RESERVE BANK OF ZIMBABWE

BANK SUPERVISION DIVISION

BANKING SECTOR REPORT

FOR

QUARTER ENDED 30 JUNE 2018

1. EXECUTIVE SUMMARY

1.1. The banking sector remained generally stable as reflected by adequate capitalisation, improved earnings performance and low credit risk.

1.2. Stress testing results conducted by the Reserve Bank on banks' exposure to credit, interest rate and foreign exchange risks indicate that the banking sector is largely resilient to various shocks of differing magnitudes.

1.3. Banking sector total assets increased by 12.79% from $10.95 billion as at 31 March 2018 to $12.35 billion as at 30 June 2018.

1.4. As at 30 June 2018, all operating banking institutions, were in compliance with the prescribed minimum capital requirements. Further, the banking sector was adequately capitalized with average tier 1 and capital adequacy ratios of 22.70% and 26.32%, respectively. The banking sector aggregate core capital, however, marginally declined during the quarter by 0.8%, from $1.40 billion as at 31 March 2018 to $1.38 billion as at 30 June 2018 due to IFRS 9 adjustment to the provisioning levels.

1.5. The aggregate banking sector deposits amounted to $9.53 billion as at 30 June 2018, while total loans and advances totaled $4.08 billion, translating to a loans to deposit ratio of 42.81%. Asset quality improved during the quarter under review as reflected by the ratio of non-performing loans (NPLs) to total loans of 6.22% as at 30 June 2018, from 7.06% reported as at 31 March 2018.

1.6. The banking sector was profitable during the half year ended 30 June 2018 with an aggregate net profit of $176.09 million, representing a 75.06% increase from $100.59 million reported in the corresponding period in 2017. The improved earnings performance was on the back of increased non-interest income, mainly fees and commissions, driven by transactional income from increased usage of plastic money by the general public. All banking institutions reported profits during the period under review.

1.7. The banking sector reported an average prudential liquidity ratio of 68.31% as at 30 June 2018. As part of the final phase of IFRS 9 implementation, banking institutions and deposit taking microfinance institutions submitted IFRS 9 compliant financial statements as at 31 December 2017 to the Reserve Bank to assess readiness to publish the 2018 accounts based on the requirements of the new accounting standard.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. The composition of the banking sector as at 30 June 2018 was 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**
Development Financial Institutions (SMEDCO and IDBZ)	2
Total (including development financial institutions)	21

2.2. In addition, the table below shows deposit taking and credit only microfinance institutions under the purview of the Reserve Bank.

Table 2: Other Institutions under the supervision of the Reserve Bank

Credit-only-MFIs	190

Deposit-taking MFIs	6

2.3. Two (2) deposit taking microfinance institutions (DTMFIs), the Zimbabwe Women's Microfinance Bank Limited and EmpowerBank Limited commenced operations during the period under review bringing the total number of DTMFIs to six (6) as at 30 June 2018.

2.4. The two institutions are expected to significantly contribute to increased access to financial services by marginalized groups such as women and youth.

3. CONDITION AND PERFORMANCE OF THE BANKING SECTOR

3.1. The performance of the banking sector remained satisfactory over the quarter ended 30 June 2018, as reflected by the expanding asset base, adequate capitalization, enhanced profitability and improving asset quality.

3.2. The financial soundness indicators for the review period are shown in Table 3 below.

Table 3: Financial Soundness Indicators

Key Indicators	Benchmark	Jun-17	Dec-17	Mar-18	Jun-18
Total Assets	-	$9.65bn	$11.25bn	$10.95bn	$12.35bn
Total Loans	-	$3.64bn	$3.80bn	$3.78bn	$4.08bn
Net Capital Base	-	$1.38bn	$1.58bn	$1.61bn	$1.61bn
Core Capital	-	$1.24bn	$1.37bn	$1.40bn	$1.38bn
Total Deposits	-	$6.99bn	$8.48bn	$8.24bn	$9.53bn
Net Profit	-	$100.59m	$241.94m	$85.58m	$176.09m
Return on Assets	-	1.26%	2.61%	0.92%	1.75%
Return on Equity	-	6.80%	15.48%	5.19%	11.16%
Capital Adequacy Ratio	12%	26.89%	27.63%	27.91%	26.32%

Key Indicators	Benchmark	Jun-17	Dec-17	Mar-18	Jun-18
Loans to Deposits	70%	52.11%	44.81%	45.88%	43.53%
Non-Performing Loans Ratio	5%	7.95%	7.08%	7.06%	6.22%
Provisions to ACL	-	126.29%	90.26%	106.96%	139.69%
Liquidity Ratio	30%	66.87%	62.62%	62.37%	68.45%
Cost to Income Ratio		72.50%	75.36%	68.58%	67.59%

Total Banking Assets…

3.3. Total banking assets have been increasing over the quarter, from $10.95 billion to $12.35 billion.

3.4. The total assets as at 30 June 2018 mainly comprised of loans and advances (31.69%), investment & advances (30.70%) as well as balances with the Central Bank (16.67%).

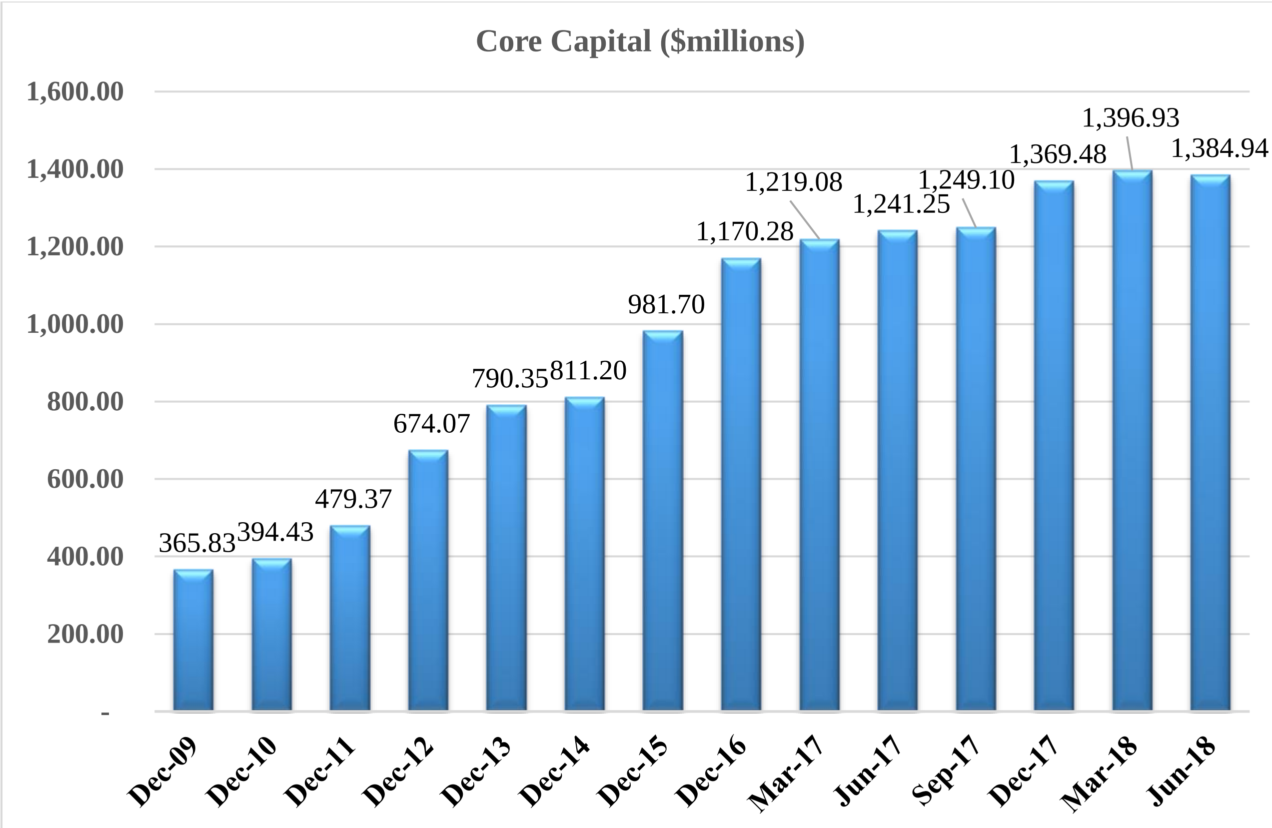
Capitalisation…

3.5. As at 30 June 2018, all banking institutions were in compliance with the minimum prescribed capital requirements.

3.6. The banking sector aggregate core capital, however, marginally declined during the quarter by 0.8%, from $1.40 billion as at 31 March 2018 to $1.38 billion as at 30 June 2018. The decline in core capital over the quarter emanated from once-off IFRS 9 adjustment to the provisioning levels at some banking institutions.

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

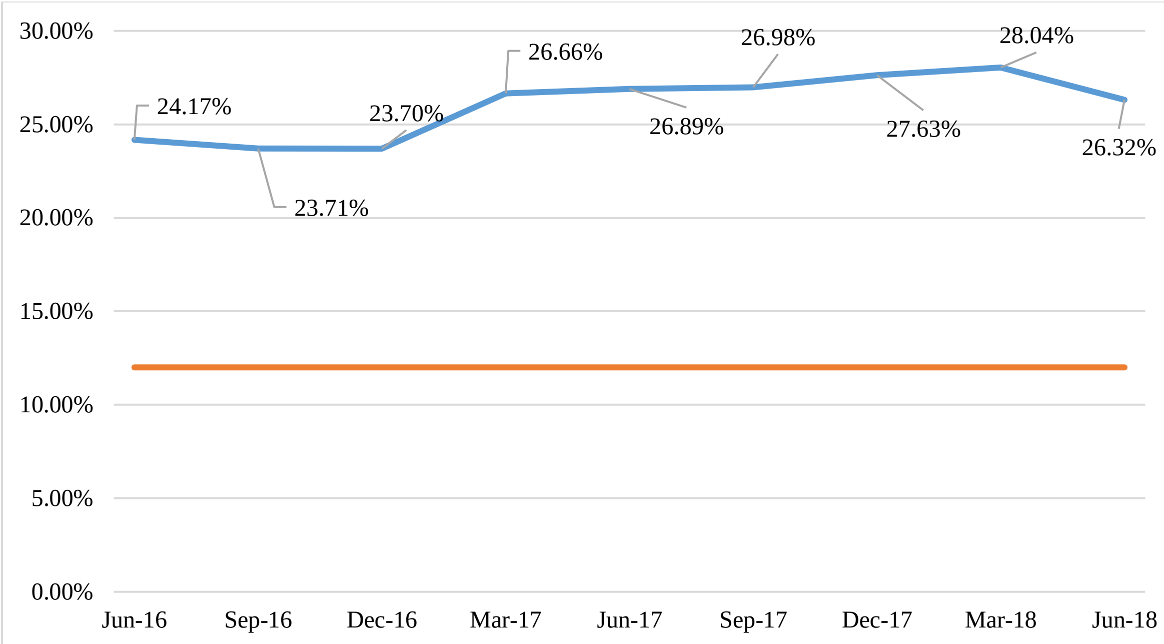
Figure 1: Core Capital Trends 2009 to June 2018



3.8. The banking sector was adequately capitalised with average tier 1 and capital adequacy ratios of 22.70% and 26.32%, respectively, as at 30 June 2018. All banking institutions were adequately capitalised with tier 1 and capital adequacy ratios above the as the regulatory minima of 8% and 12%, respectively.

3.9. The banking industry's average capital adequacy ratios (CARs) from June 2016 to June 2018 are shown in the figure below.

Figure 2: Capital Adequacy Ratios Trend

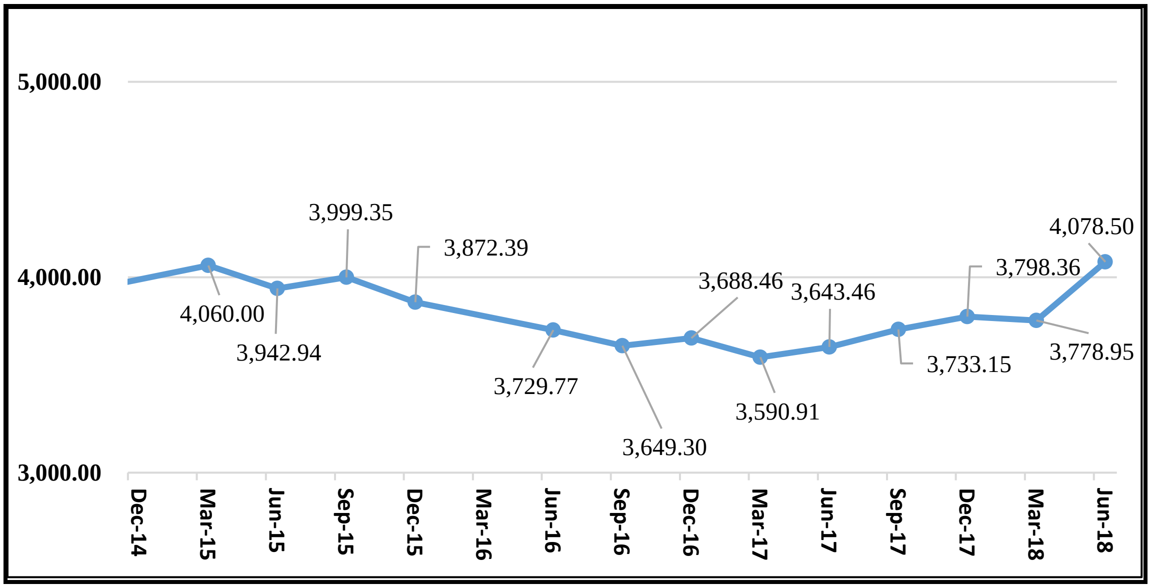


3.10. Banking institutions are making significant progress towards meeting the 2020 minimum capital requirements and as at 30 June 2018, three (3) banking institutions were already compliant with the 2020 minimum capital requirements of $100 million for tier 1 strategic group.

Asset Quality...

3.11. Total banking sector loans and advances increased by 7.93%, from $3.78 billion as at 31 March 2018 to $4.08 billion as at 30 June 2018. Figure 3 below shows the trend of banking sector loans and advances from 31 December 2014 to 30 June 2018.

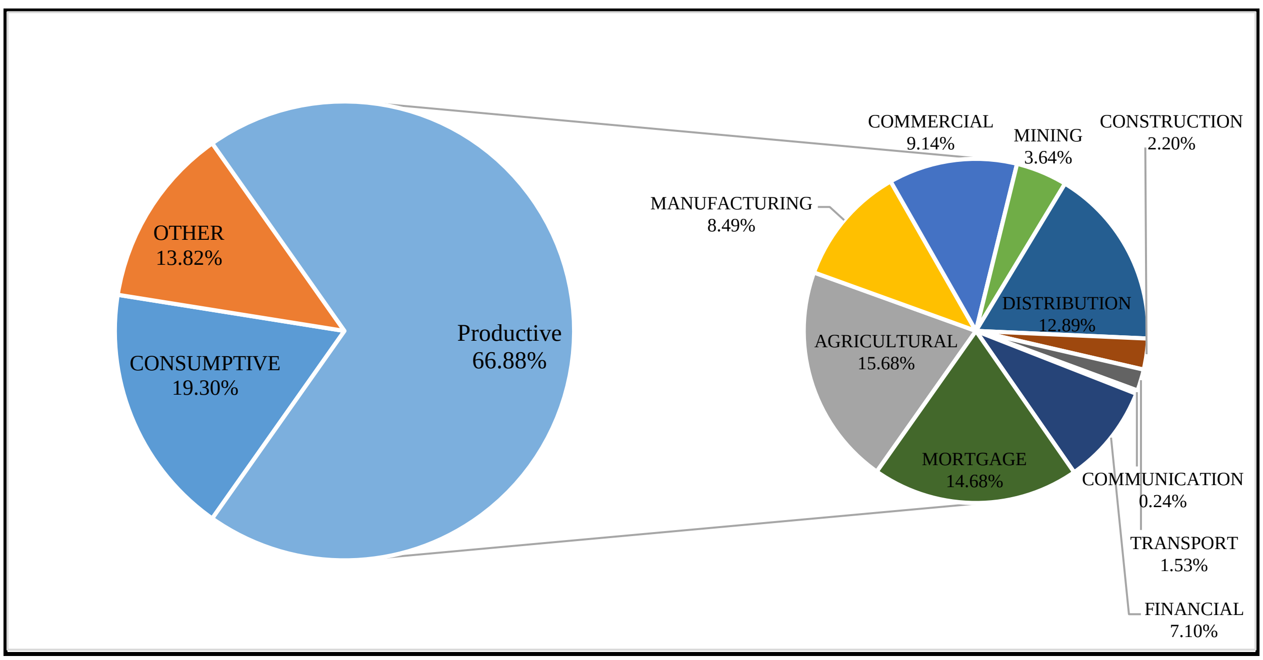
Figure 3: Banking Sector Loans & Advances ($)



Distribution of Loans and Advances…

3.12. As at 30 June 2018, banking sector lending to the productive sector constituted 66.88% of total loans as shown in Figure 4 below.

Figure 4: Sectoral Distribution of Loans as at 30 June 2018

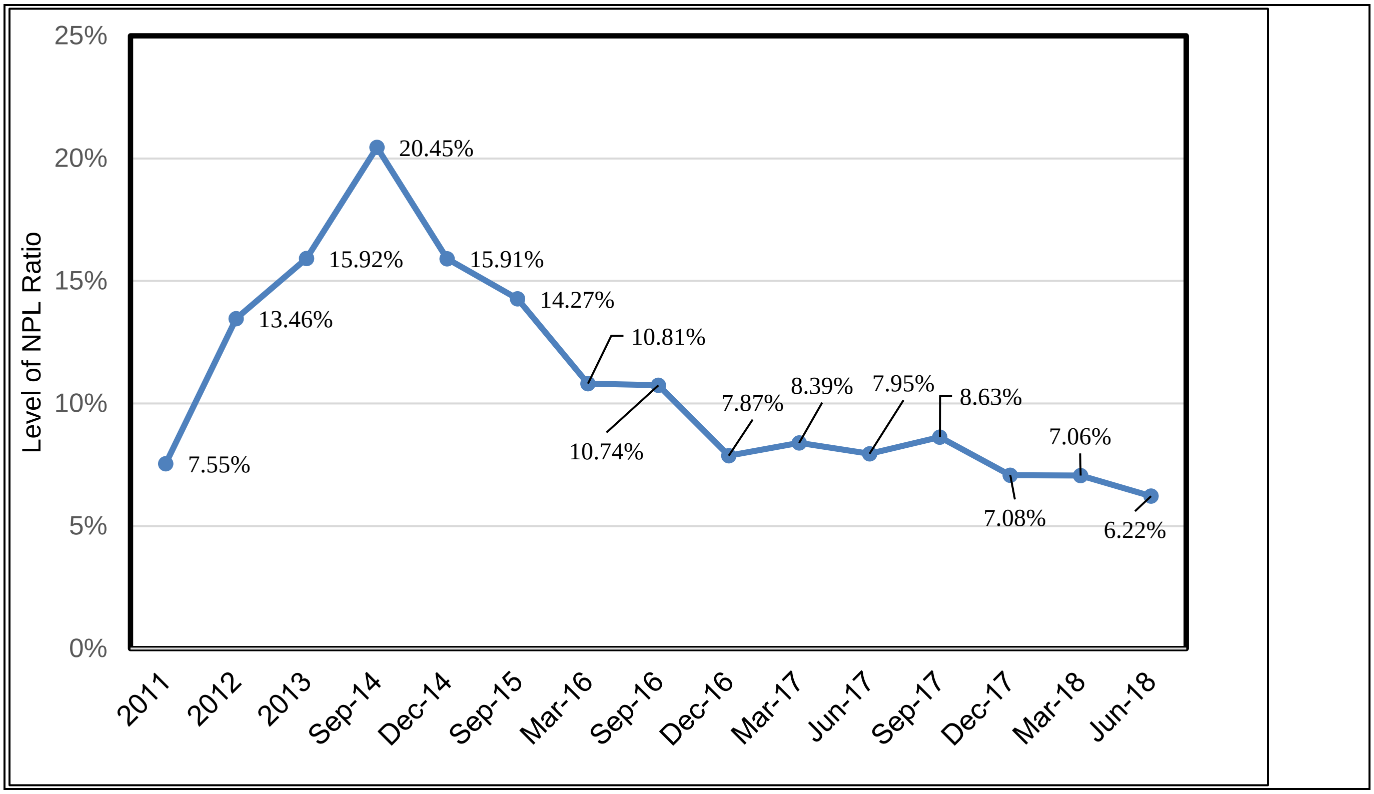


Non-Performing Loans

3.13. The quality of the banking sector loan portfolio continues to improve as reflected by the ratio of non-performing loans (NPLs) to total loans of 6.22% as at 30 June 2018, from 7.06% as at 31 March 2018.

3.14. The trend in the level of non-performing loans from 2011 to June 2018 is indicated in Figure 5 below:

Figure 5: Trend in Non-Performing Loans 2011 – June 2018



3.15. The sustained reduction in NPLs is expected to continue strengthening banks' balance sheets thus enhancing banking sector's safety and soundness.

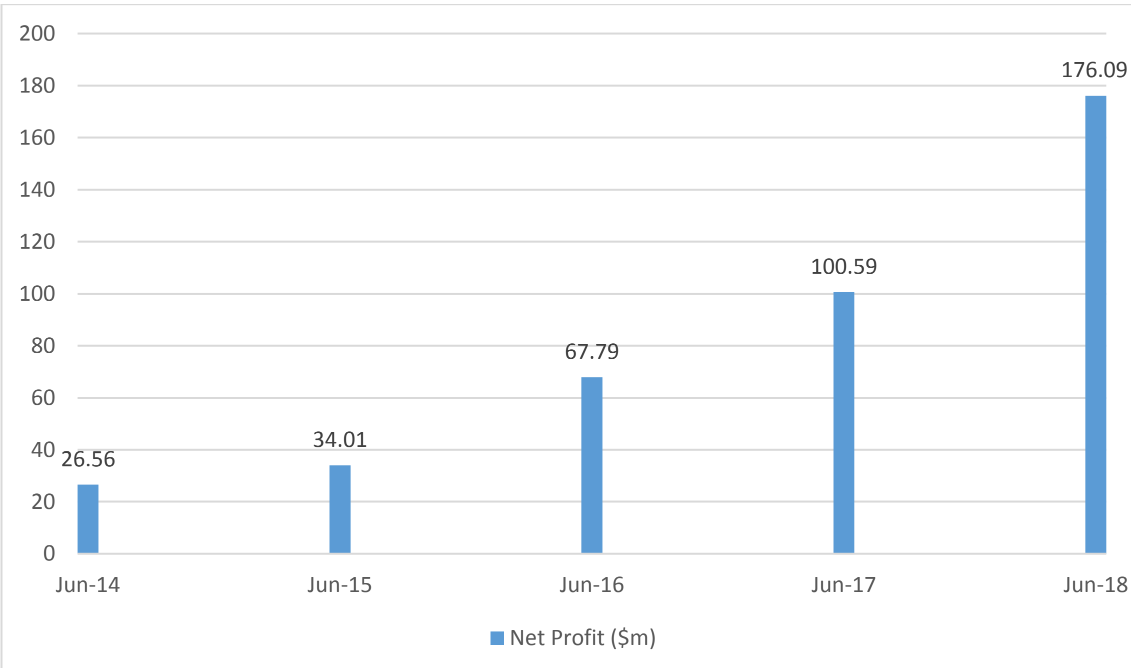
Earnings Performance...

3.16. The banking sector recorded improved earnings during the period under review with an aggregate net profit of $176.09 million for the six (6) months ended 30 June 2018, representing a 75.06% increase from $100.59 million reported in the corresponding period in 2017.

3.17. The improved earnings performance translated to improved average return on assets and return on equity from 1.26% and 6.80%, to 1.75% and 11.16%, respectively.

3.18. Figure 7 shows trend in net profit from June 2017 to June 2018.

Figure 7: Trend in Net Profit from 30 June 2014 to 30 June 2018



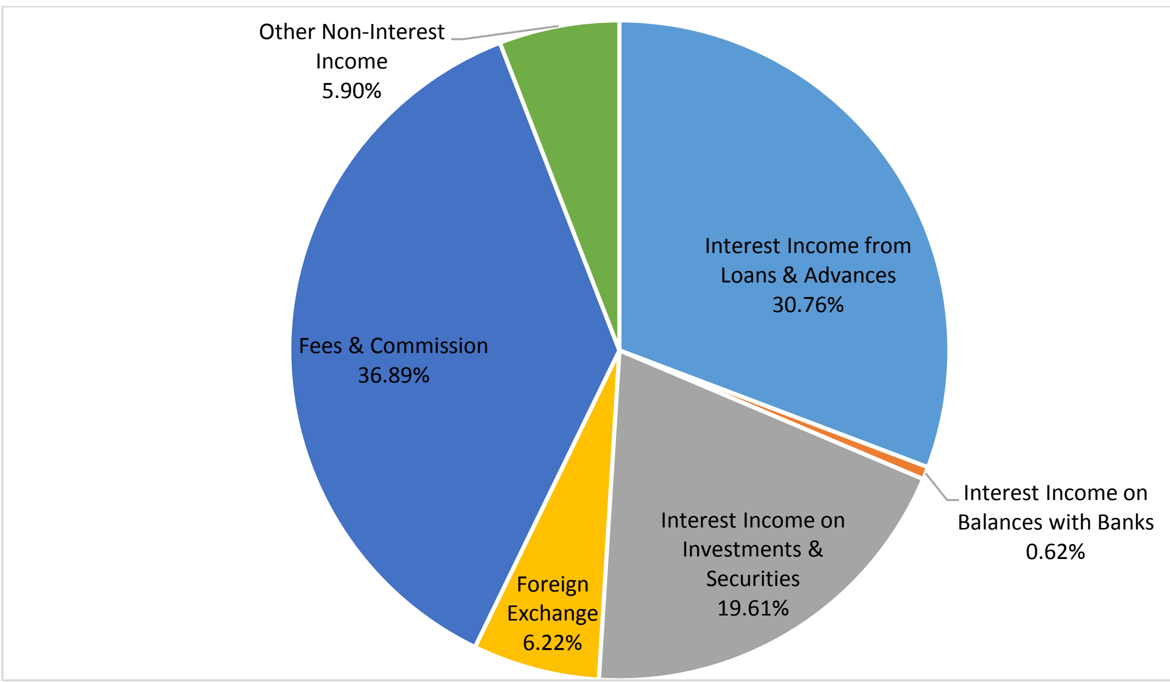
3.19. The improved banking sector earnings performance were on the back of non-interest income, mainly fees and commissions, driven by transactional income from increased usage of plastic money by the general public.

3.20. Fees and commission accounted for 36.89% of total income for the period ended 30 June 2018, compared to 36.60% in 2017, arising from an increase in electronic transactions volumes.

3.21. Over the year, fees and commission increased by 22.76% from $200.95 million reported during the half year ended 30 June 2017 to $246.69 million reported during the corresponding period in 2018. Interest income from loans and advances were 30.76% of total income for the half year ended 30 June 2018, compared to 39.02% in 2017, while interest on investments and securities accounted for 19.61% (in 2018) against 14.43% (in 2017).

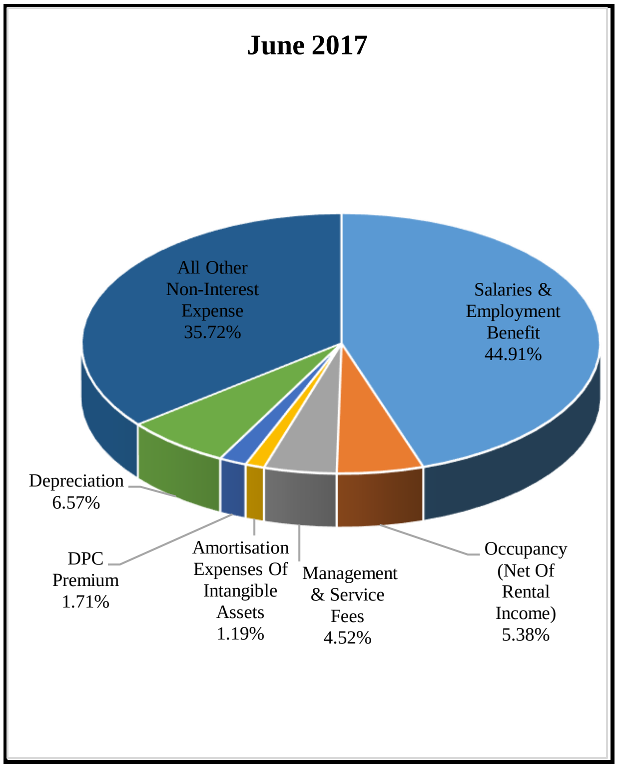
3.22. The income mix for the sector for the half year ended 30 June 2018 is shown in Figure 8:

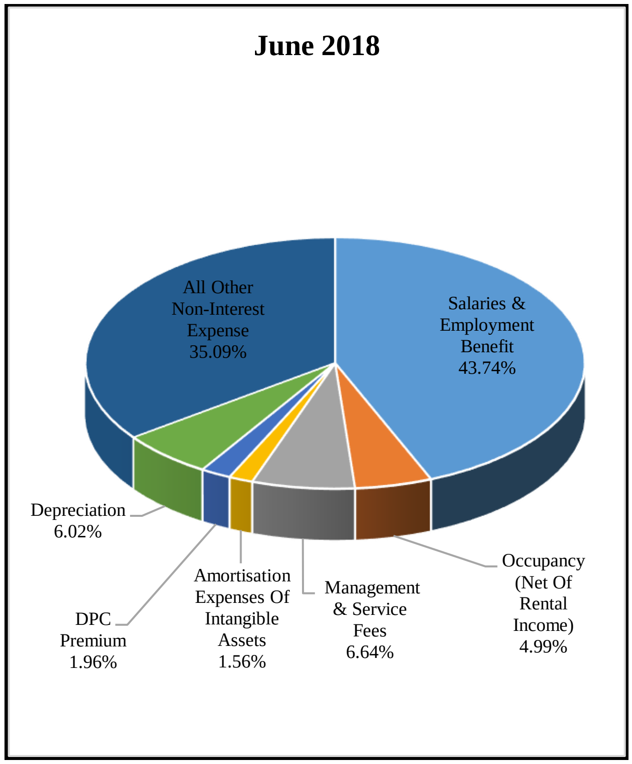
Figure 8: Banking Sector Income Mix as at 30 June 2018



3.23. For the half year ended 30 June 2018, salaries & employment benefits constituted 44.18% of total banking sector costs as shown in the figure below.

Figure 9: Banking Sector Operating Expenses



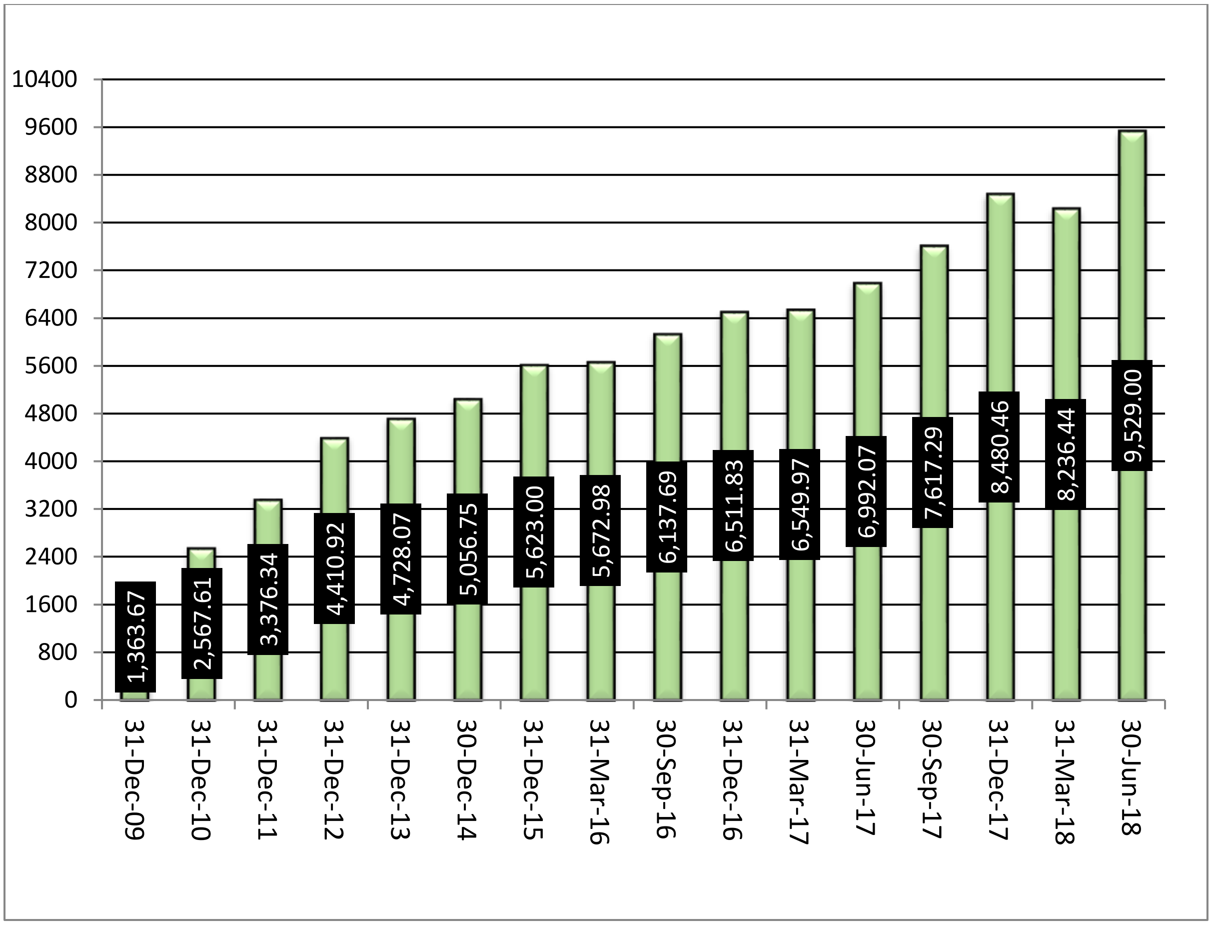


Liquidity and Funds Management...

3.24. Total banking sector deposits amounted to $9.53 billion as at 30 June 2018, representing an increase of 15.66%, from $8.24 billion reported as at 31 March 2018.

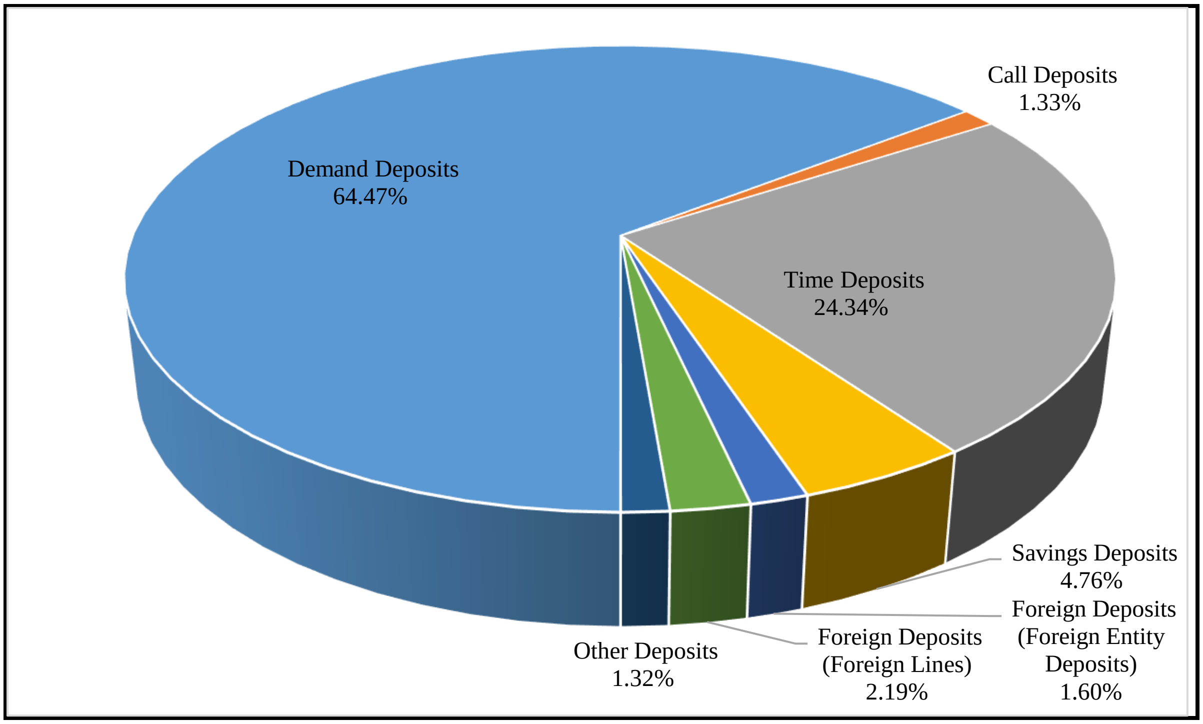
3.25. The figure below shows the trend of banking sector deposits over the period 31 December 2009 to 30 June 2018.

Figure 10: Trend of Banking Sector Deposits ($)



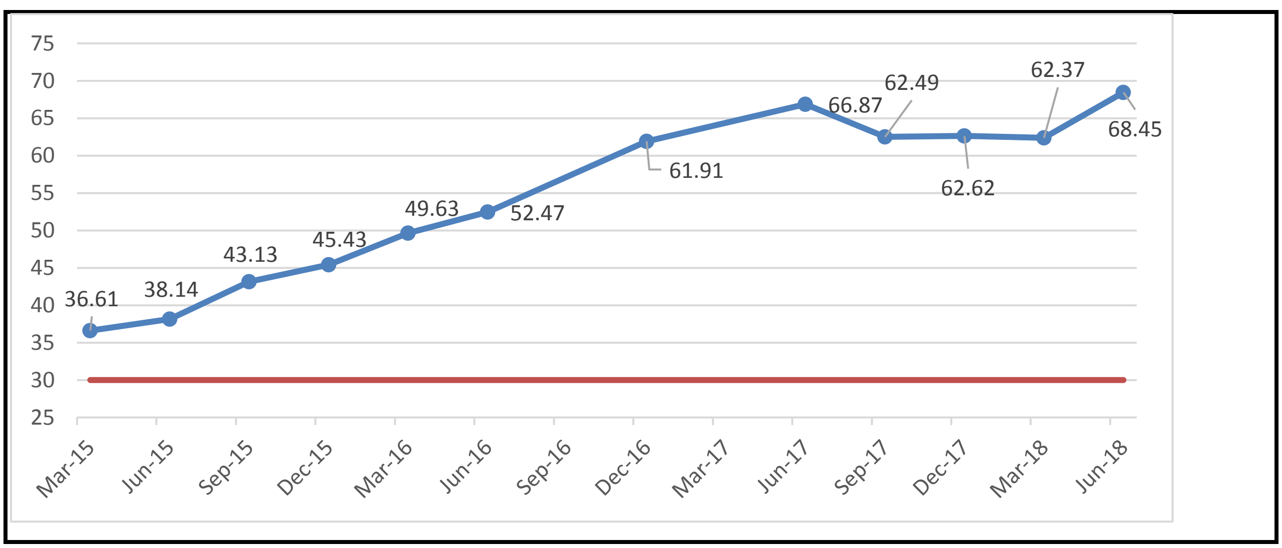
3.26. The banking sector was predominantly funded by demand deposits which accounted for 64.47% of total deposits as at 30 June 2018. The composition of total banking sector deposits as at 30 June 2018 is depicted in Figure 11.

Figure 11: Composition of Deposits as at 30 June 2018



3.27. Figure 12 below shows the trend in the banking sector average prudential liquidity ratio since March 2014.

Figure 12: Prudential Liquidity Ratio Trend (%)



3.28. The average prudential liquidity ratio for the banking sector 68.45% as at 30 June 2018 All banks were compliant with the minimum prudential liquidity ratio of 30% as at 30 June 2018, with the exception of one institution.

3.29. The high average prudential liquidity ratio is largely attributed to high levels of treasury bills (TBs) held by banking institutions. TBs accounted for 58.27% of net available liquid assets of $6.59 billion held by banking institutions.

Sensitivity to Market Risk...

3.30. The banking sector's exposure to market risk remained low on account of limited trade in foreign exchange by banks and are not taking positions on their own account.

3.31. All banking institutions were resilient to a moderate level interest rate risk shock of 5% increase or decrease in interest rates as their capital adequacy ratios would remain above the prescribed minimum of 12%.

3.32. All banking institutions were resilient to a moderate foreign exchange risk shock of an appreciation of the USD against major currencies by 5% as the sector's capital adequacy ratio will remain above 12% at 23.49%.

30 JUNE 2018