Chapter 4

Trends in the South African banking sector

This chapter contains an overview of banking-sector financial and risk information received from registered banks for 2007. Certain comparative figures in respect of 2006 may differ from those reported in the 2006 *Annual Report*, as some banking institutions subsequently submitted amended returns.

The reports and graphs presented in sections 4.1 to 4.7 are dominated by the size of the balance sheets and activities of the four largest banks, which constituted 85,1 per cent of the banking-sector assets in December 2007 (December 2006: 84,1 per cent). The five largest banks constituted 90,9 per cent of the banking-sector assets at the end of December 2007 (December 2006: 89,7 per cent). A list of the balance-sheet sizes of individual banks is available in Appendix 2.

four largest banks constituted 85,1 per cent of banking-sector assets

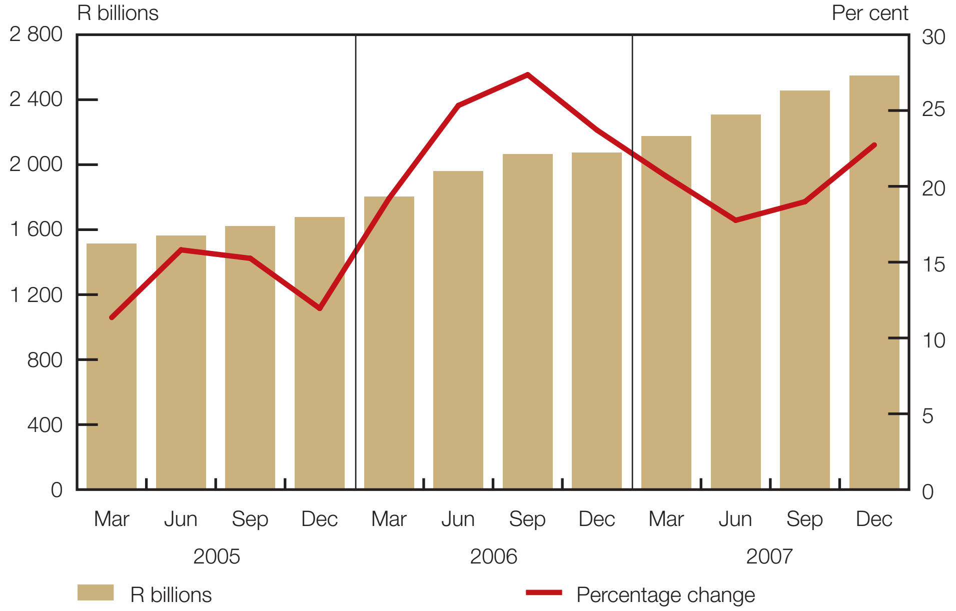
4.1 Balance-sheet structure

The balance sheet is analysed in terms of its composition to form an opinion on the type and spread of banking-sector activities. Changes in the composition of the assets and liabilities are analysed to assess their impact on the overall risk profile of the banking sector. As indicated in Figure 1, the aggregated balance-sheet size of the banking sector amounted to R2 547,0 billion as at 31 December 2007, compared with R2 075,3 billion as at 31 December 2006 and R1 677,5 billion as at 31 December 2005.

The year-on-year growth in the aggregated balance sheet of the total banking sector amounted to 23,7 per cent at the end of December 2006. It slowed down in the first two quarters of 2007, reaching 17,8 per cent at the end of June 2007, before recovering to end the year at 22,7 per cent. Loans and advances, and investment and trading positions were the main contributors to the increase in banking-sector assets during 2007.

22,7 per cent annual growth in total banking-sector assets

Figure 1 Aggregated balance sheet



4.1.1 Liabilities and capital

non-bank deposits remained main source of funding

The composition of banking-sector liabilities and capital as portrayed in Figure 2, remained fairly stable between December 2006 and December 2007. By the end of 2007, total liabilities and capital amounted to R2 547,0 billion, compared with R2 075,3 billion at the end of 2006. Non-bank deposits remained the main source of funding for the banking sector throughout 2007 and represented 65,1 per cent of total liabilities and capital at the end of December 2007 (December 2006: 65,2 per cent). Other liabilities constituted 13,2 per cent of total liabilities at the end of 2007, compared with 14,1 per cent at the end of 2006. Interbank funding, foreign funding, repurchase agreements and acknowledgements of debt rediscounted represented 5,3 per cent, 4,9 per cent, 3,5 per cent and 0,01 per cent of total liabilities and capital respectively at the end of 2007. Capital and reserves remained unchanged at 8,0 per cent of total liabilities and capital.

Figure 2 Liabilities and capital (year-on-year comparison)

Per cent

	December 2006		December 2007
Non-bank deposits	65,2	Non-bank deposits	65,1
Interbank funding	5,5	Interbank funding	5,3
Other liabilities	14,1	Other liabilities	13,2
Foreign funding	4,3	Foreign funding	4,9
Repurchase agreements	3,0	Repurchase agreements	3,5
Acknowledgements of debt rediscounted	0,01	Acknowledgements of debt rediscounted	0,01
Capital and reserves	8,0	Capital and reserves	8,0

(Figures do not add up due to rounding.)

4.1.2 Non-banks deposits

demand deposits represented 44,1 per cent of non-bank deposits

By the end of 2007, total non-bank deposits increased to R1 657,8 billion from R1 353,2 billion at the end 2006. The composition of non-bank deposits is reflected in Figure 3. Demand deposits represented 44,1 per cent of non-bank deposits in December 2007 (46,1 per cent at the end of 2006). Fixed and notice deposits, and NCDs accounted for 32,7 per cent and 17,8 per cent of non-bank deposits respectively in December 2007 (December 2006: 33,4 per cent and 15,1 per cent). Savings deposits continued to constitute the smallest portion of non-bank deposits, representing 5,4 per cent at the end of both December 2006 and December 2007.

Figure 4 reflects the composition of non-bank deposits according to the maturities, respectively classified as either short term, medium term or long term. Short-term deposits are repayable on or before the thirty-first day from the reporting date. A medium-term deposit is repayable on or after the thirty-second day from the reporting date, but not later than the day on which a period of six calendar months from the reporting date expires. Long-term deposits are repayable after the expiration of more than six calendar months from the reporting date.

Figure 3 Composition of non-bank deposits

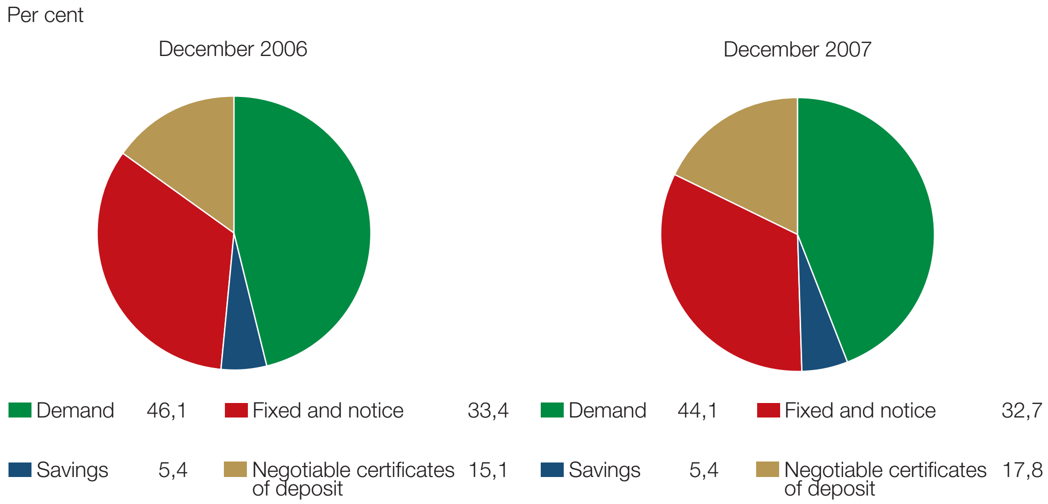
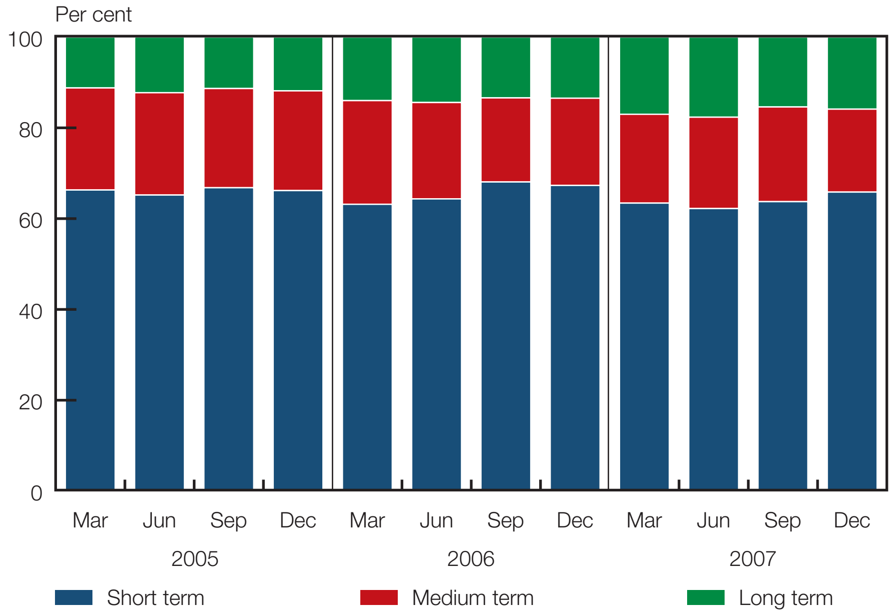


Figure 4 Composition of non-bank deposits according to maturity



Short-term non-bank deposits as a percentage of total non-bank deposits remained stable and thus continued to constitute the main source of funding for banks throughout 2007, representing 65,9 per cent of non-bank funding at the end of December 2007 (December 2006: 67,3 per cent). Medium- and long-term non-bank deposits constituted 18,3 per cent and 15,9 per cent of non-bank funding respectively at the end of December 2007 (December 2006: 19,2 per cent and 13,5 per cent).

non-bank deposits mainly short term

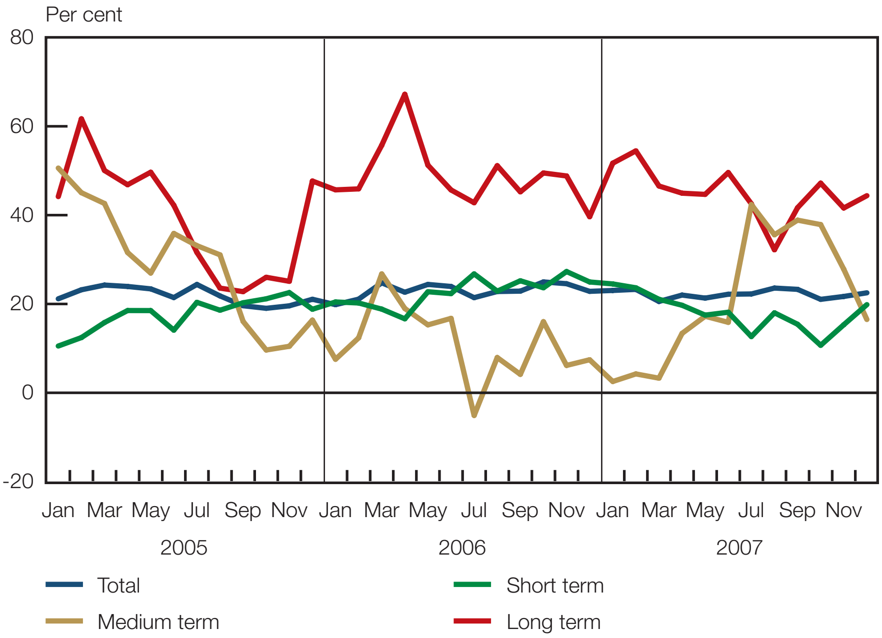
Year-on-year growth in non-bank deposits according to maturity is portrayed in Figure 5. Apart from a deceleration to 32,3 per cent at the end of August 2007, the growth in long-term deposits remained above 40 per cent throughout 2007. By the end of December 2007, growth in long-term deposits amounted to 44,4 per cent (December 2006: 39,6 per cent). Fixed and notice deposits and NCDs remained the main sources of long-term non-bank deposits for banks during 2007.

significant growth in long-term deposits

Growth in medium-term non-bank deposits was volatile during 2007, with a sharp increase over the first half of the year to a rate of 42,4 per cent at the end of July 2007, before declining to end the year at 16,5 per cent (December 2006: 7,4 per cent). Medium-term fixed and notice deposits and, to a lesser extent, NCDs were the main contributors to the higher growth rate in medium-term non-bank deposits during this period.

Growth in short-term non-bank deposits slowed down during 2007, and amounted to 19,9 per cent at the end of December 2007 (December 2006: 25 per cent). Demand deposits represented the largest portion of short-term non-bank deposits throughout 2007.

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



other sources of funding

Furthermore, the following other sources of funding were reported by banks:

- Interbank funding amounting to R135 billion at the end of December 2007 (increased by 18,8 per cent during 2007)
- Foreign funding amounting to R124,5 billion at the end of December 2007 (increased by 39,0 per cent during 2007)
- Funding received under repurchase agreements amounting to R89,2 billion at the end of December 2007 (increased by 44,9 per cent during 2007)
- Other liabilities and acknowledgement of debt rediscounted amounting to R336,8 billion and R364 million at the end of December 2007 respectively (increased by 15,4 per cent and 23,8 per cent respectively during 2007).

4.1.3 Assets

non-bank loans and advances remained largest portion of total banking-sector assets

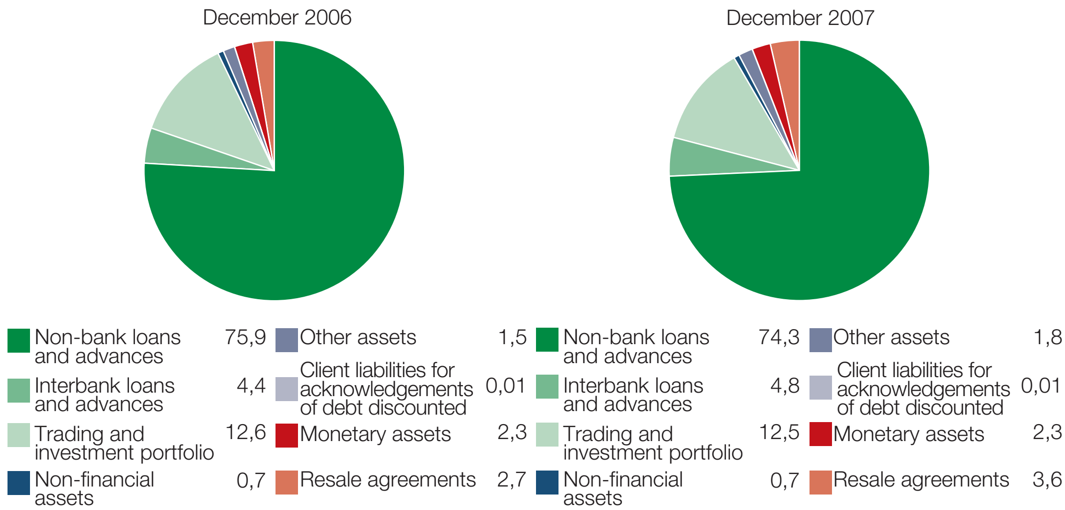
The composition of total assets, amounting to R2 075,3 billion and R2 547,0 billion at the end of December 2006 and December 2007 respectively is portrayed in Figure 6. Non-bank loans and advances remained the largest portion of total banking-sector assets during 2007, constituting 74,3 per cent at the end of December 2007, compared with 75,9 per cent at the end of December 2006. Non-bank loans and advances increased from R1 575,3 billion at the end of December 2006 to R1 892,0 billion at the end of December 2007, representing an annual growth rate of 20,1 per cent.

The remaining 25,7 per cent of total banking-sector assets included 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 Bank) increased from R47,2 billion in December 2006 to R58,6 billion in December 2007, representing an annual growth rate of 24,3 per cent.
- Interbank advances increased from R91 billion in December 2006 to R122,4 billion in December 2007, representing an annual growth rate of 34,5 per cent.
- Loans granted under resale agreements increased from R55,6 billion in December 2006 to R91,9 billion in December 2007, representing an annual growth rate of 65,4 per cent.
- Trading and investment assets increased from R261,1 billion in December 2006 to R319,4 billion in December 2007, representing an annual growth rate of 22,3 per cent.
- Non-financial assets increased from R14,7 billion in December 2006 to R17,5 billion in December 2007, representing an annual growth rate of 19,3 per cent.
- Client liabilities for acknowledgement of debt discounted increased from R293,9 million in December 2006 to R373,2 million in December 2007, representing an annual growth rate of 27,0 per cent.
- Other assets increased from R30,1 billion in December 2006 to R44,9 billion in December 2007 representing an annual growth rate of 49,2 per cent.

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

Per cent



(Figures do not add up due to rounding.)

Figure 7 depicts the year-on-year growth in total loans and advances. The growth in total loans and advances slowed down during 2007, reaching 19,8 per cent in June 2007 before recovering to end the year at 22,4 per cent (December 2006: 28,2 per cent).

growth in total loans and advances slowed

Total loans and advances amounted to R2 124,2 billion in December 2007, compared with R1 735,8 billion in December 2006. The increase in total loans and advances during 2007 can be attributed primarily to the increase in mortgage loans (24,7 per cent year-on-year increase) and overdrafts and loans (24,8 per cent year-on-year increase).

Loans granted under resale agreements and credit card debtors also increased significantly, with year-on-year growth rates amounting to 65,4 per cent and 25,5 per cent respectively. However, as a result of their relative size, the increase did not have a major impact on the growth in total loans and advances.

Figure 7 Total loans and advances

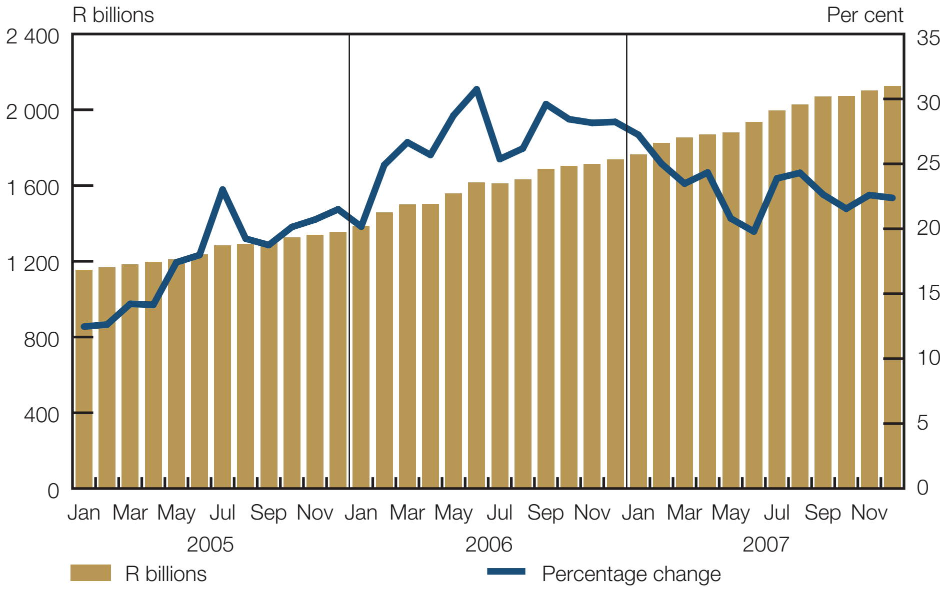
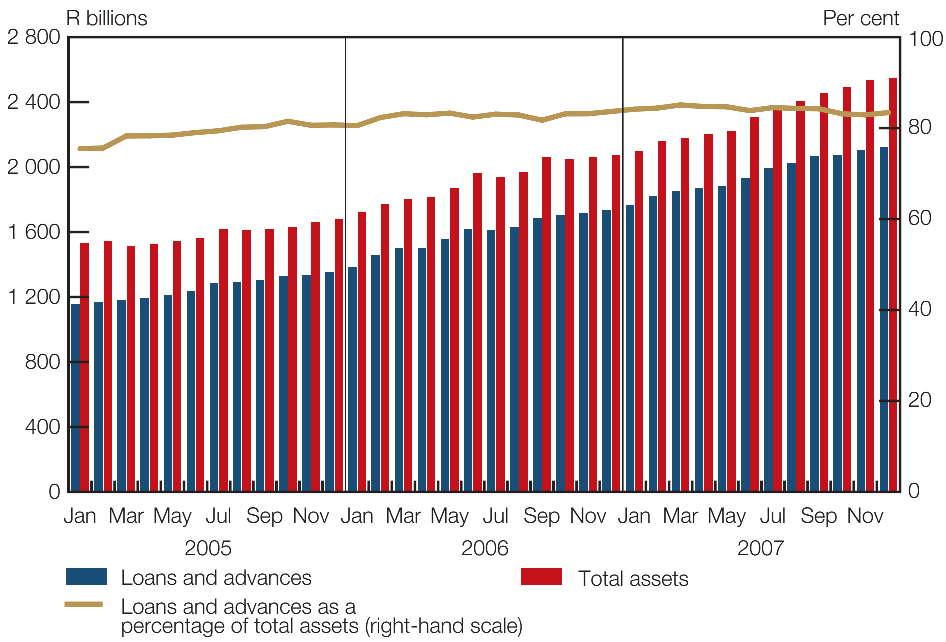


Figure 8 reflects loans and advances as a percentage of total banking-sector assets. Loans and advances represented more than 80 per cent of total banking-sector assets throughout 2007, amounting to 83,4 per cent at the end of December 2007, compared with 83,6 per cent at the end of December 2006.

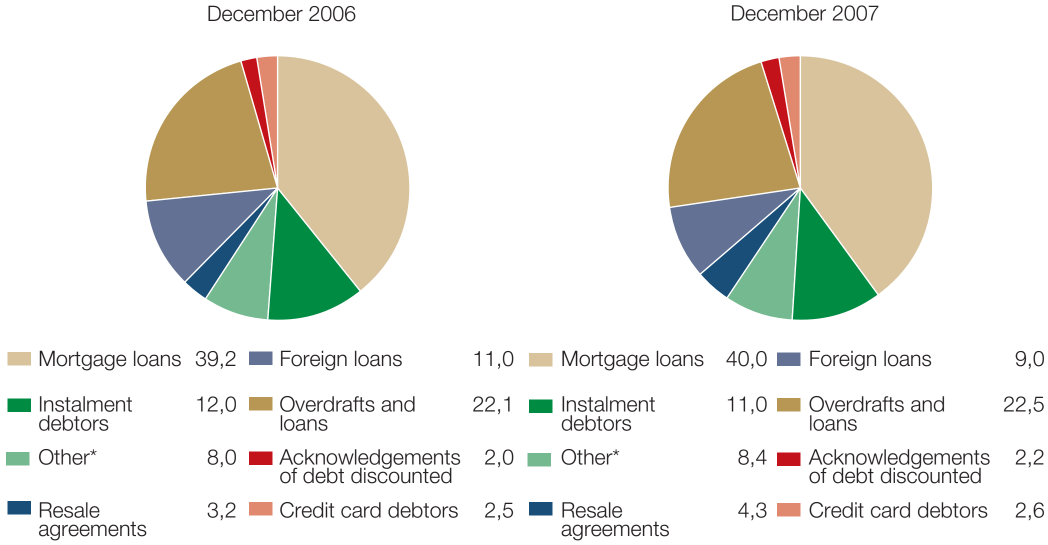
Figure 8 Loans and advances as a percentage of total assets



4.1.4 Loans and advances

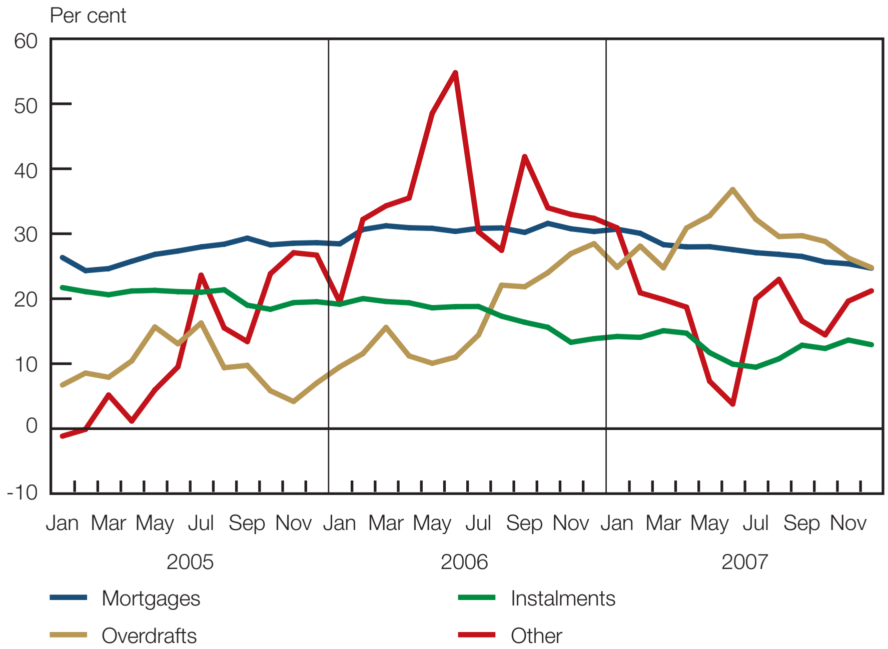
A comparison of the composition of loans and advances between December 2006 and December 2007 is illustrated in Figure 9. The differing growth rates of loans and advances (as depicted in Figure 10) resulted in the changes to the composition during 2007.

Figure 9 Composition of loans and advances (year-on-year comparison)



* Interbank loans and advances, redeemable preference shares and negotiable certificates of deposit

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



Mortgage loans, and overdrafts and loans represented the largest portions of loans and advances, amounting to 40,0 per cent and 22,5 per cent respectively at the end of December 2007 (December 2006: 39,2 per cent and 22,1 per cent).

mortgage loans represented the largest portions of loans and advances

Instalment debtors, foreign-currency loans and advances, and other loans (including interbank loans and advances, redeemable preference shares and NCDs) constituted 11,0 per cent, 9,0 per cent and 8,4 per cent of loans and advances respectively at the end of December 2007. Resale agreements, credit card debtors and acknowledgements of debt discounted represented smaller portions amounting to 4,3 per cent, 2,6 per cent and 2,2 per cent respectively at the end of December 2007.

growth rate of selected loans and advances

The year-on-year growth rates of selected components of loans and advances were as follows:

- Mortgage loans increased from R680,9 billion at the end of December 2006 to R849,0 billion at the end of December 2007, representing an annual growth of 24,7 per cent (December 2006: 30,3 per cent). Even though the growth rate in mortgage loans slowed down during 2007, mortgage loans as a percentage of total loans and advances increased slightly, indicating strong growth in comparison with other asset classes.
- Overdrafts and loans increased from R383,5 billion at the end of December 2006 to R478,5 at the end of December 2007, representing an annual growth of 24,8 per cent (December 2006: 28,5 per cent). The growth rate peaked at 36,8 per cent in June 2007 and subsequently began to decline.
- Instalment debtors increased from R207,4 billion at the end of December 2006 to R234,2 billion at the end of December 2007, representing an annual growth of 12,9 per cent (December 2006: 13,9 per cent). Instalment debtors grew at a steady pace during 2007. However, the growth was somewhat distorted by securitisation transactions that occurred during the year.
- Foreign-currency loans and advances decreased slightly from R191,7 billion at the end of December 2006 to R190,4 billion at the end of December 2007, representing a negative annual growth rate of 0,7 per cent. This asset class fluctuates on a monthly basis and is not trend specific.
- Interbank loans and advances increased from R91 billion at the end of December 2006 to R122,4 billion at the end of December 2007, representing an annual increase of 34,5 per cent (December 2006: 26,0 per cent).
- Credit card loans increased from R43,9 billion at the end of December 2006 to R55,1 billion at the end of December 2007, representing an annual growth of 25,5 per cent (December 2006: 40,8 per cent).

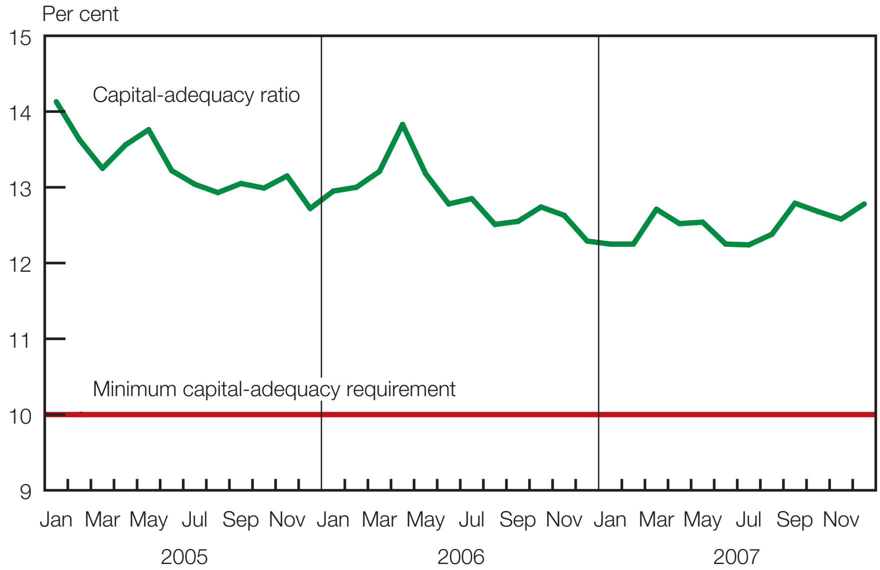
4.2 Capital adequacy

The capital-adequacy ratio, that is, the ratio of a bank's capital to its risk-weighted assets, for the banking sector remained fairly stable during 2007, fluctuating between 12,24 per cent at the lowest level (July 2007) and 12,79 per cent at the highest level (September 2007).

capital-adequacy ratio remained well above minimum requirement

The minimum required capital-adequacy ratio prescribed for South African banks and bank controlling companies was 10 per cent until the end of December 2007. Banks maintain a capital level to allow for some absorption of losses when they occur. As portrayed in Figure 11 the capital-adequacy ratio of the banking sector remained well above the 10 per cent minimum requirement during 2007, increasing from 12,29 per cent in December 2006 to 12,78 per cent in December 2007. The net qualifying capital increased from R153,5 billion in December 2006 to R196,1 billion in December 2007

Figure 11 Capital-adequacy ratio



(27,8 per cent annual increase), whereas the total risk-weighted assets (including assets and off-balance-sheet items) increased from R1 248 billion to R1 535 billion (22,9 per cent annual increase).

net qualifying capital increased by 27,8 per cent

An analysis of the percentage distribution of banks in terms of capital adequacy at the end of December 2007 (refer to Figure 12a) indicates that there were no banks that reported capital-adequacy ratios below the minimum requirement of 10 per cent. At the end of December 2007, 39,4 per cent of banking institutions had capital-adequacy ratios that exceeded 20 per cent (42,4 per cent at the end of December 2006). The percentage of banks with capital-adequacy ratios between 10 and 12 per cent remained at 21,2 per cent, that is, at the end of December 2006 and December 2007.

Figure 12a Distribution of banks in terms of capital adequacy

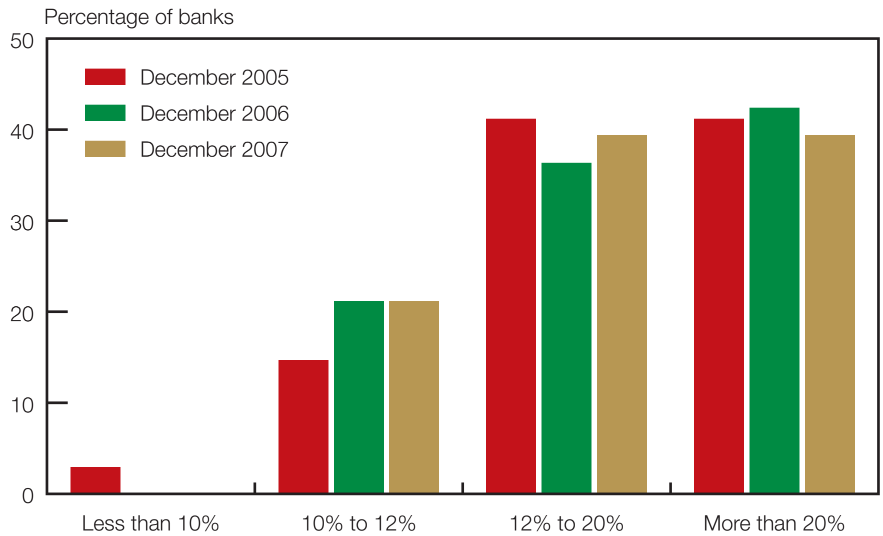


Figure 12b represents the sector distribution in terms of capital-adequacy ratios for December 2007. As a percentage of total banking-sector assets, 64,3 per cent of the assets belonged to banks that had capital-adequacy ratios between 10 and 12 per cent (21,2 per cent of banking institutions). Banks that reported capital-adequacy ratios between 12 and 20 per cent (i.e., 39,4 per cent of the institutions) held 30,9 per cent of the total banking-sector assets. Banks that reported capital-adequacy ratios above 20 per cent (i.e., 39,4 per cent of the institutions) owned 4,9 per cent of the total banking-sector assets.

Figure 12b Capital-adequacy ratios – sector distribution (December 2007)

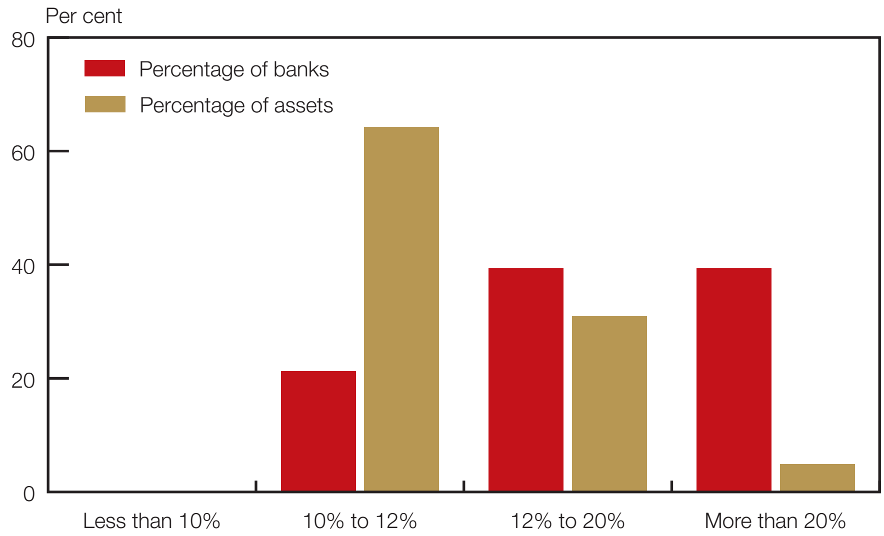
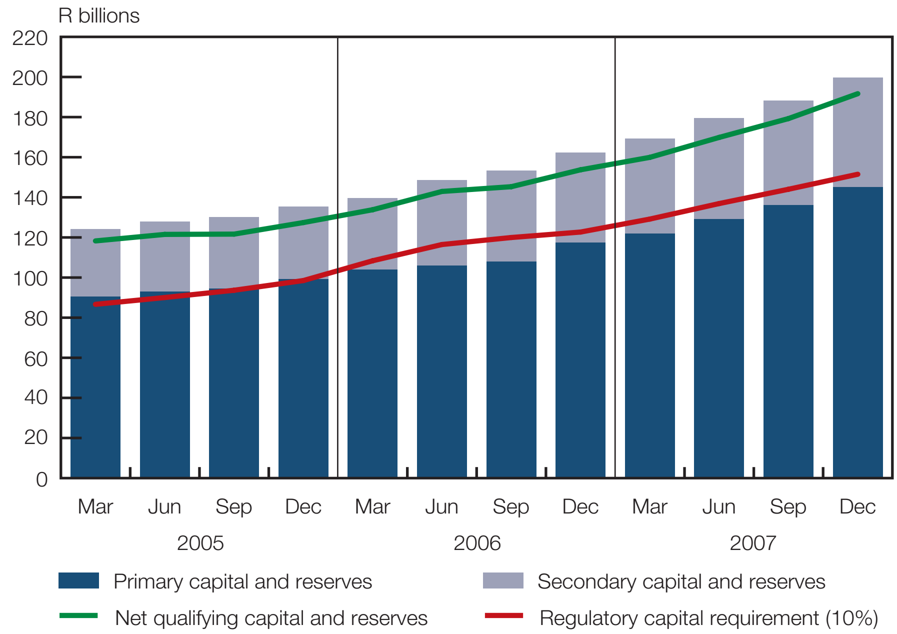


Figure 13 reflects the quarterly average monetary values of primary capital and reserves, secondary capital and reserves, net qualifying capital and reserves, and the regulatory capital requirement. Primary capital and reserves increased from R117,5 billion in

Figure 13 Qualifying capital and reserves



December 2006 to R145,0 billion in December 2007 (23,4 per cent annual increase) and constituted 72,6 per cent of total primary and secondary capital and reserves (before impairments) at the end of December 2007.

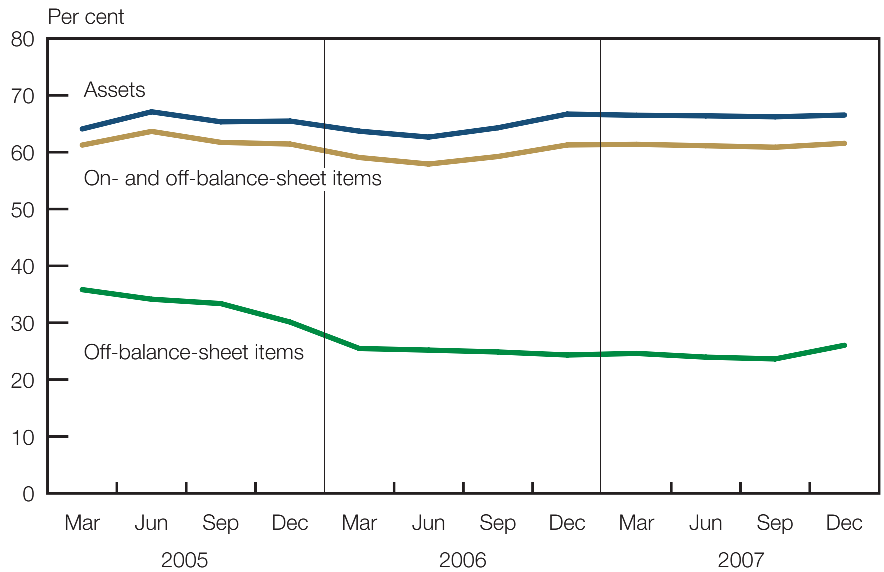
Secondary capital and reserves increased by 22,4 per cent to R54,7 billion at the end of December 2007 (R44,7 billion at the end of December 2006). Primary and secondary capital increased in line with total assets during 2007.

Figure 13 also confirms that the net qualifying capital and reserves exceeded the 10 per cent minimum requirement throughout the period under review.

4.2.1 Risk profile

Figure 14 displays the on- and off-balance-sheet items from a risk-weighted perspective. The risk-weighted percentage of total assets decreased slightly from 66,7 per cent in December 2006 to 66,5 per cent in December 2007. The risk-weighted percentage of off-balance-sheet items increased from 24,3 per cent in December 2006 to 26,0 per cent in December 2007, which resulted in a slight increase in the combined risk-weighted percentage of on- and off-balance sheet items from 61,3 per cent in December 2006 to 61,6 per cent in December 2007.

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



4.3 Profitability

Banks' profitability remained favourable during 2007, due to strong asset growth.

profitability remained favourable

For 2007 the total income, an aggregation of net interest turn (interest income less interest expense) and non-interest income (income derived from investment and trading positions, from assets repossessed, net mark-to-market adjustments and fee income), amounted to R130,0 billion compared with R106,9 billion at the end of December 2006, representing an annual growth of 21,6 per cent. Total net income after taxation increased from R26,4 billion at the end of December 2006 to R31,8 billion at the end of December 2007 (20,6 per cent year-on-year increase).

income emanated primarily from intermediation

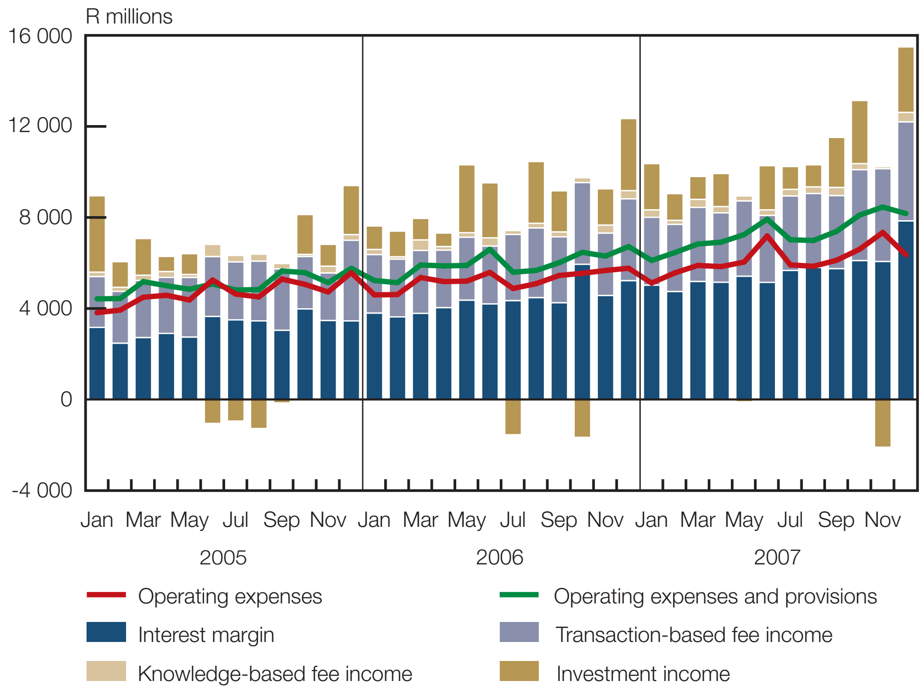
A breakdown of the main income statement components is presented in Figure 15. Income realised by banks during 2007 emanated primarily from the intermediation function. The intermediation function comprises interest margin and transaction-based fee income, and amounted to R108,5 billion at the end of December 2007 (December 2006: R87,1 billion). The interest margin increased from R52,6 billion at the end of December 2006 to R67,9 billion at the end of December 2007, representing 2,7 per cent of total assets at the end of December 2007. Transaction-based fee income increased by R6,1 billion, amounting to R40,6 billion at the end of December 2007 (December 2006: R34,5 billion). At the end of December 2007, transaction-based fee income constituted 1,6 per cent of total assets.

The income of R108,5 billion derived from the intermediation function during 2007 exceeded the sum of operating expenses and provisions, which amounted to R87,6 billion. Knowledge-based fee income, and investment and trading income amounted to R3,3 billion and R15,2 billion respectively at the end of December 2007, constituting 0,1 per cent and 0,6 per cent of total assets.

Interest income increased by 43,4 per cent at the end of December 2007 compared with the 28,6 per cent annual growth measured at the end of December 2006. The high growth in interest income during 2007 is attributable to the high interest income realised from mortgage loans and overdrafts and loans, constituting 40,1 per cent and 23,5 per cent of total interest income respectively at the end of December 2007 (December 2006: 38,7 per cent and 23,1 per cent).

The growth in interest expense also remained high during 2007. By the end of December 2007, interest expense had increased by 51,2 per cent compared with 24,7 per cent at the end of December 2006. The high interest expense is ascribed to the high interest paid on fixed and notice deposits, and demand deposits of 30,6 per cent and 29,1 per cent of total interest expenses respectively at the end of December 2007. The turn in the interest-rate cycle, following the 400-basis-point increase since the start

Figure 15 Composition of the income statement



of 2006, contributed considerably to the increasing trend in both interest income and interest expense.

The high growth in interest expense during 2007 slowed down the growth in interest margin somewhat. The interest margin increased by 29,1 per cent at the end of December 2007 compared to 36,4 per cent at the end of December 2006.

high growth in interest expense slowed down the growth in interest margin

Figure 16 depicts the interest margin of the banking sector whereas Figure 17 depicts the monthly percentage-point change in the components of the interest margin. As illustrated in Figure 16, the interest margin was steady in the region of 3 per cent throughout 2007. However, the interest margin increased from 3,3 per cent at the end of November 2007 to 4,3 per at the end of December 2007, due to a significant increase

Figure 16 Interest margin

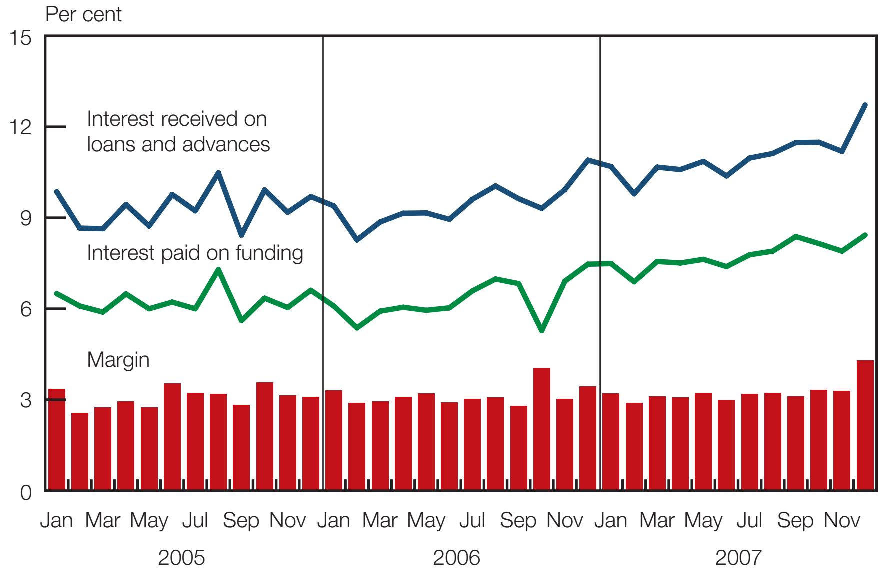
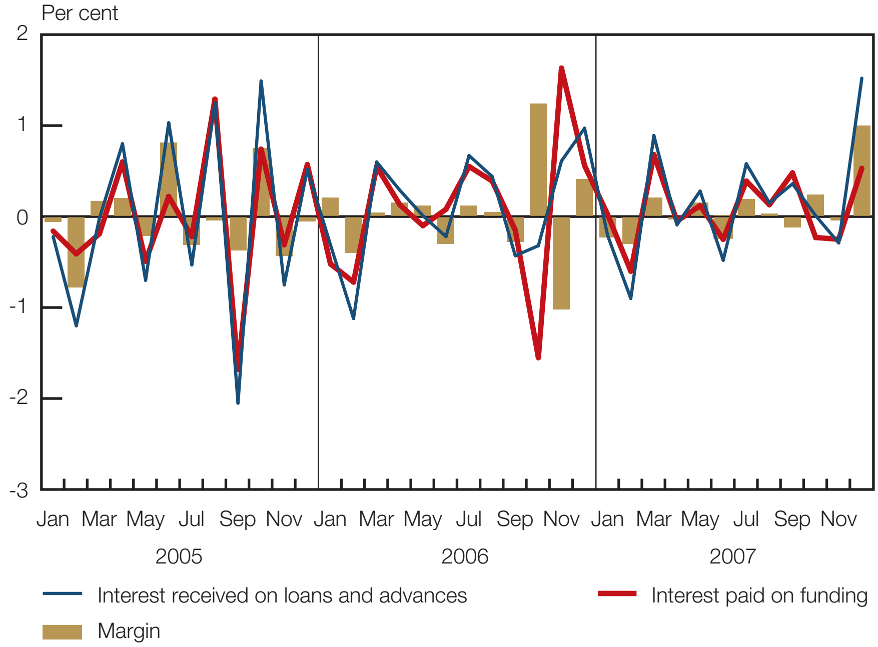


Figure 17 Percentage-point change in interest margin (month on month)



in interest income reported by a large bank, resulting from a reporting refinement exercise that occurred as a one-off year-end adjustment. The amount was reallocated from non-interest income and therefore had no impact on the net income after tax amount reported.

staff expenses accounted for 51,2 per cent of total operating expenses

Measured over a 12-month period, total banking-sector operating expenses (excluding bad debts written off) increased by 17,6 per cent at the end of December 2007 compared with 11,8 per cent at the end of December 2006, mainly as a result of an increase of 17,1 per cent in total staff expenses, which accounted for 51,2 per cent of total operating expenses in December 2007 (December 2006: 51,3 per cent).

Administrative and other expenses, and marketing and communications expenditure also contributed to the increase in operating expenses during 2007. Administrative and other expenses increased by 18,9 per cent and represented 38,8 per cent of total operating expenses at the end of December 2007. Marketing and communications expenses grew by 18,5 per cent at the end of December 2007 and contributed 5,5 per cent to total operating expenses.

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 increased from 15,2 per cent at the end of December 2006 to 17,1 per cent at the end of December 2007. The annual growth rate in the number of employees in the banking sector increased from 5,9 per cent at the end of December 2006 to 7,3 per cent at the end of December 2007. However, the annual growth rate in the number of branches decreased from 8,6 per cent at the end of December 2006 to 4,3 per cent at the end of December 2007. The average number of branches for 2006 amounted to 3 019 and increased to an average of 3 149 for 2007.

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

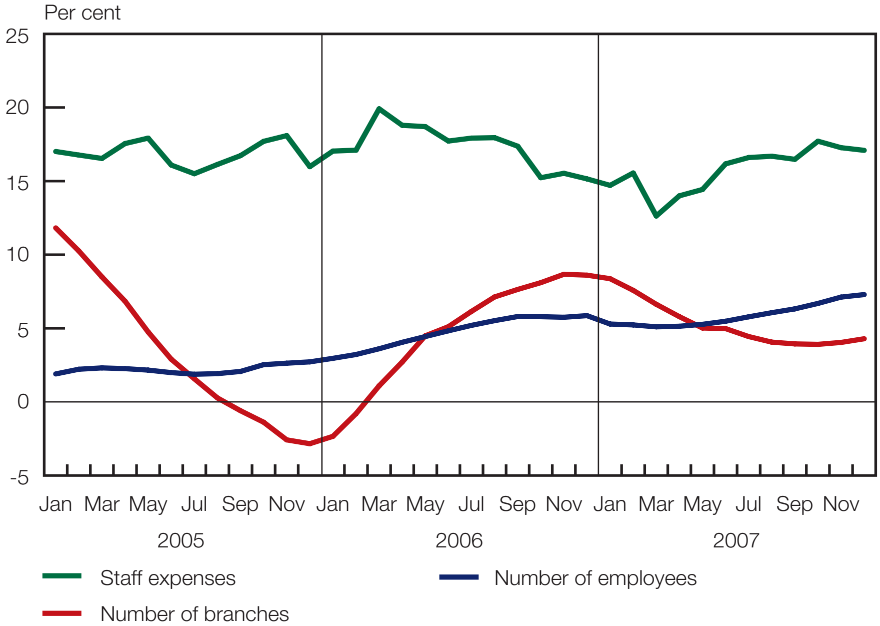
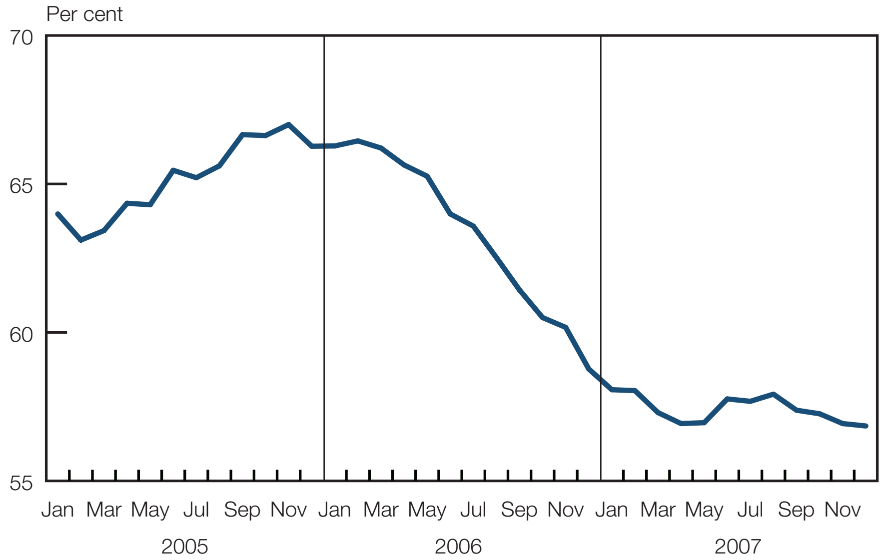


Figure 19 reflects the efficiency ratio of the South African banking sector (smoothed over a 12-month period). The efficiency ratio, also referred to as the ‘cost-to-income ratio’, is a measure that expresses the total operating costs incurred as a percentage of operating income. The efficiency ratio of the banking sector improved from 58,8 per cent at the end of December 2006 to 56,9 per cent at the end of December 2007, owing to a continued increase in total income. However, the ratio deteriorated somewhat between May 2007 and August 2007, as a result of high operating expenses.

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. The growth in total income slowed down during 2007, but remained at a higher level than the growth in operating expenses. Total income grew by 21,6 per cent at the end of December 2007, compared with 26,1 per cent at the end of December 2006. However, the growth in operating expenses increased during 2007, amounting to 17,6 per cent in December 2007 (December 2006: 11,8 per cent).

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

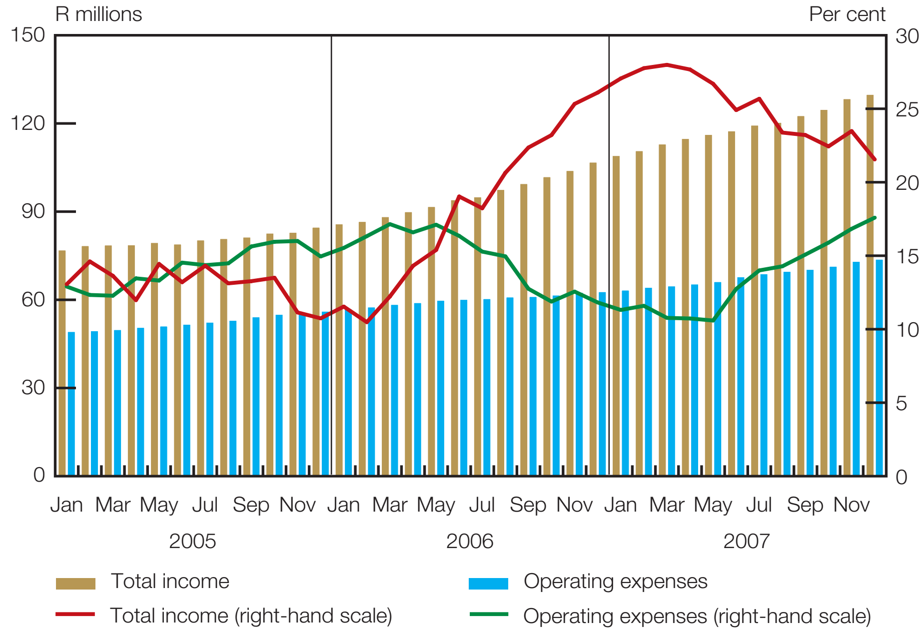
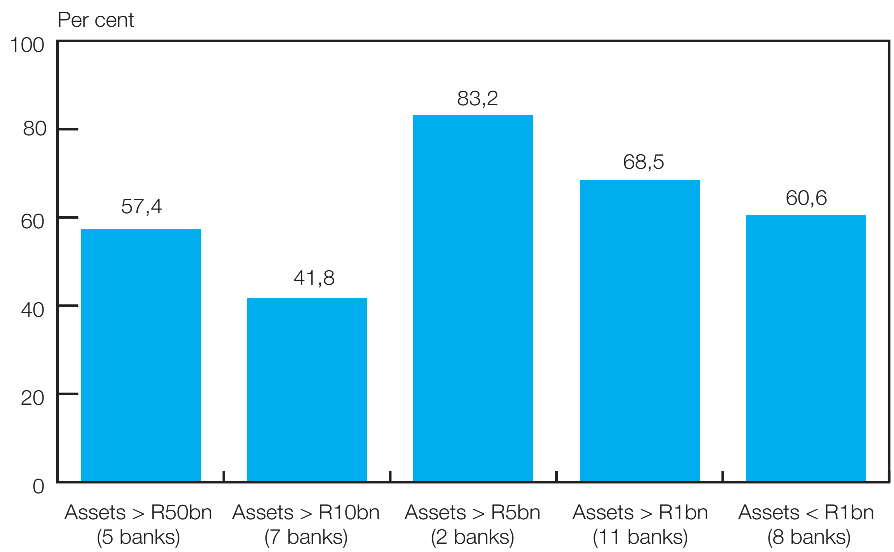


Figure 21 provides the efficiency ratio calculated for each asset-size category (12-month smoothed average). By the end of December 2007, banks with assets exceeding R10 billion, but below R50 billion, were the most efficient with an efficiency ratio of 41,8 per cent. Seven banks fell within this category. Banks with asset values greater than R50 billion (the five largest banks) had an efficiency ratio of 57,4 per cent at the end of December 2007. Banks with the asset values between R1 billion and R5 billion and asset values below R1 billion had efficiency ratios of 68,5 per cent and 60,6 per cent respectively. Two banks with asset values between R5 billion and R10 billion were least efficient, with an efficiency ratio of 83,2 per cent at the end of December 2007.

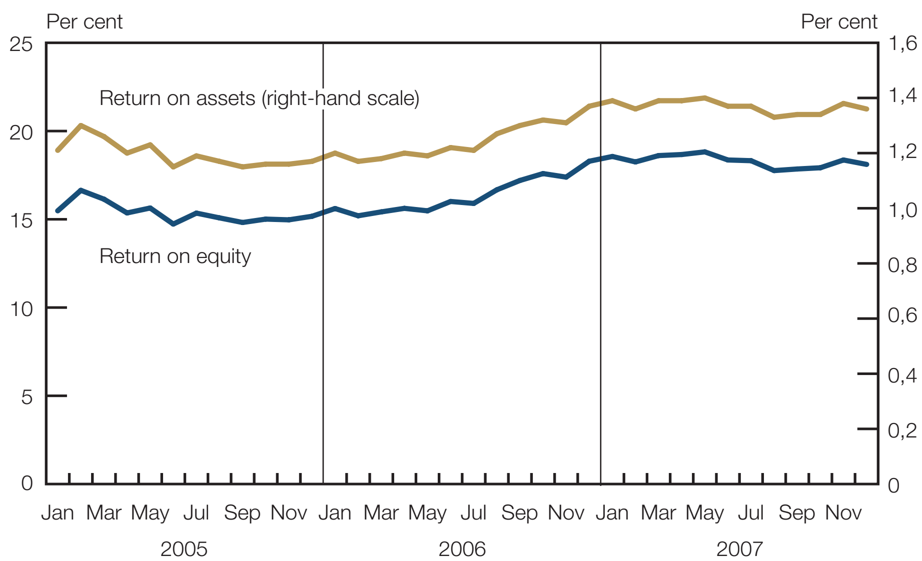
Figure 21 Efficiency of banking institutions according to asset value – 12-month smoothed average (December 2007)



ROE decreased slightly

Figure 22 portrays the profitability of banks using the return on equity (ROE) and return on assets (ROA) ratios. Both ratios remained favourable during 2007. The ROE

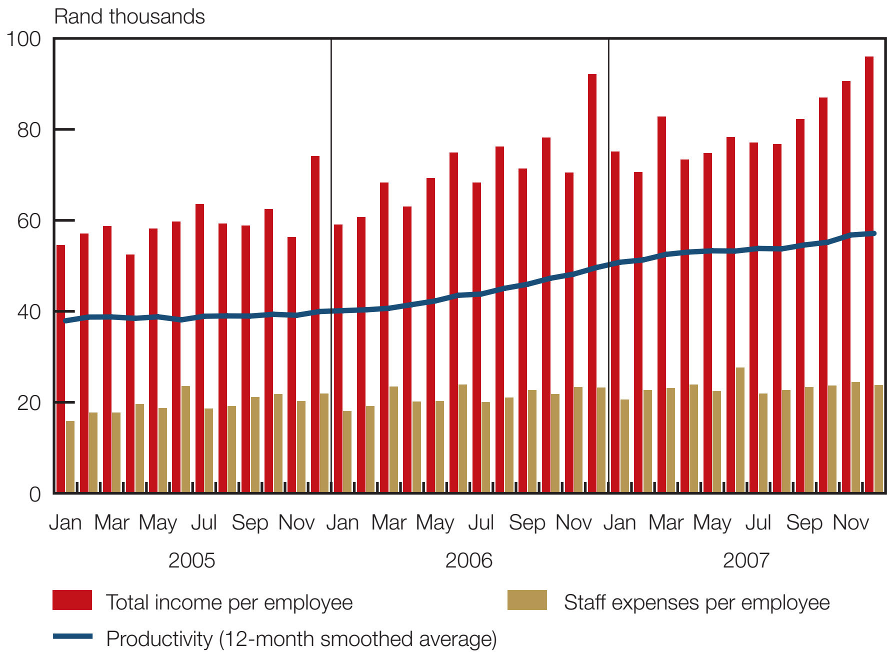
Figure 22 Profitability (12-month smoothed average)



decreased slightly from 18,3 per cent at the end of December 2006 to 18,1 per cent at the end of December 2007, while the ROA remained at 1,4 per cent at the end of December 2006 and December 2007. Total income continued to improve amid increasing operating expenses.

Figure 23 depicts the productivity of the banking sector measured by comparing the expenditure on employees to the amount of income generated. The total income generated per employee increased from R92 140 at the end of December 2006 to R96 017 at the end of December 2007. Total staff expenses per employee also increased from R23 224 at the end of December 2006 to R23 845 at the end of December 2007. The net income generated per employee, calculated on a 12-month smoothed basis increased to R57 142 at the end of 2007, compared with R49 650 for 2006.

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 one of the most important activities conducted at banks, and has gained increased attention as a result of the international sub-prime market turmoil and the effect it had on banks' liquidity.

liquidity is crucial to sustained viability

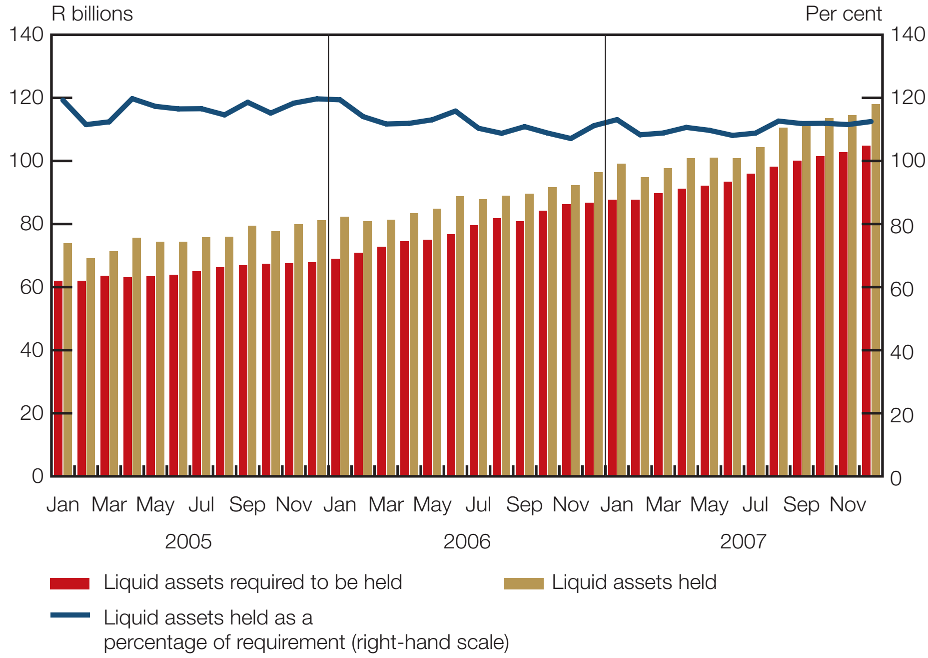
4.4.1 Statutory liquid-asset requirement

The statutory liquid-asset requirement is calculated as a percentage of adjusted liabilities. Refer to Appendix 6, Table 16, for the calculations of adjusted liabilities and the liquid-asset requirement.

banks' average liquid assets exceeded minimum requirement

Figure 24 presents the average daily amount of liquid assets held by banks compared with the statutory liquid-asset requirement. Throughout 2007, banks' average liquid assets exceeded the minimum liquid-asset requirement. The average daily amount of liquid assets held during December 2007 represented 112,5 per cent of the statutory liquid-asset requirement compared with 111,2 per cent held in December 2006.

Figure 24 Statutory liquid assets (actual versus required)



The liquid assets held consisted of the following assets:

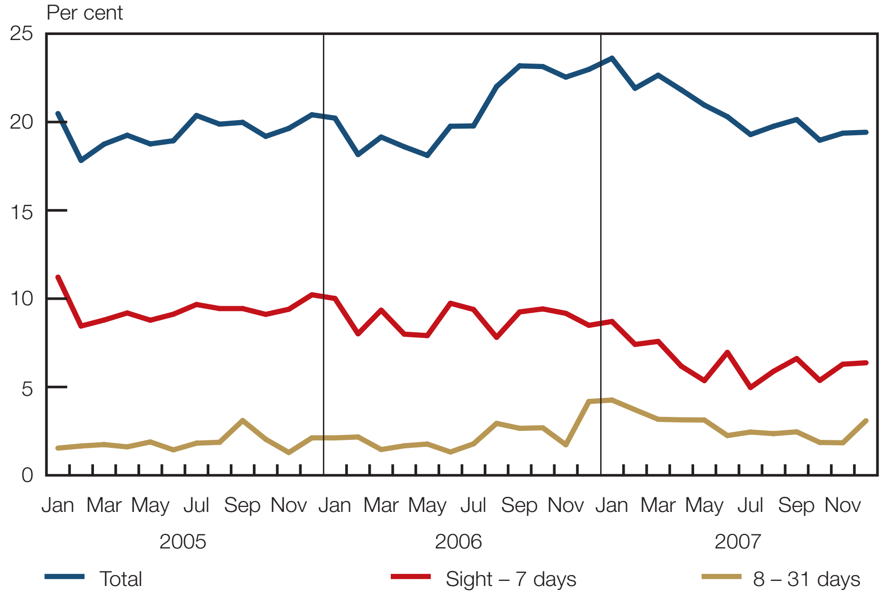
- Securities issued by virtue of section 66 of the Public Finance Management Act, 1999 represented 43,2 per cent of total liquid assets at the end of 2007, compared with the 45,6 per cent at the end of December 2006
- Treasury bills of the Republic of South Africa represented 38,9 per cent of total liquid assets at the end of December 2007, compared with 39,7 per cent at the end of December 2006
- Securities of the Bank amounted to 9,2 per cent of total liquid assets held at the end of December 2007, which is substantially higher than the 4,4 per cent reported at the end of December 2006
- South African Reserve Bank notes and coin held at the end of December 2007 constituted 8,3 per cent of total liquid assets held, compared with the 9,5 per cent held at the end of December 2006
- Short-term bills issued by the Land Bank represented 0,5 per cent of liquid assets at the end of December 2006 and December 2007.

Cash management schemes managed on behalf of bank clients increased by 13,6 per cent during 2007, amounting to R65,4 billion at the end of December 2007. Set-off increased substantially from R58,5 billion at the end of December 2006 to R131,3 billion at the end of December 2007 (annual increase of 124,7 per cent).

4.4.2 Volatility of funding

All banks are required to report the ten largest depositors on their respective balance sheets on a monthly basis. These amounts are aggregated and presented as a percentage of total funding in Figure 25.

Figure 25 Deposits from banks' ten largest depositors (as a percentage of total funding)

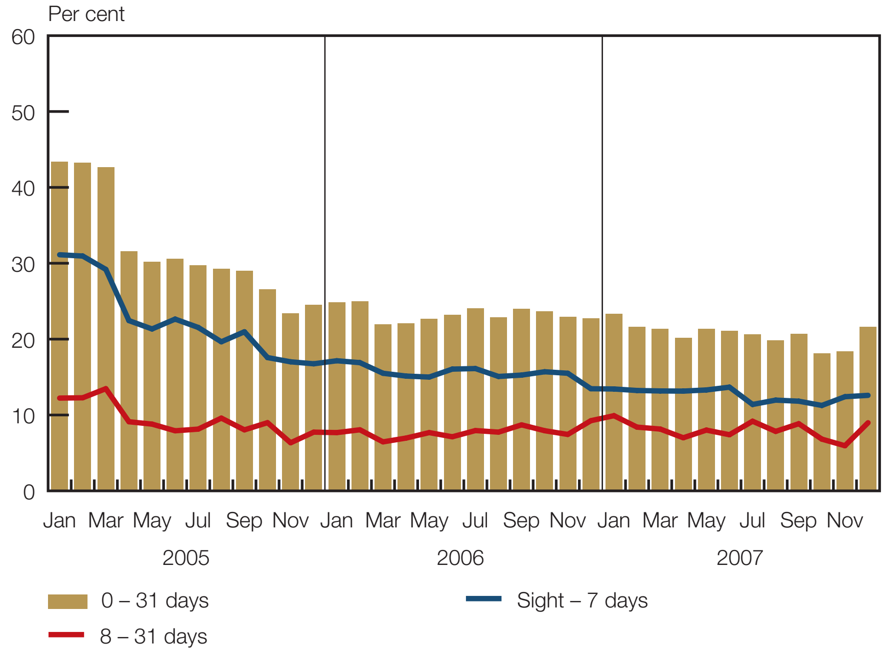


Growth in funding supplied by the ten largest depositors slowed down in 2007. The ten largest depositors represented 19,4 per cent of total funding at the end of December 2007 compared with 23 per cent at the end of December 2006. The largest depositors with a maturity within sight to 7 days and within 8 and 31 days constituted 6,4 per cent and 3,1 per cent of total funding respectively at the end of December 2007 (December 2006: 8,5 per cent and 4,2 per cent).

ten largest depositors represented 19,4 per cent of total funding

Figure 26 presents the maturity of short-term funding, as anticipated by the banks' ALCOs. The contractual maturities are adjusted by the ALCOs as an anticipated maturity per deposit.

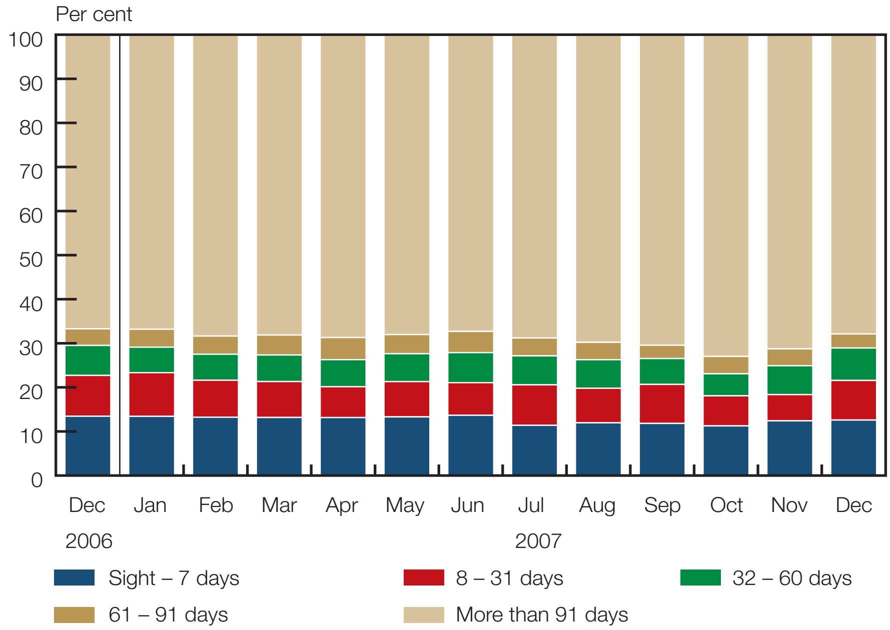
Figure 26 Anticipated maturity of short-term funding (as a percentage of total funding)



Total short-term funding (with an anticipated maturity of nil to 31 days) amounted to 21,6 per cent of total funding at the end of December 2007, compared with 22,7 per cent at the end of December 2006. Short-term funding with an anticipated maturity within sight to 7 days and within 8 to 31 days represented 12,6 per cent and 9,0 per cent of total funding respectively at the end of December 2007 (December 2006: 13,5 per cent and 9,3 per cent). Total short-term funding as a percentage of total funding declined at the end of October 2007, due to a decrease in short-term funding maturing within 8 to 31 days.

The anticipated maturity of total funding remained stable throughout 2007, as reflected in Figure 27. At the end of December 2007, deposits with an anticipated maturity longer than 91 days and deposits with an anticipated maturity shorter than 7 days constituted the largest portions of total funding, namely 67,9 per cent and 12,6 per cent respectively. Deposits with an anticipated maturity of 8 to 31 days constituted 9,0 per cent of total funding, with deposits with an anticipated maturity of 32 to 60 days, constituting 7,4 per cent. Deposits with an anticipated maturity of 61 to 91 days constituted the smallest portion of total funding, namely 3,2 per cent.

Figure 27 Anticipated maturity of total funding (composition)



4.5 Derivative contracts

Derivative contracts are financial instruments that derive their value from the value of underlying assets. The main types of derivative contracts are futures, options, forward contracts and swap agreements. Derivatives are mainly used as risk mitigants. Derivatives can be based on different types of assets such as commodities, equities, bonds, interest rates, exchange rates or indices.

Figure 28 portrays the turnover in derivative contracts in terms of the gross notional long and short positions. As depicted, the turnover in forward contracts is the main contributor to total derivative turnover in the banking sector and amounted to R2 189,5 billion for December 2007 (R1 879,0 billion for December 2006). The remainder of the turnover in derivative contracts amounted to R1 527,4 billion for December 2007 (R737,5 billion for December 2006).

Turnover in derivative contracts can fluctuate substantially from month to month. As can be seen in Figure 28, the turnover increased to higher levels for the period from June 2007 to October 2007 mainly due to an increase in trading volumes as a result of increased volatility, increased client demand, and market conditions such as anticipated interest-rate hikes and so forth.

turnover in derivative contracts fluctuated

Figure 28 Turnover in derivative contracts

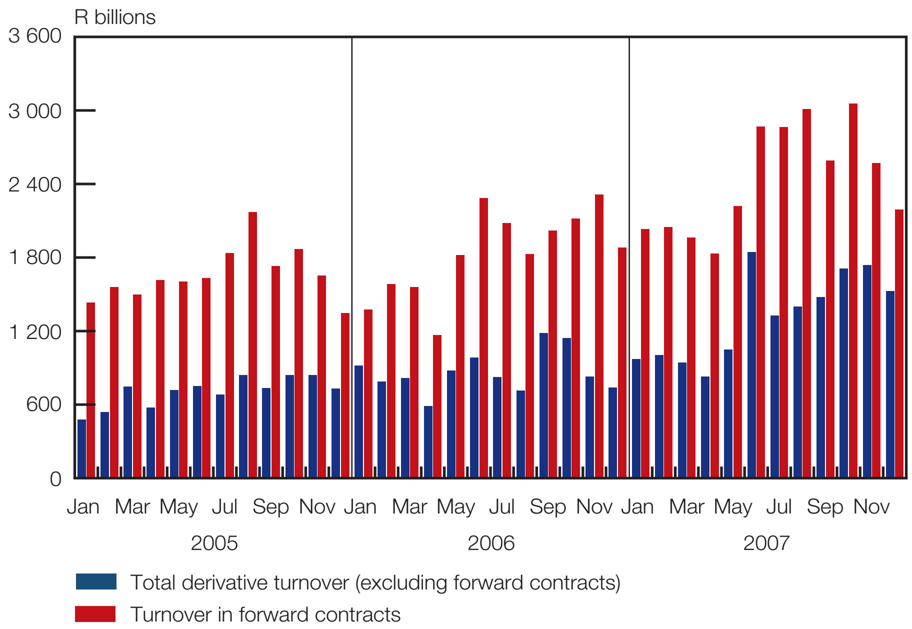
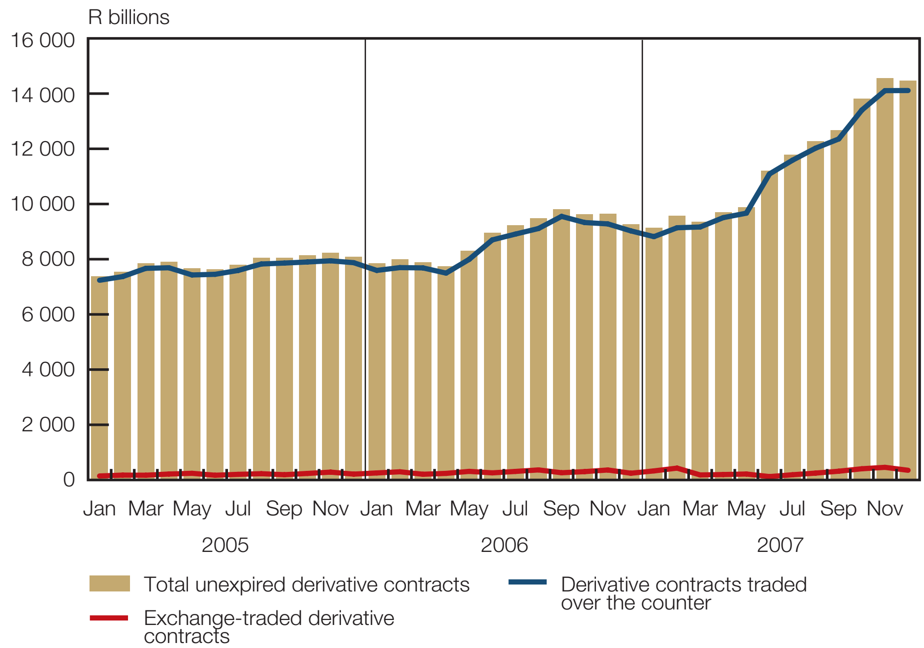


Figure 29 portrays the gross notional value of total unexpired derivative contracts. Derivative contracts traded over the counter (OTC) as a percentage of total unexpired contracts increased marginally from 97,4 per cent at the end of December 2006 to 97,6 per cent at the end of December 2007.

Figure 29 Total unexpired derivative contracts



Total unexpired derivative contracts increased from R9 270,7 billion in December 2006 to R14 463,2 billion in December 2007, amounting to a 56-per-cent annual increase as a result of the increase in OTC contracts. Total unexpired derivative contracts as a percentage of total banking assets increased from 446,7 per cent at the end of December 2006 to 567,9 per cent at the end of December 2007.

4.6 Credit risk

overdue ratios deteriorated

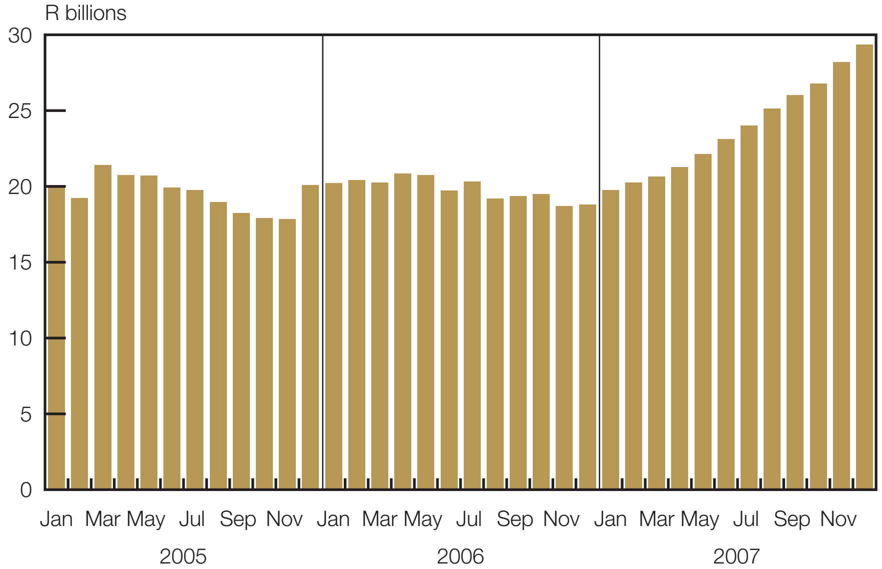
Credit risk was a key focus area for the banking sector throughout 2007. The growth in overdues exceeded the growth in total assets and, as a result, the overdue ratios deteriorated. The increase in interest rates, together with other adverse developments in the South African and international economic environments, contributed to the deterioration of the credit risk ratios. During 2007 the repurchase rate increased by 200 basis points (cumulatively) as announced by the Monetary Policy Committee of the South African Reserve Bank, following the cumulative 200-basis-point increase experienced in 2006. The impact of these interest-rate increases, together with the global credit turmoil will continue to be monitored closely by the Department during 2008.

4.6.1 Analysis of amounts overdue (non-performing loans)

gross overdues increased by 56,4 per cent

The monetary value of gross overdues (non-performing loans that have been overdue for a period longer than 180 days) is reflected in Figure 30. Gross overdues increased by 56,4 per cent, from R18,8 billion in December 2006 to R29,4 billion in December 2007.

Figure 30 Total overdues



Net overdues (gross overdues less specific provisions) as a percentage of net qualifying capital and reserves increased from 5,6 per cent in December 2006 to 8,3 per cent in December 2007 (refer to Figure 31). The higher ratio was mainly owing to the substantial increase in gross overdues during 2007. At the end of December 2007 net overdues amounted to R16,2 billion, up from the R8,6 billion at the end of December 2006. Specific provisions increased from R10,2 billion at the end of December 2006 to R13,2 billion at the end of December 2007, amounting to a 28,7 per cent annual increase at the end of December 2007.

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

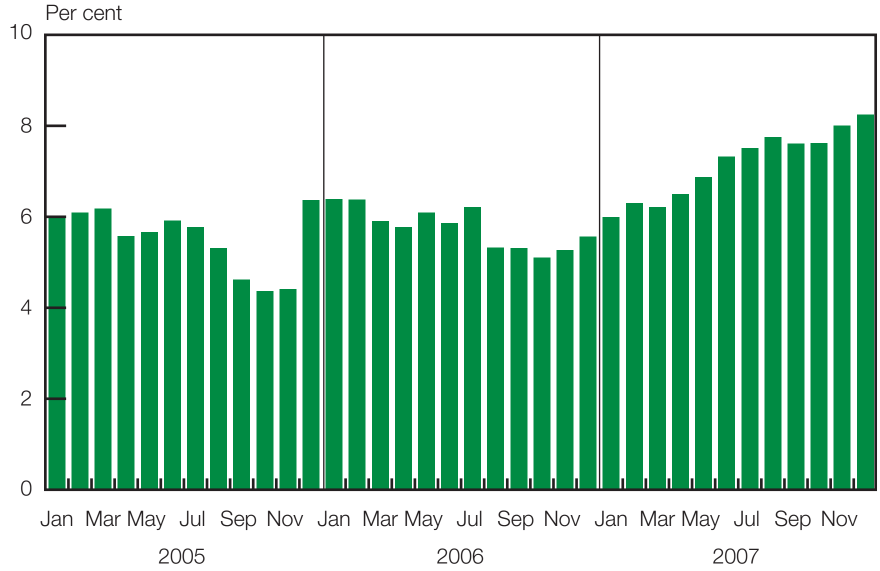
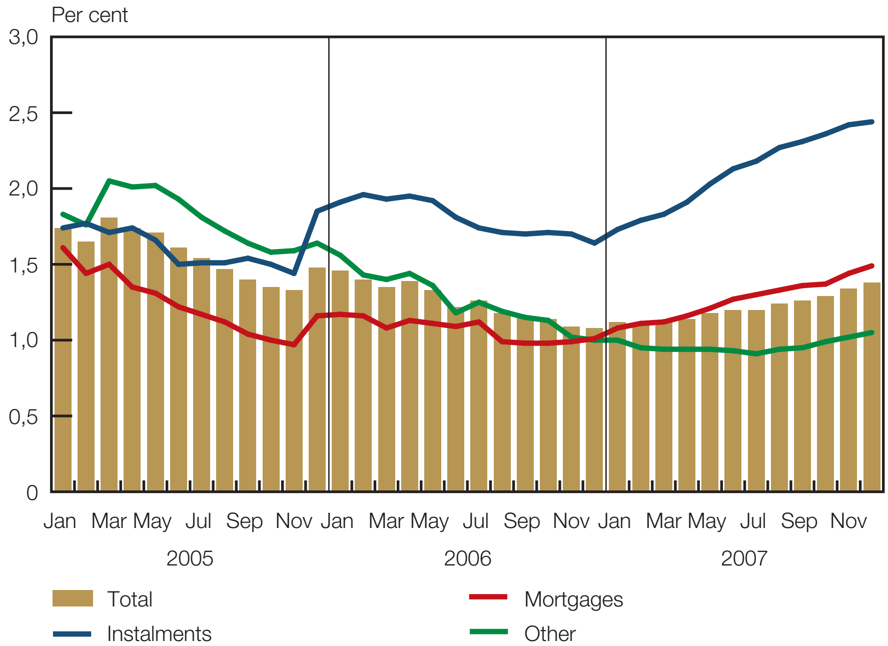


Figure 32 depicts that gross amounts overdue as a percentage of total loans and advances increased from 1,1 per cent at the end of December 2006 to 1,4 per cent at the end of December 2007.

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



Overdue amounts in respect of mortgage loans and instalment debtors were the main contributors to the higher total overdue ratio as outlined below:

- Mortgage loans overdue expressed as a percentage of total mortgage loans deteriorated from 1,0 per cent at the end of December 2006 to 1,5 per cent at the end of December 2007

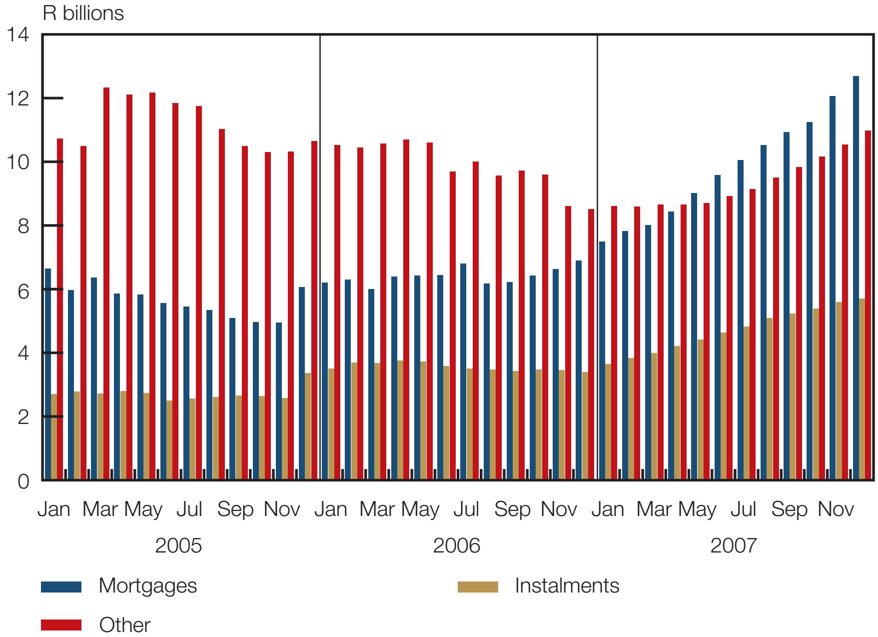
- Expressed as a percentage of total instalment debtors, instalment debtors overdue increased from 1,6 per cent at the end of December 2006 to 2,4 per cent at the end of December 2007
- Other loans and advances overdue expressed as a percentage of total other loans and advances increased slightly from 1,0 per cent at the end of December 2006 to 1,1 per cent at the end of December 2007.

monetary value of gross overdues

A breakdown of the monetary value of gross overdues according to the different asset categories is presented in Figure 33. Gross amounts overdue in respect of mortgage loans increased significantly from R6,9 billion in December 2006 to R12,7 billion in December 2007, now exceeding other loans and advances overdue. The increase in the mortgage loans overdue was mainly a result of increased interest rates.

Other loans and advances overdue increased from R8,5 billion at the end of December 2006 to R11,0 billion at the end of December 2007, while instalment debtors overdue increased from R3,4 billion in December 2006 to R5,7 billion in December 2007.

Figure 33 Analysis of overdues



4.6.2 Provisioning

banking sector adequately provided

In terms of the minimum regulatory provisioning requirements, the banking sector was adequately provided for throughout 2007.

Specific provisions and the market value of security held expressed as a percentage of gross overdues decreased from 100,7 per cent in December 2006 to 93,7 in December 2007 (refer to Figure 34) owing to the substantial increase in gross overdues as discussed above. Specific provisions as a percentage of gross overdues decreased from 54,5 per cent in December 2006 to 44,9 per cent in December 2007.

Specific provisions, expressed as a percentage of gross overdues per asset category, amounted to the following at the end of December 2007:

- Mortgage loans: 21,0 per cent (30,2 per cent on 31 December 2006)

- Instalment debtors: 45,7 per cent (57,7 per cent on 31 December 2006)
- Other loans and advances: 72,0 per cent (72,9 per cent on 31 December 2006).

Figure 34 Specific provisions and the market value of security held as a percentage of gross overdues

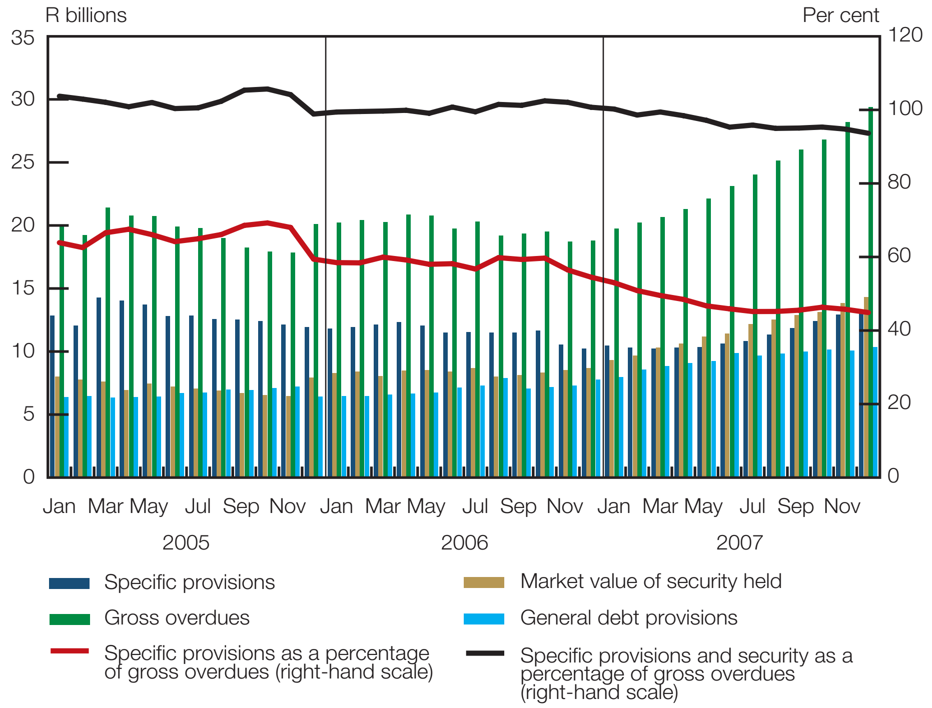
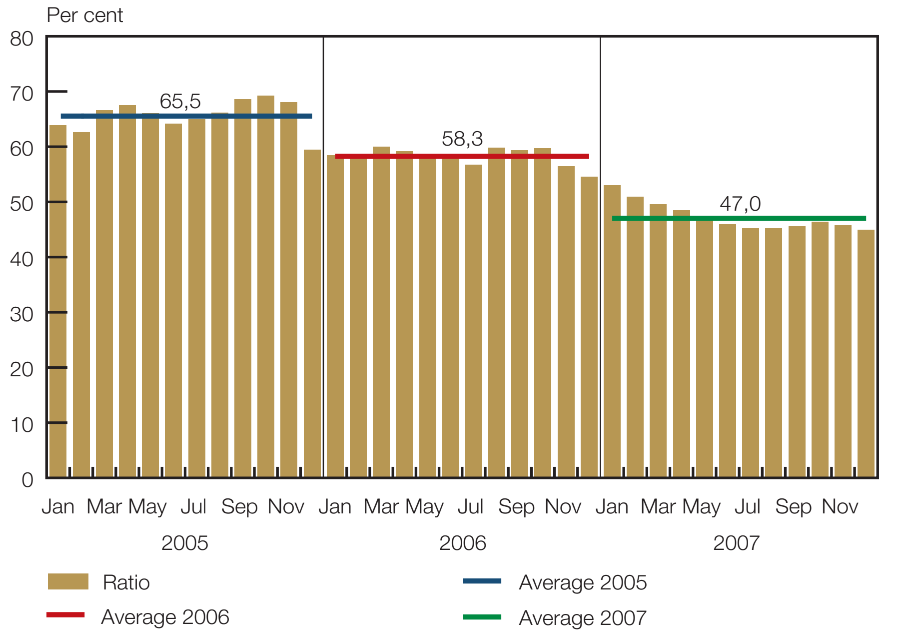


Figure 35 depicts specific provisions as a percentage of gross overdues from January 2005 to December 2007. On average, specific provisions as a percentage of gross overdues declined from an average of 65,5 per cent in 2005 to 58,2 per cent in 2006 and, thereafter, to 47,0 per cent in 2007. The ratio deteriorated sharply during the first

specific provisions as percentage of gross overdues declined

Figure 35 Specific provisions as a percentage of gross overdues



half of 2007 as specific provisions increased at a lower rate than that of gross amounts overdue. The main contributor to the deterioration was mortgage loans. The accounting impairments in terms of IFRS also contributed to the reduction in the specific provisioning ratio.

4.6.3 Large exposures

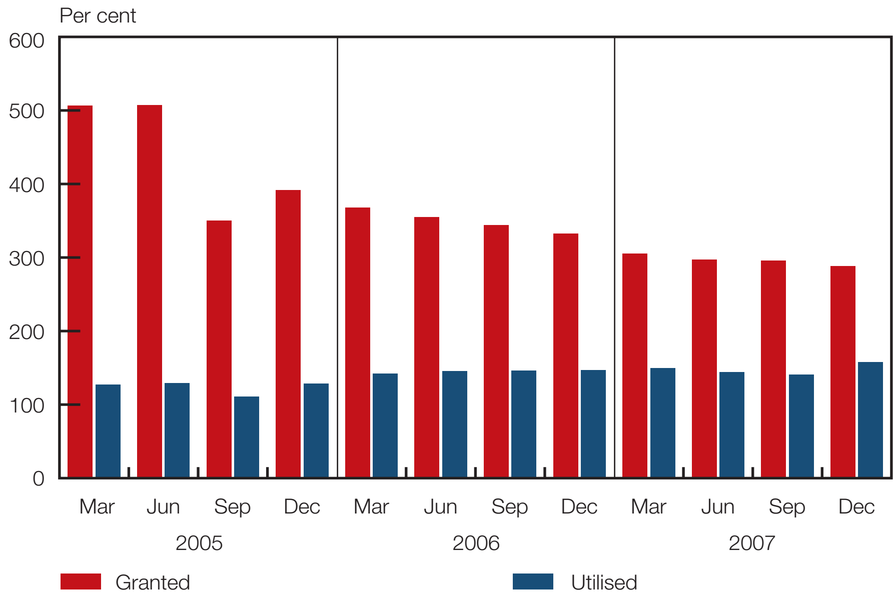
In terms of section 73(1)(b) of the Banks Act, 1990, exposures granted that exceed 10 per cent of qualifying capital and reserves (referred to as 'large exposures') should not exceed, in total, 800 per cent of qualifying capital and reserves, and any single exposure granted exceeding 25 per cent should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

As shown in Figure 36, large exposures granted as a percentage of net qualifying capital decreased from 332,9 per cent at the end of December 2006 to 288,4 per cent at the end of December 2007.

large exposures utilised increased

Large exposures utilised as a percentage of net qualifying capital and reserves increased from 147,2 per cent at the end of December 2006 to 157,9 per cent at the end of December 2007, mainly due to an increase in 'other exposures' (consists of exposures to government, public-sector exposures and exposures secured by cash deposits) and an increase in exposures to banks or regulated securities firms.

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

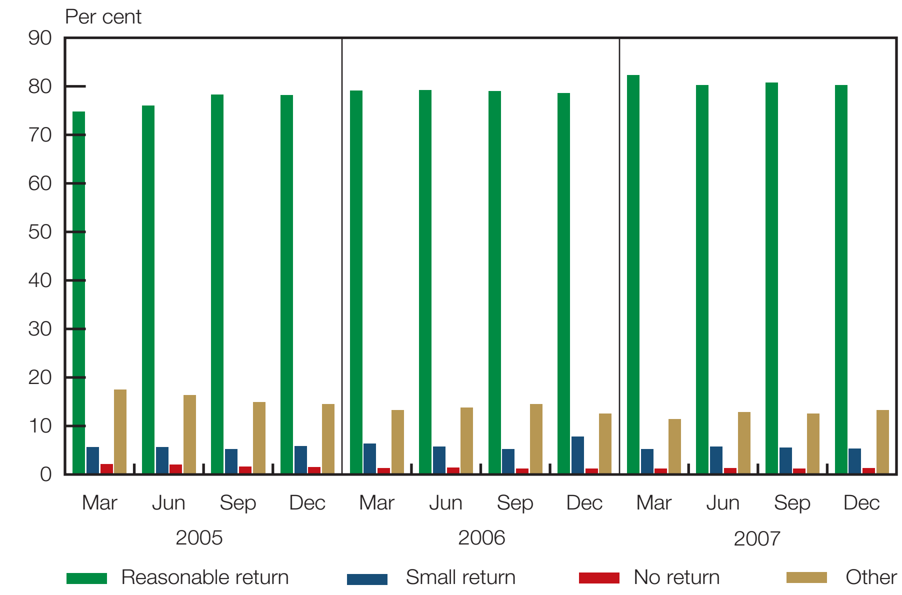


4.6.4 Quality of assets

Figure 37 indicates that 80,2 per cent of banking-sector assets earned a reasonable return at the end of December 2007, compared with the 78,6 per cent at the end of December 2006. The percentage of assets that earned a small return declined from 7,8 per cent at the end of December 2006 to 5,3 per cent at the end of December 2007, whereas 1,3 per cent earned no return (1,2 per cent at the end of December 2006).

Assets classified as 'other' amounted to 13,3 per cent of total assets at the end of December 2007 (12,5 per cent at the end of December 2006).

Figure 37 Asset performance

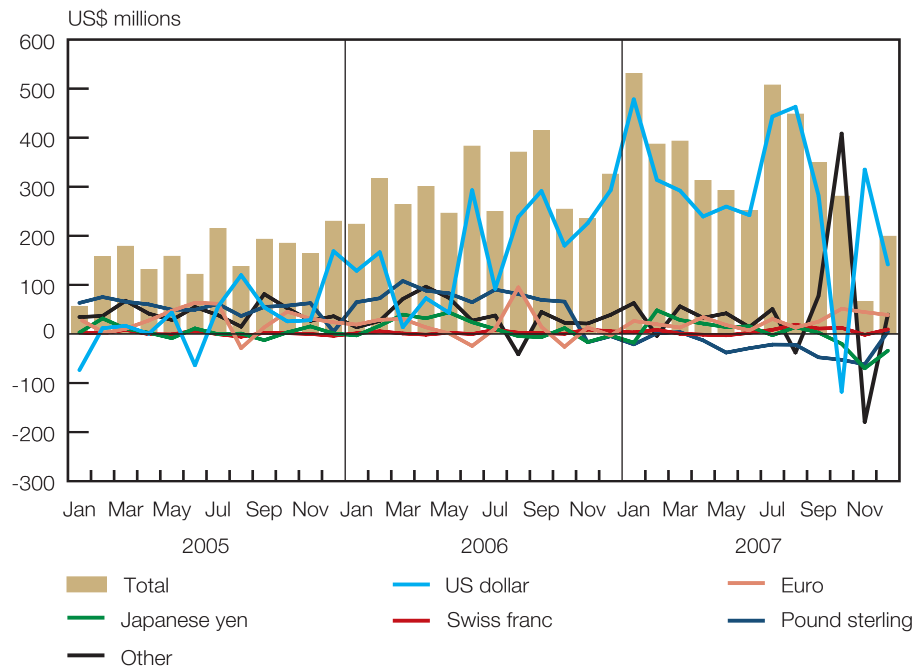


4.7 Currency risk

Figure 38 illustrates the total aggregated effective net open foreign-currency position, as well as the net open positions per currency. In general, the total aggregated effective net open foreign-currency position was higher during 2007 than in previous years, with substantial US dollar and 'other currency' fluctuations reported in October 2007 and November 2007. The US dollar positions continued to be the main contributors to the larger aggregated effective net open foreign-currency position.

US dollar positions continued to be main contributors

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



The total aggregated effective net open foreign-currency position increased from US$327,2 million in December 2006 to US$532,0 million in January 2007, its highest level reported in 2007, due to the US dollar positions increasing as a result of favourable market conditions. The lowest level was reported in November 2007 at US$66,6 million.

In October 2007 the net open position in 'other' currencies increased to US$408,3 million due to a transaction in Taiwanese dollar by one bank. The US dollar net open position equalled -US$117,7 million (short position) at the end of October 2007. The year ended with a total aggregated effective net open foreign-currency position amounting to US$200,2 million.

During 2007 the maximum effective net open foreign-currency position as a percentage of net qualifying capital and reserves remained well within the 10 per cent statutory limit, but generally fluctuated above the levels reported during 2006 (refer to Figure 39). As a percentage of net qualifying capital and reserves, the maximum effective net open foreign-currency position declined from 1,5 per cent in December 2006 to 1,1 per cent in December 2007, reaching its highest ratio at the end of April 2007, amounting to 3,3 per cent.

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

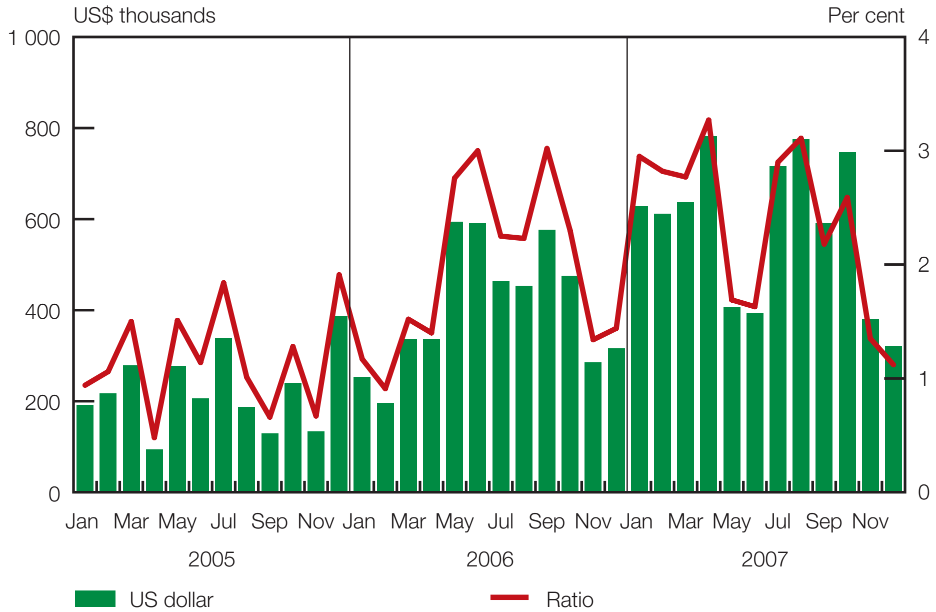
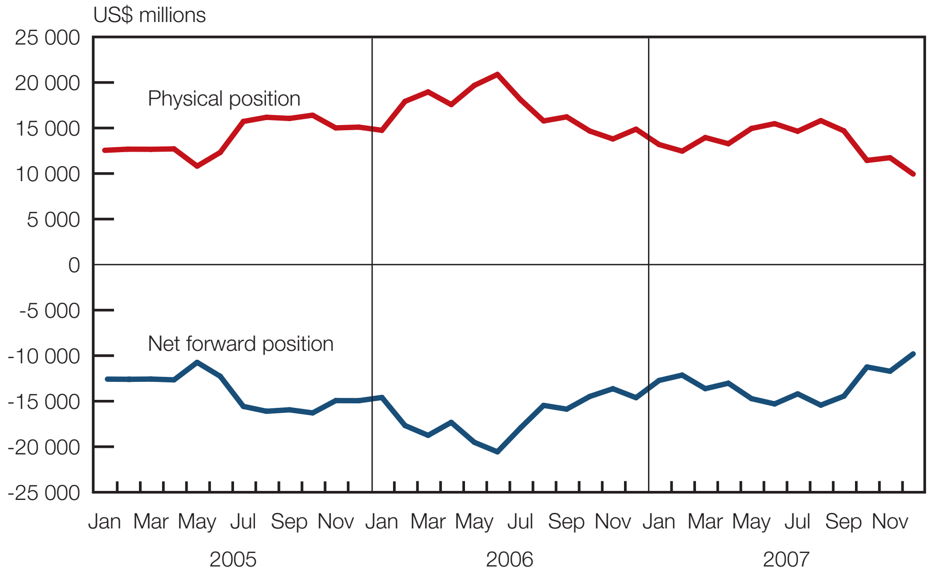


Figure 40 presents the position in foreign-currency instruments. The physical position equals the difference between foreign assets and foreign liabilities, whereas the net forward position is the difference between commitments to sell foreign currency and commitments to purchase foreign currency. The physical position decreased from US$14,9 billion in December 2006 to US$9,9 billion in December 2007, whereas the net forward short position decreased from US$14,6 billion in December 2006 to US$9,8 billion in December 2007. 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. During 2007, as in previous years, the net impact of the maturity ladder was small.

Figure 41 Maturity structure of forward contracts denominated in US dollar