DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 30TH SEPTEMBER 2013

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

The Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company, 9 deposit taking microfinance institutions, 7 representative offices of foreign banks, 106 foreign exchange bureaus and 2 credit reference bureaus during the quarter ended September 30, 2013.

The sector registered improved performance with the size of assets standing at Ksh. 2.62 trillion, loans & advances worth Ksh. 1.52 trillion, while the deposit base was Ksh. 1.91 trillion and profit before tax of Ksh. 92.5 billion as at 30th September 2013.

Structure of the Balance Sheet

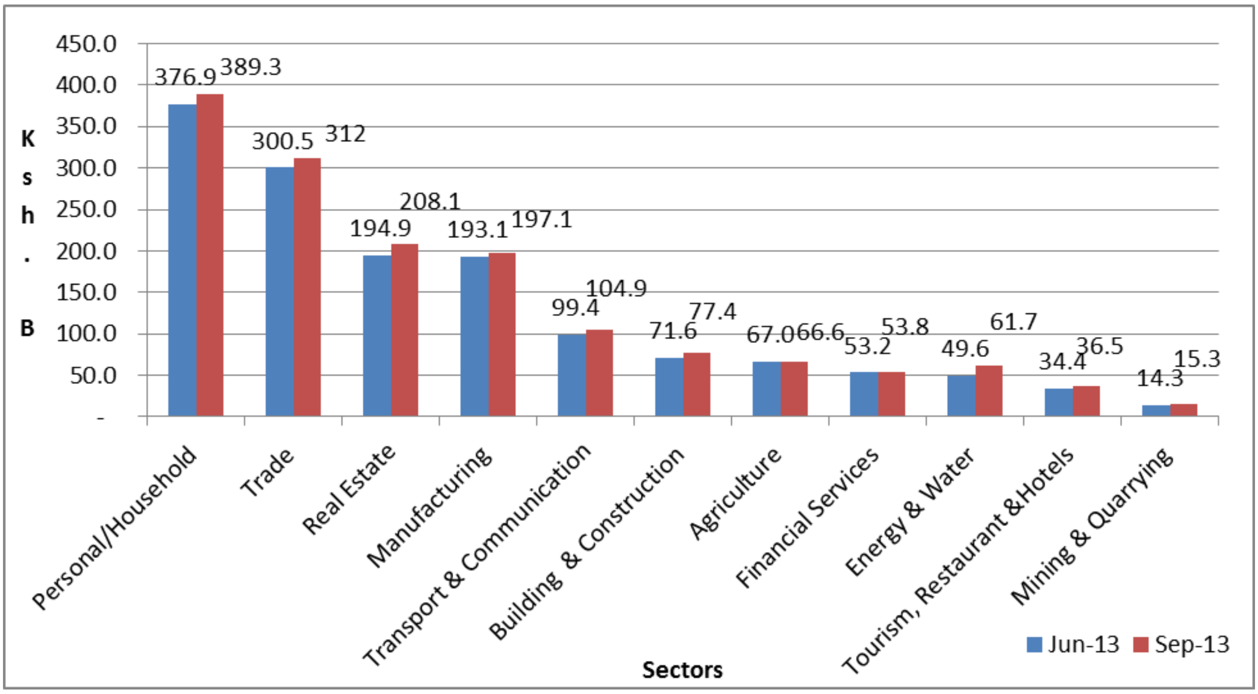
i) Assets

The banking sector's aggregate balance sheet size expanded by 4.4 percent from Ksh. 2.51 trillion in June 2013 to Ksh. 2.62 trillion in September 2013. The key components of the balance sheet comprised of loans and advances, government securities and placements, which accounted for 56.1 percent, 22.1 percent and 6.2 percent of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances rose from Ksh. 1.45 trillion in June 2013 to Ksh. 1.52 trillion in September 2013, which translated to a growth of 4.8 percent. The growth, which stood at Ksh. 67.8 billion, was in 10 sectors as shown in Chart 1 with Agriculture sector registering a marginal decline occasioned by higher repayments than the new loans advanced to this sector during the period.

Chart 1: Sectoral Distribution of Loans (June 2013 Vs September 2013)



iii) Deposit Liabilities

Deposit base, which is the main source of funding for the banking sector, accounted for 73.0 percent of total funding liabilities. The deposit base increased by 2.7 percent from Ksh. 1.86 trillion in June 2013 to Ksh. 1.91 trillion in September 2013 mainly supported by branch expansion, remittances and receipts from exports.

There was increased uptake of banking services as evidenced by the number of bank deposit accounts which increased from 18.97 million in June 2013 to 21.12 million in September 2013 representing a growth of 2.15 million accounts or 11.3 percent.

iv) Capital and Reserves

The banking sector recorded improved capital levels in September 2013 with total capital growing by 5.4 percent from Ksh. 364.0 billion in June 2013 to Ksh. 383.8 billion in September 2013, while shareholders' funds grew by 4.1 percent from Ksh. 394.4 billion in June 2013 to Ksh. 410.6 billion in September 2013. However, the ratio of total capital to total risk-weighted assets decreased marginally from 23.3 percent in June 2013 to 22.9 percent in September 2013, with core capital to total risk weighted assets declining from 20.2 percent to 19.5 percent over the same period. The decline in capital adequacy ratios was occasioned by a higher growth in risk weighted assets than the growth in capital base.

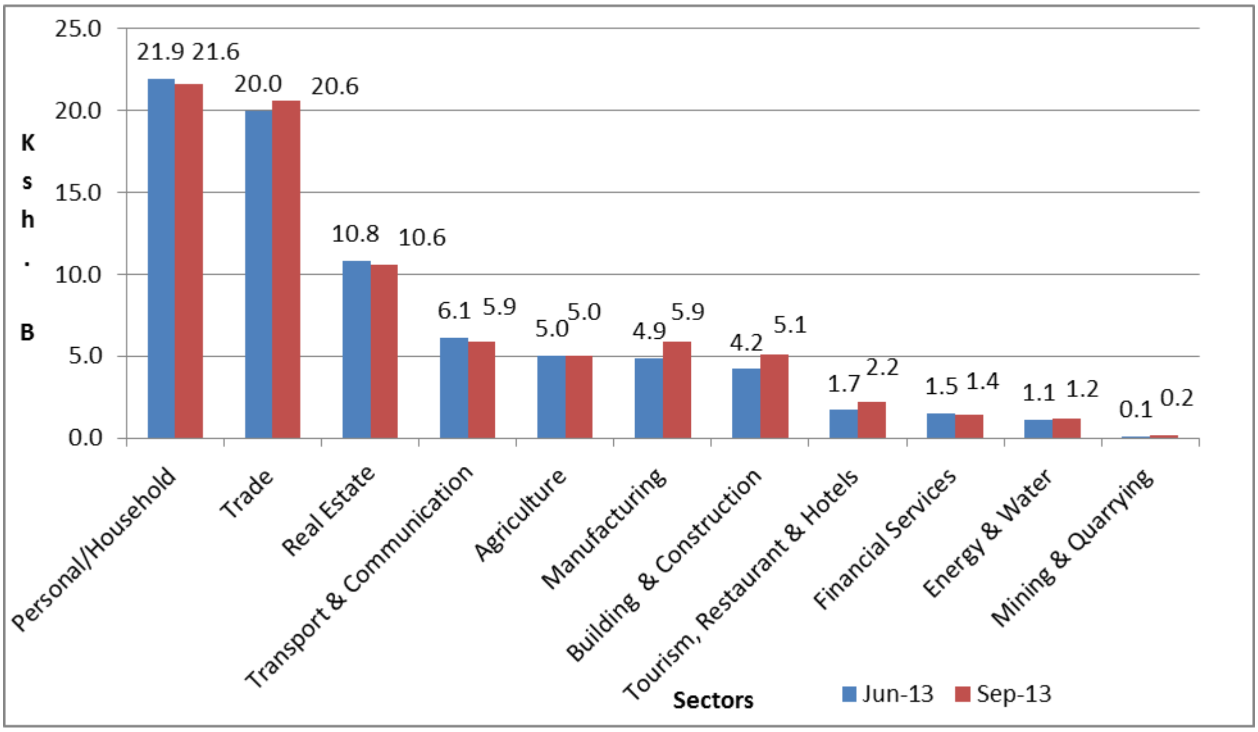
Other Banking Sector Performance Indicators

i) Assets Quality

The value of gross non-performing loans (NPLs) increased from Ksh. 77.3 billion in June 2013 to Ksh. 79.7 billion in September 2013 representing a growth of 3.1 percent. However, the ratio of gross NPLs to gross loans decreased from 5.3 percent in June 2013 to 5.2 percent in September 2013 due to a higher growth in loans than the growth in NPLs. Similarly, the quality of assets, measured as a proportion of net non-performing loans (Gross non-performing loans less provisions and interest in suspense) to gross loans improved from 1.54 percent to 1.53 percent over the same period.

During the period under review, 6 out of 11 sectors registered increase in NPLs by Ksh. 2.4 billion as shown in Chart 2. The increase in NPLs is partly attributed to high interest rates and reduced economic activities during the period towards and after the March 2013 general elections. The banks experiencing upsurge in NPLs have put in place stringent risk management practices and enhanced their credit administration procedures to mitigate against credit risk.

Chart 2: Sectoral Distribution of NPLs (June 2013 Vs September 2013)



ii) Profitability

The banking sector profit before tax for the quarter ended September 2013 decreased by 6.6 percent from Ksh. 33.2 billion in June 2013 quarter compared to Ksh. 31.0 billion for the quarter ending September 2013. Over the same period, total income stood at Ksh. 88.6 billion being a decrease of 4.1 percent from Ksh. 92.4 billion registered in the second quarter of 2013. The decline was partly attributed to the reduction in lending rates. Whilst total expenses decreased by 2.7 percent from Ksh. 59.2 billion in the June 2013 quarter to Ksh. 57.6 billion in the September 2013 quarter. The reduction in expenses was partly attributed to decline in interest paid on deposits. On an annual basis, the profitability of the sector increased by 14.5 percent to Ksh. 92.5 billion in September 2013 from the Ksh. 80.8 billion registered in September 2012.

Interest on loans and advances, fees and commissions and government securities, which are the main sources of income accounted for 58.9 percent, 19.0 percent and 15.4 percent of total income respectively. On the other hand, interest on deposits, staff costs and other expenses were the main components of expenses, accounting for 30.8 percent, 29.7 percent and 24.9 percent respectively.

iii) Liquidity of the Banking Sector

For the period ended September 2013, average liquid assets amounted to Ksh. 750.3 billion while total liquid liabilities stood at Ksh. 1,855.4 billion, resulting to an average liquidity ratio of 40.4 percent, against 42.7 percent registered in June 2013, and above the minimum statutory limit of 20 percent. The gross loans to deposits ratio increased from 78.3 percent in

June 2013 to 79.7 percent in September 2013 an indication of a higher increase in credit than the growth in mobilized deposits, thus contributing to a decline in liquidity ratio.

B. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

The banks and their customers continue to use Credit Information Sharing (CIS) mechanism since its launch in July 2010. The number of credit reports requested by institutions stood at 3,255,519 in September 2013 up from 2,907,375 reports in June 2013, representing an increase of 12.0 percent or 348,144 reports. Over the same period, the number of reports requested by customers increased from 41,681 to 49,190.

The number of credit reports requested by banks increased from 310,775 registered in the quarter ending June 2013 to 348,144 reports registered in the quarter ending September 2013. Similarly, credit reports requested by customers increased from 6,509 to 7,509 over the same period. The increased demand for credit reports by banks demonstrates the importance of these reports in enhancing credit appraisal standards.

Banks have incorporated credit reference reports in their credit risk appraisal processes. As the use of CIS mechanism increases banks are expected to grant credit facilities at competitive terms to borrowers with good track records.

ii) Agency Banking

The agency banking model which was launched in 2010 continued to contribute to increased access to banking services. As at 30th September 2013, CBK had authorized 13 commercial banks to offer banking services through third parties (agents). Since 2010, a total of 21,816 agents had been contracted facilitating over 69.2 million transactions valued at Ksh. 366.8 billion. In comparison with June 2013, 13 banks had been authorized and had contracted 19,649 active agents, which facilitated over 58.6 million transactions valued at Ksh. 310.5 billion.

The number of banking transactions undertaken through agents increased from 10.2 million registered in the quarter ending June 2013 to 10.6 million transactions registered in the quarter ending September 2013. However, the value of banking transactions undertaken through agents decreased from Ksh. 60.4 billion to Ksh. 56.3 billion over the same period.

iii) Deposit Taking Microfinance Institutions

As at 30th September 2013, Deposit Taking Microfinance Institutions (DTMs) had gross loans worth Ksh. 25.5 billion compared to Ksh. 22.5 billion registered in June 2013 thus translating to a growth of 13.3 percent. Similarly, the deposit base stood at Ksh. 22.6 billion representing a growth of 14.7 percent from Ksh. 19.7 billion in June 2013. The long-term borrowings by DTMs decreased from Ksh.7.0 billion in June 2013 to Ksh. 6.8 billion as DTMs focus on enhancing deposits mobilization to support their increased lending. The number of DTMs deposit accounts and loan accounts stood at 1,895,026 and 469,886 respectively in September 2013 compared to 1,854,240 deposit accounts and 461,624 loans accounts registered at end of June 2013.

iv) Issuance of New Guidelines

The Central Bank formulated two new Prudential Guidelines which were issued in September 2013, with an effective date of 1st October 2013. These guidelines are:

- **Incidental Business Activities** – this guideline enables licenced institutions to provide a distribution channel for authorized financial services as part of an initiative to offer Kenyans a "one-stop shopping experience" where licenced institutions can offer various financial services under one roof; and
- **Non-Operating Holding Companies** – this guideline enables non-operating holding companies to obtain control of an institution as part of an initiative to strengthen capital requirements at the consolidated level, reduce complexity of structures to enable effective consolidated supervision and to manage risks within the groups.

Banking Sector 2013 Outlook

The banking sector is expected to maintain its growth momentum on the backdrop of a stable macro-economic environment, domestic and regional expansion by banks, increased use of ICT by banks and the increased economic activities through the devolved system of government.

CENTRAL BANK OF KENYA
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