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FINANCIAL STABILITY REPORT

Overall Assessment of the Financial Stability

The global economy was on the recovery path in the first half of 2010. The economic recovery, which was mainly supported by accommodative macroeconomic policies in the advanced economies, was modest and uneven, and unemployment remained high in some economies. The recovery pace has been stronger in many emerging and developing economies, where household expenditure has been vigorous and job creation has propelled investment. Although risks to growth forecast are on the downside, the probability of a sharp global slowdown remains low. The IMF (in its October 2010 World Economic Outlook) expects economic recovery to continue.

Despite the global economic recovery, the global financial stability was negatively affected by the fallouts from the sovereign debt crisis in Europe during the period. As concerns over sovereign credit risks intensified and uncertainty about the banking institutions' sovereign debt holdings heightened, financial market volatility increased and investor confidence fell. Uncertainty led to pressure in the interbank markets and to a reduction in lending by banking institutions. At the same time, volatility resulted in sharp movements in currency, equity and commodity markets. However, policy actions helped to stabilise funding markets and reduced risks. As a result, financial market conditions improved, somewhat, although underlying sovereign and banking vulnerabilities remain.

The domestic economic activity improved in line with global economic recovery in the first half of 2010. Output expansions were noted in the agriculture and mining sectors. The secondary and tertiary industries also showed signs of improvements. The pickup in domestic demand was reflected in higher growth in credit extension to the private sector. As a result, the Bank, in its latest economic outlook for 2010, projected the domestic economic improvement to continue and expects GDP to expand by 4.2 percent in 2010, after contracting by 0.8 percent in 2009. At the same time, the potential reversal in the global economic recovery in 2010 remain the main downside risk to the domestic economic recovery and, hence, the outlook for Namibian key exports.

The recovering domestic economic conditions are expected to lead to improvements in the financial situation of households, and to further support internal demand and stimulate output. Similarly, the rebound in economic activity would boost corporate performance. These favourable circumstances would likely result in improved repayment ability of the banking borrowers and in further reductions in non-performing loans for the banking sector.

The real effective exchange rate of the Namibia Dollar (NAD) appreciated against the currencies of the major trading partners in the first half of 2010. The real appreciation could have resulted in reduced proceeds of some of Namibia's exports. During the same period, the country's international reserves have fallen, but remained sufficient to maintain the currency peg. In addition, level of reserves is adequate to support both the financial health of the domestic economy and financial stability.

Limited links, to international financial markets, continued to act as a shield for the banking sector against the negative impacts of the recent financial turbulence. As a result, the banking sector was adequately liquid, profitable and well capitalised. Furthermore, non-performing loans and overdue loans fell. The status quo, thus, boded well for banking sector stability. The banking sector, consequently, remained sound and stable in the first half of 2010.

The Bank continued to carry out its oversight function of the performance of the National Payment System (NPS) during the period. The principal aim of these oversight activities was to ensure the efficiency and safety of the NPS. Overall the

NPS was efficient and safe and thus, did not pose systemic risk to the financial system during the review period.

In summary, the impact of the global financial turbulences on the Namibian banking sector was limited to the first half of 2010. The domestic economy recovered during the same period, in line with improvements in global economic conditions, with key economic sectors experiencing significant output expansion. The domestic economic recovery would improve the financial conditions of both businesses and households and eventually boost banking performance and financial stability. The overall impact of the global economic conditions is assessed to remain low in the foreseeable future, as long as the current economic recovery endures.

Please find the full report on the Bank of Namibia's website at www.bon.com.na, under: ***Economic Information and Publications-Publications-Financial Stability Reports (September 2010)***.

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