Chapter 4

Trends in South African banks

This chapter contains the banking-sector overview of monthly financial information received from registered banks for the year under review. Certain comparative figures in respect of 2005 may differ from those reported in the 2005 *Annual Report*, as some banking institutions subsequently submitted amended returns.

reports and graphs dominated by activities of four largest banks

The reports and graphs presented in this chapter are dominated by the size of the balance sheets and activities of the four largest banks, which constituted 84,1 per cent of the banking-sector assets in December 2006 (December 2005: 83,8 per cent). The five largest banks constituted 89,7 per cent of the banking sector as at the end of December 2006 (December 2005: 89,6 per cent). A list of the balance-sheet sizes of individual banks is available in Appendix 2.

4.1 Balance-sheet structure

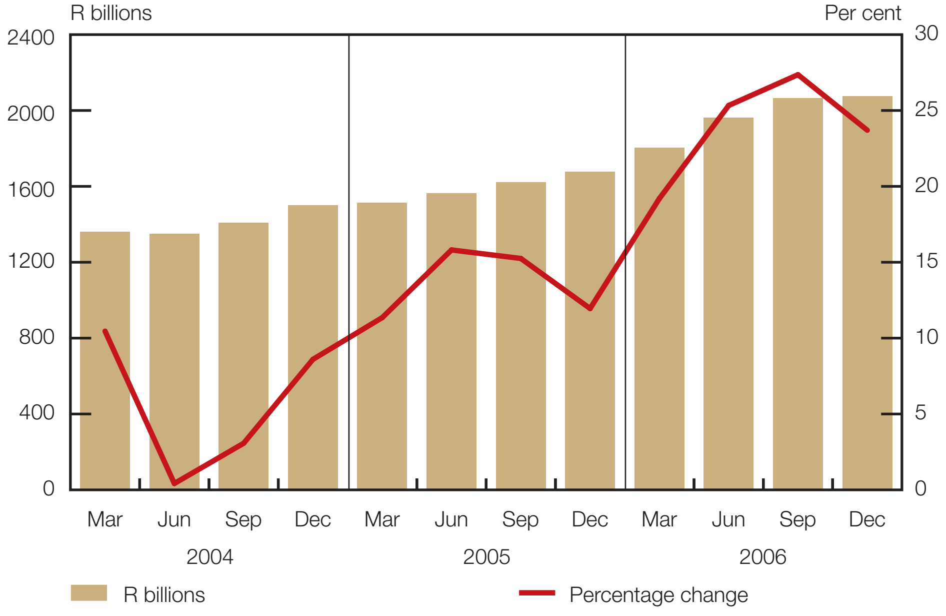
determine the type and spread of banks' business activities

The composition of the balance sheet is analysed to determine the type and spread of banks' business activities, as well as to consider the impact of changes thereto on the risk profile of the banking sector. The aggregated balance-sheet size of the banking sector in South Africa amounted to R2 075,1 billion as at 31 December 2006, in comparison to R1 677,5 billion as at 31 December 2005 and R1 498,4 billion as at 31 December 2004.

annual growth of 23,7 per cent

Figure 1 depicts the quarter-end value and percentage growth (measured over 12 months) in the aggregated balance sheet of the banking sector for the period March 2004 to December 2006. The aggregated balance sheet of the banking sector continued to grow strongly, albeit at a slower rate, during the fourth quarter of 2006. During 2006 the growth rate accelerated until September 2006 (27,4 per cent) and ended the year at 23,7 per cent (December 2005: 12 per cent).

Figure 1 Aggregated balance sheet

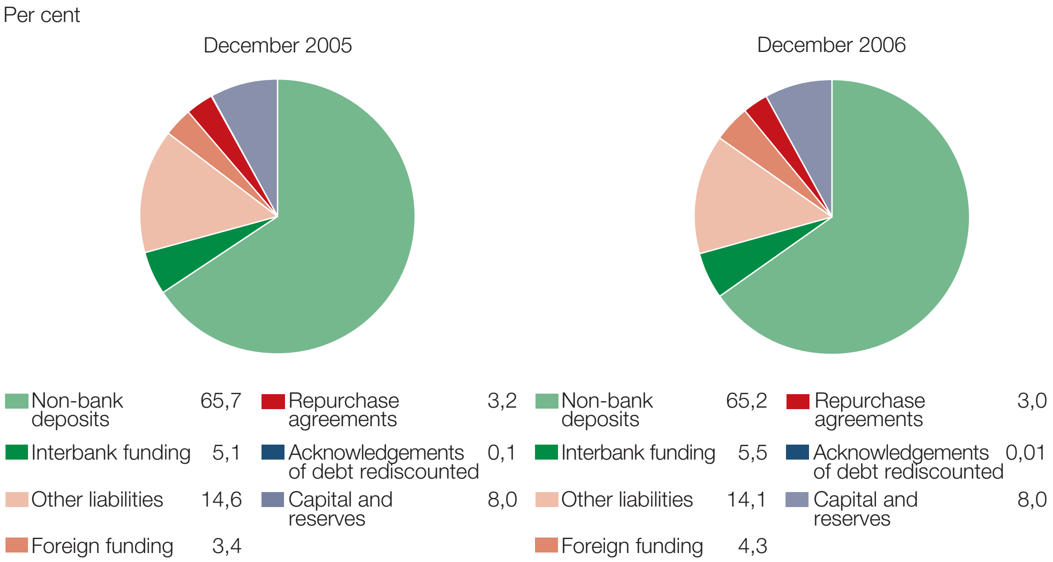


4.1.1 Liabilities

A year-on-year comparison of the composition of liabilities is reflected in Figure 2. Total liabilities as at the end of December 2006 equalled R2 075,1 billion, as opposed to R1 677,5 billion as at the end of December 2005. Non-bank deposits remained the main source of funding for the banking sector and constituted 65,2 per cent of total liabilities in December 2006, compared to 65,7 per cent in December 2005. Other liabilities, repurchase agreements and acknowledgements of debt rediscounted, as a percentage of total liabilities, however, decreased from 14,6 per cent, 3,2 per cent and 0,1 per cent, respectively, in December 2005 to 14,1 per cent, 3,0 per cent and 0,01 per cent in December 2006. Foreign and interbank funding increased from 3,4 per cent and 5,1 per cent, respectively, in December 2005 to 4,3 per cent and 5,5 per cent in December 2006. Capital and reserves remained unchanged at 8,0 per cent of total liabilities.

non-bank deposits remained main source of funding

Figure 2 Liabilities (year-on-year comparison)

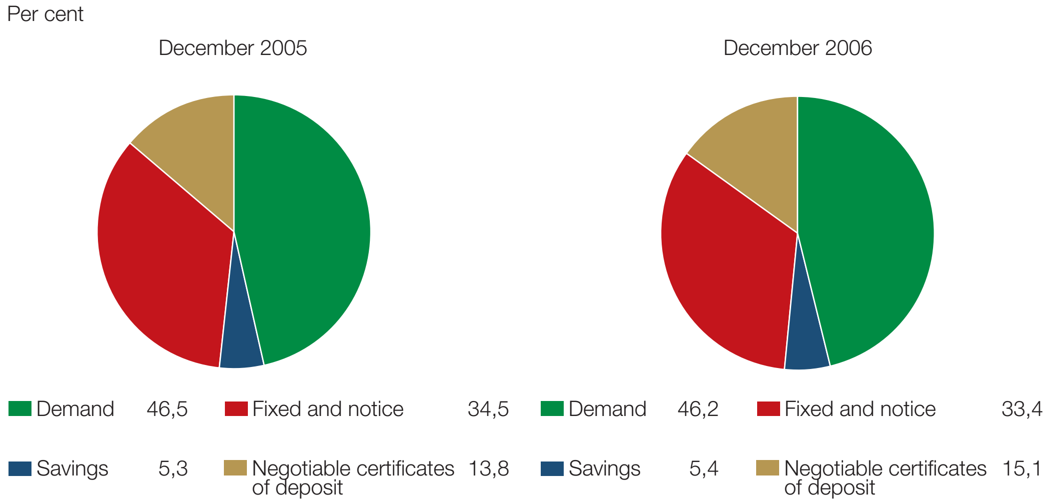


4.1.2 Non-banks deposits

Figure 3 reflects a year-on-year comparison of the composition of non-bank deposits. Total non-bank deposits as at the end of December 2006 equalled R1 353,2 billion, as opposed to R1 101,5 billion as at the end of December 2005. Demand deposits and fixed and notice deposits as a percentage of total non-bank deposits constituted the largest portion of total non-bank deposits, followed by negotiable certificates of deposit (NCDs) and savings accounts. Demand deposits and fixed and notice deposits as a percentage of total non-bank deposits decreased from 46,5 per cent and 34,5 per cent, respectively, in December 2005 to 46,2 per cent and 33,4 per cent in December 2006. The share of non-bank deposits represented by NCDs increased from 13,8 per cent as at the end of December 2005 to 15,1 per cent as at the end of December 2006. The increase in NCDs during 2006 can be attributed to investors switching to NCDs due to the favourable characteristics of the instrument in an environment of higher interest rates. Savings deposits constituted a small portion of total non-bank deposits, amounting to 5,4 per cent in December 2006 (December 2005: 5,3 per cent).

demand deposits constituted largest portion

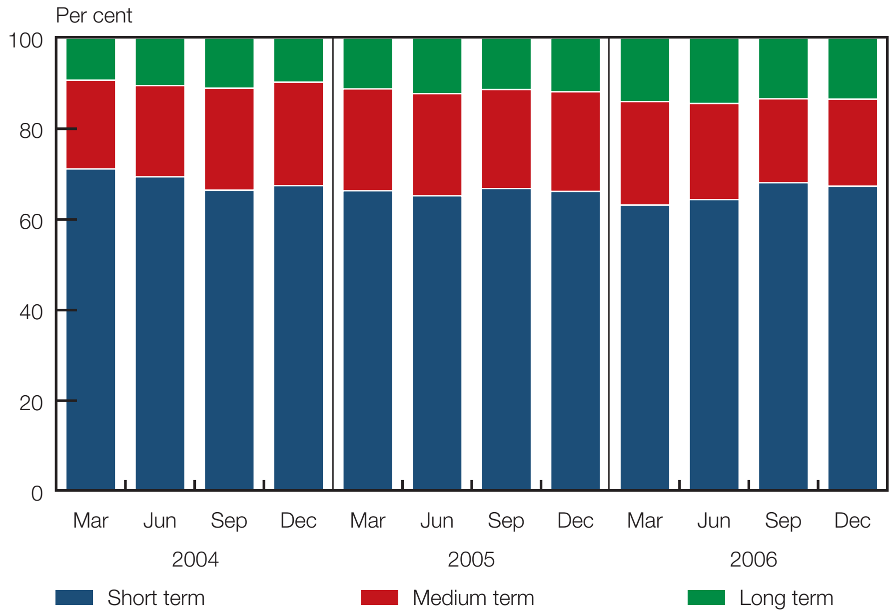
Figure 3 Composition of non-bank deposits



short-term deposits remained largest component

The composition of non-bank deposits according to maturity is portrayed in Figure 4. Short-term deposits remained the largest component of total non-bank funding and accounted for 67,3 per cent of total non-bank funding as at the end of December 2006, compared to 66,2 per cent as at the end of December 2005 and 67,4 per cent as at the end of December 2004. Medium-term deposits accounted for 19,2 per cent as at 31 December 2006, compared to 22,0 per cent and 22,9 per cent as at the end of December 2005 and 2004, respectively. Medium-term deposits decreased during the third quarter of 2006 to 18,5 per cent in September 2006 (June 2006: 21,2 per cent) as a result of a decrease in medium-term fixed and notice deposits and, to a lesser extent, medium-term NCDs. Although long-term deposits remained the smallest component of total non-bank funding and accounted for 13,5 per cent of total non-bank funding as at 31 December 2006, they portrayed steady growth when compared to 11,9 per cent and 9,7 per cent as at the end of December 2005 and 2004, respectively.

Figure 4 Composition of non-bank deposits according to maturity



As shown in Figure 5, growth in short-term deposits increased at a steady pace over the past three years, increasing from 11,3 per cent in December 2004 to 18,8 per cent in

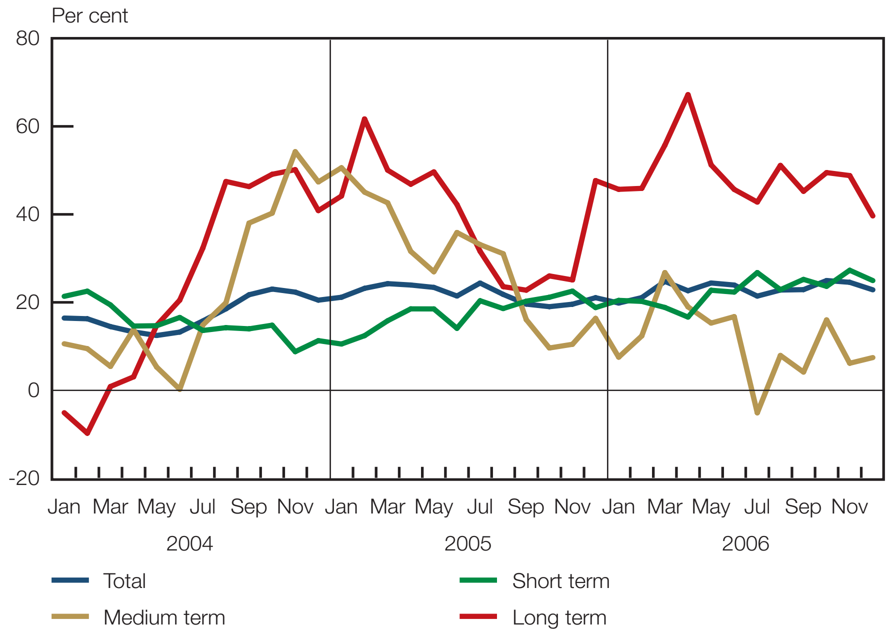
December 2005 and, by the end of December 2006, had increased to 25,0 per cent (percentage change over 12 months). The growth rate in short-term deposits was comparable to the growth rate in the total balance sheet size for the period under review. Demand deposits were the main contributor to the growth in short-term deposits.

Growth in medium-term deposits was at a lower level than short and long-term deposits during 2006. Medium-term deposits consist mainly of fixed and notice deposits and to a lesser extent, NCDs. These two sources of funding, although fluctuating, increased only slightly in the medium term, whereas as long-term deposits they increased substantially during 2006. Growth in medium-term deposits decreased from 16,4 per cent in December 2005 to 7,5 per cent in December 2006. In July 2006, medium-term deposits had a negative growth rate of 5,1 per cent due to a decline in medium-term fixed and notice deposits.

Growth in long-term deposits remained above 40 per cent for most of 2006, peaking at 67,2 per cent in April 2006, before decreasing to 39,6 per cent in December 2006.

growth in long-term deposits remained above 40 per cent

Figure 5 Growth in non-bank deposits according to maturity (change over 12 months)



In addition, at the end of December 2006 other major sources of funding included the following:

- Interbank funding amounting to R113,7 billion, having increased by 32,8 per cent during 2006.
- Foreign funding amounting to R89,6 billion, having increased by 57,6 per cent during 2006. The increase was mainly due to a growth in foreign funding deposits from banks, often foreign operations of locally registered banks.
- Funding received under repurchase agreements amounting to R61,5 billion, having increased by 13,3 per cent during 2006.
- Other liabilities amounting to R291,9 billion, having increased by 19,2 per cent during 2006.

4.1.3 Assets

Figure 6 reflects a year-on-year comparison of the composition of assets as at 31 December 2005 and 31 December 2006. Banking-sector assets increased by R397,6 billion during 2006 – representing a growth rate of 23,7 per cent – to a total of R2 075,1 billion as at the end of December 2006. This strong asset growth is attributable to the following:

- Monetary assets (which refer to legal tender in the Republic of South Africa, gold coin, bullion and non-South African currency holdings, and deposits with the South African Reserve Bank) grew by 23,1 per cent, from R38,3 billion as at 31 December 2005 to R47,2 billion as at 31 December 2006.

- Interbank advances grew by 26 per cent, from R72,2 billion as at 31 December 2005 to R91,1 billion as at 31 December 2006.

- Non-bank loans and advances grew by 27,9 per cent, from R1 231,4 billion as at the end of December 2005 to R1 575,3 billion as at the end of December 2006. Non-bank advances constituted 75,9 per cent of the banking-sector assets as at the end of December 2006 (December 2005: 73,4 per cent).

- Loans granted under resale agreements increased by 60,4 per cent, from R34,6 billion as at the end of December 2005 to R55,6 billion as at the end of December 2006.

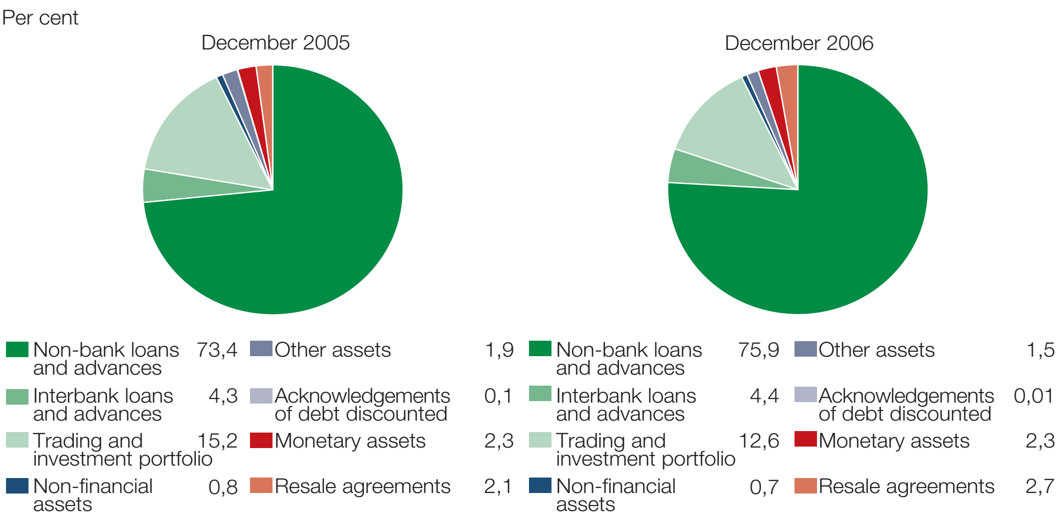
- Trading and investment assets increased by 2,7 per cent, from R254,3 billion as at the end of December 2005 to R261,1 billion as at 31 December 2006. This asset category fluctuated substantially throughout 2006.

- Non-financial assets increased by 5,8 per cent, from R13,8 billion as at the end of December 2005 to R14,6 billion as at the end of December 2006.

securitisation diluted reported asset growth

It is worth mentioning that certain asset categories, specifically assets that form part of loans and advances, had higher growth rates than those presented in this report. The growth rates are diluted or decreased due to the effect of securitisation transactions during 2006, mainly by the larger banks. Securitisation is the process whereby similar assets are pooled together and repackaged into marketable securities which can be sold to investors. The asset categories that have been most influenced by securitisation are mortgage loans, instalment debtors and credit cards. The process of loan securitisation enables a bank to

Figure 6 Total assets (year-on-year comparison)

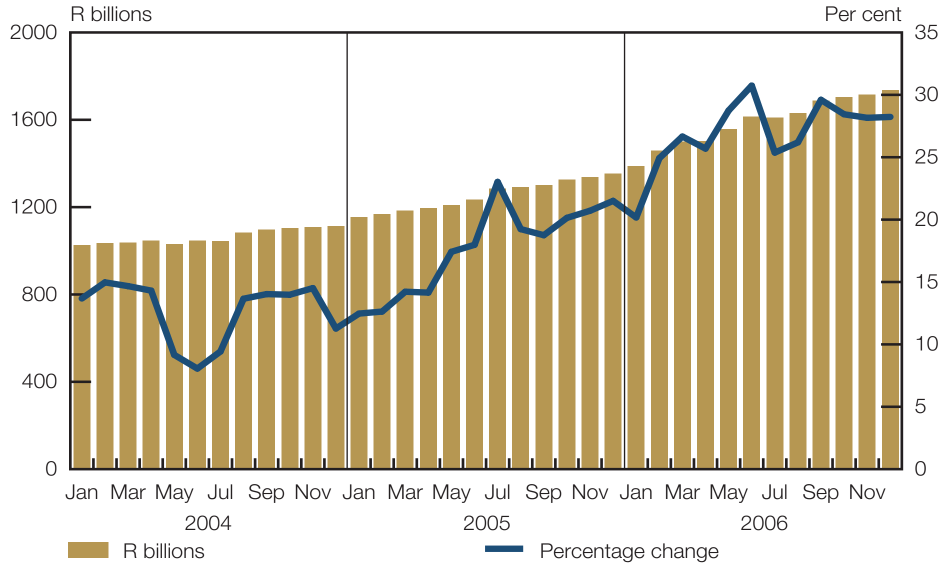


move its assets off the balance sheet, thereby improving liquidity due to an increased funding pool, and free up capital, resulting in an improved capital-adequacy ratio.

In a trend similar to that of total assets, total loans and advances continued to increase during 2006 (refer to Figure 7). By the end of December 2006, total loans and advances equalled R1 735,8 billion as opposed to R1 353,6 billion at the end of December 2005. The 12-month growth rate accelerated from 20,2 per cent in January 2006 to 30,7 per cent in June 2006, before easing to 28,2 per cent at the end of 2006. The strong growth in total loans and advances during 2006 was mainly due to growth in mortgage loans, followed by growth in overdrafts and loans, instalment debtors and foreign-currency loans. The peak in the growth rate reported in June 2006 was mainly due to increases in interbank advances, mortgage loans and foreign-currency loans reported by most of the large banks.

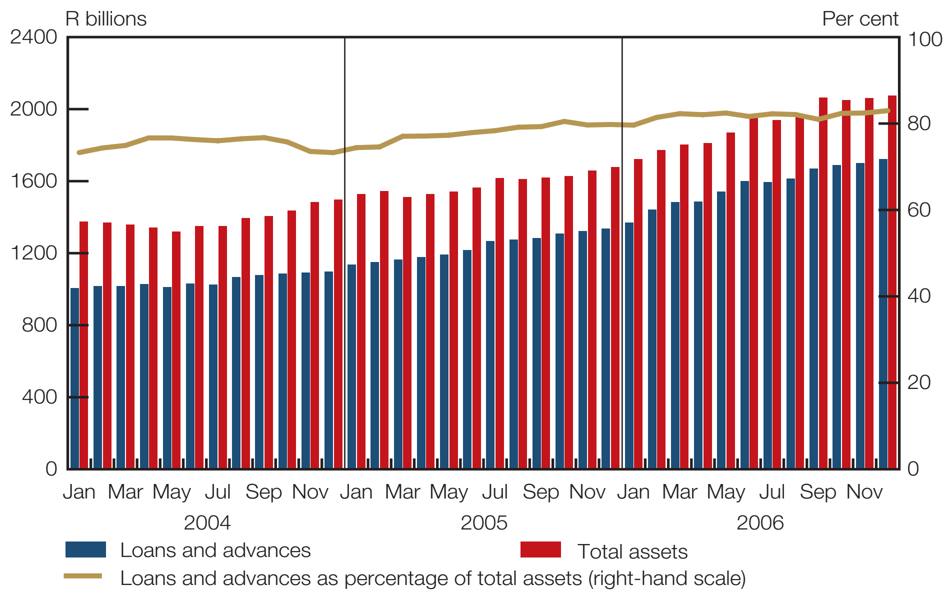
28,2 per cent growth in loans and advances

Figure 7 Total loans and advances



Loans and advances constituted 83 per cent of total assets as at the end of December 2006 as opposed to 79,8 per cent as at the end of December 2005 and 73,3 per cent as at the end of December 2004, as presented in Figure 8.

Figure 8 Loans and advances as percentage of total assets



4.1.4 Loans and advances

strong growth in most loan categories

As depicted in Figure 9, a comparison of the composition of loans and advances as at the end of 2005 and 2006 clearly shows that mortgage loans remained the largest portion of total loans and advances, followed by overdrafts and loans, instalment debtors, foreign loans and other loans. Figure 10 portrays the 12-month growth rates for instalment debtors, mortgage loans, overdrafts and loans and other assets. The 12-month growth in total assets can be broken down according to the following contributing components:

- Mortgage loans increased by R158,5 billion to a level of R680,9 billion in December 2006, representing an increase of 30,3 per cent. The growth in mortgage loans remained stable in the region of 30 per cent throughout 2006.

- Overdrafts and loans increased by R85,0 billion to a level of R383,5 billion in December 2006, representing an accelerated growth rate of 28,5 per cent (December 2005: 7 per cent). Non-financial companies, closed corporations and individuals contributed to this increase.

- Instalment debtors increased by R25,2 billion to a level of R207,4 billion as at the end of December 2006. The growth rate in instalment debtors decreased during 2006, ending the year at 13,9 per cent compared to 19,5 per cent in December 2005. The decline in the growth rate during 2006, specifically noticeable in November 2006, was mainly a result of securitisation transactions by the larger banks.

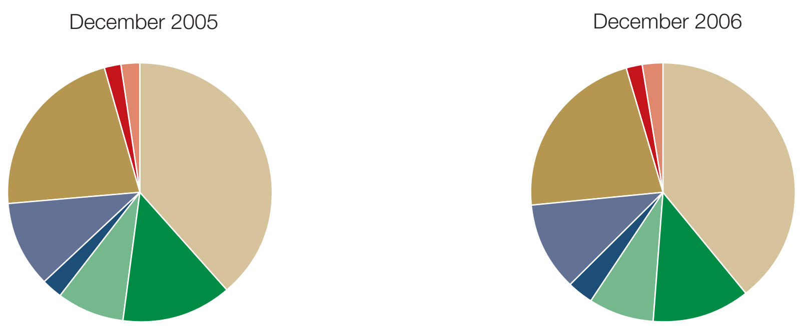
- Foreign-currency loans and advances increased by R46,2 billion to a level of R191,7 billion, representing an increase of 31,7 per cent as at the end of December 2006.

- Credit-card loans increased by R12,7 billion to a level of R43,9 billion, representing an increase of 40,8 per cent as at the end of December 2006. Individuals were responsible for the substantial increase in this asset class.

- Acknowledgements of debt discounted increased by R6,6 billion to a level of R34,1 billion, representing an increase of 24,1 per cent as at the end of December 2006.

Figure 9 Composition of loans and advances

Per cent

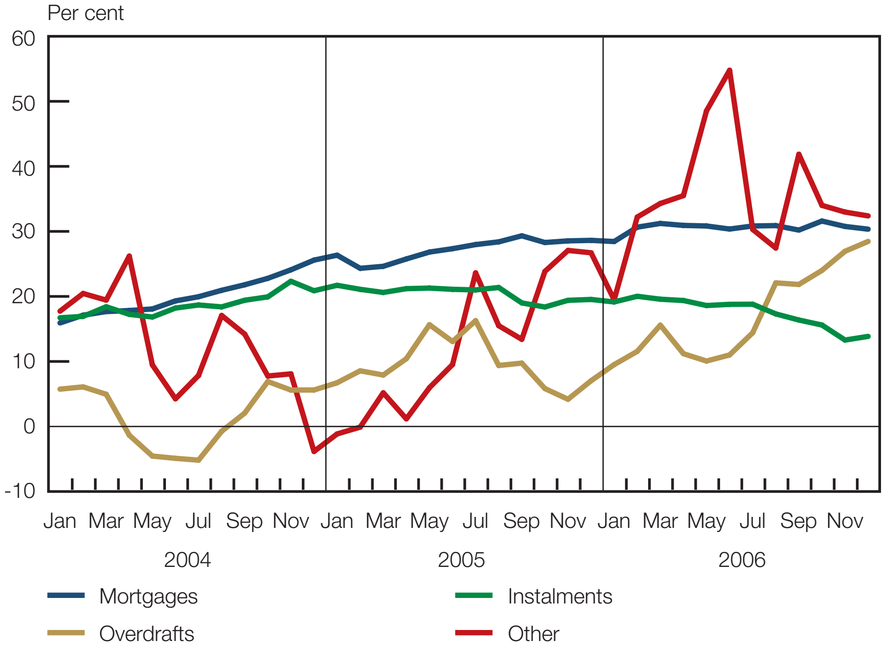


	December 2005	December 2006
Mortgage loans	38,6	39,2
Instalment debtors	13,5	12,0
Other*	8,3	8,0
Resale agreements	2,6	3,2
Foreign loans	10,7	11,0
Overdrafts and loans	22,0	22,1
Acknowledgements of debt discounted	2,0	2,0
Credit-card debtors	2,3	2,5

* Negotiable certificates of deposit and redeemable preference shares

- Redeemable preference shares increased by R5,1 billion to a level of R23,3 billion, representing an increase of 27,7 per cent as at the end of December 2006.

Figure 10 Growth in selected loans and advances (change over 12 months)



4.2 Capital adequacy

Capital adequacy is a measure of the adequacy of a banking institution's capital resources in relation to its current liabilities and to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent.

Under the guidelines of the Basel Committee on Banking Supervision (Basel Committee), banking institutions are required to maintain a certain level of capital against their risk-adjusted assets. In South Africa these guidelines have been adopted but with a higher minimum capital-adequacy ratio requirement of 10 per cent in comparison to the Basel Committee guideline of 8 per cent.

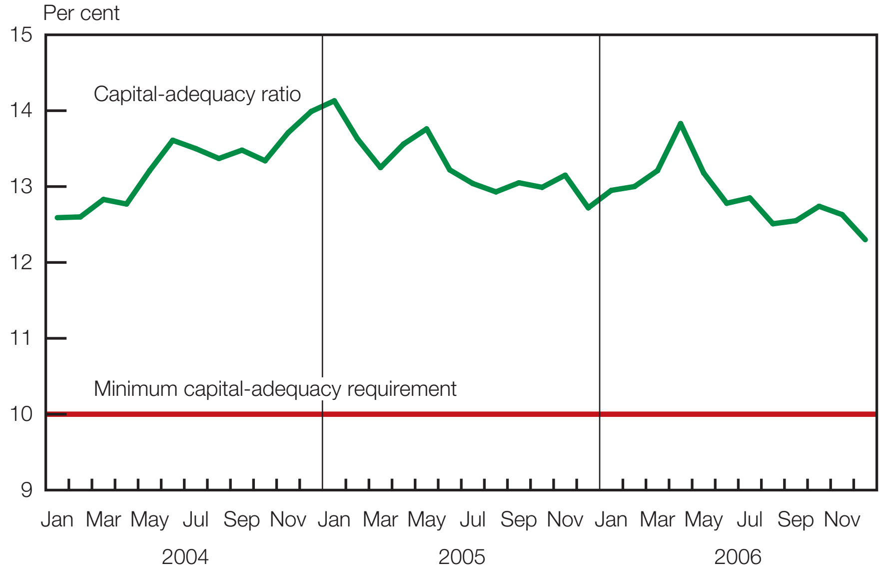
capital-adequacy ratio declined

Figure 11 shows the capital-adequacy ratio of the banking sector in relation to the 10-per-cent minimum requirement. During 2006, the banking sector was capitalised in excess of the minimum requirement of 10 per cent. The capital-adequacy ratio declined from 12,7 per cent in December 2005 to 12,3 per cent in December 2006 as a result of the following:

- The total capital requirement increased by 24,5 per cent, from R100,3 billion in December 2005 to R124,9 billion in December 2006.

- Total net qualifying capital increased by 20,3 per cent, from R127,4 billion in December 2005 to R153,3 billion in December 2006.

Figure 11 Capital-adequacy ratio



An analysis of the percentage distribution of banks in terms of capital adequacy as at the end of December 2006 (refer to Figure 12a) reveals that there were no banks that reported capital-adequacy ratios below the minimum requirement of 10 per cent, whereas there was one bank that did not meet the minimum requirement as at the end of December 2005. As at the end of December 2006, 39,4 per cent of banking institutions had capital-adequacy ratios that exceeded 20 per cent (41,2 per cent as at the end of December 2005).

Figure 12a Distribution of banks in terms of capital adequacy

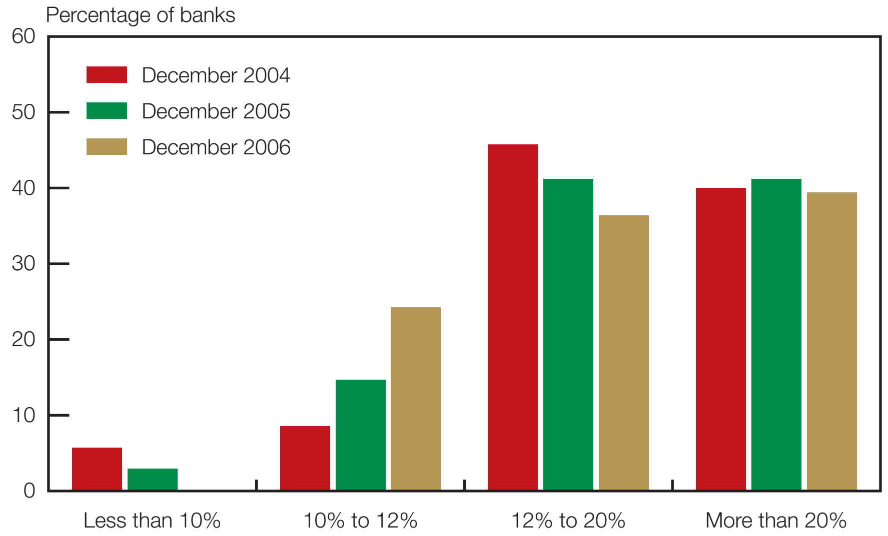


Figure 12b represents the sector distribution in terms of capital-adequacy ratios for December 2006. As a percentage of total banking-sector assets, 86 per cent of the assets belonged to banks that had capital-adequacy ratios between 10 and 12 per cent (24,2 per cent of banking institutions). Banks that reported capital-adequacy ratios between 12 and 20 per cent (that is, 36,4 per cent of the institutions) represented 10,2 per cent of total banking-sector assets. Banks that reported capital-adequacy ratios above 20 per cent (that is, 39,4 per cent of the institutions) represented 3,9 per cent of the total banking-sector assets.

Figure 12b Capital-adequacy ratios – sector distribution (December 2006)

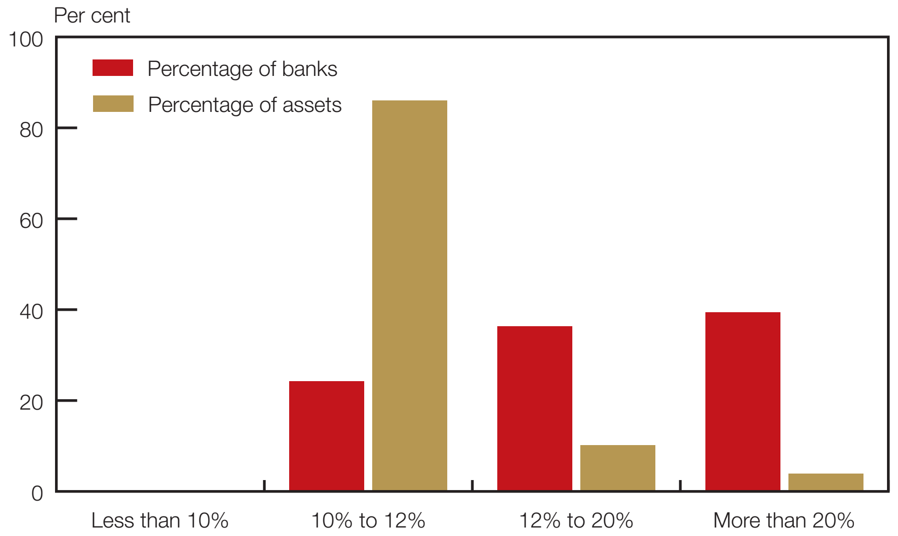
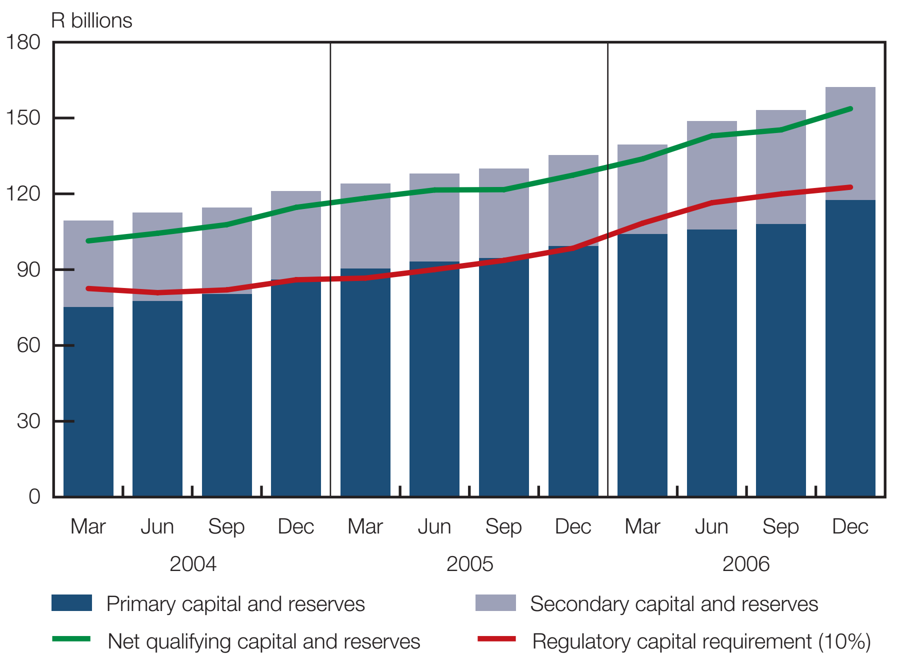


Figure 13 reflects the quarterly average monetary values of primary capital and reserves, secondary capital and reserves, net qualifying capital and reserves, and the regulatory capital requirement. Primary capital and reserves constituted 72,5 per cent of total primary and secondary capital and reserves (before impairments) as at the end of December 2006. Primary capital and reserves increased from R99,2 billion as at the end of December 2005 to R117,5 billion as at the end of December 2006 (18 per cent year on year). Secondary capital and reserves increased by 23,8 per cent to R44,6 billion as at the end of December 2006 (R36 billion as at the end of December 2005).

capital and reserves increased

As indicated earlier, net qualifying capital and reserves remained above the 10-per-cent minimum regulatory requirement throughout the period under review (Figure 11).

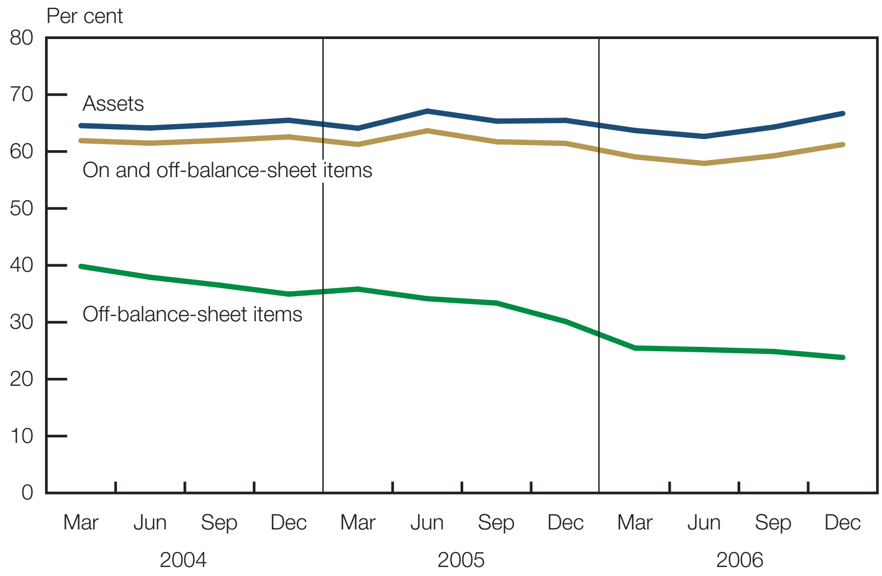
Figure 13 Qualifying capital and reserves



4.2.1 Risk profile

On and off-balance-sheet items are portrayed in Figure 14 from a risk-weighting perspective. The risk-weighting percentage of total assets increased from 65,5 per cent in December 2005 to 66,7 per cent in December 2006. The risk-weighting percentage of off-balance-sheet items declined from 30,1 per cent in December 2005 to 23,8 per cent in December 2006 due to an increase in the zero risk-weighted unutilised facilities, and a decline in the 100-per-cent risk-weighted items. As a result of the aforementioned downward movement, the combined risk-weighting percentage of on and off-balance-sheet items decreased slightly from 61,4 per cent in December 2005 to 61,2 per cent in December 2006.

Figure 14 Risk profile of on and off-balance-sheet items



4.3 Profitability

profitability ratios improved

The improvement in banks' profitability ratios for 2006 was owing to, among other things, the favourable economic conditions that prevailed during the period under review.

Total income, that is, the sum of net interest turn (interest income less interest expense) and non-interest income (income derived from investment and trading positions, assets repossessed, net mark-to-market adjustments and fee income) amounted to R106,9 billion as at the end of December 2006, as opposed to R84,8 billion as at the end of December 2005. Total net income (after operating expenses and provisions) after taxation increased from R18,6 billion as at the end of December 2005 to R26,4 billion as at the end of December 2006.

intermediation function remained main source of income

Figure 15 provides a monetary value breakdown of the main components of the income statement from January 2004 to December 2006. During 2006, the intermediation function remained the main source of income for banks. The intermediation function generates interest margin (2,5 per cent of total assets for 2006) and transaction-based fee income (1,7 per cent of total assets for 2006). The income of R87,1 billion derived from the intermediation function during 2006 exceeded the sum of operating expenses and provisions, which amounted to R71,3 billion. Fee income (December 2006: R37,5 billion), and investment and trading income (December 2006: R15,2 billion) as a percentage of total assets amounted to 1,8 per cent and 0,7 per cent, respectively, for 2006, as opposed to 2 per cent and 0,5 per cent for 2005.

The interest margin increased by 36,4 per cent in December 2006 compared to 10,6 per cent in December 2005. The higher growth in December 2006 was a result of interest income that increased at a higher rate than interest expense. The main components of interest expense were interest in respect of fixed and notice deposits at 31,2 per cent of total interest expense in December 2006 (December 2005: 31,7 per cent) and interest in respect of demand deposits at 28,9 per cent of total interest expense in December 2006 (December 2005: 27,4 per cent). Interest income derived from mortgage loans, and overdrafts and loans constituted 38,7 per cent and 23,1 per cent, respectively, of total interest income in December 2006, as opposed to 36,5 per cent and 25,1 per cent in December 2005.

interest margin increased

Figure 15 Composition of the income statement

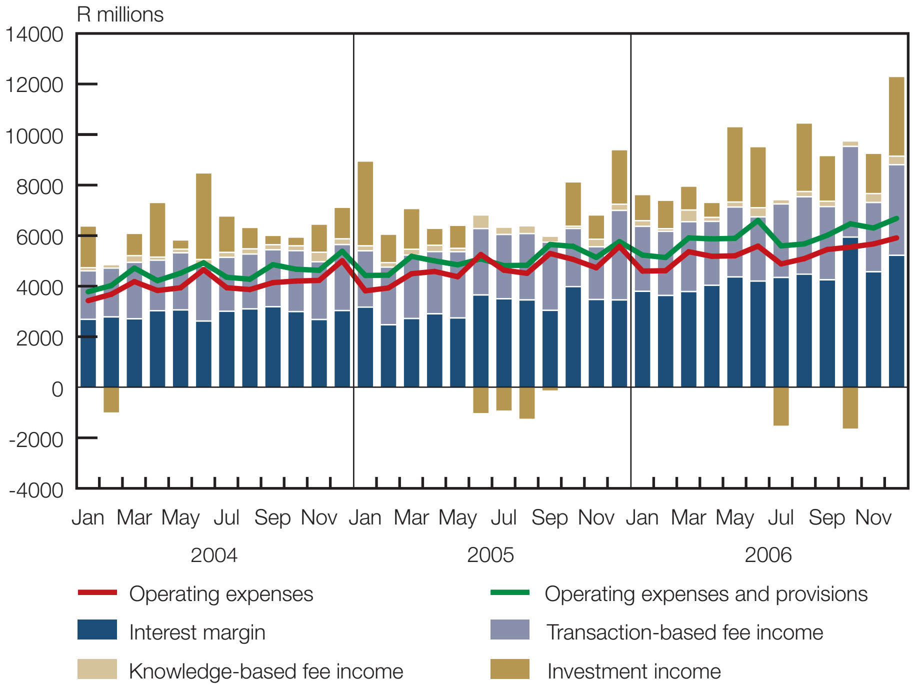


Figure 16 depicts the interest margin of the banking sector for the period January 2004 to December 2006, whereas Figure 17 depicts the monthly percentage-point change in the components of the interest margin for this period. The interest margin was stable in the region of 3 per cent throughout 2006. By the end of December 2006, the interest margin was 3,4 per cent, compared to 3,1 per cent in December 2005 and 3,4 per cent in December 2004. However, the interest margin increased from 2,8 per cent in September 2006 to 4 per cent in October 2006 as a result of a substantial decrease in interest expenses from foreign funding (change in reporting by a large bank). The said decrease caused total interest expense to decline from 6,8 per cent in September 2006 to 5,3 per cent in October 2006.

Figure 16 Interest margin

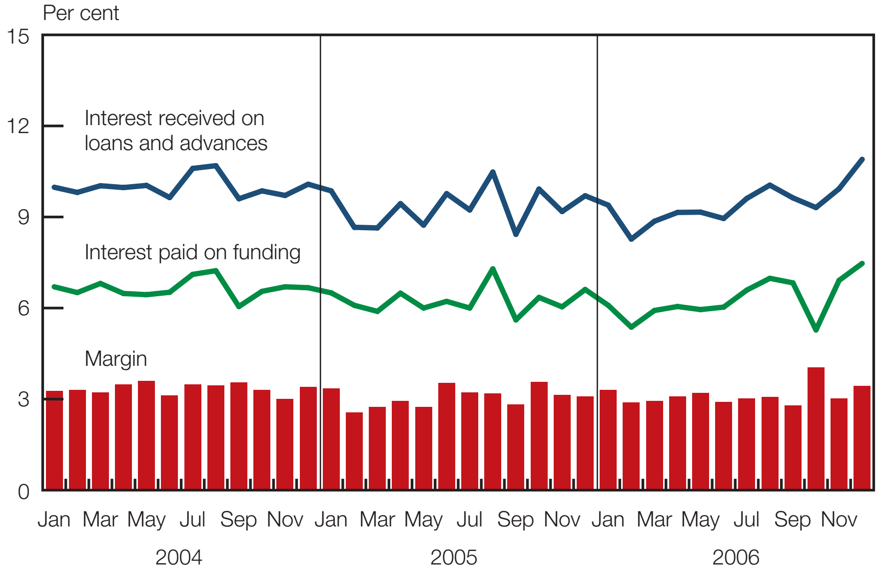
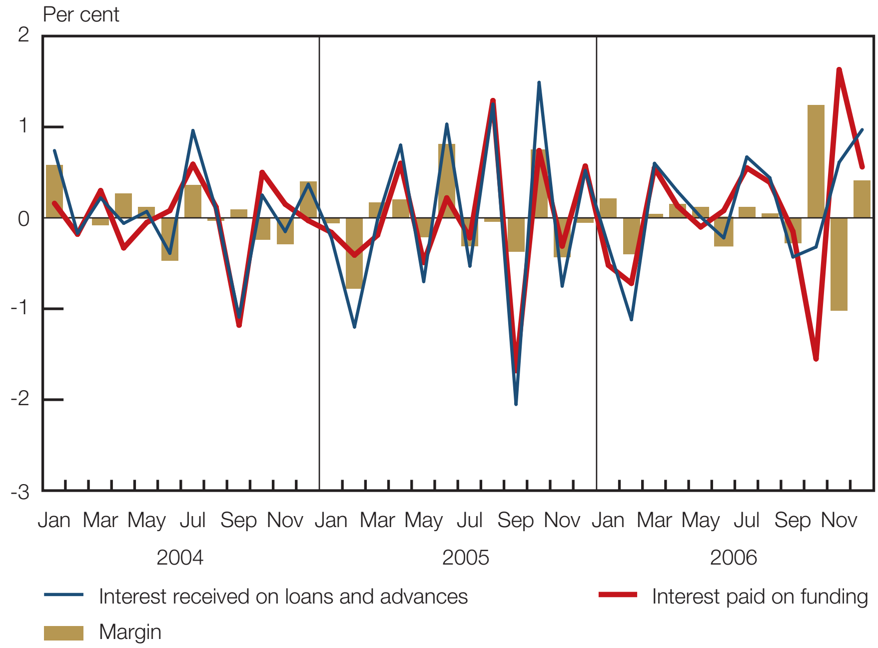


Figure 17 Percentage-point change in interest margin (month on month)



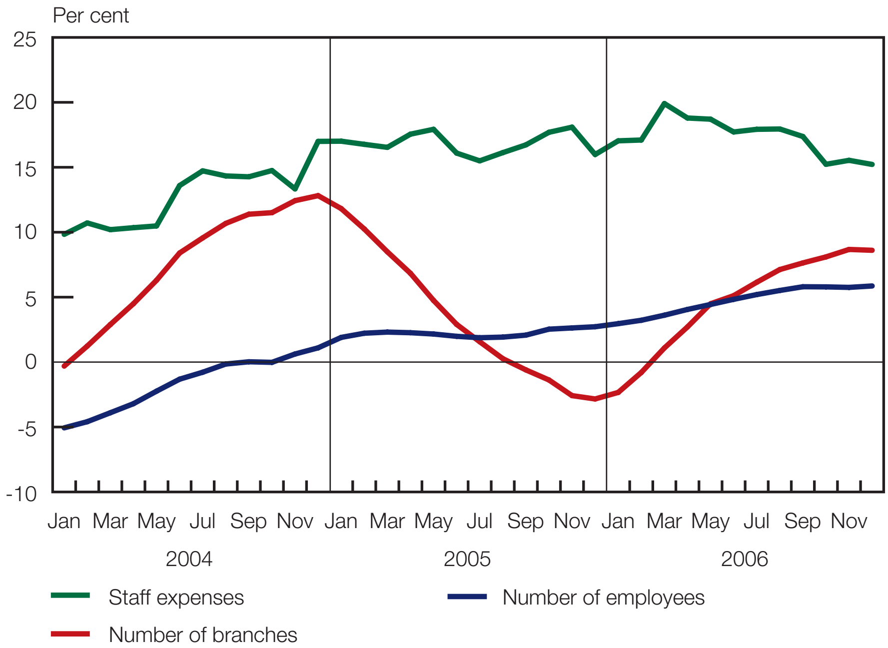
operating expenses increased due to staff expenditure

The operating expenses of the total banking sector increased by 12,2 per cent in December 2006 (14,6 per cent in December 2005), mainly as a result of an increase of 15,2 per cent in total staff expenses. Staff expenses accounted for 51,2 per cent of total operating expenses in December 2006 (2005: 49,8 per cent).

Figure 18 depicts the percentage change (calculated on a 12-month smoothed average) in total staff expenses, the number of employees and branches for the past three years.

The growth in staff expenses fluctuated between 15,2 per cent and 19,9 per cent during 2006, ending the year with a growth rate of 15,2 per cent (2005: 16,0 per cent). By December 2006, the number of employees in the banking sector and the number of bank branches had increased by 5,9 per cent and 8,6 per cent, respectively, as opposed to an increase of 2,7 per cent and a decrease of 2,8 per cent during December 2005 (12-month smoothed average).

Figure 18 Growth in staff expenses, number of employees and branches (12-month smoothed average)

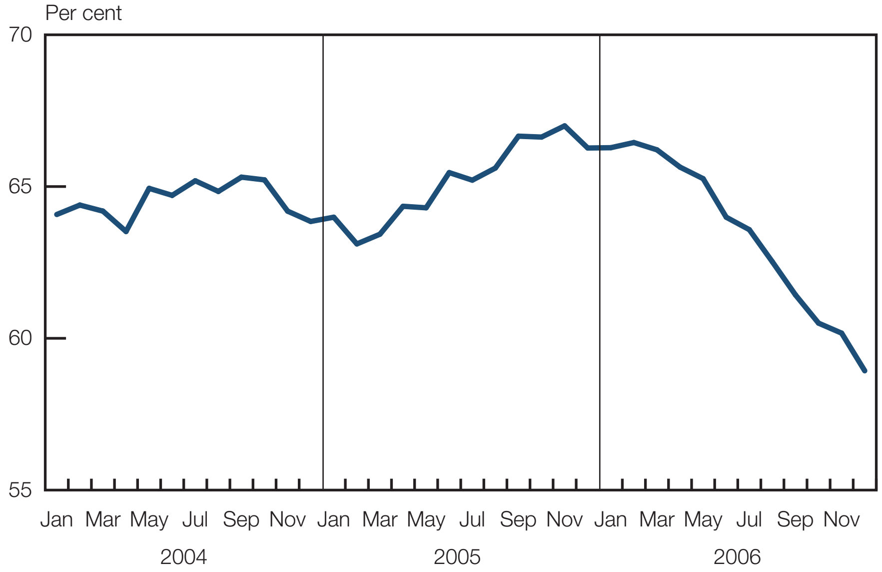


Increases in administrative and other expenses, and in marketing and communications expenditure also contributed to the growth in operating expenses. In December 2006, administrative and other expenses increased by 6,7 per cent and accounted for 38,4 per cent (December 2005: 40,4 per cent) of total operating expenses. Marketing and communications costs increased by 36,3 per cent in December 2006 and contributed 5,4 per cent to total operating expenses (December 2005: 4,4 per cent).

The efficiency ratio, also referred to as the cost-to-income ratio, is a measure that expresses the total operating costs incurred as a percentage of operating income. An informal investigation into the efficiency ratios reported by the largest and most efficient international banks indicated that these banks reported efficiency ratios of approximately 50 per cent. Figure 19 reflects the efficiency ratio of the South African banking sector for the past three years. Smoothed over a 12-month period, the efficiency ratio of the banking sector improved from 66,3 per cent in December 2005 to 58,9 per cent in December 2006. The improvement in the efficiency ratio in December 2006, compared to December 2005, can be attributed to an increase in total income with operating expenses remaining fairly stable throughout 2006.

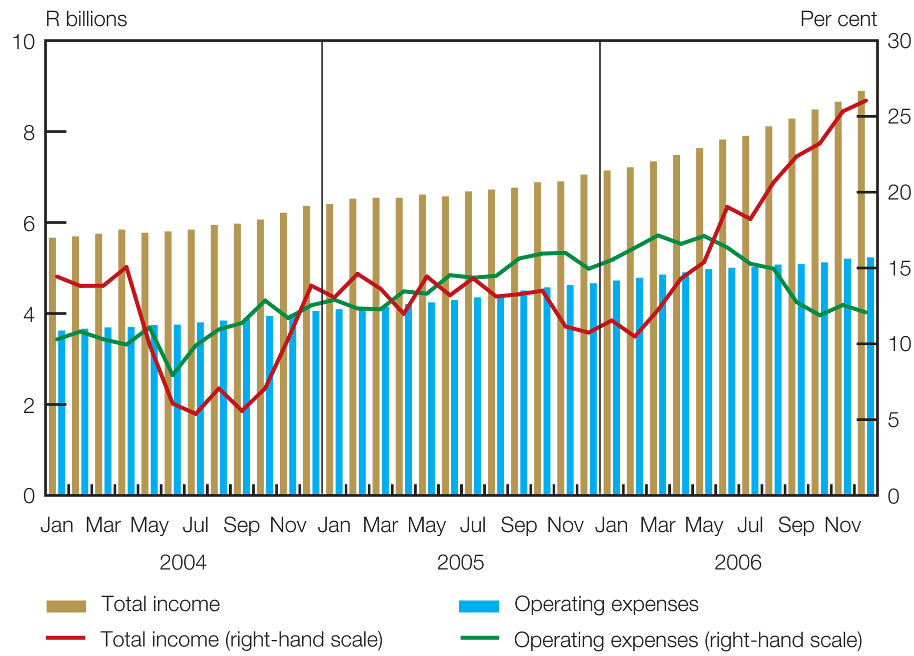
efficiency ratio improved

Figure 19 Efficiency ratio (12-month smoothed average)



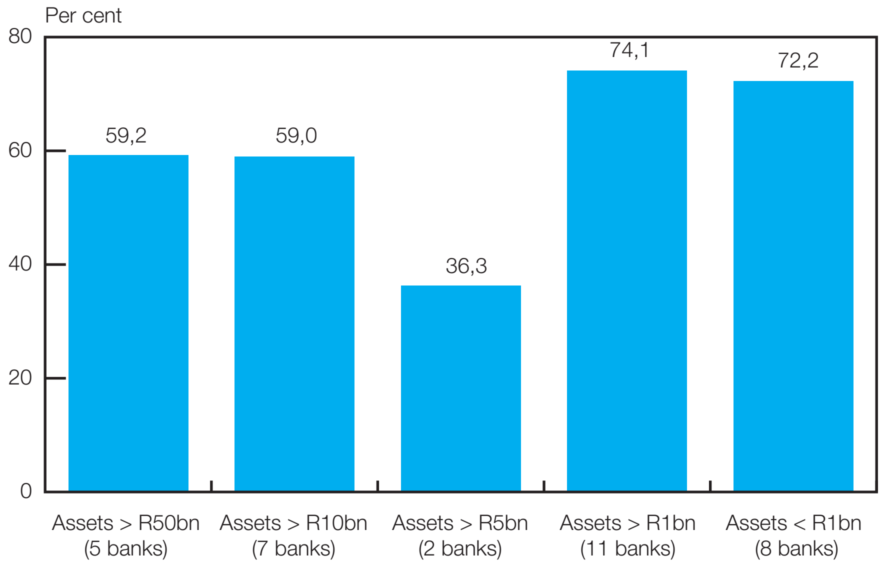
The monetary values of, and the growth (12-month smoothed average) in the determinants of the efficiency ratio are illustrated in Figure 20. Growth of 26 per cent in total income for 2006 offset the increase of 12,1 per cent in total operating expenses, resulting in an improvement in the efficiency ratio for the banking sector during 2006 (see Figure 19).

Figure 20 Determinants of efficiency ratio (12-month smoothed average)



The efficiency ratio calculated for each asset-size category (12-month smoothed average) is presented in Figure 21. As at December 2006, banks with assets exceeding R5 billion, but below R10 billion, were the most efficient with an efficiency ratio of 36,3 per cent, followed by banks with asset values between R10 billion and R50 billion (59 per cent). Banks with asset values greater than R50 billion (the five largest banks) had an efficiency ratio of 59,2 per cent. The least efficient were banks with asset values between R1 billion and R5 billion (74,1 per cent).

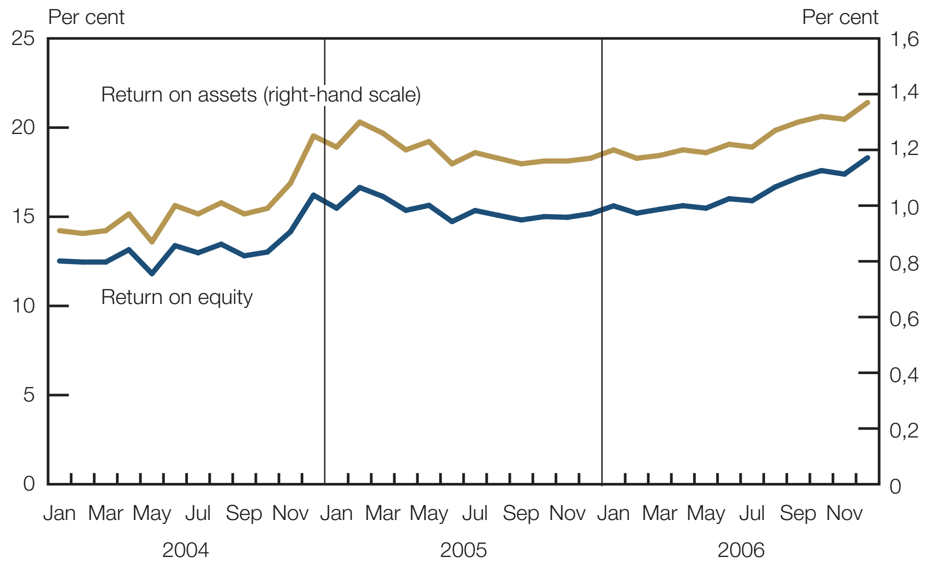
Figure 21 Efficiency of banking institutions according to asset value – 12-month smoothed average (December 2006)



ROE and ROA showed increasing trend

Figure 22 portrays the improved profitability of banks operating under favourable economic and market conditions during the period under review. The trends in return on equity (ROE) and return on assets (ROA) continued to improve during 2006 (12-month smoothed average). The improvement mainly resulted from higher total income recorded during 2006. At the end of December 2006, an after-tax return of 1,4 per cent on total assets (2005: 1,2 per cent) was reported, whereas an after-tax return of 18,3 per cent on net qualifying capital and reserves (2005: 15,2 per cent) was reported. The banking sector achieved a before-tax return of 1,8 per cent on total assets as at the end of December 2006 (12-month smoothed average) in comparison to the 1,6 per cent as at the end of 2005.

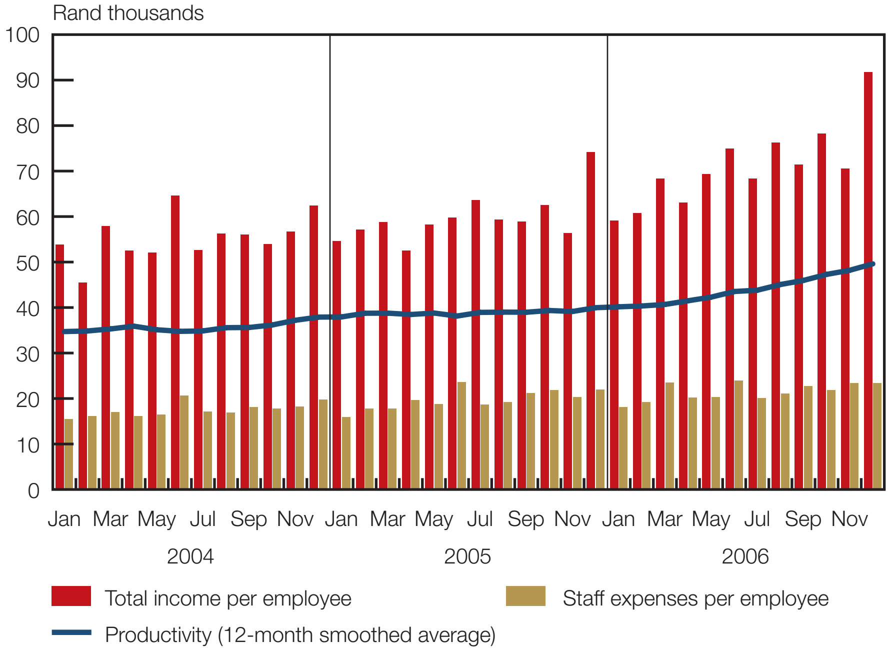
Figure 22 Profitability (12-month smoothed average)



net income generated per employee improved

Productivity can be measured by comparing the expenditure on employees with the amount of income generated. Figure 23 depicts the productivity of the banking sector for the past three years. During 2006, the total income generated per employee was on average R71 062, as opposed to R59 685 in 2005. During 2006, the average staff expenses per employee were R21 459 (2005: R19 716). Also portrayed in Figure 23 is the average (smoothed over a 12-month period) net income generated per employee. The net income generated per employee was R49 604 as at the end of 2006, as opposed to R39 969 as at the end of 2005.

Figure 23 Productivity



4.4 Liquidity risk

Liquidity – the ability to fund increases in assets and meet obligations as they become due – is crucial to the sustained viability of any banking institution. But the importance of liquidity transcends the individual bank as a liquidity shortfall at an individual bank can have systemic repercussions. The management of liquidity is therefore among the most important activities conducted by banks.

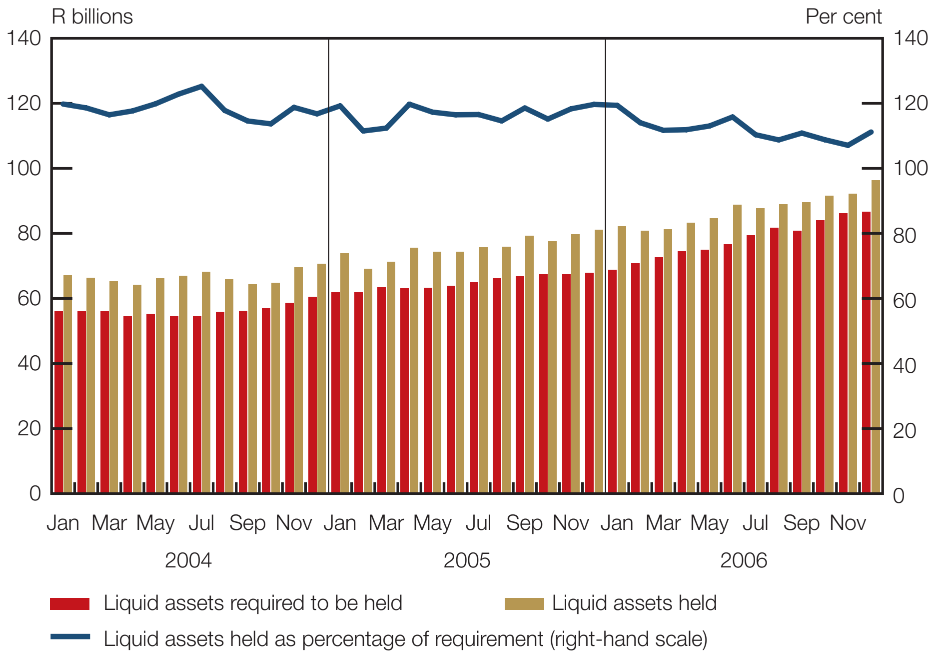
4.4.1 Statutory liquid-asset requirement

liquid assets held by banks exceeded the statutory requirement

The statutory liquid-asset requirement is calculated as a percentage of total liabilities less capital and reserves (referred to as adjusted liabilities). As indicated in Figure 24, the average daily amount of liquid assets held by banks exceeded the statutory liquid-asset requirement throughout 2006. For the month of December 2006, the average daily amount of liquid assets held represented 111,2 per cent of the statutory liquid-asset requirement, compared to 119,7 per cent for December 2005.

On average for 2006, 43,1 per cent of the liquid assets held consisted of securities issued by virtue of section 66 of the Public Finance Management Act, 1999 (2005: 46,8 per cent), whereas 39,8 per cent consisted of Treasury bills of the Republic of South Africa (2005: 32,3 per cent) and 0,7 per cent of short-term bills issued by the Land Bank (2005: 1 per cent). Measured over 12 months, cash-management schemes managed on behalf of bank clients decreased by about 1,6 per cent as at the end of December 2006 (down by 13,2 per cent from 2005). Set-off increased by 0,3 per cent as at the end of December 2006 (down by 48,8 per cent from 2005). Cash-management schemes and set-off represented 4,5 per cent and 5,9 per cent of average adjusted liabilities (12-month average), respectively, in December 2006 (2005: 5,4 per cent and 11 per cent).

Figure 24 Statutory liquid assets (actual versus required)



4.4.2 Volatility of funding

During 2006, the banking sector absorbed interest-rate increases amounting to 200 basis points. This has an influence on the demand/supply of certain types of funding, which affects the pricing and maturity of the pool of deposits.

The ten largest depositors on the balance sheets of every banking institution, including the maturity structure of each deposit, are reported to the Department. The sum of the ten largest depositors, as a percentage of total funding, is portrayed in Figure 25. The ten largest depositors, in total, constituted 23 per cent of total funding-related liabilities to the public (total funding) as at the end of December 2006 (2005: 20,4 per cent). The largest depositors with a maturity within sight to seven days amounted to 8,5 per cent of total funding-related liabilities to the public as at the end of December 2006 (2006: 10,2 per cent).

ten largest depositors constituted 23 per cent of total funding

Figure 25 Deposits from banks' ten largest depositors, as percentage of total funding

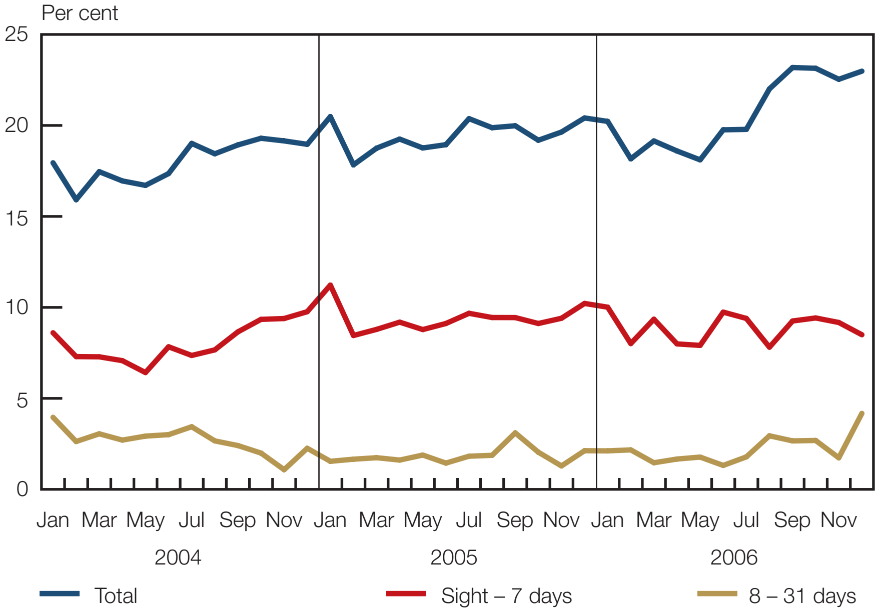


Figure 26 depicts the anticipated maturities of short-term funding. Anticipated maturities are calculated/forecasted by the asset-and-liability committees (ALCOs) of banking institutions. The contractual maturities are adjusted to what is perceived by an ALCO as an anticipated maturity per deposit. Total short-term funding (with an anticipated maturity of nil to 31 days) amounted to 22,7 per cent of total funding as at the end of December 2006, as opposed to 24,5 per cent for December 2005. As at the end of December 2006, total funding with an anticipated maturity within sight to seven days and total funding with an anticipated maturity within eight to 31 days represented 13,5 per cent and 9,3 per cent, respectively, of total funding.

Figure 26 Anticipated maturity of short-term funding (as percentage of total funding)

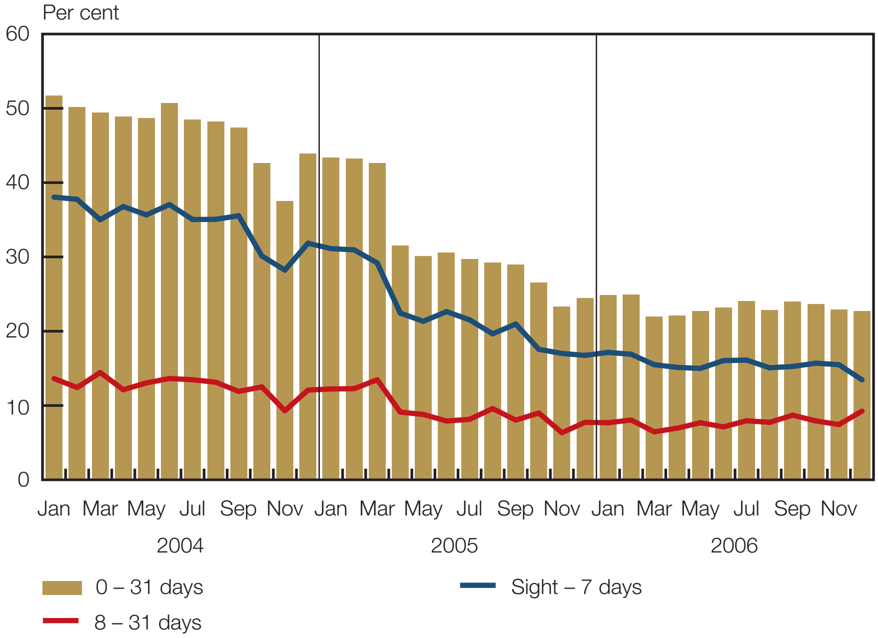
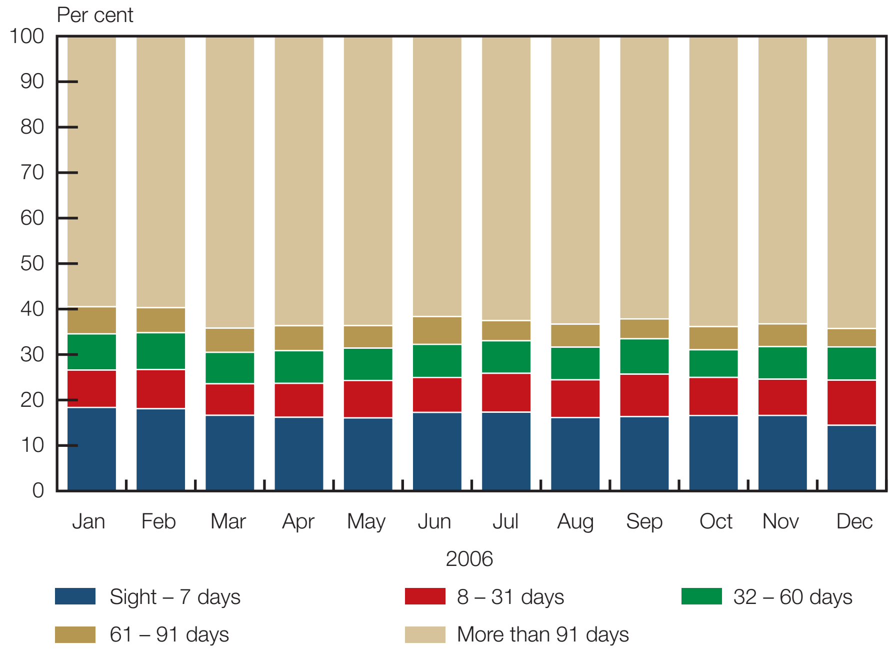


Figure 27 presents the composition of total funding according to anticipated maturity for 2006. As at the end of December 2006, deposits with an anticipated maturity longer than 91 days and deposits with an anticipated maturity shorter than seven days constituted the largest portion of total funding, namely 64,3 per cent and 14,5 per cent, respectively. Deposits with an anticipated maturity of 8 to 31 days constituted 9,9 per cent of total funding, followed by deposits with an anticipated maturity of 32 to 60 days, which constituted 7,3 per cent. Deposits with an anticipated maturity of 61 to 91 days constituted the smallest portion of total funding, namely 4 per cent.

Figure 27 Anticipated maturity of total funding (composition)



4.5 Derivative contracts

In this section a summary of banking institutions' derivative activities is provided. A derivative contract derives much of its value from an underlying asset. Examples of derivatives include futures, options, forward contracts and swap agreements. For the period under review, forward contracts were the main contributors to total derivative turnover. A forward contract can be derived from the spot currency market and the spot markets for borrowing and lending transactions.

Figure 28 depicts the monthly turnover in forward contracts and other derivative contracts. The monthly turnover in forward contracts fluctuated between R1 168 billion (lowest turnover amount reported) and R2 311,5 billion (highest turnover amount reported) during 2006. The turnover in forward contracts amounted to R1 879 billion for December 2006 (R1 346 billion for December 2005), while the remainder of the turnover in derivative contracts amounted to R739,2 billion for December 2006 (R728,9 billion for December 2005).

Figure 28 Turnover in derivative contracts

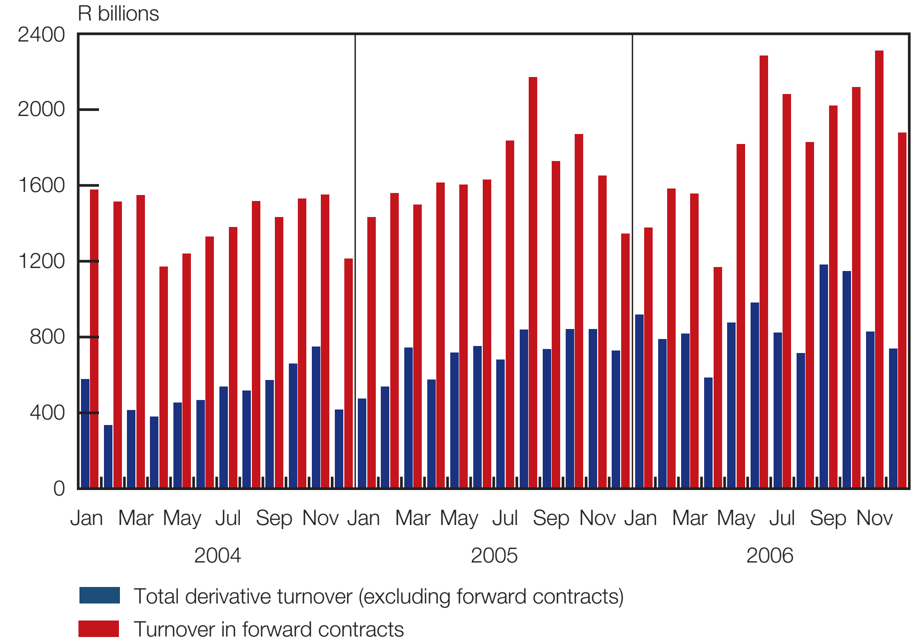
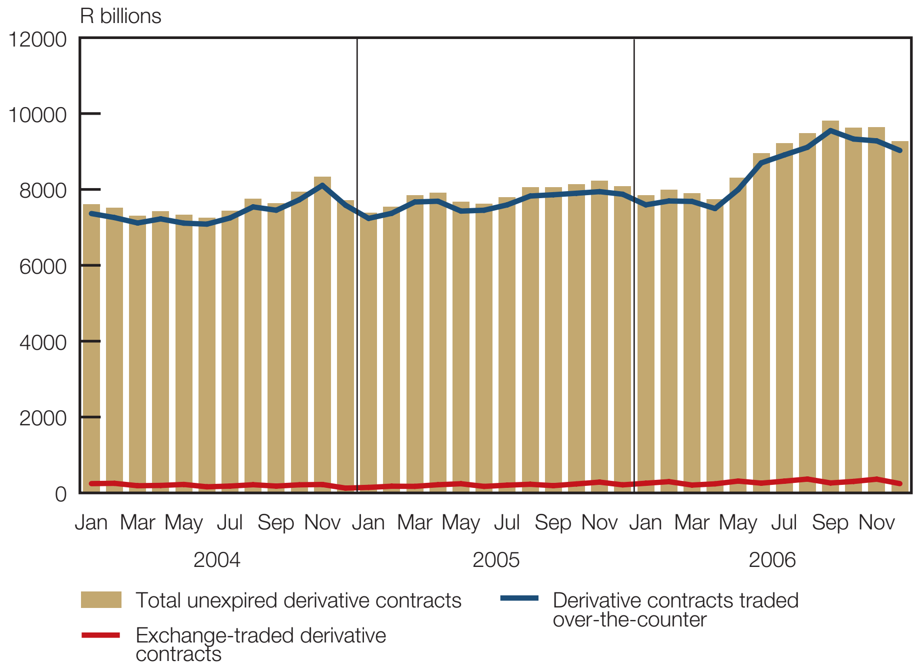


Figure 29 portrays the gross nominal value of total unexpired derivative contracts. Derivative contracts traded over-the-counter (OTC) as a percentage of total unexpired contracts remained at 97,4 per cent for both December 2005 and December 2006.

Figure 29 Total unexpired derivative contracts



Total unexpired derivative contracts increased from R8 086,1 billion in December 2005 to R9 272,2 billion in December 2006 as a result of the increase in OTC contracts. Total unexpired derivative contracts as a percentage of total banking assets declined from 482,0 per cent in December 2005 to 446,8 per cent in December 2006.

unexpired derivative contracts increased

4.6 Credit risk

Banking institutions are in the business of lending, and therefore face the risk that a party to a contractual agreement/transaction will be unable to meet its obligations or will default on commitments, which in essence describes credit risk. As a result of the strong asset growth during 2006, credit-risk ratios generally continued to improve. Given the cumulative 200-basis-point increase in the repurchase rate, as announced by the Monetary Policy Committee of the South African Reserve Bank during 2006, these ratios will be monitored closely during 2007.

4.6.1 Analysis of amounts overdue (non-performing loans)

The monetary value of gross overdues (non-performing loans that have been overdue for a period longer than 180 days) is portrayed in Figure 30. The gross overdues continued along a downward trend, tapering off from R20,1 billion in December 2005 to R18,8 billion in December 2006.

total gross overdues declined

Figure 30 Total overdues

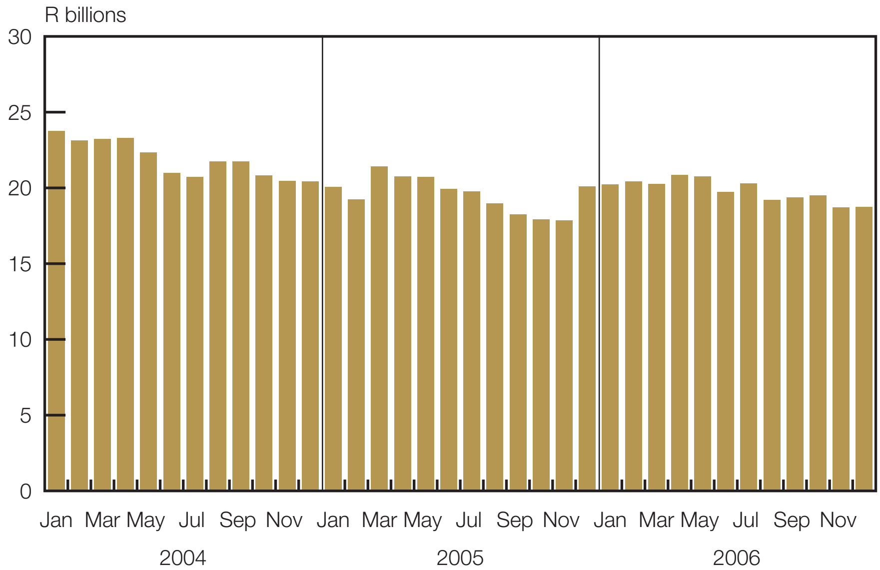
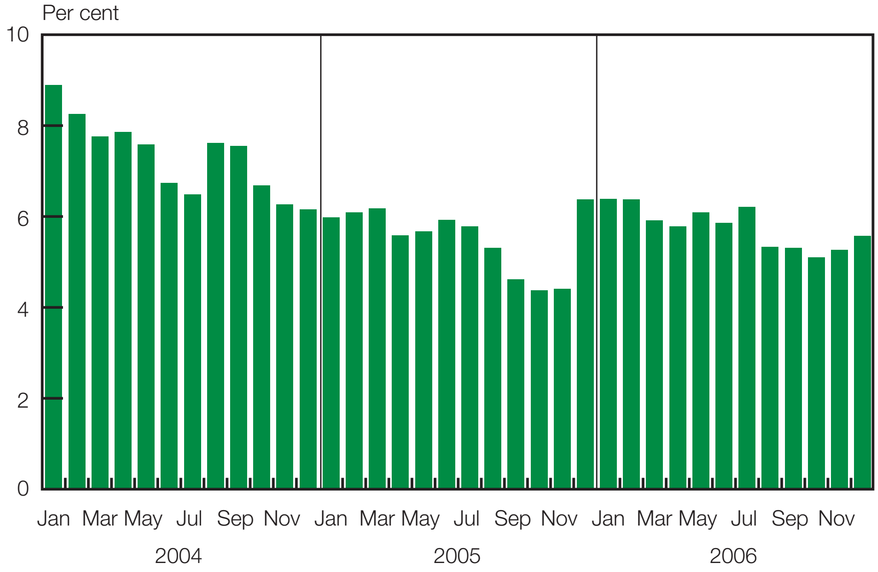


Figure 31 depicts net overdues (gross overdues less specific provisions) as a percentage of net qualifying capital and reserves. This ratio continued to decline from 6,4 per cent in December 2005 to 5,6 per cent in December 2006, mainly as a result of the decline in specific provisions and gross overdues, while net qualifying capital continued to increase. As at the end of December 2006 net overdues amounted to R8,5 billion (R8,2 billion as at the end of December 2005), and specific provisions amounted to R10,2 billion (R11,9 billion as at the end of December 2005).

Figure 31 Net overdues as percentage of net qualifying capital and reserves

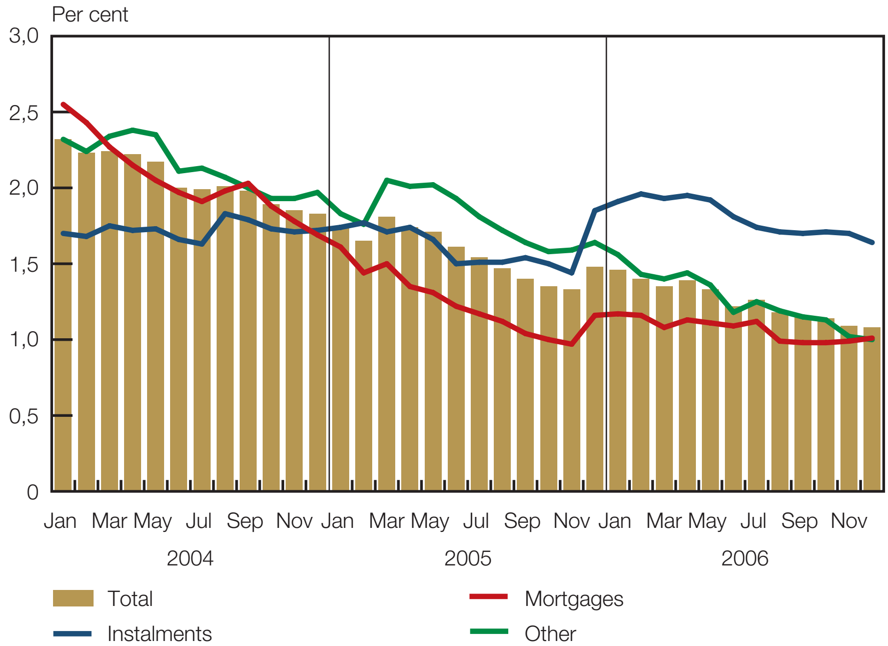


overdue ratios improved

Expressed as a percentage of total loans and advances, gross amounts overdue improved from 1,5 per cent in December 2005 to 1,1 per cent in December 2006 (refer to Figure 32) as a result of strong asset growth and a decline in gross overdues, caused by favourable economic conditions. The overdue ratios of all the asset categories contributed to this improvement as follows:

- Mortgage loans overdue expressed as a percentage of total mortgage loans improved from 1,2 per cent in December 2005 to 1,0 per cent in December 2006.
- Expressed as a percentage of total instalment debtors, instalment debtors overdue improved from 1,9 per cent in December 2005 to 1,6 per cent in December 2006.

Figure 32 Composition of overdues (as percentage of loans and advances)



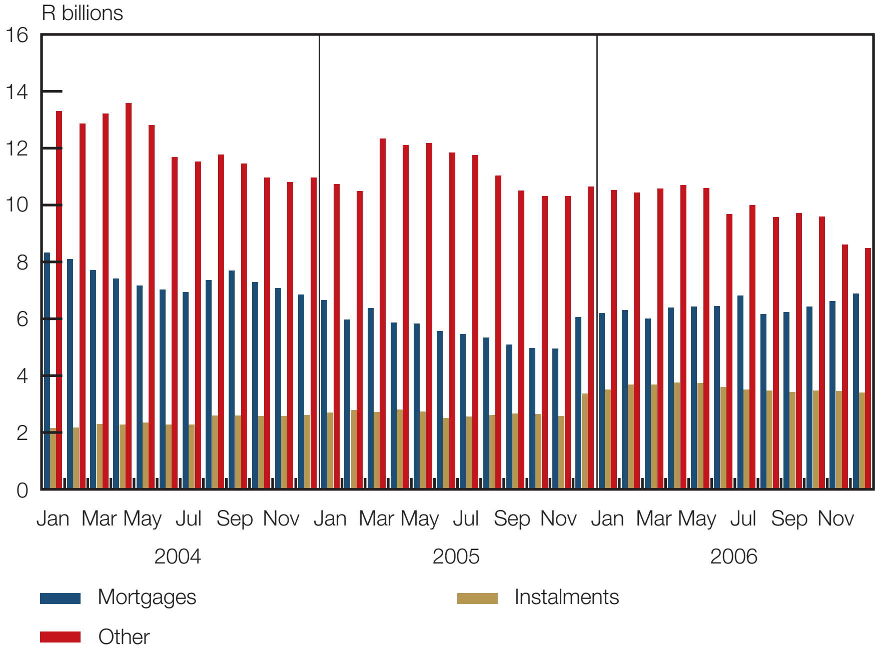
- Other loans and advances overdue expressed as a percentage of total other loans and advances improved from 1,6 per cent in December 2005 to 1,0 per cent in December 2006.

Figure 33 presents a breakdown of the monetary value of gross overdues according to the different asset categories. Gross overdues in respect of other loans and advances declined substantially from R10,7 billion in December 2005 to R8,5 billion in December 2006, whereas instalment debtors overdue remained at R3,4 billion for the aforementioned periods. Other loans and advances overdue decreased in June 2006 and November 2006 as a result of write-offs of accounts overdue.

Gross overdues in respect of mortgage loans, however, increased from R6,1 billion in December 2005 to R6,9 billion in December 2006.

mortgage loans overdue increased

Figure 33 Analysis of overdues



4.6.2 Provisioning

In terms of the minimum regulatory provisioning requirements, the banking sector was adequately provided for throughout 2006.

provisions remained adequate

The coverage ratio, expressing specific provisions and the market value of security held as a percentage of gross overdues, is portrayed in Figure 34. The coverage ratio increased from 98,9 per cent in December 2005 to 100,7 per cent in December 2006. Specific provisions as a percentage of gross overdues decreased from 59,4 per cent in December 2005 to 54,4 per cent in December 2006, due to the decline in specific provisions during 2006.

Specific provisions per asset category, expressed as a percentage of gross overdues, were as follows as at the end of December 2006:
- Mortgage loans: 30,2 per cent (31,5 per cent on 31 December 2005).
- Instalment debtors: 57,7 per cent (56,8 per cent on 31 December 2005).
- Other loans and advances: 72,8 per cent (76,1 per cent on 31 December 2005).

Figure 34 Coverage ratio (specific provisions and security as percentage of gross overdues)

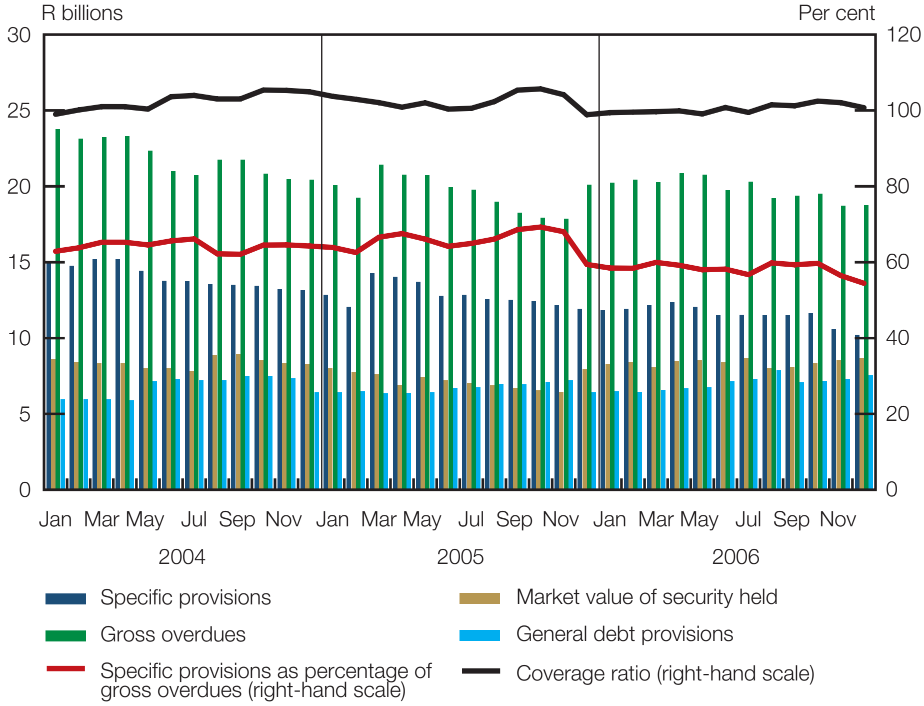
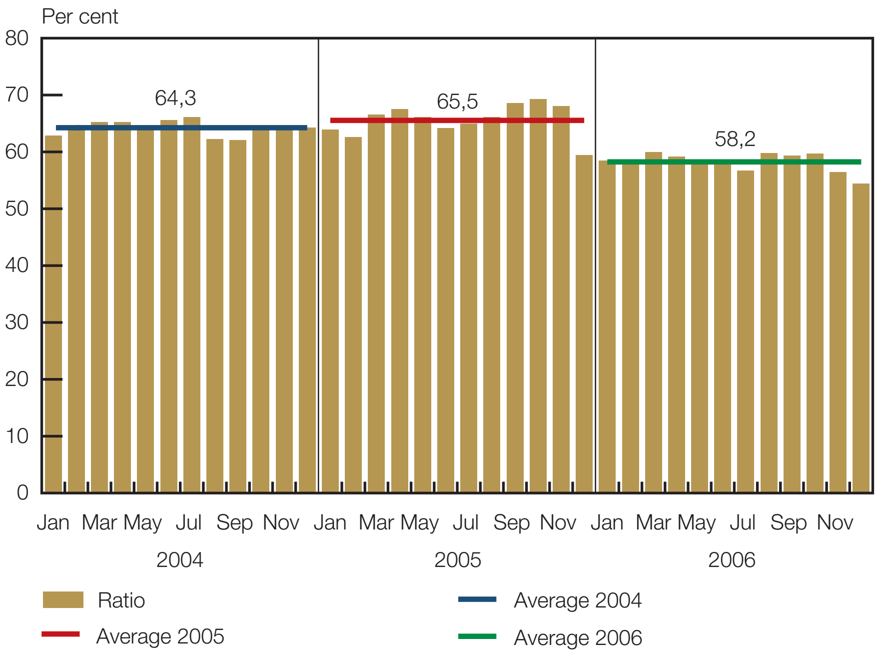


Figure 35 depicts specific provisions as a percentage of gross overdues from January 2004 to December 2006. On average, specific provisions amounted to 58,2 per cent during 2006 (65,5 per cent during 2005). The ratio declined from 59,7 per cent in October 2006 to 56,5 per cent in November 2006 (due to write-offs in loans classified as overdue) and continued to decline in December 2006 to 54,4 per cent.

Figure 35 Specific provisions as percentage of gross overdues



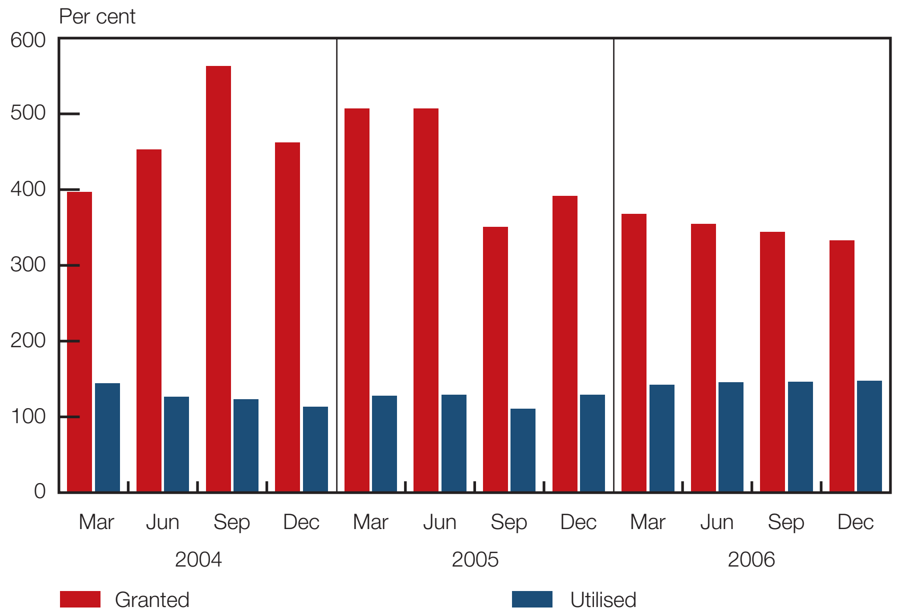
4.6.3 Large exposures

In terms of section 73(1)(b) of the Banks Act, 1990, exposures granted that exceed 10 per cent of qualifying capital and reserves (referred to as large exposures) should not exceed, in total, 800 per cent of qualifying capital and reserves, and any single exposure granted exceeding 25 per cent should be an impairment against the capital of the bank. It should be borne in mind, however, that this refers only to large exposures to private-sector non-bank borrowers and that the total of the large exposures analysed in this report includes, among other things, exposures to government and other banking institutions.

Figure 36 compares large exposures granted and large exposures utilised, expressed as a percentage of net qualifying capital. Large exposures granted as a percentage of net qualifying capital decreased from 391,5 per cent in December 2005 to 333,1 per cent in December 2006. Large exposures utilised as a percentage of net qualifying capital and reserves increased from 128,8 per cent in December 2005 to 147,3 per cent in December 2006.

large exposures granted continued to decrease

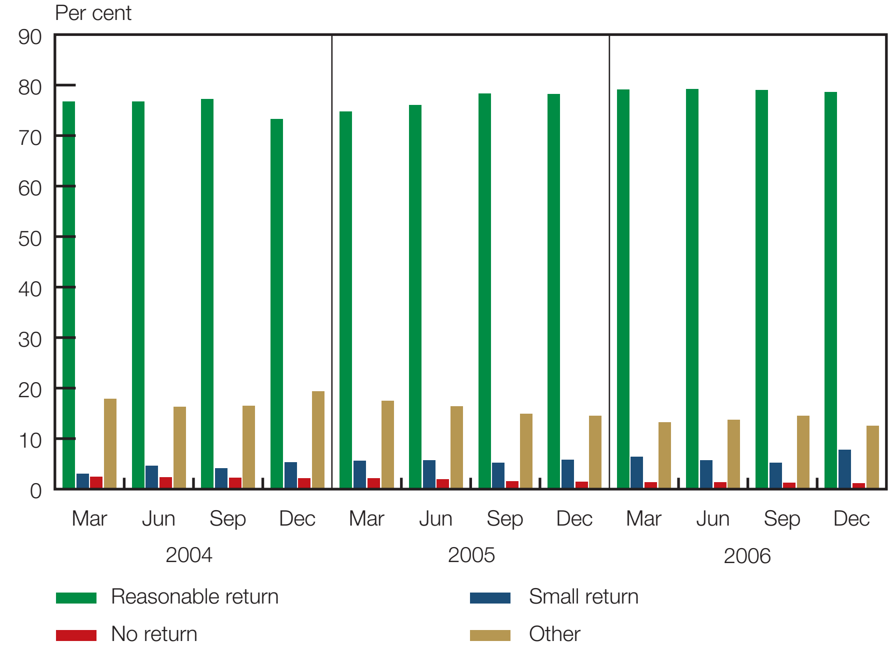
Figure 36 Large exposures as percentage of net qualifying capital and reserves



4.6.4 Quality of assets

Figure 37 indicates that 78,6 per cent of banking-sector assets earned a reasonable return as at the end of December 2006 (78,2 per cent as at the end of December 2005). The assets that earned a small return amounted to 7,8 per cent as at the end of December 2006 (5,8 per cent as at the end of December 2005), whereas 1,2 per cent earned no return (1,5 per cent as at the end of December 2005).

Figure 37 Asset performance



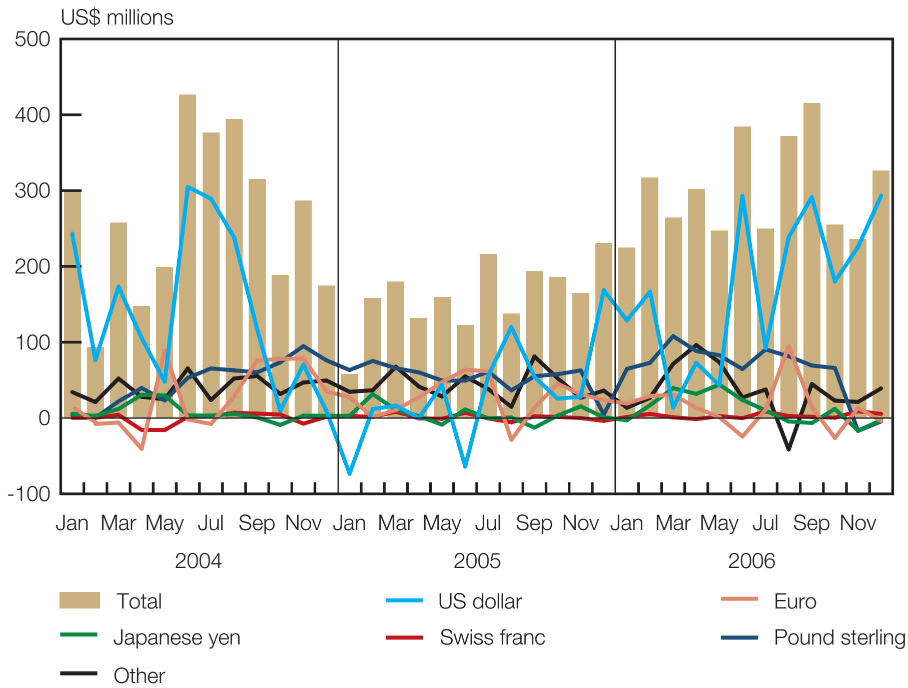
4.7 Currency risk

US dollar remained main contributor to net open position

During 2006, the aggregated effective net open foreign-currency position fluctuated at higher levels, if compared with fluctuations in 2005. The US-dollar positions were the main contributors to the larger aggregated effective net open foreign-currency position.

Figure 38 illustrates the total aggregated effective net open foreign-currency position, as well as the net open positions per currency. The total aggregated effective net open

Figure 38 Aggregated effective net open foreign-currency position (all currencies converted to US dollars)



foreign-currency position increased from US$230,6 million in December 2005 to US$326,4 million in December 2006. Expressed as a percentage of net qualifying capital and reserves, the total aggregated effective net open foreign-currency position amounted to 1,5 per cent in December 2005, compared to 1,1 per cent in December 2006.

The aggregated effective net open position in US dollars increased to its highest level in June 2006, amounting to US$293 million. The total aggregated effective net open foreign-currency position reached its highest level in September 2006 amounting to US$415 million (2,2 per cent of net qualifying capital and reserves).

During 2006 the maximum effective net open foreign-currency position remained well within the 10-per-cent statutory limit, but fluctuated above the levels reported during 2005 (refer to Figure 39). As a percentage of net qualifying capital and reserves, the maximum effective net open foreign-currency position declined from 1,9 per cent in December 2005 to 1,4 per cent in December 2006, reaching its highest ratio at the end of September 2006, amounting to 3 per cent.

Figure 39 Maximum effective net open foreign-currency position as percentage of net qualifying capital and reserves

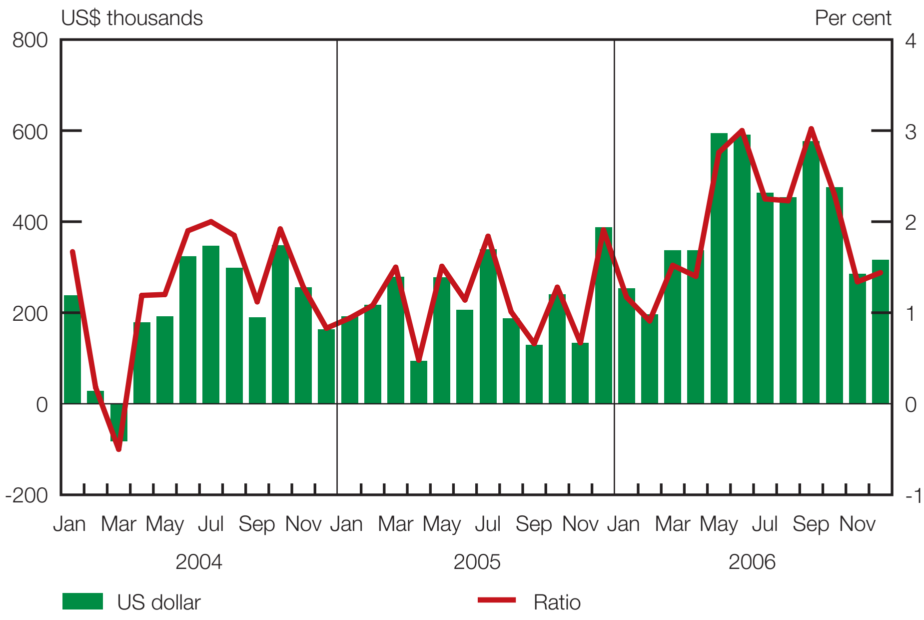
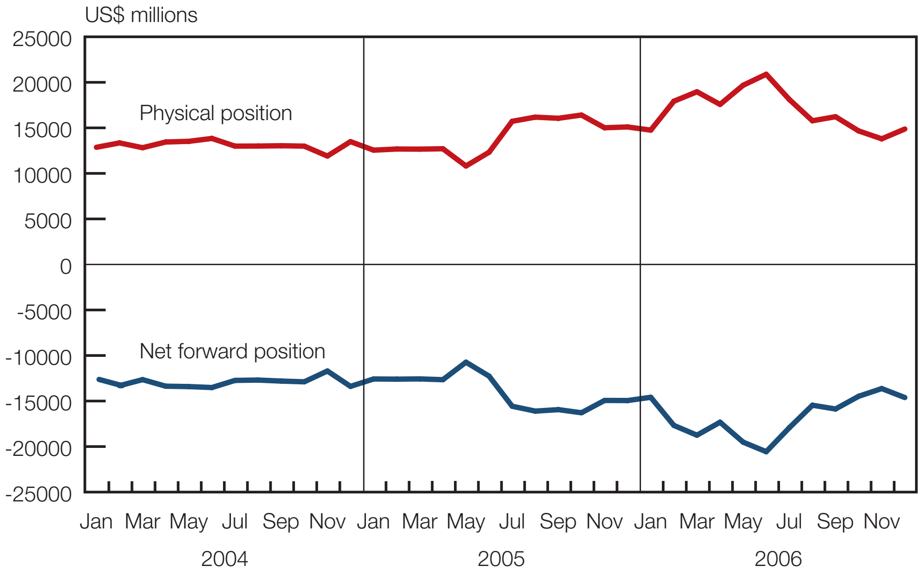


Figure 40 presents the position in foreign-currency instruments. The physical position equals the difference between foreign assets and foreign liabilities, whereas the net forward position is the difference between commitments to sell foreign currency and commitments to purchase foreign currency. The physical position decreased slightly from US$15,1 billion in December 2005 to US$14,9 billion in December 2006, whereas the net forward position decreased from -US$14,9 billion in December 2005 to -US$14,6 billion in December 2006. The increase in the physical position mirrored the movements of the forward position in order to maintain the overall net open position within the regulatory limit of 10 per cent of qualifying capital.

Figure 40 Position in foreign-currency instruments



The liquidity-maturity structure of foreign assets, liabilities and commitments is portrayed in Figure 41. The net impact of the maturity ladder was minimal during 2006.

Figure 41 Maturity structure of forward contracts denominated in US dollar