RESERVE BANK OF ZIMBABWE

BANKING SECTOR

REPORT FOR QUARTER ENDED 31 MARCH 2014

1. EXECUTIVE SUMMARY

1.1. During the quarter ended 31 March 2014, the banking sector remained generally stable in spite of the challenging operating environment which was characterized by transitory deposits, limited inter-bank trading, general market illiquidity and limited lender of last resort function.

1.2. The prevailing macroeconomic environment translated into low capitalisation of banking institutions, high cost of funding; limited credit creation, liquidity constraints and rising non-performing loans. Credit risk remains one of the most significant challenges facing the banking sector.

1.3. A number of banking institutions are compliant with the minimum capital requirements. The remaining non-compliant banks are instituting various measures towards compliance. The banking sector was generally profitable, with 16 out of 21 operating institutions (including the savings bank), recording profits for the quarter ended 31 March 2014.

1.4. As at 31 March 2014, banking sector deposits amounted to $4.82 billion, whilst loans and advances were $3.64 billion, translating into loans to deposits ratio of 78.03%. Banks lending portfolio continue to be skewed towards consumptive lending.

2. ARCHITECTURE OF THE BANKING SECTOR

2.1. As at 31 March 2014, the architecture of the banking sector was as shown below.

Table 1: Architecture of the Banking Sector

Type of Institution	Number
Commercial Banks	15
Merchant Banks	2
Building Societies	3
Savings Bank	1
Microfinance Institutions	146

3. MACROECONOMIC ENVIRONMENT

3.1. The **macroeconomic** environment has been characterised by:

a) widening current account balance on the back of progressive expansion in imports against static exports;

b) low aggregate demand;

c) low industry capacity utilization

d) limited inflows of foreign direct investment; and

e) limited foreign lines of credit.

3.2. The aforementioned macroeconomic constraints and indicators as well as institution-specific deficiencies translate into challenges which affect banking institutions performance in respect of **capitalisation**, **asset quality**, **earnings performance** and **liquidity.**

4. CONDITION AND PERFORMANCE OF THE SECTOR

4.1. The overall performance of the banking sector based on CAMELS rating framework of Capital Adequacy (**C**), Asset Quality (**A**), Management (**M**), Earnings (**E**), Liquidity (**L**) and Sensitivity to Market Risk **(S)** was satisfactory.

4.2. A few banking institutions with a combined market share of only 8.14% in terms of assets were facing liquidity and solvency challenges and these were considered to be of low systemic importance. The Reserve Bank continues to closely monitor these institutions.

4.3. The performance and condition of the banking sector is summarised by the key banking sector statistics depicted in the table below:

Table 3: Banking Sector Statistics

Key Indicators	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Mar-14
Total No of Accounts	-	-	2,511,101	1,651,073	1,852,556	1,852,556
Total Assets	$2.19 billion	$3.69 billion	$4.74 billion	$6.12 billion	$6.74 billion	$6.81 billion
Total Loans	$693 million	$1.56 billion	$2.76 billion	$3.56 billion	$3.08 billion	$3.64 billion
Net Capital Base	$382 million	$458 million	$512 million	$644 million	$706 million	*$909 million
Total Deposits	$ 1.36 billion	$ 2.31 billion	$ 3.04 billion	$4.41 billion	$ 4.73 billion	$4.89 billion

Key Indicators	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Mar-14
Net Profit	$9.50 million	$37.95 million	$86 million	$69.23 million	$4.46 million	*$20.47 million
ROA	0.60%	-2.02%	2.43%	1.64%	0.06%	0.26%
ROE	2.47%	0.57%	15.13%	9.17%	0.51%	2.12%
CAR	27.26%	27.34%	13.51%	13.07%	14.01%	14.10%
Loans to Deposits	50.99%	86.25%	90.59%	93.27%	102.36%	78.03%
ACL/TL	1.80%	10.95%	7.55%	13.46%	15.92%	16.96%
Provisions to ACL	112.81%	887.71%	57.53%	207.45%	70.88%	46.73%
NIM	3.29%	5.75%	8.21%	14.81%	15.26%	-0.15%
Liquidity Ratio	97.44%	70.88%	56.80%	55.70%	40.57%	38.1%
Cost to Income Ratio	94.38%	148.95%	185.11%	99.95%	173.43%	87.15%

*Excluding one bank which is under curatorship

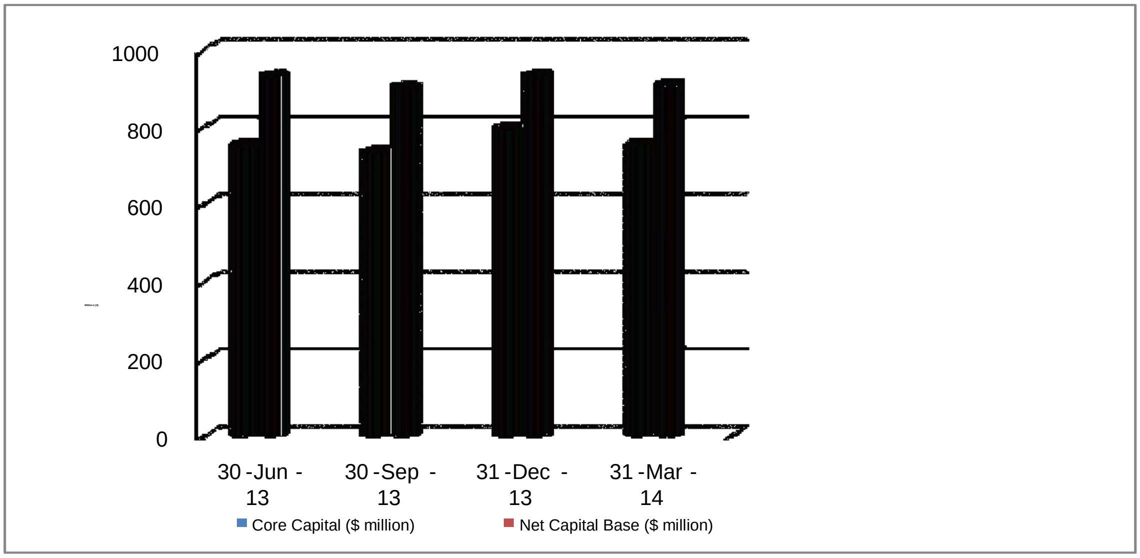
4.4. A summary of the condition and performance of the sector based on the CAMELS framework is provided hereunder.

Capital Adequacy…

4.5. On aggregate, as at 31 March 2014 the banking sector was capitalized to the tune of $909 million and $755 million in terms of **net capital** and **core capital** respectively, compared to $933 million and $784 million as at 31 December 2013**.** Core Capital diminution is largely attributed to losses incurred by the non compliant banks during the quarter under review.

4.6. Figure 1 shows the trend in net capital base and core capital levels from June 2013 to March 2014.

Figure 1: Banking Sector Capitalisation Levels

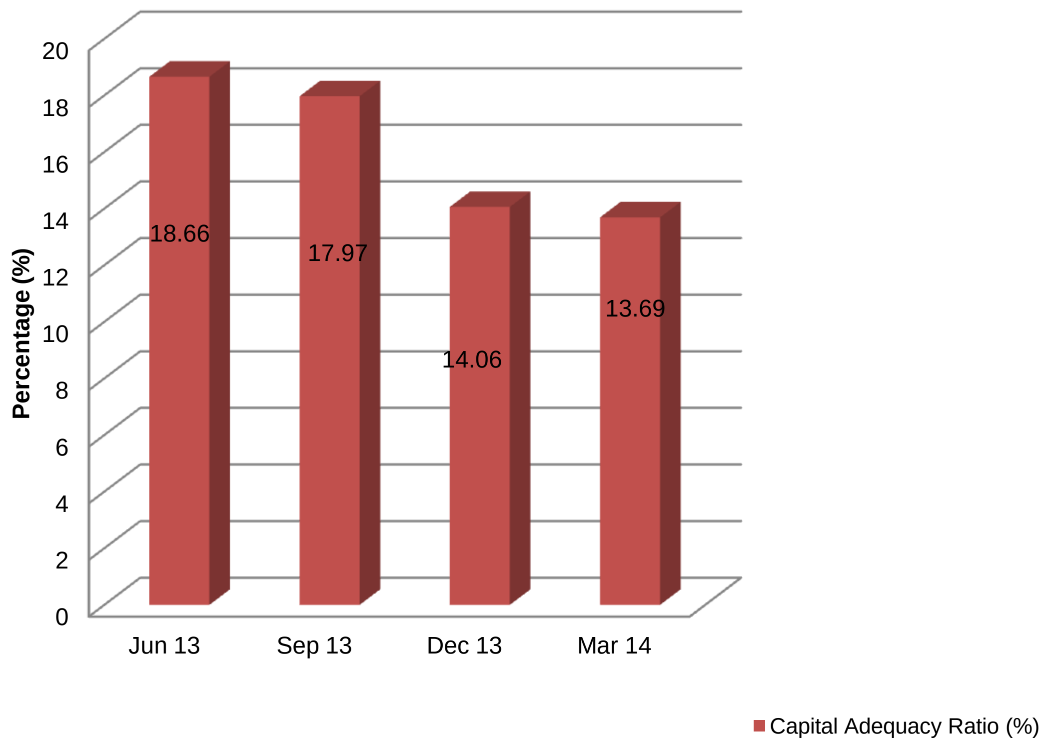


4.7. One banking institution has already surpassed the $100 million minimum capital requirement which is effective 2020. As at 31 March 2014, a total of 14 out of 20 operating banking institutions were in compliance with the prescribed minimum capital requirements. The compliance levels are the same as at 31 December 2013. Non-compliant banks are taking various measures to regularize their capital positions which are at different stages of implementation.

4.8. The banking sector remained adequately capitalised during the period ended 31 March 2014. The average CAR for the sector has been declining as indicated below although the ratio was still above the required minimum regulatory capital adequacy ratio of 12%.

4.9. The trend in the banking industry's capital adequacy ratios (CARs) from June 2013 to March 2014 is indicated in figure 2 below.

Figure 2: Capital Adequacy Ratio



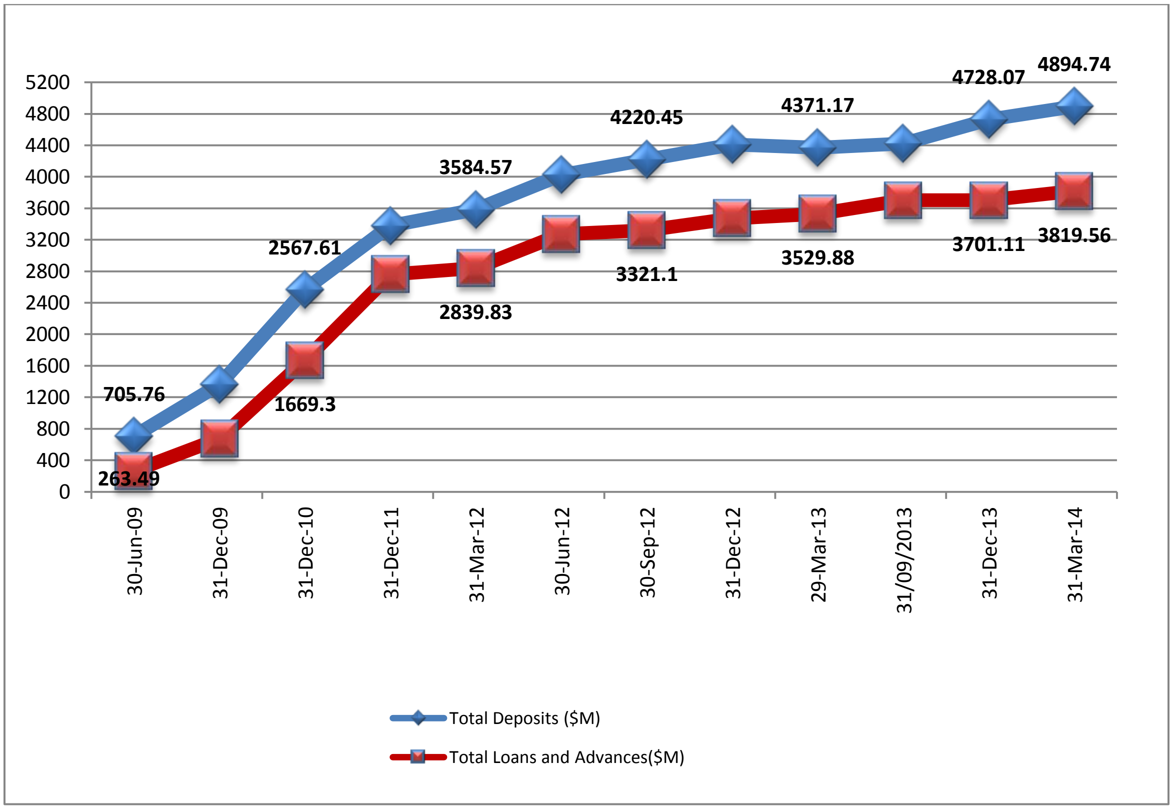
4.10. The decline in CAR was attributable to the decline in the level of capital coupled with the growth in risk weighted assets (sector loans & advances).

4.11. The persistent losses being recorded by some banking institutions further threaten the sector's capital levels.

Asset Quality...

4.12. Total loans and advances amounted to $3.82 billion as at 31 March

2014. There has been a growth in the level of total loans and advances as depicted below

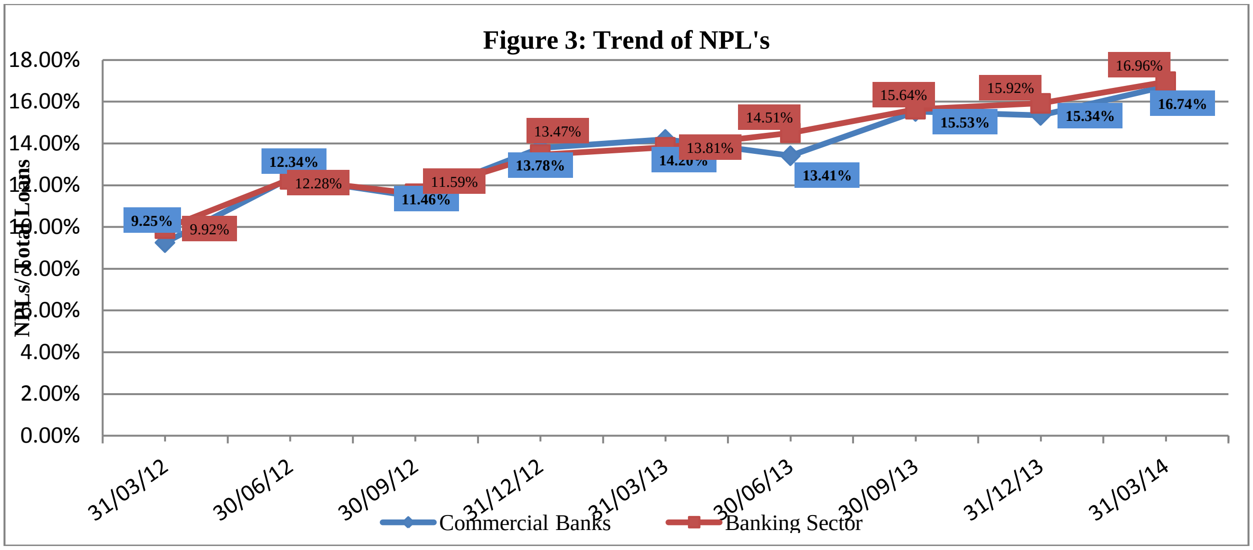


4.13. Commercial banking institutions accounted for 92.73% of total banking sector loans and advances.

4.14. The top five (5) banks had loans & advances amounting to **$2.12** billion which accounted for **59.18%** of total banking sector loans & advances as at 31 March 2014.

4.15. Credit risk remained a key challenge as evidenced by the the average ratio of non-performing loans to total loans (NPL/TL) which increased to **16.96%** as at 31 March 2014, up from 15.92% as at 31 December 2013. This trend is partly a reflection of macroeconomic challenges that have militated against borrowers' ability to service loans.

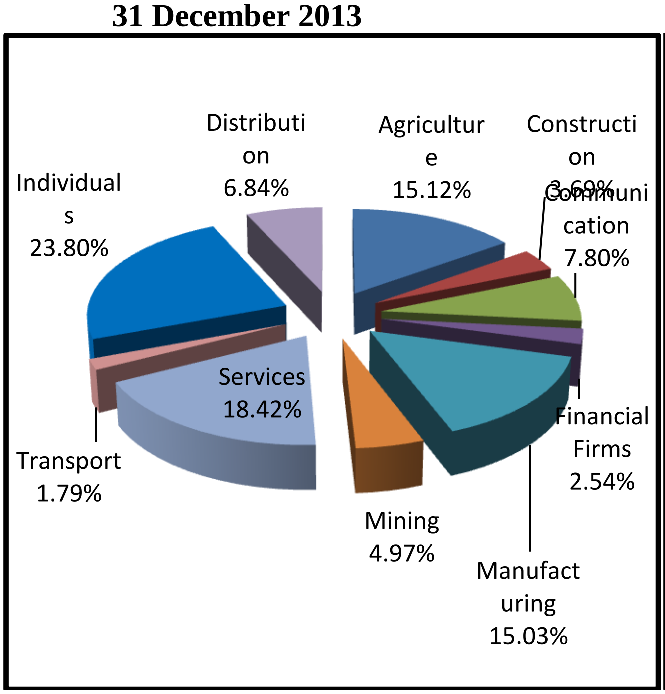
4.16. The trend of the banking sector NPLs ratio is depicted below:



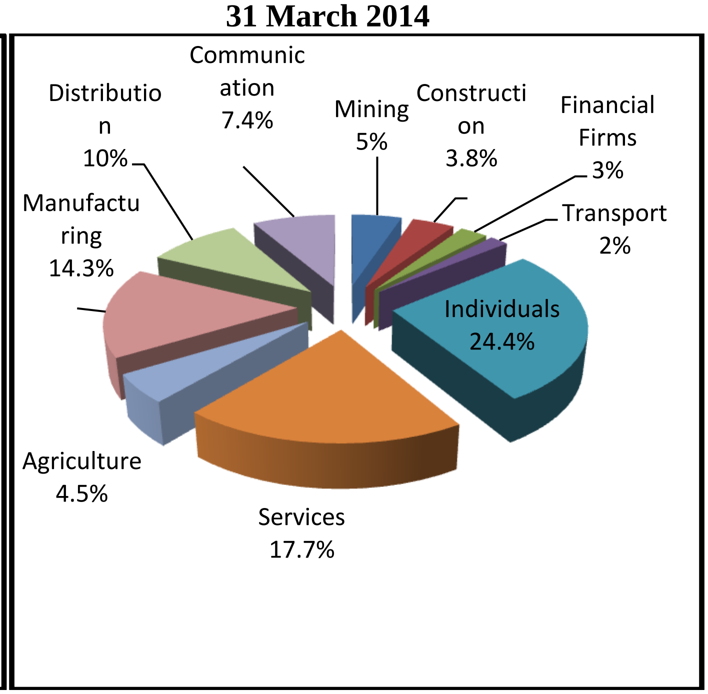
4.17. Banks lending portfolio is skewed towards consumptive lending at the expense of productive sectors of the economy as shown below.

Figure 4: Sectoral Distribution of Credit

31 December 2013



31 March 2014



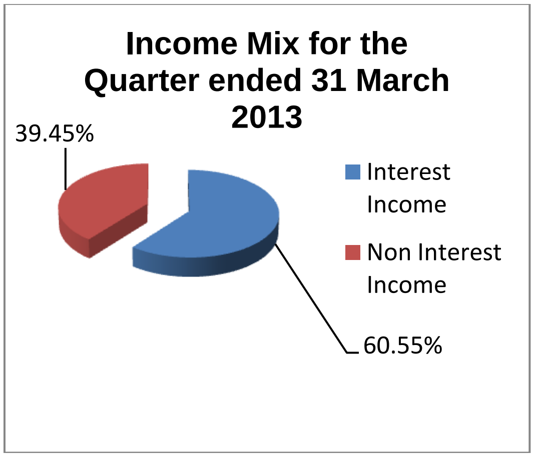
Earnings...

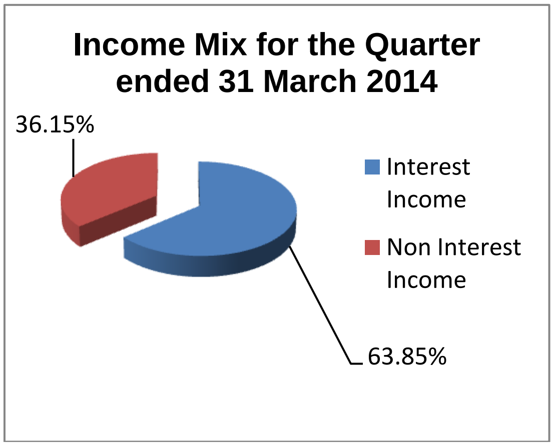
4.18. The banking sector remained profitable during the quarter ended 31 March 2014, with an **aggregate net profit of $20.47 million** up from $**0.47 million** during the corresponding period in 2013.

4.19. A total of 16 operating banking institutions recorded profits for the quarter ended 31 March 2014.

4.20. Generally, banks that recorded losses lacked critical mass to generate sufficient revenue and cover operating costs. The losses were mainly attributable to credit impairment, in a market characterised by increased loan delinquencies, balance sheet structures which are skewed towards non-interest earning assets, largely a reflection of non- liquid capital, high funding costs and operational expenses. The income mix for the banking sector is indicated below.

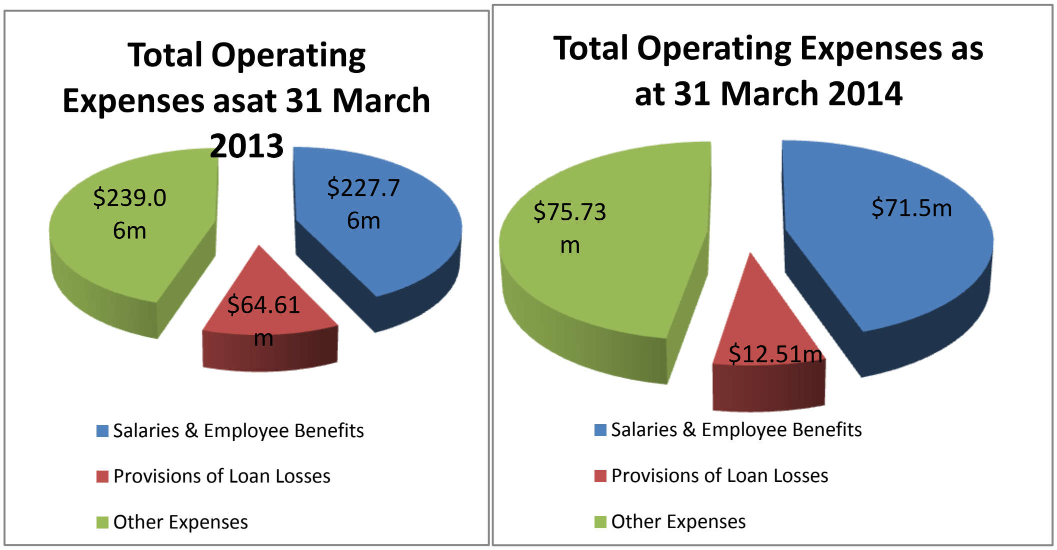
Figure 5: Distribution of Total Income for periods 31 March 2013 & 2014





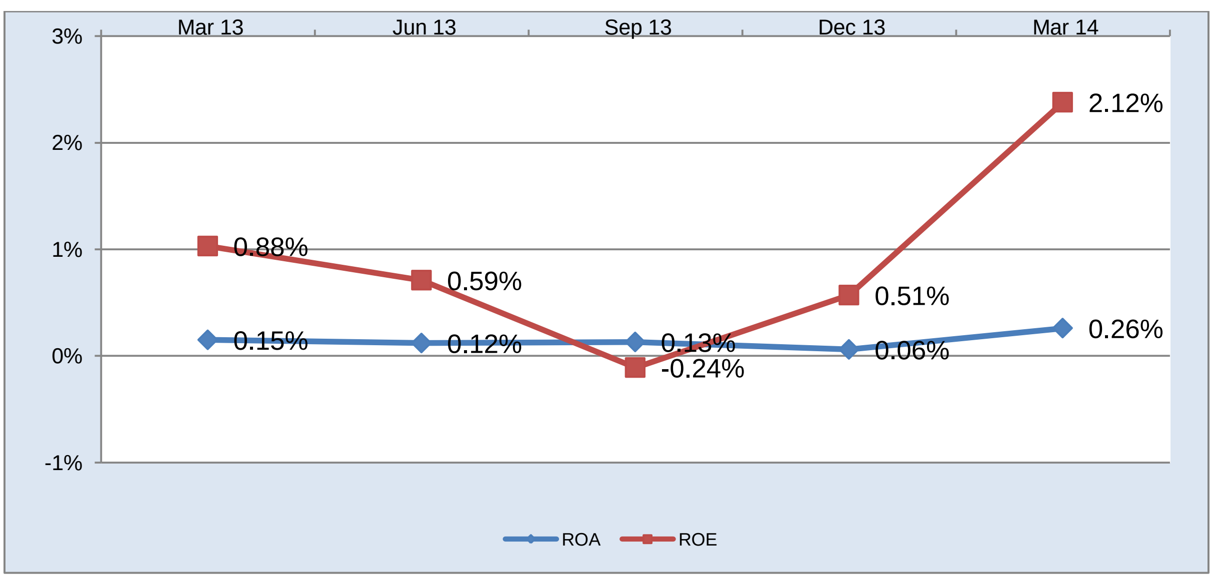
4.21. The composition of operating expenses is shown in the figure below.

Figure 6: Composition of Operating Expenses



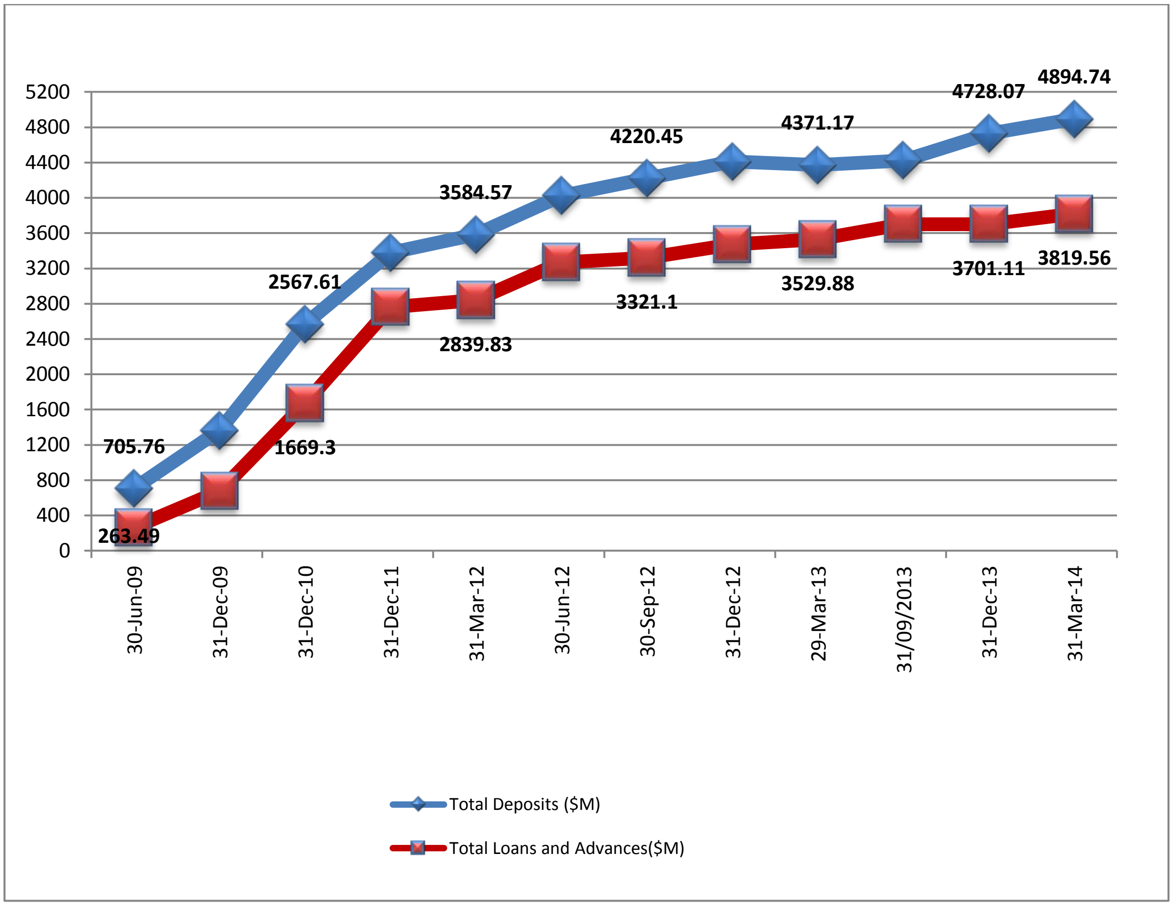
4.22. Profitability indicators for the banking sector as measured by the average return on assets (ROA) and return on equity (ROE) improved during the period ended 31 March 2014 as reflected in figure 7.

Figure 7: Profitability Indicators



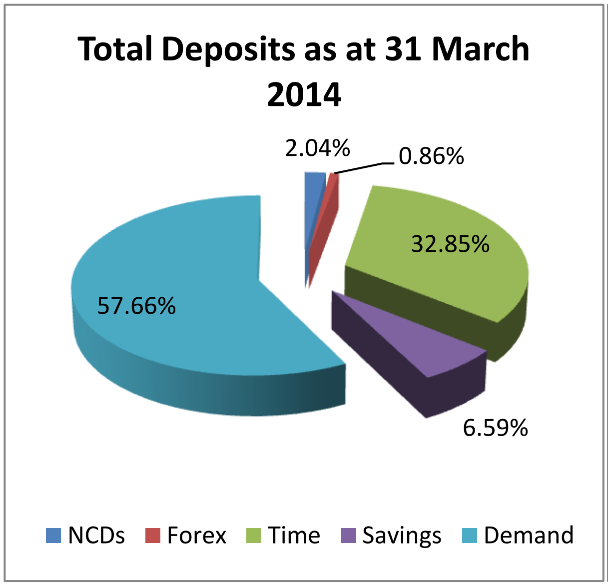
Liquidity and Funds Management...

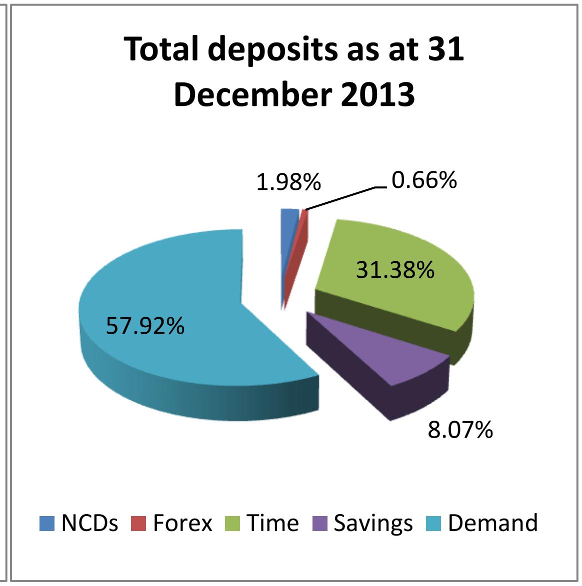
4.23. The trend in the level of deposits is shown below.



4.24. Banking sector deposits continued to be dominated by demand deposits which accounted for 57.92% of total deposits as at 31 March 2014 as indicated in figure 8 below:

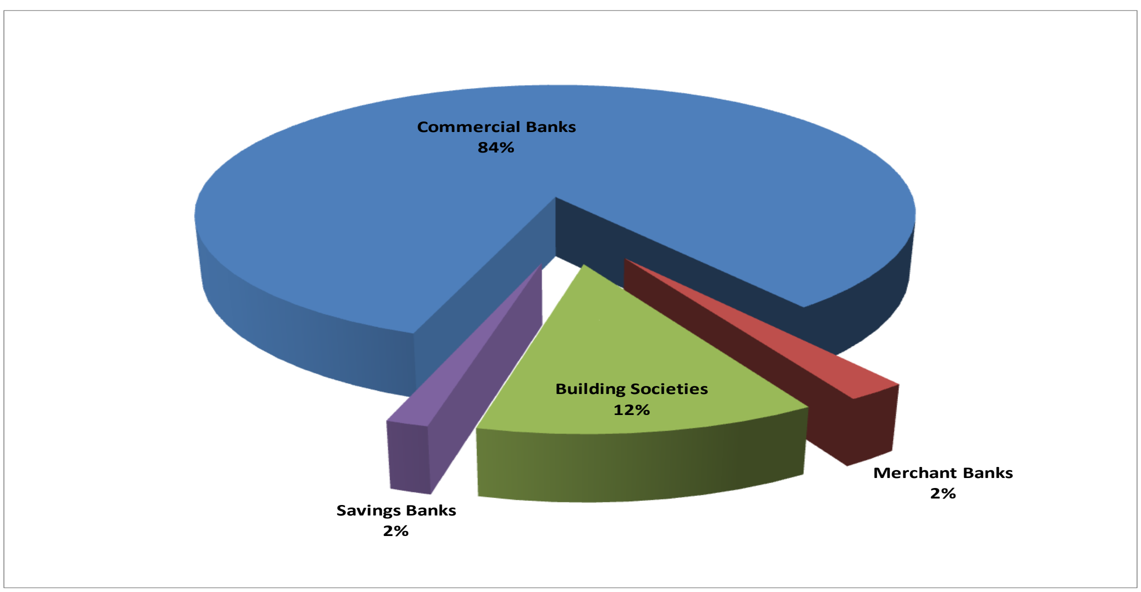
Figure 8: Deposit Structure





4.25. In terms of concentration, the commercial banking sub-sector dominated the market for deposits, controlling 84% of total banking sector deposits as at 31 March 2014.

Fig 9: Distribution of Banking Sector Deposits



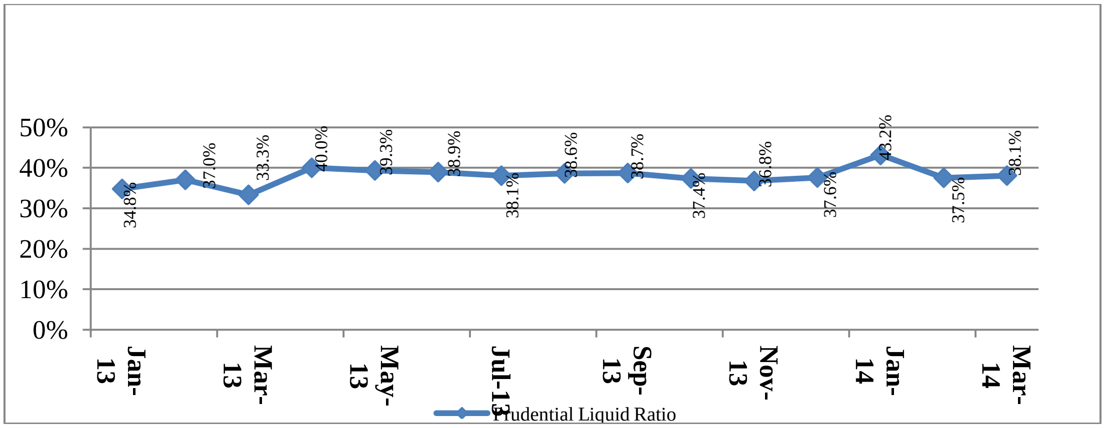
4.26. As at 31 March 2014, five (5) banking institutions held cumulative deposits amounting to **$3.02 billion,** representing **61.72%** of total banking sector.

4.27. One banking institution continued to account for the largest share of total deposits, with deposits amounting to $1.46 billion and representing 29.88% of total banking sector deposits.

4.28. The liquidity of the banking sector measured by the prudential liquidity ratio, which is a reflection of an institution's ability to meet its maturing obligations as they fall due, remained satisfactory as in the previous quarter ended 31 December 2013.

4.29. The banking sector average prudential liquidity ratio of 38.1% as at 31 March 2014 was above the regulatory minimum of 30%, and has been stable since 31 January 2013 as shown below.

Figure 10: Prudential Liquidity Ratio Trend



4.30. While the majority of the banking institutions are compliant with the minimum prudential liquidity ratio, the sector is beset by various underlying liquidity constraints that mirror the real economy structural rigidities. The graph below shows the trend in the banking sector prudential liquidity ratio.

Sensitivity to Market Risk…

4.31. As at 31 March 2014, the banking sector's sensitivity to market risk was moderate. The ratio of Rate Sensitive Assets to Rate Sensitive Liabilities and Net Open Position to Core Capital were 159.69% and 43.36 %, compared to 158.44% and 37.80 %, recorded as at 31 December 2013 respectively. The table below shows the average interest rate sensitivity ratios for the banking sector as at 31 March 2014 and 31 December 2013 respectively.

Table 4: Interest Rate Sensitivity Ratios

Period	3 months	6 months	9 months
Dec-13	126.74%	170.50%	158.44%
Mar-14	127.50%	172.70%	159.69%