# Namibia Financial Stability Report

April 2018

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

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

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

# List of Abbreviations

| | |
|---|---|
| AEs | Advanced Economies |
| AfDB | African Development Bank |
| ALSI | All Share Price Index |
| AM | Asset Managers |
| ATM | Automatic Teller Machine |
| AuM | Assets Under Management |
| BEL | Best Estimate of Policyholder Liabilities |
| CCBG | Committee of Central Bank Governors |
| CIS | Collective Investment Schemes |
| CMA | Common Monetary Area |
| CMA-CPOC | Common Monetary Area Cross-border Payment Oversight Committee |
| CPI | Consumer Price Index |
| DLTs | Distributed Ledger Technologies |
| EFT | Electronic Fund Transfers |
| EMDEs | Emerging Markets and Developing Economies |
| EMEs | Emerging Market Economies |
| EMV | Euro-Pay MasterCard Visa |
| FIM | Financial Institutions and Markets |
| FS | Friendly Societies |
| FSAP | Financial Sector Assessment Programme |
| FMI | Financial Market Infrastructure |
| FNB | First National Bank |
| FSR | Financial Stability Report |
| FSSC | Financial System Stability Committee |
| GDP | Gross Domestic Product |
| GFSR | Global Financial Stability Report |
| HPI | House Price Index |
| IAIS | International Association of Insurance Supervisors |
| ICP | Insurance Core Principles |
| IMF | International Monetary Fund |
| JSE | Johannesburg Stock Exchange |
| LTD | Loan-to-Deposit |
| LTFR | Loan-to-Total Funding Ratio |
| LTI | Long Term Insurance |
| LTV | Loan-to-Value |
| MCR | Minimum Capital Requirement |
| MPC | Monetary Policy Committee |

| | |
|---|---|
| MoBEL | Margin over the Best Estimate of policyholder Liabilities |
| 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 |
| PCIDSS | Payment Card Industry Data Security Standards |
| PF | Pension Fund |
| PFMIs | Principles for Financial Market Infrastructure |
| POS | Point-Of-Sale |
| PSCE | Private Sector Credit Extension |
| RBOPF | Risk-Based Oversight Policy Framework |
| ROA | Return on Assets |
| ROE | Return on Equity |
| ROI | Return on Investment |
| RWCR | Risk-Weighted Capital Ratio |
| SACU | Southern African Customs Union |
| SARB | South African Reserve Bank |
| SCR | Solvency Capital Requirement |
| SOEs | State Owned Enterprises |
| SSA | Sub-Saharan Africa |
| STI | Short Term Insurance |
| UK | United Kingdom |
| US | United States of America |
| VCs | Virtual Currencies |
| VIX | Volatility Index |
| WEO | World Economic Outlook |
| Y-o-Y | Year-on-Year |
| ZAR | South African Rand |

# PREFACE

The purpose of the Financial Stability Report (FSR) is to identify risks and vulnerabilities in the financial system and assess the resilience of the financial system to domestic and external shocks. The Report also serves as a communication tool. The report presents recommendations to 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.

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 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 of policy actions to ensure lasting financial system stability.

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# I. INTRODUCTION AND SUMMARY

1 **The Namibian financial system continued to be resilient amidst recessionary economic conditions.** Overall, the financial system and markets in Namibia remained sound, profitable, with no disruptions or disorderly functioning of key financial services despite unfavourable domestic economic conditions. Specifically, the banking industry remained well capitalised and maintained capital levels well above the minimum prudential requirements during 2017. The banking institutions displayed healthy aggregate balance sheet growth, positive profitability and satisfactory liquidity levels during the period under review. Given challenging economic conditions and the associated shedding of jobs, disposable income has come under pressure, resulting in a significant increase in the ratio of non-performing loans (NPLs). This deterioration in asset quality however does not pose any immediate risk to banks as they are adequately capitalised to offset this risk. Similarly, the non-bank financial institutions (NBFIs) continued to be financially stable, sound, with growing assets, and with no major risks. The payment system and infrastructure also continued to perform efficiently and effectively, and with increasingly robust risk mitigating measures to facilitate safe payments. House prices decelerated, however, with no threat to the stability of the financial system. Household debt moderated marginally, while corporate debt increased. Although both these ratios remained high when compared to those of peer countries, the associated risks to financial stability remain minimal.

2 **While still supportive of economic growth, global financial conditions have tightened slightly.** According to the IMF's April 2018 Global Financial Stability Report (GFSR), financial vulnerabilities which have accumulated during the years of very low interest rates and volatility could put financial stability and economic growth at risk. Going forward, easy financial conditions may further contribute to the build-up of financial fragilities as well as increasing risk to the global financial stability and economic growth over the short and medium-term. Although greater risk taking by financial intermediaries is part of a healthy economic recovery, it may breed vulnerabilities that could harm future growth if excessive, particularly when investors go over and beyond risk tolerance into riskier instruments. In this regard, continued monitoring and heightened vigilance is therefore essential.

3 **Global growth, strengthened in 2017, supported by improved demand in Advanced Economies (AEs) and the recovery of some Emerging Market and Developing Economies (EMDEs) as well as strengthened economic activity in Sub-Saharan Africa.** Economic growth in the US improved on the back of strong business investment, while the resilience of the growth momentum in the Euro Area and Japan was underpinned by robust private consumption, investment and external demand. EMDEs such as Brazil, Russia and Nigeria recovered significantly, which was ascribed to growth in trade and investment, while growth in China remained healthy owing to policy support, strong external demand, and progress in domestic reforms. Growth in Sub-Saharan Africa improved mainly due to the Angolan, Nigerian and South African economies.

4 **The global economy is projected to expand further in 2018.** According to the IMF's April 2018 World Economic Outlook (WEO), global output is estimated to increase by 0.1 percentage point to 3.9 percent in 2018. The projected improvement in global output is expected to emanate mainly from a marginally higher growth projected for EMDEs and steady growth in AEs on account of strong sentiment and favourable global financial conditions, which is expected to boost demand. Economic activity in Sub-Saharan Africa is also expected to pick up. Generally, the upturn in global economic activity is expected to continue in 2018.

5 **The domestic economy contracted in 2017, compared to 2016.** Real GDP in Namibia is estimated to have contracted by 0.8 percent in 2017, from a positive growth of 0.7 percent in 2016, due to declines in construction, wholesale and retail trade and the public sector. Growth is projected to improve steadily to 1.4 percent in 2018; however, the risks to the domestic outlook remain pronounced, primarily due to persistently low uranium prices and unpredictable rainfall that is expected to affect the performance of the agricultural sector. The slowdown in the economy in 2017 has contributed to the shedding of jobs in various sectors of the economy, thereby resulting in the increase in NPL ratios as household income became constrained. Going forward however, the relative improvement in economic growth is expected to contribute positively to financial stability in Namibia.

6 **While the level of household indebtedness moderated slightly, corporate debt grew during the period under review.** Household debt to disposable income moderated

from 84.1 percent in 2016 to 83.3 percent in 2017, in line with the slower growth in total credit extended in 2017. In contrast, total corporate sector debt grew by 12.7 percent in 2017, compared to 9.8 percent in 2016. The growth in the corporate debt stock was attributed to a higher increase in foreign debt, compared to domestic debt to the private sector. Foreign private sector debt grew by 20.3 percent as a result of base effects attributed to the restructuring of debt to equity by some mining companies in 2016. Despite that the risks emanating from both the household debt and corporate debt sectors remained well contained, that is, with no immediate threat to financial stability. Continuous monitoring is nonetheless required.

7 **Overall house price inflation for residential properties, though positive over the last 5 years, continued to decelerate in 2017.** With the economy sluggish and grinding into recession in 2017 and the associated shedding of jobs, disposable income remained under significant pressure. These macroeconomic challenges continued to weigh on the Namibian housing market as annual house price inflation decelerated to 4.0 percent in December 2017, in contrast to 5.4 percent during the same period in 2016. The moderation in the housing market may however not pose a threat to the stability of the financial system even if prices were to continue slowing, given the sustained demand and a relatively smaller proportion of non-primary residential properties.

8 **Since the last FSR, the performance of the Namibian banking sector has been sound, although the asset quality deteriorated.** The banking industry remained adequately capitalised and maintained capital positions well above the minimum prudential requirements during 2017. The banking institutions' assets continued to grow, although the non-performing loans (NPLs) ratio which is the key measure of the asset quality deteriorated significantly to 2.5 percent at the end of December 2017, up from 1.5 percent during the same period in 2016.

9 **The NBFI industry remained financially stable and sound and continued to grow its assets, despite recessionary economic conditions in the domestic economy.** The NBFI asset base grew by 18.0 percent in 2017, driven mainly by a general increase in investment income due to buoyant financial markets and thus improved market returns during the period under review. Going forward, concentration risk within NBFIs however needs to be monitored.

10 **The payments system and infrastructure continued to perform efficiently and effectively, and with increasingly robust risk mitigating measures to facilitate safe payments.** During the period under review, key payment systems and infrastructures remained broadly available with no major disruptions or disorderly functioning that may compromise the provision of key financial services that support the economy. The Bank continued to fulfil its regulatory mandate as the overseer of the National Payment System (NPS) in 2017, in line with the Payment Systems Management Act 18 of 2003, as amended. Security efforts by the Bank and industry contributed to ensure that the NPS and the broader financial sector remained stable, safe and secure, which in turn, reinforced confidence in the financial system.

# 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 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 the probability of occurring and the potential impact on financial stability in Namibia.

**From a risk profile point of view, the key risk to Namibia's financial system resulted mainly from the country's economic slowdown.** Most risks to the financial system have either remained low or unchanged with minimal potential impact on the financial system. Of concern, however, is the sustained slowdown in the economy over the past 2 years, which has the potential to reverse the current profiles of risks and increase vulnerability across the board (Figure 1a). Although the slowdown in some of the economic activities could partly be attributed to the fiscal consolidation efforts underway, the long-term objective of these efforts are to restore and strengthen structural macroeconomic fundamentals, which could aid the stability of the financial system in the medium to long run. Globally, growth which has been gaining momentum, accompanied by improved commodity prices and favourable financial conditions for the most part of 2017, has positively contributed to global financial stability. Going forward, however, high levels of uncertainty in key markets may create excessive volatility in financial markets, which can trigger a recession and/or slowdown and potentially reverse or exacerbate the current profiles of the risks identified.

## Figure 1a: Risks to financial stability in Namibia


[1] The NBFIs funding position remained well funded, financially sound and improved mainly due to growth in investment income.

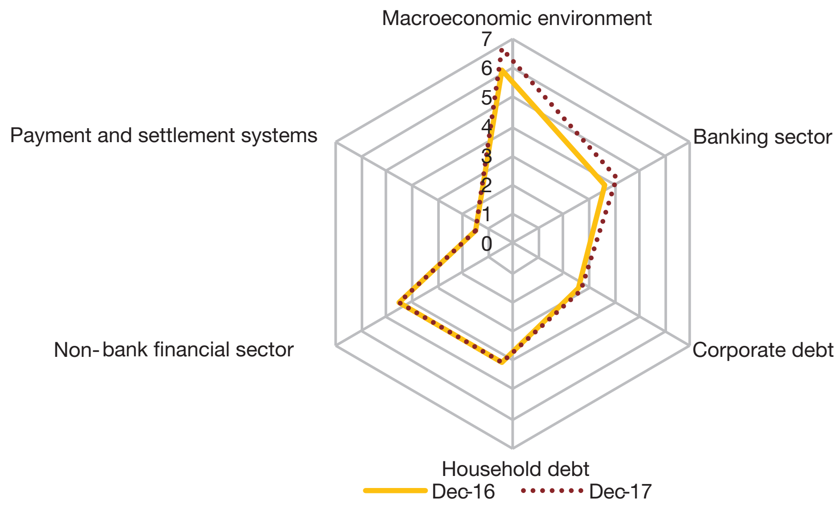
[2] Growth in investment income was generated primarily from improved equity market returns.

[3] The market share split between top 5 vs. non-top 5 remained steady at a 70-30 ratio. As top 5 entities per sector continued to dominate, maintaining their share of about 70 percent of total NBFI assets. However, NBFIs remained compliant with investment regulations despite concentration risk.

[4] NBFIs remained financially sound and solvent on the back of strong reserve base. Further, excess reserves increased due to investment income growth, thus the NBFI industry held surplus reserves to cushion against adverse movements.

**Since the issuance of the last FSR in April 2017, trends in key risks to domestic financial stability remained broadly unchanged.** Risks emanating from the household debt, corporate debt, the non-banking as well as the payments and settlement systems remained virtually unchanged irrespective of deteriorating economic conditions (Figure 1b). Similarly, risks from the banking sector remained steady despite the deterioration in asset quality during the period under review. Although the household debt ratio moderated slightly, corporate debt on the other hand increased significantly. Nonetheless, risks emanating from these two sectors remained broadly unchanged, minimal and manageable. Risks to NBFIs as well as the payments and settlement systems remained unchanged. While risks to global financial stability moderated as a result of the overall global economic upturn, the domestic macroeconomic environment deteriorated.

**Figure 1b: Domestic financial stability risks map[5]**




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

# III. MACROECONOMIC ENVIRONMENT

## Global Economic Growth

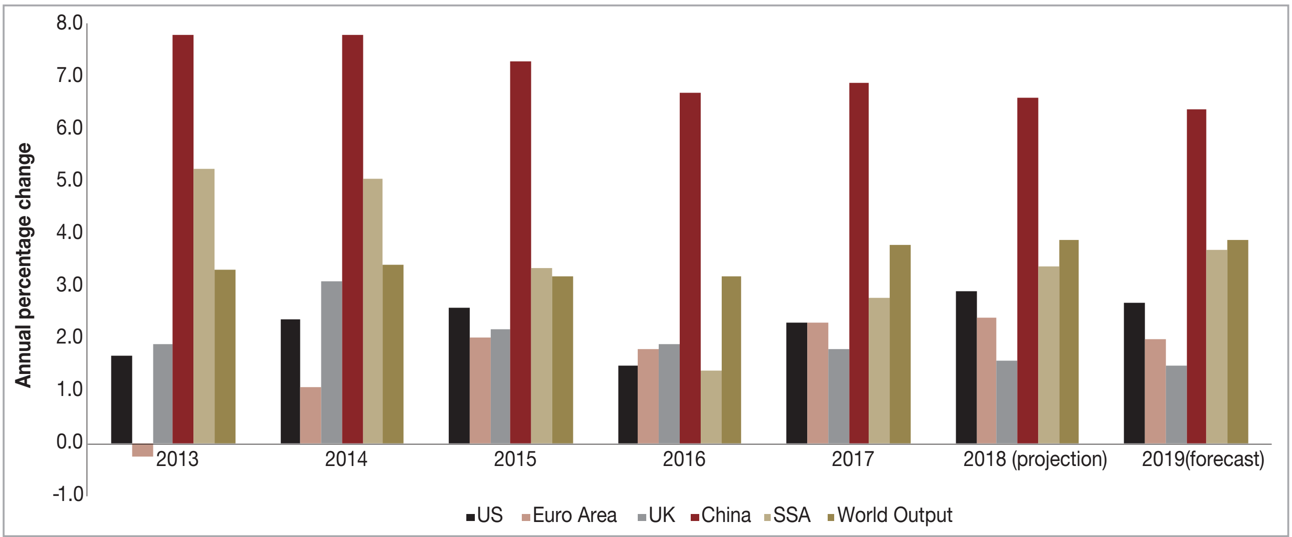
**Global growth is estimated to have strengthened since the last Financial Stability Report (FSR).** According to the IMF's April 2018 World Economic Outlook (WEO), the pace of global output growth increased to 3.8 percent in 2017 from 3.2 percent in 2016, supported by improvements in investment, trade and industrial production. The global growth for 2017 was broad-based reflecting enhanced activities in both Advanced Economies (AEs) and Emerging Market and Developing Economies (EMDEs). In Advanced Economies, real growth improved by 0.6 percentage point to 2.3 percent in 2017 driven by the US, Eurozone and Japanese economies. Economic activity in some of the Emerging Market and Developing Economies, in particular Russia, Brazil and Nigeria, registered notable improvements.

**GDP growth in AEs improved in 2017, owing to increased local and external demand, reinforced by higher consumer and business confidence.** Output and domestic demand grew faster in 2017, compared to 2016. Economic growth in the US increased to 2.3 percent in 2017, from 1.5 percent in 2016, on the back of strong business investment and a moderate recovery in the energy sector. Similarly, the growth momentum in the Euro Area and Japan picked up in 2017 to 2.3 percent and 1.7 percent, up from 1.8 percent and 0.9 percent respectively in 2016, underpinned by robust private consumption, investment and external demand. On the contrary, growth in the UK slowed to 1.8 percent from 1.9 percent over the same period due to subdued exports and a reduction in the growth rate of the service sector.

**EMDEs grew steadily driven by recoveries in some emerging market economies and sustained growth in China and India.** Key EMDEs, notably Brazil, Russia and Nigeria recovered to record positive growth of 1.0, 1.5 and 0.8 percent in 2017 from the contractions of 3.5, 0.2 and 1.6 percent, respectively in 2016, ascribed to growth in trade and investment. Growth in China improved to 6.9 percent in 2017 from 6.7 percent in 2016, owing to policy support, strong external demand, and progress in domestic reforms. In India growth also remained strong at 6.7 percent, although it was down by 0.4 percentage point.

**Economic activity strengthened in Sub-Saharan Africa driven by enhanced growth in Angola, Nigeria and South Africa.** Growth in Sub-Saharan Africa increased by 1.4 percentage points to 2.8 percent in 2017 largely attributed to the Angolan, Nigerian and South African economies. The IMF projected real GDP for Angola to have switched to positive growth of 0.7 percent in 2017, from a contraction of 0.8 percent in 2016. The GDP in Nigeria expanded by 0.8 percent in 2017 from a contraction of 1.6 percent in 2016, while in South Africa growth improved to 1.3 percent from a slow pace of only 0.3 percent in 2016. The recessions in Angola and Nigeria were reversed by the recovery in oil prices. In the case of Nigeria, growth was also supported by the strong activities in the agricultural sector. Growth in South Africa improved by 1.0 percentage point in 2017 on account of strong performances of the agriculture and mining sectors.

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




Source: IMF World Economic Outlook, April 2018

**Global growth is projected to improve moderately during 2018 and 2019, supported by both the AEs and EMDEs.** Global output is projected to increase to 3.9 percent in both 2018 and 2019, respectively. The projected improvement in global output results mainly from marginally higher growth in EMDEs supported by recoveries in Brazil and Nigeria. AEs are projected to remain steady given strong sentiment and favourable global financial conditions which are anticipated to boost demand, with a beneficial impact on economic growth and financial stability in large exporting countries. Economic activity is expected to pick up in Sub-Saharan Africa owing largely to the oil exporting countries Angola and Nigeria. While GDP growth and investment in South Africa is expected to improve given improved sentiment as a result of a change in leadership, unresolved issues surrounding property rights remain a concern.

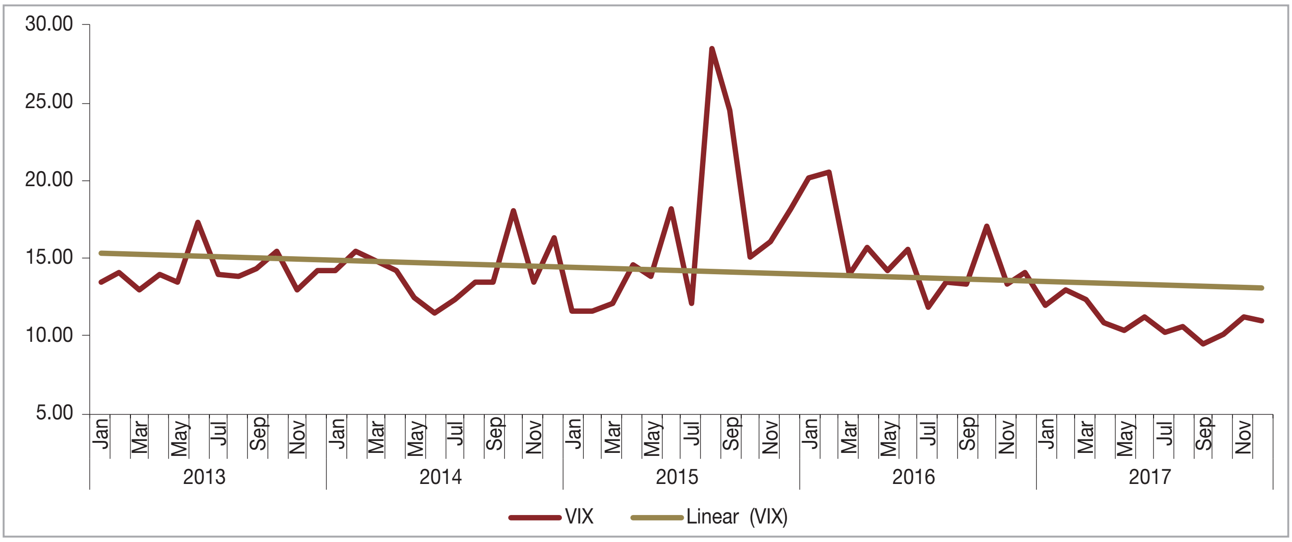
**Risks to global growth are broadly balanced.** On the upside, a rebound could prove stronger as the increase in activity and relatively easy financial conditions reinforce each other. On the downside, asset valuations and compressed term premiums elevate the possibility of a financial market correction, which could dampen growth and confidence. A possible trigger is a faster-than-expected increase in AEs' core inflation and interest rates as demand accelerates. If global sentiment remains strong and inflation muted, then financial conditions could remain expansionary into the medium term, leading to a buildup of financial vulnerabilities in AEs and EMDEs alike. Inward-looking policies, geopolitical tensions, and political uncertainty in some countries also pose downside risks.

## Developments in the Financial Markets

### Advanced Economies

**Financial markets sentiment remained strong with low volatility in 2017, compared to 2016.** The volatility index (VIX) of the Chicago Board Options Exchange declined to an average of 11.1 index points in 2017, from 15.3 index points in the preceding year and varied between 9.6 and 12.9 index points, a smaller range than the variation between 11.9 and 20.6 index points recorded in 2016 (Figure 3). Equity markets continued to grow amid strong earnings and a gradual normalization path for monetary policy in a weak inflation environment, coupled with further improvements in consumer and business confidence.

**Figure 3: Volatility Index**




Source: Bloomberg

**The fixed income market was characterized by a mixed performance during the period under review.** The yield on 10-year US Treasury bonds declined by 20 basis points, in line with markets pricing in a more gradual than initially expected normalization of the US monetary policy and diminished fiscal stimulus expectations. Long-term sovereign bond yields rose by about 10 basis points in the UK, while they remained stable in Germany and Japan.

### Emerging Market Economies

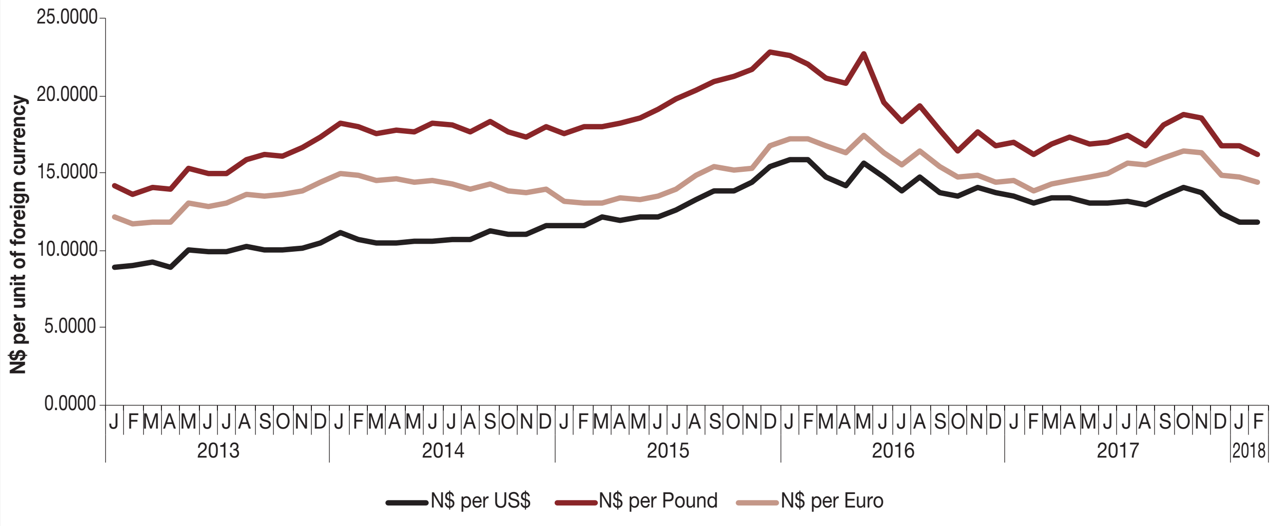
**The performance of financial markets amongst EMDEs improved during 2017.** The major factors that contributed to enhanced performance in the period under review were improved world trade volumes, increased oil prices and resilient capital flows to EMDEs. During 2017 capital flow recovery continued and remained resilient after a significant decline at the end of 2015 and the beginning of 2016. This was reflective of an increase in capital flows to China and a robust global recovery in nonresident portfolio inflows in the first two quarters of 2017 on the back of improved investors' optimism with regard to the global economic outlook as well as relatively easy financial conditions. EMDE currencies generally strengthened relative to the US dollar, as investors' search for yields continued. This search for yields has led to greater capital flows to low-income countries, where enhanced policy buffers in the form of higher international reserves can be beneficial for financial stability, but can also be a risk when sentiment turns around.

## Exchange Rate Developments

**The Namibia Dollar appreciated against most of the major tradeable currencies during 2017.** Comparing the annual average level of the exchange rate in 2017 with that of 2016, the Namibia Dollar appreciated against the US Dollar, British Pound and the Euro. However, it depreciated by 2.8 percent against the Euro in December 2017 compared to December 2016, although over the same period it appreciated by 9.9 percent and 0.4 percent against the US Dollar and the British Pound, respectively (Figure 4). The appreciation was supported by stronger commodity prices, the narrowing current account deficit of South Africa and its partners in the Common Monetary Area (CMA), base effects and a rebound in appetite for emerging market risks from developed markets as well as a change in leadership in South Africa during the period under review. The likely sustained period of low interest rates in

AEs could further deepen financial stability risks as investors take on more risk in their search for yield.

**Figure 4: Exchange rate movements of the Namibia Dollar against selected currencies**




Source: Bloomberg

## Monetary Policy Stance of South Africa

**The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) reduced the Repo rate in July 2017 and March 2018, in line with improved inflation.** The MPC after the reduction in July maintained the Repo rate at 6.75 percent in the remainder of 2017 as the further moderation in food price inflation was balanced by the recurrence of increases in international oil prices as an upside risk to domestic inflation. The Repo rate was further cut by 25 basis points in March 2018, in light of an improved inflation outlook and the moderation in risks to the forecast. The annual inflation rate decreased to an average of 5.3 percent in 2017 from 6.3 percent in 2016, which is well within the 3 to 6 percent target (Table 1). South Africa's economic growth outlook remains subdued, but more positive than before, benefiting from the stronger global economy.

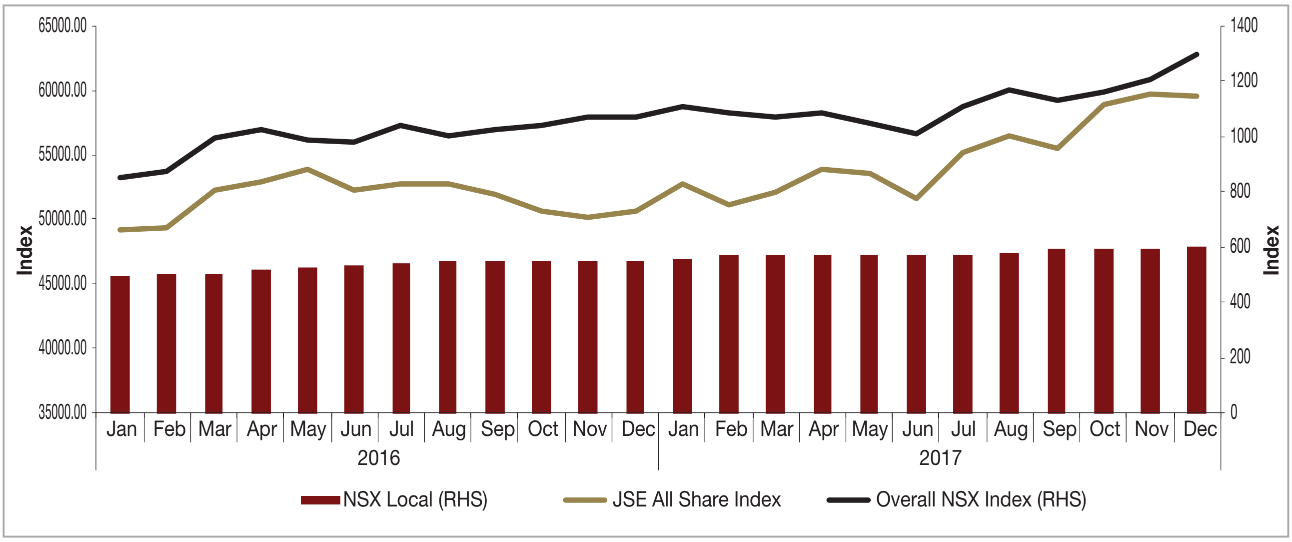
**Table 1: South Africa's Consumer Price Index and Annual Inflation Rate (Dec. 2016=100)**

| 2016 | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| INDEX | 94.4 | 95.7 | 96.4 | 97.2 | 97.4 | 97.9 | 98.7 | 98.6 | 98.8 | 99.3 | 99.6 | 100.0 |
| RATE(%) | 6.2 | 7.0 | 6.3 | 6.2 | 6.1 | 6.3 | 6.0 | 5.9 | 6.1 | 6.4 | 6.6 | 6.8 |
| **2017** | **Jan** | **Feb** | **Mar** | **Apr** | **May** | **Jun** | **Jul** | **Aug** | **Sep** | **Oct** | **Nov** | **Dec** |
| 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 |
| 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 |

Source: Statistics South Africa

**The outlook for the monetary policy stance of the South African Reserve Bank (SARB) remains a key factor to financial stability in Namibia.** The dynamics that will inform the policy stance entails amongst others the inflation outlook, the path of the exchange rate of the Rand against major currencies and fiscal consolidation which could potentially improve the scope for further monetary policy accommodation. Adverse developments in these variables could induce the SARB to adjust the repo rate upwards which could result in the Bank of Namibia following suit, exerting pressure on highly exposed corporate and individual borrowers and financial stability in the country.

**Figure 5: The JSE and NSX performance**




Source: Bloomberg

**The Johannesburg Stock Exchange (JSE) All Share Index (ALSI) and the NSX Overall Index initially moved broadly sideways with an upward trend in the second half of 2017, while the Local Index remained steady during 2017.** On the JSE, the top three big gainers over the course of the year in the large- and mid-capitalization space were Kumba Iron Ore, Exxaro Resources and Naspers. Furthermore, the top performing sectors were Coal, Industrial metals and Media. Coming from a relatively low base, coal and iron mining corporates had a good year, notably so with two commodity companies topping the list. Out of the 105 largest companies on the JSE, only 31 recorded a negative performance in 2017. Similarly, the NSX overall Index rose by 12.9 percent in 2017, driven by an increase in share prices for most industries, with the exception of health care and consumer industries (Figure 5). The NSX Local Index remained relatively steady in both 2016 and 2017. All in all, financial markets in both South Africa and Namibia performed well during the period under review, therefore contributing positively to financial stability.

# Domestic Economy

## Output and Inflation

**The domestic economy is estimated to have contracted and inflation declined during 2017.** Real GDP in Namibia is estimated to have contracted by 0.8 percent in 2017 from a positive growth of 0.7 percent in 2016, mainly driven by negative growth rates in construction, wholesale and retail trade and the public sector. Other sectors such as manufacturing, electricity and water, transport and communication slowed. Growth is projected to improve steadily to 1.4 percent in 2018; however, the risks to the domestic outlook remain pronounced, primarily due to persistently low uranium prices and unpredictable rainfall that may affect the performance of the agricultural sector. The medium term growth is expected to be supported by developments in the primary sector as well as the transport and communication sectors. Annual average inflation fell to 6.2 percent in 2017 from 6.7 percent in 2016, with an inflation rate of 5.2 percent in December 2017. The slowdown in 2017 was caused by all the categories within the NCPI, with the exception of Education, Transport and Health. Food inflation, in particular, slowed considerably in the wake of improved agricultural conditions and a stronger exchange rate.

# IV. DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

## Household Debt to Disposable Income

**Since the last FSR, the ratio of household indebtedness to disposable income moderated slightly on the back of slow growth in mortgages and a contraction in instalment credit.** Annual growth in household indebtedness slowed to 6.7 percent in 2017 from 9.3 percent in 2016. The sluggish growth in credit extended to households was more evident in the category instalment sales credit, which contracted by 3.9 percent in 2017 from a positive growth rate of 8.1 percent in 2016. Mortgage lending, which makes up 67.8 of total loans and advances to households, recorded growth of 8.0 percent at the end of 2017, slightly down from 8.7 percent at the end of 2016. The slower growth in credit extended to households in 2017 was driven by poor domestic economic conditions, supported by the introduction of the maximum loan-to-value (LTV) ratios for non-primary residential mortgages and the amendments to the Credit Agreement Act which added further downward pressure. Household income grew at a marginally higher rate of 7.8 percent in 2017 relative to the growth in household debt of 6.7 percent in 2017 (Table 2), resulting in a very moderate improvement in the ratio of household indebtedness to disposable income. In this regard, risks to the financial system resulting from household indebtedness remained broadly unchanged.

**Table 2: Household Debt and Disposable Income**

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Disposable Income (N$) | 48 035 | 55 378 | 60 287 | 65 938 | 71 503 |
| Disposable Income (Percentage growth) | 15.4 | 10.5 | 10.3 | 13.3 | 7.8 |
| Credit to Disposable Income (%) | 74.8 | 73.5 | 76.0 | 75.9 | 74.7 |
| Credit to Individuals/Households (N$) | 35 939 | 40 703 | 45 810 | 50 054 | 53 420 |
| Adjusted Credit* to Disposable/Households (N$) | 40 072 | 45 384 | 51 079 | 55 811 | 59 563 |
| Adjusted Credit** % of Disposable Income | 83.4 | 85.6 | 87.3 | 84.1 | 83.3 |

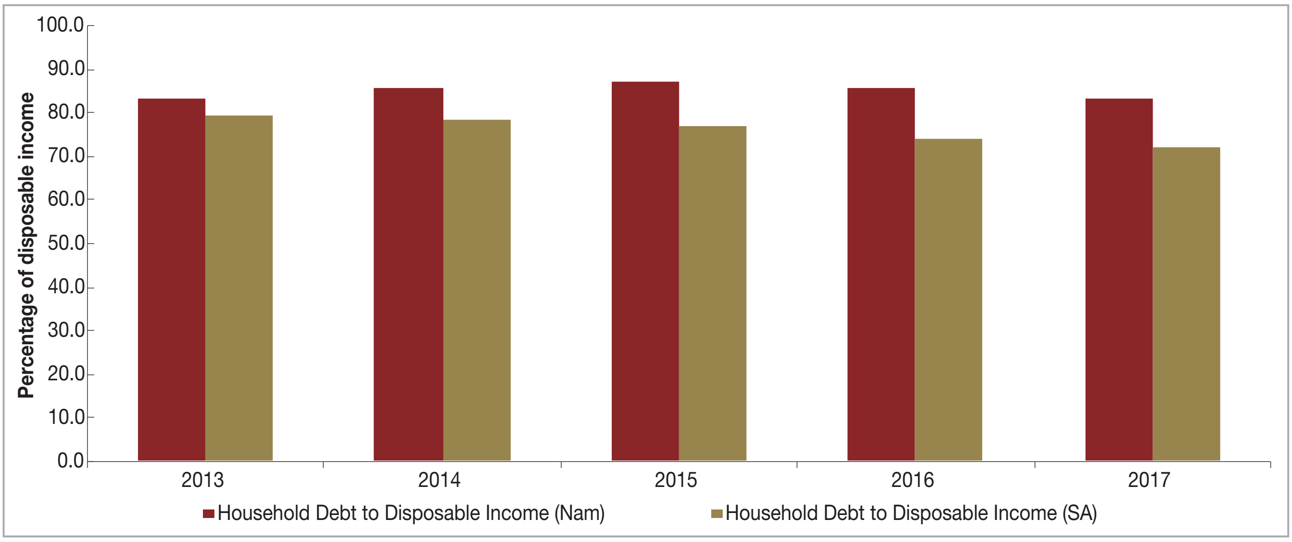
*The ratio of household debt to disposable income is calculated based on income and tax data from the national budget documents, national accounts, and household debt data from the Bank of Namibia. The National Accounts were revised from 2007 to 2017, resulting in changes in the household disposable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

Source: Bank of Namibia

**Despite a slight downward moderation, the household indebtedness-to-disposable-income ratio remained high in 2017.** Household debt to disposable income moderated from 84.1 percent in 2016 to 83.3 percent in 2017, in line with the slower growth in total credit extended to households in 2017. The contraction in instalment credit was the main contributor to the developments in the household debt-to-disposable-income ratio. Moreover, the moderation in mortgage lending to households contributed to the lower household debt-to-disposable-income ratio. Although household debt relative to disposable income remained high when compared to peer countries, it is largely made up of mortgage lending. In addition, the debt-servicing-to-disposable-income ratio remained below 20.0 percent, which implies that less than 20.0 percent of household income goes towards servicing debt. In turn this means that households in Namibia are not over-borrowed, at least at the macro level. Although there could be certain segments of households that are over-borrowed at the micro level, at the macro scale household debt does not pose an immediate threat to financial stability (Table 3).

**The ratio of household debt to disposable income in Namibia continues to be above that of South Africa.**[6] At 83.3 percent of disposable income, Namibia's household debt ratio in 2017 was higher that of South Africa, which stood at 71.2 percent during the same period (Figure 6).

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

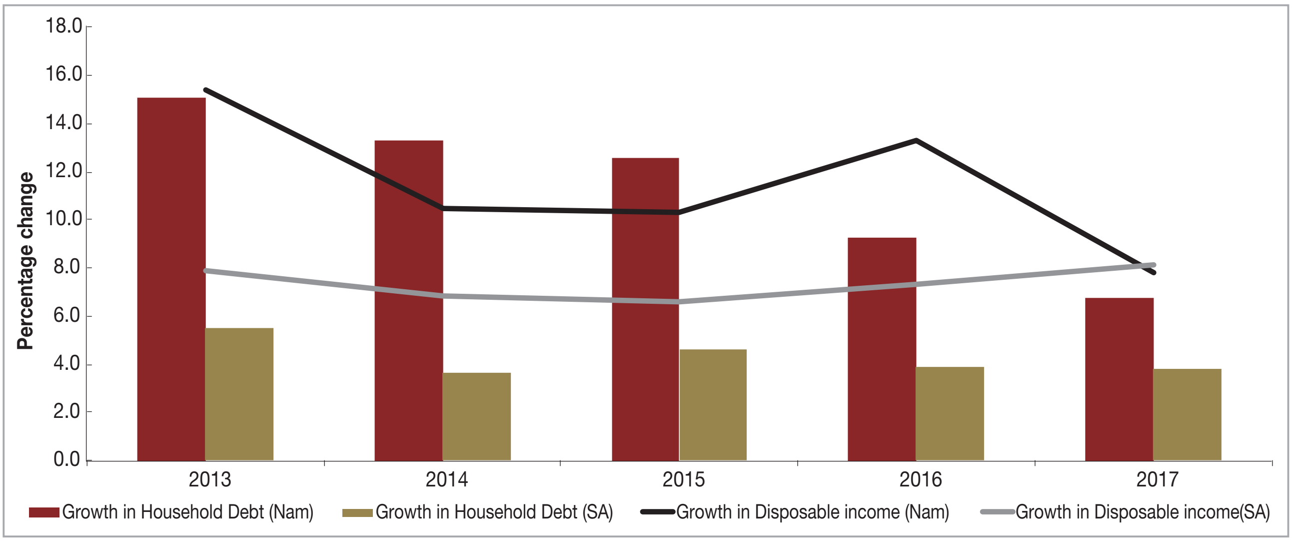



Source: Bank of Namibia and South African Reserve Bank

[6] The methodology for compiling household debt in Namibia takes into account credit extended by commercial banks, microlenders as well as the informal sector.

**The growth rate in household disposable income decelerated in Namibia during 2017, compared to 2016.** The pace of growth in household disposable income slowed by 5.5 percentage points to 7.8 percent in 2017 from 13.3 percent in 2016. This was ascribed to the moderated growth rate in the compensation of employees on account of recessionary domestic economic conditions. The higher growth rate in household income compared to that of household indebtedness, coupled with the reduction in the repo rate have reduced the pressure on household finances compared to the previous year On the contrary, household disposable income for South Africa increased by 0.8 percentage point to 8.1 percent in 2017 from 7.3 percent in 2016, underpinned by wages and salaries (Figure 7).

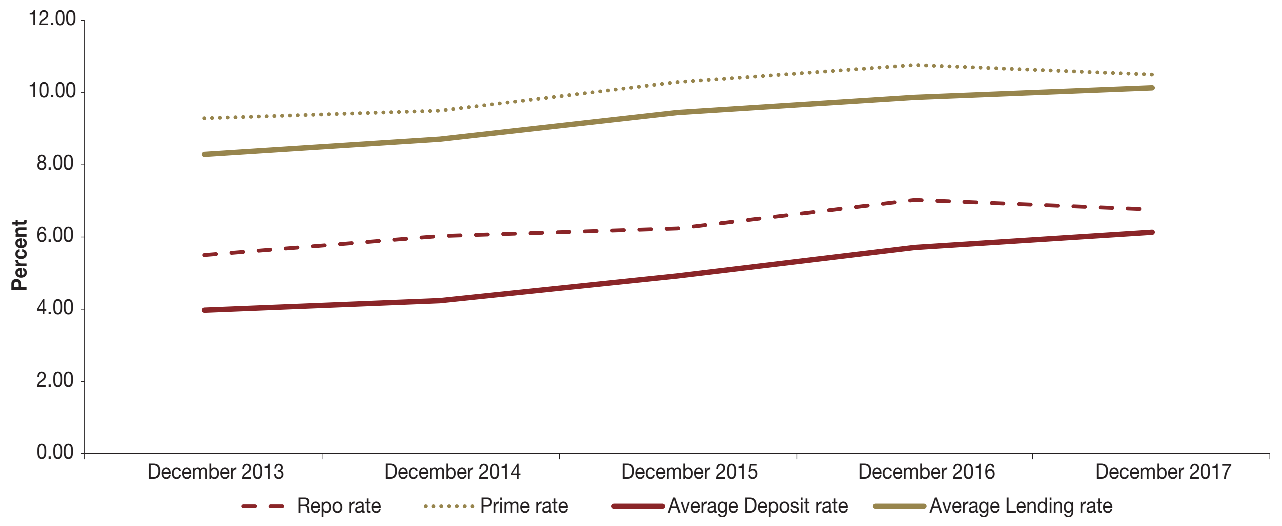
**Figure 7: Growth in household debt and disposable income**




Source: Bank of Namibia and South African Reserve Bank

**The Bank of Namibia cut its policy rate during 2017, and as a result, various money market rates were affected during the period under review.** The Monetary Policy Committee (MPC) of the Bank of Namibia reduced the Repo rate by 25 basis points to 6.75 percent at its August 2017 meeting. The decision to cut the Repo rate was to support domestic economic growth, while maintaining the one-to-one peg between the Namibia Dollar and the South African Rand. As a result, the prime lending rate of the commercial banks declined to 10.50 percent during 2017, lower by 25 basis points when compared to 2016. Despite the decline in the policy rate and the banks' prime lending rate, the banks' average lending rate rose to 10.12 percent at the end of 2017, compared to 9.87 percent at the end of 2016. The average deposit rate also rose to 6.11 percent during 2017, from a lower level of 5.69 percent at the end of 2016 (Figure 7). Historically, interest rates in Namibia are still low and continue to facilitate the servicing of loans. In addition, local banks remain in a favourable position as their assets could reprice faster than their liabilities should interest rates start to increase, which may aid financial stability.

**Figure 8: Selected Interest Rates**




Source: Bank of Namibia

## Debt Servicing Ratio

**The debt-service-to-disposable-income ratio in Namibia remained almost unchanged in December 2017, compared to December 2016.** The debt service to disposable income ratio declined marginally from 15.5 percent in 2016 to 15.2 percent in 2017 (Table 3). The key factors that contributed to this development were a slowdown in credit extension, as well as base effects, which caused a moderation in the growth of the stock of debt outstanding for the main credit categories (i.e. mortgages and instalment credit).

**Table 3: Debt servicing ratio (percentage)**

| | Gross Income Growth (Y-o-Y) | Disposable Income Growth (Y-o-Y) | Annual Debt Servicing Growth (Y-o-Y) | Debt Servicing to Gross Income | Debt Servicing to Disposable Income | Adjusted Debt Servicing to Gross Income | Average Prime Rate |
|---|---|---|---|---|---|---|---|
| Dec-13 | 14.5 | 15.4 | 12.7 | 12.2 | 14.5 | 20.7 | 10.0 |
| Dec-14 | 14.1 | 10.5 | 15.9 | 12.4 | 15.2 | 18.2 | 9.0 |
| Dec-15 | 8.3 | 10.3 | 13.8 | 13.0 | 15.7 | 19.1 | 10.0 |
| Dec-16 | 9.2 | 13.3 | 11.3 | 13.2 | 15.5 | 19.5 | 10.1 |
| Dec-17 | 6.2 | 7.8 | 5.9 | 13.2 | 15.2 | 19.4 | 10.5 |

Source: Bank of Namibia

## Corporate Debt

**Since the last FSR, the total corporate debt stock increased, primarily due to an increase in foreign debt.** The total corporate sector debt grew by 12.7 percent in 2017, compared to 9.8 percent in 2016 (Table 4). The stronger growth in the corporate debt stock was driven by a rapid increase in foreign debt, compared to domestic debt. Domestic debt grew marginally by 3.7 percent, while foreign debt grew by 18.7 percent in 2017. Consequently, the total corporate debt stock swelled to N$105.2 billion at the end of 2017 from N$93.3 billion a year earlier. Although corporate debt grew significantly, particularly the foreign debt component, it is not a major concern given that companies that borrow externally earn foreign exchange and such borrowing is neither expected to adversely impact their debt servicing capabilities, nor pose a direct threat to the domestic banking sector in Namibia.

**The corporate debt-to-GDP ratio increased by a large margin during the course of 2017.** The debt-to-GDP ratio rose by 4.1 percentage points from 57.9 percent at the end of 2016 to 62.0 percent at the end of 2017 (Table 4). The increase in the debt-to-GDP ratio is mainly as a result of growth in foreign debt. The increase in corporate debt has taken place during easy financing conditions, coupled with sluggish domestic economic activity. This has potential negative effects on the financial system should it continue to grow and bring about excessive levels of indebtedness.

**Table 4: Domestic and external corporate debt (private sector and parastatals)**

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Domestic (Percentage contribution) | 40.1 | 46 | 40.6 | 39.9 | 36.7 |
| Foreign (Percentage contribution) | 59.9 | 54.0 | 59.4 | 60.1 | 63.3 |
| Domestic debt (N$ million) | 24,111 | 29,163 | 34,483 | 37,198 | 38,577 |
| Foreign debt (N$ million) | 35,989 | 34,303 | 50,485 | 56,093 | 66,578 |
| Total Debt (N$ million) | 60,100 | 63,466 | 84,968 | 93,291 | 105,155 |
| Y-o-Y Change in % in Total Debt | 27.2 | 5.6 | 33.9 | 9.8 | 12.7 |
| Nominal GDP (N$ million) | 122,792 | 138,763 | 147,635 | 161,030 | 169,738 |
| Debt to GDP ratio | 48.9 | 45.7 | 57.6 | 57.9 | 62.0 |

Source: Bank of Namibia

**Since the last FSR, the share of private sector debt in total corporate debt increased.** The proportion of private sector debt increased by 0.4 percentage point from 93.9 percent to 94.3 percent of total corporate debt, while State Owned Enterprises (SOE) debt declined from 6.1 percent in 2016 to 5.7 percent in 2017 (Table 5). The decline in the proportion of SOE debt is attributed to the foreign debt component which declined from N$3.8 billion in 2016 to N$3.7 billion in 2017. On the contrary, the increase in the share of private sector debt is primarily ascribed to the 20.3 percent increase in the foreign private sector debt, from N$52.2 billion to N$62.8 billion during the period under review. This was as a result of base effects attributed to the restructuring of debt to equity by mining companies in the previous year. Similarly, local private sector debt rose by 2.7 percent to N$36.3 billion from N$35.3 billion and hence contributed to the increase in the share of private sector debt. This increase could be ascribed to expansion projects aimed at fulfilling long-term contracts by various corporate entities.

**Table 5: SOEs and Private sector debt breakdown**

| N$ million | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Foreign Private Sector Debt | 31,878 | 30,775 | 46,335 | 52,217 | 62,841 |
| Local Private Sector Debt | 23,384 | 28,364 | 32,584 | 35,343 | 36,300 |
| Foreign Debt of SOEs | 4,111 | 3,528 | 4,150 | 3,876 | 3,736 |
| Local Debt of SOEs | 727 | 799 | 1,899 | 1,855 | 2,277 |
| Total Corporate Debt | 60,100 | 63,466 | 84,968 | 93,291 | 105,155 |
| Foreign Debt to Total Debt (%) | 59.9 | 54.0 | 59.4 | 60.1 | 63.3 |
| Local Debt to Total Debt (% ) | 40.1 | 46.0 | 40.6 | 39.9 | 36.7 |

Source: Bank of Namibia

**SOE total debt outstanding increased marginally in 2017, relative to the same period in the preceding year.** Total debt outstanding of SOEs amounted to N$6.0 billion in 2017, comprising of N$3.7 billion foreign debt and N$2.3 billion local debt (Table 5). The foreign debt portfolio of SOEs declined by 3.6 percent, while the local debt portfolio rose by 22.7 percent during the year under review. Although the appreciation of the Namibia Dollar against major trading currencies contributed to the decline in the external debt stock in 2017, the increase in local debt was attributed to increased borrowing activities to meet the financing requirements. The stock of bonds issued by Namibian corporates on the Namibian Stock Exchange (NSX) increased by 47.2 percent to N$5.3 billion in 2017 from N$3.6 billion in 2016. The increase stemmed from the new issuance of bonds by SOEs and commercial banks during the year under review. Total outstanding corporate bonds comprised of N$4.2 billion issued by commercial banks, N$741 million issued by SOEs and N$310 million by non-bank corporates.

**Table 6: Foreign private sector debt and debt servicing**

| N$ million | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Total Foreign Private Sector Debt | 31,878 | 30,775 | 46,335 | 52,217 | 62,841 |
| Total Foreign Private Sector Debt Servicing | 15,534 | 6,301 | 11,613 | 15,208 | 8,802 |

Source: Bank of Namibia

**Total foreign private sector debt servicing declined significantly during the period under review.** Total foreign private sector debt servicing cost fell by 42.1 percent to N$8.8 billion in 2017 from N$15.2 billion in 2016 (Table 6). This was due to a debt-to-equity swap by one of the mining companies and high base effects (i.e. increased repayments by the mining sector in 2016), compared to reduced payments in 2017.

## BOX 1: IMPACT OF EXCESSIVE HOUSEHOLD INDEBTEDNESS ON FINANCIAL STABILITY AND ECONOMIC GROWTH

***An increasing number of empirical studies indicate that the benefits of debt-to-GDP growth will gradually diminish when aggregate leverage[7] is rising.*** *A similar conclusion was reached in a recently published IMF analysis[8], according to which excessive leverage could undermine economic growth in the future.*

*Furthermore, high private sector credit, including household debt, may increase the medium-term likelihood of a financial crisis and could lead to lower economic growth. Henceforth there is a certain trade-off between the short-term benefits of rising debt-to-GDP growth and its medium-term costs to macroeconomic and financial stability. In the short term, an increase in the household debt-to-GDP ratio is usually associated with higher economic growth and lower unemployment; nonetheless the effects might be reversed over the medium to longer term. These adverse effects are typically stronger when household debt is higher and are therefore usually more pronounced for advanced economies.*

*Overleveraging can be a risk to financial stability and a source of macroeconomic and financial imbalances and crises. Disproportionate increases in household leverage are associated with a higher likelihood of financial crises, and financial stability may be adversely affected through two key channels. One channel is the adverse impact of excessive debt on economic growth, employment, and disposable income, all of which reduces the servicing capacity of households' debt. Overleveraging may therefore stifle credit demand by constraining households that wish to borrow. Another channel is the deterioration in household sentiment in response to worsening economic developments, and the consequent decline in households' willingness to borrow.*

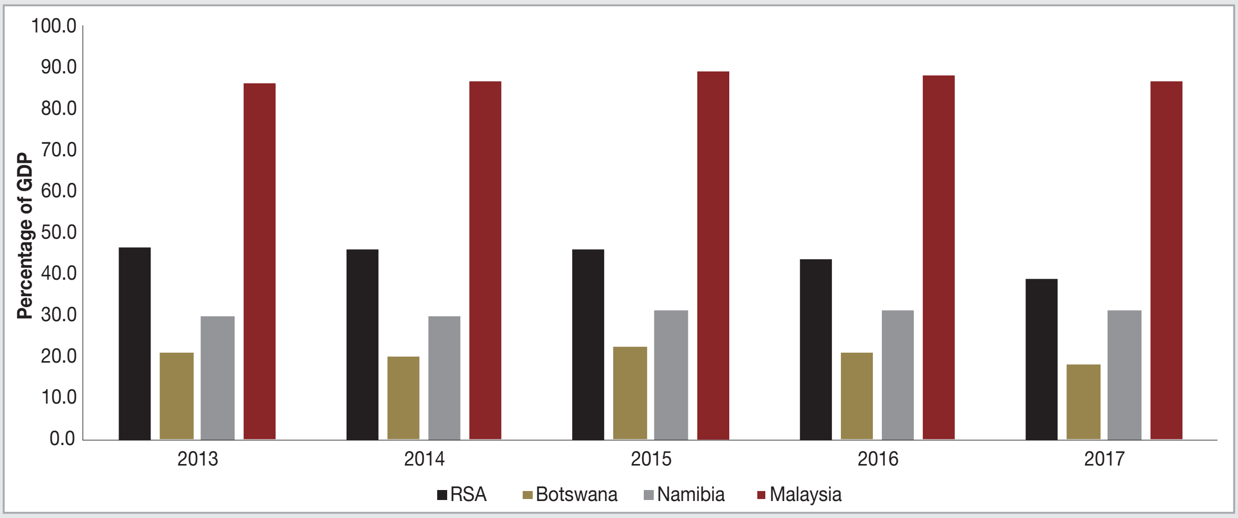
*Although it is difficult to define the point at which debt becomes excessive, the IMF analysis finds that the association between household debt and future real GDP growth turns negative at relatively low levels of household debt, i.e. exceeding 30 percent of GDP. When household debt is at 60 percent of GDP, its increase correlates quite strongly with the increasing likelihood of a financial crisis. This suggests that*

7 Leverage is defined in this box as borrowed funds that are used to finance consumption and investment.

8 Valckx, N. et al., "Household debt and financial stability", Global Financial Stability Report, IMF, October 2017.

*low-leveraged emerging market economies have some scope to stimulate economic growth by increasing households' access to credit, while advanced economies have generally exhausted this possibility. The ratio of household debt to GDP in Namibia compares favourably with comparator economies, such as South Africa, Malaysia and Botswana and averaged 30.7 percent for the period 2013 to 2017, compared to 45.1, 87.4, and 20.6 percent in South Africa, Malaysia and Botswana, respectively over the same period (Figure 1). At the same time, however, the indebtedness of Namibian households relative to disposable income is higher than that of their South African counterpart, which points to the diminishing scope for increasing households' access to credit, other things held equal. In this context, the practice applied by commercial banks which requires that the servicing cost of credit extended to households should not exceed 30 percent of their gross monthly income promotes prudent household financial behaviour and should be continued.*

**Figure 1: Household debt to GDP ratio in selected economies**




Source: IMF and respective Central Banks

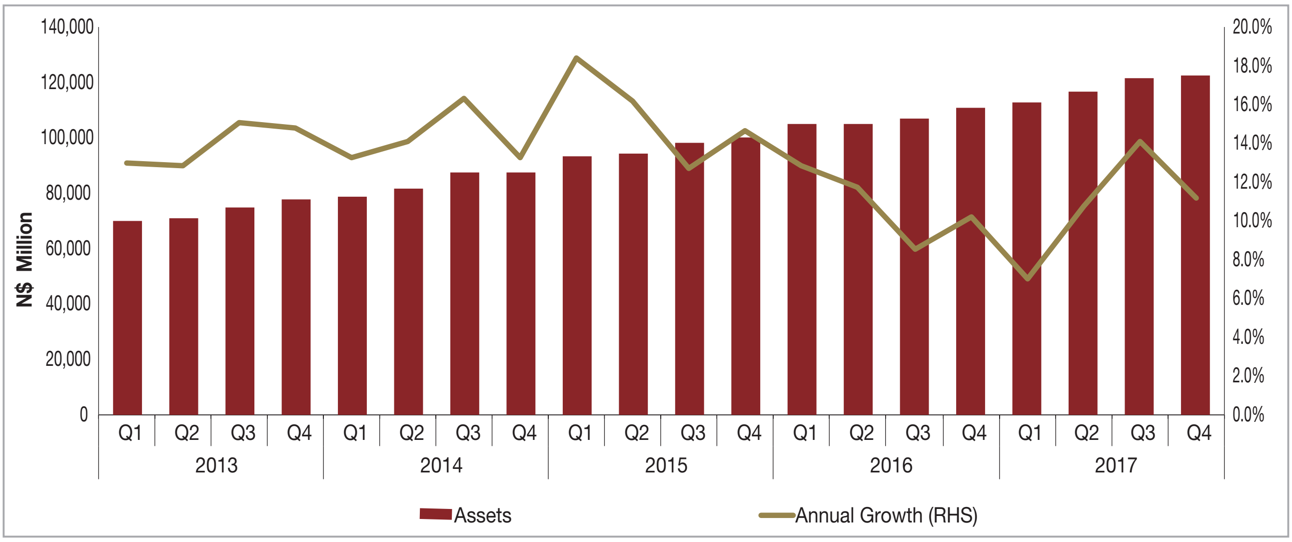
*The risks associated with increasing household debt, however, can be mitigated by certain factors in the economy, such as the strength of institutions, and the implementation of macroprudential policy. Sound institutions, high-quality regulation and supervision, less dependence on external financing, flexible exchanges rates, and lower income inequality can reduce the risks associated with increasing household debt. Namibia has implemented the Loan-to-Value ratios regulation on non-primary residential properties as a macroprudential policy tool to curb speculation in the residential housing market segment. It is expected that the regulation will contribute to managing excessive household indebtedness and promote a culture of responsible borrowing in the country.*

# V. PERFORMANCE OF THE BANKING SECTOR

## Banking Sector Asset Growth

**The growth in total assets of the banking sector picked up to double-digit rates in the second half of 2017.** The banks' assets continued to increase at a rate above that of inflation amidst recessionary economic conditions and low consumer confidence during the period under review. However, the increase in assets was concentrated in liquid assets such as banks' holdings of government securities and deposits, whereas growth in credit extension to the private sector was quite slow as discussed later on in the review. As at 31 December 2017, the banking industry balance sheet stood at N$ 122 billion, representing a growth rate of 11.1 percent, year-on-year, slightly higher than the 10.1 percent increase at the end of 2016 (Figure 9). The pace and composition of this growth signify a stable banking sector, amidst challenging economic conditions.

**Figure 9: Banking sector asset growth**



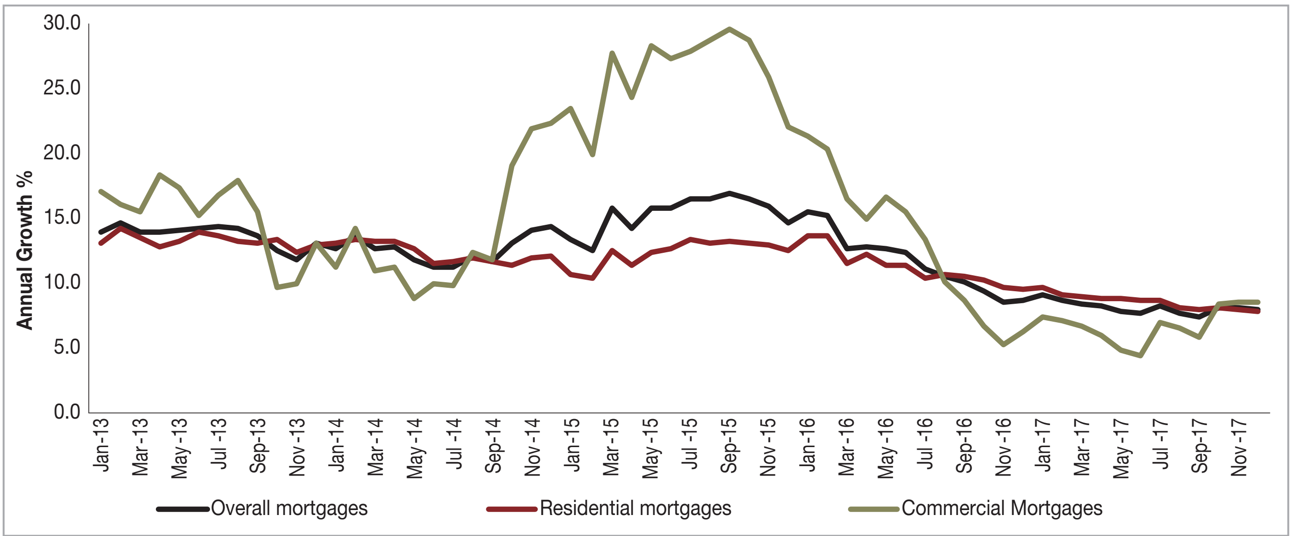

Source: Bank of Namibia

**Growth in mortgage loans, which constitute the largest asset class of the banking sector, continued to slow during 2017.** Growth in mortgage loans (i.e., residential and commercial), which account for about 52 percent[9] of total bank loans and two-thirds of lending to households, slowed to 8.0 percent at the end of December 2017, from 8.7 percent a year earlier. Mortgage loans which experienced double-digit year-on-year growth rates,

[9] Composition of Total Loans & Advances: Residential mortgages: 39%; Commercial mortgages:13%; Instalment sales:15%; Overdrafts:13%; Fixed term loans:13%; Personal loans:5%: Preference shares:1%; Credit cards:1%; and Loans to non-banks:1%.

averaging about 12.7 percent over the past ten years, peaked at the end of 2015 and has since sharply slowed (Figure 10). This slowdown could be attributed to both lower credit demand due to the deceleration in the economy and in house prices, and tentatively to the Loan-to-Value (LTV)[10] limit set for non-primary housing introduced in March 2017.

**Figure 10: Mortgage loans growth**




Source: Bank of Namibia

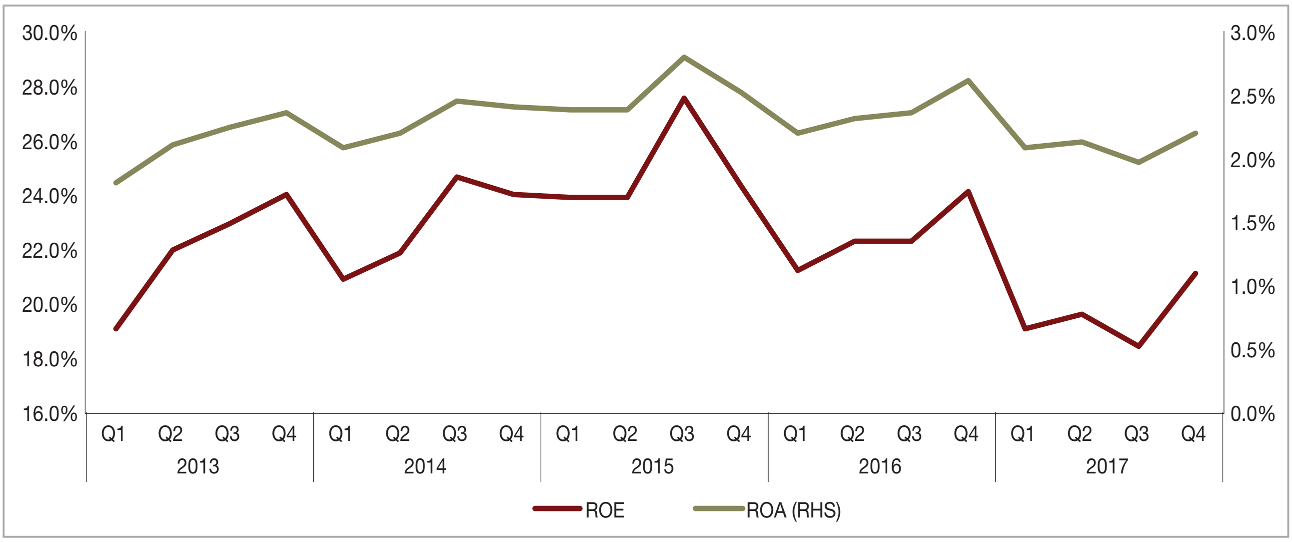
## Profitability of the Banking Sector

**The banking sector continued to be profitable despite the recession that prevailed for the most part of 2017.** The banking sector continued to record respectable profit margins, but lower in contrast to previous years, amidst a general slowdown in the economy. The Return on Equity (ROE) as well as the Return on Assets (ROA) slowed to 21.1 percent and 2.2 percent in 2017, from 24.1 percent and 2.6 percent[11], respectively, in 2016 (Figure 11). Although both ratios declined as a result of the recent weakening of the economy, the sustained profitability of the sector over so many years reflects that its overall mix of business is healthy for the sustainability of the banking institutions.

[10] A comprehensive impact assessment of the LTV regulation on the housing market is under way.

[11] These ratios were computed using after-tax figures. As per the IMF Financial Stability Indicators Manual, using before-tax figures arrives at ROE and ROA of 29.9 percent and 3.2 percent in 2017, down from 32.6 percent and 3.5 percent, respectively, in 2016. Despite the difference in methodologies, the direction of the movements remained consistent.

**Figure 11: Profitability of the banking sector**




Note: Based on after-tax profits

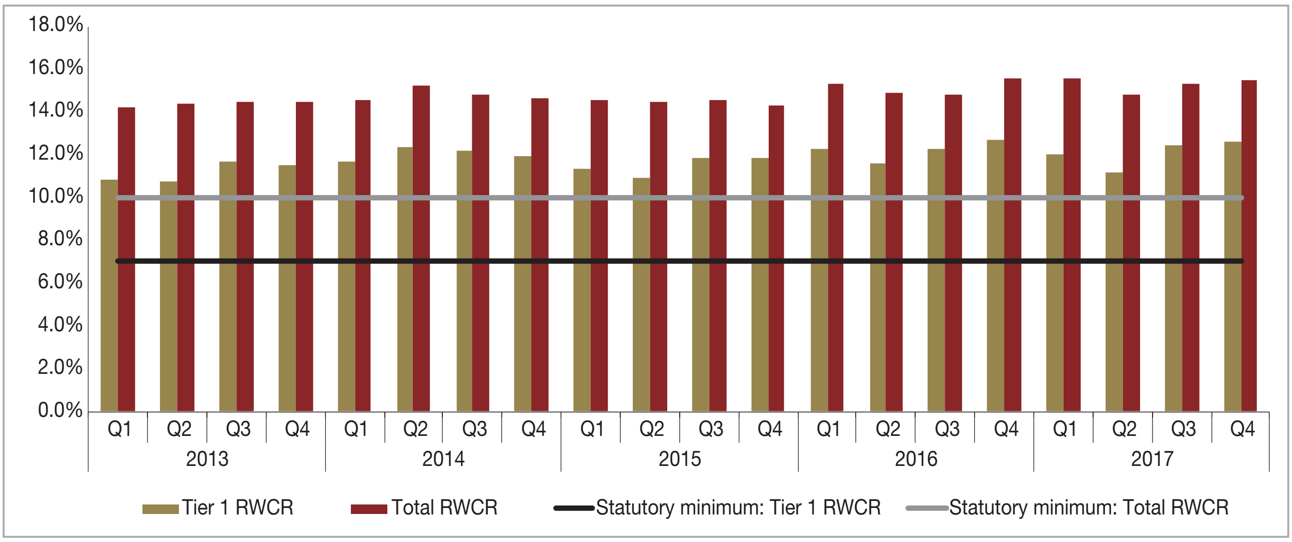
Source: Bank of Namibia

## Adequacy of Capital

**The banking industry remained adequately capitalised and maintained capital positions in 2017 well above the minimum prudential requirements.** While the industry Total Risk-Weighted Capital Ratio (RWCR) remained unchanged at 15.5 percent, the Tier 1 Capital Adequacy Ratio[12] moderated marginally to 12.6 percent from 12.7 percent during the review period (Figure 12). At these levels, both ratios are well above the minimum regulatory levels of 10 percent and 7 percent, respectively. The purpose of maintaining adequate capital and reserves is to cushion against risks associated with banking institutions' operations and growth, including to protect the banks against unsecured risk that can result in operational losses, and also to build and maintain public confidence. In addition, adequate capital is necessary to absorb shocks and risks related to increased defaults as a result of a recession.

[12] The Bank obliges banking institutions to maintain a risk-weighted capital ratio (RWCR) of 10 percent, of which 7.0 percent ought to be Tier 1 risk-weighted capital. In addition, a minimum Tier 1 leverage ratio of 6.0 percent should be retained at all times. Tier 1 capital is the core capital of a bank, which consists mainly common equity and retained earnings, intended to measure a bank's financial health and is used to absorb the bank's losses without ceasing business operations.

**Figure 12: Capital adequacy**

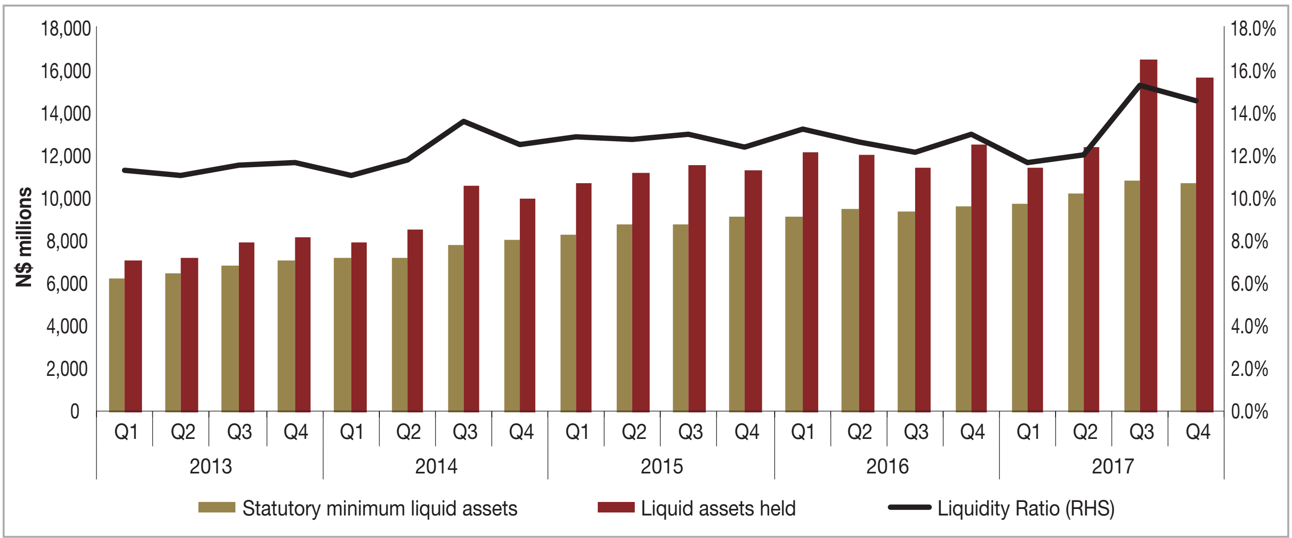



Source: Bank of Namibia

## Liquidity Position

**The liquidity position of the banking sector increased significantly, as shown by liquid assets held, that were well in excess of the statutory minimum liquid asset requirement.** The liquidity ratio improved to 14.6 percent in 2017, up from 13.0 percent during the last quarter of 2016 (Figure 13), well above the statutory minimum liquid asset requirement of 10.0 percent of the average total liabilities to the public. This translates into about N$5.0 billion surplus liquid asset holding above the required level. The significant increase in the domestic liquidity conditions during 2017 could be associated with relatively higher SACU receipts, improved mineral export earnings as well as the general improvements in the current account deficit. In addition, the use of the N$3.0 billion first tranche of the Rand-denominated African Development Bank (AfDB) N$10.0 billion loan to the Namibian Government, to partially finance the 2017/18 and 2018/19 fiscal deficits and support infrastructure development, has eased the liquidity condition in the country. Furthermore, a large corporate restructuring deal, concluded in May 2017, that resulted in the repatriation of institutional funds to Namibia also contributed to higher levels of liquidity.

**Figure 13: Liquidity position of the banking sector**




Source: Bank of Namibia

**Domestic liquidity conditions may also have started to benefit from the inflow of funds in anticipation of the implementation of amendments to Regulation 8, 15 and 28, respectively, expected in 2018.** The amendments[13] to Regulation 28 under the Pension Fund Act, Regulation 8 under the Short Term Insurance Act as well as Regulation 15 under the Long Term Insurance Act, which will compel pension funds and other institutional investors to henceforth increase their domestic asset holdings could have contributed positively to liquidity conditions. The phased increase which will eventually raise the minimum required domestic investments from 35 to 45 percent of assets has also seen an increase in the uptake of government instruments, which may eventually result in the Namibian capital market increasingly becoming dominated by government fixed income instruments. It is however expected that the phased increase in the domestic asset requirement will incentivise the development of the domestic capital market with a sound mix of investment instruments such as equity and bonds. To this end, the deepening of the capital market will go a long way in enhancing the long-term liquidity of the financial system.

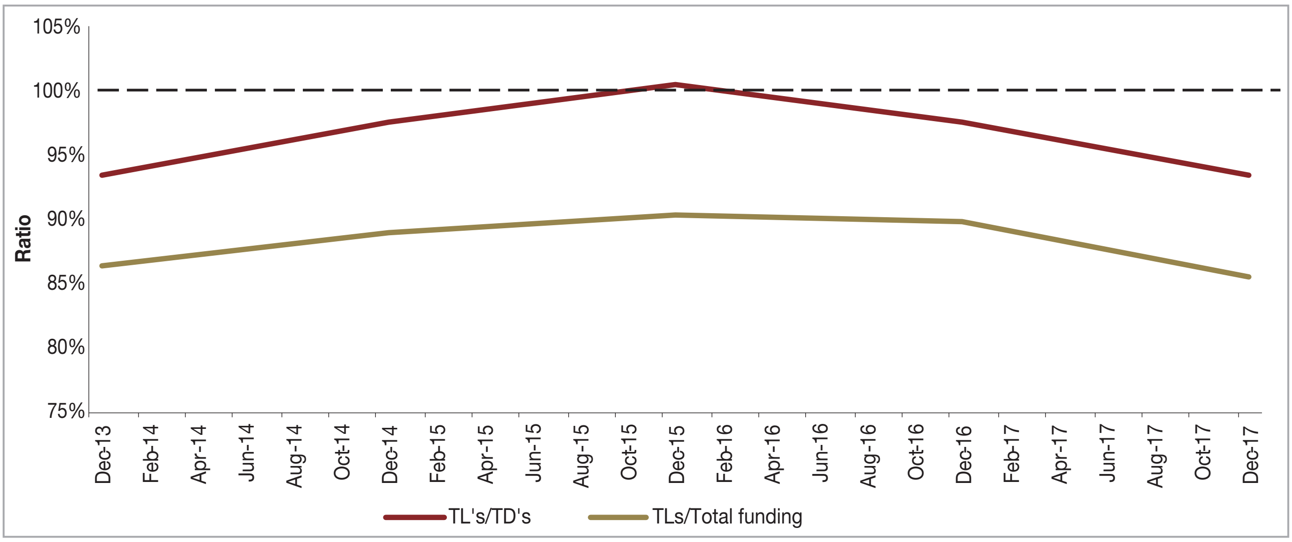
[13] Amendments to Regulation 28 of the Pension Fund Act, and Regulation 8 of the Short-term insurance Act and Reglutation 15 of the Long-term Insurance Act are underway to raise the Domestic Asset Requirement from 35 percent to 45 percent.

## Loan-to-Deposit (LTD) Ratio and Loan-to-Funding Ratio (LTFR)

**Another key liquidity indicator, the loan-to-deposit (LTD) ratio, moderated significantly.** The LTD[14] ratio for Namibian banks moderated to 94.0 percent in December 2017, from 98.0 percent in December 2016 (Figure 14). This implies that banks, on average, lend 94 cents for every dollar in deposits that they receive, and have made relatively less use of deposits to fund loans and advances and have increased the usage of other funding sources such as debt and capital, which tend to be relatively more expensive. The moderation in the LTD could also be as a result of significant improvements in liquidity, as evidenced by faster growth in deposits relative to the growth in loans.

**The banking sector's Loan-to-Total-Funding[15] Ratio (LTFR) similarly moderated.** The LTFR declined to 85 percent in December 2017, down from 90 percent during the corresponding period in 2016 (Figure 14). This ratio implies that, on average, 85 percent of the banks' funding (i.e., deposits, debt issues as well as loans received) has been extended as loans and advances. This lower ratio could also be as a result of improved liquidity conditions, the slowdown in credit extension associated with lower consumer confidence and stricter lending practices of banks.

**Figure 14: Loan-to-Deposit (LTD) and Loan-to-Funding Ratios (LTFR)**




Source: Bank of Namibia

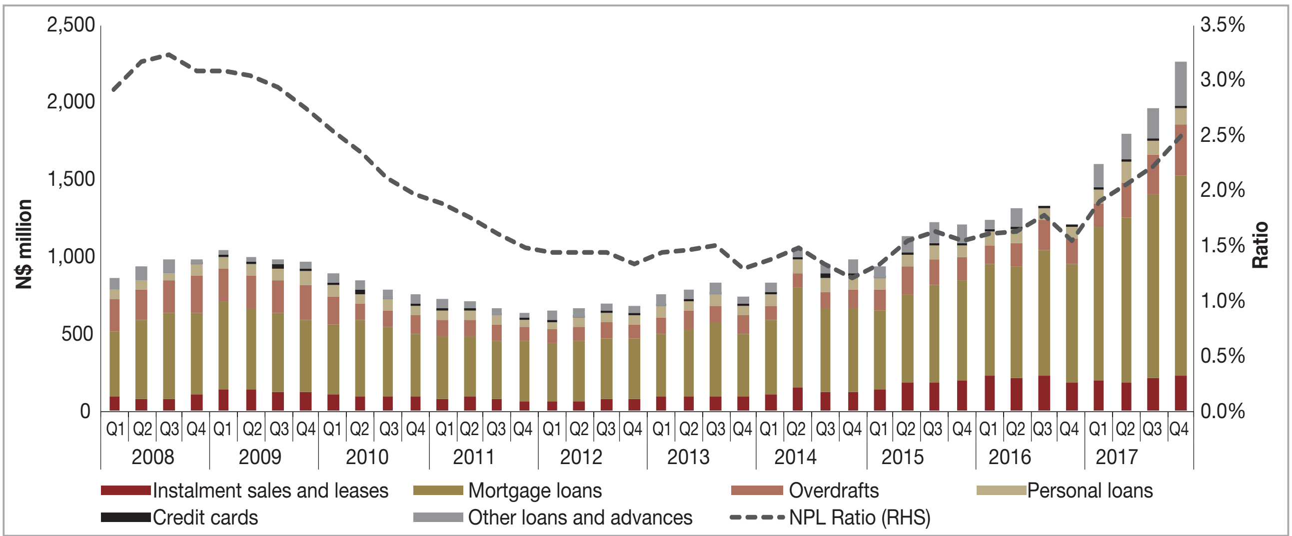
[14] Despite there being no set benchmark, a loan-to-deposit ratio close to or over 100 percent implies that some banks, on average, lend one dollar or more for every dollar received in deposits. In turn, this means that some of the banks rely on borrowed funds to fund their loans, or on capital entrusted to them by shareholders.

[15] Funding is usually defined as deposits plus loans received. It excludes capital and reserves.

## Asset Quality

**In line with the recessionary economy during the period under review, the non-performing loan (NPL) ratio as a measure of credit risk in the banking sector, increased significantly.** The non-performing loans as a ratio of the total loan book increased by 1.5 percentage points to 2.5 percent at the end of December 2017 (Figure 15). Despite the significant increase during the period under review, this ratio nonetheless remained well within the 4.0 percent internal benchmark and also below Namibia's historically highest NPL ratio observed to date, even amidst the recent economic downturn[16]. While the banking sector is adequately capitalized to offset the deterioration in asset quality, going forward, the Bank will continue to closely monitor this ratio and take prompt action to safeguard the stability of the banking industry should the need arise.

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



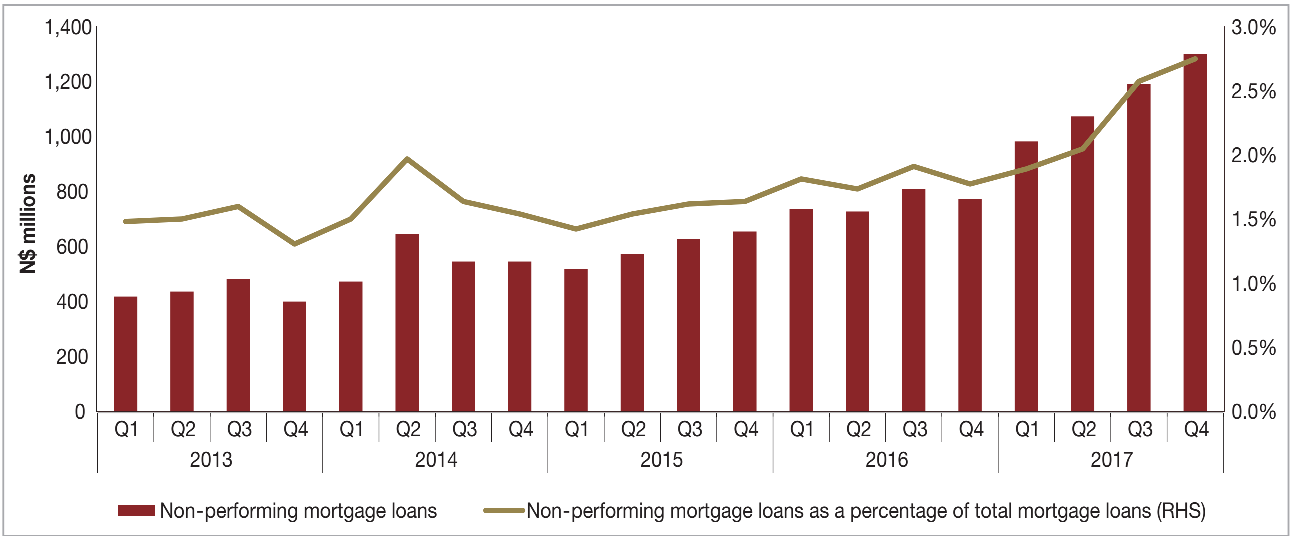

Source: Bank of Namibia

**The increase in the overall NPLs during the review period was displayed by a general increase in NPLs across all asset classes.** The general increase in NPLs in 2017 resulted from a proportional increase in NPLs across all asset classes, which implies that the relative share of NPLs of individual asset classes in total NPLs remained broadly unchanged (Figure 15). Mortgage NPLs as a share of total NPLs remained the largest with a share of 58.0 percent, followed by overdrafts and other loans and advances NPLs with relative shares of 14.0 percent and 13.0 percent, respectively. Given that residential and

[16] An NPL ratio that moves in tandem with macroeconomic variables could also mean that the banking sector plays an active developmental role in the economy by taking on board some risk, but in a measured way.

commercial mortgage loans account for more than 52 percent[17] of the total loan book, it is therefore not surprising that the increase in the non-performing mortgage loans category contributed significantly to the increase in total NPLs (Figure 15 & 16).The relative shares of NPLs for the remaining categories, namely instalment sale & leasing finance, personal loans and credit card advances remained very low at 10 percent, 5 percent and 1 percent, respectively.

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




Source: Bank of Namibia

## Large Exposures

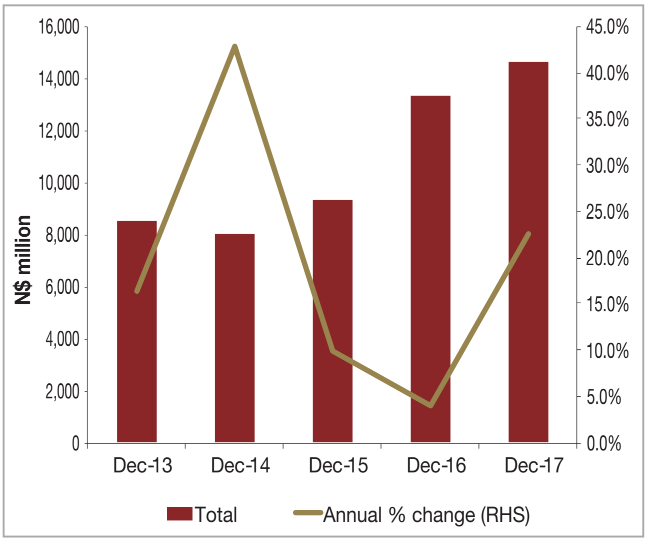
**The banking sector's large exposures have grown considerably since 2016, with notable increases for most sectors.** The value of the total large exposures increased to N$18.6 billion as at 31 December 2017, from N$15.2 billion a year earlier. This acceleration was also reflected in the year-on-year growth rate of 22.6 percent, in comparison to a significantly lower growth rate of 4.0 percent in 2016 (Figure 17a). The strong increase over the past year was primarily driven by a significant growth in exposures to the property & construction, fishing, transport & logistics, mining & minerals, and other sectors. The significant increase in year-on-year growth in exposures to some sectors may be due to the prevailing weak economic conditions and the associated declining revenues and profits, thus prompting them to borrow more, while in others it may reflect capital projects and working capital needs associated with expansion of the business. Large exposures

[17] In a country where the population is growing accompanied by rural-urban migration, a lot of housing activity and finance thereof is to be expected. As such structurally, a lot of mortgage business on the banks' books must be expected in Namibia.

to both the manufacturing and tourism sectors, however, contracted year-on-year by 2.6 percent and 100 percent, respectively, in 2017. Given the diverse distribution of banks' large exposures[18] across sectors, concentration risks to the financial system remain low, and potential risks would likely emanate from the general performance of the economy as opposed to excessive concentration of exposure to individual companies or sectors.

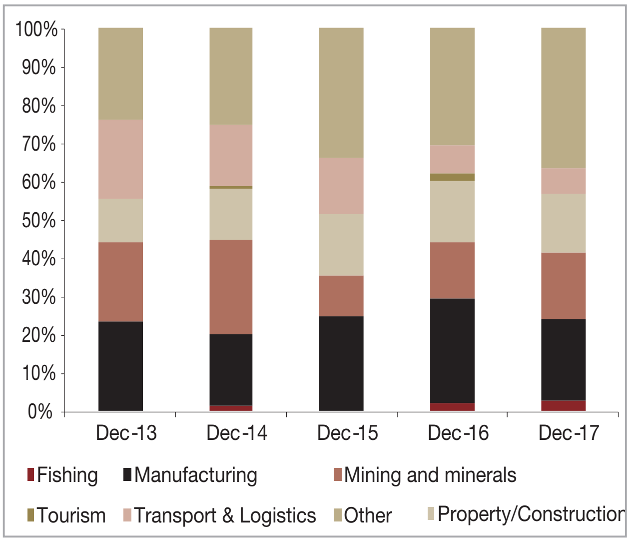
**The sectoral composition of large exposures remained broadly diversified during 2017, with minor movements in the relative shares.** In line with the consistent movements in the exposures to individual sectors, the relative share of the manufacturing, mining & minerals as well as property & construction sectors remain the largest at 21.0 percent, 17.0 percent and 15.0 percent, respectively (Figure 17b). Further, the relative share of the transport & logistics, fishing and tourism sectors collectively remained below 10.0 percent. The remaining 37.0 percent of the large exposures was evenly distributed between nine corporate borrowers outside the aforementioned sectors, which was about 7.0 percentage points higher than in the previous year. These compositions however do not warrant any concerns regarding the stability of the financial system.

**Figure 17a: Banking sector large exposures and growth rate**




Source: Bank of Namibia

**Figure 17b: Sectoral composition of large exposures**




**As a proportion of total private sector credit extension (PSCE), large exposures increased.** The large exposures as a proportion of PSCE increased to 20.8 percent during 2017, from 17.8 percent at the end of December 2016 (Table 7). In relation to private

[18] In terms of the regulation, a large exposure means any exposure to a single person or group of related persons which, in the aggregate, equals or exceeds 10 percent of the bank's capital funds.

sector credit to businesses, large exposures similarly increased to 50.7 percent from 43.1 percent over the same period. While recent increases in exposures to the mining sector could be ascribed to expansion projects driven by higher commodity prices or by long-term contracts, increases in exposures to some sectors appear to have been prompted by the current challenging economic conditions, and the associated lower revenues and profitability for the private sector experienced during this period.

**Table 7: Large exposures in relation to private sector credit extension**

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Total Largest Exposures N$ million | 9,305 | 13,296 | 14,631 | 15,223 | 18,669 |
| Total PSCE N$ million | 59,323 | 69,067 | 78,394 | 85,397 | 89,720 |
| PSC to Businesses N$ million | 22,702 | 28,364 | 33,086 | 35,343 | 36,811 |
| Large Exposures to PSCE | 15.7% | 19.3% | 18.7% | 17.8% | 20.8% |
| Large Exposures to Business PSCE | 41.0% | 46.9% | 44.2% | 43.1% | 50.7% |

Source: Bank of Namibia

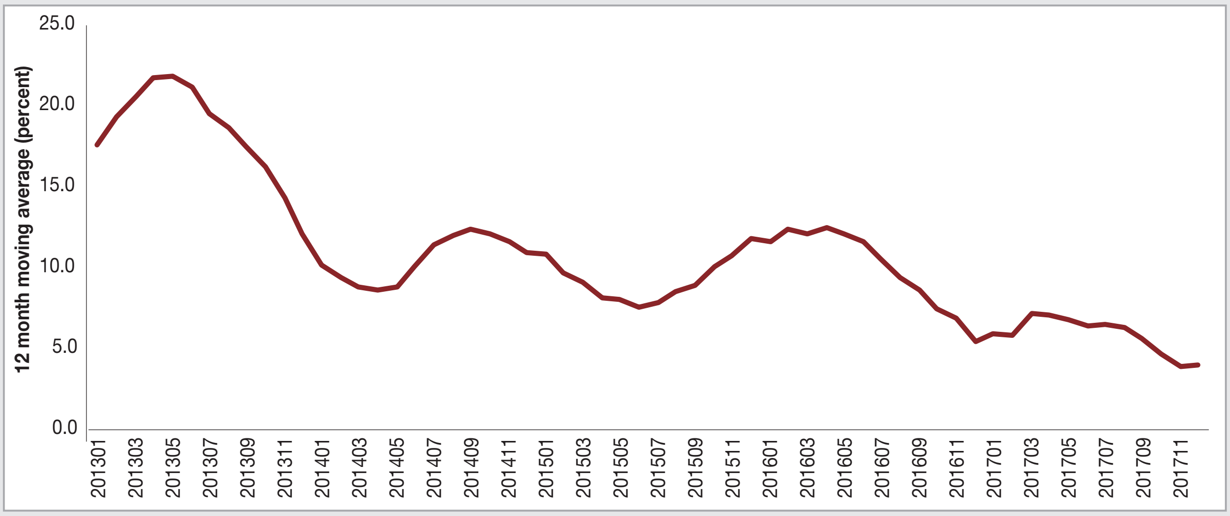
## BOX 2: PROPERTY PRICE DEVELOPMENTS

***Overall house price inflation for residential properties, though positive over the last 5 years, continues to decelerate.*** *With the economy sluggish and grinding into recession in 2017 and the associated shedding of jobs, disposable income remained under significant pressure. These macroeconomic challenges continue to weigh on the Namibian housing market as annual house price inflation decelerated to 4.0 percent in December 2017, in contrast to 5.4 percent during the same period in 2016 (Figure 1). The current moderation in the housing market may however not pose a threat to the stability of the financial system. This is due to structural factors such as sustained demand compounded by slow delivery of serviced land and by implication housing volumes supplied; the smaller share of non-primary residential properties, estimated at about 20 percent[19] of total mortgages; and also given equity accrued on the properties over the years. Further, following the implementation of a macroprudential measure in the form of Loan-to-Value regulations that applies to non-primary residential properties in 2017, aimed at, among others, curtailing speculation in the residential housing market segment, reducing the exposure of banking institutions to mortgage loans, and promoting responsible borrowing while giving preferential access to housing for first time buyers, the share of the non-primary residence properties is not expected*

[19] Based on point-in-time industry data.

*to increase further. Accordingly, the stability of the financial system is unlikely to be compromised, even if prices should start declining rather than just increasing at a slower pace.*

***Figure 1: House Price Index (HPI) annual % change: 12 month moving average***

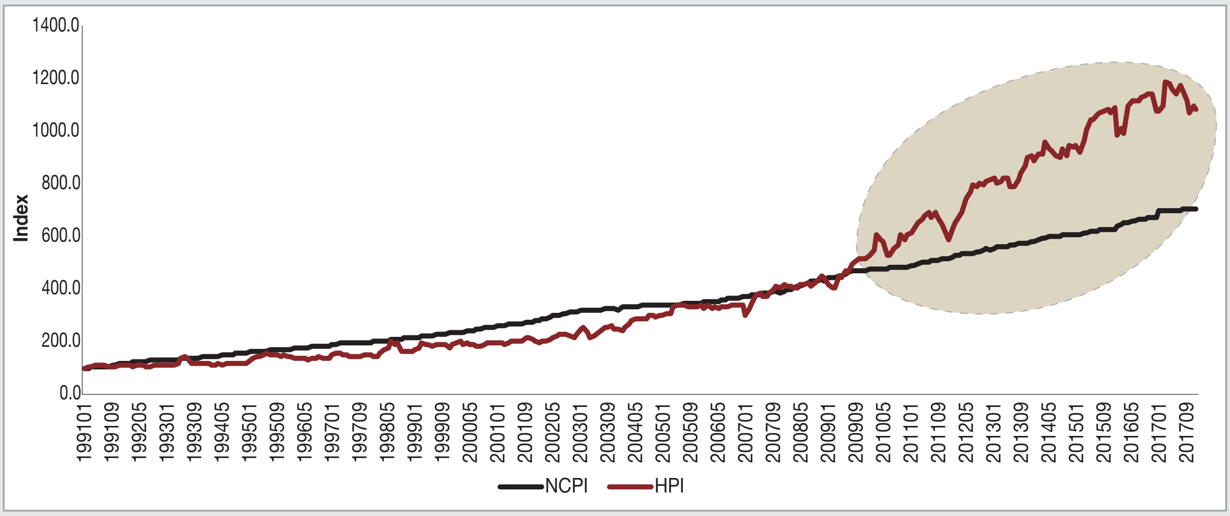



Source: First National Bank Namibia

*Despite the deceleration in the growth of house prices during 2017, house prices in Namibia remain generally high, following sustained sharp increases over a long period of time. The House Price Index (Figure 2) shows that property prices in Namibia have increased exponentially over the years, outstripping the Consumer Price Index, thereby fueling fears of an asset bubble, of which its burst may compromise the stability of the financial system should prices start to fall abruptly. These increases have contributed to increased household borrowing and debt over the years. Lately, growth in property prices has begun to moderate, with especially the large segment[20] properties staying longer in the market as prospective buyers adopt a wait-and-see approach, by waiting before buying. As alluded to earlier, as long as structural factors do not adjust, such as the delivery of serviced land and by implication supply of housing, the prices are likely to remain high, with virtually no major direct threat to the financial system stability. The sustained demand, coupled with conservative lending practices by financial institutions are factors indicating that there is no housing bubble. Nonetheless, an increased supply of housing and a slower rate of price increase are expected to contribute to a more stable housing market.*

[20] Small: N$ 448 000 ≤ value < N$1 368 000
Medium: N$ 1 368 000 ≤ value < N$3 129 000
Large: N$ 3 129 000 ≤ value < N$6 500 000.

*Figure 2: House Price Index (HPI) and Consumer Price Index (CPI): 1991:1 - 2017:12*




Source: First National Bank Namibia & Bank of Namibia

## Stress Test

**The Bank of Namibia's 2017 stress test has been designed to assess the resilience of the systemically important banking institutions to interest rate, credit and liquidity shocks.** The severity of the shocks is related systematically to the Financial System Stability Committee's (FSSC's) assessments of risk levels across markets and economies. In this context, the scenarios reflect the judgment of the FSSC regarding global and domestic risks to the Namibian banking system. The scenarios were calibrated to assess not only the banks' capital and liquidity adequacy in relation to the requirements, but also the general health of the banking system to support the real economy.

### a. Interest Rate Risk

**Having grappled with the potential collapse of commodity prices over the last few years, Sub-Saharan Africa (SSA) and in particular the southern region is now moving safely along the business cycle and benefiting from the improved global sentiment towards emerging market economies.** In this environment, a number of countries in the region, some with the aid of leadership changes such South Africa and Angola, are making progress in delivering the kind of macroeconomic reforms needed to sustain a more long-term recovery. However, several key markets still find themselves facing structural challenges such as excessive fiscal deficits, high unemployment rates, policy uncertainty and constrained alternative revenue sources. This augments pressure on future productive capacities of these economies, and increases the region's vulnerability to shocks when sentiment eventually turns and the region finds itself in a less supportive global environment.

**While growth in South Africa, one of the largest economies in the region, is expected to improve moderately, accompanied by the recent strengthening of the Rand and lower inflation, optimism should be exercised with caution.** The South African economy is estimated to have expanded by 1.3 percent in 2017, following a lower growth rate of 0.3 percent in the previous year, thereby defying general pessimistic expectations. Recent inflation forecasts for 2018 have been lower than previously, with inflation expected to remain within the target range. While the Rand has performed strongly in recent months, principally on the back of a change in political leadership in South Africa and thus a reinforcement of investor confidence and sentiment, it would be prudent to exercise caution, given pockets of policy uncertainties. These uncertainties coupled with general elections in 2019 may turn the renewed investors' confidence around and weigh on the exchange rate of the Rand. The performance of commodity prices, combined with the outcomes of the sovereign credit ratings of the South African economy during 2018 may also influence the performance of the Rand in the near future. In the end, while the South African Reserve Bank (SARB) has been exercising accommodative monetary policy in recent times, it may at some stage be prompted to increase interest rates so as to manage inflation. Inflationary pressures may for instance come from the depreciation of the Rand and/or rising global food and energy prices.

**In order to maintain the currency peg, the Bank of Namibia may elect to also increase the Repo rate to align interest rates with those in South Africa.** Ultimately, the end of the low interest rate environment may increase direct interest rate risk; that is, the risk incurred by a bank when the interest rate sensitivities of its assets and liabilities in various time bands are mismatched. While local banks are likely to be in a favourable position initially, should interest rates start to increase, as their assets will reprice faster than their liabilities, after some time the level of NPLs may start to increase further. To account for the above scenario, the stress testing model assessed the impact of an interest rate increase on net interest income stemming from repricing gaps in each time band, over a 12-month horizon. The stress test results include the interest rate risk and credit risk scenarios, using the following assumptions:

1 percentage point increase in the interest rate (Baseline scenario);

2 percentage points increase in the interest rate (Intermediate scenario);

3 percentage points increase in the interest rate (Adverse / severe scenario).

### b. Credit Risk

**The possible monetary policy tightening assumed above could prompt banks to increase their prime lending rates, exacerbating the effects of the weak economy, so that with a lag, further increases in NPLs may be expected.** The effects of higher interest rates could further strain household income and thus lead to higher default rates. Further, the low growth environment in Namibia's key trading partners in the region, external shocks, coupled with a weaker domestic fiscal space could further lead to delinking of Namibia's growth trajectory from the stronger global growth dynamics in the short-term. With the resultant further fiscal consolidation, this may imply that sectors which depend on government contracts to service their loans may continue to endure an extended period of hardship prompting them to shed more jobs, which may also strain disposable income thus resulting in higher NPLs. The slowing property prices observed over the last year has resulted in slower activity in the property market and in an increase in the vacancy rates of residential, retail, commercial and industrial properties, and could negatively impact rental incomes. This could further negatively affect the ability to service mortgage loans; and given its share in the total assets on the banks' book, higher NPLs may be expected.

**The above scenario may ultimately result in higher default rates and NPLs across all loan asset categories.** To account for this shock, the following increases in the NPL ratio were assumed:

1.5 percentage point increase in the NPL ratio above the current level (Baseline scenario);

3.0 percentage point increase in the NPL ratio above the current level (Intermediate scenario); and

5.0 percentage point[21] increase in the NPL ratio above the current level (Severe scenario).

[21] The NPL percentage increases stated above, relate to the Namibian banking industry NPLs which demonstrated a historic industry high of 6.6 percent in 2001. During that time, the prime interest rate was 15.4 percent and the Repo rate was 11.25 percent; which reflects the same approximate magnitude increase above the current levels assumed in the adverse scenario of the Interest Rate Risk.

### c. Liquidity Risk

**Another concern is whether or not the banks are able to withstand liquidity shocks if some of the depositors were to make sudden withdrawals of their funds from the system.** This assumption is made despite the banks being well-capitalized, having excess liquid assets and being profitable, using the following assumptions:

- 3.97 percent of the total deposits withdrawn from the system; over 5 days (15 percent of call deposits in total) (Baseline scenario)[22];
- 7.95 percent of the total deposits withdrawn from the system; over 5 days (30 percent of call deposits in total) (Intermediate scenario); and
- 13.24 percent of total deposits withdrawn from the system; over 5 days (50 percent of the call deposits in total) (Adverse/Severe scenario)

**Deposit withdrawals can be triggered principally by market conditions (unscheduled withdrawals).** Factors that may cause liquidity constraints include reduced government spending due to fiscal consolidation; delayed tax refunds for corporates; capital flight to other markets in search of better returns; dividend payments by subsidiaries of foreign entities; and weak commodity prices that may dampen Namibia's export earnings. 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[23]. It is acknowledged, however, that the envisaged phased increase in domestic asset requirement from 35 percent to 45 percent as a result of the regulatory amendments to Regulation 8, 15 and 28 expected in 2018 could serve as a buffer[24] in the event of sudden withdrawals.

**From the above shocks, the ultimate objective was to obtain an estimate of losses that the banking institutions could face in the event of a significant shock, or combination of shocks, and make recommendations pertaining to improved risk management or capital add-ons.** These shocks are believed to be plausible and yet sufficiently adverse. A summary of these shocks is presented in Table 8 below.

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[22] Under stress, one expects the general public to respond.

[23] 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.

[24] It is however noted that if an institutional investor is scared of the stability of the banking sector, it may decide to convert its deposits with a bank in Namibia into central bank (BoN) notes.

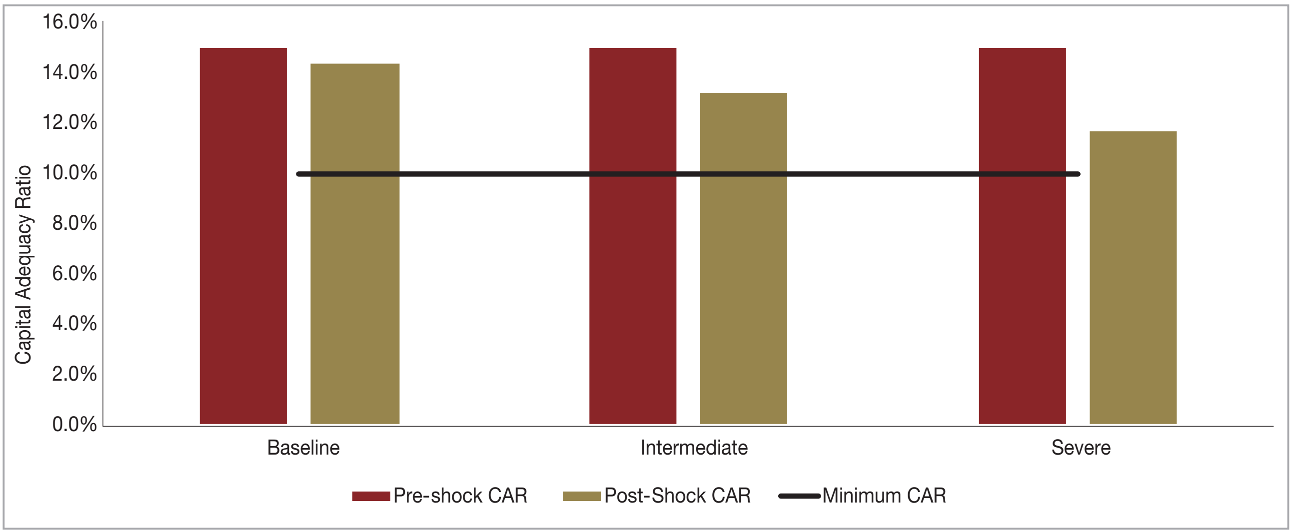
**Table 8: Summary of the stress testing scenarios**

| Risk Category | Baseline | Intermediate | Severe |
|---|---|---|---|
| Credit risk (NPL Ratio) | 1.5% ↑ | 3.0% ↑ | 5.0% ↑ |
| Interest Rate | 100 basis point ↑ | 200 basis points ↑ | 300 basis points ↑ |
| Liquidity | 3.97% of total deposits withdrawn ↓ over 5 days (15 % of call deposits) | 7.95% of total deposits withdrawn ↓; over 5 days (30 % of call deposits) | 13.24 % of total deposits withdrawn ↓; over 5 days (50 % of call deposits) |
| Exchange Rate | 5%[25] ↓ | 9%↓ | 15%↓ |
| Other Variables:<br>- 50% haircut on collateral<br>- 50% Provisioning | | | |

## Capital Adequacy Stress Test

**Based on December 2017 data, the stress test results show that the banking sector is adequately capitalized to withstand the impact of the potential increase in interest rates, or that of adverse credit risk effects, in all scenarios.** With respect to the baseline and intermediate scenarios, the post-shock risk-weighted capital ratio stood at 14.3 percent and 13.2 percent, respectively, well above the minimum regulatory level of 10 percent (Figure 18). In the severe case scenario, however, with the continuation and exacerbation of the assumed conditions and thus the erosion of capital, the post-shock risk-weighted capital ratio is observed to decline to 11.7 percent, but still above the minimum regulatory level. These results are broadly similar to those of December 2016, which implies that the capital base of the banking sector is sufficient to absorb risks such as the significant deterioration of the asset quality observed during 2017.

**Figure 18: Solvency stress test results**

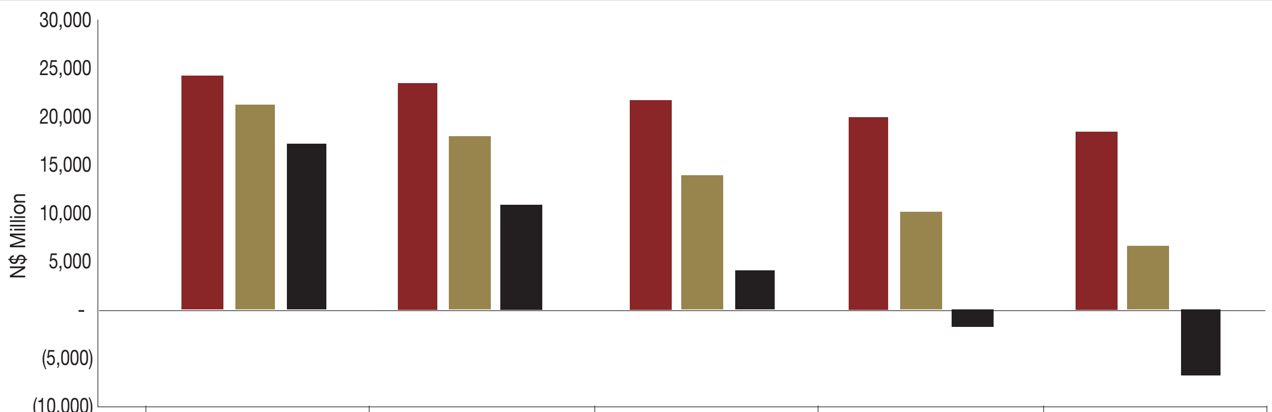



Source: Bank of Namibia

[25] On average, the exchange rate is expected to depreciate at the same rate as the average inflation rate in a year. Given that the net foreign position of the Namibian banks is denominated in US$, £ and €, the exchange rate shock in this regard refers to the depreciation of the N$ against each of these currencies..

**Using the IMF Cihak model adopted by the Bank of Namibia, the banking sector appears to have sufficient liquid assets to withstand the assumed shocks, particularly in the baseline and intermediate scenarios.** The liquidity stress test results indicate the ability of the banks to withstand liquidity shocks, if some of the depositors were to make sudden withdrawals of their funds from the system thereby exacerbating liquidity constraints. The results show that the banking sector has sufficient liquid assets to withstand the assumed shocks, particularly in the baseline and intermediate scenarios. As the magnitude of the shocks increases, however, that is to 50 percent of the call deposits withdrawn over 5 days, the banking sector would be able to honour its payment obligations only up to the third day (Figure 19). Similar to the solvency stress test results above, these liquidity stress test results do not significantly differ from those published in the last FSR. If the effects of these shocks become systemic, however, in that the interbank lending becomes increasingly inactive, this will prompt banks to approach the central bank for Lender of Last Resort assistance to ensure the stability of the financial system. Notwithstanding these outcomes, the liquidity position of the banking sector has been improving significantly and with commodity prices improving, and amendments to the regulation with respect to the phased increase in domestic asset requirements, liquidity in the banking sector is estimated to remain stable over the next 12-month horizon.

**Figure 19: Liquidity stress test results**




| | Day 1 | Day 2 | Day 3 | Day 4 | Day 5 |
|---|---|---|---|---|---|
| Baseline | 24,136 | 23,535 | 21,782 | 20,053 | 18,414 |
| Intermediate | 21,188 | 17,946 | 13,834 | 10,003 | 6,488 |
| Severe | 17,257 | 10,812 | 4,119 | (1,764) | (6,887 ) |

Baseline Intermediate Severe

Source: Bank of Namibia

## Conclusion & Policy Options

**Based on the Financial System Stability Committee's assessment of risks to the domestic financial system and to enhance the surveillance and vulnerability assessment, there are specific policy options available to counteract potential risks.** These policy options may be based on the current economic situation, structural circumstances and/or stem from current regulatory issues. These policy options may relate to banks, nonbank financial institutions as well as at other market participants, or at legislations and other authorities.

| Policy options | Timeframe |
|---|---|
| 1. Effectiveness of the LTV for non-primary properties as a macroprudential measure aimed at reducing excessive house price growth and concentration of exposure to the housing market should be assessed. | Immediate to medium term |
| 2. The current practices in the banking sector in terms of the application of their screening methods and application of Debt Service to Income Ratios should be assessed, to mitigate potential vulnerabilities associated with high household debt-to-income ratios. | Immediate to medium term |
| 3. The stress test models should be enhanced to capture the dynamic nature of macroeconomic variables such as GDP or house prices and BoN should also start requesting regular bottom-up stress test results from the banking institutions. | Medium to long term |
| 4. The banking sector's exposure to systemically important non-bank financial institutions should be assessed continuously. | Immediate to medium term |
| 5. Namibia's capital market should be deepened so as to enhance liquidity conditions in the financial system. | Medium to long term |

# VI. PERFORMANCE OF THE NON-BANKING FINANCIAL SECTOR

## Industry assets

**The Non-Bank Financial Institutions (NBFIs) industry remained financially sound and stable.** The industry continued to grow its asset base in 2017, despite domestic economic recessionary conditions. During the period under review total industry assets grew by 18.0 percent to N$288.9 billion (Table 9). The growth in NBFI assets was mainly driven by a general increase in investment income due to improved market returns during the period under review.

**Global financial markets generally rebounded in 2017, partly due to an anticipation of expected tax cuts in the United States and partly reflecting stronger global economic activity.** These buoyant financial market performances had a positive impact on the performance of investment portfolios of NBFIs, therefore reducing risks to financial stability. Nonetheless, there is a greater risk that imbalances have built up, in part through assets that are overvalued due to investors' search for returns with a potential of market corrections. Such imbalances could amplify future strains in the financial system, due to uncertainty of the financial markets reaction when the central banks reverse their current monetary policy trajectory. Moreover, risks due to protectionist regimes in recent periods could lead to a fall in asset prices. The Namibian NBFI sector, nonetheless, remained sound and stable in 2017.

**Table 9: Total assets per sector**

| Total assets (N$ billion) | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Long-term insurance | 36.4 | 40.2 | 44.7 | 47.6 | 53.9 |
| Short-term insurance | 3.5 | 4.7 | 5.6 | 5.8 | 6.2 |
| Pension fund | 105.3 | 119.6 | 133.1 | 137.5 | 152.9 |
| Medical aid fund | 1.0 | 1.2 | 1.4 | 1.4 | 1.8 |
| Collective investment schemes[26] (unadjusted total) | 33.4 | 15.5 | 38.9 | 39.6 | 47.5 (*55.9) |
| Investment Management[27] (unadjusted total) | 3.9 | 5.2 | 5.7 | 7.6 | 19.8 (*164.3) |
| Microlending and credit agreements | 2.6 | 3.4 | 4.3 | 4.2 | 5.5 |
| Friendly society | - | 0.9 | 1.0 | 1.2 | 1.4 |
| Industry total | 186.0 | 181.5 | 234.7 | 244.9 | 288.9 |

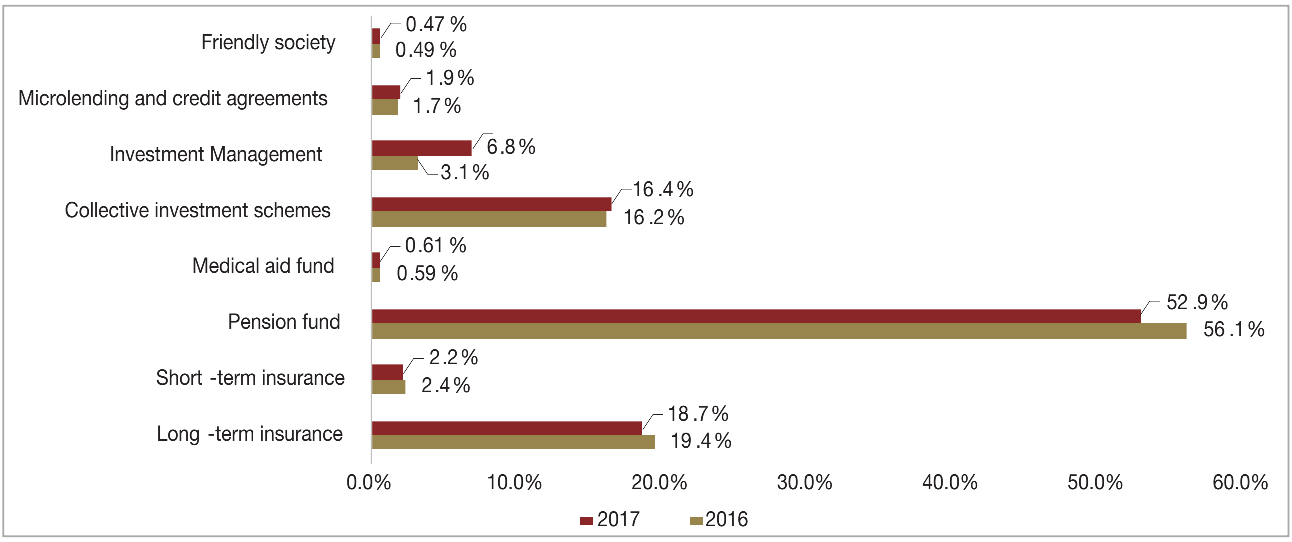
Source: NAMFISA

[26] Collective investment funds (Unit Trust funds): To avoid double counting the CIS total was adjusted by the sum of funds sourced from the following sectors: Pension, Insurance (STI&LTI) and Medical Aid: 2013 (N$3.9bn), 2014 (N$8.6bn), 2015 (N$8.8bn), 2016 (N$8.7bn) and 2017 (N$8.4bn).

[27] Investment Management: Similarly, the following adjustments were effected on funds sourced from the following sectors; Pension, Insurance (STI&LTI), Medical Aid and Unit trusts: 2013 (N$119.4bn), 2014 (N$131.0bn), 2015 (N$142.0bn), 2016 (N$143.2bn), 2017 (N$144.5bn).

**In terms of sectorial contribution, pension funds constituted more than half of the NBFIs total assets.** The pension fund sector constituted 52.9 percent of total NBFI industry assets despite a relative decline from 56.1 percent in the previous year. Long-term insurance companies and collective investment schemes followed with 18.7 percent and 16.4 percent, respectively (Figure 20).

**Figure 20: Sectorial composition (percent) of total NBFI assets**




Source: NAMFISA

## Developments in the Asset Management Industry

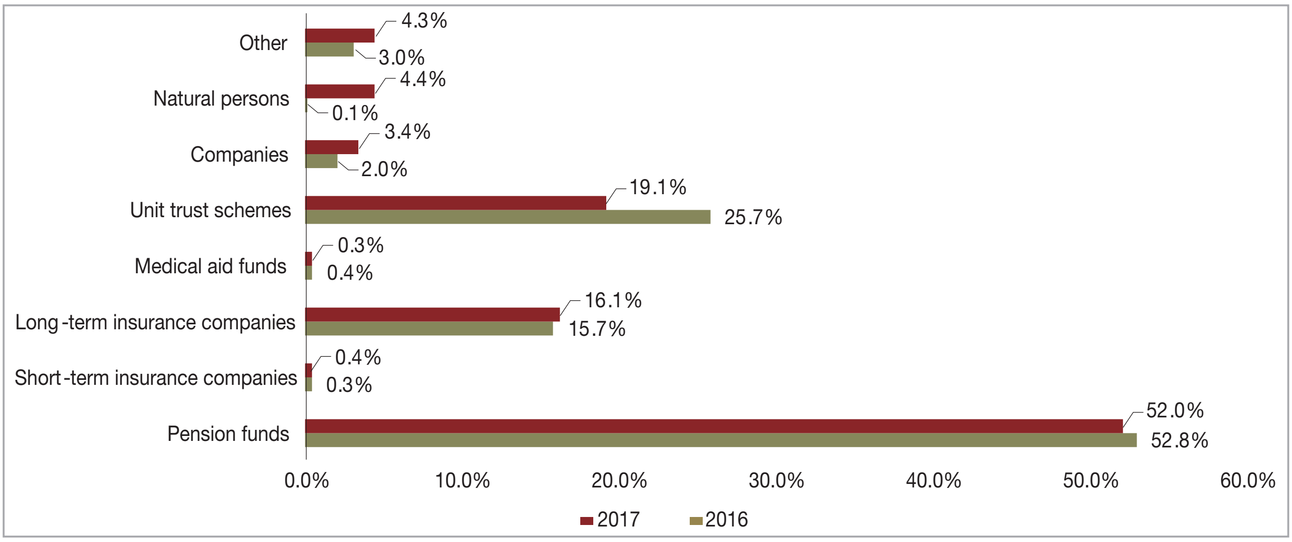
**The asset management (AM) industry continued to grow its Assets under Management (AuM), as a key conduit in the financial sector, which consists of investment managers (IM) and collective investment schemes (CIS).** During the period under review, the industry total AuM (inclusive of total CIS and IM) grew by 10.6 percent on a yearly basis to N$220.2 billion[28] at the end of 2017. In terms of proportional contribution to total funds under management, investment managers accounted for 74.6 percent, compared to 25.4 percent held by CIS. The risk to financial stability mostly emanates from the CIS within the AM industry (inclusive of collective investment schemes and investment managers) as CIS schemes are discretionary savings in nature which could be withdrawn at short notice by their investors, especially natural persons (households). Nonetheless, the total asset management industry as a whole, continues to fulfil an important function in asset allocation and serving as a conduit to the financial markets and the banking sector.

[28] The unadjusted total Asset Management sector amounts to a total sum of N$220.2 billion; inclusive of both CIS N$55.9 billion and IM N$164.3 billion, as at the end of 2017.

## Sources of funds: Investment Management (IM)

**The total AuM by investment managers was mainly sourced from pension funds.** Major movements of funds were noted during the period under review. Investment managers largely managed pension fund assets worth N$85.4 billion which accounted for 52.0 percent of total assets. This is followed by unit trust schemes which accounted for 19.1 percent at the end of 2017 of the total IM assets translating to an increase of N$5.8 billion and N$7.1 billlion, respectively. Further, companies increased by N$2.6 billlion accounting for 3.4 percent of the total AuM. In comparison, a major reduction was observed under the CIS funds under AuM, which decreased by N$7.3 billion accounting for 19.1 percent of the total Investment Management (Figure 21). The reason for these movements could be attributed to investment strategies employed by asset managers motivated by better returns during the period under review.

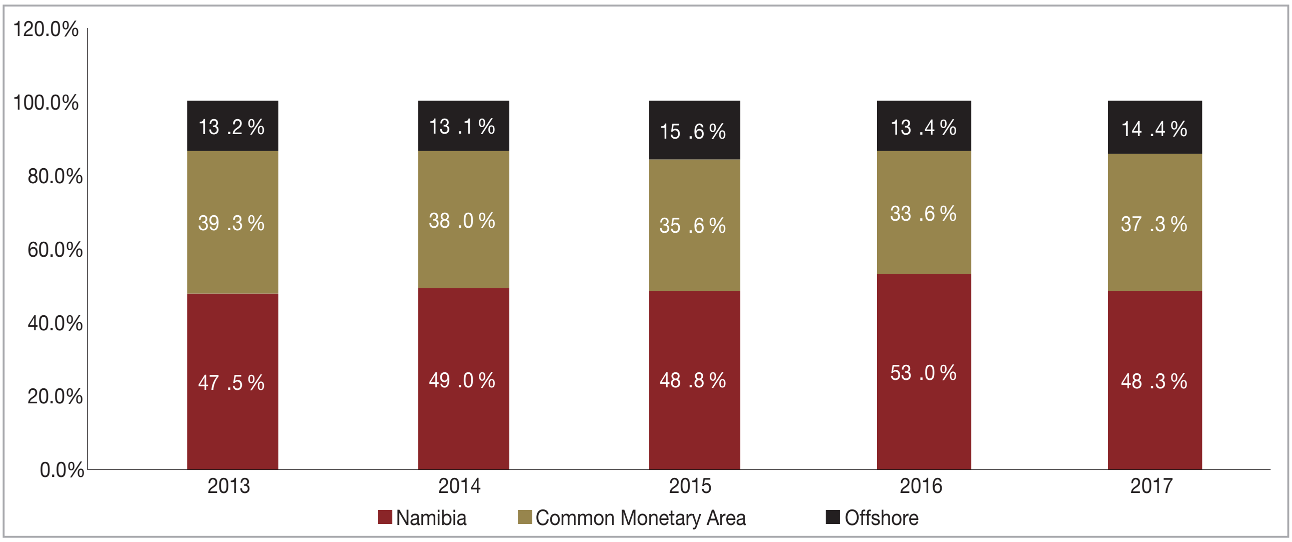
**Figure 21: IM assets per source of funds (investor), percent of total**




Source: NAMFISA

**In terms of geographic asset allocation, the bulk of AuM by investment managers were invested abroad.** The Namibian domiciled assets accounted for 48.4 percent of total assets, followed by CMA at 37.3 percent and Offshore assets at 14.4 percent as at 31 December 2017.

**Figure 22: Geographic asset allocation, percent of total, at year end**

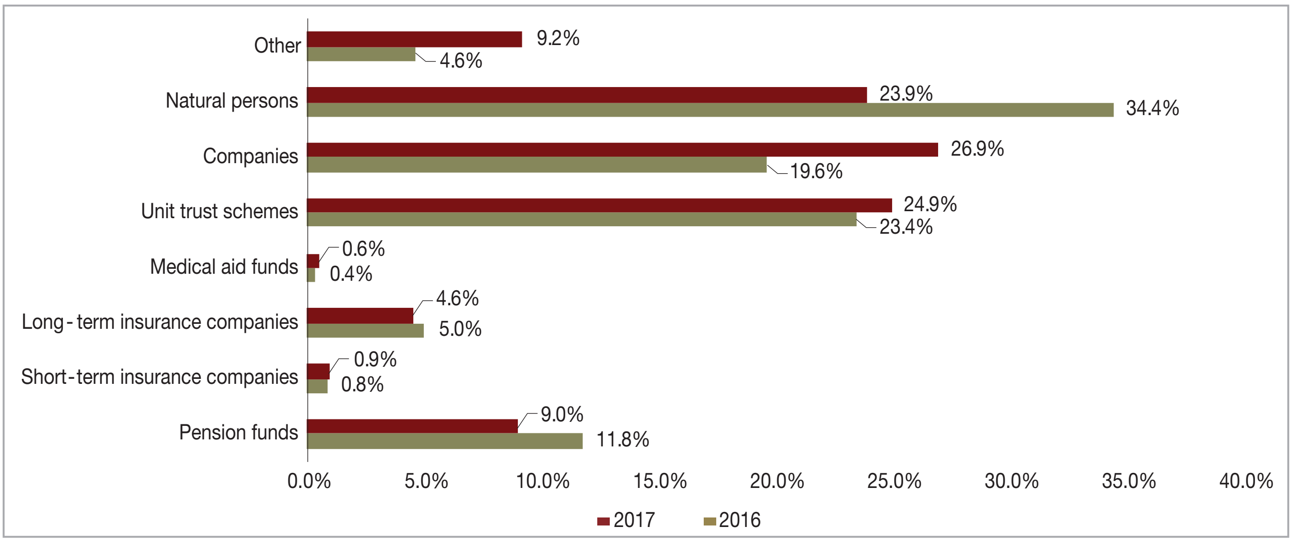



Source: NAMFISA

## Sources of funds: Collective Investment Schemes

**Assets under management in collective investment schemes (CIS) were largely sourced from companies, unit trusts and natural persons.** The contribution to total AuM were distributed as follows: companies 26.9 percent, unit trusts 24.9 percent and natural persons 23.9 percent, respectively. Furthermore, these were the key players in the CIS segment, with a joint contribution of about three quarters of the total AuM worth N$55.9 billion (unadjusted CIS total assets), during the period under review. CIS exposure to commercial banks stood at 46.1 percent and large withdrawals by investors through this channel could potentially bring about liquidity strain for domestic commercial banks. Nonetheless, the banking sector remained stable, liquid and well capitalized with no significant event posing risks to financial stability. Further, natural persons' funds declined by 19.6 percent annually accounting for 23.9 percent of the total assets in 2017 (Figure 23). This could be attributed to withdrawals of funds during the period under review. Whereas, funds sourced from companies increased by N$5.6 billion accounting for 26.9 percent of total assets at the end of 2017.The reason for movements of funds could be attributed to inhouse-investment management strategies executed by asset managers during 2017.

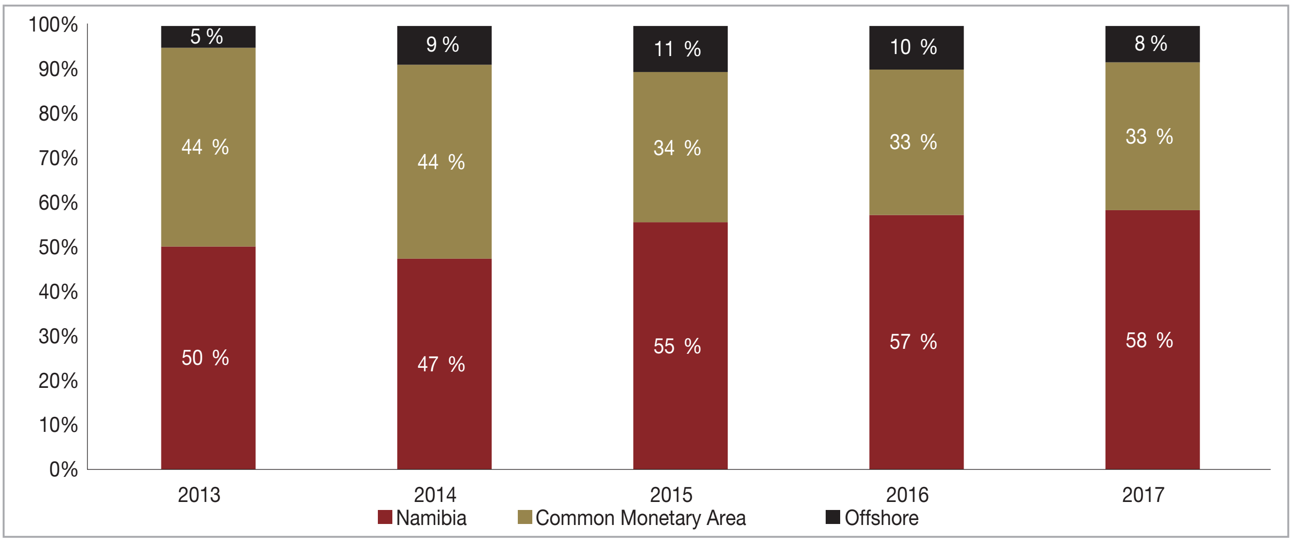
**Figure 23: CIS assets per source of funds (investor), percent of total**




Source: NAMFISA

**The geographical asset allocation reported that most of the CIS funds were invested domestically.** During 2017, asset allocation under CIS were 58.1 percent in Namibia, 33.5 percent in the Common Monetary Area (CMA) and 8.4 percent Offshore (Figure 24). Domestic regulation framework benchmarks continue to influence the geographical allocation decisions of the schemes since the pension funds and insurances mostly invest in CIS portfolios that are required to comply with statutory investment limits of regulation 28 and 15, respectively. Further, the assets invested in the Namibian markets increased by 17.3 percent to N$32.5 billion over the same period followed by investments in the CMA which increased by 19.0 percent to N$18.7 billion, while offshore investments decreased by 3.5 percent to N$4.7 billion during the period under review.

**Figure 24: Geographic asset allocation, percent of total**




Source: NAMFISA

## Key NBFI Industry developments

### Pension Funds

**The pension fund industry remains robust, supported by growth in investment income.** Growth in the stock markets has supported the positive developments in the pension fund industry, despite adverse economic conditions domestically. In this regard, the pension fund sector remained financially sound and stable with funding levels above the prudential limit of 100 percent.

### Key Risks

**The Government owned pension fund, which is the largest fund, remains a defined benefit fund[29].** The fund accounts for 73 percent of the total pension fund sector. Although the probability of adverse events for pension funds is generally limited, the impact on both other financial intermediaries and other parts of the economy, including private households, corporations and the public sector (ultimately the taxpayer) requires monitoring. In this regard, the impact on financial stability is measured by whether risks within the pension fund have worsened, improved or remained steady. Generally, the high exposure to equity markets brings about market risks, which can potentially affect the funding levels of pension funds and increase obligations for the employer, particularly for the defined benefit fund. However, too low risk taking may also result in lower returns which can also potentially negatively affect the funding of a defined benefit fund and could increase the obligations of the employer to mitigate the potential funding shortfall.

### Exposures

**Pension funds remain largely exposed to the equities market, while most assets are invested abroad.** Structurally, pension funds are mainly linked to equities in line with their risk profile, which is long-term in nature. The sector has a total asset base of N$151.4 billion, of which 44.1 percent was held in Namibia; while the remaining shares of 26.0 percent and 29.9 percent were held in CMA and Outside CMA, respectively (Table 10). The large exposures to international markets is mainly due to limited investment opportunities

[29] A defined benefit pension plan is a type of pension plan in which an employer/sponsor promises a specified pension payment lump-sum (or combination thereof) on retirement that is predetermined by a formula based on the employee's earning history, tenure of service and age rather than depending directly on individual investment returns.

domestically but implies exposure to significant market and exchange rate risks, especially in economic downturns.

**Table 10: Pension fund investment allocations, 2017**

| Total Assets invested in: | Namibia | Common Monetary Area (CMA) | Outside CMA |
|---|---|---|---|
| Equities[30] | 32% | 83% | 70% |
| Fixed Interest | 38% | 11% | 9% |
| Property | 3% | 3% | 0% |
| Cash/Money market[31] | 9% | -2% | 13% |
| Unlisted investments | 6% | 1% | 5% |
| Other | 12% | 5% | 3% |
| **TOTALS[32] (N$ billion)** | **66.8** | **39.4** | **45.4** |

Source: NAMFISA

**In terms of investment exposure, the sector was heavily invested in equities, but generally the entire investment mix remained fairly steady during the period under review.** The exposure to equity markets was 58.0 percent and 56.0 percent for 2016 and 2017, respectively (Figure 25a & 25b). In 2017, total investment for the pension funds sector amounted to N$151.4 billion of which equity being the largest exposure with 56.0 percent was followed by 22.0 percent in fixed interest income securities (Figure 25b).

**Figure 25a: Investment mix (percent), 2016**

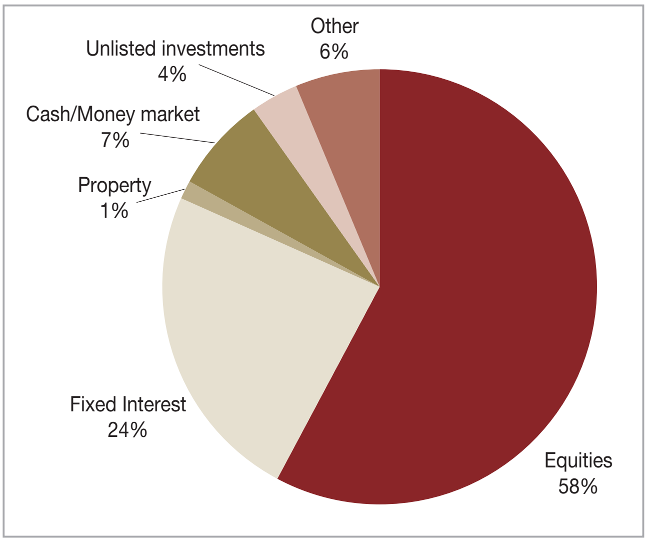
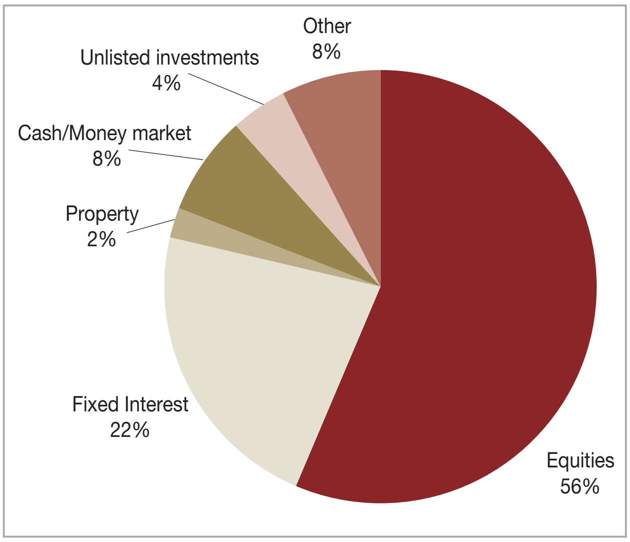



**Figure 25b: Investment mix (percent), 2017**



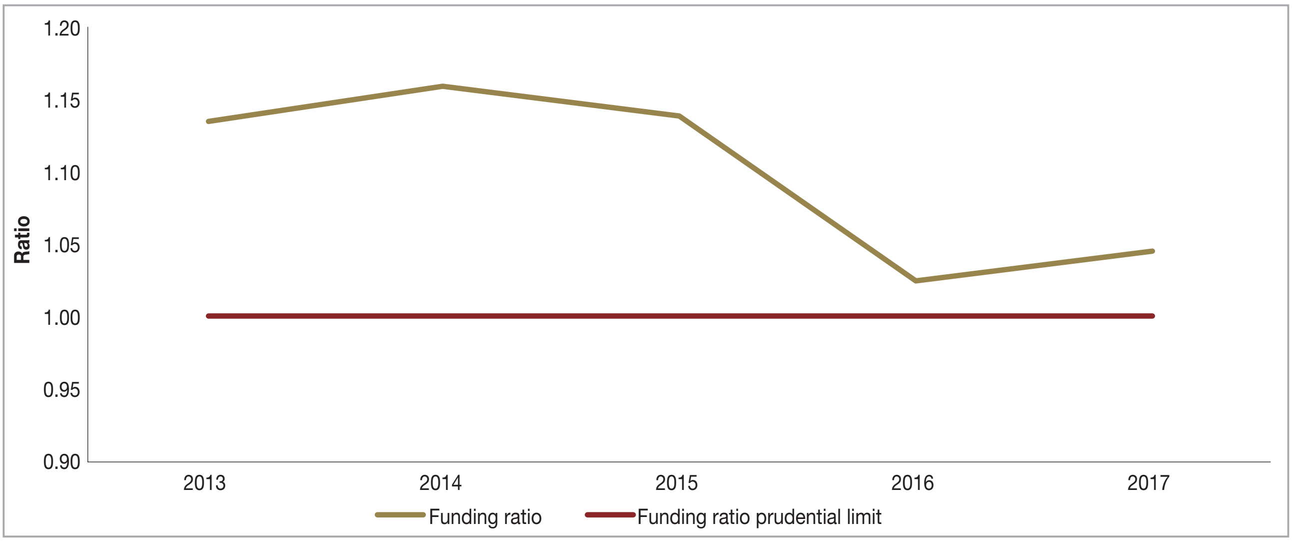

Source: NAMFISA

[30] The 32% local investment in equities is mostly in shares dual listed on the NSX and JSE (Table 2).
[31] Please note: The -2% under CMA is due to derivatives transactions to the tune of N$787.6 million
[32] This only refers to investment in financial instruments as it excludes non-financial assets such as buildings, land, furniture and etc.

## Funding ratio

**There has been a steady decline in the funding ratio since 2015, mostly owing to market volatility in the emerging markets; however, this trend has since been reversed in 2017.** The funding ratio improved during the period under review, as a result of an improvement in investment income. The increase in the funding ratio is mainly due to an improvement in investment income, as illustrated in Figure 26 and Figure 27, respectively. The higher funding ratio creates a buffer, serving as a cushion against adverse market conditions. In this case, the pension sector has a buffer of 4.0 percent above the prudential limit of 100.0 percent.

**Figure 26: Funding ratio**



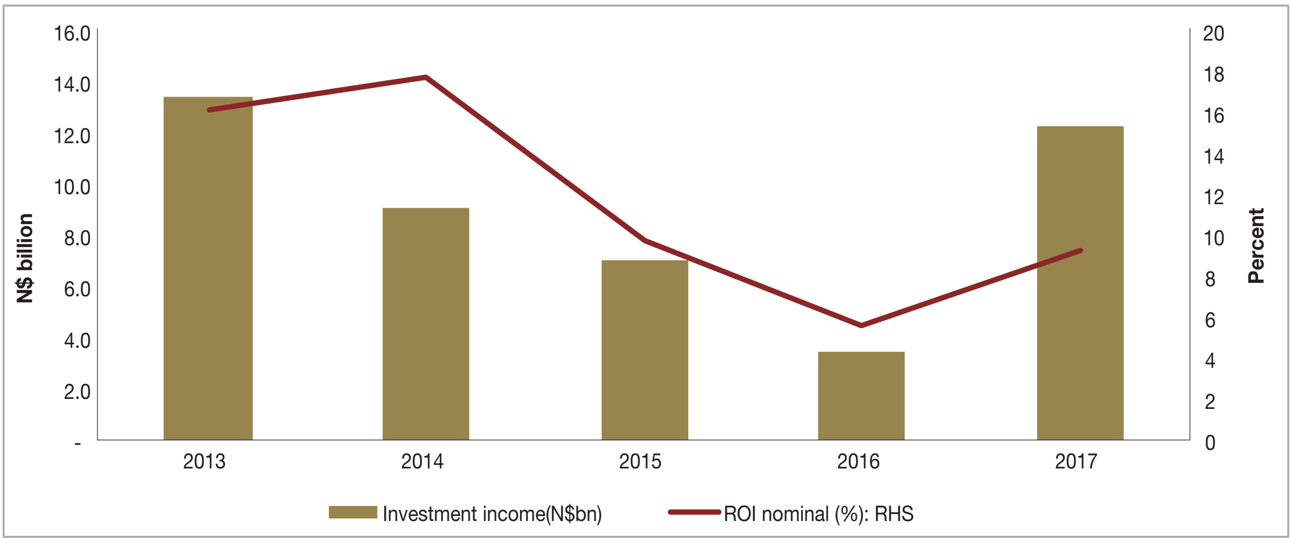

Source: NAMFISA

## Investment Income

**For pension funds, investment income has declined significantly since 2015 but recovered in 2017.** The downward trend in investment income moderated in 2017, due to improved market returns which increased the return on investment (ROI[33]) to 9.3 percent at the end of 2017 (Figure 27). The upward movement was mainly driven by positive stock market performances during the period under review.

[33] ROI is calculated as follow;
R = (2i / A+B - i)
Where R = Return on investment
A = Initial value of investment
B = End value of investment
i = Net investment income + Capital appreciation - Investment costs

**Figure 27: Investment income**




Source: NAMFISA

**The pension fund core activities are generally resilient.** However, it is worth noting that increased activities of introducing innovative investment vehicles in the NBFI industry may require close monitoring by the regulatory authority with potential changes in the risk-taking behaviour. Nonetheless, risks to pension funds mainly from the volatile equity markets remain and should be monitored, going forward.

## Long-term Insurance

**The Long-term Insurance (LTI) sector remained financially sound and stable, backed by buoyant financial markets.** The positive market performance in 2017 supported growth in assets in the LTI sector. In this respect, the sector held a total of N$8.7 billion excess assets above total liabilities. The impact of the protracted recessionary conditions is yet to be seen, as the sector continues to grow its business activities.

### Key Risks

**Risks to the LTI improved in 2017.** There are several risks that could potentially affect the financial soundness of the sector, specifically solvency and concentration risks. In general, the solvency position of the long-term insurance sector is sound, as buoyant financial markets continue to support the asset base. Moreover, market risk remains steady, although exposure in particular to the equity markets remains sizeable. The rise in financial instability can be mostly experienced in times of a sharp fall in asset prices, if entities are not able to meet obligations or capital requirements. This, however, has not been seen in 2017. Despite soundness of LTIs, it is nevertheless critical to understand the risks inherent to high equity investments, promote certain level of diversification from risky assets, and establish contingency plans for periods of declining stock markets, perhaps through required adequate buffers and risk-based regulatory capital.

### Exposures

**In general, the LTI's investment mix remained steady despite its large exposure to equity markets.** The equity exposure declined by 3.0 percentage points to 58.0 percent 2017 (Figure 28a & 28b). In 2017, the exposure to the equity market was followed by government bonds with 21.0 percent exposure and 16.0 percent exposure to corporate bonds (Figure 28b).

**Figure 28a: Investment mix (percent), 2016**

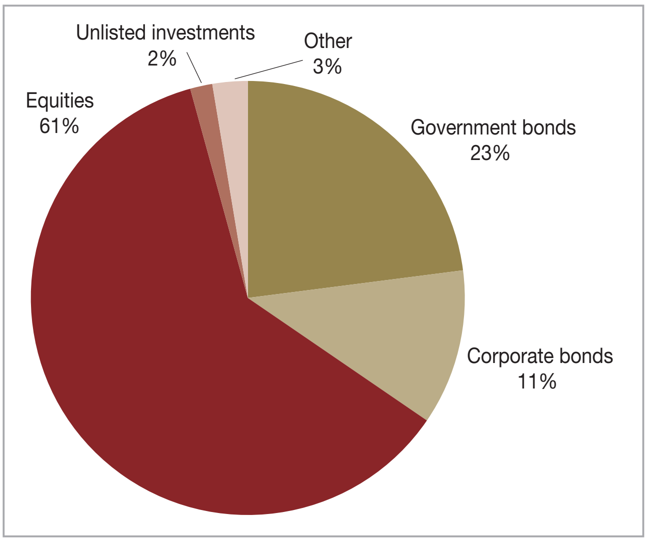
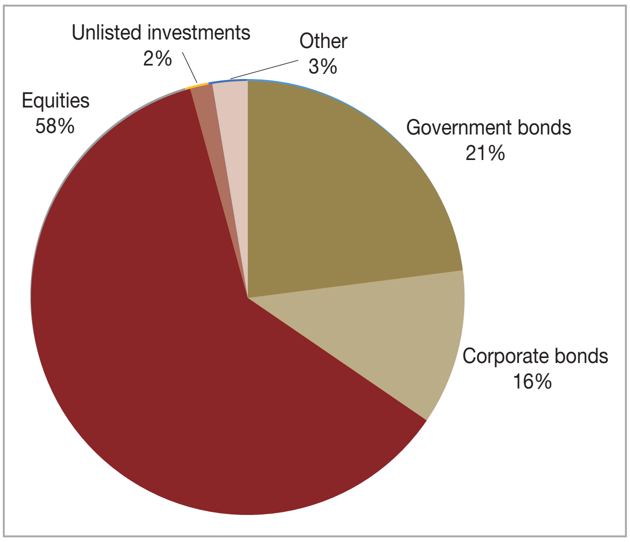



**Figure 28b: Investment mix (percent), 2017**

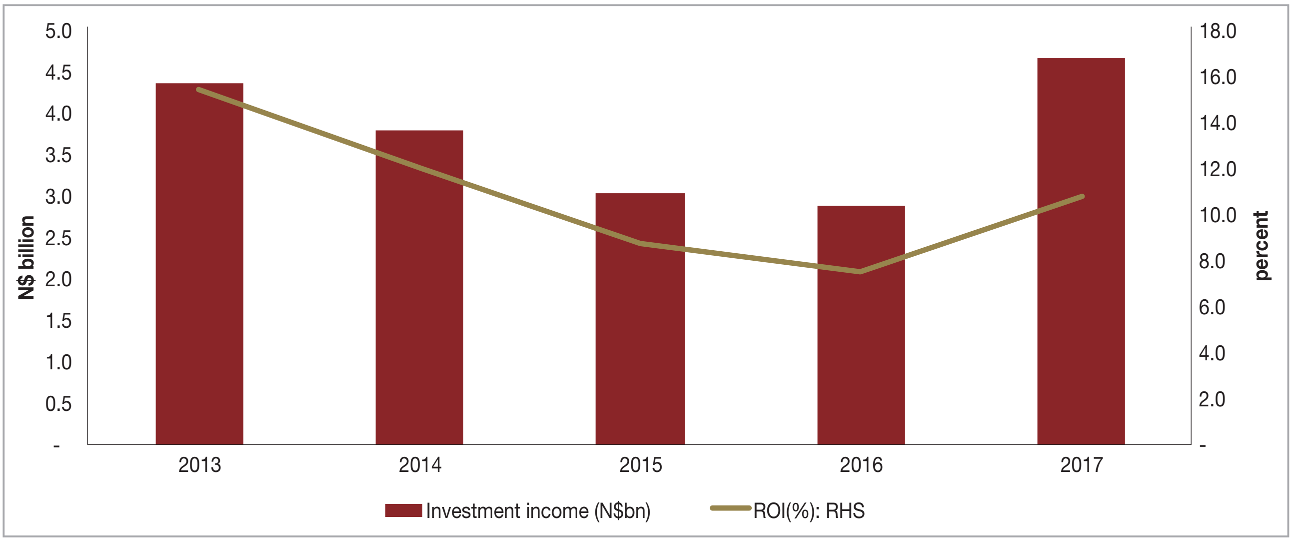



Source: NAMFISA

## Investment Income

Investment portfolio for LTI moderated year on year as its investment income increased, mainly due to an improvement in equity market performance during 2017. Investment return decelerated from 15.4 percent in 2013 to 7.5 percent in 2016, before rising to 10.7 percent in 2017 (Figure 29). The increase in 2017 is mostly attributed to the positive performance in equity markets.

**Figure 29: Investment returns**

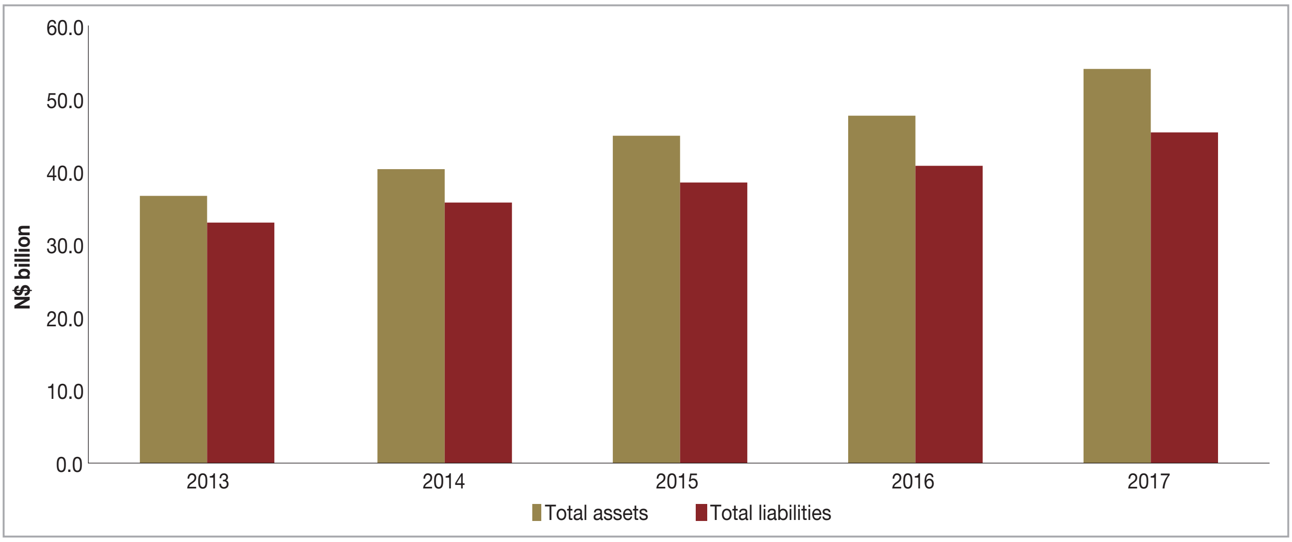



Source: NAMFISA

## Solvency

**As illustrated in Figure 30, the industry remained solvent as its total assets consistently exceeded total liabilities.** During the period under review, the sector remained solvent as it held excess assets to the tune of N$8.7 billion. Further, the industry solvency position improved due to an increase in excess assets by N$2.1 billion translating to a 27.4 percent increase during 2017. The increase in investment income grew the asset base of the LTI sector which in turn improved the accumulation of excess reserves which could be used to cushion against adverse movements of the financial market in future.

**Figure 30: Total assets vs. total liabilities**




Source: NAMFISA

**The above risks identified both in Pension Fund and Long-term Insurance industries require enhanced risk analyses and adequate risk mitigating factors such as the risk-based solvency regimes (see Box 3).** In this regard, the authority has put in place measures that will improve risk analyses within the institution. The key tools geared towards enhancing risk analysis are: the risk rating model, stress-test model and the interconnectedness assessment model (Table 11).

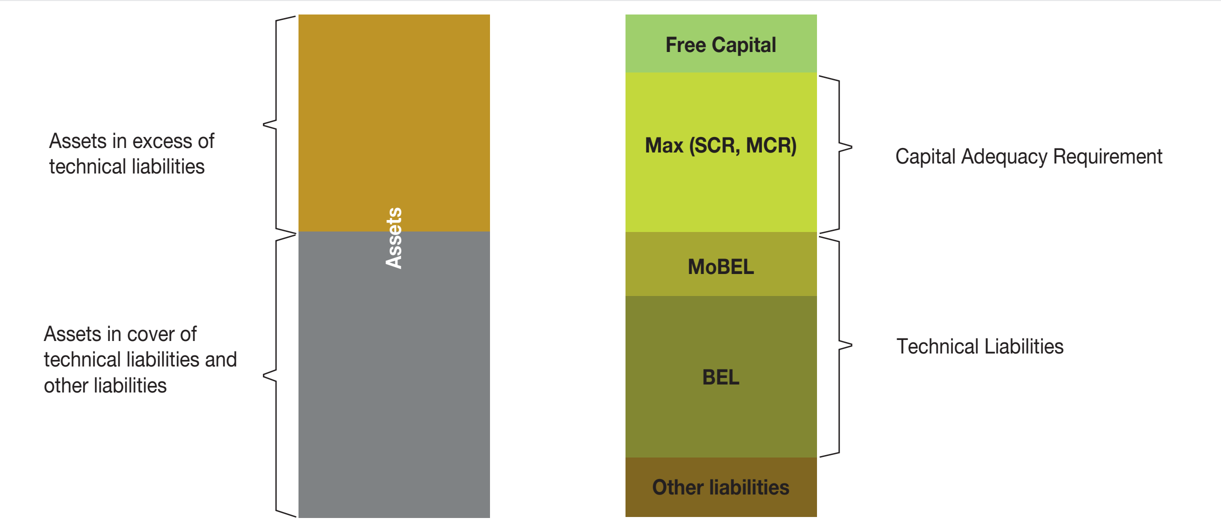
**Table 11: Envisaged risk analytical tools**

| Activity | Purpose |
|---|---|
| 1.Risk rating model | Risk rating model is a framework that quantifies the risk facing individual entities or the whole sector. The Risk rating model is the centerpiece of NAMFISA's risk-based approach to supervision.<br><br>Overall, the risk model simply determines probability of an entity failing and its impact thereof; the model result guides the Authority on how to efficiently allocate its supervisory resources. |
| 2.Stress testing model | It is a diagnostic tool to determine the resilience of entities to systemic risks and vulnerabilities when exposed to external shocks. Pilot stress testing as conducted by FSAP 2017 on three sectors namely; pension funds, short-term and long-term insurance sector. |
| 3.Interconnectedness tool | It aims to determine the interconnectedness of NBFIs and the nature and extent of the interconnections. Further, the tool intensifies potential financial systemic risks stemming from the interconnectedness of NBFIs. |

## BOX 3: NAMFISA'S CAPITAL ADEQUACY REQUIREMENT REGIME FOR SHORT-TERM AND LONG-TERM INSURERS

***NAMFISA is in the process of introducing a Risk-based Capital Adequacy Requirements regime for both short term and long term insurers under the Financial Institutions and Markets (FMI) Bill, which is meant to allow insurance companies to measure the risks they face more accurately, therefore giving policyholders greater protection.*** *This broadly follows the same approach as prescribed in Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS). The capital adequacy requirements prescribe a standard way of measuring risk capital for insurers as well as a prescribing a way of valuing assets and liabilities to demonstrate solvency. The risk capital is a buffer that acts as a cushion against the different risks faced by an insurance company. The graph below shows a summary of the capital adequacy requirements;*

***Figure 1: The proposed capital adequacy requirements under the FIM Bill***




*The Best Estimate of policyholder Liabilities (BEL) is the best estimate of the policyholder liabilities for an insurance company, usually referred to as an actuarial best estimate. The Margin over the Best Estimate of policyholder Liabilities (MoBEL) is a margin over the BEL and is a margin for prudence.The Minimum Capital Requirement (MCR) is the absolute minimum amount of capital that an insurance company is required to hold for registration and ongoing operations. The Solvency Capital Requirement (SCR) is a cushion that protects the insurance company against adverse experience or unexpected losses over the following year.*

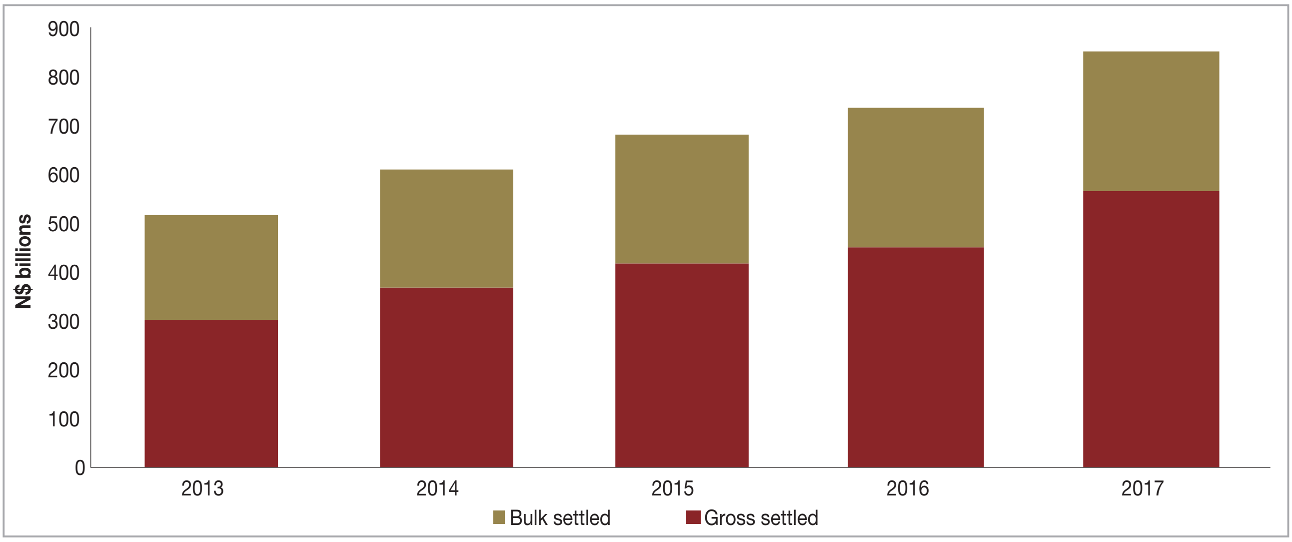
Source: NAMFISA FIM Bill: INS 2.1 and INS 2.2

# VII. PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

**The National Payment System has continued to operate effectively since the previous FSR in 2017.** The Bank continued to fulfil its regulatory mandate as the overseer of the National Payment System (NPS) in 2017, in line with the Payment Systems Management Act 18 of 2003, as amended. This includes ongoing offsite monitoring activities, as well as onsite inspections aimed at identifying and addressing risks in the national payment system (NPS) as per the Risk-Based Oversight Policy Framework (RBOPF).

**During the second semester of 2017, the Namibia Interbank Settlement System (NISS) recorded a decrease in terms of volume and an increase in value, compared to the same period in 2016.** The volumes decreased by 5.2 percent and values of payments settled in NISS increased by 15.5 percent, respectively when compared to the same period in 2016. The decrease in the volume of payments was mainly due to challenging economic conditions, coupled with the withdrawal of participation in NISS by two participants in the second semester of 2017. The value of the share of real-time /gross settled (typically high-value) transactions processed in NISS was 66.0 percent of the total value settled in NISS, whilst that of the retail payment systems[34]/ bulk settled was 34.0 percent of the total value settled in NISS (Figure 31).

**Figure 31: Value of payments processed in NISS**



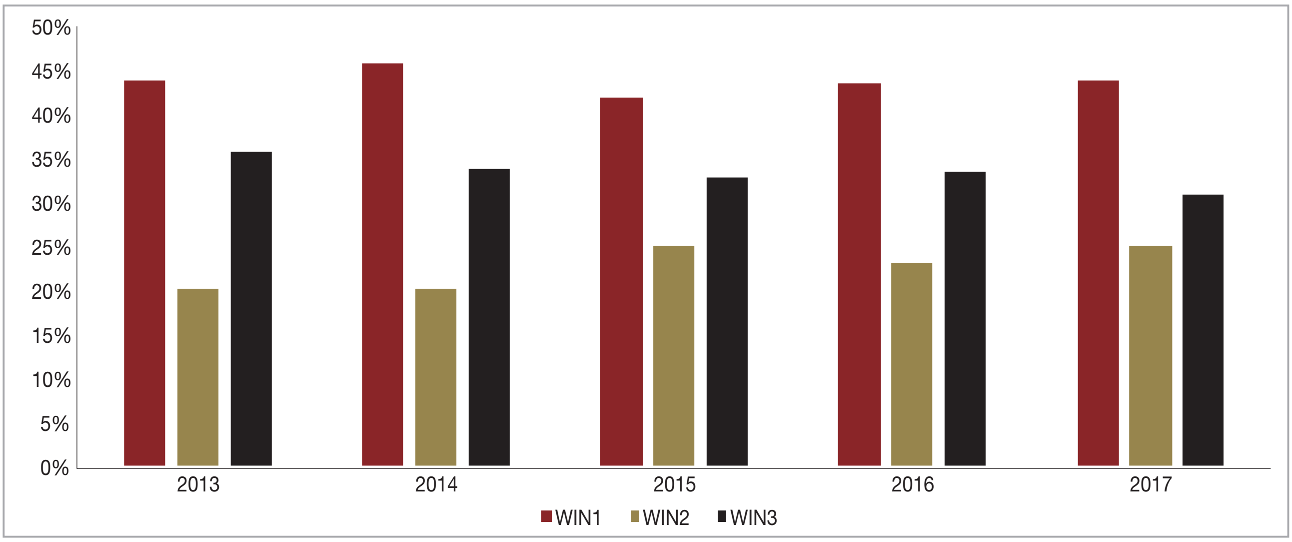

Source: Bank of Namibia

[34] The EFT, Cheque and Card Systems

## Settlement Windows

**Since the last FSR, the likelihood of operational and settlement risks decreased slightly as the proportion of payments settled in Window 3 decreased.** Settlement window periods for payments settled in NISS during 2017 indicate that around 44 percent or N$200.9 billion in payments, was settled in Window 1 (08h00 to 12h00). Furthermore, 25 percent, or N$121.4 billion was settled in Window 2 (12h00 to 15h00) and 31 percent, or N$134.9 billion, in Window 3 (15h00 to 16h40) (Figure 32). To minimise operational and settlement risks, it is ideal that the majority of all settlement take place in the earlier windows (i.e. Windows 1 and 2). Currently 69.0 percent of payments are settling in Windows 1 and 2, which significantly assists in mitigating operational and settlement risks, although improvements are welcome.

**Figure 32: Proportions of payments processed in NISS settled in each settlement window**




Source: Bank of Namibia

## Disruptions to the Namibia Interbank Settlement System (NISS)

**Minor disruptions to NISS were recorded over the second half of 2017.** The NISS front-end[35] availability ratio was 99.98 percent, which was slightly below the acceptable availability level of 99.99 percent. The NISS availability variance was negligible and does not pose any risk to financial stability.

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

## Security of Retail Payments

**The total value of fraud within the NPS decreased when compared to 2016 which resulted in the fraud-to-turnover ratio remaining below the set threshold of 0.05 percent.** A safety index indicator is monitored by the Bank to ensure that the fraud-to-turnover ratio is below 0.05 percent. The fraud-to-turnover ratio is calculated as a proportion of the total value settled by Namibians using cheques, Electronic Fund Transfers (EFT) and payment cards (debit, credit and hybrid cards). During 2017, the average fraud-to-turnover ratio was 0.003 percent, a decrease when compared to the 0.006 percent recorded for 2016. The general decrease of fraud was mainly due to the increased adoption of the Europay-MasterCard-Visa (EMV) compliant cards, which were introduced to combat card fraud (card cloning). Industry recorded a decrease of 66.0 percent which was lost through the use of cards as a payment instrument when compared to 2016. The EFT and cheques streams remained the safer payment instruments for the reporting period. The total value of fraud attributable to the EFT and cheque streams amounted to N$2.3 million and N$2.07 million, respectively.

**The National Payments Systems stakeholders continue to collaborate and monitor emerging fraud trends and related activities, and work with enforcement agencies and consumer associations to avert fraud incidents involving retail payment systems.** There have been significant efforts by the payments industry to enhance business practices, payments infrastructure and related products to better protect consumers against new methods of perpetrating fraud. Furthermore, consumer awareness programmes are ongoing and have assisted in creating public awareness on fraud risks and prevention measures. Security efforts by the Bank and industry contribute to ensuring that the NPS and broader financial sector remain stable, safe and secure, which in turn reinforces trust in the financial system.

**To combat fraud such as forged or counterfeited cards, the industry has embarked upon an Europay-MasterCard-Visa (EMV) compliance project for various cards used in the NPS.** This international standard requires cards to have a “chip” instead of a “magstripe” for authenticating card transactions, making it much more difficult for cards to be cloned. The main objective of the EMV compliance project is to ensure the timely implementation of EMV-compliant Chip and PIN cards in Namibia. The initiative is expected to curb card fraud (card cloning) locally and internationally. As was previously reported, 100 percent of all Point-Of-Sale (POS) and Automated Teller Machines (ATM) are compliant, which means that all POS and ATMs can accept Chip and PIN cards. At the end of 2017, 92.0 percent of the total number of cards in the NPS were EMV-compliant. This is a significant improvement from the 64 percent reported in 2016. Furthermore, as of 31 May 2018, all non-EMV-compliant cards will be discontinued and will no longer be usable. Currently, all banks have devised strategies to get their clients to collect their EMV compliant cards.

**Protecting payment card data along all points in its journey i.e., from payment initiation to payment settlement remains one of the strongest ways to prevent data compromises that can lead to card fraud.** PCI DSS compliance helps with the protection of confidential card payment information across all payment points. The current PCI DSS project plan indicates that all relevant NPS participants aim to be PCI DSS certified by 31 December 2018.

## BOX 4: CURRENT AND FUTURE DEVELOPMENTS IN PAYMENT AND SETTLEMENT SYSTEMS

***The Determination on the Reduction of the Item Limit for Domestic Cheque Payments within the Namibian NPS (PSD-2) was amended and gazetted to postpone the phasing out of cheques to address legislative concerns by recommending the amendment of the affected legislations to Government for reform.*** *The affected legislations make pertinent reference to cheques as a payment instrument and is therefore deemed contradictory with the envisaged phasing out of cheques in Namibia. Once progress is made on the aforementioned, the Bank will provide the necessary communication with regard to the full implementation of the undertaking. The cheque instrument is one of the most embattled instruments when it comes to fraudulent transactions, because of current manual inefficient processes. The phasing out of cheques and the utilising of other instruments will increase efficiency and safety around payments processing for the consumer.*

***During 2017, stakeholders of the NPS participated in the review of the National Payment System Vision 2020.*** *The review assessed the progress and challenges on the key strategies outlined in the 2020 Vision document. Annual reviews will be conducted to ensure execution of the key strategies concerned with but not limited to the financial inclusion and accessibility, governance of the NPS, fees and charges and NPS Capacity. Continuous monitoring of the NPS Vision also ensures that the Bank and relevant stakeholders contribute to the National Development Plan strategies, which include the enhancement of the National Payment System infrastructure, safety, security and cost effectiveness, as well as the creation of an enabling regulatory environment for the financial and service sector.*

***In 2017, the Bank of Namibia released a position paper on Distributed Ledger Technologies (DLTs) and Virtual Currencies (VCs).*** *The position paper is aimed at informing and educating the Namibian public and stating the Bank's position on DLTs and digital currencies with a specific focus on VCs. The overall position of the Bank is that virtual currencies are not legal tender currencies or payment instruments in Namibia and the establishment of virtual currency exchanges or bureaus is also not allowed in Namibia. The Bank does however recognise the potential impact distributed ledger* *technologies might have in Namibia. Distributed ledger technologies could introduce efficiencies and less costly methods in the financial sector. The Bank is currently conducting further research and investigations with a view to provide further regulatory guidance on digital innovations inclusive of virtual currencies and other related financial technologies.*

***In line with the NPS Vision 2020, the Bank has embarked on research around interoperability in the National Payment System.*** *A position paper will be issued during 2018 which will outline the state of interoperability in Namibia and measures that the industry should take to ensure that the interoperability objective of 70 percent as outlined in the NPS Vision 2020 is achieved. This initiative contributes to making the NPS and broader financial sector more efficient.*

***The Bank continues to undertake costing exercises with the system participants, such as banks, as it works towards the determination of standards for fees and charges.*** *The information on the costs involved in the provision of payment services is critical to ascertain that charges payable by users are in the public interest, promote competition and efficiency and are cost-effective. Further research to understand the cost of payment services provision will be conducted during 2018, in order to provide the relevant information to set standards for fees and charges.*

***The Committee of Central Bank Governors (CCBG) granted approval for the CMA Cross-border Payment Oversight Committee (CMA-CPOC) to normalise the current unfitting practice of clearing and settlement of cross border low-value credit EFT transactions within the Common Monetary Area.*** *In executing the mandate provided by the CCBG, the CMA-CPOC issued a directive on 15 May 2017 to that effect. Engagements towards the successful implementation of the directive are ongoing and the Bank, which forms part of CMA-CPOC, continues to provide the necessary guidance and support to the local participants to ensure that the directive is duly implemented in the Namibian jurisdiction.*

***As part of its regulatory reform efforts, the Bank continues to review legislation and supporting regulation.*** *The revision of the Payment System Management Act, as amended, is underway and will continue as a multi-year project. In 2017, the Bank* *reviewed the Determination on Issuing of Electronic Money in Namibia (PSD-3), as well as the Directive on the Conduct within the National Payment System in Namibia (PSDIR-1). The review of these regulations are still underway.*

***In executing its mandate to ensure the safe, secure, efficient and cost-effective operation of the National Payment System (NPS), the Bank ensures that the NPS conforms to international standards for payment systems, such as the Principles for Financial Market Infrastructure (PFMIs).*** *Accordingly, the Bank has identified systems in the National Payment System that are systemically important and has designated Namclear (the automated Clearing house) and NISS as financial market infrastructures in accordance with the PFMIs. FMIs are central to the clearance and settlement of transactions in financial markets as well as the movement of money nationally and globally. The PFMIs require that a designated systemically important payment system observe and apply the standards set out and in particular provide relevant information to its participants, relevant authorities and the broader public.*

# VIII. CONCLUDING REMARKS AND POLICY IMPLICATIONS

**The Namibian financial system continued to be resilient amidst recessionary economic conditions.** Overall, the financial system and markets in Namibia remained sound, profitable, and with no disruptions or disorderly functioning of key financial services despite unfavourable domestic economic conditions. Specifically, the banking industry remained well capitalised with capital levels well above the minimum prudential requirements during 2017. The banking institutions displayed healthy aggregate balance sheet growth, profitability and satisfactory liquidity levels during the period under review. Given challenging economic conditions and the associated shedding of jobs, disposable income has been under pressure, resulting in a significant increase in the ratio of non-performing loans (NPLs). This deterioration in the asset quality however does not pose any immediate risk to banks as they are adequately capitalised to offset this risk. Similarly, the non-bank financial institutions (NBFIs) continued to be financially stable and sound with growing assets and minimal risks, despite recessionary economic conditions in the domestic economy. The payments system and infrastructure also continued to perform efficiently and effectively, and with increasingly robust risk mitigating measures to facilitate safe payments. House prices decelerated, but however with no threat to the stability of the financial system. Finally, household debt moderated, while corporate debt increased. Although both these ratios remained high when compared to those of peer countries, the associated risks to financial stability remain minimal.

**Despite the generally healthy and sound Namibian financial system, specific pockets of risk require monitoring and/or action, going forward.** In this regard, the significant increase in the NPL ratio in the banking sector and the concentration risks in the NBFIs sector will continue to be monitored. In addition, the interconnectedness and exposures between banks and non-bank financial institutions will also continue to be monitored. Finally, there are a number of regulatory amendments, risk monitoring and surveillance enhancements underway aimed at containing and managing risks to the financial system.

**Globally, financial vulnerabilities which have accumulated during the years of very low interest rates and volatility could put financial stability and economic growth at risk.** Going forward, easy financial conditions may further contribute to the build-up of financial fragilities as well as increasing risk to the global financial stability and economic growth over the short and medium-term. Although greater risk taking by financial intermediaries is part of a healthy economic recovery, it may breed vulnerabilities that could harm future growth if excessive, particularly when investors go over and beyond risk tolerance into riskier instruments. In this regard, continued monitoring and heightened vigilance is therefore essential.

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