Namibia Financial Stability Report

April 2021

Bank of Namibia

NAMFISA

Members of the Financial System Stability Committee

Bank of Namibia

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CORPORATE CHARTERS

Bank of Namibia

Vision
Our vision is to be a centre of excellence - a professional and credible institution - working in the public interest and supporting the achievement of the national economic development goals.

Mission
To support economic growth and development in Namibia, we

- Act as fiscal advisor and banker to the Government,
- Promote price stability,
- Manage reserves and currency,
- Ensure a sound financial system,
- Conduct economic research.

Values
- We value high performance to achieve positive impact and excellence.
- We value open communication, diversity, integrity and teamwork.
- We care for each other's well-being.

NAMFISA

Vision
To have a safe, stable and fair financial system contributing to the economic development of Namibia in which consumers are protected.

Mission
To effectively regulate and supervise financial institutions and to give sound advice to the Minister of Finance.

Values
- We are committed to teamwork
- We are passionate about service
- We act with integrity
- We drive performance excellence
- We are accountable
- We are agile

LIST OF ABBREVIATIONS

AEs	Advanced Economies
AfDB	African Development Bank
ATM	Automated Teller Machine
BoN	Bank of Namibia
CAR	Capital Adequacy Ratio
CET1	Common Equity Tier 1
CIS	Collective Investment Schemes
CMA	Common Monetary Area
CNP	Card-Not-Present
CPOC	Payments System Oversight Committee
DB	Defined Benefit
DR	Disaster Recovery
DSIB	Domestic Systemically Important Banks
EFT	Electronic Funds Transfer
EMDEs	Emerging Market and Developing Economies
FATF	Financial Action Task Force
FY	Fiscal Year
GDP	Gross Domestic Product
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
LTD	Loan-to-Deposit
LTF	Loan-to-Funding
LTI	Long-term Insurance
MAF	Medical Aid Funds
MoF	Ministry of Finance
MPC	Monetary Policy Committee
MTEF	Medium-Term Expenditure Framework
NAD	Namibia Dollar
Nam	Namibia
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFIs	Non-Bank Financial Institutions
NISS	Namibia Inter-Bank Settlement System
NPL	Non-Performing Loan
NPS	National Payment System
NSX	Namibia Stock Exchange
PCI-SSC	Payment Card Industry Security Standards Council (PCI-SSC)
PCI DSS	Payment Card Industry Data Security Standards

PFI	Pension Fund Institutions
POS	Point of Sale
PSCE	Private Sector Credit Extension
PSD-10	Determination on Standards for Fees and Charges for Payment System Services within the National Payment System
QPM	Quarterly Projection Model
Repo	Repurchase
RHS	Right Hand Side
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investments
RTO	Recovery Time Objective
RWCR	Risk-Weighted Capital Ratio
SADC-RTGS	Southern Africa Development Community Real-Time Gross Settlement System
SARB	South African Reserve Bank
SACU	Southern African Customs Union
SOE	State Owned Enterprise
S&P	Standard & Poor's
SSA	Sub-Saharan Africa
STI	Short-term Insurance
UK	United Kingdom
US	United States of America
VAT	Value Added Tax
VIX	Volatility Index
WEO	World Economic Outlook
Y-o-Y	Year-on-Year
ZAR	South African Rand

PREFACE

The purpose of the Financial Stability Report (FSR) is to identify risks and vulnerabilities in the financial system and assess the resilience of the financial system to domestic and external shocks. The Report also serves as a communication tool. The report presents recommendations to deal with the identified risks. Lastly, the report is published to inform the reader about the soundness of the financial system, and what the regulators and government are doing in order to mitigate risks to the Namibian financial system. While the FSR is published once a year, the tracking of the state of financial stability by the authorities is an ongoing process at all times.

Financial system stability is defined as the resilience of the domestic financial system to internal and external shocks, be it economic, financial, political or otherwise. It can also be described as the absence of macroeconomic costs of disturbances in the system of financial exchanges between households, corporates, and financial institutions.

The financial system in Namibia consists of financial markets, instruments, institutions and infrastructure. The regulatory structure plays an important role in regulating and monitoring the system. Under Section 4(1) of the Bank of Namibia Act, 2020 (Act No. 1 of 2020) the Bank of Namibia has an objective “to promote monetary stability and to contribute towards financial stability conducive to the sustainable economic development of Namibia.” Section 4(1)(i) further expands on the functions of the Bank, “to have macro-prudential oversight over the financial system and to co-ordinate activities involved in the safeguarding of financial stability in order to maintain and enhance a stable financial system in Namibia”. The stability of the financial system is critical as the system provides important services to households, corporates, and the real economy.

This report is a joint effort between the Bank of Namibia (BoN) and the Namibia Financial Institutions Supervisory Authority (NAMFISA). The two institutions, which are entrusted with the regulation of the financial system in Namibia, work closely together to ensure a healthy financial system. There is also active engagement between the BoN, NAMFISA and the Ministry of Finance (MoF) to ensure a comprehensive assessment of systemic financial risks and of policy actions to ensure lasting financial system stability.

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I. INTRODUCTION AND SUMMARY

1. **The Namibian financial system remained sound and resilient in 2020, despite the pre-existing sluggish economic activity that was further exacerbated by the COVID-19 pandemic.** Both the global and domestic economy contracted in 2020, primarily as a result of the COVID-19 pandemic. The financial system continued to function efficiently and effectively while remaining generally sound and profitable. The banking sector remained adequately capitalised, profitable (albeit less so than before) and maintained liquidity levels well above the prudential requirement. Asset quality as measured by non-performing loans (NPL) deteriorated further in 2020, partly ascribed to unfavourable economic conditions and their resultant impact on household disposable income and business performance. The Non-Bank Financial Institutions (NBFIs) continued to be financially stable and sound despite unfavourable economic conditions. The National Payment System (NPS) continued to effectively contribute toward the safety and reliability in payments, thus enhancing financial stability in Namibia. Household debt growth slowed and corporate debt declined significantly in 2020 with risks to financial stability having gone down. The financial system's resilience was maintained into early 2021, with the start of the rollout of vaccines in many parts of the world bringing the prospect of imminent normalisation closer.

2. **Global growth prospects were recently revised slightly upwards due to stronger than expected momentum towards the end of 2020 and the anticipation of the end of the COVID-19 pandemic sooner than expected.** Based on the International Monetary Fund's (IMF) April 2021 World Economic Outlook (WEO), global real GDP is estimated to have contracted by 3.3 percent in 2020 and projected to rebound to positive growth of 6.0 percent and 4.4 percent in 2021 and 2022, respectively, owing to additional fiscal support in a few large economies and the anticipated vaccine-powered recovery in the second half of the year. The projected improved growth in 2021 is broadly spread across both Advanced Economies (AEs) and Emerging Market and Developing Economies (EMDEs), but with divergent magnitudes largely based on country-specific factors relating to how the pandemic and its new variants are contained, as well as the depth of the health crisis in each country. As such, the probability of a global growth slowdown in 2021 is medium; however, should it materialised, the impact would be considered high.

3. **The domestic economy contracted in 2020 but is expected to recover in 2021 and 2022.** The Namibian economy is estimated to have contracted by 8.0 percent in 2020, nonetheless, it is projected to pick up to growth rates of 2.7 percent in 2021 and 3.3 percent in 2022, respectively. The contraction during 2020 is attributed to the outbreak of the COVID-19 pandemic, which has led to the protracted travel restrictions across the world and lockdowns in many countries, including Namibia. Since the last Financial Stability Report, real activity in Namibia seems

to have bottomed in the middle quarters of 2020 with indications of recovery from the final quarter of 2020. The risk of a renewed domestic economic slowdown is softened given the low base, good policy support and the possibility of viable vaccines which are expected to end the pandemic sooner than had been anticipated earlier on. Therefore, the probability of renewed economic slowdown is medium, while the impact, if the risk materialises, is high.

4. **The Namibia Dollar (NAD) depreciated against all major trading currencies, international reserves grew, while Namibia's as well as South Africa's sovereign credit outlooks were revised downwards by all major credit rating agencies.** The depreciation of the NAD against all major currencies was attributed to investors' risk aversion towards EMDEs associated with the COVID-19 pandemic and with it a flight to the familiarity of the AEs. At the time of releasing the April 2020 FSR, the risk of sharp NAD/ZAR depreciation had already materialised, with some of that depreciation being reversed during the remainder of 2020 as risk aversion softened. Going forward the risk of renewed sharp NAD/ZAR depreciation is projected to be moderate in line with market forecasts and forward cover rates. Namibia's international reserves increased mostly due to capital inflows, higher Southern Africa Customs Union (SACU) receipts as well as a lower import bill. The international reserves remain at a sufficient level to safeguard the peg of the NAD to the South African Rand (ZAR) and meet the country's international financial obligations. The risk of a decline in international reserves has therefore, went down. South Africa's and Namibia's sovereign credit rating outlooks were revised downwards by rating agencies, implying that the risk has increased compared to the April 2020 FSR. Going forward, the risk of a further sovereign credit rating downgrade for both Namibia and South Africa is medium with a medium impact.

5. **Household debt growth slowed and corporate debt declined significantly in 2020.** The annual growth in household debt slowed from 5.4 percent in 2019 to 4.5 percent in 2020, on the back of a much lower demand for short term credit. The ratio of household debt to disposable income increased due to subdued growth in disposable income, relative to the growth in credit. Disposable income contracted by 1.7 percent in 2020, in contrast to growth of 1.1 percent registered in 2019. Nominal income and GDP declined, leading to an increase in debt-to-income ratios which does not bode well for financial stability; however, given lower interest rates, debt service ratios have gone down thus relieving financial pressure and reducing risks to financial stability. Should the risk of an increase in household and corporate debt materialise in 2021, the probability would be medium and low respectively, with medium impact. The stock of corporate sector debt contracted significantly from N$128.6 billion in 2019 to N$123.9 billion in 2020, driven mainly by intercompany borrowing and repayments made by the mining sector. The risk to financial stability of an increase in corporate debt, has declined. However, the probability of this risk materialising in 2021 is low with a medium impact.

6. **The banking sector remained liquid, profitable and well capitalised amidst the adverse impact of the COVID-19 pandemic induced recessionary conditions.** Total assets of the banking sector continued to grow, although at a slower pace, with liquid assets remaining well beyond the statutory minimum required. Furthermore, the banking sector continued to be profitable and maintained adequate capital levels well above the prudential statutory requirements during the period under review. Asset quality deteriorated and breached the crisis times benchmark in 2020. Similarly, write-offs in relations to profits increased, which reflects the recessionary economic condition triggered by COVID-19. However, this is expected to improve once the economy recovers during the course of 2021 and 2022. The probability of downside risk to financial sector stability emanating from liquidity constraints in the banking sector declined in 2020, while that from asset quality deterioration remained high. The potential impact on financial stability originating from both liquidity constraints and asset quality deterioration in the banking sector was assessed to be medium. To mitigate the impact of the deterioration in asset quality, the Bank of Namibia implemented additional regulatory reporting and will continue to monitor heightened credit risk going forward.

7. **Despite a moderation in the growth rate of Non-bank Financial Institutions (NBFIs) assets, the NBFI sector remained financially stable and sound.** The NBFI sector assets grew by 4.8 percent to N$341.5 billion in 2020, much lower than the 12.3 percent growth realised in 2019. This slower growth in total NBFI assets was mainly driven by the continued recessionary conditions, worsened by the COVID-19 pandemic, during the review period. Nonetheless, the sector's funding and/or solvency position remained above prudential requirements indicating financial soundness. Long-term insurance and pension fund institutions assets are heavily exposed to financial markets through their respective investment mix. Taking into consideration the positive short-term financial markets' outlook, it is expected that NBFIs will remain sound in 2021.

8. **The National Payment System (NPS) remained stable, safe, efficient, and effective during 2020, in the face of the COVID-19 pandemic.** The Bank continued to fulfil its regulatory role through the issuance of relevant payment regulations and oversight of participants to ensure that potential risks to the NPS are appropriately managed. Namibian participants including the Bank continued to participate in the SADC Real-Time Gross Settlement System (SADC RTGS) and maintained a significant share of transaction values processed in the SADC RTGS.

II. SUMMARY OF RISK ANALYSIS

This section presents a brief analysis of the main risks to the stability of the domestic financial system. Consistent with sections III-VII of this Report, the analysis identifies risks arising from the external macroeconomic environment, trends in household and corporate debt, and trends in the domestic banking and non-banking institutions' financial soundness indicators, before concluding with an analysis of the payment and settlement system. The risks are analysed and rated from low risk to high risk based on their probability of occurrence as well as their potential impact on financial stability in Namibia, should they be realised.

According to the IMF's April 2021 Global Financial Stability Report (GFSR), the global financial system has been resilient since the outbreak of the COVID-19 pandemic and financial conditions have improved significantly underpinned by enormous policy support. Two overarching themes have emerged, (1) unprecedented policy support may have unintended consequences and (2) the recovery is expected to be asynchronous and divergent across economies. Firstly, excessive risk-taking in markets is contributing to stretched valuations, and rising financial vulnerabilities may become structural legacy problems if not addressed. Secondly, any further delays in economic recovery may require continued accommodation beyond 2021 and 2022, thus fueling further financial vulnerability. The fiscal stimulus measures adopted since the start of the pandemic have contained the number of bankruptcies, restrained the increase in unemployment, and reduced economic scarring. Policy makers are faced with a policy trade-off between continuing to support the recovery to sustainable growth on the one hand and addressing pre-existing financial vulnerabilities as well as those that emerged as a result of the pandemic, on the other.

Looking ahead, ongoing policy support remains essential until a sustainable recovery is entrenched to maintain the flow of credit to the economy and prevent the pandemic from posing a threat to the stability of the global financial system. Monetary policy will need to remain accommodative until policy objectives are achieved. Policymakers are expected to act promptly to prevent financial vulnerabilities from becoming entrenched and turning into legacy problems. Macroprudential policies are thus crucial to address vulnerabilities, while avoiding putting growth at risk in the medium term.

Despite an increase in some risks to Namibia's financial stability, on the back of sluggish economic activity, most risks remained broadly unchanged or even improved. All the risks to financial stability emanating from the macroeconomic environment since the beginning of 2020 have gone down, with the probability of these risks materialising in 2021 ranging between low and medium, the impact of which is mostly medium (Figure 1a). Risks to financial stability coming from public sector debt, have increased of which the probability and impact of this risk materialising in 2021 is medium. The risk of household and corporate debt increasing in 2020, has also declined; however, the probability of these risks materialising in 2021 are medium and low, respectively, with overall medium impact. Although the risk of liquidity constraints in the banking sector has gone down during the period under review, the probability of this risk materialising in 2021 is high with medium impact. Furthermore, the risk of banking sector asset quality deteriorating further, as measured by the non-performing loans (NPL) ratio, increased in 2020 with a high projected probability of occurrence and impact, respectively. Risks from the payment system pertaining to settlement in the last window, have remained unchanged with medium probability of occurrence and impact in 2021. Moreover, the security risk of retail payments may have increased in the advent of digitisation and emerging cyber security risks during the period under review; however, the probability and impact of this risk materialising in 2021 is medium. Risks from the NBFIs were broadly mixed; however, going forward the probability of these risks are generally low to medium with mostly medium impact should they materialise in the next review period.

Figure 1a: Risks to Financial Stability in Namibia as assessed in April 2021

	Direction of risk[1] Since December 2019	Probability of risk in 2021[2]	Impact of risk in 2021[3]
Macroeconomic Environment Events/Risks			
Global economic slowdown	Down	Medium	High
Domestic economy slowdown	Down	Medium	High
Sovereign credit rating downgrade: Namibia	Down	Medium	Medium
Decline in international reserves	Down	Low	Medium
Sovereign credit rating downgrade: South Africa	Down	Medium	Medium
NAD/ZAR depreciation	Down	Medium	Medium
Public Sector Debt			
Increase in public sector debt	Up	Medium	Medium
Household debt risks			
Increase in household debt	Down	Medium	Medium
Corporate debt risks			
Increase in corporate debt	Down	Low	Medium
Banking Sector risks			
Liquidity constraints	Down	Medium	Medium
Asset quality deterioration (NPLs)	Up	High	Medium
Payment System risks			
Security of retail payments	Up	Medium	Medium
Settlement in last window	Unchanged	Medium	Medium
NBFIs risks			
Funding position	Up	Medium	Medium
Cash flow risk	Unchanged	Medium	Medium
Market risk	Up	Medium	Medium
Capital adequacy	Down	Low	Medium
Credit risk	Unchanged	Low	Low

Risk analysis keys: Low | Medium | High

Source: Bank of Namibia and NAMFISA

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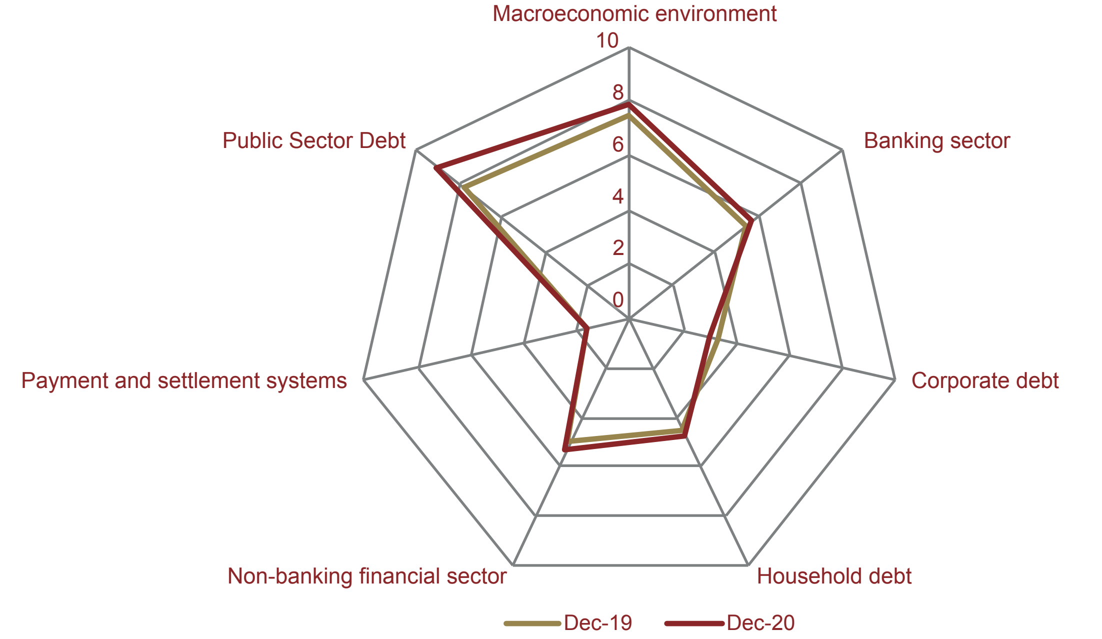
[1] This is the direction of risk compared to the last FSR.

[2] This is the probability of the risk materialising.

[3] This is the impact that the risk will have, if it materialises.

The trends in the key risks to domestic financial stability have eased year-on-year, with some improvements and some areas of continued concern. Risks emanating from household debt have deteriorated, while that of the corporate sector have eased and risks from the payment and settlement system remained broadly unchanged, during the period under review (Figure 1b). On aggregate, risks from the banking sector deteriorated given the less-than-optimal asset quality performance during the period under review. The COVID-19 induced economic downturn in 2020 elevated the risks to financial stability stemming from the macroeconomic environment and the NBFIs. The impact of the COVID-19 pandemic and its associated uncertainty will remain a key factor regarding risk to financial stability.

Figure 1b: Domestic Financial Stability Risks Map as assessed from December 2019 to December 2020[4]



Source: Bank of Namibia

[4] The further from the centre, the greater the risk.

III. MACROECONOMIC ENVIRONMENT

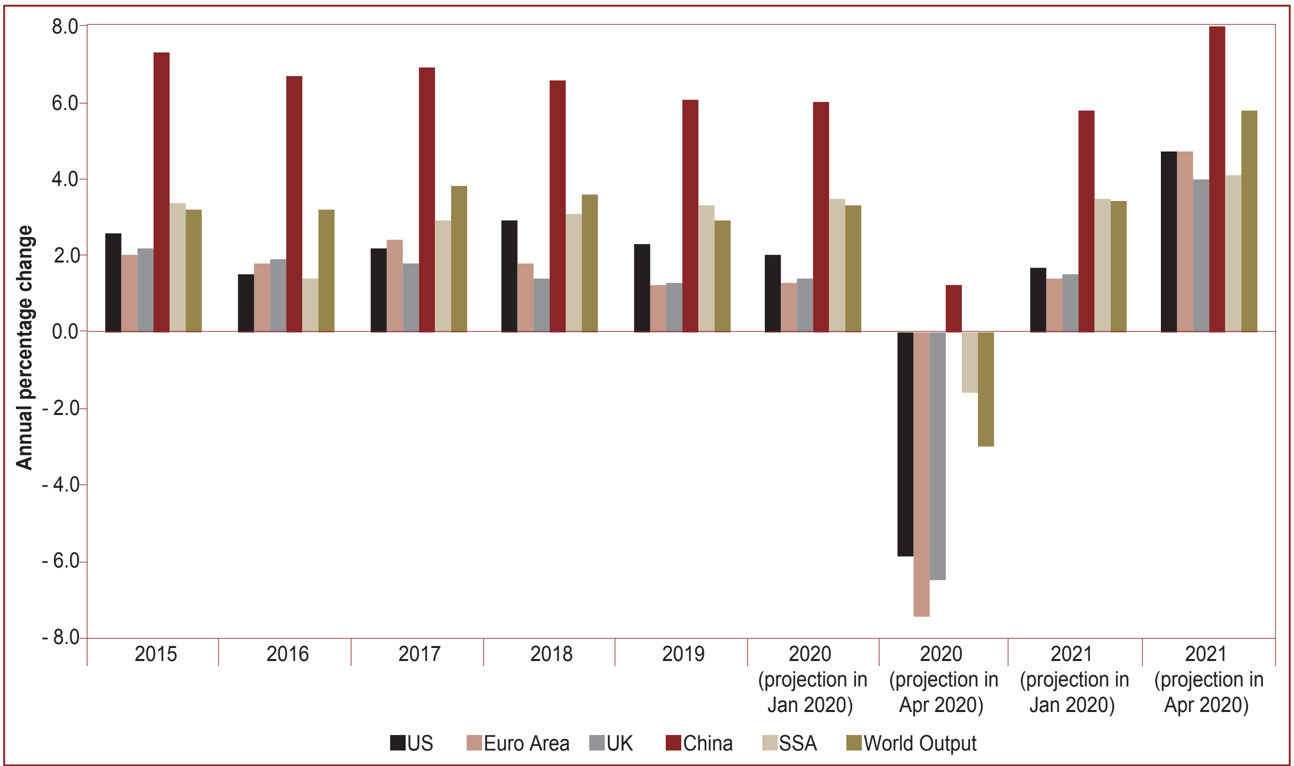
GLOBAL ECONOMIC GROWTH

Global economic activity contracted sharply in 2020 but is expected to recover in 2021. Global real GDP is estimated to have contracted by 3.3 percent in 2020 but is projected to grow by 6.0 percent and 4.4 percent in 2021 and 2022, respectively, according to the IMF's April 2021 World Economic Outlook (WEO). The steep contraction in 2020 was widespread, with a recovery in most countries in 2021 and 2022. However, the rate of recovery will depend on each country's COVID-19 containment measures and unique circumstances. These include access to vaccines and medical interventions as well as effective policy support. Moreover, exposure to cross-country risks, as well as the position of the economy prior to the pandemic will have a significant impact on the pace of recovery. Many low-income developing countries had high debt levels prior to the pandemic. Therefore, the international community will need to work together closely to ensure that financially constrained economies have adequate access to international liquidity, so they are able to manage the pandemic without increasing their debt beyond sustainable levels. Countries will need to tailor their policy responses to the stage of the pandemic, strength of the recovery, and structural characteristics of the economy.

Although high uncertainty surrounds the global outlook, there is more direction and positivity regarding the global economy now than at the time of the April 2020 Financial Stability Report. The COVID-19 pandemic started unfolding in the first few months of 2020 with uncertainty looming and risks obscure. The outlook hinges on how effectively economic policies deployed under high uncertainty can limit lasting damage from this unprecedented crisis. Future developments will largely depend on the path of the pandemic, the evolution of financial conditions and commodity prices, policy actions and the capacity of the economy to adjust to health-related impediments to activity. The upward revision of global GDP forecast as per the April 2021 WEO, is a positive sign in terms of global risks. The approval and rollout of vaccines have improved risk sentiment, especially for countries who are able to purchase these vaccines in the short term. Furthermore, swift policy actions across the globe have muted the impact of the pandemic on economic activity and many businesses are adjusting to the 'new normal' and figuring out how to work around the challenges posed by the pandemic. Looking ahead, the new variants to the virus and new waves cause potential lockdowns to still pose a great global risk. Moreover, access to vaccines and uncertainty about the take-up of vaccines (even in countries with good access) may also cause further uncertainty for the global outlook in the short and medium term.

Going forward, the global economy is projected to rebound by 6.0 percent in 2021, reflecting additional fiscal support in a few large countries and the anticipated vaccine-powered recovery in the second half of the year. Compared to the October 2020 WEO, the IMF has in April 2021 increased the projected global real GDP for 2021 by 0.8 percent on the back of a stronger than expected momentum experienced in the second half of 2020 (Figure 2). Extra fiscal stimulus, particularly in some big economies, coupled with accommodative monetary policy stances as well as the roll out of vaccines also contributed to the upward revision of the projected global growth rate for 2021. Moreover, businesses are quickly adapting their operations during the pandemic, creating a stronger than expected recovery in 2021. In the AEs, the United States and Japan are expected to be the main drivers of economic activity in 2021 following additional fiscal support legislated in both countries at the end of 2020. China has also made a notable recovery towards the end of 2020 becoming one of the first countries to resume economic activity after reporting large numbers of COVID-19 cases in 2020. This is an indication of the importance of swift policy action to contain the virus thus allowing domestic economic activity to resume, which fosters a quick recovery in economic growth.

Figure 2: Global growth and projections (annual percentage changes)



Source: IMF April 2021 World Economic Outlook

Global growth is expected to moderate in the medium term. This is attributed to projected challenges to supply potential and aging and relatively slower labour force growth in AEs and some EMDEs. Furthermore, a necessary rebalancing to a sustainable growth path in China is expected to weigh on the growth outlook for the global economy in the medium term. GDP levels are projected to remain well below the pre-pandemic trend path through 2024 for most countries. In AEs, occasional regional restrictions will possibly be necessary at times to stem the progression of new strains of the virus. As the vulnerable population gets vaccinated, contact-intensive activities are expected to resume and drive a significant increase in growth due to pent-up demand funded by savings accumulated in 2020. In EMDEs, vaccine procurement data suggest that effective protection will remain unavailable for most of the population in 2021. Services trade such as cross-border tourism and business travel is still not expected to recover to pre-COVID-19 pandemic levels until the end of 2022, while merchandise trade is expected to recover at a faster rate once borders are fully opened. The strength of the projected recovery will partly depend on the severity of the health crisis in individual economies.

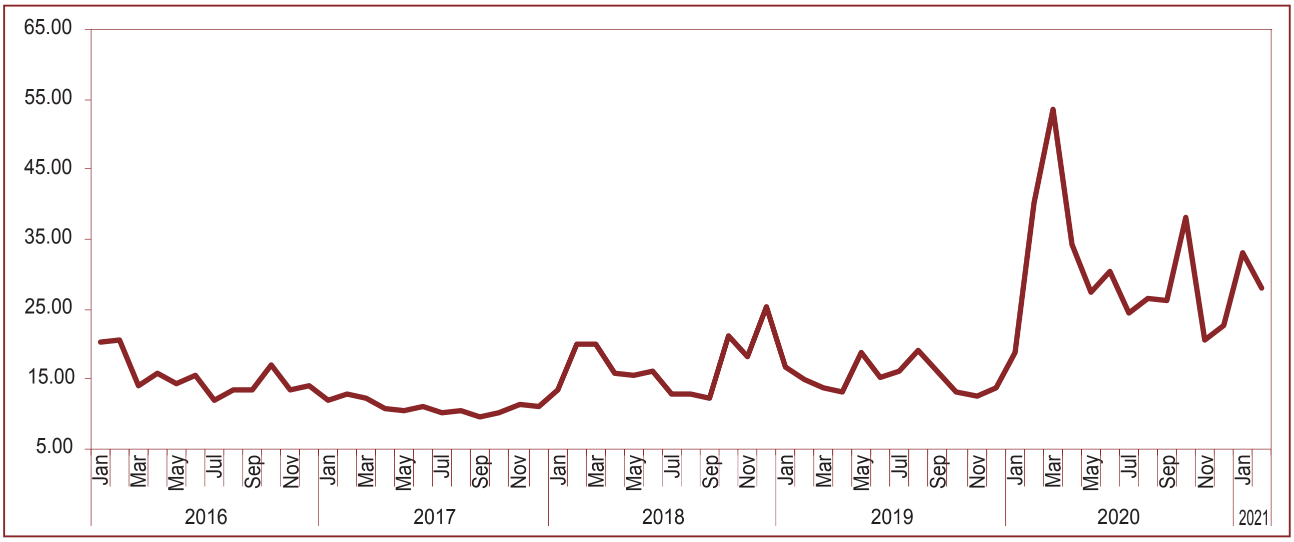
The positive outlook is surrounded by significant uncertainty; however, risks are balanced in the near term. Although most countries have managed to contain the infection rate, on the downside growth could still turn out weaker than expected if the new virus strains surge and prove difficult to contain. If this causes more infections and deaths before appropriate vaccines are available, it is possible that countries will shut down economic activity once again to save lives and manage these infections. Moreover, if mutations outpace the rollout of vaccines, COVID-19 could become an endemic disease of unknown severity. Slower than expected medical interventions could dampen hopes of a quick exit from the pandemic and weaken confidence in the market. Uncertainty regarding the effectiveness of the vaccines is also a downside risk. Furthermore, policy support is crucial during this time because if countries withdraw policy support prematurely, before economic recovery is certain, it could lead to bankruptcies of illiquid firms resulting in further unemployment, income losses and poverty. Many pre-COVID-19 risk factors continue to be relevant, such as increased frequency of natural disasters and geopolitical, trade and technological risks. On the upside, the main risks to the outlook include the expedited vaccine production and rollout, unanticipated larger effects from fiscal support and coordinated policies.

On the upside, expedited vaccine manufacturing and distribution on a large scale is increasing expectations that the pandemic could end faster than expected earlier on, boosting confidence for both firms and households. If these expectations materialise then this would generate stronger domestic consumption and investment and increase employment as firms begin hiring and expanding capacity to meet the improved consumption in the long term. Other upside risks entail: unanticipated larger effects of fiscal support and well-coordinated monetary and fiscal policy easing. Well-coordinated monetary and fiscal policy easing were implemented in a strong and synchronised fashion during the early phase of the pandemic. Hence a better-than-expected recovery could occur if international coordination on exit policies is maintained in the later phase of the recovery. Moreover, intensified cooperation on vaccination could expedite the production and distribution of vaccines thereby ending the pandemic sooner than expected and limiting its impact on economic growth and financial stability.

DEVELOPMENTS IN FINANCIAL MARKETS[5]

The Volatility Index (VIX) was higher in 2020 than in previous years, reflecting the uncertainty of investors due to the COVID-19 pandemic. During the early months of 2020, the VIX shot up to as high as 53.54 index points at the end of March from 13.78 index points at the end of December 2019 (Figure 3). As the VIX is an indicator of investor risk sentiment, this implied panic in investment markets during the first quarter of 2020 was largely due to the uncertainty surrounding the new COVID-19 virus and its impact on the global economy. At the time, most countries were still in their first phase of lockdowns and the end of the pandemic was nowhere in sight. As countries began offering fiscal and monetary support and as businesses adjusted to conducting their affairs virtually, markets stabilised, although the VIX was still notably higher throughout 2020 compared to the previous year. The VIX averaged 30.26 index points with a standard deviation of 9.42 from the mean during 2020, compared to an average of 15.24 index points with a standard deviation of 2.03 from the mean during 2019. This indicates that 2020 was a much more volatile year compared to 2019, further indicating the risk investors faced due to the pandemic. The second highest point during 2020 (after the first quarter) was at the end of October 2020 when the VIX rose to 38.02 index points. This was mostly because of the announcement of many countries experiencing second waves of the pandemic, coupled with new variants of the virus. Nonetheless, the market is expecting continued fiscal and monetary support plus the rollout of vaccines, especially in AEs, in the short and medium term; therefore, the outlook is positive. Going forward, one can expect the VIX to continue to be relatively high compared to previous years until the end of the pandemic.

Figure 3: Volatility Index (VIX)

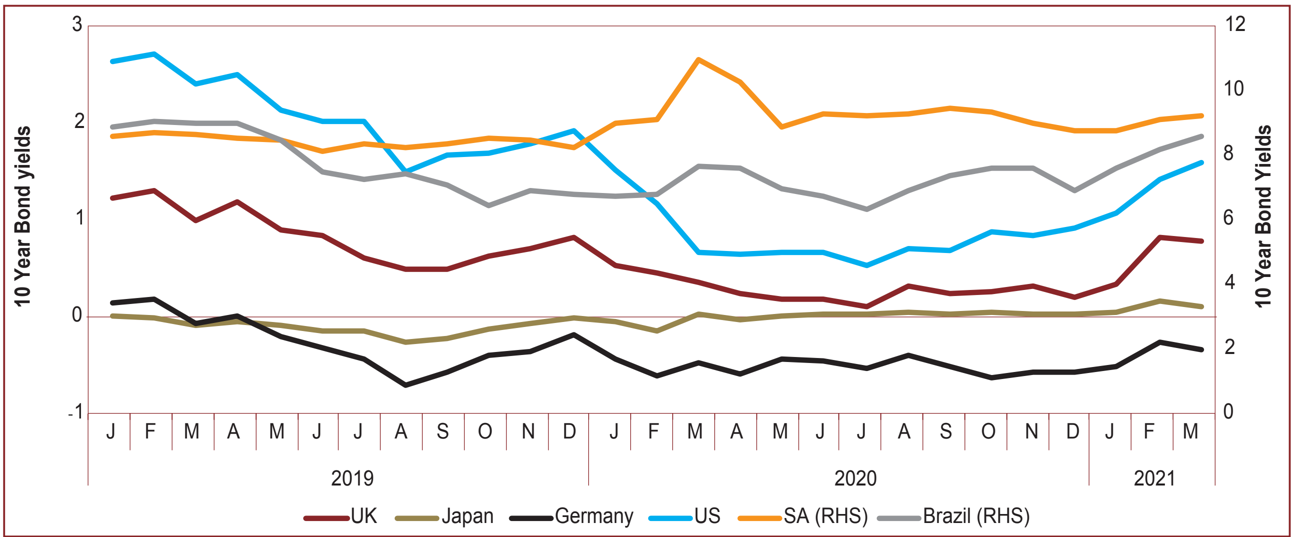


Source: Bloomberg

[5] This section borrows significantly from the Bank for International Settlement (2020) publication titled: "BIS Quarterly Review - International banking and financial market developments"

The fixed income market was volatile during the beginning months of 2020 but began to stabilise at the end of 2020. During the first few months of 2020, volatility in the fixed income market increased as the markets priced in uncertainty as a result of the COVID-19 pandemic. However, the market stabilised after central banks and governments began pursuing accommodative policies in order to support markets through the pandemic. Central banks in the AEs and EMDEs adopted accommodative monetary policy stances during 2020 in order to support businesses and households, while the COVID-19 pandemic continued to dampen economic activity. The accommodative monetary policy stance boosted investor confidence somewhat, although many investors still preferred safe-haven investments such as gold and cash, especially during early 2020. Sovereign bond yield spreads decreased, as investors priced in both global and domestic risks and some feared a global crisis in early to mid-2020. Although still lower than pre-COVID-19 levels, yields increased towards the end of 2020 and continued to increase during the first quarter of 2021 as breakthroughs with COVID-19 vaccines were announced and the market confidence increased (Figure 4).

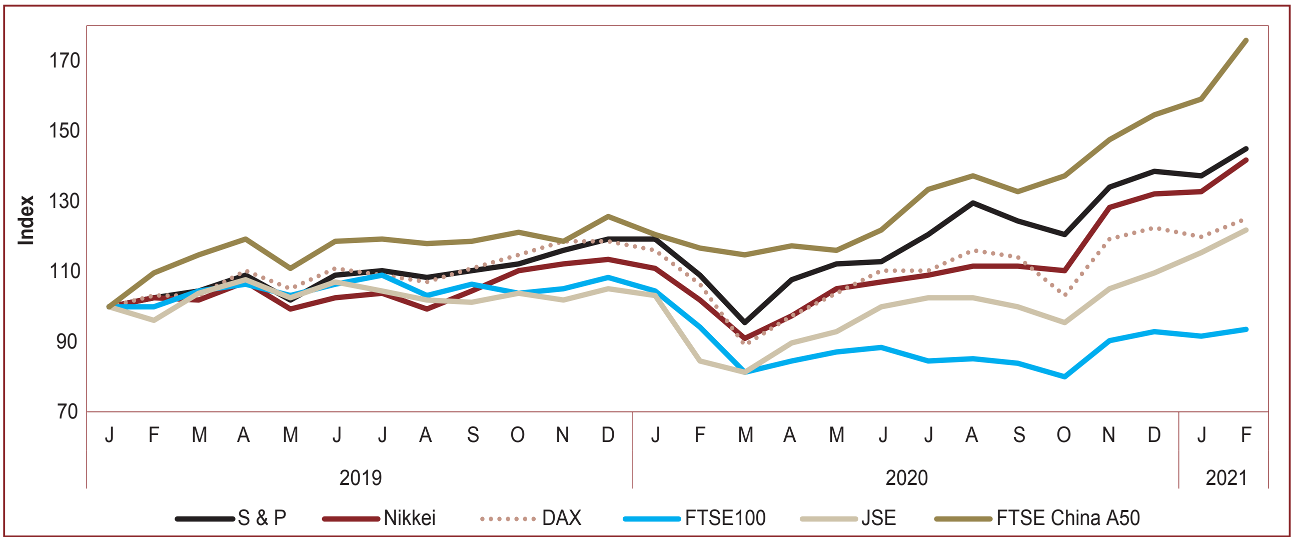
Figure 4: 10 Year Bond Yields (Monthly)



Source: Investing.com

For equity markets overall market sentiment was negative in early 2020 but has since turned positive with equity prices rising as announcements of earlier than expected effective COVID-19 vaccines boosted market confidence. Towards the end of 2020, announcements of viable vaccines, as well as improved policy support have strengthened market confidence in a reasonably quick recovery from COVID-19. As a result, industries such as airlines, hospitality and consumer services have rebounded from late 2020. Despite the increase in COVID-19 cases towards the end of 2020 as some countries experienced a second wave of infections, the market has remained confident about growth prospects in 2021, betting that continued policy support will offset any near-term possible negative effects of increased infections. As a result of this expectation of continued policy support, equity prices began picking up towards the end of 2020. Equity prices recorded strong returns during the second quarter of 2020 but moved largely sideways during the third quarter before picking up again towards the end of 2020 (Figure 5). Most of these gains were evident in countries with the largest policy support such as the United States, China and Japan, where equity prices in these markets at times actually surpassed pre-COVID-19 levels.

Figure 5: Stock Price Indices (Monthly)



Source: Bloomberg

According to the IMF's April 2021 Global Financial Stability Report, rising vulnerabilities in the corporate and non-bank financial sector could put medium term global financial stability at risk. The corporate sector in many countries is emerging from the pandemic overindebted, with notable differences depending on firm size and sector. Concerns about the credit quality of hard-hit borrowers and the profitability outlook are likely to weigh on the risk appetite of banks during the recovery. The search for yield spurred by the low-interest-rate environment has intensified at nonbank financial institutions. For example, pension funds have increased their share of investments in alternative assets such as private equity, infrastructure, and real estate strategies with greater leverage and liquidity risks in an attempt to meet their return targets. Insurance companies have also increased their investments in less liquid and riskier lower-rated corporate bonds, foreign bonds, and other illiquid exposures. This could pose risk to global financial stability in the medium term.

On the positive front, the approval and rollout of vaccines and policy support have boosted expectations of global recovery, lifting asset prices. New vaccines are being approved on an ongoing basis. While operational challenges are large, these may be overcome sooner than anticipated, especially if more vaccines are approved that do not require cold chain low-temperature storage or can be administered in one jab. Therefore, assuming continued monetary and fiscal policy support by governments and central banks as well as a good uptake of vaccines, the risks to financial stability remain low in the medium term.

DOMESTIC ECONOMY

Output

Similar to the global economy, the Namibian economy is estimated to have contracted significantly during 2020 but is expected to recover during 2021. According to the Namibia Statistical Agency (NSA), preliminary national accounts, the domestic economy contracted by 8.0 percent in 2020. The contraction is mostly due to the impact that COVID-19 posed on economic activity during 2020. Going forward however, the Bank of Namibia in its February 2021 Economic Outlook Update projects the economy to improve to positive growth rates of 2.7 percent and 3.3 percent in 2021 and 2022, respectively. The improvements in the economy in 2021 and 2022 are anticipated to originate from broad based base effects (especially in sectors deeply affected by the pandemic such as tourism and hospitality) as well better prospects in the diamond mining, agriculture and transport sectors. Growth prospects in these sectors were revised slightly upwards compared to the December 2020 Economic Outlook update.

Risks to the domestic outlook continued to be dominated by COVID-19, especially regarding uncertainties around the duration of the pandemic as well as the rollout of vaccines in Namibia and elsewhere. Although improvements in commodity markets are expected to improve risk sentiment in the global markets, the persistently low international prices for some of Namibia's export commodities still pose a risk to Namibian economic growth. Furthermore, risks to domestic growth are still largely dependent on the ability to end the health crisis in the medium term domestically and internationally. In this regard, continued travel restrictions posed by new variants of the virus as well as further waves of coronavirus infections continue to threaten the domestic economic recovery. Since the April 2020 Financial Stability Report, the probability of the adverse risk originating from the domestic economy has declined. However, given the vulnerable fiscal position at the end of the 2020/2021 fiscal year, the impact would be high.

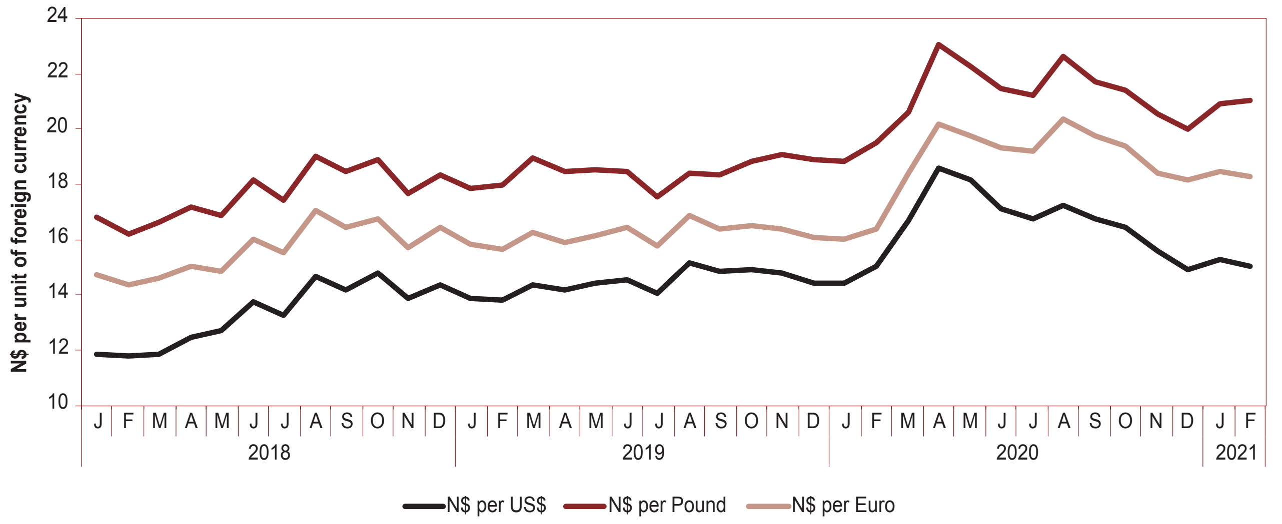
International reserves

International reserves grew during 2020 mostly due to higher SACU receipts, capital inflows and a lower import bill. The stock of international reserves increased by 9.7 percent, compared to the previous year. The higher reserve level was mostly on the back of higher SACU receipts of N$21.4 billion during 2020, compared to N$18.5 billion during 2019. The increase in reserves was further supported by the receipt of the third tranche of the African Development Bank (AFDB) loan worth N$2.0 billion which was disbursed to the Namibian Government. Moreover, largely due to the overall decrease in domestic income and international trade, the import bill was lower in 2020, compared to 2019. These developments, coupled with a deprecation of the Namibia dollar against all major currencies, supported the uptick of international reserves during the period under review. The estimated import cover stood at 5.2 months at the end of 2020 and at the end of March 2021 amounted to 5.0 months, significantly higher than the international benchmark of 3.0 months. Therefore, the probability of the risks in relation to international reserves materialising is low with a medium potential impact in the foreseeable future.

Exchange Rate Developments

The Namibia Dollar (NAD) depreciated against all major trading currencies during 2020, compared to 2019. The COVID-19 pandemic reduced the demand for most emerging market currencies. As a result, the NAD depreciated by 13.9 percent against the US Dollar, 14.4 percent against the British Pound and 16.0 percent against the Euro, during 2020 (Figure 6). The depreciation of the NAD against all major currencies was largely attributed to investors' risk aversion towards EMDEs associated with the COVID-19 pandemic. Most EMDEs including South Africa witnessed major capital outflows during the first few months of 2020 which weakened the demand for their currencies, causing the exchange rates to depreciate. The downgrade of South Africa's sovereign credit rating to sub-investment grade by Moody's further contributed to the weakening of the Namibia Dollar against major currencies. Within 2020, the NAD/ZAR depreciated sharply in the first four months of the year when global uncertainty was at its worst, and thereafter gradually regained some of the lost ground as a measure of confidence was restored. Extrapolating from this trend, some analysts predicted that in 2021 the NAD/ZAR exchange rate may appreciate against most major currencies. However, in early 2021 there was a widespread view that the ZAR would be one of the worst performing emerging market currencies mainly due to worries regarding the mutation of the virus and risks of serious lockdowns in the country as well as the country's ability to manage these risks should they materialise. This means that the probability of a rapid depreciation of the ZAR going forward is medium with medium impact.

Figure 6: Currency movement of the Namibia Dollar against selected currencies

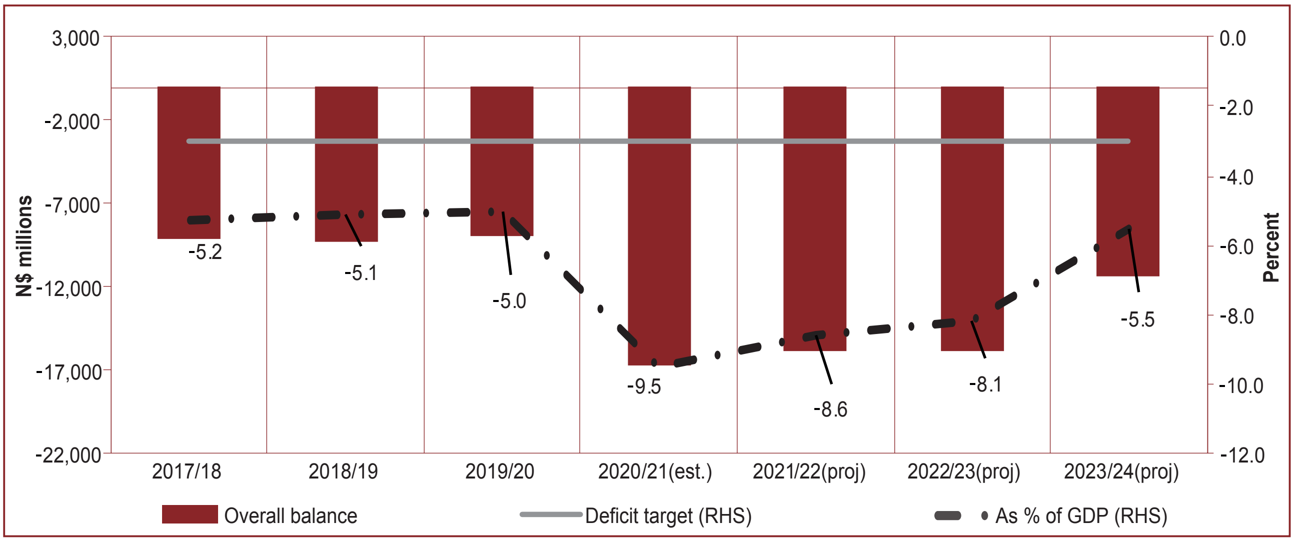


Source: Bloomberg

Public Finance

Central Government's budget deficit widened to a record level during the FY2020/21, mainly as a result of Government's response to soften the impact of the COVID-19 on economic activity and pressure on tax revenue. In the 2021/22 budget statement which was tabled in Parliament on 17th March 2020, the estimated Central Government budget deficit for the FY2020/21 was revised downward to 9.5 percent of GDP, lower than the 10.4 percent earlier estimate in the October 2020 mid-year budget review (Figure C.18a). The downward revision was attributed to an upward adjustment in revenue, due to better Government revenue collection than what was forecasted earlier on. However, when compared to the previous fiscal year, the deficit-to-GDP ratio rose significantly, making it the highest deficit ever registered in Namibia. This was attributed to Government's commitment to reduce the impact of the COVID-19 on economic activity and the negative impact of the pandemic on tax revenue. Meanwhile, the deficit is estimated at 8.6 percent of GDP during the FY2021/22 and is expected to gradually improve to 5.5 percent in the FY2023/24, as Government contains its expenditure levels. A vulnerable fiscal position was one of the main reasons used by the rating agencies to downgrade Namibia in 2020. Furthermore, Government would risk a further downgrade, if it does not contain expenditure as projected.

Figure 7: Public Finance



Source: Bank of Namibia

Sovereign Credit Downgrade: Namibia And South Africa

During 2020 Namibia's long-term foreign currency credit rating was downgraded to Ba3 (Moody) and BB (Fitch), both with a negative outlook. On 22 May 2020 Moody's rating agency affirmed Namibia's rating as Ba2 but changed the outlook from stable to negative. Similarly, on 16 June 2020, Fitch revised Namibia's outlook from BB Stable to BB Negative. The key drivers of the revision were the significant impact of COVID-19 on the economy as well as its impact on public finances. Given the state of the fiscus before the pandemic, Fitch believed that the pandemic would only make Namibia's attempt at fiscal resuscitation more challenging. Fitch believed a subdued growth outlook and particularly high inequality will present a challenging environment for resumption of fiscal reforms. Moreover, the fall in global demand for luxury goods and manufacturing inputs as well as disruption to the global gemstone supply chain were seen as dampening exports of diamonds and other mining products. On 4 December 2020, Moody's further downgraded Namibia to Ba3 mostly due to the agency's opinion that the strain on the fiscal deficit imposed by COVID-19 would negatively impact the country, particularly if Namibia is to purchase vaccines and offer further policy support to the economy. Fitch's downgrade was affirmed on 7 December 2020 (Table 1).

Table 1: Namibia's Sovereign Credit Rating and Outlook

Rating Agency	Rating	Outlook	Last Update	Action
Moody's Investors Service	Ba2	Negative	22-May-2020	Affirmed outlook changed from stable to negative.
	Ba3	Negative	04-Dec-2020	Rating downgrade
Fitch Ratings	BB	Stable	16-Jun-2020	Rating downgrade
	BB	Negative	22-Jun-2020	Affirmed outlook changed from stable to negative.
	BB	Negative	07-Dec-2020	Affirmed

Source: Rating Agencies' websites

All credit rating agencies downgraded South Africa's sovereign credit rating during 2020. On 27 March 2020 Moody's downgraded South Africa's credit rating to Ba1 with a negative outlook. This took South Africa's credit rating from investment grade to junk status. According to Moody's, the key driver behind the rating downgrade to Ba1 was the continuing deterioration in fiscal strength and structurally very weak growth, which the rating agency does not expect to be effectively addressed by the current policy settings. On 20 November 2020 Moody's further downgraded South Africa's credit rating to Ba2 with a negative outlook. The key driver behind the rating downgrade to Ba2 is the expected weakening in South Africa's fiscal position over the medium term. The rating action reflects Moody's assessment of the impact of the pandemic shock, both directly on the debt burden and indirectly by intensifying the country's economic challenges. While the entire world has been severely impacted by the crisis, South Africa's capacity to mitigate the shock over the medium term is lower than that of many sovereigns given significant fiscal, economic and social constraints and rising borrowing cost. Similarly, Fitch downgraded South Africa's credit rating to BB with a negative outlook on 3 April 2020 and further downgraded the country's rating to BB-, while maintaining the negative outlook on 20 November 2020. On 30 April 2020, Standard & Poor (S&P) also downgraded South Africa's credit rating to BB- although with a stable outlook for similar reasons relating to the fiscal position of the country given the impact of the COVID-19 pandemic (Table 2).

Table 2: South Africa's Sovereign Credit Rating and Outlook

Rating Agency	Rating	Outlook	Last Update	Action
Standard and Poor's (S&P)	BB-	Stable	30-Apr-2020	Rating downgrade
Moody's Investors Service	Ba1	Negative	27-Mar-2020	Rating downgrade
	Ba2	Negative	20-Nov-2020	Rating downgrade
Fitch Ratings	BB	Negative	03-Apr-2020	Rating downgrade
	BB-	Negative	20-Nov-2020	Rating downgrade

Source: Rating Agencies websites

There are numerous developments that could individually or collectively lead to a downgrade or a stabilisation of the outlook for South Africa. These include a continued increase in the Government debt/GDP ratio and failure to formulate a clear and credible path towards stabilising this ratio, as well as a further deterioration in South Africa's trend GDP growth rate. On the upside, SA's rating will be influenced by the formulation of a clear and credible path towards stabilising the government debt/GDP ratio over the medium term and strengthening in trend GDP growth.

South Africa and Namibia continue facing the possibility of further sovereign credit rating downgrades. This is mostly due to high levels of uncertainty regarding the duration of the impact of COVID-19 on economies in both SA and Namibia. However, despite weak fiscal positions characterised by high fiscal deficits and public debt, coupled with recessionary economic conditions in both economies, both sovereigns are able to raise funds to finance the deficits. Moreover, there are credible commitments to fiscal consolidation from the fiscal authorities in both countries and measures have been put in place to boost investor confidence. Nevertheless, should the impact of the pandemic be prolonged, it is possible that further strain on the fiscal position could trigger sovereign credit rating downgrades making it more difficult for Namibia to raise funds to finance deficits. Although the risk of further downgrades remains, the impact thereof is medium.

Monetary Policy Stance in Namibia and South Africa

The South African Reserve Bank (SARB) and the Bank of Namibia (BoN) both pursued accommodative monetary policy stances during 2020 in order to support their economies during the COVID-19 pandemic. According to the 16th January 2020 MPC statement, the SARB reported that the domestic outlook was fragile since South Africa reported negative growth in the third quarter of 2019, and a low inflation environment below the mid-point of the target range. It is against this background that the SARB decreased the repo rate by 25 basis points before COVID-19 even reached the South African shores. At the meeting on the 19th March 2020, the SARB noted that the coronavirus pandemic will have an impact on domestic activity, specifically on exports of goods and services, although the impact was still uncertain. Therefore, the SARB adopted an accommodative monetary policy stance and cut the repo rate by 100 basis points, stating that this support along with prudent macroeconomic policy was expected to mitigate the impact of the pandemic on the economy. During the rest of 2020, the SARB maintained this accommodative policy stance and reduced the repo rate significantly further to support the economy throughout the pandemic. BoN followed suit both in an effort to maintain the one-to-one link between the NAD and the ZAR as well as to support the domestic economy through the pandemic. At the first MPC meeting on the 19th February 2020, BoN cut the repo rate by 25 basis points on the back of the weak domestic economic performance in 2019. Once COVID-19 began impacting the local economy towards the end of February 2020, the Bank joined other central banks and adopted a very accommodative monetary policy stance in order to support the domestic economy amidst low inflationary pressures, while growth in Private Sector Credit Extension (PSCE) slowed during the same period. In this regard, the Bank cut its Repo rate by an unprecedented 275 basis points throughout 2020 to a historic low of 3.75 percent (Table 3).

Table 3: SARB and BoN repo rate developments

SARB meeting date	Repo Cut	Repo Rate	BON Meeting date	Repo Cut	Repo Rate
16 January 2020	25 basis points	6.25%	19 February 2020	25 basis points	6.25%
19 March 2020	100 basis points	5.25%	20 March 2020	100 basis points	5.25%
14 April 2020	100 basis points	4.25%	15 April 2020	100 basis points	4.25%
21 May 2020	50 basis points	3.75%	17 June 2020	25 basis points	4.00%
23 July 2020	25 basis points	3.50%	19 August 2020	25 basis points	3.75%
17 September 2020	Unchanged	3.50%	21 October 2020	Unchanged	3.75%
19 November 2020	Unchanged	3.50%	09 December 2020	Unchanged	3.75%
Total Cut	300 basis points		Total Cut	275 basis points	

Source: South African Reserve Bank and Bank of Nambia Monetary policy statements

IV. DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

HOUSEHOLD DEBT TO DISPOSABLE INCOME

Household indebtedness slowed since the last FSR, driven mainly by the subdued demand for short-term credit facilities. The annual growth rate of household indebtedness slowed from 5.4 percent at the end of 2019 to 4.5 percent at the end of 2020**.** The main driver was the category *other loans and advances* which slowed from an annual growth rate of 17.1 percent in 2019 to 5.7 percent in 2020. *Overdrafts* also slowed year-on-year but by a smaller margin, from 9.5 percent to 8.6 percent at the end of 2019 and 2020, respectively. The annual growth in *mortgage loans* remained consistent at 5.2 percent in 2019 and 2020. Although still negative, *instalment sale and leasing finance* improved from a contraction of 7.4 percent in 2019 to a lesser contraction of 2.6 percent in 2020.

Elements of the demand for credit are normally higher during times of financial distress. The COVID-19 pandemic has had a negative impact on disposable income; as such, some households may seek credit to make up for the shortfall. However, the supply of credit by financial institutions, primarily banks, has been subject to more prudent practices so as to manage potential credit risk. This has also played an important role in the overall slowdown in household indebtedness. Risks to financial stability arising from an excessive increase in household indebtedness in 2020 has declined. The probability of this risk materialising in 2021 is low with a medium impact.

Table 4: Household Debt-to-Disposable-Income

	2016	2017	2018	2019	2020
Disposable Income (N$)	66 645	71 381	76 630	77 035	75 725
Credit to Disposable Income (%)	75.1	71.8	71.7	75.2	79.9
Credit to Individuals/Households (N$)	50 054	51 275	54 932	57 921	60 518
Adjusted Credit* to Individual/Households (N$)	55 811	57 172	61 249	64 582	67 478
Adjusted Credit**% of Disposable Income	83.7	80.1	79.9	83.8	89.1

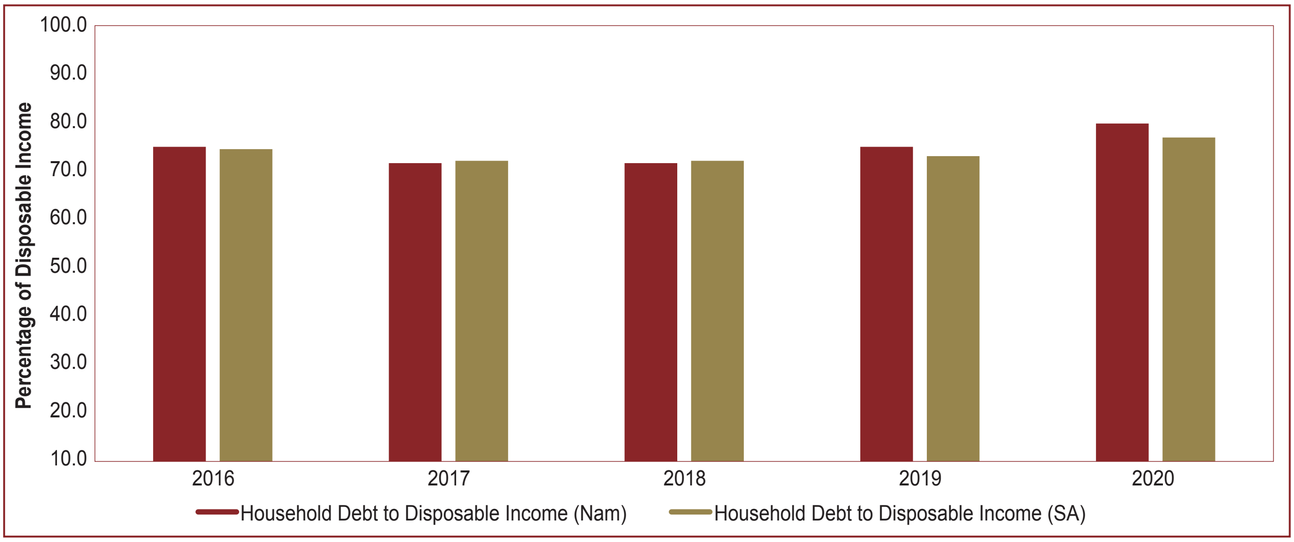
*The ratio of household debt to disposable income is calculated based on income and tax data from the national budget documents, national accounts, and household debt data from the Bank of Namibia. The National Accounts were revised from 2013 to 2019, resulting in changes in the household disposable income data, which were published in the April 2020, FSR.
** This category includes credit extended to households by both the banking and non-banking financial institutions.

Source: Bank of Namibia

The ratio of household debt to disposable income increased due to subdued growth in disposable income, relative to the growth in credit. Household debt to disposable income increased from 83.8 percent in 2019 to 89.1 percent in 2020 (Table 4). Credit extended to individuals grew by 4.5 percent whereas disposable income contracted by 1.7 percent, thus yielding a higher credit to disposable income ratio in 2020. The contraction in disposable income of 1.7 percent in 2020 outweighed the growth in disposable income of 0.5 percent in 2019. At face value, a higher ratio of household debt to disposable income does not bode well for the stability of the financial system; however, it largely depends on the type of debt. In 2020 for instance, 69.2 percent of household debt was attributed to mortgage lending, while *Overdrafts*, *Instalment and Leasing*, and *Other Loans and Advances* collectively contributed 30.8 percent of household debt. This means that the majority of household debt is collateralised thus putting the banks in a favourable position to recover a significant amount, if not all, of the debt in the case of default. In this context, an increase in household indebtedness does not pose a significant risk to financial stability; however, a growth in unsecured lending would not be a positive development for financial stability because it can have a significant negative impact should it materialise.

Namibia reported a higher unadjusted ratio of household debt to disposable income in 2020, when compared to South Africa. The unadjusted ratio of household debt to disposable income stood at 79.9 percent in Namibia compared to 77.1 percent in South Africa, during the period under review (Figure 8). Similar to Namibia, South Africa experienced positive growth in household debt alongside negative growth in disposable income. This was mainly attributed to the impact of the COVID-19 pandemic on households' disposable income due to job losses and decreases in remuneration as a result of national lockdowns.

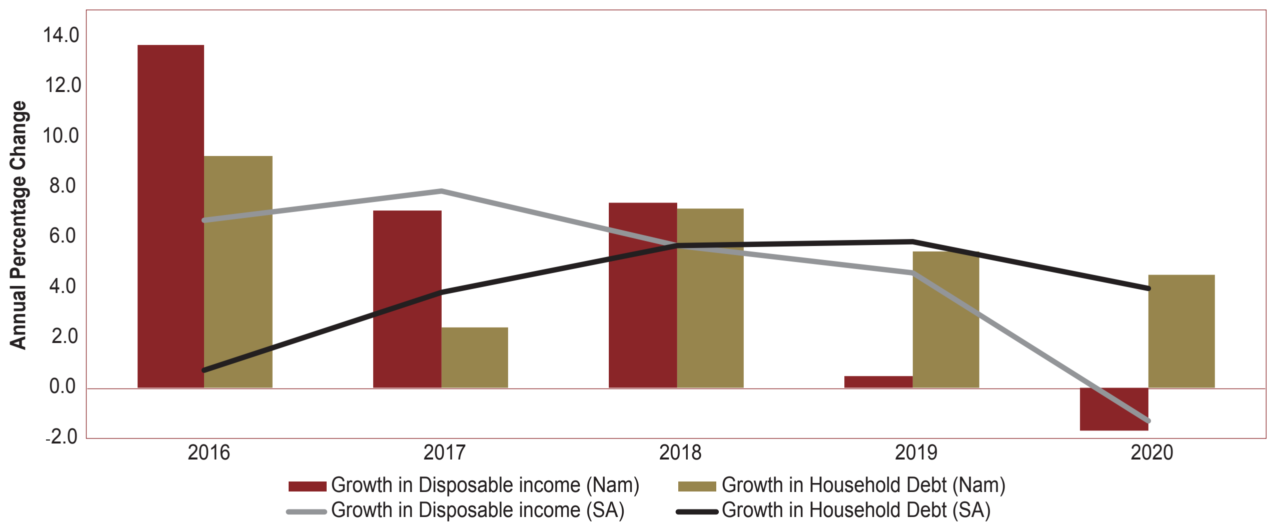
Figure 8: Household Debt-to-Disposable Income (Namibia & South Africa)



Source: Bank of Namibia and South African Reserve Bank

Household disposable income contracted in 2020 owing to rising unemployment and a decline in the compensation of employees. Since the last FSR, household disposable income contracted by 1.7 percent in 2020 from a growth rate of 0.5 percent in 2019. Similarly, household disposable income in South Africa contracted by 1.3 percent in 2020 from growth of 4.6 percent in 2019 (Figure 9). Evidently, South Africa experienced a much larger slowdown compared to Namibia. National lockdowns lasted much longer in South Africa compared to Namibia, with South Africa reporting a significantly higher rate of COVID-19 infections. The growth in household debt in both Namibia and South Africa slowed in 2020, which is in line with subdued economic activity and prudent banking practices during times of crisis.

Figure 9: Growth in Household Debt and Disposable Income



Source: Bank of Namibia and South African Reserve Bank

DEBT SERVICING RATIO

During 2019 the debt service to disposable income ratio decreased. The debt servicing to disposable income ratio fell to 9.0 percent in December 2020 from 11.8 percent in 2020 (Table 5). Total debt service cost contracted by 23.7 percent in 2020 from 8.8 percent growth in the previous year and amounted to N$17.5 billion. The key categories that contributed to the contraction in debt servicing cost were mortgage loans and instalment credit. This could be due to households and businesses facing lower interest rates on their loans during 2020, while some debt servicing was also suspended for borrowers struggling to service their loans given the impact of the COVID-19 pandemic on their earnings during 2020.

Table 5: Debt servicing Ratios (percentage)

	Gross Income Growth (Y-o-Y)	Disposable Income Growth (Y-o-Y)	Annual Debt Servicing Growth (Y-o-Y)	Debt Servicing to Gross Income	Debt Servicing to Disposable Income	Adjusted Debt Servicing to Gross Income	Average Prime Rate
Dec-16	6.1	13.7	11.2	28.8	11.2	42	10.75
Dec-17	8.2	6.8	2.0	27.4	10.4	40	10.50
Dec-18	3.7	7.1	8.5	29.1	10.9	43	10.50
Dec-19	0.6	2.0	8.8	32.0	11.8	47	10.25
Dec-20	-3.9	-0.2	-23.7	25.4	9.0	37	7.50

Source: Bank of Namibia

CORPORATE DEBT

Since the last FSR, the total corporate debt stock contracted significantly, driven mainly by foreign debt. The total corporate sector stock contracted by 3.7 percent during the year 2020 compared to marginal growth of 0.2 percent in 2019. In nominal terms, total corporate debt contracted from N$128.6 billion at the end of 2019 to N$123.9 billion at the end of 2020 (Table 6). Domestic debt contracted by 1.9 percent in 2020, from N$45.7 billion in 2019 to N$44.8 billion in 2020. The contraction in domestic debt was attributed to the contraction in private sector credit extended, as a result of subdued economic activity. The significant contraction of 4.7 percent in foreign debt was ascribed to a slowdown in intercompany borrowing that was mainly driven by repayments made by the mining sector.

The corporate sector debt-to-GDP ratio declined marginally in 2020. The corporate sector debt-to-GDP ratio stood at 70.8 percent at the end of 2019, before declining to 70.3 percent at the end of 2020 (Table 6). The decline in the ratio was mainly as a result of a deeper contraction in foreign debt relative to domestic debt, coupled with a contraction in nominal GDP as well. Similarly, the stock of foreign corporate debt to GDP declined to 39.1 percent in 2020 from 40.1 percent in the previous year. Risk to financial stability of an excessive increase in corporate debt in 2020 went down; the probability of it materialising in 2021 is low and the impact would be medium. In addition, the rigorous credit lending standards applied by banking institutions prior to extending loans to borrowers are expected to mitigate the probability of default emanating from the corporate sector.

Table 6: Domestic and External Corporate Debt (Private Sector and Parastatals)

N$ billion	2016	2017	2018	2019	2020
Domestic debt (N$ billion)	37 198	40 722	42 309	45 713	44 842
Local Private Sector Debt	35 343	38 445	40 966	44 853	44 307
Local Debt of SOEs	1 855	2 277	1 343	860	535
Foreign debt (N$ billion)	61 259	73 939	86 027	82 906	79 034
Foreign Private Sector Debt	56 508	64 749	75 952	72 808	68 966
Foreign Debt of SOEs	4 751	9 190	10 075	10 098	10 068
Total Corporate Debt (N$ billion)	98 457	114 661	128 336	128 619	123 876
Nominal GDP (N$ billion)	157 708	171 570	181 054	181 555	176 327
Y-o-Y Change in % in Total Debt	9.8	16.5	11.9	0.2	-3.7
Y-o-Y Change in % in GDP	8.0	8.8	5.5	0.3	-2.9
Corporate Debt to GDP (%)	62.4	66.8	70.9	70.8	70.3
Foreign Private Sector Debt to GDP (%)	35.8	37.7	41.9	40.1	39.1
Foreign Debt to Total Debt (%)	62.2	64.5	67.0	64.5	63.8

Source: Bank of Namibia and NSA

The total debt stock of State Owned Enterprises (SOEs) contracted moderately during 2020. Total debt of SOEs moderated to N$10.6 billion at the end of 2020, N$0.4 billion lower than what was reported 2019 (Table 6). The decline in total debt of SOEs was predominantly driven by loan repayments in 2020.

The value of corporate bonds outstanding declined during 2020. In this regard, the stock of bonds issued by Namibian corporates listed on both the Namibia Stock Exchange (NSX) and the Johannesburg Stock Exchange (JSE) declined from N$8.3 billion registered in 2019 to N$6.7 billion in 2020. Of the N$6.7 billion, a total of N$5.2 billion was listed on the NSX, while N$1.6 billion was listed on the JSE. The value of corporate bonds declined due to several bonds maturing and fewer new bond issuances during 2020. Meanwhile, N$5.9 billion of the total outstanding corporate bonds in 2020 were issued by commercial banks, and N$606 million by SOEs, while non-bank entities were responsible for the remaining N$263.3 million. Corporate bonds represented only 13.8 per cent of total bonds outstanding in the market at the end of 2020, with Government bond issuances continuing to dominate the domestic bond market.

Table 7: Foreign Private Sector Debt and Debt Servicing

N$ billion	2016	2017	2018	2019	2020
Total Foreign Private Sector Debt	56 508	64 749	75 952	72 808	68 966
Total Foreign Private Sector Debt Servicing	21 979	15 256	17 197	21 644	16 996

Source: Bank of Namibia

Total foreign private sector debt servicing declined significantly during the period under review. Foreign debt service cost contracted by 21.5 percent to N$17.0 billion in 2020 from N$21.6 billion in 2019 (Table 7). This was mainly attributed to a decline in principal repayments made on intercompany borrowings in the mining sector.

BOX ARTICLE 1

MACROPRUDENTIAL POLICY OVERSIGHT AND FINANCIAL STABILITY FRAMEWORK IN NAMIBIA

Introduction

A key contributing factor to the global financial crisis (GFC) of 2008/2009 was the absence of an institution charged with the responsibility to mitigate the build-up of risks which could threaten the entire financial system. *Against this background, many countries are developing macroprudential policy frameworks to reduce the risks to the financial system from boom-bust cycles6. Macroprudential policy involves the use of macroprudential policy tools in the face of rapid credit growth or other risk factors such as rapid growth in asset prices, rising leverage or abundant liquidity. The goal is to limit and mitigate risk of a systemic nature, thereby minimising the incidence of disruptions in the provision of key financial services that could have serious ramifications for the real economy.*

In 2020 and in line with international best practices, major changes were put in place to enhance financial stability in Namibia. *In this regard, the Bank of Namibia Act of 1997 was repealed and replaced with the Bank of Namibia Act 2020 (Act No. 1 of 2020). Of significance to financial stability in the Bank of Namibia Act of 2020 was the establishment of the Financial System Stability Committee and the expansion of the Bank of Namibia's mandate to include macroprudential oversight of the financial system. The Bank is expected to carry out this mandate in consultation with the Namibia Financial Institutions Supervisory Authority (NAMFISA) and the Ministry of Finance (MoF). This is crucial as it enhances effective and efficient decision making on macroprudential policy.*

Objectives of Macroprudential Policy in Namibia

The overall objective of macroprudential policy in Namibia is to promote and safeguard financial stability through the early identification and mitigation of systemic risks. *Macroprudential policy has two broad aims that are complementary: 1) Strengthening the resilience of the financial system to economic downturns and other adverse aggregate shocks; and 2) Limiting the accumulation of financial risks and the likelihood or the extent of a financial crisis. Macroprudential policies focus on the interaction between financial institutions, infrastructure, markets and the real economy. As such, sound*

[6] Boom-bust cycles are also referred to as economic cycles and is generally the fluctuation of gross domestic product (GDP) around its long-term trend. A boom being when an economy has reached the peak of its expansion in a given economic cycle, whereas a bust is when an economy has reached the peak of its contraction.

macroprudential policy increases the resilience of the financial system to adverse systemic shocks by establishing buffers to help cushion their impact, while sustaining the provision of financial services and credit to the economy.

Financial System Regulation in Namibia

The Namibia financial system is regulated on a sectoral basis by two authorities. *The Bank is responsible for regulating the banking sector under the Bank of Namibia Act, 2020 (Act No. 1 of 2020), and any other law that confers powers to the Bank. NAMFISA is responsible for regulating the non-banking financial institutions (NBFIs) under the NAMFISA Act (Act No. 3 of 2001) as amended, as well as any other laws that confers powers to NAMFISA. The Bank strives to manage its expanded mandate by collaborating with NAMFISA through existing regulatory and supervisory channels.*

Prior to 2020, safeguarding financial stability in Namibia was carried out by an inter-agency Financial System Stability Committee (FSSC), without a macroprudential oversight mandate. *Chaired by the Deputy Governor of the Bank of Namibia, the FSSC comprised of the staff members of the Bank of Namibia, NAMFISA and the Ministry of Finance. The FSSC operated under a cooperation agreement between the three institutions. The FSSC was established in accordance with Chapter 6 (Section 32) of the Bank of Namibia Act of 2020, to assist the Bank in monitoring risks affecting the financial system as well as to provide advice and make recommendations to the Bank of Namibia. The FSSC is responsible for;*

(a) assisting the Bank in monitoring the financial system against risks, weaknesses, disruptions or developments that may harm or threaten financial stability of Namibia;
(b) advising the Bank of Namibia on any necessary action to be taken in order to mitigate or remedy the risks, weaknesses or disruptions to financial stability,
(c) making recommendations to the Bank on which financial institutions must be considered as systemically important financial institutions for purposes of financial stability;
(d) drafting the annual financial stability report in order to assist the Bank of Namibia in assessing the stability of the financial system and
(e) promoting the coordination of information exchange and sharing among members of the committee and the Bank.

Similar to the old FSSC, the Financial System Stability Committee now consists of members from the Bank of Namibia and NAMFISA, as well as a representative from MOF but with minor changes. *The Bank is represented by the Governor as Chairperson, the Deputy Governors plus two staff members* *nominated by the Governor, while NAMFISA is represented by its Chief Executive Officer as Deputy Chairperson as well as three staff members, nominated by the CEO of whom, at least one staff member must be a senior staff member. A representative of the Ministry of Finance is nominated by the Minister, although that person only serves as an observer with no voting rights.*

The macroprudential oversight mandate vests with the Bank. *The Act provides the responsibility of macroprudential oversight and the coordination of activities to safeguard financial stability, to the Bank. In terms of Section 79 (2) of the Act, the Board of the Bank, in writing and on such conditions as the Board may determine, delegates a power or assigns a function conferred or imposed on the Board by or under this Act to a committee of the Board or to the Governor, a Deputy Governor or a staff member. In line with Section 79 (2), the Board of the Bank subsequently delegated macroprudential decision-making powers to the Governor who will be supported by the Macroprudential Oversight Committee (MOC) an internal committee at the Bank which was established to support the Governor in implementing the macroprudential oversight mandate. The MOC is chaired by the Governor (Chairperson) and consists of the Deputy Governors (the Deputy Governor responsible for financial stability matters will be the Deputy Chairperson), the advisors to the Governor, as well as selected members of the senior management of the Bank of Namibia. Specifically, the MOC supports the Governor in carrying out the following functions:*

(i) Issue directives after consultation with NAMFISA, regarding macroprudential matters on behalf of the Bank;

(ii) Co-ordinate activities involved in safeguarding of financial stability and ensure compliance with the directives;

(iii) Carry out periodic assessments of the financial system in order to identify and manage systemic risk to financial stability;

(iv) Managing the event of a system-wide financial crisis jointly with the Minister of Finance and NAMFISA with the aim of stabilising and restoring confidence in the financial system;

(v) Provides for regular briefing by the Bank of Namibia to the Minister of Finance, Cabinet or the relevant standing committee of the National Assembly regarding the status of financial system stability in Namibia, particularly in the event of crisis resolution, and to recommend the action to be taken.

The Bank is advised by the FSSC, and may request information from various agencies as is considered necessary for financial stability purposes. *The FSSC was formed as an advisory body to the Bank on actions to mitigate or remedy risks to the financial sector. The Bank of Namibia may request any ad hoc information, or commission periodic reports from any office, ministry or agency of the Government, a regulatory authority, a supervisory authority or any institution which is overseeing banking institutions, financial institutions, payment system participants, which the Bank of Namibia considers necessary to give effect to financial stability.*

Coordination of financial stability, macroprudential regulation and monetary policy is critical to safeguard financial stability in Namibia. *Coordination is catered for through cross-membership in the FSSC, MOC and the Monetary Policy Committee (MPC). The Governor, Deputy Governors and some of the Bank officials' cross-membership between these committees ensures that the interaction between monetary policy, financial stability and macroprudential policy is duly considered in the decisions taken that relates to financial stability in Namibia.*

Conclusion

The Bank's expanded mandate includes the coordination and oversight of macroprudential activities in Namibia. *This is achieved through continued communication and interaction with NAMFISA and the Ministry of Finance through the Financial System Stability Committee, while macroprudential decision-making is carried out by the Governor with the assistance of the Macroprudential Oversight Committee. NAMFISA remains the regulator of the NBFIs, and as such any macroprudential directives that affect the NBFIs, will be issued after consultation with NAMFISA to ensure that implementation is done effectively and efficiently. This highlights the importance of a strong institutional framework for effective macroprudential regulation and supervision. Keen readers are encouraged to familiarise themselves with the Bank of Namibia's Macroprudential Oversight and Financial Stability Framework on the Bank's website at www.bon.com.na .*

V. PERFORMANCE OF THE BANKING SECTOR

Since the last FSR, the performance of the banking sector deteriorated but remained positive amidst the adverse impact of the COVID-19 pandemic on the economy and the accompanying low interest rate environment. Banking institutions maintained liquidity and capital levels well above the prudential requirements. Liquid assets held by the banking sector increased from N$19.0 billion in 2019 to N$20.1 billion in 2020. This was largely ascribed to payments by the Government such as Valued Added Tax (VAT) refunds and deferred tax payments, and to corporates repatriating funds. The banking sector also recorded some improvements in loan repayments from various customers, coupled with a slowdown in the demand for credit from households and businesses. Similarly, the sector's capital adequacy position remained satisfactory despite a marginal deterioration in the total capital adequacy ratio, which resulted from lower capital holdings. All capital ratios stood above the statutory minimum requirements. Asset quality as measured by the non-performing loans (NPL) ratio worsened, exceeding the 6.0 percent crisis time supervisory intervention trigger point of the Bank of Namibia. The increase in the NPLs was registered across sectors such as individuals, agriculture and forestry, real estate and business services as well as construction. The only sector which recorded a decline in NPLs was the electricity, gas and water sector.

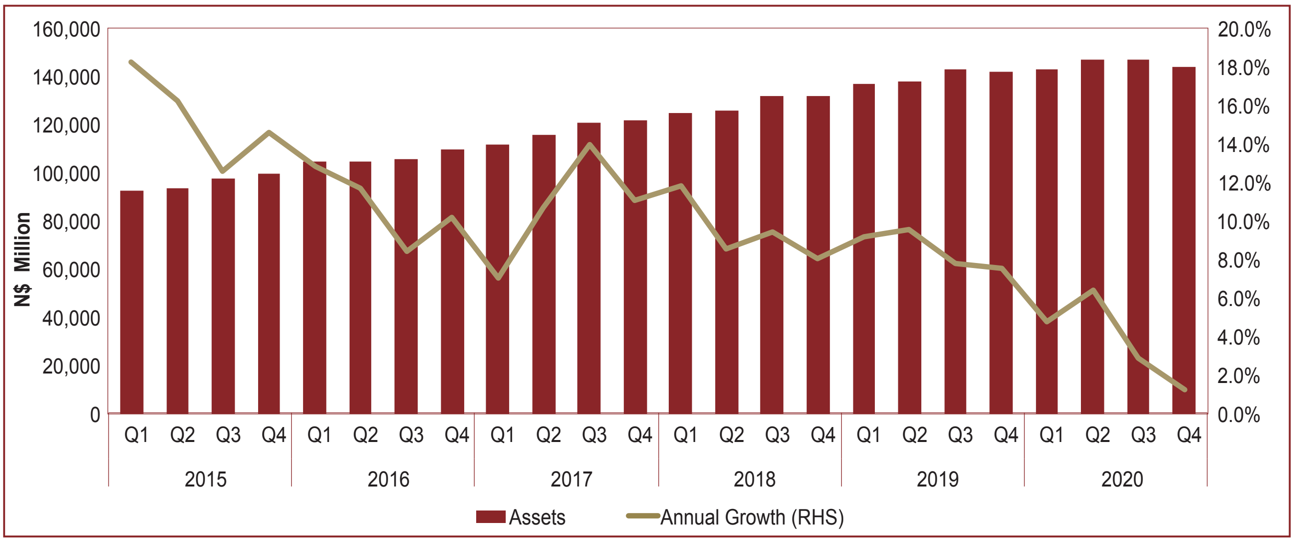
BALANCE SHEET STRUCTURE OF THE BANKING SECTOR

Despite registering a slowdown owing to the impact of the COVID-19 pandemic, growth in the balance sheet of the banking sector remained positive during the review period. In this regard, the balance sheet of the banking sector rose to N$144.0 billion as at 31 December 2020 from N$142.2 billion as at the end of December 2019, constituting an annual growth rate of 1.3 percent. This was principally underpinned by higher cash balances as well as short term negotiable securities such as treasury bills held by the banking institutions compared to the previous year on the asset side. As demand for credit was absent, commercial banks opted to invest excess cash in liquid instruments, pushing cash and balances to N$14.8 billion, representing an increase of N$1.1 billion. Similarly, short term negotiable securities supported the growth on the asset side of the balance sheet when it expanded by N$723 million to N$16 billion. Conversely, net loans and advances decreased from N$101.2 billion to N$100.7 billion, an indication of the poor demand for credit. On the liability side, the largest liability of the banking sector consisted of demand deposits, which accounted for 51.0 percent of total funding, up from 47.1 percent, and is comprised primarily of wholesale deposits, which are volatile by nature, posing potential risks to financial stability.

Assets

Despite the recessionary economic environment, total assets of the banking sector continued rising but growth moderated year-on-year during 2020. The total assets of the banking sector continued to grow amidst recessionary economic conditions increasing from N$142.2 billion in 2019 to N$144.0 billion in 2020 (Figure 10). This represented a year-on-year growth rate of 1.3 percent, which was lower, compared to the 7.6 percent increase recorded in 2019. Moreover, the growth rate was well below the average inflation rate, which stood at 2.2 percent during the period under review. Growth in assets was observed in cash and balances and total trading and investment securities. Cash and balances grew from N$13.6 billion in 2019 to N$14.8 billion in 2020. Net loans and advances (i.e., net of general provisions, specific provisions and interest in suspense) declined due to the impact of the COVID-19 pandemic on economic activities and the reduced demand for loans. Despite declining slightly from 71.2 percent of total assets in 2019 to 69.1 percent in 2020, net loans and advances continued to dominate the banking sector's assets. Mortgage lending remained the largest loan product on the balance sheet of the banks accounting for 52.3 percent of total lending in 2020, compared to 51.3 percent in 2019. Cash and balances with banks increased by 8.8 percent from N$13.6 billion in 2019 to N$14.8 billion in 2020. Similarly, total trading and investment securities expanded by 9.7 percent from N$6.5 billion in 2019 to N$7.1 billion in 2020. The decelerating pace at which the banking sector assets grew during the period under review signifies the extent of the challenging economic conditions that were encountered.

Figure 10: Banking Sector Asset Growth

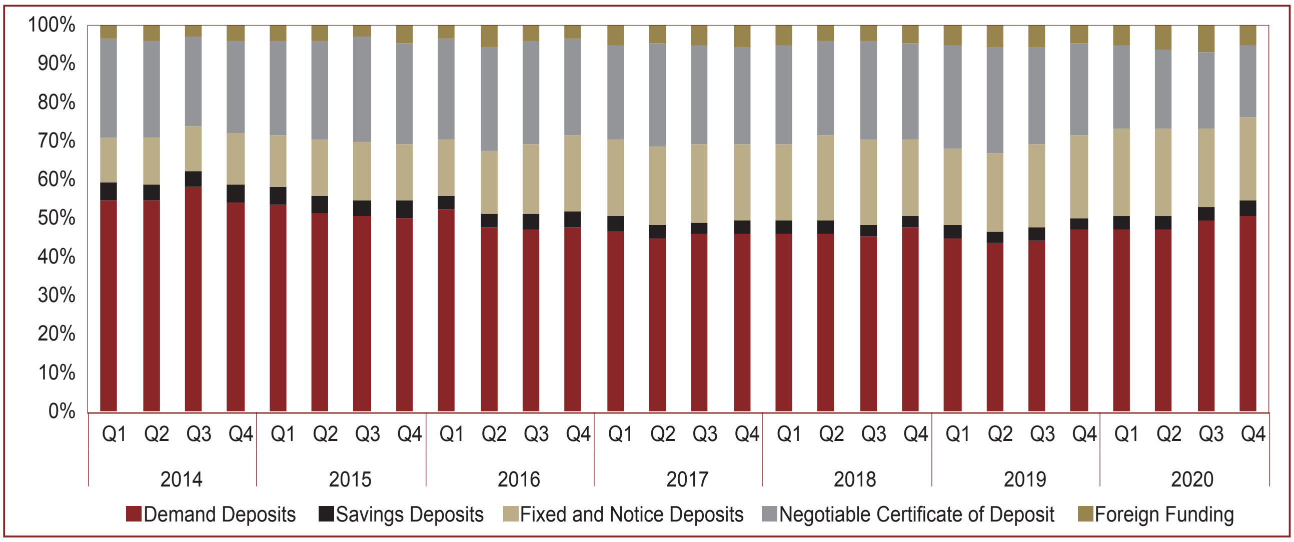


Source: Bank of Namibia

Capital and Liabilities

Non-bank funding continued to be the main driver of growth on the capital and liabilities side of the balance sheet. The largest source of funding for the banking sector remained non-bank funding, which consisted of demand deposits, fixed and notice deposits, and negotiable certificates of deposit. Non-bank funding registered growth of 1.6 percent in 2020 compared to 8.4 percent during period under review. As a result, non-bank funding stood at N$117.8 billion in 2020 from N$115.9 billion in 2019. This growth stemmed from an increase of N$6.2 billion in demand deposits and N$1.1 billion in foreign funding. Non-bank funding accounted for 76.7 percent of total funding, an improvement from the share of 75.6 percent in 2019. Demand deposits comprised the highest share of non-bank funds, which is largely made up of wholesale deposits. Wholesale deposits can be withdrawn at short notice and are volatile in nature. The overall funding portfolio of banks moved towards demand deposits during 2020 when compared to 2019 as banks opted to protect their interest margin in an environment of sharply declining interest rates. In this regard, demand deposits increased from 47.1 percent of total funding in 2019 to 50.1 percent in 2020, a cause for concern for financial stability. Meanwhile, the share of fixed and notice deposits grew slightly from 21.4 percent in 2019 to 21.5 percent in 2020 (Figure 11). To manage the potential concentration and liquidity risks, research is being undertaken on the behaviour of wholesale funding and the structure of the market pertaining to liquidity. The recommendations of the study are anticipated to inform diversified funding, liquidity risk assessment and management processes going forward.

Figure 11: Composition of Non-Bank Deposits



Source: Bank of Namibia

CAPITAL ADEQUACY

During 2020, the banking sector remained adequately capitalised and maintained a capital position well above the prudential requirement. The Common Equity Tier 1 (CET1), Tier 1 and total eligible capital ratios stood well above their minimum regulatory requirements of 6.0 percent, 8.5 percent and 10.0 percent, respectively[7]. Total qualifying capital increased from N$15.9 billion in 2019 to N$16.2 billion in 2020, owing to an increase in risk weighted assets of 4.4 percent. Consequently, the total risk weighted capital ratio declined marginally from 15.6 percent to 15.2 percent. On the contrary, Tier 2 capital declined from N$2.6 billion in 2019 to N$2.2 billion during the period under review ascribed to decreases in instruments issued that meet the criteria for inclusion in Tier 2 capital, unaudited profits and revaluation reserves. As a policy relief measure, the Bank of Namibia reduced the capital conservation buffer to zero percent for at least 24 months in order to support banking institutions in supplying credit to the economy. The release of the capital conservation buffer had enabled banking institutions to use the capital they have built up during good times during times of distress.

The total risk weighted capital ratio (RWCR) decreased slightly, while Tier 1 risk weighted capital ratio increased marginally during the period under review. The total RWCR declined from 15.3 percent in 2019 to 15.2 percent in 2020 but it remained well above the statutory minimum of 10.0 percent (Figure 12). The Tier 1 RWCR ticked up marginally to 13.1 percent in 2020 from 13.0 percent in 2019 and remained above the prudential requirement of 7.0 percent. A favourable capital position buffers the banks from losses as well as risks associated with the banking business, which bode well for financial stability.

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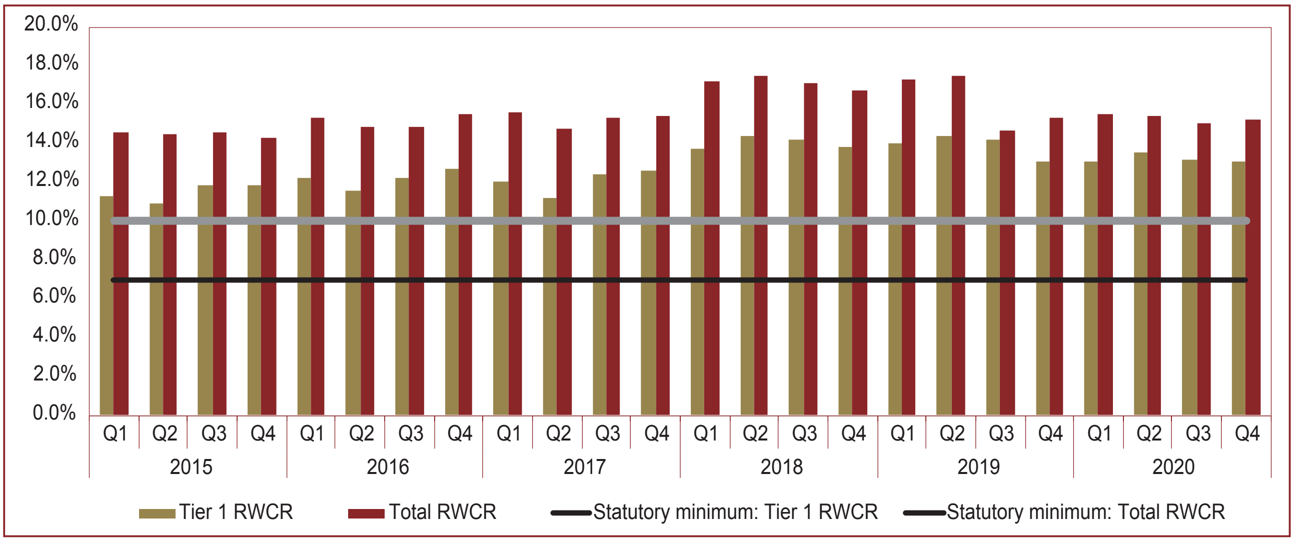
[7] The prudential requirement for the total risk weighted capital ratio increased from 10.0 percent to 11.0 percent; this was to accommodate the 1.0 percent that made up the capital conservation buffer requirement. Given that the buffer has been released and will be maintained at zero for at least 24 months which started in April 2020 as part of the regulatory and policy relief measures implemented by the Bank of Namibia, the total RWCR is therefore maintained at 10.0 percent. For consistency purposes the 10.0 percent is maintained over the observed period in Figure 12. In terms of the solvency stress test results, the RWCR is also maintained at 10 percent because the stress test projects 12 months ahead of which the capital conservation buffer will effectively be at zero and therefore the total RWCR will remain at 10.0 percent.

Figure 12: Capital Adequacy



Source: Bank of Namibia

BANKING SECTOR RISK ANALYSIS

The financial stability authorities analyse the resilience of the domestic financial system to internal and external shocks, be they economic, financial, political or otherwise. The main objective is to identify potential risks in the banking sector, while also determining how best to mitigate any foreseeable risks. It is therefore crucial to analyse credit risk, liquidity risk and concentration risk in the banking sector. The analysis of these risks also serves as a basis for the magnitude of banking sector stress test and its resilience to shocks.

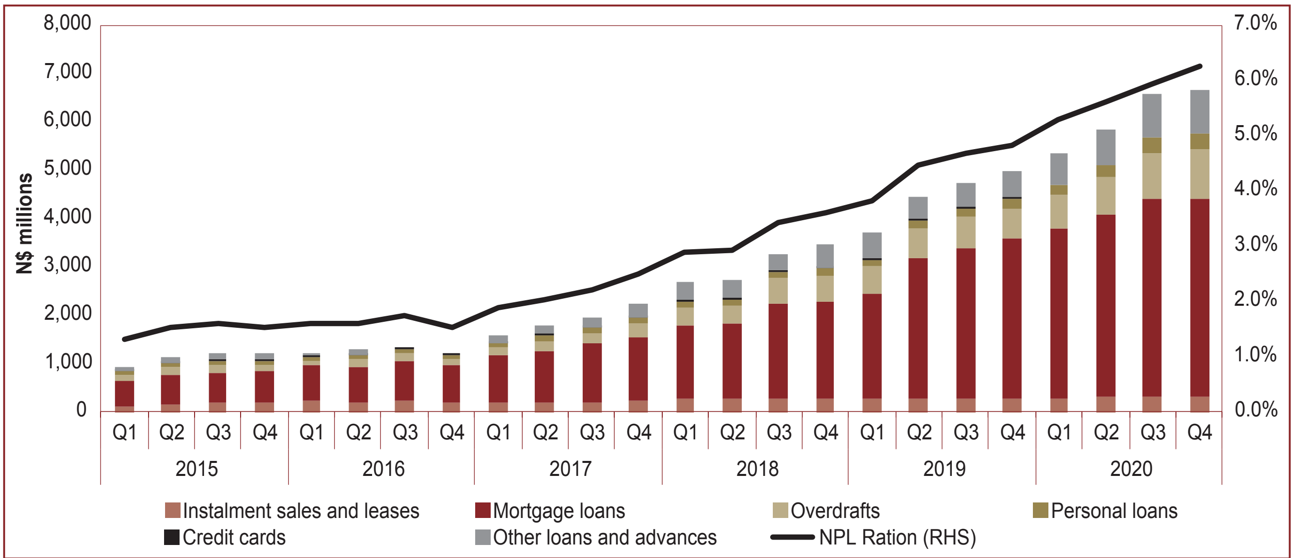
CREDIT RISK

Asset Quality

Since the last FSR, asset quality, as measured by the non-performing loan (NPL) ratio, continued to deteriorate. Asset quality worsened as the banking sector's NPL ratio rose above the new trigger ratio of 6.0 percent for times of crisis and stood at 6.4 percent during the period under review, a significant escalation from 4.8 percent registered in 2019 (Figure 13). The persistent increase in NPLs is ascribed to unfavourable economic conditions, cash flow constraints experienced by both households and businesses and the downside risk emanating from the COVID-9 pandemic, which caused business to either scale down operations or close. In terms of the sectors, non-performing loans in the mortgage and overdraft categories increased by 24.2 percent and 59.7 percent, respectively, during the period under review. Similarly, non-performing loans in the personal loans and other loans and advances categories increased by 76.0 percent and 60.8 percent, respectively over the same period. Growth in the NPL ratio of this magnitude is ascribed to the recessionary economic conditions given the COVID-19 pandemic. Mortgage loans contributed significantly to the growth in the NPL ratio during the period under review; however, this is expected given that mortgage loans make up 52.3 percent of the total loan book of banks. Current economic conditions played a rather large role in the ability of clients to service their debt, more so with lay-offs and retrenchments experienced.

To mitigate the impact of the deterioration in NPLs on the banking sector, the Bank of Namibia implemented additional regulatory reporting to monitor heightened credit risk in the banking sector. Specifically, the Bank implemented closer monitoring by engaging with banking institutions on a bilateral basis and initiating monthly reporting of credit risk indicators, which also includes operational and liquidity risk updates and the conduct of solvency stress tests to closely monitor downside risks emanating from the pandemic. Provisions were also made for this non-conforming exposure to ensure that it is, as far as possible, fully asset backed.

Figure 13: Non-performing loans as a percentage of total loans

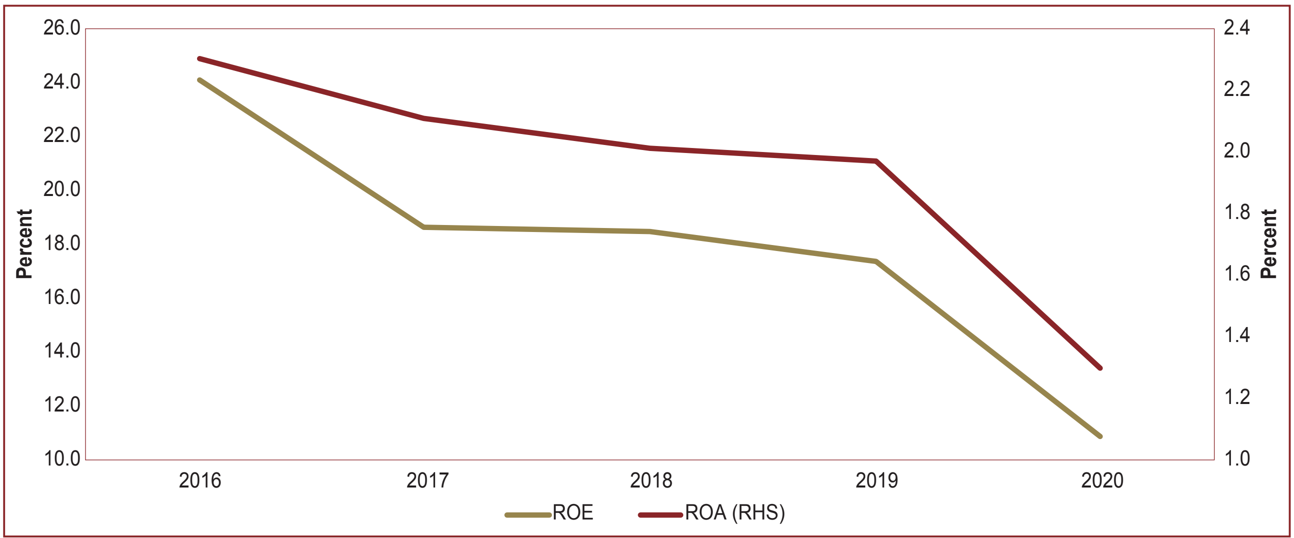


Source: Bank of Namibia

Profitability of the Banking Sector

Profitability of the banking sector weakened amidst recessionary conditions due to decreases in net interest income, while other operating income rose. The banking sector's after-tax profits decreased by 33.4 percent to N$1.8 billion in 2020 from N$2.7 billion in 2019. Net interest income declined significantly by 17.3 percent in line with the reduction in the Bank of Namibia's repo rate and interest rate reductions by commercial banks. On the contrary, other operating income increased by N$63.0 million and amounted to N$3.7 billion, contributing positively to the growth in total income. The increase in other operating income was driven by transaction-based fees. Net interest income declined from N$5.9 billion in 2019 to N$5.4 billion in 2020. The decline in net interest income was ascribed to the reduction in interest income emanating from lower interest received on balances held with banks, short-term negotiable securities, instalment debtors, residential mortgages and fixed term loans as well as interest rates on fixed deposits that could not reprice. Profitability as measured by the Return on Equity (ROE) as well as the Return on Assets (ROA) ratios contracted significantly during 2020 predominantly driven by an increase in provisions and write-offs charges owing to the unfavourable macroeconomic environment. The ROE decreased from 17.3 percent in 2019 to 10.9 percent in 2020 (Figure 14). Equally, the ROA fell from 2.0 percent in 2019 to 1.3 percent in 2020.

Figure 14: Profitability of the banking sector

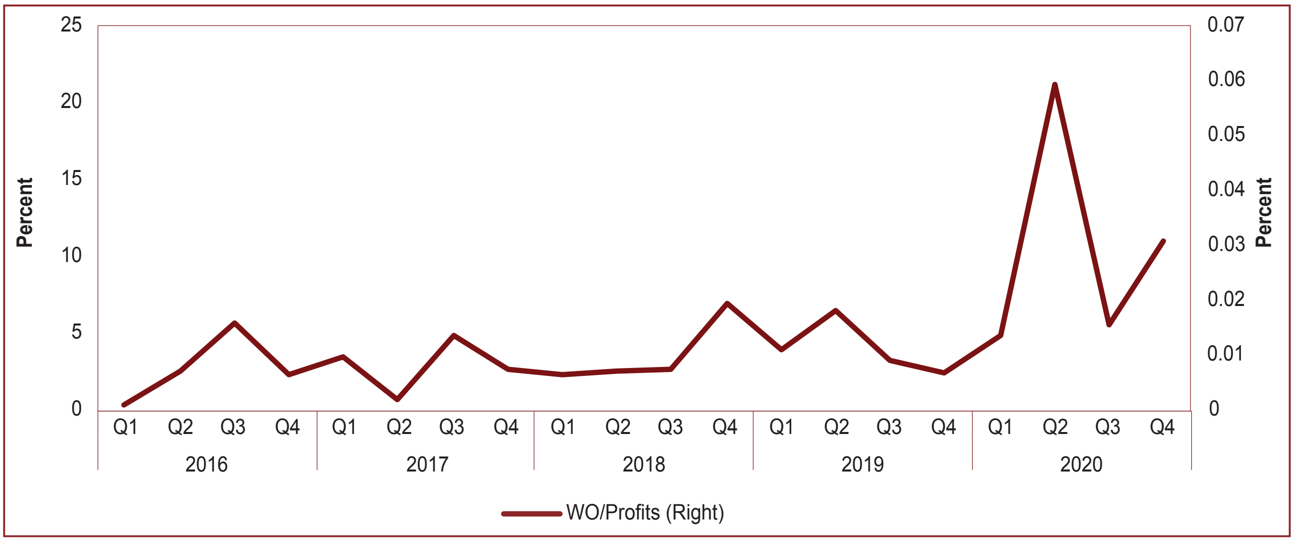


Source: Bank of Namibia

Write-offs in relation to profits

In line with the deterioration in asset quality, the write-offs in relation to profits increased during the review year. The percentage of write-offs in relation to profits also increased, from 2.47 percent in 2019 to 11.09 percent in 2020 (Figure 15). The increase in the write-off to profits ratio reflects the recessionary economic conditions triggered by COVID-19 and is expected to improve once the economy recovers during the course of 2021 and 2022.

Figure 15: Write-offs in relation to profits



Source: Bank of Namibia

Adequacy of Provisions

Adequate provisions were raised for delinquent loans during the period under review. Specific loan loss provisions increased from N$98.5 million in 2019 to N$145.3 million in 2020, representing a growth rate of 57.4 percent. Bad debts written off increased in 2020 when compared to the preceding period, from N$22.5 million to N$62.7 million, which is expected given the increase in the NPL ratio. The increase in the NPL ratio is aligned with the bad debt written off owing to the recessionary economic conditions which were exacerbated by the impact of the COVID-19 pandemic. The growth in specific loan loss provisions was on the back of the anticipated losses as the pandemic unfolded in 2020. The banks, therefore, had adequate provisions and buffers to cushion against any potential losses during the period under review. The banks' ability to manage credit risk was overall satisfactory.

LIQUIDITY RISK

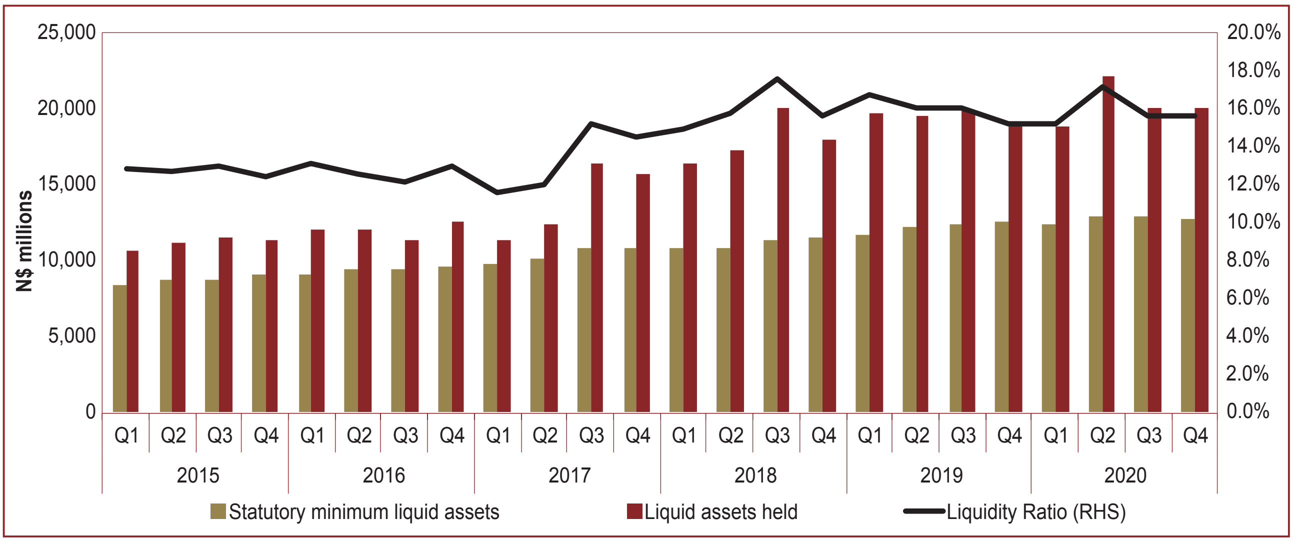
Liquidity Position

During 2020, the banking sector continued to hold liquid assets well in excess of the statutory minimum liquid assets requirement. The banks are required to keep liquid assets of at least 10.0 percent of average total liabilities to the public. Liquid assets actually held increased from N$19.0 billion in 2019 to N$20.1 billion in 2020. The statutory minimum liquid assets increased to N$12.7 billion in 2020, from N$12.5 billion in 2019. The liquid assets held were therefore well in excess of the statutory minimum required. The liquidity ratio[8] increased marginally from 15.3 percent in

[8] The liquidity ratio is calculated to determine the banks capacity to pay their short-term obligations, while also determining the banks' ability to convert its assets into cash.

2019 to 15.7 percent during the period under review (Figure 16). The improved liquidity was largely caused by payments from the Government such as VAT refunds and deferred tax payments, and by corporates repatriating funds. The banking sector also saw some improvement in loan repayments from various customers, coupled with a slowdown in the demand for credit from households and businesses.

Figure 16: Liquid Assets and Liquidity Ratio



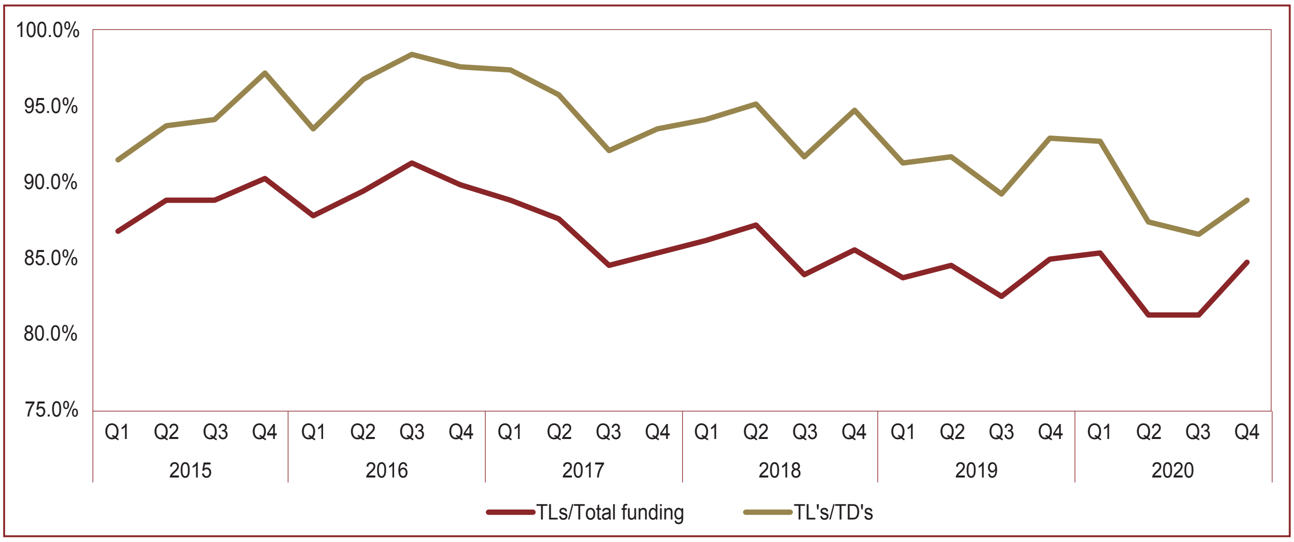
Source: Bank of Namibia

Loan-to-Deposit (LTD) and Loan-to-Funding (LTF) Ratios

A key liquidity indicator, the loan-to-deposit (LTD) ratio, moderated but remained high. The ratio slowed from 92.9 percent during 2019 to 88.8 percent during the period under review (Figure 17). The lower ratio implies that the banks have made relatively less use of more expensive sources of funds such as debt and instead made more use of deposits to fund loans and advances. Despite there not being a set benchmark, a LTD ratio close to or over 100 percent implies that some of the banks rely on borrowed funds to fund some of their loans. The new Basel III liquidity framework will require banks to diversify their funding sources; coupled with the revised BID-6, the banks should therefore be able to further enhance their management of liquidity risk going forward.

The banking sector's loan-to-funding (LTF) ratio remained virtually unchanged in 2020 when compared to 2019. The LTF ratio stood at 84.8 percent in 2020 compared to 84.9 percent in 2019 (Figure 17). This ratio indicates that, on average, 84.8 percent of the banks' funding has been extended as loans and advances, which means that only 15.2 percent of total funding, capital and equity was available for use on liquid and other assets. A high LTF ratio limits banks' ability to further expand their loans and advances book and manage liquidity risks at the same time. As a result, the ratio remained at manageable levels.

Figure 17: Loan-to-Deposit (LTD) and Loan-to-Funding (LTF) Ratio



Source: Bank of Namibia

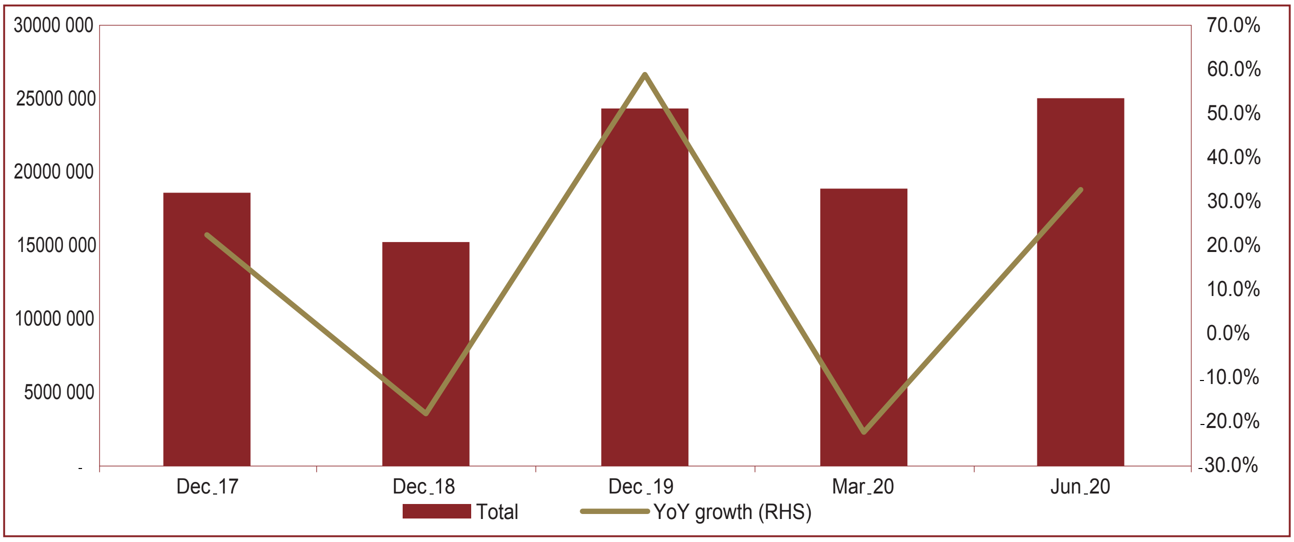
CONCENTRATION RISK

Large exposures[9]

During the period under review, the value of large exposures to some of the sectors decreased, while it increased to others. The value of large exposures decreased by 7.1 percent during 2020 and stood at N$22.6 billion compared to N$24.4 billion recorded in the previous year (Figure 18A). As a result, the ratio of large exposures to Private Sector Credit Extension (PSCE) decreased from 23.5 percent to 21.5 percent, year-on-year. This ratio remained compliant with the statutory limits for single parties of 30 percent of capital funds. Expressed as a percentage of qualifying capital, large exposures decreased to 139.3 percent compared to 155.7 percent recorded the previous year and is well within the permissible limit of 800 percent of capital funds. Large exposures pose a potential risk to the overall financial stability of the banking sector, in the form of excess concentration to individual companies or sectors. The significant increase in the banking sector's large exposures to all sectors with the exception of the *Manufacturing, Fishing* and *Tourism* sectors, may pose a concentration risk. Exposure to the *Mining and Minerals* and *Property and Construction* sectors grew significantly and constitute 16.4 and 16.9 percent of total large exposures, respectively. The Mining Sector should be able to service the relevant large exposures fairly well, given their capacity to earn foreign exchange and the financial backing of their parent companies. Similarly, loans extended to the Property and Construction Sectors are largely secured by properties which should enable banks to largely or fully recover the outstanding balance on properties in case of default.

[9] A large exposure is an exposure to a single person (or group of related persons in aggregate), which equals or exceeds 10 percent of a bank's capital funds.

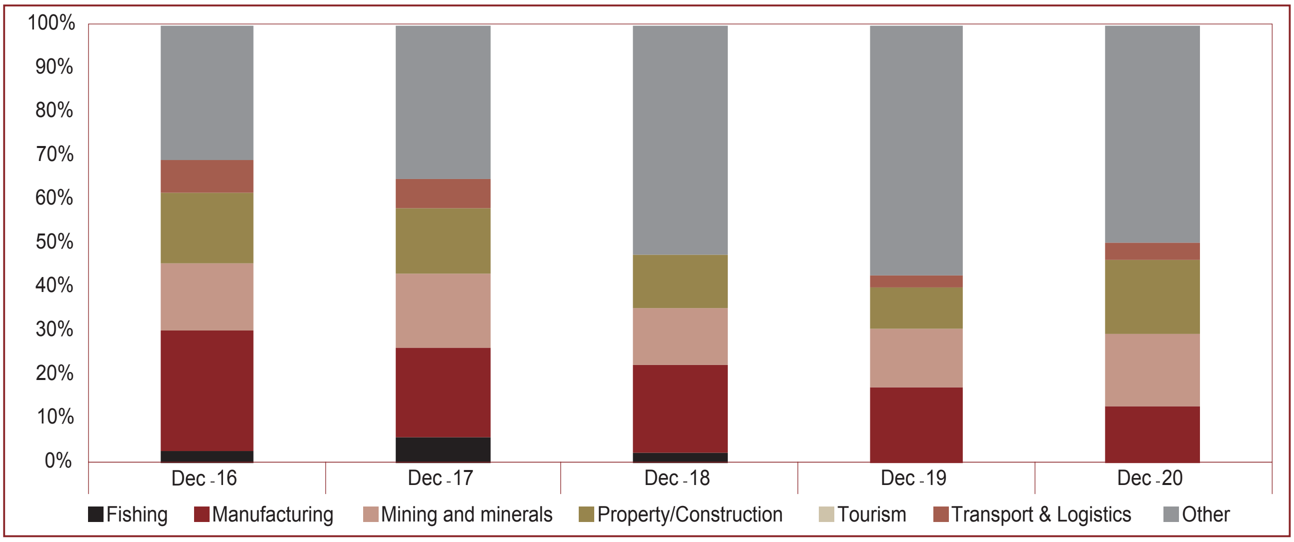
Figure 18A: Banking Sector Large Exposures - Value and Growth Rate



Source: Bank of Namibia

The sectoral composition of large exposures remained broadly diversified during 2020, with minor movements with regard to the relative share of total large exposures that the respective sectors occupy. In line with the consistent movements in the exposures to individual sectors, the relative share of the *Other, Construction and Property*, *Mining and Minerals* and *Manufacturing* sectors were the largest at 49.7 percent, 16.9 percent and 16.4 percent and 13.0 percent, respectively (Figure 18B). These compositions, however, did not warrant any concerns regarding the stability of the financial system. The banking sector large exposures, therefore, remained adequately diversified and posed minimal concentration risk to the financial system during the period under review.

Figure 18B: Sectoral Composition of Large Exposures



Source: Bank of Namibia

The proportion of total private sector credit extension (PSCE) to large exposures declined in 2020. The large exposures as a proportion of PSCE decreased from 23.5 percent in 2019 to 21.5 percent in 2020 (Table 8). In relation to private sector credit to businesses, large exposures similarly declined to 51.1 percent during the period under review, from 58.9 percent during the previous period.

Table 8: Large Exposures in relation to Private Sector Credit Extension

	2016	2017	2018	2019	2020
Total Large Exposures	15 223	18 668	15 332	24 379	22 636
Total PSC	85 397	89 720	95 748	103 739	105 380
PSC to Businesses	35 343	36 811	38 656	41 419	44 307
Large Exposures to PSCE	17.8%	20.8%	16.0%	23.5%	21.5%
Large Exposures to Business PSCE	43.1%	50.7%	39.7%	58.9%	51.1%

Source: Bank of Namibia

STRESS TEST

The Bank of Namibia conducts quarterly stress tests for the banking sector to assess the resilience of the Domestic Systemically Important Banks (DSIBs). The Cihak model was used to stress test the solvency and liquidity position of the DSIBs 12 months into the future. In addition, the model was deployed in assessing the resilience of the banking sector to potential shocks by using three scenarios. The first scenario is the baseline scenario which assumes that the current policy environment will continue to prevail, followed by the moderate scenario that adopts slightly adverse shocks and finally the severe/worst case scenario which can sometimes be hypothetical in nature. The scenarios consider the recent developments in the global, South African and Namibian economies, respectively, while also focusing on the performance of the DSIBs should the scenarios materialise.

The stress test is focused on potential interest rate, credit and liquidity risks facing the banking sector. Interest rate risk is determined by the movements in the repurchase (repo) rate; therefore, the scenarios assume the potential course of the repo rate in the next 12 months, supported by economic developments both domestically and globally. Credit risk is determined by considering the potential performance of the non-performing loan (NPL) ratio, which is a measure of asset quality. Another concern is whether the DSIBs would be able to withstand a liquidity shock if large numbers of their depositors were to make sudden withdrawals of their funds from the system. The objective is to quantify the impact on solvency and liquidity should the identified scenarios ensue.

Interest Rate Risk

The outbreak of the COVID-19 pandemic has led to expansionary monetary policy stances globally to mitigate the impact of the pandemic on the economy, and South Africa's response is no different. Global real GDP is estimated to have contracted by 3.5 percent during 2020, before recovering to a projected growth of 5.5 percent in 2021. The South African economy is estimated to have contracted by 7.1 percent in 2020. However, growth is projected to recover at a rate of 3.8 percent in 2021 and 2.4 percent in 2022, respectively. South Africa's inflation for 2020 averaged at 3.3 percent, while the overall risks to the inflation outlook appear to be balanced in the near and medium term. The South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) noted that the slow economic recovery will help keep inflation below the midpoint of the target range for 2021 before rising to around the midpoint of the inflation target range in 2022 and 2023. During 2020, the SARB's MPC cut its repo rate significantly in response to the COVID-19 pandemic. The repo rate was cut by a cumulative 300 basis points and currently stands at 3.50 percent. The implied policy rate path of the Quarterly Projection Model (QPM) indicates two increases of 25 basis points in the second and fourth quarters of 2021. However, the repo rate projection from the QPM is a broad policy guide, changing from meeting to meeting in response to new data and risks.

While supporting domestic economic activity and safeguarding the currency peg between the Namibia Dollar and the South African Rand, BoN has also adopted an expansionary monetary stance in response to the COVID-19 pandemic. Domestic economic activity slowed, with an estimated contraction of 7.3 percent in 2020 (under the baseline scenario) before a moderate recovery of 2.7 percent projected in 2021. Annual inflation declined to 2.2 percent during 2020 which was mainly ascribed to the decline in transport, housing and food inflation. Inflation is projected to average 3.0 percent in 2021. The Bank of Namibia cut the repo rate by a cumulative 275 basis points since the beginning of the year, bringing it to a historic low of 3.75 percent. At their recent MPC meetings in 2021, both the SARB[10] and BoN opted to keep the repo rate unchanged. As a result, the stress testing working group assumed that both central banks may not have much monetary policy easing scope left and may leave the rates unchanged for some time to support the economic recovery. However, should inflation start to increase owing to exogenous factors, such as the depreciation of the exchange rate or increase in international price of crude oil, SARB may be forced to hike the repo rate gradually.

In order to maintain the currency peg, the Bank of Namibia may opt to follow the same path as the SARB and raise the repo rate to align interest rates with those of South Africa. In all 3

[10] In the March 2021 MPC Statement, the SARB stated that the implied policy rate path of the Quarterly Projection Model (QPM) indicates two increases of 25 basis points in the second and fourth quarters of 2021. However, it should be noted that the implied policy rate path is used as a broad guide and changes from meeting to meeting in response to new data and risks.

scenarios the starting point is the current repo rate of 3.75 percent, thereby already incorporating the initial policy response to the intensification of the COVID-19 pandemic. From this level the following further repo rate decisions are foreseen:

- Retain the repo rate at the current level- 3.50 SARB, 3.75 BoN (Baseline scenario);
- Increase the repo rate by 25 basis points (Intermediate scenario);
- Increase of 50 basis points in the repo rate (Severe scenario).

Credit Risk

In line with the current economic conditions, the banking sector asset quality, as measured by the non-performing loan ratio (NPL), deteriorated further in the fourth quarter of 2020. Economic activity has been affected by the COVID-19 pandemic including the livelihood of many. Although the NPL ratio is a lagged indicator, the exponential deterioration of banking sector assets is indicative of the economic climate in Namibia. The NPL ratio increased from 5.20 percent at the end of the first quarter to 5.78 percent at the end of the second quarter and stood at 6.44 percent in the fourth quarter of 2020. Thus, surpassing the supervisory intervention trigger point of 6.0 percent during crisis time. The asset quality deterioration faired relatively well, which is primarily ascribed to the relief measures implemented by the banks. However, the NPL ratio is projected to deteriorate further as economic activity remains subdued. The potential increases in the NPL ratio were assumed as follows, with the starting point being the current NPL ratio of 6.44 percent:

- A 2.0 percentage point increase in the banking sector NPL ratio (Baseline scenario);
- A 3.0 percentage point increase in the banking sector NPL ratio (Intermediate scenario);
- A 5.0 percentage point increase in the banking sector NPL ratio (Severe scenario).

Liquidity Risk

Liquidity risk measures the ability of the banks to honour their financial obligations in a timely manner. The factors that may cause liquidity constraints include capital outflows to deeper and more liquid financial markets to diversify risk and optimise investment returns as well as a large number of unscheduled deposits withdrawals. Unscheduled deposit withdrawals can be triggered by market conditions; therefore, it is pertinent that the banks maintain adequate liquidity levels throughout economic cycles. The concern of BoN is whether commercial banks would be able to withstand a liquidity shock as a result of sudden withdrawals by depositors, despite being well capitalised, profitable and solvent. Although the liquidity position of the banks remained positive at the end of the fourth quarter with a liquidity ratio of 15.8 percent, it is uncertain if this may change in the next 12 months. Therefore, the concern of the FSSC is whether commercial banks could withstand a liquidity shock if depositors make a sudden withdrawal of their funds from the banking system. Depositors are assumed to withdraw their funds in the magnitudes outlined below.

- 13.65 percent of total deposits withdrawn over 5 days (23 percent of demand deposits) (Baseline scenario);
- 21.83 percent of total deposits withdrawn over 5 days (36 percent of demand deposits) (intermediate scenario);
- 32.75 percent of total deposits withdrawn over 5 days (54 percent of demand deposits) (severe scenario).

A summary of the stress test scenarios is presented in Table 9.

Table 9: Summary of the stress test scenarios

Variable	Baseline	Moderate	Severe
Interest Rate Risk (repo rate)	retain repo rate at current level of 3.75% (BoN), 3.50% (SARB)	increase repo rate by 25 basis points	increase repo rate by 50 basis points
Credit Risk (NPL ratio)	2.0 percentage point increase	3.0 percentage point increase	5.0 percentage point increase
Liquidity Risk	12.32% of total deposits withdrawn over 5 days (23% of demand deposits)	19.71% of total deposits withdrawn over 5 days (36% of demand deposits)	29.56% of total deposits withdrawn over 5 days (54% of demand deposits)
Other variables: - 30% haircut on collateral - 50% Assumed provisioning of the new NPLs			

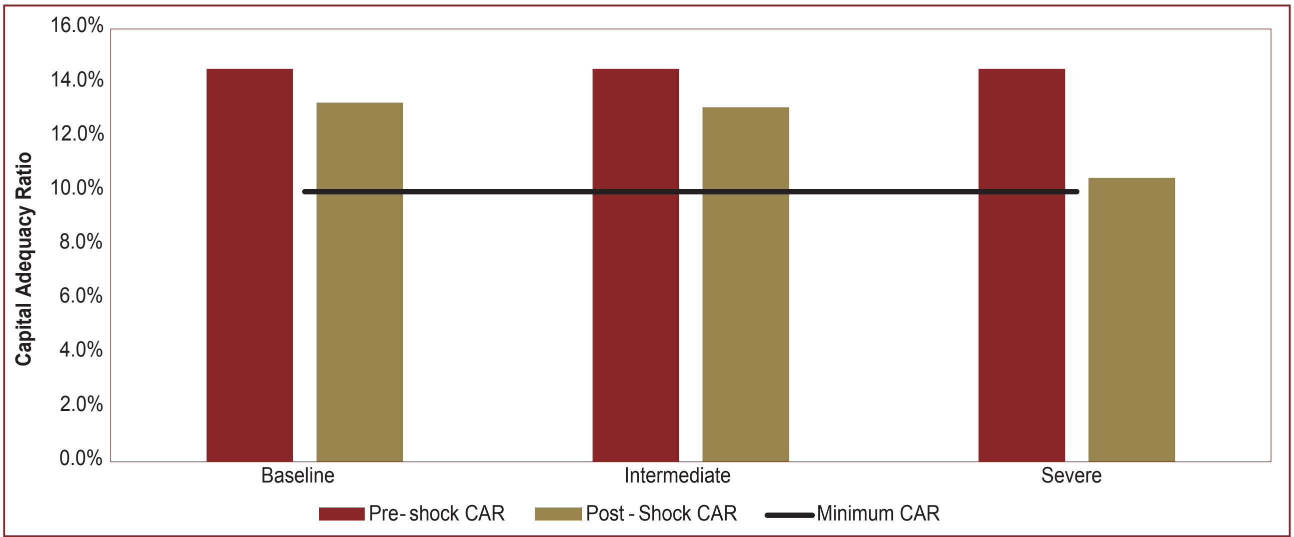
Source: Bank of Namibia

Stress Test Results

Solvency

The stress test results indicate that the banking sector remained solvent in all three scenarios. The pre-shock capital adequacy ratio (CAR) stood at 14.5 percent. In the baseline scenario the post-shock CAR stood at 13.3 percent, which is 3.3 percent higher than the statutory limit of 10 percent. The moderate scenario recorded a post-shock CAR of 13.1 percent, whereas in the severe scenario, the post-shock CAR was significantly lower at 10.5 percent (Figure 19). Overall, the 12-month projection of the Cihak model points toward a solvent banking sector, in all three scenarios with the severe scenario marginally meeting the prudential limit. The capital base of the banking sector is therefore adequate to absorb shocks, including potential risks emanating from asset quality in the banking sector.

Figure 19: Solvency Stress Test Results

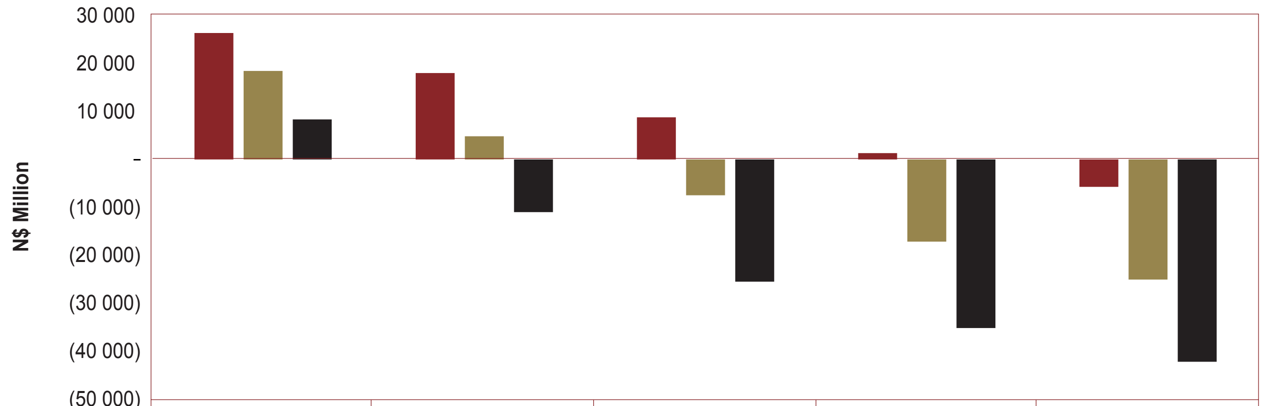


Source: Bank of Namibia

Liquidity

The liquidity position of the banking sector was mostly sound in the baseline scenario, while it deteriorated in the second and third day in the intermediate and severe scenarios, respectively. In the baseline scenario where 23 percent of demand deposits were withdrawn over 5 days, the liquidity of the banking sector remained sound up to the fourth day. Under the baseline scenario, all DSIBs excepts one remained sound up to the fourth day. In the moderate scenario, where 36 percent of the demand deposit are withdrawn, all DSIBs except one are liquid up to the second day. In the severe scenario where 54 percent of the demand deposits are withdrawn, three of the DSIBs are only liquid up to the first day, while one experiences outflows on day one (Figure 20). The banking sector would, therefore, only be able to meet its payment obligations in the baseline scenario up till the fourth day, while in the moderate the sector can meet the liquidity demands up to the second day. In the worst case scenario, the banking sector can honour its obligation only in the first day, nonetheless banks are still able to use other sources of funds to avert a liquidity crisis. Other sources of funds entails: credit lines with their parent companies, cash and central bank reserves in excess of minimum reserve requirements or liquid asset requirements, available repo facilities (Central Bank eligible collateral deposits), unencumbered assets not at the central bank, foreign exchange market liquidity or investment securities available for sale, securitised assets and interbank funding amongst others.

Figure 20: Liquidity Stress Test Results



	Day 1	Day 2	Day 3	Day 4	Day 5
Baseline	26,303	17,801	8,878	1,089	(5,630)
Intermediate	18,479	4,660	(7,686)	(17,483)	(25,167)
Severe	8,052	(11,057)	(25,479)	(35,415)	(42,130)

Baseline Intermediate Severe

Source: Bank of Namibia

OVERALL BANKING SECTOR RISK ASSESSMENT

The risks to the banking sector remain imminent but could subside as the economy recovers in the near to medium term and measures adopted by the Bank take effect. As economic activity recovers, the NPL ratio may start declining and reduce credit risk to the banking sector. To mitigate the impact of the deterioration in NPLs on the banking sector, the Bank of Namibia implemented additional regulatory reporting to monitor heightened credit risk in the banking industry. Specifically, the Bank implemented closer monitoring by engaging with banking institutions on a bilateral basis and initiating monthly reporting of credit risk indicators, which also includes operational and liquidity risk updates and the conduct of solvency stress tests to closely monitor the downside risks emanating from the pandemic. Provisions were also made for non-conforming exposure to ensure that it is, as far as possible, fully asset backed. Liquidity risk was not of concern during 2020 owing to the fact that the liquidity ratio was well above the statutory minimum requirements. The significant cuts in the repo rate had adversely affected the profitability of the banks, with the repo rate at the lowest historical rate of 3.75 percent. All these developments have put a strain on the banking industry, leaving the industry in a vulnerable position. Although still adequately capitalised and liquid, the severe case of the stress test indicates that the banks barely meet the minimum CAR. In this regard, it is important for the Bank of Namibia to continue monitoring the performance of the economy, and the balance sheet of banks, in order to stand ready with interventions as needed in order to support the economy. The risks in the banking industry remain imminent but could subside as the economy recovers in 2021 and 2022 and policy measures instituted by the Bank take effect.

BOX ARTICLE 2

THE IMPACT OF COVID-19 ON THE FINANCIAL SYSTEM

Introduction

The year 2020 was an extraordinary year for individuals, nations and the global economy. *The unpredictable health and socio-economic phenomenon of the COVID-19 pandemic has in one way or another affected everyone in varying degrees. In many cases, households lost their income or experienced income reductions, as businesses closed or significantly reduced activities. In the cases of banks and non-banking financial institutions, the profitability, reserves, and overall financial stability was tested during this period. However, most of the banks and non-banking financial institutions domestically managed to withstand the impact of this unprecedented shock, bolstered by the timely and effective support and relief measures implemented by central banks, governments and various regulators.*

Financial institutions in both the banking and non-banking sectors were put to the test, not just financially but on an operational level as well. *The national lockdown regulations initially allowed only essential workers to continue working in office, whereas others were limited from doing so. Therefore, employers were forced to come up with innovative ways to continue non -essential services, while complying with the national COVID-19 regulations until these laws were eased around mid-2020. The financial sector further had to guarantee that all their clients' needs were met, and business activities could continue with minimal interruption. Most importantly, they had to ensure that they were able to withstand the impact the pandemic had on their finances. Financial institutions were generally able to overcome these obstacles, although the impact was felt across the sector. This article briefly analyses how the COVID-19 pandemic has affected Namibian commercial banks and non-banking financial institutions. The article further discusses the various relief measures implemented by the Bank of Namibia and NAMFISA, and how those measures have impacted the respective industries within the sector.*

Policy relief measures implemented by BoN and their impact on the Banking sector

In terms of monetary policy, the Bank of Namibia reduced the repo rate by a cumulative 275 basis points to support the vulnerable sectors of the economy. *In this regard, the repo rate was reduced in steps from 6.50 percent at the beginning of 2020 to 3.75 percent at present as the Bank adopted an expansionary monetary policy stance to provide relief to the domestic economy and simultaneously maintain the one-to-one peg with the South African Rand. This significant decrease in the repo rate had several effects on the economy and the banking sector's income. On the positive side, servicing mortgages and other loan products became cheaper for households, and commercial banks were able to, in turn, borrow from the Bank of Namibia at cheaper rates. This helped alleviate the debt burden, effectively relieving the pressure on households and businesses. The yields on short- and medium-term Government bonds and Treasury bills decreased significantly, as the repo rate was cut and investors* *increasingly sought safety in the sovereign bond market, causing yields to decrease and prices to rise for shorter-term maturities. The lower interest rate environment also contributed to the significantly reduced profit margins of the banking sector as discussed later in this article. Going forward, the monetary policy stance of the Bank of Namibia will be data dependent with a view to support the economic recovery.*

Additionally, the Bank implemented relief measures in terms of capital, credit risk, liquidity and limits on large exposures. *On 30 March 2020, the Bank issued a determination (BID 33) effective 1 April 2020. This determination was issued to provide policy and regulatory changes amid economic challenges posed by the COVID-19 pandemic in Namibia and is summarised in table 1. Most of these measures were received positively by the industry. Although the market players, argued that the loan repayment moratorium which allows for banks to retain assets for longer periods, could complicate the process of writing off assets. Moreover, helping borrowers that were in difficult financial positions may became arduous; therefore, in some instances commercial banks may move to liquidate companies at a faster rate, in an effort to protect themselves against an increase in non-performing loans (NPLs).*

Table 1: BID 33 policy changes in response to the economic and financial stability challenges as a result of COVID-19 (Effective 1 April 2020)

Policy Changed	Main Conditions
Credit Policy Measures	
Loan repayment moratorium	• Holiday is allowed on the principal amount for a period ranging from 6 months to 24 months (two years) based on thorough assessment of economic and financial condition of individual borrowers. • Interest may be capitalised, on condition that a reduced interest rate shall apply during the repayment holiday period.
Write-offs under the Loss Category	• Any asset, which is overdue by 360 days or more shall be classified as Loss and shall be written-off within 3 years after being classified as a "Loss" against the provision for loan losses account unless such loan is: (i) well secured; (ii) in the process of collection; and (iii) the time needed to realise collateral does not exceed three years after judgement. • When an asset is classified as loss, the banking institution shall apply a haircut of 25 percent on the value of the collateral. In the event that the asset remains in loss category for 1 year from date of classification as loss, a haircut of 50 percent shall apply; for 2 years from date of classification as loss, a haircut of 75 percent shall apply; 3 years from the date of classification as loss a 100 percent haircut on the value of the collateral shall apply.
Liquidity relief measures	• The Bank decided to relax the two Business-as-Usual maturity mismatch limits required in terms of the Determination on Minimum Liquid Assets (BID-6) for the next 6 months and require banking institutions outflows in the (0 to 7 days) time bands to exceed their inflows by only the amount equivalent to unencumbered liquid assets buffer, which is the portion above the 10 percent minimum liquid assets requirement held during that period. • For the (8 to 30 days) time band, the Boards of banking institutions may decide and set their own limit.
Capital conservation buffer	• The Bank has reduced the Capital Conservation Buffer rate for the DSIBs to 0 percent for a period of at least 24 months.

Policy Changed	Main Conditions
Concentration risk limit / single borrower limits	• The Bank decided to postpone the introduction[11] of the limit in respect of the total exposures outstanding at any time to a single person or a group of related persons in terms of the Determination on Limits on Exposures to Single Borrowers, Large Exposures and Concentration Risk (BID-4, The limit was set to be reduced to 25 percent of a bank's capital funds from December 2019 but was kept at 30 percent of a bank's capital funds.

Moreover, the Bank of Namibia postponed the introduction of the concentration risk limit, also referred to as the single borrower limit, in respect of the total exposures outstanding at any time to a single person or entity. *The limit was initially at most 30 percent of the bank's capital and reserves. A new determination, announced in December 2019, set the limit at a stricter level of 25 percent, due to be implemented during the course of 2020. The pandemic led to the postponement of such implementation and keeping the limit at 30 percent for now has enabled banks greater flexibility to extend credit to large clients in vulnerable sectors during the pandemic, thereby providing further scope for the industry to provide relief to the economy.*

To further support commercial banks in supplying credit to the economy, the Bank has decreased the Capital Conservation Buffer (CCB). *As per the Government Gazette of The Republic of Namibia, 7166 1 April 2020, the capital conservation buffer rate was decreased to 0 per cent over 24 months from the previous figure of 1.0 percent over the same period. The capital conservation buffer is the mandatory minimum capital that the banks are required to retain to guard against all risks faced by the commercial banks. This measure enables the Banks to use the capital they have acquired during periods of economic prosperity in times of crisis such as the COVID-19 pandemic. Having a lower buffer meant that Banks could provide more credit in the economy and hence increase economic activity.*

The banks approved the majority of the relief applications received. *Out of a total of 14,806 applications received by the commercial banks for the year 2020, 14 148 applications were approved, representing a 95 percent of application approval rate. Majority of the loans approved under those relief measures were for individuals comprising 44.0 percent of the applications, followed by other miscellaneous business sectors such as agriculture, transport etc at 33.9 percent. The total value of these repayment holidays amounted to N$10.3 billion, of which 46.0 percent were granted for the period of 1-3 months, 18.9 percent for 4-6 months, 4.0 percent was over a 7-12-month period. This implies that most of the relief provided was only for the short term..*

Overall, banks remained adequately capitalised and profitable during the period under review, despite being impacted by the pandemic. *Total assets grew at a slower pace of 1.3 percent during 2020, down from 7.6 percent in 2019. Banking institutions maintained liquidity and capital levels well above the prudential requirements. Liquid assets held by the banking sector increased from N$19.0*

[11] The current concentration risk limit shall remain at 30 percent until further notice.

billion in 2019 to N$20.1 billion in 2020. However, asset quality as measured by the non-performing loan (NPL) ratio worsened to exceed the 6.0 percent crisis times benchmark trigger point for supervisory action by Bank of Namibia. The increase in the NPLs was registered across sectors such as individuals, agriculture and forestry, real estate and business services as well as construction. The only sector which recorded a decline in NPLs was the electricity, gas and water sector. The NPL ratio stood at 6.4 percent in December 2020, well above the 4.8 percent registered in December 2019. The gradual increase in NPLs has been observed since the beginning of the economic recession that began in 2016; however, NPLs increased at a steeper rate since the beginning of the pandemic.

Lastly the banks became more risk-averse and became significantly less profitable amidst the weak and uncertain economic environment. *Annual growth in PSCE decreased by 5.2 percentage points to 2.0 percent at the end of December 2020 from 7.2 percent at the end of the previous year. Although lower than in 2019, the above-zero growth in PSCE indicates that at least some credit was extended during the period under review. The lower growth in PSCE versus stronger growth in liquid assets also implies that the banks have reduced risk. Moreover, the banking sector profitability was adversely affected by the pandemic as indicated by the lower profitability ratios. In this regard, the Return on Equity (ROE) for 2020 stood at 13.5 percent, significantly lower than the 21.1 percent reported for 2019.*

Policy measures implemented by NAMFISA and their impact on the NBFIs Sector

In the case of the Non-Banking Financial Institutions (NBFIs), relief extended to NBFIs included blanket extensions of statutory submission deadlines; and relaxed standing on electronic signatures, thereby allowing entities to make only online submissions of applications during the hard lockdown. *Prior to the pandemic, the practice was that any application submitted with NAMFISA would be considered complete only when all required accompanying documents are deposited both in hardcopy and through the electronic regulatory system. With respect to relief to consumers, the insurance sector was particularly encouraged to ensure that premium holidays were made available with specific conditions. Where applicable, the industry was directed to inform clients about the existence of premium holiday clauses in existing insurance policies, as well as explain the circumstances under which the said clauses would be usable. Moreover, the industry was further directed to ensure that cover in respect of Group Life Policies and business electronics used from home remained unaffected while employees worked from home. It was further dictated to the industry to accept motor accident claims of vehicles with expired licenses, provided that such licenses expired during lockdown period. In similar vein, the insurance sector was directed to where applicable and following the individual industry players' due diligences, consider providing discounts on household contents premiums as well as motor vehicle insurance premiums, seeing as the probability of loss relating to the two classes of business was reduced during the lockdown period. Last but not least, the sector was encouraged to consider extending policies which were deemed to have lapsed during the State of Emergency, for the duration of the State of Emergency.*

In terms of performance, the Long-Term Insurance (LTI) sector solvency position remained adequate throughout the review period, seeing that assets remained sufficient to meet liabilities with excess assets. *Exposure to counterparty risk increased, as industry risk retention marginally decreased and net premium received remained satisfactory. Exposure to market risk increased, mostly attributable to a significant decline in return on investments from 8.6 percent at the end of 2019 to 4.2 at the end of 2020, owing to the COVID-19 pandemic. Notwithstanding the effects of the pandemic, the LTI remained profitable with returns on assets recorded at 2.0 percent. Excess assets continued to cover required capital and as a result, the industry remained solvent during the period under review with sound capital and reserves. Aside from the marginal decrease in risk retention, and premium debt remaining satisfactory, net premiums continued to sufficiently cover claims. Equities and bonds remained the preferred asset classes for the LTI sector with combined exposure of 70 percent. Retained risks decline in 2020 when compared to 2019, therefore, exposure to counterparty (re-insurer) default increased.*

In the case of Medical Aid Funds, NAMFISA encouraged the Medical Aid Funds Industry (MAF Industry) to submit their rule amendment applications, to allow for the introduction of contribution holidays. *The MAF Industry was further encouraged to waive waiting periods in respect of members who opted to go on contribution holidays, as well as, those whose membership is and was terminated as a result of COVID-19 enforced cash flow problems as and when they resume active participation in any medical aid fund. The industry was urged to allow members to downgrade their benefit options during the course of the year, an exercise ordinarily allowed only once in medical aid fund's financial year, at the beginning of any such year. Finally, medical aid funds were urged to provide ex-gratia allowance and/or benefits in respect of all COVID-19 related claims, in the event that member benefits related to COVID-19 treatments are depleted. Initially, at the start of 2020, no claims were being filed in terms of hospitalisation and COVID-19 related cases. However, during the third quarter the number of claims registered began increasing, as the nation saw a surge in the number of cases and a sizeable number of confirmed cases were being placed on ventilators. NAMFISA is not concerned as the number of COVID-19 related claims was immaterial in the broader context of the aggregate claims typologies as at the end of the fourth quarter of 2020, meaning there was minimum strain on the Medical Aid Funds' reserves. At the end of 2020, NAMFISA began facilitating discussions between the Medical Aid Funds and the relevant ministries to enable the purchase of vaccines by the Medical Aid Funds. These discussions are still ongoing. Notably, Namibia received the first batch of 100 000 doses of the Sinopharm vaccine donated by China on the 16th of March 2021. This first batch was received followed by the highly anticipated 30 000 doses of Covid-19 vaccines from the Serum Institute of India and the 27 700 AstraZeneca/Oxford vaccine doses from the Covax facility 2021. This comes as positive news to the general public, who shall receive the vaccines after approximately 22 000 healthcare workers, and the vulnerable members of the public who are first in line.*

With regards to the Pension Fund Industry (PFI), NAMFISA was informed of financial difficulties faced by employers participating in Pension Fund Institutions (PFI), as well as the said employers seeking relief or assistance from the Pension Fund Institutions. *It is noteworthy that participants in*

Pension Fund Institutions are bound by section 13A of the Pension Funds Act, which prescribes timelines within which full contributions ought to be paid. The Pension Funds Act requires that before any change to contribution rates to Pension Funds in respect of members is effected, the changed contribution rate should be reflected in Fund Rules. NAMFISA considered administrative inconveniences associated with processing multiple applications for amendments to Pension Fund Rules relating to contribution rates. NAMFISA also took note of the implication those inconveniences could have on obligations to comply with legislative instruments amidst the worsening of financial position of the afore mentioned participants. Accordingly, a circular was issued, which empowered Trustees of Pension Funds to permit temporary contribution reductions or suspensions in respect of participating employers. In that regard, the circular also outlined conditions that needed to be met for Trustees to enjoy the aforementioned powers. The PFI recorded surplus reserves of N$30 Billion, at the end of the fourth quarter of 2020. Even though the benefits paid out exceeded contributions received, the net cash flow position improved. This could be ascribed to returns on assets amidst favourable market movements. The funding level remained above the prudential limit, albeit by narrowing margins. Should this continue, the total assets will become less than liabilities and this could negatively impact the funding levels of the sub-sector. Total investment assets grew in line with financial market performances. Shares and bonds remained the preferred asset classes for the sub-sector, comprising 70.0 percent of sub-sector portfolios.

Conclusion

Overall, the Namibian financial sector remained resilient despite the challenges brought on by the COVID-19 pandemic. *Both the Bank of Namibia and NAMFISA have adequately supported the financial sector by relaxing regulations to provide scope for financial institutions to aid their clients through the pandemic. In this regard, the sector has welcomed the relief measures as they have mitigated the impact of the pandemic on the financial sector. Although much has been done and the current global vaccine rollout is providing a sense of reduced risk looking ahead, there is still a fair measure of uncertainty regarding the stability of the financial sector going forward. This is largely because, although the profitability, capitalisation and liquidity of the sector were adequate at the end of 2020, the margins have decreased significantly. If the pandemic is not adequately contained in the short to medium term, and the industry ratios continue their current trend, it may become difficult for the sector to provide further support to the public without significant strain. On a positive note, no major retrenchments, salary decreases, or closures have been noted in the industry and the overall financial sector remains stable. However, there is light at the end of the tunnel as the vaccines donated by China reached our shores on the 16th of March 2021 and at the time of writing were being distributed to the most vulnerable citizens first. Going forward, the Bank of Namibia and NAMFISA shall continue to monitor and support the economy as necessary.*

VI. PERFORMANCE OF THE NON-BANKING FINANCIAL SECTOR

The assets of the Non-bank Financial Institutions Sector (NBFI) grew by 4.8 percent to N$341.5 billion, despite the continued recessionary conditions, worsened by COVID-19 during the review period. The sector's growth is observed in the Long-term Insurance, Pension Fund Institutions and Collective Investment Schemes whose assets grew by 2.5 percent, 4.1 percent and 8.7 percent, respectively (Table 10). Growth in the assets of Long-term Insurance emanated from a combination of positive market returns as well as premiums received which exceeded claims paid out. Growth in Collective Investment Schemes' assets was primarily due to new business and positive financial market returns. Growth in Pension Funds' assets on the other hand was primarily due to positive financial market returns post COVID-19. Nonetheless, growth in assets moderated during 2020, compared to the previous year.

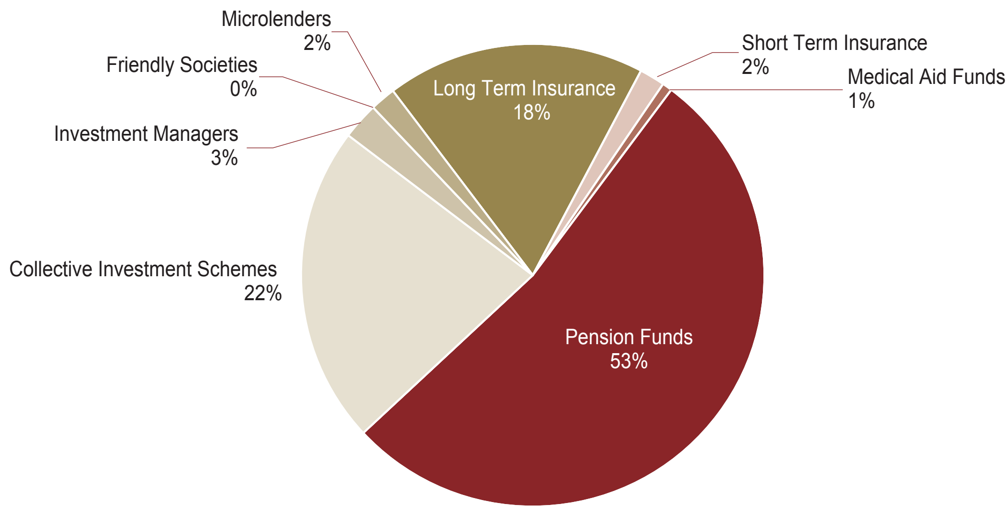
Table 10: NBFI Asset Size

Total Assets per subsector (N$ Million)	2016	2017	2018	2019	2020
Long-Term Insurance	47,554	53,934	56,640	60,165	61,681
Short-Term Insurance	5,769	6,233	6,540	6,830	6,056
Medical Aid Funds	1,445	1,772	1,933	2,028	2,359
Pension Funds	137,462	152,885	158,528	173,427	180,526
Collective Investment Schemes*	39,609	47,483	52,252	69,987	76,056
Investment Managers*	7,620	8,225	7,795	7,669	8,775
Friendly Societies	1.21	1.36	1.57	2	2
Microlenders	4,222	5,460	6,447	5,853	6,055
Total	**243,682**	**275,994**	**290,137**	**325,960**	**341,509**
Annual growth (%)	**4.3%**	**13.3%**	**5.1%**	**12.3%**	**4.8%**

Source: NAMFISA

The distribution of assets across the sector remained fairly unchanged, with the Long-Term Insurance, Pension Funds and Collective Investment Schemes Sectors making up more than 90.0 percent of NBFI assets as at December 2020. The NBFI sector is largely dominated by top 5 players per industry which accounts for an average of 70 percent to 90 percent market share (Figure 21). This is evident given the existence of conglomerates in the Namibian market with various business lines. Moreover, one defined benefit fund remains the largest in the Namibian economy. Conglomerates carry the potential to provide contagion shock in the event and/or persistence of crisis, as risk could spill over from one segment to another within the conglomerate structure. This risk is being closely monitored by the regulator. Figure 21 depicts the makeup of the NBFI Sector.

Figure 21: Industry Contribution to NBFI – 2020



Source: NAMFISA

INTERCONNECTEDNESS IN THE NAMIBIAN FINANCIAL SYSTEM

The high interconnectedness of Non-Bank Financial Institutions (NBFI) needs to be taken into account when evaluating the size of the NBFI sector. The NBFI sector plays a significant role in the Namibian economy given the asset size of the NBFI sector which amounted to about 193.7 percent of GDP as at the end of 2020. Institutional investors such as Pension Fund Institutions and Long-term Insurance Companies play a crucial funding role in the economy as they channel wholesale funds in the financial system. Pension Fund Institutions and Long-term Insurers invest part of their assets through Collective Investment Schemes, as well as investment managers. The overreliance of banks on NBFIs for wholesale funding could pose a potential shock on banks. The situation is being dealt with by Bank of Namibia under the Base 3 liquidity risk requirements[12].

Table 11: Exposures to Domestic market – 2020

Sector	Assets in Nam (N$ ' billion)	Banks	Government and SOE Bonds	Corporate Bonds	Unit Trust Schemes	Equity	Other[13]
MAF	1.0	16.4%	11.1%	1.1%	67.4%	2.9%	1.1%
PFI	81.7	12.8%	37.6%	3.2%	0.0%	26.8%	19.6%
LTI	25.2	16.1%	23.3%	6.9%	2.2%	19.6%	31.9%
STI	3.5	38.5%	8.7%	4.3%	17.6%	10.2%	20.6%

Source: NAMFISA. MAF=Medical aid funds, PFI=Pension fund institutions, LTI=Long-term insurers, STI=Short-term insurers

[12] The Bank is in the process of implementing new liquidity risk management standards as recommended by the Basel Committee for Bank Supervisors.

[13] Other includes property, value of insurance policies, unlisted investments, other investments, other claims, debentures, investments in the businesses of associate and subsidiary companies and other.

Ownership links add to the degree of interconnectedness within the NBFI sector, as well as the degree of interconnectedness with the Banking System, while Collective Investment Schemes have significant claims on banks. Medical Aid Funds have significant claims on both banks and Collective Investment Schemes, while Short-term Insurance has significant claims on Banks. However, Pension Funds and Long-term Insurance Companies are mostly exposed to equity and bonds markets due to the nature of their business. Both the Pension Fund and Long-term Insurance Institutions have exposure to offshore equities exceeding 68.0 percent of their respective offshore portfolios (Table 12).

Table 12: Exposure Outside Namibia

Sector	Assets held elsewhere (N$ 'billion)	Banks	Government and SOE Bonds	Corporate Bonds	Unit Trust Schemes	Equity	Other[14]
MAF	1.0	1.8%	4.0%	0%	80.0%	13.0%	1.3%
PFI	97.6	3.8%	3.8%	10.7%	0.0%	62.3%	19.4%
LTI	30.6	2.3%	2.7%	2.9%	0.0%	74.3%	17.9%
STI	0.9	0.2%	16.7%	7.6%	6.8%	12.2%	56.5%

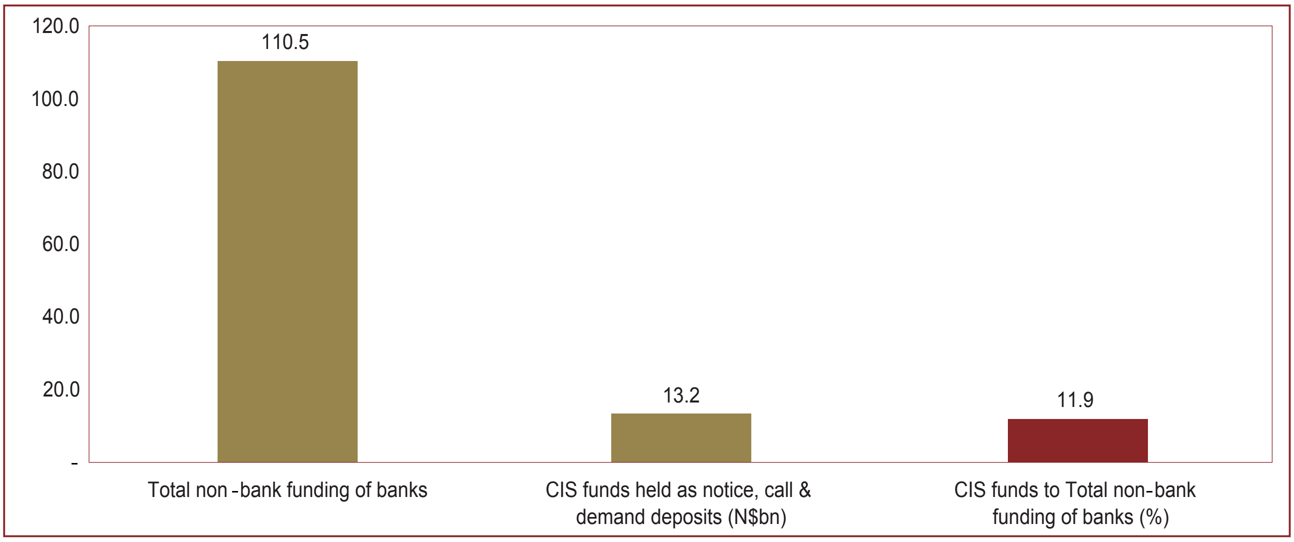
Source: NAMFISA. MAF=Medical aid funds, PFI=Pension fund institutions, LTI=Long-term insurers, STI=Short-term insurers

COLLECTIVE INVESTMENT SCHEMES

Collective Investment Schemes (CIS) remain a conduit through which the financial system sets prices and allocates risk and capital, and remained stable in the review period. CIS total assets under management improved by 8.7 percent to N$76 billion as at the end of 2020. Considering that CIS are discretionary in nature, in conjunction with the role CIS play in the financial system, the industry CIS has the potential of causing liquidity constraints in the financial system. However, it should be noted that CIS funds sourced from households are monitored closely by NAMFISA, given that household investments are generally without mandate and can be withdrawn at short notice. CIS funds held as notice, call and other deposits were N$13.2 billion, representing 11.9 percent of total funding of banks for the review period (Figure 22). Despite the recessionary conditions that would affect household income and balance sheets, no significant withdrawals of unit trust funds were observed. Thus, the industry remained stable and sound in 2020.

[14] Other includes property, value of insurance policies, unlisted investments, other investments, other claims, debentures, investments in the businesses of associate and subsidiary companies and other

Figure 22: CIS exposure to Banking System – December 2020

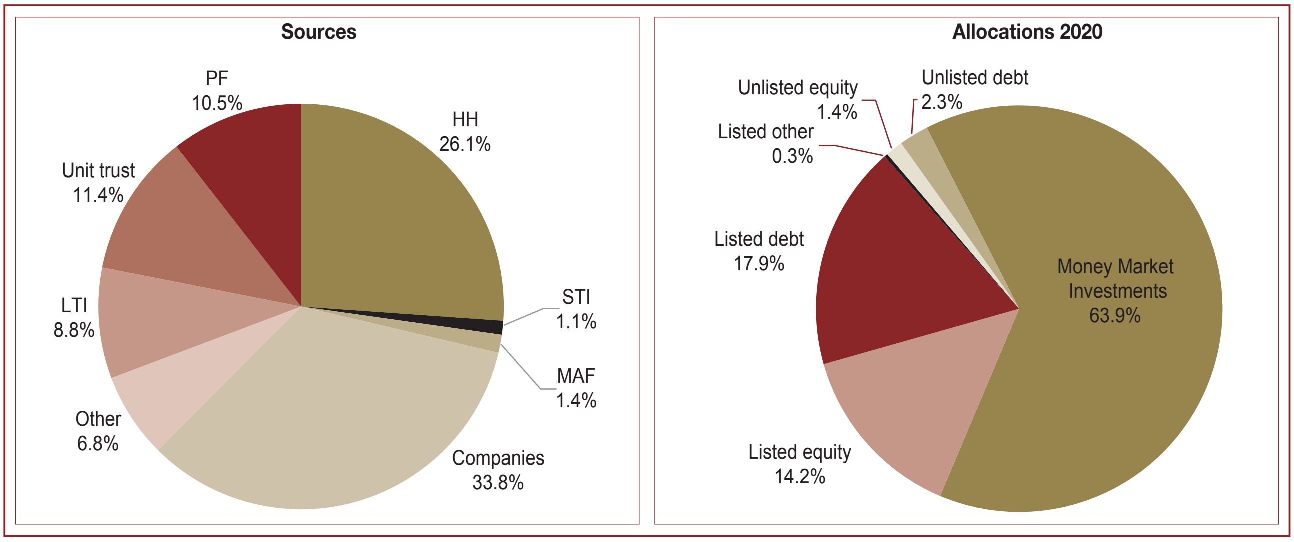


Source: NAMFISA and Bank of Namibia

Sources and Allocation of Funds

As at December 2020, N$46 billion (59.9 percent) of CIS funds were sourced from a combination of companies and natural persons compared to N$43 billion (62.0 percent) in 2019 (Figure 23). Similarly, the Long-term Insurance; Medical Aid Funds; as well as Short-term Insurance Industries' exposure to CIS grew by 61.2 percent, 31.2 percent and 14.2 percent, respectively (Table 13). CIS funds under management were primarily channeled through to money market instruments, as well as listed equity and debt, with allocations of 63.9 percent, 14.2 percent and 17.9 percent respectively.

Figure 23: CIS Sources and Allocation of Funds – 2020

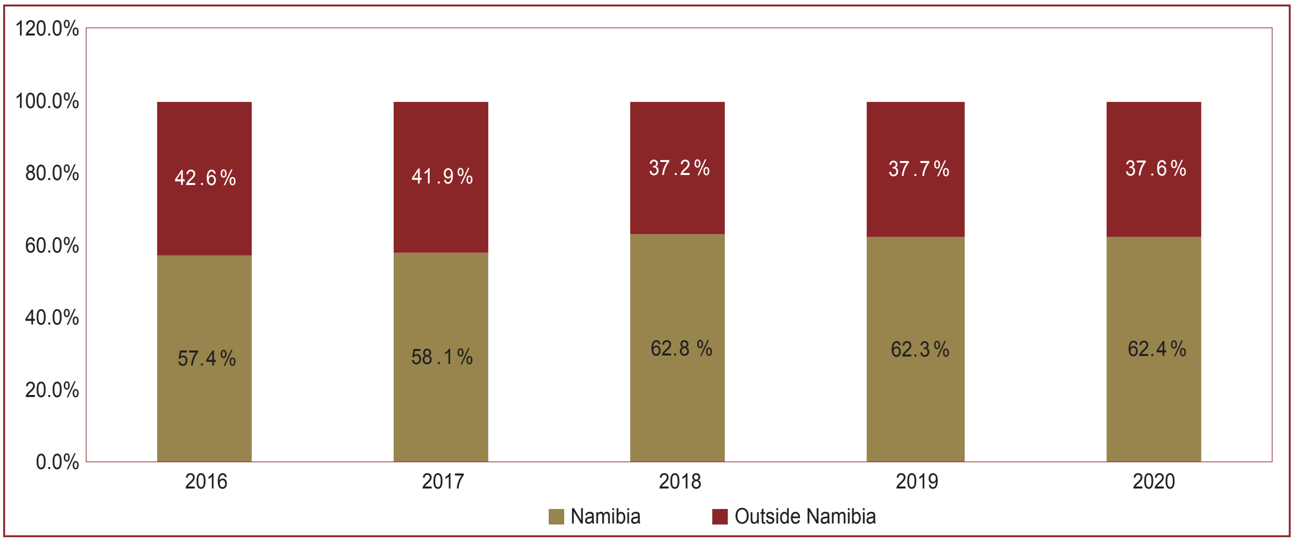


Source: NAMFISA

Geographic allocation of funds

The CIS industry continued to invest most of its assets domestically, attributable to domestic holding requirements. In terms of geographical allocation of funds, 62.4 percent and 37.6 percent of the funds under management were invested in Namibia and outside Namibia, respectively compared to 62.3 percent and 37.7 percent in 2019 (Figure 24).

Figure 24: CIS Geographic allocation of funds



Source: NAMFISA

PENSION FUND ANALYSIS

The Pension Fund Institutions Industry (PFI) remained financially sound and stable, with funding level remaining above statutory requirements. Although funding level remains above the prudential limit, margins by which it is above the prudential limit continued to narrow. The PFI's assets grew by 4.1 percent to N$180.5 billion as at the end of the review period. Table 13 below provides a summary of key macro prudential risks faced by the PFI, their historical direction from 2019 to 2020 as well as likelihood of occurrence and impact should the risk materialise.

Table 13: PFI Macro Prudential Risks

Events/Risks	Indicators	Risk Direction	Probability of Risk 2021	Impact of Risk 2021
Funding position	Funding ratio	Up		
Cash flow risk	Contributions Received vs Benefits Paid	Unchanged		
Market risk	RoI[15]	Down		

Key	Low	Medium	High

Source: NAMFISA

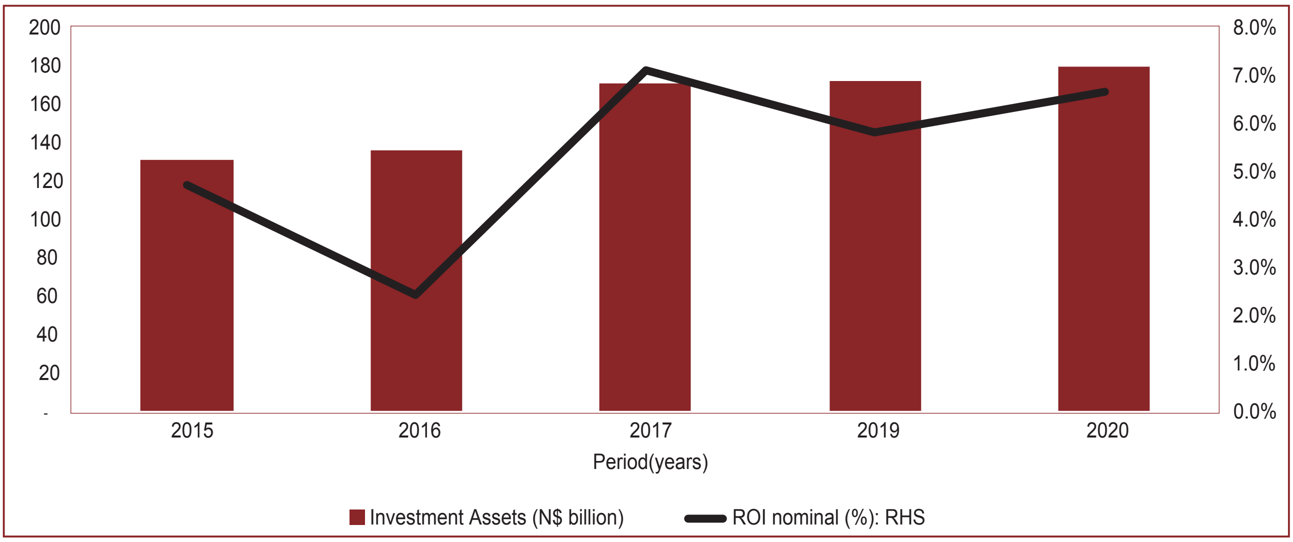
[15] Return on Investments.

Market Risk

Although the PFI's exposure to market risks improved during 2020, the volatility of financial markets threatens a significant drop in PFI's funding ratios. As alluded to in Chapter III of the report, the Volatility Index is expected to remain high in the short-term, implying continuation of investor uncertainty attributable to the COVID-19 pandemic, even though vaccinations increased over the last few months. Therefore, given the Volatility Index outlook, it is expected that the PFI will face a medium probability of market risk in 2021. Notably, when valuations of future liabilities are carried out on defined benefits PFI's and/or PFI's of hybrid nature, arrays of assumptions and resulting forecasts are made on expected returns. Additionally, returns on investment in conjunction with the net contributions received, and benefits paid represent the accumulation rate of PFI's assets. Therefore, persistence of volatility in the financial markets might result in over or under valuing of defined benefit and hybrid PFI's liabilities, which will threaten PFI's funding position. The aforesaid informs the medium ranking in respect of the impact of market risk in 2021.

Returns on investment recorded as at the end of 2020 were sufficient to withstand the impact of the pandemic. It is noteworthy that one defined benefit Fund accounted for 71.3 percent of the PFI at the review period. The defined benefit Fund's investment assets realised returns amounting to 8.6 percent over the review period. The return on investment was chiefly derived from the Fund's offshore exposure, its other international and emerging markets equities, which returned 25.7 percent and 36.9 percent respectively over the review period. The Fund's international property returned 29.1 percent over the year ended December 2020. In turn, this drove the return on investment realised at PFI level.

Figure 25: Investment performance 2015 – 2020

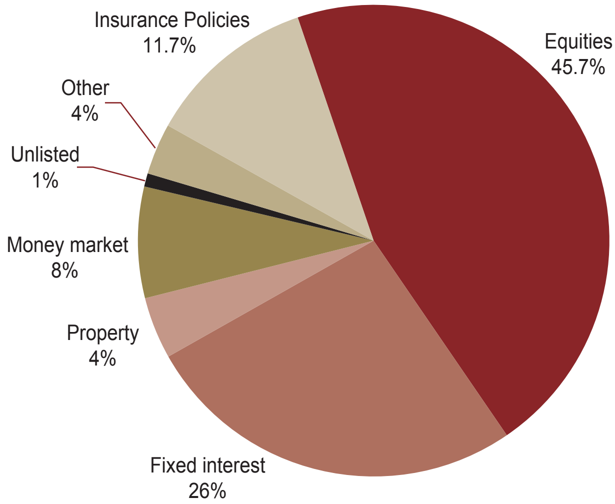


Source: NAMFISA

Investment mix: Pension funds

The industry held at least 45.7 percent of its investment assets in equities. Bonds and insurance policies made up the remainder of the subsector's top three investment instruments. There evidently exist cross sectoral interlinkages between PFI's and the Long-term Insurance Industry, as alluded to above. About 11.7 percent or N$21 billion of the PFI's investment assets were held in insurance policies as at December 2020 compared to 13 percent or N$22 billion in 2019 (Figure 25).

Figure 26: Investment mix 2020



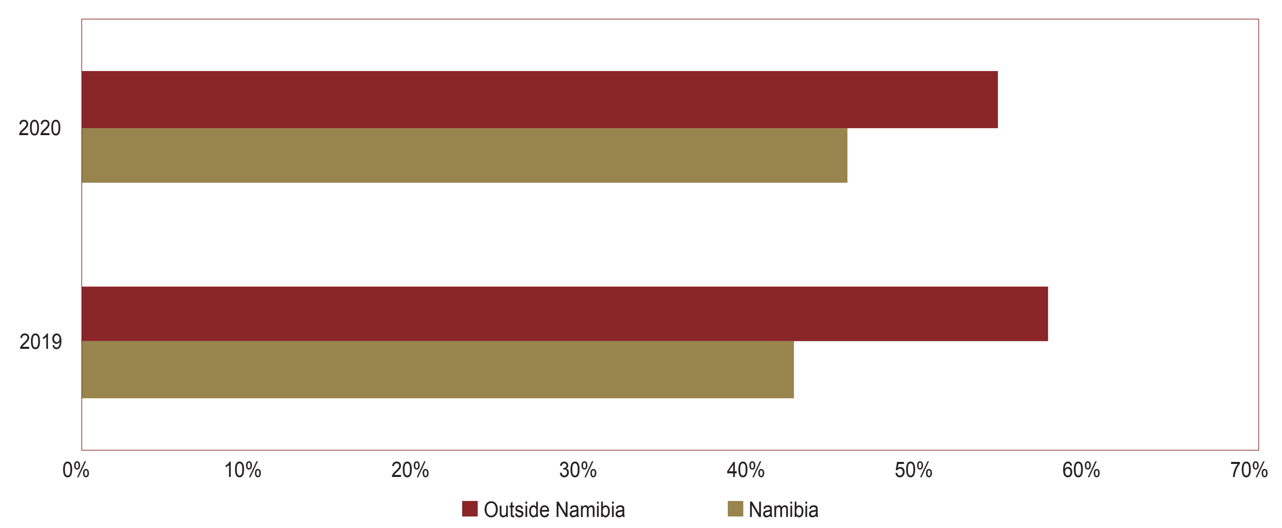
Source: NAMFISA

PFI's equity holdings were found to be well spread across different geographic locations. Equity holdings per geographic location as a proportion of total investment assets amounted to 12.1 percent, 17.6 percent, and 16.0 percent in Namibia, Africa (including CMA) as well as international, respectively. Ominously, the domestic equity market continued to decline along with the NSX Local Index which declined by 20.6 percent year-on-year as at 31 March 2021. Therefore, in the short-term, there is a medium probability of risk assigned to PFI's exposure to market risk.

Geographical allocation of funds

PFI's exposure to the domestic economy increased as at the end of December 2020 (Figure 27). The industry's domestic exposure increased from 42.0 percent in 2019 to 45.6 percent in 2020. The proportional growth in domestic assets is attributable to the domestic holding requirements as prescribed by legislations. PFI investment assets held in the domestic economy amounted to N$83 billion as at December 2020, with N$98 billion held outside Namibia over the same period.

Figure 27: PFI Geographic allocation of funds

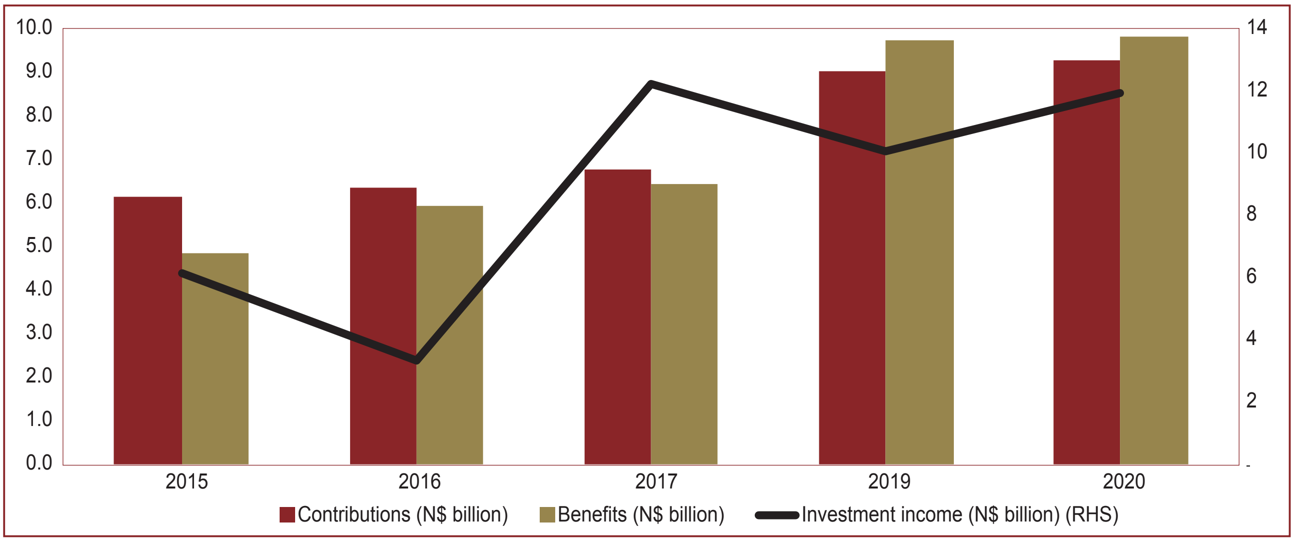


Source: NAMFISA

Cash Flow Risk

Benefits paid exceeded contributions received even prior to occurrence of the COVID-19 pandemic, raising questions around the liquidity conditions of DB and hybrid PFIs (Figure 28). It is not expected that levels of contributions received will in the short term exceed benefits paid. However, given the short-term financial markets outlook, it is expected that the returns on investments will sufficiently absorb any cash flow mismatch that may arise. Ultimately, continued reliance on investment income to absorb any negative mismatches that may arise between contributions received and benefits paid is worrisome, more so in these times when financial markets are arguably most vulnerable due to the economic crisis at hand. The concerns vis-à-vis overreliance on investment income intensified during the first and third quarters of 2020 when investment income was negative and barely positive, respectively. Given that by definition PFI obligations are long-term in nature, mismatches suffered are expected to have a low to medium impact in the short-term, particularly, if they are non-structural (Table 13). NAMFISA is investigating the cash flow mismatch at entity level. Nonetheless, the funding levels remains sufficient to cover any risks emerging.

Figure 28: Flow of Funds: 2015 - 2020

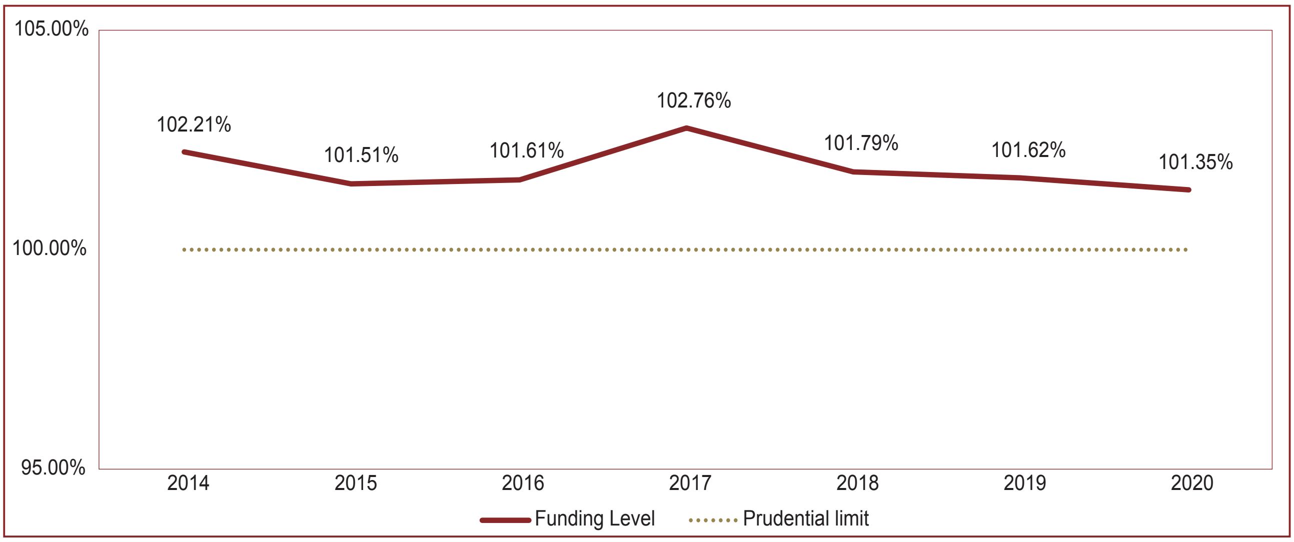


Source: NAMFISA

Funding Position

Despite narrowing margins, the PFIs remains above prudential limit. The funding level of Pension Funds declined from 101.6 percent to 101.3 percent in 2020. This was mainly driven by the reduction in interest rates. Empirically, as interest rates drop, the present value of defined benefit PFI's liabilities increase and vice versa.

Figure 29: Funding Position



Source: NAMFISA

LONG-TERM INSURANCE ANALYSIS

Overall, the Long-term Insurance Industry (LTI) remained financially sound and stable, with capital adequacy levels remaining above statutory requirements. The LTI's assets grew by 2.5 percent to N$62 billion as at the end of the 2020 calendar year. The assets growth was mainly driven by positive returns on investments. Table 14 below provides a summary of key macro prudential risks faced by the LTI, their historical direction from 2019 to 2020 as well as likelihood of occurrence and impact should the risk materialise.

Table 14: LTI Macro Prudential Risks

Events/Risks	Indicators	Risk Direction	Probability of Risk 2021	Impact of Risk 2021
Capital adequacy[16]	- Solvency ratio - CAR17	Down		
Reinsurance Credit risk	- Net premiums vs net policyholder benefits - Retention ratio	Unchanged		
Market risk and Profitability	- RoI18 - RoA19	Up		

Key	Low	Medium	High

Source: NAMFISA

Market Risk and Profitability

The LTI's exposure to market risks worsened during the 2020 calendar year. The LTI's investments returned 4.2 percent over the review period, down from 8.6 percent recorded in 2019. The decline in return on investments is attributable to the effects of the COVID-19 pandemic on financial markets.

Investment Mix: Long-term insurance

The long-term insurance industry held 50.0 percent of their investment assets in equities, while 16.8 percent was held in bonds (Figure 30). A sizeable proportion of the industry's investment assets were held in the inclusive other[20] asset class as at the review period.

16 Capital adequacy performed is the simple method as provided by current legislation.

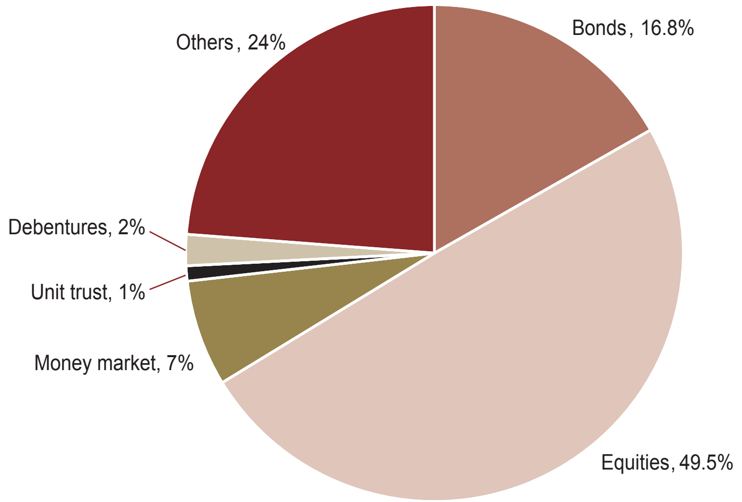
17 Capital Adequacy Ratio

18 Return on Investments

19 Return on Assets

20 Other includes property, unlisted investments, other investments, other claims, as well as investments in the businesses of associate and subsidiary companies.

Figure 30: Investment mix 2020

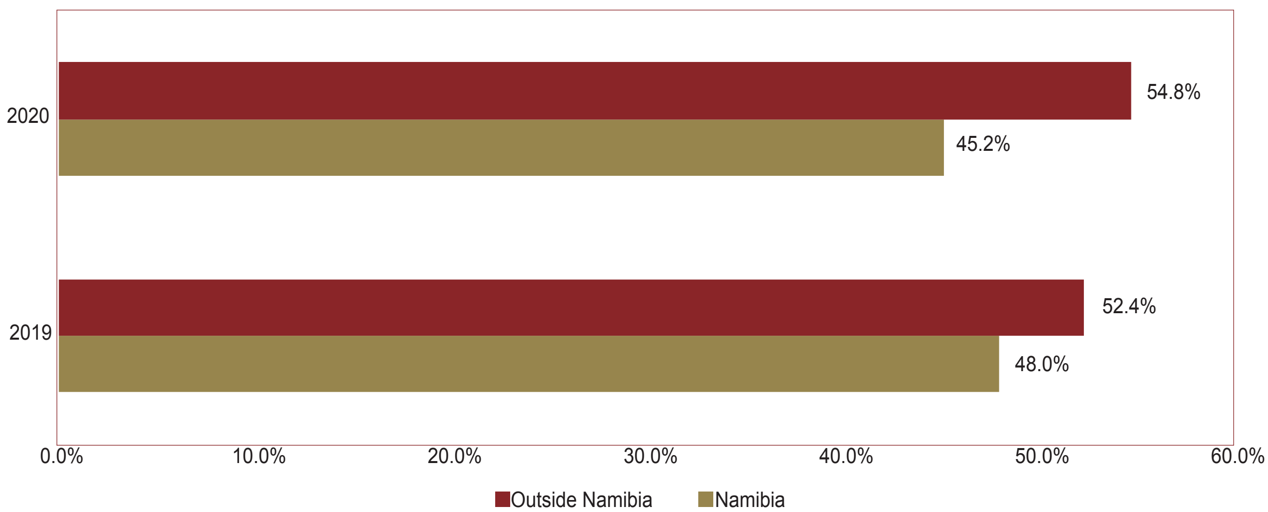


Source: NAMFISA

Geographic allocation of funds

The domestic holding of investment assets of LTI decreased to 45.2 percent as at December 2020, from 48.0 percent in 2019. On the contrary, outside Namibia investment assets held by the LTI increased to 54.8 percent, from 52.4 percent a year ago (Figure 31).

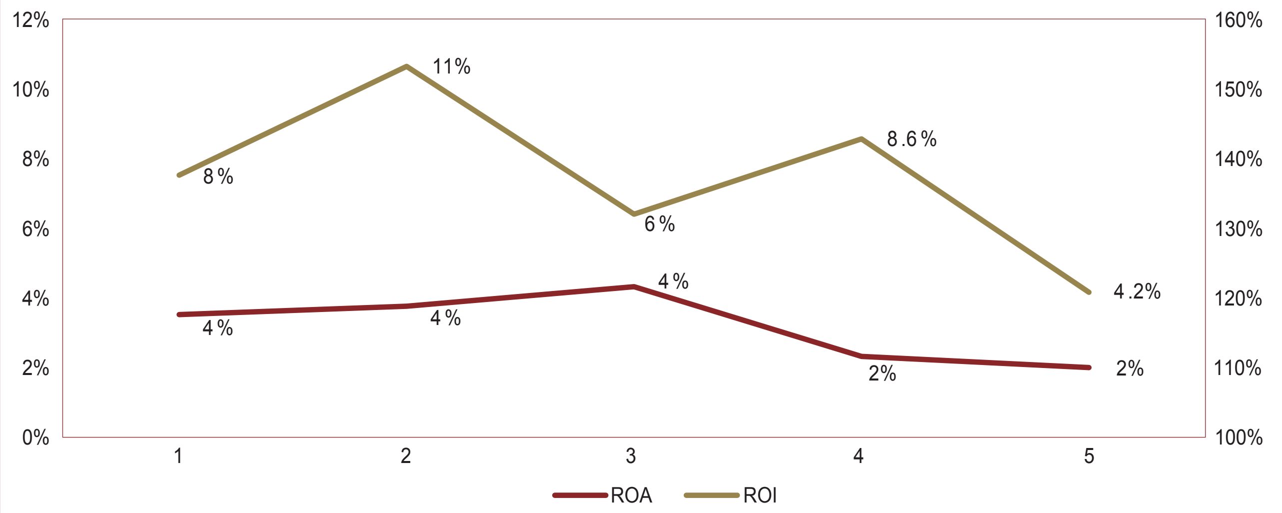
Figure 31: LTI Geographic allocation of funds



Source: NAMFISA

Significantly, 40.7 percent of the subsector's investment assets were held in equities outside Namibia. Therefore, driven by equity markets, the LTI's investment assets declinded significantly during the first quarter of 2020, falling by 7.1 percent, after which an instantaneous recovery of 5.5 percent was realised during the second quarter of 2020. The steep fall in LTI investment assets during the first quarter of 2020 is ascribed to the effects of COVID-19, which restricted carrying out of business, which also brought uncertainties that influenced confidence in the financial markets. In the same vein the recovery in financial markets experienced latter in the year is attributed to global fiscal and monetary stimulus from governments and central banks which contributed to alleviating some of the effects of the COVID-19 pandemic.

Figure 32: Investment Performance and Profitability



Source: NAMFISA

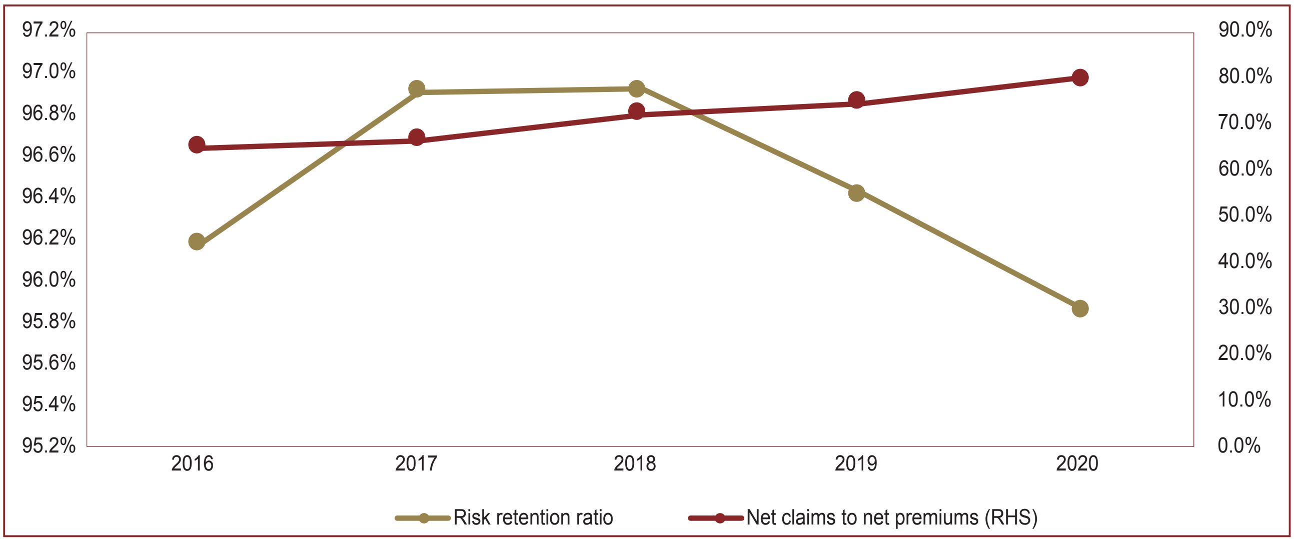
Notwithstanding the effects of the pandemic, the LTI remained profitable with returns on assets remaining steady at 2.0 percent. Return on assets was observed to be on a downward trend since 2018. The diminishing of the return on assets is attributable to the volatility of investment income and investment assets. The regulator will continue to monitor these developments. The returns on investments dwindled from 9 percent recorded in 2019 to 4.2 percent in 2020 (Figure 32). This is similarly ascribed to the effects of COVID.19. Going forward it is expected that investment assets of LTI will recover, as financial markets are performing better and global economies recover. Hence the rating of medium-term probability of risk for 2021.

Reinsurance Credit Risk

Altogether, the risks retention ratio reduced marginally from the 96.9 percent five-year high recorded in 2018 to 95.9 percent in 2020, it remains satisfactory over the review period (Figure 32). Declining levels of the risk retention ratio may signal the presence of financial difficulties for primary insurers. Allaying any concerns, allthough the risk retention ratio was observed to reduce year-on-year, risks transferred to reinsurance remained below 5.0 percent and therefore remains absorbable by the industry in the unlikely event of reinsurer default.

The net premiums received to net claims paid cover remained satisfactory, with net premiums sufficiently covering historical net claims (Figure 33). Net claims accounted for up to 80.5 percent of net premiums at 2020 (75 percent: 2019). The aforesaid implies implementation of a prudent pricing policy at industry level. However, the margins by which net premiums cover net claims declined continuously from 2016 through to 2020. This signifies an early warning vis-à-vis the LTI's continued financial soundness and will be monitored closely in the 2021 calendar year.

Figure 33: Risk Retention Ratio and Net Claims Paid to Net Premiums Received

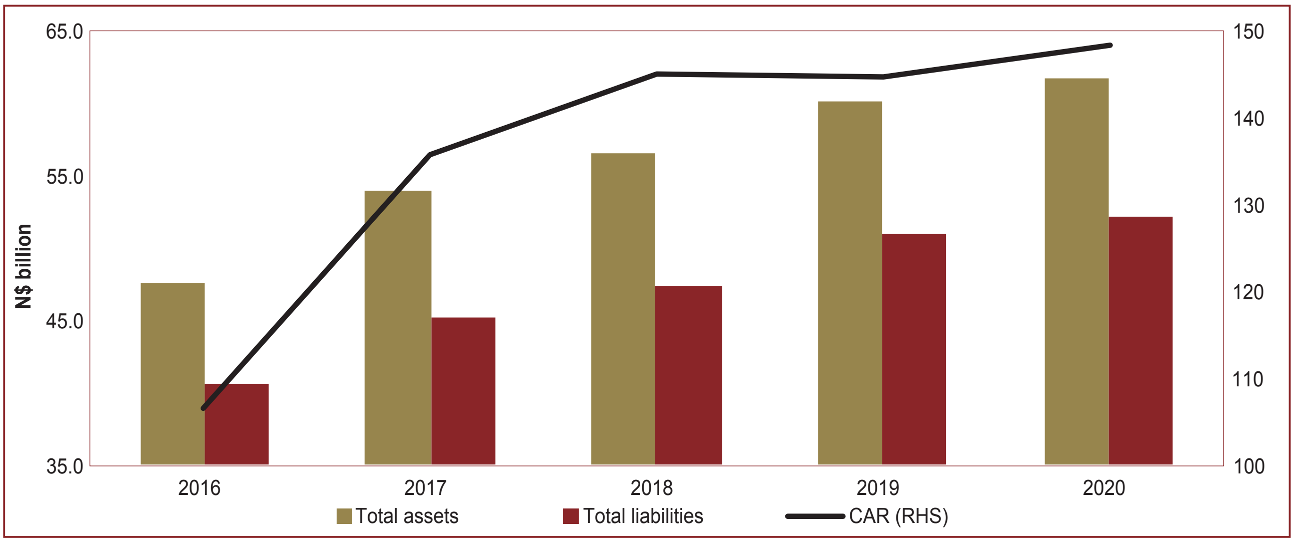


Source: NAMFISA

Capital Adequacy

The LTI remained solvent in accordance with current solvency requirements, which admittedly are not risk oriented. Excess assets were measured to cover required capital 148 times as at the end of 2020 (148 times: 2019). Correspondingly, the LTI remained solvent in the accounting sense with assets sufficiently covering liabilities (Figure 34).

Figure 34: Solvency Position & Capital Adequacy

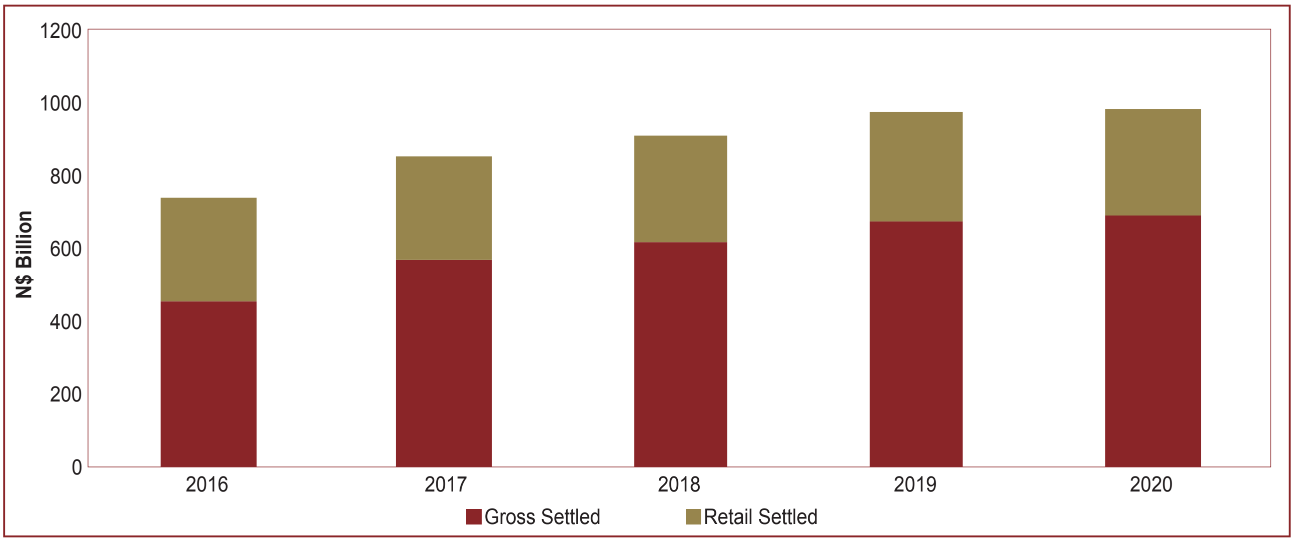


Source: NAMFISA

VII. PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

Operational risk and settlement risk remained relatively low within the National Payment System (NPS). For the year 2020, the Namibia Interbank Settlement System (NISS) noted an increase in settlement volume and value. During 2020, the settlement volume increased by 6.1 percent, from 66,148 to 70,150 settlement transactions, and with regards to the values of payments that were settled in NISS, an increase of 0.83 percent from N$975.7 billion to N$983.8 billion, was recorded in 2020. The share of real-time gross settled transactions (typically high value) processed in NISS was 70.0 percent of the total value settled in NISS, while the retail payment systems[21] bulk settled was 30.0 percent of the total value settled in NISS (Figure 35).

Figure 35: Value of payments processed in NISS



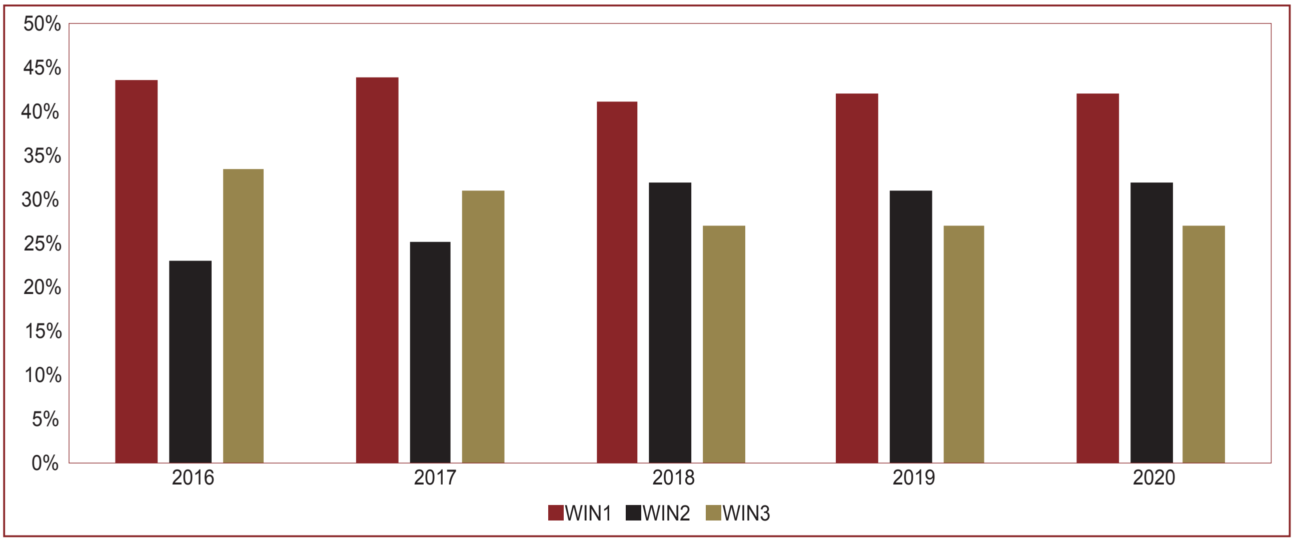
Source: Bank of Namibia

SETTLEMENT WINDOWS

Similar to 2019, the proportion of payments settled in Window 3 remained unchanged at 27.0 percent. Settlement statistics in NISS in 2020 showed that 41.6 percent or N$409.3 billion in payments settled in Window 1 (08h00 to 12h00); 31.8 percent or N$312.9 billion was settled in Window 2 (12h00 to 15h00) and 26.6 percent or N$261.6 billion, was settled in Window 3 (15h00 to 16h40) (Figure 36). In order to mitigate operational and settlement risks, it is preferred that the majority of settlements should take place in the earlier windows (i.e., Windows 1 and 2). During the period under review 73.4 percent of payments settled in Windows 1 and 2, thereby assisting in mitigating operational and settlement risks.

[21] The EFT and Card Systems.

Figure 36: Proportions of payments settled in each settlement window



Source: Bank of Namibia

DISRUPTIONS TO THE NAMIBIA INTERBANK SETTLEMENT SYSTEM (NISS)

The NISS maintained high system availability during 2020. The NISS front-end[22] availability ratio was 99.96 percent, which was well within the target availability level of 99.90 percent. During 2020, two NISS Disaster Recovery (DR) exercises were conducted. Of the two exercises, the announced DR test was successful, while the unannounced DR test was unsuccessful. The unsuccessful exercise was due to the two-hour recovery time objective (RTO) not being met. Furthermore, no business continuity management exercises were conducted during the period under review.

SECURITY OF RETAIL PAYMENTS

When compared to 2019, the period under review recorded an overall decrease in the total value of fraud across all payment streams. Despite the abovementioned decrease, industry recorded fraud increases of N$2.5 million and N$1.2 million for the card and e-money streams respectively, in comparison to 2019. Consequently, card payment fraud and e-money payment fraud reported an increase of 82.0 percent and more than 100.0 percent, respectively. The increase in card payment fraud was primarily due to Card-Not-Present payment23 incidents perpetrated via internet banking platforms and/or mobile applications whilst the fraud concerned with e-money payments can be attributed to incidents that were perpetrated via mobile phone scams. The total value of fraud

[22] This is the availability of NISS from a customer/front-end perspective.

[23] Card-Not-Present Payment: a payment card transaction made where the cardholder does not or cannot physically present the card for a merchant's visual examination that a payment is affected.

attributable to the card, e-money and Electronic Funds Transfer (EFT) streams, for the period under review amounted to N$5.6 million, N$1.5 million and N$1.4 million, respectively. Overall, the total fraud perpetrated within the NPS remained within the fraud safety index indicator of 0.05 percent as per the Bank's Strategic Goal, resulting in an actual percentage of 0.00076 percent.

The Bank continues in its efforts to encourage all participants to comply with the Payment Card Industry Data Security Standards (PCI-DSS). PCI-DSS is a set of security standards designed to ensure that all institutions that accept, process, store or transmit card information maintain a secure environment. The Payment Card Industry Security Standards Council (PCI-SSC) continuously updates the PCI-DSS as required to ensure that it continues to protect institutions against existing and new exploits. These standards have been adopted by industry as one of the means through which the compromise of data can be prevented and to help reduce card payment fraud in the NPS. By the end of the 2020 reporting period, only three out of eight participants were fully PCI-DSS compliant. The Bank continues to closely monitor compliance with this initiative and through its catalyst and oversight roles, ensures that potential risks are appropriately managed.

DEVELOPMENTS IN PAYMENT AND SETTLEMENT SYSTEMS

During the period under review, the Bank issued the Determination on Standards for Fees and Charges for Payment System Services within the National Payment System (PSD-10). PSD-10 is an overarching regulation which stems from the mandate around payments fees and charges outlined in the Payment System Management Amendment Act, 2010 (Act No.6 of 2010), which stipulates that the Bank should ensure that fees or charges payable by a consumer are in the public interest, promote competition, efficiency and cost effectiveness. The standards outlined in PSD-10 were as a result of the Bank's efforts over a number of years investigating bank fees and charges by understanding the cost drivers behind the provision of payments products and services. PSD-10 thus makes provision for all applicable payment streams and products and is aimed at minimising the financial burden for users in as far as fees and charges are concerned as well as ensuring that the said fees and charges are applied in a fair manner for users, as defined in the aforementioned Act.

The Bank of Namibia issued a Guidance Note on Interchange Determination in the National Payment System (NPS). The said Guidance Note was published on 26 November 2020 and aims to communicate the outcomes from the Bank's engagements with the relevant stakeholders conducted during 2020. The engagements were with regards to the revision and determination of domestic interchange rates in the NPS. The Guidance Note further serves to communicate the way forward and the process to be followed by the Bank in its efforts to determine domestic interchange rates for the interbank card stream i.e., point of sale (POS), Automatic Teller Machine (ATM) and Card-Not-Present (CNP) transactions. Interchange generally refers to the payment card processing fees paid by one bank to another bank when a payment card issued by one bank is used to make a purchase at a POS device owned by another bank at a merchant.

The Bank continues to participate in the SADC Real-Time Gross Settlement System (SADC RTGS). The SADC-RTGS is a regional settlement system that processes time-critical or high-value payments between participating SADC countries. At the end of the 2020 reporting period, there were 83 participants (i.e., registered banking institutions, as well as central banks within the respective SADC jurisdictions) of which five, including the central bank, were Namibian. During 2020, the total value of payments processed in the SADC-RTGS amounted to R1.2 trillion. Namibian banks accounted for R393 billion, which is 32 percent of the total value of payments processed in the SADC-RTGS. This reflects the optimal usage of Namibian banks of the SADC-RTGS in support of regional payments integration in accordance with the SADC Finance and Investment Protocol.

The Common Monetary Area (CMA) Payments System Oversight Committee (CPOC) set aside the CPOC Directive No. 01 of 2018. This directive was initially issued by CMA CPOC to regularise the practice of clearing and settlement of cross-border low-value credit EFT transactions within the CMA. After issuing an amendment notice during 2018 to amend the implementation date of the said directive, and the subsequent implementation of the interim solution during 2019, CMA CPOC approved the decision to set aside the directive, given complexity challenges experienced by the CMA payments industry pertaining to the full implementation of the solution. In the short term, the CMA payments industry was requested to focus its efforts on ensuring transparency and visibility in processing low-value cross-border transactions, while retaining the interim solution to ensure compliance with the Financial Action Task Force (FATF) requirements. In the long-term, the CMA industry is expected to work towards ensuring the sustainability of this requirement through the appropriate payment systems modernisation programmes, some of which are already underway.

DIGITAL TRANSFORMATION STRATEGY

Given the ongoing disruption by digital technologies and innovations within the financial sector, the Bank of Namibia through its Digital Innovations Working Group is in the process of developing a Digital Transformation Strategy (the Strategy). The Strategy will serve as a response to the changing ecosystem by ensuring that the Bank adopts the necessary digital tools, skills, and culture to transform the Bank's operations in its endeavour to continue serving its stakeholders in the fulfilment of its mandate and strategic objectives.

VIII. CONCLUDING REMARKS AND POLICY IMPLICATIONS

The financial system remained sound, profitable and resilient, despite unfavourable domestic and global economic conditions. Overall, the financial system and markets in Namibia remained sound, profitable, and with no major disruptions or disorderly functioning of key financial services despite unfavourable domestic and global economic conditions. Specifically, the banking sector continued to be financially stable, sound, profitable and well capitalised while maintaining liquidity levels well above the prudential requirement. The banking institutions displayed a healthy aggregate balance sheet growth, profitability and satisfactory liquidity levels given the impact of the COVID-19 pandemic. The challenging economic conditions and the associated shedding of jobs exerted immense pressure on disposable income thus increasing the debt-to-disposable income ratio of households, although household debt slowed in 2020. Credit extended to the corporate sector also slowed in tandem with slower economic activity. Asset quality as measured by the incidence of non-performing loans deteriorated further in 2020, mainly ascribed to COVID-19 induced unfavourable economic conditions and their concomitant impact on household disposable income and business performance. Despite a moderation in the growth rate of NBFIs assets, the NBFI sector remained financially stable and sound. The payment system and infrastructure remained stable, while efficiently contributing towards safety and reliability in payments in order to facilitate financial stability in the country. Overall risks to financial stability have moderated.

Going forward, risks to the Namibian financial system require continuous monitoring. Overall, risks to financial stability moderated, however some risks increased and may require continuous monitoring. Specifically, the significant increase in the NPL ratio in the banking sector will be monitored closely. The deterioration in banking sector asset quality has surpassed the crisis time supervisory intervention trigger point; as such it poses a risk to financial stability and needs to be monitored. Proactive regulation and supervision can therefore mitigate potential systemic risks. Risks to financial stability in Namibia will be monitored accordingly under the advisory guidance of the Financial System Stability Committee and direction of the Macroprudential Oversight Committee.

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