SA Banks benchmarking report – H1'22 summarised

August 2022

EY is pleased to share a summarised version of the South African Banks peer benchmarking analysis for the six months to 30 June 2022. Our report includes some of the key financial performance indicators from the recently published results of Absa Group Limited, Standard Bank Group Limited and Nedbank Group Limited. The full report, which will be released later in September, will include the FirstRand Group Limited results as well.

In a first for South Africa, the EY South African Banks Benchmarking database allows users to benchmark the performance of select key players in the South African banking industry, supplemented with the latest thinking from EY's Chief Economist and our team of banking and capital markets thought leaders. The database includes the most recent published results and the historical financial results of seven South African Banks.

Summary of results

All 3 reporting banks achieved significant growth in earnings of between 26%-32% during H1'22, supported by rising interest rates, increased economic activity and stable expected credit loss charges. Returns on equity ranged between 11%-15% and net interest margins were up between 13bps-22bps. Anticipated ongoing monetary policy tightening from global central banks and the SARB is expected to provide net positive support to net interest income in the short term.

In contrast to 2020 and 2021, these results were not negatively impacted by volatility in ECL, coverage ratios have remained largely flat and ECL charges were within the banks' through the cycle target ranges. Some of the Covid-19 and macro-economic overlays which were built up over the preceding two years have been utilised or released as impairments have crystallised or have been absorbed into ECL models. All banks highlighted that ECL provisions remain at prudent levels, given forward looking risks including rising inflation and interest rates, South Africa's power supply constraints and geopolitical instability.

Supported by their strong earnings growth and robust capital positions, all banks returned cash to shareholders through increased dividends, with expectations of maintaining dividend pay-out ratios of between 45%-60%.

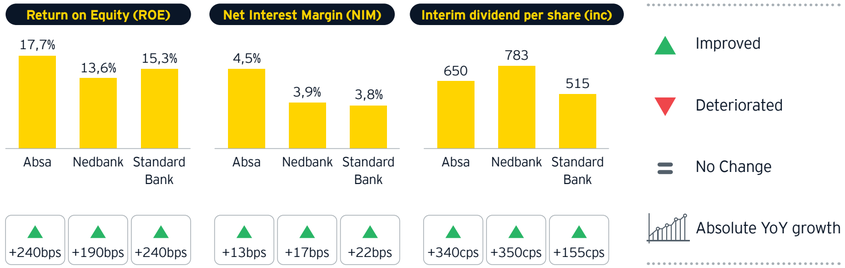
Key strategic themes across all three banks included:

- Cost containment and ongoing improving in cost to income ratios.
- Improving customer experience to drive customer acquisition and retention.
- Increased pace of digitisation, with significant growth in digital transactions and digitally active customers across all three banks.

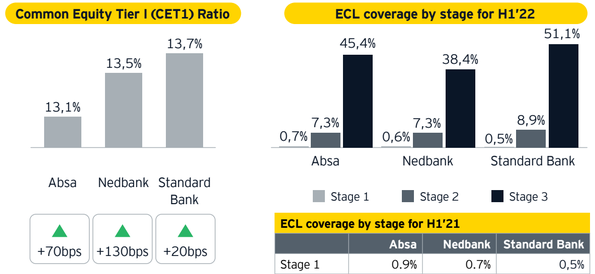
H1'22 Financial performance snapshot

In H1'22, South African banks showed resiliency and reported some of their strongest interim results, supported by the removal of Covid-19 restrictions and rising interest rates. This is despite increased geopolitical tensions, floods in Kwazulu-Natal, renewed electricity disruptions and rising inflation.

Three of the largest South African banks reported strong earnings growth in H1'22, which led to significant growth in capital distribution to shareholders.



The banks maintained robust capital positions and prudent levels of cover to navigate the emerging risks.



ECL coverage by stage for H1'21

	Absa	Nedbank	Standard Bank
Stage 1	0.9%	0.7%	0,5%
Stage 2	6.2%	7.0%	9.7%
Stage 3	47.1%	36.3%	46.8%

- ROE for all banks improved YoY. This was driven largely by higher earnings growth on the back of rising income, which increased by 11%-15% for all banks.
- NII increased between 8%-13% YoY, driven largely by the rising interest rate environment, balance sheet growth and favourable funding mix. Non-II increased between 13%-18% YoY in H1'22 due to foreign exchange (FX), equity & commodity market volatility and recovery in insurance business as claims reduced.
- Strong earnings growth between 26%-32% YoY saw the growth of interim dividends in the range of 155cps-350cps YoY across banks, which are now back above H1'19 levels.

- The banks remain strongly capitalised, with CET1 ratios well above SARB's minimum regulatory requirements.
  - During H1'22, the CET1 ratio of banks increased between 20bps-130bps, driven primarily by strong earnings growth and RWA optimisation. This was partly offset by capital distribution in form of dividends.
- Additionally, banks are maintaining robust coverage and are well positioned against an uncertain macroeconomic backdrop.

Banks performance outlook

Financial Parameters	Nedbank	Absa	Standard Bank
NII growth	Low double-digit growth	-	Low double-digit growth
NIR growth	Upper single-digit growth	Non-II growth to be slightly higher than that of NII	High single-digit growth
Expense growth	Above mid single-digit growth, with upside risk	Mid-single digit operating expense growth	-
Credit Loss Ratio (CLR)	60-100 bps range	Upper half of 75-100 bps range	70-100 bps range
CET 1 ratio	Above through the cycle range of 11.0-12.0%	CET1 ratio is expected to remain strong	-
Dividend	Dividend cover range of 1.75x-2.25x	Dividend pay-out ratio at least 50%	Dividend pay-out ratio in range of 45%-60%

Long term outlook	Nedbank	Absa	Standard Bank
RoE	> 15% in FY23 (>18% in long term)	>17% by FY24	17%-20%
Cost to Income ratio	< 54% in FY23 (<50% in long term)	Low 50%s by FY24	Approaching 50%

EY Economic Outlook

Uncertainty is the new normal. Geopolitical developments over the past six months added significantly to pandemic-related risks. Russia's invasion of the Ukraine in February set off a series of shifts in the global economy: from spikes in the price of fuel and food, to fundamentally changing the structure of global trade. In addition, tensions between the US and China over Taiwan are mounting, which could have further implications for geopolitical dynamics and global trade. Looking at South Africa, the economy has been affected by floods in KwaZulu-Natal and extended Stage 6 loadshedding, which surpassed the energy constraints already priced into most baseline economic forecasts.

Global volatility has manifested in higher prices. Inflation in the US, Euro area and UK has made headlines, with July year-on-year price growth in these markets reaching 8.5%, 9.8% and 10.1% respectively. Although US inflation is showing signs of easing, UK and Euro area inflation will likely remain elevated. South Africa's inflation rate recorded a thirteen-year high of 7.8% in July, from 7.4% in June. While inflation has not reached the levels seen in other countries, it is above the Reserve Bank's target range and South African consumers are particularly vulnerable given the context of stubbornly high rates of unemployment and inequality. The Monetary Policy Committee acted cautiously by starting to hike rates in November 2021 – well ahead of the US Fed – and most recently increasing the repo rate by 75 basis points to moderate future inflation.

Global growth is expected to reach 3.2% in 2022, 0.4 percentage points lower than the April forecast, according to the IMF's July World Economic Outlook. This is due to the pressures on the global economy from pandemic-related lockdowns in China, the war in Ukraine, muted spending in the US, and global uncertainty. In 2023, global GDP is expected to grow by 2.9%. In contrast to the global outlook, the IMF raised South Africa's 2022 growth forecast to 2.3%, up from its April forecast of 1.9%. Compared to many other countries, South Africa's broader economy is expected to fare better. Elevated metals prices have kept the country's Balance of Payments in strong positive territory and brought in higher-than-anticipated tax revenue for the government. The electricity crisis in July has spurred the South African government to act decisively on electricity sector reform. This will drive investment in the near term, with the electricity supply constraint beginning to ease in the next two to three years as new projects come online.

Focusing in on the financial sector, we have seen strong performance coming out of the local banks with higher earnings, returns on equity and net interest margins. Continued elevated commodity prices, better-than-anticipated economic growth and the lack of Covid-19 restrictions lent support to the sector over the past 6 months. Growth in total credit extension reached, and remained at, pre-pandemic levels in the first half of 2022, with credit to households elevated by a continued strong installment credit growth. Looking forward, rising interest rates to battle inflation and align with developed market policy rates will support local banking sector returns. However, consumers will remain under pressure amidst continued high inflation and a high rate of unemployment, which could affect the retail portion of South African banks by raising credit risk. On the commercial lending side, the pick-up in investment, led by the energy sector, will increase loan growth. The banking sector should continue to carefully monitor, and adjust to, the broader environment as uncertainty and volatility is the new normal.

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