Namibia Financial Stability Report

April 2019

Bank of Namibia

NAMFISA
NAMIBIA FINANCIAL
INSTITUTIONS SUPERVISORY AUTHORITY

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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, and
Ensure sound financial systems and conduct economic research.

Values

We speak our hearts,
We deliver as a team,
We do right things right,
We work smarter,
We value our differences, and
We help each other grow.

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
ALSI	All Share Index
ATM	Automated Teller Machine
CIS	Collective Investment Scheme
CPI	Consumer Price Index
EFT	Electronic Fund Transfers
EMDEs	Emerging Market and Developing Economies
EMEs	Emerging Market Economies
EMV	Euro-Pay MasterCard Visa
FSR	Financial Stability Report
FSSC	Financial System Stability Committee
GDP	Gross Domestic Product
GFSR	Global Financial Stability Report
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
LFR	Loan-to-Funding Ratio
LTD	Loan-to-Deposit
LTI	Long Term Insurance
MPC	Monetary Policy Committee
NAD	Namibia Dollar
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFIs	Non-bank Financial Institutions
NCPI	Namibia Consumer Price Index
NISS	Namibia Inter-Bank Settlement System
NPL	Non-performing loan
NPS	National Payment System
NSX	Namibian Stock Exchange
PAN	Payments Association of Namibia
POS	Point-Of-Sale
PSCE	Private Sector Credit Extension
ROA	Return on Assets
ROE	Return on Equity
RWCR	Risk-Weighted Capital Ratio
SARB	South African Reserve Bank
SOEs	State Owned Enterprises
SSA	Sub-Saharan Africa
UK	United Kingdom

US	United States of America
VCs	Virtual Currencies
VIX	Volatility Index
WEO	World Economic Outlook
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 presents recommendations to the identified risks. Lastly, the report is published to inform the reader on the soundness of the financial system, and what the regulators and government are doing in order to mitigate risks to the Namibian financial system, hence it serves as a communication tool.

Financial system stability is defined as the resilience of the domestic financial system to internal and external shocks, be they 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, while not strictly a part of the financial system, plays an important role in regulating and monitoring of the system. Under the mandate of Section 3(a) of the Bank of Namibia Act, 1997 (No 15 of 1997, as amended) the Bank of Namibia has an objective “to promote and maintain a sound monetary, credit and financial system in Namibia and sustain the liquidity, solvency and functioning of that system”. 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 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 to ensure a healthy financial system. There is also active engagement between the Bank of Namibia, NAMFISA and the Ministry of Finance to ensure a comprehensive assessment of systemic financial risks and policy actions to ensure lasting financial system stability.

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I. INTRODUCTION AND SUMMARY

1. **The Namibian financial system remained resilient during the period under review, despite sluggish economic conditions.** Generally, the financial system remained sound and profitable. Regardless of unfavourable economic conditions, the financial system continued to function efficiently and effectively. The banking sector remained adequately capitalised, profitable and maintained liquidity levels well above the prudential requirement, during the period under review. Asset quality as measured by the non-performing loans deteriorated further in 2018, partly ascribed to unfavourable economic conditions and their concomitant impact on household disposable income and business performance, but remained within acceptable limits. Similarly, the non-bank financial institutions (NBFIs) continued to be financially stable and sound despite weak economic conditions. The National Payment System (NPS) remained stable and continued to efficiently contribute towards safety and reliability in payments, hence enhancing financial stability in the country. Finally, both household debt and corporate debt increased moderately.

2. **According to the IMF's April 2019 Global Financial Stability Report (GFSR), global financial conditions remained largely accommodative, but characterised by variations across regions which may increase financial stability risks.** Since the October 2018 GFSR, global financial conditions were broadly accommodative characterised by reduced financial market volatility and stable interest rates in both the Advanced Economies (AEs) and Emerging Market and Developing Economies (EMDEs). Nonetheless, vulnerabilities have continued to build up, particularly in some AEs sovereign, corporate, and nonbank financial sectors, leading to elevated medium-term risks. At the same time, financial conditions in EMDEs have tightened, which could be ascribed to a combination of country-specific factors, trade tensions, as well as worsening external financial conditions. Near-term risks to global financial stability have risen modestly, while medium-term risks remain elevated due to persistent financial vulnerabilities, coupled with increased debt levels and stretched asset valuations.

3. **Global growth slowed marginally, owing to weaker performances in both Advanced Economies (AEs) and Emerging Market and Developing Economies (EMDEs).** According to the April 2019 World Economic Outlook (WEO) of the International Monetary Fund (IMF), global growth is estimated at 3.6 percent in 2018, down by 0.2

percentage points from 3.8 percent in 2017. Gross Domestic Product (GDP) growth in AEs, apart from the US, slowed from 2.4 percent in 2017 to 2.2 percent in 2018. Similarly, growth in EMDEs slowed on the back of less than expected activity in China, as well as, emerging and developing Europe. GDP growth in Sub-Saharan Africa (SSA) rose slightly to 3.0 percent in 2018, compared to 2.9 percent in 2017, on account of increase in the growth rate of Nigeria.

4. **The global economy is projected to slow further in 2019, but a slight recovery is expected in 2020.** According to the IMF's April 2019 WEO, global output growth is estimated to decrease by 0.3 percentage points to 3.3 percent in 2019, before improving slightly to 3.6 percent in 2020. The projected slowdown in global output will be driven by lower growth rates for both AEs and EMDEs. In the AEs, GDP growth is projected to slow in 2019 on the back of a moderation in most key AEs with the exception of Japan. Economic activities are also expected to moderate in key EMDEs during 2019 on account of a greater than previously envisaged slowdown in China, before picking up in 2020. Growth in Sub-Saharan Africa is however, projected to continue improving supported by expected improvements in the growth rates of both Nigeria and South Africa. Going forward, risks to the outlook remain and include, the possible collapse of the China/US trade negotiation, escalation of trade tension to other countries and a no-deal withdrawal of the UK from the EU.

5. **The domestic economy contracted at a slightly slower pace in 2018, but a marginally positive growth rate is expected in 2019.** Real GDP in Namibia contracted by 0.1 percent in 2018, from a slightly deeper contraction of 0.9 percent in 2017 but is expected to expand by 0.3 percent in 2019. The decline in Namibia's economic growth during 2018 emanated mainly from the weak performance in both the secondary and the tertiary industries. The external current account deficit, however, is estimated to have improved during 2018 as a result of increased exports and higher inflows on the sevices account. Going forward, risk to the domestic outlook remain and include, the persistently low uranium price und unpredictable rainfall.

6. **The level of household indebtedness as well as the stock of corporate debt rose, while the ratio of household indebtedness to disposable income moderated in 2018.** Household debt increased by 7.0 percent in 2018, slightly up from 6.7 percent

in 2017, on the back of an increased demand for short term credit. On the contrary, the household indebtedness to disposable income ratio moderated due to disposable income increasing at a faster pace, compared to household debt. Disposable income increased by 8.5 percent in 2018, from 4.2 percent in 2017. Despite the higher levels of debt in the household sector, the risk to financial stability remains unchanged since disposable income also increased. The stock of corporate sector debt grew during 2018 to reach N$126.4 billion, which is a 12.2 percent increase, compared to 2017. The higher corporate debt stock was mainly as a result of intercompany lending to resident companies in the mining sector. The increased level of the corporate debt stock therefore, is not deemed to pose a significant risk to financial stability because it is linked to expansion in production.

7. **Although asset quality deteriorated further since the last FSR, the banking sector remained profitable, liquid and well capitalised.** The non-performing loan (NPL) ratio increased from 2.5 percent in 2017 to 3.6 percent in 2018, which signifies that the banking sector asset quality worsened. The banking sector however continued to grow in terms of assets. Moreover, banks continued to register positive profit growth, despite a challenging economic environment over the period under review. Both capital and liquidity remained well above the minimum statutory requirements during 2018, meaning that the banking sector had adequate capital as well as a favourable liquidity position.

8. **Despite a moderation in the growth rate of NBFI assets, the NBFI sector remained financially stable and sound.** The NBFI sector assets grew by 0.9 percent in 2018, although growth has moderated compared to the previous year. This slower growth in total NBFI assets was mainly driven by slow growth in pension fund assets, owing to volatile and poor performing financial markets, during the period under review. Nonetheless, the sector's assets remain above prudential requirements indicating financial soundness.

9. **Since the last FSR, the National Payment System (NPS) remained stable and continued to operate efficiently and effectively.** The Bank continued to fulfil its regulatory mandate as the overseer of the NPS in line with the Payment System Management Act 18 of 2003, as amended. The payment system maintained high system availability with two disaster recovery tests for the Namibia Interbank

Settlement System (NISS) successfully conducted. Significant efforts and initiatives were embarked upon to enhance the payments system infrastructure and to align it to international standards to allow for greater efficiency and security in the NPS Three new participants were granted access and allowed to participate in the NPS, during the period under review.

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 realise.

According to the IMF's April 2019 Global Financial Stability Report (GFSR), near-term risks to global financial stability have risen modestly, while medium-term risks remain elevated. Although near-term risks to global financial stability have risen slightly, financial conditions are still broadly accommodative and supportive of growth in the near-term. Risks could rise sharply should pressure in emerging market economies mount and trade tensions escalate. A broader escalation of trade actions may undermine investor confidence, thereby harming economic expansion. Political and policy uncertainty could therefore adversely affect market sentiment and lead to a spike in risk aversion. Similarly, medium-term risks remained elevated as eased financial conditions contribute to a further buildup of financial vulnerabilities owing to elevated debt levels as well as stretched asset valuations. Potential systemic risks can be addressed through proactive financial regulation and supervision.

Despite a rise in some risks to Namibia's financial stability, on the back of sluggish economic activity, most risks remained broadly unchanged. Since the last Financial Stability Report (FSR) most risks either remained unchanged or went up marginally (Figure 1a). The uptick in risks in the macroeconomic environment were mainly related to the global and domestic economic slowdown, depreciation of the Namibia Dollar, as well as the possibility of sovereign credit rating downgrades for both Namibia and South Africa. However, the probability of these risks materializing going forward is medium with a medium to low impact. The domestic economy is projected to improve, although if the current slowdown persists, the impact on financial stability would be considered high. Despite the higher levels of debt in the household sector, the risk to financial stability remained unchanged as disposable income also increased. The increased level of the corporate debt stock similarly is not deemed to pose a significantly higher risk to financial stability due to the nature of the debt driving the increase, and the impact is expected to be low. Although asset quality of the banks deteriorated further during the period under review, the probability and impact of a further deterioration remain medium as the banks continue to be profitable, liquid and well capitalised. Risks from the payment system as well as the non-bank financial institutions (NBFIs) remained broadly unchanged with low to medium risks going forward.

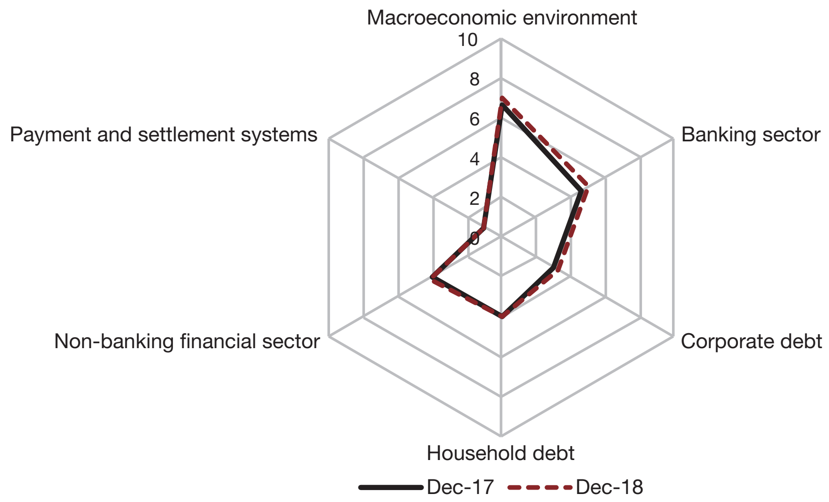
Figure 1a: Risks to financial stability in Namibia

	Direction of risk[1] Since December 2017	Probability[2]	Impact[3]
Macroeconomic Environment Events/Risks			
Global economic slowdown	Up		
Domestic economic slowdown	Unchanged		
Sovereign credit rating downgrade: Namibia	Up		
Decline in international reserves	Unchanged		
Sovereign credit rating downgrade: South Africa	Up		
NAD/ZAR depreciation	Up		
Household debt risks			
Increase in household debt	Unchanged		
Corporate debt risks			
Increase in corporate debt	Up		
Banking Sector risks			
Liquidity constraints	Unchanged		
Asset quality deterioration (NPLs)	Up		
Payment System risks			
Security of retail payments	Unchanged		
Settlement in last window	Unchanged		
NBFIs risks			
Funding risk	Unchanged		
Market risk	Up		
Concentration risk	Unchanged		
Solvency risk[4]	Unchanged		
Risk analysis keys	low	medium	high

[1] This is the direction of risk compared to the last FSR.
[2] This is the probability of the risk materializing.
[3] This is the impact that the risk will have, if it materializes.

Trends in the risk to financial stability were mixed at the end of December 2018, compared to December 2017. The risks associated with the macroeconomic environment, non-banking financial institutions and household debt sectors, as well as the payment and settlement system remained relatively unchanged, compared to December 2017 (Figure 1b). In contrast, risks associated with corporate debt increased during 2018 due to a higher corporate debt stock. Similarly, the risks emanating from the banking sector increased marginally since the last FSR due to asset quality deterioration, although the banking sector remained liquid, profitable, and adequately capitalised.

Figure 1b: Domestic financial stability risks map[4]



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

III. Macroeconomic Environment

Global Economic Growth

Since the last Financial Stability Report (FSR), global growth is estimated to have slowed during 2018 owing to weaker performances in some economies. According to the April 2019 World Economic Outlook (WEO) of the International Monetary Fund (IMF), global growth is estimated at 3.6 percent in 2018, down by 0.2 percentage point from 3.8 percent in 2017 (Figure 2). Economic activity in Advanced Economies (AEs) slowed from 2.4 percent in 2017, to 2.2 percent in 2018. For Emerging Market and Developing Economies (EMDEs) growth slowed by 0.3 percentage points to 4.5 percent during 2018, while Sub-Saharan Africa (SSA) growth edged higher from 2.9 percent in 2017 to 3.0 percent in 2018.

Real Gross Domestic Product (GDP) growth in the AEs slowed in 2018. The US economy was the outlier in this group and expanded by 2.9 percent in 2018 from 2.2 percent in 2017, supported by fiscal stimulus as well as strong growth in domestic demand. GDP growth in the Euro Area was subdued in most of the countries in the block and slowed to 1.8 percent in 2018 from 2.4 percent in 2017 (Figure 2). In Germany, GDP grew by 1.5 percent in 2018, down from 2.5 percent in 2017. The slowdown was ascribed to amongst others, soft private consumption, subdued foreign demand and weak industrial production. GDP growth in Italy declined by 0.7 percentage points to 0.9 percent, driven largely by higher borrowing costs as sovereign yields remained elevated, coupled with weak domestic demand. France recorded an estimated 0.7 percentage point decline in growth from 2.2 percent in 2017 to 1.5 percent in 2018, owing to the negative impact of street protests and industrial action. Japan, the United Kingdom and Canada all experienced subdued economic growth of 0.8 percent, 1.4 percent and 1.8 percent, respectively during 2018, while other advanced economies also experienced a moderate slowdown in growth[5].

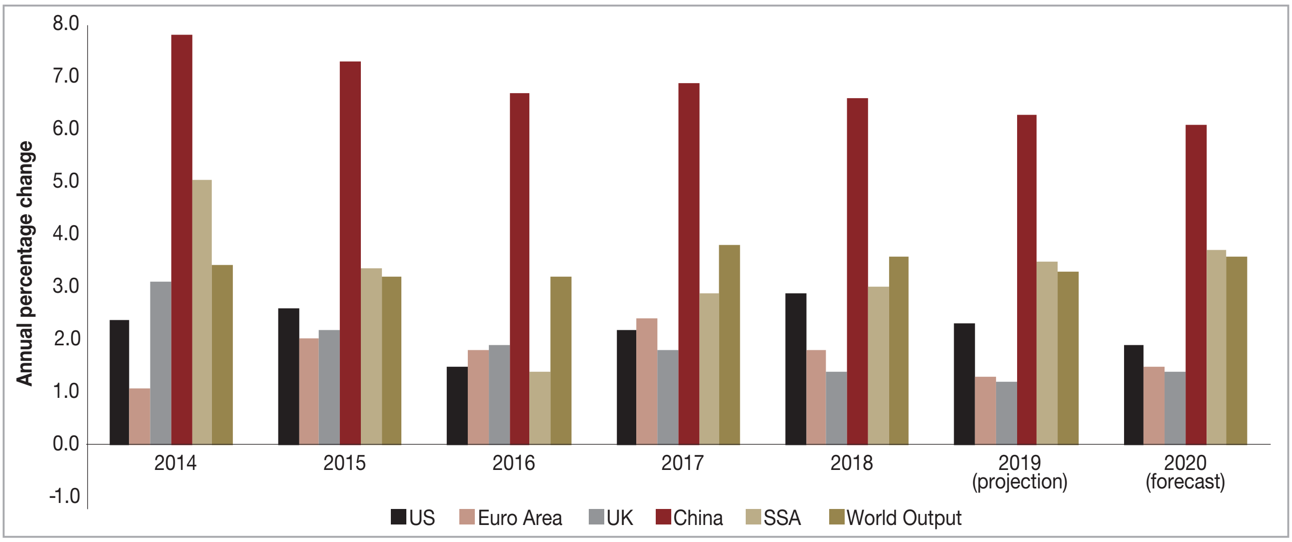
Growth in EMDEs slowed marginally, on the back of weakened activity in China as well as emerging and developing Europe. Economic growth in Emerging and Developing Asia edged lower from 6.6 percent to 6.4 percent, as GDP growth in China slowed from 6.8 percent in 2017 to 6.6 percent in 2018, respectively. This was attributed to the negative impact of trade tariff increases enacted in the US and China, therefore slowing external demand, coupled with financial regulatory tightening. Growth in Emerging and Developing

[5] Excludes the Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

Europe declined, from 6.0 percent in 2017 to 3.8 percent in 2018, due to weaker financial markets sentiment and a deeper than anticipated contraction in Turkey, owing partly to policy tightening as well as adjustment to more restrictive external financing conditions. Russia recorded improved growth during 2018, underpinned by higher oil production and favourable oil prices for most of the year.

GDP growth in Sub-Saharan Africa (SSA) increased slightly in 2018, benefitting from an improved performance in Nigeria. Growth in SSA rose from 2.9 percent in 2017 to 3.0 percent in 2018 (Figure 2). Growth in Nigeria is estimated to have improved significantly from 0.8 percent in 2017 to 1.9 percent in 2018, driven by the recovery in oil production and favourable oil prices. Meanwhile, in South Africa, economic activity slowed by 0.6 percentage point to 0.8 percent growth in 2018 due to structural and socio-economic challenges. GDP shrank by 0.1 percentage point in Angola, the second largest exporter of oil in the region, despite favourable oil prices.

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



Source: IMF World Economic Outlook, April 2019

Going forward, global growth is projected to slow further in 2019 with an expected recovery in 2020. Global output growth is projected at 3.3 percent and 3.6 percent for 2019 and 2020, respectively. The projected slowdown in 2019 is driven mainly by an overall softening in economic activity ascribed partly to the negative effects of tariff increases enacted in the US and China, coupled with softer momentum in the second half of 2018. Growth in Emerging and Developing Europe is set to slow considerably in 2019 but to rebound strongly in 2020. Emerging and Developing Asia is projected to register a marginal improvement in growth during 2020 after a slight slowdown in 2019, whereas SSA is projected to improve its growth momentum throughout. The projected recovery in 2020 is therefore supported by strong growth in EMDEs, while AEs growth is expected to remain subdued.

Risks to the outlook remain. The key risks to the outlook stem from the outcome of trade negotiations as well as the state of financial conditions going forward. Global trade, output and investment remain under threat due to policy uncertainty as well as ongoing trade tensions between the US and China. Trade tensions involving China and the US may spread globally resulting in a simultaneous slowdown in both economies which could have severe effects on the global outlook. The possibility of financial stress could further weaken economic activity in EMDEs. Also, the fiscal space is particularly limited in countries with high foreign-currency-denominated debt.

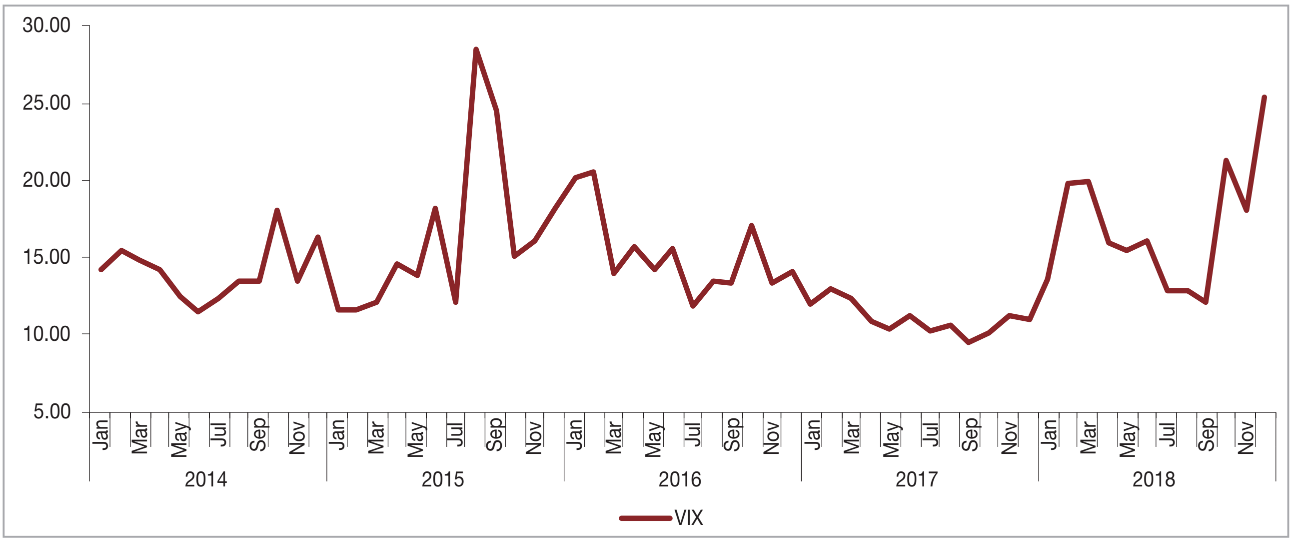
Developments in the Financial Markets

Advanced Economies

Financial markets sentiment weakened with high volatility in 2018, compared to 2017. The volatility index (VIX) of the Chicago Board Options Exchange increased to an average of 16.9 index points in 2018, from 11.1 index points in 2017. The VIX varied between 12.1 index points and 25.4 index points which was a larger range, compared to that of 2017, when it ranged between 9.6 index points and 12.9 index points (Figure 3). This is as a result of diminished optimism about earning prospects amid slower global growth and escalating trade tensions, while fears of a US government shutdown[6] further weighed on financial sector sentiment.

[6] On 22 December 2018, the US partial government shutdown began and lasted for 35 days. Furthermore, this was the longest government shutdown in the history of the US.

Figure 3: Volatility Index (VIX)



Source: Bloomberg

The fixed income market was characterised by a positive performance. A drop in sovereign yields and therefore an increase in prices was experienced during the period under review, notably for US Treasuries, UK gilts and German bunds. This was as a result of shifts in policy expectations with most central banks adopting a more cautious approach, as well as increasing risk aversion, coupled with deteriorating sentiment regarding growth prospects. US credit bond spreads widened, reflecting energy concerns owing to lower oil prices for part of the year and a general decline in financial markets optimism. In the Euro area, the Italian sovereign spreads, although remaining high, declined during most of 2018, from a mid-October 2017 peak. A softening trend was caused by the resolution of the budget standoff with the European Commission.

Global equity markets were volatile during the first three quarters of 2018 but volatility subsided in the fourth quarter. As a result, risk asset performance improved toward the end of 2018, owing to renewed optimism about trade negotiations between the United States and China, coupled with shifting perceptions about monetary policy normalisation. Furthermore, global equities recouped most of their 2018 losses, while credit spreads tightened significantly. The long-lasting credit cycle may be reaching its late stage in the United States and other advanced economies, therefore further impacting on investor sentiment despite the already present risk-on sentiment. In the Euro Area, fiscal challenges in Italy raised concerns regarding a sovereign-financial nexus, while in the United Kingdom financial assets continue to be affected by fears of a no-deal Brexit. During the late 2018 sell-off, emerging markets remained relatively resilient. Moreover, aggregate portfolio flows have been supported by a subsequent turnaround in global risk sentiment.

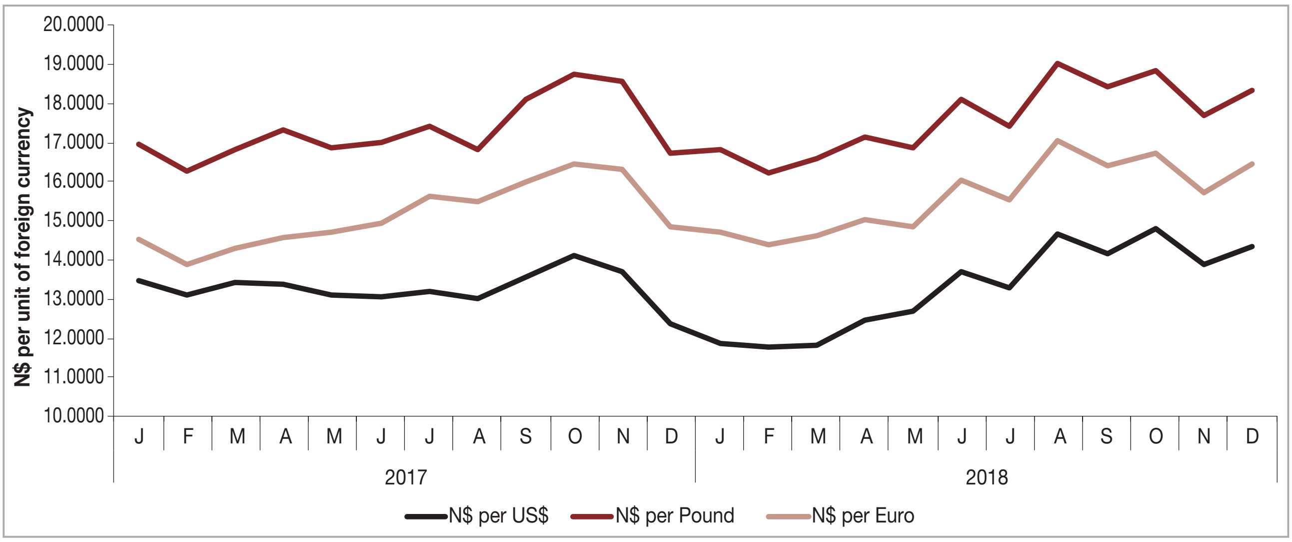
Emerging Market Economies

Financial market conditions in EMEs tightened modestly during the period under review. The factors that contributed to tightened financial markets included rising trade tensions and risk averse sentiment. Increases in policy rates in South Africa, Thailand, Mexico, Russia, Chile, Indonesia and the Philippines during the second half of 2018 which were spurred by concerns about inflationary effects from earlier oil price increases also contributed to tighter equity markets. Furthermore, in some cases, the effects of currency depreciation contributed to the hikes in policy rates. In the third quarter of 2018, EMEs experienced net capital outflows on the back of reduced exposure to riskier assets by investors.

Exchange Rate Developments

The Namibia Dollar depreciated against all major trading currencies during 2018. The Namibia Dollar depreciated by 15.9 percent against the US Dollar, 9.5 percent against the British Pound and by 10.8 percent against the Euro, when comparing the end of 2018 to the end of 2017 (Figure 4). The depreciation of the Namibia Dollar against all these currencies was attributed to base effects as well as investors reducing their exposure to riskier EME assets.

Figure 4: Currency movement of the Namibia Dollar against selected currencies



Source: Bloomberg

Monetary Policy Stance in South Africa

The South Africa Reserve Bank (SARB) Monetary Policy Committee (MPC) changed the repo rate twice during the period under review. At the March 2018 meeting the MPC reduced the repo rate by 25 basis points from 6.75 percent to 6.50 percent. The reduction in the repo rate was on the back of an improved inflation outlook as well as a moderation in the risks to the outlook. However, at the November 2018 meeting, the MPC decided to increase the repo rate by 25 basis points, back to 6.75 percent. The MPC noted that although within the target range, the inflation trajectory was rising and deviating from the mid-point. The annual inflation rate declined to an average of 4.6 percent in 2018, from 5.3 percent in 2017 (Table 1). Risks to the longer-term inflation outlook were assessed to be on the upside and included a weaker exchange rate, higher wage growth, rising electricity and water tariffs as well as increases in international oil prices.

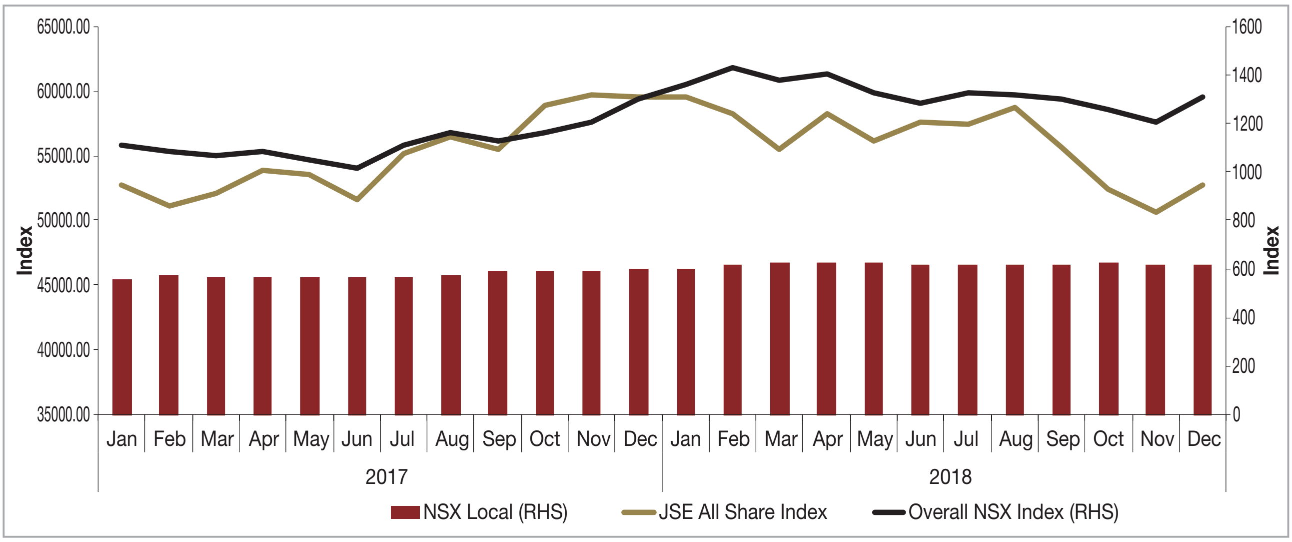
Table 1: South Africa's Consumer Price Index and Annual Inflation Rate (Dec. 2016=100)

2017	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
INDEX	100.6	101.7	102.3	102.4	102.7	102.9	103.2	103.3	103.8	104.1	104.2	104.7	103.0
RATE (%)	6.6	6.3	6.1	5.3	5.4	5.1	4.6	4.8	5.1	4.8	4.6	4.7	5.3
2018	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Avg**
INDEX	105.0	105.8	106.2	107.0	107.2	107.6	108.5	108.4	108.9	109.4	109.6	109.4	107.8
RATE (%)	4.4	4.0	3.8	4.5	4.4	4.6	5.1	4.9	4.9	5.1	5.2	4.5	4.6

Source: Statistics South Africa

The outlook for monetary policy in South Africa is expected to influence financial stability in Namibia. At the November 2018 meeting, the SARB MPC reaffirmed its monetary policy stance to be accommodative with a continued focus on anchoring inflation expectations near the mid-point of the inflation target range in the interest of balanced and sustainable growth. The main factors expected to underpin the SARB's monetary policy stance are the risks to the inflation outlook as well as inflation expectations; and the exchange rate path of the Rand against major trading currencies.

Figure 5: The JSE and NSX performance



Source: Bloomberg

The Namibia Stock Exchange (NSX) Local and Overall Indices improved during the first few months of 2018, followed by a slight decline, while the Johannesburg Stock Exchange (JSE) All Share Index (ALSI) moved broadly sideways during the first half of 2018 with a sharp downward trend during the second half of 2018. The NSX Overall Index and the Local Index rose during 2018, compared to the same period of 2017. The Overall Index rose by 8.3 percent over the year to the end of 2018, driven by a rise in the prices of shares in the consumer goods and basic materials sectors. Similarly, the Local Index rose to close at 621.48 Index points at the end of 2018 (Figure 5). This represents an increase of 5.1 percent, compared to 2017.

Domestic Economy

Output

Economic growth in Namibia continued to contract in 2018, although to a lesser extent than in 2017 and is expected to recover gradually during 2019 and 2020. Real GDP contracted by 0.1 percent in 2018, from a slightly deeper contraction of 0.9 percent in 2017, as the strong performance of the primary sector in 2018 was broadly offset by contractions in the secondary and tertiary sectors. Going forward, the domestic economy is projected to grow by 0.3 percent and 1.9 percent in 2019 and 2020, respectively, which is a recovery from a contraction of 0.1 percent in 2018, according to NSA's preliminary estimates. The projected recovery during 2019 will mainly be supported by expected improvements in the construction and hotels and restaurants sectors. Furthermore, a smaller contraction of the wholesale and retail trade sector is anticipated to reduce the drag on overall growth when compared to the last two years.

Risks to the domestic economic outlook remain and include, the persistently low uranium price and unpredictable rainfall. The low uranium price continues to negatively impact the prospects on expected uranium production in the country, while the erratic rainfall may continue to adversely affect the performance of the agriculture sector in 2019 and beyond. Furthermore, the China/US trade tensions may negatively affect the demand for Namibian minerals.

Inflation

Namibia's average inflation rate declined in 2018, compared to 2017, mainly due to a significant reduction in housing inflation, coupled with that of the food and non-alcoholic beverages category. The overall inflation rate in Namibia slowed to an average of 4.3 percent in 2018, compared to 6.2 percent in 2017. The inflation categories of housing and food and non-alcoholic beverages contributed to this reduction. Housing inflation slowed by 5.6 percentage points to 3.5 percent during 2018. The slowdown in housing inflation was due to a decline in most of the sub-categories of housing, especially the rental payments for dwellings, which decreased significantly by 7.0 percentage points to 2.6 percent. Inflation for food and non-alcoholic beverages decelerated by 2.5 percentage points to 3.2 percent during 2018. The decline was reflected in most of the subcategories, with the exception of bread and cereal, fruits, and vegetables, which registered higher inflation. This was ascribed to the improved rainfall and a somewhat stronger exchange rate.

BOX 1: IMPACT OF ECONOMIC SLOWDOWN ON FINANCIAL STABILITY

The Namibian economy has been in a prolonged recession since June 2016. *In this regard, real GDP growth contracted for 11 consecutive quarters, since the second quarter of 2016. During this time, the domestic economy was constrained by various factors, structural impediments, tighter financial conditions, as well as the introduction of fiscal consolidation measures. As the tough economic conditions persist, key sectors slowed significantly, while some sectors reported positive growth since the beginning of the recession.*

The primary industry performed fairly well since June 2016 on the back of improved diamond production, coupled with capital injections into the mining and quarrying sector. *The primary industry performed fairly well since the start of the recession, recovering from a contraction of 5.2 percent in 2015, to positive growth of 11.4 percent and 12.9 percent in 2017 and 2018, respectively. The good performance of the industry was largely ascribed to growth in the* mining and quarrying sector *from a contraction of 3.2 percent in 2016 to growth of 13.3 percent and 22.0 percent in 2017 and 2018, respectively. The positive growth was as a result of improved diamond production, production by a new uranium mine, as well as capital injections into the sector. These developments are an indication of positive sentiment in the industry going forward. Agricultural fortunes were however mixed, partly related to climate swings.*

Annual growth in the secondary industry slowed significantly as a result of reduced activity in the construction sector, while the manufacturing sector grew slightly since 2016. *The secondary industry contracted during 2016 from a positive growth rate of 6.8 percent in 2015, to -6.3 percent and -6.7 percent in 2016 and 2017, respectively. Reduced activity in the construction sector drove the slowed growth as major projects in both the private and public sector reached completion. During 2018, the construction sector is estimated to have contracted, less severely than in 2017, to reach -18.3 percent, following an even stronger contraction of -25.6 percent in 2017. On the contrary, manufacturing* has recorded *improved growth from 2016 to date, compared to a contraction in 2015 on the back of an increase in the supply of rough diamonds which led to more diamonds being processed in that sector.*

The tertiary industry slowed considerably since the start of the recession during the second quarter of 2016*.* *The tertiary industry is by far the largest contributor to GDP, contributing an average of 58 percent to GDP during the period 2007 to 2018. Once the recession became eminent in 2016, the* wholesale and retail trade *sector began slowing and contracted by 7.9 percent and 7.2 percent in 2017 and 2018, respectively. These developments, coupled with fiscal consolidation measures, caused reduced growth in other sectors such as the* public administration and defence *sector as well as other* businesses services *sector. Other major sectors such as the transport and communications sector and the financial intermediation sector continued to grow although their growth was significantly reduced since 2016.*

On the monetary front, annual growth in Private Sector Credit Extension (PSCE) has decreased significantly since 2016. *Annual growth in PSCE slowed significantly from 13.5 percent in 2015 to 8.9 percent in 2016. During 2017, PSCE further slowed to 5.1 percent, although increasing slightly in 2018 to reach 6.7 percent. The slower growth in credit can be ascribed to the lower demand in all major categories as a result of stricter lending requirements by financial institutions,the negative impact of fiscal consolidation measures on the private sector, and reduced confidence in the domestic economy. Considering inflation, real PSCE also slowed and contracted at the end of 2017, although recovering to positive growth in 2018. From a financial stability perspective, a slowdown in credit is not always negative as not all credit categories promote economic growth. For example, vehicle sales and housing price increases were high prior to 2016, hence additional regulations were introduced to curb the growth of installment sales credit and speculative mortgage credit, respectively. Furthermore, credit levels that are too low indicate low levels of activity in the economy which negatively affect economic growth. The current PSCE levels are not considered a risk for financial stability. Nevertheless, should the recession persist and significantly affect the income of the borrowers, rendering them unable to service their loans, this may increase the default risk and thereby reduce the willingness of banking institutions to lend funds.*

Table 1: GDP by activity (annual percentage change)

	2014	2015	2016	2017	2018
Primary industry	-1.6	-5.2	0.1	11.4	12.9
Secondary industry	10.9	6.8	-6.3	-6.7	-3.4
Tertiary industry	7.7	7.9	3.6	-1.6	-2.4
GDP at market prices	16.4	6.1	1.1	-0.9	-0.1
Private Sector Credit Extension (PSCE)	6.4	13.5	8.9	5.1	6.7

Source: Bank of Namibia

Although the economy is still contracting, the outlook going forward is moderately positive. *Although this is the longest recession in Namibia's post independence history, it is important to note that there are some major industries such as the mining and quarrying as well as the manufacturing sectors which are still growing. Furthermore, even sectors which have been significantly affected by the recession such as construction are beginning to recover which is a positive sign for the economy. Although the current economic conditions are still poor, the outlook is anticipated to be more positive as GDP is estimated to improve slightly in 2019 and going forward.*

IV. DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

Household Debt to Disposable Income

The level of household indebtedness rose slightly in 2018, compared to 2017, as a result of increased demand for short term credit facilities. The annual growth in household indebtedness rose marginally to 7.0 percent in 2018 from 6.7 percent in 2017. The slight rise in household indebtedness was most evident in the growth in *other loans and advances* category which rose by 1.0 percentage point to reach 18.6 percent at the end of 2018. Similarly, growth in *overdrafts* accelerated by 0.7 percentage point to reach 4.2 percent in 2018 which further supported the higher growth rate in household indebtedness. The categories which drove the higher growth in 2018 are an indication of the increased demand for short term credit facilities. An increase in these credit categories may be a sign of strain on the cash flow of households, which is expected considering the current economic conditions. On the other hand, all other major credit categories, including mortgage credit, slowed during the period under review. Pertaining specifically to credit extended to households, the risk to financial stability remains relatively flat.

Table 2: Household Debt-to-Disposable-Income

	2014	2015	2016	2017	2018
Disposable Income (N$ million)	53070	58466	65766	68538	74347
Credit to Disposable Income (%)	76.7	78.4	76.1	77.9	76.9
Credit to Individuals/Households (N$ million)	40698	45810	50054	53420	57170
Adjusted Credit* to Households (N$ million)	45378	51078	55811	59563	63745
Adjusted Credit** % of Disposable Income	95.3	97.3	94.5	96.8	95.5

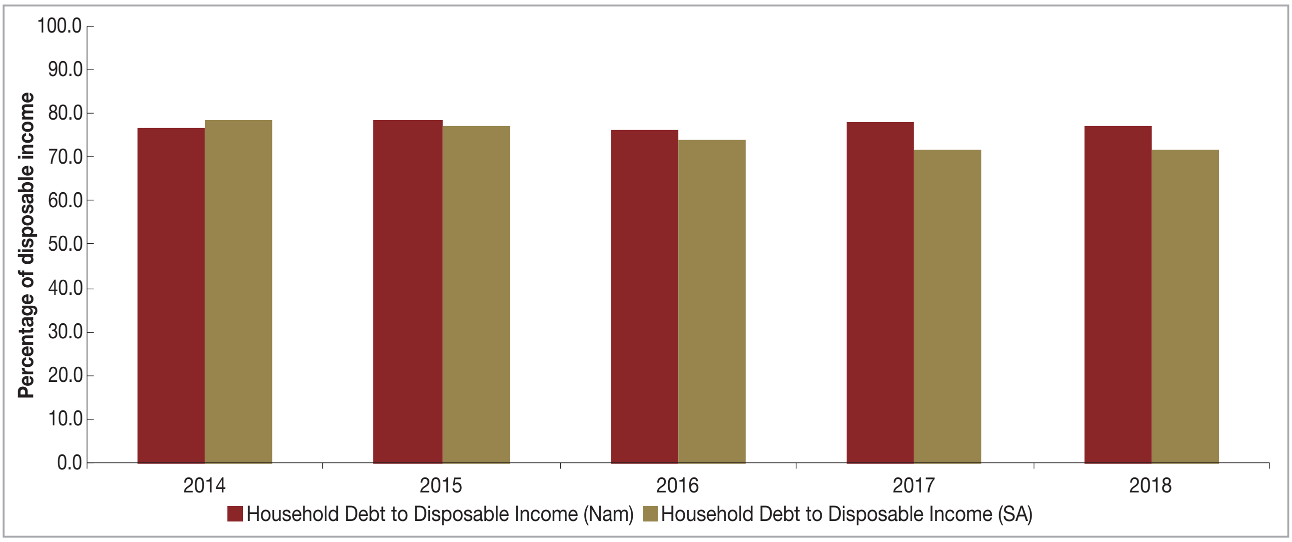
*The ratio of household debt to disposable income is calculated based on income and tax data from the national budget documents, national accounts, and household debt data from the Bank of Namibia. The National Accounts were revised from 2007 to 2017, resulting in changes in the household disposable income data, which were published in the April 2018 FSR.
**This category includes credit extended to households by both the banking and non-banking financial institutions.

Source: Bank of Namibia

While still remaining high, the ratio of household indebtedness to disposable income moderated on the back of relatively faster growth in nominal disposable income. Household debt relative to disposable income moderated from 96.8 percent in 2017 to 95.5 percent in 2018, despite an increase in credit extended to individuals (Table 2). The ratio of household indebtedness to disposable income slowed due to disposable income rising at a faster pace, compared to household indebtedness. While credit extended to individuals rose by 7.0 percent in 2018 compared to 6.7 percent in 2017, disposable income rose by 8.5 percent, compared to 4.2 percent in 2017. This has resulted in the slight improvement in the debt ratio. A lower ratio does not necessarily point to reduced household indebtedness nor to subdued demand for credit by individuals, but is an indication of the change in credit relative to disposable income. As the increase in disposable income was faster than the growth in household credit in 2018, the ratio improved. A lower ratio is positive for the stability of the financial system.

In line with previous trends, the unadjusted ratio of household debt to disposable income of Namibia was higher than that of South Africa at the end of 2018. The unadjusted household debt to disposable income for Namibia was 76.9 percent during 2018, which is 5.0 percentage points higher than in South Africa at 71.9 percent, during the period under review[7] (Figure 6).

Figure 6: Household debt to Disposable income (Namibia & South Africa)

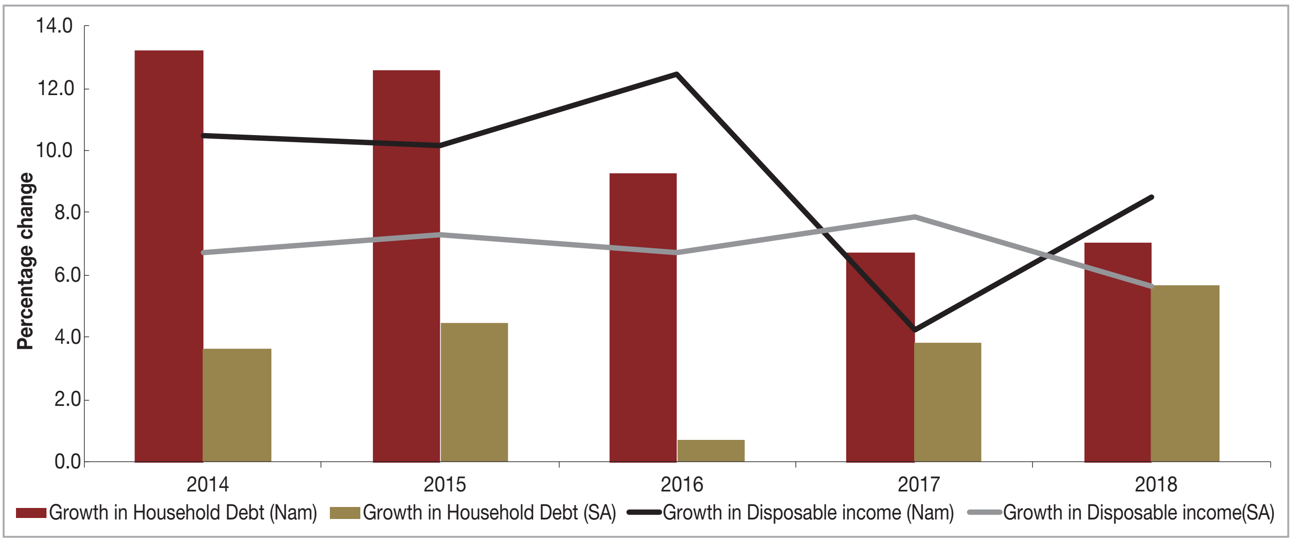


Source: Bank of Namibia and South African Reserve Bank

The annual growth of household disposable income rose in 2018. Since the last FSR, annual growth in nominal household disposable income rose significantly to 8.5 percent in 2018 from 4.2 percent in 2017. The higher level of household disposable income could be attributed to more government transfers, employee compensation, as well as foreign income received by individuals during 2018. In contrast, the growth in nominal disposable income of households in South Africa decreased by 2.2 percentage points to reach 5.6 percent in 2018 (Figure 7).

[7] The unadjusted household debt to disposable income ratio does not consider debt of the informal sector and microlenders.

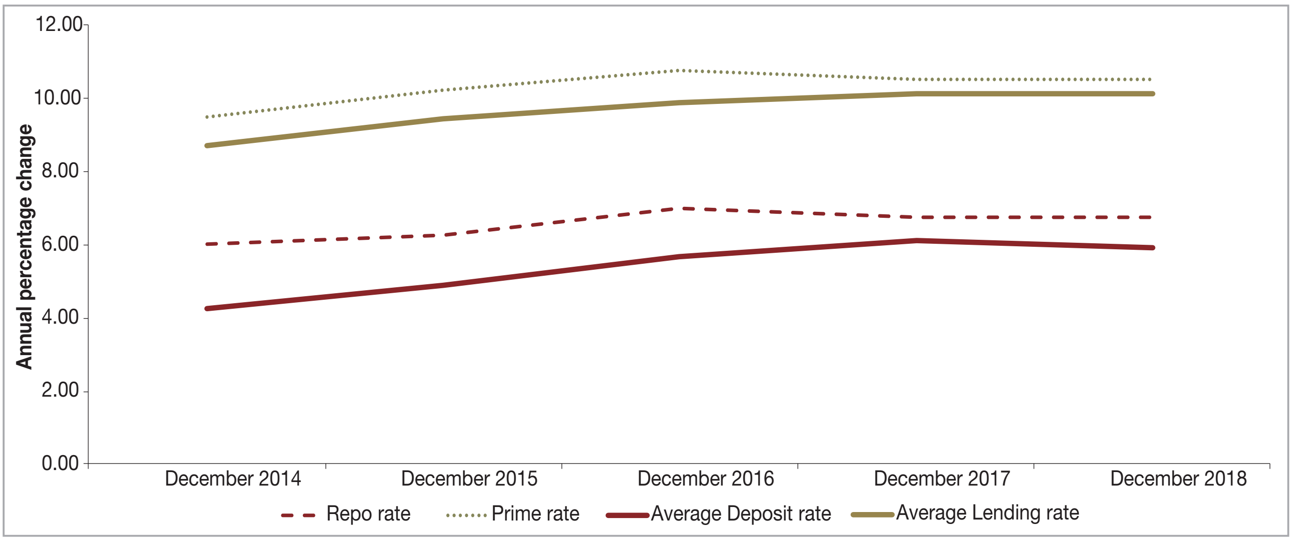
Figure 7: Growth in household debt and disposable income



Source: Bank of Namibia and South African Reserve Bank

The Bank of Namibia policy rate remained unchanged during 2018. The Bank of Namibia maintained the repo rate at 6.75 percent during the period under review to support both domestic growth and maintain the one-to-one exchange rate peg between the Namibia Dollar and the South African Rand. Average lending rates increased marginally from 10.12 percent in 2017 to 10.19 percent in 2018, while deposit rates decreased from 6.11 percent in 2017 to 5.57 percent in 2018 (Figure 8). The decrease in deposit rates was driven by improved liquidity in 2018, compared to 2017. The improved liquidity in 2018 was partly due to the return of funds from outside markets by institutional investors, coupled with low demand for credit.

Figure 8: Selected Interest Rates



Source: Bank of Namibia

Debt Servicing Ratio

The debt servicing to disposable income ratio moderated slightly during 2018. The debt servicing to disposable income ratio declined by 0.50 percentage point to reach 15.2 percent at the end of 2018 (Table 3). The weak economic conditions continued to add further downward pressure on the ratio as consumers were finding it increasingly difficult to service debt. This was further supported by the increase in the non-performing loans ratio recorded in the banking sector, during the period under review. Consumers reacted by inter alia purchasing less durable goods and encuring less installment sales credit, thereby reducing the debt servicing pressures.

Table 3: 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
2014	11.4	10.5	15.9	13.2	15.3	19.4	9.00
2015	9.6	10.2	13.7	13.7	15.7	20.2	10.00
2016	8.8	12.5	11.3	14.0	15.6	20.6	10.75
2017	4.6	4.2	4.9	14.1	15.7	20.7	10.50
2018	7.7	8.5	5.1	13.7	15.2	20.2	10.50

Source: Bank of Namibia

Corporate Debt

Since the last FSR, the total corporate sector debt stock increased, driven mainly by a rise in foreign debt. Total corporate sector debt rose by 12.2 percent to N$126.4 billion, from N$112.7 billion in 2017. Growth in corporate debt was underpinned by an increase in foreign debt, coupled with a slight increase in domestic debt. Foreign debt increased by N$12.3 billion, while domestic debt rose by N$1.4 billion during 2018 (Table 4). The increase in foreign debt was mainly due to increases in intercompany lending to resident companies in the mining sector from their foreign holding company, and is an indication of positive sentiment in the market and long-term commitment.

The corporate sector debt-to-GDP ratio increased during 2018. The corporate sector debt-to-GDP ratio stood at 67.7 percent at the end of 2018, compared to 63.9 percent at the end of 2017 (Table 4). The higher ratio was caused by corporate debt growing faster than GDP, although it was specifically linked to an increase in foreign direct investment (FDI) in the mining sector. The increase in corporate sector indebtedness is unlikely to pose a risk to financial system stability in Namibia given that it is linked to expansion in production which will be positive for economic growth and exports. Foreign debt does, however, come with an exchange rate risk which needs to be closely monitored to ensure financial stability.

Total debt of State-Owned Enterprises (SOEs) increased slightly during 2018. Total debt of SOEs stood at N$11.8 billion at the end of 2018, N$300 million more than reported in the previous FSR (Table 4). The increase in total debt of SOEs was driven by an increase in foreign debt taken up by SOEs which grew by N$1.2 billion to reach N$10.4 billion. The increase in foreign debt of SOEs was mainly driven by an increase in long term loans taken up by the transport sector.

The stock of corporate bonds issued increased during 2018. The value of corporate debt stock issued to the public increased by 17.9 percent to N$9.2 billion at the end of 2018, from N$7.8 billion in 2017. Both commercial banks and SOEs issued new bonds during 2018. Commercial banks issued bonds worth N$ 926 million, while the Development Bank of Namibia issued a N$500 million bond during 2018. Corporate debt stock at the end of 2018 comprised of N$7.2 billion of commercial banks stocks, N$1.7 billion of SOEs stocks, and N$309 million of non-bank corporates stocks.

Table 4: Domestic and External Corporate Debt (Private Sector and Parastatals)

N$ million	2014	2015	2016	2017	2018
Domestic debt (N$ million)	**28,350**	**34,482**	**37,198**	**38,577**	**39,999**
Local Private Sector Debt	27,551	32,584	35,343	36,300	38,656
Local Debt of SOEs	799	1,899	1,855	2,277	1,343
Foreign debt (N$ million)	**49,813**	**54,803**	**62,024**	**74,100**	**86,414**
Foreign Private Sector Debt	46,285	50,153	57,273	64,910	75,982
Foreign Debt of SOEs	3,528	4,650	4,751	9,190	10,432
Total Debt (N$ million)	**78,163**	**89,286**	**99,222**	**112,677**	**126,413**
Nominal GDP (N$ million)	138,763	150,083	165,934	176,445	186,807*
Y-o-Y Change in % in Total Debt	30.5	14.2	11.1	13.6	12.2
Y-o-Y Change in % in GDP	13.0	8.2	10.6	6.3	5.9
Corporate Debt to GDP (%)	56.3	59.5	59.8	63.9	67.7
Foreign Debt to Total Debt (%)	63.7	61.4	62.5	65.8	68.4
Local Debt to Total Debt (%)	36.3	38.6	37.5	34.2	31.6

Source: Bank of Namibia, *estimate

Total foreign private sector debt servicing increased significantly during the period under review. Foreign debt service cost increased by 20.5 percent to N$14.6 billion in 2018 from N$12.1 billion in 2017. This was mainly due to the servicing of intercompany debt of about N$2.6 billion as well as the repayment of long-term debt by companies in the financial sector estimated at N$918.0 million (Table 5). All other industries reduced their debt repayments during the period under review, which is expected considering the current economic conditions.

Table 5: Foreign Private Sector Debt and Debt Servicing

N$ million	2014	2015	2016	2017	2018
Total Foreign Private Sector Debt	46,285	50,153	57,273	64,910	75,982
Total Foreign Private Sector Debt Servicing	6,301	21,170	21,233	12,085	14,563

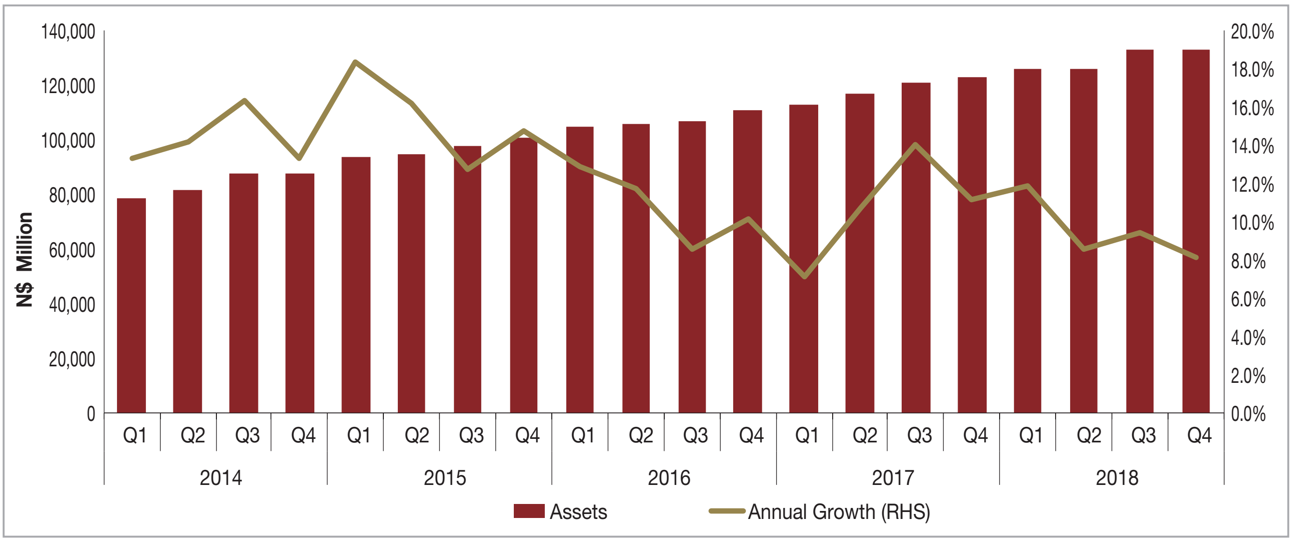
Source: Bank of Namibia

V. PERFORMANCE OF THE BANKING SECTOR

Banking Sector Asset Growth

Banking sector total assets continued to grow; however, the growth rate slowed in 2018, compared to 2017. The banking sector continued to record asset growth irrespective of current sluggish economic conditions although it was more prevalent in short term securities and other liquid assets. The increase in assets was concentrated in net loans and advances, short-term negotiable securities and cash and balances with banks. Net loans and advances increased from N$90.3 billion in 2017 to N$95.4 billion in 2018, while short-term negotiable instruments increased sharply from N$11.8 billion in 2017 to N$15.4 billion in 2018, with cash and balances increasing by N$305 million to N$12.3 billion in 2018. Although asset growth slowed to 8.1 percent in 2018 from 11.1 percent in 2017, the growth rate remained positive, coupled with a balance sheet worth N$132 billion, as at 31 December 2018, compared to N$122 billion as at 31 December 2017 (Figure 9). The growth of banking sector assets signifies a healthy and stable banking sector amid subdued economic activity.

Figure 9: Banking sector asset growth

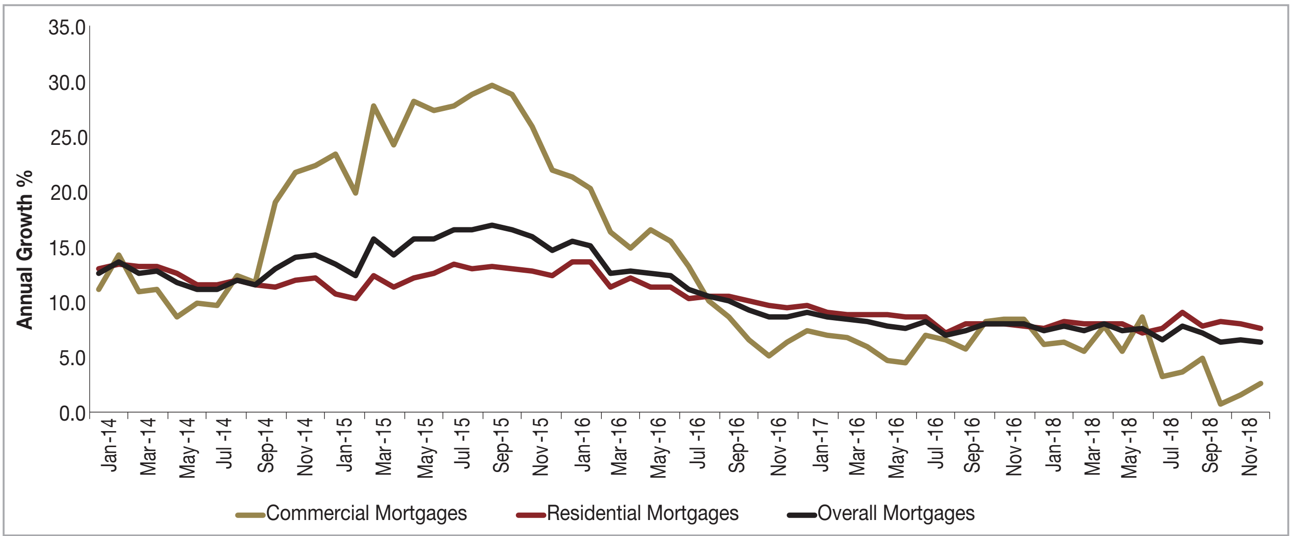


Source: Bank of Namibia

During 2018, overall mortgage loan growth slowed significantly as recessionary conditions persisted. The overall mortgage growth slowed to 6.5 percent as at December 2018, compared to 8.0 percent for the same period of the previous year. Growth in commercial mortgages declined by 5.9 percentage points, from 8.5 percent in December

2017 to 2.6 percent in December 2018. Residential mortgages growth, on the other hand, declined very marginally, from 7.8 percent during December 2017 to 7.7 percent during December 2018 (Figure 10).

Figure 10: Mortgage loans growth



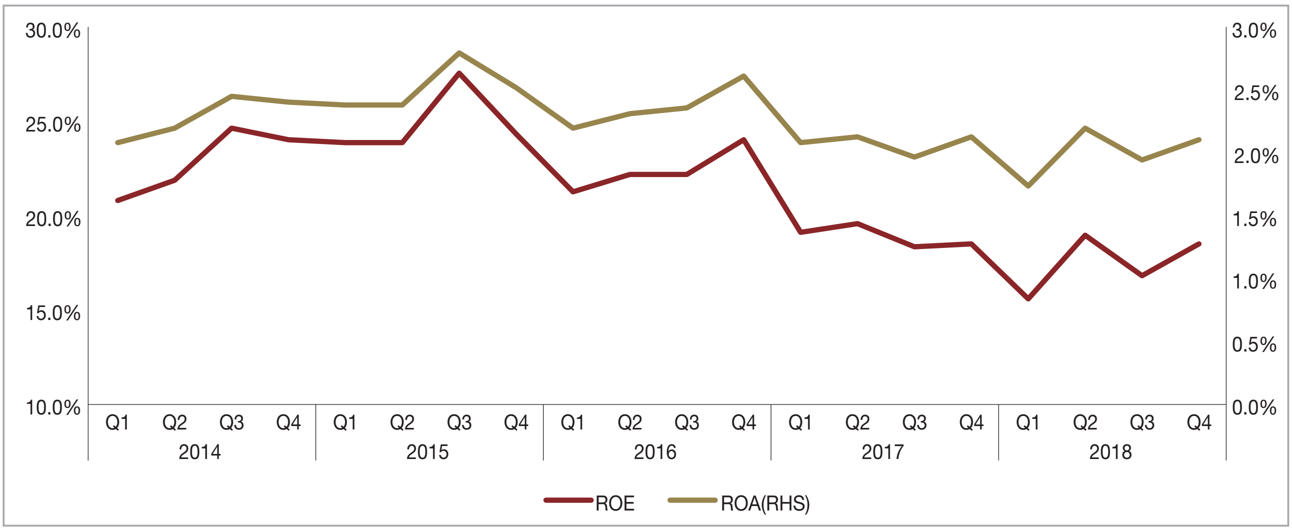
Source: Bank of Namibia

Profitability of the Banking Sector

The banking sector remained profitable during 2018, owing largely to growth in total income. Total income increased from N$8.9 billion in 2017 to N$9.6 billion in 2018. Net interest income, which represented more than 50 percent of total income, increased by N$269 million to N$5.4 billion, coupled with a favourable increase of N$448 million in operating income, to N$4.2 billion in 2018. Even though operating expenses grew by 10.3 percent during 2018, mainly due to staff costs, the banking sector still recorded a growth in net-income after tax for the year ending 31 December 2018. Both the Return on Equity (ROE) and the Return on Assets (ROA) declined marginally, with the ROE declining to 18.5 percent in 2018 from 18.6 percent in 2017, and the ROA declining to 2.0 percent[8] in 2018 from 2.1 percent in 2017 (Figure 11). The increase in net income after tax was however outpaced by the growth in total equity which consequently led to the decline in the ROE ratio. The only marginal declines in the ROE and ROA as well as positive growth in net income after tax, during unfavourable economic conditions, signals an overall healthy and profitable banking sector, which therefore poses no real threat to financial stability.

[8] Income after tax figures were used to compute the ROE and ROA ratios. As per the IMF Financial Stability Indicators Manual, using before tax figures arrives at a ROE and ROA of 29.9 percent and 3.3 percent in 2017, down to a ROE of 25.0 percent in 2018, while the ROA moderated slightly, recording 2.9 percent during 2018. Despite the difference in methodologies, the direction of the movement remained consistent.

Figure 11: Profitability of the banking sector[9]

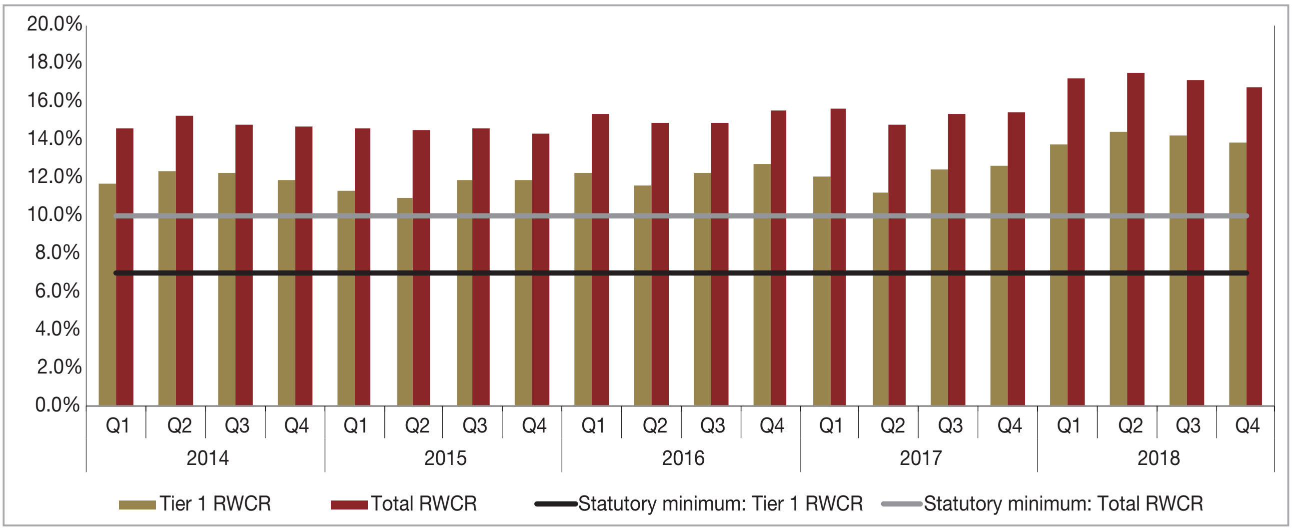


Source: Bank of Namibia

Adequacy of Capital

The banking sector remained well capitalized throughout 2018, with capital well above the minimum statutory requirement. The total risk-weighted capital ratio (RWCR) as well as the Tier 1 RWCR stood well above their minimum regulatory requirements of 10.0 percent and 7.0 percent, respectively. Furthermore, maintaining adequate capital levels insulates banks against potential losses, while also covering the risks associated with banking business. Total RWCR and the Tier 1 RWCR both increased during the period under review, as a result of higher general reserves and retained earnings which increased by N$740.1 million and N$567.7 million, respectively. The total RWCR improved from 15.5 percent in 2017 to 16.7 percent in 2018, while the Tier 1 RWCR increased from 12.6 percent in 2017 to 13.8 percent in 2018 (Figure 12).

Figure 12: Capital adequacy



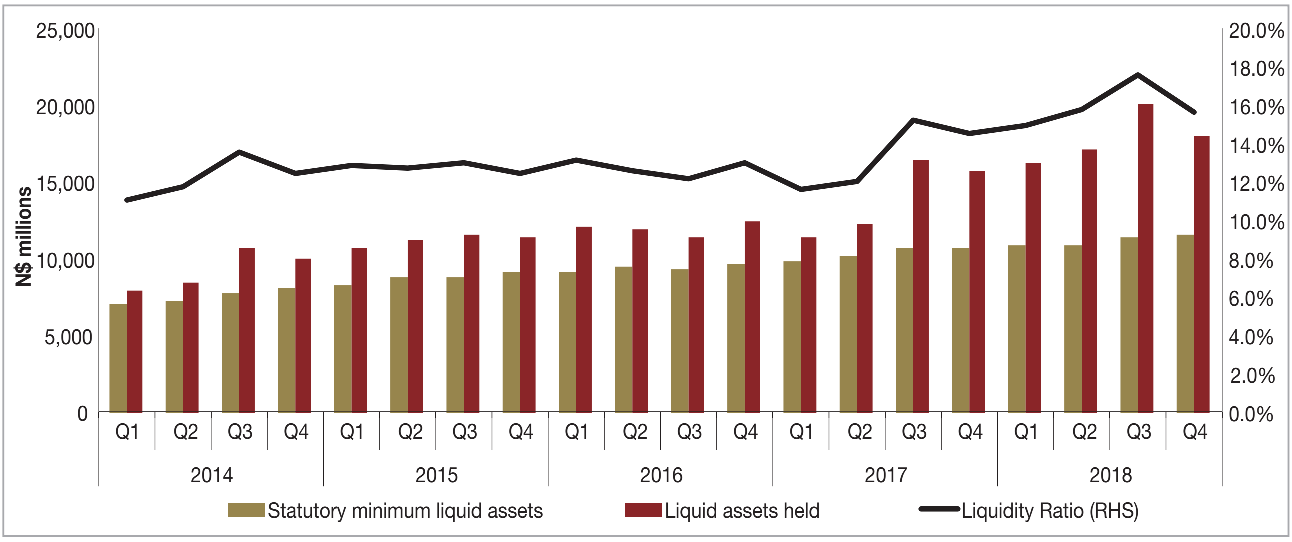
Source: Bank of Namibia

[9] Based on after-tax profits.

Liquidity Position

The liquidity position of the banking sector improved during the period under review. The liquid asset holdings of the banking sector grew from 14.6 percent of liabilities in 2017 to 15.6 percent in 2018, while remaining well above the statutory minimum requirement of 10 percent. The banks are required to keep 10 percent of the average total liabilities to the public as liquid assets. Liquid assets held stood at N$18.1 billion in 2018, compared to N$15.7 billion in 2017. The liquid assets held significantly exceeded the statutory required minimum of N$11.6 billion, recording a surplus of N$6.5 billion (Figure 13). The liquidity position in 2018 has therefore been the most favourable over the past three years. The upsurge in liquidity was as a result of various factors, including diamond sales in some months, subdued demand and appetite for credit, as well as the gradual compliance with recent adjustments to Regulations 8, 15 and 28[10] which apply to institutional investors, requiring them to hold an increased proportion of their assets locally.

Figure 13: Liquidity of the banking sector



Source: Bank of Namibia

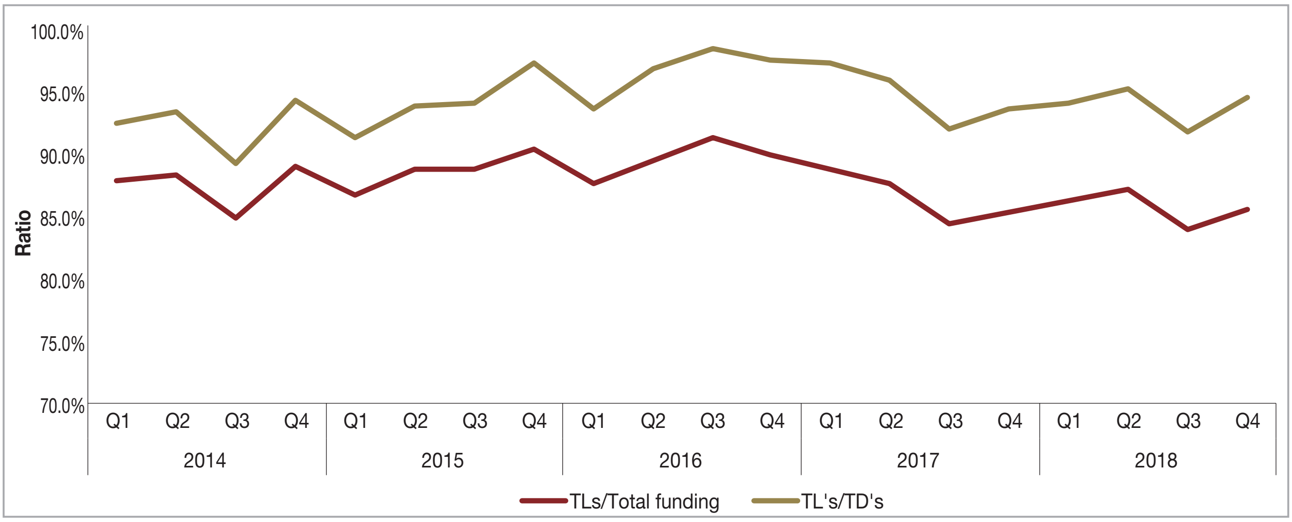
[10] Amendments to Regulation 8 of the Short-term insurance Act, Regulation 15 of the Long-term Insurance Act and 28 of the Pension Fund Act, are underway to raise the Domestic Asset Requirement from 35 percent to 45 percent.

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

The loan-to-deposit ratio, which is a key liquidity indicator, increased marginally during the period under review. The LTD ratio for the banking sector picked up marginally from 93.5 percent in 2017 to 94.6 percent in 2018 (Figure 14). Although there is no set benchmark for the LTD ratio, it remained below 100 percent which is indicative of a sufficient deposit base to fund lending activities within the banking sector. On average, for every dollar in deposits received by the banks, the banks lend 95 cents. Moreover, the banks have made relatively more use of deposits to fund their loans and advances as opposed to other more expensive funding sources such as debt and capital.

The banking sector Loan-to-Funding Ratio (LFR) similarly increased slightly. The LFR increased slightly to 85.5 percent in 2018 from 85.4 percent in 2017 (Figure 14). This ratio implies that, on average, 85 percent of the banks' funding has been extended as loans and advances, therefore 15 percent of total funding, coupled with capital and equity was available to be used on liquid and other assets. Funding comprises of deposits plus loans received, excluding capital and reserves.

Figure 14: Loan-to-deposit (LTD) and Loan-to-Funding (LTF) Ratio



Source: Bank of Namibia

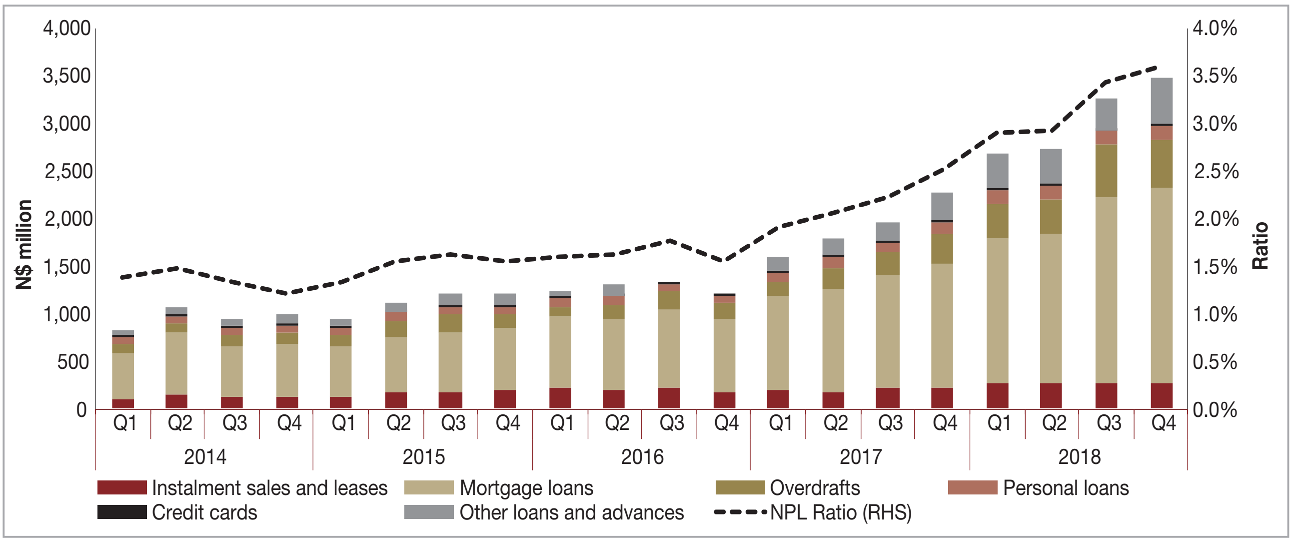
Establishment of a Deposit Guarantee Scheme in Namibia

Considerable progress has been made with the establishment of a Namibia Deposit Guarantee Scheme. This scheme will support financial stability by guaranteeing the repayment of smaller deposits held with banks in the event of a bank failure. The Namibia Deposit Guarantee Act (No. 16 of 2018) was gazetted on 28 December 2018. The Scheme will be administered by the Bank of Namibia and is due to be operationalized during the course of 2019. It will be funded by deposit guarantee premiums collected from the banks. Although the Scheme will only cover a small portion of total deposits by value, it will make a positive contribution towards financial stability, giving peace of mind to smaller depositors in times trouble.

Asset Quality

The asset quality of the banking sector deteriorated further during 2018, owing to weak domestic economic activity. The non-performing loans (NPL) ratio of total loans increased significantly, from 2.5 percent as at December 2017 to 3.6 percent in 2018 (Figure 15), despite the low interest rate environment. Although the NPL ratio remained below the 4 percent benchmark as well as below the historical highest of 5.6 percent, it has been the highest recorded over the past 5 years. Moreover, prevailing recessionary conditions contributed to the growth in credit risk stemming from the non-performance of the loan book. Non-performing loans increased by 52.8 percent during 2018, from N$2.3 billion in 2017, with all the loan product categories represented in the increase in the NPLs. Irrespective of the growth in NPLs, the banking sector remained well capitalised, liquid and profitable with sufficient provisions in place to cushion against any potential losses. The write-off rate relative to loans and profits declined during 2018, compared to 2017, coming in at 0.06 percent and 7.51 percent, respectively. These low write-off rates confirm that a rise in NPLs does not automatically translate into an increase in loans written off and losses to banks.

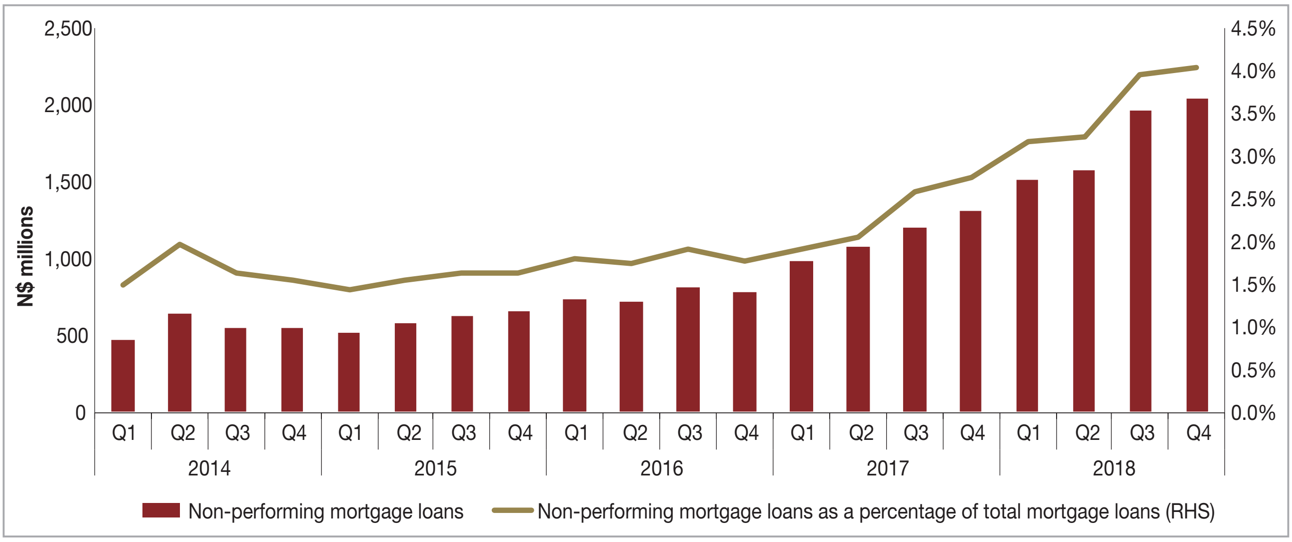
Figure 15: Non-performing loans as a percentage of total loans



Source: Bank of Namibia

The growth in the non-performing loans (NPLs) ratio was mainly driven by an increase in the share of NPL's recorded for mortgages, overdrafts and other loans and advances, during the period under review. Among the loan categories, mortgages have the largest share of total NPLs comprising of 58.8 percent (Figure 16), with overdrafts at 15.2 percent, other loans and advances at 13.6 percent, instalment sales at 7.7 percent, while personal loans and credit cards take up 4.1 and 0.7 percent, respectively, during the period under review. The general economic slowdown has had an impact on household disposable income and businesses with potential implications for loan repayments, therefore impacting on NPLs.

Figure 16: Non-performing mortgage loans as percentage of total mortgage loans



Source: Bank of Namibia

Large Exposures

The banking sector's large exposures[11] declined since 2017 in all sectors except the fishing sector. The value of the total large exposures decreased from N$18.7 billion in 2017 to N$15.3 billion at the end of 2018. On an annual basis, the value of total large exposures declined by 17.9 percent during 2018, compared to an increase of 22.6 percent in the previous year (Figure 17a). These developments were driven by lower exposures in the *manufacturing, mining and minerals, property* and *construction sectors*. The *transport and logistics*, as well as the *other* sector further supported the subdued exposures, reducing the exposure to these sectors by 100 percent and 13.2 percent, respectively, on an annual basis. The slowdown in large exposures may be ascribed to more stringent market lending practices, as well as disintermediation and large repayments made mainly by the private

[11] A large exposure is an exposure that exceeds 10% of a bank's capital fund.

sector. On the contrary, large exposures to the fishing sector increased by 93.8 percent in 2018 to reach N$898 million. Although this is a significant increase for the sector, the fishing sector only constitutes 5.9 percent of the total value of large exposures and therefore does not have a significant impact on the total value of large exposures.

The sectoral composition of large exposures has shifted slightly, although remaining adequately diversified across sectors, during 2018. Large exposures to the *fishing sector* and *other* sector grew by 3.4 percentage points and 13.8 percentage points to reach 5.9 percent and 50.3 percent, respectively at the end of 2018. The significant increase in both these sectors is due to new entities meeting the large exposure criteria in 2018, specifically financial institutions in the other category (Figure 17b). The *manufacturing, mining* and *minerals* as well as the *property and construction* categories all reduced their shares of total large exposures marginally to 19.5 percent, 12.5 percent and 11.8 percent, respectively during 2018. The banking sector's large exposures remain adequately diversified and pose minimal concentration risk to the financial system.

Figure 17a: Banking sector large exposures and growth rate

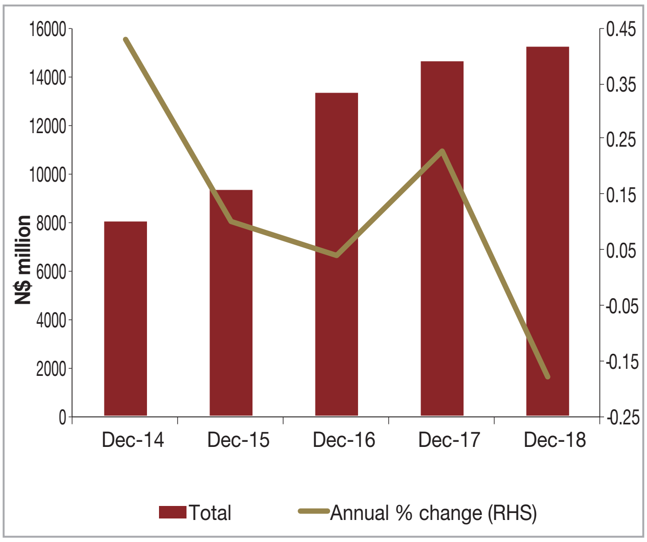
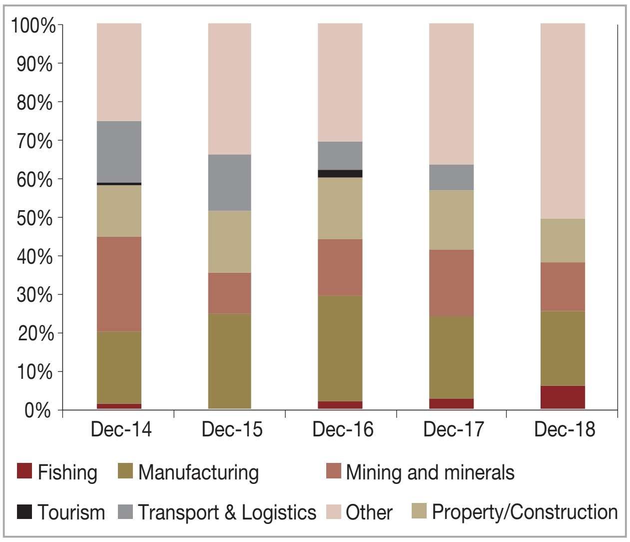


Figure 17b: Sectoral composition of large exposures



Source: Bank of Namibia

The ratio of large exposures to private sector credit extension (PSCE) decreased. While the nominal value of credit extended to businesses increased, large exposures as a percentage of PSCE decreased to 16.0 percent at the end of 2018 from 20.8 percent in the previous year (Table 6). Similarly, large exposures as a percentage of PSCE extended to businesses also declined in 2018, compared to 2017. Apart from significant repayments and disintermediation, the current sluggish economic conditions paved the way for the adoption of stringent lending practices by many commercial banks as they continue to be more risk averse and therefore impacting on the slower growth rate of large exposures, during the period under review

Table 6: Large exposures in relation to private sector credit extension

	2014	2015	2016	2017	2018
Total Largest Exposures	13,296	14,631	15,223	18,669	15,332
Total PSCE	69,067	78,394	85,397	89,720	95,748
PSCE to Businesses	28,364	33,086	35,343	36,811	38,656
Large Exposures to PSCE	19.3%	18.7%	17.8%	20.8%	16.0%
Large Exposures to Business PSCE	46.9%	44.2%	43.1%	50.7%	39.7%

Source: Bank of Namibia

Stress Test

The Bank of Namibia's stress test was designed to evaluate the ability and resilience of the domestically systemically important banking institutions to withstand severe, yet plausible shocks. The Cihak stress testing model is the model used for banking sector stress testing at the Bank of Namibia. This model focuses on both the solvency and liquidity position of the banks, while projecting the likely impact 12 months ahead. The reference date for this stress test is 31 December 2018, meaning that the Cihak model made use of the data for quarter 4 of 2018. The model requires an input of scenarios that speak to developments in the global and domestic economies in order to produce results that are as accurate as possible. The scenarios are divided into three, the first being the baseline scenario, followed by the intermediate scenario which is slightly more adverse and finally the severe scenario which is somewhat hypothetical, but still worth analysing. The ultimate objective is to quantify the impact on solvency and liquidity in the event that the identified scenarios materialise, and therefore make the necessary recommendations to mitigate an unfavourable outcome.

a. Interest Rate Risk

It is expected that Namibia will move into a higher interest rate environment should global and local economic developments necessitate such a policy action. Global and domestic economic developments may increase direct interest rate risk; that is, the risk incurred by a bank when the interest rate sensitivity of its assets and liabilities in various time bands reprices resulting in potential mismatches. This is anticipated to primarily stem from increasing inflation in South Africa underpinned by the depreciating currency and the normalization of interest rates, coupled with the recovery of the US economy. In order to prevent capital outflow to South Africa and other markets, the Bank of Namibia may opt to increase interest rates. The stress testing model therefore assesses the impact of the interest rate increases on net interest income emanating from repricing gaps in each time band. The repo rate in Namibia remained unchanged for the whole of 2018. As such, the following interest rate increases over 12 months was assumed:

- *0.5 percent increase in the interest rate (baseline scenario);*
- *1.0 percent increase in the interest rate (Moderate scenario);*
- *2.0 percent increase in the interest rate (Adverse / severe scenario)*

Although the Rand has appreciated by 1.4 percent against the US Dollar, by 1.5 percent against the Euro, and by 0.5 percent on a trade-weighted basis since November 2018, it remains vulnerable to changes in investor sentiment. It is thus reasonable to expect the Rand to depreciate in the next 12 months, particularly due to weak growth prospects in South Africa, coupled with political developments and policy uncertainties that are negative for business, consumer and investor confidence. On average, for the baseline scenario, the exchange rate of the rand against the US Dollar is expected to depreciate at the same pace as the inflation rate. In this regard, the Rand is assumed to depreciate by 4.6 percent for the baseline scenario and 9.2 percent and 13.9 percent for moderate and severe scenarios against the US Dollar, respectively. Given the mandate of the South African Reserve Bank (SARB), it is expected that this will prompt the SARB to increase the repo rate to contain inflationary pressures resulting from the depreciation of the Rand. The Bank of Namibia (BoN) might also pursue a contractionary monetary policy stance, in line with the peg of the Namibia Dollar to the South African Rand.

b. Credit Risk

The monetary tightening assumed above will prompt banks to increase their prime lending rates. This can result in an increase in default rates and therefore, higher Non-Performing Loans (NPL) across all loan asset categories. It is therefore imperative to consider the resultant increase in the NPL using the following assumptions:

- *1.0 percentage point increase in the banking sector NPL ratio (baseline scenario)[12];*
- *2.0 percentage point increase in the banking sector NPL ratio (moderate scenario);*
- *3.0 percentage point increase in the banking sector NPL ratio (severe scenario).*

The NPL percentage increases stated above, relate to the Namibian banking industry NPLs which demonstrated a historic industry high of 5.6 percent in the second quarter of 2002. At that time, the repo rate was 12.75 percent and the prime rate was 17.50 percent which was significantly higher and more challenging to borrowers than at present. During 2018, asset quality of the banking industry deteriorated to 3.6 percent, compared to 2.5 percent in 2017, on the back of tough domestic economic conditions.

c. Liquidity Risk

Liquidity risk indicates the ability of the bank to honour its financial obligations in a timely and effective manner. Liquidity is required for deposit withdrawals, including deposits that mature and unscheduled withdrawals. A bank's least expensive means of funding loan growth is through deposits. When this is not available, banks rely on more expensive funding sources such as borrowing funds at wholesale rates, liquidating investment securities portfolios or issuing bonds.

The liquidity position of banking institutions is affected by many factors. These factors entail the outflow of capital from emerging markets following the interest rate increase by the US Federal Reserve, coupled with improving financial conditions in the US, which adversely impact liquidity. Entities with surplus funds such as collective schemes (i.e. unit trust schemes) are not affected by the amendments in regulations to increase domestic asset requirements and therefore these surplus funds may find their way to the more liquid and developed South African financial markets. In addition, the amendment to the regulations makes provision to apply for exemption if they can prove to NAMFISA and the Minister of Finance that they could not find financial instruments in which they may place the excess funds resulting from the application of the amended regulations. On the contrary, Government spending usually has a positive impact on the liquidity position of commercial banks.

[12] The assumed increase in the NPL ratio is based on the current NPL ratio of 3.6 percent observed in December 2018. It is therefore assumed that the NPL ratio will deteriorate further in the moderate and adverse scenarios, particularly if depressed economic conditions continue at the current pace. Namibia experienced 10 consecutive quarters of negative GDP growth which started in the third quarter of 2016 and continued until the fourth quarter of 2018.

Deposit withdrawals can be triggered primarily by market conditions (unscheduled withdrawals). Factors that may cause liquidity constraints are: capital flight to other markets in search of better returns; and dividend payments by subsidiaries of foreign entities. Furthermore, the growing loan book of the banking sector also exerts pressure on the liquidity conditions of the banks, especially given suboptimal interbank lending, hence the need to assess the banks' resilience in terms of liquidity. The concern of the Bank is whether commercial banks can withstand a liquidity shock if these depositors made a sudden withdrawal of their funds from the system, despite being well capitalized, profitable and solvent. The following assumptions were therefore used:

- *3.80 percent of total deposits withdrawn over 5 days (15 percent of demand deposits - baseline scenario)*
- *7.59 percent of total deposits withdrawn over 5 days (30 percent of demand deposits - moderate scenario)*
- *12.66 percent of total deposits withdrawn over 5 days (50 percent of demand deposits - adverse scenario)*[13]

Based on the subdued economic conditions currently prevailing, the abovementioned scenarios are deemed plausible. Deposits from collective investment schemes which are dominated by natural persons and companies are a key source of funds for Domestic Systemically Important Banks (DSIBs) in Namibia and they are inherently volatile. These funds are not subjected to domestic asset requirements and due to their discretionary nature, can be easily disinvested. This will be possible if alternative investments become more attractive or investors lose confidence in the current offerings. Such events can cause major capital flight, resulting in withdrawal of deposits and other investments at commercial banks.

[13] The liquidity stress test is over a horizon of 5 days and does not account for the liquidity Contingency Funding Plan of each bank which would represent cash inflows over the 5-day period.

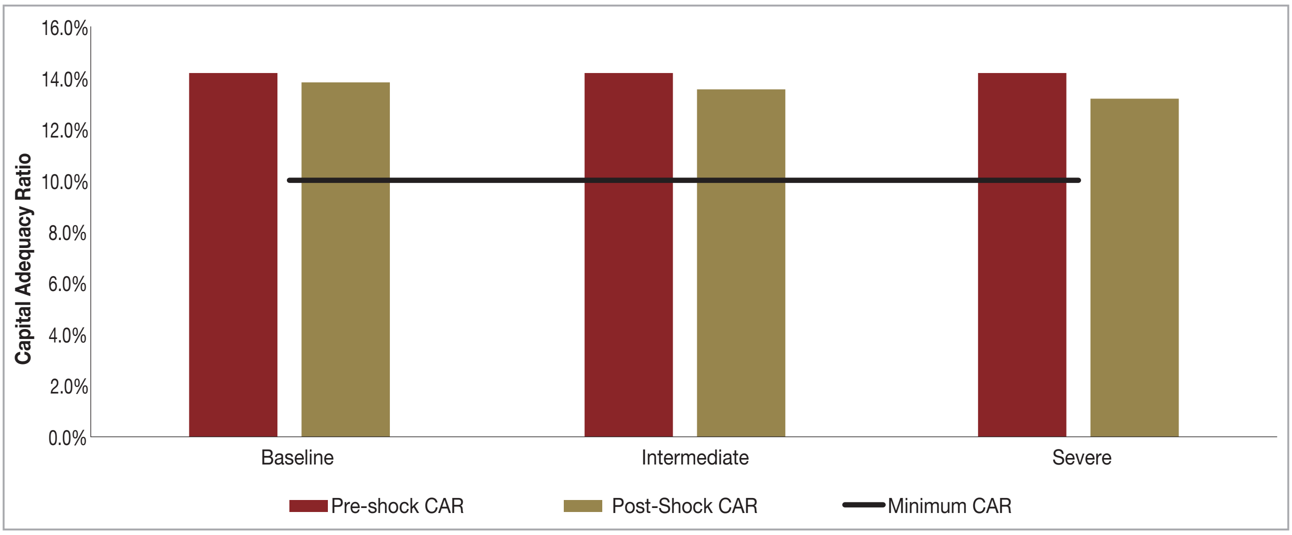
Table 7: Summary of the stress testing scenarios

Risk category	Baseline	Moderate	Severe
Credit risk (NPL Ratio)	1.0% ↑	2.0% ↑	3.0% ↑
Interest rates	50 basis point ↑	100 basis point ↑	200 basis point ↑
Liquidity	3.80% of total deposits withdrawn over 5 days (15% of demand deposits-baseline scenario) ↓	7.59 % of total deposits withdrawn over 5 days (30% of moderate deposits-demand scenario) ↓	12.66% of total deposits withdrawn over 5 days (50% of demand deposits-adverse scenario) ↓
Exchange rate	4.6% ↓	9.2% ↓	13.9% ↓
Other variables - 30% haircut on collateral - 50% Assumed provisioning of the new NPLs			

Capital Adequacy Stress Test

The stress test results show that the banking sector was efficiently capitalized during the period under review, to endure the impact of the probable credit risk in all three scenarios. The post-shock risk-weighted capital ratio therefore stood at 13.9 percent in the baseline scenario and at 13.6 percent in the moderate scenario, while it was observed to have decreased to only 13.2 percent in the adverse scenario, however, remaining well above the minimum regulatory level of 10 percent (Figure 18). Indications are therefore that banks may be able to withstand these shocks and remain well above the minimum regulatory level. These results are largely comparable to those of the previous FSR, implying that the capital base of the banking sector is enough to absorb risks, including those potentially emanating from the significant deterioration of the asset quality observed during 2018.

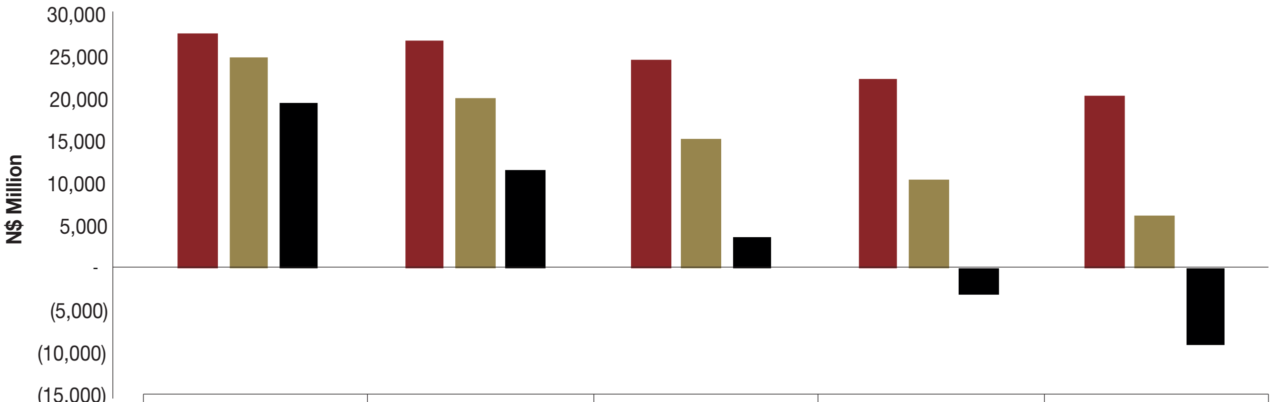
Figure 18: Solvency stress test results



Source: Bank of Namibia

The liquidity stress test results indicate that the banking sector seems to have adequate liquid assets to withstand the assumed shocks, especially in the baseline and moderate scenarios. Generally, liquidity stress test results are used to gauge the ability of the commercial banks to withstand a severe, but plausible shock caused by unexpected withdrawals of short-term deposits. Using December 2018 banking sector data, the liquidity stress test results show that the Namibian banking sector has enough liquid assets to endure the shocks assumed in the baseline and moderate scenarios. Nevertheless, as the scale of the shocks increases to 12.66 percent of the total deposits withdrawn over 5 days (i.e. 50 percent of the demand deposits withdrawn), the sector would be able to meet its payment obligations only up to the third day (Figure 19). These results are largely similar to those published in the 2018 FSR. The amendment to regulations of Medical Aid Funds, Short Term Insurers, Long Term Insurers and Pension Funds has contributed to a significant improvement in the liquidity levels of the banking sector. This was also supported by the inflows of the South African Rand, particularly during the fourth quarter of 2018. Overall, the results imply that the banking system will be able to withstand the types of shocks assumed, given that they have enough liquidity buffers. Looking ahead, it is estimated that banking sector liquidity may remain stable over the next 12-months.

Figure 19: Liquidity stress test results



	Day 1	Day 2	Day 3	Day 4	Day 5
Baseline	27,836	26,907	24,655	22,466	20,344
Intermediate	24,835	20,210	15,180	10,529	6,290
Severe	19,535	11,672	3,667	(3,274)	(9,229)

Baseline Intermediate Severe

Source: Bank of Namibia

BOX 2. NEW DEVELOPMENTS: BANKING SECTOR STRESS TESTING

Stress testing is a method of analysing the resilience of the financial system to adverse events and it is one of the key techniques for quantifying vulnerabilities. *The Bank of Namibia undertakes quarterly stress testing in order to determine the performance of the banking sector under the baseline, intermediate and severe scenarios. Currently, stress testing is undertaken using the Cihak model which employs various assumptions on global and domestic economic developments and their probable impact on asset quality and the liquidity of the banking sector. In the context of the assumptions and scenarios, specific analysis on credit, interest rate, exchange rate and liquidity risks are conducted in order to ascertain which banks, if any, would be able to withstand the assumed shocks, while simultaneously quantifying the associated costs should a bank(s) face difficulty during times of stress. The Cihak model gives a 12-month projection under the respective scenarios.*

Going forward, the Dynamic Bank Balance Sheet Tool (DBBT) will be used alongside the Cihak model to strengthen the banking sector stress testing process. The DBBT model, which was specifically designed for Namibia, focuses on macro stress testing, which is a micro-financial scenario conditional projection of individual bank balance sheets dynamically into the future, with elements of cross-institutional linkages and hence contagion potential[14]. The tool is a multi-year, dynamic bank balance sheet projection tool with a maximum projection horizon of 5 years, compared to the 12-month projection of the Cihak model. The two models will therefore complement each other to give both a short-term and medium-term projection of the performance of the banking sector given economic conditions in Namibia. The DBBT model further requires calibration of two scenarios, the baseline and adverse scenarios, within an annual frequency of the key macro-financial variables such as GDP growth, interest rates, inflation, house prices as well as exchange rates.

The banking sector is a crucial part of the financial system, therefore its performance under stress needs to be analysed frequently in order to mitigate any foreseeable risks well before they materialise, if they do at all. The Bank of Namibia has identified the systemically important banks within the banking sector. These are the banks with

[14] Contagion is defined as the spread of a shock in a particular economy, sector or region, to other areas., therefore having a domino effect.

the potential to disrupt the operations of the financial system, should they fail or face significant difficulties. As a result, these banks are regulated differently. The Bank therefore conducts a top-down stress test[15] on the identified systemically important banks, while the individual banks conduct a bottom-up stress test[16] for the purpose of quantifying potential risks to the performance of the banks and therefore establish ways to mitigate the risks identified.

Financial stability fundamentally analyses the resilience of the domestic financial system to internal and external shocks, be they economic, financial, political or otherwise. *Stress testing forms part of the said analysis, with the aim to mitigate any foreseeable risks to the banking sector, while taking into consideration the macroeconomic environment within which the respective banks operate. It is therefore imperative to continuously stress test as well as improve on the methods and tools used. The Bank of Namibia practices innovation and often works towards finding better and supplementary ways to improve its analysis, while benchmarking against peers and international standards. It is for this reason that the DBBT model will form part of the stress testing toolkit going forward.*

[15] The top-down stress testing approach estimates the impact using aggregate data. In this case it is the aggregate data for the identified systemically important banks.

[16] The bottom-up stress testing approach makes use of respective stress testing models adopted but the individual banks.

VI. PERFORMANCE OF THE NON-BANKING FINANCIAL SECTOR

NBFI Assets

The Non-bank Financial Institutions (NBFIs) sector remained financially stable and continued to grow its assets, despite recessionary economic conditions. The NBFIs asset base slightly increased by 0.9 percent to N$290.3 billion, reflecting a moderation in growth, compared to the previous year (Table 8). The moderate growth in NBFI assets were mainly reflected in pension fund industry assets attributed to marginal growth in investment income. This is mainly reflected in volatile financial markets owed to softening of global economic activity mainly influenced by trade tensions and tariff hikes between the United States and China, a decline in business confidence, a tightening of financial conditions, and higher policy uncertainty across many economies. Nonetheless, the industry held excess reserves, which is sufficient to cushion against potential adverse movements.

Table 8: Total assets (N$ billion)

Total assets (N$bn)	2014	2015	2016	2017	2018
Long-term insurance	40.2	44.7	47.6	53.9	56.6
Short-term insurance	4.7	5.6	5.8	6.2	6.5
Pension funds	119.6	133.1	137.5	152.9	158.5
Medical aid funds	1.2	1.4	1.4	1.8	1.9
Collective investment schemes[17]	15.5	38.9	39.6	47.5	52.4
Investment Management[18]	5.2	5.7	7.6	19.8	7.8
Microlending and credit agreements	3.4	4.3	4.2	5.5	6.4
Friendly societies	0.09	0.104	0.121	0.136	0.157
Sector total	189.8	233.8	243.8	287.7	290.3

Stability in the insurance and pension fund industry

Insurance and pension funds fulfils an important function as institutional investors to provide funding to the financial system and the real economy. Both insurance and pension fund industries are interconnected to the financial system through investments

[17] CIS: Collective Investment Schemes (CIS) total assets amounts to N$63.0 billion which were adjusted down by 16.8 percent to N$52.4 billion to avoid double counting as CIS funds is also sourced from pension, medical aid and insurance funds.

[18] IM: Similarly, Investment managers (IM) total assets amounts to N$164.1bn which were adjusted down by 95.2 percent down to N$7.8 billion to avoid double counting as the bulk of IM assets are sourced from pension, medical aid, insurance and CIS.

and issuance of debt and capital. In this regard, they continue to play an intermediation role between companies and households and the financial markets.

Life insurance undertakings offering life insurance products primarily invest in assets whose maturity and sensitivity to market fluctuations do not match the risks in the long-term liabilities. If a firm's financial strength were to deteriorate, for example due to a sharp fall in share prices, the firm may be forced to reduce its risks by better matching the maturities of its assets and liabilities. It could do this by selling riskier assets, for example shares, and buying interest-bearing securities with a long-term maturity.

The lack of depth in the Namibian financial markets encourages entities to invest outside the country and in highly volatile equity markets. It is worth mentioning that if several entities simultaneously apply this same investment strategy they could experience subdued returns on investments in the case of adverse shocks in the international financial markets. This could have implications on financial stability within the domestic financial sector.

Pension Fund Industry

The pension funds industry remained financially sound with funding levels above the required limit. The industry accounted for 54.6 percent of total NBFIs assets at the end of 2018. The overall risk profile of the sector increased due to a relatively subdued financial market performance[19] during the year. Nonetheless, the industry's funding level remained above the 100 percent prudential limit.

Risk indicators

The overall industry risk rating score increased marginally, mainly driven by market risks. Similar to the long term insurance Industry, the pension fund industry's assets were adversely affected by the increase in volatility in the equity markets. The rising market risk is reflected in the declining trend in the JSE All Share index, owing to large exposure to the equity market. Nonetheless, the pension fund industry remained financially sound and stable, as it maintained funding levels above the prudential limit of 100 percent.

[19] JSE All Share Index performance, refer to figure 5 in report

Table 9: Risk rating inherent risks score pension fund

Indicators	2017	2018	Risk direction
Overall risk rating			increased

Source: NAMFISA

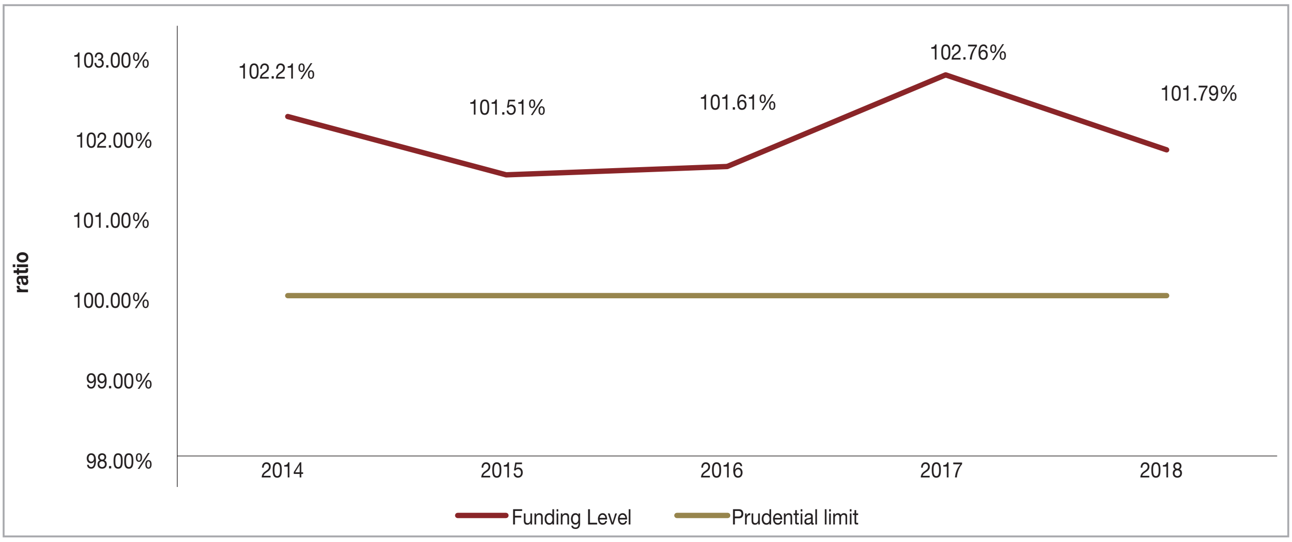
Key risk ratings scale

Risk Flag	Risk
0.00	Very Low
1.00	Low
2.00	Moderate
3.00	High
4.00	Extreme

Funding risk

Due to the volatility in the financial markets, the funding ratio of the pension fund industry, declined, however, it remained above the prudential limit. The lower funding level experienced in 2018 compared to the level in 2017, is due to a decline in asset prices, as global financial markets faced a turbulent period. Nonetheless, the industry's funding level remained above the 100 percent prudential requirement.

Figure 20: Funding ratio

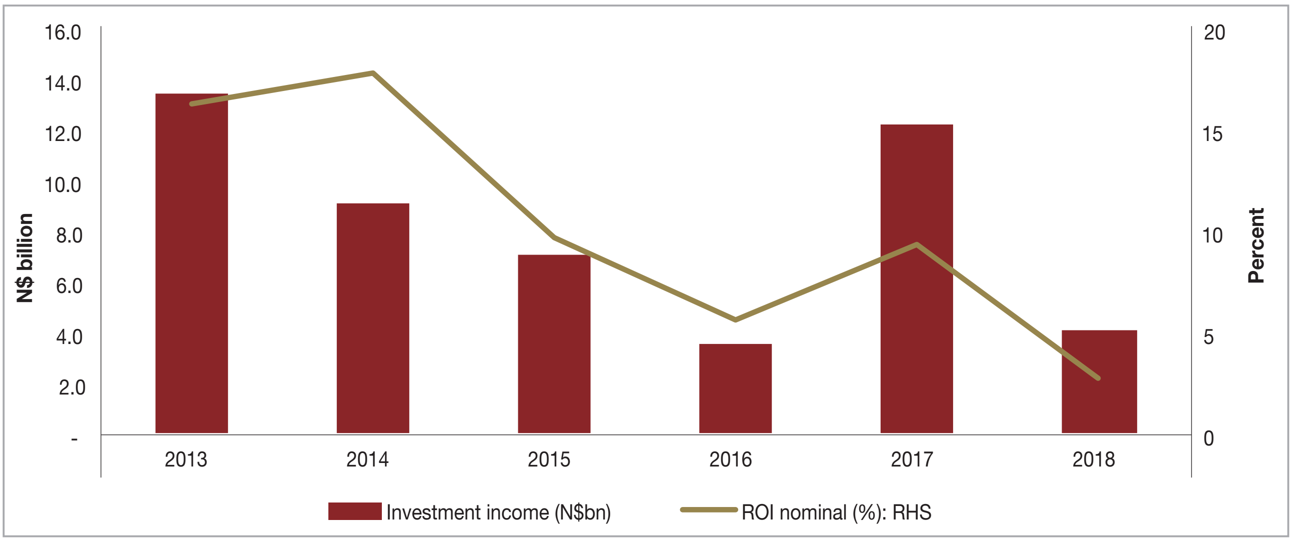


Source: NAMFISA

Market risk

The fall in asset prices in 2018, adversely impacted pension funds, given its large exposure to the equity markets. This is shown by dwindling investment income, as observed in the declining JSE All Share index (Figure 5). The JSE All share Index performance was driven by uncertain domestic policy environment (property rights), depressed growth prospects and general aversion of emerging market risks. Pension funds remain largely exposed to the equity markets, and such exposure, especially to international markets, holds significant market and exchange rate risks.

Figure 21: Investment income

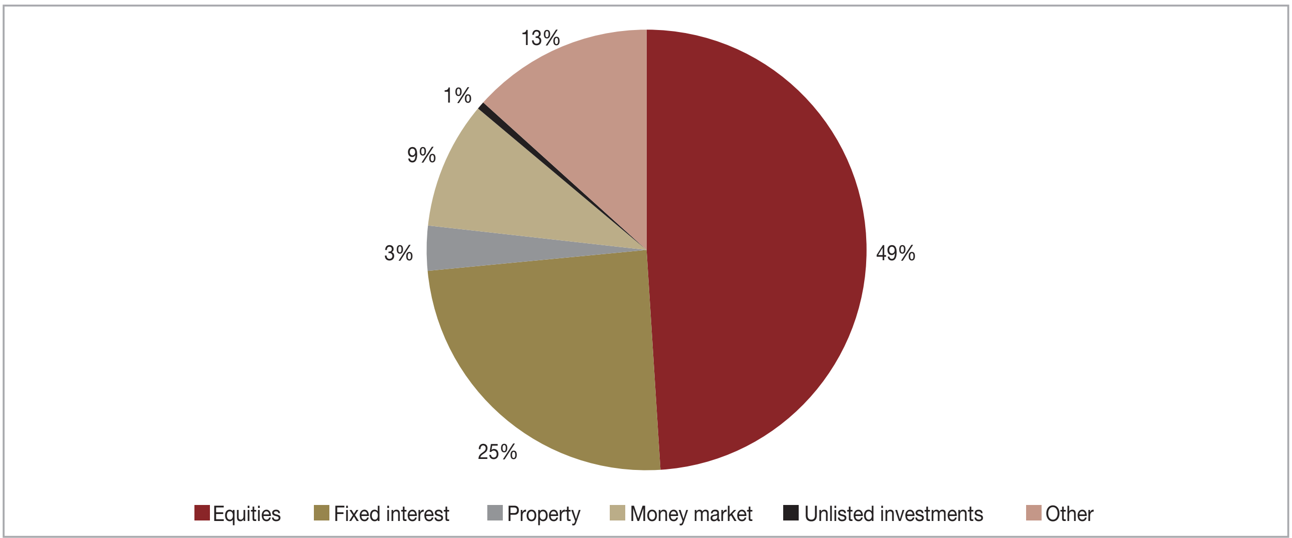


Source: NAMFISA

Investment mix

In terms of investment exposure, pension funds' profile is long-term in nature as such they are expected to channel their investments into assets with relatively higher returns over the long term. The bulk of pension funds were invested in equities with an exposure of 49.0 percent in 2018, followed by fixed interest instruments at 24.5 percent. In this regard, equities are preferred as their returns, historically, outperformed other asset classes over the long term (Figure 22).

Figure 22: Investment exposure per instrument

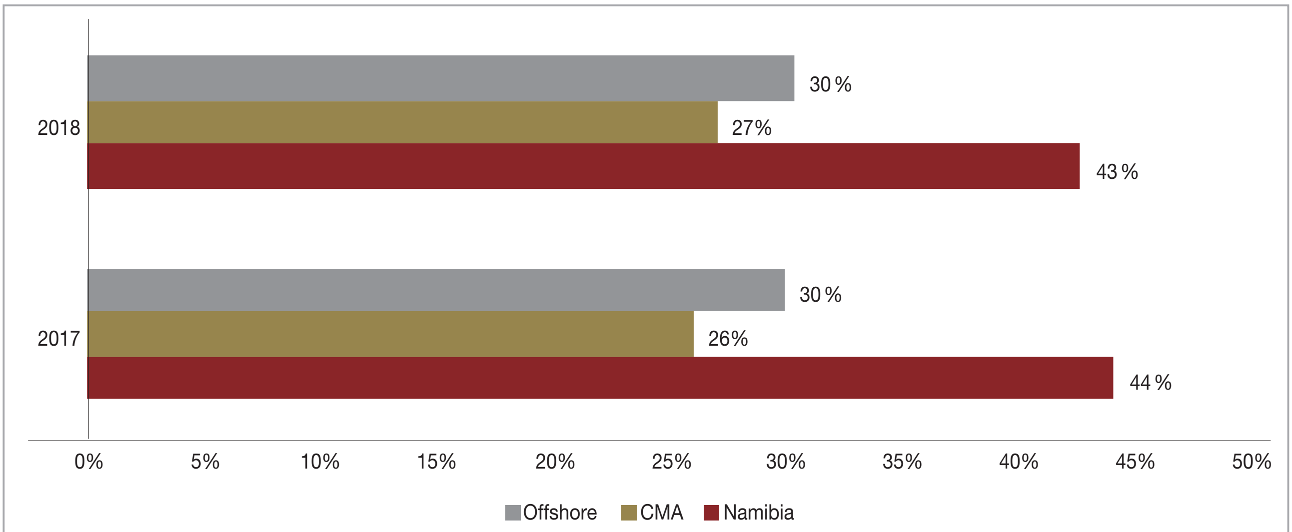


Source: NAMFISA

Geographic asset allocation

The pension industry invested most of its assets domestically, although this share has marginally declined, compared to the previous year. The largest share of funds were invested in Namibia at 42.6 percent followed by Common Monetary Area (CMA) and offshore at 30.3 percent and 27.0 percent, respectively during the period under review (Figure 23). The relative domestic exposure for pension funds decreased due to the depreciation of the ZAR against major currencies, which increased the value of foreign exposure in Namibia Dollar terms.

Figure 23: Geographic allocation of funds under management



Source: NAMFISA

In summary, it is observed that the industry is heavily exposed to equity markets. This significant exposure of the pension fund industry to equity markets could have a negative repercussion in the event of adverse market movements. This may result in capital losses, which has a direct impact on funding levels, especially for defined benefit funds. A persistent decline in returns on investment in the long run could potentially pose a risk to defined benefit funds i.e. a scenario where growth in liabilities outweighs the growth on the asset side. Despite some of the risks identified, the pension fund industry remains robust as it maintained funding levels above prudential limits.

Long-term insurance industry

Overall, the long-term insurance industry remained financially sound and stable, despite moderate growth in total assets. The industry's assets grew by 5.0 percent to N$56.6 billion at the end of 2018, this was a slowdown in growth, compared to the previous year. Similar to pension fund assets, the long-term insurance industry was adversely affected by unfavorable financial markets performances. Nonetheless, the industry remains financially sound as excess assets[20] exceed the minimum capital adequacy requirement[21], indicating sufficient buffers in the case of adverse shocks.

Risk indicators

The overall sector risk rating score increased slightly mainly driven by adverse movements in the equity markets. Global financial markets volatility has heightened in 2018 affecting the asset position of NBFIs. Concerns around slowing global economy and US-China trade tensions, adversely affected global financial markets performance and subsequently the valuation of long-term insurance industry assets. Nonetheless, the long-term insurance industry remained financially sound and stable as demonstrated by its solvency position.

Table 10: Risk rating inherent risks - Long-term insurance

Indicators	2017	2018	Risk direction
Overall risk rating			Slight increase

Source: NAMFISA

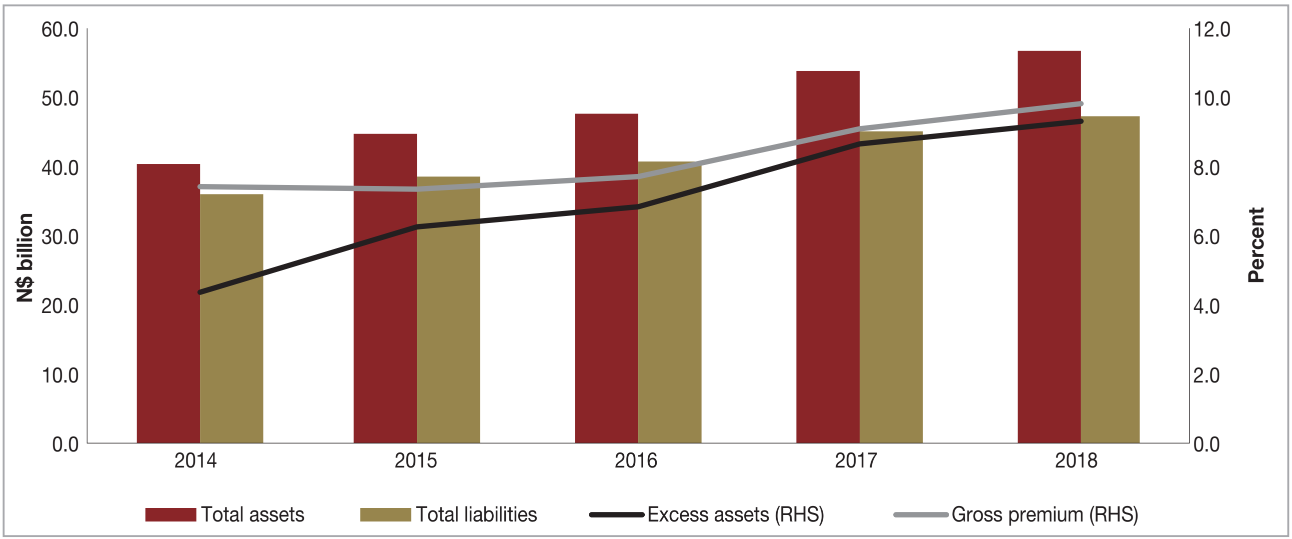
20 Total assets minus total liabilities, whilst free assets are excess assets minus Capital Adequacy Requirement (CAR).

21 The minimum capital requirement is N$4 million per entity.

Solvency risk

The long-term insurance industry remains financially sound, as shown by the solvency position during the period under review. Long-term insurance assets exceeds liabilities by N$9.3 billion showing the resilience of the industry despite tough economic times (Figure 24). The industry excess assets remain above the capital adequacy requirement during the period under review. This shows the overall financial soundness of the long-term insurance industry.

Figure 24: Total assets versus total liabilities, excess assets and gross premium income



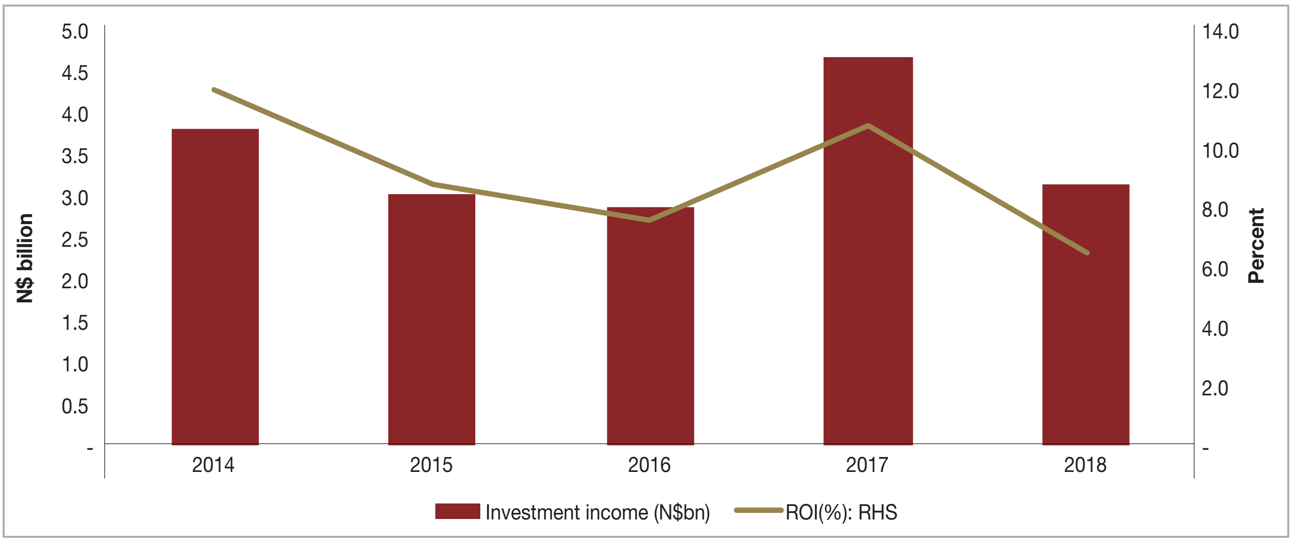
Source: NAMFISA

Despite economic hardship owed to the current recessionary conditions, households' appetite for insurance products continue to grow, although at a moderate rate. Gross premiums grew by 7.9 percent to N$9.8 billion during 2018 (Figure 25). However, in comparison to the previous period, there has been a moderation from 18.2 percent in 2017. Nonetheless, since 2014, gross premiums grew at a positive growth rate of 9.1 percent on average, showing the growing insurance business, despite tough economic conditions.

Market risk

In terms of market risk, the long-term industry position worsened due to a significant reduction in investment returns. Investment income declined by 33.0 percent to N$3.1 billion, mainly due to adverse movements in financial markets, coupled with base effects from the previous period.

Figure 25: Investment returns

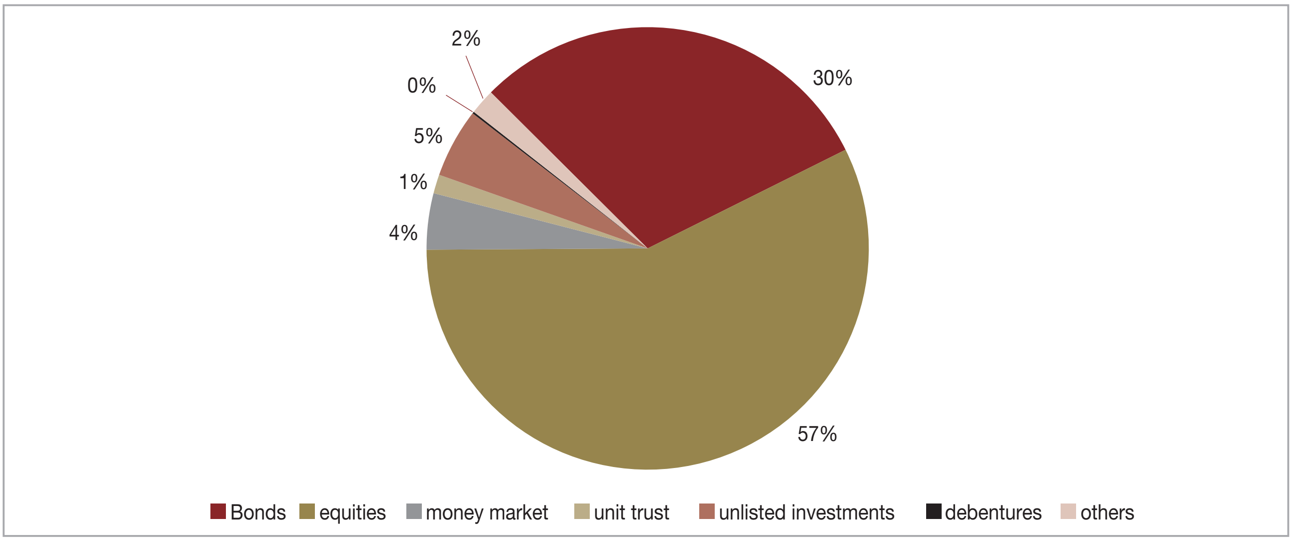


Source: NAMFISA

Investment mix

The majority of long-term investments is tilted towards equities, followed by government and corporate bonds during the period under review. The industry's exposure to equities was 57.3 percent in 2018, followed by government and corporate bonds, which accounted for 30.2 of total investments (Figure 26).

Figure 26: Investment exposure per instrument, end of 2018

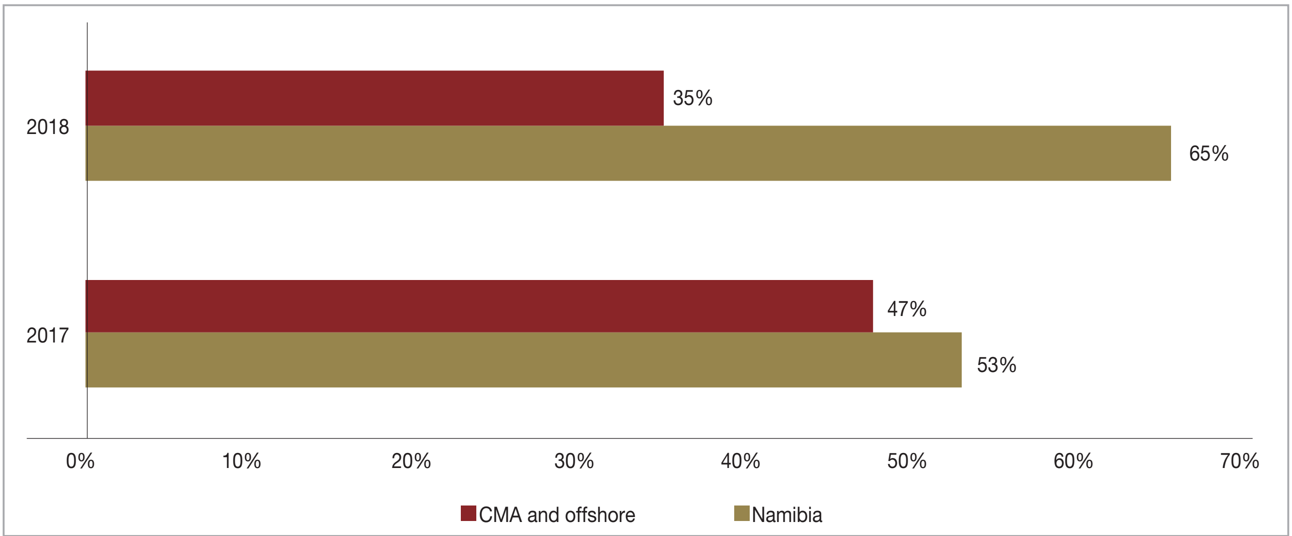


Source: NAMFISA

Geographic asset allocation

The long-term insurance industry invested most of its assets domestically followed by CMA and offshore markets. In terms of geographic allocation of funds, the bulk of funds were invested in Namibia with a share of total assets invested, which increased to 65.0 percent in 2018, compared to 53.0 percent in 2017. Despite the fact that the invested assets in Namibia of the long-term insurance were well-above the minimum asset requirements already in 2017, it increased further to 65.0 percent during the period under review. (Figure 27).

Figure 27: Geographic allocation of funds under management



Source: NAMFISA

In conclusion, it is observed that the industry remains concentrated in the equity market. Exposure to the equity market could be a potential trigger for vulnerability in the event of adverse market movement and could result in capital losses, which has a direct impact on solvency levels. Further, it could pose a mismatch risk to the industry in terms of its assets and liabilities. Despite some of the risks identified, the long-term insurance industry remains robust as the funding levels remain above prudential limits.

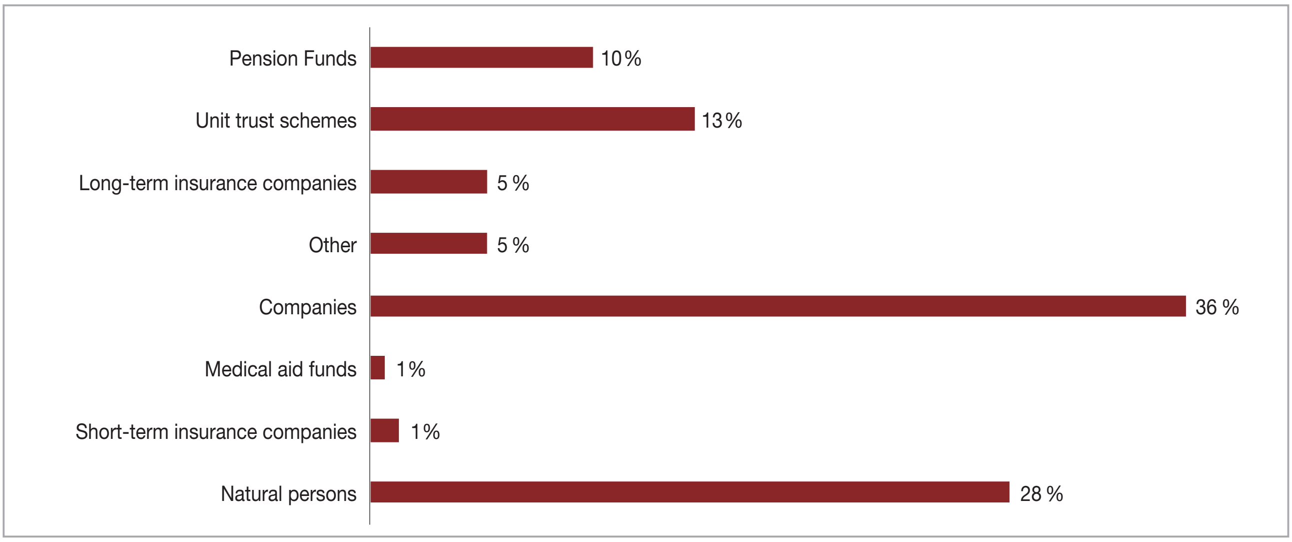
Collective Investment Schemes (CIS)

The unit trust schemes play a central role in financial stability and provide the channel through which the financial system sets prices and allocates risk and capital. Total assets under management for the CIS improved by 4.4 percent to N$63.0 billion at the end of December 2018, mainly exposed to the money market instruments as demonstrated in Figure 30. CIS is considered an important sector due to its discretionary nature of business that has the potential of causing liquidity constraints in the financial system, given that two thirds of its funds are sourced from households and companies (Figure 28). Hence, an interruption of this critical function could have serious consequences for the rest of the financial system and, by extension, the economy. A sudden liquidation of investments in CIS can cause liquidity constraints to banks.

CIS are mainly funded by households and companies. The largest source of funds in the unit trust schemes are companies with a market share of 36.4 percent, followed by natural persons with a market share of 28.3 percent during the period under review (Figure 28). Currently 12.1 percent of the N$63.0 billion assets of CIS are deposited with Namibian banks. Hence, CIS are considered an important but potentially volatile source of funding for banks due to the discretionary nature of the investments.

Source of funds

Figure 28: Assets per investor as at 31 December 2018

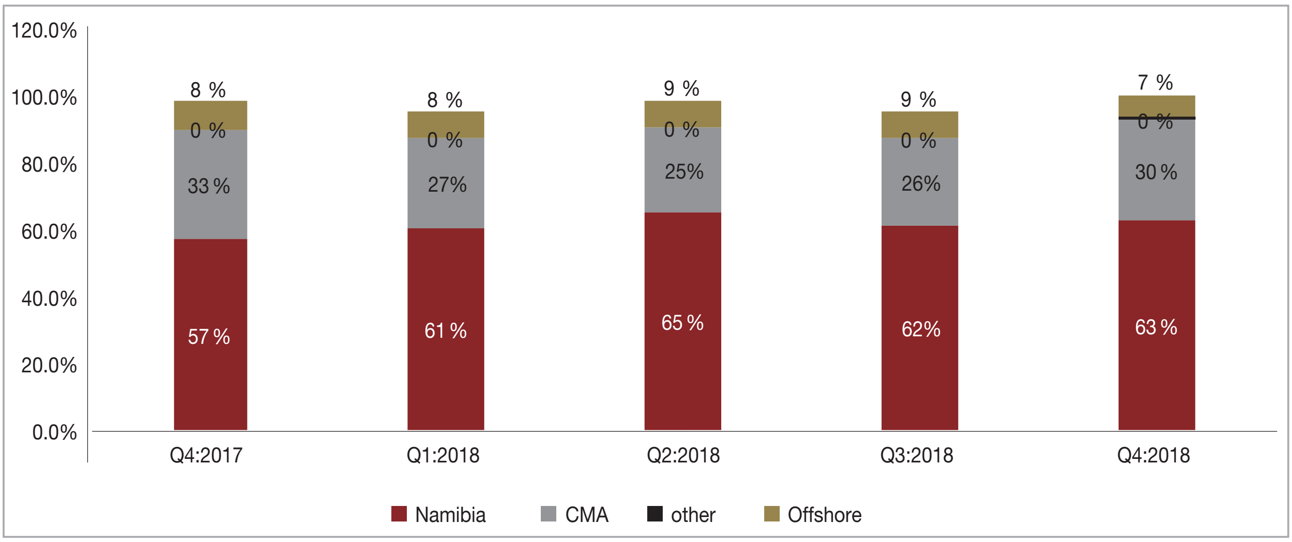


Source: NAMFISA

Geographic allocation of funds

The CIS industry continued to invest most of its assets domestically followed by the CMA and African markets. In terms of geographical allocation of funds, 62.8 percent, 29.9 percent, 0.2 percent and 7.0 percent of the funds under management were invested in Namibia, the Common Monetary Area, Africa and Offshore, respectively. This is compared to 61.6 percent in Namibia, 25.6 percent in CMA, 0.0 percent in Africa and 8.6 percent in offshore markets during 2017 (Figure 29).

Figure 29: Assets per geographic allocation

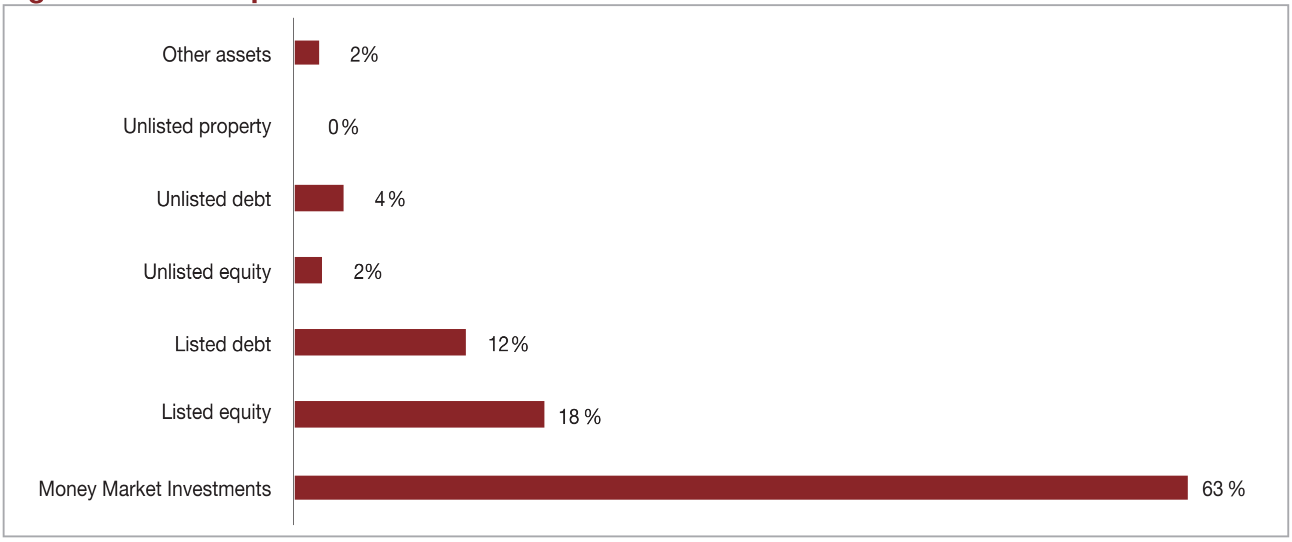


Source: NAMFISA

The preferred choice of asset class allocation is skewed towards the money market instruments followed by listed equities. Asset allocation per type of investment instrument depicts that money market instruments continue to be the asset class of choice, accounting for 62.9 percent of assets under management, while listed equities represented 17.7 percent as at 31 December 2018. The remaining 19.4 percent is spread among listed and unlisted debt, unlisted equity and other assets. The availability of instruments in the financial markets as well as maturity of instruments continues to influence asset classes invested (Figure 30).

Allocation of funds per investment instrument

Figure 30: Assets per class as at 31 December 2018



Source: NAMFISA

Conclusion

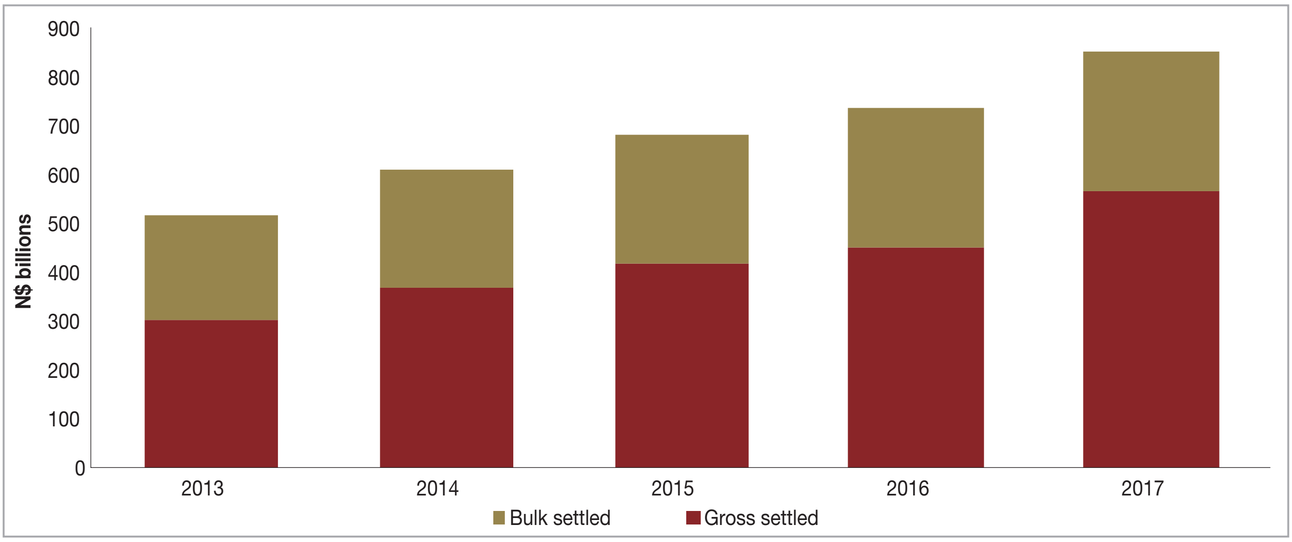
Overall, risks to systemic stability remained low despite worsening domestic recessionary conditions. The NBFIs sector remained financially sound and stable as its funding and solvency levels were above prudential levels as illustrated by the risk rating indicators. Financial markets experienced turbulent periods during 2018, reducing equity valuations and asset positions of non-banks. Nonetheless, this had no significant impact on the funding position of the entities. The authority continues to monitor the NBFIs accordingly.

VII. PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

The Bank continued to fulfil its regulatory mandate as the overseer of the National Payment System (NPS) in 2018, in line with the Payment Systems Management Act 18 of 2003, as amended. During the review period, the Bank concluded four risk-based inspections and continued with its off-site activities by monitoring its system participants through a combination of assessments based on information provided by the regulated institutions in the NPS.

A decrease in settlement volume and an increase in value was observed during 2018 in the Namibia Interbank Settlement System (NISS). The settlement volume decreased by 8.8 percent, from 65 983 in 2017 to 60 189 in 2018. In terms of values of payments that settled in NISS, an increase of 7.1 percent from N$852.7 billion to N$913.1 billion was recorded during 2018. The increase in value was due to two new participants that joined NISS during 2018. The value of the share of real-time/gross settled (typically high-value) transactions processed in NISS was 67.8 percent of the total value settled in NISS, whereas the retail payment systems[22] /bulk settled was 32.2 percent of the total value settled in NISS (Figure 31).

Figure 31: Value of payments processed in NISS



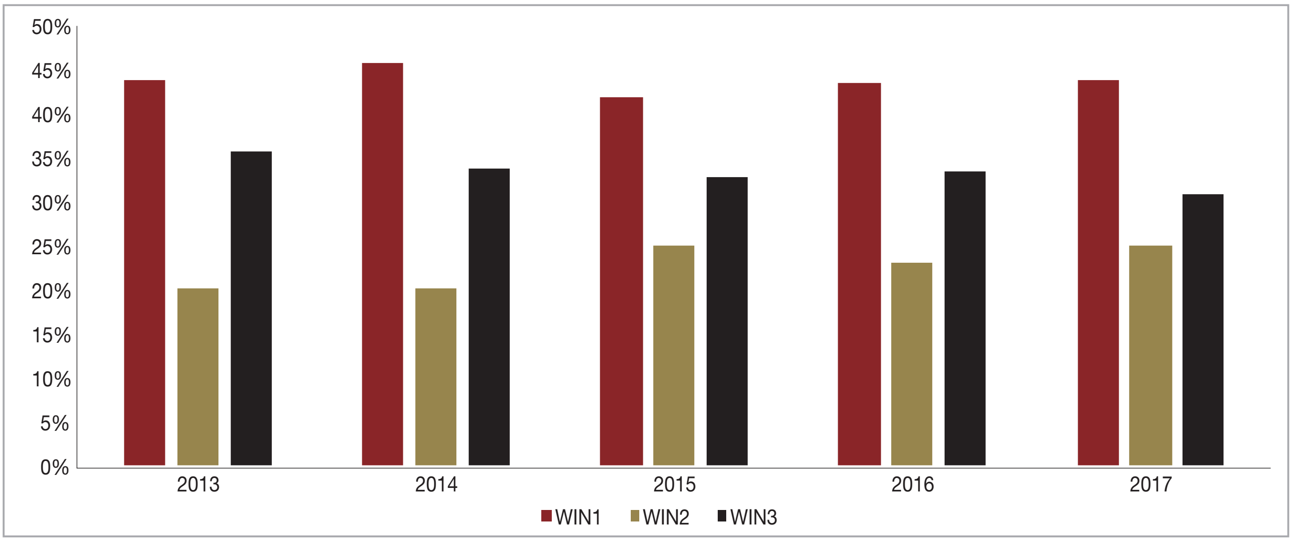
Source: Bank of Namibia

[22] The EFT, Cheque and Card Systems

Settlement Windows

The proportion of payments settled in Window 3 decreased from 31 percent in 2017 to 27 percent in 2018. Settlement statistics in NISS during 2018 indicate that 41 percent or N$373.7 billion in payments were settled in Window 1 (08h00 to 12h00); 32 percent, or N$288.7 billion was settled in Window 2 (12h00 to 15h00) and 27 percent, or N$250.6 billion, was settled in Window 3 (15h00 to 16h40) (Figure 32). In order to curb operational and settlement risks, it is ideal that the majority of all settlements takes place in the earlier windows (i.e. Windows 1 and 2). During the period under review 73.0 percent of payments settled in Windows 1 and 2 which considerably assisted in mitigating operational and settlement risks.

Figure 32: Proportions of payments settled in each settlement window



Source: Bank of Namibia

Disruptions to the Namibia Interbank Settlement System (NISS)

NISS maintained high system availability during 2018. The NISS front-end[23] availability ratio was 99.96 percent, which was above the target availability level of 99.9 percent. During 2018, two disaster recovery tests (one unannounced, the other announced) were successfully conducted for NISS. NISS also successfully tested business continuity by participating in two Bank-wide business continuity plan exercises during 2018.

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

Security of Retail Payments

During the period under review, the Bank noted a decrease in the total value of fraud and a decrease in the total fraud-to-turnover ratio when compared to 2017. The decrease demonstrates that the NPS remains within the fraud safety index indicator of 0.05 percent as per the Bank's strategic goal. However, the industry recorded an increase of 15 percent in payment card fraud in comparison with 2017. The total value of fraud attributable to the Card, EFT and Cheque streams amounted to N$5,216,000, N$194,000 and N$677,000, respectively. The payments industry continues to monitor its landscape for any emerging fraud trends and continues to cooperate with enforcement agencies and consumer associations to prevent fraud perpetrated in the retail payment system. There have been significant efforts by the payments industry to enhance business practices, payments infrastructure and related products to better protect consumers against modern methods of perpetrating fraud. Furthermore, consumer awareness programmes are ongoing and have assisted in creating public awareness of fraud risks and prevention measures.

To combat fraud such as forged or counterfeited cards, the industry made strides in the replacement of magnetic strip-based cards and the issuing of chip-based cards in 2018. The Europay, MasterCard and Visa (EMV) standard covers the processing of card payments using a card that contains a microprocessor chip at a payment terminal. The initiative to replace magnetic strip payment cards and to issue EMV-standard compliant cards is expected to curb card fraud (such as card cloning) locally and internationally. At the end of the reporting period, 100 percent of all acquiring devices in Namibia, such as Point of Sale (POS) and Automatic Teller Machines (ATMs) were EMV-compliant and enabled. This means that for domestically issued cards, all POS and ATM devices will only accept chip-based and PIN cards. Furthermore, all card issuers only issue EMV-compliant cards.

End-to-end protection of payment card data i.e. from payment initiation to payment settlement remains one of the strongest ways to prevent data compromises that can lead to card fraud. Payment Card Industry Data Security Standards (PCI DSS) is a widely accepted set of policies and procedures intended to optimise the security of card transactions and protect cardholders against the misuse of their personal information. PCI DSS compliance therefore helps with the protection of confidential card payment information across all payment points. The Bank is closely monitoring compliance with this initiative and any issues identified are being managed appropriately.

Developments in Payment and Settlement Systems

In collaboration with the Payments Association of Namibia and the industry, the Bank conducted the annual assessment of the National Payment System (NPS) Vision 2020, during 2018. The review showed 29 percent of the set strategic measures were found to be on target, while 71 percent of the set strategic measures were lagging behind. Measures were put in place to address the challenges for the strategies that are behind schedule. Annual NPS Vision 2020 reviews will continue to be held to ensure that all strategies are monitored, measured and implemented.

The Bank granted three new participants authorisation to access and participate in the NPS. The three participants are, Trustco Bank Namibia, Bank BIC and Banco Privado Atlantico Namibia, all joined the NPS in 2018. The first two are licenced banking institutions, while the Banco Privado Atlantico Namibia is a foreign bank branch.

As part of its regulatory reform efforts, the Bank issued a revised Determination on Issuing of Electronic Money in Namibia (PSD-3) and Guidelines for Payment Intermediation Service Providers. The Determination on Issuing of Electronic Money in Namibia (PSD-3) repealed the previous PSD-3 in its entirety and the revised determination was published during the period under review. The supporting Guidelines and Circular were also revised and published. Furthermore, following an exemption from compliance with section 7(1) of the Payment System Management Act (Act No. 18 of 861 2003, as amended) by the Minister of Finance, the Bank published the Guidelines for Payment Intermediation Service Providers in the NPS of Namibia in March 2018. The Guidelines provide conditions under which service providers may conduct and provide payment intermediation services.

In line with the NPS Vision 2020, the Bank published its position on interoperability[24] in the NPS. To ensure an efficient and cost effective NPS, it is the objective of the Bank to achieve 70 percent interoperability of all payment instruments by 2020 as envisioned in the NPS Vision 2020, and to ensure that full interoperability is achieved by 2025. Interoperability has to a large extent been achieved through scheme interoperability, across the retail payment instruments i.e. Cheque, Electronic Fund Transfers (EFT) and Card, while

[24] Interoperability – a term used in a variety of industries, including telecommunications and financial services – is generally understood to refer to the ability of different systems and sometimes even different products to seamlessly interact. Interoperability enables different payment infrastructures and financial service providers to effect payments between customers. Interoperability has the potential to enable users to make and receive payments faster, through a single or minimal entry points, thus maximising efficiency as well as user convenience.

Electronic Money (e-money) issued by both banks and non-banks remains closed loop (not interoperable). As such, the Bank has calculated that the current level of interoperability in the NPS is already at 75%.

The Bank strengthened its position on virtual currencies. Following the release of its position paper on *Distributed Ledger Technologies and Virtual Currencies in Namibia* during 2017, the Bank updated its position in an amended document which was issued during the review period. The revised position stressed that the Bank does not recognise, support or recommend the possession and utilisation of and trading in cryptocurrencies. Members of the public were advised to refrain from engaging in cryptocurrencies and related activities. The position further reiterated that members of the public must ensure that their conduct in no way contravenes the country's various laws as listed in the position paper. The Bank continues to monitor these digital innovations and will supplement or amend its position when necessary.

Full compliance with the Determination on the conduct of card transactions within the National Payment System (PSD-4) has been achieved within the Banking Industry. Fleet card operations were granted a dispensation by the Bank to afford industry participants sufficient time to ensure that their domestic fleet card transaction processing was localised. The routing and processing of these transactions were previously done through the South African national payment system. All fleet card transactions currently comply with the law and are routed and processed domestically.

The Bank remained a participant in the SADC Real-Time Gross Settlement System (SADC RTGS). During the review period, the SADC RTGS was renamed from what was formerly known as the Southern African Development Community Integrated Regional Electronic Settlement System (SIRESS). The SADC RTGS is a regional settlement system that processes time-critical or high-value payments between participating SADC countries. In 2018, there were 83 SADC RTGS 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 at the end of the reporting period. During 2018, the total value of payments processed in the SADC RTGS amounted to R1.2 trillion. Namibian banks accounted for R439 billion, which is 35 percent of the total.

VIII. CONCLUDING REMARKS

The financial system remained sound, profitable and resilient, despite unfavourable domestic and global economic conditions. Specifically, the banking sector as well as the non-bank financial institutions continued to be financially stable, sound, profitable and well capitalised. Furthermore, the banking sector maintained liquidity levels well above the prudential requirement. Asset quality as measured by the incidence of non-performing loans deteriorated further in 2018, partly ascribed to unfavourable economic conditions and their concomitant impact on household disposable income and business performance, but remained within acceptable limits. This deterioration in the asset quality however does not pose any immediate risk to banks as they are adequately capitalised to offset this risk. Although both household and corporate debt increased moderately, risk to the financial system remained modest. Despite a moderation in the growth rate of NBFI assets, the NBFI sector remained financialy 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.

Although medium-term risks to global financial stability have remained elevated, near-term risks have risen modestly over the period under review. Furthermore, global financial conditions are still broadly accommodative and therefore supportive of growth in the near-term. Risks could rise sharply should pressure in emerging market economies mount and trade tensions escalate, thereby having an impact on investor confidence and as a result harming economic expansion. On the contrary, medium-term risks remained high as eased financial conditions contribute to a further buildup of financial vulnerabilities owing to elevated debt levels as well as stretched asset valuations. Proactive regulation and supervision can therefore mitigate potential systemic risks.

Going forward, risks to the Namibian financial system requires continues monitoring. Overall, the financial system and markets in Namibia remained sound with no disruptions or disorderly functioning of key financial services despite recessionary economic conditions. However, since the last FSR some risks increased and may require continued monitoring. Specifically, the significant increase in the NPL ratio in the banking sector and the market risk in the NBFIs sector, will be monitored accordingly under the advisory guidance of the Financial System Stability Committee.

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