QUARTERLY BANKING SECTOR REPORT

30 JUNE 2017

BANK SUPERVISIONDIVISION

1. EXECUTIVE SUMMARY

1.1. The banking sector remained generally stable and performed satisfactorily during the quarter ended 30 June 2017, on the back of measures to promote safety and soundness of the sector.

1.2. As at 30 June 2017, all operating banking institutions were in compliance with the prescribed minimum capital requirements and had an aggregate core capital of $1.24 billion.

1.3. The banking sector aggregate net profit was $100.59 million for the six months to 30 June 2017. A total of 18 out of 19 operating banking institutions recorded profits during this period.

1.4. As at 30 June 2017, aggregate banking sector deposits amounted to $**6.99 billion,** representing a 6.71% increase from $6.55 billion reported as at 31 March 2017. Total banking sector loans and advances amounted to $3.64 billion, translating into a loans to deposits ratio of 52.11%.

1.5. Credit risk in the banking sector continued to improve as reflected by an average NPL ratio of **7.95%** as at 30 June 2017, from a peak of 20.45% in September 2014. The improvement is largely attributable to enhanced credit risk management practices at most banking institutions, as well as, disposal of non-performing loans to ZAMCO.

1.6. The sector's prudential liquidity ratio of **66.87%** as at 30 June 2017 was significantly above the regulatory minimum of 30%, mainly reflecting a cautious approach to lending adopted by banking institutions.

1.7. Banking institutions continue to realign their business models in this dynamic operating environment. The realignment includes serving previously unserved and underserved segments in line with the financial inclusion drive.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 30 June 2017, the banking sector was configured 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	181
Deposit-taking MFIs	4
Development Institutions - SMEDCO and IDBZ	2

3. CONDITION AND PERFORMANCE OF THE BANKING SECTOR

3.1. The financial condition of the banking sector was considered satisfactory as at 30 June 2017. The following table summarises the sector's financial soundness indicators as at 30 June 2017:

Financial Soundness Indicators

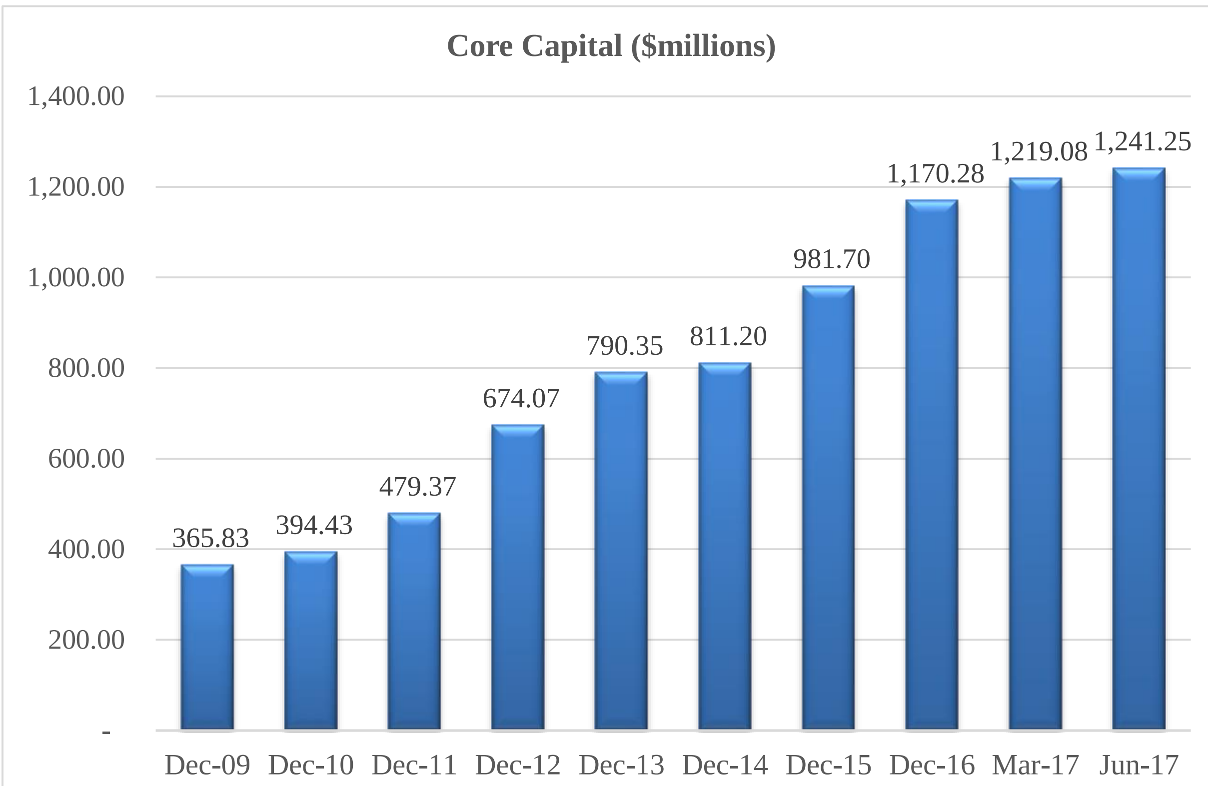
Key Indicators	Benchmark	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Total Assets	-	$8.01bn	$8.25bn	$8.73bn	$8.88bn	$9.65bn
Total Loans	-	$3.73bn	$3.65bn	$3.69bn	$3.59bn	$3.64bn
Net Capital Base	-	$1.22bn	$1.24bn	$1.34bn	$1.37bn	$1.38bn
Core Capital	-	$1.04bn	$1.07bn	$1.17bn	$1.22bn	$1.24bn
Total Deposits	-	$5.91bn	$6.14bn	$6.51bn	$6.55bn	$6.99bn
Net Profit	-	$67.97m	$111.78m	$181.06m	$50.34m	$100.59m
Return on Assets	-	0.98%	1.57%	2.26%	0.69%	1.26%
Return on Equity	-	3.53%	8.94%	12.64%	3.65%	6.80%
Capital Adequacy Ratio	12%	23.45%	23.71%	23.70%	26.66%	26.89%
Loans to Deposits	70%	63.08%	59.45%	56.64%	54.82%	52.11%
Non-Performing Loans Ratio	5%	10.05%	10.74%	7.87%	8.39%	7.95%
Provisions to Adversely Classified Loans	-	69.87%	68.05%	68.51%	65.86%	126.29%
Liquidity Ratio	30%	52.47%	54.15%	61.91%	60.20%	66.87%
Cost to Income Ratio		84.23%	82.75%	79.20%	76.58%	72.50%

Capital Adequacy…

3.2. As at 30 June 2017, all operating banking institutions were in compliance with the prescribed minimum capital requirements.

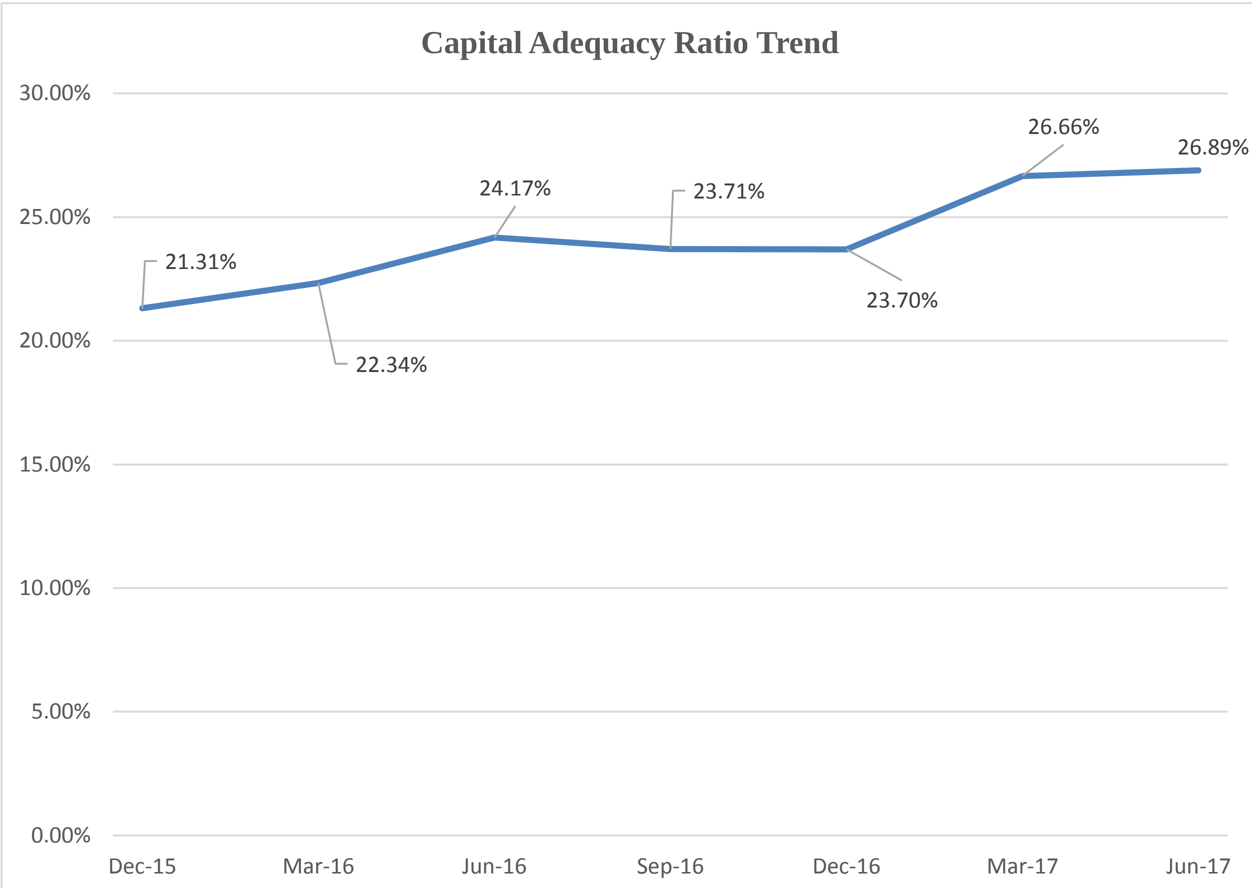
3.3. The aggregate core capital increased by 1.81% from US$1.22 billion as at 31 March 2017 to US$1.24 billion during the quarter ended 30 June 2017, on the back of improved earnings performance. Net capital base increased from $1.37 billion to $1.39 billion during the same period.

3.4. The graph below shows banking sector core capital trends from 2009 to June 2017:



3.5. The banking sector is adequately capitalized with average capital adequacy and tier 1 ratios of 26.89% and 24.02% respectively as at 30 June 2017. The capital ratios are above the required minima of 12% and 8% for capital adequacy and tier 1 ratios respectively. Tier 1 capital constituted 89.31% of the banking sector's net capital base of $1.39 billion as at 30 June 2017, reflecting high quality capital held by the sector.

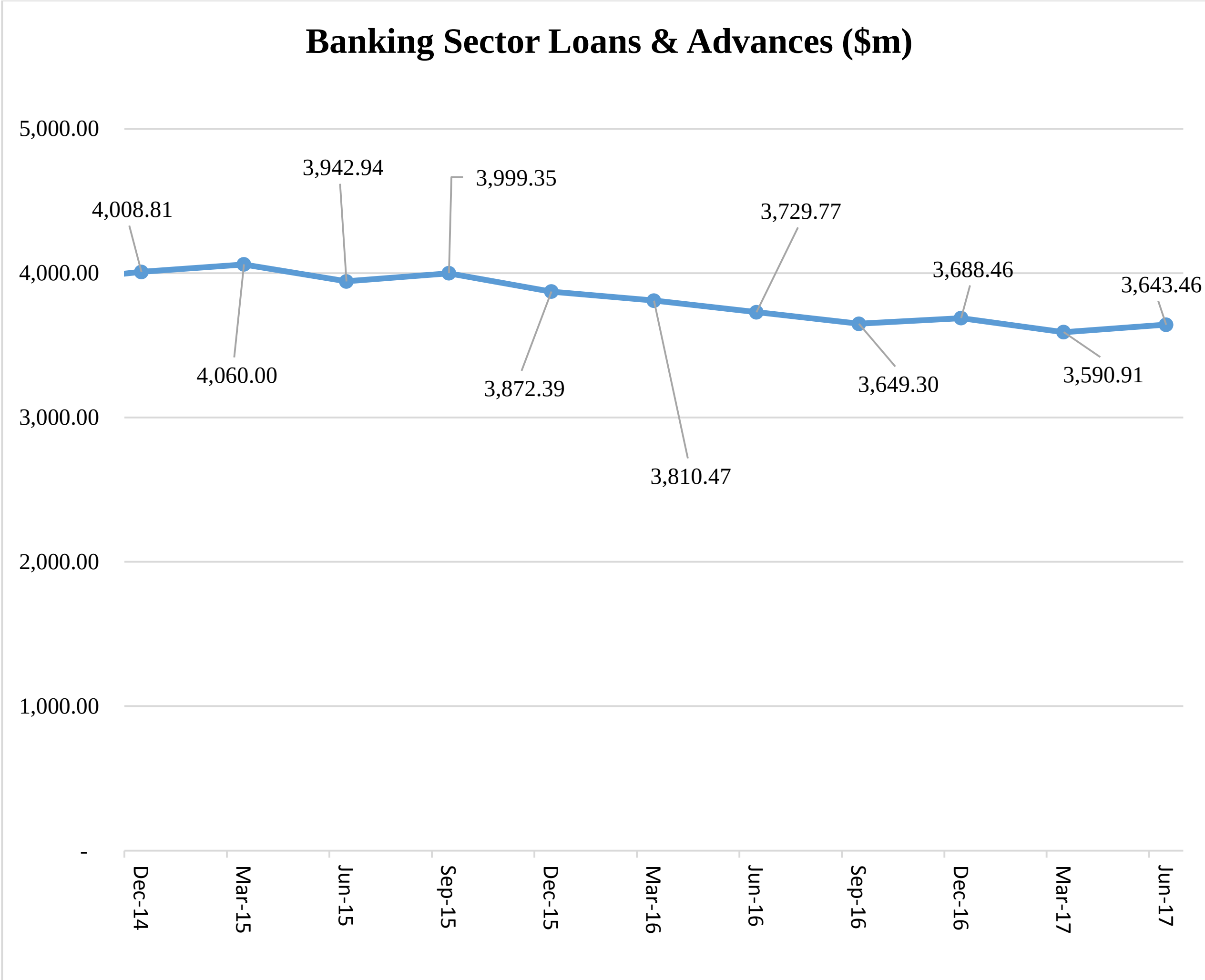
3.6. The trend in the banking industry's average capital adequacy ratios (CARs) from December 2015 to June 2017 is shown in the figure below.



3.7. The Reserve Bank is monitoring implementation of the banking institutions' capital plans and progress towards compliance with the 2020 minimum capital requirements, on an on-going basis.

Asset Quality...

3.8. Total banking sector loans and advances marginally increased from **$3.59 billion** reported as at 31 March 2017, to **$3.64 billion** as at 30 June 2017. The graph below shows the trend of banking sector loans and advances from 31 December 2014 to 30 June 2017.



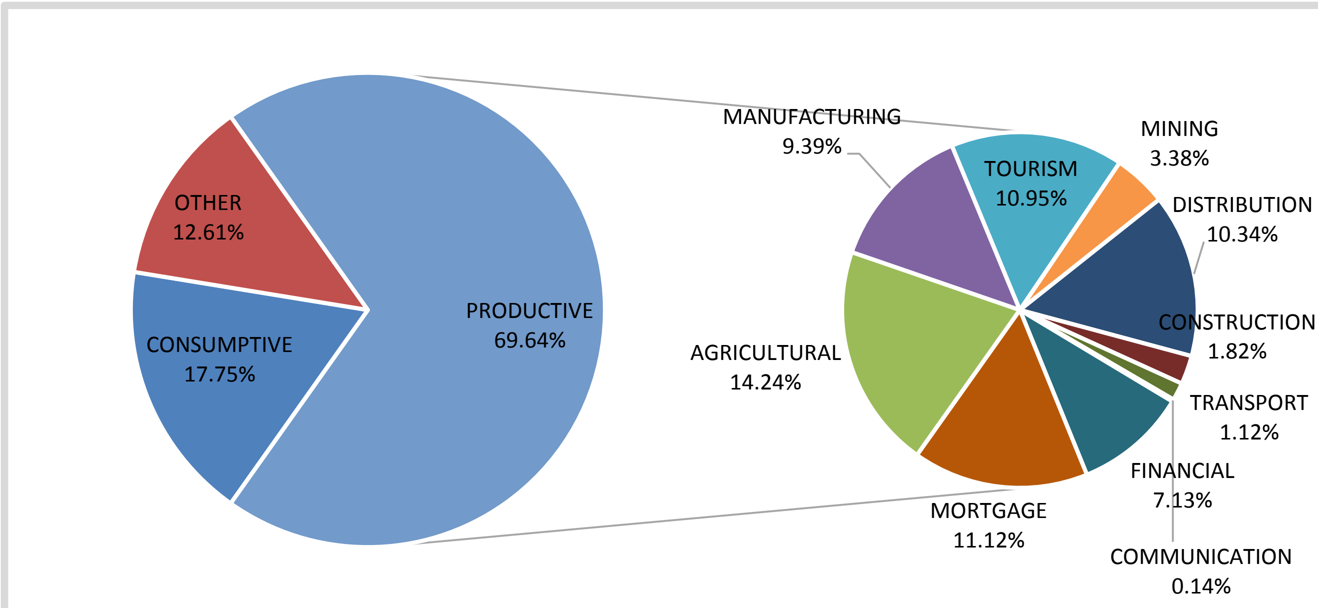
3.9. The banking sector loans have generally been on a downward trend since September 2015, largely as a result of reduction in new lending by most banking institutions due to perceived high credit risk. However, the ongoing financial stability measures which include macroeconomic stabilization, as well as establishment of a credit reference system, credit guarantee scheme and collateral registry, are envisaged to create a conducive environment for increased lending.

Distribution of Loans and Advances…

3.10. As at 30 June 2017, lending to the productive sectors accounted for 69.64% of total loans. Loans to Agriculture, Mortgages and Tourism segments dominated the distribution of productive loans as at 30 June 2017

3.11. The distribution of credit as at 30 June 2017 is indicated in the figure below.

Distribution of Credit as at 30 June 2017



3.12. The reduction in lending rates for the productive sector, including mortgages, to 12% per annum, effective 1 April 2017 is expected to spur economic growth in the medium to long-term.

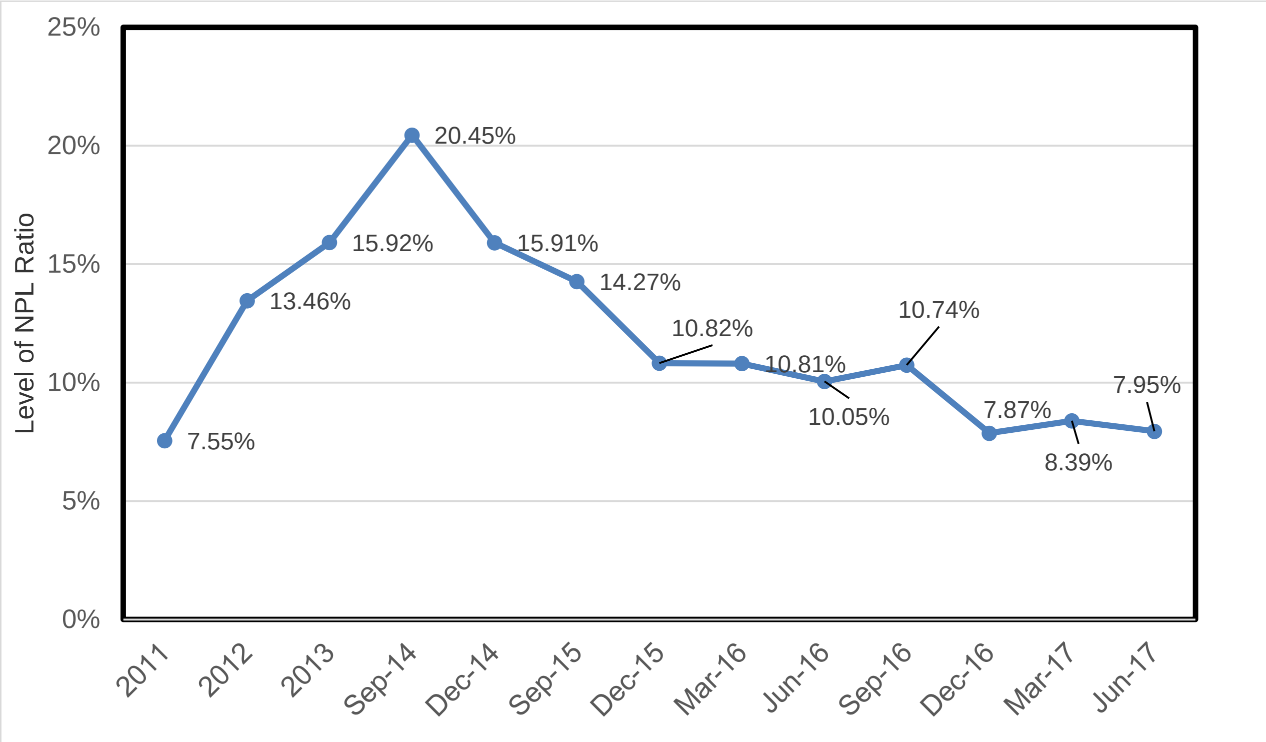
3.13. As at 30 June 2017, the average maximum effective lending rate was 11.94% against an average deposit rate of 2.03% resulting in interest rate spreads average of 9.19%.

Non-Performing Loans (NPLs)…

3.14. There has been a notable improvement in the quality of the banking sector loan portfolio over the years, from a peak of 20.45% as at 30 September 2014 to 7.95%, as at 30 June 2017.

3.15. The figure below shows the trend in NPLs from 2011 to 30 June 2017.

Non-Performing Loans Trend



3.16. The improvement in the performance of the banking sector loan portfolio is largely attributed to enhanced credit risk management practices at most banks and disposal of non-performing loans to **ZAMCO** amounting to **$898.57 million** as at 30 June 2017. The Reserve Bank continues to monitor the NPLs and the effectiveness of banks' credit risk management practices.

3.17. The sustainable reduction in NPLs is expected to strengthen banks' balance sheets and position them to meaningfully contribute to the revival of the economy.

Earnings Performance...

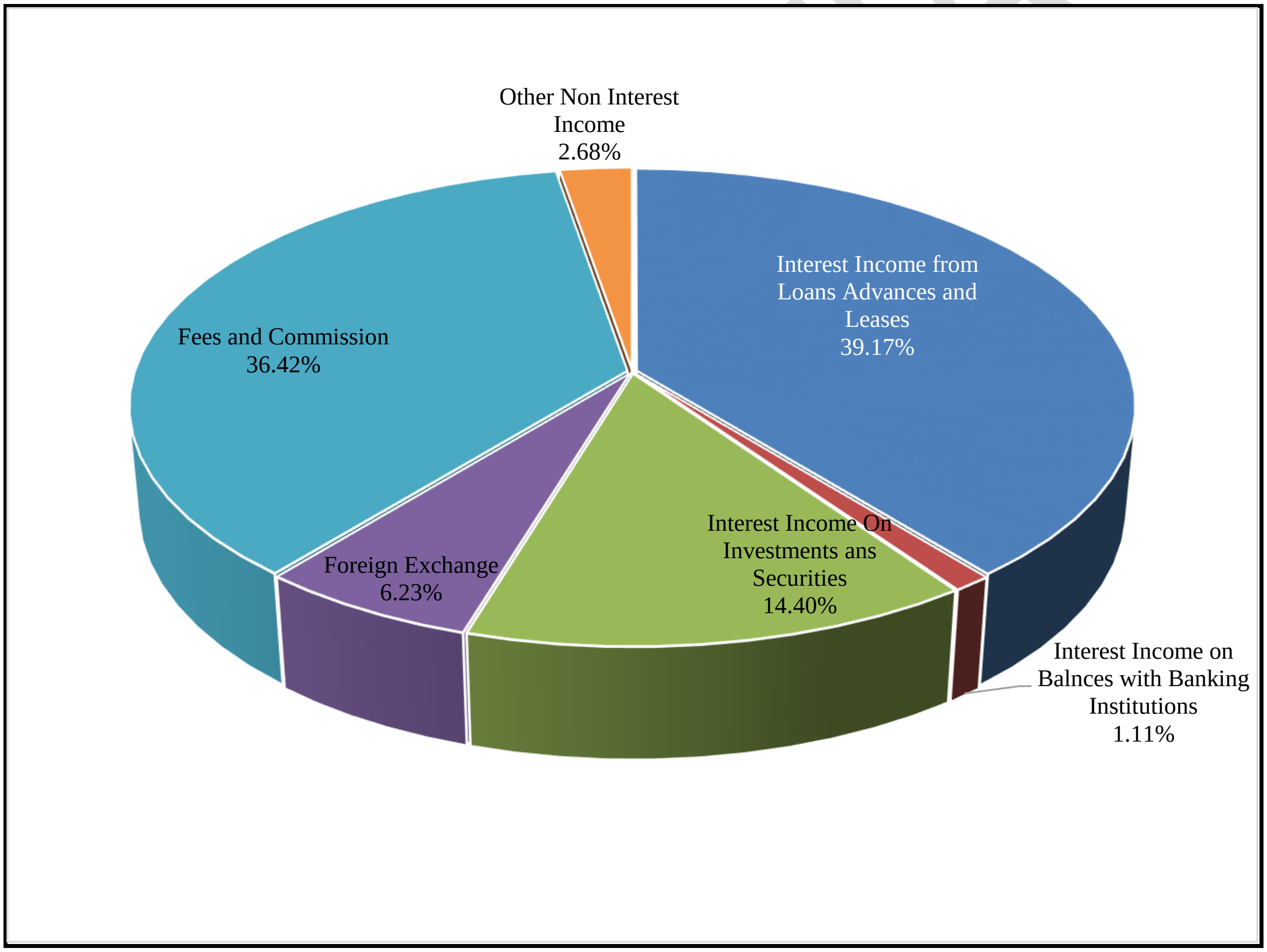
3.18. The banking sector earning performance was satisfactory during the six months ended 30 June 2017. The aggregate **net profit** for the half year ended 30 June 2017 amounted to **$100.59 million**, representing an increase of 47.99%, from $67.97 million reported in the corresponding period in 2016.

3.19. During the period ended 30 June 2017, a total of 18 out of 19 operating banking institutions recorded profits.

3.20. The average return on assets and return on equity improved from 0.98% and 5.54% as at 30 June 2016 to 1.26% and 7.17% as at 30 June 2017, respectively.

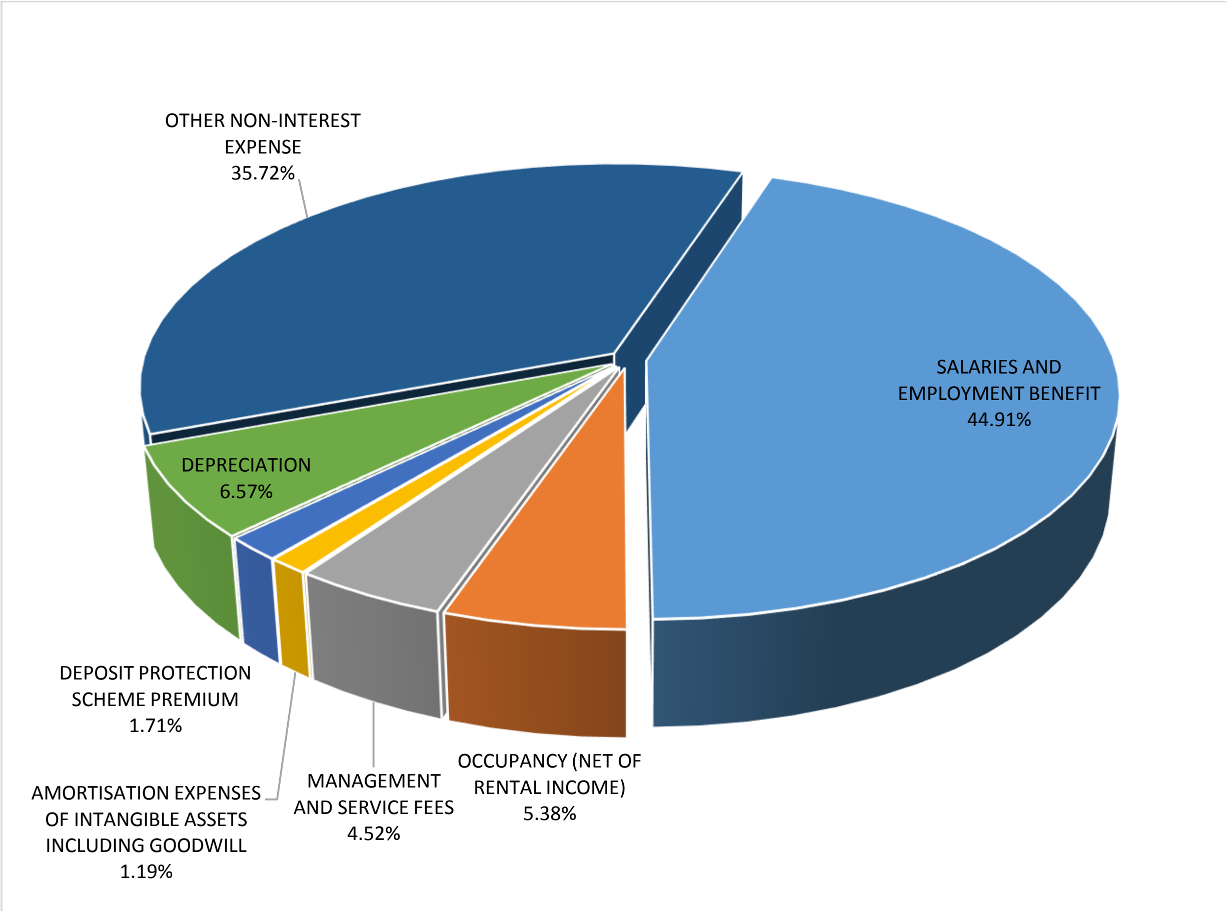
3.21. Interest income continued to be the major income driver, constituting 39.17% of total income amounting to $0.54 billion for the six months ended 30 June 2017. The sources of income for the banking sector as at 30 June 2017 are shown in the chart below.

Banking Sector Income Mix as at 30 June 2017



3.22. As at 30 June 2017, salaries & employment benefits continued to dominate total non-interest costs for banking institutions as they accounted for 44.91% of total banking sector costs as shown in the figure below.

Banking Sector Expense Mix as at 30 June 2017



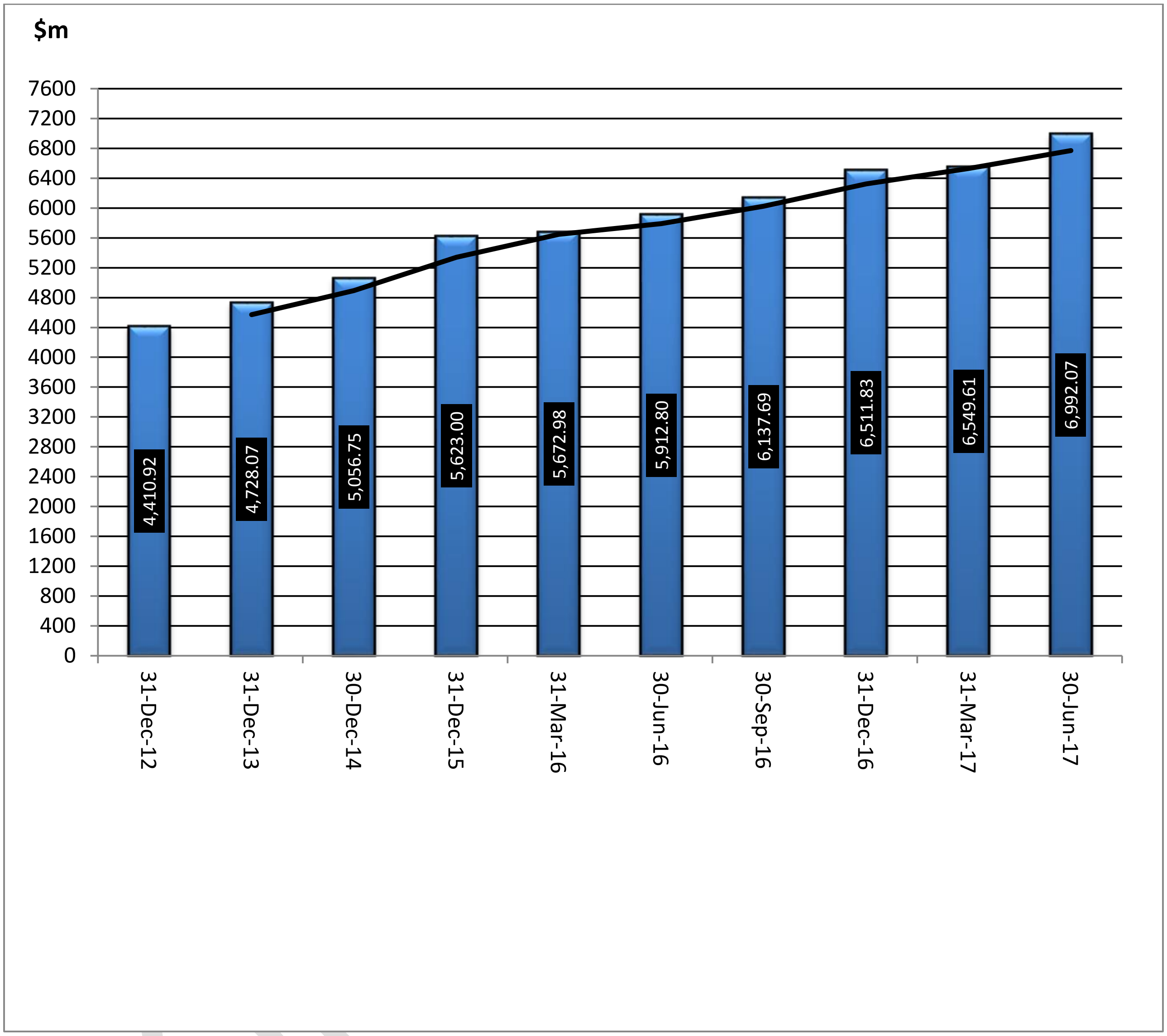
3.23. To ensure sustainable profitability, banking institutions are implementing adaptable business models by further interrogating their value chains, with a particular focus on efficiency enhancement.

Liquidity and Funds Management...

3.24. The aggregate banking sector deposits increased by 6.71%, from $6.55 billion as at 31 March 2017 to **$6.99 billion** as at 30 June 2017.

3.25. The figure below shows the trend of banking sector deposits over the period 31 December 2012 to 30 June 2017.

Trend of Banking Sector Deposits

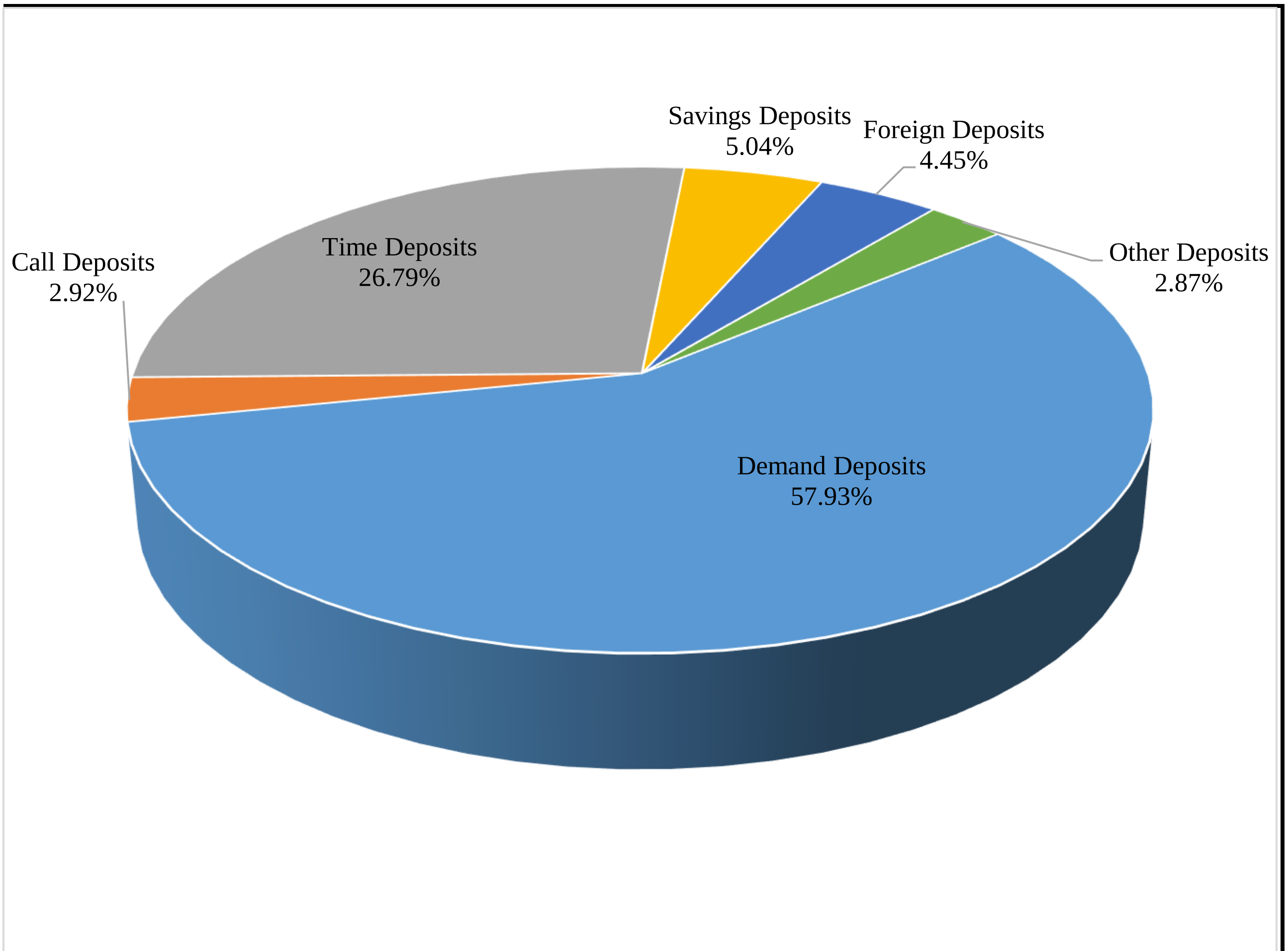


3.26. The commercial banking sub-sector accounted for 82.36% of total banking sector deposits and 73.90% of total banking sector loans as at 30 June 2017.

3.27. Banking sector deposits were dominated by demand and time deposits, which accounted for 57.93% and 26.79% of total deposits, respectively, as at 30 June 2017.

3.28. The composition of total banking sector deposits as at 30 June 2017 is depicted in the figure below.

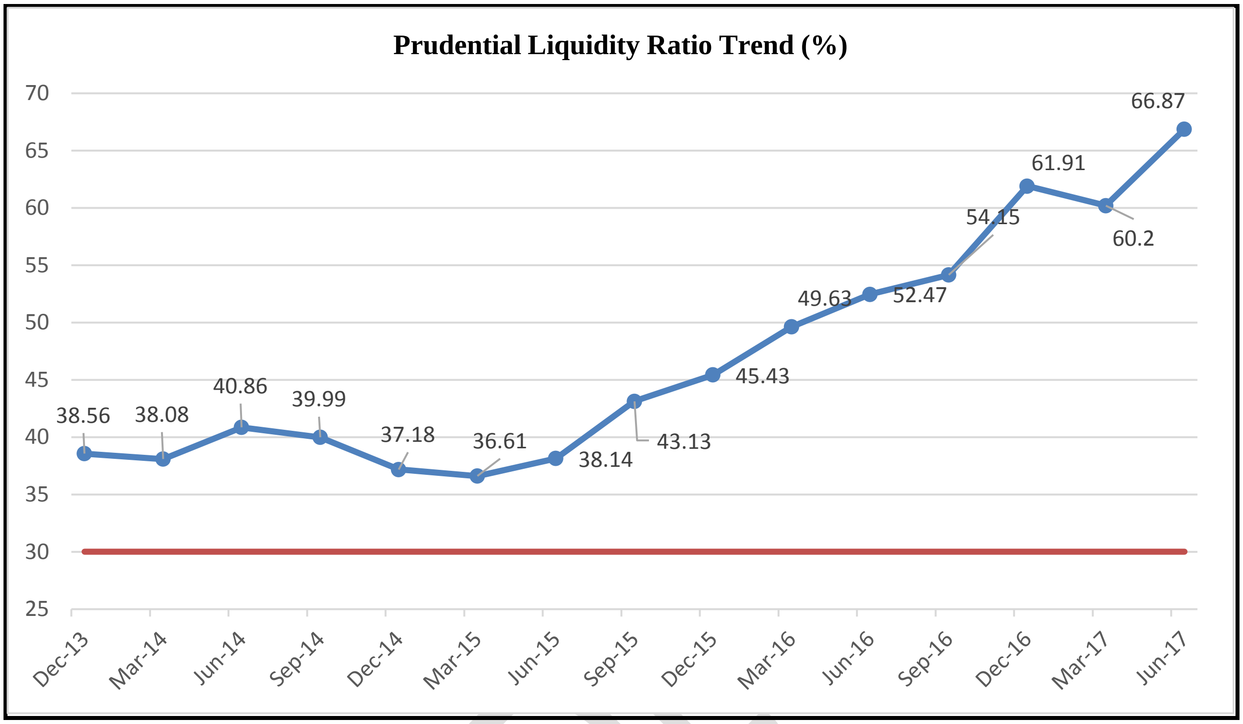
Banking Sector Deposit Mix as at 30 June 2017



3.29. A total of 18 out of the 19 operating banks were compliant with the prudential liquidity ratio of 30% as at 30 June 2017. The non-compliant bank has initiated appropriate measures which include deposit mobilisation initiatives, intensified loan collections, and revenue enhancement to ensure compliance with the regulatory requirement.

3.30. The trend in the banking sector average prudential liquidity ratio since December 2013 is shown in the figure below.

Trend of the Prudential Liquidity Ratio (31 December 2013 – 30 June 2017)



3.31. The high average prudential liquidity ratio is largely reflective of the cautious lending approach adopted by banking institutions especially in the context of foreign currency shortages. It is noteworthy that lending exacerbates the demand for foreign currency.

3.32. Notwithstanding the high average prudential liquidity ratios recorded across the sector, the banking industry continued to experience underlying shortages of physical cash. The increased demand for cash and the resultant cash constrains are largely a manifestation of the structural challenges confronting the economy including high fiscal recurrent expenditure and constrained exports.

Sensitivity to Market Risk…

3.33. Generally, the sector's exposure to market risk remained low. Under the current operating environment, the sector's exposure to interest rate risk was mainly in the banking book.

3.34. Aggregate stress test results reflect strong resilience to market risk shocks for the banking system as a whole.

3.35. Inherent foreign exchange rate risk remained low given banks' current balance sheet structures. 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 of **$1.80 billion** as at 30 June 2017, an increase from $1.68 billion as at 31 March 2017.

3.36. Stress tests conducted to assess the vulnerability of banking institutions' to foreign exchange rate movements showed that only one (1) banking institution is susceptible to a major level foreign exchange rate risk shock of a 15% appreciation of the US dollar against major currencies.

30 June 2017