**PERFORMANCE AND DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 31ST MARCH 2016**

## A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended 31st March 2016, the banking sector comprised 42 commercial banks[1], 1 mortgage finance company, 12 microfinance banks, 8 representative offices of foreign banks, 79 foreign exchange bureaus, 17 money remittance providers and 3 credit reference bureaus.

During the quarter, Real Value Foreign Exchange Bureau was converted to a Money Remittance Provider leading to a reduction in the number of the Foreign Exchange Bureaus and an increase in the number of Money Remittance Providers.

The Kenyan Banking Sector's total assets stood at Ksh. 3.6 trillion, with gross loans worth Ksh. 2.4 trillion, while the deposit base was Ksh. 2.6 trillion and profit before tax was Ksh. 38.4 billion as at 31st March 2016. Over the same period, the number of bank customer deposit accounts and loan accounts stood at 37,455,795 and 7,163,560 respectively.

## B. STRUCTURE OF THE BALANCE SHEET

### i) Assets

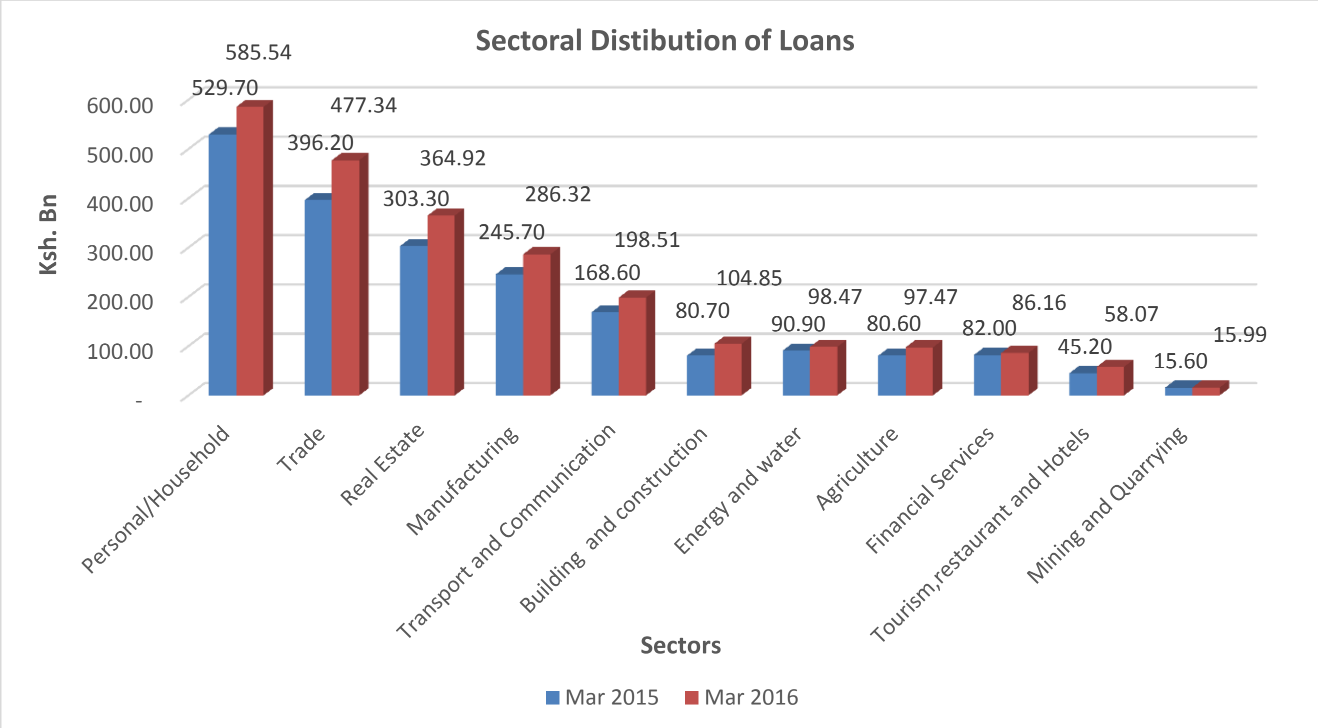
Total net assets grew by 5.9% from Ksh. 3.4 trillion in March 2015 to Ksh. 3.6 trillion in March 2016. This was mainly attributed to increased loans and advances of Ksh. 170.6 billion and investment in government of Kenya securities of Ksh. 48.2 billion. The increased loans and advances was as a result of increased demand for credit across most of the economic sectors. The increased investment in government securities was as a result of large banks investing surplus liquidity in risk free instruments.

### ii) Loans and Advances

The sector's gross loans and advances increased from Ksh. 2.0 trillion in March 2015 to Ksh. 2.2 trillion in March 2016, translating to an increase of 20%. The increase in the loan book was contributed by increased demand for credit from all the economic sectors as shown in Chart 1 below. Trade, Real Estate and Personal/Household sectors having the highest growth in credit of Ksh. 81.14 billion, Ksh. 61.62 billion and Ksh. 55.84 billion respectively.

[1] Charterhouse Bank is under statutory management while Imperial Bank and Chase Bank are under receivership. In the quarter ended March 2015 the data for these three banks have been included but excluded in the quarter ended March 2016.

**Chart 1: Sectoral Distribution of Loans (March 2016 vs. March 2015)**




### iii) Deposit Liabilities

Customer deposits remain the main source of funding for the banking sector, accounting for 71.7% of total liabilities. The sector's deposit base grew by 8.3% from Ksh. 2.4 trillion in March 2015 to Ksh. 2.6 trillion in March 2016. This growth was supported by increased deposit accounts and alternative delivery channels such as the agency banking model.

The number of commercial banks deposit accounts increased by 7.8 million (26.3%) from 29.7 million in March 2015 to 37.5 million in March 2016. Part of the increase in deposit accounts was driven by deposit accounts opened through the mobile phone platforms.

So far 17 banks have embraced the agency banking model, which has been cited by some banks as having had a positive impact in their performance including deposit mobilisation. The number of transactions through banks agents increased by 21.1 million between March 2015 and March 2016.

### iv) Capital and Reserves

The banking sector registered increased capital levels in the quarter ended March 2016 with total capital increasing by 5.1% from Ksh. 530.1 billion in March 2015 to Ksh. 557.1 billion in March 2016. Over the same period, core capital increased by 6.3% from Ksh. 447 billion to Ksh. 475 billion. Despite the increased capital levels, the capital ratios decreased marginally. The ratio of core capital to total risk-weighted assets decreased marginally from 16.2% in

March 2015 to 16.0% in March 2016 while the total capital to total risk weighted assets marginally decreased from 19.2% in March 2015 to 18.8% in March 2016.

The decrease in capital ratios were mainly occasioned by a higher increase of risk weighted assets of 7.2% between March 2015 and March 2016 as compared to the increases in core and total capital over the same period of 6.3% and 5.1% respectively.

Despite the drop in the capital ratios, they remained above the minimum statutory limits of 10.5% and 14.5% for core capital and total capital respectively.

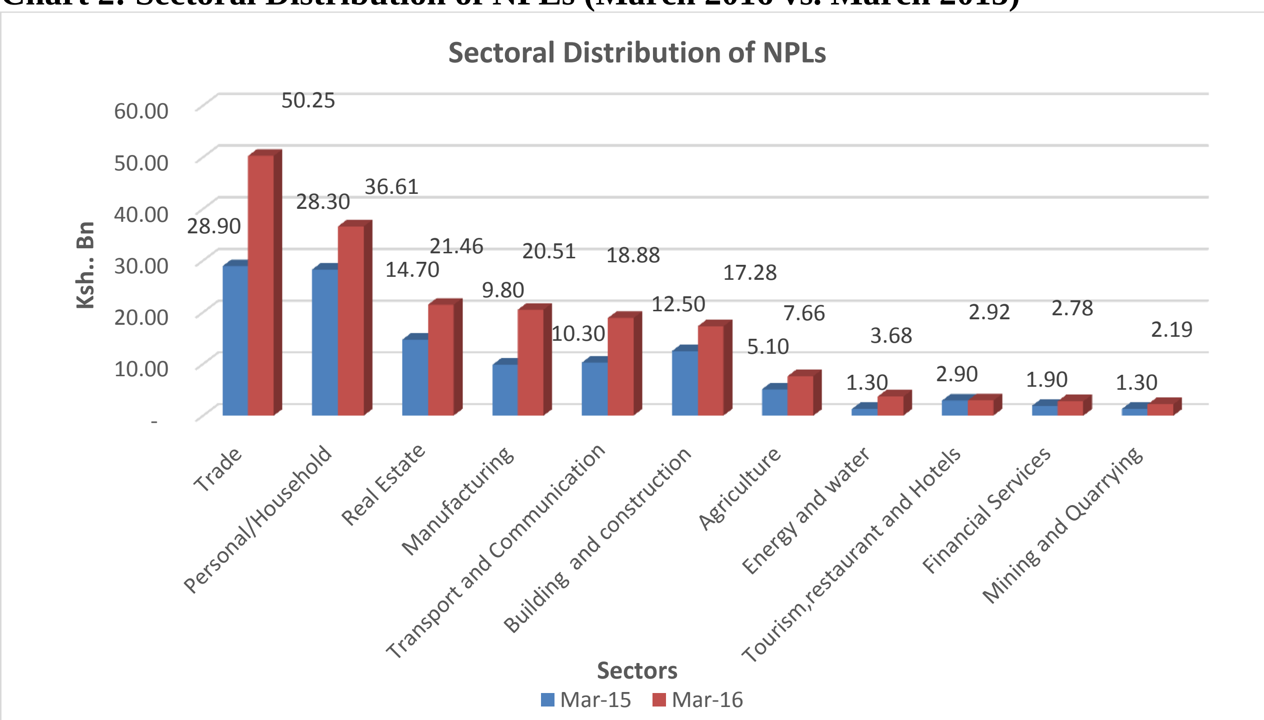
## C. OTHER BANKING SECTOR PERFORMANCE INDICATORS

### i) Assets Quality

The value of gross non-performing loans (NPLs) increased by 47.5% from Ksh. 117.2 billion in March 2015 to Ksh. 172.9 billion in March 2016. This resulted in an increased ratio of gross NPLs to gross loans of 7.8% in March 2016 from 5.7% in March 2015. Consequently, the quality of assets, measured as a proportion of net non-performing loans to gross loans deteriorated from 2.6% in March 2015 to 4.3% in March 2016.

During the period under review, all the economic sectors registered increased NPLs as shown in Chart 2. The sectors which experienced the highest increase in NPLs in the quarter were Trade and Manufacturing sectors whose NPLs increased by Ksh. 21.4 billion and Ksh. 10.7 billion respectively. The increase in NPLs is attributed to delays in payments to suppliers and contractors and challenges in the business environment.

**Chart 2: Sectoral Distribution of NPLs (March 2016 vs. March 2015)**



### ii) Profitability

The banking sector recorded a Ksh. 38.4 billion pre-tax profits in the quarter ended March 2016. This was an increase of 2.9% from Ksh. 37.3 billion registered in the quarter ending March 2015. This increase in profitability is attributed to a 15% (Ksh. 16.5 billion) increase in total income from Ksh. 110 billion in Q1 of 2015 to Ksh. 126.5 billion in Q1 of 2016. However, the increase in income was neutralised by an increase of total expenses by 21.2% (Ksh. 15.4 billion) from Ksh. 72.7 billion in Q1 of 2015 to Ksh. 88.1 billion in Q1 of 2016.

Interest on advances, interest on government securities and other income were the main sources of income and accounted for 61.6%, 16.4% and 15.1% of total income respectively in March 2016 as compared to 61.0%, 15.3% and 16.4% respectively in March 2015. On the other hand, interest on deposits, salaries and wages and other expenses were the major components of expenses and accounted for 29.9%, 22.9% and 19.8% of total expenses respectively March 2016 as compared to 35%, 27% and 22% respectively in March 2015.

Yield on advances increased from 13.5 % in March 2015 to 14.4% in March 2016 while cost of deposits increased from 4.9% in March 2015 to 6.0% in March 2016. Meanwhile bad debts charge increased from Ksh. 3.8 billion in March 2015 to Ksh. 8.4 billion in March 2016 due to the increase in non-performing loans.

### iii) Liquidity of the Banking Sector

In Q1 of 2016, the banking sector's average liquid assets stood at Ksh. 1,023.2 billion while total short-term liabilities were worth Ksh. 2,567.3 billion. This translated to an average liquidity ratio of 39.9% which was the same as it was in Q1 of 2015. The sector as a whole remained liquid and the short-term liquidity challenges faced by small and some medium banks was a sign of skewed distribution of liquidity. Depositors migrated their deposits to selected medium banks and large banks while most large banks rationed lines of credit affecting mainly banks in small peer group and some in the medium peer group. However, CBK provided liquidity support to the banking sector to mitigate these challenges.

### iv) Agency Banking

Since the rollout of the agency banking model in May 2010, commercial banks have continued to contract varied retail entities to offer basic banking services on their behalf. The contracted entities include security companies, courier services, pharmacies, supermarkets and post offices who act as third party agents to provide cash-in-cash-out transactions and other services in compliance with the laid down guidelines.

As at 31$^{st}$ March 2016, there were 17 commercial banks that had contracted 40,224 agents which had facilitated over 170.5 million cumulative transactions valued at Ksh. 930.2 billion as compared to 16 commercial banks that had 34,381 agents that had facilitated 149.4 million transactions valued at Ksh. 817.7 billion as at 31$^{st}$ March 2015.

The number of banking transactions undertaken through bank agents increased from 10.3 million in Q1 of 2015 to 55.8 million transactions in Q1 of 2016. Similarly, the value of banking transactions undertaken through agents increased from Ksh. 65.0 billion to Ksh. 176.7 billion over the same period. This was mainly due to increased confidence and acceptability of the agency banking model by banks and the public as an economical, convenient delivery channel.

## D. OVERVIEW OF PERFORMANCE OF THE NON-BANKS

### i) Microfinance Banks

As at 31st March 2016, there were 12 operational Microfinance Banks (MFBs) as compared to 10 as at 31st March 2015. The 2 new Microfinance Banks are Choice Microfinance Bank Ltd and Caritas Microfinance Bank Ltd which were granted licences on 22nd May 2015 and 12th June 2015 respectively.

All the Microfinance Banks had granted loans and advances worth Ksh. 47.4 billion compared to Ksh. 40.8 billion as at the end of March 2015 thus translating to a growth of 16.2%. The MFBs deposit base stood at Ksh. 36.8 billion as at March 2016 representing an increase of 13.2% from Ksh. 32.5 billion in March 2015. The growth in deposit base was partly attributed to a significant increase of Ksh. 3.4 billion in the deposit bases of two large Microfinance Banks, which engaged in aggressive campaigns to mobilise deposits in the quarter to support increased demand for loans.

The two new Microfinance Banks, Choice Microfinance Bank Ltd and Caritas Microfinance Bank Ltd also contributed to the increase in the deposit base. The two Microfinance Banks had deposit bases of Ksh.15.6 million and Ksh.199.3 million respectively.

The long-term borrowings by the MFBs increased from Ksh. 4.7 billion in March 2015 to Ksh. 11.5 billion in March 2016, which could be attributed to tighter liquidity and increased cost of deposits during the quarter. The number of MFBs deposit accounts stood at 2,145,043 in March 2016 compared to 2,310,637 registered as at the end of March 2015. This is mainly attributed to the maturity of fixed deposit accounts, which were not rolled over leading to tighter liquidity conditions in the quarter.

### ii) Credit Reference Bureaus

The credit information sharing mechanism has continued to expand since its launch in July 2010. The cumulative number of credit reports requested by banks from all the three licensed credit reference bureaus stood at 12,546,983 in March 2016, a 106% increase from 6,098,916 cumulative credit reports that had been requested as at March 2015. Over the same period, the cumulative number of credit reports requested by customers increased from 101,288 to 177,450, a 75% increase.

On a quarterly basis, the number of credit reports requested by banks increased by 105% from 826,921 in Q1 of 2015 to 1,693,297 in Q1 of 2016. Over the same period, credit reports requested by customers increased by 15% from 12,752 to 14,701. The increased number of credit reports requested by banks is an indication that the credit information sharing mechanism has been embraced as a tool to enhance credit risk management.

## E. Other Developments

- **Transparency in Credit Pricing**

As part of CBK's efforts to promote transparency in credit pricing, the Central Bank decided to publish on its website the average lending rates for various loan products by banks as well as the overall average weighted lending rates by the commercial banks.

The first publication for the quarters ended June 2015, September 2015 and December 2015 was done in February 2016 and the update to include the data for the quarter ended March 2016 was done in April 2016. The publication will be done on a quarterly basis.

The publication of average lending rates for commercial banks is expected to increase transparency and enable the borrowing public to making informed borrowing decisions.

## F. Banking Sector 2016 Outlook

Credit and Liquidity risks are expected to slow down in the next quarter based on expected improvement in the business environment. Also, the enhanced reclassification of loan accounts and resultant additional provisions at the end of 2015 was one-off and the mitigating measures implemented against enhanced liquidity risk will continue to support the sector in Q2 of 2016.

**CENTRAL BANK OF KENYA**
**JULY 2016**