Bank of Namibia

Opening Remarks: "Old and New Challenges on Financial Stability and Development in MICs"

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1. **Thank you for the opportunity to provide some opening remarks to this important discussion, which focuses on financial stability and development issues facing MICs**. The invitation letter from the Director of the African Department, Ms Sayeh requested that I should speak about the old and new challenges facing MICs on financial stability and development matters. That alone is a big challenge and a wide topic!

2. **By way of background, the Bank of Namibia has been producing financial stability reports since 2008, which have progressively transited from an analysis focussed on financial soundness indicators to a more comprehensive one**. The new report in addition to the above indicators, it also include an assessment of additional systemic risks to the financial sector, covering the activities of banks and non-bank financial intermediaries. This approach has been compelled by the recent global financial crisis, which necessitated the policy makers to: (i) reassess the role that complex financial system structures play in achieving good economic outcomes, (ii) strengthen frameworks for maintaining systemic financial stability and developing crisis resolution mechanisms, and (iii) assesses emerging financial risks, including

financial engineering/innovation and moral hazard issues by risk-taking financial institutions.

3. **Through the years, the Bank of Namibia's assessment of the banks' financial soundness indicators has been upbeat, with local banks being liquid, solvent, and well capitalized**. This has been the result of our banks having strong and low-risk balance sheets in terms of their lending patterns, liquidity and risk conditions, and weak international links. Also, banking institutions in Namibia are mostly deposit funded, have low leverage, and are highly liquid, with moderate loan-to-deposit ratios. The banks have had limited exposure to high risk/exotic assets, as well as limited off-balance-sheet operations. In terms of international links, Namibian commercial banks have had limited reliance on foreign funding and limited integration with international capital markets. The requirement that Namibian deposits can only be used for acquiring Namibian assets also limit the scope for banks to venture outside the borders of Namibia.

4. **In a way, the traditional characteristics of Namibian commercial banks are possibly similar to those that could be found in other MICs**. For example, banks in Botswana, Cape Verde, and Mauritius have been traditionally very liquid banks, as measured by the share of banks' liquid assets in their total assets. What has been also notable is the quality of bank supervision, which has been improving among all African MICs, as international standards, such as Basel core principles are being implemented. The Bank of Namibia, together with other Bank Supervisors in the region, has additionally adopted practices set out by the Basel Committee regarding consolidated regulation.

5. As a result, the Bank has entered into MoUs with countries in which its banking system has links, namely South Africa, Zambia and Botswana. We also recognize that FSAPs reviews (Financial Stability Assessment Program reviews) have added further direction and helped shaped financial sector development programs.

6. **While the conditions in Namibia and in others MICs, have been generally favourable in terms of financial soundness indicators, the 2008 global financial crisis—and its protracted resolution, as attested by the European debt problem--raised a number of concerns/risks that warrant continuous monitoring going forward**. Indeed, there has been a slowdown in trade flows and economic growth, as most African economies are highly export-dependent. Some export sectors are still recovering after being badly hit due to weak demand/prices and/or reduced access to trade financing. Also, banking sector vulnerability has increased due to sectoral loan concentration encountered in some MICs.

7. Further, a weakened household sector (due to below-trend economic growth or income) has led to enhanced credit risk given the local financial sector's exposure to the real estate market development. In some cases, household income may have also suffered from a slowdown in workers' remittances, which is a major contributor to foreign exchange earnings and household income in many African countries, such as Cape Verde, Lesotho and Swaziland.

8. **Changing regulatory regimes in the aftermath of the 2008 global financial crisis will also pose new challenges to the local banking industry going forward**. On the one hand, the review of Basel principles (Basel III) and its reported financial costs from implementation; on-going discussions about countercyclical capital requirements (including problems in calibrating/identifying turning points); and the emphasis on risk-based banking supervision (rather than compliance, alone) as well as stress testing pose major challenges for African banks and regulators. On the other hand, African regulators need to address a number of issues including, notably, surveillance and development of early warning indicators of financial stress; more thorough assessments of households' and corporates' balance sheets, indebtedness, and vulnerabilities; development of contingency plans and bank resolution mechanisms; fragmentation of regulatory and supervisory framework (focus should be on banks and non-bank financial institutions); and mapping of financial sector inter-linkages. In all cases, the enhanced work

agenda demands high-frequency and timely data for analysis and policy decision.

9. **The economic realities unfolding from the on-going crisis in industrialized economies and the regulatory challenges emerging in the aftermath of the 2008 global financial crisis will need to be *balanced against* some pending financial structural reform agenda in African MICs**. In particular, financial inclusion is an economic and political objective across MICs, as it is view as a supporting instrument to increase income, employment, and entrepreneurial opportunities. The relative size of the unbanked populations in MICs is telling, and more could be done in this area as a way to support business initiatives and encourage savings among the population.

10. In this regard, let me note that the Namibia Financial Sector Strategy (NFSS) was launched by the government in mid-August 2012.Highlights to date regarding the Strategy's implementation include, among others, the introduction of a Basic Bank Account in Namibia (intended for individuals earning N$2000 per month or less --US$210 dollars—with no monthly fees charged by banks on these accounts), the issuance of regulations on electronic money, and many other initiatives aimed at promoting the financial inclusion agenda.

11. **Striking the balance between financial inclusion and financial stability is particularly prominent in Namibia, which suffers from one of the most uneven distributions of income in the world**, as measured by a Gini-coefficient of 0.60. While Namibia's inequality is extreme, such inequality is, however, not uncommon in many MICs, with, in many instances, inequality increasing as countries become more wealthy, before levelling-off when countries reach high-income status. This income inequality factor presents development-related challenges in MICs, not least in the fiscal and monetary policy making. Technical activities such as the setting of interest rates, for

example, require careful consideration so as to avoid regressive practices with excessively negative impacts on the poorer sectors of society.

Another emerging tension point between financial stability and financial inclusion has to do with the rapid growth of commercial banks' real estate credit and the sharp hike of property prices observed in Namibia and other African MICs in recent years. The rapid growth in banking sector credit, in general, and real estate credit, in particular, is not singular to African MICs, but it is, in fact, an emerging commonality across emerging market economies that responded to the spill-over effects from the global financial crisis through accommodative monetary policies.

12. The reduction in interest rates coincided with further increased household indebtedness and households' debt servicing costs, which in the case of Namibia are both significantly high by international standards. As households gain access to first-time housing ownership and build their wealth in a context of historically low interest rates, property prices increased significantly across-the-board, thus having a regressive impact on the population, unfortunately.

13. **It is against this heightened risk of elevated household indebtedness and commercial banks' significant exposure to the real estate market that the Bank of Namibia has put in place a number of macro-prudential measures to ensure financial stability**. In particular, banking institutions are required to conduct regular stress testing on the impact of possible interest rate shocks on the banks' performance. Also, the Bank of Namibia applies a 50% risk-weight to residential mortgage loans to ensure that banking institutions have an adequate capital buffer to absorb possible losses from this type of loans. At the same time, the Bank is conducting a study on the use of the loan-to-value ratio for second properties to contain household leverage, without constraining access to first properties. Going forward, however, an emerging challenge for the Bank of Namibia would be to ensure that the referred macro-prudential policies do not unduly limit access to housing to first-time house owners—many of them, part of an emerging middle class in Namibia—which have been traditionally "asset poor" and need

to build up their wealth to access the regular circuits of financial intermediation and economic growth and inclusion.

14. **In conclusion**, banking systems in Namibia and other African MICs have been resilient to the impact of the global financial crisis thanks to their initial conditions of liquidity, solvency, and strong capital positions. Old efforts by market players and vigilance by Regulators appear to have paid off. New challenges remain, however: Banks need to be vigilant with regards to risks—especially elevated levels of household indebtedness at historically low interest rates—and respond to new supervisory demands.

15. Regulators need to swiftly transit to risk-based banking supervision, improve surveillance schemes and human capital, and improve contingency planning and supervisory cooperation--to address regulatory gaps and supervisory inconsistencies within/across countries-- while governments pursue long term reforms, such as financial inclusion.

16. I trust that the IMF, through is regular Article IV consultation and technical assistance missions, will continue to support African MICs as they address the financial sector challenges sketch in this presentation.

Thank you