PwC analysis of major banks' results for the reporting period ended 30 June 2014
16 September 2014

Stability amid uncertainty
South Africa – Major banks analysis

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Contents

1. Combined results overview

This analysis presents the combined local currency results of South Africa's major banks (Barclays Africa Group, FirstRand, Nedbank and Standard Bank). 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.

**Combined headline earnings up*	***13.1%***
Average return on equity of	***17.1%***
**Bad debt expenses down*	***9.6%***
**Total operating income up*	***9.5%***
**Operating expenses up*	***9.8%***

**1H14 vs 1H13*

One of the key themes that characterised the first six months of 2014 is the mixed and varied sentiment associated with the global and domestic economic landscape. This provides the context for the operating environment that underpins the financial results of our major banks.

In our previous edition of the Major Banks Analysis (March 2014) we noted that '*key questions for 2014 will centre around whether the outlook for advanced economies can live up to expectations; whether the domestic economy can stand up to the risks it is facing – including the consumer impact of higher inflation and interest rates, labour unrest and the weak rand – and the local impact of global monetary policy*'.

From the current vantage point, it remains difficult to suggest clear answers to these questions. Domestically, the operating environment for the major banks for the first half of 2014 remained difficult and considerably volatile on the back of macroeconomic uncertainty, weighing heavily on local business confidence. While it appears that the outlook for the advanced economies seems firmer, the domestic economic situation appears more fragile and uncertain. What is clear, however, is that global growth considerations, while expected to continue along a recovery path, are expected to proceed at an uneven pace, and continue to be impacted by a number of risk scenarios that could negatively impact the pace of global growth.

External developments[1]

Alongside concerns over inflation and unpredictable exchange rates – which rank high in the thinking of emerging market economists, executives and policymakers – concerns about geopolitical tensions and related uncertainties have recently added to the concerns of the advanced economies. This new risk development has been evident in the volatility brought about by the recent political unrest and conflict in the Ukraine and Russia, as well as the renewed tension in the Middle East. At the same time, the impact of less favourable fundamentals within the emerging economies has been made ever more challenging through uncertainty around the sustainability of China's traditionally strong growth path, which has recently begun to show signs of tapering off. While, within the continent, the impact of the Ebola virus outbreak in West Africa continues to weigh on economic confidence.

Inflation has been dropping in the eurozone – a key SA export market – for some time now, with recent estimates for annual inflation in the region of 0.5%, down from 0.7% estimated earlier in the year. At its June monetary policy meeting, the European Central Bank (ECB) introduced an unprecedented negative deposit rate to mandatory reserves placed with it by the commercial banking sector. This represented a break with conventional monetary policy thinking, which held that the 'zero-bound' provided a floor for policy rates. The full impact and related implications of this unique situation on lending in the European economy are yet to be seen in financial markets, both in the eurozone and globally.

Notwithstanding these global growth and inflationary concerns, evidence of a sustainable economic recovery in some advanced economies, particularly those of the US and UK, have contributed to a general improvement in global financial conditions over the first half of 2014.

South Africa's economic environment remains challenging, with a number of structural concerns having recently risen in prominence. These include significant energy supply concerns and a period of debilitating labour unrest in key output sectors of the economy earlier this year. The South African economy contracted by 0.6% in the first quarter of 2014, sparking some concern at the time over whether the country was on a path toward a technical recession. While some of the initial concern has been disproved with an ironic second-quarter growth figure of 0.6%, the overall theme of the domestic economy continuing to perform significantly below its potential remains a key concern.

In addition, a number of South African retailers have recently highlighted profit concerns, as high unemployment and inflation result in a more adverse retail consumer base. Earlier this year, South African retail sales saw the weakest year-on-year performance since 2009 (as reported in the SARB Quarterly Bulletin – June 2014), highlighting the strain currently facing the domestic retail consumer market.

While GDP has been recovering at a modest pace in most advanced economies, the impact of this momentum on employment figures presents a more balanced picture. Employment figures remain an important metric for businesses to monitor, as they correlate strongly with household consumption which, in turn, is a key driver of company revenues.

The US has more jobs now than before the crisis, reaching a key milestone in April as employment in the world's largest economy exceeded its pre-crisis level for the first time since the fourth quarter of 2008. We expect this picture to continue to improve as US GDP growth is expected to be around 2–3% per annum in 2014–15. In the eurozone, the employment picture remains mixed. Germany – the region's most significant economy – sits at one end of the spectrum, having created more than two million jobs, while other eurozone countries have seen around 6.7 million jobs lost since the global financial crisis, mostly driven by the peripheral nations.

As the advanced economies adapt to an ever-changing macroeconomic landscape, it is widely believed that the extent of monetary policy accommodation that is currently in place in some of these key countries will be unwound with increasing frequency. This is expected to result in emerging market headwinds through higher future global interest rates and continued volatility in capital flows, particularly within economies dependent on those flows to fund domestic deficits such as South Africa.

Major banks performance

It is against this challenging and uncertain operating environment that the major banks have posted admirable results for the current review period. Collectively, the banks reported a combined increase of 13.1% in headline earnings to R27.8bn against the comparable period. The levers impacting this growth continue to be strong net interest income growth of 13.0 %, non-interest revenue growth of 5.6% and reduced impairment charges

[1] PwC Global Economy Watch – July and August 2014

which declined by 9.6%, largely a result of focused efforts in previous periods to streamline provisioning policies and strengthen collection efforts. However, impairment charges increased by 16.2% when compared to 2H13.

Growth in gross advances continues to reflect the focused approach adopted by the major banks to ensure that credit written is of appropriate quality, and is priced to generate more risk-reflective levels of margin. Gross loans and advances grew 5.4% in the first half of 2014 when compared to the first half of 2013. This is slightly higher than the growth of 2.3% noted in the second half of 2013.

Interestingly, while impairment charges decreased against 1H13, combined non-performing loans (NPLs) have begun to show a reversal of the downward trend seen consistently since 2011, and grew by 1.2% for the current review period. This reversal in the NPL trend is reflective of both the consumer and business impacts of a turning interest-rate cycle, and the seasoning of high-quality credit written in pre-crisis years negatively impacting on the average credit quality of the lending books.

All the major banks continue to highlight their decisions taken in the past to adopt a measured approach to limiting the origination of high-risk portfolios, particularly unsecured loans, while continuing to provision appropriately and adequately price for the higher levels of risk inherent in these portfolios.

The benefit of an increased endowment impact as a result of dual increases in the repurchase rate by the Monetary Policy Committee over the current review period has been offset by intense competition and margin compression arising from wholesale assets growing faster than higher-margin retail assets. In spite of the changing asset mix to reflect the strategic decisions of the major banks, the combined net interest margin improved by 17 basis points against the comparable period to 4.47%. Margins have also been positively impacted by increased high-yield foreign currency lending, particularly US dollar-denominated loans, as banks continue to focus aggressively on expanding into the rest of the African continent, while continuing to position hedging strategies to reflect expectations of an upward-trending interest rate cycle.

The domestic retail credit market is expected to remain challenging, largely as a result of the turn in the South African interest rate cycle. The latest available National Credit Regulator's quarterly *Credit Bureau Monitor* (for Q1-2014) showed a reversal in the previously increasing trend of consumers with impaired records and the percentage of consumers classified as being in good standing. However, the South African economy remains characterised by generally high levels of household debt-to-GDP ratios, with further expected strain as a consequence of the domestic interest rate outlook.

The themes reported previously with regard to non-interest revenue (NIR) remain consistent, with a few notable developments during the current review period. In particular, while NIR growth continues to be driven by fee and commission income, we have started to see greater strategic focus on growth in the wealth and bancassurance offerings of the banks. At the same time, continued focus on migrating customers to online channels positively impacted electronic volumes, but this was offset in some respects by intense pricing competition, mainly in the retail market, among the major banks. The contribution of the banks' rest of Africa operations to NIR growth is a key feature of the growth drivers, and we expect the upward trend in contribution from the rest of the continent to continue as the banks focus on executing on their African ambitions with greater intensity. Looking ahead, the recent announcement by the South African Reserve Bank of the revised card interchange rates, which come into effect on 1 January 2015, is expected to negatively impact fee and commission income from this important product stream for the major banks.

Other notable features driving growth in non-interest revenue include:

- Net fee and commission income grew by 7.2% against the comparable period, but slowed by 1.7% when compared to 2H13. In some ways, these figures reflect the fierce competition for wallet-share among the major banks, as well as the highly competitive transactional banking environment in South Africa across both the retail and corporate sectors. It is evident that regulatory pressure continues to result in the banks realigning their strategic priorities and enhancing their focus on less capital-intensive business lines which, in turn, adds to the competitiveness and attractiveness of the transactional banking environment in South Africa;
- Trading income slowed narrowly when compared to 1H13 as a result of continued financial market volatility, the mixed macroeconomic environment and increasing competition in the investment banking landscape. We continue to note the positive impact of fair-value realisations on private equity investments attracting strong levels of market interest with deal pipelines remaining strong; and
- Insurance revenue and income from wealth products continue to show a positive growth trend, despite the consumer and business impact of a challenging economic context and an increase in weather-related claims during the current review period.

From an efficiency perspective, the combined cost-to-income ratio of the banks deteriorated marginally to 54.9%, compared to 54.2% in 1H13. Consequently, we note a slight reversal in the positive jaws effect we have seen for a number of prior periods, driven by a 9.5% increase in operating income, offset against 9.8% growth in operating expenses.

Cost-containment remains an area of focus for the banks while they continue to invest in talent and undergo enhancement of their information technology capabilities to respond to customer demands, heightened concern over cyber-crime, and regulatory requirements that call for enhanced data capabilities. The divergent paths taken by the major banks to respond to the information technology challenge, and the related impact on the cost base, remains an interesting differentiating factor between the banks. As they continue to expand across the continent, the negative impact of having dollar-based costs in a weakened-rand environment will continue to place pressure on their operating costs.

The theme of divergence in return on equity (ROE) levels that we reported in our previous analysis has continued in the first half of 2014. While maintaining or improving ROE levels remains a key area of focus for all of the major banks, the combined ROE of 17.1% (compared to 16.2% at 1H13) reflects admirably on the resilience, through the cycle, of the banks' earnings capabilities achieved through solid franchises and diversified product streams. However, when compared to the combined ROE of 17.5% observed at 2H13, the impact of a difficult operating environment prevalent throughout the current review period is observable.

In line with expectations, the impact of an evolving regulatory landscape and, in particular, higher capital requirements being phased in under Basel III have begun to influence regulatory capital levels. In spite of this impact, the combined capital adequacy ratio of the major banks of 15.4% reflects solid capital buffers, and the prudent approach to capital management taken by them over prior years in anticipation of changing regulations. Overall earnings growth has continued to generate capital and, together with a continued focus on risk-weighted assets optimisation, has resulted in all the banks being comfortably in compliance with minimum required capital ratios. From a capital adequacy perspective, this positions the banks well, given the higher minimum capital requirement phased in from 1 January 2014. It is also positive that the solid capital adequacy ratios of the banks at 1H14 has been achieved in spite of the existence of old-style capital instruments which continue to be phased out, and the South African operations of the major banks having to capitalise for the impact of different capital regimes across their foreign operations.

Stakeholder expectations

Globally, we continue to observe a trend towards heightened regulatory focus on compliance and market conduct of banks, with various large, internationally active banks recently subject to high-profile fines and penalties. Given South Africa's imminent move to a 'twin peaks' model of financial regulation, we expect market conduct supervision for banks to gain significantly in both prominence and intensity.

The first half of 2014 has seen a number of significant developments that have had implications for the South African banking industry. In line with the trend of increasing regulatory focus on compliance, the South African Reserve Bank (SARB) has highlighted the importance for robust anti-money laundering and countering the financing of terrorism (AML/CFT) controls through penalty action taken earlier in the year against the major banks. All the banks have noted that the process of responding and strengthening these controls, including compliance capabilities, more broadly is already under way.

Turning to other domestic banking sector issues and in an effort to maintain and enhance the stability of the South African banking system, the SARB instituted a number of support measures in response to the trading update of African Bank Investment Limited, the parent company of African Bank, issued in early August 2014, and which highlighted the challenges facing this institution. A key measure in this response was the decision by the Registrar of Banks and the Minister of Finance to place African Bank under curatorship on 10 August 2014.

The SARB has set a plan in motion with respect to this institution, as detailed in the Governor's statement announcing the curatorship. It will be interesting to note the regulatory responses once the full picture with respect to African Bank is understood.

One of the less positive implications resulting from the resolution measures regarding African Bank has been the impact of ratings actions and cautionary announcements issued by the large credit rating agencies. Downward revisions in credit ratings, changes in the credit outlook or perceptions of possible changes in either will manifest in driving up the banks' funding costs, which could add to earnings pressure going forward.

However, most market commentators, industry analysts and some of the agencies themselves have welcomed the swift supervisory actions taken by the SARB in the interest of maintaining the strength and credibility of the South African banking and financial system.

It is also positive to note that earlier this month the World Economic Forum ranked South Africa first among 144 countries, both for the country's regulation of its securities exchange and the auditing and reporting standards to which companies are required to adhere. South Africa's strong position in terms of regulatory standards and corporate reporting continues to reflect well on the credibility of its institutions and regulators, in spite of our other economic and socio-political challenges.

Internal responses

During the current review period, we have seen emphasis placed in the market on vulnerabilities that can arise from reliance on external custodians, particularly those located in international jurisdictions far removed from the governance and control oversight of the domestic banking operations of the major banks in South Africa. It is too early to forecast the outcomes of detailed investigations undertaken by some of the banks in response to this growing concern, which does highlight the risks that can arise from reliance placed on external custodians.

The drive to expand their footprint, product offerings and customer capabilities in markets within the continent and beyond South Africa continues to be highlighted as a headline strategic objective of all of the major banks. While individual strategies are nuanced, the desire to incrementally enhance the earnings contribution of their operations in the rest of Africa remains a core area of focus for the banks.

Domestically, channel and platform innovation, together with customer-centric product diversification priorities, all represent strategic focus areas for each of the major banks. All of the banks have highlighted the importance of driving customers and product delivery through to mobile and online channels.

Investments in IT systems across all the major banks continues to rank high on the strategic agenda, mainly to ensure that they have the necessary scale, are well positioned for, and have platforms that can sufficiently enable their future growth expectations. However, there are other external drivers influencing the need for IT investment. Sophisticated developments in cyber-crime have contributed to growing global concern about the vulnerability of banks to potential attacks, and have highlighted the need to ensure resilient and adequately defensible IT architectures.

At the same time, advancing regulatory requirements and rapid developments in analytical technologies will continue to present opportunities for banks that can leverage sufficiently granular data into actionable insight to make more informed strategic decisions.

Prospects

It is against the mixed economic background described earlier that we note that macroeconomic trends in the financial services marketplace and the global economy suggest that periods of turbulence, uncertainty, and a series of highly complicated and ambiguous risk-and-reward scenarios lie ahead. At the same time, the regulatory and operating landscape in which banks function is changing at an exhilarating pace. We explore some of these themes and 'the future shape of banking' later in our analysis.

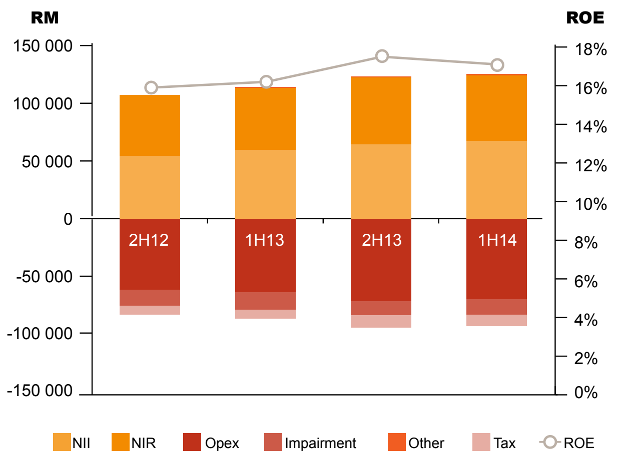
While all the banks have highlighted cautious optimism over their short-term prospects, the combined results for the current review period continue to reflect the strength of the South African banking sector and the resilience of our banks' ability to generate earnings, despite the subdued operating environment.

Forecast risk, volatility, complexity and uncertainty will all continue to characterise the macroeconomic and domestic environment over the short term. However, the strength of our major banks' core franchises, trust in their brands and strong customer relationships remain key strengths. Those that continue to focus strategically on building their core capabilities, while continuously optimising all elements of human and economic capital, will emerge as key differentiators in a dynamic and evolving operating environment.

Combined results for six-month periods (Rm)

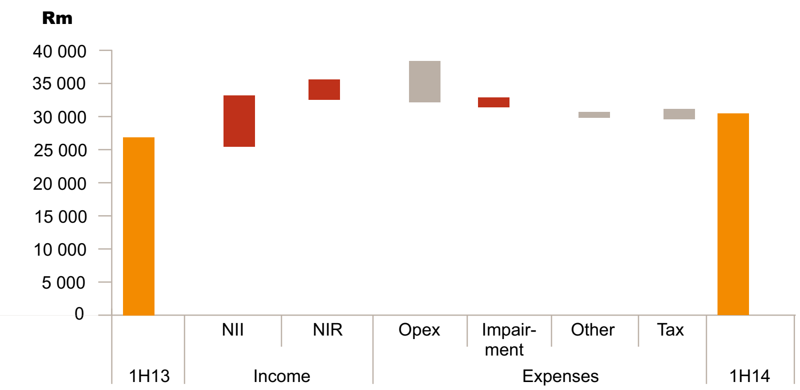
	1H14	2H13	1H13	2H12	1H14 vs 2H13	1H14 vs 1H13
Net interest income	67 091	64 277	59 374	54 285	4.4%	13.0%
Non-interest revenue	56 975	57 995	53 936	52 833	-1.8%	5.6%
Total operating income	124 066	122 272	113 310	107 118	1.5%	9.5%
Total operating expenses	-69 964	-71 985	-63 738	-61 766	-2.8%	9.8%
Core earnings	54 102	50 287	49 572	45 352	7.6%	9.1%
Impairment charge	-13 927	-11 985	-15 413	-14 140	16.2%	-9.6%
Other income/(expenses)	998	1 008	851	-642	-1.0%	17.3%
Discontinued operations	-1 032	-	-	2 004	100.0%	-
Income tax expenses	-9 676	-11 415	-8 151	-7 817	-15.2%	18.7%
Profit for the period	30 465	27 895	26 859	24 757	9.2%	13.4%
Attributable earnings	27 448	27 784	24 268	23 161	-1.2%	13.1%
Headline earnings	27 826	27 642	24 612	22 210	0.7%	13.1%
Return on equity	17.1%	17.5%	16.2%	15.9%	-	-

Figure 1.1 Combined income statement of the major banks



***Source**: PwC analysis*

Figure 1.2 Key drivers of combined profit and loss



***Source**: PwC analysis*

2. *Economic outlook*

By Dr Roelof Botha, economic advisor to PwC

Welcome improvement in short-term growth prospects

A huge sigh of relief would have been audible at the National Treasury when the real GDP growth rate for the second quarter of the year was announced in late August.

The result was a positive 0.6% (quarter-on-quarter), compared to a marginally negative growth rate during the first quarter of 2014. The upshot is, of course, that a technical recession was averted, albeit by the narrowest of margins.

On a year-to-year basis, the GDP picture is less dismal. Although economic growth rates remain substantially below the country's potential, the second quarter output figure represents the eighteenth successive quarter of positive growth (in real terms).

As was to be expected in the aftermath of the longest strike in South Africa's history (in the platinum sector), followed by several more strikes in the metal and engineering sectors, mining and manufacturing were primary contributors to the weak growth seen during the first half of 2014.

Negative output growth in the largest primary and secondary sectors of the economy stands in sharp contrast to sustained growth in all the tertiary sectors, most notably transport, storage and communication.

The rise of services

Fortunately for South Africa, the relentless rise in economic activity related to the services sectors should allay any fears of a return to recession in the short and medium term. In 1994, the primary and secondary sectors represented more than 44% of total GDP. This contribution dropped to 34% a decade later, and now stands at less than 30%.

Since the beginning of this year (2014), negative economic sentiment has been fuelled, among other factors, by labour unrest, higher unemployment, poor corporate governance standards in the public sector (especially at municipal level) and weak retail sales figures. When electricity supply constraints, uncertainty over land reform and decaying infrastructure in several parts of the country are added to this list, the country's lethargic and stuttering recovery from the 2008/09 recession is not altogether surprising.

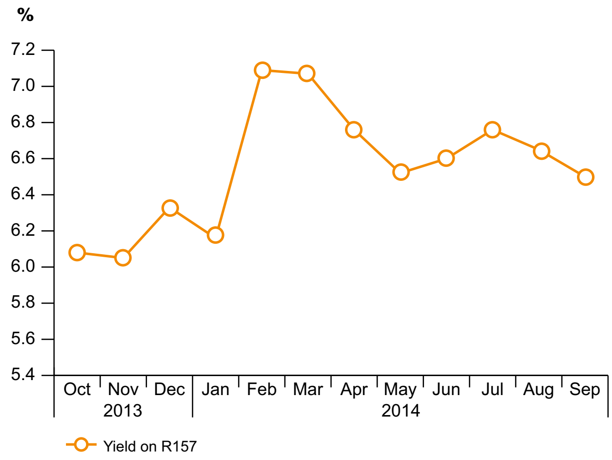
The immediate future, however, looks more promising. An impressive array of indicators suggests that real GDP growth of 2–3% may be achieved over the next two to four quarters. One of the reasons for cautious optimism is the fact that 1 200 megawatts (MW) of base-load electricity should become available via the Medupi power station before the end of the year. In addition, an estimated 2 000 MW of electricity from renewable sources will be available by the end of the year, swelling to 4 000 MW by the end of 2015.

Barring any major incidents of work stoppages during the rest of the year, it is clear that mining and manufacturing should start making positive contributions to growth during at least the next two quarters, as production levels rise off a low base.

Declining bond yields

The declining trend in the short-term South African government bond yield, combined with lower interest rates in Europe and the US, suggest that capital markets are expecting monetary policy to be as accommodating as possible, especially in an environment of relatively low inflation and subdued levels of consumer confidence, as reflected in figure 2.1.

Figure 2.1 Yield on the SA R157 bond

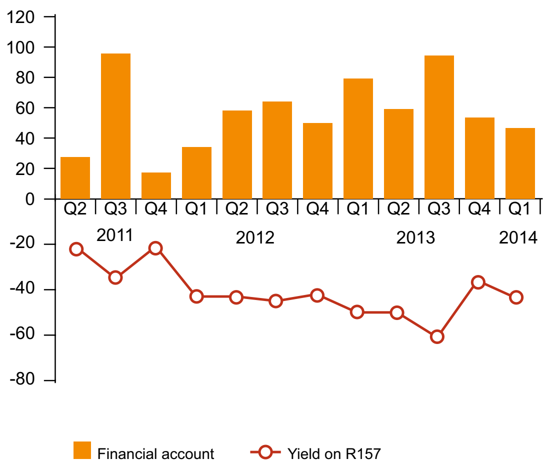


***Source**: Thebe Securities*

The producer price index (PPI), a traditional precursor of consumer inflation, seems to have peaked at 8.8% (in April), with the consumer price index (CPI) having declined from 6.6% in June to 6.3% in July. Consumers will soon start to benefit from these trends.

A further positive factor is the sustained inflow of significant funds on the financial account of the balance of payments, which has more than matched the current account deficit for eight consecutive quarters and serves to explain, to a large extent, the new-found stability of the rand exchange rate depicted in figure 2.2.

Figure 2.2 Balance of payments – current & financial account (including unrecorded and special drawing right (SDR) transactions)

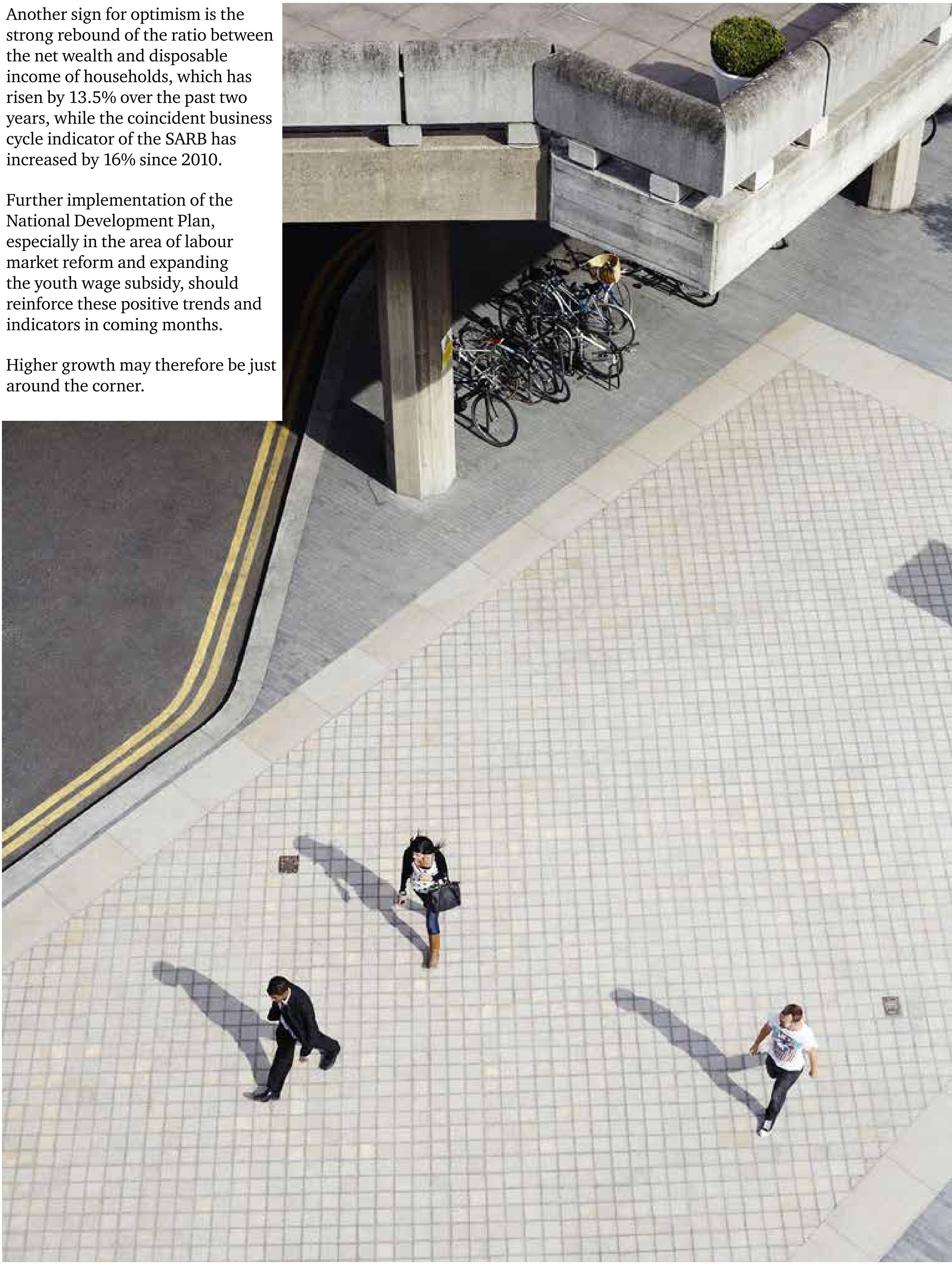


***Source**: SARB*

Another sign for optimism is the strong rebound of the ratio between the net wealth and disposable income of households, which has risen by 13.5% over the past two years, while the coincident business cycle indicator of the SARB has increased by 16% since 2010.

Further implementation of the National Development Plan, especially in the area of labour market reform and expanding the youth wage subsidy, should reinforce these positive trends and indicators in coming months.

Higher growth may therefore be just around the corner.

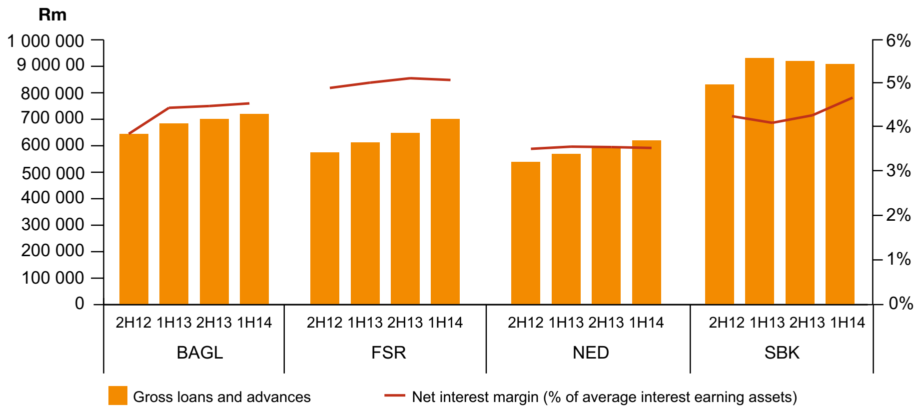


3. Net interest income

Net interest margin (Rm)

	Combined			
	1H14	2H13	1H13	2H12
Gross loans and advances	2 945 912	2 859 262	2 795 257	2 589 032
Net interest margin (percentage of average interest- earning assets)	4.47%	4.37%	4.30%	4.25%

Figure 3.1 Net interest margin and advances



Source: *PwC analysis*

Loans and advances growth continues, but at a measured pace

Increased interest rates and a potential change in the credit impairment cycle will continue to place pressure on bank margins

Asset mix continues to benefit NII, while the positive impact of risk-adjusted pricing seen in previous periods is offset by intense competition

Credit growth

Industry credit growth in loans and advances was 6.1% when compared to 2H13, and 9.1% when compared to 1H13. For the major banks, gross credit extension in the form of loans and advances increased 3.0% on 2H13 and 5.4% on 1H13.

Key drivers for gross loan growth remain generally consistent with our previous observations, with a key theme being a continuation of growth contributions from corporate and wholesale advances portfolios compared to retail portfolios.

Some of this growth certainly comes from the traction achieved by the banks' focused expansion across the rest of Africa, where significant infrastructure and commodity-related deals are written in US dollars. Given the dollar nature of these loans, some of the growth reflects the weaker rand exchange environment, which may suggest lower levels of growth on a constant currency basis.

Mortgage loan portfolios, which continue to be significant in absolute value, continue to show limited new growth and are generally expected to remain flat, given the increasing interest-rate cycle. At the same time, margins in this loan category are considerably lower when compared to other lending portfolios and, together with the higher-interest-rate environment, volatile residential property market and capital-punitive nature of this business line, result in a subdued outlook for mortgage lending growth over the short-term horizon.

Customer deposits

Total deposits of the major banks grew only 2.2% in the first half on a rolling six-month basis, but grew by 5.1% when compared to 1H13. The modest growth rates seen in combined deposits underlines the pressures that consumers continue to face in a challenging economic environment.

Growth in deposits continues to be driven by corporate and retail deposits, which have longer tenor expectations than wholesale and institutional deposits.

Consistent with our previous observations, this trend remains supported by industry data which reflects that the growth in the deposits for 1H14 has materialised through corporate, wholesale and retail deposits while government, municipal and inter-bank deposits remain generally flat. This trend continues to highlight the importance of maintaining strong corporate and retail transactional banking franchises for the major banks, as these businesses generally maintain the customer relationship and serve as a key platform for cross-sell opportunities.

Hedge portfolios

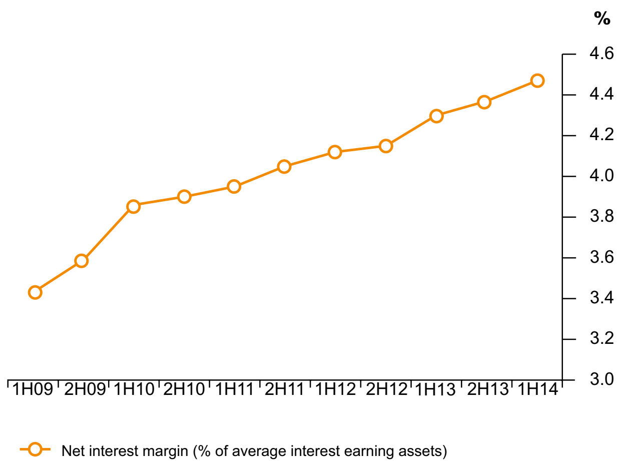
The effectiveness of hedge portfolios, designed to limit the impact of interest rate volatility, depends on the timing of the hedges, positioning against the interest rate cycle and the size of the risk hedged.

Higher South African interest rates in the first half of the year resulted in a positive impact of endowment on margins, and have resulted in varied impacts of hedging on margins for the banks that disclose this information.

Net interest margin

Whilst the drivers of interest margin remain consistent with the themes reported previously, we continue to note improvements from asset mix, balance sheet positioning initiatives and offset by competitive pricing strategies. Although margins from the banks' operations outside South Africa generally remain above those of the local balance sheet, increasing levels of competition, declining rates over the short term and regulatory changes which will materially impact pricing decisions under the new prudential liquidity regime will all pose key challenges to the banks' margins going forward.

Figure 3.2 Combined net interest margin



Source: PwC analysis

4. Non-interest revenue

NIR is primarily driven by fee and commission income, which represents 71% of the total for 1H14.

NIR grew 5.6% in 1H14 compared to 1H13.

Non-interest revenue has maintained its growth trajectory in the recent past, although the momentum appears to have slowed down somewhat. We have observed increased competition in this area, and with structural reforms such as the revised card interchange rates, which come into effect on 1 January 2015, a challenging time lies ahead if further growth is to be extracted from this line in the future.

On the positive side, the major banks continue to grow non-interest revenue at a fast pace from their Rest of Africa operations, although the absolute contribution continues to be relatively small.

Net fee and commission income

Net fee and commission income grew by 7.2% when compared to 1H13. Once again this represents a remarkable outcome, given the low-to-zero inflationary increases on bank charges, and highlights the considerable effort made by the banks to increase their customer bases.

We have also seen a continuation in the trend of customers migrating to electronic channels, which with the lower-revenue-generating effect of 'value bundles' continue to place pressure on absolute growth in this revenue line. An interesting development has been the upturn over the last couple of periods in the relative contribution of net fee and commission income related to credit card products to this income statement line.

Looking ahead, the recent announcement by the South African Reserve Bank of the revised card interchange rates, which come into effect on 1 January 2015, is expected to negatively impact fee and commission income for this important product stream for the major banks.

Diversification of the net fee and commission income revenue stream across various geographical regions on the African continent continues to receive management focus, and is expected to be one of the factors that will distinguish the winners from the losers in this area.

Fair value income

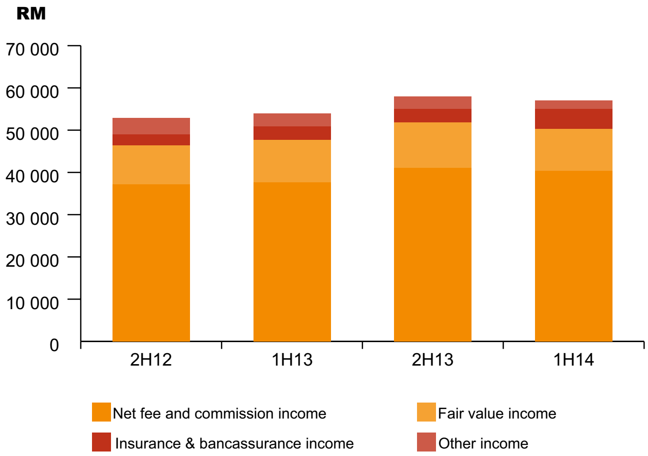
Fair value income continued on the volatile trend established in previous reporting periods, and was 1.0% down on 2H13 and 7.6% down on 2H13.

On the domestic front, the trading environments remained challenging due to increased competition, compressed margins and lower volumes. The major banks are increasingly looking northwards to bolster trading revenues, given the strong economic growth being experienced in many countries on the continent and opportunities that exist in these territories to capitalise on. These results, although currently a relatively small percentage of the total trading operations, were also boosted further by the weakening rand.

Insurance and bancassurance income

Insurance and bancassurance income continued their upward trend, and were buoyed by strong equity markets. This line of business experienced some headwinds in 1H14, such as a higher number of weather-related claims, moderating premium growth and a general slowdown in bancassurance sales following more subdued growth in the retail advances environment.

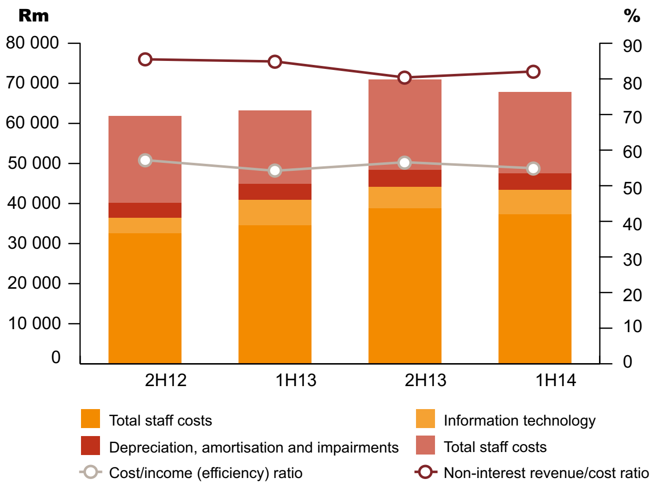
Figure 4.1 Non-interest revenue



***Source**: PwC analysis*

5. Efficiency

Figure 5.1 Operating expenditure



***Source**: PwC analysis*

Compared to 1H13, the major banks' operating expenses increased by 9.8%, while total operating income increased by 9.5%. Consequently, their combined cost-to-income ratio deteriorated marginally to 54.9% in 1H14 (1H13: 54.2 %).

Cost-containment strategies, which have been in place for a number of years, continue to be rigorously enforced as revenue growth remains subdued.

Significant investments continue to be made in Information Technology and retail banking franchises.

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

Cost-containment strategies, which have been in place for a number of years, continue to be rigorously enforced as revenue growth remains subdued. It is becoming increasingly difficult for the banks to minimise their cost base while operating in a higher inflationary environment, compounded by the increased costs of building out a footprint in the rest of Africa and ongoing investment required to significantly enhance IT platforms.

Successfully executing these cost-containment strategies will become increasingly difficult, as discretionary costs have already been an area of focus for a number of years, with a shift to more strategic initiatives being observed.

Increased salary costs reflect annual salary increases as well as 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 and key talent in the rest of Africa. We have also observed an increase in the banks' marketing spend as efforts to attract and maintain retail customers – considered absolute gold in the context of regulatory changes and forthcoming prudential liquidity requirements – becomes increasingly competitive.

Information technology (IT) spend also continues to be on the rise on a year-on-year basis, as banks continue their efforts to implement new systems to cater to increased regulatory requirements and heightened customer expectations of seamless transactional banking and treasury solutions. The amortisation charges related to the enduring benefit brought about by the new IT systems will continue to place pressure on the banks' cost base in the future as these systems come on-stream and are fully activated.

Operating expenses were 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 9.22 in 1H13 to 10.70 in 1H14, and negatively impacted the earnings of those banks with significant operations outside South Africa.

6. Asset quality

Asset quality (Rm)

	Combined			
	1H14	2H13	1H13	2H12
Gross loans and advances	2 945 912	2 859 262	2 795 257	2 589 032
Non-performing loans	93 923	92 714	99 331	101 583
Impairments	-62 015	-59 764	-58 277	-56 164
Portfolio provisions	-21 019	-19 418	-17 690	-16 768
Specific provisions	-40 996	-40 346	-40 587	-39 395

Gross loans and advances

Combined loans and advances of the major banks grew by 3.0% in 1H14 and 5.4% against 1H13 (compared to the 2.3% growth seen for the six months to 2H13 and 13.1% for the 12 months to 1H13).

The marginal levels of growth in gross loans across the major banks continue to reflect the difficult operating environment facing households and corporates, as well as the impact of macro and domestic economic factors negatively affecting business confidence.

Corporate lending

Consistent with the trend we have observed previously and our outlook six months ago, growth in corporate lending continues to outpace retail lending, and grew by 7.7% for 1H14, compared to growth of 4.2% across all retail portfolios.

Key product drivers of growth in corporate lending for the current period are resilient demand for foreign currency loans, corporate overdrafts as well as other demand loans, offset by slowing combined growth in term lending. Underpinning growth in these corporate lending product categories is increased demand for trade finance lending, as the weaker rand increased the value of import transactions as well as the inventory holdings of corporates. Ongoing activity related to renewable energy projects, which includes the participation of all of the major banks, and the funding of their African expansion strategies also facilitated growth in corporate lending portfolios, despite the backdrop of a challenging but moderately improving macroeconomic environment and lacklustre domestic economic performance.

Looking forward, the outlook for corporate lending is perhaps less favourable than it was six months ago, given the economic headwinds and levels of uncertainty prevalent in the macro and domestic economic landscape. This challenging context is also expected to be made more difficult by a still-challenging labour environment in certain key output sectors of the economy, as well as rising cost pressures given the current inflationary environment. However, some of the major banks have highlighted their expectations of favourable drawdowns in their deal pipelines to continue over the rest 2014, as a result of forecast activity in development sectors expected in the rest of Africa, which ties into their stated strategies of targeting pan-African lending growth.

Retail mortgages

Industry data for the current period shows that capital repayments on mortgage advances – which have partly been contributing to the moderate growth in net mortgage advances over the past three years – slowed in the first quarter of 2014. This slowdown in the trend of early capital repayments on mortgages can be expected, given the turn of the interest-rate cycle prompting some caution on the part of retail borrowers.

Interestingly, despite the challenging domestic environment, the SARB's latest available Quarterly Bulletin (June 2014) reports that 'demand and trading activity in the real-estate market seemed to be picking up'. The average time that residential properties remained on the market declined from 15.1 weeks in the fourth quarter of 2013 to 13.6 weeks in the first quarter of 2014 – the lowest average time on the market since the first quarter of 2010.

Against this context, the downward trend in mortgage loan growth reversed in the current period, with growth inching moderately higher at 0.7% for 1H14 against 2H13, compared to 0.4% growth for the six months to 2H13. Looking ahead, most market expectations are for subdued consumer demand in this category to continue, as consumers are expected to be reluctant to enter into long-term loans, given the higher inflationary environment, upward-trending interest rate cycle, and still-fragile levels of household debt as a percentage of disposable income. In addition, with low levels of margin typically associated with mortgage lending portfolios, together with nominal house price inflation expected to trend close to, or marginally above, national inflation, we expect mortgage lending activity to remain relatively flat over the next six months.

Instalment sale credit, card debtors and other unsecured lending

Resilient growth in card debtors of 7.1% for 1H14 (5.3% for the six months to 2H13) was offset by slowing growth in instalment sale credit and finance leases, which grew by 5.2% (compared to the 6.6% growth seen for the six months to December 2013).

Consistent with industry data, a slowdown in retail vehicle sales occurred within the existing environment of rising vehicle prices. Rising prices in this sector are largely attributable to a weaker rand exchange rate, which limits the ability of vehicle suppliers and dealers to maintain favourable prices and attractive financing options, given the high import costs associated with the vehicle industry in South Africa. This, together with still-high levels of household-debt-to-GDP ratios, dual increases in the prime repurchase rate and suppressed household credit confidence adds to the reluctance to purchase higher-value items.

From the perspective of the major banks, the historically high levels of focus over potential over-exposure to unsecured lending appear to have receded somewhat, with all of the banks continuing to note that their combined total exposure to unsecured lending portfolios as a proportion of total loans and advances remains within acceptable risk appetite levels and continues to be proactively managed. Industry focus in this area was exacerbated recently following the trading update of African Bank in August 2014. However, most market commentators and industry analysts have welcomed the swift supervisory actions taken by the SARB in responding to this situation in the interest of maintaining the strength and credibility of the South African banking and financial system. All the major banks have noted that they do not maintain significant exposure to this institution and, where exposures do exist, they are appropriately provided for.

Continued focus on product mix within the various lending categories, pricing and provisioning strategies have been expressed through the major banks' views that they are appropriately providing and pricing for the risk taken on in their unsecured lending portfolios.

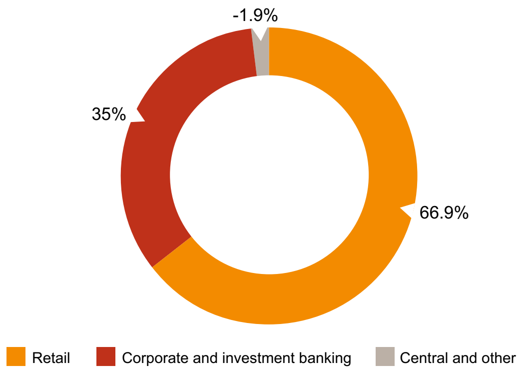
Combined growth in the other loans and advances categories, which includes unsecured lending, continued to slow, with growth falling to only 6.2% for 1H14 (compared to 29.4% for the six months to 2H13), reflecting the strategic decisions of the major banks to limit their exposure to unsecured lending portfolios.

On 1 April 2014, an amendment was introduced into the National Credit Act which saw a credit amnesty being introduced in South Africa. The amnesty refers to the removal of adverse consumer credit information and information relating to paid-up judgements. Looking ahead, it is likely that the implementation of this credit amnesty may have an influence on retail credit extension over the medium to short term, as this amendment will enable certain consumers with historical credit judgements to re-enter the borrowing market.

We expect, however, that all the major banks will continue to exercise caution, and in some cases restraint, in their lending decisions – particularly in view of their strategic focus to scale back exposures in their unsecured lending portfolios.

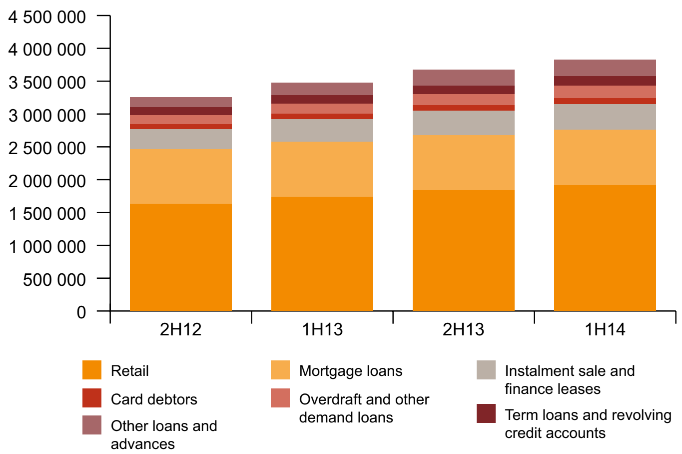
Looking ahead, ongoing and anticipated labour unrest in certain industrial sectors, coupled with the current high inflationary environment, may further dampen economic confidence in, and weigh on the credit decisions of, the household sector. We expect that all of these factors, either individually or in combination, could pose challenges to growth in retail credit demand over the next six months.

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 (NPLs)

Combined NPLs have begun to show a reversal of the downward trend seen consistently since 2011, and grew by 1.2% for 1H14. This reversal in the NPL trend is reflective of both the consumer and business impacts of a turning interest-rate cycle, and the seasoning of high-quality credit written in pre-crisis years negatively impacting on the average credit quality of the banks' lending books. On a year-on-year basis, however, the legacy of declining NPLs continued, decreasing by 5.4% against 1H13.

Interestingly, the drivers contributing to the rise in combined NPLs on a rolling six-month basis can be isolated to two product segments – card debtors (which saw NPLs rise by 38.1%) and instalment sale and finance leases (with NPL growth of 14.3%).

Mortgage and corporate loan NPLs, however, both decreased by 2.8 and 5.9% respectively against 2H13, clearly reflecting the sensitivities of the current domestic economic environment to the various product segments. At 42.4% as at 1H14, residential mortgages continue to represent the bulk of the major banks' NPLs as a percentage of total NPLs (compared to 44.2% at 2H13), followed by corporate NPLs at 20.3% (21.7% at 2H13). These declines in the stock of the major banks' NPLs in these lending categories were offset by a greater contribution to total NPLs of both instalment finance and card loans, reported at 11.7 and 8.1% respectively (compared to 10.4 and 5.9% at 2H13).

Coverage ratios

The major banks' combined specific impairment coverage ratio (specific impairments divided by total NPLs) increased to 68.2% over the six months to 1H14 (compared to 66.0% at 2H13 and 60.3% at 1H13).

The increasing trend in the combined specific impairment coverage ratio continues to be driven by retail portfolios, specifically within the mortgage lending and instalment finance categories, as both of these portfolios generally comprise interest-sensitive variable-rate loans, which remain particularly susceptible to the upward-trending rate cycle.

Looking ahead, we expect the major banks to manage these portfolios with greater intensity, as the forecast interest-rate cycle is expected to continue to trend upward, given the inflationary concerns prevalent within the South African economy, while households continue to face strain in the current rate environment.

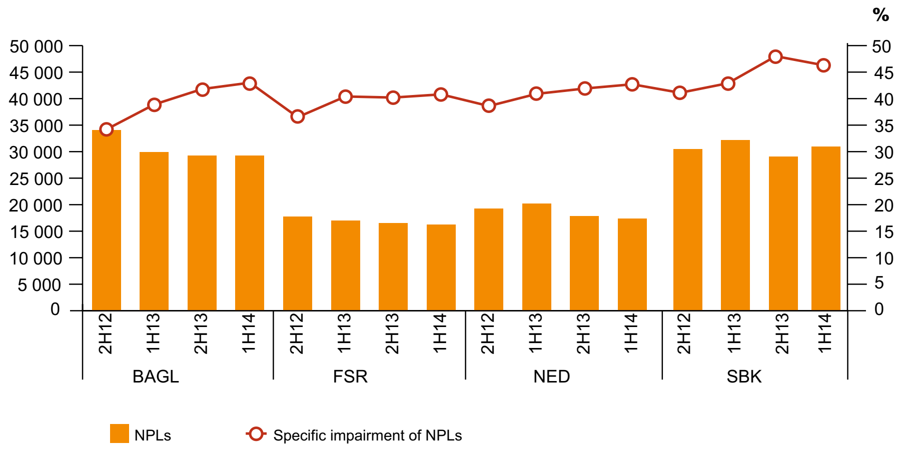
Income statement impairment charges

The relatively linear trend in the combined credit loss ratio (income statement impairment charge divided by average gross advances) observed over prior periods continued, with the slight improvement of 31 basis points to 0.92%, observed at 2H13 and reversed by 20bps to 1.12% at 1H14. In spite of continued focus on their collections process and proactive approach to facilitate post write-off recoveries, the slight deterioration in the credit loss ratio reflects the level of stubborn mortgage NPLs that still persist on the balance sheets of the major banks.

It remains difficult to ascertain a specific trend in the combined impairment charge of R13.9nb of the major banks, which grew by 9.6% at 1H14 compared to the six months to 2H13, but contracted by 16.2% when compared to 1H13.

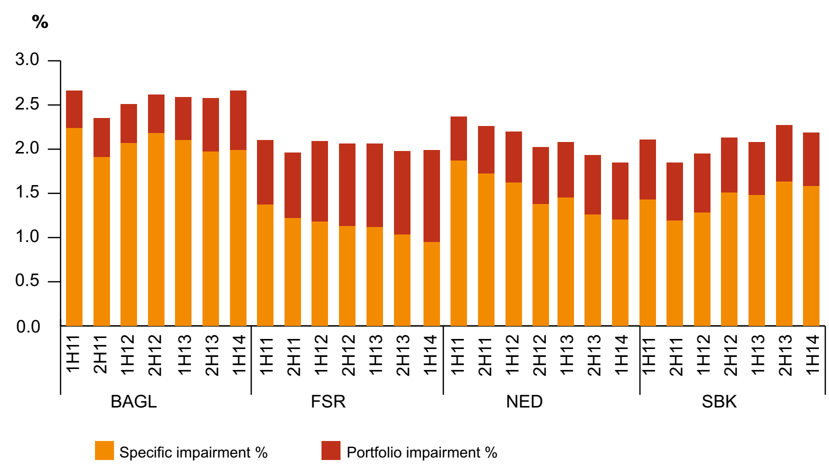
The theme observed in previous periods around variability in the credit loss ratios between the major banks showing contraction continued in the latest reporting period, with all the banks reporting total credit loss ratios in the 0.8 – 1.2% range. However, within specific lending portfolios, some divergence can be seen, and reflects each of the banks' individual areas of credit focus and lending strategies.

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			
	1H14	**2H13**	**1H13**	**2H12**
Common Equity Tier 1	294 752	285 841	204 937	195 814
Total Tier 1	313 220	307 044	282 020	255 748
Tier 2	53 120	55 594	54 103	55 192
Total qualifying capital and reserve funds	**366 340**	**362 638**	**336 123**	**310 940**
Total capital adequacy ratio	15.4%	15.9%	15.8%	15.5%
Risk-weighted assets	2 465 769	2 330 473	2 196 525	2 077 770
Deposits	3 053 880	2 986 913	2 906 221	2 716 905

The slowing growth trend of total qualifying capital of the major banks, first observed in our previous analysis covering the period to December 2013, has continued. Total qualifying capital grew by 9% compared to 1H13, and by 1% on a rolling six-month basis against 2H13 (compared to 7.9% for the comparable six-month period).

The major banks remain well-capitalised, with all capital adequacy ratios above minimum regulatory requirements. The impact of relatively higher risk-weighted assets and the slowing growth trend of qualifying capital resulted in a combined total capital adequacy ratio of 15.4% (compared to 15.9% at 2H13).

As the South African banking sector continues to move along the Basel III implementation timeline, minimum required regulatory capital ratios will rise through to 2019, with additional capital buffers – which include both the capital conservation and countercyclical buffers – being phased in from 2016.

The regulatory landscape for banks continues to evolve, influencing overall bank strategy, balance-sheet positioning and capital-planning decisions. Over the current review period, the Basel Committee on Banking Supervision (BCBS) and the Bank Supervision Department of the SARB have introduced various consultative documents and pieces of new guidance dealing with a range of technical regulatory matters. We analyse recent developments with one of the key areas of regulatory reform, the leverage ratio, and related considerations in the section below.

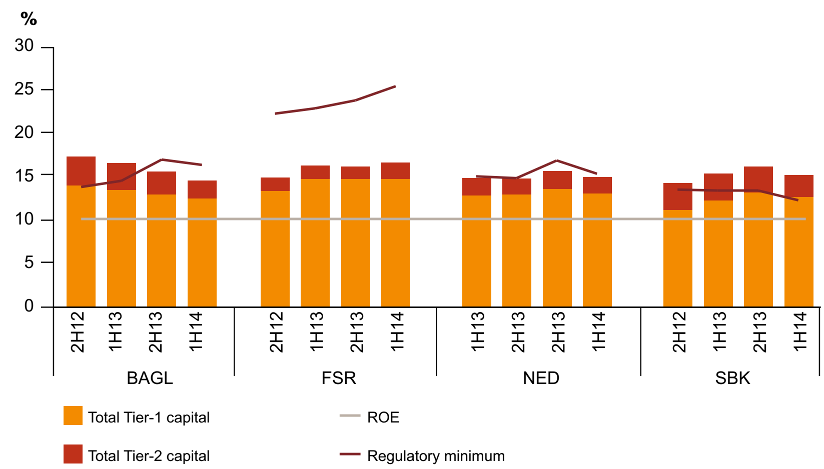
The combined total capital adequacy ratio of the major banks for the current review period has been impacted by the evolving regulatory landscape. In particular, old-style additional Tier I and Tier II capital instruments continue to be phased out in line with the Basel III transitional requirements. In addition, as the major banks continue to focus on African expansion as a core element of their growth strategies, the South African operations of the banks will continue to be required to capitalise for the impact of different capital regimes across their foreign operations, which still mainly adopt higher-RWA contributing standardised approaches to risk measures for regulatory capital purposes. It is also positive to note that the banks' combined Common Equity Tier 1 (CET 1) capital ratio – the core measure of regulatory capital under Basel III – remains strong at 12.5% at 1H14 (12.7% at 2H13 and 12.5% at 1H13), and well above the regulatory minimum.

Against this context, the major banks continue to remain adequately capitalised at levels comfortably above minimum requirements across all capital metrics. The total capital adequacy ratio of 15.4% (compared to 15.9% at 2H13) reflects solid capital buffers and the prudent approach to capital management taken by them over prior years in anticipation of changing regulations. While growth in organic earnings continues to generate capital for the banks, this has been offset by the impact of higher risk-weighted assets (RWA) observed in the current period. The RWA of the major banks grew by 5.8% compared to 2H13, and 12.3% compared to 1H13.

Interestingly, the RWA density (RWA divided by total assets) of the major banks in South Africa has been following an upward trend for the last 18 months, reflecting a combined average of 59.8% for the current period (compared to 58.8% at 2H13 and 55.9% at 1H13). This ratio provides a useful measure to demonstrate risk-modelling behaviour of the banks' measuring credit risk under one of the Basel advanced approaches and, when compared to some of the large, internationally active banks, reflects the relatively prudent approach adopted and assumptions applied by the major banks in modelling their risk exposures. Going forward, it will be interesting to note the impact of the banks' African operations on this ratio as they continue to grow their asset base across the continent, and given that many banks in the rest of Africa continue to adopt more capital-intensive standardised approaches to the measurement of credit risk.

Looking ahead, while total capital levels are expected to remain strong, we continue to anticipate that the banks will face some pressure on their capital buffers as the minimum regulatory capital requirements increase over the period towards the end-state Basel III requirements in 2019. While all the major banks have commented on the strength of their capital ratios, they recognise the importance of aligning capital planning with these increasing requirements. This has been evident in the capital-raising market activity seen during the current review period, as the banks start to think about the replacement of old-style capital instruments being subject to phase-out with Basel III-compliant instruments.

Figure 7.1 Regulatory capital ratios and ROEs



Source: *PwC analysis*

Customer deposits remain important…

Growth in total deposits of the major banks for the current period slowed moderately to 2.2% compared to 2.8% at 2H13 while, on a year-on-year basis, it grew by 5.1%.

It is interesting to note that the combined loans-to-deposits ratio of the major banks has stayed relatively flat, albeit at strong levels, for the last 18 months, and grew marginally to 96.5% for 1H14 (compared to 95.7% at 2H13).

The South African economy continues to be characterised by a relatively low discretionary savings, high household-debt-to-GDP ratios and a challenging consumer environment. This context adds to the challenge for the major banks to compete for wallet-share as they seek to differentiate themselves as banker of choice for the retail market. We continue to observe efforts to diversify their deposit base, and fierce competition for highly sought-after customer deposits among the banks, particularly in view of an evolving regulatory landscape from a liquidity perspective.

The predominantly short-term funding structure of the South African economy, together with relatively mature banking assets on the back of strong mortgage loan growth in previous periods, results in material contractual liquidity mismatches that exist in the domestic banking sector and generally calls for liquidity to be managed on a behavioural or business-as-usual basis. In spite of these mismatches being mitigated by the closed-rand settlement system in South Africa, the two new prudential liquidity ratios will present some strategic challenges to the banks, and will require them to continue to focus on lengthening the tenor of their funding profiles.

We continue to observe the changing regulatory environment impacting the banks' funding strategies and business models, with the enhancement of their retail and corporate transactional banking franchises, product innovation and pricing differentiators all remaining core areas of strategic focus.

Now less than six months away, the liquidity coverage ratio (LCR) continues to rank high on the banks' strategic agendas.

Given the structural constraints that many emerging market economies, including South Africa's, face, the SARB has implemented a committed liquidity facility (CLF) to assist the banks in meeting 40% of the LCR requirement. If needed by individual banks, the existence of the CLF provides relief to ensure compliance with the LCR, and highlights the proactive approach to regulation adopted by the SARB for a number of years. All the banks regard themselves as well-positioned to meet the LCR, given the accumulation of surplus liquidity buffers in anticipation of the changing regulatory environment.

A greater challenge for the South African and emerging market banking sector will be the net stable funding ratio (NSFR) also introduced as part of the Basel III package of regulatory reforms, which will require banks to ensure that longer-dated assets are funded with longer-dated and more stable sources of funding.

While the BCBS announced proposals to revise the NSFR in January 2014, all the major banks commented on their expectations for a pragmatic approach to this requirement and further revisions to the NSFR framework by banking regulators to cater for the liquidity constraints of emerging market economies. The implementation of the NSFR commences on 1 January 2018.

Keeping pace with rapidly evolving industry developments

Making sense of the revised Basel III leverage ratio

Having spent several years primarily looking at banks' capital through the lens of capital ratios based on risk-weighted assets (RWA), regulators have recently renewed their focus on the leverage ratio (LR) as a significant tool in their supervisory toolkit to monitor banks' activities.

The leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), expressed as a percentage:

$$\text{Leverage ratio} = \frac{\text{Capital measure}}{\text{Exposure measure}}$$

- Capital measure – the Tier 1 capital applying at the time of calculation of the risk-based capital framework
- Exposure measure – the sum of the following exposures: (a) on-balance-sheet exposures; (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance- sheet items

Banks will have to juggle the three regulatory measures of the CET1 ratio, LCR and the LR. Each has its own distinctive and potentially conflicting implications for business mix, the kind of assets banks would need to hold, and how this affects pricing and profitability.

While risk-based capital is still seen as the most coherent way to regulate capital adequacy, the leverage ratio may actually emerge as the 'front stop' capital measure, which could have implications for many other aspects of Basel III.

Some of the industry discussions to date on the new framework have centred on whether the ratio may present 'the new constraint', as banks may encounter difficulty in meeting the prudential requirement in 2019, at the same time as old-style capital requirements will have been fully phased out. Globally, some industry practitioners have also begun to question whether it turns out that, aside from a 'back-stop measure', the ratio is also designed to address concerns that either the bar for the CET1 ratio may have been set too low, or that risk may not be adequately reflected in RWA model results.

On 12 January 2014, the Basel Committee published a revision of its leverage ratio framework. We have previously indicated that we expect banks will report higher leverage ratios under the revised calculation than they would have done under the calculation proposed in the initial BCBS consultation document. The final standard brings greater clarity on the mechanics of the LR calculation, adopts a more pragmatic approach for certain exposure types and allows for some recognition of netting in the 'exposure measure' – the denominator of the leverage ratio.

Greater clarity around key principles…

The revisions brought about by the BCBS this year follow certain guiding principles that align the LR calculation with existing risk and capital requirements.

For example, where a bank offers clearing services to clients, the bank has trade exposures to the central counterparty (CCP), which arise when it is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults. This scenario results in the bank having to hold risk-based capital under existing regulatory capital principles and, under the LR revisions, must be captured by applying the same treatment that applies to any other type of derivatives transactions.

…while opportunities for relief exist

Interestingly, in spite of the requirement to gross-up the exposure measure in the LR calculation to reverse the effect of accounting set-off where it may exist, some opportunities exist for banks to obtain relief in their exposure measure where transactions can be structured in a way that avoids accounting set-off. An example of this relates to cash management schemes generally offered in the corporate transactional banking sector, where current accounts are legally structured in such a way that accounts are managed on a 'single account basis', and multiple accounts with individual debit/credit balances are consolidated on a daily basis. This situation, if legally and economically structured effectively, falls outside the ambit of accounting set-off, and therefore no gross-up for the LR would be required.

Leverage ratio timeline

2015 – Banks to publically disclose LRs on a consolidated basis

2017 – Following a monitoring period, regulators will finalise calibration of the LR

2018 – LR implemented as a prudential requirement, expected to be calibrated at 3% (for BCBS)

Disclosure requirements

The revisions also introduced the disclosure requirements for the LR, which take effect on 1 January 2015.

A key principle adopted by the BCBS in setting the disclosure requirements was to ensure that users of a bank's disclosed 'Pillar 3' information would be able to reconcile LR disclosures with published financial statements and to enable comparisons to be made across different jurisdictions and accounting frameworks.

Consequently, a common disclosure template* has been prescribed, which will include:

- A ***summary comparison table*** that provides a comparison of banks' total accounting assets amounts and leverage ratio exposures;
- A ***common disclosure template*** that provides a breakdown of the main leverage ratio regulatory elements;
- A ***reconciliation requirement*** that details the sources of material differences between banks' total balance sheet assets in their financial statements and on-balance sheet exposures in the common disclosure template; and
- ***Other disclosures*** that include an explanation of key drivers of material changes in the leverage ratio from period to period.

These disclosure requirements will present considerable data and reporting challenges for banks and, to facilitate the transition to public disclosure, banks are already reporting the LR to the SARB as part of their transition process.

**BCBS – Basel III leverage ratio framework and disclosure requirements (January 2014)*

8. The future shape of banking – Time for reformation of banking and banks?

Introduction

In our 2012 report on global banking industry reform, A new equilibrium,[2] we made a prediction about the financial crisis. We said that the financial sector would emerge from the crisis to a world very different from the one we remember going in, partly as a result of the crisis itself, and partly due to other global trends and developments that have been gathering pace alongside it. These included changes in global economic growth patterns, advances in technology, a new competitive landscape, and, crucially, changes in stakeholder attitudes and expectations. We added that banks' responses to the crisis – and the related reform agenda – should take full account of these trends and developments, or they would risk emerging from the crisis 'recapitalised, restructured, reformed ... but irrelevant'.

What doesn't kill you makes you stronger

How does this prediction look today? Given the regulatory reform that is still sweeping through the banking sector, it is tempting to see regulation as the key determinant of the industry's future shape. Certainly regulation will have an influence, both in shaping the industry directly and forcing through more fundamental structural change. A specific case in point is the European banking sector, which is currently undergoing a period of intense regulatory scrutiny and

[2] http://www.pwc.com/gx/en/banking-capital-markets/publications/banking-industry-reform.jhtml

challenge and is already responding with, in some cases, quite radical transformational change (through, for example, the Comprehensive Assessment).

However, there are much more fundamental forces at work than regulation. In our view it is these wider shifts that will ultimately dictate both how the banking sector as a whole will re-form, and also what the role and shape of banking regulation will need to be. At the macro level, PwC has identified five global 'megatrends' whose impacts, intersections and collisions are re-shaping the business world. These megatrends are: demographic and social change, shifts in global economic power, rapid urbanisation, climate change and resource scarcity, and technological breakthroughs.

The question of relevance is still unanswered

To remain relevant, banks must do much more than respond to the post-crisis shifts in policy and regulation. They also need to be astute in anticipating and responding to these other forces. This imperative also applies to regulators and policymakers. For both groups, this means anticipating the risks and opportunities that the megatrends will create, responding in clever ways, and adapting to the resulting changes in the industry landscape. A key priority in the short- to medium-term will be staying on top of the migration of 'banking' activities beyond the traditional banking sector.

Context

An industry facing irresistible forces for change…

Banks today are facing rapid and irreversible changes across technology, customer behaviour and regulation. The net effect is that the industry's current shape and operating models are no longer sustainable into the future. The combined power of these three drivers of industry change is increased by the fact that they are often closely interwoven. For example, regulatory changes prompt both service and structural innovations, which together change the nature of the activities or entities that need regulating.

…with technology as a core disruptor

Developments in high-performance analytical software are enabling actionable intelligence to be derived from vast volumes of data in virtually real time, and at multiple points in the value chain. This capability is having a profound impact on how firms operate and make decisions. On the upside, this can enhance companies' ability to provide customers with what they want, when, where and how they want it. On the downside, it can introduce complexities and vulnerabilities that lead to adverse outcomes such as service disruptions, new fraud risks and breaches of privacy.

At the same time, generational shifts in technology can alter the cost structure of whole industries, to the point where what was once a barrier to new entrants suddenly becomes a major handicap for incumbents. Historically, banks' expensively-assembled and bespoke physical and software systems have acted as a defensive asset against start-up competition. The rise of software solutions that allow users to embrace mobile banking implies that the defensive asset is turning into a liability in the form of a rigid legacy infrastructure, cost base and technology platform that actually hinders customer innovation. This challenge is heightened by the fact that the inherently intangible nature of banking makes it almost uniquely suitable for digitisation and online delivery.

Traditional banks need to sharpen their strategic focus to remain relevant

Given the forces and changes we've described, it's conceivable that leadership in banking services could be taken up by a new generation of customer-focused, technology-savvy enterprises – which would not necessarily need to be banks. Although the field is open to incumbents and challengers alike, without investment and adaptation in customer service, operational efficiency and agility, some of the present incumbents could find that they are not among the winners.[3]

Regulators and regulation also need to adapt…

The challenges and dilemmas posed by the parallel changes in technology, customers and revolution are not confined to incumbent banks, or even non-bank pretenders. The banking policy and regulatory community will face its own challenges and struggle for relevance. The starting point here is a regulatory model based on the regulation of a defined set of institutions and an obsession with ensuring that those institutions are not 'too big to fail'.

Going forward, the provision of banking services may no longer be restricted to a set of regulated banking institutions, but could be opened up instead to a more diffuse set of commercial enterprises that would extend into other financial and non-financial service domains. If all this happens, the scope of the regulatory challenge widens and becomes more complex, and the core focus becomes the resilience of

[3] This view is also shared by a number of senior industry figures in Europe and Asia http://www.ft.com/cms/s/0/3325338c-cf5b-11e3-bec6-00144feabdc0.html#axzz30U4MDfoA

the network rather than of a set of institutions within it. In this scenario, the job of ensuring financial stability, protecting customers, maintaining competition and so on would change almost beyond recognition. With that, regulatory bodies would also need to reinvent themselves.

...all adding up to a paradigm shift in the banking landscape

While we are not looking at the end of banking as a grouping of services focused on meeting financial needs, we are surely looking at the end of banking and banks as we currently know them. A failure to adapt could also mean the end of some regulatory bodies and instruments. The substitution of non-bank providers of banking services is a challenge which is not, at this point, reflected in banking regulatory frameworks, or yet – fully at least – in policy and regulatory change agendas. It needs to be.

Against this background, we have three hypotheses to help us develop our thinking and scenarios further:

Our three hypotheses

Hypothesis 1: A future in which core banking services are delivered outside of the regulated banking industry is feasible

The traditional role of banks

Banks have traditionally fulfilled a number of 'core functions' in economic systems. In undertaking these functions, the banking industry has operated as a more or less contained system. Within this system, banks have assumed credit, liquidity and maturity risk; been protected/supported by regulation; invested in complex operational and technological structures; and benefited from an assumed implicit state support. Insured deposits and access to central bank funding have seen banks benefit from greater access to low-cost liquidity than they might otherwise have had.

Historically, these attributes have created a high level of trust between customer and bank, and significant barriers to market entry – thus protecting banks from challengers to the status quo.

The financial crisis undermined trust in banks and spawned extensive regulation...

However, this environment has now been heavily disrupted, with the crisis having challenged the public and official trust previously placed in banks and opened the system up to radical challenge. Not least, it has helped make transparent the cost of implicit state guarantees and subsidies. While less evident in emerging markets, the resulting regulatory changes worldwide are introducing a set of frictional costs and diseconomies of scope and scale. Together, these factors are disturbing and undermining the economic model for the traditional, regulated part of the industry.

...as changing markets, technology and regulation reduce barriers to entry

In parallel with these changes, technology and capital markets are evolving with increasing speed. These changes are challenging the business models of today's banks, as alternative providers emerge across almost all aspects of the banking spectrum. These shifts in the environment are seeing new entrants come in to compete with different areas of banking. In some emerging markets, notably in Africa, payment systems and lending activities led by mobile phone operators have emerged outside traditional banking structures. And in developed markets, the rapid take-up of mobile banking in countries such as the UK and US, together with the rollout of improved wireless and broadband infrastructures, is presenting attritional challenges to the branch-based model, and helping to spawn new Internet-based entrants unhindered by legacy system or business model issues.

Technology companies are also entering the financial services arena, with Facebook applying for an Electronic Money Institution licence, and Google already having launched its 'mobile wallet'. Equally, Internet and mobile platforms are also driving innovation within banking – and the challenge for incumbents will be to maintain focus and investment at a time when so much management time and financial resource is diverted to dealing with legacy issues and regulation.

Overall, we expect that the barriers to entry for non-banks to provide formerly 'core' banking services will continue to decline. The only question that remains is how much of the banks' traditional territory the new entrants will occupy.

Hypothesis 2: Banks still have advantages, but – to be part of the future – they need to invest heavily, rediscover and reassert their core role in society, and secure the ongoing support of policymakers.

The future for banks...

Even a conservative extrapolation of the trends we've described could mean that, by as soon as 2025 or 2030, a market economy could readily exist without banks of the traditional kind. However, banks retain some substantial advantages to help them prevent this from happening. Although much-maligned and tarnished recently by the financial crisis, banks' brands and reputations remain hugely recognisable and potentially powerful, shored up by familiarity, experience and regulation. Trust and brand matter in financial transactions; some of the resistance to alternative banking providers results from a lack of trust in their security.

Some observers have commented that without significant change banks could shrink to a much narrower core of activities. An extreme outcome could see them become utilities focused on the management of deposits below insured limits, and providing a narrow range of domestic credit products. Perhaps the biggest danger for banks is if they lose sight of customer transactions to other players in the value chain, thereby also losing insight into customer behaviours and allowing the power of their brands to diminish.

…may depend on building on their brands

What is clear is that banking services will migrate increasingly away from physical, tangible distribution into technology-enabled channels. The friction and inertia for customers in moving between banks and other service providers will decline under the impacts of both technology and competition regulation. And as banking service models become more digitally enabled, and financially more about an agency relationship, the value of brands will tend to rise. This would play to the banks' strengths. By representing trust, integrity, security and quality of service to the customer, brands could increasingly help to solve the transaction cost problem of choosing how and with whom to bank. So, while their brands have traditionally been seen as a relatively limited part of banks' value, in the future they may become central to it.

Fighting on various fronts to sustain relevance

Adapting to this, however, will not be a straightforward matter. Ongoing regulatory change, and the legacy of challenged assets and tarnished reputations, will still tie up a high proportion of banks' resources and management attention, distracting them from the longer-term challenge of repositioning themselves for the future. Yet the changes needed to compete and stay relevant cannot be left until after the regulatory and legacy issues have been dealt with.

Must-do actions for executive management

- Adapting to regulatory change and executing compliance, at least at the pace and to the standards expected by regulators
- Working through the legacy of underperforming assets and misaligned cost structures, at least at the pace and to the standards expected by their shareholders
- Changing the culture and behaviours of their organisations and demonstrating the security, integrity, dependability and quality of their service offerings to regain the trust of all their stakeholders, at least at the pace and to the standards expected by their stakeholders
- Investing in customer service and operational innovation, at least at the pace and to the standards set by their competitors.

Hypothesis 3: Regulators and regulation need a radical re-orientation, realigning from policing to protecting and with public policy shifting its focus, to some extent, from institutions to markets and services

As regulators seek to avoid overstretch…

A high proportion of the decision-making power about the future of banking currently lies with the regulators, who are understandably focused on making sure that banks are not too big to fail. But at times regulation itself appears fragmented and scattergun in nature, spawning a mass of tactical, siloed regulation that is no longer aligned across territories – or sometimes even within territories – or driven by economic forces. For regulators, this blend of diversity and complexity raises a risk of overstretch and counterproductive outcomes. To mitigate this, regulators need to draw the regulatory strands back together and make regulation manageable for firms. While the pendulum of political power is with the regulators, there may be insufficient pressure to do this. But regulators should care about this, as their own purpose is best achieved through simplicity and focus.

…they may need to refocus on products and services not entities

If a transition does take place to a system where banking services are more dispersed and diffuse, then it would be logical for regulation and policy to move toward focusing on products and services rather than institutions. In this case, conduct regulation would become the primary firm-level regulation, with a much more limited form of micro and macro-prudential regulation increasingly focused on system-wide issues rather than on firms themselves.

With scale economies and network effects still there to be exploited, we could see concentrations of activities and power: witness the relative concentration of the global card payment systems market by Visa and MasterCard. The technology sector also shows how network effects can lead to high market concentration: Google in search, eBay in auctions, Amazon in retail. If this happened in banking, regulators would face challenges understanding how to regulate mono-line service providers, rather than traditional banks. Concentration and de-lamination could lead to new vulnerabilities, particularly in areas such as cyber-security.

Overall, if this hypothesis holds true, it's clear that regulators' competencies would need to change, with much greater thought given to how the banking industry as a whole is regulated.

Major challenges are in prospect for regulators…

However, even if these issues can be addressed, a move to regulate products and services rather than institutions would still present huge challenges for regulators and policymakers. At root, it's easier to direct policy towards – and to regulate – a relatively small number of large banks. Also, larger banks offer a more straightforward transmission mechanism for policy, as it is possible to make them carry a significant part of the financial and operational costs. In contrast, regulating a highly fragmented banking products and services market would be quite a different prospect, since the costs of pulling together the data to run prudential regulation and understand the system would fall increasingly on the regulators themselves.

…demanding a clearer vision of what banking is 'for'

As a starting point, we believe there could be a clearer and more imaginative policy vision of 'what banking products and services need to be', as opposed to the current public policy debate that still focuses on 'what banks should not be'. In this sense, the fragmentation of banks into a more diffuse set of banking services providers would require policymakers to adopt a more positive view of the purpose of banking and its role in the economy. That would be a step forward for all stakeholders – and for society as a whole.

Conclusion: the future is different

The status quo is no more – but the need for banking services remains

As our first hypothesis underlines, our view is that the current shape and makeup of the banking industry is inevitably going to change. The question is in which ways, and by how much? The sheer scope and speed of evolution in regulation, customer behaviour and technology – coupled with changing market dynamics and aggressive non-bank competitors – mean that banking in the future cannot simply be a continuation of banking as it has been. Yet banks are facing up to the imperative of change at a time when the task of dealing with legacy issues and a blizzard of regulation are consuming a huge amount of management time. This creates a real risk that they will be left without a clear strategy and business model to execute the degree of transformation required if they are to maintain their central role in the delivery of banking services. Corporate history is full of cautionary tales about incumbency advantage being lost at the turn of technological cycles.

Traditional banks need to sharpen their strategic focus to remain relevant

By as soon as 2025 or 2030, a market economy could readily exist without banks as we have traditionally known them – a point reinforced by our second hypothesis. Banks still have some useful weapons to hand: their brands and reputations remain potentially powerful, and alternative banking providers still suffer from some lack of public trust. However, many technology players have brands that could translate into the kind of trust necessary to challenge banks in banking services, should they choose to do so. Managing a transformation programme of the scale required will be a challenge – but it is one the banks cannot afford to shirk.

Regulators and regulation also need to adapt

Mirroring the banks, regulators also need to change their mindset and approach, as highlighted by our third hypothesis. Currently, banking regulators worldwide appear to be focused on tactical responses, and their strategic objectives for the future of banks and banking are clouded by political expediency and the 'too big to fail' debate. There is a need for greater certainty around the regulatory agenda, and for policy to focus on the role of banking as a positive contributor to economic growth. Regulators should care more about this. Areas that fall outside their remit – or which are only lightly touched by them at the moment – will grow in importance, and they will need to focus on these intelligently or face being perfectly prepared for the crisis before last.

…all adding up to a paradigm shift in the banking landscape

While reports of banks' demise are premature, for the reasons we've described they may not be as wildly exaggerated as some may think. Banking, of which traditional banks are only a part, already looks and will continue to look very different post-crisis to the way it looked entering this crisis. Although diminished, banks' trust and brands remain powerful assets in the post-crisis world, as do their customer relationships.

In our view, all this adds up to a call to arms for banks and regulators to accept the inevitability of change, and develop a new vision for the future of banking services. Turning that vision into reality will not be quick or easy. But unless both banks and regulators embrace and embark on this journey today, they face a very real risk of being left behind on the roadside.

9. Key banking statistics

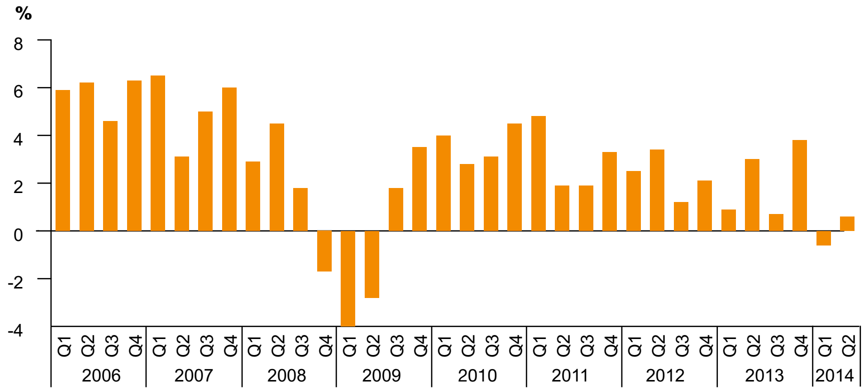
Key banking statistics – 1H14

Rm	BAGL				FSR			
	1H14	2H13	1H13	2H12	1H14	2H13	1H13	2H12
Balance sheet								
Total assets	977 803	959 599	948 013	898 371	946 609	894 431	869 669	825 327
Gross loans and advances	718 683	701 357	683 516	644 550	699 826	648 254	611 611	574 850
Total deposits	662 323	657 075	620 926	584 525	768 234	727 032	697 005	651 349
Risk weighted assets	595 053	560 865	457 480	438 216	572 446	535 410	519 960	490 373
Asset quality & provisioning								
Non-performing loans	29 225	29 300	29 960	34 054	16 281	16 564	17 001	17 797
Impairments	-16 787	-16 049	-14 341	-15 777	-13 900	-12 811	-12 636	-11 812
Collective provisions	*-4 206*	*-3 811*	*-2 692*	*-2 831*	*-7 259*	*-6 152*	*-5 775*	*-5 322*
Individually assessed provisions	*-12 581*	*-12 238*	*-11 649*	*-12 946*	*-6 641*	*-6 659*	*-6 861*	*-6 490*
Non-performing loans (% of advances)	4.1%	4.2%	4.4%	5.3%	2.33%	2.56%	2.78%	3.10%
Impairment charge (% of average advances)	1.2%	1.05%	1.35%	1.60%	1.35%	0.77%	1.07%	0.91%
Impairment coverage ratio	57.4%	54.8%	47.9%	46.3%	85.38%	77.34%	74.33%	66.37%
Implied loss given default	43.0%	41.8%	38.9%	38.0%	40.79%	40.20%	40.36%	36.47%
Profit & loss analysis								
Net interest income	17 197	16 656	15 695	12 202	16 965	16 397	14 458	13 606
Non-interest income	13 487	14 387	12 668	11 567	15 853	14 839	14 007	14 237
Total operating income	**30 684**	**31 043**	**28 363**	**23 769**	**32 818**	**31 236**	**28 465**	**27 843**
Total operating expenses	-17 880	-18 311	-16 142	-13 682	-17 046	-17 108	-14 708	-15 582
Core earnings	**12 804**	**12 732**	**12 221**	**10 087**	**15 772**	**14 128**	**13 757**	**12 261**
Impairment charge	-3 568	-3 151	-3 836	-4 270	-3 074	-2 445	-3 187	-2 518
Other income/(expenses)	71	51	79	214	578	487	528	289
Discontinued operations	-	-	-	-	-	-	-	-
Income tax expenses	-2 714	-2 772	-2 450	-1 610	-2 557	-2 891	-2 240	-2 442
Profit for the period	**6 593**	**6 860**	**6 014**	**4 421**	**10 719**	**9 279**	**8 858**	**7 590**
Attributable earnings	6 166	6 388	5 593	4 204	9 390	9 050	7 520	7 019
Headline earnings	6 110	6 289	5 554	4 475	9 832	8 839	7 919	7 195
Key data								
Other operating income (% of total income)	43.95%	46.35%	44.66%	46.70%	48.31%	47.51%	49.21%	51.13%
Net interest margin (% of total assets)	3.54%	3.63%	3.83%	3.30%	3.62%	3.72%	3.31%	3.41%
Net interest margin (% of average interest earning advances)	4.56%	4.50%	4.46%	4.28%	5.09%	5.13%	5.03%	4.91%
Standardised efficiency ratio	56.40%	57.27%	55.20%	58.04%	50.68%	52.50%	50.10%	54.30%
Return on equity	**16.10%**	**16.70%**	**14.30%**	**13.60%**	**25.00%**	**23.40%**	**22.50%**	**21.90%**
Total number of staff	42 114	42 356	33 897	33 717	38 989	38 026	37 231	36 491
Capital ratios								
CET 1	11.8%	11.9%	12.5%	13.00%	13.9%	13.7%	13.8%	12.5%
Tier 1	12.5%	13.0%	13.5%	14.00%	14.8%	14.8%	14.8%	13.4%
Tier 2	2.1%	2.6%	3.1%	3.40%	1.9%	1.4%	1.5%	1.5%
Total	**14.6%**	**15.6%**	**16.6%**	**17.4%**	**16.7%**	**16.2%**	**16.3%**	**14.9%**

NED				SBK				Combined				Growth	
1H14	2H13	1H13	2H12	1H14	2H13	1H13	2H12	1H14	2H13	1H13	2H12	1H14 v 1H13	1H14 v 2H13
783 792	749 594	714 330	682 979	1 414 243	1 358 467	1 394 024	1 273 083	4 122 447	3 962 091	3 926 036	3 679 760	5.0%	4.0%
619 686	590 828	569 208	538 036	907 717	918 823	930 922	831 596	2 945 912	2 859 262	2 795 257	2 589 032	5.4%	3.0%
631 663	602 952	578 807	550 878	991 660	999 854	1 009 483	930 153	3 053 880	2 986 913	2 906 221	2 716 905	5.1%	2.2%
422 165	392 926	386 804	359 568	876 105	841 272	851 545	789 613	2 465 769	2 330 473	2 215 789	2 077 770	11.3%	5.8%
17 409	17 848	20 176	19 273	31 008	29 121	32 194	30 459	93 923	92 833	99 331	101 583	-5.4%	1.2%
-11 476	-11 456	-11 859	-10 870	-19 852	-19 448	-19 441	-17 704	-62 015	-59 764	-58 277	-56 163	6.4%	3.8%
-4 046	*-3 986*	*-3 605*	*-3 427*	*-5 508*	*-5 469*	*-5 618*	*-5 188*	*-21 019*	*-19 418*	*-17 690*	*-16 768*	*18.8%*	*8.2%*
-7 430	*-7 470*	*-8 254*	*-7 443*	*-14 344*	*-13 979*	*-13 823*	*-12 516*	*-40 996*	*-40 346*	*-40 587*	*-39 395*	*1.0%*	*1.6%*
2.8%	3.0%	3.5%	3.6%	3.4%	3.2%	3.5%	3.7%	3.2%	3.2%	3.5%	3.9%	-10.9%	-2.4%
0.83%	0.81%	1.31%	1.05%	1.13%	1.04%	1.17%	1.08%	1.1%	0.9%	1.2%	1.2%	-8.4%	22.3%
65.9%	65.6%	58.8%	56.4%	64.0%	66.2%	60.4%	58.1%	68.2%	66.0%	60.3%	56.8%	13.0%	3.4%
42.7%	42.8%	40.9%	38.6%	46.3%	47.6%	42.9%	41.1%	43.2%	43.1%	40.8%	38.5%	5.9%	0.3%
11 263	10 911	10 309	10 038	21 666	20 313	18 912	18 439	67 091	64 277	59 374	54 285	13.0%	4.4%
9 480	9 826	9 535	9 059	18 155	18 943	17 726	17 970	56 975	57 995	53 936	52 833	5.6%	-1.8%
20 743	**20 737**	**19 844**	**19 097**	**39 821**	**39 256**	**36 638**	**36 409**	**124 066**	**122 272**	**113 310**	**107 118**	**9.5%**	**1.5%**
-12 012	-11 965	-11 055	-10 918	-23 026	-24 601	-21 833	-21 584	-69 964	-71 985	-63 738	-61 766	9.8%	-2.8%
8 731	**8 772**	**8 789**	**8 179**	**16 795**	**14 655**	**14 805**	**14 825**	**54 102**	**50 287**	**49 572**	**45 352**	**9.1%**	**7.6%**
-2 333	-2 240	-3 325	-2 497	-4 952	-4 149	-5 065	-4 855	-13 927	-11 985	-15 413	-14 140	-9.6%	16.2%
10	-19	-4	-52	339	489	248	-1 093	998	1 008	851	-642	17.3%	-1.0%
-	-	-	-	-1 032	-	-	2 004	-1 032	-	-	2 004	100.0%	-
-1 627	-1 603	-1 413	-1 471	-2 778	-4 149	-2 048	-2 294	-9 676	-11 415	-8 151	-7 817	18.7%	-15.2%
4 781	**4 910**	**4 047**	**4 159**	**8 372**	**6 846**	**7 940**	**8 587**	**30 465**	**27 895**	**26 859**	**24 757**	**13.4%**	**9.2%**
4 598	4 727	3 910	3 979	7 294	7 619	7 245	7 959	27 448	27 784	24 268	23 161	13.1%	-1.2%
4 599	4 756	3 914	4 042	7 285	7 758	7 225	6 498	27 826	27 642	24 612	22 210	13.1%	0.7%
45.70%	47.38%	48.05%	47.44%	45.59%	48.26%	48.38%	49.36%	45.89%	47.37%	47.58%	48.66%	-3.5%	-3.1%
2.96%	3.09%	3.35%	3.30%	3.73%	3.33%	3.08%	3.08%	3.46%	3.44%	3.39%	3.27%	2.1%	0.6%
3.55%	3.57%	3.58%	3.53%	4.69%	4.29%	4.12%	4.27%	4.47%	4.37%	4.30%	4.25%	4.1%	2.3%
56.50%	56.27%	54.20%	57.17%	55.90%	60.46%	57.30%	59.28%	54.87%	56.62%	54.20%	57.20%	1.2%	-3.1%
15.10%	**16.60%**	**14.60%**	**14.80%**	**12.10%**	**13.20%**	**13.20%**	**13.30%**	**17.08%**	**17.48%**	**16.15%**	**15.90%**	**5.7%**	**-2.3%**
30 061	29 513	28 889	28 748	42 211	42 221	48 730	42 736	153 375	152 116	148 747	141 692	3.1%	0.8%
12.1%	12.5%	11.8%	12.0%	12.2%	12.6%	11.8%	10.6%	12.5%	12.7%	12.7%	12.5%	-	-
13.1%	13.6%	13.0%	12.9%	12.7%	13.2%	12.3%	11.7%	13.3%	13.7%	13.4%	13.0%	-	-
1.9%	2.1%	1.8%	2.0%	2.5%	3.0%	3.1%	2.9%	2.1%	2.3%	2.4%	2.5%	-	-
15.0%	**15.7%**	**14.8%**	**14.9%**	**15.2%**	**16.2%**	**15.4%**	**14.6%**	**15.4%**	**15.9%**	**15.8%**	**15.5%**	**-**	**-**

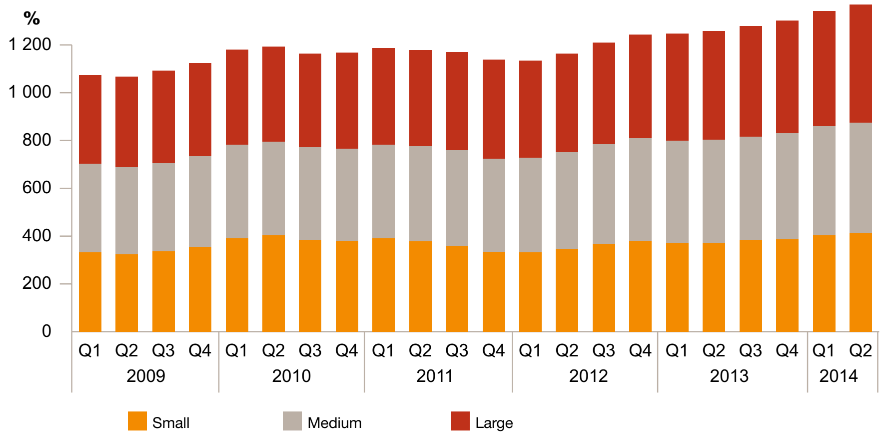
10. Industry data

GDP growth



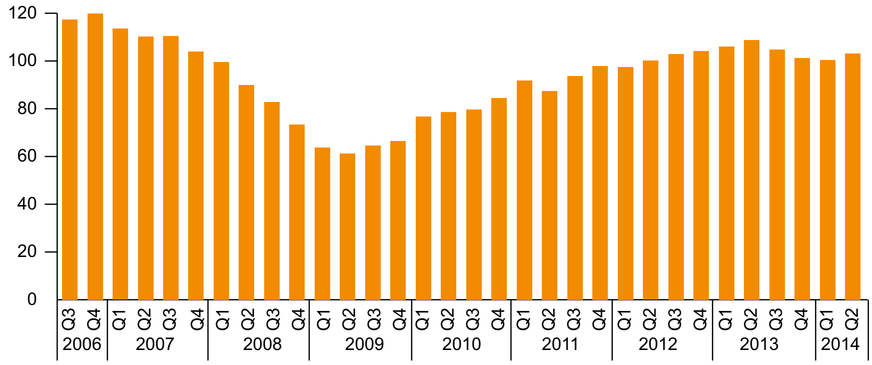
Source: *Statistics SA*

BAGL House Price Index



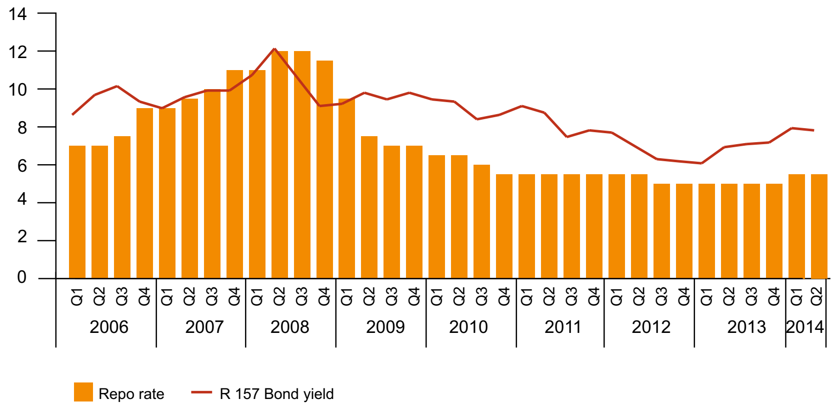
Source: *BAGL*

New vehicles sold



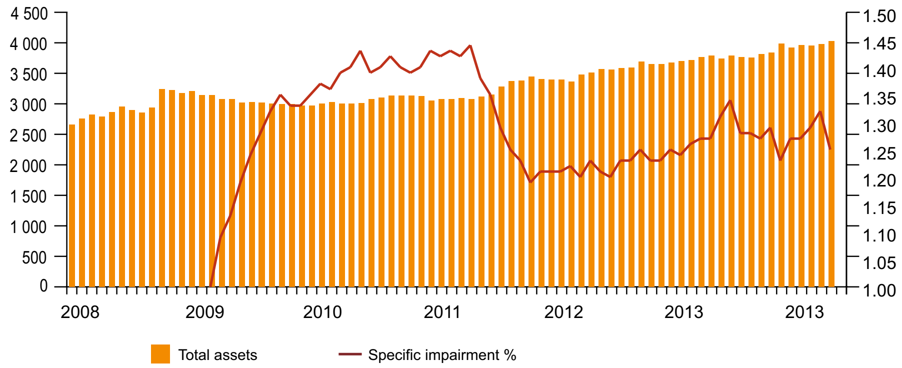
Source: *SARB*

Interest rates



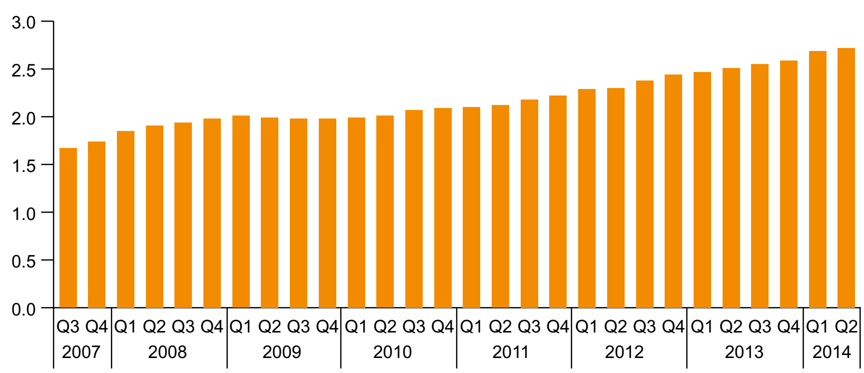
Source: *SARB*

Industry credit impairments



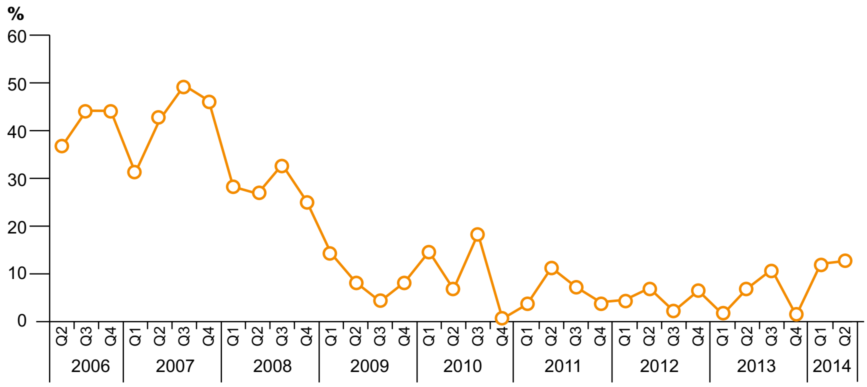
Source: *SARB*

Industry credit extension (Rtn)



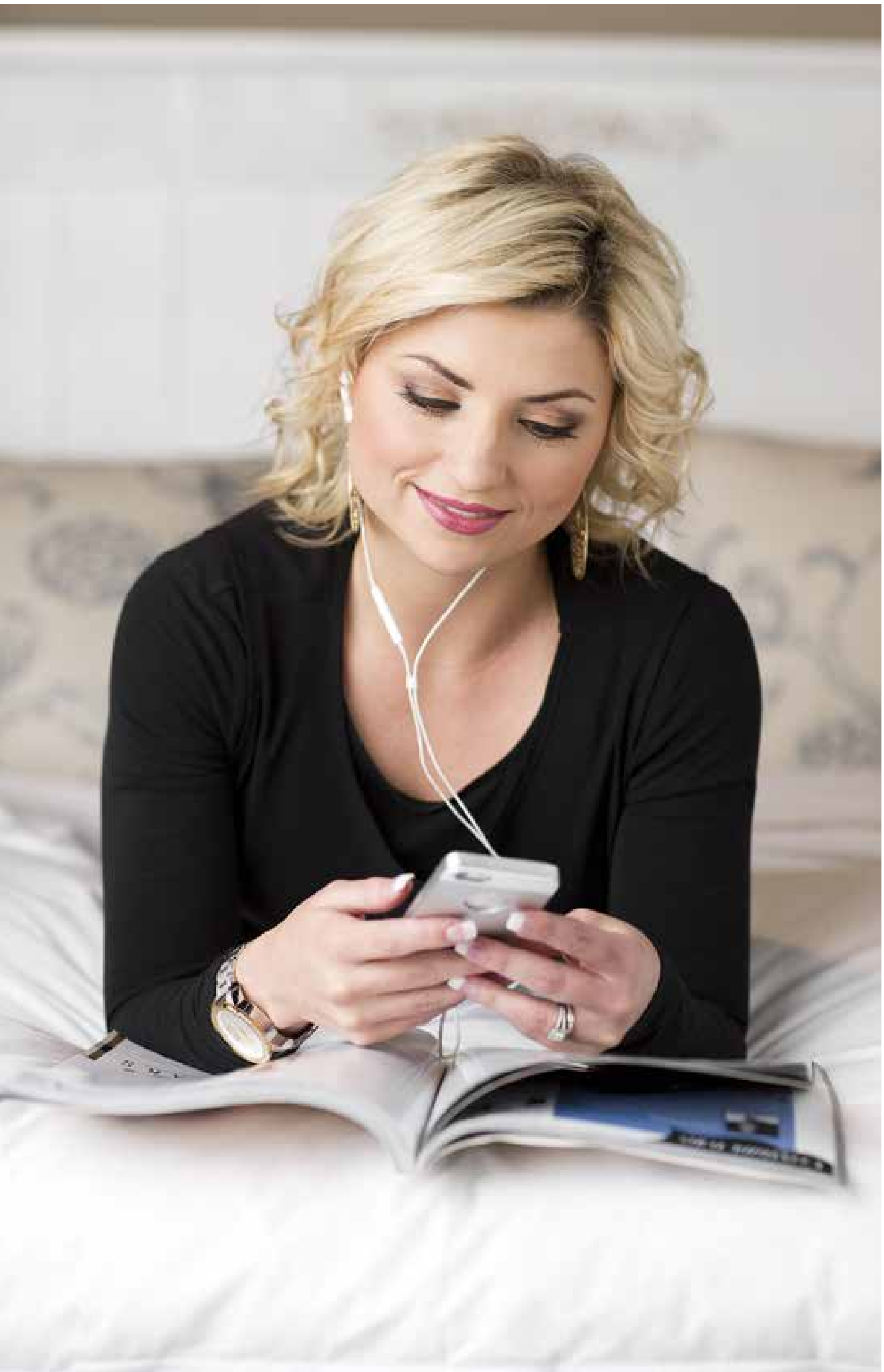
Source: *SARB*

Growth in mortgage advances



Source: *SARB*

11. Contacts



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