QUARTERLY BANKING SECTOR REPORT

31 DECEMBER 2018

BANK SUPERVISIONDIVISION

1. EXECUTIVE SUMMARY

1.1. During the quarter ended 31 December 2018, the banking sector remained generally stable. Stress tests conducted by the Reserve Bank indicate that the sector is largely resilient to various shock scenarios.

1.2. As at 31 December 2018, all financial soundness indicators depicted satisfactory condition and performance of the banking sector, as reflected by adequate capitalization, sustained improvement in earnings performance, an expanding asset base, as well as satisfactory asset quality.

1.3. Banking sector total assets maintained an upward trend, and increased by 2.73% from $13.57 billion as at 30 September 2018 to $13.98 billion as at 31 December 2018.

1.4. The banking sector remained adequately capitalized, with average tier 1 and capital adequacy ratios of 27.68% and 30.23%, against the regulatory minima of 8% and 12%, respectively.

1.5. The banking sector aggregate core capital was $1.57 billion as at 31 December 2018, representing a 6.08% increase from $1.48 billion reported as at 30 September 2018, which was attributed to organic capital growth.

1.6. Credit risk in the sector deteriorated marginally as reflected by the movement in the ratio of non-performing loans (NPLs) to total loans deteriorated from 6.68% as at 30 September 2018 to 6.92% as at 31 December 2018.during the period under review

1.7. Total banking sector deposits decreased marginally during the review period, from $10.38 billion as at 30 September 2018 to $10.32 billion as at 31 December 2018, while total banking sector loans and advances increased by 2.25%, from $4.00 billion as at 30 September 2018 to $4.09 billion as at 31 December 2018. This translated to an average loans to deposit ratio of 39.62%.

1.8. The banking sector recorded a 75.55% increase in aggregate profits, from $242.25 million in 2017 to $425.26 million in 2018.

1.9. The average prudential liquidity ratio for the banking sector was 67.82% as at 31 December 2018, which was above the minimum regulatory requirement of 30%.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 31 December 2018, the financial sector comprised 19 operating banking institutions, as shown in the table below.

Table 1: Architecture of the Banking Sector

Type of Institution	**Number**
Commercial Banks	13
Building Societies	5
Savings Bank	1
Total Banking Institutions	**19**

2.2. Further, other institutions under the Reserve Bank's purview were as follows:

Table 2: Architecture of Other Financial Institutions

Other financial institutions	**Number**
Development Financial Institutions	2
Deposit taking Microfinance Institutions	6
Credit-only-Microfinance Institutions	199
Total	**207**

3. CONDITION AND PERFORMANCE OF THE BANKING SECTOR

3.1. The performance of the banking sector was considered satisfactory over the quarter ended 31 December 2018, on the back of improvement in earnings performance, as well as adequate capitalization.

3.2. The financial soundness indicators for the review period are provided in Table 3 below. Note that the financial soundness indicators were adjusted after one of the commercial banks reduced its NPLs ratio post audit adjustments.

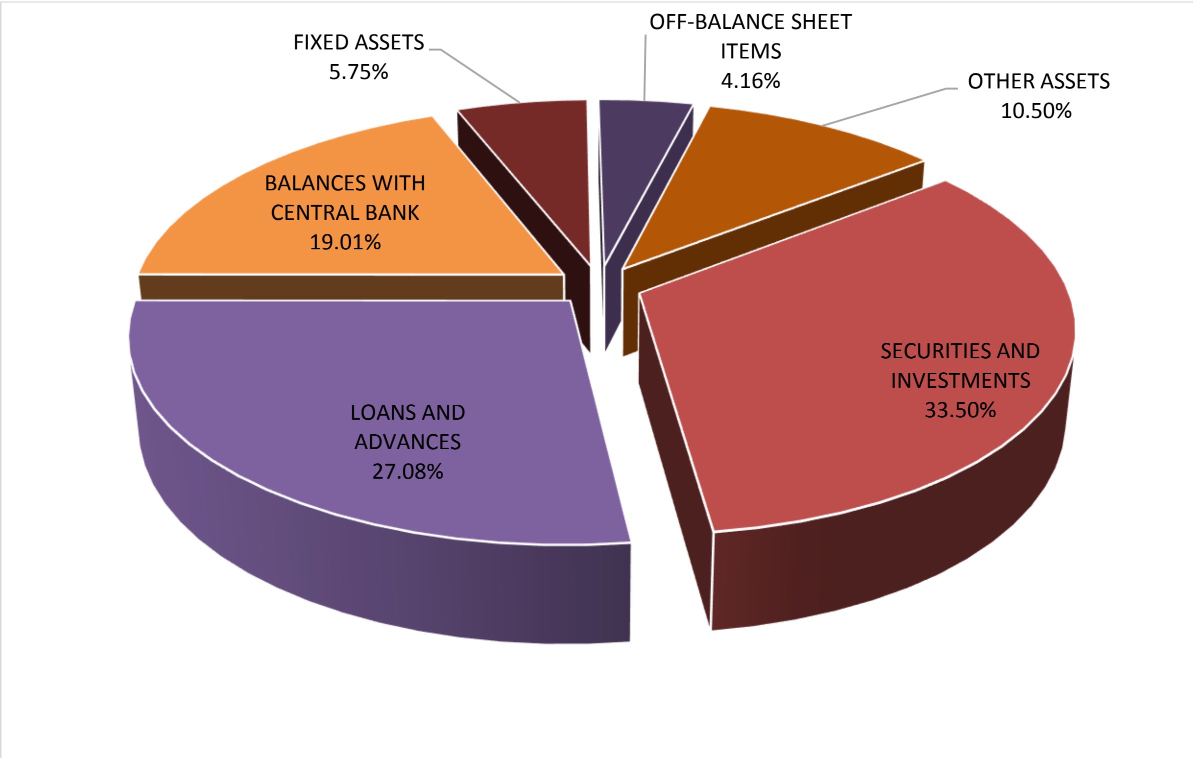
Table 3: Financial Soundness Indicators

Key Indicators	Dec-17	Jun-18	Sept-18	Dec-18
Total Assets	$11.25bn	$12.35bn	$13.31bn	$13.98bn
Total Loans & Advances	$3.80bn	$4.08bn	$4.00bn	$4.09bn
Net Capital Base	$1.58bn	$1.61bn	$1.72bn	$1.83bn
Total Deposits	$8.48bn	$9.53bn	$10.38bn	$10.32bn
Net Profit	$242.25m	$176.09m	$283.98m	$425.26m
Return on Assets	2.61%	1.75%	2.61%	4.56%
Return on Equity	15.48%	11.16%	16.80%	20.61%
Capital Adequacy Ratio	27.63%	26.32%	27.79%	30.23%
Loans to Deposits	44.81%	43.53%	41.8%	39.62%
Non-Performing Loans Ratio	7.08%	6.22%	6.69%	6.92%
Tier 1 Ratio	23.97%	24.16%	27.68%	30.23%
Liquidity Ratio	62.62%	68.45%	70.66%	67.82%
Cost to Income Ratio	75.36%	67.59%	66.85%	70.05%

Total Banking Assets…

3.3. The sector recorded a 5.03% increase in total assets, from $13.31 billion as at 30 September 2018 to $13.98 billion as at 31 December 2018.

3.4. The figure below shows the asset mix as at 31 December 2018.



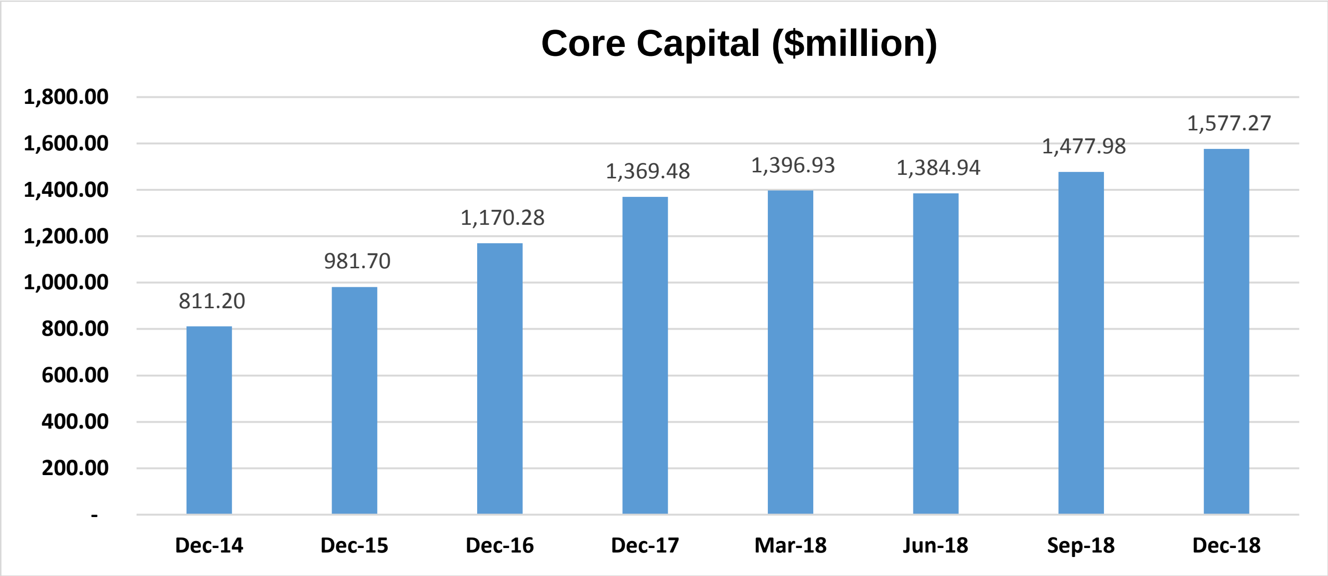
3.5. Banking sector assets were largely composed of securities & investments (33.50%), loans and advances (27.08%) and balances with the Central Bank (19.01%).

Capitalisation…

3.6. The sector is adequately capitalized, with aggregate core capital of $1.58 billion as at 31 December 2018, representing a 6.08% increase from $1.48 billion as at 30 September 2018, largely due to organic capital growth.

3.7. The graph below shows the trend in the banking sector core capital levels for the period December 2009 to December 2018:

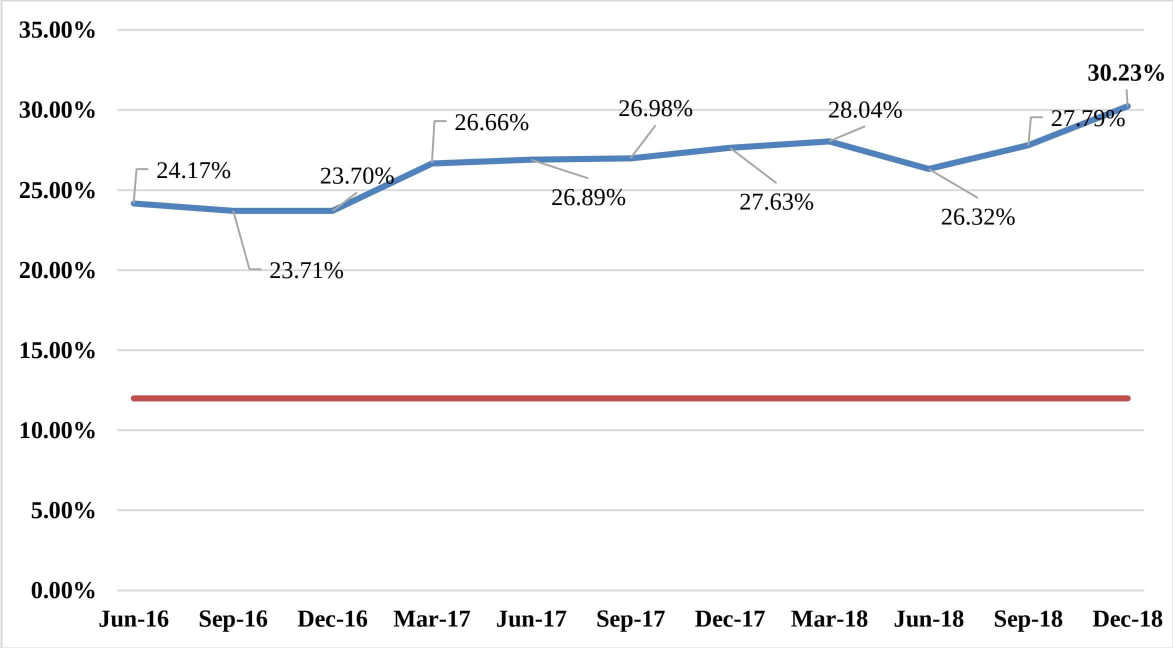
Figure 1: Core Capital Trends 2009 to December 2018



3.8. As at 31 December 2018, all banking institutions except one were compliant with the prescribed minimum capital requirements.

3.9. Adequate capitalization was also evidenced by the average capital adequacy ratio trend as shown below:

Figure 2: Capital Adequacy Ratios Trend



3.10. While all banking institutions were compliant with minimum CAR, there is need for banking institutions to implement capital preservation strategies in light of the current challenging macroeconomic environment

Asset Quality...

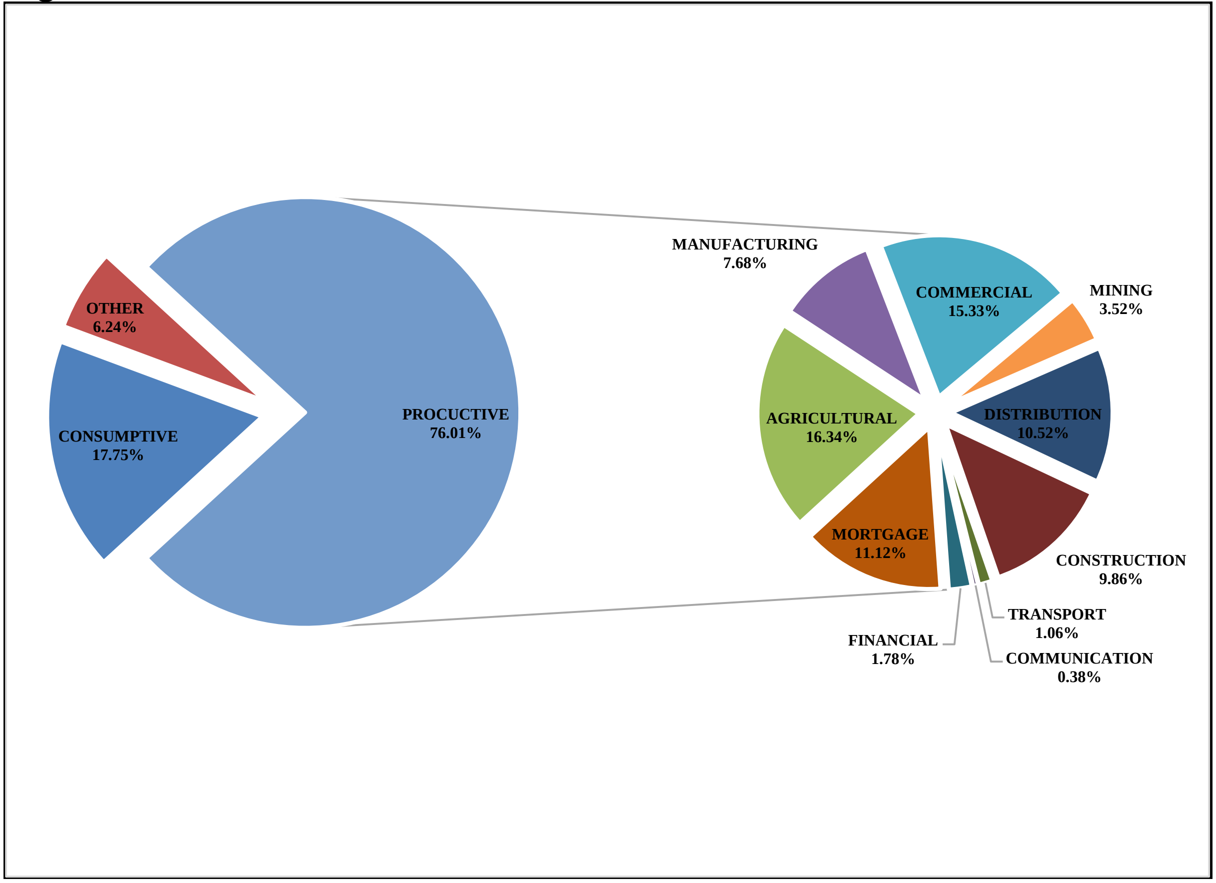
3.11. Total banking sector loans and advances increased by 2.25%, from $4.00 billion as at 30 September 2018 to $4.09 billion as at 31 December 2018. The figure below shows the trend of banking sector loans and advances from 31 December 2014 to 31 December 2018.

Figure 3: Banking Sector Loans & Advances ($ millions)

Distribution of Loans and Advances…

3.12. As at 31 December 2018, lending to the productive sector accounted for 76.01% of total loans, as shown in the diagram below.

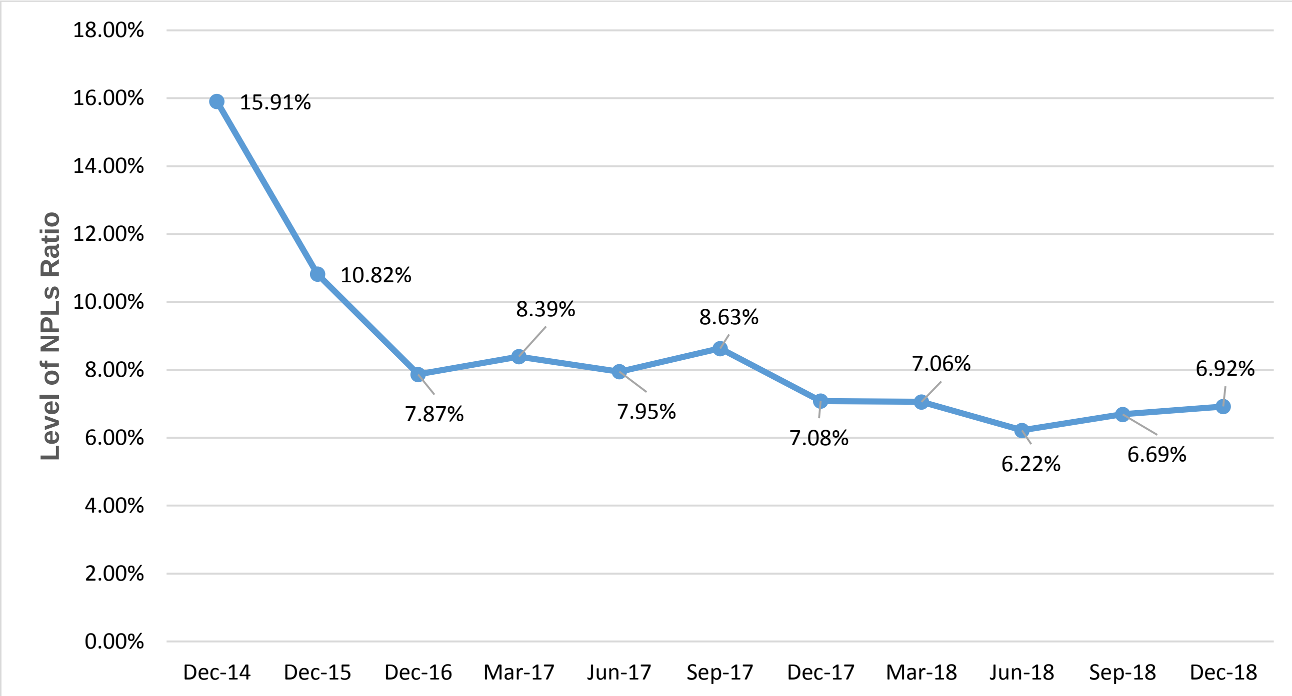
Figure 4: Sectoral Distribution of loans as at 31 December 2018



Non-Performing Loans

3.13. Credit risk in the banking sector loan portfolio increased marginally during the period under review, as the ratio of non-performing loans (NPLs) to total loans deteriorated from 6.69% as at 30 September 2018 to 6.92% as at 31 December 2018. Despite the marginal increase in the NPLs ratio, some banking institutions enhanced their credit risk management practices through enhancing their loan grading methodologies, recoveries and write-offs. Figure 5 below shows the trend in the level of non-performing loans from 2014 to December 2018:

Figure 5: Trend in Non-Performing Loans 2014 – December 2018



Earnings Performance...

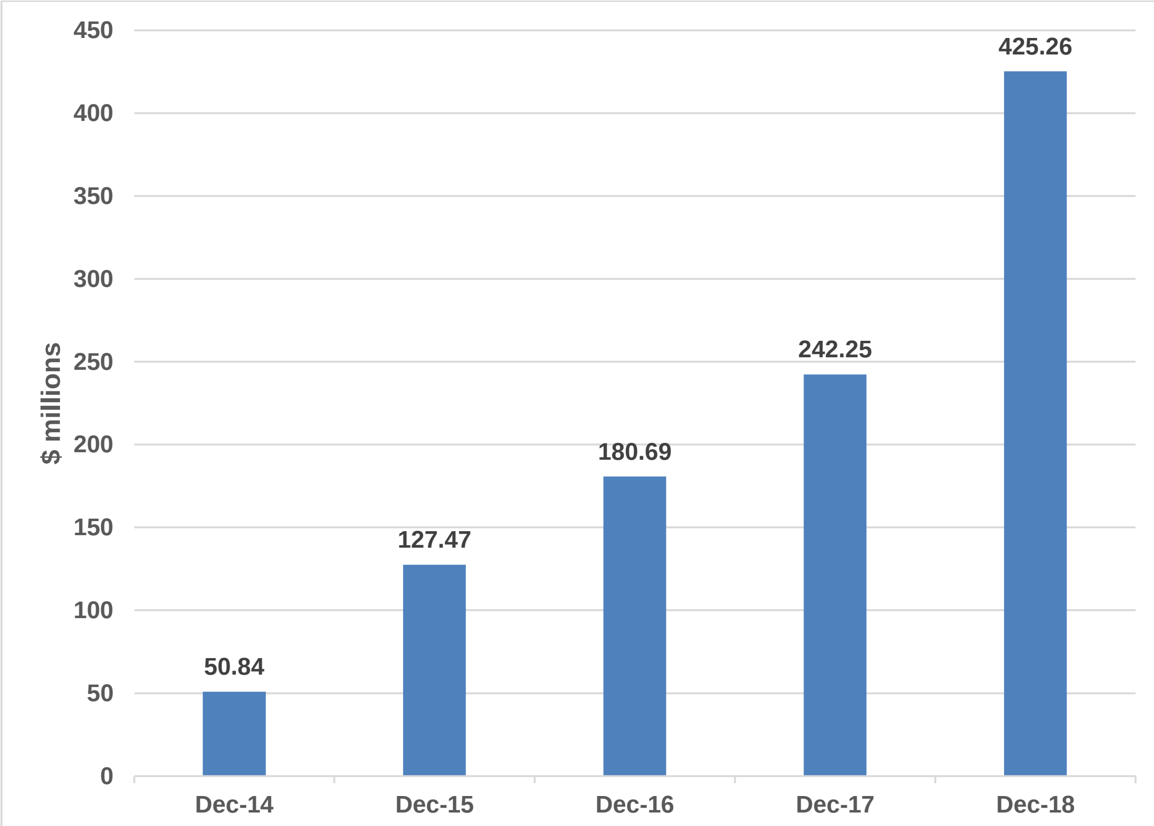
3.14. All banks, except for one institution, remained profitable, with the sector recording a 75.77% increase in aggregate profits, from $242.25 million in 2017 to $425.26 million in 2018.

3.15. The improvement in earnings performance was buoyed by non-interest income arising from an increase in digital transactional volumes, as well as interest income from investments in securities, which largely comprised treasury bills.

3.16. During the period under review, the major profitability indicators, return on assets and return on equity improved, from 2.61% and 15.48%, to 4.56% and 20.61%, respectively.

3.17. Figure 6 shows trend in net profit from December 2014 to December 2018.

Figure 6: Trend in Net Profit from December 2014 to December 2018

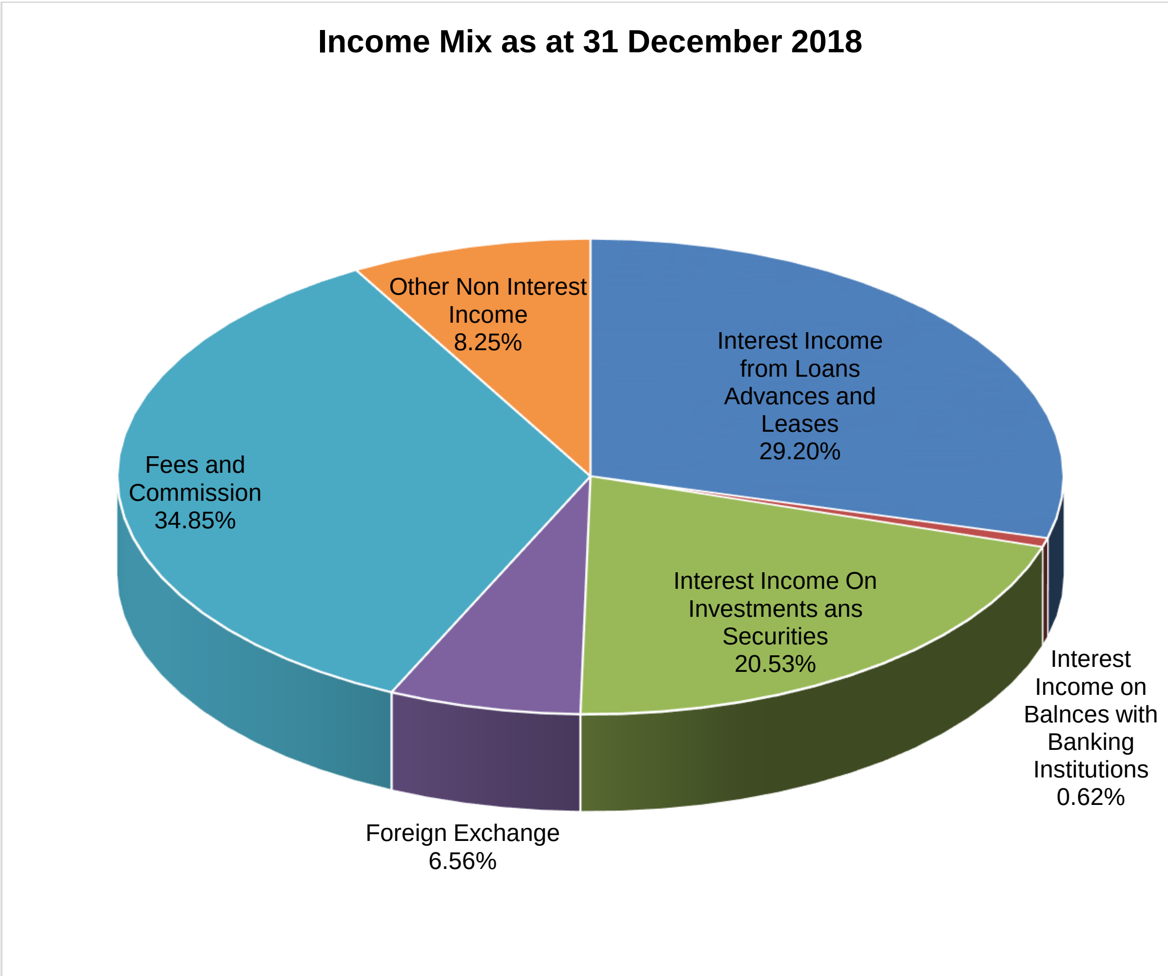


3.18. The growth in total income continued to be driven by fees and commissions, which increased by 11.84% from $458.26 million during the twelve months ended 31 December 2017 to $512.52 as at 31 December 2018, and accounted for 34.85% of total income in 2018.

3.19. Interest income from loans and advances accounted for 29.20% of total income for the twelve months ended 31 December 2018, compared to 49.90% in 2017, while interest on investments and securities accounted for 20.53% of total income in 2018, compared to 17.06% in 2017.

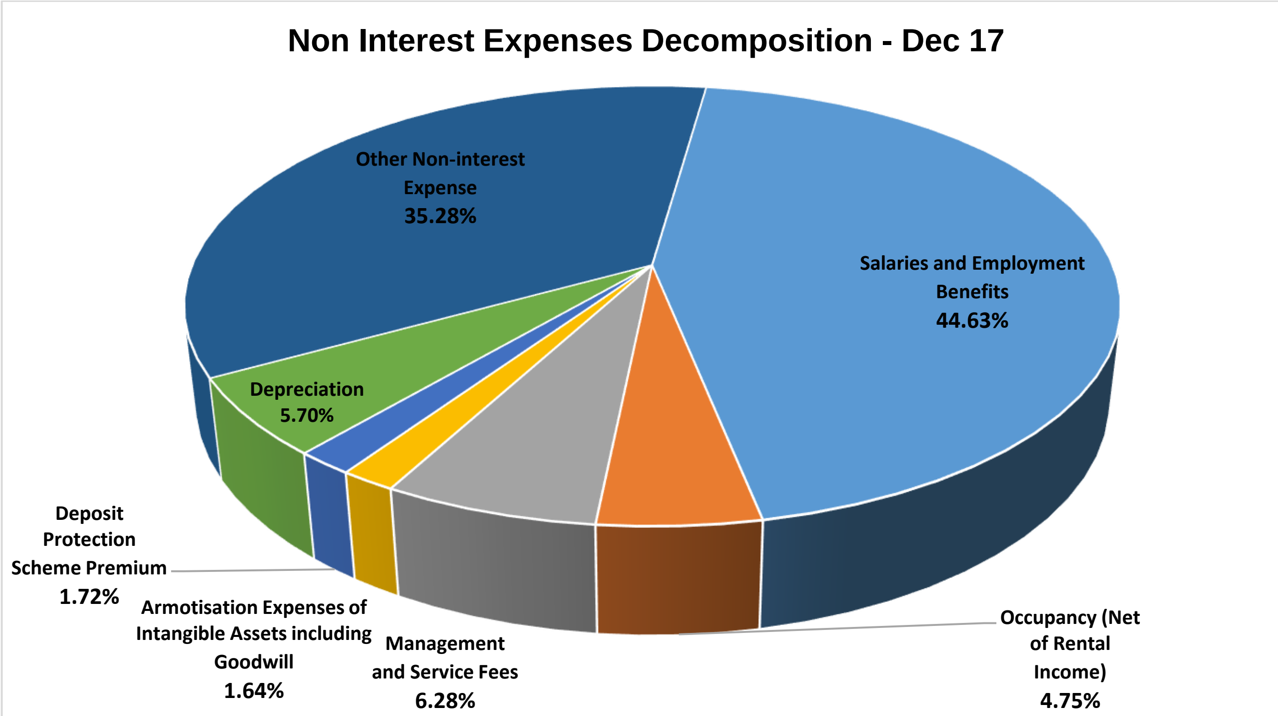
3.20. Figure 7 below shows the income mix for the sector for the twelve months ended 31 December 2018:

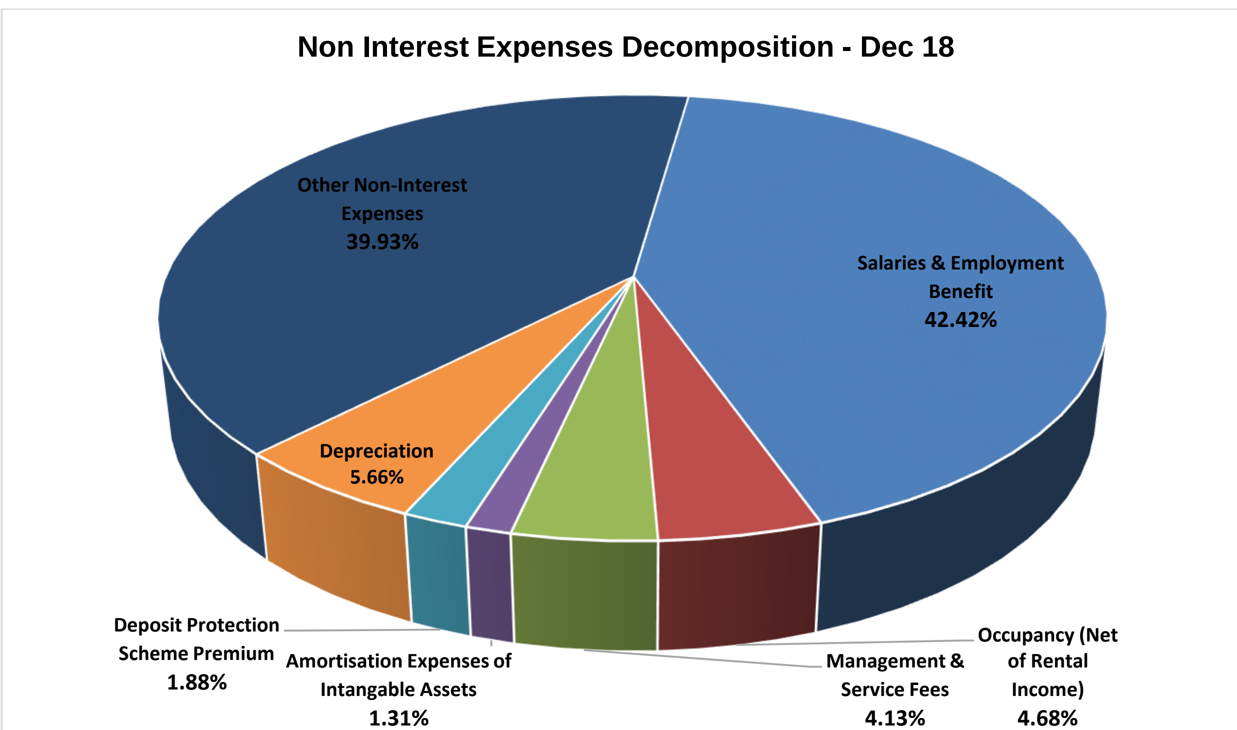
Figure 7: Banking Sector Income Mix as at 31 December 2018



3.21. As at 31 December 2018, the major component of non-interest expenses was salaries & employment benefits, which accounted for 42.42% of total banking sector costs as shown in the figure below.

Figure 8: Banking Sector Operating Expenses



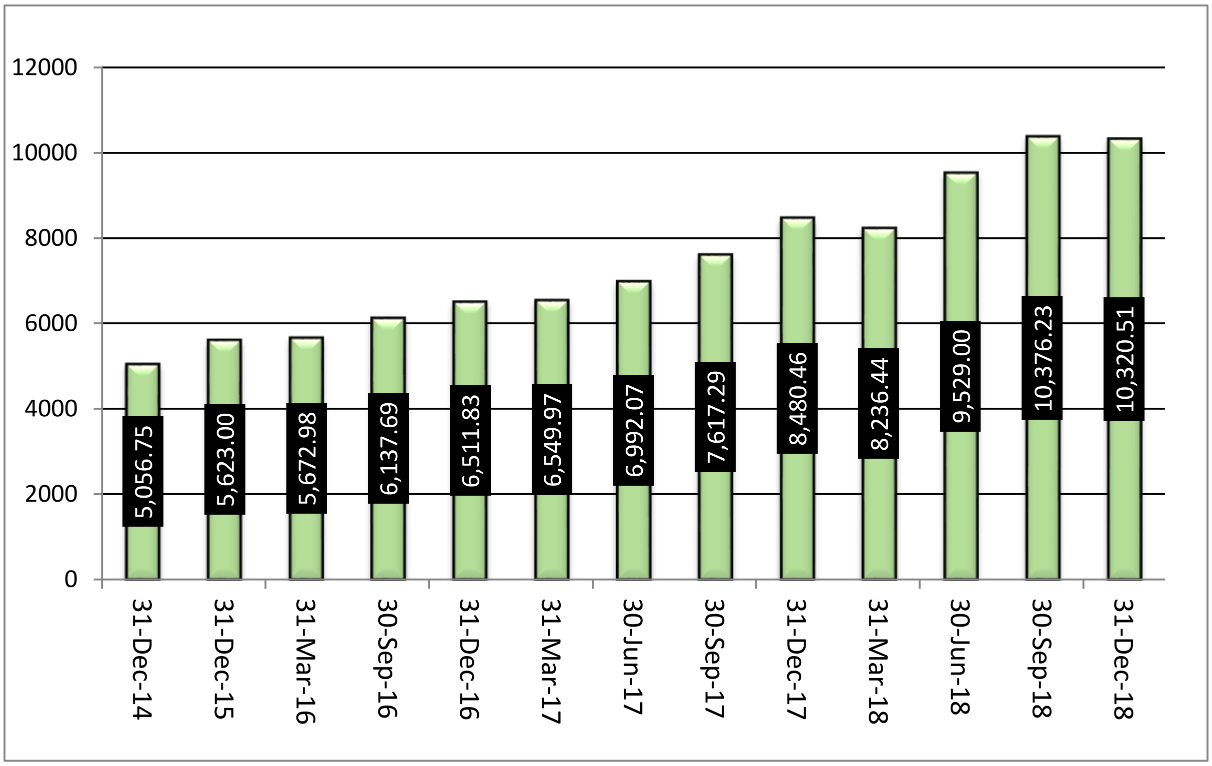


Liquidity and Funds Management...

3.22. During the quarter under review, banking sector deposits marginally decreased by 0.54%, from $10.38 billion as at 30 September 2018 to $10.32 billion as at 31 December 2018.

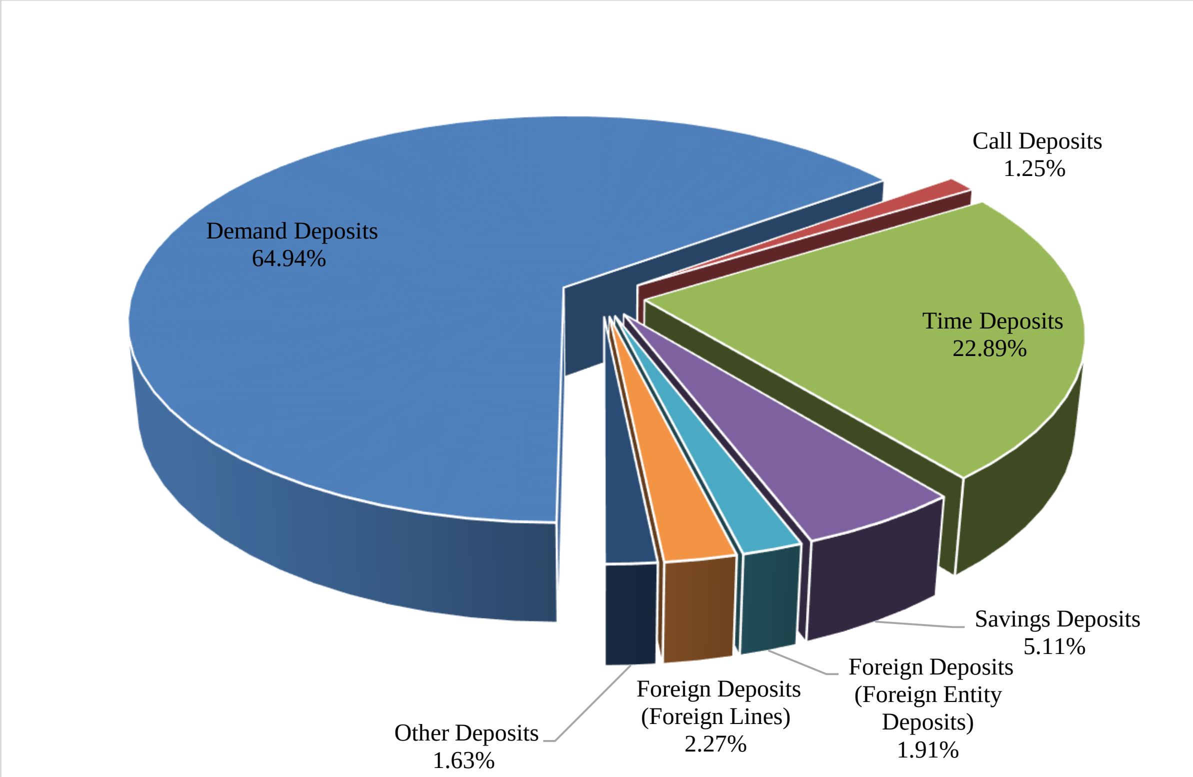
3.23. The figure below shows the trend of banking sector deposits over the period 31 December 2009 to 31 December 2018.

Figure 9: Trend of Banking Sector Deposits ($ millions)



3.24. As at 31 December 2018, the banking sector was predominantly funded by demand deposits, which accounted for 64.94% of total deposits as shown in the figure below:

Figure 10: Composition of Deposits as at 31 December 2018



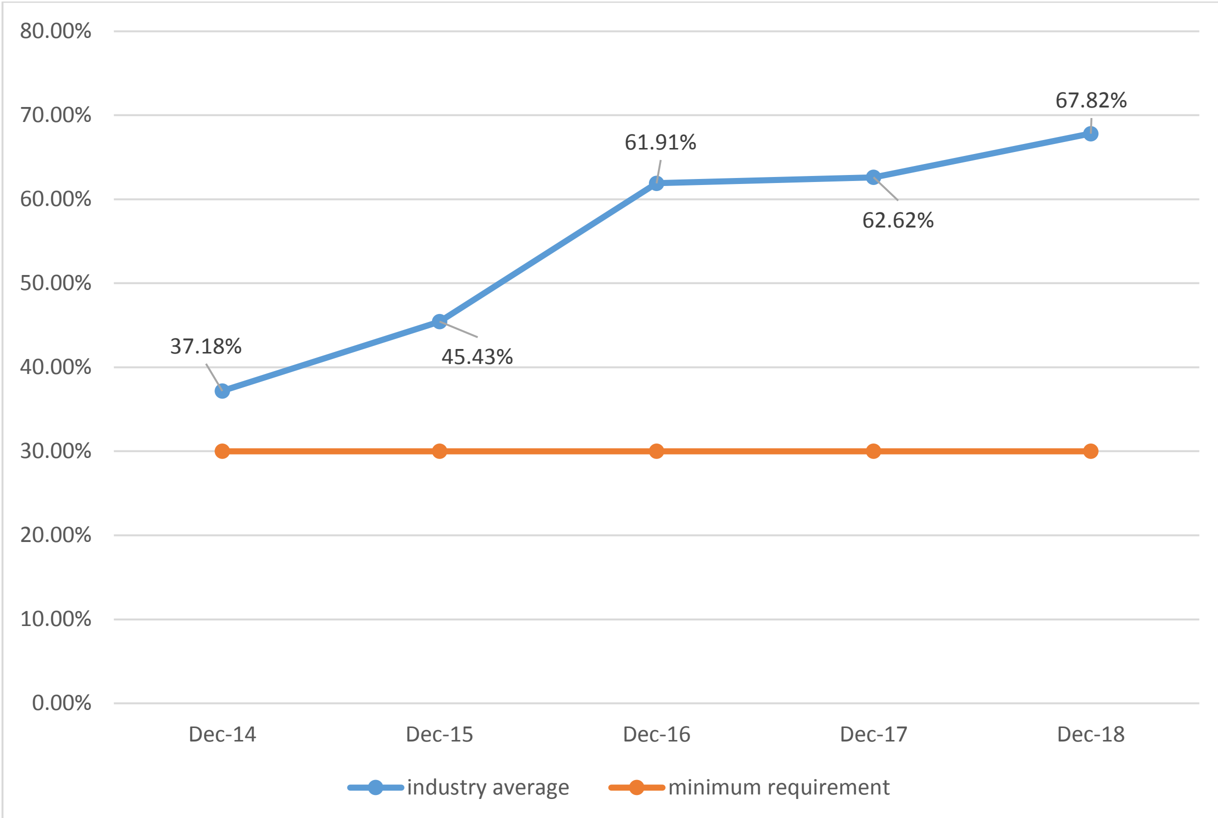
3.25. The Monetary Policy Statement of October 2018 required banking institutions to operationalize the ring-fencing policy on Nostro foreign currency accounts by separating foreign currency accounts (FCAs) into two categories, namely Nostro FCAs and RTGS FCAs.

3.26. Going forward, Nostro FCA deposits are expected to increase given the upcoming tobacco selling season, as well as growth in sales from mineral exports.

3.27. As at 31 December 2018, seventeen (17) out of nineteen (19) banking institutions were compliant with the minimum prudential liquidity ratio of 30%. The average prudential liquidity ratio for the banking sector was 67.82%. The non-compliant institutions are taking measures to ensure compliance with the minimum prudential liquidity ratio.

3.28. The figure below shows the trend in the banking sector average prudential liquidity ratio since March 2015.

Figure 12: Prudential Liquidity Ratio Trend (%)



3.29. The high average prudential liquidity ratio is largely attributed to substantial holdings of securities and investments by banks, as well as the cautious lending approach adopted by banking institutions.

Sensitivity analysis...

3.30. Due to the limited trade in foreign exchange by banking institutions, during the period under review, the banking sector's exposure to foreign exchange rate risk remained low.

3.31. Stress testing results indicate that the sector is resilient to a major foreign exchange risk shock of an appreciation of the United States Dollar against major currencies by 15% as the capital adequacy ratio will remain above 12%.

3.32. Fifteen (15) banking institutions had liability sensitive books, implying that the banks would lose when market interest rates go up.

3.33. As at 31 December 2018, all banking institutions were resilient to a major level interest rate risk shock of 10 percentage point increase or decrease in interest rates, as their capital adequacy ratios would remain above the prescribed minimum of 12%.

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