

Chapter 3

Trends in South African banks

This chapter reflects the main trends and industry statistics that are apparent from the information received from registered banks.

Aggregated information of individual banks is contained in the reports and graphs in sections 3.1 to 3.7 below. Certain of the comparative figures in respect of 2002 may differ from those reported in the 2002 annual report, because banking institutions subsequently submitted amended returns.

comparative figures may differ from those in 2002 annual report

The reports and graphs that follow are largely affected by the position of the "big four" banks, which constituted 80,9 per cent of the banking sector in December 2003 (74,2 per cent in December 2002). The five largest banks constituted 87 per cent of the banking sector as at the end of December 2003 (80 per cent in December 2002).

3.1 Balance-sheet structure

The balance-sheet structure is analysed to determine the type and spread of a bank's business activities, as well as to consider the impact of changes thereto on the risk profile of the banking sector. The aggregated balance sheet of the banking sector in South Africa, as at 31 December 2003, equalled R1 377,6 billion, as opposed to R1 100,8 billion as at 31 December 2002 and R1 050 billion as at 31 December 2001.

type and spread of a bank's business activities

Figure 1: Aggregated balance sheet

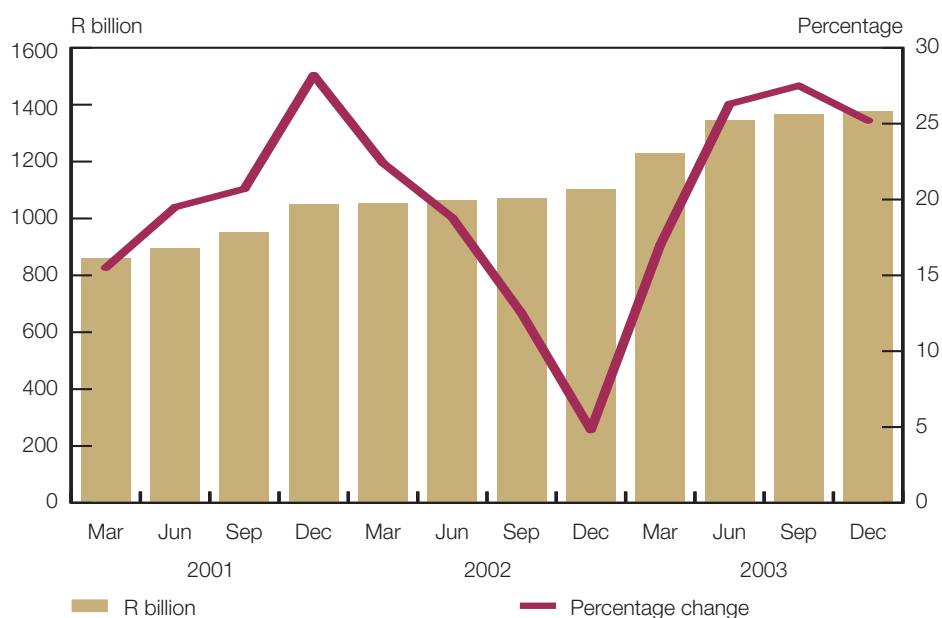


Figure 1 graphically depicts the quarter-end value of, and percentage growth (measured over 12 months) in, the aggregated balance sheet of the banking sector for the period from March 2001 to December 2003. From December 2001, when a growth rate of 28,2 per cent was recorded, growth in the aggregated balance sheet slowed down uninterruptedly until December 2002 (4,8 per cent). By the end of December 2003, however, growth in the aggregated balance sheet had increased to 25,2 per cent. The

growth in aggregated balance sheet increased to 25,2 per cent

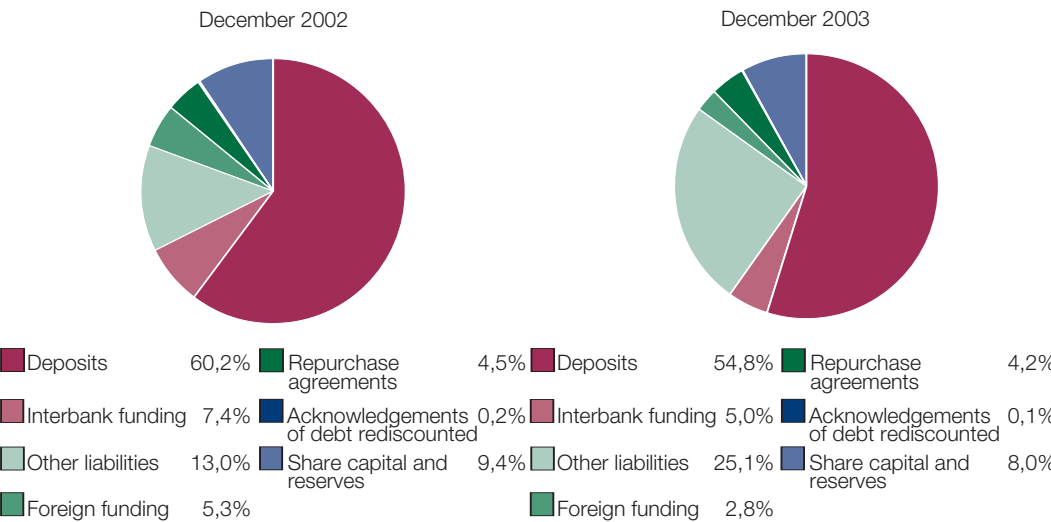
sharp increase in total assets was due to an amendment to the Regulations

sharp increase in total assets during the year under review was due to an amendment to the Regulations relating to Banks whereby banks were required, from 1 January 2003, to report their trading-book positions on the basis of gross values instead of net balances. By the end of January 2003, the net impact on the balance sheet of the total banking sector of the required reporting of gross, instead of net, asset values in respect of derivatives amounted to approximately R118 billion.

Liabilities

A year-on-year comparison of the composition of liabilities is reflected in figure 2.

Figure 2: Liabilities – year-on-year comparison



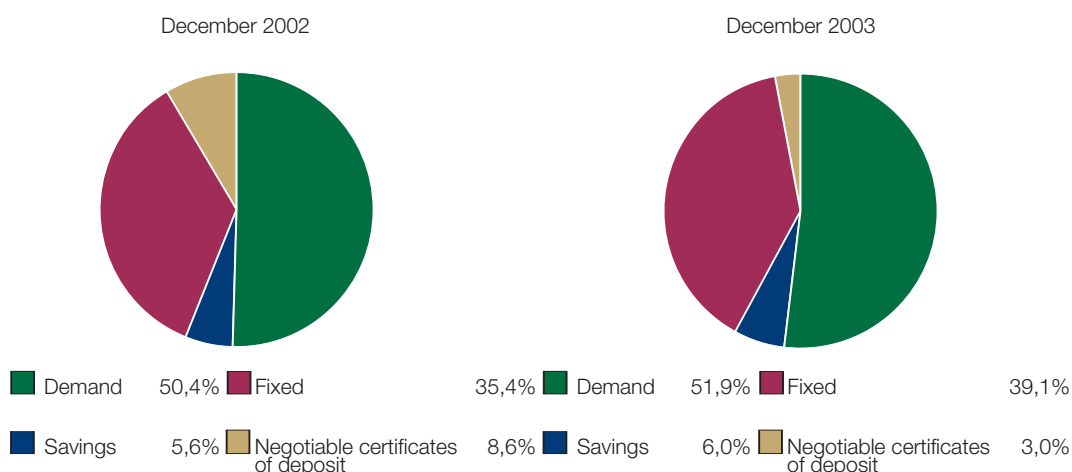
domestic deposits from the public remained the main source of funding

Domestic deposits from the public, in the amount of R755,7 billion, remained the main source of funding for the banking sector and constituted 54,8 per cent of total liabilities in December 2003, compared to 60,2 per cent in December 2002 and 56,1 per cent in December 2001. Foreign funding and interbank funding as a percentage of total liabilities, on the other hand, decreased from 5,3 per cent and 7,4 per cent in December 2002 to 2,8 per cent and 5 per cent in December 2003, respectively. Other liabilities, on the other hand, increased from 13 per cent in December 2002 to 25,1 per cent in December 2003. The sharp increase in other liabilities was due to the previously mentioned amendment to the Regulations relating to Banks. By the end of January 2003, the net impact on the balance sheet of the total banking sector of the newly required reporting of gross, instead of net, liability values in respect of derivatives amounted to approximately R125 billion.

sharp increase in other liabilities was due to an amendment to the Regulations

Composition of non-bank deposits

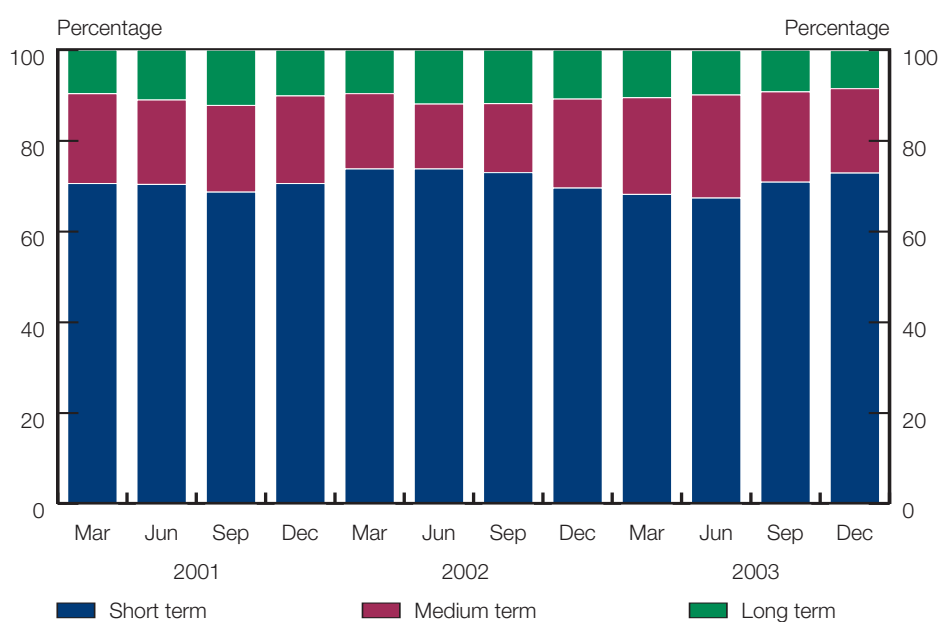
Figure 3 reflects a year-on-year comparison of the composition of non-bank deposits. Fixed and notice deposits increased by 3,7 percentage points during the year under review. Demand deposits as a percentage of total non-bank deposits increased from 50,4 per cent to 51,9 per cent. Negotiable certificates of deposit as a percentage of non-bank deposits decreased from 8,6 per cent at the end of December 2002 to 3 per cent a year later.

Figure 3: Composition of non-bank deposits

Maturity structure of non-bank deposits

Figure 4 reflects the composition of non-bank deposits (according to maturity) for the period from March 2001 to December 2003. As can clearly be seen from this figure, short-term deposits remained the largest component of total non-bank funding and accounted for 72,9 per cent of total non-bank funding as at 31 December 2003, compared to 69,6 per cent at the end of December 2002 and 70,6 per cent at the end of December 2001. Medium-term deposits accounted for 18,6 per cent as at December 2003, compared to 19,6 per cent and 19,3 per cent at the end of December 2002 and the end of December 2001, respectively. Long-term deposits remained the smallest component of total non-bank funding and accounted for 8,4 per cent of total non-bank funding as at 31 December 2003, compared to 10,8 per cent and 10,1 per cent at the end of December 2002 and the end of December 2001, respectively.

short-term deposits remained the largest component of total non-bank funding

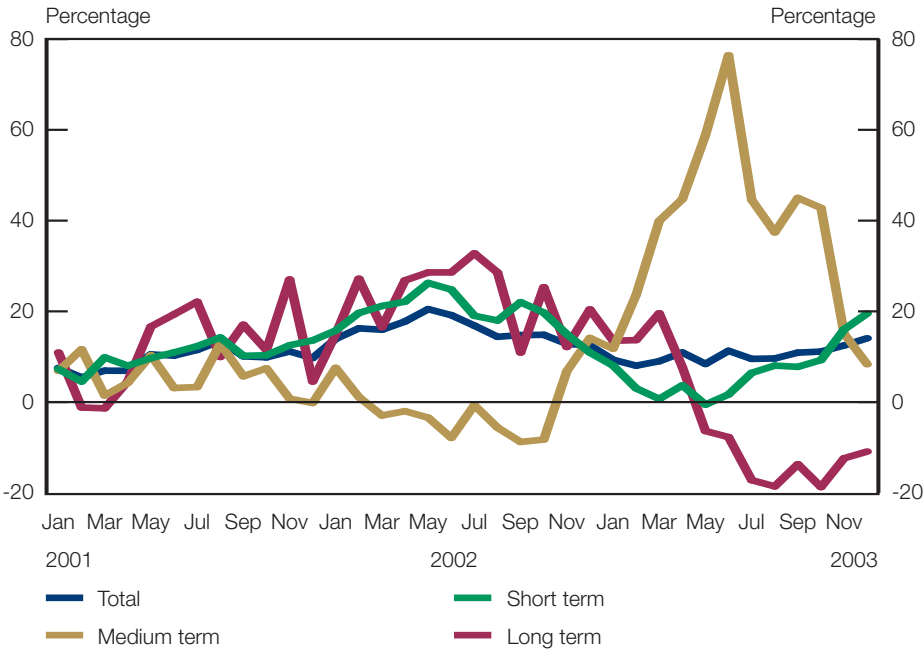
Figure 4: Composition of non-bank funding according to maturity

The slight increase in the proportion of total deposits represented by short-term deposits resulted in a slightly higher percentage of the banking sector's assets (consisting of non-bank loans and advances) being financed by short-term funding.

growth in long-term deposits decreased

Long-term deposits not only remained the smallest component of total non-bank funding, but growth therein decreased by 10,9 per cent during the year under review. This is in contrast to increases of nearly 20,4 per cent and 4,5 per cent during 2002 and 2001, respectively. The strong slowdown in the growth of long-term deposits can be attributed to the significant decline in interest rates that resulted from a relaxation in South Africa's monetary policy during 2003 and the South African Reserve Bank reducing its repurchase rate by five percentage points. By the end of 2003, the big five banks held more than 92 per cent of long-term deposits.

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



growth in medium-term deposits slowed down

Growth in short-term deposits increased from 10,9 per cent in December 2002 to 19,5 per cent in December 2003. For six consecutive months, growth in medium-term deposits was strong (76,4 per cent). From July 2003, however, growth in medium-term deposits slowed down and, by the end of December 2003, had moderated to 8,3 per cent.

other major liabilities

Other major liabilities of the banking sector as at 31 December 2003 included foreign funding of R38,8 billion, which decreased by 33,6 per cent from December 2002. This decrease in foreign funding was due mainly to the appreciation of the South African rand during 2003. Capital and reserves, on the other hand, increased to R110,1 billion (an increase of 6,5 per cent when compared to the December 2002 level of R103,4 billion). Interbank funding decreased to R68,2 billion (a decrease of 16,4 per cent when compared to the December 2002 level of R81,6 billion). Other liabilities, on the other hand, increased significantly, to R346 billion (an increase of 141,9 per cent when compared to the amount of R143,1 billion at the end of December 2002). The sharp increase in other liabilities was due to the amendment to the Regulations relating to Banks mentioned above.

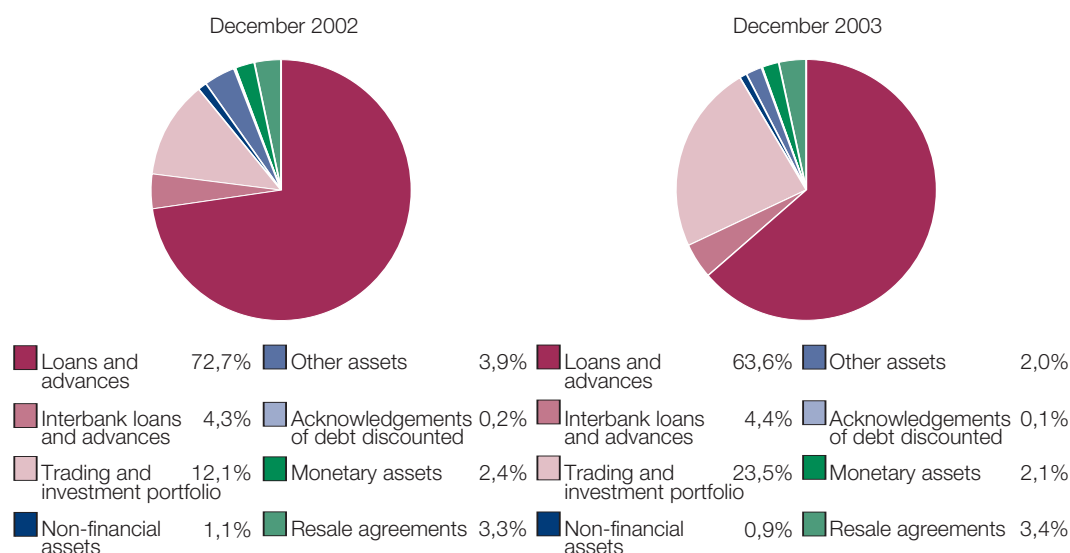
Assets

Figure 6 graphically reflects a year-on-year comparison of the composition of assets as at 31 December 2003 and 31 December 2002. The banking sector's assets increased by R276,9 billion (representing a growth rate of 25,2 per cent) during the year under review, to a total of R1 377,6 billion at the end of December 2003. Factors contributing to this growth were the following:

factors contributing to asset growth

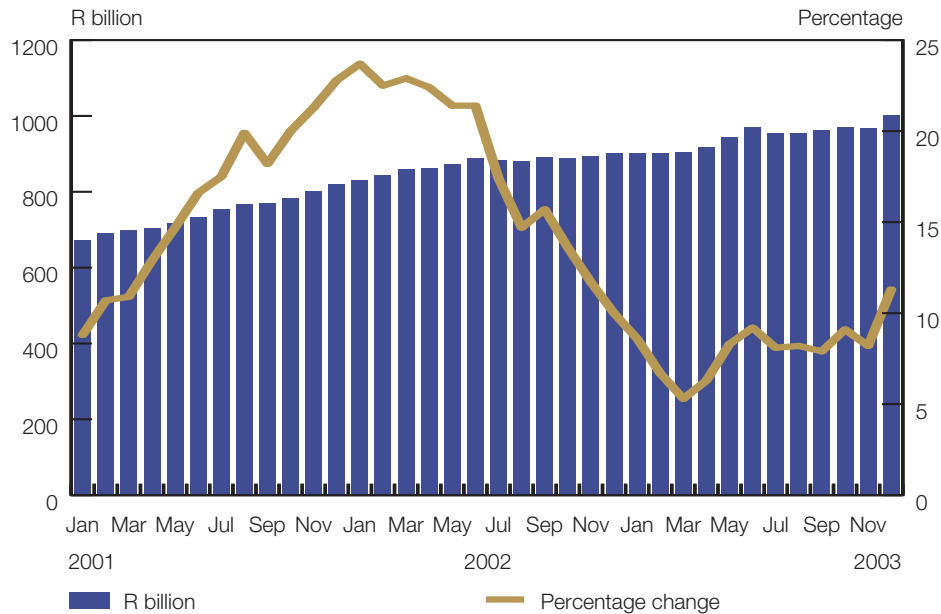
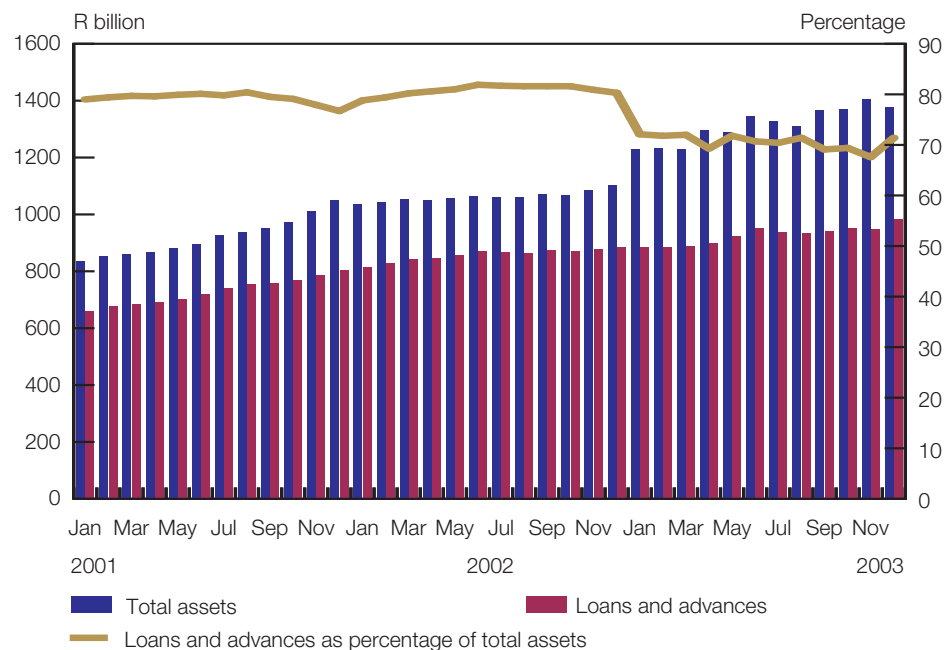
- Monetary assets grew by 8,7 per cent, from R26,5 billion as at 31 December 2002 to R28,8 billion as at 31 December 2003.
- Non-bank advances grew by 9,6 per cent, from R799,8 billion at the end of December 2002 to R876,6 billion a year later.
- Loans granted under resale agreements increased from R36,8 billion at the end of December 2002 to R46,8 billion at the end of December 2003, representing a growth rate of 27,1 per cent.
- Non-financial assets decreased by 2 per cent, from R12,5 billion at the end of December 2002 to R12,3 billion at the end of December 2003.
- Other assets decreased by 36,8 per cent, from R42,7 billion at the end of December 2002 to R27 billion at the end of December 2003.
- Trading and investment assets grew by 144 per cent, from R132,9 billion at the end of December 2002 to R324,3 billion as at 31 December 2003. The sharp increase in trading and investment assets was due the amendment to the Regulations relating to Banks mentioned above.

Figure 6: Assets – year-on-year comparison



It is apparent from figure 7 that growth in total loans and advances increased during 2001, but slowed down significantly during 2002. From April 2003, however, growth in total loans and advances recovered and, by the end of the year, had increased by 11,3 per cent (measured over a period of 12 months), compared to 10 per cent at the end of December 2002. At the end of December 2003, loans and advances accounted for about 71,4 per cent of total assets (see figure 8).

growth in total loans and advances increased

Figure 7: Total loans and advances**Figure 8: Loans and advances as a percentage of total assets**

Loans and advances as a percentage of total assets increased from 76,7 per cent in December 2001 to 80,3 per cent in December 2002, before decreasing throughout 2003 to 67,6 per cent in November 2003. Loans and advances as a percentage of total assets increased somewhat during the last month of 2003, to end the year at 71,4 per cent (see figure 8).

Composition of loans and advances

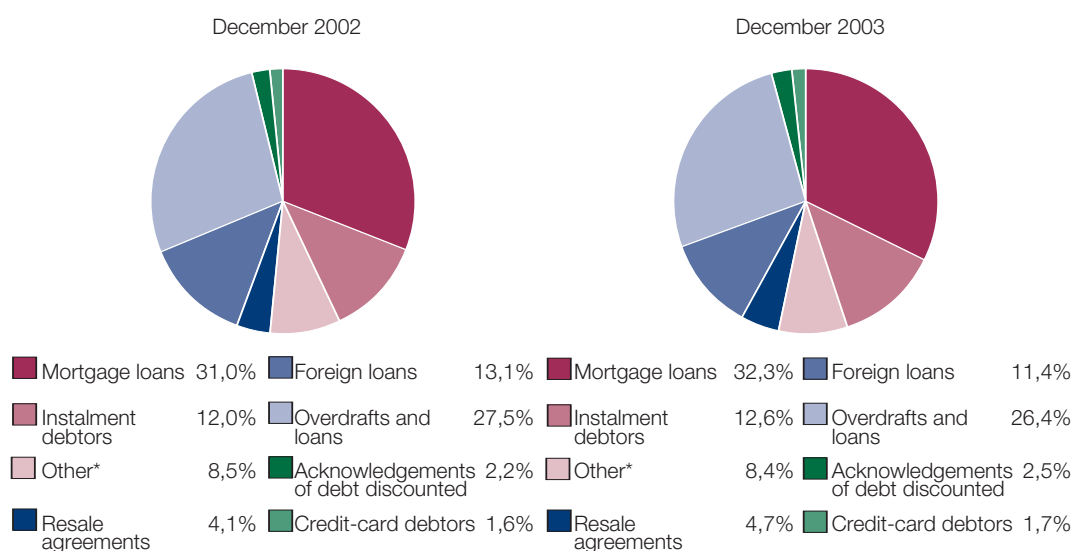
The composition of loans and advances is shown graphically in figure 9. A comparison of the composition of loans and advances in 2002 and 2003 clearly shows that the composition remained almost unchanged.

As at the end of December 2003, non-bank loans and advances constituted 63,6 per cent (December 2002: 72,7 per cent) of the banking sector's assets and, thus, represented the main area of focus for the management of on-balance-sheet credit risk. The increase of R76,8 billion (2002: R67 billion), representing a growth rate of 9,6 per cent (2002: 9,1 per cent), achieved in respect of non-bank advances during the year under review and measured over a 12 month period can be attributed to the following areas (figure 10):

non-bank loans and advances represented the main area of focus

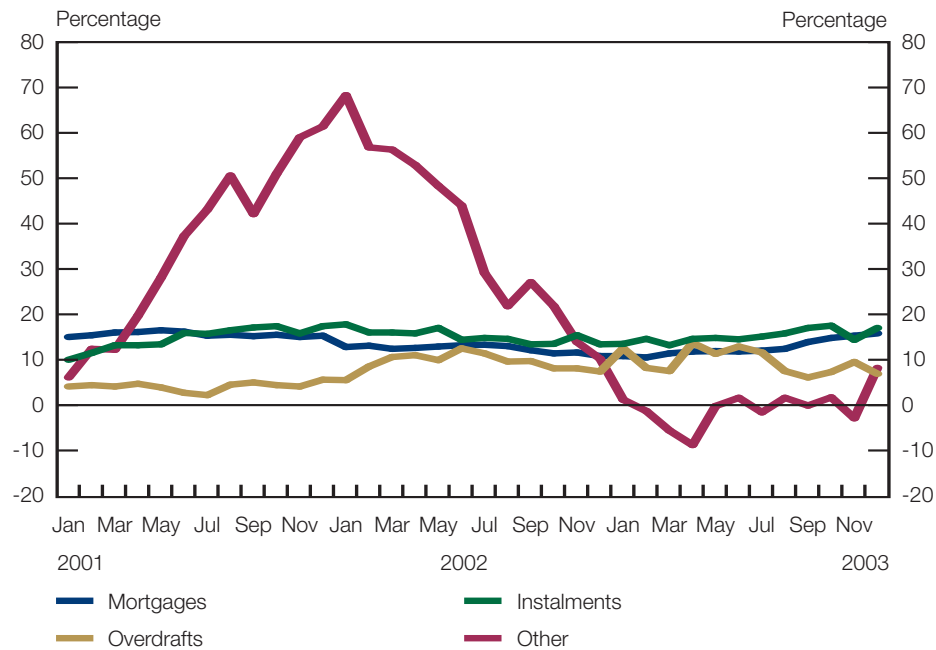
- Mortgage loans increased by R44,2 billion to a level of R323,4 billion, representing an increase of 15,8 per cent.
- Overdrafts and loans increased by R17,1 billion to a level of R264,8 billion, representing a growth rate of 6,9 per cent.
- Instalment debtors increased by R18,3 billion to a level of R126,2 billion, representing an increase of 17 per cent.
- Foreign-currency loans and advances decreased by R3,3 billion to a level of R114,4 billion, representing a decrease of 2,8 per cent.
- Credit cards increased by R2,3 billion to a level of R17 billion, representing an increase of 15,8 per cent.
- Acknowledgements of debt discounted increased by R5,5 billion to a level of R24,9 billion, representing an increase of 28,4 per cent.
- Redeemable preference shares decreased by R1,6 billion to a level of R15,3 billion, representing a decrease of 9,5 per cent.

Figure 9: Composition of loans and advances



* Negotiable certificates of deposit and redeemable preference shares

Figure 10: Growth in selected loans and advances



3.2 Capital adequacy

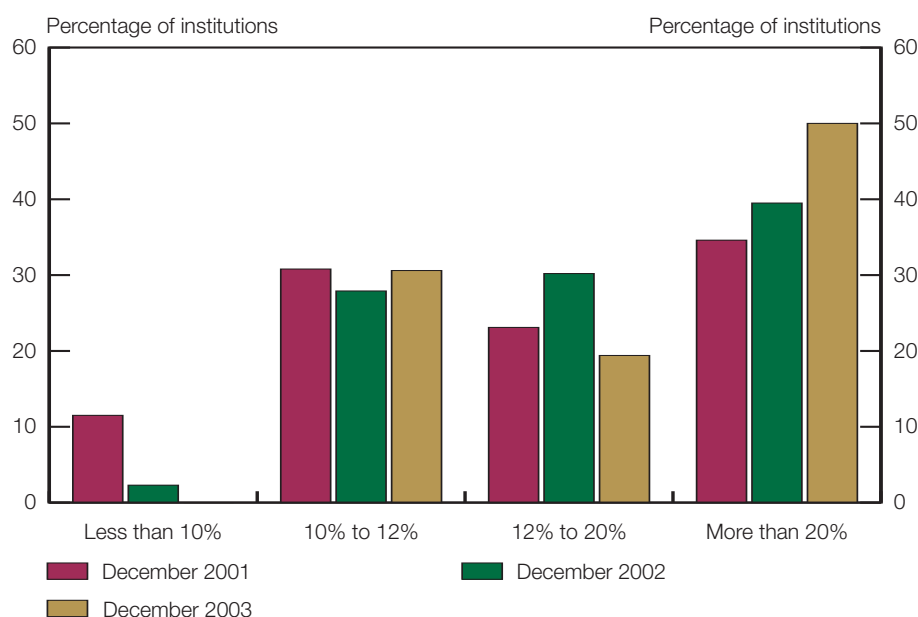
adequate capital does not provide a guarantee against failure

Capital provides a safety net to depositors and other providers of loan finance against losses that a bank might incur. For this reason, it is very important that only banks that are adequately capitalised be authorised to accept deposits from the public. As experience has shown, however, the existence of adequate capital does not provide a guarantee against the failure of a bank that is badly managed.

For the year under review, the average capital and reserves held by the banking sector amounted to R104 billion (R98,3 billion in December 2002), and R93,2 billion (R84,9 billion in December 2002) thereof constituted qualifying capital and reserves for purposes of assessing capital adequacy. The capital-adequacy ratio for the year under review was 12,2 per cent (2002: 12,6 per cent).

all banking institutions met the minimum capital-adequacy ratio

An analysis of the percentage distribution of banks in terms of capital adequacy at the end of December 2003 (see figure 11) reveals that all banking institutions met the minimum capital-adequacy ratio of 10 per cent, whereas 50 per cent of banking institutions (2002: 39,5 per cent) had capital-adequacy ratios that exceeded 20 per cent.

Figure 11: Distribution of banks in terms of capital adequacy

Banking institutions that reported capital-adequacy ratios of above 20 per cent (that is, 50 per cent of institutions) represented only 4,7 per cent of total banking-sector assets (see figure 12). Banking institutions with a capital-adequacy ratio of between 10 per cent and 12 per cent (30,6 per cent of banking institutions) represented the largest portion of total banking-sector assets, namely, 85,3 per cent.

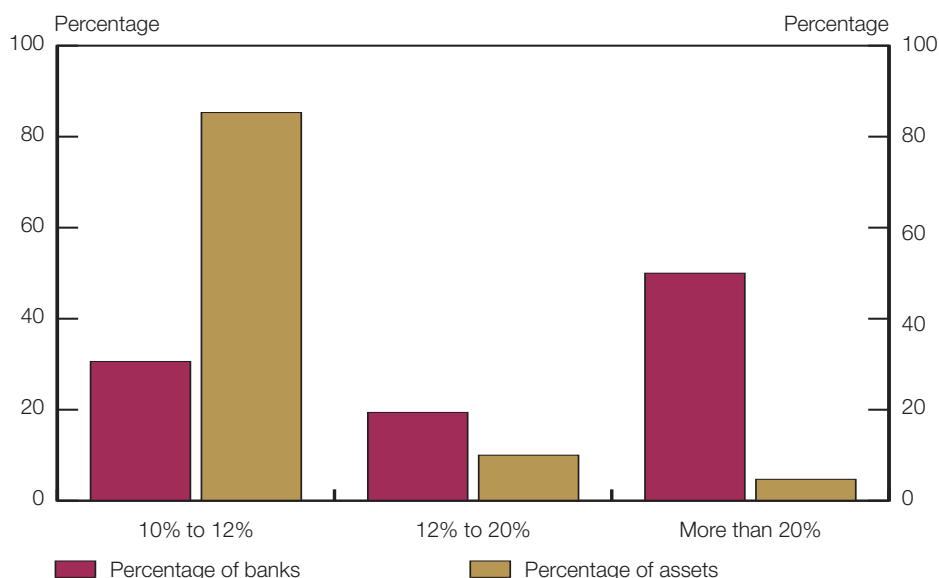
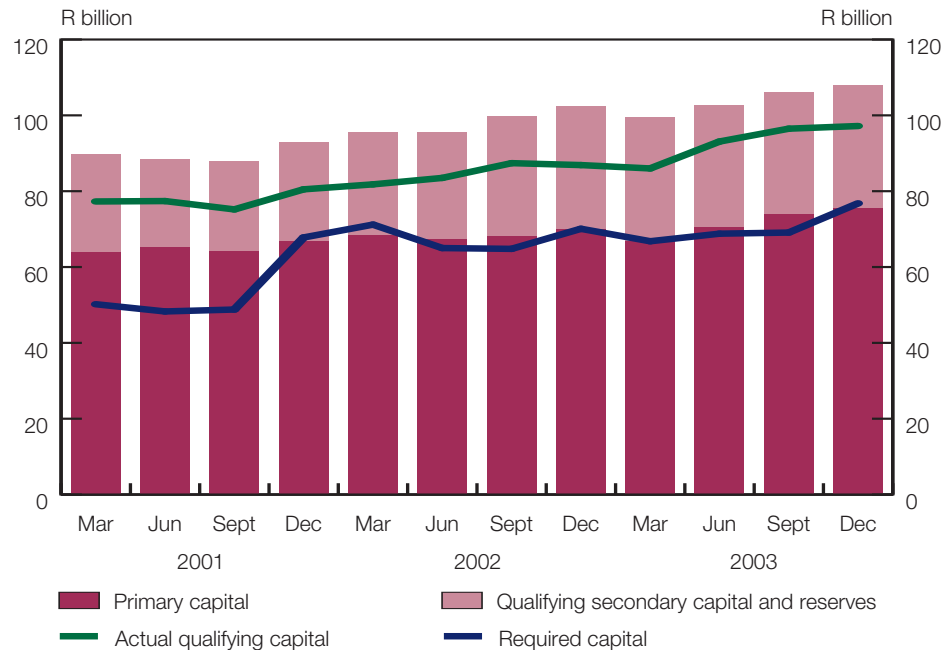
Figure 12: Banks' capital adequacy in terms of total asset value

Figure 13 reflects the split, over time, between primary and secondary capital, as well as the rand values of required capital and actual qualifying capital. At the end of December 2003, primary capital and reserves constituted 70,1 per cent (2002: 68,4 per cent) of qualifying capital and reserves before deduction of impairments amounting to R10,6 billion (2002: R15,5 billion). Primary capital and reserves grew by 8,1 per cent

primary capital and
reserves grew

(2002: 4,6 per cent) during the year, to R75,6 billion at the end of December 2003. Qualifying secondary capital and reserves, on the other hand, decreased by 0,5 per cent, to R32,2 billion at the end of December 2003. The growth in net qualifying capital and reserves of 11,9 per cent was lower than the growth of 25,2 per cent in the total balance sheet.

Figure 13: Qualifying capital and reserves

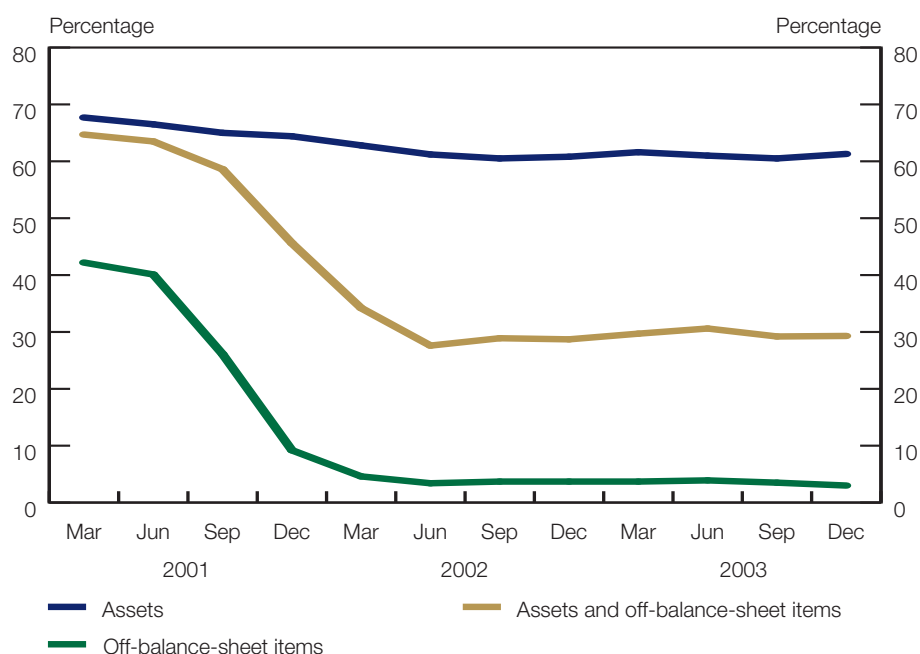


Risk profile of on- and off-balance-sheet items

For the year ended 31 December 2003, total assets and off-balance-sheet items (see figure 14) grew by 7,6 per cent (2002: 68,2 per cent), whereas total risk-weighted assets and off-balance-sheet items grew by 10,1 per cent (2002: 5,8 per cent). The marked increase in off-balance-sheet items from 2001 was due mainly to amendments to the Regulations relating to Banks. In terms thereof, banks were required to report on central securities-depository participation, which, however, did not affect the average risk weighting of assets.

The composition of off-balance-sheet-items had the effect of decreasing the average combined risk weighting of assets and off-balance-sheet items from 29,9 per cent in 2002 to 29,7 per cent in 2003. Off-balance-sheet items accounted for approximately 54,9 per cent (December 2002: 56,3 per cent) of the combined total of assets and off-balance-sheet items at the end of December 2003. The risk-weighted percentages of assets and off-balance-sheet items and of the combined total of assets and off-balance-sheet items are graphically illustrated in figure 14.

marked increase in off-balance-sheet items

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

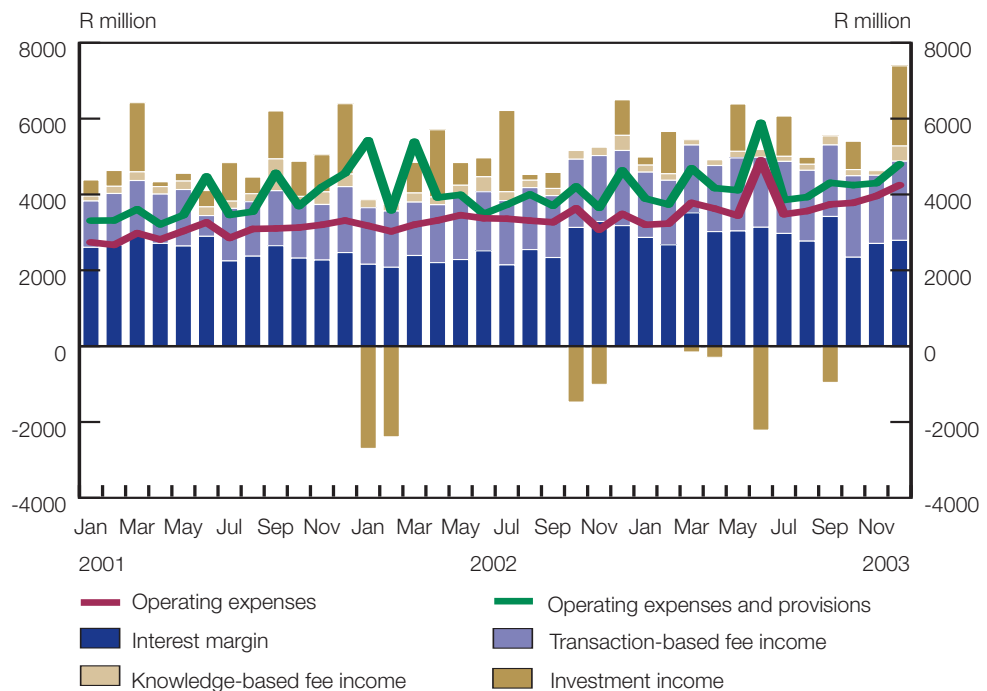
3.3 Profitability

An evaluation of the profitability of banks involves an assessment of the quality of income and the long-term sustainability of the activities that generate the income. For this reason, the analyses focus on the following aspects:

analyses focus on the following aspects

- Quality of earnings (riskiness of earnings).
- Balance in the various sources of income (such as, a good spread of income sources).
- Nature of income (such as, the intermediation function, advisory services or trading activities).
- Integrity of the information (whether the income statement is consistent with the balance sheet).
- Profitability of assets and effectiveness of activities versus cost control and cost optimisation.
- Balance between the effort expended on activities and the income generated therefrom.
- Structural changes in profitability during the year.

Figure 15: Composition of the income statement



intermediation function again constituted the main source of income

As can be seen in figure 15, the intermediation function again constituted the main source of income for banks. The intermediation function consists of interest margin (an average of 2,6 per cent of total assets for the year, as opposed to 2,8 per cent in 2002) and transaction-based fee income (an average 1,8 per cent of total assets for the year). The income derived from the intermediation function (R57,7 billion) was generally sufficient to cover the sum of operating expenses and provisions (R51,9 billion). The generation of additional income from investments in Government stock and Treasury bonds, knowledge-based fee income derived from trading activities and agency type and advisory activities also remained contributors to the continued profitability of banks. Fee income and investment and trading income earned during the year were on average equivalent to 1,8 per cent and 0,2 per cent, respectively, of total assets (as opposed to 2,1 per cent and 0 per cent, respectively, during 2002).

interest margin increased

For the year, interest expense increased by about 8,4 per cent, which was 2,1 percentage points lower than the increase of 10,5 per cent in interest income. The net result thereof was that the interest margin increased by 16,5 per cent, whereas it decreased by 1,7 per cent in 2002. Interest derived from mortgage bonds and overdrafts and loans constituted 33,3 per cent and 28,4 per cent, respectively, of total interest income (as opposed to 32,3 per cent and 30,3 per cent, respectively, during 2002).

The main component of interest expense was interest of 31 per cent paid in respect of demand deposits (2002: 35,2 per cent), whereas interest paid on fixed and notice deposits constituted 32,3 per cent (2002: 27,7 per cent) of the total interest expense for the year.

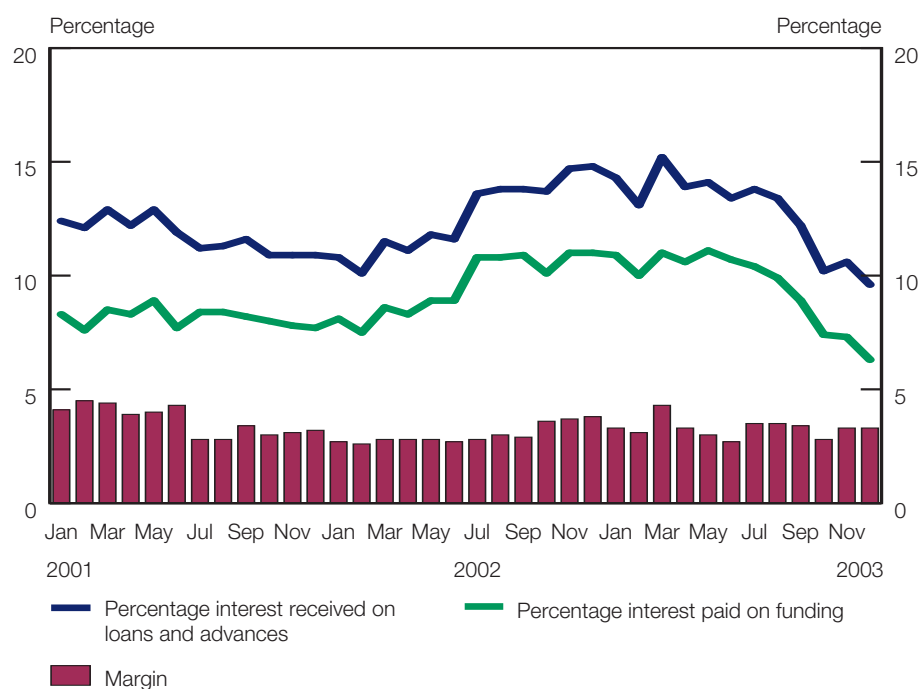
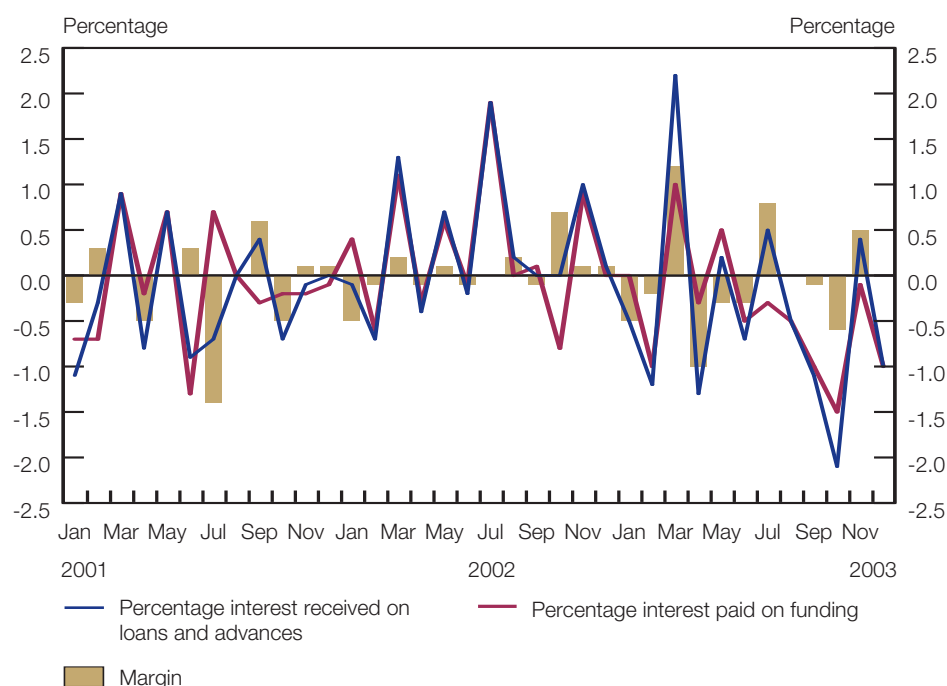
Figure 16: Interest margin

Figure 16 graphically depicts the interest margin of the banking sector for the period from January 2001 to December 2003. The interest margin for the year was on average higher in 2003 than in 2002. By the end of December 2003, the interest margin was 3,3 per cent, compared to 3,8 per cent in 2002 and 3,2 per cent in 2001.

Figure 17 represents the percentage-point change in the components of the interest margin for the past three years. By the end of December 2003, both interest received and interest paid had decreased by 1,0 percentage points, compared to an increase of 0,1 percentage points and 0 percentage points in 2002, respectively. This decrease was due to the relaxation in monetary policy mentioned earlier in this chapter.

both interest received and interest paid decreased

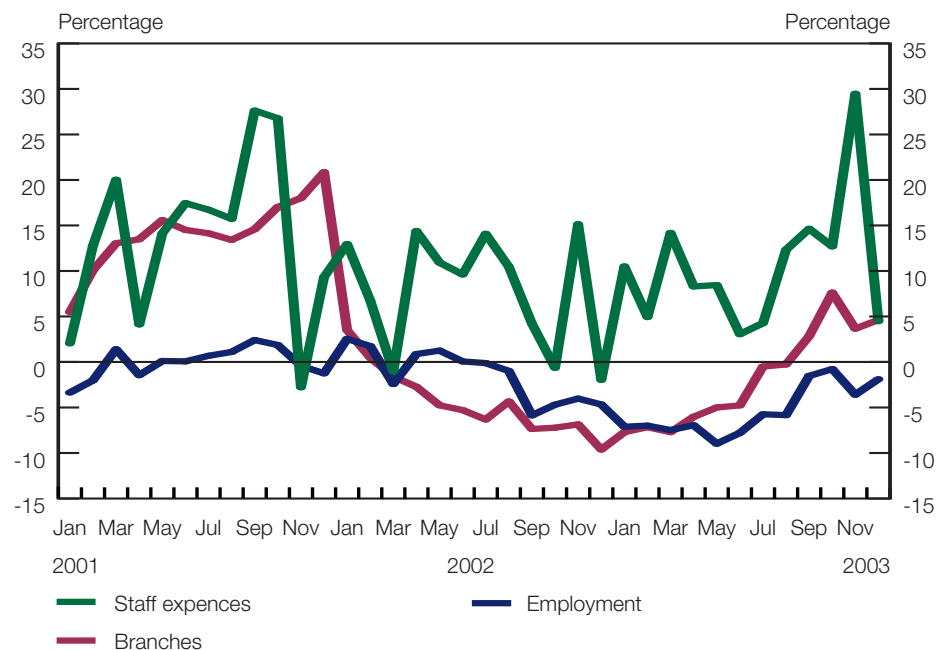
Figure 17: Percentage-point change in interest margin

operating expenses increased

employment and number of branches declined

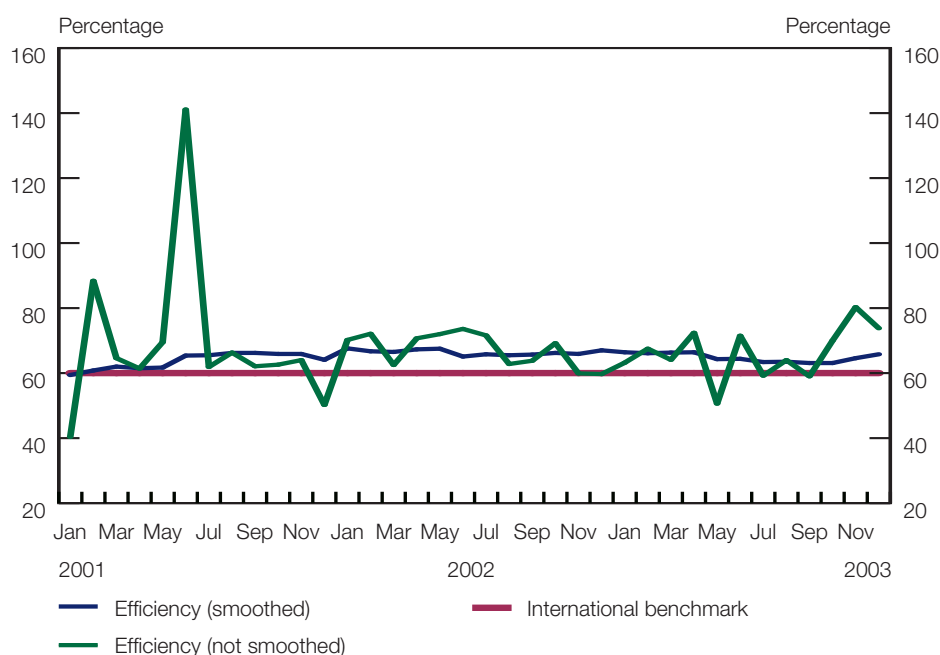
The operating expenses of the total banking sector increased by 13,3 per cent in 2003 (9,6 per cent in 2002), mainly as a result of an increase of 10,5 per cent in total staff expenses, which accounted for about 46 per cent (2002: 47,2 per cent) of total operating expenses. The increase in total staff expenses, however, was not due to an increase in the number of people employed. This is confirmed by figure 18, which graphically depicts the percentage change (measured over a 12-month period) in total staff expenses, the number of people employed and the number of branches for the past three years. During 2003, both employment in the banking sector and the number of branches declined by 5,4 per cent and 1,9 per cent, respectively, as opposed to a decrease of 1,4 per cent and 4,4 per cent, respectively, during 2002. An increase in administrative expenses also contributed to the growth in operating expenses. Compared to the previous year, administrative expenses increased by 16,8 per cent and accounted for 43,3 per cent (42 per cent in 2002) of total operating expenses.

Figure 18: Growth in staff expenses, number of employees and number of branches



The efficiency of the banking sector can be determined by expressing operating expenses as a percentage of total income. Currently, the international benchmark for efficiency is 60 per cent. In other words, banks that have an efficiency ratio of above 60 per cent are regarded as less efficient.

Figure 19 reflects the efficiency of the South African banking sector for the past three years. The high volatility in efficiency for 2001 was due mainly to the implementation of Accounting Standard AC 133 by some banks in January 2001. In terms of the disclosure requirements of AC 133, banks were required, in respect of financial-year periods commencing on or after 1 January 2001, to reflect the net mark-to-market adjustments of investments (fair-value accounting) in their financial statements, as opposed to the previous equity accounting (book value or purchase price).

Figure 19: Efficiency of South African banking sector

After reconsidering the implementation date of AC 133, however, the Accounting Practice Board announced that AC 133 would become effective for financial years commencing on or after 1 July 2002. The objective of the delayed implementation was to enable companies to improve their business practices and systems and to complete the necessary training. Some banks, however, had already implemented AC 133 and reported data in accordance with the requirements of AC 133 for 2001. For 2003, efficiency (65,8 per cent) was on average better than in 2002 (67 per cent).

The actual values of, and the percentage growth in, the determinants of efficiency are graphically illustrated in figure 20. Growth of 15,4 per cent in total income offset the increase of 13,3 per cent in operating expenses, resulting in improved efficiency in the banking sector (see figure 19) during the year under review.

improved efficiency

Figure 20: Determinants of efficiency

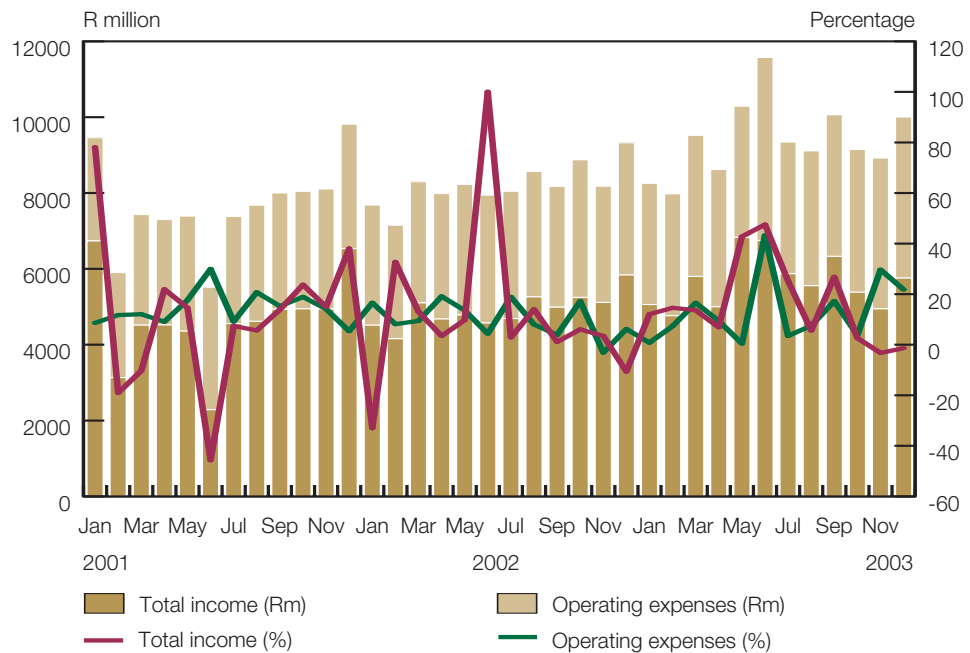


Figure 21: Efficiency of banking institutions according to asset size – December 2003

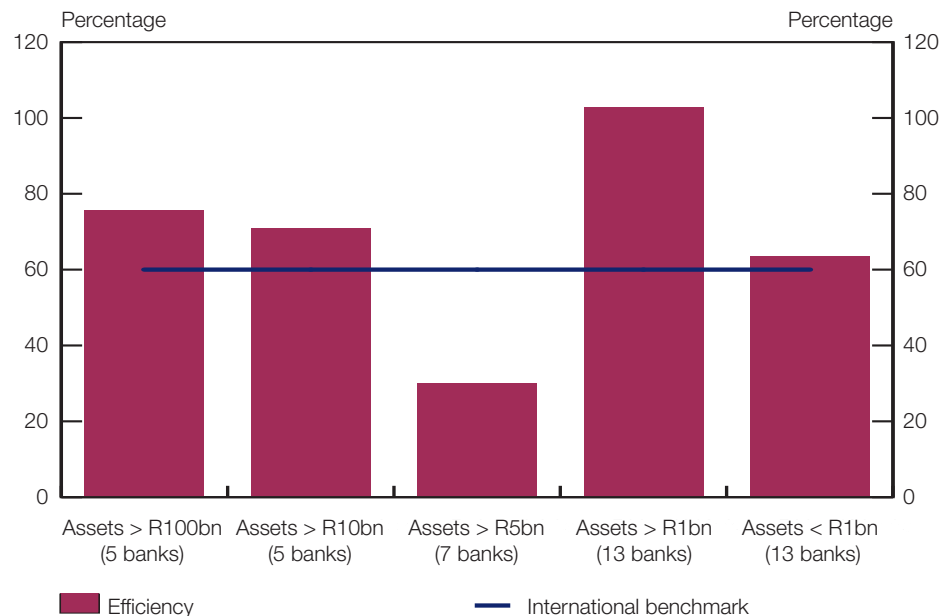
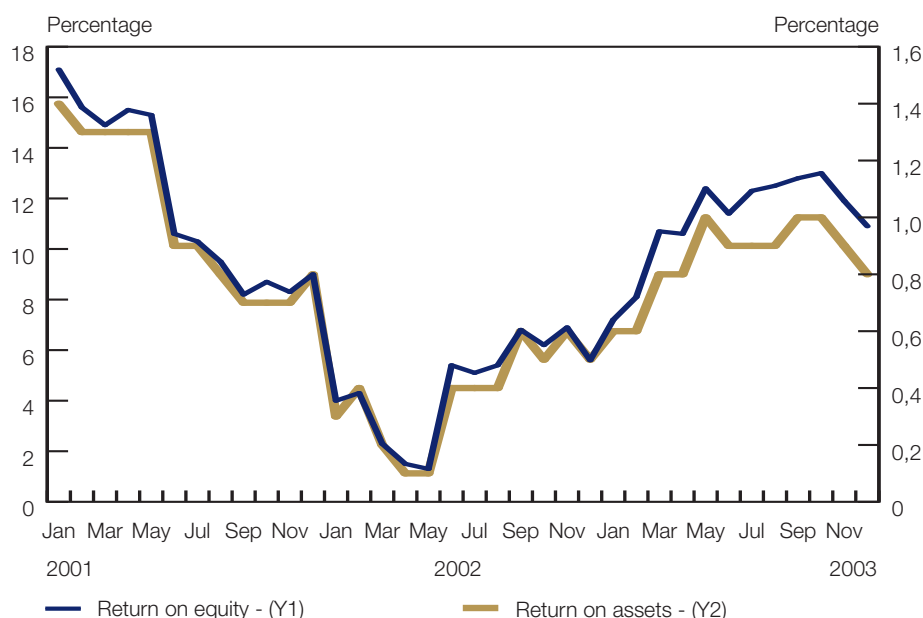


Figure 21 graphically depicts the efficiency of the various categories (according to asset size) of banking institutions for the year ended December 2003. The graph shows that banks with assets of above R5 billion, but below R10 billion, were the most efficient in December 2003 with an efficiency ratio of 30 per cent, followed by banks with assets of above R10 billion, but below R50 billion (71 per cent). The least efficient were banks with asset values of above R1 billion, but below R5 billion, with an efficiency ratio of 102,9 per cent. It should be borne in mind that these figures are compiled for one

month at a time. Because operating expenses and total-income components can fluctuate drastically from one month to another, the average efficiency ratios of different banks will fluctuate accordingly.

Figure 22: Profitability (12-month smoothed average)

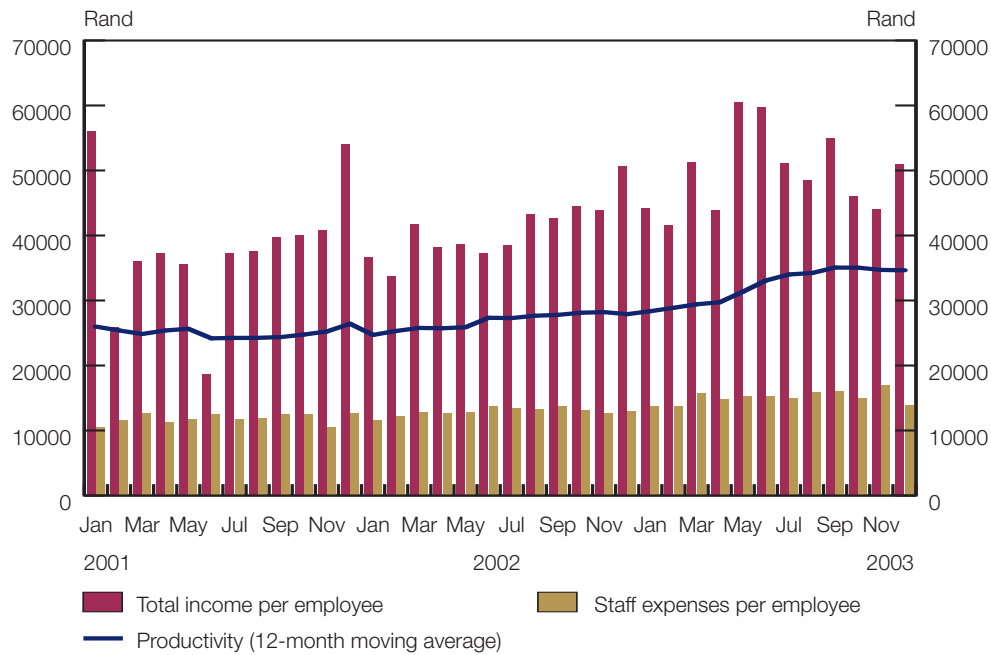


The banking sector achieved a before-tax return of approximately 1,1 per cent of total assets (0,8 per cent in 2002). For 2003, an after-tax return of approximately 0,7 per cent of total assets (0,4 per cent for 2002) was reported, whereas an after-tax return of approximately 10,9 per cent was reported on net qualifying capital and reserves (5,6 per cent for 2002).

The trends (calculated on the basis of a 12-month moving average) in return on equity (ROE) and return on assets (ROA) for the past three years are graphically displayed in figure 22. After a marked deterioration in both the ROA and the ROE during the period from January 2001 until May 2002, both the ROA and the ROE improved noticeably until October 2003. This improvement was due mainly to higher net income after tax resulting from slower growth in operating expenses.

both the ROA and the ROE improved noticeably

Figure 23: Productivity



productivity of employees improved

Productivity can be measured by comparing the expenditure on employees with the amount of income generated. Figure 23 graphically depicts the productivity of the banking sector for the past three years. During the year under review, the total income generated per employee was on average R49 766, as opposed to R40 840 in 2002. The average staff expenses per employee, on the other hand, were R15 118 in 2003 (R12 940 in 2002). Also reflected in figure 23 is the average (smoothed over 12 months) net income generated per employee. The net income generated per employee increased from R27 900 to R34 648, indicating that the productivity of employees in the banking sector improved during the year under review.

3.4 Liquidity risk

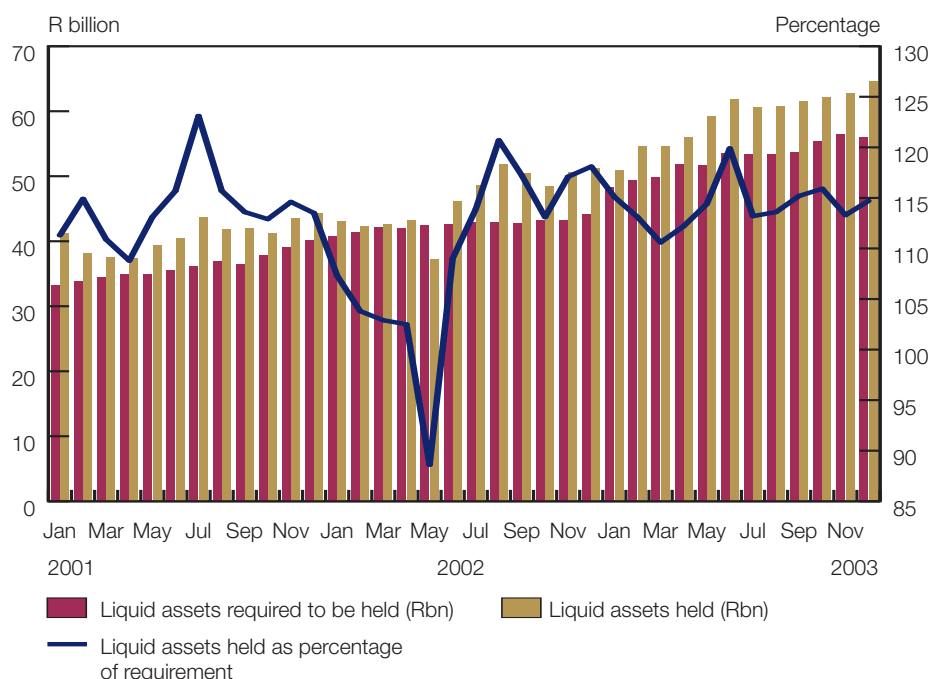
Liquidity risk is the potential risk arising when an entity cannot meet payments when they fall due.

An evaluation of liquidity-risk management involves an assessment of the level of compliance with the statutory liquid-asset requirements, an analysis of the short-term liquidity mismatch in relation to total funding and the trend thereof, an assessment of the sources of liquid funds available for funding such mismatches and a consideration of the volatility of funding sources available.

Statutory liquidity

average daily amount of liquid assets held exceeded the statutory liquid-asset requirement

The liquid-asset requirement is calculated on total liabilities less capital and reserves (referred to as adjusted liabilities). Figure 24 shows that the average daily amount of liquid assets held by banks exceeded the statutory liquid-asset requirement throughout the year under review.

Figure 24: Statutory liquid assets – actual versus required

Approximately 52 per cent (2002: 56,1 per cent) of the average daily amount of liquid assets held during December 2003 consisted of securities issued by virtue of section 66 of the Public Finance Management Act, 1999, whereas 27,8 per cent (2002: 29,5 per cent) consisted of Treasury bills of the Republic of South Africa, and 1,1 per cent (2002: 2,3 per cent) consisted of short-term bills issued by the Land Bank. Cash-management schemes managed on behalf of banks' clients increased by about 17,3 per cent (2002: 7,7 per cent). Set-off increased by 27,6 per cent (measured over 12 months) as at the end of December 2003 and represented approximately 8,7 per cent (2002: 10 per cent) of adjusted liabilities. This means that the adjusted liabilities, which are used for purposes of computing the liquid-asset and reserve-balance requirements, decreased by 11,9 per cent (2002: 12,2 per cent), or R133,2 billion (2002: R108,3 billion), because of the use of cash-management schemes by banks' clients and the setting off of some asset balances against liabilities.

adjusted liabilities decreased

Volatility of funding

As at 31 December 2003, total wholesale deposits constituted 95,2 per cent (2002: 81,2 per cent) of total wholesale and retail deposits. As can be seen in figure 25, wholesale deposits shorter than three months represented 66,4 per cent of total funding for December 2003. The aggregate amount of the 10 largest depositors of individual banks averaged R147,4 billion (2002: R167,4 billion) during the year under review. Expressed as a percentage of the aggregate amount of total funding-related liabilities to the public, large depositors averaged 14,3 per cent (2002: 18 per cent) at the end of December 2003 (see figure 25).

total wholesale deposits constituted 95,2 per cent of deposits

Figure 25: Wholesale deposits shorter than three months and large depositors

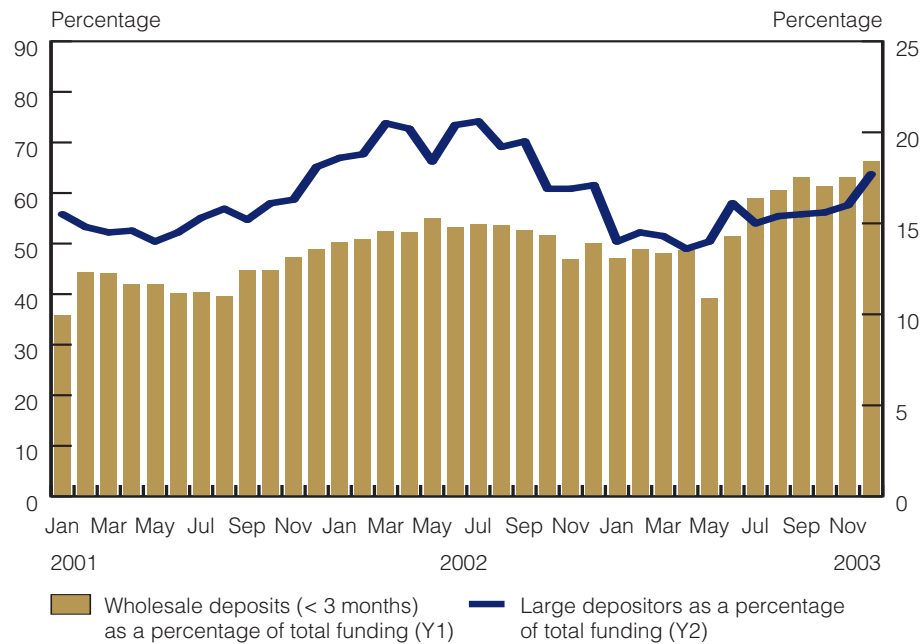
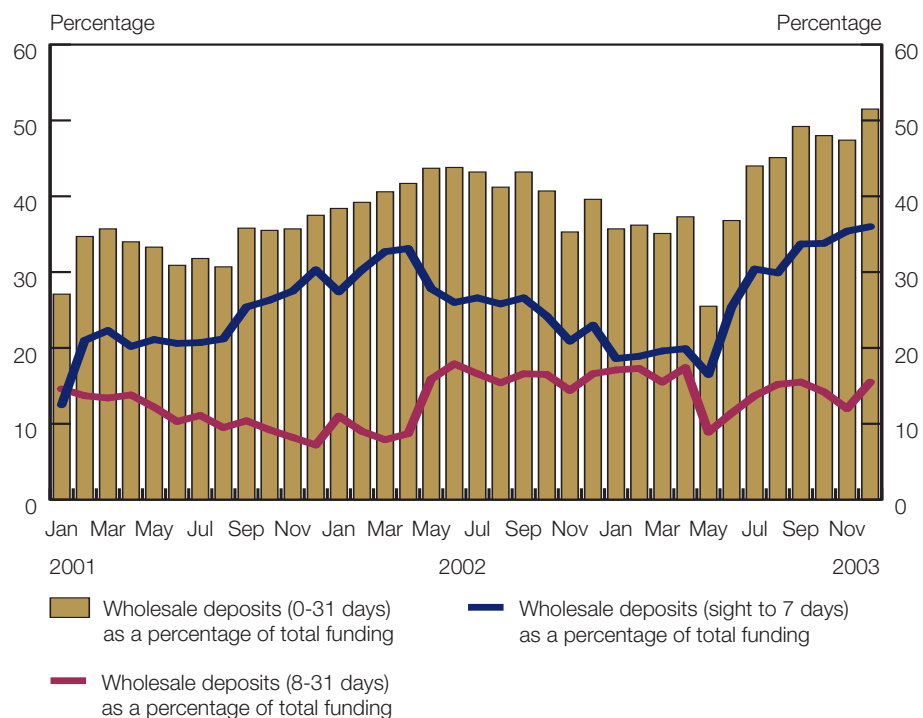


Figure 26: Short-term wholesale deposits



Short-term wholesale deposits (0-31 days) represented 51,5 per cent of total funding in December 2003, as opposed to 39,6 per cent for December 2002 (see figure 26). As at the end of December 2003, wholesale deposits shorter than seven days and wholesale deposits between eight and 31 days represented 36 per cent and 15,5 per cent, respectively, of total funding.

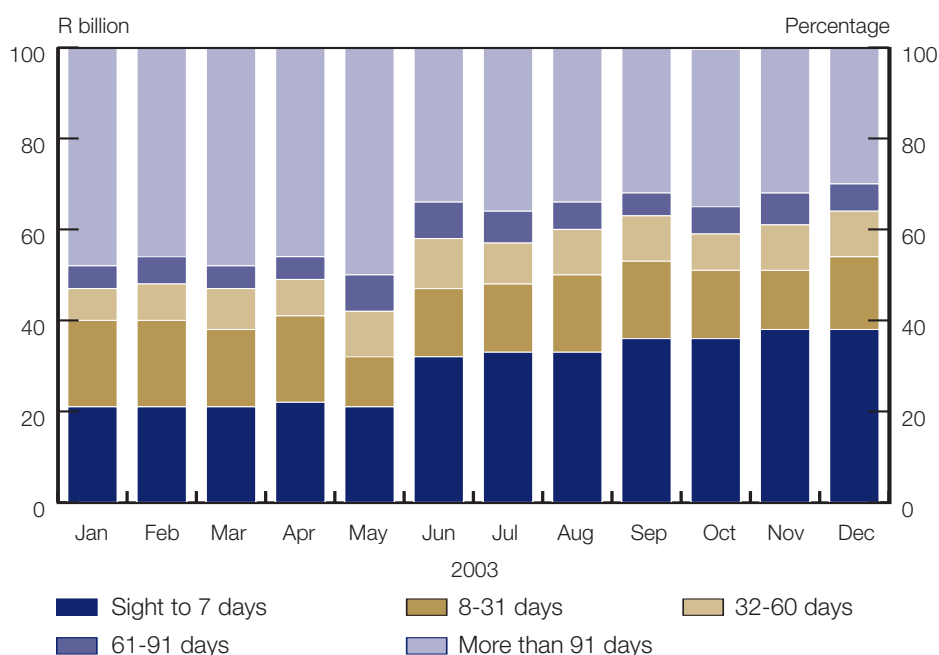
Figure 27: Composition of wholesale deposits according to maturity

Figure 27 depicts the composition (measured over a period of 12 months) of wholesale deposits according to maturity for the year under review. Wholesale deposits with a maturity shorter than seven days and wholesale deposits with a maturity greater than 91 days constituted the largest portion of wholesale deposits in December 2003, namely, 38 per cent and 30 per cent, respectively. Wholesale deposits with a maturity of 32 to 60 days constituted only a small portion of total wholesale deposits, namely, 10 per cent, followed by deposits with a maturity of eight to 31 days at 16 per cent of total wholesale deposits.

3.5 Market risk

Market risk is the risk that investments will lose money based on the daily fluctuations of the market.

Turnover in derivatives fluctuated during the year, from approximately R 609,3 million in January 2003 to R752,3 million in October 2003 and to R507,4 million in December 2003 (see figure 28). Forward contracts decreased from R1 404,5 billion in January 2003 to a level of R1 365,2 billion in December 2003.

turnover in derivatives
fluctuated

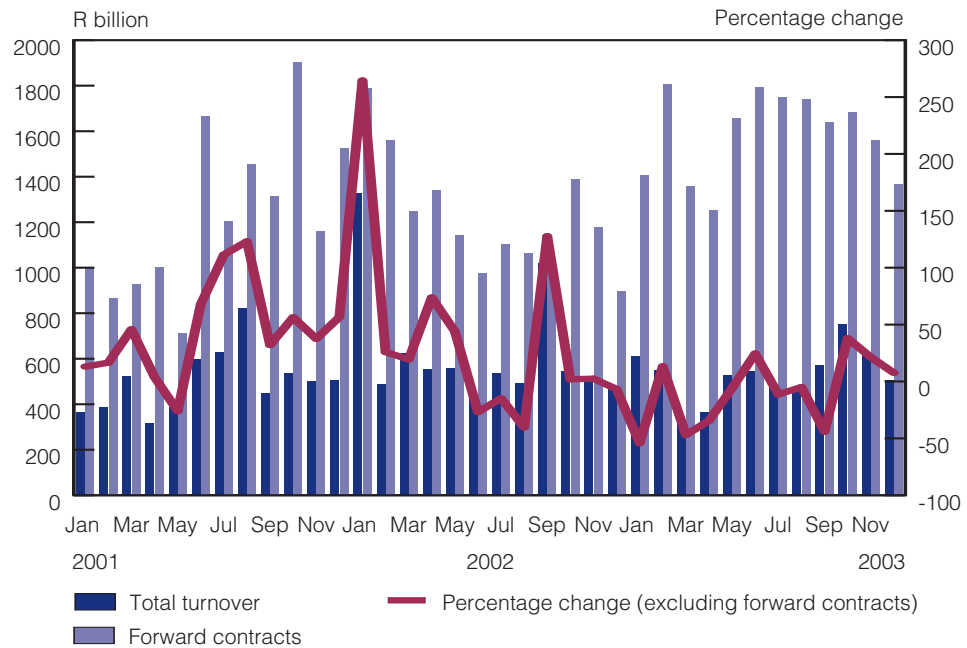
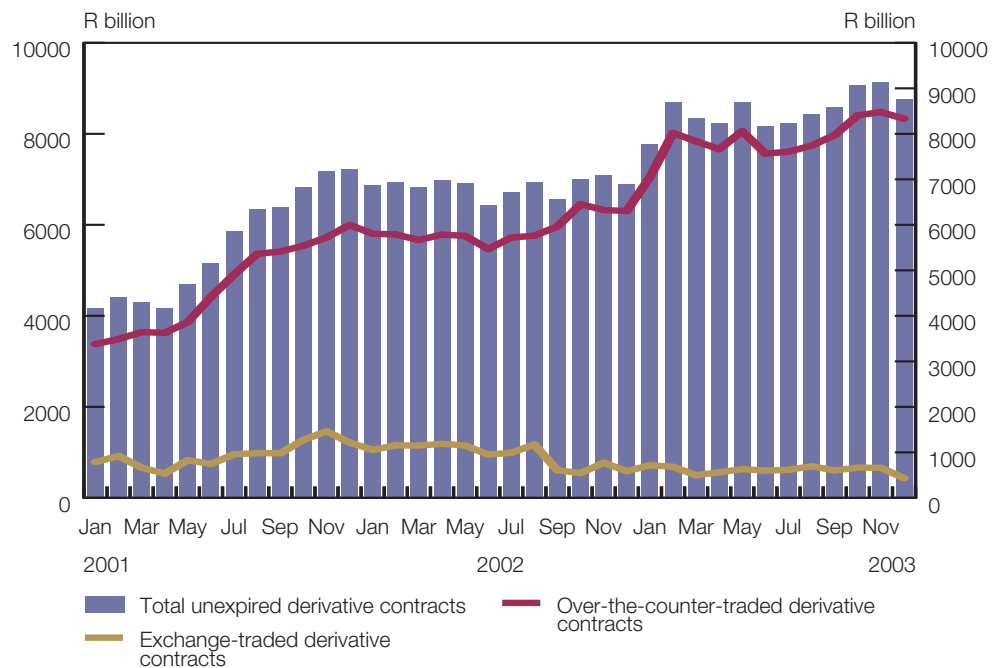
Figure 28: Turnover in derivative contracts**Figure 29: Total unexpired derivative contracts**

Figure 29 reflects the value of and growth (measured over a period of 12 months) in total unexpired derivative contracts. Unexpired exchange-traded derivative contracts amounted to R433,2 million in December 2003 (R586,5 million in December 2002), or 31,4 per cent of the banking sector's total assets (53,3 per cent in December 2002). Average monthly balances, computed on a quarterly basis, were reported as R631,9 million, R597,3 million, R637,6 million and R585,7 million for the quarters ended March 2003, June 2003, September 2003 and December 2003, respectively.

Compared to the previous year, total unexpired derivative contracts increased by 27,2 per cent. As at 31 December 2003, the total value of unexpired derivative contracts was R8,765 billion (December 2002: R6, 891 billion), representing 636,2 per cent of total assets (December 2002: 626,1 per cent). As at 31 December 2003, over-the-counter-traded derivatives accounted for 95,1 per cent (2002: 91,5 per cent) of all unexpired derivative contracts.

3.6 Credit risk

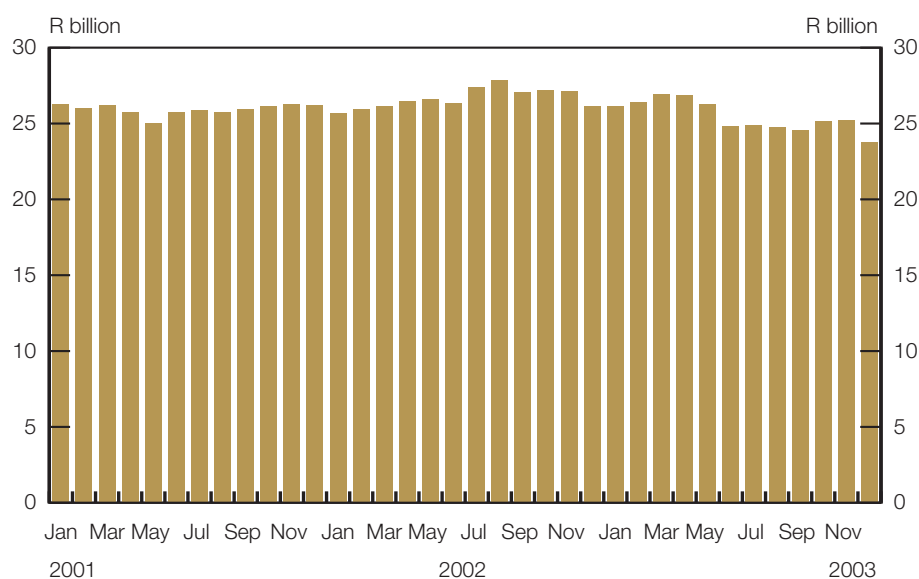
Credit risk is the risk that a counterparty to a financial obligation, such as a loan, will default on repayments linked to the obligation.

Analysis of overdue amounts

Figure 30 graphically depicts the level of total overdues for the banking sector for the period from January 2001 to December 2003. Gross overdues increased from R25,7 billion in January 2002 to R26,1 billion in December 2002. From January 2003 to the end of December 2003, gross overdues decreased to R23,8 billion, representing a net decrease of R2,4 billion.

gross overdues decreased

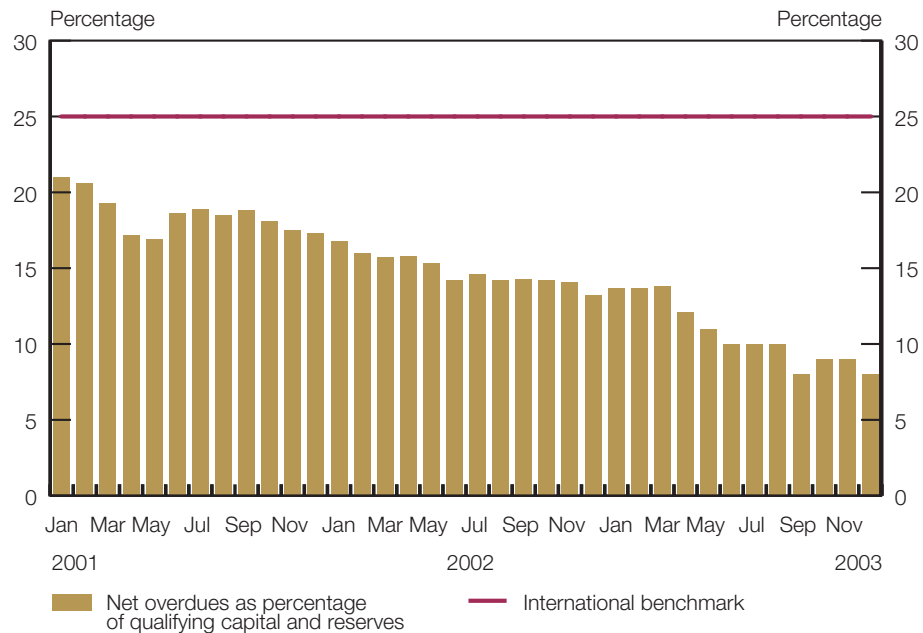
Figure 30: Total banking-sector overdues



The ratio of net overdues (that is, gross overdues less specific provisions) to net qualifying capital and reserves is used internationally to benchmark the extent of amounts overdue in a banking sector. Figure 31 depicts this ratio for the past three years. It is evident from this figure that net overdues as a percentage of net qualifying capital and reserves decreased uninterruptedly from April 2003. Net overdues as a percentage of net qualifying capital and reserves decreased from 13,2 per cent in December 2002 to 12,1 per cent in April 2003. By the end of December 2003, this ratio had improved to 8,5 per cent, which was well below the international benchmark of 25 per cent.

net overdues decreased
uninterruptedly

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



Expressed as a percentage of total loans and advances (see figure 32), gross amounts overdue improved from 3,1 per cent in January 2002 to 2,9 per cent in January 2003. By the end of December 2003, this ratio had improved to 2,4 per cent. From January 2003 to December 2003, mortgage loans overdue (as a percentage of total mortgage loans and advances) and instalment sales overdue (as a percentage of total instalment sales) improved from 3,1 per cent to 2,5 per cent and from 2 per cent to 1,7 per cent, respectively. Other loans and advances overdue (as a percentage of total other loans and advances) decreased from 3 per cent to 2,4 per cent during the year.

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

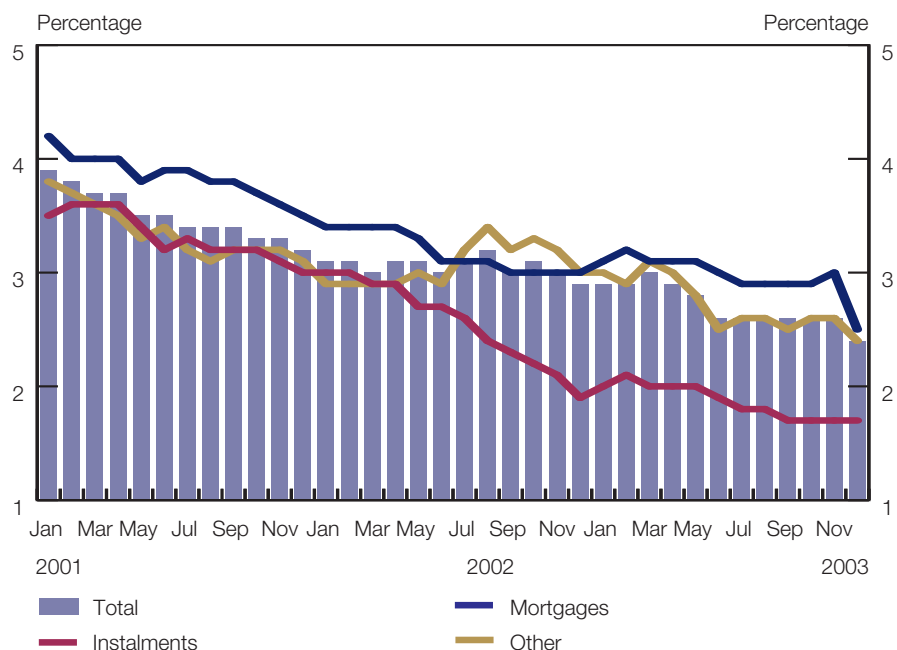


Figure 33 graphically depicts an analysis of overdue accounts for the period from January 2001 to December 2003. The gross amount overdue in respect of other loans and advances decreased from R15,3 billion in January 2003 to R13,4 billion in December 2003. Overdues in respect of other loans and advances still constituted the biggest portion of amounts overdue and, by the end of December 2003, exceeded mortgage accounts overdue by R5,2 billion. Mortgage accounts overdue increased from R8,4 billion in December 2002 to R8,7 billion in January 2003. From January 2003 to December 2003, however, mortgage accounts overdue decreased to R8,2 billion, whereas instalment accounts overdue increased from R2,1 billion to R2,2 billion.

Figure 33: Analysis of overdue accounts

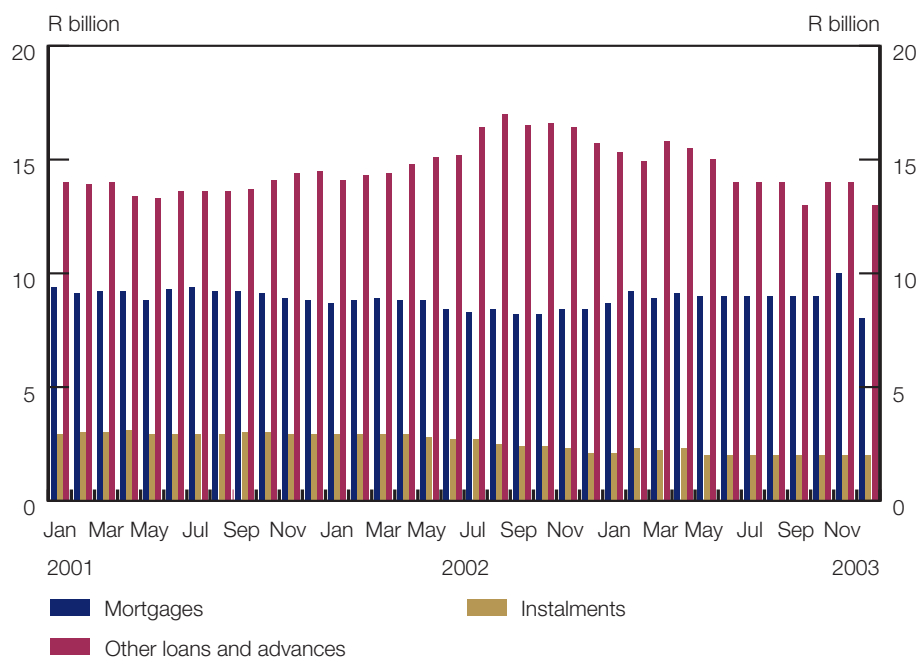
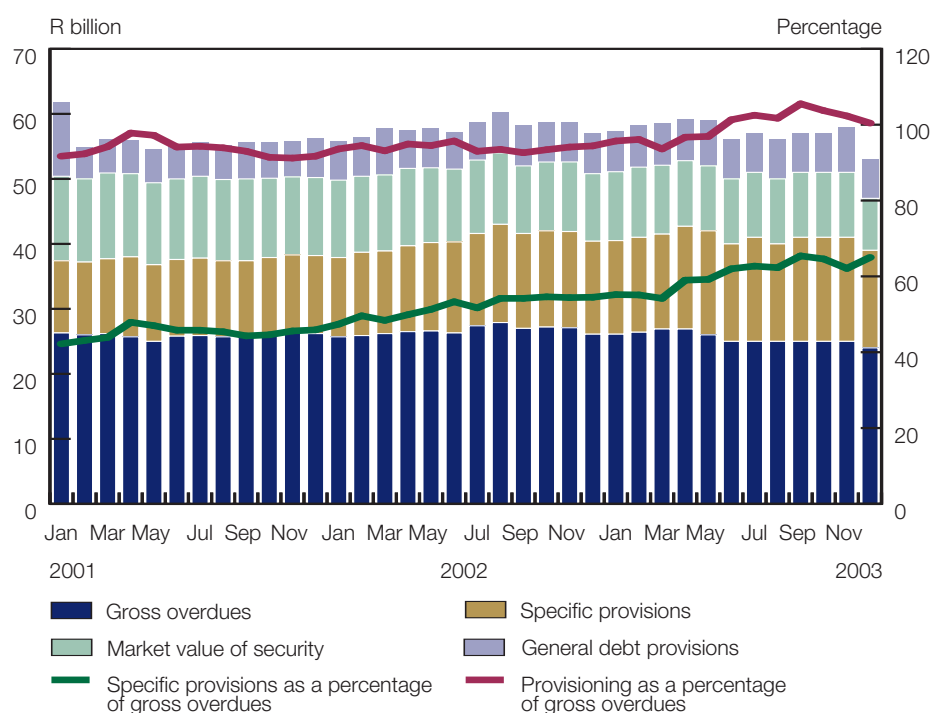


Figure 34: Adequacy of provisions



Provisioning policy for bad and doubtful loans and advances

provisioning by banks
remained adequate

Figure 34 indicates that provisioning by banks remained adequate throughout the year under review. By the end of December 2003, specific provisions covered about 65 per cent (December 2002: 54,5 per cent) of all overdues. At the end of December 2003, provisioning (that is, specific provisions plus security) covered about 100,4 per cent of overdues, compared to 94,4 per cent in December 2002.

specific provisions by loan
type

Specific provisions made at the end of December 2003, by loan type and expressed as a percentage of overdue amounts, were as follows:

- Mortgages - 40,7 per cent (26,1 per cent on 31 December 2002).
- Instalment sales - 67,2 per cent (66,5 per cent on 31 December 2002).
- Other loans and advances - 79,5 per cent (68,2 per cent on 31 December 2002).

Figure 35: Specific provisions as percentage of total overdues

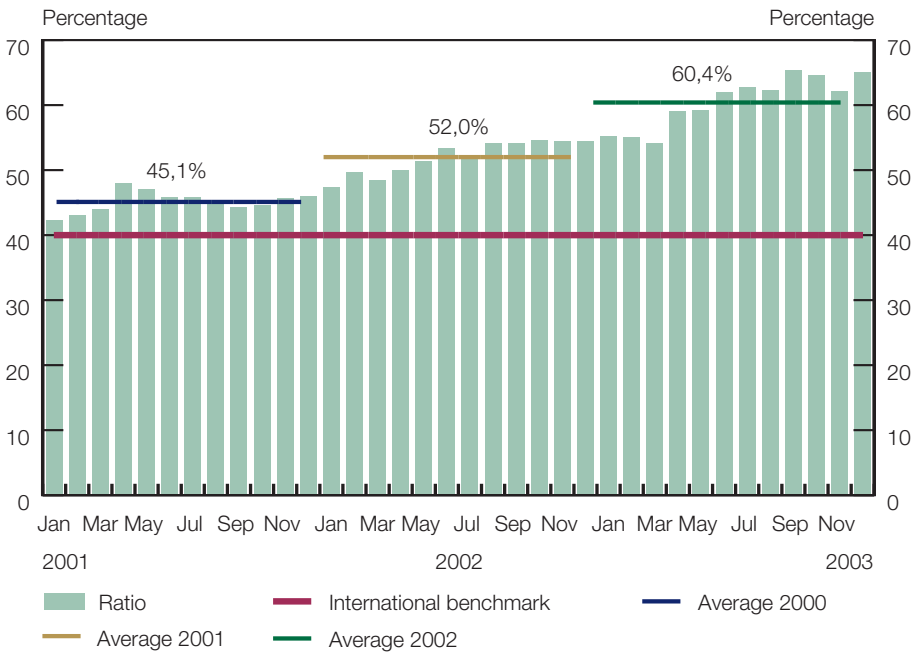


Figure 35 graphically depicts the relationship of specific provisions to total gross overdues for the past three years. On average, about 60,4 per cent of overdues were covered by specific provisions during 2003 (2002: 52 per cent). Internationally, it is generally accepted that specific provisions should cover at least 40 per cent of non-performing loans, which indicates the slightly more conservative stance of South African banks in this regard.

conservative stance of
South African banks

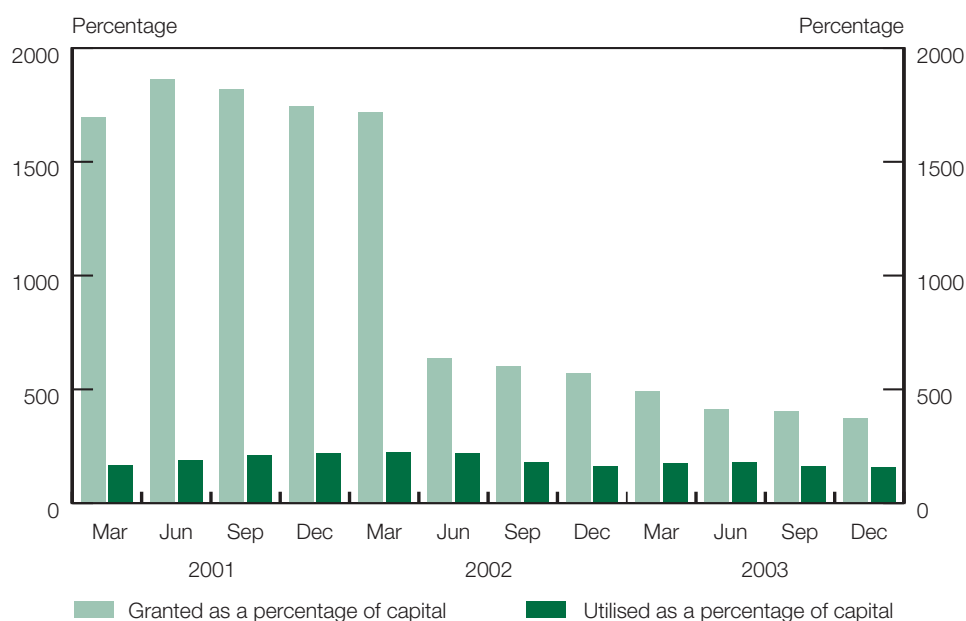
Large exposures

Since January 2001, the Regulations relating to Banks have required large exposures granted not to exceed 800 per cent of capital and reserves, in line with the guidelines of the European Economic Community. In terms of these guidelines, those large exposures granted that exceed 15 per cent of capital and reserves should not exceed, in total, 800 per cent of capital and reserves, and no single exposure should exceed

25 per cent of an institution's capital base. 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 annual report includes, amongst others, exposures to Government and interbank settlements.

The position of large exposures granted and utilised during the period from March 2001 to December 2003 is illustrated graphically in figure 36.

Figure 36: Large exposures granted and utilised as a percentage of capital



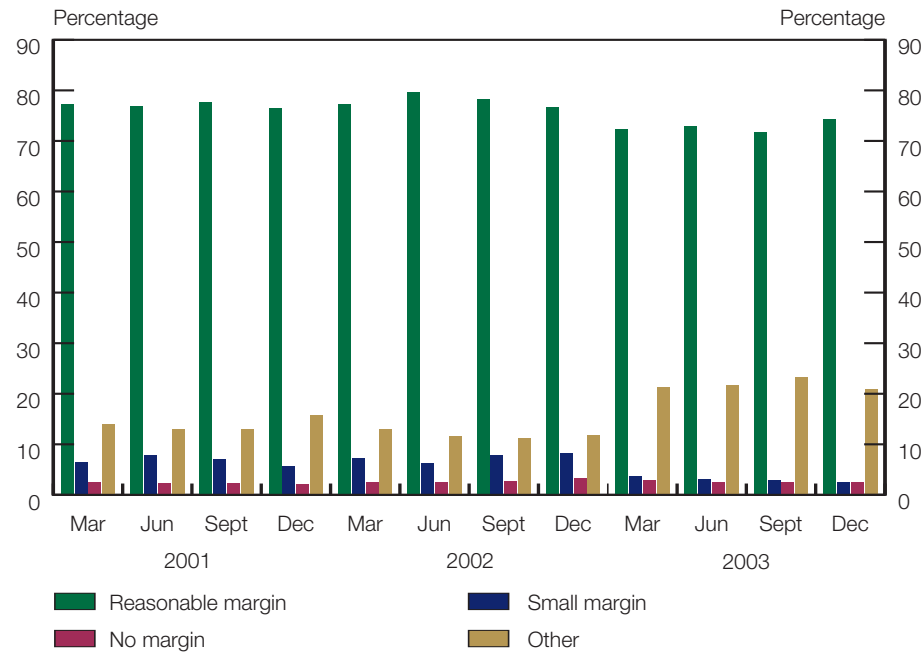
Large exposures granted decreased by R24,6 million, to a level of R489,6 million in January 2003 (representing 571,4 per cent of net qualifying capital and reserves), compared to R514,2 million (570,2 per cent of net qualifying capital and reserves) in December 2002. By the end of December 2003, large exposures granted had decreased to a level of R367,6 million (representing 374,2 per cent of net qualifying capital and reserves). Overdues in respect of large exposures increased from R32,57 million in December 2002 to R48,8 million in January 2003. By the end of December 2003, overdues in respect of large exposures had increased to R95,9 million, and specific provisions covered about 21 per cent of overdues. The remaining overdues were covered by the value of the security held by banks.

overdues in respect of large exposures increased

Quality of assets

By the end of December 2003, about 74,3 per cent of the banking sector's assets (December 2002: 76,7 per cent) earned a reasonable margin, 2,4 per cent (December 2002: 8,2 per cent) earned a small margin, and the remaining 23,3 per cent (December 2002: 15 per cent), including infrastructure, earned no margin (see figure 37).

Figure 37: Asset performance

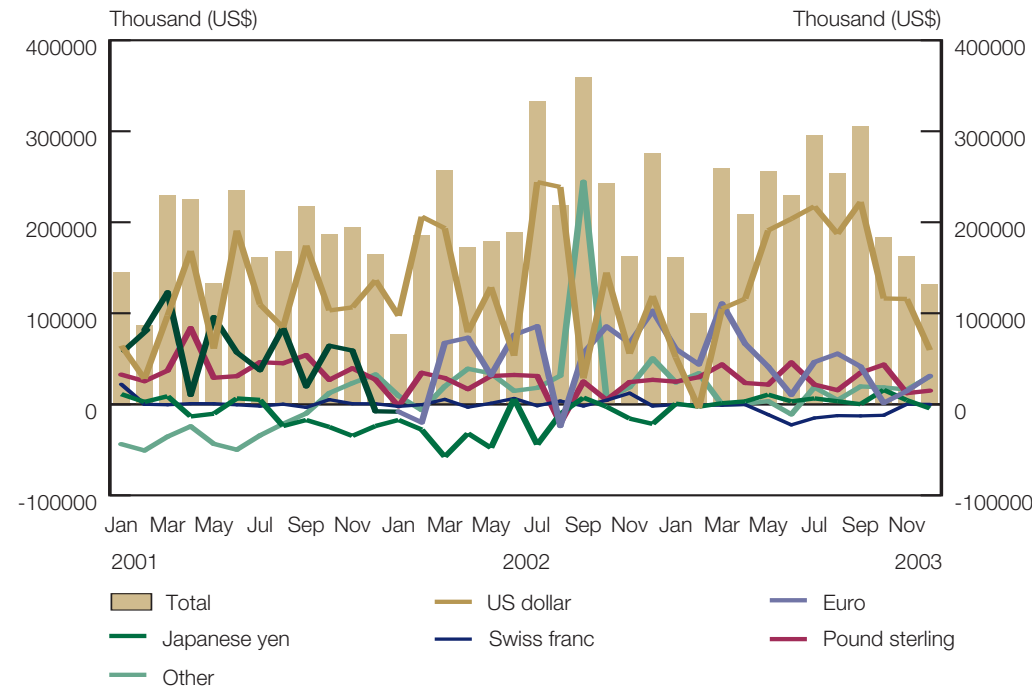


3.7 Currency risk

position remained within the limit

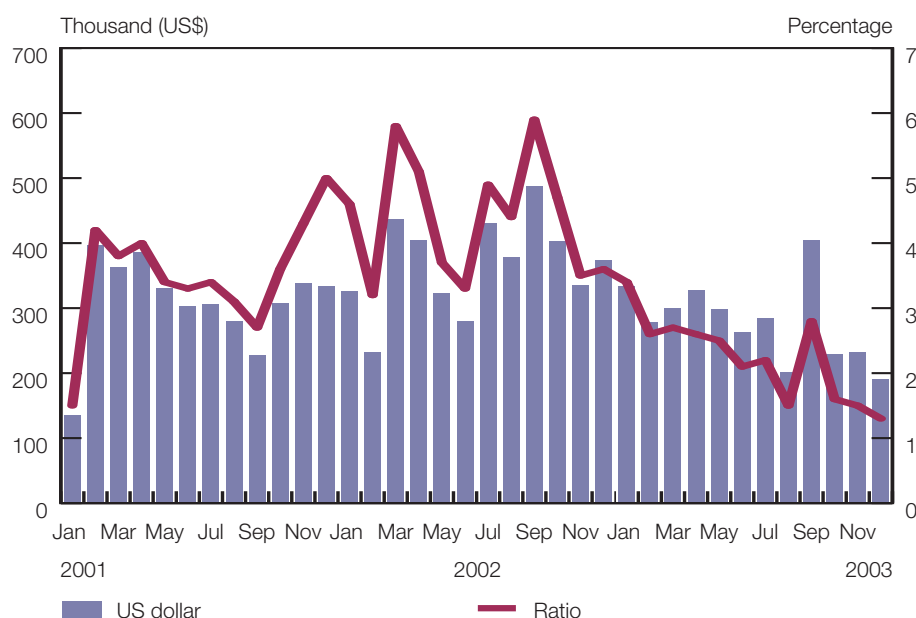
For the year under review, the aggregated net open foreign-currency position after hedging remained within the limit of 10 per cent of net qualifying capital and reserves. The aggregated net effective open foreign-currency position of individual banks, expressed as a percentage of net qualifying capital and reserves, amounted to 0,2 per cent in January 2003 and, by the end of December 2003, the ratio had decreased to 0,1 per cent. The aggregated net effective open foreign-currency position of the total banking sector is depicted in figure 38.

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



From January 2003 to December 2003, the maximum net open position in foreign currency after hedging decreased from 3,4 per cent to 1,3 per cent and remained safely within the limit of 10 per cent of net qualifying capital and reserves (see figure 39).

Figure 39: Maximum effective net open foreign-currency position as a percentage of net qualifying capital and reserves (compliance with limit of 10 per cent)



The position in foreign-currency instruments and the liquidity-maturity structure of US dollar positions are shown in figures 40 and 41, respectively.

Figure 40: Position in foreign-currency instruments

