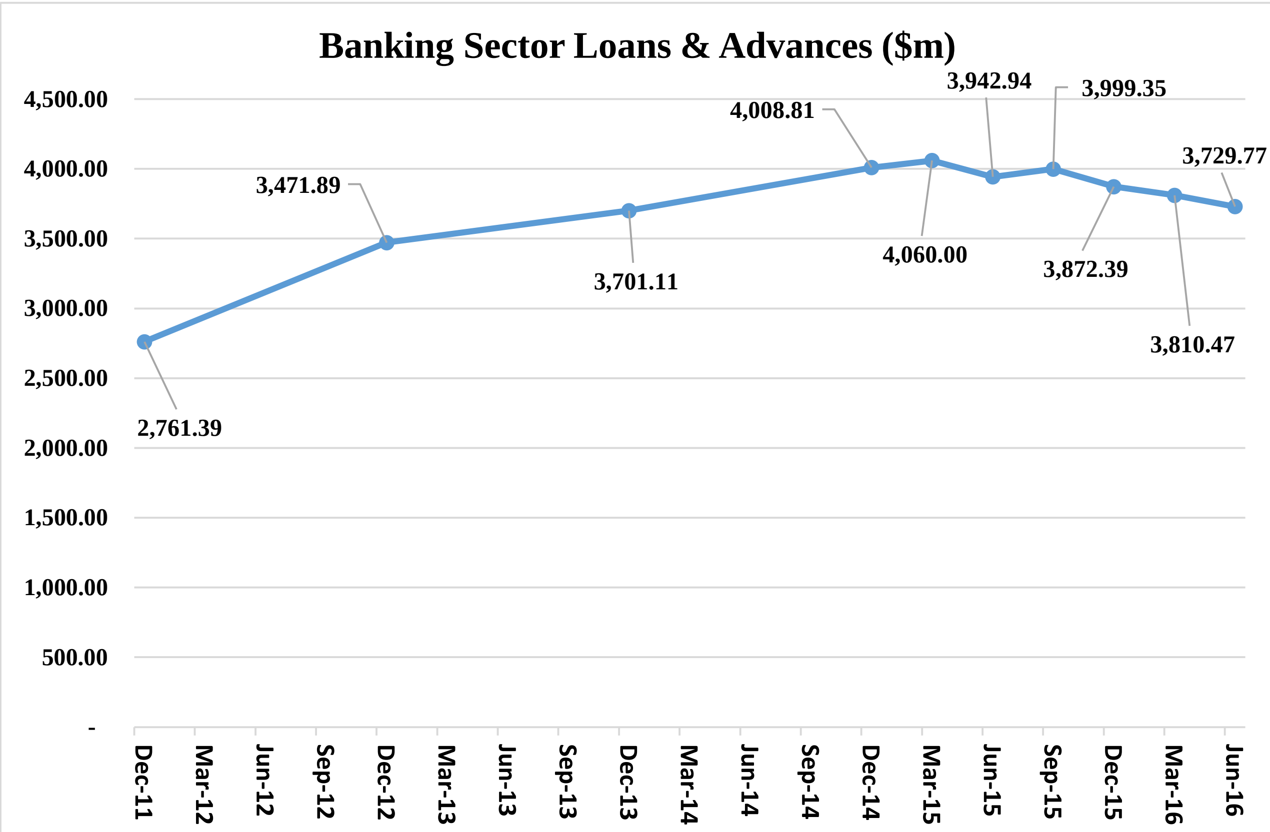
3.10 The Reserve Bank is monitoring banking institutions' progress towards compliance with the 2020 minimum capital requirements.

Asset Quality…

3.11 Banking sector loans and advances marginally declined by 2.14%, over the quarter, from **$3.81 billion** to **$3.73 billion** as at 30 June 2016. The downward trend in loans and advances continues to reflect intensified collections as well as disposal of non-performing loans to ZAMCO.

3.12 The graph below shows the trend of banking sector loans and advances from 31 December 2011 to 30 June 2016.

Trend of Banking Sector Loans

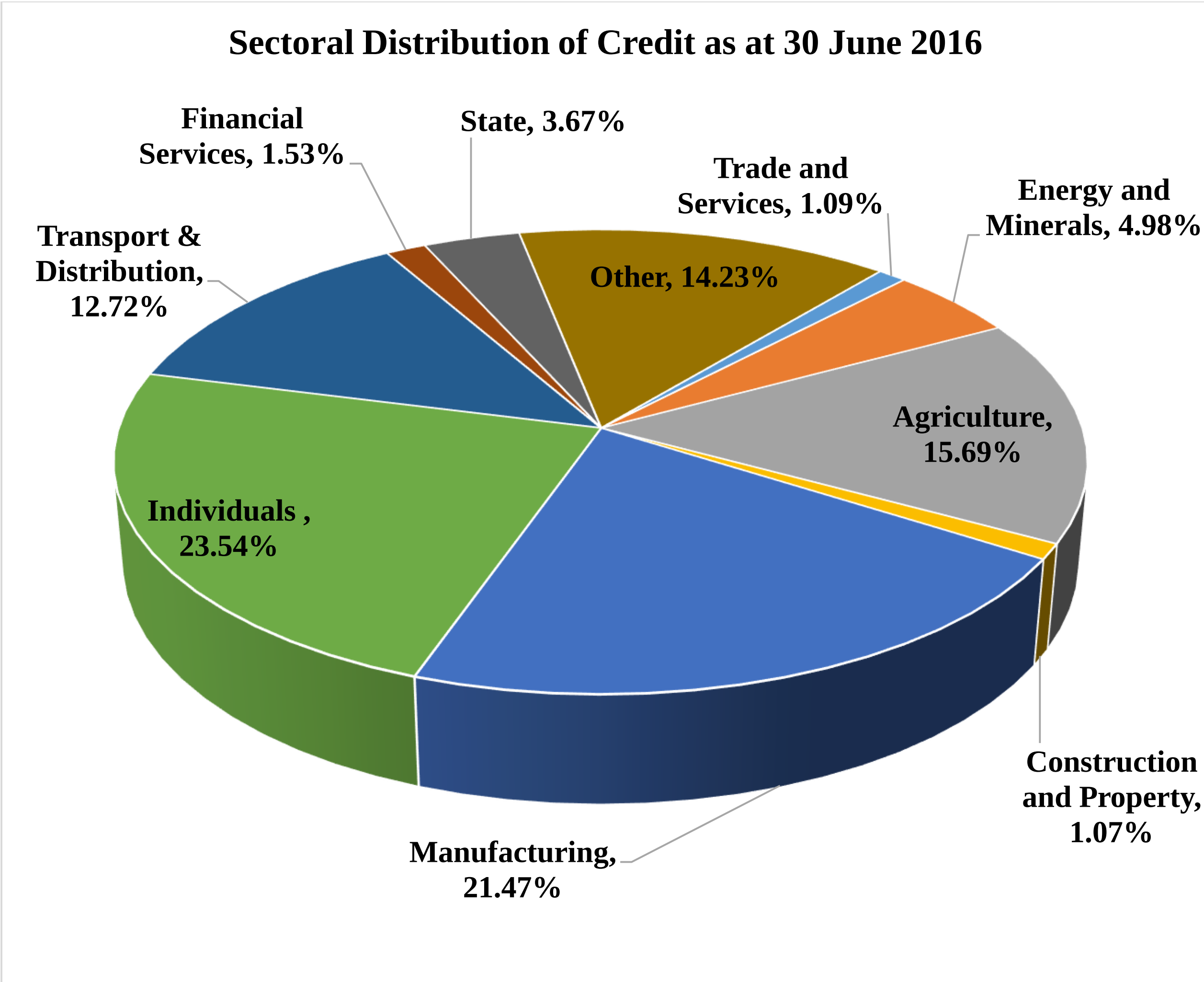


3.13 As at 30 June 2016, thirteen banking institutions were compliant with the target NPL ratio of 10% set for 30 June 2016. The remaining banks have instituted measures to improve the quality of their loan portfolios.

3.14 As at 30 June 2016, commercial banks accounted for 76.95% of total banking sector loans and advances, while building societies accounted for 21.10%.

3.15 Five banks, each with loan books in excess of $200 million, had total loans & advances amounting to **$2.29 billion**, accounting for **61.52%** of total banking sector loans & advances as at 30 June 2016.

3.16 The figure below indicates the distribution of banking sector lending to the various sectors as at 30 June 2016.



3.17 During the period under review, lending to individuals and the manufacturing sector continued to dominate the distribution of credit.

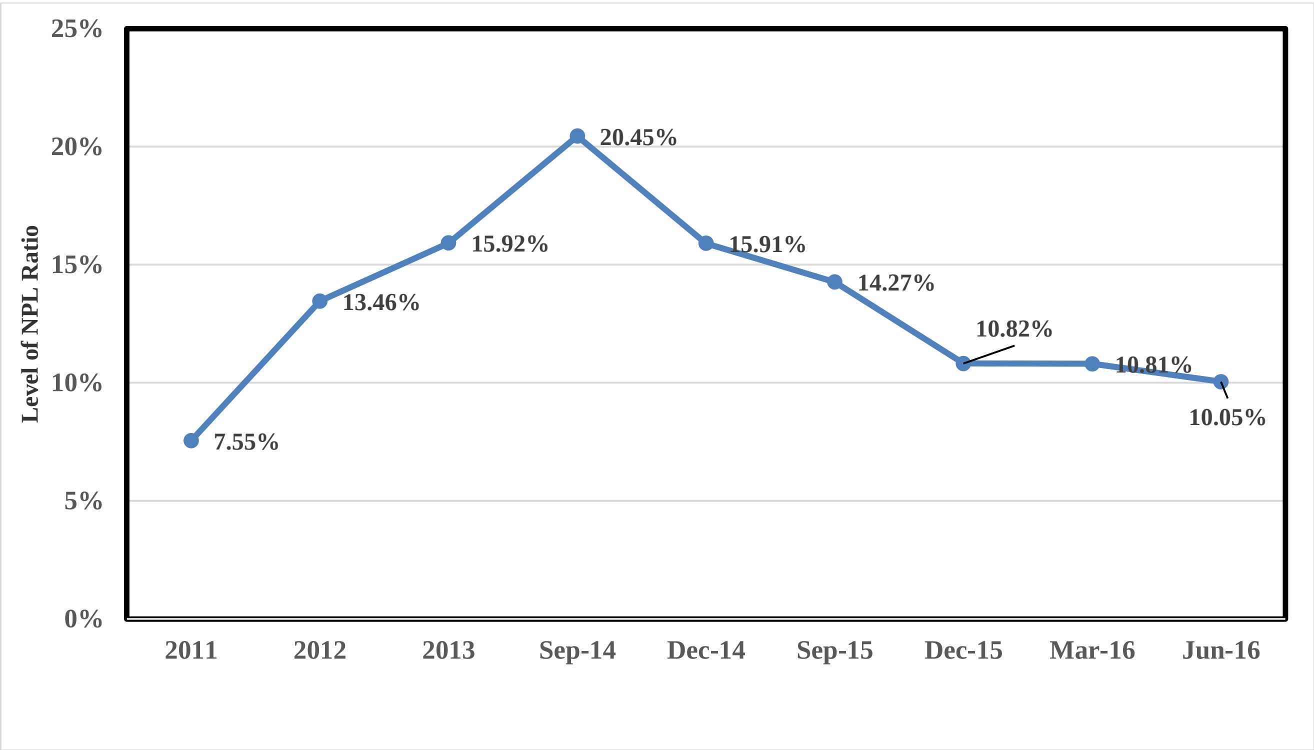
3.18 The ratio of non-performing loans (NPLs) in the banking sector improved from **10.81%** to **10.05 %** during the quarter ended 30 June 2016. The improvement is a manifestation of continued efforts by bank management to strengthen credit risk management systems, coupled with intensified collections and workout plans. In addition, banking institutions continued to dispose of qualifying NPLs to ZAMCO.

3.19 As at 30 June 2016, banking institutions had disposed loans amounting to $528.40 million to ZAMCO compared to $418.62 million as at 31 March 2016.

3.20 The above actions have assisted banking institutions to reduce their NPLs ratios to below the target ratio of 10% as at 30 June 2016.

3.21 The graph below shows the trend in NPLs from 2011 to 30 June 2016.

Trend in Non-Performing Loans as at 30 June 2016



Earnings Performance…

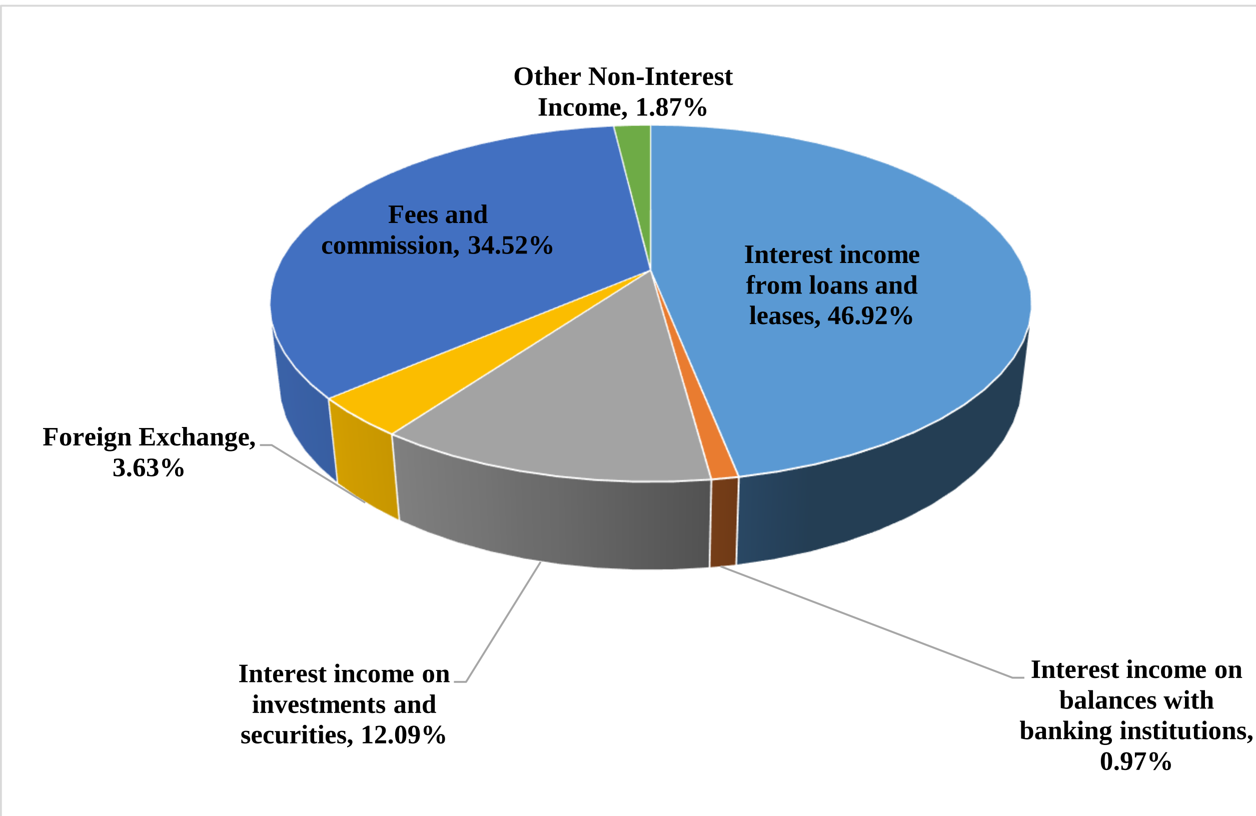
3.22 The banking sector recorded an increase of 99.85% in aggregate net profit to $67.79 million for the six months ended 30 June 2016 compared to $34.01 million recorded in the corresponding period in 2015. The increase translated to improved average return on assets and return on equity from 0.63% and 3.26% to 0.98% and 5.54%, respectively.

3.23 The increase in profitability was largely driven by lower loan loss provisions in line with the general improvement in asset quality, lower interest expenses, as well as continued realignment of cost structures at most institutions.

3.24 Seventeen out of 19 operating banking institutions recorded profits during the period ended 30 June 2016.

3.25 Interest income continued to be the major driver of total income, representing 59.98% of total income of $497.48 million. Non-interest income mainly comprised fees and commission, which constituted 86.25%.

3.26 The sources of income for the banking sector as at 30 June 2016 are shown in the figure below.



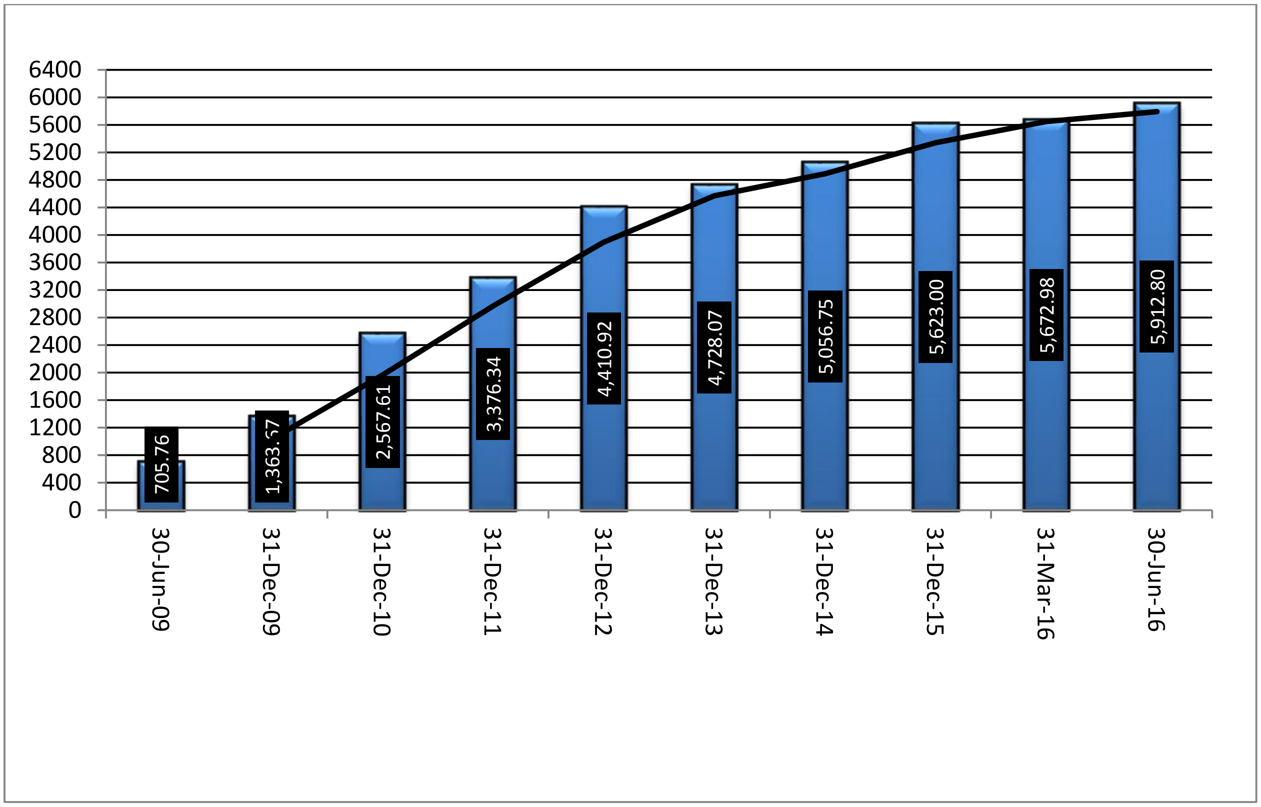
3.27 Banking institutions are taking various measures to enhance their earnings capacity through embracing technology and branchless banking, which are more cost efficient than traditional approaches to banking.

Liquidity & Funds Management…

3.28 Total banking sector deposits increased by 4.13%, from **$5.67 billion** to **$5.91 billion** during the quarter ended 30 June 2016.

3.29 The figure below shows the trend of banking sector deposits over the period 30 June 2009 to 30 June 2016.

Trend of Banking Sector Deposits



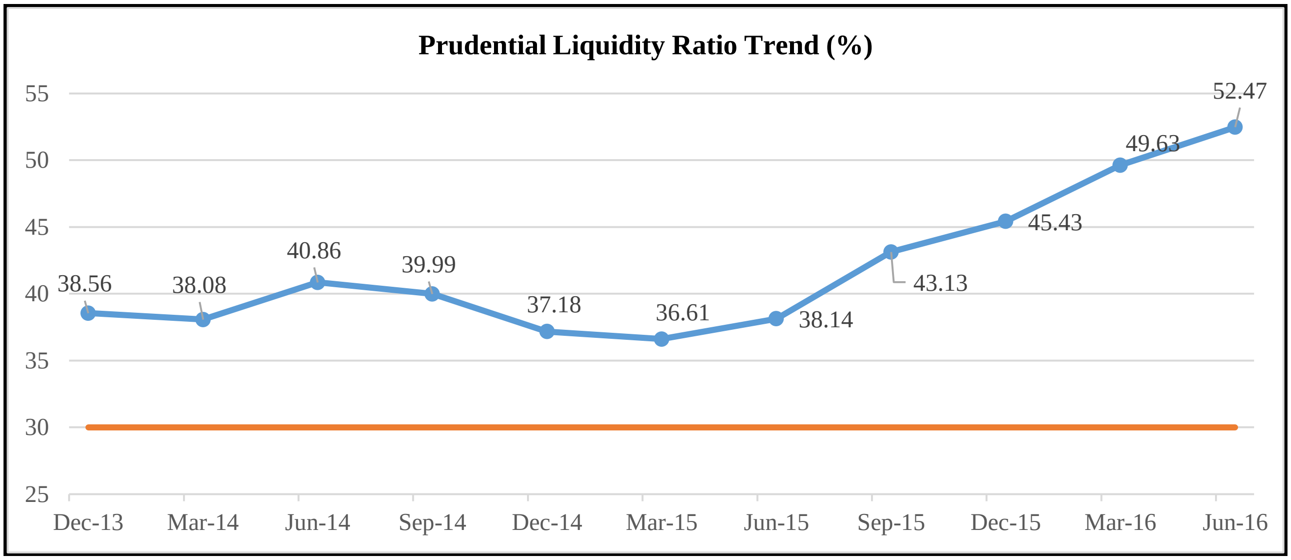
3.30 The commercial banking sub-sector accounted for 82.17% of banking sector deposits as at 30 June 2016.

3.31 Demand and time deposits continued to account for highest market shares in terms of banking sector deposits, constituting 50.75% and 22.33% respectively

3.32 The banking sector average prudential liquidity ratio at 52.47% as at 30 June 2016 remained above the stipulated minimum regulatory requirement of 30%.

3.33 The graph below shows the trend in the banking sector average prudential liquidity ratio since December 2013.

Prudential Liquidity Ratio: Dec 2013 - June 2016



3.34 Notwithstanding the high average prudential liquidity ratio, the banking sector continued to experience cash challenges. This, to a large extent, reflects macrostructure bottlenecks that include current account deficits and lack of fiscal space.

3.35 The Reserve Bank instituted a number of policy measures to ameliorate the cash challenges, including:

a) Limiting cash withdrawals;
b) Promoting the use of plastic money; and
c) Promoting the use of other currencies within the multi-currency basket.

Sensitivity to Market Risk…

3.36 As at 30 June 2016, the banking sector's sensitivity to market risk was considered low. Exposure to interest rate risk remains predominantly in the banking book.

3.37 Foreign exchange rate risk continues to be low as banks are not undertaking proprietary trading positions, while client transactions are mainly currency switches. The banking sector had an overall positive net foreign exchange open position as at 30 June 2016.

3.38 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.

30 June 2016