PERFORMANCE AND DEVELOPMENTS IN THE KENYAN BANKING SECTOR FOR THE QUARTER ENDED 30th JUNE 2015

A. OVERVIEW OF THE BANKING SECTOR PERFORMANCE

During the quarter ended 30th June 2015, the sector comprised 43 commercial banks, 1 mortgage finance company, 12 microfinance banks, 8 representative offices of foreign banks, 86 foreign exchange bureaus, 14 money remittance providers and 3 credit reference bureaus.

The Kenyan Banking Sector's performance improved with the size of total assets standing at Ksh. 3.60 trillion, gross loans worth Ksh. 2.17 trillion, while the deposit base was Ksh. 2.57 trillion and profit before tax of Ksh. 76.91 billion as at 30th June 2015. Over the same period, the number of bank customer deposit and loan accounts stood at 31,570,749 and 6,033,279 respectively.

Structure of the Balance Sheet

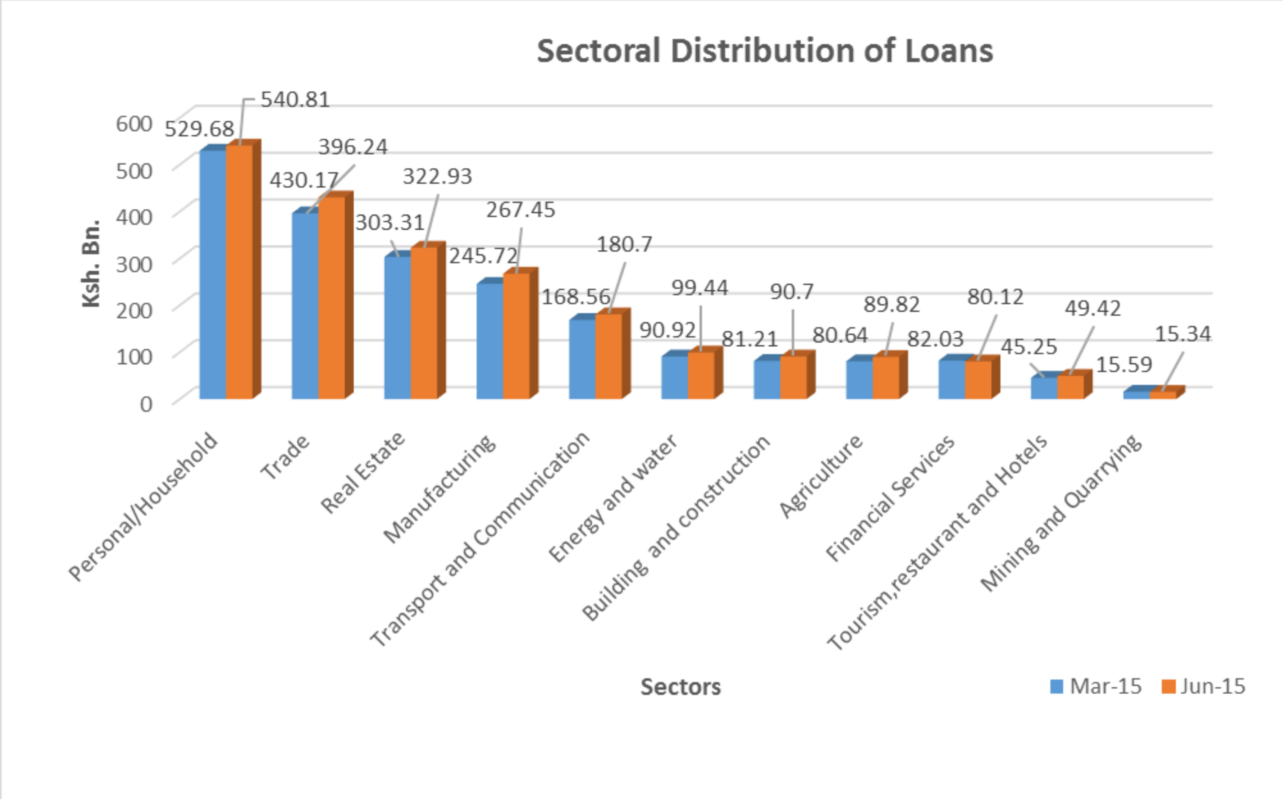
i) Assets

The banking sector's aggregate balance sheet grew by 6.8% from Ksh. 3.37 trillion in March 2015 to Ksh. 3.60 trillion in June 2015. The major asset components were local and foreign currency loans, government securities and placements which accounted for 58.0%, 20.4% and 5.3% of total assets respectively.

ii) Loans and Advances

The sector's gross loans and advances increased from Ksh. 2.04 trillion in March 2015 to Ksh. 2.17 trillion in June 2015, translating to a growth of 6.4%. The growth in loans was witnessed in all economic sectors except Financial Services and Mining and Quarrying sectors which reduced by 2.3% and 1.6% respectively as shown in Chart 1.

Chart 1: Sectoral Distribution of Loans (March 2015 vs. June 2015)



iii) Deposit Liabilities

Deposits were the main source of funding for the banking sector, accounting for 71.4% of total liabilities. The deposit base grew by 6.6% from Ksh. 2.41 trillion in March 2015 to Ksh. 2.57 trillion in June 2015 which was supported by branch expansion and increased use of alternative delivery channels of banking services such as agency banking model.

The number of Commercial banks deposit accounts increased from 29.7 million in March 2015 to 31.6 million in June 2015 representing a growth of 1.9 million accounts or 6.4%.

iv) Capital and Reserves

The banking sector registered increased capital levels in the quarter ended June 2015 with total capital increasing by 3.6% from Ksh. 530.1 billion in March 2015 to Ksh. 549.0 billion in June 2015. Shareholders' funds increased by 1.8% from Ksh. 533.9 billion in March 2015 to Ksh. 543.3 billion in June 2015. However, the ratio of core capital to total risk-weighted assets reduced from 16.2% in March 2015 to 15.7% in June 2015 and total capital to total risk weighted assets reduced from 19.2% in March 2015 to 18.9% in June 2015. The drop in capital adequacy ratios is mainly attributable to a faster growth in risk weighted assets as compared to growth in capital.

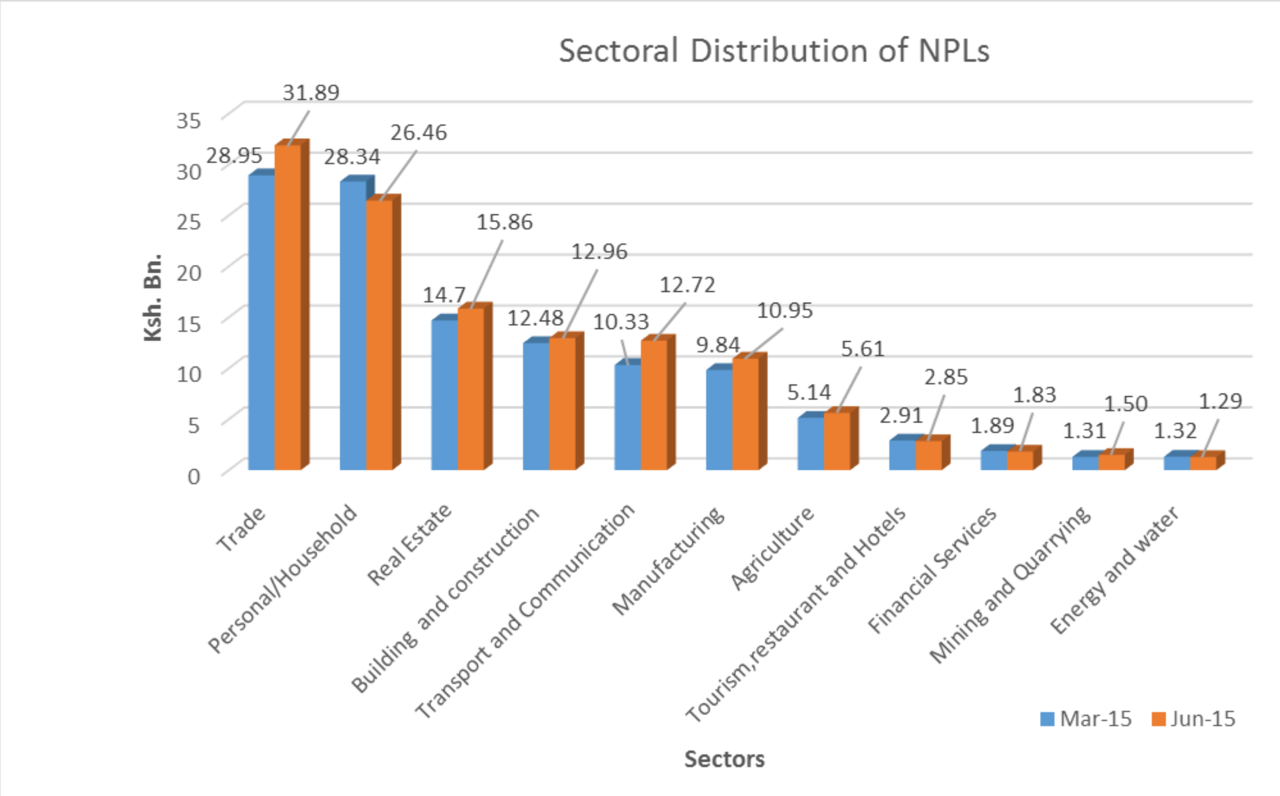
B. Other Banking Sector Performance Indicators

i) Asset Quality

The value of gross non-performing loans (NPLs) increased by 5.7% from Ksh. 117.2 billion in March 2015 to Ksh. 123.9 billion in June 2015. The quality of assets, measured as a proportion of net non-performing loans to gross loans slightly rose from 2.6% in March 2015 to 2.7% in June 2015. However, the ratio of gross NPLs to gross loans remained constant at 5.7% over the same period.

During the quarter under review, 7 out of 11 economic sectors registered increases in NPLs as shown in Chart 2. 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 Trade and Transport and Communication whose NPLs increased by 10.2% and 23.1% respectively. The sector with the highest decrease in NPLs in the same period was Personal/Household sector which recorded a decrease of 6.6%.

Chart 2: Sectoral Distribution of NPLs (March 2015 vs. June 2015)



ii) Profitability

The banking sector recorded Ksh. 39.61 billion pre-tax profits in the quarter ended June 2015, which was an increase of 6.2% from Ksh. 37.3 billion registered in the quarter ending March 2015. Similarly, total income of Ksh. 116.29 billion was generated in the 2nd quarter of 2015 being an increase of 5.7% from Ksh. 110.03 billion in the 1st quarter of 2015. The total expenses increased by 5.4% from Ksh. 72.73 billion in quarter ended March 2015 to Ksh. 76.68 billion in quarter ended June 2015. On an annual basis, the profitability of the sector increased by 5.3% from Ksh. 37.61 billion registered in June 2014 to Ksh. 39.61 billion in June 2015.

Interest on advances, other income and interest on government securities were the main sources of income accounting for 60.4%, 16.4% and 15.5% of total income respectively. On the other hand, interest on deposits, salaries and wages and other expenses were the major components of expenses, accounting for 35.6%, 26.6% and 22.4% of total expenses respectively.

iii) Liquidity of the Banking Sector

For the quarter ended 30th June 2015, average liquid assets stood at Ksh. 970.1 billion while average liquid liabilities were worth Ksh. 2,507.3 billion, resulting to an average liquidity ratio of 38.7% as compared to 39.9% registered in March 2015. Despite the marginal drop in the liquidity as at June 2015, the ratio remained above the minimum statutory limit of 20.0%.

C. 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 7,545,757 in June 2015 up from 6,098,916 reports in March 2015. Over the same period, the number of reports requested by customers increased from 101,288 to 111,633.

The number of credit reports requested by banks increased from 826,921 in the quarter ending March 2015 to 1,446,841 reports requested in the quarter ending June 2015.Credit reports requested by customers decreased from 12,752 to 10,345 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 on their behalf. 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 30th June 2015, there were 17 commercial banks that had contracted 36,080 agents which had facilitated 175.4 million cumulative transactions valued at Ksh. 930.1 billion. As at 31st March 2015, 16 commercial banks had 34,381 cumulative agents since the rollout which had facilitated 149.4 million transactions valued at Ksh. 817.5 billion.

The number of banking transactions undertaken through agents increased from 13.4 million in the quarter ending March 2015 to 25.9 million transactions in the quarter ending June 2015. Similarly, the value of banking transactions undertaken through agents increased from Ksh. 74.7 billion to Ksh. 112.7 billion over the same period.

iii) Microfinance Banks

As at 30th June 2015, there were 12 Microfinance Banks (MFBs) in operation. The 2 new Microfinance institutions in this quarter are Choice Microfinance Bank Ltd and Daraja Microfinance Bank Ltd. All the Microfinance Banks had granted loans and advances worth Ksh. 43.3 billion compared to Ksh. 41.1 billion as at the end of March 2015 thus translating to a growth of 5.4%. The MFBs deposit base stood at Ksh. 39.7 billion as at June 2015 representing an increase of 0.8% from Ksh. 39.4 billion in March 2015. The long-term borrowings by the MFBs increased from Ksh. 4.7 billion in March 2015 to Ksh. 8.1 billion in June 2015 signalling decreased reliance on deposits by MFBs as a source of funding customers' loans. The number of MFBs deposit accounts and loan accounts stood at 2,366,799 and 434,752 respectively in June 2015 compared to 2,320,637 deposit accounts and 440,517 loan accounts registered as at the end of March 2015.

iv) Kenya Banks' Reference Rate (KBRR) Framework

The Kenya Banks' Reference Rate (KBRR) Framework was rolled out effective 8th July 2014 to promote transparency and disclosure on pricing of credit by banks. KBRR is a common interest rate base for all banks and the banks are required to explain to their customers and Central Bank of Kenya the makeup of any premium levied above KBRR.

KBRR is computed as an average of the Central Bank Rate (CBR) and the two-month weighted moving average of the 91-day Treasury bill rate. The Central Bank of Kenya, through the Monetary Policy Committee, reviews KBRR every six months. At rollout, KBRR was set at 9.13% and was reviewed to 8.54% in January 2015.

D. Banking Sector Outlook for Q3 of 2015

The Kenyan banking sector is foreseen to remain stable and maintain an upward growth trend in the remainder of 2015. The growth momentum will be underpinned by on-going efforts by the Central Bank and the National Treasury to ensure a stable macro-economic environment.