Bank of Namibia

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CORPORATE CHARTER

VISION

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

MISSION

"In support of economic growth and development our mandate is to promote price stability, efficient payment systems, effective banking supervision, reserves management and economic research in order to proactively offer relevant financial and fiscal advice to all our stakeholders."

VALUES

"We value high-performance impact in the context of teamwork.

We uphold open communication, diversity and integrity.

We care for each other's well-being and we value excellence."

LIST OF ABBREVIATIONS

AML/CFT	Anti-money laundering and combating of financing of terrorism
BoN	Bank of Namibia
CBS	Central Statistics Bureau
CMA	Common Monetary Area
EMEs	Emerging market economies
FIA	Financial Intelligence Act
FIC	Financial Intelligence Centre
FNB	First National Bank
FSR	Financial Sector Review
GC10	Government Internal Registered Stock Maturing in 2010
GC12	Government Internal Registered Stock Maturing in 2012
GC15	Government Internal Registered Stock Maturing in 2015
GC18	Government Internal Registered Stock Maturing in 2018
GC24	Government Internal Registered Stock Maturing in 2024
HI	Herfindahl Index
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
NAD	Namibia dollar
NISS	Namibia Inter-bank Settlement System
NPL	non-performing loan
NSX	Namibian Stock Exchange
RHS	right-hand side (of graph)
SA	South Africa
SACU	Southern African Customs Union
SARB	South African Reserve Bank
T Bill	Treasury bill
USA	United States (of America)

CONTENTS

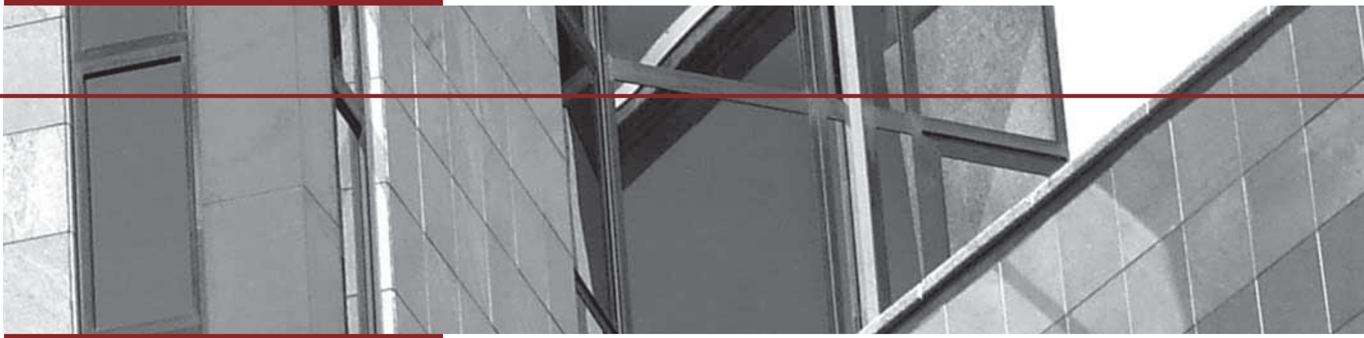
INTRODUCTION

The Bank of Namibia is mandated "*to promote and maintain a sound monetary, credit and financial system in Namibia and sustain the liquidity, solvency and functioning of that system*". For that purpose, the Bank compiles and publishes the biannual Financial Stability Review (FSR) that contains an analysis of the stability of the financial system. The latter comprises financial institutions, financial markets, payment and settlement system, and financial infrastructure. The FSR, therefore, provides the Bank's summary assessment of the financial soundness and efficiency in these areas.

Banking institutions are a key element of the financial system, and shocks to the banking sector can be transmitted to the rest of the financial sector and the real economy with detrimental effects. Much of the financial stability assessment, therefore, centres on the banking sector's performance and ability to absorb unexpected shocks.

The review starts with a short outline of the latest developments in the international real economy and financial markets, as well as in the real domestic economy and financial markets. It then proceeds with an assessment of the Namibian banking sector. The review also covers regulatory issues with a bearing on financial markets and concludes with a synopsis of risks and outlook.

Each main section ends with a suggestive ranking of the assessed impact of developments and factors on financial stability. The rankings, in ascending order of degree of impact are: low, moderate, and high impact.



1. SUMMARY OF THE STABILITY ASSESSMENT

Since the last review, global financial and economic conditions have improved and are encouraging. The concerted policy interventions by authorities worldwide have helped minimise the risk of a systemic collapse. However, significant downside risks remain. Global trade continues to be weak and key real economic and financial sectors are still struggling to recover.

The impact of the deepened global financial crisis on the Namibian real economy has been hardest on the diamond mining and tourism sectors. The former has lost more than 1,900 jobs and 65.6 percent of production so far; but it is expected to recover by 6.6 percent in 2010. The latter is expected to contract by 20 percent during 2009 and by 5 percent in 2010. Consequently, the Bank's latest economic outlook forecast GDP growth at minus 0.6 percent in 2009. Economic recovery remains possible for 2010, although the downside risks persist.

Improvements in economic conditions would enhance the financial position of households and improve domestic demand further. By the same token, acceleration in economic activities would boost corporate profitability. Both scenarios would lead to a reduction in non-performing loans for the banking sector, with positive implications for banking stability.

The NAD had depreciated minimally against the US dollar in the first half of 2009. The currency weakness mainly emanated from the risk aversion against developing market currencies. Recently, however, the NAD has been appreciating against the dollar. An appreciation of the NAD would likely keep inflation subdued, with favourable consequences for financial stability.

SACU inflows have swelled Namibia's international reserves, the deepened global crisis notwithstanding. The addition to reserves is supportive of financial stability and the financial health of the economy, although greater dependency on a single reserve source could be a concern.

The local banking institutions' limited links, to the international financial markets ravaged by the global financial crisis, have shielded the banking sector from the severe impacts of the global financial crisis. Profitability, as measured by ROE, remains solid, liquidity is satisfactory and capital adequacy ratios trend above regulatory minima. This augurs well for banking sector stability. However, profitability has fallen in the first half of 2009. Furthermore, overdue loans have risen considerably during the period. These concerns notwithstanding, the banking sector continues to be profitable, solvent and sound for the foreseeable future.

The Bank continued its oversight of the key activities of the National Payment System (NPS) in order to ensure system safety and efficiency. Consequently, the NPS has performed satisfactorily in the first half of 2009, despite a few incidences of malfunctioning. The NPS, therefore, does not constitute any systemic risk to the financial system.

Although the global economic crisis has deepened more than expected since the last FSR, its impact on the local banking sector continued to be limited due to the sector's insulation from afflicted international financial markets. Nevertheless, the financial crisis has adversary affected the real economy hard, with significant production and employment losses. If the crisis deepens further, this could adversely affect the financial position of both corporate and households, eventually affecting the banking performance and banking stability. However, as indicated earlier, recent developments seem to suggest that this risk is moderating. Therefore, these concerns notwithstanding, the overall impact of the global financial crisis on banking stability is adjudged to be low so far.

2. EXTERNAL ENVIRONMENT

2.1 MACRO-FINANCIAL CONDITIONS

The current international financial market crisis began in the summer of 2007, as an extended period of financial turmoil caused by the losses in the US sub-prime mortgage market. In mid-September 2008, it erupted into a full-blown and global financial crisis, precipitated by the failure of the investment bank Lehman brothers. The subsequent loss of confidence in the financial system provoked a liquidity crunch in the interbank market. Banks became extremely reluctant to lend to one another, and liquidity dried up rapidly. By the first quarter of 2009, the global economy was in the midst of a deep downturn/recession. All major advanced economies were in recession while activity in emerging and developing economies slowed abruptly.

The impact of the financial crisis on major advanced economies came through credit crunches and liquidity freezes. The eruption of the financial crisis and uncertainty that followed provoked an increase in precautionary saving and the associated reduction in investment and consumer demand. This, together with increased borrowing costs and tighter lending standards, provoked a severe slowdown in global economic growth. The cutback in investment demand was widespread, and continued sharply/precipitously in the first quarter of 2009. It involved countries directly affected by the financial crisis, those with close links to affected commercial and investment banks, and those emerging and developing economies that suffered through the indirect channel of falling export demand prices.

Though it began in the major advanced countries, the global financial crisis has hit emerging and developing countries severely, through indirect channels. Several developing countries, notably those with vulnerable capital accounts and weak macro-economic fundamentals experienced severe economic downturns. Developing-country commodity exporters have suffered a decline in incomes resulting from falling export demand and lower commodity prices. However, lower food and energy prices have boosted the purchasing power of consumers in commodity importing countries.

Net private capital flows to emerging market economies fell from 7.3 percent of GDP in 2007 to 4.9 percent in 2008, and are projected to turn negative in 2009. For some economies, notably those with large current-account deficits, the transmission channels were further amplified by a reversal in private capital flows, which forced a much sharper decline in domestic (consumer) demand. Although inflows of foreign direct investment were down worldwide, developing countries were affected the most severely.

Overall, fiscal positions in emerging and developing economies have weakened because of slowing domestic revenues, increase spending on social programs in response to the crisis, and deteriorating terms of trade for commodity exporters. As a result of the food and financial crisis, the pace of poverty reduction has slowed. Consequently, poverty reduction is expected to decline in these economies in 2009.

According to the IMF's World Economic Update of July 2009, the global economy has started to pull out of its worst recession since World War II. Unprecedented policy actions undertaken by central banks and governments worldwide have succeeded in stabilising the financial condition of banks, reduced counterparty risk, and prevented another systemic failure. There are signs of a global economic recovery appearing in the second quarter of 2009 in the USA, Euro Zone, Japan, and China. Financial conditions have improved with reduced risk of systemic collapse and resumed bank lending, albeit still slow. Volatility in financial markets has also abated and risk appetite has returned.

In emerging and developing countries, commodity prices have recovered, portfolio inflows have resumed, and asset prices have risen as investors move into risk assets and away from traditionally safe havens.

Furthermore, since March 2009, spreads on developing-country bonds have started to narrow, with the financial market now distinguishing better between the risks posed by different countries. In addition, there are also strong signs of renewed external appetite for emerging market exposure/bonds, in particular, sub-Saharan African debt.

The IMF expects the global economy to perform better than previously anticipated and has revised its growth forecast upwards. Accordingly, the IMF expects the global economic activity to contract by 1.4 percent in 2009 and expand by 2.5 percent in 2010. The IMF projects GDP in advanced economies to decline by 3.8 percent in 2009 before expanding by 0.6 percent in 2010. At the same time, economic growth in emerging markets and developing economies is expected to decline sharply to 1.5 percent in 2009, from 6.1 percent in 2008; but improving to 4.1 percent in 2010.

2.2 INFLATION RATES

Global inflation has eased significantly in the second half of 2008, following notable decreases in fuel and commodity prices. Global consumer price inflation is projected to decline further in 2009 because of the disinflationary influence of continued lower commodity prices. Inflation in the G-7 countries is projected to decline from 2.9 percent in 2008 to 0.5 percent in 2009, due to lower commodity prices, weak demand, and rising unemployment.

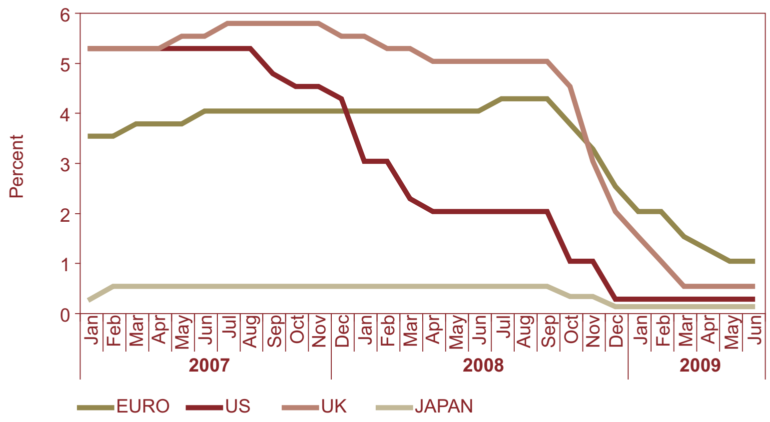
Falling commodity prices since July 2008 and weaker (external) demand conditions have contributed to a decline in inflation in emerging and developing countries. Among these countries, inflation, after increasing from about 6 percent in 2007 to a peak of more than 16 percent by mid-2008, could decline to less than 2 percent by the end of 2009.

2.3 INTEREST RATES

Low inflation rates in the major economies have augured well for low interest rates. Except for the US Federal Reserve and the Bank of Japan, which kept their policy rates intact since December 2008 at 0/0.25 and 0.10 percent, respectively, the two other major central banks cut their policy rates during the first half of 2009 (Chart 1). The European Central Bank lowered its policy rate four times in the first six months of 2009. The last interest cut by 25 basis points to 1.0 percent came on May 7, 2009. The Bank of England, similarly, reduced its rates three times during the same period, with the last reduction coming in March 2009.

Among emerging market and developing economies, China has kept its policy rate unchanged at 5.31 percent since December 2008. Other central banks, on the other hand, reduced their policy rates. The South African Reserve Bank (SARB) lowered its benchmark interest rate (the repo rate) by five percentage points between December 2008 and August 2009, mainly to spur economic growth and help pull the

Chart 1: Major policy interest rates



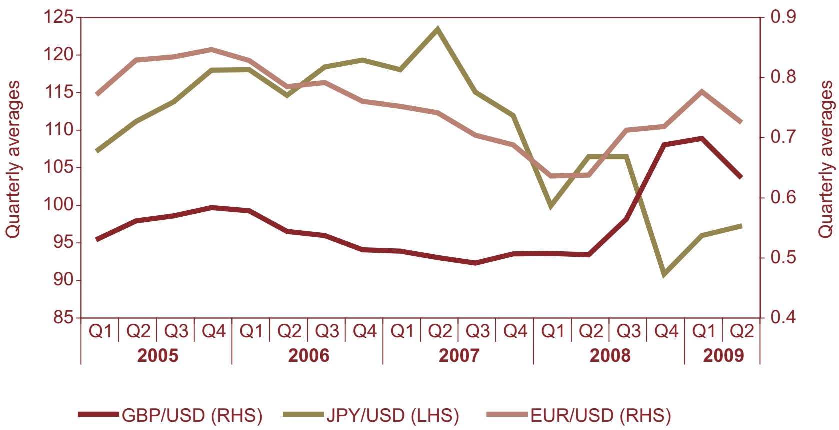
Source: Bloomberg

economy out of recession. The official repo rate was cut by 100 basis points to 7.5 percent in May 2009. Citing adverse economic conditions that tilted the risk of inflation to the downside (on worries that the recession will be longer and deeper than previously thought), the SARB further trimmed the repo rate by 50 basis points to 7.0 percent on August 13, 2009.

2.4 EXCHANGE RATES

The volatility in the major currency markets, symptomatic of prevailing uncertainty over economic outlook, continued in the first half of 2009. The Dollar appreciated against the Euro, Pound and Yen in the first quarter of 2009 (Chart 2). The currency was considered safe under uncertainty emanating from the global financial crisis and economic recession. However, in the second quarter, the Dollar only continued to appreciate against the Yen but depreciated against both the Euro and Pound.

Chart 2: Currency per US dollar

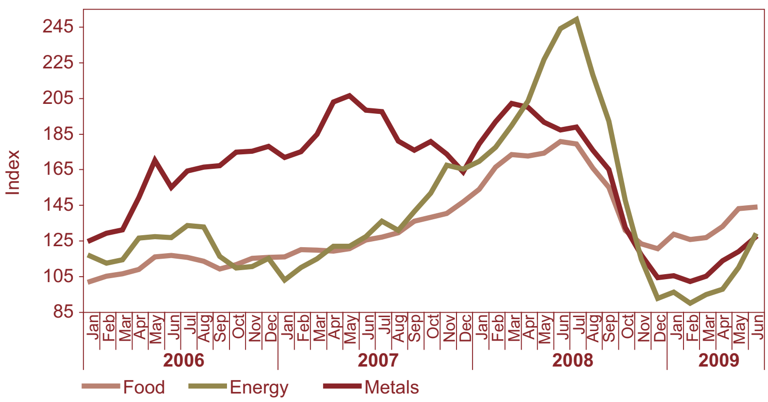


Source: Bloomberg

2.5 COMMODITY MARKETS

By early 2009, the sharp fall in commodity prices has stabilised, although sustainability is questionable. However, the IMF all-commodity (fuel and non-fuel commodities) index rose from 98.0 in December 2008 to 126.6 in June 2009. Energy (crude oil) prices led the commodity price increases during the period, with the index moving form 91.7 at the end of the fourth quarter of 2008 to 127.6 at the end of the second quarter of 2009 (Chart 3). At the same time, the food index and the metals index rose, respectively, from 120 and 103 in December 2008 to 143 and 126 in June 2009. Crude oil prices have risen from US$41 a barrel in December 2008 to US$69.13 at the end of June 2009, and have reached US$71.63 at the end of August. Oil price has rebounded as stronger economic results (from the US and China) boosted investor optimism.

Chart 3: Selected commodity price indices



Source: IMF

Metal prices rebounding towards the end of the first half of 2009 on strong import growth (from China), mainly due to re-stocking, and are expected to be relatively stable over the remainder of 2009. The average spot price for uranium has fallen to US$51.50 per pound at the close of the first half of 2009 from US$53 per pound at the end of 2008. By the end of August, uranium prices have declined further to US$47.19. However, the market outlook for uranium for 2009 is strong due to revived interest in nuclear energy, as uranium supply struggles to meet demand. Gold prices increased in the six months to the end of June 2009 from US$822.00 to US$945.67, despite the impact of the global recession curbed jewellery consumption. Jewellery demand fell by 22 percent year-on-year in the second quarter of 2009. Gold prices have risen further to US$947.60 at the end of August. Gold prices are normally driven by the strength and/ or volatility of the US dollar, oil prices and by the precious metal's demand and price.

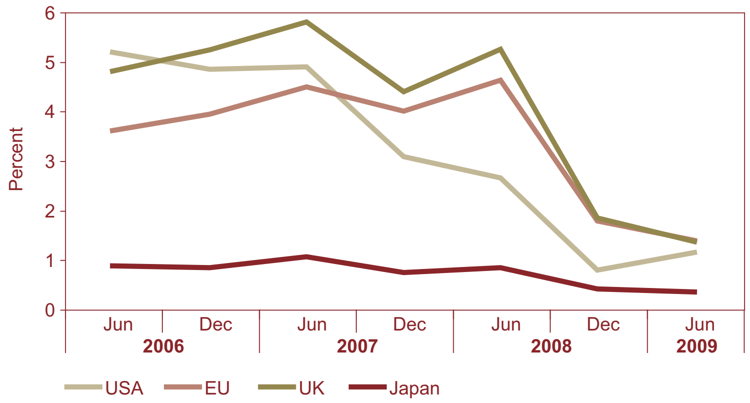
Copper price rose from US$3,260.36 per metric tonne in January 2009 to US$5, 013.30 a metric tonne at the end of June and to US$6,176.88 at the end of August 2009. The copper price was mainly supported by record imports by China's fabricators as they replenish their inventories of copper and zinc, in the first half of 2009. In the first quarter of 2009, the average price of zinc declined by 1.2 percent to US$1,181 per metric tonne, following near-collapse global demand for the metal. However, the price of zinc buoyed to US$1, 555.46 per metric tonne at the end of June 2009, as China boosted global demand. Zinc price has increased to US$1,818.01 at the end of August 2009.

2.6 BOND MARKETS

After declining sharply in the second half of 2008, the two-year bond yields in most major international bond markets continued to fall in the second half of 2009 (Chart 4). Market risk sentiments drove investors to buy government securities (bonds), thus bidding up their prices and driving down their yields given the inverse relationship between bond prices and yields. As consequence, yields in the Euro-zone, UK and Japan fell from 1.7, 1.8 and 0.4 percent in December 2008 to 1.4, 1.3 and 0.3 percent in June 2009, respectively.

In the US, by contrast, the reverse was happening. The bond yields were rising, as bond prices started falling because increased bond issuance by the US Treasury meant that the supply of the two-year bonds overwhelmed the demand. In addition, apparent signs that worst of the global recession might be over could have encouraged a move back into 'riskier' asset classes, such as equities. The U.S. two-year bond yields rose from 0.8 percent in December 2008 to 1.1 percent in June 2009.

Chart 4: Two-year bond yields

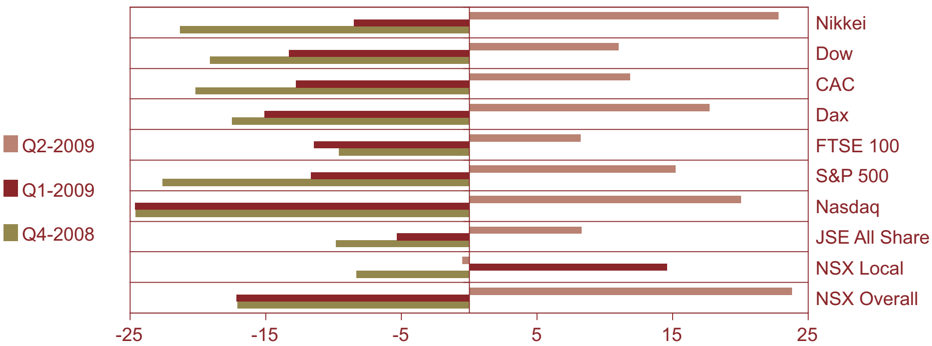


Source: Bloomberg

2.7 STOCK MARKETS

The intense volatility that characterised major international stock markets in 2008 continued in the first half of 2009, as the global financial economic recession plagued business profits. Most global stock indices fell in the first quarter of 2009 as the stocks of commodity producers fell (along with oil and metal prices) on expectations that the recession would drain demand for raw-materials and reduce corporate profits (Chart 5). The Nasdaq index declined the most, by 24.7 percent, followed by the Dax index (15.1 percent) and the Dow index (13.3 percent). In the second quarter, most stock markets recovered significantly, as signs of economic recovery appeared. For example, the Nikkei index, the Nasdaq index, and the Dax index rose by 22.8, 20.1, and 17.7 percent, respectively. In tandem with global markets, the JSE All Share index, which fell by 5.3 percent in the first quarter of 2009, recovered by 8.3 percent in the second quarter of the year.

Chart 5: Global stock exchanges quarterly growth rates (USD terms)



Source: Bloomberg

2.8 SUMMARY ASSESSMENT

The impact of the global financial and economic crises on the Namibian financial system continued to be largely limited to the NSX, through the JSE. The real economy, on the other hand, has suffered the harmful impact of the crisis through an array of channels. The recession in the country's main trading partners has led to decreased demand for export commodities and prices. Consequently, overall economic growth in Namibia has decelerated significantly as a result of weaker external demand for primary commodity and service exports. This has resulted in declining output in some key sectors, especially, diamond mining and tourism, which, in turn, led to job losses. This has put some pressure on the banking sector but its impact has been limited so far. Going forward, though, there are some positive, but tentative, signs of economic recovery.

3. DOMESTIC ECONOMY

3.1 ECONOMIC CONDITIONS AND FINANCIAL MARKETS

3.1.1 Economic performance

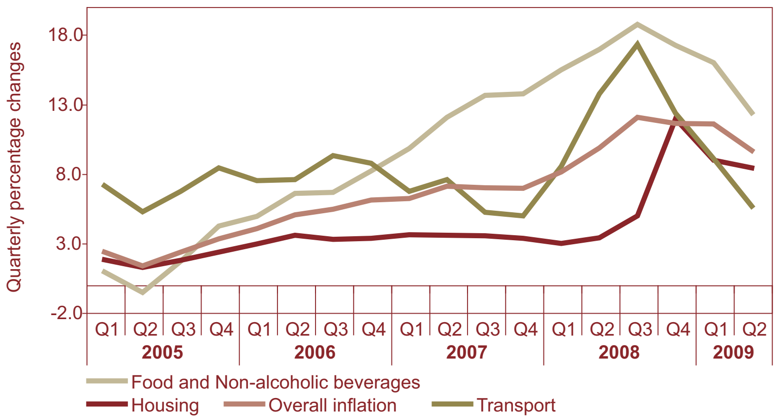
The current global economic recession, through a fall in demand for export commodities and prices, continued to have negative implications for economic activities. GDP growth contracted by 12.4 percent in the first quarter of 2009, and is estimated to contract further by 0.6 percent for 2009 as a whole. The impact of the crisis continued to be mostly felt on the diamond mining and tourism sectors. The former is forecast to contract by about 65.6 percent and the latter by about 20.0 percent in 2009. In addition, the slump in global demand for diamonds has resulted in over 1,900 job losses. The tourism industry is expected to contract by 5.0 percent in 2010, while diamond mining is forecast to decline by 6.6 percent.

The downside risks to the domestic outlook continue to be the possibility of a deepening and prolonged economic slowdown. The slump in the global economy will continue to limit export growth and adversely affect domestic economic growth. Slow economic activity will negatively impact the incomes of both firms and households, with possible adverse consequences for banking institutions and financial stability.

3.1.2 Consumer prices

The fall in key commodity prices, such as food and energy products, in the second half of 2008 had eased inflationary pressure. The declining trend in overall inflation continued in the first half of 2009 (Chart 6). The principal drivers of the fall in the overall inflation continued to be the *food and non-alcoholic beverages* sub-category, and the *transport* sub-category. The two categories declined from an average of 17.1 and 12.2 percent at the end for December 2008 to an average of 12.3 and 5.6 percent at the end of June 2009, respectively. As a result, the overall inflation fell to a yearly average of 9.1percent in June 2009 from (a yearly average of) 11.5 percent at the end of the second half of 2008. In August 2009, the overall inflation fell significally to an annual rate of 7.6 percent. However, on a month-on-month basis, the overall inflation rose to 0.9 percent in August from 0.8 percent in July.

Chart 6: Contributions to CPI

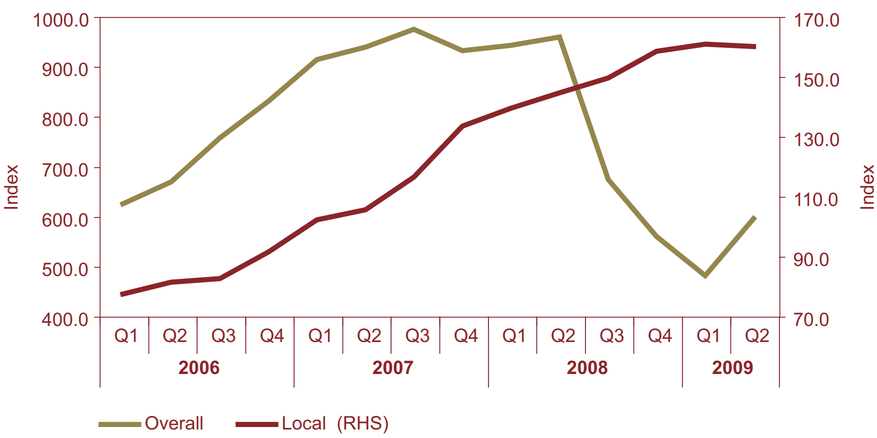


Source: Central Bureau of Statistics

3.1.3 Equity markets

The overall price index of the Namibia Stock Exchange (NSX) rose by 6.7 percent in June 2009 from 556 points in December 2008 to 593 points (Chart 7). The overall index comprises the performance of both local and dual-listed companies. The latter are simultaneously listed on both the NSX and the Johannesburg Stock Exchange (JSE). The impact of the credit crisis, and the subsequent deepening economic recession on the overall index, came through the JSE and mirrored the general downward trend in stock markets in US, Europe and Asia during the period. The NSX overall index increased following modest improvements in share prices.

Chart 7: Namibia stock exchange price indices



Source: Namibia Stock Exchange

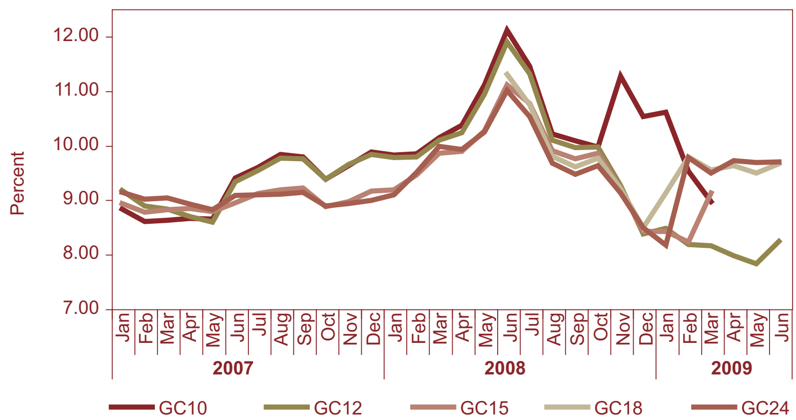
The total overall market capitalisation of the NSX rose to N$783.0 billion at the end of the first half of 2009 from N$736.5 billion at the end of the fourth quarter of 2008. The increase in the overall market capitalisation is in line with the positive performance of global markets crisis.

The local index of the NSX closed 0.6 percent higher at 159 points at the end of the first half of 2009 from 158 points at the end of the fourth quarter of 2008. The local market capitalisation rose marginally by 1.8 percent to N$5.8 billion in the first half of 2009 from N$5.7 billion at the end of the fourth quarter of 2008. The relative stability of the local market derived from its insulation from the shocks emanating from the global markets affected by the financial crisis.

3.1.4 Bond markets

The yields for the Namibian Government bonds were subdued in the first half of 2009 (Chart 8). The yields' softening came in the wake of reduction in inflation pressures worldwide and the expectations of the subsequent rate cuts in the face of the worsening global economic developments. The shorter dated bond yield on the GC12, the most sensitive to interest rate expectations, fell to 7.8 percent in May 2009 from 12.1 percent in June 2008. The longer dated bond yields, on the other hand, fell less sharply. The yields on the GC18 and GC 24 declined from 12.3 and 10.2 percent in June 2008 to 9.6 and 9.7 percent, respectively, in June 2009.

Chart 8: Government Bond yields



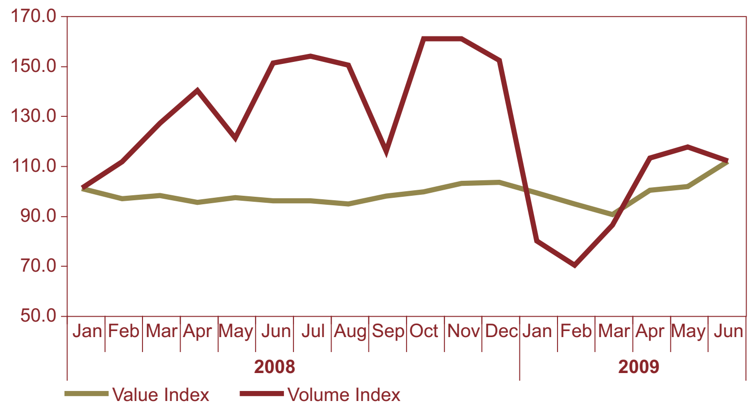
Source: Bank of Namibia

Namibian bond yields, which are priced off the South African yield curve, are also largely influenced by developments on the South African bond market. In the first half of 2009, RSA bond yields trended lower as investors remained concerned about the prospects of economic recovery.

3.1.5 Housing sector

The national housing demand remains subdued despite lower interest rates. Furthermore, prices for smaller houses remain under pressure and prospective home buyers are facing tighter lending criteria (Chart 9). In April 2009, demand for housing (in terms of deeds registered) fell to 240 bonds from 320 bonds the same time in 2008. The housing volume index fell from 112.5 points at the end of April 2009 to 111.6 in June 2009.

Chart 9: National Housing Indices



Source: First National Bank

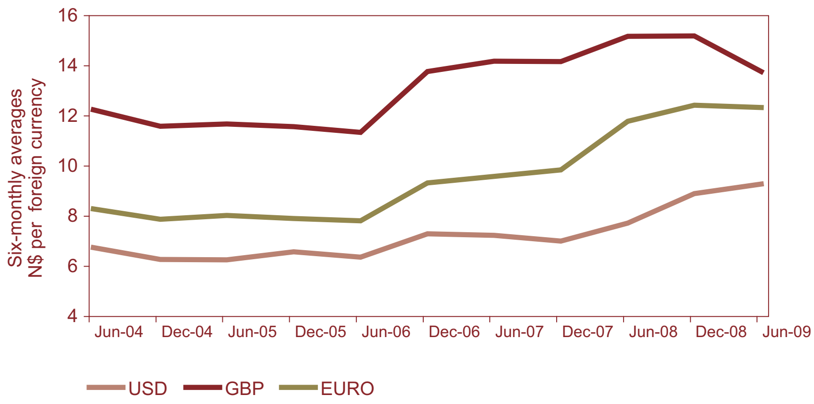
While the house prices for smaller houses remained low, the medium house prices held firm, and those for large houses increased; the overall house prices were generally flat in the first half of 2009. The national house price index increased from 102.0 points in December 2008 to 110.7 points at the end of June 2009. The moderate increase in house prices during the first half of 2009 does not pose any financial stability concerns at the point in time.

3.1.6 Exchange rate

The local currency depreciated against the US dollar in the first half of 2009, but appreciated against both the Euro and the Pound Sterling during the same period[1]. The significant weakness against the dollar emanated from sharp declines in prices of key export minerals. The NAD further depreciated against the US currency following a decrease in demand for higher-yielding, emerging market assets.

Consequently, the NAD exchanged at six-monthly averages of N$9.2, N$13.7 and N$12.3 against the USD, Pound and Euro, respectively, in the first half of 2009 (Chart 10). This brought the half-annually loss against the USD to 4.2 percent, and the gain against the Pound and Euro to 9.4 and 0.6 percent, respectively.

Chart 10: Namibia dollar per foreign currency



Source: South African Reserve Bank

By the end of August 2009, the NAD has appreciated against the dollar, but remained unchanged against the euro and depreciated significantly against the pound. This brings the appreciation (between June and August) against the dollar to 13.7 percent and the depreciation against the pound to 4.2 percent. Going forward, the NAD appreciation may decelerate the increase in inflation, which will have a positive impact on financial stability.

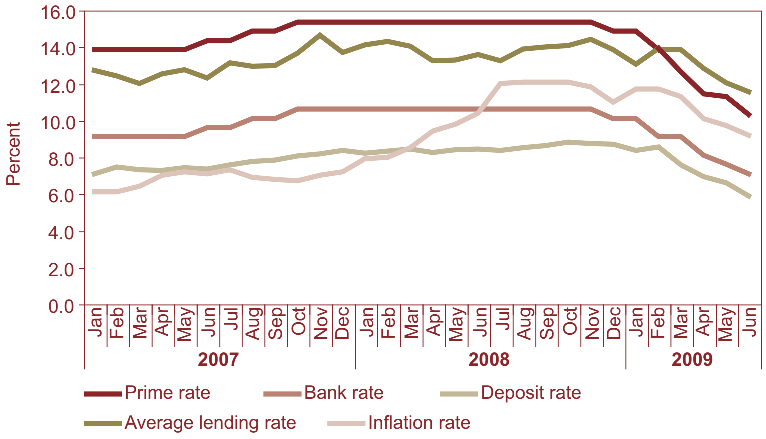
3.1.7 Interest rates

Interest rates in Namibia have been on the downward trend in the first half of 2009 (Chart 11). The Bank of Namibia cut its policy rate four times during the period, for a total of 300 basis points. The Repo (Bank) rate was lowered on February 18, 2009 by 100 basis points to 9 percent. The final rate cut of the period came in June, from 7.5 percent to 7.0 percent. Lower interest rates were expected to relieve debt repayment pressures on household and corporate borrowers by reducing their interest repayment, and to revive economic growth.

Following the series of policy rate cuts, banking institutions adjusted their rates downwards. Consequently, during the first half of 2009, the prime lending rate was reduced by a total of 231 basis points from 13.75 percent in February to 11.44 percent in June. Similarly, the average nominal lending rate was lowered by 364 basis points from 13.84 percent to 10.21 percent during the same period. The average nominal deposit rate also fell by 268 points to 5.78 percent from 8.46 percent. As a result, the spread between the nominal lending and deposit rates fell from 5.38 percent in February to 4.43 percent in June.

[1] The Namibia Dollar trades one to one against the South African Rand (ZAR) and is therefore referred to interchangeably against international currencies. The rates being referred to are period averages of mid-rates, per one foreign currency.

Chart 11: Interest and inflation rates



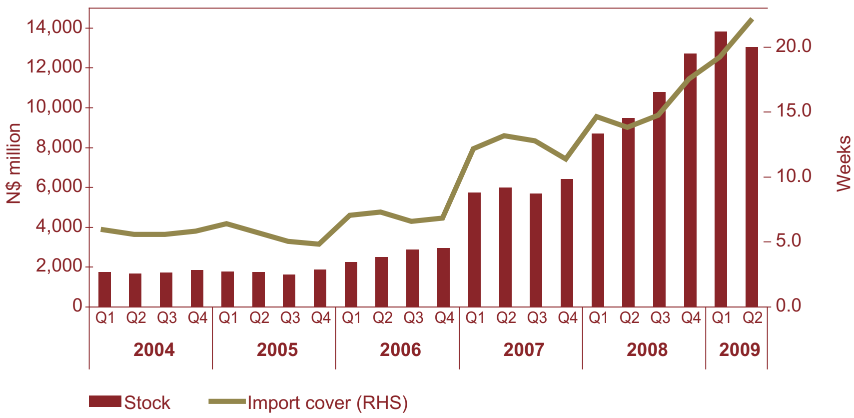
Source: Bank of Namibia

3.1.8 Reserve adequacy

Foreign-exchange reserves act as cushion when access to foreign borrowing and credit lines is limited or withdrawn, and foreign-currency liquidity shortages might result. The total foreign exchange reserves level rose slightly from N$ 12.7 billion as at the end of December 2008 to N$13.0 billion at the end of June 2009. The increase in reserves during the second half of 2009 was chiefly attributed to SACU revenues;) Rand (ZAR notes repatriated to South Africa) repatriation credit; net purchases of foreign currencies; and net realized gains; and compensation for the use of the Rand.

Namibia's total foreign exchange reserves, as measured in weeks of import cover, increased from 17 weeks of import cover at the end of December 2008 to 21.9 weeks of import cover at the end of June 2009 (Chart 12). The country's import cover is well above international import-cover benchmark of 12 weeks of imports. Furthermore, this means that the country would continue importing goods and services for close to 22 weeks without running short of reserves, if all foreign exchange earnings dried up.

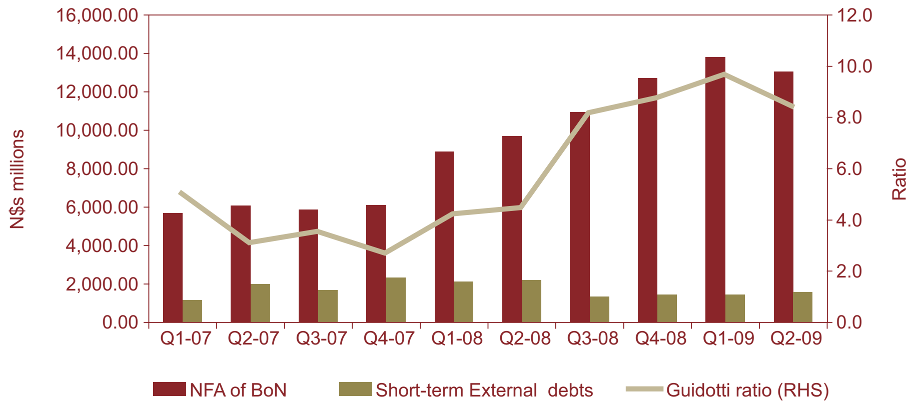
Chart 12: Quarterly international reserve stock and import cover



Source: Bank of Namibia

The Guidotti ratio (the ratio of official reserves to short-term external debt falling due within 12 months) is another measure widely used to determine the economy's foreign currency liquidity risk and, therefore, the vulnerability to external shocks. Namibia's Guidotti ratio fell slightly from 8.7 at the end of December 2008 to 8.4 at the end June 2009 (Chart 13). A country, as a rule of thumb, should hold reserves such that its resulting Guidotti ratios are greater than one. The value 8.4 means that the country's reserves were adequate to cover 840 percent (or 8.4 times) of its short-term liabilities if foreign borrowing became inaccessible. During the period, official reserves rose from N$12,712.3 million at the end of 2008 to N$13,048.6 million at the end of the first half of 2009. At the same time, short-term external debt of the country increased from N$1,458.8 million to N$1,556.8 million. So, short-term external debt rose more (6.7 percent) than reserves (2.6 percent), resulting in a fall in the Guidotti ratio.

Chart 13: Guidotti ratio



Source: Bank of Namibia

The Namibian foreign reserve adequacy, as based on the above indicators, has significantly improved in the first half of 2009. The foreign exchange reserve accumulation would mitigate the impact of a foreign exchange liquidity crisis. The improvement in the ratio should, therefore, serve as a positive development for financial stability.

3.1.9 Summary assessment

After falling considerably in the second half of 2008, commodity prices have risen in the first half of 2009. However, global inflation has fallen sharply in during the same period. In the medium term, global inflation is expected to continue its downward trend mainly on account of a continuously slowing world economy. Subsequently, the overall inflation in Namibia has also declined significantly during the period. The *transport, food and non-alcoholic beverages*, and *housing* components of the consumer price index were the principal contributors to the decline in the overall inflation. Lesser inflation would allow the monetary authorities to keep lower interest rates longer to spur economic recovery. Lower rates, in addition, would enhance corporate profits and improve capacity for debt repayment.

The negative impact of the global financial crisis on the NSX, mostly through the JSE, has continued in the first half of 2009. On the other hand, the impact on the local component of the NSX remained modest at best. Since Namibian banking institutions do not hold equity portfolios, the impact of the decline in the NSX on them continued to be limited in the first half of 2009.

The NAD depreciated against the US dollar in the second half of 2008. The currency depreciation continued in the first half of 2009, with weakness derived from uncertainties related to the global financial and economic crises. The currency, however, has appreciated against the dollar by 13.7 percent between June and August. The real appreciation of the NAD would lead to relatively low inflation, going forward. Low inflation could enhance the purchasing power of consumer income and improve their debt repayment capacity. This could enhance the financial soundness of the banking sector and, hence, the safety of financial stability.

The overall position of Namibia's international reserves continued to improve in the first half of 2009. Consequently, the financial health and stability of the country has been enhanced. However, since most of the increase in reserves came from SACU revenues, the country remains susceptible to fluctuations in SACU revenue. Nevertheless, the current level of reserves is not a cause for financial stability concern. Therefore, the risk posed to financial stability by the domestic real economic and financial market conditions is assessed to be low in the foreseeable future.

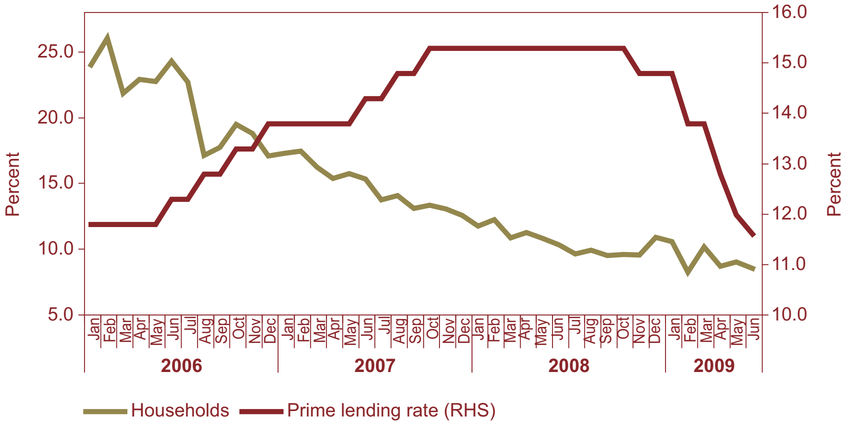
3.2 BANKING INSTITUTIONS' BORROWERS

Total claims on the private corporations and households (that is, private sector) amounted to N$37.8 billion in June 2009 from N$33.3 billion at the end of 2008. Total private sector credit decelerated, on annual basis, from 11.4 percent in 2008 to 9.5 percent in June 2009. On quarterly basis, the growth in total claims on the private sector by banking institutions fell significantly to 2.3 and 0.2 percent in the first quarter and second quarters of 2009, respectively. The severe slump in private credit growth during the first six months of 2009 could be ascribed to low disposable income (given relatively high interest rates and recession) and high cost of living (given still high inflation). Given the downward trend in private sector credit extension, in real terms, the country's economic growth prospects continued to be suppressed. Subsequent to the 300 basis points rate cut by the Bank between February 2009 and June 2009, banking institutions lowered their average lending rate from 13.8 percent to 10.2 percent in the first half of 2009. The rate reduction, together with other fiscal measures, would be expected to mitigate the impact of the recession on borrowers and spur economic recovery.

3.2.1 Household sector

Growth in credit to households slowed, on annual basis, to 8.4 percent at the end of June 2009, from 10.4, at the end of the 2008. The fall in credit extension to the sector was a result of a decline in credit to the category *other loans and advances*, which did not grow in the first quarter of 2009 but fell to minus 1.4 percent in the second quarter of 2009. On quarterly basis, credit extension to the households fell from 3.0 percent in December 2008 to 1.4 and 0.8 percent, respectively, in the first and second quarters of 2009 (Chart 14).

Chart 14: Claims on households



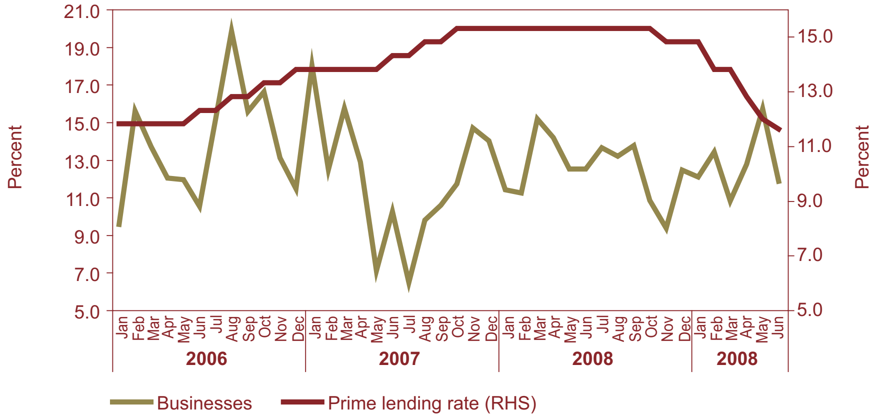
Source: Bank of Namibia

The decline in credit to households was mainly due to the decline in credit extended to the category *instalment credit*. Quarter-on-quarter, the category fell by 0.4 and 1.1 percent, respectively, in the first and second quarters of 2009.

3.2.2 Corporate sector

Credit extension to the corporate sector, on year-on-year basis, declined from 12.0 percent in December 2008, to 11.8 percent in June 2009. On a quarterly basis, growth in credit extended to the corporate sector fell to 4.2 and minus 1.0 percent in the first and second quarters of 2009, respectively (Chart 15). The fall in growth in loans to the business sector was mainly a result of the decline in *other loans and advances* that fell by 9.0 percent in the second quarter of 2009.

Chart 15: Claims on businesses



Source: Bank of Namibia

The corporate sector's profitability and the strength of corporate balance sheet have important implications for financial stability. The key components of the corporate sector, mining and tourism sectors, continued to be the hardest hit by the global economic slowdown in the first half of 2009. The adverse impact has resulted in loss of corporate profits and employment in the respective sectors. Credit extension to the Namibian corporate sector has declined significantly in the first half of 2009. This has lessened corporate indebtedness. However, positive recovery prospects would mitigate the current weak conditions and could improve non-performing loans in the banking sector and, hence, positively affect financial stability.

3.2.3 Summary assessment

The global economic downturn has continued to impact the Namibian mining and tourism sectors particularly hard in the first half of 2009. This has resulted in labour shedding, which, in turn, has led to strained household budgets and weighed down on consumer spending. In addition, lower corporate profits could reduce corporate debt servicing ability. Nonetheless, the current debt repayment capacity of both corporate and household remains realistically sustainable. But, as noted before, the banking borrowers' debt repayment capacity could be curtailed with the intensification of the deepening impact of the global economic slowdown.

However, the recent series of interest rate cuts, aimed at pulling the economy out of recession, is expected to mitigate the possible negative impacts of the financial crisis on the banking sector. Furthermore, amid indications that the world economy may be recovering, the domestic economy has shown early signs of a rebound. An economic recovery would improve the financial position of both corporate and households, and hence their debt repayment capacity. The impact of the financial crisis on financial stability, therefore, is low.

3.3 BANKING SECTOR PERFORMANCE

3.3.1 Banking structure

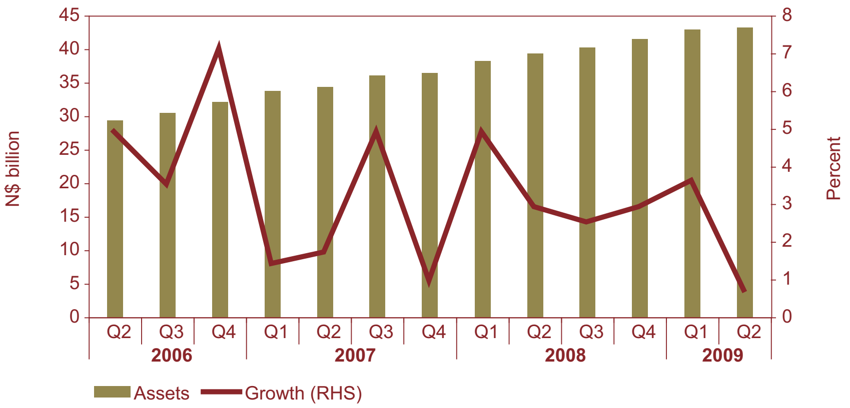
The banking sector in Namibia continued to be characterised by high concentration in the first half of 2009. Indicative of this high degree of concentration are the existence of a few number of banks (4) in the sector and elevated levels of concentration indices, the Gini index and the HHI. The Banking Supervision Department has granted two provisional banking licenses to Fides Bank Namibia and Platinum-Habib Bank Namibia (Bank PHB) for a period of six months. A provisional licence allows an applicant bank to organise itself in order to comply with all Bank of Namibia conditions before being granted a full banking licence. The former proposed bank would focus on the rural poor and would thus be the first micro-finance bank in the country, while the latter is aimed to be a fully-fledged bank. Market entry by new banks is expected to break the dominance of the local banking sector by four banks and to introduce much needed competition.

As a measure of asset inequality among banking institution, the Gini index ranges between zero (representing asset equality) and 100 (representing absolute asset inequality). The Gini index for Namibian banks declined slightly from 11.3 in December 2008 to 10.8 in June 2009 (Table 1). The fall in the index indicated that Namibian banks' asset shares have continued to become more equal in the first half of 2009. During the period, the two smaller banks have again advanced their market shares from 13.2 and 28.0 percent to 13.5 and 30.2 percent, respectively. Traditionally, high levels of banking concentration are seen to restrain competition in the banking sector and to pave the way for costly banking services.

3.3.2 Assets and lending

The aggregated balance sheet (total assets) of the banking sector has risen by 4.1 percent in the first half of 2009 (Chart 16). On the liability side, the balance sheet growth was mainly driven by a 5.1 percent increase in non-bank funding (mainly customer deposits), while bank funding (mainly intergroup and interbank deposits and borrowings) declined by 24.1 percent.

Chart 16: Banking sector assets and growth rates



Source: Bank of Namibia

On the asset side, balance sheet growth was led by increases in loans and advances (3.2 percent), cash balances (3.8 percent) and trading and investment portfolio (8.8 percent). In addition, balances with banks rose by 22.4 per cent. Mortgage loans grew by 4.3 percent in the first half of 2009, compared with a growth rate of 5.5 percent in the second half of 2008.

The balance sheet structure of the banking sector did not change much during the first half of 2009, as non-bank funding, at 84.8 percent (73.5%), remained the main source of funding, whereas loans and advances, at 76.3 percent (75.6%), constituted the major application of funds. Other sources of funding, on the other hand, included equity capital, at 10.0 percent (10.1%); other liabilities, at 3.1 percent (3.4%); and bank funding, at 2.1 percent (3.2%).

The modest growth in both the banking sector assets and loans poses no significant threat to banking stability and, therefore, only requires minimum monitoring.

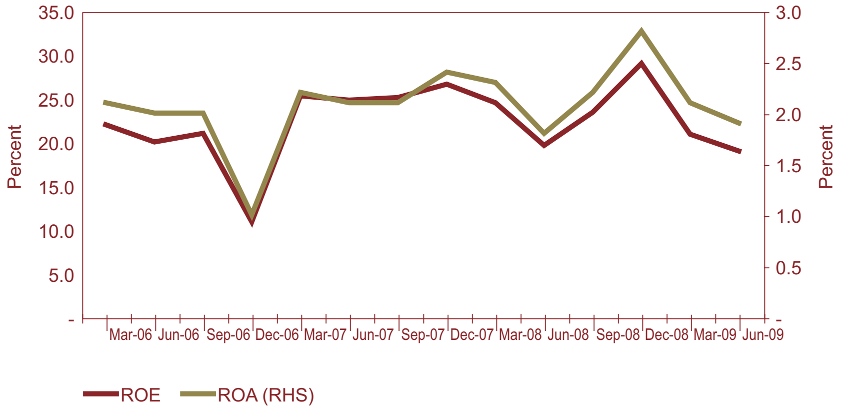
3.3.3 Profitability, capitalisation and cost efficiency

Profitability

A banking sector should be profitable in order to sustain operations and maintain capital levels required for solvency and financial stability. Banking profitability, in turn, depends on developments in (total) income, provisions and costs (containment).

A fall in interest income (-16.4 percent) and in other income (-14.6 percent), aided by a rise in operating expenses (6.0 percent), led to a deterioration in banking sector earnings in the first half of 2009. Interest income fell more than interest expense, leading to a decline in net interest income (-4.9 percent). The fall in interest income was mainly due to the decrease in the repo rate and the resultant decline in the prime lending rates. It could also be attributed to the current economic conditions that compel the public to maximise on the utilisation of saved funds as inflation continues to exert pressure on the disposable income of households.

Chart 17: Post-tax return on assets and return on equity



Source: Bank of Namibia

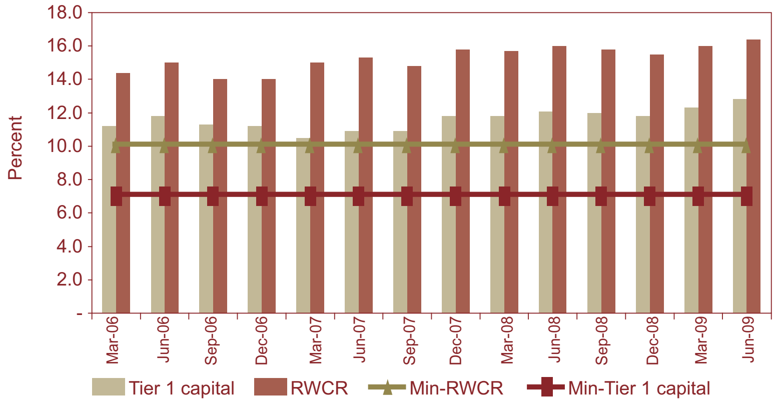
The twin negative impact of the rise in operating expenses and the fall in total income led to a record 29.8 percent decline in after-tax income in the first half of 2009. As a result, both return on assets (ROA) and return on equity (ROE) decreased to 1.9 and 19.0 percent in June 2009, from 2.8 and 29.0 percent, respectively, in December 2008 (Chart 17).

Capitalisation

Adequate bank capital, as it provides banking institutions with a “cushion” against unanticipated losses, is fundamental to a safe and stable banking system. The Banking Institutions Determination 5 (BID-5) prescribes capital minima to all banking institutions in Namibia. Currently, the leading indicator of capital adequacy, the regulatory risk-weighted capital ratio (RWCR) of no less than 10 percent is in force. 7.0 percent of this figure should be tier 1 or primary capital. Another capital-adequacy measure is the tier 1 capital leverage ratio, at 6.0 percent.

At the end of the first half of 2009, the RWCR and Tier 1 capital ratio of the banking sector averaged 16.4 and 8.6 percent, respectively, from 15.5 and 7.9 percent in the fourth quarter of 2008 (Chart 18). The increase in the RWCR during the period was mainly due to a slower growth in risk-weighted assets relative to the addition of transfer profits to retained earnings.

Chart 18: Capital adequacy for banking institutions



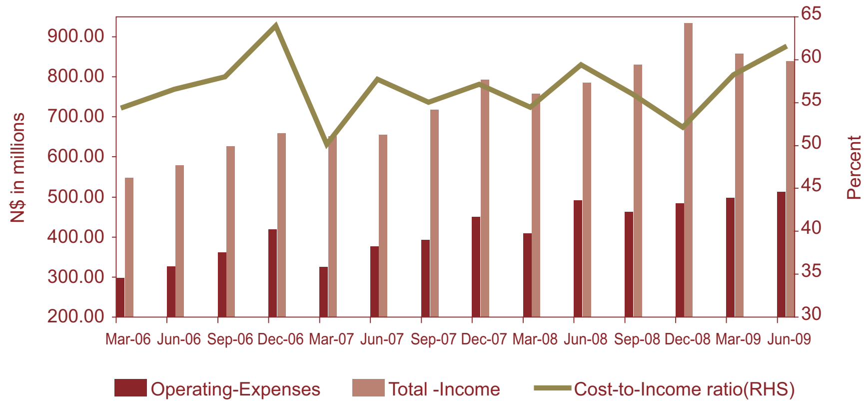
Source: Bank of Namibia

Despite the adverse developments in the principal earnings indicators, profitability of the banking sector remained robust and sustainable, with industry capital levels above regulatory requirements. The state of capitalisation in the banking sector, therefore, does not raise any foreseeable financial stability concerns.

Cost efficiency

Total income fell by 10.2 percent in the first half of 2009, while other (operating) expenses rose by 3.2 percent. This caused the cost-to-income (C/I) ratio[2] to escalate to 61.2 percent in the first half of 2009 from 51.9 percent during the second half of 2008 (Chart 19). The deterioration in the cost-to-income relationship, which is generally utilised as a measure of cost efficiency, sent the cost efficiency ratio well above the international benchmark of 50.0.

Chart 19: Banking costs, income and cost-to-income ratio



Source: Bank of Namibia

The increase in operating expenses mainly resulted from a 4.4 percent enlargement in staff cost, administration and other overheads, and marketing costs. These costs together rose by 74.3 percent, in the second quarter of 2009.

[2] Cost-to-income ratio is also referred to as cost efficiency ratio and measures the relationship between operating expenses and total income (net interest income plus operating income).

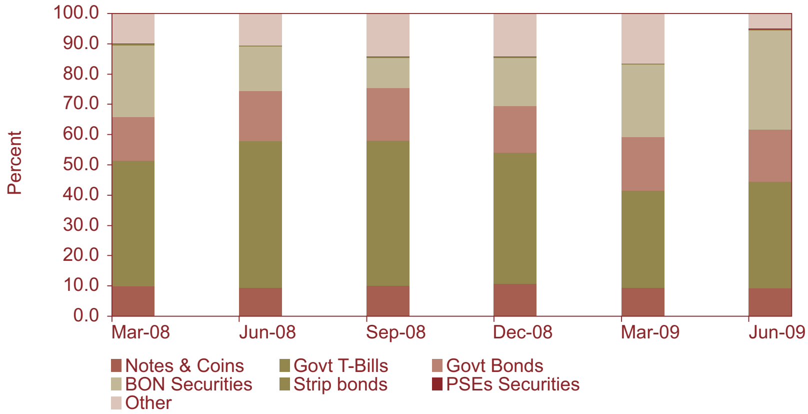
3.3.4 Liquidity risk

Loans expressed as a percentage of assets decreased slightly during the first half of 2009 to 74.6 per cent compared with 75.2 per cent at the end of the second half of 2008. The loans-to-assets ratio remained close to the international benchmark of 75 percent. The ratio, therefore, does not raise any supervisory concerns. Loans-to-deposits ratio also decreased slightly during the period from 87.9 per cent to 87.1 per cent and remained below 100 percent, signifying the ability of the sector to further fund loans with cheaper and safer core deposits.

The banking sector's liquid asset holdings rose by 2.1 percent in the first half of 2009, from N$4.2 billion at the end of December 2008 to N$4.3 billion at the end of June 2009. Liquid assets required, on the other hand, increased by 4.6 percent to N$3.7 billion. At these levels, the holdings of liquid assets by the banking institutions were, therefore, not a cause for financial stability concern.

In the first half of 2009, the composition of liquid assets held by the banking industry continued to be dominated by Government treasury bills (35.3%) followed by Securities of the Bank of Namibia (32.6%) and Government bonds (17.3%) (Chart 20). Growing market interest in the Securities of the BoN rose by 16.7 percentage points from December 2008, while Government bonds increased by 1.8 percentage points during the first half of 2009. The treasury bills category and the *other category*, on the other hand, declined by 7.9 and 9.4 percentage points, respectively.

Chart 20: Structure/Composition of liquid assets



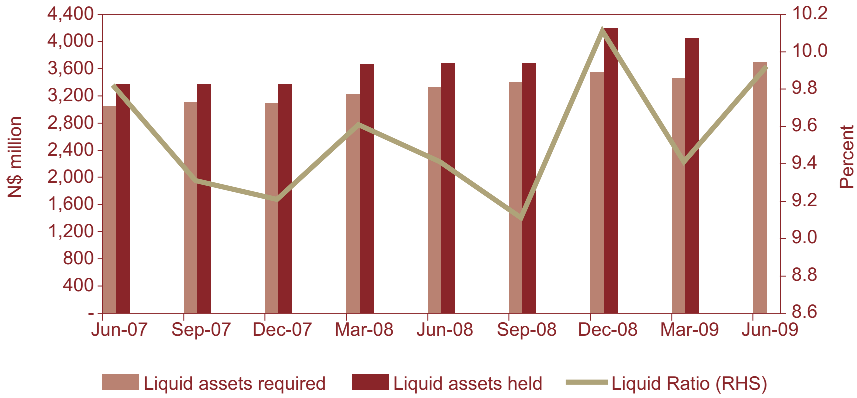
Source: Bank of Namibia

The liquid assets ratio[3] fell from 10.1 percent at the end of December 2008 to 9.9 percent at the end of June 2009 (Chart 21). The slight drop in the ratio was due to the growth in total assets of 4.1 per cent that outpaced the growth in liquid assets (held) of 2.1 per cent at the end of the first half of 2009.

The composition of retail deposits could have an important influence on the liquidity risk faced by banking institutions. There has been a sizeable shift from fixed and notice deposits to demand deposits in the first half of 2009. The share of demand deposits in total deposits rose from 49.9 percent in December 2008 to 53.4 percent at the end of June 2009. On the other hand, the share of fixed and notice (time) deposits, which are more stable than demand deposits, has fallen from 26 percent in December 2008 to 21.4 percent in June 2009 (Chart 22).

[3] Liquid assets ratio means total liquid assets held expressed as a percentage of total assets.

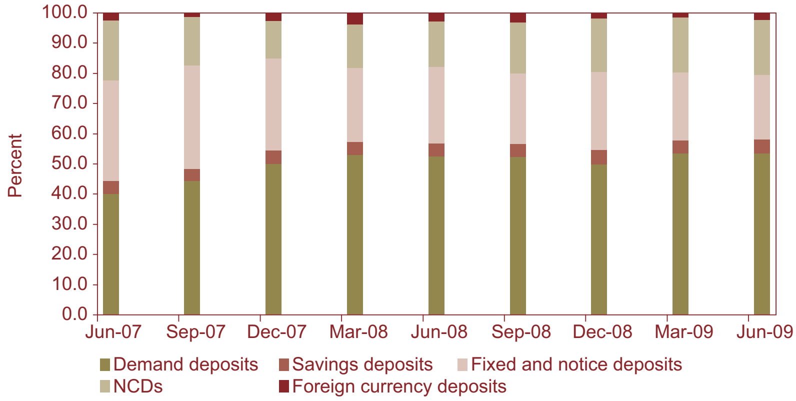
Chart 21: Liquid assets and liquidity ratio



Source: Bank of Namibia

The share of retail/core deposits in total funding-related liabilities continues to be stable, although slightly up from 93.7 percent in December 2008 to 94.8 percent in June 2009. The lofty ratio indicates that the banking institutions continued to be funded predominantly by core deposits. Thus, banking institutions continued to fund the largest share of their operations with retail deposits, which are regarded as stable and cheaper source of funding (for example, bank funding or equity capital).

Chart 22: Composition of retail deposits



Source: Bank of Namibia

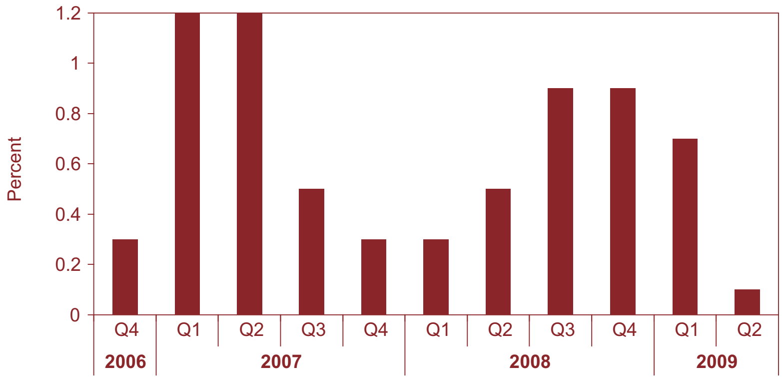
Banking liquidity also depends on the extent to which retail deposits are used to fund illiquid assets/loans. The banking system in Namibia has continued to run a positive “customer funding gap”, with the amount of retail deposits exceeding the amount of loans. The ratio of loans to deposits fell slightly from 87.9 percent at December 2008 to 87.1 percent in second half of 2009. A high loan-to-deposit (LTD) ratio means that banking institutions have limited exposure to turbulence in international financial markets.

With the loan-to-total deposit ratio averaging 87 percent and limited dependence on external funding, in the first half of 2009, liquidity risk in the banking sector remained within manageable limits. There are, therefore, no major liquidity risk concerns in the banking sector; and the banking sector’s vulnerability to liquidity risk and, hence, financial stability is nominal.

3.3.5 Exchange rate risk

The net open position in foreign currency as a proportion of the banking institutions’ tier 1 capital funds fell from 0.9 percent in the fourth quarter of 2008 to 0.7 and 0.1 percent in the first and second quarters of 2009, respectively (Chart 23). The ratio fell because the net open position (the numerator) decreased by 16.8 and 79.2 percent in the first and second quarters, respectively. The capital funds (the denominator), on the other hand, rose by 6.8 and 6.6 percent over the respective quarters. The decrease could be interpreted to mean that the exchange rate risk of the banking sector has diminished and remained well below the regulatory limit of 20 percent of capital funds.

Chart 23: Net open position

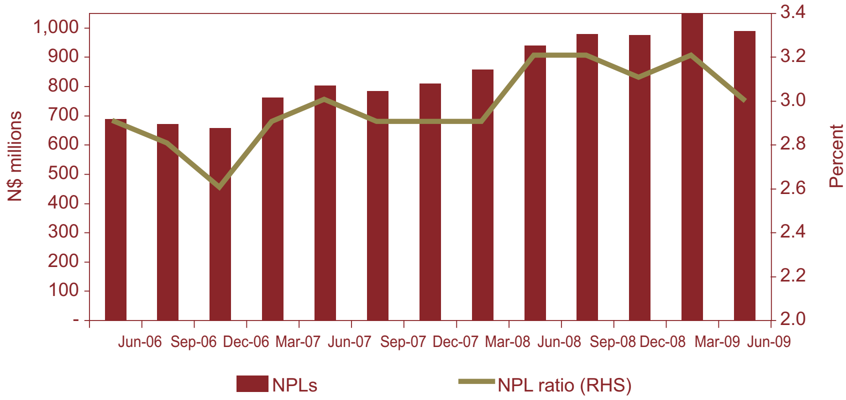


Source: Bank of Namibia

3.3.6 Credit risk

The banking sector's asset quality improved slightly during the first half of 2009. The NPL ratio fell from 3.1 percent in December 2008 to 3.0 percent at the end of June 2009 (Chart 24). Growth in loans and advances (3.2 percent) during the period outpaced the growth in NPLs (1.3 percent), resulting in the fall in the NPL ratio (the ratio of NPLs as a percentage of the loan book). The ratio is still considered to be within the acceptable range[4]. In the first half or 2009, mortgage loans constituted the highest portion of the non-performing loans at 53.7 per cent, followed by overdrafts at 21.5 per cent (Chart 25).

Chart 24: Banking asset quality

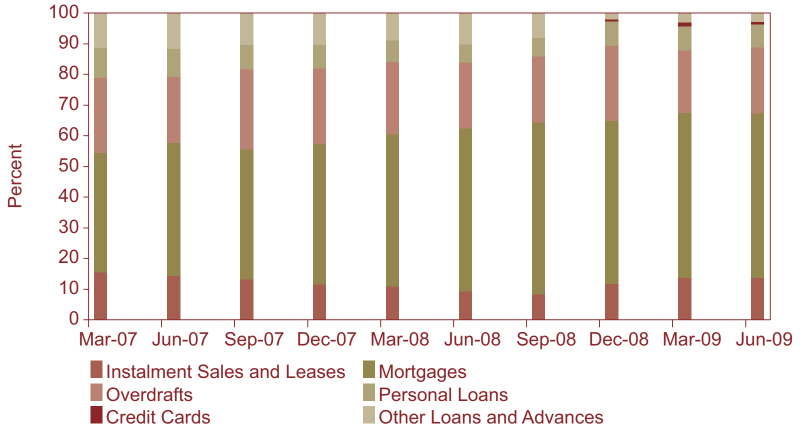


Source: Bank of Namibia

Overdue loans rose by 17.8 percent to N$2.1 billion at the end of June 2009. The NPLs constituted 46.4 percent of overdue loans as at June 2009 compared with 54.0 percent as at December 2008. This increase in overdue loans could be attributed to adverse local conditions prevailing at the time, that is, the recent floods that affected the business clients in the north of the country.

[4] In term of the CAMELS rating system, the NPL ratio of less than 5 percent is considered to be very low.

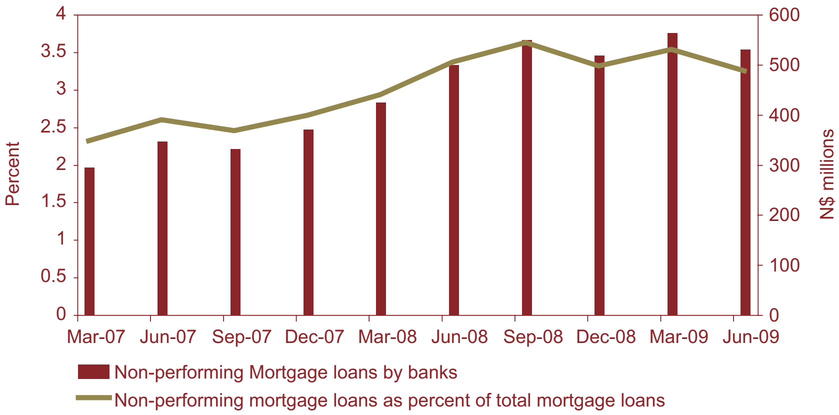
Chart 25: Non-performing loans by category



Source: Bank of Namibia

The proportion of non-performing mortgage loans out of total mortgage loans extended by banking institutions, after rising to 3.5 percent in the third quarter, has declined slightly from 3.3 percent in December 2008 to 3.2 percent in June 2009 (Chart 26). However, the proportion of overdue mortgage loans in total mortgage loans rose in the first half of 2009 from 5.7 percent to 6.5 percent at the end of June 2009.

Chart 26: Non-performing mortgage loans



Source: Bank of Namibia

In the second quarter of 2009, the banking sector's large exposure (exposures that are at least 10 percent of industry qualifying capital) accounted for 16.8 percent of the total loan portfolio of banking institutions, compared with 18.2 percent in the fourth quarter of 2008. As a proportion of banking industry capital funds, large exposures stood at 112.3 percent compared with 129.5 percent in at the end of December 2008. The Determinations on Single Borrower Limit (BID 4) set an 800 percent statutory-limit for the aggregate large exposures as a percentage of industry capital funds.

Large exposures to the mining and related sectors, as a share of banking industry capital funds fell from 34.1 percent in the fourth quarter of 2008 to 26.8 percent in second quarter of 2009. This share is relatively small. The likely impact of this exposure on banking stability is, therefore, moderate.

3.3.7 Summary assessment

The Namibian banking sector continued to have very limited links to financial markets ravaged/devastated by the global financial crisis. Consequently, the overall impact of the global financial crisis on the banking sector remained meek in the first half of 2009. Furthermore, the financial position of banking institutions remained strong and sustained in the first half of 2009; as banking institutions continued to be liquid, well capitalised, and solvent.

However, ROE has decreased considerably, in the first half of 2009, following a fall in banking profit. In addition, the rise in industry cost-to-income ratio has increased the risk of negative implications for future banking profitability. Furthermore, the proportion of overdue loans in total loans has risen during the period, due partly to the impact of the global financial crisis. In addition, there is still a risk/possibility that the real economy impact may spill over into the banking sector, as weaker growth blunts business and increases in non-performing loans. These issues warrant close monitoring, going forward.

The above-mentioned concerns notwithstanding, by and large, the banking sector performance has been satisfactory in the first half of 2009. Furthermore, positive signs of economic recovery have started to appear, which will augur well for banking performance. The overall assessment of the sector, therefore, as was the case in the previous reporting period, is that the impact of the global financial crisis on the banking sector has been limited and the sector remains generally stable. The impact of the financial crisis on the banking sector, therefore, has been low.

Box A: The Global Plan for Recovery and Reform

The Leaders of the Group of Twenty (G-20) met in London on April 2, 2009 to discuss the challenges to the world economy posed by the global crisis that has deepened since they last met. The G-20 Finance Ministers and Central Bank Governors pledged to do whatever was necessary to:

* Restore confidence, growth and jobs;
* Repair the financial system to restore lending;
* Strengthen financial supervision and regulation;
* Strengthen global financial institutions;
* Resist protectionism and promoting global trade and investment; and
* Ensure a fair and sustainable recovery for all.

The meeting also reached an agreement which, in principle, provided US$1.2 trillion to various programmes designed to improve international finance, credit, trade, and overall economic stability and recovery. The programmes included:

* US$500 billion for the IMF to aid struggling economies,
* US$250 billion to boost world trade,
* US$100 billion to assist international development banks in lending to poor countries.

Under the strengthening of financial supervision and regulation, the meeting also issued a declaration: *Strengthening the Financial System*. In the declaration, the G-20 agreed to establish a new Financial Stability Board (FSB) with a strengthened mandate, as a successor to the Financial Stability Forum (FSF). The FSB is a Basel-based body of regulators.

Declaration on further steps to strengthen the financial system

The G-20 Finance Ministers and Central Bank Governors met again in London, 4-5 September, 2009 and re-affirmed their commitment to strengthen the financial system to prevent the build-up of excessive risk and future crises and to support sustainable growth. To this end they agreed on the following actions:

1. Clear and identifiable progress in 2009 on delivering a framework on corporate governance and compensation practices.

2. Stronger regulatory and oversight for systemically important firms, including: *rapid progress on developing tougher prudential requirements to reflect the higher costs of their failure;

   *a requirement on systemic firms to develop firm-specific contingency plans; *the establishment of crisis management groups for major cross-border firms to strengthen international cooperation on resolution; and

   *strengthen the legal framework for crisis intervention and winding down firms.

3. Rapid progress in developing stronger prudential regulation by:

*requiring banks to hold more and better quality capital;

*introducing countercyclical buffers;

*developing a leverage ratio as an element of the Basel framework;

*continuing to improve risk capture in the Basel II framework;

*accelerating work to develop macro-prudential tool; and

*exploring possible role of contingent capital.

4. Tackling non-cooperative jurisdictions (NCJs): capacity building and countermeasures to tackle NCJs that fail to meet regulatory standards, AML/CFT and tax information exchange standards;

*standing ready to use countermeasures against tax havens from March 2010; and

*ensuring developing countries benefit from the new tax transparency.

5. Consistent and coordinated implementation of international standards, including Basel II, to prevent the emergence of new risks and regulatory arbitrage.

6. Convergence towards a single set of high-quality, global, independent accounting standards on financial instruments, loan-loss provisioning, off-balance sheet exposures and the impairment and valuation of financial assets.

Table 1: Banking sector indicators

	Jun-06	Dec-06	Jun-07	Dec-07	Jun-08	Dec-08	Jun-09
Structure							
Number of banks	4	4	4	4	4	4	4
Total assets of banks	30,130,094	33,397,304	34,448,220	36,504,795	39,443,450	41,562,708	43,275,865
Gini concentration index	13.2	14.1	12.5	11.6	12.2	11.3	10.8
Herfindahl index	2,712	2,730	2,769	2,678	2,705	2,689	2,677
Capital adequacy (%)							
Tier 1 leverage ratio	8.2	7.5	7.4	7.9	7.9	7.9	8.6
Tier 1 capital ratio	11.8	11.2	10.9	11.8	11.9	11.8	12.8
Total RBC (regulatory capital RWA's)	14.8	14.2	14.9	15.8	15.8	15.5	16.4
Asset quality (%)							
NPL's/Total gross loans	2.9	2.6	3.0	2.9	3.2	3.1	3.0
Gross overdue/Total loans and advances	3.7	3.3	3.8	3.8	3.9	5.7	6.5
Provisions/ Total loans	2.2	2.4	2.3	2.1	2.1	2.0	1.9
Provisions/NPL's	65.7	90.3	78.9	77.2	68.6	64.7	62.8
Specific provision/NPLs	28.4	45.6	41.8	37.0	33.8	29.2	27.2
Earnings and profitability (%)					3		
Return on assets	2.0	1.0	2.1	2.4	1.9	2.8	1.9
Return on equity	20.3	10.9	24.0	26.6	20.0	29.0	19.0
Net interest margin	4.8	5.4	5.0	5.7	468	4.7	4.3
Cost to income ratio	56.3	63.7	57.5	56.9	59.2	51.9	61.2
Liquidity (%)							
Liquid asset to total assets	9.5	9.1	9.8	9.2	9.3	10.1	9.9
Total loans/Total deposits	93.7	92.8	89.2	89.9	86.4	87.9	87.1
Total loans/Total assets	77.6	73.6	76.8	76.2	74.2	75.2	74.6

3.4 FINANCIAL INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

3.4.1 Financial infrastructure

The Bank of Namibia has performed a multitude of oversight activities in the first half of 2009. To this end, the Bank reviewed performance of the payment system as well as key related issues. The Bank also conducted on-site inspections at participants to share information and to assess compliance. The findings of the assessment of the on-site inspections revealed that the participants have substantially complied with the Bank's oversight policy. In addition, substantial progress has been made in terms of compliance with payment system regulations and with full localisation of core banking systems.

3.4.2 Regulatory developments

Anti-Money Laundering

Namibia is signatory to the United Nations Convention on Transnational Organized Crime (Palermo Convention). Under the terms of this Convention Namibia has acquired international obligations to combat organized crime, in general, and money laundering, in particular.

As a result of these obligations, the Government has introduced the Prevention of Organized Crime Act, 2004 (Act 29 of 2004) that defines money laundering as a crime. The POCA further places an obligation on businesses, or any citizen, or any other person, to report transactions suspected to be linked to proceeds of crime or money laundering activities to the FIC, Bank of Namibia. In addition, it provides for processes whereby proceeds of crime can be confiscated by the State.

Government further introduced the Financial Intelligence Act, 2007 (Act 3 of 2007) which provides for measures to combat money laundering. The FIA further places certain obligations on identified accountable institutions in order to protect their businesses from being abused by money launderers. The FIA also places supervisory obligations on the Supervisory Bodies of these accountable institutions.

The POCA, the POCA Amendment Act, the POCA Regulations, the FIA and the FIA Regulations became operational on May 5, 2009.

3.4.3 Summary assessment

The payment system has performed satisfactorily in the first half of 2009. The system was available most of the time and there were no major system breakdowns. In terms of combating of money laundering, the requisite legal framework is put in place and became operational on May 5, 2009.

4. OUTLOOK, RISKS AND OVERALL ASSESSMENT

4.1 GLOBAL OUTLOOK

According to the IMF's *Update* for July 2009, global economic recovery is underway. Positive indicators have started to appear in USA, Europe, Japan and Asia. The *Update*, however, noted that the recovery would remain slow. Consequently, the IMF expects global economic activity to contract by 1.4 percent in 2009 and to expand by 2.5 percent in 2010. Furthermore, economic activity in advance economies will decline by 3.8 percent in 2009, while that of emerging market and developing economies will grow by 1.5 percent.

4.2 DOMESTIC OUTLOOK

In the first quarter of 2009, the Namibian economy has experienced its second worst quarter on record with a seasonally adjusted growth on annual basis of negative 5.8 percent. This came after a negative growth of 3.9 and 4.1 percent in the second and third quarters of 2008, respectively, and was punctuated by a brief recovery of 1.1 percent in the fourth quarter of 2008. GDP growth in 2009 is forecasted at minus 0.6 percent, due to the continued impact of the global financial crisis on the domestic economic activities. In line with the global economy, economic recovery in Namibia is expected in 2010, with GDP growth forecast to recover to 4.2 percent. However, the risks to domestic economic recovery remain tilted to the downside.

4.3 OVERALL ASSESSMENT

By the first quarter of 2009, the financial crisis has turned into global financial and economic crises. Most of the world became engulfed into a global economic recession. Global inflation has fallen significantly (following a decline in global demand that led to falling commodity prices) and remained subdued (on concerns over the sustainability of global economic recovery). In due course, monetary and fiscal stimuli by authorities worldwide have started to stabilise global conditions. Consequently, by the end of the first half of 2009, signs of an economic recovery and/or stabilisation have emerged, although to varying degrees among regions.

Financial conditions have also started to improve in both advanced and emerging and developing countries. Improving macro-economic conditions (in response to concerted fiscal and monetary policy stimulus measures) have helped stimulate some return to risk appetite and a decline in volatilities, with investors moving into riskier assets and out of safe havens. In emerging and developing economies, risks have lessened, reflecting the recovery in commodity prices and the resumption of portfolio inflows. However, concerns about the sustainability of the global recovery remained, as the global recession was continuing and global trade was slumping. In addition, financial institutions remained frail and bank lending was still limited.

The Namibian banking institutions have very limited exposure to the financial markets plundered by the current global financial crisis. Thanks to this insulation, the impact of the global financial crisis on the local banking sector continued to be moderate in the first half of 2009. The banking institutions persisted to be liquid, well capitalised and solvent. However, profitability (ROE) has fallen significantly, although capital adequacy ratios stayed above regulatory minima.

The global financial and economic crises have led to a severe decline in economic activities in key sectors and loss of employment in Namibia in the first six months of 2009. However, recently, positive signs of economic recovery have emerged. This would mitigate the possible negative impact of the crises on the local economy. The risk on banking stability, therefore, is expected to remain low in the foreseeable future.

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Bank of Namibia