DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 31ST MARCH 2014

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended March 31, 2014, the sector comprised 43 commercial banks, 1 mortgage finance company, 9 microfinance banks, 7 representative offices of foreign banks, 97 foreign exchange bureaus, 3 money remittance providers and 2 credit reference bureaus.

The Kenyan Banking Sector registered enhanced performance with the size of net assets standing at Ksh. 2.8 trillion, loans & advances worth Ksh. 1.7 trillion, while the deposit base was Ksh. 2.0 trillion and profit before tax of Ksh. 33.4 billion as at 31st March 2014. Over the same period, the number of bank customer deposit and loan accounts stood at 23,816,147 and 3,463,900 respectively.

Structure of the Balance Sheet

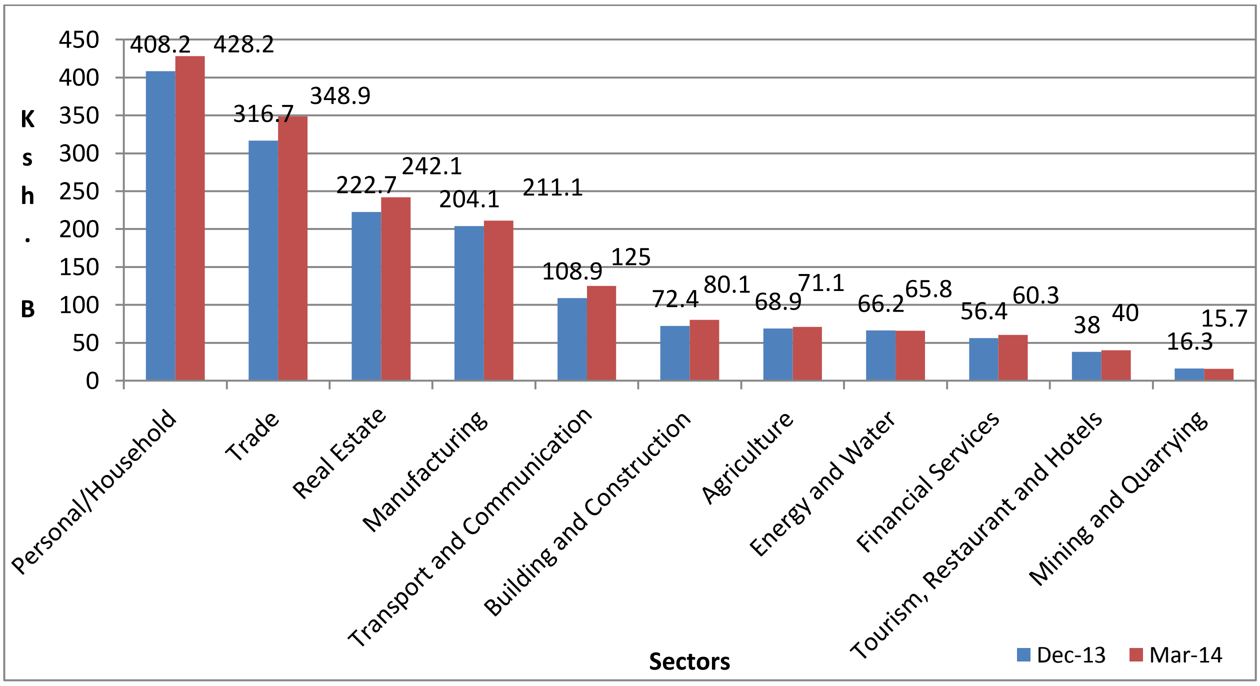
i) Assets

The banking sector's aggregate balance sheet expanded by 4.4 percent from Ksh. 2.70 trillion in December 2013 to Ksh. 2.82 trillion in March 2014. The main components of the balance sheet were loans and advances, government securities and placements, which accounted for 57.8 percent, 21.8 percent and 5.2 percent of total net assets respectively.

ii) Loans and Advances

The sector's gross loans and advances grew from Ksh. 1.58 trillion in December 2013 to Ksh. 1.69 trillion in March 2014, translating to a growth of 7.0 percent. The growth was in 9 sectors as shown in Chart 1 with Energy and Mining sectors registering a decline occasioned by higher repayments than the new loans advanced to these sectors during the period.

Chart 1: Sectoral Distribution of Loans (December 2013 Vs March 2014)



iii) Deposit Liabilities

Deposits were the major source of funding for the banking sector, accounting for 72.3 percent of total funding liabilities. The deposit base grew by 5.2 percent from Ksh. 1.94 trillion in December 2013 to Ksh. 2.04 trillion in March 2014 supported by branch expansion, remittances, receipts from exports and adoption of alternative channels of delivering banking services such as use of agency banking model.

The number of bank branches increased by 21 from 1,342 in December 2013. Equally, the number of bank deposit accounts increased from 21.8 million in December 2013 to 23.8 million in March 2014 representing a growth of 2.0 million accounts or 9.2 percent.

iv) Capital and Reserves

The banking sector recorded increased capital levels in March 2014 with total capital growing by 2.0 percent from Ksh. 418.2 billion in December 2013 to Ksh. 426.6 billion in March 2014, similarly shareholders' funds grew by 5.0 percent from Ksh. 432.2 billion in December 2013 to Ksh. 453.6 billion in March 2014. However, the ratios of core and total capital to total risk-weighted assets decreased from 17.9 percent and 20.7 percent to 15.7 percent and 18.2 percent respectively.

The decline in capital adequacy ratios is due to higher increase in total risk weighted assets than the increase in capital base. This is because with effect from January 2014, banks are required to hold capital charge for market and operational risks which in effect increases their risk assets base.

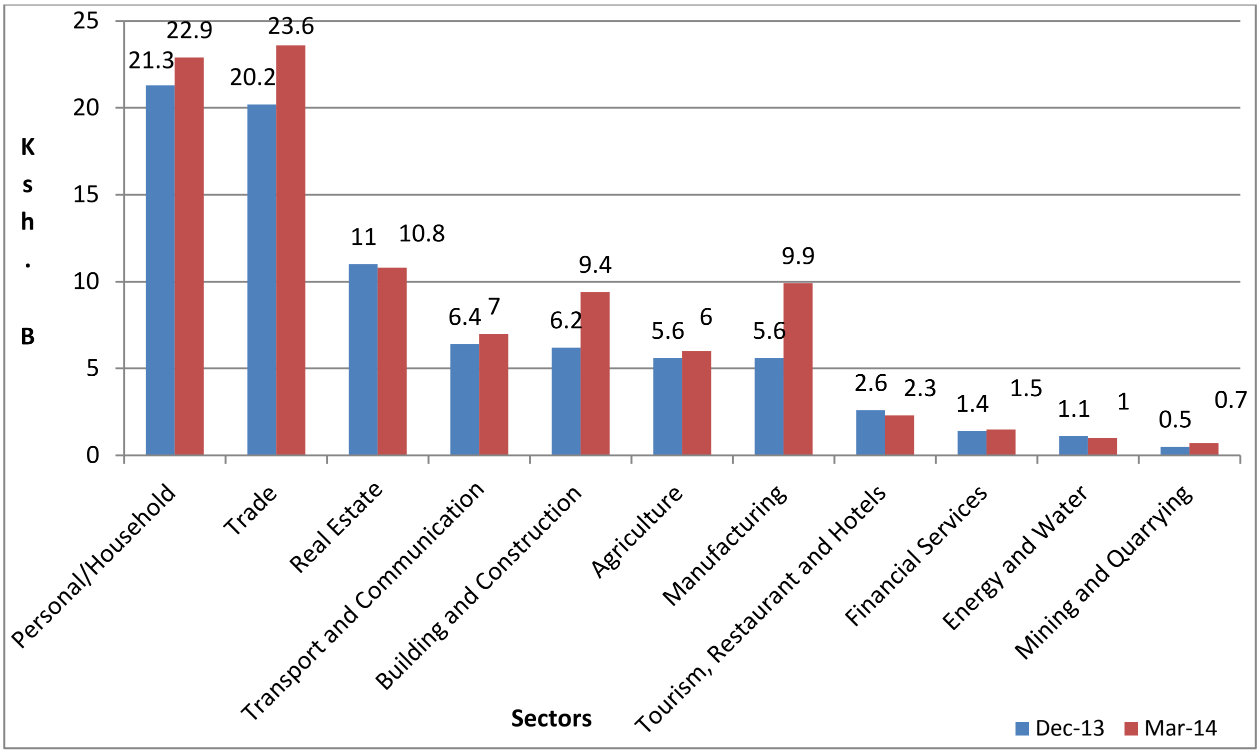
Other Banking Sector Performance Indicators

i) Assets Quality

The stock of gross non-performing loans (NPLs) increased by 16.1 percent from Ksh. 81.9 billion in December 2013 to Ksh. 95.1 billion in March 2014. Similarly, the quality of assets, measured as a proportion of net non-performing loans to gross loans deteriorated from 1.5 percent to 2.0 percent over the same period. The sector also registered an increase in the ratio of gross NPLs to gross loans from 5.2 percent in December 2013 to 5.6 percent in March 2014.

During the period under review, 8 out of 11 sectors registered increase in NPLs as shown in Chart 2. Spill-over effects of high interest rates and delays in payments particularly in the building and construction sectors contributed significantly to the increase in NPLs. However, banks continue to deploy enhanced appraisal standards to mitigate credit risk.

Chart 2: Sectoral Distribution of NPLs (December 2013 Vs. March 2014)



ii) Profitability

During the 1st quarter of 2014, the sector registered Ksh. 33.42 billion pre-tax profits, which was a marginal increase of 0.4 percent from Ksh. 33.28 billion recorded in the quarter ending December 2013. However, total income stood at Ksh. 95.05 billion in the first quarter being a decrease of 1.2 percent from Ksh. 96.21 billion registered in the fourth quarter of 2013. Whilst total expenses decreased by 2.4 percent from Ksh. 62.94 billion in the December 2013 quarter to Ksh. 61.46 billion in March 2014 quarter. On an annual basis, the profitability of the sector increased by 18.4 percent from the Ksh. 28.2 billion recorded in March 2013 to Ksh. 33.4 billion in March 2014.

Interest on loans and advances, fees and commissions and government securities were the main sources of income accounting for 58.8 percent, 19.1 percent and 15.2 percent of total income respectively. On the other hand, interest on deposits, staff costs and other expenses were the key components of expenses, accounting for 32.4 percent, 28.7 percent and 23.7 percent respectively.

iii) Liquidity of the Banking Sector

As at end of March 2014, liquid assets amounted to Ksh. 782.6 billion while total liquid liabilities stood at Ksh. 1,994.7 billion, resulting to an average liquidity ratio of 39.2 percent, against 38.6 percent registered in December 2013, which was above the minimum statutory limit of 20.0 percent.

B. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

The Credit Reference Bureaus (CRBs) are mandated to collect, collate and disseminate credit information to lenders to aid them in their credit decisions. This mode of establishing credit worthiness enables borrowers with no physical collateral to use their repayment history as collateral thus making credit markets more competitive and in the long run, more affordable.

During the last quarter of 2013, CBK undertook a comprehensive review of the Banking (Credit Reference Bureau) Regulations, 2008 which culminated in the revised Credit Reference Bureau Regulations, 2013. The new Regulations were gazetted on 17th January 2014. The revision of the Regulations was necessitated by the need to incorporate amendments to the Banking Act and the Microfinance Act which allowed Commercial Banks and Microfinance Banks to share both positive and negative (full file) credit information and also to enhance the robustness of the existing CIS framework. Following this amendment, with effect from 28th February 2014, all Commercial Banks and Microfinance Banks commenced submission of full file information to the two licenced credit reference bureaus.

Since the launch of credit information sharing in July 2010, the number of credit reports requested by institutions stood at 3,954,957 in March 2014 up from 3,597,288 reports in December 2013, representing an increase of 9.9 percent or 357,669 reports. Over the same period, the number of reports requested by customers increased from 55,094 to 61,516 reports.

The number of credit reports requested by banks increased from 341,769 registered in the quarter ending December 2013 to 357,669 reports registered in the quarter ending March 2014. Similarly, credit reports requested by customers increased from 5,904 to 6,422 over the same period. The commencement of full file credit information sharing and the inclusion of Microfinance Banks and other credit providers will go a long way towards enriching the CRBs database and credit information sharing mechanism in general.

ii) Agency Banking

Following the roll out of the agent banking model in May 2010, commercial banks have continued to contract varied retail entities to offer basic banking services. These entities, such as security companies, courier services, pharmacies, supermarkets and post offices act as third party agents to provide cash- in -cash-out transactions and other services in compliance with the laid down guidelines. As at 31st March 2014, there were 14 commercial banks that had contracted 24,645 active agents facilitating over 92.6 million transactions valued at Ksh. 499.0 billion. This was an increase from 13 commercial banks in December 2013 with 23,477 agents facilitating over 80.8 million transactions valued at Ksh. 432.0 billion.

The number of banking transactions undertaken through agents increased from 11.6 million registered in the quarter ending December 2013 to 11.8 million transactions registered in the quarter ending March 2014. Similarly, the value of banking transactions undertaken through agents increased from Ksh. 65.2 billion to Ksh. 67.0 billion over the same period.

The agent banking model is expected to facilitate commercial banks to provide banking services to their customers in a cost effective manner including improving deposits mobilization by reaching the unbanked or under banked.

iii) Microfinance Banks

The Microfinance (Amendment) Act, 2013 which was assented to by His Excellency the President on 27th November 2013 introduced a number of changes such as the deposit taking microfinance (DTMs) institutions to be referred to as Microfinance Banks (MFBs) and for MFBs to share both negative and positive information with credit reference bureaus. However, even though they are called banks, they will still operate under the Microfinance Act and will not be affected by the Banking Act under which commercial banks are licensed.

As at 31st March 2014, 9 Microfinance Banks (MFBs) were in operation and had gross loans and advances worth Ksh. 29.6 billion compared to Ksh. 27.5 billion registered in December 2013 thus translating to a growth of 7.6 percent. Similarly, the deposits base stood at Ksh. 27.8 billion representing a growth of 12.6 percent from Ksh. 24.7 billion in December 2013. The long-term borrowings by MFBs decreased from Ksh. 9.0 billion in December 2013 to Ksh. 6.6 billion in March 2014. The number of MFBs deposit accounts and loan accounts stood at 2,154,982 and 442,518 respectively in March 2014 compared to 1,946,859 deposit accounts and 456,470 loans accounts registered at end of December 2013.

iv) Money Remittance Providers

The Central Bank of Kenya Act was amended in 2012 by expanding the definition of authorized dealers to include Money Remittance Providers. This amendment facilitated the formulation of the Money Remittance Regulations which were gazetted in April 2013. Some of the factors that necessitated the creation of this framework were:

- ✓ the need to reduce barriers and lower the cost of sending and receiving money and increase transparency;
- ✓ to foster competition, enhance innovations and increase access to money remittance products and services to the low income group; and
- ✓ to create an enabling environment to increase the flows of remittances through formal financial delivery channels.

As at end of March 2014, three money remittance providers had been licensed compared to one in the quarter ending December 2013 and a number of applications for license were at various processing stages.

Banking Sector 2014 Outlook

The banking sector is expected to maintain its growth momentum mainly driven by the rollout of full file credit information sharing, regional integration initiatives, advances in information and communications technology and the introduction of the devolved governance system in Kenya.