Namibia Financial Stability Report

April 2020

Bank of Namibia

NAMFISA

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Bank of Namibia

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- Director: Research and Financial Stability
- Director: Banking Supervision
- Director: Financial Markets
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CORPORATE CHARTERS

Bank of Namibia

Vision

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

Mission

- To support economic growth and development in Namibia, we
- Act as fiscal advisor and banker to the Government,
- Promote price stability,
- Manage reserves and currency,
- Ensure sound financial system and conduct economic research.

Values

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

NAMFISA

Vision

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

Mission

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

Values

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

LIST OF ABBREVIATIONS

AEs	Advanced Economies
ALSI	All Share Price Index
ATM	Automated Teller Machine
BCM	Business Continuity Management
BID	Banking Institutions Determination
BoN	Bank of Namibia
CAR	Capital Adequacy Ratio
CET1	Common Equity Tier 1
CIS	Collective Investment Scheme
CPI	Consumer Price Index
DAX	German Dax
DBN	Development Bank of Namibia
DSIB	Domestic Systemically Important Banks
EFT	Electronic Fund Transfers
EMDEs	Emerging Market and Developing Economies
EMEs	Emerging Market Economies
EMV	Euro-Pay MasterCard Visa
FMI	Financial Market Infrastructure
FNB	First National Bank
FSR	Financial Stability Report
FSSC	Financial System Stability Committee
FY	Financial Year
GDP	Gross Domestic Product
GFSR	Global Financial Stability Report
HPI	House Price Index
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
TL	Total Loans
LTD	Loan-to-Deposit
LTF	Loan-to-Funding
LTI	Long Term Insurance
LTV	Loan-to-Value
MoF	Ministry of Finance
MPC	Monetary Policy Committee
NAD	Namibia Dollar
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFIs	Non-Bank Financial Institutions

NCPI	Namibia Consumer Price Index
NISS	Namibia Inter-Bank Settlement System
NPL	Non-Performing Loan
NPS	National Payment System
NSX	Namibian Stock Exchange
PAYE	Pay-As-You-Earn
PCI DSS	Payment Card Industry Data Security Standards
PSCE	Private Sector Credit Extension
Repo	Repurchase
RHS	Right Hand Side
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
RTO	Recovery Time Objective
RTGS	Real-Time Gross Settlement
RWCR	Risk-Weighted Capital Ratio
SARB	South African Reserve Bank
SACU	Southern Africa Customs Union
SME	Small and Medium-sized Enterprises
SOEs	State Owned Enterprises
S&P 500	Standard & Poor 500
SSA	Sub-Saharan Africa
UK	United Kingdom
US	United States of America
VAT	Value Added Tax
VIX	Volatility Index
WEO	World Economic Outlook
WHO	World Health Organization
YOY	Year-on-Year
ZAR	South African Rand

PREFACE

The purpose of the Financial Stability Report (FSR) is to identify risks and vulnerabilities in the financial system and assess the resilience of the financial system to domestic and external shocks. The Report also serves as a communication tool. The report presents recommendations to deal with the identified risks. Lastly, the report is published to inform the reader 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 (BoN) and the Namibia Financial Institutions Supervisory Authority (NAMFISA). The two institutions, which are entrusted with the regulation of the financial system in Namibia, work closely to ensure a healthy financial system. There is also active engagement between the BoN, NAMFISA and the Ministry of Finance (MoF) to ensure a comprehensive assessment of systemic financial risks and of policy actions to ensure lasting financial system stability.

CONTENTS

CONTENTS

Figure

Table

Box

I. INTRODUCTION AND SUMMARY

1. **The global economic environment has deteriorated as the world faces the worst setback since the Great Depression of the 1930s.** On 11 March 2020, the World Health Organisation (WHO) declared COVID-19 a pandemic, after the number of cases of COVID-19 outside China increased manyfold and the affected countries tripled. The outbreak has caused a massive health crisis across the world. Governments worldwide have imposed severe restrictions and lockdown measures to curb the spread of the pandemic, subsequently bringing economic activity to a standstill in the process. The International Monetary Fund (IMF) has termed this extraordinary period 'The Great Lockdown' and has estimated that the shock on the global economy could be a staggering US$9 trillion in the worst-case scenario. World leaders have invested trillions of dollars in stimulus packages in an attempt to contain the impact of the virus on the global economy however, it is inevitable that COVID-19 will reduce the output of almost every economy during 2020. The IMF expects the impact to be 'far worse' than the 2008/2009 global financial crisis, estimating it to be as devastating as the Great Depression of the 1930s. These are very uncertain times because the degree of the fallout will largely depend on unpredictable factors. The Financial Stability Report (FSR), therefore, described the economic environment in 2019, while also being cognisant of the available year-to-date developments associated with the COVID-19 pandemic.

2. **According to the IMF's April 2020 Global Financial Stability Report (GFSR), global financial conditions have tightened sharply since the onset of COVID-19.** Financial conditions were broadly accommodative characterised by reduced financial markets volatility and stable interest rates in both the Advanced Economies (AEs) and Emerging Markets and Developing Economies (EMDEs) during 2019. With the outbreak of COVID-19, uncertainties have increased significantly as portrayed by stock prices that have dropped notably as investors seek to rebalance their portfolios to reduce risk as well as invest in safe and liquid assets such as cash and treasury securities. The rapidly worsening risk sentiments across the globe has prompted a series of central bank rate cuts, relaxation of macroprudential requirements, and large-scale asset purchase programmes to support liquidity. Going forward, fiscal and monetary authorities world-wide are expected to continue with stimulus packages, accommodative monetary policy stances and easing of macroprudential regulation to support their economies during this uncertain time. The Namibian financial system was able to withstand the impact of the 2008/2009 global financial crisis due to the availability of financial and fiscal buffers at the time, however, COVID-19 is expected to adversely affect the resilience of the financial system, and thus measures have been adopted to address its potential consequences.

3. **The Namibian financial system remained sound and stable during 2019; but risks increased 2020, due to the spread of COVID-19.** Overall, the financial system was sound and profitable in 2019 and continued to function efficiently and effectively. However, since the outbreak of COVID-19 in January 2020, sentiment became gloomy. During 2019, total banking sector assets continued to grow, with liquid assets well in excess of the statutory minimum required. Although asset quality deteriorated further in 2019, the banking sector remained liquid, profitable and well capitalised with sufficient provisions for delinquent loans. Similarly, the Non-Bank Financial Institutions (NBFIs) continued to be financially stable and sound, despite subdued economic conditions. The National Payment System (NPS) remained stable, safe, efficient and effective. Household and corporate debt increased but posed minimal threat to financial stability at the end of 2019. Although risks to financial stability have increased given the COVID-19 pandemic, policy measures were adopted to mitigate these risks. It is anticipated that the adopted policies will go a long way towards containing the potential impact on financial stability.

4. **Growth in the global economy slowed during 2019 and is expected to deteriorate rapidly in 2020 if COVID-19 is not well contained.** Global growth slowed to 2.9 percent in 2019, from 3.6 percent in 2018 on the back of trade wars, geopolitical tensions between the United States (US) and Iran as well as unique stresses in EMDEs. On the other hand, economic activity in Sub-Saharan Africa (SSA) increased slightly, driven by Nigeria, while activity in other economies in SSA remained subdued.

5. **The global economy is expected to contract in 2020, however, a significant recovery is projected in 2021.** According to the IMF's April 2020 World Economic Outlook (WEO), global GDP is projected to contract by 3.0 percent in 2020 in the best-case scenario. The global output is then projected to expand by 5.8 percent in 2021. This forecast assumes that the pandemic would have been controlled through containment measures by the second half of 2020. Should the virus not be contained in the short term, the IMF predicts growth to decline by a further 8.0 percent on top of the baseline scenario. Going forward, risks to financial stability remain uncertain as they are largely dependent on the world's ability to adequately contain and recover from the virus.

6. **The domestic economy continued to contract in 2019 and going forward, growth prospects are bleak.** Real GDP in Namibia contracted by 1.1 percent in 2019 compared to a marginal growth rate of 0.7 percent in 2018. Real GDP is expected to contract by an astounding 6.9 percent in 2020 due to the impact of the COVID-19 pandemic. On 1 April 2020, the Minister of Finance announced the implementation of a N$8.1 billion stimulus package to support corporates and households during the COVID-19 crisis. The stimulus package is expected to help mitigate the negative impact of the pandemic on the economy. The domestic outlook

remains bleak, hence the extent and spread of the pandemic remains uncertain. Going forward, risks to domestic growth and outlook are the ongoing restrictions and lockdowns in many countries including Namibia which are restricting business activities and causing disruptions to supply. Moreover the volatile and persistently low international prices of some of Namibia's export commodities also pose a risk

7. **In addition to the reduction in the repo rate by 200 basis points since March 2020, the Bank of Namibia has implemented various policy relief measures in order to support the economy and manage the impact of the COVID-19 pandemic, however future COVID-19 induced economic developments remain largely uncertain.** The Central Bank reduced the repo rate by cumulative 225 basis points thus far in 2020, of which the last two reductions of 100 basis points each were intended to mitigate the impact of COVID -19 on the economy. The objective of the relief measures is to directly support individuals, farmers, small and medium-sized enterprises (SMEs) and corporates in managing the impact emanating from the COVID-19 outbreak as well as the impact of the recent drought. On the individual borrower level, payment holidays, including the principal and interest, can be extended to clients for a period of 6 to 24 months based on their circumstances. On a banking institutions level, the liquidity relief measures of the capital conservation buffer, as well as the postponement of single borrower limits and reduction of the concentration risk, adopted by the Bank of Namibia will enable banking institutions to support the economy. The implementation of relief measures will be based on a case by case assessment of clients by banks, while also taking into consideration the respective bank's internal policies and processes. These measures provide banking institutions the necessary flexibility to respond to the needs of their clients, thereby enabling them to support the economy during these challenging times.

8. **Household and corporate indebtedness increased moderately in 2019 underpinned by short-term credit facilities and may pose risks to financial stability given COVID-19.** The annual growth in household indebtedness amounted to 7.3 percent during 2019 compared to 7.0 percent in the previous year, driven by demand for short term credit facilities. Household debt to disposable income rose from 92.9 percent in 2018 to 97.7 percent in 2019 as credit extended to individuals continue to increase, while disposable income moderated in the period under review. The slowdown in disposable income was due to the significantly slower growth in the compensation of employees, from 5.9 percent in 2018 to 1.9 percent in 2019. The total corporate debt stock increased marginally on the back of domestic debt. Total corporate sector debt edged higher by 0.8 percent to N$127.2 billion in 2019, up from N$126.1 billion in 2018, owing to a N$1.5 billion rise in domestic debt. Going forward, policy responses to COVID-19 may support the cashflows of households and corporates in the short to medium term with a probable softening of the threat to financial stability, although a portion may be utilised as

contractual repayment of bank debt. Nonetheless, if the risks to financial stability emanating from the COVID-19 pandemic materialise, the impact on the financial system could be adverse.

9. **The banking sector remained robust, profitable and well capitalised despite sluggish economic conditions during the period under review.** The total assets of the banking sector continued to grow, albeit at a slower pace with liquid assets well in excess of the statutory minimum required. The banking sector remained profitable, while also maintaining adequate capital levels above the prudential requirements. Although asset quality deteriorated further in 2019 when compared to 2018, write-offs in relation to both total loans and profits slowed, with adequate provisions raised for delinquent loans. The overall impact of risks to the banking sector did not appear significant during the period under review, therefore having had no real threat to financial stability in Namibia. In light of the current developments, the probability of further downside risks to the banking sector is high, however the impact is estimated to be medium as relief measures are implemented and developments monitored.

10. **Despite the recessionary conditions the NBFI sector remained stable and sound during the period under review, although the positive performance of the NBFIs may be dampened by the outbreak of COVID-19 in 2020.** The NBFI sector assets grew by 9.0 percent in 2019 supported by a robust financial market performance. This, however, is expected to change in 2020 due to the COVID-19 pandemic. To combat the spread of the pandemic the Government implemented a nationwide lockdown which encourages social distancing and prohibits large-scale public gatherings. It is therefore, anticipated that the lockdown will negatively impact business operations and livelihoods of ordinary citizens through the suspension of production and job lay-offs. NAMFISA expects the impact of COVID-19 to be felt by all industries. For the insurance sector it will be through reduced or no new insurance business during the lockdown period. Moreover, the deterioration and uncertainty in the financial markets will lead to varying adverse impacts on different industries. This has led to the change in direction of risks for both the Insurance and Pension Funds, which are leaning to the upside in 2020. Increased pressure will be particularly on pension funds, given that the industry funding levels were only slightly above the prudential limits. The robust capital buffers, are nonetheless, expected to cushion most of the NBFIs sector from the shocks in the interim, while the long-term impact remains uncertain due to the changing dynamics of the pandemic. NAMFISA continues to monitor the NBFI sector to ensure that it remains sound.

11. **Namibia's payment system and infrastructure remained stable and continued to operate efficiently and effectively during 2019 as well as early 2020, despite the impact of COVID-19 on the business operations of the NPS participants.** The Bank of Namibia continued to fulfil its regulatory mandate as the overseer of the National Payment System (NPS) in line with the Payment System Management Act 18 of 2003, as amended. Compared to 2018, the

period under review recorded an increase in the total value of fraud across all payment streams although this is being monitored closely. The National lockdown imposed in the face of the COVID-19 pandemic, impacted the operations of the NPS participants and their ability to offer their full range of payment solutions, particularly in-branch payment services. However, both banks and non-banking financial institutions encouraged customers to use digital channels and given its high level of automation, the NPS continued to function smoothly during this period.

II. SUMMARY OF RISK ANALYSIS

This section presents a brief analysis of the main risks to the stability of the domestic financial system. Consistent with sections III-VII of this Report, the analysis identifies risks arising from the external macroeconomic environment, trends in household and corporate debt, and trends in the domestic banking and non-banking institutions' financial soundness indicators, before concluding with an analysis of the payment and settlement system. COVID-19 was an overwhelming factor in assessing the risks to financial stability going forward and the Financial System Stability Committee (FSSC) analysed risks with the information provided at the end of March 2020, despite the extreme global uncertainty at the moment. The risks were analysed and rated from low risk to high risk based on their probability of occurrence as well as their potential impact on financial stability in Namibia, should they be realised.

Risks to Namibia's financial stability have increased significantly since 2018 as a result of the economic contraction experienced in 2019, coupled with the expected impact of COVID-19 going forward. Since the last Financial Stability Report (FSR), the probability and impact of most risks increased, particularly in the macroeconomic environment (Figure 1a). On the back of relatively weak growth, COVID-19 poses a major threat to the already fragile global and domestic growth. According to the IMF's April 2020 GFSR, global financial conditions have tightened abruptly since the outbreak of COVID-19. Since the beginning of 2020, global financial conditions have become very strained amidst the growing uncertainty around the COVID-19 pandemic. Similar to most other countries, Namibia has put in place measures to contain the spread of the pandemic as well as to mitigate its impact on the economy. These measures may mitigate the risks; however, should the risks materialise, the impact on both the global and domestic economy will be severe. Namibia's credit rating was downgraded by both major rating agencies in 2019. Similarly, South Africa's credit rating was downgraded by Fitch in March 2020. Fitch was the last international rating agency to issue a downgrade to below investment grade; therefore, it is expected to have a limited impact on the overall economy.

All risks to financial stability in Namibia emanating from the banking sector, payment and settlement system as well as the Non-Bank Financial Institutions (NBFI) sector, increased in 2019 when compared to 2018. Banking sector risks have increased during the period under review when compared to December 2018 because the COVID-19 pandemic poses a threat to the liquidity of the banks and the income of households and businesses, rendering some of them unable to meet financial obligations. However, the relief measures put in place by the Ministry of Finance and the Bank of Namibia, are expected to soften this impact to some extent and help manage the risk. Payments system risks also increased during the period under review due to an increase in the total value of fraud across all systems, elevating the risks associated with the security of retail payments. The probability and impact of market risks to the NBFIs increased substantially due to the COVID-19 pandemic. The NBFIs are however expected to absorb this risk, given their high capital buffers. It should be cautioned, however, that the overall risk associated with the COVID-19 pandemic to financial stability in Namibia may be more severe than projected in this report, given growing uncertainty.

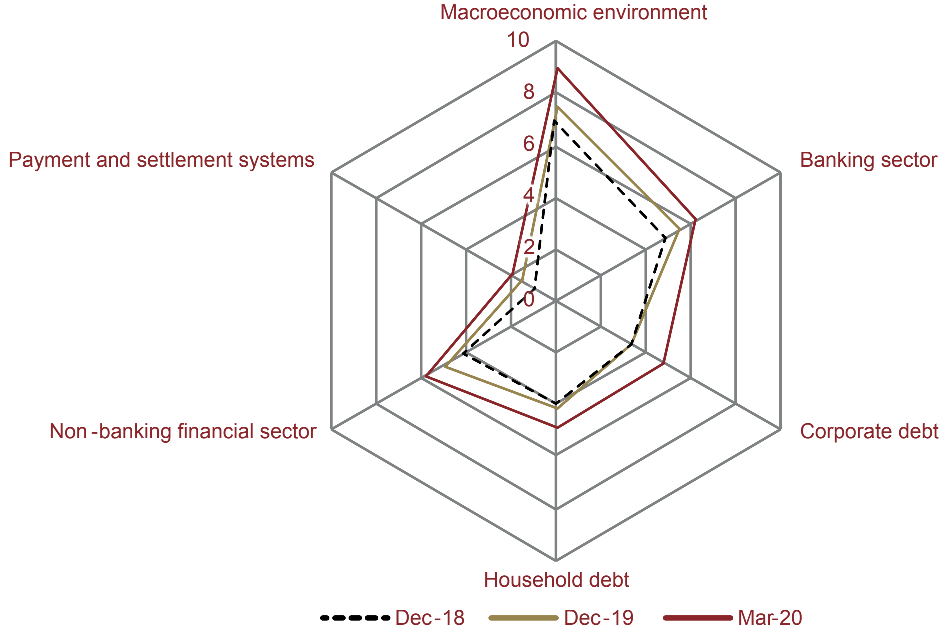
Figure 1a: Risks to financial stability in Namibia

	Direction of risk[1] December 2018	Probability of risk[1] in 2020[2]	Impact of risk[1] in 2020[3]
Macroeconomic Environment Events/Risks			
Global economic slowdown	Up		
Domestic economic slowdown	Up		
Sovereign credit rating downgrade: Namibia	Up		
Decline in international reserves	Up		
Sovereign credit rating downgrade: South Africa	Up		
NAD/ZAR depreciation	Up		
Household debt risks			
Increase in household debt	Up		
Corporate debt risks			
Increase in corporate debt	Up		
Banking Sector risks			
Liquidity constraints	Unchanged		
Asset quality deterioration (NPLs)	Up		
Payment System risks			
Security of retail payments	Up		
Settlement in last window	Unchanged		
NBFIs risks			
Funding risk	Up		
Market risk	Up		
Concentration risk	Up		
Solvency risk	Up		

Risk analysis keys	low	medium	high

Risks to financial stability increased during the period under review and surged during the first quarter of 2020 due to uncertainty regarding the impact of COVID-19. Risks associated with the macroeconomic environment, household and corporate debt sectors, banking sector, non-banking financial institutions, as well as the payment and settlement system all went up compared to December 2018 (Figure 1b). The higher risks during the period under review could be ascribed to the sluggish economic activity during 2019, which was further exacerbated by the outbreak of COVID-19 in early 2020. Going forward, the impact of the COVID-19 pandemic on the global and domestic economy as well as financial stability, will be a key factor.

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



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

2 This is the probability of the risk materializing going forward.

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

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

III. MACROECONOMIC ENVIRONMENT

COVID-19 – The Great Lockdown of 2020

In December 2019, the first case of a pneumonia of unknown cause was detected in Wuhan, China and reported to the Chinese country office of the World Health Organisaion (WHO). The virus quickly spread from China to the rest of the world. WHO subsequently termed the virus COVID-19 on 1 February 2020, after declaring it as a public health emergency of international concern on 30 January 2020. On the 11 of March 2020, WHO declared COVID-19 a pandemic. COVID-19 is a high level risk hazard to life, to the global and domestic labour force and consequently to economic activity in general. Governments quickly realised the importance of containing the highly contagious COVID-19 through inter alia the practice of social distancing, which extended to partial or full lockdowns of country borders, private, and government non-essential activities and institutions, such as schools. Social distancing poses a massive threat to the global financial system, both due to the speed at which governments are imposing the lockdowns and the panic arising from the massive uncertainty around the virus as well as the damage to the sustainability of businesses globaly.

Since early 2020, growth projections have been revised down dramatically on account of the impact of the COVID-19 outbreak. While these scenarios obviously did not inform the analysis of financial stability developments in 2019, they are at the centre of all current analyses and planning. The risks outlined in 2019 remain in the background but have been relegated to secondary importance as the world focuses on managing and recovering from the pandemic. The extent of the envisaged setback to the global growth path is illustrated in the section below, incorporating the IMF projections contained in its April 2020 World Economic Outlook[5] and the most recent data where applicable.

Global Economic Growth

Global growth is estimated to have weakened during 2019 both in Advanced Economies (AEs) and Emerging Market and Developing Economies (EMDEs). The global economy is estimated to have slowed to 2.9 percent growth in 2019, 0.7 percentage point lower than in 2018. (Figure 2) Economic activity in the AEs is estimated to have slowed to a growth rate of 1.7 percent in 2019, compared to 2.2 percent in 2018. Similarly, growth in the EMDEs is estimated to have slowed to 3.7 percent in 2019, 0.8 percentage point lower than in 2018. The lower global growth in 2019 was mainly attributed to trade wars, geopolitical tensions between the US and Iran as well as macroeconomic and financial stresses in EMDEs. Global growth was further dragged down by a series of weather-related disasters, coupled with social unrest in several countries during 2019. GDP growth in Sub

[5] The IMF scenario depicted in the April 2020 WEO is the baseline scenario under the assumption that the pandemic fades in the second half of 2020 and containment efforts can be gradually unwound.

Saharan Africa is estimated to have improved to 3.1 percent in 2019, from 3.3 percent in 2018, driven by the Nigerian economy which was spurred by the telecommunications services industry and improved oil production.

The global economy was initially projected to pick up in 2020 and 2021; however the COVID-19 pandemic has turned the outlook extremely gloomy. Global output was initially expected to increase to 3.3 percent in 2020 and 3.4 percent in 2021 from 2.9 percent in 2019 (Figure 2). This is the forecast that informed financial stability analyses throughout 2019. This projected growth path relied on the strong activity in the relatively healthy EMDEs (such as India, Nigeria and Brazil) combined with steady growth in AEs as well as China since the IMF expected them to gradually reach their potential growth rates. The easing in monetary policy across a range of AEs and EMDEs during the course of 2019 was also factored in as supportive of this projected acceleration in global growth. The outbreak of COVID-19 has reversed this positive sentiment and forced governments and international organisations to dramatically revise their growth projections downwards.

In April 2020, the IMF revised its global growth projections for 2020 downwards by a staggering 6.3 percent to a contraction of 3.0 percent as a direct result of the COVID-19 pandemic. There is still extreme uncertainty around the virus and the ability of economies to recover from this health crisis with its huge economic consequences. The uncertainties caused by the pandemic have significantly impacted major industries around the world and crashed financial markets resulting in higher volatility, lower commodity prices, and tighter financial conditions. Economies that rely heavily on tourism, trade, entertainment and transport experienced massive shocks when countries were forced to lockdown and close borders to contain the virus. No country is spared by the effects of COVID-19, Emerging Asia is the only region expected to grow positively in 2020, albeit at a very subdued rate.

Advanced Economies (AEs)

Real Gross Domestic Product (GDP) in the AEs is estimated to have slowed in 2019. Annual growth in the AEs slowed to 1.7 percent in 2019, compared to 2.2 percent in 2018 (Figure 2). Economic growth in the United Kingdom (UK) slightly increased to 1.4 percent in 2019, moderately lower than to the previous year, as fears of a no-deal Brexit softened and investors' sentiment towards the UK economy improved, increasing the risk appetite. The US economy is estimated to have slowed to a growth rate of 2.3 percent in 2019, which is 0.6 percentage point lower than in 2018, on the back of trade-related policy uncertainty, coupled with geopolitical tensions with Iran. GDP in the Euro area is estimated to have expanded by only 1.2 percent in 2019, lower than the 1.9 percent registered in 2018 due to weaker growth in foreign demand and a drawdown of inventories. In contrast, growth in economic activity in Japan increased to 0.7 percent in 2019, compared to 0.3 percent in 2018. The improved growth in Japan in 2019 can be ascribed to increased spending by both the private and public sector during the first three quarters of the year in anticipation of the higher consumption tax implemented on the 1st October 2019.

Going forward, real GDP in the AEs is projected to deteriorate significantly due to the impact of the COVID-19 pandemic. Despite efforts by the governments and Central Banks to mitigate the impact of the pandemic, the IMF projects real GDP in the AEs to contract by 6.1 percent in 2020, a 7.7 percent lower than the growth rate anticipated in January 2020. COVID-19 spread rapidly through the Euro Area and by March 2020, the outbreak was severe, particularly in Italy and Spain. Consequently, the IMF revised economic growth in both Italy and Spain, to contractions of 9.1 percent and 8.0 percent, respectively. Projected GDP growth in the United States has similarly been revised downward although by a lesser margin. Real GDP in the US is expected to contract by 5.9 percent in 2020, 7.9 percent lower than expected in January 2020. The significant downward revision is unprecedented in such a short time and is expected to impact all major economies in the group, including Germany and France, which are expected to contract by 7.0 percent and 7.2 percent, respectively. Although many AEs have announced strong stimulus packages and a series of lockdowns to mitigate the impact of the virus and hopefully support economies through the recovery process, economic activity is still expected to contract significantly during 2020. Going forward, the IMF projects the AEs to recover to a positive growth rate of 4.5 percent in 2021 in the baseline scenario.

Emerging Market and Developing Economies (EMDEs)

During 2019, economic activity is estimated to have slowed in the EMDEs partially owing to weak domestic demand in major economies. GDP in the EMDEs is estimated to have expanded by 3.7 percent in 2019, compared to 4.5 percent in 2018 attributed to shocks that negatively affected domestic demand (Figure 2). India's growth rate is estimated at 4.2 percent in 2019, significantly lower than the 6.1 percent recorded in 2018 as the risks emanating from the non-bank financial sector and the decline in credit growth negatively impacted domestic demand. The Chinese economy expanded by 6.1 percent in 2019, a 0.6 percentage point lower than in 2018, mainly due to escalating tariffs resulting from trade tensions with the US and weakening external demand. Growth in Brazil is estimated to have weakened from 1.3 percent in 2018 to 1.1 percent in 2019 as a result of disruptions in the supply of minerals which hampered economic activity. Similarly, real GDP growth in Russia slowed due to weaker activity in the mining sector in 2019.

Economic activity in the EMDEs is similarly expected to contract in 2020 due to COVID-19. Real GDP of EMDEs is projected to contract by 1.0 percent in 2020; however, excluding China, Real GDP could contract by up to 2.2 percent. China and India are among the exceptional few EMDEs expected to post a moderately positive growth rate in 2020. It must also be noted that many of the EMDEs are not experiencing the same magnitude of the outbreak of COVID-19 as experienced in the AEs. Therefore the downward revision to the Real GDP of EMDEs is based on the economic disruptions caused by the measures they implemented to contain the virus. Furthermore, should more containment measures be required to combat COVID-19, this could further lower the projected growth in the EMDEs, with possibly devastating effects, especially on those with limited fiscal space and heavy reliance on commodity exports and tourism.

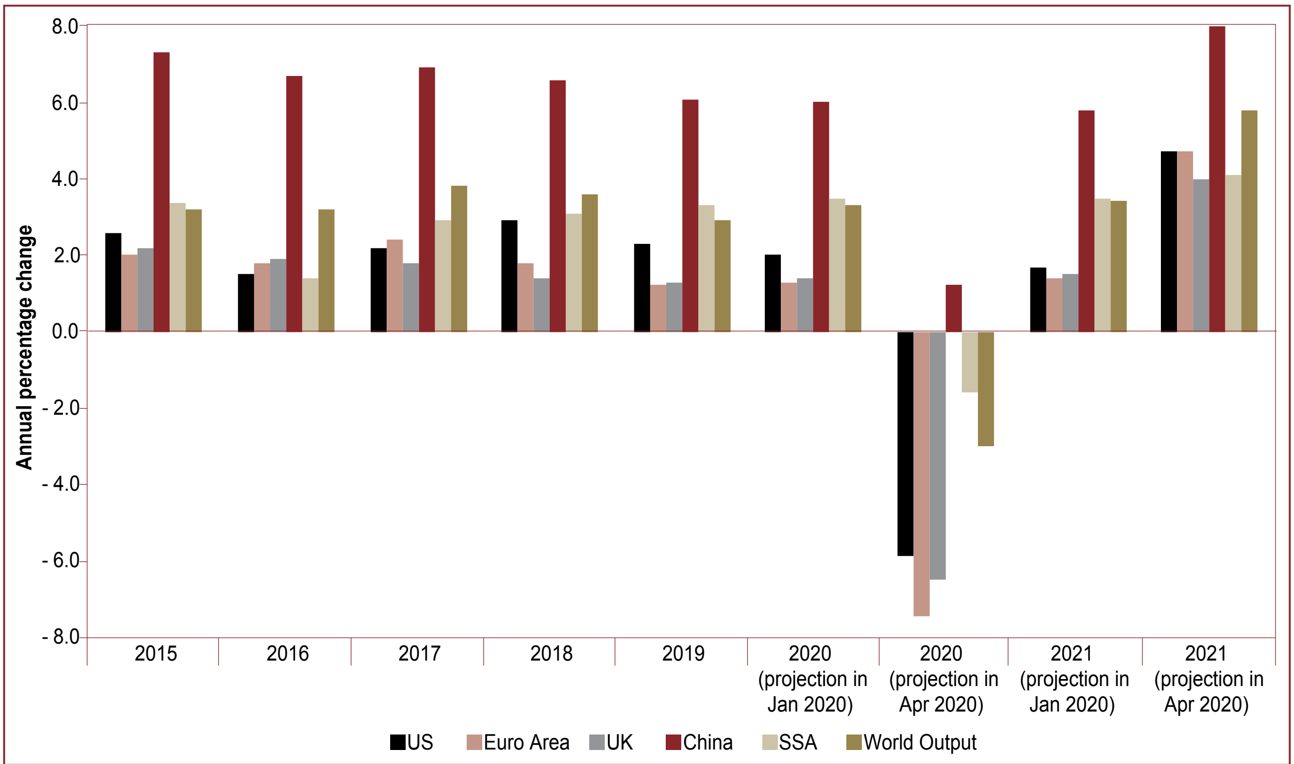
Emerging Asia is expected to be the only region with a positive growth rate in 2020. India is expected to be the key driver of growth in 2020, albeit annual GDP is projected to moderate to 1.9 percent, before rebounding to 7.4 percent in 2021. Despite remaining on a positive trajectory, economic growth in China is estimated to slow to 1.2 percent in 2020 from 6.1 percent estimated in 2019. This will be largely due to policy measures adopted to contain the impact of the COVID-19 and lockdowns implemented on 23 January 2020. Going, forward, the Chinese economy is projected to rebound to a 9.2 percent growth rate in 2021 due to the impact of the economic stimulus programme. On the contrary, Thailand is projected to contract by 6.7 percent in 2020 as activity in the tourism sector comes to a complete halt.

Sub-Saharan Africa (SSA)

Economic activity in Sub- Saharan Africa (SSA) increased slightly in 2019, aided by the Nigerian telecommunications services industry. Growth in SSA is estimated at 3.1 percent in 2019, slightly higher than the 3.3 percent recorded in 2018 (Figure 2). The Nigerian economy's Real GDP is estimated to have expanded by 0.3 percentage point to reach 2.2 percent in 2019. The improved growth for 2019 was mainly driven by the telecommunications services sector and firm oil prices. Meanwhile, other economies in SSA remained subdued. South Africa's growth rate stood at 0.2 percent in 2019, a moderation compared to 0.8 percent in 2018. The further slowdown in 2019 was underpinned by a deteriorating fiscal position which negatively impacted business confidence and private investment, alongside unresolved land issues, regulatory uncertainty and unreliable electricity supply. Economic activity in Angola is estimated to have contracted by 0.3 percent in 2019, an improvement from a decline of 1.2 percent in 2018.

Real GDP in SSA is projected to contract by 1.6 percent in 2020, a downward revision of 5.1 percent compared to January 2020. At the time of the publication of this report, SSA has reported the lowest cases of COVID-19 compared to all the regions in the world. As a result, not all countries in SSA have deployed strict containment measures such as those imposed by the AEs and EMDEs. Nonetheless, many countries in SSA are vulnerable to trade and commodity price shocks or rely heavily on tourism, therefore the pandemic is expected to have a negative impact on their domestic economies in 2020. Moreover, many countries in SSA are highly indebted and do not have enough fiscal space to adequately support their economies. The IMF encouraged countries to spend what is necessary to save lives and not make a trade-off between lives and livelihoods. However, countries should avoid borrowing excessive amounts of debt and falling into a debt trap, as it may pose significant risks to financial stability going forward.

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



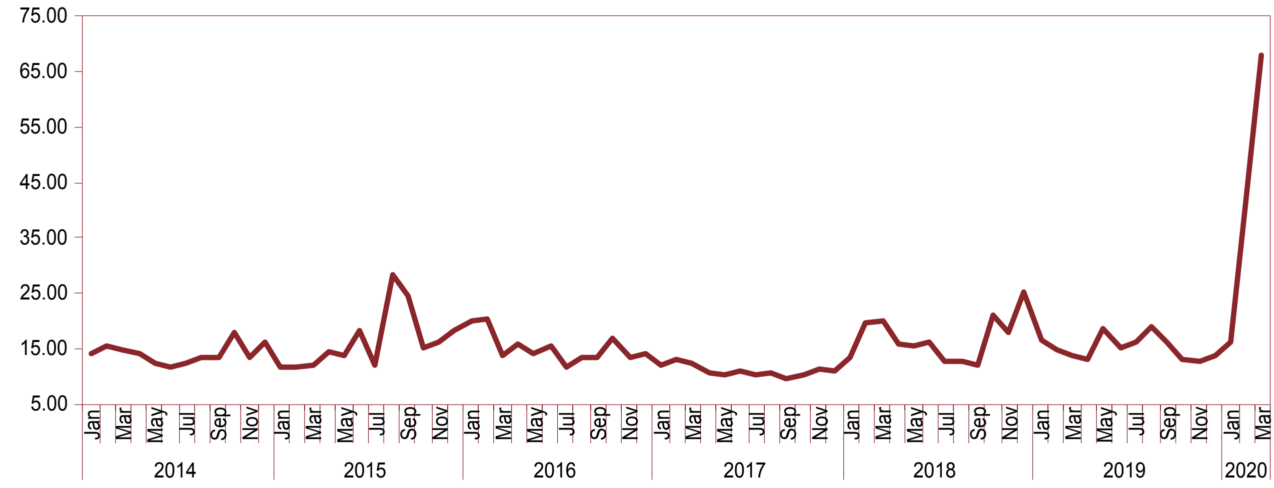
Source: IMF World Economic Outlook, April & January 2020

Developments in the Financial Markets

Advanced Economies

The volatility index (VIX) of the Chicago Board options exchange decreased during 2019 on the back of monetary easing in the AEs as well as reduced fears around trade tensions; however, the index surged in early 2020 due to the COVID-19 pandemic. The VIX averaged 15.24 index points in 2019, lower than 16.95 index points recorded in 2018 (Figure 3). The VIX is a measure of global market stability; the higher the VIX, the more uncertainty in the market. The lower VIX implies a more stable investment environment in the AEs. The lower VIX in 2019 could be ascribed to waning fears of a no-deal Brexit as well as positive sentiment towards the US-China trade deal. Despite tensions between the US and Iran, monetary easing in most AEs was expected to support global growth going forward and continue stabilising the global economy. The VIX has surged since the beginning of 2020 amidst panic around the COVID-19 pandemic. The VIX stood at an astounding 67.86 index points on 20 March 2020, which is 4 times higher than at the end of 2019. Governments and Central Banks have applied various fiscal, monetary and macroprudential tools, to support their respective economies. These efforts have improved investor confidence and as a result, the VIX declined to 40.44 points on 15 April 2020. Despite efforts by regulators, uncertainty around how businesses will survive during the pandemic remains a big risk for investors.

Figure 3: Volatility Index (VIX)



Source: Bloomberg

Encouraged by easy monetary policy, the fixed income market remained resilient during 2019, but financial market conditions tightened rapidly since the beginning of 2020. Most Central Banks in the AEs adopted accommodative monetary policy stances during 2019 in order to support economic activity. The loose monetary policy stance boosted investor confidence slightly, although downside pressures such as global trade tensions and the generally sluggish global growth prevailed. Sovereign bond yield spreads decreased notably, as investors priced in both global and domestic risks, thereby increasing the price of bonds in the fixed income market during 2019.

Since the outbreak of COVID-19, the prices of risky assets and commodities fell at a rapid pace, while the price of safe-haven assets such as gold and US treasuries increased as investors searched for alternative assets viewed as less risky. The observed declines in asset prices were significant, but lower than the magnitude seen in the 2008/2009 global financial crisis in some classes. Although the sell-off was overall, industries directly impacted by social distancing such as airlines, transportation, hotels and the energy market experienced extreme pressure. Similarly, high yield bond spreads widened dramatically, particularly for energy and the sectors most affected by the pandemic such as transportation. This prompted several countries to ease their monetary policy rates to support their respective economies. As a result of the monetary easing, investor confidence improved slightly towards the beginning of April 2020, although downside pressures such as global trade tensions and the generally weak global growth prevailed.

Despite geopolitical and trade tensions during the year, global equity markets performed well during 2019 up to the outbreak of the COVID-19 pandemic. Most major global indices improved during 2019, despite risks emanating from trade wars and increased geopolitical tensions as well as social unrest during the year under review. Some major indices reported record gains in 2019. The improved sentiment was on the back of monetary easing measures adopted by AEs during 2019. Reduced Brexit uncertainty after the UK Prime Minister managed to pass a Brexit deal through parliament, coupled with Phase 1 of the US-China trade deal, further improved global sentiment during 2019. The aforementioned factors coupled with recoveries in the Asian markets supported the strong performance in equity markets before the outbreak of COVID-19.

Global equity markets plummeted as the panic around the COVID-19 outbreak dampened investor confidence in the markets. Equity markets recorded the worst fall in history with the S&P 500 crashing 20.0 percent from its peak in only 16 trading sessions. Equity markets sold off dramatically and portfolio flows in emerging markets reversed as the markets reacted to fears emanating from the COVID-19 epidemic. In an environment of fear and uncertainty investors traded equity securities, for safer liquid assets such as cash, treasuries and gold. The lower value in equity markets may pose a threat to institutional investors with substantial exposure to equity and pension plans that are near to maturity.

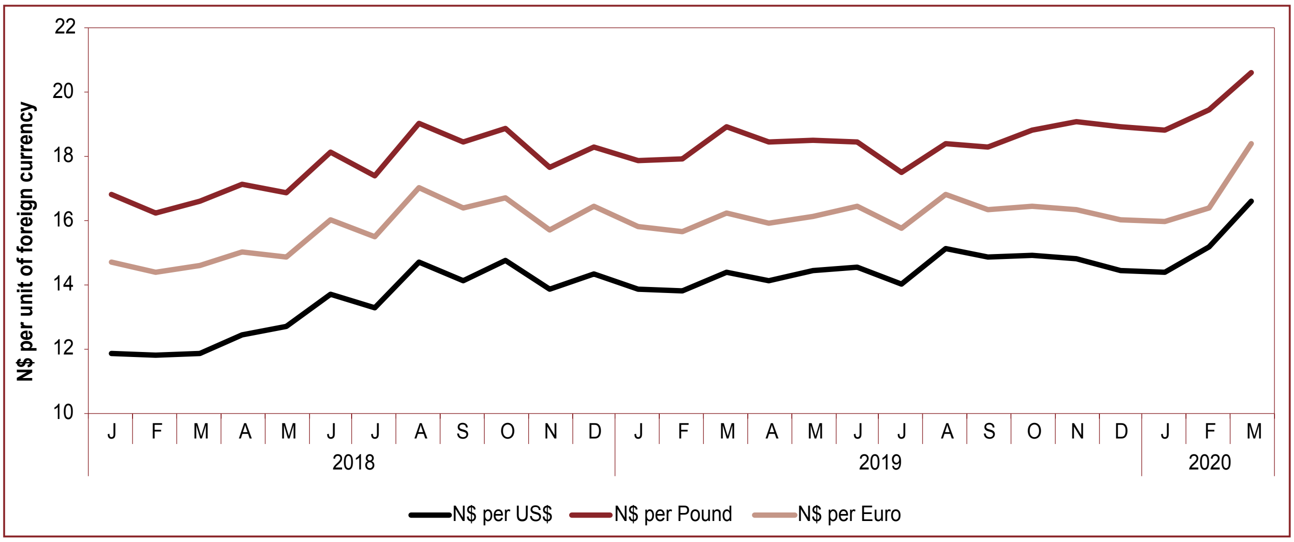
Emerging Market and Developing Economies (EMDEs)

Financial market conditions in the EMDEs generally improved during 2019, supported by accommodative monetary policy stances; however, they tightened significantly in early 2020. Most Central Banks in the EMDEs cut their benchmark interest rates in 2019 in order to stimulate economic activity and offset the effects of unique risks. This added stimulus improved financial market conditions despite slower GDP growth in 2019. Meanwhile, average inflation in the EMDEs declined during 2019 except for China which reported higher levels of inflation during the period. The outlook for EMDEs took a negative turn from the beginning of 2020 with the outbreak of COVID-19. Since then, many EMDEs have cut their benchmark interest rates further in an effort to mitigate the impact of the virus.

Exchange Rate Developments

During 2019, the Namibia Dollar (N$) depreciated against most major trading currencies, notably the US Dollar (US$) and Pound Sterling. On average, the Namibia Dollar depreciated by 9.6 percent against the US Dollar to an annual average of N$14.45 per (US$) in 2019 (Figure 4). The depreciation of the Namibia Dollar against the US Dollar exceeded the relevant inflation differential and was partly owing to increasing trade tension between the US and China which negatively impacted the appetite for emerging market commodities. The Namibia Dollar depreciated against the Pound Sterling and the Euro by 4.7 percent and 3.8 percent, respectively to averages of N$18.44 per Pound Sterling and N$16.17 per Euro (Figure 4). The depreciation of the Namibia Dollar against these currencies was more aligned with inflation differentials, while also being ascribed to subdued growth in global trade and reduced appetite for commodity exports from emerging markets. Moreover, sluggish growth prospects for the South African economy resulted in a weaker appetite for the Rand. On 28 April 2020, the Namibia Dollar exchange rate against the US Dollar stood at N$18.85 per US$. Since the outbreak of COVID-19, the Namibia Dollar has depreciated rapidly on the back of concerns over the impact of the virus as well as the decision by Moody's Investor Service to downgrade South Africa. The outlook for the exchange rates remains uncertain and will largely depend on how the pandemic is managed.

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



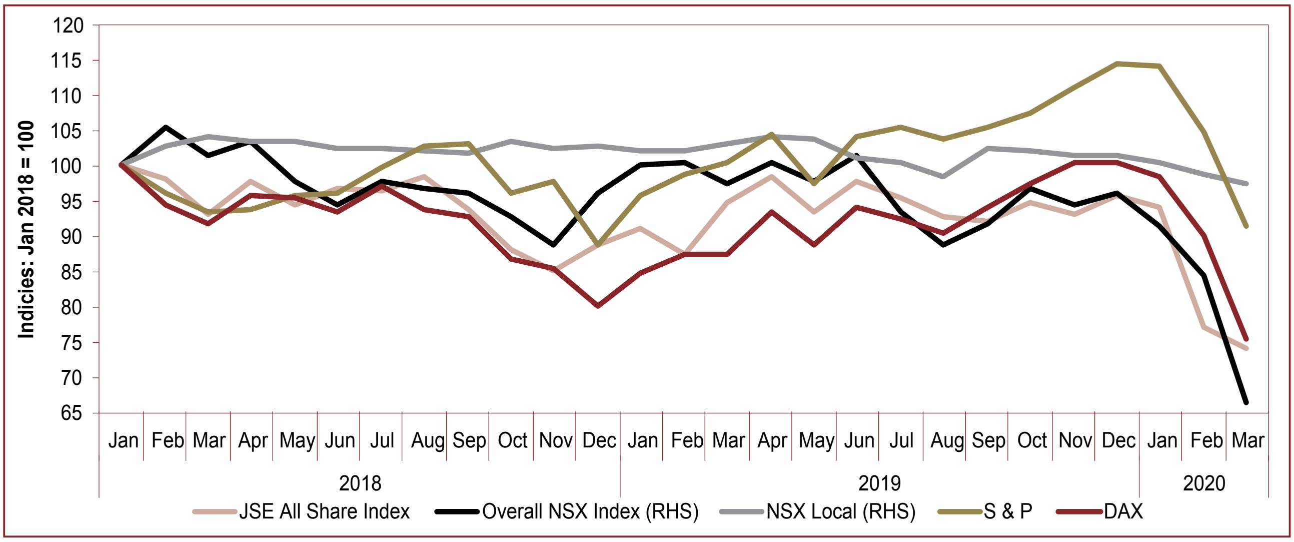
Source: Bloomberg

Equity Markets

Along with most major global indices, the US Standard & Poor 500 and the German Dax (DAX) gained value during 2019 due to easing monetary policy stances of major Central Banks, coupled with reduced geopolitical and trade uncertainty, but fell dramatically at the beginning 2020 due to the COVID-19 outbreak. The German Dax stood at 13 249 index points at the end of 2019, 25.5 percent higher than the end of the previous year. Similarly, the S&P 500 increased by 28.9 percent to 3 231 index points at the end of 2019 (Figure 5). The gains stemmed from lower uncertainty regarding trade and geopolitical tensions amid the US-China Phase 1 trade agreement. The markets were further supported by easing monetary policy stances by most major Central Banks, reducing interest rates and improving investor sentiment. Since the outbreak of COVID-19, both the S&P 500 and the DAX fell dramatically to 2 585 index points and 9 936 index points at the end of April 2020, respectively, amidst major uncertainty in the market. The S & P 500 recorded its fastest fall in history during March 2020; surprisingly, the index gained 12.0 percent in the second week of April before falling again the Monday thereafter. This is a clear illustration of the extent of the uncertainty and resulting volatility in the financial markets at present.

The performance of the Namibia Stock Exchange's (NSX) overall share price index slowed marginally in 2019 when compared to 2018, however a significant decline was experienced in the first quarter of 2020. The NSX Overall share price index closed at 1306.36 points at the end of 2019, when compared to 1307.76 points in 2018, but fell to 900.32 at the end of the first quarter of 2020. Market capitalisation declined by 1.5 percent at the end of 2019, compared to a year earlier. The share prices essentially fluctuated sideways over the course of 2019 as recessionary conditions further dampened investors' appetite for equities on the NSX Local Index, with the lower market capitalisation primarily driven by the de-listing of Bidvest Namibia (Ltd) on the 11 June 2019. The local index closed at 613.87 points at the end of 2019, 1.5 percent lower than at the end of 2018. Over the first three months of 2020, the NSX Overall Index decreased to 900.32 points as the market reacted to the growing uncertainty concerning COVID-19. A similar trend was observed on the Johannesburg Stock Exchange's (JSE) where the All Shares Index (ALSI) closed at 57 084 index points on 27 December 2019, 8.2 percent higher than the end of 2018 (Figure 5). The moderately higher value of the ALSI is an indication that despite significant challenges to economic growth, market sentiment was still relatively positive at the end of 2019. Since early 2020, the ASLI has fallen significantly to 44 110 index points at the end of March 2020 as the market reacted to the COVID-19 pandemic.

Figure 5: Share Price performance



Source: Bloomberg

Monetary Policy Stance in South Africa

The South African Reserve Bank (SARB) Monetary Policy Committee (MPC) cut the repo rate once during 2019. SARB reduced the repo rate from 6.75 percent to 6.50 percent effective 19 July 2019 (Table 1). The accommodative monetary policy stance was meant to stimulate the South African economy as it remained weak during 2019, partly due to social unrest and challenges in the energy sector. A relatively low inflation environment also created some room for an accommodative monetary policy stance. The South African inflation rate stood at 4.0 percent, on average, in 2019 which is 0.5 percentage point lower than in 2018, driven mostly by lower cost for housing and utilities, and transport (Table 1). According to the SARB, the risks to the inflation outlook in South Africa remain relatively balanced although tilted towards the downside as the domestic economic outlook remains fragile. Risks to the South African economy in 2019 stemmed from weak global and domestic GDP growth combined with uncertain business confidence.

Table 1: South Africa's Consumer Price Index and Annual Inflation Rate December 2016=100

2018	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual Average
INDEX	105	105.8	106.2	107	107.2	107.6	108.5	108.4	108.9	109.4	109.6	109.4	107.8
RATE (%)	4.40	4.00	3.80	4.50	4.40	4.60	5.10	4.90	4.90	5.10	5.20	4.50	4.6
2019	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Annual Average**
INDEX	109.2	110.1	111	111.7	112	112.4	112.8	113.1	113.4	113.4	113.5	113.8	112.2
RATE (%)	4.00	4.10	4.50	4.40	4.50	4.50	4.00	4.30	4.10	3.70	3.60	4.00	4.1
2020	**Jan**	**Feb**											
INDEX	114.1	115.2											
RATE (%)	4.50	4.60											

Source: Statistics South Africa

To avert the impact of COVID-19, the SARB intensified monetary easing in early 2020, while it continues to monitor economic developments going forward. The outlook for monetary policy in South Africa has a direct bearing on monetary policy in Namibia. The SARB Monetary Policy Committee (MPC) aims to anchor inflation expectations near the mid-point of the inflation target range, in the interest of balanced and sustainable growth. According to the MPC, inflation expectations for South Africa have moderated further in 2020, on the back of lower service prices, modest food price inflation, and slower-growing nominal wages. The lower than expected inflation coupled with the improved risk profile provided space for the MPC to cut interest rate by 25 basis points to 6.25 percent in January 2020 to stimulate the economy. The COVID-19 pandemic subsequently took centre stage and prompted the SARB MPC to reduce its repo rate by a full 100 basis points on 19 March 2020 to 5.25 percent, to provide some support and relief to the economy amid the exceptional turmoil. Furthermore, on 14 April 2020 the SARB further cut the repo rate by another 100 basis points to provide additional stimulus to the economy as the Government extended the lockdown. The MPC will continue to monitor and support the economy going forward to offset the impact of the virus on the economy.

Domestic Economy

COVID-19 – The Great Lockdown

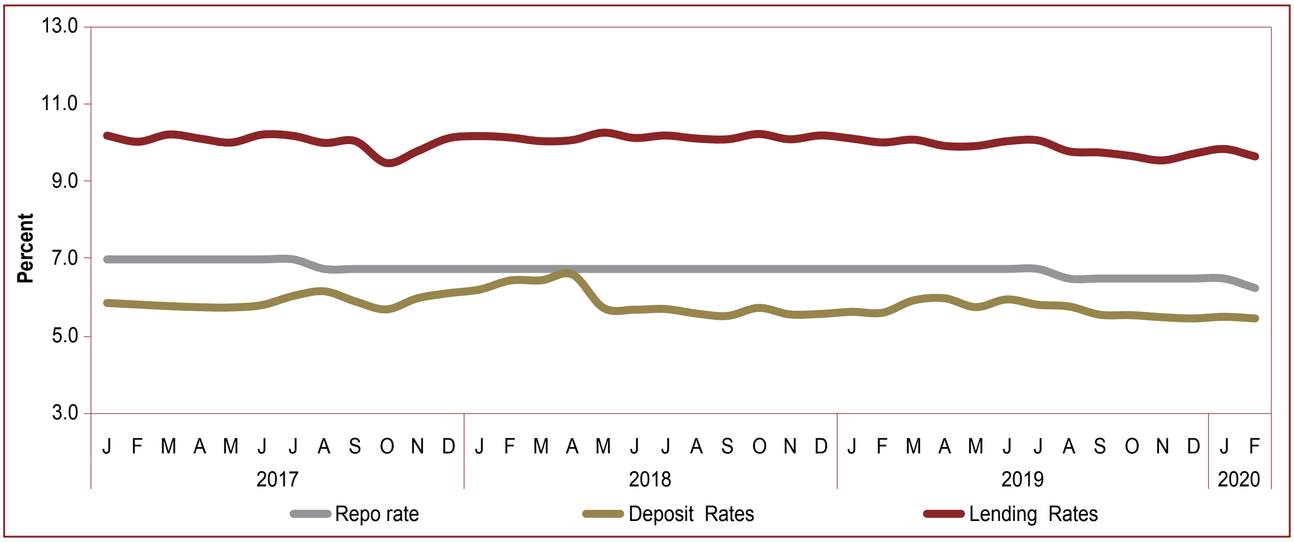
Subsequent to the country reporting three cases of COVID-19, the President of Namibia declared a state of emergency on 17 March 2020 and imposed a travel ban on all international flights in and out of Namibia. The President further ordered a 21-day lockdown on all non-essential businesses and services starting 28 March 2020, for the Khomas and Erongo regions, enforced social distancing and banned gatherings of more than 10 people, amongst other measures to contain the spread of COVID-19. The lockdown that initially covered only two regions was subsequently extended to the 4 May 2020 and broadened to cover the entire country. Although these measures are expected to lessen the direct health impact of COVID-19, the virus and the containment response to it will still have a significiant negative impact on the various sectors of the domestic economy. Social distancing has already put a strain on the incomes of corporates and households alike. Industries such as tourism and entertainment have lost almost all revenue immediately as a result of the social distancing measures. Furthermore, many households have been unable to earn income, making it difficult for them to meet their financial obligations. This immediately posed a threat to financial stability, prompting regulators to declare immediate relief measures to mitigate the effect of COVID-19 on the economy.

Monetary Policy Stance in Namibia

The Bank of Namibia's Monetary Policy Committee (MPC) reduced the repo rate once during 2019 and three times in the first four months of 2020, the latter movements largely in response to COVID-19. The MPC reduced the repo rate at its August 2019 meeting by 25 basis points to 6.5 percent in order to support the domestic economy, while maintaining the peg to the South African Rand. This decision was taken on the back of monetary easing in South Africa, in order to support its economy. The Bank of Namibia kept the repo rate unchanged for the rest of 2019 because it was considered sufficient to support domestic economic activity and maintaining the peg with the South African Rand. On 18 February 2020, the MPC cut the repo rate by another 25 basis points to 6.25 percent as the global, regional and domestic economic developments were reassessed, noting a further move to more accommodative monetary policy in key economies and further moderation of inflationary pressures, while Namibia's foreign reserves remained adequate to support the currency peg. The exceptional circumstances arising from the COVID-19 pandemic subsequently prompted the MPC to reduce the repo rate by 100 basis points on 20 March 2020, in alignment with the actions of numerous other Central Banks across the globe. On 16 April 2020, the MPC decided to reduce the repo rate by a further 100 basis points to provide further stimulus to the domestic economy while at the same time maintaining the one-to-one peg to the Rand.

Interest Rate Environment

Figure 6: Selected Interest Rates



Source: Bank of Namibia

The Namibian interest rate environment remained stable during 2019. Interest rates in Namibia trended sideways during 2019 (Figure 6). Therefore, the repricing risk[6] remained relatively low during the period under review. In an environment of minimal repricing risk, market participants can feel confident that interest rates will not differ markedly in the future from their levels at the time of entering into a contract. In response to the sharp lowering of the repo rate during March and April 2020 and increase in uncertainty, the yield curve has steepened significantly with lower short term interest rates and much higher rates at the long end of the yield curve.

The nominal value of domestic government bonds in issue increased while the yield spread narrowed towards the end of 2019. The nominal value of government bonds stood at N$38.1 billion at the end of 2019, higher than the N$32.7 billion in issue at the end of the previous year in order to accommodate the higher financing requirement of the 2019/20 fiscal year. The government continued to deepen the domestic capital market by issuing two fixed rate bonds (GC43, GC50), maturing in 2043 and 2050, respectively. The government further issued one inflation-linked bond (GI36) maturing in 2036 during 2019. The amount of trades on secondary bonds remained broadly unchanged during 2019 compared to the previous year, as depicted by the turnover ratio which declined to 5.97 percent in 2019 compared to 7.25 percent in 2018. The GC20 bond was the most traded bond of the year as it neared maturity, accounting for 25.0 percent of trades in 2019. Government bond yields picked up toward the end of 2019 after a slight drop during the year. In line with their counterparts in the South African markets, government bond yields softened during the first half of the year before picking up somewhat towards the end of 2019 and hence the spread narrowed

6 Repricing risk refers to the risk of a change in interest rates in an economy at the time contracts are signed.

during the year[7]. This was further supported by the increased demand for Namibian bonds, following the phased-in implementation of domestic requirements. In the first four months of 2020 yields rose considerably as the implications of the pandemic for the government finances – higher expenditure and lower revenue - shaped investors' expectations.

Output and Inflation

Domestic output in Namibia is estimated to have contracted in 2019 compared to the previous year. After a marginal positive growth rate of 0.7 percent in 2018, GDP contracted by 1.1 percent in 2019. The agricultural sector was negatively impacted by severe drought, putting a strain on farmers. Production of diamonds was held back by inter alia maintenance of a sea mining vessel, while uranium output was disappointing due to operational challenges and one of the mines remaining under care and maintenance. Similarly, fiscal consolidation continued to impact the construction and public finance sectors, thereby putting a drag on domestic growth. Furthermore, the distressed economy continued to adversely affect the tertiary industry sectors such as hotels and restaurants, wholesale and retail trade. In contrast, economic activity in the manufacturing sector rose in 2019, led by increased production of cement and beverages as well as the processing of minerals and meat.

Going forward[8], the Namibian economy was initially projected to improve, but the latest forecasts are grim. Real GDP was in early 2020 still anticipated to grow by 1.5 percent and 1.4 percent in 2020 and 2021 respectively, from a contraction of 1.1 percent in 2019. The improved growth was expected to be driven by recoveries in the mining, wholesale and retail trade and construction sectors. The COVID-19 pandemic has resulted in large-scale disruptions to production and the consensus is that the economy will contract further in 2020. According to the Bank of Namibia April 2020 Economic Outlook, real GDP is expected to contract by 6.9 percent in 2020 and rebound to positive growth of 1.8 percent in 2021. The crisis is widespread, severely affecting especially hotel and restaurants, mining and quarrying and beverages production in 2020. Risks to the domestic outlook, are the ongoing travel restrictions and lockdowns in many countries including Namibia, which are restricting business activities and costing disruption to supply. Other risks include the volatile and persistently low international prices of some of Namibia's export commodities.

Namibia's inflation rate declined in 2019, driven by the transport and housing categories. The annual average inflation rate for Namibia stood at 3.7 percent in 2019, 0.6 percentage point lower than in 2018 (Table 2). Weak domestic economic activity caused inflation to fall, particularly in the

7 The term spread refers to the interest rate differential between two bonds. Bond spread reflect the relative risks of the bonds being compared. The higher the spread, the higher the risk usually is.

8 For more information regarding the domestic outlook, please refer to the Bank of Namibia's Economic Outlook update on the website. www.bon.com.na

housing category where rental inflation turned negative and electricity inflation declined to zero. Inflation in the transport category also decelerated, benefitting from lower international fuel prices. Turning to the monthly numbers, inflation trended lower during 2019 as reflected in Table 2. This was especially driven by the transport and the food and non-alcoholic beverages categories, which slowed by 8.8 percent and 3.4 percent respectively, to reach 1.7 percent and 2.0 percent respectively, at the end of 2019. During the first three months of 2020 Namibia's inflation fell to successive rates of 2.1 percent in January, 2.5 percent in February, and 2.4 percent in March respectively. The lower inflation is reflected in the food, housing and transport inflation categories.

Table 2: Namibia's Consumer Price Index and Annual Inflation Rate December 2012=100

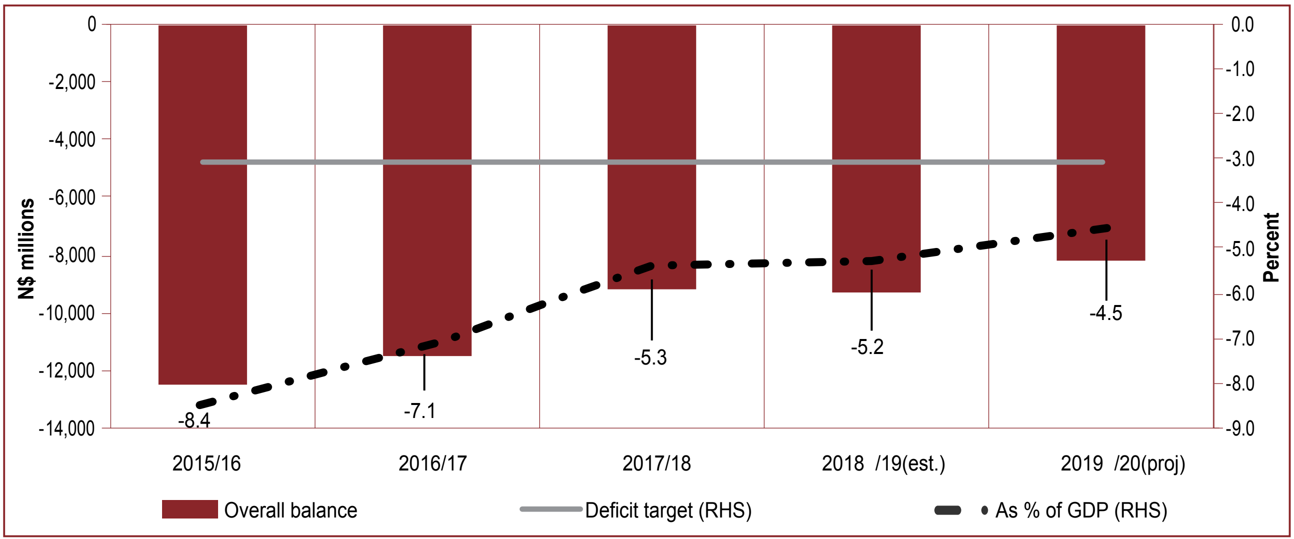
2018	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Annual Average**
INDEX	130.5	130.7	130.9	131.3	131.8	132.1	132.8	132.9	133.9	134.4	135.4	135.0	132.6
RATE (%)	3.60	3.50	3.50	3.60	3.80	4.00	4.50	4.40	4.80	5.10	5.60	5.10	4.3
2019	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Annual Average**
INDEX	136.6	136.5	136.8	137.2	137.2	137.3	137.7	137.8	138.2	138.5	138.7	138.5	137.6
RATE (%)	4.70	4.40	4.50	4.50	4.10	3.90	3.60	3.70	3.30	3.00	2.50	2.60	3.7
2020	**Jan**	**Feb**											
INDEX	139.4	139.8	140.0										
RATE (%)	2.05	2.45	2.35										

Source: Bank of Namibia

Government Finances

The Central Government deficit has been following a narrowing trajectory, but due to increased expenditure to contain the impact of the COVID-19 pandemic and lower revenue, the deficit going forward is set to widen significantly compared to earlier estimates. The Central Government deficit was estimated to narrow to 4.4 percent of GDP during 2019/20, compared to 5.2 percent in the previous fiscal year (Figure 7). The narrowing deficit was expected to be driven by a higher increase in revenue than in expenditure on the back of higher Southern African Customs Union (SACU) receipts during the period. This was anticipated to contribute towards containing the fiscal deficit and support financial stability. The outbreak of the COVID-19 pandemic is likely to contribute towards an increase in the fiscal deficit as a result of the lockdown and the reduction in tax collections amidst increased Government expenditure in the short run. This is expected to increase the deficit more than what is depicted in Figure 7. Current planning is to finance the expected larger fiscal deficits by tapping from a variety of financing sources and to diversify funding sources, in order to prevent a possible overstretch of a single source. Going forward there is a need to reduce the deficit after the crisis has passed, thereby helping to safeguard financial stability.

Figure 7: Public Finance



Source: Bank of Namibia

Sovereign Ratings

Namibia's credit rating was downgraded by both major rating agencies in 2019. Moody's Investor Service and Fitch Ratings downgraded Namibia's credit rating during 2019. National credit ratings are determined annually by two rating agencies after consultations with the Government, the private sector and non-state actors. National credit ratings affect a country's borrowing costs because the worse the credit rating, the higher the cost of borrowing will be.

On 1 October 2019, Fitch Ratings downgraded Namibia's long-term non-rand foreign currency bonds from BB+ with a negative outlook to BB with a stable outlook on the back of continued stress in the domestic economy and fiscal metrics. According to the rating agency, the negative outlook was due to expectations that the economy is projected to remain subdued in the short to medium term, amidst worsening macroeconomic conditions. Furthermore, Fitch Ratings is of the opinion that Namibia has insufficient policy measures to achieve adequate fiscal consolidation. Expenditure risks emanate from high State-Owned Enterprises (SOEs) debt as well as a high government wage bill. Risks to revenue in the short to medium term remain uncertain as SACU transfers continue to be volatile which increased downside risks for Namibia's public finances. Furthermore, the rating agency noted that the sluggish economy, coupled with high inequality and unemployment, could pose a challenge for a government that plans on stabilising debt levels.

Similarly, Moody's Investor Service downgraded Namibia's long-term issuer and senior unsecured ratings from Ba1 with a negative outlook to Ba2 sub-investment grade with a stable outlook during December 2019. Moody's Investor Service reiterated Fitch Rating's opinion that the government has insufficient policy measures in place to execute the fiscal consolidation necessary to revive the economy. The rating agency noted the inability to reduce the high government wage bill in a low growth environment as one of the major domestic risks. Moody's Investor Service further considered the negative impact of climate change on agriculture as well as poor performance in the mining sector. Additionally, the rating agency cited Namibia's national competitiveness which has been declining relative to global rankings. The agency recognised some positive factors in Namibia that could underpin domestic growth, namely the highly liquid financial sector, as well as price stability.

The government has reiterated its commitment to sustainable fiscal consolidation. In response to the sentiments of the rating agencies, the government has recommitted itself to fiscal consolidation, preserving public debt at sustainable levels, and has pledged to employ policy reforms that support domestic activity and bring about the stimulus needed in the domestic economy. Examples of reforms include the implementation of the SME and youth entrepreneurship financing facilities at the Development Bank of Namibia (DBN). Should these actions be followed and executed diligently, the Namibian economy would recover, potentially improving the country's international credit rating, which would augur well for financial stability.

Fiscal response to COVID-19

On 1 April 2020, the Minister of Finance launched an economic stimulus and relief package in order to mitigate the impact of COVID-19 on the economy. The purpose of the package was to ensure that the core economic activities are supported during this time of restictions on business activities. The total stimulus and relief package amounts to N$8.1 billion, comprising of N$5.9 billion in direct support to businesses, households and cash flow acceleration payments for services rendered to Government and N$2.3 billion off balance sheet contingent liabilities[9]. The package is directed at the formal and informal business sectors as well as households which are directly affected by the lockdown measures to mitigate the negative impact on income thereof. These measures were effective immediately and were complemened by the measures announced by the Bank of Namibia on 26 March 2020.

9 A contingent liability is a liability that may occur depending on the outcome of an uncertain future event. A contingent liability is recorded if the contingency is likely and the amount of the liability can be reasonably estimated.

BOX 1: MACROPRUDENTIAL POLICY DEVELOPMENTS

1. Macroprudential Oversight –expanding the Bank of Namibia (BoN) 's mandate.

The Bank of Namibia Act, 1997, as amended was repealed and replaced by the Bank of Namibia Act (Act 1 of 2020). *NAMFISA remains the regulator of non-banking financial institutions as per the NAMFISA Act (Act No 3 of 2001). The new Act expands BoN's mandate to explicitly include macroprudential regulation, which aims to manage systemic risk in the financial system.*

The Bank of Namibia Act (Act 1 of 2020) gives BoN the responsibility to maintain and enhance a stable financial system, macroprudential oversight as well as the co-ordination of activities involved in safeguarding financial stability, and establishes the Financial System Stability Committee (FSSC). *In particular, the BoN has the power through the FSSC to carry out periodic assessment for the identification of vulnerabilities, monitoring and mitigation of risks to financial stability. BoN is also charged with the responsibilities of issuing directives regarding macro-prudential matters after consultation with NAMFISA and the coordination of activities involved in safeguarding financial stability and to ensure compliance with directives. According to the Act, the FSSC is tasked with managing events of system-wide financial crisis jointly with the Minister of Finance and NAMFISA with the aim of stabilising and restoring confidence in the financial system; and to regularly brief the Minister of Finance, Cabinet or the relevant standing committee of the National Assembly regarding the status of financial system stability in Namibia, particularly in the event of crisis resolution, and recommend the action to be taken.*

The primary role of the FSSC is to assist the Bank in monitoring the financial system with regard to risks, weaknesses and disruptions or developments that may harm financial stability in Namibia. *The FSSC is mandated with advising BoN on any necessary action to be taken in order to mitigate or remedy the risks, weaknesses or disruptions that may harm or threaten financial stability in Namibia and making recommendations to the Bank of Namibia on which financial institutions are to be considered as systemically important financial institutions for purposes of financial stability. It is the duty of the FSSC to draft the annual financial stability report and assist the Bank of Namibia in assessing the stability of the financial system. The FSSC also promotes the coordination of information exchange and sharing among members of the committee and the BoN. The Act further gives powers to the Bank of Namibia to request information or documents needed for financial stability purposes from any office, ministry or agency of the Government, a regulatory authority, a supervisory authority of either banking institutions, financial institutions, system participants or providers of clearing or settlement, or any person or institution identified by the Minister of Finance by notice in the Government Gazette.*

2. Changes to the Loan-To-Value (LTV) Ratio Restrictions

The purpose of this regulation is to set out the procedures for determining the LTV restrictions when banking institutions extend mortgage loans to customers for the purchase of residential properties in Namibia. *The LTV regulation was implemented in 2017 in order to mitigate the impact of an overheating housing market on the financial system. After thorough assessments conducted in 2019, it was determined that economic developments warranted a review of the policy. The review was in line with the international best practice where macroprudential policies, by nature, are subject to continuous review and are not intended to remain static.*

The LTV ratio restrictions were revised in line with economic developments. *The economic developments that warranted the policy revision included a significant slowdown in the economy as well as a sharp correction in the housing market. For instance, according to the First National Bank (FNB) House Price Index (HPI), house prices recorded an average annualised growth rate of 10.4 percent from January 1991 to February 2017. However, as from March 2017 to February 2018, the HPI slowed to an average growth rate of 5.3 percent. Further, the HPI inflation slowed and eventually turned negative as house prices contracted at an average rate of 2.4 percent during the period March 2018 to September 2019. Thereafter, residential property prices contracted further reaching a historic low of 5.1 percent in the third quarter of 2019. Given the above developments, coupled with the sluggish economic performance, the FSSC at its meeting on 15 November 2018, recommended to the Ministry of Finance (MoF) a relaxation of the LTV ratios as tabled below:*

Table 1: Loan-To-Value Restrictions

	Old LTV Restrictions	New LTV Restrictions
First Residential Property	Not applicable	Not applicable
Non-primary residences		
Second Residential Property	80%	90%
Third Residential Property	70%	80%
Fourth Residential Property	60%	80%
Fifth+ Residential Property	50%	80%

Source: Regulations Relating to Restrictions on Loan-to-Value Ratios: Banking Institutions Act 1998 (Act No. 2 of 1998)

The revised regulation relating to restrictions on the LTV ratios came into effect on 7 November 2019. *Similar to the old regulations, there are no restrictions on first residential properties. However, the deposit payable for a second residential property has been revised down from 20 percent to 10 percent. Similarly, the deposit payable for third and subsequent residential properties was relaxed from 30 percent, 40 percent and 50 percent, respectively, to 20 percent.*

IV. DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

Household Debt to Disposable Income

Since the last FSR, household indebtedness increased moderately driven by the demand for short term credit facilities. The annual growth in household indebtedness rose somewhat to 7.3 percent during 2019 from 7.0 percent in 2018. The key driver of the rise in household indebtedness was the category *other loans and advances* which rose by no less than 32.0 percent year-on-year at the end of 2019, roughly double its pace of increase in 2018. Likewise, o*verdrafts* grew at a pace that accelerated from 4.2 percent in 2018 to 8.2 percent in 2019 and contributed to a slightly higher growth rate in household indebtedness. The categories which underpinned the growth in household indebtedness during 2019 reflected increased demand for short term credit facilities by households to cope with depressed disposable income amidst recessionary economic conditions. Conversely, the growth rate for *mortgage loans* slowed to 5.9 percent in 2019, from 7.7 percent in the previous year, consistent with the weakened property market and subdued home building activity. The rate of contraction in instalment credit worsened to 6.0 percent during the period under review from 5.0 percent in 2018. Risks to financial stability arising from mortgage loans were virtually unchanged during 2019.

Table 3: Household Debt-to-Disposable-Income

	2015	2016	2017	2018	2019
Disposable Income (N$)	58,765	66,814	71,378	76,415	77,977
Credit to Disposable Income (%)	78.0	74.9	74.8	72.3	78.7
Credit to Individuals/Households (N$)	45,810	50,054	53,420	57,170	61,352
Adjusted Credit*to Disposable/Households (N$)	51,078	55,811	59,563	63,745	68,407
Adjusted Credit**% of Disposable Income	96.8	93.1	93.0	92.9	97.7

*The ratio of household debt to disposable income is calculated based on income and tax data from the national budget documents, national accounts, and household debt data from the Bank of Namibia. The National Accounts were revised from 2013 to 2018, resulting in changes in the household disposable income data, which were published in the April 2019, FSR.
** This category includes credit extended to households by both the banking and non-banking financial institutions.

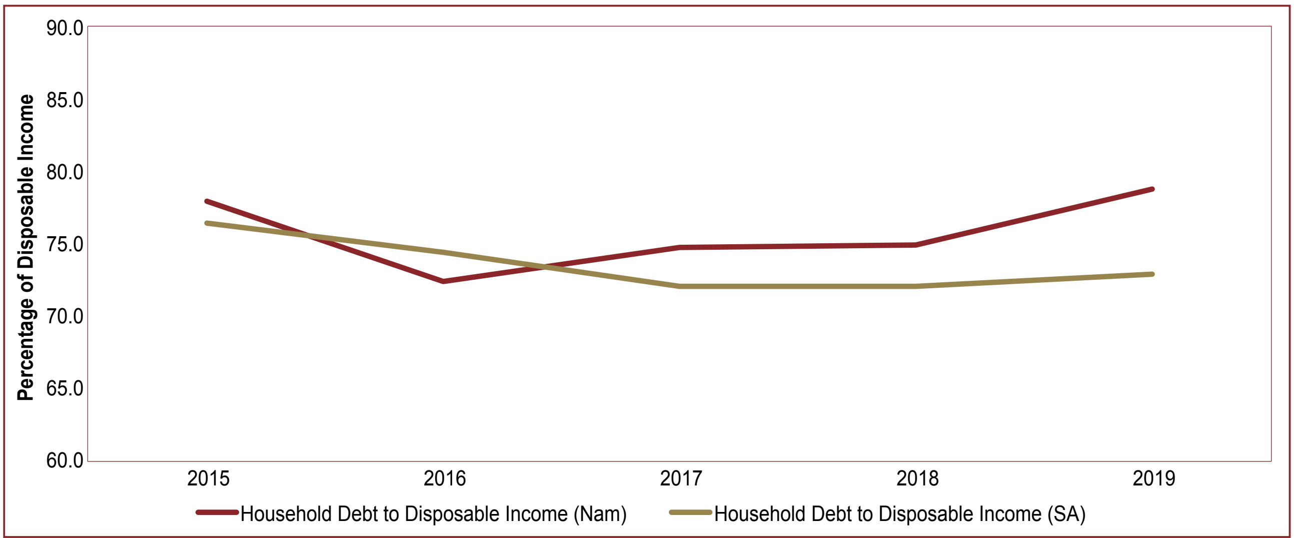
Source: Bank of Namibia

The ratio of household indebtedness to disposable income increased due to subdued growth in disposable income. Household debt to disposable income increased to 97.7 percent in 2019 from 92.9 percent in 2018 as credit extended to individuals continued to rise, while disposable income moderated at a lower rate during the period under review (Table 3). The increase in the ratio of household indebtedness to disposable income was largely driven by the slowdown in disposable income as growth in the compensation of employees moderated to 1.9 percent in 2019 from 5.9

percent in the preceding year. Meanwhile, the rise in household indebtedness, though moderate, still contributed to the increase in the ratio, which indicate that households experienced financial constraints under recessionary economic conditions. A higher ratio of household indebtedness to disposable income does not bode well for the stability of the financial system.

During 2019, the unadjusted ratio of household debt to disposable income of Namibia was higher than that of South Africa. The unadjusted ratio of household debt to disposable income stood at 78.7 percent in Namibia compared to 72.8 percent in South Africa, during the period under review (Figure 8).

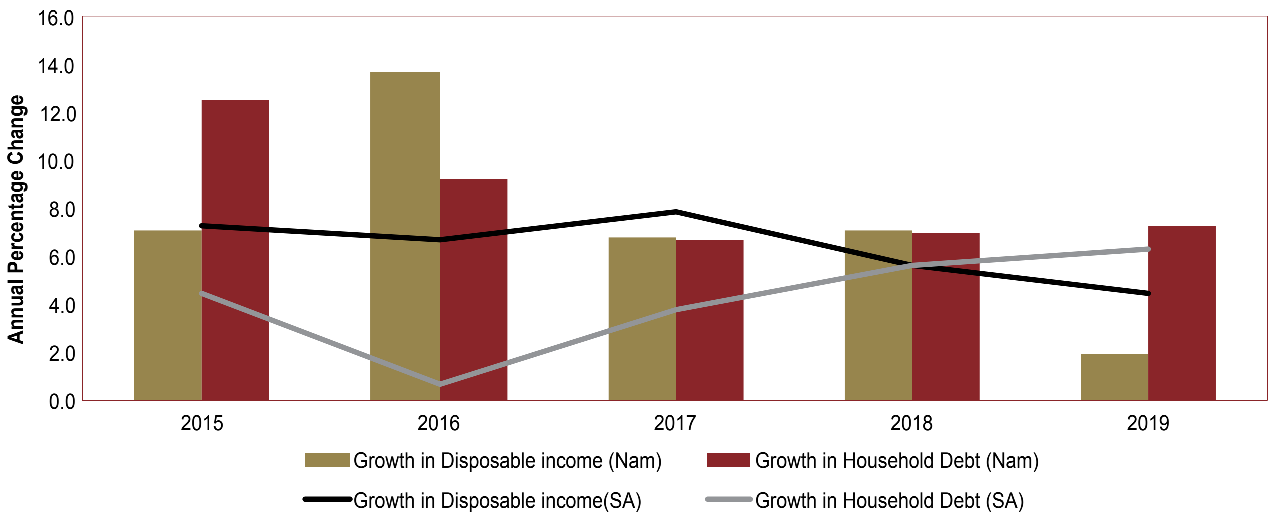
Figure 8: Household debt to Disposable income (Namibia & South Africa)



Source: Bank of Namibia and South African Reserve Bank

Growth in household disposable income moderated during 2019 as the compensation of employees slowed down. Since the last Financial Stability Report, annual growth in household disposable income eased to 2.0 percent in 2019 from 7.0 percent in 2018. The key factor that caused the moderation in household disposable income was the category *compensation of employees* which slowed as wage growth was weak in line with recessionary conditions. Similarly, the growth in disposable income of households in South Africa eased to 4.5 percent in 2019 from 5.6 percent in 2018 on the back of subdued wage growth (Figure 9).

Figure 9: Growth in household debt and disposable income



Source: Bank of Namibia and South African Reserve Bank

Debt Servicing Ratio

During 2019 the debt service to disposable income ratio increased. The debt servicing to disposable income ratio rose to 20.1 percent at the end of 2019 from 18.8 percent in 2018 (Table 4). Growth in total debt service cost rose to 8.8 percent in 2019 from 8.4 percent in the previous year and amounted to N$23.0 billion. The key category that contributed to the increase in debt servicing cost was other loans and advances, which grew to 24.5 percent in 2019 from 23.0 percent in 2018. This could be ascribed to households and businesses who serviced their unsecured loans during the period under review.

Table 4: Debt servicing Ratios (percentage)

	Gross Income Growth (Y-o-Y)	Disposable Income Growth (Y-o-Y)	Annual Debt Servicing Growth (Y-o-Y)	Debt Servicing to Gross Income	Debt Servicing to Disposable Income	Adjusted Debt Servicing to Gross Income	Average Prime Rate
Dec-15	8.8	7.1	14.4	11.9	19.9	16.4	10.25
Dec-16	6.1	13.7	11.2	12.4	19.5	16.7	10.75
Dec-17	8.2	6.8	2.0	11.7	18.6	15.8	10.50
Dec-18	3.7	7.1	8.5	12.3	18.8	16.1	10.50
Dec-19	0.6	2.0	8.8	13.3	20.1	17.1	10.25

Source: Bank of Namibia

Corporate Debt

Since the last FSR, the total corporate debt stock increased slightly on the back of domestic debt. Total corporate sector stock recorded a marginal increase of 0.8 percentage point to N$127.2 billion, compared to N$126.1 billion in 2018 owing to a rise in domestic debt. Domestic debt increased by N$1.5 billion, while foreign debt declined by N$404.0 million during 2019 (Table 5). The increase in domestic debt was on the back of credit extended to businesses, especially during the festive season. The moderate fall in foreign debt was ascribed to principal repayments mainly by mining entities, coupled with the appreciation of the Namibia Dollar against the US Dollar[10].

The corporate debt sector debt-to-GDP ratio increased marginally in 2019. The corporate sector debt-to-GDP ratio stood at 71.2 percent at the end of 2019, compared to 70.8 percent at the end of 2018 (Table 5). The higher ratio was supported by a relatively higher domestic corporate debt stock, coupled with a moderation in nominal GDP. Similarly, the stock of foreign corporate debt increased to 42.3 percent in 2019 from 42.7 percent in the previous year mainly ascribed to the subdued nominal GDP. Despite increasing, risks emanating from corporate sector indebtedness on financial system stability remain moderate. Moreover, the rigorous credit lending standards applied by banking institutions prior to extending loans to borrowers are expected to mitigate the probability of default emanating from the corporate sector to, materialise.

The total debt stock of State Owned Enterprises SOEs contracted moderately during 2019. Total debt of SOEs moderated to N$11.1 billion at the end of 2019, N$0.3 billion lower than reported in the last FSR (Table 5). The decline in total debt of SOEs was predominantly driven by principal repayments by SOEs in the energy and transport sectors during 2019.

The value of corporate bonds outstanding decreased during 2019. In this regard, the stock of bonds issued by Namibian corporates listed on both the Namibian Stock Exchange (NSX) and the Johannesburg Stock Exchange (JSE) declined to N$8.3 billion, from N$9.2 billion registered in 2018. Of the N$8.3 billion, a total of N$5.6 billion was listed on the NSX, while N$2.7 billion was listed on the JSE. The value of corporate bonds declined due to several bonds maturing during 2019. In addition, there were fewer bond issuances during 2019 in comparison to the preceding year. Meanwhile, N$6.5 billion of the total outstanding corporate bonds in 2019 were issued by commercial banks, and N$1.5 billion by SOEs, while non-bank entities were responsible for the remaining N$0.3 billion.

[10] The exchange rate of the Namibia Dollar to the US Dollar used in this section is the end-of-period rate which appreciated by 2.1 percent year-on-year at the end of 2019. A depreciation of 9.1 percent was registered in the N$-US$ exchange rate in 2019 based on the annual average exchange rate.

Table 5: Domestic and External Corporate Debt (Private Sector and Parastatals)

N$ million	2015	2016	2017	2018	2019
Domestic debt (N$ million)	**34,482**	**37,198**	**38,577**	**39,999**	**41,458**
Local Private Sector Debt	32,584	35,343	36,300	38,656	40,389
Local Debt of SOEs	1,899	1,855	2,277	1,343	1,069
Foreign debt (N$ million)	**55,166**	**59,884**	**76,390**	**86,119**	**85,715**
Foreign Private Sector Debt	50,517	55,133	67,200	76,044	75,668
Foreign Debt of SOEs	4,650	4,751	9,190	10,075	10,047
Total Debt (N$ million)	89,649	97,083	114,967	126,118	127,174
Nominal GDP (N$ million)	145,207	156,879	169,529	178,052	178,677*
Foreign Private Sector Debt	50,517	55,133	67,200	76,044	75,668
Local Private Sector Debt	21,170	21,233	12,085	14,563	14,563
Y-o-Y Change in % in Total Debt	14.7	8.3	18.4	9.7	0.8
Y-o-Y Change in % in GDP	8.4	8.0	8.1	5.0	0.4*
Corporate Debt to GDP (%)	61.7	61.9	67.8	70.8	71.2*
Foreign Private Sector Debt to GDP (%)	34.8	35.1	39.6	42.7	42.3*
Foreign Debt to Total Debt (%)	61.5	61.7	66.4	68.3	67.4

*The National Accounts were revised from 2013 to 2019 resulting in changes in the above marked data items.
Source: Bank of Namibia and NSA

Total foreign private sector debt servicing increased markedly during the period under review. Foreign debt service cost increased by 15.3 percent to N$19.9 billion in 2019 from N$17.2 billion in 2018. This was mainly attributed to increased principal repayments made on intercompany borrowings in the mining sector of about N$2.6 billion (Table 6).

Table 6: Foreign Private Sector Debt and Debt Servicing

N$ million	2015	2016	2017	2018	2019
Total Foreign Private Sector Debt	50,517	55,133	67,200	76,044	75,668
Total Foreign Private Sector Debt Servicing	21,170	21,979	13,071	17,243	19,880

Source: Bank of Namibia

Going forward, policy responses to mitigate the impact of COVID-19 may give households and corporates more time to repay their debt obligations and manage their cashflows in the short to medium term and minimise the threat to financial stability. The cumulative reduction of 200 basis points in the repo rate by the Monetary Policy Committee of the Bank of Namibia to 4.25 percent in the March and April 2020 meetings and subsequent lending rate cuts by the commercial banks could offer households and corporates breathing space to repay their loans, while somewhat minimizing systemic risks to the financial system. Furthermore, the loan payment holidays including principal and interest ranging between 6 and 24 months may cushion the impact of the pandemic on both households and businesses. Fiscal policy responses such as the wage subsidy for the impacted sectors, accelerated repayment of overdue and undisputed Valued Added Tax (VAT) refunds, tax-back loan scheme for tax registered and tax paying pay-as-you-earn (PAYE) employees and self-employed individuals could encourage jobs retention and enhance the cashflow of enterprises paying VAT as well as households. However, if the risks from COVID-19 pandemic to the financial system materialises, the impact on financial stability might be severe.

V. PERFORMANCE OF THE BANKING SECTOR

Since the last FSR, the performance of the banking sector in Namibia has remained sound, despite subdued economic conditions. Banking institutions maintained liquidity and capital levels well above the prudential requirements. The banking sector assets continued to grow; however, the growth rate slowed during the period under review. Growth in assets and profitability, amidst subdued economic activity, is indicative of the robustness of the operations of the banking sector. Asset quality as measured by the non-performing loans (NPLs) ratio continued to deteriorate, surpassing the 4.0 percent trigger point for supervisory action by Bank of Namibia. The deterioration in asset quality was predominantly evident in the mortgage lending category, which will be closely monitored, while targeted interventions will be adopted should the situation warrant. The impact of the risks to the banking sector did not appear significant, therefore posing no real threat to financial stability in Namibia in 2019. However, the pandemic-related risks which have subsequently stepped to the fore are of a more serious and immediate concern, requiring the full focus and determination of banks and regulators in order to manage the situation. The Bank of Namibia has therefore implemented various relief measures in order to curb the potential impact of risks to the banking sector following the COVID-19 outbreak.

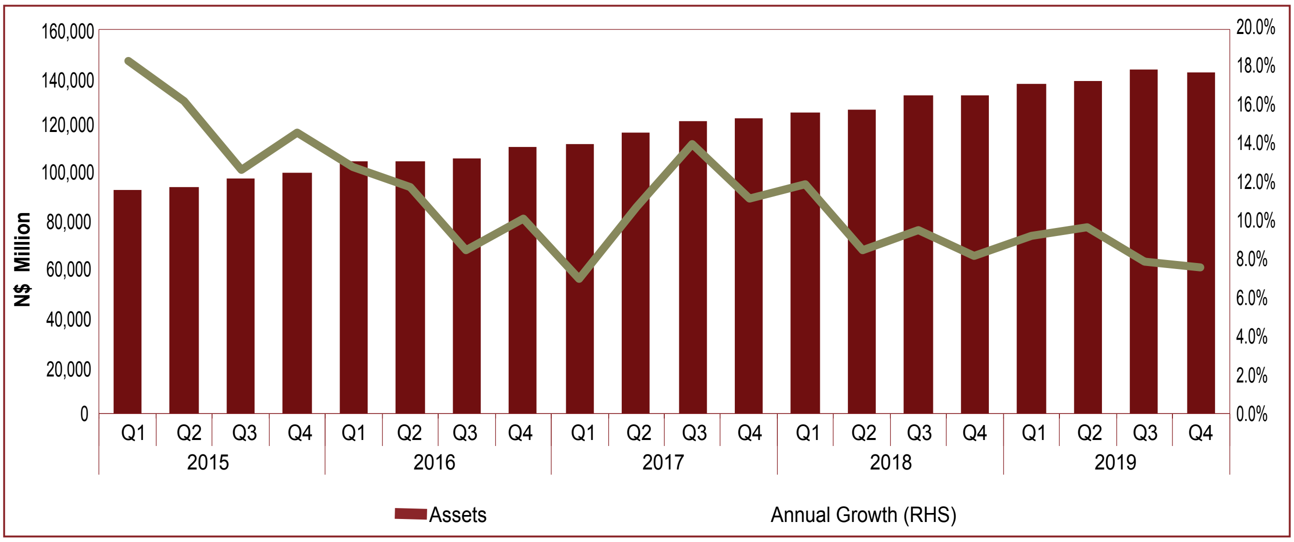
Balance Sheet Structure of the Banking Sector

The banking sector balance sheet growth remained positive during the period under review. The balance sheet of the banking sector stood at N$142.2 billion as at 31 December 2019, compared to N$132.2 billion as at 31 December 2018, representing year-on-year growth of 7.6 percent. Growth in the balance sheet was mainly driven by surges in the non-bank funding (deposits) on the liability side and by net loans and advances on the asset side.

Assets

The growth in total assets in the banking sector, though positive, slowed year-on-year. The total assets of the banking sector continued to grow despite lackluster economic activity. Total assets grew from N$132.2 billion in 2018 to N$142.2 billion in 2019 (Figure 10). This represented a year-on-year growth rate of 7.6 percent, which was lower, compared to the 8.1 percent recorded in 2018. However, the growth rate was well above the average consumer inflation rate during the period under review, which stood at 3.7 percent. Growth in assets was observed in the following categories, namely, net loans and advances, cash and balances with banks as well as total trading and investment securities. Net loans and advances grew from N$94.8 billion in 2018 to N$101.2 billion in 2019. Net loans and advances continued to dominate banking sector assets constituting 71.7 percent and 71.2 percent in 2018 and 2019, respectively. Despite remaining the largest loan product on the bank's balance sheet, the share of mortgage lending in total loans and advances slowed from 52.0 percent in 2018 to 51.3 percent in 2019. Cash and balances with banks increased by 11.4 percent from N$12.3 billion in 2018 to N$13.7 billion in 2019 which could probably be largely attributed to the repatriation of funds by institutional investors to Namibia, as prescribed by the respective regulations. In addition, total trading and investment securities expanded by 24.5 percent from N$5.2 billion in 2018 to N$6.5 billion in 2019. The pace at which the banking sector assets grew during the period under review, signifies a stable banking sector, amidst challenging economic conditions.

Figure 10: Banking Sector Asset Growth

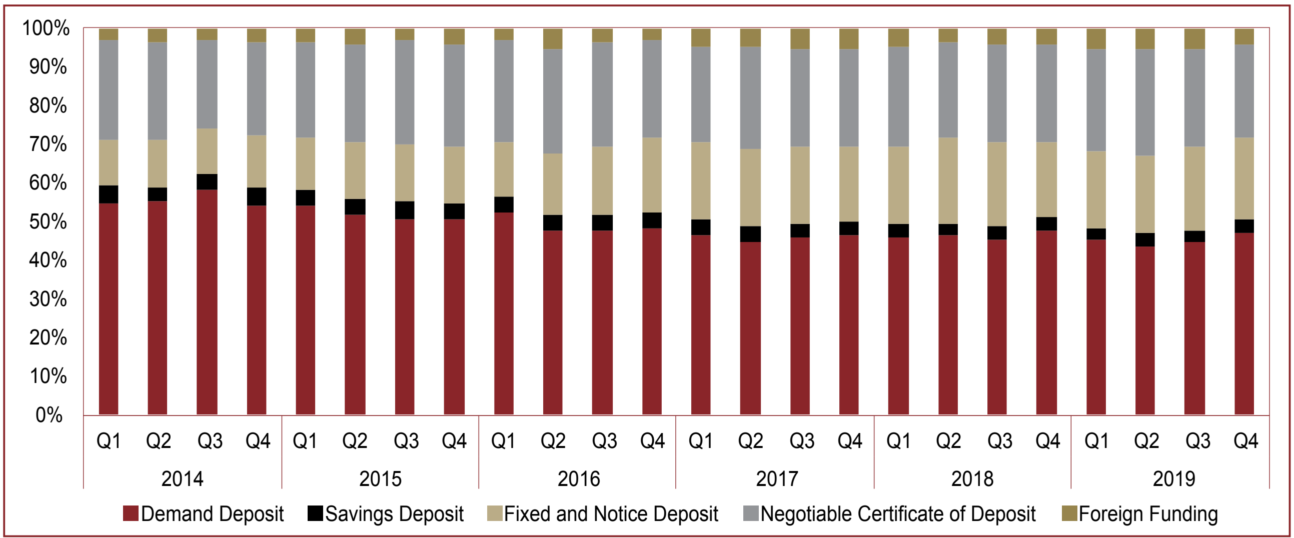


Source: Bank of Namibia

Capital and Liabilities

Non-bank funding continued to be the main driver of growth on the capital and liabilities side of the balance sheet. The non-bank funding, capital and reserves constitute the total funding of which non-bank funding remained the dominant component, accounting for 75.6 percent of total funding. The year-on-year growth rate for non-bank funding and for capital and reserves stood at 9.4 percent and 7.7 percent, respectively. However, bank funding slowed by 3.2 percent during the period under review. The growth in capital and reserves was concentrated in general reserves. Demand deposits made up the highest proportion of non-bank funds, which largely comprised of wholesale deposits. Wholesale deposits can be withdrawn at short notice, therefore rendering them volatile in nature. Wholesale deposits which are used to fund longer-term assets may cause funding mismatches in maturities between assets and liabilities. The overall funding portfolio of banks moved marginally from demand deposits to fixed and notice deposits during 2019 when compared to 2018. Demand deposits slowed from 47.6 percent of total non-bank deposits in 2018 to 47.1 percent in 2019, while fixed and notice deposits grew from 19.3 percent in 2018 to 21.4 percent in 2019 (Figure 11).

Figure 11: Composition of Non-Bank Deposits



Source: Bank of Namibia

Banks are expected to diversify their funding sources with the introduction of the Basel III standards, that aim to mitigate banks' dependency on wholesale depositors' funding. Banks are not only expected to diversify their funding types but also diversify their funding maturity horizon. This will allow banks to resolve the maturity mismatch challenge by matching longer term assets with the appropriate funding sources and in turn address the concerns regarding over-dependency on wholesale depositors' funding. Regulatory limits for maturity mismatches have been implemented by the Bank of Namibia, for cash flows for the 0-7 days and 8-31 days' time buckets. This has been effective since September 2019 and are calculated on a behavioural adjusted[11] basis. However, subsequent to the COVID-19 outbreak the Bank of Namibia decided to relax the Determination on Liquidity Risk Management. The Determination requires banking institutions to ensure that their cash inflows match their cash outflows expected within the 0-7 days' time bucket. The limit has therefore been relaxed such that the expected outflows may exceed the inflows, however not by more than the excess liquidity above the regulatory liquid assets limit.

Capital Adequacy

During 2019, the banking sector remained adequately capitalised and maintained a capital position well above the prudential requirement. All the capital ratios recorded ratios above the minimum regulatory requirements, specifically, 6.0 percent for Common Equity Tier 1 (CET 1), 8.5 percent for Tier 1 capital and 11.0 percent for total risk-weighted capital. The capital conservation

[11] Behavioural adjustments entail taking into consideration the contractual maturity of assets and liabilities when determining cash in- and outflows as well as liquidity mismatches in each successive maturity band, in order to align it with the behaviour of the assets

buffer requirement made-up 1.0 percent of the total risk-weighted capital ratio requirement[12]. Total qualifying capital declined from N$16.8 billion in 2018 to N$15.7 billion in 2019, owing to an increase in dividend pay-outs as well as the switch to Tier 2 instruments. Dividends paid out by the Domestic Systemically Important Banks (DSIBs) totaled N$0.8 billion in 2018, with a significant upsurge in 2019 to N$1.6 billion. The increase in dividend pay-outs, coupled with the elimination of unaudited profits and revaluation reserves from total eligible capital as per the Basel III capital adequacy standards, all contributed to the slowdown in total qualifying capital. In addition, Tier 2 capital declined from N$2.9 billion in 2018 to N$2.4 billion during the period under review. As a policy relief measure, the Bank of Namibia relaxed the capital conservation buffer and reduced it to zero percent for at least 24 months in order to support banking institutions to supply credit to the economy. The release of the capital conservation buffer will therefore allow banking institutions to use the capital they have built up during good times for use during times of distress. This is anticipated to boost the already distressed economy by lending to the most vulnerable sectors.

Both the total risk weighted capital ratio (RWCR) as well as the Tier 1 risk weighted capital ratio declined in 2019 when compared to 2018. The total RWCR declined from 16.7 percent in 2018 to 15.3 percent in 2019; however, it remained well above the statutory minimum of 11.0 percent (Figure 12). The Tier 1 RWCR declined by 0.8 percentage point to 13.0 percent during the period under review, while still remaining above the prudential requirement of 7.0 percent. Although capital levels declined, risk weighted assets increased, resulting in lower RWCRs for the banking sector. A favourable capital position buffers the banks from losses as well as risks associated with the banking business. The Basel III capital adequacy standards which are applicable to DSIBs, will be phased in over a period of 5 years with 2019 being the second year of implementation.

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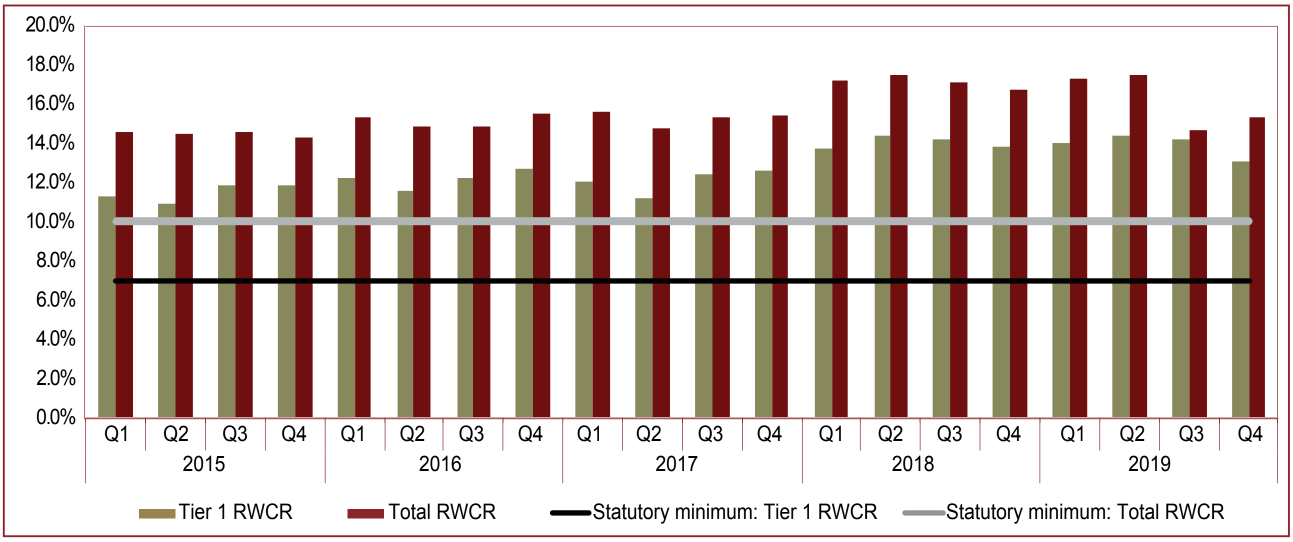
[12] The prudential requirement for the total risk weighted capital ratio increased from 10.0 percent to 11.0 percent, this was to accommodate the 1.0 percent that made up the capital conservation buffer requirement. Given that the buffer has been released and will be maintained at zero for at least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

Figure 12: Capital Adequacy



Source: Bank of Namibia

Banking Sector Risk Analysis

Financial stability essentially analyses the resilience of the domestic financial system to internal and external shocks, be they economic, financial, political or otherwise. The main objective is to identify potential risks in the banking sector, while also determining how best to mitigate any foreseeable risks. It is therefore imperative to analyse credit risk, liquidity risk and concentration risk in the banking sector. The analysis of these risks further informs the magnitude of the stress test performed on the banking sector, which forms part of the overall analysis of the resilience of the banking sector.

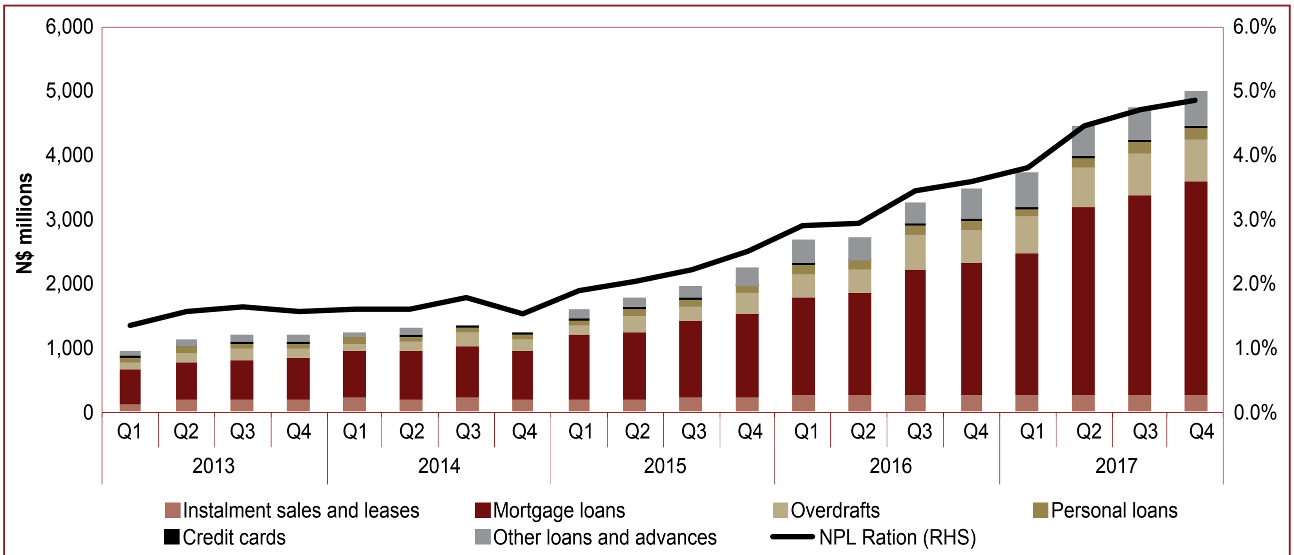
Credit Risk

Asset Quality

Asset quality, as measured by the non-performing loan (NPL) ratio, continued to deteriorate during the period under review and therefore, poses a credit risk to the banking sector. The NPL ratio deteriorated from 3.6 percent in 2018 to 4.8 percent in 2019 (Figure 13). The NPL ratio has been increasing exponentially since 2017, exceeding the 4.0 percent trigger point for supervisory action from the Bank of Namibia; however, it is still below the historical highest of 11.2 percent recorded during 1998. NPL ratios for most loan categories' deteriorated further in 2019, apart from the NPL ratio of instalment sales and leases that slowed marginally by 0.003 percent. In this regard, the non-performing loans in the mortgage loans and overdrafts categories increased by 62.5 percent and 22.9 percent respectively, during the period under review. Similarly, the non-performing loans in the following categories all increased: personal loans increased by 29.4 percent, credit card advances increased by 39.5 percent while other loans and advances increased by 17.3 percent in 2019, compared to 2018. The growth in the NPL ratio of this magnitude is reflective of recessionary economic conditions. Mortgage loans contributed significantly to the growth in the NPL ratio during the period under review; however, this is expected given that mortgage loans make up 51.3 percent of the total loan book of banks. Current economic conditions played a rather large role in the ability of clients to service their debt, more so with lay-offs and retrenchments experienced. As a regulator, BoN has been engaging individual banks accordingly with each bank's NPL developments considered independently, while also taking into consideration their respective business models as well as their capital and reserves. Despite the NPL ratio increasing, it should be noted that it is a lagged indicator, with some of the loans feeding into it having the ability to still be rehabilitated and migrate from non-performing to performing status.

The impact of the COVID-19 outbreak may pose downside risks for the banking sector asset quality. The Bank of Namibia aims to promote and maintain a sound monetary, credit and financial system and is therefore cognisant of the potential impact that the COVID-19 pandemic may have on the domestic financial system. One such way the impact may materialise is through potential defaults on loan repayments and debt servicing, which could lead to a significant deterioration in the asset quality of the banking sector with potential spillover effects on the financial system as a whole. As a result, the Bank of Namibia implemented a loan payment moratorium in order to directly support individuals, small and medium-sized enterprises (SMEs) and corporations to mitigate the impact of the COVID-19 as well as the impact of the recent drought. Banking institutions can therefore grant payment holidays, which include principal and interest, to their clients for a period of six to 24 months. In addition, a thorough assessment should be conducted of economic and financial difficulties experienced by the client; the process of which should be transparent, fair and equitable. The banks should therefore act in the national interest and be guided by their internal policies and processes. Although the Bank of Namibia has allowed banks to give the loan payment moratorium to their customers, the implementation of such relief measure on a product basis is at the discretion of the banks, who assess clients on a case-by-case basis in order to determine the necessary relief applicable. This policy intervention through financial relief is expected to mitigate or curb potential credit risk to the banking sector as a result of the COVID-19 outbreak; however, future economic developments remain largely unknown.

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

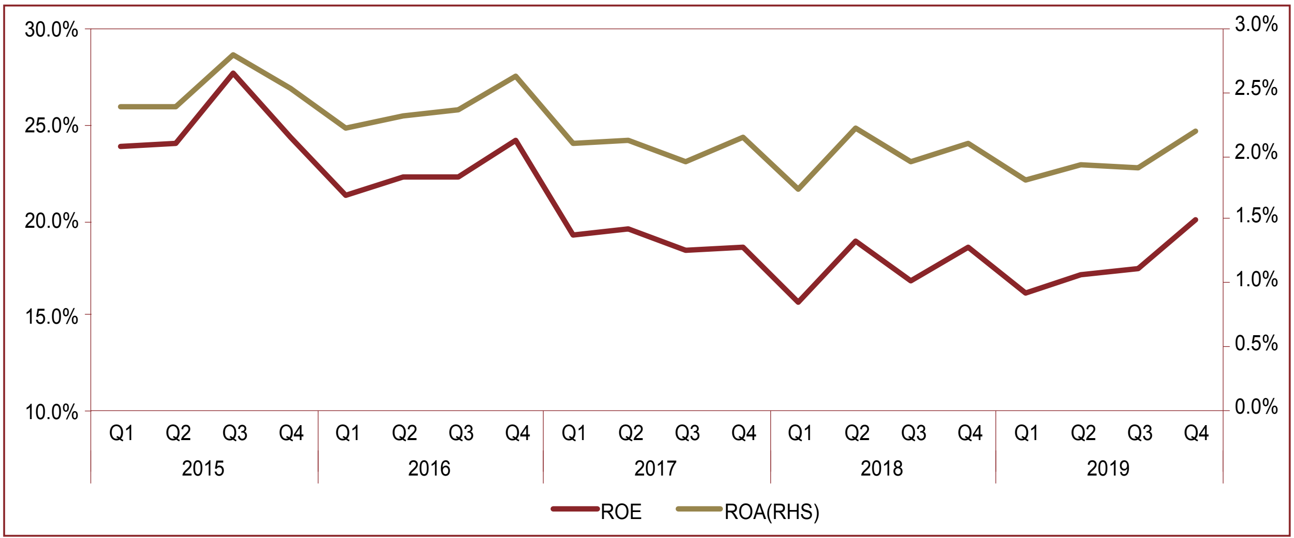


Source: Bank of Namibia

Profitability of the Banking Sector

The banking sector continued to be profitable despite the prevailing recessionary conditions due to increases in both the net interest income and operating income. The banking sector's after-tax profits increased by 5.9 percent to N$2.7 billion in 2019. Income growth remained positive with both net interest income and other operating income contributing positively to the growth in total income. Net interest income increased from N$3.1 billion in 2018 to N$3.3 billion in 2019, while other operating income increased from N$930.0 million in 2018 to N$970.6 million during the period under review. The increase in net interest income was attributed to increases in interest income emanating from higher interest received on balances held with banks, short-term negotiable securities, instalment debtors, residential mortgages and fixed term loans. The industry also experienced an increase in other operating income driven by transaction-based fees. Profitability as measured by the Return on Equity (ROE) as well as the Return on Assets (ROA) ratios, indicate that the banking sector profitability has improved since 2018. The ROE increased from 18.5 percent in 2018 to 20.0 percent in 2019 (Figure 14). ROA increased marginally from 2.1 percent in 2018 to 2.2 percent in 2019.

Figure 14: Profitability of the banking sector

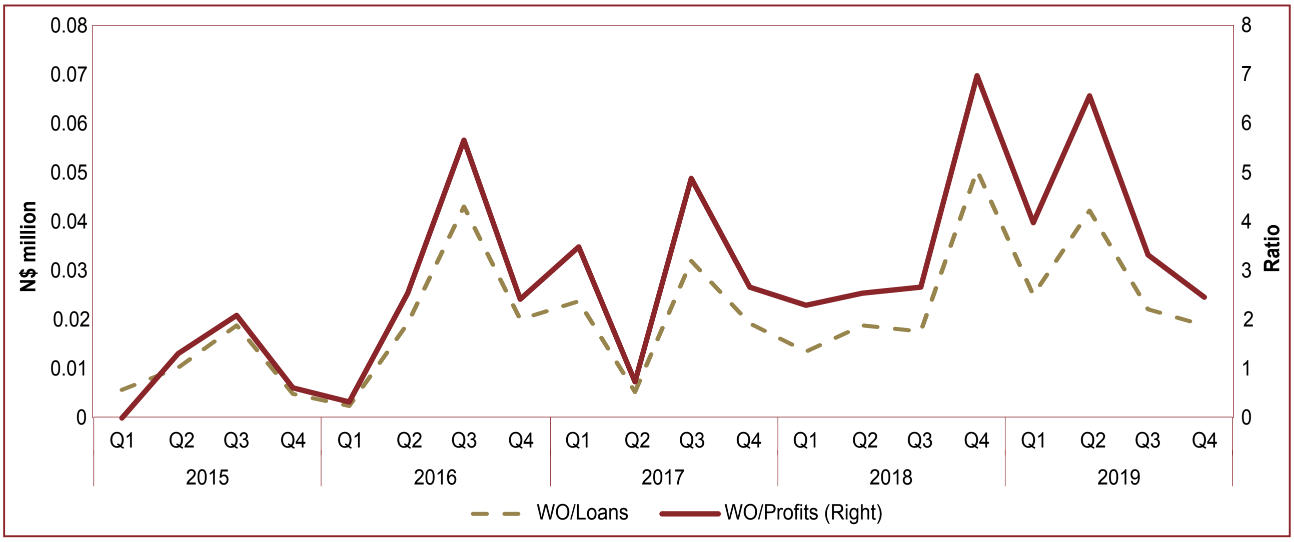


Source: Bank of Namibia

Write offs in relation to total loans and profits

Although asset quality has deteriorated during the period under review, write-offs in relation to total loans and profits, respectively, has declined. The percentage of write-offs in relation to total loans, slowed from 0.05 percent in 2018 to 0.02 percent in 2019. Write-offs in relation to profits also slowed, from 6.96 percent in 2018 to 2.47 percent in 2019 (Figure 15). Although the asset quality of the banking sector continued to deteriorate, the banks remained profitable with growing assets and minimal loan loss write-offs.

Figure 15: Write offs in relation to total loans and profits



Source: Bank of Namibia

Adequacy of Provisions

Adequate provisions were raised for delinquent loans during the period under review. Specific loan loss provisions increased from N$72.0 million in 2018 to N$86.7 million in 2019, representing a growth rate of 20.3 percent. Even though bad debts written off declined in 2019 when compared to the preceding period, from N$49.0 million to N$19.6 million, the NPL ratio increased by 1.2 percentage points to 4.8 percent. An increase in the NPL ratio is therefore not synonymous with bad debts and loan losses written off. A loan is classified as non-performing after being in default over a 3-month period. As it may be rehabilitated to performing status again in future and or the borrower may provide additional security, the value of write-offs maybe significantly lower than the initial non-performing loans. The growth in specific loan loss provisions indicates that the banks were expecting to experience more losses in 2019, but that instead bad debts written off during the period under review declined significantly. The banks therefore had adequate provisions and buffers to cushion against any potential losses during the period under review. The banks' ability to manage credit risk was therefore satisfactory. The implementation of the loan repayment moratorium may also soften the impact on provisions going forward.

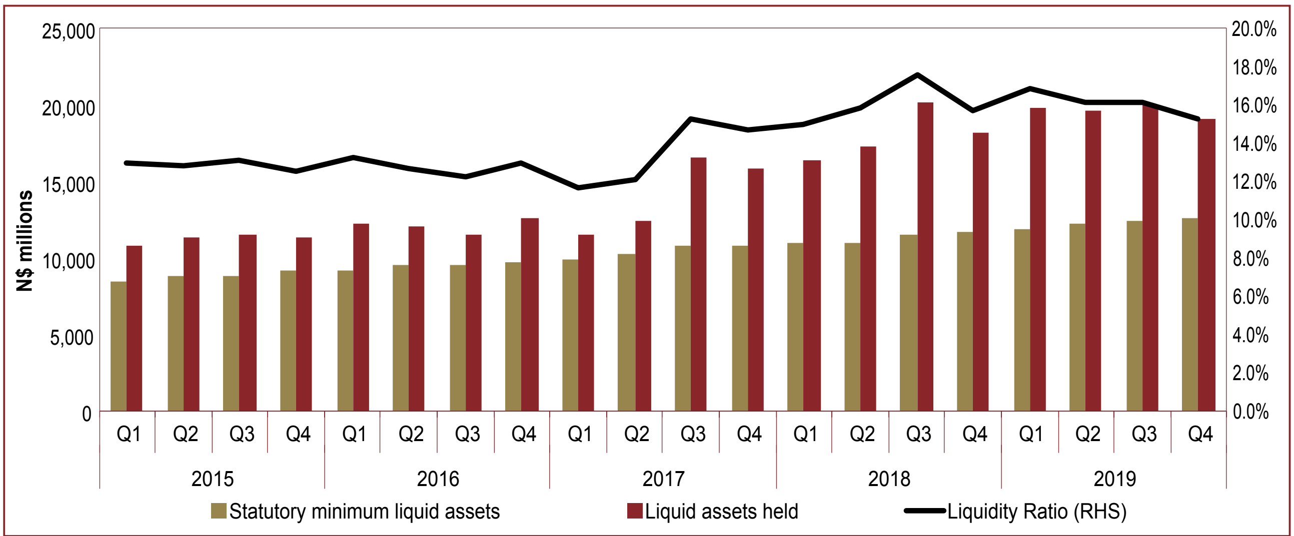
Liquidity Risk

Liquidity Position

During 2019, the banking sector continued to hold liquid assets well in excess of the statutory minimum liquid assets requirement. The banks are required to keep liquid assets of 10.0 percent of average total liabilities to the public. Liquid assets held increased significantly from N$18.1 billion in 2018 to N$19.1 billion in 2019. The statutory minimum liquid assets increased to N$12.5 billion in

2019, from N$11.6 billion in 2018. The liquid assets held were therefore well in excess of the statutory minimum required. The liquidity ratio[13] slowed marginally from 15.6 percent in 2018 to 15.3 percent during the period under review (Figure 16). The Determination on Liquidity Risk Management (BID-6) gazetted on 28 August 2019 was revised in order to strengthen the quantitative liquidity risk framework of banking institutions. This determination requires BoN to determine the minimum liquid assets which a banking institution should hold at any time, alternatively over a required period. The growth in liquidity in the banking sector was due to various factors, including mineral sales proceeds, Southern Africa Customs Union (SACU) receipts, low appetite for credit as well as the repatriation of funds by institutional investors in line with Regulation 8, 15, and 28[14]. The banking sector held liquid assets in the form of cash balances with other banks as well as Government securities and BoN Bills.

Figure 16: Liquid Assets and Liquidity Ratio



Source: Bank of Namibia

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

A key liquidity indicator, the loan-to-deposit (LTD) ratio, moderated but remained high. The ratio slowed from 94.6 percent during 2018 to 92.9 percent during the period under review (Figure 17). The lower ratio implies that the banks have made relatively less use of more expensive sources of funds such as debt and instead made more use of deposits to fund loans and advances. Despite there not being a set benchmark, a LTD ratio close to or over 100 percent implies that some of the banks rely on borrowed funds to fund their loans. The new Basel III liquidity framework will therefore

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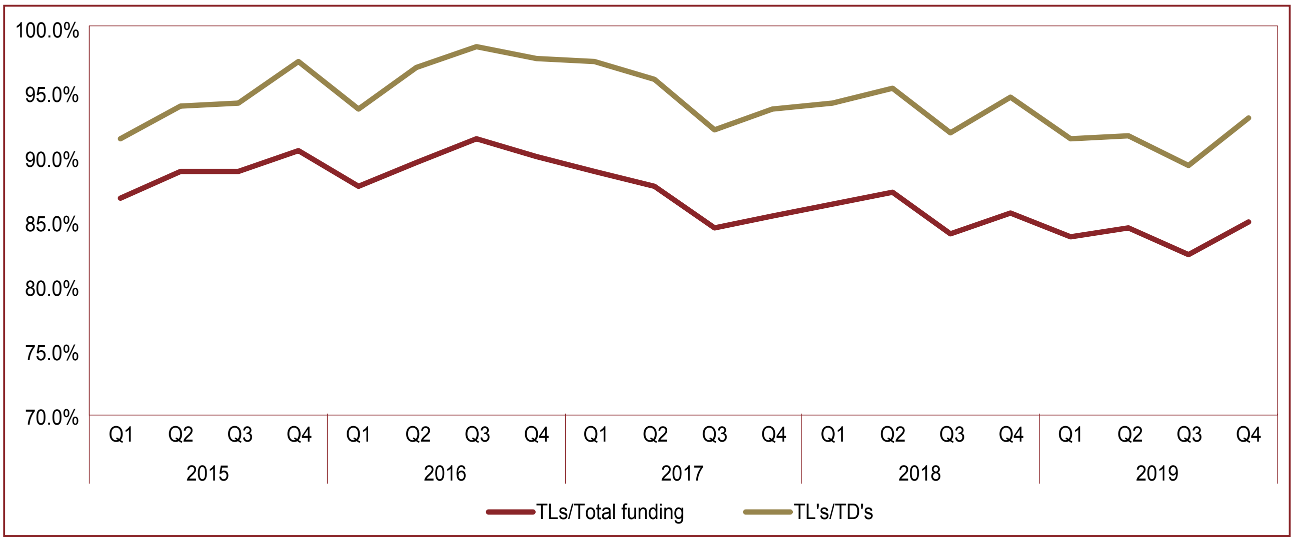
[13] The liquidity ratio is calculated to determine the banks capacity to pay their short-term obligations, while also determining the banks' ability to convert its assets into cash.

[14] Regulation 8 of the Short-term Insurance Act, Regulation 15 of the Long-term Insurance Act and Regulation 28 of the Pension Fund Act, require that domestic assets held by institutional investors be at least 45 percent of total assets.

require banks to diversify their funding sources; coupled with the revised BID-6, the banks should therefore be able to effectively manage liquidity risk going forward.

The banking sector's loan-to-funding (LTF) ratio declined in 2019 when compared to 2018. The LTF ratio declined by 0.6 percentage point, to 84.9 percent in 2019 (Figure 17). This ratio indicates that, on average, 85.0 percent of the banks' funding has been extended as loans and advances, which means that only 15.0 percent of total funding, capital and equity was available for use on liquid and other assets. A high LTF ratio limits banks' ability to further expand their loans and advances book and manage liquidity risks at the same time. As a result, the ratio remained at manageable levels.

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



Source: Bank of Namibia

CONCENTRATION RISK

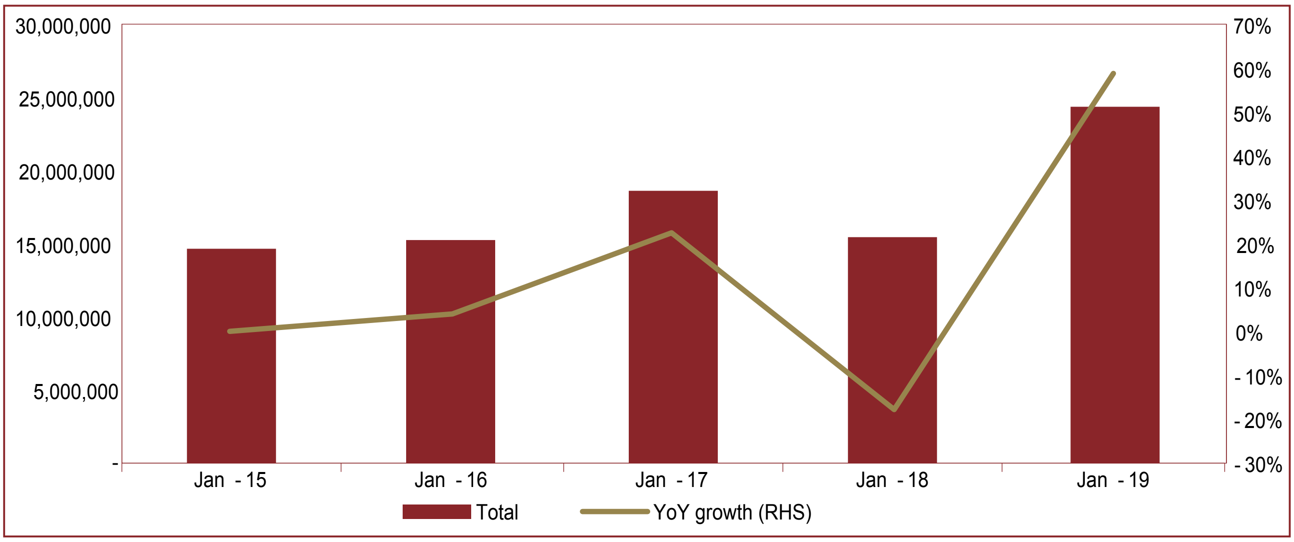
Large exposures[15]

The banking sector's large exposures have grown significantly since 2018, with a notable increase in the *Other* category. The value of total large exposures increased to N$24.4 billion as at 31 December 2019, from N$5.3 billion a year earlier (Figure 18A). This significant growth was primarily because of an upsurge in overall large exposures in all sectors, with the exception of the *Tourism* sector that did not record large exposures during the period under review. The banking sector's overall exposure to the *Fishing* sector, on the contrary, recorded a significant decline of 43.7 percent. The *Other* category's large exposures increased considerably by 77.1 percent during the period under review. Large exposures pose a potential risk to the overall financial stability of

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

the banking sector, in the form of excess concentration to individual companies or sectors. The significant upsurge in the banking sectors large exposures to all sectors with the exception of the *Fishing* and *Tourism* sectors, may pose a concentration risk. Exposure to the *Mining and Minerals* sector grew significantly, however, the *Mining and Minerals* sector only constituted 13.4 percent of the total large exposures, hence rendering its impact less significant.

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



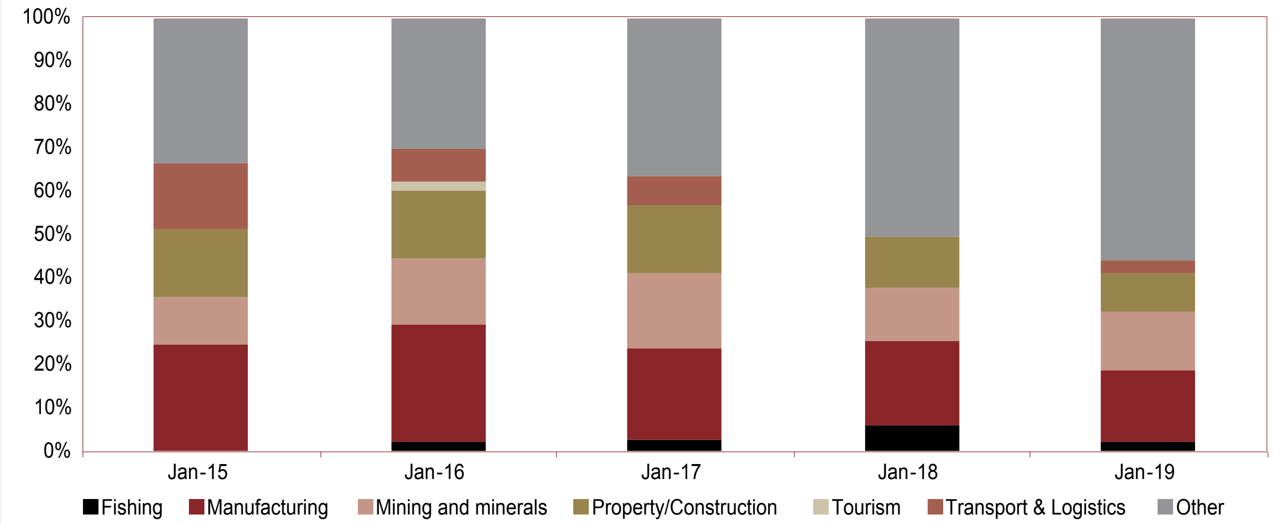
Source: Bank of Namibia

The Determination on Limits on Exposures to Single Borrowers, Large Exposures and Concentration Risk (BID-4) was revised and published in the Government Gazette on 1 March 2019. This Determination sets out conditions and limitations on the borrowing of excessive amounts of a bank's funds by one person or a group of related persons - alternatively a group of counterparties whose performance is determined by common or correlated underlying factors. The revision of the Determination was to adjust the level of the total of all exposures outstanding at any time to a single person, or a group of related persons, from 30.0 percent to 25.0 percent of a bank's capital funds. This revision is in line with a standard set by international standard-setting bodies on banking regulation. However, the effective date of this revision has been postponed, therefore the single borrower limit remains at 30.0 percent, allowing banks a wider scope to lend to vulnerable economic sectors. These measures provide banking institutions the necessary flexibility to respond to the needs of their clients thereby enabling banks to support the economy during these challenging times.

The sectoral composition of large exposures remained broadly diversified during 2019, with minor movements with regard to the relative share of total large exposures that the respective sectors occupy. In line with the consistent movements in the exposures to individual sectors, the relative share of the *Other, Manufacturing* and, *Mining and Minerals* sectors remain the largest at 56.1 percent, 16.7 percent and 13.4 percent, respectively (Figure 18B). Further, the relative share of the *Fishing, Property and Construction, Tourism* and the *Transport and Logistics* sectors remained below

10.0 percent. These compositions, however, did not warrant any concerns regarding the stability of the financial system. The banking sector large exposures therefore remained adequately diversified and pose minimal concentration risk to the financial system during the period under review.

Figure 18B: Sectoral Composition of Large Exposures



Source: Bank of Namibia

The proportion of total private sector credit extension (PSCE) to large exposures increased in 2019. The large exposures as a proportion of PSCE increased significantly from 16.0 percent in 2018 to 23.5 percent in 2019 (Table 7). In relation to private sector credit to businesses, large exposures similarly increased to 58.9 percent during the period under review, from 39.7 percent during the previous period.

Table 7: Large Exposures in relation to Private Sector Credit Extension

	2015	2016	2017	2018	2019
Total Large Exposures	14,631	15,223	18,668	15,332	24,379
Total PSC	78,394	85,397	89,720	95,748	10,3739
PSC to Businesses	33,086	35,343	36,811	38,656	41,419
Large Exposures to PSC	18.7%	17.8%	20.8%	16.0%	23.5%
Large Exposures to Business PSC	44.2%	43.1%	50.7%	39.7%	58.9%

Source: Bank of Namibia

STRESS TEST

The Bank of Namibia stress test has been designed to assess the resilience of the Domestic Systemically Important Banking (DSIB) institutions, to interest rate, credit and liquidity risk, through scenarios employed in the stress test. The scenarios consider the recent developments in the global, South African and Namibian economies, respectively, while also focusing on the performance of the DSIBs should the scenarios materialise. Credit risk is determined by considering the potential performance of the non-performing loan (NPL) ratio, which is a measure of asset quality. Interest rate risk is determined by the movements in the repurchase (repo) rate; therefore, the scenarios assume the potential course of the repo rate in the next 12 months, supported by economic developments both domestically and globally. Another concern is whether the DSIBs would be able to withstand a liquidity shock if large numbers of their depositors were to make sudden withdrawals of their funds from the system. The magnitude of the shocks in the various scenarios are based on the expert judgement of the Financial System Stability Committee (FSSC). The Cihak model was used to stress test the solvency and liquidity position of the DSIBs, 12 months into the future.

Interest Rate Risk

Considering the cuts in the repo rate in February, March and April 2020, coupled with an anticipated further reduction in the repo rate in South Africa in the next 12 months and the global broad-based shift toward ultra-accommodative monetary policy, banks will be prompted to decrease their prime lending rates. Lower interest rates could provide some relief for corporates by way of lower debt-servicing costs, coupled with the slowed average consumer inflation for the year 2019 which stood at 3.7 percent, down from 4.3 percent during the preceding year. A cut in the repo rate brings about lower borrowing costs and a potentially stronger appetite for credit which is a stimulus to the subdued private sector credit extension (PSCE) in the economy. The pandemic-related damage to the economy and to cash flows of normally creditworthy firms and households is also likely to bring about a surge in distress borrowing. This may be further boosted by government measures to encourage lending, in order to protect jobs by rescuing otherwise viable firms from floundering as their turnovers collapse. Real Gross Domestic Product (GDP) growth in Namibia and South Africa remained weak during 2019, and is now expected to deteriorate further in 2020, in line with the decline in global output.

In order to maintain the currency peg, the Bank of Namibia may opt to also cut the repo rate to align interest rates with those of South Africa. In all 3 scenarios the starting point is the current (April 2020) repo rate of 4.25 percent, thereby already incorporating the initial policy response to the intensification of the coronavirus pandemic; from this level the following further moves are foreseen:

- A decline of 0.25 percentage point in the interest rate (Baseline scenario);
- A decline of 1.00 percentage point in the interest rate (Intermediate scenario);
- A decline of 2.00 percentage point in the interest rate (Severe scenario).

Credit Risk

On the back of the overall expected economic setback, both domestically and globally, NPLs of the various credit categories are expected to deteriorate at a faster rate, compared to 2019. An acceleration in the growth of the NPL ratio may materialise with a lag as a result of the expected economic headwinds related to the COVID-19 outbreak. The main determinant of economic outcomes in the short to medium term is the COVID-19 outbreak and associated measures and reactions. The disruptions that it will bring to borrowers' cash flows will be severe, and with it the impact on debt service capacity and ultimately NPLs. Direct, indirect and induced effects will combine to push output, expenditure and cash flows lower. While there is much uncertainty about the magnitude of these effects, coupled with the potential cushioning of the loan payment moratorium that the Bank has implemented; the potential increase in the NPL ratio was assumed as follows, with the starting point being the current NPL ratio of 4.8 percent:

- A 1.0 percentage point increase in the banking sector NPL ratio (Baseline scenario);
- A 2.5 percentage point increase in the banking sector NPL ratio (Intermediate scenario);
- A 5.0 percentage point increase in the banking sector NPL ratio (Severe scenario).

Liquidity Risk

Liquidity risk measures the ability of the banks to honour their financial obligations in a timely manner should a liquidity shock ensue. These assumptions are made despite the banks being well capitalised, profitable and having access to liquid assets, and do not consider the liquidity contingency funding plan of each bank which would represent a cash inflow over the five-day period post liquidity shock. The liquidity stress test is over a five-day horizon. A bank's most affordable means of funding loans growth is through deposits. Consequently, when deposits are not available then banks rely on more expensive funding sources such issuing of debt instruments at much higher costs. The various factors that may cause liquidity constraints include, but are not limited to, delayed tax refunds, increased preference for holding notes and coins, and capital flight to other markets in search of lower risk or better returns.

The concern of the FSSC is whether commercial banks would withstand a liquidity shock if depositors made a sudden withdrawal of their funds from the banking system. Depositors are assumed to withdraw their funds in the magnitudes outlined below.

- 7.06 percent of total deposits withdrawn over 5 days (15 percent of demand deposits) (Baseline scenario);

- 14.12 percent of total deposits withdrawn over 5 days (30 percent of demand deposits) (intermediate scenario);
- 35.30 percent of total deposits withdrawn over 5 days (75 percent of demand deposits) (severe scenario).

The liquidity scenarios are interpreted as follows, a select portion of the demand deposits relative to the total deposits which determines the percentage at which total deposits will be withdrawn over 5 days. In the baseline scenario 15 percent of demand deposits relative to total deposits yielded a withdrawal rate of 7.06 percent of total deposits. The intermediate as well as the severe scenarios should be interpreted in the same way.

The liquidity position of the banking sector improved during 2019, due to a slowdown in the demand for credit and changes to the local asset requirement that resulted in the repatriation of funds by institutional investors back into Namibia. However, in the event of stress caused by economic conditions, economic agents may be prompted to liquidate their demand deposits to cater for their day-to-day needs, or to hoard banknotes in an environment perceived to be very risky, or potentially to seek alternative investments. Unlike the investments of pension funds and long-term insurance companies which are subjected to domestic asset requirements, demand deposits belonging to households and businesses are volatile, and can therefore easily be withdrawn from the banking system, thus rendering the above-mentioned scenarios plausible. Such funds may potentially be held in the form of bank notes, or invested in the more developed and liquid South African financial markets given the interconnectedness between the two financial systems. A summary of these shocks is presented in Table 8 below.

Table 8: Summary of the stress testing scenarios

Risk category	Baseline	Intermediate	Severe
Interest Rate Risk	0.25 percentage point decrease	1.00 percentage point decrease	2.00 percent decrease
Credit Risk (NPL ratio)	1.0 percentage point increase	2.5 percentage point increase	5.0 percentage point increase
Liquidity Risk	7.06 percent of total deposits withdrawn over 5 days (15% of demand deposits - baseline scenario)	14.12 percent of total deposits withdrawn over 5 days (30% of demand deposits - moderate scenario)	35.30 percent of total deposits withdrawn over 5 days (75% of demand deposits - adverse scenario)
Other variables - 30% haircut on collateral -50% Assumed provisioning of the new NPLs			

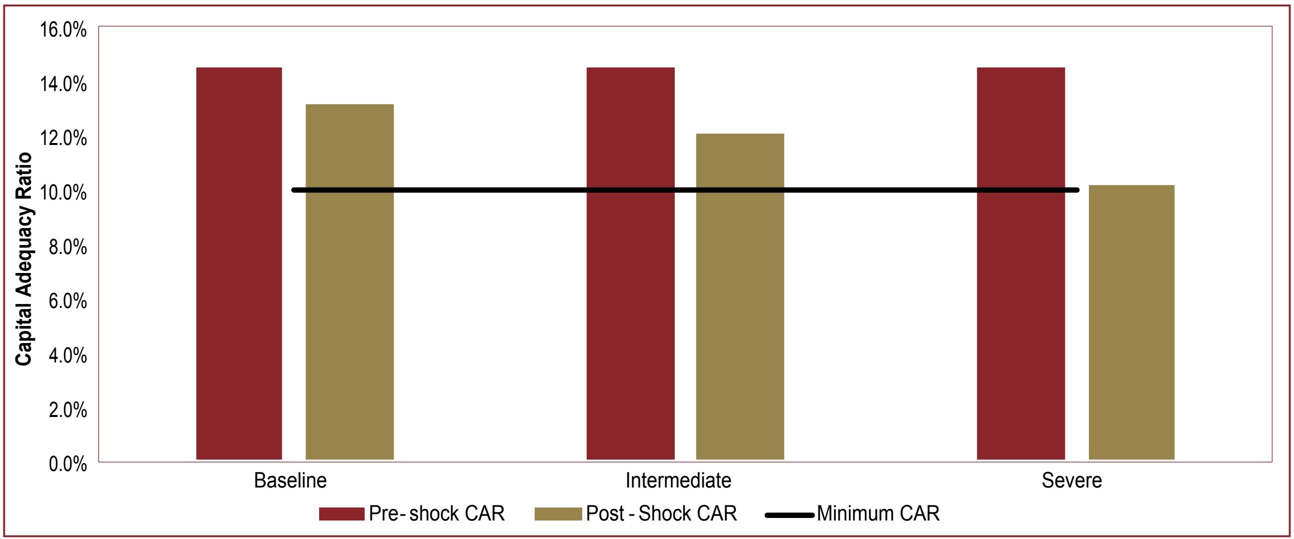
Source: Bank of Namibia

Stress Test Results

Solvency

Despite the phasing in of the Basel III capital requirements, the stress test results indicate that the banking sector remained solvent in all three scenarios. In the baseline scenario the post-shock capital adequacy ratio (CAR) stood at 13.2 percent, which is 3.2 percent higher than the statutory limit of 10 percent. The intermediate scenario recorded a post-shock CAR of 12.1 percent, whereas in the severe scenario, the post-shock CAR was significantly lower at 10.2 percent (Figure 19). Overall, the 12-month projection of the Cihak model points toward a solvent banking sector, in all three scenarios with the severe scenario marginally meeting the prudential limit. The capital base of the banking sector is therefore adequate to absorb shocks, including potential risks emanating from asset quality in the banking sector.

Figure 19: Solvency Stress Test Results

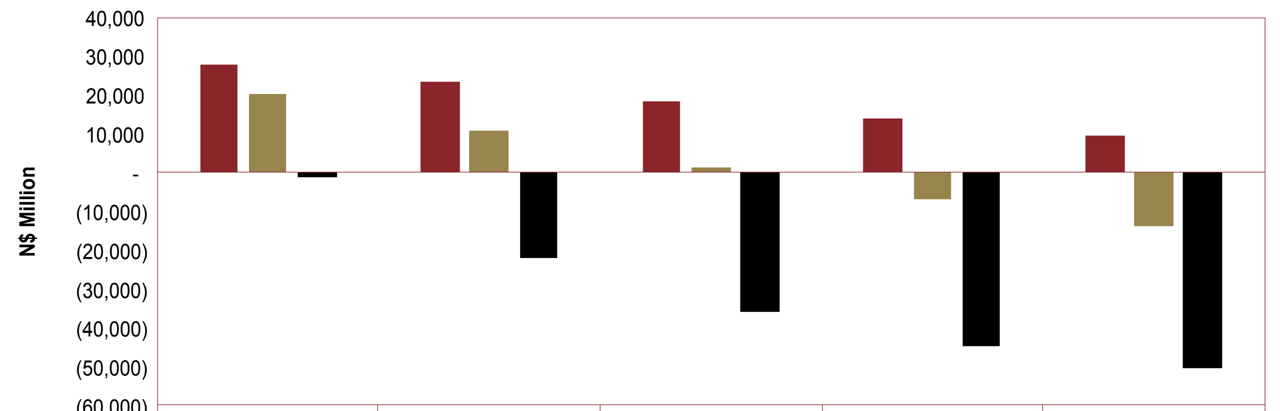


Source: Bank of Namibia

Liquidity

The liquidity position of the banking sector remained sound only in the baseline scenario, with a noticeable deterioration in liquidity in both the intermediate and severe scenarios. In the baseline scenario, the liquidity position for the 12-month projection remained sound but, declined gradually over the five days (Figure 20). The intermediate scenario had similar results, however with a much steeper downward trend over the five-day period, moving into negative territory as from day four. The severe scenario on the other hand, experienced a much steeper downward trend, starting in negative territory. The banking sector would, therefore, only be able to meet its payment obligations in the baseline scenario and up until the third day in the intermediate scenario, after which the banks liquidity contingency funding plans would become effective.

Figure 20: Liquidity Stress Test Results



	Day 1	Day 2	Day 3	Day 4	Day 5
Baseline	27,314	23,299	18,157	13,366	8,972
Intermediate	20,078	10,360	796	(7,352)	(14,220)
Severe	(1,628)	(22,325)	(36,361)	(45,141)	(50,476)

Source: Bank of Namibia

OVERALL BANKING SECTOR RISK ASSESSMENT

The risk assessment of the banking sector prioritises inherent risks associated with the banking sector as well as its implications for financial stability. The growing NPL ratio poses a credit risk to the banking sector, however banks have implemented various interventions such as rigorous credit assessments in order to reduce continued credit risk brought about by a deterioration of the banking sector's asset quality. Liquidity risk was not a concern during the period under review, given the favourable performance of banking sector liquidity, which was well above what is statutorily required. Concentration risk remained low and well managed. Operational risks in the banking sector increased owing to increased operational expenses, on the contrary, market risks declined significantly given slowed market exposure during unfavourable economic conditions. There were marginal interest rate risks during the year under review, if at all present, however in 2020 interest rate risk will increase sharply given the positive interest rate gap banks have. This is based on the assumption that a significant portion of liabilities will not reprice to the same extent as assets, resulting in pressure on growth in net interest income. Stress testing remains paramount in determining the potential performance of the banking sector given various levels of stress imposed on the banking sector. The stress test results showed that the banking sector will remain solvent and liquid if the scenarios imposed, materialise, except for liquidity mainly in the severe scenario, of which banks effectively have liquidity contingent fund plans in place.

Overall, the impact of the risks to the banking sector, in 2019, did not appear significant, thus having had no real threat to financial stability in Namibia; however, risks associated with the COVID-19 outbreak may pose a threat to financial stability in Namibia. The policy relief measures implemented by the Bank of Namibia gives banking institutions the necessary flexibility to respond to the needs of their clients thereby enabling banks to support the economy during these challenging times. The Bank of Namibia will continue to closely monitor developments and the response of banking institutions to these measures in order to ensure and maintain a sound monetary and financial system in Namibia amid economic challenges posed by the COVID-19 outbreak.

BOX 2: Developments in Non-Performing Loans (NPLs)

Non Performing Loans refer to loans that are more than 90 days overdue. *Banks categorise their loan book into five categories: pass or acceptable, special mention, substandard, doubtful and loss/bad loans. NPLs refer to loans that are more than 90 days overdue and represent the sum of the last three categories. An increase in the NPLs can have a negative impact on the financial position of a bank, particularly if it is not managed properly.*

In a broad context, when assessing asset quality, one should not only consider the size of NPLs, but the overall process of generating and managing assets, as well as controlling overall risk. *The NPL ratio is widely used as a quantitative measure of asset quality in the banking industry because in most jurisdictions, bank assets comprise mainly of loans and advances. For example, in Namibia, total loans and advances represent 70 percent of the total assets of banks. However, the size of NPLs alone is not a reason for concern because one should also consider the banks' ability to absorb these losses. NPLs can be managed and provided for in order to minimise the impact on the financial position of the bank. In Namibia, banks follow BID-2, the Determination on Asset Classification, that requires them to identify and classify problem loans at an early stage and provide adequately for these loans. Moreover, banks have recorded good profits over the years; as a result, they have built up enough buffers to absorb the steep rise in NPLs.*

Since 2017, NPLs have been rising in line with sluggish economic growth. *Between 2011 and 2015, the average NPL ratio stood at 1.5 percent of total loans, while real GDP grew on average by 5.6 percent during the same period. Real GDP began to contract in 2016 and continued to deteriorate further, shrinking by (1.1) percent during 2019. During that time, the NPL ratio more than doubled from 1.5 percent in 2016 to 4.8 percent at the end of 2019 (Table 1). This was expected considering the rapid deterioration of GDP during the same period. Moreover, NPLs were more volatile (i.e. increased rapidly) following the onset of the economic recession, as depicted by the standard deviation of the NPL ratio which increased to 1.0 percent between 2016 and 2019 from 0.2 percent between 2012 and 2015. Once the economic recession began to affect household and corporate income, the impact on NPLs was inevitable. The higher NPLs were observed across the industry, on all loan products, in all sectors, implying that the issue* *was systemic. Nonetheless, the prudent lending practices observed by the industry have helped contain the growth in NPLs as the economic recession persists.*

Despite declining slightly, the earnings ratios remained positive since the recession began in late 2016. *The ROE declined from 24.4 percent at the end of 2015 to 18.5 percent at the end of 2018 before tilting up to 20.1 percent at the end of 2019. Similarly, the ROA decreased moderately from 2.6 percent in 2016 to 2.2 percent in 2019 (Table 1). In this regard, strong profits boosted capital through retained earnings. The industry capital ratios have continued to trend well above statutory minimum requirements despite the stress from the weak economy. Stable earnings and good capital buffers are anticipated to enable the banks to absorb potential losses going forward. Over 50 percent of total loans and advances are mortgage loans, which generate stable income because they are secured, have recurring income streams and are expected to generate revenue over the long term.*

The banks increased total provisions as NPLs and write-offs rose, thereby adequately mitigating the risk associated with the higher NPLs. *Total write-offs grew from N$ 29.6 million in 2015 to N$ 109.2 million at the end of 2019 while total provisions rose from N$ 982.0 million to N$ 2.1 billion over the same period. The increase in provisions as write-offs and NPLs rose is a further indication that the banks are adequately providing for the higher risk associated with the growing NPLs.*

Table 1: Asset Quality Indicators

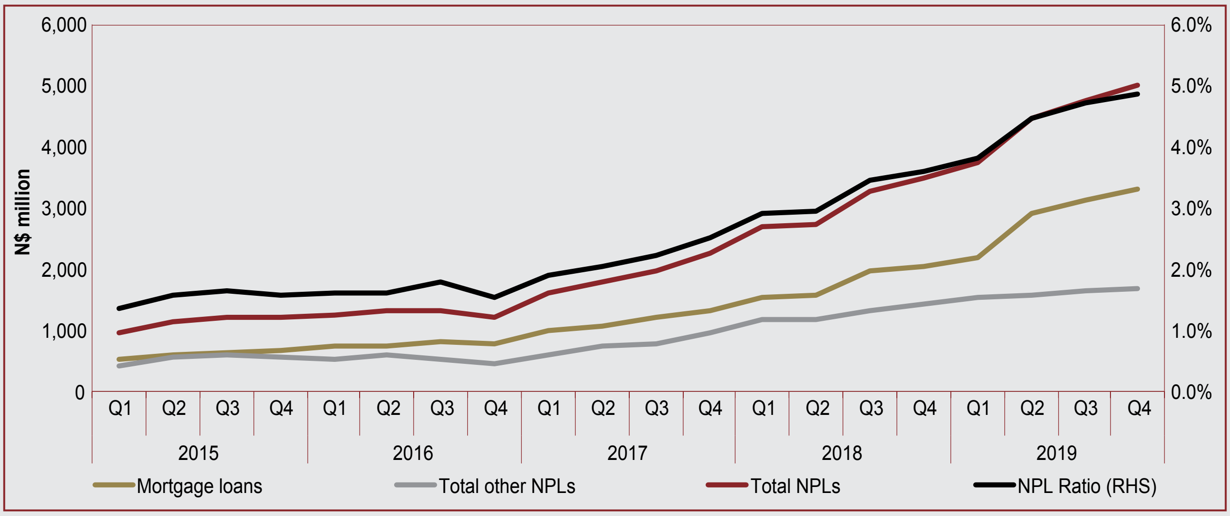
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real GDP growth(%)	5.1	5.1	5.6	6.4	4.5	-0.3	-0.1	0.7	-1.1
Total NPLs (‘000)	641.2	676.0	747.9	987.8	1 209.9	1 205.3	2 263.1	3 467.9	4 994.2
Total Write- offs (WO) (‘000)	23.1	19.4	14.9	24.8	29.6	70.4	71.2	96.2	109.2
Total Provisions (‘000)	602.9	619.3	694.2	813.0	982.2	929.0	1 085.8	1 624.9	2 063.2
Write off ratio (WONPLs) (%)	3.61	2.86	1.99	2.51	2.44	5.84	3.14	2.78	2.19
NPL ratio (NPLs/ Total loans) (%)	1.5	1.4	1.3	1.2	1.6	1.5	2.5	3.6	4.84
Provisions/TL’s (%)	1.4	1.2	1.2	1.2	1.1	1.0	1.1	1.3	1.3
ROE (%)	26.4	22.7	24.0	24.0	24.4	24.1	18.6	18.5	20.0
ROA	2.6	2.2	2.4	2.4	2.5	2.6	2.1	1.9	2.2
Leverage Ratio (%)	7.8	8.0	8.5	8.9	9.4	9.31	9.24	10.4	9.1

Source: Bank of Namibia

NPLs can be rehabilitated and reclassified as pass and special mention loans. *As mentioned above, banks categorise their loan book into five categories, NPLs represent the sum of the substandard, doubtful and loss/bad loans categories. The loss/bad loans represent actual losses, while the substandard and* *doubtful loans can be rehabilitated to become acceptable or special mention loans, thereby reducing NPLs. In this regard, the ratio of loans written off to non-performing loans remained relatively low, although spiking briefly from 2.4 percent in 2015 to 5.8 percent in 2016 (Table 1). The average write-offs ratio between 2017 and 2019 was 2.7 percent. The low write-off rate confirms the good management practices by the industry.*

NPLs are a lagging indicator and should only raise concern if they continue to persist as the economy turns around. *The NPL ratio stood at 3.2 percent in the second quarter of 2008, at the peak of the global financial crisis. After the crisis, the ratio decreased gradually as the global economy recovered and stayed below 2.0 percent for over five years (Figure 1). The NPL ratio started deteriorating rapidly in the second quarter of 2017, four quarters after GDP began contracting. The impact on NPLs was felt after the effect on the cashflows of the borrower. In the same vein, for NPLs to decrease, there must be a recovery in the cashflow of households and corporates, coupled with market confidence around the sustainability of said income. GDP is estimated to have contracted by 1.1 percent in 2019, with a further deterioration now expected in 2020 before staging a recovery in 2021. Therefore, as economic conditions improve, households and corporates should feel less of a strain on their income and may catch up on their loan payments; hence over time NPLs may grow at a slower pace and eventually start contracting.*

Figure 1: Non-performing loans



Source: Bank of Namibia

The availability of credit can stimulate economic growth, hence a low NPL ratio is not always desirable. *The size of NPLs is positively related to the supply of credit in the market, so growth in the nominal value of NPLs is expected if PSCE grows. It is the rate at which the NPLs are growing compared to the total loan book (NPL ratio) that should be closely monitored along with the banks' strategy to manage it. Although a low level of NPLs means low credit risk in the market, little to no NPLs may be an indication that lenders are too risk averse, which may in turn dampen economic growth.*

BoN will continue to closely monitor the growing NPL ratio, especially since banks breached the 4.0 percent trigger point for supervisory action from BoN in 2019. *The 4.0 percent benchmark is an internal trigger set by the management of the Bank of Namibia to indicate when should BoN engage formally with the banks regarding their asset management strategy. BoN has engaged with the individual banks to discuss their strategies to manage the growing NPLs. Moreover, BoN will continue to monitor the effectiveness of these plans and take corrective action if needed. Going forward, BoN will continue to monitor the industry's NPLs and take necessary measures. Despite increasing significantly, BoN would like to assure the public that NPLs are currently not a threat to financial stability because the banks are able to adequately manage the associated credit risk. Moreover, BoN has increased the internal NPL trigger during crisis times to 6.0 percent.*

The banks are facing severe financial headwinds in 2020 on account of the coronavirus outbreak and associated disruption of income-generating activities and cash flows. *The servicing of debt by borrowers generally depends on their sustained engagement in income-generating activities. Due to the travel bans, lockdowns and other measures introduced to slow the spread of the virus, numerous businesses have closed or scaled down their activities or face sharply lower prices for their products, resulting in a loss of income and an inability to service their debt. Employees of such businesses face similar setbacks. This is set to lead to a sharp escalation of NPLs among borrowers who used to be in good standing, servicing their debt regularly and posing normal risks. Going forward, NPL developments will be scrutinised closely, particularly in an attempt to distinguish between those arising from normal economic risks and those that have been brought about by the COVID-19 pandemic. Measures such as special repayment holidays, loan write off extensions, government assistance programs etc are expected to mitigate against an accelerated increase in NPLs due to the Covid-19 pandemic.*

VI. PERFORMANCE OF THE NON-BANKING FINANCIAL SECTOR

NBFI Assets

Despite worsening economic conditions, the Non-Bank Financial Institutions (NBFIs) sector remained stable and continued to grow its assets. The NBFIs total assets increased significantly by 9.0 percent to N$316.3 billion in 2019 (Table 9). The growth in assets was due to improved equity market performance, in particular, during the fourth quarter of 2019. The improved performance in the fourth quarter of 2019 is in line with an increase in the JSE All Share Index, which rose by 4.1 percent during the fourth quarter and increased by 8.2 percent on an annual basis.

Table 9: Total NBFIs Assets (N$ billion)

Year	2016	2017	2018	2019
Long-term insurance	47.6	53.9	56.6	60.2
Short-term insurance	5.8	6.2	6.5	6.8
Pension funds	137.5	152.9	158.5	173.4
Medical aid funds	1.4	1.8	1.9	2.0
Collective investment schemes(CIS) [16]	39.6	47.5	52.4	60.3
Investment management (IM)	7.6	8.2	7.8	7.7
Micro-lending	4.2	5.5	6.4	5.7
Friendly societies	0.121	0.136	0.157	0.173
Sector total	**243.8**	**276.1**	**290.3**	**316.3**

Going forward, however, the performance of the NBFIs might be adversely affected by the outbreak of the COVID-19 pandemic. The long-term effects of the COVID-19 pandemic upon the global economy remain difficult to model, due to ever changing conditions, but in the short-term global economic growth is expected to severely decline. The severe losses on the global financial markets are expected to also adversely affect the NBFIs asset position[17] with possible spillover to the banking sector through the wholesale funding channel, if the current conditions persist. To date, however, the robust capital buffers continue to cushion the NBFIs against these shocks.

[16] Note: Both CIS and IM total funds under management were adjusted accordingly to avoid double counting

[17] This will mainly affect life insurance and pension fund industry as more than half of their portfolios are heavily exposed to equities.

Box 3: The Impact of COVID-19 on the Insurance Industry

Insurance industries globally are likely to be adversely affected by COVID -19, depending on the specific classes of business underwritten by an insurer and its policy wordings. *In summary, the effects of the pandemic on the insurance industry in general is twofold, both on the asset side (investment losses) and liability side (claim costs), as highlighted below:*

The impact on insurance claims depends on the country, but could be incurred via claim costs, including death and disability claims, and drug costs (medical expenses). *The reaction of investors to the COVID-19 outbreak negatively affected movements in the financial markets, including bond prices and equity markets which will consequently result in reducing profitability of insurers', including earnings generated from their investment portfolios which are heavily exposed to equity markets. Insurers are seeing some disruption in their day-to-day operations, which will likely have an impact on revenues.*

In Namibia, measures to combat the spread of the COVID-19 pandemic as communicated in section 5(1) of Government Gazette Notice No. 9 dated 28 March 2020 include a 21-day lock-down of the Khomas and Erongo Regions, enforcement of social distancing and prohibition of public gatherings of more than 10 people. *The lockdown was extended to the 4 May 2020, with the coverage extended to the entire country. These measures have an impact on operational functions of businesses and ordinary citizens through lay-offs and furloughing (temporary layoff). On the operational side, insurance entities have transitioned their work to online service provision. Where consumers are challenged with internet services and places where the lockdown is not enforced, branches continue to service their clients. NAMFISA expects the impact of COVID-19 through reduced or no new business during the lockdown period, an adverse impact from the weak performing financial markets and rising claims or benefits payable, although the scale will still be manageable in Namibia.*

To help cushion the impact of COVID-19 in Namibia, the following regulatory guidance was proposed by NAMFISA:

Long-term / Life Insurance

- *Given the extension of the lockdown period nationally, premium holidays should be considered, whilst ensuring that clients are covered 100 percent during the relief period as determined by the insurers. In the event that a claim occurs during or after the relief period the outstanding premiums should be deducted from the claimed amount.*
- *Upon request by clients, allow for premium holidays on saving, investment and retirement annuity policies and therefore treat such policies as paid-up policies, which can be reinstated after the holiday period as determined by the insurer has passed, without imposing penalties or costs for clients for the "missed" premiums and without clients having to pay the missed premiums. Clients should be informed*

that when choosing this option, they forfeit investment returns on the portion of the "missed" premiums for the period.

- *Inform and educate clients regarding policies (including funeral policies) that have premium holidays and also explain the circumstances under which the holiday provision can be used.*
- *Group Life Policies to allow cover whilst employees work from home during the State of Emergency.*
- *Credit Life Policy claims be honoured and not unduly be repudiated.*

Short-term insurance

- *Insurance on all business electronics currently on a corporate customer's policy should also enjoy the same cover at home as at the business premises, to enable work from home during the State of Emergency.*
- *Accepting motor accident claims when vehicle licenses expires during the lockdown period.*
- *Consider extensions when policies are deemed to have lapsed for the duration of the State of Emergency.*

Relief by the Authority to regulated entities

- *Allow insurers to provide financial assistance to insurance intermediaries who will not be able to engage in day to day activity during the lockdown period(s).*
- *Postponement of Quarter 1 Returns due 1 May 2020 by 30 days i.e. submission now due 1 June 2020.*

Pension Funds Industry

Despite the persistent recessionary economic conditions, the pension fund industry remained financially sound during the period under review, with funding levels above the required limit. The pension fund assets grew by 9.4 percent to N$173.4 billion, supported by positive performance in the financial markets during the period under review. In this regard, the funding level remained steady above the prudential limit of 100 percent. The industry accounted for 54.8 percent of total NBFIs assets at the end of 2019. Going forward, COVID-19 might lead to lower funding levels for the pension fund industry, if the prevailing downturn in financial market performance persists.

Risk indicator

Due to improved investment returns, the overall risk rating remains low and steady in 2019. Improved returns were mainly driven by the JSE All Share Index which increased during the year given the industry equity exposure of 47.9 percent, in particular during the fourth quarter.

Table 10: Overall risk rating - Pension Funds [18]

Indicators	2018	2019	Risk direction
Overall risk rating			Steady

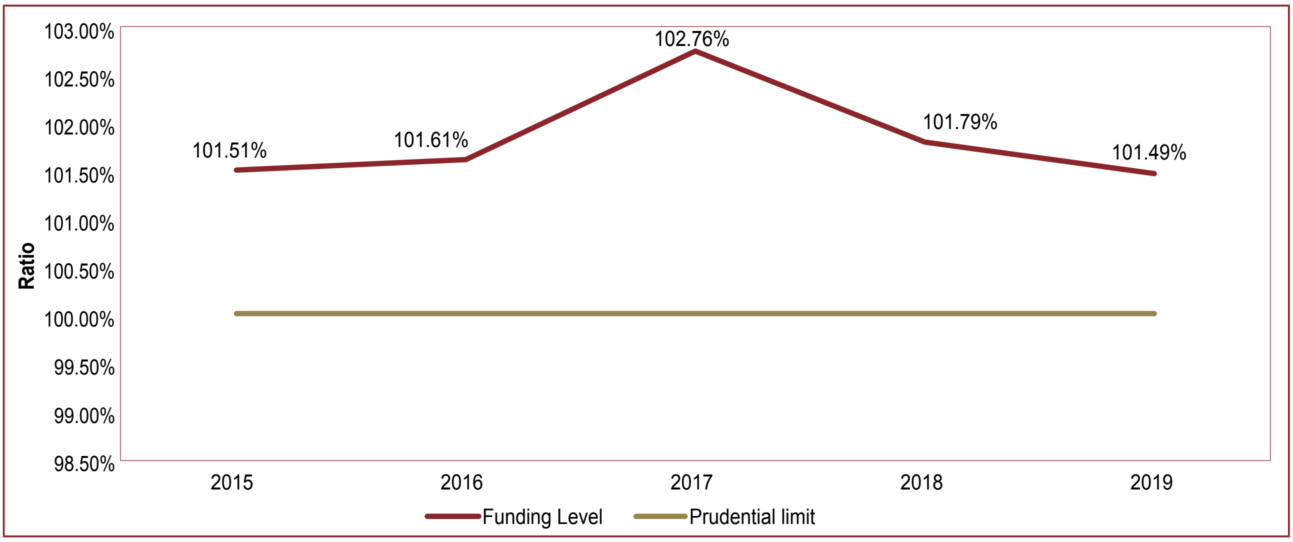
Key risk ratings scale

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

Funding risk[19]

The funding ratio of the pension fund sector remains above the prudential limit, despite the notable adverse economic conditions. The funding level declined marginally in 2019 compared to 2018. The reduction in the funding level was as a result of accumulated funds and reserves (long term liabilities) growing at a higher rate than assets during 2019 (Figure 21). However, despite a marginal decline in its overall funding level, the industry remained financially sound in 2019, as it maintained a sound funding position above prudential requirements.

Figure 21: Funding Risk



Source: NAMFISA

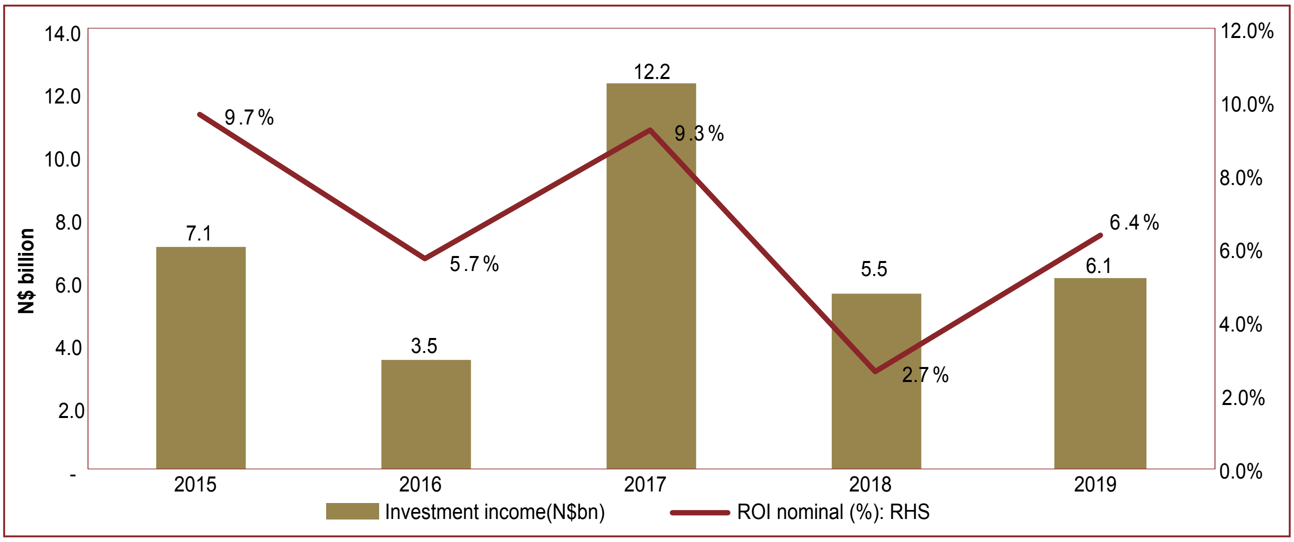
[18] The overall risk rating score was adjusted against the capital rating, hence the overall inherent risk rating was rated low as indicated in table 10.

[19] Funding risk – is applicable to defined benefit pension funds

Market risk[20]

The pension fund industry invested significantly in equities and was therefore exposed to volatility in the market value of equities. The increase in investment income was on account of a strong market performance, mainly reflected in a robust performance in the JSE All Share Index. Further, the JSE performance in the fourth quarter was driven by external positive events such as the US and China's partial agreement as well as the decisive UK elections. Looking ahead, circumstances in 2020 are unfavourable with investment income likely to decline.

Figure 22: Investment Income[21]



Source: NAMFISA

Investment mix

Due to the nature of pension funds, equities remain their preferred investment instrument. The bulk of pension funds' assets were invested in equities with an exposure of 54.6 percent in 2019 which increased, year on year, by 6.2 percent to a level of equity holdings amounting to N$82.4 billion . The equity exposure being the largest in terms of composition is followed by fixed interest instruments at 27.1 percent and money market instruments at 8.4 percent (Figure 23). In this regard, equities are preferred as their returns generally outperform other asset classes over the longer term.

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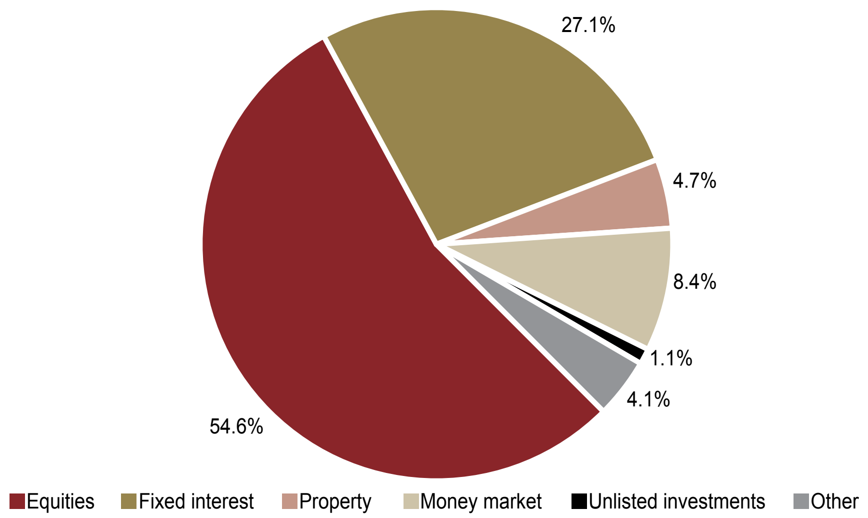
[20] Investment or market risk: risk of losses due to adverse movements in interest rates and other market prices - leading to underfunding in DB plans and low balances in DC accounts. The problem may materialise due to 'concentration risk' (i.e. the risk that the investment portfolio is not sufficiently diversified and is too concentrated on one asset or issuer).

[21] To avoid data gaps due to system migration challenges, the net investment income data of N$5.5 billion for 2018 was estimated based on asset growth trends and will be rectified in due course against audited financials.

Figure 23: Investment Exposure per instruments

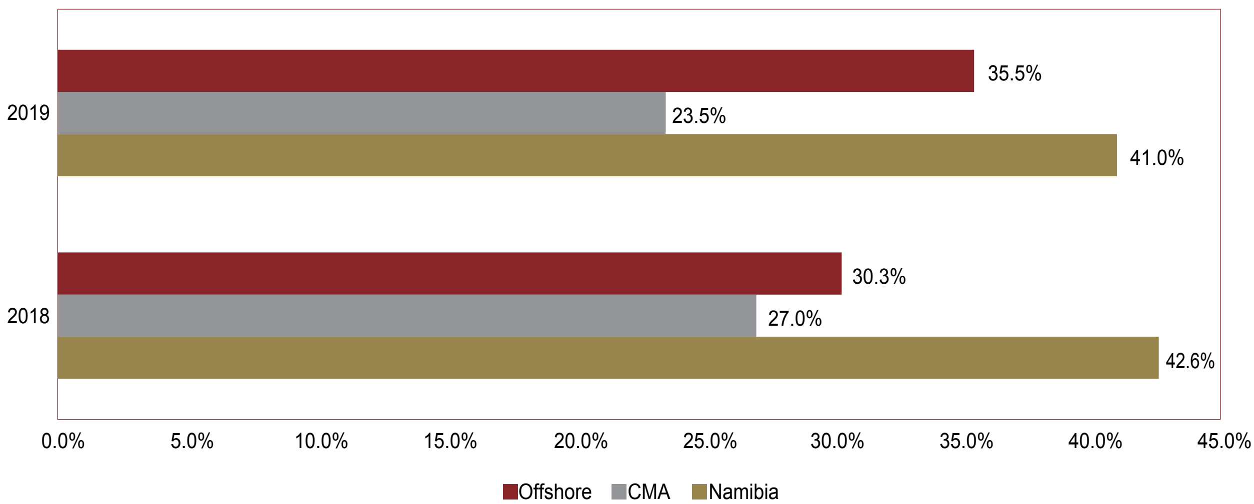


Source: NAMFISA

Geographic asset allocation

The pension funds industry invested most of its assets outside of Namibia. The geographical exposure was as follows: 41.0 percent in Namibia, 35.5 percent offshore and 23.5 percent in other CMA countries. The rise in offshore investment from 30.3 percent in 2018 to 35.5 percent in 2019 could be mainly attributed to increases in major global indices, such as the US's Standard & Poor 500 and the German Dax (Dax), which increased by 28.9 percent and 25.5 percent, respectively. These two indices increased largely due to easier monetary policy stances of major Central Banks, coupled with reduced geopolitical and trade uncertainty towards the end of 2019.

Figure 24: Geographic allocation of funds under management



Source: NAMFISA

Going forward, the worsening economic conditions, due to COVID-19, are however, expected to have a negative impact on the investment value of pension funds[22]. The weak performance in financial markets at the beginning of 2020, is ascribed to the uncertainty created by COVID-19, and it is expected to affect the funding level of pension funds. This may not be a concern if there is worsening of financial market performances over the short term, as pension funds take a longer-term view on investments. NAMFISA, however, continues to monitor the funding levels of pension funds and has requested the industry to provide up to date information and plans to restore funding levels in case limits are breached.

Other risks that may appear due to COVID-19 is the inability of employers to service their pension contributions. There is also an increasing risk as a significant number of exits from funds, in hard-hit industries is plausible in the coming months, if employees are retrenched from their places of employment. There are a number of employers in the tourism industry who can no longer afford to pay their contributions and are making decisions as to whether to send employees on unpaid leave, retrench or reduce their contributions to funds. In this regard, an increase in non-payment and late payments of contributions is highly probable. To mitigate possible retrenchments, the Government of Namibia has launched stimulus and relief packages for business and individuals. To complement these efforts, NAMFISA is working with the relevant pension funds to ensure that fund rules are relaxed to provide relief for such employers that may not be able to honour their payment obligations.

Long-Term Insurance

The long-term insurance industry remained sound and stable, with growth in the asset base despite recessionary economic conditions. The industry's assets grew by 6.2 percent to N$60.2 billion at the end of 2019, which reflects higher asset growth compared to the previous year. Overall, long term insurance is solvent as it is backed by free assets, which are sufficient to cushion against adverse movements in times of economic distress. Going forward, COVID-19 might impact the business operations, investment income and funding position of long-term insurers in 2020.

[22] Funding risk is only applicable to defined benefit funds as inadequate funding levels have an impact on defined benefit funds only as these funds commit to pay a set pension to retirees as pension. Should funding levels remain below 100 percent indefinitely, as defined benefit funds would be unable to pay retirees their promised pension. Whereas defined contribution fund transfer the risk of investment performance to retirees, who will only be able to entitled to the market value of investments at the time when pension benefits are settled.

Risk indicators

The overall risk rating for the insurance industry remained low and steady, supported by improvement in market performance. Despite the increase in the number of lapses and terminations during the year, the industry maintained a sound financial position with sufficient free assets.

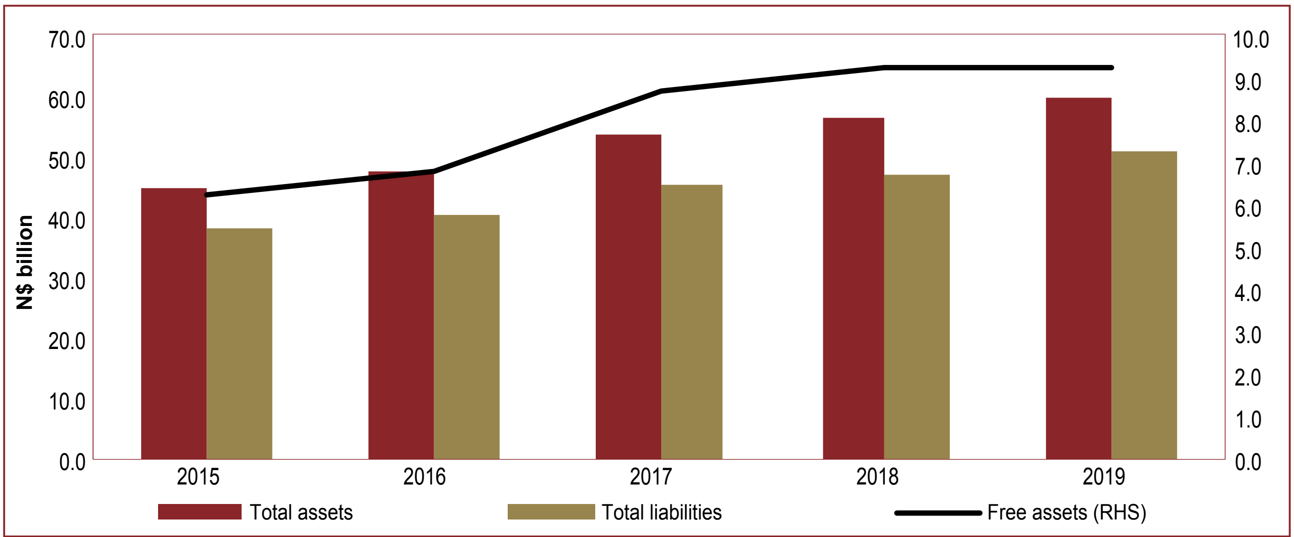
Table 11: Risk rating inherent risks - Long-term insurance

Indicators	2018	2019	Risk direction
Overall risk rating[23]			Steady

Solvency risk

The long term insurance industry is financially stable as shown by its solvency ratio (Figure 25). Assets, in the year under review, exceeded liabilities by N$9.3 billion, which shows that the industry is solvent and is able to pay off its long-term obligations. The industry's free assets remains above the capital adequacy requirement of N$4.0 million during the period under review. This confirms the overall financial soundness of the long-term insurance industry.

Figure 25: Solvency of Long-Term insurance



Source: NAMFISA

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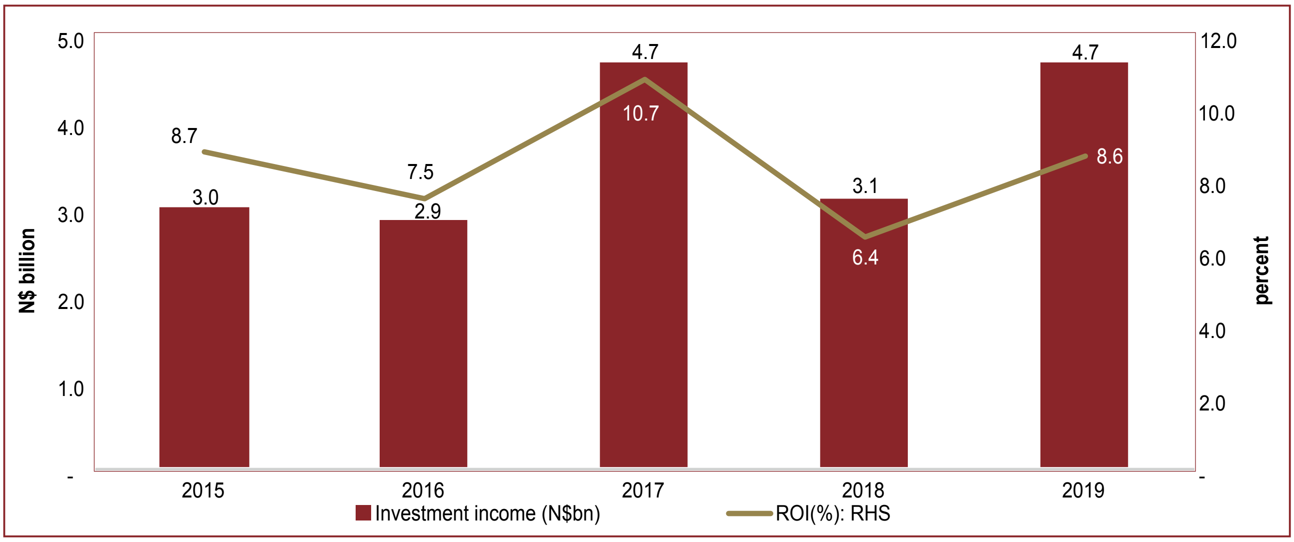
[23] The overall risk rating was adjusted against the solvency rating, as such the overall risk rating was rated low as indicated in table 11.

Market risk

In terms of market risk, the long-term insurance industry improved due to increase in investment returns. Investment income increased by 48.3 percent to N$4.6 billion, due to a robust performance in financial markets (Figure 26). In this regard, the Return on Investment (ROI) increased from 6.4 percent in 2018 to 8.6 percent in 2019, largely in line with an increase in the JSE All Share Index in 2019. The JSE's improved performance was mainly driven by external events despite domestic problems such as load-shedding, a weak fiscal outlook and the negative outlook from credit rating agencies.

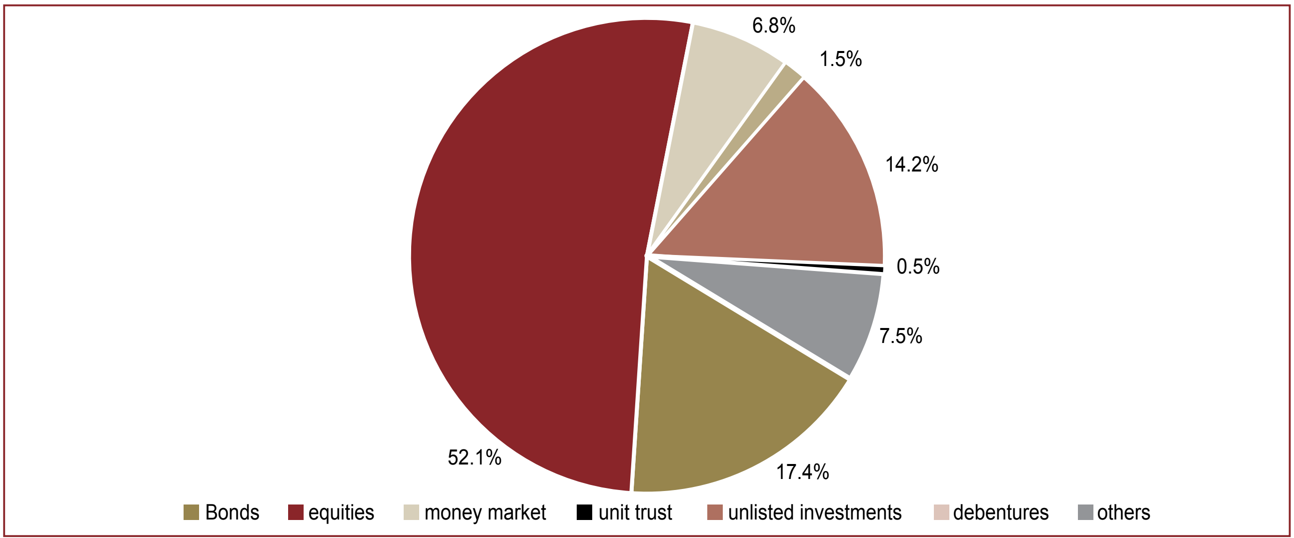
Figure 26: Investment Income



Investment mix

The long-term insurance entities invested most of their assets in equities, followed by government and corporate bonds. The industry's exposure to equities was 52.1 percent in 2019, while government and corporate bonds accounted for 17.4 percent of total investments (Figure 27). The higher exposure to equities and bonds could potentially render the industry to be more vulnerable to the current downward cycle triggered by COVID-19. Should the current downward trend persist it could potentially affect the solvency positions of insurers. The industry, however, held significant excess assets to the tune of N$9.3 billion. Nevertheless, the double-digit declines in equity and bond prices observed in the first quarter of 2020 have eroded the mark-to-market value of the N$60 billion in assets that were held by long-term insurers at the end of 2019 with a corresponding contractionary effect on free assets. Quantification will have to await the submission of the first quarter's financial statements by these institutions.

Figure 27: Long Term Insurance Investment portfolio

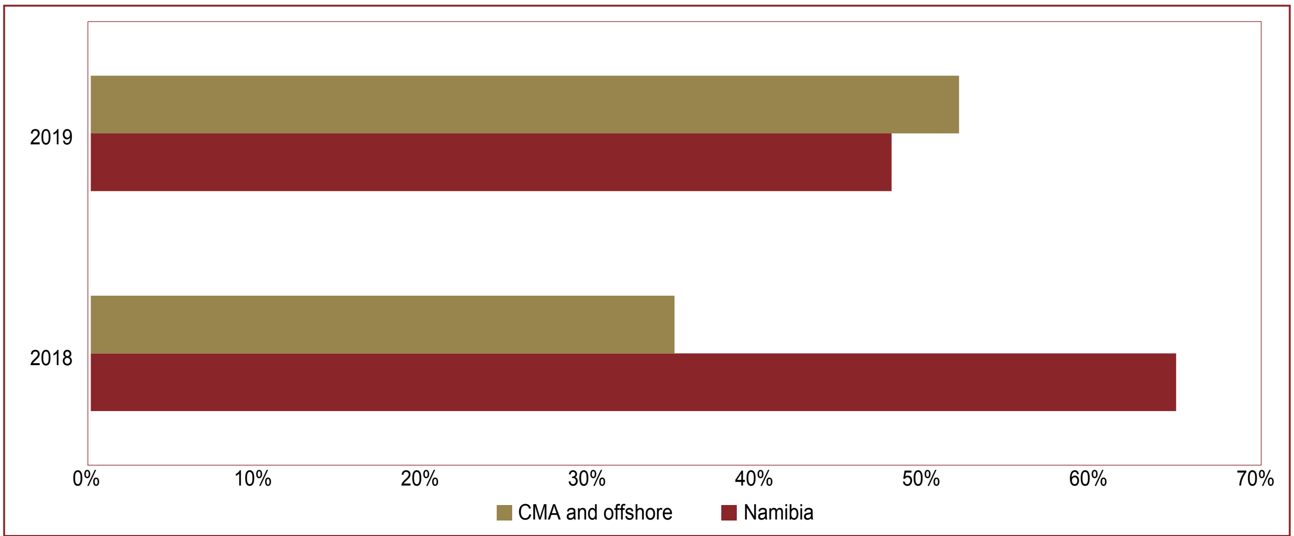


Source: NAMFISA

Geographic asset allocation

The Long term insurance industry invested most of its assets in offshore and CMA markets followed by domestic investments. More than 48.0 percent was invested in offshore and CMA markets, compared to 35.0 percent in 2018, and 52.0 percent was invested in Namibia compared to 65.0 percent in 2018 (Figure 28). The geographic movement of funds could be attributed to investment strategies and preferences of investors.

Figure 28: Geographic allocation of funds



Source: NAMFISA

Going forward, COVID-19 is expected to negatively impact the performance of the industry. The nationwide lockdown as issued by the Government of Namibia is expected to result in reduced or no new business for the insurance entities. In this regard, the premium income might slow down due to a potential decrease in new business underwriting and potential increase in lapses and terminations. Furthermore, should unemployment conditions increase this may result in policy lapses, although to date this has been limited. Finally, the recent downturn in financial markets is expected to affect the solvency position of the insurance industry. The insurance industry, however, has sufficient capital buffers to cushion against these shocks, as its solvency levels remain above prudential limits. NAMFISA continues to engage the insurance industry to ensure that the industry remains financially sound.

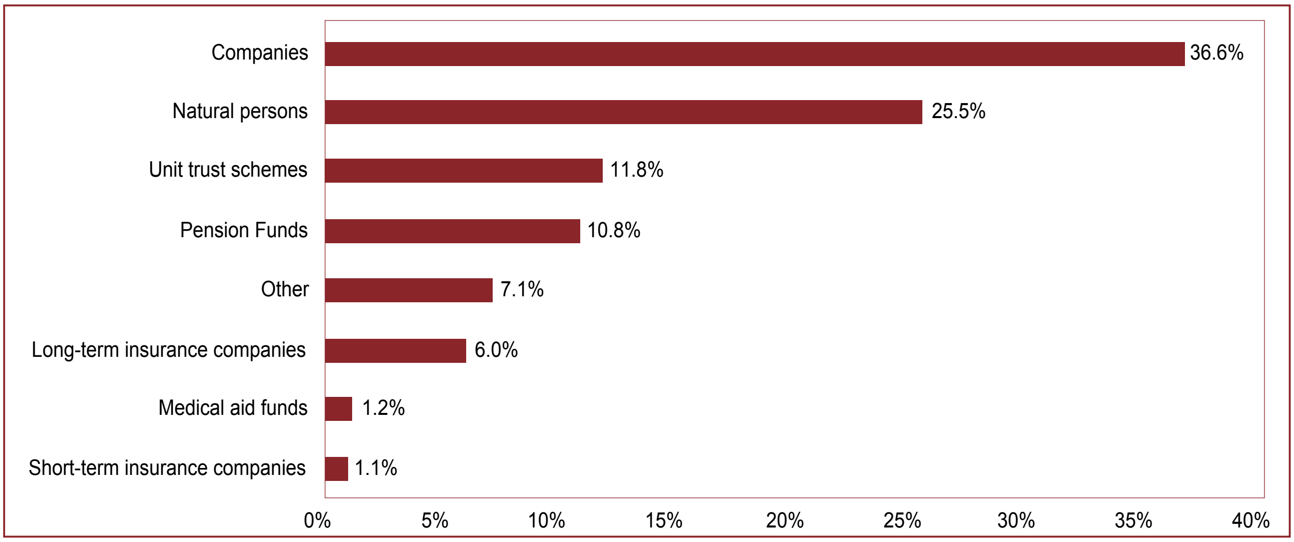
Collective Investment Schemes (CIS)

The unit trust schemes serves as a conduit between investors and financial markets. Total assets under management for CIS improved by 11 percent to N$70.0 billion at the end of December 2019, which is mainly exposed to money market instruments as demonstrated in Figure 31. Two thirds of CIS funds are sourced from households and companies which makes it a vulnerable funding base for banks (the main issuers of the money market instruments) given its discretionary nature (Figure 29). Hence, in the event of economic distress, it could potentially lead to liquidity constraints in the financial industry.

CIS is mainly funded by households and companies. The largest source of funds in the unit trust schemes is companies with a market share of 37 percent, followed by natural persons with a market share of 25 percent during the period under review (Figure 29). A total amount of N$12.2 billion of CIS' assets was invested in Namibian banks in the form of deposits during the period. Hence, CIS are considered an important but potentially volatile source of funding for banks due to the discretionary nature of the investments. As such given the over-reliance of banks on NBFIs for wholesale funding (about 75.0 percent of the top 10 depositors in the banking sector is sourced from NBFI's), the CIS exposure in particular should be managed carefully to prevent potential mismatch risk on the bank balance sheets.

Source of funds

Figure 29: Assets per investor as at 31 December 2019, percent of total

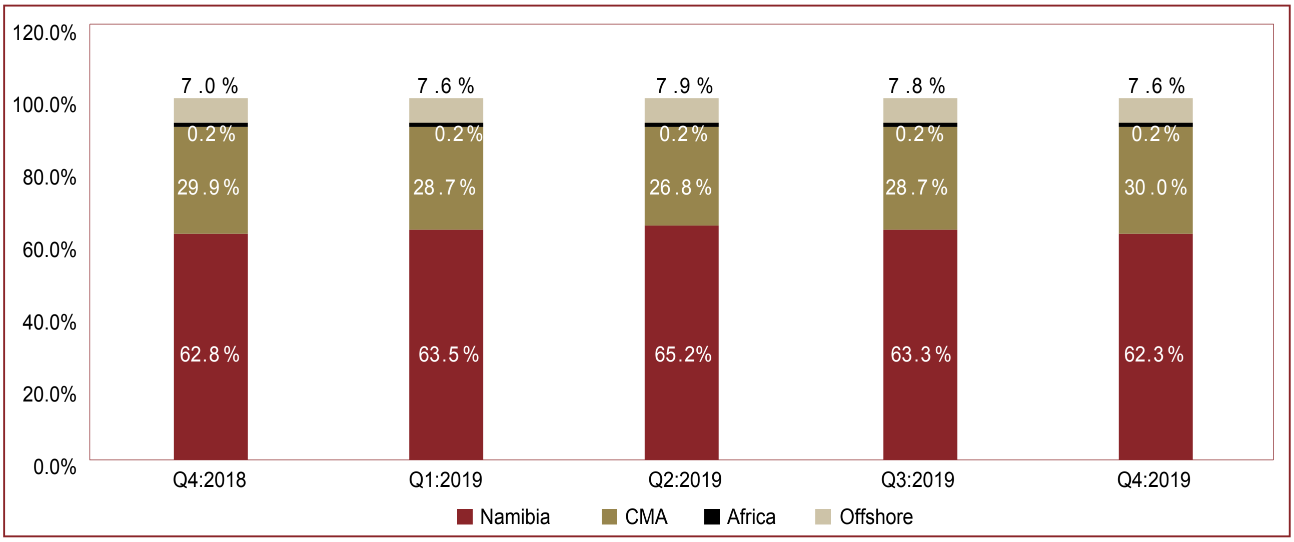


Source: NAMFISA

Geographic allocation of funds

The CIS industry continued to invest most of its assets domestically followed by CMA and African markets. In terms of geographical allocation of funds, 62.2 percent, 30 percent, 0.2 percent and 7.6 percent of the funds under management were invested in Namibia, the Common Monetary Area (CMA), Africa and Offshore respectively. This is compared to 62.8 percent, 29.9 percent, 0.2 percent and 7.0 percent in 2018, respectively (Figure 30).

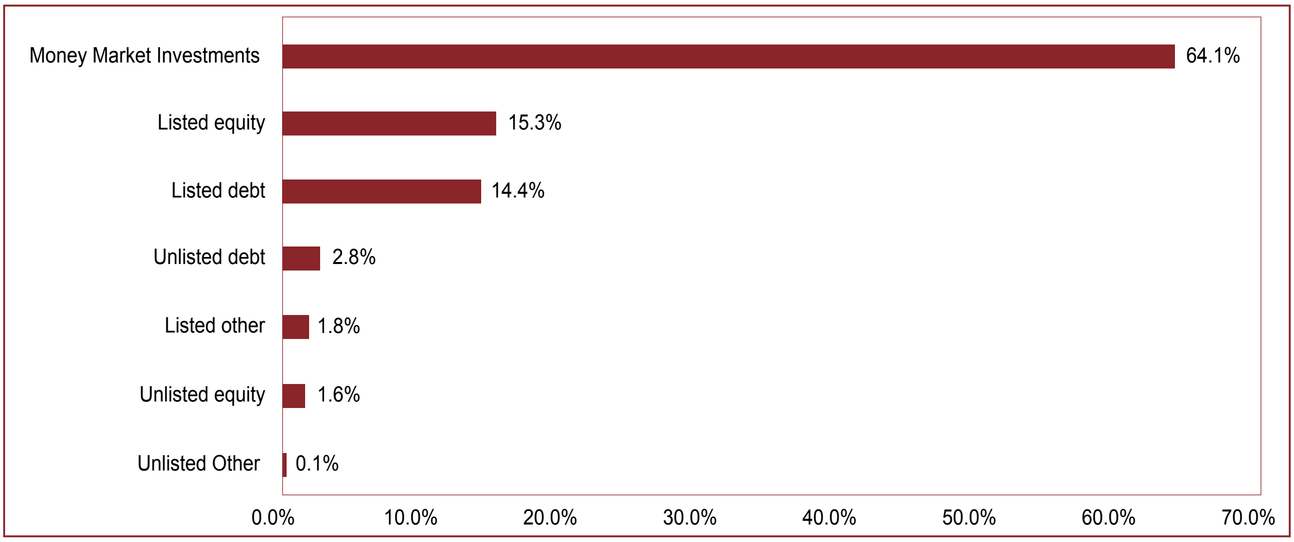
Figure 30: Assets per geographic allocation, as at 31 December 2019 percent of total



Source: NAMFISA

The preferred choice of asset class allocation is skewed towards the money market instruments followed by listed equities. Money market investments accounted for 64.1 percent of assets under management, while listed equities represented 15.3 percent as at 31 December 2019. The remaining 20.7 percent was spread among listed and unlisted debt, unlisted equity and other assets (Figure 31). The availability of instruments in the financial markets as well as investor's preference according to their needs and risk appetite influence choice of asset classes invested in.

Figure 31: Assets per class as at 31 December 2019, percent of total



Source: NAMFISA

Overall NBFIs Risk Assessment

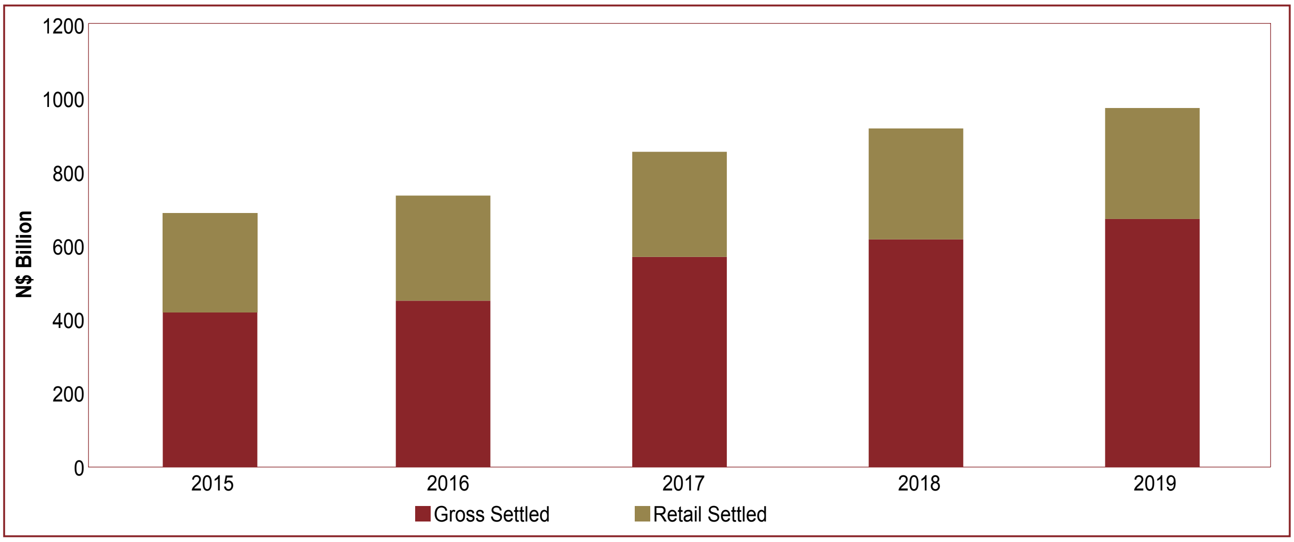
Overall, risks to financial stability remain contained, but there are many unknowns in the road ahead, as risks have been rising due to the recent developments related to COVID-19. The NBFIs sector remained financially sound and stable as their funding and solvency levels were above prudential levels. Robust performances in the financial markets led to strong asset growth and a sound solvency and funding position of insurance and pension funds, respectively, at the end of 2019. Recent events led by the COVID-19 pandemic, however, have led to a rise in market risks with potential impact on solvency and funding levels. The insurance industry, however, will be able to maintain solvency positions above the prudential requirement in line with their strong excess assets, but any prolonged lockdown might have a more severe and lasting impact on the business of insurance. Increased pressure will be on the pension funds, given that the industry funding levels were only slightly above the prudential limits. These will be further pressurised by lay-offs and unpaid leave of employees in some industries of the Namibian economy. Nonetheless, NAMFISA has started to engage the pension industry to ensure that pension fund funding levels remain above the prudential limits.

VII. PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

Operational risk and settlement risk remained relatively low within the National Payment System (NPS), although the total value of fraud increased across all payment streams. Payment systems are a crucial part of the financial infrastructure of a country. In Namibia, the regulatory mandate to oversee the NPS was accomplished through risk-based on-site and off-site oversight activities. Namclear as a designated Financial Market Infrastructure (FMI) was amongst the institutions for which an information security assessment was conducted. The assessment was conducted by the Bank of Namibia, with the assistance of an external assessor. Risks identified through oversight activities are being addressed.

During 2019, the Namibia Interbank Settlement System (NISS) observed an increase in settlement volume and value. The settlement volume during 2019 increased by 9.9 percent, to 66148 settlements, while the values of payments that settled in NISS increased by 7.1 percent from N$913.1 billion in 2018 to N$975.7 billion in 2019. The share of real-time gross settled transactions (typically high value) processed in NISS was 69.0 percent of the total value settled in NISS, whereas the retail payment systems[24] bulk settled was 31.0 percent of the total value settled in NISS (Figure 32).

Figure 32: Value of payments processed in NISS



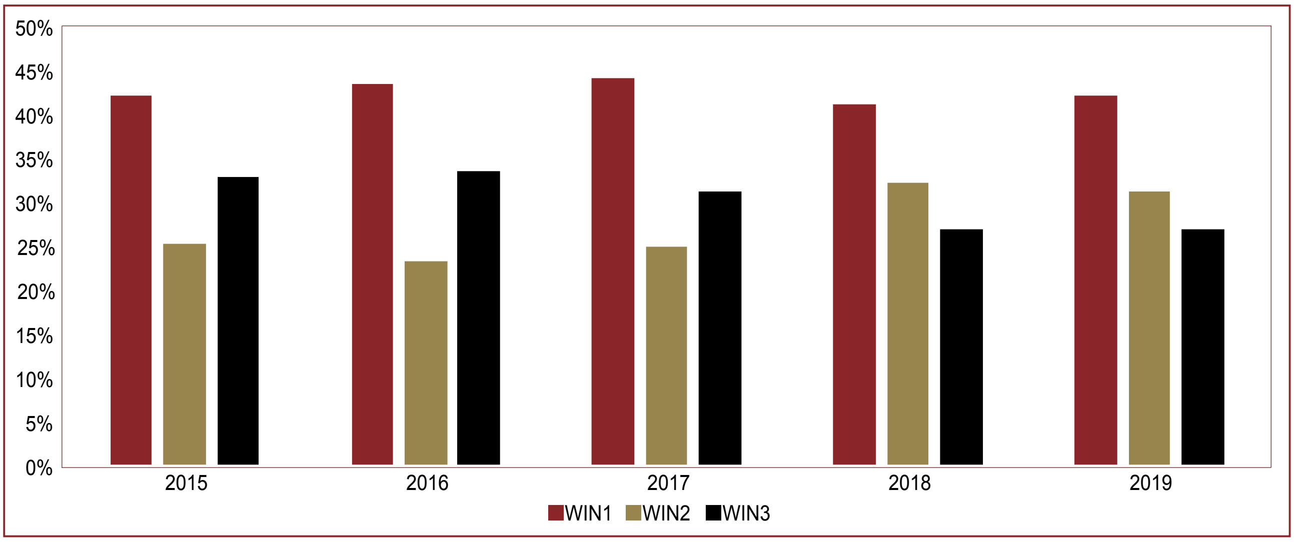
Source: Bank of Namibia

[24] The Electronic Funds Transfer (EFT), Cheque and Card Systems.

Settlement Windows

Similar to 2018, the proportion of payments settled in Window 3 remained constant at 27.0 percent. Settlement statistics in NISS during 2019 indicate that 42.0 percent of payments were settled in Window 1 (08h00 to 12h00); 31.0 percent was settled in Window 2 (12h00 to 15h00) and 27.0 percent was settled in Window 3 (15h00 to 16h40) (Figure 33). In order to curb operational and settlement risks, it is ideal that the majority of settlements take place in the earlier windows (i.e. Windows 1 and 2). During the period under review, 73.0 percent of payments were settled in Windows 1 and 2, which considerably assisted in mitigating operational and settlement risks.

Figure 33: Proportions of payments settled in each settlement window



Source: Bank of Namibia

Disruptions to the Namibia Interbank Settlement System (NISS)

The NISS maintained high system availability during 2019. The NISS front-end[25] availability ratio was 99.9 percent, thus the NISS achieving the target availability level. During 2019, one announced disaster recovery test was conducted for the NISS, which was unsuccessful because the 2-hour Recovery Time Objective (RTO) was not met. Furthermore, the Bank of Namibia conducted two Business Continuity Management (BCM) exercises on its most critical systems, including the NISS. All NISS related tests within the BCM exercises conducted during 2019 were successful.

Security of Retail Payments

When compared to 2018, the period under review recorded an increase in the total value of fraud perpetrated through the various payment streams. The industry recorded an increase of N$5.4 million in Electronic Funds Transfers (EFT) payments fraud from N$194 000 in 2018 to N$5.6

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

million in 2019. Card and cheque payments fraud decreased by 40.0 percent and 53.0 percent, respectively. The total value of fraud attributable to Cards decreased from N$5.2 million in 2018 to N$3.1 million during 2019. Similarly the total value of fraud owing to Cheque streams fell to N$320 000 in 2019 from N$677 000 during 2018. Despite the overall increase outlined above, the total fraud perpetrated within the NPS remained within the fraud safety index indicator of 0.05 percent as per the Bank's strategic goal, with an actual figure of 0.00089 percent. The payments industry continues to monitor risks emerging from fraud-based trends and continues to cooperate with enforcement agencies and consumer associations to prevent fraud perpetrated in the retail payment system. Furthermore, there have been significant efforts by the payments industry to enhance business practices, payments infrastructure and related products and services to improve data and customer protection against emerging fraud methods. Lastly, consumer awareness programs are ongoing and continue to assist in creating public awareness on fraud risks and prevention measures.

The Bank of Namibia continued to induce change by encouraging the adoption of safer means of processing payments by participants within the NPS. During the reporting period, the industry commissioned a project to implement a new security protocol for authenticating online (e-commerce) card payments known as 3D Secure. This protocol will enhance the safety of online payments processing by serving as an additional security layer for online credit and debit card transactions and will largely complement the already adopted Payment Card Industry Data Security Standards (PCI DSS) policies and procedures currently used for the protection of cardholders against the misuse of their personal information.

Impact of COVID-19 on the National Payment System (NPS)

The spread of COVID-19 has impacted the business operations of participants in the NPS. Given the State of Emergency and the national lockdown, all payment system participants and payment service providers have made arrangements to ensure business continuity, particularly from a service delivery perspective. Such arrangements included employees operating from home, assessments and prioritization of critical processes, working and providing services through digital means etc. Notably, COVID-19 and the resulting national directives impacted the day-to-day operations of the participants, and their ability to render their full suite of payment and related services, particularly in-branch payment services provided by banking institutions. Participants, both banking institutions and non-banks, have encouraged greater use of their digital channels to ensure continuity of services to their customers. In line with Bank of Namibia's request to the banking institutions, relief to customers was provided through a reduction in payment fees and charges on some of the products and services offered to customers.

The Bank of Namibia (BoN) has not detected any impact on payments infrastructure, as these platforms continue to function seamlessly. There has been no notable negative impact of COVID-19 on clearing and settlement services, as Namclear and the BoN as the operators of the clearinghouse and the RTGS respectively, have taken measures to ensure that disruptions are kept at a minimum. The BoN will continue to provide the requisite settlement services to ensure interbank settlement. Liquidity in the inter-bank settlement system also proved to be sufficient to-date, as no overnight credit was utilised by participants since the commencement of the national lockdown period. Despite this stability, there is a possibility that various payments industry projects may possibly be halted or delayed given the unique dynamics created by this global pandemic. The BoN is however managing this aspect jointly with the payments industry and provides the necessary guidance in respect thereof.

VIII. CONCLUDING REMARKS AND POLICY IMPLICATIONS

The financial system remained sound and resilient in 2019, despite unfavourable domestic and global economic conditions. Specifically, the banking as well as non-bank financial sectors continued to be liquid, profitable and well capitalised. Furthermore, the banking sector maintained liquidity levels well above the prudential requirement. Asset quality as measured by the incidence of non-performing loans deteriorated further in 2019, partly ascribed to unfavourable economic conditions and their concomitant impact on household disposable income and business performance but remained within acceptable limits. This deterioration in the asset quality however does not pose any immediate risk to banks as they are adequately capitalised to offset this risk. Both household and corporate debt increased moderately, however risks to the financial system remained modest. Despite the recessionary conditions, the NBFI sector remained financially stable and sound, but the positive performance of NBFIs could be dampened by the outbreak of the COVID-19 pandemic. Similarly, the payments system and infrastructure remained stable, while efficiently contributing towards safety and reliability in payments in order to facilitate financial stability in the country.

On the global front, financial conditions have tightened sharply since the onset of the COVID-19 pandemic, prompting Central Banks and fiscal authorities to adopt policy measures to deal with vulnerabilities. Uncertainties have increased significantly as exhibited by the decline in stock prices owing to investors' efforts to rebalance their portfolios and reduce risk by investing in safe, liquid assets, notably cash and treasury securities. The rapidly worsening risk sentiments across the globe has caused central banks to reduce policy rates, relax macroprudential requirements and adopt large-scale asset purchase programmes to support liquidity. Fiscal stimulus measures were also implemented to support the productive capacity of the economies amidst temporary shutdowns in many countries. Although such policy actions have stabilized investors' sentiment, there is still a risk of a further tightening in financial conditions that could expose financial vulnerabilities, particularly the outflow of capital from EMDEs. Going forward, accommodative monetary and fiscal policy measures will still be needed to safeguard economic and financial stability by ensuring credit flow to the economy, while minimising the impact of the temporary shutdown on economic activity.

With the outbreak of COVID19, risks to the Namibia financial system will be intrusively and strongly monitored. Since the last Financial Stability Report some of the risks identified in that report have became more prominent. Monetary and supervisory authorities in Namibia have since relaxed interest rates and prudential requirements to cushion the impact of the pandemic on the economy and financial stability. At the time of writing this report, the expected deterioration in financial stability arising from the COVID-19 pandemic was of paramount importance because of the potential impact to the cashflows of households and businesses. Going forward, such risks will be intensely monitored by the Financial Systems Stability Committee and the authorities will not hesitate to adopt further policy measures to preserve the stability of the financial system if warranted.

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