QUARTERLY BANKING SECTOR REPORT

30 SEPTEMBER 2015

BANK SUPERVISION DIVISION

1. EXECUTIVE SUMMARY

1.1. The banking sector remained safe and sound and continued to play a significant role in the economy. The sector recorded improvements in key financial indicators on the back of a number of measures instituted by the Reserve Bank to deal with credit and liquidity risks confronting the sector.

1.2. All operating banking institutions (*excluding Tetrad which is under judicial management*), were in compliance with the prescribed minimum capital requirements.

1.3. As at 30 September 2015, total banking sector deposits and loans amounted to $5.5 billion and $4.0 billion, respectively. Demand deposits continue to dominate the sector's funding sources while banking sector lending to individuals, agriculture and manufacturing were 25%, 17% and 13% respectively.

1.4. Non-performing loans ratio improved from 14.52% as at 30 June 2015 to 14.27% as at 30 September 2015. Nonetheless, credit risk continued to be a significant risk for the sector.

1.5. The sector recorded an aggregate net profit of $86.09 million compared to $7.47 million recorded in the same period ended 30 September 2014.

1.6. As at 30 September 2015, the banking sector had a strong liquidity position with an average prudential liquidity ratio of 43.13%.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1 As at 30 September 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	4
Savings Bank	1
Total Banking Institutions	**19**

***under provisional judicial management**

2.2 The following are other institutions that are under the purview of the Reserve Bank:

Credit-only-MFIs	147
Deposit-taking MFIs	2
Development Institutions	2

2.3 During the quarter ended 30 September 2015 the Reserve Bank licensed National Building Society Limited, a building society wholly owned by the National Social Security Authority. The society will commence operations once the Reserve Bank has conducted a pre-opening inspection.

2.4 The Reserve Bank granted a deposit-taking microfinance license to Getbucks Financial Services Limited during the quarter under review, to bring the number of deposit-taking MFIs to two. The deposit taking microfinance institutions are currently preparing for commencement of operations, subject to Reserve Bank authorization.

2.5 Tetrad Investment Bank remained under provisional judicial management of the Deposit Protection Corporation, as the bank pursues recapitalisation initiatives.

3. CONDITION AND PERFORMANCE OF THE BANKING SECTOR

3.1 The banking sector's financial condition was considered satisfactory as at 30 September 2015.

The following table summarises the financial soundness indicators of the banking sector.

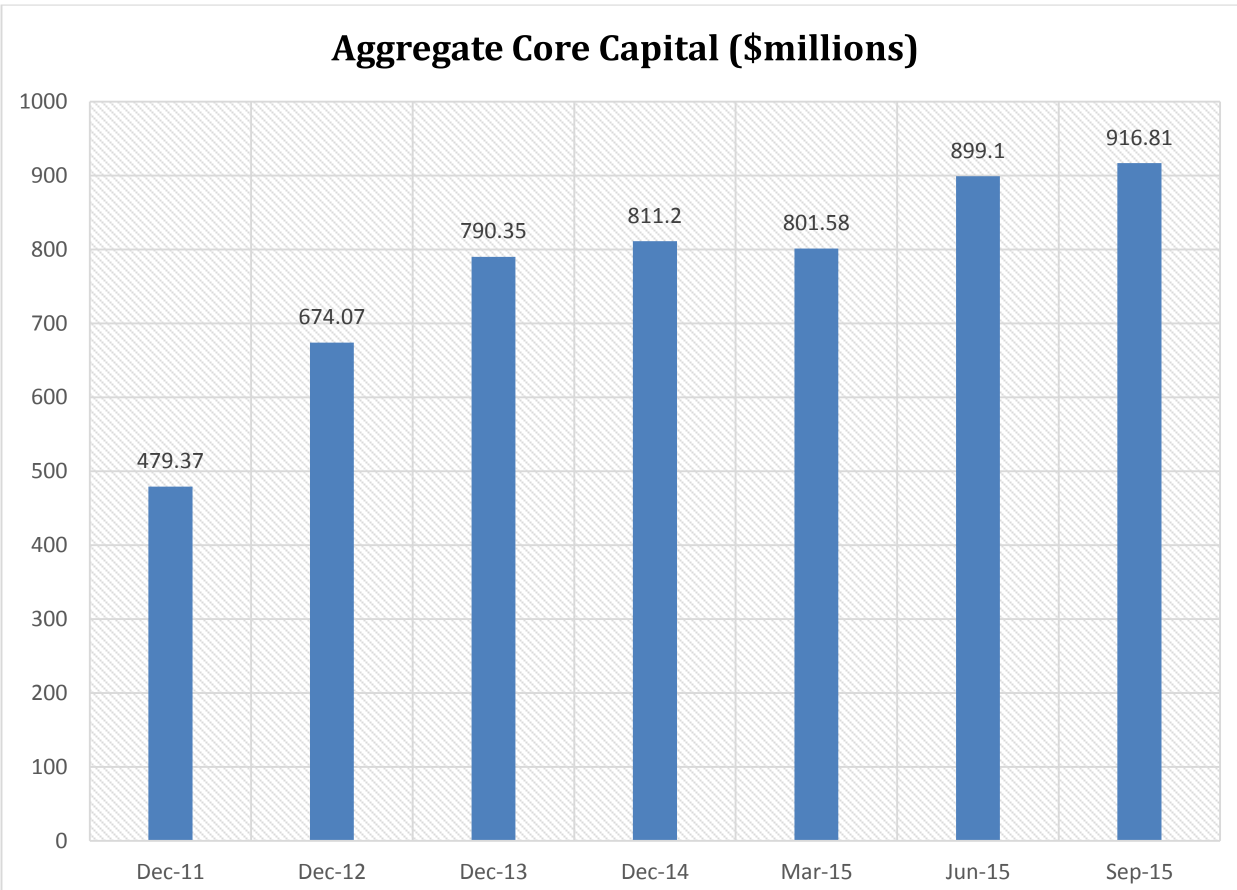
Financial Soundness Indicators (Dec 2011 to Sept 2015)

Key Indicators	Dec -11	Dec - 12	Dec – 13	Sept – 14	Dec -14	June-15	Sept-15
Total Assets	$4.74bn	$6.12bn	$6.74bn	$7.11 bn	$7.12bn	$7.59bn	**$7.73bn**
Total Loans	$2.76bn	$3.56bn	$3.08bn	$3.84 bn	$4.01bn	$3.94bn	**$4.00bn**
Net Capital Base	$512m	$644m	$706m	$913 m	$926.6m	$1.04bn	**$1.07bn**
Total Deposits	$ 3.04bn	$4.41bn	$ 4.73bn	$4.96 bn	$5.08bn	$5.60bn	**$5.5bn**
Net Profit	$86.00m	$69.20m	$4.46m	$7.47 m	$50.84m	$43.01m	**$86.09m**
Return on Assets	2.43%	1.64%	0.06%	0.37%	0.92%	0.63%	**1.37%**
Return on Equity	15.13%	9.17%	0.51%	2.54%	5.37%	3.26%	**7.91%**
Capital Adequacy Ratio	13.51%	13.07%	14.01%	18.20%	17.33%	19.72%	**19.7%**
Loans to Deposits	90.59%	93.27%	102.36%	77.41%	78.94%	71.40%	**72.70%**
Non-Performing Loans Ratio	7.55%	13.46%	15.92%	20.45%	15.91%	14.52%	**14.27%**
Provisions to Adversely Classified Loans	57.53%	207.45%	70.88%	47.76%	54.72%	64.29%	**61.04%**
Net Interest Margin	8.21%	14.81%	15.26%	4.20%	4.24%	2.22%	**4.76%**
Liquidity Ratio	56.80%	55.70%	40.57%	38.20%	39.34%	38.14%	**43.13%**
Cost to Income Ratio	82.17%	86.41%	96.60%	98.64%	93.72%	90.76%	**86.65%**

Capital Adequacy…

3.2 The banking sector's capitalization level continued to improve. The aggregate core capital base increased to $916.81 million as at 30 September 2015 from $899.10 million as at 30 June 2015, mainly due to capitalisation of earnings. The banking sector's net capital base also increased from $1.04 billion as at 30 June 2015 to $1.07 billion as at 30 September 2015.

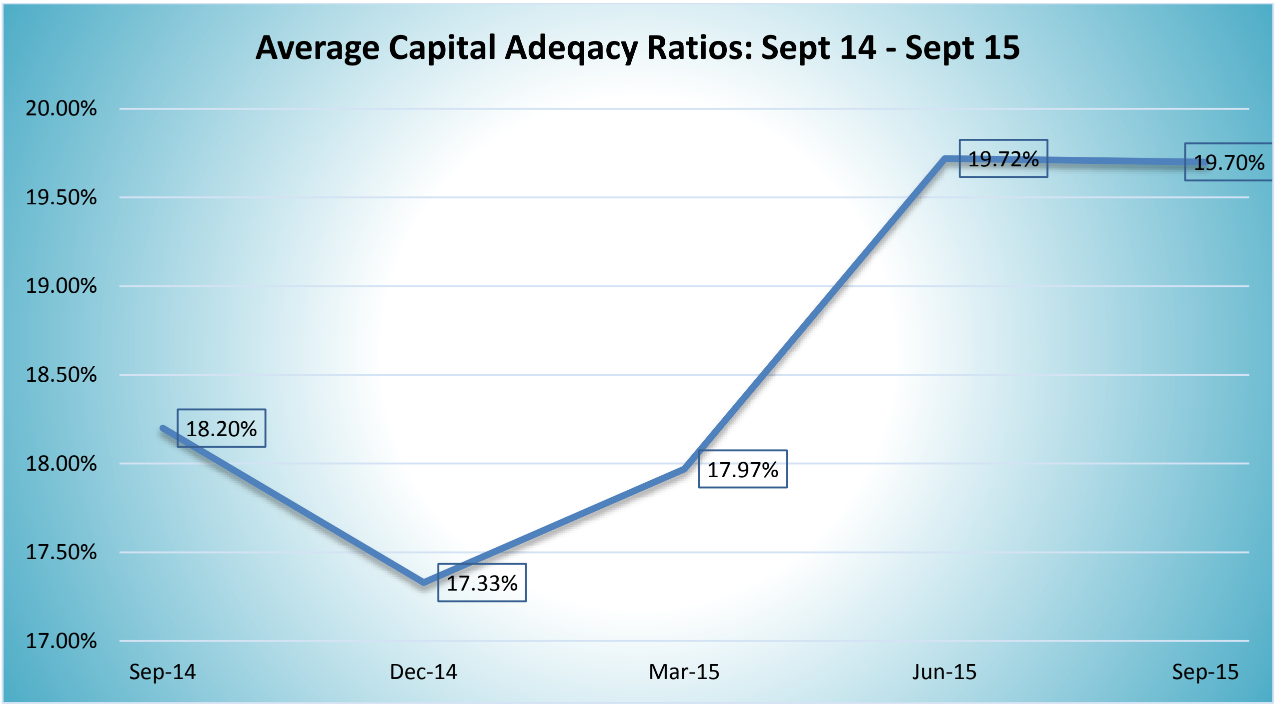
3.3 The graph below shows banking sector core capital trends from 2011 to September 2015:



3.4 The banking sector average capital adequacy ratio remained largely static at 19.7% as at 30 September 2015, from 19.72% as at 30 June 2015. This position is above the minimum regulatory capital adequacy ratio of 12%.

3.5 The trend in the banking industry's average capital adequacy ratios (CARs) from

September 2014 to September 2015 is indicated in the figure below.



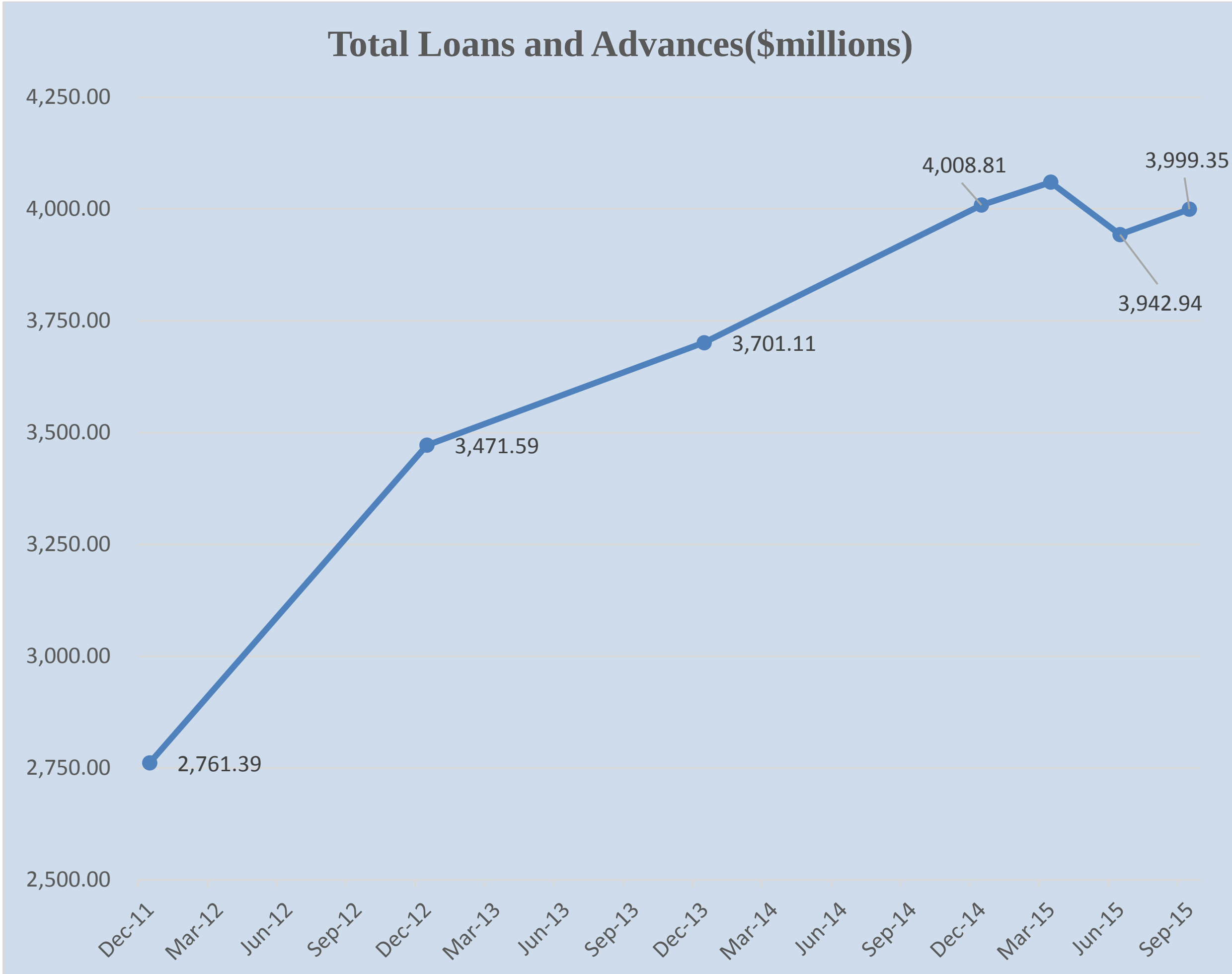
3.6 As at 30 September 2015, all operating banking institutions (excluding *Tetrad Investment Bank*), were in compliance with the prescribed minimum capital requirements.

3.7 Banking institutions are expected to continuously review their capital positions to assess adequacy in respect of the risks assumed in the intermediation role. In this regard, preservation of capital remains key to all players in the sector.

Asset Quality...

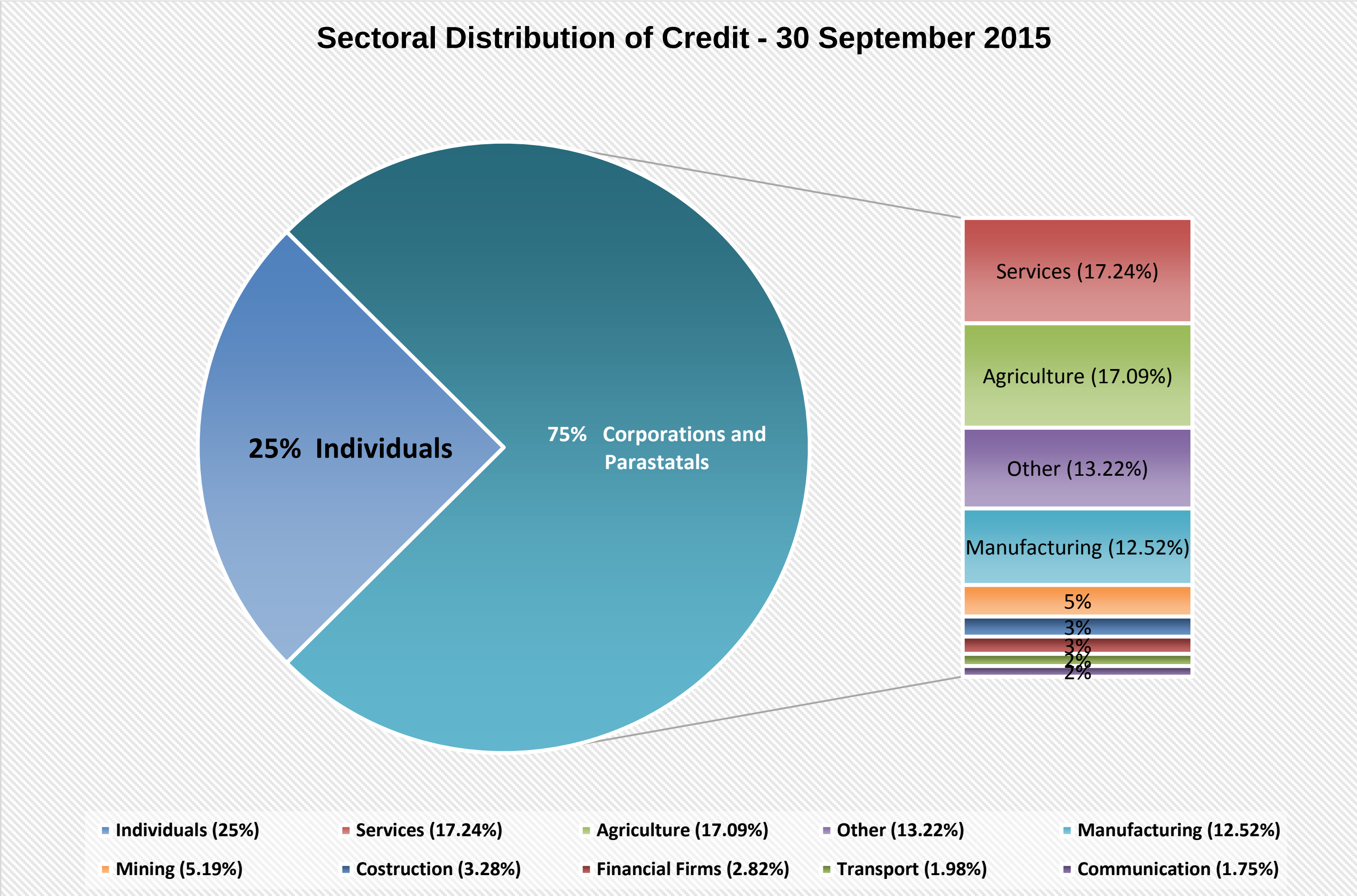
3.8 Banking sector loans & advances have remained relatively stable over the year. As at 30 September 2015 there was a marginal increase from $3.94 billion to **$4.0 billion.** This trend is attributed to the strategy adopted by most banking institutions to moderate the growth of their loan portfolios, while focusing on loan collection efforts to reduce the level of non-performing loans.

3.9 The graph below depicts the trend in total loans and advances since June 2011.



3.10 The banking sector has advanced more loans to the individuals segment compared to other segments. The lending to individuals is mainly dominated by salary based loans and these are sometimes utilized to support the individuals' micro enterprises.

3.11 The sectorial distribution of loans and advances as at 30 September 2015 is illustrated below:



3.12 The banking sector continued to be constrained in its ability to meet the long-term funding requirements of capital intensive sectors, such as construction and mining, due to the generally short-term nature of deposits held.

3.13 Commercial banks dominated the sector in terms of loans and advances, accounting for **77.35%** of same as at 30 September 2015.

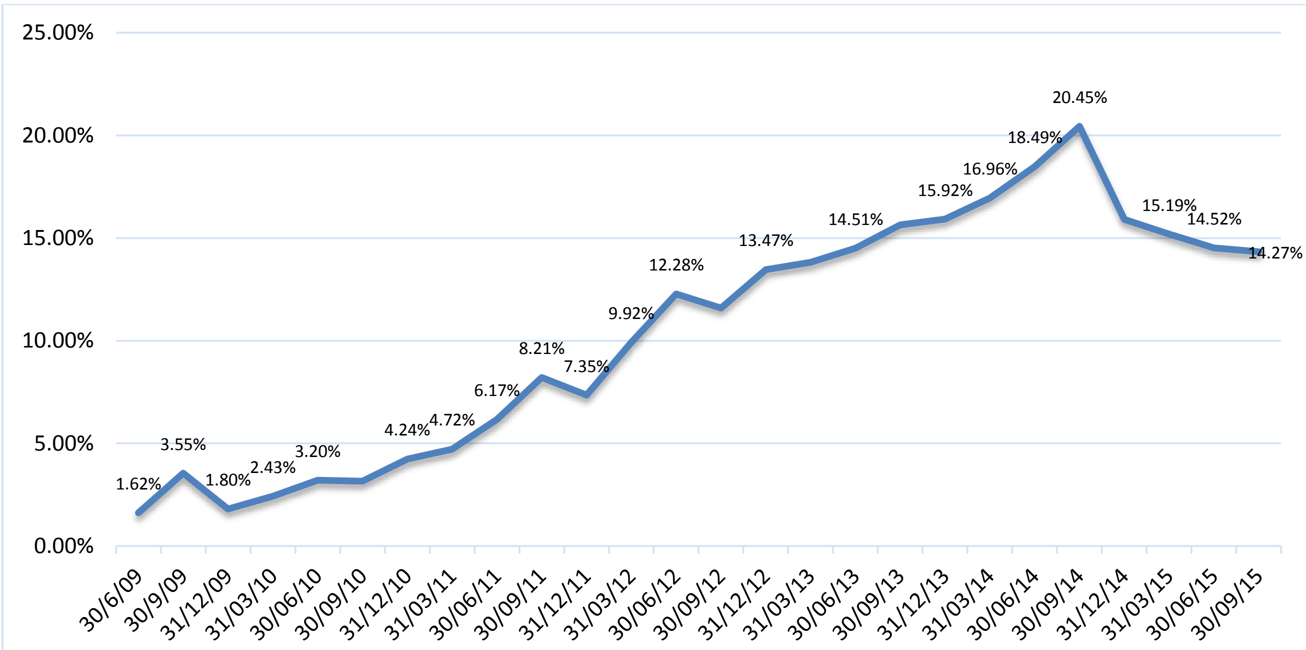
3.14 The top five banks had loans & advances amounting to **$2.45 billion**, which accounted for **61.25%** of total banking sector loans & advances as at 30 September 2015.

3.15 The level of non-performing loans (NPLs) in the banking sector continued to improve as reflected by a ratio of non-performing loans to total loans of 14.27% as at 30 September 2015, from 14.52% as at 30 June 2015 and a peak of 20.45% in

June 2014. The NPL ratio further improves to 12.79%, excluding Tetrad Investment Bank, which is under provisional judicial management.

3.16 The graph below shows the trend in NPLs from 2009 to 30 September 2015.

Non-Performing Loans as at 30 September 2015



3.17 In line with the Monetary Policy Statement directive issued in August 2015, banking institutions are working towards reducing their NPL ratios to below 10% and 5% by 30 June 2016 and 31 December 2016, respectively.

3.18 The various measures being instituted by the Reserve Bank to resolve non-performing loans in the banking sector are expected to contribute towards a reduction in the level of non-performing loans. The measures include the creation of ZAMCO, which will purchase secured non-performing loans from banks, thereby removing toxic assets from banks' balance sheets. Additionally, the Reserve Bank is finalizing the establishment of a Credit Reference system and this will be complemented by the operationalization of the Collateral Registry.

3.19 On their part, banking institutions continued with implementation of various internal measures to address the challenge of NPLs.

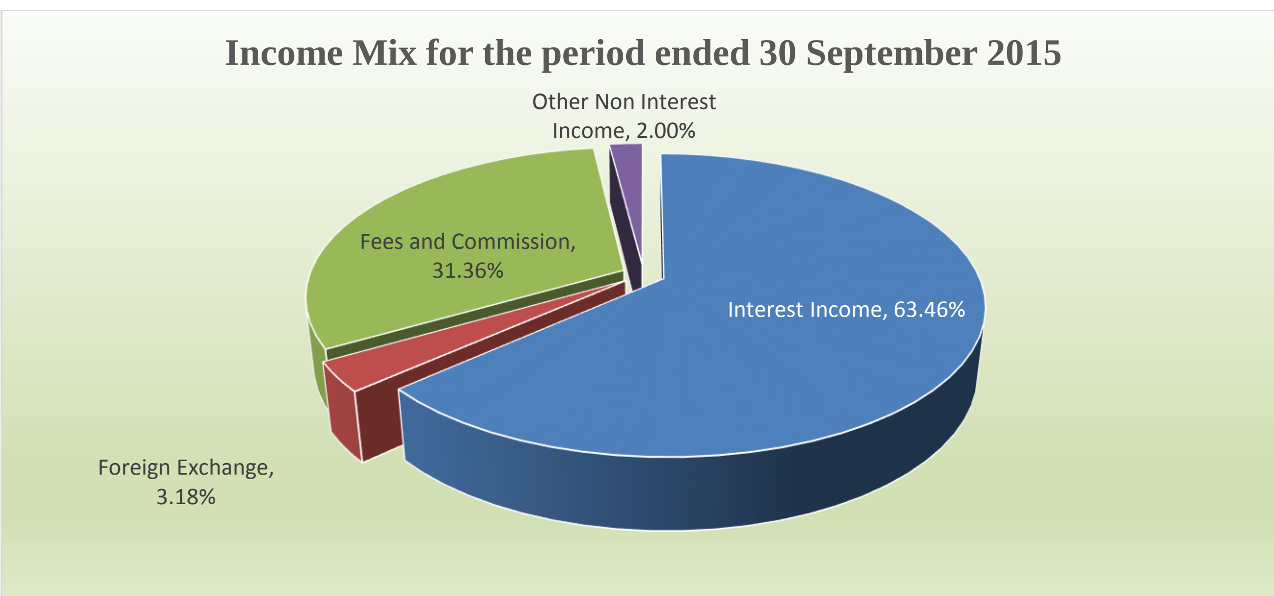
Earnings Performance...

3.20 The banking sector remained profitable during the nine months ended 30 September 2015, with an aggregate net profit of $86.09 million. A total of 14 out of 18 operating banking institutions (excluding Tetrad Investment Bank – under provisional judicial management) recorded profits, during the period under review.

3.21 The profitability indicators for the banking sector as measured by the average return on assets (ROA) and return on equity (ROE) improved from 0.37% and 2.54% as at 30 September 2014 to 1.37% and 7.91% as at 30 September 2015, respectively.

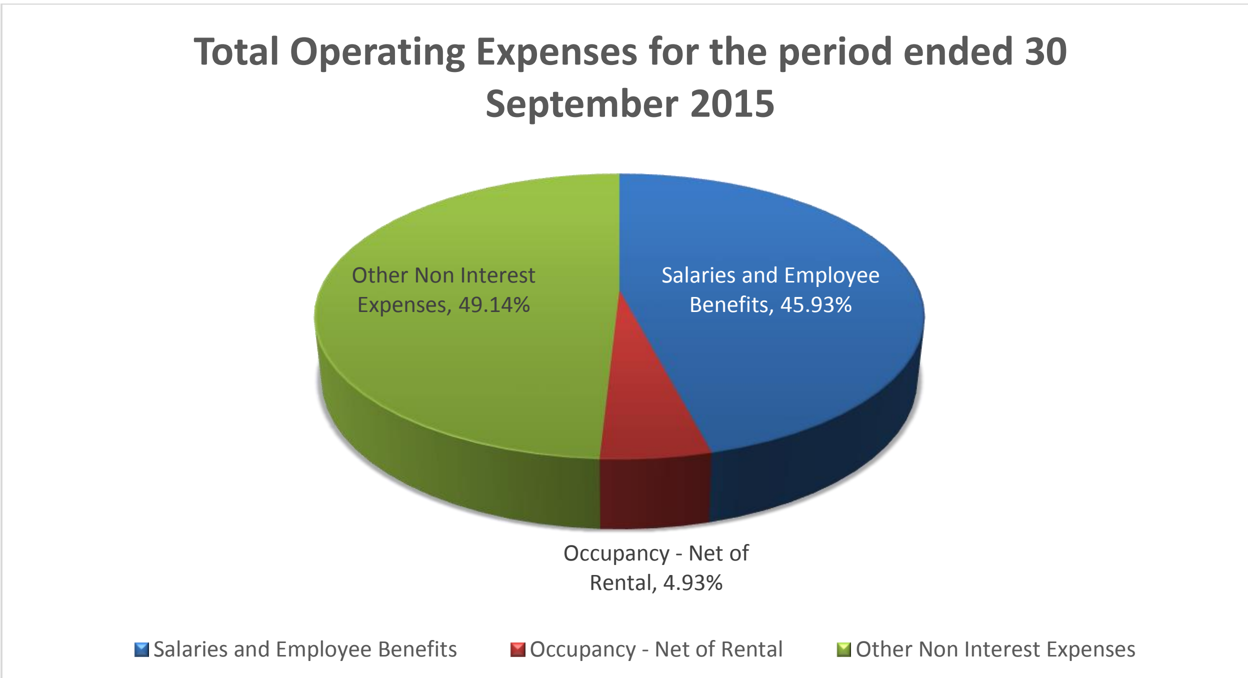
3.22 The major source of income for the banking sector was interest income, largely from loans & advances, which constituted 63.46% of total income amounting to $799 million. Non-interest income accounted for 36.54% of total income and largely comprised of fees and commissions.

3.23 The graph below shows the sources of income of the banking sector as at 30 September 2015.



3.24 Salaries and employment benefits accounted for 45.93% of the total banking sector operating expenses ($416.29 million), for the period ended 30 September 2015. Other non-interest expenses, which included depreciation, deposit protection premiums and administration costs, constituted 49.14% of operating expenses, while rental expenses accounted for 4.93%.

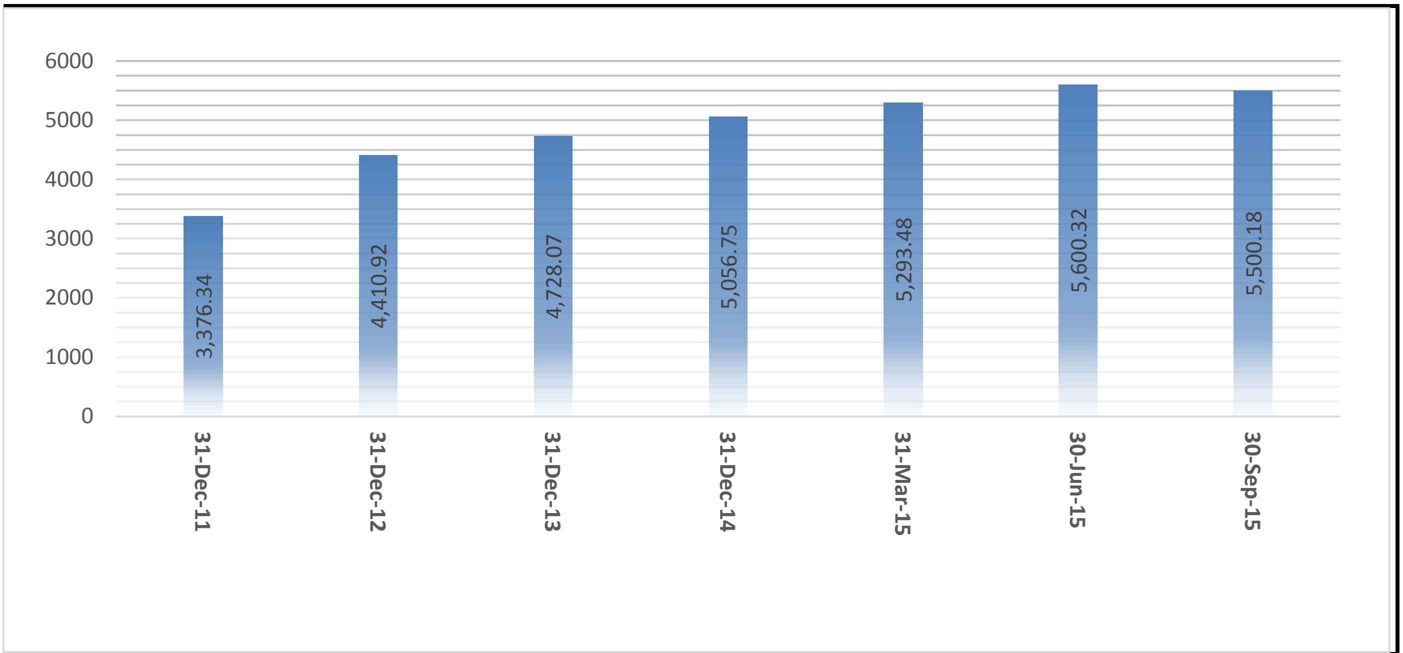
3.25 The composition of operating expenses for the banking sector is shown in the figure below.



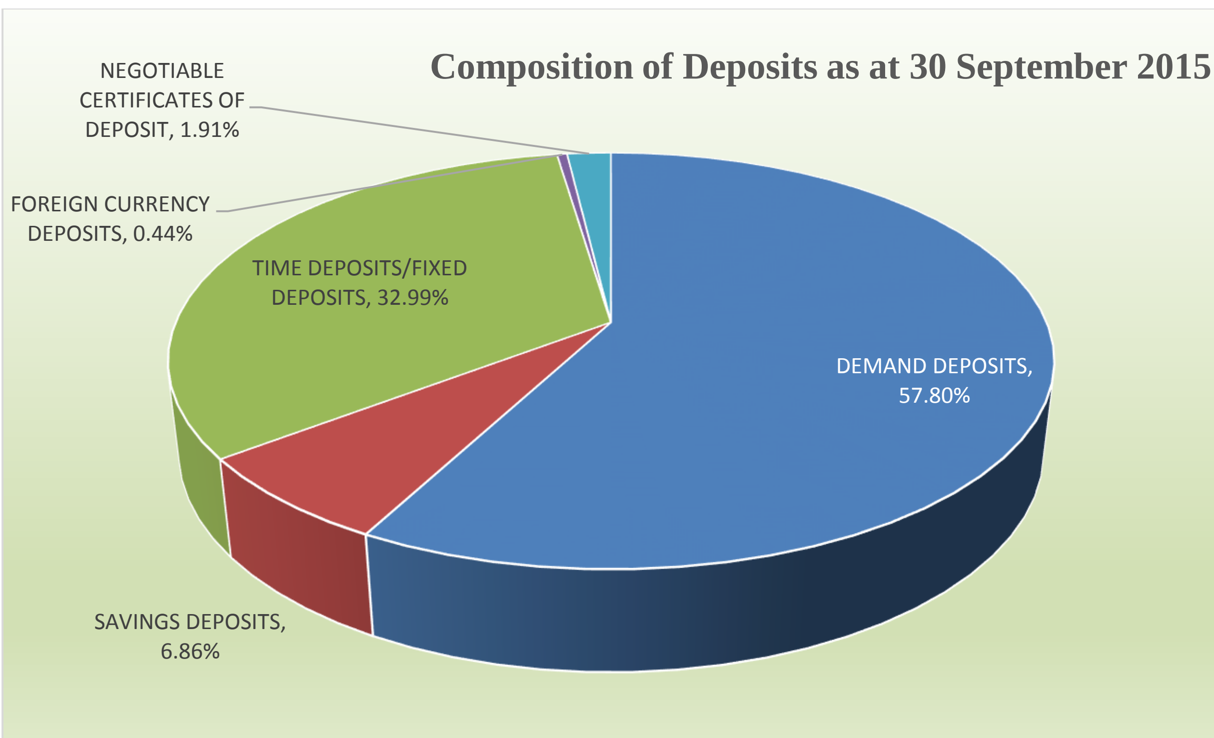
3.26 A number of banking institutions continue to institute cost containment measures while concomitantly implementing revenue enhancement measures.

Liquidity and Funds Management...

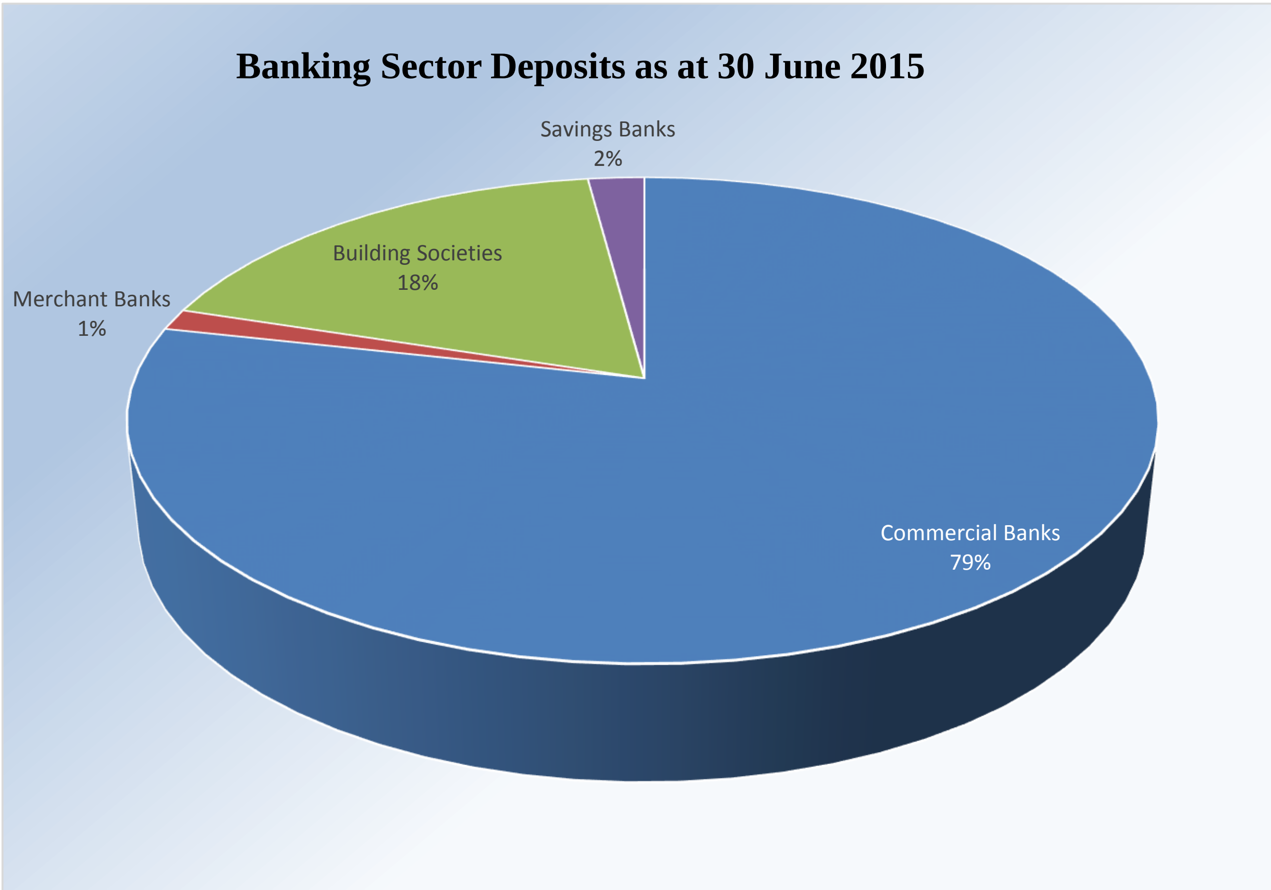
3.27 The total banking sector deposits were $5.5 billion as at 30 September 2015. The trend in deposits from December 2011 to 30 September 2015 is shown in the graph below.



3.28 The sector deposits continued to be dominated by demand deposits which accounted for 57.80% of total deposits as at 30 September 2015 as indicated below.



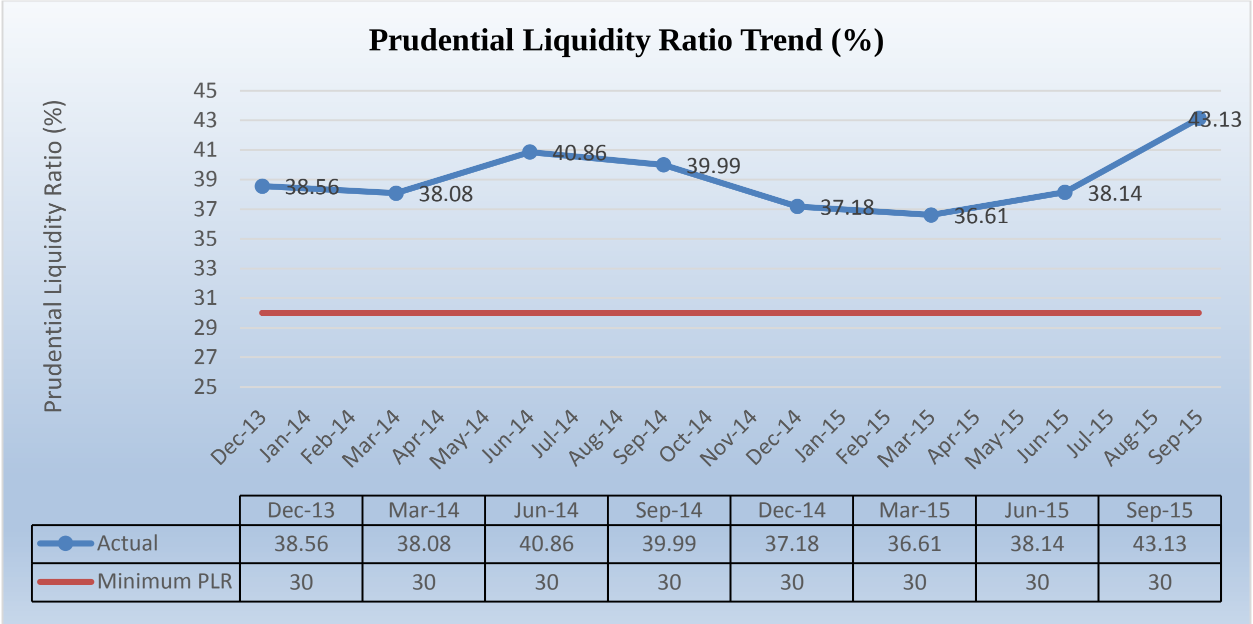
3.29 The commercial banking sub-sector held 78.09% of total banking sector deposits as at 30 September 2015 as shown in the figure below.



3.30 The top five (5) banks, in terms of deposits, had deposits amounting to $2.65 billion as at 30 September 2015, representing **62.54%** of total banking sector deposits.

3.31 The banking sector average prudential liquidity ratio of 43.13% as at 30 September 2015 was in compliance with the regulatory minimum of 30%.

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



***Minimum Prudential Liquidity Ratio = 30%**

3.33 Three (3) banking institutions were not compliant with the minimum liquidity regulatory requirement as at 30 September 2015. The institutions have put in place measures to regularize their prudential liquidity ratios.

Sensitivity to Market Risk…

3.34 The banking sector's sensitivity to market risk was considered low, as at 30 September 2015, as the sector's exposure to interest rate risk was mainly in the banking book.

3.35 Foreign exchange rate risk continues to be low as banks are not undertaking proprietary trading positions, while client transactions are mainly currency switches.

3.36 All banking institutions are resilient to a major level foreign exchange rate risk shock in view of the low foreign exchange exposures on their balance sheets.

OUTLOOK

3.37 The performance of the banking sector is expected to improve against the backdrop of a number of holistic measures currently being instituted. Banking institutions have made significant progress towards compliance with the 2020 minimum capital requirements. Further, the interest burden on borrowing clients is expected to lessen as banking institutions have adjusted their lending rates in line with the July 2015 Monetary Policy guidelines, which called for reduced interest rates, effective 1 October 2015.

30 SEPTEMBER 2015