Growing in turbulent times

Major banks analysis – South Africa

PwC analysis of major banks' results for the reporting period ended 31 December 2015

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*Combined headline earnings up **12.5%**

*Total operating income up **6.9%**

Average return on equity of **17.9%**

*Operating expenses up **6.8%**

Bad debt expenses up to **10.8%**

*2H15 vs 2H14

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

The 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.

Seven years on from the global financial crisis, the international business landscape has still not convincingly returned to the state it was in prior to the onset and peak of the crisis. A year ago, when PwC launched our 2015 annual Global CEO Survey, regulation, skills, national debt, geopolitical uncertainty and taxes topped global CEOs' list of concerns about threats to business growth. Fast forward to today and none of these concerns have gone away. In fact, the level of concern about impediments to business growth is higher today than at any point in the past five years.

What is clear is that financial services CEOs, in particular, know that unprecedented change is not only coming, but is potentially here to stay. The combination of technological change, regulatory challenges, and customer and social expectations is daunting, while the stakes are enormous.

At the same time, our global Banking Banana Skins survey for the current review period notes that the global banking industry is under attack from many angles, not just from traditional risks but also as a consequence of new uncertainties. Criminality and technology risk are increasingly becoming concerns of banks given the rise in cyber security and new competitors who are challenging traditional ways of doing things and operate using more nimble systems and lower overheads. How will banks respond in the face of the relentless change that characterises the current operating environment?

These are some of the questions that an analysis of the results of our 2016 Global CEO Survey yields, which we provide further insight on in the section titled *Insights – PwC's 19th Annual Global CEO Survey and Banking Banana Skins Survey.*

Consistent with the themes reported in our previous *Major Banks Analysis,* the macroeconomic context within which our major banks' results have been achieved remains highly volatile and subject to a range of persistent challenges at the global and domestic levels over the current period under review.

External developments[1]

Severe challenges within the global economy are hardly new and have been prevalent over a series of recent periods. As we analyse the major banks' results for the current reporting period, once again the global economic environment that characterised the period under review presented a range of risks. These include slowing growth in China, a key commodity export market; a strengthening US dollar amidst weakening emerging market currencies; and a sustained cycle of low commodity prices. This time, emerging market economies look particularly vulnerable to these challenges while advanced economies face a range of questions about the sustainability of recent growth figures.

Our global economic research leads us to expect Chinese growth to slow further to around 6.5% during 2016 – after growing at rates above 8% per annum from 2000 to 2011 – as the country manages a tricky rebalancing from a consumption-led economy to a more sustainable investment-led economy. Adding to the challenges faced by commodity-dependent economies like South Africa is an expectation of lower commodity prices for longer. This will specifically affect oil prices, with the Organisation for Petroleum Exporting Countries (OPEC) refusing to cut production, against a softening in demand that many market analysts expect to lead to insufficient absorption of the global oil supply glut. A further challenge to emerging-market economies is represented by the sustained strength of the US dollar. While less positive recent economic data may slow the Federal Reserve's monetary tightening cycle, our global economic research suggests it may be unlikely to alter the Fed's monetary policy stance, thereby maintaining upward pressure on the US dollar and in turn presenting heightened challenges to emerging-market currencies and creating balance sheet issues for countries whose debts are primarily dollar-denominated.

While the dramatic decline in global oil prices, which first began just over 12 months ago, presented polarised price expectations among market analysts, it has since become increasingly clear that oil prices will remain lower for longer – creating a variety of challenges for companies engaged in upstream oil, and countries with sizeable oil reserves. The factors that support this view are many and include ongoing geopolitical tensions in Russia, slow growth conditions across the Eurozone and China, the political deal recently struck between Iran and a number of significant economies, increased domestic production of crude oil in the US on the back of innovative technologies, and material uncertainties regarding capital investments by major global energy companies. These factors and others are bound to result in ongoing volatility in oil prices for some time to come.

How each of these complex, interconnected economic dynamics plays out will continue to have material implications for the global economy, and in particular for emerging economies dependent on foreign capital flows to support growth and fund domestic deficits, like South Africa.

A look at the economic landscape globally suggests that while challenges may presently be most acute for emerging markets, advanced economies also have a lot to think about. The US, still the world's largest economy, only managed to produce a disappointing 1% growth rate during the fourth quarter of 2015, while the Eurozone in aggregate recorded growth of just 0.3% on the back of low growth rates in Germany and France – both key drivers of the Eurozone economy. At the same time, economic growth in Japan retracted by 0.4%, emphasising the extent of low growth conditions across the breadth of the global economy.

The response from a number of central banks has been to implement negative interest rates, a historically unprecedented stance and one that highlights the scale of the challenge associated with low growth conditions. With growth sluggish and inflation well below target levels, central banks in the Eurozone, Sweden, Switzerland, Denmark and Japan – representing around one quarter of the global economy in total – have adopted a negative interest rate policy. In doing so, these central bankers have to negotiate a careful balancing act, managing the act of taking interest rates sufficiently negative in order to persuade banks to increase lending, but not so negative that they unsettle the financial system as whole.

A key economic development that occurred during the period under review has been the much anticipated increase in the federal funds rate by the US Federal Reserve. In December 2015, the Fed led the way with its first rate increase since 2006, sparking expectations of a continued interest rate hiking cycle, albeit gradually, in 2016. As we commented in our previous *Major Banks Analysis – September 2015*, however gradual the tightening of monetary policy in the US may be, it will likely have wide global

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repercussions. For example, businesses and households with exposure to dollar-denominated debt will come under pressure as funding costs impact their finances. Economies such as Chile, Turkey and Russia could be particularly impacted due to their relatively high levels of US dollar debt. In contrast to these emerging economies, however, South Africa's foreign currency-denominated debt levels, particularly debt denominated in dollars, are lower.

Unlike expectations for the US and the UK, our global research leads us to expect that the European Central Bank, the Bank of Japan and the People's Bank of China will maintain an accommodative monetary policy stance in 2016 – highlighting the uneven state of conditions across the global economy, and adding to already high levels of economic uncertainty.

Sub-Saharan economies were also negatively affected by these developments taking place at the macro level. Key economies that include Zambia, Nigeria and Ghana have been showing marked weakening, while growth rates also slowed in important parts of the continent such as Namibia and Botswana.

Perhaps the only clear positive story among the global economic narratives over the current period under review, India's strong growth momentum seen recently appears to be continuing. The International Monetary Fund (IMF) expects India to grow faster than China for the first time in over a decade, with an expectation of gross domestic product (GDP) growth of 7.3% and 7.5% during 2015 and 2016 respectively.

Domestically, the South African economy continued to experience a variety of challenges during the second half of 2015, amplified by the macroeconomic developments and volatility at the global level.

If the forecasts of the South African Reserve Bank (SARB) are correct, economic growth in South Africa for 2016 – expected to come in at only 0.9% – will be the weakest in nearly a decade. Like other commodity-exporting countries, South Africa has been facing a range of shocks as a result of the persistent decline in global commodity prices. This challenge has been made worse by severe drought conditions across the country in recent months which weighed on activity in the agricultural sector. At the same time, electricity supply constraints persist and continue to cast a pall over domestic economic activity, although at much more gradual rates of outages in the second half of 2015 as compared to the first.

Additionally, the SARB also notes that at an aggregate level, corporate profit growth in the third quarter of 2015 was at its lowest level on record at 0.3% year on year as a result of declining profitability in key South African private sectors, including agriculture, mining and manufacturing. These persistent pressures on corporate earnings suggest that investment, consumption and labour absorption by corporate South Africa may remain muted during 2016 – adding to concerns of prolonged uncertainty within the domestic economy. The SARB's leading indicator of economic activity (the composite leading business cycle indicator) has declined on a year-on-year basis for the past 12 months, supporting its view that forecast risks to the domestic growth outlook worryingly face to the downside.

In parallel to the structural challenges that persist within the South African economy, the domestic inflation outlook remains in a state of deterioration. According to data analysed by the SARB, inflation averaged 4.6% during 2015 and is expected to increase to 6.8% and 7% during 2016 and 2017 respectively – beyond the target band of 3%–6%.

Sustained weaknesses within the domestic economy presents real risks to employment and investment growth over the medium to long terms. In the words of the SARB, '*ultimately, this means that the collective gains in prosperity which we as a nation have achieved are at risk of being eroded*[2]'.

Weaker growth prospects and negative perceptions around political events such as the recent cabinet reshuffle compounded volatility in local financial markets and resulted in investor concerns increasing sharply just prior to the end of 2015. Through this and other events, the rand exchange rate continued to experience a cycle of severe volatility during the period under review. The local currency surpassed its lowest recorded levels against the US dollar earlier in the year, while negative economic sentiment associated with the domestic economy could also be seen in South Africa's five-year credit-default swap (CDS) spreads widening substantially by around 72 basis points relative to emerging market peers. Part of the implications of this for economic metrics later reversed, yet the implications for investor perception and sentiment, coupled with the negative impact it has had on local business and consumer confidence, may persist. This has been most clearly expressed in wide concern over how international credit rating agencies may react in their determinations of the country's sovereign credit rating.

[2] Monetary policy in South Africa, address by Deputy Governor, February 2016 – *https://www.bis.org/review/r160226b.htm*

These factors and others combined to result in South Africa's economy growing by just 1.3% in 2015, down from 1.5% in 2014 and 2.2% in 2013, according to estimates of real gross domestic product (GDP) published by Statistics South Africa.

Major banks' performance

Against this highly challenging operating and economic background both globally and domestically, the major banks have produced commendable results for the second half of 2015. In aggregate, the major banks reported combined growth in headline earnings of 12.5% against the comparable period to reach R33.8bn – a credit to the strength of their franchises and the resilience and diversity within their profit pools to withstand economic headwinds while delivering growth at the group level.

The growth in headline earnings remains underpinned by solid operating drivers, with net interest income growth of 8.4% and non-interest revenue growth of 5.2% against the comparable period. However, similar to our previous major banks analysis, total combined credit impairments of the major banks show increases over a rolling year-on-year period, growing 10.8% against 2H14 as a result of latent credit stresses, both realised and unrealised, that remain within the banks' total credit portfolios as a consequence of highly challenging macroeconomic considerations that weigh heavily on specific industry sectors such as the mining and agricultural sectors.

Gross loans and advances continued to experience resilient growth of 13.5% for the six months to December 2015, and grew by a healthy 4.8% against the first half of 2015. Consistent with our previous observations, growth in gross loans and advances remains driven by corporate and investment banking demand, which continues to outpace retail and instalment credit growth. However, the rate of growth between corporate and retail lending has come much closer than seen in previous periods, with combined corporate credit growth across the major banks amounting to 5.6% against the comparable period, while retail credit grew by 5.4%.

In response to growing concerns about the credit quality of their portfolios, all of the major banks continue to emphasise their application of conservative judgements in relation to credit provisioning strategies, evident in the sizeable increase of 13.7% in their unidentified (or general) credit provisions.

Combined non-performing loans (NPLs) continued to reflect a negative trajectory, reversing a declining trend seen in previous periods by growing 6.8% against the comparable period, and 9.1% when compared to the six months to June 2015. It is worth noting that the growth in combined NPLs over the last six months was much stronger, which points to the economic challenges being faced.

At the same time, an ongoing focus on debt restructuring and tighter collection strategies has resulted in combined credit impairment charges falling marginally by 1.9% against the results for the period to June 2015, but increasing by 10.8% compared against the period to December 2014. Consistent with the theme from the previous six-month period to June 2015, there are certain performing book provisioning strategies contributing the six-month increase in impairment charges, which we analyse further in the Asset quality section of our analysis.

Interestingly, the latest edition of the National Credit Regulator's quarterly *Credit Bureau Monitor (for Q3-2015)* indicates that the South African retail credit environment within the third quarter of 2015 demonstrated improvement, showing that the percentage of consumers with impaired credit records relative to all credit active consumers had decreased marginally by 6% by the end of September 2015. At the same time, consumers classified as being in 'good standing' increased as a percentage of the total number of credit-active consumers, reflecting an increase of 2.8% quarter on quarter and 2.4% year on year against the period to September 2015. However, the increase in apparent retail credit consumer standing is in all likelihood reflective of restrained consumer appetite, given the various challenging domestic economic issues and uncertainty that prevailed over the period under review.

Net interest income growth of 7.8% came in on the back of healthy growth in average loans and advances. It continued to benefit from the positive endowment impact as the higher interest rate environment aided faster asset repricing relative to fixed-rate liabilities, equity and non-rate-sensitive funding sources of the major banks. In spite of net interest income growth in absolute terms, we expect to continue to see margins come under pressure as a result of higher term funding and liquidity costs. This confirms our earlier-held view that margin pressure was inevitable given the challenging economic context and prudential regulatory developments associated with liquidity risk management.

While non-interest revenue (NIR) growth continues to be supported by growth in net fee and commission income in absolute terms, a key factor contributing to NIR growth over the current period has been very healthy growth in trading revenue, amounting to 17.2% against 2H14 and 14% against 1H15. As a result, total NIR grew at a healthy 7% over the second six months of 2015 compared to 1H15, reversing the uncharacteristic decelerating growth trend witnessed in the first six months of the year.

However, a range of factors, including severe pricing competition, and the reduced interchange fees effective since March 2015 are weighing in on the levels of NIR growth seen in previous periods.

Operating costs grew by 7.6% against the comparable period, indicating that ongoing focus on cost management – while still an important focus area for the banks – is being offset to some extent through investments in their businesses, technological and system capabilities, and talent spend. At the same time, the impact of dollar-based costs for those banks with large physical presences in the rest of Africa contributed to ongoing operating cost pressure during the current review period.

In response to more regulatory requirements to ensure the integrity and granularity of risk data, together with relentless sophistications in and exposure to cybercriminals as well as the need to cater to customers' increasing online presence, IT spending continues to show an increasing trend, both in absolute terms and as a percentage of period-on-period growth.

The major banks' combined cost-to-income ratio deteriorated marginally to 55.1% at 2H15, compared to 54.9% at 1H15 and 54.6% at 2H14, highlighting the challenges associated with cost management and efficiency strategies across the major banks.

While still commendable at 17.9%, the combined return on equity (ROE) of the major banks fell slightly by 30 basis points against the comparable period. Each of the four major banks continued to be impacted by different growth stories and individual operating circumstances over the period.

Consistent with expectations and our commentary in previous analyses, the impact of higher prudential capital requirements still being phased in under Basel III remains an influencing factor with regard to overall bank capital levels. The combined total capital adequacy ratio of the major banks fell slightly against the comparable period to come in at 15.2% (15.4% at 1H15), but remains underpinned by credible earnings growth, strong capital buffers and a traditionally prudent approach to capital management by both the banks themselves and the SARB. It is worth highlighting that all of the major banks reported that they continue to remain adequately capitalised in compliance with present minimum required capital ratios across all capital tiers.

Growth of 8.8% in risk-weighted assets (RWAs) over the current period can, in some part, be attributed to an industry-wide requirement by the SARB for the removal of a zero-rated risk weighting for credit valuation adjustments (CVA) on over-the-counter (OTC) rand-denominated and local derivatives not cleared through a central counterparty. With the lifting of the exemption, banks are required to treat both ZAR and local OTC derivatives that are not cleared through a central counterparty as bilateral trades and calculate the capital requirement for the default risk component of counterparty credit risk on the basis of the capital requirements as specified in the Regulations to the Banks Act.

Stakeholder expectations

Throughout 2015, global regulatory bodies continued with the task of delivering against the internationally agreed regulatory reform agenda. A number of significant consultations were issued that are expected to materially impact the prudential regulatory environment in which our banks operate. Many of these consultations will likely weigh on banks' regulatory capital levels within the near future; but more fundamentally, they may play a meaningful part in influencing the banks' overall strategies, business models and chosen markets of operation.

In particular, significant revisions to the standardised approaches for measuring credit and operational risk capital have been proposed, while revisions continue to be made to market risk capital measurement and standardised capital floors for banks using internal ratings-based (IRB) approaches. From a liquidity perspective, all of the major banks commented on their strategies for actively managing balance sheets since the implementation of the liquidity coverage ratio (LCR) requirements.

As regulatory requirements become more onerous, it is expected that they may change the shape of banks' balance sheets, increase their costs – both direct and indirect – of regulatory compliance, and influence their strategic direction. However, some relief appeared during the latter part of 2015 when the SARB noted, through a proposed directive that sought to reflect its view, that the calibration of the net stable funding ratio (NSFR) (Basel III's longer-term prudential mechanism to manage liquidity risk) by the BCBS does not cater to the actual stability of institutional funding in the domestic context given the barriers preventing liquidity through South Africa's closed funding system. As a result, the SARB has proposed a lower factor for institutional funding less than six months in tenor, compared to the BCBS' NSFR framework – a change expected to assist our banks in meeting the required NSFR without unduly impacting the domestic economy.

Parallel to prudential regulatory developments at the global level, the Basel Committee on Banking Supervision (BCBS) has finalised numerous pieces of guidance that seek to strengthen overall risk management and conduct practices within banks. In February 2016, the BCBS – being aware of the risk of banks being used, intentionally or unintentionally, for criminal activities – published guidelines relating to the '*Sound management of risks related to money laundering and financing of terrorism*' to describe how banks should include risks relating to money laundering and financing of terrorism within their overall risk management.

This comes on the back of a range of other regulatory pronouncements and guidance from the BCBS, including its '*Guidance on credit risk and accounting for expected credit losses'*, at a time when the International Accounting Standards Board is moving towards an expected credit loss accounting framework (IFRS 9); and it represents an important step forward in resolving the weakness identified during the global financial crisis that credit loss recognition was too little, too late. Additionally, the BCBS ended 2015 with its publication of a *third progress report* on banks' adoption of the '*Principles for effective risk data aggregation and risk reporting*' *(BCBS 239)*. First published in 2013, the *BCBS 239 framework* maintains the objective of strengthening risk data aggregation and risk reporting at banks to improve their risk management practices and decision-making processes. Banks designated as global systemically important banks (G-SIBs) are required to implement the principles in full by 2016, while expectations are that domestic systemically important banks (D-SIBs) in many jurisdictions, including South Africa, may be expected to demonstrate compliance with a range of its principles in the near future.

At the same time, the global regulatory environment has seen the introduction of new rules in certain advanced economies that are intended to legally separate retail from investment banking activities, and regulatory pressures have weighed heavily on earnings within some of the largest global banks in other ways too. Most relevantly, regulatory pressures alongside other strategic considerations were highlighted as key reasons in the broader restructuring recently announced by the global Barclays group to sell down its stake in Barclays Africa Group Limited over the next two to three years.

In accordance with its role as global standard setter, the BCBS has embedded a rigorous supervisory review and reporting process to periodically review the implications of the Basel III capital and liquidity standards for banks at the global level. Based on the most recent study, the Committee believes that banks remain on track to meet the Basel III standards. Owing to the SARB's long and prudent strategy of ensuring complete alignment with the global regulatory framework, the BCBS' recent review of South African prudential banking standards yielded full compliance with the Basel III rules text, with only a few minor technical departures.

South Africa's imminent move to a Twin Peaks model of financial services regulation will undoubtedly result in elevating the supervisory prominence of market conduct activities, given two distinct and focused supervisors for prudential (SARB) and market conduct supervision (FSB). As a result, in parallel to numerous prudential regulatory developments, our banks continue to place significant strategic focus on strengthening their risk management capabilities with respect to compliance and conduct risk.

Internal responses

Disruption to traditional banking by global technology industry players and smaller, more agile firms operating within the financial technology (FinTech) industry continues at a rapid pace. FinTech is a digital arena where a diverse range of players – traditional financial services firms, technology firms, e-commerce and telecommunications companies, start-ups and infrastructure operators – are contending with a common imperative: to respond effectively to the evolving needs of their customers.

The impact of FinTech is yet to be fully felt across the global banking industry, but what is clear is that it is changing the financial services industry from the outside in. Banks currently focus on the application of technology to their financial processes, while these non-banking firms look in a completely converse direction – wanting to apply financial processes to their unique technologies. Our global research estimates that within the next three to five years, cumulative investment in FinTech globally could exceed $150 billion. If this plays out as anticipated, the result will be a new competitive landscape and playing field. As the lines between traditional finance, technology firms, e-commerce and telecom companies are blurring, many innovative solutions are emerging and there is clearly no straightforward solution to navigating this new FinTech world.

Locally, some banks have highlighted innovative, strategic partnerships with FinTech and non-traditional financial services companies in order to mutually share in the opportunities that FinTech clearly presents.

The major banks all continue to highlight that it remains central to their strategies to build their franchises in both existing and selected new markets through product and platform innovation, particularly focusing on electronic and digital channels.

The need for embedding a culture of innovation is a theme that has been consistently underlined in previous reporting periods, which can be understood given the range of disruptions challenging the traditional banking industry alongside severe economic and operating environment challenges pressuring business models. Current innovation strategies across all of the major banks appear firmly focused on enhancing existing capabilities in response to the dynamic needs of clients at the transactional banking level. In particular, the use of technology to better interpret the complex and evolving needs of customers so as to better engage with them is an area that the banks are expected to continue to invest in with a view to strengthening their capabilities through smarter and deeper use of predictive data analytics and better harnessing the wealth of information that already exists within their systems.

Investing in IT at the enterprise-wide, architectural and individual application system levels remains high on the strategic agendas of the major banks in response to their client-centred strategies. At the same time, the motivation for large IT change programmes continues to be driven by factors beyond just customer centricity and the needs of a more connected customer base. Vulnerabilities within IT architectures to increasingly sophisticated and agile cybercriminals operating globally add to the importance of ensuring and maintaining IT resilience.

Maintaining, and in some cases expanding, their presence, product and technological capabilities in key African markets beyond South Africa remains among the headline strategic objectives for all of the major banks. While individual growth and execution strategies differ for each of the banks, diversifying and building earnings contributions from their operations across the continent remains a central strategy, particularly in view of the considerable economic challenges experienced domestically.

Prospects

As outlined above, macroeconomic developments over the period under review and as at the time we go to press are increasingly complex and global in their impact and consequences. A range of market and economic commentators expect that the increasingly global nature of economic developments will persist into the immediate future and may represent a new normal as a result of the significant increase in interconnectedness of financial markets over the last few years.

To articulate what is going on within the global economy at present is a puzzling engagement – some indicators are weak while others are strong. Our research indicates that this is often the case when the pattern of growth is changing, which appears to be exactly what we are seeing at present. There are a number of aspects to this shift in global growth, but some market commentators believe that the US and UK in particular may well continue on a path of relatively sustained economic recovery.

However, the outlook for emerging economies has far fewer positive undertones. Many corporates will no doubt be stress testing business plans against a lower-than-baseline scenario for emerging market economies over the next few years, as the near-term economic outlook for emerging economies has deteriorated even further since our last analysis, even though some specific jurisdictions maintain considerable long-term potential according to our global economic research.

Key risk factors impacting sub-Saharan Africa over the next two years include ongoing fiscal consolidation in key jurisdictions as policy makers balance low economic growth in the context of deficit management, sustained low commodity prices, and lower foreign direct investment as capital flows are maintained within home markets within the advanced economies. Domestic economic sentiment within many economies across the continent will likely be amplified even if weak global economic conditions show a level of dissipation towards the end of the year.

Domestically, ongoing weaknesses associated with the rand, electricity tariff increases, and the impact of the recent drought on food prices are expected to outbalance the positive impact of lower oil prices on local consumers and businesses. However, consistent with its previous posture, the SARB has made it clear that any future monetary policy decisions will be data dependent and driven by the developments in the inflation and growth outlooks.

Regarding their performance outlook over the short to medium time horizon, most banks have noted that forecast risk in the context of the current environment remains elevated and consequently makes guidance for performance more difficult to formulate. Nonetheless, what is clear is that 2016 is expected to remain characterised by low economic growth, with the SARB potentially finding itself in a position to again have to increase rates during the year. Any monetary policy action may place further pressure on South African businesses and local consumers. The added complexity to the economic outlook is represented by the fact that unemployment levels in South Africa are trending upwards, with staff cuts increasing across a range of industry sectors.

Credit growth across both the retail and corporate sectors is likely to stay at current levels or demonstrate moderate upward movements, while commercial activity is unlikely to pick up significantly with any sustained momentum. From a credit quality perspective, most banks have highlighted the risk that bad debts within their retail and corporate portfolios may further increase in 2016. Non-interest revenues in the form of transactional volumes are also expected to remain at similar levels with little suggestion of strong upside growth, making top-line revenue growth more difficult to achieve and sustain in the period ahead.

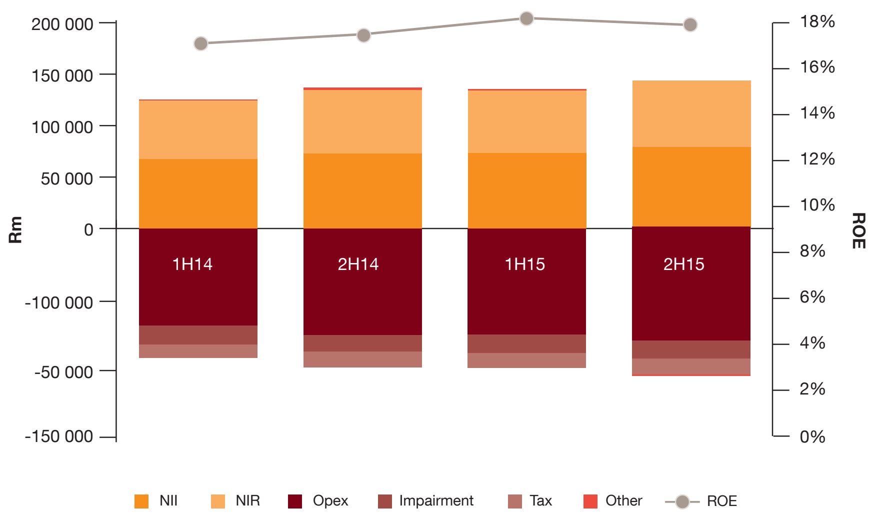
Balance sheet resilience; a sustained focus on proactive risk management and overall bank strategy, including their methods of execution; and diversification in earnings profiles and income streams will all continue to be key for the major banks to ensure that they can navigate the heightened levels of forecast risk and map their paths through the headwinds that are likely to persist throughout the rest of 2016.

Combined results for six-month periods (Rm)

	2H15	1H15	2H14	1H14	2H15 v 2H14	2H15 v 1H15
Net interest income	78 838	73 153	72 740	67 091	8.4%	7.8%
Non-interest revenue	65 044	60 800	61 812	56 975	5.2%	7.0%
Total operating income	143 882	133 953	134 552	124 066	6.9%	7.4%
Total operating expenses	-82 070	-76 288	-76 853	-69 964	6.8%	7.6%
Core earnings	61 812	57 665	57 699	54 102	7.1%	7.2%
Impairment charge	-13 336	-13 590	-12 038	-13 927	10.8%	-1.9%
Other income/ (expenses)	-1 022	1 709	2 224	998	<100%	<100%
Discontinued operations	-261	3 002	-2 713	-1 032	-90.4%	>100%
Income tax expenses	-11 429	-10 768	-11 318	-9 676	1.0%	6.1%
Profit for the period	35 764	38 018	33 854	30 465	5.6%	-5.9%
Attributable earnings	32 502	35 718	31 191	27 448	4.2%	-9.0%
Headline earnings	33 745	32 763	29 984	27 826	12.5%	3.0%
Return on equity	17.9%	18.2%	17.5%	17.1%	1.9%	-1.7%

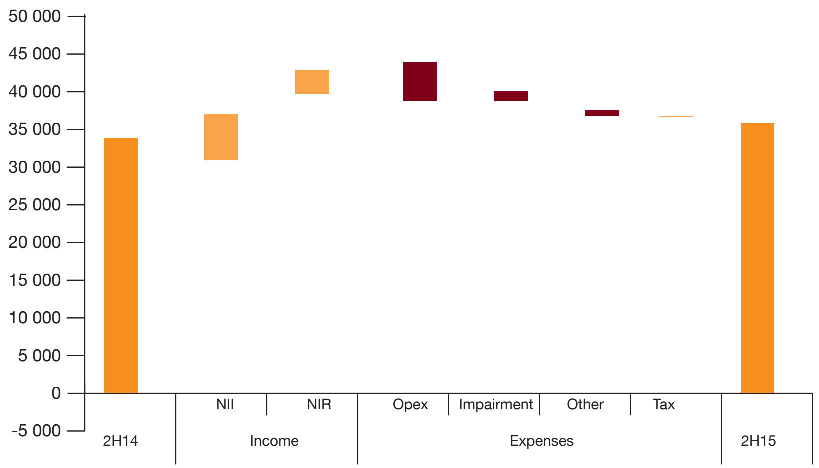
Source: PwC analysis

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

The dynamics of monetary policy and growth objectives

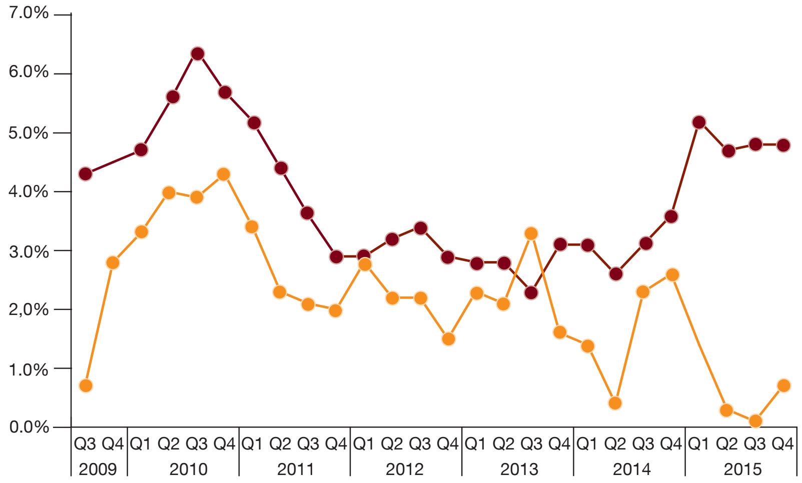
Higher money market interest rates pose a significantly higher threat to the South African banking sector than during previous phases of restrictive monetary policy. Although most financial and economic commentators expected the Monetary Policy Committee (MPC) of the South African Reserve Bank to raise the repurchase (repo) rate at the end of January 2016, more divergent views exist on the timing of stricter monetary policy.

The last time the MPC abandoned an accommodating monetary policy stance, the South African economy had embarked on a growth trajectory of 5% – an economic boom fuelled by the so-called 'commodity super-cycle' and increased household consumption expenditure. This time around, most commodities are in a slump and the economy is barely clinging to positive real growth.

Scrutiny of the state of the global and domestic economies reveals a number of caveats to the MPC's new policy stance, some of which resemble a proverbial minefield for the South African economy's prospects of avoiding a return to recession. These factors and potential alternative considerations are listed below:

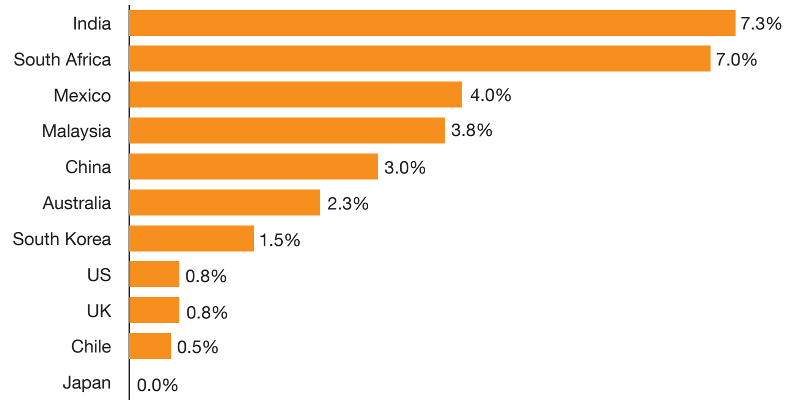
- First and foremost, the economic growth trajectory has been declining for the past five years, with negative real GDP growth having been recorded as recently as the second quarter of 2015. The key demand components of household consumption expenditure and capital formation are inversely correlated to the level of borrowing rates.

Figure 2.1 Real GDP growth and real prime rates



Source: SARB, PwC analysis

Figure 2.2 Money market rates – February 2016, selected countries



Source: EIU

- Secondly, South Africa's domestic monetary policy appears to be out of kilter with that of virtually each of its major trading partners, a fact acknowledged by the MPC. Since 2015, every statement issued after MPC meetings has made due reference to the difficult global economic conditions which continue to threaten South Africa's export performance and domestic growth prospects. As a result of low or below-par growth in the US and Europe and structurally lower growth in China, most central banks are attempting to stave off recession by being accommodating, resulting in money market rates of between zero and 1% in countries such as the US, UK, Japan, Germany, France, Chile, Hong Kong and Sweden, whilst rates are negative in the Eurozone (in nominal and real terms). In sharp contrast, South Africa currently has one of the highest real commercial lending rates in the world.

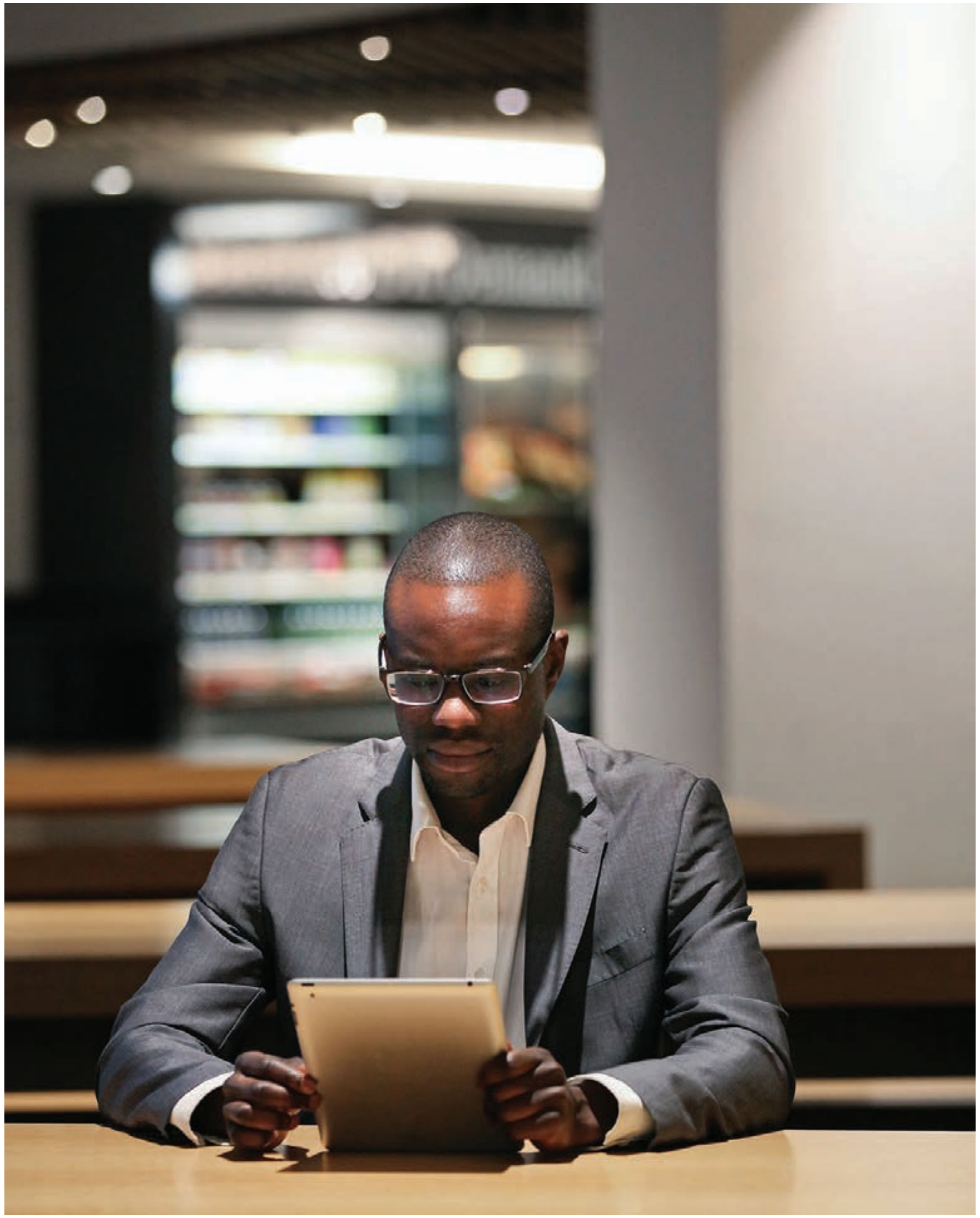
- Thirdly, monetary policy appears to be inconsistent and, of late, arguably not flexible enough. Between the fourth quarter of 2009 (after the end of the global recession) and the fourth quarter of 2014, the average real prime rate was 1.2 percentage points above the average real GDP growth rate. Over the past four quarters, however, this difference has increased to 4.4 percentage points, raising the cost of working capital by almost 11% (measured against prime).

- A fourth area of concern is the increase of 13% in the ratio of household debt servicing costs to disposable income between the third quarter of 2012 and the third quarter of 2015. Two rating agencies (Moody's and Standard & Poor's) have warned that higher lending rates in South Africa will put pressure on the ability of households to repay debt and that the asset quality of banks may deteriorate as a result.

- A fifth caveat is the reaction by policymakers to the politically induced depreciation of the rand over the past three months. Although the latest MPC statement refers to the dismissal of Finance Minister Nene (in December 2015) in very diplomatic terms, most domestic commentators have been more forthright in pointing out its damaging effects on South Africa's investment profile. Some stability has, however, been achieved in the aftermath of the re-appointment of Mr Pravin Gordhan as Minister of Finance, with a significant claw-back of the domestic currency being likely over the medium term. The difference between the current real effective exchange rate of the rand (REER) and the long-term average of the REER points to an undervaluation of 18.6% (as at mid-February 2016). The rand has always managed to recover from such situations.

- Concern number six is related to the fact that no demand inflation appears to be in sight in South Africa. Some market commentators believe that higher interest rates are not expected to solve the cost-push inflationary effect of either increases in administered prices or costlier imports linked to the depreciation of the rand.

- A seventh concern is the apparent lack of coordination with fiscal policy, which represents a significant threat to the investment grade status of South African sovereign bonds. Due to a tax revenue shortfall, little leeway existed in the latest national budget to stimulate the economy, although Finance Minister Gordhan managed to avert tax rate increases (beyond fiscal drag) whilst maintaining public spending on infrastructure.

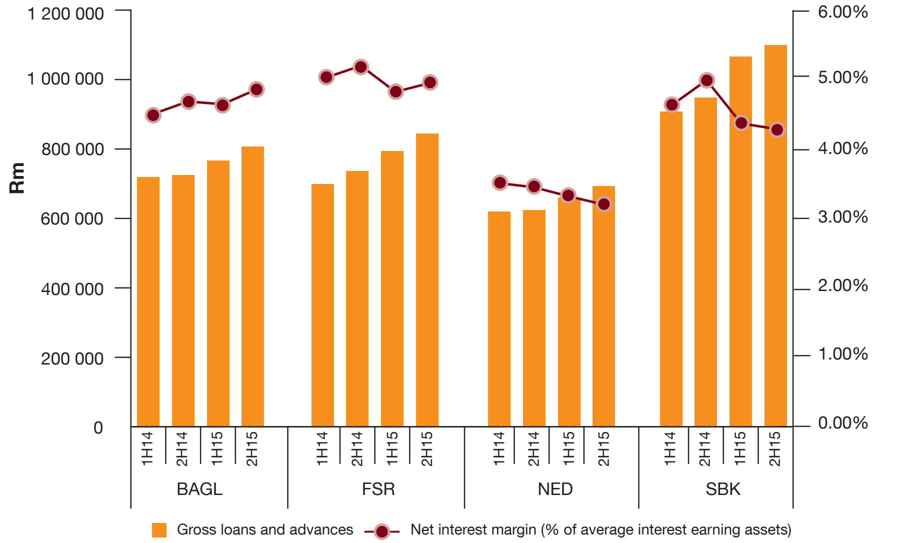


3. Net interest income

Net interest margin (Rm)

	Combined			
	2H15	**1H15**	**2H14**	**1H14**
Gross loans and advances	3 444 191	3 287 314	3 033 571	2 945 912
Net interest margin (% of average interest-earning assets)	4.38%	4.34%	4.64%	4.47%

Figure 3.1 Net interest margin and advances



Source: PwC analysis

Growth in combined net interest income (NII) for the major banks for the current period amounted to 8.4% when compared to 2H14, and 7.8% against 1H15.

The impact of endowment, balance sheet mix and ongoing focus on asset pricing continue to benefit NII. However, the impact of regulatory requirements and competitive pricing among the banks counteracted this benefit on the major banks' net interest margins.

Growth in gross loans and advances amounted to 13.5% compared to 2H14, and 4.8% against 1H15. A continued key driver of loan growth for the major banks remains corporate and investment banking lending, which is consistent with the theme observed in our previous analyses. However, as noted in the Asset Quality section, the gap by which corporate lending exceeded retail lending in the current period is lower than that seen previously.

NII has grown consistently across all the banks over a number of periods, as we have commented on previously, and continued to grow in the current period by 8.4% when compared to 2H14, and 7.8% against 1H15.

In the current period, the combined net interest margin grew to 4.38% from 4.34% at 1H15, but remains lower than the 4.64% seen at 2H14. The drivers influencing the major banks NII continues to comprise of the following factors:

- Endowment impact and economic sentiment;
- Regulatory requirements;
- Asset and liability mix and pricing; and
- The effect of foreign exchange rates.

Endowment impact and economic sentiment

The impact of endowment positively affects the earning capacity of banks' assets during times of increases in market interest rates, as the change in these rates result in variable-rate assets typically re-pricing faster than non-rate sensitive liabilities or equity that funds those assets.

As a result, and given the increase in the repurchase rate introduced by the SARB during the third and fourth quarters of 2015, the impact of endowment has been positive for the banks' income statements as it uplifts income potential from the banks' asset base and enhances interest earned on loans advanced.

While bank margins benefitted to some extent as a result of higher market interest rates in the current period, the effect of higher interest rates and consumer price inflation (CPI) puts additional strain on household incomes and debt-service costs and therefore, over the medium to longer term, the impact of endowment on margins would be expected to normalise.

Regulatory requirements and asset and liability mix

A continued influence on the net interest margin over the current period has been the need for banks to build up their stocks of high-quality liquid assets (HQLA) to meet contractual liabilities over a 30-day simulated period of stress, as the Basel III liquidity coverage ratio (LCR) increases from its current minimum of 60% in equal annual steps of 10% towards 100% in 2019.

Consequently, margins from interest-earning assets have continued to come under pressure in light of larger amounts of HQLA being held to ensure LCR compliance, and increased term funding being generated in anticipation of the Net Stable Funding Ratio, which comes into effect on 1 January 2018.

The LCR and the NSFR both have real implications for liquidity management and the cost of bank funding, as higher quantities of HQLA place downward pressure on bank margins as these instruments are typically lower-interest yielding.

Consistent with our observations in previous periods, the major banks continue to place focus on proactive improvements to pricing strategies and appropriately pricing for risk.

Some banks have seen healthy asset growth in relatively higher-margin asset businesses such as the 'other' retail lending category, which comprises general overdrafts, as well as corporate and investment banking term lending.

Particularly in the competitive retail banking sector, we continue to note improvements in balance sheet mix being counteracted by competitive pricing strategies amongst the major banks.

It is also important to note that ongoing regulatory developments regarding liquidity risk will result in banks placing greater emphasis on the deposit-taking franchises of their balance sheets going forward. Asset and liability mix efforts continue to include favouring shorter term rather than longer-term assets such as retail mortgages, as the introduction of the Net Stable Funding Ratio (Basel III's longer-term prudential ratio for liquidity risk) will require access to stable sources of funding that are difficult to attract for an emerging market economy like South Africa.

The effect of foreign exchange

Those banks using their physical footprints or operations outside South Africa to grow lending will have seen foreign currency translation reserves continue to be impacted by the volatilities in exchange rates experienced over the current period.

Each of the major banks have different structures, business models and strategies with regards to the management of advances denominated in foreign currency. While some maintain large physical footprints (and separate legal entities through which they lend in foreign currency), others make use of their South African balance sheets to lend in markets outside South Africa.

As a consequence, the effects of exchange-rate volatility will have impacted the banks' results in different ways, with some benefitting through a stronger USD where their loan book outside South Africa is USD-denominated. Others would have experienced an element of dilution in earnings as a result of a weaker rand (i.e. reporting currency).

In either case, what is clear is that volatile exchange rate markets introduce added complexity for the banks to navigate in managing their margins. The still uncertain exchange rate outlook over the short term will continue to be a focus area for the banks as they look to manage their exposure to foreign currency risk.

The way forward

Ongoing pressure on the major banks' net interest margin is expected to continue as the regulatory requirements from a liquidity perspective will play a significant part in the banks' strategic objectives as they look to accumulate their stocks of liquid assets and lengthen the tenor of their funding profiles.

The effects of these changes could potentially lead to continued pressure on margins. As such, focusing on growth in revenues through fee and commission-based income is expected to be a key focus area as opportunities for margin growth will be impacted by a variety of continued pressures.

4. Non-interest revenue

Non-interest revenue (NIR) continues to be primarily supported by growth in fee and commission income, which represents 71% of the total for 2H15.

NIR grew 5.2% in 2H15 compared to 2H14, but grew by 7.0% against 1H15.

NIR has continued on a positive growth trajectory, although levels of growth have slowed during recent periods with NIR growing 5.2 % in 2H15 compared to 2H14. NIR composition continues to be dominated by fee and commission income, which represents 71% of the total for 2H15, largely consistent with the contribution for the previous three six-month periods. The level of growth noted in NIR varied less significantly between the banks than noted historically, with growth rates ranging between 4% and 6% compared to 2H14.

An interesting development, noted in the prior period, has continued with the significant increase in the contribution of 'rest of Africa' operations to the growth in the NIR line for the major banks. Although absolute contributions remain relatively small, the growth seen bears testimony to the successful implementation of strategies to cater for growth in these markets at a time when it is becoming increasingly more challenging to extract strong growth from the South African market, which has become increasingly saturated. This growth was achieved across most spectrums of NIR, being net fee and commission income and fair value income. However, this was somewhat muted by the decline in the insurance and bancassurance income.

Net fee and commission income

Net fee and commission income grew by 5.1% compared to 2H14, which represents a slowing of the growth trajectory recorded in the past.

The banks have commented that this growth is attributable to net growth in customer numbers and inflation-related increases in the prices of selected products. We see this as a remarkable achievement in the face of headwinds experienced during the prior period. These included the revised lower interchange fees, effective March 2015, the impacts of which are starting to reflect in the numbers of customers who are continuing to migrate to cheaper digital channels. The current reporting period includes the full impact of the revised lower interchange fees for the first time, with roughly three months included in the preceding reporting period. The majority of banks also commented that they have seen strong growth in card-acquiring volumes that have softened the impact of lower interchange fees.

Management teams continue to diversify the net fee and commission income revenue streams across various geographical regions in Africa, given the relatively mature state of the banking market in South Africa and muted opportunities for significant further growth in this region. Management continue to focus on growth in annuity revenue in the rest of Africa, particularly through focusing on less capital-intensive activities.

The success of these diversification programmes is expected to be one of the factors that will distinguish the frontrunners in this area. An interesting recent development has been the increased intervention by regulators in other African countries regarding the appropriateness of fees charged to customers as 'Treating Customers Fairly' campaigns, which have been prevalent in South Africa for a number of years, gain traction in these territories and increased regulatory oversight is exercised over fees and commissions charged to customers.

Knowledge-based fee income, largely associated with investment banking advisory activities, has also continued to show resilience despite tough trading conditions. The current economic uncertainty could, however, impact negatively on this line item in the near term as big financing decisions, listings and takeovers are delayed.

Fair value income

Fair value income continued to follow the volatile pattern observed in previous reporting periods, growing by a robust 17.2% on 2H14 and 14.0% against 1H15.

Trade flows within the major banks generally benefited from increased demand for hedging and risk management products in light of the levels of market volatility prevalent over the current review period. At the same time, the trading environments remained challenging due to increased competition and compressed margins. Given the currency volatility noted in December 2015, all banks recorded a very favourable month given the demand to hedge against the rand, benefiting from this tailwind, notwithstanding the pressure placed on other areas of the banks during the same period.

The growing contribution of trading operations in the rest of Africa has been a positive development for some of the major banks as they capitalise on the increase in cross-border trading activities. The relative contribution of trading operations in the rest of Africa now constitutes a significant portion of the banks' fair value income, although the banks have commented that given weaker fundamentals and increased competition, the strong growth experienced in the rest-of-Africa portfolio is expected to moderate in the near term. One bank has noted that 40% of the contribution of trading income came out of its African operations in 2H15, which provides an indication of the size of the opportunity.

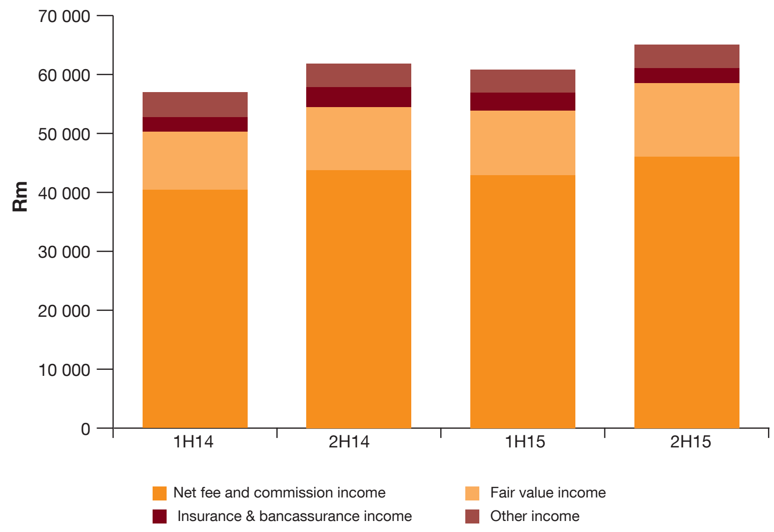
Fair value income has also been affected by downward private equity revaluations at some banks. On the positive side, some banks have had favourable realisations/revaluations of private equity and property investments, which boosted their fair value income. Given the unstable economic environment we foresee a slowdown in these frequent realisations continuing to come through in the upcoming reporting periods.

Insurance and bancassurance income

Revenue related to insurance and bancassurance activities decreased by 23.7% compared to 2H14. This has been ascribed to the historic slowdown in unsecured retail lending volumes, partially offset by a good weather-related claims experience. At 4% of the contribution to the overall NIR line, insurance and bancassurance income remains a relatively small contributor.

Various headwinds were faced during the reporting period, including softer global equity markets, a moderation in the growth of life and short-term insurance premiums on the back of slower economic growth, and increased investments being required to meet the increased regulatory obligations expected in the near term. An interesting development is that the banks are increasingly looking for expansion opportunities in the rest of Africa in both the short-term and long-term insurance markets to bolster growth, given the relatively low levels of penetration in insurance markets in these territories.

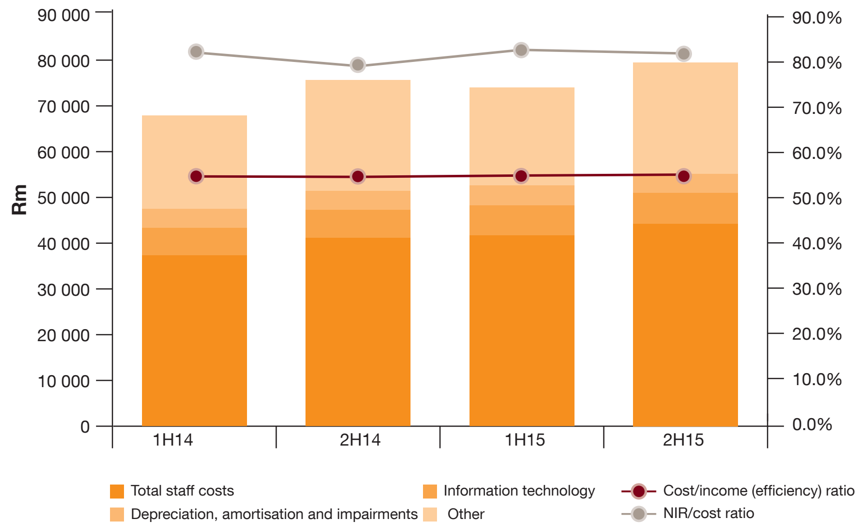
Figure 4.1 Non-interest revenue



Source: PwC analysis

5. Efficiency

Figure 5.1 Operating expenditure



Source: PwC analysis

The combined cost-to-income ratio deteriorated marginally to 55.1 % in 2H15 (1H15: 54.9%).

Disciplined cost containment strategies, which have been in place for a number of years, continue to be an important strategic lever as achieving robust revenue growth remains challenging.

Sizeable investments are being made in information technology and adapting the retail banking franchises and physical branch networks towards the 'bank of the future'.

The major banks have continued to experience challenges in extracting efficiencies from operations while investing for future growth, reflected in a marginal deterioration in their cost-to-income ratio to 55.1% (2H14: 54.6%). This ratio continued its downward trend from a high of 59% in 2H11 as banks continue to intensify their efficiency efforts and seek to manage costs effectively across their organisations. Interestingly, this is the fourth reporting period where the cost-to-income ratio is in the 55.1% to 54.6% range, illustrating the challenge that the banks are facing to improve on it.

As previously observed, we continue to expect pressure on the cost-to-income ratio as the major banks invest for future growth within a challenging current economic climate. A few areas where these increased costs may manifest include:

- Initiatives to right-size the branch networks and consolidate branches, coupled with increased costs to build out a branch network that is fit for the future and responsive to the changing needs of customers. The banks are looking critically at internal processes and levels of automation with the aim of simplifying processes and rationalising systems where possible in order to ensure an enhanced customer experience.
- Initiatives to invest in the rest of Africa, where significant investment is currently being made in infrastructure/IT systems. The inflationary environment outside South Africa is generally higher than domestically. The average USD/ZAR rate weakened from R10.98 in 2H14 to R13.59 in 2H15, placing significant additional pressure on the cost line for imported IT services. Given that the significant decline was only noted towards the back end of 2H15 and that the rate has remained weak in 2016 to date, it is expected to further weaken in 1H16.

The major banks have commented that they are making significant investments in IT systems to meet increased regulatory requirements and heightened customer expectations for seamless transactional banking and digital solutions. Increased amortisation charges as these systems come online could also negatively impact costs. Specific areas receiving focus include the banks' responses to the rising threat of cyber risk and their overall readiness for new regulation in the form of the Basel Committee's Principles for effective risk data aggregation and risk reporting (BCBS 239). The principles contained in this BCBS document became effective on 1 January 2016 for the majority of global banks (those designated as G-SIBs). The principles require greater linkage between risk and finance systems and also seek to ensure the integrity of risk data nearly to the same extent as financial reporting data. There is also a heightened awareness of IT spend as the major banks race to embed digital platforms in competition with non-traditional opponents in the form of companies residing within industries outside financial services.

More than 56% of the total operating expenses of the major banks relate to staff costs, which represents a slight increase on the contribution of 54% at 2H14. One of the banks noted that significant increases in staff costs was because they converted temporary staff into permanent staff in line with strategic and legal considerations. This increase was, however, somewhat mitigated by the reduced share-based payments charge given the decrease in the majority of the bank's average share price as at the end of 2H15. We expect this increasing staff cost trend to continue as specialist and skilled resources are employed to assist the banks with the IT transformation described above and to help meet the heightened levels of regulatory compliance required.

The major banks have to be commended on their cost containment strategies over the current period, which have resulted in a relatively stable cost-to-income ratio. Over the coming period it will be interesting to see how banks react to deal with subdued global growth, an unstable local economic environment, a depreciating currency, creeping inflation and continuing levels of investment in IT-related costs to meet their future ambitions.

6 Asset quality

Asset quality (Rm)

	Combined			
	2H15	1H15	2H14	1H14
Gross loans and advances	3 444 191	3 287 314	3 033 571	2 945 912
Non-performing loans	100 076	93 685	91 690	93 923
Impairments	-67 321	-62 486	-60 926	-62 015
Portfolio provisions	-24 552	-23 050	-21 602	-21 019
Specific provisions	-42 769	-39 436	-39 324	-40 996

Gross loans and advances

The major banks' combined loans and advances grew by 4.8% in 2H15 compared to 1H15 and by a more robust 13.5% against 2H14. This growth continues to build on the strong growth recorded in the previous reporting periods and brings the cumulative growth in gross loans and advances to 21% in the last two years off an already high base.

An interesting observation about the drivers of the major banks' loan growth for the current period is that while corporate credit continues to show stronger levels of growth than retail, the gap between corporate lending growth and retail lending growth has narrowed, with both categories growing by 5.6% and 5.4% against 1H15 respectively. At the same time, notable increases have been seen in this period within the 'other' loans and advances category within retail lending, which includes general bank overdrafts.

Corporate lending

While presenting a relatively mixed picture when considered for each of the banks individually, all of the banks continued to record growth in corporate and commercial property lending for the current review period, with their combined corporate loan books growing by 5.6% against the comparable period.

Consistent with the trend noted previously, growth in advances continued to be driven by corporate demand during the current period, with healthy credit drawdowns extended to corporate clients operating in the renewable energy and commercial property sectors, as well as reasonable demand for term loans, preference shares and reverse repurchase agreements.

On a combined basis, growth in general bank overdrafts was noticeably absent from the list of corporate credit growth drivers for this period, as reflected in the banks' results commentaries. SARB data for all South African banks for the current review period supports the analysis that:

> *Loans and Advances to the corporate sector in the latest quarter were characterised by rising general loans to both financial and non-financial companies, and a decline in overdrafts.*

While forecasting where corporate credit demand will end up for the rest of 2016 remains difficult, what is clear is that the impact of lower oil and commodity prices is expected to continue to have a range of implications for different sectors of the South African economy.

Retail mortgages

While mortgages to the retail sector, in absolute terms, still constitute a sizeable portion of the major banks' total loan portfolios (amounting to 26.4% of the total major banks' loans books at 2H15, and 27.3% at 1H15), it is clear that caution continues to be exercised in growing retail mortgage portfolios given the economic challenges presently facing the South African consumer and the NPL experience some major banks have had in this portfolio in recent years.

Efforts to reduce the size and composition of their balance sheets is evident as the retail mortgage portfolio accounted for more than 37% of the total loan book of the major banks just over four years ago.

For the current period, retail mortgage credit extended by the major banks increased by only 1.5% against 1H15, and 2.6% against when compared to 2H14.

While the supply side of this loan category has been the subject of caution by the major banks, demand for retail mortgage credit continues to be constrained by various economic conditions that are unlikely to improve much over the course of 2016. These include increases in the ratio of household debt to disposable income, which increased marginally in the third quarter of 2015 and question marks that remain over the local property market.

We therefore maintain our view that clear incentives for the major banks to focus significantly on growing their retail mortgage portfolios appears somewhat limited, as they may rather look to deploy resources in higher-margin, less capital intensive and lower-tenored retail banking products and grow their deposit base given the regulatory implications on the horizon from a liquidity risk perspective.

Instalment sale credit, card debtors and other unsecured lending

A review of SARB economic commentary for the period under review makes evident the scale of challenges impacting the South African consumer at present. In particular, the SARB's latest Quarterly Bulletin notes:

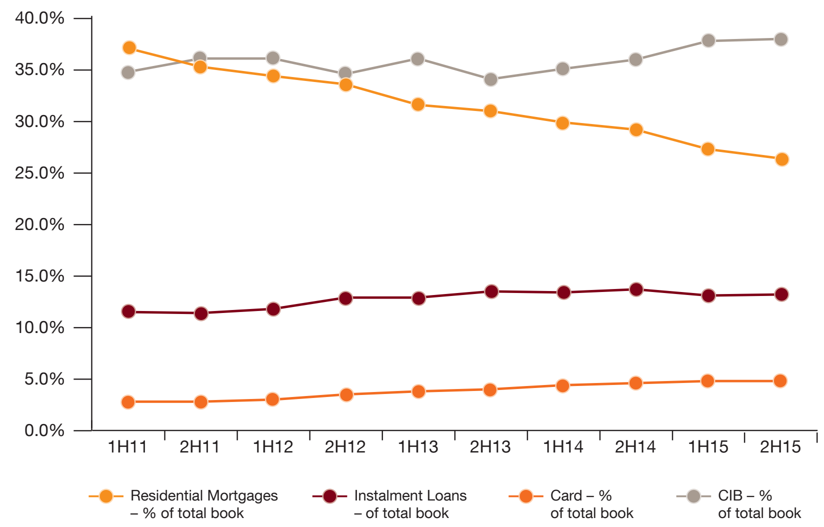
> *Factors restraining demand for credit included, among other things, high levels of unemployment, weaker domestic economic growth prospects, negative wealth effects stemming from weak growth in property prices and lower share prices, and stricter credit regulations. Notwithstanding a slight recovery in consumer confidence in the third quarter of 2015, consumer optimism generally remained subdued. Low levels of consumer confidence suggest a muted recovery in consumer spending and weak growth in the uptake of credit. Credit extension to the household sector was particularly subdued, expanding at rates marginally below the concurrent rate of consumer price inflation as consumer confidence remained low and personal income constrained.*[3]

The impact of this sentiment is clearly evident in the growth rates of instalment finance and credit card growth for the major banks over the current review period, at 5.8% and 1.3% against the comparable period respectively. These are the weakest growth rates we have seen in these categories for some time by a considerable margin.

However, good growth has been generated in the major banks' 'other' retail lending categories, which increased healthily over the current period by 15.6% against 1H15 and 27.5% against 2H14. It should be noted that while this category of lending includes overdrafts and other personal lending, the total contribution of 'other' retail lending continues to make up less than 10% of the major banks' total loan book.

Given the persistence of negative economic factors seen over the current period, and the uncertain outlook for the rest of 2016, it will be interesting to see how retail lending portfolios play out over the next six months and, in particular, what the major banks' strategies will be.

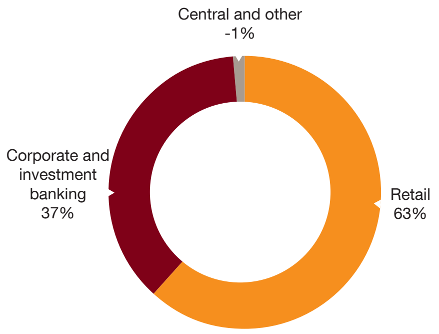
Figure 6.1 Composition of loan portfolios



Source: PwC analysis

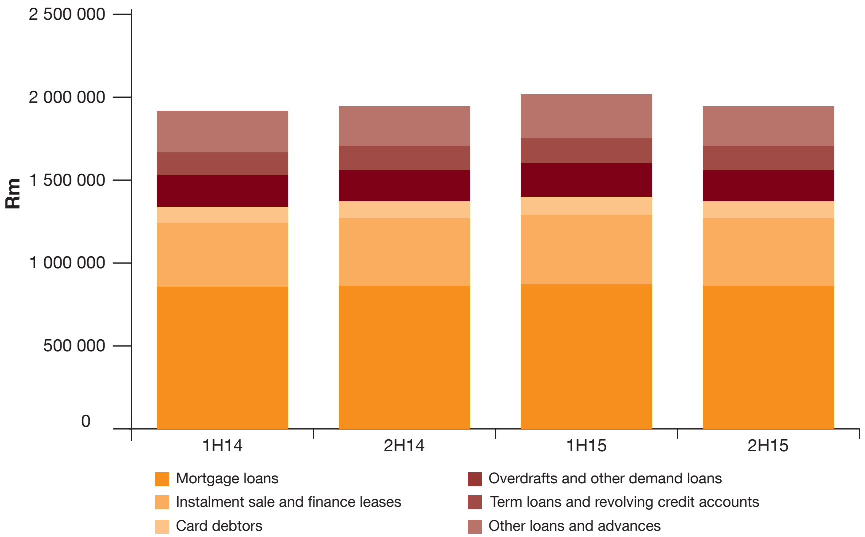
[3] SARB, "Quarterly Bulletin", December 2015 – *https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/6999/01Full%20Quarterly%20Bulletin%20%E2%80%93%20December%202015.pdf*

Figure 6.2 Combined loans and advances by product



Source: PwC analysis

Figure 6.3 Retail advances per product



Source: PwC analysis

Non-performing loans

As at 2H15, the combined non-performing loans (NPLs) of the major banks increased 6.8% against 1H15 and 9.1% when compared to 2H14. As such, the NPL picture remains mixed, with clear nuances in the stock of NPLs across individual credit categories. Our analysis shows that, at 2H15, retail NPLs comprised 75% of the major banks' total NPLs, with a sizeable portion attributable to legacy retail mortgages that continue to remain on the books. However, we continue to see a noticeable decrease in mortgage NPLs across the major banks' retail portfolios with the relative contribution of retail mortgages to the total NPL portfolio decreasing from 58% of all NPLs in 2H11 to 38% of all NPLs in 2H15. This is a credit to the bank's efforts to work-out, restructure and recover on this generally long-term and sticky loan category.

For the current period, double-digit NPL growth of 17.8% and 18.7% was seen in both the corporate and retail instalment credit categories respectively, each of which have consistently seen portfolio growth over recent periods. As a result, NPL growth in these credit categories can, in some part, be attributed to the general book growth observed in previous periods and the emergence of credit quality challenges since origination.

All of the banks continue to highlight prudent approaches to credit origination being applied in recognition of the high levels of market volatility prevalent in the South African economy and significant fragilities in the macroeconomic environment. Nonetheless, the growth seen in NPL portfolios in the current period is partly a result of the application of prudent judgements by the major banks in recognising portfolio provisions for the latent stresses considered to exist in their loan portfolios for credit previously originated.

Coverage ratios and income statement impairments

Our previous analyses have supported the view that the major banks consistently maintain healthy credit coverage ratios, and this trend has continued in the current period. As a percentage of total advances, total NPLs have remained below 5% for the last four years, and amounted to 2.9% as at 2H15 (2.9% at 1H15). At the same time, the specific impairment coverage ratio – calculated as specific impairments divided by total NPLs – has remained within the 68% – 68.5% range for this period, and amounted to 68.5% as at 2H15 (68.4% at 1H15).

From a bad debt income statement charge perspective, a slight improvement in the combined credit loss ratio (calculated as income statement impairment charge divided by average gross advances) of 0.82% was noted as the ratio moved from 0.89% at 1H15 and 0.84% at 2H14.

Given the increases in NPLs over the current period and, in particular, the growth in the portfolio provision charge on the back of the banks' general proactive provisioning strategies, the total combined impairment loss for the major banks continued to present a mixed picture between 1H15 and 2H14. Combined impairments fell marginally by 1.8% when compared to 1H15, but increased 10.8% against 2H14.

For the rest of 2016, we continue to expect the major banks to focus intensively on managing their loan portfolios and their provisioning strategies across all lending categories given the extent of economic forecast risk that is expected for the rest of the year, the subdued expectations for business confidence and the array of stresses facing all sectors of the South African economy.

7. Capital and funding

Capital and funding (Rm)

	Combined/Average			
	2H15	1H15	2H14	1H14
Common equity tier 1	330 350	310 685	294 724	294 752
Total tier 1	353 555	327 393	321 360	313 220
Tier 2	60 687	55 488	54 855	53 120
Total qualifying capital and reserve funds	414 242	382 881	376 215	366 340
Total capital adequacy ratio	15.2%	15.4%	15.3%	15.4%
Risk-weighted assets	2 828 345	2 599 837	2 527 286	2 465 769
Deposits	3 578 418	3 403 126	3 197 387	3 053 880

While the major banks remain well capitalised, with total regulatory capital adequacy ratios comfortably above required minimums, the effects of higher risk-weighted assets and challenging earnings growth combined to result in a slight decline of the total capital adequacy ratio to 15.2% (compared to 15.4% at 1H15 and 15.3% at 2H14).

Consistent with our observations in the previous period, growth in combined risk-weighted assets (RWAs) represented a major driver in compressing the combined total capital adequacy ratio of the major banks in the current review period. Total RWAs grew by 8.8% against the comparable period and by a robust 11.9% against 2H14. Credit and counterparty credit RWAs still represent the most sizeable portion of the major banks' total RWAs, amounting to nearly 75% at the combined level.

During 2015, the SARB introduced an industrywide credit valuation adjustment (CVA) capital charge for OTC derivatives denominated in local currency and for OTC derivatives with local counterparties not cleared through a central counterparty. There is still no central counterparty for OTC derivatives in the South African market. Discussions are being held at an industry level to potentially introduce a central clearer to cater to the South African derivatives market in the near term.

At the same time, growth in credit RWAs for most of the banks is also attributed to loan growth, coupled with downward credit ratings migration across certain corporate and investment banking loan portfolios as a consequence of the deteriorating macroeconomic environment that persisted over the current review period.

Excluding the Pillar 2b (bank-specific) capital add-on, the minimum total required capital adequacy remained at 10% – a level which all of the major banks comfortably surpass owing to their prudent stance on capital management in current and previous years in preparation for the current increasing capital regime still being brought about by Basel III. However, capital generated through earnings growth continues to be offset by sustained growth in RWAs, as mentioned above, and we continue to see 'old-style' issued additional tier I and tier II capital instruments being phased out in line with transitional regulatory requirements under Basel III.

The combined total capital adequacy ratio of the major banks for the current review period fell marginally to 15.2% at 2H15, compared to 15.3% at 2H14 and 15.4% at 1H15. As banks move along the Basel III timeline towards full implementation in 2019, this trend of relatively flat capital adequacy ratios that we have seen being sustained over the past few reporting periods is consistent with the major banks' own expectations and those of market analysts, given the still evolving prudential capital landscape.

It is 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 robust at 12.5% at 2H15 (12.6% at 1H15 and 12.4% at 2H14), comfortably above the required regulatory base minimum of 6.5% for this capital tier.

As required regulatory capital ratios continue to rise through to the end of the Basel III implementation timeline in 2019, additional required capital buffers – including both the capital conservation and countercyclical buffers – will start to be phased in from the current year. As such, ongoing capital management and paying attention to the future capital landscape are still expected to remain areas of focus for the major banks.

At the global level, standard-setting bodies have had a busy close to the 2015 year with a number of significant areas of prudential regulation having been consulted on and guidelines issued. These include revisions to the standardised approaches for measuring credit, counterparty credit, market risk ('Fundamental Review of the Trading Book') and operational risk capital, while revisions to capital floors for banks using internal ratings-based (IRB) approaches continue to be refined.

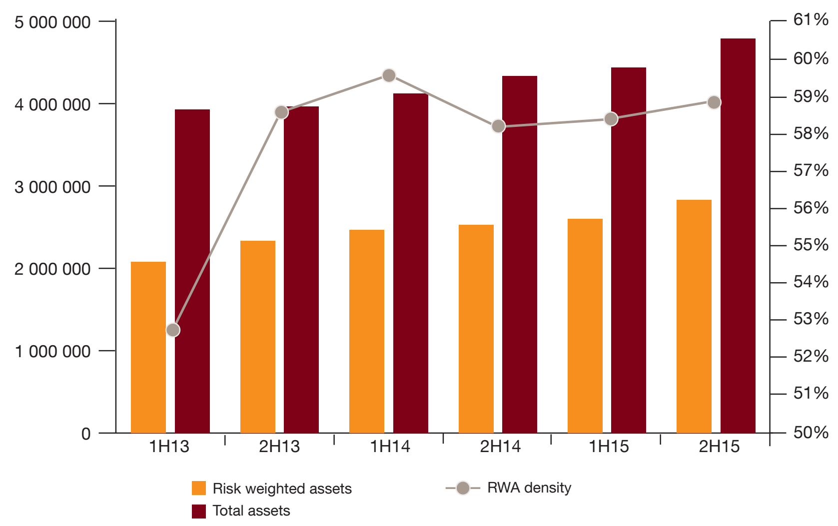
Focus on how the rules pertaining to prudential regulation develop and become implemented into national regulations will be maintained by all of the major banks in the coming periods, particularly as the rules evolve and broaden in scope. New rules pertaining to capital for interest rate risk in the banking book (IRBB) have also been proposed for the first time. These rules are expected to fundamentally impact deposit-taking franchises of the banks at a time when building their corporate banking franchises and retaining their transactional banking franchises have been areas of particular focus for the major banks.

Given the Basel Committee's increasing focus on enhancing the standardised approaches in measuring RWAs as a result of concerns over apparent disparities in RWAs between large internationally active banks due to divergent modelling practices and judgements, we continue to track the RWA-density ratio of the major banks, which provides useful insight. The RWA-density ratio represents an indicative measure which reflects the modelling practices of banks measuring credit risk under one of the Basel framework's advanced approaches.

In South Africa, all of the major banks adopt an advanced approach for the measurement of the majority of their credit RWAs; therefore, modelling practices are a key component in the consumption of credit risk capital. However, for operations outside South Africa which do not have sufficiently granular data to utilise modelling for credit risk purposes, the major banks indicate that they typically apply conservative assumptions or make use of the Basel framework's standardised approach to measure credit risk exposure for regulatory capital purposes.

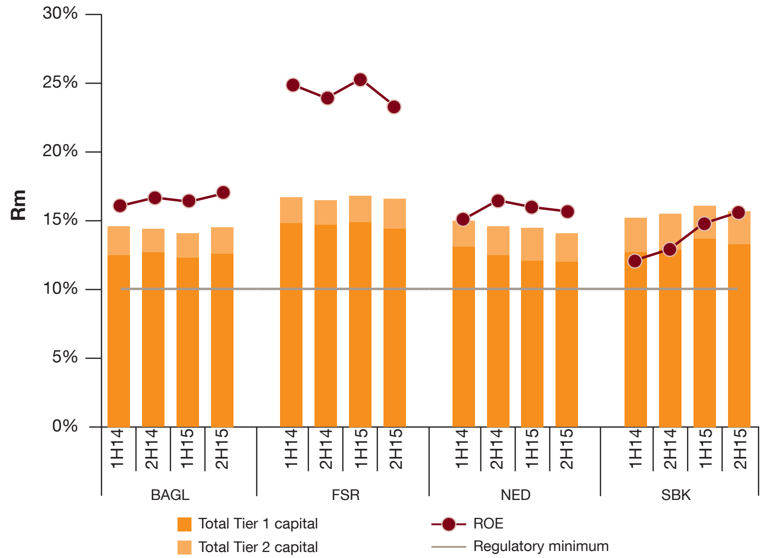
At 2H15, this ratio (measured as total RWA divided by total assets) for the major banks reflected a combined average of 59.1% (compared to 58.4% at 2H14 and 58.6% at 1H15). It is also worth mentioning that growth in RWA over the current period surpassed growth in total assets, which is not entirely surprising given the increased consumption of regulatory capital as a result of the embedding of technical considerations and changes introduced by Basel III, including the SARB's decision in 2015 to impose a capital charge for CVA, as mentioned above.

Figure 7.1 RWA density



Source: PwC analysis

Figure 7.2 Regulatory capital ratios and ROEs



Source: PwC analysis

Resiliency still seen in deposit-taking franchises

The major banks have traditionally reported healthy loan-to-deposit ratios (calculated as total deposits divided by total banking book assets), a trend which continued in the current period on the back of resilient deposit book growth.

The combined loan-to-deposit ratio came in at 96.2% at 2H15, marginally lower than the 96.6% reported at 1H15, but notably higher than the 95.9% reported at 2H14. The sustained resiliency in the loan-to-deposit ratio reflects the banks' focused efforts to grow their deposit-taking franchises – still a highly competitive market – through product, channel and business model innovation.

Growth in the major banks' total deposits for 1H15 remained commendable at 4.8% compared to 1H15, but a very strong 13.5% against 2H14. In particular, some banks with stronger franchises in markets outside South Africa commented on the fact that healthy growth in retail deposits was assisted by the significant rand depreciation seen over the current reporting period.

Managing liquidity risk within risk appetite and tolerance levels continues to represent an important strategic task for bank management, as a result of the first prudential liquidity ratio – the liquidity coverage ratio (LCR), which came into effect on 1 January 2015 – now being embedded as a prudential requirement in South Africa.

The LCR is currently being phased in over the Basel III implementation timeline to reach 100% by 2019, with the requirement for 2015 set at 60%. All of the major banks highlighted their focus on accumulating surplus liquidity buffers and growing their stock of high-quality liquid assets (HQLA) in anticipation of the required LCR increases over the coming periods.

While complying with the LCR has consumed a significant amount of management focus over the recent periods, the net stable funding ratio (NSFR), which was also introduced as part of the Basel III regulatory reform package, is expected to add to the challenge associated with liquidity risk management for South African banks and, indeed, emerging market banks. The NSFR requires banks to ensure that longer-dated assets are funded with longer-dated and more stable sources of funding – both of which are difficult to source to the extent required in emerging-market economies like South Africa. The relatively short-tenor funding structure of the South African economy, coupled with relatively longer-dated banking assets such as retail mortgages or corporate term loans, results in material contractual liquidity mismatches being prevalent in the local banking sector.

However, some relief appeared during the latter part of 2015 when the SARB noted through a proposed directive that the calibration of the NSFR by the BCBS does not cater for the actual stability of institutional funding in the domestic context, given the barriers preventing liquidity through South Africa's closed-funding system. As a result, the SARB has proposed a lower factor for institutional funding less than six months in tenor, compared to the BCBS' NSFR framework – a change expected to assist our banks in meeting the requirements of the NSFR without unduly impacting the domestic economy.

The prudential regulatory environment continues to impact the major banks' funding strategies and business models, which has led them to focus in recent years on enhancing and diversifying their retail and corporate transactional banking franchises, while strategically considering where within the banking groups these businesses and their product sets are best positioned. However, while low-RWA-generating businesses are less capital intensive than investment banking businesses, the Basel framework effectively constrains the capital benefit through the non-risk-sensitive leverage ratio – which some commentators have referred to as the 'new binding constraint' for banks.

Managing this multitude of regulatory factors may change the shape of banks' balance sheets, increase their costs – both direct and indirect – of regulatory compliance, and influence their strategic direction. It is not surprising, therefore, that regulation and compliance consistently rank at the peak of bank management teams' areas of focus, which our industry surveys regularly confirm.

8. Insights – PwC's 19th Annual Global CEO Survey and Banking Banana Skins Survey

Key findings for banking and capital markets (B&CM) – 19th Annual Global CEO Survey

81% of B&CM CEOs see the pace of technological change as a threat to growth, more than that observed in any other industry sector.

The proportion of B&CM CEOs who see new market entrants as a threat to growth (56%) is lower than insurers (65%), reflecting the growing maturity of FinTech in banking and the partnerships being developed between B&CM organisations and FinTech companies.

B&CM organisations are facing the immediate challenges of economic and political uncertainty and the longer-term impact of new technology, more regulation and shifting customer expectations. Some long-established business models are struggling to sustain competitive relevance in the wake of these developments. In turn, new entrants are changing the competitive playing field and blurring industry boundaries. But today's market shake-up also opens up significant opportunities for reinvigorating growth and re-engaging with customers, employees and society as a whole.

What comes through clearly from our survey findings is how quickly and effectively the market leaders are turning disruption into an opportunity. They're capitalising on the full value of technology and the creativity of their people to tap into new value chains and transform operational speed and cost. They're seeking out new sources of data and gathering the broad array of talent needed to enhance customer experiences and outcomes. Individually and through industry bodies, they're also playing a prominent role in supporting public policy priorities in areas ranging from promoting sustainability to advising clients, suppliers and other stakeholders on cyber risk management.

Combating cyber threats

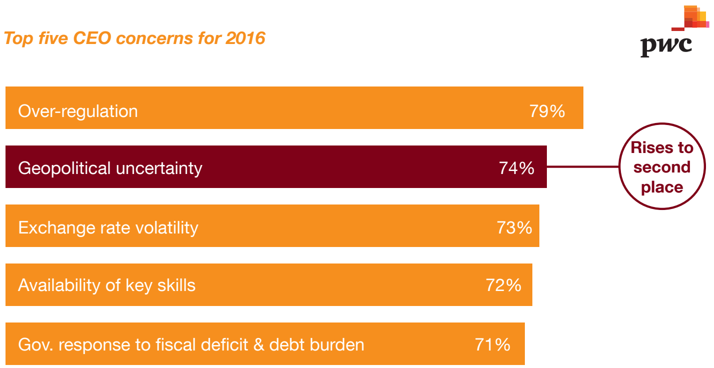
With technology comes a new and escalating raft of cyber and broader financial crime risks – nearly three-quarters of B&CM CEOs see cyber threats as a barrier to growth. B&CM organisations have always been in the frontline of the fight against cybercrime, though they are only as strong as the weakest link in an ever more extended business chain. It's therefore vital that cyber risk is recognised as a strategic risk that demands board-level insight and leadership, rather than simply seeing it as a matter for IT or compliance.

Key questions BCM boards should be asking as they look to strengthen protection include:

- Who are our adversaries, what are their targets and what would be the impact of an attack?
- We can't lock down everything, so what are the most important assets ('crown jewels') to protect?
- Are we integrating threat intelligence and assessments into proactive cyber-defence programmes?
- Do we assess vulnerabilities against known tactics and tools used by perpetrators who might target them?

Beyond the confines of your own systems, it's important to identify and tackle the weaknesses within your wider supply and service chain. This requires a more collaborative approach in which you work more closely not only with clients and suppliers, but also with governments and technology companies to share expertise, threat intelligence and protective systems within a multi-agency approach.

Top five CEO concerns for 2016

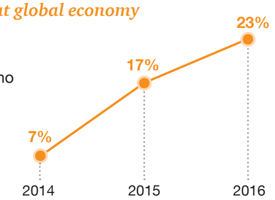


www.pwc.com/ceosurvey

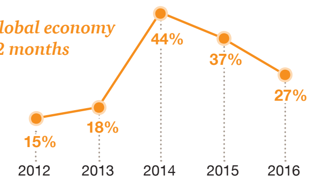
Source: PwC 19th Annual Global CEO

CEO pessimism about global economy on the rise

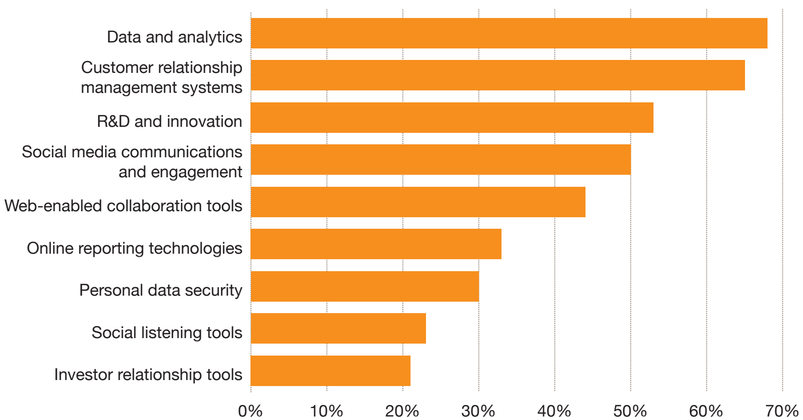
Percentage of CEOs who say global economic growth will decline



CEOs are less confident the global economy will improve over the next 12 months



Which connecting technologies do CEOs think generate the greatest return in terms of engagement with wider stakeholders? (All respondents:1,409) (Banking & capital markets CEOs: 176)



Technology priorities

Please select the connecting technologies you think generate the greatest return in terms of engagement with wider stakeholders

Respondents who stated 'significant change'

Explore the data and find the full 2016 PwC Global CEO Survey and B&CM industry cuts: http://www.pwc.com/gx/en/ceo-agenda/ceosurvey/2016/banking-and-capital-markets.html

Recovery under threat – Banking Banana Skins

Conducted in September and October 2015 by the Centre for the Study of Financial Innovation (CSFI) and sponsored by PwC, the Banking Banana Skins survey provides a periodic snapshot of the risk landscape in the banking sector. This year's survey was based on 672 global responses from individuals in 52 countries (SA – 14 responses).

The survey was conducted in three parts:

- Respondents were asked to describe, in their own words, their main concerns about the financial system over the next two to three years.
- Respondents were asked to score a list of potential risks, or Banana Skins, selected by a CSFI/PwC panel.
- Respondents were asked to rate the preparedness of financial institutions to handle the risks they identified.

The survey findings in the current year highlighted the fact that, at the global level, the banking industry appears to be under attack from many angles, not just from traditional risks but also from new uncertainties. It is not surprising that in 2015, uncertainties in the macroeconomic environment have risen to be the top risk, rising from number three in 2014. Despite prudential reforms, banks remain vulnerable to high debt levels, future interest rates, weakness in China and other emerging markets, and softening commodity prices. Lower growth rates, together with regulatory reforms, will put pressure on banks to manage returns.

The sharpest rise in concern in 2015 was about criminality (including the risks to banks in areas such as money laundering, tax evasion and cyber-attacks), which rose from number nine in 2014 to number two in 2015. This risk was coupled with continued concern about technology risk (number four), where underinvestment and obsolescence as well as the boom in new Fintech present major challenges to banks.

Criminality and technology risk are becoming increasingly concerning for banks given the rise in new competitors who are challenging traditional ways of doing things and operate using more nimble systems and lower overheads. Traditional bank earnings models are starting to be threatened as these competitors chip away at many traditional ways of doing things. To help them improve margins, banks are experimenting with new industry models which leverage on technology and focus more on customer centricity and less on products; however, this could expose them to even higher risks in the areas of cybercrime and financial terrorism.

Not surprising, regulation remains the number three Banana Skin for banks in 2015. Whilst banks recognise the need for tougher controls, many question their cost and effectiveness. Banks are not only bearing the direct costs of regulation – new capital and liquidity requirements, restructuring costs, the impact of market conduct requirements (including potential regulatory fines), higher costs of compliance, and higher costs of customer acquisition – but also the cost of greater management time to re-engineer processes, change culture and increase compliance efficiency. Industry margins are also being impacted.

Find the full report, including individual country cuts – Banking Banana Skins 2016 – Recovery under Threat: *http://www.pwc.com/gx/en/industries/financial-services/banking-capital-markets/publications/banking-banana-skins-2016.html*

Global top ten risks (previous 2014 survey results in brackets)

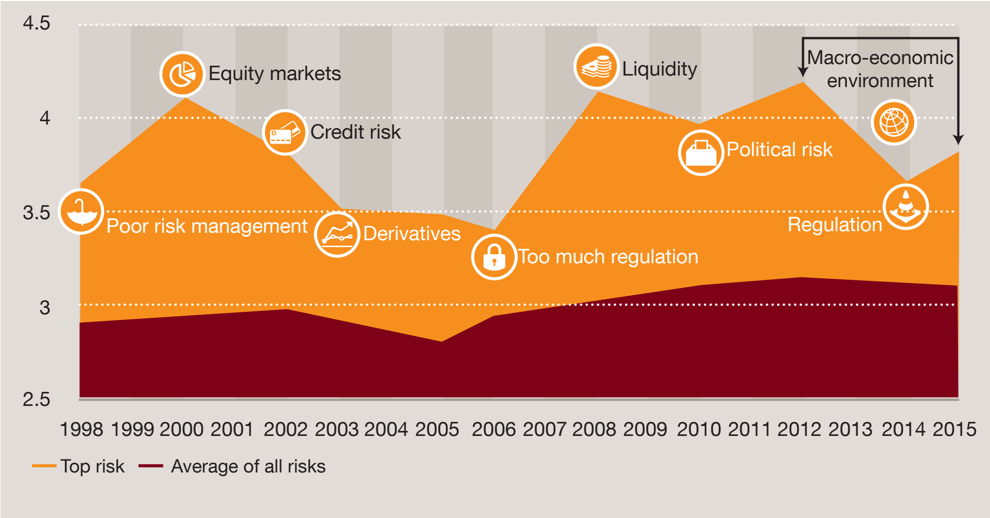
1. Macro-economic environment (3)
2. Criminality (9)
3. Regulation (1)
4. Technology risk (4)
5. Political interference (2)
6. Quality of risk management (11)
7. Credit risk (7)
8. Conduct practices (16)
9. Pricing of risk (6)
10. Business model (-)

SA top ten risks (global ranking in brackets)

1. Macro-economic environment (1)
2. Regulation (3)
3. Criminality (2)
4. Emerging markets (15)
5. Credit risk (7)
6. Technology risk (4)
7. Interest rates (14)
8. Currency (17)
9. Human resources (22)
10. Political interference (5)

Banana Skins index

The Banana Skins index tracks survey responses over time and can be read as an indicator of changing anxiety levels. The upper line shows the average score (out of five) given to the top risk, and the bottom line shows the average of all the risks.



9. Hot off the press

Recent PwC financial services and related publications


Adjusting the Lens on Economic Crime
Preparation brings opportunity back into focus
36%
32%
44%
pwc

Adjusting the lens on economic crime PwC Global Economic Crime Survey 2016

The PwC Global Economic Crime Survey 2016 interviewed over 6 000 participants in 115 countries. Despite the marginal decline in economic crime reported overall, the financial cost of each fraud is on the rise. 14% of respondents experienced losses of more than $1m in the last two years.

More than one in three organisations (36%) experienced economic crime in the last two years, with cybercrime affecting almost a third (32%), the highest ever level in PwC's biennial survey of Global Economic Crime.

http://www.pwc.com/crimesurvey

PwC Market Abuse Surveillance Survey 2016

One of the biggest challenges in financial markets is how to conduct effective surveillance to spot market abuse and rogue trading. Surveillance has yet to deliver as a fully effective tool for preventing market abuse in financial markets. That's largely owing to limitations in technology and a lack of clarity about optimal organisation of responsibilities and activities. But the stakes are too high for the banks to do anything other than invest further and rely on emerging technologies to plug the gaps. To gauge banks' estimations of the challenge and to provide more transparency to the market, we developed a survey focused purely on surveillance. Twenty of the largest global banks participated in the survey, each with a significant presence in EMEA. The survey was conducted during December 2015 and January 2016.

http://www.pwc.co.uk/services/forensic-services/insights/surveillance-survey-2016.html

2015 Africa Capital Markets Watch

PwC's 2015 Africa Capital Markets Watch provides an analysis of African equity and debt capital market transactions that took place between 2011 and 2015. It also highlights the trends in African capital markets in 2015. The publication focuses on the following two main areas:

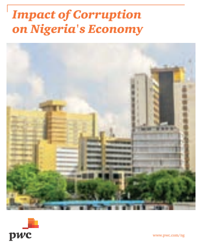
- Equity capital market transactions included in the analysis comprise capital-raising activities, whether initial public offerings or further offers, by African companies on exchanges worldwide, as well as those made by non-African companies on African exchanges.
- Debt capital market transactions analysed include debt funding raised by African companies and public institutions.

http://www.pwc.co.za/en/publications/africa-capital-markets-watch.html

Creating value in Africa
Using and enhancing your capabilities to succeed across the continent

Africa's markets are too diverse for one business model to be successful everywhere. Companies venturing in can pick the markets that are most suitable by being more conscious of their own distinct capabilities, and by adding new capabilities that will complement them. As successful firms have shown, strong human capital development, partnering, and cross-border coordination are also needed to successfully execute such a strategy in Africa.

http://www.pwc.co.za/en/publications/creating-value-in-africa.html



Impact of corruption on Nigeria's economy

Corruption is a pressing issue in Nigeria. President Muhammadu Buhari launched an anti-corruption drive after taking office in May 2015. Corruption affects public finances, business investment as well as standards of living. Recent corruption scandals have highlighted the large sums that have been stolen and/or misappropriated. But little has been done to explore the far-reaching effects of corruption that affect the long-term capacity of the country to achieve its potential.

In this report we formulate the ways in which corruption impacts the Nigerian economy over time and estimate the impact of corruption on Nigerian GDP, using empirical literature and PwC analysis.

http://www.pwc.co.uk/services/economics-policy/insights/impact-of-corruption-on-nigerias-economy.html

10. Key banking statistics

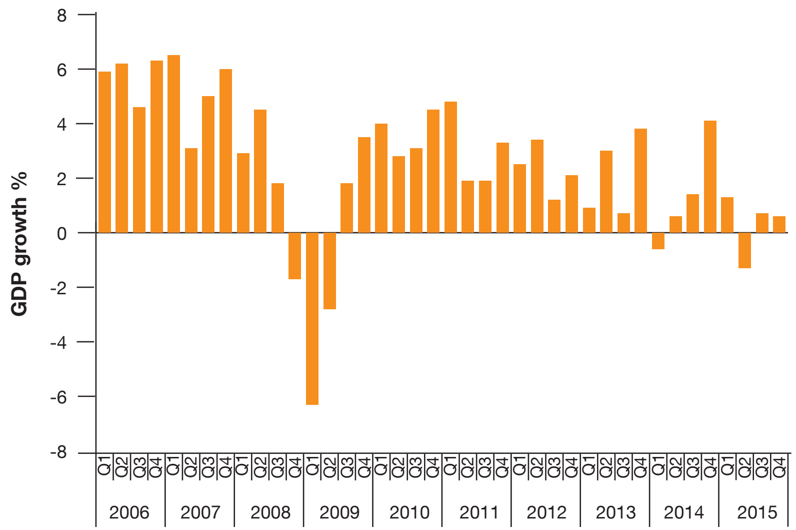
Key banking statistics – 2H15

Rm	BAGL				FSR				NED				SBK				Combined				Growth	
	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15 v 2H14	2H15 v 1H15
Balance sheet																						
Total assets	1 144 604	1 038 945	991 414	977 803	1 139 523	1 059 262	980 176	946 609	925 726	866 624	809 313	783 792	1 578 859	1 471 293	1 550 261	1 414 243	4 788 712	4 436 124	4 331 164	4 122 447	10.6%	7.9%
Gross Loans and advances	806 410	767 395	724 681	718 683	844 691	793 964	736 523	699 826	693 043	659 848	624 116	619 686	1 100 047	1 066 107	948 251	907 717	3 444 191	3 287 314	3 033 571	2 945 912	13.5%	4.8%
Total deposits	751 399	700 267	677 863	662 323	899 619	865 521	801 698	768 234	725 851	690 495	653 450	631 663	1 201 549	1 146 843	1 064 376	991 660	3 578 418	3 403 126	3 197 387	3 053 880	11.9%	5.2%
Risk weighted assets	702 663	647 472	619 705	595 053	680 400	630 441	598 698	572 446	501 243	465 544	440 696	422 165	944 039	856 380	868 187	876 105	2 828 345	2 599 837	2 527 286	2 465 769	11.9%	8.8%
Asset quality & provisioning																						
Non-performing loans	27 980	26 758	27 367	29 225	19 409	17 551	17 970	16 281	17 559	16 695	15 846	17 409	35 128	32 681	30 507	31 008	100 076	93 685	91 690	93 923	9.1%	6.8%
Impairments	-17 100	-16 448	-16 130	-16 787	-16 158	-14 793	-14 994	-13 900	-11 411	-11 004	-11 095	-11 476	-22 652	-20 241	-18 707	-19 852	-67 321	-62 486	-60 926	-62 015	10.5%	7.7%
Collective provisions	-5 027	-4 790	-4 359	-4 206	-7 988	-7 760	-7 665	-7 259	-4 747	-4 386	-4 263	-4 046	-6 790	-6 114	-5 315	-5 508	-24 552	-23 050	-21 602	-21 019	13.7%	6.5%
Individually assessed provisions	-12 073	-11 658	-11 771	-12 581	-8 170	-7 033	-7 329	-6 641	-6 664	-6 618	-6 832	-7 430	-15 862	-14 127	-13 392	-14 344	-42 769	-39 436	-39 324	-40 996	8.8%	8.5%
Non-performing loans (% of advances)	3.5%	3.5%	3.8%	4.1%	2.3%	2.2%	2.4%	2.33%	2.5%	2.5%	2.5%	2.8%	3.2%	3.1%	3.2%	3.4%	2.9%	2.8%	3.0%	3.2%	-4.0%	1.8%
Impairment charge (% of average advances)	0.99%	1.11%	0.86%	1.18%	0.77%	0.68%	0.86%	1.35%	0.77%	0.77%	0.75%	0.83%	0.74%	0.99%	0.87%	1.13%	0.82%	0.89%	0.84%	1.12%	-2.1%	-7.9%
Impairment coverage ratio	61.1%	61.5%	58.9%	57.4%	83.3%	84.3%	83.4%	85.38%	65.0%	65.9%	70.0%	65.9%	64.5%	61.9%	61.3%	64.0%	68.5%	68.4%	68.4%	68.2%	0.0%	0.1%
Implied loss given default	43.1%	43.6%	43.0%	43.0%	42.1%	40.1%	40.8%	40.79%	38.0%	39.6%	43.1%	42.7%	45.2%	43.2%	43.9%	46.3%	42.1%	41.6%	42.7%	43.2%	-1.4%	1.1%
Profit & loss analysis																						
Net interest income	19 944	18 463	18 404	17 197	20 823	19 562	19 048	16 965	12 210	11 675	11 698	11 263	25 861	23 453	23 590	21 666	78 838	73 153	72 740	67 091	8.4%	7.8%
Non interest income	14 831	13 960	14 037	13 487	16 909	16 595	16 114	15 853	11 298	10 450	10 832	9 480	22 006	19 795	20 829	18 155	65 044	60 800	61 812	56 975	5.2%	7.0%
Total operating income	34 775	32 423	32 441	30 684	37 732	36 157	35 162	32 818	23 508	22 125	22 530	20 743	47 867	43 248	44 419	39 821	143 882	133 953	134 552	124 066	6.9%	7.4%
Total operating expenses	-20 252	-18 768	-19 380	-17 880	-20 130	-18 900	-18 724	-17 046	-13 987	-12 906	-13 157	-12 012	-27 701	-25 714	-25 592	-23 026	-82 070	-76 288	-76 853	-69 964	6.8%	7.6%
Core earnings	14 523	13 655	13 061	12 804	17 602	17 257	16 438	15 772	9 521	9 219	9 373	8 731	20 166	17 534	18 827	16 795	61 812	57 665	57 699	54 102	7.1%	7.2%
Impairment charge	-3 370	-3 550	-2 722	-3 568	-3 145	-2 701	-3 086	-3 074	-2 482	-2 307	-2 173	-2 333	-4 339	-5 032	-4 057	-4 952	-13 336	-13 590	-12 038	-13 927	10.8%	-1.9%
Other income/ (expenses)	58	71	71	71	813	757	742	578	294	436	48	10	-2 187	445	1 363	339	-1 022	1 709	2 224	998	-146.0%	-159.8%
Discontinued operations	-	-	-	-	-	-	-	-	-	-	-	-	-261	3 002	-2 713	-1 032	-261	3 002	-2 713	-1 032	-90.4%	-108.7%
Income tax expenses	-2 992	-2 907	-2 859	-2 714	-3 557	-3 352	-3 274	-2 557	-1 699	-1 820	-1 841	-1 627	-3 181	-2 689	-3 344	-2 778	-11 429	-10 768	-11 318	-9 676	1.0%	6.1%
Profit for the period	8 219	7 269	7 551	6 593	11 713	11 961	10 820	10 719	5 634	5 528	5 407	4 781	10 198	13 260	10 076	8 372	35 764	38 018	33 854	30 465	5.6%	-5.9%
Attributable earnings	7 561	6 770	7 050	6 166	10 480	11 319	10 304	9 390	5 393	5 328	5 198	4 598	9 068	12 301	8 639	7 294	32 502	35 718	31 191	27 448	4.2%	-9.0%
Headline earnings from continuing operations	7 532	6 755	6 922	6 110	10 399	11 240	9 901	9 832	5 508	5 323	5 281	4 599	10 306	9 445	7 880	7 285	33 745	32 763	29 984	27 826	12.5%	3.0%

Rm	BAGL				FSR				NED				SBK				Combined				Growth	
	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15	1H15	2H14	1H14	2H15 v 2H14	2H15 v 1H15
Key data																						
Other operating income (% of total income)	42.65%	43.06%	43.27%	43.95%	44.81%	45.90%	45.83%	48.31%	48.06%	47.23%	48.08%	45.70%	45.97%	45.77%	46.89%	45.59%	45.37%	45.49%	46.02%	45.89%		
Net interest margin (% of total assets)	4.04%	3.96%	3.75%	3.54%	3.79%	3.79%	3.95%	3.62%	2.77%	2.79%	3.02%	2.96%	3.33%	3.44%	3.76%	3.73%	3.48%	3.49%	3.62%	3.46%		
Net interest margin (% of average interest earning advances)	4.92%	4.70%	4.74%	4.56%	5.01%	4.88%	5.26%	5.09%	3.24%	3.36%	3.49%	3.55%	4.34%	4.42%	5.05%	4.69%	4.38%	4.34%	4.64%	4.47%		
Standardised efficiency ratio	56.10%	55.90%	57.20%	56.40%	51.10%	51.19%	50.80%	50.68%	56.40%	55.80%	56.50%	56.50%	56.70%	56.70%	53.90%	55.30%	55.08%	54.90%	54.60%	54.72%		
Return on equity	17.6%	16.4%	16.7%	16.1%	23.4%	25.4%	24.0%	25.0%	15.4%	16.0%	16.5%	15.1%	15.0%	14.8%	12.9%	12.1%	17.9%	18.2%	17.5%	17.1%		
Total number of staff	41 018	41 723	41 644	42 114	43 406	42 263	39 508	38 989	31 312	30 739	30 499	30 061	47 958	50 960	42 642	42 211	163 694	165 685	154 293	153 375		
Capital ratios																						
CET 1	11.9%	11.7%	11.9%	11.8%	13.7%	14.1%	13.8%	13.9%	11.3%	11.4%	11.6%	12.1%	12.9%	13.2%	12.4%	12.2%	12.5%	12.6%	12.4%	12.5%		
Tier 1	12.6%	12.3%	12.7%	12.5%	14.4%	14.9%	14.7%	14.8%	12.0%	12.1%	12.5%	13.1%	13.3%	13.7%	12.9%	12.7%	13.1%	13.3%	13.2%	13.3%		
Tier 2	1.9%	1.8%	1.7%	2.1%	2.2%	1.9%	1.8%	1.9%	2.1%	2.4%	2.1%	1.9%	2.4%	2.4%	2.6%	2.5%	2.2%	2.1%	2.1%	2.1%		
Total	14.5%	14.1%	14.4%	14.6%	16.6%	16.8%	16.5%	16.7%	14.1%	14.5%	14.6%	15.0%	15.7%	16.1%	15.5%	15.2%	15.2%	15.4%	15.3%	15.4%		

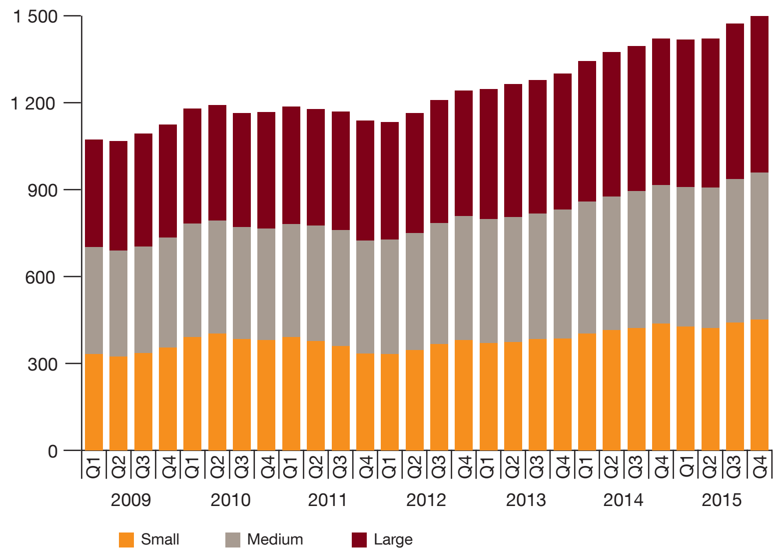
11. Industry data

Figure 11.1 GDP growth



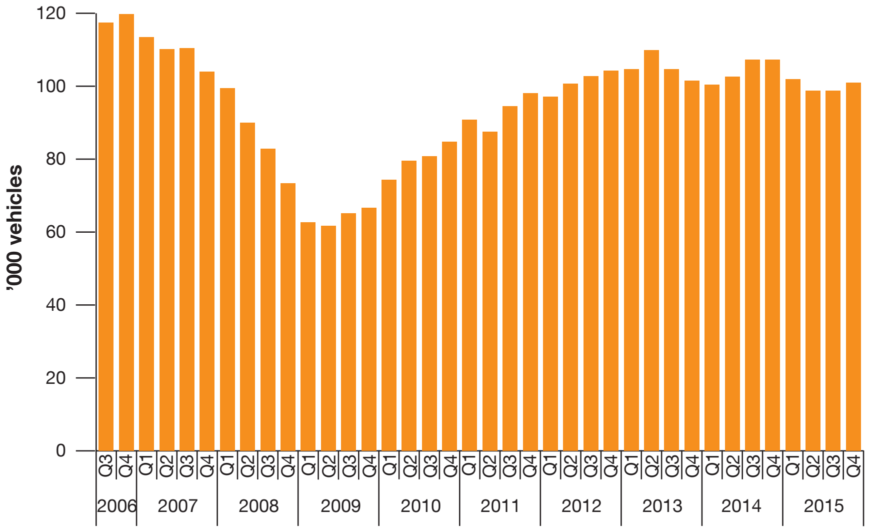
Source: Statistics SA

Figure 11.2 BAGL House Price Index



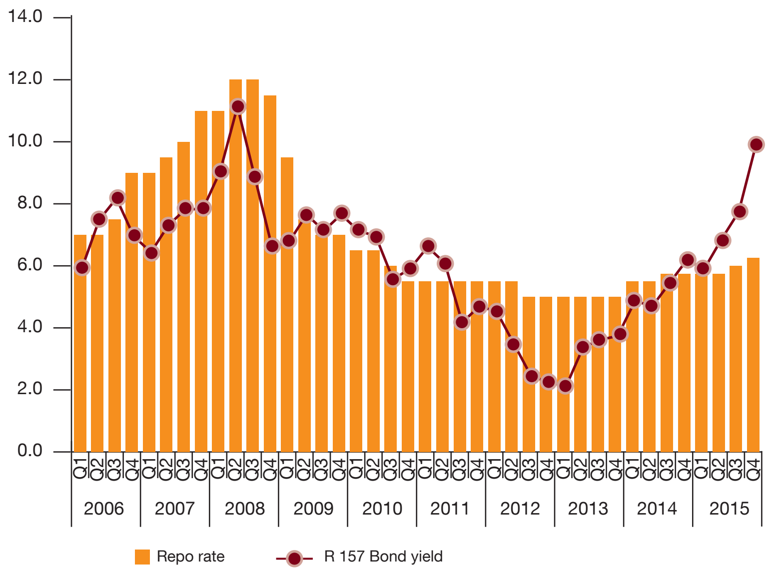
Source: BAGL

Figure 11.3 New vehicles sold



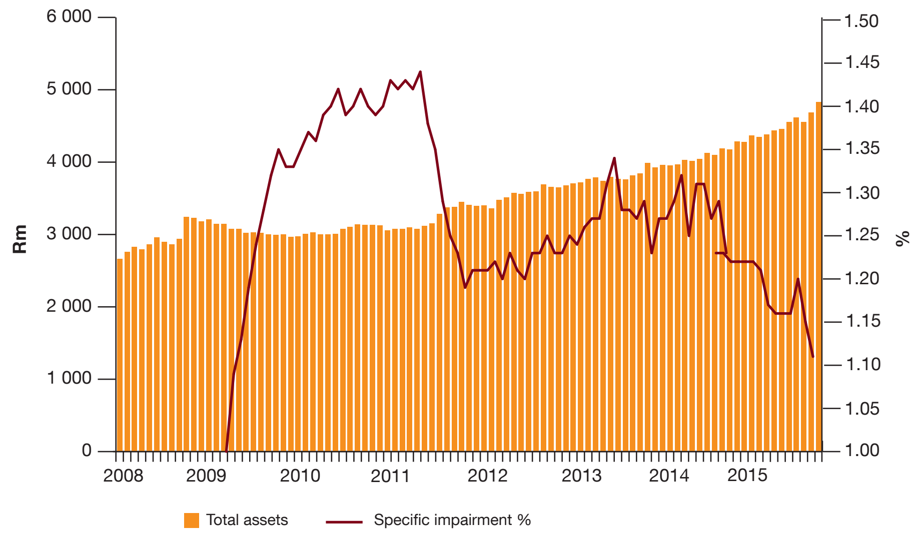
Source: SARB

Figure 11.4 Interest rates



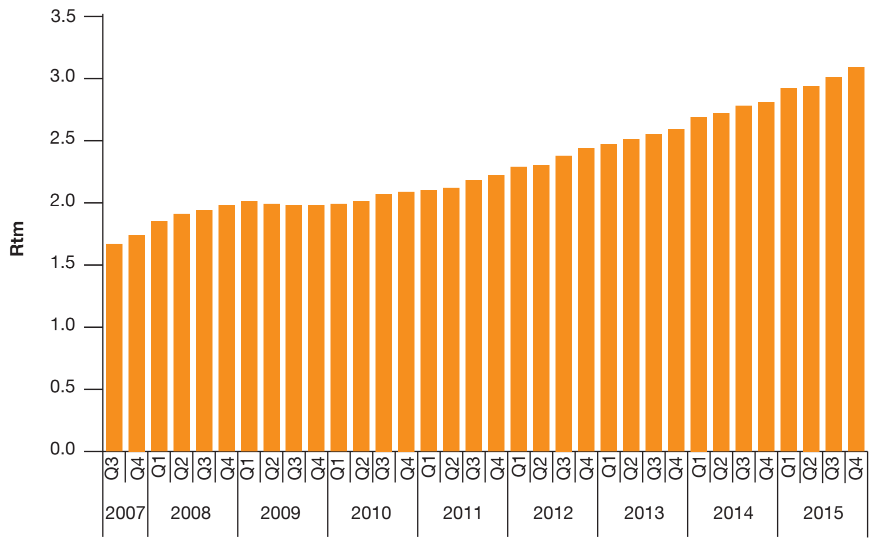
Source: SARB / RMB

Figure 11.5 Industry credit impairments



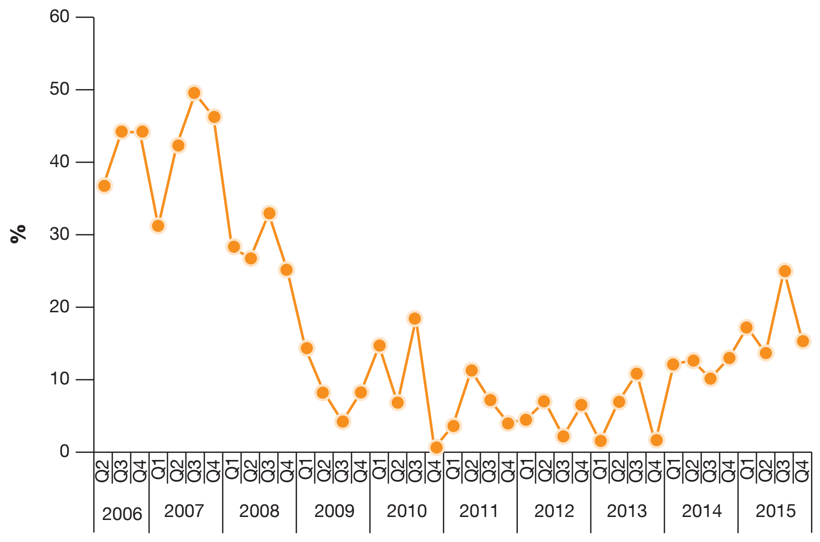
Source: SARB

Figure 11.6 Industry credit extension (Rtn)



Source: SARB

Figure 11.7 Growth in mortgage advances



Source: SARB

12. Contacts

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