PERFORMANCE AND DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 30TH SEPTEMBER 2015

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended 30th September 2015, the sector comprised 42 commercial banks, 1 mortgage finance company, 12 microfinance banks, 8 representative offices of foreign banks, 86 foreign exchange bureaus, 14 money remittance providers and 3 credit reference bureaus.

During the quarter Dubai Bank limited was placed under receivership and eventually on liquidation for failure to maintain adequate capital and liquidity ratios as well as provisions for non-performing loans and weak corporate governance structures.

The Kenyan Banking Sector's performance improved with the size of total assets standing at Ksh. 3.65 trillion, gross loans worth Ksh. 2.32 trillion, while the deposit base was Ksh. 2.57 trillion. Profit before tax of Ksh. 114.22 billion was realised for the nine months to 30th September 2015. Over the same period, the number of bank customer deposit and loan accounts stood at 33,291,000 and 7,016,378 respectively.

B. STRUCTURE OF THE BALANCE SHEET

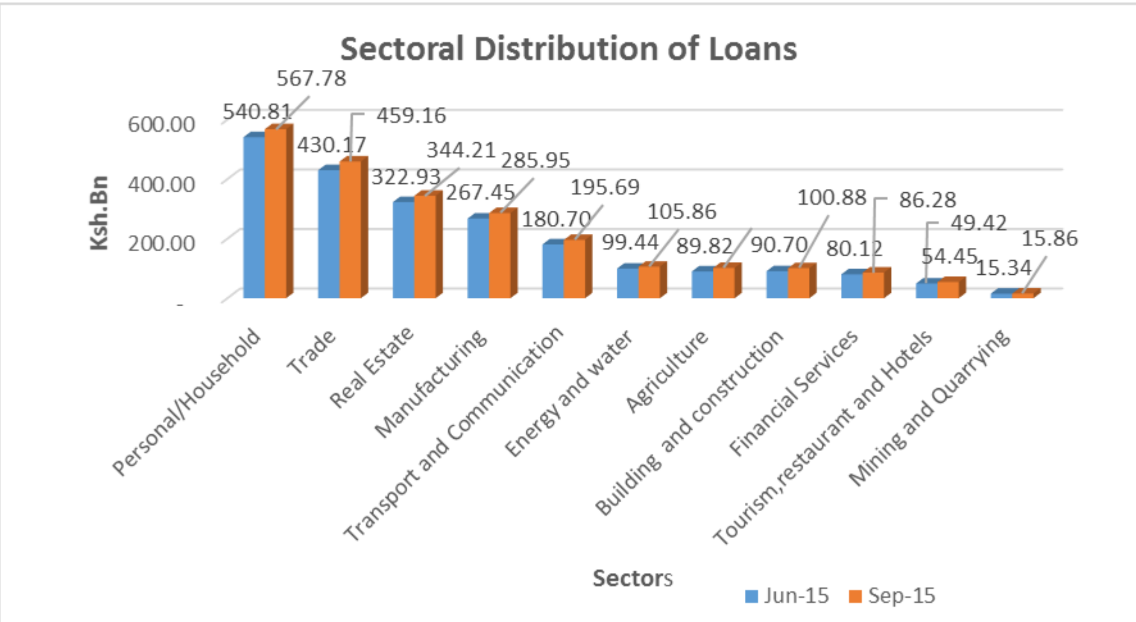
i) Assets

The banking sector's aggregate balance sheet grew by 1.4% from Ksh. 3.60 trillion in June 2015 to Ksh. 3.65 trillion in September 2015. The major asset components were local and foreign currency loans, government securities and placements which accounted for 61.2%, 17.4% and 5.4% of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances increased from Ksh. 2.17 trillion in June 2015 to Ksh. 2.32 trillion in September 2015, translating to a growth of 6.9%. The growth in loans was witnessed in all economic sectors as shown in **Chart 1** below.

Chart 1: Sectorial Distribution of Loans (June 2015 vs. September 2015)



iii) Deposit Liabilities

Deposits remain the main source of funding for the Kenyan banking sector, accounting for 70.3% of total liabilities. The deposit base marginally decreased by 0.2% from Ksh. 2.574 trillion in June 2015 to Ksh. 2.568 trillion in September 2015.

The number of Commercial banks deposit accounts increased from 31.6 million in June 2015 to 33.3 million in September 2015 representing a growth of 1.7 million accounts or 5.4%.

iv) Capital and Reserves

The banking sector registered increased capital levels in the quarter ended September 2015 with total capital increasing by 2.1% from Ksh. 549.0 billion in June 2015 to Ksh. 560.7 billion in September 2015. Shareholders' funds increased by 2.2% from Ksh. 543.3 billion in June 2015 to Ksh. 555.5 billion in September 2015. However, the ratio of core capital to total risk-weighted assets reduced from 15.7% in June 2015 to 15.5% in September 2015 and total capital to total risk weighted assets ratio reduced from 18.9% in June 2015 to 18.7% in September 2015. Despite the drop, the capital ratios remain above the minimum statutory limits of 10.5% and 14.5% for core capital and total capital respectively. The decrease was occasioned by higher increase of risk weighted assets as compared to the increase in core and total capital.

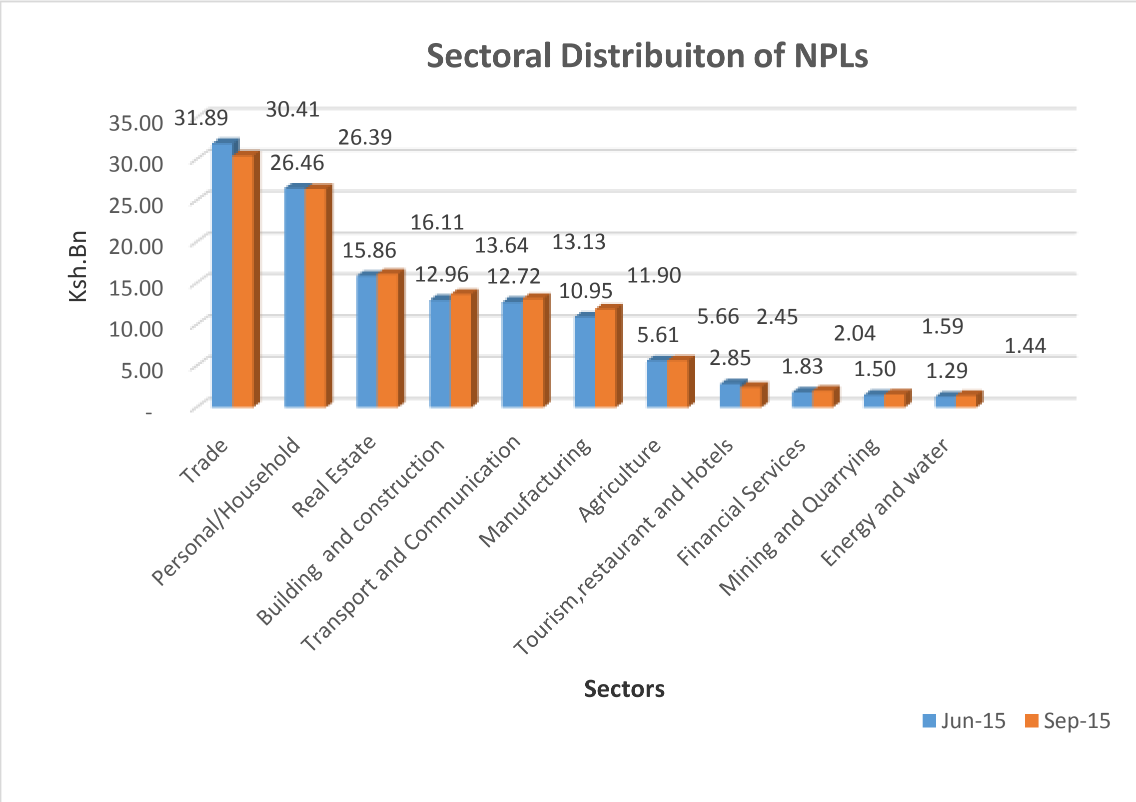
Other Banking Sector Performance Indicators

i) Assets Quality

The value of gross non-performing loans (NPLs) increased by 0.7% from Ksh. 123.9 billion in June 2015 to Ksh. 124.8 billion in September 2015. The quality of assets, measured as a proportion of net non-performing loans to gross loans slightly decreased from 2.7% in June 2015 to 2.5% in September 2015.The ratio of gross NPLs to gross loans also decreased slightly from 5.7% in June 2015 to 5.4% in September 2015 since gross loans increased with a higher margin than the increase in gross NPLS.

During the period under review, 8 out of 11 economic sectors registered marginal increases in NPLs as shown in Chart 2. Banks continue to deploy enhanced credit appraisal standards to mitigate credit risk. The sectors which experienced the highest increase in NPLs in the quarter were Financial Services and Energy and Water sectors whose NPLs increased by 11.5% and 11.6% respectively. The sector with the highest decrease in NPLs in the same period was Tourism, Restaurant and Hotels sector which recorded a decrease of 14.0%.

Chart 2: Sectorial Distribution of NPLs (June 2015 vs. September 2015)



ii) Profitability

The banking sector recorded Ksh. 37.31 billion pre-tax profits in the quarter ended September 2015, which was a decrease of 5.8% from Ksh. 39.61 billion registered in the quarter ending June 2015. Similarly, total income of Ksh. 121.52 billion was generated in the 3rd quarter of 2015 being an increase of 4.5% from Ksh. 116.29 billion in the 2nd quarter of 2015. The total expenses increased by 9.8% from Ksh. 76.68 billion in the quarter ended June 2015 to Ksh. 84.21 billion in quarter ended September 2015. On an annual basis, the profitability of the sector increased by 9.3% from Ksh. 104.5 billion registered in September 2014 to Ksh. 114.2 billion in September 2015.

Interest on advances, other income and interest on government securities were the main sources of income accounting for 60.7%, 15.0% and 16.1% of total income respectively. On the other hand, interest on deposits, salaries and wages and other expenses were the major components of expenses, accounting for 35.8%, 25.7% and 21.9% of total expenses respectively.

iii) Liquidity of the Banking Sector

For the quarter ended 30th September 2015, average liquid assets stood at Ksh. 946.63 billion while average liquid liabilities were worth Ksh. 2,531.90 billion, resulting to an average liquidity ratio of 37.4% as compared to 38.7% registered in June 2015. Despite the marginal drop in the liquidity as at September 2015, the ratio remained above the minimum statutory limit of 20.0%.

C. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

The use of credit information sharing mechanism has continued to expand since its launch in July 2010. The cumulative number of credit reports requested by commercial banks and microfinance banks stood at 9,994,289 in September 2015 up from 7,545,757 reports in June 2015. Over the same period, the number of reports requested by customers increased from 111,633 to 141,023.

The number of credit reports requested by commercial and microfinance banks increased from 1,446,841 in the quarter ending June 2015 to 2,448,532 reports requested in the quarter ending September 2015. Credit reports requested by customers in the quarter increased from 10,345 to 29,390.

ii) Agency Banking

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 30th September 2015, there were 17 commercial banks that had contracted 39,871 agents which had facilitated over 193.4 million cumulative transactions valued at Ksh. 1.0 trillion. As at 30th June 2015, 17 commercial banks had 36,080 cumulative agents since the rollout which had facilitated 175.4 million transactions valued at Ksh. 930.1 billion.

The number of banking transactions undertaken through the bank agents in the quarter decreased from 25.9 million in the quarter ended June 2015 to 19.5 million transactions in the quarter ending September 2015. However, the value of banking transactions undertaken through agents increased from Ksh. 112.7 billion to Ksh. 116.2 billion over the same period.

iii) Microfinance Banks

As at 30th September 2015, there were 12 Microfinance Banks (MFBs) in operation. All the Microfinance Banks had granted loans and advances worth Ksh. 46.1 billion compared to Ksh. 43.3 billion as at the end of June 2015 thus translating to a growth of 6.5%. The MFBs deposit base stood at Ksh. 39.2 billion as at September 2015 representing a decrease of 1.3% from Ksh. 39.7 billion in June 2015. The drop in deposit base was due to increased long-term borrowings from Ksh. 8.1 billion in June 2015 to Ksh. 10.5 billion in September 2015 signalling decreased reliance on deposits by MFBs as a source of funding customers' loans.

The number of MFBs deposit accounts and loan accounts stood at 2,365,323 and 415,528 respectively in September 2015 compared to 2,042,963 deposit accounts and 434,752 loan accounts registered as at the end of June 2015. The reduction in loans accounts was due to the new products that necessitate merging of some existing loan accounts.

D. POST QUARTER EVENTS

Imperial Bank Limited was placed under receivership on 13th October 2015 due to unsafe and unsound banking practices that warranted immediate remedial action by CBK. As at the time of placing the bank under receivership, it controlled a market share of 1.8 per cent and the inappropriate practices at the bank were isolated hence the action does not present a systemic concern for the banking sector.

E. BANKING SECTOR 2015 OUTLOOK

The Kenyan banking sector is foreseen to remain stable and maintain an upward growth trend in the remainder of 2015. Liquidity risk also increasing as some banks are exposed to liquidity challenges as evidenced by drop in liquidity level from 38.7% to 37.4% in June and September 2015 respectively. Credit and Liquidity risks are expected to remain elevated to the end of the year 2015.