DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 31ST MARCH 2012

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended March 31, 2012, the sector comprised 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions, 4 representative offices of foreign banks, 112 foreign exchange bureaus and 2 credit reference bureaus.

The Kenyan Banking Sector recorded improved performance with the size of assets standing at Ksh. 2.1 trillion, loans & advances worth Ksh. 1.2 trillion, while the deposit base was Ksh. 1.6 trillion and profit before tax of Ksh. 24.7 billion as at 31st March 2012. Over the same period, the number of bank customer deposit and loan accounts stood at 14,356,759 and 2,032,327 respectively.

Structure of the Balance Sheet

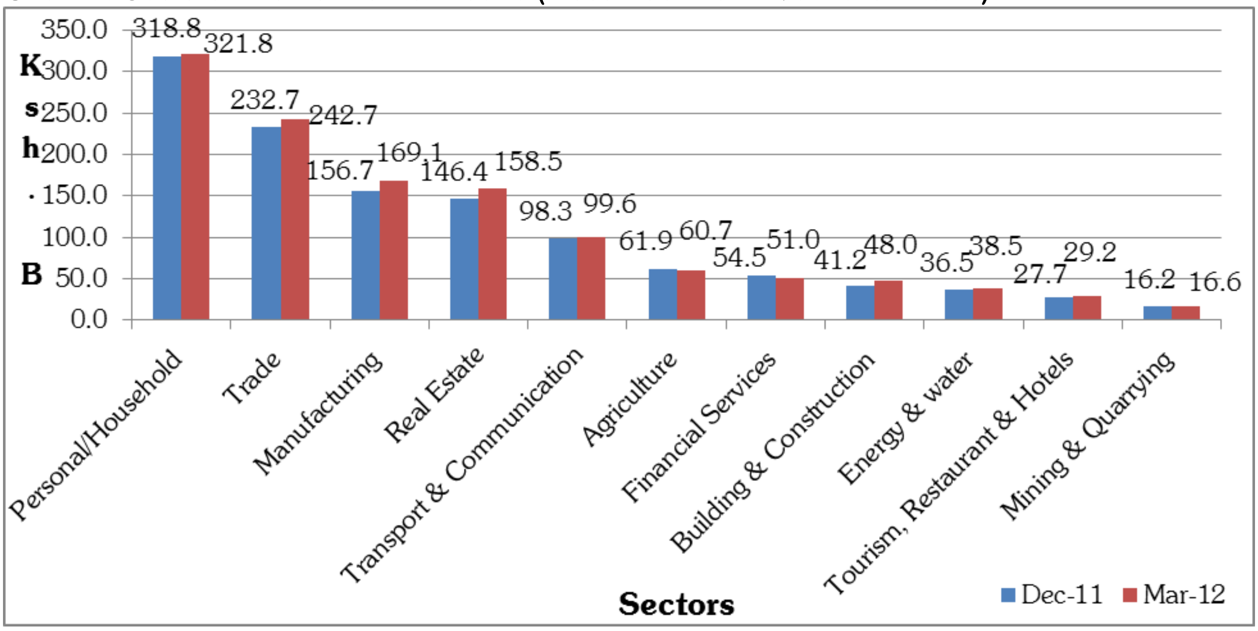
i) Assets

The banking sector's aggregate balance sheet expanded by 5.0 percent from Ksh. 2.0 trillion in December 2011 to Ksh. 2.1 trillion in March 2012. The major components of the balance sheet were loans and advances, government securities and placements, which accounted for 57 percent, 21 percent and 6 percent of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances grew from Ksh. 1.19 trillion in December 2011 to Ksh. 1.24 trillion in March 2012, translating to a growth of 4.2 percent. The growth was in 9 sectors as shown in Chart 1 with Agriculture and Financial Services sectors registering a decline occasioned by higher repayments than the new loans advanced to the sectors during the period.

Chart 1: Sectoral Distribution of Loans (December 2011 Vs March 2012)



iii) Deposit Liabilities

Deposits were the main source of funding for the banking sector, accounting for 75 percent of total funding liabilities. The deposit base rose by 4.7 percent from Ksh. 1.49 trillion in December 2011 to Ksh. 1.56 trillion in March 2012 mainly due to branch expansion, remittances and receipts from exports.

The number of bank branches increased by 13 from 1,161 in December 2011. Equally, the number of bank deposit accounts increased from 14.25 million in December 2011 to 14.36 million in March 2012 representing a growth of 0.11 million accounts or 0.8 percent.

iv) Capital and Reserves

The banking sector recorded improved capital levels in March 2012 with total capital growing by 3.8 percent from Ksh. 270.8 billion in December 2011 to Ksh. 280.9 billion in March 2012, whereas shareholders' funds increased by 1.4 percent from Ksh. 295.8 billion in December 2011 to Ksh. 299.8 billion in March 2012. Similarly, the ratios of total and core capital to total risk-weighted assets increased from 19.4 percent and 17.3 percent to 20.2 percent and 17.9 percent respectively.

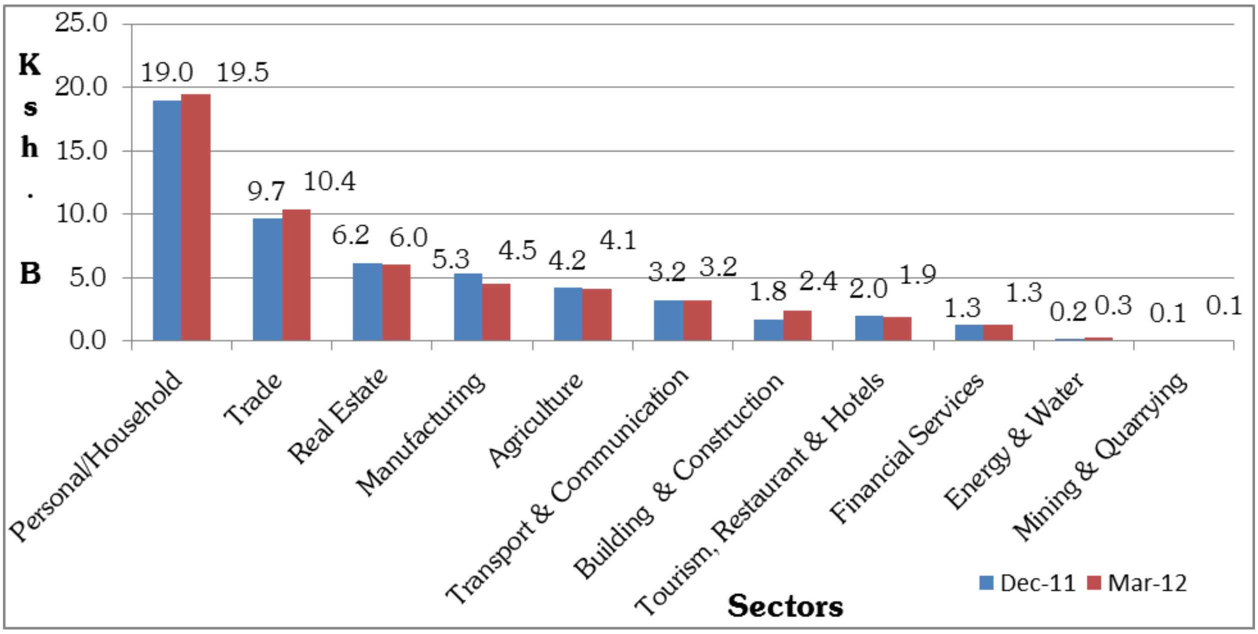
Other Banking Sector Performance Indicators

i) Assets Quality

The stock of gross non-performing loans (NPLs) increased by 1.3 percent from Ksh. 53.0 billion in December 2011 to Ksh. 53.7 billion in March 2012. However, the quality of assets, measured as a proportion of net non-performing loans to gross loans improved from 1.5 percent to 1.4 percent over the same period. Similarly, the ratio of gross NPLs to gross loans improved from 4.4 percent in December 2011 to 4.3 percent in March 2012.

During the period under review, 4 out of 11 sectors registered increase in NPLs as shown in Chart 2. The high lending interest rates contributed to increased NPLs; however, banks continue to deploy enhanced appraisal standards to mitigate credit risk.

Chart 2: Sectoral Distribution of NPLs (December 2011 Vs March 2012)



ii) Profitability

During the 1st quarter of 2012, the sector registered Ksh. 24.7 billion pre-tax profits, which was a decrease of 5.4 percent from Ksh 26.1 billion recorded in the quarter ending December 2011. Similarly, total income stood at Ksh. 88.4 billion in the first quarter being an increase of 8.9 percent from Ksh. 81.2 billion registered in the fourth quarter of 2011. Whilst total expenses increased by 15.6 percent from Ksh. 55.1 billion in the December 2011 quarter to Ksh. 63.7 billion in March 2012 quarter. On an annual basis, the profitability of the sector increased by 24.1 percent from the Ksh. 19.9 billion recorded in March 2011.

Interest on loans and advances, fees and commissions and government securities were the major sources of income accounting for 62 percent, 26 percent and 12 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 40 percent, 24 percent and 19 percent respectively.

iii) Liquidity of the Banking Sector

As at end of March 2012, liquid assets amounted to Ksh. 560.2 billion while total liquid liabilities stood at Ksh. 1,502.5 billion, resulting to an average liquidity ratio of 37.3 percent, against 37.0 percent registered in December 2011, and above the minimum statutory limit of 20 percent. The gross loans to deposits ratio increased from 78.6 percent in December 2011 to 79.5 percent in March 2012, an indication of increased intermediation by banks.

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.

The Credit Information Sharing (CIS) mechanism for the Banking institutions has successfully taken root with mandatory sharing of negative information on a monthly basis. All the 43 licensed commercial banks and institutions under the Deposit Protection Fund Board have been submitting negative credit information to the licensed CRBs within the required timeframes.

Since the launch of credit information sharing in July 2010, the number of credit reports requested by institutions stood at 1,542,988 in March 2012 up from 1,306,439 reports in December 2011, representing an increase of 18.1 percent or 236,549 reports. Over the same period, the number of reports requested by customers increased from 6,041 to 7,603 reports.

ii) Agency Banking

Following the roll out of the agent banking model in May 2010, commercial banks have been able to contract varied retail entities. These entities, such as security companies, courier services, pharmacies, supermarkets and post offices act as third party agents to provide cashin -cash-out transactions and other services in compliance with the laid down guidelines. As at 31st March 2012, there were 8 commercial banks that had contracted 10,066 active agents facilitating over 13 million transactions valued at Ksh. 64.8 billion.

The agent banking model is expected to facilitate commercial banks to provide banking services to their customers in a cost effective manner, particularly those who are currently unbanked or under banked.

iii) Deposit Taking Microfinance Institutions

As at 31st March 2012, 6 Deposit Taking Microfinance Institutions (DTMs) were in operation and had gross loans and advances worth Ksh. 17.2 billion compared to Ksh. 16.5 billion registered in December 2011 thus translating to a growth of 4.2 percent. Similarly, the deposits base stood at Ksh. 10.8 billion representing a growth of 8.0 percent from Ksh. 10.0 billion in December 2011. The long-term borrowings by DTMs increased from Ksh. 6.4 billion in December 2011 to Ksh. 6.8 billion in March 2012. The number of DTMs deposit accounts and loan accounts stood at 1,522,041 and 522,509 respectively in March 2012 compared to 1,404,677 deposit accounts and 476,188 loans accounts registered at end of December 2011.

Banking Sector 2012 Outlook

The banking sector is expected to sustain its growth momentum largely driven by adoption of cost effective delivery channels and increased presence of Kenyan banks in the East African Community Partner States and South Sudan. The downside risks of inflationary pressures and the resultant high interest rate regime are expected to abate in the course of the year.