PERFORMANCE AND DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 31st MARCH 2015

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended 31st March 2015, the sector comprised 43 commercial banks, 1 mortgage finance company, 10 microfinance banks, 8 representative offices of foreign banks, 86 foreign exchange bureaus, 14 money remittance providers and 2 credit reference bureaus.

The Kenyan Banking Sector recorded improved performance with the size of net assets standing at Ksh. 3.37 trillion, loans & advances worth Ksh. 2.04 trillion, while the deposit base was Ksh. 2.41 trillion and profit before tax of Ksh. 37.3 billion as at 31st March 2015. Over the same period, the number of bank customer deposit and loan accounts stood at 29,714,738 and 5,354,017 respectively.

Structure of the Balance Sheet

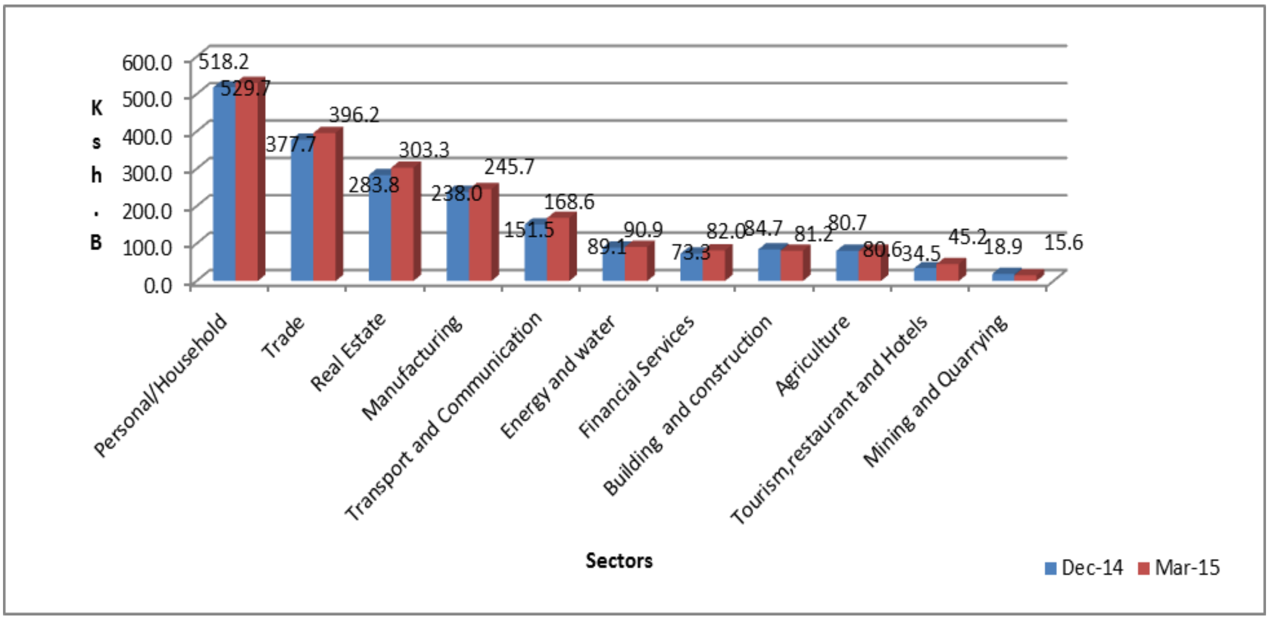
i) Assets

The banking sector's aggregate balance sheet grew by 3.4 per cent from Ksh.3.26 trillion in December 2014 to Ksh.3.37 trillion in March 2015. The major asset components were loans and advances, government securities and placements, which accounted for 58.2 per cent, 21.4 per cent and 5.2 per cent of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances increased from Ksh. 1.97 trillion in December 2014 to Ksh. 2.04 trillion in March 2015, translating to a growth of 3.6 per cent. The growth in loans was witnessed in all economic sectors except the Building and Construction, Mining and Quarrying, and the Agriculture sectors as shown in **Chart 1** below.

Chart 1: Sectorial Distribution of Loans (December 2014 vs. March 2015)



iii) Deposit Liabilities

Deposits were the main source of funding for the banking sector, accounting for 71.5 per cent of total liabilities. The deposit base grew by 3.4 per cent from Ksh. 2.33 trillion in December 2014 to Ksh. 2.41 trillion in March 2015 supported by branch expansion, remittances and increased use of alternative delivery channels of banking services such as agency banking model.

The number of bank deposit accounts increased from 28.4 million in December 2014 to 29.7 million in March 2015 representing a growth of 1.3 million accounts or 4.6 per cent.

iv) Capital and Reserves

The banking sector registered increased capital levels in March 2015 with total capital increasing by 4.3 per cent from Ksh. 508.4 billion in December 2014 to Ksh. 530.1 billion in March 2015, whereas shareholders' funds increased by 0.9 per cent from Ksh. 529.1 billion in December 2014 to Ksh. 533.9 billion in March 2015. However, the ratio of core capital to total risk-weighted assets increased from 15.9 per cent in December 2014 to 16.2 per cent in March 2015 and total capital to total risk weighted assets remained constant at 19.2 per cent at the end of the two quarters.

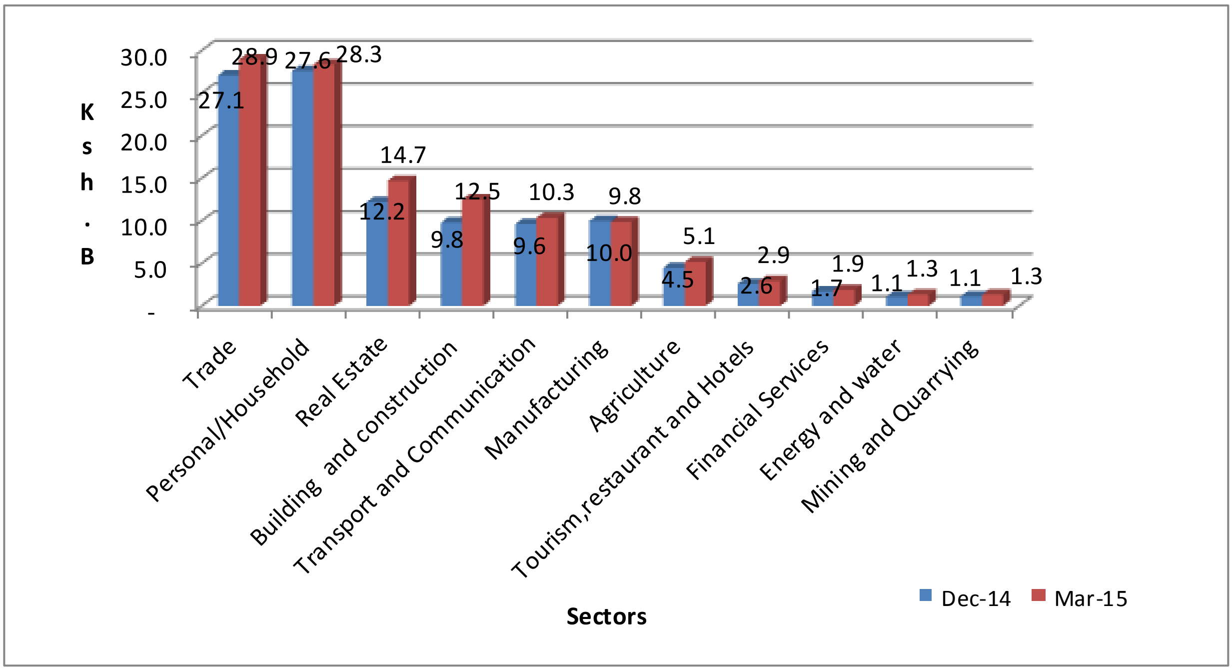
Other banking sector performance indicators

i) Assets Quality

The value of gross non-performing loans (NPLs) increased by 9.4 per cent from Ksh. 107.1 billion in December 2014 to Ksh. 117.2 billion in March 2015. The sector recorded an increase in the ratio of gross NPLs to gross loans from 5.4 per cent in December 2014 to 5.7 per cent in March 2015. However, the quality of assets, measured as a proportion of net non-performing loans to gross loans remained constant at 2.6 per cent over the same period.

During the period under review, 10 out of 11 economic sectors registered increases in NPLs as shown in Chart 2. The spill-over effects of high lending interest rates and challenges in the business environment in the first quarter of 2015 contributed to the increased NPLs. However, 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 Building and Construction, and Real Estate sectors whose NPLs increased by 27.55 per cent and 20.49 per cent respectively.

Chart 2: Sectorial Distribution of NPLs (December 2014 vs. March 2015)



ii) Profitability

During the 1st quarter of 2015, the banking sector recorded Ksh. 37.3 billion pre-tax profit, which was an increase of 2.7 per cent from Ksh. 36.32 billion registered in the quarter ending December 2014. Similarly, total income stood at Ksh. 110.03 billion in the first quarter of 2015 being a decrease of 1.6 per cent from Ksh. 111.84 billion in the fourth quarter of 2014. The total expenses decreased by 3.7 per cent from Ksh. 75.52 billion in December 2014 quarter to Ksh. 72.73 billion in March 2015 quarter. On an annual basis, the profitability of the sector increased by 11.7 per cent from Ksh. 33.4 billion registered in March 2014 to Ksh. 37.3 billion in March 2015.

Interest on loans and advances, fees and commissions and interest on government securities were the major sources of income accounting for 61.0 per cent, 16.4 per cent and 15.3 per cent of total income respectively. On the other hand, interest on deposits, salaries and wages and other expenses were the main components of expenses, accounting for 35.3 per cent, 26.7 per cent and 22.3 per cent respectively.

iii) Liquidity of the Banking Sector

For the quarter ended 31st March 2015, average liquid assets stood at Ksh. 938.6 billion while average liquid liabilities were worth Ksh. 2,355.3 billion, resulting to an average liquidity ratio of 39.9 per cent, against 37.7 per cent registered in December 2014, which was above the minimum statutory limit of 20.0 per cent.

B. BANKING SECTOR POLICY DEVELOPMENTS

i) Credit Reference Bureaus

The credit information sharing mechanism has continued to expand since its launch in July 2010. The cumulative number of credit reports requested by institutions stood at 6,098,916 in March 2015 up from 5,271,995 reports in December 2014, representing an increase of 15.7 per cent. Over the same period, the number of reports requested by customers increased from 88,536 to 101,288.

The number of credit reports requested by banks increased from 492,722 registered in the quarter ending December 2014 to 826,921 reports registered in the quarter ending March 2015. Credit reports requested by customers increased from 11,134 to 12,752 over the same period.

ii) Agency Banking

Since the rollout of the agency banking model in May 2010, commercial banks have continued to contract varied retail entities to offer basic banking services. 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 31st March 2015, there were 16 commercial banks that had contracted 34,381 active agents which had facilitated over 149.4 million transactions valued at Ksh. 817.7 billion.

The number of banking transactions undertaken through agents increased from 9.3 million registered in the quarter ending December 2014 to 13.4 million transactions registered in the quarter ending March 2015. Similarly, the value of banking transactions undertaken through agents increased from Ksh. 55.7 billion to Ksh.74.7 billion over the same period.

iii) Microfinance Banks

As at 31st March 2015, there were 10 Microfinance Banks (MFBs) in operation which had granted loans and advances worth Ksh.40.8 billion compared to Ksh. 40 billion registered in December 2014 thus translating to a growth of 2 per cent. The MFBs deposit base stood at Ksh. 32.5 billion as at March 2015 representing a decline of 0.6 per cent from Ksh. 32.7 billion in December 2014. The long-term borrowings by the MFBs decreased from Ksh. 6.9 billion in December 2014 to Ksh. 4.9 billion in March 2015 signalling increased reliance on deposits as a source of funding customers' loans. The number of MFBs deposit accounts and loan accounts stood at 2,310,742 and 440,517 respectively in March 2015 compared to 2,254,591 deposit accounts and 457,631 loan accounts registered at end of December 2014. The increase in MFBs deposit accounts was as a result of enhanced deposit mobilisation efforts while reduction in loans accounts was due to introduction of new products that necessitated merging of some existing loan accounts.

C. Banking sector 2015 Outlook

The Kenyan banking sector is expected to remain stable and resilient in the remainder of 2015. The capital buffer requirement that took effect from January 2015 will enhance the resilience of the banking sector as banks explore new opportunities in Kenya and beyond.