DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 30TH SEPTEMBER 2012

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended September 30, 2012, the sector comprised 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions, 5 representative offices of foreign banks, 111 foreign exchange bureaus and 2 credit reference bureaus.

The Kenyan Banking Sector continued to register improved performance with the size of assets standing at Ksh. 2.3 trillion, loans & advances worth Ksh. 1.32 trillion, while the deposit base was Ksh. 1.72 trillion and profit before tax of Ksh. 80.8 billion as at 30th September 2012. During the same period, the number of bank customer deposit and loan accounts stood at 15,072,922 and 2,055,574 respectively.

Structure of the Balance Sheet

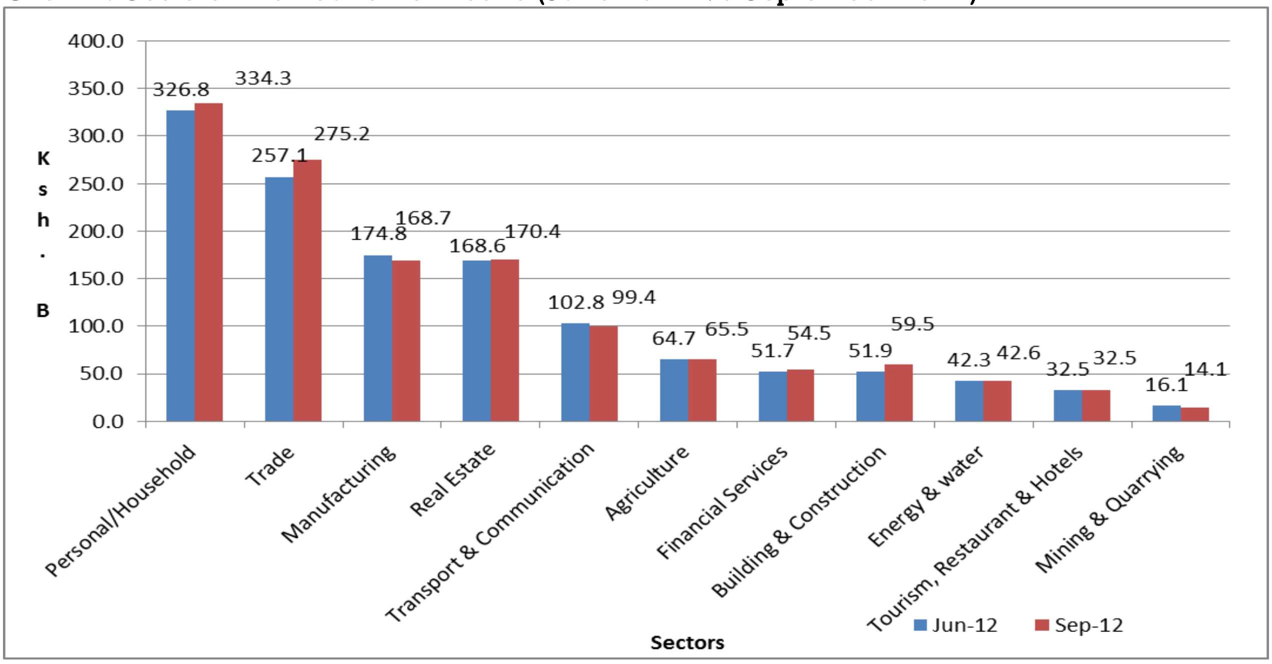
i) Assets

The banking sector's aggregate balance sheet grew by 4.5 percent from Ksh. 2.2 trillion in June 2012 to Ksh. 2.3 trillion in September 2012. The main components of the balance sheet comprised of loans and advances, government securities and placements, which accounted for 55.2 percent, 21.0 percent and 6.5 percent of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances rose from Ksh. 1.29 trillion in June 2012 to Ksh. 1.32 trillion in September 2012, which translated to a growth of 2.3 percent. The growth, which stood at Ksh. 27.5 billion, was in 8 sectors as shown in Chart 1 with Manufacturing, Transport & Communication and Mining & Quarrying sectors registering marginal declines occasioned by higher repayments than the new loans advanced to these sectors during the period.

Chart 1: Sectoral Distribution of Loans (June 2012 Vs September 2012)



iii) Deposit Liabilities

Deposits, which form the major source of funding for the banking sector, accounted for 74.8 percent of total funding liabilities. The deposit base increased by 3.6 percent from Ksh. 1.66 trillion in June 2012 to Ksh. 1.72 trillion in September 2012 mainly supported by branch expansion, remittances and receipts from exports.

The number of bank branches stood at 1,209 an increase of 12 from the 1,197 branches registered in June 2012. Similarly, the number of bank deposit accounts increased from 14.89 million in June 2012 to 15.07 million in September 2012 representing a growth of 0.18 million accounts or 1.2 percent.

iv) Capital and Reserves

The banking sector recorded enhanced capital levels in September 2012 with total capital growing by 3.5 percent from Ksh. 294.3 billion in June 2012 to Ksh. 304.5 billion in September 2012, while shareholders' funds grew by 6.9 percent from Ksh. 315.1 billion in June 2012 to Ksh. 336.9 billion in September 2012. Similarly, the ratio of total capital to total risk-weighted assets increased from 20.3 percent in June 2012 to 20.5 percent in September 2012, however, core capital to total risk weighted assets declined from 17.7 percent to 17.6 percent over the same period.

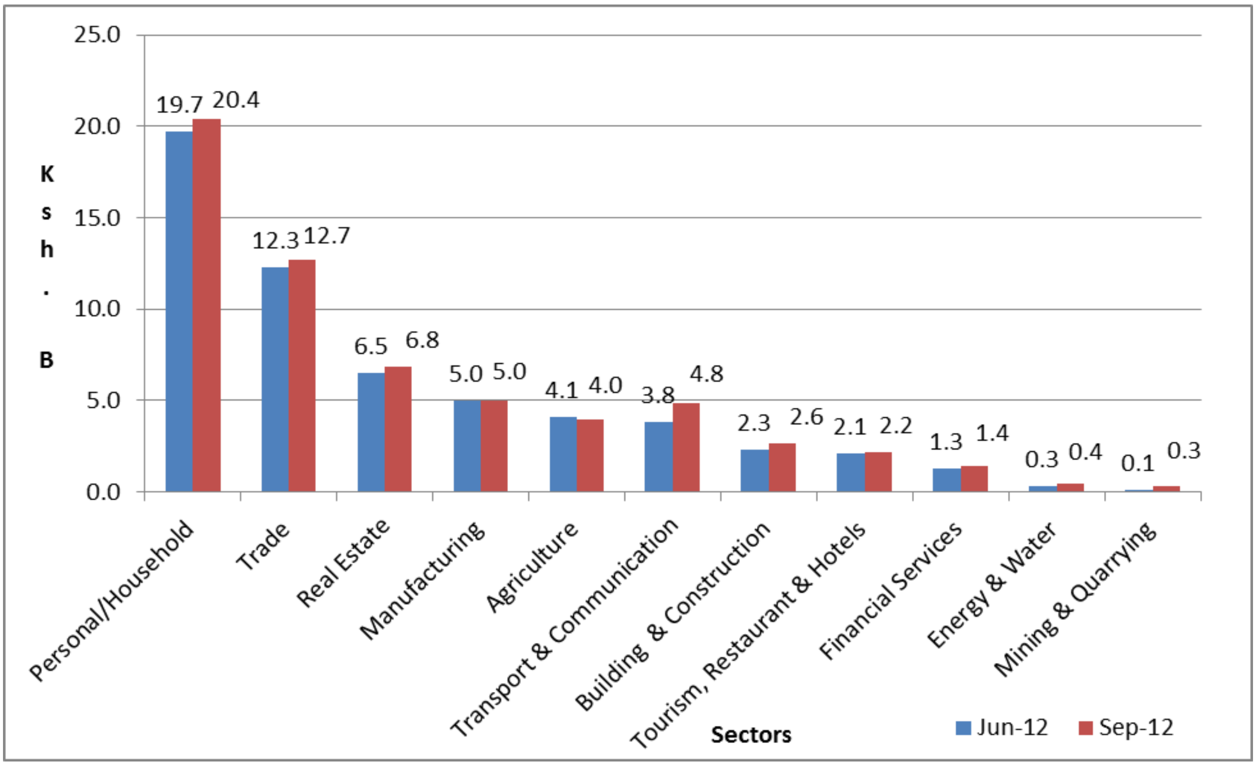
Other Banking Sector Performance Indicators

i) Assets Quality

The stock of gross non-performing loans (NPLs) grew from Ksh. 57.5 billion in June 2012 to Ksh. 60.7 billion in September 2012 representing a growth of 5.6 percent. Accordingly, the ratio of gross NPLs to gross loans increased from 4.5 percent in June 2012 to 4.6 percent in September 2012. Similarly, the quality of assets, measured as a proportion of net non-performing loans (Gross non-performing loans less provisions and interest in suspense) to gross loans rose marginally from 0.8 percent to 0.9 percent over the same period.

During the period under review, 9 out of 11 sectors registered increase in NPLs by Ksh. 3.2 billion with Agriculture being the only sector that registered a decline as shown in Chart 2. The high lending interest rates regime contributed to the increase in NPLs. However, banks continue to deploy enhanced appraisal standards to mitigate credit risk and the Central Bank is closely monitoring the trend. In addition, reduction in Central Bank Rate in September 2012 from 16.50 percent to 13.0 percent is expected to influence banks to revise downwards their lending rates.

Chart 2: Sectoral Distribution of NPLs (June 2012 Vs September2012)



ii) Profitability

The banking sector profit before tax for the quarter ended September 2012 declined marginally by 3.2 percent from the Ksh. 28.5 billion registered in the second quarter to Ksh. 27.6 billion in the three months of the third quarter of 2012. However, the cumulative pre-tax profits stood at Ksh. 80.8 billion as at September 2012 from the Ksh. 53.2 billion registered as at end of June 2012.

Interest on loans and advances, fees and commissions and government securities, which are the major sources of income accounted for 62 percent, 17 percent and 13 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 42 percent, 24 percent and 21 percent respectively.

iii) Liquidity of the Banking Sector

For the period ended September 2012, average liquid assets amounted to Ksh. 683.2 billion while total liquid liabilities stood at Ksh. 1,658.9 billion, resulting to an average liquidity ratio of 41.2 percent, against 38.1 percent registered in June 2012, and above the minimum statutory limit of 20 percent. The gross loans to deposits ratio decreased from 77.8 percent in June 2012 to 76.7 percent in September 2012 an indication of a higher increase in mobilized deposits than the growth in credit.

B. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

As at end of September 2012, there were two Credit Reference Bureaus authorized by the Central Bank to operate in Kenya i.e. Credit Reference Bureau Africa Ltd and Metropol Credit Reference Bureau Ltd.

The number of credit reports requested by institutions stood at 2,036,634 in September 2012 up from 1,774,185 reports in June 2012, representing an increase of 14.8 percent or 262,449 reports. Over the same period, the number of reports requested by customers increased from 10,032 to 13,510 reports. The uptake of credit reports by banks demonstrates the importance of credit information sharing initiative as one of the mechanisms that will go a long way in mitigating credit risk in the Kenyan banking sector.

ii) Agency Banking

As at 30th September 2012, there were 10 commercial banks that had contracted 14,168 active agents facilitating over 24.7 million transactions valued at Ksh. 144.2 billion. This was an increase from 9 banks that had contracted 12,054 active agents facilitating over 18.7 million transactions valued at Ksh. 93.1 billion in June 2012.

iii) Deposit Taking Microfinance Institutions

As at 30th September 2012, 6 Deposit Taking Microfinance Institutions (DTMs) were in operation and had gross loans worth Ksh. 19.1 billion compared to Ksh. 17.9 billion registered in June 2012 thus translating to a growth of 6.7 percent. Similarly, the deposits base stood at Ksh. 13.8 billion representing a growth of 12.2 percent from Ksh. 12.3 billion in June 2012. The long-term borrowings by DTMs increased from Ksh. 6.4 billion in June 2012 to Ksh. 7.0 billion in September 2012. The number of DTMs deposit accounts and loan accounts stood at 1.7 million and 0.48 million respectively in September 2012 compared to 1.6 million deposit accounts and 0.47 million loan accounts registered at end of June 2012.

iv) Kenyan Banks Regional Footprint

As at 30th September 2012, ten Kenyan banks had established subsidiaries within the East African Community (EAC) Partner States and South Sudan. The subsidiaries had opened a total of 269 branches compared to 240 branches in June 2012. The subsidiaries posted a profit before tax of Ksh. 3.8 billion for the nine months to September 2012 up from Ksh. 2.5 billion for the six months to June 2012. Growth in profit was mainly supported by the increase in gross loans and advances from Ksh. 101.2 billion in June 2012 to Ksh. 118.9 billion in September 2012.

Banking Sector 2012 Outlook

The banking sector is expected to register improved performance compared to 2011 on the backdrop of innovations, adoption of cost effective channels and continued expansion of banks through new branches and subsidiaries operating in the EAC region.