Namibia Financial Stability Report

April 2017

Bank of Namibia

NAMFISA

Members of the Financial System Stability Committee

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Corporate Charters

Bank of Namibia

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

Mission
To support economic growth and development in Namibia, we

- Act as fiscal advisor and banker to the Government,
- Promote price stability,
- Manage reserves and currency, and
- Ensure sound financial systems and conduct economic research.

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

NAMFISA

Vision
NAMFISA's vision is to be a respected regulator of the financial sector that fosters a stable and safe financial system contributing to the economic development of Namibia.

Mission
NAMFISA's mission is to effectively regulate and supervise financial institutions and to give sound advice to the Minister of Finance.

Values
- Teamwork
- Service
- Integrity
- Performance Excellence

List of Abbreviations

AEs	Advanced Economies
ALSI	All Share Price Index
ATM	Automatic Teller Machines
AuM	Assets Under Management
CIS	Collective Investment Schemes
CMA	Common Monetary Area
DR	Disaster Recovery
EMDEs	Emerging Market and Developing Economies
EMEs	Emerging Market Economies
EMV	Euro-Pay MasterCard Visa
EU	European Union
FNB	First National Bank
FSR	Financial Stability Report
GDP	Gross Domestic Product
GFSR	Global Financial Stability Report
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
LTD	Loan-to-Deposit
LTFR	Loan-to-Total-Funding Ratio
LTV	Loan-to-Value
MAF	Medical Aid Funds
MPC	Monetary Policy Committee
NAD	Namibia Dollar
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFIs	Non-Bank Financial Institutions
NISS	Namibia Inter-Bank Settlement System
NPL	Non-Performing Loan
NPS	National Payment System
NSX	Namibian Stock Exchange
PAN	Payments Association of Namibia
PCIDSS	Payment Card Industry Data Security Standards
PSC	Private Sector Credit

PSCE	Private Sector Credit Extension
ROA	Return on Assets
RHS	Right-Hand Side
ROE	Return on Equity
RWCR	Risk-Weighted Capital Ratio
SACU	Southern African Customs Union
SARB	South African Reserve Bank
SOEs	State Owned Enterprises
S&P	Standard & Poor's
UK	United Kingdom
US	United States of America
VIX	Volatility Index
WEO	World Economic Outlook
Y-o-Y	Year-on-Year

Preface

The purpose of the Financial Stability Report (FSR) is to identify risks and vulnerabilities in the financial system and assess the resilience of the financial system to domestic and external shocks. The report presents recommendations to the identified risks. Lastly, the report is published to inform the reader on the soundness of the financial system, and various initiatives the regulators and government are doing in order to mitigate risks to the Namibian financial system.

Financial system stability is defined as the resilience of the domestic financial system to internal and external shocks, be they economic, financial, political or otherwise. It can also be described as the absence of macroeconomic costs of disturbances in the system of financial exchanges between households, corporates and financial institutions.

The financial system in Namibia consists of financial markets, instruments, institutions and infrastructure. The regulatory structure, while not strictly a part of the financial system, plays an important role in regulating and monitoring the system. Under the mandate of Section 3(a) of the Bank of Namibia Act, 1997 (No 15 of 1997, as amended) the Bank of Namibia has an objective “to promote and maintain a sound monetary, credit and financial system in Namibia and sustain the liquidity, solvency and functioning of that system”. The stability of the financial system is critical as the system provides important services to households, corporates, and the real economy.

This report is a joint effort between the Bank of Namibia and the Namibia Financial Institutions Supervisory Authority (NAMFISA). The two institutions, which are entrusted with the regulation of the financial system in Namibia, work closely to ensure a healthy financial system. There is also active engagement between the Bank of Namibia, NAMFISA and the Ministry of Finance to ensure a comprehensive assessment of systemic financial risks and of policy actions to ensure lasting financial system stability.

CONTENTS

I. INTRODUCTION AND SUMMARY

1. **The Namibian financial system continued to prove its resilience during the period under review, when it withstood an array of adverse developments in the global and domestic economies.** Generally, the financial system and markets in Namibia remained sound, profitable, and with no disruptions or disorderly functioning of key financial services despite unfavourable domestic and global economic conditions. Specifically, the banking sector and the non-bank financial institutions (NBFIs) continued to be sound and well capitalised, with a consistently low level of non-performing loan (NPL) ratio of 1.5 percent and sufficient buffers to cushion any potential volatility in liquidity and profitability. Notwithstanding this sound position, the liquidity levels and sustainability of the liquidity management strategies require monitoring. The payment system and infrastructure similarly continued to perform efficiently and effectively, and with increasingly robust risk mitigating measures to facilitate safe payments.

2. **Risks to global financial stability have subsided since the last Financial Stability Report.** According to the IMF's April 2017 Global Financial Stability Report (GFSR), the improvement in the risks was mainly ascribed to the projected improved economic growth in 2017, accommodative monetary policy and financial conditions in advanced economies. Emerging market risks remained unchanged, as recovering commodity prices and modest deleveraging in some corporate sectors were offset by higher external financing risks and rising financial vulnerabilities in China. Despite these improvements, downside risks and uncertainties to financial stability remain, and include the global shift towards protectionism which may adversely affect trade and global growth and thereby exerting pressure on financial stability.

3. **The global economy remained sluggish in 2016, but it is projected to expand in 2017.** According to the IMF's April 2017 World Economic Outlook (WEO), global growth is estimated at 3.1 percent in 2016, which represents a marginal slowdown from 3.4 percent in 2015. The slowdown in global growth during 2016 was mainly driven by subdued growth in AEs, as well as the slow recovery in the EMDEs. The slow recovery in the EMDEs and to a large extent the depressed commodity prices are ascribed to reduced momentum in the pace of expansion in China, partly as a result of rebalancing in the economy, and the temporary negative consumption

shock in India. Going forward, global growth is projected to improve moderately to 3.5 percent and 3.6 percent during 2017 and 2018, respectively.

4. **The domestic economy, slowed in 2016 and is expected to improve in 2017.** Economic growth in Namibia is estimated to have slowed to 0.2 percent in 2016 from 6.1 percent in 2015, due to a decline in construction and mining sectors as well as activities in public sector. The improvement in 2017 will mainly be supported by anticipated recoveries in both agriculture and diamond mining as well as robust growth in the uranium mining and transport and communication sectors. In addition, the Southern Africa Customs Union (SACU) receipts, as an external liquidity injection, will improve significantly in 2017 compared to 2016, which will thus enhance the stability of the financial system in Namibia.

5. **While the level of indebtedness of the private sector remained high, growth in both household and corporate debt slowed during 2016.** Household debt as a ratio of disposable income was virtually unchanged at 84.6 percent in 2016, compared to 84.7 percent 2015 underpinned by a slowdown in mortgage lending and instalment credit to households. Moreover, growth in the corporate debt stock slowed considerably in 2016, following the exceptionally strong growth recorded in 2015. In this regard, the ratio of corporate debt to GDP remained steady at 62.4 percent in 2016 compared to 61.9 percent in 2015. This was largely owing to sluggish economic activity, especially in the construction and mining sectors. The slow growth in corporate sector debt, particularly the external debt component, is however not a major concern, given that most companies that borrow externally earn foreign exchange and such borrowing is neither expected to adversely impact their debt servicing capacities, nor pose any meaningful and/or direct threat to the domestic banking sector in Namibia.

6. **Since the last FSR, the performance of the Namibian banking sector has been sound, with the banks remaining healthy, profitable and adequately capitalized.** The banking industry remained adequately capitalised and maintained capital positions well above the minimum prudential requirements during 2016. The banking institutions assets continued to grow, although at a lower rate, while the non-performing loans (NPLs) ratio improved slightly from 1.6 percent in 2015 to 1.5 percent in 2016.

7. **Since the last FSR, a macroprudential regulation in the form of Loan-to-Value (LTV) ratios for non-primary residential properties has been gazetted on the 26th of September 2016 and took effect in March 2017.** This policy tool was introduced to curb speculation in the residential housing market segment and thereby reduce the exposure of banking institutions to mortgage loans. It is also expected that LTV will promote responsible borrowing while giving preferential access to housing for first time buyers in Namibia.

8. **The Non-Banking Financial Institutions (NBFIs) remained sound and do not pose systemic risks to the country's financial system.** Growth of the assets of the NBFIs sector remained positive and is expected to continue going forward. Since the last FSR, the capitalization of provident, insurance and investment institutions was adequate to ensure solvency and funding levels were in excess of the statutory requirements. These levels were sufficient to withstand the shocks and risks to which these institutions are exposed.

9. **The payment system and infrastructure operated effectively and efficiently since the previous FSR.** In this regard, the payment system maintained high system availability with one Disaster Recovery (DR) test conducted successfully in NISS (Settlement System) during the period under review. On-site activities were also conducted to assess the operations of new and existing participants based on their risk profiles as established through the offsite monitoring activities.

II. SUMMARY OF RISK ANALYSIS

This section presents a brief analysis of the main risks to the stability of the domestic financial system. Consistent with sections III-VII of this Report, the analysis identifies risks arising from: the external macroeconomic environment, trends in household and corporate debt, and trends in the domestic banking and non-banking institutions' financial soundness indicators, before concluding with an analysis of the payment and settlement system. The risks are analysed and rated from low risk to high risk based on their probability of occurring and the potential impact on financial stability in Namibia, should they be realised.

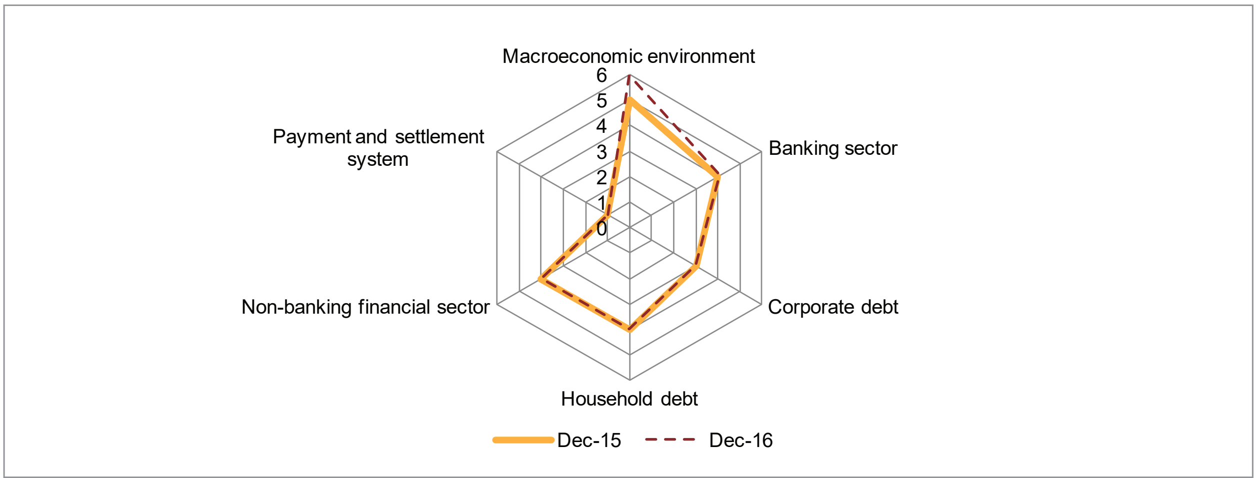
According to the IMF's April 2017 Global Financial Stability Report (GFSR), risks to financial stability have improved during the period under review. This was mainly ascribed to the projected improved economic growth in 2017, accommodative monetary policy and financial conditions in advanced economies. Furthermore, rising equity prices and steeper yield curves have mitigated some of the negative side effects of low interest rates for banks and insurance companies. Emerging market risks remained unchanged, as recovering commodity prices and modest deleveraging in some corporate sectors were offset by higher external financing risks and rising financial vulnerabilities in China. Despite these improvements, the global shift toward protectionism could increase uncertainties which may adversely affect trade and global growth and thereby exerting pressure on financial stability.

From a risk profile point of view, most risks have either subsided or remained unchanged, with minimal corresponding impact on the stability of the financial system. These risks to Namibia's financial stability remained low and well absorbed during 2016 when compared to the same period in 2015 (Figure 1a). The recent and further potential increases in the US interest rates are partly attributable to a relatively more positive economic and business environment, which will be positive for the rest of the world, especially commodity producing countries. Going forward, however, the high level of uncertainty in key markets may stifle global and domestic growth and create excessive volatility in financial markets, and thus the reversion of the current profiles of these risks remains a key concern. Namibia's macroeconomic environment will face negative consequences in the event that the country loses its investment grade credit rating status. The downward revision of the Namibian economic outlook from stable to negative by the credit rating agencies in 2016, and the potential of a downgrade, which may result in Namibia losing its investment grade, remain a concern

Figure 1a: Risks to Financial Stability in Namibia

Since the issuance of the last FSR in May 2016, trends in key risks to domestic financial stability have been mixed. Risks emanating from the household debt, corporate debt, the non-banking as well as the payment and settlement systems remained virtually unchanged (Figure 1b). The risks from the banking sector remained generally unchanged despite liquidity constraints experienced during the period under review. In contrast, the risks from the macroeconomic environment worsened following sluggish and weaker-than-expected economic growth in the AEs, a slower recovery in the EMDEs, as well as depressed commodity prices, coupled with high levels of uncertainty.

Figure 1b: Domestic Financial Stability Risks Map*



* The further from the centre, the greater the risk

III. MACROECONOMIC ENVIRONMENT

Global Economic Growth

Global growth is estimated to have slowed during 2016 on the back of subdued growth in advanced economies (AEs). According to the IMF's April 2017 World Economic Outlook (WEO), global growth is estimated at 3.1 percent in 2016, which represent a marginal slowdown from 3.4 percent in 2015 (Figure 2). Growth in economic activity in the advanced economies eased to 1.7 percent in 2016, compared with 2.0 percent in 2015. This was largely ascribed to weaker activity in the United Kingdom (UK), following the June 2016 vote to leave the European Union (EU) (Brexit) and slower-than-expected growth in the US. Although real GDP growth was steady at 4.1 percent in EMDEs during 2016, it was not strong enough to offset the impact of lower growth in AEs. The stable growth in EMDEs was mainly supported by the above average pace of economic activity in China and India.

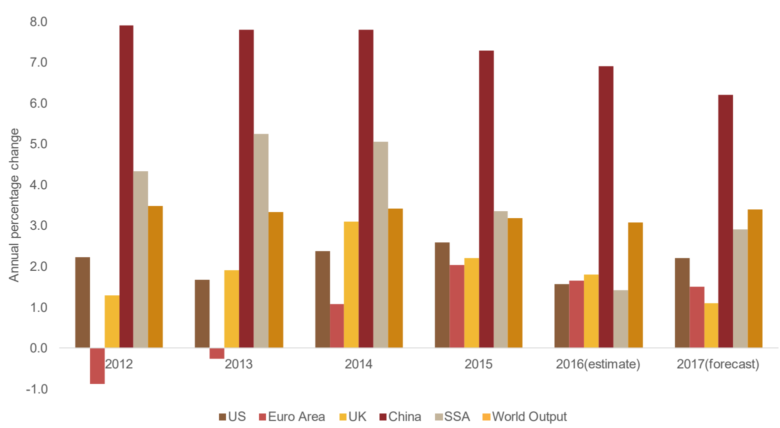
Real GDP growth in the AEs eased in 2016 owing to weaker-than-expected activity in the US and concerns introduced by the Brexit decision. The growth rate of the US economy slowed to 1.6 percent in 2016 from 2.6 percent in 2015. This was despite an improvement during the second half of 2016 as firms' confidence improved, coupled with the expected fiscal stimulus that would boost the economy's GDP and counter the effects of Dollar appreciation. The slowdown in 2016 was due to weakness in business fixed investment, coupled with a reduction in inventories. Sluggish business fixed investment seems to reflect the continued (albeit moderating) decline in capital spending in the energy sector and the impact of the Dollar strength on investment in export-oriented industries. Economic growth in the UK moderated to 1.8 percent in 2016, from 2.2 percent in the preceding year, partly as a result of the impact of the vote to leave the European Union. The Euro Area registered slower growth of 1.7 percent in 2016, from 2.0 percent in 2015, mainly attributed to a deceleration of domestic demand in France and Germany. In Japan, real GDP growth was estimated to have eased to 1.0 percent in 2016, from 1.2 percent in 2015, on account of weaker external demand and corporate investment.

Growth in EMDEs was steady in 2016, compared to 2015, driven by activity in China and India. The pace of expansion in economic activity in China moderated slightly to 6.7

percent during 2016, from 6.9 percent in 2015, partly as a result of rebalancing from an investment-driven to a consumption-based economy. In India, real GDP growth eased to 6.8 percent in 2016, from 7.9 percent in 2015, primarily due to the temporary negative consumption shock induced by cash shortages and payment disruptions associated with the higher-denomination currency withdrawal. On the back of a recovery in oil prices, real GDP in Russia recorded a slower contraction, declining by 0.2 percent in 2016, from a decline of 2.8 percent in the preceding year. Similarly, economic activity in Brazil contracted at a slower pace of 3.6 percent in 2016, from a contraction of 3.8 percent in 2015.

Economic activity weakened in Sub-Saharan Africa, led by Nigeria, where production was disrupted by shortages of foreign exchange and electricity blackouts. Growth in economic activity in Sub-Saharan Africa slowed to 1.4 percent in 2016, from 3.4 percent in the previous year on the back of subdued commodity prices, a decline in the terms of trade and weak external demand (Figure 2). Real GDP in Nigeria was estimated to have contracted by 1.5 percent in 2016, from 2.7 percent in 2015, reflecting temporary disruptions to oil production, foreign currency shortages resulting from lower oil receipts, lower power generation, and weak investor confidence. Equally, economic activity in South Africa weakened to an 0.3 percent growth rate in 2016, compared to 1.3 percent in 2015. This weaker growth was underpinned by depressed commodity prices, policy uncertainty, persistent drought and electricity supply constraints. Furthermore, the Angolan economy stagnated in 2016, on the back of a sharp decline in crude oil prices and export receipts.

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



Source: IMF World Economic Outlook, April 2017

Going forward, global growth is projected to improve moderately during 2017 and 2018. Near term growth projections show global growth at 3.5 percent and 3.6 percent in 2017 and 2018, respectively, after a lacklustre outturn in 2016. The upward momentum is anticipated to be supported by steady growth from AEs and stronger economic activity in EMDEs.

Growth in AEs is projected to improve during 2017 and 2018. AEs are expected to grow by 2.0 percent in both 2017 and 2018 representing an upward revision of 0.2 percentage points from the October 2016 WEO. The stronger outlook in AEs reflects a cyclical recovery in the manufacturing sector. With the exception of France, Euro Area projections for 2017 have been revised downward, with Germany, Spain, and the United Kingdom all revised downward by 0.2, 0.1, and 0.6 percentage points, respectively for 2017.

EMDEs are expected to improve, with a better than previously expected growth recovery in Brazil and Russia during 2017 and 2018. EMDEs growth is projected to reach 4.5 percent and 4.8 percent in 2017 and 2018, respectively. In India, growth is expected to rise to 7.2 percent and 7.7 percent in 2017 and 2018, while in China it is expected to slow down to 6.6 percent and 6.2 percent in 2017 and 2018, respectively. On the contrary, Sub-Saharan Africa's growth projection for 2017 was revised down by 0.3 percentage points,from 2.9 percent in October 2016 to 2.6 percent in the latest WEO, which also expects a 3.5 percent growth in 2018.

The risks to the outlook remain. Major risks to the outlook include the possible slowdown in global trade due to a shift in trade policies toward protectionism. In addition, there are downside risks which comprise continued rapid credit expansion in China, weak demand and balance sheet problems in parts of Europe, geopolitical tensions as well as domestic conflicts and peculiar political problems, notably in parts of the Middle East and North Africa.

Developments in the Financial Markets

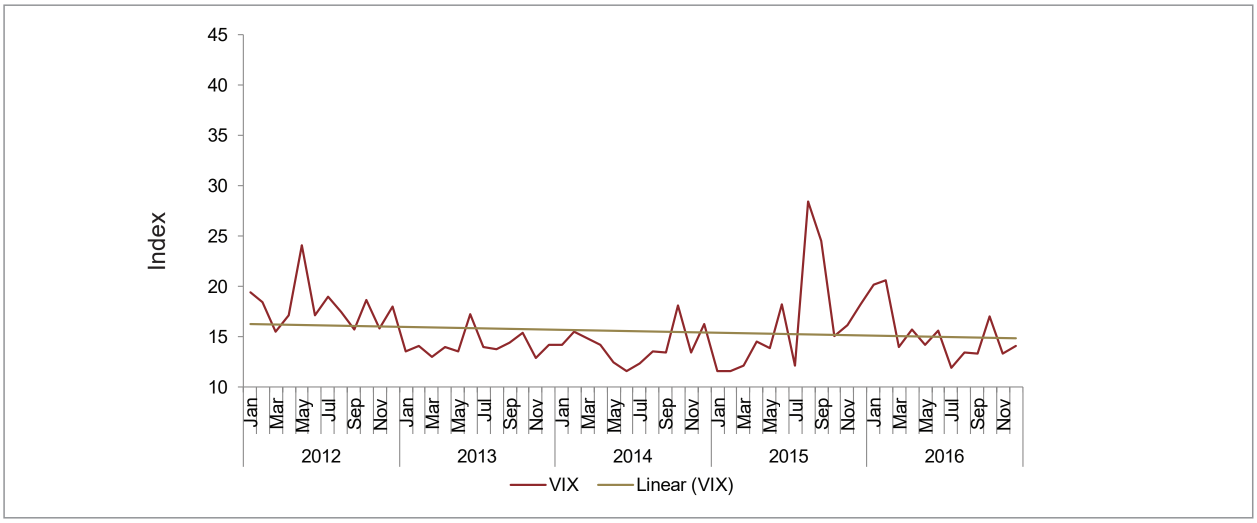
Advanced Economies

Financial markets were less volatile in 2016 compared to 2015, supported by expectations of minimal change in monetary policies, reduced corporate and individual taxes, financial deregulation and increased infrastructure spending in the US.

The US volatility index (VIX) slowed to an average of 15.3 index points in 2016, from 16.4 index points in the preceding year and varied between 11.9 and 20.6 index points, a smaller range than the variation between 11.6 and 28.4 index points recorded in 2015 (Figure 3). After a weak start to the year on the back of fears over global manufacturing, the devaluation of the Chinese currency and a collapse in oil prices, 2016 ended up being a good year for equities. In the advanced economies, US equity markets, in particular, benefitted from a scaling back in the Federal Reserve's plans to increase interest rates, further monetary easing by some of the other major central banks and the pro-growth implications of the new US administration's expansionary fiscal policies. Both the S&P 500 and the UK's FTSE rose in 2016, with the latter underpinned by the depreciation in the Pound Sterling, post the UK referendum on its membership of the European Union.

In the fixed income markets, bonds had a mixed year with government bonds underperforming. After a brief setback at the beginning of the year, the best performing bond market was high yield bonds, which benefitted from a rebound in the crude oil price, as the energy sector represents a meaningful component of the US High Yield Bond Index. Despite a good first half of the year for US government bonds, they ended up being the worst performing asset class, with a virtually flat return, as a result of the perceived inflationary consequences of president Trump's fiscal policies and expectations of a more rapid pace of increase in US policy interest rates. These policies may also result in an increase in debt, with the increased supply of treasury securities resulting in an increase in yields (lower prices of bonds).

Figure 3: Volatility Index



Source: Bloomberg

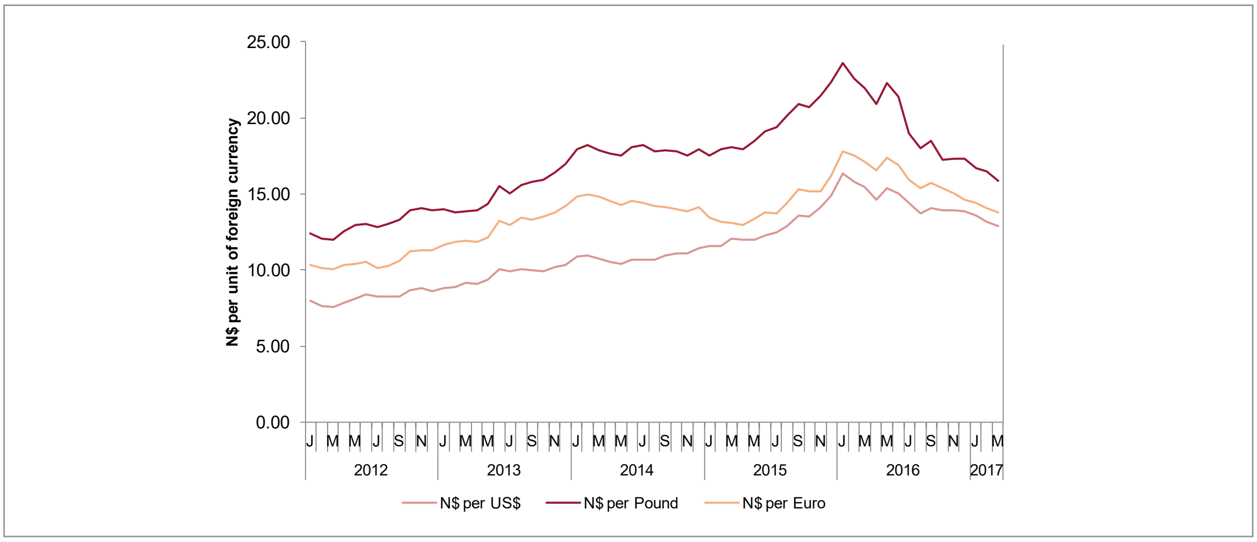
Emerging Market Economies (EMEs)

Financial markets in EMEs were subdued at the beginning of 2016, due to concerns about China's economy, uncertainty regarding the UK referendum outcome and falling prices of oil and other commodities; however, this trend reversed as the year progressed. As a result, investor sentiment towards EMEs has generally improved, capital inflows have increased, corporate and sovereign bond yields have fallen, and equity prices have increased. Nonetheless, the increase in debt-servicing burdens over recent years remains a significant vulnerability to financial stability in EMEs. The rise has been driven by a sharp increase in debt levels, slower economic growth, lower commodity prices and some large currency depreciations (which raise the local currency cost of foreign currency-denominated debt).

Exchange Rate Developments

The Namibia Dollar appreciated against all the major trading currencies during 2016. The Namibia Dollar appreciated by 5.7 percent against the US Dollar, 22.7 percent against the British Pound and by 9.9 percent against the Euro, by the end of December 2016, compared to the end of December 2015 (Figure 4). The appreciation of the Namibian currency against all these currencies was attributable to base effects, a moderate increase in commodity prices, and a rebound in appetite for emerging market risks in developed markets during the period under review.

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



Source: Bloomberg

Monetary Policy Stance of South Africa

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) raised the repo rate twice during 2016 to ease inflationary pressures. The mounting price pressures stemmed from the drought-induced increase in food prices and after-shocks of the exchange rate depreciation towards the end of 2015 and the early weeks of 2016. Having raised the policy rate at its January and March 2016 meetings, the MPC subsequently maintained the repo rate at 7.0 percent amidst weak economic growth. The annual inflation rate increased to 6.3 percent in 2016, from 4.6 percent in 2015, mainly due to increases in the prices of food and non-alcoholic beverages as well as housing and utilities (Table 1).

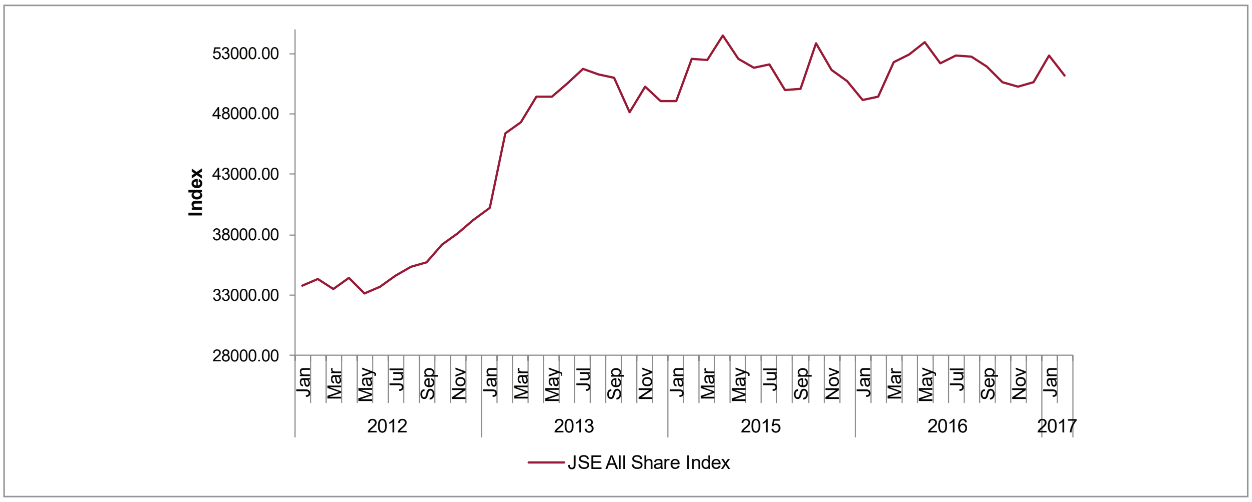
Table 1: South Africa's Consumer Price Index and annual Inflation Rate (Dec. 2012=100)

2015	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
INDEX	110.8	111.5	113.1	114.1	114.4	114.9	116.1	116.1	116.1	116.4	116.5	116.8
RATE (%)	4.4	3.9	4.0	4.5	4.6	4.7	5.0	4.6	4.6	4.7	4.8	5.2
2016	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
INDEX	118.0	119.0	120.0	121.0	121.0	122.0	123.0	123.0	123.0	124.0	124.0	124.7.0
RATE (%)	6.2	7.0	6.3	6.2	6.1	6.3	6.0	5.9	6.1	6.4	6.6	6.8

Source: Statistics South Africa

Looking forward, the monetary policy stance of the South African Reserve Bank will be data dependent. In this regard, the main factors expected to underpin the SARB's monetary policy stance are largely: the inflation outlook and risks, inflation expectations and the exchange rate of the Rand against to the major trading currencies. The SARB's more recently stated that it is of the view that South Africa may have reached the end of the policy tightening cycle. However, it further indicated that it would like to see a more sustained improvement in the inflation outlook before reducing interest rates and that such an assessment may still change if the inflation outlook and the risks to the outlook deteriorate.

Figure 5: The JSE All Share Price Index (ALSI)



Source: Bloomberg

The Johannesburg Stock Exchange (JSE) All Share Index (ALSI) fluctuated broadly sideways in 2016. The JSE ALSI's performance was mainly affected by international events such as Brexit, commodity price and exchange rate fluctuations as well as weakening consumer and business confidence in South Africa (Figure 5).

Domestic Economy

Output and Inflation

Economic growth in Namibia slowed considerably in 2016, while inflation increased. Real GDP growth slowed to 0.2 percent in 2016, from 6.1 percent in 2015, due to the contraction in various sectors such as construction, metal ores and diamond mining, as well as the fiscal consolidation in the public sector. On average, the inflation rate rose by 3.3 percentage points to 6.7 percent during 2016. The rise was mainly reflected in the categories Housing, water, electricity, gas and other fuels, Transport and Food during the period under review.

Going forward, the Namibian economy is projected to grow by 2.9 percent in 2017. The expected growth as projected by the Bank of Namibia will mainly result from an anticipated recovery in both agriculture and diamond mining, as well as improved growth in uranium mining and transport and communication.

IV. DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

Household Debt to Disposable Income

Despite a slight moderation, the ratio of household indebtedness to disposable income remained high at the end of December 2016, relative to the same period in 2015. Annual growth in household indebtedness slowed to 9.3 percent during the period under review, from a double-digit growth rate of 12.5 percent in December 2015. The moderation in the growth of household debt was principally pronounced in the categories mortgage lending, overdrafts and instalment credit. Growth in mortgage lending, which represents the largest portion of total loans advanced to households, slowed to 9.5 percent at the end of 2016, from 12.5 percent in 2015 (Table 2). Similarly, growth in instalment credit slowed significantly to 4.9 percent in 2016, from 13.7 percent a year earlier, while a slight moderation to 7.5 percent was recorded in growth in overdrafts from 8.0 percent over the same period. This could partly be attributed to persistently high property prices, higher interest rates and weak economic conditions that prevailed in 2016.

Table 2: Household Debt-to-Disposable-Income

	2012	2013	2014	2015	2016
Disposable Income (N$)	41,625	48,035	55,378	60,287	65,938
Credit to Disposable Income (%)	75.1	74.8	73.5	76.0	75.9
Credit To Individuals/Households (N$)	31,242	35,939	40,703	45,810	50,054
Adjusted Credit * to individuals/Households (N$)	34,834	40,072	45,384	51,079	55,811
Adjusted Credit ** % of Disposable income	83.7	83.4	82.0	84.7	84.6

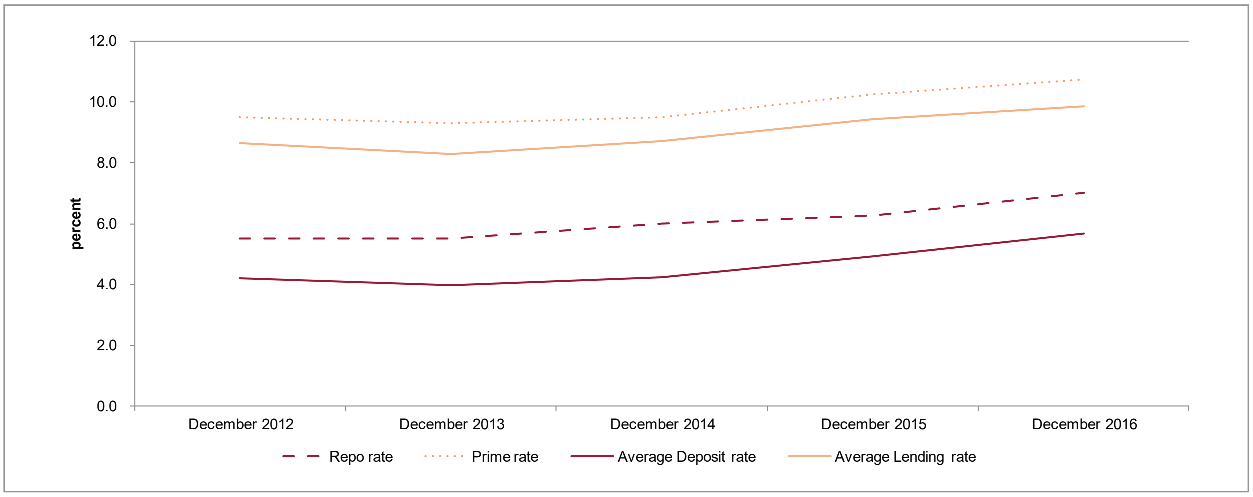
* The ratio of household debt to disposable income is calculated based on income and tax data from the national budget documents, national accounts, and household debt data from the Bank of Namibia. The National Accounts were revised from 2007 to 2016, resulting in changes in the household disposable income data, which were published in the May 2016, FSR.

** This category includes credit extended to households by both the banking and non-banking financial institutions.

Source: Bank of Namibia

The ratio of household debt to disposable income in Namibia remained high, despite the slight slowdown in 2016. The moderation in mortgage loans, instalment credit as well as overdrafts were the key drivers behind the development in the household debt to disposable income ratio. Despite slower growth in mortgage loans in 2016, it continued to account for the largest share of household debt and stood at 51.5 percent in December 2016. As a proportion of disposable income, mortgage loans remained more or less the same at 48.6 percent in December 2016, from 48.5 percent in December 2015. The implementation of the Loan-to-Value (LTV) regulations may contribute to slower growth and a consequent reduction in the share of mortgage loans in total loans to households, thereby softening a potential systemic risk to the banking system stemming from this source (Figure 6). Given the high exposure to mortgage lending of the banks and the potential risks thereof, coupled with an elevated level of household indebtedness, the slower growth in mortgage credit is a positive development for financial system stability.

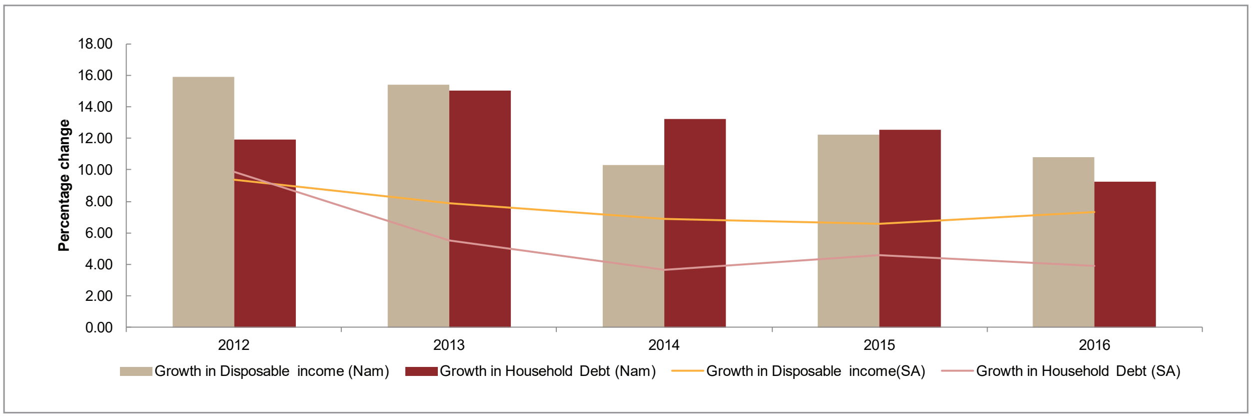
Figure 6: Selected Interest Rates 2012-2016



Source: Bank of Namibia

Growth in household disposable income rose marginally in 2016, compared to 2015 in both Namibia and South Africa. The main drivers of the increase in household disposable income in Namibia for the review period were: social pensions, remittances as well as the compensation of employees (Figure 7). A similar pattern was observed in South Africa with household disposable income driven by an increase in the aggregate remuneration of employees.

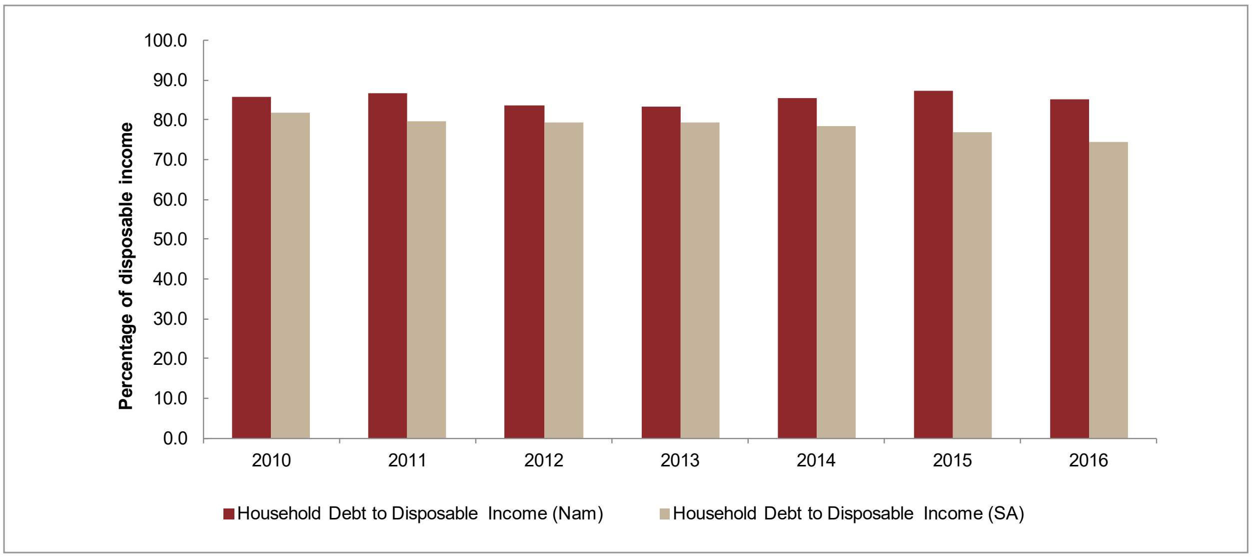
Figure 7: Growth in household debt and disposable income



Source: Bank of Namibia and South African Reserve Bank

The ratio of household debt to disposable income in Namibia continued to be above that of South Africa during the period under review[1]. At 84.6 percent of disposable income, Namibia's household debt ratio in 2016 was higher than South Africa's which stood at 74.4 percent during the same period (Figure 8).

Figure 8: Household Debt to Disposable Income (Namibia & South Africa)



Source: Bank of Namibia and South African Reserve Bank

[1] The methodology for compiling household debt in Namibia covers credit extended by commercial banks, microlenders, as well as the informal sector. In South Africa, it excludes the informal sector.

Debt Servicing Ratio

The debt service[2] to disposable income ratio in Namibia remained virtually unchanged in December 2016, compared to December 2015. The key factor that contributed to this development was the moderation in the stock of debt outstanding for the main credit categories namely: mortgages loans, overdrafts, other loans and advances, leasing as well as instalment credit, which countered the increase in interest rates (Table 3).

Table 3: Debt Servicing Ratios (percentage)

	Gross Income Growth (Y-o-Y)	Disposable Income Growth (Y-o-Y)	Annual Debt Servicing Growth (Y-o-Y)	Debt Servicing to Gross Income	Debt Servicing to Disposable Income	Adjusted Debt Servicing to Gross Income	Avg. Prime Rate
Dec-12	16.8	15.9	13.2	11.9	14.3	17.5	10.0
Dec-13	14.5	15.4	17.0	12.2	14.5	17.9	9.0
Dec-14	13.9	10.3	15.9	12.4	15.3	18.2	10.0
Dec-15	8.4	10.5	13.8	13.0	15.7	19.1	10.1
Dec 16	8.2	12.0	9.1	13.1	15.3	19.3	10.7

Source: Bank of Namibia

Corporate Debt

Since the last FSR the total corporate debt stock rose, primarily due to an increase in both domestic and foreign debt to the private and public sectors. Total corporate sector debt grew by 6.7 percent year-on-year to N$97.4 billion in December 2016, with foreign debt increasing by N$3.8 billion, whilst domestic debt increased by N$2.7 billion, relative to the same period in 2015 (Table 4). The increase of only 6.7 percent in total corporate sector debt in 2016 was significantly lower, compared to an exceptionally strong growth of 30.1 percent in 2015. The moderation in the corporate debt stock was owing to slower growth in both domestic and foreign debt of the private sector in 2016.

The corporate debt-to-GDP ratio increased by a small margin at the end of December 2016, compared to December 2015. The corporate sector debt-to-GDP ratio for 2016

[2] The debt service ratio gauges the financial burden that the repayment of debt places on the average household relative to its income.

stood at 62.4 percent; an increase of a mere half a percentage point from the previous year[3]. Accounting for this development is the restrained growth in both domestic and foreign debt, on the back of sluggish economic activity and contractions in the construction and mining sectors.

Table 4: Domestic and External Corporate Debt (Private Sector and Parastatals)

N$ Million	2012	2013	2014	2015	2016
Domestic debt	21 231	24 111	29 164	34 482	37 198
Foreign debt	26 014	35 990	34 302	56 316	60 164
Total Debt	47 245,3	60 100,7	63 466	90 798	97 362,2
Percentage (%)					
Domestic	44.9	40.1	46.0	38.0	38.2
Foreign	55.1	59.9	54.0	62.0	61.8
Y-o-Y Change in % in Total Debt	0.4	21.4	5.3	30.1	6.7
Nominal GDP (N$ million)	**106,864**	**122,791**	**138,741**	**147,479**	**159,105**
Debt to GDP ratio	**44.2**	**49.0**	**45.5**	**61.9**	**62.4**

Source: Bank of Namibia

Private sector debt continued to be the main contributor to total corporate debt for the year ending December 2016. The proportion of private sector debt increased to 93.5 percent of total corporate debt in 2016, compared to 92.8 percent in 2015. The remainder of the debt was accounted for by the State Owned Enterprises (SOEs). The private sector debt stock amounted to N$91.0 billion in 2016, with N$55.7 billion owed to foreign lenders and N$35.3 billion locally (Table 5). Annual growth in foreign private sector debt slowed down to 7.9 percent in 2016. The moderation was partly a reflection of increased loan repayments by the private sector in 2016, as well as an appreciation of the Namibian Dollar against major currencies. Key mine expansion projects were completed, production commenced and as a consequence additional funding requirements were reduced, hence contributing to the decline in the growth rate of the private sector's foreign debt during the period under review. Growth in the private sector's domestic debt declined from 12.9 percent in 2015, to 9.3 percent in 2016, primarily due to a sharp decline in instalment credit from 13.7 percent in 2015 to 4.9 percent in 2016. The slowdown was in line with business spending patterns, given slower domestic economic growth. The stock of bonds issued by Namibian corporates on the Namibian Stock Exchange (NSX) decreased from N$4.9 billion in 2015, to N$3.8 billion in 2016. This is due to bonds issued by SOEs and

[3] According to the Bank for International Settlement, when corporate debt goes beyond 90.0 percent of GDP, it starts to adversely impact on economic growth.

commercial banks that matured during 2016. The subdued appetite for new bonds also contributed to the drop in new bonds issued by Namibian corporates on the NSX. Of the N$3.8 billion outstanding at the end of 2016, the majority was issued by commercial banks (N$3.1 billion), while SOEs issued N$450 million.

Table 5: SOEs and Private Sector Debt Breakdown

N$ Million	2012	2013	2014	2015	2016
Private Sector Foreign Debt	23 827	31 878	30 775	51 666	55 729
Private Sector Local Debt	20 639	23 384	28 364	32 584	35 343
Foreign Debt of SOEs	2 187	4 111	3 528	4 649	4 435
Local Debt of SOEs	592	727	799	1 899	1 855
Total Corporate Debt	47 245	60 101	63 466	90 798	97 362
Foreign Debt to Total Debt (%)	55.1	59.9	54.0	62.0	62.0
Local Debt to Total Debt (%)	44.9	40.1	46.0	38.0	38.2

Source: Bank of Namibia

Total debt outstanding of SOEs decreased slightly in 2016, relative to the same period in the preceding year. SOEs owed a total of N$6.2 billion in 2016, with N$4.4 billion owed to foreign lenders and N$1.8 billion to local lenders (Table 5). The foreign and local debt portfolios of SOEs declined by 4.6 percent and 2.3 percent, respectively. The decline in both local and foreign debt obligations of SOEs was because a portion of SOE bonds that matured during the year under review. The appreciation of the Namibia Dollar against major trading currencies also contributed to the decline in the external debt stock in 2016.

The foreign exchange risk to the financial system from foreign loan guarantees decreased during the year under review. Foreign loan guarantees declined during 2016, for both US Dollar and Euro denominated foreign loan guarantees due to some foreign loans that have matured as well as the positive impact of the Namibia Dollar appreciating against these currencies during the year under review.

Table 6: Foreign Private Sector Debt and Debt Servicing

N$ Million	2012 Dec	2013 Dec	2014 Dec	2015 Dec	2016 Dec
Total Foreign Private Sector Debt	23 827	31 878	30 775	51 666	55 729
Total Foreign Private Sector Debt Servicing	2 562	15 534	6 301	11 613	6 211

Source: Bank of Namibia

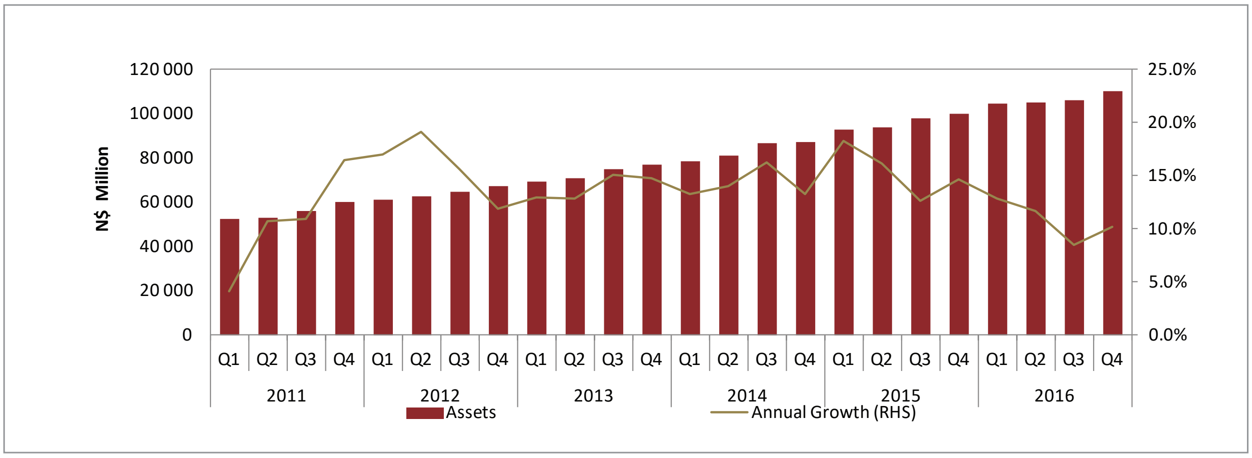
Foreign private debt servicing cost decreased significantly in 2016. In this connection, foreign debt service cost fell by 87 percent, from N$11.6 billion in 2015 to N$6.2 billion in 2016 (Table 6). Explaining the lower debt servicing during 2016 was the high base effect linked to the debt-to-equity swap in 2015.

V. PERFORMANCE OF THE BANKING SECTOR

Balance Sheet Structure

The banking sector total assets continued to grow, however, the growth rate of the balance sheet slowed year-on-year. The bank assets continued to grow despite the recent deterioration in the banking sector liquidity position. As at 31 December 2016 the balance sheet stood at N$110 billion, representing a reduced growth rate of 10.1 percent year-on-year compared with the 14.6 percent increase in 2015 (Figure 9). On the liabilities side, non-bank funding (deposits) grew by 15.4 percent year-on-year in 2016, higher than 11.6 percent in 2015.

Figure 9: Banking Sector Assets and Growth Rate

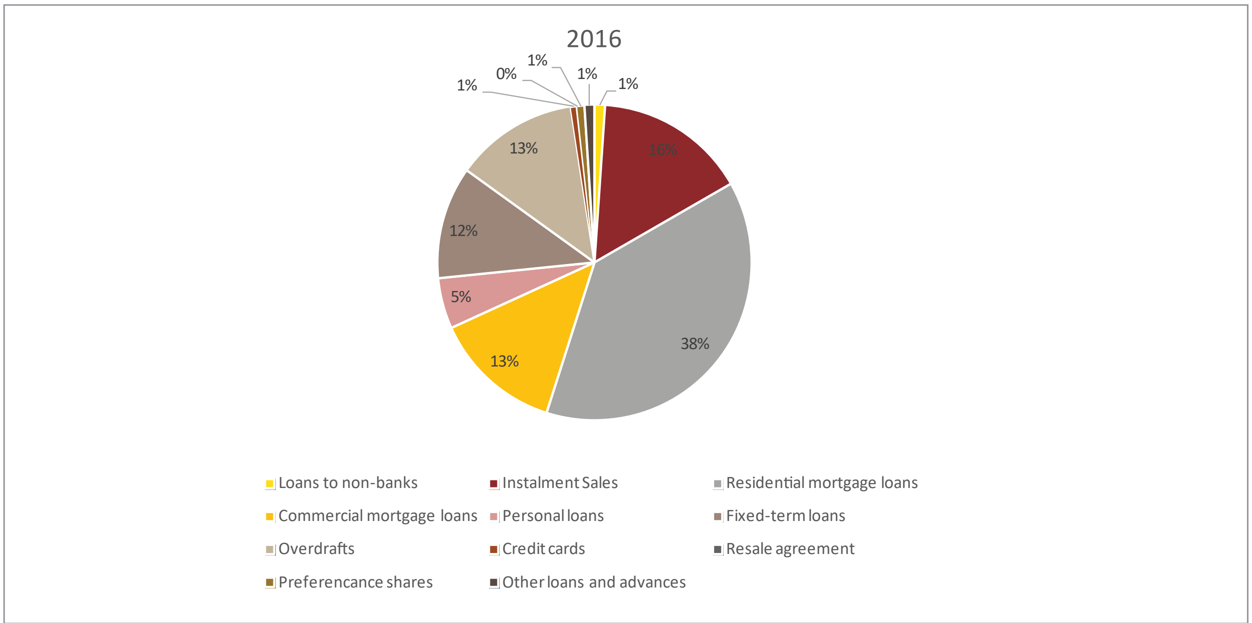


Source: Bank of Namibia

Asset Structure

Overall, the asset structure remained fairly unchanged during the period under review, with mortgage lending still dominant. The domestic banking sector continued to offer a variety of conventional banking products. Residential and commercial mortgage loans increased slightly to 51.5 percent of the total loan book, compared with 51.3 percent in 2015 (Figure 10). While the continuously high exposure to mortgage lending remains a concern, the introduction of the Loan-to-Value ratio is expected to reduce this concentration. Furthermore, total loans and advances increased from N$78.1 billion at the start of 2016, to N$85 billion at the end of the same year, representing an increase of 9.0 percent. Slowing from double-digit rates previously, cash and balances held by banks recorded an increase of just more than 9.0 percent from N$8 billion to N$8.8 billion during the period under review. Short-term negotiable securities increased by 14.0 percent to N$8.9 billion over the same period. In terms of asset composition, both cash and balances with other banks as well as short-term negotiable securities share of total assets remained unchanged at around 8.0 percent of total assets, respectively. Similarly, trading and investment securities remained steady at 4.0 percent of total assets.

Figure 10: Composition of Total loans and advances

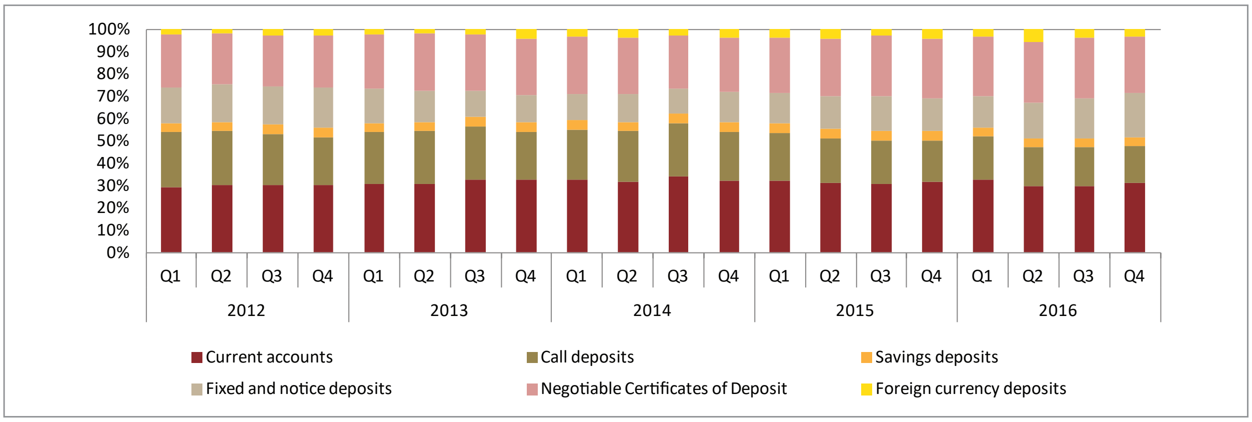


Source: Bank of Namibia

Funding Structure

Short-term deposits continued to be the main driver of growth on the capital and liabilities side of the balance sheet. Demand deposits constituted 47.9 percent of total deposits at the end of 2016, which is less than the 50.4 percent recorded in 2015. Evidently, demand deposits continued to be the dominant non-bank funding source. As such the maturity funding structure of bank deposits continued to lean towards short-term rather than long-term deposits, (Figure 11). Savings deposits represented 4.0 percent of non-bank funding, Fixed and Notice Deposits accounted for 19.5 percent with Negotiable Certificates of Deposits accounting for 25.2 percent. The share of Foreign Funding decreased from 4.3 percent in 2015 to 3.2 percent in 2016.

Figure 11: Composition of non-bank funding

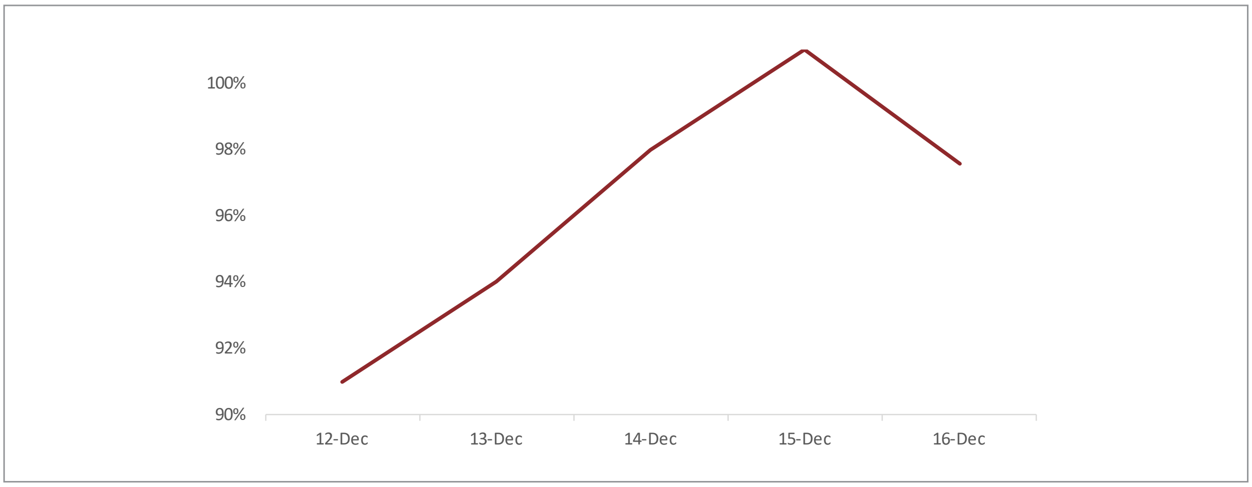


Source: Bank of Namibia

Loan-to-Deposit Ratio (LTD)

A key liquidity indicator, the loan-to-deposit (LTD) ratio, moderated but remains high. The LTD[4] ratio which was cited as a source of concern and warranted monitoring in the last FSR moderated to 98.0 percent in December 2016 from 101.0 percent in December 2015 (Figure 12). This lower ratio implies that banks have made relatively more use of deposits to fund loans and advances than other funding sources such as debt capital which normally tend to be more expensive.

Figure 12: Loan-to-deposit ratio



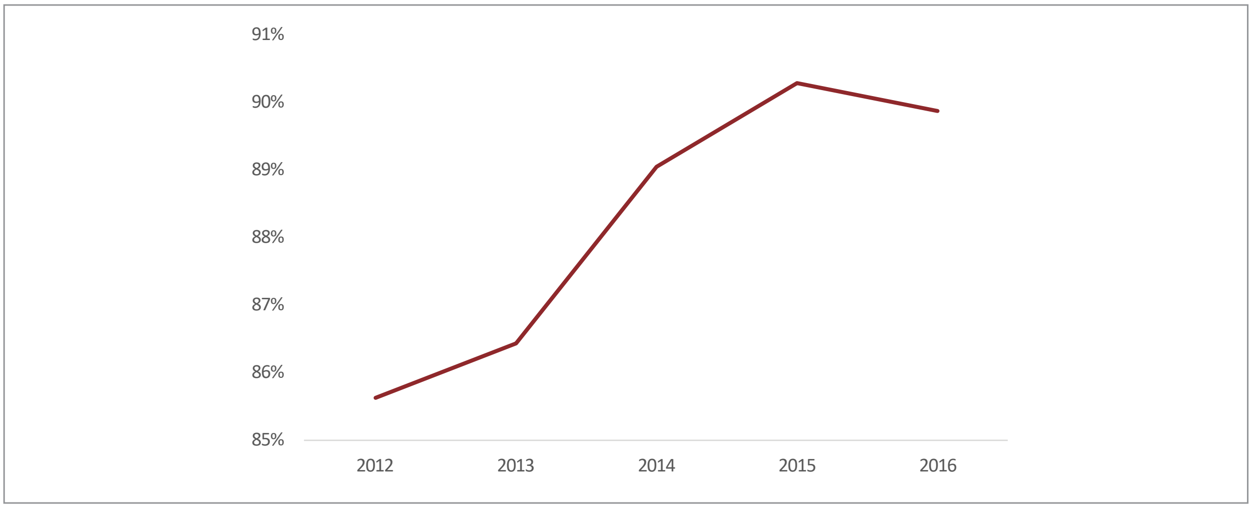
Source: Bank of Namibia

[4] Despite there not being a set benchmark, a loan-to-deposit ratio close to or over 100 percent implies that some of the banks rely on borrowed funds to fund their loans.

Loan-to-Total Funding Ratio (LTFR)

The banking sector Loan-to-Total Funding Ratio (LTFR) remains high. The LTFR remained above 90 percent during the period under review, confirming sustained pressure on the banks' funding base. This ratio implies that, on average, 90 percent of the banks' funding has been extended as loans and advances (Figure 13), implying that only 10 percent of total funding as well as total capital and equity was available to be employed on liquid and other assets. A high LTFR limits banks to expand the loans and advances book, while maintaining sufficient liquid assets to proactively manage liquidity risks. This ratio is even of more importance given the current maturity mismatch between assets and liabilities, experienced by all banks.

Figure 13: Loan-to-Total Funding Ratio

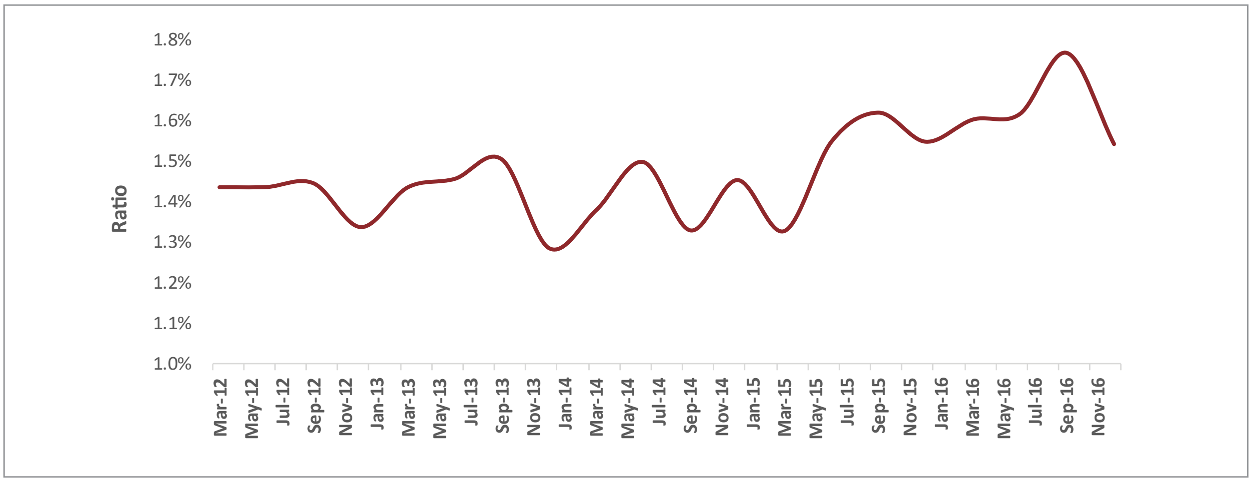


Source: Bank of Namibia

Asset Quality

Non-performing loans NPLs ratio as a measure of credit risk in the banking sector, improved slightly and remained well within the 4.0 percent benchmark, consequently posing no threat to the stability of the banking sector. Non-performing loans as a ratio of total loans decreased from 1.6 percent in 2015 to 1.5 percent in 2016, both well below the 4.0 percent Bank of Namibia benchmark (Figure 14). Overall, the NPL ratio remained satisfactory, even amidst the recent economic downturn which implies that the banks have managed to maintain healthy loan servicing as shown by the decline in the NPL ratios. In nominal value terms the NPLs improved, falling by a small margin of N$ 4.6 million during the period under review.

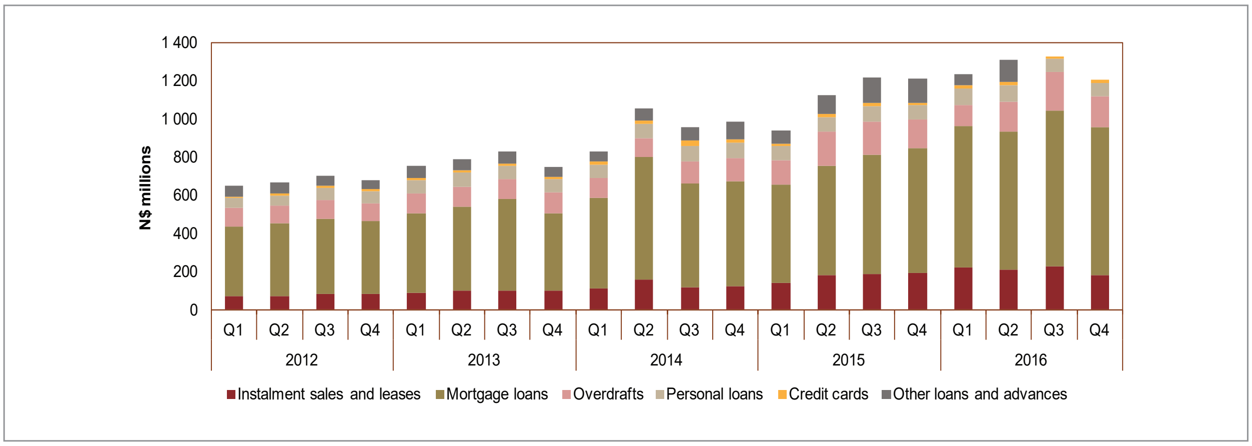
Figure 14: Non-performing Loans as a Percentage of Total Loans



Source: Bank of Namibia

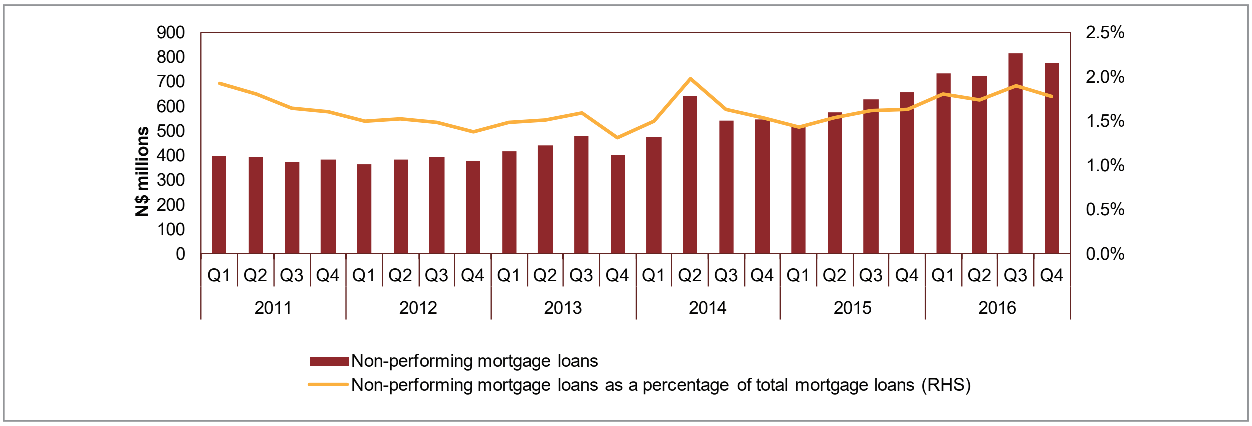
The decline in the overall NPL was due to lower NPLs on banks' other loans and advances, instalment sale credit and leasing finance, which surpassed the increase in NPLs on mortgage loans, overdrafts and credit cards. Other loans and advances recorded zero non-performing loans in both the third and fourth quarters, thus substantiating the overall improvement of NPLs. This was a great improvement from N$124.1 million of NPLs recorded for other loans and advances in 2015. Instalment sales and leasing NPLs decreased by N$10.5 million, whereas NPLs on personal loans decreased by N$2.4 million. On the contrary, mortgage loan, overdraft and credit card NPLs increased by N$120.6 million, N$11.2 million and N$0.6 million, respectively. Non-performing mortgage loans continued to have the biggest share of non-performing loans, at 64.3 percent, which is 10.2 percent higher than that of 2015. The percentage of total NPLs for Instalment sale and leasing finance stood at 15.2 percent and for overdrafts at 13.3 percent (Figure 15a). Residential and commercial mortgage loans accounted for more than 50 percent of the total loan book, therefore the high share of mortgage loans in total NPLs is not surprising (Figure 15b).

Figure 15a: Non-performing Loans per product



Source: Bank of Namibia

Figure 15b: Non-performing Mortgage Loans as percentage of Total Mortgage Loans



Source: Bank of Namibia

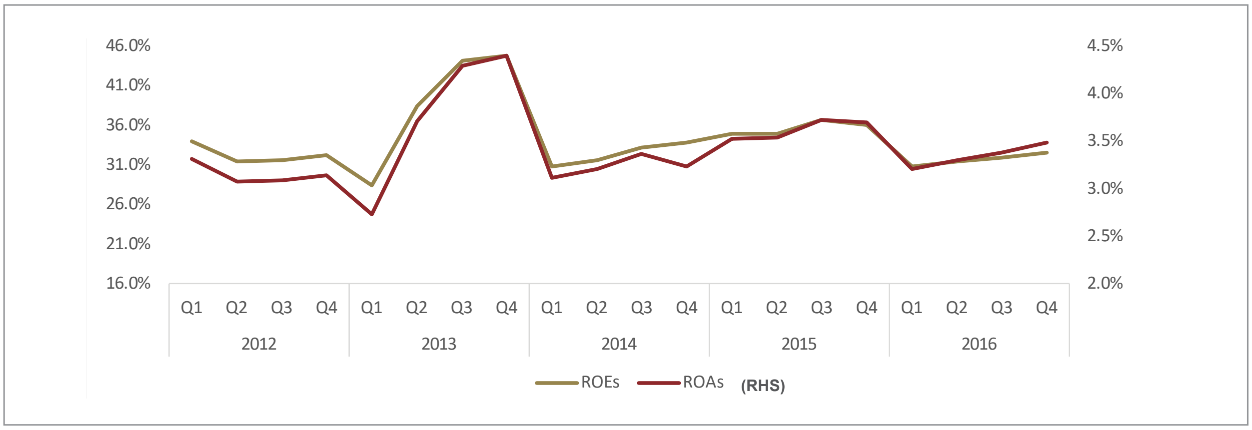
Profitability of the Banking Sector

The banking sector continued to be profitable despite a slowdown during 2016. The banking sector continued to post solid profit margins[5] amidst a general slowdown in the economy, coupled with changes in certain regulations aimed at taming growth in specific credit categories. This could be attributed to the short-term positive effects on interest income following the two Repo rate increases during the period under review. The Return on Equity (ROE) as well as the Return on Assets (ROA), both slowed to 32.6 percent and

[5] For the purpose of this report, the figures used in calculating ROE and ROA include net income before tax, in line with the IMF method. These may be different from the ROEs & ROAs used in the Bank of Namibia Annual Reports which are computed using after tax figures.

3.5 percent in 2016, from 36.0 percent and 3.7 percent, respectively, in 2015 (Figure 16). Although both ratios declined as a result of the recent weakening of the economy, they remain relatively high and confirm that the banking industry is still quite profitable.

Figure 16: Profitability Ratios: ROE & ROA



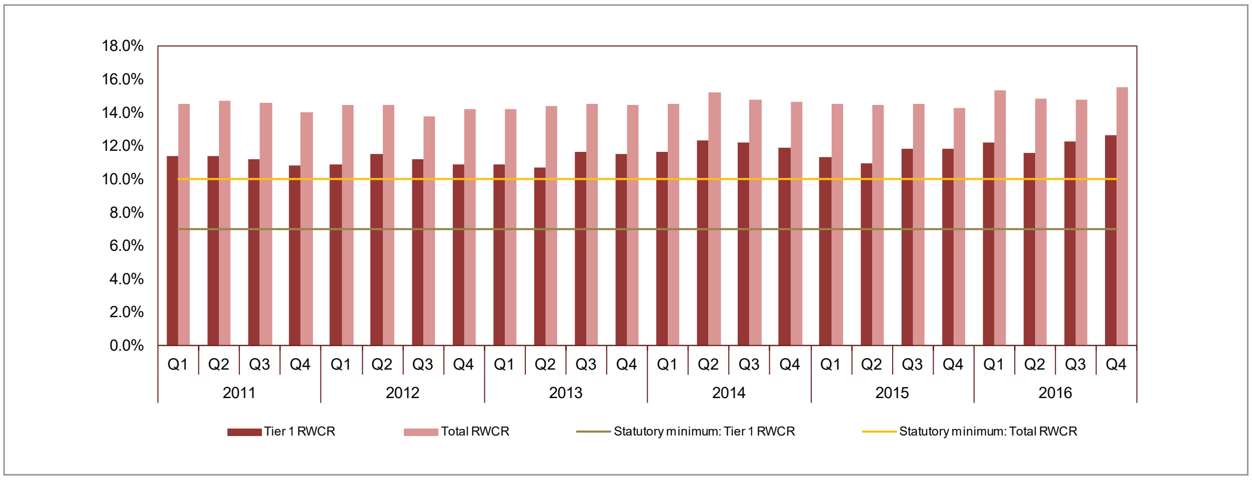
Source: Bank of Namibia

Adequacy of Capital and Liquid Assets

The banking industry remained adequately capitalised and maintained capital positions in 2016 well above the minimum prudential requirements. Both the Total Risk-Weighted Capital Ratio (RWCR) and the Tier 1 Capital Adequacy Ratio increased to 15.5 percent and 12.7 percent, respectively (Figure 17a). At these levels, both ratios are well above the minimum regulatory levels of 10 percent and 7 percent, respectively. The purpose of maintaining adequate capital and reserves is to cushion against risks associated with banking institutions' growth and to protect the banks against unsecured risk that can result in operational losses and also to build and maintain public confidence.

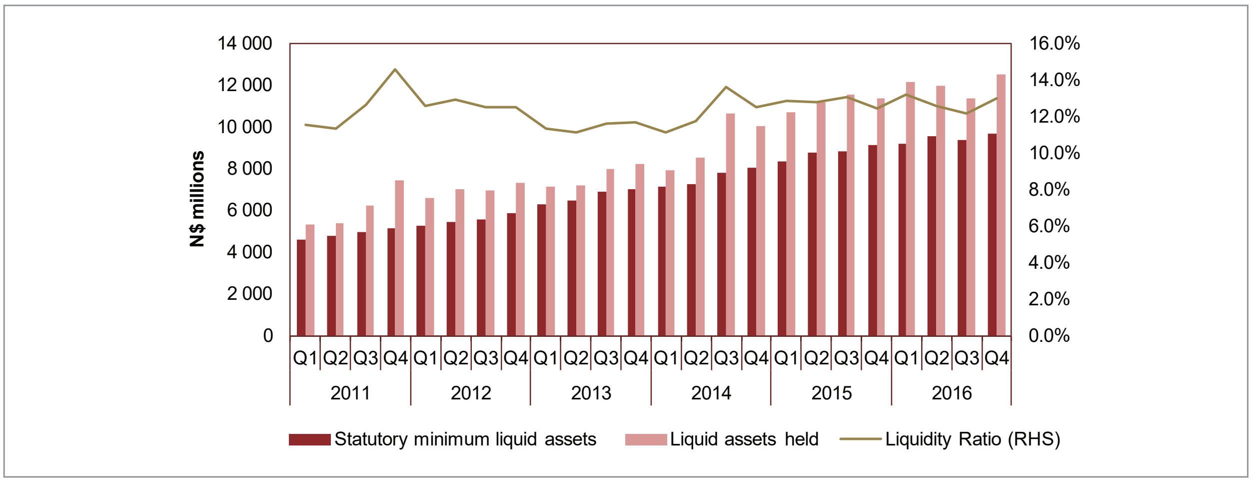
Although liquidity in general deteriorated in most parts of 2016, the banking sector continued to hold liquid assets well in excess of the statutory minimum liquid asset requirement. The liquidity ratio improved to 13.0 percent, up from 12.4 percent during the last quarter of 2015 (Figure 17b), well above the statutory minimum liquid asset requirement of 10.0 percent of average total liabilities to the public. This translates into about N$2.8 billion surplus holding above the required level.

Figure 17a: Capital Adequacy



Source: Bank of Namibia

Figure 17b: Liquid Assets and Liquidity Ratio



Source: Bank of Namibia

Stress Test

The Bank of Namibia's 2016 stress test has been designed to assess the resilience of the systemically important banking institutions to interest rate, exchange rate, credit and liquidity shocks. The severity of the shocks is related systematically to the Financial System Stability Committee's (FSSC) assessments of risk levels across markets and economies. In this context, the scenarios reflect the judgment of the FSSC regarding global and domestic risks to the Namibian banking system. The scenarios are run, to assess not only the banks' capital and liquidity adequacy in relation to the requirements, but also the general health of the banking system to support the real economy.

a. Interest Rate Risk

Namibia's macroeconomic environment may face negative consequences should the country lose its investment grade status. The recent downward revision of the Namibian outlook from stable to negative by credit rating agencies, which implies a higher risk of Namibia losing its investment grade status may prompt interest rates to increase in Namibia. The loss of an investment grade will result into an imbalance in the demand and supply of all Namibian bonds and consequently into an increase in interest rates of all investment instruments. In order to prevent capital outflow to other markets as a result of deteriorating investor appetite and sentiments, Bank of Namibia may be prompted to tighten interest rates, should this shock be realised.

In addition, rising inflation in South Africa due to a possible depreciating currency following the downgrade to sub-investment grade status of that country may force the SARB to increase interest rates. The continued depreciation of the South African Rand could be inflationary. To maintain the currency peg, the Bank of Namibia may also increase the Repo rate to align interest rates with those in South Africa. Ultimately, an elevated interest rate environment may increase direct interest rate risk; that is, the risk incurred by a bank when the interest rate sensitivities of its assets and liabilities in various time bands are mismatched. While local banks are likely to be in a favourable position initially should interest rates start to increase, as their assets will reprice faster than their liabilities, after some time the level of NPLs may start to increase. To account for the above scenario, the stress testing model assessed the impact of an interest rate increase on net interest income stemming from repricing gaps in each time band, over a 12-month horizon. The stress test results include the interest rate risk and credit risk scenarios, using the following assumptions:

- 1 percentage point increase in the interest rate (Baseline scenario);
- 3 percentage points increase in the interest rate (Intermediate scenario);
- 6 percentage points increase in the interest rate (Adverse / severe scenario).

b. Exchange Rate Risk

As stated above, the South African Rand has followed a strengthening trend since February 2016, but remains very volatile. The appreciation over the 13 months to mid-March 2017 was partly due to base reasons. Adverse political developments in

South Africa in December 2015 and early 2016 pushed the rand to an extremely weak level in January 2016. From this overly depreciated level, the Rand and Namibia Dollar appreciated during the course of 2016, on average, and in early 2017, as the political concerns moderated and CMA commodity export prices also started recovering. The sudden depreciation from mid-March 2017 onward as well as a remarkable recovery from the middle of April however, again illustrated the volatility of the exchange rates. From the point of view of the Namibian banking sector, exchange rate risk is not a major concern in the short to medium term, given that banks have a positive net foreign asset position which will benefit them when the Namibia Dollar depreciates against other currencies. The shocks assumed with respect to the depreciation of the Namibian dollar against major currencies were:

a. 5 percent depreciation (Baseline);
b. 15 percent depreciation (Intermediate);
c. 25 percent depreciation (Adverse).

c. Credit Risk

The possible monetary policy tightening assumed above could prompt banks to increase their prime lending rates and thus with a lag increased NPLs may be expected. This is further compounded by the impact of the prevailing low oil prices on Angolans' spending patterns in Namibia and potential defaults on property rentals and thus potential defaults in mortgages as well as trade and other services in general. In addition, reduced government spending following fiscal consolidation, reduces the income streams of businesses and individuals that depend on government contracts to service their loans with the banks, while the economic slowdown will also weaken income streams more broadly. This may ultimately result in higher default rates and NPLs across all loan asset categories. The following increases in the NPLs ratio are assumed:

- 1.5 percentage point increase in the NPL ratio above the current level (Baseline scenario);
- 3.0 percentage points increase in the NPL ratio above the current level (Intermediate scenario); and
- 6.0[6] percentage points increase in the NPL above the current level (Severe scenario).

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

d. Liquidity Risk

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

- 2.4 percent of the total deposits withdrawal from the system; over 5 days (15 percent of call deposits in total) (Baseline scenario)[7];
- 4.8 percent of the total deposits withdrawal from the system; over 5 days (30 percent of call deposits in total) (Intermediate scenario); and
- 8.0 percent withdrawal from the system; over 5 days (50 percent of the call deposits in total) (Adverse/Severe scenario).

Factors that may precipitate liquidity constraints include reduced government spending due to fiscal consolidation; delayed tax refunds, capital flight to other markets in search of better returns; dividend payments by subsidiaries of foreign entities, and weak commodity prices that dampen Namibia's export earnings. Furthermore, the growing loan book of the banking sector also exerts pressure on the liquidity conditions of the banks, especially given poor interbank lending, hence the need to assess the banks resilience in terms of liquidity[8].

Deposit withdrawals can be precipitated principally by market conditions (unscheduled withdrawals). It is acknowledged that the 35 percent domestic asset requirement imposed by regulation could serve as a buffer in terms of sudden withdrawals.

From the above shocks, the ultimate objective was to obtain an estimate of losses that the banking institutions could face in the event of a significant shock, or combination of shocks, and make recommendations pertaining to improved risk management or capital add-ons. These shocks are believed to be plausible and yet sufficiently adverse. A summary of these shocks are presented in Table 7 below.

[7] Under stress, one expects the general public to respond.
[8] The liquidity stress test is over a horizon of 5 days and does not account for the liquidity Contingency Funding Plan of each bank which would represent cash inflows over the 5-day period.

Table 7: Summary of the Stress Testing Scenarios

Risk Category	Base	Intermediate	Severe
Credit	1.5% ↑	3.0% ↑	6.0% ↑
Interest Rate	100 basis point ↑	300 basis points ↑	600 basis points ↑
Liquidity	2.4% of total deposits withdrawal ↓; over 5 days (15 % of call deposits)	4.8% of total deposits withdrawal ↓; over 5 days (30 % of call deposits)	8.0 % of total deposits withdrawal ↓; over 5 days (50 % of call deposits
Exchange Rate	5%[9] ↓	15% ↓	25% ↓
Other Variables: – 50% haircut on collateral – 50% Provisioning			

Capital Adequacy Stress Test

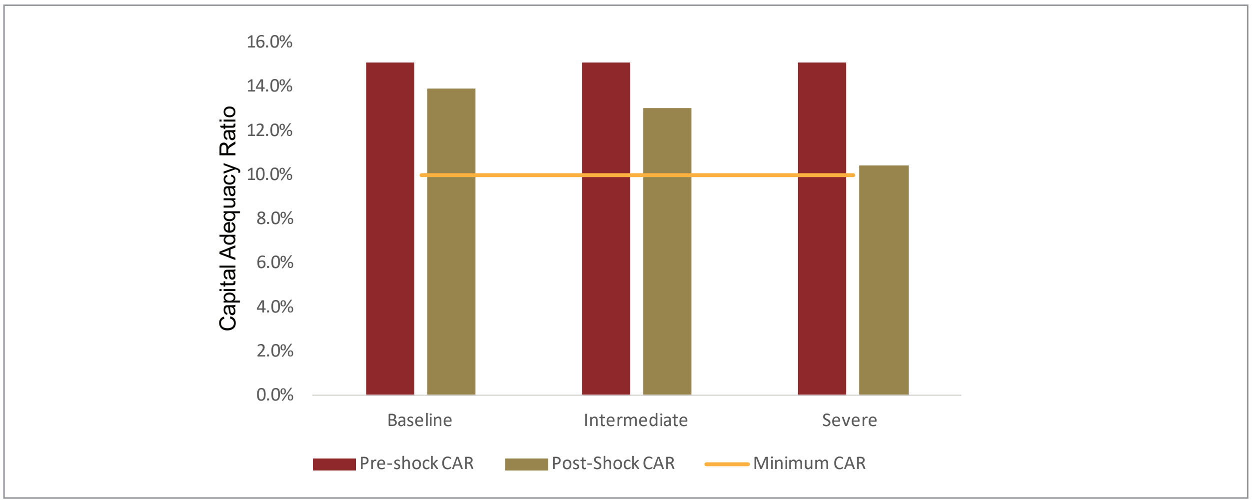
Based on December 2016 data, the stress test results show that the banking sector is adequately capitalized to withstand the impact of the potential increase in interest rates, depreciation of the exchange rate or that of adverse credit risk effects, in all scenarios. With respect to the baseline and intermediate scenarios, the post-shock risk-weighted capital ratio stood at 13.9 percent and 13.0 percent, respectively, well above the minimum regulatory level of 10 percent (Figure 18a). In the severe case scenario, however, with the continuation and exacerbation of the assumed conditions and thus the erosion of capital, the post-shock risk-weighted capital ratio is observed to decline to 10.4 percent, marginally above the minimum regulatory level. These results fared relatively poorly when compared to those of the same period in 2015.

Liquidity Stress Test

Using the IMF Cihak model adopted by the Bank of Namibia, the banking sector appears to have sufficient high quality liquid assets to withstand the assumed shocks, particularly in the baseline and intermediate scenarios. The liquidity stress test results indicate the ability of the banks to withstand liquidity shocks, if some of the depositors were to make sudden withdrawals of their funds from the system thereby exacerbating the current tightness in liquidity. The results show that the banking sector has sufficient high quality liquid assets to withstand the assumed shocks, particularly in the baseline and intermediate scenarios. As the magnitude of the shocks increases, however, that is to 50 percent of the call deposits withdrawals over 5 days, the banking sector would be able to honour its payment obligations, albeit only up to the third day (Figure 18b). This may trigger the possibility of all banks to approach the central bank for Lender of Last Resort assistance simultaneously.

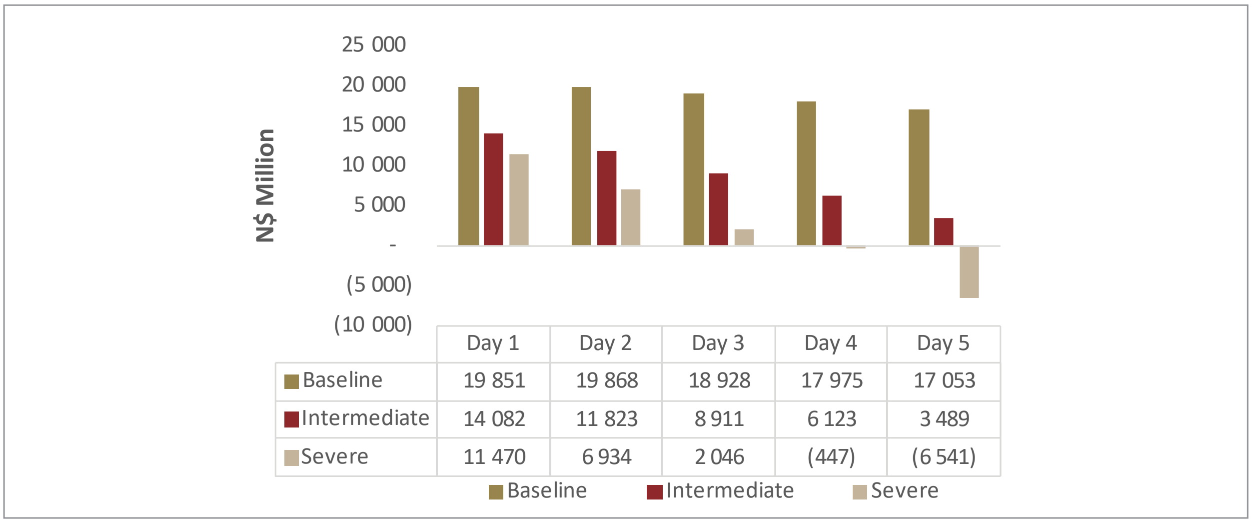
[9] On average, the exchange rate is expected to depreciate at the same rate as the average inflation rate in a year.

Figure 18a: Capital Adequacy Ratio Stress Test



Source: Bank of Namibia

Figure 18b: Liquidity Stress Test



	Day 1	Day 2	Day 3	Day 4	Day 5
Baseline	19 851	19 868	18 928	17 975	17 053
Intermediate	14 082	11 823	8 911	6 123	3 489
Severe	11 470	6 934	2 046	(447)	(6 541)

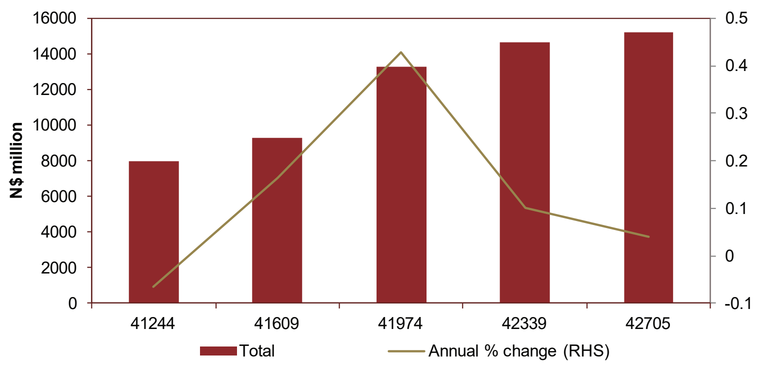
Source: Bank of Namibia

Large Exposures

The banking sector's large exposures have grown at a moderate pace since 2015, with a significant increase in exposures to the mining sector that warrants monitoring. Total large exposure value increased moderately to N$15.2 billion as at 31 December 2016, from N$14.6 billion a year earlier. This is also reflected in the year-on-year growth rate of 4.0 percent, in comparison to a significantly higher growth rate of 10.0 percent in 2015 (Figure 19a). This deceleration was primarily driven by a significant reduction in exposures to Transport & logistics as well as the Others categories, which both contracted year-on-year by 48.7 percent and 6.7 percent, respectively, in 2016. **ex**the significant increase in year-on-year growth in exposure to the mining sector warrants monitoring as this sector is highly vulnerable to external shocks such as international commodity prices, and could pose risks to the financial sector. Large exposures[10] pose a potential risk to overall financial stability in the form of excess concentration to individual companies or sectors.

The sectoral composition of large exposures has become relatively more diversified during 2016, with the relative share of manufacturing, mining & minerals, property and construction increasing. The sectoral composition of large exposures has become more diversified with the inclusion of the fishing and the tourism sectors in 2016, albeit their collective share being less than 5 percent. The relative share of the manufacturing, mining & minerals as well as property & construction sectors all increased moderately during the review period (Figure 19b). Further, the relative share of the transport & logistics sector continued to decline from 15.6 percent in 2015, to 7.4 percent in 2016. The remaining 30.2 percent of the large exposures was roughly evenly distributed between seven corporate borrowers outside the aforementioned sectors, which was about 3.5 percent lower than that of the previous year.

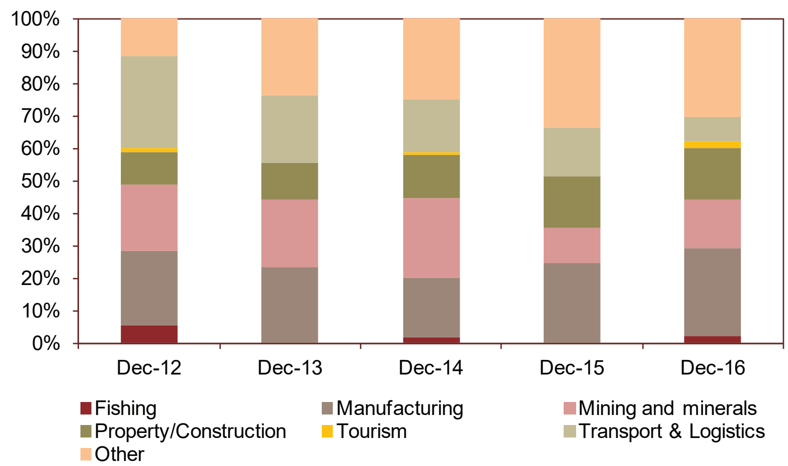
Figure 19a: Banking sector large exposures and growth rate



Source: Bank of Namibia

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

Figure 19b: Sectoral composition of large exposures



Source: Bank of Namibia

As a proportion of total private sector credit extension (PSCE), large exposures moderated. The large exposure as a proportion of PSCE continued to moderate to 17.8 percent during 2016, from 18.7 percent at the end of December 2015 (Table 8). In relation to private sector credit to businesses, large exposures similarly declined to 43.1 percent from 44.2 percent over the same period. The recent moderations appear to be in line with tight economic conditions experienced during this period.

Table 8: Large exposures in relation to private sector credit

	2012	2013	2014	2015	2016
Total Largest Exposures N$ million	**7,997**	**9,305**	**13,296**	**14,631**	**15,223**
Total PSC N$ million	51,881	59,323	69,067	78,394	85,397
PSC to Businesses N$ million	**20,049**	**22,702**	**28,364**	**33,086**	**35,343**
Large Exposures to PSC	15.4%	15.7%	19.3%	18.7%	17.8%
Large Exposures to Business PSC	**39.9%**	**41.0%**	**46.9%**	**44.2%**	**43.1%**

Source: Bank of Namibia

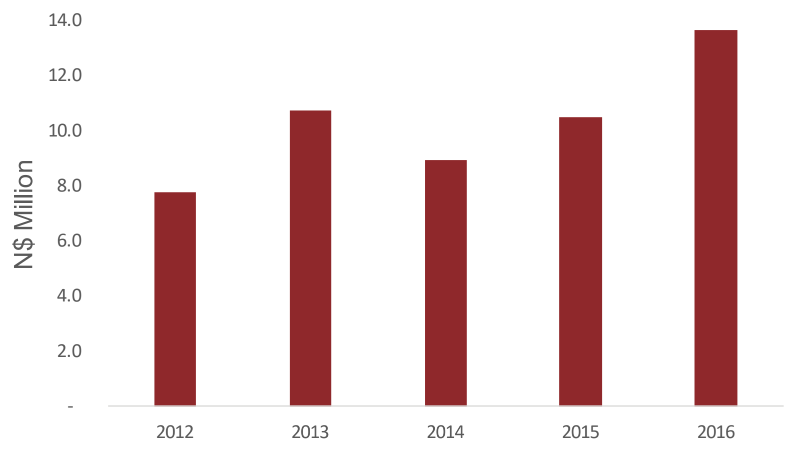
Non-Bank Financial Sector Deposits with Banks[11]

The non-bank financial institutions deposits with banks generally remained high over the last 5 years. The non-bank financial institutions' deposits with banks remain elevated and grew at a compounded growth rate of 15.2 percent over the last 5 years (Figure 20). This is an indication of banks' continued dependence on non-bank financial

[11] Pension funds, unit trusts, asset management, as well as insurance (short & long term)

institutions for funding, which requires monitoring going forward. This may however not necessarily pose any immediate systemic risk as most of these investments principally serve to fulfil and maintain the regulatory domestic investment requirement of 35 percent.

Figure 20: Banking Sector Exposure to Non-Bank Financial Sector



Source: Bank of Namibia

Box: Loan-to-Value Regulation

A macroprudential regulation in the form of Loan-to-Value (LTV) ratios for non-primary residential properties was gazetted on the 26th of September 2016. *This measure will strengthen financial system stability, although it may not address the key underlying issues pertaining to the limited supply of houses and slow delivery of serviced land, so that it needs to be complemented with other measures. It is believed that the implementation of LTV ratios as of the 22nd of March 2017 is likely to contribute to reduced concentration risk for commercial banks, as well as promote preferential access to housing for first time buyers. For example: the regulation does not require any upfront deposit by the buyer for the purchase of his or her first residential property, while for the second residential property, the LTV ratio is set at 80 percent of the purchasing price or market value of the property. For instance, if the value of the second property that one intends to buy is N$1 000 000.00, the bank may finance up to N$800 000.00 and the buyer will be expected to pay a deposit of at least 20 percent (N$200 000.00) upfront. The minimum deposit becomes 30 percent on a third house, 40 percent on a fourth house, and 50 percent* *on a fifth and all further houses acquired. As such, the introduction of these caps will promote system-wide stability of the financial sector in Namibia.*

Macro-prudential instruments are policy tools that are intended to target the sources of systemic risk, such as liquidity and maturity mismatches, leverage or interconnectedness. A macro-prudential policy has two broad aims that are mutually compatible, namely; strengthening the resilience of the financial system to economic downturns and other adverse aggregate shocks; and leaning against the financial cycle to limit the accumulation of financial risks and the likelihood or the extent of a financial crisis. For macro-prudential policy to be successful there is a need to identify intermediate policy objectives, such as:

- *reducing excessive growth in credit, asset prices and leverage;*
- *reducing excessive lending and funding maturity mismatches;*
- *reducing direct and indirect concentrations of exposures to the same markets, products and institutions; and*
- *reducing moral hazard by avoiding situations where institutions increase their exposure to risk with the expectation that the government will bail them out.*

Namibia's house prices have recorded sharp increases in recent years. The residential property price index compiled by First National Bank Namibia (FNB) since 2007, shows that the average price of properties in the residential property segment increased from N$380,300 in 2009 to N$705,400 in 2014. This translates into an average annual rate of increase of 17.1 percent, outpacing the inflation rate that averaged 6.2 percent over the same period. Over a period of five years, residential property prices increased sharply by 85.5 percent. It may be noted that according to the price index mentioned above, average residential property prices increased by approximately 17 percent in 2015, tappering to about 13 percent in 2016, as demand softened. The recent evolution of Namibia's house prices and rising mortgage loans raise questions as to whether or not the country is experiencing a housing bubble, which could be a significant source of systemic risk. A possible reversal of the prevailing house price trends, coupled with high household indebtedness, raises financial stability concerns due to banks' high exposure to the real estate sector, particularly in the residential segment. This justifies the introduction of the LTV regulation.

Conclusion & Policy Implications

From the above analyses, it is important to note that, while the banking industry appears to be sound and profitable, there are key issues, not mutually exclusive, that need to be addressed so as to enhance its health and soundness, thereby allowing it to continue to support the real sector of the economy:

- Banks should align their loan book growth with their funding sources.
- Banks should ensure that the maturity structure of their liabilities more closely matches that of their assets.
- Banks should strengthen their liquidity management strategies in line with the prevailing economic conditions.

VI. PERFORMANCE OF THE NON-BANKING FINANCIAL SECTOR

The Non-Banking Financial Sector, during the period under review continued to maintain sound financial positions, reflected in continued asset growth. Further, despite the potential challenge that could emanate from concentration risk, the sector continued to play a significant intermediation role in the economy as reflected by its overall assets-to-GDP ratios. For example, the pension funds and investment subsectors continued to record ratios (i.e., assets-to-GDP) above 80 percent and 90 percent, respectively (Table 9). Similarly, the long-term insurance and collective investment scheme (CIS) sub-sectors continued with significant performances over the same period; each recording a ratio of 30 percent, respectively.

Table 9: Size of Balance Sheets of NBFIs[12]

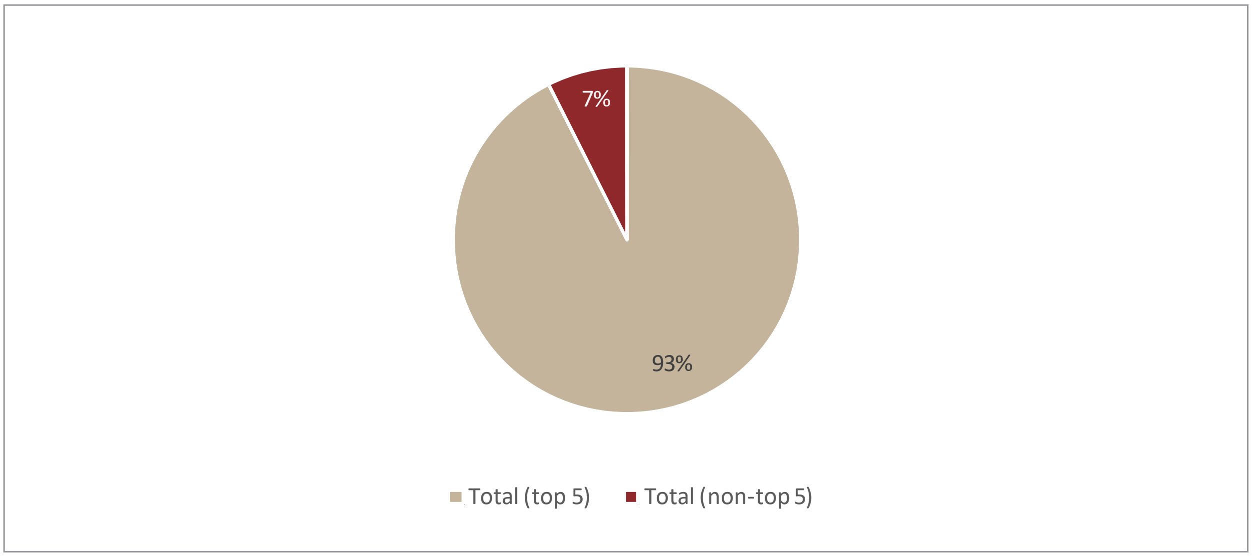
	Dec 12		Dec 13		Dec 14		Dec 15		Dec 16	
Asset Values N$ Million	**Assets**	**% of GDP**	**Assets**	**% of GDP**	**Assets**	**% of GDP**	**Assets**	**% of GDP**	**Assets**	**% of GDP**
Long Term Insurance	31,654	30%	36,424	29%	40,224	28%	44,746	29%	47,554	30%
Short Term Insurance	3,001	3%	3,461	3%	4,749	3%	5,587	4%	5,769	4%
Medical Aid Funds	858	1%	1,002	1%	1,160	1%	1,042	1%	1,445	1%
Pension Funds	85,757	80%	105,267	84%	119,569	82%	133,089	87%	137,462	86%
CIS	32,106	30%	37,267	30%	42,083	29%	47,772	31%	48,313	30%
Investment Management	109,110	102%	123,322	99%	136,186	93%	147,689	97%	150,775	95%
Micro-lending	1,753	2%	2,616	2%	3,382	2%	4,257	3%	4,222	3%
Financial Market:										
-Local market capitalization	11,057	10%	18,729	15%	22,322	15%	29,430	19%	32,016	20%
-Local debt issued	17,125	16%	19,077	15%	21,806	15%	20,195	13%	59,372	37%
GDP current price (N$ Million)	106,895		124,863		145,744		153,031		159,105	

Source: NAMFISA and Namibia Statistics Agency

[12] Note: The total NBFI's has a component of double counting since most of the assets of Pension Funds, Long Term Insurance, etc. do also form part of total investments under collective investment schemes and asset managers (Investment Management). Total investment funds under management as at December 2016 was N$150.8 billion, of which about 50 percent were sourced from different sub-sectors, and thus accounts for the stated double counting. For more information, please refer to figure 41 which gives an indication of the source of funds per sub-sector under management.

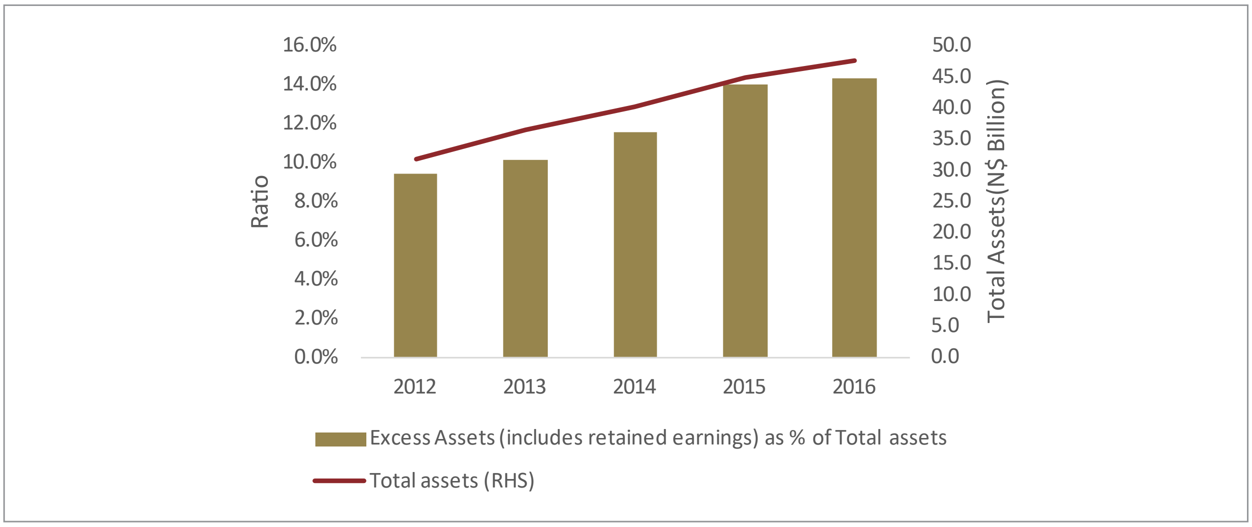
Long-term insurance

Figure 21a: Concentration Risk



Source: NAMFISA

Figure 21b: Capital Adequacy Indicators

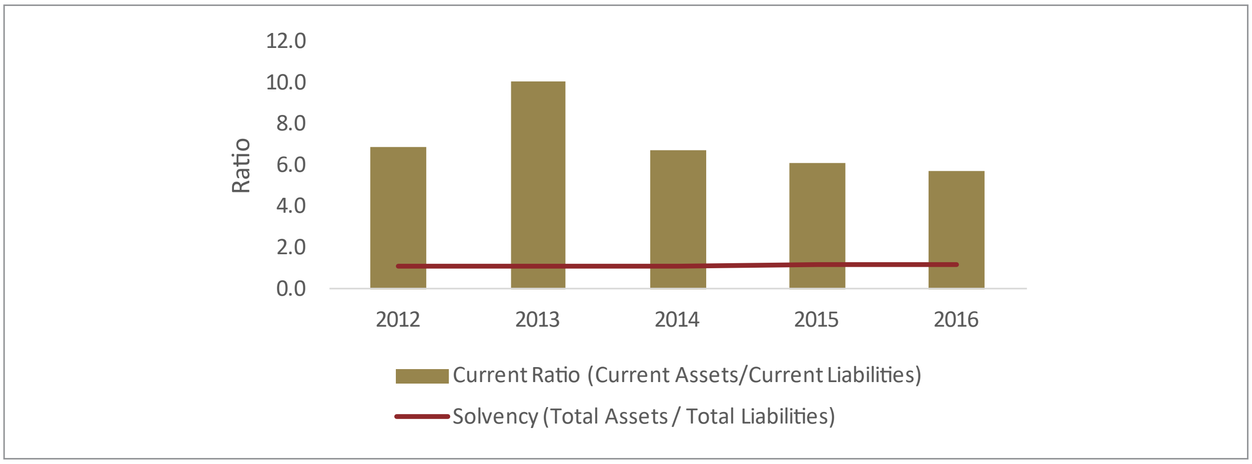


Source: NAMFISA

The top 5 long term insurance entities to constitute 93 percent of total assets in the sub-sector, which could be a potential source of systemic risk emanating from concentration risk. This high concentration could be attributed to the market structure of financial system, characterised by a small market with few players dominating the market share for decades. NAMFISA continues to intensively monitor these players (Figure 21a).

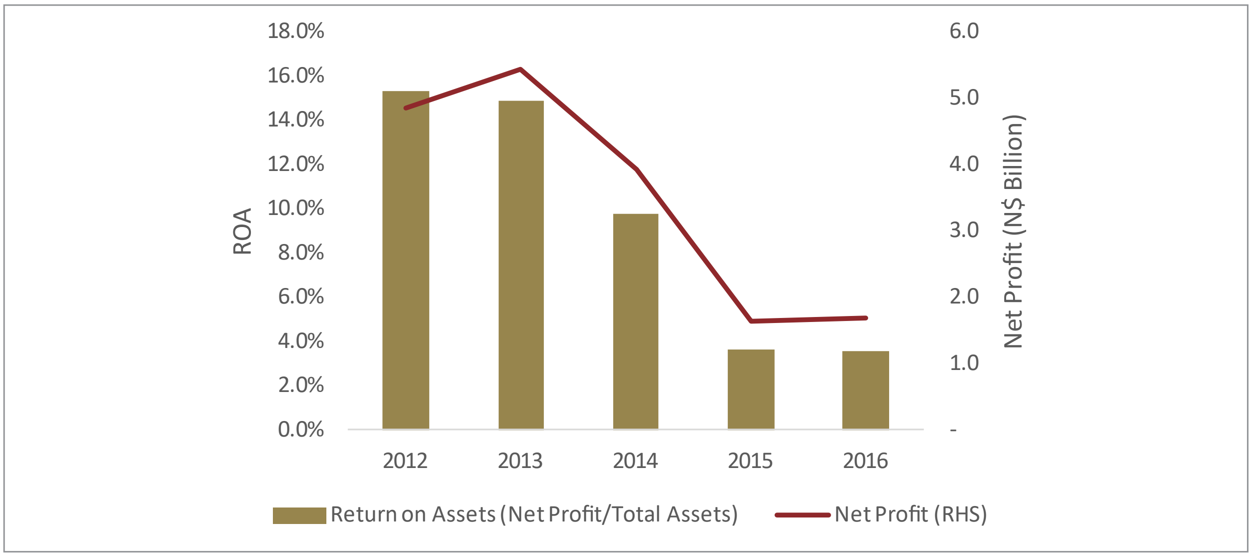
In terms of capital adequacy, the sector continued to grow its asset base, which increased from N$44.7 billion at the end of 2015 to N$47.6 billion at the end of 2016. Further, the sub-sector maintained its buffer of surplus (free) assets as a percentage of total assets, which stood at 14.3 percent as at December 2016 (Figure 21b). The margin of surplus funds could serve as a safety net against adverse events.

Figure 22a: Liquidity Indicators



Source: NAMFISA

Figure 22b: Profitability Indicators

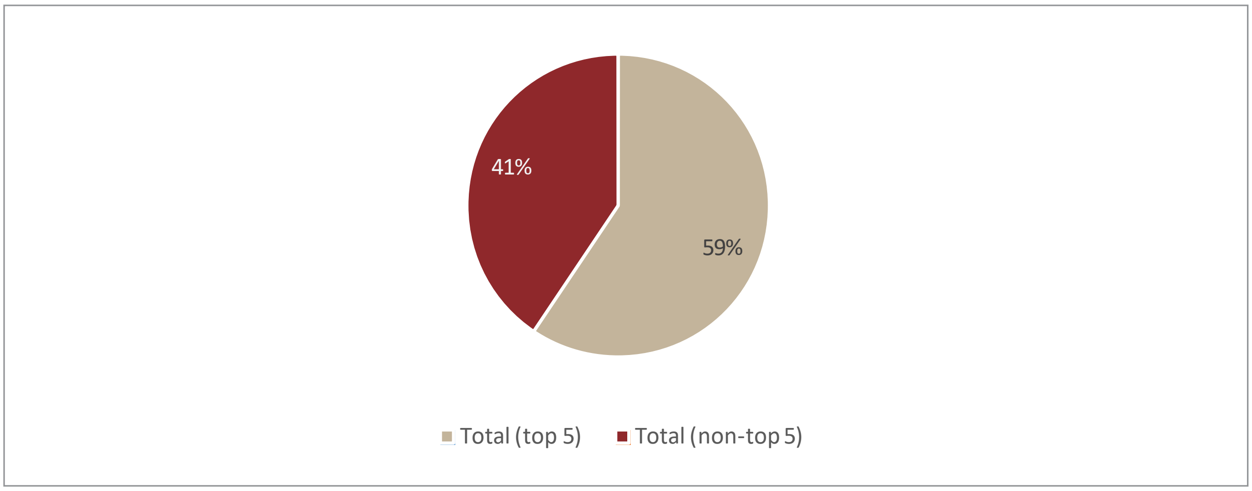


Source: NAMFISA

The long-term insurance sub-sector had a healthy financial position as reflected in its balance sheet. The sub-sector recorded a liquidity ratio of 5.7 as at December 2016 (Figure 22a). Profits recorded a slight decline of 3 percent, year-on-year, (Figure 22b), mainly due to a 10 percent (N$ 471.6 million) increase in gross policy benefits paid during the period under review. The sub-sector's liquidity and solvency levels remained stable during the period under review (Figure 22a).

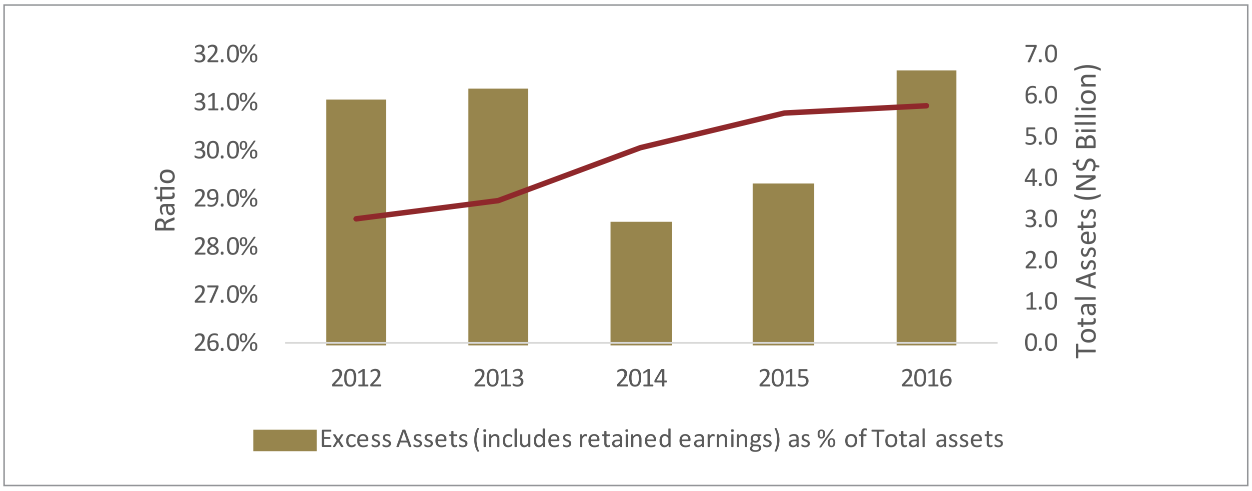
Short-term Insurance

Figure 23a: Top 5 Concentration Risk



Source: NAMFISA

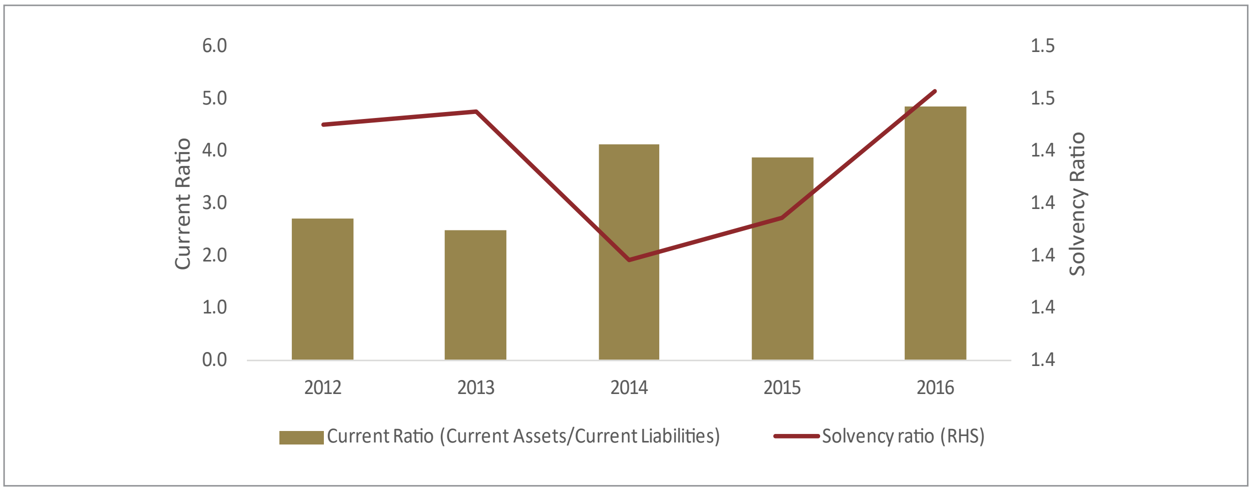
Figure 23b: Capital Adequacy Indicators



Source: NAMFISA

The sub-sector had moderate concentration risk as the top 5 entities constituted 59 percent of total assets (Figure 23a). During the period under review, the sector remained well capitalised with the total assets improving from N$ 5.6 billion at the end of 2015 to N$5.8 billion at the end of 2016 (Figure 23b). Further, the sub-sector was backed by a high margin of surplus capital which improved to 31.6 percent from 29.3 percent recorded in 2015. This implies that there is a sufficient buffer to withstand economic shocks that may impact the short-term insurance sub-sector.

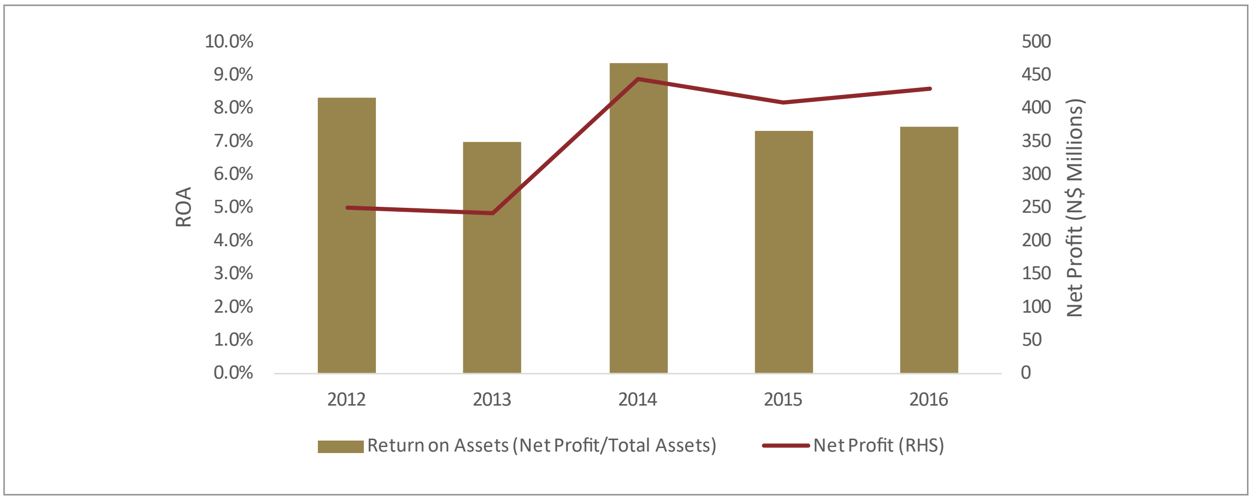
Figure 24: Liquidity Indicators



Source: NAMFISA

With regard to liquidity and solvency positions, during the period under review, the Short-term insurance sub-sector recorded an improvement in both indicators. Further, the sub-sector remained profitable and solvent, during the period under review as its net income increased to N$ 429 million in 2016 from N$407 million in 2015 (Figure 24 & 25). A Current ratio of 4.9 and Solvent ratio of 1.5 were recorded at the end of 2016.

Figure 25: Profitability Indicators

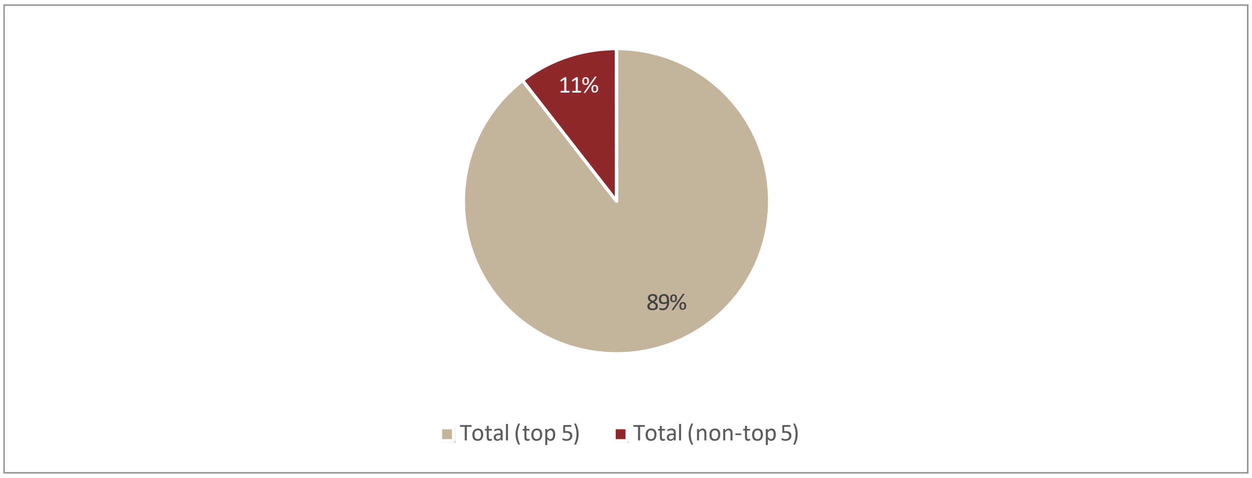


Source: NAMFISA

Medical Aid Funds (MAFs)

In terms of the medical aid funds' concentration risk, the sub-sector remained heavily concentrated. The top 5 entities accounted for 89 percent of the total assets of the sub-sector (Figure 26). However, the MAF sub-sector remained well capitalised with surplus assets of over 78 percent of total assets as at December 2016 (Figure 27), implies that the sub-sector had sufficient reserves to withstand adverse events impacting liquidity (Figures 27).

Figure 26: Concentration Risk Medical Aid Funds



Source: NAMFISA

The medical aid funds sub-sector remained well capitalised and profitable during the period under review. The sub-sector is well capitalised with surplus capital at 78.2 percent of total assets during the period under review (Figure 27). However, a sharp decline in net income from N$165 million in 2015 to N$ 65 million in 2016 (Figure 29) was recorded. The reasons for the decline in profitability could be attributed to the following:

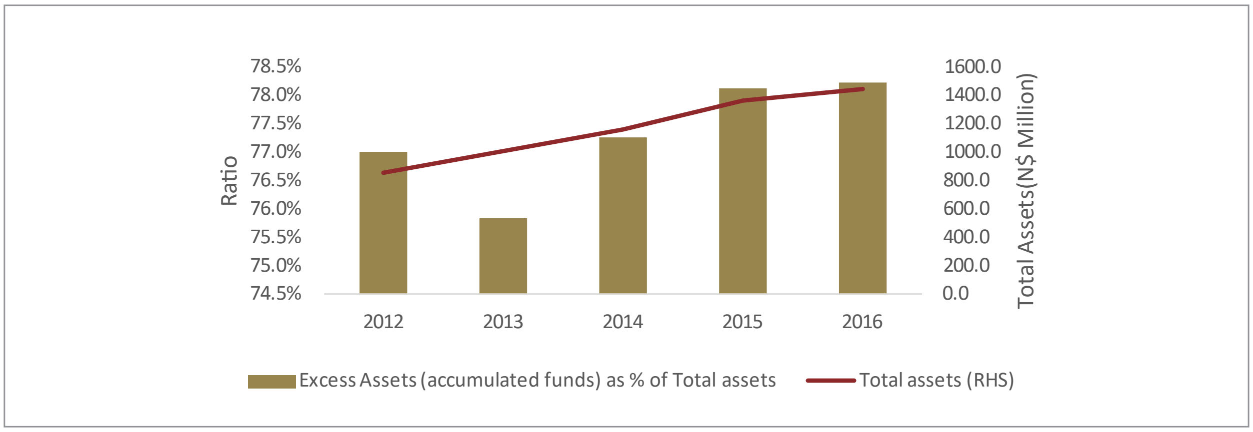
(i) The industry's gross contribution income on average increased by 11.8 percent during the 2016 financial year, while an increase of 15.2 percent in healthcare expenditure ("claims") was reported by the industry during the same period.

(ii) Total healthcare expenditure incurred by the medical aid fund sub-sector increased by 15.2 percent from N$2.5 billion recorded during the 2015 financial year to N$2.9 billion as reported during the 2016 financial year due to inflationary increases on healthcare costs.

(iii) Total non-healthcare expenditure increased year-on-year by 8.9 percent from N$299.7 million reported for the year ended 31 December 2015 to N$326.4 million reported for the year ended 31 December 2016.

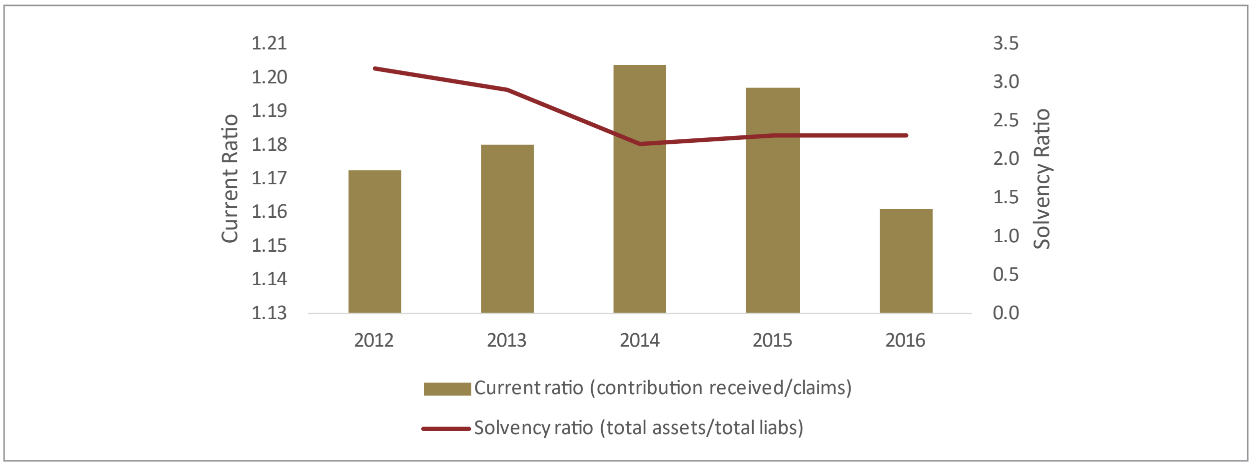
During the period under review the sub-sector remained liquid and solvent. Although the sub-sector's current ratio decreased from 2.3 to 1.2, this does not pose a threat as the sub-sector is well capitalised (Figure 28). The sub-sector's surplus asset-margin was at 78 percent of total assets, which is well above the minimum threshold of 25 percent and can therefore be considered as well capitalised (Figure 27).

Figure 27: Medical Aid Funds Capital Adequacy Indicators



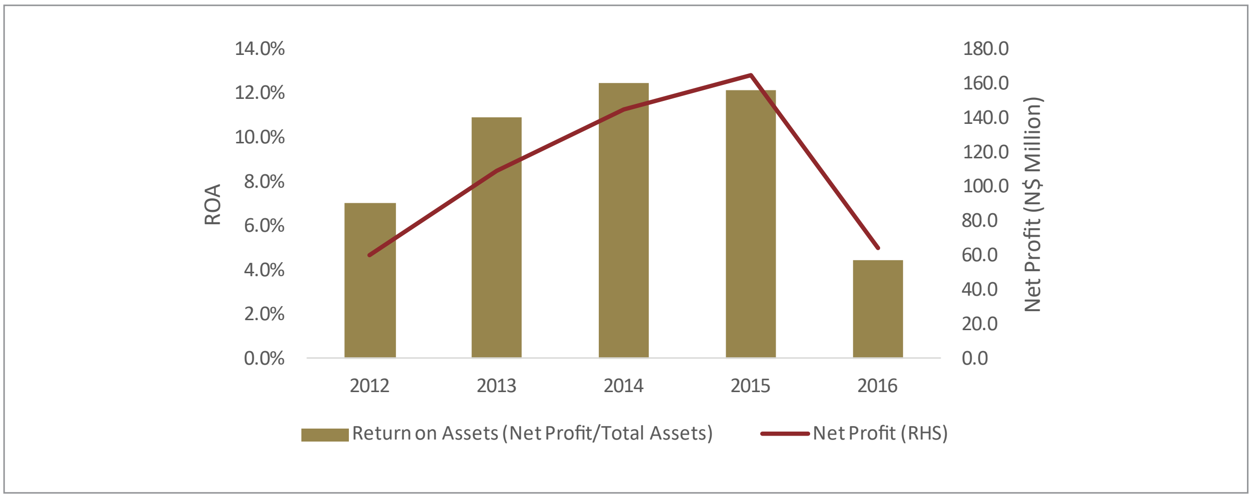
Source: NAMFISA

Figure 28: Medical Aid Funds Liquidity Indicators



Source: NAMFISA

Figure 29: Medical Aid Funds Profitability Indicators

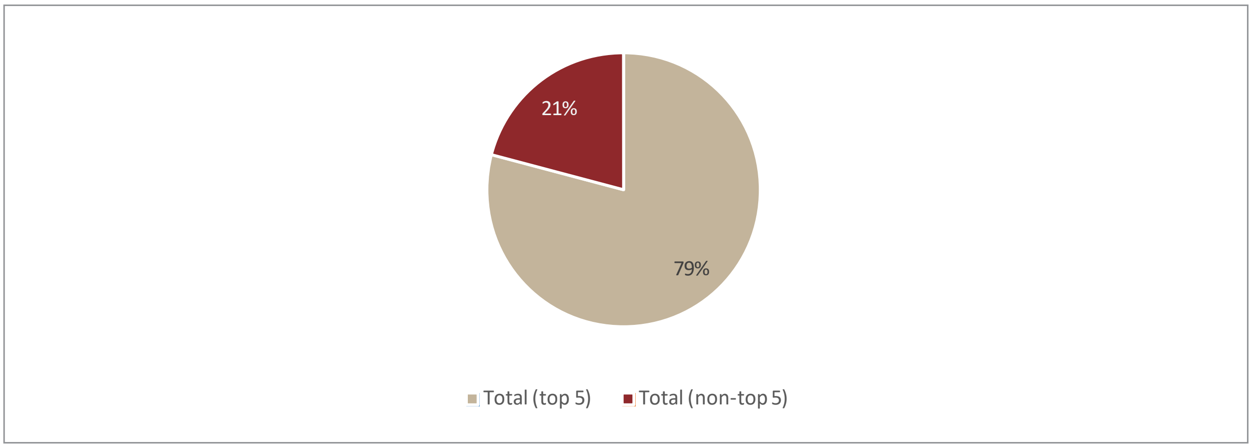


Source: NAMFISA

Pension funds

The Pension funds sub-sector remained well capitalized underpinned by strong asset base to the tune of N$137.5 billion during the period under review, despite concentration risks emanating. The industry remained well capitalised with a sound asset base of N$137.5 billion at the end of 2016, from N$133.1 billion at the end of 2015. The top 5 entities, however, accounted for 79 percent of the total pension fund assets reflecting a highly concentrated industry (Figure 30).

Figure 30: Pension Funds Concentration Risk

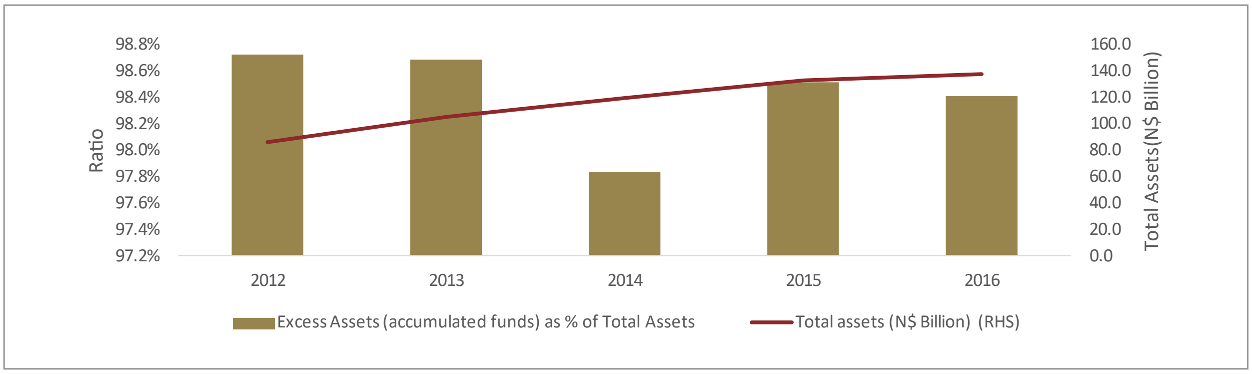


Source: NAMFISA

In terms of capital adequacy, the pension funds sub-sector has a sizeable balance sheet which remained well capitalised and profitable during the period under review. The sub-sector, however, recorded a sharp decline in net investment income from N$ 7.1 billion in 2015 to N$3.3 billion in 2016 (Figure 31). The decline in net investment income was driven mainly by the following developments:

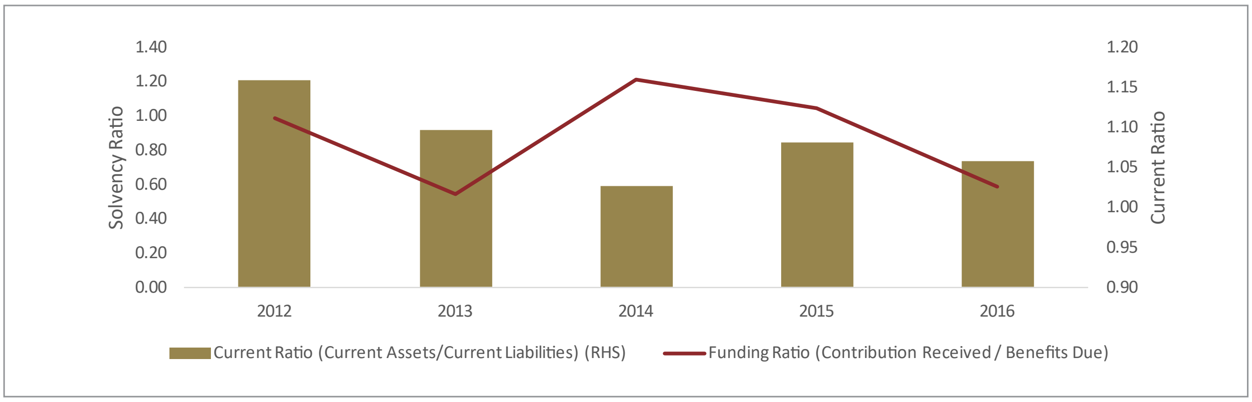
- Pension fund membership declined quite significantly during the year, and settling of claims through disinvesting of associated assets would have impacted on investment returns, and
- The investment environment was challenging and characterised by volatile exchange rates, declining commodity prices, social and political instability as well as low economic growth.

Figure 31: Pension Funds Capital Adequacy



Source: NAMFISA

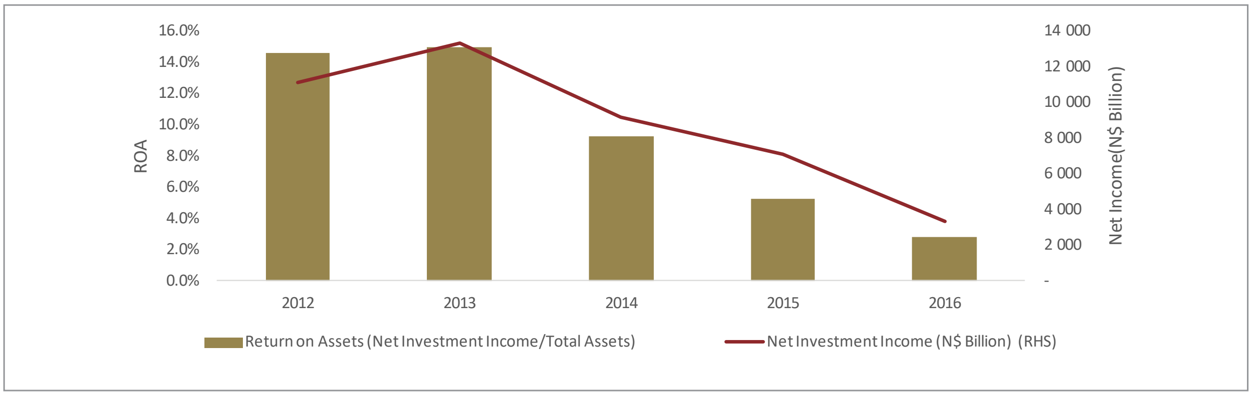
Figure 32: Pension Funds Liquidity Indicators



Source: NAMFISA

In terms of liquidity and solvency, the sub-sector consistently maintained a solvent funding level above the minimum threshold of 100 percent. During the period under review, the balance sheet liquidity ratio (funding ratio) of the pension fund sub-sector recorded 103 percent which is above the minimum limit of 100 percent (Figure 32). However, the declining profitability trend (Figure 33), could be attributed to adverse economic conditions which had a negative effect on net investment income as it declined from N$9.1 billion in 2015 to N$7.1 billion in 2016.

Figure 33: Pension Funds Profitability Indicators

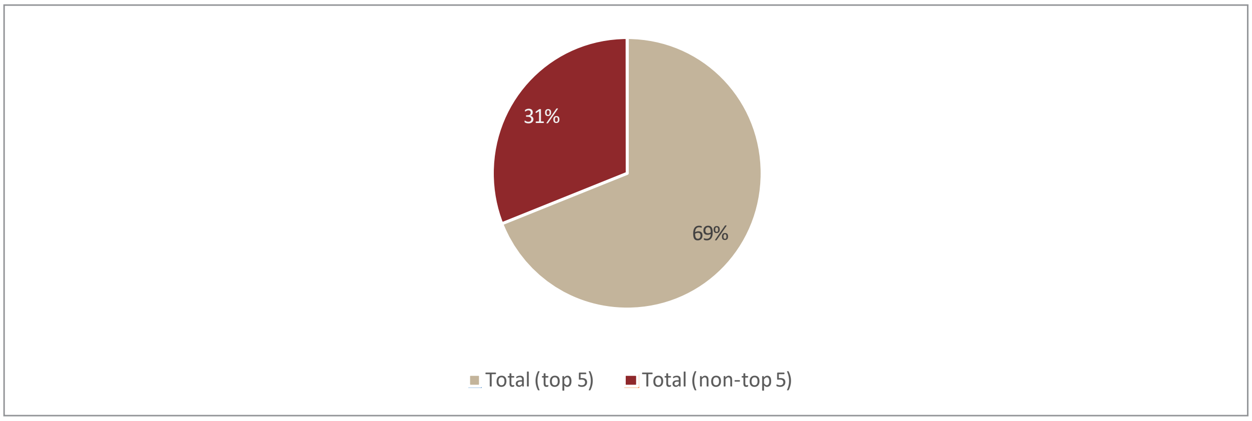


Source: NAMFISA

Collective Investment Schemes (CIS)

The collective investment schemes industry remained stable and highly concentrated. The top 5 entities accounted for 69.0 percent of total funds under management (Figure 34). The total Assets under Management (AuM) increased by N$541 million during the past year, to an amount of N$48 billion at the end of 2016.

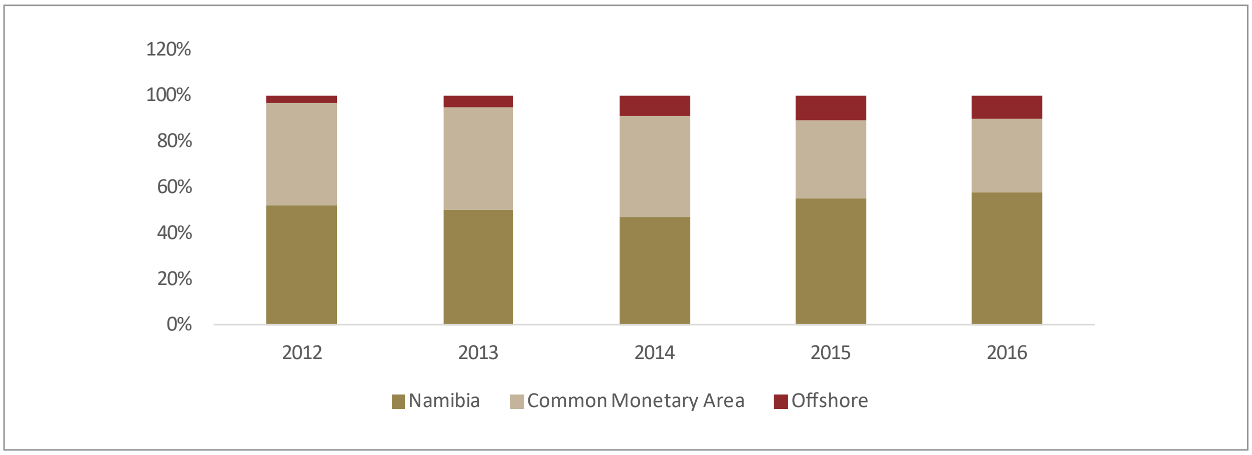
Figure 34: Concentration Risk



Source: NAMFISA

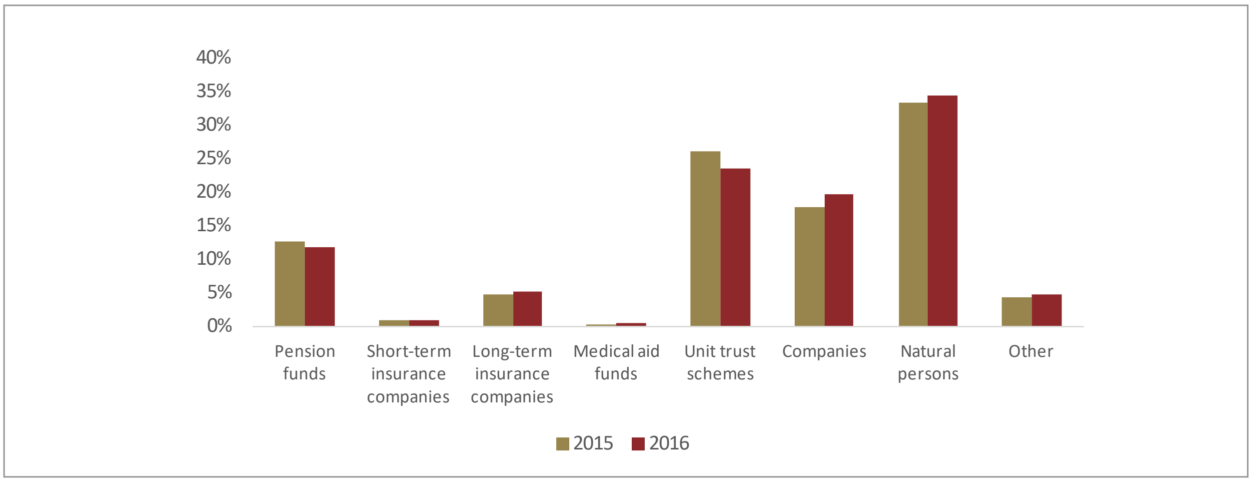
Further, the asset geographical allocation remains tilted towards the domestic market. In this regard, 57.0 percent, 33.0 percent and 10.0 percent of the funds under management were invested in Namibia, the CMA and Offshore, respectively (Figure 35a).

Figure 35a: Assets per Geographical Location of Total CIS Funds



Source: NAMFISA

Figure 35b: Assets per investor as a Percent Total unit Funds, as at 31 December 2016

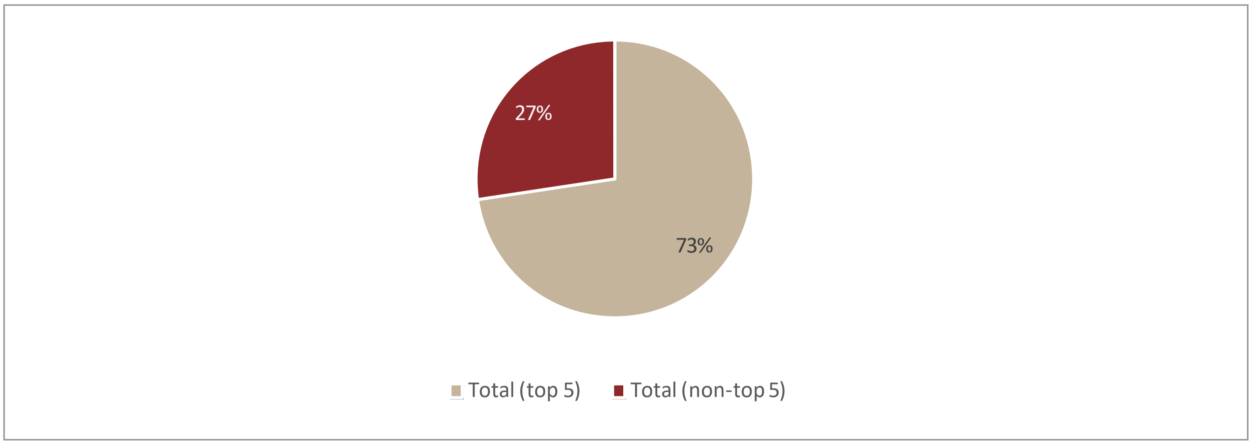


Source: NAMFISA

The unit trust sources of funds remained relatively steady during the period under review. Assets sourced from long-term insurers decreased by 4.8 percent from N$2.6 billion to N$2.4 billion, while investments by natural persons in CIS increased by 2.7 percent from N$16.2 billion to N$16.6 billion during the period under review (Figure 35b).

Investment Management Funds: Assets Under Management (AuM)

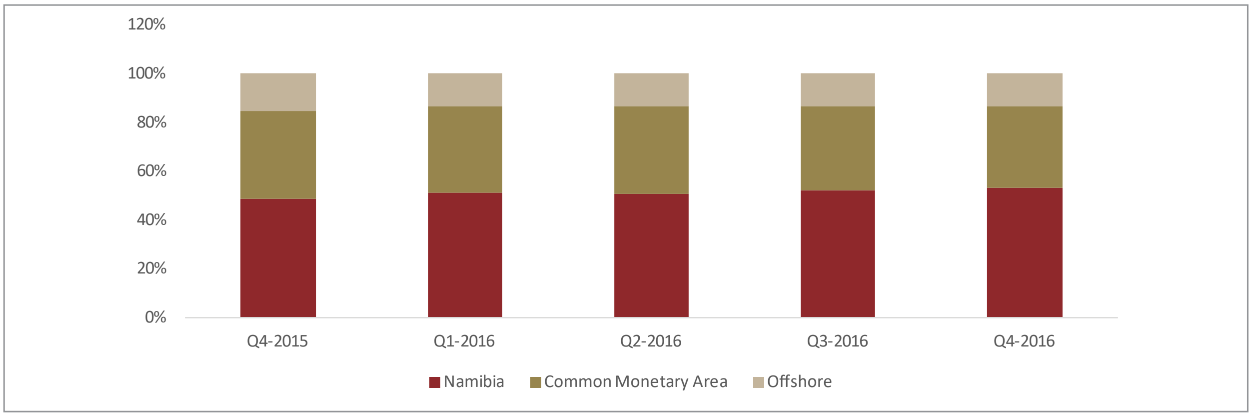
Figure 36: Assets Under Management Top 5 Concentration Risk



Source: NAMFISA

The investment funds under management remained concentrated as the top 5 investment managers account for 73 percent of total funds under management (Figure 36). The investment managers' assets under management increased by N$3.1 billion or 2.1 percent from N$147.7 billion as at 31 December 2015 to N$150.8 billion as at 31 December 2016. Namibian based investments accounted for 53.0 percent of total AuM as at 31 December 2016, up by 4.0 percent from 49.0 percent of AuM at 31 December 2015. CMA assets decreased slightly by 2.0 percent from 36.0 percent of AuM to 34.0 percent as at 31 December 2016. Offshore assets also decreased from 16.0 percent of AuM to 13.0 percent as at 31 December 2016 (Figure 37).

Figure 37: Assets per Geographic Area, as a Percent of Total Investment Funds

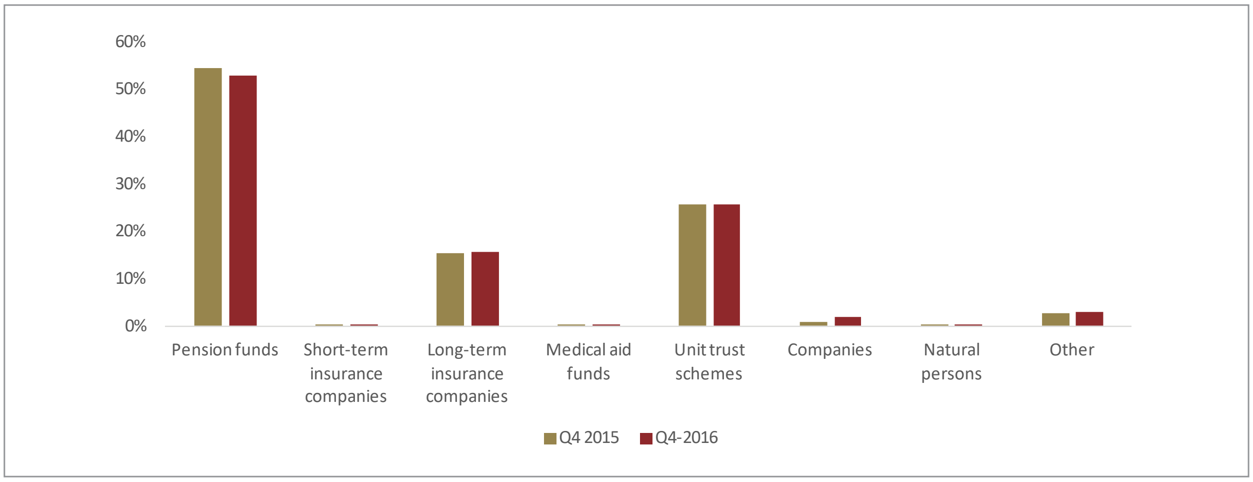


Source: NAMFISA

Pension funds continue to be the main source of funds for Investment Managers,

followed by unit trust schemes. However, pension fund assets decreased slightly by N$974.0 million from N$80.8 billion at 31 December 2015 to N$79.6 billion as at 31 December 2016. During the period under review, pension funds contributed 52.8 percent of total assets. Unit trust schemes accounted for the second largest portion of assets under management with a 25.7 percent share (Figure 38). This is slightly up by N$968 million or 2.6 percent from N$37.2 billion at 31 December 2015 to N$38.7 billion as at 31 December 2016.

Figure 38: Assets per investor as at 31 December 2016, as a percent of total investment funds under management



Source: NAMFISA

The NBFIs continued to play a key role in funding liquidity in the banking sector. Through the placement of deposits and acquiring of debt instruments (Figure 20). Further, domestic asset requirements for long term insurers and pension funds, robust growth in NBFIs and the biasness of unit trusts to money market instruments will increase NBFIs' investment in banking products and this warrant continuous monitoring.

Microlending

The microlending and credit agreement sub-sector total assets slightly decreased at the end of 2016 to N$4.2 billion, from N$4.3 billion recorded at the end of 2015. However, the microlending sub-sector could pose a risk if toxic loans accumulate over time. Hence, this sub-sector requires ongoing monitoring by the regulator since salary earners are already heavily indebted in Namibia.

Conclusion

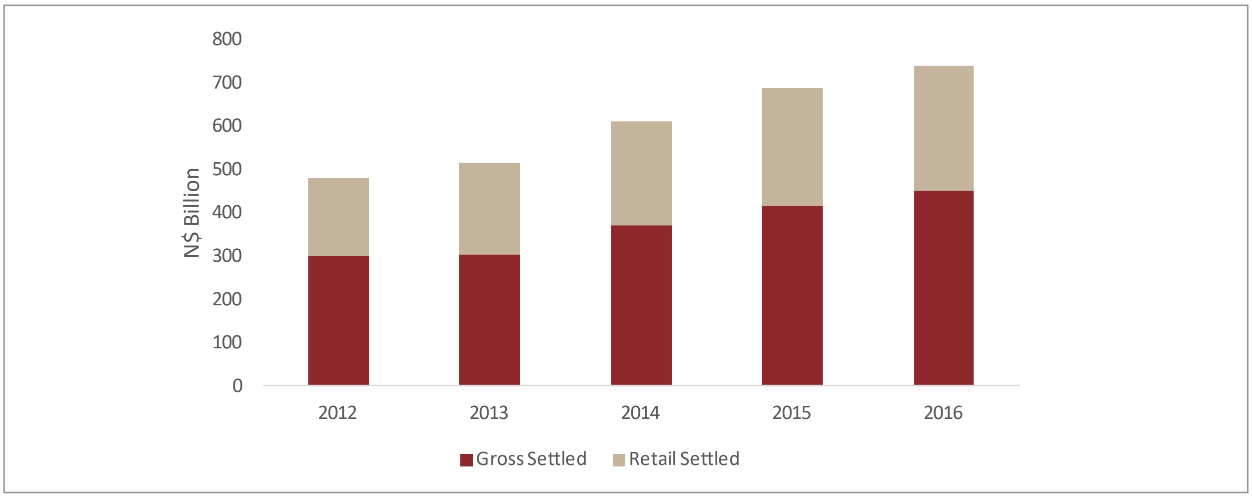
In light of the above, the NBFIs industry remained financially sound with respect to liquidity, solvency, profitability and capital adequacy. NAMFISA however,continues to monitor the NBFIs industry accordingly.

VII. PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

The Bank successfully executed its regulatory mandate to oversee the National Payment System (NPS) in 2016. The Bank of Namibia continued with its normal on-going oversight monitoring activities (offsite and onsite inspections) aimed at the identification and resolution of risks to the National Payment System (NPS) as per the Risk-Based Oversight Policy Framework (RBOPF). Through its offsite activities, the Bank of Namibia maintained its efforts to obtain data and information from participants and service providers on a regular basis in order to identify risks that need to be proactively managed. The Bank also conducted onsite activities to assess the operations of new and existing participants based on their risk profiles as established through the offsite monitoring activities.

The Namibia Interbank Settlement System (NISS) transactions increased both in terms of volume and value during 2016. The volume and value of payments settled in NISS increased to 69 579 and N$738 billion, respectively, in 2016, from 62 131 and N$688 billion in 2015 (Figure 39). NISS transaction volumes and values averaged 5 798 transactions and N$62 billion per month, respectively, during 2016. The value of the share of real-time (typically high-value) transactions processed in NISS was 61 percent of the total value settled in NISS, whilst that of the retail payment systems was 39 percent.

Figure 39: Value of Payments Processed in NISS

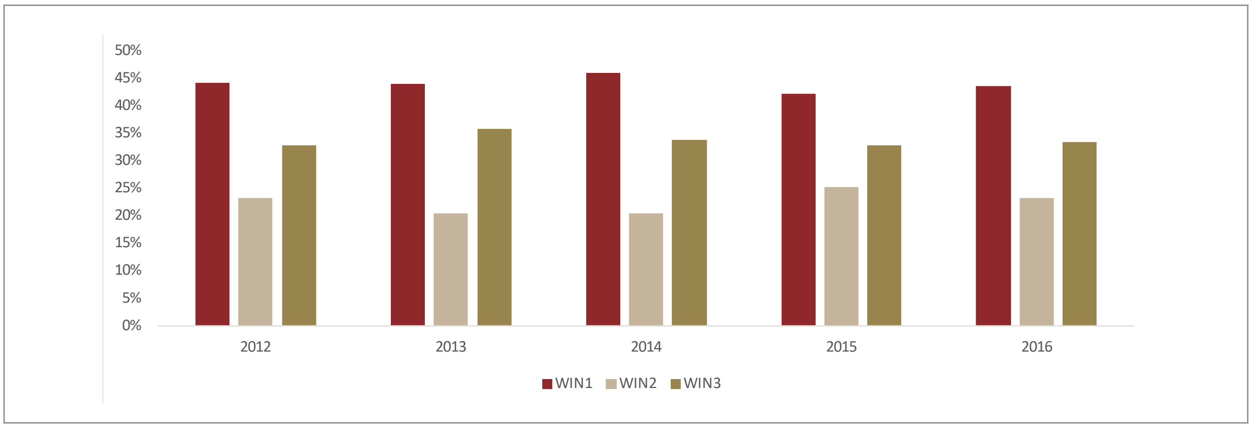


Source: Bank of Namibia

Settlement Windows

Operational and settlement risks in terms of value remain minimal as most of the payments are settled in the earlier windows. NISS has three timeframe windows in which payments can be settled. The windows are; Window 1 (08:00 to 12:00), Window 2 (12:00 to 15:00) and Window 3 (15:00 to 16:40). To minimize operational and settlement risks, it is ideal that the majority of all settlement take place in the earlier windows i.e. Window 1 and Window 2. During 2016, 67.0 percent or N$246 billion of payments were settled in Window 1 and Window 2. During 2015, the same percentage of payments as in 2016, i.e. 67 percent or N$235 billion was also settled in Window 1 and Window 2, which significantly assists in mitigating operational and settlement risks. Figure 40. Below shows NISS' per window settlement for the periods 2012 to 2016.

Figure 40: Proportions of payments settled in each settlement window value of payments processed in NISS 2012 - 2016



Source: Bank of Namibia

Disruptions to the Namibia Interbank Settlement System (NISS)

NISS maintained high system availability over the second half of 2016. The NISS front-end availability was 99.0 percent. One successful Disaster Recovery (DR) test was conducted during the second half of 2016.

During the period under review, the payment systems were monitored, safeguarded and enhanced to maintain financial stability by observing a fraud-to-turnover ratio of less than 0.05 percent. When calculated as a proportion of the total amount transacted by Namibians using cheques, Electronic Fund Transfers (EFT) and payment cards (i.e.

debit, cheque / hybrid, credit, etc.), fraud-to-turnover losses decreased further to 0.00241 percent during the second half of 2016 from 0.00249 percent during the second half of 2015. The Bank of Namibia has set a maximum fraud-to-turnover limit of 0.05 percent.

Security of Retail Payments

During the second semester of 2016, the payment industry continued with its efforts to combat fraud in the NPS. The main reason for the Europay, MasterCard and Visa (EMV) compliance project is to achieve countrywide acceptance of domestic and international EMV / Chip and PIN cards in Namibia. This international standard will require cards to have a “chip” instead of a “magstripe” for authenticating card transactions, making it much more difficult for these cards to be cloned, and thus curbing card fraud (card cloning) locally and internationally. By the end of the fourth quarter of 2016, 64 percent of all cards in the NPS were EMV compliant. All participants are currently issuing EMV compliant cards and at the same time, are engaging their clients to recall the magstrip cards that are in circulation and replacing them with EMV / Chip and PIN cards.

The industry is continuing with its efforts to ensure that all participants become Payment Card Industry Data Security Standards (PCI DSS) compliant. PCI DSS compliance is concerned with the compliance to the standards that are aimed at protecting payment card information across all points in a transaction chain. Compliance with these standards remains one of the strongest ways to prevent data compromises that can lead to fraud. By the end of 2016, only one participant was fully PCI DSS compliant.

Developments in Payment and Settlement Systems

The Bank launched the second cost and income survey focusing on Automatic Teller Machines (ATM) services during the first quarter of 2017. The Bank is currently in the process of rolling out a costing and income survey focused on ATM services. The information gathered through the survey will enable the Bank to set relevant standards for fees and charges for the services mentioned, in line with the mandate as provided in the Payment System Management Act, 2003 (Act No.18 of 2003) as amended. The objective of the cost and income survey remains to determine standards for fees and charges payable by users of payment services, and to determine whether these fees and charges are in the public interest, promote competition and efficiency, and are cost effective.

The banking industry, under the auspices of the Payments Association of Namibia (PAN) and supported by the Bank, took a decision to reduce the cheque item limit from N$500 000 to N$100 000 as of 1 February 2016. The Bank, as a result, issued a determination to this effect. The elimination of cheques by 31 December 2017 is currently under consideration. In its efforts to ensure efficiency in the phasing out of cheques and to ensure that the public is effectively engaged and consulted, the Bank and the Bankers Association of Namibia (BAN) requested that an impact assessment be conducted by all the relevant system participants. The feedback is currently under review and discussions are underway on the overall impact of the decision to phase out cheques.

The Cross-border Low Value Electronic Fund Transfer Credit Transfer project was approved by the Common Monetary Area (CMA) Governors. Discussions were held within the CMA Payments Oversight Committee (CPOC) to ensure that the industry in their respective jurisdictions are gearing themselves for implementation. The routing of CMA cross border low value transactions will be directed to route through the appropriate regional clearing infrastructure in due course.

The banking industry, through PAN, and in accordance with the determination on the efficiency within the National Payment System (NPS) (PSD-7), continues in its efforts to embark on an industry-wide EFT project. The enhanced EFT Project aims to improve the efficiency in the NPS, particularly around EFT payments by enhancing the speed of settlement and security thereof. Looking ahead, the project timelines are being closely monitored to ensure that all industry participants are on track, and any risks and complexities are addressed appropriately.

As part of the ongoing modernisation of the National Payment System, the Bank periodically reviews the relevant payments regulations. The Bank is currently working towards the development and revision of relevant payments regulations to cater for the local, regional and international developments that impact the NPS. Furthermore, as a result of these trends and developments, the Bank will provide a position paper on some of the pertinent digital innovations impacting the NPS.

VIII. CONCLUDING REMARKS AND POLICY IMPLICATIONS

Generally, the financial system and markets in Namibia remained sound, profitable, and with no disruptions or disorderly functioning of key financial services, despite unfavourable domestic and global economic conditions. Specifically, the banking sector and the non-bank financial institutions (NBFIs) continued to be sound and well capitalised, with a consistently low level of non-performing loans (NPLs) and sufficient buffers to cushion any potential volatility in liquidity and profitability. Further, the payments system and infrastructure continued to perform efficiently and effectively, and with increasingly robust risk mitigating measures to facilitate safe payments. Finally, household and corporate debt remained fairly stable during the period under review and will continue to be monitored.

Despite the generally healthy and sound Namibian financial system, specific pockets of risk require monitoring and/or action, going forward. With regard to the banking and non-banking sectors, despite their sound positions, the liquidity levels and sustainability of the liquidity management strategies thereof require monitoring.

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