DEVELOPMENTS IN THE BANKING SECTOR (SEPTEMBER 2011 QUARTER)

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended September 30, 2011, the sector comprised 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions, 3 representative offices of foreign banks, 121 foreign exchange bureaus and 2 credit reference bureaus.

The Kenyan Banking Sector registered enhanced performance with the size of assets standing at Ksh. 2.0 trillion, loans & advances worth Ksh. 1.2 trillion, while deposit base was Ksh 1.5 trillion and profit before tax of Ksh. 63.5 billion as at 30th September 2011. Over the same period, the number of bank customer deposit accounts stood at 13.65 million with a branch network of 1,114.

Structure of the Balance Sheet

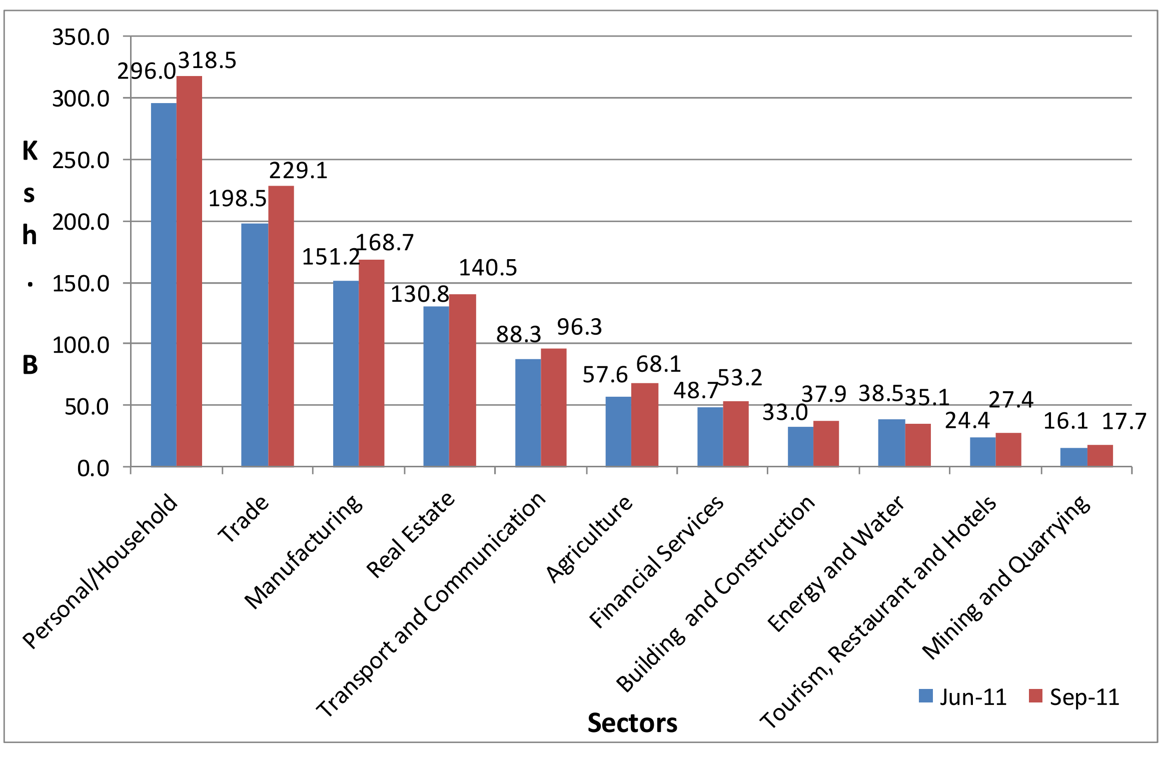
i) Assets

The banking sector's aggregate balance sheet increased by 5.3 percent from Ksh 1.9 trillion in June 2011 to Ksh 2.0 trillion in September 2011. The major components of the balance sheet were loans and advances, government securities and placements, which accounted for 56 percent, 19 percent and 8 percent of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances grew from Ksh 1.1 trillion in June 2011 to Ksh 1.2 trillion in September 2011, translating to a growth of 9.1 percent. The growth was in 10 sectors with energy & water sector registering a decline occasioned by higher repayments than the new loans advanced to the sector during the period.

Chart 1: Sectoral Distribution of Loans (June 2011 Vs September 2011)



iii) Deposit Liabilities

Deposits were the main source of funding for the banking sector, accounting for 75 percent of total funding liabilities. The deposit base rose by 7.1 percent from Ksh 1.4 trillion in June 2011 to Ksh 1.5 trillion in September 2011 mainly due to branch expansion, remittances and receipts from exports.

The number of bank branches increased by 12 from 1,102 in June 2011 to 1,114 in September 2011. Equally, the number of bank deposit accounts increased from 12.8 million in June 2011 to 13.7 million in September 2011 representing a growth of 0.9 million accounts or 7.0 percent.

iv) Capital and Reserves

The banking sector recorded strong capital levels in September 2011 with total capital growing by 4.6 percent from Ksh 240.1 billion in June 2011 to Ksh 251.1 billion in September 2011, whereas shareholders' funds increased by 5.9 percent from Ksh 264.9 billion in June 2011 to Ksh 280.4 billion. However, the ratios of total and core capital to total risk-weighted assets decreased from 19.0 percent and 16.9 percent to 18.1 percent and 16.0 percent respectively mainly due to a more than proportionate increase in total risk weighted assets than the increase in core and total capital. The growth in total risk weighted assets is attributed to increased extension of credit to private sector during the quarter.

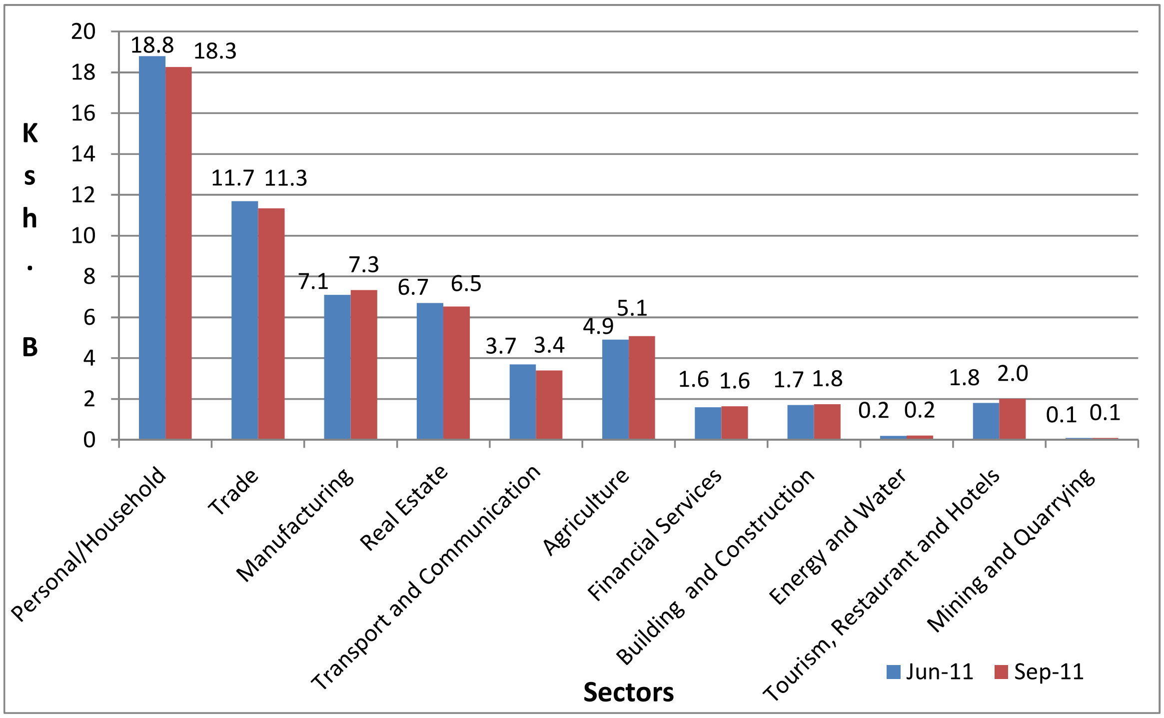
Other Banking Sector Performance Indicators

i) Assets Quality

The stock of gross non-performing loans (NPLs) declined by 1.0 percent from Ksh 58.3 billion in June 2011 to Ksh 57.7 billion in September 2011. The quality of assets, measured as a proportion of net non-performing loans to gross loans improved from 1.9 percent to 1.8 percent over the same period. Similarly, the ratio of gross NPLs to gross loans improved from 5.4 percent in June 2011 to 4.8 percent in September 2011.

The reduction in NPLs is attributed to enhanced appraisal standards deployed by banks. Subsequently, reduction in NPLs was registered in 5 out of 11 sectors during the quarter ending September 2011. The reduction in NPLs was also attributed to recoveries and write offs during the period.

Chart 2: Sectoral Distribution of NPLs (June 2011 Vs September 2011)



ii) Profitability

During the 3rd quarter of 2011 the sector registered Ksh. 22.7 billion pre-tax profits, which was an increase of 8.1 percent from 21.0 billion recorded in the quarter ending June 2011. Similarly, total income stood at Ksh. 65.8 billion in the third quarter being an increase of 17.1 percent from 56.2 billion registered in the second quarter of 2011. Whilst total expenses increased by 23.1 percent from Ksh 35.1 billion in the June 2011 quarter to Ksh 43.2 billion in September 2011 quarter.

Interest on loans and advances, fees and commissions and government securities were the major sources of income accounting for 55 percent, 31 percent and 14 percent of total income respectively. On the other hand, staff costs, other expenses and interest on deposits were the key components of expenses, accounting for 35 percent, 29 percent and 21 percent respectively.

Consequently, the profit before tax for the nine months to September 2011 stood at Ksh 65.3 billion, which was 87.8 percent of the twelve months profit before tax for the year ended December 2010 of Ksh 74.3 billion. This reflects a slower growth in profit before tax compared with 2010 when by September 2010 it had surpassed the twelve months profit before tax for the year 2009 by 8.8 percent.

iii) Liquidity of the Banking Sector

As at end of September 2011, liquid assets amounted to Ksh 535.5 billion while total liquid liabilities stood at Ksh 1,436.1 billion, resulting to an average liquidity ratio of 37.3

percent, against 38.9 percent registered in June 2011, and above the minimum statutory limit of 20 percent. The reduction in liquidity ratio is attributed to increase in loans and advances as evidenced by the growth in loans to deposits ratio from 76.7% in June 2011 to 78.2% in September 2011.

B. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

There is increased uptake of credit information sharing which was launched in July 2010. During the quarter ending March 2011, the number of credit reports requested by institutions stood at 531,591, this increased by 196,962 to 728,553 at end of June 2011 and subsequently increased by 332,312 to a total of 1,060,865 at end September 2011.

Currently, there are two licensed credit reference bureaus, namely; CRBAfrica which was licensed in 2010 and Metropol Ltd licenced in April 2011.

ii) Agency Banking

The agency banking model which was rolled out in 2010 is registering increased interest from the financial institutions. As at 31st March 2011, six (6) banks had been granted approval to roll out Agent Banking Network, which increased to eight (8) banks as at 30th June 2011, and subsequently to 10 banks as at 30th September 2011. Over the same period, the number of agents increased from 3,647 in March 2011 to 6,513 in June 2011 and subsequently to 7,999 agents in September 2011. The introduction of agent banking is intended to enable institutions to provide banking services more cost effectively to customers, particularly to those who are currently unbanked or under banked.

iii) Deposit Taking Microfinance Institutions

The gross loans and advances for the 6 deposit taking microfinance institutions (DTMs) at end of September 2011 stood at Ksh.15.7 billion compared to Ksh. 15.2 billion registered in June 2011 thus translating to a growth of 3.3 percent. Similarly, the deposits base stood at Ksh. 9.9 billion representing a growth of 3.1 percent from Ksh. 9.6 billion in June 2011. The number of DTMs deposit accounts stood at 1.52 million while the number of loan accounts was 0.51 million at end of September 2011 up from 1.4 deposit accounts and 0.50 million loans accounts registered at end of June 2011.

iv) Combating the Financing of Terrorism

Combating the financing of terrorism constitutes one of the primary components of the overall fight against terrorism. Kenya like most developing countries has unique features that make the country's financial sector vulnerable to terrorists financing risks. These features emanate from amongst others, the high volume of cash based transactions and borders with countries facing civil strife and institutional breakdown/failure. In view of these concerns and their potential effects on the financial sector, the Central Bank issued a guidance note in September 2011 to the banking sector on the need to safeguard against terrorism financing.

The guidance note requires banks to develop procedures that will help them to detect those transactions that may involve funds used in terrorism financing and are also required to report suspicious transactions relating to terrorist financing to Central Bank among other requirements. Since the issuance of the note, five cases of suspected terrorism financing related activities have been reported by banks to the Central Bank. These cases are under investigation by the relevant government agencies.

The note serves to supplement on-going efforts by the Government to enhance Kenya's Anti-Money Laundering and Financing of Terrorism legal and regulatory framework. The Government in June 2011 launched the Advisory Board of the Financial Reporting Centre that will act as the pivot of the framework.

Banking Sector 2011 Outlook

The sector is expected to sustain the growth/performance in the three quarters to the end of the year. The challenging macro-economic environment is expected to be mitigated by growing uptake by banks of innovative delivery channels and the credit referencing mechanism.