Namibia Financial Stability Report

April 2022

Bank of Namibia

NAMFISA

NAMIBIA FINANCIAL INSTITUTIONS SUPERVISORY AUTHORITY

Bank of Namibia

NAMFISA

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CORPORATE CHARTERS

Bank of Namibia

Vision
To be a leading central bank committed to a prosperous Namibia.

Mission
To support sustainable economic development through effective monetary policy and an inclusive and stable financial system for the benefit of all Namibians.

Values
Act with integrity
Lead through innovation
We care
Open engagement
Performance excellence
Embrace diversity

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 passionately serve
We value integrity
We drive performance
We are accountable
We are agile

LIST OF ABBREVIATIONS

AACB	Association of African Central Banks
BoN	Bank of Namibia
CAR	capital adequacy ratio
CIS	collective investment scheme
COVID-19	coronavirus disease 2019
DSIB	domestic systemically important bank
EFT	electronic fund transfer
FinTech	financial technology
FSR	Financial Stability Report
FSB	Financial Stability Board
FSSC	Financial System Stability Committee
GDP	gross domestic product
IMF	International Monetary Fund
LTI	long-term insurance
MPC	Monetary Policy Committee
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFI	non-bank financial institution
NISS	Namibia Inter-bank Settlement System
NPL	non-performing loan
NPS	National Payment System
Q	quarter
repo (rate)	repurchase (rate)
RF	retirement fund
RTGS	real-time gross settlement
RWCR	risk-weighted capital ratio
SADC	Southern African Development Community
SARB	South African Reserve Bank
SOE	State-owned enterprise
WEO	World Economic Outlook
US	United States of America
ZAR	South African Rand

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PREFACE

The purpose of any financial stability report is to identify risks and vulnerabilities in the financial system, assess the system's resilience to domestic and external shocks, and present recommended policy responses to the risks identified. Thus, such reports inform interested parties about the soundness of the financial system and about actions being taken by the country's regulators and government to mitigate the identified risks. In this role, a financial stability report functions as a communication tool as well.

Financial system stability is defined as the resilience of, for example, a domestic financial system to internal and external shocks, be they economic, financial, political or otherwise. Financial system stability can also be described as the absence of significant macroeconomic disruptions in the system of financial transactions 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. Chapter 6 of the Bank of Namibia Act, 2020 (No. 1 of 2020) gives Namibia's central bank the explicit mandate of macroprudential oversight and of coordinating activities to safeguard financial stability in the country. The main functions of the MOC1 include consulting with NAMFISA and MOF to ensure policies are in place to manage financial stability and foresee crisis that could impact the entire financial system. The stability of Namibia's financial system is critical, as it provides important services to households, corporates, and the real economy.

The contents of financial stability reports are reviewed and, if found satisfactory, are approved by the Financial System Stability Committee. This Committee was established to monitor risks affecting the financial system and to provide advice and make recommendations to the Bank of Namibia. The Committee also acts as a liaison between the Ministry of Finance, the Namibia Financial Institutions Supervisory Authority and the Bank of Namibia on matters related to Namibia's financial stability.

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[1] Specific functions of the MOC include to Issue directives after consultation with NAMFISA, regarding macroprudential matters on behalf of the Bank; Co-ordinate activities involved in safeguarding of financial stability and ensure compliance with the directives; Carry out periodic assessments of the financial system in order to identify and manage systemic risk to financial stability; Manage the event of a system-wide financial crisis jointly with the Minister of Finance and NAMFISA with the aim of stabilising and restoring confidence in the financial system; Provide for regular briefing by the Bank of Namibia to 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 to recommend the action to be taken.

1. EXECUTIVE SUMMARY

Overall, the financial system continued to withstand the shocks from the impact of the global health crisis. Both the Global and Namibian economies are estimated to recover from the initial shock of the pandemic during 2021, albeit at a slower pace than initially anticipated. Financial markets remained resilient and continued to be profitable on the back of very accommodative monetary and fiscal policy during the period under review. Asset quality in the banking sector deteriorated beyond the crisis trigger point of 6.0 percent, although the liquidity and solvency ratios of the sector remained above the prudential requirements. Stress tests show vulnerabilities in liquidity but considering the relaxed liquidity requirements plus no significant withdrawals in Collective investment Schemes recorded, this risk is well managed by the regulators. Similarly, Non-Bank Financial Institutions (NBFIs) remained profitable and solvent during the period and the payment system infrastructure continued to operate efficiently. Going forward, risks are centred around the military conflict between Russia and Ukraine, supply chain disruptions and the continued management of the COVID-19 pandemic.

Global growth prospects weakened on the back of military conflict, geopolitical tensions, supply chain challenges, rising cost pressures, and the withdrawal of monetary accommodation. Based on the IMF World Economic Outlook for April 2022, global real gross domestic product (GDP) was estimated to have expanded by 6.1 percent in 2021 and was expected to improve by another 3.6 percent in 2022. However, the IMF's latest forecast for 2022 was notably weaker than previous projections as Russia's invasion of Ukraine led to significant disruptions to supply and trade, exacerbating global inflationary pressures in the process. In addition, the ongoing retrenchment in China's real estate sector and a rise in its coronavirus disease 2019 (COVID-19) cases were expected to limit growth prospects further. Moving forward, the risks to the global outlook are centred largely on the evolution of geopolitical tensions and military conflict in Eastern Europe, as well as the world's ability to contain the spread of the COVID-19 pandemic.

Domestic economic performance should improve in 2022 and 2023, following marginal growth in 2021. According to the Namibia Statistics Agency March 2022 national accounts, real GDP growth for Namibia, was estimated at 2.4 percent for 2021 from a deep contraction of 7.9 in 2020. As published by the Bank of Namibia February economic outlook, this growth is expected to accelerate to 3.4 percent in 2022 and to 3.7 percent in 2023. These projected improvements are expected to be broad-based, with robust growth rates across all industries, but particularly in the diamond mining and manufacturing sectors. As with the global economy, risks to domestic growth were dominated by health outcomes related to the COVID-19 pandemic, rising energy and food prices following Russia's invasion of Ukraine, and lower domestic rainfall, which could impact agricultural production adversely.

The level of household indebtedness decreased during the reporting period, with the level of corporate debt stock increasing at the same time. The ratio of household debt to disposable income stood at 77.4 percent at the end of December 2021, compared with 87.7 percent for the previous reporting year end. The drop was driven by a steeper rise in disposable income in relation to household debt. Disposable income had grown by 15.64 percent by the end of December 2021 compared with the prior reporting year, boosted by policy relief measures as well as fiscal spending to support households impacted by COVID-19. Meanwhile, the overall demand for household debt remained subdued, growing at a relatively slow pace of 2.1 percent at the end of 2021 compared with the 4.5 percent reflected in 2020, being driven largely by the *Other loans and advances category. On the other hand, total debt stock expanded in 2021* due to increases in both foreign and domestic debt. The corporate sector's debt-to-GDP ratio had increased to 89.5 percent by the end of 2021, up from the 87.4 percent recorded for the end of 2020. The ratio of debt servicing to disposable income rose by 8.2 percent to reach 17.2 percent at the end of 2021, mostly driven by greater servicing of foreign debt. The short-term risks to financial stability in respect of household and corporate debt appear limited, although continued borrowing to support business operations or household cash flow could pose medium-term risks, especially if incomes are not elevated at the same rate. Notwithstanding the current fluid economic environment, the probability of debt risks materialising is medium with a low impact in terms of household debt, and medium for corporate debt.

The banking sector remained liquid, profitable and well capitalised during 2021, despite sluggish economic conditions. Growth in total banking sector assets remained positive, with liquid assets well in excess of the statutory minimum liquid assets requirement of 10.0 percent of monthly average liabilities to the public. The banking sector was profitable during the period under review, despite unfavourable economic conditions, while also maintaining capital levels above the prudential requirements. Although asset quality - as measured by the non-performing loans ratio to total loans - improved marginally, it remained above the 6.0 percent crisis time supervisory intervention trigger point. Nonetheless, the banking sector was able to manage its credit risks owing to adequate provisions for delinquent loan losses coupled with low write-offs relative to total loans and profits as well as a host of relief measures, that supported the banking sector in managing its credit risks. Overall, risks to the banking sector did not appear significant in 2021, therefore posing no real threat to financial stability in Namibia. However, asset quality requires continuous monitoring as well as intervention if and when needed. Going forward, credit risks to the banking sector may increase in 2022 on the back of potential interest rate hikes, inflationary pressures and slower-than-expected economic recovery.

By and large, the Non-Bank Financial Institutions (NBFI's) sector remained resilient during 2021, withstanding the effects of COVID-19, rising inflation, and the interest rate hikes in various jurisdictions. Total NBFI assets grew by 13.9 percent to N$370.6 billion during 2021. This growth was attributable to new business, the performance of financial markets, and increased economic activity as a result of the economic recovery during the period under review. The NBFI sector therefore remained stable and resilient, with funding and/or solvency positions recorded above prudential requirements in 2021. The sector is expected to remain sound in 2022.

Since the 2021 Financial Stability Report (FSR), Namibia's payment system and infrastructure remained stable and continued to operate efficiently and effectively. The Bank of Namibia (BoN) continued to fulfil its regulatory mandate as the overseer of the National Payment System in line with the Payment System Management Act, 2003 (No. 18 of 2003, as amended). Operational and settlement risks remained relatively low compared with those recorded in the 2021 FSR, with 77.0 percent of transactions settled within the first and second windows during 2021. The Namibia Inter-bank Settlement System (NISS) continued to maintain high system availability throughout 2021. The NISS also recorded a settlement milestone of N$1.0 trillion during the reporting year. The same period saw the BoN finalise the Interchange Determination Project, which revised existing interchange rates for interbank card transactions. Other highlights included the BoN's development of a Financial Technology (FinTech) Regulatory Framework and its participation in the Continental Payments Integration Project to interlink regional payment systems on the African continent. As part of the BoN's efforts to address the changing payment landscape, the institution also began addressing the complete revision of the Payment System Management Act. Given these developments and despite a slight increase in the value of fraud transactions during the period under review, risks to financial stability from national payment system remained relatively low.

2. SUMMARY OF RISK ANALYSIS

This section presents a brief analysis of the main risks to the stability of the domestic financial system. Consistent with Chapters 3 to 7 of this Report, the analysis identifies risks arising from the external macroeconomic environment, trends in household and corporate debt, and trends in the financial soundness indicators for domestic banking institutions and NBFIs, before concluding with an analysis of the payment and settlement system. The risks are analysed and rated from low to high, based on their probability of occurrence as well as their potential impact on financial stability in Namibia, should they be realised. This Report considers risks since the 2021 FSR. Table 1 summarises the Financial System Stability Committee (FSSC) risk position, which shows the direction of risks since the 2021 FSR and the probability of said risks materialising. Figure 1 considers the same risks but shows whether risks have increased or decreased overall during the review period.

Table 1: Risks to financial stability in Namibia

Nature of risk	Direction of risk[2] since April 2021	Probability of risk materialising in 2022	Impact of risk materialising in 2022
Macroeconomic environment events/risks			
Global economic slowdown	Up		
Domestic economy slowdown	Up		
Decline in international reserves	Down		
Domestic Debt: Namibia	Up		
Sovereign credit rating downgrade: Namibia	Up		
Sovereign credit rating downgrade: South Africa	Down		
Namibia Dollar/South African Rand volatility	Down		
Household debt risks			
Increase in household debt	Unchanged		
Corporate debt risks			
Increase in corporate debt	Unchanged		
Banking sector risks			
Liquidity risk	Down		
Credit risk	Down		
Payment system risks			
Security of retail payments	Up		
Settlement in last window	Unchanged		
NBFI risks			
Funding position	Unchanged		
Cash flow risk	Up		
Market risk	Unchanged		
Solvency position	Up		

Keys	Low	Medium	High

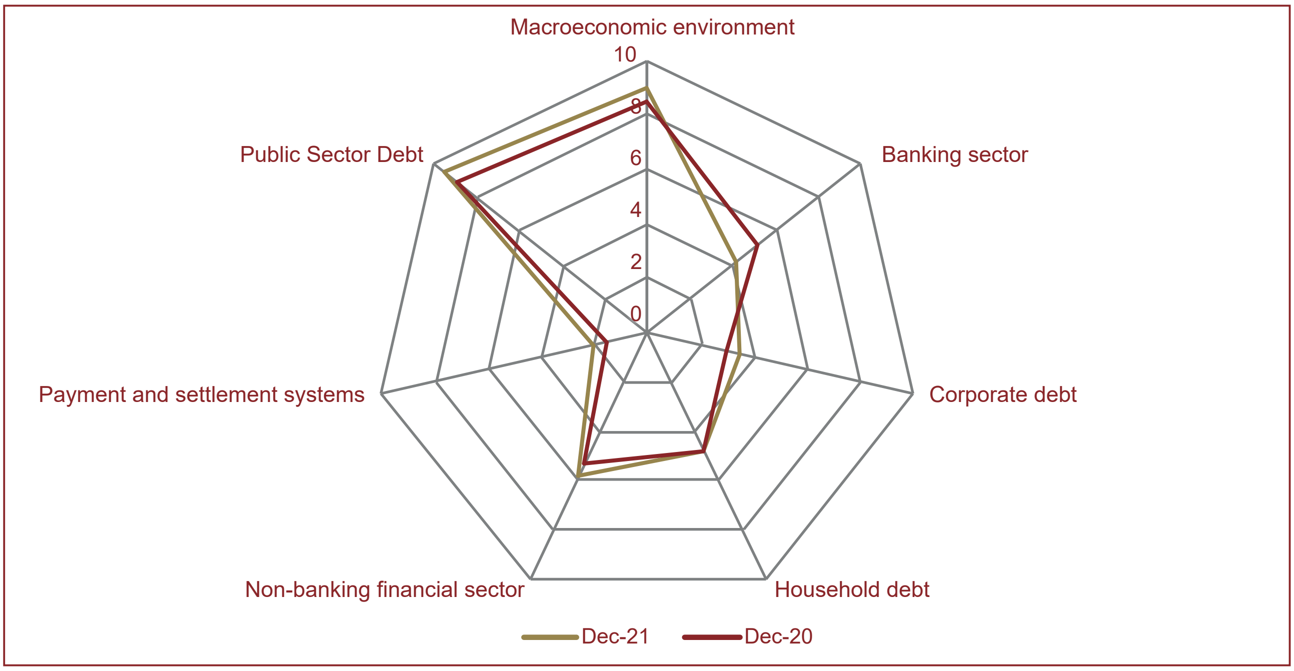
[2] Compared with the 2021 FSR.

Although risks to the growth outlook and Namibian sovereign credit have increased since the 2021 FSR, risks related to the domestic currency and international reserves appear to have moderated. Risks to financial stability emanating from a slowdown in global and domestic growth increased from the beginning of 2021, reflecting a worsening of supply shortages and cost pressures, with the potential impact assessed as medium. Sovereign credit risks in Namibia have also increased following a notable rise in the Namibian debt to GDP ratio during the 2021/2 fiscal year, while conversely this risk has moderated in South Africa as fiscal revenues exceeded expectations over the same period. The South African Rand has exhibited a reduction in volatility relative to the 2021 FSR, benefitting largely from the improvement in the perception surrounding South African sovereign credit risk highlighted above. There has also been a moderation in risks related to a decline in international reserves, given the capital inflows recorded during 2021 and current reserves levels being close to a record high. These reserves are expected to be enough to maintain the currency peg between the Namibia Dollar and the South African Rand comfortably.

Banking sector risks declined during the period under review, while the risks in the NBFI sector increased slightly. Given exceptional liquidity performance in 2021, the probability of liquidity risks materialising in the banking sector during 2022 was assessed as medium with medium impact. The probability of asset quality deteriorating, as indicated by the NPL ratio, is medium with medium impact. The latter probability can be traced to improved asset quality overall as well as to banks remaining profitable with sufficient provisions and buffers to cushion against potential risks. The banking sector was generally sound, with both capital and liquidity levels well above prudential requirements; however, going forward, credit risk needs to be monitored intensively given the potential impact of global events and geopolitical tensions. Cash flow risk to the retirement fund subsector remains a concern, as indicated by the widening shortfall between benefits paid and contributions received. However, this risk is unlikely to materialise as other income within the subsector is more than sufficient to absorb the related shortfall, and due to the long-term nature of the industry. Risks to the payment systems remained broadly unchanged since the previous reporting period, although settlement risks increased slightly due to rising fraud during 2021. Risks to the financial system in respect of household and corporate debt also hardly changed since the 2021 FSR. In this regard, the financial system appeared sound overall, and the risks identified continue to be monitored to ensure they impact minimally on the financial system if they materialise.

Overall trends in the risks to financial stability remained largely stable, despite tilting upwards. The risks associated with the banking sector decreased due to the positive impact of regulatory support during the reporting period, while risks to the NBFI sector rose marginally due to the enactment of the FIM Act which places more stringent and risk based solvency requirements on long term insurance companies. By contrast, the risks associated with the macroeconomic environment, domestic economy and payment systems grew in comparison with the 2021 FSR. The rise in macroeconomic and payment systems risks was due mostly to worsening supply shortages around the globe which affected the domestic economy, as well as a rise in fraud transactions in the domestic payment system.

Figure 1: Domestic financial stability risks map

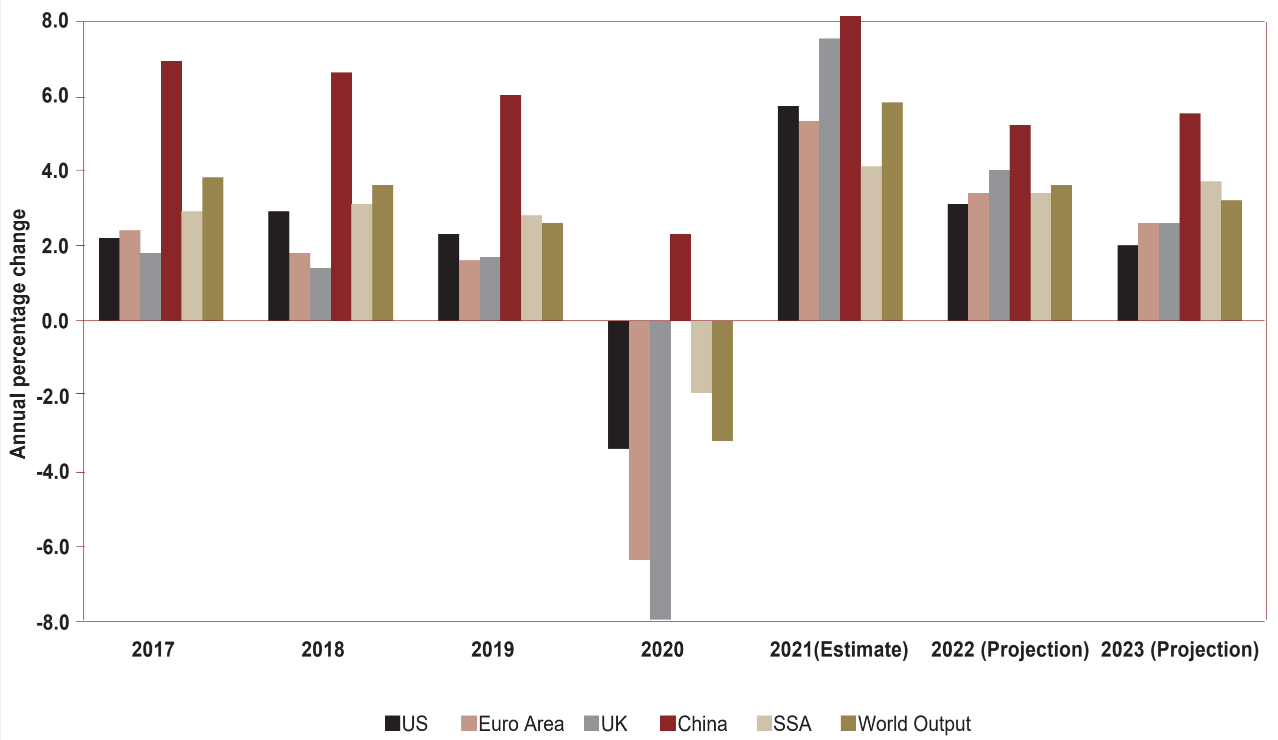


Note: The further from the web centre, the greater the risk.

3. MACROECONOMIC ENVIRONMENT

Following a sharp rebound in 2021, global growth is expected to moderate in 2022 and 2023. According to the IMF WEO for April 2022, global growth was projected to moderate from an estimated 6.1 percent in 2021 to 3.6 percent in 2022 (Figure 2). The latest projection for 2022 (conducted in April) was downgraded considerably compared with previous forecasts, reflecting worsening global supply shortages, a quicker withdrawal of monetary accommodation across most economies, and lower-than-anticipated fiscal support in the United States (US).[3] Disruptions to supply and trade were exacerbated by Russia's invasion of Ukraine in February 2022 and will likely dampen growth through higher inflation. In addition, the global outlook was negatively impacted by pandemic-induced disruptions related to China's "Zero COVID-19" policy, coupled with protracted financial stress among property developers in that economy. Global growth is expected to remain constant at 3.6 percent in 2023, representing a downward revision of 0.2 percentage point from the IMF WEO Update in January 2022.

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



Source: IMF WEO, April 2022

Risks to the global outlook remained skewed to the downside. Further deterioration in supply shortages and commodity price volatility emerged as the main threat to the global economy's prospects, given that de-anchoring of inflation expectations would force central banks to raise interest

[3] According to the IMF WEO April 2022 Global Economic Outlook, the global growth forecast was revised downward by 0.8 percent relative to its January 2022 counterpart.

rates at a much faster pace. From a financial stability standpoint, a sharp rise in interest rates would pose serious concerns for fiscal sustainability across emerging market and developing economies (EMDEs), given the large increase in debt over the past two years. Additionally, geopolitical tensions worsened dramatically in Russia and Ukraine in recent months, culminating in military conflict; this situation will likely exacerbate inflationary pressure since the world relies heavily on oil and grain production from these two countries.

DEVELOPMENTS IN FINANCIAL MARKETS

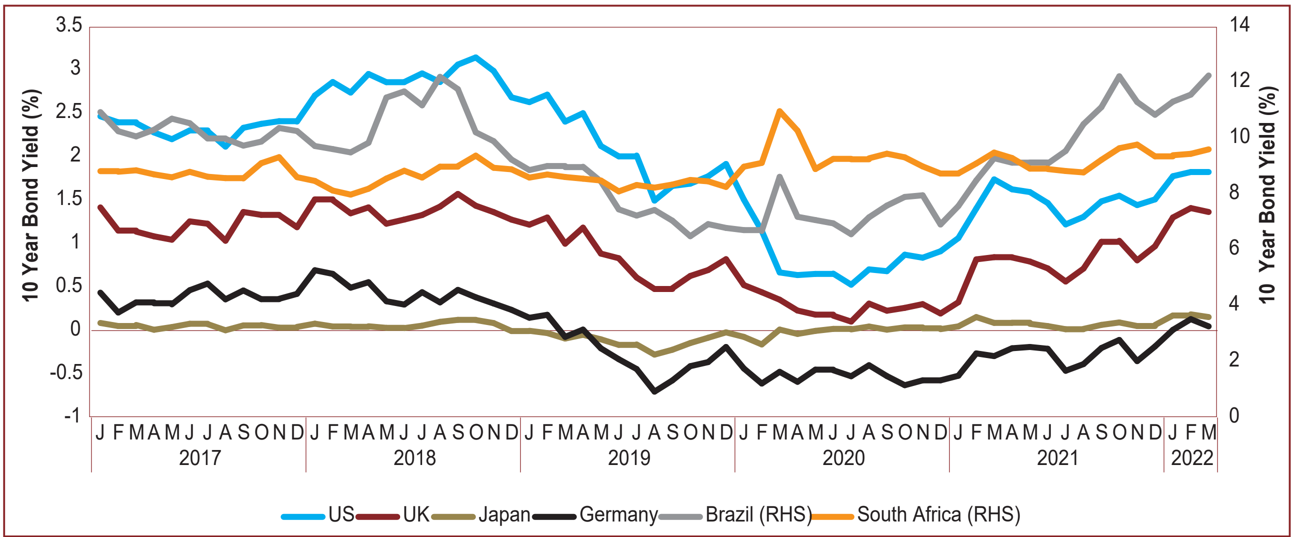
Although global financial conditions continued to be accommodative by historical standards, substantial tightening occurred in recent months. Financial conditions generally reflect the availability of liquidity in global markets and tend to be monitored closely by central banks given its perceived correlation with future growth. The recent market fallout stemming from Russia's invasion of Ukraine led to a sharp deterioration in these conditions, which are currently at their tightest level in two years – even though such levels remained low in advanced economies by historical standards. Although the normalisation of global interest rates from an ultra-accommodative level was welcomed in respect of financial stability, the pace at which the current tightening was proceeding posed some concern, given its implications on the spending, saving and investment decisions by households and businesses (Figure 3).

Figure 3: Bloomberg Financial Conditions Index – Advanced economies

Source: Bloomberg

Global bond yields rose over the course of 2021 as the threat of inflation and monetary tightening gathered pace. Fixed income markets were characterised by considerable levels of volatility in 2021, driven by rising inflation, a slowdown in the economic recovery, and revisions to the expected path of monetary policy. The US yield curve steepened during the reporting year, with the ten-year benchmark yield rising by 0.6 percentage point (Figure 4). Short-dated yields rose modestly over the same period, although yield increases at the short end of the curve are expected to be much more profound in 2022, considering the shift by most major central banks to more hawkish policy stances.

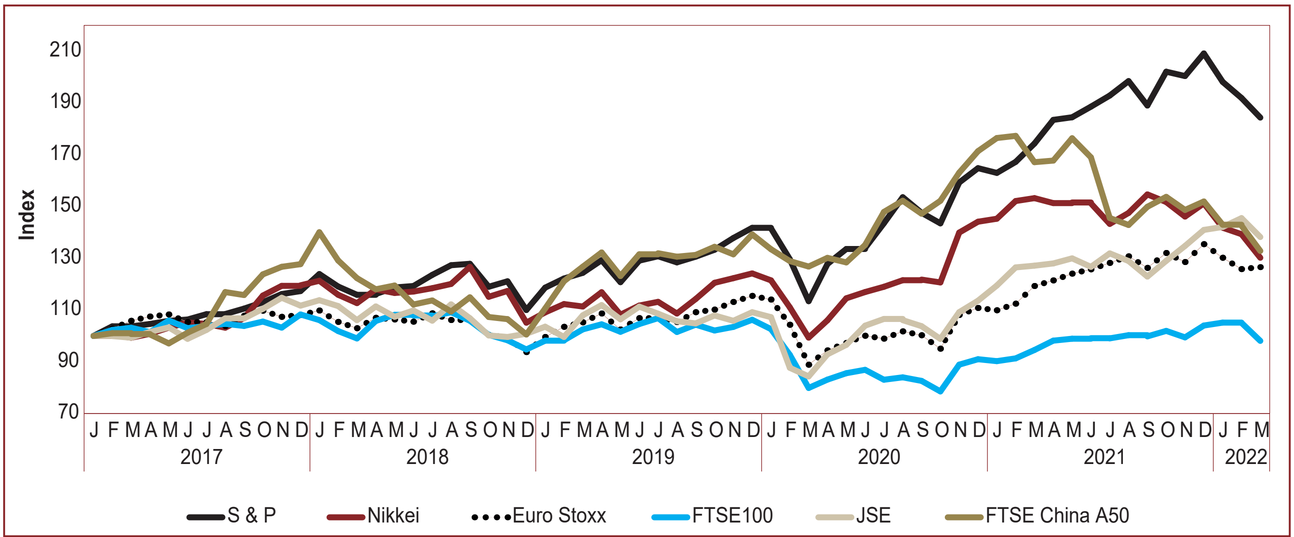
Figure 4: Ten-year bond yields in selected countries



RHS = right-hand side
Source: Bloomberg

Despite widespread uncertainty across global financial markets, major stock market indices rose over the course of 2021. Although markets experienced substantial volatility in 2021 due to labour shortages, supply chain woes and rising inflation, most major stock market indices managed to finish the year in positive territory. The Standard & Poor (S&P) 500 Index generated a return of 28.7 percent in 2021, supported by several positive developments on health outcomes related to the pandemic, strong corporate earnings, and increased consumer demand in the US (Figure 5). Similarly, European and UK stocks performed strongly during 2021, with annual returns of 23.2 and 15.2 percent, respectively, benefitting from attractive valuations as well as monetary and fiscal support in these economies. Chinese equities lagged behind other major markets (which can be measured by the 13.9 percent decline in the Financial Times Stock Exchange/FTSE China A50 Index during 2021), following a widespread crackdown on large-cap Chinese stocks by regulators, together with negative sentiment regarding corporate defaults by Chinese property developers. Domestically, the strong performance across global markets ensured that the balance sheets of Namibian asset managers remained sound and well capitalised. However, the war in Ukraine caused setbacks to most share markets during the first quarter of 2022, which offset some of the gains achieved in 2021.

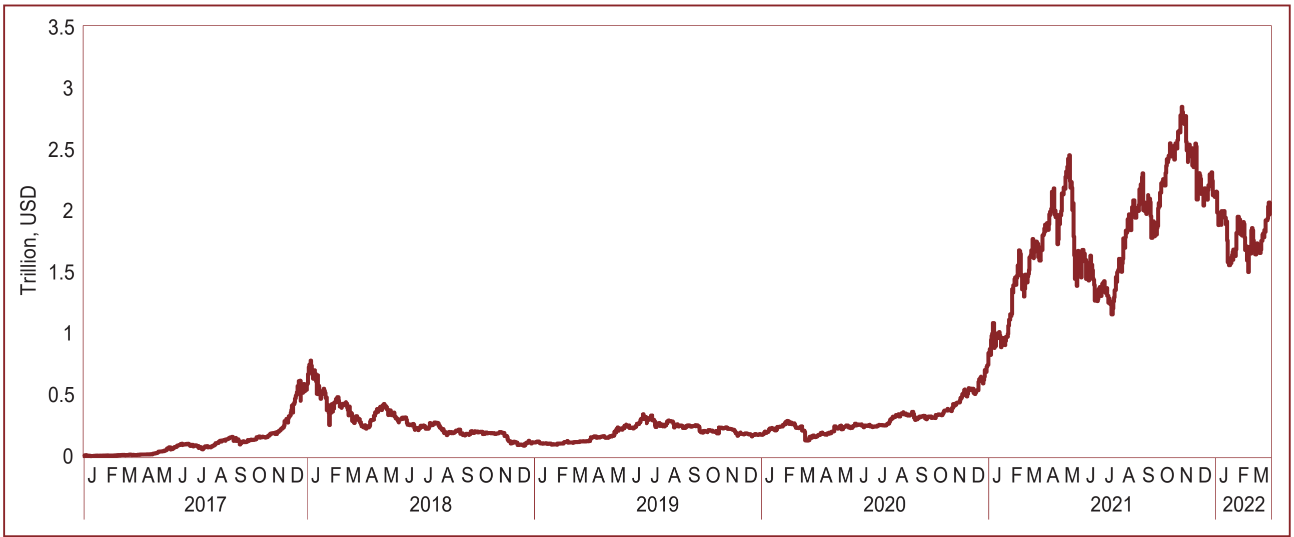
Figure 5: Stock price indies



Source: Bloomberg

Although risks emanating from cryptocurrency assets rose sharply during 2021, their potential impact on the broader financial system remains limited (Figure 6). According to an assessment conducted by the Financial Stability Board (FSB) in February 2022, Cryptocurrency assets are fast evolving and could reach a point where they represent a threat to global financial stability due to their structural vulnerabilities and increasing interconnectedness with the traditional financial system. The market capitalisation of total cryptocurrency assets grew by 3.5 times in 2021 to a value of US$2.6 trillion, driven mainly by increased market speculation as well as greater adoption of alternative assets within the cryptocurrency industry. Although the interconnectedness between the cryptocurrency industry and systemically important financial institutions has risen in recent years, these linkages still appear to be limited at present. This is mainly because cryptocurrency assets constitute a small portion of overall global financial system assets and are not widely used in critical financial services (such as payments) on which the global real economy depends. However, it is challenging to assess the true extent of risks emanating from this industry, given its rapid evolution as well as the fact that its products and market participants typically fall outside of regulatory frameworks.

Figure 6: Total market capitalisation – Cryptocurrency market



Source: CoinMarketCap

DOMESTIC ECONOMY

Output and outlook

The Namibian economy is expected to have experienced positive growth in 2021, though at a much slower pace than the global economy. According to the NSA March 2022 National Accounts, real GDP growth was estimated at 2.4 percent for 2021, resulting mainly from recoveries in the production of *Diamonds and uranium coupled with improvements in sectors such as Retail trade, Hotels and restaurants, and Information and communication.* Domestic economic growth is projected to pick up to 3.4 percent in 2022 and 3.7 percent in 2023, driven by broad-based recovery across all sectors – particularly via improvements in diamond mining operations and manufacturing-related industries.

Risks to domestic growth continue to be focused on pandemic-related outcomes, inflationary pressures, spillover effects from military conflict, geopolitical tensions and climatic swings. Despite a significant decline in COVID-19 infection rates from their peaks in June and December 2021, persistent vaccine hesitancy – coupled with the risk of further virus variants – means that Namibia is still susceptible to new waves of the pandemic. Additionally, the intensification of the military conflict between Russia and Ukraine is likely to impact global oil and wheat markets adversely and create further spikes in energy and food prices for Namibian consumers, given that the two nations contribute a significant portion towards global oil and wheat output. Finally, swings in rainfall patterns could have a negative impact on domestic agricultural production, which would place additional upward pressure on domestic food prices. Higher prices would adversely impact both consumer and producer spending in Namibia, should these risks materialise.

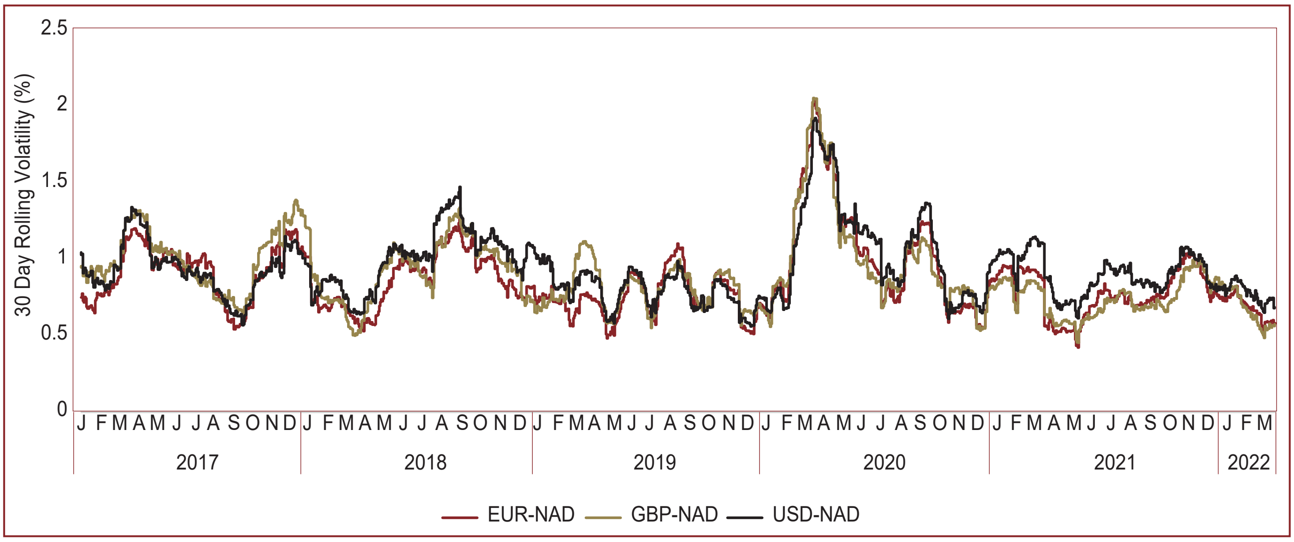
International reserves

Namibia's international reserves grew substantially over the course of 2021. Despite lower Southern African Customs Union receipts of N$16.6 billion in 2021 (2020: N$21.4 billion) as well as the redemption of Namibia's first Eurobond of N$7.2 billion, the foreign reserve position increased by 38.5 percent over the course of 2021 to a level of N$43.9 billion at year end. The growth in foreign reserves during 2021 resulted mainly from the International Monetary Fund's Rapid Financing Instrument amounting to N$3.9 billion, an inflow of N$1.5 billion from the African Development Bank, and the N$6.8 billion inflow from the Asset Swap Programme. By the end of March 2022, the international reserves level stood at N$36.7 billion, which was 8.6 times higher than the total currency in circulation and could adequately maintain the one-to-one currency peg with the South African Rand. At this level, the international reserves translated to an import cover of 6.4 months. These robust reserve levels are expected to provide some insulation against a potential deterioration in global liquidity as monetary conditions tighten across developed and developing economies – a situation which augurs well for financial stability in Namibia.

Exchange rate developments

Compared with the previous reporting year, the Namibia Dollar (NAD) appreciated against all major currencies during 2021. On the back of a broad risk-on environment in financial markets, the Namibia Dollar/South African Rand (ZAR) appreciated over the course of 2021 against the US Dollar (USD) by 8.5 percent, the Euro (EUR) by 1.0 percent, and the British Pound (GBP) by 7.4 percent. The South African Rand was also supported by an improvement in that economy's terms of trade (fuelled almost entirely by the rise in global commodity prices), coupled with a boost to South Africa's fiscal credibility as government revenue collection exceeded expectations throughout the year. The improvement in risk perception surrounding the South African Rand was also evident from a volatility standpoint, as volatility levels have remained far lower than previous extremes reached in early 2020 (Figure 7). The domestic currency appreciated further against all three major currencies in the first quarter of 2022, with the USD/ZAR, EUR/ZAR and GBP/ZAR pairs, respectively trading at 15.48, 16.13 and 18.99, at the end of March. The broad consensus is that the South African Rand will depreciate moderately against these three major currencies over the remainder of 2022 given the expectation that global monetary conditions are set to tighten further, although the volatility in the exchange rate is expected to remain within a relatively normal range as seen over the past twelve months.

Figure 7: Volatility of the Namibia Dollar against selected currencies

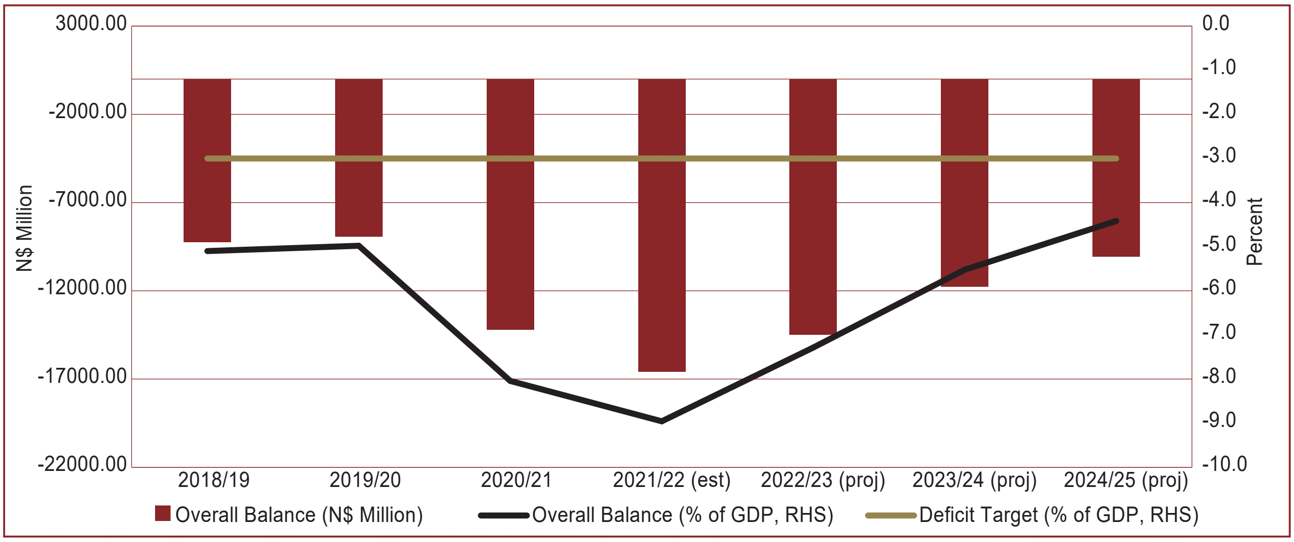


Source: Bank of Namibia

Public finance

Central Government's budget deficit is estimated to have widened to a record level during the 2021/2 financial year. The Central Government budget deficit for 2021/2 was estimated to have widened to 8.7 percent of GDP, compared with the 8.0 percent recorded for the previous fiscal year (Figure 8). The widening of the deficit was fuelled mainly by a contraction in Southern African Customs Union receipts and company tax revenue on the back of the COVID-19 pandemic. The overall deficit is projected to moderate to 5.6 percent and 5.7 percent in 2022/3 and 2023/4, respectively, as a result of improvements in domestic tax collection and a reduction in overall expenditure as fiscal consolidation efforts progress. These developments are likely to be welcomed by the major credit rating agencies once future reviews on Namibia's sovereign credit quality are conducted in 2023.

Figure 8: Public finance



RHS = right-hand side
Source: Bank of Namibia and National Budget

Sovereign credit ratings – Namibia and South Africa

During 2021, Fitch Ratings affirmed Namibia's long-term foreign currency credit rating as BB with a negative outlook. Ratings agencies have continued to rate Namibia's sovereign debt as below investment grade (Table 2). For example, on 15 July 2021, Fitch Ratings affirmed Namibia's rating at BB with a negative outlook. The negative outlook reflects increased downward pressures on creditworthiness due to a continued rise in government debt, wide budget deficits, and low growth aggravated by the prolonged COVID-19 pandemic. Fitch Ratings noted two key factors which could lead to an upgrade in Namibia's outlook and rating, namely, evidence of the government's ability to implement sufficient fiscal reforms to stabilise the debt-to-GDP trajectory, and stronger medium-term growth. After not conducting a review in 2021, Moody's Investor Service opted to downgrade Namibia's long term foreign currency credit rating from Ba3 to B1 on 5 April 2022. Moody's highlighted the economy's continued increase in the debt ratio, stagnating growth trend and the potential increase in social safety nets to cushion against rising food and energy costs as the key reasons for the downward revision in the rating. In addition to an improved fiscal and growth trajectory, Moody's view lengthening the average maturity of Namibia's debt profile as a key factor which could lead to an upgrade in the rating.

Table 2: Namibia's sovereign credit rating and outlook

Rating agency	Rating	Outlook	Last update	Action
Fitch Ratings	BB	Negative	15 July 2021	Rating affirmed
Moody's	B1	Stable	5 April 2022	Rating downgraded and Outlook Upgraded

Source: Moody's and Fitch Ratings

All three major rating agencies affirmed South Africa's sovereign credit rating during 2021 (Table 3). Given the Namibia Dollar's peg to the South African Rand, sovereign credit rating decisions in South Africa play a role for financial stability in Namibia. Moody's and Standard and Poor's (S&P) Rating Agency respectively affirmed South Africa's long-term foreign currency credit rating at Baa2 and BB-. Moody's affirmation of the rating was accompanied by a negative outlook citing the debt-to-GDP trajectory, a weakened growth trend, and additional financial assistance needed to keep State-owned enterprises (SOEs) operational as key risks. However, an improvement in fiscal performance during the second half of the year resulted in both Fitch Ratings and Moody's revising their respective outlooks to *Stable in December 2021, which will likely be followed by a similar revision by S&P once it conducts its review in 2022*. Similar to the Namibian case, upward revisions to South Africa's credit outlook in the near term will largely depend on the government's ability to show progress in its fiscal consolidation and in improving its prospects for economic growth, which would help address key issues such as high inequality and unemployment.

Table 3: South Africa's sovereign credit rating and outlook

Rating agency	Rating	Outlook	Last update	Action
Standard and Poor's (S&P)	BB-	Stable	21 May 2021	Rating affirmed
Moody's Investor Service	Ba2	Negative	12 May 2021	Rating affirmed
	Ba2	Stable	01 April 2022	Rating affirmed and outlook upgraded
Fitch Ratings	BB-	Negative	21 May 2021	Rating affirmed
	BB-	Stable	15 December 2021	Rating affirmed and outlook upgraded

Source: S&P, Moody's Investor Service and Fitch Ratings

Monetary policy stance in Namibia and South Africa

Both the BoN and the South African Reserve Bank (SARB) maintained an accommodative monetary policy stance throughout most of 2021. The BoN opted to maintain its policy rate at a historically low level of 3.75 percent throughout 2021 (Table 4). This level was deemed appropriate for continuing to support a domestic economy impaired by the impact of the COVID-19 pandemic and to safeguard the one-to-one link between the Namibia Dollar and the South African Rand. The BoN also continued implementing special relief measures throughout 2021. Such measures included not only loan payment holidays for businesses and consumers, but also a reduction in the capital conservation buffer to zero percent. The zero-percent buffer served to support banking institutions' ability to supply credit to the economy, which boded well for financial stability. However, after having held the policy rate unchanged for 18 months, the BoN increased it by 25 basis points in February and April 2022 respectively. Similarly, to counter the negative effects of the COVID-19 pandemic on economic activity, the SARB adhered to its accommodative stance at five of its six meetings held in 2021. The SARB's shifted stance in recent months followed the rise in global inflationary pressure, resulting in a 25-basis point increase in the policy rate at both its November 2021 and January 2022 meetings.

Table 4: Influence of South African Reserve Bank repurchase (repo) rate developments on Bank of Namibia decisions

SARB meeting date	Decision	Repo rate (%)	BoN meeting date	Decision	Repo rate (%)
21 January 2021	Unchanged	3.50	17 February 2021	Unchanged	3.75
25 March 2021	Unchanged	3.50	14 April 2021	Unchanged	3.75
20 May 2021	Unchanged	3.50	16 June 2021	Unchanged	3.75
22 July 2021	Unchanged	3.50	18 August 2021	Unchanged	3.75
23 September 2021	Unchanged	3.50	20 October 2021	Unchanged	3.75
18 November 2021	Increase, 25 basis points	3.75	8 December 2021	Unchanged	3.75

SARB meeting date	Decision	Repo rate (%)	BoN meeting date	Decision	Repo rate (%)
27 January 2022	Increase, 25 basis points	4.00	16 February 2022	Increase, 25 basis points	4.00
24 March 2022	Increase, 25 basis points	4.25	13 April 2022	Increase, 25 basis points	4.25
Total repurchase (repo) rate change	75-basis-point increase		Total repo rate change	50-basis-point increase	

Source: South African Reserve Bank and Bank of Namibia

4. DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

HOUSEHOLD DEBT TO DISPOSABLE INCOME

The ratio of household debt to disposable income moderated at the end of 2021. Household debt constituted 77.4 percent of disposable income at the end of December 2021, notably lower than the 87.7 percent recorded at the close of the previous reporting year (Table 5). The lower ratio was driven by disposable income increasing at a faster pace than debt during the period under review. Compared with December 2020, disposable income had grown by 15.64 percent by the end of December 2021, possibly boosted by increased economic activity after the COVID-19 pandemic. Debt extended to households grew by a sluggish 2.1 percent during the same period, mostly driven by short-term credit facilities such as *Other loans and advances*. Nonetheless, it is worth noting that households continued to demand mortgage credit during the period, albeit at a slower pace than in previous years. Annual growth in mortgage credit extended to households stood at 2.6 percent at the end of 2021 compared with 5.2 percent in the previous reporting year. The low demand for mortgage credit usually mirrors a weak housing market amidst a depressed economic environment, especially when household incomes become uncertain. Generally, a lower ratio is positive for the stability of the financial system. Thus, since NPLs were still at manageable levels, household credit posed a minimal risk to financial stability during the reporting period.

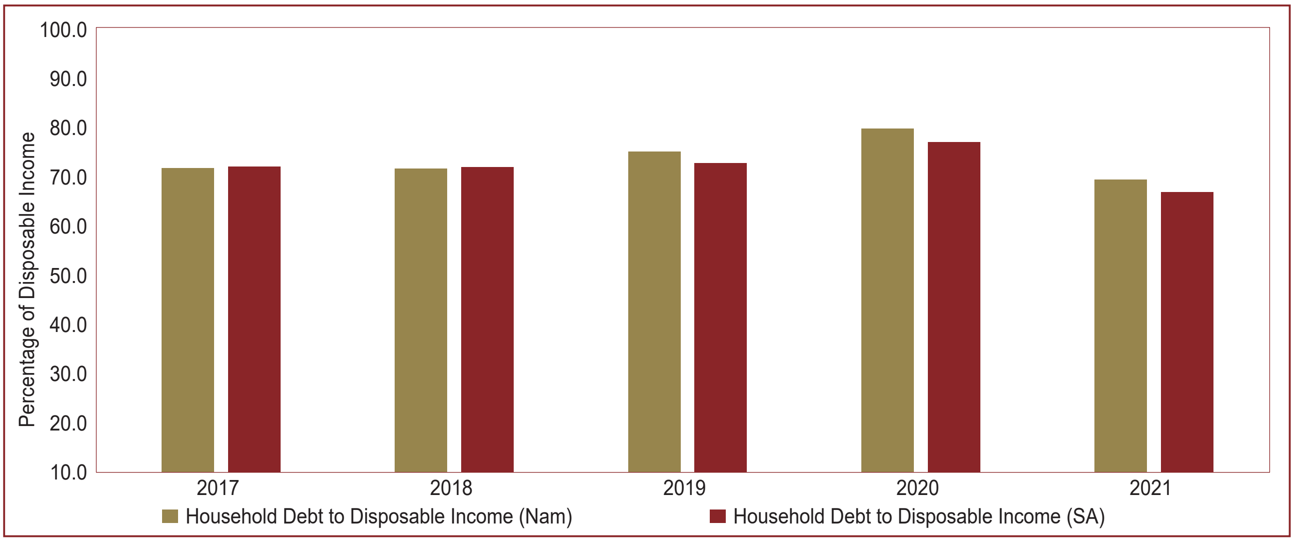
Table 5: Ratio of household debt to disposable income

Disposable income and Household Debt	2017	2018	2019	2020	2021
Disposable income (N$)	68,538	74,347	77,035	76,930	88,962
Ratio of credit to disposable income (%)	74.8	73.9	75.2	78.7	69.5
Total credit extended to individuals/households (N$)	51,275	54,931	57,921	60,518	61,791
Adjusted credit to households/Individuals* (N$)	59,563	63,745	64,582	67,478	68,897
Adjusted credit** of households/Individuals to disposable income (%)	86.9	85.7	83.8	87.7	77.4

* The ratio of household debt to disposable income is calculated based on income and tax data from National Budget documents, National Accounts, and household debt data from the BoN. The National Accounts were revised from 2013 to 2020, resulting in changes in households' disposable income data. These revisions were published in the 2021 FSR.
** This category includes credit extended to households both by banking institutions and NBFIs.
Source: Bank of Namibia

Namibia's unadjusted ratio of household debt to disposable income was higher than South Africa's at the end of 2021, although both ratios decreased in comparison with their values in the previous reporting year. During the period under review, the unadjusted ratio of household debt to disposable income stood at 69.5 percent in Namibia compared with 67.0 percent in South Africa (Figure 9).

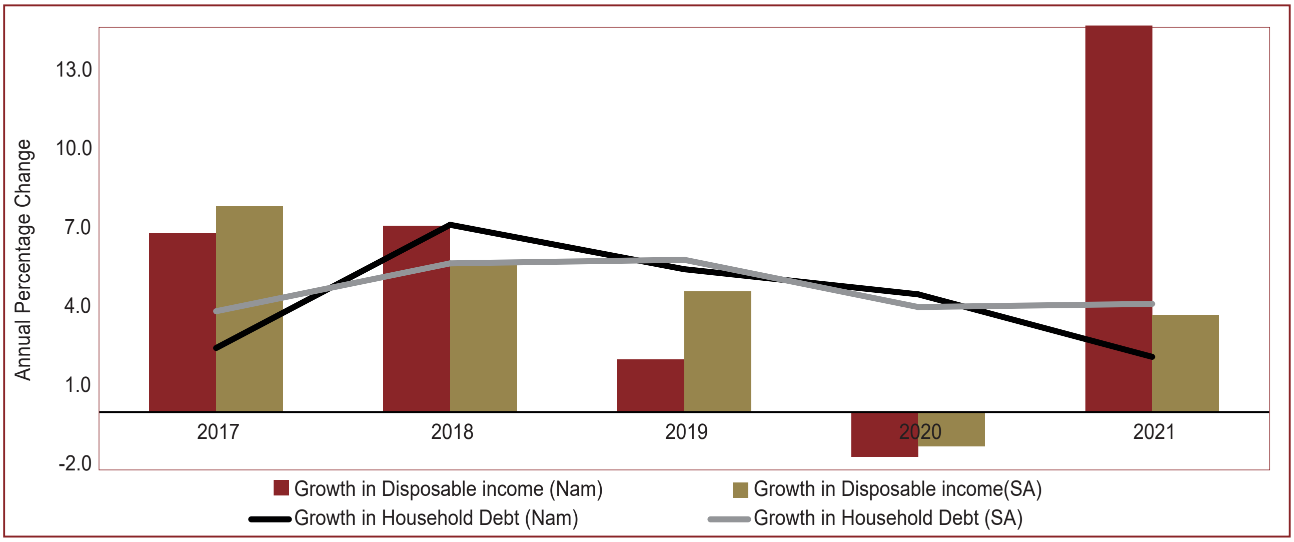
Figure 9: Household debt to disposable income – Namibia and South Africa



Source: Bank of Namibia and South African Reserve Bank

Disposable household income rose significantly in 2021 in comparison with 2020 (Figure 10). Disposable household income climbed to 15.6 percent in 2021, from its 1.7-percent contraction ascribed to base effects in 2020. This recovery could be attributed to higher government transfers during the period under review as households whose income was impacted by COVID-19 restrictions were supported by subsidies during the peak of the COVID-19 pandemic. However, because these subsidies were once-off payments , the growth rate is expected to normalise going forward. Similarly, the disposable income of households in South Africa had grown by 3.1 percent by the end of December 2021, which was up from -1.3 percent for the same period in 2020.

Figure 10: Growth in household debt relative to disposable income



Source: Namibia Statistics Agency, Bank of Namibia and South African Reserve Bank

Total debt service ratio

The ratio of total debt service to disposable income increased notably during 2021. The ratio rose by 8.2 percent in comparison to its value at the end of 2020, to reach 17.2 percent by the end of 2021 (Table 6). Although both variables increased during the period under review, the higher ratio was due to a sharp growth in total debt service during the reporting year, especially in respect of foreign debt. Thus, total debt service stood at N$15.3 billion at the end of 2021, which was 45.2 percent higher than at the end of 2020. The high service value was ascribed to households servicing their debt at a faster pace given a low interest rate environment.

Table 6: total debt service ratios and the average prime rate

Review period	YoY growth in gross income (%)	YoY growth in disposable income (%)	YoY growth in debt service (%)	Ratio of debt service to gross income (%)	Ratio of debt service to dispos-able income (%)	Adjusted ratio of debt service to gross income (%)	Average prime rate (%)
31 Dec. 2016	6.1	13.7	11.2	12.4	11.2	17.3	10.75
31 Dec. 2017	8.2	6.8	2	11.6	10.4	18.2	10.50
31 Dec. 2018	3.7	7.1	8.5	12.4	10.9	17.0	10.50
31 Dec. 2019	0.6	2	8.8	13	11.8	17.9	10.25
31 Dec. 2020	-3.9	-1.7	-23.7	10.1	9.00	19.2	7.50
31 Dec. 2021	0.08	15.6	11.8	8.6	17.2	14.9	7.50

YoY = year-on-year
Source: Bank of Namibia

Corporate debt

The total debt stock expanded in 2021, driven by increases in both domestic and foreign debt. The total debt registered for the end of 2020 increased by 5.1 percent to reach N$161.8 billion by the end of 2021 (Table 7). Both foreign and domestic debt increased during the review period. Given that the impact of the COVID-19 pandemic had peaked during the second and third quarters of 2021, these increases are likely to be related to corporates expanding their demand for debt to finance projects or maintain operations. Although the short-term risks to financial stability of such lending appear limited, continued borrowing to fund operations may pose greater risks in the long run, especially if corporate revenues are decreasing at the same time.

Table 7: Domestic and foreign corporate and SOE debt

Type of debt (N$ million)	2017	2018	2019	2020	2021
Total domestic debt	40,722	54,492	62,300	73,773	76,965
Local corporate debt	38,445	40,966	44,853	44,307	44,137
Local SOE debt	2,277	1,343	860	535	616
Total foreign debt	73,939	86,027	82,906	80,243	84,820
Foreign corporate debt	64,749	75,952	72,808	73,636	75,943
Foreign SOE debt	9,190	10,075	10,098	10,068	8,877
Total debt	114,661	140,519	145,206	154,016	161,785
Nominal GDP*	171,570	181,054	181,555	176,327	180,836
Corporate debt to GDP (%)	66.83	77.61	79.98	87.35	89.46
Foreign corporate debt to GDP (%)	37.70	41.90	40.00	39.40	42.00
Foreign debt to total debt (%)	59.90	66.80	63.80	65.30	64.90

* Estimate
Source: Bank of Namibia and Namibia Statistics Agency

In line with the nominal value of debt, the ratio of corporate sector debt to GDP increased in 2021. The ratio stood at 89.5 percent at the end of 2021, compared with 87.4 percent at the end of 2020 (Table 7). The higher ratio can be attributed to corporate debt stock increasing at a faster rate than GDP. For similar reasons, the ratio of foreign corporate debt to GDP increased to 42.0 percent in 2021, up from 39.4 percent in the previous reporting year.

The total local and foreign SOE debt stock decreased during 2021. Total SOE debt moderated to N$9.5 billion by the end of 2021, which was 6.6 percent lower than the N$10.6 billion recorded at the end of 2020 (Table 7). The decline in total SOE debt was predominantly propelled by companies repaying the principal of their foreign debt stock during the reporting period.

Total foreign corporate debt service decreased notably during the year under review. Compared with the previous reporting period, the cost of foreign debt service fell by 11.2 percent to N$14.8 billion in 2021. The lower debt level was driven by repayments in most industries except mining, which demanded more debt to finance operational expenses (Table 8).

Table 8: Foreign corporate debt and debt service

Type of debt (N$ million)	2017	2018	2019	2020	2021
Total foreign corporate debt	64,749	75,952	72,808	73,786	80,659
Total foreign corporate debt service	15,256	17,197	21,644	16,614	14,765

Source: Bank of Namibia

5. PERFORMANCE OF THE BANKING SECTOR

The performance of the banking sector in Namibia has remained sound, despite subdued economic conditions. The banking sector maintained an adequate capital position coupled with less onerous asset quality, a recovery in profitability, as well as a liquidity position well above the prudential requirement. In 2021, the banking institutions' assets grew at a rate higher than that recorded in the previous year. The relief measures rolled out by BoN continued to support the banking sector and the economy at large, while further amendments were made to avoid premature withdrawals during a time when continued support may be required. Risks to the financial system from the banking sector have declined primarily due to the absence of liquidity constraints being experienced in 2021 and an improved NPL position (although the ratio of NPLs to the loan book remains above the supervisory intervention trigger point of 6.0 percent). The improvement in asset quality aligned with a slowdown in write-offs in relation to both total loans and profits as well as adequate provisions raised for delinquent loan losses and growing profitability. However, going forward, the banking sector faces potential spillover effects from an accommodative monetary policy stance shift to one that is contractionary and aimed at curbing inflationary pressures, which could also lead to liquidity constraints due to an outflow should the repo rate in Namibia and South Africa not be at par. As a result, the probability of credit risk and liquidity risk intensifying in 2022 is viewed as medium with medium impact. This is mainly driven by the anticipated global economic damage and increased inflation, and its concomitant impact on client's ability to service their debt at a time where food and fuel prices are rising rapidly. Credit risk will be monitored closely, and policy intervention made when warranted.

BALANCE SHEET STRUCTURE

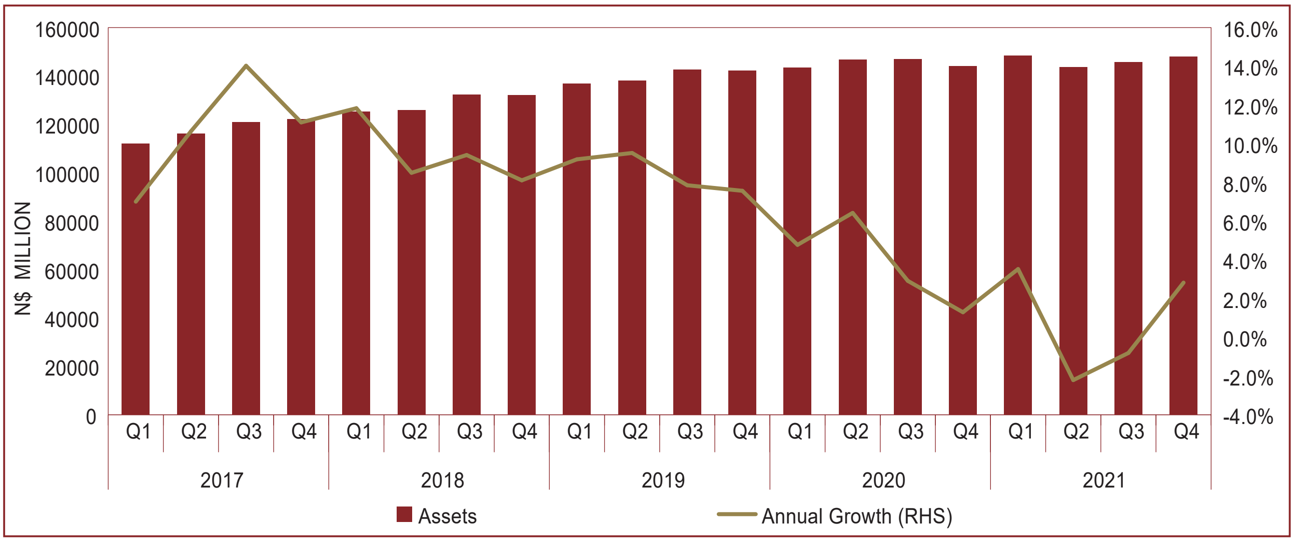
The banking sector balance sheet growth remained positive during the period under review, despite lacklustre economic conditions. The balance sheet of the banking sector stood at N$ 144.0 billion as at 31 December 2020 rising to N$ 148.1 billion as at 31 December 2021, representing a year-on-year growth rate of 2.8 percent (Figure 11). This failed to match inflation over the review period, testimony to the slow pace of economic and financial activity[4]. The growth in the balance sheet reflected moderate expansions in non-bank funding (deposits) on the liability side and in loans and advances on the asset side.

[4] The other incidences where inflation was higher than the banking sector balance sheet growth rate, was during Q2 of 2009, Q1 of 2017, Q4 of 2020; and Q2, Q3, and Q4 of 2022.

Assets

Total assets of the banking sector grew at a faster rate in 2021 than in 2020. The growth rate of banking sector total assets improved from 1.3 percent in 2020 to 2.8 percent in 2021. This improvement was on the back of a N$3.3 billion growth in non-bank funding deposits, driven primarily by demand deposits. Total loans and advances continued to dominate the banking sector assets, constituting 70.0 percent and 68.5 percent of total assets in 2020 and 2021, respectively. Residential and commercial mortgage loans combined, remained the largest component of total loans and advances, contributing over 50 percent in both 2020 and 2021. Notably, despite the year-on-year rise in banking sector assets, the rate of growth was nevertheless below the average consumer inflation rate in 2021, which stood at 3.6 percent. Nonetheless, the narrowing of this gap signifies a stable banking sector, amidst challenging economic conditions.

Figure 11: Banking sector asset growth



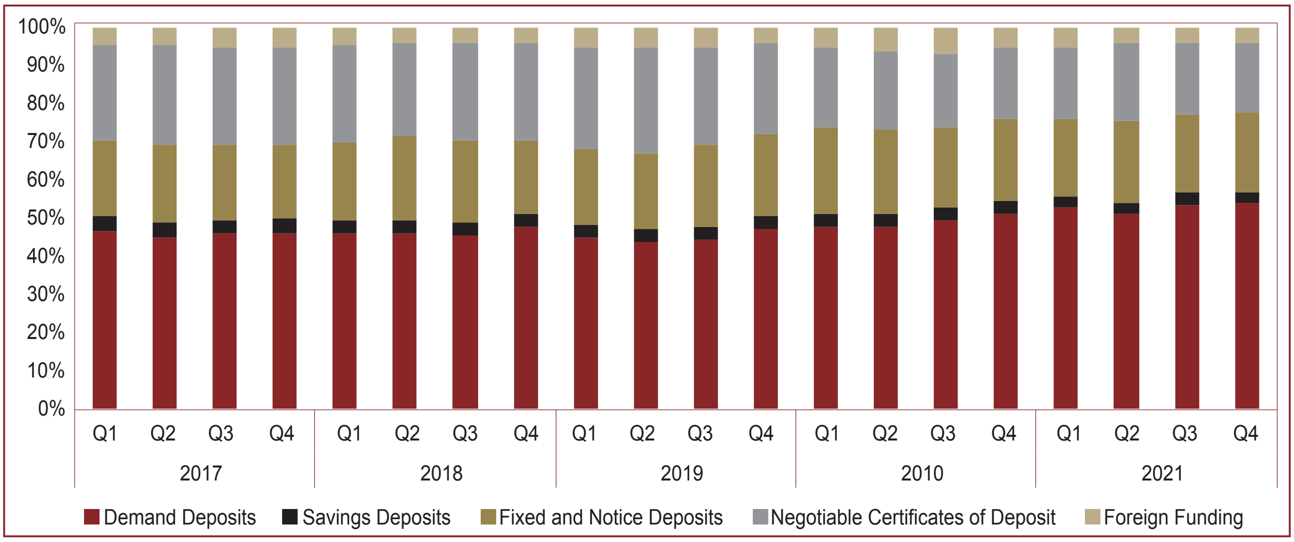
RHS – right-hand side
Source: Bank of Namibia

Capital and liabilities

Non-bank funding continued to be the main driver of growth on the capital and liabilities side of the balance sheet. Non-bank funding remained the dominant source of banking sector funding, comprising 76.7 percent and 76.9 percent of total funding in 2020 and 2021, respectively. Non-bank funding effectively comprises deposits held with the banks, including demand deposits, fixed deposits, notice deposits, and negotiable certificates of deposits. The year-on-year growth rate for non-bank funding stood at 3.0 percent, increasing from N$110.2 billion in 2020 to N$113.8 billion in 2021, owing to a rise in demand deposits over the reporting period. The share of demand deposits grew by 2.7 percentage points on an annual basis, while the other non-bank funding deposits categories all slowed, although not significantly (Figure 12). The growth in capital and reserves was ascribed to an increase in general reserves, specifically retained earnings, which rose from N$16.9

billion in 2020 to N$18.3 billion in 2021. By contrast, bank funding contracted. Bank funding declined by N$1.4 billion to reach N$3.7 billion at the end of 2021, due to a decline in demand deposits, which made up the largest portion of bank funding and consisted mainly of wholesale deposits.

Figure 12: Composition of non-bank deposits



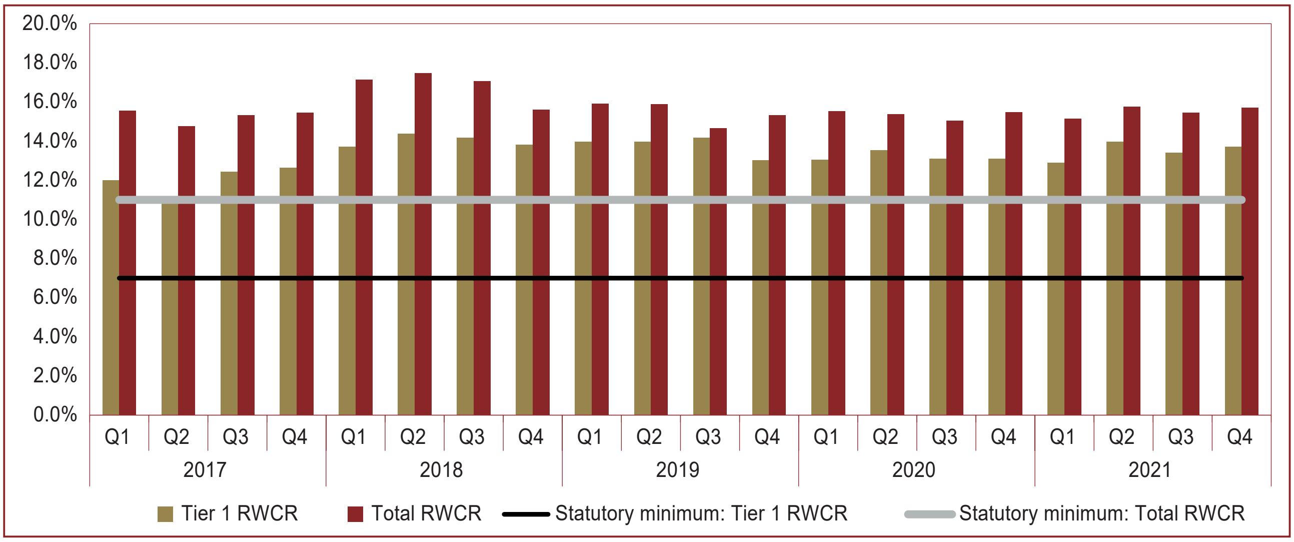
Source: Bank of Namibia

CAPITAL ADEQUACY

The banking sector remained well capitalised throughout 2021 and maintained a capital position well above the prudential requirement. All the capital ratios recorded values above the minimum regulatory requirements of 6.0 percent for the Tier 1 Risk Weighted Capital Ratio (RWCR) and 10.0 percent for the Total RWCR[5]. Maintaining adequate capital levels insulates banks against potential losses, while also covering the risks associated with banking business. Both Tier 1 RWCR and Total RWCR increased marginally by 0.6 and 0.2 percentage point to 13.7 and 15.7 percent, respectively (Figure 13). These increases were as a result of retained earnings of N$8.6 billion, having increased by nearly N$1 billion year-on-year. The Domestic Systemically Important Banks (DSIBs) were therefore well capitalised and maintained a capital position comfortably above the prudential requirements during the period under review. This bodes well for financial stability purposes and where risks to the financial system are concerned.

[5] Prior to the COVID-19 pandemic, the prudential requirement for the Total RWCR was increased from 10.0 percent to 11.0 percent. The 1.0 percentage point increase was to account for the capital conservation buffer. This buffer was subsequently released as part of the COVID-19 banking sector relief measures and has subsequently been kept at 0. The RWCR prudential requirement is accordingly presented as 10.0 percent in figure 13 as well as in figure 17, for consistency and as a true reflection of the developments during the period under review.

Figure 13: Capital adequacy



RWCR = risk-weighted capital ratio
Source: Bank of Namibia

RISK ANALYSIS

Financial stability is concerned with the resilience of the domestic financial system to internal and external shocks of various kinds. The system is continuously monitored not only to identify and assess potential risks in the banking sector, but also to determine how best to mitigate them. In the banking sector, it is imperative to analyse credit risk, liquidity risk and concentration risk in the banking sector. The overall impact of these risks on the banking sector is subsequently assessed through the results of the Čihák Stress Test model, which uses a 12-month projection period[6].

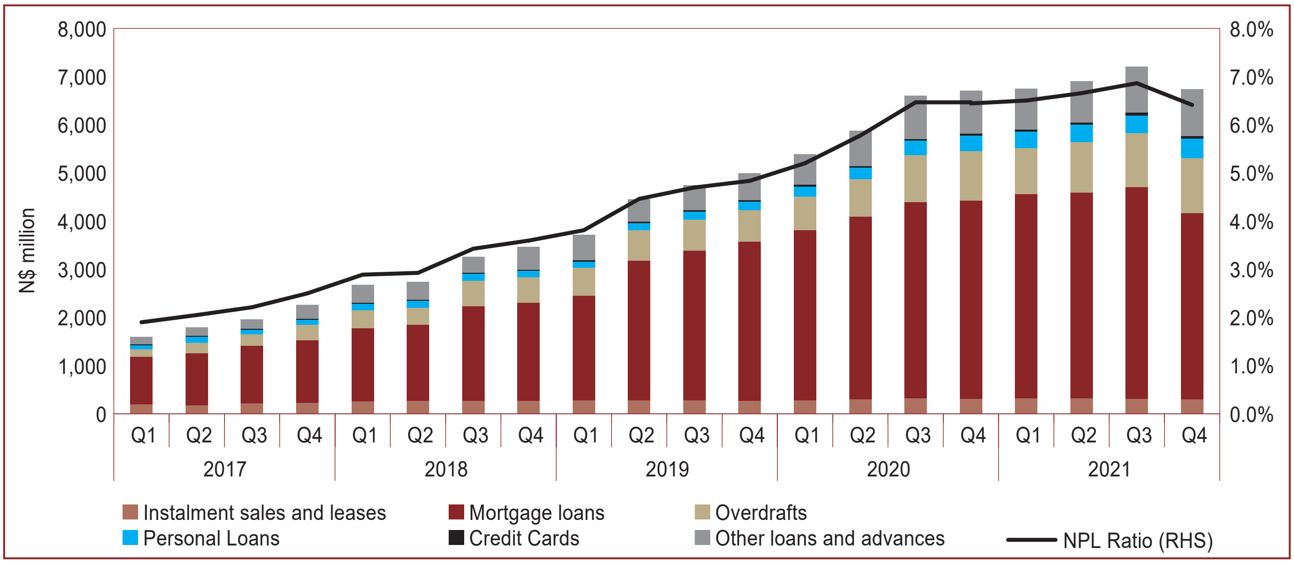
Credit risk

Asset quality

Although the NPL ratio remained above the supervisory intervention trigger point, it improved marginally during the period under review. Asset quality, as measured by the ratio of NPLs to the total loan book, has a 6.0 percent supervisory intervention trigger point during crisis times. The NPL ratio contracted marginally from 6.44 percent in 2020 to 6.41 percent in 2021 (Figure 14). More importantly, after reaching a maximum of 6.9 percent in the third quarter (Q3) of 2021, the NPL ratio declined notably to 6.4 percent in Q4. Given the continuous increase in the NPL ratio since 2017, the plateau and most recent dip were welcome developments.

[6] See later herein under the section entitled "Stress test" for more information on the scenarios for, and results of, this test on the Namibian banking sector.

Figure 14: Non-performing loans as a percentage of total loans



Source: Bank of Namibia

NPL ratios across all the loan categories deteriorated further in 2021 in relation to their 2020 positions, with the exception of *Mortgage loans* and *Instalment sale and leases*. The NPL ratios in respect of *mortgage loans* and *instalment sale and leases* declined by 6.1 percent and 3.2 percent, respectively, during the review period. Although the majority of the loan categories' NPL ratios increased, the overall NPL ratio declined marginally. This decline was attributable mainly to an improvement in non-performing mortgage loans, since mortgage loans make up more than 50 percent of the total loan book. The NPLs for *Overdrafts, Personal loans, Credit cards* and *Other loans and advances* all increased (by 10.5, 27.6, 31.3 and 8.6 percent, respectively), which was an immediate result of unfavourable economic conditions. Current economic conditions play a considerable role in the ability of clients to service their debt, more so with lay-offs and retrenchments being experienced. The NPL ratio is a lagging indicator of stress, therefore NPLs can still be rehabilitated and migrate from non-performing to performing status, the result of which may not immediately be visible.

The risks to the financial system emanating from asset quality levelled off during the period under review. However, the FSSC is of the view that credit risk, in 2022, could increase to medium status, on the back of potential interest rate risks as monetary policy authorities around the world try to curb inflationary pressures. Interest rate risk has a direct bearing on credit risk, i.e. via debt servicing. That said, even after allowing for a notable increase in short-term interest rates in 2022, the level of such rates will still be comparatively low, historically speaking, which suggests that the risks to banks and borrowers will likely be manageable.

BOX ARTICLE 1:

CREDIT RISK: NON-PERFORMING LOANS IN CONTEXT

INTRODUCTION

A loan becomes non-performing when a borrower has defaulted for 90 days. *This essentially means that the borrower has not made any scheduled payments of principal or interest for a period of 90 days. In this regard, the impact of NPLs is most likely to reflect in future quarters, i.e. when quarterly assessments are made, due to the lagged nature of the NPL ratio. During the review period, more than 50 percent of the banking sector loan book comprised of mortgage lending which is secured by an underlying asset. The FSSC's concern is, therefore, focused on unsecured lending such as personal loans and credit card debt. The impact of the COVID-19 pandemic on NPLs was more prominent in the quarters following the onset of the pandemic. Nonetheless, various relief measures offered by the Bank of Namibia (BoN) served as a buffer for the banking sector and its borrowers alike. This allowed the banks to better manage the impact of the pandemic, coupled with sufficient provisions and adequate capital. Although risk emanating from asset quality remained, its further contextualization is important, and requires taking into consideration the banking sector's profitability, its write-offs relative to its total loans and profits, the adequacy of provisions, and policy measures introduced by BoN.*

PROFITABILITY

The banking sector continued to be profitable despite sluggish economic conditions. *The banking sector's after-tax profits increased by 12.5 percent from N$558.5 million in 2020 to N$ 628.1 million in 2021. Income growth was positive across both main categories, i.e. net interest income and non-interest income increasing by 16.2 percent and 1.0 percent, respectively, during the period under review. The significant rise in net interest income was largely driven by a decrease in interest expenditure due to a decline in deposit holdings. The sector's profitability, as measured by the Return on Assets (ROA) and the Return on Equity (ROE) ratios, improved since 2020, although not to the levels attained prior to the COVID-19 pandemic. The ROA ratio increased from 1.5 percent in 2020 to 1.7 percent in 2021 (Box Table 1). The ROE inclined upward from 13.4 percent in 2020 to 13.9 percent in 2021. The banks remained profitable during the review period despite exceptionally difficult global and domestic economic conditions, signalling a healthy and resilient banking sector.*

Box Table 1: Profitability[7]

Indicator	2017	2018	2019	2020	2021
Return on assets (%)	2.1	2.1	2.2	1.5	1.7
Return on equity (%)	20.3	18.5	20.1	13.4	13.9

Source: Bank of Namibia

WRITE-OFFS RELATIVE TO TOTAL LOANS AND PROFIT

Write-offs relative to total loans and profit declined in 2021 when compared to 2020. *Write-offs relative to profits maintained their five-year historically low position, showing a miniscule decline from 0.06 percent in 2020 to 0.05 percent in 2021 (Box Table 2). Write-offs relative to total loans have been somewhat larger over the five years presented in Table 2, reaching 11.2 percent in 2020 before declining to 8.6 percent in 2021. The decline in these ratios is attributable to the combination of a 13.7 percent slowdown in total write-offs and an increase of 12.5 percent in profits, coupled with a 0.7 percent increase in total loans. Although the asset quality of the banking sector remained above the 6.0 percent supervisory intervention trigger point, it improved marginally during the reporting period, as banks remained profitable with growing assets and minimal loan write-offs. Risks to the financial system from the perspective of write-offs remain minimal and pose no real threat to financial stability.*

Box Table 2: Write-offs relative to total loans and profit

Indicator	2017	2018	2019	2020	2021
Write-offs (N$ million)	18	49	20	63	54
Total loans (N$ million)	90,885	96,904	103,866	104,963	105,684
Net profit (N$ million)	658	703	798	558	628
Write-offs/Total loans (%)	2.68	6.96	2.46	11.23	8.62
Write-offs/Profit (%)	0.02	0.05	0.02	0.06	0.05

Source: Bank of Namibia

ADEQUACY OF PROVISIONS

Adequate provisions were raised for delinquent loan losses during the period under review. *Specific loan loss provisions rose sharply from N$146.1 million in 2020 to N$256.9 million in 2021, growing by 75.8 percent. The value of bad debts written off declined in 2021 when compared to the preceding year, from N$62.7 million to N$ 54.1 million. The growth in specific loan loss provisions indicates that the banks were expecting to experience more losses in 2021: however, bad debts written-off during the period under review declined by a significantly, by 13.7 percent. While total provisions for loan losses*

[7] The profitability indicators are based on year-on-year fourth quarter developments whereas those reported in the annual report are annualised, hence the differences in the two reports.

increased from N$ 3.4 billion to N$3.6 billion, specific provisions cover increased from N$2.0 billion to N$2.3 billion, in line with the slight increase in in NPLs during the period under review. The banks had therefore provided adequate buffers to cushion themselves against any potential losses, allowing them to effectively manage credit risk effectively.

POLICY MEASURES

BoN introduced several policy measures to support the banking sector as the pandemic persisted and extended the applicability of these measures to April 2023. *The Determination on Policy Changes in Response to Economic and Financial Stability Challenges as a Result of the COVID-19 Pandemic (BID-33) was implemented to manage credit risk and safeguard financial stability. The measures introduced included the loan repayment moratorium based on a thorough assessment of the economic and financial conditions of both individual borrowers and businesses. The loan repayment moratoriums provided short-term relief on the repayment of the principal amount on loans, for a period ranging from one month but not exceeding 24 months. Furthermore, BoN presented the industry with possible NPL recovery options aimed at increasing the banking institutions' ability to recover such loans. This included the lengthening of the period before loans that are in default are written off, asset securitisation, debt restructuring and debt-to-equity options. These supervisory measures were implemented to manage banking sector credit risks.*

CONCLUSION

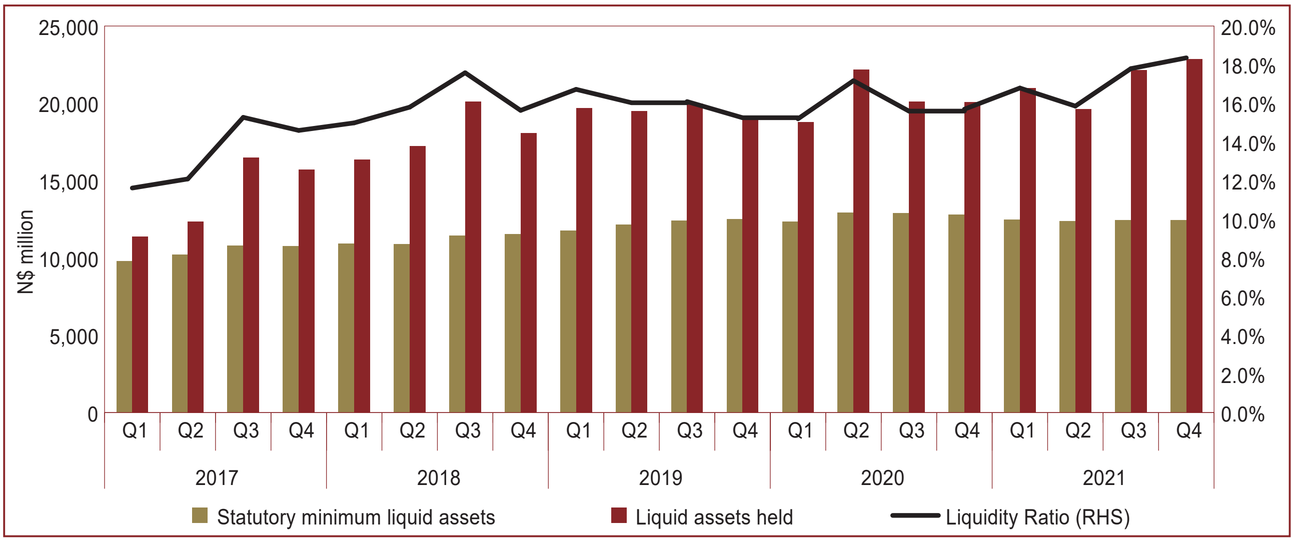
In conclusion, even though the NPL ratio remained above the supervisory intervention trigger point, it nevertheless improved during the period under review. *The developments in banking sector profitability, write-offs relative to total loans and profit, and in provisioning, indicate that the banks were able to manage their credit risk during these unprecedented times, and that the relief measures implemented also played a significant role in supporting the banking sector. In addition, the largest loan category is mortgage lending, which is secured by the underlying collateral. The security of this potential recoverability of debt ameliorated the overall credit risk, as did the well-capitalised and profitable banking sector. The FSSCs concern therefore lay ore with the unsecured lending component in the sector. Nonetheless, since banks employ relatively prudent policies when extending credit, the overall credit risk slowed in 2012 – even though the NPL ratio remained above the 6.0 percent supervisory intervention trigger point. Going forward, the trajectory of the repurchase (repo) rate may see credit risk elevated to medium with medium impact.*

Liquidity risk

Liquidity position

The liquidity position of the banking sector improved significantly during the period under review. The liquidity ratio of the banking sector grew from 15.7 percent to 18.4 percent of liabilities in 2020 and 2021 (Figure 15). The statutory requirement is for banks to keep 10.0 percent of the average total liabilities to the public, as liquid assets. Liquid assets held stood at N$20.1 billion in 2020, rising to N$22.9 billion in 2021, which is significantly higher than the statutory required minimum of N$12.5 billion in 2021, thus recording a surplus of N$10.4 billion. This significant upward move in liquidity was ascribed to growth in non-bank deposits, government spending, diamond sales, Value Added Tax (VAT) refunds, fund repatriations by NBFIs, and a weak demand for credit.

Figure 15: Liquid assets and liquidity ratio



RHS = right-hand side
Source: Bank of Namibia

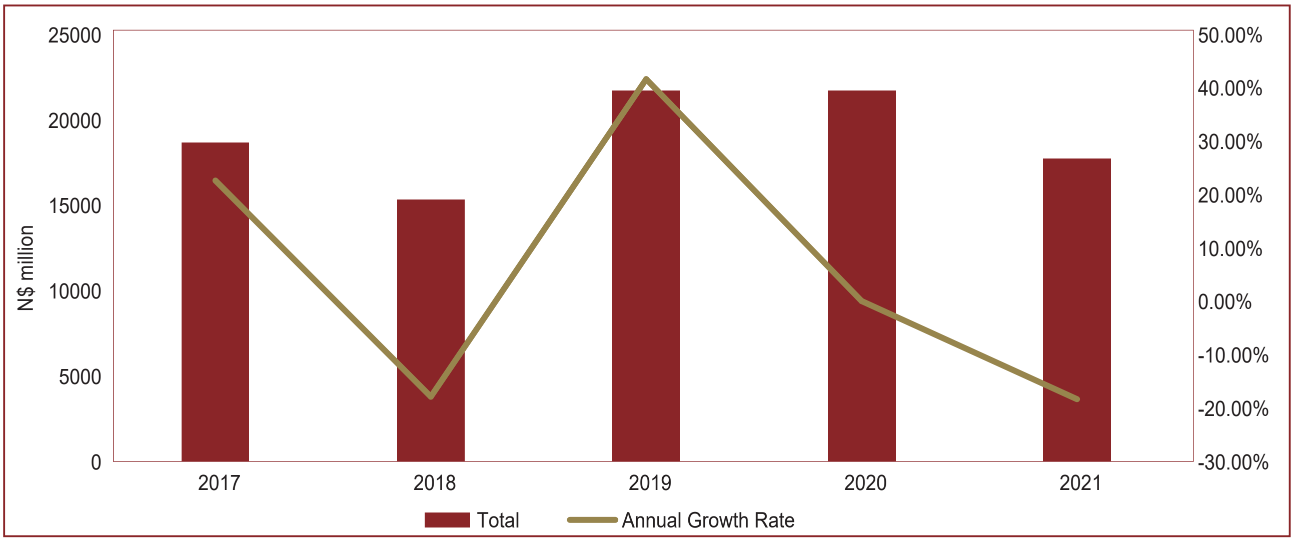
Both the loan-to-deposit (LTD) and the loan-to-funding (LTF) ratios remained below one hundred percent. This means that the banks continue to make use of deposits to fund loans and advances, while still being in a comfortable position to fund and extend their lending. Thus, the LTD ratio increased from 88.8 percent in 2020 to 89.9 percent in 2021, while the LTF ratio decreased from 84.8 percent to 83.2 percent over the same period. The implementation of the Third Basel Accord (Basel III) of international capital standards issued by the Basel Committee on Banking Supervision, which requires banks to diversify their funding sources, was postponed to early 2023 due to the COVID-19 pandemic. For the year under review, therefore, the predominant funding source in the banking sector comprised wholesale deposits. Such deposits tend to be short-term and volatile in nature, and as a result may cause maturity mismatches between assets and liabilities. Nonetheless, risk to the financial system stemming from a lack of banking sector liquidity has declined in 2021 in relation to the previous reporting period and is projected to be medium in 2022. This risk is assessed to have a medium impact, taking into consideration the potential liquidity outflow if the repo rate in Namibia and South Africa are not at par coupled with the potential effects of COVID-19 and the concomitantly elevated levels of uncertainty going forward.

Concentration risk

Large exposures

The banking sector's large exposures have declined significantly in both 2020 and 2021 owing to the impact of the COVID-19 pandemic. A large exposure is any exposure to a single person or group of related persons that, in aggregate, is equal to or exceeds 10 percent of a banking institution's capital funds. The value of large exposures declined by 18.3 percent from N$21.7 billion at the end of 2020 to N$17.7 billion at the end of 2021, due to a reduction in some corporate entity exposures (Figure 16). This reduction in large exposures implies that concentration risks were managed well throughout the pandemic, which in turn is a good sign for financial stability.

Figure 16: Large exposures and growth rate – Banking sector



Source: Bank of Namibia

Stress Test

The Čihák stress test assess how resilient DSIBs are to shocks caused by spikes in interest rates or NPL ratios or sudden drops in liquidity by exposing such banks to certain simulated scenarios. The simulations consider the recent developments in the global economy, South African and Namibian economies, and test how the DSIBs would perform if the envisaged scenarios should materialise. For example, interest rate risk is determined by the repo rate, while credit risk is estimated by considering the potential performance of the NPL ratio as a measure of asset quality. Thus, the stress test scenarios project the potential performance of the repo rate in the next 12 months, supported by economic developments both domestically and abroad. Furthermore, the stress test scenarios determine' s whether BoN is expected to increase, decrease, or keep the repo rate unchanged in the foreseeable future. Another concern is whether the DSIBs could withstand a liquidity shock if some depositors suddenly withdrew funds from the system. The Čihák model was used to stress test the solvency and liquidity position of the DSIBs 12 months into the future.

Interest rate risk

Global economic growth is estimated to have recovered in 2021; however, it is expected to moderate in 2022 and 2023. According to the WEO Update released in January 2022, the global economy recovered from a contraction of 3.1 percent in 2020 to an estimated growth rate of 5.9 percent in 2021. The growth in 2021 was primarily ascribed to base effects on the back of the continued adaptation of economic activity to the COVID-19 pandemic and related restrictions, vaccine rollout, and ongoing policy support in numerous countries. However, global growth is projected to moderate to 4.4 percent in 2022 due to the withdrawal of monetary accommodation, as well as continued supply shortages and pandemic-induced disruptions. Although still moderate, the forecasted growth for 2023 was revised up by a 0.2 percentage point, reflecting a mechanical pickup after current drags on growth dissipate in the second half of 2022. Nonetheless, the forecast is conditional on adverse health outcomes declining to low levels in most countries by the end of 2022, assuming vaccination rates improve worldwide, and therapies become more effective. South Africa, for example, is expected to record an estimated 4.6 percent growth in 2021 and has projected growth rates of 1.9 and 1.4 percent in 2022 and 2023, respectively. The deceleration in growth is primarily because of the fading rebound from the pandemic, alongside a decline in high export prices. Overall, risks to the outlook for South Africa were assessed to be balanced.

Thus, risks to the global baseline are tilted to the downside. This is because the emergence of new COVID-19 variants could prolong the pandemic and induce renewed economic disruptions, coupled with the potential intensification of geopolitical tensions emanating from the Russian invasion of Ukraine. In addition, supply chain disruptions, energy price volatility and wage pressures mean that uncertainty around inflation and policy paths is elevated. Furthermore, the ongoing climate change emergency underlines that the probability of major natural disasters remains high.

Namibia's economic performance, on the other hand, is expected to continue improving during 2022 and 2023, following an estimated recover in 2021. Real GDP growth is estimated at 2.4 percent for 2021 with projected growth of 3.4 percent in 2022 and 3.7 percent in 2023. Anticipated better growth rates across all industries in addition to robust growth in diamond mining are the underlying determinants of the projected improved growth. The new diamond mining vessel has commenced production during the first quarter of 2022. Risks to domestic growth remain dominated by the impact of the COVID-19 pandemic, coupled with unpredictable rainfall patterns, high energy prices and supply disruptions around the world.

Elevated inflation is expected to persist for some time given the ongoing supply chain disruptions and energy prices that are likely to remain high globally, in 2022. Global inflation continued to rise throughout the second half of 2021, driven by several factors across the regions. Fossil fuel prices have almost doubled in 2021, driving energy costs up which, in turn, caused higher inflation – most prominently in Europe – while rising food prices contributed to climbing inflation in sub-Saharan Africa. Meanwhile, ongoing supply chain disruptions, clogged ports, land-slide constraints, and a high demand for goods have also led to broadening price pressures, during the reporting period, especially in the United States. Raised prices for imported goods fed inflation in Latin America and the Caribbean region. In South Africa, headline inflation increased from 3.3 percent in 2020 to 4.5 percent in 2021, and it is projected to steer upwards to 5.8 percent in 2023. Risks to the inflation outlook in South Africa were assessed to be on the upside because of global producer price and food price inflation coupled with increased oil prices - particularly if the war in Ukraine persists.

Domestically, the annual average inflation rate increased in relation to the prior reporting year. Inflation rose to 3.6 percent in 2021, compared to 2.2 percent in the previous year. By the end of 2021 and in early 2022 inflation hovered around 4.5 percent. These increases were driven mainly by higher prices for food, transport, and housing. Although inflation remains within a reasonable range, its food and transport components are expected to increase in the coming months and may continue to have a disproportionate effect on the low-income segment of society.

In respect of the repo rate, both the BoN Monetary Policy Committee (MPC) and its SARB counterpart increased their respective positions at recent meetings in 2022. The BoN MPC kept its repo rate unchanged in 2021 and increased it twice by 25 basis points to 4.25 percent, at the February and April 2022 meetings, respectively. The SARB MPC consecutively increased its repo rate by 25 basis points at the November 2021, January 2022, and March 2022 meetings, to reach a repo rate of 4.25 percent for the current reporting period. The decision by the SARB to tighten monetary policy was informed especially by inflation developments, with real growth and other factors also playing a role. The policy rate path of the SARB Quarterly Projection Model (QPM), which provides broad guidance on future rates, implied a gradual normalisation. In April 2022, the BoN MPC believed its 4.25 percent policy rate was appropriate not only to safeguard the one-to-one link between the Namibia Dollar and the South African Rand, but also to meet the country's international financial obligations.

In order to maintain the currency peg, BoN may opt to follow a path broadly similar to the SARB with gradual increments in 2022. The interest rate stress test therefore accounted for three possible decision scenarios, as described below, all of which assume the current repo rate of 4.25 percent as their starting point:

- ***Baseline scenario:*** Retain the repo rate at the current level of 4.25 percent in the first quarter of 2022, followed by three consecutive 25 basis points increases in 2022, thus a cumulative increase of 75 basis points.
- I***ntermediate Scenario:*** Retain the repo rate at the current level of 4.25 percent in the first quarter of 2022, followed by two consecutive 50 basis points increases, and an additional 100 basis points increase, thus a cumulative increase of 200 basis points.
- ***Severe scenario:*** Retain the repo rate at the current level of 4.25 percent in the first quarter, followed by two consecutive 100 basis points increases, and an additional 125 basis points increase, thus a cumulative increase of 325 bas**is points.**

Credit risk

In line with current economic conditions, the banking sector's asset quality, as measured by the NPL ratio, improved marginally, although still registered above the supervisory intervention trigger point. Although the impact of the COVID-19 pandemic on the economy is increasingly apparent, the banking sector was able to manage its credit risk by not recording a NPL ratio higher than that of the previous year. The projected economic recovery coupled with the relief measures put in place could have led the FSSC to assume that credit risk will start to ease further. However, a stress test is concerned with potential shocks and the performance of the banking sector in adverse conditions. Thus, if the economy does not recover at the projected rate given global economic performance and the impact of geopolitical tensions, then credit risk is assumed to be medium to high - as captured by the *Intermediate* and *Severe* scenarios described in the previous section. Generally, the NPL ratio has fared relatively well in 2021, if one considers that the impact of a deteriorating NPL ratio could have been more severe in the absence of the relief measures as outlined in the Determination on Policy Changes in Response to Economic and Financial Stability Challenges as a Result of the COVID-19 Pandemic (BID-33).

The NPL ratio is projected to recover and improve further in the near to medium term. An improvement in the NPL ratio is a positive development for the financial system. Again, however, a stress test is concerned with potential shocks and the performance of the banking sector in adverse conditions. Thus, should the economy experience a shock emanating from, say, the uncertainty caused by the COVID-19 pandemic or geopolitical tensions, it would an impact on the banking sector's credit risk. The credit risk stress test therefore accounted for three possible scenarios involving potential increases in the NPL ratio, as described below, all of which assume the 2021 NPL ratio of 6.41 percent as their starting point:

- ***Baseline scenario:*** A 1.0 percentage point increase in the banking sector NPL ratio
- ***Intermediate scenario:*** A 3.0 percentage point increase in the banking sector NPL ratio, or

- ***Severe scenario:*** A 6.0 percentage point increase in the banking sector NPL ratio (Severe scenario).

Liquidity risk

Liquidity risk measures the banks' ability to honour their financial obligations in a timely manner. The banking sector liquidity ratio improved significantly from 15.9 percent in 2020 to 18.4 percent in 2021. This translated into an increase of 2.5 percentage points. This improvement was mainly ascribed to diamond sales, coupon payments as well as increased government expenditure. The concern of the FSSC is whether commercial banks would be able to withstand a liquidity shock as a result of a sudden withdrawal of funds from the banking system, despite the banks being liquid, well capitalised, profitable, and solvent. The liquidity risk stress test therefore accounted for three possible scenarios involving potential increases in the magnitude of depositor withdrawals, as described below:

- ***Baseline scenario:*** 10.75 percent of total deposits, of which 20 percent comprise demand deposits, withdrawn over five days
- ***Intermediate scenario:*** 21.50 percent of total deposits, of which 40 percent comprise demand deposits, withdrawn over five days, or

  Severe scenario: 32.25 percent of total deposits, of which 60 percent comprise demand deposits, withdrawn over five days.

Summary of stress-test scenarios

A summary of the stress test scenarios is presented in Table 8.

Table 8: Summary of stress-test scenarios for interest-rate, credit and liquidity risks

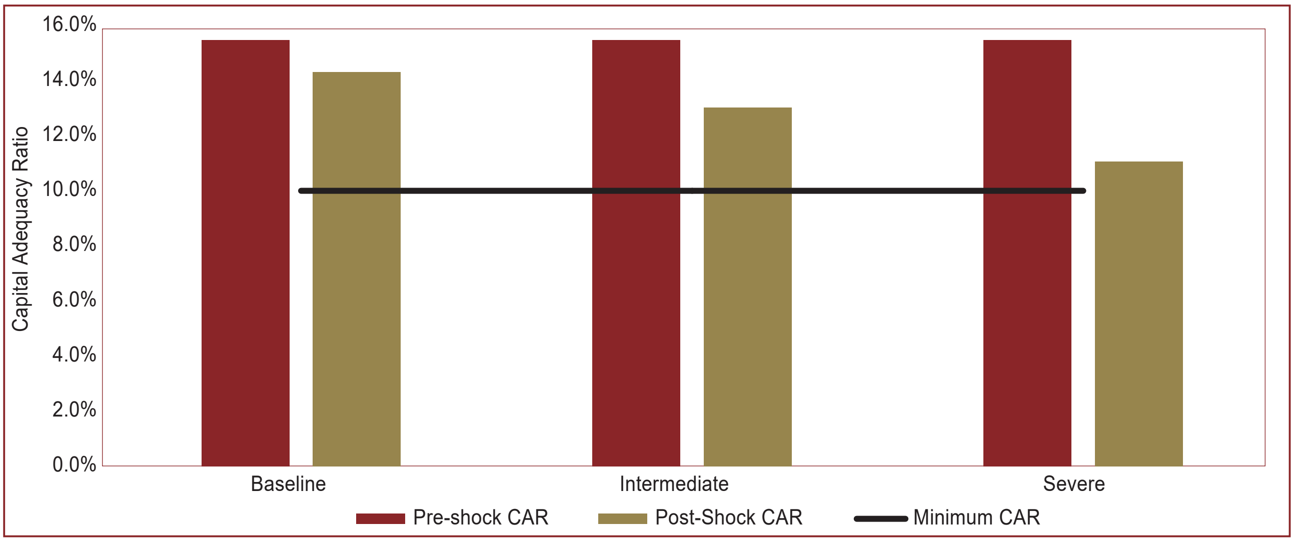
Risk category	Stress-test scenario		
	Baseline	Intermediate	Severe
Interest-rate risk	0.75 percentage point increase	2.0 percentage point increase	3.25 percentage point increase
Credit risk	1.0 percentage point increase	3.0 percentage point increase	6.00 percentage point increase
Liquidity risk	10.75 percent of total deposits, of which 20 percent comprise demand deposits, withdrawn over five days	21.50 percent of total deposits, of which 40 percent comprise demand deposits, withdrawn over five days	32.25 percent of total deposits, of which 60 percent comprise demand deposits, withdrawn over five days
Other variables • 30% haircut on collateral • 50% assumed provisioning of new NPLs			

Stress test results

Solvency

The stress test results indicate that the banking sector remained solvent in all three scenarios, during the projected 12-month period, despite interest rate and credit risk shocks. The pre-shock capital adequacy ratio (CAR) stood at a healthy 15.0 percent (as per the Čihák model), well above the 10.0 percent statutory requirement. In the baseline scenarios the post-shock CAR declined to 14.5 percent. The intermediate scenarios recorded a post-shock CAR of 13.0 percent, whereas in the severe scenarios, the post-shock CAR was lower, as expected, at 11.1 percent (Figure 17). Overall, the 12-month projection by the Čihák Model points toward a solvent banking sector, in all three scenarios. The capital base of the banking sector is therefore adequate to absorb potential shocks, including risks emanating from asset quality in the banking sector.

Figure 17: Solvency stress test results

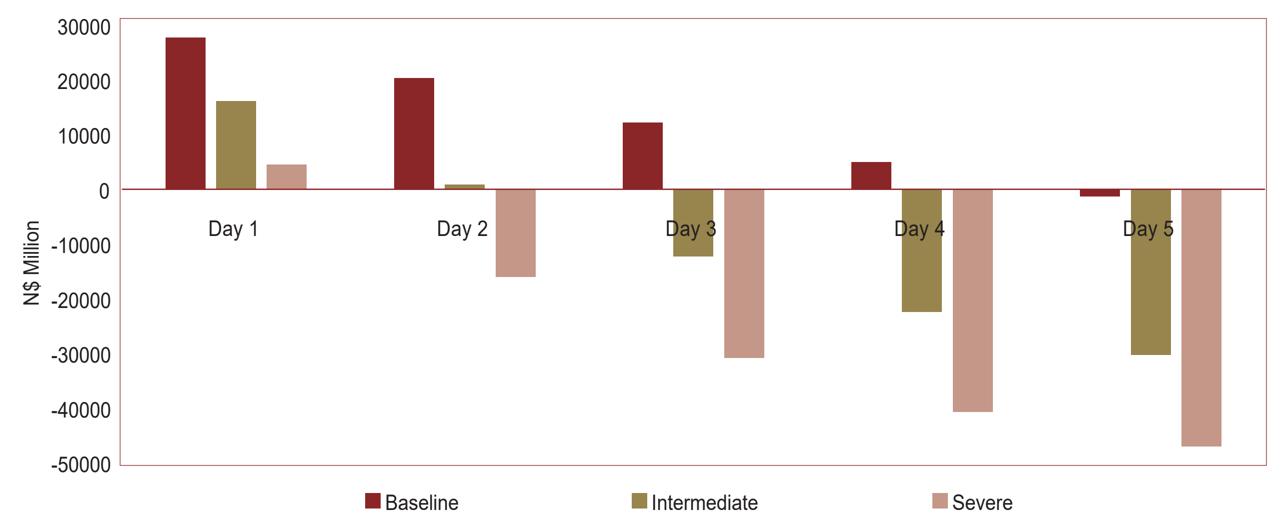


Source: Bank of Namibia

Liquidity

The liquidity position of the banking sector remained mostly sound in the baseline scenario. Generally, the results of a liquidity stress test are used to gauge the commercial banks' ability to withstand an intense but plausible shock caused by unexpected withdrawals of short-term deposits. In the baseline scenario, the liquidity position for the five-day rundown period, remained sound until the fourth day, while declining gradually over the full five days (Figure 18). The intermediate scenario results had a similar trajectory, but with a shorter positive liquidity position and steeper downward trend over the five-day period. The severe scenario on the other hand, experienced a much steeper downward trend, and the liquidity position entered negative territory from the second day onwards. The banking sector would therefore only be able to meet its payment obligations until the fourth day in the baselines scenario, until the second day in the intermediate scenario and on the first day only in the severe scenario, after which the banks liquidity contingency funding plans would become effective.

Figure 18: Liquidity-stress test results



Source: Bank of Namibia

Stress testing remains paramount not only in determining the potential performance of the banking sector when various levels of stress are imposed, but also for projecting risk implications. The stress test results, which consider interest rate, credit, and liquidity risks over a 12-month period, indicate that the banking sector would remain solvent and liquid, for the most part, if the scenarios imposed materialised. The results of the liquidity position in the intermediate and severe scenarios indicate that a liquidity rundown might be more pronounced than that envisaged in the baseline scenario. However, should the banks face liquidity constraints within the first five days of a potential bank run, their respective liquidity contingent fund plans will take effect. Overall risks to the banking sector did not appear significant in 2021. Nonetheless, going forward, asset quality requires continuous monitoring as well as intervention if and when needed.

Overall risk assessment

Although risks in the banking sector have subsided since the 2021 FSR; uncertainty caused by the COVID-19 pandemic and potential interest rate hikes may lead to an uptick in risks in 2022 with concomitant implications for financial stability. Although the NPL ratio remained above the supervisory intervention trigger point of 6.0 percent, the ratio has improved in 2021Q4. This is because the banks have implemented various interventions such as rigorous credit assessments, various relief measures and the NPL recovery options provided to the banks by BoN. Thus, credit risk slowed during 2021, but potential interest rate risk may lead to credit risk rebounding in 2022. Moreover, although stresses from interest rate hikes remained marginal in 2021 with only one policy rate increase, inflationary pressures may push up the associated risks if interest rates increase during

2022. The risk to banks' liquidity was not a concern, given the sector's favourable performance in this respect, namely being well above statutory requirements. However, should a shock ensue that causes a run on the banks, the sector could face liquidity constraints - as indicated by the stress test results, especially in the intermediate and severe scenarios. Liquidity constraints were cited as a factor that could contribute to further credit downgrades for Namibia. In addition, if the repo rate between Namibia and South Africa is not at par and that of South Africa is higher, then there is the potential for a liquidity outflow. As such, liquidity risk in 2022 is assessed as medium with medium impact. On the other hand, concentration risk remained low and well managed.

BOX ARTICLE 2:

LEGISLATIVE CHANGES AND STRUCTURAL DEVELOPMENTS

PRIMARY LEGISLATIVE CHANGES

Proposed changes to the Banking Institutions Act, 1998 (No. 2 of 1998, as amended) are yet to be considered and implemented. *The proposed changes intend to introduce a framework for the second-tier banks. This is in an effort to enhance access to financial services as well as to improve provisions related to investigations of illegal financial schemes. The key provisions of the amended legislation will be tabled once ongoing consultations and deliberations between the legal drafters, the Ministry of Finance, and the Bank of Namibia (BoN) have been finalised.*

SECONDARY LEGISLATIVE CHANGES

The Bank of Namibia (BoN) amended some key provisions of the Determination on Policy Changes in Response to Economic and Financial Stability Challenges (BID-33). *This aimed not only to assist households, Small and Medium Enterprises (SMEs,) and corporates but also to guarding against premature withdrawal of support to the economy and mitigating effects of economic scarring. The factors that necessitated the amendments included the ongoing macroeconomic strain and the uncertainty surrounding emerging COVID-19 variants and their concomitant impact on economic activity at large, which continue to delay economic recovery. Although banking institutions remained adequately capitalised and profitable during the reporting period, prolonged economic distress beyond the initially considered timelines demanded further remedial measures.*

The following amendments came into force during the review period:

i) The Determination was extended for an additional twelve months until 1 April 2023

ii) The loan repayment moratorium was revised from the current 6-24 months to a period of 1-12 months

iii) Banking institutions were prohibited from increasing a client's initial contractual interest rate

iv) A general loan moratorium will not result in an adverse classification at the initial extension thereof, if it was extended as a result of COVID-19 distress

v) A once off 30.0 percent collateral haircut could be imposed on loans by banks once they become non-performing

vi) Liquidity relief measures were extended for the duration of the Determination, and

vii) Credit bureau reporting is not allowed, especially in respect of clients being delinquent if they were benefiting from a loan moratorium rolled over for less than 12 months.

The Bank of Namibia believes that these changes will afford the banking sector and the economy at large the necessary support during these unprecedented times. *The Bank will also continue to closely monitor these developments to ensure a sound domestic monetary and financial system.*

STRUCTURAL DEVELOPMENTS

The Bank of Namibia Act, 2020 (No. 1 of 2020), expanded the Bank's responsibility to include macroprudential oversight of the financial system. *To enable the execution of this new responsibility, respond to the changes in the macroeconomic environment, and implement its Strategic Plan, the Bank reviewed its organisational structure during the reporting year. The review led to the establishment of a new department to deal with financial stability and macroprudential oversight. Accordingly, the mandate of the newly appointed second Deputy Governor is thus responsible for the expanded mandate of macroprudential oversight and financial stability, among others. The new department is responsible for safeguarding and enhancing financial stability, identifying risks and vulnerabilities in the financial system, and assessing the system's resilience to domestic and external shocks. In this regard, the department will support the Macroprudential Oversight Committee (MOC) in formulating and applying macroprudential policies to reduce systemic risks to the financial system. The department is also tasked with resolving distressed banks and supporting NAMFISA in resolving systemically important non-bank financial institutions (SIFIs) in Namibia.*

6. PERFORMANCE OF THE NON-BANK FINANCIAL INSTITUTIONS SECTOR

The NBFI sector's assets grew by 13.9 percent to N$370.6 billion during 2021, despite the continued effects of COVID-19 and inflation (Table 10). The long-term insurance, retirement fund and collective investment scheme (CIS) subsectors – whose collective assets made up more than 90.0 percent of the NBFI sector – grew by 8.1 percent, 16.9 percent and 4.9 percent, respectively. Growth in the assets of long-term insurers emanated from positive market returns as well as from received premiums exceeding claims paid. The growth in CIS assets was primarily due to new business and positive financial market returns, while growth in retirement fund assets could be traced largely to positive financial market returns after COVID-19.

Table 10: Non-bank financial institution (NBFI) sector – Asset size

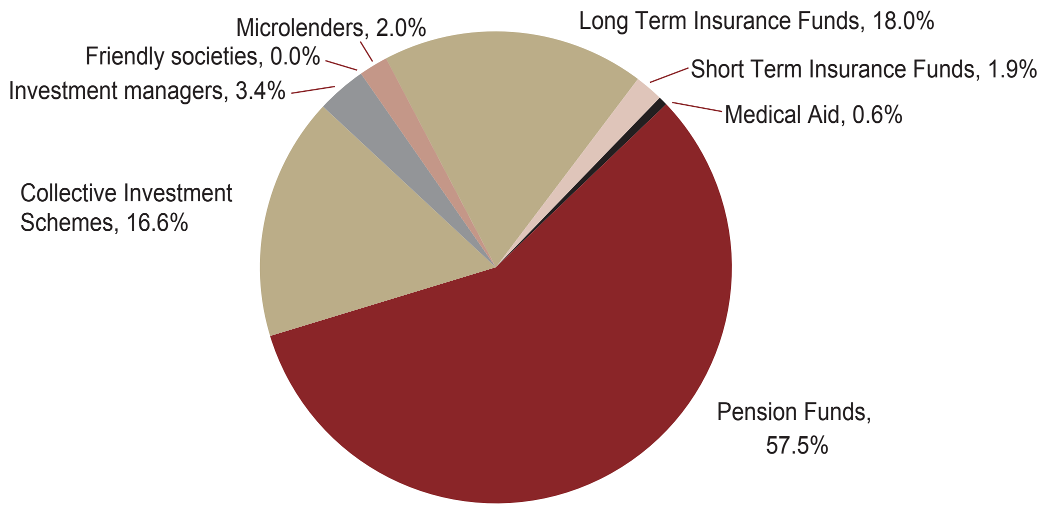
Subsector (N$ million)	2017	2018	2019[8]	2020	2021
Long-term insurers	53,934	56,640	60,165	61,681	66,672
Short-term insurers	6,233	6,540	6,830	6,056	7,188
Medical aid funds	1,772	1,933	2,028	2,359	2,287
Retirement funds	152,885	158,528	173,427	182,192	212,896
Collective investment schemes	47,483	52,252	56,703	59,390	61,622
Investment managers	8,225	7,795	7,669	8,775	12,584
Friendly societies	1.36	1.57	1.73	1.93	2.04
Microlenders	5,460	6,447	7,480	6,055	7,316
Total NBFIs	275,994	290,137	312,677	326,941	370,568
Growth (%)	13.3	5.1	7.8	4.6	13.9

Source: NAMFISA

The distribution of assets across the NBFI sector remained fairly unchanged. The NBFI sector is largely dominated by five players per industry that account for an average of 70–90 percent of the market share. This is evident in the existence of conglomerates in the Namibian market who have various business lines. Moreover, one defined benefit retirement fund remains the largest in the Namibian economy. Conglomerates carry the potential to provide contagion shocks in the event and/or persistence of a crisis, as risk could spill over from one segment to another within the conglomerate structure. The Namibia Financial Institutions Supervisory Authority (NAMFISA) monitors this risk closely. Figure 19 depicts the composition of the NBFI sector.

[8] The total figure for NBFI assets has been restated from what was reported in the 2020 FSR. The restatement was needed to exclude CIS assets under management in respect of the NBFI sector.

Figure 19: Subsector contributions to the NBFI sector, December 2021



Source: NAMFISA

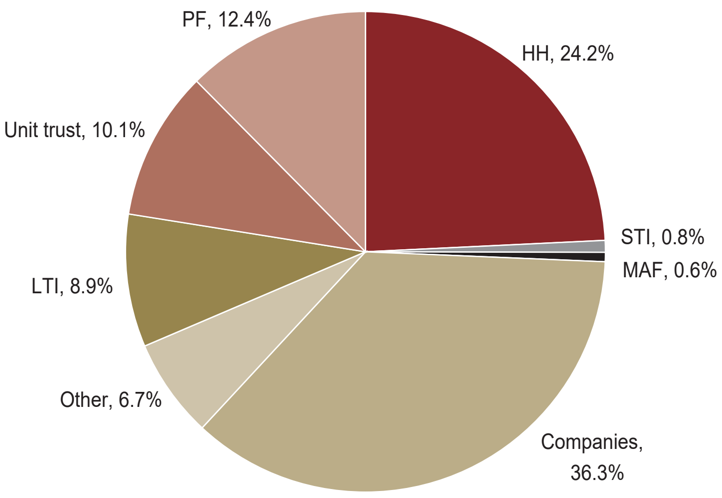
COLLECTIVE INVESTMENT SCHEMES

The CIS subsector remained stable in the review period. CISs remain a conduit through which the financial system sets prices and allocates risk and capital. CIS total assets under management increased by 4.9 percent from the end of 2020 to N$79.8 billion in December 2021. Considering that such schemes are discretionary in nature, in conjunction with the role they play in the financial system, the CIS subsector has the potential to cause liquidity constraints. Therefore, NAMFISA closely monitors CIS funds sourced from households, given that household investments are generally without mandate and can be withdrawn at short notice. CIS funds held as notice, call and other deposits comprised N$17.0 billion of the total during the reporting year. No significant withdrawals of unit trust funds were observed, despite the continued recessionary conditions that affected household income and balance sheets. Thus, the industry remained stable and sound in 2021.

Source and allocation of funds

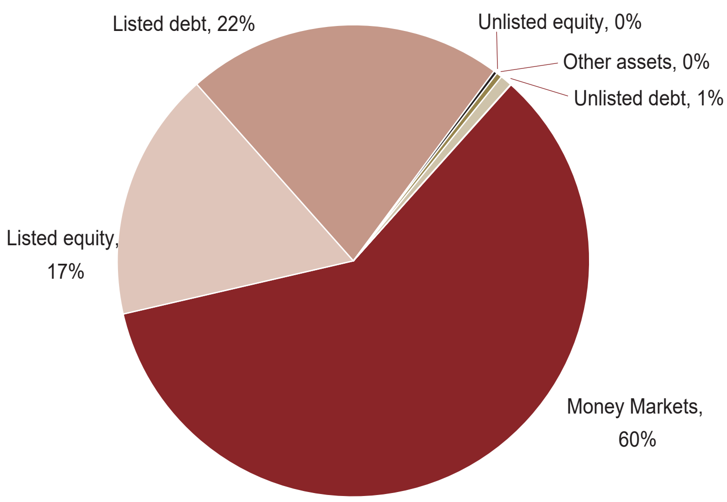
As at December 2021 companies and natural persons were the main sources of funding for CIS. Natural persons and companies, individually, had respectively contributed N$19.3 billion and N$28.9 billion to CIS funds by the end of the review period. As regards the allocation of CIS funds under management, these were primarily channelled through to Money Market, listed equity and debt instruments, with respective shares of 59.8 percent, 17.1 percent, and 21.7 percent (Figure 20b).

Figure 20a: Collective investment schemes – Source of funds, December 2021



Source: NAMFISA

Figure 20b: Collective investment schemes – Allocation of funds, December 2021

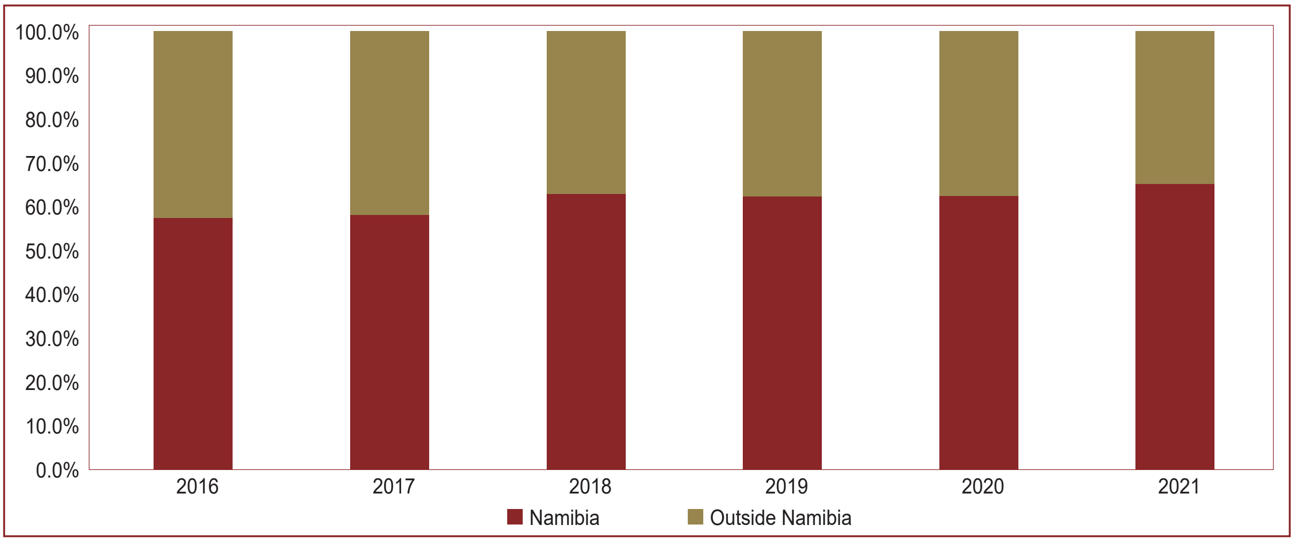


Source: NAMFISA

Geographic allocation of funds

Given the minimum domestic holding requirements, the proportions of the CIS sector per geographic location remained largely unchanged in comparison with the prior reporting period. As at the end of December 2021, the CIS subsector showed it had continued to invest most of its assets domestically, with 65.2 percent of funds under management in Namibia and 34.8 percent outside the country, compared with 62.4 percent and 37.6 percent, respectively, as at 31 December 2020 (Figure 21).

Figure 21: Collective investment schemes – Geographic allocation of funds



Source: NAMFISA

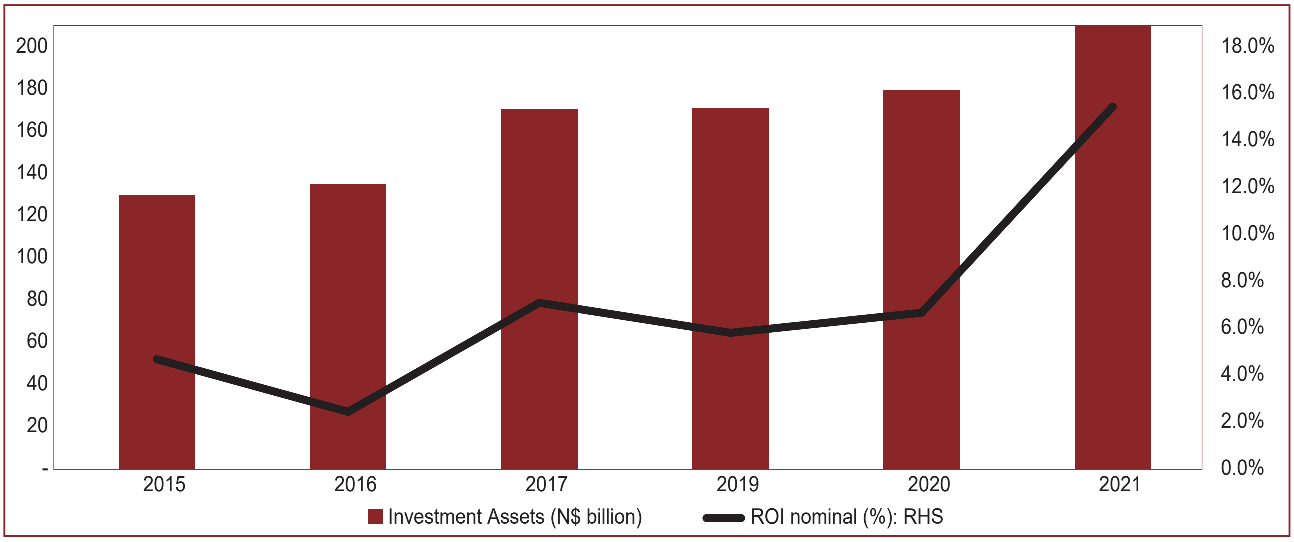
RETIREMENT FUNDS

The retirement fund industry remained operationally resilient for the duration of 2021, withstanding the effects of COVID-19 and rising inflation, as well as the resulting interest rate hikes in various jurisdictions. During the review period, the retirement fund subsector's assets grew by 17.9 percent to N$212.9 billion as at the end of December 2021, due to favourable financial market performances.

Market risk

The retirement fund industry's investment assets withstood the threats arising from COVID-19, higher-than-expected inflation rates, and relatively tighter central bank policies during the review period. Returns on investment were recorded at 15.6 percent in 2021, growing from 6.7 percent and 5.8 percent in 2020 and 2019, respectively (Figure 22). Strong performance was observed particularly in the first and fourth quarters of 2021. Performance in the first quarter of 2021 was due to COVID-19 vaccine rollouts as well as a relatively significant US government stimulus. Furthermore, financial markets withstood the threat of the Omicron COVID-19 variant as well as the prospect of stricter central bank policies to close off the fourth quarter of 2021 positively. Spiking oil prices and the outbreak of the Russia–Ukraine war have contributed to the uncertainty faced by financial markets going forward, which could potentially have negative implications for the retirement fund industry's investment assets.

Figure 22: Retirement funds – Investment performance

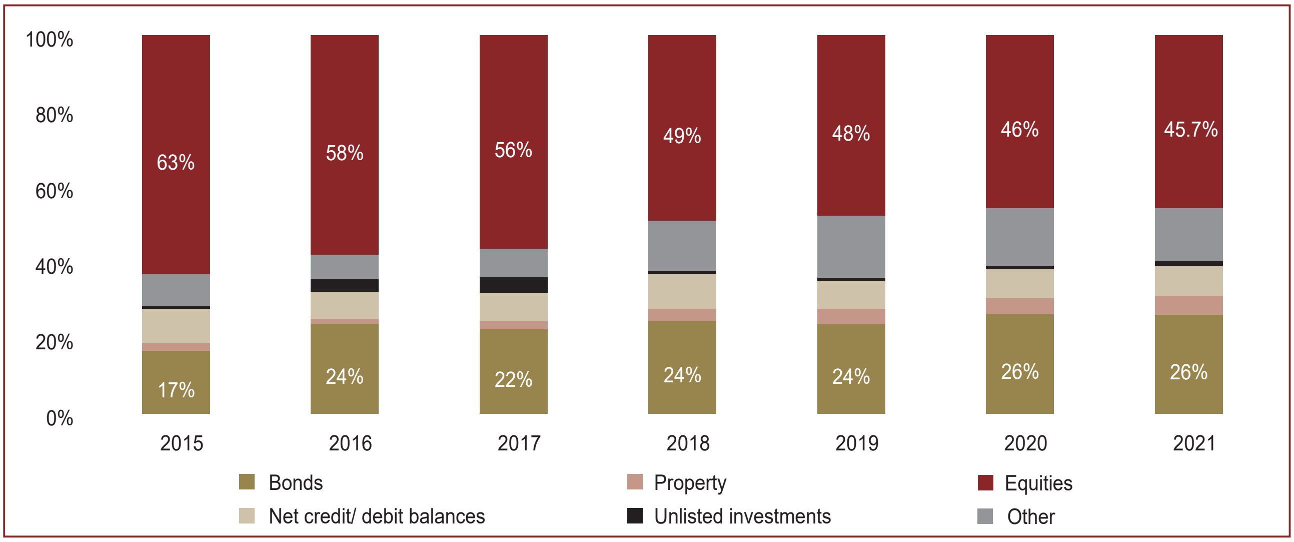


Source: NAMFISA

Investment mix

The retirement funds industry held at least 45.7 percent of its assets in equities during the review period (Figure 23). Bonds and insurance policies made up the remainder of the subsector's top three investment instruments. The reduction in exposure to equities over time coincided with revisions to investment regulations governing these funds. Chief amongst the revisions was the staggered raising of the minimum domestic holding requirement from 35 percent in 2014 to 45 percent effective as at March 2019. Inherently, shocks to financial markets will channel the most severe distress onto the RF subsector's investment assets, given the industry's investment mix. NAMFISA therefore monitors developments in the financial markets relative to inflation and geopolitics.

Figure 23: Retirement funds – Investment mix

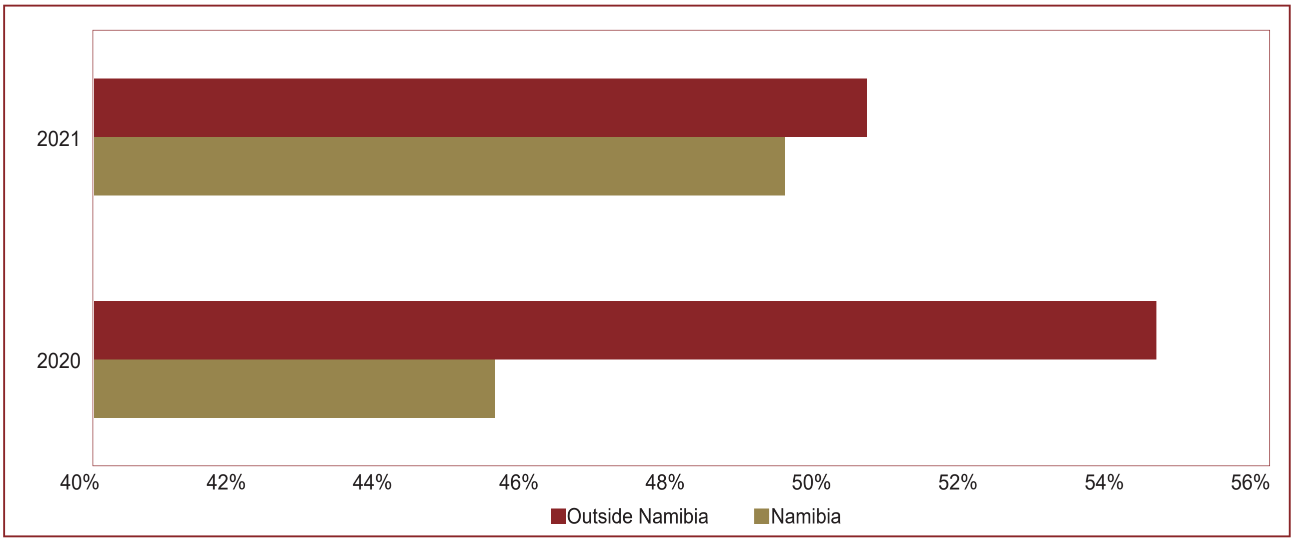


Source: NAMFISA

Geographic allocation of funds

The retirement fund subsector's exposure to the domestic economy increased over the course of 2021 (Figure 24). The industry's domestic exposure increased from 45.6 percent in December 2020 to 49.4 percent in December 2021. The proportional growth in domestic assets is attributable to the domestic holding requirements prescribed by legislation. Retirement funds' investment assets held in the domestic economy amounted to N$104.6 billion as at December 2021, with N$107.0 billion held outside Namibia over the same reporting period.

Figure 24: Retirement funds – Geographic allocation of funds

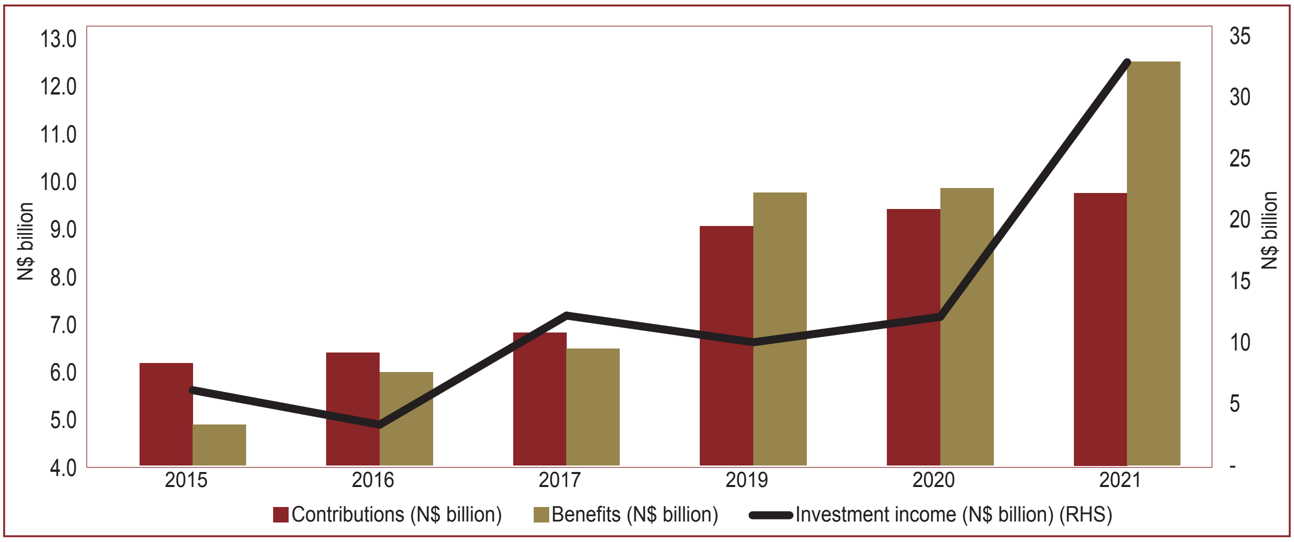


Source: NAMFISA

Cash flow risk

The trend of benefits paid exceeding contributions received, which emerged in 2019 was observed to persist over the review period (Figure 25). The shortfall for the reporting period between benefits paid and contributions received is absorbable by investment income many times over. Furthermore, since retirement fund obligations are long-term in nature, this shortfall is expected to have a low to medium impact in the short term. NAMFISA will nonetheless closely monitor the trend. The growth in benefits paid in 2021 is attributable to the combination of a maturing retirement fund membership and early exits from retirement funds enforced by COVID-19.

Figure 25: Retirement funds – Cash flow risk, 2015–2021

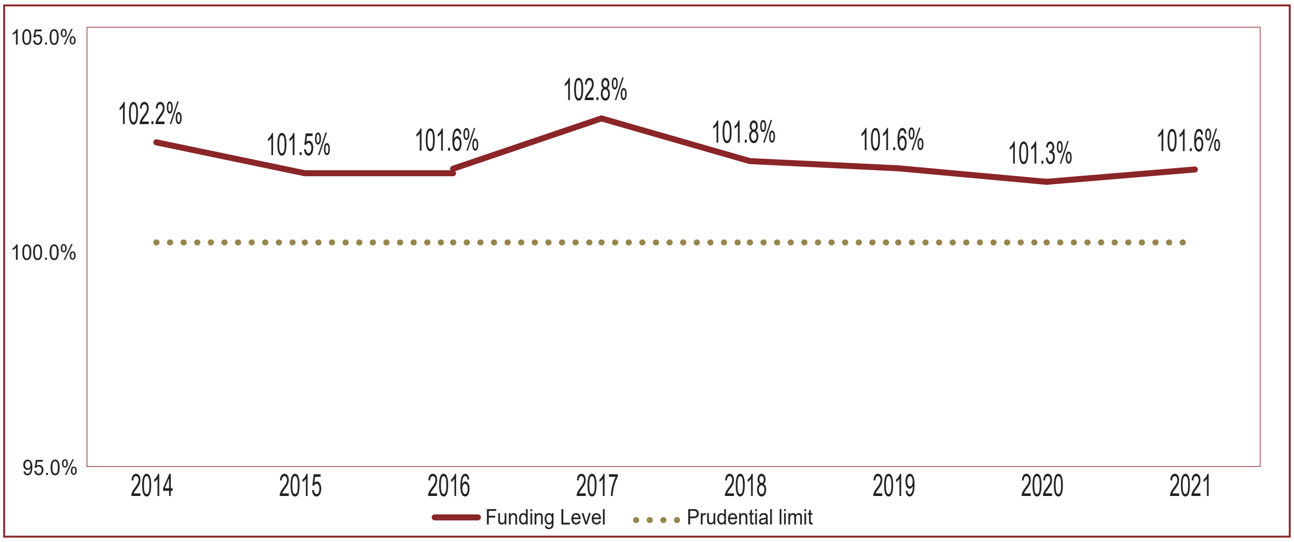


RHS = right-hand side
Source: NAMFISA

Funding position

The retirement fund subsector's funding position remained stable over the review period, supported by positive returns on investments (Figure 26). The funding level steadied over the reporting year, registering at 101.6 percent on average for the period. Due to investment mix, inflation and the threat of an escalating Russia–Ukraine war are the biggest threats to the subsector's soundness.

Figure 26: Retirement funds – Funding position



Source: NAMFISA

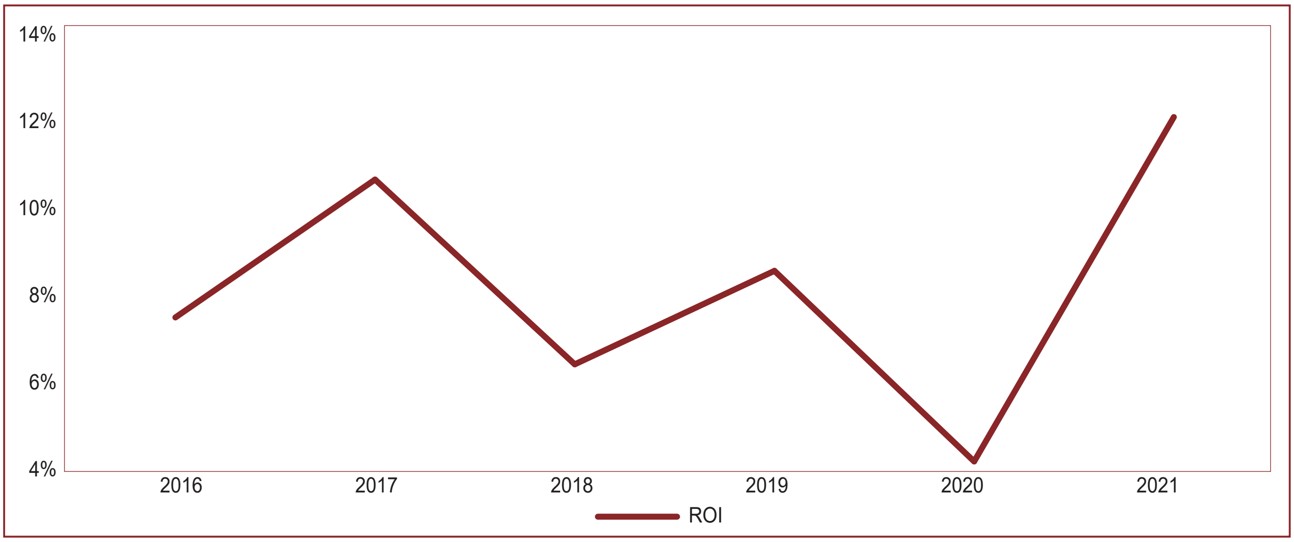
LONG-TERM INSURANCE

Overall, the long-term insurance (LTI) subsector remained financially sound and stable during the year under review, with capital adequacy levels remaining above statutory requirements (Figure 27). The subsector's assets grew by 8.1 percent from the end of 2020 to reach N$66.7 billion by December 2021. This growth was driven by positive returns on investments and new business.

Market risk

LTI investment assets withstood the threats arising from COVID-19, higher-than-expected inflation rates, and relatively tighter central bank policies during the review period. The LTI subsector's investments returned 12.1 percent over the reporting year, improving from the 4.2 percent recorded in 2020 and 8.6 percent registered in 2019. Given how similar the investment mix of the LTI and retirement fund subsectors is, LTI investment assets also performed relatively stronger in Q1 and Q4 of 2021, similar to retirement funds, on the back of COVID-19 vaccine rollouts as well as a relatively significant US government stimulus.

Figure 27: Long-term insurance – Return on investments

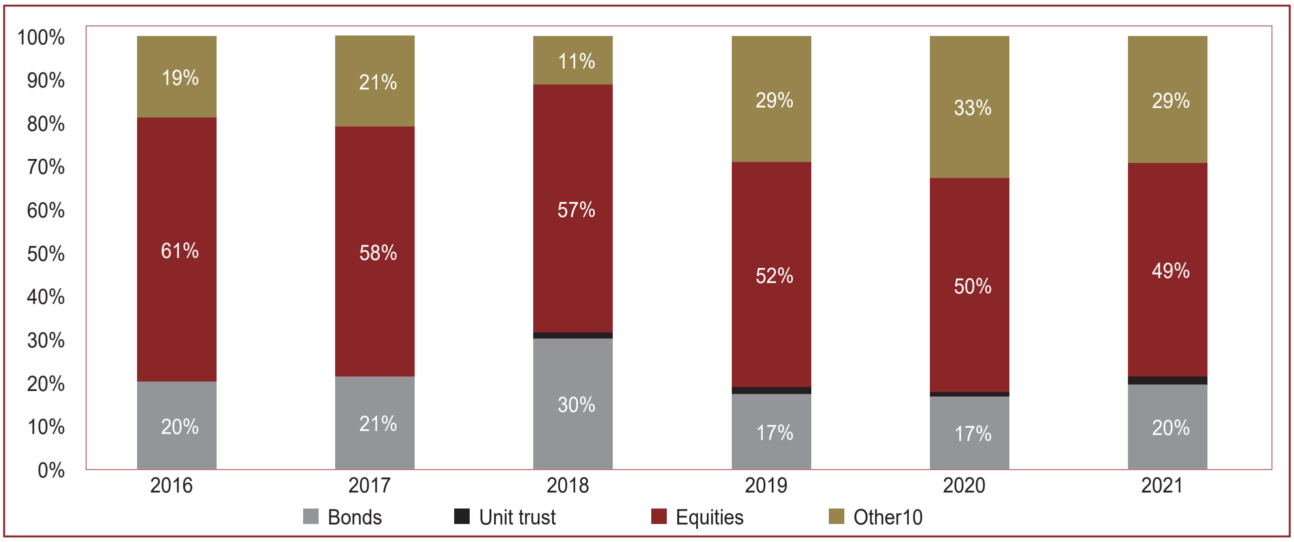


Source: NAMFISA

Investment mix

Given the long-term nature of the LTI subsector, equity remained its preferred asset class, making up 49.4 percent of the subsector's investment assets during the 2021 reporting year (Figure 28). As with retirement funds, the revision of investment regulations – with respect to which the LTI subsector invests – coincides with the subsector's diminishing asset allocation to equities. A sizeable proportion of the sector's investment assets were held in the inclusive Other[9] asset class during the review period.

Figure 28: Long-term insurance – Investment mix

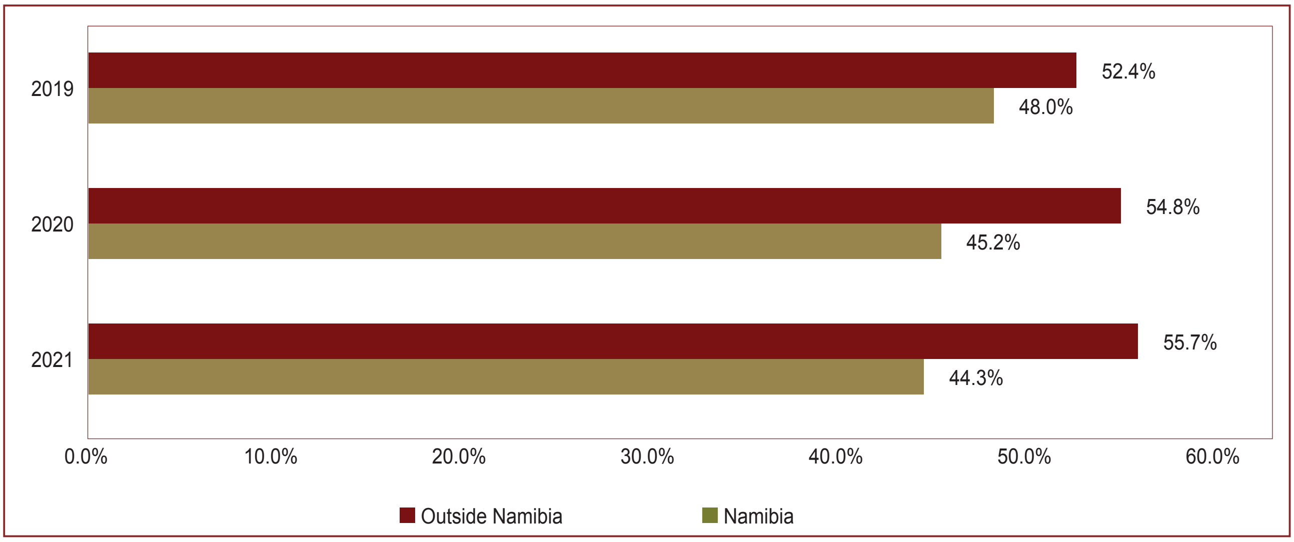


Source: NAMFISA

Geographic allocation of funds

The LTI subsector's domestic exposure reduced proportionally during the review period in comparison with such exposure in 2020 (Figure 29). The proportion of investment assets held domestically reduced from 48.0 percent and 45.2 percent in 2019 and 2020, respectively, to 44.3 percent in 2021. Notwithstanding the proportional reduction in domestic investments, in absolute terms, domestic assets were observed to grow by 5.4 percent from 2020, to N$26.6 billion.

Figure 29: Long-term insurance – Geographic allocation of funds



Source: NAMFISA

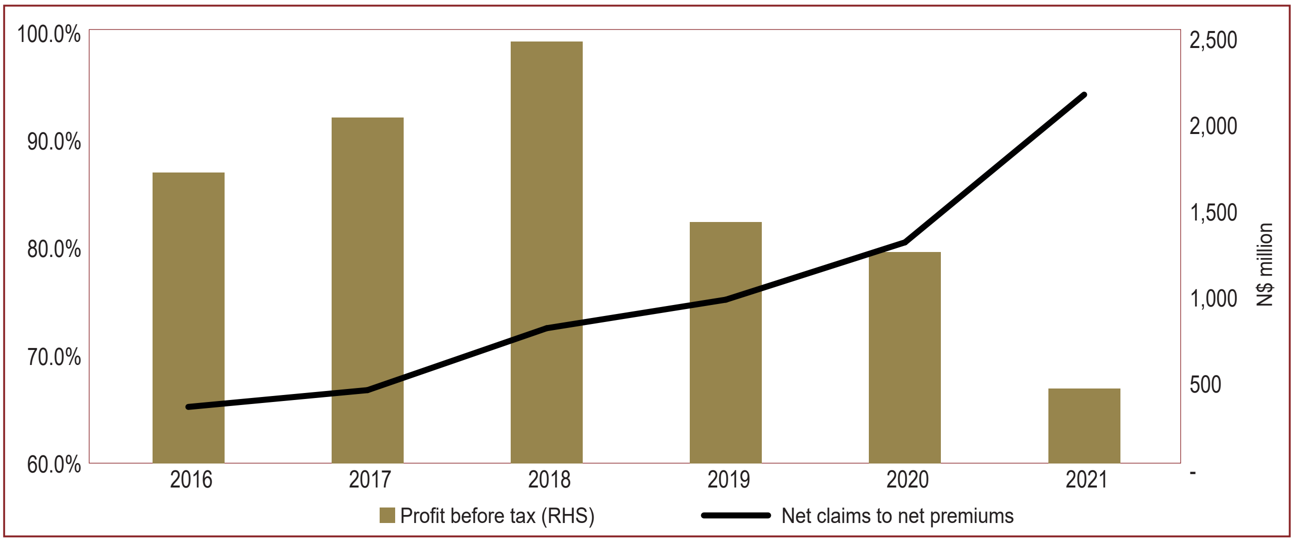
[9] *Other* includes property, unlisted investments, other investments, other claims, and investments in the businesses of associate and subsidiary companies.

Investment assets held in equities outside Namibia remained above 40.0 percent, recorded at 41.7 percent as at December 2021, growing from 40.7 percent at December 2020. Therefore, driven by equity markets, the LTI subsector's investment assets soared from the lows encountered during the first quarter of 2020, to N$60.0 billion in 2021. However, persistent inflationary pressures as well as the Russia–Ukraine conflict give cause for concern.

Earnings and profitability

Margins by which net premiums cover net claims declined continuously from 2016 through to December 2021. Net claims accounted for up to 94.2 percent of net premiums at 2021 (Figure 30). Growth in the net-claims-to-net-premiums cover is attributable to the COVID-19 pandemic, as immoderate levels of COVID-19-related mortality rates were observed, particularly over Q2 and Q3 of 2021. However, it is important not to consider this cover in isolation, since the industry's other income channels adequately offset the effects of the expanding claims experience. This contributed to a positive profit-before-tax position of N$432.6 million being reported for 2021. Nevertheless, the regulator will continue to monitor these developments and take appropriate action where needed.

Figure 30: Long-term insurance – Net claims paid to net premiums received



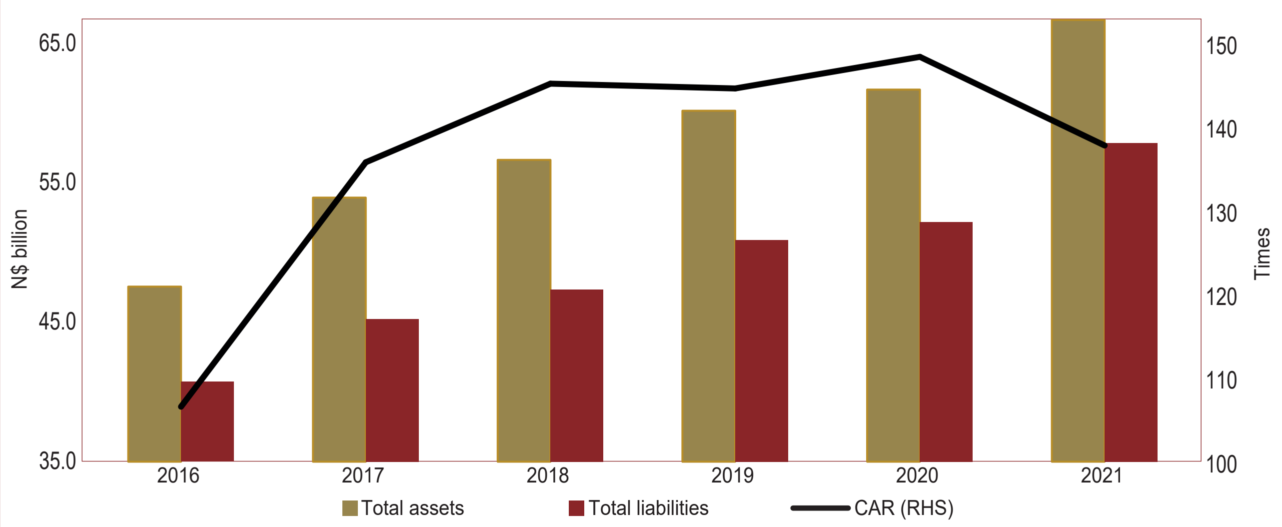
Source: NAMFISA

Capital adequacy

The LTI subsector remained solvent in line with current requirements, which are, admittedly, not risk-based. According to calculations, as at 31 December 2021, excess assets were able to cover the required capital 138 times. Correspondingly, the LTI subsector remained solvent in the accounting sense, with assets sufficiently covering liabilities (Figure 31). In this regard it is notable that the Financial Institutions and Markets Act, 2021 (No. 3 of 2021), was gazetted on 1 October

2021. Under its subordinate legislation, the Act places more stringent and risk-based solvency requirements on LTI companies.

Figure 31: Long-term insurance – Solvency position and capital adequacy



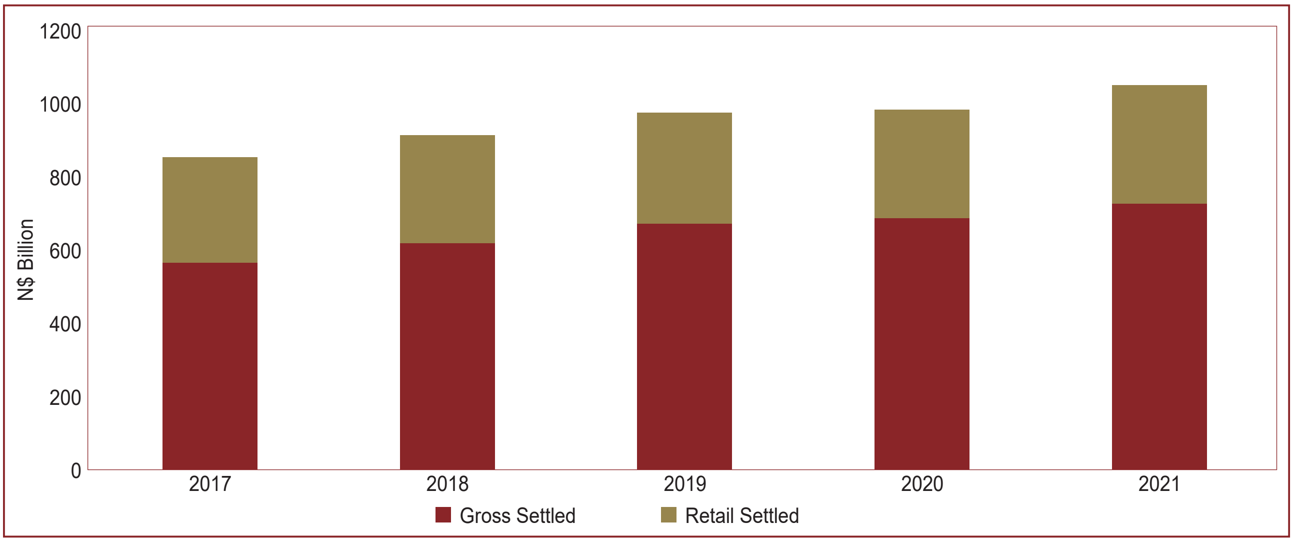
Source: NAMFISA

7. PAYMENT INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

Operational and settlement risk remained relatively low within the National Payment System (NPS), while the total value of fraud increased across all payment streams. Payment systems are a crucial part of a country's financial infrastructure. In Namibia, the regulatory mandate to oversee the NPS was accomplished through risk-based oversight activities both on- and off-site. Namclear, as a designated Financial Market Infrastructure, completed a self-assessment in line with international standards, namely the Principles for Financial Market Infrastructures, while an independent assessment was conducted on the Namibia Inter-bank Settlement System (NISS) to assess the latter's observance of the said Principles. As Financial Market Infrastructures, both Namclear and NISS will, as per their agreed timelines, address any gaps identified by these assessments. Risks identified through the on- and off-site oversight activities are being addressed as well.

The NISS, which was established in 2002, attained a settlement value milestone of one trillion Namibia Dollars during 2021. Key contributors to this achievement were high volumes in the new domestic electronic fund transfer (EFT) system streams via NamPay, the utilisation of the BoN's credit lending facilities (primarily the seven-day repo rate), the purchase/resale of government securities, and the inflow of funds to comply with NAMFISA's Regulation 28. The review period also saw the aggregate settlement value recorded in the NISS totalling N$1,050.4 billion, with 89,758 transactions processed. In this regard, the share of real-time gross-settled transactions accounted for 69 percent or N$726.4 billion, of the total processed via the NISS, while bulk-settled transactions in respect of retail payments made up the remaining 31 percent, or N$323.9 billion (Figure 32). In the period under consideration, the NISS settled an average of 298 transactions per settlement day.

Figure 32: Value of payments processed in the NISS

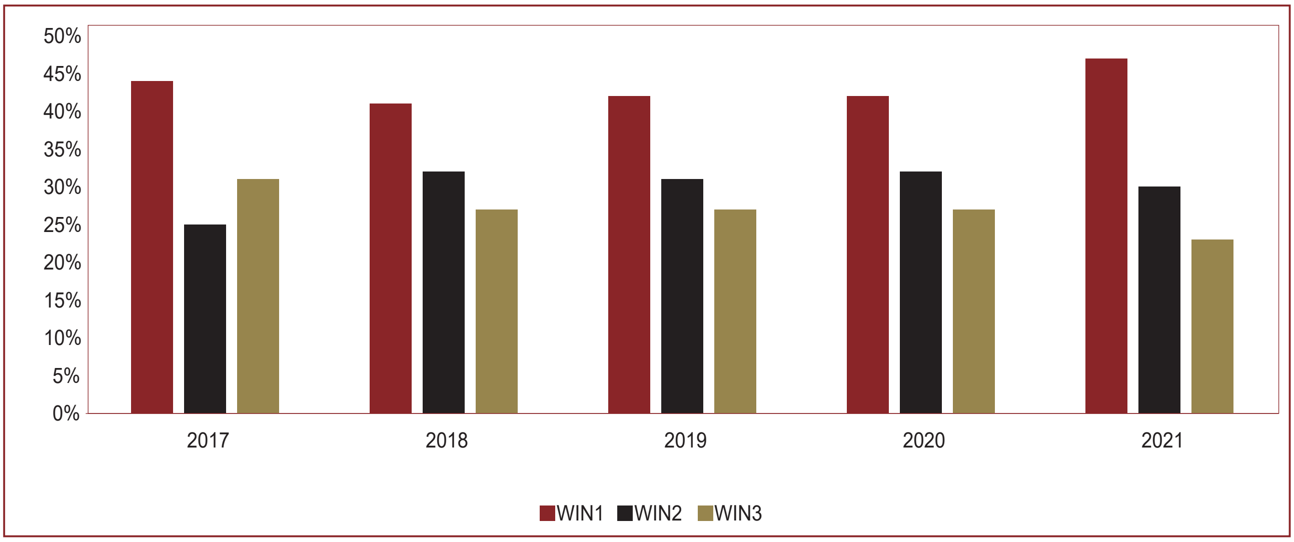


Source: Bank of Namibia

NISS SETTLEMENT WINDOWS

Settlement and operational risks remained minimal within the NPS during the 2021 reporting year in comparison with its 2020 counterpart. The bulk of the payments settled in earlier windows (i.e. Windows 1 and 2) accounted for 77 percent or N$804.8 billion of the aggregate settlement in the review period. This is in line with the preference that most settlement obligations should occur in the earlier windows to curb settlement and operational risks, as participants may be under pressure to arrange sufficient liquidity to meet such obligations during later windows. The NISS settlement statistics in Figure 33 depict that, during 2021, 47 percent or N$488.9 billion of payments were settled in Window 1 (08:00–12:00), 30 percent or N$315.9 billion in Window 2 (12:00–15:00), and 23 percent or N$245.6 billion in Window 3 (15:00–16:40).

Figure 33: Proportions of payments settled in each NISS settlement window



WIN = payment window
Source: Bank of Namibia

DISRUPTIONS TO THE NISS

As was the case in 2020, throughout 2021 the NISS continued to maintain high system availability. From a front-end standpoint, the NISS availability ratio during 2021 was 99.31 percent, which was slightly below the 99.90-percent target. A NISS Disaster Recovery and two Business Continuity Management exercises were successfully conducted in 2021, and the two-hour recovery time objective was achieved.

SECURITY OF RETAIL PAYMENTS

When compared with 2020, the period under review recorded an increase in the total value of fraud across all payment streams. The total value of fraud attributable to card, EFT and e-money streams during 2021 amounted to N$6.8 million, N$2.9 million, and N$3.6 million, respectively. Card payment fraud increased by 16 percent, while fraudulent EFT and e-money payments increased by 49 percent and 56 percent, respectively. The increase in card fraud was primarily due to incidents involving payment where cards were not present, i.e. via internet banking platforms and/or mobile applications, whilst EFT incidents were perpetrated via phishing. Fraudulent e-money payments ensued from incidents involving phone scams. The total fraud perpetrated within the NPS remained within the fraud safety index indicator of 0.05 percent per the BoN's Strategic Goal, namely with a figure of 0.0012 percent being recorded for the review period. Various initiatives are under discussion and are slated for implementation through industry platforms such as the Financial Institutions Fraud and Security Committee to heighten fraud awareness not only among payment system participants, but also vulnerable members of the community.

DEVELOPMENTS IN PAYMENT AND SETTLEMENT SYSTEMS

On 31 October 2021, the BoN finalised the Interchange Determination Project, which involved revising the existing interchange rates for interbank card transactions. Interchange refers to the revenue exchanged between banks every time that a card transaction is performed at an automated teller machine (ATM) or point-of-sale device, involving more than one bank. The Project aimed to revise the existing interchange rates for debit card, hybrid card, credit card, and ATM transactions to reflect current dynamics in the domestic card environment. With the assistance of a consultant, the BoN conducted an interchange costing exercise which involved the collection, validation and analysis of cost data from all the banks that issue payment cards in the NPS. The information, collected through questionnaires, was ultimately used to derive cost-based interchange rates for the card stream. A regulation will be issued in regard to the new rates in due course.

The BoN also recently developed a Financial Technology (FinTech) Regulatory Framework. The Framework aims to guide how the BoN will treat FinTech innovations that are not already subject to BoN regulations. The BoN intends to subject such innovations to a regulatory approach to understand, evaluate and test the innovation before determining a regulatory outcome. The Framework uses three regulatory tools, namely the Allow-and-See Approach, the Test-and-Learn Approach, and the Regulatory Sandbox Approach. Ultimately, the Framework aims to encourage and embrace the introduction of FinTech innovations safely and responsibly. Through the Framework, the BoN intends to provide innovators with an enabling environment to develop, test and deploy much-needed financial products that will promote competition in the provision of financial services and enhance financial inclusion.

The BoN continued to participate in the Southern African Development Community (SADC) Real-time Gross Settlement (RTGS) System during 2021. This regional settlement system processes time-critical or high-value payments between participating SADC countries. At the end of the 2021 reporting period, 84 registered banking institutions and central banks within SADC participated in the System. Five of these participants – which included the BoN – were Namibian. During 2021, the total value of payments processed in the System amounted to ZAR1 317 billion. Namibian banks accounted for ZAR381 billion, which is 29 percent of the SADC-RTGS System total. This position reflects Namibian banks' optimal use of the System in support of integrating regional payments, in accordance with SADC's 2006 Protocol on Finance and Investment.

During the period under review, the Transactions Cleared on an Immediate Basis (TCIB) Payment Scheme, which is being led by the SADC Banking Association and BankservAfrica, went live on 18 November 2021. Following the launch and successful technical testing that took place between selected central banks and participants, the TCIB Payment Scheme became fully operational for participation by banking institutions and NBFIs alike. SADC Member States' participation in the scheme is subject to authorisation by their respective in-country authorities responsible for domestic and cross-border payments. During 2021, the BoN oversaw the on-boarding of one Namibian participant in the regional scheme as it conducted live tests. The assessment for full authorisation into the TCIB Payment Scheme is underway.

The reporting year also saw the SADC Payment System Oversight Committee amending the access and participation criteria related to the SADC-RTGS System to include NBFIs. The inclusion of NBFIs is intended to enhance the SADC payment system platform. The amended criteria will be presented to the Committee of Central Bank Governors in SADC during 2022 for ratification.

In support of adopting the new International Organization for Standardization (ISO) 20022 messaging standards for cross-border payments, the SADC-RTGS Operator, in collaboration with the SADC Banking Association, logged an ISO 20022 Migration Project during the reporting period to ensure the global standard is adopted timeously within the SADC Region. In this regard, the Society for Worldwide Interbank Financial Telecommunication (SWIFT) instructed financial institutions across the globe to migrate from the current Messaging Types (MT) messaging standards upgrade to the new ISO 20022 messaging standards by November 2025. The ISO 20022 messaging standards, in comparison to the MT messaging standards, are deemed to be richer as they improve the overall quality and consistency of data across messages, to mention but one example. Relevant engagements are currently under way at both regional and domestic levels to comply with this deadline. At a regional level, the SADC-RTGS Operator and the SADC Banking Association's current ISO 20022 Migration Project proposes an earlier implementation date for the SADC Region, namely October 2023. Domestically, the BoN, as part of its oversight efforts, will continue to ensure that the NPS not only continues to comply with international standards, but also migrates to the ISO 20022 by the proposed SADC deadline date. The BoN also issued a Guidance Note during the reporting year to ensure timely migration.

The reporting period saw the BoN participating in the continent wide payments system integration project to interlink the various African regional payment systems. The Project was initiated by the Association of African Central Banks (AACB) and is driven by AACB Governors. All AACB members and the regions are expected to align their strategies with the Project. Two Working Groups under the AACB Task Force were established and are mandated to develop an interregional integration framework for the payment systems concerned as well as an integrated mobile/retail payment strategy for the continent. Both the BoN and representatives from Namibia's private sector are members of these Working Groups

IMPACT OF THE COVID-19 PANDEMIC ON THE NPS

The review period recorded a considerable impact of the COVID-19 pandemic on NPS participants' business operations. Given the emergency regulations to combat the spread of COVID-19 during the reporting period, all payment system participants and payment service providers duly arranged to ensure business continuity, particularly from a service delivery perspective. Thus, both banking institutions and NBFIs encouraged greater use of their digital channels to ensure continuity of services to their customers. A significant increase in the use of digital payment channels was recorded during the reporting period.

The BoN did not detect any impact on the payment infrastructure during the year under review, as these platforms continued to function seamlessly. The pandemic had no notable impact on clearing and settlement services. This was because their operators, Namclear and the BoN, took appropriate measures to ensure that disruptions were kept to a minimum. Furthermore, no significant industry projects were halted during the pandemic, while the enhanced EFT system known as *NamPay* was fully implemented during the period under review. Moreover, despite the pandemic, the BoN maintained high system availability and provided intraday and overnight repo lending facilities to NISS participants to fulfil their settlement obligations within the NISS.

BOX ARTICLE 3

FUTURE DEVELOPMENTS IN PAYMENT AND SETTLEMENT SYSTEMS

Given the ongoing conversation on digital transformation and innovation within the national payment system, the Bank has identified four key projects that will serve as a response thereto. *In this regard, the below-listed action items serve as a depiction of the Bank's intention and drive towards creating an enabling regulatory environment geared toward the realities of the 21st century. Most of the identified initiatives will be finalised during 2022, however, they might also warrant a multi-year approach; this however is dependent on a number of factors.*

As part of its efforts to address the changing payments landscape, the BoN is revising the existing Payment System Management Act, 2003 (Act No. 18 of 2003), as amended (the Act). *The review period saw the BoN in the process of finalising the new Bill for the Ministry of Finance's consideration and further engagement, in line with the legislative process. Given the developments in the NPS and beyond, the new Bill aims at expanding the BoN's regulatory scope to include non-traditional payment instruments and participants, and it will address notable gaps in the existing Act, such as the lack of consumer protection principles.*

In line with the Bank's digitisation agenda as articulated in its new Strategic Plan for 2022-2024 as well as the National Payment System (NPS) Vision 2025, the Bank was tasked to research the feasibility of Open Banking in the Namibian financial system. *Open Banking involves the usage of APIs by authorised third-party financial institutions to access and exploit data owned by customers but stored and managed by banking institutions and non-banks to produce value for customers without infringing on customers' privacy rights. Given the aforementioned, the Bank is presently conducting the relevant research and stakeholder engagements to develop and issue an NPS policy position paper herein. The outcomes of the policy position paper will determine how the Bank in conjunction with the NPS industry will implement Open Banking in the domestic market in future.*

Furthermore, in accordance with the Bank's Strategic plan for 2022-2024, the Bank deemed it imperative to embark on a real time gross settlement (RTGS) system modernisation journey. *The ever-evolving payment system landscape has compelled the Bank to reassess the adequacy of the current RTGS system. In this regard, the Bank is conducting a study to determine payment related aspects in the RTGS environment that could add value to the provision of services to the RTGS participants, with the aim to ensure a resilient, modern RTGS system that operates in line with international best practices.*

To strengthen operational excellence and enhance security in the NPS, the Bank has planned to issue operational and security standards in 2022. *The NPS requires at a minimum, a standardised instrument that is enforceable and which covers the operations and safety of the NPS. The operational aspects may consider key risk indicators for the operations (e.g., availability, recovery time objectives, type of failovers, etc.) of important systems in the value-chain of payments in the NPS. The security aspects may consider, among others, the safety of payment data to curb data breaches and reduce cyber fraud in general. The implementation timelines will be dependent on the complexity and requirements of the standards.*

8. CONCLUDING REMARKS AND POLICY IMPLICATIONS

As global economic conditions stabilised during the review period, the Namibian financial system remained resilient and solid, within a fluid economic environment. Thus, banking institutions and NBFIs remained profitable and met all relevant statutory requirements, despite feeling the shock of the COVID-19 pandemic. In the banking sector, although asset quality deteriorated slightly, the banks remained well capitalised and liquid. The risk to financial stability from this sector remains minimal. Similarly, NBFIs also remained profitable, even growing their asset base during the period under review. Despite household and corporate debt increasing marginally in 2021 compared with 2020, this was expected: the domestic economy was hit hardest during the reporting year, meaning that both households and businesses demanded more credit to finance cash-flow shortages. The payment system and infrastructure nonetheless remained resilient and reliable, reaching a milestone transaction value of N$1 trillion during 2021.

Near term risks to global financial stability remain elevated and uncertain. At the end of 2021, there were positive sentiments around the global outlook as economic activity recovered from the devastation caused by the pandemic in 2020. Swift Vaccine roll out and uptake in the developed world helped lessen the severity of the pandemic in those economies, allowing authorities to reopen economic conditions with minimal restrictions. Global financial markets remained robust with returns basically going back to pre-pandemic levels. However, going forward, near term risks are centered around how the less wealthy countries handle the pandemic, coupled with military conflict and geopolitical tensions. The Russian invasion on the Ukraine could significantly impact inflation and overall military stability globally. Given the fact that the global economy has recently begun recovering from the shock of the pandemic since Q1 2020, it is difficult to predict how the global economy will fair if inflation skyrockets as incomes are dragging behind. Most major economies have maintained an accommodative monetary policy stance, although this may change if inflation spikes, and Central Banks choose monetary policy as one of the tools to manage inflation. Therefore, the FSSC found that medium term risks remain elevated but uncertain going forward with a slightly negative outlook. Proactive regulation and supervision would therefore be required to mitigate potential systemic risks.

Going forward, risks to the Namibian Financial System will be monitored closely. Risks to the domestic financial system remained centered around global risks as over half of the assets invested by Namibian financial firms are held abroad. Therefore, the performance of the global economy has a direct impact on the investment returns of investors in Namibia. Despite relaxed regulations and the significant increase in economic activity since 2020, COVID-19 remains a health crisis in Namibia because individuals are hesitant to take the vaccines which could prevent Namibia from reaching herd immunity. Since the April 2021, the most pertinent risk is the military conflict between Russia and Ukraine which has the potential to cause a significant spike in imported inflation and the risk of further sovereign credit rating downgrades if public debt is not managed efficiently. Notwithstanding the highlighted risks, the Namibian financial system remained robust and stable during the period under review.

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