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

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended 30th September, 2014, the sector comprised 43 commercial banks, 1 mortgage finance company, 9 microfinance banks, 7 representative offices of foreign banks, 94 foreign exchange bureaus, 7 money remittance providers and 2 credit reference bureaus.

The Kenyan Banking Sector registered enhanced improved performance with the size of net assets standing at Ksh. 3.08 trillion, loans & advances worth Ksh. 1.91 trillion, while the deposit base was Ksh. 2.25 trillion and profit before tax of Ksh. 104.54 billion as at 30th September 2014. Over the same period, the number of bank customer deposit and loan accounts stood at 26,603,385 and 4,068,304 respectively.

Structure of the Balance Sheet

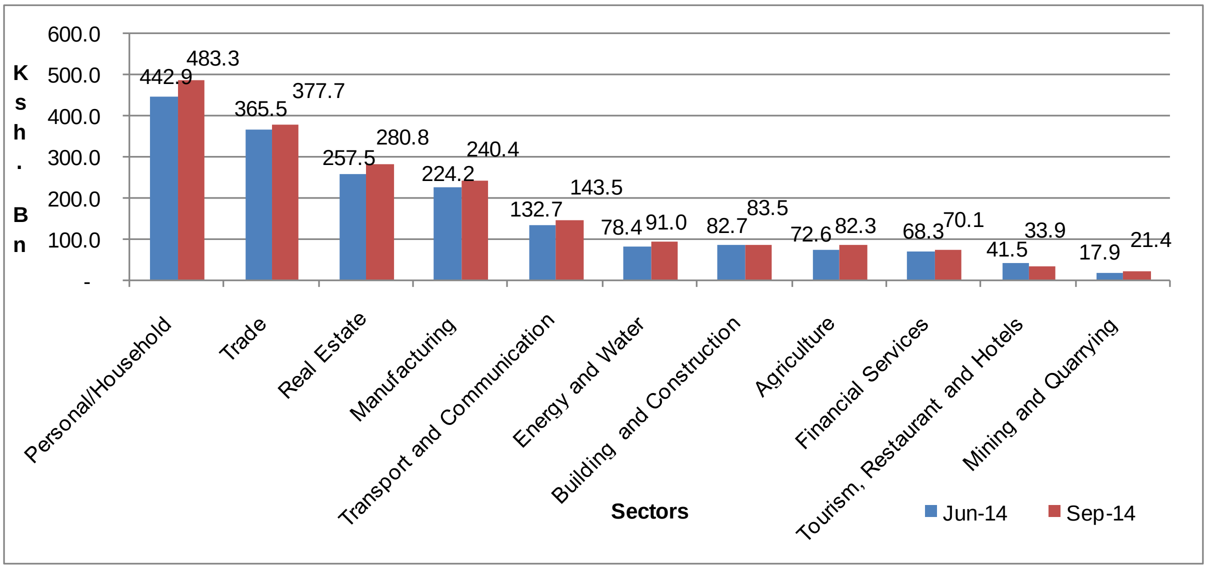
i) Assets

The banking sector's aggregate balance sheet increased by 3.7 percent from Ksh. 2.97 trillion in June 2014 to Ksh. 3.08 trillion in September 2014. The major items on the balance sheet were loans and advances, government securities and placements, which accounted for 59.9 percent, 20.5 percent and 4.7 percent of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances grew from Ksh. 1.78 trillion in June 2014 to Ksh. 1.91 trillion in September 2014, translating to a growth of 7.3 percent. The growth was in 10 out of 11 sectors as shown in Chart 1. Tourism, Restaurants and Hotels sector registered a decline due to higher repayments than the new loans granted during the period.

Chart 1: Sectoral Distribution of Loans (June 2014 Vs September2014)



iii) Deposit Liabilities

Deposits were the major source of funding for the banking sector, accounting for 73.1 percent of total funding liabilities. The deposit base increased by 4.7 percent from Ksh. 2.15 trillion in June 2014 to Ksh. 2.25 trillion in September 2014 supported by branch expansion, remittances, receipts from exports. The increased use of alternative delivery channels of banking services such as agency banking model has also contributed to increased deposits.

The number of bank deposit accounts increased from 25.3 million in June 2014 to 26.6 million in September 2014 representing a growth of 1.3 million accounts or 5.1 percent.

iv) Capital and Reserves

The banking sector registered enhanced capital levels in September 2014 with total capital increasing by 4.9 percent from Ksh. 436.6 billion in June 2014 to Ksh. 458.1 billion in September 2014, whereas shareholders' funds increased by 6.4 percent from Ksh. 459.4 billion in June 2014 to Ksh. 488.7 billion in September 2014. Similarly, the ratios of core and total capital to total risk-weighted assets increased from 15.0 percent and 17.5 percent to 15.1 percent and 17.8 percent respectively.

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

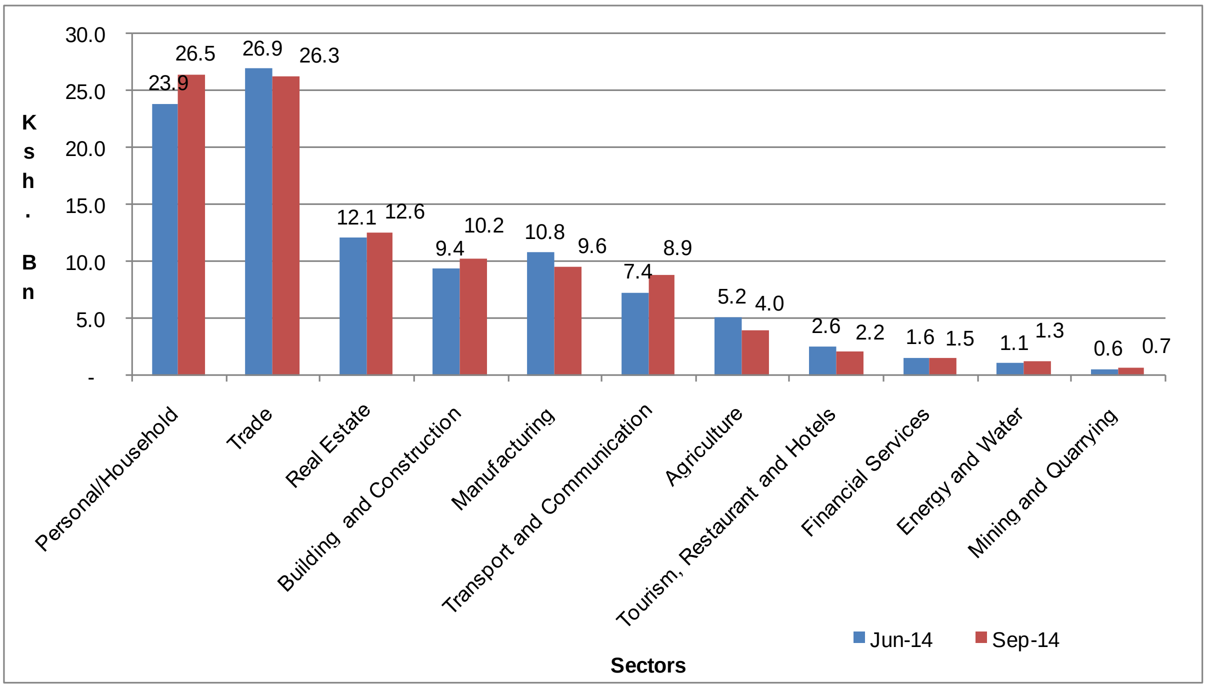
Other Banking Sector Performance Indicators

i) Assets Quality

The stock of gross non-performing loans (NPLs) increased by 2.0 percent from Ksh. 101.7 billion in June 2014 to Ksh. 103.7 billion in September 2014. The quality of assets, measured as a proportion of net non-performing loans to gross loans improved from 2.1 percent to 1.9 percent over the same period. Similarly, the ratio of gross NPLs to gross loans declined from 5.7 percent in June 2014 to 5.4 percent in September 2014.

During the period under review, 6 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 have adopted enhanced appraisal standards to mitigate credit risk.

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



ii) Profitability

During the 3rd quarter of 2014, the sector recorded Ksh. 33.5 billion pre-tax profits, which was a decrease of 10.9 percent from Ksh. 37.6 billion registered in the quarter ending June 2014. Total income stood at Ksh. 104.0 billion in the third quarter which was similar to what was registered in the second quarter of 2014. The total expenses increased by 5.7 percent from Ksh. 66.6 billion in June 2014 quarter to Ksh. 70.4 billion in September 2014 quarter. On an annual basis, the profitability of the sector increased by 13.0 percent from the Ksh. 92.5 billion registered in September 2013 to Ksh. 104.5 billion in September 2014.

Interest on loans and advances, fees and commissions and government securities were the major sources of income accounting for 59.2 percent, 18.7 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, 28.2 percent and 24.1 percent respectively.

iii) Liquidity of the Banking Sector

For the period ended 30th September 2014, average liquid assets stood at Ksh. 816.3 billion while average liquid liabilities were worth Ksh. 2,180.9 billion, resulting to an average liquidity ratio of 37.4 percent, against 38.7 percent registered in June 2014, which was above the minimum statutory limit of 20.0 percent.

B. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

Since the launch of credit information sharing in July 2010, the number of credit reports requested by institutions stood at 4,779,273 in September 2014 up from 4,325,200 reports in June 2014, representing an increase of 10.5 percent or 454,073 reports. Over the same period, the number of reports requested by customers increased from 67,610 to 77,422 reports.

The number of credit reports requested by banks grew from 370,243 registered in the quarter ending June 2014 to 454,073 reports registered in the quarter ending September 2014. Similarly, credit reports requested by customers increased from 6,094 to 9,812 over the same period. As banks and microfinance banks embrace credit information sharing in processing credit facilities they are expected to offer customers with good track record, such credit facilities on competitive terms.

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 30th September 2014, there were 16 commercial banks that had contracted 30,449 active agents facilitating over 120.6 million transactions valued at Ksh. 653.7 billion. This was an increase from 15 commercial banks in June 2014 with 26,750 agents facilitating about 106.1 million transactions valued at Ksh. 571.5 billion.

The number of banking transactions undertaken through agents increased from 13.5 million registered in the quarter ending June 2014 to 14.5 million transactions registered in the quarter ending September 2014. Similarly, the value of banking transactions undertaken through agents increased from Ksh. 72.5 billion to Ksh. 82.2 billion over the same period.

The use of agency banking model continues to facilitate banks to reach the under-banked and unbanked Kenyan public.

iii) Microfinance Banks

As at 30th September 2014, there were nine (9) Microfinance Banks (MFBs) in operation which had granted loans and advances worth Ksh. 37.6 billion compared to Ksh. 32.7 billion registered in June 2014 thus translating to a growth of 15.0 percent. The MFBs deposit base stood at Ksh. 33.2 billion representing a growth of 8.1 percent from Ksh. 30.7 billion in June 2014. The long-term borrowings by the MFBs decreased from Ksh. 5.5 billion in June 2014 to Ksh. 4.9 billion in September 2014 signalling increased reliance on deposits as a source of funding customers' loans. The number of MFBs deposit accounts and loan accounts stood at 2,195,289 and 424,914 respectively in

September 2014 compared to 2,094,843 deposit accounts and 430,393 loans accounts registered at end of June 2014. The reduction in MFBs loans accounts was due to introduction of new products that necessitated merging of some existing loan accounts.

iv) Kenya Banks' Reference Rate

In January 2014, a committee led by the National Treasury was constituted to explore ways of increasing and enhancing private sector and mortgage finance supply in Kenya. The committee's report was issued by the National Treasury in May 2014. One of the key recommendations of the committee was the introduction of a transparent credit pricing framework to be known as the Kenya Banks' Reference Rate (KBRR).

The Monetary Policy Committee in the meeting of July 2014 set the Central Bank Rate at 8.5 percent and considered a weighted 2-month moving average of the 91-day Treasury bill in setting the KBRR at 9.13 percent. Therefore banks and microfinance banks with effect from 8th July 2014 were required to price their flexible rate loans using the KBRR as the base rate. Thus customers were to be charged KBRR + K for all new credit facilities on variable interest rates with effect from 8th July 2014. However, banks and microfinance were granted a grace period on existing credit facilities to be transitioned to the new KBRR framework by 30th June 2015. In addition, both banks and microfinance are required to disclose the make-up of "K" to both the customers and the Central Bank.

Currently banks and microfinance banks submit on a weekly basis to CBK a summary of new credit facilities and existing facilities composition of "K". Plans are underway for the Central Bank to publish the "K" for all the banks and microfinance banks for reference by borrowers in making informed decisions while seeking credit facilities.

Banking Sector 2014 Outlook

The banking sector is expected to sustain its growth momentum to the end of 2014 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.