DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 30TH JUNE 2014

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended 30th June, 2014, the sector comprised 43 commercial banks, 1 mortgage finance company, 9 microfinance banks, 8 representative offices of foreign banks, 97 foreign exchange bureaus, 5 money remittance providers and 2 credit reference bureaus.

The Kenyan Banking Sector recorded improved performance with the size of net assets standing at Ksh. 2.97 trillion, loans & advances worth Ksh. 1.78 trillion, while the deposit base was Ksh. 2.15 trillion and profit before tax of Ksh. 71.03 billion as at 30th June 2014. Over the same period, the number of bank customer deposit and loan accounts stood at 25,328,428 and 3,841,666 respectively.

Structure of the Balance Sheet

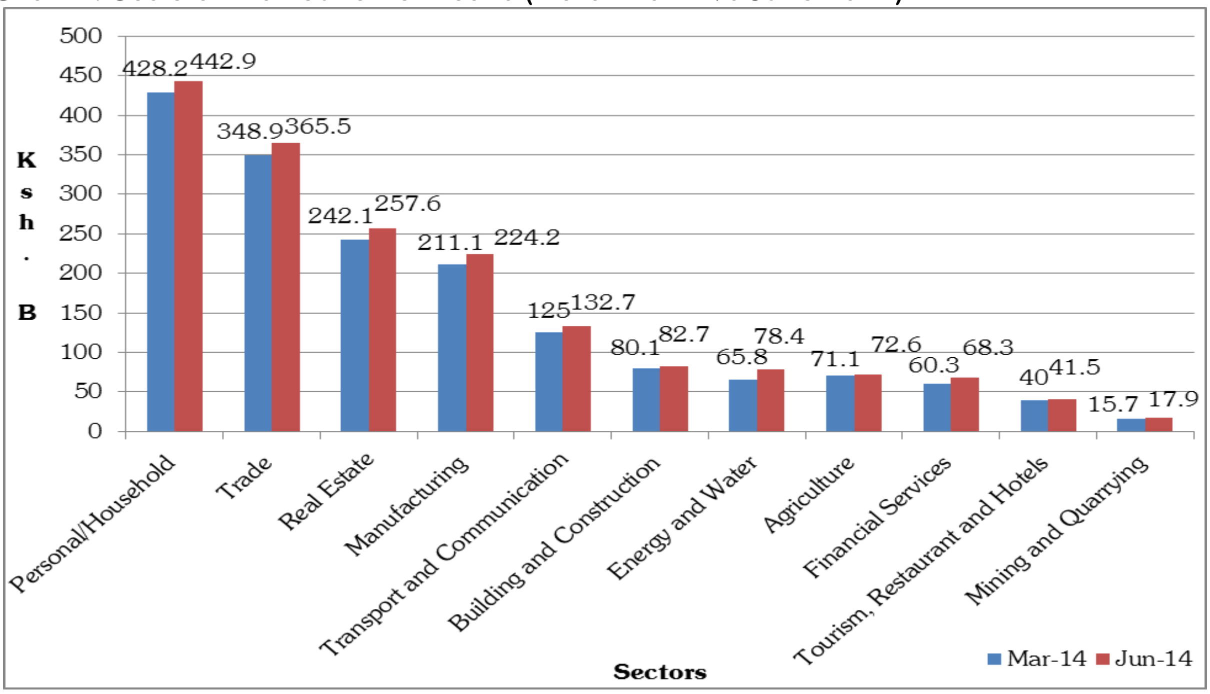
i) Assets

The banking sector's aggregate balance sheet grew by 5.3 percent from Ksh. 2.82 trillion in March 2014 to Ksh. 2.97 trillion in June 2014. The major items of the balance sheet were loans and advances, government securities and placements, which accounted for 58 percent, 21.3 percent and 5.1 percent of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances increased from Ksh. 1.69 trillion in March 2014 to Ksh. 1.78 trillion in June 2014, translating to a growth of 5.3 percent. The growth was in all the 11 sectors as shown in Chart 1.

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



iii) Deposit Liabilities

Deposits were the main source of funding for the banking sector, accounting for 72.3 percent of total funding liabilities. The deposit base grew by 5.4 percent from Ksh. 2.04 trillion in March 2014 to Ksh. 2.15 trillion in June 2014 supported by branch expansion, remittances, receipts from exports and increased use of alternative delivery channels of banking services such as agency banking model.

The number of bank deposit accounts increased from 23.8 million in March 2014 to 25.3 million in June 2014 representing a growth of 1.5 million accounts or 6.3 percent.

iv) Capital and Reserves

The banking sector registered improved capital levels in June 2014 with total capital increasing by 2.3 percent from Ksh. 426.6 billion in March 2014 to Ksh. 436.6 billion in June 2014, whereas shareholders' funds increased by 1.3 percent from Ksh. 453.6 billion in March 2014 to Ksh. 459.4 billion in June 2014. However, the ratios of core and total capital to total risk-weighted assets decreased from 15.7 percent and 18.2 percent to 15.0 percent and 17.5 percent respectively.

The decline in capital adequacy ratios is due to higher increase in total risk weighted assets than the increase in capital base during the period under review.

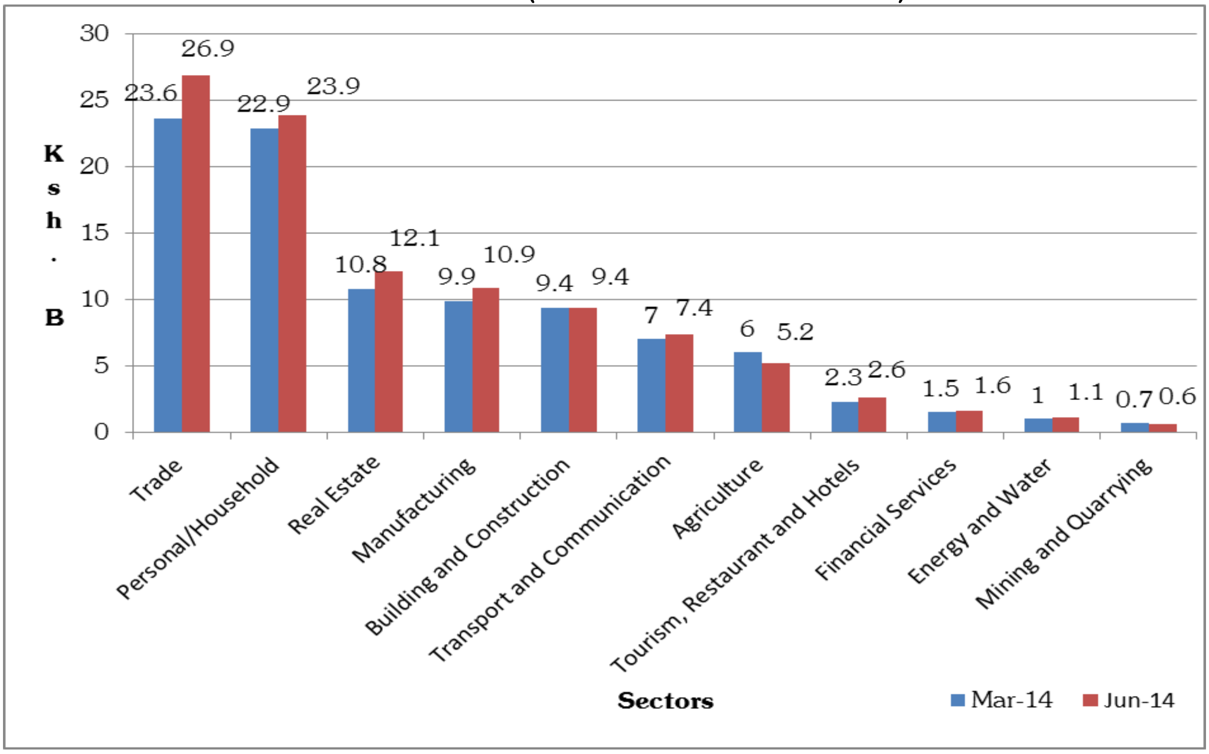
Other banking sector performance indicators

i) Assets Quality

The value of gross non-performing loans (NPLs) increased by 6.9 percent from Ksh. 95.1 billion in March 2014 to Ksh. 101.7 billion in June 2014. The quality of assets, measured as a proportion of net non-performing loans to gross loans declined from 2.0 percent to 2.1 percent over the same period. Similarly the sector recorded an increase in the ratio of gross NPLs to gross loans from 5.6 percent in March 2014 to 5.7 percent in June 2014.

During the period under review, 8 out of 11 sectors registered increase in NPLs as shown in Chart 2. The spill-over effects of high lending interest rates and challenges in the business environment contributed to increase in NPLs. However, banks continue to deploy enhanced appraisal standards to mitigate credit risk.

Chart 2: Sectoral Distribution of NPLs (March 2014 Vs June 2014)



ii) Profitability

During the 2nd quarter of 2014, the sector recorded Ksh. 37.61 billion pre-tax profits, which was an increase of 12.5 percent from Ksh. 33.42 billion registered in the quarter ending March 2014. Similarly, total income stood at Ksh. 104.0 billion in the second quarter being an increase of 9.4 percent from Ksh. 95.05 billion in the first quarter of 2014. The total expenses increased by 8.3 percent from Ksh. 61.46 billion in March 2014 quarter to Ksh. 66.56 billion in June 2014 quarter. On an annual basis, the profitability of the sector increased by 15.6 percent from the Ksh. 61.47 billion registered in June 2013 to Ksh. 71.03 billion in June 2014.

Interest on loans and advances, fees and commissions and government securities were the major sources of income accounting for 58.5 percent, 19.4 percent and 15.1 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 32.7 percent, 28.4 percent and 24.3 percent respectively.

iii) Liquidity of the Banking Sector

For the period ended 30th June 2014, average liquid assets stood at Ksh. 820.7 billion while average liquid liabilities were worth Ksh. 2,118.1 billion, resulting to an average liquidity ratio of 38.7 percent, against 39.2 percent registered in March 2014, which was above the minimum statutory limit of 20.0 percent.

B. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

Following the launch of credit information sharing in July 2010, the number of credit reports requested by institutions stood at 4,325,200 in June 2014 up from 3,954,957 reports in March 2014, representing an increase of 9.4 percent or 370,243 reports. Over the same period, the number of reports requested by customers increased from 61,516 to 67,610 reports.

The number of credit reports requested by banks increased from 357,669 registered in the quarter ending March 2014 to 370,243 reports registered in the quarter ending June 2014. However, credit reports requested by customers decreased from 6,422 to 6,094 over the same period. The commencement of full file credit information sharing in February 2014 and the inclusion of Microfinance Banks will increase demand for credit reports. Both commercial banks and microfinance banks are expected to offer their customers with good track record credit facilities on competitive terms.

ii) Agency Banking

Since 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 30th June 2014, there were 15 commercial banks that had contracted 26,750 active agents facilitating over 106.1 million transactions valued at Ksh. 571.5 billion. This was an increase from 14 commercial banks in March 2014 with 24,645 agents facilitating about 92.6 million transactions valued at Ksh. 499.0 billion.

The number of banking transactions undertaken through agents increased from 11.8 million registered in the quarter ending March 2014 to 13.5 million transactions registered in the quarter ending June 2014. Similarly, the value of banking transactions undertaken through agents increased from Ksh. 67.0 billion to Ksh. 72.5 billion over the same period.

The adoption of agency banking model is expected to facilitate commercial banks to reach the under-banked and unbanked Kenyan public.

iii) Microfinance Banks

As at 30th June 2014, there were 9 Microfinance Banks (MFBs) in operation which had granted loans and advances worth Ksh. 32.7 billion compared to Ksh. 29.6 billion registered in March 2014 thus translating to a growth of 10.5 percent. The MFBs deposit base stood at Ksh. 30.7 billion representing a growth of 10.4 percent from Ksh. 27.8 billion in March 2014. The long-term borrowings by the MFBs decreased from Ksh. 6.6 billion in March 2014 to Ksh. 5.5 billion in June 2014 signalling increased reliance on deposits as a source of funding customers' loans. The number of MFBs deposit accounts and loan accounts stood at 2,094,843 and 430,393 respectively in June 2014 compared to 2,154,982 deposit accounts and 442,518 loans accounts registered at end of March 2014. The reduction in MFBs deposit accounts was occasioned by clean-up of dormant accounts while reduction in loans accounts was due to introduction of new products that necessitated merging of some existing loan accounts.

Banking sector 2014 Outlook

The banking sector is expected to sustain its growth mainly supported by the branch expansion, regional integration initiatives, advances in information and communications technology and the adoption of the devolved governance system in Kenya.