*PwC analysis of major banks' results for the reporting period ended 30 June 2013*
18 September 2013

# *Finding strength in adversity*
# South Africa – Major banks analysis

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# *Contents*


| | |
|---|---|
| 1. Combined results overview | 3 |
| 2. Economic outlook | 6 |
| 3. Net interest income | 8 |
| 4. Non-interest revenue | 10 |
| 5. Efficiency | 12 |
| 6. Asset quality | 13 |
| 7. Capital and funding | 16 |
| 8. Aligning financial services businesses with new global dynamics | 20 |
| 9. Key banking statistics | 26 |
| 10. Industry data | 28 |
| 11. Contacts | 31 |

# 1. Combined results overview

*This analysis presents the combined local currency results of South Africa's major banks (Absa, FirstRand, Nedbank and Standard Bank). Investec, the other major player in the South African market, has not been included due to its unique business mix, different currency reporting methodology and reporting period.*

*This analysis is unique in that it aims to aggregate the results of the major banks with a view to identifying common trends and issues currently shaping the financial services landscape, as it builds on our previous analyses over the last two years.*

***Compared to 1H12:***

*Combined headline earnings up* **11.5%**

*Impairment expenses up* **6.7%**

*Total operating income up* **9.0%**

*Operating charge up* **6.6%**

*and Average return on equity of* **16.1%**

In June 2013 we launched the 13th edition of the PwC banking survey on Banking in South Africa – *Shaping the bank of the future*.

We have examined the combined results of the major banks in the context of the themes identified in our banking survey. We also provide an executive summary of the findings of our survey in Section 8 of this report.

## External developments

With most of the major advanced economies recording growth at levels below potential, the global economic recovery is still struggling to gather momentum. While there are signs of positive economic growth and rising employment in the world's largest economy, the United States, a number of risks to its growth outlook remain. These risks mainly come in the form of uncertainties relating to additional fiscal consolidation, the impact of rising long-term interest rates in response to expectations of a tapering of asset purchases by the Federal Reserve and continued uncertainty over debt ceiling levels. These developments precipitated revised growth forecasts by the IMF, which in July downgraded its projections of global economic growth to 3.1% for 2013.

This is now their fifth consecutive downgrade of 2013 global growth prospects since early 2012.

Signs of positivity flickered across the global economy in August 2013 when the 18-month double-dip recession in the eurozone, the longest since the creation of the single currency, officially ended. This was brought about by modest growth driven by industrial production and a relatively stronger than anticipated performance from some countries in the region's core, including its biggest economy, Germany.

However, with speculation of a new bailout needed in Greece, public finances remaining generally bad and the economic climate fragile in most countries on the region's periphery, many commentators believe that a 'subdued' eurozone recovery is probably the best global markets can hope for in 2013.

Considering further factors shaping sentiment, from monetary policy changes in Japan to instability in China's banking system, global financial markets continue to face considerable volatility. In summary, the substantial stimulus provided by central banks and fiscal authorities has translated into only a marginal improvement in the global economic outlook with questions remaining about its sustainability.

In South Africa, the imbalance caused by the large current account deficit highlights our economy's reliance on foreign capital flows to fund growth and its vulnerabilities to global economic developments.

The impact of subdued global demand and a challenging domestic economic climate means that South Africa's economic growth levels remain well below pre-crisis averages.

Growth remains below the level necessary to effectively reduce high unemployment rates and fully support and utilise manufacturing capacity. Meanwhile, labour unrest across various industry sectors continues to overshadow the domestic economic debate.

The South African economic growth outlook remains sensitive to this context and low growth prospects negatively affect local banks from the perspective of hampering the writing of new business, impeding credit extension and challenging their ability to sustain robust earnings growth.

## Macro trends

In our banking survey we highlighted the significant opportunity banks in South Africa have given the increase in emerging market trade flows.

It is therefore not surprising that the rest of Africa operations of our major banks are receiving prominence in their latest set of results. However, at present, given the nature of the disclosures and the development life cycle of operations, it is difficult to aggregate the results of the major banks' operations in Africa. As these operations grow and their contribution to earnings grow, we expect investors will seek additional disclosures of the returns generated from African operations.

From the banks published information available, we continue to observe strong trading performances from the banks' African operations given the strong economic performance being experienced in many countries across the continent. While the relative contribution of these operations to the banks' bottom line remains generally low given the various stages of development, it is expected to increase substantially as the banks continue to gain traction on the execution of their strategies for Africa. These strategies are interesting in their variety and the returns vary depending on the maturity of the market and the level of development of the banks' in-country operations. What is consistent is that each of the banks is focusing on growing their presence in a number of countries simultaneously, which is taking up a considerable part of management time.

The weak Rand helps with the translation of dollar-based earnings to local currency, but set-up costs and operational costs in such jurisdictions will weigh more heavily on the minds of banks' management teams as they weigh up the need to grow with the ever-increasing cost of funding that growth.

## *Internal responses*

We reported in our banking survey that banks will continue with their relentless focus on cost with an aim of reducing their cost bases by 5% in each of the next two years. The reduction in the banks' cost-to-income ratio to 54.1% bears testimony to the success of the cost containment strategies implemented which continued from previous periods.

Innovation remains a priority and the market has seen a number of new products launched in an attempt to attract new customers to banks and encourage them to use cheaper electronic channels, facilitating less spend or investment in new and expensive branch infrastructure. This focus is part of the banks strategy of finding mechanisms to increase transaction flows as apposed to increasing prices in an effort to generate non-interest revenue.

Technology is seen as one of the key enablers of innovation and efficiency as well as aiding with customer service, enhancing the customer experience and retention. As reported in our banking survey, investment in technology remains high and each of the banks is busy with large internal systems or process implementations, with a view to increasing efficiency in the medium to longer term. These projects are complex, costly and consequently a drag on ROE until the benefits of better processes are achieved. We expect that our banks will seek to optimise their staff levels if increased automation and efficiency is achieved through new technology.

Customer centricity is not a new term, but we have seen renewed effort by our banks to focus on onboarding new clients and retaining existing ones. Loyalty plans continue to be an important driver to attract and retain customers.

For example, Standard Bank relaunched their loyalty plan this year while the other banks have focused on emphasising and enhancing their current offerings.

## *Stakeholder expectations*

Our research reveals that while a world of lower nominal return on equity (ROE) is a natural function of the scale of regulatory change facing the banking industry, changes to bank capital requirements and funding structures will reduce balance sheet gearing and, therefore, risk within banking systems – a scenario we describe as 'the new economics of banking'.

With the implementation of Basel III in South Africa from 1 January 2013, the banking industry has transitioned towards the most significant regulatory change since the adoption of Basel II. Nevertheless, all banks reported that they have successfully transitioned to Basel III.

Despite the transition to Basel III, the aggregated ROE of the major banks is still strong at 16.1%, compared to 15.9% in the prior six-month period and 15.6% in the comparable period last year. This, however, does not reflect the different circumstances that exist at each of the different banks, particularly those that have significant capital tied up in African operations, where they are in the process of building businesses. This compares favourably to the average ROE of the top 4 banks in each of the BRICS countries as set out in figure 1.2. Our banking survey highlights regulatory reform as the most significant development, most pressing issue and most significant weakness facing the South African banking industry at present. We expect that regulatory change will continue to play a significant role in banks' strategies and results going forward, particularly as higher capital levels in terms of Basel III are phased in.

## *Combined results*

Impacted by global and domestic economic sentiment on the one hand, and the broader operating environment on the other, the themes underpinning the performance of South Africa's major banks for the latest reporting period to June 2013 are in many ways reflective of the headwinds economies across the world remain sensitive to.

Against this backdrop, the major banks continue to focus on their domestic stengths and building their banking footprint in selected markets across the continent. Headline earnings grew 11.5% on the comparable period (1H12) and 6.8% on the prior period (2H12).

Core earnings rose 12.4% on 1H12 and 5.0% on 2H12, which highlights that these results have been achieved within an environment of commendable revenue growth of 9% on 1H12.

This has been driven by both net interest income (NII) growth of 11.7% and non-interest income (NIR) growth of of 6.4%. Combined impairment charges have continued their upward trend and grew by 6.7%, but the story for each of the contributing banks remains quite different in this area.

From a lending perspective, the major banks' combined gross loan growth of 7.2% came primarily from corporate lending, strong card lending, overdrafts, instalment credit and leases. Mortgage growth remains muted in the context of a stubborn real estate market.

Concern about the extent of unsecured lending growth has continued in the last six months and the banks have highlighted that they continue to reduce this type of lending while providing appropriately for their current exposure in this segment. The National Credit Regulator has noted that the number of consumers with impaired credit records increased by 189,000 accounts to 9.53m accounts during Q1 2013 highlighting the pressure consumers are under despite the current low interest rates. In response, the Banking Association of South Africa has announced plans to propose changes to lending rules for unsecured lending in an effort to respond to concerns of rising bad debts in this lending category.

## *Prospects*

Most banks were cautious about their prospects in the short to medium term. The trend of slower growth in 1H13 when compared to 2H12, reflects this caution. Bearing testimony to this – the combined profit for this period compared to the previous six months grew by 5.6%, which is slower than the 9.9% growth experienced in the second half of 2012.

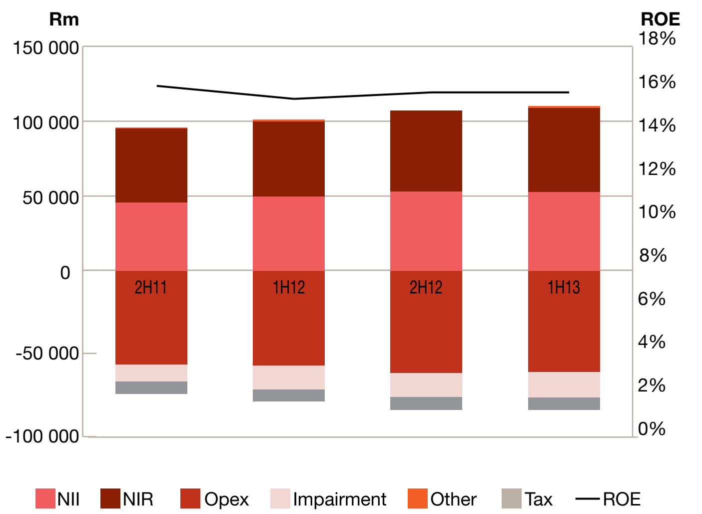
Slower growth should be seen in the context of the economic environment described earlier, the strong capital position of our banks, their significant investments in technology and their expanding geographical reach. Our view remains that execution in the areas of specific focus will continue to be the key differentiator. Central to each of the individual banks' strategies will also be the optimal utilisation of capital as they look to expand across Africa within a changing regulatory framework.

## Combined results of six-month periods (Rm)

| | 1H13 | 2H12 | 1H12 | 2H11 | 1H13 vs 2H12 | 1H13 vs 1H12 |
|---|---|---|---|---|---|---|
| Net interest income | 56 182 | 54 285 | 50 309 | 49 676 | 3.5% | 11.7% |
| Non-interest revenue | 52 610 | 52 833 | 49 460 | 45 529 | -0.4% | 6.4% |
| **Total operating income** | **108 792** | **107 118** | **99 769** | **95 205** | **1.6%** | **9.0%** |
| Total operating expenses | -61 168 | -61 766 | -57 402 | -56 532 | -1.0% | 6.6% |
| **Core earnings** | **47 624** | **45 352** | **42 367** | **38 673** | **5.0%** | **12.4%** |
| Impairment charge | -15 123 | -14 140 | -14 177 | -10 201 | 7.0% | 6.7% |
| Other income/(expenses) | 1 209 | -642 | 1 312 | 515 | -288.3% | -7.9% |
| Discontinued operations | - | 2 004 | 431 | 390 | -100.0% | -100.0% |
| Income tax expenses | -7 563 | -7 817 | -7 412 | -7 741 | -3.2% | 2.0% |
| **Profit for the period** | **26 147** | **24 757** | **22 521** | **21 636** | **5.6%** | **16.1%** |
| | | | | | | |
| Attributable earnings | 23 376 | 23 161 | 21 276 | 21 571 | 0.9% | 9.9% |
| **Headline earnings from continuing operations** | **23 721** | **22 210** | **21 282** | **20 306** | **6.8%** | **11.5%** |
| | | | | | | |
| **Return on equity** | **16.08%** | **15.90%** | **15.60%** | **16.15%** | **1.1%** | **3.0%** |

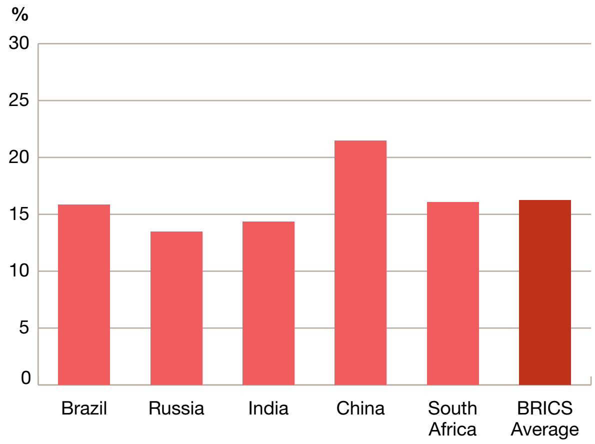
*Source: PwC analysis*

### Figure 1.1 Combined income statement of the major banks



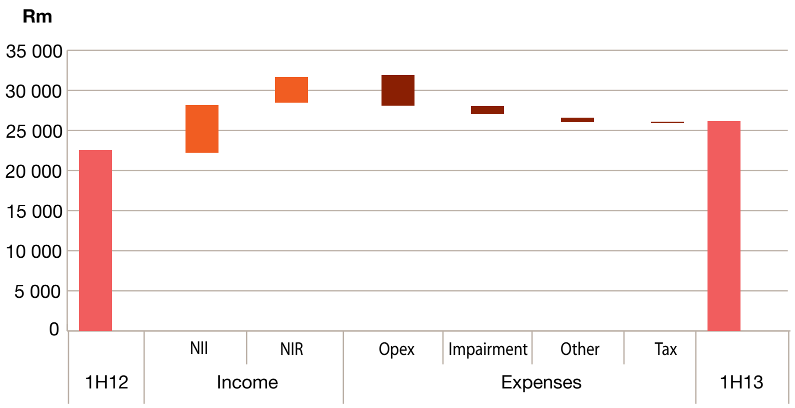

*Source: PwC analysis*

### Figure 1.2 Average bank ROEs




*Source: Latest reported information – Thompson Reuters / Barrons / Moneycontrol*

### Figure 1.3 Key drivers of profit and loss




*Source: PwC analysis*

# 2. Economic outlook

By Dr Roelof Botha, economic advisor to PwC

## *Reversal of bond yield trend placing pressure on the fiscus*

The abrupt end of the downward trend in bond yields has caught many financial analysts and economists by surprise.

Lethargic economic recovery after the 2008/09 recession in most advanced economies and a number of prominent emerging markets resulted in the most stimulatory monetary policy in decades, leading to record low interest rates over the past twelve months.

In the US, the 10-year government bond yield declined to 1.5% in early June last year and then settled at a level of around 1.7% until the beginning of May. Since then, it has gained more than 110 basis points, trading at 2.8% at the end of August.

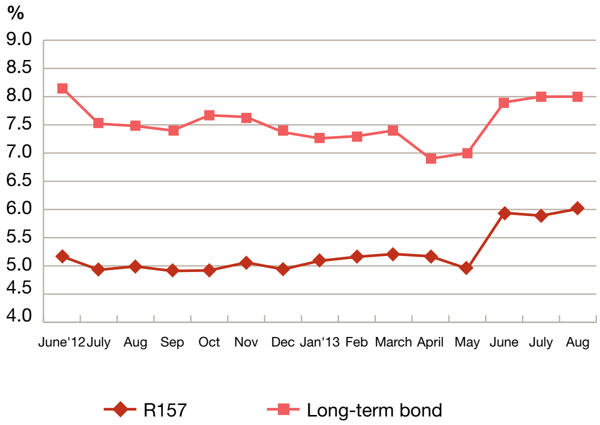
South African long-term bonds have followed suit, gaining marginally more than 100 basis points between April and August 2013.

The most plausible explanation forwarded for the jump in capital market interest rates is the imminent unwinding of the policy of quantitative easing by the US Federal Reserve and potentially other central banks around the globe, combined with fears over higher inflation.

This practice of monetary accommodation virtually guaranteed cheap credit across the full spectrum of money market and capital market rates (Greece was a notable temporary exception during the onset of its fiscal instability).

In South Africa, the recent change in the long-term bond yield trend was, rather surprisingly, matched by the R157, which jumped from below 5% in May 2013 to above 6% at the end of August.

**Figure 2.1 Interest rates**




***Source: SARB, Thebe Securities***

The short- to medium-dated R157, which matures in three tranches of R24 billion each in September 2014, 2015 and 2016, respectively, has been acting as a proxy for money market rates over the past year.

The increase in the yield on this bond, a portion of which has effectively become a money market instrument, suggests that the next movement in the repurchase rate (repo rate) of the South African Reserve Bank (SARB) is likely to be upwards. Until the swing in bond yields, speculation was rife as to the possibility of a further repo rate cut, mainly due to a need to stimulate economic activity. Although the South African economy has recorded 15 successive quarters of positive real GDP growth, the pace of output growth is below that of the country's peers in emerging markets and declined to below 2% during the first quarter of 2013 (annualised).

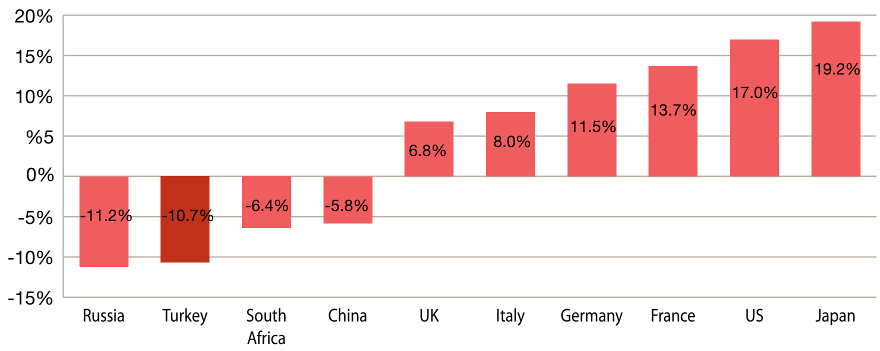
As confirmed by the trends in Figure 2.1, the narrowing of the gap between the yields on the R157 bond and the long-term government bond represents somewhat of a paradox. Bond investors typically expect a premium for a longer-dated maturity, due to the higher risk associated with uncertainty over a longer redemption period.

A clue to the jump in the short-term government bond yield was provided with the release of July's consumer price index (CPI) by Statistics SA. Consumer inflation jumped from an annualised rate of 5.5% in June to 6.3% in July.

Although an increase in the CPI was widely anticipated by economists, mainly due to relentless increases in administered prices, the extent of the escalation in prices was alarming. Regulated administered prices in South Africa have increased by 12.7% since July 2012 and this has not been matched by higher levels of efficiency in public service delivery.

Within government's economic policy establishment, the cat is no doubt among the pigeons. It is not surprising that the Minister of Finance has already stated his concern over the escalation of inflation, as it entails a direct increase in government expenditure at a time when taxation revenues are under pressure.

**Figure 2.2 Equity market performance in US-dollar terms (Jan-Aug 2013)**




***Source: Economist Intelligence Unit***

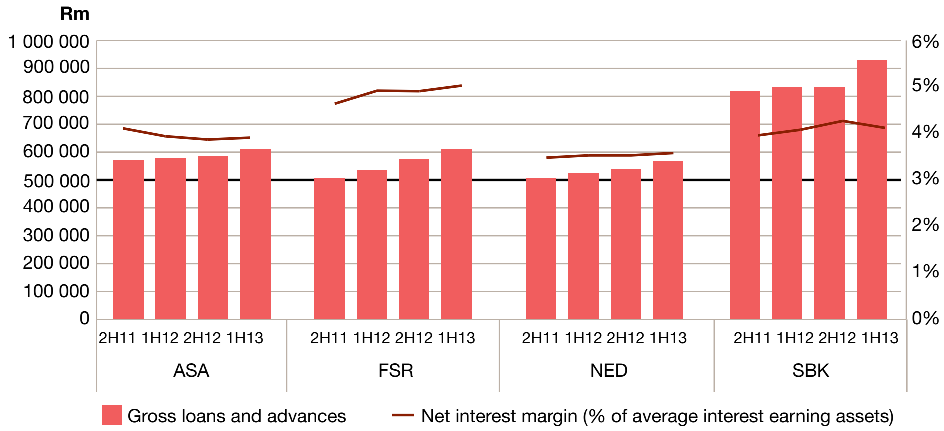
An immediate result of higher global bond yields has been to raise the return on bonds of advanced countries relative to emerging markets, with a predictable strengthening of currencies in most high-income countries. In US dollar terms, this has also placed pressure on secondary capital markets of developing countries, a trend that may continue during at least the remainder of 2013.

# 3. Net interest income

**Net interest margin (Rm)**

| | Combined | | | |
|---|---|---|---|---|
| | **1H13** | **2H12** | **1H12** | **2H11** |
| Gross loans and advances to customers | **2 665 425** | 2 486 685 | 2 413 619 | 2 351 850 |
| Net interest margin (% of average interest earning assets) | **4.16%** | 4.15% | 4.12% | 4.05% |

**Figure 3.1 Net interest margin and advances**




*Source: PwC analysis*

## Credit growth

The ongoing low growth in credit extension continues but there are some signs of growth which sustain the trends we have highlighted previously.

Total industry credit growth in loans was 1.7% for 1Q13 and 1.3% in 2Q13. For the major banks, we saw credit extension in the form of loans and advances increase 7.2% on 2H12 and 10.4% on 1H12.

This loan growth remains higher than the negative industry growth experienced in 2009 and lending by the major banks remains focused. We continue to see growth in higher yielding advances in the form of vehicle and asset finance and unsecured lending. Some of the banks have also alluded to the fact that longer dated lending to corporates has increased, which could be a sign that the impact of Basel III on the pricing of these transactions has now been embedded and the banks are comfortable in the pricing of transactions under the new regulatory framework. In addition, Africa expansion continues to have a positive impact on loan book growth and, whilst it is difficult to estimate this growth, these loans would typically attract risk profiles which result in higher margins for banks.

Housing credit growth continues to be weak (up 1.4% on 1H12 and 1.0% on 2H12) as consumers take advantage of record low interest rates to repay debt. The lower interest rates seen over the past year have continued this trend and the banks are reporting positive run off of older mortgage advances. In contrast, better pricing on new mortgages continues to have a positive impact on interest margin.

## Customer deposits

The broad trends in bank funding from customers are largely unchanged over the past six months.

Core bank deposits grew by 6.6% in 1H13, compared to 10.9% over the previous twelve months. The banks are reporting that the growth in deposits has been from increased corporate and retail deposits which have longer tenor expectations than wholesale and institutional deposits as banks continue their funding efforts due to Basel III liquidity requirements.

This is supported by total industry data reflecting a 4.5% increase in deposits, driven primarily by a 5.7% increase in deposits by corporate customers and a 3.7% increase in deposits from retail customers. Both funding categories grew in relative share of total deposits at the expense of government and related deposits.

## Hedge portfolios

Overall hedging strategies have remained effective in decreasing the volatility caused by the endowment effect.

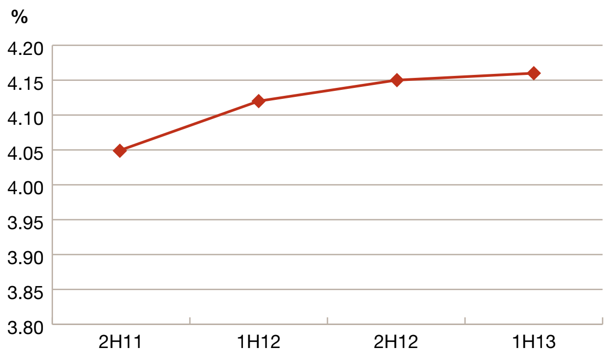
The interest rate volatility seen in the final quarter of the reporting period has yet to play itself out fully in the earnings of the major banks. The impact can be seen in the moving hedge reserves for two major banks and this will be reflected in their interest margin over the coming months.

## *Net interest margin*

Net interest margin growth has continued along the same trajectory we have reported on previously, largely driven by the movements in balance sheet composition mentioned earlier.

The relatively stable average interest margin (4.16%) can primarily be attributed to asset mix and better pricing for risk. This upward trend should start to slow as we continue to move through the cycle of reduced interest rates, increasing bad debts and as the funding profiles of the banks stabilise under Basel III.

**Figure 3.2 Combined net interest margin (% of average interest earning assets)**




***Source: PwC analysis***

# 4. Non-interest revenue

NIR is primarily driven by fee and commission income, which represents 70% of the total for 1H13. This is in line with the relative contribution of 70% in 2H12.

NIR is primarily driven by fee and commission income, which represents 70% of the total for 1H13. This is in line with the relative contribution of 70% in 2H12.

Trading income increased moderately in 1H13 as a result of difficult trading conditions and continuing global economic uncertainty.

Banks continue to focus on client flows and minimising the volatility associated with proprietary trading, given the more onerous Basel III capital rules. While volatility persists, customer flows should remain robust, but the positioning of portfolios can be a significant challenge when there is lack of market direction.

We have also observed a strong trading performance from the banks' African trading operations, given the strong economic growth being experienced in many African countries. While the relative contribution of these operations to the banks' bottom line currently remains low, it is expected to increase substantially as the banks execute on their African ambitions.

## Net fee and commission income

Growth in net fee and commission income was generally flat on 2H12, but grew by 9.3% on 1H12.

This should be seen in the context of the inflationary environment, the lower income-generating effect of innovative pricing packages introduced by some banks and the considerable base established in prior periods.

The growth in this area has been largely driven by an increase in transaction volumes with limited price increases. In the current period we have seen a continutation in the trend to market 'value' packages. These offer customers the flexibility to tailor a banking fee package to meet their individual requirements in a cost-effective manner.

While this strategy has the effect of reducing overall fee income in absolute terms, there has been an increase in customer numbers as the banking net has been widened and the major banks compete more fiercely in the lower-income market. In 1H13 we have observed a continuation of this trend.

Other significant contributors to the growth in net fee and commission income are card based commission income, due to higher turnover volumes and growth in customer numbers, as well as improved structuring fees. A significant driver of these fees has been the renewable energy project which have seen keen participation by the banks, both local and foreign.

The major banks also continue to be at the forefront of innovation as they seek to meet the requirements of changing client behaviour. This has been achieved through the launch of innovative products such as mobile and electronic banking applications and the focus remains on driving up discretionary transaction volumes by customers, rather than increasing prices.

We have continued to observe that the ability to translate innovative product offerings into increased customer numbers remains a key differentiating factor between the relative growth of the fee and commission income lines for the various banks. We have also noted further aggressive marketing of loyalty programmes as banks compete fiercely to widen the banking net and seek to create new cross-sell opportunities. To this end Standard Bank relaunched their loyalty plan and other banks continue to add to the benefits of their existing plans.

## Fair value income

Fair value income continued on the volatile trend established in previous reporting periods and was 4.8% up on 2H12 but 12.0% down on 1H12.

European sovereign debt concerns, concerns about a fiscal disruption in the US and volatile currency and commodities markets negatively impacted trading conditions.

Customer flow business has remained at relatively high levels, although a decrease in the demand for risk management products was observed. However, continuing to position trading books in an environment in which market direction is lacking remains a significant challenge.

We have also observed a continuation in the trend of strong positive trading results from the banks' African trading operations, given the strong economic growth being experienced in many countries on the continent. These results, although currently a relatively small percentage of the total trading operations, was also boosted further by the weakening Rand.

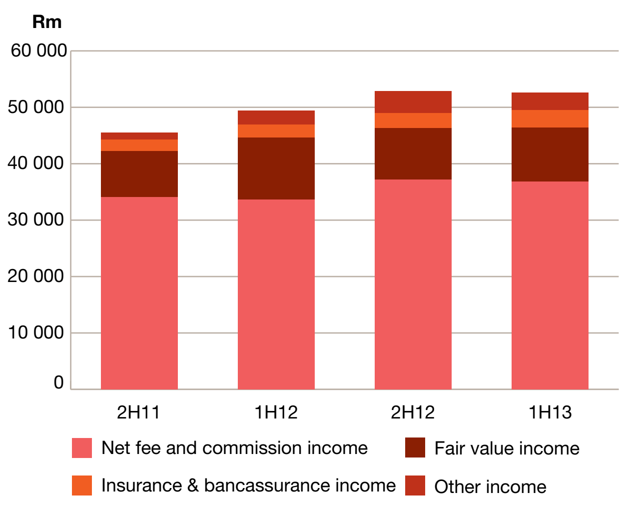
# *Insurance and bancassurance income*

Insurance and bancassurance income was up 16.4% on 2H12.

On a year-on-year basis this equates to growth of 31.4% which is commendable given the overall benign state of the South African economy. This increase is due largely to continuing strong premium growth through the launch of innovative product offerings and relatively volatile equity markets.

These favourable results were offset by increased claim levels in 1H13 in contrast to claim levels experienced in prior periods.

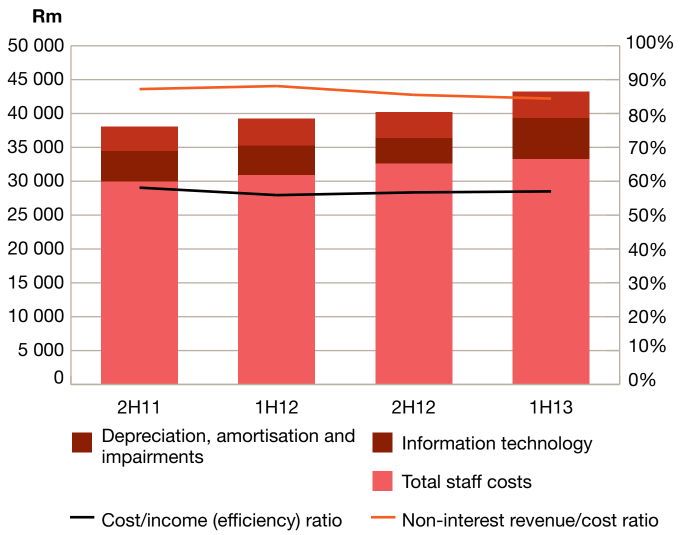
**Figure 4.1 Non-interest revenue**




***Source: PwC analysis***

# 5. Efficiency

Figure 5.1 Operating expenditure




*Source: PwC analysis*

*Compared to 1H12, banks' operating expenses increased by 6.6% , while total operating income increased by 9.0%. Consequently, their combined cost-to-income ratio improved to 54.1 % in 1H13 (1H12: 56.6%).*

*Salaries, which continue to represent roughly half of the total expense bill, grew at a rate of 7.5% on an annual basis.*

*The weaker Rand continues to be a drag on the expense base.*

The aggregate improvement in the banks' cost-to-income ratio bears testimony to the successful continuation of cost containment strategies implemented in previous periods. We expect these strategies to continue as revenue growth potential remains under pressure.

Increased salary costs reflect annual salary increases as well as the increased short- and long-term incentive awards associated with the banks' improved operating performances.

Tight headcount management continues to be top priority for management teams, although this continues to be balanced with the need for ongoing investment in human resources in the rest of Africa.

Operating expenses were also unfavourably impacted by the weak Rand during the period, which continued to be a drag on the expense base. The average USD/ZAR rate weakened from 8.48 in 1H12 to 9.22 in 1H13 and negatively impacted the earnings of those banks with operations outside of South Africa.

IT spend also continues to be on the rise as banks seek to implement new systems to cater for increased regulatory requirements and customer expectations.

# 6. Asset quality

**Asset quality (Rm)**

| | Combined | | | |
|---|---|---|---|---|
| | 1H13 | 2H12 | 1H12 | 2H11 |
| Gross loans and advances to customers | **2 665 425** | 2 486 685 | 2 413 619 | 2 351 850 |
| Non-performing loans | **99 331** | 99 012 | 106 139 | 109 359 |
| Impairments | **-58 277** | -54 398 | -52 024 | -48 808 |
| Portfolio provisions | **-17 690** | -16 295 | -15 819 | -14 186 |
| Specific provisions | **-40 587** | -38 103 | -36 205 | -34 622 |

***Source: PwC analysis***

## Gross loans and advances

Largely driven by a sustained low interest rate environment, total credit extension of the major banks continued to expand, although at a moderate growth trajectory not dissimilar to the growth rates reported in our previous analyses. Total gross loans and advances to customers of the major banks grew by 7.2% for 1H13 (compared to 3.0% for 2H12).

The relatively slow growth levels of combined gross credit extension of the major banks reflect, in part, a still fragile domestic and global business climate, lingering uncertainty precipitated by recent labour unrest in various industries across the country, and the increasing scrutiny which high levels of South African household indebtedness continue to receive.

## Corporate advances

Despite a difficult trading environment, resilience in corporate activity contributed to 9.2% growth in corporate lending in the first half of 2013 (compared to just 1.1% for 2H12).

Looking ahead, a positive outlook for corporate lending remains, with some of the major banks commenting on their expectations of strong drawdowns in their deal pipelines to continue for the rest of 2013. This comes on the back of forecast activity in the mining, energy and infrastructure sectors, much of which is expected from the African countries in which the banks are operating. However, expectations of subdued commercial property lending books are anticipated to remain, consistent with a current theme of a sluggish domestic real estate market.

## Retail mortgages

Combined credit extension of the major banks in the retail category showed moderate half-year growth of 6.6% (compared to 4.1% growth between the third and fourth quarters of 2012). In addition to the difficult consumer environment, a significant contributor to the continued trend of modest single-digit growth levels of credit extension in the retail market is attributable to sustained lacklustre growth rates being seen in mortgage advances.

Relatively low bank margins on mortgage loans, competitor activity between the banks in this segment and accelerated capital repayments, brought about by a continually low interest rate environment, continue to suppress mortgage lending with little positive outlook for an upside in mortgage lending in the short term.

As we indicated in our 2013 South African Banking Survey, we believe that a structural shift has occurred in the credit industry, in which a lethargic real estate market has led to a decline in the real value of outstanding mortgage loans, contrasted by relatively high growth rates for bank overdrafts and other small loans.

## Card debtors and other unsecured lending

The positive growth story for gross credit extension of the major banks continues to come from the overdrafts, other demand loans, credit cards and instalment credit and leases categories.

Across the major banks, double-digit credit growth came from instalment finance, overdrafts and other loans and advances (12.8%, 13.8% and 16.7% respectively for 1H13).

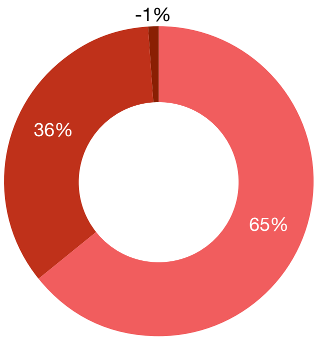
Instalment credit growth for the period benefitted as the demand for new and second-hand vehicles remained resilient in a competitive trading environment characterised by the introduction of new car models and low financing costs.

Concerns around South African banks' potential overexposure to unsecured credit and the potential for the emergence of an unsecured lending asset bubble continued to receive scrutiny from regulators, National Treasury and the financial press over the first half of 2013.

In this respect, there remains the theme that we have consistently reported in previous analyses, namely that the major banks' combined total exposure to unsecured lending as a proportion of their total credit portfolios remains within low percentages. These banks continue to highlight their views that they are pricing appropriately for the risk they have taken on in their unsecured lending portfolios. At the same time, all of the major banks have explicitly commented in the latest reporting period on their continued monitoring, risk management efforts and a potential reduction in risk appetite for unsecured lending. The increase in los rates in the last year has contributed to the banks reducing their exposures in this segment.

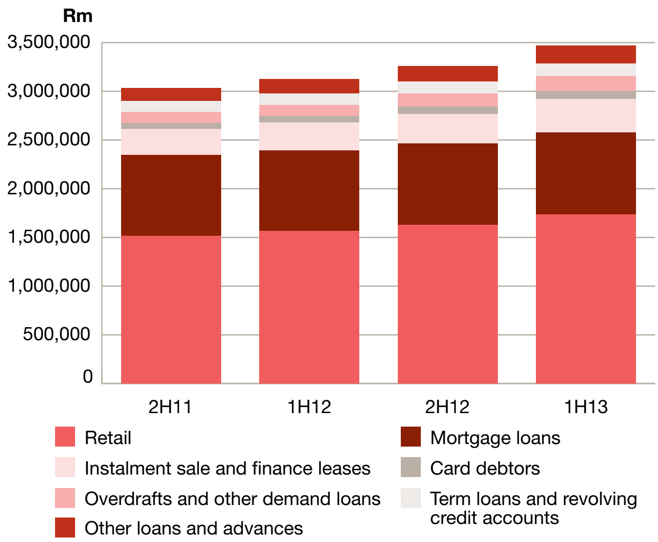
It is important to note that, in April 2013, the Banking Association of South Africa announced plans to propose changes to lending rules for unsecured lending in an effort to respond to concerns of rising bad debts in this credit category. Industry expectations for these changes largely focus on stricter rules relating to lending affordability and the garnishing of workers' salaries in cases of delinquent payments.

**Figure 6.1 Combined loans and advances by product**




***Source: PwC analysis***

**Figure 6.2 Retail advances per product**




***Source: PwC analysis***

## *Non-performing loans*

The positive historical trend of improving combined total non-performing loans (NPLs) moderated in 1H13, ending the consistently improving reported credit experience for the major banks.

This observation is more likely a reflection of domestic economic factors, including consumer stress given the persisting high levels of household indebtedness, asset price uncertainty and the bottoming out of the interest rate cycle, as all the major banks continue to highlight the trend towards tighter credit origination practices on the supply side.

Total NPLs for the major banks grew 0.3% for 1H13 (compared to an optimistic -6.7% decline in combined NPLs for 2H12). While mortgage and corporate lending registered declining NPLs, the primary drivers of the combined increase arose from the retail credit sector, specifically credit card and other loans and advances. Further analysis reveals that the 'inclusive' or lower-income lending books of the major banks have been affected over the current reporting period by subdued growth in disposable income levels and higher living costs affecting customers within this segment. The obvious concern in this sector is that, given recent inflationary pressures and the bottoming of the interest rate cycle, increases in interest rates could push customers in this segment, who are already on the margin, towards further credit stress.

In contrast, mortgage NPLs continued on a positive trajectory, although at a more moderate pace, declining 7.31% for 1H13 (compared to a 13.2% decline in mortgage NPLs for 1H12), reflecting improved recovery efforts being observed within the residential property market in South Africa. Those banks with large NPL books have seen a marginal decrease in older NPLs as a result of continual challenges in the legal enviroment.

## *Coverage ratios*

The major banks' specific impairment coverage ratios (specific impairment divided by NPLs) increased by 238 basis points for 1H13 (compared to an increase of 437 basis points for 2H12).

Consistent with our observations in previous reporting periods, this increase in specific impairment coverage ratios continues to be influenced largely by the banks' retail portfolios, specifically within the mortgage lending and instalment finance categories.

This observation highlights the concerns within the retail credit industry and its dynamics against the backdrop of a challenging household and consumer environment.

## *Income statement impairment charges*

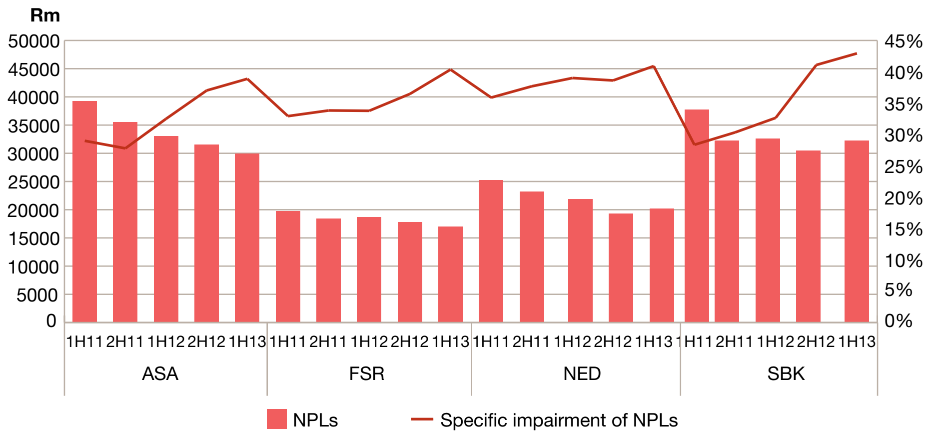
The unprecedented default of First Strut (Pty) Ltd's listed corporate bond in the first half of 2013 represents a notable event for the South African bond market. While some of the major banks reported exposure in the form of general banking and other credit facilities to the defaulted client, industry consensus is that the total exposure from the perspective of the major banks is not significant and is adequately provided for.

It will be interesting to observe what changes are implemented by regulators and banks in light of this default.

The combined credit loss ratio (income statement impairment charge divided by average advances) of the major banks stayed flat at 1.2% for 1H13 compared to 2H12, largely reflecting continued retail credit market stresses.

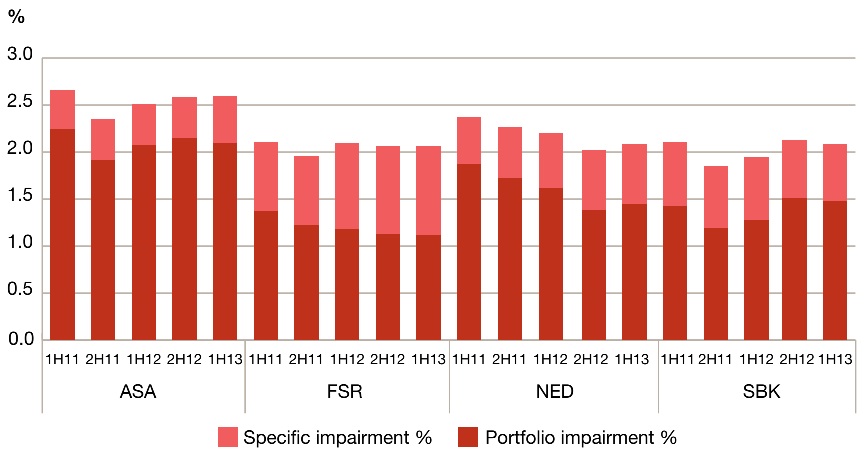
It is interesting to note that the variability in credit loss ratios between the major banks which we reported on in previous analyses appears to be showing signs of contraction, with all of the banks reporting total credit loss ratios in the [1 – 2%] range. However, some divergence within credit loss ratios across the various credit portfolios of the major banks is noted and is reflective of their individual strategies and specific areas of market focus.

## Figure 6.3 Non-performing loans and level of specific impairment




*Source: PwC analysis*

## Figure 6.4 Specific and portfolio impairment levels




*Source: PwC analysis*

# 7. Capital and funding

**Capital and Funding (Rm)**

| | Combined | | | |
|---|---|---|---|---|
| | 1H13 | 2H12 | 1H12 | 2H11 |
| Total Tier 1 | **282 020** | 260 191 | 246 840 | 239 507 |
| Tier 2 | **54 103** | 52 326 | 46 764 | 42 676 |
| Total qualifying capital and reserve funds | **336 123** | 312 517 | 293 604 | 282 183 |
| Risk-weighted assets | **2 215 789** | 2 077 770 | 2 057 601 | 1 822 315 |
| Deposits | **2 819 799** | 2 645 842 | 2  543 405 | 2 484  582 |

*Source: PwC analysis*

*Total qualifying capital and reserve funds of the major banks increased by 7.6% (in contrast to 6.4% growth for 2H12).*

*Highlighting the capital strength of our major banks, the combined total capital adequacy ratio strengthened to 15.2%, compared to 15.0% at December 2012, in spite of the new Basel III capital requirements.*

From 1 January 2013, South Africa transitioned to Basel III – one of the biggest regulatory changes the banking industry has seen since the introduction of Basel II. As described in the next section, our 2013 South African Banking Survey has highlighted regulatory reform as top of mind for bank executives, being regarded as the most significant development, most pressing issue and most significant weakness currently facing the banking industry.

This theme is expected to be reflected in the reported capital ratios of our banks in future periods as bank executives continually consider optimising their business models and capital management strategies in light of the scale of current and planned regulatory change. Interestingly, in the current reporting period, certain technical changes[1] brought about by the application of Basel III capital rules have positively impacted the core equity tier 1 (CET 1) ratios for some of the major banks. In particular, inclusions of certain reserve funds  and the less punitive treatment of 'capital held in insurance entities' have benefited some of the major banks' CET 1 ratios.

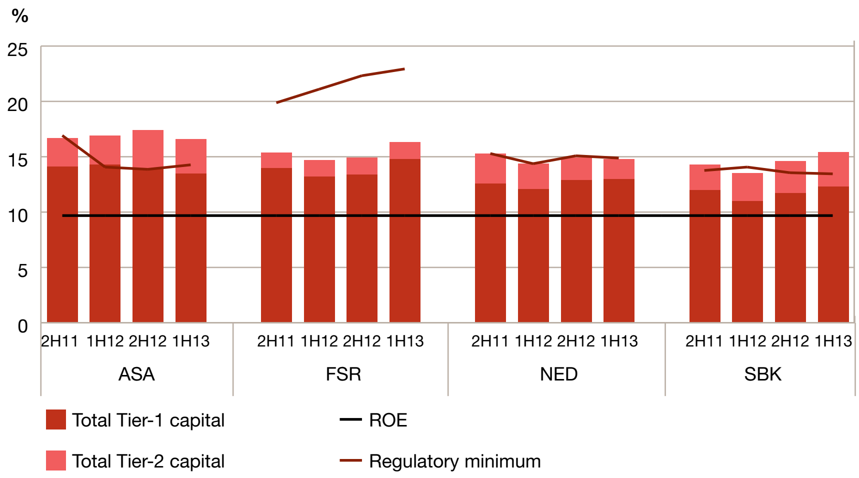
Driven by organic earnings growth, on-going risk-weighted assets optimisation efforts and the technical reasons outlined, overall, the combined capital adequacy ratio of the major banks improved by 128 basis points to 15.2% for 1H13 (compared with 15.0% for 2H12), in spite of the application of the generally more capital-punitive Basel III rules. When compared against June 2012, the current period's combined ratio further highlights the strong capital positions of our major banks, as the total combined capital adequacy ratio strengthened from 14.9% for 1H12.

These observations confirm our previous commentary that the well-capitalised status of the South African banking sector as a result of the banks' prudent business practices, as well as the strong regulatory capital regime adopted by our regulator over the years, was expected to result in an overnight transition to Basel III without significant deterioration in regulatory capital levels.

However, looking ahead, it is expected that some pressure to the banks' tier 1 and total capital adequacy ratios could be seen, as the additional tier 1 (AT 1) and tier 2 instruments of some of the banks are expected to not qualify as eligible capital instruments under Basel III rules. Commencing from this year, these instruments will be grandfathered over a ten-year period. Responding to this change, we have seen some banks engage in capital-raising activities by moving towards placements of Basel III-compliant capital instruments as existing instruments approach maturity.

[1] Foreign currency translation reserves (FCTR), available for sale reserves (AFS), share-based payments reserves and property revaluation reserves, previously disallowed for regulatory capital purposes under Basel II.5, are eligible for inclusion as core equity tier 1 capital under Basel III.

Figure 7.1 Regulatory capital ratios and ROEs




***Source: PwC analysis***

***Customer deposits continue to be an important source of total funding for our major banks. The significant change in the regulatory environment from a liquidity perspective, through the Net Stable Funding Ratio[2] (NSFR) to be introduced as a prudential requirement from 1 January 2018, highlights the importance of long-term, stable funding which typically would arise from retail sources.***

***Total deposits for the major banks grew 6.6% for the six months to June 2013 (compared to 2.4% for 1H13 and 10.9% compared to 2H12). In spite of subdued interest rates and volatile money market rates, growth in corporate call, notice and cash management deposits continues to contribute strongly to the major banks' combined total deposits as clients opt to retain liquidity to manage cash flows in a challenging economic environment.***

***Interestingly, the combined loan-to-deposit ratio of the major banks increased to 96.5% at June 2013 (95.7% for the six months to December 2012), suggesting the banks' confidence in their overall liquidity and funding positions.***

Our analysis continues to show that volatility and uncertainty in equity and bond markets generally contribute to increased deposit levels as treasurers look to manage cash flows more proactively against market turbulence.

Our banking survey has highlighted that the differentiating structural features of the South African economy compared to developed economies, including the relatively low discretionary retail savings rate, pose challenges for the banks in terms of meeting the NSFR.

In the latest reporting period, all of the banks have commented on their expectations that, following recent amendments to the Liquidity Coverage Ratio[3] (LCR), the NSFR will be subject to significant change by regulators prior to being finalised for implementation as a prudential requirement.

[2] The NSFR is a longer-term structural ratio designed to address liquidity mismatches. It covers the entire balance sheet and provides incentives for banks to use stable sources of funding. The NSFR effectively requires that the proportion of a bank's long-term assets to long-term 'stable funding' be maintained at 100%.

[3] The LCR will require banks to have sufficient 'high-quality liquid assets' to withstand a 30-day stressed funding scenario specified by supervisors.

## Making sense of rapidly changing industry developments

In our previous major banks analysis published in March 2013, we briefly introduced PwC research which suggested that, in our view, the industry is not going through a simple cycle or period of consolidation or adjustment, but rather a permanent one.

While a lot has been written about the impact of Basel III on banks in the advanced economies and in South Africa, much less is known about the impact on banks on the rest of the continent. As the Business 20 (B20) described in a report following its 2012 summit in Los Cabos, Mexico, "Given that most of the regulatory policy focus has been on the advanced economies, the effects of the changes for emerging markets are even less clear. However, it is inevitable that these markets will be affected: directly via local implementation of the international reforms; indirectly as international banks in advanced economies change their business models in response to the new regulatory landscape; and as a result of the knock-on impact of deleveraging in the advanced economies."

### *Meeting Basel III capital requirements*

Africa is a continent comprising 55 member states, with different cultures, stages of economic development, and sophistication of financial markets and banking systems. Despite the diversities within African financial systems, it would be safe to say that Basel III would raise the level of capital required for African banks. In our view, the African banks should be able to meet the new capital requirements, given that they are relatively well capitalised. However, it is important to remain mindful that Basel I, or even Basel II, capital ratios are not directly comparable to Basel III ratios because the new rules for both eligible capital and required capital are more stringent. This suggests that management and other stakeholders would need to accept that African banks would, in a Basel III world, operate with lower capital buffers than under current regimes.

Despite this, it is inevitable that capital will become a more significant constraint than before and banks may want to adapt their businesses in the new regime to maintain current returns on equity (ROE). While this is a laudable objective on the face of it, the performance expectations and decision rules formed in the pre-crisis era are, in our view, no longer valid, largely due to the substantial restructuring and de-gearing of banks' balance sheets that Basel III would bring about. This, we believe, forms part of what we describe as 'the new economics of banking'.

### *The new normal*

Our research shows that under the "new normal", investor expectations would shift eventually. Investors are, however, not being asked to accept worse performance. They are merely being asked to accept a different risk/return proposition to the one they had become used to during the boom years. There are very plausible conditions in which a bank's economic profit (the excess profit after all economic costs, including capital costs, have been met) would be unaffected, or even enhanced, by the equity injection required by regulatory changes. This largely stems from the expectation that the cost of equity "(COE") will fall because the changes to bank capital requirements and funding structures will reduce balance sheet gearing and, therefore, risk within banking systems. Consequently, ROE expectations and targets should reduce in a similar manner.

This "new normal", to which Basel III is a significant contributor, has huge implications for the manner in which banks, particularly those in emerging markets, respond to Basel III. First of all, with new regulations requiring higher capital levels, it is intuitive that banks would embark on risk-weighted asset (RWA) optimisation programmes. However, there is an inherent risk of over-interpreting regulatory formulations and allowing them to displace economic considerations in areas such as pricing and portfolio management. In the case of portfolio management, RWA optimisation is an example of regulation displacing economics. At its most extreme, this can take the form of RWA utilisation being given first-order prominence in portfolio optimisation decisions and in setting overall bank strategy.

### *The world needs a stable and vibrant banking industry, and will find a way to have one…*

Although our starting point remains that banks should endeavour first and foremost to alleviate portfolio constraints (i.e. fix the problem on the supply side), for many banks on the rest of the continent it is true that the Basel III capital rules may have kicked in before they have had the chance to build up their capital levels. Therefore, banks may have no option but to find ways to reduce their regulatory capital requirements.

Most organisations in this situation have identified the 'low-hanging fruit', such as cleaning up data and models, restructuring capital to ensure favourable tiering treatment and disposing of genuine non-core assets. Where it gets trickier is when the low-hanging fruit do not get them far enough, fast enough, and tougher decisions need to be made. This might include cutting back business lines that, while attractive from a long-term strategic perspective, are hard to justify in the context of short-term capital constraints. The key question is how these optimisation decisions should be taken.

The blunt approach is to rank businesses according to their contribution, relative to RWA usage and then to weed out the weakest until the constraint is satisfied. A more strategic approach would first aim to relieve that constraint or at least anticipate future periods in which that might be possible, before performing irreversible surgery. Consideration should also be given to the long-term integrity of the business in terms of its brand and customer offering, recognising that individual businesses do not perform in isolation from each other, either commercially or operationally. This should prevent the business from getting bent out of shape by arbitrary regulation or short-term market frictions.

It is also important to recognise that actions of competitors (who are subject to the same pressures, constraints and regulatory prescriptions) might change the commercial landscape. For example, if a large part of the industry is forced or induced into less RWA-intensive product areas, it will compress margins, thereby creating opportunities in more RWA-intensive product areas for those with the capital resources to exploit them.

[4] The impact of regulatory reforms on emerging markets – B20 Business Summit, June 2012.

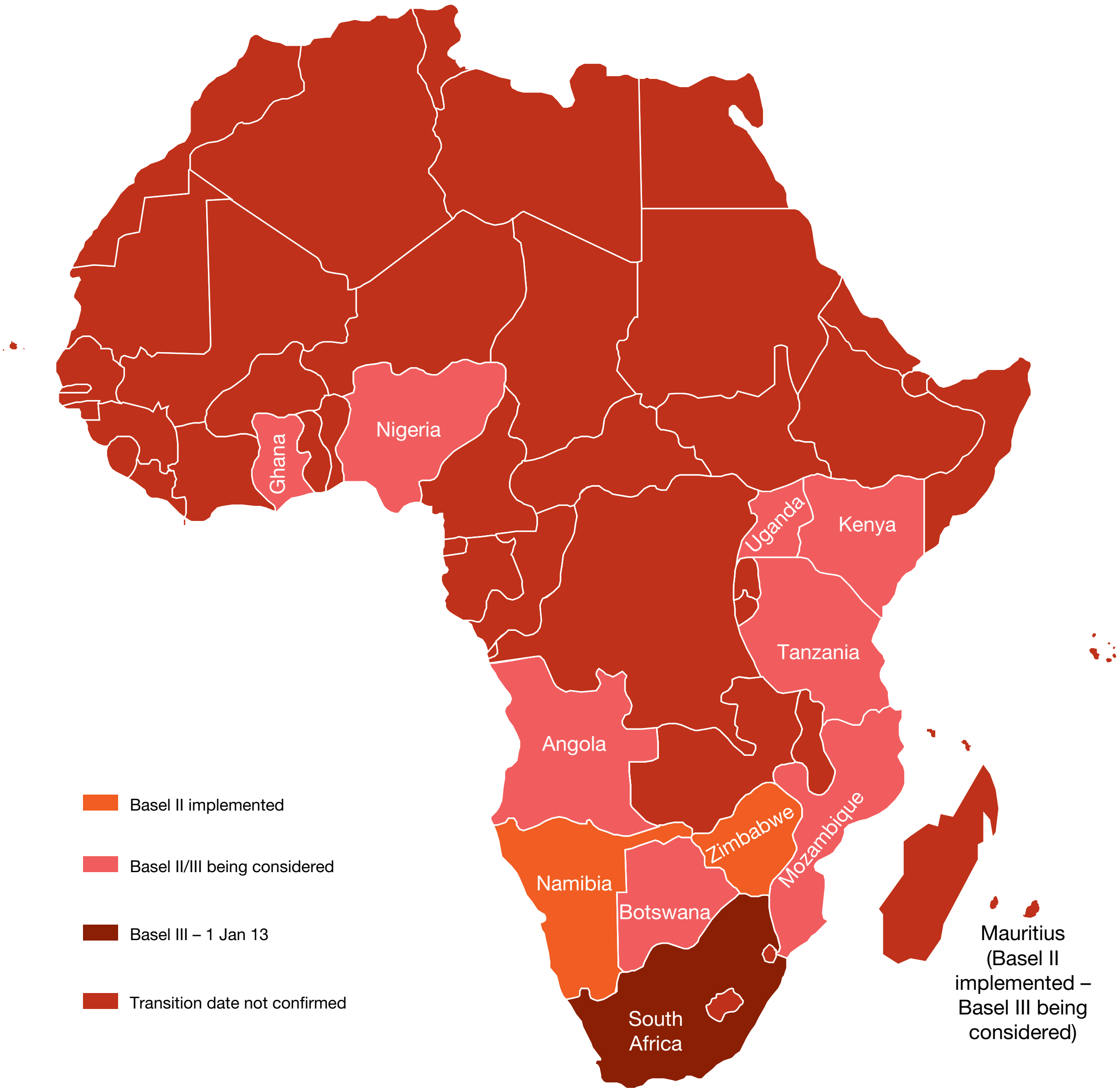
*In summary*

The adoption of Basel III on the continent will provide the African financial markets with world-class regulatory capital and liquidity standards. This should enhance investor confidence and help to attract foreign direct investments as a consequence of reduced risk within the banking sectors.

At the same time, Basel III introduces significant implementation challenges. At least in the short term, banks should resist the urge to do irreversible damage to their business by allowing regulatory formulations to displace economic fundamentals in assessing their response to Basel III. Additionally, there is a concern that the adoption of Basel III may not give credit to the underlying soundness of local banking industries, as is evident from the NSFR liquidity standard which emerging market economies will find difficult to meet. This is, however, still being debated at the Basel Committee for Banking Supervision, and revisions to the initial NSFR liquidity rules now seem increasingly clear.

Finally, we believe that the winners in the new economics of banking, brought about largely by the Basel III framework, would be those who take a measured approach to their responses and a long-term view based on sound strategic and economic fundamentals.

## Status of banking regulatory regimes across Africa: Selected jurisdictions



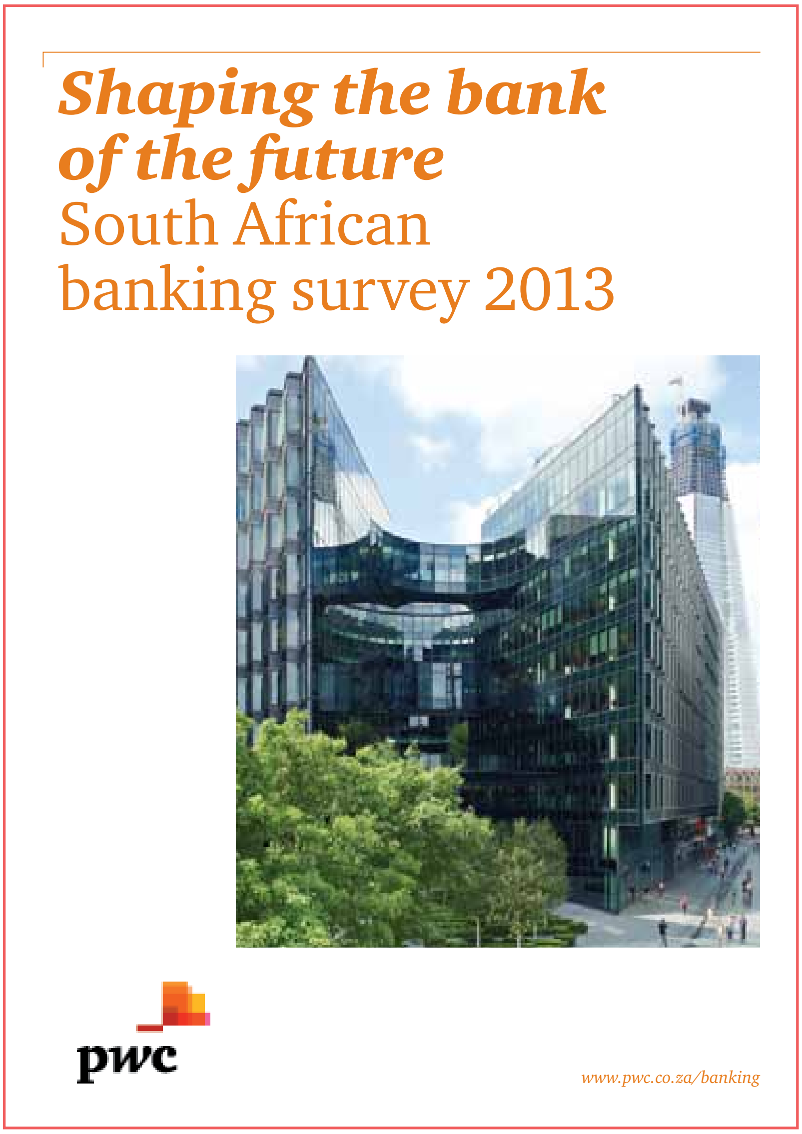
# 8. Aligning financial services businesses with new global dynamics

PwC recently launched the 13th edition of its bi-annual survey on banking in South Africa. The survey was conducted based on interviews held in early 2013 with executives of 12 domestic and 10 foreign banks, ranging from local niche players and branches of global banks to the four major domestic banks (Absa, Nedbank, FirstRand and Standard Bank).

It is clear from our survey results that the world in general, and the banking industry specifically, are more complex now than they were a decade ago. At the same time, a number of trends and developments are currently shaping the global landscape for financial services and in particular the banking industry.

In our interviews, bank executives confirmed these emerging trends and the resulting impact on their organisations. They were also positive about their respective organisations' ability to respond to these trends. In many instances, tactical solutions have already been implemented in response to short-term changes, while some organisations have started to implement more fundamental strategic changes to capitalise on longer-term opportunities.

The general optimism observed in our interviews with bank executives is evident from the ROE they forecast for the next reporting period, as well as over the next three to five years.




Industry average ROE (12-month forecast)
***14.85%***

Industry average ROE (three-five-year forecast)
***16.95%***

We have grouped these challenges and opportunities faced by banks into four broad themes, namely external developments, macro trends, internal responses and stakeholder expectations. Central to all themes is how CEOs are planning to maintain a solid return on equity, given the challenges they are facing.

## External developments

A combination of local and global factors that directly impact the banking industry: The majority of these factors typically detract from a bank's ability to achieve ROE targets. They include the sluggish economic environment, large-scale regulatory change and competition in various attractive market segments.

## Macro trends

Macro trends currently shaping the global landscape for all industries, in particular the banking industry: Strategic alignment to these trends, which include the rise and interconnectivity of emerging markets as well as urbanisation and demographic shifts, could contribute significantly to strong ROE growth over the medium to long term, or could represent a lost opportunity for those who do not respond.

## Internal responses

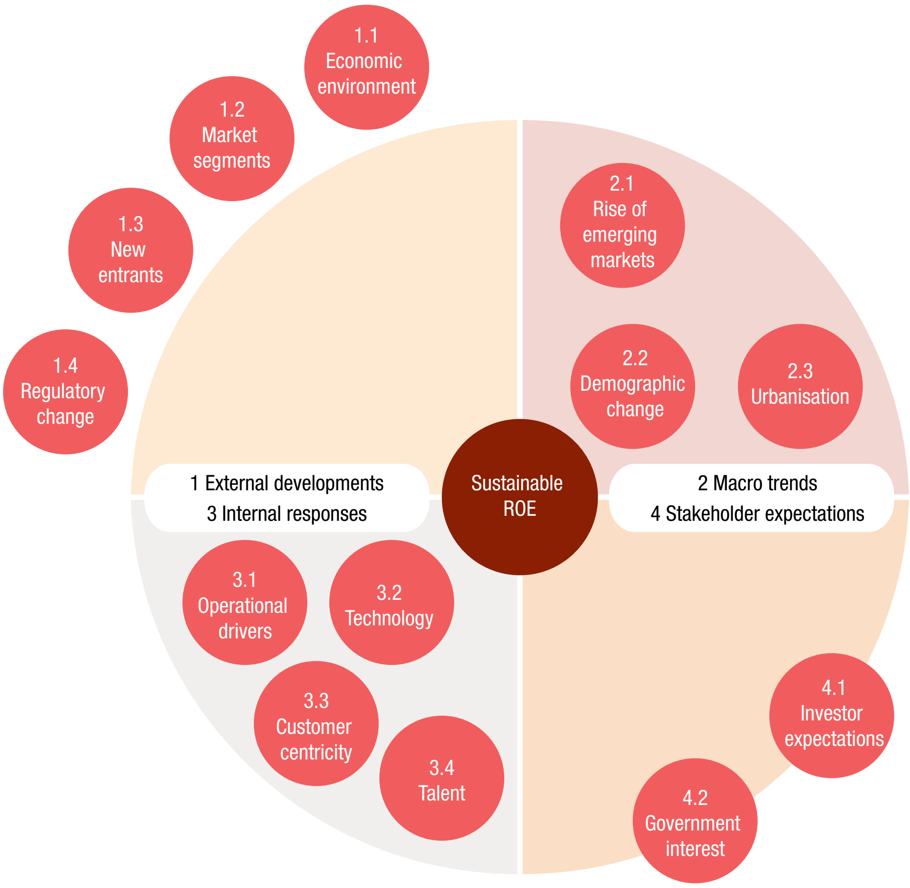
Tactical and strategic responses already implemented or planned by the banks: In general, these responses are aimed at improving ROE (if properly implemented) and include cost control, innovation and technology. Talent shortages are also explored as part of this dimension. Inability to source the right talent could detract significantly from achieving growth objectives, while winners in the war for talent could establish a competitive edge that is hard to match.

## Stakeholder expectations

Expectations of a range of external stakeholders: Banks cannot maintain control of their destinies without the confidence of a variety of stakeholders, such as investors, government and the societies in which they operate. These stakeholders could influence, either favourably or obstructively, how banks achieve their growth objectives.

The trends and developments highlighted in this report could contribute to – or detract from – executives' ability to achieve these forecast ROE levels. The trends located inside the circle contribute in a positive manner to banks' ability to achieve ROE targets, while those outside the circle have a negative impact.

**Figure 8.1 Trends shaping the banking industry**




# Trends and developments shaping the South African banking industry

## 1. External developments

### 1.1 Economic environment

- Despite concerns that the consumer is under pressure, the ratio between household debt and disposable income in South Africa has declined consistently since 2008, from 82.3% to 74.7%.
- Similarly, the ratio between debt service costs and disposable household incomes has declined by almost 50% since 2008, which is partly attributable to a relatively benign interest rate environment.
- From a macroeconomic perspective, there is justification for concern over the possibility of sharp rises in money market interest rates and higher unemployment. This coupled with a weaker Rand may impact the consumer negatively.

### 1.2 Market segment competitiveness

- Corporate banking, flow businesses (foreign exchange and rates) and business banking are the most important wholesale market segments.
- Traditional retail banking (deposit taking and transactional banking), electronic banking and personal banking are the most important retail market segments.
- Traditional retail banking (deposit taking and transactional banking) is viewed as the most intensely competitive market segment and banks believe a fundamental change in strategy and positioning is required to compete aggressively in this segment.
- Rapid expansion in unsecured lending is the second-most important development in the South African banking industry. Interestingly it was also considered to be the second-biggest weakness in the industry.

### 1.3 New entrants

- The likelihood of new entrants into the South African banking market is regarded as low.
- The likelihood of a foreign entrant is considered to be higher than the establishment of a new local bank.
- Bank executives acknowledge the threat posed by non-traditional competitors, such as retailers and mobile service providers.

### 1.4 Regulatory reform

- Regulatory reform is regarded as the most significant development, most pressing issue and most significant weakness in the banking industry. The sheer scope of current and planned reforms that will impact the industry are top of mind for bank executives.
- Risk-weighted assets optimisation and compliance with the Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR) are regarded as the top three implications of Basel III.
- Remuneration remains a hot topic as authorities continue to explore how best to regulate rewards in the sector, with the aim of reducing excessive risk taking.

## 2. Macro trends

### 2.1 Rise and interconnectivity of emerging markets

- Nearly half of respondents expect 10-15% of their after-tax profits to come from the sub-Saharan region (excluding South Africa) in the medium term, with Nigeria, Ghana and Kenya regarded as key growth territories.
- Growth potential, political stability and availability of quality local talent are important considerations for executives when expanding into Africa.

### 2.2 Demographic shifts

- Demographic changes will have a pronounced impact on the profile of economies around the world. Banks must anticipate these changes and align products and services to their changing customer base.
- Developing economies are experiencing significant population growth, specifically in economically active segments. This creates an attractive market for deposits, lending and transactional banking.

### 2.3 Urbanisation

- Over the next 30 years, the urbanisation of 1.8 billion people is expected to bring the global urban population to 5.6 billion.
- Urbanisation increases the stress on physical and service infrastructure, creating demand for investment that will support the migration of people into cities.
- Banks must tailor their service offerings for rural and urban populations. Urban populations have a higher demand for financial products and services. However, banks should continue to explore innovative ways of meeting rural customer needs.

## 3. Internal responses

### 3.1 Operational levers to restore ROE

- Cost containment is regarded as the most important mechanism to achieve ROE/ROA targets, followed by a focus on new markets.
- Internal efficiency drives, automation and optimisation of staff levels are key mechanisms for containing costs.
- Overall staff numbers are predicted to grow marginally from 150 768 to 154 354 by 2016, which equates to growth of 2%. Based on these modest increases, rapid adoption and implementation of automation will be critical if banks are to achieve their growth aspirations.

### 3.2 Technology

- Innovation is critical in this rapidly changing landscape with the Big Four banks all ranking it of maximum importance.
- Technology is regarded as one of the key enablers of innovation.
- The majority of respondents expect to invest significantly in technology over the medium term, with the Big Four banks each projecting R3-R5bn.
- Some banks have already achieved profitable revenue growth in the South African market by encouraging customers to migrate to electronic channels. Banks are seeking to leverage this experience as they expand across Africa.
- The Big Four banks currently operate 2 877 traditional branches, forecast to reduce by 21% to 2 285 by 2016. This is consistent with their stated intention to transition more customers to electronic distribution channels.
- ATM numbers are stabilising at around 20 000.

### 3.3 Customer centricity

- Banks are adopting a more holistic approach to customer relationships. They are analysing big data to identify customer needs and inform more granular pricing decisions.
- Banks' views on the importance of the client onboarding process vary. The majority agree that service quality and client retention are pressing issues in the highly competitive South African banking market.

### 3.4 Talent

- Bank executives continue to place significant value on global experience, as well as leadership skills and adaptability.
- Lack of qualified staff is a key concern for banks looking to improve their credit business lines.

## 4. Stakeholder expectations

### 4.1 Investor expectations

- Although banks are positive about forecast ROE levels, they do not expect these returns to recover to pre-crisis levels.
- In a new world of reduced leverage and increased capital, the risk/return proposition of investing in bank shares has changed. Banks will have to explain this to the investor community.

### 4.2 Government interest

- Increased government interest is regarded as the third-most important development in the industry.
- The move to a twin peaks regulatory model is supported by the majority of respondents, despite some concerns about potential regulatory duplication.
- Most banks support deposit guarantee insurance up to R100 000.

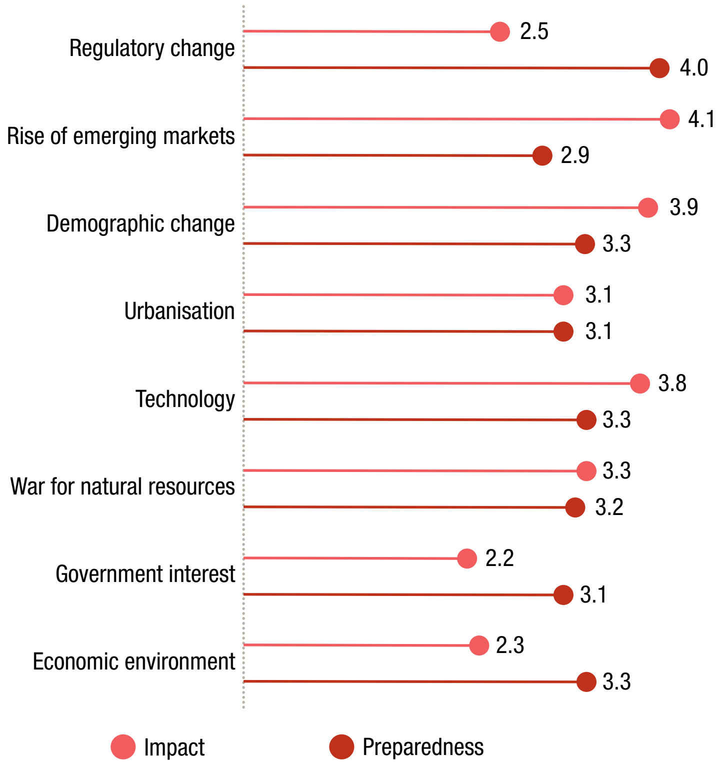
As in the past, we also asked participants to list the key developments, weaknesses and pressing issues in the industry. We list the top three below.

| # | Developments | Weaknesses | Pressing issues |
|---|---|---|---|
| 1 | Regulation | Regulation | Regulation |
| 2 | Unsecured lending | Unsecured lending | Skills availability |
| 3 | Government focus | Big Four concentration | Revenue growth |

Participants were also asked to rank the impact of selected trends on their business, as well as to assess how prepared they are to respond to them. Generally, banks appear well prepared to deal with the challenges these developments will bring.

**Domestic banks' expectations of potential impact and their preparedness for key factors driving changes**

(1 is considered most negative impact and 5 is considered most positive / 1 is not prepared and 5 is most prepared)




***Based on reponses from 12 banks***

# 9. Key banking statistics

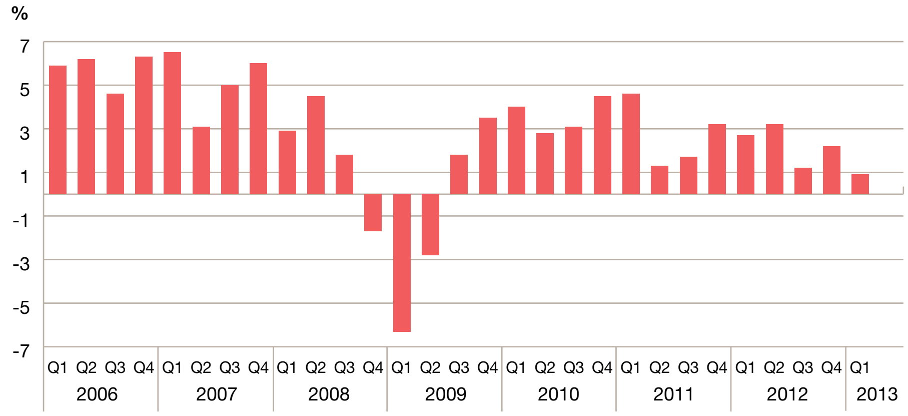
## Summary financial information - 1H13 (Rm)

| Rm | ASA | | | | FSR | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1H13 | 2H12 | 1H12 | 2H11 | 1H13 | 2H12 | 1H12 | 2H11 | 1H13 |
| **Balance sheet** | | | | | | | | | |
| Total assets | 841 333 | 807 939 | 808 806 | 786 719 | 869 669 | 825 327 | 769 765 | 763 514 | 714 330 |
| Gross loans and advances (to banks and customers) | 609 991 | 586 852 | 577 734 | 573 066 | 611 611 | 574 850 | 535 704 | 508 253 | 569 208 |
| Total deposits | 534 504 | 513 462 | 483 707 | 479 299 | 697 005 | 651 349 | 606 281 | 595 200 | 578 807 |
| Risk-weighted assets | 457 480 | 438 216 | 426 452 | 424 489 | 519 960 | 490 373 | 471 468 | 415 121 | 386 804 |
| **Asset quality & provisioning** | | | | | | | | | |
| Non-performing loans | 29 960 | 31 483 | 33 029 | 35 536 | 17 001 | 17 797 | 18 666 | 18 366 | 20 176 |
| Impairments | -14 341 | -14 012 | -13 029 | -12 131 | -12 636 | -11 812 | -11 197 | -9 995 | -11 859 |
| Collective provisions | -2 692 | -2 358 | -2 294 | -2 254 | -5 775 | -5 322 | -4 892 | -3 779 | -3 605 |
| Individually assessed provisions | -11 649 | -11 654 | -10 735 | -9 877 | -6 861 | -6 490 | -6 305 | -6 216 | -8 254 |
| Non-performing loans (% of advances) | 4.9% | 5.4% | 6.8% | 6.2% | 2.78% | 3.10% | 3.48% | 3.61% | 3.5% |
| Impairment charge (% of average advances) | 1.35% | 1.59% | 1.6% | 1.01% | 1.07% | 0.91% | 1.08% | 0.80% | 1.31% |
| Impairment coverage ratio | 47.9% | 44.5% | 33.2% | 34.1% | 74.3% | 66.4% | 60.0% | 54.4% | 58.8% |
| Implied loss given default | 38.9% | 37.0% | 32.5% | 27.8% | 40.4% | 36.5% | 33.8% | 33.9% | 40.9% |
| **Profit & loss analysis** | | | | | | | | | |
| Net interest income | 12 503 | 12 202 | 11 909 | 12 807 | 14 458 | 13 606 | 12 964 | 11 905 | 10 309 |
| Non-interest income | 11 342 | 11 567 | 11 174 | 10 723 | 14 007 | 14 237 | 13 517 | 11 455 | 9 535 |
| **Total operating income** | **23 845** | **23 769** | **23 083** | **23 530** | **28 465** | **27 843** | **26 481** | **23 360** | **19 844** |
| Total operating expenses | -13 572 | -13 682 | -13 011 | -13 820 | -14 708 | -15 582 | -14 383 | -13 380 | -11 055 |
| **Core earnings** | **10 273** | **10 087** | **10 072** | **9 710** | **13 757** | **12 261** | **12 098** | **9 980** | **8 789** |
| Impairment charge | -3 546 | -4 270 | -4 020 | -2 179 | -3 187 | -2 518 | -3 510 | -1 961 | -3 325 |
| Other income/(expenses) | 79 | 214 | 35 | 12 | 528 | 289 | 1 096 | 401 | 354 |
| Discontinued operations | - | - | - | - | - | - | - | - | - |
| Income tax expenses | -1 862 | -1 610 | -1 767 | -2 185 | -2 240 | -2 442 | -2 181 | -2 168 | -1 413 |
| **Profit for the period** | **4 944** | **4 421** | **4 320** | **5 358** | **8 858** | **7 590** | **7 503** | **6 252** | **4 405** |
| | | | | | | | | | |
| Attributable earnings | 4 701 | 4 204 | 4 189 | 5 093 | 7 520 | 7 019 | 7 129 | 6 067 | 3 910 |
| Headline earnings from continuing operations | 4 663 | 4 475 | 4 332 | 5 124 | 7 919 | 7 195 | 7 003 | 5 639 | 3 914 |
| **Key data** | | | | | | | | | |
| Other operating income (% of total income) | 47.6% | 48.5% | 48.4% | 45.6% | 49.2% | 51.1% | 51.0% | 49.0% | 48.0% |
| Net interest margin (% of total assets) | 1.5% | 3.0% | 3.0% | 3.3% | 3.3% | 3.4% | 3.2% | 3.3% | 3.3% |
| Net interest margin (% of average interest earning advances) | 3.9% | 3.9% | 3.9% | 4.1% | 5.0% | 4.9% | 4.9% | 4.6% | 3.6% |
| Standardised efficiency ratio | 54.9% | 55.2% | 54.9% | 56.3% | 50.1% | 54.3% | 54.6% | 58.9% | 54.2% |
| **Return on equity** | **14.0%** | **13.6%** | **13.8%** | **16.6%** | **22.5%** | **21.9%** | **20.7%** | **19.5%** | **14.6%** |
| **Return on average assets** | | | | | | | | | |
| Total number of staff | 33 897 | 33 717 | 34 244 | 35 200 | 37 231 | 36 491 | 36 398 | 35 526 | 28 889 |
| **Capital ratios** | | | | | | | | | |
| Tier 1 | 13.5% | 14.00% | 14.3% | 14.1% | 14.8% | 13.4% | 13.2% | 14.0% | 13.0% |
| Tier 2 | 3.1% | 3.40% | 2.6% | 2.6% | 1.5% | 1.5% | 1.5% | 1.4% | 1.8% |
| **Total** | **16.6%** | **17.4%** | **16.9%** | **16.7%** | **16.3%** | **14.9%** | **14.7%** | **15.4%** | **14.8%** |

| NED | | | SBK | | | | Combined | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 2H12 | 1H12 | 2H11 | 1H13 | 2H12 | 1H12 | 2H11 | 1H13 | 2H12 | 1H12 | 2H11 |
| | | | | | | | | | | |
| 682 979 | 670 021 | 648 127 | 1 394 024 | 1 273 083 | 1 296 030 | 1 257 361 | 3 819 356 | 3 589 328 | 3 544 622 | 3 455 721 |
| 538 036 | 525 071 | 507 545 | 930 922 | 831 596 | 833 154 | 818 996 | 2 721 732 | 2 531 334 | 2 471 663 | 2 407 860 |
| 550 878 | 536 944 | 521 115 | 1 009 483 | 930 153 | 916 473 | 888 968 | 2 819 799 | 2 645 842 | 2 543 405 | 2 484 582 |
| 359 568 | 362 022 | 331 980 | 851 545 | 789 613 | 797 659 | 710 725 | 2 215 789 | 2 077 770 | 2 057 601 | 1 882 315 |
| | | | | | | | | | | |
| 19 273 | 21 838 | 23 073 | 32 194 | 30 459 | 32 606 | 32 225 | 99 331 | 99 012 | 106 139 | 109 200 |
| -10 870 | -11 545 | -11 497 | -19 441 | -17 704 | -16 253 | -15 185 | -58 277 | -54 398 | -52 024 | -48 808 |
| -3 427 | -3 027 | -2 748 | -5 618 | -5 188 | -5 606 | -5 410 | -17 690 | -16 295 | -15 819 | -14 191 |
| -7 443 | -8 518 | -8 749 | -13 823 | -12 516 | -10 647 | -9 775 | -40 587 | -38 103 | -36 205 | -34 617 |
| 3.6% | 4.2% | 4.5% | 3.5% | 3.7% | 3.9% | 3.9% | 3.7% | 3.9% | 4.6% | 4.6% |
| 1.05% | 1.11% | 1.1% | 1.17% | 1.08% | 1.0% | 0.9% | 1.2% | 1.2% | 1.2% | 1.0% |
| 56.4% | 52.9% | 49.8% | 60.4% | 58.1% | 49.8% | 53.1% | 60.3% | 56.4% | 50.5% | 46.4% |
| 38.6% | 39.0% | 37.9% | 42.9% | 41.1% | 32.7% | 37.9% | 40.8% | 38.3% | 34.5% | 32.5% |
| | | | | | | | | | | |
| 10 038 | 9 642 | 9 351 | 18 912 | 18 439 | 15 794 | 15 613 | 56 182 | 54 285 | 50 309 | 49 676 |
| 9 059 | 8 265 | 8 273 | 17 726 | 17 970 | 16 504 | 15 078 | 52 610 | 52 833 | 49 460 | 45 529 |
| **19 097** | **17 907** | **17 624** | **36 638** | **36 409** | **32 298** | **30 691** | **108 792** | **107 118** | **99 769** | **95 205** |
| -10 918 | -10 182 | -10 334 | -21 833 | -21 584 | -19 826 | -18 998 | -61 168 | -61 766 | -57 402 | -56 532 |
| **8 179** | **7 725** | **7 290** | **14 805** | **14 825** | **12 472** | **11 693** | **47 624** | **45 352** | **42 367** | **38 673** |
| -2 497 | -2 702 | -2 539 | -5 065 | -4 855 | -3 945 | -3 522 | -15 123 | -14 140 | -14 177 | -10 201 |
| -52 | 34 | 2 | 248 | -1 093 | 147 | 100 | 1 209 | -642 | 1 312 | 515 |
| - | - | - | - | 2 004 | 431 | 390 | - | 2 004 | 431 | 390 |
| -1 471 | -1 404 | -1 169 | -2 048 | -2 294 | -2 060 | -2 219 | -7 563 | -7 817 | -7 412 | -7 741 |
| **4 159** | **3 653** | **3 584** | **7 940** | **8 587** | **7 045** | **6 442** | **26 147** | **24 757** | **22 521** | **21 636** |
| | | | | | | | | | | |
| 3 979 | 3 497 | 4 436 | 7 245 | 7 959 | 6 461 | 5 975 | 23 376 | 23 161 | 21 276 | 21 571 |
| 4 042 | 3 468 | 3 376 | 7 225 | 6 498 | 6 479 | 6 167 | 23 721 | 22 210 | 21 282 | 20 306 |
| | | | | | | | | | | |
| 47.4% | 46.2% | 46.9% | 48.4% | 49.4% | 51.1% | 49.1% | 48.3% | 49.1% | 49.2% | 47.7% |
| 3.3% | 3.3% | 3.2% | 3.08% | 3.1% | 2.5% | 2.6% | 2.8% | 3.2% | 3.0% | 3.1% |
| 3.5% | 3.5% | 3.5% | 4.12% | 4.3% | 4.1% | 4.0% | 4.2% | 4.1% | 4.1% | 4.1% |
| 57.2% | 55.5% | 57.2% | 57.3% | 59.3% | 61.4% | 63.5% | 54.1% | 56.5% | 56.6% | 59.0% |
| **14.8%** | **14.1%** | **15.0%** | **13.2%** | **13.3%** | **13.8%** | **13.5%** | **16.1%** | **15.9%** | **15.6%** | **16.2%** |
| | | | | | | | | | | |
| 28 748 | 28 678 | 28 494 | 48 730 | 42 736 | 45 755 | 46 375 | 148 747 | 141 692 | 145 075 | 145 595 |
| | | | | | | | | | | |
| 12.9% | 12.1% | 12.6% | 12.3% | 11.7% | 11.0% | 12.0% | 13.4% | 13.0% | 12.7% | 13.2% |
| 2.0% | 2.3% | 2.7% | 3.1% | 2.9% | 2.5% | 2.3% | 2.4% | 2.5% | 2.2% | 2.3% |
| **14.9%** | **14.4%** | **15.3%** | **15.4%** | **14.6%** | **13.5%** | **14.3%** | **15.8%** | **15.5%** | **14.9%** | **15.5%** |

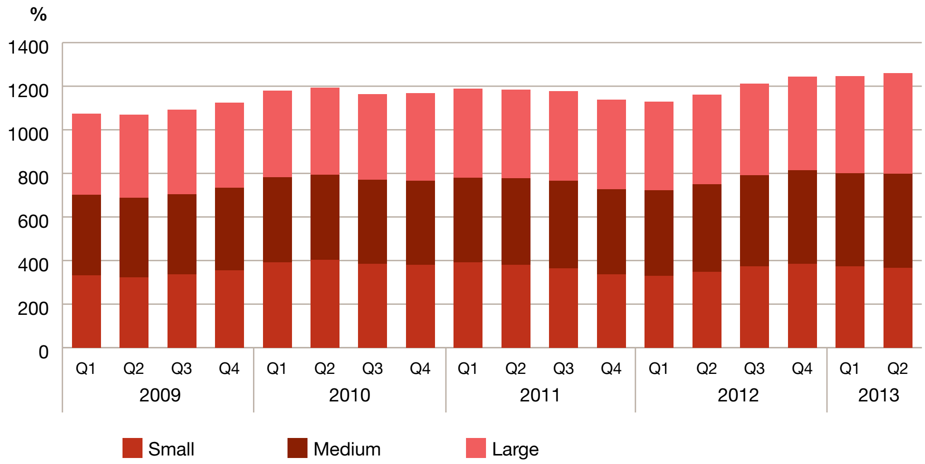
# 10. Industry data

## GDP growth



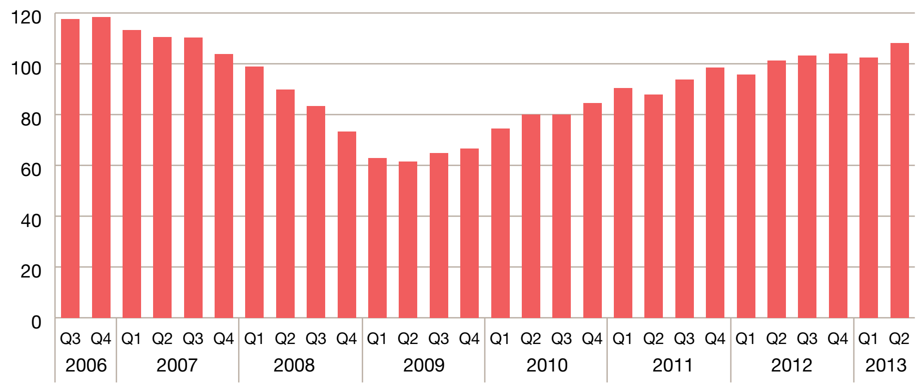

*Source: Statistics SA*

## Absa House Price Index



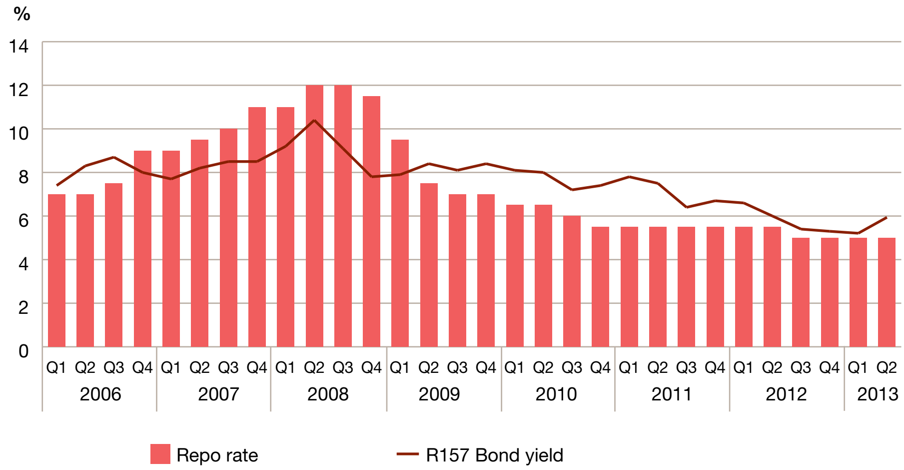

*Source: Absa*

## New vehicles sold



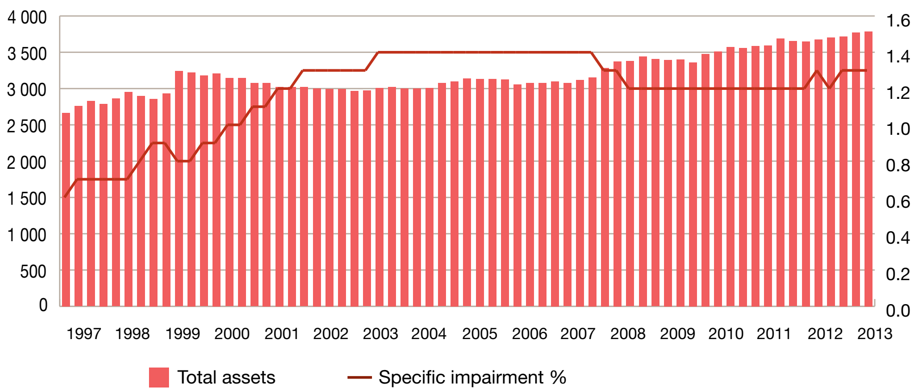

*Source: SARB*

## Interest rates



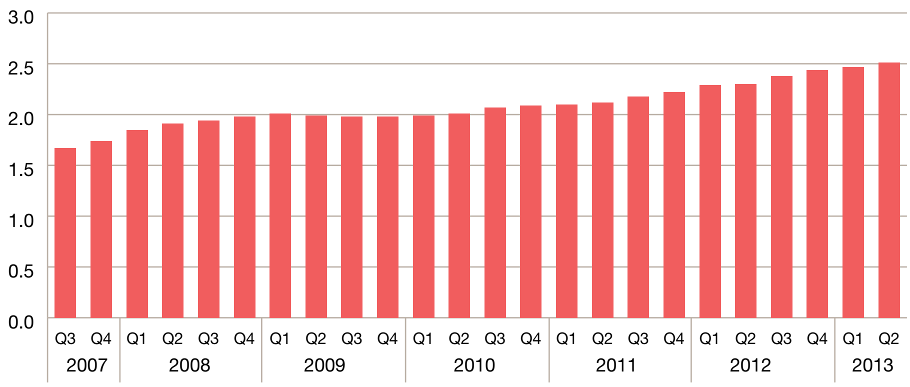

*Source: SARB*

## Industry credit impairments



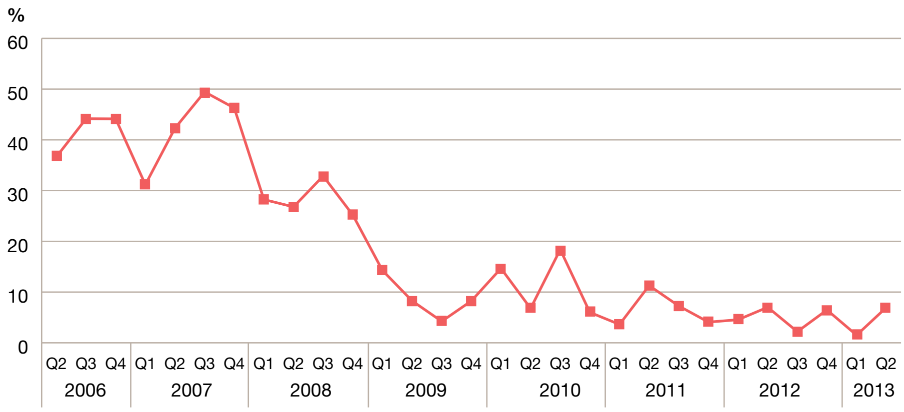

*Source: SARB*

## Industry credit extension (Rtr)



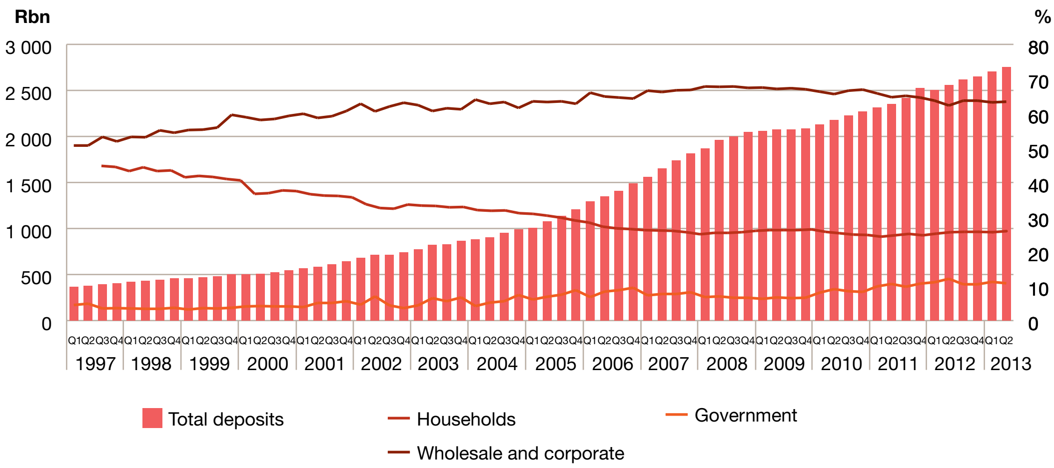

*Source: SARB*

## Quarterly growth in mortgage advances



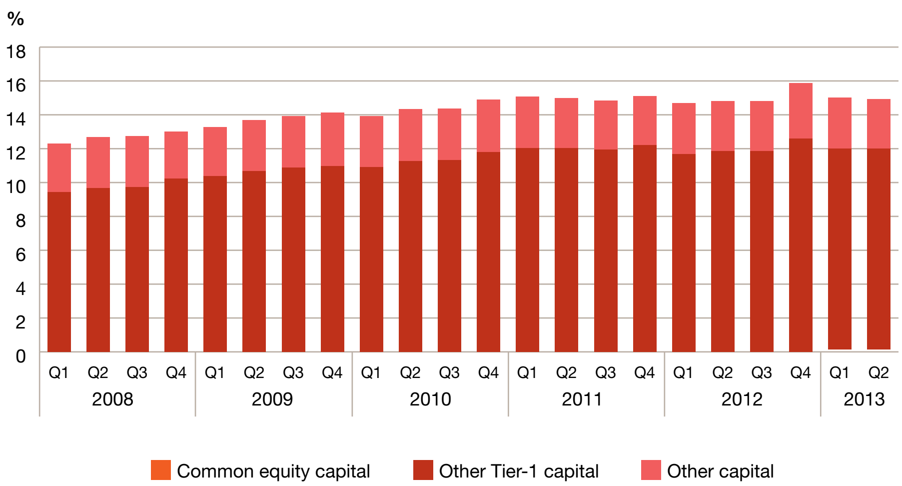

*Source: SARB*

## Industry deposit mix




*Source: SARB*

## Industry capital adequacy




*Source: SARB*

# 11. Contacts


### Tom Winterboer

Financial Services Leader - Africa
+27 11 797 5407
tom.winterboer@za.pwc.com



### Johannes Grosskopf

Banking & Capital Markets Leader - Africa
+27 11 797 4346
johannes.grosskopf@za.pwc.com



### Stefan Beyers

Banking & Capital Markets Partner
+27 11 797 4690
stefan.beyers@za.pwc.com


## *Contributors*

*Costa Natsas*

*Irwin Lim Ah Tock*

*Louwrens van Velden*

*Rivaan Roopnarain*

*www.pwc.co.za/banking*