Bank of Namibia

NAMFISA
NAMIBIA FINANCIAL
INSTITUTIONS SUPERVISORY AUTHORITY

NAMIBIA FINANCIAL STABILITY REPORT
APRIL 2023

Publishers:

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CORPORATE CHARTERS

Bank of Namibia

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
NAMIBIA FINANCIAL INSTITUTIONS SUPERVISORY AUTHORITY

NAMIBIA FINANCIAL INSTITUTIONS SUPERVISORY AUTHORITY

Vision

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

Mission

To regulate and supervise financial institutions and financial intermediaries to foster a stable, fair non-banking financial sector and to promote consumer protection and provide sound advice to the Minister of Finance

Values

We are committed to teamwork
We are passionate about service
We act with integrity
We are accountable
We are agile

MEMBERS OF THE FINANCIAL SYSTEM STABILITY COMMITTEE

Bank of Namibia

BANK OF NAMIBIA

- **Governor (Chairperson)**
- **Deputy Governors**
- **Director:** Financial Stability and Macroprudential Oversight
- **Director:** Banking Supervision

NAMFISA
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- **Chief Executive Officer (CEO) (Deputy Chairperson)**
- **Deputy CEO:** Market Conduct and Operations
- **Deputy CEO:** Prudential Supervision
- **General Manager:** Research, Policy and Statistics

Ministry of Finance and Public Enterprises

MINISTRY OF FINANCE

- **Director:** Economic Policy Advisory Services (Non-voting member)

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 also functions as a communication tool.

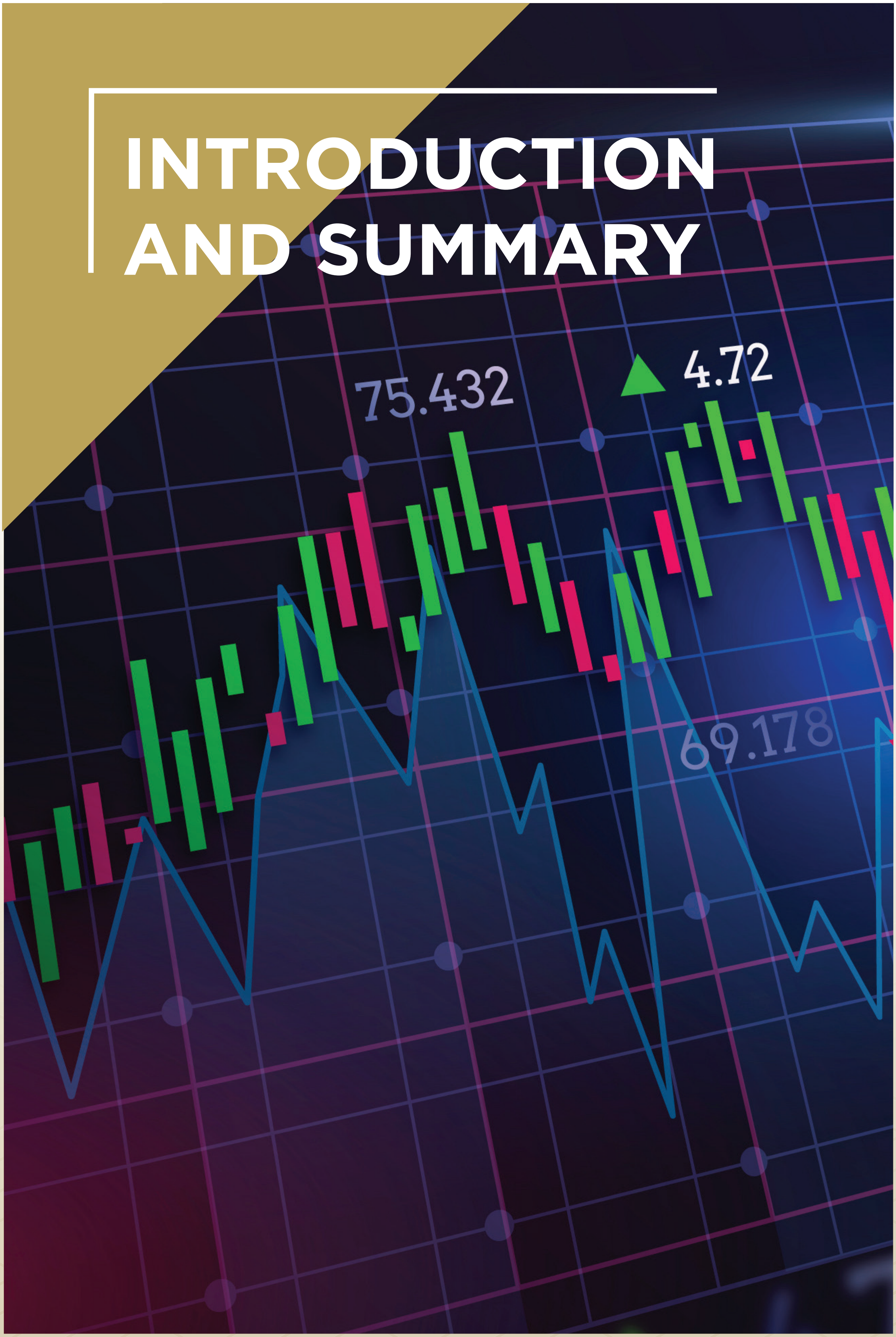
Financial system stability is defined as the resilience of a financial system to internal and external shocks, be they economic, financial, political, or otherwise. Financial system stability can also be described as the absence of significant macroeconomic disruptions in the system of financial transactions 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 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 Macroprudential Oversight Committee include consulting with the Namibia Financial Institutions Supervisory Authority (NAMFISA) and the Ministry of Finance (MoF) to ensure that policies are in place to manage financial stability and foresee crises 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, 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 (BoN). The Committee also acts as a liaison between the MoF, NAMFISA, and the Bank of Namibia on matters related to Namibia's financial stability.

[1]More information is provided in the Financial Stability and Macroprudential Oversight Framework which can be found on the Bank of Namibia website (bon.com.na).

INTRODUCTION AND SUMMARY



1 INTRODUCTION AND SUMMARY

The international financial system was put to the test by recent bank failures, inflationary pressures and rapid monetary policy tightening, while simultaneously being faced with additional vulnerabilities in 2023. The failure of Silicon Valley Bank and Signature Bank in the United States, caused by liquidity constraints, and the state supported merger of Credit Suisse and UBS in Europe, has significantly impacted market confidence and triggered emergency responses by the respective authorities. These bank failures pose a threat to global financial stability as further contagion could have far reaching implications, thus highlighting the importance of safeguarding the financial system. The International Monetary Fund (IMF) April 2023 ***Global Financial Stability Report*** indicates that risks to the financial system have increased on the back of rapid interest rate increases to contain inflation. In addition, further monetary policy tightening is projected to continue well into 2023. Although inflation is projected to slow down in 2023, inflation's return to target is unlikely before 2025, for most countries. Going forward, global growth is expected to shrink by 2.8 percent in 2023 amidst severe tightening of financial conditions in which corporate and sovereign spreads widen, stock prices fall and a currency depreciation of most emerging market economies. Policymakers are therefore cautioned to act resolutely to maintain trust, while faced with heightened risks to financial stability.

Overall, the Namibian financial system remained sound and resilient in 2022; however, projected vulnerabilities in the global financial system could potentially impact the financial system. Risks are centred around global and domestic output developments coupled with anticipated tighter financial conditions globally. Both the global and the Namibian economies are projected to slow down in 2023, mainly due to continued geopolitical tensions and rising central bank rates. Notwithstanding the decline in global output, domestic output improved in 2022, while the domestic financial system continued to function effectively and efficiently. Both corporate and household debt however increased during the reporting period. The banking sector remained adequately capitalised and profitable while maintaining liquidity levels well above the prudential requirement and managing credit risk accordingly. Similarly, the non-bank financial institutions (NBFIs) maintained stable, sound and profitable operations during the period under review. The payment system infrastructure continued to reliably contribute toward the efficiency of the financial system. Overall, risks to the financial system mostly increased; however, the probability of this persisting is medium with medium impact.

Global growth prospects weakened further amidst continued military conflict, geopolitical tensions, inflationary pressures, and rising interest rates. Global growth slumped during 2022 from 6.3 percent registered in 2021 to 3.4 percent in 2022. This slowdown was primarily on the back of the war in Ukraine that further fuelled inflationary pressures, coupled with the resurgence of Covid-19 in China. According to the International Monetary Fund (IMF) April 2023 ***World Economic Outlook***, it is estimated that global growth will fall further, from 3.4 percent in 2022 to 2.8 percent in 2023, before improving slightly to 3.0 percent in 2024. Going forward, risks remain heavily skewed to the downside because of the military conflict in eastern Europe, potential worsening of debt distress, tight monetary policy to fight inflation, China's slow recovery, recent further tightening of financial conditions, and looming geoeconomic fragmentation.

Although the domestic economy recorded improved growth in 2022, it is projected to slow down in 2023. Domestic economic growth improved from 3.5 percent in 2021 to 4.6 percent in 2022. This improvement was mainly driven by the primary and secondary industries that recorded growth rates of 12.9 and 3.3 percent, respectively. Growth is projected to moderate to 3.0 percent in 2023 on the back of anticipated weaker global demand and reduced spending power, as inflationary pressures persist. Risks to domestic growth are predominantly in the forms of a global tightening of monetary policy and high costs of key import items. Other domestic risks include water supply interruptions, potential spillovers to Namibia of electricity cuts in South Africa, and uncertainty about the effects of climate change going forward.

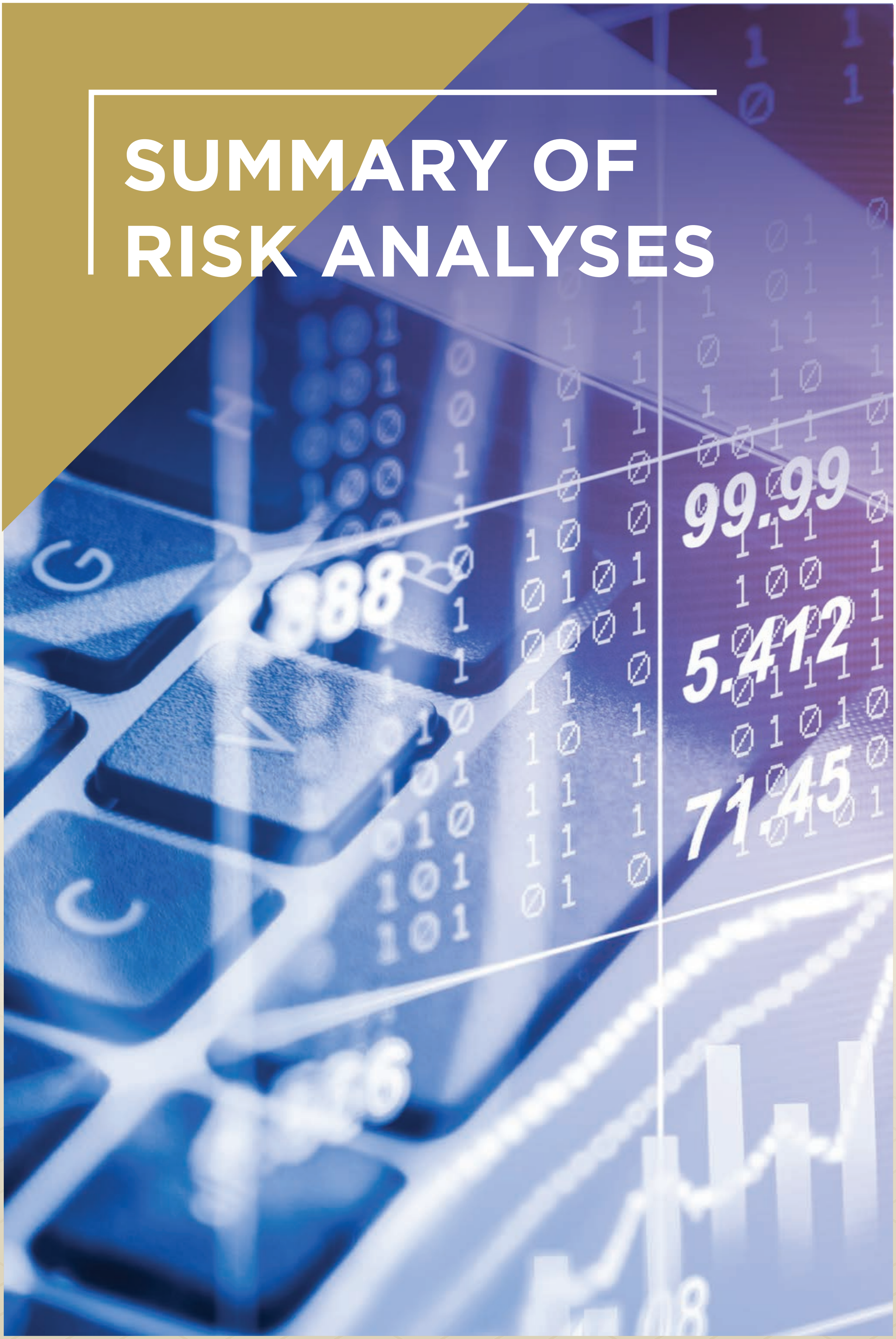
Both household and corporate debt stock increased during the reporting period, although growth in household debt slowed. The annual growth in household debt slowed to 3.4 percent by the end of 2022, compared to a growth rate of 3.8 percent in 2021. The ratio of household debt to disposable income moderated from 79.4 percent in 2021, to 77.9 percent in 2022, following the recovery in economic activity and approval of salary increments for government employees in 2022. The total corporate debt stock rose somewhat in 2022 due to increases in both foreign and domestic debt. The corporate sector's debt-to-Gross Domestic Product ratio increased to 72.0 percent by the end of 2022, up from the 69.2 percent recorded in 2021. The short-term risks to financial stability in respect of corporate debt appear to be moderate, although sharp interest rate increases in 2022 to curb inflation have put a strain on the cashflow of indebted corporates and households. Notwithstanding the current fluid economic environment, the probability of both household and corporate debt risks materialising is medium.

The banking sector remained liquid, profitable, and well capitalised during the period under review, with improved asset quality. Banking sector assets grew at a rate higher than the prevailing inflation; though a positive development, it is not sustainable to maintain asset growth at this level given slowed economic activity. In addition, the banking sector reported higher profits, improved asset quality, a healthy liquidity position, and capital adequacy well above prudential requirements, which is indicative of a stable banking sector. The overall impact of risks from the banking sector did not appear to be significant during the period under review, and have therefore not posed a real threat to financial stability in Namibia. Going forward, the stress test results point toward a liquid and solvent banking sector; as such, the probability and impact of downside risks to financial system stability emanating from liquidity constraints and asset quality deterioration range between low and medium.

The NBFIs sector remained resilient in 2022. NBFI assets contracted by 1.2 percent to N$366.1 billion, coinciding with negative financial market performances over the first three quarters of 2022, despite the contraction. The sector is expected to remain solvent in the short- to medium-term, with its net assets expected to robustly absorb adverse asset side shocks. Risks inherent in NBFIs include inflation and its impact on the affordability of NBFI services, particularly medical aid funds, long- and short-term insurance, and market risk and its impact on the asset side.

The National Payment System (NPS) and infrastructure remained stable, efficient, and effective during 2022. The Bank of Namibia (BoN) ("the Bank") continued to fulfil its regulatory mandate as the overseer of the NPS in line with the Payment System Management Act 18 of 2003, as amended. The Namibia Interbank Settlement System (NISS) continued to maintain high system availability throughout 2022. When compared to 2021, there has been an overall increase in the total value of fraud across all payment streams, primarily electronic fund transfers (EFTs) and e-money payments; however, client education and awareness initiatives are under discussion to mitigate this going forward. Overall, risks to the financial system emanating from the NPS have remained broadly unchanged and well managed.

SUMMARY OF RISK ANALYSES



2 SUMMARY OF RISK ANALYSIS

This section presents a brief analysis of the main risks to the stability of the domestic financial system. In line 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 *April 2022 Financial Stability Report* (FSR). Table 1 summarises the risk position of the Financial System Stability Committee (FSSC), which shows the direction of risks since the previous FSR and the probability and impact of the cited risks materialising in 2023. Figure 1 considers the same risks but shows whether risks have increased or decreased overall during the period under review.

Table 1: Risks to financial stability in Namibia

Nature of risk	Direction of risk[2] since April 2022	Probability of risk materialising in 2023	Impact of risk materialising in 2023
Macroeconomic environment events/risks			
Global economic slowdown	Up		
Global financial turbulence	Up		
Domestic economic slowdown	Down		
Decline in international reserves	Down		
Sovereign credit rating downgrade: Namibia	Up		
Sovereign credit rating downgrade: South Africa	Up		
Excessive NAD/ZAR depreciation	Up		
Public sector debt			
Unsustainable increase in public sector debt	Up		

Nature of risk	Direction of risk[2] since April 2022	Probability of risk materialising in 2023	Impact of risk materialising in 2023
Household debt risk			
Excessive increase in household debt	Up		
Corporate debt risks			
Excessive increase in corporate debt	Up		
Banking sector risks			
Liquidity risk	Down		
Credit risk	Down		
NPS risks			
Security of retail payments	Unchanged		
Settlement in last window	Down		
NBFI risks			
Funding position	Up		
Cash flow risk	Down		
Market risk	Up		
Solvency position	Unchanged		

Key	*Low*	*Medium*	*High*

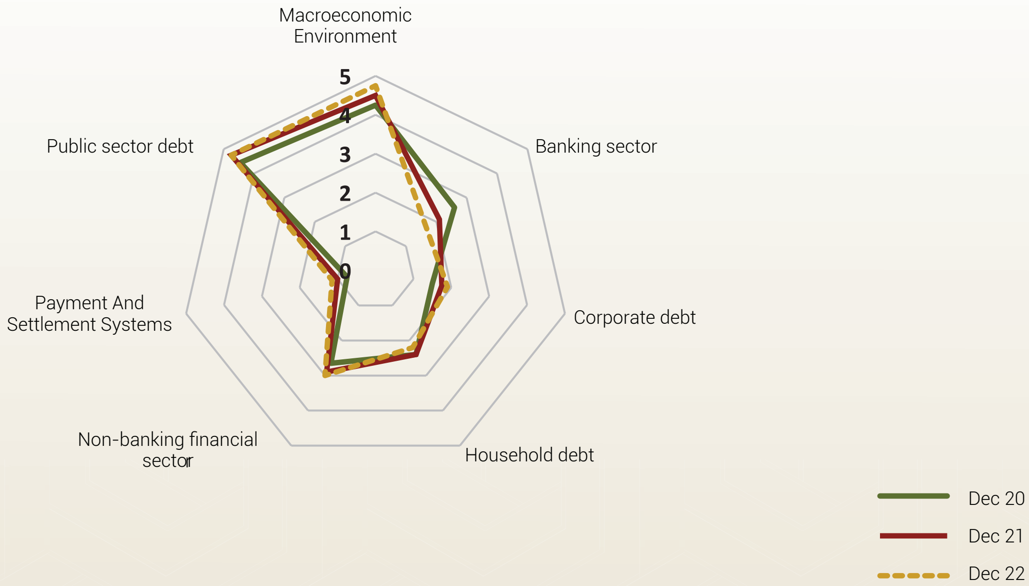
[2] Compared with the April 2022 FSR.

Global financial stability risks have increased, and the balance of risks is significantly skewed to the downside. According to the IMF's April 2023 ***Global Financial Stability Report,*** financial vulnerabilities are elevated in the sovereign and NBFI sectors, while market liquidity has deteriorated across some key asset classes. As central banks aggressively tighten monetary policy, soaring borrowing costs and tighter lending standards, coupled with stretched valuations after years of rising prices, could adversely affect housing markets and asset quality in the banking sector. High levels of capital and ample liquidity buffers bolstered the resilience of the global banking sector. It is recommended that central banks act resolutely to bring inflation back to target, levels in order to, keep inflationary pressures from becoming entrenched and avoid the de-anchoring of inflation expectations that has the potential to damage credibility. Potential systemic risks can be addressed through proactive financial regulation and supervision.

Although some risks to Namibia's financial system stability have eased, others, primarily risks emanating from the macroeconomic environment, have increased. Since the 2022 FSR, most risks have gone up; however, these are risks associated with developments in the macroeconomic environment which have a subsequent impact on household and corporate debt, the banking sector, the NBFIs; and (to a lesser) extent the NPS (Table 1). The uptick in risks in the macroeconomic environment was mainly as a result of a significant slowdown in global output, increased global financial turbulence, the depreciation of the Namibia Dollar (NAD) against major trading currencies, and sovereign credit rating downgrades. Risks from a slowdown in the domestic economy, as well as from a decline in international reserves, eased in 2022. Risks to financial stability emanating from unsustainable public sector debt went up; the probability and impact of this risk materialising in 2023 is medium. The probability and impact of risks to financial stability emanating from the macroeconomic environment in 2023 are projected as broadly medium.

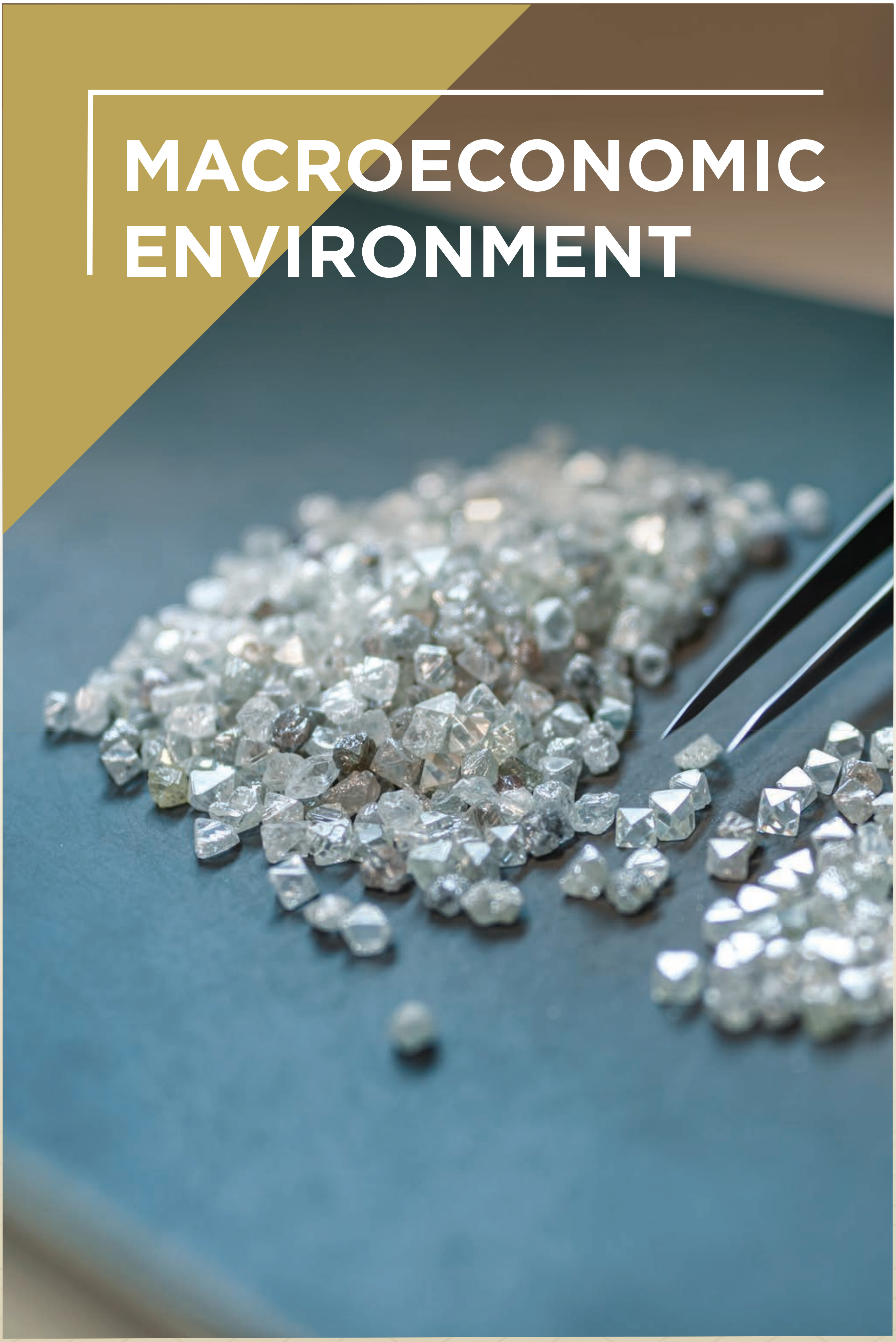
Risks from the banking sector declined in 2022 while household debt, corporate debt, the NPS, and NBFIs reported mixed results. The banking sector remained sound and resilient. Household debt and corporate debt risk increased; however, the probability and impact of their increasing further in 2023 are both medium. The risks from increased settlement in the last window went down in 2022, while those from the security of retail payments remained unchanged. Going forward, the probability and impact of payment system risks materialising in 2023 are determined as medium. The NBFIs experienced a moderation in risks with regard to the cashflow risk, while risks from the solvency position of the sector remained broadly unchanged. Conversely, market risks and risks emanating from the funding position of NBFIs went up during the period under review. The probability of materialising and the potential impact of the majority of the NBFIs risks, are projected to remain medium. Overall risks to financial stability in Namibia, though stable, edged up in 2022 and are expected to remain broadly medium in 2023 as economic uncertainty persists.

Figure 1: Domestic financial stability risks map



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

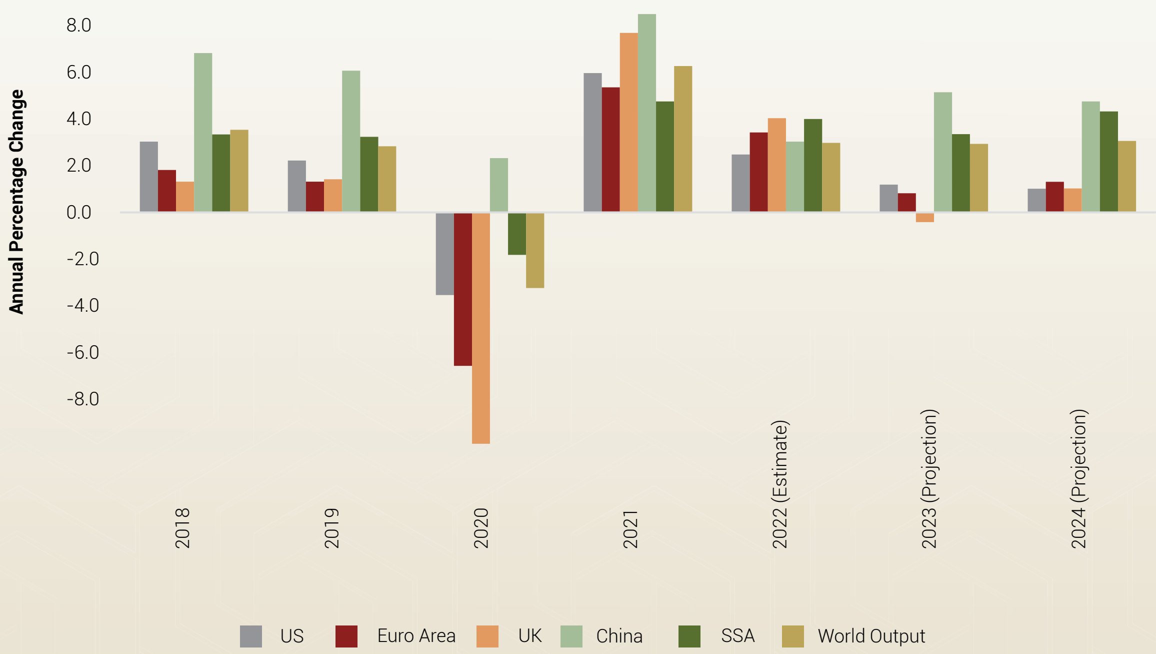
MACROECONOMIC ENVIRONMENT



3 MACROECONOMIC ENVIRONMENT

Amidst rising interest rates and geopolitical tensions, global growth slumped in 2022 and is expected to fall further in 2023 before picking up in 2024. According to the International Monetary Fund's (IMF) April 2023 ***World Economic Outlook,*** global growth in 2022 is 3.4 percent, down by 2.8 percentage points from 6.3 percent in 2021 (Figure 2). The deterioration in global growth during 2022 was underpinned by inflationary pressures, which were further fuelled by the war in Ukraine, the rise in central bank rates to curb inflation, and the resurgence of Covid-19 in China, coupled with its zero-Covid policy. As most of these inhibiting factors continue, global growth is projected to fall further to 2.8 percent in 2023 before rising to 3.0 percent in 2024. Growth in Advanced Economies (AEs) experienced a slowdown to 2.7 percent in 2022 from 5.4 percent in 2021 and is projected to further decline to 1.3 percent in 2023 before improving to 1.4 percent in 2024. Similarly, growth in Emerging Market and Developing Economies (EMDEs) declined to 4.0 percent in 2022 from 6.9 percent in 2021, and is projected to fall further to 3.9 percent in 2023 before picking up to 4.2 percent in 2024. The growth expected in 2023 is mainly due to easing of supply-chain bottlenecks, excess savings from the pandemic, and tight labour markets.

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



Source: IMF April 2023 World Economic Outlook Update

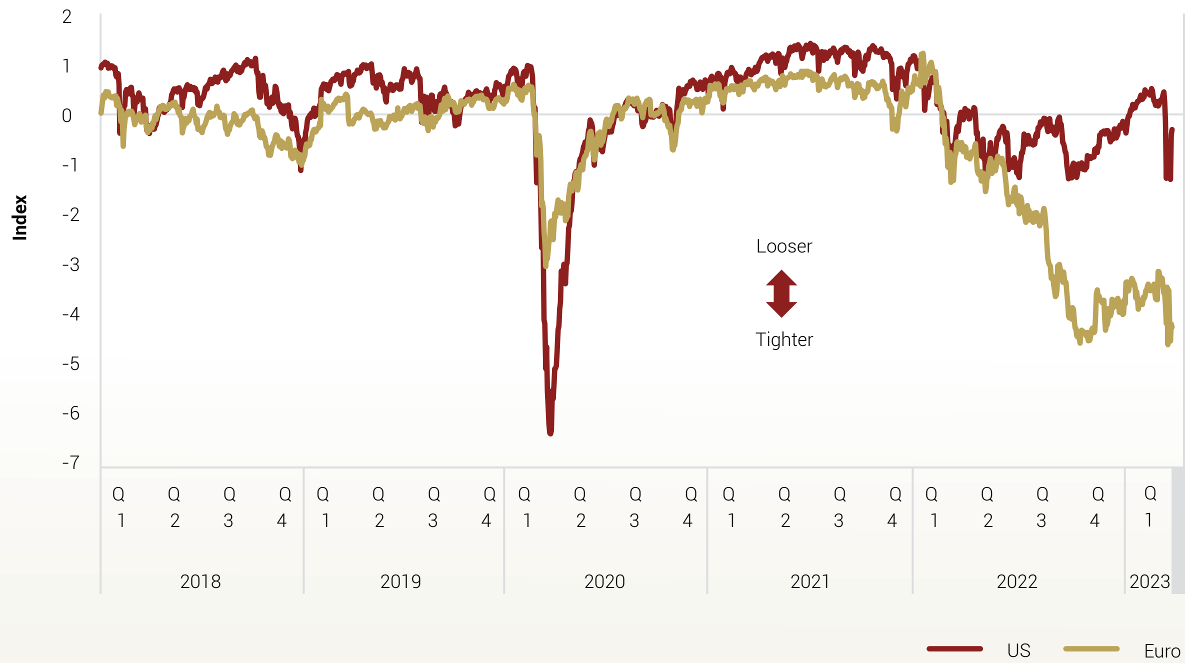
Global inflation peaked during the period under review but is expected to decrease in 2023, albeit at a slower pace. Global inflation increased significantly from 4.7 percent in 2021 to 8.7 percent in 2022, driven mainly by an increase in the prices of fuel and nonfuel commodities. However, global inflation is expected to fall to 7.0 percent and 4.9 percent in 2023 and 2024, respectively. Despite this slowdown in inflation, the rate is still above pre-pandemic levels of about 3.5 percent. The projected disinflation partly reflects the declining international fuel and nonfuel commodity prices due to weaker global demand. In addition, it also reflects the cooling effects of monetary policy tightening on core inflation. Inflation is projected to decline the most in low-income developing economies, followed by AEs and EMDEs. Upside risks to the inflation outlook remain. Despite the recent moderation in headline inflation, core inflation remains stubbornly high, labour markets are still tight, and energy prices remain pressured by Opec+ supply cutbacks and Russia's ongoing war in Ukraine; supply chain disruptions may reappear. Financial conditions will likely tighten further to keep inflationary risks at bay. If not, central banks may need to increase policy rates even more in order to achieve their inflation objectives.

Risks to the global outlook remain skewed to the downside. The main threats to the global economy's prospects are the war in Ukraine, the slow recovery in China, and the severe impact of tight monetary policy to fight inflation that appears to be more intractable than previously expected. These factors are coupled with potential worsening of debt distress due to tight global financial conditions, and the recent failure of banks in the United States of America (US) and Europe. Furthermore, geoeconomic fragmentation efforts are intensifying. Economic progress could possibly be hampered by sudden repricing by financial markets in response to adverse inflation news, and further geopolitical tensions. Although central banks have resolved to fight inflation through tight monetary policies, the impact is not expected to be fully realised prior to 2024. From a financial stability standpoint, interest rates are expected to remain elevated given that core Inflation remains sticky in the US and the Euro area, which could pose serious concerns for fiscal sustainability across EMDEs given the current debt levels. However, the brisk pace of interest rate increases observed in 2022 is likely to make room for smaller interest rate adjustments in 2023.

DEVELOPMENTS IN FINANCIAL MARKETS

Global financial conditions remained tight throughout 2022 but eased early in 2023, until the recent bank failures which sent shockwaves across global financial markets. Financial conditions generally reflect the availability of liquidity in global markets and tend to be monitored closely by central banks given their perceived correlation with future growth. A mild winter in Europe partly defused the energy crisis, and prices fell. Falling energy prices reduced headline inflation and fuelled optimism that monetary policy may be eased later this year. However, the recent failure of Silicon Valley Bank in the US and Credit Suisse in Europe have sent shockwaves across global financial markets, although the respective governments did react quickly to prevent a financial crisis. Financial conditions are also now being tightened further in a number of AEs due to reductions in central bank balance sheets. Calibrating domestic monetary policy actions is difficult and policies will need to remain responsive to new data, given uncertainty about the speed at which higher interest rates take effect and the potential spillovers from restrictive policy in other countries. The widespread tightening by many countries is likely to reduce global demand and prices to a greater extent. Tighter global financial conditions, the continued rise in policy rates in the advanced economies and persisting inflation pressures limit the room for policy manoeuvre in most EMDEs.

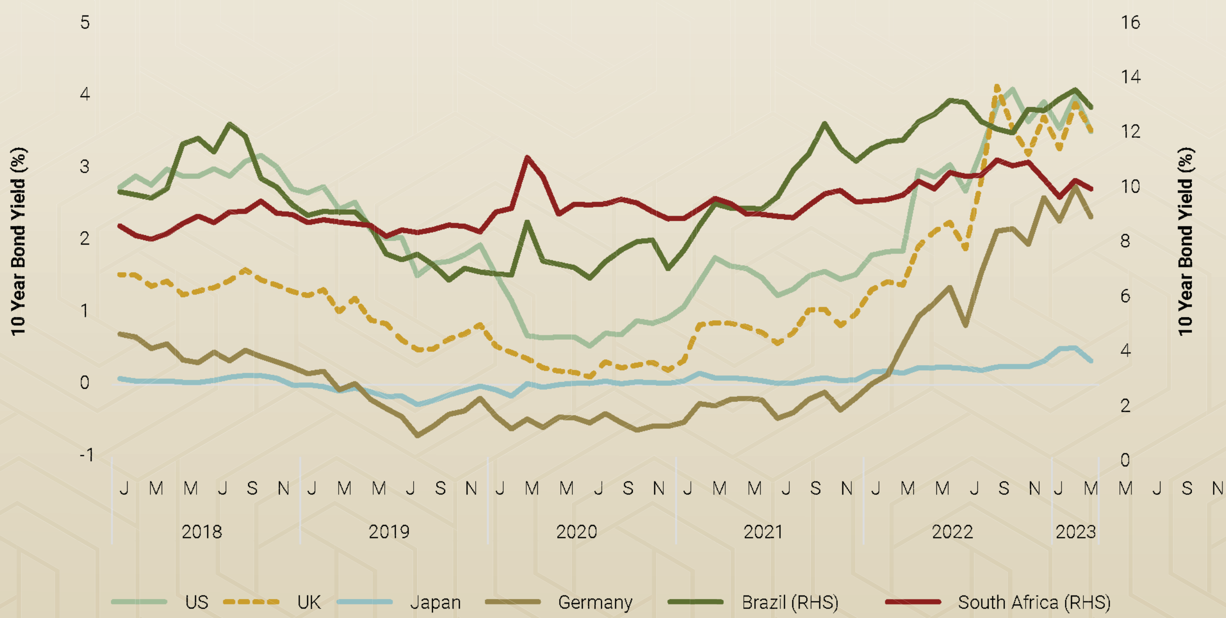
Figure 3: Bloomberg Financial Conditions Index



Source: Bloomberg

Global bond markets suffered unprecedented losses in 2022, with Bloomberg assigning a high probability of a technical recession in 2023. Fixed income markets were characterised by considerable levels of volatility in 2022, driven by rising inflation, a slowdown in the economic recovery, and revisions to the expected path of monetary policy (Figure 4). The US Treasury Yield Curve is currently inverted. Yield curve inversion has historically been a very reliable indicator of an upcoming economic recession. Bloomberg has assigned 65 percent probability to a technical recession in 2023, and there is consensus regarding an expected quarter of negative growth in 2023.

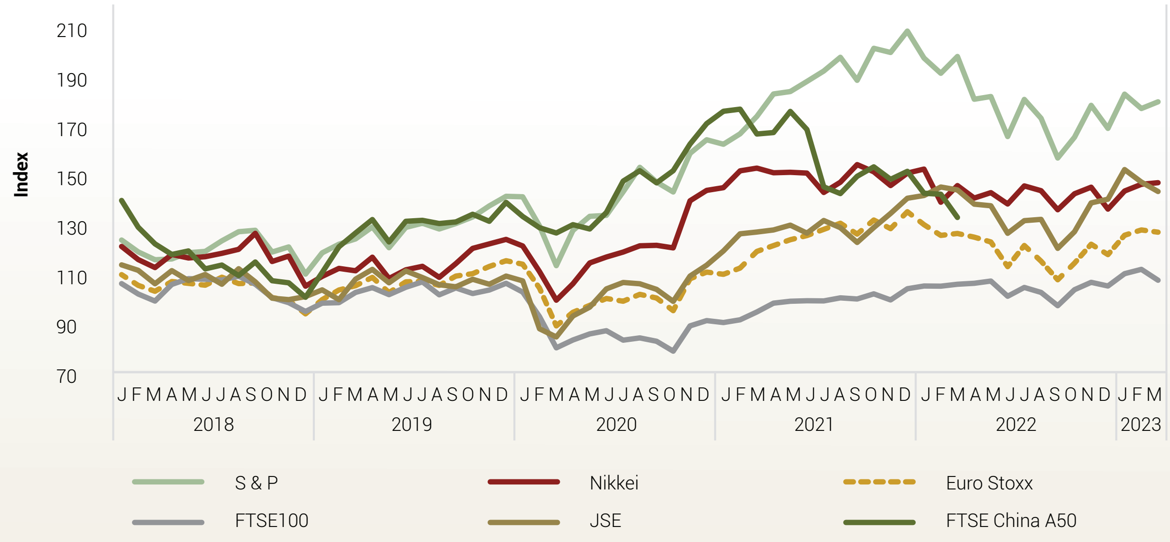
Figure 4: Ten-year bond yields in selected countries



Source: Bloomberg

Global stock markets posted their biggest annual drop in 2022 since the 2008 financial crisis. The volatility in the equity markets during 2022 were at levels last seen in 2008. This reflects major uncertainty regarding the US Federal Reserve Bank's monetary policy, given the current bank turmoil, which will result in a broader contraction in credit, on the back of tighter lending standards and increases in funding costs. Excessive volatility in the stock market is a concern for financial stability, as it impacts asset valuations.

Figure 5: Stock price indices



Source: Bloomberg

DOMESTIC ECONOMY

Output and outlook

Although Namibia recorded improved growth in 2022, the economy is projected to slow down during 2023 and 2024, largely due to weaker global demand. Following growth of 3.5 percent in 2021, Namibia's Gross Domestic Product (GDP) recorded a higher growth rate of 4.6 percent in 2022. The improved growth for 2022 was largely based on higher production volumes from the ***Diamond mining*** sector as well as sustained growth for most industries in the secondary and tertiary sectors. Going forward, growth is projected to moderate to 3.0 percent and 2.9 percent in 2023 and 2024, respectively. This lower growth is largely due to weaker global demand and reduced spending power of consumers in line with peaking inflation, and would be fairly close to the 3.1 percent average growth rate recorded over the ten years up to 2019, before the pandemic set in.

Domestic growth risks are primarily posed by further global monetary policy tightening and high import costs that are expected to persist throughout the projection period. Globally, major central banks are continuing to tighten monetary policies, which is expected to result in a worldwide downturn in 2023 and 2024. Additionally, the war between Russia and Ukraine is expected to last longer, as are the high costs for related goods, such as fuel, wheat, and cooking oil, of which Namibia is a net importer. Additional internal hazards include drought and floods, water supply disruptions that continue to impair mining output along the coast, the possible spillover of South African power outages to Namibia, and uncertainty about the effects of further climate change going forward.

Namibia's average inflation rate increased in 2022 over that recorded in 2021, mainly due to a significant increase in transport inflation. The overall inflation rate in Namibia increased to an average of 6.1 percent in 2022, compared to 3.6 percent in 2021. The inflation rate was primarily driven by the categories of ***Transport; Hotels, cafes and restaurants;*** and ***Furnishing, household equipment*** and ***routine maintenance*** that registered price increases of 17.5 percent, 9.7 percent and 8.7 percent, respectively. Increasing inflation continues to put pressure on households, and may affect their ability to service their debts, increasing financial stability risk.

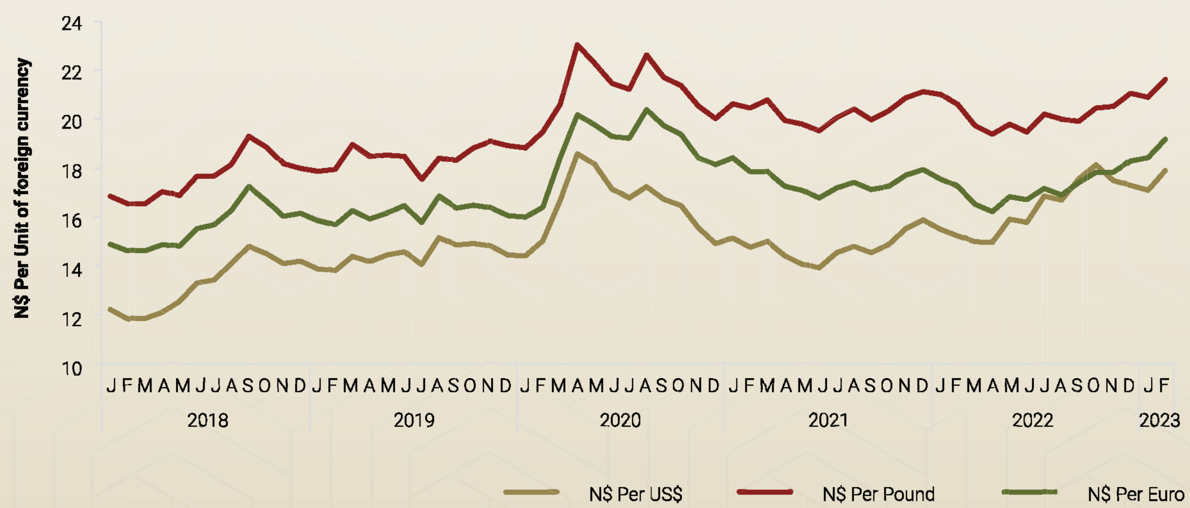
INTERNATIONAL RESERVES

The level of international reserves increased during 2022 and is anticipated to rise further in 2023. The stock of international reserves rose on an annual basis by 8.4 percent to settle at N$47.6 billion at the end of December 2022. This increase was ascribed to inflows from the foreign asset swap arrangements between the Bank and local institutional investors, an African Development Bank loan of N$2.6 billion, diamond sales proceeds, and revaluation gains from the exchange rate depreciation during 2022. The stock of international reserves at year-end translated into an import cover of 5.7 months, compared to 5.6 months reported during the previous year. Going forward, international reserves are projected to increase by 5.9 percent to N$50.8 billion at the end of 2023, from N$47.6 billion in 2022. These are robust reserve levels and are expected to contribute to the resilience of the financial system amidst potential deterioration in global liquidity, as monetary conditions tighten across developed and developing economies.

EXCHANGE RATE DEVELOPMENTS

The Namibia Dollar (NAD)/South African Rand (ZAR) depreciated against the US Dollar, whereas it appreciated against the British Pound and the Euro during 2022. The year 2022 proved to be a turbulent period for the NAD/ZAR as aggressive monetary tightening in the US coupled with broad risk-off sentiments in financial markets fuelled a 10.7 percent depreciation in the local currency against the United States Dollar over the course of the year. Furthermore, the depreciation of the ZAR was exacerbated by uncertainty surrounding the political climate and the persistent load-shedding woes in South Africa. However, the NAD/ZAR appreciated slightly against the Euro by 0.7 percent, and the British Pound by 1.6 percent (Figure 6). The steep rate increases by SARB supported the appreciation, which was further reinforced by the continued resilience of most commodity prices. Bloomberg projections suggest that the ZAR could strengthen by 3.8 percent against the US Dollar, 4.0 percent against the Euro and 3.1 percent against the British Pound by the end of 2023 as the Federal Reserve softens its stance on future interest rate hikes.

Figure 6: Currency movement of the Namibia Dollar against selected currencies



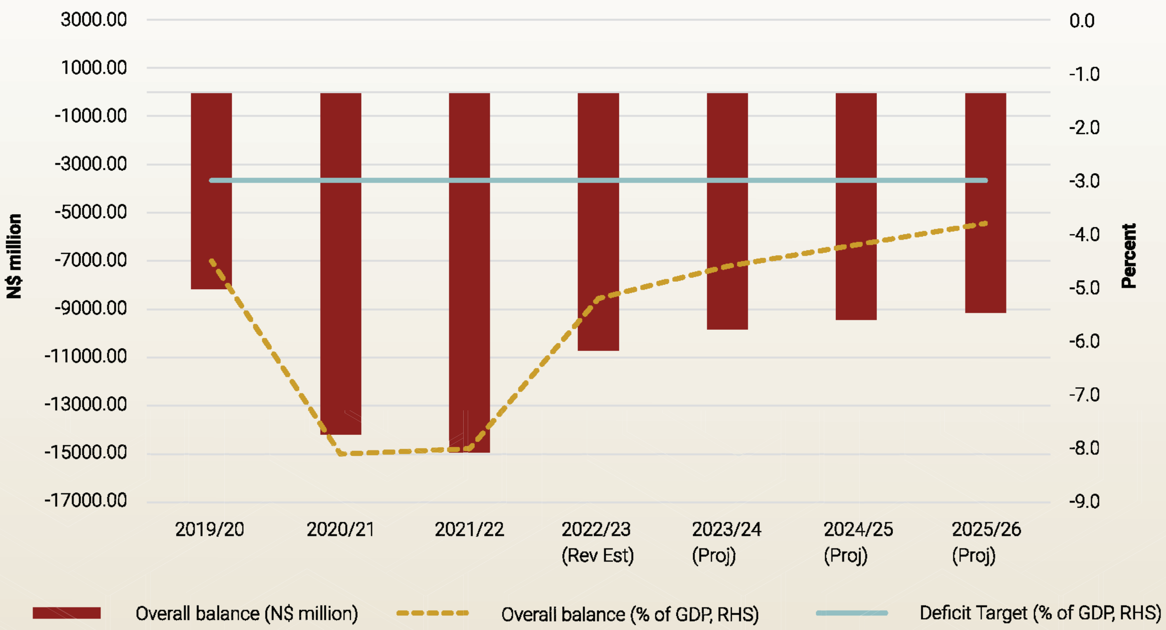
Source: BoN

PUBLIC FINANCE

Public finance

Namibia's central government budget deficit narrowed during FY2022/23, mainly due to an increase in revenue. The central government budget deficit as a percentage of GDP narrowed notably to 5.2 percent during FY2022/23, compared to 8.0 percent of GDP in the previous fiscal year (Figure 7). The narrowing of the deficit is ascribed to an increase in revenue collection owing to an increase in personal income tax on individuals and diamond mining tax, as well as VAT (value-added tax) collections. The overall deficit is projected to decrease from 5.0 percent of GDP in FY2022/23 to about 4.6 percent of GDP in FY2023/24. This projected moderation is attributed to the recovery in domestic economic activity, supported by gains from improved tax compliance in line with tax administration reforms, and a 71.8 percent increase in Southern African Customs Union (SACU) receipts. The increase in SACU receipts is as a result of notably higher revenue collections and an adjustment for under-payments for the fiscal year 2021/22. These developments are likely to be welcomed by the major credit rating agencies once future reviews on Namibia's sovereign credit quality are conducted.

Figure 7: Public finance



Source: Bank of Namibia and Ministry of Finance

NAMIBIAN AND SOUTH AFRICAN SOVEREIGN CREDIT RATINGS

During 2022, both Fitch Ratings ("Fitch") and Moody's Investor Service ("Moody's") downgraded Namibia's long-term foreign currency credit rating to BB- and B1 respectively, with stable outlooks. Ratings agencies have continued to rate Namibia's sovereign debt as below investment grade (Table 2). The key drivers underpinning Fitch's downgrade in June 2022 were the elevated fiscal deficit, high and rising debt, and low growth prospects. The stable outlook balances Fitch's view that the government's fiscal consolidation efforts will limit the rise in government debt and lead to its stabilisation over the medium-term against significant fiscal risks related to expenditure pressures and an uncertain global economic environment. The rating and outlook were affirmed in December 2022 by Fitch, who cited Namibia's strong governance indicators and institutional framework, as well as the government's fiscal consolidation efforts and a large non-bank financial institution sector that support the government's financing flexibility. After not conducting a review in 2021, Moody's opted to downgrade Namibia's long-term foreign currency credit rating from Ba3 to B1 on 5 April 2022. Moody's highlighted the increase in the government debt ratio, a 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. Moody's views the lengthening of the average maturity of Namibia's debt profile as a key factor which could lead to an upgrade in the rating, along with an improved fiscal and growth trajectory.

Table 2 Namibia's sovereign credit rating and outlook

Rating agency	Rating	Outlook	Date of update	Action
Moody's	B1	Stable	5 April 2022	Rating downgraded and Outlook Upgraded
Fitch	BB-	Stable	24 June 2022	Downgrade
Fitch	BB-	Stable	9 December 2022	Rating affirmed

Source: Moody's and Fitch Ratings

All three major rating agencies affirmed South Africa's sovereign credit rating during 2022; however, one of them downgraded the outlook. Given the NAD peg to the ZAR, sovereign credit rating decisions in South Africa play a role for financial stability in Namibia. Fitch indicated that the downgrade to a BB- rating reflects high and still rising government debt, low trend growth and high inequality that will continue to complicate fiscal consolidation (Table 3). The ratings are supported by a favourable debt structure with long maturities and denomination mostly in local currency, as well as a credible monetary policy framework. During March 2023, Standard and Poor's (S&P) further downgraded South Africa's credit rating outlook to stable from positive and affirmed its debt grade at BB-. According to the rating agency, the stable outlook was due to expectations that economic growth may face increasing pressure from infrastructure constraints, particularly severe electricity shortages. S&P noted that reforms to address infrastructure shortfalls and improve governance and performance at state-owned enterprises (SOEs) were slow and impeding economic growth. On a positive note, however, the rating agency acknowledged that the country's fiscal position improved in 2022 as tax revenue rose. In April 2022, Moody's credit rating for South Africa was set at Ba2 with a stable outlook. As with the Namibian case, upward revisions to South Africa's credit outlook in the short-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	Date of update	Action
Moody's	Ba2	Stable	01 April 2022	Rating downgraded and Outlook Upgraded
S&P	BB-	Positive	20 May 2022	Downgrade
Fitch	BB-	Stable	25 November 2022	Rating affirmed
S&P	BB-	Stable	08 March 2023	Rating affirmed and outlook downgraded

Note: For SA, S&P changed the outlook to "stable" from "positive" on 8 March 2023. It remains BB-, which is three notches below investment grade. Source: S&P, Moody's Investor Service and Fitch Ratings

MONETARY POLICY STANCE IN NAMIBIA AND SOUTH AFRICA

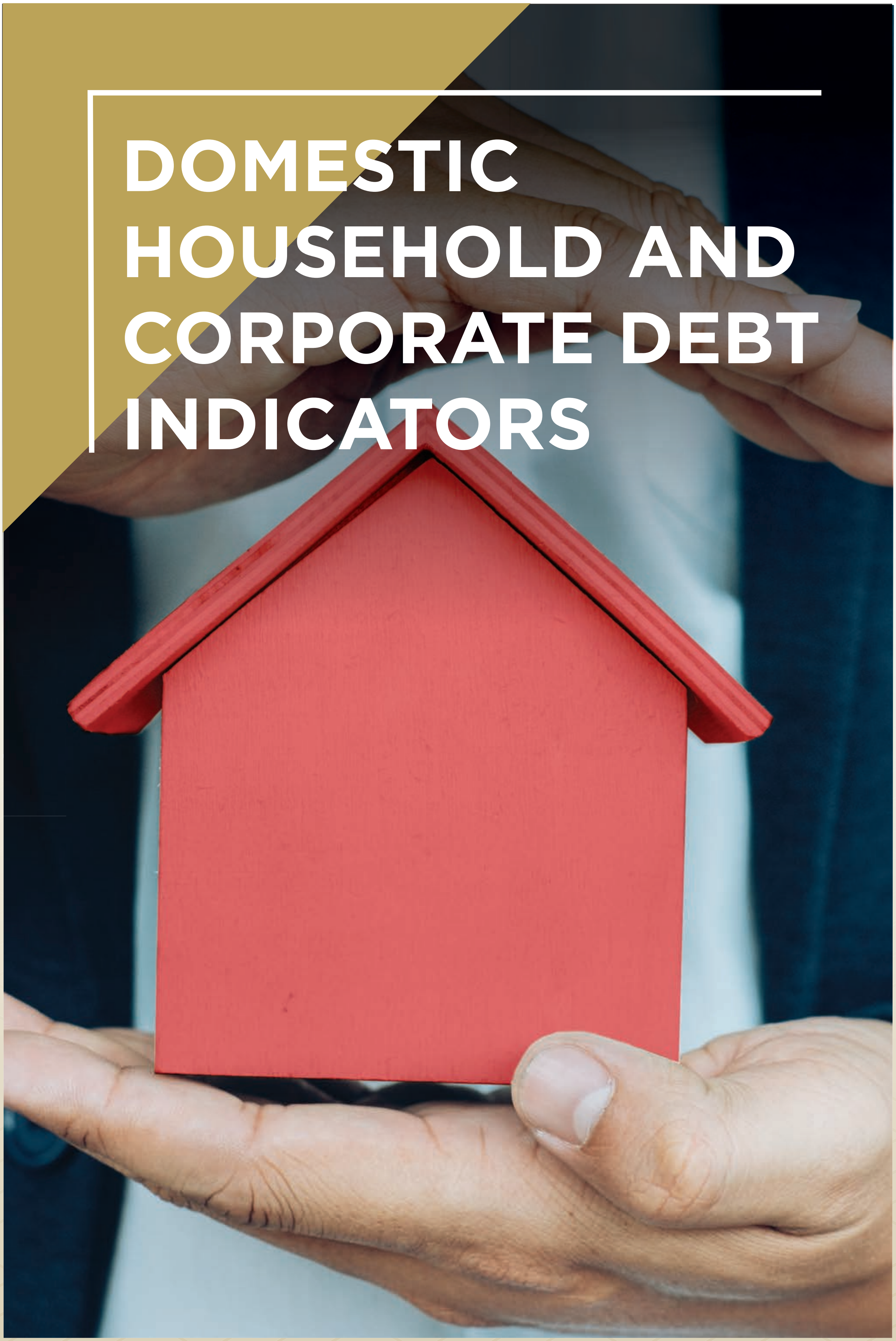
Both the Bank of Namibia and the South African Reserve Bank (SARB) tightened monetary policy aggressively during 2022. The Bank increased the repo rate by an aggregate of 300 basis points during the course of 2022, from 3.75 percent at the end 2021 to 6.75 percent at the end of 2022 (Table 4). These increases were necessary to contain inflationary pressures and its second-round effects, and anchor inflation expectations. The tightening continued during the first four months of 2023 with a 25 basis point increase at the Bank's February and April meetings, respectively. The SARB also continued with its policy normalisation which started in November 2021, to anchor inflation expectations more firmly around the mid-point of the target band of 3-6 percent and to achieve the inflation target in 2024. The aggregate increase in 2022 was 325 basis points, up from 3.75 percent at the end of 2021 to 7.00 percent at the end of 2022. The SARB further increased its repo rate by 25 and 50 basis points at its January and March 2023 meetings, respectively, making it the 9th consecutive increase since November 2021. The move was driven by SARB's assessment that risks to the inflationary outlook remain skewed to the upside.

Table 4 SARB and BoN repurchase rate

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
25 March 2022	Increase: 25 basis points	4.25	13 April 2022	Increase: 25 basis points	4.25
20 May 2022	Increase: 50 basis points	4.75	15 June 2022	Increase: 50 basis points	4.75
22 July 2022	Increase: 75 basis points	5.50	15 August 2022	Increase: 75 basis points	5.50
23 September 2022	Increase: 75 basis points	6.25	26 October 2022	Increase: 75 basis points	6.25
25 November 2022	Increase: 75 basis points	7.00	30 November 2022	Increase: 50 basis points	6.75
Total repo rate change during 2022	**325 basis-point increase**		**Total repo rate change during 2022**	**300 basis-point increase**	
27 January 2023	Increase: 25 basis points	7.25	15 February 2023	Increase: 25 basis points	7.00
30 March 2023	Increase: 50 basis points	7.75	19 April 2023	Increase: 25 basis points	7.25

Source: South African Reserve Bank and Bank of Namibia

DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS



4 DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

HOUSEHOLD DEBT TO DISPOSABLE INCOME

A lower growth rate was reported for household indebtedness for 2022 than had been for 2021, on the back of low demand for credit facilities in the non-banking space. The annual household debt growth rate slowed to 3.4 percent at the end of 2022, in comparison with a growth rate of 3.8 percent in 2021. The lower growth in household debt was mainly due to a lower uptake of credit by individuals from non-banking financial institutions, particularly microlenders. However, during 2022 households continued to borrow from the banks, where such credit registered a higher growth rate of 4.7 percent, compared to a growth rate of 2.1 percent reported for 2022. This increase in the growth rate stemmed primarily from growth in the *Other loans and advances* category, which accelerated from 4.0 percent in 2021 to reach 17.4 percent at the end of 2022. Similarly, the *Instalment sale and leasing finance* credit category reported a growth rate of 2.7 percent in 2022 from a marginal contraction of 0.03 percent in 2021. Although marginal, annual growth in mortgage loans improved by 0.2 percentage point to reach 2.8 percent at the end of 2022. The categories which drove the higher growth in credit extended by the banks were a combination of long- and short-term credit facilities, although the latter outpaced the former. The increase in short-term credit facilities relative to longer term credit facilities may be a sign of strain on the cash flow of households, which does not bode well for financial stability.

Table 5 Ratio of household debt to disposable income

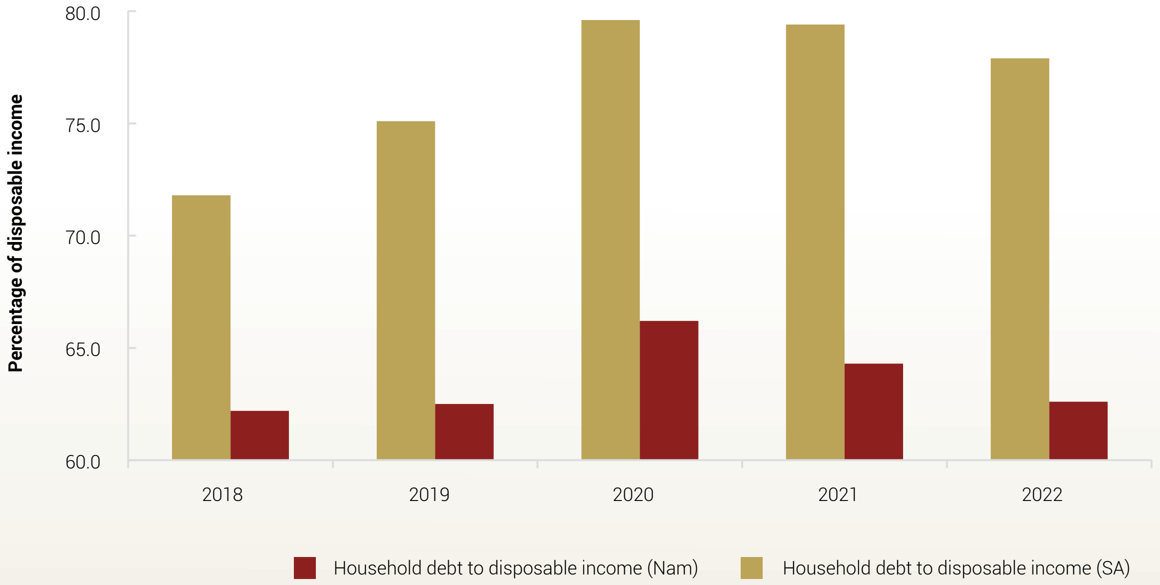
Disposable income and household debt	2018	2019	2020	2021	2022
Disposable income (N$ million)	76,519	77,167	76,026	77,832	83,079
Ratio of credit to disposable income (%)	71.8	75.1	79.6	79.4	77.9
Total credit extended to individuals/households (N$ million)	54,931	57,921	60,518	61,791	64,723
Adjusted credit to households/Individuals* (N$ million)	61,378	63,774	66,573	69,107	71,465
Adjusted credit** of households/Individuals-to-disposable income (%)	80.2	82.6	87.6	88.8	86.0

*The ratio of household debt to disposable income is calculated based on income and tax data from the national budget documents, national accounts, and household debt data from the BoN.
** This category includes credit extended to households by both the banking and non-banking financial institutions.
Source: BoN

The ratio of household debt to disposable income declined over the course of 2022 due to relatively higher growth in nominal disposable income. Household debt constituted 86.0 percent of disposable income in 2022, compared to 88.8 percent in the previous year (Table 5). The lower ratio is driven by the fact that disposable income outpaced the increase in household debt during the period under review. In this regard, disposable income grew annually by 6.7 percent in 2022, compared to growth of 2.4 percent reported in 2021. This was mainly on account of an increase of N$5.8 billion observed during 2022 under the Compensation of employees category, of which the Government sector is the largest component. This is in line with the approved salary increments in the Government sector during the period under review. A lower ratio does not necessarily point to reduced household indebtedness or to subdued demand for credit by individuals, but is an indication of the change in credit relative to disposable income. Generally, a lower ratio is a positive development for the stability of the financial system. Risks to financial stability emanating from household credit therefore remain minimal, especially given the fact that non-performing loans have recently improved to below the crisis time supervisory intervention trigger point of 6.0 percent.

The unadjusted ratio of household debt to disposable income in Namibia was higher than that of South Africa in 2022, although both ratios decreased in comparison with the previous year. The unadjusted ratio of household debt to disposable income stood at 77.9 percent in Namibia, compared to 62.6 percent in South Africa, during the period under review (Figure 8).

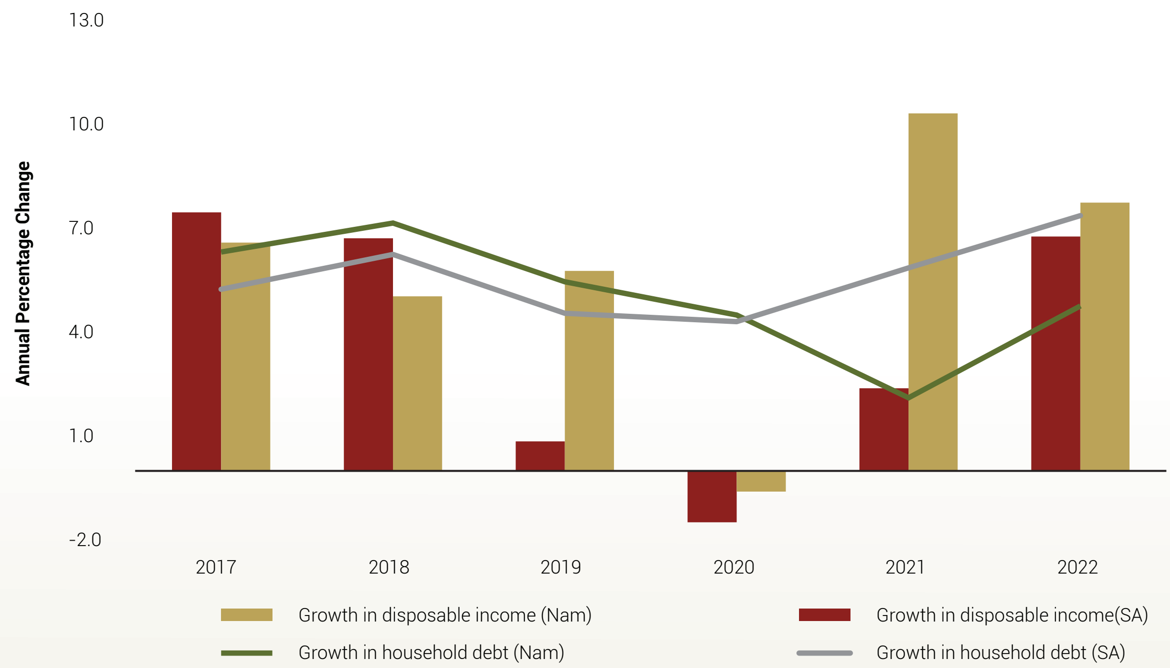
Figure 8: Household debt to disposable income (Namibia and South Africa)



Source: BoN and SARB

The annual growth in household disposable income rose notably in 2022 compared to 2021 as a result of an increase in the compensation of employees. Since the last FSR, annual growth in household disposable income has risen notably, by 4.4 percentage points to 6.7 percent in 2022 (Figure 9). The main driver that caused the upsurge in household disposable income was the compensation of employees, which increased by 7.2 percent following the approval of a salary increment for government employees in 2022. However, the disposable income of households in South Africa reported a lower growth rate of 8.9 percent in 2022 when compared to a 9.9 percent growth rate experienced in 2021.

Figure 9: Growth in household debt and disposable income



Source: Namibia Statistics Agency (NSA), BoN and SARB

DEBT SERVICING RATIO

The debt servicing to disposable income ratio increased during 2022. The debt service to disposable income ratio increased from 5.7 percent in 2021 to 6.2 percent at the end of 2022 (Table 6). Although both variables increased during 2022, the higher ratio is because of a sharp increase in total debt service which is in line with the interest rate trajectory during the period under review.

Table 6 Debt servicing ratios (percent)

	Gross income growth (Y-o-Y)	Disposable income growth (Y-o-Y)	Annual debt servicing growth (Y-o-Y)	Debt servicing to gross income	Debt servicing to disposable income	Adjusted debt servicing to gross income	Average prime rate
Dec 18	3.5	2.9	6.7	6.5	5.8	9.5	10.25
Dec 19	1.4	1.4	4.4	6.7	6.0	9.8	10.25
Dec 20	-1.8	0.1	-6.3	6.4	5.6	9.4	7.5
Dec 21	3.5	0.7	1.8	6.3	5.7	9.2	7.5
Dec 22	11.5	9.5	19.2	6.7	6.2	9.8	10.5

Source: BoN

CORPORATE DEBT

Namibia's total debt stock increased in 2022 mainly due to an increase in foreign debt. The total debt increased from N$137.3 billion at the end of 2021 to N$158.6 billion at the end of 2022 (Table 7). Although the growth in total debt was mostly driven by foreign debt, domestic debt also increased by N$1.3 billion during the period under review. The upsurge in domestic debt was on account of an increase in demand for asset-backed credit facilities and Other loans and advances specifically by corporates in the Agriculture, Fishing, Transport, Mining, Energy and Services sectors, as well as corporates in the Commercial rental space. The significant increase of N$19.9 billion in foreign debt was primarily because of increased borrowing by companies in the Mining sector from their related entities abroad, coupled with higher deposits by non-resident entities in the domestic banks. This was further exacerbated by the depreciation of the NAD against the United States Dollar.

Since the last FSR, corporate debt as a percentage of GDP has risen. Namibia's corporate debt as a percentage of GDP increased from 69.2 percent at the end of 2021 to 72.0 percent at the end of 2022 (Table 7). Similarly, the ratio of foreign corporate debt to GDP increased from 45.1 percent in 2021 to 49.8 percent in 2022. The increase in domestic corporate debt does not pose a significant risk to the stability of the domestic financial system because most of the increase emanated from sectors that boost growth in the economy. However, it is still important, for financial stability purposes, to continue monitoring foreign corporate debt given its exposure to exchange rate risk.

The total SOE debt stock declined marginally during 2022. Overall, SOE debt fell to about N$10.0 billion by the end of 2022, down by 0.8 percent from N$10.1 billion at the end of 2021 (Table 7). Total SOE debt fell because the parastatals, for the most part, repaid some of the principal amount on their domestic debt during the reporting period, while their foreign debt increased only marginally.

Table 7 Domestic and external corporate debt (corporate and parastatals)

N$ million	2018	2019	2020	2021	2022
Domestic debt	42,309	45,713	44,842	44,874	46,173
Local corporate debt	40,966	44,853	44,307	44,258	45,808
Local debt of SOEs	1,343	860	535	616	365
Foreign debt	83,777	80,656	82,435	92,445	112,377
Foreign corporate debt	74,202	71,058	72,367	82,975	102,741
Foreign debt of SOEs	9,575	9,598	10,068	9,470	9,636
Total debt	126,086	126,369	127,277	137,319	158,550
Nominal GDP	181,067	181,211	174,243	183,940	206,205
Corporate debt as a % of GDP	63.6	64.0	67.0	69.2	72.0
Foreign corporate debt as a % of GDP	41.0	39.2	41.5	45.1	49.8
Foreign debt as a % of total debt	66.4	63.8	64.8	67.3	70.9

Source: BoN and NSA

Total foreign private sector debt servicing increased during the period under review. The total value of repayments on Namibia's foreign private sector debt increased to N$25.8 billion in 2022 which was 53.2 percent higher than in the previous year (Table 8). This was mainly driven by repayments made by other sectors on their trade credit obligations in addition to repayments of intercompany borrowing in the mining sector which all contributed to the increase in debt servicing.

Table 8 Foreign private sector debt and debt servicing

N$ million	2018	2019	2020	2021	2022
Total foreign private sector debt	83,777	80,656	82,435	92,445	112,377
Total foreign private sector debt servicing	17,197	21,644	16,614	16,816	25,761

Source: BoN

BOX ARTICLE 1

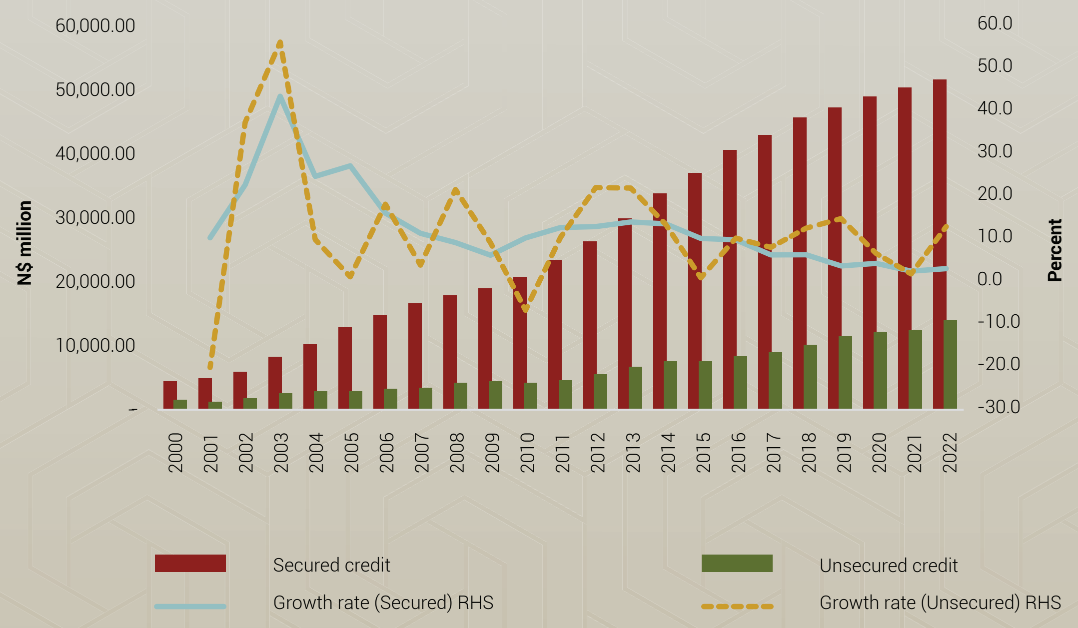
INFLATIONARY PRESSURES VS HOUSEHOLD INDEBTEDNESS: IMPLICATIONS FOR NAMIBIA

The household sector in Namibia accounts for the majority of private sector credit extended (PSCE). It is therefore an important participant in the domestic financial system, accounting for almost 58.0 percent of total private sector credit extended by the banking sector over the past 5 years. Households' participation in the domestic banking sector (via credit) supplements income, boosts consumption and subsequently contributes to economic growth. On the contrary, rising debt levels under conditions of persistently low economic growth, inflationary pressure, and stagnant disposable income, raises concerns about households' debt-servicing capacity. Both the direct and indirect credit exposure by the banking sector to households could have a significant impact on the stability of the banking system and, consequently, pose a risk to domestic financial system stability. Historically, household credit growth remained below double-digits with the exception of the period 2011 to 2014. Following this period, household credit slowed in line with the contraction in GDP starting late 2016, and further weakened by the impact of the Covid-19 pandemic.

During the period 2001 to 2009, secured credit[3] on average grew at a faster pace than unsecured credit. Following the contraction of unsecured credit in 2010, this trend later reversed, with growth in secured credit slowing between 2011 and 2016 (Figure BA1). The growth in secured credit continued to stabilise between 2017 and 2022 following the introduction of the loan-to-value ratio in the real estate market, where mortgage lending makes up more than half of the banking sector loan book. The impact of the Covid-19 pandemic further stabilised the growth in secured lending. During 2022, unsecured credit grew by 12.6 percent compared to secured credit, which grew by 2.1 percent. However, the growth in unsecured credit did not show any signs of slowing down with the exception of the Covid-19 pandemic period, when banks were more prudent in their credit extension to mitigate potential losses while managing their asset quality.

[3] Secured credit includes instalment sales, leasing finance and mortgage advances, while unsecured credit includes overdrafts, general loans and advances, and credit cards. Secured lending is pledged against an asset such as a house or a car, for example, while unsecured lending is based on a client's credit history, loan term and amount, as well as their personal circumstances.

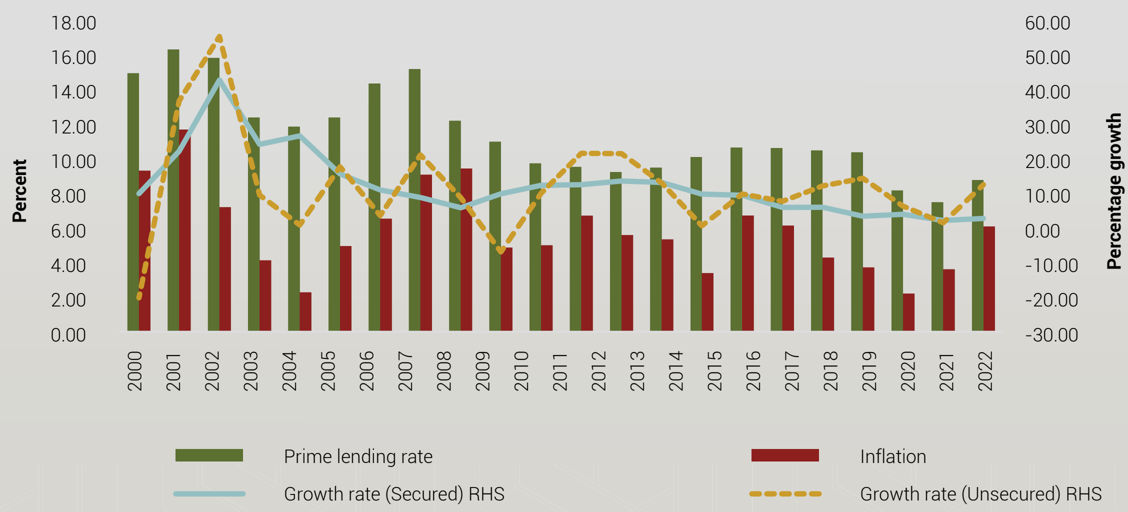
Figure BA1: Secured and unsecured household credit



Source: BoN

Inflationary pressures, coupled with rising interest rates put households in an unfavourable position. Inflation peaked at 6.1 percent in 2022 (Figure BA2). The acceleration in inflation, relative to a low base of 2.1 percent in 2020, was mainly driven by a rise in transport inflation. This was on account of the high international oil prices resulting from the imposition of sanctions on Russia following its invasion of Ukraine in February 2022. Furthermore, the exchange rate depreciation exacerbated the increase in transport inflation. With an increase in inflation in 2022, the central bank pursued a tighter monetary policy stance by increasing its benchmark rate by a total of 300 basis points to close the year at 6.75 percent. This was deemed necessary to strike a balance between anchoring inflation expectations and safeguarding the exchange rate peg, while supporting domestic economic recovery.

Figure BA2: Household debt with inflation and prime rate



Source: BoN

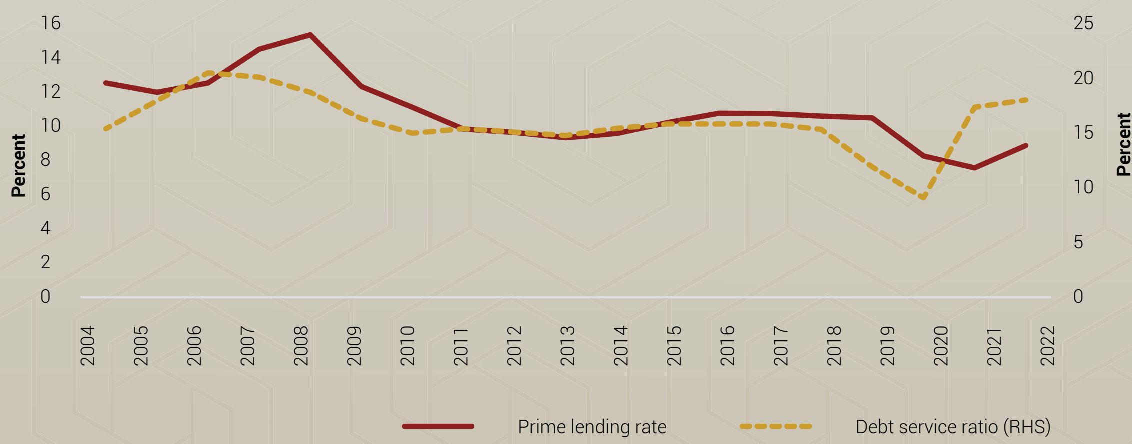
An increase in the prime lending rate has direct implications on the households' debt-servicing cost. This puts additional strain on already vulnerable households, as such their ability to service both interest and capital repayments has weaken, which is substantiated by the growth in household debt (Figure BA3). Both compositional shifts in different lending categories as well as ever changing risk profiles of borrowers influenced households' ability to service their debt.

Figure BA3: Household debt and disposable income

Source: BoN

Households' debt servicing cost almost doubled during the period 2020 to 2022. The household debt servicing costs increased from 9.0 percent in 2020 to 17.8 percent in 2022, reflecting a combination of higher debt levels as well as high interest rates (Figure BA4). Although households are highly indebted, the majority of their debt is secured lending of which mortgage lending accounts for most of it. The equity position of homeowners remained in positive territory as such risks to financial stability are less pronounced. However, of concern is the growth in unsecured lending which is, for the most part, consumption spending in nature. It becomes a financial stability concern when unsecured lending grows significantly because it also speaks to a need for a review of the credit policies of the Domestic Systemically Important Banks (DSIBs) to become more prudent. In addition, the Covid-19 pandemic hit the Namibian economy while in a recession thus exacerbating the situation further, as such household indebtedness will continue to be monitored going forward while simultaneously establishing whether developments warrant additional macroprudential policy intervention or not.

Figure BA4: Household debt service cost



Source: BoN

PERFORMANCE OF THE BANKING SECTOR

5 PERFORMANCE OF THE BANKING SECTOR

The banking sector balance sheet growth remained positive during the period under review. Despite fluid economic conditions, the total assets in the banking sector showed significantly more growth in 2022 than they did in 2021. The total assets of the banking sector grew by 11.0 percent year-on-year, which is significantly higher than the 2.8 percent annual growth rate reported in the previous year. This was ascribed to growth in cash and balances with banks, net loans and advances, and property, plant and equipment. Non-bank funding continued to be the main driver of growth on the capital and liabilities side of the balance sheet, specifically call deposits, negotiable certificates of deposit and foreign currency deposits. The banking sector assets grew at a rate which was higher than the prevailing inflation rate, which bodes well for financial stability purposes; however, it would be a challenge to sustain an asset growth at this level given slowed economic activity.

RISK ANALYSIS

The financial stability authorities analyse the resilience of the domestic financial system to internal and external shocks, be they economic, financial, political, or otherwise. The main objective is to identify potential risks in the banking sector, while simultaneously determining how best to mitigate such risks. It is therefore important to analyse credit, liquidity, and concentration risks in the banking sector. These risks further inform the scope of stress tests that are conducted, which are part of the overall analysis of the resilience of the banking sector.

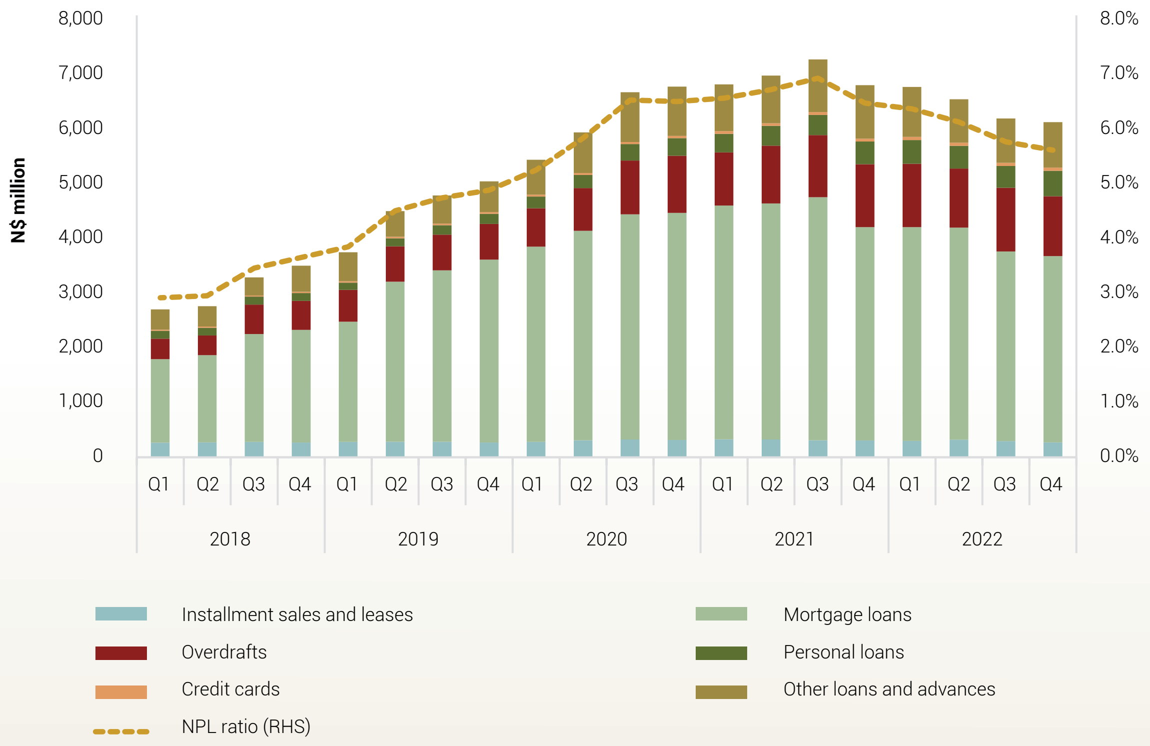
CREDIT RISK

Credit risk is in essence the risk of default by borrowers and its potential impact on profitability and capital adequacy. Banking sector assets are comprised primarily of loans granted to corporates and households. The interest earned on these assets is a key component of banks' income and profit, but is subject to the risk of default on loans by borrowers. The risk of default therefore determines the quality of the assets: the higher the rate of default, the lower the quality of assets; conversely, the lower the credit risk, the higher the asset quality. Banks are required to hold more capital when their asset quality deteriorates. This is to cover the related credit risk while also accounting for higher provisions in preparation for the expected losses, thus impacting on profitability.

Asset quality

Asset quality, as measured by the ratio of non-performing loans (NPLs) to total gross loans, improved during the period under review. The NPL ratio improved from 6.4 percent at the end of 2021 to 5.6 percent at the end of 2022 (Figure 10). The NPL ratio remained well contained even at the height of the pandemic and has since improved to below the crisis time supervisory intervention trigger point of 6.0 percent. The improvement was on the back of a combination of repayments, write-offs, and debt restructuring measures. The year-on-year improvement in the NPL ratio was ascribed to a decline in NPLs in the following loan categories: ***Instalment sales and leases*** (10.9 percent); ***Mortgage loans*** (12.7 percent); ***Overdrafts*** (4.9 percent); and ***Other loans and advances*** (15.2 percent). Conversely, the NPLs for ***Personal loans*** and ***Credit cards*** deteriorated by 12.2 percent and 11.2 percent, respectively. These loan categories can be classified as consumption spending-related and are thus associated with the unfavourable economic conditions experienced during the review period. The NPL ratio is a lagged indicator of stress experienced by borrowers; NPLs can therefore still be rehabilitated and migrate from non-performing to performing status.

Figure 10: Non-performing loans as a percentage of total gross loans



Source: BoN

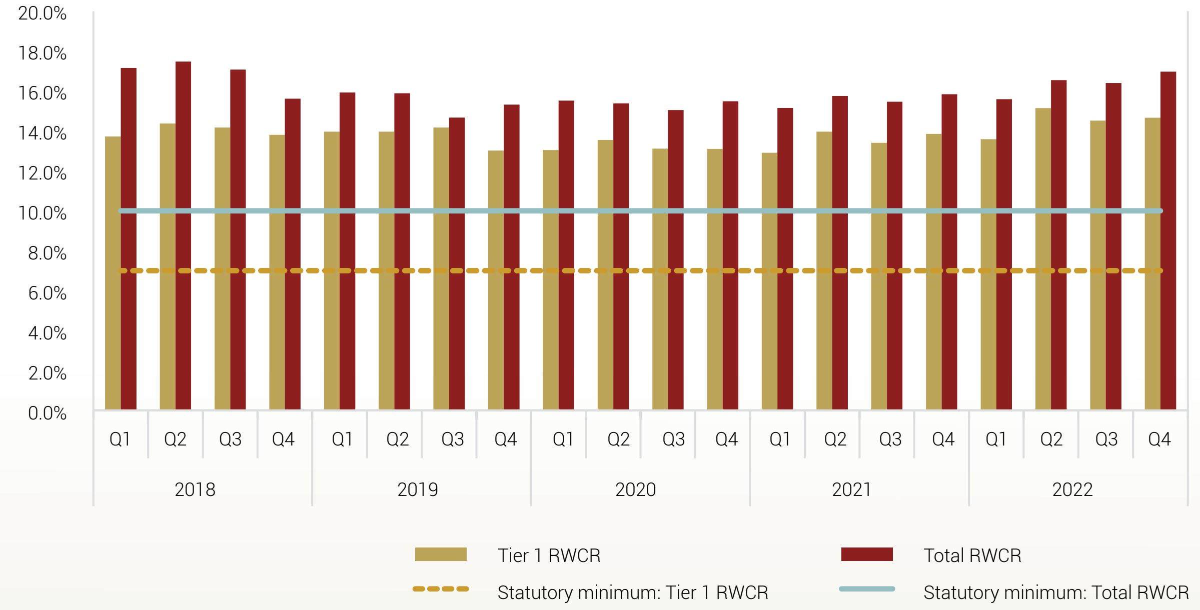
Although credit risk emanating from asset quality has subsided, its further contextualisation in relation to banking sector capital adequacy and profitability is pertinent. A higher capital adequacy ratio indicates that because of the availability of capital, the banks are in a better position to deal with unexpected losses. The higher the asset quality (lower NPLs) in the banking sector, the higher the return on assets and the return on equity, which are profitability indicators. The banking sector remained well capitalised and profitable during the period under review.

Capital adequacy

During 2022, the banking sector remained adequately capitalised and maintained a capital position well above the prudential requirement. The Tier 1 risk-weighted capital ratio (RWCR) as well as the total RWCR recorded values above the minimum regulatory requirements of 6.0 percent and 10.0 percent, respectively, during the period under review. Overall capital adequacy increased in the banking sector with the Tier 1 RWCR increasing from 13.9 percent at the end of 2021 to 14.7 percent at the end of 2022 (Figure 11). In addition, the total RWCR also increased, from 15.8 percent to 17.0 percent during the period under review. This improved capital position was on the back of an increase in general reserves to the tune of N$1.4 billion year-on-year. A favourable capital position buffers the banks from losses and risks associated with banking business. The banking sector thus remained well capitalised in 2022, which bodes well for the mitigation of credit risks to the banking sector, and thus for financial stability.

[3]The prudential requirement for the total RWCR was increased from 10.0 percent to 11.0 percent prior to the Covid-19 pandemic to account for the capital conservation buffer; however, as a Covid-19 relief measure, the buffer was released so that the prudential requirement is back at 10.0 percent. The statutory minimum of the total RWCR is therefore reflected as 10.0 percent throughout the five-year period presented in Figure 11; for consistency, the same approach was applied in Figure 15 under the solvency stress test results.

Figure 11: Capital adequecy

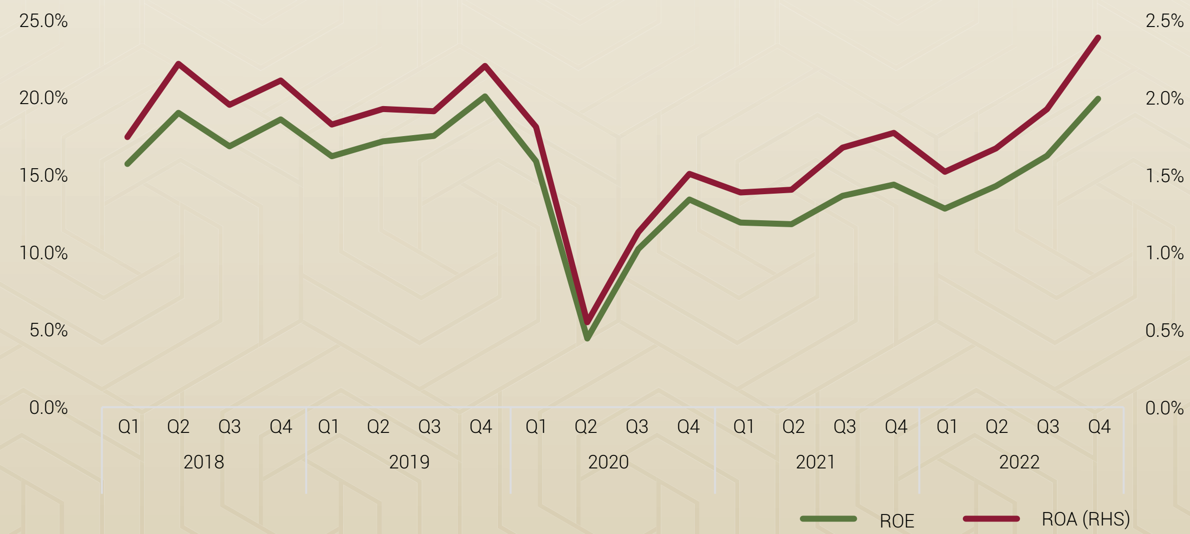


Source: BoN

Profitability

Profitability in the banking sector improved to beyond pre-pandemic levels. The banking sector's profitability as measured by returns on assets and on equity ratios improved significantly, from 1.8 percent to 2.4 percent and from 14.3 percent to 19.8 percent, respectively, during the period under review (Figure 12). The pre-pandemic averages were 2.0 percent for return on assets and 17.6 percent for return on equity. These positive developments were ascribed to net income increasing by 14.3 percent year-on-year. Although both interest income and non-interest income contributed to overall banking sector profitability, interest income was more prominent. This is to be expected given the extent to which the prime lending and other lending rates increased during the review period; deposit interest rates, on the other hand, take more time to catch up since fixed and notice deposits do not reprice immediately. The banks remained profitable in 2022 despite sluggish demand for credit, signalling a healthy and resilient banking sector with scope for more risk-taking.

Figure 12: Profitability



ROE = return on equity; ROA = return on assets
Source: BoN

Adequacy of provisions

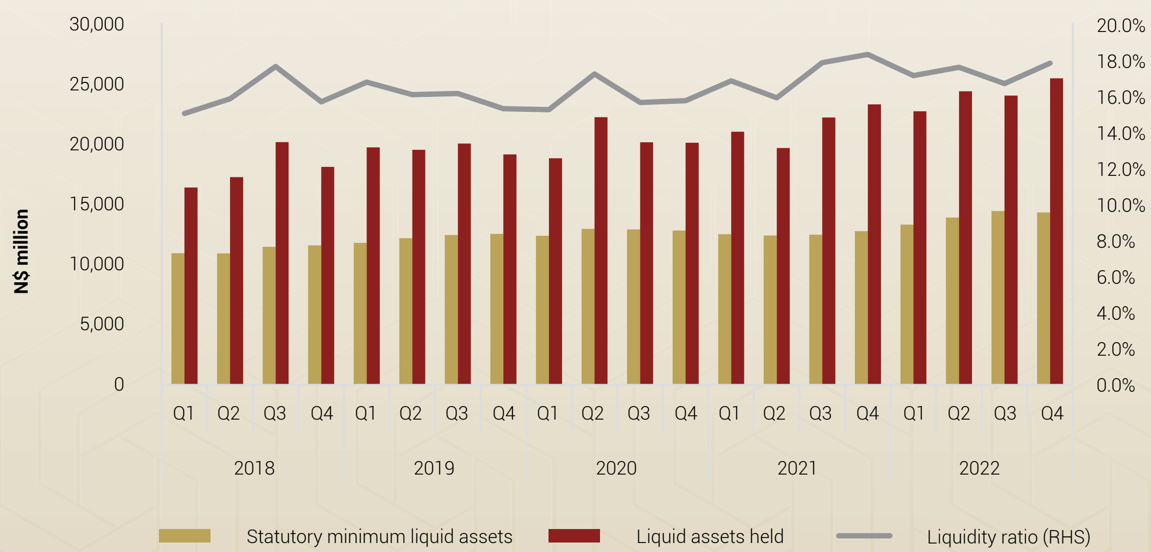
Adequate provisions were raised for delinquent loans during the period under review. Specific loan loss provisions declined by 20.3 percent from N$2.31 billion in 2021 to N$1.84 billion in 2022. This decline was due to repayments and debt restructuring relief granted during the period under review. In addition, the improved asset quality of the banking sector also contributed to this decline. The banks therefore provided adequate buffers to cushion themselves against any potential losses, allowing them to manage their credit risk effectively.

Credit risk to the financial system emanating from the banking sector levelled off in 2022, with the potential for picking up in 2023. This was as a result of improved asset quality with an NPL ratio below the crisis time supervisory intervention trigger point of 6.0 percent, coupled with a comfortable capital position well above the prudential requirement, and profitability ratios higher than pre-pandemic averages with adequate provisions. However, the FSSC is of the view that the probability of credit risk increasing in 2023 is medium, with medium impact, 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 through debt servicing, and if interest rates continue to increase, credit risk may become challenging to manage.

LIQUIDITY RISK

During 2022, the banking sector continued to hold liquid assets well in excess of the statutory minimum liquid asset requirement. Liquidity risk, plainly put, is the risk of banks not having the capacity to pay their short-term obligations. It also reflects their ability to convert their assets into cash. Deposit takers' assets are typically of longer maturity than their liabilities, and it is thus of paramount importance to monitor this risk to establish the financial soundness of the banking sector. Banks are required to keep liquid assets of 10.0 percent of average total liabilities to the public. Liquid assets held increased by 9.3 percent, from N$23.2 billion in 2021 to N$25.4 billion in 2022 (Figure 13). The statutory minimum liquid assets increased by 12.2 percent, from N$12.7 billion in 2021 to N$14.3 billion in 2022. The liquidity ratio declined marginally from 18.3 percent in 2021 to 17.8 percent in 2022. The overall improved liquidity position of the banking sector is ascribed to diamond sales, government spending, capital inflows and weak demand for credit.

Figure 13: Liquid assets and liquidity ratio



Source: BoN

Both the loan-to-deposit (LTD) and the loan-to-funding (LTF) ratios remained below 100 percent during the review period. These are two key liquidity indicators and they both moderated in 2022, which means that banks have made relatively less use of more expensive sources of funds such as debt, but rather made use of deposits to fund loans and advances. The LTD moderated from 89.9 percent in 2021 to 83.7 percent in 2022, and although there is no threshold, an LTD ratio close to or over 100 percent implies that some of the banks rely on borrowed funds to fund some of their loans. On average, 77.8 percent of the banks' funding was extended as loans and advances in 2022 (83.2 percent in 2021), which means that 22.2 percent (16.8 percent in 2021) of total funding, capital and equity was available for use on liquid and other assets. A high LTF ratio limits banks' ability to further expand their loan book while simultaneously managing their liquidity risks. Both ratios remained at manageable levels.

Liquidity risk from the banking sector to the financial system remained low in 2022 and is expected to remain as such in 2023 as well. The overall liquidity position in the banking sector improved in 2022 relative to 2021. In addition, both the loan-to-deposit and loan-to-funding ratios performed better in 2022 than in 2021. This signals that the banking sector is managing its liquidity risk well, and perhaps a lot more conservatively. The FSSC is of the view that liquidity risk has always been well managed and that this will still be the case in 2023, especially given higher expected SACU receipts. The probability of liquidity risk to the financial sector from the banking sector deteriorating in 2023 is medium, with medium impact.

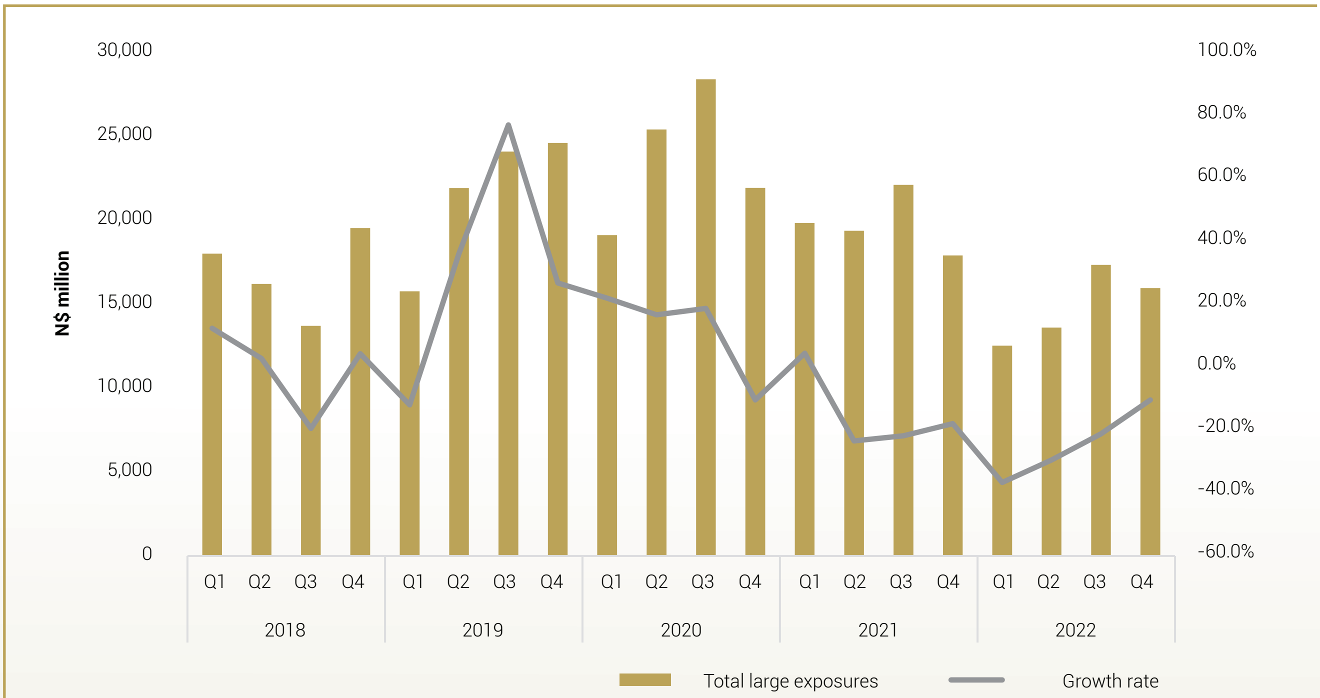
CONCENTRATION RISK

Large exposures

Large exposures[5] in the banking sector decreased in 2022 relative to 2021. The value of large exposures declined by 10.9 percent, from N$17.7 billion in 2021 to N$15.8 billion in 2022 (Figure 14). The decrease in large exposures occurred primarily in the ***Mining and quarrying***, ***Real estate, Government services*** and ***Other sectors***. The large exposures in the ***Mining and quarrying*** sector declined by 27.2 percent, while ***Real estate, Government services*** and ***Other sectors*** declined by 7.2 percent, 8.3 percent, and 5.0 percent, respectively (Figure 15). The slowdown in large exposures could be ascribed to demand constraints as well as more stringent market lending practices, especially given that the banks acted more prudently in order to manage credit risk. In addition, credit repayments also reduced the large exposures of banks. Conversely, large exposures in the ***Manufacturing*** and ***Fishing*** sectors increased the most, by 54.0 percent and 27.2 percent, respectively; the remaining sectors increased by relatively small margins. Although the ***Manufacturing*** and ***Fishing*** sectors' large exposures grew significantly during the period under review, these two sectors only constitute 3.5 percent and 2.2 percent of total large exposures in the banking sector, respectively, and therefore do not have a significant impact on the value of large exposures. Concentration risk, from a financial stability perspective, is therefore low and does not pose a real threat to overall financial system stability.

[5] 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.

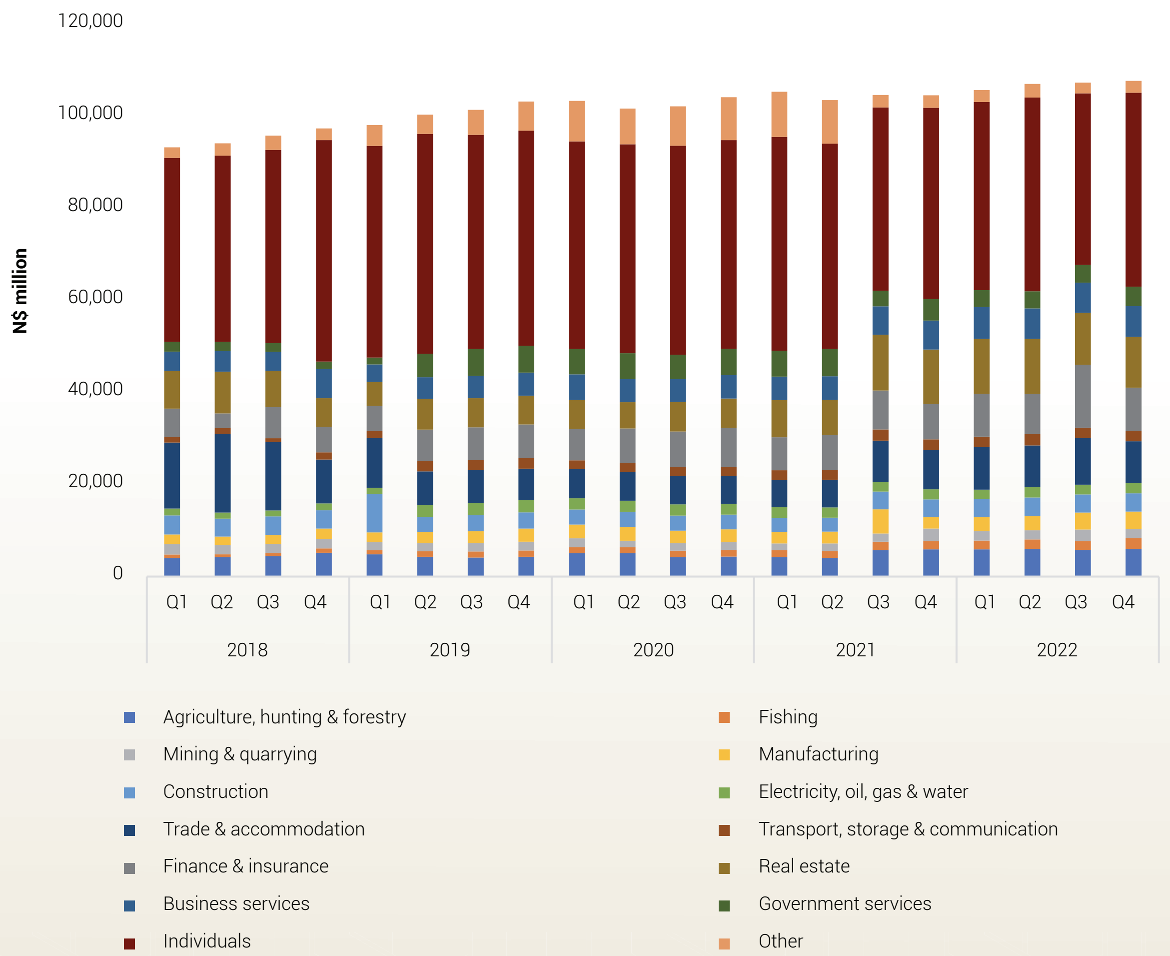
Figure 14: Total large exposures and growth rate



Source: BoN

The sectoral composition of large exposures remained broadly diversified during the period under review. The share of total large exposures that the respective sectors account for remained relatively unchanged. The following sectors' share of large exposures to total large exposures remained unchanged: ***Agriculture, hunting and forestry*** (5.6 percent); ***Construction*** (3.7 percent); and ***Electricity, oil, gas and water*** (2.1 percent) (Figure 14). However, the share of total large exposures of the following sectors declined by less than a percentage point year-on-year to reach their respective shares of total large exposures during the period under review: ***Mining and quarrying*** (1.8 percent); ***Transport, storage and communication*** (2.1 percent); ***Real estate*** (10.4 percent); ***Government services*** (4.0 percent); ***Individuals*** (39.1 percent); and ***Other*** (2.4 percent). The banking sector's large exposures remain adequately diversified and pose minimal concentration risk to the financial system.

Figure 15: Sectoral composition of large exposures



Source: BoN

The ratio of large exposures to private sector credit extension (PSCE) declined during the period under review. While the nominal value of credit extended to businesses increased, large exposures as a percentage of PSCE decreased to 14.4 percent at the end of 2022, from 16.8 percent the previous year (Table 9). Similarly, large exposures as a percentage of PSCE extended to businesses also declined in 2022 in comparison with 2021. Apart from fewer large projects undertaken, significant repayments, and disintermediation, the current economic conditions paved the way for the adoption of more stringent lending practices by the banking sector as they continue to be more risk averse, thus supporting the slower growth rate of large exposures during the period under review.

Table 9 Large exposures in relation to PSCE

N$ million	2018	2019	2020	2021	2022
Total large exposures	19,356	24,379	21,726	17,741	15,811
Total PSCE	95,898	102,774	104,825	106,049	110,531
PSCE to businesses	40,966	44,853	44,307	44,258	45,809
Large exposures as a % of PSCE	20.2	23.7	20.7	16.8	14.4
Large exposures as a % of business PSCE	47.2	54.4	49.0	40.1	34.5

Source: BoN

STRESS TEST

The BoN makes use of the Čihák Stress Test Model to assess the resilience of the Domestic Systemically Important Banks (DSIBs) to credit and liquidity risks, through a scenario-based approach. This stress test exposes the DSIBs to shocks caused by spikes in interest rates raising credit risk, or sudden drops in liquidity. There are three scenarios, namely baseline, intermediate and severe. The baseline scenario assumes a moderate tightening in the current policy environment in line with the expected tightening cycle both domestically and globally, followed by the intermediate and severe scenarios where increasingly adverse shocks are considered. The ultimate objective is to quantify the impact on solvency and liquidity should the identified scenarios ensue, as well as to suggest policy options to minimise the impact of potential shocks on the banking sector and the overall economy. The scenarios consider recent developments in the global, South African, and domestic economies, respectively, while also focusing on the performance of the DSIBs should these scenarios materialise. The Čihák model was used to stress test the solvency and liquidity position of the DSIBs 12 months into the future.

Credit risk

Global and domestic economic developments have a bearing on interest rate developments in Namibia, and thus affect credit risk. Global and domestic growth are both expected to slow down in 2023, with risks to the baseline remaining tilted to the downside. As outlined in Chapter 3 (Macroeconomic environment) above, global growth is expected to slow by 0.6 percentage points in 2023, while domestic growth is expected to slow by 1.2 percentage points. Global downside risks include worsening health outcomes in China, the war in Ukraine, and a debt distress event triggered by rapid tightening in global financial conditions. Domestic downside risks are dominated by monetary policy tightening globally and high costs of key import items, thus putting further pressure on inflation. Domestic inflation rose sharply during 2022 on the back of higher international prices for food and energy, coupled with depreciation in the domestic currency. The respective monetary policy committees of both the Bank and the SARB have consistently raised their respective repo rates throughout 2022. In order to maintain the currency peg, the Bank may opt to follow a path broadly similar to that followed by the SARB, with gradual increments in 2023. The current repo rate of 7.25 percent is the starting point, and from this level the following further repo rate decisions are foreseen:

- Baseline scenario: Increase the repo rate by a total of 100 basis points over the next 12 months
- Intermediate scenario: Increase the repo rate by a total of 300 basis points over the next 12 months
- Severe scenario: Increase the repo rate by a total of 500 basis points over the next 12 months

Although improvements in the NPL ratio were recorded in 2022, downside risks remain on the horizon. The repo rate projections listed above have a direct bearing on asset quality and its projected performance. Asset quality improved from 6.4 percent in 2021 to 5.6 percent in 2022. Despite these positive developments, it is anticipated that asset quality will deteriorate over the coming 12 months as disinflationary monetary policy adds further pressure on households and corporates to service their debt. It is therefore important to consider what the potential ramifications on the banking sector's solvency position would be if this risk were to materialise. In the stress test, the following trajectory is assumed under each scenario with an NPL ratio of 5.6 percent as the starting point:

- Baseline scenario: A 2.0 percentage point increase in the banking sector NPL ratio over the next 12 months
- Intermediate scenario: A 4.0 percentage point increase in the banking sector NPL ratio over the next 12 months
- Severe scenario: A 6.0 percentage point increase in the banking sector NPL ratio over the next 12 months.

Liquidity risk

Liquidity risk measures the banks' ability to honour their financial obligations in a timely manner. Although the overall liquidity position of the banking sector improved in 2022 relative to 2021, stress tests are concerned with the resilience of the sector in the event of a liquidity shock. The concern of the Bank is whether commercial banks would be able to withstand a sudden withdrawal of funds from the banking system, despite the banks being liquid, well capitalised, profitable, and solvent. The following assumptions on withdrawals by depositors are therefore assumed in the stress test:

- Baseline scenario: 20 percent of demand deposits, withdrawn over five days (10.61 percent of total deposits withdrawn over five days)
- Intermediate scenario: 40 percent of demand deposits withdrawn over five days (21.21 percent of total deposits withdrawn over five days)
- Severe scenario: 60 percent of demand deposits, withdrawn over five days (31.82 percent of total deposits withdrawn over five days)

SUMMARY OF STRESS TEST SCENARIOS

A summary of the stress test scenarios is presented in Table 10 below.

Table 10 Summary of stress test scenarios

Variable	Baseline	Intermeidate	Severe
Credit Risk			
Repo rate	Increase repo rate by 100 basis points	Increase repo rate by 300 basis points	Increase repo rate by 500 basis points
NPL ratio	2.0 percentage points increase	4.0 percentage points increase	6.0 percentage points increase
Liquidity Risk			
Liquidity	20% of demand deposits withdrawn over 5 days (10.61% of total deposits)	40% of demand deposits withdrawn over 5 days (21.21% of total deposits)	60% of demand deposits withdrawn over 5 days (31.82% of total deposits)
Other variables: 30% haircut on collateral 50% assumed provisioning of the new NPLs			

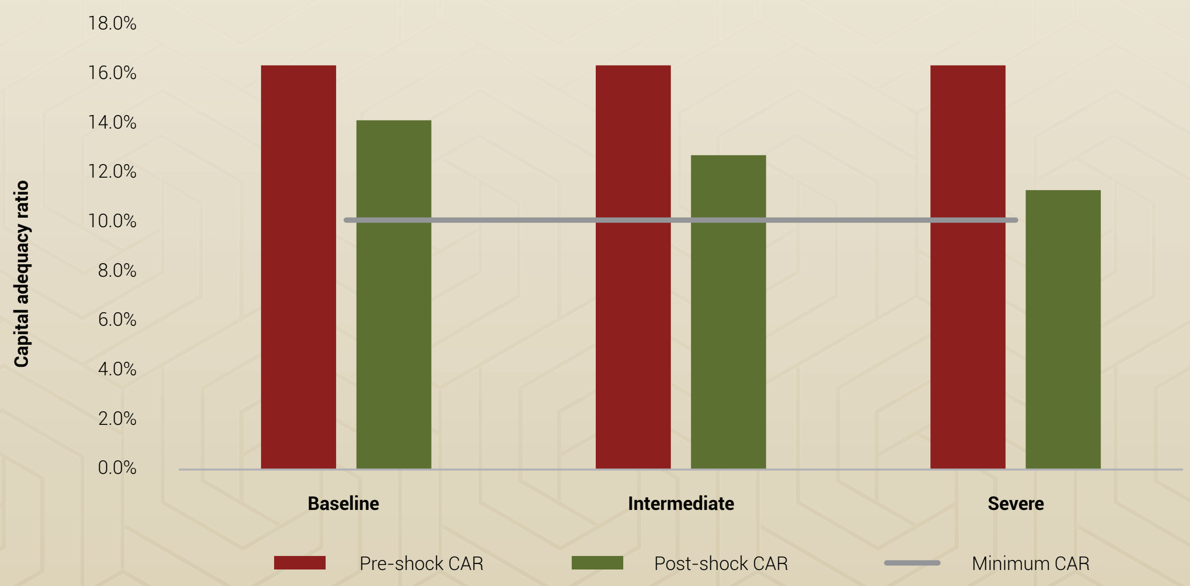
Source: BoN

STRESS TEST RESULTS

Solvency

The stress test results indicate that the banking sector remained solvent in all three scenarios. The pre-shock capital adequacy ratio (CAR), as per the Čihák model, stood at 16.2 percent. In the baseline scenario, the post-shock CAR fell to 14.0 percent, which is 4.0 percentage points higher than the statutory minimum limit of 10.0 percent. The intermediate scenario recorded a post-shock CAR of 12.6 percent, whereas in the severe scenario, the post-shock CAR was quite low, at 11.2 percent (Figure 16). The 12-month projection of the Čihák model thus points toward a solvent banking sector in all three scenarios. The capital base of the banking sector is therefore adequate to absorb credit risk shocks, if all else remains constant.

Figure 16: Solvency Stress Test Results

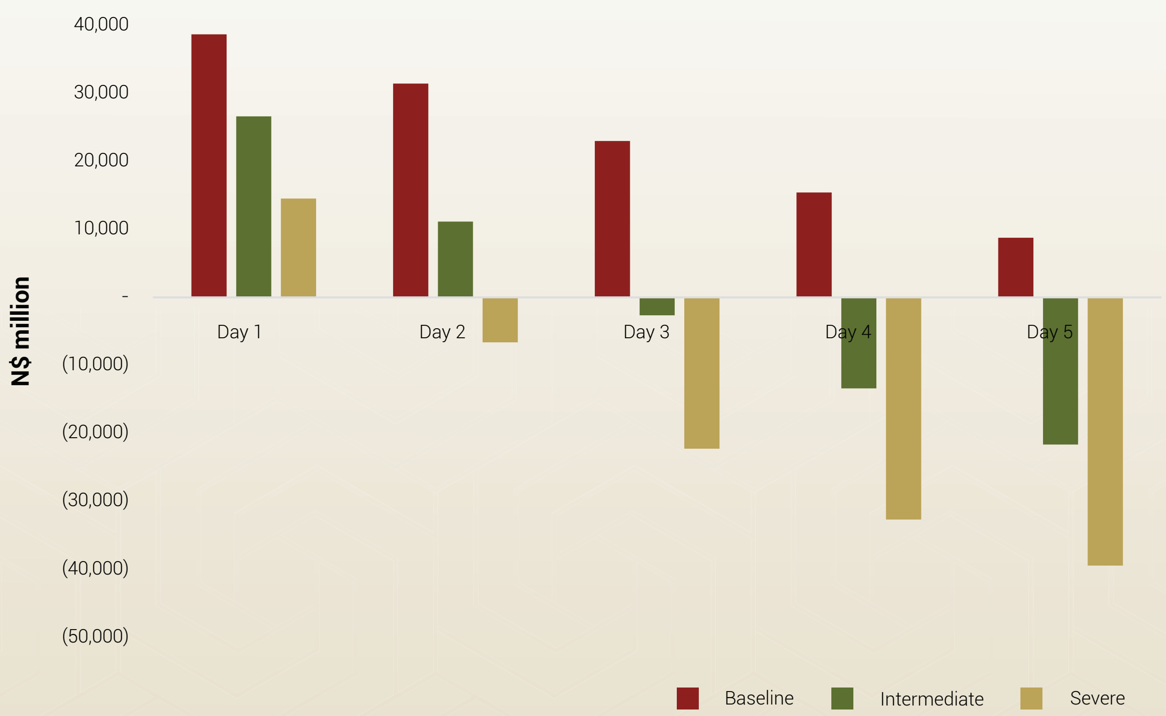


Source: BoN

Liquidity

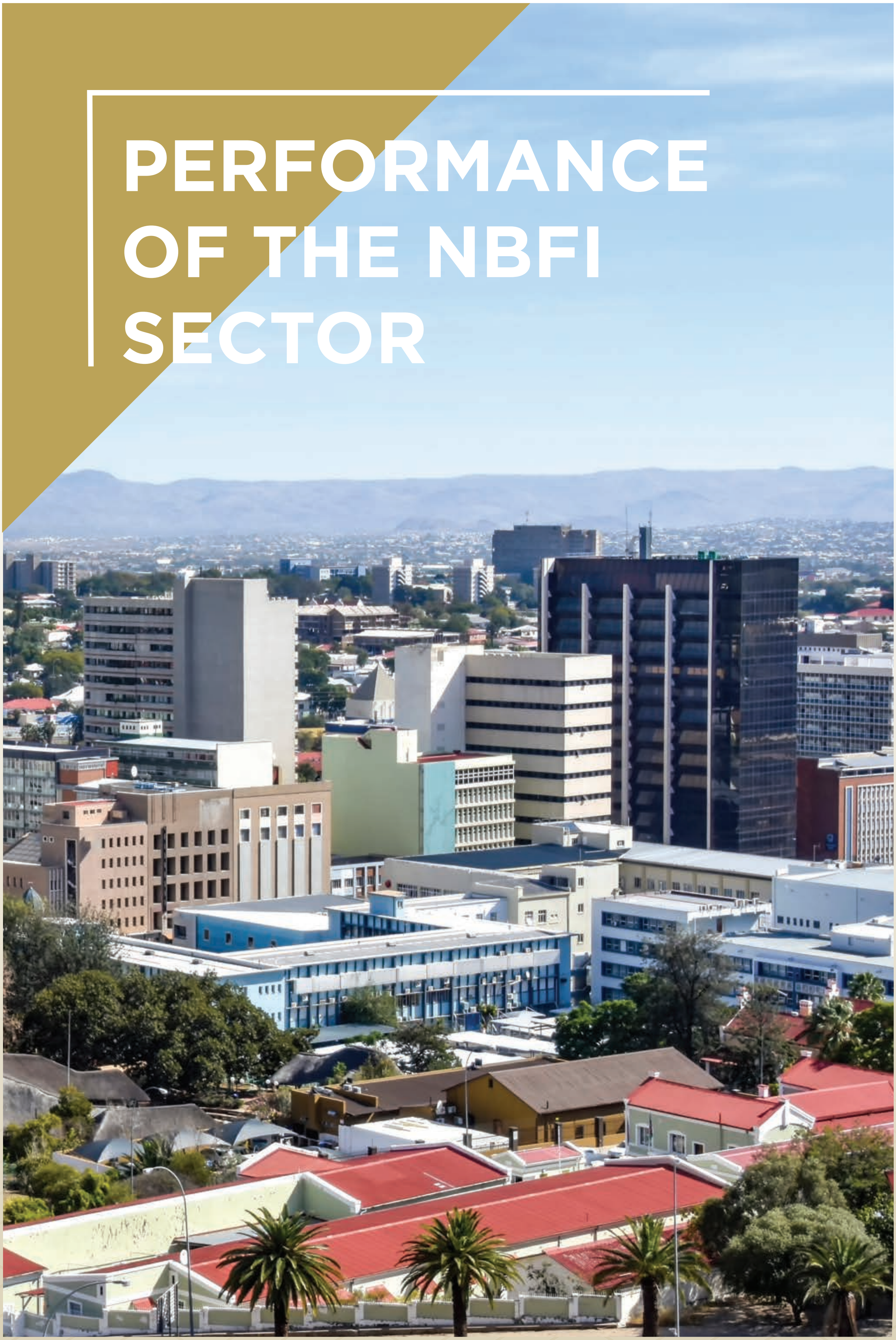
The liquidity position of the banking sector in the event of a liquidity shock would remain sound in the baseline scenario, with a noticeable deterioration in both the intermediate and severe scenarios. In the baseline scenario, the liquidity position for the 12-month projection remained sound, but declined gradually over the five days (Figure 17). The intermediate scenario produced similar results, but with a much steeper downward trend over the five-day period, moving into negative territory from day three. The severe scenario, on the other hand, produced a much steeper downward trend, starting in negative territory as of the second day. The banking sector would therefore only be able to meet its payment obligations in the baseline scenario. Furthermore, in the intermediate scenario, it would only meet its liquidity obligations on the first and second days; and in the severe scenario, it would only do so on the first day. However, the banks can make use of other sources of funds to avert a liquidity crisis. Other sources of funds include credit lines with their parent companies; cash and central bank cash reserve deposits in excess of minimum reserve requirements or liquid asset requirements; available repo facilities (central bank eligible collateral deposits); unencumbered assets not at the central bank; foreign exchange market liquidity or investment securities available for sale; securitised assets; and interbank funding, amongst others. The banks also have liquidity contingency plans in place to guide them in the event of a shock.

Figure 17: Liquidity stress test results



Source: BoN

PERFORMANCE OF THE NBFI SECTOR



6 PERFORMANCE OF THE NBFI SECTOR

During the review period, the assets of NBFIs contracted by 1.2 percent to N$366.1 billion, on the back of higher-than-expected inflation and global monetary policy tightening. The sectoral contraction in assets emanated from 1.1 percent and 3.3 percent reductions in the assets of collective investment schemes (CIS) and retirement funds (RFs), respectively, which collectively accounted for 72.9 percent of NBFI assets over the reporting period.

Table 11 NBFI sector asset size

Subsector (N$ million)	2018	2019	2020	2021	2022
Long-term insurers	56,640	60,165	61,681	66,672	68,757
Short-term insurers	6,540	6,830	6,487	7,188	7,200
Medical aid funds	1,933	2,028	2,359	2,287	2,001
Retirement funds	158,528	173,427	182,234	212,909	205,817
Collective investment schemes	52,252	56,703	59,390	61,622	60,974
Investment managers	7,795	7,669	8,775	12,584	14,654
Friendly societies	1,57	1,73	1,93	2,04	2,25
Microlenders	6,447	5,853	6,055	7,316	6,743
Total NBFIs	290,137	312,677	326,983	370,582	366,149
Annual growth (%)	5.1	7.8	4.6	13.3	-1.2

Source: NAMFISA

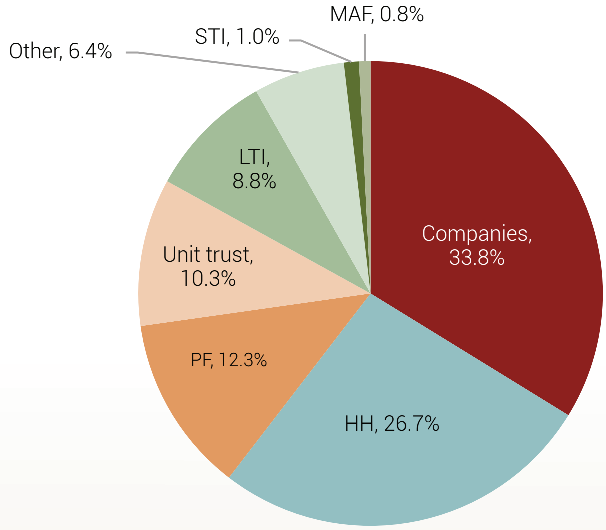
COLLECTIVE INVESTMENT SCHEMES

The CIS subsector, a conduit through which the financial system sets prices and allocates risk as well as capital, remained stable during 2022. This was despite CIS total assets under management declining marginally by 0.8 percent to N$79.1 billion over the review period, a reduction which coincided with gloomy financial market conditions, particularly over the first three quarters of 2022. NAMFISA is cognisant of the role the CIS subsector plays in the financial system, as well as its potential to contribute to liquidity constraints. In view of the discretionary nature of household investments, NAMFISA therefore pays particular attention to closely monitoring funds sourced from households. No significant withdrawals of unit trust funds were observed.

Source and allocation of funds

By and large, companies and natural persons remained the main sources of funds over the review period. A third of the funding was sourced from companies and just over a quarter from natural persons in 2022 (Figure 18). The aforesaid funds were primarily channelled through to money market instruments (57.3 percent), listed equity (13.1 percent), and listed debt (22.9 percent) (Figure 19).

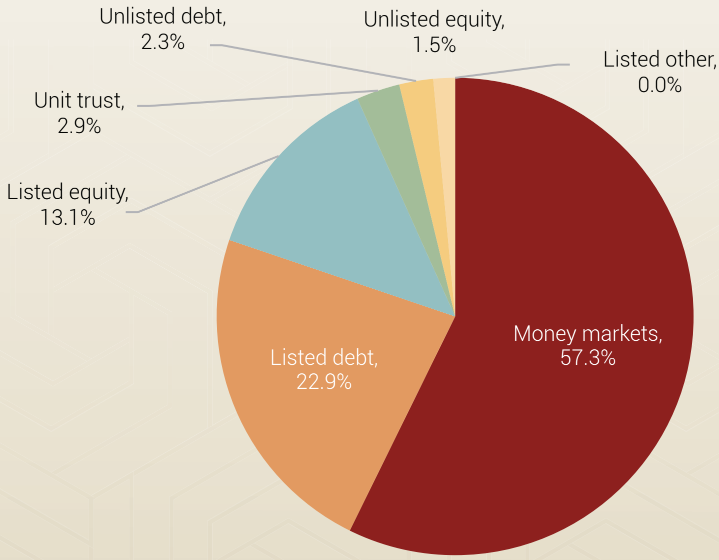
Figure 18: Collective investment schemes – source of funds



PF=retirement funds; HH=natural persons; LTI=long-term insurance; STI=short-term insurance; MAF=medical aid funds

Source: NAMFISA

Figure 19: Collective investment schemes – allocation of funds

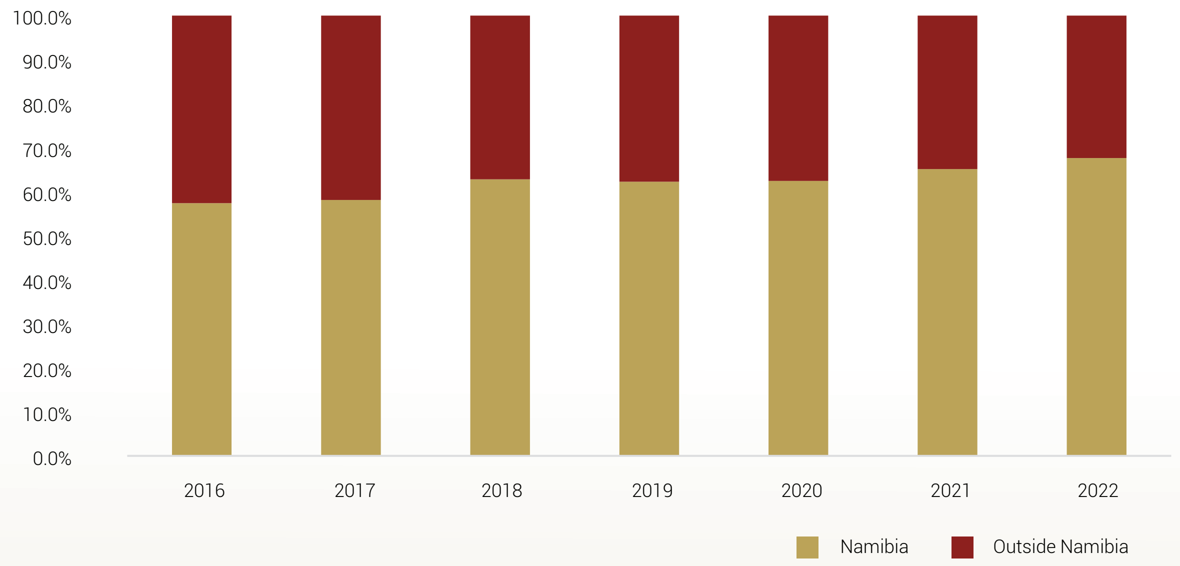


Source: NAMFISA

Geographic allocation of funds

The subsector channeled 67.6 percent of its assets under management into the domestic economy during 2022 (Figure 18). In monetary terms, the subsector's domestic exposure was recorded at N$53.5 billion. The aforesaid accentuates the subsector's role as an allocator of capital in the Namibian financial system.

Figure 20: Collective investment schemes – geographic allocation of funds



Source: NAMFISA

RETIREMENT FUNDS

The retirement funds subsector remained fully funded over the review period, withstanding unfavourable financial market developments. Despite its resilience, the subsector's assets contracted by 3.3 percent to N$205.8 billion over the review period. On the other hand, liabilities contracted by 3.0 percent to N$203.2 billion over the same period. The contraction in assets was the result of a sell-off across global fixed income and equity markets, on the back of recessionary fears, as well as steep rate hikes. Liabilities, on the other hand, declined as a result of maturing obligations. The risks and/or events associated with the retirement funds subsector that should be monitored closely over the next 12 months are market risks, and contribution shortfalls.

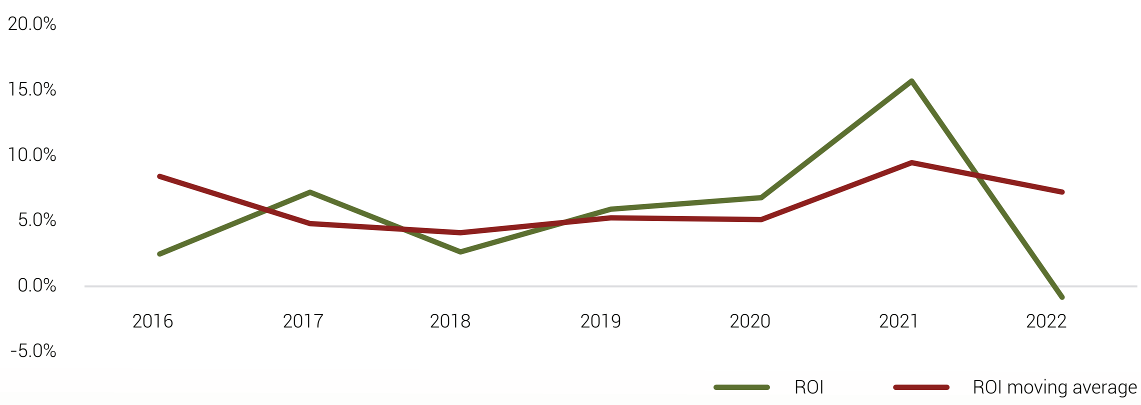
Market risk

The subsector's investment assets returned -0.8 percent during the review period, consequent to higher-than-expected inflation rates which persisted during the review period. This is the poorest the subsector's investment assets have performed in a single year over the last ten years, highlighting the bearish extent of financial markets in 2022. Poor financial market performances directly affect the asset side of RFs, as is observable from the 3.3 percent reduction in total assets. When assets either contract faster than liabilities, or grow slower than liabilities, it has the undesirable effect of diminishing the buffer over liabilities, threatening the ability to meet obligations in the long run, particularly in defined benefit and hybrid RFs.

Concerns around the subsector's exposure to market risk were initially allayed in the fourth quarter of 2022, when financial markets were observed to recover. Ominously, following developments involving banks in the US and Europe in the first quarter of 2023, it remains to be seen how the fear of a financial crisis materialising will be priced into stocks. Any adverse effect on stocks and the financial markets at large will put more pressure on RF assets and inherently, threaten the viability of the subsector, specifically the defined benefit and hybrid RFs.

On the other hand, given the long-term nature of the subsector's obligations, it is important to consider a multi-period moving average return on investments. Accordingly, a three-year moving average was computed, with respect to which the subsector's investment assets returned 7.1 percent per annum at the end of 2022, down from 9.4 percent at the end of 2021 (Figure 21). This medium-term view of returns on investments paints a less ominous picture, allaying concerns regarding the realistic future viability of the RF subsector, notwithstanding the fear of a financial crisis stemming from developments in the US and Europe materialising.

Figure 21: Retirement funds – investment performance

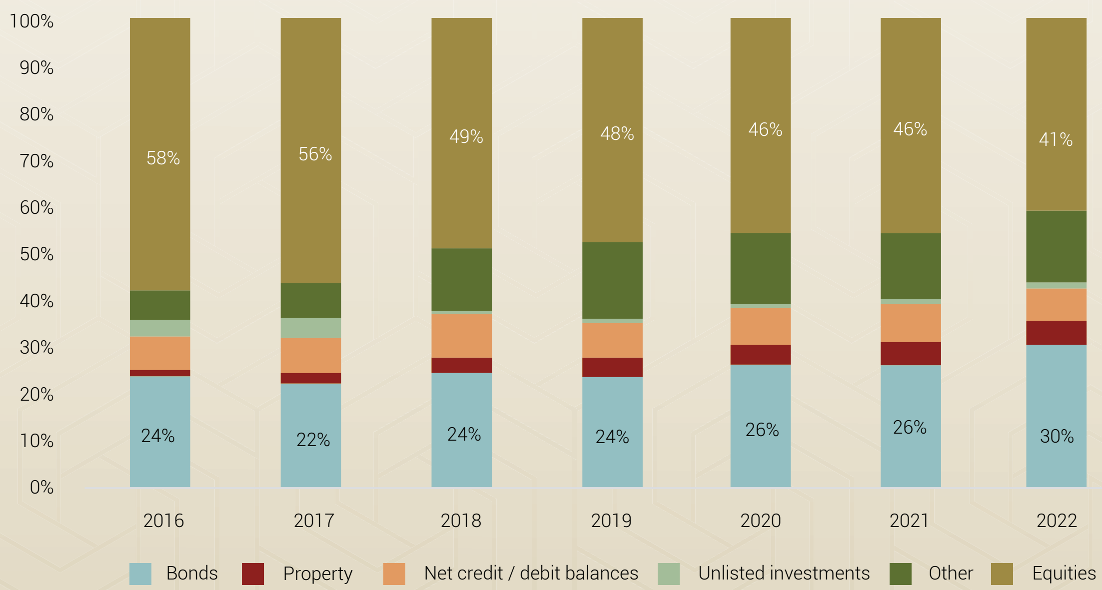


Source: NAMFISA

Investment mix

Consequent to the bearish financial markets, the subsector's absolute exposure to equities decreased by 13.4 percent to N$83.8 billion, while exposure to bonds increased by 12.7 percent to N$7.0 billion, which is attributable to base effects and favourable interest rate offerings. Similarly, the proportional exposure to equities declined by 5 percentage points to 41 percent, while the proportional exposure to bonds increased by 4 percentage points to 30 percent over the review period (Figure 22). The risks inherent in the subsector's allocation of investment assets with respect to asset class are relatively matched with the time-to-maturity of the liabilities. Therefore, there were no concerns regarding how the subsector allocated its investment assets with respect to asset classes during 2022.

Figure 22: Retirement funds – investment mix

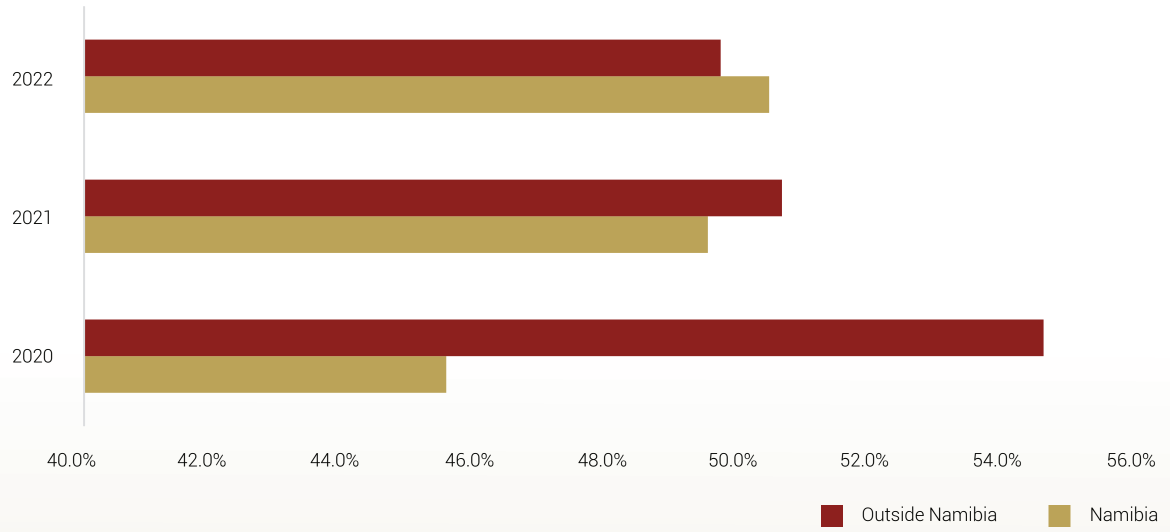


Source: NAMFISA

Geographic allocation

Investment assets held outside Namibia contracted by 5.1 percent to N$101.5 billion, while those held domestically declined by 1.5 percent to N$103.0 billion. The reduction in investment assets held outside Namibia is attributable to bearish developments in offshore financial markets. With respect to proportions, the subsector channelled 50.4 percent of its investment assets into the domestic economy in 2022, realizing a 0.9 percentage point increment from 2021 (Figure 23). The higher proportional exposure is the result of relatively lower foreign equity valuations, as well as the minimum domestic holdings requirements as prescribed by the relevant laws.

Figure 23: Retirement funds – geographic allocation

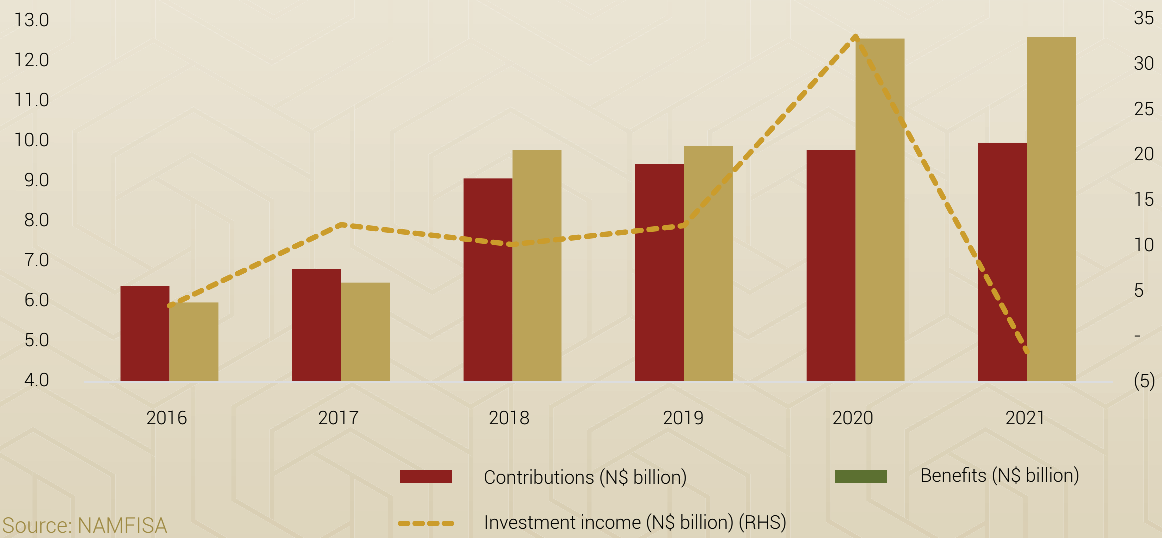


Source: NAMFISA

Cash flow risk

Benefits paid remained relatively elevated, increasing marginally by 0.3 percent to N$12.5 billion, whereas contributions received grew 1.5 percentage points faster than benefits paid during 2022 (Figure 24). As a result, the gap between contributions and benefits narrowed marginally during 2022. The change in contributions made to retirement funds is reliant on developments in active members, as well as pensionable salaries, while membership to Namibian retirement funds is largely occupational. By and largely, economic growth and employment creation are positively correlated. Therefore, growth in contributions received is dependent on economic growth. Contributions received will remain relatively stagnated for as long as economic growth remains subdued. The current age structure of the subsector suggests that benefits paid will remain escalated in 2023. The three-year investment income moving average consistently absorbs the three-year moving average in respect of the shortfall between contributions and benefits. Liquidity concerns vis-à-vis contributions' shortfall to benefits paid remain low, given that retirement funds undertake asset-to-liability matching exercises, with respect to which it is ascertained that member benefits are invested in portfolios aligning with their respective date-to-maturity.

Figure 24: Retirement funds – cash flow

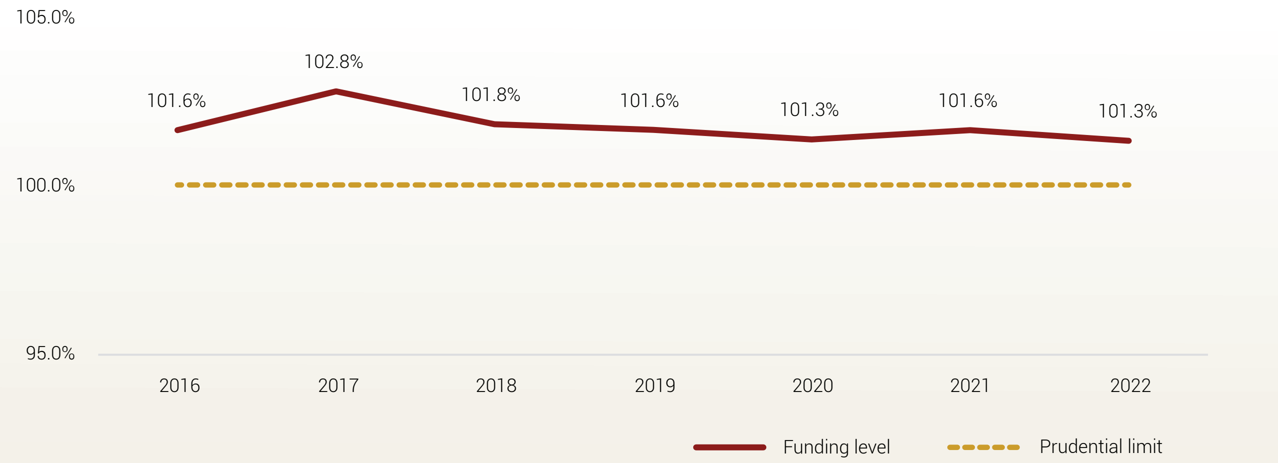


Source: NAMFISA

Funding position

The retirement funds subsector remained resilient during the reporting period, withstanding the effects of bearish financial markets as well as a negative net flow of funds. Notwithstanding the aforesaid, asset side shocks resulted in assets contracting by 3.3 percent, thereby diminishing the buffer over liabilities by 0.3 percent during the review period (Figure 25). Given the widespread bearish shock of equity markets in 2022, as well as vulnerabilities of stock markets in the first quarter of 2023, it is inherent that shocks to the subsector's assets will correspondingly proceed. However, the subsector has a healthy buffer of net assets which is expected to continue absorbing asset-side shocks in the short- to medium-term.

Figure 25: Retirement funds – funding position



Source: NAMFISA

LONG-TERM INSURANCE

Long-term insurance

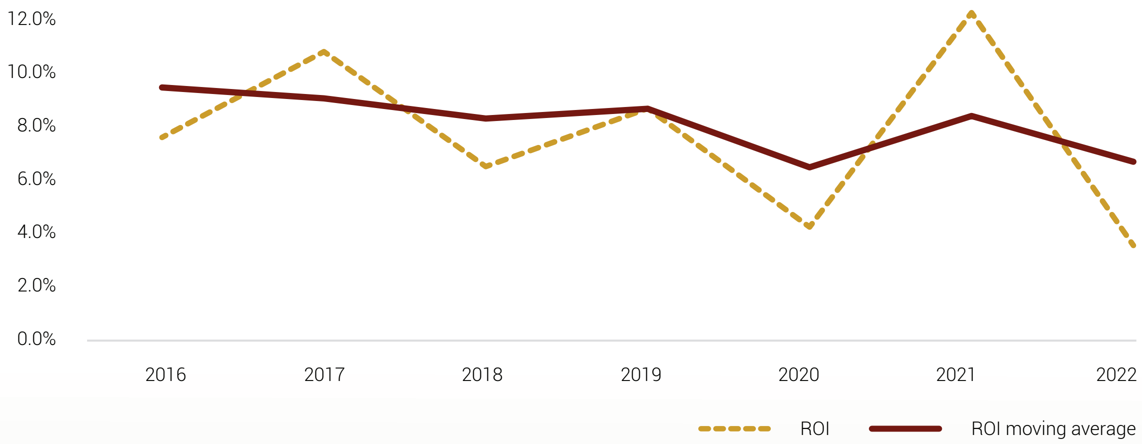
The long-term insurance subsector remained solvent over the review period, withstanding unfavourable macroeconomic and financial market developments. The subsector continued its recovery from the high claims experience observed in 2021, which was attributable to the Covid-19 pandemic. The Delta variant of the virus was accompanied by the worst mortality levels, and consequently the most significant impact of the pandemic on the liabilities side was experienced in 2021.

The subsector's assets expanded by 3.1 percent to N$68.8 billion in 2022, while marginal growth of 0.8 percent was recorded in liabilities, which stood at N$58.3 billion. Market risk is of primary concern to the subsector's viability and will be monitored closely over the next 12 months.

Market risk

The long-term insurance subsector's investment assets returned 3.5 percent in 2022, withstanding bearish financial markets (Figure 27). As at the mid-year review, the subsector's investment assets had returned -2.7 percent, with the stock market rally of the fourth quarter of 2022 responsible for the positive returns over the course of the year. The uncertainty associated with the financial markets is not likely to affect the subsector's soundness in the short- to medium-term. However, the persistence of higher-than-expected inflation rates is bound to affect the capacity of policyholders to afford insurance policies. As with retirement funds, the long-term horizon of the subsector's obligations warranted computation of return on investments using three-year moving averages. Accordingly, the three-year moving average was observed to trend downward until 2020, recovering in 2021. The downward trend in the three-year return on investments was observed to coincide with the subsector's diminishing exposure to equities, coupled with an increase in exposure to the "other" asset class (Figure 26).

Figure 26: Long-term insurance – investment performance

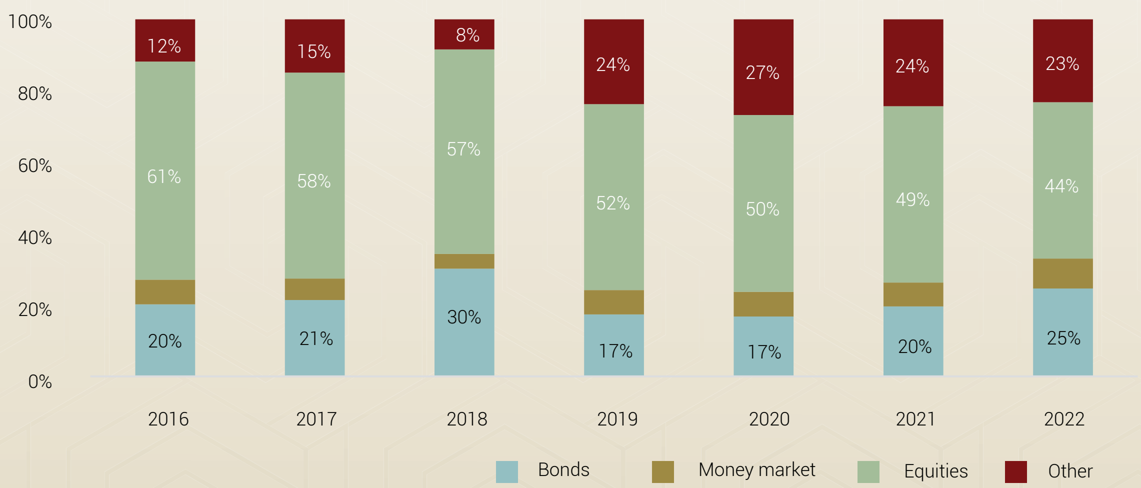


Source: NAMFISA

Investment mix

The subsector remains heavily exposed to equities, albeit by diminishing proportions, with exposure to equities recorded at 43.8 percent in 2022. Ominously, more than a fifth of the long-term insurance subsector's investment assets were held in the broad "other" asset class, which includes property, unlisted investments, other investments, other claims, and investments in the businesses of associate and subsidiary companies. It was noted that the bulk of the subsector's holdings in this class are in the businesses of associates and subsidiary companies.

Figure 27: Long-term insurance – investment mix

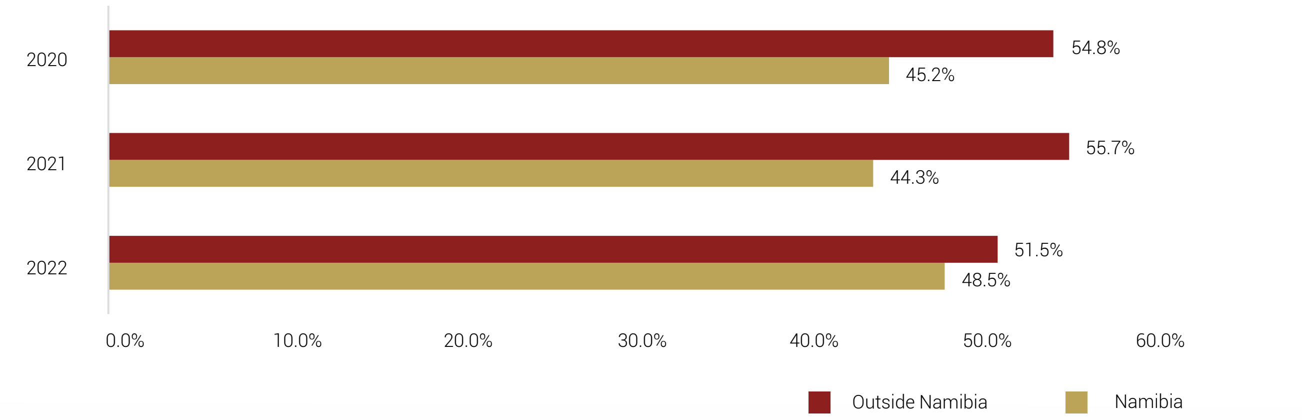


Source: NAMFISA

Geographic allocation

The long-term insurance subsector remained a strategic source of funds in the domestic economy, channelling 48.5 percent of its investment assets into the domestic economy over the review period (Figure 28). In nominal terms, N$29.9 billion was held in the domestic economy in 2022, of which 30.8 percent was in government bonds, 15.4 percent in equities, and 21.7 percent in unlisted investments, which are predominantly holdings in the businesses of associates and subsidiary companies.

Figure 28: Long-term insurance – geographic allocation of investments

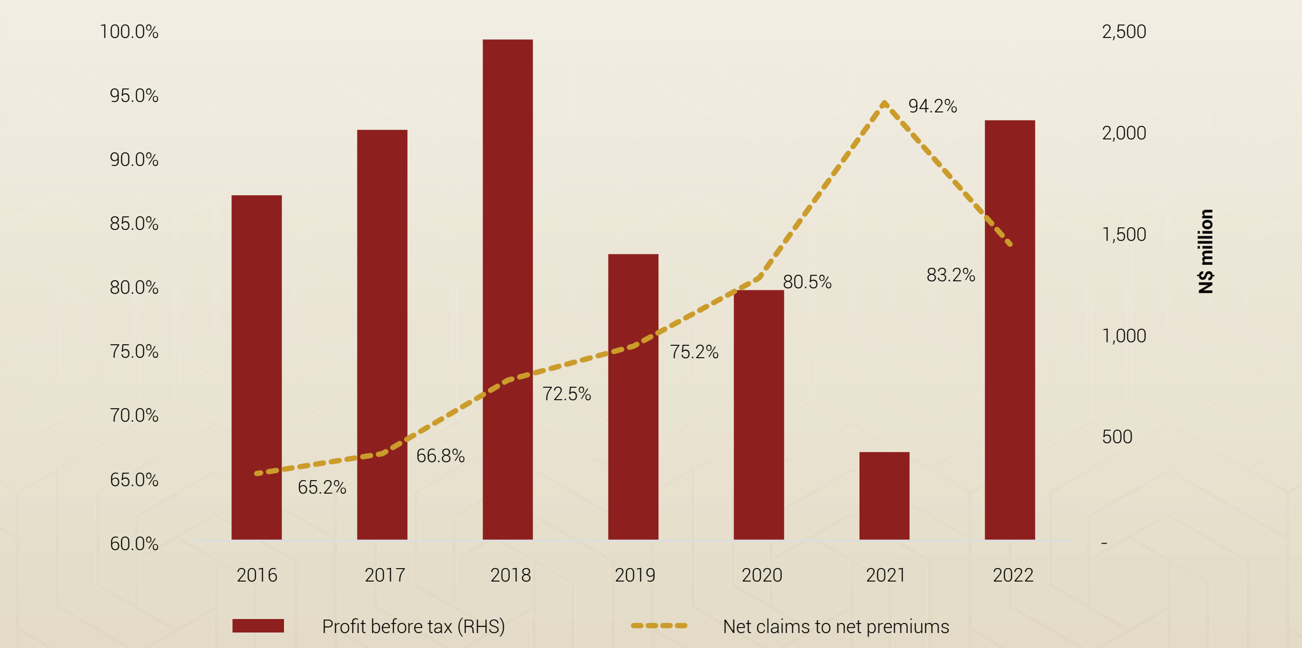


Source: NAMFISA

Earnings and profitability

Net claims paid by the long-term insurance subsector were observed to contract by 11.7 percent to N$8.7 billion, attributable to base effects, while net premiums were observed to remain relatively unchanged at N$10.5 billion. In 2021, an elevated claims experience was observed, which followed the relatively higher mortality rates resulting from the Covid-19 pandemic. Accordingly, the ratio of net claims to net premiums peaked in 2021, and thereafter contracted by 11.1 percent to 83.2 percent in 2022 (Figure 29). Consequent to the 11.7 percent contraction in net claims, the subsector reported profits of N$2.1 billion in 2022, a sharp increase from the 2021 profit levels. The spike in profitability is a return to the pre-Covid 19 levels and not necessarily an anomaly.

Figure 29: Long-term insurance – earnings and profitability

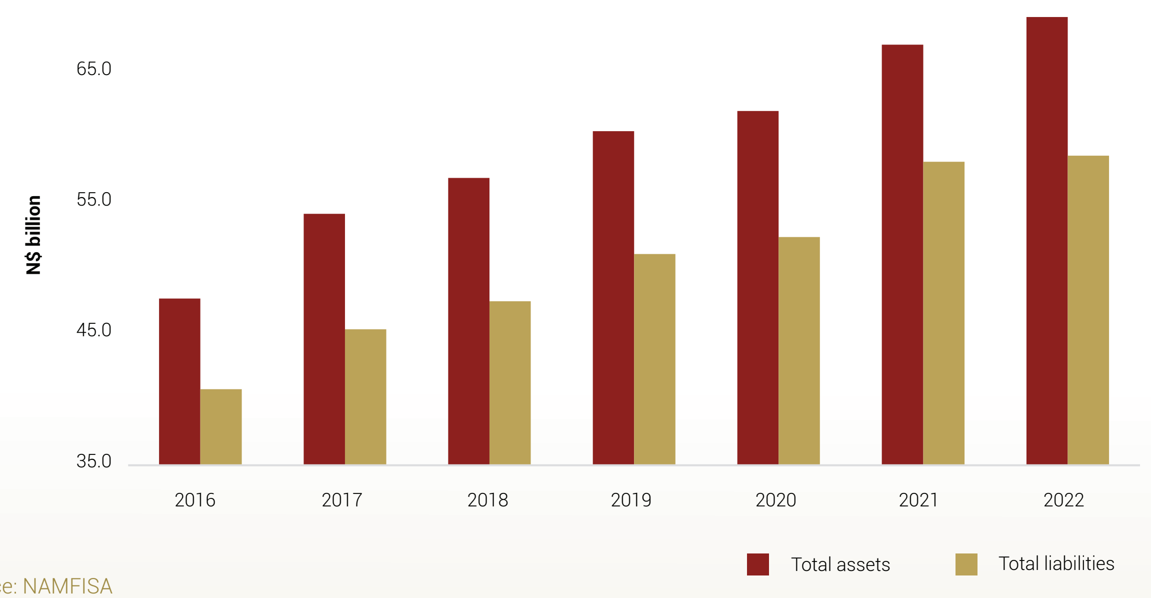


Source: NAMFISA

Capital Adequacy

The long-term insurance subsector withstood the bearish financial markets, remaining solvent in 2022 (Figure 30). Financial market developments, underwriting of insurance business as proxied by written premiums, and the claims experience, remain important considerations for assessing the solvency position of the subsector, and will be monitored continuously.

Figure 30: Long-term insurance – solvency position



Source: NAMFISA

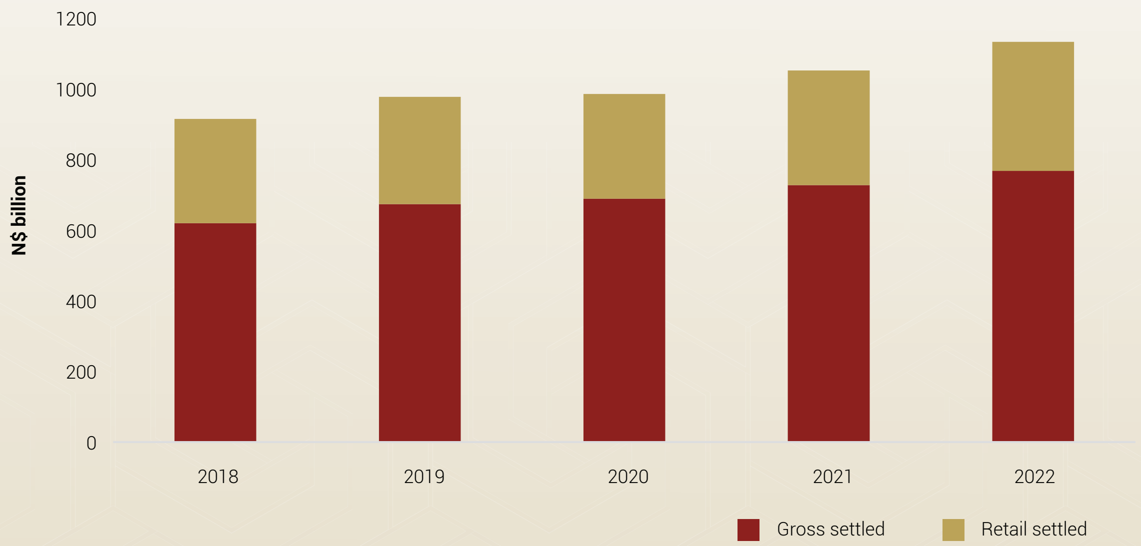
PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

7 PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

Operational risk 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 the financial infrastructure of a country. In Namibia, the regulatory mandate to oversee the NPS was carried out through risk-based off-site oversight activities. Namclear, as a designated financial market infrastructure, completed a self-assessment as per the Principles for Financial Market Infrastructures, and is implementing the recommendations emanating from the self-assessment. A self-assessment, followed by an independent assessment, was conducted on the Namibia Interbank Settlement System (NISS) to assess their observance of the principles. Both financial market infrastructures, as per their agreed timelines, are addressing the identified gaps. Risks identified through off-site oversight activities are also being addressed.

After reaching the settlement value milestone of a trillion Namibia dollars during 2021, the NISS has continued along the same trajectory during 2022. The aggregate settlement value recorded in the NISS during 2022 was N$1 131.0 billion, with the number of transactions processed amounting to 90 434, which translates to an average of 299 transactions per settlement day. In this regard, the share of real-time gross settled transactions accounted for 67.8 percent, or N$766.3 billion, while the retail payment bulk settled transactions constituted 32.2 percent, or N$364.7 billion, of the total value settled in the NISS (Figure 31).

Figure 31: Value of payments processed in NISS

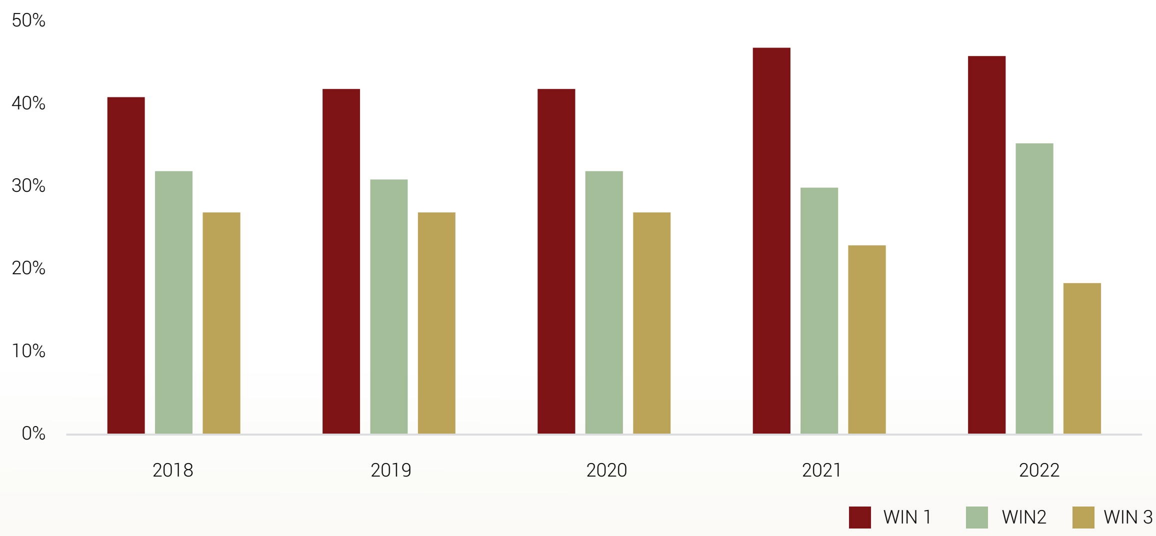


Source: BoN

NISS SETTLEMENT WINDOWS

Settlement and operational risks remained minimal within the NPS in 2022. The bulk of the payments settled in earlier windows (i.e., Windows 1 and Window 2), which accounted for 81.0 percent (N$922.8 billion) of the aggregate settlement, while the remainder of payments were settled during the later window, Window 3 (Figure 32). To deter settlement and operational risks, it is preferred that the majority of settlement obligations occur in the earlier windows to afford participants sufficient time to meet settlement obligations timeously. In line with this ideal, the NISS settlement statistics in Figure 32 indicate that in 2022, 46.0 percent (N$522.5 billion) of payments settled in Window 1 (08h00 to 12h00); 35.0 percent (N$400.3 billion) settled in Window 2 (12h00 to 15h00); and 18.0 percent or N$208.3 billion settled in Window 3 (15h00 to 16h40).

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



Source: BoN

DISRUPTIONS TO THE NISS

The NISS continued to maintain high system availability throughout 2022. From a front-end standpoint, the NISS availability during 2022 was 99.89 percent, which was slightly below the target availability ratio of 99.90 percent. The NISS disaster recovery test conducted during 2022 was successful, as the two-hour recovery time objective was met. Two business continuity management exercises were conducted during the review period where one of the exercises was deemed successful, while the other exercise did not meet the two-hour recovery objective and was thus adjudged to be unsuccessful. The failure of this business continuity management exercise is attributed to information technology-related issues, and the Bank is engaged in work to address these to ensure the success of future business continuity management exercises.

SECURITY OF RETAIL PAYMENTS

In comparison with 2021, there has been a substantial increase in the total value of fraud across all payment streams during the period under review. The industry recorded fraud increases of N$638 000, N$11.5 million and N$5.9 million for the card, EFT, and e-money streams, respectively, compared to 2021. Payment card fraud increased by 9.0 percent, EFT fraud by 80.0 percent, and e-money payments fraud by 62.0 percent. The increase in payment card fraud was primarily due to Card-Not-Present payment incidents perpetrated via internet banking platforms and/or mobile applications. The EFT fraud was perpetrated primarily via phishing, whilst that in e-money payments resulted from incidents that were perpetrated via phone scams, particularly on the wallets. The total value of fraud attributable to the card, EFT, and e-money streams for the period under review amounted to N$7.3 million, N$14.5 million and N$9.6 million, respectively. The total fraud perpetrated within the NPS stood at 0.00223 percent during the period under review, which is within the Bank's fraud safety index of 0.05 percent. The fraud safety index is the total value of fraud measured against the total value transferred via the payment streams.

Various initiatives are under discussion and are slated for implementation through industry platforms such as the Financial Institutions Fraud and Security Committee to combat fraud at all levels. These initiatives set good practice, create awareness among the participants and reinforce their drive to better inform and educate their clients on the types of fraudulent activities, particularly those that target vulnerable members of the community. The initiatives include the Payment Card Industry Data Security Standard, a set of security standards designed to ensure that all institutions that accept, process, store, or transmit credit card information maintain a secure environment. The Bank issued a regulation aimed at ensuring the safety of payment data to curb data breaches and reduce cyber fraud in general. Additionally, the risk of wholesale payments fraud related to endpoint security is being addressed by a BoN-led initiative throughout the industry. To this end, an action plan has been developed for the NISS participants to implement to address the identified gaps. Lastly, the Bank launched the new Cyber-Security Council, which is envisaged as an effective platform through which the bank and non-bank financial sectors can facilitate discussion and formulate operative approaches, either collectively or individually, for participants to combat cyber fraud by 1) working together to roll out a cyber strategy for the Namibian financial sector; 2) sharing best practices on cyber risk management; and 3) sharing information regarding cybersecurity threats, vulnerabilities, and incidents.

DEVELOPMENTS IN PAYMENT AND SETTLEMENT SYSTEMS

The Bank continued to provide collateralised lending to the NISS participants through overnight and intra-day lending facilities. During 2022, the NISS participants utilised the intra-day and overnight credit facilities on numerous occasions to bridge liquidity shortages in order to fulfil the settlement obligations within the NISS. In addition, the Bank developed default management procedures to guide the NISS participants in the event of payment clearing house batch(es) defaulting.

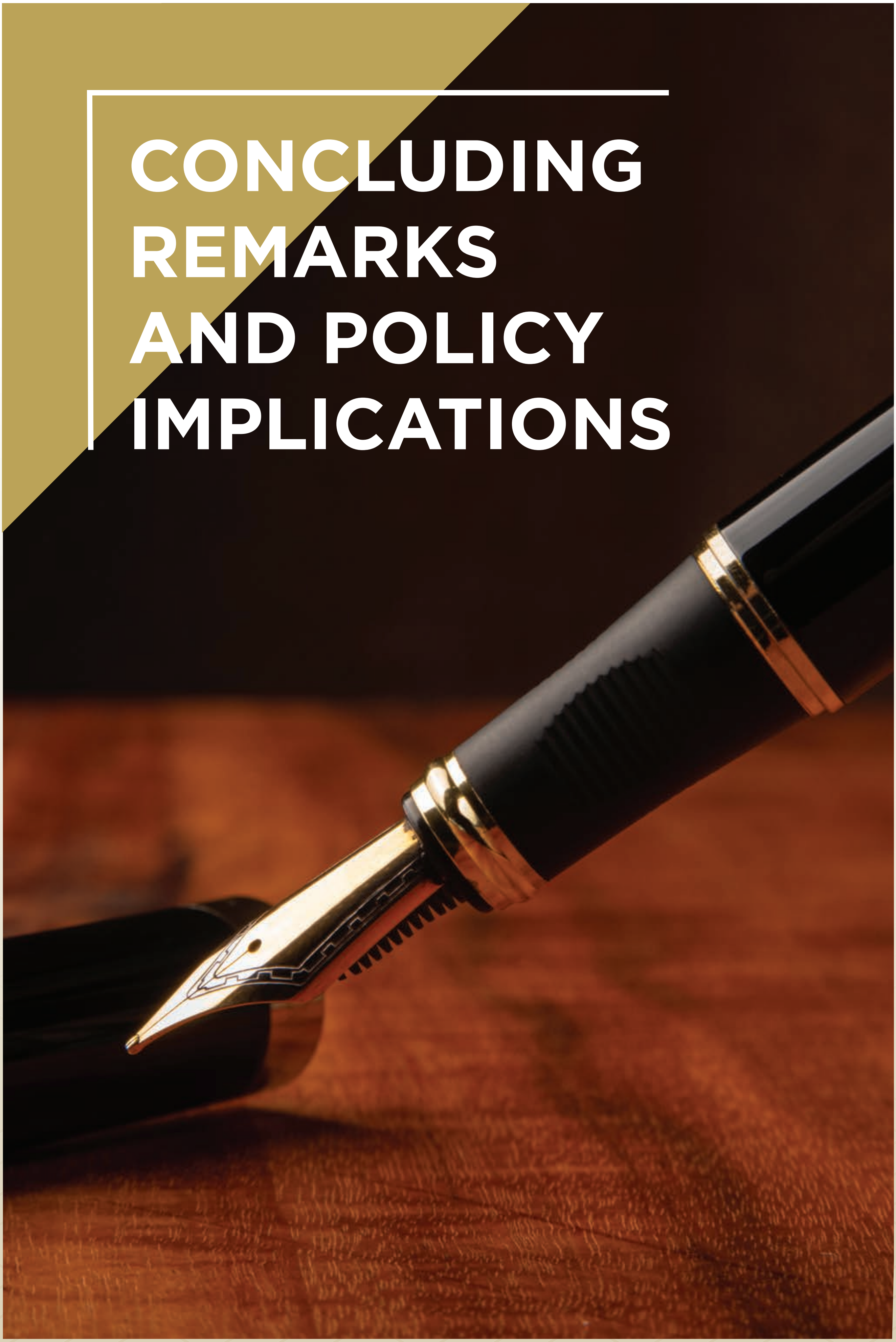
The Bank remained a participant in the Southern Africa Development Community (SADC) Real-Time Gross Settlement (SADC-RTGS) system. The SADC-RTGS is a regional settlement system that processes time-critical or high-value payments between participating SADC countries. At the end of the 2022 reporting period, there were 89 participants (i.e., registered banking institutions, as well as central banks within the respective SADC jurisdictions) of which five, including the BoN, were Namibian. During 2022, the total value of payments processed in the SADC-RTGS amounted to R1.7 trillion. Namibian banks accounted for R558 billion, which is 33 percent of the SADC-RTGS total. This reflects the optimal usage by Namibian banks of the SADC-RTGS in support of regional payments integration, in accordance with the SADC Finance and Investment Protocol.

In support of the adoption of ISO 20022 messaging standards for cross-border payments, the SADC-RTGS Operator, in collaboration with the SADC Bankers Association, logged an ISO 20022 Migration Project to ensure timeous adoption within the SADC region. SWIFT (the Society for Worldwide Interbank Financial Telecommunications) directed financial institutions across the globe to migrate from the current MT (messaging text) standards to ISO 20022 messaging standards by November 2025. To ensure compliance with SWIFT's deadline, relevant engagements are currently underway at both regional and domestic levels. At a regional level, the SADC-RTGS Operator and the SADC Bankers Association ISO 20022 Migration Project have proposed the implementation date for the SADC region to be October 2023. Domestically, the Bank will, as part of its oversight efforts, continue to ensure domestic compliance with international standards. Furthermore, in support of the ISO 20022 migration efforts, the Bank issued a guidance note to ensure the timely migration to the new standards by participants within the Namibian jurisdiction.

FUTURE DEVELOPMENTS IN PAYMENT AND SETTLEMENT SYSTEMS

A position paper on the Feasibility of Open Banking within the Namibian Financial Sector was published by the Bank on 31 October 2022. The position paper was issued in line with the Bank's Strategic Plan for 2022 to 2024 as well as the NPS Vision 2025, which identified open banking as one of the global payment system megatrends and an opportunity for the industry to explore over its five-year span, to promote innovation and transformative payment solutions. The Bank for International Settlements defines open banking as the sharing and leveraging of customer-permissioned data by banks with third-party providers. The goals of open banking are the building of applications and services such as those that provide real-time payments; greater financial transparency for account holders; and marketing and cross-selling opportunities. In simple terms, open banking allows third-party providers and other financial service providers to access customer data at banks to enable them to provide customers with other value-added financial services not offered by banks. Overall, open banking is aligned with the Bank's commitment to drive greater digital transformation, achieve financial inclusion, and lead through innovation. A forum is to be created during semester 1 of 2023 at the Payments Association of Namibia for industry engagements on open banking, and to advise the Bank on relevant data and security standards, amongst others. Notwithstanding the potential benefits of Open Banking, cybersecurity and operational risks may arise in the absence of a robust Open Banking infrastructure, which intends to strengthen the sharing of data. Open Banking regimes should therefore ideally be backed by strong data protection and cybersecurity laws to protect banking systems and their customers.

CONCLUDING REMARKS AND POLICY IMPLICATIONS



8 CONCLUDING REMARKS AND POLICY IMPLICATIONS

The financial system remained sound, profitable and resilient, despite sluggish economic conditions. Overall, the financial system in Namibia remained sound, profitable, and with no disruptions or disorderly functioning of key financial services, despite the economy performing below potential. Both household and corporate debt increased during the reporting period; however, risks to financial stability remained moderate. The banking sector in particular remained well capitalised, with capital levels well above the minimum prudential requirements during 2022. Despite the current inflationary pressures, the banking sector's asset growth outpaced the prevailing inflation rate, which bodes well for financial stability. Asset quality, as measured by the ratio of NPLs to total gross loans, improved in 2022, as observed in most loan categories. This is a welcome development. Similarly, the NBFIs sector remained resilient despite the gloomy macroeconomic conditions. However, the sector's assets contracted during 2022 on the back of the negative financial market performance mainly in the first quarter of 2022. The payment system and infrastructure remained stable, while efficiently contributing towards reliability in payments in order to facilitate financial stability in the country.

Going forward, risks to the Namibian financial system require continuous monitoring. Overall, risks to domestic financial stability remained stable; however, some risks are anticipated to increase on the back of uncertainty in the global macroeconomic environment. Going forward, global growth is expected to shrink amidst severe tightening of financial conditions in which corporate and sovereign spreads widen, stock prices fall and an overall currency depreciation of most emerging market economies is projected. In addition, there is a potential for spillover risk into the Namibian financial system emanating from the global macroeconomic environment which can be addressed through proactive financial regulation and supervision. Policymakers are therefore cautioned to act resolutely to maintain trust, while faced with heightened risks to financial stability. Risks to financial stability in Namibia will be monitored accordingly under the advisory guidance of the Financial System Stability Committee and the direction of the Macroprudential Oversight Committee. No policy recommendations are warranted at present, but to steer the course.

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ABBREVIATIONS

AEs	Advanced Economies
BoN	Bank of Namibia
CAR	capital adequacy ratio
CIS	collective investment schemes
DSIB	Domestic Systemically Important Banks
EFT	electronic funds transfer
EMDEs	Emerging Market and Developing Economies
FED	Federal Reserve System
FinTech	Financial Technology
FSR	Financial Stability Report
FSSC	Financial System Stability Committee
GDP	Gross Domestic Product
IMF	International Monetary Fund
LTD	loan-to-deposit
LTF	loan-to-funding
MoF	Ministry of Finance
NAD	Namibia Dollar
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFI	Non-bank financial institution
NISS	Namibia Interbank Settlement System
NPL	non-performing loan
NPS	National Payment System
ROA	return on assets
ROI	return on investment
PSCE	private sector credit extension
RWCR	risk-weighted capital ratio
SACU	Southern African Customs Union
SADC	Southern Africa Development Community
SADC-RTGS	SADC Real-Time Gross Settlement System
SARB	South African Reserve Bank
SOE	state-owned enterprise
S&P	Standard & Poor's
US	United States of America
ZAR	South African Rand

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